BRITISH AIRWAYS PLC

Q2 & INTERIM RESULTS 2006/07

Friday, 3 November 2006

BRITISH AIRWAYS PLC
Q2 & INTERIM RESULTS 2006/07
Friday, 3 November 2006

Martin Broughton (Chairman): Good morning everyone and welcome. 10 August does not have the same resonance as 7/7 or 9/11 but, fortunately, neither was it as tragic as those two dates. However, the impact of the events of that day on British Airways, and indeed on Heathrow as Britain's gateway has also been very far-reaching. Focus on the foiled plot to blow up aircraft and commit mass murder quickly receded and shifted to the bureaucracy and confusion resulting from the introduction of the new security measures to prevent further attacks. I shall not labour the fact that the issue was badly handled in the immediate aftermath; I believe that our position has been well documented in the media on that.

In the results today, we estimate the cost of disruption in the quarter at around £100 million. I would not like to put a cost on the damage to the reputation of Heathrow as a result of the media images, queues and chaos which flashed around the world. The impact on our shorthaul premium business and the longhaul premium transfer traffic has been significant, and Keith and Willie will take you through this detail shortly.

What is clear is that these particular customers have been voting with their feet to the benefit of our European competitors. It is this Government's rightful objective to make Britain, and specifically London, a competitive place to do business. Yet long after the additional security measures lost credibility with passengers, they remained in place, damaging London's competitiveness. Heathrow is the prime gateway to London, and it is important for the country, to BAA and to BA that its image and performance is dramatically improved.

I welcome the Government's announcement yesterday on the reintroduction of liquids to cabin baggage, which finally brings the UK into line with the rest of the EU. I am also pleased that BAA and ourselves are working constructively together to further improve the customer experience.

Against this background, our operating profit of £240 million for the quarter, pre-tax of £282 million, both before the BA Connect write-down, we made in the quarter are good results. The improvement in revenue, up 4.9%, was encouraging and driven by volume. Fuel costs, however, continue to be a challenge, up almost a third to £534 million.

We have announced today that we have reached agreement in principle to sell the regional business of BA Connect to Flybe. Not only was the business unprofitable, but we believe that point-to-point regional operations are not a strategic part of our business, and that these operations will be stronger as part of Flybe. We shall retain the London City business, which serves the key financial markets and is a better fit with our strategic goals.

Turning to costs, I am pleased to see a good performance, which has helped to offset some of the revenue impact of recent weeks. We have also reached agreement with another group of staff ahead of our move to Terminal 5, and tackling our pension deficit continues to be a priority, and we remain confident that it will be solved soon.

The Stern Report, published this week on the impact of climate change, once again puts aviation in the spotlight. The report makes clear that, despite many media reports to the contrary, air transport remains a relatively small producer of greenhouse gas emissions. Ranking UK industries by carbon intensity, the Stern Report puts aviation in 12th position, far behind major sectors such as gas, electricity and oil refining.

British Airways has led the industry for the last seven years in promoting carbon trading as the most efficient and environmentally effective method of limiting aviation's impact on climate change, and I am pleased to note that Stern endorses this approach. We are the only airline to take part in the UK emissions trading scheme, and we hope that aviation will soon be included in the European emissions trading scheme.

We have improved our fuel efficiency by 27% since 1990, which has saved the equivalent of three years of our CO_2 emissions. Environmental performance will be one of the key criteria in our choice of new aircraft in the next decade. The aircraft we are looking at as possible replacements for the 747s are likely to be at least 17% more efficient in terms of fuel burn, and produce 21% less nitrogen oxide emissions. For Boeing 767s, those improvements, are likely to be at least 30%. The new aircraft will also be noticeably quieter.

Finally, I am delighted that our next generation of Club World flatbed rolls out in 10 days' time, and I hope to see you at the launch event in Canary Wharf. I shall now pass over to Keith to take you through some of the numbers.

Keith Williams (Chief Financial Officer): Thank you, Chairman, and good morning everyone. There is quite a lot to run you through this quarter but, first, let us look at the headline numbers.

Headline numbers

Revenues for the quarter were up 4.9%, reflecting a strong performance for July and the early part of August, but were impacted by the disruption at the airports from 10 August. Costs for the quarter increased 6.6%, which was driven almost entirely by increased fuel costs. This left an operating profit before impairment, as the Chairman mentioned, of £240 million, down £21 million from the previous year. We took a one-off impairment charge of £106 million for our regional operation BA Connect, and that left a bottom line operating profit of £134 million. The one-off impairment charge at BA Connect meant that the operating margin for the quarter fell from an underlying 10.4% to 5.8%.

