BRITISH AIRWAYS

Q4 & PRELIMINARY RESULTS

2005/2006

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Martin Broughton (Chairman): Let me first ask you to join me in welcoming Keith Williams, our new Chief Financial Officer who took over in January. This is his first formal presentation to analysts on behalf of British Airways, and he will take you through the results in detail. Willie, whom you all know by now after a year with the airline, will update you on specific issues affecting the business and then we shall take questions as usual.

In the unique world of aviation, IATA's narrowing of its red ink forecast for airline losses for 2006 from $4.3 billion to $2.2 billion amounts to talk of a new cautious optimism emerging in the industry. The fanfare surrounding the inaugural flight yesterday of the A380 at Heathrow I believe was evidence of this. Our operating profit of £705 million for the year and £620 million pre-tax were good results, and I am happy to say they reflect our performance against our competitors. We also achieved an improved operating margin of 8.3%.

A particular highlight for me is that we have finally delivered on our long-standing objective of returning our shorthaul business to profit, albeit a marginal one. These results set us apart from the US legacy carriers still in Chapter 11 and able to offload many liabilities like pensions, and now struggling to achieve cost efficiencies in a highly competitive industry. Soaring fuel costs with Brent crude reaching an all-time high of over $72 per barrel in May continue to stalk the industry, and there is no sign that this will change. Our other costs are up too, especially employee costs, driven mainly by the pensions deficit, which continues to rise despite the fact that we have doubled our contribution over two years. While it is good news that we are all living longer, there is a price tag attached and BA is not unique in this respect. UK plc has been grappling with this and there is no easy fix: we either have to work longer, pay more or get less.

We have been working hard to achieve a shared solution with staff, Trustees and the trades unions which should solve our pension issue for the future, and this is a key pre-requisite before we can invest for growth, re-equip the fleet and restore the dividend.

As you probably know, the goalposts moved once again on the timetable for ratifying a new aviation pact between the EU and the US. The delay has been caused by congressional opposition to a key element of the deal. Growing protectionism in the US does not bode well for the US being able to deliver a meaningful liberalisation of their policies on foreign control of US airlines. We agree with the European Commission that any

policy change should have meaningful benefits for Europe, should be clear and should be legally robust. Frankly, it is difficult to see how any of these criteria can be satisfied. We believe the best course of action is for the EU negotiators to get back round the table with the US counterparts to achieve a more balanced deal. We await the next chapter in aviation's equivalent of The Mousetrap, and we are on our guard against any attempt to settle for an unambitious arrangement that fails to deliver a balanced deal.

Media headlines have recently been dominated by the bids for the BAA. Whatever the outcome, we expect the Civil Aviation Authority's economic regulator to ensure that it is the airport users, ultimately the flying public, who reap the benefits of cost efficiencies and lower financing costs rather than BAA shareholders.

Another vital issue for us in relation to the potential expansion of runway capacity at Heathrow is local air quality. Air quality monitoring by the National Environmental Technology Centre, supported by BA, shows that levels of nitrogen dioxide around Heathrow are coming down to levels in the proposed new EU legal limits. This is encouraging evidence as the Government prepares to issue its own technical analysis based on the project for sustainable development at Heathrow. The evidence supports the case for mixed mode in the short term and a third runway at Heathrow can proceed sooner rather than later to ease queuing, delays and congestion.

British Airways believes in working with Government and other industry players to reduce the environmental impacts including climate change. The whole of UK aviation is responsible for just 0.1% of global carbon dioxide emissions but we must still play our part in reducing our contribution to climate change. We believe this is best achieved by including aviation in emissions trading and allowing market rather than regulators to decide the right balance between cuts in emissions from aircraft and reductions on the ground.

In summary, we have made good progress this year towards our goal of a 10% operating margin in a market that continues to be challenging. I shall now pass over to Keith for details on the results.

Keith Williams (Chief Financial Officer): Good morning everyone. I did see earlier in the week that one of the analysts wrote that we might achieve our all employee reward bonus plan if we cut back on the gin and tonics on the aircraft. Our revenue performance suggests that that is not true!

Headline numbers

Let us start with the headline numbers as usual. We have strong revenue performance in the fourth quarter with Group turnover up 13.2% to £2.1 billion. Operating profit was £93 million, up £46 million from last year, and this produced a record Q4 margin of 4.4%. This left profit before tax of £91 million.

Looking at the year, revenue was up 9.6% or £8.5 billion, but it is still below the level we experienced prior to 11 September. Our total costs bill, driven primarily by fuel and employee costs, increased by 8.2% to £7.8 billion. This left an operating profit of £705 million, up 26.8% from last year. The margin, as the Chairman suggested, was up from 7.2% to 8.3%. During the year, we operated an employee reward programme and that was triggered and paid out £48 million to our staff. The operating margin at 8.3% is stated after that programme.

