NATS (EN ROUTE) PLC

REGULATORY ACCOUNTS 2004/2005

Contents

1. RESPONSIBILITIES IN RESPECT OF THE PREPARATION OF THE REGULATORY ACCOUNTS

The Air Traffic Services Licence issued to NATS (En Route) PLC ("NERL") requires NERL, in consultation with the Civil Aviation Authority (CAA), to draw up Regulatory Accounting Guidelines governing the format and content of the regulatory accounts and the basis on which they are to be prepared, and to prepare and publish regulatory accounts in conformity with the Regulatory Accounting Guidelines. The Guidelines currently in force (dated 16 March 2005) were approved by the CAA for application to this year's accounts on 12 April 2005.

2. PURPOSE AND BASIS OF PREPARATION

2.1 Purpose of the regulatory accounts

The purpose of the regulatory accounts, as set out in the Licence and the Regulatory Accounting Guidelines, is to make available such regulatory accounting information as will:

(a) enable the CAA and the public to assess the financial position of NERL and the financial performance of each Separate Business (see section 2.2) on a consistent basis, distinct from each other and any other business of NERL and its affiliate or related undertakings;

(b) assist the CAA to assess NERL's compliance with the Licence in respect of the financial relationship between NERL and its affiliate or related undertakings;

(c) assist the CAA to monitor performance against the assumptions underlying the current price control; and

(d) inform future price control reviews.

2.2 Structure of the regulatory accounts

To meet the objectives stated above, the Regulatory Accounting Guidelines specify two main components of the regulatory accounts:

a) an accounting analysis of the financial position and financial performance for the financial year; and

b) a report of regulatory performance measured on the basis used to set the price caps.

Each of these two sets of reports is prepared for the two segments for which price caps have been set:

- UK Air Traffic Services; and
- Oceanic air traffic services ("Oceanic").

UK Air Traffic Services comprises the En route (UK) Business as defined in the Licence, services provided to the Ministry of Defence and the Other Services provided by NERL. The En route (UK) Business constitutes one of the Separate Businesses specified by the Licence and comprises the UK En route Air Traffic Control Service ("Eurocontrol"), the Advisory Control Service, the London Terminal Approach Service and the Specified Services (including the North Sea helicopter services). The services to the Ministry of Defence and the Other Services are permitted businesses as defined in Condition 5, paragraph 12 of the Licence. Other Services comprise miscellaneous services permitted under the Licence, including services provided to NATS (Services) Ltd ("NSL").

The UK Air Traffic Services grouping reflects the Single Till which formed the basis on which the Eurocontrol charge condition was assessed for the first five-year period (Control Period 1).

The regulatory accounts should be read in conjunction with the statutory accounts for NATS Holdings Ltd ("NHL"), National Air Traffic Services Ltd ("NATS") and for NERL. Notes included in the statutory accounts of NERL are not repeated. Reconciliations between the amounts shown in the regulatory accounts and the statutory accounts of NERL are included where appropriate.

2.3 Basis of preparation

2.3.1 Segmental Analysis

These accounts are prepared on the basis set out in the Regulatory Accounting Guidelines. The areas where the basis differs from that used in the statutory accounts are described below.

(a) Format of the statements

The format of the statements is as set out in the Regulatory Accounting Guidelines.

In the regulatory accounts, fixed assets are stated net of grants and other contributions (deferred income), whereas in the statutory accounts fixed asset cost, deferred income and the related depreciation and amortisation are shown gross. Current assets exclude cash and short term deposits.

Operating costs are classified on a management accounts basis which reflects the categorisation used to manage the business. As a result, some costs are classified differently between the regulatory and statutory accounts.

In preparing the segmental analysis, where appropriate, amounts have been attributed directly to a segment. However, because of the integrated nature of the NERL activities, it is necessary to allocate or apportion certain costs to the segments using the NATS group's activity based costing system. Elements not attributable to an individual segment such as taxation, funding and interest are presented at a company level.

The inter-company revenues and charges included in the segmental analysis represent the net amounts allocated from the cost source to each segment, whereas the statutory accounts show the actual trading transactions between the companies.

Services provided by NERL to NSL are represented as intra-group turnover. The revenue for these services is included in Other Operating Income in the NERL statutory accounts.

(b) Historical cost basis

The segmental accounting analyses in the regulatory accounts are prepared on a historical cost basis. The comparative figures for 2003/4, originally prepared on a current cost basis, have been re-stated. The effect of this restatement is shown in the table below:

(£ million)	UK Air Traffic Services	Oceanic	NERL
Profit and loss account			
Depreciation charge	-15.6	-0.2	-15.8
Net operating costs (note 1)	-16.6	-0.1	-16.7
Profit before interest	+16.6	+0.1	+16.7
Capital employed			
Tangible fixed assets	-63.8	-	-63.8
Capital employed	-63.8	-	-63.8

Notes
1. Includes the impact of removing the monetary working capital adjustment (UKATS £0.9m, Oceanic £nil) from Other operating and General costs.
2. Numbers may not add up due to rounding.

(c) Exclusion of the intangible asset and its amortisation

On the completion of the PPP transaction on 26 July 2001, statutory transfer schemes hived down the operating assets and liabilities of NATS to NERL and NSL. As the valuation of the assets and liabilities was determined by the statutory transfer schemes, fair value accounting was not carried out. As a result of the transfer schemes, an intangible asset of £385.7m was generated in NERL, being the excess of consideration over the values of the net assets acquired. In the statutory accounts, this is stated at carrying value, subject to annual impairment tests, and is amortised over 30 years (NERL's minimum Licence period), in accordance with UK Generally Accepted Accounting Principles. As at 31 March 2005, the net book value of goodwill in NERL was £338.0m (2004: £351.0m).

As required by the Regulatory Accounting Guidelines, the intangible asset and its associated amortisation are not included in the regulatory accounts, and they are shown as reconciling items in the reconciliation to the statutory accounts.

(d) Cash flow analysis

Cash flow analyses for UK Air Traffic Services and Oceanic are derived from the segmental profit and loss and capital employed statements. UK Air Traffic Services and Oceanic are not trading entities with their own cash movements and the purpose of this analysis by segment is limited to providing an indication of the cash impact of these activities.

2.3.2 Reports compared with the regulatory basis

The reports on regulatory performance are prepared on the basis used by the CAA to set the price cap for Control Period 1. They compare NERL's actual performance with the baseline set by the projections underlying the CAA's Advice to the DETR (now the Department for Transport ("DfT")) in August 2000, adjusted in the case of the tracking of the regulatory asset base (RAB) for the 12% uplift to the UK Air Traffic Services RAB agreed as part of the financial restructuring. The financial restructuring is the revised regulatory framework, financing structure and equity structure for NERL which was implemented on 19 March 2003. Additional statements are included to monitor aspects of the financial restructuring, as specified in the CAA Decision on NATS' Application to re-open the Eurocontrol Charge Control (March 2003).