Given the accounting adjustments for the quarter, the EBITDAR probably serves as a useful guide to performance, and was down 2.4% to £490 million. The EBITDAR margin for the quarter was 21%. Pre-tax profits were £176 million. The improvement between operating margin and pre-tax profits is mainly the result of the £48 million profit on the sale of the company's interest WNS, the Indian outsourcing company which was subject to IPO in July. The tax rate for the quarter was 5%, which reflected further utilisation of ACT. That left distributable profits of £168 million, which was broadly flat versus last year. Earnings per share reduced slightly from 14.9p to 14.5p. No interim dividend is proposed.

Q2 statistics

If we turn now to the underlying statistics, ASKs for the quarter were up 3.4%, principally reflecting the transfer of 767 aircraft from shorthaul to longhaul flights, and greater aircraft utilisation. RPKs in the same period were up 3.6%, resulting in an increased seat factor from 79.6% to 79.7%. Yields in the quarter were up 2.2% mainly as a consequence of fuel surcharges. Unit costs for the quarter were impacted by the BA Connect impairment and increased fuel costs and, accordingly, were up 10.5%. However, the underlying trend on our controllable costs was down 1.1%.

One-off impacts

Let us now turn to the one-off events for the quarter. Willie will talk you through the disruption costs and the position of BA Connect later. However, if we look at the impact on the results, as we said in both August and September, transfer traffic volumes in all cabins and premium shorthaul traffic has been hit by the restrictions on baggage and liquids policies. We estimate the total cost of disruption in the quarter to be around £100 million, principally in reduced revenues, equivalent to around 3 to 4 percentage points of margin in the quarter.

Looking at BA Connect, accounting rules under IFRS require us to review the performance of the operations to ensure that future cash flows are sufficient to meet the fair values of the assets in the books. For the six months since relaunch, BA Connect has incurred operating losses of £6 million on a turnover of £172 million. Although load factors at around 65% are running at higher levels than its plan, revenues are behind plan, reflecting lower yields. Accordingly, on a measurement of future discounted cash flow as against the asset value, it is necessary to consider an impairment charge. In simple language, this is the provision of additional depreciation on all of the £32 million good will and £74 million of the fixed assets carried in the company's books.

As you will see, we announced agreement in principle this morning to dispose of the regional operations of BA Connect to Flybe. That disposal is subject to further work but we do not anticipate any further material write-off. Together, the disruption and the impairment have reduced the operating margin by more than £200 million in the quarter.

Passenger revenue vly

The impact of the disruption on passenger revenues can be seen on this slide. We had a very strong start to the month in July and early August, with premium RPKs in particular showing some double digit growth. However, that fell away in the latter part of August and September. The result has been that, although passenger revenues increased by 5.9%, the rate of increase slowed over recent trend.

Turnover split

If we turn now to the split of revenues, passenger revenues, as I said, were up 5.9%. Cargo revenues were also increased, up 3.2% on CTKs down 1.1% versus last year, with cargo yields increased by 4.4%, mainly again as a result of higher fuel surcharges. Other revenues were down, mainly because last year included revenues from the London Eye in the base.

Q2 seat factor and yield – both up

Despite the effects of this disruption impacting around half the quarter, seat factor and yields were up. Seat factor for the quarter was up from 79.6% to 79.7%; we need to go back 10 years to find a higher seat factor during the quarter. Yield was 6.5p per RPK, up from 6.3p the previous year.

Q2 yield split

If we turn to the analysis of the yield, total reported yields were up 2.2%. Price was up 1.8%, again as a result of increased fuel surcharges. Mix showed 0.7% improvement but it was a lower rate than previous quarters because of the impact of disruption, while exchange was down as dollar and dollar-related revenues were weaker against sterling.

Q2 costs

Turning now to the cost side of the equation, the cost picture is obscured by BA Connect and the fuel cost increases. Reported costs were up 12.1% but, if we strip out the impairment charge and fuel, controllable costs were up 0.3%. If we reflect capacity increases, measured in terms of ATKs, unit costs were down 1.1% on the quarter.

Q2 costs flat excluding fuel

Looking now to the individual cost lines, employee costs were up 1.4%. This was wholly attributable to the increased pension costs of £16 million which we face following the recent pension review. It was partially offset by management reductions.

Engineering costs were down mainly as a result of lower inventory provisions versus the previous year, as we benefited from our new enterprise engineering system – SAP – which was completed in September.

Selling costs were down, again mainly as a result of further commission savings and also the timing of promotional activities. Other costs were up, reflecting additional depreciation costs.

As the Chairman said, fuel costs rose on the quarter and were up £124 million, despite favourable exchange and hedging results. These were more than offset by increased commodity prices and volume impacts.

Fuel hedging cover

Looking now at our fuel hedging cover, we said, following our Q1 announcement, that we felt the balance of risk had moved towards a fall in prices. Accordingly, much of our fuel hedging has been moved to collars where we participate in any price fall. At the present time, for the remainder of this year, we are 83% hedged through to 31 March 2007, 31% in swaps with the balance in collars, with an average cap of $66 and a floor of $53. For next year, we are around 40% hedged with the majority of the cover in collars.

