

NATS

Annual Report and Accounts 2012

NATS Holdings Limited



Company Number: 04138218

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OUR BUSINESS

Our vision is to become the acknowledged global leader in innovative air traffic solutions and airport performance.

NATS Holdings Ltd (NHL) owns two principal operating subsidiaries and a number of other companies which, together with NHL, form the NATS Group. NATS provides air traffic control services for aircraft flying 'en route' in UK airspace and the eastern part of the North Atlantic through its subsidiary NATS (En Route) plc and at 15 airports in the UK and at Gibraltar through NATS (Services) Ltd.

Our vision is to become the acknowledged global leader in innovative air traffic solutions and airport performance.

NATS (En Route) plc

NATS (En Route) plc (NERL) is the sole provider of air traffic control services for aircraft flying 'en route' in UK airspace and the eastern part of the North Atlantic. It provides approach services to aircraft arriving at or departing from the major airports around London and air traffic control services to helicopters operating in the North Sea. NERL also has a long-term agreement to provide the military with engineering, surveillance

and communications services. It is economically regulated and operates under licence from the Civil Aviation Authority (CAA). It operates from two air traffic control centres, at Swanwick in Hampshire and Prestwick in Ayrshire.

NATS (Services) Ltd

NATS (Services) Ltd (NATS Services) is a commercial business not subject to economic regulation, and provides air traffic services at most of the UK's major airports. These range from the world's busiest dual-runway airport, Heathrow, and Gatwick, the world's busiest single-runway airport, to the city airports of Glasgow and Edinburgh. NATS Services also manages air traffic at airports in Aberdeen, Birmingham, London City, Luton, Manchester and Stansted.

NATS Services has a joint venture with Spanish infrastructure company Ferrovial, which is contracted to provide air traffic control tower services at ten airports in Spain.

NATS Services also provides engineering, consultancy (including training), defence and aviation information management services to customers in the UK and more than 20 other countries.





HIGHLIGHTS

We are the first air navigation service provider to implement an environmental performance metric.

Safety, operational and environmental performance

- ▶ We handled just under 2.2 million flights in the year (2011: 2.1 million) and maintained our safety record, with no risk-bearing airprox attributable to NATS. Average delay per flight was 7.3 seconds, up on 2011 (4.3 seconds) as we successfully implemented a significant systems upgrade.
- ▶ By providing customers with more efficient flight profiles we enabled savings of 25,000 tonnes of fuel (2011: 12,000 tonnes), equivalent to 80,000 tonnes of CO₂ emissions (2011: 38,000 tonnes), worth approximately £16.5m based on average fuel prices of £655 per tonne (2011: £7.5m at average fuel prices of £620 per tonne).

- ▶ We are the first air navigation service provider to implement an environmental performance metric, measuring the efficiency of flight profiles to reduce CO₂ emissions. The new metric forms the cornerstone of a new incentive regime which is designed to deliver 600,000 tonnes of CO₂ savings over the next three years, worth up to £120m at today's fuel prices.
- ▶ We received our best ever customer satisfaction score in our annual survey with 81.1% of customers satisfied or highly satisfied with our service (2011: 80.7%).
- ▶ We achieved a high level of contract renewals, launched our growth strategy and successfully generated new business in new markets, securing orders worth £495m in the UK and 20 other countries. These included a new seven year contract with BAA to continue to provide air traffic control services to five airports, a two year extension to the Gatwick airport contract and a five year contract awarded to our Spanish joint venture for air traffic control services to 10 airports. We also secured consultancy contracts in the USA, the Middle East and Asia-Pacific.

Financial performance

- ▶ Revenues increased by £88m to £865m (2011: £777m) mainly due to net increases in regulatory revenue allowances following the price control review for 2011 to 2014 and contract renewals and growth in our commercial business. Profit before tax also improved by £89m to £195m (2011: £106m), largely due to these factors.
- ▶ In line with our capital investment plan for the year, we invested £128m (2011: £123m) in air traffic control infrastructure and systems.
- ▶ Net debt at £509m (2011: £528m) was £19m lower than previously. The level of gearing (net debt defined by bank covenants relative to regulatory assets) of the economically regulated business was 58% (2011: 57%).
- ▶ Shareholders received dividends of £51m (2011: £40m) during the year.



CHAIRMAN'S STATEMENT

We continue delivering a world-class service and growing the business at home and abroad.

“Are the skies any brighter yet?” Many boards in the aviation industry must have asked this question as they faced on-going economic challenges. In the West, the Eurozone crisis, double-dip recession and pension costs continued to dominate the headlines. Meanwhile, emerging markets presented new opportunities for infrastructure and services in support of ambitious expansion plans.

And change continued to define the regulatory arena. In 2012 the Single European Sky (SES) performance scheme was introduced, setting the performance targets for national air traffic management plans.

NATS faced up squarely to these shifting political, economic and regulatory environments. In last year's report, we talked of our potential and a new strategy to capitalise on core competencies. This year, we can point to the first steps taken to realise that opportunity.

Richard Deakin and the leadership team rolled out their vision and strategy for the years ahead. These focus on two main requirements: to continue delivering a world-class service as the leading air navigation service provider in the UK market, and growing the business both at home and abroad through a new range of innovative services and solutions, designed to meet the changing needs of airports, airlines, air navigation service providers, military and governments around the world.

