BRITISH AIRWAYS

INVESTOR DAY

Thursday, 9 March 2006

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[*Presentation with slides*]

[*NB: slide pack not provided to transcriber with tapes*]

INTRODUCTION
George Stinnes
Head of Investor Relations

Good morning everybody and welcome to our annual Investor Day. I am pleased to see there are just as many here as usual. I do not know whether it is the 10th or 15th annual but I know that we have been doing these things every year just about since privatisation.

Disclaimer

The first part is the boring bit, just the same as when you get on the aeroplane and you get the safety demonstration which you have seen 43 times before. That is the first safety briefing, the part about the disclaimers, and you have all read them so I will leave them there. [*fire drill*] We operate a non-smoking policy on the aeroplanes and at Waterside so for those of you in the break who do have the need, you can go outside in the courtyard and join the others out there with the same habit. As far as mobile phones, we have this debate every year as well. There is a glass up here for a contribution to our charity Dream Flight that sends children around the world who could not otherwise do so, and we would ask for a nice voluntary contribution for every mobile phone that goes off. The other problem is that it sometimes messes up some of the electronics.

Map

This is a little map of Waterside which is in your packs in case you get lost. In your packs there is also a feedback form. A good thing when you do feedback is to remember between speakers to fill in the sections. We will collect them at the end of the day, and there is a competition form but you have to answer some questions in order to be eligible.

Agenda

Looking at the agenda for a moment, that is the programme for the day and some of you have already seen it. Martin Broughton, our Chairman, will make a few remarks to begin with. Last year many of you went down to our engineering facility in Cardiff with us and Alan

McDonald promised at the time that he would give you another update and, indeed, you asked for another update. Therefore, that will be part two of his presentation of last year.

Martin George will take you through many of the exciting commercial changes for the business, followed by Drew Crawley who will address the all important part of what we are doing to maximise our revenues.

There will be a short coffee or Blackberry break, whatever you want to call it, followed by Keith Williams, who will take us through the financial outlook and a few other issues in the same format as last year. Then we will have an open Q&A forum for the best part of an hour where you can ask Willie anything you like. Whether he answers, of course, is entirely at his discretion. Finally, after lunch we will have a session on cargo and then we will give you a tour of the cargo area.

I have a couple of opening thoughts for you. Why does it say 10 years up there? I have been in this role for 10 years, a frighteningly long time, so I did what some of you do which is look at a bit of trivia. I looked at the business 10 years ago and I looked at the business today, and what is interesting is that British Airways 10 years ago had some £8.4 billion of revenue. If you look down at your models, you will find that most of you are at about £8.4 billion. If you look at the total costs 10 years ago, you will find they were about £7.7 billion. Surprise, surprise, if you look down at your models for this year, you will find the same number. Back in 1979 we had an operating profit – I have to check here as it was a long time ago – of £673 million. Look down at your models and you will find that with the usual airline accuracy you are within a few percent of that number today. Guess what the operating margin was? It was 8.1% and, again, I can suggest that your models will show you that nothing has changed.

However, much has changed in British Airways. If I start with some of the key headlines, back then we had just short of 310 aircraft; today we have 290 aircraft but those aircraft are flying 16% more, and we today have some 10% more RPKs and 6% more ASKs out of the same number of aircraft, which is really good news from an investor's point of view. We also have 20% fewer staff flying more passengers today.

If you look at the cost lines, it is also quite interesting. Give or take, most of the costs are about the same but no points for guessing which one is up – it is called fuel, and it is about £800 million more. Interestingly, we have offset that 100% in terms of around £800 million in our selling costs.

There are some other differences which it is quite important to point out. Our net debt in 1997 – does anyone want to shout out a best guess of what it was? Try £4 billion. Our net today is £2 billion, so we have a stronger business, flying more people, with fewer assets. It is interesting to see what else has halved from 1997 to today – the share price. My question there to you is are we wrong today or were we wrong then? Interesting.

Finally, there is a theme that runs through today's presentations and that is the Business Plan for 2006-2008. If you look at it, much of it will be familiar to you which will be very encouraging, because we have always said to you that restructuring a big company like this is a marathon and not a sprint. Competitive cost base is as critical to the business today as it has been. In particular, as we look at a deregulating industry and we see the growth of what I would call specialist airlines like low cost carriers in shorthaul, or the business only carriers in longhaul. Having the right cost base is critical to the future.

If you look at products, it is Service That Matters. It is very important that we continue to have world-beating products and, yes, we shall continue to invest in them, and that we make sure that our staff are trained to deliver those world-beating products. The last part that is even more important is that those are products that the customer is prepared to pay for. This is not a world of nice-to-haves any more, we all know that.

Then we have T5 or Fit for Five, which was on the agenda last year and do not be surprised if it is on the agenda next year. It is the airline's biggest opportunity and also our biggest challenge to get it right.

Finally a new theme: what do we mean by Fit for Growth? Over the last number of years, we have grown our business and our volumes very successfully within our existing assets, and we have made the commitment to you that we would not grow our business unless we created value doing so. Post 9/11 we were in 18 feet of water and drowning with an oxygen tank that fortunately had enough air in it to get our heads above water and we are now walking towards the beach. We are now in six inches of water and we can see the beach in front of us, 8% operating margin. Recognise two things in this business: there are hurricanes and they wash the sand away so that the beach goes further away on you. Also we all know that you can trip and fall in six inches of water and drown as well. We are very clear that our business is getting better, but we have to be mindful of the opportunities in the long term once we have a value-generating business. With that, I now ask Martin to start our day formally for us.

OPENING REMARKS
Martin Broughton
Chairman

Thank you, George, and let me add my welcome to everybody to today's Investor Day. I am sure you are all aware that during the year there have been some substantial changes to the Board, all three Executive Directors have changed and we have had a number of changes on the non-Executive front as well. Of the three new non-Execs, Baroness Symons and Chumpol NaLamlieng cannot be with us today but we have Ken Smart – can you just stand up please, Ken? Ken came from the Air Accident Investigations Branch which he was running for a long time, and he has also taken on the chairmanship of the Safety Committee. The other non-Executives with us today are Martin van den Berg, a senior independent Director whom you already know, and next to him Alison Reid, who is Chair of the Audit Committee.

Since the inaugural Investor Day for Willie, although he is no stranger now to any of you, he joined us last May and assumed full responsibility as Chief Executive from 1 October when Rod retired. I am pleased to say that that handover period has led to a seamless transition and Willie is already very much making his mark. He has re-energised our focus on costs, he is restructuring the management team and tackling the unprofitable parts of the business.

Alongside Willie, we have a new CFO Keith Williams. Keith was our former Group Treasurer, Head of Tax, and is known to all of you. He was one of the architects of the now legendary Future Size and Shape programme, and is well placed to succeed John Rishton who left us to join Ahold around Christmas. Keith will update you on the financial state of the business and the outlook. He will update you a little on the progress in tackling the yawning deficit on the pensions. We have spent a long time discussing that issue with staff, explaining the severity of it and the scale of the problem and its implications for our business. By the end of this month, we hope to be able to go back to staff and trade unions and the trustees with a shared solution.

To complete the new Executive line-up we have Martin George. Martin will be tackling the challenge of providing the Service That Matters that George just mentioned. That is not the only challenge since, as ever in this industry, there are plenty of them. We have the rising cost of fuel that George mentioned, the threat of a pandemic is there and, while we can not prepare for any eventuality, the extensive experience we have gained in recent years strengthens our ability to sustain external shocks.

Another challenge facing us is the possibility of an EU-US bilateral deal being concluded and approved by the EU Council this summer. It would be a mistake to do it because the EU has a much better offer on the table, the American Open Skies, but it is likely that the EU will ratify it. As it stands, there is nothing much in it for BA. To allow more US carriers to fly to Heathrow, it would give them unlimited freedom rights and it would give us no access to the US domestic market. The Transport Council will take into account the updated proposal, the rule-making that the US is doing, tinkering at the edges frankly, messing around with definitions of what is control and what is not control. The final form will be published either later this month or next month but it only tinkers at the edges, and I am sceptical that it has any real value for anybody. Interestingly, despite our scepticism, it is raising quite a few hackles in the US and it is part of the debate raging over there on the acquisition of strategic assets by foreign interests. It is really quite a disconcerting debate that is going on in the US at the moment.

Whatever cards we are dealt there, we have an ace in Terminal Five, which is a clear winner in terms of what it will offer the customer and the benefits it will bring to our business. The countdown shows we are now 752 days away from moving to Terminal Five, and by this time next year we will be seriously gearing up for Operation Readiness for Terminal Five. We are making a lot of progress on changes in working practice and you will hear more about that later on today.

Finally, I am encouraged by our overall financial performance. There is still much to be done, and George showed that perhaps it has not come very far in 10 years, but you all know what it has been through in those 10 years. When I think back to where we were just a few years ago, you have to accept that we have made great progress on the road to sustained profitability and achieving that 10%. I shall hand over now to Alan who will take you through the latest on the engineering situation.

ENGINEERING UPDATE
Alan McDonald
Engineering Director
[*Presentation with slides*]

Good morning. Last year, we took many of you down to Cardiff to have a look at one of our major maintenance bases, BAMC at Cardiff, and we showed you exactly what happened to a wide-bodied aircraft during its maintenance cycle. We maintain the aircraft on a pyramid basis, every aircraft gets a check on every turnaround. Every day it gets a check on some of the primary systems. Every week it gets a further inspection with more things done to it. Every 100 days or so it comes into the hangars and has several of its panels taken off and more inspections done. About every 18 months, it gets a real strip-out with new carpets, new bits and pieces inside, further inspection. Every five or six years, it gets completely overhauled. That is what aircraft maintenance is about. It is not the sexy side of the business but it is a very costly side of the business, and it is important that we do it effectively and efficiently. Over the last number of years, we have made some very big changes in engineering. We have moved further towards industry standard and we have had some significant reduction in both our property portfolio and our staff.

What have we achieved in real terms? We have reduced our staff by a third since 1997, most of it in the last four to five years. In becoming more efficient, we have been able to release more aircraft to the fleet to fly. In other words, we have been able to reduce the overall downtime that we take on our aircraft to enable our efficiency in terms of uptime on aircraft, the amount of flying and sectors that each aircraft can do, thereby upping the amount of ASKs we can do for the same asset base.

We have simplified our base locations. We used to maintain in several places round the country and abroad in times when our capacity was not sufficient. We have reduced our inventory by about 50%. These are big figures and how have we done this? I shall take you through some detail about the major changes that we have had. There will not be any exam at the end of this, this will not be a technical presentation, but we have a smaller, simplified fleet.

We used to have 11 aircraft types to maintain. Each type of aircraft needs a set of qualified people able to do that particular aircraft. There is a limit to how many aircraft types an engineer can be qualified on, so that was increasing the number of qualified staff we needed to have. We have newer, modern technology aircraft and many of the legacy aircraft have left our fleet. We have eliminated third party work by and large. We still do about £40 million worth of work for other airlines. It is not in the heavy maintenance arena, it is not in the parts of the business where we need a lot of manpower, but it is in the line maintenance arena, and we are the provider here at Heathrow for a lot of OneWorld and other carriers. It is reciprocal so that when we are in Australia, Qantas will do us. Therefore, in order to reduce our costs, we work together with our partners in OneWorld to try to have one operator working at one large station in order that we all gain the benefit from that.

We have spent a great deal of money on improving our facilities and, for those of you who went to Cardiff last year, that is probably our best example. It is a world-class facility, built to do the job efficiently. We have spent some money at Heathrow on certain facilities and at Glasgow to enable us to do this work more effectively.

We have improved our systems and two years ago I would not like to have stood up here to tell you about the introduction of SAP. I am sure that some of your businesses have used SAP. It is a fantastic system but it is an absolute nightmare to install. People like MFI who tried it saw what happened to their supply chain, and that is exactly what happened to us. Our supply chain really faltered as we put this system in. However, we are way past that now and are reaping the benefits of this integrated system.

We have also had to retrain our staff completely. The legislation change when we moved from the CAA to the JAA and then subsequently to EASA and the licensing regime in the industry went to a multi-skilled regime. Therefore, all of our qualified staff have had to be retrained to get them up to the latest qualifications required to do the job.

However, if we move from that into some of the detail, you can see what this really means. On the left-hand side here, you can see that the top figure is about 4.5 million man hours of work. What is a man hour of work? This is all the jobs that we have to do on the aircraft and they all have a time: a wheel change is about 40 minutes, an engine change is four men for about 12 hours. We add those up and at our peak right in the middle of 2001 we reached the total of 4.5 million man hours. The bits in yellow there were the modification programmes that happened to be going on just as we got to 9/11, and that was the introduction of our new Club World and the World Traveller introduction to IFE systems. That modification programme added quite a lot of work. However, as you can see by 2006, we are down to around 3 million man hours of work, that is the content of the work that we do. This change has been dramatic, partly because we have had some of the old aircraft disappear, particularly the last two at the bottom here: the RJ 100s which we put up to BA Connect and the ATRs which were old propeller aircraft and latterly Concorde. Concorde absorbed a huge amount of engineering time and spares to keep that aircraft flying, albeit we only had seven of them. As you can see, that dramatic drop coincided with 9/11 when in mainline at that point we had 288 aircraft, and about 80 in BA Connect. We are down now to

230 aircraft in mainline and 50 in BA Connect, making a total of 290, and all the aircraft that have left have been old legacy aircraft.

Why are some of these modern aircraft so different? It is a step change in technology which all of you see at home with your television. There will be many people in this room who have never had a television repair man in their house. I have been here for 40 years in British Airways and the television repair man was a regular feature in my house. In fact, I thought my mum was having a fling with him because he came so often! People rented televisions in those days. They did not rent for them for no reason at all but they did so because they were so unreliable that you were better off renting them than buying them and paying the repair bills. Most of the televisions you see at the council tip, if you ever go down there to drop your rubbish off, are probably in good working order but they are not flat screen or they are the wrong colour. They are not there because they are broken.

Our aircraft are no different and, if you look at these statistics, the engines on a 747-400, which are not the latest engines, have an average on-wing time, before we have to take them off the wing to do any overhaul maintenance, of 24,000 hours, they are on the wing for years. Concorde used to last 1,000 hours and the classic 747s that we had in 2001 used to sit there at about 14,000 hours, so we have nearly doubled the life on wing. If you look at the instrumentation system, the navigation systems, they are nearly ten-fold more reliable. These things are also on the aircraft for 20,000 or 30,000 hours.

The whole industry has gone to "on condition". We used to have to change them every so many months just to make sure that they did not break down too many times in service. They are now so reliable that we leave them there until they break down, and on the aircraft system we would have three of them in order that one could break down and we would still bring it home. We have seen a real magnitude change. Even the brake units - to you it would be your disk pads on your car – last that much longer. You can see the magnitude change there from a 747-200, which was not much different in weight to that of a 747-400, and it is lasting probably four times as long. The tyres even last twice as long. As we probably do not have many pilots in here, I truly believe that the auto-land helps do that as it lands much more smoothly than any of our pilots do.

Why is the operation simpler? It is six basic types. We fall within the band of being able to get all our licence engineers capable of doing all the aircraft. We have been able to reduce our hangar bays by nearly 50% down to 26 bays. These are big assets, they are not small hangars. For the modification programme on our aircraft, when they were that unreliable, we had teams of technical engineers in my department working tirelessly trying to get the components more and more reliable. The manufacturers have taken that on. The step change that the engine manufacturers and the avionics manufacturers have made has been incredible and it is down to digital technology, no moving parts. The vibrations, bangs and shakes that an aircraft gets in service no longer affect the electronic systems, and very shortly we shall be going to wireless systems, so the weight on the aircraft of all the wires will disappear as well. There are further advances to be made.

We have been able to reduce significantly our stores location because of the size of our inventory and the fact that we have been able to reduce these other areas. We only have 14 left, which means that not only do we no longer need those assets and buildings, but it has also meant a significant reduction in staff. This is what it means for Heathrow. These areas that have come out in red were engineering's hangars, an overview of the engineering base at Heathrow, and you can see that we have reduced it by about 50%. Most of the reductions I have talked about have happened here at Heathrow and Gatwick and we have not reduced some of our more efficient plants down in Wales or in Glasgow. Therefore, as we have had the opportunity to do so, we have moved more and more work as we have become more efficient to the low cost areas where we also have plants.

This area is now free and we have one more area to come out of just here where we have a training centre, and we shall be out of there by the end of the summer. That gives us the opportunity of about a 90-acre site here at Heathrow, which is quite a valuable site I would imagine.

As far as the modifications that we do, I have already told you about the technical modifications. We also used to move things around in the cabin from time to time. We would have an idea to move the magazine rack six inches in or five inches up, we were always tinkering with our stuff, and we decided a programme with the marketing department to say we will modify our aircraft once and then perhaps every 18 months, as in the motor industry, we will refresh it. However, we had to learn to stop tinkering all the time just because we could. Because we had enough engineers and facilities to do it, we used to do it, and when we got onto that programme just after 9/11 you can see the scale of the reduction that we made.

What does it mean in inventory terms? You can see here the number of stores that we had and you can see the reduction that we have come down to. It is not just the building, it is also the square footage because we rent by square footage in many places. We had several off-base stores. We would hold stuff for other companies in our stores when we did their maintenance without probably realising the true cost of it, and in getting out of it we found more and more ways of becoming efficient. Our major store area which is in Bedfont is virtually totally automated, and we have been able to halve the number of staff that it takes to run that store.

Moving to industry standards is a difficult one to explain. The way I like to think about it is when you buy a car, you probably look at the handbook for a second or two and you want to get started. However, in the glove compartment it will tell you when to maintain your car at what mileage, and what to do when you take it in. That was not the way that legacy aircraft operators worked. We had such a big technical department and, along with Lufthansa, Air France, American Airlines and the other legacy carriers, we would invent our own maintenance schedule. We would get it approved by the CAA because we liked to work on the aircraft as a series of components and we liked to try to get the best and the longest period of time out of each component. Therefore, our aircraft would come into the hangar and we would change bits and pieces all the time. It was the philosophy we had because we overhauled our own components and every department would be fighting to get the best possible life out of each component but we did not work it as a whole. Therefore, it is very important for us to use the manufacturer's planning document, and we found that they really know what they are talking about.

