Q4 Results Presentation
British Airways
Monday 20 May 2002 at 09:00 Hrs (UK Time)

Overview

Lord Marshall

Chairman

Good morning. Thank you all for joining us today. The fact that British Airway's pre-tax results appear in parenthesis for the first time since 1982 is clearly a great disappointment to all of all. For the 12 months ending 31 March, a loss before tax of £200 million was recorded and this compares with the profit of £150 million in the previous year. No interim dividend was paid and the Board has not recommended that any final dividend be paid. Some comfort for us comes from knowing that the loss is significantly smaller than many expectations.

The background of extensive economic downturn coupled with unprecedented acts of terrorism in a prime market, and subsequent international crisis is well enough known and does need repeating in any detail now. Neither do the dire effects on British Airways and the industry as a whole. Work on confronting existing economic adversity was well on the way in the earlier part of the year. After September 11 more drastic action was needed and the immediate steps that we announced on 20 September have produced results and they can be seen in our performance for the fourth quarter, when a £96 million improvement at the operating level was recorded – that is before exceptions.

The Future Size and Shape programme, which evolved from the longer-term in depth review of our business was revealed to you on 13 February and is now biting comprehensively into costs and reforming the structure of our business. We are, for instance, already more than halfway to realising £500 million from property and aircraft disposals and the first major moves in network adjustment have taken place. Existing ways of doing things are changing radically, including changes to the numbers we employ, the way we work, and the way we price, sell and distribute our services. The symmetry of British Airways is becoming visibly more sleek and it goes almost without saying that we believe the effects of Future Size and Shape actions will be reflected in improved financial performance over this current year.

Positive aspects of last year included the return to service of Concorde, the ongoing implementation of earlier product and service investments, with the new Club World flat beds receiving much acclaim and approval, and the Government decision of Heathrow's Terminal Five. This year, with the White Paper on future aviation policy due, we will be stressing the need for long-term infrastructure development. Also of special note is the creation of British Airways City Express through the integration at the end of March of two wholly owned subsidiaries, Bryman Airways and British Regional Airlines. And Britain's newest airline brand completed its own Size and Shape review last month and consolidation of our United Kingdom regional activities will be completed with the integration of British Airways Regional and Manx Airlines into BA City Express later this year.

Reform and restructuring against a substantially changed competitive background are well underway. The concentration is on providing customers with the services they want at prices that are of value and at costs that make a satisfactory return for shareholders. The current year is one of transition and the industry is still subject to global, economic and political uncertainty. The market is expected to remain soft, but further capacity cuts should help to underpin yields and to support increases in seat factors. In a weak environment, costs remain the focus.

Now I am going to hand over to John Rishton to take you through the results in detail and then he will be followed by Rod Eddington, who will take you through our business strategy, and after that we will have question time. Thank you.

Financials

John Rishton

Chief Financial Officer

I. Overview

In the three months to 31 March, our fourth quarter, BA lost £85 million on turnover, down 8% on the previous year. For the full year, BA lost £200 million on turnover, down 10%. As a result of the losses the Board are recommended no dividend payout. At an operating level BA lost £45 million in the fourth quarter, £16 million better than last year. Excluding a provision of £80 million for restructuring cots associated with the Future Size and Shape programme, the fourth quarter operating result was a profit of £35 million. This is an improvement of £96 million on the previous year, despite the lower sales.

The main reason for this improvement of £96 million in the fourth quarter operating profits was the cost efficiencies worth £270 million. These efficiencies were achieved through manpower reductions, selling and operational efficiencies and tight controls of discretionary spend. In total, costs were down by more than 12% in the quarter.

II. Geographical Area

As you can see, the economic slowdown, the foot and mouth epidemic and September 11 impacted all areas. America was still profitable but down substantially; Europe and Asia-Pacific each declined due to weak demand, especially in premium cabins. Europe was also impacted by a rise in transfer traffic but in the fourth quarter all areas performed better than last year.

III. The Sales Picture

This slide shows the pattern of sales decline through the year. Three points are clear:

- September 11 hit hard in the third quarter

- Demand was already weakening before this in Q1 and Q2
- Q4 shows some improvement

This graph tracks capacity reductions for the year, the green line, and the decline in total RPKs, the red line, and premium RPKs, the blue line. The good news is that supply and demand are back in balance and seat factors in Q4 were even up on last year by more than 5%. The bad news is that the premium market continues to be weak. However, we have benefited from substantial market share gains in many markets, particularly the North Atlantic. As you can see, yields grew strongly earlier in the year but fell away in the second half.

