

NATS (En Route) plc BUSINESS PLAN REPORT 2006

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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 2005 to 31 March 2006 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 2005 and the Service and Investment Plan (SIP) 2005 were selected as the most appropriate reference points. Hence, actual performance during 2005/06 is compared with these two plans.

In addition to the highlights contained in this report, further information on performance during 2005/06 can be seen in the following documents:

- NATS (Holdings) Ltd Annual Report and Accounts 2006
- NATS (En Route) plc Financial statements for the year ended 31 March 2006
- NATS (En Route) plc Regulatory Accounts 2005/06
- NATS Operational Performance Reports (published monthly)

2. DEMAND

Chargeable Service Units (CSUs), which are the basis of charging en route services, grew by 5.8% in 2005/06 compared with 2004/05. The out-turn for 2005/06 was 9.96m against the 2005 NERL Plan forecast of 9.79m, better by 1.8%.

Total UK flights grew by 5.9% in 2005/06 compared with 2004/05. The out-turn for 2005/06 was 2.33m against the 2005 NERL Plan forecast of 2.31m, better by 1.0%.

Traffic has performed well on all markets in 2005/06. Domestic and European markets showed strong growth due to the continuing expansion of the low cost

carriers. Flights to the newly emerging Eastern European countries were particularly strong. Because of the competition from the low cost carriers, European legacy airlines have been moving from short haul to long haul, with both charter and scheduled flights expanding into the fast growing Asian markets. US legacy airlines have been doing the same, moving off domestic and onto Transatlantic.

The outlook is for continued but slightly weaker growth in 2006. The impact of high oil prices meant airline fares increased in 2005 and this is expected to soften demand in 2006 particularly on Transatlantic routes. Flights to Eastern Europe and Asia continue to grow very strongly but not as strongly as in 2005. Domestic growth has also been weakening.

Demand in 2005/06

	2005 NERL Plan	Actual	Difference
CSUs (000s)	9,787	9,963	1.8%
Total UK Flights (000s):			
- Domestic	490	502	2.6%
- Transatlantic	312	310	-0.5%
- Other	<u>1,507</u>	<u>1,518</u>	0.7%
- TOTAL *	2,308	2,331	1.0%

* Totals may not add due to rounding

3. SAFETY

Safety Performance

During FY05/06 the number of airproxes where NATS was providing a service fell from 71 to 57. 17 of these were attributable to NATS, none of which have been assessed by the UK airprox board (UKAB) to be risk bearing (Category A or B). In assessing one risk-bearing airprox B attributed to a pilot, the UKAB also cited NATS as being contributory. The FY05/06 target of zero NATS attributable risk bearing Airprox has therefore been met.

A summary of en-route SSE1-3 for FY05/06, together with figures for FY04/05 for comparison, is given in the table below.

	2005/06	2004/05
SSE1	3	3
SSE2	26	24
SSE3	82	64
SSE1-2	29	27
SSE1-3	111	91
NATS Attributable SSE1-3	72	46

The 72 NATS attributable SSE1-3s equate to a rate of 3.09 per 100,000 movements (compared with a rate of 2.09 for FY04/05). This did not meet the 2005/06 target of 2.1 per 100,000 movements.

The increase in SSE1-3 between FY04/05 and FY05/06 was primarily due to an increase in the number of lower severity SSE 3 incidents. This has been attributed to:

- A change in the Separation Monitoring Function parameters at Manchester Area Control Centre (MACC) in summer 2005 resulting in additional incidents being reported.
- Increased reporting of airspace infringements due to awareness campaigns.
- More rigorous application of the Safety Significant Event Scheme following the introduction of Incident Investigator Training.

The increase in SSE1-3 therefore reflects an improved reporting rate and a better understanding of incidents rather than a deterioration in safety performance.

Safety Plan

The 2005/06 NERL business plan focused on four key areas for safety. Good progress has been made in all these areas. This is summarised below:

Incident Reporting & Risk Analysis

- The new Safety Tracking and Reporting (STAR) database was rolled out across NATS units.
- A formal Incident Investigation Course commenced in September 2005.
- The results of incident data analysis have been used to prioritise safety improvement actions for the work in support of NATS 21 Destinations.

Safety Awareness & Improvement

- Working with stakeholders to reduce the risk from airspace Infringements, level busts and communication errors.
- Optimising Operations room performance and engaging the operational workforce in safety improvement.
- Addressing the underlying causes of human error.
- Improving Safety Leadership across the organisation and a set of activities to enhance safety culture.

Safety Management Process

- Update to NATS Safety Policy & Principles for incorporation into NATS safety management system in 2006.
- Working closely with the safety regulator to improve safety processes for software assurance.
- Introduction of processes to integrate human factors techniques within NATS' Safety Management procedures.

Safety Development & Investment

- Delivery into service of Mode-S radar in LTCC airspace enabling:
 - *Downlink of Selected Altitude* helping controllers to intervene in situations which might have otherwise led to the erosion of standard separation.
 - *The Vertical Stack List tool* providing a vertical representation of aircraft in holding stacks to aid the controller in managing the stack safely.

4. SERVICE

NATS reports on its service delivery on a monthly basis in the Licence Condition 11 operational performance report. Key points for 2005/06 were as follows:

- Actual attributable delay per flight during 2005/06 was 22.2 seconds – this can be compared with the NERL Business Plan 2005/6 stretch target to deliver less than 1 minute average delay per flight against high traffic during the period to 2011; average delay during 2005/06 was slightly higher than the 20.9 seconds figure recorded during 2004/05 but, as noted in section 2 above, the number of flights handled was almost 6% higher.
- Average delay per delayed flight during 2005/06 was 16.7 minutes, compared with 17.1 minutes the previous year
- Only 2.2% of flights experienced any NATS attributable delay, the same percentage as in the previous year

The major airspace developments planned for 2005/06 were:

- TC/MACC Midlands development to meet forecast growth around Manchester, Birmingham and East Midlands
- West End development to deliver increased capacity and create a new offshore military training area

Both of these developments were implemented on schedule during winter 2005/06.

