FINAL TRANSCRIPT

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PRESENTATION

Operator

Good morning, good afternoon, and thank you for standing by. At this time all participants are in a listen-only mode. After the presentation, we will conduct a question-and-answer session. (Operator instructions) Today's conference is being recorded, and if you have any objections you may disconnect at this time.

And now I'll turn the meeting over to your host today, Mr. Willie Walsh. Thank you. Sir, please go ahead.

Willie Walsh - *British Airways - CEO*

Thank you. Good morning, good afternoon, everybody. Keith Williams has a presentation to give for the third quarter results, 2008/2009. I'll hand it straight over to Keith, and then we'll give an opportunity for questions after Keith's presentation. Thank you.

Keith Williams - *British Airways - CFO*

Yes, we have just got a few slides to talk you through to get you more data behind the IMS information this morning. And looking first at the half year we said that trading conditions were bleak, and we're still heading towards the eye of the storm. As you can probably see the eye of the storm is normally a calm place. We have certainly not reached that point yet today. We're currently contending with all of the slowdown in all the world's economies and volatile commodity and exchange markets. Against that backdrop, we have delivered operating profits of GBP89 million for the nine months to the 31st of December, and a credible operating performance for the calendar year of GBP223 million. However, as you have seen from the change of guidance last week, we're now seeing the impact of a significant slowdown which is impacting volumes and yields. We're forecasting an operating loss of the year to the 31st of March of GBP150 million.

Our balance sheet remains strong for the tough times ahead with cash reserves of GBP1.6 billion, and committed facilities of GBP3.1 billion, which increases our total liquidity to GBP4.7 billion. This next slide just shows you some of your volatility. I can't remember ever having seen so much volatility in various markets. The slide shows you the major movements in commodity prices which have impacted us year to date and over the last three months. I'll come back to their effects in a moment.

Moving on to the headline numbers, reported revenues of nine months were up 6.2%, although that helped significantly on an exchange. On an underlying basis, revenue was up 2%. Third quarter revenues were up 5.9% to just under GBP2.3 billion, but most of this was attributable to exchange. On an underlying bases, revenues were down 1.3% for the quarter. On the cost side fuel costs were up for the nine months by some 48%, and that was better than what we had seen at the half year, some 4% better. As we suffered from weak pound but also some relief from fuel costs, and non-fuel costs were up around the 8%, driven mainly from exchange, and that left the operating profits at GBP89 million.

Looking at the key statistics, and we reduced capacity in the third quarter by 2.3%, and that's left capacity now for the year to date roughly flat or slightly up. Passenger volumes measured in terms of RPKs was down 4.5% for the quarter in line with the market, with total RPKs for nine months now down 2.8%. And that left a load factor down 2.3 percentage points to 78.4%. I'm come back to yield performance in a moment, but total yield was up 9.6% for the nine months with price mix exchange positive.

On the cost side total costs were impacted adversely by exchange and the impact of fuel costs, and we're up 18%, or 20.4% measured in terms of ATKs. Before fuel costs were up just under 8% and up 9.7% [year to date]. Looking at the costs in a little more detail, we have seen a steady increase in cost and unit costs over the course of the year driven largely by that exchange movement and we'll come back to fuel in a moment. Excluding exchange, the rate of non-fuel cost increases in the first part of the year was driven higher in part by the move into terminal five. These are starting to slow, and in quarter three, the underlying costs were flat year own year, resulting in costs, excluding fuel and exchange, up some 2.2% on the year.

Now, talking through exchange in a little more detail, and taking each item in turn, underlying revenue in the first nine months has been up 2% year on year, as I said earlier. The benefit of foreign exchange adds a further 4.2% or GBP286 million, leaving the total revenue up 6.2%. Almost all of our cost items have some elements of overseas cost, most notably, of course, fuel, and total underlying costs were up 11.6% before exchange, which added 6.5% or GBP381 million to the cost picture. And then if we take the total picture, exchange has a GBP95 million adverse impact on the results for the nine months. At the operating level, it's also includes a GBP56 million translation of working capital balances, which are referred to in the notice we sent out on January the 25th.

