BRITISH AIRWAYS PLC

PRELIMINARY FULL YEAR RESULTS 2007-08

PRESENTATION TO ANALYSTS

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Martin Broughton: Good morning and welcome. In a survey this week, British Airways was voted one of the four most loved and most hated brands alongside Manchester United. As a Chelsea fan, I am getting used to being at the top of the league table for Manchester United, not so happy about being second, but I am much happier about being among the top players in the airline profitability league. This is where our full results show us as we have delivered record profits for both operating and pre-tax level, and this despite the relentless rise of fuel costs and the economic slowdown caused mainly by the credit crunch.

More significant perhaps, we have delivered our goal of a 10% operating margin and the Board has recommended a dividend for the first time since 2001. Keith will take you through the numbers in detail but, in summary, I am pleased to report we have delivered an operating profit of £875 million, 45% up on last year, and an £883 million profit before tax. Revenue performance was good at 3.1% up, cost performance was excellent, down 0.7% despite fuel costs rising 6.4%. Fuel continues to be the major cost and, at current prices, we would expect our fuel bill next year to be some £3 billion, up £1 billion on this year. Just to note that cargo performance was good and revenue was up 3%.

These results have been achieved through a lot of hard work by everyone in the company over a number of years. Although it might seem that we have magically hit precisely 10%, the true figure is in fact 10.4% operating margin, but it is appropriate that the 0.4% should go to staff through a bonus scheme as a well-deserved reward.

I would like to pause for a moment to reflect on the journey to this point, because we set ourselves the 10% target six years ago and we have achieved it now in spite of a raft of unforeseen external shocks. It is against a backdrop of security scares, government-imposed baggage restrictions etc, we tackled the pension deficit, we have used the base, disposed of loss-making business, reduced the debt mountain from over £6 billion to £1.3.

The move to Terminal 5, of course, has taken the gloss off a very good set of results. There is absolutely no doubt that 27 March, the opening day of Terminal 5, was very disappointing for our customers and acutely embarrassing for British Airways. Since then, however, our people have worked tirelessly to resolve the difficulties from those early days and the terminal is now working well; Willie will update you on the recovery plan. In the meantime, many customers have been contacting me to express their praise for our new home and their bewilderment at the difference between the reality and the way the terminal is being portrayed. The images of those early days flashed around the world and will remain with us for many months to come but I am confident that the move into our new home will still herald a great era for British Airways.

A new era of another kind began on 31 March, when the new Aviation Treaty agreed by the EU-US on Open Skies was implemented. Talks on the second stage of Open Skies began this week. Although we are on record as saying we were disappointed in the first stage because it did not go far enough, we are determined to make the most of the advantages that it offers. It has enabled us to move our Houston and Dallas services from Gatwick to Heathrow, increase the frequencies to Seattle and Washington. It has allowed four other US carriers to launch services into Heathrow. The change to our landscape at Heathrow has been exactly as we expected and we are confident that our product, extensive network and frequencies on the North Atlantic leave us in a very strong position. It is the best of any carrier and this summer we will fly 41 times each day to 18 US destinations.

We are seizing the other opportunities or offers, and are now poised to launch the new subsidiary Open Skies, offering direct services between Paris Orly and JFK with effect from 19 June. At the start of stage 2 talks yesterday, I was delighted to hear that the European side reiterated its absolute commitment to the goal of negotiating a full open aviation area. I am also pleased to learn that the US side placed its negotiations in the broader context of the EU-US economic relationship. At the meeting of the Transatlantic Economic Council on Tuesday in Brussels, both sides agreed to an open investment statement, which described the principles that should apply to investments between the EU and the US, and those principles specifically state that any national security concerns should be dealt with in a proportionate manner and we are pleased that the aviation negotiations will take place in the context of that statement.

When I addressed you at the half year, bid interest in Iberia was intense. As you know, we withdrew from our consortium bid but since then, we have increased our stake to 13.1%, at a very good price, and we will be extending our quota-sharing agreements with them. More recently, we announced that we were exploring opportunities with Continental as well as American Airlines and talks continue there in what could be a very exciting development for us, and for OneWorld.

The new Club World cabin is now on our entire 747 fleet and winning praise and awards from customers and the industry. We continue to enhance BA.com, making it even easier for customers to manage their bookings. I was pleased to note only this week that we were voted Best European Airline in the *Telegraph* Ultras award. We operate in a very volatile business and this year has been no different. There were significant achievements including the 10% margin with new aircraft orders and new services.

The outlook is challenging. We may see more airlines fail as a result of the relentless rise in fuel costs. We are under no illusion that we must remain focused and prepared to adapt to tough market conditions. The history of aviation economics suggests that you want to be in a strong financial condition at the start of a cyclical downturn. With oil at $120 a barrel, that is exactly where we are today. In the coming year, we will need a sensible financial outcome, albeit down on the year just ended, but it will be equally important to win back our customers' trust.

Thank you.

Keith Wiliams

Chief Financial Director

Good morning, everyone. At Investor Day in March, I spoke about the high price of oil and the impact on both the company and the industry and that is the theme I would like to come back to later. I will also update you on the trading outlook for the year just started.

Profits up on good results

To start off, the results for the quarter and for the year: the first thing I want to emphasise is that we delivered record quarterly results for the period January to March. We have now delivered two consecutive quarters of record results. In fact, if you go back over the year, we delivered record results in three of the four quarters. That is quite an achievement against the backdrop of both a slowing economy and higher oil prices. In the fourth quarter, we achieved an operating profit of £141 million and an operating margin of 6.6%. As you know, our fourth quarter coincides with the first quarters of most airlines and they have already reported; this result is amongst the best in class.

The record fourth quarter left us with an operating margin for the year, as the Chairman has mentioned, at 10.4% before bonuses which were awarded to our staff totalling £35 million. After bonus awards, we are left with an operating margin of exactly 10%. As the Chairman also said, the 10% is a milestone and represents the culmination of a lot of hard work over six years, which has removed loss making activities, taken control of our pension costs and restructured the cost base in many areas. Moreover, it has been achieved despite fuel costs which have increased from £1 billion to £2 billion over that period.