Crucially, we do this from solid foundations. I'm pleased to report that our economically regulated business has made a good start in delivering its service quality and cost efficiency targets in the first full year of the new price control period (CP3). Also as expected in this year, there was a net increase in its revenue allowances which were reset to reflect allowed investment, operating costs, pension contributions and cost of capital, based on the traffic conditions forecast for CP3. Our commercial business continued to perform well in fiercely competitive markets, successfully renewing significant airport contracts in the UK and winning new business overseas, including airport contracts in Spain through our joint venture with Ferrovial.

CHAIRMAN'S STATEMENT

For the year, the group's turnover improved by £88m to £865m. This mainly resulted from net increases in revenue allowances in our economically regulated business, combined with the contribution from contract renewals and growth in our commercial business. As a result, group profit before tax increased by £89m to £195m.

Underpinning this success is our focus on the customer, which sets us apart as an air navigation service provider. Over recent years we have created a range of innovative ways to listen directly to their needs and concerns, which we address in our operations, in our investment and engineering transition programmes and in our coordinated response to incidents, disruptions and delays. We strive continually to find ways to contribute further, the latest example being our 3Di metric for measuring and improving flight efficiency, saving both CO₂ and fuel burn.

In our commercial business, our expertise in information management, designing and managing complex airspace, and optimising runway capacity for our customers, supports the world's busiest single and dual runway airports at Gatwick and Heathrow and is now helping us to win new business internationally in markets from the USA to India, and from the UAE to Singapore.

Recognising that the Executive team have a key role to play both in delivering our operations and in formulating and driving our growth strategy, we have welcomed several new members in the past year. I am particularly pleased with the calibre of the current Executive team and the cohesiveness that has been achieved in a short period of time.

Martin Rolfe, Managing Director Operations, has joined NATS from Lockheed Martin. His relationship with NATS dates back many years and his commercial experience will help ensure our regulated business has the flexibility to respond to the changing European environment. Gerry Skelton has also joined us from DB Schenker as HR Director, and Simon Warr from Jaguar Land Rover as Communications Director, both adding significantly to the Executive team's strength.

CHAIRMAN'S STATEMENT

To enable the new strategy, the company has rightly recognised the need to recruit, reward and manage talent differently, and is introducing new performance and career development processes, adapted from external best practice. As a service provider, our people will always be our most valuable asset and NATS' success is due in large part to strong leadership, professionalism and respect across the organisation. This is underpinned by an internationally recognised approach to working in partnership with employee representatives.

Two Board members, Baroness Dean of Thornton-le-Fylde and Andrew White, nominated by the Government as its Partnership Directors, stand for re-election this year. Ian Mills resigned from the Board and has left NATS. Over the last 7 years Ian made a significant contribution to our high standards of safety, service and efficiency, for which I would like to thank him.

Finally, we look forward to the Olympic and Paralympic Games which present one of NATS' greatest operational challenges ever. Three years in the planning, preparations typify the NATS approach; unique expertise, a focus on listening and responding to customer needs and a partnership with Government and military that is trusted, efficient and above all else safe.

Pierre de Coubertin famously focused on taking part rather than winning. At NATS, we hope to do both.



John Devaney
Chairman



Business and Financial Review

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CHIEF EXECUTIVE'S REVIEW

The past year has been characterised by change, challenge, and opportunity.

The past year has been characterised by change, challenge, and opportunity. Within our core business we maintained our high safety standards and continued our focus on mitigating areas of safety risk. Our attributable average ATFM delay¹ was 7.3 seconds per flight (2011: 4.3 seconds), about 11% of the equivalent European average, and this was achieved while delivering new technology into the operation. We have also made a good start in delivering the performance targets set by the Civil Aviation Authority (CAA) for our economically regulated business for the four year control period 2011 to 2014 (CP3). Significantly, we introduced in January 2012 a new metric (3Di) which will track our performance in providing efficient flight profiles which will help airlines reduce their fuel burn and enable further progress in our aim to reduce CO₂ emissions in UK airspace. We are the first air navigation service provider to implement such a scheme and this now forms part of our incentive arrangements where the CAA has established performance targets to complement our existing value-added focus on service-delivery.

¹ATFM or air traffic flow management delay represents the delay between the last take-off time requested by an airline and the take-off slot which is allocated when an air navigation service provider (ANSP) applies a flow restriction. Delay which is directly attributable to an ANSP includes staffing, capacity and systems-related delay. Delay which is not directly attributable to an ANSP, includes weather at airports and en route, and delay attributed to airport infrastructure. NATS determines its delay based on those factors which are directly attributable to its activities (i.e. staffing, capacity and systems-related) and has compared its performance with the equivalent European value.

We measure our operational performance against a set of key performance indicators. These are set out on page 74.

Across the company we made significant progress this year in implementing the growth strategy that I set out in last year's report. We have been very successful in winning business in new markets and retaining our existing domestic airports contracts. Our success in winning contracts relies on three key principles. Firstly, our focus on adding value to our customer's operations, secondly our unrelenting focus on our core competencies and thirdly our export focus where we are delivering the same services for our customers overseas as we do in the UK within carefully chosen markets where risk can be managed effectively.

Financially, NATS delivered its best financial performance since the Public Private Partnership was established in 2001. Revenue for the year increased by £87.6m to £864.9m (2011: £777.3m) and pre-tax profits rose by £88.4m to £194.5m (2011: £106.1m). As explained in the financial review, the exceptional increase in profit mainly arises from the price control review for 2011-2014 (CP3). This reset the mainly cash-based revenue allowances of the economically regulated business to enable the company to meet higher pension contributions and to recover additional investment in air traffic control systems, and adopted new traffic forecasts thereby ending the sizeable under-recovery of revenue allowances in the previous year caused by the weak economic environment. Contract renewals and growth in NATS' commercial business also contributed.

