FINAL TRANSCRIPT

Thomson StreetEvents℠

BAIRY.PK - Q2 2009 British Airways Earnings Presentation

Event Date/Time: Nov. 06. 2009 / 9:00AM GMT

CORPORATE PARTICIPANTS

Martin Broughton
British Airways - Chairman

Keith Williams
British Airways - CFO

Willie Walsh
British Airways - CEO

CONFERENCE CALL PARTICIPANTS

Andrew Light
Citi - Analyst

Geoff Van Klaveren
Deutsche Bank Securities - Analyst

Jarrod Castle
UBS - Analyst

Douglas Mcneill
Astaire Securities - Analyst

Edward Stanford
Cazenove - Analyst

Jonathan Wober
Societe Generale - Analyst

Andrew Lobbenberg
RBS - Analyst

Samantha Gleave
Bank of America Merrill Lynch - Analyst

Tim Marshall
Redburn Partners - Analyst

PRESENTATION

Martin Broughton - *British Airways - Chairman*

Good morning; good morning, everyone, and welcome. Now I'd like to be able to stand in front of you today and talk about green shoots, but unfortunately, I'm not really in a position to do that. The challenges facing the industry remain as critical as ever, with IATA forecasting an $11 billion loss for the industry this year.

Today, we've announced our first ever loss at the first half, at the half year stage, with operating loss of GBP111 million, underlying revenues down over 20%, and we expect that revenue for the full year is likely to be down by GBP1 billion. Naturally, in the light of these conditions, the Board has determined not to declare a dividend.

On the positive side, we did react quickly to the financial crisis, and instigated a cost cutting program more than 12 months ago. That's seen us remove capacity, ground aircraft, reduce manpower, and cut external spend. As you can see, these actions are really beginning to bear fruit, with a 5.2% reduction in unit costs in the last six months.

While we've taken costs out of the business in this half, I'm delighted to say that the operational performance continues to go from strength to strength as we celebrated our first full summer in T5.

84% of flights departed on time during the half year, and last month saw the best ever October performance, with 90% of flights leaving on time. We're also seeing record baggage performance levels, and high customer satisfaction ratings.

We've been successful in reducing costs and improving operational performance, but these actions on their own are not enough. To secure the long term future of the business, we must introduce more permanent structural change. We've reached agreement on change with our engineers and pilots, but it is very disappointing that the cabin crew union has decided to ballot for industrial action.

We've been talking to UNITE now for nine months, and following their failure with the injunction hearing yesterday, we remain available to meet our unions at any time in a genuine attempt to protect customers, the Company, and the cabin crew from these unnecessary and unjustified actions.

We remain focused on our merger talks with Iberia. We've developed a good relationship with the new management team. We believe we'll be in a position to make a decision about our future plans soon, but I'm not going to speculate about timing.

We look forward to hearing shortly from the US Department of Transportation about our ATI application to operate the transatlantic joint business with American Airlines and Iberia. We are not unduly concerned that the DoT failed to meet its self-imposed deadline of October 31 to announce its views. It happened also recently in the Star Alliance case. We do not anticipate a protracted delay.

In terms of the European process, we have received a statement of objections from the EU. We are submitting a response soon. This thorough review of our plans by the EU was anticipated; is similar to their continuing review of the Star SkyTeam Alliances, which have already received ATI clearance in the US.

We remain confident of gaining approval from the US and the EU authorities, and ensuring robust competition for consumers by allowing Oneworld to compete on a level playing field with Star and SkyTeam.

While aviation continues to face its worst ever crisis, it is extremely unfortunate that the Government has chosen to kick the industry in the teeth with a two stage increase in air passenger duties, the first stage of which came into effect last Sunday.

The Government says that APD is an environment tax, but not a penny of it is spent on improving the environment. Aviation is being used to fill the Treasury's coffers at a time when it can least afford to do so.

Carbon trading is far more effective than taxation, as it provides financial incentive for aviation to improve its environmental performance. And the industry remains united in its efforts to reduce carbon emissions, and our ultimate goal is to see a global sector approach to aviation emissions. And we are lobbying hard for this to be endorsed at the Copenhagen Summit on climate change next month.

At this stage, I'll pass to Keith to take you through the numbers.

Keith Williams - *British Airways - CFO*

Thank you, Chairman; morning everyone. The Chairman mentioned the progress we've been making. What I thought I'd do this morning is to take you back to a slide that we showed you at last year end results, and this was a slide on the key trade-offs within our business. If you recall, we were recognizing the deep recession that was impacting the business, and set out a planned recovery.

We had three main aims. The first was to reduce capacity to meet expected demand. The second was to reduce our costs by more than that capacity reduction to achieve an improvement in unit costs. And the third was to achieve some volume stabilization which would ultimately lead to some yield improvement.

Now we always expected that yields would be weak over the summer period, as we told you at the half year results. Now, what I'm going to show you now is where we are against those trade-offs.

Firstly on capacity versus demand, in the half year, we reduced overall capacity by some 3%, as you can see there, and over the same period, demand measured in RPKs, revenue passenger kilometers traveled, fell by 1.6%, and that meant that we achieved a yield factor up about 1%, 1.1%, to over 80%. And the seat factor over the six month was 80.6%.

In terms of the trade-off between capacity and costs, our aim here was always to see a real and permanent cost reduction below capacity changes so that we would see a permanent improvement in unit costs.

Capacity measured in ATKs was down 3.7%. It was slightly different to the ASKs, because if you recall, we've been taking out some of the larger aircraft, some of the 747s, and replacing them with 777s. So the number of aircraft didn't fall but in ATKs, our capacity was down.

Against that, our cost performance has been excellent. Reported overall costs were down 8.7%. Now that is helped by significant fuel benefit. I think the fuel benefit was almost 18%.

Now a better measure of costs is probably to strip out currency impacts, and at constant exchange rates, our costs were down 16.9%, and non-fuel costs before exchange down almost 9%.

Overall unit costs, as the Chairman mentioned, were down 5.2%, and again, if we strip out currency, unit costs were down 5.5%. Now much of this was achieved through employee productivity, with productivity per employee improving by more than 5%; 5.4%, as you can see on the chart there.

So those are the positives. The most difficult trade-off has been between volume and yield, and that was something that we were anticipating as we went into the year.