NATS continued to exchange service information with customers through the Operational Partnership Agreement (OPA), as a mechanism for achieving effective planning and collaborative decision making.

5. CAPITAL INVESTMENT PROGRAMME

The 2005 SIP is taken as the baseline against which to assess capital investment performance during 2005/06. Capital expenditure during the year amounted to some £161m (compared with £115m the previous year). This was broadly in line with the plan. Significant items of expenditure consisted of:

- Developing the new air traffic control centre at Prestwick
- Preparing the new operations room at Swanwick, ready for the transfer of London terminal control and military operations from West Drayton in 2007
- Continued development of airspace to improve service capability
- Developing phase 2 of the Corporate and Technical Centre
- Development of future systems to support the group's two centre strategy, including collaborations with European partners
- Improvements to NATS' communications infrastructure network
- Continuation of the radar upgrade programme for civil and military use
- Sustainment of existing systems at air traffic control centres

The following investment milestones were achieved during 2005/06:

- TC Move Project – Implementation Approved – Spring 05
- Burrington 2 Radar Replacement – Apr 05
- NERC System Upgrade N12 – Apr 05
- Midlands Airspace Development (Phase 2 – NEMA) – May 05
- TC/LMARS Relocation – Swanwick ready for Systems Installation – Oct 05 (early)
- Pease Pottage Radar Replacement – Oct 05
- Midlands Airspace Development (Phase 2) – Nov 05
- iFACTS – Implementation Approved – Nov 05 (late)
- NERC Systems Upgrade N13 – Dec 05
- NAS Software Upgrade 30.01 – Dec 05
- Mode S Tools in TC – Dec 05
- TC/LMARS Relocation: Swanwick Systems Installation Complete – Feb 06

6. MANPOWER AND BUSINESS EFFICIENCY

	Plan March 2006	Actual March 2006
ATCO	1,365	1,398
ATSA	848	850
ATCE	1,128	1,050
Others	547	537
Total	3,888	3,835

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.

ATCO numbers at 1398 were 33 higher than plan principally reflecting fewer retirements and losses than anticipated in operations. ATSA numbers at 850 were 2 higher than plan. Lower than planned numbers of engineers mainly reflected losses prior to site relocations. Other staff numbers were a little lower than planned across a number of business areas.

7. FINANCIALS

Overview of financial performance

The table below summarises NERL's financial performance for the year relative to the 2005 NERL Business plan:

	Results for the Year Ended 31 March 2006:		
	Reported under IFRS - Note 1	Reported under UK GAAP (unaudited) - Note 2	UK GAAP Results Better/(Worse) than UK GAAP Business Plan - Note 3
	£m	£m	£m
Revenue - external	574	574	21
- inter-group	10	10	(1)
	584	584	20
Staff and non-staff operating costs	(374)	(371)	25
Depreciation, amortisation and impairment	(85)	(98)	(22)
Operating costs	(459)	(469)	3
Earnings before tax	125	115	23
Interest	(50)	(49)	(6)
Profit before tax	75	66	17

Notes:

1. The actual results for NERL for the year were reported in accordance with International Financial Reporting Standards (IFRS). An explanation of the impact of IFRS on NERL is summarised briefly below and in more detail in its financial statements for the year ended 31 March 2006 which are available via the NATS website.

2. The UK GAAP results presented above, which are unaudited, have been extracted from NERL's management accounts which were reported under UK generally accepted accounting practice (UK GAAP).

3. The 2005 NERL Business Plan was prepared in accordance with UK GAAP and accordingly the performance relative to the UK GAAP management accounts has been presented on a like-for-like basis above.

International financial reporting standards ("IFRS")

In accordance with European regulations, NERL adopted IFRS in preparing its financial statements for the year ended 31 March 2006.

The principal impacts of adopting IFRS were: the recognition of employee benefits and the defined benefit pension scheme; the cessation of the systematic amortisation of goodwill; the recognition of derivative financial instruments; the reclassification of certain tangible assets as intangible assets; the revaluation of share-based payments; a change in timing of recognition of lease incentives and changes in the deferred tax charge associated with these effects.

External revenue

External revenue, under UK GAAP, for the year at £574m was £21m better than plan. This principally reflected higher UK en route traffic revenues with CSU volumes better than assumed in the business plan, higher oceanic income and the benefits of good service performance.

Operating costs

NERL reported operating costs under UK GAAP of £469m for the year or £3m better than plan.

Staff and non-staff operating costs amounted to £371m, £25m better than plan.

Depreciation, amortisation and impairment at £98m was £22m worse than the plan, reflecting higher charges for asset impairment and underlying depreciation.

Interest

Net interest charges, under UK GAAP, of £49m were £6m worse than plan and included losses on hedging instruments. These losses offset the benefits of refinancing of the company's bank facilities and lower gearing levels.

Profit before tax

NERL generated a profit before tax, on a UK GAAP basis, of £66m.

Net debt

Under UK GAAP, NERL net debt at 31 March 2006 amounted to £566m, a reduction of £7m compared with the previous year. This reflected total borrowings of £693m offset by cash and short term deposits of £127m.