Investor Day
12 March 2003

Introduction

George Stinnes
Head of Investor Relations

Welcome to our annual Investor Day

Today is the day for you to meet many of our senior people who you only see at this event. For the rest of the year, you see Rod, John and me quite frequently. We bring them all out today so that you can meet them. You can appreciate we have a strong team, but the rest of the year we leave them to run the business which is the job that they are primarily here with us for.

In my time at BA, which includes something like 12 years, not just five in this role, because I still fly airplanes for BA on the odd occasion, I have never seen so much change happen so quickly, and in such a short time as we have now.

Let us walk through today's agenda. It runs into five parts. The first part, Lord Marshall is going to give us a good backdrop to the difficult times that we are in. The next part we will review with you those aspects that we talked about last night, namely, future size and shape, how we have done in the year, and also Ray will talk to you about the revenue development, i.e. those things that we do not control around us.

The second part is reminding you of the framework into which all our actions fit and some of the key initiatives that we have planned over the next period of time. Third part is lunch. Lunch is not just to feed you, but is also the opportunity for you to meet individual managers, senior managers in the firm. They are split around the tables, and if you look at the name badges, you will see what their expertise is, and you will have a chance to talk and ask them questions.

Finally, we have a tour set up, unfortunately not for all of you, because we cannot accommodate the large number that we have here, at our operations centre, called Compass Centre, where you will be able to see how the operational management of the business and the airline runs. It is a very good tour. The good news is that I have one or two spare seats, I will know how many by the coffee break. Then if anyone who is currently down to do would like to go, they can let me know.

One year on. A lot has happened. I am going to buzz you through some of the highlights.

We said a year ago that we were going to change our short haul proposition. In simple terms, in one year, we have put together a new booking engine. This is the beginning of its produce life cycle, not the end, and you will hear more on this. We have put new fares on 180 routes. We have advertised and promoted those fares, and as a result of all that, we have seen our seat factors rise every month since we last met year in the short haul side, and also we have seen our online bookings in that segment of the business more than double. It is amazing how we have put together a new airline business within the framework of an existing airline.

We talked to you about fleet. We said capacity down by 2004 - this is 12 months from today – of 9%. We are in at 7% so far.

Gatwick capacity. We got that one wrong. We have taken out more than we said we would, sorry!

Destinations down 11%. Again, a long way towards next year's target.

Aircraft, a long way towards next year's target. Aircraft sub-types, a long way towards next year's target. Short haul utilisation – long way towards next year's target. Things are going on.

What about simplification? Essentially, big network carriers like ours are not the ideal starting point, and we have a lot of work to do in terms of making ourselves fit for the long term future of a network airline business.

The good news is that we are running down that road, I believe, faster than any body else. One or two examples: Exec Club. We have just launched a new Exec Club. It is so complicated, I cannot even remember how complicated it was, but I think it was 22,000 rules, three IT platforms and five clubs, all into one. Launch has happened and becomes effective on 1 July.

Gatwick Fleets. We have gone from seven aircraft type down to two, or it will be two by the end of the summer.

Flight manuals. I am a pilot, as you know. When I joined BA, you got a flying a manual, how to fly airplanes. We used to write our own manuals. Boeing used to send us the manufacturer's book, but of course BA thought 'we need to make this a BA manual', so we would rewrite it. You have no idea how much time and effort goes into that, because you have to make sure you get it right.

The same thing we said last year in engineering. We would go to standard manufacturers maintenance processes, rather than those that we thought were better. There are huge simplifications on all these things.

Our pilot deal is very important to a pilot. Things like cheese trays. You have often heard us joke about cheese trays for pilots, but all these complexities of agreement. We used to get meal allowances every time. It is not as if they were served a standard lunch allowance of £3, £4 or £5. Oh no, we had to have a different meal allowance for every single city in our network, for every single meal that we served. Gone! We have one payment now. This is called simplification action, and it is moving really quickly.

So what is today about? Today, for me personally, is to demonstrate to you that British Airways is adapting to the environment, that we have sensible but stretching plans for our company, and indeed, that we have a management team led by Rod that is absolutely delivering all the plans that we bring forward to you.

It is your day, please enjoy it. I now leave the podium to Lord Marshall.

FUTURE SIZE AND SHAPE – YEAR 1
John Rishton
Chief Financial Officer

[*Presentation with slides*]

Good morning, it is lovely to see you all here today. I look forward to taking you through a couple of things this morning. For my sins, I have two slots so I cannot relax after I have got through this one.

The first part I shall take you through is where we are in terms of Future Size and Shape, how we are getting on with it, and the second part is looking a little more into the future, and I shall come back at the end of the morning to discuss that.

This time last year, we told you about Future Size and Shape for the first time and we said it was about profitability, simplification, competing with the no-frills carriers and manpower reduction. Where are we in terms of those targets?

Profitability: we said we were going to drive profitability, we were striving to achieve a 10% operating margin which I am sure you will all remember is our proxy internally for positive CVA. So our real financial target is about driving positive CVA but we use internally a 10% operating margin, which is something we have found much easier to communicate and much more understandable to the people of British Airways. We were going to drive that to cost reduction and we said we would drive £650 million of cost reduction over a two-year period. We said we would drive it through simplification of our business and George has already given you a number of examples whereby, throughout the entire business, we are simplifying what we do and how we do it. I believe that we are only just starting to reap some of the benefits of that simplification. The simplification benefits I believe are much greater than we believe them to be, even as we stand here today, and I am optimistic that that will help us more and more into the future.

We have completely changed the way in which we are competing with the no-frills. We have gone through a number of phases as you are all aware. We have gone through a denial phase, we have gone through a "let's set up our own no-frills" phase, and it is interesting to see a number of other carriers going through similar phases. I wonder how they will fare. We concluded that we needed to restructure our business. As you know, we have been simplifying the fleet for many years and we are now clear about on which destinations we should compete with the no-frills carriers and on which destinations we should not.

We have changed our web bookings so that we probably now have the best front-end web booking engine in the business. We have also changed our pricing model, which has been a major change for British Airways. It is much simpler, much more understandable and with the no-frills carriers competing in a similar way and our front-end website, we now have a proposition which people can understand, use and which really helps us to compete.

Finally, as you have seen and as you saw again this morning, we have changed the emphasis of our advertising. By bringing all of those aspects together, we now have a competitive package against the no-frills carriers. We also said that we would significantly reduce our manpower. We recognised that we had far too many people in the business and that we needed to reduce the number. That is what we said a year ago and I know many of you said, "That is interesting, we will see". Therefore, let us see where we are.

This slide shows where we are up to in our targets. The first column shows what we wanted to achieve by the end of this financial year, so March 2003. This column shows the year-end March 2004 target. Future Size and Shape is a two-year programme and we are one year into it, so only half-way through at the moment.

We said we would reduce our manpower by 10,000 by the end of this financial year. At the end of January, we are at 9,619 so I am pretty confident that we will get to the 10,000 on the way to the figure of 13,000 next year. Manpower cost savings driven by those manpower reductions: the target is £350 million run rate for this year; we are at £335 million. Therefore, I am confident that we will achieve or beat the target on that, on our way to £450 million next year. Distribution cost savings: we set ourselves the target of £45 million on the way to £100 million, and we are already at £55 million at the end of December, so we are already in excess of where we thought we would be with three months of the year to go.

Procurement and IT savings: £52 million against a target of £55 million, again on the way to £100 million. So we are in very good shape on the manpower and in very good shape on the cost savings. The total cost savings run rate was £450 million and we are at £442 million already on our way to the £650 million we promised you a year ago.

In terms of disposals, you will remember that we said we would make £900 million of disposals over the two years: £500 million in the first year and £400 million in the second year. By the end of December, we were at £570 million worth of disposals, so well in excess of the £500 million disposal target that we set ourselves. Therefore, as far as the simple numbers, we seem to be doing pretty well.

Let us look in a little more detail at the manpower reductions, which are a core part of the Future Size and Shape programme. I know that, at this time last year, people were doubtful that we could achieve this with the support of the staff and of the unions. We have done. In total, the 13,000 reduction is a 23% reduction in our manpower, so these are not small numbers. We sometimes get a little blasé as we have used the figure of 13,000 and it has been talked about a great deal but it is a 23% reduction in the manpower numbers. That includes a 36% reduction in our overheads and our support staff areas. Support staff are not just the finance department, the procurement department or the IT department. It is all of the support staff who help in the front-line areas, so it is a 36% reduction across the board in our support areas and a 20% reduction in our front-line staff without damaging the customer proposition.

I would say so far so good. You travel on us and I hope you have a similar view. We are in good shape. We were going to do 10,000 in the first year, which is nearly 80% of that reduction, and we are at about 74% and, in terms of the support reduction, the front-line reduction and the total reduction, we will reach the 10,000 target by the end of this financial year.

Where has it come from? This chart shows in simple terms the various key elements of the reductions. The largest part shown in blue is net wastage. In the business we turn over about 3,000 people a year, though they do not always leave from the areas where we want them to leave from, and we have benefited a great deal over the last year to the tune of 43% of the total reductions which is just over 4,000 people just leaving the business. Overtime is down, as you would expect.

We have taken out a huge amount of workforce in terms of contractors representing 15% of the total. BRS, this white section here, represents 15% of the reduction. That is the Business Response Scheme, which is where we have offered our staff the opportunity to take unpaid leave for varying periods of time whether it is three or six months or a year. We have found that to be incredibly popular and there is an ongoing demand for that. When we first launched the programme, we thought that people would take it and then return to work and we would just get a one-off benefit for a short period of time. However, we have found that there is an ongoing demand for it, people use it as an opportunity to reassess their life, change careers or have a rest, which sometimes sounds very attractive to me but I won't be taking BRS – I hope! [*laughter*]

The other element is the voluntary severance and early retirement which is 15%. A year ago when we set up the Future Size and Shape, we told you that we thought we would need around £200 million of restructuring costs. We told you earlier this financial year that we thought that we had over-cooked that and that we would only need £150 million, and that is where we are today. You will remember that £80 million of that we provided in last year's accounts and we have £70 million in this year's forecast, so I think we will need that £150 million for restructuring. However, the restructuring costs have been less than we expected a year ago primarily because of the success of people just leaving the business and the Business Response Scheme. Therefore, there is a good story on manpower and the customer proposition to me seems intact. The staff and the unions have been supportive of this through the period and, as Lord Marshall said, that is critical to the success of our business.