Results in line with forecast

Taking the results in context, they were in line with what we said at Investor Day. Growth in revenue was up 3.1%. This was at the lower end of expectation as we continue to see weak demand in short haul premium and longhaul non-premium traffic. The weakness in that demand started last summer and has increased steadily throughout the year. If we take out exchange effects, principally from the weaker dollar, underlying revenue was actually up 4.6%. On costs, fuel costs were up £124 million versus last year in line with forecast and helped both by significant fuel hedging profits and exchange. The rise of more than 6% over the year should be seen in the context of commodity prices that rose by around 17% in that year. Non-fuel costs were down more than forecast at £182 million, a 3% decline on the previous year and, as I said earlier, that left the margin at 10%.

Headline numbers for the year

That is the summary. Let us look at the headline figures for the year. Passenger revenue was up 3.8%, mainly from increased fuel surcharges, cargo revenue is up 3% and other revenue down 5.5%, leaving overall revenues up 3.1%. Although, as I mentioned earlier, fuel costs were up more than 6%, this was more than offset by other cost reductions elsewhere in the business. Total costs for the year were very slightly down. All of this left operating profits up 45% at £875 million. EBITDAR was also strong, up around 15% or £230 million to almost £1.8 billion. Pre-tax profits were up £272 million to £883 million, and post-tax profits were up to £694 million. Basic earnings were 59.2p and, as the Chairman has mentioned, the Board is proposing a dividend of 5 pence per share at a total cost of some £57.6 million. I shall come back to discuss the dividend later.

Headline numbers for the quarter

I said earlier that we had a strong quarter. Comparisons with last year are largely meaningless because of the impact of the threatened industrial action by cabin crew in January 2007. Nevertheless, it was a good performance. Stripping out the industrial set, underlying revenue performance was up some 6%, and was up over 10% overall. We benefited in particular from strong yields and I shall review that in a moment.

On costs, fuel was a major headache and fuel costs were up almost 20% in a market that saw commodity fuel price escalate very quickly where they were up 50% over the previous year. Despite fuel cost increases, we still managed to contain the total cost increase to 2.2%. This gave us a record performance by quite some distance.

Statistics

Turning to the key statistics and performance measures for the year, we have seen some capacity increase in Q3 but the loss of the BA38, cancellations from weather and Terminal 5 move meant that ASK increase in the quarter was small. Capacity measured in ASKs was up just 0.8% for the quarter and by the same amount for the year. In terms of flown passenger numbers, we are slightly up, 0.3% year on year, at just over 33 million passenger. Revenue passenger kilometres flown were up just 0.1%. With passenger growth lagging capacity growth, overall seat factor was down 0.5% to 75.6%.

Looking at pricing costs, yields were up 3.6% despite currency weakness for most of the year, particularly the dollar. Unit costs were down on flat capacity, despite the high impact of higher fuel prices.

Yield drives revenue improvement

As I mentioned, total yield was up 3.6%. However, the year had started with yields flat and increased rapidly as we saw the benefit of higher prices including fuel surcharges. The impact is particularly marked in Q4 and deserves explanation. First, the prior year comparative was relatively weak from the impact of industrial effects, and the fact that we paid over £11 million to the Treasury last year from the changes in APD in February, so that was the weak base. This year we were also helped by some refund of overpaid passenger taxes. Taking these one-offs impacts the yield but in the fourth quarter underlying yields were still up over 7%. In part, this was because we increased our passenger surcharges twice in the last four months in response to higher commodity prices.

Price and mix both driving yield

The increasing yields had some impact on volumes. Fourth quarter load factor was down 0.3% to 71.1%, even though we were cycling against a fairly low space in the previous year.

In all, in the fourth quarter, yield was up 10.7% year on year, mainly from price as we have seen. We also saw some improvement from mix as we continue to fill longhaul premium seats and, for the first time in seven quarters, from exchange as we benefited from a strong euro and a dollar which was less weak than it had been previously.

Solid revenue growth

Revenue growth in the last three years has been solid. Total growth was up 3.6% in 2007 and 3.1% this year against negative exchange rates. On an underlying basis, revenue was up some 4.6% in 2008 on top of the 5% increase in 2007.

Turnover split full year

If we look behind the revenue increase for the year, passenger traffic was quite strong, up 5.1% excluding exchange, and up 3.8% as reported. Cargo revenue, as the Chairman mentioned, was up 3% on record volumes and increased yields helped by fuel surcharging. Other revenue was down, mainly because of the loss of maintenance and other work from our franchisee GP Airways. As you know, that franchise agreement finally terminated at the end of March.

Turnover split quarter four

As we discussed earlier, we were expecting a strong Q4 performance because of the low baseline from the previous year, so the prior year comparatives are largely meaningless. The increase in cargo up 30.4%, however, deserves particular comment.

Cargo volumes – strong recovery

As you know, our cargo business suffered in the second half of 2006/7 but we are now seeing volumes recover. Full year tonnage reached a record 805,000 tonnes and tonnage carried in terms of cargo ton kilometres (CTKs) was up just over 4%. In Q4, CTKs were up more than 13%, which was significantly above market growth, though helped again by the weak base last year. April has similarly started well.

Cargo - highlights

If we look in more detail, we can see there was an improvement from both more favourable market conditions and from better operation performance. In terms of the market, there was some recovery in the UK freight market in the second half of the year, and some strong performance in the fourth quarter out of Asia Pacific and the Americas. Europe has remained relatively weak. Our decision to focus more on premium products is working well with volumes up more than 13%, and operation performance has improved with delivery of promised volumes up 88% and improved operational recovery.

Looking forward, the year has started well with volumes slightly ahead of plan, mainly as a result of improving demand for exports out of the US and the strong UK market. There is, of course, some risk going forward depending on what happens to consumer demand.

Strong cost performance

In terms of cost performance, capacity measured in terms of ATKs was slightly down for the year, and down in the fourth quarter. Total costs were down 0.7% despite the increase in fuel costs which I showed you earlier. Excluding fuel, costs were down some 3%. Unit cost performance was also strong and costs down 0.5% overall, and excluding fuel, down some 2.8%.

