Speech by Mike Clasper
Chief Executive Officer, BAA plc
2004-05 Annual Results
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Thank you Marcus and good morning everyone. It's good to see you here at Bloomberg again, for what is, again, another very good set of results.

I will take you through our strategic thinking, how it delivered operational improvement and how it will sustain future performance, and then Margaret will take you through our financial performance last year. She will also give you more specific guidance as to what to expect from us during the current financial year.

My main theme for today, and for all the communications around our results, is innovation. I chose that theme for two reasons. Firstly, because that's our strategic focus, it's the way we will grow shareholder value. But secondly, because I suspect some investors are tightly focused upon BAA as a kind of regulated utility and don't see us as an innovator. My aim today is to persuade you to at least adjust that perception and hear what I believe is the real BAA story.

Before I get into specific examples of how we have delivered innovation, I want to start by reviewing the overall performance of the business.

Firstly, these results are very good indeed.

Passengers – up over 6%.
Revenue – up 7%.
Operating profit - up 9%.
Profit before tax – up 36%.
Net retail income – up over 7%.

Great numbers but not the full picture.

Take our retail performance.

The results show 1% growth in net retail income per passenger, but the real story is that we have delivered growth in really tough conditions. EU expansion and the consequent reduction in the duty free universe; a weak dollar hitting demand from both UK and US passengers concerned about their spending power; and the short-term effects of British Airways flightswitch.

These were all adverse forces for retail. So growth of 1% per passenger is a great achievement, particularly since we pulled it off without any major new space. If we were Tesco, Marks and Spencer, Dixons or almost anyone on the high street, this would be headline news. That's the real story behind our retail performance.

Likewise, the rise in passenger numbers hides significant achievement. An increase of over

6% in passenger numbers, twice GDP, makes BAA a growth business, but growth brings challenges.

At Gatwick, the world's busiest single runway airport, we are currently dealing with 32 million passengers a year. We aim to grow this to over 40 million passengers on one runway. To put this in perspective, Schipol currently has around 42 million passengers from 5 runways.

At Heathrow, already the world's busiest two runway airport, we have to keep finding more terminal capacity before T5 becomes operational to cope with demand. Already 68 million passengers are passing through facilities originally designed for 50 million and we are improving the experience for passengers.

According to the CAA service quality benchmark, we are doing better than ever. Queuing time is almost universally less than 10 minutes; travelators and escalators are more reliable; and the terminals are cleaner. These improvements are noticed by passengers and flow through into improved retail sales.

At the same time as running the airports efficiently, we are also well advanced in creating new capacity and replacing old facilities. As you know our major development is Terminal 5, which is now nearly 60% complete, still on budget and ahead of schedule.

As British Airways moves in to Terminal 5, we will take advantage of the consequent release of space to relocate other airlines and redevelop and improve the rest of the airport. By 2012, our vision of a "new Heathrow" will be taking shape. As part of this strategy, we have signed an agreement with the STAR alliance to relocate into Terminal 1 and refurbish the facilities. In March 2005 we signed an agreement with Virgin Atlantic to redevelop part of Terminal 3. Talks with Sky Team about a move into Terminal 4 are also well advanced.

So, great retail performance, smart use and development of assets and improved customer service are key chapters in the real story of our year. They are all supported by an innovative approach, adding value beyond business as usual.

Let me now say something about this year's exceptional property profits.

Here we had a year of real breakthrough. Not only did we sell a number of hotels and petrol stations for £60 million, in March we completed our deal with Morley Fund Management to form the Airport Property Partnership, which aims to grow our property portfolio.

This 50/50 joint venture involved BAA injecting £793 million worth of airport property assets and receiving net cash of £565 million.

At a stroke, the transaction has given Lynton, through its management of APP, the financial freedom necessary to expand its airport-related property activities - acquiring, developing and investing - without relying on BAA for additional funding. At the same time, it crystallises value for a large slice of our property portfolio and delivers cash to deploy against our core strategies. Again, an innovative approach to growing shareholder value.

