BRITISH AIRWAYS

FINANCIAL RESULTS

Friday, 13 May 2005

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Martin Broughton (Chairman): Good morning and welcome everyone. It is very satisfying to be able to report on a good set of results in my first year. Once again, our focus on tight cost control, coupled with stronger demand for our products, has produced better margins despite the spiralling fuel costs. This focus puts the airline back at the top of the airline league table for operating profit last year, and we intend to be there this year. This is no mean achievement in an industry that lost almost $5 billion and is forecast to lose another $5.5 billion this year, the fifth successive year of global losses.

After my introductory remarks, our Chief Financial Officer, John Rishton, will take you through the results in detail, and then our Chief Executive, Rod Eddington, will bring you up to date on our past and present business strategies. After that, we shall be happy to take your questions.

You are no doubt aware that this is Rod's final presentation to you before he steps down in September to return to his native Australia. I would like to acknowledge the huge contribution that Rod has made in restoring the fortunes of British Airways. He has led this company through the most difficult period in living memory and kept it on course despite an onslaught of crisis, which included foot and mouth, 9/11, global terrorism, economic downturn, war in Iraq and SARS. As Rod himself has said: "I have had lots of luck since I joined BA and all of it bad!".

During this period, some airlines went out of business, although not enough of them, and others survived by virtue of government handouts, loan guarantees, pension write-offs and the protective cushion of Chapter 11. British Airways took charge of its own destiny and came through as a result of bold, remedial strategies put in place by Rod and his management team, and delivered by a committed workforce at every level. I am extremely grateful to have had someone of Rod's calibre at the helm during this period. Willy Walsh, a much respected former CEO at Aer Lingus, will succeed Rod in September and he will continue with our business plan strategies as outlined to many of you at the Investor Day in March.

Looking at broader industry issues, little progress has been made on a new transatlantic Air Treaty between the EU and the US to replace the restrictive bilateral and international agreements negotiated by each member state. We still stand by our recommendation to the UK Government to reject the offer that was on the table last year.

That would have given the Americans everything they wanted – full access to the EU market at Heathrow – but allow them to keep the high walls around their home territory. Nothing new there I hear you say. Off limits were sensible foreign ownership rules, removal of the cabotage restrictions and the biased Fly America policy.

It is encouraging to note, however, that recently some US carriers are beginning to push for change. United Airlines CEO Glen Tilton recently complained that foreign ownership with limits would sideline US airlines as the so-called super carriers emerge. So some prospects. Fresh talks are now pending following the hiatus caused by the US presidential election, which we hope will lead to a truly barrier-free transatlantic market that can set the standard for open skies negotiations around the world.

In Europe we continue to lobby against state aid and I believe that our position is unequivocal. A decision about the rescue plan for Alitalia, which has already received €3 billion in aid of one kind or another, is imminent. We urge the European Transport Commissioner, Jacques Barrot, to maintain the rigorous policies of his predecessors but, I have to say, the omens are not good in the light of the commission's recent decision to approve a six-month multi-million pound government-backed loan to Cyprus Airways.

At home, we support the UK Government in its objective to include aviation in the EU Emissions Trading Scheme from 2008, or as soon as possible thereafter. We are very clear that tax on fuel is a nonsense and will not deliver the environmental improvements or reduce aviation's impact on the environment. In the meantime, we continue to reduce our own environmental impact, focusing on noise and emissions, which are particularly important if Heathrow airport is to secure its mixed mode operations ahead of a third runway. In the short term, this will help reduce congestion and delays but add costs to the business and frustrate our customers.

Come 2008, we are sure our customers will welcome the new Terminal Five, now more than 50 percent complete. It will allow us to offer a unique travel experience and, for the first time in our history, we shall have a single terminal operation. It is a catalyst for change in the business and will transform travel for millions of our customers.

Finally, the market outlook shows no real change, though revenue shows a slight increase on our last forecast mainly due to the latest fuel surcharges. Our fuel bill is expected to be some £400 million higher on the year just ended. The focus, as announced in our latest business plan, is on preparing for the move to Terminal Five in 2008, investing in our products for our customers, and continuing to drive simplification to deliver a competitive cost base. Now let me hand over to John Rishton to take you through the numbers.

John Rishton
Chief Financial Officer
[*presentation with slides*]

Headline numbers

Thank you, Chairman, and good morning. As usual, let us start with the headline numbers. Turnover in the quarter was £1.9 billion, up 1.9% compared with last year. This brought the full year turnover to £7.8 billion, up 3.3% compared with last year. Operating profit for the quarter was £40 million, up £8 million. This brings the full year operating profit to £540 million, a 33% improvement on last year. The operating margin in the quarter was 2.1% and for the full year 6.9%, after taking into account payment of the employee reward programme, which is worth around 0.6 points of margin in the full year. Pre-tax profits were £5 million in the quarter, down £40 million from last year, primarily due to reduced profits from associates following the sale of Qantas shares in September. In the full year, pre-tax profits of £415 million were up 80%, and the Board has again recommended that no dividend be paid.

Fuel increase more than offset by revenue and cost performance

The increase in operating profit of £135 million in the year has been driven by increased revenue, largely due to fuel surcharges and cost performance partially offset by increased fuel costs.