We had strong cash flow. Cash from operations was £1,339 million, and EBITDA was £1.7 billion. Pre-tax profits were £620 million. The tax charge at 25% benefited from a recovery of previously paid advance corporation tax. This left profits after tax of £467 million and earnings per share at 40.4p.

Revenue continues to improve

If we look at the revenue performance, at 9.6% revenue increased at its highest rate for some 10 years, driven by both positive yields and improved seat factors. Underlying revenue growth was 5.2%, with fuel surcharges on passengers and on cargo accounting for a further 4.4% increase.

Seat factors continue to improve

Looking at the seat factor, traffic measured in terms of ASKs was up 2.6% on the year and in terms of RPKs was up 3.7%. This gave a passenger seat factor up 0.8% at 75.6%. This is the fourth successive year of seat factor improvement and at 75.6% it is the highest ever recorded seat factor. Seat factor for Q4 itself was 73.1%, which is also a record.

And yields were positive

Seat factors were up and yields were positive. We indicated at Investor Day back in March that we expected yields to be up on the year and that proved true. In the end, yields were up 1.3% compared to last year, and the yield in terms of pence was 6.1p. This is the first time in five years that both traffic volumes and yields have been going the same way.

Yield improvement driven by mix

In terms of yield improvement, we said that prices continue to fall as we see continued promotional activity to support traffic volumes and price declined by 1.2%. Mix has improved as a result of strong performance in the premium cabin. Exchange has also benefited principally from the stronger dollar, which moved from 1.84 to 1.78 during the year. This left total yield up 1.3%. We said at Investor Day that we would start to give you figures on yield including fuel surcharge and, if we include fuel surcharges, the yield was up 5.2%.

Revenue by geographical area

If we turn now to the revenue by geographical area, under IFRS accounting, which we now adopt, there are some changes to the way in which we disclose segment reporting. First, in terms of business segment reporting, we have a split going forward between network airline business, regional airline business, which is BA Connect, and our non-airline businesses. BA Connect narrowed its losses from £27 million to £20 million. Overall, our shorthaul operation was brought back into profit and Willie will talk to that later.

Regarding revenue by geographical area in terms of area of original sale, we have a much more balanced position going forward and all areas improved. In particular, the Americas were up 18% on the year.

In the Middle East, the region was up 10.5% and this primarily as a result of additional flights to India which rose from 19-42 a week. The Far East was up, and that reflects partially our increased flying to China where we increased frequencies from 21 to 31 and introduced a service to Shanghai of five per week.

Q4 Revenue Strong

Looking now specifically at Q4 revenue, revenue is up 13.2% to £2.1 billion. Passenger revenue was up 7% over last year. Other revenue was up 65% driven largely by fuel surcharges.

The point I should make here is that there is an increase of £31 million in revenue during the quarter as a result of mileage changes. Under IFRS earned frequent flyer miles are taken as part of revenue whereas bought miles are deferred. The adjustment of £31 million reflects a change in the split of earned and bought miles. Nevertheless, the underlying revenue was still up 11.6%. The adjustment of £31 million has no impact on yield, it is taken to other revenue. Yield, including fuel surcharges, were up 7.6%.

Full year costs up

That looks at the revenue. If we now turn to costs, capacity measured in ATKs was up 2.4%. Net costs were up 2.9% with fuel up 45% within that, and other revenue up 52%. Total costs excluding fuel and other revenue were up 1.5 percentage points, which is slightly more than the 1% we indicated at Investor Day. This was driven by increased severance costs, which were £48 million for the year, and the trigger of the employee bonus scheme. Unit costs on this basis were still down.

Full year net costs up

Looking at the major cost lines, employee costs were up 5%, and that was driven by pensions costs up £47 million, severance costs, which I mentioned earlier, and increased pay awards.

Engineering costs were up primarily due to the timing of engine repairs and maintenance.

Fuel was up 45%, up £504 million year on year, and that is in line with the guidance that we gave you on Investment Day. Selling costs were down for the year, primarily as a result of lower commission charges.

Quarter 4 costs

Looking more specifically at Quarter 4 costs, net costs were up 4.1% and capacity up 2.2%. The main increase was fuel costs, up 65%, and I will come back to that in a minute. Excluding fuel and other revenue, total costs were up 1.6%.

Quarter 4 net costs up

Again, if we look at the detail, the major cost item up there was of course fuel, up 65% to £444 million. Of that fuel price increase of 65%, half is price, quarter is reduction in hedging profits and a quarter is exchange and volume, the majority of that being exchange as the dollar strengthened in the quarter. Of the other costs, the increased employment costs were driven by increased severance costs, up £9 million for the quarter, and increased bonus awards over the previous year.