Gone are the days when they would produce an aircraft that had a delay rate for a technical reason at about 20%, because that is where we were with the Trident, a VC10 or 707. Engineering would be at 20% delays, so one in five departures would be delayed. We fly now at a far higher rate than that. The components have that same step change as your motor vehicles but it took quite a change within the industry, particularly within the big legacy carriers, to convince that these manufacturers really have a hold of this and they have. Therefore, we maintain the fleet now strictly in accordance with the manufacturer's recommendations, because all the new carriers that started up did not have any superior knowledge and that is how they started and we realised they were getting more … [*blip in recording*] with their aircraft.

The manufacturer's standards and techniques for doing repairs have been very important to us, because we have had and still have a large design organisation. We have so much technical expertise that, if there is damage to an aircraft, we could design the repair on it. The only thing is that, because we stopped scrapping aircraft and dismantling them at the end of their term, we started to get into leasing aircraft and moving them back to the lessors at the end of their term. They demanded that they were done as per the manufacturer's standard. Therefore, early on when some of our aircraft went back, we had to spend millions of pounds putting them back to standard and we have stopped doing that. We will only do standard, approved repairs by the manufacturer now. It is very difficult to convince your own department even though they had a safe repair, and the manufacturers would say we are very happy with the repair, we have no objection, but people want the aircraft to be maintained exactly as per the manufacturer. In the same way, when we buy a car, we want it serviced by an approved supplier and it has taken a while for this industry to catch up with this. We all work now on minimising the aircraft downtime and getting more flying time out of all the fleet all the time.

What about the workforce, because this has been quite a change for them? I explained a moment about the CAA requirements and now the EASA requirements, which require people to be multi-skilled. You cannot just be a mechanical engineer on the aircraft now, because there is such an integration on the systems that you need to know what the other parts of the aircraft are doing to be able to maintain it safely. Therefore, this massive training programme has gone on with all our licensed engineers. They have been exceptionally cooperative and we have had many battles with the engineers over the last 30-40 years, but in the last 10 years we have not had a dispute with the engineers. Our engineers have been very aware of what is happening in the industry, and they have been extremely cooperative in getting into lean manufacturing techniques and up-skilling themselves.

We have been able to change their working patterns to improve efficiency and the example is fly by day, fix by night. That meant that every engineer in British Airways Engineering at Heathrow who works on the shorthaul fleets – 757s, Airbuses, 767s, 737s – had to start doing night shift. We have quite a high age profile in engineering and people who had never worked nights in their lives who are in their late 50s/early 60s were put onto nights, not permanent nights but a rotating night shift. Every single one of them now does night shift and they did that willingly. It took some negotiation but we had no fights over it and we did not pay anything for it. They just realised that we would have two aircraft de-scheduled every day to maintain and we could do that at night and fly them.

Having modern, efficient hangars has also helped and those of you who went to BaMC can see that, because we have fewer types in engineering, we are able to dock them perfectly and get efficient pieces of equipment round them, rather than having Jack-of-all-trades equipment that has to fit several types of aircraft.

These are the facilities we are left with. Up on the top left there, British Airways Avionic Engineering, a wholly-owned subsidiary based in Wales, does all our avionics stuff, it does all our IFE stuff now, which has significantly reduce the cost of overhauling some of this. It is a fraction of the size that we used to have dotted around Heathrow and other areas, and it is now all concentrated in one area in Llantrisant in Wales. The British Airways Interior Engineering does all the overhaul of our seats now. Just bringing in the First Class seat overhaul alone saved us over £1.5 million a year. There are only 140 people there, a fantastic workforce working effectively and efficiently, doing all our requirements.

BAMG on the bottom left is our plant at Glasgow, which does all our narrow-bodied heavy maintenance now in two lines of work, just two narrow-bodied lines which are looking after 60 Airbuses and 30 737s. Occasionally, we might have to subcontract one out if we cannot get it fitted in but we are talking about three or four times a year maximum.

BADC is our distribution centre at Bedfont, which is our main central stores, virtually fully automated.

TBC is here at Heathrow and we have an on-wing support unit for the engines to strip them of components that we need prior to sending them off to our engine overhaul contractor GE in Wales.

BAMC down at Cardiff Airport is at world-class downtimes: 777s on their six-yearly check, 19 days is the best in the world by Singapore Technology, and we are at 20 days in Cardiff and are still pushing to get it down to 19 days. However, at Cardiff the last 41 aircraft have come out on time, which is far better than our competitors are doing.

BACE (British Airways Component Engineering) is at Hayes, where they do all the mechanical, hydraulic, electro-generation products, and it is a very efficient plant.

TBK/TBJ in the top middle is what is left at Heathrow plus two other small hangars, and they, too, have been cleared out and made much simpler.

What about our systems? We all remember the problems we had two years ago in the summer. Much of that was to do not just with staff shortages as made the headlines, but quite a lot of it was to do with our bringing in the SAP system. We have 150 legacy systems in engineering, half of which were probably designed by ourselves, real bespoke stuff, no industry standard solution. We decided to put in SAP and the good news is that it is nearly finished. We are 95% over the SAP introduction and they would never have brought me onto a stage a year ago to say this is a good system; it was a very difficult project. However, we are already in a position where we are on electronic data. This might sound old hat to you but in this industry it is manuals and people have to sign off and certify every single job they do, even if it is fitting a panel back, and they have been looking at paper manuals all the time. We are totally electronic now and people get updated as individual people when something changes, and they have to sign off that they have read it in order to make sure they are fully up to speed with the latest information.

We have all materials and workshop control done by SAP. SAP knows which component is on which aeroplane, how many hours it has flown, when it was last overhauled, who overhauled it, which parts they changed, how much it cost and how long it took. It knows that for every single component flying on British Airways now. Our previous data were held in all sorts of places and it has taken us four years to get these data right. One of the other reasons why we have been able to reduce our inventory is that we gained a real handle on what we had.

The design and technical documentation is all on SAP, all the staff's approvals are on SAP. Today as we stand here, more than 50% of our aircraft are being planned and controlled by SAP and we are moving them over at the rate of six a day. By June, all our aircraft will be flying with what is required on them in alignment with the manufacturer's planning document controlled in SAP, and a huge swathe of people I have manually doing this will disappear. Thus there will be further major headcount reductions in engineering because of the introduction of this system.

What has it done for performance? You all read the papers and the odd comment you see in *The Times* about how this must affect safety and performance. I can assure you that it does not. The green line here is our headcount coming down from 9,000 to 6,000 and, as you can see, we had the big push after 9/11 associated with getting rid of some of the classic aircraft: the 737-200s and 747-200s. You can see what happened to our performance as we put the supply chain cutover into SAP: we had a really bad period for a few months. What does performance here mean? The red line is the number of departures on the dot – not at three minutes, not at 15 minutes, but the ones that went on time to the second – and that is how we run engineering at about 96%. If you look at the 15-minute factor for engineering, we are up at 99%, we are right up there in the top of world carriers. This was a real shock for us and it has taken us a while to recover but that is what has happened in the delays and departures cancellations. Did it affect performance by the headcount coming down? No.

Let us have a look at the other factors. An acceptable deferred defect: surely we do not fly with something wrong with the aeroplane? Of course we do. An oven might be out, one avionic system out of three might be out as we take off from Narita and, of course, we do not fix it in Narita, we fly it home. This is the inbuilt redundancy of an aircraft. Each of the landing lights has two bulbs in it. If you are somewhere away from base and one of the bulbs goes, the landing lights or the navigation lights are still on but we change it. They are called acceptable deferred defects. The number we have here is down here shown in blue and we fly at way below three. Three is a very low number in this industry. The target of many of our competitors is five, ours is three. We fly to some very remote places and we want these aircraft as serviceable as possible. You can see what happened with SAP, we all had a bit of a shock here but we are back down well below three again. As you can see, the manpower was still coming down. We have managed to make these changes without affecting the performance there.

It is the same with the cabin. IFE systems, galleys, chillers, seat reclines: we have nearly 30,000 seats flying at any one time, so of course we will get defects. Down the line, if something goes wrong, we will move a passenger around and raise an ADD, and we try where possible to clear it at Heathrow. We have gradually over the years brought it down, and we are down here at the moment, and you can see again what this cutover did. That is why we and others were getting anxious about this. This is not a safety issue, these are things which are flying in accordance with regulations, you are allowed to fly with them.

If we look at the Air Safety Reports, remember that if a passenger is caught smoking in the cabin or he has a violent row with a cabin crew member, you raise an Air Safety Report. If something happens on pushback you raise an Air Safety Report. We have a very open culture in this business and we report everything, because if it comes along with another load of instances and you get a chain event, you can have an incident. We are wholeheartedly focused on not having an incident so in our open reporting system, that is about how many we have in a month, about 700 is the monthly average, and engineering's number at the bottom has remained steady over that same period. Therefore, we have managed to make these major changes without affecting any of these performance criteria.

What about our staff as we have reduced the complexity of what we do, we have cleared out our hangars as many of you have seen for yourself? You can see there that the number of incidents we have had per year has dropped significantly and, as you get a place uncluttered and you start to put purpose-built stuff around the aeroplane so that you can turn it quicker, you get a safer environment. Those are the figures over the last five years.

The qualified staff: this is very important to us. This is where we get a lot of press attention. The number of people physically working on aircraft is about 3,500 and out of that number all the ones in yellow are fully qualified licensed engineers. Many of our competitors here are putting their maintenance to other places where they have a much lower ratio of qualified staff. Is the ratio too high? It probably is and, as the processes become simpler, we can probably reduce that ratio as we recruit. However, we have not recruited anyone in engineering at Heathrow or Gatwick for seven years and we are unlikely to recruit any more for another couple of years. It is when we get to the position of recruiting that we shall be able to bring in people who do not have to be at that level, but we have been absorbing natural wastage now for the last seven years. [*end of tape, no overlap*] ………

To summarise, yes, there have been big changes and much of it is to do with simplification, reducing types and so on. Much of it is about technology, which will carry on at a pace. Much of it is about going to industry standard and realising that we are not the world's biggest knowledge base on this and that the manufacturers have a fantastic insight into how this works. They have been able to work with us and pool the industry knowledge, so that we are all now pooling our experience to get a far better handle on what we need to do. We have had a lot of success with the workforce in getting them multi-skilled. Over the time, as I have said, the performance has remained stable.

Are we complacent? No. Is there much more to do? Yes. Are we likely to recruit any more engineers in British Airways at Heathrow and Gatwick over the next few years? No. Do the staff see this as a threat? Probably not to themselves but they realise that this industry is changing and, as time goes on, the maintenance side of the cost for the airlines will continue to reduce. We are relying on the manufacturers to keep innovating and getting reliability ahead.

What are the major challenges for us? We have Terminal Five to look forward to. We can make some step changes in engineering in Terminal Five. We have further consolidation to make as soon as SAP is finally implemented, so by the end of this summer I shall be able to release at least another 300 support staff. We are coming to a point where there is still much more to do.

I would like to finish by saying that, in spite of all of this change and movement, do not think for a second that we ever take our eye off safety, because it is still our No.1 priority and it will remain so. Thank you. I would like to hand over to Martin now.

COMMERCIAL DEVELOPMENTS
Martin George
Commercial Director
[*Presentation with slides*]

Thanks, Alan, and good morning everybody. I plan to walk you through the commercial agenda over the next 40 minutes or so. I shall talk you through the progress that we have made over recent years in bringing to life the commercial strategy, I shall show you the results of that and some of the underpinning changes that we have made. Then I shall talk to you about the commercial contribution to the Business Plan for the next two years that you heard George outline.

It is worth starting by emphasising the fact that everything that we do around the commercial side of the business emanates from the BA way. This is intended to be on one piece of paper with the strategic statements around the key priorities for this company. It is something that we use very powerfully internally to galvanise the organisation and make sure that everybody is clear of what it is that really matters around here. It also makes it very clear that we have five key areas of focus of business, and we have to deliver on all of them. It is not just about delivering on one; it is about delivering on all five. Then when people ask what the company is all about, it is about delivering Service That Matters to people who value how they fly.

Service That Matters is the thought that underpins the commercial strategy, and let me explain why. Over recent years, we have quite consciously developed market-leading products and services appealing direct to the customer, whether that be the consumer in the leisure market, or the corporate customer, or the consumer in the business market. We are marketing very aggressively to the direct and end customer and, as a consequence, placing less reliance on the costly intermediaries, particularly the travel agency community. What I intend to do now is bring that to life for you.

If we were to summarise what we have done over the last three, four or five years, we could best do so in these four points. We have put a lot of money, focus and effort into market-leading products and services, best exemplified by Club World about which I shall say a few words in a moment. We have seen a significant reduction in cost of sale, and I shall talk about that as well. That is what you see in our quarterly results as selling costs. We have reallocated that money very significantly, and I shall bring that to life in a few moments, and part and parcel with this is putting a great deal of emphasis of driving more business direct, and I shall also bring that to life in a few minutes.

Everybody is familiar with the fact that Club World was very successful immediately after it was launched. We created a new market, we redefined the sector, we saw significant market share improvements, it has been very successful with our corporate customers, and many of you probably think that that is history. However, let me tell you that this is a product that continues to perform well for us. You see the monthly RPKs when we produce the traffic stats, but let me give you some stats to put some flavour on this.

If we take the North Atlantic, it is hugely competitive and a very important market. Out of the UK we have gained over two points of market share year to date. Out of the US we have gained over 3.5 points of market share in this critical market, so this has been a very successful product for us and continues to be so.

Our seat factor compared to last year for the year to date is over 3.5 points up at over 60%, and it is not that long ago that at a session like this we would have been talking about mid-50s as being a successful seat factor in the business class cabin. Thus this product has performed well for us and continues to perform well.

Shorthaul non-premium, Club Europe, is another competitive market, in fact so competitive that a number of our competitors have fled the market, British Midland being the latest to downscale their involvement in the premium shorthaul market. As a consequence, we continue to gain share in this market too. The most recent data out of Europe for the month of January saw a further 3 point increase in market share for Club Europe, so this market is still highly profitable, it is one to which we are committed and in which we continue to do well.

We are the only global carrier that offers four classes of travel on our longhaul aircraft, an issue of much debate when we first introduced World Traveller Plus, but I have to tell you that we have been extremely pleased with the performance of this product. It appeals to business and leisure customers, it delivers a significant yield benefit over the standard World Traveller product, and it enjoys a seat factor of well over 60% net worldwide. The revenue and the volume are very significantly up year on year.

Those products have helped us to focus direct on the end customer and to drag the demand through the intermediaries, which has in turn helped us significantly to reduce our selling costs. These numbers should be familiar to you, they are the numbers that we report on a quarterly basis. If you go back to 2001/2 when we spent £824 million on selling costs, on bringing in the revenue. This year I would expect the number to be almost half of that, which shows the degree of change that we have seen. We have transformed our selling cost line as a consequence of our commercial strategy, something that you will see continuing into the future.

What about the profile, as this also tells a very important story? The difference between 2001/2 and 2005/6 is virtually – not quite – a halving of our selling costs, but the profile has also changed considerably. Commission spend has fallen significantly: it was 44% of our selling costs and this year it will be around 25%. The GDS costs and the credit costs are a bigger proportion of spend but they have also reduced significantly – they just have not reduced to the same rate as the total pie. The spend on contact centres and the salesforce is about 25% in both periods but, as you have seen a significant reduction in the total spend, that spend is down too. The one big number that has increased, not surprisingly, is the marketing spend, as we appeal direct to the end consumer, the end consumer, we describe to them what it is about British Airways that we believe they are looking for, which has enabled us to reduce costs in the expensive intermediaries.

I have taken two months for comparison purposes, as it dramatises the effect very well. I have taken December '02 and December '05 to show how our booking profile has changed on a worldwide basis. As you can see, in December '02 just over 10% of worldwide PSJs were sold through ba.com: about 16% direct offline, so that is the travel shops, ticket desks and the call centres, and over 70% worldwide through the trade. As you can see, by December '05 that profile has changed very significantly. A third of our worldwide business now comes direct through a combination of ba.com and direct offline. Not surprisingly, the direct offline number – the amount coming through the call centres, through the shops and the ticket desks – has declined as a proportion.

I would also expect you not to be surprised by this, which shows you how different the channel mix is by region of the world. As you can see, in the UK market more than 40% of our business now is coming direct, which is no great surprise. If you compare that with Asia Pacific, where we are a smaller distribution and the channels of distribution are not quite as mature, you can see it is a much smaller proportion: something like 94% of our business in Asia Pacific comes through the travel trade. If you talk about a market like Japan, where the travel trade have a major impact on the choice of carrier, where much of the business is group business, much of the longhaul business is connecting business which has a lower propensity to go onto the internet, and if you talk about some of the other markets as well, the internet has not yet really penetrated. This shows how you can forecast the evolution since it is only a matter of time before the markets gradually migrate towards the UK picture, I am quite convinced of that.

It is also worth identifying the fact that benefits of channel shift are not just about lower cost of sale. There are some other very significant benefits of selling direct. We get customer details which enable us to market and to talk direct to customers, to make offers to customers that we believe will be motivating to them. This, in turn, will enable us to reduce our marketing spend and spend less money on costly above-the-line TV or press advertising.

As far as ancillary sales, I shall show you in a minute how we have developed ba.com to sell hotel rooms, to offer car hire and sightseeing tours, which is an area where we believe there is a significant upside for us as a business.

Online servicing: we are seeing massive increases in the use of ba.com for servicing purposes, and I shall share some of the data with you in a moment. People going on, choosing their seat, ordering a special meal, submitting their APIS data, it is really powerful in terms of developing a stronger direct relationship between British Airways and the ultimate consumer. The other thing about being able to sell direct is that we can simplify many of the back office processes: the rather cumbersome legacy processes that are a part of this industry we are able to override with the new technology coming out of ba.com. Thus there are a multitude of benefits.

Let me give you some data. This servicing aspect of ba.com is critical and particularly important as we move towards Terminal Five. We have over 50% of our customers' email addresses, which is incredibly powerful from a marketing point of view but it is also powerful in times of disruption. If we have had to cancel a flight or to rearrange a flight, we can email customers with the details having rebooked them. We have over a quarter of our customers' mobile phone numbers, again useful not only for marketing but particularly useful in times of disruption. A third of our passengers are now filling in their APIS details online and let us not forget that these are worldwide data. A third of them are managing their bookings online, they are going onto ba.com and are selecting a seat. They are filling in other information to help the experience become more bespoke, to take some of the hassle out of the airport experience. This puts the customers in control and gives them a greater sense of comfort and reassurance before they arrive at the airport. Already more than 10% of our customers are checking in on ba.com, which is absolutely booming, so next time we meet, I am convinced that that number will be significantly higher.

