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BAY.L - Q3 2009 British Airways Earnings Conference Call

Event Date/Time: Feb. 05. 2010 / 2:00PM GMT

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PRESENTATION

Operator

Welcome, and thank you for standing by. At this time, all participants are in a listen-only mode. (Operator Instructions) I would now like to turn the meeting over to line of Mr. Walsh. Please go ahead. Your line is open.

Willie Walsh - *British Airways - Director of IR*

Thank you, and good afternoon, everyone, thank you for taking the time to join us for our nine-month results. I'm going to hand over to Keith Williams, who will take you through a short presentation on the results. Keith?

Keith Williams - *British Airways - CFO*

Okay. Good afternoon, everyone, and good morning in New York. Our third quarter results are ahead of consensus, largely because of the progress we've made on costs, and that's a theme I'll come back to later. Capacity reduction in the third quarter was 5.6%, and total ASKs for the nine months were down 3.9% against this flow in traffic measured in terms of RPKs was down 3.4% in the third quarter and 2.1% over the nine months. This resulted in increased load factors of 77.9% for the third quarter, up 1.9 percentage points from the previous year and 79.8% for the nine months as a whole, up 1.4%. The increasing load factors allowed us some improvement in yields, with third quarter passenger yields down 8.8% as against 11.1% for the nine months as a whole.

The improvements in performance drove positive operating cash flow. Cash flow for the nine months was GBP94 million and cash balances rose in the quarter by some GBP80 million to just under GBP1.6 billion. Overall liquidity has remained at around GBP4 billion. Firm controls and capital expenditures remained in place. Total capital expenditures to date has been some GBP400 million for the year and planned capital expenditures for the full year is now GBP525 million. All of this has delivered an operating profit of GBP25 million for the quarter, including GBP14 million of restructuring costs. This is the first positive operating result for 15 months, and it is some GBP76 million better than in the previous year.

Looking at the headline numbers, reported revenue was down just over 11% versus the prior year, despite benefiting from continued currency benefits, principally on euro sales. Underlying revenues were down 13.3%. This, however, has been better than recent trend. Fuel benefited from lower price and volume effects and despite continuing adverse exchange, was down 22%. Control on non-fuel costs was excellent and despite adverse exchange and one-off restructuring costs of GBP14 million, we are still down 10.4%. This left us with a positive operating margin of 1.2% and EBITDA margin of over 12%. We are, however, still a long way off return to profitability and the pretax loss for the quarter was some GBP50 million.

Looking at the year to date figures, they still make grim reading. Revenues are down 12.9% year-to-date, just over GBP900 million from a year ago. The only good news is that the rate of decline is slowing, as I said earlier. Fuel costs overall are down almost 20%, as prices have come off from the high of $147 to a steady band of between $70 and $80. Non-fuel cost control has gained momentum over the year and reported non-fuel costs are down 6.4%. Excluding the impact of exchange, they are down more than 10%. Operating losses for the nine months stand at GBP86 million and pretax loss is some GBP342 million.

Looking now at the split of the passenger revenue, passenger revenue is down from both volume, price, and mix. The number of passengers carried over the period has been down just under 3%, with total passenger journeys just over 25 million. As we've previously shown you, the fall has been particularly noticeable in premium cabins. Yields have been weak, but as we've taken out capacity and consistent with some improvements in the economic outlook, we have seen some slow recovery in premium cabins, with performance in non-premium cabins remaining more sensitive to price. I shall come back to cargo in a moment, but suffice to say that performance in the first six months of the year was extremely weak, but is now showing good sign of recovery. Other revenue is again performing well, partly from increased ancillary sales and from increased transfer payments coming in from our alliance partners. Looking at the three months, the rate of decline in both passenger and cargo revenues has slowed. Whilst in part this is being driven by poor comparatives from last year and some help from exchange, there are also signs of some improvements in both businesses.

As we have seen, passenger revenues showed slow improvements in long haul premium through yield and some improvement in non-premium volume. I should also point out that last year in the third quarter, we changed the estimation for outdated paper so that this year the actual result is somewhat better than that shown and some 8% lower than last year. Cargo is showing good signs of improvement, with volumes now actually up on last year, although yields still remain relatively weak.