Results by geographical area

Profitability has improved across all geographical segments. In short haul, the result was a loss of £26 million, including a write-off of £16 million for the City Express 146s that we retired during the year. The Americas remains the most profitable area, contributing 64% of the profits, lower than previous years due to improvements in other areas.

Revenue up …. slightly

This slide shows turnover compared with the previous year. In the year just ended, turnover was up 3.3%, the first increase in three years.

Yields continue under pressure

Yields remain under pressure. In the year, passenger yields, which as you know exclude fuel surcharges, fell by 4.4%, the third year running that yields have fallen.

Quarter 4 yield analysis

Looking at the fourth quarter yield, it was down 3.7% compared with last year, if I exclude last year's one-off revenue releases of £35 million. Of this, price was negative 2.9%, mix plus 0.2 points and exchange negative 1%. Last year, releases were worth 2.1 points, bringing the reported number to a fall of 5.8%.

More seats filled

Traffic continued to improve with total RPKs up 4.7% in the year, premium was up 8% and non-premium up 4.2% on an ASK growth of 2.1%. As a consequence, full year passenger load increased by 1.8 points to a record 74.8%, the third year of seat factor improvement. In the quarter, the seat factor was also a record at 73%, up 2.2 points on last year.

Quarter 4 costs

Turning now to costs, in the quarter capacity in terms of ATKs rose 1.6%, net costs fell 1.9% and unit costs improved by 3.5%. In total, net operating costs fell by 1.9% or £32 million. Employee costs rose by 2.2% or £13 million, reflecting the cost of the employee reward programme of £45 million, which is all taken in the fourth quarter, and pay award increases partially offset by manpower reductions. Fuel costs were up 18% or £41 million, reflecting the price rises partially offset by hedging benefits and exchange. Engineering costs were up 11.2%, reflecting the phasing of engine maintenance and the costs for an additional cargo freighter introduced in September 2004. Handling costs rose by nearly 6% for numerous causes, including volume and specification changes to catering. Other costs improved 29% mainly due to increases in other revenue, in particular passenger and cargo fuel surcharges. In addition, aircraft lease costs fell by 42 % or £18 million, due mainly to the non-repetition of the onerous lease costs incurred last year following the disposal of the ATP fleet. Depreciation costs, however, increased by £16 million reflecting the write-off of the City Express 146 fleet which, as I said, will be retired during this year.

Quarter 4 net costs down 1.9%

This slide shows net cost performance in blue and unit cost performance in red over the last two years compared with the prior year period. As you can see, we have made good progress reducing total and unit costs. The slide shows that costs have fallen in seven of the last eight quarters, despite rising fuel prices. In fact, unit costs have been falling for 11 out of the last 12 quarters. Let us take a closer look at fuel costs.

This slide shows the cost of jet fuel for the last two years. As you know, prices have risen sharply, up 89% between December 2003 and March 2005. The orange line shows the latest spot price and forward curve, and the green line shows the position at Investor Day. As you can see, not only is the current price higher but the forward curve has shifted up significantly since Investor Day. Consequently, I now think that our fuel costs will be up £400 million in the year to March 2006 rather than the £300 million I estimated at Investor Day.

Fuel hedging position

Our hedging position has continued to increase. We now have an average of 60% cover in this financial year with prices capped at $40 a barrel. In the year ending March 2007, we had 20% cover.

Capex and disposals

Turning now to capital expenditure and disposals, we have for the third year running managed to sell more than we have bought. This year total capex was £326 million. Disposals during the year amounted to £484 million, including the sale of Qantas. Next year, capex will again be less than £400 million – I should say this year now we have started it.

Cashflow before borrowings

Over the last three years, we have driven strong, positive cash flow of £3 billion, unlike the previous eight years when we had £3.2 billion outflow. In the year just ended, cash flow before borrowings was £1.2 billion. Cash of £1.7 billion is up £12 million on last year.

Liquidity remains strong

Total liquidity is strong at £1.9 billion, including £200 million of committed facilities.

Early debt repayment

In the quarter, in addition to £227 million of scheduled debt repayment, we have made a further £253 million of early repayments. Total repayments in the year were nearly £1.3 billion, including £729 million of early repayments, and we shall continue with early debt repayments this year.

Debt repayments fall

As a consequence, our future debt repayment profile continues to improve both in shape and amount. As you can see, for the next six years, our debt repayments average about £460 million per annum, less than half the amount we have repaid in each of the last two years. In fact, we have repaid more debt in the last two years than we have scheduled to repay in the next four and a half years. So we have reduced our capex, we continue to make disposals, we have driven up our operating cash flow and use the cash generated to make scheduled and early debt repayments.

Net debt £3.7bn lower

As a consequence, our net debt has fallen by £3.7 billion in 39 months. It now stands at £2.9 billion and it will continue to fall.

Gearing down 21.4 points

As debt has fallen, our gearing has also improved. The slide shows gearing including the impact of capitalising operating leases. As you can see, gearing has improved by 21.4 points from the 2002 position and by 10.2 points in the last year.