Good progress made on non-fuel costs

This chart looks at the history of the cost reduction we have achieved in our controllable cost base and it is an important one in looking at the successful rebuilding of the operating margin. We have made important strides over the years to offset the impact of higher fuel costs with cost savings elsewhere. For example, you saw earlier total costs down 0.7% in 2008, despite fuel costs being up 6%. That position clearly becomes much more difficult in the short term with the increase in fuel costs that we are seeing today and some increase in price going forward looks inevitable.

Strong underlying cost performance

Looking at the individual cost lines for the year: employee costs were down 4.9%, mainly from lower pension and severance costs offset in part by pay awards. Engineering costs were up from increase in spending on contracts which provide for maintenance based on flying hours. Handling costs increased as we increased spend on catering and as a result of additional customer compensation. Selling costs were down, reflecting lower costs as booking through BA.com increased and from lower advertising costs and agency commissions. Other costs were down, primarily from reduced operating lease commitments from our reduced property portfolio and from information technology savings. We have covered off the fuel cost increase elsewhere.

Fuel cost starting to impact

That story is pretty much repeated for the quarter. The only point to note are the increases in employment costs and that arises mainly from the accrual of the bonus payments, the £35 million which I mentioned earlier, as well as the impact of pay increases which took it back from February. Non fuel costs were down 1.6%. Fuel costs increased £88 million over the corresponding period last year, to £543 million – an increase of 19.3% on the quarter.

Heathrow manpower increased

I would like to say a few more words on our two largest costs, employment and fuel as between them, they now account for more than half our expenditure. As you saw earlier, our total employment costs were down from 4.9%, or £111 million and stand at just over £2.1 billion. As I said, this came primarily from pension changes and lower severance costs. Employee numbers overall were down some 2.2%, mainly from back office headcount reductions and outsourcing of regional ground handling. We had increased front line headcount at Heathrow for the move to Terminal 5, as you already know, and headcount reached over 7,400 at March and was already planned to remain at high levels over the summer for the T5 transition. This has now reached just under 7,800 people at the remaining three terminals over the short term.

T5 revised impact

The delayed move into Terminal 5 had some impact on both revenue and costs. As you know, in the results in March we had already incurred £16 million of cost, as you can see here. The cost elements for additional manpower and other costs are estimated to come in at around £20 million, mostly in the first half of this year. Additionally, there is likely to be some revenue cost of about £20 million as transfer passenger numbers are impacted by longer connecting times remaining in place over the summer.

Jet fuel prices

Looking at our other major cost, fuel, this is a repeat of the slide that I showed at Investor Day and is a simple reminder of what has happened to fuel prices during last year, as compared to the year before. Price of fuel has increasingly become a challenge. As I said earlier, commodity prices were up more than 50% in Q4 over the previous year and up around 20% for the year as a whole.

£194m hedging profit offsets fuel price rise

We dealt well with that increase last year, offsetting the increase with exchange and hedging. Hedging benefit saved around 10%, while exchange was around 6% beneficial overall, because of the weakness in the dollar. Volume impacts increased costs by around 2% to 3%. The current year is obviously much more of a problem at these prices and I will come back to that in a moment.

Strong balance sheet

So far, it has covered off the improvement in margin. As you can see, we have taken steps over the last six years to improve profitability and that has completely transformed the balance sheet from where it was after 9/11. The record price of oil and slowing economies represent clear challenges going ahead but we meet those from a position of real strength. We have a strong balance sheet and cash balance. At the end of the year, the cash balance was £1.86 billion. Looking forward, the generation of free cash flow, of course, is heavily geared towards fuel price assumptions, given the enormous volatility of the oil market at the present time. However, we benefit from a manageable capital expenditure programme, which will be less than our depreciation costs over the period. We also have moderate scheduled debt repayments over the next three years, with payments averaging around £350 million a year and we have good access to finance.

Net debt in good shape

As you already know, the balance sheet shows real progress. Net debt is just over £1.3 billion, excluding pension deficit. We have also made considerable progress on pensions, and I will come back to that.

Gearing remains low

Looking quickly at gearing, this has fallen from a peak of 74% in 2002 to a current level of 29% and, including pensions, is around 34%.

Pension funds in better shape

Coming back to pensions, we agreed major changes to the NAPS pension scheme in February last year and benefit changes have reduced the scheme liabilities by more than £400 million and the company has made contributions of some £1.1 billion towards the deficit over that period. Of the two major schemes of the company at 31 March 2008, the NAPS pension deficit stood at £357 million and APS was in surplus.

New capital expenditure profile

I mentioned earlier that we expect depreciation to exceed our capital expenditure plans for the next few years. Our depreciation charge runs at something like £700 million a year. Our capital expenditure programme will be lower for the next four years, partly driven by the delay in the 787 aircraft, and partly by other savings. Now the delay in the 787 is disappointing and we are looking to take other aircraft on operating lease to fill the gap, or to retain existing aircraft for longer, so we do retain considerable flexibility in the fleet.

New capital expenditure profile

I mentioned earlier our ability to raise finance. We have added significant additional long-term facilities, taking advantage of the strength of our balance sheet.

Committed facilities of £2.1 billion

These total some £2.1 billion and are sufficient to cover all our aircraft deliveries out to 2013. With additional cash reserves of £1.8 billion, we are well placed with liquidity against the current impact of high oil prices.

Dividend

Based on the position of underlying strength in the business, and the cash position, the Board have proposed a dividend of 5 pence per share. That would make a total return of about £57.6 million.

Looking forward

2008/9 revenue guidance

Looking forward at revenue, fuel and non-fuel costs, at Investor Day I spoke about revenue guidance for 2008/9. I said at that time we expected total growth in revenues of between 4-4.5%. That expectation was built principally around growth in yields, with some anticipation of volume increase and some help from exchange and from growth in our cargo business. We have discussed cargo which is performing slightly better than our expectation, and exchange is currently in line with our assumptions. However, as you have seen from our latest traffic statistics, non-premium traffic is soft as is shorthaul premium traffic. We are seeing some volume dilution mainly from the slowing economic environment and in part from recent changes in fuel surcharges. We are also likely to see some reduction in volume in the summer from the delayed move to Terminal 5, as we discussed earlier.

