BRITISH AIRWAYS PLC

FIRST HALF 2003 RESULTS PRESENTATION

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Lord Marshall: Thank you for taking the time to come and see us this morning. By now you will have seen the results for the first half year and the second quarter, so I shall not repeat them. Shortly, John Rishton will take you through the financial details of the performance and then Rod will bring you up to date with our business strategies. After that we will take your questions.

Now that British American Tobacco has sorted out its succession, we have been able to resolve ours. With immediate effect, therefore, Martin Broughton will become our Deputy Chairman and Martin will then take over from me as Chairman of British Airways as of the Annual General Meeting on 20 July next year. Martin has been our senior independent director and a Board member since May 2000. He already makes a significant contribution to the governance of British Airways as Chairman of our Audit Committee and a member of the Nominations, Remuneration and Safety Review committees. I think you all know of Martin Broughton, whose business credentials are, I believe, impeccable other than the context of smoking I suppose, but then he does not smoke so there we are! I am delighted that he has agreed to take on the role of Chairman of British Airways from July next year, and I believe that he will bring wise and effective leadership to BA alongside Rod Eddington and the team. By the time he assumes the BA chairmanship in July, he will have retired from BAT.

In another move, we have recruited Alison Reed, the Group Finance Director of Marks & Spencer, as a new non-executive director and Alison will join us on 1 December and will, I am certain, bring a valuable fresh perspective to bear on our affairs.

For the moment, the results presented today reflect a business climate still affected by the dire sequence of adverse world events, which have taken place over the last two years, and perhaps one self-inflicted wound reflecting back to July of this year. Yields over the six months have fallen year on year with the consequent impact on our turnover. Nevertheless, towards the end of the period we have seen some encouraging signs that the traffic volumes and yields are becoming more stable.

You will hear about alliance developments from Rod in Europe especially. They are closely related to aero-political initiatives towards long-awaited and much-needed industry

merger and acquisition, so I shall not pre-empt Rod's presentation. However, I would like to emphasise that the alliance progress we are making in association with key partners is designed to place us in a good strategic position to take full advantage of consolidation opportunity when that is possible and when the time is right.

Future global competitiveness for BA and the UK industry as a whole also depends on adequate, effective infrastructure and, by the end of this year, in the very short period of weeks now, we expect the Government aviation policy proposals for the next three decades to be published. We remain utterly convinced that the right and proper policy will be to promote the construction of a new short runway at Heathrow as an absolute priority. It is self-evident that the long-term interests of British air transport and, therefore, the national economy, would best be served by building on the strengths of Heathrow as this country's only global hub airport. We believe that a third short runway can be constructed and operated in a way which is consistent with Government policies for sustainable development and we are, and will be, making these views widely known. We find ourselves in some conflict, I see, with Michael Meacher with his piece in the *Financial Times*, which is perhaps not too surprising.

Anyway, for the immediate future, market conditions continue to be tough and our commitment to cost control and business reformation remains crucial. At the same time, we will be working hard to consolidate and sustain the business stability beginning to emerge. Now let me hand over to John Rishton to take you through the financial details.

John Rishton: Thank you, Chairman, and good morning. Let us start with the headline numbers. In the three months to September 2003, our second quarter, operating profits were down £53 million to £195 million, on turnover down £121 million or 6%. The operating margin was 9.8%, two points worse than last year. The reduction compared with last year reflects another quarter of falling revenue due to ongoing competitive pressures and the impact of the unofficial strike in July. Once again, these were partially offset by cost savings.

The pre-tax profit was £105 million, down £140 million from last year, reflecting the reduced operating results and a non-cash impact of yen retranslation, a loss of £101 million compared with last year. The Board has again decided not to pay an interim dividend.

This chart shows the quarterly breakdown of last year's operating margin (the top line) and this year's results to date. As you are all aware, the first half is the most important for driving our profits and, while last year's Q4 results were severely impacted by the Middle East war and SARS, profits are difficult to come by in the Winter season, especially when business travel, which is proportionately more important in the second half, is depressed. The operating profit decline of £53 million reflects the revenue decline of £121 million partially offset by cost improvements of £68 million.

Turning to revenue, this slide shows the percentage changes in revenue compared with the prior year. Revenue in the quarter was down almost 6%. The outlook is for revenue stabilising but how strong the recovery will be and when it starts is still unclear. Certainly, the improving economic data from the USA in particular is not being reflected in forward bookings at present. Yield remains weak especially in the non-premium market and in total is down by 6% in the quarter. The good news is that the decline has slowed.