IV. Costs

In Q4, capacity was 9.6% lower than a year ago. However, costs were even lower, down 12%, so despite capacity reductions unit costs improved by 2.8%. Aggressive cost reduction actions were implemented in all parts of the business immediately after 11 September. Q4 employee costs were down by over 10% reflecting manpower reductions, including overtime and contractors, working practice changes and, of course, pay cuts. Substantial savings were also achieved at operational, selling and overhead costs. Increases in other costs primarily relate to insurance security and engineering, where we have written off £30 million of spare parts following a detailed review of inventory levels and usage patterns.

Our cost reduction actions have delivered the first reduction in unit costs since 1999 despite the upward pressure caused by lower capacity. The cost performance actions were worth the equivalent of 12.6% reduction in unit costs. On 20 September, we set ourselves a target to reduce manpower by the end of the year by 7,200. We have achieved over 7,000 with negligible severance costs. Looking ahead, the Future Size and Shape programme will deliver further manpower efficiencies to a cumulative total of 13,000 over the next two years. In Q4, we have taken £80 million of the total expected severance costs of £200 million.

V. Cash

Liquidity is not an issue: at the end of the year, we had cash of £1.2 billion, committed facilities of £600 million and other realisable assets of £1.6 billion. This gives a total of £3.4 billion, unchanged from my November presentation. There has been much speculation in the Press over the last six months about whether BA needs a rights issue – we do not.

In Q3, in the wake of September 11, BA was burning cash at the rate of £2 million per day. In Q4, we stopped the cash draining away. Cost reduction actions improved operating cash flow. In fact, our operating cash flow has been positive since September 11. Asset disposals and cutbacks in capital spending generated positive net cash flow and we were repaying debt at the rate of over £3 million per day. The bottom line is that we were cash neutral in Q4.

For the year as a whole, BA generated £2 million before financing, the first positive cash flow since 1996/97. In the quarter, we reduced our debt by £268 million, reflecting improved operating cash flow, asset disposals and reduced capital spend. This exceeded my expectations back in our investor day in February. The gearing ration has improved by 0.5% to 66%. During the year ahead, I expect our debt to gradually fall further and remember, our debt in long-term with no repayment spikes and no financial covenants.

We are on track to deliver the £0.5 billion of disposals we forecast at investor day. On 13 February, I told you we would dispose of assets worth £0.5 billion in 2002/03. In fact, in the final six weeks of last year we sold £218 million of assets; a further £46 million has been sold in the six weeks since and we are confident we are confident we will achieve the remain £236 million in the rest of the year.

So, to sum up, it was a difficult and unpleasant year, but we said we would survive and we have; we said did not need a rights issue – we do not; we said we would reduce manpower – we have; we said we would cut costs substantially – we have; we said we would conserve cash by disposing of assets and cutting capital spend – we have. BA has delivered; BA will deliver Future Size and Shape. Thank you.

Restructuring

Rod Eddington

Chief Executive

I. Overview

Good morning everyone. As the Chairman said, last year was an extraordinary one. It was an extraordinary one for British Airways and for aviation in general. Today I would like to talk about the story behind our 2001/02 financial results; I will tell you what we have delivered in 2001/02, both before and after the events of September 11, and how we have coped with the challenges that we have faced. I will give you an update on Future Size and Shape work and our plans for the coming year, and I will also deal with important industry issues.

At our annual results presentation 12 months ago, I told you that two of our objectives were to manage our business in tough times and to focus on cost control. I do not think anyone could have imagined quite how tough things would get, nor how important cost control would become. However, these financial results demonstrate that British Airways has delivered on those two objectives. We have delivered by completing the tasks we had previously announced as well as reacting to the changing circumstances.

II. What We Have Delivered

In terms of the things that we knew we faced a year ago, this is what we have delivered:

- The restructuring of our wide body fleet is complete, having taking the last of our Boeing 777s in October last year. This has proved especially beneficial in light of the events of September 11. Many other airlines would like to be in the position of having no outstanding wide body deliveries or orders on the books.

- Within the narrow body fleet, the coming year will see us bring in 11 Airbus A320s to replace the larger 757s from Boeing.

- Fleet complexity has been reduced.

- We have also continued the rollout of our exciting new products, as the Chairman said, including World Traveller Plus and Club World.

- Capacity reductions – our strategy of reducing capacity has reached its conclusion with the arrival of the summer programme. We have continued our network and frequency reductions in line with our desire to focus on the profitable parts of our business.

- The promised short haul integration has made excellent progress. We have combined Bryman and BREL, as the Chairman said, into British Airways City Express. Later this year, Byron Manx will join them.