When we move into Terminal Five, we expect 80% of our customers to check in using a self-service kiosk or using ba.com, and we expect that to be split 40/40. You might think that that is ambitious but let me tell you right now that we have a number of airports on our network that are already achieving that: Basle 80% during February, Lisbon 60%, Zurich 60%, Jersey 55%, with one kiosk already checking in over half of the customers. Therefore, 80% is absolutely deliverable and we have airports doing it as we speak.

Just to show how customers are really embracing this new technology, worldwide e-ticket, I believe we have the highest number of any international airline: 83% of total PSJs are now e-ticket, that is 96% of all possible PSJs. It is a target of 100% e-ticket and we expect to be at 95% by the time we get into Terminal Five. The only reason why we are not at 100% is because a number of our interline partners will not have the technology in time for Terminal Five.

That is a quick catch-up with where we are: a very significant investment in products and services, directly appealing to our corporate customers, selling direct to our corporate customers, directly appealing to our leisure customers and, as a consequence, getting the pull through the channels of distribution, enabling us to reduce cost, particularly commission, involved in those intermediaries.

What about the future? George has already described the four key themes of the Business Plan, and I want to talk in particular about what we shall be doing in the commercial arena to address both the competitive cost base and talk about Service That Matters, which, not surprisingly, means I shall also talk about Terminal Five.

Our major contribution to the competitive cost base is the continued redefinition of the sales and marketing model that British Airways will employ around the world. I have talked about the fact that we have virtually halved our selling costs since 2001/2 but we shall still spend more than £400 million on bringing the revenue in, so there is still plenty to go at if we are to reduce that figure further.

Channel shift: previously at sessions like this, we have said that our objective is to have 50% of our shorthaul, non-premium, UK-sold business on ba.com. You may not remember the caveats but that is what it was described as. That figure has now risen to 60% and we shall put that measure to one side. Our objective by the end of the Business Plan is to have 50% of our worldwide business coming direct to British Airways, so moving from broadly a third to a half during the life of the Business Plan. We can do that by continuing to grow our penetration of the leisure market but also by growing our penetration of the small and medium enterprise market where we believe there is a big opportunity to move more business direct. As you can see, there are a number of markets outside the UK and the US where we have only just started and where I expect to see significant improvement. As I have said, the benefits are not just in revenue terms, they are much broader than that, much more significantly financial than just the cost of sale reduction.

There will be some business that will not come online. Some of the major corporates may well resist a movement online, and there will be some markets that will not move online, but we are confident, through a continuation of commission reductions in some markets and other cost of sale reduction which I shall talk about in a moment, that we can continue to drive that cost down. Therefore, we recognise that some markets will not come online but we have plans for those too.

Database marketing is the second ingredient. We have virtually two million people who are in the Executive Club but we have many more people than that who fly with British Airways. We have a major drive to grow the size of our database. An effective database marketing strategy, coupled with an effective website, is a very significant opportunity for us. Better targeting and greater marketing efficiency will lead to reduced marketing spend, which is really important.

We shall refocus our salesforce. We are spending less and less time, as you would expect, calling on travel agents and more and more time calling on corporate customers but out of that there will be an opportunity to reduce account management numbers and to reduce account management offices. We shall increasingly use telephone account management and online account management, both of which we have started and have found to be very successful. We shall simplify pricing and inventory, and use technology much more to file fares and distribute fares, which is a cumbersome and expensive process. We shall also continue to reduce our call centre costs. In 2001 we took 29 million calls and had 3,850 people in our call centres. Now we take 12 million calls a year and we have 1,750 people in our call centres. We still have 13 call centres in more than 20 people (*sic*) so there is still an opportunity for some significant consolidation. As you will see, we shall bring more business direct but less of that business will be on the phone, which will lead to fewer people in the call centres and reduced call centre costs. Where we have call centres, we shall put them in cost-efficient locations.

We shall extend the use of lower cost payment mechanisms like debit cards and, during the period of the Business Plan, we have the opportunity to renegotiate our three-year GDS deals, which represents another opportunity for us to reduce costs. As I have said before, recoveries, ancillary sales are a real focus for the commercial organisation. We can do a much better job in selling other things off the back of seats on ba.com, and we can do a better job of selling BA miles into the marketplace, both of which will generate a good profitable income. In summary, therefore, there are many opportunities for further cost reduction and to reduce that £400 million spend.

Let me now talk about Service That Matters. I shall talk about 3, 4, 5 and 6 here particularly, but let me just touch briefly on the first two. This is the agenda that we have set internally for Service That Matters, and it absolutely critical that everybody in the business recognises that the top priority is to deliver the customer promise consistently. I did not want to leave that off, because I want you to be reassured that that has to be where we place our attention first and foremost. It is also vital, as the Chairman mentioned, that people recognise that customer service is an ongoing commitment of British Airways. World-class customer service is part of the BA DNA, there is no doubt about it, but it is a different form of customer service: it is a fusion of technology and human service, which will be the bedrock on which Terminal Five is founded, that has to be the direction that we take. Therefore, consistent world-class customer service across the experience and across time, that is what the first two represent.

Let me talk about the others in a little more detail. It is worth saying that in total during the Business Plan period, we expect to spend nearly £200 million on improving the quality of the customer experience. We have already announced a £100 million investment in the new Club World but, in addition, the investment we shall make in ba.com, that we shall make in First, in the lounges and the IFE amounts to nearly £100 million more, and that excludes the T5 spend. So nearly £200 million will be spent during the life of the Business Plan on improving the quality of the customer experience.

As far as ba.com is concerned, this is intended to show how over time the role of ba.com has evolved. There is no denying that in 2003 the development of ba.com was really geared to ensure we had a selling engine that could compete effectively with the "no frills" carriers. We said at the time that we are unashamedly copying what was good about the "no frills" carriers and combining it with what we thought was good about British Airways. Therefore, ba.com was a selling tool but what you can see subsequent to that is that we have put a much greater emphasis on the whole servicing dimension: purchase, pre-airport and service recovery. Increasingly, that is where we shall place the emphasis. Purchase will continue to be critically important as we move to 50% of our business being sold direct. The pre-airport is giving people the opportunity to do more for themselves, thus taking the hassle out of the experience and increasing emphasis. Service recovery on the occasions when things go wrong will be something that we shall increasingly do on ba.com. Therefore, the role of ba.com is evolving very quickly and very significantly.

In the last 12 months, the functionality of ba.com has changed dramatically, and you can expect to see that rate of change increase yet further for the future. You will not be surprised that I shall not take you through in great detail the things that we shall do in 2006/07 other than to tell you that we shall improving selling and we shall improve servicing. Let me show you some of the things that we have done over recent times. These are screen grabs so, if they are not entirely clear to you, my suggestion is that you have a look yourself on ba.com, and I hope that some, if not all, of this functionality is familiar to you.

Product attributes – up-sell. For a long time, the website was an outlet for effectively distressed capacity for many airlines: it was remainder capacity, the lowest fares only. Through introduction product attribute and up-sell capability, we have outlined to people what they get for their money. So you buy your Eurotraveller ticket but, if you want to pay a little more, and we describe to people how much more it is, in Club Europe you get other benefits. This is already starting to yield some significant benefits. It is an excellent way of nudging up the yield, offering people ancillary products and services, and offering them the opportunity to get more flexibility or more product benefits for a premium.

CUG stands for Closed User Groups. This is an ability we have to create bespoke offers, price and availability and target particular subsets of our target market. Discounted rates to Closed User Groups is a technology which has proved very effective, so we can do travel clubs, offers for major corporates, we can do all sorts of offers to special interest groups and in a very targeted way. A Closed User Group can be huge or it can be very small but it is a great way of creating a bespoke offer for a particular target market.

Change booking. Previously, when people have wanted to change their booking, they pick up the phone or go into the travel agent, and we have given people the opportunity to do it themselves.

Shopping basket: I have mentioned this a couple of times. Giving people the opportunity to book a hotel, to hire a car, to book a sightseeing tour or whatever and then pay just once is something that customers are increasingly looking for. You will see us evolve this package proposition very significantly during the life of the Business Plan.

A new servicing portal: this is the opportunity that people have to go on and do the things that they want to do before they fly such as have advance passenger information, advise special dietary requirements, request a seat, and we shall continue to enhance that functionality. About a third of our customers worldwide are using this capability before they fly with British Airways.

I have talked about small and medium enterprises, the SME market. Our on-business proposition is an online proposition, which offers a loyalty scheme for small and medium companies. We have a very effective mechanism for getting to large corporates, as we have a salesforce that deal direct with them but, of course, in many markets there are hundreds if not thousands of small and medium companies who historically have booked through travel agents. With this direct tool, we are able to target them directly, offer them a loyalty vehicle and offer them discounts, which we believe will be a cost-effective way of penetrating that market. What we can offer through a combination of inventory, price and the service benefits is something that is genuinely unique and something with which the travel agent cannot compete.

What will you see? We are going to change the design of ba.com. If you look at most leading websites, they are now changing the design probably about 18 months at most, but we are going to redesign ba.com based on customer feedback to make it easier for navigation, and that is coming very soon. As another example, there will be a better layout, it will be more accessible with easier navigation.

The majority of our business is coming on a point-to-point basis, primarily out of the UK. Many of our overseas markets have been inhibited in growing their direct revenue because of their inability to sell effectively online connections, but we are going to fix that. Using the calendar-led selling approach that has been so successful with ba.com, we shall introduce a six freedom selling engine again during the first year of the Business Plan. That will significantly increase the amount of business that we generate out of a number of our key markets, particularly Europe and particularly the US.

We shall continue to enhance the ba.com functionality for online check-in and boarding pass. Customers love this, it is working very effectively and we shall continue to improve the way it looks to make it even easier for customers. The self-service kiosks have been very effective but for many customers this technology is now bypassing the SSKs and I expect to see that continue for the future. Later this year, we shall give people the opportunity to pre-pay their excess baggage on ba.com. That is by no means the entirety of the development portfolio that we have for the first year of the Business Plan, but it gives you a flavour of the continuing innovation that we are pursuing.

What is next? Let me just talk about how we intend to maintain leadership in longhaul premium. This summer we shall introduce a brand new Club World product, and you may be disappointed to hear that I shall not tell you very much about it. We shall spend £100 million on upgrading it, and it will reinforce our leadership position in the longhaul business class market. We have been very fortunate in that we have had five years without any serious competition, without anybody truly competing with the flatbeds that we first introduced into the market, but that is changing. Before our competitors catch up, we want to move on and that is what we shall do.

It will address a number of the fundamental issues of real importance for customers: privacy, space, stowage being just three of these. The investment of £100 million is more than just changing the seats; we shall change many other elements of the experience.

The other thing that you will want to hear is that the embodiment programme will be a rapid embodiment programme. Again, I shall not describe how long it will take but it will be much less time than the previous Club World embodiment programme. We have had a very successful product but it is time for us to upgrade it. You will see the first product on board the aircraft this summer, and then you will see it rapidly embodied after that.

Unlike a number of our competitors, we are absolutely committed to the First Class market. We have taken First off a number of our aircraft, quite right, but we have no plans to take First off any more of our aircraft – quite the opposite. We intend to invest in First during the life of the Business Plan, so that we grow our share and that we are able to maintain the differentiating yield between First and Club World. This is a really important product for a number of our major corporate customers, it is the one to which we remain absolutely committed.

The next area of major change that you will see is in the inflight entertainment arena. Again, this summer you will see us introducing audiovisual on demand for all of our customers, not just our premium customers. We expect all of our customers, wherever they are in the world, to pay a premium to fly on British Airways, so it is imperative that we continue to invest in a quality experience for all of our customers. New audiovisual on demand technology goes on board this summer. It enables us to increase the quality and the quantity of IFE, of the content, and, very importantly, it increases the reliability of the equipment. This is digital technology, not tape technology, so its reliability is significantly enhanced. Therefore, it is good news for customers and it will be a lower cost method of distributing IFE.

Let me talk about shorthaul. Let us not forget that in 2001 we lost over £300 million with our shorthaul business, and this year, as we have said publicly before, we expect to make money on shorthaul. Our shorthaul business is really three shorthaul businesses, each requiring a bespoke action plan. For Heathrow, it is important that we continue to grow and invest in Club Europe. Club Europe is highly profitable, it is a product to which we are committed and it is a product that does extremely well at Heathrow. It is a product where we have seen some significant benefits recently through a real focus on premium leisure. The premium leisure market longhaul has been well established and we have benefited from that significantly, particularly in Club World. However, we are also starting to see some real growth in the premium leisure market shorthaul.

During the first year of the Business Plan, you will see a brand new pricing approach at Heathrow, and in fact across the entirety of our shorthaul business. You will also see us put some extra capacity in through the introduction of slimline seats in the economy cabin, and I shall say more about that in a moment. You will see us continue to advertise our European proposition, because we want to demonstrate to customers that we are focusing on the quality of the experience but we are also able to offer very attractive fares. For those of you who can remember the PJ O'Rourke advertising, we want to continue with that kind of approach. It is about value for money, a very good quality product but also offering very competitive fares.

The new slimline or space-saver seats are similar to those that we have on some of the latest A321s. These give our passengers more space with 30 inches of legroom than they get on our older aircraft at 31 inches of legroom, because the seats are much thinner and the passenger ratings are very good for these seats. They are lighter, they are more space efficient and it gives us the opportunity to put more seats on the aircraft. Therefore, we get extra capacity on our shorthaul Heathrow fleet without having to buy new aircraft.

At Gatwick, we announced in the autumn a programme of changes to enhance both revenue and cost, and that programme is well under way. It is an integrated plan and it is very early days in the implementation of that plan, but the reception from our people at Gatwick has been very positive and they have embraced the need for change very effectively and very warmly.

Of course, the most recent set of announcements that we have made in the shorthaul arena have been around BA Connect. I am sure you will all remember, single class offer, pay on board, the introduction of BA Connect Plus for business and frequent flyers, and a guarantee of more than two million fares at the lowest levels. Of course, the fares which are one way, fully changeable, start at £25. As you can see, it is very early days in the life of BA Connect, we do not even start operating until 26 March but the reaction so far has been encouraging. We have recently announced new routes to both Geneva and Berlin from Birmingham.

This brings me onto the final element which is an extremely important one. It is about redefining the airport experience. This is setting in place the foundations for Terminal Five and, as the Chairman said, there are only just over 750 days to the opening in March 2008. Let me make an important point here. The expectation you probably have is that all of our operations will be going into Terminal Five on day one. The reality is that on day one we expect 90% of our operations to go into Terminal Five. Phase 1, main building, first satellite opens in 2008; phase 2 when the second satellite opens is 2010, more likely 2011. Ninety percent of our operation will go into Terminal Five on day one, the rest we expect to go into Terminal Three. The good news about it going into Terminal Three is that it allows us to keep our Spanish services and our Australian services with our OneWorld partners Qantas and Iberia, and we also expect our Italian services to be in there as well.

The reason that the whole of our operation does not go into Terminal Five on day one is because we have gained more slots since the development of Terminal Five started. As a consequence, we now have more operations than we had when we first thought we would be able to move in one go. So we have more slots at Heathrow, we require more space at Heathrow, 90% in T5, the rest in T3 and the bit that goes into T3 very conveniently will be located with Iberia, with whom we code-share, and with Qantas with whom we have a joint service agreement. That is excellent news for the future.

As the Chairman said, this is a once in a generation opportunity, which is absolutely right. This is a once in a generation opportunity to create a world-class customer experience and a working environment that is conducive to delivering that. I have talked about the evolving role of ba.com and how important it will be when we go into Terminal Five. I have talked about the fact that 80% of our passengers will use SSKs or ba.com, half and half, so 40%/40%. I have talked about how a number of airports around Europe in particular are already achieving those kind of targets but there are other major changes that Terminal Five affords for us. Lounges, for instance: we are developing a brand new lounge concept which you will see trialed both in a European station and in a US station during 2006. This allows us to value engineer the product and it allows us to test customer reaction. These are some early visuals we have of the Club World lounge, of the First lounge and then a rest area that we shall have in Terminal Five. We shall test all of this in advance and in good time to be able to incorporate the learnings from the test in the roll-out and introduction into Terminal Five.

This brings me to one final point which is around simplification. Simplification is a mantra inside British Airways, something that is driving all of the things that we do. Let me give you a couple of examples of how we are embracing simplification: externally, by changing our baggage policy and our seating policy, and you will see those changes in the first year of the Business Plan, and through the management restructuring, which will make the decision-making process and the accountability much clearer inside the commercial business.

In summary, this year we have seen a strong revenue performance. Our revenue will grow by more than 8%, you know that, but, at the same time, when we announced our results you will see that the focus on bringing our cost of sale down has continued. The story for the Business Plan is very similar. We have a very significant investment programme. Setting Terminal Five aside, we are investing nearly £200 million in appealing direct to our customers, offering something which we believe will be unique and compelling in the marketplace. At the same time, because of appealing direct to the customer, because of placing the emphasis on customer poll, we are able to take cost out of the costly intermediaries, and we are able to continue to reduce our cost of sale.

To finish where I started, Service That Matters is more than just a glib marketing phrase. It is a philosophy that is about really identifying the things that matter to customers. It is about delivering them better than our competitors and, as a consequence of that, reducing costs from the areas that are not productive. That is our ongoing commitment. Now let me hand over to Drew to talk about the revenue.

MARKET OUTLOOK & CUSTOMER FOCUSED REVENUE MANAGEMENT
Andrew Crawley
Head of Sales
[*Presentation with slides*]

[*opening words not on tape*] … from the rest of the organisation and what I shall share with you is the fact that we are absolutely integrated in our approach to revenue management. Then I shall talk about some of the segments of our business, the current trading conditions and some of the initiatives that we are undertaking by segment to improve the revenue outlook going forward into the Business Plan period.