Seat factor was about flat compared with last year at 76.5% on ASK capacity of 1%. In summary on the revenue, premium volumes remain well down and non-premium volumes are very price sensitive resulting in weak yields.

Turning now to costs, in the second quarter capacity measured in ATKs was 1.7% higher than a year ago. Net costs were down 2.8% resulting in unit costs improving 4.4%. The net costs down 2.8% in the quarter primarily reflects the significant savings in selling costs partially offset by increases in fuel costs. Employee costs rose 1% due to wage and national insurance increases, more than offsetting manpower reductions. As we near the 13,000 manpower target, reductions have tended to be of below average BA wage earners. You will remember, of course, that we started the programme with a 27% reduction in higher senior manager wage earners.

Handling savings reflect ongoing efficiencies partially offset by strike costs. Selling cost reductions reflect lower incentive commissions, more online sales as well as lower revenue. Engineering also benefits from continued efficiencies as we simplify the business. Fuel costs increased due to price rises, lower hedging benefits than last year and increased flying. Other costs fell primarily due to reduced aircraft lease costs, reduced property costs and lower IT costs.

This chart shows our net cost savings compared with the prior year in blue and unit cost performance in red. As you can see, we continue to reduce costs and improve unit costs,

albeit at a slower pace as we cycle against last year's strong performance and contend with cost headwinds including the increase in fuel, national insurance, wage and landing charges. Costs, overall, are down £1.7 billion since the peak in June 2001.

This chart shows labour productivity. As you can see, productivity in terms of ATK per MPE improved by 11% in the quarter as we continue to reduce manpower despite capacity increases. Cash flow before financing for the six months ended 30 September is £367 million and, while lower than last year, this is a strong performance given the difficult trading environment.

We remain on track to deliver our £900 million disposal target. At the end of the quarter, we have raised £694 million, as of today that number having increased to £719 million.

Our liquidity is strong. Cash is up £248 million from last year to £1.8 billion, and we have increased our committed facilities by £100 million to £0.5 billion, giving a total of £2.3 billion, more than enough to withstand any market disruption. The committed facilities are a mixture of general and aircraft facilities, with expiry dates between June 2004 and January 2009. The aircraft facilities are sufficient to fund all 16 of our remaining aircraft deliveries over the next three years.

Our debt is now £4.8 billion, the lowest level since June 1998, and down £1.8 billion from the December 2001 peak. We will continue to reduce the debt. As you are all aware, the debt repayment profile is fairly smooth going forward, there are no financial covenants or credit figures and 60% of our debt is at fixed interest rates.

In summary, we continue to reduce costs, manpower and debt. Disposals remain on target, capital spend will be less than £400 million this year and cash is strong at £1.8 billion plus £0.5 billion of committed facilities. We continue to deliver against our targets but we are not complacent. We have a number of major challenges including further business simplification and ongoing cost headwinds including fuel and an expected increase in pension costs. Thank you and now over to Rod.

Rod Eddington: Thank you, John, and good morning ladies and gentlemen. Six months ago when I last stood here and addressed you, I told you that my priority was to deliver the second year of Future Size and Shape with the new Customer Enabled BA and

procurement initiatives. Despite the difficult times, including the strike, we have made good progress on meeting our targets.

Today I shall update you on Future Size and Shape progress: simplifying the business, harnessing technology to simplify customer interactions, and improving the customer service experience. I shall also update you on how we are addressing the wider issues of consolidation in Europe as the Chairman indicated. It has been a busy half-year for all of us, as John has shown you. The revenue environment overshadows the accomplishments of the business and it continues to be difficult for the whole industry.

Taking a closer look at revenue, you will see that it has fallen from £9.2 billion in March 2001. Delivering the profit in such an environment, albeit smaller than this time last year, is a significant achievement. The market points to a more stable outlook for revenue but still early days. Forward bookings do not yet reflect the apparent market improvements. Before the industry can talk about really turning the corner, we need a sustained period of uneventful air travel and economic recovery, and the timing of the market recovery for me is still uncertain.

Volumes remain very price sensitive. In long haul, there continues to be sufficient demand to maintain our seat factors with small ASK growth. In short haul we have maintained seat factors but expect the Winter to be tough with large industry-wide capacity growth. Premium volumes in long haul have stopped falling and are showing some improvement, while short haul premium continues to fall. As a consequence, we expect revenue to recover slightly in the second half but to be down for the full year.

Turning to Future Size and Shape targets, simplification is at the heart of the two-year Future Size and Shape programme and our business plan initiatives and is helping to drive costs out of our business. Against the FSAS manpower reduction target of 13,000 we have achieved 12,087, thus delivering manpower savings of approximately £437 million. The remaining headcount reductions and savings will be achieved by our March 2004 deadline.