- Go has been sold and we recently announced the proposed sale of Deutsche BA. EOG and City Flyer have been integrated at Gatwick.

- The restructuring of Gatwick is well underway: long haul capacity is down by 43% this summer. Since the capacity peak of 1999, 29 long haul and 12 short haul destinations have been cancelled or moved to Heathrow. We have ceased operating on long haul routes under the AML Agreement.

- Our work on the Amadeus project saw us complete perhaps the largest computer reservation system in Europe. This has been a huge challenge.

III. September 11

I said at this time last year that we faced a year of complexity: regardless of September 11, that proved true and we have reacted accordingly. We were confident we could meet the known challenges; what was unexpected were the tragic events of September 11. We had to act fast – we already faced difficult trading conditions as the world economy weakened. After September 11, the need to react to the operational challenges that we faced and to conserve cash became paramount. Our first priority was to get our flying programme back to something approaching normality as quickly as possible. Having achieved this, we needed to assess the impact of September 11 attacks on the business and to act immediately.

On 20 September, we announced a series of measures to protect our business from the worst effects of the September 11 attacks based on the best information that we had available at that time. In fact, we used our learnings from the Gulf War. We announced a manpower reduction programme of 7,200; today, I can report, as John said, that we have delivered a reduction of just over 7,000. We grounded aircraft and reduced frequency, helping us to deliver a higher seat factor in Q4. We reviewed all our capital expenditure and put in place strict cash management guidelines because we were burning cash. There was also a recruitment freeze. Because of this, we have been cash neutral in Q4 and also reduced our debt by £268 million. We have strengthened our liquidity position – we have never had less than £1 billion of cash in hand.

These things underpin the strong performance in the last quarter of the financial year and this has given us the breathing space we need to focus on the delivery of Future Size and Shape. There were some six weeks between announcing the Future Size and Shape review and the end of the financial year. The results we are announcing today have not been significantly driven by the Future Size and Shape plan. They reflect the work done following the changes announced on 20 September. The momentum generated in Q4 will help as we drive forward to deliver Future Size and Shape.

IV. Future Size and Shape

As you know, the main elements of Future Size and Shape are removing complexity from our business, competing more effectively with the no frills carriers and reducing costs, particularly through manpower reductions. Together these actions will help us towards our aspirations of achieving a 10% operating margin; we know this target is achievable. Many of you will recognise this chart from investor day; as we said then, the recovery is based on predictions that the market will remain soft. We have significant control over the improvements detailed in yellow and we will deliver. British Airway's recovery must be cost driven.

The first elements of Future Size and Shape are now being implemented: final capacity reductions are in place for the summer programme – that means some 10% fewer ASKs versus last year. We are serving 9% fewer destinations this summer: seven in long haul and 7% short haul, as well as five Heathrow/Gatwick duplications. We are flying 27 fewer aircraft this summer; long haul Gatwick will be a single fleet of Boeing 777s by July. This summer the RJ100s start to leave Gatwick as we move towards a single short haul fleet of Boeing 737s there. At Heathrow, we lose three sub-fleets and as we have reported, manpower reductions are on target.

An integral part of the Future Size and Shape work is to improve our ability to compete with the no frills carriers. We can profitably combine the best of British Airways with the best of the no frills offering to provide a compelling proposition for our customers. It is worth remembering that we will have fewer seats in the short haul market and we will focus on the key routes with greater frequency. Heathrow's short haul capacity has reduced 9% this summer while frequency increases slightly. At Gatwick, short haul capacity falls by 32% and frequency by about 19% in the summer programme.

The capacity reduction combined with the selling and marketing changes will underpin average yields. We know that our customers value the levels of service they receive when they travel on British Airways and are willing to pay a premium to do so. They also value our network and schedule. The early signs are very promising: our new Fare Explorer booking engine went live on our website in March; online bookings are at record levels; our new inventory management and pricing model is being trailed in the UK with good results; the rollout in Europe will begin in June and we will be able to tell you more soon. A new commission structure and web incentives to travel agents will also be put in place in June.

It is clear that the changes we have made are starting to work if the Press are anything to go by. Their comments are mirrored every day by what our customers are telling us. Here are three examples. We can and will compete alongside the no frills carriers and we will do this profitably. As I said earlier, we have already delivered significant manpower reductions since 20 September, when we announced a reduction of 7,200. We are well on the way to completing the senior management reductions and middle management reductions should be completed in June. By the end of the current financial year, we will have reduced manpower by 10,000, well on the road to our overall target of a 13,000 by March 2004.

