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Delta Air Lines, Inc. (DAL)

Q4 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Delta Air Lines December Quarter Financial Results Conference. My name is Kelly Ann and I'll be your coordinator. At this time all participants are in a listen-only mode until we conduct a question-and-answer session following today's presentation. As a reminder, today's call is being recorded.

I would not like to turn the call over to Ms. Jill Sullivan Greer, Managing Director of Investor Relations. Jill, please go ahead.

Jill Sullivan Greer

Managing Director-Investor Relations

Great. Thanks Kelly Ann. Good morning, everyone, and thanks for joining us. Here in Atlanta today we have Rich Anderson, our CEO; Ed Bastian, our President; and Paul Jacobson our CFO, and we have the remainder of the leadership team here in the room with us for Q&A. Richard will open the call, Ed will then address our financial and revenue performance, and Paul will conclude with a review of cost performance and cash flow. To get in as many questions as possible during the Q&A, please limit yourself to one question and a brief follow up.

Today's discussion contains forward-looking statements that represent our beliefs or expectations about future events. All forward-looking statements involve risks and uncertainties that could cause the actual results to differ materially from the forward-looking statements. Some of the factors that may cause such differences are described in Delta's SEC filings. We'll also discuss non-GAAP financial measures. All results exclude special items unless otherwise noted. You'll find the reconciliation of our non-GAAP measures on the Investor Relations page at ir.delta.com.

And with that, I'll turn the call over to Richard.

Richard H. Anderson

Chief Executive Officer

Good morning. This morning Delta reported a $1 billion pre-tax profit for the December quarter with EPS of $0.77, which beat consensus of $0.75. We grew the top line 6% despite a fuel price decline of 14%. Delta expanded margins by over four points. For 2014 we generated a $4.5 billion pre-tax profit, an increase of 70% over 2013. Revenues grew for the full year by 7%, and we expanded our operating margin by four points to 13.1%. Our ROIC was 20.7%. We generated $5.8 billion of operating cash flow, and $3.7 billion of free cash flow, and returned $1.35 billion of cash to our owners.

Delta was the sixth best performing stock in the S&P 500 with a 79% gain. In two years we have increased our market cap by $30 billion. Our $3.7 billion of free cash flow was better than 90% of the S&P Industrials, and Delta has the third highest free cash flow yield on the S&P Industrials. These results include over $1 billion of profit-sharing for our employees, equal to more than 16% of their 2014 pay. We are proud of that at Delta, and I want to thank the entire Delta team for their hard work that is the reason why we were successful in 2014.

We ran the best operation of global aviation industry with 95 days of no mainline cancellations, a completion factor of 99.8%, and an on-time rate of 85%, excluding the one-time impacts of the winter storms in 1Q of 2014. Remarkably, Delta had only 414 mainline maintenance cancellations for all of 2014, a number our competitors sometimes exceed in a single month. That operational excellence, along with investments we've made in products and services drove increases in our customer satisfaction with our domestic Net Promoter Score increasing more than two points to 33%.

High customer sat translates into a revenue premium, as customers have shown a willingness to pay for high-quality service. For 2014 we generated 107% of industry average revenues across the system and 113% domestic RASM premium. We continually obtain efficiency and productivity which caused roughly flat non-fuel costs year-on-year in 2014. These factors combined to produce a $1.9 billion increase in our pre-tax profit for 2014.

This profitability translated into strong cash flows which produced $6 billion of operating cash flow and allowed $2.1 billion of capital investments. We used a portion of that to strengthen our balance sheet, reducing our net debt to $7.3 billion. Our stronger balance sheet has been recognized by rating agencies as we are just two notches away from investment grade. We run the company on investment-grade metrics and strive to attain investment-grade ratings.

We are exceeding our long-term shareholder commitments. Our long-term op margin goal is 11% to 14%. We achieved 13.1%. EPS growth long-term goal is 10% to 15%. We achieved 70% growth on a pre-tax basis. Our ROIC goal is 15% to 18%, we hit 20.7%. Our free cash flow goal is $3 billion, we hit $3.7 billion.

We make decisions in the business for the long-term. We're focused and disciplined. We manage our capacity, capital and cost tightly. We drive high ROIC. We're focused on growing free cash flow and raising cash shareholder returns. We believe these are the most important metrics for large cap long-term equity owners. Our top line growth is strong which is driven by operational and service excellence. We have increased our earnings by $3 billion since 2012 and generated $6.5 billion in free cash flow over that time. We expect to significantly improve on this performance in 2015.

There's a tremendous opportunity in front of us from lower fuel prices. We will drive these savings to the bottom line with strong revenue growth and yield preservation regardless of fuel prices. At current fuel prices we expect to capture over $2 billion in fuel savings benefit in 2015 net of our hedges. If fuel remains at these levels, we are set up to fully participate in recent fuel declines during 2016. In addition, our hedge book provides excellent protection should fuel rise from current levels. We will use the decline in fuel prices as an opportunity to accelerate progress toward our long-term goals.

Fuel will remain volatile in 2015. We are not making any changes to our 2015 capacity plan in light of the lower fuel prices. In fact, we continue to trim capacity on the margin to maintain yields and our RASM premium. Between fuel savings and the benefits of our revenue initiatives, we expect to produce a significant pre-tax profit increase in 2015. These higher earnings should translate into growing free cash flow which will be allocated between strengthening the balance sheet and returning cash to our owners.

Our top priority continues to be paying down debt. We expect to have our adjusted net debt below $6 billion by the end of this year, and achieve a $5 billion target next year. We will contribute over $900 million to our pension plans this year, which marks the third year of excess contributions to the plan to address that obligation. We will accelerate our capital returns to our owners with a minimum of $1.5 billion in dividends and buybacks this year. We will complete our repurchase authorization by the end of 2015, a full-year ahead of schedule.

Similar to the past two years, we will update you on our capital deployment plans in May after our board of directors completes its annual strategic plan review in the spring meeting of 2015. As we discussed at our Investor Day last month, our work lies in continuing to build a durable industrial company with strong financial performance throughout the cycle. We're making great progress. We've got the right people and the right strategies to continue to do so. Delta today has the fourth lowest P/E of the S&P Industrials, so there is much opportunity ahead.

