BRITISH AIRWAYS

INTERIM MANAGEMENT STATEMENT

1st QUARTER RESULTS 2008-2009

ANALYSTS' PRESENTATION

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Martin Broughton: Good morning everyone. As you know, it is not normally our routine to call you in for either the first quarter or the third quarter, we normally do it as a teleconference call. We are not changing that pattern, that will remain the norm but we thought that, on this occasion, given the Iberia announcement specifically, and given the winter capacity reductions, we would make it easier by having a presentation. It also gives us a bit of a chance to talk a little about the progress in T5. I shall hand straight over to Keith to take you through the numbers.

Keith Williams (Chief Financial Officer): Good morning everyone. This is the second year of reporting on the Interim Management Statement as you know. The format tends to give you more business information but fewer financial data. I hope to add some details to the finances this morning and we shall be glad to take your questions at the end, once Willie has spoken to you about our recent announcements.

Fuel costs hit Q1 result

I would like to start by reminding you what we said in May when we gave you some guidance at the year end results. We said that Q1, in particular, would be difficult as we headed into an environment of higher fuel costs and we saw some slowdown in non-premium traffic.

The results today are in line with that guidance, not that the fuel cost was any better. The market price of jet fuel increased by some 72% over last year and with hedging our fuel bill was up just under 50%, or £233 million to £706 million. In the quarter, we were burning around £8 million of fuel per day. Mainly caused by the fuel costs, our total costs saw a rise of some 15% in the quarter.

As you know, we have looked to offset some of this cost increase with price increases and have put up surcharges twice in the quarter on 2 May and in June. The full effect of those increases is yet to come through, so in the quarter yields were up 4.7% at constant exchange rates and 6.9% overall. This has had some impact on volumes, with overall passenger traffic measured in terms of RPKs down some 3.7%.

Looking at segment performance, longhaul non-premium traffic volumes have been down in most of our markets but particularly in the US, which accounts for most of the decline, and increasingly in the UK driven by economic slowdown. Shorthaul non-premium traffic grew. Longhaul premium traffic has remained broadly flat, with shorthaul premium remaining weak.

Headline numbers

I shall take you now to the headline numbers. Passenger revenues were up 2.9%. A strong cargo performance was offset by weaker other revenue performance with the result that overall revenue was up 2.8%. That result was helped in part by favourable exchange, particularly from the strength of the euro, with underlying revenues just up around 1%.

As I said, costs were dominated by fuel, which accounted for more than 30% of the total cost bill. Fuel itself was up 49% and non-fuel costs were up around 4%, leaving total costs up 15%. The operating profit for the quarter was £35 million, leading to an operating margin of 1.5% and pre-tax profits were £37 million as you can see there.

Statistics

We started the year with planned ASK growth in the first half of the year, and at market level growth in the second half. ASK growth in the first quarter was in line with our original forecast, up just 0.7%. As we saw above, traffic volumes were down with RPKs down 3.7% and passenger load factor was down 3.4 points with an overall load factor of 73.4%. In part this is the consequence of increased prices as we trade off volume for yield in the face of unit costs, up some 16% year on year.

If we look at the yield, the price elasticity trade-off between yield and volume is an important one in this environment. Passenger revenue per RPK in the quarter was 7.1p, up 6.9% year on year. It was offset in part by volume declines of 3.7%, as we have just discussed, in terms of RPK and lower load factors.

We have seen greater resilience in the longhaul premium segment where traffic declined for the year but was flat against the market. Here the increase in fuel and other charges is proportionately greater in non-premium.

Yield drives revenue improvement

Looking at the yield, prices were 2.2% up overall over the previous year, with fuel surcharge increases offset to some degree by pricing weakness elsewhere. Mix was positive as premium traffic held almost flat, whereas there was volume weakness in non-premium markets. Exchange, as discussed was favourable as sterling remained relatively flat against the dollar and was around 14% weaker against both the euro and the yen.

Solid revenue despite the challenges

Looking at the revenue, revenue performance overall was up 2.8%, driven in large part as a result of additional fuel surcharges in both our passenger and cargo businesses.

Turnover split first quarter

Looking at the split, as we saw earlier that passenger revenue was up 2.9%. There was, once again, a very solid performance in our cargo business with volumes up around 4% and yields up 17% driven in large part by fuel surcharges. This offset declines in other revenues driven by a number of factors but, in the main, from the loss of third party work and franchise fees following the departure of GB Airways to easyjet, and in part from the impact of the slowdown in some of our subsidiary businesses such as Air Miles and BA Holidays.

Costs challenging

Looking at costs, the quarter saw significant pressures on costs both from the high fuel price and from other costs, with overall costs being up more than 15% and unit costs up more than 16%. We spoke about the impact of fuel. Costs, excluding fuel, were up 4.1% but within this there was a major exchange impact from the strong euro, at constant exchange rate costs were up just under 2%.