We have delivered £701 million of annualised cost savings which exceeds the £650 million target which we set ourselves for next March when we first launched Future Size and Shape. As John has demonstrated already, distribution, procurement and IT cost savings have all exceeded targets ahead of deadline and disposals and capex remain on track.

We have achieved the headcount reductions in both overhead and service delivery areas. We are today flying a bigger programme up 1.7% in ATK terms, due largely to improvements in aircraft utilisation but with fewer staff.

Looking at the manpower reductions in more detail, we have maintained a voluntary approach to headcount reductions and hence the biggest reductions of 50% have come from natural wastage. Early retirement and voluntary severance have continued to be used only in a very targeted way.

If you look at our London short haul market share, thanks to the success of our relaunched online booking engine BA.com, revenue management is now able to drive improvements in short haul volumes; market share is stable.

Back to simplification, the simplification drive is at the heart of everything we do. In engineering, maintenance schedules have been integrated and we have less down time on aircraft. Spares and inventory holdings reduced by £135 million and the number of hangars has been reduced from 33 to 23. Simplifying the fleet has helped to drive a large part of those savings. We have reduced the number of aircraft variants by some 30% and where we once had seven different aeroplane types at Gatwick, we now have just two. We have also been working out short haul fleet harder, utilisation has improved by 8.5% this Winter and by next Summer this will rise to 10.8%.

Externally, new technology is simplifying processes for our customers and they are embracing it enthusiastically. Over half our customer processes now have self-service options. We have upgraded our software and made things so easy that customers often want to do things for themselves. The launch of Manage My Booking last month means that customers can now control, monitor and manage their own travel itineraries online if they wish. We will be expanding this capability to allow customers to book their own seat as well as their meals both online. In fact, 60% of customers now choose to communicate with us by e-mail. Fare types have been reduced by 15% effectively removing half a million fares from the reservation system. Call centre staff are starting to use the same calendar-based booking tool available on BA.com to customers. Travel agents can now use our Fare Explorer booking engine on their desktops to book simpler journeys. We have also harnessed technology for our own staff: more and more learning, training and invoice transactions are technology-led and the latest move is the introduction of e-pay, and electronic payslip.

Turning to our BA.com bookings, the average weekly book revenue on BA.com has almost doubled since this time last year, and the number of passenger sector journeys has also almost doubled to around 150,000 per week. We are driving changes in distribution too. BA.com accounts now for 46% of short haul bookings where 18 months ago it was just over 20%. Aside from making us more competitive with the No Frills carriers, online distribution is key to reducing costs and supporting e-ticket growth. At the end of September, 64% of all sectors world-wide can be booked as e-ticketable. Today 44% of our passengers are travelling this way.

Let us look at procurement. Procurement and IT savings are ahead of schedule: £116 million against a target of £100 million. Suppliers have reduced by 80% from 15,000 to 2,875. We hold an e-auction at least once a week to achieve cost savings from suppliers. Over 50% of our smaller purchasing is now done through our online purchasing BA To Buy.

Consolidation: turning to wider industry matters for a moment. We have been active in the alliance arena as the chairman indicated. Our first code share flights with American Airlines have started which will ultimately add more than 100 online destinations to BA.com. Closer to home, we have signed a commercial agreement with Swiss International Airlines, which includes the Swiss frequent flyer programme Travel Club. The first code share flights have already started and soon Swiss will join the One World alliance, adding an important hub in central Europe serving one of the world's most important financial centres.

Other progress in Europe centres on Iberia, our key European partner. The European Commission has posted a report on proposed remedies to our application for anti-trust immunity and we hope that the deepening of that commercial relationship is approved at an acceptable regulatory price by the end of the year.

At a time when European consolidation is gaining pace, it is more important than ever that we have sufficient landing and take-off slots to maintain a strong Heathrow base. This Winter we will be in our strongest slot position at Heathrow for 11 years with almost 41% of slots up from 36.9% in 1999. The increased slot holding is a direct result of a carefully planned acquisition strategy. The recent consolidation moves in Europe have put even more emphasis on developing extra runway space at London's Heathrow, as the Chairman has already indicated. If the Government are to avoid condemning British aviation to long-term decline, a positive decision for a third runway at Heathrow is absolutely critical, not just for

us but for the country. Extra space at Heathrow is also something that will keep customers from defecting to other European hubs for a better travel experience.