The operating environment for Delta and the overall industry in the U.S. is remarkably good. Carbon price declines are a huge benefit to the overall U.S. economy. In addition the U.S. is experiencing a pilot shortage at the regionals caused by the 1,500-hour rule, and the long-term hiring trends at the majors. At Delta the large size of the airline requires 12 months to 18 months of advanced planning to significantly change our capacity plans. The same is true across the industry.

These jet fuel savings are enormous and we are diligent at maintaining those savings for the bottom line. In high-level conceptual terms at Delta, the first quarter is a good indicator of the macro trends for 2015. We expect to keep our RASM and non-fuel CASM about flat in 1Q, capacity growth will be about 5% but just 3% net of last year's weather, with fewer airplanes and fewer departures with revenues growing 7%. Fuel savings will go to the bottom line, which will set up for a very strong 1Q, and these trends in 1Q bode well for all of 2015.

Thanks for your support. And I'll turn the call over to Ed who will detail our strategies and commercial initiatives.

Edward H. Bastian

President & Director

Thanks, Richard. Good morning, everyone. Thanks for joining us today. For the December quarter our pre-tax income increased $474 million year-over-year to just over $1 billion. Our net income was $649 million or $0.78 per share, which was generally in line with consensus of $0.77. We expanded our operating margin by more than 400 basis points to 12.6%. Our results for the quarter include $262 million in profit-sharing expense, which brings the total for the year to $1.1 billion.

2014 was a fantastic year on all fronts and will be an honor to be able to report the Delta team come profit-sharing day for driving industry-leading operational customer service and financial results. These results have led Delta to be the second best-performing stock in the S&P 500 over the last two years. Hats off to our 80,000 strong. We had solid revenue performance growing the top line against a backdrop of significantly lower fuel prices. Passenger revenues increased 4.6% on 3.7% higher capacity.

2014 has been a strong year in corporate sales with our corporate revenues increasing 7%. We saw the strongest performance this year in the financial services, media, and automotive sectors. This corporate sales growth was a key factor in driving our New York hub to profitability. In our most recent Ford Corporate Travel Survey, 88% of our customers anticipate increasing or at least maintaining travel spend in Q1 and over the balance of 2015.

We also saw good traction with our ancillary and merchandising revenues, which increased by 16% for the quarter. Our first-class paid load factor increased by six points to 49%, and we did that off a base of 8% more first-class seats than last year. Our revenues for our premium economy product Comfort Plus increased by 18%, and we are now generating an annual incremental revenue stream of roughly $350 million. Passenger unit revenues grew 1% with our strongest performance in the domestic entity.

International faced headwinds from the dollar strength versus both the euro and yen, which combined with the impact of our service reduction to Venezuela impacted revenues by $60 million, and lowered system unit revenues by about 0.6 points. Domestic unit revenues increased nearly 3% on 3.6% higher capacity. We're especially pleased with our performance in New York and Seattle which have built good momentum as we've been up-gauging the domestic fleet and investing in our network of products and facilities in those two cities. Seattle's domestic unit revenue grew 6% on 33% higher capacity.

In the trans-Atlantic, unit revenues declined slightly on 2% higher capacity. Our best performance was to Europe, especially Amsterdam and Paris, where our joint venture with Air France-KLM helped produce unit revenue increases above the entity average. We continue to face headwinds in Africa, the Middle East, and Russia, which pressured European entity unit revenues by more than two points despite 13% capacity reductions in those markets. Our joint venture with Virgin Atlantic continues to perform well with an 800-basis point margin improvement in the quarter on 2% increase in capacity. Our Latin unit revenues declined 4% on 15% higher capacity, but nearly all of the unit revenue decline was driven by our capacity reduction into Venezuela.

Our investments in Latin America are paying off as we had strong performance in Mexico and Brazil. Our commercial partnerships with Aeroméxico and GOL are driving higher yield in traffic onto our core business markets. Those two carriers accounted for $35 million in incremental revenue for the quarter. In the Pacific, our unit revenues declined 5% on slightly lower capacity as the entity continues to see pressure from the weakened yen. Net of hedges, the yen reduced revenue by $31 million and pressured unit revenues by four of those five points. Since we began down-gauging the 747s and restructuring our Narita hub, we've already seen nearly $25 million improvement on our Tokyo routes in Q4.

Turning to guidance, Richard made an important point earlier. The focus of the commercial team is to continue to grow revenues as we seek to drive the fuel savings to the bottom line. We are seeing some continuing pressure on our international unit revenues from the stronger dollar and lower fuel surcharges. In the domestic market, demand and revenues remained solid. We are forecasting our March quarter revenues to increase about 7% with RASM roughly flat on 5% higher capacity. That forecast includes about a point of unit revenue pressure and two points of capacity growth from last year's winter storms. So schedule-over-schedule, our Q1 capacity will be up roughly 3%.

The storm impact will also affect the monthly RASM OpEx. We expect our January RASM will be the lowest performer with monthly results progressively improving as we move through the quarter. Our revenue growth combined with $0.50 to $0.60 in lower fuel prices and solid non-fuel cost productivity should result in an operating margin of 11% to 13%. This is a 400-basis point improvement compared to last March's quarter and a 500-basis point improvement on pre-tax earnings.

Looking ahead, we face about $300 million of revenue headwinds in 2015 from the stronger dollar close to a full point of RASM, but we have a number of revenue initiatives that give us confidence we can not only overcome that pressure but continue to grow revenues through the year. First, we're continuing to make adjustments to our network to improve our revenue and our margins. While we will make incremental capacity additions in New York, Seattle and Los Angeles this year, we are also focused on tactically adjusting the gauge and frequency of flying to better match demand, including deciding this week to take 1.5 points out of our domestic schedule starting in March.

In Latin America, our growth will tail off in the back half of the year. We're already seeing benefits in those markets as our capacity additions have matured, and we expect to see that momentum build as we go through 2015. We will also benefit as we begin to lap the impact of our Venezuelan reductions later this year. And in the Pacific, we continue to restructure our network in light of continued pressure from the weakened yen. This will take a couple of years as we retire the 747s and backfill a portion of that flying with new smaller-gauged aircraft. However, we expect to make good progress in 2015 as we will retire five additional 747s, which will reduce capacity into Japan by 15%.

