BRITISH AIRWAYS PLC

FINANCIAL RESULTS

Monday, 17 May 2004

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Lord Marshall (Chairman): I would like to thank you all for showing up on this beautiful Monday morning. You have seen the results for the fourth quarter and the full year and shortly, as usual, John Rishton will take you through the financial details of our performance, and then Rod will bring you up to date on our business strategies. After that, we will be available for your questions.

Despite the recent signs of traffic improvement and particularly in respect of long-haul premium travel and cargo, it is clear that our profit improvement stems very largely from ongoing cost control and reduction programmes. The results reflect a year of repair to a business damaged by a sequence of harsh external events. We are not alone among airlines in suffering economic setback but I believe that we have stood out from the crowd in the way that adversity has been independently tackled and financial recovery achieved. Of particular note are the signs of business turnaround within the European short-haul network in the face of sustained price and capacity competition from what we term the “nil service” operators.

Another encouraging development was publication last December of the Government’s Aviation Policy White Paper, recommending a third runway and sixth terminal for Heathrow in due course, subject to certain environmental conditions which we believe can and will be met. We have given our backing to a planned, comprehensive open aviation area covering the European Union and the United States, now past its fifth round of negotiation without resolution. However, it would bring important competitive benefits and pave the way for effective industry consolidation in Europe. For the immediate future, the combination of additional security costs and higher fuel bills with a weak but recovering market will focus our attention on continued cost reduction.

This is my last appearance before you on behalf of British Airways. I shall be retiring from the airline at our AGM on 20 July and Martin Broughton will be taking over from me. as I said at Investor Day a couple of months ago, it gives me satisfaction to be handing over the reins knowing that the airline has successfully survived recent ordeals, has gained strength from the experience and is well placed for the future. May I say to all of you, thank you for your support and interest over the past 20 years and especially since the privatisation of BA all that time ago in 1987. Now I shall hand over to John Rishton.

John Rishton (Chief Financial Officer): Thank you very much, Chairman, and good morning. Let us start with the headline numbers. Turnover at £1.9 billion in the quarter was up 10.7% compared with last year, the growth really reflecting last year's weak base that was severely affected by the Iraq war and SARS. In the year, turnover was down 1.7% at £7.6 billion. Operating profit for the quarter was £32 million, up £196 million from last year. This brings the full year operating profit to £405 million, up £110 million from last year. The full year margin at 5.4% is 1.6 points better than last year. The pre-tax profit in the quarter was £45 million and the full year £230 million. The Board has again recommended that no dividend be paid.

Once again, the year has been about cost control. The £110 million improvement in operating profit was achieved despite revenue being down £128 million. Looking at the operating profit results area, it shows good progress in Europe, Americas, Africa, Middle East and India. In total these areas were £170 million better than last year. Only the Far East showed deterioration in the year due primarily to the impact of SARS in that area at the start of the year and the proportionately greater impact of rising fuel costs on longer routes.

We have made real progress in our short-haul business, reducing losses from £244 million two years ago to £60 million last year, and half of that loss related to DBA and the BA City Express/ATP write-off.

This slide shows some of the key statistics by region for the year. As you can see, our capacity mix is unchanged with America still representing some 45% and short-haul just under 20%. Yields are down for the full year across all sectors. However, I can tell you that in Q4 yields were up in all sectors.

Turning now to revenue, this slide shows the percentage change in revenue compared with the previous year. As you can see, revenue growth was nearly 11% in the quarter but last year's Q4 revenue was off 14% due to SARS and war, so while revenue is improving, it is gradual and for the year we are still running some 2% below last year's levels. Compared with the peak in 2001, revenue is down £1.7 billion. In the quarter, yields improved by 3.9% off a weak base. Yields in both short-haul and long-haul improved. Yield breaks down into price up 3.7%, mix up 1.4% and exchange down 1.2%. Yields declined by 4.3% in the full year. Yields remain weak. Demand is very price-sensitive and, as I said to you at Investor Day, I expect yields to be down in the current year. Seat factors improved to 73% in the year, up 1.1% from last year. This is the highest seat factor achieved since 1997. The fourth quarter seat factor was up 1.3% to 70.8%. Significant promotional activity has been necessary to achieve these seat factors. Seat factors were up for the full year in Americas, Africa, Middle East and India, flat in Europe and down in the Pacific.

Let me turn now to costs. In the quarter, capacity was up 6.7% in terms of ATKs, net costs were down 2.5% resulting in unit costs improving by 8.6%. If I exclude the Concorde write-off of £84 million from the previous year's results, net costs increased by 2.5% but unit costs still improved by 3.9%.

