

FINAL TRANSCRIPT

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Blue Mountain Capital - Analyst

Alexi Soroca

BNP Paribas - Analyst

PRESENTATION

Operator

[Audio starts in progress] ladies and gentlemen, and welcome to the third quarter 2006 SAS AB earnings conference call. My name is Carol and I will be your coordinator for today. [OPERATOR INSTRUCTIONS]. I would now like to turn the call over to Mr. Gunnar Reitan. Please proceed, sir.

Gunnar Reitan - *SAS AB - Acting President and CEO*

Thank you and welcome to this telephone conference. My name is Gunnar Reitan and with me is our CFO, Gunilla Berg, our Head of Investor Relations, Sture Stolen, and Director of Investor Relations as well, Bjorn Tibell.

We will make a brief introduction to this third quarter report and then we would be more than happy to answer any questions you might have. I assume that you have all had access to the presentation which has been distributed.

And I will start off on slide number two, just to address the fact that we have concluded the third quarter with a result very much in line with our own plans. And we will be excluding non-recurring items of SEK969m, which is a scale of improvement versus last year of SEK350m.

We are in a very favorable business cycle, which is, of course, part of the reason why the improvement is of this magnitude. We have, however, been very cautious on capacity, which is in combination with our new business model. And the way to address one way fares in most markets, we have seen a better yields coming from better loads. And that is, of course, the positive movement in the airline business. And likewise, when things are getting tougher this can also be the tendency the other way around.

The cycle is one thing, yields and load factor is connected to that. But I would like to emphasis up front that a very significant part of the result improvement is coming from the cost reduction program which we have implemented over the last quarters and years, a strong inflow and a positive result, a consequence of this, coming from the cost side.

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We have had higher fuel costs, about SEK800m above last year. But most of that, or for that sake all of it, has been compensated from volumes and the yield increase. That is as well the gearing effect, as well as price increases, different in different markets.

We have, in addition to the SEK14b turnaround program which we have completed, we have an extension of SEK2.5b in the form of a new program. And we have implemented that to the extent of 68%. The rest will be, of course, completed and we will be doing this into the New Year after we have done all that.

And the SAS Board has appointed Mats Jansson as our new CEO. And he will join the Company as from January 1, 2007.

Finally, and I will refer to that in the end of the presentation, we are in the final stage of an IPO process regarding our hotel business Rezidor Hotel Group. And we expect this to take place before the year end.

Turning to the next page, showing the figures, and I will just briefly comment on that. SEK350m versus last third quarter and SEK658m above last year's nine-month period, January to September. That said, we had a tough start to this year. And we had a couple of conflicts impacting a negative SEK350m bottom line consequence. So, the underlying improvement is on a root of around about SEK300 to SEK400m per quarter underlying.

The next slide, number four, shows the troublesome journey from 2001. We passed through the breakeven point in the very first part of 2006. And the 12-month result ending in September 2006 is now around about close to SEK800m. This is, of course, not sufficient for a decent return but the speed of the improvement the last few quarters is very much according to our internal expectations.

I leave then the floor to Gunilla Berg.

Gunilla Berg - SAS AB - EVP and CFO

Good afternoon. Gunilla speaking. The first slide shows what's the non-recurring items we have had for this quarter and for the three first quarters of this year. We have had restructuring costs this quarter totaling SEK145m, mostly within the Ground Services and Technical Services but also some in [inaudible].

Then we closed down the Sola base last -- in August. We had restructuring costs there of SEK160m. And then we lost the case in the High Court in Norway and we have this one-off effect, because we had to reverse the employment in Ground Services and that will cost us about SEK105m. And then we have had some gains. And within this other, we have this cost of cargo space and that will cost us, or has cost us so far SEK32m. As Gunnar mentioned, we have had had this cost of conflict, SEK350m, the pilots [discount] -- the pilots strike last June this year and the cabin strikes we had in Norway, is about SEK100m. So if we are talking about the underlying EBT, we have an improvement from last year of about SEK1b.

Looking at the next slide, we have a strong improvement in the result in Denmark and in Sweden. Of course, we are far away from the return level but we have strong improvement. And this is due to very strong cabin factors in both these countries and an improved yield, especially in quarter three. And these strong cabin factors are, of course, affected by this positive business climate, but also that we have had really good success with our new business model. And we are adjusting the capacity much better now to the demand.

