

# NATS (EN ROUTE) plc BUSINESS PLAN REPORT 2004

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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 2003 to 31 March 2004 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.” Hence, actual performance during 2003/04 is compared with the NERL Business Plan 2002 and the Service and Investment Plan 2003.

In addition to the highlights contained in this report, further information on performance during 2003/04 can be seen in the following documents:

- NATS (Holdings) Ltd Annual Report and Accounts 2004
- NATS (En Route) plc Financial statements for the year ended 31 March 2004
- NATS (En Route) plc Regulatory Accounts 2003/04
- NATS Operational Performance Reports (published monthly)

## 2. DEMAND

Chargeable Service Units (CSUs), which are the basis of charging for en-route services, grew by 4.5% in 2003/04 compared with 2002/03. The out-turn for 2003/04 was 8.86m against the 2002 NERL Plan forecast of 9.71m, a difference of -8.7%.

Total UK flights grew by 3.4% in 2003/04 compared with 2002/03. The out-turn for 2003/04 was 2.10m against the 2002 NERL Plan forecast of 2.24m, a shortfall of 6.3%. A more detailed breakdown of flight numbers can be seen in Table 1 below.

A rebound in air traffic was forecast through 2003/04 as economic growth accelerated and airlines gradually recovered from the effects of September 11. However, in March 2003 the advent of the Iraq War and the SARS virus outbreak hit confidence and led to uncertainty which dampened economic recovery. These factors affected flights and hence CSUs across all markets. In the short haul market,

this impact was exacerbated by strong growth of the 'low cost' sector at the expense of the 'traditional' carriers, which declined.

An improved economic outlook, the end of the Iraq War and the elimination of the SARS virus should provide a positive stimulus to commercial aviation in the short term. However, growth prospects are being tempered by continuing geopolitical tension and stubbornly high oil prices, which are affecting airlines' already weak finances.

**Table 1 – Demand in 2003/04**

	<b>2002 NERL Plan *</b>	<b>Actual</b>	<b>Difference</b>
CSUs ('000)	9,706	8,858	-8.7%
Total UK Flights ('000):			
- Domestic	481	456	-5.2%
- North Atlantic	296	285	-3.7%
- Other	1,465	1,359	-7.2%
- TOTAL	2,242	2,100	-6.3%

\* The same forecasts were used in the 2003 SIP

### **3. SAFETY**

The main safety milestone for 2003/04 in the NERL Business Plan 2002 was to upgrade safety risk assessment techniques (including continuously improving quantified risk analysis in line with Eurocontrol Safety Regulation Commission recommendations) to identify key safety risks to NATS' business and a mitigation strategy, by the end of 2003. The 2003 SIP elaborated on this in the planned implementation in 2003 of an upgraded SSE scheme to provide a better assessment of the risk involved in events. This would include separate targets for en-route and airport ATS, reflecting the differences in their operations.

A new SSE scheme was successfully implemented in 2003. It is designed to score incidents relative to risk and all incidents, regardless of where the error occurred, are recorded and scored. In conjunction with the introduction of the new SSE scheme a more sophisticated target setting and monitoring process was also introduced. Separate targets have now been set for en-route and airport ATS and confidence bands above the targets are defined to reflect the statistical variability in incident rates.

With respect to the 2003 SIP, performance in comparison with the airprox targets set for calendar year 2003 is summarised in Table 2 below:

**Table 2 – Safety Performance in 2003**

	<b>Actual</b>	<b>SIP 2003 target</b>
Category A airprox	0	0
Category B airprox	2	<6

#### 4. SERVICE

NATS reports on its service delivery on a monthly basis in the Licence Condition 11 operational performance report. Key points for the calendar year 2003 (the basis used for operational performance reporting) are as follows:

- Actual attributable delay per flight during calendar year 2003 was 0.74 minutes – this can be set in the context of the NERL Business Plan 2002 target to reduce attributable delay from an average of 1.4 minutes per flight in 2000 to less than 1.2 minutes by the end of CP1
- NAS operational computer availability was 99.9953% compared with a (NERL Business Plan 2002) target of 99.9% or better
- Oceanic FDPS computer availability was 99.893%, compared with the (Licence Condition 11 Statement) minimum service standard of 99.7%

The 2003 SIP set a specific target of ensuring that attributable delay per flight in summer 2003 was no greater than 1.5 minutes. This target was achieved – actual attributable delay per flight during June-September 2003 was below 1 minute.

The major capacity enhancements scheduled for 2003/04 in the 2003 SIP were re-sectorisations in North Sea and Clacton. The North Sea development was successfully implemented – North Sea delays in summer 2003 were reduced by 95% compared with summer 2002. The reconfiguration of Clacton was completed in March 2004.

