Chairman’s statement

There is no doubt that the past year has been a turbulent one for our Company. There have been highlights and lowlights – some of our own making, others outside our control.
The embarrassing events surrounding the opening of Terminal 5 have been well documented, as has our deep regret at the frustration and inconvenience the disruption caused.

I want to reassure you that our recovery plan is in place and we are determined to rebuild our reputation worldwide and restore the trust of our customers in British Airways. In the meantime our staff are rising to the challenge of delivering the service our customers deserve, despite the difficulties of working across three terminals at Heathrow.

While the change to a phased move to Terminal 5 has had a broader impact on Heathrow, it is vital that our operation is embedded fully before the next stage of development at the airport. Although this has put back the move of other airlines into Terminal 4, BAA agrees that it is in the interests of our industry and UK plc that we move forward together.

These events have taken the gloss off a very good set of results which we achieved despite record fuel costs and the impact of economic slowdown, caused mainly by the credit crunch in the US.

Financial performance
Our operating profit of £875 million gives us a record operating margin of 10 per cent. Our pre-tax profit of £883 million is also a record.

Achieving 10 per cent operating margin was a major milestone for our Company. It has been our goal since 2002 and one of the necessary triggers for the restoration of the dividend. The other was addressing the pensions deficit which was one of the biggest of the FTSE 100 companies.

The Board has always maintained that we needed to tackle our pension deficit, strengthen our balance sheet and achieve a 10 per cent operating margin before we would restore a dividend. Based on successful resolution of these matters, the Board has decided on a dividend policy for the current year to start at a modest level that reflects our lowered financial expectations for the coming year and that will allow it to grow over time and be consistent with other cyclical companies and our major airline competitors.

Our revenue performance was good, up 3.1 per cent in 2007/08. Operating costs were down 0.7 per cent despite the impact of rising fuel costs. Fuel continues to be a major cost and at current prices we expect our fuel bill next year to be some £3 billion, up £1 billion on this year. Our cargo performance improved and cargo revenue was up 3.0 per cent.

Runway capacity
We await the recommendation from the government on plans to allow full utilisation of Heathrow’s two existing runways and the construction of a short, third runway – subject to meeting stringent environmental safeguards.
This follows a public consultation during which protestors made sure it was high on the media agenda. Interestingly, in the area around Heathrow, where you might expect opposition to expansion to be strongest, a Populus opinion poll of residents in the 12 boroughs closest to the airport showed 50 per cent backing for a third runway, with opposition running at 30 per cent. The majority in favour of mixed mode was larger still.

Business leaders were vocal in their backing for sustainable growth and made it clear that London and the UK needs a world-class airport that has the capacity to provide the range of air links you need for success in a global economy. We hope the government holds firm in its clear intent to go ahead with the third runway because it is important not just for British Airways but for London and the UK economy.

Climate change
In this context we realise that climate change is perhaps the biggest long-term challenge we face. It is important for the public to understand that the atmosphere has no preferences whether emissions come from aviation or agriculture, from China or the UK. But it does matter that cuts in those emissions are achieved in the most economically sensible manner. This message is often lost in the emotional headlines around the issue.

Aviation worldwide accounts for approximately 2 per cent of global CO₂ emissions, and allowing for growth, it is forecast by the UN to produce about 3 per cent by 2050. In comparison, road transport generates about six times as much CO₂ and power generation and deforestation around ten times as much.

We believe carbon trading is the most effective way of controlling emissions in an economically sensible manner. So when the UK Government endorsed the introduction of aviation into the EU Emissions Trading Scheme it should have been a decision to welcome. But we were disappointed that the implementation date was delayed until 2012 and not confined to intra-EU airlines.

To impose it on foreign airlines flying into and out of the EU will provoke significant international opposition and lead to further delays in implementation. A better approach would be to restrict the scheme to intra-EU travel and negotiate the global development of an emissions trading scheme.

HM Treasury announced its intention to replace Air Passenger Duty with a new ‘per plane’ tax with effect from November 2009. The Treasury’s consultation on this proposal has now closed.