Now, let's have a look at the evolution of the revenue by quarter, and this really shows you the exchange impact becoming more pronounced as the years progressed. We have been promoting transfer traffic through terminal five to take advantage of stronger foreign currencies, and underlying revenue showed a deterioration year on year for the first time in quarter three. Now looking in volumes, we have seen a steady deterioration of volume in the last quarter, and the traffic stats that we have released today, show that this was continued in premium travel in to January. Based on the forward bookings we have to date, we expect volumes to remain weak. Accordingly, we expect RPKs in the fourth quarter to be down slightly more than in quarter three.

Now yields. Yields in the quarter were up 7.1%, with negative mix, positive exchange, and a higher rate of decline in premium RPKs. Although we have had some trading down in booking class in December, this has been become more noticeable in January. Accordingly we expect underlying yields to be considerably weaker than last year in the fourth quarter, in part because of the strong basin crease in quarter four last year, and in part from the changes we have made in fuel surcharges. Looking at the split of the revenue, passenger revenue is up 6.6%, and the strong performance in cargo had been helped by strong volumes in the early part of the year, and car go fuel surcharges, which of course are now starting to fall. Other revenue has fallen because of the loss of franchise, and from some weakness in air miles as the result of the financial slowdown.

On cost, I would like to split this into two, to look at costs and then costs excluding exchange. First of all, taking a look at the cost line items. You can see we have had cost pressure across the business, and this has impacted most of the line items. However, if we move on and look at costs excluding exchange, you get a better appreciation of the underlying trend in our cost performance. The biggest exchange movement outside of fuel relates to landing charges, and as you can see from this chart, some of our underlying costs have started to come down. Now, the same picture is also true of the third quarter, and this slide just gives you the makeup of the third quarter expenditure. Now turning to fuel, you can see the volatility in jet prices over the course of the last year, yet prices being anything from $147, down to $37. Against that, our fuel cost has remained pretty constant. It's about GBP3 billion, and this slide is trying to explain why.

What it does is to look at our forecast fuel spend for the year, at the end of quarter one and quarter two, and what has happened since . The blue bar is showing you the fuel spend at constant exchange rates. The yellow bar is showing you the impact of exchange, which is steadily been increasing the spend. On the red bar, it is showing you what would have happened without fuel hedging. The amount of hedging profit has been falling for the year, but the books remains in profit at this stage for the year as a whole. Now, at quarter two, we showed you this slide, which showed you the break-even point of our hedge book for next year. That's around $96. And this has fallen in line with the hedging we have put in place since quarter two, at more favorable prices.

Moving on to the balance sheet, the cash position of the company remains very strong at GBP1.6 billion. We have added further facilities in the period, now total liquidity stands at GBP4.7 billion. And just to emphasize one point, there are no covenants which prevent the drawing down of these facilities. Now finally, you'll see your net debt has shown an increase around GBP900 million since the start of the year, and this slide is giving you the makeup of that movement. Most of it, around GBP600 million, is due to the revaluation of our foreign currency debt to current exchange rates. There are also some off balance sheet operating leases which were converted into finance leases in the latter quarter with underlying net debt being up GBP170 million.

Now as a reminder of what we guided to at the start of last week, our revenue position remains unchanged at guidance up at least 4%, out by exchange. Fuel costs remains constant at GBP1 billion, and non-fuel costs are expected to be up some 8%. So we're now expecting an operating loss for the year of some GBP150 million. And that finishes the presentation. It's over to you

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Willie Walsh - *British Airways - CEO*

Thank you, Keith. We're happy to take your questions now.

QUESTIONS AND ANSWERS

Operator

Thank you. We'll now begin the question-and-answer session. (Operator instructions) One moment, please, for the first question. And our first question comes from the line of Stephen Furlong. Thank you, sir, please go ahead.

