

NATS (En Route) plc
Financial statements for the year ended 31 March 2005



Company Number: 4129273

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Company Secretary

Andrew Picton

Registered office

5th Floor South, Brettenham House,
Lancaster Place, London WC2E 7EN

Registered in England and Wales
Company No. 4129273

Head of Legal

Debbie Adams

Auditors

Deloitte & Touche LLP

Operating and financial review

This review presents a summary of the operating performance and results, financial position and cash flows of NATS (En Route) plc (“NERL”) for the year ended 31 March 2005.

After cumulative losses after tax of £115.0m for the three years to March 2004, NERL reported a profit after tax of £43.2m this year.

This year’s result was achieved through a positive operating environment, with higher revenues generated by UK air traffic services more than offsetting increases in operating costs.

Highlights

- ◆ NERL met its safety target for the 2004 calendar year and is on target for the 2005 calendar year after the first quarter.
- ◆ Average delays during 2004/05 reduced to less than 21 seconds (0.35 minutes) per flight from 0.7 minutes per flight in 2003/04 despite handling record traffic volumes during the period.
- ◆ Turnover increased by £37m (7.4%) to £542m over the prior year. Operating costs before exceptional items (see profit and loss account) increased by £29m (7.4%) to £423m. Operating profit before exceptional charges of

£4m increased by £8m to £119m. Net interest costs before exceptional items reduced by

£2m (4.3%) to £49m and, after allowing for prior year losses on debt restructuring of £57m, were £59m lower.

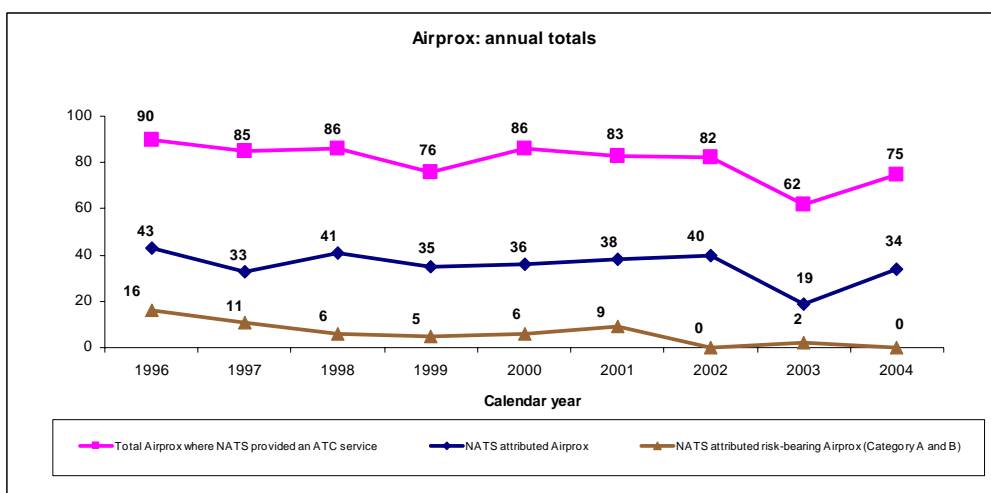
- ◆ Profit before tax increased by £65m to £66m.
- ◆ Investment in the capital expenditure programme increased by £37m to £115m (see page 6). The investment spend of £108m in the year was financed wholly through operating cash flows.
- ◆ Net debt reduced by £75m to £573m.

Safety

Despite the many pressures and demands we face, it is a tribute to our people that our safety performance has been maintained.

Our commitment to safety has never been stronger. Since the part privatisation of NATS in July 2001, there have been no Airprox attributable to NATS where there was an actual risk of collision (Category A).

During 2004 there have been no Airprox attributable to NATS where the safety of the aircraft was compromised (Category B).



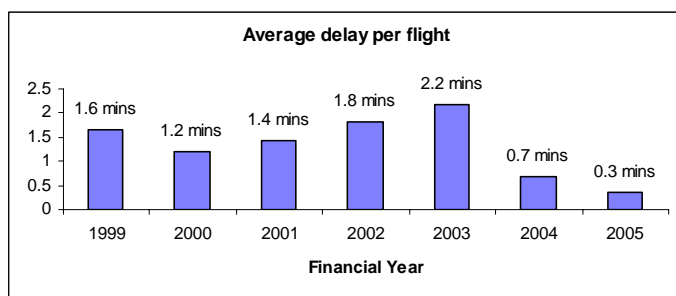
Service delivery

The volume of en route traffic handled by NATS increased by 4.8% to an all time high of 2,201,000 flights compared to the previous financial year.

	2004/05 ('000s)	2003/04 ('000s)	% change in year
Chargeable Service Units	9,415	8,858	6.3%
Total UK traffic (flights):			
Domestic	479	456	4.9%
North Atlantic	297	285	4.3%
Other	<u>1,425</u>	<u>1,359</u>	<u>4.9%</u>
Total	<u>2,201</u>	<u>2,100</u>	<u>4.8%</u>

Service performance has been equally impressive. The average delay, per flight, for the financial year was just 20.9 seconds (0.35 minutes). This compares with 0.7 minutes in 2004 and 2.2 minutes in 2003.

This creditable performance was achieved in spite of two brief, but regrettable, interruptions to our service on 3rd June 2004 and 16th February 2005.



The improved service performance reflects a continuing shift towards more proactive air traffic management and improved traffic management between air traffic control centres for the benefit of UK traffic as a whole and closer working with our airline customers.

It has also been enabled by the resectorisation of TCEast/Clacton, consolidation of the Hurn sector, improved sector configuration at

Swanwick, the tactical use of controller additional voluntary attendances and continuing improvements in industrial relations.

The average delay per delayed flight for the year was 17.1 minutes (2004: 15.4 minutes) but only 2.2 per cent of flights were delayed by NATS.

Review of financial performance

The company reported its first significant pre-tax profit of £66.0m, an improvement of £65.4m on last year (2004: £0.6m).

Turnover at £542.3m was £37.3m (7.4%) higher than prior year (2004: £505.0m).

Turnover from UK air traffic services increased by £36.1m. This mainly reflected a 6.3% growth in volume as measured by chargeable service units, based on the combination of aircraft weight and distance flown, and increases in turnover from other services.

Turnover from North Atlantic air traffic services increased by £1.2m. This mainly reflected a 5.1% growth in chargeable flight volumes and a small increase in the charges.

Operating costs, before exceptional items and depreciation, amortisation and deferred grant releases were £330.2m, £26.9m (8.9%) higher than 2004 mainly due to staff costs. The company's plans for subsequent years, however, anticipate further increases in operating costs as the business gears up for the delivery of the capital programme and higher capacity.

Staff costs were £24.8m more than prior year reflecting the two-year pay and productivity awards negotiated in 2003 and higher pension scheme charges. The latter accounted for £13.1m of the increase in the year and followed a higher accrual rate of 19.5% (2004: 13.3%). This reflects changes in market conditions.

Employees in post at 31 March 2005 increased by 98 (2.6%) to 3,856 (2004: 3,758) mainly from the recruitment of engineers and other staff to support the investment programme and air traffic service assistants.

Non-staff related operating costs before exceptional items and depreciation, amortisation and deferred grant releases increased by 1.8% to £116.3m (2004: £114.2m).

The depreciation charge of £86.1m (2004: £84.1m) includes charges of £9.6m in relation to asset impairment (2004: £4.2m) and £76.5m for underlying depreciation (2004: £79.9m). The lower underlying charge reflects the full depreciation of certain assets relating to Swanwick. The amortisation charge at £13.0m is the same as 2004 following the amortisation of goodwill on a straight line basis over 30 years. Deferred grant releases were £5.9m (2004: £6.1m).

NERL incurred exceptional charges associated with redundancy and relocation of £4.0m (2004: £2.6m).

