

**Speech by Margaret Ewing  
Group Finance Director, BAA plc  
2004-05 Interim Results  
2 November 2004**

Thank you, Marcus. Good morning.

Mike is going to talk more in a minute about our operations, the successes we have had over the past 6 months and how these influence our view of the future.

I am going to focus on our financial performance and short term outlook. But to put that in perspective, let me highlight some of the key events that have influenced our financial results in the first six months of this year.

In the first three months we had traffic growth of 9.7%. We experienced significant underlying growth, primarily from those sectors which had been weak for a number of years, particularly the North Atlantic market.

But we also benefited from a weak comparator, impacted by the Iraq war and SARS epidemic.

This strong performance continued into the second quarter, with 5.7% traffic growth.

We were able to accommodate a record number of passengers in July and August by ensuring our passengers and airline partners experienced reduced waiting times for security screening and increased reliability of our facilities.

We also achieved a good performance in our retail operations over the 6 months. Net retail income per passenger grew 1.2%.

During these six months we continued to focus on delivering our capital programme. This year we will spend a record amount investing in our airports, particularly on the continued development of Terminal 5.

To fund our capital investment programme it is essential that we have access to the capital markets. As we informed you previously, our funding strategy is to maintain maximum flexibility, to be opportunistic wherever possible, and to retain as a minimum a single A credit rating. The appropriateness of this strategy was born out in September - speedily capitalising on a market opportunity, we successfully launched our debut Euro bond issue. In addition, both credit rating agencies reaffirmed our single A ratings.

Let me now go through some of the detail behind our financial performance.

Our UK airports dealt with 77.5 million passengers during the six months - that's over 5 million more than last year.

Group revenue grew nearly 10%. This reflected the 7.5% growth in passengers, higher

landing and passenger tariffs, particularly at Heathrow, and robust retail performance.

Group operating profit increased over 11%, with the 10% increase in revenue partially offset by operating cost rises. Operating costs increased principally through wage inflation, significantly higher levels of depreciation and two unusual costs that I will explain in a minute.

Increased contribution from our associate and joint venture interests, improvements in FRS 17, other finance income, and growth in operating profit led to profit before tax increasing more than 16%.

Earnings per share also increased, nearly 17%, to 23.6p.

And the Board has declared an interim dividend of 6.9 pence, an increase of 4.5%.

But these results do not fully reflect the underlying performance of our business, due to a couple of unusual items.

Firstly, as you are aware, we and Ryanair issued counter writs in July. As a result of the non payment of airport charges, we regard Ryanair as having repudiated its existing agreements. This has resulted in Ryanair being invoiced an additional £7 million of airport charges since July. Ryanair has refused to pay these additional charges. We are very confident of winning the dispute. However, given the current litigation, we felt it appropriate to provide against this additional income.

Secondly, we have seen a decline in interest from airlines wishing to operate the check in facilities provided by Heathrow Express at Paddington. This reflects both the cost of operating such facilities and passenger demand. The last remaining airlines, bmi and Air Canada, have given notice. We're therefore writing off the carrying value of these facilities. This has resulted in a £6 million exceptional cost.

This slide illustrates the impact of these two issues on the results for the six months and clearly highlights the underlying performance of the business. For the remainder of this presentation, all of the slides and my commentary are focused on the underlying performance and figures.

Let me now explain in more detail some of the fundamentals underlying the results of our UK airports, including World Duty Free.

I have included the main points in the slides. A lot of further detail is also provided in the appendices to the slide pack.

The UK airports grew operating profit over 12%. The first three months saw profit increase nearly 16%, as a result of the 9.7% rise in passengers. On the back of the 5.7% traffic growth in the last three months, operating profit of the UK airports, including WDF, was up nearly 10%.

At all 7 airports we saw strong profit growth during the period.

Traffic grew 7.6% at Heathrow, benefiting from the strong recovery of the airport's North

Atlantic and other long haul markets, which were up over 10% and 15% respectively. The first quarter was also positively impacted by the return of passengers following last year's SARS epidemic and Iraq war. This traffic growth, along with higher landing and passenger tariffs and strong retail performance, contributed to Heathrow's 13% increase in revenue and 11% rise in operating profit.

