



NATS Holdings Limited

Annual Report and Accounts 2007

NATS

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Directors, officers & advisers

Directors* of NATS Holdings Limited

Other companies within the group for which they are also directors



John Devaney
NATS Limited,
NATS (En Route) plc,
NATS (Services) Limited.



Paul Barron
NATS Limited,
NATS (En Route) plc,
NATS (Services) Limited,
NATSNav Limited,
National Air Traffic Services Limited.



Nigel Fotherby
NATS Limited,
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NATS (Services) Limited,
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Ian Hall
NATS Limited,
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Lawrence Hoskins
NATS Limited,
NATS (En Route) plc,
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Derek Stevens
NATS Limited,
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Danny Bernstein
NATS (En Route) plc,
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Giovanni Bisignani



Barry Humphreys
NATS Limited,
NATS (En Route) plc,
NATS (Services) Limited.



Peter Read



**Baroness Dean of
Thornton-le-Fylde**
NATS Employee
Sharetrust Limited.



Stephen Pettit



Andrew White



Roger Cato

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Richard Churchill-Coleman

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Company No. 4138218

Auditors
Deloitte & Touche LLP

Chairman's statement

This has been what is often referred to as a year of consolidation, when an organisation quietly gets on with its business and notches up a steady improvement in performance.



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NATS is comparatively young with only six years under its belt as a PPP. Consolidation for us means demonstrating a track record, business maturity and establishing a reputation which marks us out as a world leader in our field.

The fact that NATS has this year turned its fourth consecutive year of profit, and handled yet another record level of traffic whilst maintaining both safety and service performance, is becoming a very good track record. It is also essential to building a firm foundation for future growth.

The Executive team concluded the financial year by reporting on 21 stretching business targets, or 'Destinations', set in late 2004. There is no doubt that people across the business have been totally engaged in this programme, that it has raised the performance bar and provided real focus.



Chairman's statement

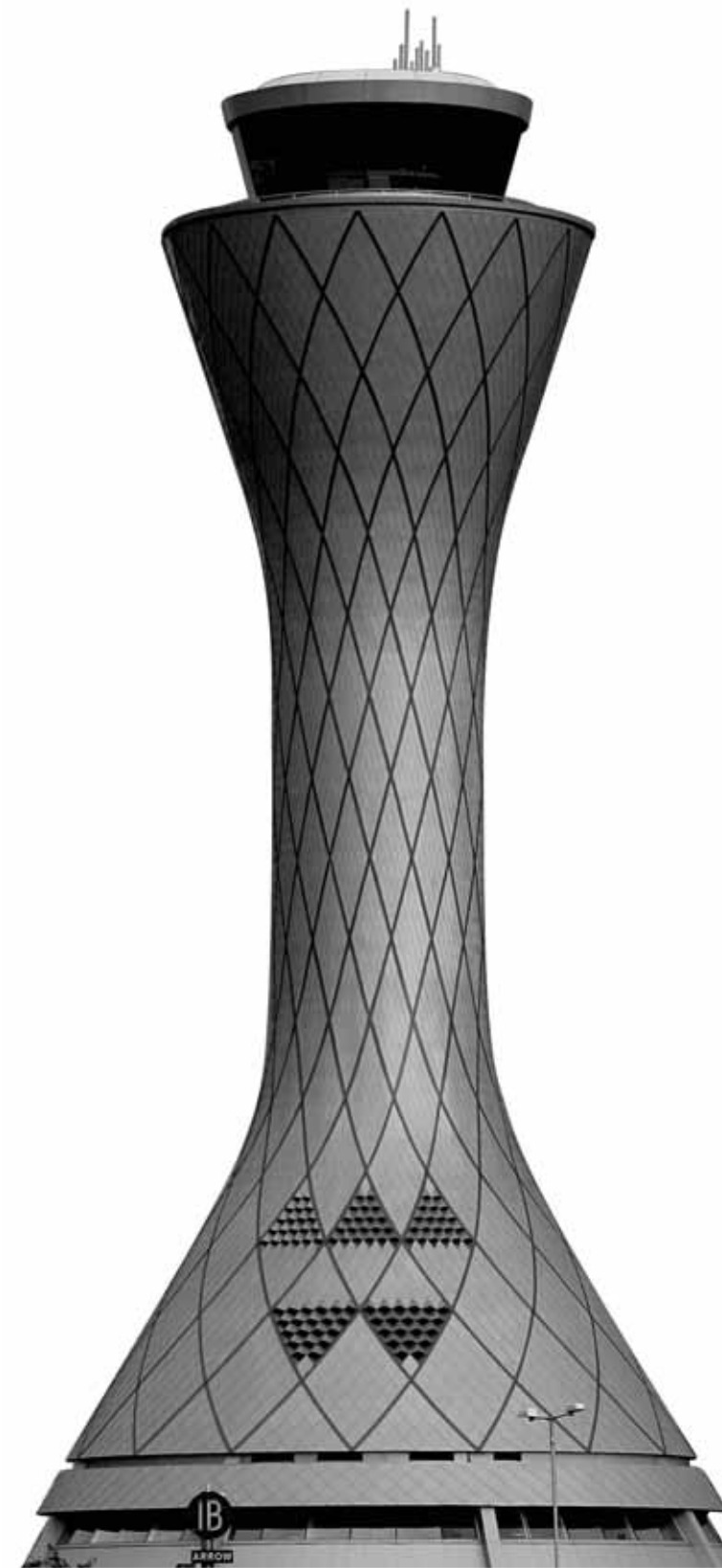
The Board has monitored progress on these targets, and we have been impressed by the level of commitment to delivering them. For me, this is indicative of the overriding professionalism of NATS' people and their capability to rise to tough intellectual challenge.

The Board has monitored progress on these targets, and we have been impressed by the level of commitment to delivering them. For me, this is indicative of the overriding professionalism of NATS' people and their capability to rise to tough intellectual challenge.

It is vital to maintain the momentum created by 'Destinations' as the Executive considers new areas of business focus. There is no doubt that environment will be amongst these; whilst NATS does not create aviation policy we have an important role to play both as manager of the UK's airspace and in ensuring the debate is kept in proper perspective.

In April, Moody's upgraded the underlying credit rating of the £600m bonds issued by our economically regulated business NATS (En Route) plc (NERL) to A3, positive. This means that both Moody's and Standard & Poor's underlying credit ratings for NERL's bonds are within the 'single-A' category, which is a considerable achievement.

One of the risks both agencies identified in our business was delivery of a complex capital expenditure programme over the next five years. I am therefore particularly pleased that in this financial year the business delivered 13 of the 14 Programmes milestones contracted with the Board. This included improving project management capability beyond the level we set as the target.



Probably the most visible of these milestones is the new Prestwick Centre, which was handed over on time and on budget. It is an illustration of NATS' flexibility that the review of systems strategy this year has not compromised the 'Operational' date and has in the Board's view provided for greater stability.

The Government appoints three non-executive Partnership Directors to the Board. Last summer two of these Directors, Lord Brooke of Alverthorpe and Bill Semple, came to the end of their terms of office and I owe great thanks to both of them for their commitment to NATS in the five years since the PPP and their professionalism in their contributions to the Board.

In Bill's case, the Board owes particular thanks. Bill spent his career in NATS and as Chief Executive did much of the groundwork that enabled the PPP. His vision contributed greatly to NATS' success today.

Chairman's statement



...there is a limited window of opportunity for the European industry to reshape itself and we simply cannot afford to miss it.

Their places on the Board have been filled by Andrew White and Baroness Dean of Thornton-le-Fylde. Brenda Dean's background in industrial relations and Andrew White's experience leading the RAF's air traffic control services are already proving extremely valuable to the business.

Amid the ambition to achieve a Single European Sky, Governments must accept that this requires a reworking of the way in which air traffic control is provided. We cannot make the system more efficient without making the service providers more efficient. I tabled this requirement a year ago, and we will continue to press for a rationalised industry based on practicality instead of nationality; there is a limited window of opportunity for the European industry to reshape itself and we simply cannot afford to miss it.

The Board shares a vision of a future in which NATS is devising smart solutions to improve, develop and grow the business, creating global alliances, delivering satisfaction to customers and providing appropriate returns to shareholders at manageable risk.

At NATS we will continue to work to that goal.

John Devaney
Chairman

Chief Executive's Review

Asking an organisation which already has a world reputation for safety and technological innovation to raise its game to a new level, is always going to be a challenge.



Overview of the business

Asking an organisation which already has a world reputation for safety and technological innovation to raise its game to a new level, is always going to be a challenge.

At NATS, with a proud safety record and improving service and efficiency levels, it was particularly challenging for a new Chief Executive to arrive on the scene and say I wanted more.

That's what I did in 2004 when I enrolled the Executive team in setting 21 stretching targets, or 'Destinations', in four broad categories of safety, service, value and people. We set March 2007 as our deadline for delivering them.

Across the business, people said it couldn't be done. Of course there were cynics; others dismissed the 'Destinations' as another management initiative that would fizzle into history. I'm pleased to report that at the end of March 2007 we had achieved 15 of the Destinations with significant progress made on those that were not achieved. We have so completely changed our mindset that even the apparently impossible ones are now considerably closer. What seemed like targets are now best practice embedded in the business – and our staff believe in them.

This past year has been important in establishing our business ambition for the future. We have moved up a gear, increased the speed and rate of change across the organisation – and restructured the organisation to deliver visible, measurable efficiencies.



Chief Executive's Review

In very practical terms, this year has helped establish the right environment for changes. We are ensuring that our relationships with our customers are more soundly based than ever and that we have the right mechanisms in place for major changes – the transfer of our West Drayton centre to Swanwick; further airspace change including new rules for the continued safe operation of uncontrolled airspace; and the introduction of new systems within our long term investment plan.

Once again we maintained our safety and service performance whilst handling record volumes of traffic. Once again we have improved our financial performance with a fourth consecutive year of profit. And we demonstrated our increasing international reputation by signing a number of contracts and agreements which underpin our ambition to be the industry's partner of choice.

Safety

Safety is the DNA of NATS' business and will always be our foremost priority. Every day thousands of people take to the air in the UK

and put their trust in our services. I will always challenge our organisation to improve safety, and the response continues to be impressive; and it is essential that we continue to raise safety standards across the industry.

The Destinations programme has fundamentally changed our approach to safety management. We made enormous progress in understanding what we need to do in order to achieve some of our most stretching targets.

Set against the increase in traffic over the past year, the number of airprox where NATS was providing a service was the same as last year at 56 and the number attributable to NATS increased by one from 17 to 18. One of these is expected to be assessed as risk-bearing.

Whilst our performance remains excellent, we have continued to focus on safety improvement. Enhancements to our safety leadership and culture, innovative work on optimising Operations

Chief Executive's Review

Room performance, new technology to deliver safety benefits, better alignment and tracking of improvements and further mitigation of safety risk, are all work in progress.

We have several initiatives under way with our airport partners to look at reducing the incidence of runway incursions, and with our Scottish centre and in Aberdeen to look at improved coordination with the Military.

Our relationship with our airline customers was further strengthened this year with the introduction of the Safety Partnership Agreement so that together we can continue to drive forward safety improvement across the industry; this includes sharing sensitive safety data which is used to establish meaningful performance comparisons and enables positive lessons to be learned.

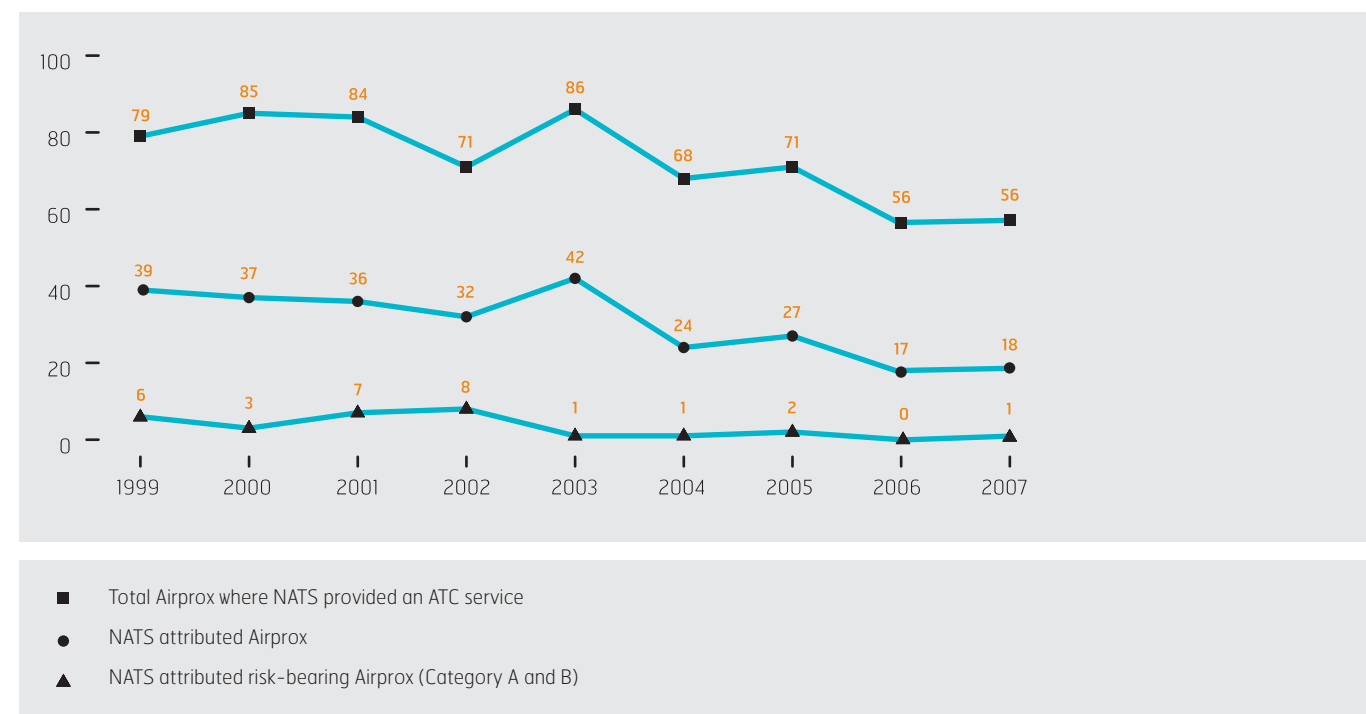
With the General Aviation community, the Ministry of Defence and our Safety Regulator, we have established the Airspace Safety Initiative to reduce the level of infringements into controlled airspace.

I am personally committed to delivering exceptional safety performance and to driving improvements beyond our direct responsibility. To this end, we have also created an innovative, company-wide 10 year Strategic Plan for Safety, published in May.

Service

| | 2006/07 ('000s) | 2005/06 ('000s) | % change in year |
|------------------------------------|--------------------|--------------------|---------------------|
| Chargeable Service Units | 10,400 | 9,962 | 4.4% |
| Chargeable Distance (km) | 772,041 | 740,084 | 4.3% |
| Total UK traffic (flights): | | | |
| Domestic | 502 | 503 | (0.2%) |
| North Atlantic | 325 | 310 | 4.8% |
| Other | 1,579 | 1,518 | 4.0% |
| Total | <u>2,406</u> | <u>2,331</u> | <u>3.2%</u> |
| Oceanic traffic (flights) | | | |
| Total flights | 396 | 379 | 4.5% |

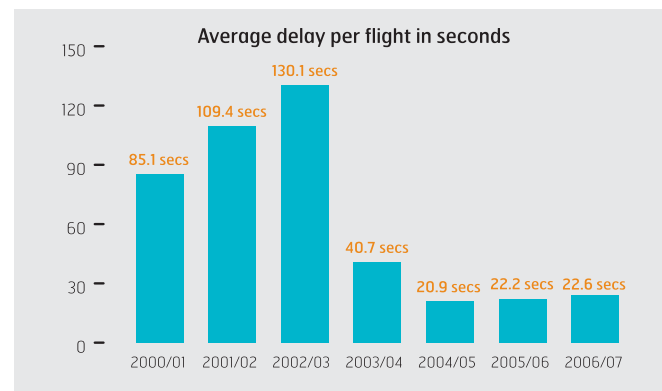
Airprox: annual totals for the financial year ended 31 March



Chief Executive's Review

I am personally committed to delivering exceptional safety performance, and to driving improvements beyond our direct responsibility.

Despite a traffic increase of 3.2% to 2.4m flights, NATS (En Route) plc (NERL) maintained delay performance with average delay per flight of 22.6 seconds compared with 22.2 seconds last year. The number of flights receiving no NATS-attributable delay remained constant at 97.8%.



This is a tremendous performance set against the background of three significant airspace changes to provide additional capacity and thereby improve service levels. These included major changes to the Hurn and Lakes sectors and the introduction of a standard upper airspace level of 19,500ft to conform with the requirements of the Single European Sky.

Development work intensified on the most complicated change to airspace that NATS has ever undertaken, up to 25,000ft north of London (Terminal Control North). This difficult piece of work, concerning the most complex area of airspace in the world, is our response to the continued expansion of airports in South East England and there will be a formal consultation on this in the coming year.

We redefined our roadmap for the evolution of our future centres systems to achieve our stated aim of a single common system across all centres. This included continuing our proposed collaboration with the German and Spanish air traffic providers DFS and Aena to develop iTEC, an electronic flight data processing system (eFDP). We also formalised the terms of our future commercial relationship with the systems development company, Indra.

Our long term investment plan continues to prepare for future customer requirements in terms of increasing capacity, improved systems infrastructure and service resilience and reduced dependence on legacy systems.

Chief Executive's Review

Value

A company of two distinct businesses, one an economically regulated monopoly and the other a non-regulated business open to market forces, presents NATS with unique challenges. The two businesses have different drivers, different markets and different risks.

The demanding regulatory price controls introduced in 2006 require NERL to focus, in particular, on operating cost efficiency and operational service performance. The challenge for NATS (Services) Limited (NSL) is to continue to generate value through new and renewed contracts with improving margins. We have organised our management teams to focus on these commercial challenges. We have also introduced a new business information system which enables every individual to record time and allows better focus on cost and streamlined decision making.

NATS (En Route) plc (NERL)

A crucial element of the two-centre strategy was completed on time and on budget when the new Prestwick Centre was handed over to NATS by the developers. It is now being fitted out and will be home to both Prestwick and Manchester centres when it opens in 2010, initially with versions of some current NATS systems. This enables a simplified transfer with lower risk.

Introduction of the new Shanwick Automated Air Traffic System (SAATS) at our Oceanic Centre in Prestwick, together with a new Operations Room, was one of the biggest systems introductions NATS has undertaken since the move to Swanwick five years ago. The system was implemented successfully in November to support the new Northern Oceanic Transition Area arrangements for air traffic management on the North Atlantic.

Our new contract with the Ministry of Defence came into effect in July and we continue to work closely with our military colleagues to provide joint and integrated services across UK airspace. They will also be a part of NATS' move from West Drayton, with the transfer of the London Military Area Radar Services (LMARS) to Swanwick early next year.

We completed the closure and sale of Spectrum House at Gatwick, with our staff transferring either to Swanwick or to the Corporate & Technical Centre at Whiteley.

Chief Executive's Review

Chief Executive's Review

In all, NERL achieved all 13 of the systems milestones contracted with the Board for this year. This is a phenomenal performance by our Programmes division...

In all, NERL achieved all 13 of the systems milestones contracted with the Board for this year. This is a phenomenal performance by our Programmes division, and included improvement in our project management capability, targeted to improve from 2.5 to 3 and actually achieving 3.4 in independent assessment. This is a doubling of our project management capability in less than two years and a significant enhancement to risk management in project delivery.

NATS (Services) Ltd (NSL)

The 14th systems milestone agreed with the Board was the introduction of new systems at Heathrow with the transition to the new Control Tower. This was successfully completed in April just a few weeks after the end of the financial year. Although later than originally hoped, this was an exceptionally challenging environment which required additional systems modifications and intensive training requirements for controllers. The new tower is continuing to perform well beyond expectations in its first few weeks.

Traffic at the 15 UK airports at which NATS provides service increased by 2.4%. This included a full year of operation at Bristol airport. A huge increase in the popularity of business jets contributed to particular growth at Farnborough and London City airports. We introduced Electronic Flight Progress Strips at Luton and prepared for the system's introduction in our most challenging airport environment at Heathrow.

This was our first full year of operations at Bristol Airport where new airspace arrangements were introduced between Bristol and Cardiff to streamline traffic management and introduce new procedures.

