BRITISH AIRWAYS PLC

INVESTOR DAY

Thursday, 11 March 2004

[*Transcriber's note: no agenda or copy of slides provided*]

George Stinnes: Let me deal with the housekeeping issues first. A health warning on what we tell you today. You have grown used to seeing this and I have done it in very fine print. It is in your packs if you want to read it but from a compliance point of view it is critical that you understand. Fire and safety – safety is the hallmark of British Airways of course. You have seen it from last year. Fire alarm continuous sounding is bad news and the exits are around you. We have a no smoking policy at British Airways, which means that inside the building there is no smoking. There is a courtyard available for those of you who cannot resist. The last one is the mobile phone issue, which we all laugh at. It is very annoying and would you please turn them off as we speak. There is no danger of the building crashing as there is the danger of an aircraft. I had a glass here and I have one here again this year. Dream Flight, our children's charity, will be pleased to receive a donation of £10 for any phone that goes off. Last year one did and unfortunately the honourable person was not that honourable but the glass is there to remind you.

The plan is in here to help you find the restaurant and various other facilities. Feedback is very important for us. There are two parts, one about each of the speaker's presentation and also for what we have as a ticket competition, it will not be a ticket competition but on the feedback I would ask you fill it out as you go along. We will ask you to give it back to us at lunchtime as the afternoon's activities will not see you coming back here again. Therefore, we would like to collect them as you go out to lunch. The competition is in honour of an aircraft that retired this year. We have a very nice picture of Concorde beautifully framed as a piece of memorabilia together with an appropriate message on the bottom of it. That will be the prize in the ticket competition and we will show it to you after the break to encourage you to fill in that form as well.

Let us move on. Change in a sense is a message that sets the context for the day. Change in our business is inevitable. If we look back over the last five years, and we look at what has happened in the low cost end of the market in the shorthaul business, our business looks completely different today from what it did five or 10 years ago. As we move forward, we know there are new challenges facing us too. We are going to have deregulation sometime, we have been promised it for a long time, and we are going to have consolidation in our industry. Change is very much a hallmark of our industry and we view it here as an opportunity for the future.

When you think about change, the first thing to do is to think about what your customers, the experts, and others say about us and what they think about us. Some even think that we have some experts in this room today. I have a short video clip which we show to our staff to help them understand the challenges that the people around us feel that we face. [*video clip shown*] One thing is pretty clear – it is not just about costs. I believe that we have a good reputation on the cost front but I can assure you that the real message is much more than about cost.

When we launched Future Size and Shape, we talked about a number of strategic priorities and we have reorganised them a little. We start very much at the core of Future Size and Shape with simplification of the business and it is that simplification which drives consistent customer service, a service that staff can deliver well. It drives products that customers want and it also drives the cost base but it is more than just costs.

For today, I have put at the top of that box "strengthen the balance sheet", which I thought would be an appropriate message for today. All these things deliver that when working together, but they also deliver a secure business both for our staff and our customers into the future. It can deliver market leadership and product innovation. It is amazing what you can do when you are a financially strong business. If it were only about costs, I would suggest to you that the awards that we have received over the last two years while we have been dealing with the Future Size and Shape clearly means that we have not taken our eye off the ball on the customer service front. The customer is very much a part of the equation at British Airways. Lest we forget, look at all the things we have done and have invested in for our customers taking us forward.

The agenda today is to remind you that this is a complete business with a vision about the future that knows where it is going, all the aspects of building a successful business. In terms of the presentations, some of them will deal with the past, what we have put together, and some will deal with the present as to how things are. We will also talk about the future with some of the pieces where we have to play a key role both in the regulatory side as we move through deregulation, open skies and so on, and also the key environmental issues that will grow in importance as we face the future for our company. Of course, the overall vision is absolutely key to tying it all together.

With that, you have heard enough from me. I shall introduce a video which highlights the ups and downs that have faced the industry and the company over the last 12 months. Thank you very much. [*video shown*]

Sir Colin Marshall: Despite your not voting for it, we seem to have moved into the romantic environment. George, I guess we were beaten by the sun in the end. You do not count on those things around here as we all know.

Let me add my greetings to those already expressed to you by George Stinnes. This is the last time that I shall have the pleasure of welcoming you as Chairman of British Airways to the Annual Investor Day. As you know, I shall be stepping down after our Annual General Meeting in July to be succeeded by our current Deputy Chairman, Martin Broughton. It gives me much satisfaction to hand over the reins in July in the knowledge that BA has not only survived to tell the tale of these recent ordeals, but has also gained great strength from the experience and is now on a much more robust business footing for the future.

The video spelled out the sequence of extraordinary and deeply damaging events which have affected air transport, and especially the intercontinental operators over the past year. When you add that to the events of the preceding couple of years, we have been through the most depressing and stressful period in the industry's history. At the same time, the nature of airline competition is changing, most notably in Europe with the emergence of the no-frills, no-service, low-fares operators on most major routes and many of the smaller ones.

Without recourse to the kind of crisis handouts made available to our US competitors in particular, we have had to create our own financial cushioning by drastically reducing the cost base, significantly increasing efficiency and sharpening our competitive edge. The business model envisioned by this strategy which we call the Future Size and Shape is now a reality. The formal curriculum has been completed successfully but it is only the first leg of a long journey and it is important that the business simplification ethos of Future Size and Shape remains very much alive to continue driving us forward. You will receive the detail very shortly but we had by December already exceeded our key cost saving targets in manpower, procurement and distribution. The profits that we reported for the third quarter and the first nine months of the financial year clearly came as a result of cost reduction during a period of acute downward pressure on revenues and yields. It is significant that we saw in our third quarter, albeit modest, the first year on year revenue increase for a very long while. Those results represent an outstanding achievement on the part of Rod Eddington, his management team and the entire committed workforce, the people of British Airways.

In last year's business plan, we announced cost savings of £450 million and we are well on the way to achieving that target. Nevertheless, we still need to reduce overheads and, at the end of January, we launched a new two-year business plan involving further necessary measures to take costs out of our business. It centres on the need to reduce employee costs by a further £300 million as we drive towards our overall objective of achieving a sustainable annual average operating margin of 10%. We aim to place British Airways on the soundest possible business footing so that the company can contend successfully over the long term with shifting economic and competitive conditions.

Today, you will hear more about how the airline sees itself for the future. British Airways will remain a global network carrier and continue to offer full service. It will invest in its products and increase value for customers wherever it can. This airline will not fall into the trap of becoming just another cheap deal but endeavour to provide high quality at a fair price. Its British reputation for reliability, professionalism and commitment will be reinforced. The Board is staunchly behind the management team in its resolve to face up to the problems of recent years, and develop effective strategies to overcome them. Martin Broughton might be new to the chairmanship of BA come July but he is no stranger to the company or to its people. Having been a Board member since May 2000, Martin understands this business and its needs in the contemporary economic, political and competitive analysis. Shareholders can be thankful for the strategic continuity that he will provide.

Corporate governance has obviously been an important issue for our Board in recent times but especially since the Financial Reporting Council issued its Revised Combined Code in July of last year. We have taken these matters very seriously and I can confirm that BA will be fully compliant with the Revised Combined Code by the end of this month, in other words before the start of our next financial year. Our Company Secretary, Alan Buchanan, will be available to answer any queries that you might have on this subject.

One of the Code's aims is to bring non-executive or independent directors closer to the investment markets, and today, in addition to Martin Broughton, we have with us our other Board members: Maarten van den Burgh and Baroness Detta O'Cathain. They will represent our hardworking and effective Board and they will be available also for any questions or queries that you may wish to ask of them, and I suspect that they may want to ask you a few questions themselves.

The business climate for the immediate future is perhaps less volatile but it remains uncertain. Demand continues to fall for shorthaul premium travel, and the non-premium market on all routes remains price sensitive. On the other hand, intercontinental premium demand is showing improvement. Cargo volume continues to grow with a year on year increase of almost 10% in the third quarter. Although yields are still depressed, the otherwise buoyant freight market marks a positive economic trend. For the longer term, we draw encouragement from the introduction of Heathrow's Terminal 5 in four years' time and in due course of a much needed third runway at Britain's one and only global hub airport, the result of a successful outcome to the Government White Paper just before Christmas.

It will take huge political effort but we believe that the creation of a free market for aviation in which the normal commercial course of business consolidation can proceed is inevitable. It is only the timing which remains in question and in doubt. For my part, I shall be very interested in following those developments from a more distant position for the future. Now we are going on to the numbers and to our Chief Financial Officer, John Rishton.

John Rishton (Chief Financial Officer): Thank you Chairman and good morning, ladies and gentlemen, it is a pleasure to have you here. You are very welcome as you are well aware. As the video has shown and as the Chairman has told you, it was another very tough year for the airline industry. I went through the video last night and it reminded me of just how difficult the last year has been and perhaps that one of the reasons why the airline industry has so many pensions problems, because I feel that I have aged another five years and ageing seems to be a real problem in our industry more than in other industries.

During the course of a year when we had all of those issues thrown at us, we have not just survived. We have consolidated our position and we have put our business onto a more robust basis. Our Q3 results with a margin of 7.3% are a reflection of that improvement in the costs. The fact that many of you are now forecasting that we will make a profit this year when previously you were not is an indication of the scale of change that has happened at British Airways over the last two years.

George has already shown you this slide. Simplification underlies everything that we are doing at British Airways at the moment. Everywhere we look, we find that we have made the business complicated and that gets in the way of consistent customer service and leads to high costs. We are simplifying everywhere. As you would expect, I shall focus on the costs and the revenues, and Keith Williams, our Group Treasurer and Head of Tax, will talk to you about some of the balance sheet issues and the changes that we have seen in the balance sheet over the last couple of years.

This is a familiar slide to many of you and it is what we said two years ago on 13 February 2001 when we announced our Future Size and Shape programme. We said it was about four things. It was about driving profitability and we set ourselves a 10% operating margin target which, as you are all aware, is a proxy of positive cash value added, a positive return to our shareholders. Internally, we have used the 10% operating margin as that proxy, it is far easier to understand internally, it is far easier to explain. You are a more sophisticated group – I was hoping for a bit of a laugh there but perhaps I was optimistic – and you understand CVA. It is a proxy for that, the 10% operating margin. We decided that we could not rely on revenue. You may remember that we forecast at the time that revenue was going down at February 2001 and even we did not forecast how much it would deteriorate over the following two years. Our focus, therefore, has been on costs to drive the profitability of the business. Simplification through everything that we do.

How do we compete with the no-frills carries? We decided that we needed a different approach. The aircraft that we fly, where we fly to, the way that we price, the fact that we have now adopted the same kind of pricing model as the no-frills carriers, the change in the booking engine which I am still told is the best booking engine on the web, and our advertising, the fact that we now advertise that there are low fares on British Airways and we are now on people's shopping lists. This has been very successful over the last few years and we are now hanging onto our market share as was said in the video, and things are improving. Manpower: we said we would reduce our manpower significantly and we have.

Let us look at where we are on Future Size and Shape. In terms of the total cost savings, we said we would save £650 million on an annualised basis by March 2004. As at December, we were at £795 million, well in excess of the £650 million, and by the end of the financial year we will be close to £850 million of annualised cost savings. We have beaten all of the targets that we set in terms of cost savings. For manpower we are at an annualised rate of £460 million against a target of £450 million; distribution over £200 million and procurement and IT savings at well over the £100 million target. On disposals we said we would make £900 million worth of disposals over that two-year period, and at December we were just over £700 million. By the end of this financial year, we will be at £900 million.

There is one item that is missing off there from a financial perspective, and Keith will talk more about that, which is capital. When we launched Future Size and Shape, we said we would spend no more than £850 million in capital over the two-year period. We will spend around £600 million over the two-year period rather than £850 million. As George said earlier, the capital that we have spent has been focused on the customer, trying to get the benefits for the customer whether that is new lounges, Terminal 1 is a good example, self-service kiosks or in the product on the plane. We continue to transform our planes, we continue to put the flatbeds on our aircraft and into next year we will have finished all of our longhaul fleet in terms of the Dusk programme. So we have exceeded all of our Future Size and Shape targets.

Let us look in a little more detail at the distribution. There have been huge savings on distribution over the last two years. We set a target of £100 million and we reckon that we have already delivered £212 million and the number continues to increase. A large part of that is clearly driven by the fact that we have reduced travel agents' commission, so in June 2002 we reduced our travel agents' commission in the UK from a 7% commission to a booking fee. We have also reduced our commission in the US to zero percent and on 1 December in the UK we announced a further change in agents' commission to a 1% charge. We have made significant savings over the last two years as a consequence of those actions. In other countries, we have followed the lead carriers in all cases and reduced commission wherever we could.

Our channel shift programme, driving sales on line to ba.com has been a very successful cost saving measure for us as well. It has also been very well accepted by the customer. In fact, many people now prefer this as a means to communicate with us than any other means. Simon Park-Smith, who will be presenting after me, will take us through a lot more detail around the innovations and channel shift. Selling efficiencies in general: we have looked at every single aspect of our distribution and have addressed the cost and customer issues in many different areas. For example, in Contact BA as we drive more and more e-ticket, our fulfilment costs reduce so the cost of putting paper tickets in envelopes and sending them out go down significantly. We have changed the way that people contact us in terms of the charges that they pay to Contact BA. We have looked closely at the incentives that we pay dealers. How do we target those incentives? We have been much more careful and precise about that targeting process. Every single area of the distribution chain has been under review and we have successfully reduced costs in every area.