What we are doing in revenue management is trading off between these four quadrants: leisure business, business business, network flows and point-to-point flows. Each of these has different characteristics, which means we have to act in different ways. For example, the business segment is one that is highly profitable, that books late, that no shows, that cancels; the leisure segment books early, is less profitable, is more sticky business, more likely to turn up but it cancels as well; with network flows we have the additional costs of transferring passengers and bags through our system, which we need to take into consideration when trading off the value of that individual customer, and point-to-point generally books a little later than network but is higher yielding.

On a typical 777 across the North Atlantic for this summer with an average of 300 seats, we will sell 1200 seats during the life-cycle of that aeroplane and when it comes to depart, about 10% of people will not show up. Therefore, we have to manage all these issues in the way we trade off the business that we are accepting at the value that we are accepting, and how we are positioning price in each of those markets to drive the relevant demands. Therefore, it is a relatively complex beast.

It is this complex because we have 870 flights a day, broadly a pricing ladder of 16 prices on average, four markets which is the aggregation of certain markets depending on the value of the yields that they give in each of those markets. So we have a UK market, a US market, perhaps a European market and another end of route market, and we have those flights available for sale 355 days out. All in all, 20 million decisions are what any one of the revenue management staff could be … [*break in recording*] decisions, and the human interaction is done on a trend basis.

I hope that this is legible in your handouts but I thought I would take you through what is the black box of revenue management here. In fact, I shall focus less on the middle part and more on the inputs and the outputs. As you can see, these are the inputs and we measure people on how they manage these inputs. Business rules is something we have which is unique to our system, and this enables us to take a series of flights and say that on each of those flights, we need to allocate five frequent flyer seats, so we can apply certain criteria across a set of flights. We use that tool to adapt the overall approach to revenue management in the context of low cost competition, and I shall come on to that a little later.

Cancellation forecast: each flight has a cancellation forecast associated with it. Therefore, certain flights will have a likelihood of more people cancelling than other flights and, indeed, no shows is similar. On one of our Indian flights, for example, departing out of Delhi, the no show rate may be up to 30%, so we have to incorporate that into the availability that we are making saleable in each of the markets so that we oversell by 30%. On other routes such as Luanda, we fly once a week and people who book to go to Luanda generally go to Luanda, because they do not have much option if they do not.

Capacity is an important element that we overlay onto our system and also yield. Yield forecasting has always been based on historical yield. We are developing our systems to be much more accurate about what we put into this pot. We do not allow our agents in revenue management to mess about with this. This is done systematically with feeds from various of our fares databases, and I shall not go into much more detail on that.

Demand forecast is something that we use to measure the accuracy of our demand forecast. We generally take a temperature test of our demand forecast two months out and monitor how successfully we are managing that demand forecast. On the output side, we measure a form of revenue margin for each of our revenue management staff members. They are managing the exceptions from the trends that the system will spit out, and they look at the inventory which is in this system here Altéa Plan owned by Amadeus, which then distributes availability to the GDS and ba.com, which then has overlaid on top of it the fares that we make available. That is an overview of how the revenue management system works.

I shall go down one level now to a little of the theory behind it. If you work in revenue management, this is what you think a customer is. It is someone who is prepared to pay £159 multiplied by the probability of that business materialising, which gives you what we commonly know as the EMSR: expected multiple seat revenue of £116. That is the value that we look at for that piece of business, so it is the value of the fare times the probability. What does that mean? It means that a 1% chance of someone who will give us a revenue margin of £500 turning up we treat the same as 100% chance of realising a 5% revenue margin.

In reality, that means that if that £500 were £501, we would hold a seat, say, on a flight to Frankfurt on a Tuesday morning, every time over that piece of business to wait for the occasion when that person turned up. Across the course of the year, that person who is paying £501 is likely to turn up four times in a year, so on every other day of the year we would have an empty seat on that scenario.

This has led to an opportunity for low cost carries, because, more often than not, we were waiting for a business traveller to turn up and not selling this. What that meant was that our price perception in the marketplace was that we were expensive and our aeroplanes were not as full as they could have been. What we now do, and this is a balance – it is not so much over there, we still focus a lot of time on this part – is overlay how the customer proposition in the marketplace impacts on that particular piece of business at the right-hand side, our overall market relevance, what market share scenario that drives if we are not selling fares to those passengers, how well we are utilising our assets, what the seat factors are and so forth, and the other income that we can generate from those passengers. Martin has already spoken to the ancillary selling, which is an important part of our business. It is most important at this end of our business and needs to be taken into consideration when we are allocating inventory and selling seats in that very price-sensitive end of the market. That is something we learned after the "no frills" carriers came in and filled that space.

What is going on in the market as that happened? If you see this continuum that we have highlighted here, we have opaque and transparent. Opaque you can describe as old world and Martin has referred to it. In Japan the distributions are very powerful, we pay them a fair chunk of money, they are generally selling to specialised groups. They are in control of that groups business, we are not. They decide when to give us the names of those passengers, they are in control of the price that is being given to those passengers. We have full service competition. The customer proposition direct from the airline is a little more confused and brand advertising plays a bigger part than price advertising.

On the right-hand side, the transparent or new world, with online purchase, simpler fare rules to enable online selling, it is more competitive than these markets. A direct relationship with the customer and aggressive price advertising are the characteristics of this side. What we need to understand and adapt our pricing inventory selling commercial proposition to is where we are along this continuum in each of our markets, and how fast each of these markets will move towards this right-hand side, because there is no doubt that the trend is towards that right-hand side. India is one to watch for me where the market is ripe, much more capacity has recently gone in. There is one problem which is online payment and, as soon as there is a resolution to online payment, I believe we shall see India move very quickly to the right-hand side, the transparent side where we have the direct relationship with the customer; we do not have slightly antiquated and more expensive distribution mechanisms in the marketplace.

By way of illustration, in those opaque markets where the agent is in control, this screen shot typifies exactly what that means. We were paying the distribution to translate what they saw on their green screen and sell what they chose to sell to the customer. We needed to simplify our fares product so that the complexity that is on this screen was easier for a customer to understand and, importantly, easier for us to automate and put online. We changed our fare rules. Previously, we used to have a publication called *Fares Fortnightly*, which was a document we used to sent out to agents on a fortnightly basis, and this was there to help them get through that green screen to explain to their customers why they could or could not have a cheap fare, or why they were paying a more expensive fare, or why they had to stay for two nights, or why they had to stay for a Sunday night, or why the fare was only valid for three months or a year and so on. Having simplified that, all our fare rules can now fit onto one page and they can be summarised thus. As a result of that, the customer is in control. You have seen a screen dump from ba.com before, the calendar-led selling proposition that we have on ba.com is one which is still unique in the market. It allows the customer or revenue management to display exactly when we want to price our fares and how we manage the transparency of those prices. It also allows the customer to make the choice about when they want to fly and how much they are prepared to pay.

What are we doing in the way we manage our pricing and inventory to ensure that we remain competitive with the new competitive challenges that are being thrown at us all the time? Shorthaul premium, which Martin spoke about, this is our Club Europe segment. The graph here shows RPKs, the red line is the year 2000-2001, the yellow line was last year and this is our current performance. What you can see is that there was a huge drop-off post 9/11 and we can see that there is a small recovery to which Martin has already referred. That recovery is driven by a number of factors. The first is that 25% of that business is linked to a Club World sector, so as Club World grows, the connecting traffic that we get flowing onto Club Europe is seen in these numbers. The other issue is that the eastern European markets where we have put more of our Club Europe capacity are very strong Club Europe markets with good demand there, and we are benefiting from that in these numbers.

Finally, there is a new product we have put into the marketplace called Premium Leisure, which is the opportunity for people to buy an upgrade to Club Europe having purchased a Eurotraveller or Economy fare. There are certain terms and conditions that we put around this. Obviously, we adapt the availability of these particular fare products dependent on pure business demand. This is a product which is particularly effective down at Gatwick where the vast majority of the routes are leisure and for a small premium, on which we make a good margin, we allow people to upgrade to Club Europe to enjoy the benefits of the lounge, the extra space and so forth.

This is the rolling 12-month picture where we introduced it probably in the middle of the previous year, but it has started to take off now, in particular when the product attribute functionality that Martin showed on ba.com came into play. This volume now accounts for about 12% of our Club Europe volume, and it is growing currently at around 12%. We are linking our pricing and inventory approach more to the needs of the customer than we have ever done, which sounds sensible but it was something that we were probably not as crisp at in the mid-1990s/early 2000.

Shorthaul non-premium RPKs: this is a very competitive market. You can see the same lines: red is 2000/2001, pink is this year, yellow the year before. You can see that we are holding our own, we have managed to retain similar volumes despite the huge influx of low cost capacity over this period of time. It is a highly competitive market. Our European proposition seems to be working very effectively. Martin has already spoken about the new pricing propositions that we are putting into the marketplace in year one of the Business Plan. The key challenge for us in this segment is domestic, where the train, the car to a degree in places like Manchester, and other competition are making that a very tough marketplace for us.

What are we doing better to align our needs with those of the customer? As far as price product, linking fare and availability is the obvious thing to do, and the output of that you see at ba.com. In addition to that, we are able to forecast over time, and we update these forecasts, the number of passengers who buy in particular the lower fares, and the proportion of them who will buy a bit of ground revenue from us such as hotel or car hire. Ancillary revenue includes up-sell, credit card surcharge and so forth. The amount that we are paying to acquire those customers and the channel through which they booked are also taken into consideration when we make space available. All of this will enable us to offer lower fares in the comfort that we shall be making margin elsewhere in the journey experience.

Let me move on now to longhaul premium – the engine room. You can see that our longhaul premium performance is very robust this year. We have overtaken 2000-2001 and we are expecting a strong, robust performance to continue. The strong, robust performance can be reflected in this next graph, which is the moving annual total for our business selling classes if you like, so this is the corporate business in classes J, C and D if any of you are familiar with our selling classes. This is the business that the likes of your company will be booking, and this trend, which we can see here, has been improving and is currently running at around 6%. In addition to that, there is an opportunity to keep, retain and grow these customers by offering a new dealing product in the marketplace that we call multi tier dealing. This is not giving one price on a route but giving three prices on a route, allowing the travel manager of the corporate company to be more in control of their travel budget by giving them access to lower fares that they previously would not have had, on the right-hand side, segmented by selling class in our system that we make available where the demand in these selling classes is less evident.

For example, you might be able to purchase on New York and, if you decide to go on an earlier flight, you might be able to pay £2,800 instead of £3,200. If you book a little earlier, you might be able to go on the flight you wanted to go on but with the inconvenience of having to book a little earlier. We are putting more control into the hands of the corporate customer and their travel budget, at the same time as aligning our objectives of filling our Club World capacity better.

In addition, if you look at our seat factors across the network, the network is the blue line, JFK is the green line and Hong Kong is the red line, this is again for illustration. This shows that there is an opportunity on certain days of the week, even though our network seat factor is around 65%, such as Tuesday, Wednesday, Saturday, and certain routes such as JFK on a Saturday and JFK on a Thursday where there is big opportunity for us to be able to top up with business that we would otherwise not have had. The product that we put into the marketplace is a premium leisure product, which again is capacity controlled, it is available on the days of the week when we believe other business demand is less strong and, importantly, in this segment it has terms and conditions associated with it to discourage the dilution from J, C and D, the corporate fare structure. So there are no refunds available on this fare but this allows us to have a price proposition in the marketplace on New York of about £1,800 which can compete with a certain segment of the market that other competitors are competing with, and it allows us to fill our Club World seats more efficiently on the days when previously we would have let them fly empty.

Longhaul non-premium: again, a tricky market. The background to the performance this year in pink is very good growth on Asia, good growth on South Asia, so generally the places where we have put our new capacity we are filling very well. There is some softness in the North Atlantic market, which has been around for the whole of this year and looks set to continue. The market on the North Atlantic is down overall. We have not lost any share but that is depressing our numbers somewhat. The opportunity we see here is in the World Traveller Plus cabin where we have two product offerings. One, which Martin spoke about, is the ability to upgrade when you purchase a World Traveller fare through the product attribute mechanism on ba.com so for, say, an extra £200 you can upgrade to World Traveller Plus on a one way basis or return.

Some recent research conducted in Asia with customers flying on low cost longhaul aeroplanes worked out that these people were prepared to pay three times the amount for that additional space for a premium economy seat, so there is the opportunity for us. In yield terms, we are seeing very good returns from the World Traveller Plus cabin. As Martin said, the seat factor in World Traveller Plus is between 60-70%, so there is opportunity there, there is opportunity for more of this up-selling and, importantly, there is opportunity for the SME segment where this product seems to fit the bill in terms of extra space, extra comfort, in-seat power and some of the other product attributes that business travellers require but at a lower fare level than our Club World proposition. In addition to that, it is another fare out in the marketplace which competes for that market with other new competition, who have a non-flatbed business class type offering.

That is our World Traveller Plus trim which is growing at around 23% on a moving annual total basis, broadly because of the new capacity that has been coming in. We expect that to flatten out but nevertheless continue to grow.

In summary, if you look at our yield volume curve and the activities that we are undertaking to move this curve that way, we have what we call total margin management at this bottom end, where we are able to offer highly competitive lower fares on the understanding that a proportion of passengers will buy certain other products from us, so we can use that in our overall value decision-making revenue management. Shorthaul premium leisure is particularly appropriate on our Gatwick leisure route network to top up on margin. World Traveller Plus up-sell for the discerning leisure traveller in our World Traveller cabin who wants to pay a little extra for a lot more product. World Traveller Plus for SME segments, longhaul premium leisure, to give sensible value for money offering in our flatbed business class product for leisure travel, and multi tier deals for our corporates.

The way we manage our inventory is wholly integrated into our commercial proposition. We believe that a combination of all these will see improved volume. Yield will come down in certain segments and it will be offset in other segments by mix. Overall, I do not think the yield pitch will be spectacular but you can see that in most segments we shall be driving good volume and improved seat factors throughout the aeroplane. That concludes my presentation. I think it is time for coffee now but I shall hand over to George.

George Stinnes: It is indeed time for coffee. We have left about half an hour so you can have a relaxed break. All the BA people wandering around have badges with a different colour from yours, so you can feel free to ask questions of people. May I just remind you about the feedback forms. If there is enough time, you might tick a few boxes before you go out. See you back at about 11.15 when we will bring you back in again.

- *Coffee Break* -

FINANCIALS AND OUTLOOK
Keith Williams
Chief Financial Officer
[*Presentation with slides*]

George was talking about the share price earlier on and what happened over the last 10 years. When John Rishton passed over the keys to his office, he told me that when he moved in the share price was £3.22 and when he left it was £3.17. At 10.40 this morning, we were at £3.22½ so I am doing well.

This is my fourth presentation at Investor Day, though my first as CFO, and up to this point I have been very much involved in reflecting on the balance sheet and getting improvement to our financial matrix, taking the business forward from the balance sheet perspective. Over the next two years, the period of the Business Plan, that focus very much continues. There is still a focus on the balance sheet, there is still a focus on improving our finances but, beyond that, we have two other things: we have delivery of Terminal Five by 2008 and we need to look at opportunity beyond T5. We need to start to look at the business beyond 2008. Those are issues I shall come back to in a minute.

To begin with, let us look at the outlook for the remainder of this year. In nine months to December, as you have already seen, our revenues are up 8.4% and this is due to two factors. There have been strong volumes, our seat factor is at 76.5% especially in the premium cabin, which Drew was talking about earlier. Secondly, fuel surcharges have been sticking. Over the last 12 months, we have had three increases in the fuel surcharge level, the last one in September of last year, and those fuel prices have been sticking. Against that, we have seen that yields have continued to weaken over time, and we have need promotional activity to support the volume. That is the story of the nine months on the revenue side.

On the cost side, fuel has dominated and fuel price increase up to December is up 35%, which is a big increase in fuel costs, and employee costs have started to run away. Employee costs are up 5.6% up to the end of December, which meant that our unit costs have been flat. In September, we started to reinvigorate the exercise to bring down our cost base. Part of that you have seen with the management reduction, and we set ourselves a target of 597 managers and senior managers to leave the business. The first phase of that is ongoing now and 94 people will have left the business by the end of March. We have also had changes on working practices. We have announced changes at Heathrow in the ground transport services, so there is a focus again on costs.

Where are we for the rest of the year? In January we gave guidance that we expected our revenue this year to be up more than 8%, and that guidance still holds. We still expect the revenue to be up more than 8% this year. That is coming off a low base over time and, even with that 8% improvement, if you take where the revenue was in 2001/02, we are still down 9% but good revenue performance this year.

As far as yield and seat factor, we said that our seat factor would be up more than 75% and that holds, and that this year we would see some improvement on yield, and that is the guidance we are still giving. These slides exclude fuel surcharges. I know that many of our competitors show yields including surcharging and, going forward, before long we shall start to show you yield including fuel surcharges.

Fuel: we gave guidance in January that our fuel costs would be up £525 million plus or minus £25 million. Three weeks from year end I can give closer guidance on fuel. We now expect our fuel costs this year to be up between £500-515 million, so that is £1.63 billion on fuel this year.

As far as costs excluding fuel, we gave guidance that they would be up 1%, some drift on costs excluding fuel, and that guidance holds as well. That excludes profit-sharing from employees, and I shall come back to that in a second.

On the capital expenditure side, we had given guidance earlier in the year that our expenditure this year would be around £350 million up on last year, refining that down to £310 million. We expect our capex this year to be up £310 million. That is partly as a result of thrift in capital expense and partly as a result of some items being postponed into next year.

Against that, you will have seen in the last quarter that we have disposed of the London Eye from which disposal we raised £100 million, and that will result in our disposals and net capex. The result of that will be that our net debt will be below £2 billion. George outlined figures earlier as to where the net debt was in 1996, which was about £4 billion. From memory, you need to go back to 1992, for those of you who are old enough, where our net debt was below £2 billion. So we have seen a significant improvement in net debt. As a result of the debt repayments we have been making, we have greater financial flexibility with more unencumbered assets than we have had before.

Employee reward plan: you may recall we set up an employee reward plan two years ago to deal with reward to employees for 2004/05 and 2005/06. In ’04/’05 we had a 6% trigger and this year ’05/’06 the trigger is 8% after the cost of the scheme, so we have a margin of around 8.5% this year to trigger the employee reward programme.