Chief Executive's Review

Elsewhere in the UK we have continued to listen to our customers in terms of developing and enhancing our services; in particular we are working with the Ministry of Defence to understand how we may support their moves towards greater rationalisation, integration and efficiency.

We won contracts at Taranto in Italy to supply, install and commission navigational aids; at Jebel Ali in Dubai to design terminal airspace; and with Romatsa, the Romanian air traffic control organisation, for the training of controllers. Contract renewal negotiations are underway with our major UK customer, BAA, for contracts effective from April 2008.

We have developed relationships and initial action plans in new markets including India, China and the USA, and a new marketing drive is underpinning our wider efforts to take our expertise in airport development and operation, air navigation services, airspace management and training to new markets across the world.

Overview of Financial Performance

NATS operates UK and North Atlantic en route air traffic control services through its economically regulated subsidiary, NERL, and provides airport air traffic control and other services through its subsidiary NSL.

The group reported a profit before tax of £94.4m (2006: £80.3m). Group revenues grew by £14.5m to £701.2m (2006: £686.7m) and operating profits at £144.0m were £6.8m better than the previous year (2006: £137.2m).

NERL reported a profit before tax of £86.3m (2006: £74.7m). External revenues improved by £1.2m to £574.7m (2006: £573.5m), reflecting increased revenues from UK and North Atlantic en route services offset by lower MoD revenues. The results reflected a full year's impact of the regulatory price control which started on 1st January 2006.

NSL's growth continued in the year with external revenues improving by £12.6m or 11.1% to £125.8m (2006: £113.2m) reflecting a full year's benefit of airport contracts won in 2006, improved contract pricing and growth in consultancy and training services. Profit before tax was £16.1m (2006: £14.0m). The market for airports air traffic services remains competitive but NSL is well positioned to take advantage of growth prospects which exist in the UK and overseas.

The financial reviews that follow include reference to operating costs that are considered to be exceptional but are not defined as such in the financial statements. Exceptional items are explained more fully opposite.

Chief Executive's Review

UK air traffic services

| | 2007 £m | 2006 £m |
|--|------------|------------|
| Turnover | 552.2 | 551.9 |
| Operating costs | (350.4) | (339.1) |
| Depreciation, amortisation, impairment and deferred grants | (81.2) | (83.4) |
| Exceptional items | 4.2 | (7.7) |
| Operating profit | 124.8 | 121.7 |
| Chargeable Distance (m's km) | 772.0 | 740.1 |
| Chargeable Service Units (000) | 10,400 | 9,962 |

UK air traffic services are provided by NERL and comprise UK en route services, services provided under contract with the MoD, London approach services, and services to North Sea helicopter operators. Revenues from these sources can be analysed as follows:

| | 2007 £m | 2006 £m |
|--------------------------|------------|------------|
| UK en route services | 496.3 | 492.9 |
| Support services to MoD | 40.9 | 44.3 |
| London approach services | 8.6 | 8.5 |
| North Sea helicopters | 6.4 | 6.2 |
| Total | 552.2 | 551.9 |

Income from UK en route services, which are provided to traffic operating in those parts of UK airspace which constitute controlled airspace, increased by £3.4m in the year to £496.3m (2006: £492.9m). This increase was mainly a function of the service performance for the year, which at 22.6 seconds of delay per flight exceeded the CAA's performance benchmark of 45 seconds and earned NERL service incentive income of £5.6m (2006: £2.1m). The benefit of a 4.4% growth in chargeable service units (CSUs) to 10.40m (2006: 9.96m) was largely offset by a reduction in the charges under the new pricing formula. CSUs are a function of aircraft weight and distance flown and are the unit used to bill services to airlines. The charge for these services is subject to

regulatory charge control conditions that allow for the annual adjustment of prices by the movement in the RPI less a specified percentage.

NERL has a service contract to provide services and support infrastructure to the MOD for military air traffic services. For 2007, revenues earned under the new 15-year contract which became effective in July 2006 amounted to £40.9m (2006: £44.3m).

London approach services, which are provided to aircraft arriving at or departing from Heathrow, Gatwick and Stansted airports, generated £8.6m (2006: £8.5m). Charges for these services are set after consultation with airlines.

Charges for services to North Sea helicopter operators are levied on the basis of a charge per flight. Revenues increased by £0.2m to £6.4m (2006: £6.2m) mainly reflecting a 12.6% increase in flight volumes to 38,447 (2006: 34,150) which was offset by lower charges per flight.

Overall operating costs increased by 3.3% to £350.4m (2006: £339.1m). Cost increases arose from higher staff related-costs, principally the cost of pay awards, and higher rent, rates and utility costs including a full year's charge for the second phase of the Corporate and Technical Centre which was completed in February 2006.

Asset-related charges for depreciation, amortisation and impairment net of deferred grants fell by £2.2m to £81.2m (2006: £83.4m).

Exceptional gains of £4.2m (2006: £7.7m net losses) arose from the continuing rationalisation of sites and consolidation of engineers and support staff in the Swanwick area and included gains from property disposals net of the costs of redundancy and relocation costs.

UK air traffic services generated an operating profit of £124.8m for the year which was £3.1m better than previously (2006: £121.7m) as the impact of higher operating costs was more than offset by increases in revenue and net exceptional gains and lower asset-related charges.



Chief Executive's Review

Chief Executive's Review

North Atlantic air traffic services

| | 2007 £m | 2006 £m |
|--|------------|------------|
| Turnover | 22.5 | 21.6 |
| Operating costs | (16.2) | (16.4) |
| Depreciation, amortisation, impairment and deferred grants | (1.8) | (1.6) |
| Exceptional items | (0.2) | (0.2) |
| Operating profit | <u>4.3</u> | <u>3.4</u> |
| Total flights (000) | 396 | 379 |
| Chargeable flights (000) | 394 | 377 |

North Atlantic air traffic services are en route services provided by NERL in the Shanwick Oceanic Control Area (part of the North Atlantic where the UK provides navigation services by international agreement and where communications are provided by the Republic of Ireland). The charges for these services are levied on a per flight basis and are subject to regulatory charge control conditions that allow for the annual adjustment of prices by the movement in the RPI less a specified percentage. Revenues from this service increased to £22.5m (2006: £21.6m). This mainly reflected an increase in chargeable flight volumes of 4.6% to 394,416 (2006: 376,982) and a small decrease in the charge per flight to £56.01 (2006: £56.44).

Operating costs at £16.2m were £0.2m lower than the previous year (2006: £16.4m) as the effect of pay awards were offset by credits for the capitalisation of staff costs associated with the development of the SAATS which was implemented during the year. Asset-related charges for depreciation, amortisation and impairment net of deferred grants increased by £0.2m to £1.8m (2006: £1.6m). Exceptional charges for redundancy and relocation at £0.2m were in line with prior year (2006: £0.2m).

Overall, North Atlantic air traffic services generated an operating profit of £4.3m, £0.9m better than previously (2006: £3.4m) principally due to traffic volume growth.

Airport air traffic services

| | 2007 £m | 2006 £m |
|-------------------------------|-------------|-------------|
| Turnover | | |
| Charges raised on customers | 75.5 | 70.8 |
| Contracted services | <u>43.9</u> | <u>39.1</u> |
| Turnover | 119.4 | 109.9 |
| Operating costs | (103.2) | (94.4) |
| Depreciation and amortisation | (1.3) | (1.8) |
| Exceptional items | (0.2) | (0.7) |
| Operating profit | <u>14.7</u> | <u>13.0</u> |

NSL provides air traffic control services at 15 of the UK's major airports and to Gibraltar. NSL also provides engineering services to airport operators in the UK and abroad.

Charges are either raised on airline customers or airport operators. Charges raised on customers increased by £4.7m to £75.5m (2006: £70.8m) reflecting contract pricing provisions and the full year of the Edinburgh control tower, completed in 2006. The £4.8m improvement in revenues from contracted services to £43.9m (2006: £39.1m) reflected the full year benefit of the Bristol and Gibraltar contracts won in 2006, an increase in engineering services revenues and improvements to some existing contract prices.

Operating costs increased by 9.3% to £103.2m (2006: £94.4m). This reflected the costs of staff pay awards, a full year of costs associated with airport contracts won last year, the Edinburgh control tower completed in 2006 and the costs of leasing equipment in service of airport contracts. Asset-related charges for depreciation and amortisation were £0.5m lower at £1.3m (2006: £1.8m) reflecting the full year impact of assets which ceased to be depreciated in the prior year. Exceptional charges for redundancy and relocation net of gains from asset disposals at £0.2m were also lower than prior year (2006: £0.7m).

Operating profit improved by £1.7m to £14.7m (2006: £13.0m) with revenue growth being partly offset by cost increases.

Chief Executive's Review

There is more we can do and the environment is one of our key areas of focus for the future. We are certainly not complacent; we recognise our responsibility...

Environment

The environment continues to accelerate as one of the most significant issues facing the aviation industry. We accept that there are no easy solutions to a dichotomy between the fact that this is an industry which creates noise and pollution in a world facing ever greater need for protection in such matters, and the need to safeguard an industry which brings value to the economy and choice to travellers.

These are wider matters for Government to consider in the context of potentially conflicting departmental policy. However, we also need honesty in the debate. It is easy to target an industry which is so photogenic in illustrating environmental arguments; yet aviation is still a minnow in terms of its environmental impact, compared with other industries such as energy and road transport. The most recent figures I have seen show that aviation created 5.9% of UK CO₂ emissions in 2005 compared with 31% for the energy industry and 21.6% for road transport.

Future growth could of course create greater pollution if the industry does nothing to reduce its impact. In fact it is making great strides, regrettably not sufficiently acknowledged, in mitigating its impact by improving engine and airframe efficiency, and seeking worldwide agreement to operating standards.

NATS is working extremely hard on what we can do in terms of ATC procedures such as Continuous Descent Approaches, which we pioneered and have now been adopted with a Code of Practice issued through the Department for Transport.

Technological innovation will also help streamline aircraft profiles in climb and descent, reducing fuel burn and therefore emissions.

Our rolling programme of airspace change proposals is designed to make the most efficient use of available airspace, increasing capacity, expediting the most direct routeings and thereby reducing delay further.

There is more we can do and the environment is one of our key areas of focus for the future. We are certainly not complacent; we recognise our responsibility, we are fully engaged with current industry initiatives and will be rolling out our own programme over the next year.

Chief Executive's Review

People

Our employees are rightly proud to work for NATS and our employee opinion survey has borne out that our performance in engaging our workforce is improving steadily.

We have in place a leadership model and performance measurement standards which have helped everyone understand the business targets and how they contribute individually to delivering them.

This has meant that despite the ongoing evolution of the business which brings change both professionally and personally for many of our employees, there is a greater understanding of the business drivers. This in turn has generated greater commitment to ensuring that significant moves such as that of our West Drayton centre to Swanwick on the south coast, planned for later this year, are achieved as smoothly as possible.

Our relationship with our trades unions continues to underpin this work and we have maintained our "working together" partnership which has already proved so invaluable to achieving change across the business despite some significant challenges.

We have raised the issue of the cost of our pension provision whilst confirming that we intend to safeguard the pensions of all our existing employees. This was a clear cause of concern to our staff and the discussion continues with the next valuation of the fund and estimate of the underlying cost of the scheme, expected shortly. To this end, we have agreed with the trade unions jointly to review the scheme when the valuation is complete.

It is with enormous pride that I can report that NATS was in February named among the top 20 big UK businesses to work for, in the annual Sunday Times Top 100 survey. For me, this independent survey of our staff says more than I can about the commitment our workforce has to this company and to its successful future.

Chief Executive's Review

Chief Executive's Review



Looking ahead

The air traffic management industry continues to face immense challenges in responding to the demand from airlines to deliver a more customer-facing service. NATS will continue to take that challenge to the rest of our industry.

We recognise there is a growing environmental debate within the aviation sector and that air traffic services providers have a responsibility and are in a unique position to influence that debate and we intend to play a key role in shaping this over the coming years.

Progress towards a Single European Sky (SES) remains painfully slow, despite the enormous amount of work now going into the Sesar programme to develop an integrated and interoperable ATC solution. But there is still no sign of any real progress towards freeing air traffic control providers from State control and the UK remains the only contestable airport market in Europe where other providers can bid for NATS' business but we can't bid for theirs.

The key issue going forward is to ensure that NATS is operating at the heart of the change process in Europe and is able to maximise both its contribution and, where appropriate, its influence.

We will continue to watch with interest what progress Germany makes in privatising DFS; it will take a critical mass of major players in the private sector to achieve change in the European industry.

We know that the rest of the industry in Europe and beyond admires NATS' achievements and that our reputation today has never been stronger. We know that our newly commercial outlook is regarded with some fear in a traditionally conservative industry; and we also

see evidence in the industry of defensive behaviour that does not set the wide-reaching targets we need for the future.

NATS today is a completely different business from the one I joined in 2004. What we have seen in the past year as we completed the 'Destinations' programme is our willingness to challenge traditional thinking, imagine the almost unimaginable and in doing so take a different approach to our business.

I have signed a new contract with NATS which commits me to leading the company until at least March 2009. It wasn't a difficult decision; I'm immensely proud of how NATS has risen to the challenge of the new world in which it operates and I'm looking forward to continuing the drive forward to achieving the aspirations we are setting for ourselves and our industry.

Paul Barron
Chief Executive

Financial review

The group reported a pre-tax profit of £94.4m, an improvement of £14.1m over the previous year (2006: £80.3m).

This result was achieved in a positive operating environment, which saw continued growth in en route and airport services revenues, gains from property disposals and the benefits of last year's re-financing. These factors outweighed cost increases mainly relating to staff.

The financial highlights of the year were as follows:

- Turnover increased by £14m (2.1%) to £701m from the previous year.
- Operating costs before exceptional items increased by £20m (3.7%) to £561m.
- Operating profit before exceptional charges was £6m lower at £140m and after exceptional items was £7m better at £144m.
- Net finance costs were £7m (12.8%) lower at £50m.
- Profit before tax was £14m better at £94m.
- Investment in the capital expenditure programme at £141m was £26m lower than last year.
- Net debt reduced by £21m to £577m.

Group financial performance

| | 2007 £m | 2006 £m |
|---|----------------|------------|
| Turnover | 701.2 | 686.7 |
| Costs | | |
| - Costs before exceptional items | (561.0) | (540.9) |
| - Exceptional items (net) | 3.8 | (8.6) |
| | (557.2) | (549.5) |
| Operating profit | | |
| - Operating profit before exceptional items | 140.2 | 145.8 |
| - Exceptional items (net) | 3.8 | (8.6) |
| | 144.0 | 137.2 |
| Finance costs (net) | (49.6) | (56.9) |
| Profit before taxation | | |
| - Profit before tax and exceptional items | 90.6 | 88.9 |
| - Exceptional items (net) | 3.8 | (8.6) |
| | 94.4 | 80.3 |
| Tax | (25.0) | (22.9) |
| Profit for the year | 69.4 | 57.4 |

Group profit before tax at £94.4m was £14.1m better than the previous year (2006: £80.3m). Overall, revenue growth was more than offset by increases in operating costs but the results benefited from net exceptional gains and lower financing costs.

| | 2007 £m | 2006 £m |
|--|--------------|------------|
| UK air traffic services | | |
| UK en route services | 496.3 | 492.9 |
| Support services to MoD | 40.9 | 44.3 |
| London approach services | 8.6 | 8.5 |
| North Sea helicopters | 6.4 | 6.2 |
| | 552.2 | 551.9 |
| North Atlantic air traffic services | 22.5 | 21.6 |
| Airport air traffic services | 119.4 | 109.9 |
| Miscellaneous services | 7.1 | 3.3 |
| Total | 701.2 | 686.7 |

Group turnover increased by £14.5m (2.1%) to £701.2m, driven mainly by airport air traffic services revenues, growth in training and consultancy revenues, service performance incentive income for the UK en route business and volume-driven growth in North Atlantic air traffic services. These factors helped offset the impact of lower revenues for services to the military.

Operating costs for the year are analysed as follows:

| | 2007 £m | 2006 £m |
|---|----------------|------------|
| Before exceptional items: | | |
| Employee costs | (333.4) | (319.3) |
| Service and materials | (70.8) | (63.6) |
| Repairs and maintenance | (27.7) | (27.0) |
| External research and development | (0.5) | (0.5) |
| Other operating charges | (44.1) | (43.7) |
| | (476.5) | (454.1) |
| Depreciation, amortisation and impairment | (89.1) | (91.4) |
| Deferred grants | 4.6 | 4.6 |
| Operating costs | (561.0) | (540.9) |
| Exceptional operating items (net) | 3.8 | (8.6) |

Included within operating costs are certain amounts considered to be exceptional but are not defined as such in the financial statements. Exceptional items are explained more fully below. Before exceptional items and asset-related charges, operating costs increased by £22.4m (4.9%) to £476.5m (2006: £454.1m).

Employee-related costs, which account for 59% of the group's total operating costs, were £333.4m and increased by £14.1m on the previous year (2006: £319.3m). This increase included the result of negotiated pay awards and a 1.6% increase in average staff numbers to 5,157 during the year. Employees in post at 31 March 2007 increased by 20 (0.4%) to 5,189 (2006: 5,169).

Financial review

Staff costs included £53.5m for pension scheme costs (2006: £57.2m), which accrued at 20.0% of staff pensionable pay (2006: 22.3%). NATS paid contributions to the scheme at a rate of 12.2%.

Non-staff related costs at £143.1m (2006: £134.8m) increased by £8.3m or 6.2%. This included higher rent, rates and utility costs and higher airport contract-related expenses and equipment hire costs. These increases were offset in part by lower staff travel allowances which were bought-out last year.

The depreciation, amortisation and impairment charges of £89.1m (2006: £91.4m) included charges of £12.5m (2006: £15.9m) in relation to the impairment of tangible and intangible assets. Underlying depreciation charges for the year were £76.6m (2006: £75.5m) and included a year's depreciation charge associated with the second phase of the Corporate and Technical Centre (CTC) which was completed in February 2006.

| Exceptional operating items (net) | 2007 £m | 2006 £m |
|---|------------|--------------|
| Redundancy costs | (2.4) | (3.4) |
| Relocation costs | (2.3) | (3.9) |
| | (4.7) | (7.3) |
| Profit/(loss) on disposal of non-current assets | 8.5 | (1.3) |
| | <u>3.8</u> | <u>(8.6)</u> |

The group incurred £3.8m of net exceptional gains in the year (2006: £8.6m loss). Charges of £4.7m were incurred for redundancy and staff relocation costs (2006: £7.3m) relating mainly to the continuing move of corporate and engineering functions to the Swanwick area. In addition, exceptional gains of £8.5m were realised on property disposals, including Spectrum House at Gatwick which previously accommodated engineering staff who are now co-located at the CTC in Hampshire (2006: £1.3m net loss on asset disposals).

Net finance costs were £7.3m lower than the prior year at £49.6m (2006: £56.9m) as the group realised benefits from re-financing in November 2005 and lower gearing and incurred lower charges associated with accounting for derivatives financial instruments.

Debt service costs included interest payable on bank loans and hedging instruments of £1.1m (2006: £4.2m), bond interest and other bond related finance costs of £29.8m (2006: £29.8m), interest on shareholders' loan notes of £16.1m (2006: £16.3m) and other miscellaneous charges were £0.2m (2006: £0.3m). The group also generated interest income of £8.0m (2006: £7.3m) from bank deposits.

Overall, the group reported a profit before tax of £94.4m, an improvement of £14.1m (2006: £80.3m).

The tax charge was £25.0m (2006: £22.9m) at an effective rate of 26.5% (2006: 28.6%). Factors affecting the tax charge for the year are set out in note 11 to the accounts.

Returns to shareholders

The financial performance in the year enabled returns to be made to shareholders in the form of repayments of loan note principal and interest. Holders of unsecured loan notes received £5.0m and will receive a further £4.6m in June 2007. Holders of secured loan notes received £5.6m during the year with £5.1m to follow in June 2007.

No interim dividends were declared in the year (2006: £2.5m) and no final dividend is to be proposed at the Annual General Meeting. An interim dividend for 2008 of £2.4m, has been approved by the Board and will be paid to all shareholders, including NATS staff, in July 2007.