Pensions – FRS 17

Of course, as we adopt International Accounting Standards, the gearing ratio will reflect the pension deficit that you are all aware of and, consequently, will not be directly comparable. While talking about pensions, the deficit according to FRS 17 valuation methods deteriorated by around £200 million in the year to £1.4 billion net of deferred tax. The deterioration is largely driven by falling long-term interest rates.

Financial year 2005/06 outlook

Looking forward, I now believe that turnover will be up 4-5% rather than the 3-4% I forecasted on Investor Day, which reflects the further fuel surcharges announced in late March. I also believe that fuel costs will be up some £400 million rather than the £300 million due to higher prices, both spot and forward. With the exception of fuel, we expect that all other costs will be about flat versus the year just finished.

In summary

These are good results in a difficult year.

Operating profits were up £135 million to £540 million despite fuel cost pressures and a decline in yield. The operating margin is up 1.5 points to 6.9% after taking into account the Employee Reward Scheme. Net and unit costs continue to fall. We are strongly cash flow positive, and our net debt of £2.9 billion is the lowest level since 1993. Thank you. Now over to Rod.

Rod Eddington
Chief Executive

Thanks, John, thanks, Chairman, and good morning everyone. Those of you who were with us at Investor Day in March will remember my "Worst to First – First to Worst" presentation. It summarised the operating profit turnaround of our company over the last five years and, importantly, the lessons that we have learned. Today, I shall reflect on the world events that have impacted our industry in the last five years. I shall also reflect on how the British Airways management team has delivered transformational change throughout the airline on our journey to safer ground. I review the past only because it gives us a clear steer as to what we must do and must not do to secure our future.

Revenue history

Let us start with the review of revenue and world and industry events. The revenue picture is one that is familiar to you. Revenue over the last five years has fallen by 16%, which includes the 3% recovery that John has already spoken about today.

The World 2001-2005

Now let us look at the world events that sit behind a bleak revenue picture. These world events will be familiar to all of you. The extremely difficult revenue environment for airlines began in 2000 with the collapse of the dot.com boom. The NASDAQ fell from over 5000 in March 2000 to 1100 in October 2002. In Britain, we had foot and mouth, the terrorist attacks in the World Trade Centre in 2001, the war in Afghanistan and then in early 2003 the global SARS epidemic, which particularly affected our Far East services and our most rapidly growing market.

The Iraq situation had a protracted effect on the industry and the threat of war continued for quite some time before the conflict actually broke. The FTSE hit a low of 3300 in March 2003 where it had been eight years before, and had traded as high as 6900 in 2000. Finally, no review would be complete without a mention of the pension challenge. It is a UK plc issue and not just a British Airways issue, and has pushed up our employee costs.

The industry 2004-2005

Some interesting thoughts on some of the industry challenges. Prior to 9/11, the entire no frills sector in Europe operated less than 75 aircraft. In 2005, the top three in Europe – and remember there are over 50 – operate some 250 aircraft and the rest of the no frills fleet in Europe operates around 100 aeroplanes. State aid and Chapter 11, as our

Chairman has already mentioned, has had a big impact on the North Atlantic where the US carriers continue to drive their businesses for cash.

Fuel Price 2001-2005

Now to fuel. Highly volatile and rising jet fuel prices have been a major feature for the last five years. There will always be many opinions about what will happen to fuel going forward. One thing, however, is clear: fuel costs three times as much today as it did in 2001. In 2001 the fuel to fly a single seat from London to New York on a 747 cost about $50; today it is more than $150.

Net Costs

Net costs – another familiar picture. Our net costs have fallen 20% in the last five years. Unit costs have fallen by almost 11% despite what has happened on the fuel front.

Drive for simplification

Now let us look at some of the five-year highlights of how the management team has changed the airline. This is not about the old BA with better ratios – it is about a different BA. Simplifying our business has been at the heart of everything we do. I have said many times before that complexity kills. Consistently to deliver a complex product well is very difficult. The cost of failure is high. Let us look at what we have done.

Assets 2001-2005

Delivering investment returns for our shareholders requires not only that we achieve a 10% operating margin but also that our assets are employed productively. In the last five years, we have reduced assets by some £2.4 billion or 25%. Much of this was driven by disposal of non-core and under-performing assets. Five years ago, we had investments in WNS, *go*, Air Liberté, Concorde Travel in Australia, Speedwing Consulting, Accoladia, Speedwing Mobile, Deutsche BA, Qantas and Basis. Today they are gone and the disposal proceeds totalled £2 billion. Aircraft utilisation has improved by 18% over the last three years. Capacity is now some 14% lower than at its peak, despite aircraft numbers being down by 21%.

Manpower 2001-2005

Manpower: this slide speaks for itself. In five years, simplifying our business has enabled us to reduce our group manpower by 25% and increase productivity by 19%.

Customer Services

Despite the challenging times, we have continued to invest in the products that are all important to our customers. We completed the introduction of Club World beds and the

World Traveller Plus embodiment. We have totally renovated our New York JFK terminal and we have introduced new premium check-in facilities and lounges at Heathrow. We have modernised our short haul fleet with the introduction of 35 new Airbuses, and we are moving very much to customer-enabled BA.

