FINAL TRANSCRIPT

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PRESENTATION

Operator

Good afternoon, thank you for standing by. At this time, all participants are in a listen-only mode. After the presentation, we'll conduct a questions-and-answer session. (Operator Instructions) Today's conference call is being recorded. If you have any objections, you may disconnect at this time. I would now like to turn the meeting over to Mr. Willie Walsh. Your line is open.

Willie Walsh - *British Airways - CEO*

Thank you. Good afternoon, and to those of you in the US good morning. Welcome to our conference call. I'm going to hand over to Keith Williams to give a brief presentation and then we'll give you an opportunity for questions.

Keith Williams - *British Airways - CFO*

I'm just going to take you through the slide presentation. Now, these results are in line with what we told the markets a couple of weeks ago when we launched the convertible. Revenues down just over 12% to GBP1.98 billion. We made an operating loss of GBP94 million in the quarter. This includes GBP9 million charged as restructuring costs. We've made good progress on costs with overall costs down over 6%. This was in part due to fuel but it we've also made good progress on our other costs as we start to see the benefits of the initiatives which we started last autumn. There's still much work to be done as we face the first operating loss in the first quarter in our history. And still have challenges ahead.

Looking now at the headlines, revenue down 12.2% was slighted by exchange. Underlying revenue was down 16.8%. As far as we can see, these results are reflective of market conditions across Europe. Other European major carriers have announced significant falls in revenue in the last few days. We're continuing to experience unprecedented trading conditions and our response can only be to reduce costs as far as possible. Here, we've made excellent progress with total costs down 6.6% despite currency movements. Fuel costs were down 15.6% and would have been down 35% but for adverse exchange. Similarly, other costs were hit by exchange which masks the excellent cost performance overall, down 2.4% on a reported basis. If we take out exchange effects, costs were down 7.6%. Overall, unit costs were down 3%. One offs included in the result were GBP9 million representing further redundancy costs. I will come back to head count in a moment.

Pretax losses were GBP148 million. There were currency and fuel derivative gains of some GBP32 million in the quarter. But these were outstripped by pension and other finance costs. Now, looking at the makeup of the revenue, passenger revenue was down 12.5%, just over GBP1.7 billion. Passenger numbers fell 3.8% and RPKs were down 3.2%. The highlight, however, was yield which was down 9.7% despite help from exchange. Cargo revenue was down over 28% with a significant decline in both volumes and yield. Volumes were down 11.5% while yields were down almost 19%. Despite exchange benefit. Almost all of the decline was driven by lower levels of fuel surcharge. We continue to do comparatively well in premium freight with volumes down 3.7%.

We seem to have reached the bottom in terms of market conditions but given the continuing oversupply of capacity, any recovering cargo is likely to be slow. Other revenue improved from a number of factors, increases in in-flight retail sales and air miles and also from the introduction of web-based ancillary sales. Looking at the key statistics, the impact of our actions on capacity and costs are starting to show in the key statistics. The amount of capacity in terms of ASKs was down 3.1% with RPKs down 3.2%. With the result that the load factor fell just 0.1 percentage point to 77.6%.

We were able to achieve a cost reduction above the low capacity with the result that overall unit costs fell 3%. This was flattered by lower fuel costs but underlying non fuel unit costs have fallen by 4.1%. Yields, as I said earlier, remain weak, being down 9.7% versus the same period last year. Despite continuing fuel surcharges of benefit for exchange.

Now, this slide just shows you graphically the data from the last slide in a historic context. For the first time in five quarters, we've been able to halt the rate of decline and overall load factor and better match supply and demand. Albeit, that we've had to achieve this with lower yields. The traffic does not, of course, reflect the mix of traffic between premium and nonpremium passengers with premium traffic levels being on average around 17% down versus the previous year. And nonpremium traffic being flat year on year.

Looking at the overall yield, just down 9.7%, both price and mix are adverse. Prices bottomed out for the moment although it looks -- we look forward, the prior year comparatives may be a little bit weaker as fuel surcharge benefits fall away. I'll come back to that in a moment. Exchange is again favorable with the dollar and yen from 20% or more stronger versus sterling year on year. And the euro some 12% stronger. That position will also weaken going forward and I would like to come back to that.