Net debt peaked at £6.6 billion as you all know back in 2001/02 and we have seen steady progress quarter after quarter. The guidance now, as I have said, is that we are below £2 billion at the end of the year.

Unencumbered assets: if you go back to 2001/02 we had very little by way of unencumbered aircraft assets. We are now up to 77 aircraft by the end of the year that will be free and unencumbered, which represents about 27% of the fleet. We have a good mix between finance, unencumbered and operating lease.

Despite all of that, steady improvement in profit, steady improvement in net debt, our credit rating remains unchanged. We have gone down four steps since 1996 to where we are today: BB+ sub-investment grade. That is an important issue to us as we go forward and we look at what we shall do in terms of fleet. Nevertheless, we expect the net debt to come down and we have our sights set on improving our credit matrix.

Turning to the Business Plan, we know the themes we have in the Business Plan and Martin spoke to those earlier. It is a competitive cost base which is a feature that we have had in the Business Plan now for the last two or three years: bringing our costs under control. We have clear competition in both shorthaul and emerging competition in longhaul as we see the US carriers come out of bankruptcy, out of Chapter 11, and we have competition coming from the likes of Emirates and Singapore. Therefore, getting control of our controllable costs remains our focus for the future.

We have Service That Matters to which Martin spoke earlier, and I shall look at the investment against that in a moment. Getting the business Fit For Five, there is not long to go to Terminal Five, and that is another focus. We have added another one which is Fit For Growth. The aim of this financial plan is to get our financials in position so that we are ready for future growth.

As far as financial goals, that translates into regaining control, regaining the initiative on our controllable costs. This year for the first time in a few years we have seen our costs likely to increase, so we need to regain control of that, which is a focus of this Business Plan.

We have been making steady progress to the 10% operating margin. Year on year we have been moving forward towards that 10% operating margin, and this Business Plan that we have put together will deliver a 10% operating margin, absent any shocks on fuel and absent any shocks in the market.

As far as investment, we are targeting this towards Service That Matters, towards the things that matter to the customer. However, we have not lost sight of asset terms. One of the big items of progress we have made over the last few years has been around asset terms, sweating the assets, getting more out of our aircraft assets, and look at our performance there in the past and ongoing.

As I said earlier, we want to improve back to investment grade. As far as our operating margin, if we can deliver the 10% operating margin we shall have a sufficient operating margin to get back to investment grade. The issue still remains around pension adjusted debt, as the credit rating agencies term it. We need to get control of the pension fund and we need further to reduce our debt to get back to investment grade.

On costs, the initiatives from Future Size and Shape, you will remember back in 2001 when we announced this programme, and we have made steady progress on costs. This year our controllable costs are increasing slightly, up 1% and we need to regain that initiative. The issue that we have sitting on top of that is fuel: up from 12% of the cost bill to around 21% this year and I shall look at next year in a moment. Therefore, we need to regain control on costs.

Similarly, unit costs are again influenced by fuel and by increases in employee costs. Our unit costs this year were down and our net unit costs against ATKs were flat. We need to regain control there.

Fuel price, as you know, has remained stubbornly high, it is up 150% from where it was in 2000/01 and today it is still around $600-620 per tonne or $60 Brent. The Business Plan forecast that we have assumes that $60 Brent remains and around $620 per tonne, so we do not see in the Business Plan any alleviation on fuel costs.

As far as Business Plan targets, our target is to have £225 million of cost savings this year or next year 2006/07 and a similar amount of saving in 2007/08, so a total of £450 million over two years. That will be delivered in costs across the business, it is not just a focus on employee costs. Employee costs will obviously play a major part, and we have started down routes which will bring our employee costs under focus. We have announced the changes in reduction in management of 597 employees there. We have made progress at Heathrow in working practice changes, and these are ongoing. Further, at Gatwick we have announced changes with the BAA on baggage transfer facilities, which not only alleviates property costs but it also alleviates employee costs. Martin spoke earlier about the new sales and marketing model, which will also relinquish costs. So across the business, we have identified £225 million of cost saving next year but it is not just about employee costs; all costs will come under scrutiny.

We also have the issue of the pensions. We need a satisfactory outcome on the pensions to deliver the Business Plan. The pension issue in August/September time, we entered into a major campaign of talking to our employees about the pension issue. We spoke to 14,500 employees across the business over a relatively short period of time, and that campaign finished in January this year. We had a survey with MORI on the results of that campaign, which identified that 90% of our employees are aware of the pension issues that face BA, and that two thirds are aware that some changes need to be made to the NAPS. That takes us to January and we have been designing proposals that we should put to the employees later this month, and we are still on track to deliver some proposals later this month.

Alongside that, we have the next actuarial review which is carried out every three years and the last review was 2003. The Actuary will start his work in March this year, and we expect the report on the actuarial valuation in the autumn time. Bringing those two together – discussions with the employees and discussions with the Actuary – we expect to see a result by the autumn.

Turning to capital expenditure, the last longhaul delivery that we had was in 2001. Our expenditure has come down over time and has flattened out at between £300-350 million for the last few years, and over the next two years we expect it to increase, focused on Service That Matters: £500 million next year and £500 million the year after.

Martin spoke earlier about where that expenditure is aimed. There are £200 million aimed at product investment, which covers the £100 million that we announced on Club World, it covers inflight entertainment, lounges, First and ba.com, so investment in product that matters to the customer. As far as delivery on T5, we expect to incur just under £200 million of expenditure over the next two years. Overall, £500 million expenditure over the next two years.

Getting ready for Terminal Five is a key part of this year's Business Plan. Construction is on track, it is one of the few projects in Europe that seems to be on track, and delivery of Terminal Five is still on track for March 2008. We make progress on our own operational readiness for Terminal Five, which clearly involves taking people off line for training and we are absorbing that cost as part of our Business Plan.

Martin spoke earlier about the schedule overspill for Terminal Three, and because we have been acquiring slots over time, the good news for BA is that 90% of our operation will now fit into Terminal Five in the initial phase, and 10% will spill into Terminal Three. We have been working on our operation performance targets for Terminal Five, whether that is around punctuality, baggage performance, self-service kiosks, e-ticketing, setting very clear operational performance targets for T5.

In terms of capacity, we have been very much sweating the assets over time. This slide looks at the number of aircraft that we have had in service for each of the years from 2001, so we are down from 338 to 284 in BA service at the end of this year. Over the last few years, we have been able to get 2-3% ASK growth each year from 2004 through to 2006, and we expect to continue that next year so that, as we convert some of our shorthaul aircraft to longhaul, that will give us some more ASK capacity of 2.5-3%. In 2008, as put more Club World product on some of our 747s, we expect our ASKs to fall slightly, as we put on more premium capacity. So we have made good progress as far as sweating the assets. Each year for the last four years, we have managed to eke out more capacity from the same assets, but there is only so much we can do on that front.

Turning to deliveries against that, we have no longhaul aircraft, shorthaul no aircraft next year, and we have seven in 2007/08 and three in 2008/09, which are a mix of A320s and A321s. Therefore, we still see a very small fleet expenditure over the next two years.

As I have said, we have no longhaul aircraft before Terminal Five, and we need to ensure that we deliver the Business Plan. We need to be sure that we have delivery of the cost savings that we have spoken about, delivery on pensions, which will enable us to make progress on fleet replacement. There is a long period between order and delivery on aircraft, so we need to start that process. If we are to grow this business, we shall grow it modestly in line with the market. As I said earlier, the period where we can eke more out of the aircraft in ASKs is coming to an end and in order to get growth, we need to grow in terms of aircraft.

That gives you a look at the Business Plan 2008. Let me drill down for a moment and look at the outlook for 2006/07. As far as capacity, we expect to put in 2.5-3% capacity next year, which is the conversion of shorthaul aircraft to longhaul. We still expect strong volume, something in the region of a 5-6% increase. Yields continuing under pressure over the next year, which means that the revenue outlook is for 4-5% growth. What we have seen is steady revenue growth through 2004/05 through to 2006/07, but revenue next year not continuing at the same pace as this year, which is up more than 8%. The reason for that is primarily because of the fuel surcharge.

This slide looks at the history of the fuel surcharge. As I said earlier, we have put three surcharges on during the last year from now, March, June and September 2005 which is its current level of £8 per sector shorthaul and £30 longhaul. Quite a lot of that fuel surcharging is in this year's base.

If you look into this year, this is the 8% for this year and you can see that there is a fairly even split between passenger revenue and other revenue including fuel surcharging, with cargo contributing a little. As I said earlier, most of that is now in the base and, if you look out to next year, although we expect a similar level of growth on passengers, because the fuel surcharge is in the base, it contributes less next year, and we see some increase from cargo as we put more capacity into the market. Next year's outlook is looking at 4-5% growth down on this year.

In terms of costs, fuel is still a major cost item for BA as it is for most of the world's airlines. Pay is driven by pensions and pay, we have the pensions to get through and the pay round which starts in October 2006. We also need to deal with offset volume-related increases.

First, in terms of fuel, 2004/05 it was £1.1 billion, this year, as we outlined earlier, we expect our costs to be up roughly £500 million at £1.63 billion on fuel or thereabouts. If we look into next year, we see a further 25% increase in our fuel bill, which will be over £2 billion next year if prices hold at these levels. Therefore, fuel is a major cost issue for the airline.

If we analyse the reasons for that, there is the £400 million, part of it is bound up in the capacity increase, part is down to exchange because of the stronger dollar, although some of that is being hedged, but most of it is due to our fuel hedging benefits diminishing over time: £200 million less fuel hedging benefit next year and the increase in price.

That is despite being fairly heavily fuel hedged this year and we still have significant amounts of fuel hedging going forward. There is not much left of this year but we are 80% covered for this month and have been for the quarter. If you look out into next year, we are around 60% hedged through to December, 42% through to March and increasing amounts between April and December 2007. Much of that has been moved from swaps into instruments which are collars and caps so that, if the price falls, we shall benefit from decline in price. This is the maximum level equivalent that we would pay on Brent if the price fell, we would participate in the price fall.

Our plan is to deliver cost efficiencies that will offset volume-related increases, that will offset the 2006 pay deal and cover the incremental costs we have on training people for T5. It also assumes that we shall deliver a solution on the pensions. Our plan is to offset to our cost increases excluding fuel.

To summarise for the year, next year we expect revenue growth of 4-5%, down on this year's 8% plus. Fuel costs we anticipate being up 25% or £400 million to over £2 billion on fuel spend. We have identified savings of £225 million across all costs in the business, not just employee costs, and that will offset our volume related increases. So we expect total costs to be around flat. The following year, if we see the fuel price continuing at those levels, if we see the market continue as it is, we have cost saving items to get us to the 10% operating margin. We have made steady progress towards the 10% margin to date and we can continue that improvement. I shall now pass over to Willie for remarks and Q&A.

Willie Walsh (Chief Executive): Thank you Keith …….. [*tape change, no overlap*] … aspect of cost control and cost reduction through the period of this Business Plan has been assigned an owner within the business. We have a name associated with every aspect of cost control and cost reduction and, therefore, I am very confident that we shall deliver on the savings that we have targeted in this Business Plan.

The second part of the Business Plan is to focus on and deliver Service That Matters, and Martin has taken you through some of the aspects of that. We shall continue to simplify the business to make it easier for us to deliver service to our customers in a consistent fashion, and that simplification of the business will also assist us in controlling and reducing our costs.

The third part of the plan is to get this business fit for Terminal Five, and you will have heard that we are now 752 days, 16 hours and 12 minutes away from the opening of Terminal Five. The building itself is on schedule and on budget. The programme that we have internally to British Airways to prepare for Terminal Five is on schedule and on budget, and I am very confident that we shall move into Terminal Five and that it will be a fantastic success for British Airways and a massive change in the experience for our customers at Heathrow.

The fourth and new theme to the business plan is to get the business fit for growth. Keith has shown you how we have been able to grow capacity in recent years by 2-3% per annum by getting better at utilisation, and we have identified a further 2-3% growth in next year. However, beyond that, we have identified little or no scope for additional capacity growth. Therefore, subject to our resolving our pension fund issues, and subject to our confidence in delivering on this Business Plan, which means delivering on the 10% operating margin target for the business, and subject to our being able to identify growth that generates value to the business, we shall look at modest growth in the business beyond the period of this Business Plan. We have been very clear in saying to you that we shall not add new longhaul aircraft to the business until after we have moved into Terminal Five in 2008. I know that some concern has been expressed about our ability to access longhaul aircraft after that period. We have, therefore, managed to secure with Boeing delivery positions on 10 Boeing 777s from the end of 2008 through 2010. These are not firm commitments, they are not on our books, they are subject to us delivering on the issues that we have identified, which is a resolution of the pensions issue, confidence in our ability to deliver on all aspects of the Business Plan, including the 10% operating margin, and subject to our identifying growth for the business beyond the period of this Business Plan that generates value. It is now over to you for questions.

Question & Answer Session

[*Transcriber's note: no list of analysts provided to check names*]

Chris Avery (JP Morgan): I have two questions. Your last fuel surcharge went on in September last year. Crude, if I recall, was $50 rather than $60. Is there any possibility to get through another fuel price surcharge here at the start of strong summer trading to keep the revenue environment a little more buoyant? Secondly, we learned this morning from Martin of over 60% load factor in the Club World cabin. That surely must be getting to the critical tipping point for pricing power: are we anywhere nearer that now?

Willie Walsh: Your favourite question, Chris. To your first issue in relation to the fuel surcharge, we have no plans to adjust the fuel surcharge from its current level. The last adjustment was in September 2005 when we increased the longhaul fuel surcharge to £30 per sector but we did not adjust the shorthaul fuel surcharge at that stage. Keith, do you want to add anything?

Keith Williams: [*off microphone*] I believe it was 8 September and the price was … [*inaudible*]

Willie Walsh: As I have said, we have no plans to adjust the fuel surcharge. In relation to your second question, we have seen and continue to see good growth in premium demand and, as Drew mentioned earlier, that demand going forward appears to be robust. We are confident that we shall be able to generate some additional revenues through a better mix, which is part of the plan that Keith has identified in terms of revenue growth for 2007. However, it is still a very competitive environment and Drew demonstrated that clearly when he was showing you the sort of action we are engaged in and the action we shall engage in to ensure that we continue to grow premium volumes.

Jonathan Wober (HSBC): Regarding your outlook for the financial year 2007/08 where you have now said that you expect to achieve the 10% margin, you have told us that there will be a small reduction in ASKs that year. You have told us that you expect fuel prices to remain the same as they are now, but can you give us any more on your thinking in terms of yield growth and other cost growth for that year? As a related but separate question, does it include any impact from Open Skies in that year?

Willie Walsh: We assume that there will be no change in fuel from what we are seeing today, so the assumption in the Business Plan is that fuel continues at the levels we are seeing today. I shall not give any detail as far as the yield for that period, and it assumes that Open Skies is not fully implemented through the period of this Business Plan. So this Business Plan assumes that Open Skies on the transatlantic is not implemented fully, and that takes us up to March 2008.

Jonathan Wober: Would Open Skies potentially dent that 10% margin for that year?

Willie Walsh: I do not believe so. What I should reinforce is the fact that the transatlantic is already a competitive environment. Sometimes people tend to forget that we compete with three other carriers directly on the transatlantic: Virgin, American and United. It has been clear that the debate on Open Skies in the US has centred on getting access to Heathrow. Carriers in the US and Continental in particular have highlighted the fact that they believe it would be impossible for them to acquire slots at Heathrow in the short term because of the restricted nature of the slot environment at Heathrow, and that is a fair assessment. Therefore, while we may see some move towards open skies, that translating into a changed competitive environment at Heathrow is likely to take some time. Heathrow is already a very congested airport and, even if airlines can access runway slots during that period, terminal capacity is a major block to expansion. Therefore, Heathrow will continue to see a difficult operating environment until after Terminal Five has opened in March 2008. We do not see that a change in the environment will have any significant impact on the business through the period of this Business Plan.

Andrew Light (Citigroup): I have two questions. First of all, on your Business Plan of £450 million savings, have you booked any T5-related savings in there such as work practice changes, and can we expect further savings once T5 opens given that you are going into predominantly one terminal? Secondly, you seem quite resigned to getting no benefit out of Open Skies and that this will just go ahead anyway. Surely, you must be able to secure some kind of anti-trust immunity with American Airlines much like the other airlines did as well?

Willie Walsh: In relation to Terminal Five, we anticipate getting benefits from the changes in work practices that are being introduced in advance of the move to Terminal Five. The first part of that, as Keith outlined, are changes in work practices for our people working in the ground transport section, where we have negotiated with the trade unions changes that will deliver around a 25% reduction in headcount. That will come through in the next financial year, so it will come through before we move into Terminal Five. We expect to agree changes in work practices in other areas of Heathrow customer service that will deliver savings in advance of the move to Terminal Five, and then, yes, we shall see additional savings after we have moved into Terminal Five when we get the advantage of moving into a single campus operation. Although we have highlighted today that not everything will fit into T5 on day one, with the overspill into T3, T3 is on the same campus as T5. If you look at a map of Heathrow, T3 is the next nearest terminal to Terminal Five, so I am confident that we shall achieve additional savings in the business through the efficiencies gained from the move to Terminal Five. Martin highlighted one of those. We expect 80% of our passengers to use self-service check-in from day one when we move into Terminal Five, which will change the way we operate within the terminal building.

As far as Open Skies and anti-trust immunity, we have not seen anything in the negotiations that has taken place to date that would make us confident of being able to achieve anti-trust immunity with American. We do not see that there is any change to the situation and we still believe that anti-trust immunity would come at a price which we are not prepared to pay and, therefore, we do not see any opportunity to progress ATI during the period of the Business Plan or as a result of any move on Open Skies between the EU and the US.

Chris Reid (Deutsche Bank): I have two questions. You are putting in the new set-up in Club World. Do you have any assumptions in the Business Plan of a mix benefit or a yield benefit from that? Secondly, on the pilots, there have been some fairly aggressive statements by BALPA in the press recently about issues such as pensions and pay deals. How are the discussions on the ground going, with whom are you talking and what is their attitude to these big changes?