In terms of selling costs as a percentage of revenue, you can see the impact that this has had. The selling costs as a percentage of revenue which, historically, have been around 15%, 16% and 17% in some years, were down to about 9%. I have to confess that the scale of the graph helps me a little in the exercise of demonstrating this but you get the message.

We continue to look at what else we can do in distribution. We have not stopped. We have just launched a new dealing system which has simplified many of the IT issues that we had in the past and the process issues that we had. We are much clearer about what we are dealing, where we are dealing, the benefits of dealing and have made huge improvements in that process. Channel Shift continues and I shall talk about that in a moment. We have recently renegotiated contracts with our major GDS suppliers. We have something called Plan G – we have an imaginative naming committee in this company – which is an important plan for us. It is a bit like the vitamin naming committee: vitamin A, B, C, D. We have plan A, B, C, D and we are now up to G. I will come back to that in a moment.

Then we have the call centres, let us just look at the Channel Shift. What this chart shows in light blue are the traditional travel agents. In dark blue at the bottom is Ba.com, the red is the call centres and the yellow are other online agents. You can see that, over time, we are projecting significant growth in ba.com but the point I would make here is that we do not see any of the channels disappearing; they are all important to us. Our distribution strategy is a multi-channel strategy where we are looking at the cost, the reach and the quality of each of those channels and how we can best use them. The travel agents remain very important to us going forward but ba.com grows in importance over the period.

Global distributions systems: we have agreements with our four major GDS partners Amadeus, Galileo, Worldspan and Sabre, and we have changed the contract significantly to reduce the cost to us substantially. At the moment, our costs for GDS are around £80-90 million a year, but we will drive significant savings as a result of the changes that we have recently negotiated in the contracts. It is very important because 72% of our bookings go through these GDS systems, so again this is a significant cost saving for us going forward.

Plan G is really about what is happening in the UK. We have announced a 1% commission from 1 December in the UK. We continue to push e-tickets, we continue to drive e-tickets and for about 70% of our routes you can now get an e-ticket. Simon will talk some more about e-ticket going forward. We are driving towards 100% which brings significant benefits to us and to the customer as well. Yesterday, we launched the ability to take debit cards online whereas previously you could only pay by credit card, which has a good cost impact as far as I am concerned. It also gives the customer wider choice and, slightly to my surprise as I would not expect customers to want to pay by debit card too much, we had about 600 people who paid online on debit cards by lunchtime yesterday, which is the last time I had an update. Therefore, in the first morning of the first day that we launched debit cards, 600 people have used that facility.

We also have a new philosophy in that, as we do more and more servicing and selling online, if you want to go offline and speak to people in the call centre or in travel shops, we are starting to charge for that service. We are starting to put a service fee in that will remunerate us for the cost of providing that additional service as we provide services online. So we have significant further opportunities to reduce our distribution costs.

Call centre volumes: I hope you are all aware that a few weeks ago we announced the closure of two of our call centres, one in Glasgow and one in London. That was driven primarily by the fact that call volumes are falling, it is just the inevitable result of more people wanting to go online. They are falling significantly, down well over 30% and as a consequence the number of people we have employed in our call centres has fallen from around 2,300 to about 1,400 in the UK over the last few years. Consequently, we do not need all the property that we had and we are consolidating our operations in the UK. We are consolidating our operations overseas as well as this pattern is not only confined to the UK but it is a world-wide phenomenon as you would expect. We continue to look for further efficiencies in that area as well.

Procurements: we have exceeded our target. We said we would save £100 million and we have saved well over £100 million. Last year, we spent quite some time explaining to you the focus that we had in terms of price, quantity and specification. We have been driving down price wherever we can and we have also been looking at the quantity and specification of everything that we buy. The example that I frequently give is around the engineering inventory. We have halved our engineering inventory. We found that we were buying hundreds of different types of gloves when we did not need to, so we are now down to two or three different types of gloves. We have changed the specification and we have changed the quantities that we buy. Every single area of the business is under that review. We are being very successful in driving out unnecessary spend on these three measures.

Simplification: as I said at the start of my presentation, simplification is at the heart of what we are doing. These are just some of the examples. You are all well aware of the fact that we have been simplifying the fleet over the last two or three years and let me give you an example. In City Express we have gone from nine aircraft types to three aircraft types. In City Express we have gone from 15 bases to nine, we have gone from three maintenance centres to one. We are simplifying their business as much as ours. We continue to look for opportunities. We have recently announced the consolidation of our terminal control which was in Terminal 1 and Terminal 4 into a single centre in the Compass Centre. It gives us improved control, it gives us the benefits of bringing the people together, the expertise together at the centre of the operation. We continue to simplify everything everywhere we can.

One of the more recent innovations that I quite like, as it is helpful for me, is something called e-pay. I now get my pay advice online every month and from the start of next month we will not longer send out paper pay information to senior managers in the company; they will only get it online. We continue to simplify everything we can throughout the business, it is at the heart of everything we do.

I shall now hand over to Keith Williams who will talk to you about the balance sheet and then I shall come back to talk about revenue and costs.

John Rishton (Chief Financial Officer): Thanks, Keith. I hope that that has given you a good insight as to where we are on the balance sheet, cash liquidity and fleet issues.

Let us move on to talk about the revenue. As you are all well aware, the revenue has fallen significantly over the last two and a half to three years, much more than anybody expected even two years ago. Almost 10 consecutive quarters of revenue decline. We hope that we are at the bottom now, there is some evidence that we are. In our fourth quarter that ends in a few weeks' time, revenue in this quarter will be up by quite a reasonable amount, because the base we are coming off last year was clearly severely affected by both the war, which was about starting now, and SARS. Therefore, we will see some improvement in revenue but we need to be careful about the base. A total of £1.9 billion of revenue gone over the last two and a half years, 20% down. If we look at where that is gone, this graph tries to show it in terms of volume which is the red bar, mix the yellow and price the blue bar and it shows year on year. Therefore, in 2001/02 – the year ending March 2002 – there is a huge reduction as a result of volume, no surprise. We started the year with foot and mouth, we had 9/11 and all those things. Volume fell away dramatically and it fell away again the following year in no small part due to the war, and it began to improve this year. However, it is improving this year but you see the blue bar going the wrong way. So we are getting a little help from the market but we are driving some of those changes by the yield changes that we are having to put into the market.

If I look now in a little more detail at the various main segments of revenue: longhaul premium, shorthaul premium, longhaul non-premium and shorthaul non-premium, and I shall just take you through those. All the charts are consistent in the sense that they have four years on them, the light blue bar that appears last is the current year, RPKs in total. The one at the top is three years ago, the dotted yellow line 2000/01, the green line 2001/02 and the red line 2002/03. What you can see on here for longhaul premium, the blue chart way down here, is that it is up versus the previous couple of years, which is what we have been saying in the traffic stats now for the last few months. We are seeing some improvement in longhaul premium revenue. If you look at where it was versus three years ago though, you can still see that there is plenty of room for further improvement. So it is well down versus three years but there has been some small improvement in the last few months compared to the previous years. If we look at shorthaul premium, there is no particular surprise there. We have all seen in the shorthaul premium market that the volume has been getting worse year on year on year, so you can see it is going the wrong way. It continues to decline primarily driven by the structural changes that we have seen in the shorthaul market.

If we look at the propensity to travel in the premium market – this is the total market – the two lines on this chart show the propensity to travel in shorthaul premium and the propensity to travel in longhaul premium. So the yellow line is the shorthaul. Going right back to 1986 it increased up to about 1990. From 1990 the propensity to travel shorthaul premium has been declining. It fell off a cliff around 2000/01 as a consequence of the success of the no-frills carriers that structurally changed the market. In addition, of course, there are all the market changes that we have seen and the economy being weak but primarily the decline from there is structural change going down. The red line shows the same for longhaul premium and you can see that it has been a steadier line, again a fall-off really economy related, 9/11 related we believe. If you go right to the end, it has shown a very slight pick-up.

If we look at longhaul non-premium, the volumes are pretty strong, getting back to the levels we were at three years ago. Seat factors in longhaul non-premium over 80%, the planes are very full. The issue, as you are all well aware, in non-premium is around the price that people are prepared to pay, it is very sensitive to price.

Shorthaul shows a similar kind of picture, in fact even stronger, up at the moment compared to where we were even three years ago. That reflects in no small part the success of our change in approach to the shorthaul non-premium market. It reflects the success of the new model that we put in place, the fact that we know where we are flying, the fact that we have changed the pricing, we have changed the advertising, all of those things. It is very sensitive to yield, of course, but we are not seeing anything like the kind of yield deterioration that Ryanair are talking about. You have seen they are talking about 25% to 30% in this quarter but we do not see that at all. Yields are not great, I would like them to be much higher but they are okay at the moment. It is very price-sensitive, strong volumes, a successful model. We will be talking about the profitability of shorthaul in total when we get to our year-end May presentation and we said we set ourselves a target of breakeven by the end this financial year, and we will update you on that in May. However, we are making good progress. All of those are consistent with the traffic stats that we have been talking to you about.

I shall now turn to the revenue outlook, which is always difficult. The crystal ball that I use is not as reliable as I would like it to be, and my only excuse is that nobody else's seems to be any better. In terms of capacity into 2004/05, so capacity into our next financial year, we will be increasing ASKs by between 2% to 3%. Over the year, we see volume increasing, seat factor increasing. We see yield remaining under pressure and likely down next year. However, the mix between volume and yield can change and it is very difficult to forecast. At the moment, we see volume and seat factor, yield likely down. Revenue in total up about 2% to 3%, so total revenues growing 2% to 3% next year with that kind of combination. Now there are all the health warnings that you would expect me to put around that and trying to forecast revenue is really difficult. It is difficult enough to forecast what the revenue will be next week, let alone what it will be over the next year, and it is subject to all the health warnings, the external factors, the events that go on all the time in our industry as is evidenced in the video clip that we showed you at the start of the programme. That is our view on revenue and now let me turn to costs.

As you are well aware, we have been very successful over the last couple of years in the reduction of costs. We have reduced our costs by £1.7 billion over that period in pretty much all parts of the business, and it is this reduction in costs that has driven the performance that you have seen particularly in the third quarter last year. The reduction in costs has kept this company alive and made us survive. It is the reduction in costs, the restructuring of the business, the restructuring of the balance sheet that means we are in a much stronger position now than we were two or three years ago.

As is always the case on the cost side as I look forward, there are a number of cost headwinds that you would expect me to talk about. I do not suppose there are any particular surprises here. Pensions are a big issue. We announced in November, as you are well aware, that the UK pension funding requirement was going up by around £133 million a year. We started to pay increased contributions into APS in November last year and we started to pay increased contributions into NAPS in January of this year. So pension costs are going up not just in the UK but there are increases in the US as well.

Pay: if we pay ourselves more, it will put our costs up higher.

Fuel: fuel prices are remaining stubbornly high at the moment. Again, it is very difficult to forecast what fuel prices will be. My best view at the moment is that our fuel costs will be about £50 million higher next year than this, so an increase in fuel costs for next year. In terms of our hedging position, we are about 30% hedged in the first half of the next financial year and about 12% in the second half.

Volume-related costs: if we increase volume, costs will go up in relation to that. My old favourite are landing charges which continue to go up particularly at Heathrow, where the regulatory package is that we pay RPI plus 6.5% year on year. In total, I see those cost headwinds of about £300-400 million next year. That is why we continue to focus on the various initiatives that we have in the various business plans. A year ago, we talked about launching the External Spend initiative and the ceBA initiative that Simon will talk to you about shortly, about £450 million. We are making good progress on both of those programmes, and by the end of this year we will be about half-way through those.

We announced, as the Chairman said in his statement at the beginning, £300 million of employee cost savings to be delivered by March 2006, and we have taken a very different approach to these savings than the approach we took when we launched the Future Size and Shape in February 2002. Future Size and Shape, the environment we were operating in, the need for speedy change, the entire position of the company was very different from the position that we are in today. It is clear that we need to have a very different approach to this.

When we announced this programme, we said that we were going to do this by engagement with our unions and our staff, and that we need to make sure that everybody in the company understood the issues that we saw we faced as a company, that we understood the issues that they had and that between us we identified the best way forward to find those savings. We have been working hard with both the unions and the staff over the last couple of months, we have had many discussions which continue and we have had many ideas coming in and many views about how we could approach this. It will take some time.

I shall not go into any more detail on the £300 million savings at the moment. We are working closely with our staff and unions and I see no benefit in my making pre-assessments about what things may or may not happen. We will see how this plays out. We are confident that we will deliver the savings. We delivered the Future Size and Shape savings in one way and we are confident that we will deliver these in a different way but we will deliver them with the support of our unions, with the support of our staff, and we will continue to discuss how we go about it with them over the coming months.

If I look at our cost base, this aircraft tries to show our Q3 results where £100 of revenue went. The tail you can see the margin of 7.3% (£7.30) and the rest is where our costs are. If we start at the front of the plane, catering and handling. We have been addressing catering and handling costs through our External Spend programme and through further negotiations with all the suppliers in that area, so we are reducing costs in that area. Fuel costs are much more difficult to reduce. We have a very fuel efficient fleet, it is a very modern fleet. We have improved systems that help us with the most efficient way of flying, the best way to minimise the fuel costs. However, it is largely about the price of fuel at the exchange rates that we pay, it is very difficult to manage the costs down in any way. As I said earlier, we expect fuel costs to increase next year.

Employee cost is the largest cost element of our cost base. We have already covered how we are going to reduce costs and over the last two years we have saved, as part of our Future Size and Shape programme, £460 million of annualised savings. We have another £300 million of savings to deliver in that area.