V. Challenges

British Airway's progress in the coming months will be against the backdrop of the challenges faced by the industry as a whole. For example, the level playing field that we want if far from reality today. It is pleasing to see that Brussels is taking a strong line on government subsidies to aviation, refusing to allow European governments to prop up failing carriers. The US Government has committed a $20 billion subsidy, a combination of grants and loans, to its carriers and this is distorting the global airline competition. In the UK, aviation infrastructure is moving up the agenda and this year we may see progress in the planning progress – let us hope. Government is conscious of the fact that we in the UK are falling behind mainland Europe. Hopefully, it will rectify this. Since September 11, we have seen some consolidation, such as the collapse of Sabena, but this can only be the beginning.

So, this year will be challenging or a number of reasons: the outlook is uncertain and we are not relying on the speed and strength of the economic recovery, both in the US and worldwide. At British Airways, our focus is clear: we have a plan for recovery and we are implementing it. We will deliver the structural changes to our company. In headline terms, by the end of this year that means an overall headcount reduction of 10,000, a ceiling on capex of £450 million and income from disposals of £500 million. BA will be further down the road to sustained profitability when we meet again in November. Thank you.

Questions & Answers

Andrew Lloyd, Schroder Saloman Smith Barney

A couple of questions, first of all on the market share gains you alluded to: can you go into a bit more detail in terms of area, class and so on and can you give us some magnitude to that? Secondly, on the labour reduction front, are there any major labour union negotiations coming up to get that passed?

Rod Eddington

I can start with market share: we have seen them across the business. If you take the North Atlantic, which is always a good place to start because it is so important to the business, we have seen in some cases high single digit increases in market share in premium business. We have got less capacity on the North Atlantic of course than we did 12 months ago, primarily because of the fact that the 747-200s are no longer there and we have replaced them with 777s and also our new products take up a bit more space. But despite that fact, we have seen some high load factors and some strong market share gains. We have also seen good market share gains to Africa. We have described the revenue picture as soft, in part because it is so difficult to read what is happening going forward but coming back to the North Atlantic, the total market on the North Atlantic is still well down. If you look at the April figures for all the European airlines it demonstrates that very starkly but we have seen some substantial market share gains. That is true in route terms, but it is also true both ex-UK and ex-North America.

On to the issue of labour, we were due to be talking about a new contract with our people about now, a bit earlier than that actually. We have put that to one side with their agreement; we recommended that we did not re-engage until right at the beginning of next year but clearly, we talk to our unions regularly about those issues. From a management viewpoint, we have said there will be no salary increases for the management team in this current financial year and, of course, there will not be any bonuses either.

Chris Tarry, Commerzbank

Coming back to labour, out of the 10,000 you talk about and of the 7,300 you have implemented, what is the breakdown between those who are brought in consultants or short-term contracts – that reduction has been achieved by a reduction of overtime, which I believe has began to start again, those who have gone on part-time and those that have been taken out of the business. The second question: you have been talking a lot in the Press recently about US/UK again; what is your current view on the state of play there and are we likely to go into another round of discussions?

Rod Eddington

If I could spend a little time talking about the labour issue because, as you rightly infer, it is a critical part of this. If you look at the 7,026, which was the group number for this period, the main line BA number was about 6,800 of that 7,026. About 1,100 of those were contractors out of the business pretty much straight away; about 2,200 were normal retirements and resignations; about 400 were early retirement voluntary severance; just over 2,000 were people moving, either permanently or temporarily, to part time, or people taking unpaid leave. We anticipate that about two thirds of that group will snap back as it were.

However, a number of observations: firstly, there is quite an appetite for moving to part time, particularly in what I would call the big battalions in our business, starting with the cabin crew community, and what we are finding is as people come back others put their hand up and wish to go. Of course, it has been a very useful part of what we have done because it has allowed us to take labour costs out of the business without having to pay large severance packages, which is an extremely expensive way to go. As I said, voluntary severance and early retirement only accounts for about 400. Overtime equivalence – just on about 1,000.

Let me make a couple of observations about overtime: as people leave the business permanently, it would be our view that there is point at which we actually see some overtime as a good thing. If there is no overtime in the business, it means we have too many people on our payroll permanently. Given the operational nature of our business, the peaks and troughs, the spikes that come – this weeks was a classic example thanks to air traffic control – we actually need to be able to use overtime to cope with what I would call the operational unforeseens.

What about the coming 12 months? We recognise that natural attrition, voluntary redundancy and retirement, will continue to take jobs out of the business. However, we recognise that in order to deliver on our target of 10,000 at the end of the year we will need a significant increase in the number of people who take one of the voluntary severance schemes and that is why, when we announced Future Size and Shape, we said £200 million of which we accounted for £80 million in the year just gone. I would anticipate that the vast majority of the other £120 million will come in this current financial year as we pay people to exit the business.