We have serious concerns that this new tax will distort competition and discriminate against UK network and longhaul carriers, while at the same time incentivising travel over rival European hub airports with no benefit to the environment.

Any new tax should be balanced and non-discriminatory and should retain the current transfer exemption for connecting passengers. In any event, once UK aviation joins the EU Emissions Trading Scheme in 2012, any existing taxes should be phased out.

EU – US
Looking at transatlantic regulatory issues, the limited progress made in stage one of the EU-US aviation agreement has allowed us to launch a new subsidiary airline called OpenSkies offering direct services from continental Europe to the US for the first time. The first service will be from Paris to New York on a Boeing 757 that offers flat beds and a unique style of service.

One reason we chose the name OpenSkies for our fledgling new business is to signal our commitment to stage two of the talks between the EU and US towards a genuine Open Aviation Area – with equal traffic rights and removal of ownership restrictions. Then the industry can finally reap the benefits of the kind of sensible cross-national consolidation that has taken place in electronics, motor manufacturing, pharmaceuticals, banking and almost every other business sector.

We will not hesitate to remind the government of its right to terminate the current deal if sufficient progress towards this bigger goal has not been made by 2010.

The new air treaty has also enabled us to move our flights to Dallas and Houston from Gatwick to Heathrow and we are increasing frequencies on flights to New York JFK, Washington, Seattle and Orlando.

Separate to the air treaty we have announced our intention to launch services from London City airport to New York using Airbus A318 aircraft in an all-business, 32-seat configuration.
New aircraft
We announced our long awaited order for longhaul replacement and growth aircraft during the year. Both the Airbus A380 and the Boeing 787 have huge potential for us and, of course, for our customers.

The 'whispering giant', as the Airbus A380 has been called, and the Boeing 787 Dreamliner, will set new benchmarks in the sky for comfort and technology, and in terms of emissions, NO\textsubscript{X} and noise.

Boeing subsequently announced a delay to the original delivery schedule, and while this is a setback we are working closely with them to mitigate this.

Strategic partnerships
In an exciting development for the one world alliance, we are exploring opportunities for closer cooperation with American Airlines and Continental Airlines.

In the UK, our franchise model has outlived its purpose and we took the opportunity to end our franchise with GB Airways when they made it clear they wanted to sell their business. We subsequently launched our own services on some of the key routes previously operated by our franchisee and we are pleased that they have proved to be very popular. We are the only airline offering the benefits of a full service carrier from Gatwick to destinations such as Antalya, Faro and Malaga.

We have also announced we are ending our franchise agreement with Loganair, and earlier in the year we ended our relationship with BMED. Our overseas franchises, however, are not affected as they provide useful feeder traffic and extend our brand into areas we cannot serve ourselves.

Our relationship with Iberia continues to strengthen and during the year we increased our shareholding from 9.95 to 13.15 per cent. This purchase reflects the strategic importance we attach to our relationship with Iberia and our continued confidence in its management. We will continue to consider further opportunities to increase our stake.

Sponsorship
Sponsorship allows us to give our support to worthy causes and sporting events. We are delighted and proud to support London’s bid for the 2012 Olympic and Paralympic Games. We will play an integral role in welcoming the world to London in 2012.

London 2012 is about inspiring young people, transforming and inspiring a nation, creating a lasting legacy for Britain and encouraging people to actively participate in the Games.

We will support this vision with a number of initiatives over the next four years that will invest in communities where the Games will be staged, support diversity and celebrate Britain at its best.

The British Airways Olympic Youth Bursary Scheme has been created with the specific aim of encouraging young people to get involved in sport and assist the next generation of Olympic hopefuls and aspiring athletes.

Looking forward
The history of aviation economics indicates that it is important to be in a healthy financial condition at the start of a cyclical downturn. With oil at $120 a barrel, that’s exactly where we are now. In the coming year we will need a sensible financial outcome, albeit down on the year just ended, but it will be especially important to win back our customers’ trust.

Martin Broughton, Chairman