BRITISH AIRWAYS

RELEASE OF FINANCIAL INFORMATION 2004/2005 UNDER IFRS

Monday, 4 July 2005

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WELCOME
George Stinnes
Head of Investor Relations

Welcome to you all. We hope this is our final presentation on the transition to International Accounting Standards from UK GAAP for British Airways. We have a select group of people for you this morning. With me today I have Mary Waldner who heads our corporate reporting efforts and has been very much at the centrefold, so to speak, of all of these activities, and she also has her team sitting in the front row to answer all the very difficult questions but hopefully you will not quite get that far. Also we have Keith Williams, our Corporate Treasurer, who will speak about some of the forward-looking aspects, particularly as they centre around IAS39 going forward.

If we could keep the Q&A for the end as we usually do at presentations. There is a lot of material to go through, and I suspect we shall be here until after lunch if we do not let people get on with their presentations.

What IFRS means for BA

The adoption of International Accounting Standards signifies a major accounting change for British Airways. The degree of changes under International Accounting Standards varies from country to country, and you have already seen Air France and Iberia report the changes for each of those companies. It has a material impact on some of our financial figures and drives a very large number of smaller changes, both in terms of how we measure our results, our assets and our liabilities, and how we present the data to you, the analysts, and other readers of our accounts.

We have been working on International Accounting Standards and the introduction of same for British Airways now for over three years, and there is a huge amount of effort that all companies are putting into this change, not just ourselves, and of course the audit and the actuarial community, in our case Ernst & Young and Watson Wyatt, have been very involved in those processes as well.

Today is the last time that we shall be providing or printing for you data under UK GAAP. From the first quarter, we shall release all of our results under International Accounting Standards and only under International Accounting Standards. Therefore, please, I would ask you to look to these standards as the way forward and stop trying to reconcile for the next 20 years how it would have been if we had not – it just does not seem very realistic.

It is quite a complex issue so we shall spend quite some time taking you through the detail. You thought the pack that you have on the RNS was large. Just wait until you see what Mary and Keith have to say. However, much of it is small, fine-tuning kind of stuff and you can see by the total impact, certainly from the P&L point of view, that it is not a very big number.

I hope that Mary's presentation today will complement your understanding not just of the announcement this morning, but also of the previous sessions we have had on International Accounting Standards, both back in October and again at our Investor Day in February. Keith's session is very much geared at looking forward to the future changes you can expect as the current standards get interpreted differently, or maybe differently as interpretations change, and there is no doubt that that will happen as many of the standards are new, and he will also talk to you about the adoption of IAS32 and 39 which will only happen for the next financial year without comparators to previous year.

IFRS is an important change which we certainly hope will ultimately bring considerable clarity and cohesion in the accounting for many industry-specific issues. If you look at it, all of you have often made remarks to me such as, "these accounts aren't that much use because they are done this way and to find my way through those accounts is terrible". At least, we shall all be broadly doing it the same way and I hope going forward that the differences will decrease over time.

However, in a sense the change in standards will not drive changes in the way we do our business, nor does it in any way change the underlying cash position and strength of our business. It will for the investment community cause significant changes to some of the additional measures that you may or may not use to judge our performance and certainly I shall spend a couple of minutes highlighting some of those more obvious ones.

2004/2005 under IFRS

To begin with, let us look at some headline numbers as they were in the RNS this morning. The operating profit for 2004/05 increases by some £17 million under IFRS, the equivalent of 0.3 points of margin. Before tax profit is almost £100 million higher and this larger figure is principally due to the goodwill adjustment on the one-off disposal of Qantas, and you saw a similar, although somewhat larger, number with Air France when they announced their changes last week.

The largest impact is on the balance sheet and on net assets which are reduced by £1.3 billion, primarily reflecting the pension deficit now held on balance sheet. As I said, there are some material changes as a result of the transition to IFRS. Mary will take you through all of those details in her presentation.

As the slide shows, it is important to be clear that not all changes come into evidence this year, and Keith will take you through IAS39, which will be disclosed for the first time with the Q1 results, and Air France, again, adopted a similar approach last week. In addition, some of the changes that you see in the 04/05 release are not representative of the situation going forward, and Keith will take you through that too.

Changes to traditional investment measures

Let me give you just a quick highlight of some of the measures that people are looking at. Distributable reserves – this has been in the Press recently. As part of the transition to IFRS, a number of adjustments have been made against our reserves and by far the most significant is IAS19, where we account for the pension deficit on the balance sheet rather than just the notice to the accounts. As a result, our IFRS reserves to 31 March are reduced by some £1.3 billion to £940 million. Of this, £1.04 billion, i.e. £1,040 million, relates to share premium, revaluation reserves and preferred securities that are not distributable under UK law.

Our gearing ratio is also materially impacted by these changes. At year end, we reported a debt to total capital ratio of 42.7%. Going forward, we shall make two changes to this measure. The 42.7% also included, as it historically did in the UK, the deferred tax position. The opening position that we reported in this release was 52.1% which eliminates the deferred tax from the calculation. Going forward, the reduction caused by the pension scheme moves the number up a further 15.5 points so the gearing ratio as reported will now be 67.7%.

To make you feel a little better, I thought I would share with you the return on equity numbers which some people look at, and you will be pleased to know in terms of after-tax net assets, return on equity increases from a humble 9.9% to 28.1%. It just shows you how some of these measures move around really quickly, but the business hasn't changed at all has it?

… but no change to ..