Until we move to Terminal Five in 2008, we are moving selected long haul flights from Terminal Four to Terminal One to relieve congestion and improve connections. At Terminal One we have also upgraded lounges and check-in facilities. We are also rolling out the next generation of self-service kiosks for customers across the network. In Newcastle in controlled trials, usage of self-service kiosks moved from 25% to over 40% of all check-ins. On the ground and in the air, we have award-winning products. We have more flat beds than any other airline, almost 6,000 beds on board or wide-bodied fleet world-wide. At the coveted Annual Business Traveller Awards, we recently won Best Airline, Best First Class, Best Business Class, Best Short Haul, Best Medium Haul and Best FFP.

The achievements that I have highlighted have helped to reduce costs by some £1.7 billion. We have acted swiftly and decisively to make these savings. However, the challenge continues. What this slide clearly shows is that, while we have done a great job of reducing costs, the revenue has fallen to an even greater extent. The challenge to drive out costs continues.

On profitability, with revenue expected to be lower for the full year, we are starting our annual business planning process earlier this year, so that we can make sensible progress on our 10% operating margin target. While we have exceeded cost targets, the challenges are tough with headwinds such as fuel, employee costs and the expected increase in pension contributions hitting us, but be assured we will continue to deliver on our targets.

Where are we now? We will deliver on the final six months of Future Size and Shape. We will deliver the business plan initiatives that we launched earlier this year. We will have extra projects in next year's business plan which is being brought forward. By doing this, we will ensure that we compete effectively and that we are in a position to benefit from the recovery when it comes. Thank you.

Lord Marshall: Thank you Rod. We are now pleased to take your questions. If you would raise your hand, we will pass you a microphone and would you give us your name and affiliation before asking your question.

Question & Answer Session

Andrew Light (Citigroup): I have a couple of questions on your restructuring. You have achieved £700 million in annualised savings on a target of £650 million with another thousand job losses to come. Can you give us an estimate of what the revised annualised savings would be? Secondly, a large part of the labour savings has been achieved from staff taking voluntary leave with their jobs guaranteed if they come back. Can you give us an update about the rate of return of staff, in other words how sustainable is the 47,000 staff target?

Rod Eddington: Why don't I start with the second one first, Chairman. You are right, people who took part-time leave and unpaid leave are coming back although others wish to take unpaid leave and part-time leave as well. Because we have been very sparing with voluntary severance, we have not arrested the normal retirement and resignation numbers. That is one of the reasons why we have been very targeted with voluntary severance. If you roll the programme out widely across the business, no-one who is thinking of resigning resigns. If you look at the last month, we continue to see healthy permanent reductions in headcount from normal resignation and retirement. So despite the fact that people are coming back into the business, it has not materially affected the decline in numbers. Remember that after SARS and the Gulf War, we brought forward the 13,000 target to September and we talked about that some time ago. With the gift of hindsight, particularly given that Summer is our busiest period, that was over ambitious. We have gone back to saying that we will deliver the 13,000 by March. We have delivered 12,087 by the end of September, which is pretty healthy, particularly given the fact that, as the numbers indicate, 50% of that reduction is reduction that is permanent and that natural reduction shows no sign of diminishing, which is important to us.

John Rishton: On where we will get to compared with the figure of £650 million, remember that £650 million was originally £450 million of manpower, £100 million of distribution and £100 million on IT and procurement. We will exceed all of those targets and today we are about £700 million and I believe we will get to over £800 by the end of the year, it is an annualised rate.

Andrew Light: Am I right in saying that you have concluded all the labour agreements with each of the groups?

John Rishton: Yes, we have.

Lord Marshall: For the current year.

Chris Avery (JP Morgan): I have two questions on short haul. First, premium demand is still down. Are you getting worried that this might be a secular change in the short haul premium business rather than just cyclical, which would require you perhaps to think again about strategy? My second question is again on short haul and on strategy: Gatwick for next summer has six new pure leisure destinations – Ibiza, Sicily, Sardinia and so on. Can you explain why, if the strategy was to maximise premium travel as much as possible, you are now announcing pure leisure destinations?

Rod Eddington: Taking them in that order, first, I do not think that anyone inside BA believes that the short haul premium business will come back to where it was pre 9/11 for which there are a whole series of reasons, the No Frills carriers apart. Also as organisations tighten their travel budget belts, increasingly they say if you want to travel short haul, you travel down the back of the bus. No doubt many of you are the beneficiaries of the change in travel policy. All my instincts are that it has changed permanently but the question is by how much. I do not know, your guess is probably better than mine but if it were 50% I would not be surprised. That does not mean to say that everyone is travelling on the cheapest fares available. There are still people travelling in economy class who want flexibility and there is a range of ticket choices which they can make on that. However, we believe that the volumes have reduced permanently. It is still a very profitable segment for us, do not forget that for one moment. Short haul premium is a very important part of the BA business mix. As some of our competitors decide to move to a single class in Europe, that just strengthens our relative position in the premium market, and I have no doubt that some will.