Let me now talk about the strategic framework of the business. Of course, we sit within a well-tested regulatory environment, which is designed to provide a stable framework for

investment. But that doesn’t mean that we can’t innovate to drive operational performance.

What are some of the qualities that characterise our real story - The innovation story?

They're things like:

- We're entrepreneurial
- smart
- dynamic
- nimble
- We know how to manage risk
- We embrace change
- We're ambitious

Let me give you some of the evidence that supports our story.

First - entrepreneurial.

We create value by growing commercial revenue. For example, we lead the world in airport retailing. Look at our track record - the creation of World Duty Free as a direct BAA-run retail operation; segmentation of car parking into short, medium and long-term categories to allow us to increase yield; working skilfully with an ever shifting mix of catering brands to raise quality, choice and penetration.

During the year just completed, our new developments included World Duty Free’s re-invention of the airport drinks store at T4 and its creation of a specialist men’s grooming section… And we’re always restless for more: for example, we’re testing “Sunglasses”, a new outlet at Gatwick, which has had a great start.

Second - We're smart.

In construction, we use our market power, as the UK’s biggest private sector construction client, to build new airport facilities that are cost effective, safe and efficient. We also use our experience to unlock value by liberating space at our airports for commercial benefit, and also to avoid building ill-judged new facilities.

For example, one Heathrow airline thought it needed a £100 million check-in overhaul. Long discussions and some clever engineering later and we agreed a plan for a £10 million upgrade.

Only yesterday we opened Gatwick’s air bridge together with the new Pier 6. In effect, we have extended the footprint of the North Terminal over a taxiway, enabling us to provide more pier service.

Next up - dynamic.

We've more than doubled our productivity since privatisation, yet our airports match the best in the world for safety. We have introduced new security screening technology, such as IRIS recognition, and at the same time dramatically improved the logistics of the central search process. We've started to introduce self-service check-in for the simultaneous use

of several airlines. The next major focus of development will be common internet check-in.

Next quality - We're nimble.

To finance T5 and our other major developments, we took out forward starting interest rate swaps, in order to lock-in historically low interest rates and to cap our interest bill, giving certainty over our maximum interest payments in the future. We also managed the programme discreetly, so we did not alert the market to the scale of our programme and so kept swap rates low.

In September, we launched our debut euro bond, giving us fresh capital, widening our investor base and taking advantage of a market hungry for corporate bonds and offering keen prices. The deal won us “Corporate Euro Bond of the Year” award.

What about risk?

We're not risk averse.

On the contrary, we have a very active approach to risk management, it is one of our strongest and most distinctive attributes and underpins our whole business. T5 provides a great example. Under the terms of the ‘Terminal 5 agreement’, BAA acts as prime client, and accepts most of the risk. This approach frees individual contractors from wasting time and energy on blame allocation and penalty calculations in the event of glitches, enabling them to concentrate instead on working together to deliver project milestones. It also means lower costs. Contractors don’t cost in a high risk allowance and BAA uses its market power to insure the entire project at optimal rates.

We're almost through the list now...

But let's talk about our appetite for change.

I have mentioned already our focus on improving customer service. As part of this effort we have gradually introduced a big programme of change, designed to help airport staff “deliver excellent experiences.”

The big shift that we’re making, organisationally, is to get as much accountability as close to the customer as possible. That means pushing more accountability to the airports: it’s an ‘airport-led’ operating model. That in turn means we’re looking at our management structures within our airports and evaluating the corporate centre and common services, to ensure that they’re focused on the right things in a way that’s fit for purpose.

The challenge is to get the business as simple as possible, to cut out bureaucracy and waste. There is still much to do.

Last but not least - we're ambitious.

We believe we are already the best airport company in the world. We want to maintain our leadership by growing both our regulated and non-regulated businesses and so increase shareholder value.