John Rishton

The £80 million is not yet spent, so that is going into the next year.

Rod Eddington

And there is a US/UK bilateral – always very difficult to read as you will appreciate. The governments are talking about engaging again; the prospect of some form of a mini deal I know is being touted. Whether that actually comes to anything remains to be seen. As I indicated in my set piece, a concern I have right now is given the level of subsidy on the North Atlantic to the US carriers, the playing field is anything but level. If I had have said to you on September 11 that after September 11, on one side of the Atlantic two carriers would go bankrupt and governments would not support them, and on the other side there would be massive state subsidies, you would have assumed that Europe would be the latter and North America the former. In fact is has been the other way round and that is a major concern because at the end of the day, when you deliver that sort of cash to the US majors with no strings attached, it has to have an impact on the competitive dynamics

Lord Marshall

I think it is fair to say that our expectation is that there will be no deal done with the US in the immediately foreseeable future and then there will be the issue of the court decision in Europe as to who is going to have the responsibility for negotiations on air service agreements subsequently and that decision is not expected until September/October time. So we will see.

Robin Horne, HSBC

Two questions: firstly, what restructuring conditions, if any, must be made regarding the sale of Deutsche BA to Easyjet? Secondly, on assets disposals, am I right in assuming that you are expecting a cash inflow this year on disposals of £280 million in the current year and what assets of those that are being sold over the remainder of the year?

John Rishton

As you are aware, at investor day we said that we were going to dispose of £500 million of assets in 2002/03. As I pointed out in my presentation, we got on with that sooner than expected and we disposed of £218 million in the last six weeks on the financial year we are covering this morning. A lot of that was aircraft – most 757s. The disposal of those was at pre September 11 prices. In addition, we disposed of some property and we also disposed of some engines, which is what falls into the other category. So £218 million of the £500 million we promised was done in the last financial year. The balance will be done in this year and I think you can already see that we have started in the fist six weeks and we have got rid of over $46 million of assets – again some property and a few aircraft.

Rod Eddington

The agreement we have with Easyjet on Deutsche BA does not require any significant restructuring over and above where Deutsche BA is at the moment. There are some things that need to happen – some maintenance issues but they are relatively minor. Deutsche BA will welcome three Easyjet managers into the business. The bottom line is that Deutsche BA effectively has tried valiantly to compete with Lufthansa as a sort of full service domestic player inside their market, a battle that it was struggling to win for obvious reasons.

To survive in the German market, Deutsche BA has to be much more of a no frills carrier and it was that as much as anything that led us to the view that we should be selling it. That and the fact that it was losing money – we have been trying to sell it for quite some time as you know. Deutsche BA, although it has never made any money – in fact it has lost us something like £250 million since the early 1990s – operationally was a good airliner and it is pretty cost competitive in many ways. The problem was it had to fight against a 900-pound gorilla in Lufthansa in its own home market, so it is going the no frills route and I believe that is right for Deutsche BA.

If you reflect on when we spoke two years ago, the three businesses we had – Air Liberte, Deutsche BA and Go – collectively for the previous several years had lost us somewhere between £50 million and £100 million per year, which came off our bottom line. If the Deutsche BA deal goes through, as we believe it will, we will have disposed of those three businesses for about £200 million collectively.

Chris Avery, JP Morgan

Rod, you have been talking a little bit about the regulatory situation and beginning to look forward to the EU perhaps having a mandate for the whole of Europe. Perhaps you can just try to answer one question for us: if we finish up from a closed Heathrow, how do we get from that to a European mandate? How does Brussels wrest power from the UK when the UK still does not have an open Heathrow? Secondly on capacity, this summer's capacity reduction reaches its conclusion – what do we think of capacity planning going forward from here?

Rod Eddington

As you know, we believe that Brussels will ultimately get the mandate it seeks to operate on behalf of the European airlines and in the broad, one of the things that appeals about that is that if the bilaterals specify an ownership clause that is European rather than British or French or German in the appropriate bilateral arrangement between the individual countries in Europe and North America, that should allow us to then consolidate internally inside Europe and not breach the traffic right provisions we currently would do if we were to buy an airline in Europe of it they were to buy us. I do not believe you will see European consolidation until the ownership control provisions in the bilaterals is one of European rather than nation states.