Net interest charges of £48.7m were £2.3m lower than last year (2004: £51.0m). The source of interest costs is now weighted

towards bonds following the refinancing in August 2003.

Debt service costs includes interest payable on bank loans of £6.4m (2004: £24.6m), bond interest and other bond related finance costs of £35.9m (2004: £21.3m), loan note interest of £7.4m (2004: £7.4m), inter company loan interest of £1.4m (2004: £1.1m) and other miscellaneous charges were £3.6m (2004: £0.1m). The latter included an unrealised loss of £3m to adjust the company's interest rate hedging portfolio. The company generated interest income of £6.0m (2004: £3.6m).

In the prior year, the company incurred one-off costs of £56.6m to terminate interest rate swaps associated with the acquisition loan put in place at PPP that were replaced in August 2003 by a £600m bond issue.

Balance sheet

Fixed assets at £864.8m were £19.0m higher than at 31 March 2004. Additions of tangible assets over the last 12 months of £115.1m exceeded depreciation charges of £76.5m, net increases in impairment provisions of £5.7m and net disposals and transfers from other group companies of £0.9m. Intangible assets reduced by £13.0m reflecting the amortisation of goodwill.

Net current assets fell by £29.9m to £74.5m. This comprised a net increase in cash and short term deposits of £32.7m, offset by a reduction in debtor balances of £13.3m, reflecting the recovery of the previous year's accrual for income allowed under the licence, and an increase of £49.2m in creditors reflecting higher corporation tax liabilities,

accruals for capital expenditure and intercompany balances, including amounts recharged for staff related costs.

Creditors falling due after more than one year of £732.3m (2004: £778.9m) comprises loans and deferred grants. Loans of £723.5m before unamortised bond issue costs of £9.1m reduced by £43.6m. The reduction in gross borrowings reflected repayment of £50m of the outstanding drawings under the capital loan facility offset by indexation of the RPI swap and the accretion of the discount on the bond issue. Deferred grants fell by £4.5m reflecting the transfer of balances to current deferred grants.

Provisions fell by £7.5m due mainly to movements in deferred tax.

Overall net assets increased by £43.2m to £159.4m.

Financial risk management

NATS operates a central treasury function, which provides a service both to the corporate centre and to operating businesses. Treasury is responsible for developing proposals as to what specific actions should be taken to meet the objectives of the Board in the area of treasury, operating within the policies approved by the Board and in line with approved operating procedures. The forum for review and agreement of these proposals is the Treasury Committee. Treasury is not a profit centre. It does not undertake transactions of a speculative nature i.e. it only undertakes transactions that are matched by underlying assets or liabilities that either presently exist or are projected to arise in its business plan.

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

- ◆ liquidity risk: the policy of the company 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, in August 2003 NERL issued a £600m amortising bond with a final maturity date of 2026. In September 2004 following a review of its existing and future funding requirements, NERL, the group's regulated subsidiary, adjusted its financing requirements by repaying £50m of the £80.3m outstanding drawing under its Capital Loan Facility. It also cancelled a further £50m of the facility thereby reducing it from £300m to £200m. This will result in an annual reduction in financing costs of over £1m. In addition to its £200m Capital Loan Facility NERL has further committed bank facilities totalling £46.2m. As detailed in Note 12, at 31 March 2005 drawings under the Capital Loan Facility totalled £30.3m while the other facilities were not drawn. Further liquidity is provided by a six-month debt service reserve account of £20.6m to fund finance payments due to be made by NERL in the six month period ending on 30 September 2005 and a £21.3m liquidity reserve account to provide liquidity in the event of certain pre-defined circumstances particularly to ensure compliance with NERL's financial covenants. In addition, as at 31 March 2005, NERL had freely available cash and short term deposits totalling £99.2m.

◆ interest rate risk: the company's policy on interest rates is to reduce exposures by ensuring an appropriate balance of fixed, floating and index-linked rates. Accordingly, the group presently maintains interest rate swaps to cover its projected loan drawings in the period to 2016. The company will review the requirement for interest rate swaps over the longer term once the outcome of the regulatory price review is determined when the level of funding required for the capital investment programme can be assessed with greater certainty. Also, as most of its regulated 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 in August 2003 whereby the company receives fixed interest at a rate of 5.25% and pays interest at a rate of 2.98% adjusted for the movement in RPI. This provides a measure of protection against a low inflation environment. As at 31 March 2005, approximately 69% of the company's borrowings (after swaps) were at fixed rates and 31% were at variable rates including rates indexed to inflation. The company charged £1.3m in the year to reflect the costs of offsetting an over-hedged position that existed in the period to September 2006 and included a further provision of £3m to reflect the costs of unwinding a potential over-hedged position in the period 2012 to 2016.

◆ currency risk: currency transaction exposure is hedged in accordance with policies approved by the Board that seek to minimise the impact on the profit and loss account of movements in exchange rates. UK en route charges which contribute 85% (2004: 85%) of total turnover are set in sterling but are billed and collected in euro by applying

a conversion rate determined monthly by Eurocontrol. The resultant currency risk has been eliminated by entering into forward foreign exchange contracts that are guaranteed to exceed the Eurocontrol rate.

◆ counterparty risk: as at 31 March 2005 the company had cash and deposits totalling £141.1m. 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 each counterparty based on its credit rating.

Cash flow, borrowings and interest charges

Overall, the company was able to finance its operating activities and capital expenditure, service its debt and repay loans without drawing on its bank facilities.

The company generated net cash from operations of £246.1m (2004: £194.7m). It paid £44.6m (2004: £107.3m, including losses on debt restructuring) for debt service, received interest of £6.0m (2004: £3.6m). It paid taxes of £16.6m (2004: £1.9m) and spent a net £108.2m (2004: £80.7m) on capital projects. The company repaid £50.0m of outstanding drawings under the capital loan facility, paid bond issue costs of £0.1m, resulting in net financing outflows of £50.1m. There was a £57.3m increase in short-term deposits.

At year end the company held cash of £60.8m (2004: £85.4m) including a liquidity reserve account of £21.3m to provide liquidity in the event of certain pre-defined circumstances

particularly to ensure compliance with NERL's financial covenants (2004: £21.3m), and short term deposits of £80.3m (2004: £23.0m). The latter include a debt service reserve account of £20.6m to fund finance payments due to be made in the six month period ending 30 September 2005.

Overall, net debt at the period end was £573.3m (2004: £648.4m) as follows:

	Cash and short term deposits £m	Loans £m	Net debt £m
Balance at 31 March 2004	108.4	(756.8)	(648.4)
Cash flow	(24.6)	50.1	25.5
Short term deposits	57.3	-	57.3
Bond financing costs	-	(7.7)	(7.7)
Balance at 31 March 2005	141.1	(714.4)	(573.3)

Capital expenditure

Capital expenditure at £115.1m was £36.8m higher than the previous year and represents the highest level of investment since PPP. The increase in expenditure included: the development and sustainment of existing systems at air traffic control centres, and the development of new systems for the North Atlantic; the development of new centres and future systems to support the NERL's two-centre strategy, including collaborations with European partners and preparations for the military move to Swanwick, NERL is investing in systems to provide improved controller tools; improvements to communications infrastructure network; the continuation of the radar upgrade programme for civil and military use; further expenditure at the new corporate and engineering technical centre near Swanwick and the upgrade of IT infrastructure.

People

To ensure we have the capacity in place to safely meet a forecast increase in demand from two million to three million flights a year by 2013, a major investment programme is underway covering some 350 inter-dependent projects. This investment programme requires a huge degree of personal effort and commitment. For example, some two thirds of our staff will need to change their location of work in the next four years.

Regulatory price review

The CAA is currently conducting a review of the price control that will apply to NERL for the five year period from 1 January 2006 to 2011 (Control Period 2 or CP2). The CAA published firm proposals in May 2005, which included a draft specification of the price control. These proposals are subject to consultation with users and NERL.