Lord Marshall: We have a good share of the market.

Rod Eddington: We have an extremely good share of the market but the overall market is significantly smaller. Perhaps it will not be minus 50%, it might be minus 40% or minus 30% - I don't know – but we recognise that it is not a cyclical change but a secular one as you have indicated.

As far as Gatwick, we are reducing the number of aeroplanes we have at Gatwick. The additional flying we will be doing will all come out of utilisation and one of the things

we will be doing at Gatwick is some mix-and-max through the Summer and Winter. One of the things we have historically done is pretty much run the same schedule through the Summer and Winter periods at Gatwick and all our instincts now are that that is no longer sensible. Demand in Winter is lower than it is in the Summer and it is to different destinations, so through increased utilisation we will be trying some new sun destinations in Europe, because we believe with the short haul online pricing distribution model that we can do pretty well to those destinations in the Summer. The yields to some of those destinations are pretty reasonable. However, we are not driving this through additional aeroplanes and, in fact, we are reducing the number of aeroplanes we will have based at Gatwick next year but we are cranking up utilisation. Also we will be looking in the broad to do some extra flying to the sun destinations in the Summer and probably to the snow in the Winter just to see how it goes, and it will all be driven out of improvements in utilisation, and the fact that with lower unit costs we may be able to do better to some of these destinations.

Martin Borghetto (Morgan Stanley): You hinted at the recent developments alliance-wise and also ATI with Iberia. Can you comment on the Open Skies talks between the US and EU and whether you expect the EU Commission to play the Heathrow slot card again, or is to leverage the Heathrow slot position and what your stance on this one is? My second question concerns 747s versus 777s: are you happy at the moment with the ratio of 7474s versus 777s given that one of your alliance partners at the moment is looking to buy 747s? If I understand correctly, Cathay are looking at that, and can you tell us what your stance on that one is please?

Rod Eddington: Let me take the last question first. The bottom line is that we would probably, if we could, have fewer 747-400s and more 777s but we are not about to do a deal with anyone to allow that to take place. The second-hand value of 747s is quite low and we will stay with our existing long haul fleet, I do not think there is any doubt about that. If we find an opportunity to sell our 767s forward, we would take that and, as you know, we are part of a consortium to try to sell those aeroplanes to the Air Force in the UK for strategic tanker conversion. However, I do not see us being in a position to switch any of our 747-400s to 777s. With our debt levels, why would you want to take on any more debt anyway? The 747-400s are extremely good aeroplanes and they have served us extremely well and will continue to do so for many years to come. We have 57 747-400s and 43 777s and, if you

could wave a magic wand, it might be the other way around but we are quite comfortable with where we are.

On the US/EU, as you know discussions started at the beginning of October. This is a long haul and not a short haul journey. Certainly, most people in Washington do not expect it to be resolved this side of the next US presidential election and that certainly is the prevailing feeling in Washington from those who follow these matters closely. It is clear that Heathrow Open Skies to those European countries which do not currently enjoy an Open Skies regime with Americans – and I use the word "enjoy" advisedly – is part of the European agenda. Britain and Spain are two of the major countries which do not have an Open Skies agreement with the Americans, and that is part of the negotiation. The interesting thing for me will be to see what appetite the Americans have for true liberalisation, we shall see.

Lord Marshall: I think the other part of the question, Rod, was the EU's attitude towards Heathrow slots.

Rod Eddington: For me the issue is not Heathrow slots, it is Open Skies. Any US carrier that wants access to Heathrow, the obvious candidates being the US carriers in Sky Team that currently serve Gatwick, their Sky Team partners all have substantial slot holdings at Heathrow so that, if they want access to Heathrow, they can get it. We certainly will not be surrendering any slots.

Stephen Clapham (Williams de Broe): On the cash flow, could you just run through the unusual numbers in the first half and perhaps talk about them and for the full year? I am thinking in particular of the working capital, capex was positive in the first half and something in for acquisitions. Could you also give us the outlook for cash flow for the full year please?

John Rishton: I am not certain about what you mean by unusual, Steve, but let me have a go at it. On the capex side, our capex in the first half of this year was slightly less than it was last year but the disposals that we made last year far exceeded our capital spend and this year they did not. Therefore, you have this flip between the cash coming in and going out year on year. In terms of other changes on working capital, let me have a look. [*consults figures*] Do you have a specific question on that, Steve?

Steve: On the capital expenditure you ended up at four for the half-way stage. I wonder whether you could give us an idea of what the net will be for the full year?

