Conference Call Transcript

BAB - British Airways Investor Day

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PRESENTATION

George Stinnes

Today I thought I would just say, one real simple thing, which this video encapsulates better than anything that I could think of and that is I've been here since 1990, so by far and away in BA terms, not a long time, but long enough to allow me to make a judgment. And that is, that I never in the time that I've been here in the company felt us as clearly focused in driving towards a common goal. We used to clearly be many times all over the place.

As well, if I could say, Rod, your biggest contribution has been to put focus in this place that exactly we know what we are and what we're not. And as I said, the video encapsulates it best. And that would be my opening remarks today.

And the agenda for today is again, very focused. And it focuses on the issues that are absolutely core to our business, and that we want to be absolutely clear on. We know what we're thinking.

So with that said and done, let me just quickly go through the compliance issues. The house warnings you all know and you see it every time. BA is very concerned about complying with, for example the combined code and Martin always reminds us that we are fully compliant with important disclosure, absolutely true, market legislation, Reg FD are top of our agenda.

You should know that there are no press with us today. However this is a public forum. This presentation is being webcast as we speak. So it's clear to every one of our investors and all to hear.

Second thing with respect to building, we need your help with safety issues. Continuous sirens mean get out, the assembly points are in the courtyard that you see out there. Clearly, you won't have to worry about lifts because there are no steps to go up and down. Accidents you can read for yourselves. This is a no smoking building for those of us who still have the need, during the break there is a courtyard out there. And finally, last year we raised money from any mobile phones that rang and there will be a collection pot of course again this year, please turn them off.

Quickly on logistic issues. You have a name badge. You need to wear the name badge at all times. And those of you who are going to Cardiff, you'll notice you have a green spot on it. If you lose the badge you are not going, putting it very simply. So please take care of those badges. You have a second badge, which is a Waterside security badge, when you leave the building please return it in reception.

Any of you who have not collected your boarding pass for Cardiff and who are going, please pick them up in the coffee break. Any of you who change your mind or who want to go to Cardiff, in the break please meet Sally who's sitting on the help desk just on the right hand side just outside that door and a pass will be arranged.

There is a few of you who have asked for meetings with non executive directors which is part of our compliance procedures, at the coffee break, I would ask you please to move forward in the corner by that door, there in the right hand side. If you go there, you've all got green badges, so you know who the 6 of you are. Please go there immediately. If you don't go there on time, you're going to be late and you're going to miss presentations after coffee break.

As in previous years, Q&A will be at the end. And we are going to host a Q&A session. Hopefully, we'll have plenty of time for those. Agenda is very full. I wish you a very pleasant day at Waterside and also later at Cardiff for our engineering session. Rod, can I -- sorry, Martin, excuse me handover to you now.

Martin Broughton - ***British Airways - Chairman***

Thank you, George. First of all, may I take the opportunity to welcome all of you. A particular welcome to some of our non-executives directors, who are here today. As George said, actually we usually don't have the opportunity to interact with them. Could I just ask each of them now to stand so that you can know who they all are so that I can introduce them to you. You can all stand together.

We've got Martin Read here, who's Chairman of the Remuneration Committee; Ashok Ganguly; Denise Kingsmill; Alison Reed, Chairman of the Audit Committee; and Mike Jeffrey, Chairman of the Safety Committee. And Maarten van den Bergh, senior independent director. And so a particular welcome to you all and please feel free to interact with the non-executive directors.

Its my pleasure to have the first opportunity for me to welcome you here as Chairman. It's of course also the last opportunity for Rod to welcome you here as Chief Executive. As I said earlier this week Rod will be a hard act to follow, classic, I think, English understatement. And I think I would just like to put to rest one view and I think you know Rod has lots of expressions and sayings. And one of his sayings is, those who the Gods wish to destroy thus make famous.

There is no truth in the rumor that following his retirement announcement, whatever election, the most favorite businessman, besides there's only one way from there. There's nothing of that, I promise you. It was strictly personal reasons, which we've known about for a long time. But all the stakeholders in British Airways have a huge debt to Rod. He's done a terrific job for this organization. Performed miracles frankly, in getting hold of the organization, giving it direction, seeing it through some of the very difficult times. And will be staying fully in charge for the next 6 months or so.

Rod and I, and the whole of the Board are convinced that in Willie Walsh, we have absolutely the right man for the job. He too has performed miracles at Aer Lingus taking it away from the edge of bankruptcy, making it a very viable business. At a youthful 43, he has a remarkable 26 years experience; 26 years in this industry And that's going to hold him. We look forward to welcoming Willie to join us in May and taking over at the beginning of October.

But today isn't about Willie, today isn't even about Rod, today is about future, about continuity, about progress, it's about the things which encapsulate British Airways and our positioning of the airline to provide the service that matters for people who value, in other words about customer service, about cost control and it's about -- one of the key things in the Agenda is Terminal 5. Terminal 5 is a key part of our agenda. Whether you think about Terminal 5 as a major new landmark going up to West London, or simply the only construction site in the country with its own airport, it is going to be our jewel in the crown, and it's going to transform the business and leisure travel experience.

It's sobering to think that it's only 101 years ago, Orville Wright took off on that inaugural powered flight. It's even more sobering to think that the entire flight could take off, flight and landing could have taken place comfortably within the confines of the terminal. That's the kind of progress that this industry has made in technological terms over the last century. It's been a fabulous growth industry. And yet, globally it remains a loss maker.

While I've often referred to it as a crazy business, largely I think to do with a crazy regulatory structure, inappropriate government interference, state aid and all of that background about which we hear so much. But which we've now recently the old (inaudible) coming in from Alice in Wonderland politics again, suggesting aviation tax on African aid, as though there is some direct correlation between the two.

But against this hostile background, British Airways has actually performed very commendably. You know we've halved our debt. And if you don't know, you can all find out. We are at the moment, I think the most profitable company in the airline business making more profit than any other airline.

So without further ado, I'll hand over to the man who's led all those achievements, Rod Eddington.

Rod Eddington *- British Airways - CEO*

Thank you Chairman.

Welcome to my last Investor Day as Chief Executive. But as we've said and as the Chairman said, the business plan and the focus and the priorities of this business are not about who is Chief Executive. And the business plan we're going to be talking here about today is something that was put together and has now for a number of years has evolved after a vigorous and sensible and lengthy debate between the Board and the management community.

It's at the base that Chairman Martin Broughton has very much led, but one in which there was complete agreement between those two groups about what our priorities need to be and what our focus needed to be. And we've shared it with the top 400/500 managers in our business. On a couple of occasions, I've had a chance to have their input to the process as well. And what we've done is to distill that thinking into a few simple things. I've always said that if you can't communicate your business strategy to the newest member of the company in 3 or 4 minutes, then it's too complicated. And that's very much our focus. There will be some familiar threads to it; there will also be some new ones, as you will see.

So let me start with a presentation, which we gave to the management community a couple of weeks ago. Because as our Chairman has said, we're now the most profitable airline in the world. Although, as I constantly reminded the management community, being the proud occupiers of the most comfortable deckchair on the Titanic was no place to be.

Although we are the most profitable airline in the world, we're still short of our 10% operating margin target, which is essential, if we are to generate the money we need to reinvest in our people, our products and new aeroplanes and in new training and development. But that 10% margin is still very much in our sight, as it must be.

But one of the challenges that comes with being profitable is that it would be very easy for the people of British Airways, for us, to take the view that because we are now the most profitable airline in the world, that we can relax. That would be fatal, absolutely fatal.

And one of the things we've done is put together a presentation for the community of British Airways that we thought we'd share with you. About why it's absolutely clear to us that we can't afford to rest on our laurels. We absolutely have to continue with a drive to ensure that we make the most of Terminal 5, that we have a competitive cost base. That we deliver 10% operating margin so we can reinvest in our people and our products. And that has to be a focus for everybody.

We've called this presentation Worst to First and First to Worst. Those of you who are not from the U.K., Brian Moore who was the well-known football commentator I think once said about a game of English soccer, football as it's called here, is a game of two halves. And we're going to be talking to you today about a game of two halves.

As I said, this is an essential part of making sure we stay focused on the right things, if we're going to deliver the business plan initiatives for the next 2 years. The first is "Fit for 5," as Martin has said, which is about ensuring that we are as a business fit to move into Terminal 5. Not just fit in the context of taking advantage of the geography that Terminal 5 gives us, a first in living memory when British Airways will have its hub in one terminal rather than 3, because we currently operate at Terminal 1, 3 and 4 at Heathrow.

So it's also about making sure that line in which we work, the things we do, how we do them, our working practices are appropriate for building and appropriate for an airline that has a long and robust future.