And, of course, they are still continuing with this cost improvement program. Whereas at Braathens we have also improved the cabin factor, but here you can see that we have lower yield and with [oil and margin] price competition we [inaudible]. And we have lowered our prices for that reason in Norway. They are also affected by the [both] price, both for the pilot and the cabin, and we calculate that to be [SEK240m]. So if we hadn't had these prices, we would have had almost the same result for SAS Braathens. And we can see in quarter three that we are almost on the same level as we were last year.

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Our international, or intercontinental business we have good improvements, according to our plans. We have closed down this heavy loss-making Bank of Singapore. We have included in rather much, of course, that part of it has to be to compensate for the very much increased fuel prices. But anyway it's going better and better for the intercontinental business.

Looking at next slide, we had a very bad result in our Technical Services, a little better in quarter three than the first two quarters. And the explanations of that you can see on the figures down at the slide. The biggest part of this is that we have gone down in prices and volume. And the reason for this is that there is a large overcapacity in the technical businesses. We closed down this Sola base in Slovenia and that was very important for us to adjust the capacity to the demand. And later we will have to do some more capacity adjustments within the Technical Services.

And then we have still very much problems with the resulting component. We just own now 33%, but for the first half-year of 2005 this was a profitable business. So, if we are to compare those figures, then we have to [inaudible] up it went down with the [process] component.

Ground Services is more, as I said, this last quarter it's much more a question about timing. They have lowered their prices and there are some less products ordered from the companies there. And they are taking away costs but they don't do that in the same speed as they have to lower their prices.

[Within the program] SAS Flight Academy we have a good improvement in the result and a stable development in both these components.

Next slide, as Gunnar mentioned, we have implemented so far 68% of this program of SEK2.5b. This program is for the -- our four [inaudible] companies and Ground Services and Technical Services. To really ensure our competitiveness on the cost side we continuously do benchmarks, and the benchmarks we have are the most efficient player in the market. And for the production platform it's very much important that we really got the [inaudible] costs.

If you look at commercial concept, we have different cost levels than some of our competitors because we have a different business model. But, of course, we have to be very conscious that we are efficient in these parts as well.

And then the last one, they are more competitively neutral. But, of course, we look at these cost elements as well. So, this SEK2.5b we will complete as quick as possible the [middle] behind the plan so far. But this is -- we will continue with this several years ahead because it's very important, as I said, that we really ensure this cost competitiveness in the long run.

I think I have finished then, yes.

Gunnar Reitan - SAS AB - Acting President and CEO

All right. Just a few words on our individually branded airlines. Spanair is the biggest one of them and we have a good growth in Spanair. We have a good third quarter result of SEK300m. The comparison for last year was unfortunately affected of some rather grave mistakes in the accounting style, which we identified one year ago. And that is the reason why you cannot see a strong improvement year on year.

This will be different in the fourth quarter and we have the -- the reality is that the performance of the company is significantly better than the case was last year. So there they are on a good track and well positioned and with a strong growth.

Our regional business in Norway, Wideroe, is doing bad this year. This is basically because of the negative cost development. The company has performed well during these five years of tough trading conditions. But this year we are dropping down to plus/minus 0. We have a program of SEK200m which is now under implementation and we will -- we expect to see a positive return to good results, but not this year.

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Blue1 is our Finnish business, growing quite a lot, well received in the Finnish market. We have expanded quite heavily than we [inaudible] earlier this year and we have had some start-up costs in that context. The company is now on track according to plans, and we will have a positive result over the year. And the company is well positioned for the future.

In the Baltic region we have a company airBaltic, which is performing very well. This result is clearly above the return requirements. And we expect to see an internal positive development in our Baltic business.

Moving on to page number 12, just to complete the comment on the Rezidor IPO. We expect that to happen before the year end and the interest in the market for this IPO is good. Carlson Companies, who is the minority shareholder today, will step up from 25% to 35%, providing a solid base, ownership wise, for the company in the future.

We intend to sell down to zero from 75% today. And this is expected to be a significant financially strengthening our balance sheet. I will not provide you with any amounts in that respect but I guess you have maybe seen speculations in the marketplace from analysts of the different banks. But this is a sizeable improvement of our financial situation and the prospectus is only a few days away at this point.

