



Chief Financial Officer's report

Our profits reached record levels in 2007/08, as we achieved our target of a 10 per cent operating margin for the first time.

This Chief Financial Officer's report forms part of, and should be read in conjunction with, the Directors' report set out on pages 54 to 58.

Financial performance

Our operating profit in the year, at £875 million, was up £273 million, against a background of ever-increasing fuel prices. Pre-tax profits were £883 million, up £272 million on the previous year. Our financial strength has been significantly improved over the last few years and these results put us in a good position to deal with the extremely difficult climate which is now gripping the industry – caused by economic slowdown and record fuel prices.

Revenue

Revenue for the year was £8,753 million, up 3.1 per cent, despite the negative impact of exchange rate movements. Excluding the impact of exchange, primarily down to the weaker US dollar, revenue was up 4.6 per cent.

Our passenger revenue, at £7,541 million, was up 3.8 per cent, on capacity up 0.8 per cent. Seat factor, being the measure of how full our flights are, was down 0.5 points to 75.6 per cent. Despite the negative impact of exchange rates, yields (measured as revenue per passenger kilometre flown) were up 3.6 per cent, mainly due to more premium passengers travelling with us. Demand for our premium cabins remained strong. The new Club World product is now available on our entire 747 fleet, and this added almost 10 per cent additional premium capacity during the second half of the year. Shorthaul premium traffic weakened, partly due to concerns within the financial markets. Non-premium traffic on the North Atlantic was soft during the year and this, in part, contributed to a reduction in non-premium revenue.

Our cargo revenue for the year was £616 million, up 3.0 per cent. Excluding the impact of exchange, it was up 4.8 per cent. Cargo capacity, measured in available tonne kilometres (ATK), decreased by 0.2 per cent. Our cargo volumes, however, recovered strongly in the year and were up by 4.2 per cent. Premium product volumes continued to grow and were up by 12.6 per cent. Our cargo yield (revenue per cargo tonne kilometre) decreased by 1.2 per cent. Increased cargo fuel surcharges and a better premium mix in the second half of the year helped offset ongoing price pressures evident in a number of markets.

The strong euro continues to impact demand from Europe, and price pressures due to overcapacity continued to be a feature in South Asia. Flown volumes from the Americas and the UK improved, and Asia Pacific continues to perform strongly.

Overall load factor for the year was 71.2 per cent, up 0.8 points on last year.

Total revenue £ million

2007/08	8,753
2006/07	8,492
2005/06	8,213
2004/05	7,772
2003/04	7,560

Operating expenditure

Our cost performance in the year was strong. Our expenditure on operations decreased by 0.7 per cent compared to last year, with unit costs (total expenditure on operations per ATK) reducing by 0.5 per cent. This was a major achievement, considering that we were facing rapidly rising fuel costs throughout the year and we had also concentrated significant additional resources on the operation for the move to Terminal 5. Excluding fuel costs, our expenditure on operations reduced by 3.0 per cent.

The table overleaf summarises total Group expenditure on operations and year on year changes in expenditure over the two financial years ended March 31, 2008 and March 31, 2007.

Our employee costs reduced by 4.9 per cent to £2,166 million. Within this, pension costs were down some £92 million primarily due to the agreed changes to the future service benefits as part of a 10-year programme to fund the deficit in the New Airways Pension Scheme (NAPS). The changes were implemented in February 2007. Lower redundancy costs and manpower efficiencies more than offset inflation-linked wage increases. Our employee costs included £35 million in respect of our Employee Reward Plan (ERP) and management bonuses. The average number of employees in the Group, measured in manpower equivalents (MPE), fell by 2.5 per cent to 42,403 and productivity (measured in ATKs per MPE) improved by 2.4 per cent.

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(£ million)	2007/08	2006/07	Better/ (worse)
Employee costs	2,166	2,277	4.9%
Depreciation, amortisation and impairment	692	714	3.1%
Aircraft operating lease costs	68	81	16.0%
Fuel and oil costs	2,055	1,931	(6.4)%
Engineering and other aircraft costs	451	414	(8.9)%
Landing fees and en route charges	528	517	(2.1)%
Handling charges, catering and other operating costs	977	930	(5.1)%
Selling costs	359	436	17.7%
Currency differences	6	18	66.7%
Accommodation, ground equipment and IT costs	576	618	6.8%
Total Group expenditure on operations*	7,878	7,936	0.7%

*Before non-recurring items.

Our depreciation, amortisation and impairment costs reduced by 3.1 per cent compared to last year. This is partly due to changes in dilapidations charges and changes to the useful economic lives of a number of assets.