CHIEF EXECUTIVE'S REVIEW

Our vision and strategy

The market for air traffic management services is changing in response to the long-term growth in aviation, which is placing greater pressure on existing airport and airspace infrastructure just as environmental concerns are making expansion of that infrastructure more challenging. The European Commission's 'Single European Sky' project is seeking to improve ATM performance, increase integration and improve network performance; and ensure that European developments are aligned with the NextGen program in the USA. We are also seeing increasing liberalisation of the airport tower contract market internationally.

We believe these developments will provide NATS with many exciting opportunities where traditional service providers focused purely on a low-cost model will lose out to those who can differentiate themselves through added value services in increasingly complex operational environments.

Within the marketplace, we expect a growing trend towards outsourcing which will enable us to demonstrate our ability to squeeze maximum use out of runways and airspace. At the same time, changes to International Civil Aviation Organisation (ICAO) standards, European legislation and network technology will mean that airports, airlines and air navigation service providers (ANSPs) will need more complete, timely and accurate information, which NATS is well placed to provide.

Many ANSPs and airports will implement major airspace improvements and systems developments over the next decade providing opportunities for NATS to help transition new equipment and facilities into operational service given our experience in this area. Cutbacks in defence budgets are also encouraging innovative thinking in the future provision of military air traffic service provision. NATS has operated a joint and integrated service with the UK's Ministry of Defence (MoD) for many years and this is a unique differentiator of our capability.

In response to these trends we have developed a clear and compelling strategy which retains and builds on the success of our existing business to realise the opportunities that we believe these changes will present. We are clear on which products and which markets offer the best opportunities at manageable risk. We also recognise that these developments may bring increased competition to our domestic market, although we have been encouraged by our significant contract renewals in the past year with customers who recognise the unique value inherent in the NATS offering.

Above all, we must continue to deliver a safe and efficient service to our en route and airport customers which is essential not only to maintain our UK market position but also to demonstrate our capabilities to new customers.

With these challenges in mind, our vision is: *"To be the acknowledged global leader in innovative air traffic solutions and airport performance"*.

Our target is to generate sustainable revenue of £1bn by 2015. This is ambitious and will only succeed through the energy and innovation of our people.

We have reorganised the economically regulated and non-regulated business by service line to reflect our core competencies and our routes to market and provide greater clarity to our customers of the capabilities offered under the NATS brand. The service lines are: NATS Airspace, NATS Airports, NATS Consultancy, NATS Defence, NATS Engineering and NATS Information. We will report our operational and financial performance by service line in next year's annual report.

In addition, our growth is very much focused on creating successful partnerships in overseas markets to mitigate risk and to support the increased supply of qualified staff to assist in contract delivery. Our win in Spain with our Spanish partner, Ferrovial is a good example of this strategy.

CHIEF EXECUTIVE'S REVIEW

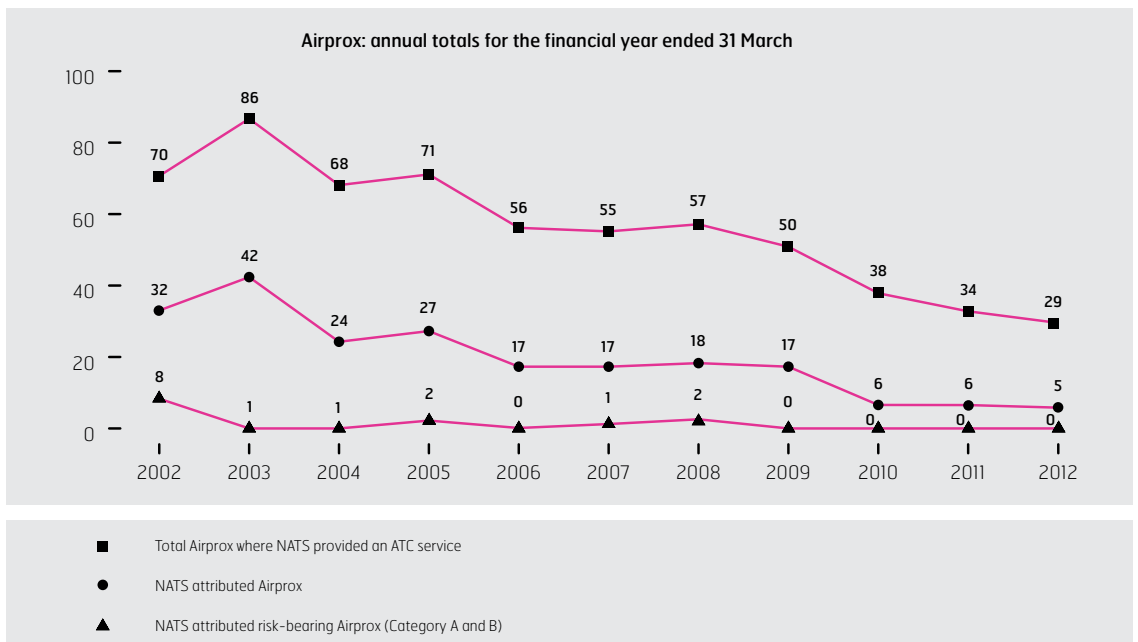
Safety

Our first priority is the safety of aircraft and the travelling public. We have an international reputation for our approach to safety management, our well established safety culture and our excellent safety record.

Our safety improvements focus on tackling the causal factors and subsequent sources of safety incidents, including working with others in our industry to do so. The most significant causal factors are: infringements of controlled airspace, level busts², civil-military interactions, Oceanic events and operational interfaces.