In terms of overall performance, therefore, as you can see from the chart here, the rate of revenue decline overall has slowed in quarter three, yet revenue is still down more than GBP250 million versus last year in the third quarter. The recovery we have seen in our results is driven from both non-fuel and fuel costs. In the third quarter, non-fuel costs were down GBP165 million over the previous year, an improvement of more than 10%. Total cost reductions for the year are now GBP300 million.

Fuel costs are also GBP165 million lower for the quarter, and that leaves us with total savings of GBP330 million from over a year ago. This more than offsets the revenue decline, and it's this that leaves us with an operating profit for the quarter. The cost reduction we have seen has been across all parts of the business. As you know, we recognized a slowdown in our business some 18 months ago and began a journey to structural changein our cost-base, initially on Terminal Five reductions and change in management headcount. This has now embraced all areas of the business and our supplier base. Manpower is down more than 11% from where it stood 12 months ago and manpower costs are down more than 8%. Greater efficiencies have reduced unit costs by more than 6%, despite capacity reductions over the same period of around 4% measured in terms of ATKs.

Looking at the individual cost lines, all reported cost lines are down for the nine months, exception of landing charges and handling and catering costs. These would also have been driven down absent adverse exchange from both the euro and the dollar. Total reported costs were down 10.5% and non-fuel costs down 6.4%. Before exchange impacts, non-fuel costs were actually down 10.2%. The story has repeated for the last three months, with all cost lines showing significant improvement.

Reported costs were down 14.1% and non-fuel costs down 10.4%. Engineering costs are down 20%, in line with the smaller engine maintenance program due to a reduction in the number of aircraft in service.

You may recall also that in Q3 last year, there was a charge relating to currency differences of some GBP50 million, and there is no repetition of that this year. Again, looking at the position without exchange, underlying non-fuel costs were down about 13%. As you know, our target was to bring costs down by more than the reductions in capacity so that we would see a reduction in overall unit costs. Total capacity over the period, as I said earlier, was 4%. Against this, we've seen steady improvement in unit cost performance, both before and after fuel costs. Before exchange, non-fuel unit costs for the nine months have been down over 2% and adjusted for exchange, down more than 6%. Including fuel unit costs are down 6.7% and if adjusted for exchange, down almost 14%.

That takes us through the profit and loss. I move to the balance sheet, liquidity is still strong, as I said earlier, and our cash balance stands at GBP1.6 billion. With general facilities liquidity is more than GBP2 billion. Of course sitting above that, we still have significant facilities covering our aircraft deliveries through to 2013, and total liquidity is about GBP4 billion.

Now, looking forward, the general position in relation to revenue is unchanged. In quarter three, overall revenue was down 11% from 15% in quarter two. We expect some further improvements into quarter four. Long haul premium volumes are expected to remain slightly ahead of last year, with short haul premium volumes remaining weak. Trans-Atlantic traffic in particular is showing some signs of improvement. In non-premium cabins, volumes still remain sensitive to yields and although volumes are starting to show signs of improvement, this is yet to translate into yield increases.

We are also starting to cycle against the weak revenue performance last year, and this will help slow the rate of decline in overall revenues in quarter four. If those are the positives, over the last year we're seeing significant benefits from exchange, and this will disappear in the fourth quarter as the sterling remains at last year's levels against the dollar and shows signs of strengthening against the euro. At the same time, there will be some impact from the January weather. The threat of industrial action over Christmas had a very modest impact in quarter three as most Christmas trips were already sold in advance. Cargo performance in the final quarter should show some further improvement from the position that we're seeing in quarter three.

Now, you can see what's currently happening to yields, passenger yields from this chart. As you can see, the overall yield including exchange, the red line, is starting to touch last year's level shown in green. Fuel surcharges have remained constant now at this level for around 12 months. Volumes will remain at lower than last year's level, though slightly less than capacity reductions over the quarter of around 6%. The results of capacity reductions that seat factors are likely to remain at higher levels in both short haul and long haul. Rising seat factors have led to fewer seats being made available for our sales, which close on February the 8th. I said overall volumes measured in terms of (RPKs are expected to be down versus last year.