Well, to round up, a tough start of the year. We had a good improvement in the second quarter and also into the third quarter. And this [inaudible] of improve the cabin factor, improve yields, providing good top line growth. And a significant contribution from cost reductions which have been implemented over the last few quarters.

We are still -- we have still more work to do on the cost side and that will be the agenda for 2007. And I can also imagine that it is going to -- that will be an ongoing issue. And the key word number one for the future is to gain productivity, specifically in the crew sector. And we have a lot to do in this area going forward with our [inaudible].

Stable outlook in the sense that we see no signs of a weaker growth, of course, and all cycles will meet the top point at some point in time, and we are prepared for that. We will take actions, capacity wise, at the slightest indication of a weakening. But at this point we do not see that so far.

Fuel is, of course, an uncertainty in itself and we don't have any news on the fuel price. But what we have is a very clear way of acting if the fuel price goes up again. We will either increase prices or at least change the steering concept, with the implication of stepping up the yield. That is what we have done with good success during the first nine months of this year. So -- and capacity wise we are looking at a very modest total increase of around about 2% for the Group, a reduction in the core Scandinavian business and growth in some of the other airlines of our Group.

That is the presentation and we are now ready for any questions you might have. And we will do our best to give straight answers to it.

QUESTIONS AND ANSWERS

Operator

[OPERATOR INSTRUCTIONS]. Your first question comes from the line of Andrew Lobbenberg. Please proceed.

Andrew Lobbenberg - ABN Amro - Analyst

Hi there. It's Andrew at ABN. Three quick questions, if I may. With regard to Spanair, I expected to see a strong quarterly performance, given Air Iberia strikes in the quarter. You alluded to accounting issues but can you explain that a bit more carefully,

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please? Because I thought the accounting issues were with last year and I thought they were straightened out at last year's full result.

The second question on long haul. The traffic data in October didn't look too good on long haul. Can you explain what's going on there, please?

And the third question is fairly straightforward. Can you give any precise guidance on what a sensible number is for fuel for this year and potentially next year? Thanks.

Gunnar Reitan - SAS AB - Acting President and CEO

Well, I can start off with the Spanair question. We had a very unfortunate situation around this time of the year last year and we made adjustments in the fourth quarter. But we did also restating in that -- in connection to the findings we did there. But the fact of the matter is that, when comparing to the statutory figures of 2005, they were too high. So now we are comparing real figures to 2006 with figures for 2005 which were just too good. That's why you do not see the real improvement in the nine first months. That will be the opposite in the fourth quarter, because everything was adjusted last year around this time of the year. So, when we get to the end of the year, you will see a significant improvement compared to the statutory figures last year.

Andrew Lobbenberg - ABN Amro - Analyst

Can you -- sorry, can you remind us what the scale of the accounting restatement was last year, if that gives us a feel of the scale of the hit?

Gunnar Reitan - SAS AB - Acting President and CEO

It was something like SEK80m. So, if you like, the result so far is, which is similar to last year, the reality is SEK88m better.

Andrew Lobbenberg - ABN Amro - Analyst

That's great.

Gunnar Reitan - SAS AB - Acting President and CEO

I will leave the floor to Gunilla with respect to the long haul and the fuel.

Gunilla Berg - SAS AB - EVP and CFO

Yes. If we start with the fuel, for 2006 we expect fuel costs to be about 10.5 and for next year about 11 to 11.5. We had some increasement in capacity which will affect the figures. So if you look at the upper end, 11.5 is still some capacity increasement.

I missed your second question. What was that, the long haul --?

Andrew Lobbenberg - ABN Amro - Analyst

Yes, it really wasn't relating to the third quarter, it was more relating to the traffic stats which were out yesterday. And the load factor was down quite sharply on long haul. Is there any issue in the trading?

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Gunnar Reitan - SAS AB - Acting President and CEO

We did close down Bank of Singapore, which is part of the story.

Andrew Lobbenberg - ABN Amro - Analyst

Yes, no, I can see that would lower the traffic. But I would think that would push the load factor up, because that was the TAG sector.

Gunnar Reitan - SAS AB - Acting President and CEO

Yes. And the U.S. or the North Atlantic business was -- has been a bit weaker, while the Asian business has been stronger. So the net of that is what you can read out in the -- from those figures.