Financial review

Balance sheet

The group balance sheet can be summarised as follows:

| | 2007 £m | 2006 £m |
|--|----------------|----------------|
| Goodwill | 351.0 | 351.0 |
| Intangible fixed assets | 92.7 | 79.2 |
| Property, plant and equipment | 571.8 | 534.3 |
| Retirement benefit asset | 238.6 | 207.0 |
| Other non current assets | 4.8 | 0.3 |
| Cash and short term deposits | 179.0 | 160.8 |
| Other net current (liabilities) | (52.6) | (73.1) |
| Total assets less current liabilities | <u>1,385.3</u> | <u>1,259.5</u> |
| Borrowings | (756.3) | (759.3) |
| Provisions and other non-current liabilities | (154.0) | (133.1) |
| Net assets | <u>475.0</u> | <u>367.1</u> |

The carrying value of goodwill, which arose at PPP, was unchanged at £351.0m following a review undertaken by reference to the future cash flows and net realisable value of the regulated assets of NERL.

Intangible assets, principally software and airspace re-sectorisation assets, increased by £13.5m and tangible fixed assets increased by £37.5m in the year. Details of the group's principal capital expenditure in the year are summarised on page 30.

The retirement benefit asset represents the pension surplus on the pension scheme. This was valued on an IAS19 basis at the balance sheet date at £238.6m (2006: £207.0m) with scheme assets representing 109% of the value of scheme obligations (2006: 108%).

Other non current assets of £4.8m (2006: £0.3m) include deferred consideration on the sales of property and accrued income.

Other net current liabilities were lower than the previous year by £20.5m due to increases in accounts receivable reflecting improved revenues, lower corporate taxes payable and capital expenditure accruals and other payables.

Provisions and other non current liabilities of £154.0m (2006: £133.1m) include deferred tax provisions which, at £143.5m are £24.4m higher than prior year. The increase in the pension asset accounted for £9.5m of this movement, accelerated capital allowances for £13.6m and £1.3m due to other factors.

Movements in cash and short term deposits and borrowings are explained below in reviews of the cash flow and treasury activities.

Overall net assets increased by £107.9m to £475.0m (2006: £367.1m).

Financial review

Financial review

Capital expenditure

Additions to intangible and tangible assets are summarised by main area below:

| | 2007 £m | 2006 £m |
|---|--------------|--------------|
| Airspace development | 4.8 | 3.8 |
| Business systems and relocation to CTC | 14.0 | 23.1 |
| Future centres programme | 23.9 | 13.5 |
| Communications, navigation and surveillance | 11.4 | 17.2 |
| Radar site services | 16.7 | 16.0 |
| Current software systems | 20.5 | 22.6 |
| Prestwick/Manchester programme | 23.4 | 37.1 |
| Swanwick/West Drayton programme | 19.1 | 27.4 |
| Airports | 4.8 | 3.8 |
| Other | 2.6 | 2.9 |
| Total | 141.2 | 167.4 |

Capital expenditure for the year at £141.2m (2006: £167.4m) was £26.2m less than the prior year. Much of the reduction in expenditure reflects the near completion of the Corporate and Technical Centre and Prestwick Centre building projects at the end of 2006 and the technical completion last year of the new operations room at Swanwick in readiness for the transfer of London terminal control and military operations from West Drayton in 2007/08. Expenditure on the Interim Future Area Control Tools Support project (iFACTS) increased in 2007 as the project entered implementation phase in January 2006.

Treasury management

As detailed below, the net debt of the group reduced by £21.2m to £577.3m (2006: £598.5m).

| | Cash and short term investments £m | Borrowings £m | Net debt £m |
|---------------------------------|---------------------------------------|------------------|----------------|
| Balance at 31 March 2006 | 160.8 | (759.3) | (598.5) |
| Cash flow | 18.8 | 3.9 | 22.7 |
| Short term deposits | (0.6) | - | (0.6) |
| Non-cash movements | - | (0.9) | (0.9) |
| Balance at 31 March 2007 | 179.0 | (756.3) | (577.3) |

Financial risk management

The main financial risks of the group relate to the availability of funds to meet business needs, the risk of default by counter-parties to financial transactions, and fluctuations in interest and foreign exchange rates. The Treasury function is mandated by the Board to manage the financial risks that arise in relation to underlying business needs. The function has clear policies and operating parameters, and its activities are routinely reviewed and agreed by the Treasury Committee. The function does not operate as a profit centre and the undertaking of speculative transactions is not permitted.

The main risks arising from the group's financing activities are set out below:

- funding risk: the policy of the group is to ensure that committed funding is available at a competitive cost to meet its anticipated needs for the period covered by its long term business plan. This is achieved by maintaining a portfolio of debt diversified by source and maturity and ensuring it has access to long term funding to finance its long term assets. Hence, the group's borrowings include perpetual shareholder loan notes totalling £65m issued by NERL, shareholder loan notes totalling £102.3m issued by NATS Ltd maturing in March 2031 and a £600m amortising bond issued by NERL with a final maturity date of 2026. In addition, NERL had bank facilities totalling £216.2m which matured in 2010 but were capable, with lender agreement, of extension by up to a further two years; in November 2006, facilities totalling £205.2m were extended for a further twelve months to November 2011.
- liquidity risk: in addition to undrawn committed bank facilities totalling £216.2m, as at 31 March 2007 the group had cash and short term deposits totalling £179m. Included in cash of £160.6m is a liquidity reserve account balance of £21.3m held to provide liquidity in the event of certain pre-defined circumstances, particularly to ensure compliance with financial covenants. The short term deposit of £18.4m represents a debt service reserve account to fund interest and fees scheduled for payment in the 6 months ending 30 September 2007. The group's policy is to hold free cash within NERL equivalent to between one and two months' Eurocontrol revenue (up to c£84m) and to use surplus cash to reduce borrowings. As the company has no bank borrowings and it is not currently cost effective to redeem its sterling bonds, NERL currently has free cash in excess of two months' Eurocontrol revenue.

- interest rate and inflation risk: the group's policy is to achieve an efficient mix of funding at fixed rates of interest, floating rates of interest and rates indexed to retail prices. At the time of the PPP in 2001, in view of NERL's high gearing and the fact that cash holdings were forecast to be minimal, the company adopted a policy of hedging projected gross borrowings. As a result of NERL's improved financial performance, cash holdings have increased significantly since 2001. Hence in September 2006, NERL moved from a strategy of hedging gross debt to hedging net debt in order to reduce its exposure to interest rate risk on its cash holdings. As part of this strategy, in February 2007 the company novated and cancelled all of the interest rate swaps previously entered into to hedge projected bank borrowings. The cost of cancellation (excluding accrued interest of £0.3m) was £10.3m which had already been charged to profits in the financial years to 2006.

To achieve an economic hedge of NERL's regulated revenue, most of which is linked to the movement in the retail price index ("RPI"), an index-linked swap with a notional principal of £200m was entered into in August 2003 whereby NERL receives fixed interest and pays interest at a rate adjusted for the movement in RPI.

Financial review

Notwithstanding the cancellation of fixed rate swaps previously entered into to hedge projected bank borrowings, as at 31 March 2007 (after swaps), approximately 121% of NERL's net debt (£538.3m) was either at fixed rates (84%) or at rates indexed to inflation (37%). It is the company's intention to reduce further the level of fixed rate debt during the current financial year such that the level of fixed rate/index-linked debt does not exceed 100% of net debt.

- **currency risk:** Our principal objective is to reduce the effect of exchange rate volatility on short-term profits. Transactional currency exposures that could significantly impact the Income Statement are hedged, typically using forward sales of foreign currencies. The company's most significant currency exposure arises because UK en route charges, which contribute 71% (2006: 72%) of total turnover, are set in sterling but are billed and collected in euros by applying a conversion rate determined monthly by Eurocontrol, which administers the UK en route revenue collection. The resultant currency risk is materially eliminated by entering into forward foreign exchange contracts. At the year end, forward foreign currency transactions, designated as cash flow hedges, equivalent to £70.5m were outstanding (2006: £65.4m) as detailed in note 18.
- **counterparty risk:** as at 31 March 2007 the group had cash and deposits (shown as short term investments) totalling £179.0m. To minimise risk, funds may only be invested in high quality liquid investments. Credit risk associated with the investment of surplus funds (and from the use of interest rate and currency hedging derivatives) is managed by setting limits for counterparties based on their credit rating. An aggregate limit has also been established for each counterparty.

Cash flow

Overall, the group's cash balances increased by £18.8m in the year to £160.6m (2006: £141.8m). Cash balances included the liquidity reserve account of £21.3m (2006: £21.3m).

| | 2007 £m | 2006 £m |
|--|----------------|----------------|
| Cash generated from operations | 239.9 | 254.1 |
| Taxation | (25.2) | (32.4) |
| Net cash from operating activities | 214.7 | 221.7 |
| Interest received | 8.0 | 7.6 |
| Capital expenditure | (149.8) | (157.4) |
| Contributions to capital expenditure | 0.7 | - |
| Sales of property, plant and equipment | 7.8 | 0.5 |
| Change in short-term investments | 0.6 | 1.6 |
| Net cash outflow from investing activities | (132.7) | (147.7) |
| Interest paid | (56.8) | (44.0) |
| Loan repayments | (1.7) | (39.0) |
| Loan from shareholder | (2.2) | 2.1 |
| Dividends paid | (2.5) | (5.0) |
| Net cash outflow from financing costs | (63.2) | (85.9) |
| Increase/(decrease) in cash and equivalents | 18.8 | (11.9) |

Financial review

Net cash from operating activities was £7.0m lower than prior year at £214.7m (2006: £221.7m) as lower cash generated from operations at £239.9m (2006: £254.1m) was offset in part by lower outflows for taxes paid of £25.2m (2006: £32.4m).

Cash outflows in respect of investing activities were £132.7m (2006: £147.7m), £15.0m lower than the prior year reflecting less capital expenditure and the proceeds from asset sales.

Cash outflows of £63.2m from financing activities were £22.7m lower than the prior year (2006: £85.9m). Outflows of £56.8m (2006: £44.0m) included interest payments and the costs of unwinding interest rate swaps, repayments of loans of £3.9m (2006: £36.9m) and dividend payments of £2.5m (2006: £5.0m). Prior year cash outflows included the repayment of bank loans of £30.3m.

The group also held short term deposits maturing after more than 3 months of £18.4m (2006: £19.0m) representing a debt service reserve account to fund finance payments due to be made in the six month period ending 30 September 2007.



Nigel Fotherby
Finance Director

Corporate governance

Code of best practice

The Combined Code on Corporate Governance was revised and reissued in July 2003, the revised code being applicable for reporting years beginning on or after 1 November 2003. Additional guidance was issued in October 2005, following a detailed review of the impact of the Combined Code and its related disclosures by the Turnbull Review Group.

The NATS Public Private Partnership (PPP) was established in July 2001 and operates within the framework of a Strategic Partnership Agreement (SPA) between the Secretary of State for Transport, The Airline Group (AG) and BAA plc. The SPA requires the company and the directors, so far as is reasonably practical, to adhere to the Combined Code.

NATS recognises that good corporate governance is of prime importance in demonstrating to all those who have an interest in the company's affairs that it is acting in accordance with best practice, seeking to match its reputation for quality in the provision of its air traffic services with adherence to the principles of good governance. NATS has continued to apply the principles of the Code throughout the period under review, to the extent considered appropriate by the Board. However, a number of Principles and Provisions in the Combined Code are not relevant to the particular partnership nature of the NATS group. The principal areas where NATS does not comply are summarised below:

Combined Code A.3: The non-executive directors on the Board are either AG nominee directors, BAA nominee directors, or Crown appointments (Partnership Directors) with particular responsibilities set out in their Mission Statement in the SPA, and therefore they do not meet the independence criteria provided in this principle of the Combined Code. This area of non-compliance affects the degree of compliance achieved with a number of the Combined Code provisions, where directors' independence is required. The Chairman is regarded as the most independent member of the Board in terms of the Combined Code criteria.

Combined Code A.4.4: The non-executive directors do not have service contracts with the company and as a result the terms and conditions of employment cannot be made available for inspection. The Partnership directors have letters of appointment from the Department for Transport. The non-executive directors disclose their other significant commitments and ensure that they have sufficient time to meet what is expected of them.

Combined Code A.7.1/2: The non-executive directors are appointed by the shareholding groups and are therefore subject to the relevant shareholding group's selection processes, rather than those included in the provisions of the Combined Code. The process of selection is supported by the Nomination Committee.

Combined Code B.1.3 and B.2.3: The level of remuneration for non-executive directors was initially determined on completion of the PPP transaction. Subsequent changes are disclosed within the Remuneration Committee report.

Combined Code B.1.6 The Chief Executive's contract contains a lock-in period until 31 March 2009, with a one year notice period from 31 March 2008.

Combined Code Part D: Within the PPP structure there are no institutional shareholders and therefore this part of the Combined Code cannot be applied to NATS.

The initial control structure for the group was established in the SPA and the Facilities Agreement with the lending banks, which came into effect on completion of the PPP transaction on 26 July 2001. This structure was subsequently amended following the downturn in traffic after September 11 2001, and this restructuring, known as the Composite Solution, was completed in March 2003.

The Board approved the NATS group's new Governance Arrangements in June 2003, in light of both the financial restructuring and the recommendations of the Higgs and Smith reports on Corporate Governance. Governance arrangements are updated as necessary but have been unaffected by the Turnbull Review Group guidance issued in October 2005.

The Roles of the Chairman and Chief Executive Officer

The Chairman, John Devaney, leads the Board and is responsible for determining its objectives, organising its business and ensuring its effectiveness. He has no day-to-day involvement in the running of the company.

The Chief Executive, Paul Barron, has direct charge for the executive management of the company.

The Board

The Board provides leadership and direction and is responsible for ensuring that the NATS group is run safely, efficiently,

effectively and legally, with appropriate internal controls to safeguard shareholders' investment and group assets. The boards of the subsidiary companies are accountable to the NATS Holdings Board for all aspects of their business activities.

The Board currently comprises a non-executive Chairman and thirteen directors, as follows:

Executive Directors

- Chief Executive
- Managing Director
- Finance Director
- Director of Operational Performance

Non-Executive Directors

- Three Partnership Directors, appointed by the Crown Shareholder
- Five non-executive Directors appointed by The Airline Group (AG), including the International Air Transport Association (IATA) representative.
- One non-executive director appointed by BAA.

Brief biographies of the directors are provided on Pages 46-49.

All directors have access to the advice and services of the Company Secretary, (who acts as Secretary to the Board), and if necessary, in furtherance of their duties, directors may take independent professional advice at the company's expense. The Board Committees have access to sufficient resources to undertake their duties.

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All non-executive directors are considered by the Board to be independent of the company management. However, they are not considered independent under the terms of the Combined Code on Corporate Governance. Consequently, it is not possible to identify a senior independent non-executive director, other than the Chairman, John Devaney, to whom concerns can be conveyed by the shareholders.

Shareholders' meetings are held twice a year, linked to the planning and reporting cycles and provide the principal shareholders with an opportunity to participate in the development of the company's long term strategy. Shareholders may also meet informally with the Chairman, Chief Executive or Finance Director on other occasions at their request.

The Board met ten times during the year with each member attending as follows:

| Name | Number of meetings attended |
|--------------------|-----------------------------|
| John Devaney | 10/10 |
| Paul Barron | 10/10 |
| Nigel Fotherby | 10/10 |
| Ian Hall | 10/10 |
| Lawrence Hoskins | 10/10 |
| Derek Stevens | 9/10 |
| Danny Bernstein | 9/10 |
| Barry Humphreys | 9/10 |
| Peter Read | 9/10 |
| Lord Brooke | 2/3 |
| Baroness Dean | 7/7 |
| Andrew White | 7/7 |
| Stephen Pettit | 9/10 |
| Bill Semple | 2/3 |
| Giovanni Bisignani | 9/10 |
| Roger Cato | 8/10 |

Lord Brooke resigned from the Board on 25 July 2006
Baroness Dean was appointed to the Board on 26 July 2006 Andrew White was appointed to the Board on 26 July 2006 Bill Semple resigned from the Board on 25 July 2006

The Board has adopted a schedule of matters reserved for its decision, and has put in place arrangements for financial delegations, to ensure that it retains overall control of the business. Matters reserved for the Board include the approval of the company's strategic and operating plans and long term investment plan, major items of capital expenditure, oversight of safety, operational and financial performance, and the regular review of the effectiveness of the group's system of internal controls.

The Board continued its ongoing review of key commercial and financial risks and those relating to the regulatory environment.

Management and control of the business is delegated by the Board to the Chief Executive, Paul Barron. The Chief Executive and executive directors of the company have responsibility for the management of the business subject to the matters reserved to external parties, shareholders and the Board.

The Board has established four standing committees, operating within approved terms of reference. The committee structure comprises an Audit Committee, Remuneration Committee, Safety Review Committee and Nomination Committee. There is also a Group Executive, which includes the members of the top management team. The number of meetings held by the principal Board committees, and individual directors attendance, is provided in the table below:

| | Audit | Nomination | Remuneration | Safety Review |
|------------------------|-------|------------|--------------|---------------|
| No. of meetings | 4 | 1 | 7 | 4 |
| John Devaney | 4/4 | 1/1 | | |
| Derek Stevens | 4/4 | 1/1 | | |
| Danny Bernstein | | 1/1 | 7/7 | |
| Barry Humphreys | | | 7/7 | |
| Peter Read | | | | 4/4 |
| Lord Brooke | | | 1/3 | |
| Baroness Dean | | | 4/4 | |
| Bill Semple | | | | 1/1 |
| Andrew White | | | | 3/3 |
| Stephen Pettit | 3/4 | 1/1 | | |
| Roger Cato | | 1/1 | | 3/4 |

The terms of reference for the Board and its Committees are available to all staff and shareholders, and can be made available externally with the agreement of the Company Secretary.

Reports and papers are circulated to Board members in a timely manner in preparation for Board meetings, and this information is supplemented by any information specifically requested by directors from time to time. The directors also receive monthly management reports and information to enable them to

Corporate governance

scrutinise the company's performance. Performance evaluation of the Board, its committees, its individual directors and the Chairman has been conducted during the year. The Board Effectiveness Review was managed by the Company Secretary and based around responses to a structured set of questions to reflect the views of all Board members and key executives who are not on the Board. The results of the 2006/07 Review were assessed at the February 2007 Board meeting.

The Chairman's performance is appraised annually as part of the Board Effectiveness Review. The non-executive directors may meet without the Chairman present and also without the executives present, on such occasions as are deemed appropriate.

Group Executive

The Chief Executive, Paul Barron, carries out day to day management of the NATS group with support from the members of the Group Executive. The focus of work at this level is on strategy development and performance management, including people development. Group Executive members are responsible for the management of business within their areas of accountability. The Group Executive has no authority as a committee to authorise expenditure, the aim being to focus decision-making on individual rather than collective accountability.

Audit Committee

The Audit Committee met four times in the year. It is chaired by the non-executive Chairman John Devaney, as he is considered the most independent member of the Board under the Combined Code criteria. The Committee comprises two further non-executive directors of the Board, Derek Stevens, and Stephen Pettit. The members have wide-ranging financial, commercial and management experience and a summary of their biographical details are provided at pages 46-49.

The company's Chief Executive, Finance Director, Financial Controller, Head of Internal Audit and the external auditors are invited to attend each meeting by standing invitation.

The duties of the Committee include monitoring the integrity and compliance of the company's financial statements, reviewing the effectiveness of the internal audit department and external auditors, reviewing the scope and results of internal and external audit work and reviewing internal controls and risk management. All published internal audit reports are provided in full to each Committee member. The Committee also advises on matters relating to the appointment, independence and remuneration of the external auditors.

Remuneration Committee

The Remuneration Committee of the Board is chaired by Danny Bernstein and comprises two further non-executive directors, Barry Humphreys and Baroness Dean. The Committee meets when necessary and is responsible for determining the company's policy on directors' remuneration and expenses, and approving remuneration and incentive payments for senior managers, including the criteria for establishing performance targets. No director is involved in deciding his or her own remuneration.

The company's Chief Executive and Human Resources Director are invited to attend meetings of the Committee, as appropriate.

Safety Review Committee

The role of the Safety Review Committee is to support the Board in the discharge of its accountabilities for the safe provision of operational air traffic services. It meets as a formal committee on a regular basis, generally four times a year, and additionally undertakes special exercises at the request of the Board. Its remit is to monitor and review the effectiveness of the safety arrangements in place in the group and review the delivery of the group's safety objectives through its operations, structures and processes.

The Committee is chaired by a Partnership Director, Andrew White, and there are two other non-executive directors as members, Peter Read and Roger Cato. Professor James Reason, formerly Professor of Psychology at Manchester University and an expert on human factors, acts as a special adviser to the Committee.