Despite nearly an 8% fall in European charter traffic during the peak summer months, Gatwick achieved a 5% increase in passengers. Continued introduction of new routes by Easyjet and other airlines contributed to - a 17% rise in European scheduled traffic, - and more than a 15% increase in other long haul passengers. This growth in passengers and the increase in airport charges tariff led to Gatwick's revenue rising more than 6.5%, and operating profit up over 10%.

At Stansted we continued to see significant traffic growth, up 12% for the six months. However, this was influenced by over 33% growth in April, reflecting the halting of all Buzz flights for the month of April 2003. Growth in passengers since April has averaged around 8% per month, with much of the growth coming from higher yielding routes.

Underlying revenue at Stansted has grown nearly 15%, leading to operating profit growth of over 29% at £31 million. This is in line with the growth we had previously predicted.

At the four non regulated airports, excellent traffic growth, strong retail performance and cost reductions have more than offset the impact of airport charges yield dilution. Overall the four airports grew total revenue 3%, and saw more than a 15% increase in operating profit.

WDF held operating profit at £13 million. But this hides the nearly 4% increase in gross revenue and significant further operating and back office efficiencies. The benefits of these efficiencies have been passed on to the airports in the form of higher concession fees paid.

Looking more closely at the revenue streams of the UK airports:

Airports' revenue, including World Duty Free, grew over 9% or £88 million. The 7.5% growth in passengers has been the key influencer of growth in our airport charges income and retail revenue.

Firstly, airport charges. Airport charges revenue grew more than 13%. This largely reflected the increase in tariffs at Heathrow and overall growth in passengers. Tariffs also increased at Gatwick and Stansted. At Glasgow and Southampton the growth in passengers has been accompanied by a decline in yield.

And now retail income - for which of course, net income is far more meaningful than gross revenue.

Net retail income grew over 9% over the six months, with net retail income per passenger up 1.2% to £4.03.

Catering grew over 22%, benefiting from the redevelopment of catering facilities at terminal 1 Heathrow last year, and at Gatwick North terminal earlier this year.

Car parking income was up over 9%, aided by a strong performance from our off airport car parks and an improved premium mix. This mix improvement was driven by the recently opened multi-storey car parks at Southampton, Glasgow and Edinburgh.

World Duty Free and airside specialist shops have been impacted during the period by the enlargement of the EU. The return of the lower spending US passengers, compounded by the weak dollar, have also taken their toll. Yet despite this, we have still achieved robust growth from these two income sources.

I will come back to our retail expectations for the remainder of this year a little later. But for now, I want to focus on operating costs at our UK airports.

Operating costs of the 7 airports increased 7.5%. The analysis of this increase is in line with the guidance we gave earlier this year.

Staff costs increased £18 million, reflecting wage inflation, additional FRS 17 pension costs, and the effect of the extra security staff recruited last year.

Rent, rates, utilities and maintenance costs increased £11 million. This represents the increase in utility prices and business rates, seen by all corporates, and the impact on our maintenance requirements of additional operating infrastructure brought into service over the last 12 or so months.

Depreciation has increased £14 million in the six months.

Our increase in airport operating costs reflects our continued focus on expanding facilities and improving the quality of service. As we have said before, it is this focus that allows us to grow our passenger throughputs and revenues.

Our UK airports contribute more than 93% of the operating profit of the Group, including our share of profit from our joint ventures and associates.

Among our international operations, the performances in Naples, Melbourne and our other Australian interests have been outstanding. The addition of the retail contract in Baltimore and the expansion of the Boston retail facilities have also contributed to profit growth during the last six months. Our exit from Oman, announced nearly two weeks ago, has had, and will have, no material impact on our financial results.

Lynton has had an active six months. The results of this activity will not be seen, however, until the end of this financial year. We anticipate a number of property sales will conclude at this time. Lynton's management also concluded the marketing and appointment of an operator to build and manage the terminal 5 hotel.