Let us look at the costs in the quarter in more detail. The three most significant areas are employee, fuel and selling costs. Employee costs are up 12% in the quarter, reflecting pension, national insurance and wage increases together with some severance costs partially offset by a 7% manpower reduction. Fuel costs were up nearly 11% due to commodity price rises partially offset by exchange. Selling costs fell by over 7% despite the 10.7% increase in revenue as the benefits of restructured agents' commission and increased online distribution more than offset the variable cost rises due to the increased revenue. In addition, I should mention other costs that are down nearly 21%. This reflects the impact of the £84 million one-off for Concorde last year. Excluding this, other costs were down 3.4%.

In the full year, capacity in terms of ATKs was up 2.5%, net costs fell 3.4% and unit costs improved by 5.7%. Excluding last year's Concorde write-off, net costs fell by 2.2% and unit costs improved by 4.6%. In the year, only employee and fuel costs were up for the reasons I have already explained. Selling costs fell by over 20% in the year. In total, cost are down £1.7 billion from the peak.

Let us look at fuel in some more detail. Fuel costs have featured a great deal in the news lately. Our hedging position is shown on the slide. As you can see, we have about 45% cover through March 2005, over 50% in the first half and 40% in the second. The average price for the cover, that includes both swaps and caps, is $28.50. Compared with our competitors, it seems to me that we are about in the middle in terms of cover, price and term.

Despite this hedging position, I now expect total fuel costs to be up £150 million on last year, that is £100 million worse than we advised at our Investor Day earlier this year. The increase reflects not only rising commodity prices but also weaker sterling against the dollar. As a consequence of the increasing costs, we have decided to introduce a fuel surcharge last Thursday. As I said at Investor Day, forecasting fuel will always be adventurous when the price and exchange are as volatile as they are at present, and we will keep you up to date on any significant changes in our monthly traffic stats.

This slide shows net cost changes compared with the previous year in blue and unit cost performance in red. As you can see, we have reduced unit costs in each of the last eight quarters despite reducing capacity over that period by some 4%. If I exclude the

Concorde write-off, Q4 is the first time that net costs have risen in 11 quarters, and excluding fuel price rises, even this quarter would have been flat versus last year.

When we launched Future Size and Shape, we said we would spend no more than £850 million in capital and make £900 million of disposals over the two year period. We have spent £572 million on capex including £253 million in the last year, and have made disposals of £939 million by mid-April. Capital expenditure in this financial year will be less than £450 million, the increase largely reflecting six A321 deliveries this year compared to three A320s last year.

Turning now to cash, cash flow before borrowings was positive by £791 million in the year. This is the first time we have had three consecutive cash flow positive years. Our liquidity position remains strong. On 31 March our cash balance was £1.7 billion, the red bar on the slide, despite the early repayment of £344 million of debt. In addition, we still have £470 million of committed facilities – the blue bar on the slide – so in total we had £2.1 billion of liquidity. Our net debt at 31 March 2004 was £4.1 billion, down £2.4 billion from the peak in December 2001, and down nearly £1 billion in the year. Our debt level is now back to the level of December 1997. If I include operating lease costs, our debt is down £1.1 billion from last year. This has meant that our gearing has improved significantly. On 31 March, the gearing ratio was 53.8%, that is a 6.9 point improvement from last year and down 12 points from the peak. This is the lowest year-end gearing since 1992. There has been a similar reduction if operating lease costs are included.

In the last two quarters, we have taken the opportunity to repay some of our expensive debt early. In total we have repaid £344 million early, £76 million in Q3 and £268 million in Q4. This has helped us to increase the number of unencumbered aircraft from 28 to 41 in the last quarter. The early debt repayment has further smoothed out annual repayment profile. You can see from this slide the repayment profile at December 2001, the total bars, and how it looks today, the red bars. As you can see, annual repayments for the next five years fluctuate between £527 million and £565 million, and we will be making further early repayments in Q1 this year.

As interest rates fell, we shifted our position from 75% variable to 66% fixed, locking in interest rates at historically low levels. Our average fixed rate borrowing cost is below 5%. This level of fixed interest clearly limits our exposure to rising rates. A full year half point increase equates to about a net £5 million impact.

In summary, we made a profit in Q4, we improved the full year operating margin by 1.6 points to 5.4%, we reduced the net debt to its lowest level since December 1997,we cut capital spend again, we achieved our disposals target, we have £2 billion of liquidity and we continue to deliver. Thank you and now over to Rod.

Rod Eddington (Chief Executive): Thank you John and good morning everyone. March 2004 marks the end of the Future Size and Shape programme. It is now complete. The process, of course, of building a more efficient and robust BA is ongoing. We delivered through Future Size and Shape and in fact went the extra mile. We delivered across all target areas. We have delivered £869 million worth of savings, £219 million more than we promised two years ago.