Stephen Furlong - *Davy - Analyst*

Yes, good afternoon. Question for Keith, maybe he can just remind me, with all of these currency movements how the breakdown on the revenues are on the currency in terms of the cost on the currency. And secondly on the balance sheet, maybe you might just go through the debt and tell us what the breakdown on the debt is between the currencies. Thank you.

Keith Williams - *British Airways - CFO*

Yes, so if I talk you through the currency impact on the revenue, I think I showed you in the slide, on the revenues because we sell in dollar denominated currencies and euro and as I said promoting transfer traffic, you see a GBP286 million benefit from exchange in the revenue. And then on the cost side, if you take fuel -- if you take non-fuel costs, the exchange impact is around is GBP381 million in total which is made up of GBP144 million of fuel, and GBP237 million of non-fuel costs. That's the currency, and your question on the debt, we have significant amounts of foreign currency debts, and the reason for that is that because we earn revenues in foreign currency, we tend to match the revenue receipts with debt payments. It's cash flow hedge. And at the end of quarter three, the amount of our US denominated debt in sterling terms was around GBP1.1 billion, and that's matching our US cash flows. In yen, the equivalent is about GBP850 million, and that's matching revenue flows that we received from flying to and from Japan, and they we have got some euro debt of about GBP50 million, so the total debt is about GBP2 billion.

Stephen Furlong - *Davy - Analyst*

That's great. Thank you.

Operator

And our next question comes from the line of Samantha Gleave, thank you. Please go ahead.

Samantha Gleave - *Merrill Lynch - Analyst*

Samantha Gleave, Merrill Lynch. Thanks. Couple of questions. You mentioned in the statement that you've opened discussions with trade unions. Can you just give us a bit more color on that process, and what has happened so far, what is your starting point? And secondly, on M&A, I noticed a few comments on the wires talking about Ibura and the common making very good progress. Just wondering sort of what that means and what is the latest there? Thank you.

Willie Walsh - *British Airways - CEO*

Okay. I'll -- with the trade unions, our pay agreement expired at the end of January, and we advised our trade unions at a meeting late last week that given the current environment that we did not envisage making any increase to base pay, but that we wanted to engage with them to discuss options around pay and productivity. Those discussions will formally start next week. I think our approach contrasts to that of some of our competitors who have imposed pay freezes on their employees.

The response from the trade unions when we met last week was that they were pleased to see we had adopted a different approach to the other airlines, and indeed some other companies that they deal with, and that they wanted to work with us to address the challenges that we face in and the industry faces. So I'm positive and optimistic about the discretions that we'll have. I think our employees are realistic about the challenges that we face, and I believe that we would be able to reach a sensible agreement in due course, but the formal discussions will start next week. On the Iberia front, we have made significant progress in the past couple of weeks. As you know the discussions really were dragging on, largely as a result of Iberia's need to understand better the rules around defined benefit pension schemes and in particular our two defined benefit schemes, and to understand the role of the regulator here in the UK. They commissioned Mercer's to do a report, if (inaudible) I think you could have seen comments from Fernando Conte, the Chairman and CEO of Iberia, to say that that report contains no surprises.

I believe from the discussions we have had, that they now have a full understanding of the issues related to pension, and that has allowed us to go back and restart the discussions on the other substantive issues, relating to our proposed merger, and those discussions have been very positive with good progress made. We're not a point where we have reached agreement, but we are getting to a point where, I think, agreement is definitely possible. There's a clear desire on our part to reach an agreement, and I believe the same applies on the part of Iberia, and I think the principal behind a merger between BA and Iberia remains as strong today as it did when we announced we were in discussions back at the end of July.

Samantha Gleave - *Merrill Lynch - Analyst*

Okay. Thank you.

Operator

And our next question comes from the line of Mr. Andrew Light, thank you, sir, please go ahead.