So, as we look forward, we expect yields to weaken in the short term. This is from fuel surcharging and exchange and also as we see trading down from expensive to less expensive tickets within cabins.

Now, looking at the fuel surcharge, the level of fuel surcharges today is pretty much on a par with last year. However, I thought you might be interested in this slide for another reason. As we look forward to the next two quarters, yields are likely to be diluted from the lower level of fuel surcharging versus last year. On exchange, we've had a continuing tail wind on revenue in the last quarter from the strength of the dollar and euro. Some of this year on year benefit will start to disappear from August onwards and at current exchange rates, will become a headwind in the second half of the year. All of this makes the revenue outlook uncertain.

On the negative side, we have currency and fuel surcharge impacts. On the more positive side, over the summer, we're starting to see some improvement in volumes. Premium traffic is slightly improved and nonpremium traffic is starting to increase over last year's levels. What is uncertain is whether the improved volumes will give any sustainable pricing power. To some degree, this will be dependent on competitor actions in terms of capacity and the timing of economic improvement, if any. To date, there has been some competitor actions in terms of schedule changes which offer some hope of more rational pricing but this is not yet pointed to any sustainable improvement.

With the revenue position remaining so uncertain, we're continuing to look at costs, have made good progress on that as I said earlier. We've been helped by lower fuel costs, down 15.6%. We have however made significant progress on our controller costs which are down 7.6% on a constant exchange basis and 2.4% on a reported basis. Over the same period, capacity in terms of APKs is down 3.7%. These reductions have been achieved across the board. We continue to work with our top 250 suppliers on cost reduction and at the same time, have achieved significant manpower reductions.

Accordingly, the underlying cost reduction that has outpaced capacity reduction with total unit costs down 3% in absolute terms and 13.2% for constant exchange. Stripping out the impact of fuel, nonfuel costs are down 4.1%, that's constant exchange rate. Looking out to quarterly cost lines, the major point to notice is employment costs which are down 5% and selling costs down 25%. The cost lines which have increased are mainly the results of exchange movements. Stripping out exchange impacts, engineering costs were down 12% and handling and catering charge from 5%. The one exception is landing fees and charges where because we're tied into regulatory increases, these were up 4.2%.

Looking at manpower, manpower is down almost 4,000 from the same point last year as we see the impact of support staff and front line productivity. The important point to note is this has been achieved at the same time as seeing significant operational and customer improvements.

On fuel, this is just a simple reminder of what has happened to jet fuel prices. Fortunately, refining margins have remained relatively low. We've added further hedging coverage, as you can see from the chart here. At today's, spot and forward prices, we expect to pay around GBP71 a barrel over the full year. This translates to a total fuel spend of around GBP2.45 billion to GBP2.5 billion at the exchange rates today. This would imply fuel spend from GBP450 to GBP500 million lower than last year. This is better than our previous guidance of some GBP400 million better. Looking at balance sheet and cash, we already said that the cash was down to just over GBP1.25 billion and that we're burning GBP1.4 billion of cash a day. At the operational level there is a cash shortfall of GBP29 million over the quarter. As you know, we're in the process of raising more liquidity subject to share holder approval. When completed, this will raise liquidity to around GBP2 billion and we have a further GBP2 billion of funding secured against future aircraft deliveries. Despite the cash burn over the quarter, net debt has fallen. This is principally from the reversal of mark to market foreign currency debts.

So, in summary, in the short-term, we expect reported revenues to continue to be weak because, largely from lower fuel surcharge and currency benefits. We anticipate over the summer that overall volumes will hold up well. If this is meant, there might be some expectation that we would see yield improvement later in the year providing economic conditions improve. But it is too early to determine whether this will prove to be the case. In the meantime, we remain focused on cost reductions.

Willie Walsh - *British Airways - CEO*

Okay, thank you, Keith. We're now available to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from the line of Jonathan Wober. Your line is open.

Jonathan Wober - *HSBC - Analyst*

Thank you very much. Three questions, please. Keith, you mentioned in the presentation other revenues were up strongly and you gave some of the reasons for that. 19% revenue increase obviously, is a very strong and positive surprise in this kind of environment. Is that the kind of run rate we can expect for the rest of the year or are there particular reasons why it was so strong in the quarter? Second question is whether you can give us an update please, on the various talks with Union groups. I know you were in a cooling off period currently with Unite, but how do you see the talks panning out? Then thirdly, it was recently announced that you're stopping various catering services on short haul and reducing around the edges, catering on long haul premium. I wondered if there were any other reductions in service quality that you're planning as a way of reducing costs? Thank you.