We must continue to invest in products and people and you'll be hearing quite a bit about it today from Simon Parks- Smith and David Noyes, who's our new Director, Heathrow Customer Services and he will be talking to you about the important work he has been doing with the leadership team and the Board on Terminal 5.

And finally, we've got to ensure that we have a competitive cost base. We cannot invest in products and people unless we can generate the cash to do it. And John Rishton, as always will be talking to you about some of the key financial issues a bit later in the morning.

So let's go now to the first part of the game of two halves, Worst to First. And this looks at our performance from 2000 to 2004.

And I'll start with a list of airlines. And we've ranked airlines here by operating profit. Not by margin, but by operating profit. And these are in U.S. Dollars. And we looked at the top 21 airlines in 2000. You might well ask, why we've chose 21 rather than 20. Simple reason, we're in the top 21, we're not in the top 20. Take it from that where we stand. We're at the bottom. We made, I think £84 million at an operating level that year, just over U.S. $100 million.

A number of interesting things about this chart. Red for the U.S. carriers, blue for European carriers, yellow for carriers to the east, the Middle East and Asia obviously. And green for the no-frills. Only one no-frills carrier in the list in 2000. Not surprisingly Southwest run by Herb Kelleher. I saw Herb in Washington last week, as irascible as ever. I congratulated him. I think, and I said to him, that the last time I'd seen him in Washington he'd retired. And now he was back as Chief Executive of Southwest. And he said he's been drafted. But only one no-frills in the list. Not true now, of course.

Next we look, 4 years later. Now the first thing to note about the chart 4 years later is that the sum total operating profits of the top 21 has gone from about U.S. $12 billion to U.S. $6 billion, it's halved. And if the operating profits have halved, you could imagine what final profit numbers looked like for this community. 2004, globally airlines lost after all costs were taken into account including taxes, about U.S. $5 billion. But at an operating level, we collectively made U.S. $6 billion. We are first. But that's not the real story. Compelling though, it may be.

The real story is that United, the most profitable airline at an operating level in 2000 is now well and truly in Chapter 11. And if you look at the list, you'll see there are only a couple of U.S. carriers in the list. And that the number of green, no-frills, has increased quite substantially. There's been a wholesale change in that list.

And let's look at some of the winners and losers in that list. We are the only airline that improved its profits at an operating level through that period. And we've improved some sevenfold. There are a number of new entrants. And as I said, uppermost amongst them in many ways, apart from Emirates, which is now a substantial force, we have some key no-frills carriers, the Ryanairs, the JetBlues, the Virgin Blues.

And the losers, there are those who still in the list grow profits, and there are those that are falling out altogether. And a list of those that's fallen out is a long and extensive one. And it includes formerly proud companies like Swissair. Once an outstanding airline, by 2004, it no longer existed.

But the lesson of United's decline, should not be lost on British Airways. Because in a game of two halves, if you go back to 1996, and remember in 2000, we were at the bottom of list -- if you go back to 1996, and look at the list again, the most profitable airline in the world at an operating level was British Airways.

The other thing to look about at this list is firstly in '96 the total operating profit of the top 21, was about 10 billion. So between '96 and 2000, the operating profits of the top 21 airlines increased by about 20%. This was a profitable period for airlines generally. The world economy was doing well, and that period, '96 to 2000 was a good time to be in the airline industry.

The other thing is if you were to look back at the 2000 list, most of the players who were there in 2000 were very much in the top 20 in 1996, 4 years earlier. Not much changed. We went from first to worst over that period. But pretty much everybody else stayed where they were. And again next to British Airways in 1996 the top of the profitability league were the U.S. majors, were people like United and Delta and American.

I think the lessons here for British Airways, to us as a community and lessons that we must be absolutely sure we don't repeat, as we move forward into our next business plan and dealings, were firstly, why did we go from first to worst? We lost control of our business. Hindsight's a wonderful thing but that's what happened. I'm going to talk to you in brief about financials, about complexity, which kills businesses, and about the challenges, that complexity, has for management.

Let's look at financials. In this period, we ordered a lot more aeroplanes. We grew very vigorously. This chart looks to our total figure 96 and compares it to our total fleet in 2000. We have short-haul aeroplanes, long-haul aeroplanes -- ML is for mainline. So we've got mainline long-haul on the left, mainline short-haul in the middle. And subsidiaries, all short-haul on the right hand side.

And there are number of things to note about this chart. Firstly, increase the size of that fleet by about 25 aeroplanes. Huge capital expenditure associated with that. Huge CapEx.

And the long-haul fleet went from 80 aeroplanes to 119. Substantial growth in long-haul capacity. And we doubled the size of our subsidiaries. We went from 55 aeroplanes in our subsidiary fleet to a 104. Just at the time, when the no-frill carriers were beginning to get a grip on short-haul aviation in Europe, we're rapidly growing our exposure to short-haul.

And let's look what that meant for the capacity. Long-haul grew by about 30% over that period. That's about 7% or 8% a year. But lot of growth in long-haul markets when mature long-haul markets grow roughly in line with GDP growth.

If you grow your long-haul business that much, you need to provide more short-haul connections and by definition you are looking at the lower yield. Our short-haul fleet grew rapidly in terms of capacity, as we put more bigger aeroplanes under our short-haul routes. And as a group, we grew vigorously.

And let's look what happened to short-haul profitability. In 1996, we made a small profit in our short-haul business, something like £25 million. At 2000, as we'd rapidly expanded our short-haul businesses, we bought the likes of and invested in the likes of a GO, in Deutsche BA, in Air Liberté as well in our own short-haul business. The short-haul businesses were burning a £300 million hole in our pocket, effectively destroying profits we had generated on long-haul.

What we've done between 2003 and 2004, is to reverse parts of that. We've reduced the number of long-haul seats we have in the air. Much of that came about as a result of the new product we've put on board our long-haul aeroplanes. Our objectives in business class and World Traveler Plus are much more space intensive.

We have fewer seats on a 747-400. We have fewer seats on a 777. It was a strategy that began before I arrived. It was absolutely the right strategy. Because it was a commitment to the premium market where the yields justify the space implications. And it's been a critical and fundamental path on our journey and our recovery over the last 3 or 4 years.

Those two classes particularly, Club World and World Traveler Plus are at the heart of our profitability. Although, increasingly we are making good money down the back of the aeroplane as well.

The reduction in long-haul ASKs at the end of the day was a function of not just slightly fewer aeroplanes but far more importantly space intensive products. This biggest reduction has been short-haul. We sold Air Liberté, We sold Deutsche BA. We stopped operating 767s to Oslo and started operating A390s with much lower trip cost instead.

We have the right sort of exposure to short-haul. Short-haul capacity is now less than 20% of total ASK. I worry about the performance of short-haul performance financially. It is much improved. It's no longer burning a £300 million hole in our pocket. Last year we lost £60 million short-haul. But that included Deutsche BA write-off and some write-offs on aeroplanes, which we disposed off.

So the short-haul business is no longer the value destroyer that it was. But it's an essential path of our network. And we substantially reduced our exposure to short-haul. It's one of the reasons why we've come through the last 4 or 5 years, in the face of the trick from the no-frills carriers. That, and the fact that we've got a much better competitive response on the map.

It wasn't just aeroplanes we invested in. We invested in infrastructure before. And that this is essential infrastructure, but it costs money. We invested in a new world cargo center here in Heathrow. We invested in a new terminal at JFK, which is absolutely essential to us and we've also built this building.

We occupy a much smaller footprint at Heathrow than we did 4 years ago. We effectively disposed off nearly half the property we used to occupy at Heathrow. This building used to have 2,500 people in it. Now we got close to 4,500 and because it's is open planned and well designed, it's the most cost effective real estate we have. But nevertheless it was investment. And investment means money and money unless you can generate it means debt.

So what went wrong between '96 and 2000? The first thing is, our debt spiraled upwards as we bought new aeroplanes, as we invested in new building. And that was because we acquired substantially new assets. And what did that to do with our cost base?

Though capacity went up by 35%, mostly particularly short-haul and the implications that had with the gift of hindsight for our business. And our costs went up 26%, especially in some less than capacity as usually happens. The problem was the revenue only went up 15%. The competitive world in which BA operated, changed. And if your costs go up by 26% and your revenue only goes up by 15%, what happens to your operating profit? It declines rapidly. And that's what happened to us. A powerful chart.

I want to talk about some of the things that happened through that period. Firstly, too much complexity. We had far too many aeroplane types. Every new aeroplane type you have there are implications for simulators, for space, for engineering training, for pilot training, for cabin crew training. Complexity kills businesses. And nothing kills them quicker than a mixed fleet.

We've taken 5 aeroplane types, out of our fleet over the last 4 years. And we have more to go. We've taken out the 747-200 having given us wonderful service. 737-200 RJ Turboprop and sadly we've retired Concorde. Too many aircraft types. Too many short-haul carriers.