Andrew Light - *Citigroup - Analyst*

Hi, that's Andrew Light from Citi. You talked about possible saw the press this morning, it talked about possible capacity cuts in the 2009/'10 winter. Can you give me a rough idea of what scale we're talking about? And secondly, I have read in the US Senate, I think Senator [Overstar], is talking about reviewing antitrust immunity on alliances. What is your understanding of that position, and do you think that could delay the ongoing applications with your joint venture?

Willie Walsh - *British Airways - CEO*

Thank you, Andrew. Yes, when asked this morning about capacity -- further capacity reductions, I just restated that our capacity reductions that we planned for this winter remain as was, so we're looking at around a 3% cutting capacity during winter '08, '09, 1% capacity reduction summer 2009, and that there would be further capacity reductions, although we haven't quantified those reductions yet, that's work that we need to do, but one thing that I think we're clear on at this stage is a reduction in the number of aircraft in our fleet at Gatwick. Why we'll take the fleet down from 35 to 32 aircraft. We're also actively pursuing the sale of our 757, the 11 757s that remain in the British Airways mainline fleet, as our intention would be to sell those aircraft and replace them with Air Bus, 320 family aircraft, which would have a capacity impact. That may -- may come through in the winter '09, '10 period. It's likely that we would start that process during that period. So there are two, sort of decisions that have been taken in principal that will impact on capacity in that period. And you had another question, Andrew? Sorry.

Andrew Light - *Citigroup - Analyst*

Regarding anti-trust immunity --

Willie Walsh - *British Airways - CEO*

Yes. I have read his -- the bill that he's introduced, and I wasn't surprised. I think it's in line with his views on the industry. I didn't really see it impacting on our application, and quite honestly, I think there has been a negative response from the US airline industry to the proposals. My own view is that the US industry has significantly benefited from open skies between the EU, and the US, and there's no doubt that they will want to retain those benefits. And clearly, any move to turn back the clock in the US would have an impact on the second stage negotiations between the EU and the US, and clearly would have an impact on the benefits that were granted. So everybody expects progress to be made during second stage negotiations, although I think we're all realistic as to how much progress could be made, but I don't think it would be acceptable to anybody if they saw an effort to turn back the clock, and I'm confident that our application will be assessed and I remain confident that we'll be successful in gaining ATI with American. And quite honestly, I think if you were to talk to American, I think they would express equal confidence, but also would express a desire to see the world to continue to apply as they exist today.

Andrew Light - *Citigroup - Analyst*

So you expect -- do you expect to get approval still in the second half of this year?

Willie Walsh - *British Airways - CEO*

Yes. Yes.

Andrew Light - *Citigroup - Analyst*

Great. Thank you very much.

Willie Walsh - *British Airways - CEO*

Thank you.

Operator

Thank you. And our next question comes from the line of John [Wuber]. Thank you, sir. Please go ahead.

John Wuber - *SocGen - Analyst*

Thanks it's John [Wuber] at [SocGen]. Maybe three questions. Firstly of the GBP550 million of CapEx planned for this year, what was already spent by December? Secondly, on the yield chart you had on the presentation, it showed a continued strong performance on price. I think it was up 7.%something, to what do you attribute to that? And what is the outlook on Q4 with the price? And finally can you give us an update on your plans for further expansion or otherwise with the open skies subsidiary?

Willie Walsh - *British Airways - CEO*

On open skies -- I'll take it in reverse order. We had originally planned to expand open skies to a six-aircraft operation by the end of this year, 2009 calendar. We've since taken the decision to hold the operating fleet at four aircraft, and that decision was taken when we reviewed the performance of the business, the outlook for the industry, but also the opportunity to sell the 11 757s that we have in the fleet, so the original plan was to release two of those 757s to open skies. So hold the open skies fleet to four aircraft operating fleet for this year, and we don't have any plans to expand on that. In relation to yield, we don't tend to give guidance in relation to the various constituent parts of the yield, but one of the things that I think you can expect is that with fuel surcharges reducing or having been reduced in December; that the year on year move on price will not be anywhere near those that we have reported in the previous quarters, because a significant part of that price movement was fuel surcharge. And on the CapEx, Keith?