CeBA 2005 – ba.com

In 2001 we had an ineffective website. This year ba.com attracted some 82 million visits for either booking or servicing, a good result when you think we only carried 40 million passengers a year. Our Executive Club members can do all of their transactions on line and currently they do so for 83% of their links with us. At 76%, we have the highest use of e-ticket of any network carrier outside the US. In 2001 just 3% of our bookings were made on ba.com; today ba.com accounts for some 20% of total bookings, the highest level of any legacy carrier. Online revenue has more than doubled in the last two years - ba.com is a hit with our customers.

Ba.com is at the heart of the customer service proposition. The Manage My Booking facility, which puts customers in control of their bookings, has won a number of awards for innovation. Customers using ba.com arrive at the airport fit for travel and spend less time completing processes there. We have a similar programme running inside the company and, as you know, we call it our employee self-service programme, and 97% of our staff use it, including me. ba.com was key to reducing travel agency payments.

Distribution costs

Distribution costs as a percentage of revenue have fallen from 14.5% to 7.5%. Distribution costs in total have fallen by 57% during the last five years.

Shorthaul 2001-2005

The short haul business looks very different today: eight businesses have been reduced to three. Gone are names like *go*, Air Liberté, Deutsche BA, CityFlyer Express, EOG, BAR and Brymon. Today the business is focused on Heathrow, Gatwick and BA City Express in the UK regions. Sixty percent of our short haul non-premium point-to-point business is now dealt on line. Most of the rest goes through the trade at zero commissions and reduced GDSVs. The short haul fleet has been reduced from 234 to 179 aircraft and capacity is some 25% lower than at its peak and, despite intense competition from the no frills airlines, short haul is at virtual break even today.

The Bottom Line 2001-2005

Let us look at the bottom line. The theme of simplification has driven real changes through our business. Our customers like it and shareholders benefit as we make our business more efficient and we improve our margins. Our balance sheet and our assets have improved dramatically in these difficult times, as John has said.

We delivered 2001-2005

Our debt is down 55% from the £6.6 billion at the peak to £2.9 billion. Early debt repayment of some £1.3 billion of debt means that our annual repayment schedule is some 20% lower. Our borrowing margin, a measure of how the debt market rates us, traded at 900 post 9/11; this year it has traded as low as 95.

The road to 10% margin

Our margin of 6.9% is the best since 1997 and is an important milestone on the road to 10%.

The Way Forward

The company is clear about the way forward for BA. The business plan for the next two years sets the direction to continue the journey to 10%. It is a natural extension of all that we have done over the last five years. The key elements of the business plan were put together by the senior mangement team and the Board working together under Martin Broughton. It is a company-wide agenda, and the management team is very clear about what needs to be done. They have an excellent track record of delivery. I am confident that Terminal Five at Heathrow will be a success for our customers, our staff and our shareholders. To maintain our brand and reputation, we shall continue to invest in our people and our products. For example, work on the next generation of Club World beds is well under way, and you will hear more about it and the other new products later in the year.

We continue to have significant opportunities to simplify our business, work smarter and improve our cost base. I well remember the doubts that many had about Future Size and Shape and we have delivered. The external spend and the customer-enabled BA targets have also been delivered. We shall deliver our £300 million employee cost saving as well.

Lessons

At Investor Day, I left you with these thoughts. I am doing the same today. We are all clear about the way forward. We now look for profitable growth only and in line with what the market can take. We now look for every opportunity to simplify our business and we now have a strong internal control system in place. We are much less fragmented and we are retaining our relentless focus on costs. That is what we have done and that is what we will continue to do, because that will enable us to continue our journey to a leaner, fitter and more profitable business. Thank you and back to our Chairman.

Martin Broughton: Thank you, Rod. Just before we open for questions, it is worth reflecting a moment. Rod has taken you through the hard numbers, so to speak, and what has happened over the last few years, where we are today and where we are going. What perhaps does not come through in that is what in my mind may well be Rod's most important and lasting legacy to BA which is cultural change. Cultural change is always frustratingly slow to achieve for impatient executives and it takes a long time, but the cultural change that is, and has been, occurring in BA over the last few years is very significant. The recognition around the airline for a 10% margin, the need for it and the understanding of the need for it, and the interest in how it can be achieved and what can be done to achieve it is something which people looking at BA five years ago when Rod joined would not have really believed possible. As ever, there is still a long way to go on that journey. It is not as though everybody in the airline is focused on that but the cultural change that has been introduced will be perhaps Rod's greatest legacy to us. We would now like to open up for questions.

Question & Answer Session

Chris Avery (JP Morgan): Rod, can I pick up on a theme you started going back to Australia. Can we look at the kangaroo routes for a moment? What will go on? We have not seen a fantastic improvement on what should be a premier long haul route, so can you talk a little about that? Secondly, about the extent of Indian liberalisation: what does that mean? That was a high yield market, there has been a very great opening up in capacity, so is the decline in yield going to offset the volume? Finally, on short haul the 146 is going and presumably the regional jets are staying. Does that mean that City Express literally keeps getting smaller?