- **Movement in the regulatory asset base**

The statement on the Regulatory Asset Bases (RABs) shows the movements in the RABs, measured on the basis used by CAA when setting the price cap and reflecting actual activity levels. This actual movement is compared with the projections underlying the CAA's Advice to the DETR (August 2000), adjusted, in the case of the opening (1 April 2001) figures for the UK Air Traffic Services RAB, to include the 12% uplift which was agreed as part of the financial restructuring.

The actual movement in the RAB starts with the opening RAB set by the CAA for 1 April 2001, plus capital expenditure and actual movements in working capital, plus capitalised financing costs calculated in accordance with the methodology used by the CAA, less the depreciation allowed by the CAA for price cap purposes during the five years of the current review period (including, in the case of the UK Air Traffic Services RAB, the depreciation included in the "price profiling adjustment").

- **Regulatory performance**

The comparison of performance with the regulatory assumptions shows the derivation of regulatory profit, measured on a basis consistent with the basis used by the CAA when setting the price cap for Control Period 1.

In the actuals column, revenue is as shown in the segmental statements in section 5 of the regulatory accounts. Operating costs are derived from the segmental statements, less depreciation, impairment charges and profit/loss on disposal of assets which are replaced in this statement by the CAA's allowed depreciation (including the price profiling adjustment).

The actuals are shown alongside the projections underlying the CAA's Advice to the DETR (August 2000).

- **Operating cost efficiency roll-forward**

Starting with 2002/03, a record of the incremental out/(under)-performance against the profile of operating expenditure assumed by the CAA in its Advice to the DETR in 2000 is maintained for the purposes of the operating cost efficiency roll-forward (see CAA Decision). This compares the year-on-year movement in the difference between actual operating costs and the CAA assumption.

The definition of operating costs is the same as that used in the statement of regulatory performance, but the costs are stated at 2001/02 price levels. These figures will be taken into account when the RAB is set for Control Period 2 starting in 2006. Further explanation is contained in the Regulatory Accounting Guidelines.

- **RAB Clawback**

A 12% addition to the UK Air Traffic Services RAB was agreed as part of the financial restructuring. Part or all of this addition will be clawed back at the start of Control Period 3 (2011/12) if NERL's cash flows exceed a benchmark.

The benchmark has been set at 80% of NERL's Base Case cash flows (expressed in present value terms) at the time of the financial restructuring. The starting value of the UK Air Traffic Services and Oceanic RABs in 2003/4 will count as a negative cash flow contribution, and the closing value of the UK Air Traffic Services and Oceanic RABs in 2009/10 will count as a positive cash flow contribution.

40% of the present value of the excess of the actual cash flows over the benchmark cash flows will be returned to users by being deducted from the RAB at the start of Control Period 3. The clawback is subject to a ceiling and cannot exceed the initial 12% uplift.

The calculation to determine the size of the clawback will be carried out in 2010. Starting with the 2003/04 cash flows, a record of the NERL operating cash flows is being maintained for the purpose of this calculation. This records the NERL cash flows as shown in the cash flow analysis in the regulatory accounts, together with the benchmark figures set out in the CAA Decision, and the building up of the record of the discounted values which will be used in the calculation in 2011/12.

Further explanation is contained in the Regulatory Accounting Guidelines and the CAA’s March 2003 Decision Document.

3. FINANCIAL COMMENTARY

These regulatory accounts should be reviewed in conjunction with the statutory accounts of NHL, NATS and NERL for the year ended 31 March 2005. The accounts of NHL and NERL include a review of the operational and financial performance of the group and NERL.

Review of financial performance (section 5)

The regulatory accounts present the results of UK Air Traffic Services and Oceanic segments for the year ended 31 March 2005. Comparatives for 2004 have been re-stated on a historical cost basis.

UK Air Traffic Services generated revenues of £529.4m for the year (2004: £492.7m), including intra-group revenues of £7.3m (2004: £6.7m) generated from services provided to affiliated undertakings. External revenues included Eurocontrol income of £460.6m (2004: £426.7m), services to the Ministry of Defence of £45.1m (2004: £44.7m), North Sea Helicopters of £5.6m (2004: £4.7m), London Terminal Approach services of £8.3m (2004: £7.9m) and Other Services of £2.5m (2004: £2.0m).

Eurocontrol income increased by 7.9%. This reflected a 6.3% increase in chargeable service units (CSUs), which are a function of aircraft weight and distance flown. Higher yield North Atlantic flights were up by 4.3% and other international flights grew by 4.9%, reflecting the growth in low cost carriers. The NERL part of the Eurocontrol charge was £50.36 for the calendar year 2004 and £48.47 from 1 January 2005 onwards, compared with £45.48 for the year to 31 December 2003.

Revenues of £18.0m (2004: £19.0m) were earned under the volume risk sharing provisions introduced under the financial restructuring in 2003. The volume risk sharing provides that, where traffic volumes are below the levels forecast at the time of the financial restructuring, NERL and the customers each bear half of the shortfall. Service performance bonuses of £2.0m were recognised in income, reflecting an average delay per flight of 0.35 minutes.

UK Air Traffic Services incurred operating costs of £404.1m (2004: £375.2m), including £37.2m (2004: £42.1m) of costs allocated from affiliated undertakings.

The principal elements were as follows:

- People costs at £232.6m, £23.8m higher than the prior year (2004: £208.8m), reflecting pay and productivity awards negotiated in 2003 and higher pension charges. Redundancy costs were £0.2m (2004: £0.7m).
- Repairs and maintenance costs at £22.3m were £7.5m higher than the prior year (2004: £14.8m) mainly due to higher radar and communications costs.
- Other operating charges at £12.6m were £4.0m higher than prior year (2004: £8.6m) reflecting the costs of staff relocation to the Corporate and Technical Centre (CTC).
- Historical cost depreciation charges were £79.2m (2004: £77.0m). Included within the depreciation charges are impairment charges of £9.6m (2004: £4.2m) resulting from a review of the book value of assets in the light of the company's investment programme.
- Credits for internal labour costs associated with capital projects amounted to £25.3m compared with prior year of £20.9m, reflecting the higher level of capital expenditure.

UK Air Traffic Services reported an operating profit of £125.3 m (2004: £117.5m).

Oceanic services, which includes charges for North Atlantic en route services and height monitoring services, generated income of £20.2m (2004: £19.0m). Income from Oceanic en route services, at £19.9m, was 6.1% higher than in the prior year (2004: £18.8m), reflecting a 5.1%

increase in chargeable North Atlantic flights and a small increase in the price to £55.77 (2004: £55.27 per flight) under the price control formula. Income from height monitoring services was £0.3m (2004: £0.2m).