Willie Walsh: Yes, we have assumed an improvement in the mix in terms of yield during the period of this Business Plan as a result of reconfiguring the Club World cabins. The main part of that reconfiguration is in the second year of the Business Plan. In relation to the pension, I have read quite a lot of coverage in the media about our pension deficit and it is probably fair to say that we have the best publicised deficit in the UK. I am very confident, as a result of all of the work that has gone on within the business in terms of the awareness campaign that we have run with our people to explain the background to the deficit, the challenges that the business faces as a result of this deficit, that we shall be successful in making changes to the pension arrangements that will give us the solution that we require, and that we shall be able to do that without disruption to the business. It is a real issue that we need to tackle, the work that has gone on to heighten the awareness in the business around this has been very successful, and we are confident that we shall be able successfully to engage with the trustees, with the trade unions and directly with the people working in the business to resolve this issue.

John Lawson (Investec): I have two questions. One is a follow-up on the T5 and with 10% of the business staying in T3, does that mean that compared with your original budget, your costs are likely to be higher than you originally thought? Related to that, could your additional revenues compensate for that? Secondly, with regard to the new aircraft options, is it possible at this stage to give us any idea of the capex profile over that period if you exercise them?

Willie Walsh: In relation to Terminal Five and Terminal Three, there is a slight change in the cost profile as a result of that but, as you heard earlier, part of the reason for the overspill into Terminal Three is the fact that we now have more slots than we originally had when the T5 programme was being discussed. Therefore, we are happy that the change in profile will be neutral, so the 10% overspill into T3 with the 90% in T5 and the way we shall manage that will not detract from any of the benefits that we had identified for the T5 programme initially.

I cannot give you details of the capex, because I wish to stress again that it is very much conditional. We are not today out ordering aircraft. We have secured delivery positions for the business if we deliver on a solution to the pension fund, if we deliver on the Business Plan, if we identify growth that generates value. The concern which has been expressed to us and which is a valid concern is that, subject to our doing all of that and I am confident that we shall do all of that, where shall we be able to access aircraft deliveries given the significant amount of wide-body orders that have been placed in recent years. We have secured delivery positions with Boeing on 10 777s, although there will be negotiations to take place between Boeing and ourselves in the future, from the end of 2008 through 2010.

Nick Van den Brule (Exane BNP Paribas): I have a follow-up on that. Have you paid for the options for those aircraft, that is the first question?

Willie Walsh: The details of that are confidential but we have had no significant change in our programme. We have previously had deposits with Boeing for future deliveries, so there is no change to the position with regard to that.

Nick: Is this part of your overall deposit situation?

Willie Walsh: Yes.

Nick: The second question is on the traffic situation on the North Atlantic. There is a decline in the North Atlantic traffic in February and Lufthansa has seen the same thing in January but not yet released statistics. Air France and KLM, however, showed an increase of over 6% in RPKs I believe. Can you say what competitive pressures you are facing there and the mix between premium and economy or non-premium in the decline, and whether this is part of an ongoing trend that you might see? The final question I have is on possible change of ownership that has been mooted for BAA and, if a bid is launched, will that have any impact on your terminal costs, how secure are your costs at both Gatwick and Heathrow, and what is the outstanding length of the leases?

Willie Walsh: I shall deal with the question on BAA first and then ask Martin to comment on the transatlantic situation. We have decided not to issue any public statement in relation to the potential activity regarding the BAA. We shall continue to work with the BAA to resolve issues of concern to British Airways. We have a significant programme with them but I do not see that a change in ownership will adversely affect the situation that British Airways is in. However, I am not prepared to comment beyond that because it is pure speculation at this stage. We continue to negotiate with the BAA, and Keith and Martin have identified that the changes we are making in Gatwick involve changes to the property that we have at Gatwick, which is being done in conjunction with the BAA. We continue to work with the BAA, we have done so since the speculation with regard to any takeover has become public, and we shall continue to do that through the period. We shall not see any change in how we work with the BAA and we are not allowing this to distract us from our dealings with the BAA.

Nick: What is the typical length of contract on the terminals?

Willie Walsh: They differ, it depends. There are different arrangements in different parts of the business.

Martin George: Let me talk about the North Atlantic. The premium market is strong and has been strong for the whole of this financial year, and we expect that to continue. Both UK sold and US sold are strong, and the US market is growing at about twice the speed of the UK market, which is a direct consequence of the state of the key industries. If you look at the key sectors that fly regularly with BA, those sectors are all doing pretty well right now such as banking and finance, pharmaceuticals and so on, and that applies both to the UK and the US.

Non-premium is a different issue in that the non-premium market is more challenging. We are not losing share in that market but the market is challenging overall. There are a number of factors at play there. If you look at UK GDP, that gives you an indication of why there is some softness in the UK sold market, and when you look at things like UK retail, that is a good indication of the fact that the man and woman on the street is lacking confidence. This is reflected in the retail numbers, which is reflected, to a certain extent, in the non-premium North Atlantic business. The recent problems with weather in places like Florida and the Caribbean have impacted the customers' confidence in those destinations. The market to Florida, for instance, is soft VOI and you will be hearing that more generally. The US sold market to the UK is fine both point-to-point and intercontinental Europe, and we expect that to continue.

The European market, and I exclude the UK from that, is patchy. France and the French market has been affected to the US by the new visa rules, which means that you must have machine-readable passports. There has been some tension between the French and the Americans over that. As a result, you must have a visa to go to the US if you are a French citizen, the visas are issued by the US embassy, you have to go to Paris to get your visa and there is a significant waiting list to get a visa. Not surprisingly, that has dampened the market quite considerably out of France to the US. The German market, which is also historically a strong one to the US, is not surprisingly being impacted by the weakness of the German economy.

In summary, premium is strong and continues to be strong and I expect it to be strong in the next financial year. Non-premium is challenging but we are not losing share.

Penny Butcher (Morgan Stanley): I have two quick questions. Can you clarify on the £450 million target to 2008 how much of that is related to employee costs? Am I correct in assuming that it is around £300 million of that total as per your original announcements? Secondly, what are the risks that the pension negotiations are delayed beyond autumn of this year?

Willie Walsh: We are not giving a detailed breakdown of the £450 million. There will be a significant element of that down to employee-related costs, but we are very clear that it is not solely a case of targeting employee-related costs. We need to target all aspects of our cost base and we have a programme that tackles every aspect of the cost base through the period of this Business Plan – that is every aspect of the controllable cost base, taking fuel to one side. However, we are not giving out a detailed breakdown on that. In relation to the risks to the pension fund negotiations, we expect to engage with the trustees, with the trade unions and we shall be talking directly with our people from the end of this month. Therefore, there is sufficient time allowed for the negotiations to conclude through the summer period and I expect that we shall see a resolution to the pension fund issue within a reasonable timescale. So I am not concerned about any overrun in relation to the negotiations.

Oleskiy Soroka (BNP Paribas): My first question is on the Open Skies. What is the worst case outcome that you envisage from the negotiations? Secondly, if everything goes according to plan with regard to your pension deficit, will that act as a catalyst for the rating agencies to upgrade you to an investment grade, or do you think it will be insufficient? Perhaps Keith will deal with the second one.

Willie Walsh: With regard to Open Skies, to be honest we are pretty clear as far as what it is likely to mean at this stage, and the Chairman outlined during his opening remarks that we do not see that it represents any major opportunity for European carriers. There are some opportunities in it for British Airways, because, like other carriers operating out of Heathrow, we are restricted in terms of the destinations that we can serve out of Heathrow. We currently serve a number of transatlantic destinations from Gatwick and would prefer to operate from Heathrow. We have the slot portfolio at Heathrow that would enable us quickly to move Gatwick-operated transatlantic flights into Heathrow and, therefore, that would be an opportunity for British Airways.

The other side of that is that it is expected that other carriers would seek entry into the Heathrow market but, as I have already said, before they could do that they would need to acquire slots. Slots are at a premium in Heathrow and, if there are slots available, we shall be active in that market also as we have been in the past, and one of the reasons why we have identified the overspill into Terminal Three is because we have been acquiring slots at Heathrow and we shall continue to look for opportunities to acquire slots there. If slots are available and acquired, terminal capacity will be an issue as well, and that is extremely difficult in the current Heathrow environment. It will become somewhat more relieved following the opening of Terminal Five in March 2008 but, as you know, the BAA's intention is to use that opportunity of the additional capacity at Heathrow to start redeveloping the central terminal area. At this stage, we know what the likely outcome will be. What is disappointing about the discussions that have taken place so far is that we believe that, while it may be viewed as a step forward or in the right direction, it is a very tiny step and we believe that this was a missed opportunity for a move towards a genuine open aviation area between the EU and the US. So it is more the missed opportunity than the concerns that we would see.

In relation to the credit agencies, I shall ask Keith to comment on that question.

Keith Williams: We have ratings as you know with both Moody's and Standard & Poor's and both rating agencies have indicated that pensions are a major issue to them in relation to our credit rating. If we resolve the pensions issue, it will make a significant impact towards movement back to investment grade but, in and of itself, it would not be the only issue.

Oleskiy Soroka: As a follow-up, what are the other preconditions apart from pensions?

Keith Williams: The main issue they are looking at is pension adjusted debt and they look at both gross and net debt. Most of our ratios are in line with an investment grade credit rating, so that is a major issue, net debt and gross debt adjusted for pensions, as an outstanding item to get back to investment grade.

Patrick Hughes (Credit Suisse): Sorry to go on about ratings but, if my memory serves me correctly, Moody's are a notch lower on the negative outlook, so what is the main difference between the approach from S&P and Moody's, and are you happy that both agencies will be looking at investment grade if you fulfil your Business Plan objectives and pension solution?

Keith Williams: Yes, I realise myself that S&P are slightly lower and we are on negative but both rating agencies continue to review the rating, and they arrive at their assessments independently.

Andrew Lobbenberg (ABN Amro): You are talking about 2.5-3% capacity growth for the coming year, can you tell us where that is coming from? I know you have more traffic into India but where else is it coming from? Secondly, relating to the prospect of mixed mode operations at Heathrow, what is the likely outlook for that, how do you see that playing out and how would that interlink with potential Open Skies talks? Finally, for Keith, I thought I heard you say that you were going to start accounting for fuel surcharges in passenger revenue and not other, can you confirm that and explain the thinking behind your change if that is correct?

Willie Walsh: In relation to capacity, the figure we have given you is overall and India will represent capacity growth in excess of that overall figure. Some of that will be funded from the cancellation of the Singapore-Melbourne leg, so you will see a fall-off in capacity in that part of the market. However, overall you will see additional capacity in excess of that 2-3% in India. You will see a reduction in the Australasia as a result of the cancellation of the Singapore-Melbourne and we shall also see increases in capacity in Europe. Some of that will be at the expense of domestic, where the guys have indicated that additional competition from the train is an issue we are seeing at the moment. Therefore, you will see growth in Europe, growth in India, growth in North America as well, and North American growth will be 767s.

Andrew: Can you talk about mixed mode?

Willie Walsh: Sorry, mixed mode, I apologise. We would hope that mixed mode would be introduced. We believe there is a strong case for the introduction of mixed mode. The first thing we would like to see with the introduction of mixed mode is that the additional slots are used to improve the operational performance at Heathrow. There are times when Heathrow is operating at above rated capacity, which leads to delays in departures and arrivals. However, we believe that mixed mode could significantly improve the operational impact of Heathrow, and that we would look to acquire some of the additional slots beyond that. You could see a potential increase in capacity at Heathrow somewhere in the order of 10% as a result of the introduction of mixed mode. That is unlikely to happen through the period of this Business Plan. It is likely to come into effect beyond 2008. It is not something that can be introduced immediately, so there needs to be agreement to introduce it, there needs to be significant training and changes to procedures in terms of air traffic control before we can see the full benefit of mixed mode. I believe it is likely to impact at Heathrow after 2008. Finally, in relation to fuel surcharges, Keith?

Keith Williams: On the question of yields including fuel surcharges, as you know fuel surcharges have been around for such a long time now and all other airlines include fuel surcharges in their yield analysis, so it was really just bringing us into line. We thought it would be easier for the analysts.

John Strickland (JMS Consulting): You have announced changes to the BA Connect, the shorthaul product in the regions, particularly on the commercial side, changed pricing and product. However, they have relatively small capacity aircraft such as the Embraer and RJ, which have high unit seat costs, so do you think that the commercial changes will be sufficient to turn the corner in profitability, because they face quite a lot of low cost competition from 737 operators for example?

Willie Walsh: The plan for BA Connect is not solely commercial changes. There are also significant cost reduction targets that have been identified that will be implemented. The issue with BA Connect is that it operates in a very competitive environment. It has been loss-making for a number of years, as you will know, and we have given the business a short period of time to reverse the financial performance. The performance will have to be reversed using the existing fleet, we are not replacing the fleet, but the plan that has been put together turns the performance around but it is a combination of both commercial changes, as Martin outlined, and there are also significant cost reduction targets associated with that. One of the issues we identified with BA Connect is that we were layering a significant additional cost on the business because of some of the commercial activities that we required them to do. However, that really did not make sense in that region of competition. I believe that the plan they have put together is sensible, reasonable and the targets identified will be achieved.

Question: I have a question on ancillary revenues. How much of this is going through your business at the minute – it was interesting when you talked about possibly increasing the hotel bookings and so on? Also what sort of assumptions do you have for that in the Business Plan, and is it practical that you can develop that as it is not something that I think about when I think of BA?

Willie Walsh: That is a fair assessment. We recognise that there is significant scope for us to drive additional ancillary revenues through the business. We have a fantastic brand, we have an excellent website and quite honestly we are only beginning to scratch the surface of this. I shall not give you specific details in terms of the targets that we have but one of the features that you will see through this Business Plan and in subsequent Business Plans will be a much greater focus on the generation of ancillary revenues through the business. We have seen where other airlines have been successful in doing that, and we believe that with our brand and our website we have significant scope within the business to do that. That will be a feature that we shall start to develop through the period of this

Business Plan, but you will see the real benefit of that being achieved through the latter stages of the plan and beyond.

Steve ?Owen (Citigroup): You said that the Open Skies deal that is currently on the table offers you very little. Would your attitude materially change if the foreign ownership of US airlines was relaxed?

Willie Walsh: Our attitude would be different if we felt that the discussions would have led to being able to achieve anti-trust immunity with American without having to pay a price. That would have been a completely different scenario but, as I commented earlier, we are not prepared to pay the price that has been identified previously, which is a significant number of slots at Heathrow. We do not see anything in the proposed agreement that would change that and it is disappointing. However, if there were a possibility of ATI with American without having to pay a regulatory price, yes, we would have a different view but that is not the case.

Question: With Delta and Continental increasing more overlying from their hubs at Newark and JFK, it will probably put more pressure on Heathrow for convenience and transferring of your through passengers, and I know you are trying to fix that problem with Terminal Five. However, it seems that you did not make it big enough. I know that everything revolves around slots but why didn't you make a bigger terminal there so that your partners like American could move in if you wanted them to do so? I do not know if you want your partners at the same terminal but it seems that you have not completely solved the convenience problem of through passengers, because they still have to go to some of the other terminals such as Terminal Three where some of your other operations are?

Willie Walsh: Quite honestly, people who want to fly with British Airways will have a fantastic experience at Heathrow where the vast majority of our operations will be in Terminal Five. We do not control the building of the terminals at the airport, that is a function of the BAA. The programme is designed to build T5A which is the main terminal building that you can see, the first satellite building which is T5B, and they are being built together for readiness in March 2008. The second satellite T5C was originally planned for 2012 and we would expect that to be delivered in 2011, possibly 2010. Looking forward, there is scope to extend further, which is why Terminal Three is a neat solution for us, so you might possibly see further satellite extensions for that. The ultimate vision that we have is that all of our customers at Heathrow will be able to enter in through the front door of Terminal Five. They may be departing from satellites away from the main Terminal Five building, but I believe that is something that can be achieved over time. However, it is a significant capital expenditure programme for the BAA, capex around T5 is of the order of £4.3 billion, and the capex that was approved through the regulatory process was for the building of T5A, the main terminal building, and T5B. The next stage of that regulatory review will start soon and that will deal with further capex in terms of the recoverable capex to the airport operator.

I am very pleased from a British Airways point of view with the development of T5. It will be a massive improvement for British Airways customers going through Heathrow, and it will give us the opportunity at Heathrow to deliver a world-class service that we aspire to. So from the point of view of British Airways, there is nothing but good news in Terminal Five, and I feel sorry for some of the other operators at the airport but they will get the benefit of improved facilities as the central terminal area is renovated. Thus our moving from T1 and T4 ultimately benefits every airline operating at Heathrow, and the only way that that could be achieved effectively was through British Airways moving to Terminal Five. While it is not perfect for everybody, it is a massive step in the right direction and certain from a British Airways point of view, it is a major plus.

Question: What will happen with T1, T2 and T4, will they be torn down eventually or used by other airlines?

Willie Walsh: You should address that to the BAA but they have plans for the future development of Heathrow. The plans that I have seen are very sensible and to give credit to the BAA with respect to Terminal Five, they have managed a massive building programme and it is being done on schedule and on budget. That is not necessarily unique but it is a significant achievement. The programme is running to plan and we looking forward to moving in in 762 days and, although I don't have a watch, probably 15 hours and 30 minutes I assume from now.

Question: Two quick supplementaries. The 777 options, have you decided whether they are 200s or 300s or do you not have to decide yet?

Willie Walsh: We have not decided and we do not have to decide yet.

Question: You just book the slot, it is a 777 and you decide later, very good. Secondly, do we no longer need a planning inquiry for mixed mode? I thought one of the big obstacles was that it had to go through a long planning inquiry?

Willie Walsh: The intention is that mixed mode will be introduced at Heathrow and there are a number of hoops to go through. That is why I said to the earlier question that I do not expect to see the benefit of mixed mode through the period of this Business Plan.

Going back to the 777, I would not read anything into the fact that it is a 777 order in terms of what we might do beyond that into the future. The reason it is a 777 order is that 777s are available, so it is to secure availability of additional capacity subject to the conditions that I outlined. The evaluation of expansion opportunities and replacement opportunities for the business continues.

Question: Given you said that the regulatory price for a tie-up with American is too much, are there any other markets that are particularly attractive to you at the moment?

