

NATS (En Route) plc BUSINESS PLAN REPORT 2005

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1. INTRODUCTION

Under Condition 10.3(b) of the NATS (En Route) plc (NERL) Licence, NERL is required to submit a business plan report no later than 4 months after the end of the financial year.

This report covers the period 1 April 2004 to 31 March 2005 and is designed to meet the requirements of Condition 10.6: to “provide a description of progress achieved in relation to the business plan and the latest service and investment plan, reconciling actual performance against these plans.” For the purposes of this report, the NERL Business Plan 2004 and the Service and Investment Plan (SIP) 2004 were selected as the most appropriate reference points. Hence, actual performance during 2004/05 is compared with these two plans.

In addition to the highlights contained in this report, further information on performance during 2004/05 can be seen in the following documents:

- NATS (Holdings) Ltd Annual Report and Accounts 2005
- NATS (En Route) plc Financial statements for the year ended 31 March 2005
- NATS (En Route) plc Regulatory Accounts 2004/05
- NATS Operational Performance Reports (published monthly)

2. DEMAND

Chargeable Service Units (CSUs), which are the basis of charging for en-route services, grew by 6.3% in 2004/05 compared with 2003/04. The out-turn for 2004/05 was 9.42m against the 2004 NERL Plan forecast of 9.32m, better by 1%.

Total UK flights grew by 4.8% in 2004/05 compared with 2003/04. The out-turn for 2004/05 was 2.20m against the 2004 NERL Plan forecast of 2.24m, a shortfall of 1.6%. A more detailed breakdown of flight numbers can be seen in Table 1 below.

2004/05 produced strong growth as a result of continued expansion by the low cost carriers in the UK and Germany and into the newly emerging Eastern European markets. However, some of this growth was achieved through corresponding declines in the charter market and this meant that growth, although strong, wasn't as

high as forecast in the 2004 NERL Plan. CSU growth was higher than forecast and higher than flight growth primarily due to better than anticipated distance factors.

The outlook is for continued growth in 2005. However, there are signs of weakening growth ahead. IATA has indicated that freight volumes are down, which is a leading indicator that the world economy may be faltering. The forecast for European GDP growth has been revised downwards in recent months. Italy is now in recession and the strong Euro is hurting exports. Continuing high oil prices, now in excess of \$60 per barrel, are leading to surcharges on ticket prices which must eventually dampen demand and the US airlines continue to look fragile in the face of domestic competition.

Table 1 – Demand in 2004/05

	2004 NERL Plan	Actual	Difference
CSUs ('000)	9,320	9,415	1.0%
Total UK Flights ('000):			
- Domestic	483	478	-0.9%
- North Atlantic	298	297	-0.3%
- Other	1,455	1,425	-2.0%
- TOTAL*	2,235	2,201	-1.6%

* Totals may not add due to rounding

3. SAFETY

The NERL Business Plan 2004/05 contained actions to:

- *Further develop the understanding of risk in ATM, supported by a new open reporting scheme, the STAR database and Safety Issues Register*

The open reporting scheme, which was introduced as a trial in August 2003, has now been rolled out to all units. Initial indications are that the procedure is working well. The first elements of STAR went operational in May 2005. Further development of the system is now under way. Following the introduction of a new causal factors scheme in January 2004, the Safety Issues Register has been developed and improved and now provides a valuable tool for identifying risk areas and directing safety improvement activities.

- *Deliver a comprehensive programme of safety improvement activities to address the most significant risk areas – presently human error and level busts*

In September 2004 a new vision for NATS, represented by a set of stretching objectives called 'Destinations', was presented to the NATS Board and was received extremely positively. Since then the concept of Destinations has been communicated throughout the company and teams formed to achieve them. Two of the destinations bear on safety improvement:

- Destination 1: No level 1 or 2 safety significant events
- Destination 2: No category A or B airproxes due to NATS

To address these Destinations a comprehensive programme of safety improvement work is under way that builds on existing plans. This work is focusing on the key incident and error types involving both NATS and the pilot community. The main incident types are level busts, runway incursions and infringements. Key errors addressed are human error/human performance and communication error.

- *Improve NATS' safety management system by implementing the recommendations of the 2003 review of NATS' safety management arrangements.*

In March 2004 a major update to the NATS safety management system was made to address the recommendations of the 2003 review of safety management arrangements. Procedures updated included:
 SP201 Safety Management System – Continuous Assessment
 SP202 Safety Reviews
 SP401 ATS System Safety Risk Classification
 SP200 Safety Surveys
 Work to address the remaining recommendations is proceeding.