Forward fuel prices at a premium

However, we recognise that forward fuel prices are still at a significant premium to spot price, so there remains some uncertainty around our fuel costs. Based on current prices and hedging, we expect our fuel bill to rise by around £400 million to around £2 billion.

Cash

Moving to cash, cash flow from operations for the six months was down £91 million to £439 million. This reflects lower collections of sales in advance of carriage of over £100 million as passengers leave it late to book as a result of the recent passenger disruption. Some of this should reverse as we see bookings revert to normal trend. EBITDAR for the three months was down 2.4% at £490 million, and for the six months stood at £941 million, up £23 million versus last year. Cash balance stood at £2.63 billion.

There is one issue on which I feel I should provide some clarification following the RFP that we issued for growth and replacement aircraft on 17 October. Based on the RFP, I felt it would be appropriate to show you the likely levels of forecast capital expenditure and debt repayment through to the end of the decade.

Capex and debt repayment profiles

The first point to note is the lower capital expenditure this year. Our previous estimate at the start of the year was for spend of £500 million. This now stands at £450 million, with some expenditure being delayed into next year. For the remainder of the decade, we expect capital expenditure to remain at around £600 million as we take delivery of 10 narrow-bodied aircraft and potentially eight wide-bodied aircraft in that period. This will run below our depreciation charge which stands at around £700 million a year for the same period. Looking at the debt repayment profile, it starts at below £500 million and reduces over the period.

October traffic statistics

As you may have seen, we announced our October traffic statistics this morning. Seat factor was up 2 percentage points at 74.9%, driven by traffic up 1.1% on capacity higher by 0.8%. We indicated earlier in the year that we anticipated lower ASK growth as we move some of our 777 aircraft to longer sectors, and we start the embodiment programme for our new seats. Premium traffic is showing some signs of recovery but still reflects the impact of disruption.

Financial year 2006/07 outlook

Now let us look at the outlook. In July and August we said that the revenue for the year would very much fall into two halves. We expected a strong first half with ASK growth at just under 4%, high seat factors and increased yield. In the second half, we anticipate slower growth as ASK growth fell to below 2%, and we cycle against a very strong performance in the second half last year. To some degree, the end of the first half came a little early because of disruption. Nevertheless, revenues in the half were still up 8.6%.

In the second half, given the above factors and some continued disruption, we now expect second half revenues to be up around 2%. This leaves revenues for the year up 4.5% to 5%.

On fuel given our hedging position, we expect the fuel cost to be up around £400 million. However, given that most of the cover is now in collars, as I explained earlier, we expect some volatility to that. Capital expenditure for the year, as I explained, now stands at £450 million.

In summary

To summarise, underlying market conditions remain largely unchanged, though the operation remains somewhat fragile to the continuing impact of restrictions at the airport. This has led us to lower our revenue forecast by 0.5%. We continue to remain focused on cost. Now over to Willie.

Willie Walsh (Chief Executive): Thank you, Keith, and good morning everyone.

Agenda

I would like to take this opportunity to give you a brief update on four current topics, starting with our shorthaul operations, then turning to ba.com, before giving you some background to the current trading conditions, and then I shall talk about the recent RFP.

Shorthaul

Looking at shorthaul, this is an important part of our business and represents about 20% of our total capacity. It generates 32% of our revenues and last year was the first time in 10 years that we made an operating profit in shorthaul. The shorthaul network provides important traffic feed to support the depth and breadth of our longhaul network and, when I spoke to you at year end results, I said that all parts of our shorthaul network have to be profitable, and that we face challenges at Gatwick and in the regional business BA Connect. I would like to update you on the progress we have made in these two areas.

Gatwick strategy

Turning to Gatwick first, this is what we said about the strategy at Gatwick when I spoke to you at full year. We have 33 aircraft at Gatwick, a mix of 737 types, and we service 44 routes. The Gatwick market is largely a point-to-point leisure market, as a result of which we compete head-to-head with the no frills carriers, most notably easyJet at Gatwick. There is some feed traffic to our Gatwick longhaul operation as well as our Heathrow longhaul operation, but it is limited. The network focus at Gatwick is on the breadth rather than the depth, so the range of destinations rather than the frequency of service, and we continue to look for profitable new routes. We have extended into new leisure destinations, particularly in eastern Europe, and we launched six new routes in the summer and we launch our latest new route to Salzburg which will commence in December of this year.

The network allows us to push premium leisure travel and we are successfully offering ba.com users the option of upgrading to Club class at the point of sale. Since a month ago, we have been offering this facility at the airport itself, so for a £50 charge one way, customers are attracted to the additional benefits of the Club cabin, and we have seen a good update of this ever since we started.

The new advertising and pricing strategy approach that we introduced at Gatwick, and across our shorthaul network in fact, in April of this year has been highly successful in driving seat factors across the shorthaul network, particularly at Gatwick.