Oceanic services incurred operating costs of £17.7m (2004: £15.4m), mainly due to a rise in people costs to £13.1m (2004: £11.6m) owing to the pay and productivity awards and higher pension charges.

Oceanic services reported an operating profit of £2.5m (2004: £3.6m).

Combining UK Air Traffic Services and Oceanic results, NERL's profit on ordinary activities before interest and related finance costs and tax was £127.8m (2004: £121.1m). The difference from the figure of £114.8m reported in the NERL statutory accounts arises from the exclusion from the regulatory accounts of the £13.0m amortisation charges (2004: £13.0m) for the intangible asset.

Inter-company transactions

The intra-group turnover and intra-group allocated costs reflect the provision of and charging for services between NERL and other group companies, which are carried out under the terms of the Management Services Agreement and Inter Company Services Agreement.

NATS, NERL's immediate parent company and a service company, and NERL entered into a Management Services Agreement on 25 July 2001. Under this agreement, NATS provides personnel and central services to NERL. The cost of the central services is recharged on the basis of a fair allocation of costs taking into account the most important drivers for the services provided.

NERL and NSL, a fellow subsidiary carrying out economically unregulated air traffic control related services, entered into an Inter Company Services Agreement on 25 July 2001; this was amended by the Inter Company Agency and Amendment Agreement dated 14 June 2002. Under this agreement NERL provides NSL with the following services:

- approach control service for London Luton airport;
- training services for ATCOs and engineers;
- radar data services at NSL airports;
- engineering and software support services;
- research and development for NSL airports division;
- administration and engineering services for Manchester airport;
- provision of private circuits for NSL airports; and
- the supply of services and resources to NSL's business development division (for example - consultancy, training and engineering services).

The services provided by NSL to NERL include:

- provision of North Sea helicopter advisory services on behalf of NERL;
- air traffic services in certain sectors;
- services to London Terminal Approach service (engineering services, use of communications facilities);
- accommodation and support services to NERL units sited on NSL's Heathrow premises; and
- miscellaneous other services.

Services are charged for on the basis of a fair allocation of costs taking into account the most important cost drivers for the services provided, or market price where a market price exists, or based on negotiation on specific projects.

Charges made by other group companies to NERL were £37.2m, £4.9m lower than in 2004. The movement is mainly the result of a reduction in the charges by NATS (NERL's immediate holding company) resulting mainly from lower accommodation costs following the move out of central London; and the transfer of the business IT activity from NATS to NERL at the start of the year. Partly offsetting this, Other Operating and General expenditure increased compared with the prior year due mainly to an increase in training and recruitment costs; the 2004 charge was also reduced by a gain in that year on the disposal of a property by NATS.

Capital employed (section 6)

UK Air Traffic Services capital employed was £511.2m, £5.0m higher than prior year (2004: £506.2m). Tangible fixed assets increased by £32.0m. This was partly offset by a £27.0m reduction in net current assets, from £46.7m to £19.7m, caused mainly by a reduction in debtor balances reflecting the recovery of the previous year's accrual for income received under the Licence and an increase in capital accruals.

UK Air Traffic Services fixed asset additions were £108.4m (2004: £75.3m), which exceeded the depreciation charge of £79.2m. The expenditure included: the development and sustainment of existing air traffic control systems, including the Swanwick system, the development of future systems to support the group's two-centre strategy, including collaborations with European partners and preparations for the military move to Swanwick; the development of systems which provide improved controller tools; construction of the new Prestwick air traffic control centre building; upgrades to NATS' communications network and system management; the continuation of the upgrade of radar infrastructure for civil and military applications; and further expenditure on the new corporate and engineering technical centre near Swanwick and the upgrade of corporate IT infrastructure.

The capital employed associated with Oceanic services at 31 March 2005 was £11.9m (2004: £7.7m). Fixed asset additions of £6.6m (2004: £2.9m) were mainly due to the expenditure on the new Shanwick automated ATS system for the North Atlantic.

A reconciliation of the capital employed at 31 March 2005 and the net assets of NERL as reported in the statutory accounts is also provided. The main items in the reconciliation are:

- The exclusion of the intangible asset from the capital employed figures (net book value £338.0m at 31 March 2005 (2004: £351.0m)).
- Financing and tax items which are dealt with at a company level.

Cash flow (section 7)

UK Air Traffic Services activities generated a cash inflow from operations of £240.7m (2004: £190.4m) which funded capital expenditure of £102.3 m (2004: £77.7m), leaving a net cash inflow of £138.4 m (2004: £112.7m) before debt service and financing.

Oceanic had a cash inflow from operations of £5.4m (2004: £4.4m), and capital expenditure of £5.9m (2004: £3.0m), leaving a net cash outflow of £0.5m (2004: inflow of £1.4m) before debt service and financing.

After funding capital expenditure, UK Air Traffic Services and Oceanic activities together generated a net cash inflow of £137.9m (2004: £114.1m).

Debt servicing charges were £38.6m (2004: £103.7m, which included £56.6m termination of interest rate swaps). The reduced level of net interest payments (£38.6m compared with £47.1m in 2004), reflected the full year impact of the financial restructuring in August 2003.

The financing outflow of £107.4m (2004: net cash inflow of £22.6m) included a repayment of £50m of outstanding drawings under the capital loan facility and an increase in short term deposits of £57.3m. Further details on the Company's financing and debt servicing costs are included in the statutory accounts.

£16.5m was paid in tax (2004: £1.9m). At year end, NERL's cash balance was £60.8m (2004: £85.4m).

Movement in the regulatory asset base ("RAB", section 8)

The closing UK Air Traffic Services RAB of £776.9 m was £1.3m lower than the opening RAB stated at year end prices. Although capital expenditure at £109.7m was £21.5m higher than the sum of the CAA's allowed depreciation and price profiling adjustment, the impact of this on the RAB was more than offset by a decrease in working capital of £28.5m in year end prices.

The closing UK Air Traffic Services RAB was £401.7m lower than the amount included in the CAA projections. This was mainly the result of capital expenditure in the four years to 31 March 2005 being £330.6m (at March 2005 prices) lower than the amount anticipated at the time the CAA prepared its Advice to the DETR which in turn was partly due to the postponement of elements of the capital programme following the events of 11 September 2001. Capitalised financing costs were also lower than in the CAA projections, reflecting the lower capital expenditure.

The Oceanic RAB at 31 March 2005 was £20.2m, £4.1m higher than the opening RAB stated at year end prices. This reflects the capital expenditure in the year, mainly on the new Oceanic automated system, which was £1.5m higher than anticipated in the CAA projections.