Accordingly, we now expect volumes to be slightly weaker than we indicated at Investor Day. However, yields are expected to be up, driven by further increases in fuel surcharges which we announced in February. As you have seen on an earlier slide, yield has been on an upward trend throughout the year and premium traffic remains strong. The net result is that we still expect revenue growth at around 4% this year, based on the existing fuel surcharges in place.

Jet fuel prices

If we update the slide on jet fuel prices, we can see the huge increase in price that exists currently.

A significant step up in price paid net of hedging

The increase in that commodity price produces a major shift in cost despite significant hedging, as you can see from this chart. At current prices, we expect our fuel bill to be up every quarter next year, and at existing spot levels of around $120 per barrel, up around $1 billion for the year.

Hedging cover

The main variable to our forecast is fuel because of its current volatility. Over the last two months, we have added around 10-15% more hedging cover on price dips below $100, or at or around $100. We now have 72% hedging in place for the first half of the year, and around 58% for the second half through to 31 March 2009. We also have around 30% cover for the financial year 2009/10, and around 10% the following year. As we indicate in our announcement today, we would expect each dollar movement in fuel price to impact profitability by some £16 million this year, which is slightly better than we indicated at Investor Day in view of the additional hedging.

Fuel spend for 2008/09

This slide looks at the forecast fuel spend given our current hedge position, and the impact on operating margin for the year. It follows on from what I presented at Investor Day. As I said earlier, we break even in terms of operating margin at around $120 per barrel for oil, assuming no further surcharge increases.

Finally, I should say that we see no change from our guidance on non-fuel costs, up 3-3.5% of some £200 million.

Q1 Outlook

If that is the outlook for the year, I want to touch briefly on the current quarter to 30 June, as the fuel price increase is pronounced in the first quarter and there is some impact from Terminal 5.

Generally, market conditions are unchanged with longhaul premium traffic remaining relatively strong. Looking forward, longhaul premium bookings are in line with, or slightly ahead of, last year. Shorthaul premium bookings remain weak. As you know, longhaul non-premium bookings have also been weak, although the sales activity which we announced in April covering some 60 destinations worldwide has brought bookings more into line with last year. Taking these factors together, we expect Q1 revenue growth to be slightly behind the growth for the full year.

On fuel, the price impact in Q1 will be quite dramatic. As you saw from one of the slides, we are coming from a price that had been down last year into an environment where fuel is at an all time high. Even with the amount of hedging that we have in place, we expect fuel costs to be up just under £250 million in Q1.

Summary

To summarise, this has been a record year with the delivery of record results for three quarters out of four. That is not a fluke, it is the result of all the hard work we have put in over the years on our controllable cost base of the company, and it is fitting in that environment that our staff should be rewarded with a bonus and the shareholders with a dividend. However, for the moment, given the slowing economy and extraordinary increase in oil price, this clearly demonstrates that we shall need to adapt to a higher oil price environment and we are already working on that. We have a strong financial position for the challenges which lie ahead for both the company and the industry. As I said at Investor Day, and I repeat today, at $120 oil the industry will start to look a very different place. With that, over to Willie.

Willie Walsh

Chief Executive Officer

Thank you, Keith, and good morning everybody. I have a few slides to present to you this morning.

Terminal 5

I would like to start with some comments in relation to Terminal 5. At this stage, most of you will be aware of the issues that challenged us on the opening day.

What went wrong:

If I were to pick out one particular issue, looking back at how we managed the transition to Terminal 5 where we did get it wrong, it was the fact that we allowed the delays in the building programme of T5 to interfere with and compromise on the training, familiarisation and the testing programme that we had put in place for T5. As you may remember, the building was due to complete all work at the building by 16 September 2007, with a period of six months of testing starting on 17 September 2007. As a result of the delays in the building programme, we delayed the start of that testing and, indeed, compromised on some of the testing programmes that we had put in place. We felt we were doing sufficient testing to give us confidence to move forward with the opening but, looking back on it, that decision to compromise on testing, training and familiarisation was clearly a mistake that we made.

On the first day of operation, there were a number of specific challenges and you have probably heard of all of them. Many parts of T5 were unfinished, but much of this was not visible to the travelling public but were behind the scenes, and this impacted on how we were operating. There was a lack of access for staff both to car-parks and the central search area getting through from landside to airside, which delayed people getting into work. The lack of familiarity with the environment in which they were operating led to a number of key tasks taking longer than had been planned. Some of that was expected but the overrun impacted on our ability to operate to the schedule. Then there were well-documented and publicised unexpected problems with the baggage system that really hit us right throughout the day but caused ultimately the closure of baggage check-in by early evening.

Just to put it into context, as we publicly stated 23,205 bags were what we call "misconnected": these are bags that did not travel on the right flights with the passenger in the first five days of operation; 16,110 of those were transfer bags, so that is just over 69% of the bags, and that pointed to a software problem that we discovered on the Sunday after the opening on the Thursday. It was a piece of software filter that had been installed in the baggage system as part of the testing programme to prevent messages generated in the system from going out into the worldwide baggage system. That filter, despite being checked that it has been removed by our people, had not been removed and it led to difficulties with transfer bags being recognised in the baggage system when they were brought into Terminal 5. Therefore, as I said, just over 69% of the bags that did not make their correct flight were transfer bags in the first five days of operation.

T5 working well

I am pleased to say that Terminal 5 is now working well. We have overcome all of the initial challenges, many of which were tackled on the day of operation. We have had no major issues associated – and this may sound like a strange thing to say – with what we call the "non-move" on 30 April. So given that we had geared up for the transfer of flights from T4 into T5 on 30 April, undoing that was a significant challenge and it was managed well with no major results from that. We have moved our shorthaul crew from their reporting point at the Compass Centre, which is a building close to the main runway, into their new reporting point in Terminal 5. That went ahead on 1 May as planned and it has worked very well. We are still using the Compass Centre for our longhaul crew, and I shall talk about that in a moment.

T1 and T4 where we have continued operations are also performing well. We have dedicated staff operating in T1 and in T4, and the operation in both of those terminals has performed very well through this period. I would like to take the opportunity to recognise the fact that an enormous amount of effort went in to support T5. The figures that Keith has shown you in relation to the manpower figures for T5 are the people working in those areas but it does not reflect the additional manpower that we have put in there through volunteers over the period to support the work that was going on.