LGW seat factors

I shall just show you a chart here which is divided into the Gatwick domestic operation as well as the Gatwick European operation. You can see here significant growth in shorthaul seat factors. In September of this year, we saw double digit seat factor growth on top of capacity growth. In the first half of this year, the Gatwick European operation saw a 6.3 point increase in seat factor on a capacity increase of 8 points. Our domestic seat factor has also risen, and this is partially driven by a reduction in capacity as we have taken out some off-peak frequencies to fund the expansion on the European operation. It is also driven by the success of the new pricing model. In the first half, the domestic seat factor from Gatwick was up 8 points from last year.

Gatwick profit plan update

The overall target for Gatwick is to improve profitability by £40 million by March 2008, and the other side of the strategy is to improve our efficiencies and our costs where we have made good progress. From October, we have a single cabin crew force operating all Gatwick flights, and this has allowed for significant gains in productivity, staff flexibility and reductions in employee costs. By removing duplication and introducing more efficient ways of working and new work practices on the ground, we have been able to reduce staff while maintaining customer service.

We have also rationalised our property assets at Gatwick, which includes the sale and redevelopment of our baggage facility and by exiting and sub-leasing under-utilised property. Therefore, I would say in summary that at Gatwick we are making good progress.

Heathrow

Heathrow is a profitable part of our shorthaul business. At Heathrow, we operate 87 shorthaul aircraft and we service 46 routes, which is a mix of Airbus 320 family aircraft as well as 757s and 767s, with seven 767s operating on shorthaul. The shorthaul network is based on frequency, which in turn supports strong premium volume. This business has been in profit for a few years but the challenge we face here is to improve the profitability of the business. Although we have had some operational difficulties since 10 August in shorthaul premium, we are expecting that this segment will recover and, in this context, I very much welcome the common hand baggage standards that are to be introduced across Europe from next week.

The move to Terminal 5 and the associated work practice changes that we are agreeing with our employee groups at Heathrow will take us forward. The introduction also of space-saver seating will enable us to carry one extra row of seats without compromising on passenger leg room. We currently have 17 of our Airbus aircraft with the new seats, and the Airbus roll-out will be complete by March 2007.

BA Connect strategy

Turning to BA Connect, we have relaunched BA Connect in March of this year. At the time, I made it clear that I did not see this business as being strategic to the Group. We set clear targets for the business and said that the business had to return to profitability by 2008.

BA Connect – the progress

I have to say that, in spite of the dedication and hard work of the staff in the business, it has not met those objectives, and Keith has taken you through the impairment charge. In simple terms, we have not seen sufficient progress and we have decided to take immediate action, and I am delighted to say that we have reached agreement in principle with Flybe to sell the regional business of BA Connect to them, and this is subject to due diligence. As part of the transaction, we shall have a 15% stake in Flybe.

We are excited by the prospects of this business. Flybee will become the largest regional airline in Europe. BA Connect also operates out of London City, and this will not form part of the transaction. We shall continue to operate a fleet of 10 RJ100 aircraft to Europe and the UK from London City, and that will be part of the British Airways operation and complement the operation that we have at Heathrow and Gatwick.

ba.com update – usage statistics

Turning to ba.com, I am pleased to say that we continue to make good progress with the use of ba.com. In the first half of this year, we have had 691 million hits on the website. We now have a look-to-book ratio of 12:1, and 25% of all flights flown on BA are booked on ba.com. If you look at the first segment of our business that we pushed to the website, we have about 63% of our shorthaul leisure fares being booked on ba.com. As I said previously, it is not just about using ba.com as a sales channel. We shall relaunch ba.com next week and further improve the functionality of the site. Let me just take you through some of the developments that we are looking at.

Slide

This is a screen shot of the new website. The middle panel there will be available for localisation, the panel on the left and the right will be standard no matter where you log onto the site across the world. We will start using best practice use of predictive drop-down menus, people will be able to book one-way fares from the first page. We shall use things like pop-up calendars to help prevent incorrect date selection.

Slide

Some further enhancements are shown on this slide where you can see that the out and back calendars are now displayed on the same page. We have also used a smaller gateway of +/- three days rather than the current default of +/- seven days. Users will have the option to change their search criteria directly from this page without having to go back to the home page as was previously required. So it is not just about bookings, it is a key tool in our drive to help customers serving themselves, which is part of the major change in our business as we move to T5. As I have said before, when we get into T5 in March 2005, we expect 80% of our customers to use some form of self-service check-in, either online check-in or self-service kiosks.

For every new booking on ba.com …

For every booking now that we see made on ba.com, somebody else is checking in online and another person is checking the live flight information.

Slide

I am sure that you have seen the online check-in facility and I have no doubt that many of you have used this and have used the option of printing out your boarding pass. We were the first airline to offer this facility of printing your own boarding pass. All of these developments allow our customer a quicker and better experience at the airport, which is extremely valuable to people flying with British Airways.