For our UK airports, the Government's White Paper on Air Transport remains the strategic framework for growth. We're now hard at work on the delivery phase, and I'm confident that we will successfully build a second runway at Stansted along with a new terminal, new car parks, aircraft stands, road and rail infrastructure and everything else. As you know, we're running a conference call for you, from Stansted, in the morning, to update you on progress.

We also have international ambitions, within the firm discipline of our overall strategy. This means we will look for growth, using either a low-capital retail management model or an airport management model with a strategic equity stake. Both models are already delivering significant value.

Baltimore is a great example of retail innovation. We're transforming the offer there.

Meanwhile at Melbourne we've just resurfaced the main runway to prepare for the A380 in a record 29 days.

So international expansion is an important part of the real BAA story. Great execution here requires both an ability to spot an opportunity and the resolve to pull back when the conditions aren't right. That's what happened in Oman, where it became clear that we could not reach financial agreement with the Omani government over the construction of a new terminal. So we exited the business, with no loss to BAA shareholders. We'll continue to seek opportunities for growth internationally, so long as it does not involve excessive risk.

What I hope I've managed to convince you, is that for us, innovation comes in many different shapes and sizes. Innovation is an important driver of our business now and this will be even more true in the future. So, if you're tempted to portray us as a utility on automatic pilot, I'd ask you to think again.

I will now hand over to Margaret, before we come to your questions.

Speech by Margaret Ewing
Chief Financial Officer, BAA plc
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Thank you Mike and good morning everyone.

Mike has just highlighted the excellent operational performance of last year. This has translated into a great financial outcome.

This morning I'm going to provide a high level overview of our financial performance and an indication of how our plans will influence our results going forward.

All our airports performed well, with strong traffic and profit growth.

Retail was at the high end of our expectations, as the retail team continued to innovate.

And our Airport Property Partnership deal changed the game for Lynton and our property strategy. It realised, along with other property transactions during the year, net cash proceeds of £625 million.

We will invest this in our core strategies.

And, of course, we have continued to make great progress on constructing Heathrow's Terminal 5. We are now into the detailed planning of operational readiness prior to opening in March 2008. So, high level, what were the financial results?

By any standard our performance was very good.

We had a record year for passengers, with over 8 million more than last year.

Group revenue grew over 7% - reflecting the 6.3% passenger growth and higher aeronautical and retail yields.

Group operating profit was up 9%, despite a £16 million exceptional reorganisation charge.

Profit before tax increased 36%. Of the £200 million increase in PBT, £112 million related to the exceptional profit recognised on the property transactions.

This led to earnings per share growing by 44% to 51 pence.

And, in line with our well understood progressive policy, the Board is recommending a dividend for the year of 21.2 pence, up 6%.

As you will have realised, our results have been influenced by exceptional costs and profits.

Let me explain what they are

Firstly, the £16 million reorganisation costs.

Mike has already referred to the significant programme of change that has commenced across the group – the move to an airport led operating model. This means delegating greater responsibility and accountability as close to the customer as possible. And therefore, becoming a more effective and agile organisation, through a more efficient use of resources and people.

In making these changes, the Group will incur further non-recurring reorganisation costs over the next two years. This is an investment in future performance. We expect it to deliver tangible benefits in the short and medium term and deliver the right organisation for long-term success. This reorganisation will realise significant benefits for our shareholders and put us in a stronger position during this next regulatory review.

Actions implemented during 2004/05 will deliver £4 million of annual savings and are essential enablers of the wider programme. We will provide further details of the costs and benefits of the reorganisation as the programme is finalised. We intend that to be no later than November.

The second exceptional item is the £112 million profit related to property transactions.

Over the last six years, our property disposals have provided £1.2 billion of cash proceeds. It is right that the profit realised on these transactions (which excludes the revaluation surplus being carried) is classified as exceptional profit. However, property development and management is a core part of our business. We have consistently delivered cash AND exceptional profits from our property skills. Our new arrangements with APP will, if anything, enhance our capabilities. We believe there is real embedded value in these assets.

Last year we sold a number of hotels and petrol stations, and realised cash proceeds of £60 million, delivered an exceptional profit of £39 million.