The closing Oceanic RAB was £17.4 m lower than projected by the CAA, mainly owing to the cumulative capital under-spend compared with the CAA projections.

A record of the closing RABs year by year is included at section 8.3.

Regulatory performance (section 9)

Section 9 shows actual performance measured on a regulatory basis compared with the CAA's projections of August 2000.

UK Air Traffic Services revenue at £529.4m was £9.1m higher than the amount included in the CAA 's projections. This is partly the result of the revised price control and the volume risk sharing introduced at the time of the financial restructuring.

Operating costs (included in this statement exclusive of depreciation and related items) were £324.4m, £65.0m lower than in the CAA's projections.

Regulatory profit at £116.8m was £73.8m higher than the CAA projection of £43.0m.

The regulatory return is the regulatory profit plus the capitalised financing costs. These are financing costs on capital investment which is not remunerated under the price control for Control Period 1; instead, the costs are added to the RAB for remuneration in future control periods. As a result of capital expenditure over the control period to date being lower than projected, the UK Air Traffic Services capital financing costs for 2004/05 at £5.5m were £27.5m lower than the CAA's projection of £33.0m. The UK Air Traffic Services regulatory return on the average RAB was 15.93%, compared with a return of 7.30% projected by the CAA. The average return over the four years to March 2004 was 10.4%.

Oceanic revenues and operating costs were respectively £3.0m and £4.5m lower than the CAA projections, leading to a regulatory profit of £2.4m compared with the CAA projection of £0.9m. Including the capitalised financing costs, the regulatory return was £2.7m compared with the CAA projection of £2.4m, giving a rate of return on the average RAB of 14.87% compared with the CAA projection of 7.06%. The average return over the four years to March 2004 was -17.8% (including the impact of the legal settlement in 2001/02).

A reconciliation between the regulatory profit and the operating profit shown in the segmental accounting analysis is attached at section 9.2.

Operating cost efficiency roll-forward (section 10)

Section 10 shows the outcome on the operating cost efficiency roll-forward mechanism.

This indicates that, in 2004/05, the out-performance (i.e. the UK Air Traffic Services cost saving compared with the CAA projections) was £11.1m lower than the previous year at 2001/02 prices . For the Oceanic segment, the out-performance was £1.6 m lower than the previous year.

Both results reflect the particular cost reduction measures taken in 2003/04 in response to the downturn after the events of September 2001.

The supplementary adjusted information, included in last year's accounts, is also shown. This excludes the 2001/02 exceptional item from the calculation; this affects the 2002/03 incremental out-performance but there is no effect on the current year result.

RAB Clawback (section 11)

Section 11 shows the record of the cash flows for the purpose of the RAB Clawback calculation which will be carried out in 2011/12 (see section 2.3.2), presented in a format agreed with CAA. The starting value of the UK Air Traffic Services and Oceanic RABs in March 2003 will count as a negative cash flow contribution and is shown on the schedule. NERL’s actual cash flows for 2004/05 were £98.2m in present value terms, compared with the benchmark cash flows of £21.5m (2003/04: £90.3m compared with a benchmark of £60.8m). The cash flows will continue to be recorded year by year until 2009/10.

4. Independent auditors' report to the Civil Aviation Authority ("CAA"), the Directors of NATS (En Route) PLC ("the Company") and NATS Holdings Limited ("NHL")

We have audited the Regulatory Accounts of NATS (En Route) PLC for the year ended 31 March 2005 which comprise the profit and loss account on pages 13 and 14, balance sheet and segmental capital employed statements on pages 15 to 17, the cashflow analysis by segment on pages 18 and 19, the movement in regulatory asset bases on pages 20 to 22, the comparison of performance with the regulatory assumptions on pages 23 to 25, the operating cost efficiency roll-forward on page 26 and the record of cash flows for the regulatory asset base clawback calculation on page 27. These Regulatory Accounts have been prepared under the accounting policies set out therein.

This report is made solely to the Directors of the Company, NHL and the CAA in accordance with the Licence. Our audit work has been undertaken so that we might state to the Company, NHL and the Regulator those matters that we have agreed to state to them in our report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility for our audit work, for our report, or for the opinions we have formed to any other person other than those to whom we have agreed in writing to accept responsibility.

Basis of preparation

The Regulatory Accounts have been prepared under the historical and current cost conventions (as applicable) and in accordance with the Company's Regulatory licence, Regulatory Accounting Guidelines ("the RAGs") approved by the Regulator and the accounting policies set out in the statement of the basis of preparation.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared wholly under the basis of Generally Accepted Accounting Practice in the United Kingdom (" UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial position of a Company as shown in the financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, Directors and Auditors

The nature, form and content of Regulatory Accounts is determined by the Regulatory Accounting Guidelines which have been drawn up by the Licensee in consultation with, and approval from the Regulator. It is not appropriate for the auditors or the Directors to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The Directors are responsible for preparing the Regulatory Accounts in accordance with the Regulatory Accounting Guidelines as set out in the statement of Directors' responsibilities on page 1.

Our responsibility is to audit the Regulatory Accounts in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board, except as stated in the " Basis of audit opinion" below, and having regard to the guidance contained in Audit 05/03 "Reporting to Regulators of Regulated Entities".

We report to the Directors of the Company, NHL and the Regulator our opinion as to whether the Regulatory Accounts have been properly prepared in accordance with the Regulatory Accounting Guidelines, and on that basis fairly present the financial performance of the Company, analysed between each separate segment as defined in the Regulatory Accounting Guidelines, and the financial position of the Company. We also report to you if in our opinion the Company has not kept proper accounting records or if we have not received all the information and explanations, which we consider necessary for the purposes of our audit.

We read any other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the UK Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express and audit opinion under Auditing Standards.