Slide

ba.com has also helped us to redirect resources within the business, as many people now use the facility to do things like ordering meals or changing their seat, which previously would have been done through our call centres, and our Executive Club is now available as a fully online service.

ba.com during disruption

It was an extremely important communications tool during the recent disruption and it is interesting to see that on a normal day we would get about 3,000 visits to the latest flight news. In the first four days of the August disruption, we had 1.9 million people logging on to check the latest news on ba.com, so it is a vital tool in allow us to communicate with our customers. We have received excellent feedback from customers as a result of this, it has been extremely positive, and I am pleased to say that our website continued to function when some others failed under the pressure of the traffic.

Current trading

Turning to current trading, we have already said that Q2 results have been impacted significantly by the security disruption in August and the ongoing effects of the new, tighter security measures which have been put in place. I have already mentioned the impact on two segments of our business, that is the longhaul premium transfer and shorthaul premium point-to-point. I have a couple of graphs to show you to help explain what it is that we have seen.

Weekly average new bookings

This graph here shows the average weekly new bookings. The red line shows the current year, the yellow line shows last year, and you can see the impact on 10 August where there was a very significant drop-off in bookings. It was much greater and more marked than we had seen the previous year when we had disruption as a result of Gate Gourmet and illegal strike action. So you can see the significant drop at 10 August, and post disruption there has been some impact on bookings. While the overall level of bookings has returned to the levels experienced last year, it is still weaker than the trend of the past few months. When we issued our August traffic stats early in September, you can see there that by the end of August it has returned to the prior year level, and we made the point that we were back at the prior year level of bookings but we were behind the trend that we had seen in the previous months.

Weekly bookings LH premium transfer

Looking at longhaul premium transfer - again the red line is this year, the yellow line is last year - approximately one third of our longhaul premium traffic is transfer, and the impact of 10 August is clearly visible from this chart. Throughout the remainder of August, all of September and the first half of October, volumes were below levels of last year. As we have seen improvements in the security process and the customer experience has been introduced, traffic volumes have started to return. We expect this trend to continue and we believe that we shall return to what we were experiencing prior to 10 August.

Weekly bookings SH premium

Turning now to the shorthaul premium – again yellow is last year, red is this year – you can see that the profile is pretty similar with the impact of 10 August and then bookings through to the current date trading slightly behind the figures that we had seen last year. In this context, we very much welcome the Government announcement yesterday regarding the carriage of liquids in hand baggage which now harmonises the rules in the UK and across the EU with effect from next Monday, 6 November. We anticipate that these changes will support the recovery of our shorthaul premium point-to-point business.

Just to give you a figure we have seen on shorthaul, the number of passengers checking in bags increased from 60% of our shorthaul passengers to 85% of shorthaul passengers as a result of the restrictions on hand baggage. So from 6 August, I expect to see a change in that profit back towards the previous figure.

Fleet expansion and renewal process – request for proposal

Turning now to fleet expansion and renewal, we issued our RFP on 17 October and the purpose of this document is to ask the aircraft and engine manufacturers to submit proposals to us regarding the expansion and replacement of our longhaul fleet over the next decade. This is to ensure strong competition between the different suppliers. I should point out that this is the first step in a lengthy process and, at this stage, there is no commitment on our part to purchase. Tender documents are due to be returned to us before the end of the year. You might ask why have we done it now and the timing of the issue of the RFP was determined by the lead time for aircraft and, depending on the aircraft type, current delivery times vary from 2008 to 2013. We have always said that new wide-bodied aircraft would not be ordered until we have seen the resolution of the pensions deficit. This remains the case and I remain confident that we shall resolve the pensions difficulties.

BA's timescales

I would like to clarify the timescales for fleet expansion and fleet renewal. First, we do not intend to take delivery of any new longhaul aircraft before we move into Terminal 5 in 513 days from now. That would add complexity to that move which we do not want to do.

Through 2010, our longhaul annual growth assumption is for a modest growth in the region of 3-4%, and capacity for that growth will be provided by new aircraft delivered in 2009 and 2010. As we move into the next decade, our longhaul annual growth assumption currently continues at around that level of 3-4%, but this will be determined by market conditions which prevail at that time.

By the middle of the decade, some of our older aircraft will reach 25 years of age and are ready for replacement. Aircraft may be replaced prior to this depending on the results of the RFP process, and we shall consider all factors in making this decision, both economic and environmental. As the Chairman said, environmental performance will be a critical facto in any orders we place for new aircraft. Possible replacement for the 747, if you look at the A380 or the 747-8, are likely to be at least 17% more efficient in terms of fuel burn and CO2 and produce probably 21% less NOX emissions. Possible replacement for the 767s, which would either be A350 XWB or the 787, are likely to be at least 30% more efficient in fuel burn and NOX emissions.