Landing and en route charges: again, it is difficult to negotiate those prices down but part of our External Spend policy has been to try to negotiate wherever we can reductions in costs there.

Aircraft leasing: we have reduced the number of aircraft that we have on lease and those costs are falling. Engineering costs are down significantly as a consequence of simplifying our business, particularly the switch from the BA approach to maintaining the aircraft to the manufacturer's approach. We are launching our new enterprise wide engineering system. We launched phase I last year, phase II is in May and phase III is later this year and it takes out 180 old legacy systems and replaces them with one system. We will continue to drive engineering efficiencies.

Accommodation: as Keith has already said, we have consolidated our property portfolio significantly over the last couple of years. We have reduced the office space by over 40% that we use around the Heathrow base. We continue to reduce contractors and all the other costs that get into this. The area that pops up, and it popped up in Q3, are some exchange rate retranslation of the balance sheet issues which caused that number to jump around more than I would like, but the controllable items in there are going down.

Selling costs we have talked about and there have been significant reductions in selling costs over the last two years. We will continue to reduce those costs going forward.

Depreciation: we have the fleet, we have the depreciation, the charge will remain pretty much unchanged. We are tackling costs in every area of our business. Our focus remains on making sure that we drive the costs down. We are not relying on revenue to come and save us. We have said before and will say again that we have been successful in reducing our cost base and we will continue to drive the costs down. We will drive the costs down but be mindful of the impact that it has on the customer.

In summary, gradual recovery of revenue. We are not relying on nor are we expecting a huge improvement in revenue in the next year – 2% to 3%. We delivered the Future Size and Shape – we did better than deliver it, we have exceeded it. I suspect that, if I went back two years ago and asked everybody in this room who was there then to make a bet as to whether we would deliver Future Size and Shape, I would have had very few takers. Not only did we deliver it but we have exceeded it in all areas. I suspect that, if I asked the same group whether they thought our liquidity and balance sheet and debt position would be where they are today, I would get no takers. We have transformed the balance sheet over that period of time and we will continue to reduce debt, we will continue to strengthen the balance sheet. Our strategies are aligned to strengthen that balance sheet and we need to strengthen the balance sheet to make sure this company is strong going forward and can take advantage of opportunities as they arise in whatever form they arise.

We have put our new cost initiatives in place and we will deliver the £300 million. We will do it with our staff and our unions, we will work together to make sure that we have a strong company to work in. We will deliver a 10% operating margin as the market improves. We always said we needed some help from the market in terms of revenue to deliver 10% and when we start to get that help, we will get to the 10% operating margin. We have delivered in the past and we will deliver in the future. Thanks very much for your time.

Keith Williams: Good morning, ladies and gentlemen. This is the first time I have spoken at one of these events and, if you look at my biography at the front of the booklet, you will see that I have an interest in history. One of the things that I did after 11 September 2001 is I started to keep a diary. It is not up to the standard of Samuel Pepys, nor would I say up to the standard of Alan Clark but I would like to share a couple of extracts with you. It gives an illustration of what life was like at British Airways immediately after 11 September. The first extract is dated Saturday, 6 October 2001:

> "Received call from *Sunday Times*. *Sunday Times* reporter Matt Getts says the *Sunday Times* would be running a story on potential bankruptcy of BA and wanted comment. Next morning, wake up very early, concerned about *Sunday Times* report. Spent night imagining headline: "Tongue-tied treasurer at British Airways". Sunday 7 October, wake up very, very early and go over to Heathrow to buy copy of *Sunday Times*. Relieved! to see headline, "BA in danger of going out of cash in five months"."

If that illustrates the ridiculousness of life after 11 September, then my favourite entry, the most sublime moment, is this one:

> "Friday, 14 December 2001, met Archbishop of Canterbury at dinner. Somewhat taken aback when Archbishop says he has been praying for success of BA post 11 September. Managed to say thank you for his concern. "That's alright", says the Archbishop, "I've got lots of Air Miles"."

Down to business and what I want to look at is what has changed in relation to the balance sheet in the two and a half years since 11 September, and look at its different elements. First, cash and liquidity, then debt and our debt repayment, currency and interest rate management, which is perhaps a side of which you do not see very much and, finally, capital expenditure and disposals.

First, this is what we said immediately after 11 September. We said we had enough cash, enough liquidity to see us through the downturn in traffic that happened immediately. We adopted a line internally that cash is king, which is something that we emphasised throughout the business. We spent a lot of time with management ensuring that we managed the cash, and a good example of that would be in our redundancy programme where we have made a lot of changes in reduction in headcount without paying high redundancy costs.

We said we had a high level of debt but we said that the debt was long term and that the repayments were manageable. We also pointed out that the debt had no financial covenants attaching to it which would lead to early repayment. In February 2002 we announced Future Size and Shape and part of that was an announcement of a £900 million disposal programme. We said that we would retain our shareholdings in Qantas and in Iberia and we said we would keep Waterside. We reviewed our property portfolio and decided it made more sense to concentrate people in this building and sell surplus properties elsewhere. Finally, we said we were coming to the end of our capital expenditure programme and that we had a partial capital expenditure holiday which would succeed for some years.

If you add that together, it meant no rights issue. We took the view that we could and we should manage our way through the events of 11 September and that we should not ask the shareholders for any money. If that was not enough, I also used to remind John that 16 out of the previous 20 rights issues had been accompanied by a change in management!

What have we achieved? We went into 11 September with around £1.2 billion of liquidity. By the time of our Interim Results announcement that year, which was 7 November 2001, we had increased our liquidity to more than £1.7 billion. It is what the *Financial Times* referred to as having pulled a rabbit out of a hat, I seem to recall. At 31 December 2003 we had liquidity of almost £2 billion and that is the level it will be at the end of the year, which is our best guess. So we have ample liquidity. What is hidden within there is the fact that we have repaid over the last four months around £350 million of debt early, we have accelerated our debt repayments. Those repayments, together with our scheduled debt repayments, have allowed us to increase substantially the number of aircraft that we own outright. After 11 September we owned 21 aircraft outright. By the end of this year we will own around 38 aircraft outright and, if you look into next year, it will be almost 50 and it will increase steadily thereafter. Of course, we still have substantial assets. We still own our shares in Qantas, Iberia, we have a lot of business interests and we still have a property portfolio starting with this building.

I said that we had repaid some debt early. This is the debt repayment profile as it existed at 31 December 2001. You can see that our repayments in the early years were under £600 million a year but that in the year to March 2005, i.e. next year, we were facing a repayment spike of around £790 million. If you look at the profile for the next five years today, you can see that we have reprofiled that debt, so for the next five years our debt repayments are averaging around £550 million a year. This is the total debt picture. The light blue box looks at the debt excluding operating leases and the red box has the debt including operating leases.

At 31 December 2001, our net debt without operating leases was about £6.6 billion. By December 2003 we had reduced that figure to below £5 billion. If we add in the operating leases, our debt is reducing more quickly than it is without operating leases, i.e. we have taken out some operating leased aircraft as well, and our gearing is reduced from 70% as it stood in December 2001 down to below 60% at December, and it is on a downward trend.

We have also taken advantage of changes in currency rates over the last couple of months. Part of our debt is in yen and I shall come back to that in a second, and part is in dollars. We have yen borrowings and dollar borrowings because we earn currency in flying to Japan and from Japan we earn yen. Similarly, from the US business we earn dollars. If we look at where the debt was, on the yen side it was just below £1 billion equivalent in December 2001. If we look at it in December 2003, we are now down to £690 million of yen debt. Similarly, on dollars we have taken advantage of the recent weakness in the dollar, the sterling's strength against the dollar, to substantially reduce our dollar borrowings. If you look overall, our gross debt over the last two years has benefited from about £400 million of exchange and we are banking some of that.

This slide looks in a little more detail at the yen. The history of the yen is that we borrowed yen in the period 1992 through to 1998 on what were called Japanese leveraged leases. They were a form of financing for aircraft. The benefit was largely twofold. One is that the yen interest rates that we paid on the borrowings were very low and, secondly, we received tax relief in the UK on the aircraft. That is why largely we have not paid any taxes since 1996. If we look on the currency front, which is the part that goes through the profit and loss account, we have a translation movement and over the history of the yen in the period 1992 through to today, we are broadly neutral in terms of translation. That 52 is taken at the end of February and is moving all the time. So in translation terms we have been broadly neutral on the yen.

However, one of the benefits of the yen is that we borrowed at very low Japanese interest rates. Had we borrowed in sterling, we would have paid a much higher interest rate. The second column there, the transaction interest saving, computes the interest saving that we have achieved over the period. So you can see that we have had substantial benefit out of the yen borrowings over the period.

Looking at interest rates, we have been fixing more of our debt as time has gone on to take advantage of low interest rates. On a net basis at the end of this year, we will be around 45% fixed but, if you add in our cash balance, we will be around 60% fixed. That gives us a great deal of certainty over our interest cost. If you look at the average rate of interest that we have been paying on our gross debt in the period post-2001, you will see that this year we expect to pay out a rate of around 4.3%. Next year we have allowed for around a half percent increase in US and UK interest rates, and we will come out at something like 4.5%. So we have a lot of certainty around our interest costs in the accounts and it should be pretty similar to what it is this year.

John mentioned capital expenditure earlier on. This looks at the capital expenditure profile post 11 September. We took delivery of our last wide-bodied aircraft in October 2001 and since that time we have had a much lower capital expenditure programme. John mentioned earlier that our Future Size and Shape target for 2003 and 2004 was capex of £800 million. You can see there on the blue chart that our capex for those two years will turn out to be around £600 million. I would not like to give the impression that this is holding back on capital expenditure on customer-related projects. John mentioned earlier that we have completed a number of projects including refurbishment of Terminal 7 at New York, expenditure on the Dusk programme – the Club World flatbeds – the introduction of the self-service kiosks and, as Simon Park-Smith will tell you in a minute, on ceBA. On the disposals front, we are well on track to achieve our target of £900 million of disposals.

Looking at mainline fleet flexibility, one of the advantages of paying off our debt early is we gain control of our aircraft, and this chart looks in the blue line at a number of unencumbered aircraft that we have. You can see that it is steadily increasing year by year, so as we repay our debt we gain total control of those aircraft. The red line looks at the operating lease returns that we have by year for the next three years. Taking those together, we have considerable fleet flexibility going forward to handle any shocks that may come along.

On the reverse side, on the order side, we have minimal orders. Looking out we have total orders of 16 aircraft which are split between A321s and A320s. In terms of growing out into further capacity, we are majoring very much on greater utilisation. As we bring our longhaul aircraft back in the air after the completion of Dusk, we gain more capacity, and on the shorthaul orders bringing in A321s gives us more seat capacity than 737s and 757s.

In summary, we have much improved cash and liquidity. That will enable us to take advantage of early debt repayment opportunities where that makes sense. Our debt is set to reduce further and we have fleet flexibility. Finally, let me say two things. In looking around the room, I see many people who have been dealing with BA after 11 September and I thank you for your support. Secondly, no diary is complete these days without pictures, so I would like to share a couple of those with you. That is my favourite and, if I pass on, I shall show you John's favourite, coming out from the cockpit door John Rishton.

Simon Park-Smith: Good morning, ladies and gentlemen. I shall talk to you for the next half an hour or so about a very exciting time for British Airways. It is a time in which we will see British Airways returning to the territory in which we are strongest and that is the territory where we are innovating for our customers, delivering world-leading products for our customers.

John started this morning by reminding you of our core strategies to deliver the 10% operating margin. Underlying all of that is simplicity and you will see through my presentation this morning that simplicity also underlies our drive for the innovative products. It will not just take costs out of our business. It will make our customer experience more consistent and superior to that of other carriers.

We talk a great deal about simplicity and people understand how simplicity helps our business. They ask how does simplicity help our customers and it is quite easy. Simplicity helps our customers by adding ease to their journey. We set out a year ago on a programme called Customer Enabled BA. The point of Customer Enabled BA and the vision that we strive for is to make BA an easy company to deal with – if you like, to take frustration out of air travel. The flip of that is that we believe customers who have an easy experience can and will choose to serve themselves.

Customer Enabled BA is both a strategy for simplification and also a rich customer experience. It is a cross-functional programme. It takes the customer experience end to end. This is not a programme about some new boxes and wires. This is about simplifying the customer experience from start to finish. It is about streamlining our product set, making it consistent when we deliver it. At the bottom line, we believe that it will deliver at least £100 million. Last year, we stood up and promised £100 million and our latest forecast is significantly over £100 million of benefit, created by the simplicity and by the self-service.

For our customers, it is about this easier, richer experience. A year ago we sat down and wrote out some statements that we would like our customers to be able to say and here are a few examples of them. I would imagine in the room today we have a few veteran travellers, and you will realise that some of these things in the business of air travel are incredibly difficult. Are airline products easy to understand? Are you sure that you have the ticket you thought you had? Remember, if you are not a veteran traveller but someone who travels once every two years, or perhaps it is your first transatlantic journey ever, are you absolutely sure that your transaction went through? Do you need to ring up again and say do you still have my booking? Are you clear about what you have bought? Have you ever had a surprise at the airport when you wanted to change your ticket and someone said you cannot change that? If you ask four people along the experience – the person you buy the ticket from, the person whom you phone up to make a check, the person at the check-in desk and the person on board – the same question, they will give you a different answer. How did that happen?