Our short-haul business wasn't a British Airways short-haul business. It was GO, it was Deutsche BA, it was Air Liberté, it was British Airways mainline, it was BA, Bral, Brymon. CityFlyer Express... All independent quasi-autonomous businesses, all with their own sales forces, their management teams, their operating charges. Completely desegregated. We had too many fare types and rules. The reason we made the radical change to the shorthaul group, the work that what we call evesham. And what is become publicly known as our response to the no-frill carriers.

Driving a lot more business online. We couldn't drive business online and make best use of the web until we massively simplified fare types and the rules that went with it. You will all remember Saturday night stays and the rest. We got rid of them 4 years ago. Interesting to note that some of the U.S. carriers are just getting around to thinking about it.

We cannot use the web intelligently unless you radically simplify your fare and fare types and rules. But complexity destroys businesses. And management, how do you manage a business that's heavily decentralized where you've got all this different entities out there. Not only out there, but competing with one another.

The GO sales activity in Spain was in direct competition to British Airways sales activity in Spain. They were completely separate independent businesses, and now were competing with one another. They weren't competing with agents yet, they were competing with one another. And that makes life very difficult for any management team.

So the world has changed between today and 1996. In 1996, the Internet was for nerds. Today, I just had an e-mail from granny. Business done on the Net in 1996, no one knows how much business was done on the Net in 1996, I've discovered, but it wasn't very much. Today it's $100 billion.

Terrorism, we didn't think about it, globally. We did here in the U.K. thanks to the IRA, but globally, no one thought about terrorism in the same way in 1996. Today there is a global war on terror.

In 1996, BSkyB was a start up. Today thanks to Tony Ball and James Murdoch, it's the dominant U.K. broadcaster. VHS was the dominant format in '96 and then the VHS business Betamax and VHS is today all but dead. The world has changed. For BA, for Airlines and for everybody else.

The aviation world has changed. In 1996, there was no real no-frill activity in Europe. Today there are many, many no-frills. They might not all survive; my view is most of them won't survive. But those that do, will lead a strong, robust path of European aviation into the future.

In '96 the U.S. majors were dominant. Today, they're bust, some of them in chapter 11 and competing with us on that basis. In '96, if you were European based, British Airways was the only game in the town. Air France and Lufthansa, to be frank, were struggling. They're now both real competitors to British Airways. The work that Jürgen Weber did at Lufthansa, ably succeeded by Wolfgang Mayrhuber has turned Lufthansa into a major global force. And Air France under Jean-Cyril Spinetta is now a top airline.

Emirates were unknown in '96. They existed, but they were unknown, and today, under Maurice Flanagan and his team, they are a world-class player.

Keith Williams, our Treasurer, will be talking to you little bit later in the day about the fact that the financing world has changed. In '96, we were rated by the rating agencies as investment grade. Today, along with the vast majority of airlines in the world, we are junk rated. In '96, there were many, many banks that were prepared to lend to us and other carriers, to buy aeroplanes. There's only 5 of those 40 banks still lending to us, to airlines today. We could borrow without covenants in 1996 because of our grade, investment grade ratings. Today covenants are almost certainly required.

We could borrow against an aeroplane for 20 years in '96. Today, it is more likely to be for 12 or 6. And in '96, you could borrow against the full value of the aeroplanes in the '90s and more. Today it's less than the full value. So, the finance world in which we operate has changed.

But a very important thing for us to remember is the business. People at British Airways, the management community and people who work for us to recognize that if you want to buy new aeroplanes we absolutely have to ensure that our balance sheet is strong enough to sustain that and we're generating the cash flows we need to reinvest in aeroplanes and another elements of our product and people. The finance world has changed.

So for us, the journey from 2000 and 2004 has been about regaining control of our business. About looking for profitable growth in line with market growth. Massive commitment to simplification. How do you take more costs out of your business? Well, you can't take cost out of your business unless you simplify. You simplify, you can take cost out of your business. You complicate, you build cost into your business. It's that simple.

So now we are putting in place strong control which the board management committee embrace and share so we control our business much more appropriate today and we have a very strong cost focus. And that must not change.

The lessons for all of us at British Airways are simple. You can never declare victory because it's never over. The only airlines for whom this journey, this battle to remain competitive, this battle to ensure you've got great products and great people and you've got a competitive cost base. The only airlines for whom that journey is over, are those that have failed.

This is no longer a struggle for Pan-American World Airways, once the world's most experienced airline. It's no longer a struggle for Swissair and Sabena. But for those of us who are still in the game, it is a never-ending struggle. And you sow the seeds of your demise in the good times. So if you think that because your numbers are looking better that you can rest on your laurels, and assume that your competitors will do the same, you are deemed a failure.

So this is the way forward for us. I've spoken about the 3 key elements of our business plans in the next 3 years. Fit for 5, investing in products and people and a competitive cost base and it sits behind and underneath the BA way. Because it's the 3 key elements in the business playing out what we need to do. About how we need to go about it, the things we need to focus on come to us from the BA way.

As the Chairman has said, we are in the business of delivering service that matters to people who value how they fly. And in order to do that, we must have a competitive cost base. But we need to do more that just have the competitive cost base. We truly need to understand our customers, better than our competitors, so we can invest in the right things. We need to have the best U.K. based network. It is critical to us. We need the company to work as one team. And we need a powerful brand that people know and trust.

So the BA way provides us with some guidance as to what we need to focus on as we move along through the next 2 years.

I'm going to introduce David Noyes to you in a moment. David, as I said is Director of Heathrow Customer Services. And he's going to talk to you about T5. T5 is an essential part of British Airways' future. It is still 3 years away from opening day. But there is a huge amount of investment, of time, effort and energy that we're committing to right now to ensure that we are Fit for 5. It is a once in the lifetime opportunity, both for people of BA, for me and everyone else at BA. The once in the lifetime opportunity for us to move into a new home and we must ensure we're fit to do it. David, over to you.

David Noyes *- British Airways - Director, Heathrow Customer Services*

Thanks so much, Rod. Good morning everybody. As Rod has said, I'm going to take you through the work we're doing in getting ready for Terminal 5, Fit for 5, as we call it.

So I'm going to start just by giving an update on Heathrow today. And the environment that we work in today, so that you get a sense of the opportunity that Terminal 5 presents for us. I'm also going to talk towards the end of my talk about our approach to our people. Because critical in all of it is going to be how we bring the 6,500 people who work for us at Heathrow, how we bring them with us on the 3 year journey.

Heathrow today for British Airways is a highly complex operation. And as Rod's already said, we operate across 3 terminals, Terminals 1, 3 and 4. And if that wasn't complex enough and since that is a further complexity in the fact that we have a live runway, running right away through the middle of that operation. Terminal 4 is on one side of the airport, Terminals 1 and 3 stand in the middle. It gives us huge complexity.

Complexity in an airport environment that is highly congested. We have all heard the phrases, Heathrow is full. To give you some sense of that, Terminal 1 in its original form, when it was originally designed is designed for 6 million passengers. Today we've put 20 million passengers per year through Terminal 1. Terminal 4 which is only 20 years old was designed for 9 million passengers. Today we put 14 million passengers a year through this Terminal.

The Terminals are full. The airports are full. As a result, it's what we call a just in time airport. When everything's working, when the weather is good, when the ATC environment is good, it works. As soon as you start getting any disruption across the whole airfield, it starts knocking on across everybody, who operates at Heathrow. It is as I said, a just in time airport.

Because we operate across 3 terminals, our transfer times are not competitive with other major airports. Most major European airports can offer transfer times in the window of 45 to 60 minutes. The best we can manage is 60 minutes for passengers transferring within a terminal. As soon as they cross terminals, the best we can do is 75 minutes. All in all, we are working in an environment that is full of bottlenecks.

The implications for British Airways are that first, because we are operating across 3 different terminals, 3 different working environments, we end up having to have different working practices. And driven by the physical infrastructure that we're having to work in, across those terminals. It's a very tough working environment. It's highly congested. Whether it's front of house in peak time when we're trying to move passengers through what are congested spaces.

Equally, on the apron, on the ramp, in some areas you -- for instance if you're traveling through terminal 1, you can see the space between the aircraft is minimal. And so to operate in an efficient way is highly complex and needs to be well coordinated.

Also our practices are outdated. The level of automation in particular, across the airport is not as we would desire it. Our baggage systems, we have, over the years upgraded our baggage systems significantly. But because we're having to work in an infrastructure that's not designed for those baggage systems, we end up having to bolt them on and compromise in terms of how they work. As a result, the amount of manual handling we still do is significant. And there are some parts of the operations, where we still have to handle a bag 2 or 3 times to get it from baggage hold into the aircraft versus of course ideally you handle a bag just once. Once on departure, once on arrival. All of that leads us to operate in an environment that is a competitive disadvantage for us.