Keith Williams - *British Airways - CFO*

I just had one more on the yield. You'll see we're all running against some pretty high comparables from last year. Q4 yield was stronger last year. And on the CapEx, the CapEx spend to December is around GBP450 million. The CapEx forecast for the year is still running around GBP550 million, and the major spend is actually take delivery of one of the [747s] before the 31st of March.

John Wuber - *SocGen - Analyst*

Okay. And second, maybe to just add one more quick follow-up. On the volume outlook into Q4, I think you said you would expect further decline -- a bigger decline in volume relative to Q3, that's even including the more positive or less negative result in January, and is that primarily because of the shorter February or are there other factors?

Willie Walsh - *British Airways - CEO*

I think there are a couple of factors, clearly, the one less day in February will have an impact. We have suffered some disruption from weather during this weak and that continues to some extent today, and the forecast over the weekend is challenging as well. And it's also the particular day that we lose in February, we'll have an impact, so the combination of factors lead us to express that view.

John Wuber - *SocGen - Analyst*

Okay. Thanks very much.

Operator

Thank you, our next question comes from the line of Neil Glenn. Thank you, sir. Please go ahead.

Neil Glynn - *NCB Stockbrokers - Analyst*

Good afternoon, folks. Just a few quick ones if I may. Just in terms of the revenue environment, I'm just wondering have you any other initiatives up your sleeps in terms of trying to maximize revenues going forward? Perhaps charging for items that you may not be charging for at the moment. Just interested in your thoughts on that. Next, in relation to the cargo market, things are falling dramatically there, and can we have your thoughts on Q4 and then beyond? And then finally, in relation to the CapEx spend beyond 2009, can you refresh my memory in terms of what proportion of that is non-aircraft spend for 2010 and 2011?

Willie Walsh - *British Airways - CEO*

Okay. On the revenue environment, it's not our intention to start charging for things that we have not traditionally charged for, we don't see unbundling the product has been the right way forward for us. However, there are opportunities for us to generate additional revenues from things that we do charge for, such as excess baggage where maybe we have been somewhat more relaxed about collecting that revenue than another airline, so we have put a greater focus on that in recent times. As Keith mentioned earlier, one opportunity that we do see that is available to us, and in fact has been working successfully in January, is to put a greater emphasis on non-sterling sales. So we have been focused on transfer traffic over Heathrow from Europe and the US, and that part has been positive. Our transfer value in January was about 46% of our total volumes through Heathrow, that's typically much higher than we would have had at that time of the year, and we have got a fantastic product transfer of projects at T5 now, and the operation at T5 is working extremely well, so that gives us confidence to look at both transfer volumes and also transfer value. So clearly we look to focus on premium transfer where possible, but equally the non-premium transfer, which in the past would have been one of the lower-yielding parts of business, has become more attractive with the currency benefit that we get. So they are the main areas that we're looking at in the fourth quarter of this year.

And on cargo, cargo is clearly a very tough environment. Our performance is significantly better than the industry, if you look at the figures that [iacha] have been quoting the reduction in cargo volumes has been very significant. So we have typically outperformed the industry on cargo. I put that down to the actions that our cargo management team are taking. Also to the stability of our operation and the performance of our operation, so our -- what we measure as called delivered as promised, and -- has been very high as we have seen a strong operational and customer performance, but it's a very tough environment. And I think that's the case right across the globe, and when we look at figures on the network there it's tough in every part of the cargo network, and I think you have seen that from a number of the other major cargo operators who have reported cargo volume declines much greater than we have reported. On the CapEx, I don't know if Keith has been able to --

Keith Williams - *British Airways - CFO*

On the CapEx next year the forecast is around GBP750 million, and from memory, I think around GBP270 million is non-aircraft, or aircraft related, and most of that is in engineering.