Andrew Lobbenberg - ABN Amro - Analyst

Okay, thanks.

Gunnar Reitan - SAS AB - Acting President and CEO

The U.S. business is basically -- the traffic on the North Atlantic has been a little weaker, so it's not only about moving from one competitor to another. We can see the same signs also in the October traffic figures.

Operator

[OPERATOR INSTRUCTIONS]. There are no more questions at this time. I am sorry, sir, we do have a question. We have a question from the line of Jacob Pedersen. Please proceed.

Jacob Pedersen - Sydbank - Analyst

Yes. Hi, gentlemen. I just have a quick question on your Scandinavian Airlines business. You have been improving earnings quite dramatically through savings. But you have had a very limited traffic growth in the Danish business, in the Swedish business and also in the internationals. What measures are you taking to capture a bigger part of this market growth in the Nordic region?

Gunnar Reitan - SAS AB - Acting President and CEO

First of all, what we have done on these two companies is not a coincidence. We have been very cautious on capacity and we have given high priority on achieving good load factors, which also has given better yield. So the profitability is coming from that type of positioning.

These markets are quite mature markets and in the case of Sweden the domestic part of the business is a significant one. So, it's not so that we have lost a big share of the market but we have prioritized to strengthen the profitability through capacity adjustments downwards, and to get good loads and correspondingly good yields.

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This will, of course, not be the name of the game going forward. But we have taken steps to get a profitability basis for our businesses. And we will, of course, play the game with -- also with capacity. But we will not be -- we do not have ambitions of stepping up to a great extent on capacity in the near future.

Jacob Pedersen - Sydbank - Analyst

Okay. But should we expect growth -- traffic growth in Scandinavian Airlines business for 2007?

Gunnar Reitan - SAS AB - Acting President and CEO

Yes, we expect growth.

Jacob Pedersen - Sydbank - Analyst

Okay. Thank you very much.

Gunnar Reitan - SAS AB - Acting President and CEO

Maybe the marketplace as such can provide something like 4 or 5%.

Operator

Your next question comes from the line of [Arty Ludo] with Blue Mountain Capital. Please proceed.

Arty Ludo - Blue Mountain Capital - Analyst

Hi there. I was wondering if I can dig a little bit deeper in what you said about the proceeds from the IPO of the hotel business. I have the debt level for the third quarter at SEK11.5b approximately, but that's not split down into the short term and the long term. And I guess, from looking at your annual report, I can't see any pressing short-term maturities. It looks like the majority of the short-term maturities are the kind that you can roll over. So, I realize that any proceeds will reduce your net debt, because the cash will be sitting on the balance sheet. But are you actually planning to pay down any debt, for example, make any prepayments for the 2008 bonds or anything like that? Because I guess the 2008 is the biggest maturity that you have coming up.

Gunilla Berg - SAS AB - EVP and CFO

We are not planning to do that or we are not doing that process yet anyway. So we will keep the money. We will pay the amortization we have next year. We have amortization next year of SEK3.9b. And strengthen our balance sheet generally. So, I can't give you an indication that we will prepay the bonds in 2008.

Arty Ludo - Blue Mountain Capital - Analyst

Okay. And when you say you have amortizations of SEK3.9b, can you give me a little bit of an indication what kind of debt that is? Is it bank loans? From the annual report, the big thing that I can see is something called other loans, and then finance leasing. And that's all that I could see for 2007. So, can you tell me what those loans are? I was under the impression that those loans were all types of loans that you would roll over.

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Gunilla Berg - SAS AB - EVP and CFO

Yes, but they are normal bank loans and so there's no bonds in 2007. They are normal bank loans.

Arty Ludo - Blue Mountain Capital - Analyst

No, exactly. And so I was under the impression that those loans don't actually need to be repaid down. When I have spoken to the Investor Relations department before, I was under the impression that these loans roll over. So, you don't actually need to use the proceeds to pay the loans back. So --

Gunilla Berg - SAS AB - EVP and CFO

We can decide to roll over some of the loans. But they are - or what do you say - ended -- expiring next year. But, of course, some of the loans, if we decide, we can roll over.