Our target recognises the significant improvement over the last 3 years – a reduction of 41% in the Weighted Safety Significant Event (SSE) index over that period. With an 18% improvement in this financial year NATS is now responsible for a decreasing proportion of safety risk which means achieving the same rate of improvement becomes more challenging.

For the fourth successive financial year NATS has achieved its target of no category A or B Airprox³ attributable to NATS and our strategic safety target to March 2015 is to maintain this record along with a further 10% reduction in our Weighted SSE index.



Note: Safety statistics for 2012 include NATS' assessment of the outcome of the UK Airprox Board reviews

² An aircraft deviation of 300 feet from its assigned level.

³ An Airprox is a situation in which, in the opinion of a pilot or controller, the distance between aircraft as well as their relative positions and speeds have been such that the safety of the aircraft involved was or may have been compromised. The severity of these incidents is assessed periodically by the UK Airprox Board, an independent body, in the interests of enhancing flight safety.

CHIEF EXECUTIVE'S REVIEW

In April NATS launched its Strategic Plan for Safety, a high level summary of NATS' safety activities. It sets out the vision, strategy and areas of focus required to deliver on our committed safety improvement targets.

As the figures attest, considerable progress has been made this year in a number of key safety improvement projects. Much effort has been focused during the year on reducing the risk of level busts. There has been a 10% reduction in level busts in NATS controlled airspace in the financial year. As part of this work a new Barometric Pressure Setting Advisory Tool was introduced into Swanwick's London terminal control centre. The tool detects incorrect pressure settings selected on the flight deck and provides controllers with an advisory warning before an aircraft suffers a level bust. Since the introduction of the tool there have been no level busts with inbound aircraft.

We have extended the capability of the SLAM (Sudden Loss and Air Traffic Service Outside Controlled Airspace (ATSOCAS) Management) project, which went live in May 2010, providing a service to the southwest of England. The implementation was a joint project with the military, airline customers and other stakeholders, such as Exeter and Newquay airports. Since April 2011 the facility has significantly improved the capability to safely land or disperse all London terminal control traffic in the event of a complete loss of service at the Swanwick centre.

Flight efficiency over the North Atlantic has also been improved with the introduction of Reduced Longitudinal Separation, a new navigation standard that reduces longitudinal separations from 10 minutes to 5 minutes for properly equipped aircraft in North Atlantic airspace. This reduction has been safely enabled by the use of enhanced surveillance and position monitoring systems, providing safety benefits by reporting aircraft positions more frequently. This alerts the air traffic controller when aircraft deviate more than 5nm laterally or 300ft vertically from their assigned routes and position. It reports every 18 minutes, an improvement from 43 minutes previously, for aircraft with compatible surveillance equipment.

The introduction of iFACTS (interim Future Area Control Tools Support) in November 2011 into the Swanwick centre also supports the reduction in safety risk. The tool, which is based on trajectory prediction and medium term conflict detection, provides decision making support to controllers and facilitates early detection of conflicts in and around the sector of airspace they are managing.

NATS has also won awards this year for safety innovations for AWARE, the GPS-based moving map device that helps private pilots to avoid infringing controlled airspace, and for the deployment of a multi-lateration system which tracks helicopters in transit to and from oil and gas platforms in the North Sea utilising transmitters and receivers fitted to offshore oil rigs.

CHIEF EXECUTIVE'S REVIEW

Environment

Our focus on the environment continues to remain one of our core values. Reducing fuel burn also reduces CO₂ emissions and our customers have a very high priority for efficient flight profiles that deliver these benefits. Four years ago we set a clear environmental target to reduce air traffic related CO₂ by an average 10% per flight by 2020 (from a 2006 baseline) with a challenging interim target to achieve a 4% per flight reduction by 2015.

This year NATS became the first ANSP in the world to be financially incentivised on the environmental performance of its network. Following nearly three years of research and development, analysing actual radar tracks since 2006 and consulting with the CAA and airlines, our environmental metric (three dimensional inefficiency score or 3Di) was introduced in January 2012. The 3Di metric measures on vertical and horizontal trajectories how smooth a climb and descent is, and how direct a route we can provide for each flight relative to the optimum flight path. Initial analysis shows there is scope to save around 600,000 tonnes of CO₂ over the next three years, saving airline customers some £120m in fuel costs against historic performance levels. Since its launch the 3Di metric has received

international acclaim as well as having won the Jane's ATC Environment Award and NATS is now working with a number of other ANSPs to see if it could be applied more broadly across the industry.

The importance of delivering short-term tactical benefits to our customers also continues to be recognised. NATS has set progressively more stringent annual targets to ensure that better fuel efficient flight profiles are delivered from procedural change and tactical measures. During the year we enabled fuel savings of 25,000 tonnes (2011: 12,000 tonnes), equivalent to 80,000 tonnes of CO₂ emissions (2011: 38,000 tonnes). This is worth approximately £16.5m based on average May 2012 fuel price and exchange rates, assumed at £655 per metric tonne of fuel (2011: £7.5m at £620 per metric tonne of fuel).

NATS has also delivered a 25% reduction in its carbon footprint over the past four years. The environmental impacts of our estates from energy and water consumption have been reduced by 26% and 40% respectively since 2008 and the amount of waste sent to landfill is 81% lower. We have also reduced the miles travelled by our staff: by 42% for business and by 25% for commuting. The improvements we have made have led directly to savings, with the reductions in energy consumption alone saving over £2m a year.