Second, we have strong opportunity in our joint venture and our investment with Virgin Atlantic, which we expect to produce $200 million of benefit this year alone. We just celebrated the first anniversary of our joint venture and we are gaining familiarity and expertise as we cooperate on pricing, scheduling and capacity decisions. Delta and Virgin combined will increase our U.S. to Heathrow capacity by 10% in 2015. Our increased service to London Heathrow, a key market that Delta didn't serve just a few years ago has been a strong driver of the momentum we've seen in our corporate sales growth.

A third focus for our commercial team is rolling out our branded fair initiative. Our basic economy of product is already in over 75 markets and is producing strong results as we continue to expand it into additional domestic and Latin markets. And finally, we've changed SkyMiles from the distance-based program to a spend-based program. This change should drive higher revenues from a stronger customer loyalty as we put rewards into the hands of our most valuable customers and we're already receiving positive feedback from them.

We were also able to translate the value of our frequent-flier program into improved terms in the new agreement we reach with American Express, which we announced last month. That new agreement which went into effect on January 1 is expected to deliver several hundred million dollars of higher revenues to Delta this year through a 15% improvement in terms. 2000 was another excellent year on all fronts and we expect that 2015 will be even better. Again, thanks to our 80,000 Delta colleagues for their contributions to another successful year.

Now, I'll turn the call over to Paul who'll take you through the details on costs and cash flow performance.

Paul A. Jacobson

Chief Financial Officer & Executive Vice President

Thanks, Ed. Good morning, everybody, and thank you for joining us this morning. Consistent cost control was again a significant contributor to our 400 basis points of margin expansion this quarter. Total operating expenses increased by $135 million driven entirely by higher profit-sharing expense. We were once again able to hold non-fuel CASM essentially flat in each quarter of 2014 and this quarter marks the sixth consecutive quarter of non-fuel CASM growth below 2%. As we are continuing to see the benefits of our up-gauging initiative and lower maintenance expense due to the 50-seat retirements.

There is tremendous commitment across the entire organization to continue to achieve our goal of cost growth consistently below 2%, and we expect that momentum to continue through this year and into 2016. This year we took delivery of 84 aircraft, and retired 89 aircraft which included 60 50-seaters. We improved our operating leverage through up-gauging generating 2% higher domestic capacity for the year on 3.9% fewer departures, all while the operational team delivered the lowest maintenance CASM in the industry with the best operational reliability. As we progress through 2015 we will continue to see the benefits from up-gauging, the retirement of 50-seaters and older mainline aircraft, as well as the benefits of productivity improvements across the organization.

Moving onto fuel; fuel expense declined by $342 million for the quarter driven by the sharp decline in market fuel prices. Our all-in fuel price was $2.62 per gallon, which was $0.43 lower year-over-year. Our results this quarter included $180 million in settled hedge losses, which were offset by $105 million profit at the refinery. At December 31 we had $925 million in hedge margin posted with counterparties which we expect will be substantially reduced by June 30 based on current prices. Based on current prices we are projecting an all-in fuel price of $2.45 to $2.50 per gallon for the March quarter.

For the full-year we are forecasting an all-in price of $2.25 to $2.35 per gallon which is approximately $0.50 to $0.60 lower than 2014. These lower prices should produce over $2 billion in lower fuel expense including hedges. For 2016 we are well positioned for full downside participation should fuel remain at these levels. As I mentioned, the refinery made a $105 million profit for the December quarter, which represents $151 million improvement versus last year. Lower crude costs combined with higher product crack spreads and increased throughput were key contributors to the refinery's heightened profitability this quarter.

Our already strong cash flow will further benefit from the low fuel price environment which will allow us to continue our progress in strengthening the balance sheet by paying down debt, funding our pension plans and continuing to return cash to our owners. This year we generated $5.8 billion of operating cash flow and reinvested $2.1 billion back into the business, primarily related to aircraft modifications and purchases of the CRJ900s and 737-900s which are replacing the 50-seaters and older 757 aircraft. For the March quarter we are projecting $700 million in CapEx primarily related to 737-900 deliveries and deposits on future aircraft.

With the $3.7 billion of free cash flow that we generated in 2014 we were able to reduce our adjusted net debt down to $7.3 billion. This reduction in adjusted net debt represents a $2.1 billion decrease compared to the same time last year and delivered $200 million in interest savings year-over-year. We expect another $200 million in interest expense savings for 2015 from continued debt reduction. Additionally, we continued our path of increasing shareholder value by returning $1.35 billion to shareholders through $251 million of dividends and $1.1 billion of share repurchases that retired over 28 million shares for the year.

Moving into 2015 we expect to generate approximately $1 billion of free cash flow during the March quarter. As Ed and Richard mentioned we will continue to grow free cash flow throughout the year, which will go towards completing the $2 billion share repurchase authorization by the end of 2015, a full-year ahead of schedule and towards paying down additional debt. We'll update you in May on further capital deployment plans. Our long-term goals remain at the forefront of how we manage our business. We will continue to prudently reinvest in the business on investments that align with our return on invested capital goal, pay down debt and return value to our shareholders.

In closing, I would like to extend my heartfelt thanks to the entire Delta team for a record breaking year. We have a special family here and our performance this quarter and throughout the year are a direct result of the contributions made by each and every one of us.

Thanks. And I'll turn the call back over to Jill.

Jill Sullivan Greer
Managing Director-Investor Relations

Kelly Ann, that is the wrap up of our prepared remarks. If you could give the instructions for the analyst to ask a questions?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll go first to Dave Fintzen with Barclays.

David Fintzen
Barclays Capital
Q

Hey. Good morning, everyone. Quick question on the pilot comments. When you look around the world, a very substantial number of Americans still flying outside of the U.S. I mean, could this tightness in pilots start to show up, not in the U.S. but in the outside the U.S. as pilots start to come home that would potentially like to?

Richard H. Anderson
Chief Executive Officer
A

I don't know, David. I just can't – my remarks were focused on what the U.S. industry faces today with a pretty significant shortage building in the regional space. And that's exacerbated by the fact that you have the majors a significant wave of retirements over the next decade just because of demographics. And it's pretty much the same in all the carriers. So there is a big pull from the majors, and the 1,500-hour rule is really affecting the ability of the regionals to be able to attract a significant number of new pilots. So it's really an effect on the U.S. industry as we see it.