Impact of change to MCT

The decision to delay the move from T4 and to phase the move does have an impact, the most noticeable of which is on what we call the MCT (minimum connection time). Keith has highlighted that this will have a revenue impact. The delayed longhaul move has seen a number of passengers, who were scheduled to connect from our shorthaul operations to the longhaul, not being able to make the planned connection. As a result of that, we estimate that around 28,000 shorthaul sectors were affected in the period of 30 April to 5 June. Eighty percent of those cancelled sectors have been rebooked on BA services. In effect, we cancelled all of them and then enabled customers to rebook with us if they chose to do so. The impact on revenue is somewhere in the order of £2-4 million as a result of the passengers who have not rebooked with us.

The second tranche of the longhaul flight moves, which are the longhaul flights that will remain in T4 after we move the first tranche of flights out on 5 June, also has an impact of somewhere in the order of 14,500 sectors. Already over 50% of those have rebooked with British Airways, and we estimate that the revenue impact of the loss of customers directly related to the increased minimum connection time is somewhere in the order of £1.5-2 million.

Ready to go performance

I shall show you some charts to give you an indication of how the facility is operating at the moment. This first one is what we call "ready to go", and is a measure of our internal performance in getting all of our procedures done so that the aircraft is ready to depart three minutes before the scheduled time of departure. We do not adjust this to record the performance of flights that have been impacted as a result of inbound delays. We have seen a significant improvement in our performance in this particular area. We recognise that there is further work to go on that but we are seeing a steady improvement there. That has led to a significant improvement in our on time punctuality. You can see the way it was impacted during the first few periods of operation. The big dip there on 6 April was as a result of the snow at Heathrow. Many of these issues are unrelated to the operation of Terminal 5, so it does not reflect solely T5 but it is a measure of the performance in terms of punctuality that we are seeing at T5.

For example, the dip that you see there on 13 June, towards the far right-hand side, was as a direct result of reduced flow rates at Heathrow on that day. If you think back and remember – it wasn't that long ago – it was a lovely sunny day but there were strong winds at 3,000 feet which significantly reduced the rate of arrivals at Heathrow and led to holding delays of up to 35 minutes. This again highlights the fragility of Heathrow in terms of runway capacity, but the performance of the terminal is working very well.

We measure regularity. This is the operation of flights as scheduled, so you can see again the level of cancellations associated with the first few days of operations. We were due to operate a full schedule from 5 April. Regrettably, the BAA-operated baggage system had a problem on that Saturday, which led to 24 flight cancellations, and we had a number of flights cancelled on the Sunday, 6th, but that was weather-related and had nothing to do with the operation of the airport. In fact, all the cancellations that we have taken since then, none of those cancellations have been related to the T5 environment. They have generally been as a result of either technical, weather or non-T5-related disruption.

Baggage performance improving

Baggage performance has been quite significance in terms of media coverage. I show this chart just to give you a feel for the improving performance of the T5 baggage system. I also show the T4 performance, so you can get an indication of how that has been working over the period as well.

The red dashed line represents the average AEA performance for annual 2007. I show that to put it into context for you. You can see the direct bag significant impact in the first few days of operation, largely sorted out after the first few days, despite, again, on 6 April which was as a result of the weather disruption. The minor spike on 11 April was a problem with what we call the 'head of stand'. We made some changes to the head of stand logic software and that has led to ongoing improvements. Despite what you see on the yellow line, that was a failure of the T4 baggage system. Nobody seems to hear about the failures of T4, but we had a failure of the T4 baggage system just over a week ago, and that led to some baggage problems.

We are pleased with the way the baggage system is performing. There is further room for improvement. The system has generally been robust. We are clearly more confident in our ability to operate it, and we're pleased to see the work that BAA is doing in terms of addressing their issues.

Baggage arrivals performance

This is an important chart, because it is one of the areas of customer performance that we believe T5 will significantly improve. This is a measure of the time it takes to get the first bag into the baggage hall. It is measured from chocks on the arrival of the aircraft. I am pleased to say that somebody has made my target more challenging because that line should be at 15 minutes rather than at 14 or 13 minutes. Thank you to whoever did that!

You can see that we had some difficulties in the first few days of operations where you don't see a yellow part. That is not because we didn't operate; it was because there was some corruption to the data. But our performance here has really improved and we are getting good, positive feedback from our customers. This was an area where we struggled in T1 and T4, and has led to quite a significant improvement in customer performance.

Next Steps

Switch 2.1

There are still challenges in relation to T5. We have announced that we are going to start the first phase of longhaul flights from T4 into T5 on 5 June, with eight additional longhaul destinations moving. You can see the list of the flights there. It includes our flagship routes of New York JFK. These flights represent about 25% of the flying activity in Terminal 4. With the exception of one flight, 747, they are all operational. We are already operating some longhaul flights out of T5. These are 747s, so we are putting more 747 operations in there. We are working closely with BAA. We have a very clear programme of work that requires completion before this move takes place on 5 June, but we are getting very good cooperation from BAA. The relationship between us is quite positive at the moment. You might expect it to be strained, given the issues associated with the opening of T5, but we are clear that it requires both of us working together to address some of the problems that remain.

Further moves

We will look at further longhaul moves. We have said that we are going to phase those moves from T4 into T5, and we continue to have discussions with BAA about the future phasing of those moves.

As I mentioned earlier, our longhaul crew continue to report into the Compass Centre. We are looking at changing that report. It is not very efficient for us to have them report into the crew report centre in T5 to operate flights departing from T4. We are looking at contingency arrangements associated with that, and we will decide on that in the next few weeks.

Clearly we are working closely with BAA on not just our moves, but how this impacts on future moves. It may indeed have an impact on our planned moves into T3. They are the 757s that are continuing to operate in T1, and our Australia flights that are operating in T4.

$125 Oil

Turning to other issues, as Keith has said, oil adds $120-125 a barrel. I think it is fair to say we are in unchartered territory here. This has every prospect, I believe, of leading to longterm fundamental changes in our industry, especially when you combine that high oil price with the general economic softness that we have seen.