The last point, though it's not actually an issue for us today in that we don't have plans for significant growth. But the current environment does not allow us to grow significantly if we wanted to.

That brings us to Terminal 5. Terminal 5 is effectively a new airport for Heathrow. Its capacity will be 30 million passengers per year. Heathrow's overall capacity today is 65 million. Effectively, it is a new airport. This main building Terminal 5 area, as we call it is 4 times the size of Terminal 4 today. I was fascinated by the Chairman's comments that the Wright Brothers would have been able to take off and land within that building. I am not quite sure we're going to try that. But it gives you a sense of the sizes. The size of the campus that's between the front of terminal 5 and the central area at the top right hand corner there, it's effectively the same size as Hyde Park.

In 2008, when we open we'll have the main building and what we call satellite A. That's the satellite in the middle. In 2011, satellite B is due to open. Key thing for British Airways, is it allows us to bring all our operations, our short-haul operations and our long-haul operations together in one terminal.

I am pleased to say the construction is absolutely on target. And if you go past Terminal 5 today you'll see that the last roof segment is in the process of being lifted on the main building. And they are now in the process raising the building. The satellite A which is the middle satellite is already 75% complete and that whole project is over halfway there. Basically it's on program, it's on budget.

But the critical thing, for British Airways is that we have been involved in the design of this building right from the outset. It's been designed around the customer experience we want to deliver for our customers. And it's been designed to give us the opportunity to develop the efficient working practices that we need to have in the 21st century. Very different from Terminal 4 where basically BA took the decision to go into terminal 4 late in the process. And we inherited a building that we had very little influence over the design of.

As a result, Terminal 5 is our future. It is our new home. We're going to use it as catalyst for change. We're going to use it to improve our customer experience, to deliver more efficient aircraft operations and be a catalyst in new efficient ways of working. I'll talk about each of these in a bit more detail in a minute. But at its heart, it gives us one campus, one operation and it gives us the opportunity to bring all our operational people together in one team.

The customer experience. Well, firstly, the first thing that it will give customers is unrivaled access. It will have rail links. It will have Heathrow Express links. It will have the underground. And it will also have a its own spur road off the M25.

In terms of the customer experience, we've been over working with the BAA to develop a much more cleaner flow-through at the whole terminal. So, as people come into the terminals and if they haven't checked in already off airport, they're going to be able to check in at self service machines or at conventional check ins.

And then flow through the baggage drop, flow through security. Where today so often you got through a check in process, you deal with check in process, you then turn back, and then it's normally a considerable walk to go through the security. There is no logical flow the way you move through an airport. This terminal is all designed for those logical flow from front through the building. Much more easier for customers. It's also of course, for us far more efficient.

In terms of transfers, the whole building is just designed around providing competitive transfer facility so we'll be able to offer 45 minutes connection so that makes us on a par, if not better than all European airports.

And then in terms of the baggage system, the baggage system is designed so that at the points where a bag enters the system, the maximum time it takes to get through what we call head of stand where the aircraft is, is 15 minutes. Very different from the world we are in today.

In terms of our aircraft operation, our terminals facilities today as I said earlier are a series of bottlenecks. Terminal 5 is designed very differently. You can see, we have the ability to have two-ways access. This means that we can move aircraft in and out of the terminal much more efficiently than we do today.

I'm sure many of you as you fly into Heathrow have had the experience where you land and then the aircraft waits on the apron for 20 minutes up to half an hour waiting to get on its stand. One of the most frequent reasons for that is the jetty that people move on will be empty but we can't approach that jetty if it's waiting for an aircraft to move out of the cul-de-sacs that we're trying to go into.

Our design of Terminal 5 is designed around making it easy for aircraft to move in and out of the terminal building at the same time. Because, we're got shorter, because we are in the middle of those 2 runways, we've got very short taxi time to the runways on landing. All of that means we should be able to generate a much more efficient operation, faster aircraft turns, get the aircraft in and out and away.

Lastly, because of the sheer size of the campus we're going to be organizing our resources, both our equipment and our people and into zones around the campus. And which will give us the opportunity to break down some of the demarcation we have today between different work groups.

And that brings me on to a new and efficient ways of working. Firstly, in Terminal 5, we will be bringing all our operational people together. Where today, our flying crew reports to a different building and then have to get bussed into the airport. That won't be the case in Terminal 5. Basically in Terminal 5, our flying crew will report for work in terminal 5. And in most cases, they will be able to walk to their aircraft.

And it's a practice you see most commonly in U.S. airports and Europe, and we're going to able to do the same. Obviously we're going to have our ground staff based there. And we think bringing the operational people at British Airways together in one place will reap benefits.

Certainly, we won't be able to do what we've done to a certain extent through flight switch, most recently in current Heathrow operations. Our long-haul and our short-haul operations tend to have different peaks and troughs in terms of their workload. That makes for inefficiencies. Clearly, by bringing them together in one terminal and having our people work across all types of work, smoothing the work flow out allows it to run a much more efficient operation without the dramatic peaks and troughs that we have today.

Equally, we're working on designing simple and single ways of working. And our working practices need to be aligned to these new processes. And lastly, it gives all our people, modern working conditions. Terminal 1 in part is over 40 years old. And to be frank, looks it and feels it, if you are working in that environment. Terminal 5 is going to bring our working environment into the 21st century.

However as Rod said, the clock is already ticking. It's 3 years away before we move into Terminal 5, and we are basically treating it like you would a major system crossover. What we're saying is, we have to be finished in terms of our working practice changes by the end of 2006. Because through 2007, we have 2 huge jobs to do. Firstly, we have to familiarize both all the ground staff and all the flying staff in the new working environment. Nearly 20,000 people, we are going to have to take through Terminal 5, make them familiar with Terminal 5.

But secondly and most importantly, one of the lessons we've learned from other major airport majors around the world, is we've agreed with the BAA that the building will be ready for us to test and commission 6 months before it opens. And that 6 months is absolutely critical. And we intend using that 6 months rigorously to test and commission the building and all the systems in it. And its absolutely essential that we do. But we have to be ready by the end of 2006.

To that end, we've identified what we call the Terminal 5 imperatives. We're grouping among the 3 key areas of things we absolutely have to do, to be ready to fully exploit the Terminal 5. The first is that we need to have a single set of processes and practices, one way of working.

Secondly due to the sheer size of Terminal 5, as I already mentioned, we need to organize our resources in zones. We also need to develop improved stand management systems to get the best out of that aircraft efficiency I talked about. And secondly logistics systems. So that we can move those people and equipment efficiently around what is a very large campus. We've already got the system within British Airways, our cargo operations and the ascentis building has a logistics system with alerts which they use for the movements of cargo and people around their operation and Heathrow. And we're in the process of instituting the same system into the passenger side of the business at Heathrow.

And lastly, our equipment. We have, just like Rod was talking about in terms of aircraft, so with equipment. We have today too many types, too many variations and this is our opportunity to develop one standard set of equipment that will allow us to reduce the amount of equipment that we have and the complexity within the operation.

We created -- for all this we're adopting what we're calling "Fit for 5" principles using 4 key elements. Much of them are borrowed from what I would describe as the manufacturing world. At British Airways, we're in the customer service business. And so at times we hesitate to refer terms like factory, production lines et cetera.

But actually as a business, if you look at the processes that we're working to, a lot of those processes are actually very similar to those processes you'd find in a manufacturing world. And the more we can develop repeatability in our processes then obviously the more consistent we will be in delivering those processes. And therefore the better customer service we will deliver.

So, we've looked at different parts of British Airways and you're going down to see the engineering operations down in Cardiff later on today. And a better example you can't find in British Airways of these types of principles.

We've also looked at other businesses and adopted some of their methods and practices.

In the product development side, what we're seeking is the type of rigor that we have today in the way we engineer our aircraft. We use the modifications to an aircraft without going through a bigger change control process.

Within Heathrow we tended not do that in the past. We just completed a review of all the different change projects that are under way currently in Heathrow. We've got to 319. I'm convinced that we probably haven't found some of the projects that people aren't telling us about. It's clearly an environment where we haven't got a rigorous control process. We've now in conjunction with the rest of the company, introduced a change control process that will allow us to make sure that we manage the way we introduce change into, what is already a highly complex environment.

Part of doing that is process engineering and we need to reengineer all of our processes in preparation for Terminal 5. However we're looking to actually introduce them over the next 2 years. Finally, it's quite simply lots of problems that you saw in Heathrow last year is because we didn't have a robust joined up planning process. I am pleased to say that we do now have that and we're much more rigorous as we plan both for this year and the next 3 years.