Selling costs were up, driven in part by volume-related costs, such as credit card commissions, but also we made a £9 million provision for the higher cost of issuing frequent flyer miles. We include the higher cost of fuel in the frequent flyer mile provision.

Cash

In terms of cash, I said earlier our operating cash flow was strong, up £334 million to £1.3 billion, and EBITDA up 9.7% to £1.7 billion. Our cash balance now stands at £2.4 billion, which reflects lower debt repayments during the year. There are also increases in

sales in advance of carriage which is taken to cash, and those advances of carriage at the end of the year were over £1 billion.

Capex and disposals

Going now to capital expenditure and disposals, at Investor Day, we indicated that our capital expenditure for the year was estimated at around £300 million. We came in slightly better than that at £290 million. The disposals of £88 million reflect the disposal of the London Eye which we disposed of in February this year.

Asset Turns

Lower capital expenditure and increased revenues allowed us to meet one of the goals we set earlier, which is to improve our asset turns to over one times, and this year for the first time in years, we managed to achieve asset turns of 1.1 times. This is the first time in ten years, evidence that we are sweating our asset base even harder.

Total costs

Looking overall at costs, you can see here that we have managed to reduce our costs over time. We have a slight increase in costs this year, excluding fuel, but fuel is becoming a major element of our cost base, and stands this year at 21%. If we look going forward, we have increases in price that taking effect now, we expect our fuel bill to be around 25% of our total cost base.

Our focus remains the same, to achieve a competitive cost base around all our controllable costs.

Fuel hedging position

In terms of fuel hedging, we have average cover for the year of 58% of our requirements which are hedged, and that is at an average cap of around $58 a barrel. This slide gives you the detail. Our hedging cover runs at 66% for this quarter at $55/barrel, and slims down over time, the January and March figure of 47% at $62/barrel. We have in place some hedging cover between April and December 2007.

As you would expect, most of that cover is now in collars and caps, and that allows us to participate if prices fall below those hedged levels.

Net debt £5 billion lower

Looking now at debt. Our net debt in the year was down to £1.6 billion. That is down £5 billion from its December 2001 peak. Our gearing is down 32.5 percentage points from last year at 44.2%, and including operating leases, is down 19.3 points. Our total debt

including operating leases is £2.3 billion. Our focus remains on achieving investment rate credit rating.

Pensions

Turning now to pensions, we announced an increase in pension liabilities as part of this year's results. In terms of pensions costs, our gross pension deficit, that is pensions before tax, now total £2.3 billion gross liabilities. Of that, NAPS, our major pension scheme, is the major element, and NAPS itself, the liability increased by £1.1 million to £2.1 billion.

In terms of accounting, we adopt pensions corridor and in the books, the recognised IAS 19 deficit of NAPS is just under £1.6 billion. The total pension liability on the balance sheet is £1.8 billion.

Pension costs in the year were more than £250 million.

Financial year 2006/07 outlook

Turning now to the outlook for this year, 2006/07, you recall that we increased the fuel surcharge on long haul in May, £30-35. That will give us something in the region of 0.5 percentage point improvement in revenue this year. We give guidance today that our traffic revenue is also expected to increase another half percentage point from the guidance we gave you earlier. That leaves our total revenue up 5-6% as opposed to 4-5% that we gave you at Investor Day.

When we put on the additional fuel surcharge we indicated that we expected our fuel costs this year to be up £600 million to £2.2 billion. That is based on a forecast fuel price of $74-75 of Brent.

Our focus as I said earlier remains on keeping our controllable costs flat, and we see that being achieved this year. In terms of capital expenditure, we announced that our capital expenditure was expected to be up as we invested in Terminal 5 and we invest in new products in Club World, First, and in in-flight entertainment. Our capital expenditure guidance remains unchanged at £500 million.

In summary

These represent a good set of results, especially given the huge increase in fuel costs that we have this year. It is clear, however, that we need to continue to pursue further cost reductions in our controllable cost areas. Fuel and pensions remain major challenges going forward.

Our outlook for 2006/07 shows revenue up 1% and our other guidance unchanged.

Thank you, and now over to Willie.

Willie Walsh: Thanks, Keith. Good morning, everyone. There are three topics that I would like to discuss with you briefly today.

Agenda

The first is the return to profitability of our shorthaul operations, and then give you an update on our pensions position, and then finally, a brief recap of the main themes of our business plan and our outlook for the current year.

Shorthaul

Shorthaul represents an important part of our business and accounts for roughly two-thirds of our passengers and approximately one-third of our revenue. We have made good progress returning short-haul to profitability, but I am clear that while we have achieved a lot, there is still a lot more that we need to do, and we have plans in place to do this.