The CAA's firm proposals for the Eurocontrol business provide for real reductions in NERL's unit revenues averaging 3.4 per cent per annum over the five year period of CP2. The cumulative reduction over the five years is around 15 per cent, with a first year reduction of some 4 per cent followed by average reductions of around 3 per cent each year.

The CAA has also proposed to tighten the current financial incentives on NERL's service quality by reducing the average delay at which no bonuses or penalties apply to 45 seconds per flight.

The company is disappointed at the stance the CAA has taken. Whilst there are some elements of the CAA's package of proposals

that are positive, for example the allowance in full of NERL's planned capital expenditure, other elements remain challenging. Of particular concern is the proposition for further reductions in CP2 operating costs, which will be on top of the £106 million reduction that has already been built into the current plan for CP2. With staff costs representing 70 per cent of operating expenditure, the CAA's latest proposals increase risk in the business and are going to be very tough to meet. Further cost reductions of this nature will undermine delivery of the investment programme and threaten the planned wholesale modernisation of the systems infrastructure, aimed at improving future efficiencies and providing the capacity increase required by customers.

The company is therefore reviewing the implications of these proposals and considering its response.

Outlook

The company's Business Plan, which was prepared and published before the publication of the CAA's May 2005 proposal, details how NERL will continue to deliver on the core themes: safety, service, value for money, growth and driving change in Europe.

As the appetite for change gathers pace in Europe, we find ourselves in an enviable position to influence and shape the future of air traffic management.

With a clear and ambitious vision for the future, we are building an organisation that is more commercially and operationally astute and capable of sustaining high levels of performance.

A package of 21 operational targets, objectives and goals has been created, that we have called Destinations. It builds on the strong safety, service and financial performance we have achieved in the last two years.

Each one is designed to stretch future business targets and plans and give every department a clear and unambiguous target to achieve by April 2007. It is ambitious yet achievable.

The Destinations initiative has not only required the personal and collective commitment of the entire leadership team, those who have the most influence internally and externally. But it has also required a new set of skills and a new way of working together.

By continuing to deliver strong operational and financial performance, marketing our expertise and investing wisely in new skills and technology, the company can play a leading role in the development of air traffic management not just in Europe, but around the world.

Paul Barron
Chief Executive Officer

Report of the directors

The directors present their report and audited accounts for the year ended 31 March 2005.

Principal activities and business review

The company's principal activity is the provision of air traffic services in the UK.

On 26 July 2001, the company's parent, National Air Traffic Services Limited ("NATS") hived down certain of its assets and liabilities to the company under a statutory transfer scheme established under the Transport Act 2000 to implement the Public Private Partnership (PPP) of NATS. The company commenced trading on 1 August 2001.

The company is subject to regulation in accordance with the Air Traffic Services Licence which was originally issued in March 2001 and has been modified on a number of occasions. The company generates revenues from UK air traffic services and North Atlantic air traffic services. The former comprises domestic en route services charged by Eurocontrol based on chargeable service units (a function of average weight of the aircraft and distance flown through UK airspace), support services provided by the Ministry of Defence, London Approach services and services provided to North Sea Helicopters.

The directors consider that the year-end financial position was satisfactory and that the company is well placed to develop its activities in the foreseeable future.

A full description of NERL's principal activities and business review is contained in the Operating and Financial Review above.

Results and dividends

The results for the period are shown in the profit and loss account on page 12. The Board recommends that no dividend is paid (2004 - £nil).

Employees

Contracts of employment with staff are held by the company's parent company, NATS. NATS continues its commitment to the involvement of employees in the decision making process. This is effected through an open dialogue with Prospect and the Public and Commercial Services Union (PCS) as 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. Staff are frequently involved through direct discussions with their managers, cross company work NERL's 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.

It is NATS' 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.

NATS 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 or creed, 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.

NATS is also committed to improving employment opportunities for disabled people. NATS 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.

NATS strives to maintain the health and safety of employees through an appropriate culture, processes and regular monitoring.

Policy and practice on payment of creditors

It is the company'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 31 days (2004 - 30 days).

Directors and their interests

The directors of the company who served during the year and to the date of this report are set out below:

Dr Chris Gibson-Smith
Paul Barron (appointed 18 June 2004)
Danny Bernstein
Colin Chisholm (resigned 31 March 2005)
Richard Everitt (resigned 18 June 2004)
Nigel Fotherby
Derek Stevens
Barry Humphreys (appointed 20 July 2004)

None of the directors had any interests in the share capital of the parent company.

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

United Kingdom company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the profit or loss of the company for that period.

In preparing those financial statements, the directors are required to:

- ◆ select suitable accounting policies and then apply them consistently;
- ◆ make judgements and estimates that are reasonable and prudent;
- ◆ state whether applicable accounting standards have been followed; and

- ◆ prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for ensuring that the company keeps proper accounting records which disclose, with reasonable accuracy at any time, the financial position of the company, and which enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditors

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

By order of the Board



Andrew Picton
Secretary
30 June 2005

Registered office

5th Floor South, Brettenham House,
Lancaster Place, London WC2E 7EN

Registered in England and Wales

Company Number: 4129273

Independent auditors' report to the members of NATS (En Route) plc

We have audited the financial statements of NATS (En Route) plc for the year ended 31 March 2005 which comprise the profit and loss account, the balance sheet, the cash flow statement and the related notes 1 to 25. These financial statements have been prepared under the accounting policies set out therein.

The 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 the 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 in the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the directors' report is not consistent with the financial statements, if 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 transactions with the company and other members of the NERL is not disclosed.

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

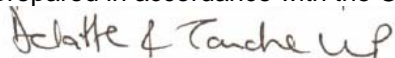
Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards 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 judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the 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 of the state of affairs of the company as at 31 March 2005 and of the profit of the company for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Southampton
30 June 2005

Profit and loss account

for the year ended 31 March 2005

	Notes	Year ended 31 March 2005			Year ended 31 March 2004		
		Before exceptional Items £000	Exceptional Items (note 4a) £000	Total £000	Before exceptional Items £000	Exceptional Items (note 4a) £000	Total £000
Turnover	2	542,259	-	542,259	504,992	-	504,992
Costs of staff seconded to NERL	3b	(213,911)	(212)	(214,123)	(189,138)	(670)	(189,808)
Services and materials		(46,265)	-	(46,265)	(45,772)	-	(45,772)
Repairs and maintenance		(23,470)	-	(23,470)	(15,050)	-	(15,050)
External research and development	4e	(386)	-	(386)	(308)	-	(308)
Depreciation and amortisation	4a	(99,121)	-	(99,121)	(97,065)	-	(97,065)
Other operating charges - external charges		(15,804)	(2,704)	(18,508)	(16,507)	(1,325)	(17,832)
Other operating charges - intra-group	4b	(44,645)	(1,123)	(45,768)	(47,851)	(615)	(48,466)
Other operating income - intra-group	4b	14,255	-	14,255	11,256	-	11,256
Deferred grants released	4a,15	5,907	-	5,907	6,135	-	6,135
Net operating costs		(423,440)	(4,039)	(427,479)	(394,300)	(2,610)	(396,910)
Operating profit	4	118,819	(4,039)	114,780	110,692	(2,610)	108,082
Loss on restructuring of debt	5	-	-	-	-	(56,568)	(56,568)
Net interest payable and similar charges	5	(48,740)	-	(48,740)	(50,956)	-	(50,956)
Profit on ordinary activities before taxation		70,079	(4,039)	66,040	59,736	(59,178)	558
Tax on profit on ordinary activities	6	(24,060)	1,212	(22,848)	(21,800)	17,750	(4,050)
Profit/(loss) for the financial year transferred to/(from) reserves	20	46,019	(2,827)	43,192	37,936	(41,428)	(3,492)

All operations are continuing. There were no recognised gains or losses except as disclosed in the profit and loss account. Accordingly no separate statement of total recognised gains and losses has been provided.