Summary

In summary, I have said before that all parts of our shorthaul business must be profitable. We have examined and explored all options related to BA Connect, and I am pleased to be able to announce that we have reached agreement in principle on the sale to Flybe today. Although operational difficulties continues, principally affecting longhaul premium transfer and shorthaul premium traffic, we expect to see an improvement in that situation. The fleet renewal process is a long one and this is the early stage of that process. I shall reiterate that we shall not take any deliveries of new longhaul aircraft before we move into Terminal 5 and until we have resolved the pensions difficulties.

The new Club World bed

Finally, to make sure that you are aware of the date, the exciting launch of our new Club World flatbed will take place on 13 November and I look forward to meeting you on that day.

Martin Broughton: Thank you very much, Willie. You have had a comprehensive run through the numbers from Keith, a fascinating insight into some of the aspects of the business from Willie, so who would like to start with questions. Please state name and affiliation for the record.

Question & Answer Session

Chris Avery (JP Morgan): I have a couple for Keith and a couple for Willie. With regard to the aircraft requirement, how can you run a full tender process until Airbus has a proper spec for the A350 XWB? Secondly, what is your attitude to being a launch customer? Your predecessor had some strong views about not being a launch customer for an aircraft type and with what happened with the A380, that is probably a wise choice. For Keith, on tax rates, you have ACT, there is a tax refund, so can you help us with an effective rate for the year? Secondly, you mentioned additional depreciation in Other Costs, what was that about?

Willie Walsh: Let me deal with the point about being a launch customer. I share the views of my predecessor and I am pleased that we are not a launch customer for the A380. It is inevitable that with the introduction of any new aircraft type, history will show that there are difficulties, and we shall avoid that. In relation to the A350 XWB, we believe it is important that we seek competition from Airbus and Boeing in this field. It is important for Airbus that they produce an aircraft type that will compete with the 787, so we wait to see what we hear from Airbus. However, we shall not rush into anything, we have stressed that point. We have started this process in time for us to be able to consider all options and it is a very important decision for us. It is not something that we shall rush and I want to signal again that this is the start of a process that will take some time. Clearly, we shall not be able to consider an Airbus A350 XWB until we are fully clear about what the specification will be, but I expect that to be part of the discussions and negotiations that we shall have with Airbus in the coming months.

Keith Williams: On your questions relating to tax and depreciation, first let me take the easy one on tax. Tax rates for the year we would anticipate being in the region of 15-20% at this point. As you know, as far as ACT we had a £94 million ACT credit which is being utilised in the year. On the issue of tax refund, we previously provided for some taxes in Brazil. Although we are principally a UK taxpayer, some overseas authorities from time to time try to tax BA overseas, and we recently won a court case against some taxes in Brazil, and the release reflects that court case being decided in our favour.

In ACT as far as recognition in the accounts it is this year, in terms of actual utilisation in cash terms it will be next year. It is a deferred tax item effectively.

Looking at depreciation, the issue on depreciation is more round the base. We stood up some aircraft last year which released some depreciation that had been provided. If you like, last year's depreciation was lower because of some aircraft that were stood up and the release of depreciation, so last year's base was lower rather than this year's increasing.

Andrew Light (Citigroup): I have three quick questions. First, on the Flybe transaction, do you expect any impact on the rest of the network by having a reduced frequent flyer base in the North of England, or will you link Flybe into the BA programme? Secondly, the Atlantic load factor is down almost three points for October. Is that wholly explainable by the security issues at Heathrow, or is there any underlying weakness there? Finally, on the new Club World product, do you hope to get a yield premium for that, or is that merely catching up with some of your competitors?

Willie Walsh: In relation to the network, I do not expect to see any impact by the decision to sell the regional business. I made the point before that it is not strategic to the Group and we saw no strategic value to British Airways in having that regional business, so there will not be any impact from our decision to sell that. Retaining the London City operation is an important step, because it complements the products that we offer from Heathrow and, to a lesser degree, out of Gatwick, and that was an important part of this arrangement as well.

On the transatlantic, we believe the figures that we have seen there are directly related to the 10 August security scare and the ongoing security regime, if you like, with the restrictions that have existed on hand baggage. It has particularly impacted on transfer traffic and I believe that the changes being introduced from Monday will improve that. We have seen similar arrangements being introduced in terms of carriage of liquids in the US since the end of September, and our experience at our own terminal at JFK has been that these work well. There was some confusion in the early stages when passengers tried to understand fully what the rules mean but I see this as being a very positive development for us.

Finally, on Club World, some of our competitors have improved their product and it is important for us to retain a lead in this area, so the decision to invest is twofold. It is to ensure that we have the lead position when it comes to the Club World product or Business Class product on longhaul, but we believe that this will drive additional traffic. This is one of the reasons why we are converting some of our 747s from what we call a low J configuration with 38 Club World seats into a mid J configuration with 52 seats, giving us an 8% increase in overall premium capacity, as we believe that this will help to grow our traffic there so it will be a positive development.