Lastly focused delivery. In terms of how we're structuring our organization in Heathrow and it's built all around delivering again 4 key metrics. Safety people, quality and in the Heathrow environment policy is primarily punctuality and baggage performance. And fourthly output. Making sure that we can deliver the passenger numbers and the turnaround numbers as are required for us to deliver the operation plan of the company.

Now as I said at the outside, all of this is dependent on our people. Terminal 5 will be a fantastic building. It will be a fantastic environment. But it will come to nothing if we can't bring our people with us and get them to change to our way of working so that we can fully exploit the building. And we recognize over the last couple of years, we've had difficulty in bringing our people with us. And we've learned the lesson of the last 2 years, developed the free trust approach that we're taking with our people.

The first element is that we are investing hugely in communicating and involving our people in the business. I'm not going to go through each of these one by one. But as you can see, it is an intensive program of both communicating to our people but also listening to what our people have to say. Because at the end of the day, they are the experts in the environment and as we look to reengineer our processes, they actually know best how to work, how to improve the way we work.

I've spent a lot of time going around on the shop floor talking and listening to what our people have to say. They are all excited by Terminal 5. They can all see Terminal 5 coming up and growing at the end of the airport. Their key question to me is always, so what are we going to do differently in Terminal 5. And that's something we have to really build on and use.

Part of that is the way we're reengineering our processes. We've brought into the Heathrow organization a small team of experts in process engineering. And we've taken some of our expertise from outside the company. We've gone to people who are experts in particular the car industry on process engineering. They're working with us, designing a process in which we can involve as many of our people as we possibly can in reengineering the way that we work. And as you can see, this is in conjunction with the Trade Union.

That brings me to the last point. And clearly much of this will have to be negotiated with the Trade Union. We work in an environment that is highly unionized/ And we've developed the plans that we are in the process of rolling out with the Trade Union. So over the next 9 months, negotiating through these changes.

I'm pleased to say that so far we have at the highest level within the Trade Union the support for the approach that we're looking for. It's a very involving approach. It will be a very incentive approach over the next 9 months. We're being very clear at the outset as to what our vision is for Terminal 5. We are being very clear about the practice that we are looking to adopt and we are just in the process of launching visits to different airports around the world where we can show people the kinds of practices that we need to adopt in the new environment.

But the key to it is that it is not about these changes only taking place in 2008. The key to it is that these are the processes that we need to adopt now over the next 18 months through to the end of 2006. So that we're ready for Terminal 5. And we're very clear about that and we've been very clear with the TUs about that.

In summary, Terminal 5 is the future for the airport. It's a huge opportunity for us. And we are determined to use it as a catalyst for change. A catalyst to improve the customer experience that we offer. A catalyst for improving our efficiency in terms of our aircraft operations and finally and most importantly, a catalyst for driving new and efficient ways of working throughout the Heathrow environment. The clock's already ticking but our focus is very much on getting Fit for 5.

Thank you very much. And I'd now like to introduce you to Simon Parks-Smith. He's going to talk you through some of our plans for investing in the customer experience.

(Video Clip)

Simon Parks-Smith - ***British Airways - Head of Product Management***

Good morning everybody. That's the video that we show to all of our customers on board at the moment. It shows a lot of the steps we're doing on BA.com.. Particularly I like the end of it, remember the days when you couldn't book online? And it reminds me that we get very complacent about these things and we think, oh yes, the world has been using the Internet for ages.

But actually the truth of it is that 2 or 3 years ago, when BA really seriously embarked on this Internet mission, there was a lot of doubt. We weren't sure, we'd been through 2 or 3 years of intense change as an airline and also on our website.

Over these 2 or 3 years, we worked to remove the complexity and legacy we'd been left with. We had too many systems, too many rules, too many policies. None of them talked to each other, none of them worked for us and worst off all none of them were designed for our customs.

But we've been good over that time in steadily and surely putting our customers in control. And that also caused quite a big debate. Do customers want control or do customers want service. Truth is the customers want both.. Customers want to be in control and customers want service once in a while.

What we've been doing at British Airways is making things easy for the customers. We've been out there redesigning our systems, redesigning our processes, redesigning the rules that sit behind all of it to make things easy. Our aim was to make things so easy that people could choose to do things themselves. That's exactly what we've done.

And in doing that, we have delivered the target that we promised to you 2 years ago. One hundred million pounds of benefit to the bottom line of British Airways. We said we would achieve an annualized run rate of 100 million by the end of this financial and with under 1 months to go, I'm pleased to say that we're on track to beat that 100 million pounds.

And better still, we've done it with an investment of 42 million pounds against our original suggestion of over 50. Where has that come from? It's come from reduced distribution costs. It's come from reduced manpower costs. We have significantly less people in our call centers. In the last year alone, we have taken 400 people out of our call centers. And the next year we will take another 400 out. You know that we closed our Glasgow call center. We've also announced call center closures again in the U.K., London, in Japan, in Sweden, in Italy.

These days almost a third of our customers use BA.com for their flight. Our vision is that every customer will use BA.com for their flight. BA.com will be the first stage of their journey. And by the time they get into Terminal 5, many of the things that people are currently used to doing in the Airport, they will do even before they even leave home. The airport is not a great environment for the hassle and the stress of those experiences.

Actually there are a lot of processes that we ask people to do and they don't even want to know that they are there. They want them to be invisible. Nobody gets up on the first day of their holidays thinking I'm really looking forward to the check in. It's not the part of the journey you're looking forward to. Our job is to make those processes invisible to the customers. They will just get through them and get on to the flight.

You can see that over the last 2 or 3 years, we've had a steady growth in bookings on BA.com but underlying that blue segment there is a very dramatic growth in the target market. There has really been a transformation of short-haul leisure booking.

And just about now, 55 almost 60% of our short-haul major bookings in the UK are made on BA.com. And that growth has been transferred from our call centers, being transferred from the trade. Right now direct bookings coming into British Airways, 4 out of every 5 are made on BA.com. Our call centers are no longer generating large numbers of bookings. Our call centers are servicing existing bookings. And that's where our focus is now. You can see on the top there in the yellow side, the servicing aspects of BA.com is growing very, very fast. So we're investing in the last and next year take those servicing calls out of the call centers.

We promised, as well 2 years ago, to make record progress with e-ticket I'm delighted to say we've made more progress with e-ticket than any other carrier outside the U.S. We have the highest proportion of e-ticket than any non U.S. carrier. We are currently sitting at 71% e-ticket. We will certainly hit the high 70's by the end of this financial month.

One of the myths that have been laid rest over the years is that people didn't want e-ticket. At the beginning of this journe,y we had quite a big debate about whether people wanted e-ticket or not. And figures have demonstrated that. For all the e-tickets that were available to any journey where you could have an e-ticket in the U.K,98% of people choose e-ticket. I think that pretty much proves the case.

An e-ticket is something you can't lose, an e-ticket is something you can't forget, you don't need to pick up. An e-ticket is something you don't need a degree in travel distribution to understand. Very, very successful for our customers and as you'll see from the rest of the presentation something that has laid the groundwork for many of the other benefits and savings we've been making over the last 2 years..

Where we really start to make benefits is where we introduced processes, introduced action that never touches the side, never touches human hands, things that do not add any value to customers.

And in the U.K. now, of our direct customers three out every four of our direct customers given e-tickets get them delivered to them instantly by email. No human intervention at all. Two years ago, we used to have a room in Newcastle with 80 people in it printing and sticking it in an envelope.

Probably the leadership area of our website has been the Executive Club. And again this put the myth to rest that Business Class, First Class won't want to use the website. Our frequent travelers are our most adamant users of the website. Our top gold passengers are using our website at least once a week. Once a week they're using BA.com. They're checking their balance; they're using BA.com for service, they're booking, they're checking in.

We promised by the end of this year, 80% of all of our Executive Club transactions would be online and we're 77% in January. And we're very confident that we'll be over 80% by the end of this year Another target that we will deliver.

In a year's time, we'll deliver 90% and we'll be on the edge of an all online Executive Club. You can join the Executive Club on BA.com right now, straight away you get used to the web site, you can check your miles, we don't send out statements anymore.

Rod talked earlier about our campaign for simplification and mentioned reductions in fares. We talked to you last year about our drive to cut out at least half of the fares we're doing. In fact, we've gone much further than that. So, we've cut out two-thirds of the fares that we had at British Airways. And importantly whittled all of our varying types of fares down to 3 basic types of flexibility. Fares that you can always change. Fares that you can never change and fares that you can change for a fee.

We've made those types of flexibility standard throughout the world and we have attached them rigorously to selling class. And that enables us to do a couple of things. Firstly as Rod said earlier, it allows us to sell more tickets on the website because we can put those confidently in front of customers and automate them easily.