David Fintzen
Barclays Capital
Q

Right. And then, on the infrastructure sort of in place to train pilots as you're kind of coming through that attrition. I mean, is that a limiting factor as well or is there sort of ample training facilities to roll through pilots?

Richard H. Anderson
Chief Executive Officer
A

Well, I can speak for Delta, Delta has ample training because we have more than ample training facilities at Delta to run a first rate training operation. And I think in the broader industry there is too, the question is the regulatory requirement on 1,500 hours.

David Fintzen
Barclays Capital
Q

Right. Right. Okay. No that's interesting. Thanks for that color. I appreciate it.

Operator: We'll move next to Bill Greene with Morgan Stanley.

William Jeffrey Greene
Morgan Stanley & Co. LLC
Q

Hi. Good morning. I think you guys probably are getting this question a lot as well, which is, I think a lot of investors think about fuel as creating a windfall. So I realize you're going to try to keep as much of it as possible, but can you talk a little bit about, in so far as you start to hit some of these targets sooner than expected, do the priorities that you outlined at the Investor Day in terms of what to do with this cash so if we did get a bit of an extraordinary windfall that wasn't persistent, how do you think about what to do with that cash? What are the order of uses in that sense?

Richard H. Anderson
Chief Executive Officer

A

Well, I think the first order of use is going to continue to reduce our net debt. And the second order of use is going to be higher cash returns for our owners. Now, that's subject to our board approval. And I've got to be careful about not getting too far out there before going through the five-year plan. But our fleet is, we can run at this level of CapEx very easily for a very long period of time on our fleet. So we don't see some big fleet order coming. We think there's going to be an opportunity for a bunch of used airplanes for us at some point here given all the neo deliveries in the narrow-body world. We just placed our wide-body order. We're fine on wide bodies. So fleet is in good shape. And the run-rate CapEx that you saw this year, the 2.1, that vicinity is a good run rate because we got to keep our ROIC above that 18%. So it's going to reduce debt and higher shareholder cash returns.

William Jeffrey Greene
Morgan Stanley & Co. LLC

Q

Okay. And then, Richard, when you think about fuel, and what you should use to underwrite in a five-year plan or even a one-year plan, what fuel price do you use? And I guess, where I'm getting at is, if fuel where to jump back up, do you have to adjust to that, or are you really operating at a much higher fuel price such that there wouldn't be a change at Delta even at higher fuel prices?

Richard H. Anderson
Chief Executive Officer

A

Well, Bill, we actually use pretty high fuel prices in all of our plans. And this was a shared experience with Ed and I back – we've learned this over the years that planning with a low fuel price will only disappoint. And planning with a high fuel price – if you end up being wrong and the fuel price is lower you will be pleased. But it's really important when you're planning an airline over the long term or making a 30-year NPV decision on buying an airplane to use a very high fuel price, otherwise you're not going to get an ROIC and a free cash flow number that you're going to like. So Paul, what's our fuel price assumption for our budget, was 2...

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

$2.82 million.

Richard H. Anderson
Chief Executive Officer

A

$2.82 million this year, even though we knew it was going to be lower. But that way you plan the capacity on a much more muted basis, and you make sure that you put the strategies in place to hold yield and RASM.

William Jeffrey Greene
Morgan Stanley & Co. LLC

Q

So insofar as fuel went back up, you wouldn't need to make any adjustments, I assume, or is that not the right way to think about it?

Richard H. Anderson
Chief Executive Officer

A

Well, if fuel goes back up, remember, it takes a lot to make a capacity adjustment at an airline of this size. You got – Paul, we have 1,200 airplanes? So 1% of 1,200 airplanes is 12 airplanes. There is eight crews per airplane. You've got to get all those people hired and trained and the flight attendants. And we tend to be on the conservative side because we don't want to overshoot on capacity or expense, because you're adding fixed expense, and you better be certain you're going to get a return on it. So bottom line is, it's always a really conservative approach to how you plan and you should always plan with fuel prices high. We've seen this movie many times in the industry. And so you've got to run the company conservatively. And we're trimming capacity as we speak, as we get close into the beginning of the second quarter.

William Jeffrey Greene
Morgan Stanley & Co. LLC

Q

Okay. Great. Thank you for the time. I appreciate it.

Richard H. Anderson
Chief Executive Officer

A

Welcome back, Bill.

William Jeffrey Greene
Morgan Stanley & Co. LLC

Q

Thanks sir.

Operator: Next we'll hear from Goldman Sachs, Tom Kim.

Thomas Kim
Goldman Sachs & Co.

Q

Good morning. Thanks for your time. I just want to ask with regard to the level of competition out there. Obviously this industry is always competitive. I'm wondering if you're beginning to see any signs or indication that competition within the domestic market might be increasing at all.

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management

A

No, Tom. We don't see any signs of that right now.

Thomas Kim
Goldman Sachs & Co.

Q

Okay. Fair enough. I didn't think, so I just wanted to confirm that. And then I guess just with LatAm and the Pacific, obviously you guys have been flagging this very well. I'm curious, is this more of a demand side issue, or is it really supply side, they are combination of the two? And then it doesn't sound like you're seeing any signs of inflection in these markets, but I'd love to hear your thoughts in terms of whether there is any supply side response, largely from the overseas carriers to actually suggest that we could see possibly a pleasant surprise with regards to the LatAm and Pacific markets more specifically? Thanks.

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management

A

If you think about our fourth quarter, four of the five points in Pacific year-over-year decline were based on yen currency. We've seen really unprecedented decline in the yen. Despite that, we think that we will be profitable in our Japanese operation in 2015. And so if you think about as we continue to restructure and become less reliant on Japan, we were very pleased with the one point decline, which means that it was a lot of core strength in a period of the year. It is not really peak demand.

Thomas Kim
Goldman Sachs & Co.

Q

Great. Thanks very much.

Operator: And from Cowen we'll go to Helane Becker.