Operating margin, the impact is very small at 0.3 points and it will not surprise you that we shall continue to strive for a 10% operating margin. We shall, however, going forward remove the impact of the unrealised fair value movements in the fuel. Clearly, that volatility does not help anybody in terms of measuring and targeting the business.

Finally, it is worth again saying that the cash in the business does not change. It is the same business that it was on Friday afternoon as it is this morning, and the way we run and manage our business will in no way change with International Accounting Standards.

Let me hand over to Mary who will talk you through all the transition adjustments, and there are a considerable number of them. She will then hand over to Keith to do the more forward-looking aspects of International Accounting Standards, followed by the Q&A session. Mary.

IFRS CHANGES 2004/05
Mary Waldner
Manager Corporate Reporting

Good morning everybody. As George said, I am Manager Corporate Reporting, and the last three years of my life have been not quite dedicated, it just feels like that, to managing the IFRS implementation project. I have gone to desperate lengths to get out of it including getting married and having a baby but I came back and it is still here!

Main applicable standards for BA – 2004/05

I am planning to talk you through the RNS that you all picked up as you came in that we released this morning. It talks about the impact of IFRS on our published financial statements for the year that has just finished – 2004/05 – and I shall do this by working through the main standards that impact BA. There are something like 32 International Accounting Standards or IFRSs and only around a third of them have a material impact on the airline and you see them here.

BA pension schemes

Let us start with employee benefits (IAS 19) and, as George has said, that is the most material in terms of its impact on BA. I thought it was worth taking a quick gander through our pension scheme to remind you what we are talking about. As you see here, we have three main UK pension schemes: APS and NAPS, the largest both in terms of number of employees and ex-employees and also in terms of deficit, and the rather amusingly named BARP, which is our new defined contribution scheme which opened in 2004; the other two are the older defined benefit schemes.

As far as valuation, the numbers I have here are the last funding valuation at 31 March 2003. As you can see, APS was in surplus to the tune of about £0.5 billion, NAPS £1.7 billion deficit, which obviously drives the deficit you see coming onto the balance sheet. There are also some other pension schemes on the right-hand side there, mainly in the US where there was a deficit of £166 million.

In terms of the asset portfolio of the scheme, it very much reflects the state of the scheme as far as its maturity is concerned, so APS is a closed, very mature scheme, with very few employees who are not retired. Therefore, it is a significant proportion of bonds in the fund, 65% bonds, whereas NAPS has many more serving employees and has 65% equity. Those are the pension schemes and, clearly, it is NAPS that is driving the impact on the numbers.

IAS 19 – employee benefits

IAS employee benefits. This is the format I shall use to go through all of the standards. Let us take a quick look at what the UK standard says and what we do in the UK under UK GAAP, moving on then to IFRS and what the standard says and how it impacts us. Finally, just a quick summary of the balance sheet numbers on transition and the income statement numbers. You will find the numbers on pages 8 through 10 of your pack, so those are the numbers to which I am referring.

Under UK GAAP, as you are aware we reported under SSAP 24, which was a P&L approach where the accounting cost charged matched the periods of service, a spreading approach. We did, however, disclose the FRS 17 balance sheet approach fully as a note in our accounts. What you see moving to IFRS is a balance sheet approach very similar to FRS 17 in terms of its magnitude, although there are some key methodology and disclosure differences which I shall point out to you in a second. However, from a balance sheet perspective the pension deficit that we disclosed under FRS 17 comes onto our balance sheet and you see a £1.2 billion reduction in net assets on transition, which is around a £1.7 billion gross deficit offset by a £0.5 billion deferred tax asset.

As far as the income statement, there is a net increase in pre-tax profit but underneath that there is a £45 million operating charge reduction, offset by an increase in financing. Whereas under SSAP 24, the whole of the charge, both the service cost and the financing element, went through operating cost, here we see the charge split between operating and financing. The operating element is the current service cost if you like. In financing, we have the return on the scheme assets plus a financing charge element which is easy to see as the unwinding of the discount on the liabilities.

Key methodology differences – IAS 19 and FRS 17

I said I would touch on the methodology differences between IAS 19 and FRS 17 and you can read them as well as I can. I shall just point out two or three that apply to BA. The second one there, you see that whereas under FRS 17 there is a clear prescription between the finance and operating charge, under IAS 19 it is not quite as prescriptive, so you may see others where, for example, you have the financing income coming through the operating line, whereas the financing cost goes through financing. We have elected to put both the finance income and the charge through financing but there is an element of choice there.

The second thing I would point out is that under IAS 19 you are allowed to use what is termed the "corridor" approach, and we are electing to use the "corridor". What that means is that annual actuarial gains and losses can be spread through what is called a corridor, which means that you only have to take any gains or losses in excess of 10% of the greater of assets or liabilities. If they are in excess of that, you take them through the income statement, what was the P&L, whereas under FRS 17 there is immediate recognition of those actuarial gains and losses. However, they go through shareholder funds rather than through the income statement, and Keith will say a little more about how that will impact us going forward, but just remember that we are electing to use the "corridor".

Finally, there is a gross approach to the balance sheet under IAS 19, so you are not allowed to net off assets and liabilities between different schemes. What you will see in our balance sheet is an asset, which is the APS asset that I talked about earlier, and a separate liability relation to the NAPS scheme. Whereas under FRS 17 you saw a net liability.

There is another impact of IAS 19 which is very much dwarfed by our pension scheme, but I shall talk about it. There is a requirement for other employee benefits, specifically compensated short-term absences, to be recognised as the service is provided. What that means is that, if you are allowed to take over annual leave as many of us are into the next service year, the company is required to provide for that in the period that the service is provided. Under UK GAAP that was not required, and many companies like us that have large workforces, specifically in the cabin crew and flight crew areas, are now required to provide for the annual leave. From an income statement perspective, it is pretty immaterial, you have a £1 million impact. However, on transition, and it is just a timing difference, we are providing a net £9 million which leads to a reduction in net assets on transition.