The company's Chief Executive, Director of Operational Performance and Director of Safety are invited to attend each meeting by standing invitation.

Nomination Committee

The Nomination Committee was established in May 2004. It is chaired by the non-executive Chairman John Devaney and comprises four further non-executive directors Derek Stevens, Danny Bernstein, Stephen Pettit and Roger Cato. The Chief Executive, HR Director and advisors may be invited to attend meetings of the Committee, as appropriate. The Committee meets when necessary.

Corporate governance

Corporate governance

As noted overleaf, appointments to the Board are made by the relevant sponsoring shareholder under the terms of the SPA, but the process of selection is supported by the Nomination Committee. In addition to assisting the shareholders and the Board with the appointments process, the Committee has the task of evaluating the balance of skills, knowledge and expertise required on the Board.

Financial reporting and internal control

The Board is responsible for the company's system of internal control and for reviewing its effectiveness. This system was in place for the year under review and up to the date of approval of the annual report and accounts.

The NATS system of internal control is designed to ensure that the significant financial, operational, compliance and business risks faced by the group are identified, evaluated and managed to known acceptable levels. As with all such systems, controls can only provide reasonable but not absolute assurance against misstatement or loss.

Risk Management

Risk management is considered essential in minimising the threat that an event or action will adversely affect the group's ability to achieve its objectives and execute its strategies effectively. Successful risk management ensures that the group is able to deliver services to its customers and meet the needs and expectations

of its shareholders in a fast changing and uncertain environment. This system for the identification, evaluation and management of risks is embedded within the group's management, business planning and reporting processes, and accords with the Combined Code. The Board formally reviews the 'Top Risks' to NATS and the risk management process on a rolling basis. This is complemented by detailed risk identification at divisional level during the business planning process, the final plans being approved and owned by the Board.

The Audit Committee and Board have assessed the group's performance against the 'Top Risks' during the year ended 31 March 2007 and agreed actions for the 'Top Risks' for year ended 31 March 2008. Regular monthly reporting to the Group Executive on business controls and progress of mitigating actions against NATS risks is supplemented by reports to the Audit Committee on the process of risk management and internal control.

The company's Internal Audit Department carries out detailed reviews of internal financial control, their associated computer environments and business risk management controls. Reports, including the relevant action plans agreed with local management, are circulated to Audit Committee members, executive directors and senior managers. In October 2006 the Board approved a decision to outsource the majority of internal audit work to an external service provider, KPMG, complemented by a small in-house team.

The company's performance is reviewed monthly by the Group Executive and the Board. This includes reviewing performance against operational targets, including those relating to safety, delays, project performance and risk management, and against financial targets, including revenue and capital budgets. The Board takes the management of risk seriously, paying particular attention to areas such as safety, service delivery, operating efficiency and financial control, project delivery, regulatory compliance and IT systems. Necessarily, NATS takes a special interest in the risk management of safety and service delivery.

Safety

NATS has an industry-leading safety management system and an embedded safety culture. There is also an objective of continuous improvement in safety performance. NATS' safety objectives, targets, performance and strategic actions to achieve the objectives are all detailed in a Strategic Plan for Safety.

Non-audit work performed by the external auditors

From time to time the external auditors perform non-audit services for the group. Any appointment to perform non-audit services by the external auditors must be agreed by the Audit Committee prior to engagement. The Audit Committee reviews the scope of each engagement to ensure objectivity and audit independence is safeguarded. Other services performed by Deloitte in the year ended 31 March 2007 principally related to taxation advice in

connection with NATS employees based abroad and tax advice relating to other projects. Details of the cost of these services is set out in note 7 of the "Notes forming part of the consolidated accounts".

Going concern

After making due enquiry, the directors have formed a judgement that taking into account the financial resources available to the group, it has adequate resources to continue to operate for the foreseeable future and have therefore adopted the going concern basis in the preparation of the financial statements for the year ended 31 March 2007.

Remuneration committee report

Remuneration committee report

This report has been prepared by the Remuneration Committee and approved by the Board.

Information not subject to audit.

Membership and responsibilities of the Remuneration Committee

The Remuneration Committee is comprised entirely of non-executive directors: Danny Bernstein (Chairman), Baroness Dean of Thorton-le-Fylde and Barry Humphreys. Their biographical details appear on pages 46–49.

Where appropriate, the Committee takes advice on specific issues from the Chief Executive, the Human Resources Director and independent consultants.

The Committee meets several times a year and is responsible for:

- Approving, on behalf of the Board, the arrangements for determining the remuneration, benefits in kind and other terms of employment for the Chairman and executive directors and the company's Personal Contract staff (comprising members of the executive team and other senior staff whose terms of employment are not subject to negotiation with the recognised trades unions through the NATS joint bargaining machinery);

- Approving company targets and individual performance targets for executive directors and other members of the executive team;
- Considering and approving a statement of remuneration policy and details of the remuneration of each director for inclusion in the annual report and accounts.

Performance Management

The Committee continued to support the drive towards a more differentiated approach to management pay, taking account of relative individual performance. Coaching for Performance continues to be the required methodology for performance management for all Personal Contract staff.

Managers' rewards are related not only to what they achieve but also to how they achieve it through their people (informed by an Employee Opinion Survey). Managers understand that they are expected to achieve outstanding results to gain substantial bonus.

In addition, a formal appraisal system is in place for all employees that enables staff to discuss their progress and performance with their managers. Supported by Coaching for Performance, the aim is that every team and individual in the company is clear about what they have to deliver and how it is measured. The success of the programme can be measured both in terms of this year's outstanding business results and by the outcome of the latest Employee Opinion Survey.

Policy

It is the company's policy to establish and maintain competitive pay rates that take full account of the different pay markets relevant to its operations. In return, employees are expected to perform to the required standards and to provide the quality and efficiency of service expected by its customers. In fulfilling this policy, the company fully embraces the principles of, and complies with, the provisions of the Combined Code on directors' remuneration as outlined below.

The level of directors' remuneration is aligned with median practice in comparable companies. Directors are rewarded on the basis of responsibility, competence and contribution, and salary increases take account of pay awards made elsewhere in the group. Performance-related elements form a substantial part of the total remuneration package and are designed to align the interests of directors with those of shareholders. Performance is measured against a portfolio of key business objectives and payment is made only for performance beyond that expected of directors as part of their normal responsibilities.

Service contracts

Paul Barron has a service contract that commits him to stay until 31 March 2009. He can give 12 months' notice of the termination of his contract from 31 March 2008 onwards. Lawrence Hoskins has a service contract which provides for 12 months' notice in the event of termination by the company. Nigel Fotherby and Ian Hall have service contracts which provide for 6 months' notice in the event of termination by the company.

The non-executive directors do not have service contracts with the company.

Remuneration packages

The remuneration package for executive directors is reviewed each year and consists of annual salary; pension and life assurance; annual and long term bonus schemes; All Employee Share Ownership Plan; company car; and medical insurance. Their annual bonus is consistent with the overall bonus scheme (see overleaf). The long term bonus is based on the performance of NATS (En Route) plc over Control Period 2 (2006–2010) on service quality, profitability and shareholder return and is payable at the end of this period. In addition, the CEO's bonus arrangements include incentives in relation to maintaining an acceptable underlying credit rating for NERL, the development of NATS' unregulated business and key investment programme milestones. Full details of directors' remuneration for 2006/07 are set out overleaf:

Remuneration committee report

Audited information Directors' remuneration

Emoluments (excluding pension arrangements) of the Chairman and directors were as follows:

| | | Salary or fees(*) £000 | Benefits(*) £000 | Performance related payments(*) £000 | Total 2007(*) £000 | Total 2006(*) £000 |
|---------------------------------------|-----|------------------------------|---------------------|---|--------------------------|--------------------------|
| Chairman | | | | | | |
| John Devaney | | 145 | - | - | 145 | 105 |
| Executive directors | | | | | | |
| Paul Barron | 1,2 | 350 | 66 | 157 | 573 | 580 |
| Nigel Fotherby | | 174 | 13 | 78 | 265 | 283 |
| Ian Hall | | 177 | 10 | 81 | 268 | 25 |
| Lawrence Hoskins | 3 | 248 | 54 | 106 | 408 | 32 |
| Non-executive directors | | | | | | |
| Dr Chris Gibson-Smith | | - | - | - | - | 66 |
| Baroness Dean of Thornton-le-Fylde | 4 | 23 | - | - | 23 | - |
| Stephen Pettit | | 34 | - | - | 34 | 34 |
| Andrew White | 4 | 23 | - | - | 23 | - |
| Lord Brooke of Alverthorpe | 4 | 11 | - | - | 11 | 34 |
| Bill Semple | 4 | 11 | - | - | 11 | 34 |
| Derek Stevens | 5 | - | - | - | - | - |
| Danny Bernstein | 5 | - | - | - | - | - |
| Barry Humphreys | 5 | - | - | - | - | - |
| Peter Read | 5 | - | - | - | - | - |
| Giovanni Bisignani | 5 | - | - | - | - | - |
| Roger Cato | 6 | - | - | - | - | - |
| | | 1,196 | 143 | 422 | 1,761 | 1,193 |

* For year, or from date of appointment or up to date of resignation.

All the directors served throughout the year ended 31 March 2007 unless otherwise stated in the notes below:

- Included in Paul Barron's benefits is an aggregate amount of £45,000 in respect of relocation costs.
- During the year Paul Barron's contract was reviewed and his remuneration was increased with a view to securing his employment with the company to March 2009.
- Included in Lawrence Hoskins' benefits is an amount of £42,000 in respect of relocation costs.
- Baroness Dean and Andrew White were appointed directors on 26 July 2006. Lord Brooke and Bill Semple resigned on 25 July 2006.
- These directors are appointed by The Airline Group (AG) who charged NATS a total of £42,000 per quarter (2006: £42,000 per quarter) for the services of the directors.
- Roger Cato represents BAA plc and is not remunerated by the company for his services as director.

Remuneration committee report

In addition, under the company's Long Term Incentive Plan, a portion of the annual bonuses are accrued and become payable after three years if the director remains with the company. The accrued bonuses are as follows:

| Year bonus accrued: | Paul Barron (Note 1) £000 | Nigel Fotherby (Note 2) £000 | Ian Hall £000 | Lawrence Hoskins £000 |
|---------------------|------------------------------------|---------------------------------------|------------------|-----------------------------|
| 2003/04 | - | 21 | - | - |
| 2004/05 | 14 | 20 | - | - |
| 2005/06 | 51 | 22 | 2 | 3 |
| 2006/07 | 99 | - | - | - |
| Total | 164 | 63 | 2 | 3 |

- Paul Barron's total accrued bonuses comprise three separate plans. Plan 1 vested in May 2007 and an aggregate amount of £91,000 was payable in respect of that plan.
- During the year, Nigel Fotherby received an amount of £16,000 in respect of an accrued bonus for 2002/03 which vested on 1 April 2006. This amount has been excluded from the emoluments table above. The accrued bonus in respect of 2003/04 vested on 1 April 2007 and was paid in April 2007.

Pensions of the directors were as follows:

| | | Accrued entitlement at 31 March 2006 £000 | Real change in accrued pension £000 | Inflation £000 | Accrued entitlement at 31 March 2007 £000 | Transfer value at 31 March 2007 £000 | Transfer value at 31 March 2006 £000 | Directors' contributions in year £000 | Cost of benefits accrued during year £000 |
|----------------------------|---|---|---|-------------------|---|--|--|--|--|
| Executive directors | | | | | | | | | |
| Paul Barron | 1 | 46 | 13 | 2 | 61 | 1,118 | 931 | 14 | 257 |
| Nigel Fotherby | 2 | 12 | 10 | - | 22 | 315 | 187 | 7 | 137 |
| Ian Hall | 3 | 113 | (58) | 4 | 59 | 1,077 | 2,224 | 7 | (1,131) |
| Lawrence Hoskins | 4 | 3 | 5 | - | 8 | 158 | 56 | 9 | 99 |
| Totals | | 174 | (30) | 6 | 150 | 2,668 | 3,398 | 37 | (638) |

- The figures include the benefits secured by a transfer value of £71,900 from the NATS FURBS (Funded Unapproved Retirement Benefit Scheme) on 4 September 2006.
- The figures include the benefits secured by a transfer value of £73,100 from the NATS FURBS on 15 September 2006.
- The real change in accrued pension, the transfer value at 31 March 2007 and the cost of benefits accrued in the year reflect the implementation of a pension sharing order on his entitlement in the scheme.
- The figures include the benefits secured by a transfer value of £17,900 from the NATS FURBS on 9 October 2006.

Remuneration committee report

Remuneration committee report

Information not subject to audit

Salaries

The Remuneration Committee determines, where appropriate, annual increases to executive directors' salaries having regard to their experience, responsibility, individual contribution, market comparatives and pay increases elsewhere in the group.

Charges for the services of non-executive directors are determined in agreement with the relevant sponsoring body – the Department for Transport in the case of the Partnership directors, The Airline Group (AG) in the case of AG directors and BAA in the case of the BAA directors.

Two new Partnership directors – Baroness Dean of Thornton-le-Fylde and Andrew White – were appointed in July 2006. The contract of the third Partnership Director, Stephen Pettit, was renewed in July 2004. The Partnership directors each receive annual remuneration of £33,600. AG directors receive no remuneration for their services to the NATS Board. However, a payment of £168,000 per annum (equivalent to £33,600 each for the services of five directors) is currently made direct to AG in lieu of remuneration for these directors. This sum is used to fund the activities of AG. The BAA director receives no payments for his services.

Pensions and life assurance

Executive directors' pensions and life assurance are based on salary only, with bonuses and other discretionary benefits excluded. The principal method of securing pensions for executive directors is through the Civil Aviation Authority Pension Scheme (CAAPS). All executive directors are members of the CAAPS.

Following the PPP, the CAA Pension Scheme remains one scheme, although from 31 March 2001, it has been split into two sections. The scheme was valued as at 31 March 2001 and the appropriate amount of assets allocated to each section.

Non-executive directors do not participate in CAAPS.

Bonus Scheme

The committee oversees a scheme of objective setting and bonus arrangements for executive directors and staff in the Personal Contract Group. Non-executive directors do not participate in the scheme. The structure of the scheme is designed to:

- Ensure rigour and differentiation in the system of performance bonus rewards; and
- Drive up performance of NATS management.

The bonus opportunity is set at a range of levels for Personal Contract staff depending on seniority. 40% of the bonus is determined by company performance on key targets and the remaining 60% is dependent on individual performance against targets and leadership behaviours. The scheme incorporates an "ability to pay" clause to override all other triggers.

Employee Share Plan

There are no share option schemes in place for executive directors.

The NATS All-Employee Share Ownership Plan is designed to give every member of staff (including executive directors) an equal stake in the future success of the company. The Share Plan holds 5% of the shares in NATS and is administered by a special trustee company with three directors – one each appointed by the Government, The Airline Group (AG) and the Unions (collectively known as the Trustee). Baroness Dean chairs the Trustee meetings.

An initial allocation of 602 free shares in NATS was offered in 2001/02 to all employees in NATS employment on the qualifying date 26 July 2001 and who continued in employment until the award date of 21 September 2001. A second free allocation of 500 shares was made to all employees in 2003/04, and a third allocation of 400 shares was awarded in 2004/05. Following the payment of a dividend in 2004/05 by NATS Holdings Ltd the Board agreed, with the support of the Trustee, to make an award of dividend shares. Staff holding all three allocations of free shares, were awarded 55 dividend shares to add to their existing holdings. Executive directors held the following interests in ordinary shares of the company: Paul Barron – 414; Nigel Fotherby – 1,557; Ian Hall – 1,557; and Lawrence Hoskins – nil.

The current HM Revenue and Customs approved valuation, for the period 1 January 2007 to 30 June 2007, values the shares at 133p each.

Danny Bernstein

Directors of NATS Holdings Limited

The directors of the company at 28 June 2007 were:

John Devaney

John joined the Board in July 2005 and was appointed Chairman with effect from 1 September. He is also Chairman of telent plc, formerly Marconi, the global telecommunications equipment company. He is also Chairman of Tersus Energy plc, as well as being the founder and Chairman of BizzEnergy, the largest independent UK retailer of electricity.

John was appointed Managing Director, Eastern Electricity plc in 1992 and became Chief Executive in August 1993. Following the acquisition of Eastern by Hanson plc, John assumed the role of Chairman. From 1983 to 1988 John was President of Perkins Engines and from 1988 to 1992 he was the Chairman and CEO of Kelsey-Hayes Corporation. He was also Chairman of Exel from 1999 to 2002. His previous non-executive directorships have included HSBC Bank plc from 1994 to 2000 and British Steel plc from 1998 to 1999. John chairs the Audit and Nomination Committees.

Paul Barron

Paul joined NATS in 2004 as Chief Executive. He was previously Country President at Alstom UK with responsibility for the day-to-day management of the company's transport business in the UK. He began his working life as an engineering apprentice working through the ranks to become Managing Director of Ruston Gas Turbines, a position he held for 15 years. He was appointed UK President ABB Alstom Power in June 1999 and, in 2000, UK President of Alstom.

Paul was formerly a Director of UK Trade & Investment, a body co-sponsored by the DTI/ FCO to assist the export of UK business; and a member of the CBI President's Committee. He is also a past member of the UK Task Force on Competitiveness and a former Chairman of the Energies Industries Council. He was formerly Chairman of the Motorsport Development Board, set up by the DTI in 1993 to retain the UK's technical expertise in this area. In 2000, he was appointed CBE for services to the gas turbine industry.

Lawrence Hoskins

Lawrence became Managing Director of NATS' two businesses NATS (Services) Ltd and NATS (En Route) plc in 2005 after initially joining the company as Commercial Director in 2004. He brought to NATS more than 30 years' international business experience in a range of markets, sectors and businesses. Following his initial career with Plessey Telecommunications in international sales and contract management he subsequently held a variety of posts including Director of Projects, Director of Sales, Commercial Director in a number of GEC and GEC Alstom energy and oil and gas related companies before being appointed as Managing Director of European Gas Turbines in 1994.

He became Managing Director of Balfour Beatty International in 1996, responsible for winning and implementing a variety of international infrastructure projects through UK and overseas partnership businesses, particularly in the Middle East and Asia Pacific. He returned to the regrouped Alstom in 2001 in Paris as Senior Vice President responsible for the company's activities in the energy and transport sectors throughout Asia and Eastern Europe.

Nigel Fotherby

Nigel joined NATS in 1999 as Finance Director. He previously worked for Lex Service plc as Finance Director of its retail group and then for BT Cellnet, where he was Deputy Finance Director. Nigel began his career with Coopers & Lybrand where he qualified as a Chartered Accountant.

Ian Hall

Ian has been Director NERL Business Centre and Director Operational Performance since January 2006. He began his career as an air traffic controller in 1968, working for fourteen years at Belfast and Prestwick airports and at the Scottish Oceanic centre. He then moved into ATC management, first at Stansted and subsequently at Belfast (International) Airport. Ian headed the air traffic flow management operation through the transition to the Central Flow Management Unit in Brussels and thereafter went on to produce the NATS Operational Strategy, now the basis for the capital investment plan. In recent years, Ian has held a number of senior management positions, as General Manager London Area and Terminal Control Centre, Director Area Control Services, responsible for all four control centres, and then Director Operations in 2003.

Derek Stevens

Derek is Chairman of The Airline Group (AG). He retired from British Airways, where he had been Director and Chief Financial Officer, in August 2001 and from the board of Aviva plc in December 2006. Previously, he was Finance Director of TSB Group plc. He is Chairman of The Travel Foundation and Deputy Chairman of Council at the Institute of Education, University of London. He is Chairman of the Aviva and The Royal Academy of Arts pension schemes and a trustee of the Rothschild pension schemes. Derek is a member of the Audit and Nomination Committees.

Directors of NATS Holdings Limited

Directors of NATS Holdings Limited

Danny Bernstein

Danny is Deputy Chairman of The Airline Group (AG) and is the Chairman of the Remuneration Committee and a member of the Nomination Committee. He is the non-executive Chairman of Monarch Airlines in addition to being the Chairman of the British Air Transport Association (BATA). He is also a non-executive director of the Watermark Group plc and of the Royal Free Hampstead NHS Trust.

Giovanni Bisignani

Giovanni has served as Director General and CEO of the International Air Transport Association (IATA) since June 2002. During his tenure with IATA he has completely restructured the association to increase its relevance and speed in driving a broad agenda for industry change.