Keith Williams - *British Airways - CFO*

The first one, on the revenue that was up 19% in the first quarter. The run rate for the year, yet to be determined. Strong first quarter and we do expect it to remain strong for the rest of the year. But probably not as strong as we experienced in that quarter.

Willie Walsh - *British Airways - CEO*

On the talks with the Unions, we're in a formal cooling off period with one group that's the Cabin Crew group and our agreements state that we should not comment publicly while in that period so there's nothing I can say in relation to that. We remain in discussions with the other two groups, that's the GSS, they're the ramp and baggage loading staff. And the final group we call the A Scales, they're the customer facing staff in the terminal building and our administrative staff. Those talks continue. They have slowed down somewhat in the past week. It is mainly due to the nonavailability of the Trade Union officials. But we will continue those discussions.

Our objective remains to reach agreement with the Trade Unions on structural world practice changes. But I think as we've demonstrated in this first quarter, with the manpower reduction of 1,450 in the quarter, there is quite a lot that we can do to manage our employee costs through direct management action and I think our performance in the first quarter was quite good in relation to that.

And your third question, we have made some changes to catering. We've not quite reduced the -- I wouldn't say we've reduced the catering acquisition on first or long haul. We're making changes to it. So, it is a change in style with some of the products that we offer there. And we will continue to keep under review the catering proposition. We're also looking clearly at opportunities going forward. We can raise additional revenues through some very limited unbundling of the product. That's clearly something that we're looking to do. But conscious of the fact that we want to maintain a clear focus on being a premium airline. So, we're very much committed to full-service customer proposition but we do see some limited opportunities to generate some revenue. So, there may well be some changes in relations to that. But I would see it as being a very limited change to the current customer proposition that we offer.

Jonathan Wober - *HSBC - Analyst*

Can you give any examples of the kind of things you're considering there?

Willie Walsh - *British Airways - CEO*

We are giving some consideration to some changes to baggage allowances for nonpremium customers and non gold card, silver card holders. We'll still offer our customers the option of checking in a bag free of charge but we are looking at some excess baggage charges. We believe that there may be a revenue opportunity for us.

Jonathan Wober - *HSBC - Analyst*

Okay. Thanks very much.

Operator

Our next question comes from the line of Dr. Andrew Light. Your line is open.

Andrew Light - *Citigroup - Analyst*

Hi, there. How much more or less confident are you in securing the joint venture approval with American Airlines? Because it seems to be mixed sounds coming from Washington on the one hand, DOJ trying to flex their muscle with Continental with the Star Alliance deal and then the DOT just approving it anyway. If we could get your opinion on that for both BC and the US point of view. And secondly, any update, any changes thought about the Iberia situation given the change of management there? That we can talk about?

Willie Walsh - *British Airways - CEO*

Yes, thank you. We saw the Continental approval by DOT as being a positive. We watched the DOJ flex their muscles, as you put it. I think the DOT stood their ground and that was a very positive signal to us. So, we believe that the developments in relation to Continental are a positive and nothing new to report in relation to the commission, European Commission in relation to our application. The process there is ongoing. We had hoped to get the formal statement of objections from the Commission around now but they advised us a couple of weeks ago that they would not be in the position to do that due to internal issues within the Commission. I think mainly around resources. And that it was unlikely to be the end of August, early September before they could serve us with the statement of objection. So we're waiting for the statement of objection.

On Iberia, I have had a meeting with Antonio Vasquez and Raphael Sanchez, I met with them, it was early last week. I met both of the guys previously. Had very constructive discussion with them. It was really just an introductory meeting. Clearly, the two guys will want to take a little bit of time to bring themselves up to speed with the specific issues relating to Iberia and particularly in the case of Antonio who's been away from the Company since he stood down as a nonexecutive. I think in 2007. But we did a good discussion and we will be meeting again in due course. The two guys are working through August, have just indicated to us that they are working through August to use that as an opportunity to get themselves up to speed. We expect to meet with them again in a few weeks' time.