BA loyalty schemes

Moving on now to IAS 18, revenue recognition, this impacts our loyalty schemes, our frequent flyer and mileage programme, so I want to remind you of the schemes that we have. To be clear, the impact of this standard on BA is limited to where we are selling miles to third parties, so the recognition of revenue on earned miles by our Executive Club members is not impacted by this at all. There are two loyalty programmes. On the left-hand side we have BA Miles, which is our Exec Club programme, the frequent flier programme with which many of you are familiar. Miles get to members in two ways: either on the left through direct issue where they earn the miles, or on the right-hand side where they are sold to third parties, the likes of American Express. They then use those for their own loyalty programmes to incentivise our Exec Club members. They issue them to our Exec Club members and then they are redeemed. It is on the sale where this standard impacts.

The other area where this affects us is on Airmiles, which is a separate programme. This is a loyalty company operated by our subsidiary Airmiles Travel Promotions Limited, and their main operation is selling airmiles to third parties, the likes of Tesco, Shell and so on. They again use them as incentives for their own customers and they come through to us on redemption. The impact of IAS 18 is on when you recognise the revenue for the sale of those miles. Currently, we recognise the revenue on issue and we make a provision under FRS 12 in the UK for the incremental cost of providing the service when it is finally redeemed.

Under IFRS, IAS 18 is slightly more prescriptive about the timing. We defer the fair value of the mile, we adjust it for breakage, people who we estimate will never redeem, and we recognise the fair value of the revenue on redemption. That means, therefore, we do not need to recognise the cost provision up front but the cost is recognised on redemption, it just flows through.

IAS 18 – revenue recognition

In terms of the financial impact, what you see on transition is a reduction in net assets of £167 million, which is the cumulative impact of deferring the revenue and as far as the impact in the income statement in the year 2004/05, it is a net reduction in pre-tax profit of £31 million. That is the net of deferred revenue of £41 million revenue reduction offset by £10 million, which is the release of the cost provision. As I said, we no longer have to provide for the cost on those miles where we are deferring revenue.

IAS 16 – property, plant and equipment

Moving on to IAS 16 property, plant and equipment, the impact of this standard is on how we account for our major engine overhaul. Under UK GAAP, FRS 15, fixed assets are accounted for on a component basis, and under IAS 16 we account for the cost of major engine overhaul as an expense to the income statement as it is incurred. IFRS takes a similar component-based approach. However, it is more prescriptive on the cost level at which parts of the engine should be determined, so what we have looked at is treating our major engine overhaul as a separate part, and it is capitalised and depreciated over the period to the next overhaul.

The impact of that on the transition balance sheet is a reduction in net assets of £27 million. That might be slightly counter-intuitive and the reason for that is that in the years immediately preceding transition, due to the cyclical nature of engine overhaul there were fewer overhauls to be capitalised than you would normally see in a business cycle. At the end of the year, that trues up again and we see the net asset impact much less. In terms of the income statement, a net increase in pre-tax profit of £28 million, which is a reduction in engine overhaul engineering costs partially offset by the depreciation charge that you see going through.

IFRS 2 – share-based payments

The next standard is one that you see most companies flagging as an impact – IFRS 2 share-based payments. Under UK GAAP, there was no income statement charge regarding the cost of share options. When you issued shares to the employees, there might have been a profit or loss on disposal but over the period of the shares vesting there was no charge. Under IFRS, you are required to make a charge to the income statement for share options granted to employees. The extent is calculated as the fair value of the award on the date of grant, and we have used the binomial lattice model with which some of you may be familiar. I find it incredibly complicated but it looks at the likely volatility of the shares, the market price of the shares both at exercise and going forward, and also the likely yield of the shares and it comes up with a fair value. That value is then spread over the vesting period of the scheme to come up with an income statement charge. On the balance sheet, there is no impact because the charge goes through the P&L but the other side goes through shareholder funds, so there is no balance sheet impact. However, in the 2004 income statement we saw a net reduction in pre-tax profit of £8 million relating to that charge. We have relatively few options granted every year, so it is a relatively small charge.

IAS 21 – foreign exchange rates

Moving on to IAS 21, which covers foreign exchange rates, the impact on us relates to our branch. Many of you will be aware that under UK GAAP we treated certain of our US dollar denominated assets and liabilities as a foreign operation, a US dollar branch with the US dollar as its functional currency. That meant that the assets and the liabilities in the branch were matched and exchange movements were taken to reserves, as if it had been a subsidiary, rather than through the P&L.

Going forward under IFRS, our US dollar branch is not treated as a foreign operation with a US dollar functional currency. Therefore, the dollar liabilities previously in the branch are translated through the income statement and on transition we take the cumulative exchange differences on the assets and unwind them back as if the branch had never existed. That explains why on the balance sheet you see an increase in net assets of £162 million, which is the unwinding of the cumulative exchange difference on those assets.

In the income statement, you see an increase in pre-tax profit of £3 million and there are a couple of effects in there. There is an increase in operating costs relating to the increased depreciation on those increased net assets. There are also the financing impacts coming through, so you see a £23 million credit in financing which is the translation of the related debt, and Keith will talk about how that will change going forward but that is the 2004/05 impact.