As you know, in the face of the economic recession, the whole industry has faced severe reductions in both volume and yield, particularly in premium cabins.

Looking over the course of the six months, passenger volumes have stabilized over time, with volumes down over the six month period 2.6%. Yields have remained under pressure, and reported passenger yield was down 12.2%, helped again by exchange, and down on an underlying basis some 18.2%.

So those are the headline statistics. If I look at the trends within that for a moment, to add a little bit of color to it, I think the first point to note is that the traffic volumes have stabilized over the course of the six months. In quarter 2, RPKs were roughly flat. They were down just 0.1%, whereas in the first quarter, they'd been down over 3%; 3.2%.

Load factors in the first quarter were flat, but up 2%; 2.3% in the second quarter. As I said earlier, the bigger issue has always remained yield, particularly in premium cabins. And the yield story is complicated by a number of factors; mix, mix within cabin, fuel surcharge levels and currency.

However, if we exclude currency impacts, what we can see is yields are stabilizing, and I'm going to show you some information on that in a moment, but it's stabilizing off a very low base.

And within that, we recognize there's been some structural change, particularly in Short Haul Premium traffic. And Short Haul Premium traffic represents some 6% to 8% of our overall business, and volume recovery in Short Haul Premium cabins has lagged the recovery in Long Haul. And we see this as a structural shift, and I'll show you some charts on that in a moment.

Given the difficult revenue environmental, our focus continues on costs. Costs, excluding fuels and exceptional, were down 3% in quarter one, and over 6% in the second quarter, so you can see the costs reduction is accelerating.

We've seen now four consecutive quarters of cost reduction, and although we expect to see further reductions going forward, that is going to prove more difficult to achieve against the capacity reductions that we're planning for the second half of the year. We're now planning a 6% capacity reduction for the second half.

Turning now to the actual numbers, overall revenue was down some GBP650 million on the half by just under 14%, even with the help of exchange benefits from sales, ticket sales in foreign currencies. On a constant exchange basis, revenue was down some 20%.

Fuel was down 18%, as you can see from the chart here, with around 35% reduction in price offset by currency impact. Reported non-fuel costs were down 4.3%, but again, stripping out currency, non-fuel costs were down around 9%.

The resulting operating loss was a basic GBP63 million. We incurred GBP48 million of restructuring costs over the half, leaving an operating loss of GBP111 million, and a pretax loss for the half of GBP292 million; GBP244 million basic and GBP48 million exceptionals.

Now looking at the numbers for the second quarter, second quarter revenue was down just over 15%, with fuel almost down 20% and non-fuel costs, as I said earlier, down from 6%. That left a small operating profit before exceptionals of GBP22 million for the quarter. Taking account of restructuring, it left us with an operating loss of some GBP17 million, and a pretax loss of GBP144 million.

Looking at the split of the revenue, the performance of different parts of the business in revenue terms, I think passenger revenues you can see was down 13.6%, mainly as a result of the collapse in yields, as we've seen.

Now Cargo I won't cover elsewhere, so I'll give you a little bit of detail on Cargo now, is Cargo volumes were down just over 8%; 8.1% in the six month period, with more recovery in the second quarter than the first. In the second quarter, Cargo volumes were down 4.6%.

Now yields have been under pressure throughout the period, and over the period were down more than 20%, and we're just -- only just starting to see some improvement in yields in the Cargo business.

Other revenue continued to improve, partly as a consequence of the performance of our Mileage business, and partly as a consequence of increased focus on ancillary sales. As you know, we've launched a number of initiatives in that area, such as Web-based selling, what we call dynamic packaging, and that's showing fruits of delivering revenue. We've had improvements in flight retail. That's contributing to additional revenue. So our other revenue was up some 11% in the first half, and that left overall revenues for the half, as we discussed, down 13.7%, or some GBP650 million.

Now as to what's happening in volumes, I'll cover volumes first and then I'll move on to yields.

Firstly, in terms of premium traffic, we announced our traffic statistics for October this morning, and if you've seen the traffic statistics, you will see that premium traffic volume measured in RPKs in October was down 1.4%. And that continues the improvement that we've been seeing over the summer, as you can see from this chart. Now as we get beyond September, the trend starts to be complicated because of the baseline effect of the severe recession that we've seen following the collapse of Lehman's. So a better measure is probably to look at where we are in terms of our peak performance in 2007/'08, and this chart is trying to illustrate for you where we are in terms of premium volumes against that peak. So although we've seen some recovery, we're still running at premium passenger levels some 10% down from where we were two years ago.

With reductions in capacity, however, what you're seeing is the Long Haul Premium seat factor is getting back to 70%, and that's because of the reductions we've made in capacity. Now this chart looks at Long Haul Premium seat factors. It doesn't include Short Haul, because as you know, in the Short Haul Premium, we can move the divider so we've got much more flexible capacity in Short Haul fleet.

Looking forward over the winter schedule, as we make further planned capacitor reductions, we see seat factors remaining strong throughout the winter period. Now within that, I did want to touch on one point. We've talked about structural change, and one of the areas that we see structural change is within our Short Haul Premium business. And what this chart is showing you is the split of the volume between Long Haul Premium and Short Haul Premium. As you can see, Short Haul Premium, which contributes about GBP0.5 billion in revenue terms, is not seeing any significant signs of improvement, and remains down some 20% to 25% from where it was a year ago, and that we see as a structural change within our business.

In terms of non-premium looking at volumes, here volume can be stimulated much more by price, and I'll show you that in a moment, but we've had a strong summer with load factors remaining at the high levels that we saw the previous year. And again, if we look at it in terms of seat factors against the peak of two years ago, what we can see is that our seat factors have remained in line with where we were over that period.

So that's on the volume. What I want to do now is turn you to yields and what we've been seeing in yield as we've been able to better match supply and demand.

Now this slide is looking at booked yields, and with a caveat that booking patterns have changed and people tend to book a little bit later than they have done in previous years. But what you can see from this chart is what's been happening to Long Haul Premium book yields over time. It's stated at constant exchange rate between years so you can get a direct comparison between 2007, 2008 and 2009. And it excludes currency effects, but it does include fuel surcharge impacts.

So as you can see from this chart is that average yields have stabilized and are now showing some improvement in the last few weeks, finally reaching the levels that they were 12 months ago.