Helane R. Becker
Cowen & Co. LLC

Q

Thanks very much, operator. I thought I heard that you said you were thinking about reducing domestic capacity growth in March. And I was just kind of wondering is that – the thought process there is that you're not seeing demand in those markets, or are you concerned about demand in those markets, or what's the thought behind that?

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management

A

Helane, we've been taking a very prudent yield strategy, and clearly we have our advanced yields in the domestic network up significantly over the next several months. And so as we came through January and saw the actual demand patterns at these higher yields, we took some capacity out. That's just a normal business process, and it doesn't say anything about core demand.

Helane R. Becker
Cowen & Co. LLC

Q

But do the yield – then does the yield outlook say something about the demand outlook?

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management

A

The yield outlook is very positive, and we would like to keep it there, and so we're adjusting the lower demand flights downwards.

Edward H. Bastian
President & Director

A

Helane, this is Ed. Just to be clear, we're still going to be growing domestic. We're just reducing some of the growth.

Helane R. Becker
Cowen & Co. LLC

Q

Okay. Great. Thanks very much. I appreciate your help on that.

Operator: We'll hear now from Michael Linenberg with Deutsche Bank.

Mike J. Linenberg
Deutsche Bank Securities, Inc.

Q

Yeah, hey. Two questions. Hey. Good morning, everyone. Just a follow-up on Helane's question. Ed, I think the forecast was 3% domestic growth for 2015. If we incorporate the contemplated adjustments at the end of March or starting in March, where does domestic shake out? Is that more closer to 2% for the year?

Edward H. Bastian
President & Director

A

It's too early to say, Mike. We're in a calibration, as we always said, as we get into the year we start to make tactical adjustments. It's somewhere in the 2% to 3% range. It's probably still pretty good guidance.

Mike J. Linenberg
Deutsche Bank Securities, Inc.

Q

Okay. Great. And then just my second question, I believe there's been a decision made to at least not retire one of the 747s that was going out in the fourth quarter. It looks like it's going to be back in the schedule starting I think in May. How much of the lower fuel price played a factor in that decision? And if it did, are there other sub fleets where maybe it make sense to fly those aircraft a little bit longer, maybe potentially pushback on the order book a bit? Are there opportunities out there? Are those decisions not made until you see fuel prices down at this level on a sustained basis?

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management

A

Mike, it's Glen. We did retire all the airplanes that we had contemplated. The activation of the 74 was a swap, so it was not a net new airplane to the system. And we saw the opportunity which is a great opportunity with our partners at China Eastern. Starting in April we will be able to be co-terminus with them. We'll be able to reduce our MCTs in Shanghai, and we have the opportunity between sometime at some time it sat in L.A. and a new maintenance facility that we're opening in Shanghai to create the airplane to fly that. And that's really a long-term decision that we've been waiting for the right opportunity within the five-year plan. With the China visa extensions we see a huge increase in demand, and with the opportunity that's presenting itself in China with our partner, China Eastern, we really saw this as a one-time opportunity that was out of the normal course of our business. But given the events that had happened with the relaxation of the visas, given the opportunity we had to relocate, it was really the right time.

Mike J. Linenberg
Deutsche Bank Securities, Inc.

Q

Okay. Great. And then anything on that second part of the question?

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management

A

We haven't changed our fleet plan by one airplane since fuel has come down. So could you? Yes. Have we? No.

Mike J. Linenberg
Deutsche Bank Securities, Inc.

Q

Perfect. Thanks, Glen. I appreciate it.

Richard H. Anderson
Chief Executive Officer

A

Actually, Michael, the total [ph] shell (36:23) count for 2015 will be down about 10 year-on-year.

Mike J. Linenberg
Deutsche Bank Securities, Inc.

Q

Great. Thanks, everyone.

Operator: And from Wolfe Research we'll go to Hunter Keay.

Hunter K. Keay
Wolfe Research LLC

Q

Hi. Good morning everybody, and thank you very much. I was wondering if I could sort of follow up a little bit on sort of what Bill was asking earlier about sort of this windfall use of cash, and sort of where we should think about the incremental cash flow going. Richard, at the Analyst Day you made a comment about taking net debt down to zero. I know you got to get to $5 billion first and you don't want to talk too far ahead here. But is that the real target, or is that sort of, if this current operating environment continues and you guys are generating a lot more cash than you thought you ever would have, that becomes something that's more of a near-term realistic possibility, or is it kind of like, let's just get to $5 billion first and see where we are type thing?

Richard H. Anderson
Chief Executive Officer

A

Well, I think it's – Hunter, it's a good question. In fact, I think it's a great question from the long-term shareholder perspective because this year we budgeted $3 billion in free cash flow and we got well above that. So there's just a natural tendency that it's going to flow against net debt because we're pretty disciplined about not wanting to take up our aircraft CapEx, and we already have the 50 wide bodies ordered, and we've got 717s, 737s and A321s coming. And on the margin there'll be a few more airplanes as we hit 30 years of age on some of our domestic fleet where we're going to have to make some purchases. But I don't see the CapEx commitment changing from where we've been.

So there's two places it ends up going, just naturally; one is higher cash returns to our shareholders, probably in the form of share buyback; and second is just cash accumulating against net debt. I don't know that we've said that our target is really zero, we want to get to $5 billion in net debt, but the cash is going to accumulate and we're going to have to be careful to be certain that we steward it wisely for long-term owners.

Hunter K. Keay
Wolfe Research LLC

Q

Great. That's helpful. Thanks a lot. And maybe a question for Glen, can you talk about how you're sort of strategically managing the inventory on basic economy right now? You highlighted in prepared remarks it's something you're clearly very excited about Glen at the Analyst Day presentation. Can you talk about how you manage inventory in terms of not competing against yourself? Like if I were to go on delta.com, I was always going to go to delta.com, how do you run the risk of – manage the risk of me not seeing that basic economy fare right next to a normal fare, if you want to call it that, and me buying that? Are you going to restrict the inventory very tightly? Are you going to roll it out in a few test markets to see how it goes? And also, long question I apologize, but how this factors into the OTA's with the full content agreements that you have with them? Thank you very much.

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management

A

Hey, Hunter. Really the basic economy is not a lower fare, it's just the lowest fare that we have available. So if you think about where it's used today in the 75 markets, it's primarily used against the ultra-low cost carriers when we have inventory we want to sell, and we want customers to buy a competitive product. So as we think about fares moving forward, we want to be less commoditized. We want people to buy the products and services they want, and this is really not about lowering fares but allowing people to select what features that Delta offers they want.