Shorthaul profit history

If you look at the graph behind me which shows the operating profit performance on short haul over the last seven years, you can see that we have returned the business to an operating profit this year with a profit of about £7 million. That is a significant turnaround from the losses in 2000 where we were generating losses in excess of £300 million. This is the first time in 10 years that we have reported a profit on our short haul operations.

This performance has been achieved by improving all aspects of the business. We have examined our selling and distribution revenue management product, fleet, network and clearly a focus on efficiencies and cost. The result, however, masks a strong performance at Heathrow with losses in both our regional business and at Gatwick. Our annual accounts will split out the performance for BA Connect and show an operating loss of £20 million, that is a £7million improvement on last year. This is the last year that we will disclose the profitability of our shorthaul operations. Keith has previously said that under IFRS we will no longer break down profitability by area of destination as we have done in the past.

The shorthaul business

If we look at the shorthaul business, it is clear that there are three distinct parts to the business. We have the regional business, Gatwick and Heathrow. In the region, we have 50 aircraft, 28 Embraers, 8 Dash 8s, 10 Avros, and 4x146s. They operate 56 routes.

In Gatwick we have 33x737s, we have 5x300s, 19x400s, and 9x500s, and they operate on 43 routes. At Heathrow we have 87 aircraft operating on 43 routes: 33x319s, 27 x320s, 7x321s, and we have 13x757s, and 7x767s operating on shorthaul.

It is a different business across the three regions, and they have different issues and clearly different solutions required to drive profitability, but it is clear that all parts of this business must be profitable and must contribute to our operating margin of 10%.

If we look at the regional business, historically this operated in a market that was virtually uncompeted. Today there is competition on all routes, and the area is dominated by the no-frills carrier. The business provides no feeds to our longhaul operations and is not strategic to the group. At Gatwick, we continue to see demand for a premium product. It is less than at Heathrow. There is limited transfer traffic to our longhaul operations, about 15% of our traffic transfers, and the market is primarily a leisure point-to-point market, and therefore we are in direct competition, head-to-head with the no frills airlines.

At Heathrow, premium demand remains relatively strong. We have significant transfer traffic, and we have a very strong focus on frequency. I think the combination of our shorthaul and longhaul network at Heathrow means that British Airways has *the* best network of any airline operating out of the UK, both in terms of the range of destinations and the frequency of services.

BA Connect

We relaunched the regional business as BA Connect in January this year as the financial performance of the business in recent years as been poor and unacceptable. We have moved to a single cabin configuration with by on board catering, as we recognise there was little demand for a premium cabin in the regional business.

We have introduced a new and simple fare structure that allows us to compete more effectively with the established no-frills carriers. Although it is early days, we have only been selling it since February and services were only launched at the end of March. We have had a promising start in terms of traffic figures, which were encouraging for April, and we have had very positive feedback from our customers.

The new fare structure is simple with only two fare types, BA Connect and BA Connect Plus all tickets are non-restricted and they are all changeable. The Connect Plus product is primarily aimed at business travellers and, as you can see from the slide, it provides differentiation in terms of lounge access, seating and frequent flyer miles.

Buy on board

The buy on board product has gone down very well. Connect tends to operate on flights and sectors that are shorter than the rest of the shorthaul network, with a strong focus on domestic, northern and western Europe. This product gives us a new focus on ancillary

revenue, and our initial experience is that the demand has been way in excess of our expectations.

Gatwick

As we look to Gatwick, we have had a very clear focus on Gatwick now for some time. It will not surprise you to know that we have adopted a very simple approach to address the problems there: we want to reduce the costs and increase the revenues. If we look at the revenue, we have a broad network at Gatwick and we have launched six new routes since the review of the business late last year and these are to destinations such as Grenoble, Reykjavik and Kiev, and we shall continue to look for profitable new destinations. The focus is on the breadth of the network rather than depth. The concentration, clearly, is on leisure passengers and this does not require high frequency, and as with the 33 aircraft that we have at Gatwick, we can serve 43 routes, while at Heathrow we serve a similar number of routes – 43 routes – but using 87 aircraft, so there is a greater focus on frequency.

We have introduced a premium leisure product where passengers can trade up from Economy to Club at the time of booking, and this is proving to be very successful. We have tested and now adopted a new advertising and pricing approach, and I shall come back to that in a moment, because that has been adopted for both Heathrow and Gatwick.

On the cost side, we have reviewed all aspects of the cost base at Gatwick. We have reviewed the product both on the ground and on board, and we have focused on areas that the customers value. This has allowed us, for instance, to reduce the amount of catering that we have on at off-peak times, to focus on and emphasise self-service check-in, which has allowed us to reduce the number of staff in this area. We have received excellent cooperation from the staff and from the trade unions at Gatwick, and we continue to identify and to introduce more efficient practices and procedures at Gatwick.