Balance sheet

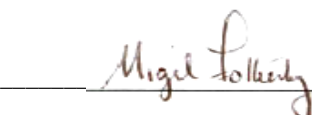
at 31 March 2005

	Notes	2005 £000	2004 £000
Fixed assets			
Intangible assets	7	338,025	351,026
Tangible assets	8	526,746	494,732
		864,771	845,758
Current assets			
Debtors: amounts falling due within one year	9a	80,807	94,299
Debtors: amounts falling due after more than one year	9b	194	-
Short term deposits		80,285	22,974
Cash at bank and in hand		60,818	85,447
		222,104	202,720
Current liabilities			
Creditors: amounts falling due within one year	10	(147,556)	(98,346)
		74,548	104,374
Net current assets			
		939,319	950,132
Total assets less current liabilities			
Creditors: amounts falling due after more than one year	11	(732,343)	(778,903)
Provisions for liabilities and charges	14a	(47,625)	(55,070)
		159,351	116,159
Net assets			
Capital and reserves			
Called up share capital	16	10,000	10,000
Special and other reserves	20	88,712	101,664
Profit and loss account	20	60,639	4,495
		159,351	116,159
Equity shareholder's funds			
	20	159,351	116,159

The accounts were approved by the Board of directors on 30 June 2005 and signed on their behalf by



Dr Chris Gibson-Smith



Nigel Fotherby

Cash flow statement

for the year ended 31 March 2005

Cash flow statement

		Year ended 31 March 2005	Year ended 31 March 2004
	Notes	£000	£000
Net cash inflow from operating activities		246,103	194,743
Returns on investments and servicing of finance	17a	(38,594)	(103,675)
Taxation		(16,564)	(1,850)
Capital expenditure and financial investment	17b	(108,159)	(80,726)
Cash inflow before use of liquid resources and financing		82,786	8,492
Financing and management of liquid resources	17c	(107,415)	22,622
(Decrease)/Increase in cash	18	(24,629)	31,114

Reconciliation of operating profit to net cash inflow from operating activities

		Year ended 31 March 2005	Year ended 31 March 2004
	Notes	£000	£000
Operating profit		114,780	108,082
Depreciation and amortisation		99,121	97,065
Deferred grants released		(5,907)	(6,135)
Loss/(Profit) on sale of tangible fixed assets		569	(99)
Decrease/(Increase) in debtors		13,906	(27,517)
Increase in creditors		3,288	6,553
Increase in amounts owing to other group undertakings		20,721	19,654
Decrease in provisions		(375)	(2,860)
Net cash inflow from operating activities		246,103	194,743

1 Accounting policies

a) Basis of preparation

The financial statements are prepared under the historical cost convention in accordance with applicable United Kingdom accounting standards.

At completion of the Public Private Partnership (PPP) transaction on 26 July 2001, a transfer scheme hived down certain of the operating assets and liabilities of National Air Traffic Services Limited ("NATS") to this company.

In addition, the company entered into a Management Services Agreement with NATS on 25 July 2001. This agreement provides for the provision by NATS of personnel and central services to the company. The cost of central services is recharged on the basis of a fair allocation of costs taking into account the most important drivers for the services provided. The company is responsible for paying to NATS an amount equal to the aggregate of all costs incurred by NATS in connection with the employment of the personnel together with appropriate staff related costs and expenses and disbursements.

NATS (En Route) plc (NERL) also entered into an Inter-company Services Agreement on 25 July 2001 with NATS (Services) Limited (NSL). Under this agreement this company provides NSL with the following services:

- ◆ approach control service for London Luton airport;
- ◆ training services;
- ◆ radar data services at NSL airports;
- ◆ engineering and software support services;
- ◆ research and development for NSL airports division and business development division; and
- ◆ other services to NSL's business development division (for example - consultancy and engineering services).

The range of services provided by NSL to NERL under the agreement includes:

- ◆ North Sea helicopter advisory service;
- ◆ air traffic services in certain sectors;
- ◆ services to London Terminal Approach service (engineering services, use of communications facilities);

- ◆ accommodation and support services to NERL units sited on NSL's Heathrow premises; and
- ◆ miscellaneous other services.

The company commenced trading from 26 July 2001.

A summary of the principal accounting policies adopted by the company and applied throughout the year are as follows:

b) Turnover

Turnover represents the amounts, excluding VAT, received and receivable in respect of services provided to customers. Turnover is recognised in accordance with company's air traffic services licence and other contracts. Amounts receivable include revenue allowed under the charge control conditions of the air traffic services licence.

c) Goodwill

Goodwill in relation to NERL, being the excess of consideration over the values of the net assets acquired at the date of the PPP, is capitalised and amortised on a straight-line basis over its useful economic life. Impairment tests on the carrying value of goodwill are undertaken annually. Goodwill is being amortised over a period of 30 years and represents the period of the Licence granted by the Minister of State for Transport on 28 March 2001 for the provision of en route air traffic services.

d) Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and provisions for impairment. The cost of fixed assets includes internal and contracted labour costs directly attributable to bringing the assets into working condition for their intended use.

Depreciation is provided to write off the cost of tangible fixed assets, less estimated residual value, evenly 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.

e) Deferred grants and other contributions to fixed assets

Contributions to fixed assets are treated as deferred income which is credited to the profit and loss account by equal annual instalments over the expected useful economic lives of the related asset. Grants of a revenue nature are credited to income in the period to which they relate.

f) Research and development

Expenditure on research and development is charged to the profit and loss account as incurred.

g) Issue costs of borrowing

The costs of raising finance such as bank loans are capitalised against the carrying value of the debt. The costs are charged to the profit and loss account on an annual basis over the life of the debt. On early redemption of debt the initial costs of raising finance are written off to the profit and loss account.

h) Taxation

Current tax being UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted at the balance sheet date.

Deferred taxation is provided in accordance with FRS 19 on all timing differences arising from the different treatment of items for accounts and taxation purposes calculated at rates at which it is estimated that tax will arise.

i) Foreign currencies

Foreign currency monetary assets and liabilities covered by forward contracts are translated into sterling at the contracted rates. All other foreign currency monetary assets and liabilities are translated into sterling at the rates ruling at the balance sheet date.

Exchange differences are dealt with through the profit and loss account. Other transactions in foreign currencies are recorded in sterling at the rates ruling at the dates of the transactions or at the contracted rate if the transactions are

covered by a forward foreign exchange contract.

j) Pensions

NATS has entered into a deed 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 method. The expected cost of providing pension benefits, as calculated periodically by professionally qualified actuaries, is charged to the profit and loss account so as to spread the cost over the expected service lives of the employees within the pension scheme such that the pension cost is a substantially level percentage of current and expected future pensionable payroll.

Pension costs are calculated using methods and assumptions specific to NATS. The projected unit method is used to calculate the regular cost. The surplus has been spread as a constant percentage of payroll.

k) Leases

The rentals payable on operating leases are charged to the profit and loss account in equal annual amounts over the lease term.

l) Financial instruments

Gains and losses on derivative financial instruments are recognised in the profit and loss account when realised as an offset to the related income or expense. The group does not enter into any such transactions for speculative purposes.

The derivative financial instruments utilised by the group are interest rate swaps, RPI swaps and foreign exchange contracts. These instruments are held principally to manage transaction risk arising from movements in interest rates, inflation and the denomination of receipts from Eurocontrol in Euro. Termination payments made where the underlying exposure ceases to exist are taken to the profit and loss account.