Heathrow Express saw passenger growth of over 7%. This drove increased revenue and improved operating profit by £2m, despite this service currently being impacted by a growing proportion of leisure and transfer passengers. Heathrow Express management is continuing with preparations for the introduction of the Heathrow Connect stopping service in March.

Now to our financing costs.

Net interest payable, before capitalisation of interest, increased £19 million. This reflects primarily the £885 million increase in net debt over the past 12 months.

Capitalised interest of £56 million in the six months reflects the level and nature of the current capital programme. £40 million of the interest capitalised related to Terminal 5, compared to only £26 million last year.

And as previously flagged, the value of the pension scheme assets and liabilities at 31 March 2004 will result in finance income for this financial year of £12 million, compared to only £1 million last year. £6 million of this has been recognised in the first half of the year.

Which takes me to the Group's balance sheet.

Net assets at 30 September 2004 were nearly £5.2 billion.

The growth in fixed assets reflects the level of our capital investment. Over the past six months, we have spent over £700 million.

Nearly £640 million of this spend related to the three south east airports.

At Terminal 5 we invested a further £378 million, taking the total investment to date to over £1.8 billion, excluding the land purchase and capitalised interest. The project is now over 45% complete.

We've also spent a further £169 million on the airfield and existing four terminals at Heathrow. This has included the ongoing work on the airfield and terminal 3 to accommodate the A380 airbus from Spring 2006, and segregation of piers for security purposes.

This capital investment has been financed by a combination of internally generated funds and debt.

The activities of the Group continue to be strong converters of profit to cash. After deduction of interest, tax and dividends, the Group generated nearly £280 million for investment. The balance of the capital expenditure in the period was financed by net debt.

At 30 September our net debt was almost £3.2 billion, giving gearing of 62%. Our gross debt was almost £4.3 billion. Cash and investments were more than £1 billion, reflecting the proceeds from the Euro bond issue, received on 30 September.

And that leads me to the outlook for the remainder of this year.

Although we were up against some weak comparators, our underlying performance in the first six months has been pretty good.

We have said throughout this year that we should see passenger growth in excess of 6%.

We are still predicting this - which means that for the next 6 months we expect the average growth rate to be just over 5%.

And we have not changed our view, expressed last May, that, for the full year, net retail income per passenger will be flat year on year.

As anticipated, we are experiencing pressure on our utility costs and business rates. Significantly higher increases in these two costs are predicted next year. In this environment, as in any other, our costs require firm management.

We continue to seek cost efficiencies and improved operating effectiveness. We are identifying changes in the way we manage our business, which will allow us to drive down certain costs.

Overall, we remain confident in delivering a good performance for this year, assuming a stable external environment.

One of my key priorities is the Group's transition to international financial reporting standards.

We have made very good progress in the transition over the last 6 months.

As we have indicated previously, our financial reporting will be particularly impacted by six new standards. Our review of these and all other standards is coming to an end. We understand how they will impact BAA, and our financial results and balance sheet.

We have almost completed the quantification of those differences to UK GAAP on the opening balance sheet and these interim results. The policies and quantification are in the process of being approved by the Audit and Assurance Committee.

We continue to focus on the impacts of these standards on the business. We are ensuring the systems and procedural changes that are required are implemented. Training is being given to all staff affected by the changes, not just finance staff. This will ensure our transition is smooth, that we remain IFRS compliant and our reporting capability will not be impacted by the transition.

It is our intention to inform the financial community in the final quarter of this financial year. At that stage, we will brief you on the implications of the transition to IFRS and the changes of accounting policy.

We believe in timely and relevant communication - we want you to gain the maximum benefit from our briefing and ensure that there is no confusion or uncertainty regarding the implications of this transition.

And finally, as you will have noted, my personal four priorities have not changed since May:

- we have continued to carefully monitor performance, and have taken corrective action when necessary;
- revenue and capital costs have been carefully controlled;

- our funding strategy is being efficiently implemented; and
- we are on the way to a smooth transition to IFRS.

I will now hand over to Mike to sketch out the bigger picture on a number of the issues I have touched on.

Thank you.