We have been much more aggressive in terms of our negotiations with airports, both existing airports and new airports as far as landing and handling charges, trading off possible new destinations, and we have submitted plans in place to reduce our property portfolio at Gatwick better to reflect the current needs and demands of the business there. Combining all of these changes, we shall deliver a £40 million improvement in the financial performance, and that is the scale of the change required at Gatwick to enable us to consider in a rational way some of the long-term issues related to Gatwick including the fleet replacement.

Heathrow

At Heathrow, our network and frequency continue to be our focus as this is key to business travel. In Club Europe, our premium business after many years of decline, we have seen demand flatten and in fact increase in the last year, and we continue to look for opportunities to adjust our flying to increase that demand further. We have been successful and shall continue actively to target the premium leisure market. Over the past five years, we have increased the utilisation of our aircraft by about 15% and going forward we shall see additional shorthaul capacity being generated by the retrofit of new space-saver seats, which are thinner and lighter, to all of our Airbus aircraft. With these seats, we can fit an extra row of seats on the aircraft, which will give us an increase of about 2.9% in the number of seats that we have on our shorthaul operations at Heathrow. The conversion of our aircraft will start in September of this year and will be complete in May of next year.

Underpinning our new pricing and advertising approach at both Heathrow and Gatwick is a continued focus on developing revenue management techniques that allow us to compete more effectively, not only with the no-frills carriers but also with the traditional network carriers.

New advertising and pricing approach

I hope by now you will all have seen our new advertising and pricing. With new low lead-in fares, we are targeting an improvement in seat factors, and over time we believe that this will push us closer to the levels achieved by the no-frills carriers, bearing in mind that they report seat factors including passengers who do not fly with them. We have introduced one-way fares, which followed on from customer research which clearly demonstrated that customers in the shorthaul market expect airlines to advertise on a one-way basis. Therefore, potential customers tended to compare our headline prices, which were advertised on a return basis, with the one-way fares advertised by the no-frills carriers. So the introduction of one-way fares allows us to compete more directly with our competitors. ba.com is an excellent website, I believe that it is a perfect shop window for this type of tickets, allowing customers easily to see where they are available through the unique calendar display that we have.

Again in response to customer feedback, we have introduced changeable fares and all of our customers are now able to change the economy ticket types. We expect this move to be revenue neutral. We do expect to see some dilution from customers who previously paid for flexibility, but this will be offset by the additional income generated by change fees. Again, ba.com offers an easy way for customers to change their travel plans. We believe that significant scope exists to drive increased seat factors, particularly at off-peak times, and this will allow us better to use our assets and to drive ancillary revenues from these

extra passengers. We shall have some seven million fares available for sale at the lowest price, and we shall continue to provide value and price. Our proposition is not solely around price. We shall continue to offer excellent value products on board our aircraft, a network that is unparalleled, frequency that nobody can match and fly to primary airports.

I have spoken a little about ba.com. It is a critical enabler to our new pricing approach. We continue to see more and more of our customers choose to book direct with us, and direct with ba.com. This provides us with the cheapest and most efficient distribution channel, and it also enables us to collect relevant customer information that allows us to service our customers. Our customers can change their travel plans online, book their seats and get pre-departure checklists, provide contact details either by email or SMS so that we can contact them in the event of disruption. They can print their boarding card and check in online, which is proving to be a very attractive facility for our customers.

We also recognise now that new revenue opportunities are developing through ba.com. Many customers are taking advantage of insurance sales, car rental and hotels, and one of the areas where we have seen success is where customers are taking advantage of the easy opportunity to upgrade to the Club cabin.

New TV ad

I know you have seen a lot of the advertising, you will see the strapline “Cutting prices not corners” has been very effective. Most of our advertising is tactical around price but it also includes a service message, and I hope you have seen the TV ads. For those of you who have not, we shall show it to you now. [*video clip shown*] We are very pleased with the launch of the new advertising and pricing campaign.

Summary

To summarise what I have said, we have three very different businesses, different solutions required for the business. All parts of the shorthaul business need to be profitable, and we have achieved a lot but there is still a lot for us to do.

Pensions – where we are

Let me turn now to pensions. You will be aware that we announced our proposals for changes to the pension scheme on 23 March. It is vital that we solve the pensions issue if we are to achieve a competitive cost base, deliver a 10% operating margin, be fit for growth and be in a position to invest in our future.