So that's Long Haul Premium. If I look at Short Haul Premium, the same story is true here where, again, we've seen yield recovery to where the yields were 12 months ago.

Moving on to Long Haul Non-premium, here you can see that yields are tracking last year's levels, but are still below the levels that we achieved two years ago. The market remains price-sensitive with lower prices necessary to stimulate volumes.

And finally, if we look at Short Haul Non-premium, the story is slightly different here, with yields having remained weak, and only now starting to reach the level of 12 months ago. So what does that mean to yields overall, and this chart is trying to show you with currency and reported yields that we saw in quarter two, and some idea of what we're likely to see going forward. So the red shaded area here is showing you what has been happening to currency benefit, which is decreasing over time as sterling gets to more stability against overseas currencies. So we saw a currency benefit in quarter two which will diminish in quarter three, and disappear on current levels in quarter four.

And what you see on yields is we expect some benefit on yield in quarter three in reported yields, and that will accelerate into quarter four, partly because of the baseline effect from 2008/09, the weak base in that year, and particularly in quarter four.

So in summary on the revenue, what we're seeing is Premium volumes are currently stable at last year's level, with volumes well down against the peak of 2007/08. There's some yield improvement from the lowest levels from the better matching of supply and demand. Long Premium volumes are strong benefiting from lower yields, albeit at much lower levels than the peak.

Although we're seeing some recovery in Short Haul Premium traffic, we continue to see signs of structural change. Pulling that together, as a consequence, we still expect overall revenues this year to be down some GBP1 billion from where they were in the previous year.

Clearly, with that level of revenue weakness, we need to continue to focus on costs.

So now moving on to costs; we're 12 months into a major cost reduction exercise. If I go back to Investor Day in March, we were talking at that point in time about some GBP300 million of cost initiatives over two years, with a target of GBP220 million in the first year. We're on track today. We've already delivered more than the GBP220 million that we were seeking at investor day at the half year. We've achieved some GBP275 million of cost reduction already, and Willie will show you some of that later on.

We've taken significant action across the business. We reduced the management headcount 12 months ago, as you know; we're seeing Terminal 5 exceed the expectations in terms of cost delivery; we've reduced functions that we had overseas, and we're on track to deliver a substantial reduction in supplier costs, which Willie will show you later.

Our total MPE is down some 10% from where it was some 12 months ago, and excluding restructuring costs, our employment costs are down some 8%.

And that's been a major contributor to the productivity improvement, as you saw earlier, is productivity per employee is up more than 5%; 5.4%. And the unit cost improvement, as you saw, is 5.2%.

Many of our suppliers and our colleagues within the business have done a lot to take us through to where we are today, and that's a focus we need to continue in the second half of the year.

So looking at the major cost lines, as you can see, total costs were down 4.3% and reported costs down 8.7%. And looking at the major contributing factors, employment costs we've discussed, and that's from the manpower reductions that we've achieved, and I'll show you more of that in a second, and Willie will show you where we are going forward in a moment.

Selling costs were down more than 23%, and within that, I'd single out changes in commission charges. We've brought commission charges down some GBP40 million in the first six months of the year, and there is less promotional activity. This time last year, we were doing a lot of promotion on the opening of Terminal 5, which was in the base, and isn't repeated this year.

Now that pace has continued in to the second quarter, so cost reduction is accelerated to an almost 11% reduction in costs in the second quarter. And again, costs coming down in almost all areas, and I'll show you in a second, is costs in all areas are down if you take account of exchange. So if I strip out exchange impact, this is the picture that you're seeing at constant exchange rates.

Again, with total costs excluding fuel almost down 9%, and reported costs on an underlying basis down 17%, so significant focus on costs delivering result.

Now within that is clearly MPE has been a major contributor, and we traditionally measure MPE, as you know, in terms of what we call manpower equivalents, and that takes account of the volume of part time working and overtime working that we have as a Company. And one of the changes that we've been making is to convert more full time contracts into part time contracts, which is something that our staff have desired, and we've been allowing that to happen over the last 12 months, as well as achieving significant cost reduction through voluntary redundancy means.

And what we're seeing is that 12 months ago, the total headcount was around 46,000. That has dropped significantly. MPE was around 42,900. 12 months later is the MPEs is 38,700, and Willie will show you a chart in a moment of what our plans are for the remainder of the year.

Looking at fuel, we recognize again that fuel is a structural cost change within our business; is that the fuel price is now between $75 and $80, and we believe it's going to remain in that range going into next year. And that means, if you go back from two or three years ago when the oil price was $40, we're seeing a structural element of change within the business that we need to respond to.

Now hedging can obviously help with that, and this chart is showing you where we're hedged for the remainder of this year, and you can see is given the hedging that we have in place, we're relatively insensitive now to what might happen to the fuel price going forward, and we expect this year our fuel bill to be down more than GBP500 million from where it was the previous year, which is just under GBP3 billion.

As we look into next year, we're about 40% hedged, and that's at an average of around $72 to $75, and if we go into the following year, 2011/'12, we're some 15% hedged for that year.

So pulling it all together, what's been happening to unit cost you can see from this chart here. You can see that the significant reduction in unit costs that we've achieved over the period, and particularly over the first half of this year as we've taken out capacity, and the capacity reduction in ATK terms of 3.7%, as I said that is -- although we will concentrate on further cost reduction over the second half of the year, achieving those step changes in unit costs is going to be -- prove more difficult against a capacity reduction of more than 6% over the winter.

So on costs overall, as I said earlier, the Investor Day target was GBP220 million reduction. We've achieved GBP275 million of that, and there is more in progress, and Willie will talk through that in a moment.

So that's on the cost side. If I briefly touch on the balance sheet and the major movements on the balance sheet, there are three issues that I'd like to highlight here.

The first is the improvement in cash, which you can see has gone up GBP126 million, and part of that is a consequence of the convertible capital bond that we did in August. The second is the movement of gross debt, which has increased by less than the cash movement. As you know, a substantial amount of our borrowings are in foreign currencies, and sterling was weak at the beginning of the year, so we're seeing some currency benefit through gross debt as we move to September 30.

And the last is the movement on reserves which, again, is benefiting from the currency revaluation of debt, and also fuel mark-to-markets and currency mark-to-markets have changed over the period. So that's the balance sheet.