Turning to distribution, we said we would drive £100 million of distribution savings and I have already told you that we are ahead of our target for this year. This is driven mainly by three elements. We changed the UK travel agents commission in June of last year when we changed the short-haul sector payments from £6 to £2.50 per sector for domestics and discount tickets, and from £11 to £5 for premium and full fare tickets. That has given us a substantial benefit in terms of cost savings. In the USA we reduced in October, in line with most of the rest of the US industry, agent commissions to zero, which has also given us a substantial benefit. Of course, as you also know, we have been driving sales on line which is still our cheapest source of distribution. John Mornement, our Chief Technology Officer, will talk to you much more about that a little later this morning, so I shall not dwell on that. We are driving substantial savings in the distribution area.

The other element that was on the first chart was IT and procurement, and again we are driving savings there. Procurement through price control price reductions from our suppliers and IT through a programme called IT21, driving simplification in our IT operations, and we are seeing substantial benefits there.

Disposals: we have made disposals in three primary areas. Aircraft, primarily 757s, two 777s that we sold last year, contributing £350 million to the £570 million of disposals. We have also disposed of a lot of property around the Heathrow area and some a little further afield, such as a hotel in New York. We are consolidating the support workforce into this building, so we are clearing out the buildings that we have around Heathrow and, as we reduce our staff, we are putting more people in here. We will sweat this asset much more effectively than we have done in the past, clear out the other buildings which will enable us to sell them. So we have been working on that pretty successfully over the last year, and have generated a further £83 million cash on disposals.

The other area is primarily engines and inventory disposals and a few business disposals. You may remember that we sold the majority share in our Indian operation WNS and a few other business disposals. However, it is primarily about engines and inventory. Therefore, in total £570 million done on the way to the £900 million target, leaving us with £330 million to go. I am confident that we will achieve that despite the fact that we have been unable to sell some of the aircraft that we told you we wanted to sell this time last year. You may remember we said we wanted to get rid of seven wide-bodied aircraft and we have only disposed of two. As far as the other five, for obvious reasons, we concluded that the market was a little soft and that the value that we gained from selling these aircraft did not represent good value. So we have held onto them which will cause us to have slightly more capacity in the air next year than we originally planned. However, despite the fact that we are not selling those five wide-bodied aircraft, I am still confident that we will achieve the £900 million disposal target.

We also said last year some broad financial targets. We talked about being CVA positive, we talked about a 10% operating margin and, clearly, in this financial year that is pretty hard work. We will talk a little more about that later. We said we wanted to reduce our debt, to reduce the gearing and that we wanted to be cash flow positive and improve our liquidity position. Let us see where we are on that.

In terms of liquidity, we had a record cash balance at the end of December of £1.8 billion and we have never had as much cash. We have undrawn committed facilities of £400 million, so we have £2.2 billion of liquidity available to us. We also have a further roughly £2 billion of realisable assets, which comprise, as most of you know, things like our Iberia shares, our Qantas shares, aircraft, property and equipment. Therefore, we have a total picture of £4.2 billion of which £2.2 billion represents cash that is available to us today.

To put that kind of position into perspective, immediately after 11 September in that quarter, you may remember that we were burning through £2 million of cash a day at the worst point. We are now sitting on £2.2 billion of liquidity and at the worst point we were getting through £2 million a day, so we have a lot of survival space there in the case of a war. We have also taken out a huge amount of cost in our business compared with where we were in September to where we are now. So we are in a much stronger position to withstand any further damage from war or any other activity than we were immediately post 11 September.

In terms of debt, net debt has come down by £1.4 billion from its peak, which I suspect is more than everybody here expected it would do, and we have reduced our gearing to just below 60% as we measure it, so down almost seven points from its peak. As you are all aware, our debt is long-term. We have no financial covenants associated with it. Our repayments are pretty flat, and we will just have a look at that in a minute, and we have also been locking in our interest position as interest rates have fallen. As interest rates came down, about %75 of our debt was variable rates and 25% fixed. Interest rates are at historically low levels, so we have been in the process of fixing some of those rates, and we are now in a position where about 60% of our interest is fixed and 40% is variable. Therefore, we are locking up at the historically low levels on the interest rates, so, again, it is a good story on debt.

In terms of the repayments, you can see from this graph which is pretty unexciting in one sense that the repayment going out into the future is flat. There is no one year where we suddenly have to repay billions of pounds. The repayments are £550-650 million a year and in this financial year, the one ending March 2004, repayments are less than £600 million. So there is no hidden bad news there: on the debt no covenants, no repayment spikes, long-term secured against finance and property about 90%. As we said before, it is larger than I would like it to be but manageable.

Cash flow is something else we said we would spend some time worrying about. This chart shows in green the cash coming into the business and in red the cash pouring out of the business. As you can see, between 1996 and here the purple/pink line shows that we were cash flow negative, so cash was going out of the business. We managed to get that positive just in the year ending a year ago. So in the year we had the events of 11 September, we managed to be slightly cash flow positive despite the fact that the cash coming in from the operations, as you would expect, was pretty low. This year we will be significantly cash flow positive. In the nine months to December, we had generated cash of over £900 million before financing. To remind you, unlike some of our competitors we have been cash flow positive at the operating level ever since 11 September, so there was never a period of time when we went negative at the operating level, and for the whole of this financial year we have been cash flow positive bottom line. Therefore, after taking into account interest, capital repayments, debt repayments and all those items, we have been cash flow positive bottom line.

On capital expenditure, we told you last year that we would spend no more than £450 million in this financial year and £400 million in the following financial year. This is down from the peaks when we were replacing our wide-bodied fleet of £1.5 billion two years ago and £1 billion a year ago. This year we will not spend £450 million, we will spend no more than £400 million, so we will be at least £50 million better than we told you a year ago, and I am confident that it will be slightly less than £400 million. Next year we told you that we would spend £400 million and we will beat the £400 million. We are cutting back on our capital spend more successfully than I had hoped when we launched Future Size and Shape.

In terms of where we are spending our money, as most of you know our wide-bodied fleet is fairly new with an average age of just over six years. We have done a huge amount of replacement of that fleet in the last five to six years and we, therefore, have very few aircraft coming at us over the next three or four years. We have no wide-bodied orders at all, we only have narrow-bodied orders. We have three Airbus coming at us in the next financial year, six the following year, nine the year after and one the year after. That is our total committed order book going forward. They are all narrow-bodied and all Airbus.

The other point I would make in these difficult and uncertain times is that for these three for the next financial year we have committed financing in place already, and we even have some committed financing in place for some of these. So we have locked up the financing position and we are sure of that for the aircraft over the next financial year and into the following financial year.

In terms of where the aircraft are financed, there is no significant change here compared to what we showed you last year. We have 43 aircraft that are unencumbered, 12 more are becoming unencumbered over the next two years as we repay the debt on them. The finance and the operating lease numbers have barely changed from last year. The total numbers of the fleet are down as George told you earlier.

The story of the year, therefore, is costs down, debt down, capital expenditure down, which is all good news. The bad news is that revenue is down. On the cost side for the 12 months ending December 2002 compared with the previous year, so the year ending December 2001, our cost base is down over £1 billion,13%, compared with a year ago.

We have had some help in that and it is clearly around fuel which is 27% down as you can see, and that has given us £300 million of help. As you all know, fuel prices are turning the other way, so that help will turn into a headwind. Of course, some of that reduction is driven by the fact that we were changing our fleet and getting a more modern fleet for the older fleet. A 747-200 burns 12 tonnes of fuel an hour and a 777 burns six tonnes of fuel an hour. The 747-200s have all gone and we have a very modern fleet which is pretty fuel-efficient. So we have gained some of the benefits by the actions we have taken. Therefore, it is not just the price falling that has helped us but changing our fleet has also helped us. However, the price will move against us as we had £300 million of help. We also had about £70 million of help from exchange and because we reduced our volume we had another £70 million of help.

There are, however, some headwinds in there. Insurance and security costs are up significantly over this period of time by £80 million or so – huge increases. Even if I take out all of those slightly unusual items and say you did not really control the fuel and on the exchange you got lucky, if you add all those up the fact that we took £1 billion out tells you that we have made huge restructuring changes to our business. We have made sustainable cost changes to our business. We are driving the costs down, the cost structure of this business is changing significantly, so that when the revenue comes back, and will come back – how much and when we will see – we are in a much stronger position than we ever were.

My summary of it, as I hope you will agree, is that we are well on track with our Future Size and Shape programme. We are delivering what we said we would deliver: manpower, distribution cost savings, IT and procurement cost savings and the manpower cost savings as well. We are delivering on the disposals. We have cut our capital spend. We are delivering on all of the targets that we set ourselves. Our costs are down by £1 billion compared with a year ago. Our net debt is down £1.4 billion compared with its peak, and our gearing ratio is down below 60% - almost seven points down from its peak.

I hope you will agree that the plans we put in place a year ago that we said we would do we are doing. Thank you. Let me hand over now to Ray Lyons, who has the slightly more difficult task of talking to you about revenue.

STRATEGIC FRAMEWORK
Rod Eddington
Chief Executive

[*Presentation with slides*]

Thank you, George, and good morning everyone. I have had a chance to say hello to some of you over coffee but welcome to you all and thank you for taking the time to come and join us at what is a very interesting time for our industry.