Willie Walsh: What we have said in relation to consolidation is that we believe the industry would benefit from consolidation. The track record in the industry has not been fantastic. However, we have to give credit to Air France and KLM in terms of the progress that they have made with the merger of the two airlines. They have had to put a complex structure in place to comply with the regulatory requirements, and to see genuine consolidation in this industry we shall need to see a move to a freer regulatory environment. That will happen at some stage in the future but it is some distance away now, which is why it is disappointing that the EU and the US did not see these negotiations as an opportunity to push that agenda forward. While that difficulty exists, we shall remain alive to any opportunity but we are not active at this stage. We would only look to consolidation where consolidation is of benefit to British Airways. It is not a case that we want consolidation to make BA bigger. We would look to consolidation to make BA better so, as I said, we are not active at this stage and, given the lack of progress in terms of regulatory change, I do not see that there is anything significant that would happen in the short to medium term.

Speaker (Rob Webb): I wonder if I might ask a question. I am not an investor in this airline other than through our compulsory share option scheme. I want to give the lie to the idea that American are in some way our partners at Heathrow. They are not, they are our deadly competitors. We have franchisees with whom we have legitimate arrangements, we have Qantas with whom we have a joint venture agreement, but someone like American over the North Atlantic, nice though they are individually, are our sworn enemies. Similarly, so far as the airport owner is concerned, it is BAA at the moment but it may very well be someone else tomorrow or the day after, we shall never comment on that. However, we saw what the CAA said, pre-emptively so far as we could see, when they went into the newspapers and said these things are a regulated monopoly and we shall regulate regardless. That will put some sort of yoke on any leveraged financial arrangement that is put in place but that is not a matter for us.

Lastly, I regretted hearing an analyst talking about a planning inquiry being an obstacle. They are the route to a fortune for all my former colleagues and represent my own future …….. [*tape change, no overlap*] …….

Willie Walsh: Thank you for that, Rob, I noticed that there was no question in that, so I appreciate you not asking me any.

Michael ? (JP Morgan): Can you kindly comment on what you view to be your minimum cash balance over the next couple of years and whether or not you intend to continue the deleveraging story that has been quite successful in the recent past? Also a bit of minutia, could you comment on your mix between wide-bodied and narrow-bodied jets in your unencumbered fleet? Lastly, can you give us any status update on the regulatory inquiry into your cargo operations as well as that of your competitors and peers?

Willie Walsh: Keith, would you like to address the first two?

Keith Williams: I caught the first one which is about cash balance. Our cash balance at the moment is around £2 billion and our scheduled debt repayments over the next one, two, three years are between £450-500 million a year. So we would continue to make those payments and deleverage appropriately. [*asks for second question to be repeated*]

The majority of our aircraft in the unencumbered fleet are narrow-bodied, but I could not give you the exact split.

Willie Walsh: In relation to the investigation, other than to say that there is an investigation ongoing and that we are fully cooperating with it, I cannot comment.

Question: The previous questioner asked if there are any other areas of market interest in terms of financial partnership. Are we likely to see a closer relationship with Iberia this year?

Willie Walsh: We have an excellent relationship with Iberia. We have worked well with one another and it is an example of where the airlines and the consumers have benefited. Other than to say that we continue to work with them, we do not intend to make any changes to the relationship that we have. We are pleased, it is a relationship that has worked positively for British Airways, positively for Iberia and positively for the consumers of both airlines.

If there are no further questions, I want to thank you for attending this morning. I look forward to talking to you over lunch and then after lunch there is a presentation from Gareth Kirkwood, our Managing Director of BA World Cargo, and a number of you will be going on the tour of the cargo facilities. Thank you very much. [*luncheon arrangements advised*]

- *Luncheon* -

CARGO
Gareth Kirkwood
Managing Director World Cargo
[*Presentation with slides*]

Good afternoon everybody, it looks like I have drawn the post-lunch slot, so I am hoping for a nice sparky debate once I have finished with this presentation. I have been Managing Director of BA World Cargo now since 2000, and I have seen a huge change in the business during that period of time. I want to talk to you about some of these changes and about where the business is going in the future.

I realise that one or two of you may not be as familiar with the air freight industry as you are with the passenger industry, so I shall give you a brief industry overview. I shall talk about BA World Cargo, the business, as it stands today in 2006 and I shall talk a little about the business strategy for the future. In May last year, we concluded and had signed off by the Board of British Airways a major strategy review of the business, and the Business Plan launch is the first two years of that strategy which looked about five years ahead broadly speaking.

Let me start off with an industry overview and I shall give you some dimensions. The size of the air logistics industry is about $225 billion, of which the air transport section, which is airport to airport, is about $44 billion. That is broken down so that around 50% is freight carried in the belly hold of passenger aircraft, and about 50% is carried on freighter aircraft, so broadly it is a 50/50 split. About five years ago that was more like 70/30 in favour of the passenger aircraft, so you can see that the penetration of freighters into this marketplace is increasing over time. It is an intensely competitive marketplace, as I shall go on to describe, and to put it into some perspective for you, big although it is at $225 billion, it represents only 2.6% of the total market for the transportation of goods. In other words, it is 2.6% of sea freight, as a much larger proportion of the world's freight goes by sea. However, the wholesale value of goods transported by air is about 45% of the total, so that reflects the fact that it is usually the higher value items and products that are closer to being finished products rather than raw materials that are transported by air, therefore having greater value.

In terms of its growth prospects, this slide shows in the top half of the box for each region the cargo growth forecast over the next 15 years, this is from Boeing, and the bottom half shows passenger growth. You can see that in the major markets, cargo is expected to outgrow passenger over the course of the next 15 years just about everywhere. In the top right-hand corner, you see the total for the whole world, cargo growth anticipated to be about 6.4% per annum over the next 15 years, passenger growth just under 5% per annum. If you look closely at the slide, you can see that much of that is driven by exports from Asia. If you look at Asia to Europe there, 7% growth per annum is anticipated. Within Asia, 8.4% growth is anticipated and this one here which is trans-Pacific is 5% growth anticipated. Therefore, it is the exports from the Asian economies that are really driving growth in this industry.

However, those growth figures mask one critical fact about the cargo business, which is that unlike the passenger business, there are huge imbalances in the direction in which freight flows across the world. When a passenger buys a ticket, there is a reasonable likelihood that they will come back from the place they are going to but that does not happen with freight. Generally speaking, freight goes from the East and to a certain extent from the South on that map towards the big consumption economies in Europe and the United States. Therefore, it tends to be the case that it is much more of a one-way flow of business. For a cargo business or airline as we are, that gives us huge challenges, because if you are sitting in Asia you are looking to optimise the freight that goes onto the aircraft.

Generally speaking, you have more freight than you have capacity, so it is a yield management exercise, looking to maximise every square inch of capacity. That is how the salesforce and the revenue management systems are set up for the Asian marketplace. If, however, you are in the UK or North America, you have a different challenge altogether, which is scraping together enough freight to make a particular sector worthwhile in the opposite direction. So you different types of revenue management systems and a different outlook from the salesforce to support that type of marketplace. Therefore, there are big differences depending on which part of the world you happen to be sitting in and on what you are trying to do to maximise the value of the franchise in each of those parts of the world.

Looking at yield now, this graph shows an historic perspective on yield over the last 20 years, where 1985 is indexed to 1, and it shows the decline on average of about 2.5% per annum in air cargo market yields over that period of time. The slight upturn towards the end of that is a one-off which was caused by a major West coast US port strike in 2003, which drove a lot of capacity from sea to air and helped yields in the process. However, after that time, the downturn has continued. Therefore, there was a significant decline in yield over that period of time, caused by a number of factors. One of these is the illogicality of the way that cargo capacity gets deployed. If you think about sitting on the passenger airline side of the business, the aircraft capacity tends to be deployed because there is passenger demand for it. However, with each of those large, wide-bodied aircraft comes belly-hold space which has to be filled by the cargo businesses of those airlines. Very often the demand is from the passenger side but the capacity is supplied onto the cargo side of the business, which means that the cargo airlines have more capacity than they would need to sell in that particular marketplace. The inevitable consequence is that the price comes down over time.

Another factor is that, for many years and until very recently, many of the world's major airlines treated the cargo business as a marginal business and, therefore, took the view that any freight they could get in the belly-hold of their aircraft was good freight, rather than looking to maximise the yield from it. Again, that caused a softness in price, driving the price down over a period of time and resulting in lower yields.

Another major factor has been the fact that the global forwarders, some of the world's biggest companies now, have been combining and consolidating for many reasons but one in particular which is to increase their buying power. They are significant sized entities now with global reach, driving down prices, and when you put those strong acquirers of capacity alongside some weaker sellers of capacity, you get the inevitable decline in yield over that period of time. Also you have seen shippers looking to drive cost out of supply chain, which has been a mantra for the last 10 years at least across industry, and this inevitably causes downward pressure on yields all across the market. The challenge for us, therefore, when we look strategically at the business is how do we go about bucking that yield trend, and that has been the key challenge for BA World Cargo whenever we have looked forward and looked strategically at our business. Some of the things we plan to do about that are what I shall show you later on.

On that point of the strength of global forwarders, the Deutsche Post Group has within it now forwarders that up until three years ago were independent: DHL, Danzas and Excel used to be independent competing companies as recently as 2002. They are now together in one organisation and, if I look at the share of BA's business that those entities combined now have, it is almost 12%, which makes it about three times the size of the next nearest of our customers. That slide serves to illustrate the sheer buying power that the major global forwarders now have, and they are not alone. Bax and Schenker have come together recently to make a much bigger entity, again with much stronger buying power, and we expect to see that consolidation continue.

Turning now to our position in the industry in 2006, I want to give you an overview of the various commodities we are in. If we start at the top right-hand side as you look at that particular slide, one of the things that we carry both from Asia and to Asia is clothing. Many of the clothes that are available for sale on the high street at the moment will have been transported into the United Kingdom on BA World Cargo. Some of the more luxury items such as Burberry and Prada will probably have been exported from the UK or Europe by BA World Cargo to the Asian marketplace.

Perishables in the top left-hand corner, fruit, vegetables, fish, flowers and so on, we pride ourselves there in having a handling facility here at Heathrow called the Perishables Handling Centre that takes raw material produce from various parts of the world, particularly from Africa and turns it into supermarket-ready goods for Safeway, Waitrose and people like that. Whereas before they would have had to do that themselves, that is now a service that is provided by BA World Cargo in conjunction with Salvesen's who run the facility for us. I shall return to that later on in the presentation.

Pharmaceuticals down here in the left-hand side: virtually all the pharmaceuticals that are transported across the world have to be transported at between 2-5 degrees centigrade, so they require very careful handling. Again, we are geared up to do that in our business now and going forward, and that is a very high added value product. On the right-hand side there, computers are a major part of air freight across the world. If you buy a Dell laptop, for example, in South Africa, the chances are that that product has been manufactured in Ireland and exported on BA World Cargo through London on our aircraft down to Johannesburg. So there is a great range of commodities flowing in different directions across the world.

As far as statistics for our business, we now have 200 destinations in over 80 countries, about 500,000 tonnes of freight each year through our facility which is known as Ascentis that those of you who are going on the tour later will see. More than 450 million, in this case this year far more than 450 million in flown revenue every year. A couple of years ago, we were the first UK airline to put a freighter service into Shanghai, we were there a year before the passenger side of the business, so we have penetrated China which was a great coup for our business. Last year, we were voted the Cargo Airline of the Year by our customers, which is an award that we hope to retain this year. We currently employ almost

2,000 people worldwide across those 80 countries that I mentioned. The majority are here in London, a significant proportion in the United States and some through the rest of the world. Therefore, it is a genuinely global and significant business in its own right within the airline.

Turning now to revenue, this slide shows our revenue performance both historically and the last two bars are our forecast revenue performance. You can see there that the revenue performance of the airline's cargo business has increased significantly in the last couple of years. What has happened there is that we have introduced new capacity into the marketplace. Two or three years ago we were operating just two dedicated freighters through our partner GSS who operate our freighter aircraft on our behalf, and we did not have any partnership with DHL in Europe. We now have …. [*break in recording*] ….. you see the challenges they put us cargo people through! In case you did not catch that last part of it, the yield improvement is down to deploying our capacity in marketplaces that have generally higher yielding business. What we have done with our longhaul freighter network in particular over the last couple of years is we have deployed it more towards Shanghai, as I mentioned earlier on, and also strengthened our Hong Kong services. We are now operating eight services a week out of Hong Kong.

We have also invested in a number of initiatives in back office commercially to help drive yield, and I shall return to those later on in the presentation. We have also benefited from BA deploying additional capacity in markets like India, which are again higher yielding markets than we have traditionally been used to from a freight point of view. So we have started to buck that yield trend that I was talking about in the marketplace on an earlier slide, and that is really the big part of our strategy going forward, to continue to make sure that we drive our yield upwards in the market generally where the pressure is driving it downwards.

In terms of our costs, this slide shows manpower on the left-hand axis and shows tonnes sold per unit of manpower (MPE) on the right-hand side. Looking at the blue bars there, manpower has come down dramatically since the start of the decade. We were employing over 3,000 MPE in the cargo business at the start of the decade and we are now just on around 2,300. During that time, the tonnage throughput through the business has increased significantly, so we have both reduced manpower and have absorbed the additional tonnage we have been putting through the business as we have grown our capacity, creating that productivity improvement that you see on the slide.

How did we take manpower out of the business? We did some outsourcing. We outsourced our UK regional operation to an organisation now called BA Regional Cargo, we tackled overtime as there were many overtime abuses in our business, and we tackled in particular absence. We were one of the worst parts of the airline as far as absence performance two to two and a half years ago, where we had sometimes as many as 18 days sickness per annum in some areas of our business. We now have that down under 10 days per annum, which is much more like the norm for an industrialised workforce in the UK. We do not intend to stop there either, we want to drive it down below that point. Therefore, you can see there the benefits of reducing manpower at the same time that the tonnage throughput has gone up through our business.

What is not on the slide but which I am also very pleased about is the fact that the quality of the service that we provide to our customer has also increased during that time, so we have managed to take the manpower down, absorb more tonnage, increase our productivity and improve our service levels all during the last four to five years. That, as much as anything, underpinned the award I was referring to on the previous slide.

Looking forward as far as our business strategy is concerned, there are four main elements to our BA World Cargo business strategy. Some of those are common with the passenger side of the business, obviously the cost reduction side at the bottom and the world-class customer service performance. However, the top two are slightly different and I shall go on to explain those in a little more detail in a moment. The main thrust of the strategy was to model the business in such a way that it underpinned the delivery of BA's 10% operating margin. Therefore, everything that we now do we measure against our ability to underpin that margin target from a financial point of view, so all of the strategy is geared to the delivery of the 10% operating margin.

Taking each of these in turn, if I can start with selling the most profitable product mix. This slide shows two things. It shows the aircraft divided down on the top half of the slide by volume and on the bottom half by contribution, and for contribution read BA World Cargo profit. I have tried to illustrate on this slide the percentage of our business on the top half accounted for by the various products that we sell, and on the bottom half the percentage of our profit or contribution accounted for by those same products.

To take you through that, if we start with the tail of the aircraft, the product known as "constant fresh" is our perishables product. That is where we take raw material, produce from various parts of the world, bring it into the UK or beyond the UK, and in some cases in the UK we turn it into supermarket-ready products for the shelves. This business is relatively low yielding on a yield per kilo basis but it is incredibly dense. If you are carrying vegetables, fruit or flowers, it is a very dense business and, therefore, it is good business because it uses the capacity on board the aircraft very well. You will see that as a percentage of our volume it is 21% but it is only 14.5% of our contribution, but it is a conscious decision to be in that business because it provides an excellent base load year-round product across our network. We have recently invested in some additional handling capacity in our Perishables Handling facility at Heathrow to broaden the range of products we can handle and to increase the capacity in that facility, because that is a market we very much want to be in for the future.

The “perform loose” product is where a forwarder brings product to the BA World Cargo warehouse, and we build it into a container or onto a pallet for shipment across our network. There is a large labour component to that where we are providing the labour to build the pallet or the container, so although that business is very high yielding, it is also quite high cost as well. That explains the difference between the 24.1% of volume and the 14.3% of contribution of profitability. Therefore, so far as that is concerned, we have decided to limit the capacity that we set aside on the ground for the handling of that product which is about 700 tonnes a day, so we shall only accept the most profitable 700 tonnes a day of that business through our handling facility here at Heathrow. That is recognition again of the fact that, while that business is profitable, it is not as profitable as some of the others as I shall come on to tell you in a moment. Therefore, we have limited the capacity on the ground that we have to handle it.

Our unitised business is where a forwarder delivers freight ready to fly on the aircraft, whether it is on a pallet or in a container. There is a very small labour component, it goes straight through the building which you will see later on almost without being touched by human hand. Therefore, although it is lower yielding, it is also much lower in terms of its cost, explaining the difference between the volume component of our total business at just under 47% and the profitability side of it, which is 49% plus. There we have some excess capacity which we are not fully utilising in our building yet, so our strategy is to sell more of that business to fill the excess capacity that we have, because on a marginal basis it is extremely profitable as we grow that footprint in terms of our total business.

Coming now to the premium products at the front of our aircraft, this is where the disparity is most significant between the volume that we have in our business of just over 8% and the contribution that it makes to our overall profitability of 22%. In times gone by, we have been constrained from doing any more than that because of limits on our handling facilities here at Heathrow. We have been in an old general cargo warehouse that was not designed for premium products. Premium products are things like express, mail, courier that sort of thing, which attract a higher yield. We were constrained in our handling facilities for those products for a long time. We have recently made an investment of £15 million in a new facility to handle premium products, which is the one you will see later on. It does not quite look like this yet because it does not open until September this year, but this is an artist’s impression of our new premium facility at Heathrow. It reflects the fact that we want to grow that portion of our business, grow beyond that 8% volume and, therefore, beyond the 22% profit that I showed on the previous slide by building a purpose-built express, premium, mail warehouse through which to take that freight in the most expeditious manner here at Heathrow. We shall relinquish the lease on the old facility when this building is complete.

We are trying not just to optimise the way in which we acquire capacity and put freight on our aircraft for highest profitability. We are trying to optimise the link between the aircraft capacity and what we have on the ground, which is the way in which we shall drive the maximum profitability out of our business going forward. We need to make sure that what we sell we can handle, and we have a balance between what we are selling and what we are handling in all markets of the world. Key to that is getting our facilities here at Heathrow, the new warehouse and the existing warehouse Ascentis, tuned to what our salesforce are selling in order that we drive the maximum profitability through the business.