Obviously, you said you will spend less than £400 million out, you have another £200 million of disposals to come, so would we be right in thinking that £200 million would be the net capex for the year? I see you spent £46 million on acquisitions and is that the accounting treatment of the deal with Swiss?

John Rishton: It is not slots but the complicated way the accountants like to explain – Steve, I am struggling to find my page in here but, as soon as I find it, I shall come back to you. In terms of the capex spend it should be about flat in the second half.

Steve: Is there anything funny on working capital?

John Rishton: No.

Andrew Lobbenberg (ABN): Can I ask about the slot acquisition programme and how that interplays with the Government's decision on where to stick a runway? At what time do you stop buying slots – I guess you are at 40/41 %. How does that decision alter given whatever the Government decide on Heathrow, Stanstead or Gatwick? As a second area, could you please update us on what is going on down under quite apart from a Rugby tournament: what is happening with the re-approval or otherwise of the Qantas partnership and what are your options?

Rod Eddington: As far as slots at Heathrow, we have increased our slot holding, as I said in my set piece, at Heathrow from just under 37% a few years ago to 41%, and that is an essential part of building a stronger hub and spoke network at Heathrow. We will not be able to utilise fully our network opportunities until we are in T5. What do I mean by that? We still have a split operation at T1 and T4. We will always be at something of a disadvantage to our major European competitors who have single terminal operations on continental Europe. We have moved some of the longer haul services from T4 to T1 to take some of the pressure off T4 but also in the first instance at the end of last month the first two services we moved across were our Johannesburg and Narita services, two daily 747s to both destinations. That is because those services have a lot of short haul connections and, having bedded down the new facilities in T1 – the new check-in area and lounges – we will be moving some more services across in the coming Summer period. That is part and parcel of using the extra slots, it is part and parcel of trying to take some pressure off T4 but we will not really exploit those opportunities until T5 is open.

A new runway at Heathrow is at least 10 years away and, therefore, given that T5 opens in 2008, which is five years away, we will not let any grass grow under our feet on slot acquisition as and when the opportunities arise. With or without an additional runway, it will still be a real priority for us, as I believe we have made quite clear.

On the situation down under, apart from the rugby, it was clear to us that our application for renewal of the joint service agreement with Qantas – and this will be the third five-year period as it was first put in place 10 years ago when British Airways became a key shareholder in Qantas – to the Australian Competition Consumer Commission (ACCC) was complicated by the fact that Qantas was also talking about doing a deal with Air New Zealand. As I read it, the ACCC were reluctant to pass judgment on the joint service agreement if they felt that there was then a subsequent likelihood that Air New Zealand would come into the fold as well, because what dynamic does that add to what happens on the kangaroo route? After all, Air New Zealand themselves operate to Europe from New Zealand albeit that they go the other way round over the west coast of North America over LA. I believe that the ACCC was reluctant to make a judgment on a Qantas/BA deal in the absence of clarity on what was going to happen with Air New Zealand.

Now that the ACCC and the New Zealand Competition Commission have said they will not approve the Qantas Air New Zealand deal, I believe that makes our application rather more straightforward, and we will be hoping for a decision. However, it is a brave man who tries to indicate a timescale on when the ACCC will opine on something. I think that our case is extremely strong. There is enormous competition on the kangaroo route, even more than there was when we and Qantas first did this deal in 1993. Therefore, the case for renewal is strong but I cannot give you a timescale.

Lord Marshall: John has now found the right page.

John Rishton: I cannot believe that I cannot remember these kind of things, Steve, but this year we had the disposal of DBA which is the main negative in there, and last year we had the benefits from the onward disposal of *go* which was the main positive last year. Therefore, it is those two items counterbalancing each other.

Jonathan Wober (HSBC): I would like to get some more detail on the yield in Q2, if you can give us a split between pricing mix and FX effects? Also is there anything you can say on within cabin yield, particularly in the premium cabins?

John Rishton: The yield decline in the quarter was 5.9% and most of that was 5% price, mix was 0.7% and exchange was negative 0.2%. So mix was not the major factor in the quarter; the major factor was discounting.

Chris Reid (CSFB): You said that as far as forward bookings for the Winter, we have not quite seen the US recovery coming through. Could you talk a little more about that? Are you sitting there saying our forward bookings are down 50% on last year, or is it a low single digit number? So some detail there would be good. The second question is on the 10% EBIT margin target: can you still confirm that there is no change to that as being your target recovery margin or, if not, given that things have been a little weak this year, whether or not you will revise that?