**Speech by Mike Clasper  
Chief Executive, BAA plc  
2004-05 Interim Results  
2 November 2004**

Good morning. I'm very pleased to be here at Bloomberg's offices once again to report another very satisfactory set of results. Margaret has taken you through the detail of our performance which once again illustrates BAA's strategic advantages:

- Robust and growing demand for air travel
- Great assets in our UK airports
- Strong balance sheet and credit rating
- A sound regulatory and political framework

But our consistently strong performance is not just about relying on these structural advantages.

Our success arises from the clarity of our strategic goals: protecting our licence to grow; driving customer service and high quality execution of our capital programme. But the strategy achieves its full potential through really smart operational performance such as:

- our focus on delivering efficient and effective service to passengers and airlines
- our entrepreneurial approach to retail development.
- and real quality in construction from commercial design through to project management

It is in these areas that I think BAA is occasionally given insufficient credit for our achievements and it is on these areas that I want to focus today.

Let me assure you that we are getting the high profile things right as well. On Terminal 5 we are 45% through Europe's biggest infrastructure project, ahead of schedule and on-budget. Nor has there been any let up in the way that we continue to improve our security operation so that passengers queue less, suffer lower stress and spend more in our shops.

Having got to grips with the security experience, we are now moving on to another critical area of passenger stress... Check-in.

Like security, check-in is a big source of stress but its also a massive user of airport space. As passenger numbers continue to grow we would, in the past, have tried to find more space to put in extra desks. But today, IT systems have made self-service check-in possible. We are starting to realise the potential for our own business.

I'm not saying self-service check-in is a BAA idea. It's being widely deployed by airlines all around the world. But our opportunity at an airport like Heathrow, which serves more than 90 airlines, is to design a common self-service solution which works for everyone.

This type of shared self-service check-in is now on trial at Terminal 3. If successful with passengers, it will enable us to stem the expansion of airline-specific check-in desks and allocate valuable floor space to other enterprises. The passenger will get a better experience, all for the price of developing some fairly simple computer software to deliver a common airline interface.

Improved check-in, like smoother security, will benefit our retail business and this is where I want to focus next: on World Duty Free.

During the last six months World Duty Free has had to contend with EU enlargement, crowded terminals and a weak dollar, all factors which you would expect to reduce the propensity to purchase.

WDF has bucked this trend through clever promotions and skilful category management. Let me give you an example in both areas. Firstly, in marketing... WDF introduced a \$1.70 to a pound exchange rate promotion in its stores. What this meant was that if you had US dollars in cash you could spend in WDF stores at a guaranteed exchange rate of \$1.70. This was really smart thinking. It got passengers into the stores, always a key challenge for WDF. It was a cash-only offer, so it encouraged those who had the dollars in their pocket to spend and, most importantly it helped to mitigate the negative impact of the weak dollar on US bound travellers. It gave BAA a brilliantly targeted promotion. We offered one set of customers a special deal, but avoided subsidising passengers travelling to strong currency areas. That's the basis of all good marketing: making some customers feel special in a cost effective way.

In category marketing, we are running a great pilot at T4 WDF. We are calling it the "Next Generation Wine and Spirits Store". This is a lifestyle-led shop that includes a bar at the centre of the store. And we have done this because our research shows that customers, especially women, are demanding a more engaging experience.

To make this promotion work required months of discussion with our business partners in the drinks business and the development of a shared goal: to drive up sales by raising customer interest and conversion rates. It's very rare, if not unknown, for all the big wine and spirit companies to collaborate in this way.

Of course individual brands still benefit from their specific promotions, but the store itself is focused on supporting all brands through the creation of an original and enticing setting. Early indications are very positive.

If the test is successful, we are likely to roll-out the concept across other terminals and, of course, Terminal 5... which as I said earlier is on budget and ahead of schedule.

A few days ago, we successfully moved the control tower cabin across the southern runway into its permanent position and completed the handover of the remaining 6 early release stands. That's another regulatory milestone passed - this one five months ahead of the deadline.