Looking forward, we have set aside capital investment for energy efficiency projects which will help achieve a further 20% reduction (from a March 2011 baseline) in energy consumption by the end of 2014. In addition we have set a target to further reduce water consumption by 10% and for maintaining our recycling rate. Over the next year NATS is conducting an ISO14001:2004 gap analysis assessment of its UK operations with a view to attaining the standard by the end of 2014.

We have continued to support community causes through our Footprint Fund and additionally this year I decided to nominate a Chief Executive's Charity, Aerobility⁴ which provides people with disabilities the opportunity to fly, and our staff have made extraordinary efforts to support them. Working with the Trades Unions, we have raised more than £100,000 for this worthy cause.

⁴www.aerobility.com



CHIEF EXECUTIVE'S REVIEW

Growing our business

NATS continues to seek growth opportunities through NATS Services and has streamlined this side of its business to be able to respond flexibly and speedily to market demands.

We made excellent progress this year with our strategy of defending and maintaining our existing business, identifying the opportunities and markets in which to grow our business, and ensuring that we have the capabilities and skills to enable that growth. Overall we renewed 8 airport contracts and secured orders worth £495m in the year in the UK and 20 other countries.

Importantly, the new growth strategy has captured the imagination of employees across the organisation and I have been greatly encouraged by the enthusiasm with which the growth challenges have been adopted and the desire of many to actively participate in the opportunities this new approach has created.

In maintaining our existing business, NATS signed a new seven year contract with BAA worth £334m to continue to provide aerodrome air traffic control and engineering services at five airports: Stansted, Glasgow, Edinburgh (sold to Global Infrastructure Partners in April 2012), Aberdeen and Southampton.

We also reached agreement with Gatwick airport on a new two year contract which runs from April 2013, secured a further six year contract from Farnborough and extended our service to Gibraltar airport by a further year.

We have also been successful in new markets. Our joint venture with Ferrovial, ferroNATS, was selected by the Spanish ANSP (AENA) to provide tower air traffic control services to 10 airports. This is the first European market to liberalise the provision of air traffic in this way and represents a significant breakthrough for NATS internationally. The contract will generate c. €75m of revenues over 5 years for ferroNATS. The process of transitioning each airport from AENA which began in June 2012 and will be complete next summer.

A consortium of companies led by global services company SRA International, including NATS' American subsidiary, NATS (USA) Inc., has been selected to bid for task orders within the En Route Technical Assistance Support Services (ETASS) contract from the Federal Aviation Administration (FAA). The SRA consortium is one of three consortia that have been selected to compete for individual tasks within the umbrella ETASS contract.

The ETASS contract will provide a set of engineering support services to the FAA's air traffic organisation. It is designed to support the transition and acceptance of many large FAA change initiatives including the En Route Automation Modernization (ERAM) programme, which will replace the 40-year-old computer and backup system used at the country's 21 en route control centres.

On the consultancy side, NATS has been awarded airspace design contracts for New Doha International Airport in Qatar and for Singapore, and a contract to assess the performance of Singapore's surveillance tracking systems. We are also supporting Hong Kong with consultations on its airport development.

Manchester Airport Group recognised NATS' engineering capability by awarding a contract to fit out the airport's new control tower which will enter service in April 2013.

Finally, we are pleased that AQUILA Air Traffic Management Services, the consortium of NATS and Thales, has been selected as one of three companies in the final stages of bidding to support the Ministry of Defence (MoD) with air traffic systems and services for its airbases in the UK and overseas.

CHIEF EXECUTIVE'S REVIEW

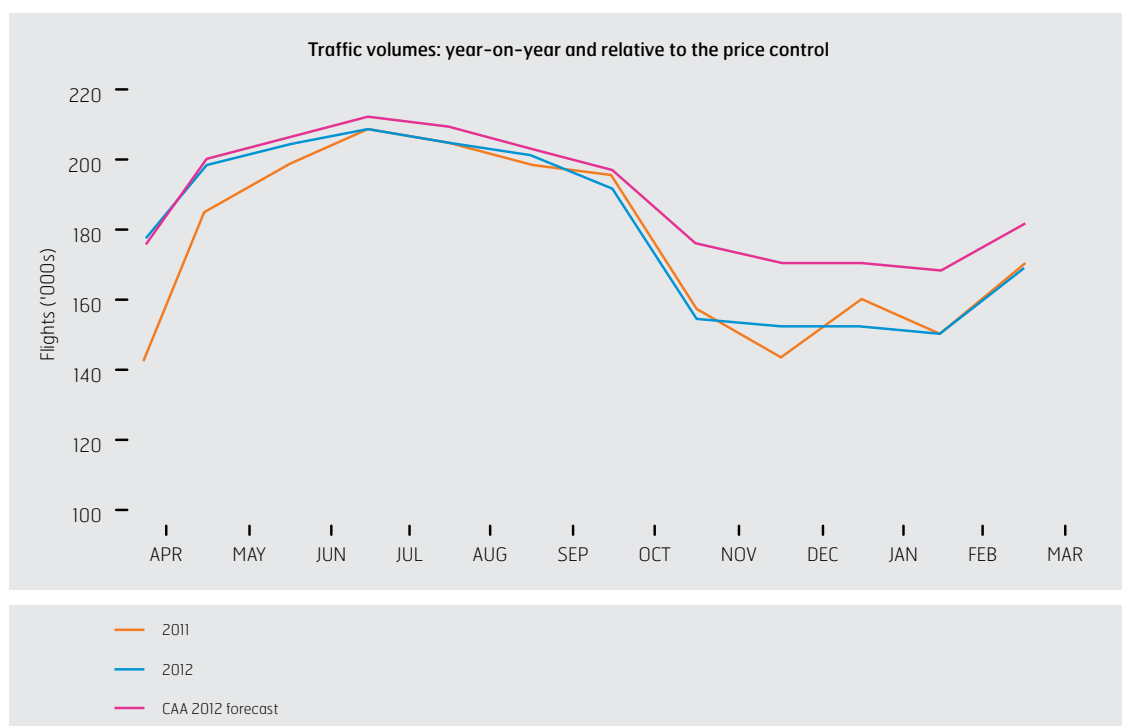
Delivering our economically regulated services