Rod Eddington: Thanks, Chris. Let me start with the kangaroo route. The kangaroo route is the most competitive route in global aviation. If you walk into a travel agent in Sydney or in London and say you want to fly to the other side of the world, they will give you a choice of 20 carriers, not just Qantas, British Airways and Virgin, all of whom are end-to-end carriers, but Singapore, Cathay, Malaysian, Thai, Emirates, Gulf, even United via the west coast of the United States – it takes a little longer but they are in the market as well – and the list goes on. It is the most competitive route that we fly and, fortunately for us, we have a good relationship on a commercial basis with Qantas and we work well with them. However,the fact that the Indians have now opened up the bilateral and the governments have been able to negotiate an additional bilateral I believe provides us with considerable opportunities. Much of that business that goes one-stop would prefer to go non-stop and it will go non-stop. As you know, we are bringing Bangalore on line in October, we are putting more capacity into Chenai and, importantly too, we are able to put more capacity into Bombay where we will go double daily, and we will go double daily to Delhi as well. This is a really important market for us and it will stay that way, and we finally have the opportunity to grow.

Shorthaul – BA City Express. The BA City Express team continue to work hard to improve the fundamentals of their business. They have done an extremely good job and the work they have done to reduce their unit costs and make their business competitive is something that is recognised across our business. However, you and I know that the short haul market is ferociously competitive and yields continue to decline. They have a simpler business, they have a simpler fleet and they are making good progress. Of course, their numbers are captured in the broad short haul numbers.

Chris Avery: Where will the planes come from for the extra India services?

Rod Eddington: We will do a couple of things. Remember, we have pulled out of both Riyadh and Jeddah, the Saudi routes, which is because the market fell away due to security concerns from customers, and those aeroplanes will be redeployed to India. We have also now begun the dusking of our 767 fleet. I believe that three of our 767s now have the flatbeds in Business and World Traveller Plus, it is a very nice config and our customers love it. The 767s were the last part of our fleet to be dusked and the difference between the Business class product particularly on them and our 777s and 747-400s was substantial. We have 21 767s, half of them currently operating on long haul and half them on short haul. We will dusk the long haul 767s first and then we will take four of the short haul aeroplanes and dusk them, and I would not be surprised if we dusk some more, which will give us some long haul growth.

Chris Reid (CSFB): Talking about the future a little, what is your view about working practices? Although things have gone extremely well, that has not been a huge function of working practice change has it. Do you think that this is something that you should be able to tackle going forward? Secondly, on the market outlook what are you assuming in terms of GDP growth in the economic environment whenever you give the 4-5% revenue guidance?

Rod Eddington: We have made substantial changes to working practices in the last five years – substantial changes – and we have also made substantial changes to the way we do things but that journey is not finished, and I would argue that it never is finished for British Airways or for anybody else. So we are very focused on areas in our business where further changes to working practices are required, and we shall deliver them as it is an essential part of the journey. As the Chairman said earlier, one of the things about creating a much stronger business awareness inside our company, which, as he said, although it is much better it is not 100% uniform but we are working very hard to ensure that it is, is to remind people that job security does not come from me as the Chief Executive or from Martin as Chairman of the Board. It comes from working in a profitable business and doing your part of that business efficiently, and there are ongoing discussions.

As to the market, to be frank your guess is as good as mine but the sum set of it is that we have given our best guidance on revenue for the year at 4% or 5% to this year, and that includes the fuel surcharge. You and I know that there are some brittle numbers coming out of the high street but they have been with us for a while and, despite that, our load factors are at an all time high across all cabins. It is not just in the premium cabins that we are seeing strong demand for our products; it is in the economy class cabin as well.

We are going to continue to invest substantially in our products and, as I said in my set piece, Martin George and his team are doing some terrific work on what the next generation in flatbeds in Business should look like, and we will be talking about that later in the year. However, that is not the only product innovation that we are working on at the moment. Therefore, we will continue to invest in our products and the improved business performance allows us to do this. The external market may be fragile but I cannot believe that it will be any more fragile than it has been over the last five years.

Andrew Light (Citigroup): I have a couple of questions. First, on premium traffic, you have seen very strong growth in the last four months. How sustainable do you see that, what would be a realistic rate for the current year, and on what routes is that taking place? Are you picking up market share, or is this a market trend? Secondly, on Asia you say Australia is profitable and yet Asia as a whole is loss-making. We also heard from Lufthansa a couple of days ago that Asia is not particularly profitable. Where are the losses being made on those routes and would you say it is a little like Europe, almost an inherently unprofitable region?

Rod Eddington: Premium products across the board are doing well. On the long haul, not just Club World but World Traveller Plus which we do not capture in our premium market numbers, we capture it in our non-premium, World Traveller Plus is doing extremely well and the profitability of that cabin is very important to us. One naturally tends to think sometimes of British Airways in profitability terms as a Club World game but it is a broader game than that.

As far as short haul, we have seen over a three or four-year period a 50% reduction in premium volumes at the front of the aeroplane, it has pretty much bottomed out, and we are beginning to see some encouraging signs at the front of the aeroplane. However, we take nothing for granted, we know how competitive the short haul business is. We have seen some good market share gains across our premium cabins, which is true in all of our major markets. It is true on the North Atlantic and it is true of other parts of the world.