Interest differentials, including those arising from RPI swaps, on derivative financial instruments are recognised by adjusting net interest payable so as to change a constant rate over the life of the underlying exposure. Discounts on derivative financial instruments are amortised over the shorter of the life of the instrument or the underlying exposure. If an instrument or part of an instrument ceases to be accounted for as a hedge, for example because the underlying hedged position is eliminated, the instrument is marked to market and any resulting profit or loss is recognised at that time.

2 Turnover and segmental analysis

	Year ended 31 March 2005			Year ended 31 March 2004		
	Turnover £000	Profit/ (loss) £000	Net assets /(liabilities) £000	Turnover £000	Profit/ (loss) £000	Net assets /(liabilities) £000
UK air traffic services	522,011	112,397	725,416	485,954	104,565	757,215
North Atlantic air traffic services	20,248	2,383	7,238	19,038	3,517	7,289
Turnover/Profit on ordinary activities before interest/Net assets excluding cash balances and loans	542,259	114,780	732,654	504,992	108,082	764,504
Loss on restructuring of debt (note 5)		-			(56,568)	
Net interest payable and similar charges (note 5)		(48,740)			(50,956)	
Net debt (note 19)			(573,303)			(648,345)
Profit on ordinary activities before taxation		66,040			558	
Net assets			159,351			116,159

Analysis of UK air traffic services turnover

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Eurocontrol navigational service charges	463,072	428,679
Support services provided to MoD	45,087	44,718
London terminal approach services	8,338	7,907
North Sea helicopters navigational service charges	5,514	4,650
UK air traffic services	522,011	485,954

Income receivable from Eurocontrol in respect of UK air traffic services is denominated in euros. NERL enters into forward exchange rate hedging contracts, in the ordinary course of business, to fix its income in sterling terms.

During the year the company received turnover from the following related parties:

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Ministry of Defence (MoD)	45,277	44,811
Department for Transport (DfT)	325	316
Meteorological Office	18	22
	45,620	45,149

All material turnover arises from operations originating within the United Kingdom. Revenue has not been shown by destination as it is not materially different to origination.

3 Directors' and employees' remuneration**a Directors' remuneration**

The directors' report on page 9 includes details of the directors of the company. None of these directors received any fees in the year for their services as directors of this company.

b Staff costs

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Salaries and staff costs were as follows:		
Wages and salaries*	186,732	172,908
Social security costs	18,406	16,661
Pension costs (note 3c)	35,252	22,135
	<hr/>	<hr/>
	240,390	211,704
Less: amounts capitalised**	(26,267)	(21,896)
	<hr/>	<hr/>
	214,123	189,808
	<hr/>	<hr/>

* Includes redundancy costs

** Includes £259,000 (2004: £nil) in respect of work for other group companies.

NATS is responsible for employing the staff engaged in the activities carried out by NERL. Under the terms of the Management Services Agreement (MSA) dated 25 July 2001 the services of certain employees are seconded to NERL by NATS. NERL is responsible for paying to NATS an amount equal to the aggregate of all costs incurred by NATS in connection with the employment of the seconded employees (including all taxes and social security and pension costs) together with appropriate staff related costs and expenses and disbursements.

c Pension costs

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Pension scheme costs for year (note 22)	35,022	22,024
Other pension costs	230	111
	<hr/>	<hr/>
	35,252	22,135
	<hr/>	<hr/>

d Staff numbers

The average number of employees (including directors) seconded from NATS during the year in accordance with the MSA was:

	Year ended 31 March 2005 Number of staff	Year ended 31 March 2004 Number of staff
Air traffic controllers (ATCOs)	1,383	1,394
Air traffic service assistants (ATSAs)	849	810
Engineers	1,066	1,070
Others	509	489
	<hr/>	<hr/>
	3,807	3,763
	<hr/>	<hr/>

The number of staff seconded from NATS at 31 March 2005 was:

	Year ended 31 March 2005 Number of staff	Year ended 31 March 2004 Number of staff
Air traffic controllers	1,386	1,380
Air traffic service assistants	850	822
Engineers	1,089	1,056
Others	531	500
	<hr/>	<hr/>
	3,856	3,758
	<hr/>	<hr/>

4 Operating profit

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
a Operating profit is stated after charging/(crediting):		
Exceptional items:		
Voluntary redundancy costs	212	670
Relocation of offices to Swanwick area	2,704	1,325
Other operating charges - intra-group	1,123	615
	4,039	2,610

The exceptional items in the year have arisen because of the planned relocation of the company's headquarters from London to the Swanwick area and costs associated with a voluntary redundancy programme.

Other items:		
Amortisation of goodwill	13,001	13,001
Depreciation of fixed assets	76,462	79,900
Fixed asset impairment	9,658	4,164
Deferred grants released	(5,907)	(6,135)
Loss/(profit) on disposal of fixed assets	569	(99)
CAA regulatory charges	4,733	4,017
Meteorological services	515	494

b Transactions with other group companies

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Other operating charges - charges for services provided by parent undertaking	38,086	41,596
Other operating charges - charges for services provided by other group companies	7,682	6,870
	45,768	48,466
Other operating income - costs recharged to parent undertaking	5,889	2,882
Other operating income - costs recharged to other group companies	8,366	8,374
	14,255	11,256

In addition to the staff costs referred to in note 3b above, NERL is responsible under the MSA for reimbursing NATS for all other staff related costs which it incurs on behalf of the employees seconded to NERL. Under the Inter Company Services Agreement NERL provides certain services to NSL. The MSA and Inter Company Services Agreement are explained in more detail in note 1a.

c Auditors' remuneration

Amounts payable to Deloitte & Touche LLP in respect of audit services were £54,000 (2004 - £60,000). In addition, the auditors received £28,000 (2004 - £28,000) for further assurance services in respect of regulatory reporting, £112,000 (2004 - £211,000) for assurance related services and £190,000 (£2004: £103,000) for other advisory services.

4 Operating profit/(loss) continued**d Operating lease rentals**

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Plant and machinery	500	554
Land and buildings	4,174	2,699
	4,674	3,253

e Research and development

Research and development expenditure charged in the profit and loss account comprises the cost of third party research bought in by the company. This includes £66,000 (2004 - £136,000) in respect of transactions with the Defence Evaluation Research Agency (DERA). In the year a further £8,055,000 (2004 - £7,743,000) of internal research and development expenditure, dealt with in other expense categories, was incurred by the company. The total cost of research and development for the year was £8,441,000 (2004 - £8,051,000).

5 Net interest payable and similar charges

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Interest payable on:		
Bank loans and overdrafts	(6,355)	(24,586)
Bond and related costs including financing expenses and accretion of the RPI swap	(35,937)	(21,312)
Loan notes	(7,382)	(7,403)
Other	(3,650)	(99)
Interest payable on intercompany loans	(1,413)	(1,134)
Interest payable and similar charges	(54,737)	(54,534)
Interest receivable and similar charges	5,997	3,578
	(48,740)	(50,956)

Interest payable and similar charges includes amortisation of issue costs, including the costs of issuing bonds or facility fees on bank loans, as well as interest hedging costs.

Loss on restructuring debt:

At the time of the PPP the company entered into interest rate swaps whereby it fixed the rate payable on its Acquisition Loan thereby protecting itself against upward movements in interest rates. Repayment of the loan in August 2003 necessitated the unwinding of these swaps to avoid the company being in an over hedged position following the issue of its fixed rate bond. As the interest rate payable on the swaps was higher than the prevailing interest rate, termination costs of £56,568,000 were incurred in the year ended 31 March 2004.