Pressure on all cost items

Looking at the individual cost lines, again these are influenced by currency and the euro. Employment costs were up based on increased manpower at Heathrow and handling costs were impacted to some degree by additional costs associated with Terminal 5.

Cashflow

Our cashflow from operations was £324 million and, as a consequence, our cash balance has increased over the quarter and stands at just under £2 billion. You will recall that at our results announcement, we indicated that we expected to spend some £650 million this year on capital. In the quarter, we spent some £134 million including the acquisition of two new A320s. In addition, we acquired some leased aircraft for CityFlyer increasing the size of the fleet now to 249 aircraft, and Willie will cover off some of our aircraft orders in a moment.

Adoption of IFRIC 13 & 14

Finally, let me quickly talk you through some accounting changes. You might recall that at Investor Day we spoke about three potential accounting changes this year. The first one relates to tax on industrial buildings. It has not been reflected in this quarter's results and that is because the appropriate legislation was not passed until early July, but it will be reflected in the half year.

The other two, however, have been adopted and both would lead to prior year restatements. This is why when you look at the accounts you see restated profit for last year.

The first is IFRIC 13 which covers revenue recognition for customer loyalty programmes, and the second is IFRIC 14, which required us to put part of our pension surplus in APS on balance sheet. Both have large balance sheet impacts but have little impact on the restatement of last year's results or on this year. Last year's first quarter has been increased by some £3 million and reserves by a total of £29 million.

Q1 conclusions

To summarise, the quarter finished up with a largely better operating result than we feared back in May. If we look at the performance of the six months from the start of the calendar year, we have delivered operating profit of some £169 million on revenues just under £4 billion. Given the industry context, I believe this is a creditable result. The ability to maintain yields above volume decline is a key performance measure going forward.

As for Terminal 5, we remain focused on continuing to deliver superior performance for our customers, and Willie will cover that off in a moment.

Looking forward

Now to the outlook for the rest of the year. As the Chairman said at the Annual General Meeting, it would be a great achievement to be profitable this year given the economic backdrop and fuel environment. He also mentioned that we are on our third business plan for the year. That plan has been built around capacity reduction over the winter through which we expect to produce some £100 million reduction in fuel costs this year and to deliver some additional £50 million of contribution, and Willie will cover that off in a moment.

Revenue still growing

On the revenue side, market conditions today remain consistent with the position that we have seen in the last quarter. We have seen continued volume decline in passenger numbers as a result of economic slowdown and price increases. The full impact of fare increases and recent surcharges is likely to have an effect on increasing yields and reducing volumes in the coming months. Price elasticity is most pronounced in the non-premium market segment, and we expect fare increases to deliver a small increase in revenue given likely further volume declines. Longhaul premium, however, remains relatively flat year on year so that more of the improvement in the yield is likely to flow through to the bottom line. The recent capacity reductions will spill some revenues and we now see total revenue for the year being up some 3% year on year.

Jet fuel prices

Looking at fuel, the increase in fuel price is well known and will have a major impact throughout the year based on current forward prices.

Hedging cover

Against that, to update you on the hedging cover, we have significant cover for the rest of this year. On a calendar basis, we are about 80% hedged this year and around 50% for 2009/10. On a financial year basis, we are about 78% covered this year at prices of between $91-95.

Fuel spend for 2008/09

If you look at the sensitivity to fuel going forward, the extent of that cover has reduced our exposure to fuel prices this year, as has the impact of capacity reduction as you saw earlier. We shall still have significant price increase on fuel. At today's forward prices, at around $130 per barrel, we would expect our fuel bill to be up some £1 billion over last year, and it will stand at just over £3.05 billion.

Other costs

Looking at other costs, our guidance previously on non-fuel costs was up 3-3.5%. We do see some benefit from the capacity reductions and are now targeting for non-fuel costs to be at the low end of that guidance at around 3% or £175 million.

Revised outlook for the year

Just to give you a summary of the outlook, we are focused on remaining profitable this year with revenue growth at around 3%, fuel costs, as I have just spoken to, up around £1 billion at a forward price of about $130 per barrel, and non-fuel costs up some 3%. With that, I shall pass over to Willie.

Willie Walsh (Chief Executive Officer): Thank you Keith and good morning everyone. I would just like to provide you with an update on a few issues starting with Iberia, then American, some of the detail on capacity and fleet and then a brief update on the performance of T5.

British Airways and Iberia

We were really pleased to be able to announce last Tuesday the talks with Iberia on a merger. These talks are unanimously supported by the Board of British Airways and the Board of Iberia. The announcement was triggered by the decision of the Iberia Board on Tuesday morning unanimously to support talks towards a merger. There is a lot of detail that needs to be negotiated between us. Under Spanish rules, Iberia had to make a public statement following the decision of the Board, so Fernando Conte and I agree to hold a joint press conference in Madrid which was called at very short notice to provide some detail. However, much of the detail has still to be discussed between us.