Our opinion on the Regulatory Accounts is separate from the opinion on the statutory financial statements of the Company on which we reported on 30 June 2005, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

Opinion

In our opinion the Regulatory Accounts have been properly prepared in accordance with the Regulatory Accounting Guidelines, and on that basis fairly present the financial performance of the Company, analysed between each separate segment as defined in the Regulatory Accounting Guidelines, for the period ended 31 March 2005, and the financial position of the Company at 31 March 2005.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Southampton

30 June 2005

5. PROFIT AND LOSS ACCOUNT

5.1 Segmental profit and loss account

Year ended 31 March **£ million**		**2005**			2004 Restated	
	UK Air Traffic Services	**Oceanic**	**NERL**	UK Air Traffic Services	Oceanic	NERL
Turnover						
- External	522.1	20.2	542.3	486.0	19.0	505.0
- Intra-group	7.3	-	7.3	6.7	-	6.7
Total	529.4	20.2	549.6	492.7	19.0	511.7
Operating Costs						
People costs	232.6	13.1	245.7	208.8	11.6	220.4
Services and materials	45.1	1.6	46.7	44.5	1.2	45.7
Repairs and maintenance	22.3	0.8	23.1	14.8	0.3	15.1
External research and development	0.4	0.0	0.4	0.3	0.0	0.3
Other operating charges	12.6	0.6	13.2	8.6	0.5	9.1
Depreciation	79.2	1.0	80.2	77.0	0.9	77.9
Capitalisation of internal costs	(25.3)	(1.0)	(26.3)	(20.9)	(1.0)	(21.9)
Intra group allocated charges	37.2	1.6	38.8	42.1	1.9	44.0
Net operating costs	**404.1**	**17.7**	**421.8**	**375.2**	**15.4**	**390.6**
Profit before interest	**125.3**	**2.5**	**127.8**	**117.5**	**3.6**	**121.1**

Notes

1. Following the adoption of the revised Regulatory Accounting Guidelines dated 16 March 2005, the 2004 figures have been re-stated on a historical cost basis (see para 2.3.1(b)).

5.2 Charges allocated from NATS and NSL to NERL

The intra-group allocation charges comprise the following amounts allocated to NERL from other group companies:

Allocated from NATS and NSL to NERL

Year ended 31 March £ million	**2005**			2004 Restated		
	UK Air Traffic Services	**Oceanic**	**Total**	UK Air Traffic Services	Oceanic	Total
Operating costs allocated						
People costs	19.7	0.8	20.5	19.5	0.7	20.2
Services and materials	1.6	0.0	1.6	6.4	0.3	6.7
Repairs and maintenance	0.6	0.0	0.6	6.4	0.3	6.7
Other operating and general	14.7	0.8	15.5	7.7	0.7	8.4
Depreciation	0.6	0.0	0.6	3.3	0.0	3.3
Capitalisation of internal costs	(0.0)	-	(0.0)	(1.2)	(0.1)	(1.3)
Total	37.2	1.6	38.8	42.1	1.9	44.0

5.3 Reconciliation to NERL statutory accounts

Year ended 31 March 2005 £ million	Regulatory accounts	less: adjustment for different treatment of intra-group services	add: amortisation of goodwill	NERL Annual Report and Accounts
Turnover				
UK Air Traffic Services	529.4	(7.3)	-	522.1
Oceanic	20.2	-	-	20.2
Total	549.6	(7.3)	-	542.3
Net operating costs	(421.8)	7.3	(13.0)	(427.5)
Profit on ordinary activities before interest	**127.8**	**-**	**(13.0)**	**114.8**
	Net interest payable and similar charges			(48.8)
	Profit before taxation			66.0
	Tax			(22.8)
	Profit for the financial year			**43.2**

6. BALANCE SHEET AND SEGMENTAL CAPITAL EMPLOYED STATEMENTS

6.1 Segmental capital employed and reconciliation to NERL balance sheet

£m	UK Air Traffic Services		Oceanic		NERL	
	31 March 2005	Restated 31 March 2004	**31 March 2005**	Restated 31 March 2004	**31 March 2005**	Restated 31 March 2004
Tangible fixed assets	491.5	459.5	13.1	7.2	504.6	466.7
Current assets	79.2	92.1	1.8	2.1	81.0	94.2
Less: current liabilities	(59.2)	(44.7)	(3.0)	(1.6)	(62.2)	(46.3)
Total assets less current liabilities	511.5	506.9	11.9	7.7	523.4	514.6
Provisions for liabilities and charges	(0.3)	(0.7)	-	-	(0.3)	(0.7)
Capital employed	511.2	506.2	11.9	7.7	523.1	513.9

£m	**31 March 2005**	Restated 31 March 2004
Total capital employed as above	523.1	513.9
Intangible asset	338.0	351.0
Inter-company creditor	(80.7)	(62.9)
Cash	60.8	85.4
Short term deposits	80.3	23.0
Interest creditor	(4.4)	(0.6)
Corporation tax	(18.3)	(4.9)
Deferred tax	(47.3)	(54.4)
Loans	(692.2)	(734.3)
Net assets per NERL statutory accounts	159.3	116.2

Share capital	10.0	10.0
Other reserves	88.7	101.7
Profit and loss account	60.6	4.5
Net assets per NERL statutory accounts	159.3	116.2

Notes

1. Fixed asset amounts are shown at historical cost and net of grants and other contributions.
2. Following the adoption of the revised Regulatory Accounting Guidelines dated 16 March 2005, the 2004 figures have been re-stated on a historical cost basis (see para 2.3.1(b)).

The regulatory accounts were approved by the Board on 30 June 2005 and signed on its behalf by

Finance Director ____________________________Nigel Fotherby

6.2 UK Air Traffic Services - movements in tangible fixed assets

£m	Land	Freehold Buildings	Leasehold Buildings	Air traffic control systems, plant and equipment	Vehicles	Furniture, fixtures and fittings	Assets in course of construction	Total
Restated cost at 1 April 2004	13.8	131.8	27.2	702.5	1.4	3.4	108.5	988.6
Additions during the year	-	0.1	2.6	18.8	-	2.8	84.1	108.4
Disposals during the year	-	-	(0.1)	(15.7)	(0.1)	-	(3.3)	(19.2)
Other transfers during year	-	0.1	1.4	50.8	-	0.1	(32.7)	19.7
Cost at 31 March 2005	13.8	132.0	31.1	756.4	1.3	6.3	156.6	1,097.5
Restated depreciation at 1 April 2004	-	(49.6)	(19.1)	(449.1)	(1.2)	(2.0)	(8.1)	(529.1)
Provided during year	-	(4.5)	(1.7)	(62.7)	(0.1)	(0.6)	-	(69.6)
Provision for impairment for year	-	-	-	-	-	-	(9.6)	(9.6)
Utilisation of impairment provision	-	-	-	0.7	-	-	3.2	3.9
Disposals during year	-	-	0.1	14.6	0.1	-	-	14.8
Other transfers during year	-	-	-	(17.1)	-	-	0.7	(16.4)
Depreciation at 31 March 2005	-	(54.1)	(20.7)	(513.6)	(1.2)	(2.6)	(13.8)	(606.0)
Net book value at 31 March 2005	13.8	77.9	10.4	242.8	0.1	3.7	142.8	491.5
Net book value at 1 April 2004	13.8	82.2	8.1	253.4	0.2	1.4	100.4	459.5

Notes
1. Fixed asset amounts are shown at historical cost and net of grants and other contributions.
2. After taking into account the utilisation of the impairment provision, the net book value of disposals was £0.5m. Transfers into NERL relate mainly to the transfer of Business IT assets from NATS to NERL.