Giovanni's airline experience includes five years at the helm of Alitalia as CEO and Managing Director, during which time he also served on the IATA Executive Committee and was Chairman of the Association of European Airlines (AEA). Prior to joining IATA, he launched and directed Opodo – the first European airline-owned online travel agency. He has been a Member of the Pratt & Whitney Advisory Board and Chairman of the global distribution services provider Galileo International. During his business career, Giovanni has held various high-level responsibilities at the energy company ENI and the Italian industrial conglomerate IRI Group. He served as President of Tirrenia di Navigazione, the largest Italian ferry company and as CEO and Managing Director of SM Logistics, a group of logistics and freight forwarding companies, partially-owned by GE Capital.

Peter Read

Peter was formerly British Airways' Director of Operations. He joined BA in 1972 as a pilot and flew as a Captain with them until 1996. He has held a number of senior management roles, including Chief Development Engineer in Engineering, General Manager in Flight Operations, leading major business change programmes in Cargo and BA Corporate. As Director of Heathrow, Peter was responsible for the airport operation of BA's principal hub. As Director of Operations, his responsibilities included the Terminal 5 Programme. Peter is currently Director of Operations for Malaysia Airlines, and acts as a Technical Advisor to the Board of Iberia on safety matters. He is a Director of The Airline Group (AG) and is a member of the Safety Review Committee.

Barry Humphreys

Barry spent his early career with the UK Civil Aviation Authority and at the time of his departure was Head of Air Services Policy. Barry joined Virgin Atlantic Airways as Director of External Affairs and Route Development in 1995 where he is responsible for economic regulatory issues, political lobbying, competition policy, licensing, environmental and consumer issues, corporate social responsibility, airport and ATC charges and, in co-operation with others, route development, security and long-term strategy. Barry is a Fellow of the Royal Aeronautical Society, the Chartered Institute of Logistics and Transport and the Tourism Society. He is Deputy Chairman of Airport Co-ordination Ltd, Deputy Chairman of the Board of Airline Representatives UK (BARUK), and a Board Member of the Indo-British Business Partnership. He is a director of The Airline Group (AG) and a member of the Remuneration Committee.

The Rt Hon Baroness Dean of Thornton-le-Fylde

Brenda Dean is Chairman of Covent Garden Market Authority and a non-executive director of Dawson Holdings plc and George Wimpey plc. She was previously Chair of the Freedom to Fly Coalition, the Armed Forces Pay Review Body and the Housing Corporation, and General Secretary of the Society of Graphical and Allied Trades. Brenda was created a life peer in 1993 and sits on the Labour benches in the House of Lords. She is a member of the House of Lords Appointments Commission. Brenda chairs the NATS Employee Sharetrust and is a member of the Remuneration Committee.

Stephen Pettit

Stephen spent his executive career at BP and Cable and Wireless, both in the UK and overseas. He has experience of large investment projects, business development and operations with a critical element of safety management. He is the non-executive Chairman of ROK plc, a non-executive director of National Grid plc, and a non-executive director of Halma plc. He chairs the Stakeholder Council and is a member of the Audit and Nomination Committees.

Andrew White

Andrew spent his career in the Royal Air Force, rising to the rank of Air Vice Marshal. Prior to his retirement from the service in 2006, Andrew had responsibility for managing one third of the Royal Air Force's front line assets, including all military air traffic control in the UK; he was also a member of the Strike Command Management Board. Andrew continues to fly as a civilian pilot and is Chief Executive of the National Security Inspectorate. Andrew chairs the Safety Review Committee.

Roger Cato

Prior to his retirement from BAA in 2006, Roger was BAA's Chairman and Managing Director of Gatwick Airport, and Chairman of Southampton Airport. Previously he was Managing Director of Heathrow Airport. Roger joined Heathrow as an engineering graduate trainee in 1969 and over the last 30 years, a variety of engineering posts have taken Roger to every BAA airport, terminal and airfield. Roger is a Fellow both of the Institute of Electrical Engineers and the Royal Aeronautical Society. He is a member of the Safety Review Committee and the Nomination Committee.

Officers

Richard Churchill-Coleman

Richard is General Counsel and Company Secretary. He joined NATS in June 2007 from TUI Northern Europe Limited where he held the position of Group Legal Counsel. Richard has more than ten years' experience of working in the aviation industry having previously held positions at Thomsonfly, Virgin Atlantic Airways and DHL Worldwide Express. Richard began his career with Norton Rose.

Report of the directors

The directors present their report and audited accounts for the year ended 31 March 2007.

Principal activities and business review

The company was established as a holding company to effect the transfer of ownership of NATS from the CAA to the Strategic Partners under the PPP. Initially the company was wholly owned by the Crown. At completion of the PPP the Crown sold 46% of the company to a strategic partner, The Airline Group (AG), and transferred 5% to employees under a share scheme. On 19 March 2003 the group underwent a financial restructuring which resulted in BAA plc acquiring a 4% shareholding in the company with AG's shareholding reducing to 42%. The company does not trade and has no employees or land and buildings. The group's principal activity is the provision of air traffic services in the UK.

Reviews of the group's activities, including comments on principal risks and uncertainties during the year and of future developments, are given in the Chairman's Statement on pages 4-9 and the Business and Financial Review on pages 10-33.

Results and dividends

The group's results for the year are shown in the income statement on page 56. No interim dividend was approved in the year (2006: £2.5m) and the Board recommends a final dividend for the year of £nil (2006: £nil).

Use of financial instruments

The company's economically regulated subsidiary, NATS (En Route) plc, uses financial instruments to manage financial risk. The accounting policies and notes to the financial statements explain the financial risk management objectives and policies of the company and describe exposures to credit and other risks.

Land and buildings

The land and buildings of one of the company's subsidiaries, NATS (Services) Limited were valued at approximately £39m at 31 March 2002. This compares with a book value of £1.6m at 31 March 2007 (2006: £1.8m). The valuation has not been reflected in the financial statements of the group or the subsidiary. The market value of the land and buildings of the other group subsidiaries continue to be reviewed and accordingly no valuation is available.

Charitable donations

The group made aggregate donations of £3,300 (2006: £5,700).

Employees

The group continues its commitment to the involvement of employees in the decision making process through effective leadership at all levels in the organisation. Staff are frequently involved through direct discussions with their managers, cross-company work groups and local committees. Regular staff consultations cover a range of topics affecting the workforce, including such matters as unit and corporate performance and business plans. The CEO maintains high visibility with staff through an annual 'roadshow' to each NATS location where he briefs them on current business issues and takes questions in an open and straightforward manner. Also, employees' views are represented through an open dialogue with Prospect and the Public and Commercial Services Union (PCS), the recognised unions on all matters affecting employees. This has been enhanced in the last year through the 'Working Together' programme aimed at working towards partnership principles as the basis for our relationship. Formal arrangements for consultation with staff exist through a local and company-wide framework agreed with the trade unions.

It is the group's policy to establish and maintain competitive pay rates which take full account of the different pay markets relevant to its operations. In return, employees are expected to perform to the required standards and to provide the quality and efficiency of service expected by its customers.

The group is an equal opportunities employer. Its policy is designed to ensure that no applicant or employee receives less favourable treatment than any other on the grounds of sex, disability, marital status, colour, race, ethnic origin, religious belief or sexual orientation, nor is disadvantaged by conditions or requirements applied to any post which cannot be shown to be fair and reasonable under relevant employment law or codes of practice.

The group is also committed to improving employment opportunities for disabled people. The group will continue to promote policies and practices which provide suitable training and retraining and development opportunities for disabled staff, including any individuals who become disabled, bearing in mind their particular aptitudes and abilities and the need to maintain a safe working environment.

The group strives to maintain the health and safety of employees through an appropriate culture, well-defined processes and regular monitoring. Line managers are accountable for ensuring health and safety is maintained; responsibility for ensuring compliance with both legal requirements and company policy rests with the HR Director.

Report of the directors

Report of the directors

Policy and practice on payment of creditors

It is the group's policy to pay suppliers within the payment terms of the contract, which is normally 30 to 60 days, based upon the timely receipt of an accurate invoice.

The average number of days taken to pay suppliers calculated in accordance with the requirements of the Companies Act 1985 is 22 days (2006: 25 days).

Directors and their interests

The directors of the company as at 28 June 2007 are set out on page 3.

Baroness Dean of Thornton-le-Fylde and Andrew White were appointed non-executive directors on 26 July 2006. Lord Brooke of Alverthorpe and Bill Semple resigned as non-executive directors on 25 July 2006. All other directors served throughout the year.

The interests of the directors in the share capital of the parent company, through their participation in the Employee Share Plan, are set out on page 45.

None of the directors has, or has had, a material interest in any contract of significance in relation to the company's business.

Directors' responsibilities

The directors are responsible for preparing the Annual Report and the Accounts. The directors have prepared the Accounts for both the group and the company in accordance with International Financial Reporting Standards (IFRS).

International Accounting Standard 1 requires that financial statements present fairly for each financial year the company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards.

Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company and group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a directors' report and directors' remuneration report which comply with the requirements of the Companies Act 1985.

Each of the directors at the date of approval of this report confirms that so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

Auditors

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors and a resolution to re-appoint them will be proposed at the Annual General Meeting.

By order of the Board



Richard Churchill-Coleman
Secretary
28 June 2007

Independent auditors' report to the members of NATS Holdings Limited

We have audited the group and parent company financial statements (the "financial statements") of NATS Holdings Limited for the year ended 31 March 2007 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash flow statement, the statement of accounting policies and the related notes 1 to 29 of the group and 1 to 9 of the parent company. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view, in accordance with the relevant financial

reporting framework, and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report and the other information contained in the annual report for the above year as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the directors' report and other information contained in the annual report as described in the contents section.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and 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 financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 March 2007 and of the group's profit for the year then ended;
- the individual company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the requirements of the Companies Act 1985, of the state of the individual company's affairs as at 31 March 2007;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Separate opinion in relation to IFRS

As explained in Note 2 to the group financial statements, the group in addition to complying with its legal obligation to comply with IFRSs as adopted by the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion the group financial statements give a true and fair view, in accordance with IFRSs, of the state of the group's affairs as at 31 March 2007 and of its profit for the year then ended.



Deloitte & Touche LLP

Chartered Accountants and Registered Auditors
Southampton, United Kingdom
28 June 2007

Consolidated accounts

Consolidated accounts

Consolidated income statement for the year ended 31 March 2007

| | Notes | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--|-------|-----------------------------------|-----------------------------------|
| Revenue | 4 | 701.2 | 686.7 |
| Staff costs | 8 | (335.8) | (322.7) |
| Services and materials | | (70.8) | (63.6) |
| Repairs and maintenance | | (27.7) | (27.0) |
| External research and development | | (0.5) | (0.5) |
| Depreciation, amortisation and impairment | 7 | (89.1) | (91.4) |
| Profit/(loss) on disposal of non-current assets | | 8.5 | (1.3) |
| Other operating charges | | (46.4) | (47.6) |
| Deferred grants released | 7 | 4.6 | 4.6 |
| Net operating costs | | (557.2) | (549.5) |
| Operating profit | 7 | 144.0 | 137.2 |
| Investment revenue | 9 | 8.0 | 7.3 |
| Finance costs | 10 | (57.6) | (64.2) |
| Profit before tax | | 94.4 | 80.3 |
| Tax | 11 | (25.0) | (22.9) |
| Profit for the year attributable to equity shareholders | | 69.4 | 57.4 |

All revenue and profit from operations have been derived from continuing operations.

Consolidated statement of recognised income and expense for the year ended 31 March 2007

| | Notes | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|---|-------|-----------------------------------|-----------------------------------|
| Actuarial gain on defined benefit pension scheme net of deferred tax | 23 | 36.8 | 116.1 |
| Change in fair value of hedging derivatives net of deferred tax | 23 | (0.2) | (1.3) |
| Net income recognised directly in equity | | 36.6 | 114.8 |
| Transfer to income statement on cash flow hedges net of deferred tax | 23 | 1.9 | 3.3 |
| Profit for the year | 23 | 69.4 | 57.4 |
| Total recognised income and expense for the year attributable to equity shareholders | | 107.9 | 175.5 |

Consolidated accounts

Consolidated balance sheet at 31 March 2007

| | Notes | 2007 £m | 2006 £m |
|----------------------------------|-------|------------|------------|
| Assets | | | |
| Non-current assets | | | |
| Goodwill | 13 | 351.0 | 351.0 |
| Other intangible assets | 14 | 92.7 | 79.2 |
| Property, plant and equipment | 15 | 571.8 | 534.3 |
| Retirement benefit asset | 27 | 238.6 | 207.0 |
| Trade and other receivables | 16 | 4.8 | 0.3 |
| | | 1,258.9 | 1,171.8 |
| Current assets | | | |
| Trade and other receivables | 16 | 125.6 | 119.1 |
| Short term investments | 16 | 18.4 | 19.0 |
| Cash and cash equivalents | 16 | 160.6 | 141.8 |
| | | 304.6 | 279.9 |
| Total assets | | 1,563.5 | 1,451.7 |
| Current liabilities | | | |
| Trade and other payables | 20 | (117.7) | (121.3) |
| Current tax liabilities | | (9.1) | (17.2) |
| Derivative financial instruments | 18 | (51.4) | (53.7) |
| | | (178.2) | (192.2) |
| Net current assets | | 126.4 | 87.7 |
| Non-current liabilities | | | |
| Borrowings | 17 | (756.3) | (759.3) |
| Trade and other payables | 20 | (10.5) | (13.8) |
| Deferred tax liability | 19 | (143.5) | (119.1) |
| Provisions | 20 | - | (0.2) |
| | | (910.3) | (892.4) |
| Total liabilities | | (1,088.5) | (1,084.6) |
| Net assets | | 475.0 | 367.1 |
| Equity | | | |
| Called up share capital | 21 | 140.6 | 140.6 |
| Share premium account | 22 | 0.4 | 0.4 |
| AESOP reserve | 23 | (0.3) | (0.3) |
| Hedging reserve | 23 | (0.2) | (1.9) |
| Other reserves | 23 | (34.7) | (34.7) |
| Retained earnings | 23 | 369.2 | 263.0 |
| Total equity | | 475.0 | 367.1 |

The financial statements were approved by the Board of Directors on 28 June 2007 and signed on its behalf by

John Devaney Chairman

Nigel Fotherby Finance Director

Consolidated accounts

Consolidated cash flow statement for the year end 31 March 2007

| | Notes | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--|-------|-----------------------------------|-----------------------------------|
| Net cash from operating activities | 24 | 214.7 | 221.7 |
| Cash flows from investing activities | | | |
| Interest received | | 8.0 | 7.6 |
| Purchase of property, plant and equipment and other intangible assets | | (149.1) | (157.4) |
| Proceeds on disposal of property, plant and equipment | | 7.8 | 0.5 |
| Changes in short term investments | | 0.6 | 1.6 |
| Net cash outflow from investing activities | | (132.7) | (147.7) |
| Cash flows from financing activities | | | |
| Interest paid | | (56.8) | (44.0) |
| Bank loans repaid | | - | (30.3) |
| Unsecured loan notes repaid | | (0.4) | (4.0) |
| Secured loan notes repaid | | (1.3) | (4.7) |
| Loan from shareholder | | (2.2) | 2.1 |
| Dividends paid | | (2.5) | (5.0) |
| Net cash outflow from financing activities | | (63.2) | (85.9) |
| Increase/(decrease) in cash and cash equivalents during the year | | 18.8 | (11.9) |
| Cash and cash equivalents at 1 April | | 141.8 | 153.7 |
| Cash and cash equivalents at 31 March | | 160.6 | 141.8 |
| Net Debt (representing borrowings net of cash and short term investments) | | (577.3) | (598.5) |

Notes forming part of the consolidated accounts

1. General information

NATS Holdings Limited is a private limited company incorporated under the Companies Act 1985 and domiciled in the United Kingdom. The address of the registered office is on page 3. The nature of the group's operations and its principal activities are set out in the Directors' Report and in the review of operations.

These financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the group operates.

2. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the group's financial statements.

Basis of preparation and accounting

The financial information has been prepared in accordance with International Financial Reporting Standards (IFRSs). The financial statements have also been prepared in accordance with IFRSs and International Financial Reporting Interpretation Committee (IFRIC) interpretations as endorsed by the European Union and therefore the group financial statements comply with Article 4 of the EU IAS Regulation.

The impact of new standards or interpretations issued but not effective has been considered and no change in accounting policies is necessary.

The financial information has been prepared on the historical cost basis. The principal accounting policies adopted are set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the company and entities controlled by the company (its subsidiaries). Control is achieved where the company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Operating profit

Operating profit is stated after charging restructuring costs but before investment income and finance costs.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods

or services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Revenue is recognised as follows:

- Income from the rendering of services is recognised when the outcome can be reliably estimated and then by reference to the stage of completion of the transaction at the balance sheet date and in accordance with NATS (En Route) plc's air traffic services licence and airports and other contracts. Amounts receivable include revenue allowed under the charge control conditions of the air traffic services licence.
- Sales of goods are recognised when they are delivered and title has passed.
- Revenue from construction contracts is recognised in accordance with the group's accounting policy on construction contracts.
- Interest income is recognised on a time-proportion basis using the effective interest method. This is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.
- Dividend income is recognised when the shareholder's rights to receive payment have been established.

Goodwill

Goodwill in relation to NATS (En Route) plc, being the excess of consideration over the values of the net assets acquired at the date of the Public Private Partnership (PPP), is recognised as an

asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. For the purpose of impairment testing NATS assesses the carrying value of goodwill against the recoverable amount of the cash generating unit to which goodwill has been allocated (NATS (En Route) plc). Where the recoverable amount is less than the carrying value, the impairment loss is allocated to goodwill.

Recoverable amount is the higher of net realisable value and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using the pre-tax nominal regulated rate of return.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other items are classified as operating leases. Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

Notes forming part of the consolidated accounts

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any provision for impairments in value. The cost of property, plant and equipment includes internal and contracted labour costs directly attributable to bringing the assets into working condition for their intended use. Depreciation is provided on a straight-line basis to write off the cost, less estimated residual value of property, plant and equipment over their estimated useful lives as follows:

- Leasehold land: over the term of the lease.
- Freehold buildings: 10–30 years.
- Leasehold buildings: over the remaining life of the lease to a maximum of 20 years.
- Air traffic control systems: 8–15 years.
- Plant and other equipment: 3–10 years.
- Furniture, fixtures and fittings: 10 years.
- Vehicles: 5 years.

Freehold land and assets in the course of construction and installation are not depreciated. The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in income.

Deferred grants and other contributions to property, plant and equipment

Government grants as contributions to non-current assets are treated as deferred income which is credited to the income statement by equal annual instalments over the expected useful economic lives of the related assets.

Grants of a revenue nature are credited to income in the period to which they relate.

Internally-generated intangible assets – research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from the group's development activities is recognised only if all of the following conditions are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Internally-generated intangible assets are amortised on a straight-line basis over their useful lives, typically over 3 to 12 years. Assets in the course of construction are not amortised. Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the group reviews the carrying amounts of its tangible and intangible assets, including those in the course of construction, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of net realisable value less costs to sell and the value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using the pre-tax nominal regulated rate of return.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss on an intangible or tangible asset, excluding goodwill, subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in the income statement immediately.

Emissions allowances

Consistent with the withdrawal of IFRIC 3, emissions allowances previously recognised at a valuation are now recognised at cost. Emission allowances granted for free are recognised at zero value on the balance sheet as an intangible asset. As carbon is produced and an obligation to submit allowances arises, a provision is created. The provision is measured at book value ("zero" or carrying amount of purchased emission certificates) of the recognised emission certificates. If there is an obligation that is not covered by allowances already on the balance sheet, the corresponding provision made is measured at current market prices.

Amounts recoverable on contracts

Where the outcome of a contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Share based payments

In 2001, the company established an All-Employee Share Ownership Plan for the benefit of its employees to hold 5% of the share capital of NATS Holdings Limited. The Plan was initially established through the transfer of shares by the Crown Shareholder at the PPP to NATS Employee Sharetrust Limited (NESL) for £nil consideration. Following financial restructuring in March 2003, further shares were transferred to NESL by The Airline Group (AG) for £nil consideration and NESL was gifted cash of £279,264 to acquire

additional shares to maintain the Plan's interest at 5% of the share capital of NATS Holdings Limited. The Plan is administered by NESL, a trustee company. The employee ordinary shares may only be owned by employee shareholders and can only be sold to the trust company.