On fuel, fuel prices over the quarter have been relatively stable, fluctuating between $70 and $80 a barrel. I said in November we expected the year-on-year fuel cost reduction to be at least 500 million, and that remains the case with the fuel bill now expected to be around 2.4 billion for the year. On non-fuel costs, investor day last year we announced the two-year non-fuel cost saving targets of GBP300 million, of which GBP220 million was meant to be delivered in 2009. There has been some additional capacity reduction, yet even allowing for that, we remain ahead of the target that we set, with total non-fuel cost savings to date of some GBP300 million and plan further cost reduction of some GBP50 million for quarter four to bring us to GBP350 million in total.

So finally to summarize, what we're seeing from the actions we've taken and the costs, is the reduced costs and the lack of significantly reduced revenues, and it's this that has enabled us to announce a small operating profit on the quarter. On the revenue side, we expect the slow improvements that we've been seeing to date to continue. Overall, the year-on-year improvements seen in quarter three operating results are likely to be similar than quarter four. However, we acknowledge that we're still heading for significant losses in 2009/10 at both the operating and pretax level. Gradual improvements in revenue, continued delivery of sustainable permanent cost savings will be the key to returned profitability on an annual basis. We're in a strong financial position, with cash of GBP1.6 billion, additional facilities of over GBP400 million, and aircraft financings already secured, leaving us GBP4 billion of liquidity in total. Now over to you for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jarrod Castle. Please go ahead. Your line is open.

Jarrod Castle - *UBS - Analyst*

Thank you. Good afternoon, gentlemen. Two questions, please. Can you quantify in terms of the January decline in traffic what you think's due to kind of weather and strike. Secondly, can you give any indication in terms of where you see staff numbers ending up at the end of March, please.

Willie Walsh - *British Airways - Director of IR*

Thank you, Jarrod. The weather impact in January was significant. Not only did we have disruption at Heathrow and Gatwick, but it was right across the UK and in many European stations. In addition, we had some disruption in other parts of the world, India and the United States. So if you look at the ASKs in January, I think we reported down minus 8.3, and I think we would have expected January to be down about 5% to 6%, around 6%. So there was probably 2 to 2.5 points of capacity reduction as a result of the disruption. And the disruption mainly impacted on our transfer traffic.

If I look at the split of traffic in January, and we don't give you this, but just to give you an idea, direct traffic at Heathrow was largely flat versus the previous year and the transfer traffic was down around 10%, 11%. So most of the direct traffic we were able to accommodate. The main impact of the weather disruption was for transfer passengers. And that was as a result of the disruption at London, but also at some of the European stations as well.

In terms of industrial relations issues, quite honestly, it's hard to see any real or material impact on the bookings profile. As Keith mentioned, we didn't really see any evidence of that in the pre-Christmas period. Looking at the January bookings and over the next couple of months, we're not seeing any evidence of changing patterns or changing trends, so at this point, I would say it's having no material impact in terms of either the flown behavior in December and January or the booking patterns that we're witnessing.

Keith Williams - *British Airways - CFO*

And Jarrod, in terms of your question on headcount, we measure that in terms of what we call MPE, manpower equivalent, and at the year end, we expect the MPE to reduce to between 36,000 and 36,500. That's a reduction of 4,000 to 4,500 of year.

Jarrod Castle - *UBS - Analyst*

Okay, thank you.

Operator

Next question comes from the line of Stephen Furlong. Please go ahead. Your line is open.

Stephen Furlong - *Davy Stockbrokers - Analyst*

Good afternoon, gentlemen. Two questions just, please. Just maybe Keith go through -- just remind me in terms of the currency exposure on the revenue and cost side so we just understand the effect of the strengthening dollar or will you be concerned about that at all? The second question, just on the premium, non-premium mix, just remind me where you would see the -- where the premium/non-premium mix has gone from peak to where it is now in terms of passenger numbers, that would be great. Thank you.