The Lynton team also masterminded the APP transaction. This deal realised a net £565 million in cash, giving a total £625 million realised from property transactions. The APP transaction also realised a gross profit of £161 million, over and above the carrying value of the investment assets at 31 March 2004. We are only recognising 50% of this in our income statement, due to our retained interest in the other 50%. Against this profit are transaction costs and other items.

So what does our performance look like if you strip out these exceptional items?

Well, as you can see it remains impressive.

Group operating profit was up nearly 12%, which along with….

An £11 million increase in our share of profit from our Australian interests, and net financing costs down £19 million, contributed to profit before tax up 19%.

Underlying earnings per share were also up 19%.

So what drove operating profit growth?

Operating profit of our UK airports and World Duty Free grew 13%, with good performance across all businesses. The record passenger numbers, improved revenue yields, and continued focus on controlling costs, contributed to this. I will talk more about our UK airports in a minute.

Our international airport operations delivered a total operating profit of £33 million, up from £19 million the previous year. This growth of 74% is a strong endorsement of our measured approach to international expansion. The continuing excellent performance of our equity interests in Melbourne and Perth, together with good results at Naples and our new retail contract in Baltimore, were the prime reasons for this strong growth.

As I have indicated, Lynton delivered £39 million of exceptional property disposal profits plus the joint venture with Morley. But it also achieved £15 million of operating profit, despite a reducing income base.

Heathrow Express' underlying profit grew £2 million, over 14%, before the £6 million write off of the check in facilities at Paddington.

Before looking in more detail at the performance of our UK airports, let's briefly look at the Group's operating costs.

With growth in passengers comes the constant need for new and improved facilities. Costs to service these are inevitable.

A significant element of the 5% increase in operating costs arose from new or expanded facilities, as is evident from the increases in depreciation, rates, utilities and maintenance.

Depreciation increased £28 million.

Maintenance, rent, rates and utilities rose £25 million.

Moving on to the UK airports performance.

As I have already stated, all airports saw strong profit growth.

Following a 5% rise in passenger numbers, Heathrow achieved 11% growth in revenue. Costs grew at the same rate due to new facilities brought on line. Profit was up 11%.

Gatwick had a superb year, with a record number of passengers, following traffic growth of 6%. This led to a 9% increase in revenue, which, along with operating efficiencies, delivered a great financial performance, with profit up 17%.

Stansted also had a very good year. Revenue grew 11%, driven by 9% growth in passengers, combined with nearly 6% increase in aeronautical charges per passenger and higher retail income. This converted into 18% profit growth.

Our four non regulated airports had an outstanding year – with revenue growth of 5% and profit increasing over 18%. These four airports now account for almost 11% of our UK airports' profit.

World Duty Free grew its profit over 4%, despite the expansion of the EU and weak dollar. The increase in profit was due to continued tight control of margins and operating costs.

And World Duty Free leads me to our retail performance in the UK airports.

Net retail income grew 7% and per passenger 1%. A significant achievement in difficult conditions.

At a time when high street retailers are being hit by dramatically falling sales, BAA continues to demonstrate an ability to deliver growth. This is a testament to our retail team. The team has created a world class retail environment at our airports that is attractive to passengers and retailers alike.

So, from the performance of our individual businesses to our finance costs.

For the year, net interest payable, before capitalisation of interest, increased £29 million. Capitalised interest of £127 million reflects the level and nature of the current capital programme. Capital projects under construction rose from around £2.3 billion last March to £3 billion this March. £90 million of the interest capitalised related to Terminal 5, compared to only £62 million the year before.

Our share of the interest charge of our associates and joint ventures has also increased in the year to £11 million, reflecting the additional stake we acquired in Melbourne in December 2003 and the refinancing of shareholders' loans.

This takes me to the Group's balance sheet.

Net assets at 31 March were £5.5 billion, up more than half a billion on the previous year. This reflects the £318 million retained profit and £214 million uplift in investment property values at 31 March.