Jonathan Wober - *HSBC - Analyst*

Not only nearer to resolving these issues, I think you've mentioned in the past, there's a governance and tax and all of these kinds of things.

Willie Walsh - *British Airways - CEO*

There's clearly issues to work out. But we had a good discussion. We didn't get into any real specific data but it was a good open and general discussion about the issues. I remain positive, I think, the proposed merger between BA and Iberia is a positive development. I think it would be good for BA and Iberia for shareholders or stakeholders. So, I certainly didn't get any indication from either Antonio or from Raphael that they thought otherwise. As I said, I was very pleased with the meeting that I had and I'm very pleased with the appointment of these two guys. They're people we respect. We know both of them. And we believe we can do business with them.

Andrew Light - *Citigroup - Analyst*

Great. Thank you very much.

Operator

Our next question comes from the line of Geoff van Klaveren. Please go ahead, sir. Your line is open.

Geoff van Klaveren - *Deutsche Bank - Analyst*

This is Geoff van Klaveren from Deutsche. Yields ex-currency seemed to deteriorated less than your peers. I'm just wondering what you put down this relatively good performance down to? And secondly, on the head count, can you just update us, where do you see the head count year end and how much of this reduction is down to reduction, Cabin Crew on board, the long haul aircraft?

Willie Walsh - *British Airways - CEO*

Well, I'm not going to go into specific detail in relation to head count reduction for Cabin Crew but it's clear that's an issue for a discussion between us on the Trade Union and as I said at the beginning, we're in a formal closed period where we're not going to talk publicly about the details of that. But we have stated previously that we're targeting a further 3,700 MPE reduction to be achieved by the end of this financial year, March of next year. And we remain confident that we can achieve that targeted reduction. And so your first question, again?

Geoff van Klaveren - *Deutsche Bank - Analyst*

Just on yields. Constant currency, they seemed to have deteriorated less than your peers. Relatively good in a sense. I was wondering what you put that down to?

Willie Walsh - *British Airways - CEO*

I think we've called the external environment clearly earlier. I would argue probably more accurately than some of our competitors. We have, in the past, been accused of being a bit bearish in terms of the outlook but it is interesting to note that if you look at the revenue decline that we reported in the first quarter, minus 12.2, that is significantly better than both Lufthansa and Air France. I think Lufthansa was down 19.4 or Air France down 20.5 so I think we've responded earlier to capacity reduction and we clearly have been moving quicker to address costs. But specifically in relation to yields, it is difficult to say what we're doing somewhat better because I haven't been able to analyze in detail the yield performance of Lufthansa and Air France. At this point, all I would say is I think we've responded quicker and I think to some degree slightly better. It may be a timing issue that we're just responding to the external environment a bit ahead of these competitors.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Thank you.

Operator

Our next question is from the line of Mr. Neil Glynn. Please go ahead. Your line is open.

Neil Glynn - *NCB Stockbrokers - Analyst*

Good afternoon. Just a three-pronged question on the revenue environment if I can. The first one, I'm interested in the different developments if applicable between short haul point to point and transfer traffic as to how that's developing? Then on the nonpremium premium side, can you elaborate a little as to the -- what you've seen in the last quarter and then the trends you're seeing, what you're hearing from corporates in terms of their intentions over the next few months? Then finally, if you could give a sense of passengers trading down within your own cabin? Demand that you may be losing from the premium cabin but that's not necessarily spilling over to your peers.

Willie Walsh - *British Airways - CEO*

Okay. Let me deal with it in a couple of ways. I think there's very little evidence of us losing traffic on short haul to our low cost competitors. In fact, if you were to analyze it -- and we don't give you the information so it would be difficult for you to work it out -- but what I could say is the drop in passengers on short haul is largely a domestic issue. Where we've significantly cut capacity on our domestic network. And to some degree, that's because we've seen, that demand decline with some people moving to the train. So, if you were to look at the passenger figures, the most significant part of the decline in short haul has been on the domestic network. Where there has been very little if any falloff in traffic on our European short haul and network.