Structure of the deal

Some of the issues have been agreed between Fernando and me. We have agreed to maintain the two brands – British Airways and Iberia – the two identities of the companies, with two operating airlines so each airline will continue to hold its own AOC and the structure will involve the creation of a new holding company which will acquire the shares of both companies. It will be listed on both the London and Madrid exchanges and it is likely to be a member of the FTSE 100. Therefore, these are early days in relation to this. We have committed to conclude the negotiations between us as quickly as possible. We expect to be able to do this certainly within the six to 12 months timeframe, and we shall try to do so as quickly as possible, but there is quite a lot of detail that needs to be discussed.

Benefits

This is a natural extension of what has been a successful 10-year relationship between British Airways and Iberia. We have a very successful joint business between Heathrow and Madrid/Heathrow and Barcelona which has been in place since early 2005. We can demonstrate significant consumer benefit as a result of that joint business. It is a structure that has worked well for British Airways, it has worked well for Iberia and it works well for our customers. When you look at the network of the two carriers, they complement one another. One of the jewels in the Iberia crown is its network into Latin America, and we are strong in North America, they are very strong in South America. We have to get into detailed discussions on the synergy benefits but it is very clear to us that there are significant revenue synergies available through a merger between British Airways and Iberia and clearly there are also cost synergies available. This is an exciting opportunity for us, it is a natural extension of where we have been, and the fact that it has been unanimously supported by both Boards, including the major shareholders in Iberia, is a positive development as well.

Comparison with other major airlines

You can clearly understand that the size of the company will put us in the top five under pretty much every measurement you want to use, and just to give you an indication of some of the figures relative to Lufthansa, Swiss, Air France and KLM, you can see them on the chart. I see this as a positive development for OneWorld as well. It is clear that the alliance structures are maturing and the importance of competition between alliances is increasing, and this is a significant boost for Oneworld, as are the discussions we are having with American Airlines.

American Airlines updates

I am pleased to say these discussions are progressing very well. They are taking place against a background of a changed regulatory environment. We now have Open Skies between the EU and the US, Heathrow is open so US carriers that have previously sought access to Heathrow have gained access to Heathrow. We have seen the Delta-Northwest proposed merger in the US and significant discussions are ongoing within the domestic US market. So the progress has been good and we are looking at concluding those discussions within the next two weeks, and we expect, if they conclude successfully as we believe they will, to move forward to an application for ATI within the next two weeks.

This is a joint venture between us on the transatlantic. I believe that it will represent significant benefit to consumers, particularly in the area of frequent flyer programmes, which is one of the biggest criticisms that both American and BA get, because of the confusion that exists in the minds of our customers as to why we do not have a reciprocal frequent flyer programme with the transatlantic at the moment. Those talks are progressing well and I expect to be in a position to announce some development within the next two weeks.

Capacity review

We have signalled our intention to reduce capacity in the light of changing demand, and we thought we would give you some details of this. We have put it in a number of different ways to try to give you as much information in relation to the changes as possible. What you see there are the capacity increases that we announced at Investor Day, an overall capacity increase of 2.4%, longhaul premium 3.5%, non-premium 0.8%, shorthaul 6.6%. Some of that shorthaul was as a result of network changes at Gatwick with the ending of the GB franchise; we were taking over a number of the routes that were previously operated by GB.

The revised capacity growth you can see on the right hand side. I said publicly that it was going to be broadly flat, so down 0.3%, longhaul premium up 1.5%, non-premium down 2% and the shorthaul growth at 3.9% versus the originally forecast 6.6%.

ASK change versus last year

If we look at that in terms of ASK changes versus last year, you can see the figures there broken down summer ’08/winter ’08 and then the full year. So we had forecast 2.4% growth and that is now down 0.3%, and we combined the figures there for longhaul premium and non-premium. You will remember that it was +1.3% for premium, -2% for non-premium. That gives a longhaul ASK reduction of 1.2%, shorthaul will continue to grow at 3.9% versus the original planned 6.6%.

ASK change versus original plan

Versus the plan, therefore, you can see it is largely all taking place in the winter period. Summer capacity was slightly down on what we had originally planned, 0.2% down on what we had originally planned, with the winter capacity down 6.4% versus original plan, giving a full year of -2.7% against the original forecast of +2.4% and the revised one of 0.3%.