Rod Eddington: Perhaps I can speak to the first question. Forward bookings are not down on where they were this time last year. What we are saying here is that we know the US economy is recovering but we have not seen a sharp uptick in premium bookings on the North Atlantic. All my instincts are that US businesses will want to have more confidence about the length of the recovery before they make any substantial additional commitments to travel and travel policy, so they are still being pretty tough on their travel policy. If it is clear that the recovery in America has some momentum and will continue, then we would expect to see some commitments to additional flying.

The other point I would make is that one of the things that has become clear over the past couple of years is that it is pretty difficult to read actual travel plans from forward bookings two, three or four months out. Three or four years ago, you could look at bookings four months out and make a pretty good estimate of what you are likely to see in flown revenue on the day, but it has become much more difficult. Through our monthly traffic stats, you will be able to monitor how our actual load is progressing and we break them down into premium and non-premium, so you will get a sense of how it is panning out. All we are saying is we know the US recovery is getting some steam up. In looking at our forward bookings, we cannot see any great evidence of substantial increases in travel plans, but watch this space – we will be watching it pretty carefully. We know our market share numbers are strong, so we are not concerned about that. What we are concerned about is the size of the total market.

Lord Marshall: John, credibility of the 10% margin target?

John Rishton: We are absolutely confident that we can achieve 10% but, as we said at the time when we announced the Future Size and Shape, in order to do so we need some help from the market. At the time when we announced the Future Size and Shape, we thought the market had reached its trough and we were accused at the time of being cautious in our outlook. Unfortunately, it proved to be that we were optimistic in our outlook and everybody else was even more optimistic. Therefore, in order to achieve a 10% margin, we need some help from the market. As you have seen, our cost-cutting is going according to plan. We are continuing to look for further efficiencies but we do need some help from the market in order to achieve 10% though we are confident we can get there.

Rod Eddington: Remember when we rolled out the Future Size and Shape, 2.5% of the 10% was market recovery and at the time we thought that that was pretty modest. John said we had assumed that the market had reached its bottom, it looked to be recovering after 9/11. There was a debate about how quickly that recovery would be maintained but we thought that that was the bottom in revenue terms. However, what has happened to revenue since then is that for a whole series of reasons, including SARS and the Gulf War, revenues continued to decline. Therefore, instead of having a positive contribution of 2.5% to the margin, we have had a significant negative contribution.

Nick van den Brule (BNP Paribas): I have a question on the customer-enabled BA, which is a follow-up from the last one. You have the second programme of a stated target of £450 million under Procurement and IT mainly driven second phase. Can you say whether that has changed in any way in terms of timing or amount of the target, given the fact that you are performing ahead of target now? Secondly, many of the cost savings currently seem to be driven by the IT infrastructure and process improvements that you have put in place. However, that must have a cost so, in order to have a vision of that, could you break out what is capex and what is ongoing expenditure and where you put that in the P&L?

Rod Eddington: Let me take the first part of that, John. The figure of £450 million was a combination of some additional external spend efficiency targets and Customer Enabled BA and IT and, from memory, it was £300 million and £150 million which is how the £450 million was made up. A big chunk of that was not IT initiatives. We have a significant IT spend, as you know, the vast majority of which has now been committed to

future projects. We have spoken today about driving more business online, we have spoken about increasing use of e-ticket, we have spoken about the new self-service kiosks and the technology that sits behind them, which is a major part of what we do. As I said in my set piece, we have also moved to a lot more self-service on the employee front, so many more internal transactions are online as well, and we have delivered the benefits and the savings from those activities more quickly than we budgeted and targeted. This is in part because the take-up of the new technology, particularly in the UK, has been quicker than we anticipated as many people in the UK are online, though it is not true in all the other markets we serve. We anticipate that that momentum will continue and I have absolutely no doubt that it will.

John Rishton: In terms of IT expense, let me say a couple of things. First, we have been reducing our operating spend on IT over the last couple of years. As we put new systems in, it reduces our IT costs and we are focusing on reducing IT costs in total in the same way we have been focusing on reducing costs across the company. We have been spending some of those savings on the new developments for IT. You see this in a number of places, the headcount costs you see in employment costs for IT, it is buried in there, and other IT costs such as maintenance and new systems will come through in Accommodation and Other in terms of the P&L. You see some of it as assets in the balance sheet.

Nick: So no changes to targets or timing at the moment?

John Rishton: No.

Damien Horth (UBS): If we started to get optimistic about 2004 – strong US economy –

Rod Eddington: We are trying not to, Damien.