The near £900 million growth in fixed assets largely reflects the £1.4 billion capital investment during the year.

Gross debt was almost £4.3 billion at 31 March, up from £3.7 billion at the previous year end. Offsetting this, we held cash and short term investments of more than £1.2 billion, up from £900 million at March 2004. The movement in net debt during the year was an increase of £310 million. This increase partly funded the £1.4 billion investment in our capital programme.

The balance of funding came from £467 million net cash flow from operations, and the

proceeds from the property transactions.

Of the £1.4 billion capital investment…..

...over £1.3 billion related to the three London airports.

At Terminal 5 we invested a further £773 million, taking the total investment to nearly £2.2 billion, excluding the land purchase and capitalised interest. Today, the project is almost 60% complete. We will invest a further £900 million during this current year.

Our planning has started to consider the activities required to ensure that we and our partners are ready for the opening of Terminal 5.

This activity involves adapting organisational structures, work practices and processes; recruiting and training staff; and assisting our airline partners to reorganise operations across the five terminals. This is a really important exercise to ensure a perfect opening of T5 on day 1.

We currently estimate that the total cash cost of Terminal 5 operational readiness will be around £60 million over the next three years, with the majority of spend in 2007/08. But this may change as our understanding and plans develop. In this current year, the costs will be modest, about £6 million. Given the nature of this activity, the costs will impact our income statement as non-recurring costs.

And the nature of activity at Terminal 5, in that final year before opening, will mean that we may start incurring depreciation and interest charges during the last few months of 2007/08. These charges would not have cash implication, but they would impact profit.

I now want to move onto IFRS, which we have been applying since last month.

We gave you very full detail of the expected impact of IFRS back in March. And we will be restating these full year results on 16 June.

We have used the adoption of IFRS as an opportunity to review our external reporting and align it with current UK practice and the European Transparency Directive.

We will no longer publish a detailed financial announcement following our quarter 1 and quarter 3 period ends. Instead, these will be replaced with pre-close trading updates before our half year and year end dates. We will retain the annual publication of our traffic and capital investment 10 year forecasts. We will also continue to issue our monthly traffic announcements, updates on key milestones or events, and our formal stock exchange interim and prelim results announcements. These will provide you with all you need to assess the performance and prospects of the company.

And that leads me to the outlook for this year and beyond.

We recently published our 10 year traffic forecasts for the three London airports. So you know we are expecting traffic growth of about 3.5% this year.

We expect an even better year from our retail operations. The external conditions that

impacted last year are now in the base. We also have an additional 2,000 square metres of retail space at Terminal 1.

At our interim presentation last November we highlighted the implications of rising energy prices and the review of the rateable value of our airports. Together, we expect these to give rise to approximately £35 million of additional costs this year.

New facilities brought on line during the past year, along with those anticipated to come on line during this year, will increase our cost base by a further £60 million. These costs are required to support our anticipated growth in passenger numbers and, in turn, our revenue and profit growth.

As I said earlier, we will let you have details of the costs and benefits of our reorganisation as soon as they are available. We intend this to be no later than November.

We will incur around £6 million of costs related to T5 operational readiness this year.

APP, our joint venture with Morley, will lead to the operating profit across our airports and Lynton falling by approximately £38 million per annum. This will be compensated for by our 50% share of the joint venture's net profit and a lower interest charge, as a result of the proceeds from the transaction.

And we are investing another £1.4 billion this year on the capital programme for our three London airports. This level of expenditure on ongoing projects obviously has implications for the level of capitalised interest in the year.

We are in a strong position. The forecast demand for air travel in London is strong but we will not be able to meet all of that demand. Whilst that clearly points to the critical need to build new runways and capacity, it also provides a very sound base to our forecasts.

There is still much work to be done. But I am confident that the changes we are making to the organisation, and our ongoing focus on innovation, will continue to deliver significant and sustainable benefits for our shareholders.

I will now hand over to Marcus to conclude and lead the question and answer session.