Pension proposal – the details

As you know, there are two parts to our pensions problem. The first is to clear the past deficit and the second is to put in place pension arrangements that are affordable for the future. Let me briefly recap on the details of our proposals: we intend to retain a final salary scheme; to raise normal retirement age for all of our employees; to introduce a slower accrual rate; to cap pensionable pay at inflation, that is in line with the practice in the airline at the moment; to cap pensions in payment to 2.5%; for the company and the staff to share in the impact of changes in life expectancy going forward and, once the rule changes have been agreed, we shall make a £500 million contribution to the pension scheme.

Pensions – where we are

Looking at where we are, the communications exercise that we initiated back in October last year has been very successful. We have had intensive communications face-to-face with our employees. We have also commissioned MORI to conduct two surveys in order to ensure that our communications with staff are effective. The result of the first survey showed that our staff clearly understood that there was a problem, they accepted that it was not unique to British Airways, they accepted that it had to be tackled in the interests of the long-term future of the business and recognised that a shared solution was the way forward.

The results of the second survey will be released at the end of this month, but we have used the initial feedback to test the understanding of the proposals and to amend, where necessary, our communications around those issues. We have held an initial meeting with our trade unions on 26 April, which was held with representatives of all of the main unions, and we have consulted on our proposals. I would say that the meeting was constructive and that further meetings are planned during June.

Separately, the Trustees have commissioned PWC to conduct an independent assessment of the company's ability to pay the existing pension arrangements, and I understand that the details of that report will be presented to the Trustees today. Today in our accounts, as Keith has said, we have disclosed the IAS19 deficit with the deficit increasing to £2.29 billion for all of our schemes, with the NAPS deficit increasing by £101 million. I am very confident that we shall find a solution to the pensions issue.

Pensions – what next

As far as the timetable, the consultation with staff continues, and we expect to get the first cut of the actuarial review sometime in June. The Trustees will review this in July and, therefore, there will be discussions and further evaluations of our proposals through the summer. The final actuarial review will be available some time in the autumn, and implementation will take place as soon as possible after the changes have been agreed.

Outlook

Turning now to the outlook, I want to remind you briefly of the aims of our business plan. You should recognise these from the Investor Day presentation. I have already talked about pensions, and it is critical to us delivering a competitive cost base, but we shall maintain a strong focus on all controllable costs. We have made a commitment to take £450 million out of the business over the two year period of the business plan, and I am confident that we shall achieve that.

The second part of our plan is to focus on service that matters, and the strong demand that we have seen during the year for our premium product clearly justifies the investment that we intend to make in our new Club World flatbed and First cabins. They will be rolled out during the summer period. New IFE will be fitted to all of our longhaul aircraft and this will start next month, and we shall continue to invest in ba.com, enhancing both the functionality and the content of the website.

We are now 681 days 19 hours and about 35 minutes away from moving into Terminal 5. I am delighted to say it is on schedule and on budget. We have made excellent progress, and we are on schedule in terms of our change. We are getting very good cooperation from both the staff and the trade unions on the issues of work practice changes. We continue to negotiate and to implement change, and we have now had agreement in a number of sections in our Heathrow operation. I am confident that all of the changes necessary to the business in relation to Terminal 5 will be achieved and will allow us to move in there on schedule and to operate in a very efficient fashion.

The arrival of the A380 brings back into focus fleet issues and growth. As we said at our Investor Day, we have secured delivery positions on 10 777s from Boeing for delivery from the end of 2008 through 2010. We shall only commit to those aircraft once the pension deficit has been addressed, and when we are confident of our ability to achieve a 10% operating margin. I am confident that we shall achieve that 10% operating margin to the year ending March 2008.

Our next major replacement of the fleet is some way away. Our fleet averages 9.5 years and our oldest 747 is just over 16 years old. However, we shall continue to evaluate options from Boeing and Airbus, and continue to talk to both manufacturers in terms of the potential development.

Turning briefly to market conditions, as you have heard we expect our revenues to grow this year by between 5-6%, and we see the US economy remaining strong. We have had very good traffic volumes from India and China, and we expect that to continue through

the year. We shall continue with our efforts to drive premium volumes including premium leisure, which has been very successful for us last year.

Martin Broughton: You have heard a comprehensive review there of what is going on behind the numbers, as well as seeing the numbers. Let us now move to questions. Even when we know who you are, could you please say who you are for the record.

Question & Answer Session

Question Chris Avery (JP Morgan): Can you elaborate further on market conditions. Can you walk through the major sectors of your market and talk about the state of demand. It seems we are still in a very strong condition, so I would be interested in going through longhaul/shorthaul/premium, the current state. Keith, probably one for you, selling costs appear to have stopped falling, what should we start thinking of those going forward. That has been a major cost driver, is that trend finished?