Reductions achieved through frequency

We have achieved the reductions by focusing on minimising disruption to the customer. On a flight number basis, we have identified flights with weak demand and we have taken capacity out on week days, week or month, so you can see that it is being done on a very detailed basis. Most of our shorthaul routes will have some frequency reduction. We shall suspend four services at Gatwick which are Poznan, Newquay, Sarajevo and Dresden, and the longhaul reductions will be achieved with periods of frequency reduction. On the slide you can see some examples: Los Angeles with three flights a day, we bring it down to two flights a day for a 12-week period; JFK from eight a day down to seven a day for the winter; Hyderabad which we planned to start at the end of October will now be delayed until 6 December; on Tokyo we are pulling back from two services a day to one from 7 December. It is broadly around taking capacity out where we have identified weak demand.

W08/09: frequency reduction vs last year

To present this in another way to give you it in terms of frequency reduction versus last year, I have shown it there in terms of shorthaul at Gatwick and Heathrow, longhaul and the total.

The reason why I have put Gatwick in red is you will remember some of that frequency reduction was planned frequency reduction as a result of moving the Houston and Dallas flights from Gatwick to Heathrow under the Open Skies agreement, so that is not a frequency change as a result of this review. That was a planned frequency change but to present it consistent with the other data, it is versus last year. You can see in frequency at

Gatwick there is almost a 10% reduction in frequency in shorthaul, 6.8% at Heathrow, giving a total frequency reduction through the winter period of 3.3%.

Considerations

In doing this, we have been conscious of our slot portfolio, so none of the changes that we have made will put at risk our slots at Heathrow. All of these changes are consistent with the 80/20 rule, which was an important issue for us. As Keith has said, there will be some revenue spill which is unavoidable but we have looked at how we maximise the recovery of any revenue spill. We have taken into account announced and likely customer changes to the winter period, and we have also carefully considered the impact that this will have on our corporate business.

Cargo, which is performing well, was an important consideration in this and, in doing the network changes, we have retained flexibility to respond in the event that we see a weakening fuel price. We do have the ability to put capacity back in if the fuel environment changes but we have no indication that is going to be the case. Therefore, we have looked at this from a consumer point of view, we have looked at it from a corporate point of view, we have carefully considered all of the changes to ensure that our slot position, particularly at Heathrow, is not compromised, and there remains flexibility within the schedule to respond if we see a changing demand situation through the winter period. We shall continue to evaluate options for capacity through the winter on a tactical basis and we shall also start looking at next summer’s capacity programme.

Fleet

Keith has mentioned fleet and this will be a critical issue as far as responding to the challenge that we see at the moment. We have been disappointed with the delays in the 787 programme but, as far as the capacity changes, we are not grounding any aircraft. We are using the existing fleet to maximise the fuel efficiency of the programme, whereas previously we would have been looking at maximising utilisation of the aircraft. To give you an idea of what the capacity reduction equates to, it is about 3-4 747s, about 2-3 Heathrow shorthaul aircraft, which, as you know, consists of a fleet of Airbus 757s and 767s, and 2-3 737s in the Gatwick shorthaul programme. We have used the change in capacity to reshape the network in an effort to maximise the fuel efficiency of the aircraft that we have.

As you know, we have four 777-200 ERs being delivered in early 2009 and it is likely that these aircraft will be replacements, in other words we continue to play with network and the shape of the operating fleet, again looking at fuel efficiency as one of the key drivers. So these are likely to be replacement and flexibility aircraft rather than growth aircraft. We have also announced today an order for six 777-300 ERs with options on four others. Four of these aircraft will be leased, two of them will be purchased. These are for delivery from 2010. They are significantly more fuel efficient than the Boeing 747, about 23-24% more fuel efficient, and this retains flexibility and gives us flexibility either to replace or grow, particularly in light of the delays to the 787 programme.

T5 update

I am pleased to say T5 is performing very well. We have now had just over 6.3 million passengers go through Terminal 5. The performance has significantly improved, the problems at the early days of operation are well behind us and just to show you some of the statistics. We showed you this slide when we announced our full year results, and you can see Ready to Go, which is a measure that we use. This is the aircraft ready for departure, all doors closed three minutes before scheduled time of departure. It is one of the measures that we use internally and it gives us an opportunity to be ready to depart on time with ATC requirements at the airport. We have had a very strong performance in relation to this. We are seeing quite a number of our flights depart ahead of scheduled time of departure, which is a significant achievement at Heathrow, so Ready to Go performance has consistently exceeded the standard that we have set for ourselves through this period.

Punctuality significantly improved

Our punctuality at the 15-minute level, which is the standard industry measure, has also significantly improved. Our July performance has been one of the best in recent memory. It is moving us up the table relative to the other AEA carriers but it is one of the strongest performances we have seen at Heathrow in many years, and we have seen a significant customer response on this. It is pleasing to see that customers have noticed the improvement in punctuality, and again, we are consistently exceeding the target that we have set.