As you know, Delta has by far the best industry record for on-time performance, for baggage, and the highest Net Promoter Score than any of the major three carriers. So how do we continue to de-content that and continue to offer best-in-class for whatever customers want to buy from us, and this is really one of those vehicles.

Hunter K. Keay
Wolfe Research LLC

Q

Thank you.

Richard H. Anderson
Chief Executive Officer

A

And Hunter, just on the OTA question, the OTAs, we've reduce the number of relationships we have in that distribution channel, and in many instances we don't really have full content agreements. So much of this product is really through our website or through a second point-of-sale at the airport. And the prominence of the OTAs has really diminished, particularly as investments in delta.com have driven very high levels of customer satisfaction. So overall, the OTAs just play a much smaller role in the distribution strategy.

Hunter K. Keay
Wolfe Research LLC

Q

Thanks a lot for the time.

Richard H. Anderson
Chief Executive Officer

A

Thank you for your questions.

Operator: We'll go now to Duane Pfennigwerth with Evercore ISI.

Duane Pfennigwerth
Evercore ISI

Q

Hey thanks. Good morning. I appreciate your flattish PRASM commentary for the March quarter, I guess 2% growth in total unit revenue. I wonder if you could give a sense from what you expect that to look like by region, or if not by region maybe just what you'd expect sort of domestic to be relative to that flat?

Edward H. Bastian
President & Director

A

Well, I think the trends you saw in Q4 probably are continuing to take hold in Q1, the international RASMs are being pressured on a continued basis by even an accelerated level of dollar strengthening. And domestic is really solid. Our corporate revenues are strong. At the current year, gotten off to a very good start in the month of January, our corporate revenues in the month of January are up 7%. So we see domestic holding up well, and we continue to make the adjustments we've talked about with some of our international entities.

Duane Pfennigwerth
Evercore ISI

Q

Appreciate that color. And then, just on hedging for 2016, I'm glad I don't have to make that decision for you, but maybe you could just talk about the thought process. What do you need to see to begin to hedge that out? What is it that you're looking for that would suggest these prices may be the lowest? And thanks for taking the questions.

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

Good morning, Duane. It's Paul. I think as we've talked about and as we mentioned at Investor Day, we've taken a little bit more of a narrower view in terms of the time versus what we've historically looked out at. 2016 is in our radar now. I don't think we're going to jump and do anything extreme, I think we're going to continue to manage our program as we see it going forward. We have to keep in mind that there is some steepness in the curves, you can't hedge in the $40s in 2016 and we have to take that into account. That being said, we are in a position where we could get some good year-over-year improvement, again, as we see continuing 2014 to 2015 and 2015 to 2016. So all that weighs in, but we're committed to our program, and I don't think you're going to see anything materially different from us.

Duane Pfennigwerth
Evercore ISI

Q

Okay. Thank you.

Operator: From Credit Suisse we'll go to Julie Yates.

Julie A. Yates-Stewart
Credit Suisse Securities (USA) LLC (Broker)

Q

Good morning. Thanks for taking my question. Just to continue on Duane's question on unit revenues, and maybe just taking a step back and thinking about 2015, I realize you only give guidance for one quarter. But can you give any perspective in light of the changes that are going on in each of the geographies on how we should think about the progression of unit revenue performance throughout the year? And whether we should see improvements maybe from some of the capacity reductions into Asia, and the restructuring and the actions on the trans-Atlantic with Virgin?

Edward H. Bastian
President & Director

A

Sure, Julie. I think the domestic entity is going to be solid throughout the year. We see no reason why we'll see any tail-off of our domestic performance. Internationally, as we mature and lap a significant amount of the Latin investment that we're making, and as we lap the Venezuelan capacity reduction, we should see the Latin unit revenue progression start to improve by the second half of the year. And in the Pacific, we have talked a lot about the changes we're making with the 747s. I think it really depends on a currency play, with what's happening with respect to the yen. So in the back half of the year for the Pacific, we see some fundamental improvements, but that's factored on based on the yen holding where it's largely at.

Julie A. Yates-Stewart
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. And then just maybe on the trans-Atlantic?

Edward H. Bastian
President & Director

A

Our JV with Virgin is going very well. I mentioned that we expect to post a net $200 million profit for the year. And our performance in Paris and Amsterdam were also quite strong in Q4. I think our unit revenue performance to those two markets were in the 3% to 5% year-over-year range of improvement. And so we'd expect 2015 to see continuing strength.

Richard H. Anderson
Chief Executive Officer
A

Yeah. 2015 in the AF-KL JV we're expecting a significant contribution improvement in the joint venture with Air France-KLM. And we're seeing a lot of the fuel price advantage obviously endorsed to the long haul.

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management
A

And one last comment on the global demand scene, we see really good core strength with just one exception, and that is Africa, Middle East and Russia. And so we will be adjusting our capacity in those key markets as we move forward through the year. But all kind of different events, Russia being more political, Middle East being related to the oil and Africa being related to the perception of Ebola, because we really don't fly to Ebola-affected areas.

Julie A. Yates-Stewart
Credit Suisse Securities (USA) LLC (Broker)
Q

Okay. And then just lastly, internationally, where are you starting to see pressure to remove fuel surcharges?

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management
A

We never comment on forward pricing initiatives. So we'd like to just continue that policy.

Julie A. Yates-Stewart
Credit Suisse Securities (USA) LLC (Broker)
Q

Okay. Thank you.

Operator: We'll go now to Jamie Baker with JPMorgan.

Jamie N. Baker
JPMorgan Securities LLC
Q

Hey, good morning, everybody. First question is the labor drama played out in recent months at American Airlines, I'm curious if there's been any impact or sort of change in the tone of dialog between Delta management and its pilots? Does it remain a goal to try and settle before the amendable date? And how confident are you that even with new economics you can succeed in keeping the consolidated ex-fuel CASM number under 2%?

Richard H. Anderson
Chief Executive Officer
A

I think the answer to the first question is no change in our great relationship. We have made a commitment with our pilots to finish on time or ahead of schedule. And we're confident that we're going to be able to maintain our cost structure over the long term.