The group has applied the requirements of IFRS 2 Share-based payments.

The cost of performance related awards to employees that take the form of rights to acquire or receive shares is recognised over the period of the employees' related performance. The cost is recognised over the period from gift or grant to when the employee becomes unconditionally entitled to the shares. In respect of the award schemes the company provides finance to NESL to enable the trust company to meet its obligations to repurchase vested or eligible shares from employees.

The costs of running the employee share trust are charged to the income statement.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

Current tax is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying values of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Notes forming part of the consolidated accounts

The carrying value of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Deferred tax in the income statement tax is charged or credited, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Foreign currency translation

Transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are translated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Gains and losses arising on retranslation are included in the income statement for the period.

In order to hedge its exposure to certain foreign exchange risks, the group enters into forward contracts (see below for details of the group's accounting policies in respect of such derivative financial instruments).

Retirement benefit costs

The company has entered into a deed of Pension Fund adherence with the CAA and the Trustees of the Civil Aviation Authority Pension Scheme whereby the company was admitted to participate in the Civil Aviation Authority Pension Scheme from 1 April 1996. At 31 March 2001, the business of NATS was separated from the CAA. As a consequence, NATS has become a 'non associated employer' which requires the assets relating to the liabilities of NATS active employees at 31 March 2001 to be separately identified within the Pension Scheme. The Pension Scheme has been divided into two sections to accommodate this and a series of common investment funds established in which both sections participate for investment purposes.

The Civil Aviation Authority Pension Scheme is a funded defined benefit scheme providing benefits based on final pensionable pay. The assets of the scheme are held in a separate trustee administered fund. Pension costs are assessed in accordance with the advice of a qualified actuary using the Projected Unit Credit Method. Actuarial valuations are carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and presented in the statement of recognised income and expense.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the balance sheet represents the fair value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the scheme.

Financial instruments

Financial assets and financial liabilities are recognised on the group's balance sheet when the group becomes a party to the contractual provisions of the instrument.

Trade receivables and trade payables

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. Trade payables are not interest bearing and are stated at their nominal value.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

Bank and other borrowings, loan notes and debt securities

Interest-bearing bank loans, other borrowings, loan notes and debt securities are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis in the income statement using the effective interest rate method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Equity instruments

Equity instruments issued by the company are recorded at the proceeds received, net of direct issue costs.

Provisions

Provisions are recognised when the group has a present obligation as a result of a past event, and it is probable that the group will be required to settle that obligation. Provisions are measured at the directors' best estimate of expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

Derivative financial instruments and hedging activities

The group's activities expose it primarily to the financial risks of changes in interest rates, inflation and foreign currency exchange rates. The group uses interest rate swap contracts and forward exchange contracts to hedge these exposures. Under IFRS derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently measured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

The use of financial derivatives is governed by the group's policies approved by the board of directors, which provides written principles on the use of financial derivatives. The group documents at the inception of the transaction the relationship between hedging instruments and the hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. The group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognised directly in equity are reclassified into the income statement in the same period or periods during which the asset acquired or liability assumed affects profit or loss. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recycled to the income statement in the same period in which the hedged item affects the income statement.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedging transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net income or expense for the period.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the income statement.

Notes forming part of the consolidated accounts

3. Critical judgements and key sources of estimation uncertainty

Impairment of goodwill, intangible and tangible assets

In carrying out impairment reviews of goodwill, intangible and tangible assets, a number of significant assumptions have to be made when preparing cash flow projections and assessing net realisable values. These include air traffic growth, service performance, future cash flows, the value of the regulated asset base, market premiums for regulated businesses and future regulatory price control determinations. If actual results should differ or changes in expectations arise, impairment charges may be required which would materially impact on operating results. A reduction in value in use or net realisable value of 2% would result in these being equal to the carrying amount of goodwill. Refer to notes 13, 14 and 15.

Retirement benefits

The group accounts for its defined benefit pension scheme such that the net pension scheme asset is reported on the balance sheet with actuarial gains and losses being recognised directly in equity through the statement of recognised income and expense.

4. Revenue

An analysis of the Group's revenue is provided as follows:

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|-------------------------------------|-----------------------------------|-----------------------------------|
| UK air traffic services | 552.2 | 551.9 |
| North Atlantic air traffic services | 22.5 | 21.6 |
| Airport air traffic services | 119.4 | 109.9 |
| Miscellaneous services | 7.1 | 3.3 |
| | 701.2 | 686.7 |

All revenue is derived from continuing operations. Note 5 summarises the source of revenues by business and geographical segment. Other revenue is described on the face of the income statement and included in note 9.

A number of key assumptions have been made in calculating the fair value of the group's defined benefit pension scheme which affect the balance sheet asset and the group's reserves and income statement. Refer to note 27 of the notes to the consolidated accounts for a summary of the main assumptions. Actual outcomes may differ materially from the assumptions used and may result in volatility in the net pension scheme asset.

Capital investment programme

The group is undertaking a significant capital investment programme to upgrade existing air traffic control infrastructure and to rationalise the number of air traffic control centres. This programme requires the group to enter into substantial contracts for the development of infrastructure assets and information systems. Whilst covered by contractual arrangements, it is in the nature of such complex projects that, from time to time, variations to the original specifications may necessitate the renegotiation of original contract scope or price and affect amounts reported in these accounts.

5. Business and geographical segments

Business segments

For management reporting purposes, the group is currently organised into four business areas. These areas are the basis on which the group reports its primary segmental information. Secondary segmental analysis is based on the geographical location of the group's customers.

Principal activities are as follows:

UK air traffic services provide en-route air traffic services within UK air space, air traffic services for helicopters operating in the North Sea, approach services for London airports and services to the Ministry of Defence. North Atlantic air traffic services provide en-route air traffic services for the North Atlantic, including an altitude calibration service. These two segments represent the regulated business. Airport air traffic services include air traffic control and engineering services provided at airports and miscellaneous services include air traffic consultancy and training services.

Inter-segment transfers are allocated to business segments on the basis of a fair allocation of costs taking into account the most important drivers for the services provided.

Segment information about these businesses is presented below.

| Year ended 31 March 2007 | UK air traffic services £m | North Atlantic air traffic services £m | Airport air traffic services £m | Miscellaneous services £m | Total £m |
|--|----------------------------------|--|---------------------------------------|---------------------------------|-------------|
| Revenue | | | | | |
| Revenue from external customers | 552.2 | 22.5 | 119.4 | 7.1 | 701.2 |
| Segment result | 124.8 | 4.3 | 14.7 | 0.2 | 144.0 |
| Operating profit | | | | | 144.0 |
| Investment revenue | | | | | 8.0 |
| Finance costs | | | | | (57.6) |
| Profit before tax | | | | | 94.4 |
| Tax | | | | | (25.0) |
| Profit for the period | | | | | 69.4 |
| Other information | | | | | |
| Capital expenditure | 135.1 | 2.1 | 4.0 | - | 141.2 |
| Depreciation and amortisation | 72.7 | 1.8 | 2.1 | - | 76.6 |
| Impairment losses recognised in income | 12.5 | - | - | - | 12.5 |
| Deferred grants released | 4.6 | - | - | - | 4.6 |
| Balance Sheet | | | | | |
| Assets | | | | | |
| Segment assets | 1,404.7 | 42.7 | 110.5 | 5.6 | 1,563.5 |
| Liabilities | | | | | |
| Segment liabilities | (994.8) | (33.9) | (58.6) | (1.2) | (1,088.5) |

Segment assets include property, plant and equipment, intangible assets, retirement benefit asset, work in progress, trade receivables and other current assets. Segment liabilities comprise trade payables, accruals and deferred income, borrowings and other short term liabilities.

Notes forming part of the consolidated accounts

5. Business and geographical segments (continued)

| Year ended 31 March 2006 | UK air traffic services £m | North Atlantic air traffic services £m | Airport air traffic services £m | Miscellaneous services £m | Total £m |
|--|-------------------------------|---|------------------------------------|------------------------------|-------------|
| Revenue | | | | | |
| Revenue from external customers | 551.9 | 21.6 | 109.9 | 3.3 | 686.7 |
| Segment result | 121.7 | 3.4 | 13.0 | (0.9) | 137.2 |
| Operating profit | | | | | 137.2 |
| Investment revenue | | | | | 7.3 |
| Finance costs | | | | | (64.2) |
| Profit before tax | | | | | 80.3 |
| Tax | | | | | (22.9) |
| Profit for the period | | | | | 57.4 |
| Other Information | | | | | |
| Capital expenditure | 158.2 | 5.3 | 3.9 | - | 167.4 |
| Depreciation and amortisation | 72.4 | 1.3 | 1.8 | - | 75.5 |
| Impairment losses recognised in income | 15.6 | 0.3 | - | - | 15.9 |
| Deferred grants released | 4.6 | - | - | - | 4.6 |
| Balance Sheet | | | | | |
| Assets | | | | | |
| Segment assets | 1,324.1 | 42.9 | 82.8 | 1.9 | 1,451.7 |
| Liabilities | | | | | |
| Segment liabilities | (1,022.7) | (31.8) | (29.5) | (0.6) | (1,084.6) |

Segment assets include property, plant and equipment, intangible assets, retirement benefit asset, work in progress, trade receivables and other current assets. Segment liabilities comprise trade payables, accruals and deferred income, borrowings and other short term liabilities.

Geographical segments

The following table provides an analysis of the Group's revenue by geographical area, based on the geographical location of its customers:

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|----------------|-----------------------------------|-----------------------------------|
| UK | 347.1 | 351.6 |
| Rest of Europe | 208.4 | 193.6 |
| North America | 104.7 | 102.8 |
| Other | 41.0 | 38.7 |
| Total | 701.2 | 686.7 |

Capital expenditure and Group assets are all located within the UK.

6. Restructuring costs

During the year further restructuring costs were incurred due to the ongoing relocation of the Group's activities to the Swanwick area. To the extent that staff could not be redeployed, termination terms were agreed. These costs are included in arriving at operating profit (see note 8a).

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--|-----------------------------------|-----------------------------------|
| Cost of relocation of staff and offices to Swanwick area | 2.3 | 3.9 |
| Voluntary redundancy costs | 2.4 | 3.4 |
| | 4.7 | 7.3 |

7. Profit for the year

Profit for the year has been arrived at after charging (crediting):

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--|-----------------------------------|-----------------------------------|
| CAA regulatory charges | 4.2 | 4.4 |
| Depreciation of property, plant and equipment | 70.1 | 70.1 |
| Impairment of property, plant and equipment | 2.0 | 10.4 |
| Amortisation of internally generated intangible assets | 6.5 | 5.4 |
| Impairment of internally generated intangible assets | 10.5 | 5.5 |
| Deferred grants released | (4.6) | (4.6) |
| Research and development costs | 10.9 | 8.9 |
| Auditors' remuneration for audit services (see below) | 0.2 | 0.2 |

The analysis of auditors' remuneration is as follows:

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|---|-----------------------------------|-----------------------------------|
| Fees payable to the company's auditors for the audit of the company's annual accounts | - | - |
| Fees payable to the company's auditors and their associates for other services to the group | | |
| - The audit of the company's subsidiaries pursuant to legislation | 0.2 | 0.2 |
| Total audit fees | 0.2 | 0.2 |
| - Tax services | 0.1 | 0.1 |
| - All other services | 0.1 | 0.1 |
| Total non-audit fees | 0.2 | 0.2 |
| | 0.4 | 0.4 |

Government grants relating to the purchase of property, plant and equipment and Ministry of Defence contributions received prior to 1 April 2001 are treated as deferred income which is credited to the income statement by equal annual instalments over the expected useful lives of the related assets.

Notes forming part of the consolidated accounts

8. Staff costs

| a Staff costs | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|---|-----------------------------------|-----------------------------------|
| Salaries and staff costs, including directors' remuneration, were as follows: | | |
| Wages and salaries* | 290.1 | 272.4 |
| Social security costs | 29.0 | 27.1 |
| Pension costs (note 8b) | 53.5 | 58.9 |
| | 372.6 | 358.4 |
| Less: amounts capitalised | (36.8) | (35.7) |
| | 335.8 | 322.7 |

*Includes redundancy costs (note 6), share based payment charges, time off in lieu of extra hours worked, allowances and holiday pay.

| b Pension costs | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|---|-----------------------------------|-----------------------------------|
| Pension scheme costs for year (note 27) | 53.5 | 57.2 |
| Other pension costs | - | 1.7 |
| | 53.5 | 58.9 |

c Staff numbers

| | Year ended 31 March 2007 No. | Year ended 31 March 2006 No. |
|--|------------------------------------|------------------------------------|
| The monthly average number of employees (including executive directors) was: | | |
| Air traffic controllers | 1,978 | 1,925 |
| Air traffic service assistants | 1,095 | 1,061 |
| Engineers | 1,182 | 1,211 |
| Others | 902 | 879 |
| | 5,157 | 5,076 |

9. Investment revenue

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|---------------------------|-----------------------------------|-----------------------------------|
| Interest on bank deposits | 8.0 | 7.3 |

10. Finance costs

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--|-----------------------------------|-----------------------------------|
| Interest payable | | |
| Interest on bank overdrafts, loans and hedging instruments | 1.1 | 4.2 |
| Interest on shareholder loan notes | 16.1 | 16.3 |
| Bond and related costs including financing expenses | 29.8 | 29.8 |
| Other | 0.2 | 0.3 |
| | 47.2 | 50.6 |
| Loss on derivatives not qualifying for hedge accounting | 10.5 | 9.7 |
| Gains on derivatives not qualifying for hedge accounting | (2.7) | - |
| Fair value losses on interest rate swaps transferred from equity (note 18) | 2.6 | 3.9 |
| | 57.6 | 64.2 |

11. Tax

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--|-----------------------------------|-----------------------------------|
| Current tax (including a credit of £0.7m in respect of prior years, 2006: £1.8m) | (17.1) | (31.2) |
| Deferred tax (note 19) | (7.9) | 8.3 |
| | (25.0) | (22.9) |

Corporation tax is calculated at 30% (2006: 30%) of the estimated assessable profit for the year.

| The charge for the year can be reconciled to the profit per the income statement as follows: | Year ended 31 March 2007 £m | % | Year ended 31 March 2006 £m | % |
|--|-----------------------------------|------|-----------------------------------|------|
| Profit on ordinary activities before tax | 94.4 | | 80.3 | |
| Tax on profit on ordinary activities at standard rate in the UK of 30% | (28.3) | (30) | (24.1) | (30) |
| Tax effect of prior year adjustments | 0.7 | 1 | 1.8 | 2 |
| Other permanent differences | 2.6 | 3 | (0.6) | (1) |
| Tax charge for year at the effective tax rate of 26.5% (2006: 28.6%) | (25.0) | (27) | (22.9) | (29) |
| Deferred tax charge taken directly to equity (see note 19) | (16.5) | | (50.6) | |

Proposed budget changes

The proposed change to the corporation tax rate from 30% to 28% from April 2008 is likely to give the group an effective tax rate of approximately 28%. The proposed changes to capital allowances will not materially affect the effective tax rate.

12. Dividends

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|---|-----------------------------------|-----------------------------------|
| Amounts recognised as dividends to equity shareholders in the year | | |
| Interim dividend for the year of nil pence per ordinary share (2006: 1.75p) | - | 2.5 |

Notes forming part of the consolidated accounts

13. Goodwill

| | £m |
|------------------------------------|-------|
| Carrying amount | |
| At 31 March 2007 and 31 March 2006 | 351.0 |

The company tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

The carrying value is determined by reference to value in use calculations and the net realisable value of the regulated asset bases of NATS (EnRoute) plc's business segments, including market premiums for regulated businesses. The key assumptions for value in use calculations are the discount rate, future cash flows to the end of the second regulatory control period (31 December 2010 for UK air traffic services and 31 March 2011 for North Atlantic air traffic services) as assumed in the group's business plans, and a terminal value at that date, reflecting the regulated asset bases and market premiums. The discount rate is a pre-tax nominal rate of 9.75%.

14. Other intangible assets

| | Operational software £m | Non-operational software £m | Airspace and resectorisation £m | Assets in course of construction £m | Other intangibles £m | Total £m |
|---|----------------------------|--------------------------------|------------------------------------|--|-------------------------|--------------|
| Cost | | | | | | |
| At 1 April 2005 | 11.5 | 4.3 | 4.9 | 44.4 | - | 65.1 |
| Additions internally generated | 1.3 | 0.3 | 0.5 | 14.6 | - | 16.7 |
| Additions externally acquired | 0.1 | 0.1 | 0.1 | 13.3 | 0.6 | 14.2 |
| Transfers | 7.8 | 3.3 | 1.3 | (13.3) | - | (0.9) |
| At 1 April 2006 | 20.7 | 8.0 | 6.8 | 59.0 | 0.6 | 95.1 |
| Additions internally generated | 0.5 | 0.2 | 1.0 | 14.2 | - | 15.9 |
| Additions externally acquired | 0.9 | 0.4 | - | 18.3 | - | 19.6 |
| Disposals and transfers during the year | 13.0 | 3.7 | 3.0 | (25.2) | (0.6) | (6.1) |
| At 31 March 2007 | 35.1 | 12.3 | 10.8 | 66.3 | - | 124.5 |
| Accumulated amortisation | | | | | | |
| At 1 April 2005 | 1.3 | 2.0 | 0.8 | 0.1 | - | 4.2 |
| Charge for the year | 2.5 | 1.6 | 1.3 | - | - | 5.4 |
| Provisions for impairment | - | - | - | 5.5 | - | 5.5 |
| Transfers | (0.2) | - | - | 1.0 | - | 0.8 |
| At 1 April 2006 | 3.6 | 3.6 | 2.1 | 6.6 | - | 15.9 |
| Charge for the year | 3.1 | 1.9 | 1.5 | - | - | 6.5 |
| Provisions for impairment | - | - | - | 10.5 | - | 10.5 |
| Disposals and transfers during the year | - | - | - | (1.1) | - | (1.1) |
| At 31 March 2007 | 6.7 | 5.5 | 3.6 | 16.0 | - | 31.8 |
| Carrying amount | | | | | | |
| At 31 March 2007 | 28.4 | 6.8 | 7.2 | 50.3 | - | 92.7 |
| At 31 March 2006 | 17.1 | 4.4 | 4.7 | 52.4 | 0.6 | 79.2 |

15. Property, plant and equipment

| | Freehold land & buildings £m | Improvements to leasehold land & buildings £m | Air traffic control systems, plant and equipment £m | Vehicles, furniture & fittings £m | Assets in course of construction and installation £m | Total £m |
|--|---------------------------------|--|--|--------------------------------------|---|----------------|
| Cost | | | | | | |
| At 1 April 2005 | 156.3 | 51.4 | 866.8 | 8.9 | 126.8 | 1,210.2 |
| Additions during the year | - | 0.2 | 7.6 | 0.2 | 128.5 | 136.5 |
| Disposals during the year | (0.3) | (0.1) | (22.9) | (0.4) | (6.4) | (30.1) |
| Other transfers during the year | 1.8 | 0.2 | 35.1 | (0.1) | (36.1) | 0.9 |
| At 1 April 2006 | 157.8 | 51.7 | 886.8 | 8.6 | 212.8 | 1,317.5 |
| Additions during the year | 6.7 | 0.3 | 26.1 | 2.6 | 70.0 | 105.7 |
| Disposals during the year | (2.7) | - | (3.3) | (0.8) | (14.6) | (21.4) |
| Other transfers during the year | 56.7 | 3.8 | 68.2 | 3.7 | (128.2) | 4.2 |
| At 31 March 2007 | 218.5 | 55.8 | 977.6 | 14.1 | 140.0 | 1,406.0 |
| Accumulated depreciation and impairment | | | | | | |
| At 1 April 2005 | 63.7 | 34.5 | 615.7 | 5.0 | 14.0 | 732.9 |
| Provided during the year | 4.7 | 2.2 | 62.5 | 0.7 | - | 70.1 |
| Provisions for impairment | - | - | - | - | 10.4 | 10.4 |
| Utilisation of impairment provision | - | - | - | - | (6.5) | (6.5) |
| Disposals and transfers during the year | (0.3) | (0.1) | (21.5) | (0.4) | (1.4) | (23.7) |
| At 1 April 2006 | 68.1 | 36.6 | 656.7 | 5.3 | 16.5 | 783.2 |
| Provided during the year | 4.2 | 1.9 | 62.7 | 1.3 | - | 70.1 |
| Provisions for impairment | - | - | - | - | 2.0 | 2.0 |
| Utilisation of impairment provision | - | - | 0.1 | - | (0.1) | - |
| Disposals and transfers during the year | (2.6) | 0.1 | (3.4) | (0.8) | (14.4) | (21.1) |
| At 31 March 2007 | 69.7 | 38.6 | 716.1 | 5.8 | 4.0 | 834.2 |
| Carrying amount | | | | | | |
| At 31 March 2007 | 148.8 | 17.2 | 261.5 | 8.3 | 136.0 | 571.8 |
| At 31 March 2006 | 89.7 | 15.1 | 229.9 | 3.3 | 196.3 | 534.3 |

The group conducts annual reviews of the carrying values of its property, plant, equipment and other intangible assets. During the year, impairment charges of £12.5m (2006: £15.9m) were made in respect of assets in the course of construction reflecting a reassessment of certain projects and the likelihood of benefits being realised in full.