IFRS 3 – goodwill arising on business combinations

Let me move on now to some of the smaller, in terms of materiality, impacts on the statements. IFRS 3 covers goodwill arising on business combinations. Under UK GAAP if goodwill arises on acquisition of businesses, it is capitalised and then amortised, and we amortised it over 20 years. Also you can account for goodwill on acquisition as one asset. Under IFRS, you are not allowed to amortise goodwill. It gets capitalised up front, you then have to test goodwill annually for impairment and additionally if there are triggers that suggest that it might be impaired, and then if a write-down is suggested by the impairment test, you then write it down accordingly. The other element of IFRS 3 is that goodwill up front is split into separately recognisable intangible assets, if you can measure the cost of that asset and also if future benefits will flow from the asset. Talking about that last part first, down here that results for us in £22 million of landing rights that were acquired with businesses being reclassified from goodwill into landing rights under these new IFRS 3 criteria. They classify as separate intangible assets. Secondly, on the balance sheet there is a reduction in net assets of £6 million on transition, which is the tax impact of this reclassification. As far as the income statement, what you see is a net increase in pre-tax profit of £5 million which is the goodwill amortisation that we were charging no longer being charged to the income statement.

IFRS 5 – assets held for resale

IFRS 5 looks at assets held for resale and this is a one-off impact in our transition year. Under UK GAAP you are required to revalue the asset to market value once the sale is confirmed, once the deal is done, whereas under IFRS that does not have to be the case. You only need to have made a decision to sell the asset and the asset is available for sale for you to depreciate the asset to market value. There is a small impact for us: one 777 which we sold in the early part of the year gets switched into Q4 of the previous year, so you see a decrease in net assets of £3 million on transition and an increase in pre-tax profit in the income statement in the year, because we did not get the loss on disposal in that year. So it is just a timing switch of one aircraft sale.

IAS 28 – associates

Moving on to associates, this clearly covers our holding in Qantas for part of the year together with Iberia and also a couple of smaller associates. The main impact is clear that under UK GAAP we equity accounted for the associates under UK GAAP, so we translated their numbers into our UK GAAP numbers. Under IFRS, however, they are clearly equity accounted under IFRS. There is also a presentational switch where under UK GAAP they are shown on a pre-tax basis and post-tax under IFRS.   The main impact on the balance sheet is there is a decrease in net assets of £58 million, which is mainly due to the way our share of Qantas is consolidated. Their net assets reduce due to the deferral of frequent flier revenue in their numbers, and also the application of IAS 19 to their pension scheme. In the income statement, the net reduction of pre-tax profit is that reclassification from pre-tax to post-tax.

IFRS 1 – first time adoption of IFRS

This is an impact on Qantas again and George touched on this in his introduction. Under UK GAAP we sold Qantas with a reported loss of £11 million. Under IFRS it switches to a profit of £86 million. There are three main reasons for that. Under IFRS we are not required to recycle the goodwill that was previously written off to reserves as we are under UK, and that resulted in a £59 million charge to the UK loss. We saw there was a £59 million difference in net assets under IAS 28 and that impacts on our reported profit/loss on disposal and, finally, there was a writing off of exchange gains arising on the investment between the start of the year and the point it was sold. Those three lead to a net increase of pre-tax profit of £97 million.

IAS 12 – income taxes

Finally, IAS 12 income taxes. The effect here is a combination of methodology differences in the standard itself, and also the tax effect of all the adjustments that we have talked about. In terms of the methodology differences, they can be summarised as under UK GAAP we provide deferred tax only on timing differences that have originated at balance sheet date but not reversed. However, under IFRS you are required to provide them on temporary differences based on future recovery or settlement of the assets or liabilities that you are recognising at that point. That means that on transition our net assets decrease by

£94 million, which is the impact of IAS 12 on various deals and asset liability treatments that we have. However, additional to that there is also the deferred tax impact of the other adjustments, and looming large is the £0.5 billion deferred tax asset on the pensions there, together with the £9 million asset on all other adjustments. In terms of the income statement impact for the year, you see a decrease in the tax charge of £14 million. That is a very quick gander through the main standards and I hope you have more details on those in your packs.

Balance sheet – reserves

To summarise, I felt it was worth putting up a slide which looks at the impacts. Starting with the balance sheet, you can see very much the impact there is the pensions on reserves, £1.2 billion of the £1.3 billion impact is the IAS 19 pensions, some ups and downs on the others, particularly on the frequent flier IAS 18, you can see that up £189 million but that is pretty much offset by the IAS 21 write-up of the assets there at £168 million. So the headline there is the impact of pensions on reserves.

Income statement – operating profit

As far as the operating profit, this says that the last three years have added up to not an awful lot really. Overall a £16 million increase in operating profit, again some ups and downs, pensions here, IAS 19 increase nearly offset by the reduction due to the frequent flier and a few other ups and downs but, overall, very little impact on operating profit. That concludes the look at the 2004/05 numbers. I shall now hand over to Keith who will talk about IFRS changes going forward.

IFRS CHANGES 2005/06
Keith Williams
Group Treasurer

Good morning everyone.

2005/06 changes

Let us start off by looking at the adjustments between 2004/05 and 2005/06 – what changes. If we take 2004/05, we had some adjustments which were just one-off adjustments. They affected 2004/05 but did not roll on into 2005/06, so we can discard those and we shall look at which ones get discarded in a second. We then have some adjustments which are ongoing, and they affected not only the income statement for 2004/05, they roll into 2005/06. They might roll on in the same amount, they might roll on in a slightly different amount and we shall look at that in a second as well. Then we have in the red box what is new: items which had no impact in 2004/05 but they come in for the first time in 2005/06.