The number of aircraft we have on operating leases reduced during the year and this, along with lease renegotiations and the weaker US dollar, resulted in our aircraft operating lease costs reducing by £13 million compared with last year.

Record fuel prices drove our fuel and oil costs up by £124 million compared with last year. This increase was after the benefits of hedging of \$392 million, and the favourable exchange impact of the weaker US dollar.

Our engineering and other aircraft costs, at £451 million, increased by 8.9 per cent compared with last year. This was partly due to contractual price increases on our flying hour engine maintenance contracts and partly due to prior year inventory provision releases on the back of a sustained improvement in the control environment. We also had an increased number of wet leases (aircraft with crew) this year, and additional shorthaul freighter costs. These increases were partly offset by reduced fleet insurance rates due to the soft aviation market.

Landing fees and en route charges cost us £528 million, up 2.1 per cent. This was partly due to rate increases and adverse exchange movements, primarily the stronger euro.

Our engineering and other aircraft costs, at £451 million, increased by 8.9 per cent compared with last year.



Handling charges, catering and other operating costs increased by 5.1 per cent compared with last year. The increase was primarily down to the costs of repatriating mishandled baggage and compensation, following the baggage issues we had in the summer and more recently following the opening of Terminal 5. We also incurred additional costs as a result of our ongoing investment in First and Club World.

Operating expenditure

down **0.7%**

Unit costs

down **0.5%**

Our selling and marketing costs fell by 17.7 per cent, year on year. This primarily reflects increased booking through ba.com, lower advertising costs and agency commissions.

Our £576 million spend on accommodation, ground equipment and IT was 6.8 per cent lower than last year. This reflects savings in IT development and operating costs as well as lower property costs – mainly due to rent and rates savings, less onerous lease costs and reduced dilapidation provisions. Our spend on legal fees reduced, but this was partially offset by higher consultancy costs associated with Terminal 5.

Financial derivatives

Net unrealised gains on fuel derivatives were £12 million (2006/07: £12 million loss), reflecting the ineffective portion of unrealised gains and losses on fuel derivative hedges required to be recognised through the income statement under International Accounting Standard (IAS) 39.

Net finance costs

Our finance costs for 2007/08 were £175 million, compared with £168 million in 2006/07.

Despite increases in the UK and US floating rates, our interest payable on bank and other loans reduced, mainly as a result of lower debt levels. Our interest costs also benefited from increased capitalised interest, thanks mostly to Terminal 5 and aircraft orders.

Our finance income for the year was £111 million, down £18 million on last year. The reduction was due to lower average cash balances, only partially offset by higher interest rates. The lower cash balance was due to one-off payments into NAPS and the fine paid to the US Department of Justice (DOJ) for anti-competitive activity.

Pension financing income and retranslation expenses

Pension financing income was £34 million in 2007/08 compared to a charge of £19 million in 2006/07. This was primarily the result of a higher return on assets in the pension scheme following the one-off cash contributions into NAPS.

The retranslation of currency borrowings generated a charge of £11 million, compared with a credit of £13 million the previous year. The movement versus last year was due mainly to a strengthening of the Japanese yen this year, partly offset by lower yen debt levels.

Profit on sale of fixed assets and investments

Profit on the sale of fixed assets and investments for the year was £14 million (2006/07: £47 million which included a profit of £48 million on the sale of our holding in World Network Services).

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Share of post-tax profits in associates

During the year, we increased our holding in Iberia from 9.95 per cent to 13.15 per cent. The increase in our share of post-tax profits in associates – up from £5 million in 2006/07 to £26 million in 2007/08 – in part reflects this increased shareholding.

Taxation

The analysis and explanation of tax is set out in note 11 to the financial statements.

Our total tax charge arising on profits from continuing operations was £187 million (2006/07: £173 million) giving us an effective tax rate for the year in relation to our profits from continuing operations of 21 per cent (2006/07: 28 per cent). The tax charge benefited from a one-off deferred tax credit of £76 million arising from the reduction in the UK corporation tax rate from 30 per cent to 28 per cent, which is effective from April 1, 2008, and there were charges relating to prior years totalling £4 million (2006/07: £14 million credit). Excluding these one-off items the effective tax rate for the Group would have been 29 per cent (2006/07: 31 per cent).

We paid corporation taxes totalling £66 million during the year, compared with £128 million last year, and we had a corporation tax provision of £4 million at March 31, 2008 (March 31, 2007: £54 million). Our deferred tax balance at March 31, 2008 was £1,154 million (March 31, 2007: £930 million).