6.3 Oceanic - movements in tangible fixed assets

£m	Land	Buildings Freehold	Buildings Leasehold	Air traffic control, systems, plant and equipment	Vehicles	Furniture, fixtures and fittings	Assets in course of construction	Total
Restated cost at 1 April 2004	-	1.5	-	16.9	-	-	3.3	21.7
Additions during the year	-	0.1	-	0.6	-	-	5.9	6.6
Disposals during the year	-	-	-	-	-	-	-	-
Other transfers during year	-	-	-	0.5	-	-	(0.2)	0.3
Cost at 31 March 2005	-	1.6	-	18.0	-	-	9.0	28.6
Restated depreciation at 1 April 2004	-	(0.7)	-	(13.8)	-	-	-	(14.5)
Provided during year	-	-	-	(1.0)	-	-	-	(1.0)
Impairment provision	-	-	-	-	-	-	-	-
Disposals during year	-	-	-	-	-	-	-	-
Other transfers during year	-	-	-	-	-	-	-	-
Depreciation at 31 March 2005	-	(0.7)	-	(14.8)	-	-	-	(15.5)
Net book value at 31 March 2005	-	0.9	-	3.2	-	-	9.0	13.1
Net book value at 1 April 2004	-	0.8	-	3.1	-	-	3.3	7.2

Note: Fixed asset amounts are shown at historical cost and net of grants and other contributions.

6.4 NERL - movements in tangible fixed assets

£m	Land	Buildings Freehold	Buildings Leasehold	Air traffic control, systems, plant and equipment	Vehicles	Furniture, fixtures and fittings	Assets in course of construction	Total
Restated cost at 1 April 2004	13.8	133.3	27.2	719.4	1.4	3.4	111.8	1,010.3
Additions during the year	-	0.2	2.6	19.4	-	2.8	90.0	115.0
Disposals during the year	-	-	(0.1)	(15.7)	(0.1)	-	(3.3)	(19.2)
Other transfers during year	-	0.1	1.4	51.3	-	0.1	(32.9)	20.0
Cost at 31 March 2005	13.8	133.6	31.1	774.4	1.3	6.3	165.6	1,126.1
Restated depreciation at 1 April 2004	-	(50.3)	(19.1)	(462.9)	(1.2)	(2.0)	(8.1)	(543.6)
Provided during year	-	(4.5)	(1.7)	(63.7)	(0.1)	(0.6)	-	(70.6)
Provision for impairment for year	-	-	-	-	-	-	(9.6)	(9.6)
Utilisation of impairment provision	-	-	-	0.7	-	-	3.2	3.9
Disposals during year	-	-	0.1	14.6	0.1	-	-	14.8
Other transfers during year	0.0	0.0	0.0	(17.1)	0.0	0.0	0.7	(16.4)
Depreciation at 31 March 2005	-	(54.8)	(20.7)	(528.4)	(1.2)	(2.6)	(13.8)	(621.5)
Net book value at 31 March 2005	13.8	78.8	10.4	246.0	0.1	3.7	151.8	504.6
Net book value at 1 April 2004	13.8	83.0	8.1	256.5	0.2	1.4	103.7	466.7

Notes

1. Fixed asset amounts are shown at historical cost and net of grants and other contributions.

Fixed asset reconciliation to the statutory accounts

At 31 March, £m	2005	2004 restated
Tangible fixed assets	504.6	466.7
add: grants and other contributions towards fixed assets	22.1	28.0
Tangible fixed assets per the statutory accounts	526.7	494.7

7. CASH FLOW ANALYSIS

7.1 Cash flow analysis by segment

£ million	Year ended 31 March 2005			Year ended 31 March 2004 (restated)		
	UK Air Traffic Services	Oceanic	Total	UK Air Traffic Services	Oceanic	Total
Profit before interest and tax	125.3	2.5	127.8	117.5	3.6	121.1
Depreciation	79.2	1.0	80.2	77.0	0.9	77.9
Loss/(Profit)loss on sale of tangible fixed assets	0.5	0.1	0.6	(0.1)	-	(0.1)
Decrease/(increase) in debtors	13.8	0.1	13.9	(27.8)	0.4	(27.4)
Increase/(decrease) in creditors and inter-company balances	22.3	1.7	24.0	26.7	(0.5)	26.2
Decrease in provisions	(0.4)	(0.0)	(0.4)	(2.9)	-	(2.9)
Net cash inflow from operating activities	240.7	5.4	246.1	190.4	4.4	194.8
Capital expenditure (Note (a))	(102.3)	(5.9)	(108.2)	(77.7)	(3.0)	(80.7)
Net cash flow	138.4	(0.5)	137.9	112.7	1.4	114.1

	Year ended 31 March 2005	Year ended 31 March 2004
NERL net cash flow (as above)	137.9	114.1
Interest and financing charges (Note (b))	(38.6)	(103.7)
Taxation: UK corporation tax	(16.5)	(1.9)
Cash inflow before financing	82.8	8.5
Financing (Note (c))	(107.4)	22.6
(Decrease)/Increase in cash	**(24.6)**	**31.1**
Opening balance	85.4	54.3
NERL cash at 31 March	**60.8**	**85.4**

Note

Following the adoption of the revised Regulatory Accounting Guidelines dated 16 March 2005, the 2004 figures have been re-stated on a historical cost basis (see para 2.3.1(b)).

Note a) Capital expenditure

£ million	Year ended 31 March 2005 UK Air Traffic Services	Oceanic	NERL	Year ended 31 March 2004 UK Air Traffic Services	Oceanic	NERL
Purchase of tangible fixed assets (net of grants and other contributions)	(77.0)	(4.9)	(81.9)	(56.8)	(2.0)	(58.8)
Own work capitalised	(25.3)	(1.0)	(26.3)	(20.9)	(1.0)	(21.9)
Proceeds from sale of tangible fixed assets	-	-	-	-	-	-
Net cash outflow for capital expenditure	(102.3)	(5.9)	(108.2)	(77.7)	(3.0)	(80.7)

Note b) Interest and financing charges

£ million	Year ended 31 March 2005	Year ended 31 March 2004
Interest received	6.0	3.6
Interest paid	(44.6)	(50.7)
Payments to terminate interest rate swaps	-	(56.6)
Net cash outflow from interest and financing charges	(38.6)	(103.7)

Note c) Financing

£ million	Year ended 31 March 2005	Year ended 31 March 2004
New loans	-	30.0
Net proceeds/(cost) of bond issue	(0.1)	586.1
Repayment of loans	(50.0)	(600.0)
(Increase)/decrease in short term deposits	(57.3)	6.5
Net cash inflow/(outflow) from financing (including movement on inter-company loans)	(107.4)	22.6