Slide

The big change for 2005/06 is fair value accounting IAS 39 and BA is impacted by fair value accounting in two principal areas. One is fuel because we are big hedgers of fuel cost going forward and in the past and, secondly, on currency because we have borrowings not only in sterling but in dollars and yen. The dollars were previously dealt with through branch accounting and, as Mary said, branch accounting has gone, and we get some relief under IAS 39 which we shall look at. Similarly, we get relief under IAS 39 for fuel, and I shall return to that in a few minutes.

Slide

I shall try to talk you through the 2005/06 changes to the reported profit in the income statement, what changes between 2004/05 and 2005/06, what changes to reported earnings because not everything goes through the income statement, some items go through reserves, and I shall talk you through that. I shall try to quantify, wherever possible, where there are ongoing adjustments for 2004/05, the quantification of those items as they roll through to 2005/06. I shall talk in a little more depth on fair value changes, because that is a significant change for BA, and, finally, I shall look at how we shall disclose that in the accounts going forward. So that is the agenda.

2005/06 changes (summary)

Let me give you a summary to begin with as to what the changes are. I have said a few seconds ago that we have items which were ongoing and items which are new and items which drop altogether. If we look through it in IFRS order, IFRS 1 dealt with the reclassification of Qantas for BA and it was a 2004/05 adjustment; it does not roll forward into 2005/06. That brought in a £97 million pre-tax profit in 2004/05 and does not impact 2005/06.

If you look at number 5, assets for resale, similarly, as Mary discussed earlier, that was a one-off reclassification adjustment so that has no impact in 2005/06. However, if you look at the other items, on share-based payments we continue to issue stock options and they are valued over their vesting period and that continues as an ongoing adjustment. Goodwill rolls through as an ongoing adjustment and there are some ongoing adjustments to income tax. Those are items which roll through.

If we continue onwards, property, plant and equipment, again there are ongoing adjustments there. Revenue recognition, dealing with the sale of airmiles, rolls through to 2005/06. Pensions and employee benefits, again that rolls through to 2005/06. Foreign exchange rolls through but we have the additional element coming through of IAS 39 dealing with currency adjustments, and we shall look at that separately.

To finish off, the adjustments for associates related primarily again to Qantas, Qantas has gone so that does not roll through to 2005/06. Intangibles are similarly small and do not roll through and, finally, we have IAS 39 fair value accounting which rolls through into 2005/06. So that gives you a broad summary of the items which are ongoing and which we need to look at to try to give you an indication of the quantum of those adjustments going forward.

IFRS 2 – share based payments

If we start, first, with IFRS 2 because I said earlier that IFRS 1 was the transitional adjustment which discards that. IFRS 2 relates to stock options, as Mary indicated earlier, and charges stock options through to the expenses. In 2004/05 the impact of that was £8 million in cost; in 2005/06 one would expect it to be something similar. It will not be exactly the same amount but it will be pretty similar.

IFRS 3 – goodwill

Looking next at goodwill, this looked at the implication of not amortising goodwill under IFRS. It gave a positive impact in 2004/05 of £5 million and that is an ongoing rolling-through adjustment. It is an adjustment to amortisation which affected 2004/05 and will affect 2005/06 and subsequent years, so the amount of the adjustment will be the same.

IAS 12 – income tax

Tax tends to follow the nature of the accounting adjustments. The overall adjustment for 2004/05 was £14 million and we would expect something similar for 2005/06. The other item I would mention here is that, because some of the IAS adjustments roll through for tax purposes, in particular some of the IAS 39 adjustments, it will impact slightly the timing of our tax payments. As we have indicated to you, we expect to be tax paying on an ongoing basis, and our first instalment of tax is due 1 October this year. There will be some slight variations in our tax payments as we tax effect some of the IAS adjustments.

IAS 16 – property, plant & equipment

IAS 16, which dealt principally with engine overhauls, produced an increase in income for 2004/05 of £28 million. The quantum of the effect for 2005/06 depends really as a function of the timing of the engine overhaul but, if we look at what we expect for 2005/06, we would expect broadly a similar adjustment for that year of £28 million for 2005/06.

IAS 18 – revenue recognition

IAS 18 dealt with airmiles and the sale of airmiles and produced a decrease in income of £31 million for 2004/05. Again, the quantum of the adjustment for 2005/06 will depend on the pattern of airmiles being issued/sold versus redemptions. We would expect a broadly similar adjustment for 2005/06, if anything a slightly smaller impact.

IAS 19 – employee benefits

We had adjustments of £16 million but most of it related to the pension fund and was an increase of £15 million in 2004/05. We would expect the position to be broadly similar again for 2005/06. Mary mentioned earlier the issue of the way in which we are treating IAS 19 and, in particular, the treatment of the pension fund corridor. We would not expect that to have any impact for 2005/06, so we believe that the impact on the accounts will be the same as it was for 2004/05, the £15 million. However, we need to keep an eye on the fact that actuarial gains and losses might give rise to some volatility on an ongoing basis.

IAS 19 – employee benefits (pensions)

Just to bring home a point that Mary mentioned, if you look at where BA was in the notes to the UK GAAP accounts for 2004/05, on the FRS 17 basis we had a deficit of £1.4 billion. Because of the use of the corridor, the actuarial gains and losses are unrecognised, so that gives us a relief of £300 million and the actual liability recognised in the accounts is £1.1 billion. When Mary mentioned earlier about looking at what happens to the actuarial gains and losses going forward, some of the actuarial gains and losses might come through the P&L account on an ongoing basis spread over a number of years.