We first showed you this slide at the launch of Future Size and Shape in February 2002. The management action was to deliver 8.7% of operating margin. We factored in what we thought at the time was a conservative 2.6% revenue improvement to take us to the 10% operating margin.

The market failed to deliver, however, and revenue continued to fall. We delivered more than our targets but it was not sufficient to cover the revenue shortfall as this slide graphically shows. As a result, we have put in place additional cost saving initiatives targeting £750 million of savings. We have exceeded all the Future Size and Shape targets. We have exceeded the 13,000 manpower reduction target without impacting customer service standards. Fifty-two percent of the manpower reductions came from natural turnover – retirement and resignation. Voluntary severance and early retirement accounted for something like 20%, helping us to keep costs to an absolute minimum. The Business Response Scheme, where people volunteered to take unpaid leave or work part-time, continues.

The target for distribution savings was £100 million; we delivered £257 million. We achieved this through restructuring agents' commission. We now have a 1% rate for UK agents and 0% commission in the US. The new commissions, more online sales, lower credit card costs and greater use of e-ticket (56% world-wide) helped us to beat the target.

Changes to buying policies have enabled us to exceed the targets in this area by £30 million. The move has brought about a step-change in company procedures and will continue. Further reductions of £300 million in external spend announced last year will build on this progress.

These are the four key areas that we tackled in our short-haul business review to compete more effectively with the "no frills" carriers. As promised, we increased short-haul leisure bookings to 50% on ba.com. Each day a quarter of a million customers visit ba.com.

We are also working our aircraft harder. Short-haul utilisation has improved by 11.2% against a 10% target. At Heathrow our short-haul planes fly 8.3 hours a day and at Gatwick 9.9 hours a day. Turnaround times at both airports can be as little as 35 minutes. We continue to rationalise our short-haul network and reduce duplication where appropriate. At Gatwick, we have started eight new services this summer.

We have changed the image of BA short-haul with an advertising campaign that promotes value for money and low lead-in fares. The net result is that we have significantly reduced losses on short-haul from more than £300 million to £60 million in four years. BA is back in the short-haul game. John has already told you that we are seeing improved performances in the rest of the world, and that means that we have a more balanced business.

However, it is not all about costs. We continue to invest in products on the ground and in the air. We have installed 191 self-service check-in kiosks across the network, launched a new Club World sleeper service on selective long-haul routes and opened new lounges and premium check-in areas at Heathrow's Terminal 1. Later this year, as John has said, we will take delivery of the first of our A321s. Our customers like what we are doing and we continue to win awards for our service and world-leading products.

Turning to revenue, the revenue outlook has not changed much since we met at Investor Day in March and many of you were there with us. ASKs we said then would be up 2% to 3%, we expect a modest increase in seat factor and a modest decrease in yields for the full year. We expect revenue will be 2% to 3% better but remember that there is still considerable uncertainty in the outlook.

This slide will be familiar to you from Investor Day. Our view on cost headwinds remained unchanged with the exception of fuel which we believe will now add something like £150 million more to our fuel bill than last year. We have cost initiatives in place over the next two years to help offset these headwinds: a £300 million reduction in procurement, £150 million savings through customer-enabled technology improvements and a £300 million saving in employee costs. We are progressing employee costs in a consultative manner with our staff and trades union. In March I said it was something that would take some time and we will update you when these discussions are concluded.

The Future Size and Shape programme has been delivered but our journey to simplify the business and make it more competitive continues. There is more to do. BA is back in the short-haul game and good progress has been made on reducing short-haul losses but it is still a tough environment for airlines. BA remains focused on building a more robust business and achieving a 10% operating margin. Thank you and now I shall hand you back to our Chairman, Lord Marshall.

Lord Marshall: If you would like to raise your hand, we will get a microphone to you and we ask you to state your name and affiliation.

Question & Answer Session

Chris Avery (JP Morgan): I have a couple of questions. Pricing power is something we concentrate on at this point in the cycle. Club World load factors must be beginning to get to something sensible on the revenue basis and yet there still seems to be no sign of pricing power. Can you comment on when, if at all, we may see some pricing power come back in Club World? Secondly, on long-haul World Traveller Plus was mentioned at Investor Day and has been mentioned as one of your more exciting cabins, most profitable per square foot of floor space. Will we see any changes there in increasing the size of the WTP cabin?

Rod Eddington: Let me take both of those, Chairman. Club World – we have seen some return in Club World numbers. Pricing power – it is a difficult call, Chris, but let me give you a couple of observations. The US carriers have had a huge amount of money poured into them over the last two years and for me that has meant that they have been more aggressive in pricing on the North Atlantic than they would otherwise have been able to be. I suspect that we will not see any return on pricing power to the producers in Club World until the American government stops pouring money into the US carriers, that would be my first guess.