Willie Walsh: To recap, we see North America continuing to be strong. We have had a good year and we expect that to continue. India has been very successful for us. We have had significant expansion into India, and we have been pleased with the traffic volumes that have exceeded our expectations, and the same applies to China where we have also launched a new route last year into Shanghai. China continues to be strong, and that includes Beijing and Hong Kong.

On the shorthaul, I believe I have covered that in the presentation I have made on shorthaul profitability. We believe that there is scope for us to drive additional seat factors on the shorthaul network. We shall look for opportunities to launch new routes particularly out of Gatwick. They will be primarily leisure routes out of Gatwick and there is significant scope for driving additional seat factor during off-peak. That will be enhanced by the introduction of the one-way pricing model introduced on 29 April. Over time, we shall be able to push our seat factors on the shorthaul network up to a level that gets close to the no frills carriers.

The business is very strong in premium demand. We have seen strong demand on our longhaul premium. We are very pleased with the premium leisure on longhaul. We have seen demand for the first time in a long time improve on shorthaul premium and we are

seeing good results as a result of the focus we have had recently on shorthaul premium leisure as well.

Question Chris Avery: No push back at all from the last fuel price surcharge increase on longhaul?

Willie Walsh: People accept that the surcharge is directly related to the high cost of fuel. The price of fuel gets plenty of publicity and we have not seen any softening in demand as a result of that.

Keith Williams: Selling costs for the year were down 8%, although selling costs for the quarter were up 9% on the quarter. That was primarily driven by the provision for frequent flyer mileage. It was a one-off for the quarter. The outlook on selling costs is for them to continue to come down.

Andrew Light (Citigroup): Following on from Chris's question on the outlook, at your Investor Day you said you are seeing some softness on the Atlantic in the non-premium classes. I just want to know if that is still the case? Secondly, on the staff bonus plan, would I be right in saying that, had it not been for the Gate Gourmet-related strike, under the formula they could have doubled their bonus during the year. Could you give us an idea on the threshold margin for this?

Willie Walsh: The guidance that we gave at Investor Day remains. There is some softness on non-premium on the transatlantic but nothing has changed since Investor Day, and we are looking at steps we can take to improve on that. However, no change from the position we outlined on Investor Day. It is fair to say that, had we not had the disruption caused by the illegal industrial action, the reward for the employees in the business would have been higher.

What I would like to say, however, is that we have had a fantastic performance by our staff, particularly in the second half. The vast majority of the people at British Airways were appalled, outraged and very angry about what had happened, and they did not want to be dragged into the dispute, and really put in a fantastic effort to recover the business. I do not think that we could have produced the result that we have produced today, particularly the fourth quarter result that we have produced, if it weren't for the effort of everybody at BA, so I think the bonus is strongly deserved.

Question: Andrew Light and the threshold level this year in terms of operating costs?

Willie Walsh: We will disclose that later on. Our intention is to do that in the next few weeks.

Question: Chris Reid (Deutsche Bank): I do not know if you could quickly run us through the various provisions and one-offs that were in the numbers? I got some of them but there is the revenue reduction and then all the various cost expenses – if that is ok Keith. Secondly, on pensions, the only thing I would push back at you a bit is that the news from the unions does not seem to be as good as what you were saying there, Willie. It seemed to me, on reading the stuff from the last meeting, that nothing substantive was discussed and they just sat there and said they did not like the proposal. What makes you so confident that the unions will go for the pension deal, and does it really matter if they don't like it at the end of the day?

Keith Williams: Shall I cover the provisions first? We announced that in Q4 there was a £31 million release to revenue, that is in respect of BA Miles, these are miles which are earned, miles which people pay for which are deferred and there was adjustment between the two. As far as other provisions, within selling costs there was a £9 million additional provision for frequent flyer mile redemption, the cost that we carry until people redeem their miles. The other one would be severance which stood at £48 million for the year, £18 million for the quarter.

Willie Walsh: I am pleased with the way that the pensions proposal has been communicated and received by the staff. Clearly, this is a difficult issue but it is recognised that the problem is not unique to British Airways. That is the big difference from where we were when the deficit was first discovered in 2003 at £928 million on an actuarial basis. Since then, people have been able to see the steps that have been taken by other companies. The fact that we have retained a final salary is very important and in the proposals we have made we have had to clarify some of the issues and we continue to do that. This is an issue that must be addressed, that is well recognised within the business, and I am confident that we can do that.

Question: **Andrew Lobbenberg (ABN Amro):** I have two quick questions. The first is a very simple one on tax: should we assume that the tax rate goes up going forward? Secondly, on your outlook for next year with regard to yields, your guidance is that yields will be down slightly. Given how strongly they are tracking at the moment and how solid you sound about premium demand going forward, try and talk us into believing that guidance.