Andrew Light: So there will be more Club World seats?

Willie Walsh: Yes, we are retrofitting a number of 747s to give us an 8% overall increase in the number of Club World seats on our longhaul network.

Samantha ?Gleave (Merrill Lynch): As a follow-up question on the premium traffic trend, you talked us through transfer traffic on the premium side. Can you perhaps provide us with a little more colour on point-to-point premium traffic and recent trends there? Secondly, on the cost side we saw good cost performance in Q2, staff productivity up 3.9%. Can you give us some colour on the full year outlook for labour?

Willie Walsh: On the premium, we identified the two areas of soft bookings that we have seen since 10 August and they were specific to longhaul premium transfer and shorthaul premium point-to-point. The longhaul premium point-to-point traffic has remained strong, so we have not seen any impact in the figures there. That has remained pretty much in line with what we had seen prior to 10 August. That is why we have specifically identified the two areas, and I believe it clearly demonstrates that these areas of the business were impacted by the 10 August event and the subsequent restrictions on hand baggage, which particularly impacted on transfer traffic through Heathrow.

In relation to costs, our cost performance in the first half has been good and we shall continue to focus on cost, not only in the second half of this year but going forward. There remains considerable scope for us to improve on our cost performance. I do not have a specific figure to give you for the full year but we see a flow through –

Keith Williams: On labour costs specifically, for the first quarter these were up mainly because of a reflection of the pensions issue, and they are up for the first half. In the second half, we expect labour costs to be down, which principally reflects the headcount reductions that you have seen during the year. So, overall, subject to the payment of employee reward at the end of the year, labour costs would be flat.

Willie Walsh: We had a significant programme on headcount reduction running through to the end of September and you will see the benefit of that flowing through into the rest of the year and into next year and on.

Stephen Furlong (Davy): In terms of the load factors which are now very high for a network carrier, and you mentioned that you would have to go back 10 years to see those type of loads, do you think they can go higher even into the 80s in the medium term, or are we looking more at a cost reduction programme to get to the 10% operating margin target? Secondly, perhaps Willie could update us on your view on the US/EU Open Skies, how you see that panning out and an update on the pros and cons for yourself?

Willie Walsh: We believe there is still scope to improve our load factor, and there is good evidence to show that the changes we have introduced on our pricing model on shorthaul has had the impact that we expected. However, we believe there is still room for us to improve on that, so there is still scope to improve on load factor both on shorthaul and on longhaul. That will be a feature going forward, so it is not solely around costs as we move to achieve our 10% target next year.

On EU/US it is pretty quiet at the moment, to be honest with you. There is very little going on and it is unlikely that we shall see any development in the short term. The signals coming out of the US have been pretty strong, which is what is to be anticipated in advance of mid-term elections, but there does not appear to be an appetite on either side of the Atlantic to progress the EU/US Open Skies agenda at this stage.

Jonathan Wober (HSBC): I have three questions. On Flybe can you say why you are taking a 15% stake in that rather than making a clean break? Related to that, will there be any operational relationship between BA and Flybe in any shape or form? Secondly, does your revenue guidance for the year assume fuel surcharges remain at current levels? Thirdly, as far as your 8% premium capacity growth next year combined with significant capacity growth on premium on the North Atlantic from a number of start-ups, does that have any implications for your outlook on pricing in that cabin?

Martin Broughton: Just on the 15%, that has been part of the negotiation, it has emerged as part of the deal. We see it as an attractive thing to do because we believe that the value of Flybe will increase as a result of this transaction, but this is not a stake which we shall be holding for the long term. When Flybe come to do an IPO, which will be a little later than they had originally planned, we would expect to sell that stake.

Willie Walsh: I do not see that there will be any operational links between Flybe and BA. I believe that our business models are pretty clear and quite different. Flybe has made great progress in recent years. They have set themselves as the largest regional operator in Europe as a result of this transaction, and I think that they operate in a very focused and niche environment, and I do not see that we shall have any links with Flybe other than the sale of the BA Connect business to them. So there will not be an operational relationship once that deal has been completed.

On fuel surcharges and our revenue guidance, we keep the fuel surcharge under constant review and beyond that I suppose I cannot say very much. It is something that we review on a weekly basis but we have no plans to adjust our fuel surcharge at this stage.

As far as premium capacity growth, we believe that this area of the business will continue to grow. Absent the impact caused by the disruption on 10 August, we would have seen strong growth in our premium market. Certainly, the 2.1% premium growth that we have reported today for October is less than we would have expected and less than we were trending prior to August, and I expect that that will recover as the operational environment returns to a more normal regime. Therefore, I do not see the growth of some of these new airlines impacting on our projections or our plans in any way.