UK aviation continued to suffer from the weak economic environment. Although the volume of flights we handled increased by 2.4% to just under 2.2m, adjusted for the impacts of volcanic ash (in April and May 2010) and severe weather (in November and December 2010) the volume of flights in UK airspace actually shrank by 0.2%.

Chargeable service units for the year were also 2.2% less than assumed by the CAA in setting the price control for 2011-2014 (Control Period 3 or CP3), and we are now forecasting that cumulative traffic growth will be about 4 percentage points lower than the forecast used by CAA for the control period. This represents a loss of revenue of c. £60m in spite of the volume risk sharing provisions of the price control conditions: our economically regulated business bears all of the risk on the first 2% of any shortfall (or upside) against the forecast used by CAA and 30% of the shortfall (or upside) from this level if traffic is up to 10% different to the CAA's forecast.

	2011/2012 ('000s)	2010/2011 ('000s)	% change in year
Chargeable Service Units	9,676	9,377	3.2%
Total UK traffic (flights):			
Domestic	395	404	(2.2%)
Transatlantic	322	311	3.5%
Other	1,450	1,401	3.5%
Total	<u>2,167</u>	<u>2,116</u>	<u>2.4%</u>
Oceanic traffic (flights):			
Chargeable flights	402	388	3.7%

CHIEF EXECUTIVE'S REVIEW



Mindful of the difficulties that the weak economic environment means for our customers, we continued to focus on maintaining safety standards whilst delivering a high standard of service, reducing delay, introducing measures to reduce fuel burn and CO₂ emissions. In addition we have successfully delivered significant new technology which will provide substantial benefits to our customers and the transition into operation was managed with minimum impact on their business.

On operating cost efficiencies, we have made an excellent start in achieving the cost reduction targets set by the economic regulator for CP3, building on the cumulative 33% real reductions in underlying operating costs achieved since the PPP and our business plans assume further efficiencies over the remainder of the control period.

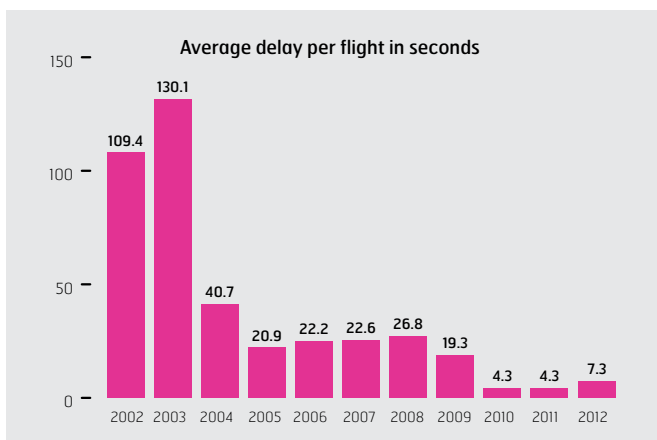
CHIEF EXECUTIVE’S REVIEW

The CP3 review set tough calendar year service performance standards for average delay per flight attributable to NATS (the T1 metric⁵), the impact of delay (T2) which incentivises low delay at peak periods and avoidance of long delays and a delay variability score (T3) which ensures a focus on technical and staffing resilience. We were able to meet these challenges.

CP3 metrics	CAA Target for 2011	Performance
T1: average delay per flight (secs)	11.5	7.9
T2: delay impact (score)	32.5	17.9*
T3: delay variability (score)	1500	402*

* The regulatory regime allows for agreed and limited exemptions to be nominated for major system or airspace changes and avoids double-counting the impact of significant system failures on service delivery. After exemptions T2 was 12.7 and T3 was 11.3.

On a financial year basis, average delay per flight was 7.3 seconds (2011: 4.3 seconds), despite considerable demands on the operation created by training for new technologies. This performance was in the upper quartile of good performance for European ANSPs. Overall 99.3% of flights suffered no delay attributable to NATS (2011: 99.6%).



Separately, customers also set us service targets under our Operational Partnership Agreement (OPA) by which we work together towards delivering near term operational improvements and collaboratively agreeing priorities. Here we achieved their fuel saving target of 25,000 tonnes, enabled 2 of the 4 targets relating to specific types of delay and delivered on 7 out of 8 “hotspot” projects directed at customer specific issues. Whilst we missed the OPA targets for evening peak traffic delay and for staffing delays, in retrospect these targets were set at unrealistic levels in a year with substantial training for new technology.

The OPA, and the safety equivalent (the Safety Partnership Agreement), are regarded as best practice in terms of engagement with customer airlines. We also have a similar means of engaging with our airport customers through the Airports Working Group.

Underpinning our success is a focus on the customer, which differentiates us as an air navigation service provider. We continue to strive to improve our customer service and I am pleased to report that we received our best ever customer satisfaction score in our annual survey with 81.1% of customers satisfied or highly satisfied with our service, compared with 80.7% previously.