You are right that cabin factors are starting to look healthier, which is great and, ultimately, that has to mean we see a return to pricing power but there is no evidence of it right now.

World Traveller Plus – Club World is still the most profitable piece of real estate we fly but World Traveller Plus is the comer, if I might use that term.

Chris Avery: Absolute or per unit of floor space?

Rod Eddington: Per unit of floor space. In a sense, you could argue that World Traveller Plus, which was launched over four years ago, was a product for the times. Revenue load factors in World Traveller Plus have continued to improve in a healthy way.

However, they are not yet at a stage where we would consider making that cabin bigger, which I guess is part of your question, but it is an extremely good cabin for us and one we have been very happy with.

Lord Marshall: We are still putting it into the last aircraft too.

Rod Eddington: We are.

Lord Marshall: So you will see some further increase as a result of that.

Andrew Light (City Group): I have a couple of questions. First, the reduction in fares at Gatwick on Friday, is that evidence of deteriorating yield conditions even further beyond what we have seen in Q4? Secondly, can you explain in a little more detail the £35 million provision on the revenue side in the quarter and how much of that relates to last year versus prior years? Thirdly, in terms of the crew, how do your flying hours for the cabin crew and pilots compare with those of your competitors, particularly the low cost guys on the short-haul?

Rod Eddington: On Gatwick fares, as we have refined our pricing distribution model on short-haul in competition with the “no frills”, one of the things we have done is to recognise the material differences between Heathrow and Gatwick on short-haul. We have always been aware of them, and we are beginning to demonstrate that by using different prices out of the two airports, particularly different lead-in fares. As always, the fares that get all the publicity are the lead-in fares; the fares that truly matter are the average fares. Also one of the things we have done over the last two or three years is we have substantially reduced the duplication out of Gatwick and Heathrow. We used to serve a lot of destinations out of both but we have separated them. So the sort of destinations we serve out of Gatwick include a stronger mix of what I would broadly describe as leisure destinations, where you would have lower lead-in fares. One of the things that the difference in pricing strategy between Heathrow and Gatwick demonstrates is a difference in the sort of destinations that we serve but even where we serve the same destination from both, and Paris is a good example, we may have smaller lead-in fares out of Gatwick than Heathrow just reflecting the difference in the catchment area. It is much more a leisure airport and Heathrow is much more a business airport and the pricing strategy should reflect that. I would not read anything in to the differences, Andrew, other than the fact that we are getting increasingly sophisticated about how we use our short-haul pricing distribution piece.

On crew hours, we spend quite a lot of time asking ourselves the question do we get enough cockpit crew and cabin crew hours from our people, particularly vis-à-vis our competitors. I would make a couple of observations. The benchmarking we have done across the industry broadly suggests that we are in about the right place. However, we have some challenges and the challenges often relate not so much to the agreement we have with the crews but to the way in which we work our aeroplanes. For example, we get fewer flying hours out of our short-haul aeroplanes at Heathrow than we do at Gatwick. I think on average we get 8.3 hours out of our short-haul aeroplanes out of Heathrow and 9.9 hours out of Gatwick, which reflects the fact that Gatwick is a more compact airport, it is much easier to turn a plane around, we have many fewer connecting customers – there is a whole range of reasons as to why that is true and, if you cannot work your aeroplanes harder, it is difficult to get the crew utilisation.

John Rishton: On the £35 million, over the last year or so we have been putting in new IT systems and we have found that we can better estimate, as a consequence of those new systems, some of the revenue balances. For example, interline balances, where we fly other airlines' customers or our customers fly on other airlines, can take up to 18 months or two years to be resolved and, therefore, at quite a high level of estimation. The new systems we have put in place, however, have meant that we can estimate those much more accurately. In the past, we have been conservative – over-conservative would be the reality now – and we have much better visibility on those numbers now, so we are able to release the £35 million this quarter which relates to the previous years.

Lord Marshall: But we are still being conservative.

John Rishton: We are still being conservative.

Andrew ?Lovenberg (ABN Amro): Following up on the Gatwick points, how close is Gatwick to profitability: is it heading in the right direction, do you think you have the magic formula to make Gatwick work? On capacity, could you give us guidance as to how the 2% to 3% capacity increase will fall across the different route areas? Finally, on the labour negotiations, I know you have said you will update us when you have something material to say but could you say what areas the discussions are going in and what the likely timeline is, or your best estimation of the likely timeline?

Lord Marshall: It sounds like quite a few for you there, Rod!