To help us do that, we are launching some new products this year. We have not named those products yet but this will be the imagery that we shall use. We are launching a cool chain product, which is the thermometer on the left-hand side, and, if you recall me talking about pharmaceuticals earlier on and the extreme temperature sensitivity for those, we shall launch a product that delivers that kind of functionality to our key pharmaceutical customers. We shall also relaunch our express product, that is the clock or the watch in the middle there, a revamped express product will be launched later on to coincide with the opening of the new facility, and we shall get back in a new and bigger way into airmail which is a product that we had temporarily come out of, at least out of the trans-shipment element of airmail, with the advent of the new facility at Heathrow. So there will be some product launches later on in the year to support the opening of the new building. Between those two elements, we hope to drive a 16.5% increase in the volume of premium products that we carry through out network during the course of the next financial year and, as the building matures and the products are launched, we hope to improve even on that percentage in the years beyond that.

To support those new initiatives, we have invested heavily in back office systems on the commercial side. In particular, we have invested in a new revenue management system and we are in the process of building a new global pricing system. As the slide says, we are in the process of investing about £10 million in both of those systems, and we expect a profit improvement of £14 million during the course of 2006/07, which will continue beyond that period of time. What those systems will do is, in the case of the revenue management system, make sure that every transaction that is conducted across the world every day, and our salesforce are out all across the world with forwarders and with other customers doing business, jump a particular hurdle rate, that they are all profitable, and that that hurdle rate is geared to the delivery of a 10% operating margin. Therefore, it makes sure, first of all, that all the business we conduct is profitable business. Beyond that, it takes all of the business that we could carry and optimises it in such a way that we only take the most profitable stuff that there is out there. Just because a piece of business jumps the hurdle rate, it does not necessarily mean that it gets space on the aircraft, because the revenue management system will be optimising the whole time to make sure that we get the best value from every cubic meter of capacity that we have for sale in the belly-hold of our aircraft.

To bolster that, the new pricing system will make sure that we sell at the highest possible prices in a given market. Obviously, there is a market rate in each market that we deal in, and we shall make sure with the pricing system that we automate the rates at which we sell, so that the salesforce have some clear guidelines as to the prices that they can sell at. At the moment, we have different systems in different countries and in some areas of the world the systems are very manual. This will give us one single, global pricing system similar to the worldwide dealing system that exists on the passenger side of BA. Therefore, we are in the middle of that at the moment.

The revenue management system is implemented and in place, and we are busy bedding that down at the present time, and the pricing database is in development. It represents £10 million worth of investment expecting £14 million worth of profit improvement during the course of the next financial year. Between the strategy to optimise the load on board the aircraft and making sure we have the right facilities to pull out on the ground and these back office systems, we are endeavouring to sell the most profitable product mix that we possibly can, always conscious of the fact that what we have to sell is the most consumable product of them all – space is what we sell and we need to make the best use of it that we can.

Turning now to our network and our goal of developing a profitable and truly global network, why do we want to have a truly global network? If we go back to those forwarders I was talking about at the beginning, as they consolidate and come together, more and more they are looking to reduce the number of airlines they deal with. When I first came into this business in 2000, it was typical that a forwarder would have 80-100 “preferred” airlines with whom they would seek to put the majority of their business. Now that is typically fewer than 10, probably about eight on average, because they have realised that the way to obtain the best value from the capacity that they buy is to consolidate down on as few airlines as possible.

To stay in that elite group, and I am pleased to say that BA World Cargo is, generally speaking, in that elite group, it is essential that we have a number of things. First of all, customer service is key but having a truly global network, having a presence in the major markets of the world is critical as well, because those forwarders are generally looking for a one-stop-shop, they are not looking to put their freight capacity with multiple airlines. Therefore, our ability to develop a truly global network over the next few years will be critical to our ability to stay in that elite group of carriers used by most of the top forwarders.

Looking at our networks individually, I shall turn to shorthaul first. This is an area where we have done some significant restructuring of our network in recent years. If I look at the environment first of all, we are located in the UK but we do not see the UK as our home market. The reason why we do not see the UK as our home market is that there simply is not enough manufacturing export to sustain an airline of our size and capacity. Therefore, we are forced to consider Europe including the UK as our home market. The problem with that is that we are on the geographic periphery of Europe and our strongest competitors are located on the mainland. Most of the forwarders are located on the mainland of Europe. Therefore, in order to persuade a forwarder to use British Airways World Cargo on an island and to back-haul freight across the Channel, we have to provide the slickest possible transfer product through Heathrow that we can.

Five years ago, we had around 26 767s operating wide-bodied capacity, which is real golden capacity as far as airfreight is concerned, especially deployed on shorthaul. For very good and sensible reasons, BA has been reducing its fleet of 767s in Europe and we are now down to fewer than a handful. That has worked very well for the airline overall but it has given us a problem in cargo because our wide-bodied capacity is reduced significantly in Europe. To augment that, we have signed a deal with DHL whereby we take space on their European freighter network, they have 757 freighters and A320 freighters deployed in Europe. The beauty of this deal is that DHL fly at night on the whole, that is the nature of the marketplace, an express marketplace, and the nature of our general freight marketplace is that we fly during the day. So there is a synergy between their operation and our operation that suits us both. They get better utilisation of their assets and we get that wide-bodied or at least narrow-bodied freighter capacity through our network in Europe.

We signed an initial deal a couple of years ago just to try it for both sides. We have now extended and expanded that deal in Europe, and the network you see on the screen is built round a series of hubs in Europe where we either have shorthaul freighters, that is the DHL capacity, or we have 767s or, in a few cases, we have both. However, we are providing the customer with either wide-bodied capacity such as BA has remaining in its fleet of 767s, or we are providing shorthaul freighter capacity, allowing us to provide a transfer of product through London that competes with point-to-point product form our major competitors in Europe. That has been a major advance for us over the course of the last couple of years or so, and it has made a big difference to our customer proposition within Europe.

If I turn now to the longhaul network, this slide shows the capacity that we are deploying year on year. In the case of the African market, we are taking 16% of our capacity out year on year, and it also shows predicted annual market growth similar to that slide that I showed at the beginning. This shows the redeployment of our capacity and it makes one key point, which is that not all growth is profitable growth. Just because a market is booming does not necessarily mean that airlines like ourselves can serve it in a profitable manner. One of the reasons, for example, that we have pulled out as much freighter capacity as we have out of Africa is because we have found it very difficult to make any money there. However, we are finding it relatively easier to make money in markets like India, Southeast Asia, Hong Kong and China, so we have redeployed our longer haul capacity to those marketplaces. The significant difference that you see on a year-on-year basis there is the deployment of capacity in India, China and other parts of Asia, and a withdrawal from the African market. We have just withdrawn our second Johannesburg freighter.

On this slide, you also see a slight reduction in longhaul freighter capacity from the Americas, which reflects less provisioning and troop movements to the Middle East. Much of the capacity that we have had in there over the last two or three years has been to support the war first of all in Afghanistan and then in Iraq and then the post-war troop movements and provisioning in Iraq. So there has been a significant redeployment of our capacity on a longhaul basis and, although we are seeing a booming marketplace in terms of growth prospects, with the high fuel price and the relative scarcity of longhaul freighter capacity and, therefore, the high price of freighter capacity, it is not necessarily the case that we can make money everywhere. We do not see tremendous growth as we look forward over the next couple of years in our longhaul freighter marketplace. We see a consolidation broadly on the three or four aircraft that we have at the moment, and a redeployment of that capacity to the most profitable areas that we can possibly find to fly.

Let me turn now to world-class customer service performance. Again, this is almost a *sine qua non* in our marketplace, because the benchmark service standards for the key global forwarders is the standard provided to them by integrators, and integrators are up in the 98/99/100% in terms of the service quality. By integrators I mean DHL, FedEx, TNT, UPS and people like that. That is the industry benchmark service quality standard and all of the cargo airlines of the world have had to look to pull their service standards up to an equivalent level to that of the integrators in order to be able to compete and stay on the elite carrier lists to which I referred earlier on.

What are we doing on that? We are big supporters of Cargo 2000, which is an initiative that was launched four or five years ago to create an industry standard set of measures for the trans-shipment of freight across the globe. Cargo 2000 measures both the forwarder and the airline at key points in the freight journey. It had limited traction to start off with but in the last two or three years, it has gained some significant momentum. Most of the major airlines are now members, a good number of major forwarders are members and a good number of handling organisations are also members. The goal for Cargo 2000 is in December of this year when it will publish for the first time a league table of performance of all the cargo airlines and all the forwarders in terms of the way they are performing against those key measures across the supply chain. We are determined that we shall be in the right place in that league table when it is launched, because forwarders in particular will look to that table to guide them in the carrier selection. If we are going to remain in those elite carrier groups to which I was talking earlier on, we shall need to make sure that our service quality is at the maximum that it can be. Therefore, we are making a big investment in that this year both in terms of systems and processes, but also in a big business transformation exercise with our people all across our business, moving them from the mentality that they are in the business to handle freight, to the mentality that they are in business to serve customers. That is a big culture change not just for BA but for the airfreight industry in general. I am confident that we shall get there in the six or so months that remain before the first publication of those data towards the end of this year.

Last, but by no means least, let me turn to cost reduction. I say relentless cost reduction because it has become a way of life both in the cargo business and in the airline generally, for the recent past at any rate. Our major initiatives this year are on this slide. We shall drive a unit cost improvement of 3.3% through the business. We are looking for a further step change improvement in that productivity that I showed you earlier on of 6.8%, and we are looking to drive our absence through sickness down to 3.75%, which is driving it down below nine days, which will be back to industry norms. We shall carry on doing that for the years beyond to get below industry norms in the UK.

Critically, we are also driving sales across our website. GFX is the portal to which we belong, it is a virtual airfreight market with forwarders on one side and airlines on the other, and capacity is bought and sold by the members of GFX. We have been a shareholder and I have been on the Board of GFX for about five years or so, and we are determined that GFX and other portals like it will succeed in the cargo industry. It is taking much longer in cargo than it has done in the passenger side of the business to convince forwarders and others to move away from paper and the telephone and to deal with one another online. I am delighted to say that, as those numbers show, we are beginning to see some breakthroughs as far as that is concerned. In 2005/06, the year just coming to an end, our bookings across GFX are nearly 78.5% higher than they were in the previous year, and we have a target next year for another 38% increase. The absolute numbers are still quite small but we are beginning to get some traction for electronic trading in the airfreight industry, and believe me there is a huge cost saving to be made by taking the paper and the human interaction out of the transactional business of booking and moving freight across the world. This is a major area of importance both for us and for the industry as a whole.

Our plan in this area is that we shall continue to be a staunch supporter of GFX and drive business across that particular portal. We shall look at the possibility of other portals in other parts of the world to help to improve the penetration of online trading across our business and, when we have the pricing database to which I referred earlier on, we shall be able to have bookings across our own website and start to do some of the things that we were talking about this morning on the passenger side of the business, and start to take some more significant costs out of our business in that particular area. So a big push on costs, many initiatives behind those percentages at the top of the slide there, and a continued focus on absence and on driving business as much as we possibly can given the technology online.

To summarise, our business strategy going forward in the cargo business is under those four headings that I have described. The most profitable product mix is all about the product contribution both on the aircraft but also optimising that with ground facilities so that we lay on just the right amount of capacity on the ground to support the freight that we are selling in the air. It is about the investment of £15 million in the new premium facility that you will see two thirds up when you go on the tour, and it is about the launch of some new products and the investment in back office technology, the new revenue management system and the pricing database that I described. It is about developing our network where we can, we have already worked on that in Europe to sort our network out. We have formed an important partnership with DHL to replace the 767 capacity that we are losing from British Airways, and in the longhaul we shall look to continue to develop our network and make it global but only where it is profitable to do so. That is largely driven by the price of fuel and the availability of our profitable freight in the growing marketplaces.

We shall look to deliver world-class customer service performance. It is easy to say but when you are seven or eight months away from being measured in a very public way, you had better believe it is a serious issue for us as a business. We have to deliver those world-class levels to warrant investment that has been put into our business in customer service terms both in the last few years and with what we shall do this year. As always, we shall focus on reducing our costs and improving our productivity as a business. We have a terrific track record of that over the last four or five years, and I am determined to see that continue through the next two. All of those things taken together are geared to cargo playing its part in delivering a 10% operating margin for the airline as a whole. That is the end of my presentation, I am happy to take any questions.

Question: Where are we with a fourth freighter? You are operating wet lease and are negotiating a fourth, is that imminent, will it come in this year?

Gareth Kirkwood: We currently operate four. We have three freighters with GSS, they are 747-400F freighters, and one that is supply directly by Atlas which is a 747-200 freighter. That arrangement expires during the course of this year and we are currently considering whether it is something that we want to extend or not. This goes back to the issue of profitable growth: can we fly it properly?

Question: What proportion of your ATKs are belly and what proportion are freighter?

Gareth Kirkwood: Broadly speaking, 70% of our total capacity is belly-hold of the passenger aircraft and 30% would be other, of which the vast majority is freighter but we also have an extensive trucking network in Europe and also in the US, so there is some truck capacity in there. However, the split is broadly 70/30,

Question: I have three questions please. First, as a point of clarification, can you say whether or not your forecast yield figures are before or after surcharges on fuel? Secondly, you say you are growing the proportion of bookings on GFX but can you say what proportion that currently is? Also related to that, can you give some indication of the scale of cost savings that are associated with selling through GFX? Thirdly, and more generally, can you comment on the way in which the cargo business is managed from a financial performance targeting point of view, particularly within that given that most of your space is belly space, how do you allocate costs and assets …….. [*end of tape, no overlap*] …….. business as opposed to the passenger business?

Gareth Kirkwood: Going back to the first question, all the yield data and revenue data that I have on the slide represents flown revenue, which does not include surcharges of any kind. That was in Keith's presentation this morning where we took that as an airline-wide number. To answer your specific question, the yield number is based on flown revenue.

Your second question was around GFX. As a percentage of our total transactions that go across our business at the moment, GFX transactions account for about 4-5% of them, so it is a very small number as yet. There are a couple of reasons for that. One is that GFX is a club, which is the easy way to think about it, where you subscribe, so the large forwarders, large airlines and a number of others have subscribed to the club, and it is not generally available to all our customers. The GFX entity charges a subscription for that, so there is a limited number of buyers and sellers in the market. Although it is 5% of the total, our penetration numbers of people who are members of GFX are more like 35-40% in total, so we need to drive that higher but it is a far higher percentage of the members of the club than it is of the total business.

The third question was about how we allocate costs in the cargo business. There are many different ways of doing it and different airlines have different models. As far as the model that we have, we look at revenues and costs on two levels. The first is all of our revenues less all of our direct costs, broadly speaking the costs that are on my budget which are the costs of the salesforce, of handling across the world, of the freighter capacity that we buy in, or ground handling contracts that we have and so on. Then we have started as a result of the strategy review to look at costs that are incurred in other departments of British Airways because there is a cargo function, so we also look at our profit on that basis as well. We are looking at it currently on two levels and we measure ourselves on both. We have worked through various methodologies to ensure that what we are doing supports the 10% operating margin. We have links between the way that we are measured and the delivery of a 10% operating margin for BA, so that we make sure we are not diluting and, if anything, that we are contributing positively to deliver that 10% margin.

Question: Lufthansa apparently said they were seeing a pick-up in the directional traffic of cargo from Europe to the US in particular in the last three to six months, are you are also seeing that? What difference does a pick-up in the less profitable leg of the operation have, what is the order of magnitude in terms of the contribution that it can make if it starts to pick up as far as the profitability of the business?

Gareth Kirkwood: The answer to your first question is that we are seeing a small pick-up in the last three to six months but particularly Europe to the US had dropped so low that there really was nowhere else for it to go. However, it is nothing that would make a significant difference in that particular flow at the moment: there is still too much capacity chasing too little demand in that direction.

As far as the unprofitable leg, it is rather difficult to answer without talking about specifics. If I look at, say, the Hong Kong route, being able to add 20 or 30 points of load factor makes a significant difference on the Hong Kong route. On a route like the Africa one I was talking about earlier on, if we are able to get parity in terms of export/import out of markets like that, it can make the difference between operating the aircraft and not operating the aircraft in those circumstances, so those legs make a big difference.

One of the things that we have done with some of the newer schedules that we have put out in the last couple of years is increase the number of stops that we make on an eastbound basis, so we are now stopping in Frankfurt and in Delhi, for example, on the way to Hong Kong and in some cases to China. The trade-off that we are working on there is the cost of bringing the aircraft down, the handling costs and parking costs versus the fact that we can uplift freight in those locations which help to bolster the load on that less fashionable eastbound leg. So we work very hard as far as our network is concerned to put those stops in to try to do the best we can to make some kind of parity between the loads in each direction.

Question: What kind of scenario do you envisage should there be Open Skies with the US, given that cargo is already quite liberalised?

Gareth Kirkwood: We do not envisage it making a great deal of difference at the moment. Most of the real volume that we have is on freighters presently and it is going through Stansted and many of the airports in the UK are not as slot-constrained particularly as Heathrow is. Our freighter capacity all goes through Stansted and most other people's capacity goes somewhere other than Heathrow, because Heathrow is constrained as it is. Therefore, we do not see Open Skies and access to Heathrow making a significant difference in that respect to the cargo business, certainly not to the numbers that I have shown.

Question: More access to some of the integrators like FedEx and UPS in terms of flying not necessarily from Heathrow but East Midlands or Prestwick out to Asia?

Gareth Kirkwood: It may do but the UK market is not so strong as to be able to sustain a tremendous amount of capacity from the likes of FedEx and UPS. Their strategies are more likely to look for hubs in cost-effective places than hubs in the UK just because there happens to be some liberalisation in the UK. The market has to be there to sustain their lift just the same as it has to be there to sustain ours.

George Stinnes: You will have a chance to talk to Gareth on the way round the cargo centre anyway. With that, we shall end the Waterside part of the programme. If I would just ask you to fill in those green pieces of paper for the last time and pass them to people on the way out. [*travel arrangements for cargo centre*] Thank you very much for joining us.

- *Ends* -