Clearly, in the context of the North Atlantic, what you would ultimately see is an open skies deal on the North Atlantic between Europe and the US as part of a transition from British ownership to European ownership. I do not think you are going to get what I would call free and open access until that happens. My instincts are that negotiation is going to take some time because Europe is going to have a number of things on its shopping list when it sits down to talk with the Americans as an entity, including issues like the fact that US carriers are currently limited to 25% foreign ownership and fly America policy. It is one of the reasons why I think it will be several years before we see a transition to European-ness in the bilateral provisions and genuinely open skies on the North Atlantic.

In terms of capacity, as I said, what we are promising as part of Future Size and Shape is a focus on profitable flow, and in a sense what we have talked about today, and what we will be talking about during the course of the next 12 months, is what that means to our business. As we take our new pricing and distribution model into what we do, one of the things that has become clear is that very quickly we have seen some substantial increases in load factor on the routes where we are driving at. The numbers you see today do not reflect any of the changes to pricing and distribution that we are currently implementing on short haul. Why? Because we did not roll it out until April; we rolled it out initially because it is trial remember.

We are getting the balance right between price and availability and we are working out through the market what premium we can sustain in the market where we compete head to head with a no frills carrier on a specific route. A lot of learning is in that for us, and we are starting with UK domestic only, ex London only. Right at the end of last month, we also wove London-Amsterdam and London-Scandinavia into the mix and as we get a sense of how that works on the short haul we will be deciding what we are going to do over and above what we currently do on our short haul routes.

Now on the long haul, we have 102 747-100s and 777s. We are selling two 777s as you know – John announced that at investor day – so we go down to a fleet of 100 wide bodies aircraft and, to be frank, for the next couple of years that is more than enough. Our focus again will be on fine tuning our long haul route network, making sure we use that capacity intelligently and as we see where the long haul markets recover we will make a decision as and when about any additional long haul capacity we put into our fleet but I do not see that happening in the next couple of years. In fact, there is an opportunity to increase long haul flying without taking additional wide-bodied aircraft because we can crank long haul utilisation up a bit.

Jonathon Webber, Deutsche Bank

Just returning to Deutsche BA briefly, if Easyjet was to choose not to proceed with the acquisition, what would be you expectation then for what would happen to Deutsche BA? Secondly, if you could just talk a bit about Oneworld and how you see that developing, particularly on the North Atlantic and the absence of US anti trust immunity. Any update on your thoughts of how it will develop and any new members likely to join. Also, if you can talk about Qantas as well.

Rod Eddington

We will sell Deutsche BA and I think there is a very good chance that the deal we have with Easyjet will come to fruition. It gives them an entry into the German market in a significant way and, as I say, Deutsche BA's future is as a no frills model rather than as a full service model. I am confident we will sell it to Easyjet and if we do not we will find someone else to buy it.

On Oneworld, to be frank our focus as British Airways is about making Oneworld work better. As you know we did not get anti trust immunity with America, so we are spending quite a bit of time, effort and energy ensuring that we strengthen our bilateral links inside Oneworld, and a major focus at the moment is what we can do with Iberia. We will be applying for anti trust immunity with Iberia. As to new members of Oneworld, we are talking to a couple of potential members. I have to say that I am always keen to get additional carriers into Oneworld but only if they add material value to the Oneworld Alliance. The core of Oneworld, both in terms of geography and size, is American, Cathay, Qantas, British Airways and Iberia. Aer Lingus are important, Finnair are important but we have a good geographic spread and we will only look at additional players in the game if they add material value to what we do. My view about alliances is that they are the cream on the cake. Our major focus must be the core business and it will be.

On Qantas, we were being encouraged to sell our Qantas stock after September 11 for reasons you will understand. We did not and it is worth £200 million more today than it was then. I think Qantas is in a situation where it has got 85%+ of the domestic market – it is in a very strong position. They are a critical part of Oneworld; we are happy with our investment; we do not see any change.

Nick Anderson, Lehman Brothers

Just two questions if I may: firstly, could you just confirm that when you announced the formal termination of the JV agreement with American that effectively ended the financial penalties that you talked about back in 1996, i.e. if either you or American broke the deal there are now no financial penalties. The second question, in terms of the 10% operating margin target, you have indicated that all of the components that build it up are under your control – what assumptions have you made for responses from competitors in terms of pricing or whatever?

Rod Eddington

The short answer to your first question is yes. The BA-AA deal did not go through. The commercial agreement we had structured with American and which included a penalty clause came off the table by mutual agreement. It was not an issue for either of us. On the issue of 10% operating margin, we have made some assumptions about how our competitors are going to react. It is built in, amongst other things, to our assumptions about what is going to happen on the revenue side. In particular, it will be interesting to see what the other full service carriers do in reaction to what we have done, not just in reaction to what we have done but in reaction to the no frills carriers generally. A lot of what I am hearing suggests that many of them do not take them seriously – suits me fine.