6 Tax on profit on ordinary activities

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
a Analysis of charge in year		
<i>Current tax:</i>		
UK corporation tax at 30%	(30,899)	(8,400)
Adjustment for corporation tax in respect of prior years	981	-
Adjustment for group relief in respect of prior years	-	(150)
	<hr/>	<hr/>
Total current tax	(29,918)	(8,550)
<i>Deferred tax:</i>		
Origination and reversal of timing differences	5,296	4,350
Prior year over-provision of deferred tax	1,774	150
	<hr/>	<hr/>
Total deferred tax	7,070	4,500
	<hr/>	<hr/>
Tax charge on profit on ordinary activities	(22,848)	(4,050)
	<hr/>	<hr/>

b Factors affecting tax charge for the year

The tax assessed for the year differs from the standard rate of corporation tax in the UK (30%). The differences are explained below:

	Year ended 31 March 2005 £000	Year ended 31 March 2004 £000
Profit on ordinary activities before tax	66,040	558
	<hr/>	<hr/>
Tax on profit on ordinary activities at standard rate in the UK of 30%	19,812	167
Effects of:		
Depreciation in period in excess of capital allowances	1,554	3,950
Goodwill amortisation not deductible for tax purposes	3,900	3,900
Other timing differences	5,326	4,833
Utilisation of tax losses brought forward	-	(4,450)
Adjustment for group relief in respect of prior years	-	150
Adjustment for corporation tax in respect of prior years	(981)	-
Other permanent differences	307	-
	<hr/>	<hr/>
Current tax charge for year	29,918	8,550
	<hr/>	<hr/>

c Factors that may affect future tax charges

Based on current capital investment plans, the company expects to be able to claim capital allowances in excess of depreciation in future years. Any group relief available from NATS in future years will be received for £nil consideration.

7 Intangible fixed assets

The movements in intangible fixed assets during the year to 31 March 2005 were as follows:-

	Goodwill £000
Cost	
Balance at 1 April 2004 and 31 March 2005	385,696
Amortisation	
Balance at 1 April 2004	34,670
Charged for the year	13,001
Balance at 31 March 2005	47,671
Net book value	
Balance at 31 March 2004	351,026
Balance at 31 March 2005	338,025

The carrying value of goodwill was supported during the year by a review which discounted the estimated future cash flows of the company to present value using a pre-tax nominal discount rate of 10.35%. This review was performed using the company's 30-year model which uses the company's long term assumptions for the period beyond 5 years reflecting the regulated nature of the company's activities that limits excessive growth assumptions and includes an assumption on terminal value.

8 Tangible fixed assets

The movements in fixed assets during the year to 31 March 2005 were as follows:-

	Land £000	Buildings Freehold £000	Leasehold £000	Air traffic control systems, plant and equipment £000	Vehicles £000	Furniture, fixtures and fittings £000	Assets in course of construction and installation £000	Total £000
Cost								
Balance at 1 April 2004	13,769	136,477	34,175	815,024	1,374	3,521	117,187	1,121,527
Additions during the year	-	121	2,645	19,451	-	2,770	90,062	115,049
Disposals during the year	-	-	(104)	(21,069)	(118)	(13)	(3,301)	(24,605)
Other transfers during the year including assets transferred to and from other group undertakings	-	87	4,670	52,090	-	98	(37,054)	19,891
Balance at 31 March 2005	13,769	136,685	41,386	865,496	1,256	6,376	166,894	1,231,862
Depreciation								
Balance at 1 April 2004	5	53,482	24,330	537,517	1,209	2,108	8,144	626,795
Provided during the year	1	4,593	2,178	68,993	70	627	-	76,462
Provision for impairment for year	-	-	-	-	-	-	9,658	9,658
Utilisation of impairment provision	-	-	-	(697)	-	-	(3,240)	(3,937)
Disposals during the year including assets transferred to and from other group undertakings	-	-	(42)	(2,982)	(117)	(24)	(697)	(3,862)
Balance at 31 March 2005	6	58,075	26,466	602,831	1,162	2,711	13,865	705,116
Net book value								
Balance at 31 March 2004	13,764	82,995	9,845	277,507	165	1,413	109,043	494,732
Balance at 31 March 2005	13,763	78,610	14,920	262,665	94	3,665	153,029	526,746

Assets in the course of construction (AICC) principally include costs of the Swanwick centre and related projects of £33,008,000 (2004 - £11,624,000), air ground radio telephony interface and control equipment of £9,301,000 (2004 - £6,657,000), en route radar control and monitoring system and related projects amount to £14,097,000 (2004 - £6,937,000), communications networks services £36,636,000 (2004 - £23,615,000), and IT Programmes £8,375,000 (2004 - £14,002,000). Also included in AICC are costs of £26,991,000 (2004: £21,280,000) for the New Prestwick Centre, £16,149,000 (2004: £4,569,000) for the development of future ATC systems and controller tools and £8,637,000 (2004: £3,066,000) for the Shanwick Automated Air Traffic System.

The net book value of leasehold buildings at 31 March 2005 in the company's accounts includes £14,920,000 (2004 - £9,845,000) attributable to leases with unexpired terms of less than 50 years.

The net book value of land at 31 March 2005 includes £24,350 (2004 - £24,950) attributable to leaseholds of less than 50 years. The remainder all relates to freehold land.

A review of the book values of tangible fixed assets has been carried out in light of a revision to the company's investment programme. This has resulted in cumulative provisions for impairment of £13,865,000 (2004 - £8,144,000).

9 Debtors**a Amounts falling due within one year**

	2005 £000	2004 £000
Trade debtors:		
- Eurocontrol	28,112	30,015
- MoD	7	-
- other	1,931	1,523
Other debtors	2,946	3,306
Prepayments and accrued income:		
- Eurocontrol	37,832	51,099
- MoD	3,615	3,791
- other	6,364	4,565
	80,807	94,299

b Amounts falling due after more than one year

	2005 £000	2004 £000
Prepayments and accrued income		
- Eurocontrol	194	-
	194	-

10 Creditors: amounts falling due within one year

	2005 £000	2004 £000
	Note	
Trade creditors:		
- Meteorological Office	62	101
- MoD	-	1,059
- other	7,446	7,800
Amounts owed to other group undertakings	69,726	46,200
Corporation tax	18,299	6,550
Other creditors	3,038	2,690
Accruals and deferred income		
- deferred grants	4,483	5,907
- other	44,502	28,039
	147,556	98,346

Included within accruals and deferred income in respect of MoD are amounts of £586,000 (2004 - £760,000).

11 Creditors: amounts falling due after more than one year

	2005 £000	2004 £000
	Note	
Bank loans	12	30,280
Other loans	12	661,626
Amounts owed to other group undertakings		653,986
- Intercompany Loan Agreement	12	22,500
Accruals and deferred income		
- deferred grants	15	17,637
- other		300
	732,343	778,903

12 Loans

The company's £600m 5.25% Guaranteed Secured Amortising Bond, shareholder loan notes of £65m and bank loans of £30.3m are secured by way of a debenture by which the company 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 first floating charge over all other assets.

	2005 £000	2004 £000
Unsecured loans		
Intercompany loan	22,500	22,500
Secured loans		
£600m 5.25% Guaranteed Secured Amortising Bonds due 2026	596,428	596,188
Fixed rate secured shareholder loan notes (11.3575%, no final maturity date)	65,000	65,000
Bank and other loans (6.55%, repayable 2008)	30,280	80,280
Accretion of RPI swap payable from 2017	9,300	3,097
	701,008	744,565
Gross borrowings	723,508	767,065
Unamortised finance costs	(9,102)	(10,299)
	714,406	756,766

The interest payable on the company's secured bank loans is the aggregate of the sterling interbank rate, the applicable margin and the mandatory costs rate.

The £65m perpetual fixed rate secured shareholder loan notes were issued by the company in March 2003 as part of the restructuring of the group's finances that took place following the events of September 11th. 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.