Rod Eddington: Gatwick's numbers are much improved – that is the most important point – and we are seeing some good improvements interestingly in long-haul and in short-haul. We have a much simpler fleet at Gatwick now with two aeroplane types: 777s long-haul and 737s short-haul, and we have been heartened by the improvements we have seen there. We have more to do but the good news is that it is much improved. We are putting in some more short-haul destinations out of Gatwick this Summer and they are a mix of primarily eastern European destinations with one or two others.

As far as capacity is concerned, we have put some more capacity into both the short-haul piece out of Gatwick and I have just spoken about that: Dubrovnik, Turin, Prague, Budapest. We have put eight new destinations into the system out of Gatwick which is, in part, because we are working our aeroplanes harder down there and we have increased utilisation. Also we believe that there are some good opportunities in eastern Europe, which traditionally has been good for us. We recognise with some of these countries now coming into the EU for the first time that there will be some increased competitive pressures there but we are up for that.

We have also put some more long-haul flying into the network over the Summer from the Winter, and that is primarily about more capacity to existing destinations, such as 17 a week to Hong Kong instead of 14, a little more capacity into Beijing and around the network. We continue to fine-tune our route network which will not change, as I said in my set piece.

Lord Marshall: We are utilising the long-haul fleet more, there are no new aircraft coming in.

Rod Eddington: That is correct.

Lord Marshall: Labour negotiations?

Rod Eddington: Ongoing – I would never say anything more than that. It is important that we get a sensible outcome and we are working very hard to ensure that we do.

Chris Reeve (CSFB): I have a couple of questions. On the European yield side, in your current guidance do you anticipate similar yield pressures this current year as last year – more or less? Secondly, on the US inbound traffic one of the slight fears is that Americans stop travelling to Europe or reduce their travel volume based on currency and general fears over the environment. Are you seeing any signs of that, or is that a concern that you have reflected in your current guidance?

Rod Eddington: To start with the second question first, it is one of the reasons why we have been relatively cautious on revenue and many of you were with us at Investor Day and, in the politest way possible, pushed us quite hard on our conservatism on revenue. Increasingly, people are saying that that conservatism is probably well placed. I believe that it was then and I still believe that it is true. The US market is very important to us as are the US routes. The UK market is very strong and that is important to us. Also if the US market weakens, we have always been able to fill seats on the North Atlantic by moving more business across our hub at Heathrow through connecting to other destinations, but we have been pretty sensible about the amount of additional capacity we are putting into our long-haul network. It is pretty modest, as the Chairman said, we are not taking any more long-haul aeroplanes, so we are keeping a foot on the beach there.

In terms of European yields, that is a very good question. If you listen to Mr O'Leary, he thinks his yields will be down anywhere between 5% and 20%. In part, I think that that is to scare the horses and he may well be right. I do not doubt for one moment that short-haul Europe will be pretty competitive. It is true year around and it will be particularly true during the Winter months. Again, our market is different to his and we do not anticipate the sort of reductions he is talking about. Given the additional capacity that is being pushed into the short-haul market, particularly from the "no frills" carriers, we expect there will be plenty of competition but I believe it will affect their market segment much more than it affects ours, albeit that the two overlap. That is factored into our conservatism about yields as well. Remember, again, there was a little bit of pushback at the Investor Day about why we were saying we expected some modest increases in yields, i.e. we did not expect them to go up and that is why.

Jonathan Weber (HSBC): My first question is in some ways what you have just been answering but perhaps I could press you again about conservatism on yields. You had a good bounce-back in the quarter just ended and going in to next year, Q1 and Q2 in particular seem like quite soft prior year comparisons. Is the downward expectation in yields for the coming year a mid-estimate or a low estimate of where you think things will turn out? Secondly, referring back to the Chairman's comments earlier on EU/US talks, can you give us any further expansion on prospects for deal timing anything this side of the US elections and what kind of a deal?

Rod Eddington: US/EU – who knows? That is the only honest answer.   I have always felt that any deal this side of the US election will not be a great deal for the EU, because no US President in the run-up to an election will be doing anything of a liberalising nature. He will be accused within his own country of attacking US jobs, and no US President or presidential candidate will do that. It has been very important that the commission takes a robust line with Secretary Minetta and the US negotiators, and the good news is that Madame de Palacio has been pretty clear and robust. It is important that she stays the course but government-to-government discussions are always difficult to read in timing terms and that has been particularly true with transatlantic aviation discussions. Therefore, it is difficult to know.