Willie Walsh - *British Airways - Director of IR*

Stephen, just to give you the currency impact, first, in the three-months, the third quarter, it was positive on revenue by GBP50 million and negative on costs by GBP95 million, therefore net negative GBP45 million. In the nine months, it was [plus 359 on revenue, minus 470 for costs.] So again, a net impact of GBP115 million. So at this point, the benefit that we've seen on the revenue, so the relatively weak pound has been benefiting us on revenue as a result of stronger euro and dollar sales, that will clearly ease in the fourth quarter. And on the premium/non-premium, what we said is that premium traffic represents about 13% of our total passenger numbers. That number is really broadly unchanged. So while we've seen some recovery in longhaul premium volumes, as I said, we've seen some reduction in short haul premium volumes, but we're still at about 13% of premium customers, against the 87% non-premium.

Keith Williams - *British Airways - CFO*

And in terms of the yield, the overall reported yield, as I said earlier, was down 8.8%. It is slightly better than that on an underlying basis, as I said earlier, there was some one-off releases last year outdated paper. It's slightly better than that, and the exchange impact within that is pretty minimal.

Stephen Furlong - *Davy Stockbrokers - Analyst*

That's great, thank you.

Operator

Our next question comes from the line of Neil Glynn, please go ahead. Your line is open.

Neil Glynn - *Credit Suisse - Analyst*

Good afternoon, folks. Just a couple questions for me. The first one of which, I'm interested in the impact you've seen, if any material one, from the APD hikes from last November. Then on the second one being on the cost side of things, I appreciate this may sound greedy, but apart from the run through of current year initiatives, is there much more that you see in the pipeline for taking down costs in FY 2011?

Willie Walsh - *British Airways - Director of IR*

On APD, we haven't really seen any material impact as a result of the November '09 increase. Our concern has always related to the November 2010 increase, which we think is likely to have a much more significant impact on the business. So I would say November 09, I would describe it as immaterial. It clearly has some impact, but nothing that would be noticeable. But November 2010 is the main area of concern for us, and that's why we focused our lobbying on November 2010 to try and get that increase set aside. And in relation to costs, we're focused on all aspects of the cost base. There is more that we can do. We don't have any major initiatives. The cabin crew reductions that we announced in November of last year, or introduced in November of last year, was the main area in terms of employee costs. We do have programs in place looking at all aspects of the cost base, but there's no one single big ticket item there. You should expect us to continue to look at opportunities to reduce costs in all areas of the business.

Neil Glynn - *Credit Suisse - Analyst*

Great.

Keith Williams - *British Airways - CFO*

And obviously, looking forward, one of the things that we'd seek to do as capacity comes back in is to hold the costs flat, so you see a continuing improvement in unit costs.

Neil Glynn - *Credit Suisse - Analyst*

Great. Thanks. Can I just, before I go, touch on the capacity decision going forward? How will you actually approach that? You obviously haven't really talked on summer as of yet.

Willie Walsh - *British Airways - Director of IR*

No, our view is that the industry is showing good discipline in terms of capacity management, and I think that discipline has continued for sometime. We're looking at, at this point, broadly flat I think, capacity for next summer. There may be a slight increase, but you're not going to see any significant change in capacity for the summer period versus last year.

Neil Glynn - *Credit Suisse - Analyst*

Great, thank you.

Operator

Next question comes from the line of Jonathan Wober. Please go ahead, your line is open.

Jonathan Wober - *Societe Generale - Analyst*

Thanks very much. Just going back to yields, Keith, you mentioned just now that the FX impact in Q3 was minimal.

Keith Williams - *British Airways - CFO*

Yes.

Jonathan Wober - *Societe Generale - Analyst*

I wonder if you could just spell out the detail of Q3 yield in terms of price, FX and mix. That's the first question. But also related to yield, your chart that you showed, chart 20, I just want to make sure that I'm looking at this right. I might be missing something, I probably am. But the red line, 2009, 2010 for the October to December quarter is considerably above the previous year, so why is yield down 8% for the quarter? Then the final question is to make sure I'm reading your cost outlook correctly. We're saying that the ex-fuel costs will be 350 million below what they were last year. Is that the right way to read it?