Our Asia numbers are a mixed bag, if you like, and they include some routes that do pretty well and some routes that have been a challenge. The Japanese economy has been soft, as we know, which has historically been a good marketplace for us. We do pretty well to Sydney particularly but Melbourne is more of a challenge for us to Australia, and so on across the patch. Asia is important to us and the important thing for me is the balance we have. One of the things about that breakdown slide that John showed you is that we are doing better on the North Atlantic but we are doing well to Africa, we are doing well to the

Middle East, we are doing well to India. Our Asian business is patchier but there are some positive signs there, and our short haul business is looking better and will continue to look better in my view. We said at 9/11 that if you looked at our profitability numbers, they were pretty much all based around the North Atlantic, we were a one-legged stool and that 9/11 knee-capped us. I believe that we have a much better balance across our business now, which is an essential part of our robustness going forward.

Andrew Light: As a supplementary on the premium traffic, is your capacity in premium growing at the same rate as the 3% overall rate, or is it growing at some faster rate?

Rod Eddington: There are a couple of issues around the premium capacity piece. The important thing is that by dusking out our 767s, we get the right sort of capacity into the right market and, without letting the cat out of the bag, it is an issue when we look at what the next generation of flatbeds in Business is going to be on board our aeroplanes.

Martin Broughton: If I may add a personal view on Asia, it is certainly not an inherently unprofitable region. We are working in what might be said to be an inherently unprofitable industry globally but it is not an inherently unprofitable region. With the opening up of the Shanghai route, we would expect to make losses on that route from the outset, because I still think that this is an attractive route to get in on and it will be an inherently profitable route as time goes by. Therefore, as Rod has said, it is an important region for us to be in.

Andrew Lobbenberg (ABN): I have two questions. If I understood your guidance correctly – no guarantee – I think you are guiding to a flat load factor for this coming year, but we have had quite a solid increase in the passenger load factor over the last three. Can you talk about what has given you the inclination to reckon that its peaked or do you think there is still more to go? Secondly, can I bring us onto the North Atlantic and ask you to discuss a little how you see the influences on trading there. We have very low capacity growth in the London market but you have Virgin rolling out their fancy product and we have Continental peppering the regions with ludicrous amounts of 757s, so how do you see that playing out on your business there?

Rod Eddington: On the trading piece on the North Atlantic, in capacity terms there has been an outbreak of common sense if you look at the market as a whole. There has been a lot of additional capacity thrown at the transatlantic over the last two years. We have seen double digit increases in total through the summer months. There has been a substantial increase in capacity but, despite that fact, we have continued to do well, which is driven primarily because our network on the North Atlantic is unparalleled not just in terms of the destination mix – 20-odd destinations to North America if you include Montreal, Vancouver and Toronto in Canada – but also we have put more frequencies into our key US destinations. Over the last two or three years, despite the challenges, we have put more frequency into the important destinations: into JFK, Newark, Chicago, Los Angeles. For me, that has been an important part of cementing our position as a leading carrier on the North Atlantic.

Yes, the Virgin product is a good one. Yes, Continental are using 757s into some of the smaller destinations in continental Europe out of Newark particularly where they have their global hub. However, the bottom line is that, if you look at the market as a whole and you look at what I see going forward, I see a much more rational approach to the business. If only the American government will stop throwing money at its carriers, the market might become more rational as well. Despite all of those realities over the last few years, our profitability has improved and the reason why we are determined not to rest on our laurels on the product front is because we know that reinvestment in the product through a sensible cycle is essential to our pre-eminent position in market share terms on many of these key routes, and we are determined that we will not lose it. I am getting old, I forgot your first question?

The load factors: 74.8% this year. My view is that its about as high as it gets when you run the sort of business that we run, and that 74.8% across the aeroplane has higher load factors down the back and lower load factors in the premium cabins, which is the norm in this business. On the North Atlantic we run pretty much 80%-plus year round down the back of the aeroplane. To be frank, what we are interested in doing as a business now, and we shall take some load factor opportunities if they appear but only if they appear in a profitable way, is to use our product mix and our space control vehicle to take every opportunity from traffic flows. How much point-to-point business do we take on routes? Let us take the North Atlantic: London-New York, Heathrow, how much business do we pull out of London and how much do we pull out of New York? How much business do we pull out of Dusseldorf on a transfer basis, how much business do we pull out of Newcastle, how much business do we pull out of Bombay to New York? What opportunities are there for us to adjust those mixes to improve our overall yield? It is a part art/part science game as we know but it is one we are pretty good at, and Drew Crawley who runs yield management/rev management for us and our world-wide sales team are very focused on how we can make the most out of the capacity that we have.

Andrew Lobbenberg: So this year will be a yield game rather than a load factor game?

Rod Eddington: It is always both, you can never take load factor for granted, but for a full service network carrier like us to run at a tad under 75%, you might get a bit of flex but you will not get much more in my view. However, it provides some very interesting opportunities.