We have already seen a number of airline report losses, or their first quarter, our fourth quarter, and it puts our fourth quarter performance into context. Indeed, we have had some business failures already. In our market, we have seen the failure of MAXjet, Eos, and Oasis, just to name three. I have no doubt that we will see further failures.

The key question facing all airlines now is how to offset the significant increase in fuel costs with cost savings in other areas, and also what impact increased fares will have on demand for travel. We were looking back at our fuel bill at the beginning of this decade. Back in 2000, it represented about 9-10% of our costs. That clearly gave us significant opportunity to compensate for increased fuel costs. As Keith has already shown you, we have reduced our non-fuel related cost by about £2 billion as the fuel price has risen.

However, looking at the year ahead, the current year that we are in, it is clear that our fuel bill is likely to be around a third of our total costs, much higher than our employee costs for the first time ever and for some carriers, it is even going to represent a higher percentage of their total costs. So it is unlikely, indeed highly unlikely, that cost cutting alone can restore economic profitability to the industry. The difficult judgment we have to make at this stage is how demand for travel with rising fares in the context of what in at least the short and medium term will be relative economic weakness.

New capital expenditure profile

Against all of that, what are we doing? Keith has already shown you this chart. We have already tightened capital expenditure for the coming years. We have got controls in place and this is controlled centrally, so our intention is to look again at all capex to ensure that we preserve our cash and balance sheet position. Our business is very strong and, as Keith has told you, even with these very high prices we will have positive cash flow this year and the years ahead. We have looked at capacity. We have already conducted a review of capacity for the summer season. Our view is that we will not be taking any capacity out for this summer operation, although we will keep that under review, but we do not see any reason at this point to take capacity out for the summer but you should expect us to take some capacity out during the winter.

Capacity

Our planned capacity growth through to the end of this year was low and that was reduced, as you have already heard from Keith, as a result of our decision not to replace the 777 that was written off at Heathrow in January – Mike-Mike-Mike. We have committed to receiving four 777-200 ERs from the beginning of next calendar year; our first delivery is in January and we take one a month over the next few months. The 787 delays mean that we currently have no wide body deliveries planned in 2010 or 2011 but, as Keith has said, we are having discussions with Boeing. It is important to say that these discussions are taking place in the context of the contractual arrangement that we have with Boeing for 787 deliveries. We have made a big deal of the fact that flexibility in our fleet is important to us and we will not do anything to reduce what flexibility we have, which is considerable. We will continue to be mindful of retaining flexibility in relation to our fleet. It is important to remind you that we have a diversified fleet and fleet age, which gives us flexibility on retirement of aircraft, so we can stand aircraft down as part of any capacity planning that we do in the months ahead.

Consolidation

I talked at Investor Day about the fact that we were always mindful of opportunities for consolidation and how I felt that the regulatory framework was changing and likely to make consolidation more possible. The high oil prices that we are seeing now, combined with the economic slowdown may well indeed make it an imperative for some in the industry to pursue consolidation. I believe that consolidation can be and indeed will be a major catalyst in both capacity reduction and industry efficiency. The failure of seven or eight airlines already – three of them in our markets – is a nice form of consolidation because clearly they depart from the industry and their customers, generally, will look to fly with other airlines. So I have always felt that bankruptcy and failure is an effective form of consolidation in our industry!

In the US, we have seen the proposed Delta Northwest merger and their plans to join up with Air France KLM under the transplanting. As you have heard, we are in discussions with both American Airlines and Continental, to see if there are opportunities for us to cooperate. I am sure we will hear ongoing rumours around Europe in terms of what is going on. Our focus in the short term will continue to be on Iberia, as the Chairman had indicated.

Cost reduction

We have not lost sight of what has been a key to our success in recent years. Our focus on costs was key to returning this business to economic profitability since the significant change post 9/11 and our reduction in non fuel related costs, in the order of about £2 billion, has been a significant achievement.

A challenging year ahead

While there are challenges – and indeed those challenges are increasing – there remain opportunities in many areas of our business to make further progress on costs and we will remain very focused. The discipline that you have witnessed in British Airways over these past five or six years will continue. It is made a little more challenging by the transfer into Terminal 5 because clearly, we have got to get that working and you have already seen the increased levels of manpower that we have put into the Heathrow operation, to ensure that we deliver a high standard of customer service to our customers and we remain absolutely committed to that. We will remain focused through this period to making T5 a success. You have heard Keith talk about it already.

It is clear that the year ahead is going to be challenging. The high fuel prices and the economic slow down are going to lead to significant change in the industry. It is certain at this stage that all airlines are going to have to take serious action to return to economic profitability. We have already reduced our capital expenditure and will look for further opportunities. We are well down the road to refining capacity – as I said, unlikely that we will take out capacity for the summer but you should expect us to do so for the winter. I believe we will see meaningful consolidation sooner rather than later and, as we have always said, we expect and plan to be a major player in that. Consolidation is important, not just in reducing costs and capacity, but in fundamentally delivering a successful airline industry. The fact that we have, over the past few years, worked hard to improve our profitability, build a robust balance sheet as we are entering into this challenging time, makes it even more important that we have done that because we are not only positioned well to weather any storms that we see but well-positioned to take advantage of any opportunities that come our way in the months and years ahead.

Thank you very much.

Martin Broughton: Thank you, Willie. Thank you, Keith. Lots of detail, lots of information for you. We have time for a few questions.

Question and Answer Session

Q: A couple of questions: you do need to raise fares, to try to do something on the revenue side to combat what is going on with oil. Yet since Investor Day, you have enclosed another tier of fuel price surcharge and reduced your revenue guidance. It doesn't give us a great deal of confidence that there is a lot more left you can do on pricing to offset fuel. Following on from that, Chairman, perhaps you could give us ?fact as opposed to policy on paying dividend out of reserves?

Willie Walsh: In relation to fares, I believe it is inevitable that we shall see oil prices flow through into fares. You have seen the way the fuel surcharges as we have implemented them have been able to stick. We are clearly looking at what impact increasing fares will have on demand, and we are working on that. However, the area that we are looking at now is whether we embed some of the fuel surcharge in the basic fares we are looking at, while looking at opportunities to manage fares, rather than chasing volumes. We have seen some success in that as well. So it is inevitable that prices will increase, and I believe that will be possible. We are looking at that in the context of what our competitors are doing as well, but our position in the market is relatively strong and we have decided not to take any capacity out. Capacity will come out of the market through airlines failing and as a result of other airlines reducing their capacity, so we shall see changes in the overall capacity in the market. We need to reflect on what impact prices will have on fares but whether this is next month, three months from now, six months from now, it is inevitable that these high oil prices will flow through to the consumer.