Baggage performance improving

In terms of baggage performance, the good news here is that we have already exceeded the target that we had set for ourselves for March 2009, so we are ahead of our performance. You see the overall London performance in green and the T5 direct baggage performance in red. You can clearly see the disruption, and we showed you this chart at the full year results, in the early period of T5 but the baggage system has been working very well. The weakness in our baggage performance continues to be transfer bags which is a feature of all hub operations but the performance of our own BA-to-BA is significantly better than other airlines to BA, so our overall figures are dragged down by the performance of other airlines delivering their bags to us. Therefore, that reflects the performance more of other airlines than it does of BA.

The best measure of the baggage system is the T5 direct baggage performance, which is operating at its standard, that is as good as, if not better than, any other airport out there. So we are really pleased with that performance.

Baggage arrivals performance

As far as the consumer benefit, again one of the critical issues that we had focused on was delivering the bags into the baggage hall. I think it was one of the weaknesses in our operation in the old Heathrow environment. This shows you the average time to get the bags into the baggage hall. It is measured from chocks on, which is the aircraft parking on stand, and, as you know, it can be a few minutes before you as a passenger can get off the aircraft. In many cases, indeed it is almost the norm now, the bags will be in the baggage hall before customers have arrived in the baggage hall, so our performance there has been consistently good, averaging around 17 minutes from chocks on to the bags arriving in the baggage hall.

Final moves to T5

There is still work to be done in terms of T5 with two further moves to complete. The next one, which we are calling Switch 2.2, will take place on 17 September and the final move into T5 on 22 October. We have delayed these moves until we got through the peak summer operation, so the 2.2 move is the significant one with the vast majority of the remaining longhaul flights in T4 moving into T5 on 17 September, and the final tranche of longhaul flights from T4 moving on 22 October. The final switch, which will be from T1 where we have 21 flights a day continuing to operate from T1 and T2, T3 and the movement of our joint business with Qantas from T4 into T3 will take place some time in January 2009. That is more dependent on other carriers moving from T3 than it is on British Airways or Qantas. Therefore, we hope to have all the moves to T5 finished by 22 October and the full Heathrow change by the end of January of next year. Thank you for that, and it is over to you now for questions.

Question & Answer Session

Question: On the capacity cuts and the cost side of the business, I would have expected a little more of available costs to come out this winter in terms of your cost guidance, given the significant capacity cuts, so it would be great if you could talk a little about that? Secondly, in terms of the American JV, I suppose the plan is to get that going from next summer's programme, or do you think it might be a little earlier?

Willie Walsh: As far as the American JV, it will be very much dependent on getting the anti-trust immunity. It would be ambitious to expect that to happen by next summer, and it certainly will not happen any earlier than that, but it will have to go through the formal regulatory process. We would like to think that it will happen as quickly as possible but it is unlikely that we shall get all the approvals in place in time for summer 2009, although we shall try to do that as quickly as we can. That is why I am reasonably confident that we can conclude the discussions and move to five or ATI within the next two weeks.

Keith Williams: To your question on variable costs, if you look at it overall, the capacity reductions that Willie spoke about, and the revenue spill we are minimising but we believe that will be £90-100 million, will be offset by fuel savings for which the figure will be around £100 million. Then the variable cost element is about £50 million which is why I spoke to a net contribution of around £50 million.

Question: I have a couple of questions. On the customer side, can you give us a little more colour on how your corporate customers are reacting to the weaker economic backdrop? For example, are they asking for new discussions on pricing? Secondly, if we assume no further changes on the capacity side, what is the current position for capacity growth next summer, is it around 2% or so? Finally, on the cost side and foreign exchange, can you just remind us of your cost exposure now?

Willie Walsh: It is far too early for us to comment on the capacity for next summer. We are going to do a detailed analysis of that in the same way as we have done it for the winter so we shall look at it on a flight number basis. However, as I signalled, the previous plan to grow using those four 777-200s, they are unlikely to be growth aircraft and more likely to be used to give us flexibility within the network. We shall finish those plans in the next couple of months and give you details in relation to that

As far as your question on corporates, we have seen no change in attitude from corporates. We continue to negotiate corporate deals so, quite honestly, that environment has not changed in recent months at all

Keith Williams: On exchange on the revenue side, we benefit from a strong euro but on the cost side that works against us. In dollar terms, we are predicting roughly flat, so the dollar has little impact on fuel spend in particular. If you look at it overall this year, we would expect to get some 2.5 points from revenue benefit on exchange, and about 2% impact on costs, so it is slightly beneficial overall.