Damien Horth, ABN Amro

Just going back to the labour negotiations, can I just clarify what you answer to Andrew's question was. Do you expect to go back into negotiations this year and if so, when do you expect to complete labour negotiations, particularly with pilots? Did I hear you say you expect a zero pay rise?

Rod Eddington

I said there has been a zero pay rise put in place for the management team. I do not want to negotiate with the unions through this forum, as you can appreciate. In a sense, our discussions are in limbo – that is the best way to describe it – and we will re-engage with them at an appropriate time for both of us.

Damien Horth

The spare parts write-off, I was just wondering if that was taken in Q4. Also, I was wondering if you could split the yield in Q4 by mixed price and currency.

John Rishton

The write-off was taken in Q4. This related to engineering and inventory expendables. I think that the yield, if I remember correctly, we had a slight favourable movement in Q4 on exchange, about 0.4. Mix was adverse by about 1.4 and price was the balance, which probably does not surprise you.

Participant, JP Morgan

You identified under your industry issues one of the key points being industry infrastructure, so perhaps three questions around that: could you speak about what your hopes and expectations are for a new runway development in the South East? Could you talk a little bit about what your views are on the pricing regulation going on at BAA? Finally, could you speak a little bit about Nats?

We note that Easyjet wrote off their stake in Nats and there are some challenges at Nats at the moment. Could you speak about that please?

Rod Eddington

New runways are clearly a critical issue to us. Equally clearly, the timing of what we have to say has to be carefully chosen. We are in discussions with the government about where their thinking is on this. To be frank, I do not want to say anything more about that. It should be clear to all of you where our preference and priorities lie – we will be making those clear at the appropriate time and we will be speaking quite vigorously about our case. BAA: again there is a hearing on at the moment and we are making our case to the economic regulator as to what is and what is not an appropriate pricing regime for BAA. Again, I do not want to debate with them through this group either. Needless to say, some of the things being proposed we support and some of them we do not. I want to make that case to them first rather than making it indirectly.

John Rishton

You are right that Easyjet decided to write-off their Nats shareholding, which is clearly a matter for them. We had a look at that – most of the other investors have not written off their Nats holding and we believe that in long-term it is a viable business and it will give us a satisfactory return. There is no need for us to take nay write-off on it.

Lord Marshall

The key issue is going to be finding equity investors.

Anthony Bore, Merrill Lynch

Rod, you said the revenue outlook was difficult to read and the Chairman’s statements were fairly lukewarm on the market. In terms of forward bookings, are you actually seeing deterioration in what they are telling you about load factor outlook and pricing outlook and could you give any regional details on that?

Rod Eddington

One of the reasons for the uncertainty is simply that the geopolitical position is uncertain. We heard over the weekend concern about the possibility of additional acts of terrorism. It is one of the things that underpins the market so I think that if there is geopolitical uncertainty then there has to be revenue uncertainty ultimately. If you look at our Q4 results, 12% reduction in capacity and 5% increase in load factor. Many of our services are running at high load factors and we are still seeing that through into the next few months. That does not mean that the yields are where we would like them to be and to be frank, one of the things about the current uncertain climate is that is becomes very difficult to read forward load factors with any great certainty.

In the last few months we have seen that we are getting a lot more late bookings: people coming later to our aircraft from both a business and a leisure viewpoint. Although that has traditional been true for our business travellers, it has not been traditionally true for our leisure travellers. We had a good February and March in load factor terms; April was quiet for a whole range of reasons for a whole range of carriers although our load factor was up marginally on April the year before. So, it is difficult to read the market, primarily because of the geopolitical uncertainties.

Lord Marshall

That is why we are focusing very heavily on getting the cost down.

Rod Eddington

As it said on that chart, the things in yellow, which are the primary cost drivers, are the things we have real control over and clearly we have got to maximise the revenue position for the airline and we do that and I believe we are doing it sensible and satisfactory. The things we have direct control over we must control.

Mike Staddart, ING

Could you give us the figure for sales in advance in carriage? Secondly, the depreciation charge for Q4 was unusually low and I was wondering if you could talk us through that. The accommodation, ground equipment and currency differences line was quite a bit lower than the first three quarters – was there any release of block funds of anything unusual in that line?