Martin Broughton: If I could just comment on the dividend. We have offered perhaps a slightly more modest level than we had in mind when we talked about it originally but Keith has outlined our reasons for coming to that conclusion, with the strong cash position, shareholders' reasonable expectations, the specific results for the year. We had quite a debate about your question at the Board as to what happens if we get into a breakeven position, and the prudent objective was not to get into a breakeven position but to stay profitable.

Q: I have a couple of questions. First, can you drill down on the outlook for premium and non-premium by region other than shorthaul, because I believe you saw significant load factor declines in all markets in April? Secondly, do you have an idea of what the capacity outlook is for the industry on some of your major routes, notwithstanding any failures right now?

Willie Walsh: Just to repeat what Keith has said, if you look by segment, we continue to see strong demand for longhaul premium. Longhaul non-premium has been weak and in the main that is ex-US on the transatlantic market. The premium market is pretty much the same picture right across the network, we are not seeing any significant difference in performance in the different parts of our business. The traffic stats that we produce do not give you the full picture, because it combines the longhaul and shorthaul premium figures together. What I can say about shorthaul premium is that it has been weak. There is no doubt that it has been impacted by the credit crunch, much more so than longhaul where we do not, at this point, see impact to our bookings. The areas of shorthaul weakness have generally been in the shorter shorthaul routes. We do not see evidence of people trading down, we see evidence of people not travelling, but parts of the shorthaul business that have been weak in premium have been places like Paris, Amsterdam, Brussels where perhaps they are travelling by train, which I suspect is the case. However, it is weak right across the shorthaul network, but particularly so on those routes: Paris, Brussels, Amsterdam.

The longhaul non-premium, as I mentioned, was weak primarily in the US market but that flows through into a number of our other destinations, because we get passengers connecting to other parts of the network, both shorthaul and longhaul. When we look at the underlying reasons for softness in the longhaul non-premium area, it is primarily the US point of sale and the transatlantic market. The shorthaul non-premium has been quite steady right across the network. We have seen what I would describe as good figures in the shorthaul non-premium side and, again, it is across the full shorthaul network that we operate.

Q: There was then the capacity question.

Willie Walsh: That is a difficult one. The fact that the wide-body deliveries will be delayed is probably something that the industry should welcome. It is disappointing for us because the 787s will be a great aircraft for us, particularly in the context of high oil prices, but also an opportunity for us to tap into some growth markets in Asia. However, from an industry point of view, it is probably a positive and I know there are airlines out there who are looking at some of the older wide-body aircraft. There are still people flying around with A300/600s in today's fuel price environment, and the operation of aircraft like that is not great. I believe that you will see some sensible capacity control, because people will be forced to deal with this in a sensible fashion with oil the way it is. I do not believe that people will be able to act in the way the industry has traditionally acted. That is why I say that we do not see any reason to take capacity out at this stage for the summer, although we shall look at it tactically. You should expect to see us take out some capacity when we go into the winter market.

Q: My first question is on the T5 additional costs. What percentage of the cost increase for the current year is represented by getting T5 right as far as putting resources into it? My second question is on the Open Skies initiative, the new airline. What are the return targets and timetable schedule for achieving that? And could you update us, finally, on the premium as a percentage of total revenues from your Premium Class?

Willie Walsh: Just let me explain some of the cost issues as related to T5: it is more the cost of maintaining operations in T4 and T5 that drives the additional cost. The cost issue is inefficiency associated with maintaining people in the T4 operation that we had planned to move into T5.

Keith Williams: And that, as I said earlier, is around £20 million on a total cost increase for the year of £200 million, so it is about 10%.

Willie Walsh: The OpenSkies, the airline, as we refer to it – OpenSkies, without the pause – is due to launch on 19 June from Paris Orly to New York JFK. That is the reason behind our codeshare with L'Avion. That gives us access to the Orly market in Paris, which we believe is a strong business airport and better than Paris Charles de Gaulle.

So we see that as a significant plus. The plan for that airline, it is clear that we have said that all possible business must be profitable, Dale Moss is under no illusion as to what he needs to do. Our original plan was to have that in profit in its third year of operation. We have not changed our outlook in relation to that.

What was the other question?

Q: Premium revenue as a percentage of total revenue, if broken down by short and long, if you have got it.

Willie Walsh: The total is about 50%.

Q: Three questions: you mentioned that capacity for the coming year is not yet finalised – particularly the winter you have not yet decided – but can you tell us what level of capacity growth is built into your 4% revenue guidance?

The second question is if I can maybe push you a bit more on the dividend question? Is there a minimum level of dividend cover that you would be looking for? Is there a threshold of profitability below which you would not expect to pay a dividend on next year's earnings? Can you give us a little more on that?

And finally, can you give us an update on the situation regarding BALPA and the strike threat and the high court case, please?

Willie Walsh: I will deal with the first and third ones and leave the Chairman to address the second. In terms of capacity, the planned capacity increase going into the year was about 2.8% but that has been reduced down to about 2%, so planned capacity at this point – and that is before we make any adjustment to the winter capacity – is about 2% capacity growth. In relation to the BALPA dispute, as you know BALPA referred the issue to the high court. They gave an undertaking to the court not to exercise their mandate for industrial action and sought a speedy trial, which we agreed to. That starts next Monday, 19 May, for five days and we will wait to see the outcome of that. The fact that it has gone into the court and the fact that BALPA have given an undertaking to the court that they are not going to exercise the mandate in relation to industrial action, I believe removes any threat to industrial action from this issue.

[Follow-up from questioner, inaudible]

Willie Walsh: As I said, BALPA referred it into the court and although it has gone for a speedy trial, I have no doubt that if BALPA do not get the result, they will appeal it, if we do not get the right result, we will appeal it. So it is now in the legal environment and

I have no clear view as to how long it could take before all parties exercise all options available to them through legal process.