Another indicator of our progress at T5 is the fact that we've just decided to bring forward the commissioning phase of the new terminal. This will now start in 2005, as individual

elements of the construction programme are completed. That means third party fit-out can start in 2006, for operational readiness in 2007. The bottom line is that we can now be even more confident that T5 will open on time on 30 March, 2008, the day when the summer airline schedule kicks in for that year. In short, we are continuing to manage down the level of risk on this huge project.

At the same time as our T5 team is performing, Pier 6 at Gatwick is also on course to be in operation in time for next year's summer schedule, many months ahead of its regulatory target. This is another great example of smart construction. It has helped us to open another part of the Gatwick airfield to pier service, but with minimal disruption to airfield operations during its construction. Great design also means safe and efficient operations, as aircraft can pass underneath the Pier.

Another example of smart construction is the new multi-storey car park at Edinburgh. A new car-park may sound prosaic, but the way we have considered the opportunity, managed its construction, and introduced the new premium product has delivered real benefits. Firstly, the case for a new car-park was entrepreneurial. Growth in car-parking income at Edinburgh had slowed right-down as we were constrained by the product, a traditional open car park with limited growth potential. The multi-storey changes the equation. Not only do we have more space on the same land footprint that will allow us to accommodate increased demand, but we have been able to introduce premium pricing for a premium offer. We also completed construction nine weeks ahead of schedule to allow us to capture some income from peak summer months.

This leads me on to a construction project that we will not be taking forward: a new airport terminal at Seeb airport in Oman. Let me put this firmly in the context of BAA's international strategy, about which I remain very confident. In Oman BAA and its partners could not reach financial agreement with the Omani government over the construction of a new terminal and this led the Omani government to exercise its contractual right to abort the privatisation process. We've done a good job managing Oman's two airports and we don't expect to lose money, as we help manage an orderly transition to the new ownership.

For me, the important point about the Oman story is that it confirms the strength of our international strategy, which is to seek opportunities for growth, so long as they do not involve significant financial risks. We fully understand that airports are strategic national assets and we remain confident that we are world-leaders in running airports as economic assets. What we will not do is bid for or run assets in a way that does not add value to our shareholders. We will avoid trophy airports that do not offer a satisfactory economic return within an acceptable framework of risk.

Our international strategy works because we are clear what we are trying to do and firm in our execution. Another example of clear thinking and firm management concerns BAA's relationships with our airline customers, which from time to time are the subject of well publicised tensions.

Our goal in our airline relationships is to enable our customers to succeed in growing and developing their businesses, in ways that are consistent with us responsibly growing our business.

I am pleased to report today that we have reached an in-principle agreement with the Star Alliance on its occupation of Terminal 1, and that we expect to sign a Memorandum of Understanding in the coming weeks. It has taken much detailed discussion to get to this point with...- BMI, - United, - Air Canada, - Lufthansa and the rest, but we now have an understanding which will help the airlines develop their businesses, and which fits into our vision of the re-modelled Heathrow which will emerge in the years following the opening of Terminal 5.

We are also making good progress working with other Heathrow airlines on individual and alliance agreements, about terminal occupancy and operating conditions. There is a major business opportunity for everyone involved in our vision of the New Heathrow.

Finally, let me re-iterate Margaret's confidence about the outlook for the business.

This recognises the lower passenger growth in the second half of the year and, as Margaret said, our need to be realistic about net retail income per passenger, given the first year impact of the EU enlargement.

Nor can we ignore the current industrial relations climate within the aviation sector, which has seen a series of disputes at UK airports. None of these have involved BAA staff and we can take some comfort from the fact that they have had a minimal impact on our operations. But an atmosphere of industrial conflict is not good for any business: it generates uncertainty for the passenger and that damages service quality.

In terms of BAA's own pay negotiations, we have reached an agreement with four out of our five major unions - Amicus, PCS, Prospect and ASLEF - but we have not yet been able to agree terms with the Transport and General Workers Union.

Nonetheless, as I said at the beginning, we have structural and operational strength. We have had a successful half year, with strong performance across the business. Growing numbers of passengers, an attractive retail offer and efficient airports with strong, innovative management mean that we are well positioned to deliver another good performance in the second half of the year.

Thank you for your attention.