In terms of liquidity, we have added a lot of liquidity to the Company over the summer, and our general purpose liquidity now stands at more than GBP2 billion, and that was something we put in place to see us through the current recessionary period. So it comes as no surprise to you is that liquidity is not a question that we're being asked about at the moment.

And then if I look at where we are going forward in terms of committed facilities against future aircraft deliveries, you can see from the chart here is that we've got committed facilities of almost GBP2.6 billion going forward. Willie will talk to aircraft changes in a moment.

So to summarize overall is what we see today is stabilization. The Chairman mentioned green shoots. I wouldn't call it green shoots, but we do see signs of stabilization. Unit costs are down again, despite capacity reduction. We are having to adapt the business to structural changes that we see, and we will continue to do that. And it's an important six months ahead. We need to complete the pay and productivity talks that are ongoing. We have pensions which will come to a head over the next few months, and we need to return the business to long term profitability.

With that I'll pass over to Willie.

Willie Walsh - *British Airways - CEO*

Good morning, everyone, and thank you, Keith. Now Keith and the Chairman have covered most of the issues, but I just want to build on some of the items that they have discussed.

When I spoke to you at Investor Day, and again at full year results, I said we would focus our attention on the listed items there. Now I believe we've responded in the right way to the challenges that we're facing. I think we've faced up to these challenges quickly, and I'm pleased with the progress that we've made. But it's absolutely clear to us that further work is required, and I just want to assure you that we remain absolutely determined to see through structural change in our cost base to address what Keith has demonstrated to be a structural change in consumer behavior.

Now I think this chart best illustrates the scale of the challenge that we face, and the nature of the challenge we face this year very different to the challenge we faced last year. If you remember, first half of last year was about rocketing oil prices against a background of weakening economic conditions in a couple of key economies, particularly the US and the UK.

Second half was about the turmoil in financial services, deepening recession in world economies. And you can see there that the oil price driving up our unit costs at a very significant pace, and we were struggling to drive unit revenues up to match the increase in the cost base that we were witnessing.

This year, it's about a significant fall in revenues. We're still witnessing some high prices, particularly in relation to oil, but you can see there that the decline in our unit revenues was the steepest decline that we've witnessed in the history of the business. And I think that we've done good work in relation to unit cost reduction, particularly as we've taken capacity out at the same time. The challenge going forward will become more difficult, particularly given the scale of the capacity reduction that we have planned for this winter, so that we expect to see a unit cost reduction in the second half showing improvement against last year, but that absolute unit cost we will probably see an increase in that absolute unit cost from where we are today.

Now in terms of addressing cost, we've split in to two general areas. The first is internal pay and productivity, and the second is in relation to supplier cost. Now as Keith has said, we've made very good progress in relation to manpower reduction, and we've seen a 10% reduction in manpower versus this time last year.

This chart shows you our plans going forward, with a further 3,000 targeted reduction in MPE, bringing our total MPE by year end down to just under 36,000; about 35,800.

We have initiatives in place to achieve that reduction. Some of those initiatives relate to changes that we have announced with our cabin crew, and I'll talk about that in a moment. But we have identified initiatives to enable us to achieve that targeted manpower reduction by year end.

In terms of the discussions that we've been having with our various groups, as you know, we concluded in agreement with our engineers, and we're seeing the benefit of that, and we're witnessing excellent cooperation from engineers.

And the same applies to pilots. We've finished negotiations with pilots. Our pilots continue to do an excellent job, and have responded very positively to the challenges that we face.

With regard to ground services, these are the people work in the ramp, baggage hall, and cargo. We've finished negotiations, so we've actually got a negotiated position that has not yet been balloted on, but the negotiations with that group have concluded, and we're satisfied with what we've achieved there, but we are waiting for a formal ballot to endorse the agreement.

We've now re-engaged in discussions with our -- what we call A-scales. These are the general administrative customer-facing staff. I had a good constructive meeting with Paul Kenny, the General Secretary of the GMB last week, and that resulted in a new phase of discussions with the A-scale group, starting this week. So those negotiations are ongoing, as we speak.

Cabin crew I think has been well documented. Following nine months of detailed discussion, consultation and negotiation, I regret to say that we've made no progress in relation to that, so we have announced changes that will come in to effect starting on November 16, and further changes on December 1. These were a subject of an attempted injunction by Unite, which was considered in the High Court yesterday. As you know, that injunction failed, and the changes that we've announced will go ahead as scheduled from November 16.

Now I did have a meeting with the joint general secretaries of Unite following on from that meeting, and some suggestions that they made, I've written to the joint general secretaries about a little over a week ago, and I'm waiting to get a formal response to my letter to the joint general secretaries. But I have told them that we remain available to discuss with them further changes that we believe are absolutely necessary to secure a viable and sustainable cost base with regard to cabin crew. It is clear to us that our costs in this area are well out of line with our competitors.

We believe that the changes that we have announced are both fair and reasonable, and are designed to protect as much is possible our existing cabin crew by giving us scope to witness significant unit cost reduction going forward.

But the focus that we have in relation to our employee cost base is structural, permanent change to the cost base to ensure that British Airways is well positioned to take advantage of the economic upturn when that happens, and to allow us to grow, and to take advantage of growth opportunities in a way that will be sustainable and profitable, and I'm pleased with the progress that we've made.

But this is very clearly about structural change. Our trade unions quickly recognized the nature and the scale of the challenge we faced, and offered us temporary changes to address what they saw as a temporary decline in our business. But as Keith has demonstrated to you, this is very much a structural change, particularly in relation to Short Haul Premium travel, and it's very clear to us that we've got to introduce structural changes to our employee cost base.

So I would describe the progress that we've made with most of the groups as being positive. I think we're on the right track, and the changes that we're implementing will achieve the targeted cost base that we're looking for.

With regard to external costs, we've got about GBP5 billion of supplier spend. The top 250 represent the vast bulk of that. So we've engaged initially with the top 250 suppliers that we've had, and we've had good progress in relation to that. We've already delivered GBP79 million of savings, and that contributes to the savings that Keith has demonstrated to you in the first half.

We are still in discussions with some of these key suppliers, but we are now turning our attention to the supplier group in the 251 to 500 category. These are smaller in terms of value, but clearly important to us in terms of overall cost savings to the business. I'm pleased with the progress we have made there.