Notes forming part of the consolidated accounts

16. Financial assets and trade and other receivables

Trade and other receivables

The group had balances in respect of other financial assets as follows:

| | 2007 £m | 2006 £m |
|-------------------------------------|------------|------------|
| Non-current | | |
| Other debtors | 2.8 | 0.3 |
| Accrued income | 2.0 | - |
| | 4.8 | 0.3 |
| Current | | |
| Receivable from customers | 47.0 | 44.3 |
| Amounts recoverable under contracts | 2.4 | 4.7 |
| Other debtors | 5.5 | 8.1 |
| Prepayments | 13.6 | 9.9 |
| Accrued income | 57.0 | 52.0 |
| Accrued interest | 0.1 | 0.1 |
| | 125.6 | 119.1 |

The average credit period taken on sales of services is 25 days. Interest is charged by Eurocontrol to UK en route customers at 8.13% on balances outstanding after more than 30 days. An allowance has been made for estimated irrecoverable amounts from sales to customers of £4.0m (2006: £3.9m). This amount has been determined by reference to past default experience. All other balances are non-interest bearing.

Bank balances and cash

Cash and cash equivalents comprise cash held by the group and short-term bank deposits with an original maturity of three months or less. The directors consider that the carrying amount of these assets approximates to their fair value.

The group's cash and short term deposits were as follows:

| 2007 | | | | Short term deposits | | | Total |
|----------|--------------|------------------------------------|-----------------------------|---------------------|------------------------------------|-----------------------------|-------------|
| Currency | Cash | | | Amount £m | Effective interest rate % | Average maturity days | Total £m |
| | Amount £m | Effective interest rate % | Average maturity days | | | | |
| Sterling | 136.5 | 5.3 | 5 | 18.4 | 5.6 | 182 | 154.9 |
| EUR | 21.6 | 2.8 | 10 | - | - | - | 21.6 |
| USD | 1.2 | 5.3 | 10 | - | - | - | 1.2 |
| CAD | 1.3 | 4.1 | 12 | - | - | - | 1.3 |
| | 160.6 | | | 18.4 | | | 179.0 |

| 2006 | | | | Short term deposits | | | Total |
|----------|--------------|------------------------------------|-----------------------------|---------------------|------------------------------------|-----------------------------|-------------|
| Currency | Cash | | | Amount £m | Effective interest rate % | Average maturity days | Total £m |
| | Amount £m | Effective interest rate % | Average maturity days | | | | |
| Sterling | 128.0 | 4.6 | 11 | 19.0 | 4.6 | 182 | 147.0 |
| EUR | 10.1 | 2.5 | 6 | - | - | - | 10.1 |
| USD | 1.5 | 4.7 | 19 | - | - | - | 1.5 |
| CAD | 1.2 | 3.7 | 19 | - | - | - | 1.2 |
| NOK | 1.0 | 2.5 | 19 | - | - | - | 1.0 |
| | 141.8 | | | 19.0 | | | 160.8 |

16. Financial assets and trade and other receivables – Continued

Included in cash is a Liquidity Reserve Account balance of £21.3m held to provide liquidity in the event of certain pre-defined circumstances particularly to ensure compliance with financial covenants. The sterling short term deposit reflects the Debt Service Reserve Account balance of £18.4m to fund interest and fees scheduled for payment in the next six months.

Credit risk

The group's principal financial assets are bank balances and cash, trade and other receivables and short term investments. The directors consider that the carrying amount of these assets approximates to their fair value.

The group's credit risk is primarily attributable to its trade receivables, mitigated in part by regulatory price control conditions. Based on previous experience the amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which is evidence of a reduction in the recoverability of the cash flows.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies. Credit risk associated with the investment of surplus funds and from the use of interest rate and currency hedging derivatives is managed by setting limits for each counterparty based on its credit rating. An aggregate limit covering all transactions is also established for each counterparty.

The group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers. Overall, the maximum credit risk for the items discussed above would be £309.4m (2006: £280.2m).

17. Borrowings

| | 2007 £m | 2006 £m |
|--|------------|------------|
| Unsecured loans | | |
| Fixed rate unsecured shareholder loan notes (8.5% interest rate, repayable 2031) | 53.6 | 54.0 |
| Loan from The Airline Group (see note 28) | - | 2.2 |
| Total unsecured loans | 53.6 | 56.2 |
| Secured loans | | |
| £600m 5.25% Guaranteed Secured Amortising Bonds due 2026 | 596.9 | 596.6 |
| Fixed rate secured shareholder loan notes (8.5% interest rate, repayable 2031) | 48.7 | 50.0 |
| Fixed rate secured shareholder loan notes (11.3575%, no final maturity date) | 65.0 | 65.0 |
| Total secured loans | 710.6 | 711.6 |
| Gross borrowings | 764.2 | 767.8 |
| Unamortised bond issue costs | (7.9) | (8.5) |
| | 756.3 | 759.3 |

The £600m 5.25% Guaranteed Secured Amortising Bond and the 11.3575% shareholder loan notes of £65m are secured by way of a debenture by which NATS (En Route) plc grants its lenders a first legal mortgage over certain properties in England and Wales, a first fixed charge over all other real estate, plant and equipment and a floating charge over all other assets. Any drawings by NERL under its £216.2m bank facilities (presently undrawn) would be similarly secured. NATS Ltd has in issue £48.7m of 8.5% shareholder loan notes secured by floating charge (which has priority over other security) of up to £95m over its holding of shares in NATS (Services) Limited.

Notes forming part of the consolidated accounts

17. Borrowings – Continued

Maturity of borrowings

| | 2007 | | | 2006 | | |
|--------------------------------|-----------------------|---------------------|-------------|-----------------------|---------------------|-------------|
| | Unsecured loans £m | Secured loans £m | Total £m | Unsecured loans £m | Secured loans £m | Total £m |
| Due between two and five years | - | - | - | - | - | - |
| Due in more than five years | 53.6 | 710.6 | 764.2 | 56.2 | 711.6 | 767.8 |
| Unamortised finance costs | - | (7.9) | (7.9) | - | (8.5) | (8.5) |
| | 53.6 | 702.7 | 756.3 | 56.2 | 703.1 | 759.3 |

Undrawn committed facilities

| | Total £m | Total £m |
|---------------------------------|-------------|-------------|
| Expiring in more than two years | 216.2 | 216.2 |

NSL has an uncommitted overdraft facility of £2m that was undrawn as at 31 March 2007.

Effective interest rate exposure

The effective interest rate exposure of the group's loans was as follows:

Excluding derivatives

| | Total £m | Variable rate £m | Inflation rate £m | Fixed rate £m | Effective interest rate % | Weighted average time for which rate is fixed years |
|---|-------------|------------------------|-------------------------|---------------------|------------------------------------|---|
| At 31 March 2007 | | | | | | |
| Sterling: | | | | | | |
| 8.5% unsecured shareholder loan notes | 53.6 | - | - | 53.6 | 8.50% | 24.0 |
| 5.25% guaranteed secured bonds | 596.9 | - | - | 596.9 | 5.28% | 13.0 |
| 8.5% secured shareholder loan notes | 48.7 | - | - | 48.7 | 8.50% | 24.0 |
| 11.3575% secured shareholder loan notes | 65.0 | - | - | 65.0 | 11.36% | N/A |
| Total | 764.2 | - | - | 764.2 | | |
| At 31 March 2006 | | | | | | |
| Sterling: | | | | | | |
| 8.5% unsecured shareholder loan notes | 54.0 | - | - | 54.0 | 8.50% | 25.0 |
| 5.25% guaranteed secured bonds | 596.6 | - | - | 596.6 | 5.28% | 14.0 |
| 8.5% secured shareholder loan notes | 50.0 | - | - | 50.0 | 8.50% | 25.0 |
| 11.3575% secured shareholder loan notes | 65.0 | - | - | 65.0 | 11.36% | N/A |
| Shareholder loans | 2.2 | 2.2 | - | - | 6.56% | N/A |
| Total | 767.8 | 2.2 | - | 765.6 | | |

17. Borrowings – Continued

Including derivatives

| | Total £m | Variable rate £m | Inflation rate £m | Fixed rate £m | Effective interest rate % | Weighted average time for which rate is fixed years |
|---|-------------|------------------------|-------------------------|---------------------|------------------------------------|---|
| At 31 March 2007 | | | | | | |
| Sterling: | | | | | | |
| 8.5% unsecured shareholder loan notes | 53.6 | - | - | 53.6 | 8.50% | 24.0 |
| 5.25% guaranteed secured bonds | 396.9 | - | - | 396.9 | 5.29% | 13.0 |
| 5.25% guaranteed secured bonds | 200.0 | - | 200.0 | - | 3.37% | N/A |
| 8.5% secured shareholder loan notes | 48.7 | - | - | 48.7 | 8.50% | 24.0 |
| 11.3575% secured shareholder loan notes | 65.0 | - | - | 65.0 | 11.36% | N/A |
| Total | 764.2 | - | 200.0 | 564.2 | | |
| At 31 March 2006 | | | | | | |
| Sterling: | | | | | | |
| 8.5% unsecured shareholder loan notes | 54.0 | - | - | 54.0 | 8.50% | 25.0 |
| 5.25% guaranteed secured bonds | 396.6 | - | - | 396.6 | 5.30% | 14.0 |
| 5.25% guaranteed secured bonds | 200.0 | - | 200.0 | - | 3.23% | N/A |
| 8.5% secured shareholder loan notes | 50.0 | - | - | 50.0 | 8.50% | 25.0 |
| 11.3575% secured shareholder loan notes | 65.0 | - | - | 65.0 | 11.36% | N/A |
| Shareholder loans | 2.2 | 2.2 | - | - | 6.56% | N/A |
| Total | 767.8 | 2.2 | 200.0 | 565.6 | | |

The £65m perpetual fixed rate secured shareholder loan notes were issued by NERL in March 2003 as part of the restructuring of the group's finances that took place following the events of September 11th, 2001. The coupon was set at 11.3575% to ensure that the new investor in the group (BAA plc) earned a satisfactory rate of return on its total investment. The 11.3575% secured shareholder loan notes in NERL are perpetual instruments and accordingly there is no fixed repayment schedule.

Costs associated with the issue of the £600m bond are being amortised over the life of the bond.

Fair value of financial liabilities

| | 2007 | | 2006 | |
|--|------------------|------------------|------------------|------------------|
| | Book value £m | Fair value £m | Book value £m | Fair value £m |
| £600m 5.25% Guaranteed Secured Amortising Bonds due 2026 | (596.9) | (593.1) | (596.6) | (623.0) |
| 8.5% shareholder loan notes | (102.3) | (102.3) | (104.0) | (104.0) |
| 11.3575% shareholder loan notes | (65.0) | (65.0) | (65.0) | (65.0) |
| Loan from shareholder | - | - | (2.2) | (2.2) |
| Total borrowings | (764.2) | (760.4) | (767.8) | (794.2) |
| Total derivative financial instruments (see note 18) | (51.4) | (51.4) | (53.7) | (53.7) |
| Total | (815.6) | (811.8) | (821.5) | (847.9) |

The fair value of the £600m bond represents the estimated cost of repurchasing the bond in the open market at 31 March 2007 prices. The book values of the short term debtors and creditors are considered to be the same as the fair values.

Notes forming part of the consolidated accounts

18. Derivative financial instruments

Fair value of derivative financial instruments

| | 2007 | | 2006 | |
|--|------------------|------------------|------------------|------------------|
| | Book value £m | Fair value £m | Book value £m | Fair value £m |
| Index-linked swaps (not qualifying for hedge accounting) | (50.2) | (50.2) | (39.7) | (39.7) |
| Interest rate swaps (cash flow hedges) | - | - | (13.0) | (13.0) |
| Forward foreign exchange contracts (cash flow hedges) | (1.2) | (1.2) | (1.0) | (1.0) |
| | (51.4) | (51.4) | (53.7) | (53.7) |

The fair value of interest rate swaps is the estimated amount which the group would expect to pay were it to terminate the swap arrangements at the balance sheet date. The fair value of forward exchange contracts represents the unrealised gain or loss on revaluation of the contracts to year end exchange rates and is expected to be realised within one year.

Retail price index swap (RPI swap)

As NERL's revenue is linked to the movement in the retail price index (RPI) an index-linked swap with a notional principal of £200m was entered into whereby NERL receives fixed interest at a rate of 5.25% and pays interest at a rate of 2.98% adjusted for the movement in RPI (the rate payable for the 6 months commencing 31 March 2007 is circa 3.37%). Although not permitted as a hedge under IFRS this provides a good economic hedge of NERL's RPI-linked revenues.

The value of the notional principal of the index-linked swap is linked to movements in RPI. The increase in the notional value is payable semi-annually commencing on 31 March 2017 and ending on 31 March 2026 (the expiry date of the swap).

Interest rate swaps

To eliminate the exposure that NERL had to falling interest rates on its cash balances, in September 2006 the NATS Board adopted a policy of hedging net debt rather than gross debt. In furtherance of this policy the company unwound all the interest rate swaps previously entered into to hedge anticipated bank borrowings at a cost of £10.3m. The fair value of the interest rate swaps at 1 April 2006 was a liability of £13.0m and gain of £2.7m had been recognised during the year. This was offset by a charge of £2.6m for losses deferred in equity which were transferred to the income statement when the interest rate swaps were unwound in February 2007. Hence there was a net gain of £0.1m in 2006/07.

Currency derivatives

The group utilises forward foreign exchange contracts to hedge significant future transactions and cash flows.

The group is a party to a variety of foreign currency forward contracts in the management of its exchange rate exposures. The instruments purchased are primarily denominated in the currency of the group's principal market.

Gains and losses recognised in the hedging reserve in equity on forward foreign exchange contracts as of 31 March 2007 will be released to the income statement at various dates within one year from the balance sheet date.

18. Derivative financial instruments – Continued

Forward contracts

The group had entered into the following forward foreign exchange contracts to sell euro forecast to be received from Eurocontrol and to buy US Dollars (USD) to fund purchases of equipment denominated in US dollars as follows:

| Payment date | 2007 | | | Exchange rate €1 = £ | Payment date | 2006 | | |
|----------------------|-----------------|-----------------------|--|-------------------------|----------------------|-----------------|-----------------------|-------------------------|
| | Euro sold €m | Sterling bought £m | | | | Euro sold €m | Sterling bought £m | Exchange rate €1 = £ |
| 25 April 2007 | 24.5 | 16.3 | | 0.6664 | 19 April 2006 | 23.5 | 16.2 | 0.6892 |
| 25 April 2007 | 24.5 | 16.3 | | 0.6663 | 19 April 2006 | 23.5 | 16.2 | 0.6892 |
| 23 May 2007 | 27.5 | 18.4 | | 0.6707 | 24 May 2006 | 24.0 | 16.5 | 0.6863 |
| 23 May 2007 | 27.5 | 18.4 | | 0.6707 | 24 May 2006 | 24.0 | 16.5 | 0.6863 |
| Total/average | 104.0 | 69.4 | | 0.6680 | Total/average | 95.0 | 65.4 | 0.6888 |

| Payment date | 2007 | | | Exchange rate £1 = \$ | Payment date | 2006 | | |
|----------------------|---------------------|-------------------|--|--------------------------|----------------------|---------------------|-------------------|--------------------------|
| | Sterling sold £m | USD bought \$m | | | | Sterling sold £m | USD bought \$m | Exchange rate £1 = \$ |
| 03 April 2007 | 0.4 | 0.8 | | 1.8452 | - | - | - | |
| 01 Nov 2007 | 0.7 | 1.4 | | 1.8502 | - | - | - | |
| Total/average | 1.1 | 2.2 | | 1.8484 | Total/average | - | - | - |

19. Deferred tax

The following are the major deferred tax assets and liabilities recognised by the group, and movements there on during the current and prior reporting periods.

| | Accelerated tax depreciation £m | Retirement benefit asset £m | Financial instruments £m | Other £m | Total £m |
|---------------------------|---------------------------------------|-----------------------------------|--------------------------------|-------------|-------------|
| At 1 April 2005 | 66.5 | 20.7 | (7.8) | (2.6) | 76.8 |
| Charge/(credit) to income | 1.6 | (8.4) | (1.5) | - | (8.3) |
| Charge to equity | - | 49.8 | 0.8 | - | 50.6 |
| At 31 March 2006 | 68.1 | 62.1 | (8.5) | (2.6) | 119.1 |
| At 1 April 2006 | 68.1 | 62.1 | (8.5) | (2.6) | 119.1 |
| Charge/(credit) to income | 13.6 | (6.2) | (0.8) | 1.3 | 7.9 |
| Charge to equity | - | 15.7 | 0.8 | - | 16.5 |
| At 31 March 2007 | 81.7 | 71.6 | (8.5) | (1.3) | 143.5 |

Notes forming part of the consolidated accounts

19. Deferred tax – Continued

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes.

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--------------------------|-----------------------------------|-----------------------------------|
| Deferred tax liabilities | (153.3) | (130.2) |
| Deferred tax assets | 9.8 | 11.1 |
| | (143.5) | (119.1) |

20. Financial liabilities

(a) Trade and other payables

The group had balances in respect of other non-interest bearing financial liabilities as follows:

| | 2007 £m | 2006 £m |
|------------------------------|------------|------------|
| Current | | |
| Trade payables | 8.5 | 8.5 |
| Other payables | 13.3 | 5.0 |
| Tax and social security | 8.9 | 8.5 |
| Accruals and deferred income | | |
| - deferred grants | 3.6 | 3.8 |
| - other | 83.4 | 93.0 |
| Dividends payable | - | 2.5 |
| | 117.7 | 121.3 |
| Non-current | | |
| Accruals and deferred income | | |
| - deferred grants | 10.5 | 13.8 |
| | 128.2 | 135.1 |

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 22 days. The directors consider that the carrying amount of the trade payables approximates to their fair value.

(b) Provisions

| | 2007 £m | 2006 £m |
|---|------------|------------|
| Reorganisation costs (Swanwick) | - | 0.2 |
| Reorganisation costs were utilised in the year. | | |

21. Share capital

| | Authorised: | | Called up, allotted and fully paid | |
|------------------------------------|------------------|-------|------------------------------------|-------|
| | Number of shares | £m | Number of shares | £m |
| Ordinary shares of £1 each | | | | |
| At 31 March 2007 and 31 March 2006 | 144,100,007 | 144.1 | 131,000,007 | 131.0 |
| Ordinary A shares of 80 pence each | | | | |
| At 31 March 2007 and 31 March 2006 | 54,272,594 | 43.4 | 12,048,193 | 9.6 |
| | | 187.5 | | 140.6 |

One £1 special rights redeemable preference share at 31 March 2007 and 31 March 2006.

Special share

The authorised and issued share capital of NATS Holdings Limited as at 31 March 2007 included one special rights redeemable preference share with a nominal value of £1. This share can only be held by a Minister of the Crown, the Treasury Solicitor or any other person acting on behalf of the Crown. The special shareholder is entitled to attend and speak at meetings. The special share does not carry any rights to vote at general meetings except in the following circumstances:

- alterations to the company's share capital;
- alterations to voting rights of any of the company's shares;
- the removal of any director appointed by a Crown representative.

If an attempt is made to approve any of these events or to pass a resolution to wind up the company at a general meeting, on an ordinary resolution the special shareholder will have no less than one vote more than the total number of all other votes cast and, on a special resolution, he shall have no less than one vote more than 25% of the total votes cast.