Earnings per share

The total earnings attributable to shareholders for the year was £680 million, equivalent to 59.0 pence per share. This represents a 131 per cent increase on last year's earnings per share of 25.5 pence. The increase was driven by both the higher profit before tax, and by a one-off credit to the tax charge, arising from the reduced corporation tax rate effective from April 1, 2008.

Dividend

The directors propose a dividend of 5 pence per share (totalling £58 million) for the year ended March 31, 2008. The dividend will be submitted for approval at the annual general meeting to be held on July 15, 2008. The financial statements do not reflect the dividend payable which will be accounted for as a reduction in shareholders' equity in the year ending March 31, 2009.

Capital expenditure

(£ million)	2007/08	2006/07
Aircraft, spares, modifications and refurbishments (net of refund of progress payments)	428	258
Property and equipment	209	81
Landing rights and other intangible assets	40	41
Investments	57	0
	734	380

Our capital spend in the year was £734 million, up £354 million on last year. This was primarily down to higher spend on fleet assets, mainly due to the delivery of seven new Airbus shorthaul aircraft, higher investment in property and equipment for Terminal 5, and additional investment in Iberia.

Capital commitments

Capital commitments authorised and contracted for but not provided in the accounts amount to £5,189 million for the Group (2006/07: £554 million) and £5,185 million for the Company (2006/07: £553 million).

The outstanding commitments include £5,162 million for the acquisition of four Boeing 777 aircraft scheduled for delivery in 2009, 19 Airbus A320 family (from 2008 to 2010), 12 Airbus A380 (from 2012 to 2014) and 24 Boeing 787 (from 2012 to 2015).

Working capital

At March 31, 2008 our total current assets and receivables were £3,148 million, compared to £3,431 million at March 31, 2007. The reduction primarily reflects lower current interest-bearing deposits, due mainly to the payments to NAPS and the DOJ, partially offset by increases in short-term derivative financial instruments.

Our total current liabilities at March 31, 2008 were £3,244 million, down £381 million versus March 31, 2007. This mostly reflects a reduction in short-term provisions, due mainly to the \$300 million (£149 million) payment to the DOJ, and a reclassification of some elements of the remainder of the provision for anti-competitive activity from short-term to long-term provisions.

We believe the working capital is sufficient for our current requirements.

Cash flow

Our cash and cash equivalents position at March 31, 2008 was £1,864 million. This was a reduction of £491 million compared with the position at March 31, 2007. The reduction was driven by a number of one-off items during the year.

Firstly, we paid £560 million into NAPS in April 2007 as part of the changes agreed to address the deficit in NAPS. Secondly, as discussed, we were fined \$300 million (\$100 million for longhaul passenger fuel surcharges and \$200 million for cargo) by the DOJ for anti-competitive activity. This was paid during the first half of the year. Finally, we paid an additional £50 million into NAPS in March 2008. Again, this was in line with the changes agreed last year, under which we agreed to pay up to an additional £50 million a year for three years if our year end cash balance exceeds £1.8 billion.

Net cash inflow from operating activities was £303 million, a reduction of £453 million over 2006/07. This was primarily due to the one-off payments highlighted above and changes to working capital, partially offset by improvements in operating cash flow.

The £78 million increased cash outflow on investing activities was primarily due to our increased spend on property, plant and equipment (new aircraft and Terminal 5), and increasing our shareholding in Iberia.

Liquidity

At March 31, 2008 we had short-term loans and deposits and cash at bank and in hand amounting to £1,864 million (March 31, 2007: £2,355 million). In addition, we had undrawn long-term committed aircraft financing facilities totalling approximately \$2,880 million, further committed general facilities of \$115 million and ¥75 billion, undrawn uncommitted overdraft lines totalling £20 million and €20 million, and undrawn uncommitted money-market lines of £45 million.

Net debt/total capital ratio

Net debt at March 31, 2008 amounted to £1,310 million, an increase of £319 million compared with March 31, 2007. This is net of cash and cash equivalents and other interest-bearing deposits totalling £1,864 million.

Despite our increase in net debt, the net debt/total capital ratio at March 31, 2008 was 28.8 per cent, a 0.3 point reduction on last year. This was mainly due to growth in retained profits. Including operating leases, our net debt/total capital ratio was 38.4 per cent, a 1.2 point reduction from last year.

Financial risk management

We are exposed to a variety of financial risks, including market risk, credit risk and liquidity risk. Our overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on our financial performance. This is covered in more detail in note 30 to the financial statements.

Keith Williams, Chief Financial Officer