John Rishton

Sales in advance of carriage: the balance at the end of Q4 was £760 million, which was down about £130 million compared with a year ago. About half of that is accounted for by BA Holidays and Go not being part of the group anymore, so the real reduction is about £75 million, which is inline with the revenue reduction over that period. In terms of depreciation, clearly we have withdrawn a number of aircraft and that impacted that line in Q4 and there is also the property we sold that had a small impact in Q4. On accommodation and other, I do not think there is anything exceptional in that line.

Howard Worthing, Prudential Bache

Can you give us an idea of where we are on heading forward of oil for fuel for the current year and perhaps further on that that? I note that you announced last week that you were discounting Concorde ticket prices. Should we infer that you are struggling more than you anticipated on that?

John Rishton

On fuel, we are about 66% hedged for this financial year we are in now and we estimate that our total fuel costs as we see them at the moment will be down £100 million compared with the year just ended.

Rod Eddington

On Concorde, remember we are only operating six services a week on the North Atlantic and a weekly service to Barbados. When the Barbados service stops over summer we will go to seven a week to New York. They are running a tad under the normal loads and that still means there are some seats available. We ran a promotion when we first put Concorde back into the air and it worked pretty well for us. To be frank, we are going to try to fill some of the empty seats on Concorde in the same way. We have historically run some promotions for Concorde and this is another one. We do not see a short-term any need to go beyond a daily service and we only have four operational aircraft so we could not go beyond a daily service if we wanted to.

Mike Powell, Dresdner Kleinwort Wasserstein

We saw capacity off 12% last year, but through the first three quarters the depreciation charge kept marching north, but then was off 7% in the final quarter. Should we assume therefore that the depreciation charge will fall more in line with capacity moving forward? On selling costs, they are down 32% and that is, I presume, an element of lower commission to travel agents as well as lower advertising spend. Should we see some sort of snap back in advertising spend and therefore what is likely to happen to selling costs moving forward? Finally, on interest costs, what was the level of capitalised interest costs in the fiscal 2002 versus fiscal 2001 please?

John Rishton

Capitalised interest in Q4 was about zero, compared with £6 million a year ago. In the full year, it was about £7 million compared with £35 million in the previous year so down about £28 million. In terms of selling, three mains elements impacted Q4: changes to the agent commission structure continued to flow through and that saved us a substantial sum; marketing costs were down substantially in Q4 and will come back slightly as we go through the year, but not snap back; the third element was volume – as the sales fell the variable cost fell. In terms of depreciation, we need to be careful about what is driving the capacity reductions. As we put aircraft on the ground and take aircraft out of the system, that will impact our depreciation. I would expect depreciation to be slightly lower going forward than it has been.

Rod Eddington

Remember that as part of Future Size and Shape we said we would take about £100 million of costs out of our distribution costs. What we are now trailing and will be rolling out across the short haul network is the online availability of non premium point to point fares and the commission associated with the selling of those seats will be much lower than the agents have traditionally enjoyed. The change in agent commission structure around that piece does not kick in until June, so there are some further downstream savings on distributions costs that are not captured in these numbers. The commission reductions that are captured in these numbers effectively flow from Plan D, which was the change to selling commissions that BA rolled out during the year.

Stephen Patten

Could you share with us you initial experiences in the way your price your product in the short haul market and have you seen yet any response from your competitors and has there been a big difference in areas where you are competing with no fills carriers and areas where you are not?

Rod Eddington

We are in a very competitive world and our focus on getting this right in complete but I am not going to share a lot of detail with you. It involves a fundamental change to the way we price and distribute. Step pricing: selling cheap a long way out and increasing in expense nearer the point of departure, something that no frills carriers do pretty well. The critical issue here is where we compete directly with a no frills carrier on a specific route. What is the premium that our customers will pay to travel on British Airways over and above the no frills carriers? There is a premium but we want to quantify it. It will vary from route to route and customer to customer but we are building a block of norms to ensure we do not sell our inventory too cheaply. You would be surprises about how relatively few routes we compete directly with no frills carriers – only seven with Easyjet out of Gatwick.

Our model has to be more complicated because the no frills carriers just sell non-premium short haul point to point. On our short haul services, we also have premium point to point and some transfer business. We are diminishing our dependence on transfer business but it will still deliver about 25% of our customers, even after fleet restructuring. We do not want to block of these transfer opportunities that are critical to our business profitability and the trial we are running out of London is helping us get our heads around all these things. We are putting fewer seats in the market as we replace aircraft and we will only roll this out across out network in a material way in June.

Lord Marshall

Thank you for taking the time to join us. I hope we leave you with a clear impression that Rod and John and the team are really intent on delivering a much improved performance and result. I look forward to seeing you in November.