We have also continued to develop our contingency capability to ensure that service recovers quickly to be capable of handling 85% of peak pre-incident demand within ten days of a catastrophic incident at either our Swanwick or Prestwick centres.

⁵T1 is the average NATS attributable air traffic flow management delay per flight expressed in seconds. T2 is a score that applies a higher weighting to delays in the 05:00-09:00 and 16:00-20:00 peak periods and to any delays greater than 15 minutes with an increased weighting for longer delays. For example, each minute of delay to a flight over 30 minutes in the morning peak is multiplied 9 times and each over 60 minutes is multiplied 18 times. T3 is a score that applies to any days when the delay is substantially higher than the seasonal average and the weighting increases at higher overall levels of delay to provide an incentive both to avoid technical and staff shortage events and to recover the situation if these events occur.

CHIEF EXECUTIVE'S REVIEW

People and investment

NATS people are professional, committed and proud of their roles. In the period since the Public Private Partnership transaction in 2001, they have taken part in a transformational journey from the public sector to today's flexible, responsive and commercially orientated business. We maintain a continuous dialogue with our staff and a constructive and forward-thinking 'Working Together' relationship with our Trades Unions which has been pivotal in achieving today's success.

Our strategic objective is for everyone to understand their own personal contribution, and that of their team, to the business's performance and the value it creates for customers.

We have made significant progress on leadership development and we are developing a transparent competency and capability model to ensure that we develop talent and have in place evidence-based succession plans.

We have continued to review working practices, seeking to introduce more flexibility and responding appropriately to changes in technology, put in place measures to streamline recruitment and selection and we are seeking to develop a more robust means of forecasting operational staffing requirements.

During the year we successfully moved our operational training centre from Hurn to a new and exceptional facility at the Corporate & Technical Centre in Whiteley. This facility provides an excellent learning environment for NATS' future controllers and is a showcase of our operational training capability to existing and potential customers.

We plan to invest over £400m over the next 3 years in new technology and infrastructure. Already underway are programmes to deliver new ATM capabilities based on new controller workstations; an advanced flight data processing system that will allow us to introduce the SESAR (SES ATM Research – see below) concepts into our operations; and major airspace programmes that propose to renew airspace structures across the UK.

During the year we delivered a number of major projects with minimal disruption to services. Between June and December 30,000 hours of training were delivered to 480 staff, culminating in iFACTS transitioning to full operational service at Swanwick. This delivers into service one of the most advanced controller decision support systems in the world and brings improvements to both safety and capacity in our largest air traffic control centre. We also replaced four radars, completing a 10-year programme to upgrade our radar infrastructure.

We delayed the implementation of paperless operations at the Prestwick Centre to enable further system enhancements to be made. The transition into live operations started in March 2012 and we expect to transition fully during the 2013 financial year.

We also plan to continue with investment in our commercial services growth strategy and to build on the momentum created in the past year.

We plan to invest over
£400m over the next
3 years in new technology
and infrastructure.



CHIEF EXECUTIVE'S REVIEW

We are building relationships to accelerate the benefits of closer ATM integration.

Partnering in Europe

The Single European Sky project is driving the evolution of Europe's ATM industry. The second SES legislative package (SES II) provides a pan-EU regulatory, operational and technological framework, the main elements coming into effect in 2012 and which are explained below.

A Europe-wide Performance Scheme established targets for Reference Period 1 (2012-14; RP1) for capacity, environment and cost efficiency. National Supervisory Authorities (the CAA in the UK's case) prepared National Performance Plans with targets consistent with EU-wide aims. The CAA's economic regulator's decision for NATS for CP3 constituted the majority of the economic component of the UK's RP1 National Performance Plan. Preparation for setting RP2 (2015-19)⁶ targets has already begun and NATS will be fully engaged in this process. We strongly support the development of a new approach to future economic regulatory reviews focusing on total economic value and believe that this should drive the way that performance targets are set at EU, Functional Airspace

Block (FAB) and national levels. As the only private sector ANSP, we believe targets should have regard to the ability of ANSPs to finance their activities. We also believe that targets should recognise past progress in achieving operating cost efficiencies.

SES II also requires FABs to be established across the EU by December 2012. The UK/Ireland FAB has been operating successfully since 2008 to create a seamless and cost efficient operation across our joint airspace and has enabled customer savings for calendar year 2011 totalling €24.5m, including 24,000 tonnes of fuel worth €17.8m and €6.7m of non-fuel costs such as reduced maintenance and crew costs. This is more than double the targeted benefit set in 2008. Expected savings for calendar year 2012 are estimated at well over €26m including 25,000 tonnes of fuel worth nearly €19m. By comparison, the costs of running the FAB are only €3m.

SES ATM Research (SESAR) is a European collaborative programme to deliver the 'European Master Plan' for future ATM network concepts, technologies and

methods of operation. The SESAR Joint Undertaking (SJU) is delivering the R&D phase through 2009-16. NATS leads several key activities. An alliance of major ANSPs has been formed (the A6 Group) to ensure that members have a strong influence in the SJU's outcomes and the deployment phase in particular – this is a key alliance for NATS in shaping our European future and one which I chair.

We are also building relationships with other air navigation service providers to accelerate the benefits of closer ATM integration. We are a 'co-operative partner' in the FAB Europe Central (FABEC), to ensure the interface between UK airspace and FABEC is safeguarded. We are co-operating with Denmark, Sweden and Ireland to identify jointly, initiatives of benefit to customers across our airspace and we are part of the Borealis group, an alliance with Scandinavian and Baltic states, to deliver benefits from joint working across operational and technical areas.