One of the things that we should do at the beginning of every business planning cycle is to remind ourselves of what we are about. If you look at Future Size and Shape, which we rolled out about 13 months ago, and if you look at the priorities in Future Size and Shape, they were quite clear. It was about intelligently reducing our cost base always remembering that we are in the customer service business; it was about ensuring that we got our manpower levels right, a critical part of the cost equation, and making some substantial changes to the way in which we push, promote and deliver our short-haul product. There are other pieces to it, of course, but these were the main threads that ran through it.

When you have a single-minded focus on delivering those sorts of things, you can create some confusion as to what you are really about. For instance, how can we be a full service airline if we are cutting costs and what does it mean to be a full service airline? How can we be in some ways a bit more like a no-frills carrier on the short-haul economy and still be full service in other segments? As part of the business planning process, we wanted to make a clear statement of our direction and strategy. It is very useful in part because you can then pressure test any specific initiatives you are taking within the business against that strategy. Therefore, clarity is important in any business particularly in difficult times. We needed to be clear about what the overall purpose and objective of our airline was, what our key goals are, what are our competitive strengths and how do we build on them, and to ensure that we have the right business plans in place and that we can deliver on those as well.

It is pretty simple in many ways. Our key objective is and must be to be a profitable British full service network airline. The goals and measures by which we measure success is that we have set our goal of delivering a 10% operating margin.

If you look at how we compete and what we have to do to ensure that we compete intelligently, our most important competitive advantage is our UK-based network and schedule which is at the heart of what we do, and we must ensure that we remain the leader in the market. We have a strong brand and we have to continue to build on things like value service and security. We want our customers to know that they get great value when they buy with us. We also want them to know that our reputation for great service will not be undermined by the cost-cutting that is essential to staying in the game. We know that reliability and reassurance are a critical part of our brand, and that there is nothing more important than safety security, which is our absolute priority. The only people who can take safety and security for granted in this business are our customers.

We have to deliver on the customer promise consistently, which is a key part of being a full service airline, and we recognise that our premium customers are particularly important to us. All our customers are important to us, we are not just about premium customers and, as you will have seen from Ray Lyons's numbers this morning, it has been in World Traveller and World Traveller Plus that we have seen some real gains at a time when the premium markets are under real pressure. Therefore, all our customers matter but we have to deliver a superior experience for our premium customers. All of this is fairly straightforward but things that we must remind ourselves about.

How are we going to deliver that? We must ensure that we have an organisation that can do that. How we manage our people effectively, how we reinforce their commitment to customer service excellence and how we ensure that our company is run efficiently and effectively. We have to deliver a competitive cost base without which we cannot remain a profitable business and, as competition intensifies, we have to deliver higher quality at lower cost. It is a challenge that all companies meet and one of which we are very conscious.

We must simplify our business. One of the key drivers of our relatively high cost base is the complexity that we have allowed to creep into our business and, in many ways, complexity undermines efficiency. We have to drive out complexity but without destroying value for our shareholders and for our customers. I have always felt that, if we can deliver simplification which we are doing and will continue to do so, it will also enable us to be more consistent on the service delivery side. We must clearly also deliver a strong balance sheet, because it gives us the essential cushion we need in an industry which has consistently been challenged by market uncertainties. It gives us also the strength to take advantage of opportunities for industry consolidation.

In your pack you will find the next slide which looks at specific initiatives that we have as priorities this year and it looks at how they fit into these all important issues of how we compete and how we manage our business. I apologise for this busy slide. If there is a business initiative which is a priority for us at the moment and it does not fit under one of these headings then, to be frank, we should not be doing it. So it is one of the tests that we have used to decide are we focusing on the right thing. It is in your pack and you can look at that at your leisure.

As George said, the first part has been reflecting on where we are at the moment, what has happened over the last 12 months, and the second part of the morning looks forward. Silla Maizey will talk about some of the procurement challenges we face and how we will meet them. John Mornement will talk about the all important work that is going on in customer-enabled BA and then John Rishton will finish that piece by talking about our operating margin targets. I shall then come back for the Q&A session for the last hour or so this morning and I look forward to joining you for that. Silla, over to you.

CUSTOMER ENABLED BA
John Mornement
Chief Technology Officer

[*Presentation with slides*]

Good morning. Before I talk about Customer Enabled BA, I want to reflect back on what we promised last year. We promised a radical improvement in our short-haul pricing proposition optimised for online distribution but available across all channels, albeit at a £10 service fee on BA direct channels. As Ray mentioned earlier, we implemented domestics in April and a progressive roll-out from May onwards across the whole of Europe supported by the marketing that you have seen.

If we jump to BA.com and look at Fare Explorer, this is a world-beating tool that shows up to 28 days available product when you come onto the website. It is a great shop window for our new pricing proposition and we calculated that without Fare Explorer, the chance of finding the best fare for the customer can be as low as 3%. With it when customers see our superb value prices advertised and they come to BA.com, there is every likelihood that they find them, and we are seen to be living up to our marketing proposition.

If we then look at a day's product offering, naturally the off-peak fares are at off-peak times, best value at off-peak times. Our prime business flights command a healthy premium which reflects the demand for those services and the whole point about this is that, when a customer comes to our website, we cannot second guess how price-sensitive or time-sensitive they are. We do not know if they have free accommodation at the other end which means they can travel out the night before, or they are on their last day's leave and they have to be back in the office. Therefore, the whole principle behind Fare Explorer is to make it very transparent to the customer what our product offering is, the fact that we have the marketed price available and then leave it up to the customer to trade up based on time and price. We have found that that transparency has gone down very well with our customers, as is demonstrated by the take-up in online bookings.

A year ago on a busy day we were taking around 2,800 bookings. We have now reached a peak of over 10,000 bookings a day which equates to 32,000 passenger sectors. We saw peak jumps in demand in April, which was the launch of the Evesham domestics, overnight, and then progressively through the rest of the year supported by the major marketing campaigns. Just before Christmas there was the usual trough in demand and then it was followed by a truly amazing doubling overnight in the New Year, and I am happy to say that our systems and our processes took that doubling in demand overnight without a hitch.

Notwithstanding the decline since then given current market conditions, we find that customers transacting on the web tend to come back, it is a fairly sticky phenomenon. So every time it goes up, we see that base demand stay up.

If we look at short-haul channel shift, particularly in the sector where we compare with the no-frills carriers, the UK sold short-haul non-premium. A year ago, BA.com was taking 20% of our bookings and that has jumped to 41% last January, which has taken market share away from the trade and also from ContactBA which is our telephone sales unit. Every shift to ContactBA gives us a cost advantage and every shift from ContactBA to BA.com, our most cost-effective channel, also gives us an advantage.

On domestics the picture was even better. BA.com's share is up to 46% and this compares with a target for this sector in the Future Size and Shape of 33% this year and 50% next year. So we have already easily hit this year's target. For the airline as a whole, BA.com represents just over 12% of our business by volume, which is an impressive result for a global network carrier, and we believe it is well ahead of our major European competitors.

Let us look at e-ticket for a minute. E-ticket volumes have rocketed in the last year, in part due to the introduction of the £10 paper ticket fee for short-haul sales but also a steady extension in the number of routes on which you can use e-ticket and increased customer acceptance of e-ticket. If we look at our best segment, the top line, which is the direct eligible routes, we have hit 79% e-ticket take-up. However, just as impressive is the bottom line which is our total number of tickets issued on all routes world-wide. It has moved from 20% of customers holding an e-ticket a year ago to 42% now using e-ticket. It is quite interesting on BA.com in June, we decided to mandate e-ticket, we did not give customers a choice, and we had no significant adverse reaction from customers and it is clearly becoming the standard way of doing business. As we will see later on, it drives major benefits for us and for our customers.

In terms of the transactional benefits of moving business online, compared with a telephone booking where we would typically take at least two calls a booking and would have to either print a ticket and send it out or print an e-ticket receipt and send it out, with an online sale we e-mail e-ticket receipts, the customer receives this minutes after making the booking untouched by human hand. The price differential there is about £10. Compared with a travel agency booking, clearly we save the booking payment that the travel agency attracts but we also save the GDS fee which runs at about £3 per sector.

In summary, we promised last year we would deliver a new pricing proposition optimised for online distribution and we have delivered it. We have seen the rate of online sales triple and e-ticket double.

Where next? Customer Enabled BA. We will build on the success with a strategy that touches every customer interaction and many of our internal processes too. We have called it Customer Enabled BA, which is about making customer self-service mainstream across the whole airline. This is much more than just putting a website on top of our current products and processes. It requires us to take a fundamental look at what we do and how we do it, to design for end customer use. Indeed, putting a website on top of current processes has been described as like putting lipstick on a bulldog: it makes the front end of it pretty but does not do anything for the back end!

The vision for Customer Enabled BA is that we will simplify our contact with our customers, drive out complexity enabling customers to self-serve when they choose to do so. This is a customer-centric vision that requires us to simplify our products and processes to make it easier for the customers to interact with us and for staff to facilitate superb customer service both online and offline. This is not a technology strategy and it is not a pure online strategy as you will see.

It focuses on what customers value. If a process is not adding value and we try to customer-enable it, they will not use it, so there is no point in customer-enabling it, so why do we have the process? Unless customers are prepared to pay for the value that we are delivering, we have to consider dropping those processes.

If you look at complexity in BA, over 50 years we have added every possible permutation to our products and processes. We have broken the human race from adult/child/infant into seamen/unaccompanied minors/standby staff/firm staff and we have a special place for hospital visitors. A bit of pseudo-maths but I have calculated the number of possible product and process permutations across our whole business at six billion in theory and, when you consider that we carry 40 million passengers, it is taking the concept of customer choice a little too far. Our product is so complex that a big role for our frontline staff and also our travel agents is just to translate it for our customers, just to cope with the complexity and, in truth, many of our staff do not understand all aspects of our processes.