We set out a programme of change to try to fix some of these issues. However, making it easy in the airline industry is incredibly difficult, because we are starting from a base that has been building up over 40 years of international aviation. We have millions of fare types, over 70 selling classes and so on. In fact, if you add up and multiply all of the different ways that you could buy fares, all the different fares that we make available to you, all the different ways you have to pay, you come up with six billion combinations. Of course, that is pseudo maths but the point is that we have complicated the industry to the point that it is almost unmanageable.

We employ 12,000 people in front line customer service roles who spend a large amount of their time translating our language into your language. I do not mean translating English into French or English into Cantonese. I mean translating IATA-speak into everyday language. Why is it that it is so much easier to transact a journey from London to Manchester on a train than it is on an aircraft – it just should not be that hard. Lying beneath the layer that you, the travellers, see are a myriad of systems of processes that make any kind of change in the airline industry frustratingly difficult.

A year ago, we stood up and said we were going to do a programme called Customer Enabled BA. We said we would simplify our business and, because we believed it was a transformation, we set some transformational targets, targets that people did not believe could be achieved. We said that we would take our shorthaul leisure business and increase the amount booked on ba.com to 50%. We said that we would make every core Executive Club transaction available on ba.com. We said we would get rid of half of our fares – three million fares and we would get rid of half of them. We were going to double the usage of e-ticket and so on. At the end of our first year, we have delivered all of those targets. Transformational targets that could not be achieved have all been achieved. What about standing up now for the second year with a continuation of those targets and the harder two-year targets, and I shall come on to talk about those in a minute.

What that means for the basic stats is that online bookings that British Airways is taking are following the hockey stick curve that people predicted but which seemed at the time to be unbelievable. You can see there that we are taking 70,000 bookings a week on ba.com and with no difficulty in the service provided, no response time difficulties and no stability difficulties. We still have over 99.9% up time on Ba.com.

We are shifting channels as John mentioned earlier. You can see there over the last year how we have shifted our channels from the traditional travel agents, from our call centres to ba.com. The core market we have aimed for has been the lowest yield of all: shorthaul leisure travel where we are head-to-head with the no-frills carriers. That has been our focus and that is where we have shifted over 50% to Ba.com. Across our wider business, the total is lower but we aim to increase the total number of bookings on ba.com to be up to 30% of BA's passengers.

E-ticket has continued its targeted growth. Fifty percent around now and this month we will probably turn in a figure of 55% and by Easter we will be past 60%. At the end of the year, we are still on track to be 100% or just shy of it depending on some of our interline partners. E-ticket is worth a bit of a conversation as many people are hesitant about e-ticket. It is worth understanding that there are two sides to e-ticket: there is a customer side of a ticket and a business side of a ticket. The customer side of a ticket is very important, because the simple fact of life is that people want a ticket, they want a piece of paper that tells them what they have bought, how much they paid, where they are going, where they have to be, when they will arrive. If you think about it and were designing it from scratch, you would not arrive at that little card, the ticket that we give you now, because that does not tell you that information clearly. What we will give you in the future with an e-ticket, and many of you will travel on e-tickets already, is a print-out, a piece of A4 paper that clearly gives you all of that information. Better still, if you lose it, you just print another one. You cannot ever lose an e-ticket.

The business side is where it gets tricky, because what many of you know, and some of you will be disappointed to find out, is that all airlines use those paper tickets as money, and we carefully track that paper ticket right through our process. All through the travel process, when you finally hand that ticket to us for what seems like the fourth time in Sydney, Australia, it flies back the next day on aircraft in a bag of tickets and we count them. That is the golden thing about e-ticket, we will get rid of all of that. All of those systems and processes involved in tracking those paper tickets are gone and, at the same time, the customers have something better which is a proper piece of paper that tells them what they need to know.

So ba.com as the core of our self-service offering is now booming. We are selling five times as many tickets on ba.com now as we are on the telephone. As I said earlier, 51% of our low value shorthaul tickets are sold on our website. We get 1.5 million visitors to the site every week, that is more people who are flying on our aircraft and, most importantly, for our frequent flyers, the Executive Club are adopting Ba.com as their channel of choice faster than we had expected. Of the total number of transactions in Executive Club, roughly two-thirds world-wide are now on our website. About 80% of our active Executive Club members have an e-mail address lodged with us and have a password access to the website. The highest penetration in the world is in fact in Asia Pacific. People are taking this up faster than we expected them to.

The reason why they are taking it up faster than we expected them to is not because we are forcing them, not because we are charging them elsewhere but because they like the experience, they love the product. This is a survey that has been conducted for us by a neutral agency who survey every quarter 12 European airlines, including a couple of no-frills carriers, to see what their customers who are on their website think of the website. It is a very detailed survey and this is a top level stat. How many people think that either ba.com or AirFrance.com is very good or excellent, and 70% of our customers think our website is very good or excellent. That is the highest out of all 12 European carriers surveyed, including easyJet. There is a dip there that you can see in the last quarter and the survey was taken six days after the industrial action we saw at Terminal 1 last June. The overall image of our airline at that time was going through a low point. However, generally, we are on an upward curve in what people think of the self-service experience.

We have talked a lot this morning about simplification and let me give you an example of simplification. The fare base is where we have been really tackling this, removing millions of fares but, most importantly, reducing all of those different kinds of fare conditions down to three basic conditions: you can always change it, you can never change it, or you can change it if you pay a fee. Out of interest, how many people in the room have bought a ticket on ba.com? [*show of hands*] That is an encouraging proportion and I urge the rest of you to give it a try.

You will remember when you were doing that buying process on ba.com, just before you reached the painful part where you entered your credit card information, that there was a little box we asked you to tick that said “I have read and understood the fare conditions”. I know that you all tick that box because we don’t let you buy a ticket otherwise, we are not allowed to. Would anyone like to raise their hand and say they were telling the truth? No-one has ever raised their hand when I have asked that question. We do not understand fare conditions and yet we say we accept them because they are pages long, they are in good old IATA-speak and they have been agreed with every carrier in the world over a period of 40 years but are just too long and complex.

In the future, we will simplify those conditions down to one sentence that says something like: “You may not change this ticket after you have bought it”. That is why simplification is good for customers. What is important here is that over the last year we have been working very hard to lay some important foundations, and these will work right through the self-service experience. Many of the carriers are operating in parts of this territory. John said earlier that we have the best booking engine on the web and that is probably still true. We are probably not the best at airport self-service check-in. easyJet currently offer the ability to change a booking while nobody else does. So as with most fast-moving technologies, various players are at the front at various stages. What will set BA part from other carriers is that we are taking an end-to-end view and simplifying things so that we can offer the best products. Simple consistent rules and processes means that automation is much easier and much more effective. If you get everybody travelling on e-tickets, if you get an e-mail address for everybody, if you have self-service available to everybody, the whole experience starts to really hum and you will see that in the next few slides I shall show you.

The people who raised their hand earlier to say that have bought an e-ticket will be familiar with this screen. This is our calendar display. This builds on our first piece of simplification. We simplified the fare structure, we took the lead from what the no-frills carriers were doing and we understood that people wanted value for money. We had some great fares out there and this shows people where the great fares are. For too long we have been making the same mistake that many major carriers still make. I have low fares, I had better hide them in case someone buys them. This shows them, it leads you to the lowest fare. As you go through the screen, it presents you with some tantalising options to pay a little more for a better departure time but at least if we are advertising £59 on a bus shelter, people can find that fare.

Over the last year, we have been adding a great deal to this. Yesterday, we added the ability to pay by Switch. We are adding the ability to buy for other people, a big frustration. Twenty percent of people who buy tickets are not paying for their own ticket. They are buying it for somebody else. We can allow people to buy tickets in other countries and because people are getting e-tickets and because they have e-mail, in four or five seconds they get their ticket in five languages. Because we have simplified down the core foundation, we can start to do some very exciting things once people are into the purchase process.

Here is what the confirmation page of Ba.com will look like and 10,000 people a day will see this page. Up at the top, a nice simple explanation of what the price is. To the right of that, we will say to our customers what they are getting for that: here are the product benefits you will get on BA that you probably would not get on a competing carrier. Then this is where it gets very exciting. Because we have simplified down and because we understand somebody is flying London-New York, they have booked a ticket in K class, if they upgraded that to the next available class, they could have all of this. Passengers do not realise that at the moment. What they know is that they have paid £149 but they do not know how near they are to the next level where the big products kick in. How much more would you have to pay to get your Exec points? How much more would you have to pay to get access to the lounge? This makes it explicit and a nice red button, click here, upgrade, another £120 and you are into the lounge. This goes live later in the Summer and it will be a very exciting time for BA.

At the same time, or perhaps a month later, we will introduce the ability for people to change bookings, update bookings and upgrade bookings. The frustration at the moment is that we allow people to come to us and make their own booking and they like that. If they want to make a change to it, however, we force them to call us. So later in the year around November, we will allow people to make changes and this will be to any booking, not just fully flexible, not just bookings made on Ba.com. Wherever you have made your booking, whatever kind of ticket it is, you will be able to change it on the site subject to the normal rules of the ticket. If you need to pay £50, we will take the £50 on the site.

This, I believe, will be the biggest breakthrough for British Airways in self-service. It is called Manage My Booking and it deals with that period of travel between the time when you have bought your ticket and the time when you go to the airport. It is a bit of a desert at the moment. The only contact we have with our passengers during that period is when they phone us up with a difficult question. With Manage My Booking, we will allow people – and this is live now and a very popular part of the site – to come to us and manage their booking. Many people want to check if we still have their booking, what time do I arrive, can I e-mail a copy of it to my colleague in New York as he will meet me. When I made a booking, I did not put my Exec card number in. I want to make sure that I get my miles, so can I put my Exec card number in. What you will see later in the year is us holding the hand of the less frequent travellers to reassure them by providing them with a check-list: if you do these 10 things before you get to the airport, you can sleep well the night before you travel.

This is one of the functions that we offer as part of that check-list: have you booked your seat? You are a family travelling together, you probably want to make sure you are sitting together, do you want to have a look at the seat map? This is probably the most popular part of Manage My Booking at the moment. It has been live for about five weeks and is getting rave reviews … [*end of tape, no overlap*] …… the whole check-in process. The exec-cardholders in the room will know that, for some time, we have been offering the chance for people to check in on the Internet, at home, before they leave home or their office. They then go to the airport to pick up their boarding card.

Over the next few months – and this is trialling at the moment in Edinburgh – we are taking that one stage further and saying that people can actually print their own boarding card at home. When they get to the airport, they should not go to any queues or kiosks, but go straight to security. There is a bar code on the side of that boarding card and the chap at security has a bar code scanner in his hand, just like Sainsbury's. He will zap your bar code, and you can go through. Customers who are using it at the moment absolutely love it and we even have positive feedback from the people who contribute to the Internet billboards, *Flyer Talk*, etc. Those are probably some of our harshest customers and they like this. I find that encouraging. This will be a winner because anything that cuts out the check-in process and cuts out all of the queues at the airport has to be a good thing.

We know that not everybody wants to check in at home. We know that many people still arrive at the airport, wanting to check in. We are doing what most other major carriers are doing – investing heavily in self-service kiosks. We have just finished renewing our estate with 150 brand new kiosks out around the world. We are building them in particularly fast in Terminal 1 and in the next month or so you will see even more going into the domestic area, with a drive to get nearly all of our domestic passengers to use self-service check-ins. The kiosks are more popular than last time: they look better, and they also work better.

I have talked to you mainly about the innovation that we are driving through the customer-enabled experience, designing British Airways for customers to use. That is not the end of it. As usual, we are adding to, enhancing, developing new parts of our product portfolio. In Club World, with the new seats, as John said earlier, the roll out will be complete across the whole network of long-haul aircraft. We are adding to that by improving the sleeper service, initially on the North Atlantic, so that passengers on that service out of the States and back to London can have the maximum amount of sleep that they want. We are therefore introducing a new sleeper service and we are introducing dining on the ground, to make sure that sleep is the No. 1 proposition for that flight.

We are allowing people to access the Internet in our lounges, through wireless access on their laptops. We have a new spa going into JFK. We have new food going in to Club Europe – we are refreshing that food there. Importantly, for our leisure passengers who are travelling long-haul, there is a new product for families.

I said at the beginning that we had set some difficult targets. We have one more year to run of this programme and we will go for another set of very difficult targets. We will take the airline all the way to 100 per cent e-ticket. We are the only carrier in the world at the moment who is aiming for 100 per cent e-ticket on all journeys. The US carriers are very high on e-tickets, but they restrict it to domestic, so we are the only carrier that is aiming for 100 per cent across the network.

We are aiming for our self-service airports - our 30 top volume airports – to get to 50 per cent of all check-ins done by self-service. We are aiming to get the Executive Club to an 80 per cent on-line club, but my personal belief is that we will get nearer 90 per cent in the next year. Crucially, we will take a bigger drive to get email addresses into bookings because, if you remember that end-to-end slide I showed you, one of the key pieces of infrastructure is for us to be able to communicate to people by email.

In three weeks' time we shall move a number of flights between Terminal 1 and Terminal 4. This will be difficult for customers to understand to start with and we are doing a great deal of work to communicate with them. However, this provides us with a very personal approach because we will send an email to every single customer who we know is affected by this, advising them of the change. It will be specific to their flight and we know that they open those kinds of emails. If we have their email address, we can often them a much richer travel experience.

Our end aspiration should be that ba.com is the first part of somebody's journey - the first stage, before you go to the airport, go the ba.com. That will make the airport experience much less frustrating and it will make it easy.