And in relation to capacity, as Keith mentioned, it was a 3% ASK reduction in the first half, and that was 3.5% reduction in capacity in the summer period, which includes the October month. We're now targeting a 6% capacity reduction for this winter. That's a slight increase in the reduction that we had previously announced to you at 5%, so 6% capacity reduction. You can see the aircraft that we've grounded. And as Keith has mentioned, some of this capacity reduction comes from small and -- sorry, flying smaller aircraft on existing routes, but it's also achieved by taking capacity out of where we have multiple frequencies on route.

So the network will not be impacted as a result of the capacity changes that we're introducing. All of the route changes have been announced already, so there's no changes to the network with this increased capacity reduction.

Now we have finished negotiations with Airbus in relation to delivery of the A380s, and you can see from this slide, we have delayed the delivery of A380s beyond what we had previously advised. So we'll now have four A380s delivered in 2013, three in 2014; you can see the delivery schedule there. So A380 deliveries have been pushed back.

We continue to discuss with Boeing the delivery schedule for the 787. The schedule that I show you here is the latest view from Boeing in relation to their plans for 787 production and delivery. And we've started taking delivery of the Embraer 170, and we're taking 190s to replace the RJ fleet at London City. So the major change that we're showing you here is in relation to the delivery schedule for the A380s.

Now that also had an impact on our CapEx, and you can see we've rounded the figures here just to give you a rough idea of the overall change in CapEx profile versus the previous chart that we showed you at investor day. So you can see a CapEx in that period down by about GBP1.8 billion. Some of that is as a result of rescheduled aircraft deliveries, but also included in that is thrifting of the CapEx program. So whilst some is just pushed to the right, we have seen reduction in overall CapEx. So we're pleased with this reprofiled CapEx program taking us through to 2013/2014.

And as Keith has mentioned, we're clear that our liquidity at this stage is appropriate for the challenge that we face. I think, as we pointed out on a number of occasions, we've benefited from the work that we did back in 2007. As the financial markets started to weaken in mid '07, we went out and put funding in place for the aircraft deliveries out to 2013, and these are irrevocably committed. They're based on funding rates that existed back in 2007 which are clearly well below rates that would be available today.

And we've also completed, as Keith said, the convertible, and we have been in the market funding aircraft, so we have recently secured funding for the first of the 318s that we took delivery of at London City.

So with liquidity at about 50% of revenue, I believe that that's a comfortable position, but clearly not a position that we're complacent about. But certainly relative to many of our competitors, it's a strong position.

Now at the same time as we have been reducing manpower, I think it's very important for me to point out that we have succeeded in driving up operational performance and customer satisfaction, so we remain focused on delivering high quality service to our customers. And as this chart shows you, we're delivering record levels of customer satisfaction, clearly demonstrating that you can reduce the number of people working in the business and deliver a better product.

We're also seeing record levels of punctuality, and we're pleased with the performance we've seen here. We believe that there's further scope for improvement. When we look at our performance relative to our competitors, it's clear that in Gatwick, for example, we are significantly ahead; and I mean, by a very significant factor ahead of the major competition that we face in Gatwick. The same is true of much of the competition we face at Heathrow.

So our operational performance is not just good relative to where we were, it's very good relative to our competitors.

And the same is true of our baggage performance. This was a major drag on the business before we moved into T5; well documented initial problems with T5. But T5 is performing well ahead of where we thought it would be, and this is contributing to excellent performance at Heathrow, and an overall network performance that is at record levels.

So we're seeing record satisfaction from our customers, record punctuality, record regularity in terms of operating flights in relation to the schedule, record baggage performance. So an overall significant improvement in our operational performance at the same time as we've taken our costs and manpower down.

Now the Chairman has commented on Iberia, so I won't say too much other than to add that the concern that I had expressed previously in relation to corporate governance, or the governance structure in relation to the proposed merger, I'm satisfied that we've made very significant progress in that area.

In relation to the ATI application, we continue to expect a positive outcome in the near future from the US Department of Transportation. We were heartened, as I've said previously, by the DoT's approach to the expanded Star Alliance, and significantly, the recognition of the consumer benefit of genuinely integrated, or what they call metal neutrality alliances, and we believe that the benefits that they identified in the Star application are even greater in terms of how they would apply to our application, because it would allow Oneworld, which is the smallest of the three alliances in terms of capacity on the transatlantic to compete much more effectively with the two immunized alliances.

And it's clear from everything the US DoT has shown that the consumer will best be served by strong competition between three alliances rather than the two alliances that have immunity today.

We're clearly disappointed that the DoT failed to meet its self-imposed statutory deadline, but this isn't the first time this has happened, and indeed, the same applied with the Star application; the deadline on that was also missed.

And the statement of objections that we've received from the EU Commission follows the line of analysis that the Commission has adopted in relation to other aviation cases, including the SkyTeam alliance, and it's important to remember that they issued that about two years ago. We carefully reviewed all of the issues raised by the Commission, and we will shortly provide our response to the Commission, but we're satisfied that we will be able to provide further evidence of what clearly demonstrates significant consumer benefit as a result of the application of a joint business with Iberia and American Airlines. So I remain optimistic in relation to our outcome on the ATI application.

You will have heard me publicly state that we are interested in BMI if Lufthansa is interested in selling it. We have made that known directly to Lufthansa, but there are no discussions or formal contact with Lufthansa on the issue. But we remain clearly interested in the future of BMI, and we'll watch with interest what Lufthansa does in relation to that. They've indicated that they want to consider all options available to them, and we're watching, as I said, with interest to see what happens in relation to that.

So finally, we thought it would be useful just to check, George, Keith and I, what you raise with us when you're talking to us, and you're -- this really covers the list of main items that you address; ATI, our discussions with Iberia, our interest in BMI, profitability, cabin crew and pensions. And I believe we've addressed most of these and, clearly, we'll give you an opportunity to ask us questions in relation to this. But I would say that we would expect activity in all of these areas to be significant over the months ahead, and we will keep you informed and up to speed in relation to any development on any of these key issues.

Thank you.

QUESTIONS AND ANSWERS

Martin Broughton - *British Airways - Chairman*

Well, thank you, Willie. Thank you, Keith. After such a comprehensive presentation, I can't believe there are many questions left unanswered. But just in case there are, usual form; please state your name and organization before asking a question, please.