Michael Ridley (Citigroup Credit Analysis): You have £2.6 billion of cash, and I wonder what your intentions are with regard to that? Is that all for pensions or debt repayment, acquisitions – perhaps you could give us some guidance on that?

Keith Williams: As you say, the cash balance is £2.6 billion. Subject to agreement on the pensions issue, we have already offered to contribute £0.5 billion to that and obviously we have been keeping high liquidity for some time now. We reckon that between £1.8-2.0 billion is our ongoing liquidity requirement.

Chris Reid (Deutsche Bank): I have two questions if that is alright. The sale of BA Connect adds something like 60 basis points to your profit margin for next year with the loss-making and the turnover loss. Is that something that you anticipated with the 10% margin goal, or should we now assume that it is a 10.6% margin goal?

Martin Broughton: That was something we assumed within the 10%.

Chris Reid: Okay, great. The other question concerns the risks with Flybe. easyJet walked away from the Deutsche BA deal, so what is your confidence that it is a done deal? The implication in the Flybe statement was that you would be giving them some money to take it away. Is that the case and does it increase your level of confidence that you will be able to get rid? Thanks very much.

Willie Walsh: It is not a done deal but we would not have announced it if we were not confident that the deal will complete. Both Flybe and BA – and I met Jim French yesterday – are both excited about this, so there is a determination on our part and on theirs to see this deal complete. It is a great opportunity for Flybe to grow their business to give them the scale that they are looking for. They have significant aircraft orders in the pipeline to the tune of around £1.2 billion, so this gives them an opportunity to invest and grow their business. It is a good move for them and it is clearly a good move for us, but the deal is not done at this stage. It is subject to due diligence and we hope to complete it by the end of the year, but we are confident that the deal will complete.

Chris Reed: Does deal need approval from the pilots?

Willie Walsh: No, it is not that they have to give it the nod. We are announcing it this morning and we did not have any internal discussions in relation to this prior to the announcement. There is no requirement for us to reach agreement in relation to that. Keith, I don't know if you want to add anything?

Keith Williams: You asked would we be putting some cash into Flybe, and the answer is, yes, we shall put some cash into Flybe, and we are getting some equity on the other side.

Andrew Lobbenberg (ABN Amro): Following the Flybe disposal, what will you have in the regions, will you have anything? I think you still have some Airbuses knocking around in the regions – will you have anything there? To the same extent, the announcement says you are not giving the Manchester-New York route to Flybe, but why would you operate a Manchester-New York route: could you not imagine a better use for a 767? You are keeping 10 Avro RJs, I don't think you use 10 Avro RJs at City at the moment, so are you envisioning a big expansion at City? Finally, you gave us what of the yield effect was from price, can you split that between surcharge and underlying please?

Willie Walsh: On the regions, our focus will be to operate from Heathrow to airports in the UK where it provides traffic feed into Heathrow, and also some services from Gatwick into regional airports in the UK, but we shall not be operating from a regional airport to another regional airport in the UK. We have significant flights into Manchester from Heathrow, we have a significant presence in Scotland flying into both Heathrow and Gatwick and London City, and we shall continue to do that. So that is an important part of our business. The feed that we get from the regions, as I mentioned in my presentation, helps to support the longhaul network that we have, but we shall not operate any regional services from one regional airport to another regional airport.

Andrew: But will you operate from the regions to continental Europe?

Willie Walsh: No. Why do we operate a 767 from Manchester? It is profitable, hence the reason we do that. If we identify a better use for that 767, we would certainly do so but the Manchester-JFK is a profitable route for us. You are right that we do not currently operate 10 RJs from London City so retaining the 10 RJs will see us expand our operations at London City. We currently operate from London City to Edinburgh, Frankfurt, Madrid and Milan, and over time we shall expand our frequencies and destinations from London City.

Keith Williams: If I understand your question on yield, the 1.8% - do we split it between fuel surcharge and price, no we don't, it is just 1.8%.

Gerald Khoo (Oriel Securities): Regarding the BA Connect transaction, you mentioned that you are keeping or certainly not transferring to Flybe the regional ground handling business. What is the future for that business and how much of that unit's revenue activity was related to what is now the former BA Connect business?

Willie Walsh: That ground handling business will be the subject of a review, and our focus there will be to ensure that anything we do there is efficient and in line with market rates. However, it will be the subject of review as a result of this transaction with Flybe.

Edward Stanford (Cazenove): Could you just update us on where you are with the wage negotiations: is that something that will take place after you have resolved the pension issue, or do you anticipate that it will run contemporaneously, or whatever the word is?

Willie Walsh: It will probably be after pensions. We have been prepared to engage in negotiations on wage but the focus from both sides, to be honest with you, has been on the pensions issue, so it is likely that that will follow on from the pension negotiations.

Martin Broughton: Thank you very much for your questions and we hope to see you at the Club World relaunch.

- *Ends* -