Neil Glynn - *NCB Stockbrokers - Analyst*

Great. And just if I could follow up with one more question in relation to fuel hedging. I don't think you have mentioned the extent of hedging you have got for the next financial year, you did allude to a slight increase in your position there.

Keith Williams - *British Airways - CFO*

Yes, we were at 40% hedged. We're now at about 50% hedged, which is what you see on the slide. You see the average floor coming down from about $96 down to about $84. And to give you an indicator, at fuel price of $60 a barrel, which is reflecting the forward, slightly more than that, I guess, an exchange is $1.50 to sterling, we would expect our fuel bill to be about GBP2.75 billion next year, so that's down some, what, GBP250 million, GBP300 million from this year.

Neil Glynn - *NCB Stockbrokers - Analyst*

Great. Thanks very much.

Operator

Thank you. And our next question comes from the line of Andrew Lobbenberg, thank you, please go ahead.

Andrew Lobbenberg - *Royal Bank of Scotland - Analyst*

Hi, it's Andrew here. When you spoke to us at the half year your mantra was you were looking to restrict volumes to drive yield. What's the marching instructions at the revenue management department now? Get anyone who is willing to fly, or it is more subtle than that?

Willie Walsh - *British Airways - CEO*

I think there are a couple of things. The thing we said was that we believe the prices we were charging had to reflect the costs that we were seeing, and that was particularly true in a high fuel environment, and if you look at what we did there, we were pricing in the cost of fuel that we were seeing. We made the point that, although we were losing some volume, that volume decline was more than offset by the yield increase that we were getting, and that's clearly still the case today. But we did also make the point that it was much easier to reverse that position if we felt that we needed to be more aggressive on price, so we keep this under constant review. I think we've got a good mix of fares available. We have introduced an additional fair class in our premium cabin, so we've previously had one, what we call premium leisure I-class, we have an [o] class in there as well. So we have introduced an traditional fare class, and we will look at every option to ensure that we're competitive on price, but we're clearly focused on generating whatever revenue we can in the current environment.

Andrew Lobbenberg - *Royal Bank of Scotland - Analyst*

Okay. Lovely, and if I can just ask another. Where did you see the third runway debate developing now from here now the government has given tentative approval and the opposition are hard core against it?

Willie Walsh - *British Airways - CEO*

I see the government decision as being a significant hurdle that we have cleared. Now, had they come out and said no to a third runway we would be having a very different discussion, but they have supported us, and I think we have succeeded in convincing people that the economic argument is very strong. We clearly have work to do on the environment argument, but I'm happy to say that we're prepared to face up to that one, and I think we can produce compelling evidence to support our arguments that the environmental conditions can be met. So I think this is remains a positive development. I was surprised that the government talked about accelerating the building of the third runway. I still don't have clarity from BAA in relation to their views on how soon the third runway could be built, but we are meeting on this in the next couple of weeks, and they should have a better view at that stage as to whether it is possible to accelerate the third runway. So I think this remains a positive development, and the feds publicly, I think politicians in opposition say different things to politicians that are in government, and it's much easier to oppose is when you are in opposition.

I think the economic case is so strong that I believe it will continue to receive support regardless of losing government. This is a critical issue for the UK economy, and I think it's important for the government and for politicians to demonstrate a willingness to invest in infrastructure, particularly at a time like this.

Andrew Lobbenberg - *Royal Bank of Scotland - Analyst*

Cool. Thanks very much.

Willie Walsh - *British Airways - CEO*

Thanks, Andrew.

Operator

Thank you very much. And at this time I have no further questions, sir. I'll hand the call back over to you. Thank you.

Willie Walsh - *British Airways - CEO*

Okay. Well, thank you, everybody, for your questions, and thanks for listening in. I think our next scheduled meeting will be our investor day on the 5th of March, so I look forward to seeing you then. Thank you.

Keith Williams - *British Airways - CFO*

Thanks.

Operator

Thank for taking part in today's conference. You may now disconnect your lines.