Not only is this complexity costly to sustain, it is impossible to apply consistently, meaning that customers get a different answer depending on whom they ask where in the travel process, because people are using different processes and systems. It makes managing and changing our business very difficult. When we implemented something about the new short-haul fare proposition, we had to go back and make changes to many systems and processes, which is expensive and time-consuming.

The start point, therefore, is to simplify what we have, the processes behind the front end, drop the inessential and the non-value-adding and then design for end customer use. Simplified processes are much easier and more cost-effective to automate for customer self-service but, as well as delivering customer service on the web, we will make it available for our staff to use. We are committed to retaining a choice of channel but the key thing is that when customers contact a staff member to help with service, they will be receiving the same service as they would have received if they went online. The staff member uses the same tools and facilitates that service on behalf of the customer.

Clearly, customers are drawn to self-service channels by access to more information and a real sense of control and empowerment. They can see all of the options and even the most thick-skinned customer will not ask for 50 fare quotes over the phone, whereas they can see 50 fare quotes in two clicks of the mouse on BA.com.

With a simplified solution that serves both customers and staff, enhancing it with new services becomes much more straightforward and improves time to market for new products as we enhance our proposition.

We have adopted four golden rules to turn this strategy into a tangible approach that we can apply to every process, every idea people come up with, every project people come up with across the airline. The first one is around making the customer proposition simple and compelling. It comes back to the point that, if we are doing something and there isn't something in it for the customer, they will not use it so there is no point in doing it. Be very clear about what the proposition is and remove complexity that customers do not value. Design our processes for end customer use and this is really the forcing mechanism for simplification, because if you have to put the process on a web page in a way that customers can understand, you have to force simplification of the back end processes. Without this, there is always wriggle room. Some department says it is okay we can manage that, we will just have a couple more people managing the exceptions.

As I mentioned earlier, once we have a superb online facility, we will treat staff as a special case of customer using the same tools on behalf of customers and, by definition, it has to be easy to use because customers are using it and when you look at our current training cycles for selling and servicing, it takes up to seven weeks to train someone and many months of mentoring before they understand all the processes and permutations.

Do it right first time is about doing it right at the point of customer contact: solving issues up front, removing back office recovery. We have seen where customers are doing processes themselves like buying tickets on BA.com, the quality and success of the information and the avoidance of back office recovery is many times that of manual processes including over the phone. A single BA solution is about one solution for customers and staff world-wide for all departments, not one solution per department, one solution per country and then add on BA.com on top, which is where we have been sometimes in the past.

A fundamental change requires transformational thinking. We have adopted some transformational stretch targets to force the pace of change and to force innovative thinking. On e-ticket we will move from the current situation, which is 67% eligibility and 42% take-up, to 100% eligibility and 100% take-up by December 2004. As you will see in a moment, this unlocks a virtuous circle of benefits and will force us to take a creative approach to how we will achieve this truly challenging target.

For self-service check-in both on and off airport, we will move to 50% self-service check-in by March 2005. Currently we average about 10% across airports where we have self-service but performance ranges up to 23% at our best airports.

We will build on our success in online selling to continue adding customer servicing interactions like change of booking and others online, and this will move us from today where we have about 40% of customer trip transactions available online to 80% by March 2004.

Moving on to the Executive Club, we have around 65% of Executive Club transactions available today on BA.com and we will move that to 100% by March 2004.

All of this means dropping some functions as well as automating others. It is not about automating every possible permutation. Remember the point about staff facilitating some of this service on behalf of customers, which is included in these targets. The difference is that the staff members are using the same tools as the customer, turning every interaction with a customer into an opportunity to train the customer in self-service.

Touching on the last point there, we have around two million public and private fares today and by March 2004 we will cut that by at least half, and we will concentrate on standardising on our ticket flexibility conditions world-wide, moving to some straightforward rules that customers and staff can understand. This is an example of how, until we do that, we will not achieve the self-service servicing around things like change booking. We must have a simpler proposition around change booking before we can provide self-service.

Simplification is core to achieving these targets and we have a programme structure that will deliver simplification across the airline. It embraces sales, marketing, revenue management, revenue accounting, information management as well as customer service and ops. This really is a win for all and by simplifying and standardising our processes and focusing on what adds value for our customers, it delivers a consistent, reliable, high quality customer experience.

It aligns staff and customers who will share the same set of tools to manage customer interactions while lowering the cost of provision, and will deliver at least £100 million of annualised benefit by March 2005. It also gives us the ability to scale our core processes at incremental cost, so it is a perfect platform for future growth and enhancement.

Looking at the annualised benefits. We have taken the transformations and mapped them onto our business, front and back office processes, and identified at least £100 million in annualised benefits, 90% of which are cost savings. Clearly, there are significant benefits from channel shift, every phone call saved, every e-ticket issued, every e-mail sent rather than a document printed and posted. By simplifying our products, we make transactions like self-service possible and we open the door for up-selling based on fare condition or additional collection of fees charged to change a booking and also cross-selling of ground product. Doing processes right first time cuts back office recovery costs and simplification generally reduces process cost and improves data quality. The knock-on synergies of that improve accounting processes and revenue management processes amongst others.

Drilling into one area, e-ticket, there is a real virtuous circle when we get to 100% e-ticket. We will not have to have ticket printers in every office world-wide. We will not have to buy ticket stock and provision it around the world. We will not have to post out tickets to our customers. We will not need ticket readers in the check-in kiosks which will reduce the cost of the check-in kiosks and will also make them more reliable because there will be fewer moving parts. There will be no coupons lost which is a benefit to us and also to our customers. We do not have to pluck coupons at airports, fly them round the world, sort them, match them and scan them. There will be easier servicing, you can change booking or get a refund without sending a ticket in and getting paper back, and it is much easier to capture accurate values at the point of sale which leads to improved revenue management and revenue accounting processes. By getting to 100%, we will be able to decommission entire processes and systems.

What is the scope of the vision, what does it encompass. There are two dimensions. One is every customer interaction from browsing for a product, buying it, pre-trip servicing, travelling to checking your Executive Club account on arrival. It also embraces a cross-channel vision. Even in the US with very high PC ownership and very high internet penetration, the telephone remains a key channel. The phone is here to stay and we have voice automation that can pick up straightforward calls but we also have call centres. On the voice automation front, again in terms of extending proven solutions, we have a flight information system that some of you may have used that has just taken its two millionth call in December and again gets very good reviews from our customers.

I have a few examples of what the customer experience will look like. You have seen Fare Explorer and what we are going to add to Fare Explorer is the value-add that you get with British Airways. We want to make it very clear to the customer why it is worth paying a small premium to buy a good value product. Our staff will also be able to access that information at point of sale and use it as a sales tool.

We will make it much clearer to our customers what they have bought, what it includes and, almost as importantly, what it does not include. When we are explaining things like the fare restrictions, we will take the opportunity to up-sell. You have bought an excellent value ticket, it is non-refundable, non-changeable but for a set fee you can upgrade it to a flexible ticket. Before travel, we will use the concept of a pre-travel check-list which we will send to customers days or weeks before travel. This will prompt them about the things they can do but also about the things they should do ahead of travel. With countries increasingly demanding advance immigration data, we will be asking customers to complete as many formalities as possible before they get to the airport. It will be a win-win, it will streamline the process through the airport for the customer saving them time, and for us it takes processes out of busy airports.

I talked about the self-service check-in target. Off-airport check-in in the future will enable customers to print their own boarding pass with a bar-code on it, putting customers in control and enabling them to avoid queues at the airports. These are just some of the examples to give you a taste of what the front end of Customer Enabled BA looks like with a transformational change behind the scenes.

In summary, with Customer Enabled BA we have a transformational programme that will deliver at least £100 million in annualised benefits by March 2005. It provides us with a compelling vision for the future of customer service: a world where we have driven out complexity so that customers can choose to serve themselves; a world where staff share the same tools as our customers, so that staff and customers are really talking the same language; a world where our staff can concentrate on really adding value to the customer experience rather than coping with complexity. It provides a practical way of describing and delivering simplification across the airline and we have proved this approach works with online selling and now have a roadmap to extend it across every customer interaction across BA. We have established a major programme and for each of the targets I took you through we have a manager taking single point accountability for the delivery of those targets. As I have demonstrated, we have a proven track record of delivery and we are already well on the way with this transformational programme. Thank you.

Industry & Company Update
Lord Marshall

Thank you very much, George. Welcome to all of you, and I join in George's warm welcome. We are delighted that you have taken the time to come and join us.

Although it is always a great pleasure to welcome you to Waterside for our Annual Investor Day, the economic circumstances in which we do so this year are clearly not so pleasing. I guess that as of last night, we have captured from West Bromwich Albion the title of the fastest promotion to relegation that has occurred in this country in a very long time. I am not sure, George, about your prescience of mind in selecting the day on which the FTSE 100 is reconstituted, but never mind, may be next year we will move the day in some way or another!

As the threat of war in the Middle East continues to hand over us, our market place clearly remains nervous and uncertain. In line with previous experience, demand is slowing down as customers, particularly business travellers, put their international travel plans on hold for the time being. Our February traffic statistics, of which you will all be aware, which were released last week, tell that story of traffic down overall, but premium traffic down nearly three times as much as non-premium.

Coming on the back of the crisis caused by the 9/11 events, almost exactly 18 months, which in turn came in the wake of worsening economic downturn, the current situation is as bad as the industry has ever experienced. Tough times have called for stern measures, and as you know, our initiatives to cut costs, improve efficiency and eliminate wasteful capacity were in place before 9/11. Just as well, because after those appalling and tragic events, we simply had to up the tempo of cost-cutting and competitive response rather than gear up from a standing start.

Our strategy, to which George has made reference already, perhaps the much-quoted future size and shape, is beginning to pay off. The return to profitability over nine months of the present financial year, was the result of cost reduction at a time of falling revenue. Rod and the management team have done a tremendous job in delivering on that. Despite so many negative factors, we still expect to record a profit for this full financial year, ending in some 19 days time.