To close. We are running a two-year cross-functional programme. We know that it is difficult in British Airways, but it is running to plan. It is meeting the targets and the milestones and our belief is that it will continue to meet those targets and milestones for the next year. We are already seeing significant benefits and we will exceed the £100 million target. We are ahead of where we should be now towards that £100 million. We have some customer products for which we are having fantastic feedback. Later this year – my belief is that it will be by Christmas this year – we will have an end-to-end self-service experience that is way ahead of any of our competitors. Thank you.

Andrew Cahn: Good morning, ladies and gentlemen. The morning's theme so far is that things are just beginning to get better. They are getting better in one way in the sense that this morning the guilty party has paid up, and I am very much hoping that there are no more guilty parties.

After the interest of this morning, I have to talk about regulation and the regulatory world in which we live. We are a highly regulated industry but unfortunately, unlike some others, we do not have a guaranteed rate of return and we have to work in the market. The way we handle regulatory affairs is important for our business.

Two changes are happening. One is that we have become more regulated in recent years, post 9/11. Obviously there are more issues – particularly security issues – coming to the fore. Secondly, power is shifting away from Whitehall and the Civil Aviation Authority, to Brussels. Safety is an obvious example, with the Single Sky and traffic rights. I will talk about those in a moment.

I believe that British Airways has an advantage here to some extent in that we are good at dealing with the regulators. There is an opportunity here for us to ensure that there is a level playing field with our competitors, and perhaps even to put some pressure on our competitors, to make sure that they have to observe the regulations. Indeed, there are even, on times, business opportunities.

I would like to deal with several issues. There are traffic rights, which are particularly interesting for our business, and infrastructure, which is closely related. The more infrastructure there is, the more traffic rights there are available to us. I want to deal with some of the new regulations applying for security reasons, and for reasons or fears of immigration and asylum. Consumer legislation is becoming increasingly onerous and difficult for our business. I would then like to focus a little on future challenges.

I was at a conference in Washington last year. One of the Americans there said, 'Well, of course, the British Government just does whatever British Airways tells it to, and regulates in your interest.' I wish that were true but it certainly is not. What is true, however, is that we are quite good at dealing with the regulators. We are quite effective at getting in there, dealing with the issues, and persuading them of our point of view and, most of all, getting in at the ground floor and helping to draft the legislation ourselves.

Let me talk first of all about traffic rights. This is an area where some power has moved to Brussels as a result of the European Court judgment at the beginning of last year – almost a year ago – and the decision of the Council to give responsibility to the European Commission to negotiate with the Americans. They did that last June. They also asked the Commission to go and negotiate with everybody a community clause.

However, there is a very strong, continuing role for the British Government. They will continue to negotiate most traffic rights on our behalf for the foreseeable future. I am pleased about that because we have a very good relationship with the British Government and we work very closely with them. It is more challenging to deal with Brussels.

Recently, the British Government on our behalf has negotiated new rights – additional rights – in Libya, and new rights in Algeria, which are two very valuable oil markets, where we have been able to start new services. They have also negotiated an agreement with Hong Kong, although it is not clear whether this will be brought into effect because they gave away some rights across the Atlantic and the European Commission is not happy with that. So although the British Government retains competence, they are subject to Brussels' control and it is not clear to me that the Hong Kong agreement will be brought into effect in the near future.

There was a very significant liberalising agreement with China a couple of months ago. That will certainly provide very significant new business opportunities. Whether we with to enter into them is a question for us to evaluate but it is always valuable to have the traffic rights, to have opportunities, and then we can take a sensible commercial decision about whether to use them.

The next major negotiation for the British Government will be with India. That has been put off for a while but it should take place in July, after the Indian General Election. There is a possibility of very significant new business opportunities there.

The area where the European Commission is now responsible is primarily America. You will no doubt have seen that a significant development this week was that the European Council of Transport Ministers told the Commission that they really had not negotiated particularly effectively so far. They did not have a balanced deal and what was on the table was not acceptable, and they had better go back and negotiate a little harder and a little more effectively. We certainly supported that.

Rod has led the way in asking for a proper, liberalised agreement with the United States of America, which would tear away all of the economic regulation that exists and provide for a single market covering both America and Europe. This is important not only to put those two biggest markets in the world together and allow competitive forces to play, but also to change the paradigm and to change the way that aviation is regulated across the world. Once Europe and America deliver something, then the rest of the world will follow. For me, it is an evolutionary battle between bilateralism and multilateralism: do we go on with the bilateralism which controls and constrains the markets, and damps it down, or do we have a single market which allows for the developments that you have had in Europe?

A recent success for our lobbying and our dealing with the regulators has been the third runway at Heathrow. When I arrived at this company four years ago, I was told that it was politically unthinkable, politically undo-able, politically impossible, for there to be another runway at Heathrow, and that we should just resign ourselves to the fact that it could not be done. We did not accept that and one of the reasons why we shifted that was because we had Rod Eddington coming in from the outside with his experience in Hong Kong, saying, 'You can build runways. I have seen Britain failing to do infrastructure and it is not good enough.'

His championship, together with our setting up of an organisation, Freedom to Fly, and doing an enormous amount of political lobbying in the background, meant that we shifted the political climate and it became possible to conceive of another runway. More than that, we now have the Government committed to it. Even more importantly, they are committed to mixed mode. This gives us a long-term growth perspective. It is now no longer a question of whether there will be another runway at Heathrow, but it is a question of when. It will be an enormous challenge to us, to keep the Government to the timescales it has set itself – 2015 to 2020 – but I believe it can be done.

The growth perspective is of course not just the third runway, which is in any normal sense quite a long way away. The Government was persuaded that Heathrow had to be a hub. For those of you who were at the Merrill Lynch conference yesterday, you may have heard the Lufthansa Chief Financial Officer saying that Heathrow was not a hub. All he meant was that we do not have ways, because we are full, but it is undoubtedly a hub in terms of being the centre of a network, a global centre for aviation. The Government began the consultation period thinking that, on the whole, they could create another hub – perhaps a second hub at Stansted, or perhaps a hub at Cliff. They ended, persuaded that Heathrow was a great national asset and was our hub.

Mixed mode was in some ways the unsung success in the Government's White Paper. Mixed mode gives us a growth perspective in the next few years. It can potentially increase capacity by 15 to 20 per cent – probably closer to 15 per cent. We may not even have that increase in capacity because it may be the right thing to take some of the increase in improved operational robustness and effectiveness. However, there is quite a significant hurdle to overcome in terms of consultation and planning inquiry, but we have the perspective that, from 2008 onwards, when Terminal 5 comes on stream, and mixed mode will come on stream at the same time, and that then gives us a growth perspective until the third runway.

Slots. This is an unsung, hidden problem, but always a major one. In December, the Council of Minister passed a revised law on slots. They changed the slot regulation, 93/92, and it was a very considerable success that the pressure to ban slot trading, which came primarily from the European Commission, was fought off. The British Government did a good job and we pressed them very hard to do that.

Also, that settlement preserved grandfather rights and allowed us to re-time our historic rights, which is very valuable. However, this battle continues. The European Commission is still minded to ban slot trading. They would like to, for some almost theological reasons. They received a report from a consultancy, which they held back from publishing for a great many months because it did not say the right thing. It says that slot trading is a good thing, and that some form of auctioning could be considered but would be very difficult to implement. That is what that report says. The Commission will come forward with new proposals and I see that our task in the coming months and years will be to ensure that the protection of slot trading, which we managed last December, is continued for the next few years.

Those are some successes. It is almost impossible to have success in this area. We act, in effect, as the unpaid agents for Government in providing border controls. With the increase in political concern in this country about immigration and asylum, the impact is that Government is asking us to do more and more on their behalf. This includes finding out information about passenger and photocopying passports at check-in, and they fine us quite heavily if we bring in a passenger who is inadequately documented – even though that passenger may have been adequately documented in check-in, but has destroyed the documentation on board.

We have saved this company a great deal of money by negotiating effectively with governments. We pay, for example, up to £2000 fine per inadequately documented passenger. We have memorandums of understanding with governments around the world, which have reduced the fines that we have had to pay greatly. Last year, we faced the British Government saying that they wanted to make the requirement to have a visa when you were transiting through Britain for a wide variety of nationalities. The Americans, of course, have done it for everybody: everybody transiting through American now needs a visa, and that has had a severe impact on the US airlines. Through a great deal of negotiation with the Government, we managed to get their plans changed and reduced, which has saved us many tens of millions of pounds, from the Government's original intention. However, I would not want to hide the fact that the continuing emphasis in this country on illegal immigration, on asylum seekers as a problem, means that airlines will have a continuing problem.

You do not need me to tell you that the US government's political obsession – and I do not mean that unkindly – their political focus on homeland security has meant a huge amount of new and onerous regulatory requirement on airlines, and there is much more to come. We had a big bun-fight between America and Europe, on the question of access to passenger data. That was resolved but I suspect that it will be slightly unpicked at some point and it will have to be resolved again.

America is coming forward with new proposals on profiling all passengers through a CAPS-2 system, to identify security risks and that will put a big burden upon us. The challenge for us is manifold but one element of it is simply to keep our operation going when we have to get information from passengers and transmit it to the regulatory authorities. This will be a continuing, high problem. We have done what we can by visiting the States. Rod was over in Washington, meeting the Department of Homeland Security, earlier this year, and we will continue to do what we can. However, it is undoubtedly a business problem for us.

Consumer legislation is another downer. The European Commission passed a really very bad piece of legislation on denied boarding compensation, which will have a very significant effect – if it comes into effect in February next year, when it is due to do so. There will, however, be a legal challenge which IATA is organising. I am not yet clear that it can operate effectively because it is a very badly drawn piece of legislation. However, after boasting a little earlier on that I thought that we were rather effective at dealing with government, I have no doubt that the industry as a whole did not lobby effectively in Brussels on this piece of legislation and we will need to do better next time.

The next time that is coming up is a legislative proposal on passengers with reduced mobility, where airlines may need to start to act rather as the American airlines do and make far more provision. However, this need not be a bad thing for our airline. The competitive level playing field is very important to us. At the moment, I would argue that – as is right and proper – we provide an excellent service for passengers with reduced mobility, whereas are other airlines, some rather loudly, do not. If they are required to do so, that may well level the playing field.

I would put competition law under consumer legislation because, in many senses, that is what it is. This, again, levels the playing field. The European Commission's State Aids legislation has, over the last decade, levelled the playing field on our behalf, because we are not receiving any state aid, and that is for sure. We have not done so in the last few years, and we certainly will not in the next few years. Some of our competitors have – over in the States, a huge amount. The State Aids legislation has helped. The Charleroi decision also helped, although it was not of direct benefit to us, but it is creating a level playing field. A particularly valuable little un-noticed change is that ministers a few weeks ago passed responsibility to the European Commission for, in effect, all aviation competition matters outside a member state. That means that, whereas in the past the Office of Fair Trading has looked at what we did with third countries very closely, and other national competition authorities did not, we are now on a level playing field.

I will skip over this [*on slide*], because we are short of time. I will simply say that we have been trying to re-focus the efforts of our trade associations, of IATA and of the Association of European Airlines, somewhat away from their traditional role of, 'How can we regulate this industry ourselves? How can we complicate this industry ourselves?' As Simon said in his previous presentation, much of the complication comes from IATA systems. We have tried to re-focus our trade associations away from that perspective, to a perspective of how to cut costs for our members. IATA has gone out with a number of high profile campaigns to cut costs at airports. The Association of European Airlines has started a campaign of its own, to do exactly that. That is exactly the sort of thing that our trade association should be doing.

To conclude, what challenges face us in the future? Delivering the infrastructure from the White Paper is a pre-eminent challenge. If we can keep the Government committed to what it has said it will do, and if we can help them get over the very real environmental challenges which still exist, and local community interest challenges, then that would be of enormous commercial benefit to this company.

We need to focus the European Union regulators on an effective, limited function, instead of allowing their focus to shift – as it has recently – into the politically more attractive but, for us, less helpful area of regulation, particularly on consumer matters. Also, we should try to persuade the Commission of the general principle that aviation needs to be a highly regulated industry, because we need really effective safety regulation, and we need really effective security regulation, but what we need far less of is economic regulation. There is still too much, and a campaign is needed to persuade the regulators of that.

We need to ensure that we do not have regulatory overlap. At the moment, competence is, as I have said, being transferred from London to Brussels but, somehow or other, London is not really letting go. The cost of regulation in London is not reducing, as the cost of regulation in Brussels increases. We have too much regulatory overlap and we will continue to try to ensure that our regulatory costs are kept down. We will also try to ensure that there is not cross-subsidy, not only from Heathrow to Stansted – something we will fight against hard – but also cross-subsidy within the regulations, whereby we, a company like

British Airways, pay more for services such as air traffic control, than other segments of the industry as at present. Somehow or other, the regulators have always felt that British Airways is a company that can afford to pay that little extra, and can afford to subsidise the rest of the industry. We cannot and, in future, we will not do that.

We need to see competition law developing in such a way, so that the consolidation of the industry, which almost all observers think is necessary, can happen in a sensible way. We have to continue to stay in a dialogue with Brussels on this and we will continue with that because it is a vital area, so that sensible changes in the structure of the industry can happen.

In slot trading, a huge win would be to ensure that we keep the present arrangements. I am confident that we will be able to do so, but it will take work and consumer legislation. We have to try to ensure that that is sensible.

Andrew Sentance, who will give the next presentation, will deal with one of the other big political challenges, which is how do we avoid the Government seeing aviation as a cash-cow, as a wonderful bucket of money into which to dip their paw and take out more tax take, through increases in APD, through a kerosene tax perhaps, and other environmental taxes. I will leave that to him, but I will leave you with one thought.