As to yields, it is very difficult when you look at last year because, as you rightly said, there were so many one-off, extraneous influences on yields last year. We started last year in April/May/June with both SARS and the Gulf war and, if you look at our Q1 yields last year, there were about 11.5% less than they were in the previous year and in the second quarter there was still some of that influence out there and our yields were slightly under 6% less than they were in the second quarter of the year before. As John has just shown you, we have seen some improvements in yield in Q4 but that is on the back of a very weak Q4 last year. Therefore, it is a very difficult read. All I can say to you about yields is this, and we have this discussion every year – it is a very important number for you and it is a very important number for us. Every year to say to me, to John and to the other members of the management team: “Aren’t you being too conservative about yields?”. Every year, when we look back on the year, we find we have been optimistic. In that environment, I am not minded to be anything other than sensibly cautious. However, it may well be in 12 months’ time when we are sitting here talking about the year that has just gone, you will say, “you guys were probably right”. When Mr O’Leary is walking around saying yields will go down 5% to 20% in his part of the short-haul game, and when easyJet is putting 24-25% more capacity into the short-haul networks, it is difficult to be anything other than reasonably cautious about yields, and we are cautious about yields. To be anything other than cautious would be to inflate the revenue line, which would be to invite us and you not to focus on the cost line, and that is the wrong place to be.

Nick van den Brul (Exane BNP Paribas): I have three questions and the first one is on short-haul turnaround: can you strip the DBA and the City Express restructuring costs to give us an underlying improvement in the turnaround? The second question is on cargo. You have significantly expanded the cargo operation in particular to the Far East this year. Can you tell us how that is going and what your expectations are for that, especially given the very weak yield environment in cargo which seems to be the case and whether you see an improvement there as well? The third question is on your attitude to the dividend and what factors might change your opinion on the dividend policy looking forward?

John Rishton: In the year that we have just had, the European operation has lost £60 million and within that about half is accounted for by DBA and the ATP write-off.

Rod Eddington: It is worth saying, John, that the rest does include a BA/City Express number but we do not strip that out separately at this time. On cargo, we are pretty comfortable with the performance of our cargo business. You are right, we have put more cargo capacity primarily into Asia and with the new, more liberal bilateral with China we are looking at additional opportunities to grow our cargo business in that part of the world. We are comfortable with the financial performance despite the fact, as you say, the yields have been under some pressure.

Lord Marshall: On the dividend, that is a decision which the Board considers at each half year and the full year and, in looking at the situation this time around, the Board concluded that it was not appropriate to recommend a dividend at this point in time. Things have improved significantly but, as you hear, there are some warning signs out there in respect of the year ahead. We are still working very hard to get the gearing ratio further down and, therefore, perhaps we are taking a fairly conservative position on the dividend. We are mindful that, at the appropriate point in time, it would be a good thing to be able to return to paying dividends. However, the Board will not do that until it is confident that we see clear skies ahead.

Steven Clapham (Williams de Broe): I understand your conservatism about yields. Can you say how confident are you about your margin target? If yields are going down and you have some cost headwinds, getting from 5.4% to 10% is quite a challenge? Secondly, on the low cost area, can you say a little more about your tactics there? For example, you mentioned Prague being one of the new routes out of Gatwick and there are two low cost carriers who have also added capacity on that route. Why are you choosing to go head-to-head in that way and what do you see in terms of performance on that sort of route?

Rod Eddington: On the margin target, we said when we rolled out Future Size and Shape in February 2002 that to deliver a 10% operating margin, we needed to be flying into still air and that observation remains true. As I showed in those two slides, in order to get to 10% we needed what we thought at the time was a modest amount of help from the market, assuming that there would be some bounce-back in the market after 911 and we would see some improvements in revenue. With a 10% margin, we assumed something like a 2.5% bounce-back in the market. In fact, it went the other way and has continued to go the other way. Therefore, to deliver a 10% operating margin in the current headwinds is a real challenge. It remains our goal and we are determined to do it but, realistically, I do not see us doing it until we have a little more help from the market, and we have had anything but in the last two or three years.

As far as our strategy to compete with the “no frills” carriers, we have spoken about this before. The critical issue for me has to been to ensure that we get our cost base down to a level where we are a genuine competitor to them, recognising that although there is some overlap between their markets and ours, there is some common ground. Eastern Europe is important to us, British Airways have been flying to eastern Europe for quite a long time, it has not just begun and, increasingly, we are seeing that for many of our big corporate customers eastern Europe is increasingly important. With the EU expanding, with some of these countries coming into the EU, there will be more focus. A number of people have looked at the changes that EU entry has meant to places like Spain and Ireland and saw the economy recovery that came with the infrastructure investment in those countries. They look at eastern Europe now and make the observation that there will be many companies investing in eastern Europe, their production costs are low and in some cases their manufacturing standards are high. Therefore, our corporate customers increasingly are going to eastern Europe and we want to be able to offer them eastern Europe not only out of Heathrow but out of Gatwick as well. The fact that the “no frills” carriers are going in there as well, to be frank in some cases they are going in there for a totally different market. Eastern Europe is important to us and we will not concede that ground to the “no frills” carriers. As we have a much more robust competitive strategy with them now, we are quite comfortable going head-to-head with them.