With respect to the 2004 SIP, performance in comparison with the airprox targets set for calendar year 2004 is summarised in Table 2 below:

Table 2 - Safety Performance in 2004

	Actual	SIP 2004 Target
Category A airprox	0	0
Category B airprox	0	≤6

4. SERVICE

NATS reports on its service delivery on a monthly basis in the Licence Condition 11 operational performance report. Key points for 2004/05 were as follows:

- Actual attributable delay per flight during 2004/05 20.9 seconds – this can be compared with the NERL Business Plan 2004 stretch target to deliver less than 1 minute average delay per flight against high traffic during the period to 2011, and with average delay of 40.6 seconds per flight during 2003/04
- Average delay per delayed flight during 2004/05 was 17.1 minutes, compared with 15.4 minutes the previous year
- Only 2.2% of flights were delayed, compared with 4.0% the previous year

The major airspace developments planned for 2004/05 were:

- Stafa/Trent development, to improve the interface with London TMA traffic
- Daventry North reorganisation
- Scottish TMA and ScACC SW sector developments

These developments were all implemented on schedule during winter 2004/05.

In the SIP 2004 NATS undertook to consult customers on its future ATM Service Strategy during summer 2004, including the potential for capacity/delay 'contracts' between parties. An initial paper was circulated and further discussions with customers are proceeding.

5. CAPITAL INVESTMENT PROGRAMME

The 2004 SIP is taken as the basis for assessing capital investment performance during 2004/05. This document set out actions to carry out customer consultation in 2004 on the following investment programmes:

- Terminal Control move to Swanwick (completed)
- Da Vinci – Data & Voice Integrated NATS Communications Infrastructure (completed)
- Participation in EGNOS service provision (deferred)

During 2004/05 some 85% of long term investment plan milestones were achieved on time, including the following:

- SACTA Collaboration: assessment simulations in Spain completed – May 04
- Site Consolidation: CTC Phase 1 completed – Summer 04
- New Prestwick Centre constructions started – Summer 04
- NAS Enhanced Gateway System migrated to SPRINT – Aug 04
- iTEC MOU with Spain & Germany (Aena & DFS) – Oct 04
- Cromer & Clee Hill (current phase) Radar Replacement – Autumn 04
- Swanwick Contingency (TDU) for ScACC and TC – Autumn 04

Capital expenditure during the year amounted to some £115m (compared with £78m the previous year). This was slightly lower than the plan, reflecting the revised capital expenditure programme included in the 2005 NERL Business Plan.

6. MANPOWER AND BUSINESS EFFICIENCY

	Plan March 2005	*Restated plan March 2005	Actual March 2005
ATCO	1385	1385	1366
ATSA	874	874	830
ATCE	1187	1114	1083
Others	430	534	520
Total	3876	3907	3799

Note: All figures in the table above show the number of staff provided by NATS to NERL under the Management Services Agreement, and are shown on a full time equivalent basis. The plan has been restated to take account of transfers from NATS to NERL during the year.

ATCO numbers at 1366 were 19 lower than plan, principally because of lower than planned trainee controllers. ATSA numbers at 830 were 44 lower than plan, reflecting the postponed recruitment of training staff at LACC, vacant pseudo pilot posts at the college of air traffic control and efficiencies due to changes in working practices. Lower than planned engineers and other staff principally reflected vacancies in engineering functions with longer than planned timescales for recruitment and a review of resource requirements.

7. FINANCIALS

Financial performance

The table below summarises NERL's financial performance for the year by reference to the 2004/05 data in the 2004 NERL Business plan:

	Actual £m	Better/(worse) than plan £m
Turnover	542	9
Net employment costs	(231)	12
Non staff related costs	(103)	20
Depreciation and amortisation	(94)	(8)
Operating costs	<u>(427)</u>	<u>25</u>
Earnings before tax	115	34
Interest	(49)	(1)
Profit before tax	<u>66</u>	<u>33</u>

Turnover

Turnover for the year at £542m was £9m better than plan. This principally reflected higher UK en route traffic revenues (with higher CSU volumes than planned), higher oceanic income and the benefits of improved service performance - enabling the company to avoid delay penalties and to earn a service bonus.

Costs

NERL exceeded its business plan objective and reported operating costs of £427m for the year at £25m better than plan. Net employment costs of £231m were £12m better than plan with costs arising from higher than planned pension charges more than offset by lower headcount. Non-staff costs of £103m were £20m better than plan and principally reflected lower engineering costs. Depreciation and amortisation were £8m worse and included impairment charges of £10m.

Interest charges of £49m were £1m worse than plan and included an unrealised loss of £3m to adjust the company's interest rate hedging portfolio.

Profit before tax

NERL generated a profit before tax of £66m.

Target savings

The financial restructuring included an operating cost savings target of £170m in the CP1 period compared to the original Airline Group bid plan. To date NERL is meeting this target.

Net debt

NERL net debt at 31 March 2005 amounted to £573m, a reduction of £75m compared with the previous year. This reflected total borrowings of £714m offset by cash of £141m.