Andrew Light - *Citi - Analyst*

Andrew Light from Citi. On the American Airlines joint venture, what happens if the EC and the US DoT come up with different conditions? Are you obliged to accept the most stringent in all cases, or is there some kind of three-way negotiation?

And secondly, on the pension deficit, where are we on the -- where are you rather on the actuarial valuation?

And in terms of remedies, what would you exclude or include? For example, would you adopt some of the measures other UK companies have done, like cancelling the defined benefits scheme, even for existing members?

Thanks.

Willie Walsh - *British Airways - CEO*

There is a slight different in approach between the Commission and the US DoT. The DoT very clearly focuses on network benefit, where the Commission still sees city peer competition as being the issue to focus on.

I think it's premature to speculate on what the outcome would be. We believe we've got a very strong case. We believe we can demonstrate both to the DoT and to the Commission that the consumer will benefit to a significant degree from the joint business that we have proposed with American Airlines and Iberia. And we will address the concerns that the Commission has expressed in terms of the statement of objections.

So we're very optimistic that we can address the concerns that the Commission has identified, and we remain optimistic that the DoT will view our application in a positive light. And we're confident that any of the concerns that remain following our response can be addressed as well.

So let's wait and see what happens, but we believe our case has very strong arguments. We believe passionately in the merits of the joint business, and we remain confident that we will get approval.

Keith Williams - *British Airways - CFO*

And on pensions, we're in talks with our colleagues, as you know, in terms of pay and productivity. And we see only a small linkage of that with pensions in the sense that pensions, ultimately, is linked with the size of the workforce. So there is some small link there, but we see them as two entirely separate work streams.

We're in talks with the Trustees at the moment. It's certainly on my pre-Christmas shopping list to complete those talks, but that is, as I say, dependent on negotiations with the Trustees.

There is nothing today to say on pensions, other than what we've said already, which is clearly there is going to be an increase in the pensions deficit. Work from Price Waterhouse six months ago for the Trustees was looking at the Company's ability to pay. Today, we pay GBP330 million a year into the pension scheme, and we don't see a need to increase the level of those contributions.

Martin Broughton - *British Airways - Chairman*

Okay. You make a very good point, Andrew. I think it would be -- it's important generally that across the Atlantic, the authorities look at these things in the same light, from the same kind of approach. It makes anything difficult where you've got completely separate regulations and approaches on either side. But I think -- I hope we'll get through those questions.

Geoff Van Klaveren - *Deutsche Bank Securities - Analyst*

Hello. It's Geoff Van Klaveren from Deutsche. Does the decision on pension have to come before any decision with Iberia? And secondly, what value do you see in BMI? Is it just the obvious slots, or do you see value in the network, and how would you pay for it?

Willie Walsh - *British Airways - CEO*

Well, we were hoping you'd tell us that one.

I think our interest in BMI is primarily in relation to the slots at Heathrow, but we have identified other value as well. They have generated an interesting network of routes following the switch-out of the Short Haul flying into the more mid-range. So there are a number of destinations that BMI currently serve that would be on our list of destinations for the future, but our primary interest is in relation to BMI.

I think if we were successful, in other words, if Lufthansa decided that they wished to dispose of BMI and we were in a position to make a successful bid, I think funding for that is something that we clearly would need to address. But I think we can make a very strong case that it would be very beneficial to British Airways. I'm very confident about that.

So our interest is real. I just wanted Lufthansa to be clear that in considering all options, that British Airways was interested in BMI despite the activity that we're involved in in all other areas, and that's why I expressed my interest in it publicly.

Keith Williams - *British Airways - CFO*

And on Iberia and pensions and, clearly, that's an element of discussion with Iberia, but the statutory deadline for resolution of pensions with the regulator is June 30 next year. I haven't got anything more to add.

Jarrod Castle - *UBS - Analyst*

Good morning. It's Jarrod Castle from UBS. Two questions, please. You spoke a bit about cost savings. Can you give us an idea in terms of what you do view in terms of percent, in terms of structural versus cyclical savings you've put through? How much do you think you can hold on to going in an upward cycle? If you could answer that one first, please.

Willie Walsh - *British Airways - CEO*

Yes, the focus we've had on structural change, in simple terms would -- our focus there is to allow us to expand and increase the number of aircraft and the capacity that we put into the operation, while controlling all non-direct operating staff involved in that.

So in other words, it's clear that if we add more aircraft, we will need more pilots and cabin crew, but what we're doing is ensuring in the first place that we don't have to add any support or back office staff to support an increased size of fleet, or increased scale of flying.

More importantly, however, we're looking at ensuring that the cost base of those new employees, or the cost of those new employees, is significantly lower than the existing costs, and that's why we're targeting structural change in the cost base of our cabin crew. We need to address the costs that we have there. The best way to address that is in relation to the pay and conditions of new cabin crew joining British Airways as we seek to expand the business in the future.

So I believe we can hold on to a lot of the cost reduction that we've achieved, but more importantly, I believe that we will significantly benefit from reducing unit costs as we start adding capacity to the operation. The fact that we've been able to bring down our unit costs at the same time as bringing down capacity I think demonstrates that it's structural rather than temporary, and that gives us quite a lot of confidence in terms of what we can do for the future.

Jarrod Castle - *UBS - Analyst*

Anything further on ancillary revenues in terms of some further initiatives, or how hard you think you can drive it now?

Willie Walsh - *British Airways - CEO*

We're really pleased with the progress that we've made, and we've been pleased with the response that we've seen to some of the new initiatives, such as the ability for our customers to book seats, or to book specific seats more than 24 hours in advance of travel. That's been really positive.

I believe, as Keith has demonstrated in the presentation, that we're only seeing the beginning of what can be an exciting revenue stream from our dynamic packaging on ba.com. That, again, is ahead of where we thought we would be, and I think we will benefit from the general economic upturn when it comes around in relation to that as well.

But it's clear to us that there is opportunity, and significant opportunity, for growth in ancillary revenues. I think we've got a new focus on it. We've made good progress with some of the recent initiatives. We've got no major -- no new major initiatives in train at this point, but we will keep under review options for further revenue streams, but we don't have any specific proposals at this point.