8. MOVEMENTS IN THE REGULATORY ASSET BASES

8.1 Movement in the regulatory asset base (RAB)

UK Air Traffic Services RAB

	UK Air Traffic Services					
Year ended 31 March	**2005**			**2004**		
(£ million)	Actual	CAA's projection	*Variance*	Actual	CAA's projection	*Variance*
Opening RAB as at 1 April in opening prices	754.1	1,062.3	*308.2*	725.5	954.4	*228.9*
The figures below are all at year end prices						
Opening RAB restated at year end prices	778.2	1,096.2	*318.0*	744.5	979.3	*234.8*
plus total capital expenditure at year end prices (Note 2)	109.7	136.6	*26.9*	76.2	142.9	*66.7*
plus capitalised financing costs on capital expenditure not remunerated during the control period (Note 3)	5.6	33.4	*27.8*	0.6	22.4	*21.8*
minus CAA's assumed ordinary depreciation charge (Note 4)	(67.8)	(67.8)	*0.0*	(67.3)	(67.3)	*0.0*
minus price profiling adjustment (Note 5)	(20.4)	(20.4)	*0.0*	(19.7)	(19.7)	*0.0*
plus increase/(decrease) in working capital (Note 6)	(28.5)	0.5	*29.0*	19.8	4.7	*(15.1)*
Closing RAB as at 31 March	776.9	1,178.6	*401.7*	754.1	1,062.3	*308.2*

See notes on page 21.

Oceanic RAB

	Oceanic					
Year ended 31 March		**2005**			2004	
(£ million)	**Actual**	**CAA's projection**	***Variance***	Actual	CAA's projection	*Variance*
Opening RAB as at 1 April in opening prices	15.6	30.7	*15.2*	13.6	23.9	*10.3*
The figures below are all at year end prices						
Opening RAB restated at year end prices	16.1	31.7	*15.6*	14.0	24.5	*10.6*
plus total capital expenditure at year end prices (Note 2)	6.7	5.2	*(1.5)*	2.9	6.1	*3.2*
plus capitalised financing costs on capital expenditure not remunerated during the control period (Note 3)	0.3	1.5	*1.2*	0.0	1.1	*1.0*
minus CAA's assumed ordinary depreciation charge (Note 4)	(1.2)	(1.2)	*0.0*	(1.0)	(1.0)	-
plus/minus increase/(decrease) in working capital (Note 6)	(1.7)	0.3	*2.0*	(0.3)	0.0	*0.3*
Closing RAB as at 31 March	20.2	37.5	*17.4*	15.6	30.7	*15.2*

Notes

1. The CAA's projections are from the CAA's Advice to the DETR (August 2000), uplifted using the Retail Price Index to current prices, and adjusted to include the 12% uplift agreed as part of the financial restructuring (£73.3m at 1999/2000 prices, £83.9m in March 2005 prices).
2. Capital expenditure for the purpose of this table is net of proceeds of disposal and grants and other contributions to fixed assets.
3. Financing costs on those assets on which a return has not been included within the current five year price control period are capitalised and added to the RAB to enable remuneration in future review periods.
4. The RAB is reduced by the amount of depreciation assumed in the price control, not by actual accounting depreciation.
5. The price profiling adjustment was included by the CAA in the price determination. It is regarded as accelerated depreciation for the purposes of the RAB.
6. The indexation of the numbers to state them at year end prices means that the working capital movement shown here is slightly different from the movement shown in the segmental capital employed statements in section 6 above.
7. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.

8.2 Reconciliation between the regulatory asset base and capital employed

(£ million)	UK Air Traffic Services	Oceanic
Closing RAB as at 31 March 2005	776.9	20.2
less: difference between opening RAB (at year end prices) and opening capital employed	(272.0)	(8.4)
less (excess)/add back shortfall of actual over allowed depreciation	(11.4)	0.2
plus: price profiling adjustment	20.4	-
less: capitalised financing costs	(5.6)	(0.3)
less: loss on disposals	(0.5)	(0.1)
plus: net book value of transfers	3.3	0.3
plus: other minor differences	0.2	(0.0)
Closing capital employed as at 31 March 2005 per the segmental analysis	511.2	11.9

8.3 History of the closing RABs

At 31 March £ million in outturn prices	2001	2002	2003	2004	2005
UKATS RAB (including 12% uplift)					
Actual	708.2	730.2	725.5	754.1	776.9
CAA projection	708.2	825.3	954.4	1,062.3	1,178.6
Oceanic RAB					
Actual	13.5	1.8	13.6	15.6	20.2
CAA projection	13.5	17.8	23.9	30.7	37.5

Note
The UK Air Traffic Services RAB includes the 12% uplift agreed as part of the financial restructuring (£73.3m at 1999/2000 prices). The value of this uplift is £83.9m in March 2005 prices.

9. COMPARISON OF PERFORMANCE WITH THE REGULATORY ASSUMPTIONS

9.1 Regulatory performance

UK Air Traffic Services regulatory performance

	UK Air Traffic Services					
Year ended 31 March £ million	**2005**			2004		
	Actual	**CAA's Projection**	***Variance B/(W)***	Actual	CAA's Projection	*Variance B/(W)*
Revenue	529.4	520.3	*9.1*	492.7	506.3	*(13.6)*
Costs:						
Operating costs (Note 3)	324.4	389.4	*65.0*	298.4	373.1	*74.7*
Monetary working capital adjustment	1.1	0.9	*(0.3)*	0.9	0.8	*(0.1)*
Depreciation assumed in price control (Note 4)	66.9	66.9	-	66.5	66.5	-
Price profiling adjustment (Note 4)	20.1	20.1	-	19.5	19.5	-
Total costs	412.6	477.3	*64.7*	385.3	459.9	*74.6*
Regulatory profit	**116.8**	**43.0**	***73.8***	**107.4**	**46.4**	***60.9***
Capitalised financing costs (Note 5)	5.5	33.0	*(27.5)*	0.6	22.1	*(21.5)*
Regulatory return - [A]	**122.3**	**76.0**	***46.3***	**108.0**	**68.6**	***39.4***
Average RAB - [B] (Note 6)	768.2	1,040.8	*(272.6)*	740.8	928.8	*(188.0)*
Rate of return (A divided by B) (Note 7)	**15.93%**	**7.30%**	***8.62%***	**14.58%**	**7.39%**	***7.19%***

See notes on page 25.