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

Maturity profile of debt	2005			2004		
	Unsecured loans £000	Secured loans £000	Total £000	Unsecured loans £000	Secured loans £000	Total £000
Between two and five years	-	30,280	30,280	-	80,280	80,280
In more than five years	22,500	670,728	693,228	22,500	664,285	686,785
	22,500	701,008	723,508	22,500	744,565	767,065
Unamortised finance costs	-	(9,102)	(9,102)	-	(10,299)	(10,299)
	22,500	691,906	714,406	22,500	734,266	756,766
			2005 Total £000			2004 Total £000
Undrawn committed facilities:						
Expiring within one year or less			-			-
Between one and two years			-			-
In more two years			215,924			265,924
			215,924			265,924

13 Financial risk management

Pages 4 to 5 of the operating and financial review provide an explanation of the role that financial instruments have had during the period in creating or changing the risks the company faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts and the strategies that have been followed during the period.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS 13").

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures other than currency disclosures.

13 Financial risk management continued

a) Currency and interest rate composition of loans

After taking into account interest rate swaps entered into by the company, the effective currency and interest rate exposure of the company's loans were as follows:

	Total £000	Variable Rate £000	Fixed Rate £000	Weighted Average Interest Rate %	Weighted Average time for which rate is Fixed years
At 31 March 2005					
Sterling					
Intercompany loans	22,500	22,500	-	6.54%	N/A
5.25% guaranteed secured bonds	596,428	200,000	396,428	4.55%	15.0
11.3575% secured shareholder loan notes	65,000	-	65,000	11.36%	N/A
Bank loans	30,280		30,280	6.55%	N/A
Total	714,208	222,500	491,708		
At 31 March 2004					
Sterling					
Intercompany loans	22,500	22,500	-	6.03%	N/A
5.25% guaranteed secured bonds	596,188	200,000	396,188	4.52%	16.0
11.3575% secured shareholder loan notes	65,000	-	65,000	11.36%	N/A
Bank loans	80,280		80,280	6.04%	N/A
Total	763,968	222,500	541,468		

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 2005 is circa 3.15%). This provides a measure of protection against a low inflation environment and results in an average interest rate applicable to the bond issue of 4.55%.

The NERL secured shareholder loan notes are perpetual instruments and accordingly there is no fixed repayment schedule.

Interest rate swaps were entered into in March 2003 to hedge anticipated bank borrowings required to fund forecast capital expenditure in the period from 2003 to 2016. The fixed rate payable by NERL is 5.88% (excluding the margin and mandatory costs rate payable under the group's banking facilities); the company receives floating rate interest at a rate equal to 6 month LIBOR. Bank borrowings have been lower than forecast resulting in NERL being over-hedged in the period to 30 September 2006. To rectify this position, NERL has entered into offsetting swaps whereby it receives interest at an average fixed rate of circa 5.03% and pays floating rate interest at a rate equal to 6 month LIBOR. These transactions have crystallised interest costs of £1.7m during the lifetime of the swaps and resulted in the following hedging profile:

Period		Hedged Amount
From	To	£m
31/03/2004	30/09/2004	83.8
30/09/2004	30/09/2006	30.3
30/09/2006	30/09/2007	128.8
30/09/2007	30/09/2008	132.6
30/09/2008	30/09/2009	145.9
30/09/2009	31/03/2011	147.5
30/09/2011	30/09/2012	159.7
30/09/2012	30/09/2015	158.2

The company charged £1.3m in the year to reflect the costs of offsetting the over-hedged position that is forecast to exist in the period to September 2006 and included a further provision of £3m to reflect the costs of unwinding a potential over-hedged position in the period 2012-2016. The company will review the requirement for interest rate swaps over the longer term once the outcome of the regulatory price review is determined when the funding requirement for its capital investment programme can be assessed with greater certainty.

Including margin and mandatory costs rate the interest rate payable on the company's £30.3m bank borrowings is 6.55%. Inclusion of the interest payments associated with the aforementioned swaps results in an effective borrowing cost of 10.33%.

b) Cash and short term deposits

The effective currency and interest rate exposure of the company's cash and short term deposits as at 31 March 2005 were as follows:

Currency	Cash	Short Term Deposits	Total Amount
	£m	£m	£m
Sterling	50.3	80.3	130.6
EUR	10.5	-	10.5
	60.8	80.3	141.1

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 also reflects the Debt Service Reserve Account balance of £20.6m to fund interest and fees scheduled for payment in the next six months.

13 Financial risk management continued**c) Fair value of financial assets and liabilities**

A comparison of the book and fair values of company's financial assets and liabilities as at 31 March 2005 and 31 March 2004 is set out below. Fair values have not been given for short-term debtors and creditors as these are considered to be the same as the book values.

	2005		2004	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Intercompany loans	(22.5)	(22.5)	(22.5)	(22.5)
£600m 5.25% Guaranteed Secured Amortising Bonds due 2026	(596.4)	(607.1)	(596.2)	(598.4)
11.3575% shareholder loan notes	(65.0)	(65.0)	(65.0)	(65.0)
Bank loans	(30.3)	(30.3)	(80.3)	(80.3)
Interest rate swaps	-	(43.1)	-	(33.6)
Forward foreign exchange contracts	-	0.9	-	1.7

The fair value of the £600m bond represents the estimated cost of repurchasing the bond in the open market at 31 March 2005 prices. 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; all of the unrecognised gains are expected to occur within one year.

14 Provisions for liabilities and charges**a Provisions**

	Reorganisa- tion costs (Swanwick) £000	Deferred tax see note 14b £000	Total £000
Balance at 1 April 2004	670	54,400	55,070
Utilised during year	(375)	-	(375)
Credited to profit and loss account	-	(7,070)	(7,070)
Balance at 31 March 2005	295	47,330	47,625

A provision was recognised in 1998 to cover the costs of transferring the area control operation from West Drayton to Swanwick. As a result of the opening of the new centre in January 2002, a significant portion of the provision has now been utilised. It is expected that the remaining provision will be utilised within one year of the balance sheet date.

b Deferred taxation

	2005 £000	2004 £000
Capital allowances in excess of depreciation	65,100	66,850
Short-term timing differences	(17,770)	(12,450)
Deferred taxation at the end of the year	47,330	54,400

15 Deferred grants

Amounts receivable from both government and other third parties in respect of expenditure on fixed assets are treated as deferred income which is credited to the profit and loss account by instalments over the expected useful lives of the related assets on a basis consistent with depreciation policy. The movements during the period to 31 March 2005 were as follows:-

	MoD £000	Other Government grants £000	Deferred Government grants £000	Other contributions to fixed assets £000	Total £000
Balance at 1 April 2004	21,072	901	21,973	6,071	28,044
Released to profit and loss during year	(5,377)	-	(5,377)	(530)	(5,907)
Disposals in the year	(17)	-	(17)	-	(17)
Balance at 31 March 2005	15,678	901	16,579	5,541	22,120
Amounts falling due within one year	3,888	-	3,888	595	4,483
Amounts falling due after more than one year	11,790	901	12,691	4,946	17,637
Balance at 31 March 2005	15,678	901	16,579	5,541	22,120

16 Called up share capital

	Authorised		Called up, allotted and fully paid	
	Number of shares	£000	Number of shares	£000
Ordinary shares of £1 each				
At 31 March 2005 and 31 March 2004	10,000,000	10,000	10,000,000	10,000

17 Analysis of cash flows reported in the cash flow statement

	2005 £000	2004 £000
a Returns on investments and servicing of finance		
Interest received	5,997	3,623
Interest paid	(44,591)	(50,730)
Payments to terminate interest rate swaps	-	(56,568)
	<hr/>	<hr/>
Net cash outflow from returns on investments and servicing of finance	(38,594)	(103,675)
	<hr/>	<hr/>
b Capital expenditure and financial investment		
Purchase of tangible fixed assets	(81,946)	(62,149)
Own work capitalised	(26,267)	(21,896)
Contributions to fixed assets	35	3,301
Sales of tangible fixed assets	19	18
	<hr/>	<hr/>
Net cash outflow for capital expenditure and financial investment	(108,159)	(80,726)
	<hr/>	<hr/>
c Financing and management of liquid resources		
Financing:		
Bank loans repaid	(50,000)	(600,000)
Bank loans drawn down under the facility agreements	-	30,000
Proceeds from bond issue	-	596,040
Issue costs of bond	(104)	(9,976)
Management of liquid resources:		
Short term deposits	(57,311)	6,558
	<hr/>	<hr/>
	(107,415)	22,622
	<hr/>	<hr/>