22. Share premium account

| | £m |
|---|-----|
| Balance as at 31 March 2006 and 31 March 2007 | 0.4 |

Notes forming part of the consolidated accounts

23. Reserves

| | AESOP reserve £m | Hedge reserve £m | Other reserves £m | Retained earnings £m | Total £m |
|--|---------------------|---------------------|----------------------|----------------------------|-------------|
| Balance at 1 April 2005 | (0.3) | (3.9) | (34.7) | 92.0 | 53.1 |
| Movement in statement of recognised income and expense | - | 2.0 | - | 116.1 | 118.1 |
| Net profit for the year | - | - | - | 57.4 | 57.4 |
| Dividends payable | - | - | - | (2.5) | (2.5) |
| Balance at 31 March 2006 | (0.3) | (1.9) | (34.7) | 263.0 | 226.1 |
| Balance at 1 April 2006 | (0.3) | (1.9) | (34.7) | 263.0 | 226.1 |
| Movement in statement of recognised income and expense | - | 1.7 | - | 36.8 | 38.5 |
| Net profit for the year | - | - | - | 69.4 | 69.4 |
| Balance at 31 March 2007 | (0.3) | (0.2) | (34.7) | 369.2 | 334.0 |

The AESOP reserve represents the cost of the ordinary A shares of 80 pence each, held by NATS Employee Sharetrust Limited (NESL) (see Accounting Policies).

24. Notes to the cash flow statement

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|--|---|---|
| Operating profit from continuing operations | 144.0 | 137.2 |
| Adjustments for: | | |
| Depreciation of property, plant and equipment | 70.1 | 70.1 |
| Amortisation of intangible assets | 6.5 | 5.4 |
| Impairment losses | 12.5 | 15.9 |
| Deferred grants released | (4.6) | (4.6) |
| (Gain)/loss on disposal of property, plant and equipment | (8.5) | 1.3 |
| Non-cash element of charge for pension costs | 20.9 | 28.0 |
| Other non-cash items | - | 0.9 |
| Decrease in provisions | (0.2) | (0.1) |
| Operating cash flows before movements in working capital | 240.7 | 254.1 |
| Increase in trade and other receivables | (9.7) | (15.1) |
| Increase in trade and other payables | 8.9 | 15.1 |
| Cash generated from operations | 239.9 | 254.1 |
| Tax paid | (25.2) | (32.4) |
| Net cash from operating activities | 214.7 | 221.7 |

Cash and cash equivalents, which are presented as a single class of asset on the face of the balance sheet, comprise cash at bank and short term highly liquid investments with a maturity of three months or less.

25. Financial commitments

| | 2007 £m | 2006 £m |
|--|------------|------------|
| Amounts contracted but not provided for in the accounts. | 86.3 | 141.0 |
| Minimum lease payments under operating leases recognised in the income statement. | 22.4 | 10.6 |
| At the balance sheet date the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows: | | |
| Within one year | 1.5 | 0.4 |
| In the second to fifth years inclusive | 10.9 | 13.4 |
| After five years | 54.0 | 50.3 |
| | 66.4 | 64.1 |

Operating lease payments represent rentals payable by the group for certain of its properties, equipment used for air navigation and vehicles. Leases are negotiated on varying terms depending on the type of asset leased.

Guarantees

NATS Holdings Limited has given guarantees to the Ministry of Defence in relation to NERL's performance under its contract with the MoD.

26. Share based payments

The company operates an All-Employee Share Ownership Plan for the benefit of employees to hold 5% of the share capital of the company. The plan is administered by NATS Employee Sharetrust Limited. The scheme allows for free shares to be awarded to employees. The shares have a vesting period of 3 years from date of award and may be cash-settled from this date. The shares may be forfeited if the employee leaves within 3 years of the date of award, depending on conditions of departure.

A liability is recognised for the current fair value of shares in issue at each balance sheet date. Changes in fair value of the liability are charged or credited to the income statement. The number of shares outstanding at the balance sheet date was:

| Date of share awards | No. shares awarded to employees | No. employee shares outstanding |
|---|------------------------------------|------------------------------------|
| 21 September 2001 | 3,353,742 | 2,374,890 |
| 20 October 2003 | 2,459,000 | 2,083,000 |
| 10 September 2004 | 1,966,000 | 1,735,200 |
| | | 6,193,090 |
| Dividend shares issued on 28 June 2005 | | 226,621 |
| Total employee shares in issue at 31 March 2007 | | 6,419,711 |

These shares are valued every six months by independent valuers, PricewaterhouseCoopers LLP. The effect of the movement in share valuation for the year was to charge £1.1m to the income statement. The liability on the balance sheet for the employee shares at 31 March 2007 was £8.2m.

Notes forming part of the consolidated accounts

27. Retirement benefit scheme

The company has entered into a deed of adherence with the CAA and the Trustees of the Civil Aviation Authority Pension Scheme whereby the company was admitted to participate in the Civil Aviation Authority Pension Scheme from 1 April 1996. At 31 March 2001, the business of NATS was separated from the CAA. As a consequence, NATS has become a "non associated employer" which requires the assets relating to the liabilities of NATS active employees at 31 March 2001 to be separately identified within the Pension Scheme. The Pension Scheme has been divided into two sections to accommodate this and a series of common investment funds established in which both sections will participate for investment purposes.

The Civil Aviation Pension Scheme is a fully funded benefit scheme providing benefits based on final pensionable pay. The assets of the scheme are held in a separate trustee administered fund. Upon transfer of National Air Traffic Services Limited to the Secretary of State, two separate sections of the scheme were established, namely the CAA section and the NATS section. The assets and membership of the scheme prior to transfer were allocated between these sections in accordance with Statutory Instrument 2001 Number 853, Transport Act 2000 (Civil Aviation Authority Pension Scheme) Order 2001.

The last formal valuation of the NATS' section was carried out at 31 December 2003 and used the projected unit credit method. The assumptions which have the most significant effect on the result of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. For the purpose of the formal valuation, it was assumed that the annual investment returns will be 2.5% higher than the annual general increases in salaries (allowance is also made for further salary increases due to promotions) and 2.4% higher than the annual increases in pensions.

The market value of the NATS' section's assets as at 31 December 2003 was £1,799m. For the purpose of the actuarial valuation assets were taken at market value. After allowing for benefit changes arising from the valuation, the assets were sufficient to cover 119% of the benefits that had accrued to existing members.

The pension cost under International Accounting Standard 19, Employee benefits, relating to the scheme is assessed in accordance with the advice of independent qualified actuaries and is such as to spread the cost of pensions over the working lives of the employees who are scheme members.

On transition to IFRS, NATS elected to adopt a 'clean start' approach which recognised all actuarial gains and losses at 1 April 2004, and NATS has reported under an immediate recognition approach in subsequent periods.

A full actuarial valuation was carried out at 31 December 2003 and updated to 31 March 2007 for IAS 19 purposes by a qualified actuary. The major assumptions used by the actuary for the purposes of the IAS 19 figures at the relevant year ends are set out in the table and narrative below:

| | 2007 | 2006 | 2005 |
|--------------------------------------|-------|-------|-------|
| Inflation | 3.20% | 2.95% | 2.80% |
| Increase in: | | | |
| - salaries | 4.40% | 4.15% | 4.30% |
| - deferred pensions | 3.20% | 2.95% | 2.80% |
| - pensions in payment | 3.20% | 2.95% | 2.80% |
| Expected return on: | | | |
| - equities | 7.50% | 7.30% | 7.20% |
| - property | 7.50% | 7.30% | 7.20% |
| - bonds | 4.73% | 4.63% | 5.05% |
| Discount rate for scheme liabilities | 5.20% | 4.95% | 5.40% |

The mortality assumptions have been drawn from actuarial tables PXA92 short cohort (2006: PXA92 short cohort). These tables assume that the life expectancy, from age 60, for a male pensioner is 25.4 years and the female pensioner is 28.2 years. Allowance is made for future improvements in longevity, such that based on the average age of the current membership, when these members reach retirement, life expectancy from age 60 will have increased for males to 26.2 years and for females to 29.0 years.

27. Retirement benefit scheme – Continued

Amounts recognised in income, in the staff costs line item, in respect of these defined benefit schemes are as follows:

| | 2007 £m | 2006 £m |
|--|------------|------------|
| Current service cost | (110.8) | (89.2) |
| Past service cost | (1.6) | (1.3) |
| Expected return on scheme assets | 182.4 | 143.5 |
| Interest cost on scheme liabilities | (123.5) | (110.2) |
| Total defined benefit charge in arriving at operating profit | (53.5) | (57.2) |

Amounts taken to the statement of recognised income and expense are as follows:

| | 2007 £m | 2006 £m |
|---|------------|------------|
| Actual return less expected return on scheme assets | (5.2) | 428.1 |
| Experience gains and losses arising on scheme liabilities | 30.7 | 27.8 |
| Changes in assumptions underlying the present value of the scheme liabilities | 27.0 | (290.0) |
| | 52.5 | 165.9 |

The amount included in the balance sheet arising from the group's obligations in respect of its defined benefit retirement benefit schemes is as follows:

| | 2007 £m | 2006 £m |
|--|------------|------------|
| Fair value of scheme assets | 2,833.1 | 2,668.6 |
| Present value of defined benefit obligations | (2,594.5) | (2,461.6) |
| Surplus in scheme | 238.6 | 207.0 |

Movements in the fair value of scheme assets during the year were as follows:

| | 2007 £m | 2006 £m |
|---|------------|------------|
| At 1 April | 2,668.6 | 2,077.8 |
| Expected return on scheme assets | 182.4 | 143.5 |
| Actuarial gains and losses | (5.2) | 428.1 |
| Contributions from scheme members | 15.3 | 14.5 |
| Contributions from sponsoring companies | 32.6 | 29.3 |
| Benefits paid | (60.6) | (24.6) |
| At 31 March | 2,833.1 | 2,668.6 |

Notes forming part of the consolidated accounts

27. Retirement benefit scheme – Continued

Movements in the present value of the defined benefit obligations were as follows:

| | 2007 £m | 2006 £m |
|-----------------------------------|------------|------------|
| At 1 April | (2,461.6) | (2,008.8) |
| Current service cost | (110.8) | (89.2) |
| Past service costs | (1.6) | (1.3) |
| Interest cost | (123.5) | (110.2) |
| Actuarial gains and losses | 57.7 | (262.2) |
| Contributions from scheme members | (15.3) | (14.5) |
| Benefits paid | 60.6 | 24.6 |
| At 31 March | (2,594.5) | (2,461.6) |

The analysis of the scheme assets and the expected rate of return at the balance sheet date was as follows:

| | Fair value of assets | | Expected return | |
|--------------------|----------------------|------------|-----------------|-------|
| | 2007 £m | 2006 £m | 2007 | 2006 |
| Equity Instruments | 1,799.3 | 2,030.2 | 7.50% | 7.30% |
| Property | 449.3 | 186.5 | 7.50% | 7.30% |
| Bonds | 573.8 | 423.6 | 4.73% | 4.63% |
| Cash | 10.7 | 28.3 | 4.73% | 4.63% |
| | 2,833.1 | 2,668.6 | 6.86% | 6.85% |

The three year history of experience adjustments is as follows:

| | 2007 £m | 2006 £m | 2005 £m |
|--|------------|------------|------------|
| Present value of defined benefit obligations | (2,594.5) | (2,461.6) | (2,008.8) |
| Fair value of scheme assets | 2,833.1 | 2,668.6 | 2,077.8 |
| Surplus in the scheme | 238.6 | 207.0 | 69.0 |
| Experience adjustments in scheme liabilities | | | |
| Amount (£m) | 30.7 | 27.8 | 70.1 |
| Percentage of scheme liabilities | (1.2%) | (1.1%) | (3.5%) |
| Experience adjustments in scheme assets | | | |
| Amount (£m) | (5.2) | 428.1 | 95.7 |
| Percentage of scheme assets | (0.2%) | 16.0% | 4.6% |

28. Related party transactions

Since 26 July 2001, the NATS group has had two major shareholders – the Crown and The Airline Group (AG). During the year transactions with the Crown have taken place with the Meteorological office, the Department for Transport (DfT) and the Ministry of Defence (MoD).

The Airline Group is a consortium of seven airlines: British Airways, British Midland, EasyJet, Monarch, My Travel, ThomsonFly and Virgin Atlantic. The Airline Group has a 42% stake in NATS Holdings Limited which it purchased through the PPP transaction in July 2001. The directors of NATS Holdings Limited are satisfied that the seven members of the AG have not exercised undue influence on the group, either acting individually or in concert, and therefore the individual transactions with each member of The Airline Group have not been disclosed in this set of accounts.

A loan of £2.2m was made by AG to one of the group companies (NERL) on 28 June 2005. The loan was repaid in full during the year and the interest rate applicable to the loan was 200 basis points above the Interbank Rate. The interest was rolled up every six months into the loan value.

Contractual arrangements exist between BAA plc and NATS (Services) Limited (NSL) in relation to air navigation services provided at Southampton Airport and where NSL invoices BAA plc. The turnover from these services for the year ended 31 March 2007 was £2.7m (2006: £2.7m). Amounts receivable at 31 March 2007 in relation to this contract amounted to £0.2m (2006: £0.2m).

NSL also provides air navigation services to BAA plc's London and Scottish airports where the charges are invoiced to airlines. The turnover from these services for the year ended 31 March 2007 amounted to £72.9m (2006: £68.5m). Amounts receivable at 31 March 2007 in relation to these services amounted to £5.9m (2006: £4.3m).

On 19 March 2003, NATS issued £27.5m secured priority loan notes and NATS (En Route) plc (NERL) issued £32.5m undated, secured, fixed rate loan notes to each of BAA plc and the Crown. These loans are described more fully in note 17. Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

Transactions between the company and its subsidiaries are disclosed in the subsidiary companies' financial statements.

Trading transactions

During the year, group companies entered into the following transactions with related parties who are not members of the Group.

| | Sales | | Purchases | | Amounts owed by related parties | | Amounts owed to related parties | |
|--------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|---------------------------------|--------------------------|---------------------------------|--------------------------|
| | Year ended 31 March 2007 | Year ended 31 March 2006 | Year ended 31 March 2007 | Year ended 31 March 2006 | Year ended 31 March 2007 | Year ended 31 March 2006 | Year ended 31 March 2007 | Year ended 31 March 2006 |
| | £m | £m | £m | £m | £m | £m | £m | £m |
| Ministry of Defence (MoD) | 42.0 | 44.3 | 3.1 | 3.5 | 4.3 | 3.3 | 1.6 | 1.2 |
| Department for Transport (DfT) | 0.3 | 0.2 | - | - | - | - | - | - |
| Meteorological Office | - | - | 0.7 | 1.1 | - | - | 0.2 | - |

Sales are made to related parties at the Group's usual rates and purchases at market prices. The amounts outstanding are unsecured and will be settled in cash. No guarantees have been received. No provisions have been made for doubtful debts in respect of amounts owed by related parties.

Notes forming part of the consolidated accounts

Company accounts

28. Related party transactions – Continued

Remuneration of key management personnel

The remuneration of key management personnel of the group, is set out below in aggregate for each of the categories specified in IAS 24, Related party disclosures. Key management includes the board of directors of the company and the group's principal subsidiaries. Further information about the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report on page 42.

| | Year ended 31 March 2007 £m | Year ended 31 March 2006 £m |
|------------------------------|-----------------------------------|-----------------------------------|
| Short-term employee benefits | 3.0 | 2.5 |
| Post-employment benefits | 0.5 | 0.5 |
| | 3.5 | 3.0 |

In addition to the above directly employed personnel, the group's key management also includes personnel employed as consultants who receive fees for their services. The aggregate amount of these fees was £0.1m (2006: £0.4m).

Directors' transactions

Paul Barron has disclosed a related party transaction in that his wife Dawn Barron of Human Alchemy had been engaged by the business during the financial year 2006/07 at a cost of £29,844 (2006: £49,366). This work was at the request of Philip James, HR Director and Ian Mills, Programmes Director who have utilised her skills and understanding in specific leadership tools and techniques being introduced across the company.

29. Subsidiaries

The group's principal subsidiaries at 31 March 2007, all of which have been consolidated in these accounts were:

| Name of Company | Principal activity | Proportion of ordinary shares held and voting rights | Country of Registration | Country of operation |
|----------------------------------|---------------------------------------|--|-------------------------|----------------------|
| NATS Limited | Corporate Services | 100% | England and Wales | United Kingdom |
| NATS (En Route) plc | En-route air traffic services | 100% | England and Wales | United Kingdom |
| NATS (Services) Limited | Airport air traffic services | 100% | England and Wales | United Kingdom |
| NATSNV Limited | Satellite based navigation | 100% | England and Wales | United Kingdom |
| NATS Employee Sharetrust Limited | Administration of employee share plan | 100% | England and Wales | United Kingdom |

Company accounts

Company balance sheet at 31 March 2007

| | Notes | 2007 £m | 2006 £m |
|-----------------------------|-------|------------|------------|
| Assets | | | |
| Non-current assets | | | |
| Investments | 4 | 141.0 | 141.0 |
| | | 141.0 | 141.0 |
| Current assets | | | |
| Trade and other receivables | 5 | - | 2.5 |
| | | - | 2.5 |
| Total assets | | 141.0 | 143.5 |
| Current liabilities | | | |
| Trade and other payables | 6 | - | (2.5) |
| Total liabilities | | - | (2.5) |
| Net assets | | 141.0 | 141.0 |
| Equity | | | |
| Share capital | 7 | 140.6 | 140.6 |
| Share premium account | 7 | 0.4 | 0.4 |
| Retained earnings | 8 | - | - |
| Total equity | | 141.0 | 141.0 |

The financial statements were approved by the Board of directors on 28 June 2007 and signed on its behalf by



John Devaney
Chairman



Nigel Fotherby
Finance Director

Notes to the financial statements

1. Cash Flow Statement

No cash flow statement has been provided because the company does not maintain a bank account or have any cash transactions.

2. Significant accounting policies

The separate financial statements of the company are presented as required by the Companies Act 1985. As permitted by the Act, the separate financial statements have been prepared in accordance with International Financial Reporting Standards.

The financial statements have been prepared on the historical cost basis. The principal accounting policies are the same as those set out in note 2 to the consolidated financial statements.

Investments in subsidiaries are designated as held to maturity and stated at cost less, where appropriate, provisions for impairment.

3. Profit for the year and dividends

As permitted by section 230 of the Companies Act 1985 the company has elected not to present its own income statement for the year.

Profit for the year has been arrived at after charging:

| | 2007 £m | 2006 £m |
|------------------------|------------|------------|
| Staff costs | - | - |
| Auditors' remuneration | - | - |

The company incurred no charge to current or deferred taxes in the year (2006: nil).

| Dividends | 2007 £m | 2006 £m |
|---|------------|------------|
| Interim dividend for the year of nil pence per ordinary share (2006: 1.75p) | - | 2.5 |

Amounts recognised as distributions to equity holders in the period:

| | | |
|---|---|-----|
| Interim dividend for the year of nil pence per ordinary share (2006: 1.75p) | - | 2.5 |
|---|---|-----|

4. Investments

| | Investments in subsidiary undertakings £m |
|---|--|
| Investments at 31 March 2007 and 1 April 2006 | 141.0 |

The company's investments in subsidiary undertakings are part of the group's principal subsidiaries as set out in note 29 to the consolidated financial statements.

5. Financial assets

| | 2007 £m | 2006 £m |
|-----------------------------|------------|------------|
| Trade and other receivables | - | 2.5 |

At the balance sheet date, trade and other receivables comprise amounts receivable from fellow group companies of nil (2006: £2.5m). The carrying amount of these assets approximates to their fair value.

6. Financial liabilities

| | 2007 £m | 2006 £m |
|--------------------------|------------|------------|
| Trade and other payables | - | 2.5 |

Trade payables comprise amounts for dividend payments to equity shareholders.

7. Share capital and share premium accounts

The movements on these items are disclosed in notes 21 and 22 to the consolidated financial statements.

8. Retained earnings

| | |
|--------------------------|-------|
| Balance at 1 April 2005 | £m |
| Net profit for the year | - |
| Dividends payable | 2.5 |
| Balance at 1 April 2006 | (2.5) |
| Balance at 1 April 2006 | - |
| Net profit for the year | - |
| Balance at 31 March 2007 | - |

9. Statement of changes in equity

| | |
|--------------------------|-------|
| Balance at 1 April 2005 | £m |
| Net profit for the year | 141.0 |
| Dividends payable | 2.5 |
| Balance at 1 April 2006 | (2.5) |
| Balance at 1 April 2006 | 141.0 |
| Net profit for the year | - |
| Balance at 31 March 2007 | 141.0 |