Our cash reserves are substantial, and will see us through whatever lies ahead in the immediate future.

You will brought up to date very soon on the existing strategy and introduced to the forward business plan prepared by Rod and the leadership team. Needless to say, it has the unanimous approval and support of the entire Board of British Airways. In the aftermath of any armed conflict in the Middle East, there is one certainty which is that the air transport industry is undergoing further change in terms of structure and competitive environment. With many major airlines hanging on to commercial life by the threads of state aid and the Sherman Act, I believe that we will see further consolidation in the United States.

In Europe, we have already seen airline blood on the walls, and can expect more. The first tentative steps enabling US-style consolidation within the European Union were made recently when Transport Commissioner de Palacio's Open Skies policy proposals to be considered now by the European Parliament and Council. Essentially, it will allow airlines, for the purposes of international agreement, initially with the United States, to be designated European, so lifting some of the national sovereignty and ownership constraints which have held back industry evolution in Europe for so long. Then we can expect to see the commercial process of merger and acquisition among the European Union's global airlines come into play.

The results could be startling with perhaps no more than three or four inter-continental airlines based in Europe. At present there are, frankly, too many global hubs, and too much global capacity in Europe. Radical competitive change is already with us, and the business will not become any less cut-throat as and when the international crisis recedes and markets return to normality.

It was Jack Welch in his time at GE who warned that IT and e-commerce would destroy existing business structures if they failed to adapt to technological change. That is certainly true in this industry, and you will hear how British Airways is adapting and in many respects, leading the way.

Great change is also on its way – at least we certainly hope it is, and believe it is – when it comes to the operating infrastructure. With the consultation process just restarted in this country, we can expect the Government's White Paper on civil aviation policy for the next three decades later this year. It is the first time in this country that a government has ever taken a look at that lengthy period of time in terms of meeting the requirements of this industry.

We continue to believe that the only logical answer to runway constraint in the south-east of England is build on established strengths. We will, therefore, be pressing very firmly indeed for the construction of a third runway at the United Kingdom's one and only global hub airport here at Heathrow.

Finally, if I may, I would like to acknowledge the people of BA. Despite the pain of job losses, substantial as they have been and will continue to be for at least another year, and the overall cutback that has taken place, our people have responded with intelligence and understanding to the challenges of future size and shape. They are delivering the desired savings, and we are grateful to all of them. I believe that they all understand fully as a result of the excellent communications processes that take place within this company, this organisation, that you can count on their continuing support. Okay, from time to time we have our differences, but I believe that they all are and will be sensibly met and resolved.

I am now going to hand over to John Rishton to take you through the financial position of the company.

Revenue Development
Ray Lyons
General Manager
Revenue Management

[*Presentation with slides*]

Thank you, John. Good morning, ladies and gentlemen. I have had a few build-ups in my time, but 'everything down, including revenue', is probably the worst I have had so far! I will try and explain.

What I am going to do is explain revenue in four segments. We are going to split out long-haul from short-haul, and premium from non-premium. Looking at it that way, we start to understand better what the individual drivers of the segments are and what is happening there.

To get into that, I shall start with a couple of economic slides. This one shows the industrial production, US in the red line, UK in the green line, and Europe the blue dotted line, from 1999 through until today. This pattern, which is growth through until the end of 2000, is very similar to the pattern you will see in our premium business market performance. We had strong growth through 1999 and 2000, but as the economics turned south at the end of 2000/beginning 2001, that coincided almost totally with a significant reduction in premium business, not just for BA, but for the market.

You can see what has happened. The economics went south, 11 September worsened that. Things have started to improve in some areas. What happens next is obviously crucial to our industry and your industry, and to industry in general. There are different views on what is going to happen to the US economy. Some people think it is going to recover quite strongly. Some people think it will go into double dip. Our view is that we are not expecting great growth. We think we will see some fairly sluggish growth, and obviously the impact of war will affect that.

You will note that at the bottom, the UK is the area that is struggling most at the moment, and obviously the UK, for us, is a major market, representing over 50% of our premium business.

If we look at a couple of slides that link best with our performance, tracking pure GDP does not particularly match well with our performance, either the premium or the non-premium end. We relate better to two sectors of the economy, manufacturing and finance.

This shows what is happening. We all know about the two-speed economy in the UK: consumer expenditure driving reasonable GDP growth and a pretty horrible experience over the last year and a half or so in terms of manufacturing output. That horrible bit is what affects the premium market, again, not just BA, the overall premium travel market. There is some sign of recovery there, but obviously with the threat of war, that is still very questionable as to whether and how long it will be before we see a good recovery.

You don't need me to talk about the last slide very much, but an awful lot of our business traffic is driven by what is happening in your industry and in the industry generally. This very sick-looking slide tells us what has been happening of late and, not surprisingly, our business traffic has not been doing well because it is set against this background.

If I move on and look at business travel over a longer period of time, this is business travel to and from the UK, not just BA - it is from the CAA IPS survey, so it is UK industry data – you can see what has happened since the early 1990s through until today.

If we look at the red line first, that is long haul, and you can see the proportion of business travellers travelling in business cabins, it has been pretty flat. It has bobbed up and down with economic activity, and of late, it has dipped down primarily because of the economic activity and latterly the threat of war, but we have seen a pretty flat performance over that period of time. I certainly believe, and within BA we believe, that we are going to see a recovery in that long-haul premium cabin market as the economics get better and the threat of war goes away, etc. We will see a recovery in long-haul.

The same is not going to be true of short-haul. The short-haul premium market has seen a structural change since the mid-1990s. Remember, we have had the whole growth of the low cost carrier competition in the UK. That has changed the market, it has changed the way people think about premium travel in Europe, and we are not going to see that line get back to where it was in the early 1990s. We will see some flattening out, but we are not going to see a huge recovery. That is our belief in those markets.

Let's move on and start to look at where does BA revenue come from and what has been happening there.

First, in December 2000 – December is a slightly soft month for premium business, slightly heavy month for leisure business, but it is a good example month for a year – you will see that 33% of our revenue came from long-haul non-premium, 22% from short-haul non-premium, leaving 45% to come from the premium segment, and that was 35% from long-haul premium, and 10% from short-haul premium. These segments are the ones that we will look at. We will look at long-haul premium, short-haul premium, etc.

Before looking at the first of the segments, let us look at how that picture has changed as we get to December 2002. Two years difference comparing December 2002 with December 2000, and the remarkable change is the red bit, the premium bit, is now accounting for 40% of our revenue as opposed to that 45%. That really is the consequence of those lines I showed you before, of how the premium has suffered over the last couple of years. We have been able to do a very good job on the non-premium side, so we have had some good seat-factor improvements, but the proportions of revenue have switched dramatically, and obviously profitability-wise, the premium business is the better business, and the one that we expect to get better, but it is not getting better in the very short term.

Let us look at long-haul premium, the overall market for long-haul premium, and this is UK/North Atlantic, is down 37% versus two years ago, 36% at the UK end and 38% at the US end. It is very similar performance at both ends. The market is significantly down. You can see the pattern, you can see 11 September, slight recovery from there, but if you track over a two-year period, you are looking at a market that is very soft and still declining.

What are the comments from that market? What is happening in the market? Here is some feedback. Not only BA has a future size and shape. Most corporations around the world have a future size and shape and that comes back to hit us because everybody is looking to reduce their controllable spend and air travel is one of those areas of controllable spend. Most of our customers are looking to make savings and they are using different techniques. Some people are asking for bigger discounts; other companies are changing philosophy and simply looking for the cheapest price on the day, no longer going with one carrier for their business or for their business to point x. They just look for the cheapest price on the day. There is a lot of buying activity from corporates. One of our bigger customers, a global oil company, has banned internal travel. This is very significant to us and it is happening not everywhere but a lot of people are looking at how they control that cost.

About eight years ago, we introduced the flatbeds in first class and it was the first flat bed in the world, a significantly better product than that of anyone else. At the time we did that, we said we will take that product out of the standard corporate discount because we should not discount it as much as we have to do with some of our other products. It is a very strong product and we will take it out. We did that and had a lot of feedback from corporate who were not particularly happy but the product did very well. Today, eight years later, we have the exact opposite. Travelling first and Concorde in many areas in many companies is seen as excessive and companies do not want to do it. We have some examples of companies wanting to take first and Concorde travel out of their corporate policy. In the US we are told it is deemed not politically correct to travel first and Concorde. That is not universal but there is pressure in many companies not to travel there.

US carriers: we all know the problems US carriers are having. One of the consequences of that is that they are very cash hungry and they are very aggressive in terms of discount. One anecdote there is that a couple of months ago we chose to walk away from some business which was a very hard decision to make. However, the only way we would get this business was to match a 73% discount that United were prepared to offer the investment bank concerned. However, we chose not to do that and I am very pleased to say that two months after experiencing the delights of United, the corporate is back and we are talking to them again. I am sure we will be able to find an arrangement to work with them but it will not be at anything like the 73% discount that we chose not to match. The point at the bottom is that everybody wants BA to match. Our products are significantly better than those of most of our competitors and there is a premium we can get from those. Therefore, we are trying to get the maximum premium we can because customers benefit from our products relative to those of our competitors.

Let us look at long-haul premium for BA and what has been happening. Here I have a comparison versus two years ago. Because of the 11 September effect last year, we will do a comparison with two years ago which is more like-for-like. The first thing to say is that the little boxes show what has happened to ASKs by month and, because of our fleet restructuring, so putting in small aircraft rather than large aircraft with 777s replacing 747s, and because of the dusking of the product, changing the configuration on both the aircraft, we have taken quite a lot of capacity out of the premium long-haul market. Not everybody understands that. Many people think that we have put a lot more premium class in but we have not and have reduced capacity quite significantly. At the time we did that, we expected the RPKs, volume of passengers, to be down, and it would have to be down as we were taking so much capacity out, but we expected the capacity declines to be less than the ASK decline and we expected the seat factor to go up. As I said, around the time that we started to do that is the time that the economics went bad and the market softened significantly.