Lord Marshall: We have a long-established sales organisation the other end of the route.

Rod Eddington: Absolutely.

Virginia Catin (Bear Sterns): I have a question for John about the fuel costs. Can I clarify that the £150 million headwind is not net of the fuel surcharge costs? The other question is related to that: when will you stop those fuel surcharges?

John Rishton: The £150 million is just the cost increase. As I said in my presentation, it is fairly adventurous projecting the fuel price at the moment and exchange but that is how we see it playing out into the future. On the fuel surcharge point, I would expect that at best we will be earning £7 million a month from that once that is fully in place. As it is on sold tickets and not on flown tickets, it takes a while for it to work through. In terms of surcharges, these are not unusual for fuel in the airline business. If you look at the cargo business, we have had fuel surcharges on cargo along with Lufthansa and many other carriers for quite some period of time – they tend to ratchet up and down with fuel costs. I believe that we will see something similar on the passenger side.

Lord Marshall: John, do you just want to go back to what you said earlier in the presentation on this question of hedging, because it is not just a question of the percentage that is hedged; it is also the price at which you hedge. Therefore, drawing comparisons with competitors, you also need to know the price at which they are hedged as well.

John Rishton: Certainly in the media, the hedging position has become of great interest and people get confused about whether a 45%, 60% or 70% cover is good, bad or indifferent. As the Chairman said, it really depends on how long it goes out for, so an 80% cover for a day will not be as good as 20% for a year, and the price is also very important. So we are seeing a number of airlines with very different hedging positions. Our position in terms of cover – the percentage, price, $28.50 on average and term out for 12 months – is about in the middle but it is quite difficult to tell. Some airlines have no hedging, others have been more aggressive. The only thing I would say about hedging is that it is a shortish-term win. If fuel prices remain high, we all get caught by it in the end, so you can run for a while but you really cannot hide in the long run.

Question (?? Munich): Your £150 million additional costs are related, if the oil price remains at the current level and the US dollar remains at the current level, am I right?

John Rishton: The extra £150 million reflects our view of where fuel prices are going which, in simple terms, is the market view and it reflects where we think exchange rates will go, which, in simple terms, is the market view as well. So it is not at exactly the same price, it is looking out into the future.

Question: Is it your best guess or the worst guess?

John Rishton: It is the market's best guess.

Question: I am very interested in your yields on the North Atlantic and intra-Europe on a currency neutral basis?

John Rishton: In the fourth quarter just finished? [*yes*] Exchange had a damping effect of about 1.2% in the fourth quarter.

Question: In total?

John Rishton: In total?

Question: What about on the North Atlantic and intra-Europe?

John Rishton: I do not have that information.

Question: Would you say it is more than 10% on the North Atlantic or less?

Lord Marshall: Ten percent more or less or what?

Question: The currency impact on your yields.

John Rishton: It has been negative on the North Atlantic, I would say, but by exactly how I don't know.

Anthony Ball (Merrill Lynch): You have been investing below capex for a fairly extended period now. I wonder whether you could talk about the framework, the planning process going forward in the context of the fleet age short-haul and long-haul and some of the products that are becoming available from the manufacturers now. How realistic is this outlook over the next couple of years and how are you thinking about it?

Rod Eddington: Totally realistic is the answer to that, Anthony. Our average is just on eight years, short-haul and long-haul. As John said, we take six A321s this year, we have ordered 10 A321s of which we will take delivery over the next couple of years, which will go into our short-haul fleet and are an important part of our fleet renewal short-haul. This is where our focus has been over the last three or four years as we phased out the old 757s. We still have a dozen or so e-powered 757s but we have got rid of the c-powered aeroplanes, the original aeroplanes. We have also returned a significant number of 737s and sold a number of 737s as well. Therefore, the strategy in short-haul is to move increasingly to an Airbus fleet – 319, 320, 321. Heathrow is, I was going to say, entirely Airbus territory now. I think there is still one 737 operating out of Heathrow and that will go down to Gatwick when the next Airbus arrives.

Long-haul is much more interesting in the sense that this is the area where there are some new aeroplanes coming. The A380 – we have not ordered it and we may order it at some stage but we will only do so if we are convinced that it is the right aeroplane for us. Of equal interest is the 7E7 but the 7E7 we are interested in is the stretch longer range variant and we do not believe that that particular longer range variant will be available until 2010. I am sure the aeroplanes that are launched in 2008 will be good aeroplanes but they are not of as much interest to us as the longer range 7E7 – the stretch longer range aeroplane which is a 2010 aeroplane. Therefore, we have plenty of time to make up our minds as to what we do and with a very large wide-bodied fleet we are well placed.