Oceanic regulatory performance

	Oceanic					
Year ended 31 March	**2005**			2004		
£ million						
	Actual	**CAA's Projection**	***Variance B/(W)***	Actual	CAA's Projection	*Variance B/(W)*
Revenue	20.2	23.2	*(3.0)*	19.0	22.1	*(3.1)*
Costs:						
Operating costs (Note 3)	16.6	21.1	*4.5*	14.4	20.4	*6.0*
Monetary working capital adjustment	(0.0)	0.0	*(0.0)*	0.0	(0.0)	*(0.0)*
Depreciation assumed in price control (Note 4)	1.2	1.2	*0.0*	1.0	1.0	*0.0*
Total costs	17.8	22.3	*4.5*	15.4	21.4	*6.0*
Regulatory profit/(loss)	**2.4**	**0.9**	***1.5***	**3.6**	**0.8**	***2.8***
Capitalised financing costs (Note 5)	0.3	1.5	*(1.2)*	0.0	1.1	*(1.0)*
Regulatory return - [A]	**2.7**	**2.4**	***0.2***	**3.7**	**1.8**	***1.8***
Average RAB - [B] (Note 6)	17.9	34.2	*(16.3)*	14.6	27.3	*(12.7)*
Rate of return (A divided by B) (Note 7)	**14.87%**	**7.06%**	***7.82%***	**25.04%**	**6.72%**	***18.32%***

See notes on page 25.

Notes

1. Performance is compared with the projection included in the CAA's Advice to the DETR (August 2000).
2. The CAA projections are presented in terms of average prices for the year.[1] Hence some figures (depreciation, price profiling adjustment, capitalised financing costs and average RAB) are slightly different from those in section 8 which are at end of year prices.
3. The Actuals column shows actual revenues and costs, with operating costs defined on a basis consistent with the regulatory approach to exclude accounting depreciation (including impairment charges) and profit/loss on disposal of assets.
4. The RAB is reduced by the amount of depreciation assumed in the price control rather than by actual depreciation. The price profiling adjustment was included by the CAA in the price determination. It is regarded as accelerated depreciation for the purposes of the RAB.
5. Financing costs on those assets on which a return has not been included within the current five year price control period are capitalised and added to the RAB. This will enable NERL to recover these costs in future review periods. To ensure a fair comparison of the return with the RAB, these financing costs are added to the regulatory profit for the calculation of the return.
6. The actual average RAB figure includes the 12% uplift of the UK Air Traffic Services RAB; the prior year figure has been re-stated to include the uplift. The CAA projections are from the CAA's Advice, prepared before the addition of this uplift.
7. The rate of return in the CAA's projection column averages to the allowed cost of capital over the five years of the price review period.
8. Current year information is the same as in the main schedule. The adjustment for the exceptional item in 2001/02 affects only the comparative.
9. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.

9.2 Reconciliation between regulatory profit and the segmental accounting analysis

Year ended 31 March 2005 £ million	**UK Air Traffic Services**	**Oceanic**
Regulatory profit	116.8	2.4
less: excess of accounting over allowed depreciation	(12.3)	0.2
add back: price profiling adjustment	20.1	0.0
add back: monetary working capital	1.1	(0.0)
less: loss on disposals	(0.5)	(0.1)
Operating profit per the accounting analysis in Section 5	125.3	2.5

[1] Average prices are taken to be the mean of the twelve monthly RPI figures for the financial year in question.

10 OPERATING COST EFFICIENCY ROLL-FORWARD

(£ million, 2001/02 prices)	**2004/05**	2003/04	2002/03	2001/02
UK Air Traffic Services				
Operating expenditure assumed by CAA	359.8	355.5	350.6	372.7
Actual operating expenditure	299.8	284.3	315.2	374.2
Out-performance	60.0	71.2	35.4	(1.5)
Incremental out/(under)-performance compared with previous year	**(11.1)**	**35.8**	**37.0**	
Oceanic				
Operating expenditure assumed by CAA	19.5	19.4	18.8	18.0
Actual operating expenditure	15.4	13.7	16.5	28.9
Out-performance	4.1	5.7	2.3	(10.9)
Incremental out/(under)-performance compared with previous year	**(1.6)**	**3.4**	**13.1**	
Supplementary information - Oceanic performance adjusted to exclude the 2001/02 exceptional item				
Operating expenditure assumed by CAA	19.5	19.4	18.8	18.0
Actual operating expenditure	15.4	13.7	16.5	17.1
Out-performance	4.1	5.7	2.3	0.9
Incremental out/(under)-performance compared with previous year	**(1.6)**	**3.4**	**1.3**	

Note for information: actual operating costs at outturn (actual) prices				
UK Air Traffic Services	324.4	298.4	321.7	374.2
Oceanic	16.6	14.4	16.9	28.9

Notes

1. The operating cost efficiency roll-forward uses the same definition of operating costs as the statement of regulatory performance in section 9.1, but for the purpose of this calculation it is stated in 2001/02 prices.
2. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.
3. In the Oceanic Supplementary Information, the exceptional item affects incremental out-performance in 2002/03, through its impact on operating expenditure in 2001/02.

11 RECORD OF CASH FLOWS FOR THE PURPOSE OF THE RAB CLAWBACK CALCULATION

(£ million)	31 March 2003	2003/04	2004/05
ACTUAL DATA			
Actual figures from the regulatory accounts			
UK Air Traffic Services RAB at 31 March 2003	725.527		
Oceanic RAB at 31 March 2003	13.597		
Total RAB at 31 March 2003	739.124		
NERL operating cash flow from cash flow statement		194.8	246.1
less: NERL capital expenditure cash flow from cash flow statement		-80.7	-108.2
Total NERL actual cash flow		114.1	137.9
Actual figures at 2001/2 prices			
RAB at 31 March 2003	714.473		
Annual cash flow		108.723	127.422
Present values (discounted using regulatory cost of capital to 1 April 2001 values)			
RAB at 31 March 2003	615.391		
Annual cash flow		90.278	98.194
BENCHMARK DATA			
RAB at 31 March 2003 (as stated in CAA Decision, discounted to 1 April 2001)	618.200		
NERL's forecast base case cash flows in 2001/2 prices		91.600	34.8
Present value of NERL's forecast base case cash flows (2001/2 prices)		76.060	26.818
Benchmark: 80% of NERL's forecast base case cash flows in present value terms (2001/2 prices)		60.848	21.454
Note: discount factor back to 1 April 2001 present value	*1.161*	*1.204*	*1.298*

Note on sources

RAB numbers are from section 8 above, cash flow from section 7. Benchmark data is from the CAA Decision (see section 2.3.2 above).

ANNEX: RECORD OF THE RETAIL PRICE INDEX USED IN THE REGULATORY CALCULATIONS

	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05
Average for year/mid year	166.4	171.3	173.9	177.5	182.5	188.2
At 31 March (year end)	n/a	172.2	174.5	179.9	184.6	190.5