Owen Gibbon (Cheuvreux): I have a couple of quick questions if I may please. In terms of ba.com bookings, how high can you go in terms of level, rough percentage, and currently what is the split between long haul and short haul bookings? On cargo, yields are down nearly 20% in three years, what is really driving that? Is it currency, price, stage length? In terms of the current surcharge on cargo, do you report that through the other revenue line and how much was it in the last year?

Rod Eddington: With regard to ba.com, as I said in my set piece 60% of the non-premium point-to-point business short haul is booked on line at the moment but only 20% of our business generally is booked on line. I think we are just getting started on ba.com, I honestly do. Now that we have a website that works and one that does not just allow our customers to book, but to change their seat, book a meal, input their APIS data for their flights and so on, the bottom line is that we are just beginning to make ba.com work long haul, and my view is that there are some real opportunities long haul.

We have used ba.com long haul for some time now, we started in the United States a couple of years ago when we started to run special promotions out of the States, and we tended to use the dot.com vehicle as the major distribution channel. So I think we are just getting started on ba.com and, when I look at what has happened to our distribution costs over the last five years which, as I said earlier, have gone from about 14.5% of revenue to about 7.5%, that says to me that there is still 7.5% to go and I am pretty clear that that journey must continue as well. Martin George and his team worldwide are very focused on that, distribution costs have come down and will continue to come down.

On cargo, the global cargo market is pretty tough too. Some of the yield reduction you have seen is currency related and our global cargo business is a good one, sensibly run with some real opportunity for us but it is a tough business. The fuel surcharge is in Other I think, John? [*agreed*] That is where the passenger fuel surcharge is as well.

Owen Gibbon: Could you give us an idea of the quantum of the surcharge? I could probably work it out by going to the website.

Rod Eddington: I think the answer is no, unless John or the Chairman overrides me.

Owen Gibbon: I shall have to do some work then! Finally, in terms of the desired level of gearing, you have done a fantastic job on paying down the debt, gearing is down to 48%. Given that you are not investing heavily at the moment, what would you regard as a proper level of gearing under UK GAAP accounting, and to what degree have the reductions in gearing been driven somewhat by forthcoming IFRS and the fact that you will shoot back up again, because we have to try to split out the two really?

Martin Broughton: As a key differential, we are going to have to stop thinking about the right level of gearing under UK GAAP, because henceforward we shall be reporting in IFRS. John, do you want to add anything?

John Rishton: One of the key points is the impact of International Accounting Standards and one of the main impacts in terms of our gearing, as I said in my presentation, will be taking the pension deficit onto the balance sheet, which is something that is real and cannot be ignored. As far as a gearing target, we have not set one. We continue to focus on driving more cash out of the business and driving the operating margin up. Clearly, our debt levels have fallen further and faster than most people would have expected. Certainly, three years ago no-one would have believed that we could be below £3 billion in such a short space of time, but we still have substantial debt on the balance sheet which we need to reduce, so the target is lower than it is today.

Martin Broughton: It was probably about three years ago when we set ourselves the target of £3 billion. At that time, there was no pension deficit, so we have hit the £3 billion but, in the meantime, we have a pension deficit of £1.4 billion.

Stephen Clapham (Williams de Broe): I have three issues which I wonder if you could talk about. The first is dividends and what will trigger a decision to pay even a nominal level of dividend? Secondly, can you talk a little about developments among your competitors in the Middle East, as there seems to be quite a lot of capacity coming in there? Thirdly, you vaguely alluded to the UK consumer but can you tell us have you seen any signs of trading down and, if you have not, does that surprise you and what do you think might be the trigger for it?

Martin Broughton: Let me take the dividend question. Part of our normal investor relations programme is to stay closely in touch with shareholders and understand shareholders' views on dividends as well as our own views. At the moment, it is fair to say that shareholders' views and our own views are entirely compatible, that we should continue to focus on the debt levels rather than pay a dividend. However, this is a question that stays permanently on the Board agenda. One additional factor which is coming into the equation now is the pension deficit and, when that comes onto the balance sheet in the current year, it eliminates the distributable reserves. You may recall that when the original plans to introduce IFRS were in train, there was concurrently a new Companies Act being proposed – that has been proposed for at least five years now – and one of the elements in the new Companies Act was to eliminate the need to have distributable reserves in order to make a dividend, recognising that it was an antiquated view and that cash was a more important element. That has not happened whereas the IFRS is becoming a reality. Therefore, in that context, one has to say that the prospect of a dividend in the current year is not looking good at this moment.

Rod Eddington: Do you want me to take the other two, Chairman? [*agreed*] Stephen, you asked about Middle East capacity. Yes, there is quite a lot of capacity coming onto the routes to the Middle East. Some of our competitors in that part of the world operate on an entirely commercial basis, some have no commercial agenda – some of them have a growth agenda with no commercial agenda, and I shall leave you to decide who sits in which camp.