What we have seen then is a seat factor performance, and here the three lines are red for 2000, dotted for 2001 and blue for this year, that has been better than last year, not surprisingly with 11 September but running below the two years ago level. That is because, even though we have been taking ASKs out, we have not been taking them out as quickly as the markets have been declining. However, the match is much closer than for many of our competitors.

What has been happening to yield? The long-haul premium yield this year was running pretty close to two years ago for most of the year but from about

November/December onwards, some of the impacts of all the discounting that is going on are starting to come through and the yield is drifting down relative to two years ago and at similar levels to last year. As we fight more and more for business, there is starting to be a yield effect but it is, I would say, relatively small in the scheme of things and, as you see for most of the year, it was pretty good.

Let me move on now to short-haul where the news is even more extreme than on long-haul premium. The UK-Europe business cabin market is down 50% year-on-year. Again, this is not the BA number, this is the market number. Therefore, if you look at everything that us happening in the premium market, it is down 50% year-on-year. As I said before, there is a similarity with the North Atlantic but there is also a structural difference happening here.

Comments back on the European corporate market are similar to the long-haul one. We have downgraded travel policies with one investment bank switching all travel under six hours to economy; others under three hours to economy. There are some significant changes happening here. We also have some of our competitors again offering very low rates. The lowest easy-to-get discount I know about in Europe at the moment is one of our UK-based competitors offering 50% off the normal economy fares and more off the business class fares, so it is very aggressive here as well. The addition of capacity by low-cost carriers has continued and that is forcing that strategic change that I talked about before. The last point is the one I made on the earlier chart.

This graph is a little different to the earlier one. I have not shown the ASKs here and I have not shown them because we have a moveable curtain, so the ASKs match the RPKs in essence. This is the picture versus two years ago of premium RPKs on BA, so this is a BA chart and you will see some significant declines versus two years ago, partly economic and partly structural.

If I look at the yield, the yield picture is a little different to the long-haul one. We did track along last year for the first part of this year which was significantly better than two years ago and that is as a result of fare increases. What you will see, latterly and especially as we have got through to the winter period, is that the trend is dropping below last year and down to and below two years ago. This is the effect of competition in the marketplace both full service carriers like ourselves competing to get market share back, because we have gained market share especially in the short-haul premium over the last two years but the result is that our volumes are down. People are fighting back and our defence to that has to be yield-related to an extent and that is starting to flow through a little.

Let us move on to long-haul non-premium. This is probably the best new segment that we have. We have taken a lot of capacity out, so here again the bars are capacity versus two years ago and this is BA. We have taken a lot of capacity out, RPKs have also declined but, as you can see in the second half of this year, we have focused very hard on making sure we sell every seat we can and we have a significantly better RPK performance than we have had ASK reductions. The consequence of that is that we have had a very strong seat factor performance especially those last five or six months. Before that we were tracking last year and virtually two years ago performance. We have had a strong seat factor performance driven by focus and the initiatives we have put in the marketplace.

What has that done to our yield? The yield performance has also been very strong and you can see we are comfortably above both last year and the year before. This includes the impact of World Traveller Plus, so if I take that out you will see that the straight World Traveller yields again are tracking the last couple of years since July/August. Prior to that they were a little above. World Traveller yields are the lowest yields that we have, the longest distance and a lot of competition. So the yields are pretty low but the positive thing is we are pushing seat factor and doing it at the same yields as we were charging last year, more if you include the effect of Dusk and World Traveller Plus.

If we move on to short-haul non-premium, what has been happening in this segment? The first slide is just looking at the domestic market and it is looking at the domestic market because it was in April that we introduced our new pricing proposition on domestics. For the rest of Europe, that was introduced from May through to September, so it is really too early to look at September. If you look prior to April last year, this was the trend. BA at the top and that is BA market share, this is low-cost carrier market share, and you can see two very distinct trends with BA's share dropping and low-cost carriers growing. Obviously, low-cost carriers are pushing an awful lot of capacity in during this time.

As John described earlier, we put in our new pricing proposition and what we have seen since virtually the time we pout it in is that, even though low-cost carriers have been adding a lot of capacity in and we have been taking capacity out, the share performance is very different. In fact January-on-January we are at the same position as we were last year despite the trend which would have suggested we would be down. In fact, low-cost carriers are virtually the same as they were year-on-year. Undoubtedly, what we have been doing in terms of being more competitive with low-cost carriers based on price is slowing down our decline and certainly slowing down their growth.

What does that mean to BA? This is the same picture again. The fleet refinement work that we have done means that over the last two years we have taken a lot of capacity out of short-haul non-premium. As you can see, the RPK line is significantly above that and, indeed, in December and February has been positive despite taking out significant capacity relative to two years ago. The consequence of that is a significant seat factor improvement versus two years ago, and the story we now need to look at is what is happening to yield.

This is fascinating – I appear to have a line missing on my slide which was this year's yield picture. I hope in your hand-outs you have the this year yield picture in it. The story of the this year yield picture is that since the start of winter but also throughout the year yield per RPK has been softer. However, that is to be expected because we are after yield per ASK in addressing the low-cost carriers and being more competitive with them. That measure has been very positive through till the start of the winter. However, from the start of the winter we are into a supply and demand game across the industry. Low-cost carriers put in over 40% growth this winter on the previous winter. There is a great deal of capacity there and it is a dog fight at the moment and will continue to be so during the winters. So we have done very well in terms of growth and we have done very well in terms of share. Yield, especially in the winter, is challenging.

If I come back on the overall picture, in summary the first point to make is that the political and economic climate is still not great and until it improves, we will not see significant revenue improvements. When it does improve, we will see revenue improvements but not until then.

The effects of that are felt primarily on the premium markets, in particular in the UK and the US, and those markets are very soft at the moment. They will not get better until the economics get better. Within that, long-haul we expect to recover back to where it was. However, short-haul we do not expect to be structurally changed and it will not get back to where it was.

In terms of the non-premium side, the picture is better. Long-haul non-premium is quite a good story, volumes are growing and yields are being held. World Traveller Plus is doing well and on short-haul non-premium, volume is good and yield soft. That is the story we have. Yield will be better in the summertime when supply and demand are better in balance but the winters are difficult and will remain difficult. [*mobile phone rings*]

Looking out into the near-term future over the next six to nine months, there is very little that tells me that revenue will improve. Our view for next year is that revenue for the next operating year starting April will be no better than this year. We cannot expect to see significant revenue gains, hence the reason for needing to keep the pressure on in terms of cost. I shall now hand back to George.

- *Refreshments* -

PROCUREMENT
Silla Maizey
Procurement Director

I am the Shopping Director and I work for John, who, like most men, does not like shopping at all, and gives me quite a tough time. Therefore, the way I have tried to cheer him up through this business planning process is to start a new initiative to build on the Future Size and Shape delivery that we have already in place. This new initiative is to deliver £300 million out of our external cost base. If you take out the fuel commodity which is about £1 billion, that means it is 10% out of our cost base, a significant reduction. It will go across all areas of the business, there will be no part untouched and, if you compare that with what we have already delivered, it is a significant sum.

How will we do that? I suppose if you think about procurement, it has three very important levers. The first one is about price. That is bread and butter to purchasing people: it is about negotiating good deals with our supply base constantly driving out price. When we look at where we will take out that £300 million, we have taken a very analytical approach to our cost base. We have gone through each type of cost that we have and we have appraised whether we believe that we can take out cost through price but also through two other very important levers. The first is demand control which, simply put, means that we buy less, we just shop less. If you take out money from demand, you are taking 100% of that cost out. Demand to us means that we buy too much volume, it costs us money in infrastructure, it means we have warehousing costs and our logistics costs are just building. We have to take control of the demand.

The third lever is about specification, which means making sure that we only bring into the company goods and services that are fit for purpose, not gold-plated, that only last the amount of time we need them to last for. We need to be very clear about how we specify the goods for which we go to market. Equally, we need not only to control that internally but also to make sure that our suppliers are absolutely crystal clear about what they are delivering to us.

This is no different to the challenges faced by any other company right now. Procurement is about taking costs out of the business, the bought-in goods and supply. However, BA is no different to any other company and we used to have a situation whereby anyone in the company could buy anything they wanted from anybody. That is serious bad news to people in procurement. Therefore, we have had to carry out a whole change in the behaviour of this company to bring goods and services in in a very compliant, controlled and co-ordinated way. This is a step change in this company's behaviour, changing the way they are permitted to bring goods and services into the business. That is what this whole initiative of Size and Shape and our new initiative of £300 million building on that is about.

During last year through Size and Shape, we put in place a number of key themes to help us deliver these activities. We moved to a process-led organisational structure and you may think what is that about. Procurement is really just a production line, it is just a process, and it does not matter whether you are buying a widget for an aircraft or whether you are buying a lettuce leaf to put on the aircraft. It is the very same process. So we moved to an organisation that is built on the key themes of how you take this production line through: the negotiations, how we manage our suppliers, how we optimise our supply chain. It is what we would call best practice procurement. We benchmark how we procure in British Airways against a number of like industries within the profession and, if you were to ask me how this best practice can be described, it is in three areas.

Do you have coverage of the spend that the company controls? In British Airways we have 100% of the spend covered by procurement. We have a process called Strategic Sourcing, and I shall take you through what that looks like just in case you fancy a change in career. We also have processes in place that would say best practice is compliance to your process, so we have to make sure that everyone in the company is complying with what we do. The final thing is that it must be consistent. Every time we go to market or we manage our supplies, it must be consistent.

We have put in place an organisational structure to build capability and we have invested in that during the year. We have also put in place a strategic sourcing process that says each time we go to market it will look the same. We have category plans that take the business strategies out of our strategic framework that determine how we go to market, so our sourcing strategies, how our negotiating strategies are delivered and, most importantly, that it meets the business need.