IAS 21 – foreign branch

As far as foreign branch, to bring home a point here Mary mentioned the fact that we had previously accounted under branch accounting for the foreign branch and that has gone. Therefore, historically everything has been restated and that has increased our asset values by £162 million. It increases the asset values on transition but one of the ongoing effects, of course, is that it increases the depreciation on the assets going forward. Therefore, we will see an impact on the operating expenditure broadly similar to the one that we saw in 2004/05 of around £20 million.

IAS 39 – fair value accounting

The financing element is dealt with separately under IAS 39 under cash flow hedging, and I shall cover that in a little more detail now. IAS 39 is new, it was not there for 2004/05. For BA it impacts us significantly in what was previously the branch accounting, as I mentioned a few minutes ago, and it impacts us on fuel. The essence of fair value accounting is that derivatives are marked to market and the producing gain or loss is recognised on the balance sheet. There are complex rules to determine what goes through shareholder reserves or what goes through the income statement, and what I shall look at now is which bits go through which area.

Principles of IAS 39

To look at the basic principle of IAS 39, it is that we have an exposure and that might be fuel or currency and we have a hedge against that exposure. What IAS 39 does in simple terms is look at whether the hedge against the exposure is effective, i.e. it matches it. If it does match it, the movement goes through to shareholders' funds, i.e. the hedge is effective so it goes through to shareholders' funds and sits on the balance sheet. If the hedge is ineffective, then it goes through to the profit and loss account.

Fuel – what we do

To understand the impact on BA, we need to look at what we do in practice because we have not changed what we do in practice when we look at the accounting changes that stem from that. On fuel hedging, we are significant users of fuel hedging as you know and we continue to fuel hedge, and you will see that the … [*end of tape, no overlap*] … hedge because it smoothes our expenditure on fuel.

Slide

The way in which we carry out those hedges by looking at the various types of fuel that we buy is that we hedge through crude into gasoil and then back to jet. We are not buyers or hedgers of jet day one. We tend to hedge, first, through crude, then gasoil into jet. The reason for that is that we are a significant purchaser of fuel, we purchase something like 42 million barrels a year and we are the biggest user of jet on one of the fuel markets, the Northwest Europe market.

Slide

Because of that, we find that the market is illiquid out into the future, so we tend to hedge crude in the short term, we move through to jet nearer the point of delivery, but we hedge through gasoil and typically we will commence our hedges into the future in crude. The issue with IAS 39 is that to get IAS 39 treatment in its entirety, we would need to hedge jet and that is not what we do in practice. The reason for that is that the size of the exposure makes it an illiquid market to BA for hedging jet day one, so, as I have said, we hedge through crude into jet as the market becomes liquid. That has implications for IAS 39. The jet and the crude markets are correlated over time but there may be variations at different points in time.

Fuel – IAS 39 tests

To get hedge accounting, you need to look at three different tests. The first test is whether you expect crude to be an effective hedge against jet. Then look at does the crude hedge remain effective throughout its life and, if the answer to that is a positive, the mark to market result of the fuel hedging is generally posted to shareholders' funds but, if it is not effective, it is posted through to the profit and loss account.

Fuel – IAS 39 expectation

What that means practically for BA is that we expect to be effective on most of our hedges but we do a test on each of them. Sometimes the correlation is imperfect and, therefore, some amount of our hedging result will be charged to the profit and loss account going forward. If you look at our entire book at any one point in time, we might have up to $0.5 billion of fuel derivatives in position with mark to market positions. Only a small proportion of that will go through to the profit and loss account, because we expect to be effective on most of our hedges.

Fuel – IAS 39 disclosure

Putting that into perspective, we propose to continue hedging through crude into jet. The accounting will give rise to some small amount of volatility through the profit and loss account. It is not cash and we will separate it out in the income statement. We will separate out fuel cost and then the mark to market position on our fuel derivatives. So it will go through the income statement but we will separate out. Then in terms of our operating margin, since it is really looking at a mark to market valuation out of future adjustments to the income statement, we shall take the operating margin excluding that adjustment. So we shall disclose the operating margin excluding the fuel derivatives adjustment.

Foreign currency debt – what we do

The second element is foreign currency debt. IAS 21 and branch accounting has disappeared and the replacement for BA is IAS 39 and, again, to look at the impact you need to look at what we do in practice. We have, as you know, substantial amounts of borrowings in both dollars and yen. We have over £800 million equivalent of borrowings in dollars and slightly fewer borrowings in yen. The reason for that is that we are big earners of dollars and yen, so in treasury and economic terms we hedge those positions.

IAS 39 – treatment

If you look at the basic principle, to repeat it from earlier on, if we have an exposure and a hedge, if the hedge is effective the movement goes through to shareholders' funds. If the hedge is ineffective, it goes through to the profit and loss account and gives rise to volatility.

Foreign currency debt – IAS 39 position

What that means in practice for BA is that we have substantial dollar revenues and we have some substantial yen revenues, and under IAS 39 we are allowed to map out the future debt repayments and match them against our anticipated future revenues. Where there is a match, the difference goes through to shareholder funds. That is a slightly better position than we have today, because if you look at our accounts one of the big adjusting items has always been on the yen and that is because the yen debt has been translated through to the profit and loss account each period and there has been no matching allowed under UK GAAP. What we are seeing going forward is that we have the match, so we shall map our yen revenues and our yen debt and, to the extent that they are effective, the movement will go through shareholder funds.