We took a decision to reconfigure our long-haul 767s with the new flatbeds in business. Those of you have travelled on our long-haul 767s, which go to the smaller destinations, will have noticed that we do not have flatbeds on them. We have taken a commitment to put the flatbeds on the 767s and that will give us much better flexibility. For instance, we operate three flights a day to Dubai at the moment and the third flight is a 767 with bucket seats on it. Therefore, for product consistency we need to ensure that we have flatbeds on those as well. It will give us more long-haul flexibility and we have quite a large fleet of 767s. The question will be how many 767s do we fly short-haul, how many do we fly long-haul and that gives us some work on flexibility. However, we do not need to rush a decision on long-haul equipment. I see one of our major competitors announced last week that they are delaying the delivery of their 380 by 18 months, so it is an interesting time. that is something we do not have to worry about right now. Introducing a new aeroplane type into our fleet is a big step, one that we will take at some point in time but we have to make sure that, when we decide to do so, we make the right decision. The 7E7 is still a paper aeroplane. The A380, although the first one rolls out of the hangar at the end of this year and goes into its test flight programme in 2005, will not fly in commercial service until 2006, and I want more certainty over both those aeroplanes before we commit any of our hard-earned money.

Anthony Ball: [*follow-up off microphone – inaudible on tape*]

Rod Eddington: I never say never. If the manufacturers come and put a disgraceful deal in front of us, we will consider it. The worst thing you could every say is never say never but we are clear about what our priorities are. We are equally clear that we have plenty of time. We do not have any DC10-30s/DC10-40s, we do not have any 747-200s or 747-300s that need to be replaced and, therefore, we have some time. It may be that the next long-haul aeroplane we buy is as simple as saying we will buy another 777-200, we ultimately buy the 777-300 – it is an interesting aeroplane and we may well do so when we have to replace some of our 747-400s as that is also an option. If you think about it, we have a number of 747-400s that operate in the North Atlantic to New York, it is a seven-hour sector and you do not need a four-engine 870,000lb aeroplane to fly seven hours from London to New York. The Boeing 777-300 would do it, so there are plenty of options for us and we will not be rushed.

Stanley Hoff (UBS): Is the move into Terminal 5 a critical date for that aircraft decision, or is it something which you can delay past the move in to Terminal 5? Also I want to clarify something on your yield guidance. The impression I have is that you are assuming that your revenue will decline in the second half at the moment. Is that a fair reading of your guidance?

Rod Eddington: Getting some visibility on the second half is difficult given all the uncertainties we have talked about. It could well be that that is right and time will tell. When we move into T5 in 2008, it is a hugely important date for us. For the first time, we will have a BA operation at Heathrow, the first time in many years, where we have all our operation in one place. We are the only major European carrier at the moment that does not have that situation; we have a split terminal operation. T1 and T4 puts us at a huge competitive disadvantage to Lufthansa at Frankfurt, to Air France at Charles de Gaulle, to KLM at Schipol. So T5 is hugely important to us and the decision by the BAA to open both the main terminal and the first satellite concurrently in 2008 is critical to us. It provides us with a whole series of opportunities, not only for further efficiency but also it gives us some exciting opportunities to test what does the check-in product particularly look like then and how do we use the new facilities to maximise that.

In many ways, if you think about it we are in 2004 and 2008 is four years away. Lead times on new aeroplanes, particularly wide-bodied, are of the order of three years, so if we do not make a decision on it this year, we could well be going into 2008 with the same aeroplane types. It does not mean to say that we will not order more of an existing type. Equally, T5, as it will be A380 compatible, will provide us with some interesting opportunities and it is just one of the things that says to me we do not need to rush our fences on new equipment, because T5 will be important for aeroplane types as well as for products on the ground.

Lord Marshall: Revenue decline in the second half, John?

Rod Eddington: I think I have said all that John or I would want to say, unless John wants to contradict me.

Question (Dublin): Could you give us an idea of what sort of percentage of the procurement savings of £300 million we are likely to see in … [*unclear*]

John Rishton: We set ourselves a target that we will have done the whole lot by the end of this financial year, so by the end of March ’05, and we are about half way through at the moment.

Rod Eddington: We met our mid-point milestone.

Lord Marshall: I hope you have taken in our new uniforms worn by our people today. They are gradually getting around the airline and it will take the best part of a year to get everybody into the new uniform. We are very pleased with the initial reception from our own people, which is extremely important in this context, and also from the marketplace as well. Thank you very much.

- *Ends* -