We have been doing that during the year and I will take you through this process. It is really important that you follow me through on this one. If you think of it as a factory production line, we go to market and source probably about 500 times in a year, so we need to know what we are doing. We have a seven-step process and I am sure that most companies you meet do the same thing. They all call it strategic sourcing, some of them have five steps, we have seven. We decide what we want, what the business need is, so not just what the company thinks they want. Then we go to the second step which asks how are we going to deliver that. There are many ways in which you can deliver a business need. The added value that procurement puts into an organisation is challenging how that business need is discharged.

We then move into defining a sourcing strategy: are there people out there with capabilities who can deliver that need? We do standard RFP stuff, going out to the market to find those people. We like the part where we negotiate, which we do for a while, and we implement agreements. Most purchasing people stop here and chuck the contracts over to the line and say, "Get on with it!". A fundamental change for British Airways is that we do not do that. What we must do is manage our suppliers and develop them, because what is important to us is that half of the costs in this company are for goods and services. It is integral to the delivery of our customer proposition that our suppliers deliver what we want them to deliver and what we have paid for. So that is the process: decide what you want, make sure you have the best process in place, find some people who can work with you, negotiate the deal, sign it, make it work and then manage it.

Does this process work? You bet it does. This year we have taken down our UK controlled suppliers by 64%. We had 14,000 when we started this process and have taken it down by 64%. You simply cannot manage 14,000 suppliers, it is a nightmare. Now we have control of our supply base. Our buyer productivity, the people who source and put agreements in place, has improved by 48%. We have quality control processes to make sure that not only is that productivity extracted, but we have quality assurance points in our process to check that productivity is not at the cost of quality. The average transaction cost means ordering and paying for goods has reduced by 40%. That is what this process does for us.

You are probably quite interested to see and hear about what our supply base looks like. This is a standard boxed matrix. We believe that we need about 2,000 suppliers overall, which is a massive shift from 14,000. We profile our supply base into these quadrants and it is really important that, in order to deliver our strategy, we have this type of matrix so that we understand, and this categorisation informs us as to how we will manage our suppliers and how we will want to negotiate with them. The top left-hand box says strategic partnerships. They are small and long term. They are the big OEMs, the big airports, the big ATC authorities, the caterers. They are very consolidated, about 100.

We have a collaborative relationship with those companies we feel we can work with and start to share infrastructure and other elements of our business processes. Then we have two very short-term focuses here which would be opportunistic and our very pure transactional process. We believe that that is the right way to manage our supply base.

Let us deal with them one by one, taking, first, strategic partnerships. Hold in your minds people like Boeing, Airbus, BAA and fuel companies. They are up there and we have to manage them consistently as they are an important part of our value chain. We have in place a process that shows very clear performance measures that are determined. These are monopolies and they are people or companies to whom we have outsourced major chunks of our business, so we have to manage tightly their performance. We have quarterly reviews with them and scorecards, and we have a very deep dialogue about their performance. We give clear visibility of our suppliers, as it is important that these suppliers have a consistent process in place for delivering goods to us, as we are not just talking about the UK but about global end-to-end. We will globally source products to bring in place, a lot of visibility.

We also believe it is important to communicate with our supply base to tell them what we are up to and to keep them engaged with our business. They cannot deliver for us if they do not understand what is important to us, so we spend a lot of time in that dialogue. We can do that and we continue to build on our strategic partnerships on those 100. Think back to those three levers that we had originally to say we were going to deliver £300 million.

Our strategic partners do three things for us. We certainly deal with them on price, we deal with them on demand control and they help us to come up with ideas to increase our ability to change that. They also have ideas about specification. If suppliers are in that quadrant, and we will tell them, there is no place for them to be complacent. We have people who sit in there who will not always be there. There are some that are and there will be some that are not. We are currently in the middle of a tender to move our ground fleet operations and we are at the end of this negotiation. That sent an interesting message through to our supply community, because everyone thought BA will not change anything to do with the operations. We will and we have because there was value in our moving.

The next part of our processes would say the collaborative relationship. This is where we look at how can we work together and to build infrastructure together; drive out under-utilised assets and transfer some of those assets and get them to start taking some of the risks and rewards in this business. Taking inventory from us: you heard John talk about some of the excess inventory that we have taken off. We believe inventory is evil in British Airways but it is a necessary evil, though excess inventory is very evil. We have spent time taking it out during the last year. We are also going through processes of handing back to different suppliers that can collaborate with us which is good news for us.

Consolidating our complex supply chains. British Airways used to be very functionally organised, which meant we built supply chains that were just fit for the purpose of that function. In fact, most of our supply chain is getting supplies to an aircraft so it is commonsense to try to combine those as much as you can. We have been putting our catering and our inflight supply chains together so that we can, again, take out costs. We take out costs from our supply base and they pass it back to us, that is a good news story, and there is a lot more of that to come.

You would not expect me to stand here and say anything about OneWorld. We do a lot of volume aggregation with OneWorld, it is a very important procurement tool for us. We will aggregate destinations, we will aggregate in terms of like supply which works well. What works really well for us is when we have simple, very streamlined commodities and there is nothing like engineering parts, there is nothing that BA can do anything to engineering parts. We can share them and when we do so, that means that we do not need the same amount of inventory individually. We can have a shared process. We share A320 parts with Iberia, we have shared some 777 flight controls with American Airlines. To give you an example, that one deal with 777s and American Airlines was worth $12 million to us. Normally, when we would have done the provisioning for that fleet, we would have put certain spares around the world and we would each have done the same. However, by collaborating, we could reduce the amount that we both purchased. Those are the things that we are currently doing and we have the capability to do that.

We are also moving more to pay-as-you-go type deals, so that it is more cyclical in terms of the variability of our programmes. Rather than buying and owning everything ourselves, we are moving to a pay-as-you-go system which is an important part of collaborating. However, we need certain attributes with our suppliers to deliver that for us.

We believe that this quadrant of suppliers addresses those levers of specification, because you cannot collaborate if you keep over-specking stuff, and they are about demand control. If you share and get supplies to take those risks, it sorts out some of your fundamental demand control problems.

Moving into more of our short-term relationships, I am sure you will all have heard of e-procurement. We have an e-procurement system called the ARIBA system. We have implemented that into British Airways and have finished the systems integration for it. It is a very important part of our process improvements and about getting the company easily to buy goods and services in BA. It increases the compliance as you simply cannot go and get something other than through this e-procurement tool. Most companies feel and see that they achieve huge cost savings out of e-procurement. It is here, it is working and is available on every employee's desk. It is tightly controlled which means that you only have access to certain suppliers and we control the catalogue content. So it is a black one and that is all you can have. That is what e-procurement does for you.

Eight percent of our transactions are electronic. That means that we are currently switching off manual systems. Many invoices and other paper transactions are being removed and our e-procurement tool does that. We also have very deep enterprise-wide systems that connect through into the oil companies and into our engineering parts, so that enables us to take out support costs. Those are the sorts of things that deliver those improved transaction costs for us.

We have 100-plus suppliers now on our BA To Buy system, that is our branded e-procurement, and this is a very good, intensive usage of the system. This is about short-term transactions and addresses price, because it is all catalogued, you cannot do anything other than use it. It controls demand because we cap volumes. Therefore, it is a very important tool for controlling that compliance and changing the behaviour in the company.

Finally, we have an opportunistic relationship with people. Quite frankly this is just about price and the best tool in the market that many companies will use is an auction capability. We use auctions in BA, which is a fabulous tool taking out cycle times. It shows that you can take real costs out, a very transparent and competitive field. Our suppliers hate it not surprisingly because what happens is very transparent and visible. We have run a number of events and within those events there are many lots. We have done courier stationery, all the stuff that is very commoditised. We do not care who we go to for these people, it is just easy stuff: auction it, get a good price, get it into the company, put it on an e-procurement system and you are there. It is really quick.

You can see the sorts of things that we do on that. We can do PCs, we have done amenity kits on the aircraft, we have done crew accommodation. People said to us you cannot do that because it is difficult and the market does not like it but we have done it and had savings. We have done blankets on the aircraft, menus, first-aid, seat leather. We have done IT servers and many people say you can only do auctions with about five different suppliers. We did IT servers with just two and we still had a very good saving because they just wanted the business and that is how we were going to market. You can tell I love this, it is very good and addresses price. We have loads more auction events booked and scheduled for next year. For example, we have 34 fuel auctions planned. Again, the fuel companies did not like it but they just have to do it.

In summary, we have corporate compliance. The whole of the procurement initiative is predicated on having corporate compliance and we have standing instructions in place to put this discipline in. We have supplier consolidation and we have taken the numbers down from 14,000 and we will shortly be at 2,000. That means that we can manage them and have proper sourcing strategies in place to go to the market. We have preferred suppliers so those are the only guys we will do business with. We have our supply chain optimisation plans in place and we have a strong, deep use of our e-procurement tool under our transactional procurement. Those levers of price, demand and specification are what will deliver us that additional £300 million. This is how we shop in BA. John, over to you.

10% OPERATING MARGIN
John Rishton
Chief Financial Officer

[*Presentation with slides*]

To wrap up the section on the future, I want to talk a little about 10% operating margins, where we stand, where we see the business going and what is coming our way. This time last year, I showed you a roadmap of how we saw ourselves getting our operating margin from where it was to 10%. As I said earlier today, the 10% margin we are using as a proxy for CVA positive. We will just focus on the 10% margin and we showed you a roadmap a year ago which looked like this.