Douglas Mcneill - *Astaire Securities - Analyst*

Thanks. It's Douglas Mcneill from Astaire. Willie, you've been prominent in the industry's preparations for Copenhagen, and I just wonder whether you could talk a little bit about what you see as the best and worst case scenarios there. And, in particular, the European Commission seems to be pushing for the industry to be compelled to reduce its carbon footprint prior to 2020. Do you think that's a realistic possibility, or is that going to be something that the Americans simply rule out of court?

Willie Walsh - *British Airways - CEO*

I don't believe it is a realistic possibility in that timescale. I think going beyond that timescale, I do believe it is realistic to see absolute reductions in CO2. I've become increasingly optimistic about bio-fuels as a credible alternative to kerosene. The work that's been done on the certification of bio-fuels for aviation has advanced much faster than I thought.

Second generation bio-fuels from sources such as jatropha, camelina, ultimately from algae, I think represent a real opportunity for the industry.

Our best and desired outcome from Copenhagen would be what we call a global sectoral approach for aviation, and this would, in effect, if you could think of aviation being considered as a country, so rather than splitting aviation and distributing the CO2 across the countries around the globe, consider aviation as a sector in itself, setting targets for that aviation sector, including aviation in an open emissions trading scheme. IATA has made proposals that I believe are very credible, initially targeting fuel and carbon efficiency between now and 2020 of 1.5% improvement per annum, followed by carbon neutral growth from 2050, with a 2050 target of a 50% reduction in net CO2 emissions.

So there is a lot that can be done, it's clear that governments have woken up to the benefit of single European skies, and the significant reduction in fuel burn and CO2 that we would get from that.

So I remain optimistic. I think Copenhagen does represent an opportunity, and I think we've done good work as an industry in the past year to demonstrate that we're capable of facing up to this challenge. We clearly need governments now to understand that there is a solution for aviation, that there is a real solution; that the targets that we've identified are credible.

And I think once you get aviation on the road, on the path that we've identified, I think our performance can be improved beyond those targets, particularly in relation to bio-fuel. I think there's real scope for increasing the industry's targets in relation to the use of bio-fuel. And so, as I said, I'm optimistic that we can get a sensible solution at Copenhagen.

Martin Broughton - *British Airways - Chairman*

A question down at the front.

Edward Stanford - *Cazenove - Analyst*

Good morning. It's Edward Stanford from Cazenove; two questions. You mentioned in the presentation about the structural change in Short Haul Premium. At what point do you decide no longer to provide it?

And secondly, a very technical question in the note on the pension costs. You talk about an unrecognized net actuarial loss has increased by GBP2.2 billion. Is that any relevance at all to the actuarial discussions you are having or entirely separate --?

Keith Williams - *British Airways - CFO*

The answer to the second one is it's entirely separate.

Willie Walsh - *British Airways - CEO*

In relation to Short Haul Premium, and we've analyzed this in some detail, and we believe that we can continue to justify a two class service at Heathrow for some considerable time. 10 years from now, I would expect that we'd still be operating a two class service at Heathrow. I think the nature of the change we've seen primarily relates to point-to-point Short Haul Premium, and I think that is structural.

We see where the Short Haul leg is part of a combined Short Haul/Long Haul journey that there's still demand for that product. We've got the infrastructure in place. The infrastructure is there for the Long Haul product. It's a variable cabin. I believe our crewing costs can be brought down so that we'll have a sustainable cost base in relation to the provision of the service.

So even with the most pessimistic outlook in relation to this, we still believe that this is a viable customer proposition for us, although it will be at a lower level. And, therefore, as Keith has pointed out, the revenue stream that we will get from that will reduce, and that's why we need to see a structural change.

In revenue terms, you could argue it's not a very -- it's not a large part of our revenue. The problem here is it falls to the bottom line, and given the small margins that the airline industry has typically generated, we see it as having such significant impact that we need to address our costs and deliver a structural change to our cost base to reflect this behavior, which is, I genuinely believe, structural change in consumer behavior.

So in short, the answer is, I think Heathrow will continue to have a two class product in Short Haul. Gatwick, I think, is a different challenge. I still am not convinced that we can continue to provide it at Gatwick. because I think the demand at Gatwick is very different to the demand at Heathrow. We don't get as much transfer from Short Haul to Long Haul at Gatwick, so I think it's probably a question of time, and sooner rather than later that we would address the issue of potentially moving to a single cabin configuration for our Short Haul operation at Gatwick.

Jonathan Wober - *Societe Generale - Analyst*

Thank you. It's Jonathan Wober from Societe Generale. First of all, on the North Atlantic joint venture, even if you get approval, how much of a concern is it that the American pilots are against it?

Second question, please. Can you give us the split on Q2 passenger yield; the usual price mix effect split? And just to come back on the pension, just to clarify the timing of the actuarial valuation, when will that be completed and announced?

Willie Walsh - *British Airways - CEO*

I'm not particularly concerned. Maybe if it was Gerard Arpey sitting here, he might give you a different answer to that. But I think it's important to point that it appears to be only the pilots in America that are opposed to this joint business. The other employee groups in America have come out in support of it, and BALPA, I think, here has been quite strong in its support of the joint business proposal. So I'm personally not concerned about the position articulated by the -- I think, the Allied Pilots Association.

Keith Williams - *British Airways - CFO*

Related to your two questions; on pensions, we had started negotiation with the Trustees. As I said earlier is that from my side, I'd like to complete those sooner rather than later, but I am dependent on the other side to the negotiation, if you like, their willingness to conclude discussions as well.

Both of us see the timeframe ahead and, as I say, by virtue of the statute, we need to complete discussions by June 30 next year, and we see a staged process where we agree a deficit with the Trustees, and then we will need to talk to the membership of the schemes as to what it means for them before concluding on a final pension settlement, probably in the spring next year.

Jonathan Wober - *Societe Generale - Analyst*

But will there will an announcement of the deficit?

Keith Williams - *British Airways - CFO*

There will be an announcement of the deficit as soon as we know it, which will be before June next year, clearly. We'll announce the deficit, and then we'll go into discussion with the membership as to how we react to that deficit.

And in relation to your question on yield, we didn't include it this time round. I thought it was much more important to give you a flavor of what was happening over the yields over the six months. But in rough terms is price and mix together, we're about 21%/22% negative, and exchange is about 8% positive.