Damien Horth: I know but there is talk of synchronised … recovery, Japan recovering, Germany recovering maybe, Australia might even win the rugby! If we have a strong recovery in 2004, what sort of capacity growth could you put into the market with asset utilisation, and what sort of capacity growth do you think your competitors could put into the market on long haul with asset utilisation? My second question is on costs. It looks like your costs per head were up 7% in Q2. Is that what we should be pencilling in for 2004 given wage increases, pensions and so on or is it not quite that significant in terms of increase? Can you remind us exactly when you start renegotiating labour contracts?

Rod Eddington: On asset utilisation, the bottom line is that we have already factored in some improvement utilisation, particularly short haul, for the coming Summer period, i.e. Summer 2004. All my instincts are that, if the market gets stronger, there are some 747-400s in the desert.

Lord Marshall: Not ours.

Rod Eddington: Not ours, I hasten to add. Pratt-powered aeroplanes, United have some aeroplanes parked and one or two other Pratt operators have as well. No doubt those operators would try to bring those aeroplanes back but the bottom line is that there are very few wide-bodied deliveries pencilled in for the next 12 months either out of Boeing or out of Airbus. I have no doubt that, if the market starts to recover and demand picks up, all the major airlines – certainly those that play the long haul game – will use it to try to crank the yields up. They will try to use their yield management systems to improve the quality of their yield base, because everyone has seen a hit to the yield curve and people are very keen to see their unit revenues pick up. So I have no doubt that an increase in demand long haul would present itself as a yield improvement opportunity.

We have 100 wide-bodied aeroplanes in our fleet. We could get a little more out of them though we work them reasonably efficiently right now. Having said that, we are always tinkering with our long haul network. For instance, we have just taken San Diego out of our long haul network and we will continue to fine tune our route network in the quest for better yields on the better routes. However, an improvement in the market will be used by all the long haul players to try to crank the yields up.

Damien Horth: [*follow-up comment off microphone*]

Rod Eddington: British Airways could only put a couple of percent more on its long haul capacity. We are doing one other thing. As you know we have started to reconfigure some of our 777s with three class not four, i.e. we are taking First Class off some of our 777s which operate to thinner routes where the First Class market is particularly thin. In our current config on a four-class 777, we have about 220 seats and the three-class 777 has about 270 seats on it, so we get some additional seats there. The question of whether or not we would play some games with capacity switching on the long haul network if the market really picked up is an interesting one but we have weeded out the majority of the long haul destinations that were not paying their way such as Taipei, Manila, San Diego, Kuala Lumpur, so I am reasonably happy with that right now.

John Rishton: On the pay negotiations, we start those in January next year for the next calendar year, however long the negotiation takes or is for. In terms of the pay costs, you are close to 10% when it comes to an MPE reduction of about 8.5% and a pay increase of about 1% employment costs, so around 9.5%. That is made up of a number of factors. It is made up of pay increase 3%, because on top of the pay increase there is some wage drift, so pilot increments each year, cabin crew increments year. There is a National Insurance increase and what I mentioned in my set piece is the mix of people who are leaving the business now compared to the mix of people who left originally. We started off on the Future Size and Shape with the most senior people leaving who were the highest paid earners, and we are now down to the lower than average paid earners, so that distorts the comparison quite significantly and we should not expect to see that continuing going forward as we get ourselves back into balance. However, that mix effect is quite significant in this quarter.

Andrew Light: Can you give us an idea about when you expect the European region to break even: is it this financial year or next, and if you have any indicators of regional profitability at the half-way stage that would be helpful? Secondly, how confident are you in the £209 million remaining disposals: is that in the bag already or still under negotiation?

Rod Eddington: When we rolled the Future Size and Shape out, we said that by March 2004 it was our goal to have our short haul network at break even, and we chose that date. What we were not saying is that we thought we would be break even for this financial year, we said by March 2004 which was based on a whole range of things. Our ability to deliver to that particular target will depend in part upon what happens to short haul revenues beyond that date. We have taken quite a bit of short haul capacity out and that has been absolutely right, and we continue to replace 757s with A320s, which has also been very useful for us. However, we will need a reasonably benign revenue environment to deliver that outcome by March 2004 in my judgment. Although we have taken the costs out, the short haul revenues have fallen a little more than we thought they were going to. Back to my earlier point on Future Size and Shape, we assumed that revenue declines had more or less bottomed out and we were expecting a 2.5% lift from revenue across the network, which we have not seen and that has affected all parts of our business including short haul.

John Rishton: On disposals we will get to the £900 million in total and we have £200 million to go. It is calendarised almost perfectly, if you think £225 million in each half year, it gets you to the £900 million and we have just over £200 million to go.

Lord Marshall: That is confidence. Thank you very much. We look forward to seeing you at the prelims in May.

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