Now, in terms of premium, nonpremium, clearly, the decline of premium has been greater on short haul premium than on long haul premium. Again, we don't give you a split on that. But if you look at the general (inaudible) figures, they show that Trans-Atlantic premium, for example, was down for the first five months of this year by 17.7% where premium within Europe was down by 27.6%. They're (inaudible) figures. But we've seen similar sort of decline between the long haul and the short haul. So, the decline on short haul premium has been greater than the decline on long haul.

And with transfer, we've seen transfers and opportunity for us where we've been able to generate additional euro revenues and dollar revenues. So, transfer traffic is currently running in Heathrow at about 44, 45% of our total traffic. And that's been a contributor to the revenue benefit, currency benefit that we've seen in yields. So, as you know, we shifted our sales focus into Europe and the US to general rate both euro and dollar revenues when the pound weakened against both of those currencies.

Neil Glynn - *NCB Stockbrokers - Analyst*

Great. Thank you.

Operator

Our next question comes from the line of Mr. Andrew Lobbenberg. Your line is open.

Andrew Lobbenberg - *ABN AMRO - Analyst*

Hi, Willie. Hi, Keith. Can I come back to the sort of premium/nonpremium split because the decline in premium traffic, you're always saying is quite large, less than (inaudible). It is just a bit surprising to see the mix impact on your yield be so small. Can you discuss whether there are any other issues going into the mix? The fact that perhaps mitigating the downtrading through the cabins. Second question, what do you think the impact will be of air passenger duty because obviously it has -- come November, it has a much more significant effect on long haul traffic than on short haul or do you have hopes that you can lobby to get the thing turned over? And then a final question on Midland, if I may. Are you seeing yet any change in their behavior under their new ownership or do you expect to see them behave particularly differently going forward?

Keith Williams - *British Airways - CFO*

Okay. Andrew, on the mix, I can't give you any real additional information on that as we've said, the decline in premium, well, you've seen the traffic that we've reported. 14.9% down in June. 17.2% in May. And 17.7% in April. We are doing, I think, significantly -- certainly, we're doing much better than the general performance at the industry based on the (inaudible) figures. As I said, we don't give you a split between short haul premium and long haul premium. But the decline has been greater in the short haul side of the business than on the long haul side of the business.

APD is clearly a concern. We have been lobbying both through industry bodies and directly. So, I've met with the Chancellor on a couple of occasions now. And have been lobbying to get the increase in November either postponed or canceled. And ideally, I would like to see APD reduced. I don't think there's much prospect of that. What I would say is that the Chancellor listened to the arguments we made. He didn't say no but he hasn't given us any positive indications either. But the -- we are concerned more about the November 2010 increase which is a very significant increase. So, the November '09 increase would be very unwelcome but the real concern I have is the impact that the November 10, increase in APD, what that would do to the business. It is not just what it would do to British Airways but it's what it would do to the whole U.K. airline industry. I think it would have a very significant negative effect on that. And so, your last question, Andrew was?

Andrew Lobbenberg - *ABN AMRO - Analyst*

Have you noticed any change in the behavior of Midland under the new ownership? And you know -- have you got any expectations of how it might play out?

Willie Walsh - *British Airways - CEO*

We haven't seen any really noticeable change in behavior at this point. It is probably too early. I think Lufthansa only acquired control in the beginning of July. So, I would expect them to start making some changes. I think it is well-known from statements that the previous management at BMI made that their financial performance has been very weak and I would imagine what we're seeing is identical, if not even worse for BMI given their particular network. So, they will require to do something. We haven't really noticed any significant change in behavior. We're not expecting to see a change in behavior. We're clearly interested to see what Lufthansa will do with the business. In due course. I suspect they're somewhat distracted by the performance of their own airline plus the acquisition of Austrian which has, I think, gone on a bit longer than they had anticipated. But they clearly get around to dealing with BMI in due course. I would imagine they begin to stem the losses within BMI as quickly as possible, which would indicate that some action is going to have to be taken there. I can't see how the financial performance can be improved without them taking some structural, making some structural changes to how BMI is operating at the moment.

Andrew Lobbenberg - *ABN AMRO - Analyst*

Thanks.

Willie Walsh - *British Airways - CEO*

Thanks, Andrew.

Operator

(Operator Instructions)

Willie Walsh - *British Airways - CEO*

Okay, if there are no further questions, then I thank you for dialing in. Thank you very much.

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