18 Reconciliation of net cash flow to movement in net debt

	2005 £000	2004 £000
(Decrease)/Increase in cash in period	(24,629)	31,114
Increase/(Decrease) in short term deposits	57,311	(6,558)
Cash outflow/(inflow) from movement in debt	50,104	(16,064)
Non-cash movements (note 19)	(7,744)	(2,922)
	<hr/>	<hr/>
Movement in net debt in the year	75,042	5,570
Net debt at 1 April 2004	(648,345)	(653,915)
	<hr/>	<hr/>
Net debt at 31 March 2005 (note 19)	(573,303)	(648,345)
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19 Analysis of net debt

	At 1 April 2004 £000	Cash flow £000	Non-cash movements £000	31 March 2005 £000
Cash	85,447	(24,629)	-	60,818
Short term deposits	22,974	57,311	-	80,285
	<hr/>	<hr/>	<hr/>	<hr/>
	108,421	32,682	-	141,103
	<hr/>	<hr/>	<hr/>	<hr/>
Unsecured loans	-	-	-	-
Bank loans	(80,280)	50,000	-	(30,280)
Bonds	(588,986)	104	(7,744)	(596,626)
Secured loan notes	(65,000)	-	-	(65,000)
Intercompany loans	(22,500)	-	-	(22,500)
	<hr/>	<hr/>	<hr/>	<hr/>
	(756,766)	50,104	(7,744)	(714,406)
	<hr/>	<hr/>	<hr/>	<hr/>
Net debt	(648,345)	82,786	(7,744)	(573,303)
	<hr/>	<hr/>	<hr/>	<hr/>

Non cash movements reflect the amortisation of bond issue costs and accretion of the discount on issue of the bond and RPI swaps.

Restricted Cash

Included in cash at bank and cash on short-term deposit are balances amounting to £41,907,000 held by the company to fund financing payments due to be made in the 6 month period ended 30 September 2005 (£20.6m) and to provide liquidity in the event of certain pre-defined circumstances particularly to ensure compliance with the company's financial covenants (£21.3m).

20 Reconciliation of movements in equity shareholder's funds

	Share capital	Special reserves	Other reserves	Profit and loss account	Total year ended 31 March 2005	Total year ended 31 March 2004
	£000	£000	£000	£000	£000	£000
Balance at 1 April 2004	10,000	24,199	77,465	4,495	116,159	119,651
Retained profit for the year	-	-	-	43,192	43,192	(3,492)
Transfers	-	-	(12,952)	12,952	-	-
Balance at 31 March 2005	10,000	24,199	64,513	60,639	159,351	116,159

The transfers between reserves of £13.0m (for the year ended 31 March 2004 - £15.4m) represents those assets which were hived down from National Air Traffic Services Limited on 26 July 2001 and subsequently realised.

In accordance with a court order issued on 21 May 2003 confirming a capital reduction, the company was required to establish a special reserve. The special reserve is not distributable until the company has discharged all liabilities existing at 22 May 2003.

Distributions from NERL to NATS are subject to various controls as a result of the terms of the Facilities Agreement entered into by the company. Distributions may be made from 1 October 2008 only if the company is in compliance with financial covenants in respect of ratios and the maintenance of reserve balances.

21 Commitments**a Capital commitments**

Amounts contracted but not provided for in the accounts at 31 March 2005 amounted to £112,000,000 (2004 - £63,300,000).

b Revenue commitments**(i) Non-cancellable operating leases**

	Plant and machinery £000	Land and buildings £000	Total £000
At 31 March 2005 annual commitments were as follows:			
Expiry within one year	114	210	324
Expiry within two to five years, inclusive	393	1,855	2,248
Expiry in more than five years	-	2,479	2,479
	507	4,544	5,051
			2004
At 31 March 2004 annual commitments were as follows:			
Expiry within one year	107	960	1,067
Expiry within two to five years, inclusive	311	699	1,010
Expiry in more than five years	-	3,780	3,780
	418	5,439	5,857

(ii) Swanwick centre

At 31 March 2005 contracts amounting to £10,600,000 (2004 - £29,300,000) for systems and software support at the above centre have not been provided for in the accounts.

(iii) Forward contracts and interest rate swaps

Details of these contracts are provided in note 13 above. The company has gross commitments in respect of forward exchange contracts of euro 221,900,000 (2004 - euro 136,100,000) and US\$nil (2004 - \$1,800,000).

22 Pension commitments

The contributions are set for the NATS section of the scheme as a whole and it is not possible for the company to identify its share of the assets and liabilities of the NATS section of the Civil Aviation Authority Pension Scheme.

The consolidated accounts of the company's ultimate parent undertaking (NATS Holdings Limited) for the year ended 31 March 2004 include details of the significant assumptions and latest actuarial valuations of the NATS section of the Civil Aviation Authority Pension Scheme including details of the surplus in the NATS section of the scheme.

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.

For the purposes of determining the accounting charge it was assumed that the annual investment return will be 2.4% higher than the annual general increases in salaries and 2.4% higher than the annual increase in pensions. The regular cost of benefits was 28.3% of pensionable payroll. After allowing for surplus amortisation, the net charge is 19.5% of pensionable payroll.

The total pension cost which the company was charged during the period by its immediate parent undertaking - the employing company - in accordance with the terms of the Management Services Agreement dated 25 July 2001 was £35.3m (2004 - £22.1m), including £0.2m (2004 - £0.1m) associated with voluntary early retirement arrangements.

The pension cost figures used in these accounts comply with the current pension cost accounting standard SSAP24. The implementation of the new pension cost accounting standard, FRS17, has been deferred and may be superseded by other developments. However the transitional arrangements remain in place and the company is required to disclose the following information about the group scheme and the figures that would have been shown under FRS17. These calculations showed an increase in the scheme's surplus from £107.3 million at 31 March 2004 to £122.1 million at 31 March 2005.

There were no benefit improvements made during 2004/05 although a number of individual augmentations were made. The company made special contributions in the year of £0.1m to meet the cost of these augmentations, the cost being calculated on a basis agreed with the Trustee (using assumptions which differ from the assumptions used to calculate the value of FRS17 purposes). In addition, the company paid normal contributions of £19.3m.

23 Contingent liabilities

The company is aware of the following matter:

National Air Traffic Services Limited is joined as an Interested Party in a judicial review application brought against the Civil Aviation Authority by local residents in respect of changes to the airspace over the Clacton region implemented in March 2004. A successful challenge may result in a costs order being made against NATS, and may lead to a renewed consultation and affect the manner in which NATS' air traffic controllers direct aircraft in this region.

24 Related Parties

Since 26 July 2001, the NATS group has two major shareholders - the Crown and The Airline Group. During the year transactions have taken place with the Meteorological office and the Defence Evaluation Research Agency (DERA). Transactions with these parties are disclosed in notes 2, 9 and 10 above.

25 Parent undertaking

The company's ultimate parent undertaking and controlling party is NATS Holdings Limited a private company incorporated in Great Britain and registered in England and Wales.

The largest and smallest group in which the results of the company are consolidated is that of which NATS Holdings Limited is the parent company. The consolidated accounts of NATS Holdings Limited can be obtained from the company's secretary, at its registered office, 5th Floor South, Brettenham House, Lancaster Place, London WC2E 7EN .