Question: I have three questions if I may. First, referring back to the expectations of anti-trust immunity, do you see any political risk in your application so close to a presidential election? Secondly, with the Iberia merger you have many details to thrash out. Have you a broad expectation of the split in value between the two, are there points at which that could become a deal-breaker? Finally, on your pension, I am mindful of BT increasing its inflation assumption and the impact that has had on the balance sheet. Could you just run through how inflation affects your own pension both in terms of the balance sheet and the actuarial side?

Willie Walsh: On the application for ATI, it is unlikely to be impacted by presidential elections, everybody is conscious of the fact that is going to happen anyway. We believe that, if we can get our application filed before the end of August, and my expectation is that we shall finish our discussions and file within the next two weeks, it will not be impacted by the elections in the US.

On Iberia, there is a lot of detail to get into but I am very confident that, based on the early discussions we have had, particularly the direct discussions that I have had with Fernando Conte, we are very much aligned. We see this as a really positive development for both British Airways and Iberia, particularly in the context of the challenges that the industry faces today. We believe that it is a natural fit, we believe there are significant synergies, and the value of those synergies relative to our market cap is certainly encouraging and, therefore, making sense of us proceeding with the discussions on a merger. While there is a lot of detail to be thrashed out, I am confident that we shall be successful in those negotiations.

There is clear determination on our part and I know there is determination on the part of Fernando Conte and Iberia, and the fact that it has the unanimous support of both Boards gives you all the signals that you should be looking for that we are optimistic about reaching agreement on successfully merging the companies under the basis that we have outlined: an all share merger, retaining the two brands, two operating companies with a new top coat which will control the strategic direction of the two companies. It is also important for me to say that we believe that this is the start of the process and not the end, but we do not see the end being a merger between BA and Iberia, we are very clear on that, and Fernando is equally clear on that. However, this positions us very well for future consolidation and we believe there will be opportunities for future consolidation. Please do not ask me where those opportunities are because I shall not give you any ideas but this is not the end game by any means, but it positions us well for future deals.

Keith Williams: On pensions let me break the question into two. I shall break it into what is happening in terms of the profit and loss this year and then the balance sheet question. In terms of profit and loss, what we see in this quarter is an increase in pension financing costs of some £16 million, which is the impact of discount rates on the pension. That is shown between operating profit and profit before tax.

As far as the balance sheet, if we go back a little in history, as you know we have put significant amounts into the pension fund. If you analyse it over the last three years since the valuation, we have put some £1.4 billion into the fund, into NAPS, and it originally stood at a deficit of £2.1 billion. At year end, we were showing a balance sheet liability of some £500 million. That will increase as a consequence of equity markets, because NAPS has around 60% of its assets in equities. If you look at the history of mortality, the recent history of mortality is in line with what is predicted within the NAPS pension fund, and the next valuation is in March next year, when we would expect to see some increase in the liability at next March.

Question: I have a couple of questions on topics you have already answered but just to revisit. On the ATI application with American, you have tried this in the past and it has not worked out for you. You talk about the change in the regulatory environment and there is a change in the whole alliance landscape with Open Skies and all of that. As I recall and understood it, the last time round it turned on the joint share of LHR to New York and that has not changed has it, so why do you think ATI will work this time whereas it didn't last time in terms of that detail?

Secondly, coming back to Iberia, I appreciate that it is a lot of detail to work out but could you give us some indication at this stage of the kind of synergies that could be available incrementally above and beyond what you already can achieve through your joint venture arrangements, and what kinds of areas those would come from? Any indication of magnitude would be useful. Thank you.

Willie Walsh: I am sure it would be useful but, no, as I said, it is far too early. We have done work separately on a couple of occasions recently, and we know that Iberia have done some work but we now need to sit down and create a joint business plan.

However, we are confident, based on the analysis that we have done, and you will remember we did quite a detailed analysis of this recently as part of the consortium that looked at Iberia, that there are significant synergies, particularly in terms of revenue but cost synergies as well. It is far too early for me to give you any figures in relation to that but we shall get into that work with Iberia as soon as possible.

On the ATI front with American, things have significantly changed. It was not just on New York where penalties were identified. We have to remember that a significant part of the argument last time round was on the basis of providing access for US carriers at Heathrow. The slot remedy that was identified was 16 daily slot pairs. Now it is just a coincidence that the US carriers that have now gained entry to Heathrow have acquired 16 slot pairs, but I believe the environment has changed very significantly. The issue of inter-alliance competition is one that the regulators are looking at and Oneworld is at a disadvantage relative to SkyTeam and Star when it comes to competition between the alliances because of the lack of ATI between American and British Airways.

Therefore, the regulatory environment is very different to the last time we made an application which was back in 2000/2001, and I remain confident that, against that changed regulatory environment, our application for ATI will be more successful this time than it was on the last two occasions that we applied for ATI. I believe it is absolutely right that we conclude these discussions and move forward to an ATI application, and we shall only proceed if it makes sense for us to proceed once the regulator has had the opportunity to assess it but the environment and landscape have changed out of all recognition to the previous application back in 2000/2001.