Martin Broughton: On the dividend, we have not set any specific minima on any front. Whenever you look at a dividend you look at all of the parameters that are in place at that time and that is going to include the cash position, the financial strength of the company, the profit of the company and the forecasts.

Q: Could you give us an assessment, please, of the commercial impact that Open Skies has had since it came into force? To what extent has it affected demand or pricing on the transatlantic routes? Secondly, could you remind us how much flexibility you have got in the terms of your aircraft orders, as regards the timing of deliveries? Or do the 787 problems make that irrelevant.

Willie Walsh: The delays largely make that irrelevant in the short term but we do have flexibility in relation to the delivery schedule on both the A380 and – well, the 787 is largely now irrelevant as a result of the delays to the programme. To be honest, we have not noticed any noticeable impact as a result of the Open Skies agreement since 30 March with the new entrants that have come into the market. It is pretty much as we thought we would see, given that these carriers have in the main operated in the London market anyway, and we never felt that they were looking to move into Heathrow to try to thrash their yields, given that they were operating successfully in Gatwick. We have not noticed any impact on demand or pricing at this point so the reaction, I would describe as very muted at this point.

Q: Three questions: just on the capacity for the winter – I know you have not decided yet – is it likely to take out more in shorthaul or longhaul, premium or non-premium, in terms of reduction in capacity? Secondly, for Keith, on the fuel prices struck for the hedging in 2010 and 2011. Thirdly, a more high level question: where do you feel BA is positioned in terms of consolidation? Particularly if you look way back, you have courted KLM and Swiss and ultimately obviously they ended up successfully with Air France and Lufthansa – it looks like BMI will probably go to Lufthansa, there are slot issues there – so I would like your comments on that.

Martin Broughton: I think we will decline to answer that last question. It is not appropriate.

Willie Walsh: On the capacity, you are right. We have not decided yet. We clearly will look at this. I think it will be driven by a number of factors, and the fuel efficiency of aircraft will be one of those factors that we look at. We do not see any need to take capacity out of the premium end, because that demand remains strong. How we manage that will be an interesting one, so it is not a simple issue but you are right when you say we have not decided yet but we are going to look at that. Our focus would more likely be on the non-premium side of the business and it may be that we shall switch aircraft around on certain markets where we change the gauge of aircraft to put more capacity into stronger performing areas of the network. However, at this point I would expect us to ground some aircraft during the winter but we have not made any final decisions in relation to that.

Keith Williams: On the fuel, we are about 30% hedged through to between 1 April 2009 and March 2010, and that is at around $84/85, and we are about 10% hedged through to March 11, and that is at slightly higher prices but below $90.

Q: I have two questions. Could you possibly give a little more granularity on what you have done to the capex budget in terms of reducing it? Secondly, on Terminal 5, do you believe it is now operating as it was originally designed, or are there still embedded problems in the terminal in your view?

Willie Walsh: As far as capex, what we have noticed before in relation to capex is that you can save quite a lot even cutting back on small amounts because we have so many projects that run. In the areas where we focus in the short-term, it has been on changes to some building projects, changes to some IT investment where we have reassessed the return on those investments. The initial focus of our capex programme has been in non-customer areas and, given the scale of our capex programme, there is scope to do that without impacting on any of the customer service initiatives that we have planned.

On T5, to be honest we have beaten many of the targets that we had set for ourselves at this point in the operation. There are some issues in relation to the baggage system that we would like to see addressed but these are not major difficulties in terms of assessment. For example, on server capacity, one of the things we have noticed is that the servers are working at a much higher level than the modelling had indicated, so there is no need for additional server capacity before we put the full operation into T5. One of the critical things we need to see is a better test environment for the IT baggage system issues, so that we can do more detailed testing – sorry, it is not us. I should again point out that these are issues that are under the control of BAA but in our discussions with BAA we have highlighted these to them as things that we believe must be addressed. That relates to a better test environment for baggage system software changes. However, in the main it is working well. The customer experience and the response from our customers has been very positive.

The arrivals experience in particular has been very good. We are doing some modelling again on the transfer area, which was a known pinch-point in the operation. It needs good manning and control by BAA to ensure that it operates smoothly, but I would have to say that, at this stage, while recognising that we have not fully loaded T5, it is working better than we would have expected. Therefore, I believe there is reason to be optimistic while still acknowledging that there are risks associated with the transfer of further activity into T5.

Q: I have a very quick question on what is happening with booking patterns and cash in advance of carriage, if that is alright, Keith? Secondly, on the industry changes, you are sensible guys given the track record, so the only deduction is you are expecting either a short downturn, or some sort of major industry bankruptcy, because these little airlines are not really moving the needle. Is that a fair summation of how you see the next two or three years, or is there some significant trick that you think you can do to keep the margins at cost return levels?

Willie Walsh: I think we are sensible and we have demonstrated that we are sensible. All you need to do is look around at the financial performance and the balance sheet position of the industry: there are many people out there who will seriously struggle. We need to ensure that there is no government intervention. The EU needs to be strong in maintaining a very clear position in relation to state aid, and I am disappointed with the situation we see with regard to Alitalia. However, there will be less of a rush to support airlines from a government point of view, given that this is a fundamental challenge to the industry in the context of fuel at $120-125 per barrel, so we shall see failures, there is no question about it.

Keith Williams: To your question on cash flow, the cash flow for the year was £1.565 billion. Now there are movements on working capital. Sales in advance of carriage is because of the timing of Easter principally, and the other one is on payables. If you look at the payables, it is because we paid a contribution into the pension fund towards the pension deficit, which is going through the trade and other payables line.

Willie Walsh: Just one comment as well in relation to the US industry. The opportunity to restructure in Chapter 11 is not as great today as it was, because many of these airlines do not have any assets, and the appetite to support airlines through Chapter

11 restructuring is clearly not the same today as it was going back a few years. The environment has significantly changed from where we were a few years back, which is why I believe this is a fundamental change issue that the industry is facing now and we are going into that period in a position of relative strength. We have a strong balance sheet, a strong cash position, we know what we need to do and we will continue to be sensible in that environment.

Martin Broughton: I think that is where we need to leave it for today. Thank you very much indeed.

[*Ends*]