Secondly, it has allowed us to do some things that no other airline is doing at the moment. That is what we call upselling. It is allowing the site to tell customers as soon as we give them a fare quote exactly what they're buying for that fare quote. We know enough about the customer to tell them the important parts of their tariff. If some of their fare quote includes an infant, we should be telling them that we are one of the airlines that offers milk warming on long-haul flights and free cots for infants.

On the retail then, it seems a bit strange that we've only just got to the stage of telling them what they are buying. But we are one of the only airlines to do this on the web. The important thing is we also tell people what they could get if they paid a bit more. If they either traded up the cabin or traded up in flexibility, exactly what it would cost. And the Exec Club points with that. Would you could get lounge access, would you get power for your seat for your laptop. And we're finding a surprising number of people are trading up.

Of course it is early days yet. But what we see across the website in the early months, is a 1.5 point lift in yield due to this. That's 1.5% improvement essentially in profit line straightaway from upselling.

And what we're doing now is to introducing similar levels to make those trade-ups more attractive. So there is a lot of experimentation going on as we start to understand when do people say yes to the trade-up and when do they say no.

Again, because we put the hard shoulder work into simplifying fares, and it was hard work, we are the first airline in the world to be able to offer change bookings on the website for any kind of booking. If you make a booking from your travel agent, you can change it on BA.com. Why would we do that? Because currently people call our call centers and ask us to change their ticket. They're actually calling British Airways and asking for a travel agent booking change. We're the first airline to change any bookings online. And we've done that because we've simplified our fares.

And not only can people change but at the same we offer them the chance to upgrade of course. We make sure they've got an Exec Club number, we make sure we've got their email address. Email address is very, very important to us in driving contact with BA. Our aim is to hold email addresses for everybody. Currently for people who book directly we've got about 85% coverage of email addresses. And for the total airline population, for everyone that flies on BA roughly one in two email addresses.

And that is driving a revolution in the way we handle disruption. Disruption in the aviation business is unfortunately inevitable. What BA can do to make that better for our customers is improve the way we handle disruption. And what we're now doing is along with our colleagues at the airport who are planning changes to flights much earlier, we are getting much better at notifying. We let people know what happened to their flight before they leave home. We send the messages by email. We send the messages by text.

In the last week, we sent out 25,000 messages on some kind of schedule change, either a short-term disruption change or a longer-term your flight has been retimed by one hour. Of that 25,000 of them, high 80% almost 90% was received effectively. And we let people know earlier.

And of course because ba.com's got ability to change bookings, we can now change the bookings. We can invite them to come to the website and change their bookings to sort the problem out before they get to the airport. Our vision is never again to have a long queue at check in. Because this step we can fix before they even get to the airport.

Probably one of the fastest growing parts of the travel industry now is online packaging. The other main players in the online travel business, all of the main online distributor's, Expedia, Travelocity, are all pursuing packaging.

The reason they're doing that is twofold. Firstly, customers want to be able to choose an entire holiday online. And secondly, the margins that you can make out of the other elements of the package are richer. In July, we're releasing our first wave of online packaging. The ability for people to build a holiday in one go. Hotels, cars, tours, flights and pay for it with one credit card transaction. We anticipate to make a significant uplift in the number of ancillaries we make.

I hope that some of you will have already experienced online boarding passes. You know now that they are available in about 30 airports around the world. For practically all of domestic travel in and out of Heathrow you can use an online boarding pass. You print it at home. You go straight to security. They scan it as shown in the picture in a little scanner and you go through the gate. No chaos, no desk, straight to the gate. If you got a bag to drop off, you drop it off at the fast bag drop.

As seen by the experience of those carriers in the States who have adopted this, it is very much the future. You can already see people converting to it very rapidly. It's the fastest growing channel of check in by a long way.

We aim to roll out to all European stations and in and out of Heathrow this summer. And furthermore we are going to start doing something BA has not done before and significantly upgrade our advertising communication around the online experience, around the check in experience and particularly around our hero product - online check in. And we'll be going on TV with this in the early summer.

At the same time, we refreshed, renewed, upgraded every single one of our 209 kiosks worldwide. We have another 40 kiosks set to roll out this year. We have upgraded the application on the kiosks so that people can check in together. A critical part that was missing in the old days, in a kiosk. If you'd noticed, if you were traveling in group of 2 or 3, you essentially had to stand next to each other at one kiosk and simultaneously check in to get seats next to each other. Really haphazard. Not ideally set to the standards we've set. So now we're going to change this so you can check in one transaction as you saw in the slide.

Use of kiosks globally is at 25%. And this is proving difficult to change in the airports but the good news is we've shown it can be done. We have a number of airports in the U.K., in Europe, long-haul airports that regularly demonstrate that you can get 30%, 40%, 50% self service check if you want.

Of course BA needs to demonstrate its leadership in innovation in its core products as well. In the last 2 years the focus of our investments has been on BA.com. As I said we have invested £40 odd million in the last 2 years on BA.com.

Focus of our investments in the next 2 years in our core product areas is our premium passengers. Club World beds have been fantastically successful and has given us true market leadership, and have grown our share on our Atlantic route. And these were enhanced in the last year by the introduction of the sleeper product. A fantastic product really giving an extra oomph to flat bed.

We're now in a position where our competitors are starting to catch up. This is of course like any product life cycle, BA takes leadership, competitors copy. We're working on right now the next generation of those flat beds. I've seen the first models, they are absolutely superb.

Of course, that means that we'll keep the attention on first class as well. First class performs two very important roles for us It generates quality high yield business, and is also an aspirational products. And many of our business class passengers are buying into it as well. So we're refreshing our business, our first class products over the next 2 years.

And not to forget short-haul. Rod's earlier described the difficulties we had with short-haul, the success we've had in improving it, that we are getting it to the breakeven point We need to make that better than that. We need to make it into a sustainable business. We need to redefine the short-haul experience so that we can regain the market leadership in short-haul service in the U.K. BA sells to a number of distinct and important segments of short-haul travelers. It sells to people who value the exclusivity, the space, the savings of time that they currently get from Club World. Very profitable passengers.

It sells to a large community of business travelers who fly in economy but want to maximize the time that they can work and want to retain the flexibility of their ticket. And of course we sell to people who value good quality travel and want the cheapest flight they can get.

They are 3 very different communities. Each of them deliver an important part in the profitability for Europe And our challenge is to reform our offerings so that we have leadership for those 3 markets.

I hope that you see the link between David's presentation and mine. Our ambition is to have simpler, consistent products that work every time. A future that built on self-service, a future where progress through airport is well prepared , and therefore fast and smooth. We have a regeneration of lounge use that will again set a new benchmark for airline lounges worldwide.

So, in summary. We promised you a 2-year program of change. And that finishes at the end of this month. It is delivering its main goals, critically it has added £100 million to British Airways bottom line. But at the end of the investment, the strategy enabling this airline for customers to use continues and that will generate continued investment in BA.com

We will continue to innovate and show leadership in our main core market products. And if we get this right, we will have a smooth entry coming into T5.

Thank you very much.

George Stinnes

Well, I'm sure everyone's ready for the coffee break. But a couple of quick announcements to remind those 6 of you who've booked to see non-execs move quickly to the front corner where Ceinwen will help you to the rooms. And the three people who haven't collected boarding cards for Cardiff yet if you could also make your way to the help desk in the foyer and if any of you've changed your minds, please go ahead to that desk as well.

Lastly we've got feedback forms for you all in your packs. As we get through the end of day, we're going to be rushing off to the buses to go to Cardiff, you might want to take the opportunity of the break to make notes on the morning session.

With that, a short coffee stop. And I would ask if you can all be back again, in 10 minutes, if possible. Thanks very much.

(Break)

George Stinnes

Hi everybody. We welcome you back again. For those of you who got back on time, to be able to see the video, which is shown internally to our staff and the key theme behind it is it's often forgotten that of course, we do all work for the same company. We're all the same team and we all have a very important role to play so it's not just the pilots who put up an aeroplane, it's the cabin crew, it's the engineers, it's everybody. We're all in this together. And that's clearly what that video is meant to show.

Now what you've all be waiting for, the excitement of the financial things, starting off by the riveting topic of International Accounting Standards. It's the follow-up to the presentation which we did as a couple of seminars -- we did earlier this year, a little bit of an update. You'll not be surprised if all is not yet clear. But then it never is in accounting. However, it's obviously a very important topic.

And my own crystal view in the investor relations side is that most people in the investment community and of course you can point to yourself and say that's not me, actually, really don't appreciate the significance of the changes. This is a really great speed train coming down the track at great speed. And it will affect all the measures, all the ratios, everything that we've historically learned to adopt and love.

So it is actually a very critical topic. And I think that's underestimated as indeed even I had a bit of levity of that. I'll come back towards the end with some logistics to make sure you all get on the right buses this afternoon. Stellan.