Jamie N. Baker
JPMorgan Securities LLC
Q

Okay. And, Ed, I don't want to get bogged down in semantics. I mean, the team seems to be speaking rather enthusiastically today about the impact of lower fuel. But I'm still getting inquiries from investors about that statement in the release about quote-unquote headwind from lower fuel? I mean, even if you only participate in 50% of the savings, how exactly is that a headwind? Were you just referring to the headwind from the hedge book?

Edward H. Bastian
President & Director

A

No, Jamie, there's no question there is a correlation. As fuel prices come down there is an industry supply macro that you need to think about. So we weren't talking about any specific headwinds other than the fact as fuel prices come down, you can expect to see pricing pressure broadly.

Richard H. Anderson
Chief Executive Officer

A

And there is a sub – Jamie, there is a subpart to the question. If you think about the effective lower fuel prices, it's affecting some of the economies around the world. While it's a huge – it's a huge boon to the American consumer, there's never a better time for Americans to go to Europe or to travel around the world, right. But when you think about the effect that it has in places like Brazil, Glen talked about Russia. There are a lot of OPEC economies. The cartel that was collecting rents that they aren't collecting anymore. And you see it in Venezuela, you see it in a number of carbon-producing economies that will have some impact on the foreign point of sale. But, the U.S., it is a huge boon to the U.S. economy.

Jamie N. Baker
JPMorgan Securities LLC

Q

No pushback from me. If I can just squeeze in a third housekeeping question, I know you reserve the right to modify the profit-sharing program. I didn't see anything in the release to suggest the 2015 breakpoints would be any different. Is that correct?

Richard H. Anderson
Chief Executive Officer

A

That's correct.

Edward H. Bastian
President & Director

A

Correct.

Jamie N. Baker
JPMorgan Securities LLC

Q

Okay. Cool. Excellent. Thank you for the time. I appreciate it very much.

Jill Sullivan Greer
Managing Director-Investor Relations

A

Thanks. And, Kelly, we're going to have time for one more question from the analysts.

Operator: And that will be from Joe DeNardi with Stifel.

Joe W. DeNardi
Stifel, Nicolaus & Co., Inc.

Q

Hey. Thanks. Good morning. Paul, I think you were the one that mentioned the pilot retirement wave coming over the next couple of years, and I'm sure you've looked at that pretty closely. Is there any way you could quantify what the impact or benefit to your cost structure you expect from that?

Paul A. Jacobson
Chief Financial Officer & Executive Vice President A

Joe, good morning. Yeah, it was Richard that was talking about the pilot staffing constraints and what it takes in order to grow capacity. I think the normal flow-through that we see in the ranks is built into our cost structure. And I think we don't expect that to result in any big unit cost pressures.

Joe W. DeNardi
Stifel, Nicolaus & Co., Inc. Q

Okay. Yeah, I mean, I guess, wouldn't it be a tailwind at some point as the retirement start to accelerate?

Richard H. Anderson
Chief Executive Officer A

Not really.

Paul A. Jacobson
Chief Financial Officer & Executive Vice President A

Not really.

Gil West
Executive Vice President and Chief Operating Officer, Delta Air Lines, Inc. A

It's not a seniority-based pay, per se. There is a little bit a training costs associated with it, but from a wage, benefit, salary standpoint, it's negligible.

Joe W. DeNardi
Stifel, Nicolaus & Co., Inc. Q

Okay. And then just a housekeeping. Did the first quarter – is that PRASM that you expect to be flat or total RASM?

Edward H. Bastian
President & Director A

It's PRASM.

Joe W. DeNardi
Stifel, Nicolaus & Co., Inc. Q

Okay. Thank you.

Jill Sullivan Greer
Managing Director-Investor Relations Q

And that's going to conclude the analyst portion of the call. I'm now going to turn it over to Kevin Shinkle, our Chief Communications Officer.

Kevin Shinkle
Delta Air Lines, Inc. Q

Good morning. We have about 10 minutes for questions from reporters. So please limit yourself to one question and one brief follow-up. And we can begin.

Operator: [Operator Instructions] We will go first to Jack Nicas, The Wall Street Journal.

Jack Nicas
The Wall Street Journal
Q

Hey, guys. You just were talking about the fact that when you do see a significant declines in the price of oil there's going to be some industry headwinds such as pricing pressures. Can you discuss whether you're seeing any of that now? And if so, can you characterize it a little bit and talk about what it is?

Edward H. Bastian
President & Director
A

Jack, this is Ed. Given the results we just posted with our unit revenues improved and given that we've got a flat outlook on a growing supply base into the first quarter of 2015, I think that will tell you what we see in the r evenue cards.

Jack Nicas
The Wall Street Journal
Q

Okay. Are you seeing at all – I mean, could you say that any competitors are cutting fares or anything like that?

Edward H. Bastian
President & Director
A

No, we can't...

Richard H. Anderson
Chief Executive Officer
A

We can't talk about that, Jack.

Jack Nicas
The Wall Street Journal
Q

Okay. Thanks, guys.

Operator: And David Koenig with the Associated Press has our next question.

David Koenig
The Associated Press, Inc.
Q

Yeah. This may be a bit of a follow-up to that. I keep getting the question all the time, when are fares going to go down because fuel is down so sharply and there was no mention of that on the call. There was mention of how you might spend the fuel – if you want to call it a windfall? Anything new that, Mr. Anderson, you can say about the impact of fuel on fares?

Richard H. Anderson
Chief Executive Officer
A

No. I think we covered it pretty thoroughly there in the call. I think Ed addressed it pretty forthrightly. Over the cycle, you do have some pressure from fuel price and particularly in the foreign point-of-sale where economies are significantly affected if they had been relying upon oil price payments from the U.S.

David Koenig
The Associated Press, Inc.
Q

Would it take some sort of a drop-off in load factors? And then how much before you might see some difference in fares?

Richard H. Anderson
Chief Executive Officer
A

There's always differences. The marketplace is incredibly competitive and there's always differences in fares in a competitive marketplace.

David Koenig
The Associated Press, Inc.
Q

Okay. I guess, I meant reductions, but my bad.