Arty Ludo - Blue Mountain Capital - Analyst

So, can you give me an idea if you are actually -- like how much debt you are actually going to pay down from the proceeds of the hotels? Or in fact forget even about the hotels, how much debt you actually need to pay down next year?

Gunilla Berg - SAS AB - EVP and CFO

No, I think we will -- my answer to you is that we will optimize this in the best way. So, I can't give you any figures of that. No detailed figures of what we are going to do or not. So, I think you have to accept my answer.

Arty Ludo - Blue Mountain Capital - Analyst

Okay. No, that's fine. And one other question on the hotel process is the IPO is clearly on track but I remember you had also brought up this possibility of a sale. So, am I right to assume that we are definitely not looking at a sale to a trade buyer or a financial buyer or anything? You are definitely going down the IPO route and that's a final decision?

Gunnar Reitan - SAS AB - Acting President and CEO

Yes. We are on an IPO route and we do not have a parallel approach.

Arty Ludo - Blue Mountain Capital - Analyst

Okay. All right. Thank you very much.

Operator

Your next question comes from the line of Alexi Soroca. Please proceed.

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Alexi Soroca - BNP Paribas - Analyst

Yes. Some -- perhaps some more follow-up questions. First of all, do I understand correctly that you plan to sell your entire stake, essentially 100% of what you own, into an IPO?

Then is it fair to expect that -- I remember correctly that it is to take place before the end of the year, i.e. in the next few weeks.

Then, again, reversing, or taking the other side of your answer, you won't use the proceeds to pay any kind of dividends? That's one set of questions and then I'll have another one. That's all. If you can start with this one.

Gunnar Reitan - SAS AB - Acting President and CEO

We intend to sell all our shareholding of 75%. And we expect it to happen before the year end. Whether this will be for consolidation of the balance sheet or whether the Board and the shareholders will decide on dividend payment, that is of course something we haven't -- we don't have a view on that. And our ambition now is to do the IPO to get the money in and to strengthen the financial situation of the Company. And the next step of that will be to consider whether to do a dividend or not.

Alexi Soroca - BNP Paribas - Analyst

Okay. Moving on, on another subject, from time to time speculations recur that you may be -- or the other way round, Lufthansa might be interested in taking over you. From a strategic perspective, if you have a strong view already by now, where do you see SAS in a couple of years' time? Do you think you will join with another operator or do you think you will continue independently? And are there any discussions in this respect going on, subject to the sign off of the shareholder -- government shareholders?

In this respect, second part, are you aware of any plans to change the current shareholdings from the part of the individual governments?

And finally, perhaps you can give us all a bit of color on what's going on from the competition point of view in the Scandinavian market, or with regard to Scandinavian Airlines franchise. That's all.

Gunnar Reitan - SAS AB - Acting President and CEO

All right. First of all, there are no processes ongoing. And with respect to M&A type of ideas, the idea of -- or the strategy of the Board and management is definitely to make a way forward where SAS is [the fourth] airline group in Europe. We have a positioning in the Nordic markets which is a strong one. And we are persistent in some of the neighboring and other European markets, which is more of the nature of growing much higher from an underdog type of position.

Whether the -- whether opportunities from different aspects will show up, in terms of consolidation, we don't know that. But this is basically a -- we don't work on anything like that for the time being. That is what [inaudible].

When it comes to the state ownership, there are some signs that some of the states would consider to sell. And we haven't seen any concrete actions so far. And, of course, this is a pure shareholder issue and we don't have a view on that other than, of course, I could imagine that the Board and the Company would be somehow involved if this is materializing. So far, it is only indications.

When you told your questions about the competition, we have a -- there has been an increasing competition in the Swedish and the Norwegian market over the -- not least on the domestic area. It is kind of stabilizing. We don't see any changes coming

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up. On the international arena there are a number of competitors, being typically national carriers on the one side and the new type of airlines, low-cost carriers, in the other end of the scale. I do not see any significant change in that. We have a competitive market in all our markets and that is very likely also the case which will continue in 2007.

Operator

There are no additional questions at this time, sir.

Gunnar Reitan - SAS AB - Acting President and CEO

All right. Then I would like to say thank you for this conference. And for those of you who have got the possibility of seeing us tomorrow morning at the Portman Hotel in London, you will be most welcome to join us there.

Operator

Thank you for joining today's conference. You may now disconnect. Good day.

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