Stellan Werling *- British Airways - Head of Corporate Finance*

Keith Williams – Group Treasurer & Head of Tax

The last 4 years between 2001 and 2005 have been about repairing the balance sheet. And we've been doing that in a very difficult time. I'll show you what progress we've made to date.

However against that progress we recognize that the financial world has changed. Financing world for the airlines has changed and the financing world for BA has changed, maybe forever.

From there we will look at our finance for the next 4 years.

But looking firstly at 2001- 2005 our priorities were actually quite easy. Like most airlines, we needed a healthy cash balance and we needed to reduce our debts, which were around £6.6 billion at the time of the events of September the 11th. We also needed to increase our financial flexibility going forward. We realized we were going to go through turbulent times and to withstand that we needed a healthy balance sheet and a good cash flow.

In terms of cash as most of you know after September the 11th we carried cash balances at around £2 billion. It was only about 3 or 4 months ago as we indicated to you that we would start to reduce our cash balance. At the end of this year we expect it to come in at around £1.5 billion.

Reducing our debt, which as I said had reached £6.6 billion was also a priority and and we've been reducing it steadily. Around 2 years ago Rod talked about getting much more comfortable if the net debt balance is down at 3 billion pounds. I'm pleased to say that at this year end we should be at there or there abouts at the 3 billion level.

In terms of improving our financial flexibility- a key to fixing that has been our cash flow. In the mid to late 90's as we invested heavily in new fleets and in property assets we ran a negative cash balance for 5 consecutive years. It turned around very slightly in 2002 and over the last 3 years has generated around £3 billion in cash flow. This year the cashflow should exceed a billion pounds, 2 years ago we had cash flow of a billion pounds, and that's been important to giving us financial flexibility.

With that we've been able to reduce our net debt. Apparently I'm known in some quarters of the city as being the terminator, representative of the amount of debt that we've repaid over the last year!

You can see that this year in total, we will have repaid at least £1.3 billion in debt. That's 20% of our total net debt. The debt repaid is being focused, it's being focused around three things -- repaying short term expensive debt, repaying debt which gives us currency advantage. (we took out some loans when the Yen was 140 against Sterling then it leads to 100 against Sterling when we started repaying Yen debt which you could say is at a 40% currency benefit in doing that). And thirdly we've been targeting our debt repayment to bring in tax depreciation going forward. I'll talk about tax position in a few minutes.

With that amount of debt repayment, it has significantly altered the profile of our repayments going forward. If you look at the repayment profile for the next 6 years you'll see that we average around £460 million a year. That is substantially down from where we were 3 years ago. 3 years ago our debt repayment averaged almost £600 million a year. Averaging today at £460 million brings lots more comfort in our financing position going forward.

Not only that, the debt repayment brings flexibility on the fleet -- if we've looked at the fleet back in 3 years ago, almost all our aircraft were encumbered with the exception of Concorde. Today 70 of our fleet are unencumbered, that's free from mortgage and owned outright. We've got a much better mix around the fleet.

Despite all our progress, we recognize the world in which we operate has changed. In 1996, we ruled the world with an A grade credit rating. Along with almost all the other airlines in the world, our credit rating has fallen. Despite the progress we have made, our credit rating today is junk bond status. That hasn't mattered in the short-term. We didn't have any financing that was triggered by the fact that we became sub investment grade. Our own position is not unusual. if you look around the world.

This chart looks at the top 25 airlines in the world and what happened to those in the last 3 years. The results all look similar in each of the continents. Everyone wanted to put more cash onto the balance sheet.

And they've done it by increasing their debt levels. In the US they have $25 billion as additional debt in 3 years. And that would appear to have happened at a time when most have been sub investment rate. In Europe, the story is similar but the debt increase is much smaller. Now bear in mind that we're in those figures in Europe. But actually we're going against the trends. We are one of the very few airlines that reduced debt in the 3-year period. You can see, if we had been taken out, then Europe would look like the rest of the world?

Rod spoke earlier about First to Worst at first and what happened to our operating cost. You can see that we have turned around the operating profit over the period. And similarly our debt levels. In 1996, we had net debts of 3.7 billion. The net debt peaked in December '01 at 6.6 billion, and it's been steadily coming down by a total of 3.4 billion to 3.2 billion at Dec 04 and it will fall further to around 3 billion by March '05.

If you look at what happened to the credit rating, we had 4 downgrades in that period. Credit ratings clearly haven't matched the operations improvements.

The reason for this is probably reflected in the nature of the net debt reduction. If we look at the reduction of the net debt reduction it is reduced by 3.2 billion. Now if you look at all that's achieved, almost exactly half of it is in disposals, exchange profit and the other half is free cash flow in the business. Cash flow in the business for over 3 years, has averaged just under £600 million.

But that £600 million is in a period we already have relatively low cash flow expenditure. And we have had no tax payments. Going forward, looking forward to the next 4 years the debt should continuously reduce. We've got very low levels of capital expenditure.

In terms of CapEx, our aircraft deliveries is minimal. We took delivery of 6 aircraft this year. Some of those were actually bought for cash. If you look at next year, we have one delivery. And unprecedented we have none in the year after. And only 5 in 3 years time. That's the extent of our deliveries.

However there are two factors which will slow the rates of reduction in the debt. The first is that we've got no planned disposals. And disposals contributed largely to the reduction so far. And secondly we have to start paying taxes.

Turning to taxes, one of the consequences of investing heavily in the mid 90's -- is that we didn't pay any significant taxes. Aircraft qualify for 25% tax depreciation, with an offset to taxes. In the period 1996 through to 2004 we've actually generated £1.8 billion profit. And we've actually disposed off £2.5 billion of assets over that 8-year period.

The tax position is made up of follows. The largest element is Advance Corporation Tax. We actually paid £93 million Advance Corporation Tax in 1998. And I actually call that a voluntary tax because it is paid on the dividend and we pay that advance corporation tax on the dividend. And then exceedingly you're paying tax, It is a down payment against what corporation tax you pay. So if you're paying tax, the Advance Corporation Tax is recoverable. As we had no taxable profit we've got £93 million that's currently sitting with the government effectively for the interest free loan. We will recover that, we will get a repayment for that 93 million as and when we make taxable profits in the future.

The remaining tax that has been paid in that period is £70 million principally Corporate taxes paid overseas and that brought our effective cash tax rate throughout that period to 9%.

Now for those of you who follow tax and in particular note 29, of the accounts, will have been fully aware that, as a consequence of spending a lot of money on equipment, this had the effect of not only did we not pay any substantial taxes but we also ended up with substantial tax losses.

For the observant, if you look at note 29 of this account, you see that the tax losses has been reducing. And this year they will even reduce further. At some stage we might expect that we will be paying taxes.

We've got no significant Capital Ex, but we have been improving our tax position by buying in assets from our debt reduction programme and this has created tax deductions.

If you add it all up, at the end of this year we will finish up with some tax losses, carry forward, that where you would expect would be wholly utilized next year. Next year for the first time in 8 years we expect a corporation tax payment. The rate of tax is difficult to predict without knowing the profit, I can't tell what tax is – it would be the cart before the horse. But what I'd expect of this is that we would expect it to be higher than the 9%, which has been our average rate over the last few years and then it would increase thereafter. The requirement to pay taxes will slow down the rate in which we're retiring and reducing our debt.

So to summarize, we have made good progress between 2001 and 2005. We will continue to make steady progress on debt reduction. The cash flow that we expect to generate will be sufficient to finance the assets that we need to finance over the next few years. But if we're looking out to the future and we want to invest significantly in the aircraft, product and people, we need to generate that 10% operating margin. It will be that achievement, that pushes up the £600 million cash flow each year and it will be that, which will enable us to invest in the future. Thank you.

John Rishton – Chief financial officier

Thanks, Keith. Good morning, everybody. Here we go again. I'm going to take you through a little bit of history about where we've been, what's going on, where things are going to go for the balance of this financial year and what we see out in the future the next year.

Let's talk about, 2004 - 05, the revenue environment has remained difficult. Turnover is well below 3 years ago. Any improvement is driven by volume not by yield.

Fuel remains at record levels.

You all know that we've exceeded our Future size and shape targets. And we are absolutely on track to deliver £450 million of further cost savings that we talked about 2 years ago. Some 100 million of that from our ceBA programme, another £300 million from external spend and £50 million from other programs. So we are on track to deliver that.

The cost saving programs continue. And we've done a pretty good job I would say as we are driving our costs down over the, over course of the year. But a tough year nevertheless.

Here's a chart from the association with European airlines. It just shows the history going back to 1996, it's traffic. Traffic grew at a constant steady rates through 2001. After 9/11 traffic recovered more strongly than what most people expected it to. And then we were hit by the Gulf War, SARS, those kind of things. And then it's recovered again pretty strongly.