What we expect in practice is that we are not entirely matched on yen, so you will see some small element of revaluation to the profit and loss account, but that is likely to be less than you have seen in the past. On dollars we are more or less hedged but there is a slight element of a bond that we have in dollars which is repayable in 2030 and 2032, there are $200 million of borrowings there which are not hedged because it is too far out into the future to hedge. Therefore, you will see some slight volatility on the dollars, which will be new.

Summary

If you pull all of that together and look at 2005/06 versus 2004/05, we do not really anticipate any material differences between the two years. Similarly, if you look at 2005/06 versus UK GAAP, again we do not anticipate there being any significant differences there. The one item that you will see is this new item of IAS 39 mark to market and part of that will go through the profit and loss account, but the bulk of it will go through shareholder funds. Thank you.

George Stinnes: I hope that that has all been fully digested. There is now the promised opportunity for Q&A. I would ask you to use the microphones, if you push the button in front of you, and state your name and company. We are recording the Q&A so that the questions can be put up on the website after today's presentation. With that I welcome any questions.

Question & Answer Session

Chris Avery (JP Morgan): I have two questions. George, in your opening remarks at the beginning running through distributable reserves, you did not conclude on it. I take it that the distributable reserves are negative, is that what you wanted to say?

George Stinnes: That is correct. We have distributable reserves, we talked about the £940 million that was left and in terms of reserves that are undistributable, it is around £1.040 billion which relates to those items, so, yes, they are negative.

Chris Avery: Negative 100, thank you. The second one is on IAS 16 adjustment engine overhaul, you would have thought that over time the change from one method to another method would not have made any difference at all. Yet we have two years where you have a pretty significant £30 million change. Do you want to explain how that arises, because I would not have expected it to be that big for that long?

Mary Waldner: You are absolutely right, Chris. Over time, there will be no impact. As I touched on in my presentation, it is really because of the cyclical nature of engine overhaul, in the years immediately preceding transition we had fewer overhauls going in than you would expect in a normal business cycle, so there were fewer overhauls capitalised than you would otherwise expect, which leads to the net benefit in these years. However, over time that will smooth out but an engine overhaul cycle is typically four or five years, so that is why a couple of years out of sync is not unusual but over a long cycle, it will smooth out.

Chris Avery: Your fleet average age is quite young, so you probably do not have as many major engine overhauls because you have a whole bunch of the narrow-bodied stuff that does not need it yet. That is the business reason for it? Okay, thank you.

Jonathan Wober (HSBC): I have a couple of broad brush questions. The first one is really just getting you to restate what is up on that summary. Would I be right in thinking that, if you look at the numbers you have just restated taking away the Qantas one-off, both the operating profit and the pre-tax would have been very close to the old UK GAAP numbers? Similarly, going forward, both operating profit and pre-tax would be similar to what they would have been under UK GAAP? Is that the same as what you are saying up there in the summary?

Keith Williams: That is absolutely right. The one difference would be the Qantas disposal for 2004/05, which is non-recurring through to 2005/06.

Jonathan: Secondly, is there anything in any of this which would change your guidance for the year?

George Stinnes: The guidance for the year stands as it is. We gave an update on the revenue when we added the last fuel surcharge last week, and that is where it currently stands. We will be updating tomorrow just the hedging positions at the same time as the traffic stats.

Andrew Light (Citigroup): Are there any implications of the pension deficit accounting and the increase in the deficit under IFRS to the actuarial valuation which determines actual contributions, and am I right in saying you will be doing another actuarial valuation at the end of the current year?

George Stinnes: That is absolutely right. The funding valuation occurs every three years and the last one was in 2003, the date of the next valuation is March 2006 and we would have the results of that valuation some time at the end of the summer/early Fall, and that will determine the contribution levels, that is absolutely right. What is on the IAS 19 valuation does not determine the actual contribution.

Anthony Bor (Merrill Lynch): I am not 100 percent clear – that is probably an understatement – about IAS 39 on fuel. It seems like your exposure to the crack spread from year to year and probably a mix issue in terms of what products you are exposed to as well. Can you explain in a little more detail when you examine what you call the effectiveness of the hedge what you are talking about? Who gets round the table and discusses what at that point to establish whether it is effective or not?

Keith Williams: The accounting rules work on the basis that, if you are between 80% and 125% effective, the movement goes through to shareholders' funds with the spread on the individual items going through to the P&L account. So as long as you are effective, most of the movement goes through to shareholders' funds. We have some hedges that we do not designate and they go through to the profit and loss account. In terms of quantum, we would expect most of our hedges to go through the profit and loss account. I mentioned earlier that, if you took last year, we had something like $500 million marked to market and I would say that 5-10% of that would go through the profit and loss account on an ongoing basis.

Anthony: So you expect a modest amount of it to go through the P&L account, but where you would get a big exception to that would probably be if the crack spread moved a great deal at the balance sheet date, is that right?

Keith Williams: Yes, that is absolutely right. In fact, not entirely because you have some hedges that are dropping off as other hedges come on. So if you look at what goes through the profit and loss account, you have to take account of what the hedges were and the mark to market on those together with the new hedges that you are taking on. If you look at each quarter, you have items dropping off and items coming on, so it is pretty difficult to give you a categorical, it is pure mark to market P&L charge.

Anthony: Okay but you would be using market available data?

Keith Williams: That is based on market available data.

Olexsy Soroka (BNP Paribas): I am on the fixed income side, hence my balance sheet question. Looking at one of the sides, in terms of pension deficit net liability recognised was mentioned as £1.1 billion. I am trying to reconcile it with the balance sheet as of 31 March, where there is a pension benefit obligation of £1.8 billion and employee benefit assets of £1.1 billion.