Keith Williams: I will take the tax question. This year we released £20 million of ACT which brought the tax rate down by 25%. There is further ACT to release, a further £74 million of ACT to release again future profit, which should bring the tax rate down next year .

Willie Walsh: In terms of the yield, it is clear that we are much more aggressive as far as our pricing than we have been in the past and we shall continue to do so through the year. We see the opportunity to drive revenue through higher seat factors, which will largely be achieved through more aggressive pricing. The changes that we have made to pricing on shorthaul are designed to do just that. The market remains very competitive and, while we have seen strong premium traffic and expect that that premium traffic will continue, I believe you will see us as aggressive in terms of our pricing to ensure that we drive the additional volume. Our expectation is for a slight decline in yields through the year.

The other issue that impacts on this is currency, and dollar is an issue there. We have strong US originating traffic and that will impact on transatlantic yields. We shall get some of that back on the cost side as well – before you tackle me!

Question: Nick van den Brul (BNP Pairbas). I have a couple of small questions on the cost. First, on the £450 million, it looks as though, if you had a target of 1% cost increase for the current year, you are above that and, therefore, you are not meeting your target for the current year. Can you say where you are on the £450 million target for the business plan for 2008 and what measures are in place that will lead to that being achieved?

A second subsidiary question of that is that if a large part of that is redundancy or staff retirement. Can you say what level of early retirement provision you are expecting in 2006/07?

Willie Walsh: The first thing I would say is that the guidance we gave at Investor Day was that costs excluding fuel would be up 1%. The question was asked did that include the bonus – exclude it – and we made that quite clear at the Investor Day when asked that question. Part of the reason why it is 1.5% against the 1% is due to the fact that we subsequently triggered the bonus which accounts for £48 million, and we have also made significant provision in the year of £48 million for severance. That accounts for the difference between the 1% that we gave you at Investor Day and 1.5% out-turn for the year.

In relation to the £450 million cost reduction programme, we are managing that in a very different way to the way it has been managed in the past. Every single aspect of that cost reduction programme has an identified owner with responsibility who will be held accountable for it. I am very confident, for that reason, that we shall achieve the target. It is very early in the year, but we are on schedule and remain on schedule to achieve that target of £450 million over the two years.

Keith Williams: Early retirement: as you are aware, age legislation is effective from 1 October this year. That will give rise potentially to some increased severance in the first half.

Question: Can you give any guidance on that?

Keith Williams: No.

Question Paul Griffith (Merrill Lynch): $100 oil is no longer an outrageous assumption. Can you give us your view on how that impacts your competitive position versus those competitors who are buyers of the A380, and also versus the low cost carriers? Secondly, you said that it still remains a longer term goal to achieve an investment grade credit rating. Can you put some timing on that? Also why do you need to get back to investment grade; might not an accelerated fleet modernisation programme take priority over that?

Willie Walsh: In relation to the A380, despite the fact that it arrived at Heathrow, it still has not gone into commercial service. I know they expect it to enter into commercial service in 2006 but we are a long way away from seeing the impact of the A380. Fuel is a factor and even at $100 a barrel it is a factor in our consideration as to whether we take the A380, but it is only one of many. I believe that it will have some influence but it is far too early to say what that will be. However, it certainly would not convince us solely on that issue for British Airways to take the A380. We shall continue to evaluate all of our options as far as longhaul fleet replacement, factoring in fuel as it is today and looking at fuel ranges up to and possibly exceeding $100 per barrel to see what that might do, but it is hard to call at this stage.

In relation to low cost competition, we have seen that we have been able to return the business to profitability which is a positive. Low cost competitors, while they are not introducing fuel surcharges, are clearly increasing their prices to recover some of the impact of the higher fuel costs. In the short term, our hedge position is better than that of many of

our competitors, so there is a short-term advantage that unwinds over time, but I do not see the dynamics changing to any significant degree.

Keith Williams: On the question about credit rating, we are currently rated BB+ with Standard & Poor's and BA1 with Moody's. Return to investment grade is predicated on two factors. The first is operating margin, and we need to get into an operating margin band of 8-10% and, clearly, we are within that. The second element is pension adjusted debt, and we are not where we need to be on that measure. As far as the need for credit rating and investment credit rating, when we come to fleet, fleet renewal and replacement, the credit rating will affect the cost of raising funds.

Martin Broughton: It is not a prerequisite of saying we have to get an investment credit rating before we look at fleet renewal.

Paul Griffith: What is your view on timing as to when you might get back to investment grade?

Keith Williams: We are in discussion with the rating agencies every six months but I cannot give a precise timing on that.

Martin Broughton: You might like to ask them for us. Any other questions? [*no further questions*] Thank you very much.

- *Ends* -