The outcome of other service-related actions for 2003/04 from the 2003 SIP is summarised in Table 3:

**Table 3 – Service-Related Actions from 2003 SIP**

Action	Outcome
Achieve an increase in the pass rate for ab-initio trainees from the current 70% to 85%	Current rate is 82%
Reduce the time taken for ATCOs to achieve first Certification of Competency (validation) by 20% and increase success rate to 80%	Time taken has been reduced and success rates increased – but insufficient data so far to draw firm conclusions

#### 5. CAPITAL INVESTMENT PROGRAMME

The 2003 SIP is taken as the basis for assessing capital investment performance during 2003/04. This document set out actions to carry out customer consultation during 2003/04 on the following investment programmes (action was completed in each case):

- Future centres programme - overall business case
- Oceanic SAATS
- New Prestwick Centre

- Radar replacement programme

The outcome of other investment-related actions for 2003/04 in the 2003 SIP is summarised in Table 4:

**Table 4 – Investment-Related Actions from 2003 SIP**

Action	Outcome
Begin implementing SAATS	Common system and approach agreed with NavCanada
Burrington replacement radar operational	Completed on time and on budget
Complete iFACTS feasibility and options study	Completed
Complete proof of concept studies for DaVinci digital data network	Completed
Conclude business case for NATS participation in the EGNOS service provision company	Delays in the European space agency programme have resulted in this being rescheduled to 2005.
Conclude CASPIAN system selection by end-2003	Completed
Resume new Prestwick Centre project by mid-2003	Project resumed in summer 2003

NERL capital spend (including the capitalisation of internal labour costs) for the year ending 31<sup>st</sup> March 2004 was £78m, against the 2003 SIP for the same period of £127m. This primarily reflected rephasing on non operational projects and of the CNS Radar Replacement programme.

## 6. MANPOWER AND BUSINESS EFFICIENCY

	Actual	Budget	Actual
	March 2003	March 2004	March 2004
ATCO	1,430	1,433	1,380
ATSA	802	794	822
ATCE	1,100	1,100	1,056
Others	478	510	500
Total	3,810	3,837	3,758

*Note: All figures in the table above show the number of staff provided by NATS to NERL under the Management Services Agreement, which is the basis used for ongoing reporting and monitoring. The NERL Business Plan recorded manpower on a different basis.*

ATCO numbers reflect lower than planned output from training courses, vacancies for instructors and the transfer of senior staff to personal contracts (subsumed within 'others' in the table above). ATSA numbers reflect a reassessment of the staff requirement and the regrading of some support staff to ATSAs. The engineer and

support staff numbers reflect a higher than planned attrition rate in the light of the accommodation moves and unfilled vacancies.

## 7. FINANCIALS

### Financial performance

The table below summarises NERL's financial performance for the year by reference to the 2003/04 data in the 2002 NERL Business plan:

	Actuals	Better/(worse) than plan
	£m	£m
<b>Turnover</b>	<b>505</b>	<b>(7)</b>
Net employment costs	(213)	2
Non staff related costs	(90)	19
Depreciation and amortisation	(94)	(7)
<b>Operating costs</b>	<b>(397)</b>	<b>14</b>
<b>Earnings before interest and tax</b>	<b>108</b>	<b>7</b>
Debt refinancing costs	(56)	(56)
Interest	(51)	6
<b>Profit before tax</b>	<b>1</b>	<b>(43)</b>

Source: Service line accounts to 31/3/04 updated for year end adjustments

### Turnover

Turnover for the year at £505m was £7m lower than plan. This principally reflected lower UK en route traffic revenues (with lower CSU volumes than planned), partially offset by an accrual for a recovery of revenue allowed under the revised price cap arrangements in the Licence 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 £397m for the year at £14m better than plan. Net employment costs of £213m were £2m better than plan with costs arising from higher than planned pension charges more than offset by lower headcount and higher capitalisation of internal labour costs. Non-staff costs of £90m were £19m better than plan and reflected continued cost savings across the business and a profit on asset realisation through the sale of its Scottish Accounting Office's building. Depreciation and amortisation were £7m worse and included impairment charges of £4m.

Following the regulatory and financial restructuring of March 2003, NERL took advantage of historically low interest rates to refinance the remaining balance of the Acquisition Loan (£600m) originally put in place at the time of the PPP through a bond issue. At the time of the PPP the company entered into interest rate swaps

whereby it fixed the rate payable on its acquisition loan thereby protecting itself against upward movements in interest rates. Repayment of the loan in August 2003 necessitated the unwinding of these swaps to avoid the company being in an over hedged position following the issue of its fixed rate bond. As the interest rate payable on the swaps was higher than the prevailing interest rate, termination costs of £56m were incurred. This cost will be offset by lower interest costs as the interest payable on the company's bond issue is lower than that payable on the debt it replaced.

Interest charges of £51m were £6m better than plan reflecting the benefits of the debt refinancing exercise and lower net debt position.

### ***Profit before tax***

NERL generated a small profit before tax of £0.6m.

### ***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.

### **Financial position**

#### ***Refinancing***

In August 2003, the £600m Acquisition Loan was successfully refinanced by way of an amortising fixed rate bond issue maturing in March 2026. Syndication of the Bank Facilities was closed in October 2003 with the result that the final stage of the restructuring of NERL's finances was successfully completed. This contributed to NERL's objective in securing its long term financial viability.

#### ***Net debt***

NERL net debt at 31<sup>st</sup> March 2004 amounted to £648m. This reflected total borrowings of £756m offset by cash of £108m. The company did not draw on its bank facilities during the year and has financed its capital expenditure and interest payments from operating cash flows.