I have noticed a tendency in recent years for government to reduce the amount of political attention to aviation and to reduce the number of civil servants dealing with aviation. I say, thank goodness for that. They are concerned with the railways, and they are concerned with London Underground. They are concerned with road policy. It is absolutely healthy that government are seeing our industry develop in such a way that the regulatory framework can be lighter, it can be dealt with with an easier touch, and they do not feel that they need to regulate every last little part of our industry. Thank you very much.

Andrew Sentance: Good morning, ladies and gentlemen. Last time I addressed one of these investor days, I was standing in front of you as the Chief Economist. As you can see from this headline slide, I have now added the environment to my responsibilities, although I am not quite called the Chief Environmentalist.

I would like to demonstrate that these two responsibilities – economics and environment – are not such strange bedfellows as they might seem. I would also like to persuade you that what we are doing on the environment makes economic sense and is therefore important for the future of our business.

I would like to cover four main issues. First, I will briefly run through why, from a business perspective, the environment matters for BA and that the work that we do in this area is important.

Secondly, I would like to talk about our priorities and performance. I will then go on to talk about two specific issues which Andrew flagged up in his presentation. One is that of global warming, taxes and emissions trading, and the second is the challenge of demonstrating that a Heathrow runway will not breach EU air quality limits.

If there is one point I would like you to take away from this presentation, it is that we have an environmental programme, and we work on our environmental issues for good business reasons. This is not just because it is warm and fuzzy and nice, but because it is actually critical to the success of our business in certain areas.

There are four ways in which there is that link between our business and the environment. First of all, our environmental work supports our long-term strategy. If we are going to get those things that Andrew talked about, like the mixed mode, third Heathrow runway, then we have to show that those are consistent with satisfactory environmental conditions in the Heathrow area.

It strengthens our corporate reputation and brand. Our customers and the Government expect us to be a good environmental performer and to be a responsible company. It helps us to manage key business risks, such as the threat of higher taxation on aviation, which has been very much driven from an environmental agenda.

There are also many ways in which environmental improvements can help business efficiency. One of the most obvious concerns waste management and that is one of our corporate priorities.

The things that we focus on flow from those business linkages, and that business case for the environment. Reducing noise and improving air quality around airports, particularly at Heathrow, which is the focus of our network – if you look at our social and environmental report, you will see that we have a particular focus. Copies of this are available outside, on Heathrow in this year's social and environmental report.

Reducing the global warming impact, showing that there are actually ways in which aviation can reduce its impact on global warming – I will say a little more about that later.

Cutting waste and improving waste management: waste is the UK Government's No. 2 environment issue, behind global warming. The cost of waste disposal is going up rapidly and the ability to dump in landfill sites is reducing. This is a potential future business risk, if we do not get on top of it.

Finally, we need to ensure that we are a reputable and responsible company, and that we have a high standard of environmental management throughout our business and supply chain, and that we are not tripped up with future problems.

We have a good track record, particularly in relation to other players in our industry. This is not something for which I, personally, can take a great deal of credit. I became responsible for environmental affairs in late 2002. Hugh Somerville, who preceded me, did a great deal of good work, and people throughout the business have done much good work on the environment within BA. We also have a Chief Executive and board who are very supporting of the work that we do in this area.

We have had an annual environmental report published since 1990. As you know, one of the first steps that you need to do on the environment is to be honest and open about what your impact is. We have clear policies and robust management systems in place and our environmental management is integrated with health and safety and is supervised separately with a corporate team. If you go on to the Internet, you can see what our environmental policies are.

We have a good record of performance improvement, particularly on noise and emissions, and I will show you some evidence of that shortly. We also have a good record of being willing to engage with government, non-governmental organisation who are concerned about the problems that we create, and locally communities, particularly in this area.

We are active nationally and internationally to promote responsible industry practice and policies, and to agree new standards. We gain external recognition for what we do. We are ranked in the FTSE for good, and in the Dow Jones sustainability indices – two of the most widely quoted in the financial sector – and we are also rated well by business in the community.

However, it is no good saying that unless we can demonstrate some improvement. If we just look at the noise and local air quality area, it is worth seeing what we have achieved over the last few years. Measured in these QC equivalents, which is the way in which noise is monitored around Heathrow and in the London airport system, we have halved our noise impact over the last five years, as we have re-equipped our fleet. As you know, there has been a cost to that in terms of the debt, which we heard about earlier. There has also been a very major environmental benefit that we can point to.

One of the issues that we now face is that we cannot repeat that performance if we do not have that fleet re-equipment. Within the business, therefore, we need to find ways of continuing to improve through operating procedures, without necessarily having the benefit. Nevertheless, this is still a good news story.

Alongside that, there are other things that we can point to. In our report, we said that 78 per cent of our fleet were now compliant with the highest international standard, which is called Chapter 4. If you look by aircraft, type for type, we have one of the quietest aircraft fleets in the world. That figure was actually reported in our last environmental report, and it is now actually up to 84 per cent.

We have support for voluntary initiatives to limit noise. We are actually cutting the nitrogen dioxide emissions around Heathrow, which are causing so much concern about a future runway – this was 20 per cent down over the last three years. We are also supportive of research and modelling into that problem.

Before I go on to talk about global warming, let me highlight the fact that, as with other companies, we are now managing the environment along with a suite of other issues, which are badged under the phrase of ‘corporate responsibility’, or ‘corporate social responsibility’. This is perhaps hard to pin down and poorly defined. We actually define being a responsible company as protecting and enhancing the welfare of three key groups: our customers, and looking after them properly; our employees; and the communities affected by our business activities. It is clearly in that third area in particular that the environment comes in to play.

We have produced a broader social and environmental report since 2000 and, more recently, we have instituted an internal Corporate Responsibility Board, chaired by Robert Webb, our general council, which is now responsible for channelling our performance and reviewing it up to the main board and the leadership team. BA is contributing the business and government initiatives in this area.

Let me turn next to aviation and global warming. Aviation is a small but growing source of carbon dioxide, one of the key greenhouse gases in the global warming debate.

Globally, the figure is round about two to three per cent but, for the UK, because our aviation industry is much more developed than the average across the world, it is about five per cent. You might think that that is quite a small issue, and quite a small part of the overall global warming problem, but there are two additional things I need to tell you. The first is that it is projected to grow quite rapidly, as the industry grows, and efficiency improvements will not be enough to offset that. Secondly, there are effects in the upper atmosphere, labelled under the very enticing phrase of 'radiated forcing', which are to do with how clouds and contrails are formed and how they may interact with global warming, and which add to that carbon dioxide effect.

These upper atmosphere effects are very poorly understood, scientifically. There is a great deal of uncertainty about their scale and we believe that much more research needs to be done before we develop any policy actions to deal with this problem.

International aviation also has special treatment in Kyoto and the Kyoto protocol. ICAO, the UN body that deals with aviation, is charged with finding a way of dealing with international aviation. International aviation, unlike domestic aviation, is not included in the targets that countries have signed up to under Kyoto.

Airport opposition groups, however, have been very active in highlighting this global warming issue as a reason for not allowing the industry to expand and not allowing new runways to develop. They highlight what we believe are greatly over-exaggerated estimates of the cost to the economy or to the environment of global warming, to try to stall runway decisions.

Having said that, if you project forward and if you take into account the Government's rather ambitious targets for 2050 of a 60 per cent cut in carbon dioxide, aviation could be contributing perhaps up to one-third of UK global warming issues. This is therefore an issue that we cannot escape.

If we look at the data, there is a good news story on which to focus. BA has been cutting its global warming emissions but, again, we have benefited largely from the fleet refinement. We cannot guarantee that that will continue in the future, although we can point to it as a performance improvement.

More significantly, with the combination of measures that we have to respond to the challenge to the industry, that it needs to do more about this issue, British Airways has been one of the more responsive airlines in addressing that challenge. First of all, this is through open and honest reporting that I have talked about, and there are those figures that I have just put up. Secondly, we have adopted a fuel efficiency target of 30 per cent improvement over the Kyoto period, and we are about three-quarters of the way to meeting that and we are confident that we can do so.

We put the focus on our property energy efficiency as well, and we have openly supported emissions trading as well as opposing taxes. We are not in the position of saying that nothing should be done but we do not think that taxes are the right way forward. We think that emissions trading is the approach that should be used for aviation and I will say a few words about that later.

We have backed that up by participating in the voluntary UK emissions trading scheme. In this area, as you will understand, it is important that you back up with actions what you think should happen. We are supportive of research into upper atmosphere effects and we are looking to participate in the next phase of that research across the ....[*Tape change: no overlap*]

What is emissions trading? We do not really have time to go into a detailed explanation. The first four bullet points on this slide sum up the way it works. A cap is set for emissions and there is a reducing cap over time. Allocations are made to various companies or participants in a scheme. Basically, if you are within that cap, then that is fine. If you are below the cap, then you can actually sell your excess into the market, while if you are above that cap then you have to buy from the market to cover your excess. This is a trading mechanism that attempts to achieve the environmental objectives.

There are two key benefits of this approach, rather than taxation. The first is that it does not involve large sums of money being sucked up by government. It is a scheme that can operate in a financially neutral way. The penultimate bullet point says that as long as allocations are grandfathers, and as long as there is no attempt to auction allocations, there should not be a net financial burden on participants as a whole. Clearly, people who are growing their emissions may have to pay more, and those who are cutting their emissions more rapidly will benefit financially. However, it is much more financially attractive than the alternative, which is taxes. You can also demonstrate that it is actually environmentally effective – it targets the actual emissions that we want to reduce - and it is economically efficient.

We are participants in the UK emissions trading scheme already. This is a voluntary scheme and there are incentive payments to induce participation, which would result – as long as we hit our targets – in us benefiting to the tune of over $6 million over the five years of participation in the scheme. However, we have to do real things to achieve that. We have to cut our emissions by 12.5 per cent over five years and, while we have had rather a tail wind from a downturn in the industry, as the industry recovers we have to make sure that we can secure that cut.

What are the benefits from participation? There is a financial benefit through the incentive payment, but the last two points [*on slide*] are the important ones from our point of view. It reinforces our leadership and reputation because we are the only UK airline in the scheme. It also means that we can learn about how emissions trading works – through our fuel hedging people and, through the treasury committee that we operate, we supervise our participation in this scheme. Our network planners now know that they have to take this into account for the routes that are covered.

The next likely step for emissions trading is the possibility that aviation could join the EU scheme. That is now supported by the UK government and it is a great victory in the White Paper. There is also the fact that air passenger duty is described, environmentally, as a 'blunt instrument'. We are well positioned to influence and benefit through our participation in the UK scheme, but the terms and conditions under which aviation comes in will be very important. Longer term, there may be progress in establishing a broader, international scheme at IKAO, or in the next step beyond Kyoto – international aviation emissions may be brought in to the caps. Those are two longer term developments that we are keeping our eye on.

Heathrow air quality: Andrew highlighted that nitrogen dioxide emissions need to be demonstrated to be manageable, if we are to achieve a third runway at Heathrow. This is the other major issue that we are working on. We are actively engaged in the government-led programme of work and we had a preliminary meeting with the officials yesterday. We are targeting the work to be done by 2006 and, hopefully, there will be a more positive decision on the third runway then. We are already doing things that would support our involvement through monitoring.

One of the key issues is that road traffic accounts for the bulk of the emissions problem. Significant improvements are expected, but this means that it is not just an airport issue. However, airlines may need to make commitments on aircraft emissions, ground vehicle use and employee travel, as part and parcel of dealing with this problem.

To sum up, what are the key messages that I would like to leave with you? The environmental issues that I have talked about are key business issues of British Airways, and that is why I am talking to you today. They are not just something that it is nice to have but they are a core part of ensuring our long-term strategy and maintaining our corporate reputation. I hope I have been able to persuade you that we are a responsible company, seeking to reduce our impact and to promote good industry performance. This also means that we are well-positioned within our industry to face future challenges, and especially the issue of emissions trading, which could have major financial implications for the industry. Thank you very much.

Rod Eddington: Thank you, Andrew. Good morning, ladies and gentlemen, and let me add my welcome to those of the other members of the BA team. It is nice to see you here at Waterside this morning.

When we spoke 12 months ago, I said that our priority for the 12 months in front of us was built primarily around delivering future size and shape. This is the second year of a two-year programme. We also rolled out some new initiatives around further cost reductions across the business, but that was very much the priority.

It is very important, when focusing on re-structuring the business – and particularly when a key part of that is cost reduction – that you do not lose sight of what kind of company you are, and want to continue to be, and where you are going. As John said earlier, there was much more to Future Size and Shape than just cost-cutting. There was a whole range of initiatives and you have heard, for instance, from Simon this morning, on some of the work that he has been leading on ceBA.

If we need to be conscious of where we are and what we want to continue to be, then we need to do some work on our strategy. We have been doing that, particularly over the last six months. I would like to share some of our initial thinking with you. It is important for me and for the rest of the BA team that you, as key investors, understand what British Airways stands for, and we have called this 'the BA way'.

We have more work to do to complete the pieces but what I am about to share with you is our thinking so far.

This slide is one you will have seen before. We spoke about it 12 months ago and it was part of last year's business plan. It basically sets out our priorities. Our objectives were built very much around the focus on being a profitable, British, full-service, network airline, and of course the key goal was delivering and operating margin of 10 per cent. While our priorities have in no way changed over the last 12 months, our strategy has evolved.

Again, you will have seen this [*slide*] earlier today, at least once – certainly as part of John's presentation. This is a clear and simplified presentation of our priorities, which you have already seen today.