Question: Forgive me if you have covered these already, I was held up getting here. The first question is on, if you look at your latest premium traffic in June. Are you able to split that between the growth or decline of point-to-point premium and connecting premium, because I know that was down last year because of baggage policy etc? Secondly, if you look at the competitive outlook for the winter season, are you able to give us an idea about the total capacity growth between London and the US from both Heathrow and London, because I know there have been quite a few announcements of cutbacks from smaller airlines?

Willie Walsh: As far as the dual capacity, I cannot give you the data other than to say that we have seen recovery in the premium transfer and I am confident that, going forward, it will continue to improve, because one of the strong points about T5 is the premium transfer arrangements at T5. The intra-T5 transfer times have reduced significantly relative to the inter-terminal transfers at Heathrow. We are still not seeing the full benefit of that because for inter-terminal transfers we still have a high minimum connecting time of two hours, which is putting us at a disadvantage to other hub airports. We have done that deliberately while the BA operation is split across three terminals. We shall revise that in light of our experience within T5, and we are looking to see whether it makes sense to revise that in light of our experience at Heathrow today. However, we believe that once we get the vast majority of our operations into T5 with the premium products that we have in the terminal and the ease of transfer within T5, we shall see further improvement in the premium transfer at Heathrow.

It is still too difficult to call what way the capacity is going on transatlantic, especially because people are announcing changes all the time. We have seen United pull out of Denver. I believe they started that in April and they announced that they are pulling out at the end of October. Some of the capacity reductions that we have announced have taken into account the rules of our competitors but there is scope for us to reduce frequency on New York, for example, where we have had eight flights a day to JFK and to pull that back to seven flights a day. It is not going to be the same flights cancelled through the winter period, which is to ensure that we retain the slots, so that is where we have a lot of flexibility to play around.

We have looked at our New York schedule, we have looked at the booking profile both in terms of current and historical bookings and have identified the weakest flights on a daily basis. Therefore, you will see us make changes to New York on that basis. I would expect competitors to make announcements on capacity reductions as we get closer to the winter season, and I fully expect there to be further capacity reductions from our competitors on the transatlantic, who will seek to do things in a similar way to us. Protecting slots at Heathrow is an important feature of any change to capacity. We have not sought, nor shall we seek, any alleviation to the 80/20 rule. I see no reason for us to do that, I do not believe it would be successful but we are definitely not going to do that.

Question: Can you remind me of the proportion of premium traffic that is connecting or transfer premium?

Willie Walsh: About 30%.

Question: Just to pick up on those Heathrow points, Willie. Would you have cut capacity at Heathrow this winter by more had it not been for the need to retain slot rights? How much more headroom do you have for reducing capacity there in future without endangering slot rights? Also do you think the fact that you are shrinking at Heathrow now undermines the case for a third runway?

Willie Walsh: Very good questions, particularly the last one, though I do not think it undermines it. In fact, I would still argue that a third runway is absolutely necessary at Heathrow for operational robustness in the short term but for growth in the longer term. I have no doubt that the industry will adapt to the change in oil price but I believe aviation will still grow. It has historically grown as a multiple of GDP though it is clearly slowing down a little as GDP growth is slowing down a little, but we are still looking at a long-term growth scenario. Therefore, I do not believe that it does undermine it. Heathrow would definitely benefit from a more robust operation and runway capacity is the only way to deal with that. There is still plenty of scope for us to reduce capacity at Heathrow without putting any of our slots at risk. It is something that needs to be managed delicately but we have the capacity to do it and the slot portfolio to do it, and the frequency of services to do it without putting any slots at risk. We are going nowhere near the 80/20 rule, we have allowed plenty of headroom to the 80/20 rule so we could, if necessary, take further capacity out without putting any of our slots at risk.

Question: On slots, do you have any interest in following BMI in putting slots on the balance sheet, what are your thoughts about that? Then I have two questions on labour. How will you manage labour through the reduced capacity in the winter: will you see headcount a touch down and maintain productivity, or will you take a hit on labour productivity? Then a second question on labour, how do you see industrial relations at the moment? You have just faced down a pilot strike but relations, I imagine, are still quite bruised there and yet you are facing up the need to take another attack on costs based on the current environment, so how would you characterise industrial relations?

Willie Walsh: I shall let Keith address the slots issue. My own view is that we see no reason to put slots on the balance sheet but maybe you agree with me, Keith?

Keith Williams: I absolutely agree! We do not need to.