Keith Williams - *British Airways - CFO*

Yes, to give you a bit more information on the yield, we stopped giving you the split between price, mix and exchange, because a lot of the mix is actually within cabin mix. It's not mix between premium and non-premium. But to give you a little bit more detail, talking about the 8.8%, within that exchange at the 2.2% positively up.

Jonathan Wober - *Societe Generale - Analyst*

Right, okay. And even with your caveat about the mix, can you say what --

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Keith Williams - *British Airways - CFO*

Mix is pretty flat within it.

Jonathan Wober - *Societe Generale - Analyst*

Okay.

Willie Walsh - *British Airways - Director of IR*

But the -- as Keith said, the big issue that's impacted on mix, I would say it's been a feature of the last 12 months. It's not been so much the mix between premium and non-premium. It's as we've said before, the mix within the premium cabin between the fully flexible fare and the restricted fare. Now, what we have seen in recent months, as the seat factors in premium have risen, we've seen that trend, which was a trend towards more restricted fares, we've seen that trend reverse. So we've still not got back to the mix that we would have had during the peak, but we have seen it reverse where more people are now buying the fully flexible fare than it would have been six months ago. And it's -- that's having a much greater impact on mix than the split between the front end premium and the non-premium cabin. And that's why we felt the way we previously showed the figures really wasn't telling the true story in terms of what was happening.

So as premium volumes have recovered and we've had good seat factors in our premium cabins, you'll see in the statement that we issued today, we highlighted the seat factor on the London city JFK service for December, which was at 75%. I think that gives you a feel for traffic on what has always been seen as a strong fourth quarter for us. What I would say to you is that the seat factor on Heathrow JFK was significantly higher than we saw on London city JFK. So with the seat factors returning, we're getting better yields within the premium space. We're seeing the mix between fully flexible and the restricted fare starting -- or it has reversed, but that trend has continued as well. Sorry, the second question in relation to cost --

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Jonathan Wober - *Societe Generale - Analyst*

-- there was another question on the yield to make sure I'm understanding the chart right. Because it looks like this year is above last year, but we have a year-on-year decrease in yield.

Keith Williams - *British Airways - CFO*

Yes, that's because that was looking at booked yield not flown, yes.

Jonathan Wober - *Societe Generale - Analyst*

Oh, okay. Okay. Then on costs--

Willie Walsh - *British Airways - Director of IR*

Yes, can you repeat your question on costs, please?

Jonathan Wober - *Societe Generale - Analyst*

Yes, it was just to clarify that I'm reading correctly what you said about the outlook for costs. You're saying that the full year, ex-fuel costs will be GBP350 million lower than they were last year.

Keith Williams - *British Airways - CFO*

That's right.

Willie Walsh - *British Airways - Director of IR*

That's correct.

Jonathan Wober - *Societe Generale - Analyst*

Okay, thank you very much.

Willie Walsh - *British Airways - Director of IR*

Thank you.

Operator

Our next question comes from the line of Andrew Lobbenberg. Please go ahead, your line is open.

Andrew Lobbenberg - *Royal Bank of Scotland - Analyst*

Hi, there. It's Andrew. Could you talk to us a little bit about what operations have been like on the aircraft following the change in the crewing levels? What customer feedback has been, and then obviously, it's the elephant in the room, but is there anything you can say about what you're hearing from the courtroom and any expectation as to when you expect to hear a result?

Willie Walsh - *British Airways - Director of IR*

In terms of operations, we've had no impact. The crew have been operating normally on board the aircraft. The feedback is -- well, you would expect me to say this, but I would say it's been very positive and better than we had expected, and that's both in terms of how it's operating and our customer feedback, where we're monitoring the performance there. So we're very comfortable with the decision that we've taken to reduce the crew complement. In fact, we're very pleased with the performance, and we're clearly delighted with the cost benefit we get as a result of that. There's no question in our minds that it was the right thing to do, both in terms of costs and service.

So we're happy with our decision and firmly committed to retaining the crew complements as they are. We will not be returning the crew member that we've taken off the aircraft. In terms of the courts, the case is ongoing. We believe it will continue to Monday and the lawyers have told me that I shouldn't expect to get a result. It may, in fact, be a couple of weeks before we hear from the judge. So other than that, I don't have anything to -- any information to give you in relation to the court case.