What are we, and who are we? We want everyone to be able to describe simply and easily what BA stands for. We are a network British airline that delivers service that matters, to people who value how they fly. Sometimes it helps people to understand what we are, if we describe what we are not.

We are networked – we are not disconnected or just point-to-point. Point-to-point business is a very important part of our business, but we are a genuinely networked carrier.

One of our key product offerings is the range of destinations that we serve, particularly out of the UK and particularly, obviously, out of London.

British. That is an important word, and it is an important part of the British Airways brand. We are proud to be British but we are not arrogant or jingoistic. Our brand represents the strong, reassuring piece of British values – professional, reliable, responsive and, of course, safe and secure.

We are an airline, and not Jack of all trades. We are very focused on our core business and we are very committed and keen to be expert at what we do. A very important part for me of the British Airways journey has been to be very clear about where our strengths lie, and to be very clear about what we are, and what we are not.

We deliver service that matters. We are not 'no frills', nor do we give too many frills. We give customers what they value, and what they are prepared to pay for.

We want to focus on customers who value how they fly. We do not focus on customers who only ever choose their airline based on price. We must have a cost base that is competitive, but we also must continue to deliver a better quality service at a reasonable price.

For me, one of the important aspects of the communication process around this particular slide in its entirety is to try to depict in pictures what we have said in words. I have always thought a picture is worth a thousand words, so let me show you this.

[*Video shown*]

So how do we measure success – an important part of any strategy? Achieving a 10 per cent operating margin and building a secure and prosperous future remains our key goal. The cost initiatives and most recent business plans will help us towards that goal. While Future Size and Shape may have been completed, the journey is not yet over. The BA Way is a means to that end but we will not succeed unless we have a shared vision of the future with our people, and what it takes to get there.

Let us have your questions, please.

Questions & Answers

Brad Crombie (Merrill Lynch): When does de-leveraging stop? What will that level be, and how do you measure it?

Rod Eddington: The important point to focus on here is debt reduction, because that is the key piece of de-leveraging. In the broad, my own focus is to get our debt down to about £3 billion, and that is our goal over the next couple of years. We are in a very strong position, fleet-wise. The major capital commitments that airlines make are primarily built around fleet, obviously. We have a young fleet, and in our long-haul fleet the average age is seven and a half years. In our short-haul fleet, we continue to take short-haul aeroplanes and we take the first of our A321s in October this year, which will be in service in November, and we will be taking 10 over the next two years. Our capex over the next two or three years is slim, but that is consistent with what we are trying to do with our business, and our fleet is in great shape.

There clearly comes a time when we need to go back into the market for new aeroplanes. I am very keen that we do not do that until our debt is at sensible levels, and I have given you a sense of what I would want that to be, and also until we are clear about how some of the long-haul alternative aeroplanes actually pan out. The 380 actually rolls out of the hangar at the end of this year in Toulouse, albeit that it will not be in commercial service until post the certification programme in 2006. The question of where the 7e7 ends up is also a very important issue for us. We have plenty of time to wait and look at what is happening on the aeroplane front, and make our own judgments about what to do on fleet. We will get a sense of where the markets are – we never buy aeroplanes for aeroplanes' sake. We are in pretty good shape.

Clearly, however, the priority for the business is to continue to reduce our debt and to continue to improve our gearing. Broadly, the target that John, Keith and I and the board have in mind is to get our debt down to £3 billion – it was nearly at £7 billion – and then we will be in a position to look at where we go from there.

Chris Avery (JP Morgan): In the light of the fact that Club World volumes, or premium long-haul if you want to classify it in that way, are up significantly, for which you will probably read double-digit, at what point does that start to give you some pricing power? That is something that you have not seen for many years. At what point does the next corporate that walks in the door to re-negotiate a travel contract with you face you saying, 'Mm, it's tougher this year, you can only have 10 per cent less discount than you had last year.' When does that turning point come?

Ron Eddington: This is a question we ask ourselves regularly. The short answer, Chris, is not soon enough. As so often in these circumstances, when we reach the tipping point on pricing in Club World will be driven not just by what we do, but what our competitors do in terms of capacity – particularly capacity on the North Atlantic, although not just the North Atlantic.

Like you, we have been looking hard at what our competitors' plans are for the coming summer period and, in particular, what their plans are for long-haul capacity. Clearly, over the last two or three years, most of the long-haul players have cranked their utilisation down, as demand goes down. What we are beginning to see now is that utilisation is coming up on some of the long-haul fleets, with people putting more capacity onto long-haul routes. This is not necessarily because they are buying any new aeroplanes but simply that aeroplanes that were sitting on the ground are now back in the air.

The rate at which that capacity goes back into service, particularly on the long-haul, will determine when we get some purchasing power back in Club World. This is very important to us and you are right to focus on Club World because it is the most important piece of real estate that we have on board the aeroplane.

Having said that, one of the things that we have been extremely happy with over the last six months in particular is the way in which World Traveller Plus has continued to do very well for us. We are seeing real increases in real loads, and we have seen strong yields in the World Traveller Plus cabin, and that has been what I described the other day in an internal meeting as our 'sleeper'. By that I meant that, quite rightly, our push has been around Club World, and the flat beds in Club World over the last couple of years. World Traveller Plus has, as it were, sneaked into the aeroplanes and into the market, and it has been an extremely good part of our product range. This is one of the reasons why we have been able to keep a strong grip on market share in the key markets.

Nick van den Brul (BNP Paribas): I was just looking at the graph that you presented of the reduction in debt in US dollars and yen. How much does that match your actual revenues in US dollars and yen? What is the new hedged position? Is it on balance, or do you have an exposure? What does it do to the non-cash adjustment that you made sometimes, usually at the end of the year, in respect of that?

My second question relates to the working capital benefit that you expect to have from the roll-out of online purchasing. Presumably, there is a reasonably significant working capital benefit there over time, as you no longer have the delay in payment from travel agents but you receive a direct credit card payment.

Rod Eddington: I will ask Keith to respond to some of the detail in a moment.

In the broad sense, I am very comfortable with where we are, both in terms of our US and our Japanese yen obligation. We are pretty much neutral on US dollars, because we have such huge US dollar earnings. In that sense, BA is an unusual airline – most airlines are much more sensitive to fluctuations in US dollar strength. Similarly with the yen, we have good yen cashflows from our double daily service to Narita, so I am very comfortable with where we are there. I think Keith spoke to some of that area.

In the main, we have some good, naturally hedged positions. Keith, would you like to comment on the rest of that?

Keith: As Rod said, we are broadly matched on dollars. On the yen, we have yen repayment obligations in 2009/10 and, by flying the Japanese routes we will earn yen over that period to repay that debt so, again, we are broadly matched. What you see in the accounts is a pure mark-to-market accounting issue, but it is not a treasury concern.

Nick van den Brul: And the second question?

Rod Eddington: The piece about working capital requirements and the impact that has – John, would you like to say something on that?

John: It will help us, going forward, but it is relatively small. That is my straightforward answer. The cash that flows into the business flows in more slowly through the BSP network as cash payments, and it flows in more quickly, monthly, and less than monthly sometimes, with credit cards, and even more quickly on debit card charges. As I said, we started those yesterday. We will see some small improvements but I would not expect to see significant change for quite some time – it will be very gradual.

Chris Reid (Credit Suisse): I have a question on the yield point which was raised earlier this morning. John, you said that you expected yield to be down, as your best guess, for the year to March 05. Could you talk about that and, specifically, what assumptions, if any, you have in for economic recovery? How much visibility do you have on forward booking patterns? Where do you see the pressure coming - on the long-haul or the short-haul, or both of them? I am asking because, obviously, your comparables start to ease up quite strongly from Q1 of this year.

Rod Eddington: The question of yield is obviously critical to our valuation of the coming year or two. As always, it is difficult to be absolutely accurate on this but let me tell you what we see as driving the yield issue.

The first is an issue that we have discussed here for the last two or three years, which is the question of what is happening to short-haul premium business. Although the short-haul premium business is still a very important and profitable piece for British Airways, the overall market is much smaller than it was three years ago. Therefore, on the short-haul front, the issue of yields will be driven to a significant extent by a mixed piece around what happens to short-haul premium volumes and also, of course, what is happening down the back of the aeroplane. We are beginning to see some substantially divergent trends here between what is happening between, say, BA and Easyjet and Ryannair, built primarily – in my view – around Ryannair's rush for growth. What will happen to those yields, and what will that mean to pricing in the market place, particularly into and out of the UK, over the next 12 months?

On the long-haul side, we think this is a much more stable picture in many ways. Long-haul yields, particularly in the premium cabins, have been pretty good to us, and the World Traveller Plus improvements are good to us. Having said that, we have usually tried to take a reasonably conservative position on yields, because that is the only sensible way to go. In the context of BA, the revenue planning group which meets monthly to talk about loads and yields is the group that John and I look to primarily for guidance on these issues. The figures you saw today represent the sum total of their best guess and in 12 months' time we will see how accurate they are. However, to plan going into this coming year on anything other than sensible yield assumptions would not be wise.

You know, as I know, that predicting yields is part art, part science. The point about the last few years is that, by and large, airlines have been overly optimistic about what will happen on the yield front and, as a result, they have not taken a strong enough position on their costs. In this business, that is fatal.

Andrew Light (City Group): Could you give us some further detail on your forthcoming business plan for the next two years, which was announced in January? For example, how do you intend to reduce absenteeism? Can you give us a time frame for when you hope to gain agreement from the labour unions?

Rod Eddington: As you know, we have set ourselves some targets for year one and year two on this. We recognise that tackling some of these issues is something that we can only achieve if we work closely with the unions and our staff across the business and we are absolutely committed to do that. Absenteeism is one of the issues that we are targeting and we are already in discussion with key unions and working groups about that.

If we are to deliver to the key parts of the business plan that we rolled out this year, we have to make progress on a number of fronts, including addressing some working issues. We know that, too, but we are absolutely committed to doing it. We are taking a different approach from the one we took two years ago, with Future Size and Shape. We were much more prescriptive about not only what savings we wanted to deliver but also about how we intended to go about them. My sense is that that was absolutely the right thing to do at the time, particularly given the emergency that we and other airlines were facing.

We are on stronger ground now and that makes it doubly important. Our approach is more consultative and we look jointly to find ways of working with our unions and our people to resolve some of these issues. They have to be resolved. We have set ourselves some targets for year one and year two and we will deliver those. It will be an interesting journey because it is a less prescriptive journey than the one we have taken in the past, but I believe that this is absolutely the right approach. It is also the only approach that will give us any substantial chance of delivering what we must deliver.

Chris Partridge (Deutsche Bank): How much utilisation fat is there in the fleet? You mentioned it briefly, about your competitors earlier. What do you have available?

Rod Eddington: We will see some significant further improvements in short-haul utilisations this coming summer. We set ourselves some utilisation improvements, remember, as part of Future Size and Shape in the beginning, and we will deliver those. As with all these areas, we are not stopping at Future Size and Shape.

We have just begun a significant piece of work on our long-haul fleet and its utilisation to see what we can do there too. The good news for us is that, when you do not take any more aeroplanes into your fleet, and certainly no growth aeroplanes into your fleet – given that we are taking some short-haul replacement aeroplanes – the additional flying comes from improving utilisation. We have demonstrated that over the last couple of years and I am confident that we can continue to achieve some sensible, reasonably modest levels of growth from the utilisation piece. We also need to look at our long-haul fleet now, as well as our short-haul fleet. Of course, we are doing more flying with fewer aeroplanes. We are doing several percentage points more flying that we thought we would be when we put Future Size and Shape out two years ago, and we are doing it in a sensible and intelligent way. There is more to come, but it is incremental rather than substantial.

Jonathan Wober (HSBC): I have a couple of questions. First, with reference to the 10 per cent operating margin target, you have mentioned many times that you need some help from the market to get there, and also through the cycle – this is the target through the cycle. So, sometimes the market helps you and sometimes it does not. How do you sustain that through the cycle? That is my first question.

My second question regards emissions trading. How realistic is the aim to get aviation into the EU scheme by 2008 and what are the threats in the meantime of governments imposing some form of environmental tax?

Rod Eddington: Let me take the first piece – 10 per cent through the cycle. Again, if you remember, when we pushed Future Size and Shape out into the water, one of the things we said was that we had a whole range of pieces that would fit together to deliver Future Size and Shape. One of them was that we expected that we would have some very modest help from the market. This was in early 2002 because, after the tragedies of 9/11, we saw a huge reduction in revenue and then we saw it come back quite quickly through the November, December and January timescale. Many people in the industry, including us, thought we would get back to where we had been pre-911, but that proved to be wrong. From memory, 2.5 points of the 10 point operating margin was going to come from market recovery – but actually, plus 2.5 has been minus several, and so we have had to do much more on the cost front, just to begin to offset the revenue reductions.

Yes, in the main, it will be very difficult for anyone in this industry to deliver a 10 per cent operating margin, given the revenue levels. The answer to your broad question is simple: in order to deliver 10 per cent through the cycle, you have to deliver more than 10 per cent through the good years. Pre-911, the best airlines in the business around the world were delivering numbers of that approximation, reasonably consistently. We have to find ourselves in that territory – it is as simple as that.

On the question of emissions trading, would you like to handle that, Andrew?

Andrew Sentance: On emissions trading, we have two governments that appear to be quite committed to trying to move this forward – the UK Government and the German government for 2008. The difficulty I see is in how much of aviation we can put into emissions trading because the international aviation emissions are not allocated under the Kyoto protocol. This creates some difficulty in including them in an emissions trading scheme.