Willie Walsh: On labour, there is plenty of scope for us to deal with headcount reduction without any need for redundancy issues through this winter period. We have a reasonable turnover and, from memory, we recruited about 3,000 people into the business last year while maintaining our headcount pretty much static, in fact there was a slight reduction in headcount, so the natural turnover of staff will allow us to reduce numbers through the winter period to cope with the reduction in the capacity. We are also looking at reducing overtime, because we use overtime as a feature within the business to allow us to flex to the peaks within the operating day, operating week, operating month, so we shall be able to reduce that and we have quite a lot of demand for unpaid leave. Therefore, I believe we shall be able to manage the headcount labour situation through the winter in line with the capacity reductions without any difficulty whatsoever.

As far as the IR environment, the relationship with Balpa will have been bruised naturally, but I am pleased to say that, as part of the settlement of that issue, both parties have committed to developing a strong relationship as Balpa recognise that, in these challenging times, it is important for us to work together. I have no doubt that we shall be able to recover from any fall-out associated with the recent dispute with Balpa. However, it was an important issue for us to deal with, I am pleased at the way it was settled and I am confident that we shall be able to manage the IR environment successfully. Therefore, I see no challenge at this stage as far as dealing with the capacity reduction. We have a number of options open to us to reduce the headcount in line with any capacity changes that we make, certainly in the short term.

Keith Williams: Just to come back to your question on slots, as you know we put acquired slots on balance sheet where there is a cash outlay and we depreciate those. For the rest of the slots, if we have a large portfolio of slots, they can be changed in how they are operated, so their market value would be determined on how we operate them. Therefore, it would make no sense for us to put them on balance sheet and we have no need to do so.

Question: I have a couple of questions around getting a little more flavour for the development of the revenue environment. With the potential for raising fuel surcharges given the retreat of the oil price seems to be diminishing, how do you see that impacting your attempts to raise your revenues over the winter period? Can you also confirm what kind of visibility you have into the winter period at this stage?

Willie Walsh: On revenue, there is no question that the industry will have to price $120/$130/$140 oil into the business and it is not there at the moment. As you saw from the presentation, we are reasonably well hedged so we are not paying that spot price for oil at the moment. That hedging has given us a cushion which gives us time to adjust and to reshape the business to cope with a high oil environment. The whole industry will have to do that. We have moved from a high fixed cost environment to a high variable cost environment the way fuel has gone, and we cannot avoid that. People will argue that they can ignore the oil price and they do not have to reflect it in the price of fares but they will go out of business. The industry will have to adjust to reflect high oil prices in their pricing structure and we are very clear on that: that will lead to an increase in price.

As Keith has said, the increase in price will certainly impact on demand. We are not clear at this stage as to what that impact will be, we are still in uncharted territory but we are in absolutely no doubt that prices have to go up to reflect the reality of the spot price. Ultimately, hedging within the industry will unwind, we have good hedging this year and are 35% hedged for the next financial year but as those hedges unwind, we shall have to reflect the reality of the oil price in our business in exactly the same way as other airlines will have to do. Therefore, I see this as an industry issue, it is not just a British Airways issue. We have limited visibility through this winter, that is no different to where we were, but the capacity changes that we have made are based on our best estimate as to what the demand is likely to be based on experience but also based on our assessment of price elasticity as a result of the changes in the price environment with the oil prices where they are.

Question: Just two more from me. Can you talk a little about Gatwick and how you see that environment changing? We have easyJet sniffing around for as many slots as they can take. What sort of level of slots do you think you have given up for them, if any, and do you think it will still be very much a head-to-head situation there for the next few years? Why do you think premium demand is holding up, which might be a slightly obvious question: is it because you are gaining market share, is it because of the product or is it just that we have all got it wrong and businessmen and women will fly through the downturn?

Willie Walsh: As far as Gatwick, we are not giving up any slots. The approach that we adopted at Gatwick was very similar to the one we adopted at Heathrow. We have been prepared to take some additional risk at Gatwick but, again, we have approached it in the same way as we have approached Heathrow. We are conscious of the 80/20 rule at Gatwick as much as we are conscious of the 80/20 rule at Heathrow.

On the premium demand, we have been saying for some time that shorthaul premium is weak and we do not see that changing, that environment will continue. Longhaul premium remains quite good. Longhaul premium leisure has been a feature of the business that we have highlighted now for some time and that remains unchanged. It is clear that we still have corporates who are travelling on business not so much around Europe but they are still travelling on business to various parts of the world where economies remain strong, or certainly stronger than they are around Europe. We have a good product, the flatbed in business class is a big positive relative to a number of competitors who still do not have that. It is a more challenging environment, but the fundamentals of the BA proposition when it comes to longhaul premium are as strong today as they have been in the past and I believe T5 will give us a further advantage. The premium product in T5 is excellent, it is better than anywhere else, and we shall continue to focus on that, because we believe it is absolutely the right thing to do.

Martin Broughton: As there are no further questions, thank you very much.

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