Richard H. Anderson
Chief Executive Officer
A

Yeah. I think we covered it. Thanks.

Operator: And from TheStreet we'll go to Ted Reed.

Ted Reed
TheStreet, Inc.
Q

Thank you. I would like to hear, Glen, explain why you're adding a flight from Los Angeles to Shanghai given capacity increases in the Pacific and the buildup in Seattle? I would just like to hear why you feel that flight is necessary and how it can make money?

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management
A

I thought I just answered that on the analyst call in pretty good detail. The one thing that's happened in the last few months is the extension of the Chinese visa program to 10 years. That was unexpected and so we've seen a significant increase in demand from China. The second thing was a long-awaited co-terminus move with our partner, China Eastern. We're already connecting about a little less than 200 people a day in Shanghai to points in interior China. And starting in April, we'll be able to reduce our minimum connect times and we'll be able to better connect to those points in China.

So we saw that the opportunity combined with the dramatic increase in Chinese visitors. And the Chinese economy just came out today in [ph] 73 (55:47) with the visas we see really, really strong demand in China materializing in the second and third quarters. And this is something that was in our five-year plan. We just saw an opportunity to accelerate it given some exogenous events that all seem to sync up at once.

Richard H. Anderson
Chief Executive Officer
A

Overall Pacific capacity should be down in 2015 about 4%.

Ted Reed
TheStreet, Inc.
Q

So that makes even Los Angeles viable for you?

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management
A

Absolutely.

Ted Reed
TheStreet, Inc.
Q

Okay. Thank you.

Operator: We'll hear now from Michael Sasso with Bloomberg News.

Michael Sasso
Bloomberg, Inc.
Q

Hi. Hello. Good morning. I just have a question. You were growing really rapidly there for quite a while in Latin America. Can you just talk about yields, how that's affecting your own yields and how that's affecting yields throughout the entire industry?

Edward H. Bastian
President & Director
A

Could you repeat your question? We didn't catch what your gist was.

Michael Sasso
Bloomberg, Inc.
Q

I'm sorry. The question was about yields in Latin America given your rapid growth there over the last year or so.

Edward H. Bastian
President & Director
A

Yeah. As we mature that growth and lap that growth, we will see certainly some improvements in our overall unit revenue performance. Anytime you're expanding in international markets, it generally takes 12 months to 24 months before the market starts to fully develop for you and you will see some natural improvements as we temper our capacity initiatives. The other factor is Venezuela which had an outsized level of unit revenue performance. With the currency changes, we decided last year to pull down our frequencies and as we lap that, will also be a benefit to our Latin unit revenues in the second half of this year.

Glen W. Hauenstein
Executive Vice President–Network Planning & Revenue Management
A

So – and just a last comment, on a fairly significant increase in capacity in the fourth quarter, absent of Venezuela, our yields would have been flat.

Operator: We'll move next to Jeffrey Dastin with Thomas Reuters News (sic) [Thomson Reuters News] (57:56).

Jeffrey Dastin
Thomson Reuters

Q

Thank you. To clarify Paul's earlier comment that [indiscernible] (58:02) anything extreme with its hedge book, does that mean Delta is not looking to lock in lower fuel prices for the long term with new hedge contract?

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

Jeffrey, good morning. What we do is we manage the book usually on inside of an 18-month time horizon, but primarily focused inside of about a 12-month period. So the comment was intended to mean that we're just going to continue to look at the program as we've been running it. 2016 is coming into view, but we're not looking to make material changes in how we manage the program. It doesn't mean that we won't be hedging in 2016.

Jeffrey Dastin
Thomson Reuters

Q

Got it. Thank you very much.

Operator: And from Argus Media we'll go to [ph] Elliott Blackburn (58:51).

Q

Good morning, and thanks for the time. Obviously, the refinery had a good quarter last quarter. I was curious if you guys could talk about what you're seeing there if the rail Bakken crude that you worked to secure, if that's still competitive there or if you're finding more opportunities for the waterborne imports with that facility?

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

Good morning, [ph] Elliott (59:11). This is Paul again. What – we've obviously seen some compression in the spread between domestic and foreign sourced oil, which has made some foreign a little bit more attractive. But what we've seen at the refinery is that crack spreads and margins on products have actually gone up while prices have gone down and that's contributed to the profitability. So we had a great fourth quarter. We expect a pretty healthy profit at the refinery in the first quarter as well on the strength of those higher crack spreads, which is helping to serve as a bit of a hedge, if you will, on widening spreads on a lower crude price for the airline.

Q

Okay. Thanks. And are you guys expecting to be able to run full-out for the year or do you have some planned work at that refinery this year?

Paul A. Jacobson
Chief Financial Officer & Executive Vice President

A

Nothing other than just ordinary maintenance. There are no planned major shutdowns.

Q

All right. Thanks very much.

Kevin Shinkle
Delta Air Lines, Inc.

A

We have time for one more question.

Operator: And that will come from Edward Russell with Flightglobal.

Edward Russell
Flightglobal

Q

Yes. I wanted to see if you could elaborate a bit on the plans for maintenance facility in Shanghai. Will you be moving any maintenance there from elsewhere and what kind of aircraft will be maintaining there?

Richard H. Anderson
Chief Executive Officer

A

It's just purely a line maintenance facility. So it's overnight line checks, overnight planned work, just like the line maintenance facility we have in Amsterdam, or São Paulo, or Paris, or Tokyo. So it's not heavy maintenance or engine maintenance.

Edward Russell
Flightglobal

Q

Okay. And approximately what is the expected investment that you plan to make in that facility?

Richard H. Anderson
Chief Executive Officer

A

We're talking about a dozen mechanics and [ph] a lot more of (01:00:55) spare parts. I think maybe you're misconstruing the idea of putting line maintenance in Shanghai into being something more than that, it's 12 people.

Edward Russell
Flightglobal

Q

Okay. Thank you.

Richard H. Anderson
Chief Executive Officer

A

We do it out on the ram, all right, we won't have a hangar.

Edward Russell
Flightglobal

Q

Okay.

Kevin Shinkle
Delta Air Lines, Inc.

Okay. Thank you. With that, we conclude our call for today. Thanks, everyone, for listening.

Operator: Again, that does conclude today's conference. Thank you all for your participation.