Andrew Lobbenberg - *Royal Bank of Scotland - Analyst*

No, fair enough. And then can I just ask about the other two elephants in the room? Is there anything you can tell us on the process with American and with the Spaniards?

Willie Walsh - *British Airways - Director of IR*

The discussions with Iberia continue positively. As you know, we're in the phase where we're working to agree the formal merger agreement, and we expect to have that finalized before the year end. The ATI application, I remain confident that we will get the right results there and that we will get approval for that. I don't have any new information to give you. We're aware that the EU is undertaking some market testing. That is confidential process, so I'm sorry, but I can't comment in relation to any of the detail of that, and we have yet to hear from the US DOT in relation to the application, but I remain optimistic and confident that we will get approval for the joint business with American and Iberia.

Andrew Lobbenberg - *Royal Bank of Scotland - Analyst*

Okay, thanks. We'll leave those elephants there.

Willie Walsh - *British Airways - Director of IR*

Thanks, Andrew.

Operator

And our final question comes from the line of Geoff van Klaveren. Please go ahead, you line is open.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Oh, hi, good afternoon. It's back non-premium revenue. I was just wondering if you say whether you are seeing more pressure on long haul or short haul in terms of pricing pressure on non-premium. And then secondly, we understand you're selling upgrades to clubs sort of at time of departure. I just wonder to what extent this is boosting premium volumes. And just a check of those, if that does happen, will that be included in your premium figures as booked?

Willie Walsh - *British Airways - Director of IR*

I don't think there's any real difference in terms of what we're seeing on short haul and long haul non-premium. We believe that that's very much influenced by the sort of general economic environment. So we haven't noticed any change in behavior. If you really wanted to drill into it, you could see some evidence of people looking for value in non-Euro destinations because of the strength of the euro, but other than that, the behavior, I think is pretty similar in short haul and long haul.

And, yes, we have a program where we do look at some on the day upgrades premium, and the customers who do upgrade would be included in the -- in the -- sorry, no. If the -- yes, if they have done it on the day at the airports, then it would be included in the premium figures, so it's included in the traffic stats that you would see. If it's done at the airport. We used to do it on board the aircraft. We stopped doing that, but where it was done on board the aircraft, it wouldn't have shown, but we're now only doing it at the airport, and where it's done at the airport are in advance of travel through management the booking on ba.com, it would show in the figures.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Okay. So presumably, that's part of the issue with the mix in the cabin with the (inaudible).

Willie Walsh - *British Airways - Director of IR*

It's very small.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Got you.

Willie Walsh - *British Airways - Director of IR*

The volumes are small, so to be honest with you, I don't believe it has any material impact, and we're not doing it on a regular basis. It's not so much ad hoc, but the way we're doing it is to take advantage, clearly, of the opportunity to generate some revenue on the day, but we won't do it in a way that people will feel comfortable that they will automatically be able to get an on the day upgrade to the premium cabin, and we don't do it on all routes. So we've got a little bit of a black box selecting routes and selecting days to ensure that we don't materially impact on our yield in the premium cabin.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Okay, thanks. Could I ask just a quick question, just on Iberia. Press reports are saying you're going to sign something this month. But presumably, you have to first negotiate changes to the pension benefits with the union. So I'm just wondering how that is possible to do that sort of within the month.

Willie Walsh - *British Airways - Director of IR*

Well, I've seen those press reports. I don't know where they have come from, but I wouldn't pay any attention to that. But, no, the merger agreement does not require the changes or resolution of the pension funds deficits programs. So we expect to finalize the formal merger agreement, as I said, by the end of the financial year.

Keith Williams - *British Airways - CFO*

And pensions, the timing hasn't changed. We need to file by the 30th of June. That's still the intention.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Okay, great. That's great. Thank you very much.

Operator

And at this time, we're showing no further questions. But as a final reminder, if you would like to ask a question (Operator Instructions)

Willie Walsh - *British Airways - Director of IR*

Okay. We see no further questions, so thank you for attending, and thank you for your questions today.

Operator

Thank you for participating in this afternoon's conference call. You may disconnect.

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