And at British Airways, we've seen a similar pattern. We’ve seen our seat factors improving over the last 4 years, and these are the Q3 numbers.

And if you look at the full year numbers, you'd see a similar kind of pattern, a similar growth in seat factors - our traffic numbers have gone up. On the other side of the equation, which many people tend to forget about, is our yield. If we go back to the history, yields have declined, yields have declined by 3% to 3.5% per annum up to around 2001. And then the rate of decline increased to around 10% - 11%. As you know, partly due to a number of low cost carriers coming along.

Again no surprise there. In British airways we've seen a similar pattern, using the Q3 numbers.

Now, let's take a moment out to read an e-mail that I got this time last year. I think that I got it a day after I stood here last year, and it criticizes me for giving negative yield guidance, is was difficult to believe then. But it has been going down. You've all seen it.

This time last year, I think most people in this room were surprised and a little bit disappointed on the guidance that we gave on yields for this year. We said that they would fall and unfortunately, we were right. They have fallen through the course of this year.

So to sum it all up. Volume is what's driving revenues. Yields remain weak. And that's meant for us that revenue has declined significantly from the peak. In 2000-2001 we had revenues well over 9 billion, today they are 20% lower. But for the first time in many years, we've some improvement. And we still believe the guidance we gave you just a month or so ago in Q3, that revenue will increase this year in total by 3% to 3.5%.

Market share is actually increasing; in the declining buckets of revenue we're getting more of it and these are a couple of the statistics. In the premium area of Europe our share has gone up, and in club world our share has gone up. So the sales guys are actually doing a terrific job in getting more customers. But nevertheless in spite of that tremendous effort revenue's fallen in the last 3 or 4 years and is increasing only gradually this year.

Let me turn now to costs. This chart attempts to show by way of reference all the cost categories that you are familiar with. We use it quite a lot. The costs in green are where we are competitive, amber where we are neutral and red where we are not competitive.

So If I pick a few of the things that are in a competitive position – we've got a modern efficient fleet, but fuel is a heavy hit to our bottom line but the prices we pay are similar to our competitors. We are competitive on fuel. Fuels cost of the industry are a real issue but we're competitive on fuel. Our selling cost. We've reduced our selling costs significantly, significantly over the last 3 or 4 years. I certainly compare us to other network carriers as competitive. Versus no frills we still have some work to do.

We need to cut the depreciation charge, Rod talked about the fact we have too many assets and that continues to lay a burden on the organization. Aircraft leasing, is a mixed bag. Some of our leases are not up-to-date. Not competitive, because they are older. I think the area where we stand apart from all the competitors is employee costs. The biggest cost that we have in this area where we are least competitive.

For that reason we set up the target of £300 million further employee cost reduction on top of the 13,000 reduction that we previously delivered- just to put in perspective, well over 20% reduction in our manpower. But its still an issue in our opinion and we will deliver the £300 million cost savings by March 2007.

The reason for the delay is the fact that the pay negotiations that we had took longer than we originally hoped. But the good news out of it was that we managed for the first time to deliver a 3 year pay deal which gives us the opportunity to make the working practice changes that we need to do because whenever you're going through a pay discussion everything else is pushed to one side.

So the opportunities that David Noyes was talking to you about in T5 earlier today, is key to delivering the £300 million. But it's not just at Heathrow, it's the cost of the entire airline. But we will deliver £300 million of savings. And employee costs will then become more competitive if not completely competitive.

So the selling cost, in 95/96 as a percentage of revenue was 17%. This year it will be less than 7%. In terms of money, we've reduced our selling costs from £1.2 billion to around £500 million a year. And we continue to look for further ways to reduce costs. We've recently announced the commission cost in the U.K will be reduced to 0%.

Simon talked to you about the success that we've been having with the ceBA programme, the demand for online selling continues to help reduce that selling cost, continues to improve our efficiency and our effectiveness and is welcomed by the customers.

This graphs shows fuels in terms of ATKs, you will notice that this year is very high and the guidance I have given to you just recently, we expect to increase total fuel cost. We forecast £245 million increase compared to last year. I think now as we get closer to the end of the year, it'll be slightly better than that, nearly £20 million better than that reflecting the actual hedging that we've taken and the shift in the exchange rate from the dollar that we've seen.

Shorthaul made steady progress. The legacy of Future Size and Shape lives on. Simplification is key and has helped improve the efficiency of the organization and in almost all cases everywhere I have seen it improves customer service. So it's a win, win, win. We will continue to simplify our business.

There are several factors in the £450 million savings. We're in good shape and on track for delivery by the end of March.

Revenue. Our revenue guidance remains unchanged at 3.0-3.5% up for the full year, which means that Q4 will be up versus last year. Just to put it in perspective, you may remember, if you look back at last year's Q4, we actually had £35 million of one off revenue related items in Q4 last year reflecting change in systems.

Also let me mention the Employee Reward Program.

We launched an Employee Reward Program for all the employees in the organization in the beginning of this financial year. And that focus was centered on one target and that target was around operating margin. It is aligned to driving improvements in the operating margins as we work towards our 10% operating margin target.

The trigger for this year was 6% and at 6% the figure paid is one week's pay or £500. That 6% is after adding the program. On the cost of the program figure would be about half a point, about £40 million.

If we meet the target the full cost of the program will be taken in the fourth quarter. We have not yet set the target for next, but their will be a new target. I just wanted to remind everybody that this program existed.

If I look out now to 2005 -2006, first lets take a look at some traffic slides. This shows long-haul premium RPKs and this year is the bold yellow line with a square.

What you can see as we go through the year, is that long-haul premium volumes have been getting closer and closer to the top red line which was a robust year in 2000-2001. The volumes are coming back.

But as those volumes come back and at some point, and we are not seeing it at the moment, but at some point we would expect to see some pricing power. We are not seeing it at the moment. But as the volume continues to improve, at some point in time, it’s a balance between volume and price, but not yet.

If we look at the same chart for Longhaul non-premium, again you’ve got the bold yellow line with a square and, right up here now, and exceeding volumes 4 years ago, and we are seeing that the planes are very, very full.

Shorthaul non-premium, again as you would expect in this case, the yellow one is this year which is the top line which I think really reflects the success of our Evesham programme.

We can drive the volume at all times in the current market. For all products yield remains under quite significant pressure. At least you say we have reduced capacity as we began to say earlier, significantly over this past period, but we are still driving, significant volumes.

Shorthaul non-premium volumes have actually just edged up above the bottom in the last month or so. Maybe we are seeing some stabilizing of volumes here but we are clearly well below where we were.

If I look into 2005-2006, the outlook is for modest capacity growth. We have got one aircraft delivery, an A321, next year, and expect growth of some 3% in ASKs reflecting increased utilization of aircraft.

We have seen strong seat factors over recent months and we expect this to continue next year.

We expect yields to be about flat next year compared to the negative that we have seen for the last few years.

So in total we see revenues increasing next year, about 3% to 4%. So we continue to see a modest gradual recovery of revenues - for this year 3-3.5% and 3 to 4% next year.

In terms of cost, if I go back to my aircraft, with the exception of fuel, we expect costs will be about flat versus this year. Fuel is the major cost issue for us and I think the industry next year.

The cost of fuel is up 75% since early December 2003. Today we are looking at about $50 to $53 per barrel. And despite our hedging position, which is pretty good, fairly competitive – we are looking at significant increases in the cost to the business.

We are 50% to 60% hedged for the remainder of the calendar year 05 at around $37 – a pretty strong position. Despite that I think that our fuel cost for next year will be up about £300 million.

Now this time last year, I think my revenue forecast was pretty accurate and my fuel forecast was pretty inaccurate. It has remained at a higher cost across the year than anybody expected.

Capital expenditure, in this year, the year ending March 2005, we will spend less than £400 million on CapEx. Next year we will spend roughly £400 million again, not much on aircraft, some money on product, some money on T5 as well as the usual things going on. But CapEx remains low, £1.5 billion -- in 2001, a billion in 2002, less than 400 million for the last four years. CapEx remains low for the future.

In summary. Three main areas of our focus for the business plan, Fit for 5, David had talked to you about that, Its absolutely essential for British airways that we get for Fit for 5.

Investing in our products and our people. It is time that we invest in our products and people, we can only do that if we can build up a competitive cost base.

We focused on costs with a passion over the last 3 years and that will continue. We must make sure that we are cost competitive in other areas.

05/06, modest revenue growth, 3 to 4% and for fuel we estimate the cost net of hedging up about £300 million.

Financial target remains 10%, as Keith has so well explained. We absolutely have to get 10% and everybody in British Airways is working towards that.

Thanks very much, indeed. Thanks for coming this morning.