Mary Waldner: You are probably looking at the balance sheet on page 8, is that right? The numbers you see there are the movements, they are reconciling differences if you like, so they are taking the UK position and then showing the movement rather than the absolute position, so the £1.1 billion is the absolute position where as the £1.2 billion we have been talking about is a movement. Is that the question?

Keith Williams: I think your difference is deferred tax.

Olexsy: I am just trying to figure out net pension deficit as of the balance sheet, and we can look at page 22 where the obligation amount is £1.8.

Mary Waldner: Correct and there is a 0.5 deferred tax asset, so that is the gross deficit and then there is a deferred tax asset of 0.5.

Alexis: Okay, if I don’t find it, I’ll come back.

George Stinnes: Come back to one of us afterwards if you are still struggling with it.

Mary Waldner: There are also provisions – although we did not have the total pension deficit on the balance sheet, there was a pre-payment on the UK balance sheet relating to our SSAP 24 treatment. There were also some provisions for the US so you are looking at a movement in terms of these numbers rather than the absolute, so that might help as well.

Owen Gibbons (Cheuvreux): I have just one more quick question on the pensions so that I am clear. In terms of the 10% you are talking of such that you will have to take it through the P&L, is it a 10% difference on roughly 15 billion of assets or liabilities in the pension fund and, if it moves more than 10%, over what period will you amortise the difference?

Mary Waldner: It is done on a scheme-by-scheme basis, so each scheme is looked at for its total assets and liabilities and it is 10% of each of those individual schemes. So you could have quite a small scheme but if the actuarial gain or loss on that scheme was greater than 10% of the assets of liabilities of that scheme, you would see a small amount going through. It would then be amortised over the remaining service lives of the individuals in that scheme, so there would be a spreading impact there.

Owen Gibbons: So you could theoretically have a position where you have the mature scheme in a fairly healthy position in terms of profitability and so the profit on that relative to the size of the scheme could be more than 10%, whereas the liability on the younger scheme might not be quite 10%, so you could have a period where you are putting profit through just as much as you could be putting a loss through. Is that the right way of thinking of it?

Mary Waldner: Yes.

George Stinnes: Bear in mind that it is spread over a considerable period of time, so the actual volatility is quite low.

Jonathan: On page 8 of your opening balance sheet, there is what looks like a movement between trade receivables and cash. I do not know whether you have explained that in something else but I have missed what that is related to?

Mary Waldner: That is just a reclassification under IFRS, it is a presentational issue in terms of the different definition of what constitutes cash. We talk about it earlier on in the statement. [*searches for reference*] Under IFRS, cash and cash equivalents are defined as cash in short-term liquid investments rather than purely cash as under UK GAAP. That is on page 3.

Jonathan: Does that flow through to change in net debt?

Mary Waldner: No, that would not impact net debt.

Jonathan: If it is changing cash, it must be changing net debt?

Mary Waldner: No - both are currently included and would be currently included going forward.

George Stinnes: The questions are becoming more challenging as you have had a chance to look at it some more.

Question (?HAB Munich): Could you give us the absolute number of net debt because I missed it in the presentation for the end of last year and a comparable figure for the year before?

Mary Waldner: We have £2,922 million under IFRS.

Question: [*off microphone*]

Mary Waldner: Let me double check that and I shall get back to you.

Question: Perhaps an additional question. You mentioned your currency exposure in debt at roughly 4.4/4.2 billion but if you look at the balance sheet at the end of last year, you had debt of about 6 or 7 billion. Am I right if you look at page 22? Long-term liabilities 4.3 billion and other liabilities roughly 3.2. Could you split the whole of liabilities by currency please?

Keith Williams: The main difference is trade payables not long-term borrowings.

George Stinnes: We will come back on the net debt in a second. Owen, you have a question?

Owen Gibbons: I have a quick question on IAS 21: am I right in interpreting the depreciation element on the branch assets that the depreciation charge will move year on year depending on the dollar exchange rate – is that a quick way of thinking of it?

Keith Williams: No, it will be fixed because the assets have been fixed in sterling, the depreciation just follows in sterling, which is a change from where it was before because the asset was in dollars so you had fluctuating depreciation whereas now it is fixed in sterling.

Owen Gibbons: And on the purchase of any further US dollars at branch level, you will translate them then in sterling?

Keith Williams: The asset will be fixed in sterling and depreciation accordingly.

Edward Stanford (Cazenove): Following on from that question, the branch accounting is now no longer applicable but does that change the way you run the business in any sense because of that?

George Stinnes: The answer to that is no.

Andrew Light (Citigroup): On that question as well, if there is a significant change in the US$/sterling rate in the next couple of years, would that mean that you would have to revalue the assets, or would that be part of the impairment test?

Keith Williams: The answer is that we would not need to revalue the assets. They have been translated into sterling and they just depreciate down in sterling terms.

George Stinnes: It is worth remembering on a similar note that we have a very high percentage of our revenue in US dollars, it is a much higher percentage than for most of the carriers flying the North Atlantic from the European end because of the big US business. Therefore, in a sense, we suffer the least exposure from that volatility compared with others.

Andrew: I was thinking more if the dollar depreciated rapidly and you were trying to sell these planes in the second-hand market, they will be worth less than what you have on the book?

George Stinnes: But the reality is we are going to fly them and in the same way we depreciate the assets on an economic life basis, not on a fair value basis, recognising that the fleet is stable, it is good and one which will fly. Anybody else or have you had your fill of this for today? There is always the opportunity to call on the phone at any time you like. With that I thank you for taking the time to come here today, and I would remind you that the traffic stats come out tomorrow.

- Ends -