If you remember, two years ago our margin was 4.1% for the 12 months ending December 2001 minus 1.5%. At that time, we said how do we get to 10% and we talked about a market recovery. A year ago, we were in the position where the general outlook was that, by Q4 of 2002, things should start recovering and would get better. The general view from pretty much everybody was that the market was at or about its bottom and would start to get better. We had a market recovery element at some time in the future of about 2.6 points, helping us get towards our 10% operating margin target. Everything else such as the fleet utilisation, the network benefits costs, distribution costs, manpower reduction in both the front line and support and our procurement and IT savings were within our control and were cost related. So a year ago we stood here and said we were expecting to get some help from the market but, even if we do not, most of it is in our hands and we can deliver that. As I have explained to you this morning, we are on or ahead of track of where we thought we would be against all of those cost targets, and we believe we will deliver them all. Therefore, for most of that staircase, we are in control and we will deliver it, but the world has changed.

Although there are only three bullet points on here, there are four items that are really affecting us, and indeed all businesses, at the moment. War and the threat of war we are all aware of. That is very different today than it was a year ago and we will see how it plays out over the next few weeks. That threat of war overhanging our business is already a major problem for us for the very obvious reason that people do not want to travel, especially long-haul, if they think there is going to be a war. As we look at our forward bookings, we immediately see the impact of that threat of war even before a war starts. My suspicion is that, if a war starts and it is clear that it is going well – although I sincerely hope there will not be a war – the bookings will start to pick up again and business will look more favourable. However, the threat of war is a real problem for us at the moment. People do not want to travel, they do not want to be stranded somewhere and they are very concerned especially on the long-haul side. The threat of war is also pushing up the fuel price and is probably affecting the fuel price more than any other single factor at the moment.

Terrorism is the second factor. I do not know whether it is more or less than it was a year ago. Clearly, the events of 9/11 changed everyone's perception of terrorism. We have lived with it in this country for many years, as have many other countries, and I suspect the threat of terrorism will always be in the background somewhere. It will never go away completely.

The economy: we were saying it was going to recover but it did not. In fact, in many countries it is worse and you can look, for instance, at Germany to see the state of the economy there. The position of the UK at the moment is stronger relevant to many other European countries but I suspect we are teetering on which direction we will go in. Will the house boom fall off, will consumer spending continue to remain strong? I do not know and where we end up on war may influence that as may the strength of the US economy. There are different views about how strong the US economy is. Consumer spending is certainly slowing over there but, if the threat of war is removed, the US economy may start to recover towards the back end of this year. However, the economy is much tougher than we thought it would be and we also have huge competitive pressures as have many other companies. There is far too much capacity in our business, as Ray was explaining, chasing far too little demand. The network carriers have put capacity back in and KLM and Lufthansa had about 10% more capacity in February this year than last year, and even we are putting slightly more capacity in over the coming year as a result of not selling aircraft.

We have carriers in the US in some ways acting irrationally but being protected by Chapter 11, and Ray gave us an example earlier today of discounts that United were giving of 73%, although he pointed out that even 73% was not enough to keep people with them, which may be why they are in Chapter 11. People behave irrationally when they are in those positions, so the competitive pressure is intense and, of course, the no-frills carriers in short-haul continue to add capacity and to keep up the competitive pressure. Therefore, we have those four main factors all of which, to a greater or lesser degree, are worse than we had assumed a year ago.

Going into this next financial year we also have some substantial cost headwinds hurting us. As I showed you earlier, we have had some cost benefits in the last financial year and we certainly have some cost headwinds coming at us in the next financial year. We have put in some more capacity which makes sense as we have the aircraft to fly them, but we will get some more volume-related costs coming in as a consequence. Some of the implications of the threat of war are also affecting our cost base. You will be aware that, at the moment, our crews are slipping in Larnaca in Cyprus rather than in the Middle East, which creates some operational issues for us and also puts up costs slightly. We now have about 400 cabin crew overnighting in Cyprus which probably makes it a good place to go and have a holiday at the moment.

It is very difficult to forecast fuel costs. The current forward curve is severely affected by the threat of war and our best guess at the moment is that fuel costs will be up £100 million next financial year compared with this financial year, though it is difficult to forecast at the moment. Our hedging position on fuel is about 50% covered in the first quarter ending June, 30% in the quarter ending September, 15% in the quarter ending December and 10% in our final financial year quarter for next financial year. So we have some protection from hedging but we will see how the fuel price goes.

As far as landing charges, you saw the results of the CAA deliberations with landing charges going up quite significantly at Heathrow. However, it is not just there but some of the over-flying charges around Europe have also gone up significantly.

PPI stands for pay, pensions and insurance. We have increased our pay by a modest increase of 1% last year but, nevertheless, we have increased pay and will increase it again for our staff this year. Pensions are an increasing concern for many companies and why don't I pick up that issue because I am sure I shall get a question on it sooner or later. There are two issues here, one of which is FRS 17, and we will see where the market is at the end of this month, which will determine where our FRS 17 position is. I suspect that with the information that we have given you over the last year, most of you can get to the answer pretty accurately yourselves.

The actuarial valuation is the one that determines how much cash we put into the pension scheme whereas FRS 17 in the UK is non-cash and a note to the accounts. We have an actuarial valuation every three years starting next month and it will take seven or eight months for them to do the work. We should get the answer to that in September/October this calendar year with any change in payments starting in around January next year. Again, we will see where the actuaries come out on that, because they take a different view and the fact that it takes seven or eight months to come to that conclusion should give you an indication of either the complexity of the work or the speed of their work. I hope there are no actuaries in the audience as they are the only people I know who believe that increasing life expectancy is bad news! [*laughter*]

On insurance, we also have friends in the Government. The Chancellor has increased National Insurance contributions for all UK companies which will increase our costs next year as well. So we have some significant cost headwinds coming at us next year – if I put my finger in the air, £300-400 million cost headwinds – coupled with the fact that, as I said in our Q3 results, we do not see any lift in the revenue next year. We see the revenue flat for the reasons I have explained before, which means that it will be a tough year, which is no surprise to anybody in this room.

This is why we have decided that we need to go beyond our Future Size and Shape programme in terms of driving further cost savings, and we are looking over the next two years to drive a further £450 million out of our cost base. As Silla has explained in some detail, this is driven by a reduction in the external spend of £300 million and, as John has explained, CEBA will drive a large part of the other benefits. However, as I said earlier, we are finding cost savings as a result of simplifying our business in all areas all of the time, and we believe that the CEBA and the other simplification initiatives will drive further cost savings of £150 million, so a further £450 million cost savings over the next two years, which will help to offset some of those cost headwinds that we are facing in the next financial year.

Our focus will remain, as it has done for the last year, on managing what we can control. We will make sure that we get our fair share of revenue in the market and in many areas we have improved our market share on the back of our product strength in the last year. However, we cannot control the total market. We will get our fair share or maybe slightly more but our focus will remain on managing what we can control. We are going to deliver the Future Size and Shape programme and we are going to sustain that cost benefit that it has given us. We will maintain the manpower reductions at 13,000 despite the fact that we will have more capacity next year than we originally planned in Future Size and Shape. For those of you who are thinking that 13,000 does not sound enough, the world has become a lot tougher so why don’t you do more on manpower, we are already doing 23% of our base on manpower and we are absorbing a 4% or so increase in capacity next year, which means that our productivity will be greater than we assumed in the Future Size and Shape programme. We have been looking at how we can do that and we are confident that we can achieve it.

We have these two major new programmes: the external spend initiative and CEBA which we have been through this morning. We will limit the capital expenditure, as I said earlier, to £400 million or less. We will deliver the £900 million of disposals and we will continue to simplify the business.

Where does that leave us in terms of our operating margin? It was 4.1% two years ago, last financial year we made a slight negative margin of 0.4% which is different to earlier because 1.5% was at the end of December and we just shifted it forward now to where we ended up in the last financial year. As you all know, the market has been a little different to the one we had in our original chart, so instead of getting 2.6 points of help, it seems to have gone about 5.3 points negative. That puts us in a slightly different position to where we thought we were going to be. If I add back our Future Size and Shape initiatives, which we are delivering and will continue to deliver, it does not get us towards the 10%.

What shall we do: shall we change the 10% target, or do we think we will get to the 10%? The simple answer is that we will not change the 10% target. We absolutely believe that we can deliver it and we absolutely believe that we have to deliver it and that we will deliver it. We will need some help from the market as we always said we would. A year ago we said we think we need help with our 2.6 points from the market, so we need some help from the market. The market will recover to a certain extent. In the last two years, our revenue is off by about £1.5 billion and it is not unreasonable to believe that some of that will come back. A £300 or £400 million improvement in revenue, yield and load factor will generate 3 to 3.5 points of margin on the way to helping us in that recovery. It does not seem unreasonable to me to make that kind of assumption. We always said we needed some help and we do. The market will come back, though when and by how much I do not know, but it will come back to a certain extent.

We also said a year ago that we need some help from things like fuel price. When the fuel price is up at $30-35 a barrel compared with an historic average of $24 a barrel, it is difficult for any full service network airline to make these kind of returns. However, we are absolutely sticking with the 10% operating margin and the new initiatives that we are putting in place to deliver the extra £450 million of savings are clearly going to help us towards achieving that. So we are sticking with our 10% operating margin, we will deliver it, we do need some help from the market to get there.

In summary, the revenue outlook is tough in the short term and we see no significant improvement in the next financial year. We have already said that we see revenues being about flat. We are on track to deliver our Future Size and Shape programme and we are focusing on controllable costs. We are cutting our capital expenditure to deliver in the disposals. We have put these new initiatives in place which should help us restructure further our cost base on top of all the restructuring work that we have done to date. We are not slowing down on cost savings, we are continuing to drive them through in all areas of the business wherever we see the opportunities. Rod has taken you through this morning how we see the strategic framework and that gives us a very good communication tool such that we can balance the cost saving that we are driving on one side of it against the customer proposition on the other. It is essential for us, if we are trying to drive revenue and revenue premium, to make sure that we retain the well-deserved reputation that we have for product leadership and service leadership. We will deliver the 10% operating margin through the cycle. I shall now hand over to Rod and we will switch to the questions.