As to what might happen in the meantime, the UK Government has signalled that they do not see APD (Air Passenger Duty) as an effective mechanism, but we will see continued pressure within Europe to do something about taxes and charges. Part of the reason for taking quite a pro-active stance on emissions trading is really to head that off.

Jonathan Wober: Is there any realistic concern in your minds that some form of taxation or increased duties, whether it is all governments, or one government here and there, could actually choke off demand to any significant degree in the next few years?

Rod Eddington: That is a good question and one that we ask ourselves quite regularly. Our view is to have eternal vigilance here. The good news for us is that everyone in the industry is very focused on this and very concerned and that the 'no frills' carriers in particular recognise that this is a much greater threat to their business model than ours.

Mike Powell (Dresdner): I have a quick question about BA Regional. Your regional routes obviously do not have quite such strong premium rolls and transfer traffic as your London-based routes. Can BA Regional compete in the longer term? You have rationalised your regional activities a little, but will that be a continuous process? How painful might that process be and what implications does it have for your regional fleet, which is obviously quite a mixed bag at the moment.

Rod Eddington: The work that the team at BA City Express has done over the last two years, and in the last 12 months in particular, has exceeded some of the key cost targets that we have set for them. It has been a real challenge because, to be frank, they have had to completely re-build the business. They had far too many aeroplane types but that is well on its way down now. They are beginning to make some real progress in terms of their ability to compete with the no-frills carriers, and that is a critical part of their longevity. After all, they confront the no-frills carriers to an even greater degree that BA mainline does, given that there are no no-frills carriers operating out of Heathrow itself.

Their success in driving their business model forward, and pretty much moving to an all-jet fleet – albeit it built around regional jets, the RJ100s and the Embraers– is working well. They have the same revenue challenges that everyone who competes with the no-frills carriers has and so the challenge for them, as it for BA mainline short-haul, is to work as hard as we can to maximise our revenue position. That is clearly a priority for them as it is for British Airways Mainline, but they have both made good progress.

I am confident that David Evans and his team can continue that progress but, in the context of regional UK, there are some challenges. I do not think for a moment that all of the players in regional UK, and that includes a significant number of no-frills carriers, will be around in three or four years' time. I am quite clear about that – any more than there will be 12 no-frills carriers in Germany in three or four years' time. We are determined that BA City Express will be a survivor.

They had a very mixed fleet, but they have got rid of the Jetstreams, and they are running down their other two low-prop fleets too. This is a critical part of rebuilding their business.

Lars Slomka (Deutsche Bank): With Air France and KLM going forward, where do you see your co-operation with Iberia and Swiss standing in two years' time?

Rod Eddington: We are working very hard on deepening our Iberia relationship, which is a very important one for us. We are a shareholder, of course, and we have two seats on the board. We now have anti-trust immunity from Brussels, so we can work much more closely with them. We have been code sharing with them now to Madrid and Barcelona in the first instance for some time but we are also looking at how we deepen the commercial links between our two companies, because – given that we now have anti-trust immunity – there is a whole range of things that we can do that we were not able to do before.

Their position in Europe is a very important one for me. They sit across one of the largest domestic markets in Europe. Clearly, Barcelona and Madrid have two major hubs and they have a good, strong, competitive cost base and a strong balance sheet. It is a well-run business and, increasingly, we are looking for ways to make our networks complementary. To be frank, that is much easier than it usually is between two airlines, because there is very little competitive overlap and, in a sense, they tend to be strong in areas like South America, which are reasonably light areas for us. They do not fly east of Madrid, so the Middle East, Asia and Africa are not points on their network. I see them as a critical long-term partner for British Airways and I know they feel the same about us. Our focus with them overwhelmingly is to deepen the commercial co-operation between the two countries.

Swiss are important to us too, because they sit on an important market and Zurich is a good hub, not *just* for Eastern Europe, but particularly for Eastern Europe, and they come into One World later this year. We are working with them very strongly on a bilateral basis and that will become even more apparent when the new summer season starts. So they are important parts of what British Airways is doing and how we do it.

My point on alliances and European relationships is always that there is nothing more important than a strong core business. Our first, second and third focus therefore remains strengthening British Airways' core business. That is the best guarantee that we will be a strong alliance partner and that we will be able to participate when it finally comes, in what we hope will be a reasonably sensible process of consolidation in Europe. I feel very comfortable with where we are. Very comfortable indeed.

I have not talked about the other key parts of One World in Europe. I have not spoken about Aer Lingus, who I think have made terrific progress over the last two years under Willy Walsh and his team, nor about Finnair, who are also a valuable European partner.

Gerald Khoo (Oriel Securities): On the issue of Open Skies negotiations between the EU and the US, what does British Airways want to get out of that? What are you looking to protect?

Rod Eddington: What we want to get out of it is genuine liberalisation on the North Atlantic. We would like to see a single aviation market that included Europe, the US and the North Atlantic and anything other than that would be a hugely missed opportunity.

In the main, the Americans have been extremely successful at positioning themselves as the liberators and in pursuing an open skies deal that gives them complete access to your market while keeping their closed. They are pretty good at it. There is the Fly America policy, and limits on foreign ownership, no cabotage - and all of those things speak to how well they have been able to keep their markets closed. The Fly America policy means that significant parts of the US market are simply not open to British Airways and that is just not good enough.

We want nothing short of full liberalisation and we are absolutely determined that Brussels should push to get it. If we do not get it this time, it will be 20 or 30 years away. This is the best chance we will ever have. I do not suggest for a moment that any of this is easy. You only need to go to the States and turn on the television and hear Lou Dobbs talking about exporting American jobs, to understand how protectionist parts of America have become. However, the bottom line is that if we do not liberalise markets now we will have missed a golden opportunity.

Damien Horth (UBS): I have a couple of quick points. I just wondered if we could focus in on the Asia Pacific market and talk a little about the demand trends and the capacity trends that you are seeing there, and in particular any opportunities in China and India. If possible, could you strip out the SARS impact on that, although I know it is difficult.

On a separate issue, what are your views on the future dividend policy for British Airways.

Rod Eddington: Let me start with the second point, because it is really simple, Damien: it is a matter for the board. Any Chief Executive and opines on dividend policy, absent a very clear steer from the board, is asking for trouble. This is clearly an important issue for the investment community and the board is very conscious of that fact and is giving this issue some thought.

Asia Pacific is an important part of our route network. We will be able to talk to you in much greater detail about it when the results for the full year are announced in May but one of the things I like about what is happening to our network profitability is the balance that is beginning to return to the British Airways route network in profitability terms. The North Atlantic remains absolutely pivotal to us, of course, and that will not change. However, we are seeing some very positive developments across what happens in Africa, what happens in the Middle East and also what happens in Asia Pacific.

As you suggested, year-on-year comparisons are skewed by SARS for this time last year. However, perhaps I could just give you a flavour of some of the things that are happening. The Australian routes are doing particularly well and clearly the World Cup helped that, but Australia is seen as a safe and good destination. Hong Kong is doing particularly well for us and in fact we have taken the decision to put more capacity into Hong Kong this coming summer. This is a key market for us.

I was in Japan in December – John, Keith and I were there to speak to the banks and our shareholders there, and we go every year in December. Japan was much more upbeat than I had seen it for at least 12 years and much Japan's – it would probably be a bridge too far to say growing confidence, but much of their confidence about where they are right now *vis à vis* where they were two years ago is based on their trading links with China. At lunch, I sat next to our senior cargo agent in Japan, who told me that they had just opened their 50th office in China: there is a huge amount of cargo flown between China and Japan in both directions, and this has been a real fillip for the Japanese economy. That clearly feeds through to our routes to Narita.

You mentioned India and China particularly, so let me start with India. The Indian market is grossly under-served from here and we have been trying very hard to get more capacity in India – not just to Mumbai, as it now is, and to Delhi, but we would also like more capacity into ?Cheni and Calcutta as well, and particularly ?Cheni. As you may know, we have been looking hard at whether we can get other points in India on line. We and the British Government have been frustrated by the way in which Air India have been able to frustrate our attempts to get more capacity into India. It is a strange quirk but, when I go to see the Chairman of Air India in India, and then I go to see the Minister for Transport with his

Permanent Secretary, I realise that the Permanent Secretary and the Chairman of Air India are one and the same. That perhaps gives you some feeling for why getting more capacity into India is difficult. However, you know and I know that India is going through a considerable renaissance and I cannot believe that that dam can stay blocked for ever.

China is also interesting for us. The challenge in China is to make money, operating to and from China. Although it is an extraordinary market with great opportunities, the question is, how do you construct a viable route network between here and China, which allows you to make money? At the end of the day, that has to be the dominant consideration for us. As Andrew intimated in his presentation, we have some additional traffic rights to China and that is a real opportunity for us, but how do we take them profitably. This might well revolve around not just passenger but cargo.

Interestingly enough, the Beijing route is doing better for us. As you know, we now have a handful of 777s that do not have first class. They have been re-configured as three-class aeroplanes: Club World, World Traveller Plus and World Traveller. We have 270 seats on those aeroplanes versus 220 seats on the four-class version and, to a route like Beijing, that is a much more appropriate aeroplane. The early signs are that those three-class aeroplanes, where they operate in the right markets, will give us significant profitably.

With China, we have to take our opportunities, but we have to be realistic about what the profit pieces are. The India picture is very different, however, and the market is massively under-served – and more capacity means that we make more money.

Andrew Lobbenberg (ABN): I have a couple of questions, the first being on regulation. The bilateral deal with Hong Kong, which is being examined by the EU, is interesting because it is the first time that the EU has played with its rubber stamp on a bilateral. How do you see that process playing out and what would be the consequences for BA?

I then have a second question relating to slots. When do you stop buying slots? In the most recent package that came up for bids, you were beaten by the evil Australians! Why did you lose? Does that show a sign that you are easing off and are not so hungry, or will you push on?

Rod Eddington: I will ask Andrew to speak to the EU issue, particularly with respect to the Hong Kong negotiations.

Slots. No deal is better than a bad deal and in the last slot deal at Heathrow the people who bought them paid too much – it was that simple. As you know, we have been keen to acquire slots at Heathrow, because they are the ?silverware which allows us to grow our route network. We have made some substantial progress over the last two and a half year, despite the tough capital constraints we have set ourselves. We have effectively gone from something like 38 per cent of the slot holding at Heathrow to over 40 per cent, on the back of some substantial with the Belgians and the Swiss but also some incremental deals – including, ironically, the fact that we bought ....[*Tape change: no overlap*] ... we will not acquire them at any price and, in our judgment, last time the price was too high. You might call that being beaten, but it simply meant that we reached a point in the discussions where we stepped back, because we were not going to provide the price on offer. That demonstrates that some of the earlier slot deals we have done were both sensible and also we paid a fair price at the time – which, with hindsight, was a good price.

Andrew, would you like to talk to the implications of the EU involvement in the Hong Kong discussion?

Andrew Cahn: Yes, the Hong Kong side in those negotiations insisted that the deal could not come into effect until such time as the European Commission had approved it. The European Commission does not have the power to approve it until the relevant regulation comes into law in Brussels, but that will not happen until later this year – quite possibly towards the back end of this year. I do not think that deal could come into effect until significantly later in this year.

It may well not even come into effect then because, from the European Commission's point of view, when the examine the deal and ask whether they should approve it, they will look and see that Transatlantic rights are given under that deal to a third country operator, to Cathay Pacific. They will be very uneasy about approving any deal which gives to a non-EU carrier the rights which some other EU carriers – in fact, many EU carriers – do not have, though under Community law, they should have it. The UK/Hong Kong deal is essentially dependent upon the EU/US deal, and the timing of all these things is of course uncertain.

Rod Eddington: We will take one more question before lunch. As always, I am delighted that some senior members of the board will be able to join us at lunch, as well as the management team. I would be more than happy to take questions over lunch, but we will take one more now.

Stephen Clapham (Williams de Broe): Perhaps I could be cheeky and ask two questions. First, you were quite upbeat in January, when you had your traffic figures.

You were saying that things looked a little better. Are you more or less confident now than you were then? I had the sensation that you were perhaps feeling a little less confident.

Secondly, on the question of dividend policy, since the new Chairman is here, could he give us some thoughts on what changes we might see under his chairmanship.

Rod Eddington: He has just gone! Perhaps he pre-empted your question!

No, I do not think our view of the world has changed materially since earlier in the year. You always have to keep a foot on the beach in this business, and you know that as well as I do. In part, that is because of the security concerns which just reminded us that consumer confidence, particularly in North America and for reasons we understand, is a fragile thing. We recognise that, tragically – you may or may not know that some bombs went off this morning in Madrid and, sadly, 140 people were killed. This had nothing to do with aviation, but we live in an uncertain world and we need to recognise that this has an impact on people's travel patterns. That is why we continue to take a measured and, I believe, sensibly cautious view about revenue, and it is not prudent to do anything else.

We have seen some very positive things on the revenue front in the last little while. Chris was talking earlier about what we are seeing in terms of premium loads, but we have also seen some negative things, security concerns amongst them. There are the challenges that some of the no-frills carriers face. As always, the revenue picture is a mix. We will continue to take what we consider to be a realistic view, but on the revenue projection front I do not think you would ever accuse us of being overly optimistic.

Having said that, I thought that was where we were after 9/11 but it turned out that the revenue projections that we made at that time were overly optimistic, albeit for reasons that we were not able to anticipate at that time. So no, our broad position has not changed at all, but the security concerns just reminded us that there is a fragility to the revenue line.

I look forward to seeing you all at lunch. Thank you very much.

[*Housekeeping notices: Feedback forms; competition forms; afternoon tours*]

- Ends -