In response to Chris's earlier question about the kangaroo route, one of the reasons why I believe the kangaroo route will remain the most competitive in the world is that much of the Middle East capacity that currently comes into the UK is not aimed at the UK to a point in the Middle East, because you could not fill a Bandeirante between the UK and those points in the Middle East. It is aimed primarily at the Australian route and the South Asian route and, in particular, the kangaroo route where that capacity is more effective in competitive terms because you cannot fly non-stop from London to Sydney. You have to go via a point, whether it is Bangkok or Singapore on us, or whether it is via Hong Kong on Cathay Pacific, whether it is via the Middle East on any one of a number of Middle East carriers. They are real competitors to South Asia as well but the premium market particularly does not want to go via a point in the Middle East on its way to Bangkok, Singapore or Hong Kong.

However, the Australian market is one where they have no competitive disadvantage in terms of the number of stops between here and Sydney or here and Melbourne. So much of that capacity is aimed at the kangaroo route and, while these airlines are effectively the arms of state policy, competing with them will bring with it its own set of challenges. We compete with subsidised carriers to other parts of the world and we shall continue to do so.

Your last question was about trading down. No, like everyone in this room we have watched with interest what is happening on the high street, and we have asked ourselves the question is this coming to a service station near us soon. There is no evidence that it is, perhaps because it has already taken place. Perhaps over the last four or five years we have already seen substantial trading down, and we have commented about that in this room before: many of you have found your own travel allocations have changed over the last four years. By and large, I believe it has already happened, Stephen, but that is not to say that we will not see more but we do not see any evidence of it right now, which is heartening I have to say. Again, it underlines the importance of making the right product decisions going forward.

Jonathan Wober (HSBC): I have a couple of questions. The first is a detailed one. You gave the full year hedging in the slides. Can you break that down by quarters if possible in terms of the amount and the Brent equivalent price? Secondly, referring back to the Chairman's comments at the beginning about the US/EU open skies and fresh talks, presumably from a BA perspective the opening up of Heathrow would be a negative but what are the positive elements that you would look to achieve? Access to the US domestic market – is that really such a good thing to have?

Martin Broughton: John, the first one was absolutely in your court.

John Rishton: I can break it down: in the first quarter it is 65% and in the second quarter 63%, in the third quarter 65% and the fourth quarter that is to March 2006, 56%, and the prices range from about $36 to over $40, if that is helpful.

Jonathan Wober: Are those prices similar through each quarter?

John Rishton: They vary, through the balance of this year it is between $36-40 and into the first quarter of next year it is about $47 but the average, as I said, is $40 for the year.

Martin Broughton: On the US, opening up Heathrow is a negative but only in the sense that we do not mind competition. If people want to come in and bid for slots, that is fine. The only opening up that would be truly negative is these other crackpot ideas that are around about confiscation of slots and things like that. Other than that, if people want to come in, we are happy to compete. The positive is much more of a macro issue. It is a domino effect leading the way on eliminating this regulatory constraint: the ending of bilaterals, the opening up of ownership rules, not making it important who owns what and enabling the commercial realities of markets to operate. If it works on EU/US in a truly barrier-free transatlantic market route, that just sets the scene for the rest of the world, and it gets the market to where the market inevitably has to get. So I see it as a very important element in the wider liberalisation which will be good for the aviation industry in the long term. Rod, I don't know if you have anything to add?

Rod Eddington: That is absolutely right, Chairman. It is part of a broader liberalisation agenda. The other point I would make is that some people look at what is happening in the US and say you would be crazy to try to buy one of the US majors, and there are plenty of points on the journey where that has always been true, and there are points where it has not been true. In the context of a consolidating global aviation world, there will, in the fullness of time – not in the next 12 months - be real opportunities, and they will not necessarily be for acquiring an entity in its entirety. It will be for acquiring assets or part of a route network or whatever – who knows how this game will play out. However, until the ownership and control provision is eliminated in the context of the current constraints, as the Chairman has said, you will not get a rational aviation industry.

Jonathan Wober: Just a quick follow-up on the consolidation theme, if the barriers were to come down, would it be Europe or North America where your focus would lie?

Rod Eddington: We trade globally, so we shall always look globally, just as a car company would, or a pharmaceuticals company would, or a computer software company would. Consolidating close to home must be the major priority but, in a world where the opportunities are global, I am sure the Board and the management team would look globally. The whole point about the Chairman's position and our position is that, when you deregulate a market, you are often surprised at where the opportunities come from, so do not try to prejudge that – take opportunities as they come. Do not do done deals. No deal is better than a bad deal, we all know that, but you often find opportunity in unlikely places.

Damien Horth **(UBS):** Can I just follow up on that, Rod? Can you see a scenario close to home where British Airways would acquire British Midland?

Rod Eddington: In this business you rule nothing in and nothing out. The Chairman would shoot me if I speculated on individual opportunities – I wouldn't last until September! Back to my earlier point, in a global world you take good opportunities to strengthen your own business wherever you can find them, and the whole point about removing ownership and control provisions is that you are not restricted to a small patch.

Martin Broughton: It need not be us. The industry becomes a better industry in which to operate if loss-makers are eliminated by the M&A process but it does not have to be us taking them over, it is just that the whole process is better for the industry.

Thank you very much for all of your questions. Before you go, we would like to show you our latest commercial which is airing for the first time on television tonight, and it focuses on ba.com. Thank you. [*advertisement shown*]

- *Ends* -