Andrew Lobbenberg - *RBS - Analyst*

Hi, it's Andrew Lobbenberg from RBS. On the cabin crew dispute, and I appreciate it's a delicate situation, how soon do you feel that you'll start losing revenue from consumers booking away from you, and what steps can you take to try and protect yourself from that?

A second question around Gatwick; how is your strategic thinking developing on that? You already alluded to changing the product, but how does that play out in the context of new owners of Gatwick and, indeed, potential Midland options?

And just a third question, how long are you going to soldier on with OpenSkies?

Willie Walsh - *British Airways - CEO*

In relation to cabin crew, we're not seeing any evidence of impact at this point. And I think it's important to point out that the trade Union has not yet formally served us with notice of their intention to commence the ballot, and that's the first step that's required.

So I know there's been a lot of comment in the press, but we've still not seen formal notice of the intention to start the ballot, so there's still quite a long way to go in relation to this.

The point I would make is that, when I met with the joint general secretaries, they asked me to consider some -- proposal's probably too strong a word, but some ideas, suggestions. I have written to them responding to that approach, I believe in a positive way, and I'm waiting for them to respond.

So it's clear that we've got to make changes. Our cabin crew, I think, do a fantastic job, and what we've tried to do is to introduce changes that do not have a direct impact on their terms and conditions, or their pay. We clearly want to address that for the future, and that's why we've talked about different contracts for new cabin crew joining the business when we do start to recruit again.

I believe the changes that we've bring -- that we are bringing into effect from November 16 are very fair and are very reasonable, and I would encourage the Trade Union to get back into discussions with us.

Crew know that changes are required, it's true that the Trade Union did offer some changes. The scale of the savings fell well below what they valued them at, and significantly below the changes, the value that we believe is necessary for the future viability of the business.

So it's recognized that things have to change. It's recognized that our cost base is not sustainable. We just now need to get together and agree a sensible way forward, and I believe we can do that. But I need to make it absolutely clear that the changes that we've announced will come into effect on November 16, and we are available to enter into further dialog with the Trade Union, and I would hope that that would happen.

On Gatwick, I still see Gatwick as an opportunity for us, and we've had some early discussions with the new owners of Gatwick. We believe we can work with them. They're very clear that they want British Airways to continue to have a significant presence at Gatwick, and we see the change of ownership as being an opportunity.

And it's not to be interpreted as criticism of BAA's ownership or running of Gatwick, but I think Gatwick will benefit from more focused ownership and more focused management.

So we're absolutely committed to a Long Haul and Short Haul operation at Gatwick, and we see further opportunity for us to improve the performance of our business.

In relation to OpenSkies, the promise of OpenSkies has improved very significantly in recent months. We're seeing very healthy load factors, and they've also been able to deliver good yields as well. So the operation, while behind business plan, but then so are we, is performing very strongly, and has performed very strongly in the last few months. And in fact, I'm more optimistic about OpenSkies today based on its performance over the last three months to four months and what we see in terms its future booking profile than I would have been six months ago.

Martin Broughton - *British Airways - Chairman*

Okay. I'm going to take two more questions down here.

Samantha Gleave - *Bank of America Merrill Lynch - Analyst*

Samantha Gleave, Bank of America Merrill Lynch. Just one question; maybe we can come back to the October traffic data. Although we did see an improvement in Premium cross traffic, can you just give us a bit more color on which parts of the network are improving versus a couple of months ago? And maybe in particular some more color on just trends on the North Atlantic?

Willie Walsh - *British Airways - CEO*

It's right across the network, and as we've said, we don't split it out in terms of different parts of the network. But again, if you look at the IATA figures, you will see that the transatlantic Premium traffic has continued to perform better than average, and that would be true of what we've seen as well.

So the Long Haul Premium performance, I wouldn't isolate any part of it or highlight any part of it. It's been a general improvement there in relation to the Long Haul Premium. I have to point out though we are cycling against the weak base from last year.

Short Haul is the very same. Again, it's down right across the network; slightly more on the nearer Short Haul destinations, so as we've seen -- and that pattern has been true over the last two years, certainly over the last 18 months. So places like Paris and Brussels have declined at a faster pace than more distant Short Haul destinations.

But no change in behavior; no change in pattern on either Long Haul or Short Haul. No unusual behavior; no stars, no duds, it's just a general position right across the network.

Tim Marshall - *Redburn Partners - Analyst*

Tim Marshall from Redburn Partners. Your delay of the A380, can you just give us some idea as to what the financial implications were of that in terms of did it cost you anything to put in those deferrals?

Secondly, you said you've been into the funding market for aircraft. Can you give us some idea as to how that's changed since the financial dislocation we've had?

And then finally just a minor point, but do you have a number for diluted number of shares in issue after the convertible?

Willie Walsh - *British Airways - CEO*

In relation to the A380, no, there was penalty associated with that. We've had very good dialog with Airbus. I think Airbus have responded very positively to our requests, and I think that demonstrates the strength of the relationship that we have with Airbus. So there's been no financial impact on us as a result of that change.

Keith Williams - *British Airways - CFO*

And if I could talk to the funding markets generally, what we see in the funding markets is, clearly, the banking market is much more restrictive today than it was two or three years ago. Certainly, one of the things we always refer to is that BA has done quite a few jumbo facilities, the latest one in 2007, and the number of participants in those facilities has fallen over time.

The geographical spread has moved, because it's moved more towards the Far East than the US and the UK, so there is still available funding today. The sources have moved. The markets are much, much tighter today. A lot of the aircraft financing that you see being done today is through export credit agencies and, clearly, that is a limited market.

In our own case is that we rely on banking relationships that we've built up over the last 20 years. Willie was mentioning the A380. That is financed through the relationships that we've built up over that period, so as BA, we that we still have access through the facilities and through relationships that we've built up over that period.

Now I don't carry the number of shares in my head.

Martin Broughton - *British Airways - Chairman*

I think we're going to have to close there. I think as a conclusion, I'd just like to say, obviously, it's disappointing to announce a first half year loss for the first time, but I think we can take a lot of encouragement from the combination of the cost reduction, the unit cost reduction, at the same time as the improvements in the operating performance and the customer satisfaction levels.

So I think we are demonstrating that we can reduce cost and improve customer satisfaction at the same time. Thank you very much.

Willie Walsh - *British Airways - CEO*

Thank you.