⁶The Performance Review Body of the Single European Sky is consulting on the length of this Reference Period which may be shorter than 5 years.

CHIEF EXECUTIVE'S REVIEW

Preparing for the Olympic Games

Our preparation for the London 2012 Olympics and Paralympics continues to gather momentum and builds on the preparation work that has been underway for the past 3 years.

During the games, we can expect 700 additional commercial flights, 3,000 additional business aviation flights, 1,500 extra helicopter movements, and the arrival and departure of 150 heads of state.

Responding to this challenge, NATS along with the CAA has developed a temporary airspace structure that has been tested and adapted through real time simulations. The design incorporates new airspace sectors and routes which will be mandated for flight planning purposes. Also, as part of its homeland security strategy the Department for Transport (DfT) has requested the establishment of an area of airspace outside controlled airspace around London which will be subject to strict flight planning requirements and monitored by the military.

By the time the Olympics opens, we will have trained around 400 air traffic controllers to operate the new temporary airspace configuration, created additional controller positions to help manage the increase in traffic, installed a state-of-the-art air operations centre for the military, coordinated with airports and operators of adjacent airspace and helped the general and business aviation communities to understand the new procedures required. We will also maintain an industry communications function throughout the Olympics period.

Overview of Financial Performance

NATS operates UK and North Atlantic en route air traffic control services through its economically regulated subsidiary, NERL, and provides airport air traffic control and commercial services through its subsidiary NATS Services. The activities of other subsidiaries are set out in note 29 to the accounts.

The group's revenue improved by £87.6m to £864.9m (2011: £777.3m) and it recorded a profit before tax for the year of £194.5m (2011: £106.1m). This result, and that of the last financial year, included some exceptional items. The underlying result, excluding exceptionals, was a profit of £196.6m (2011: £117.5m). The group's result is explained in more detail in the Financial Review on page 37.

NERL reported a profit before tax of £154.8m (2011: £70.8m), including exceptional charges of £1.7m (2011: £8.0m). Before these exceptional items, the underlying result was a profit of £156.5m (2011: £78.8m), £77.7m higher than previously. This mainly reflects the full-year effect of net increases in revenue allowances following last year's price control review. This is explained in more detail in the financial review below.

NATS Services reported a profit before tax of £39.4m (2011: £35.6m), including exceptional charges of £0.4m (2011: £3.4m). Before these exceptional items, the underlying profit improved to £39.8m (2011: £39.0m). The improved result reflects the contribution from contract renewals and new business generated in the year.

CHIEF EXECUTIVE'S REVIEW

UK air traffic services

	2012 £m	2011 £m
Turnover	653.2	578.2
Operating costs	(369.1)	(355.3)
Depreciation, amortisation, impairment and deferred grants	(88.1)	(93.3)
Exceptional items	(1.6)	(7.8)
Operating profit	<u>194.4</u>	<u>121.8</u>
Chargeable Service Units ('000s)	9,676	9,377

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

	2012 £m	2011 £m
UK en route services	575.0	504.0
London Approach services	10.6	8.4
Support services to MoD	46.1	44.6
North Sea helicopters	8.5	8.3
Other external	13.0	12.9
Total	<u>653.2</u>	<u>578.2</u>

Income from UK en route services, which are provided to traffic operating in those parts of UK airspace which constitute controlled airspace, are subject to incentive-based economic regulation. The basis for establishing revenue allowances is explained in detail in the financial review below.

UK en route revenues increased by £71.0m in the year to £575.0m (2011: £504.0m) reflecting the increase in net revenue allowances for CP3. Revenues also included a bonus for service performance of £5.4m (2011: £10.4m). This was less than previously due to the challenging targets set for CP3.

CHIEF EXECUTIVE'S REVIEW

London Approach services, provided to aircraft arriving at or departing from Heathrow, Gatwick, Stansted, Luton and London City airports, generated £10.6m (2011: £8.4m). Revenues from these services are combined with those from UK en route services and capped by the economic regulator. As for UK en route revenues, the increase in income reflects the CP3 revenue allowance for this service and the regulator's decision to include Luton and London City airports within the approach service. The charge for this service is levied based on aircraft tonnage, which increased by 10.8% to 55.8m tonnes (2011: 50.4m tonnes), with Luton and London City accounting for 7.5% of the increase in tonnage.

NERL has a contract to provide services and support infrastructure to the MoD for military air traffic services. Revenues generated under the contract amounted to £46.1m (2011: £44.6m) with the inflation uplift to charges offsetting rebates under operating cost sharing arrangements.

Revenues for services to North Sea helicopter operators of £8.5m were slightly higher than previously (2011: £8.3m).

Other external income increased by £0.1m to £13.0m (2011: £12.9m) as NERL continued to generate income supporting windfarm operators in mitigating their effects on radar feeds and from the SESAR research collaboration, which is part-financed by the European Commission.

The costs of UK air traffic services, including asset-related charges and exceptional items, increased by £2.4m to £458.8m (2011: £456.4m) mainly due to higher staff costs, as savings from lower headcount were offset by pay awards and pension charges. The prior year result included higher asset impairment charges.

Overall, UK air traffic services generated an operating profit of £194.4m (2011: £121.8m), £72.6m higher than the prior year.

North Atlantic air traffic services

	2012 £m	2011 £m
Turnover	26.8	21.1
Operating costs	(15.8)	(15.9)
Depreciation, amortisation, impairment and deferred grants	(4.1)	(3.4)
Exceptional items	(0.1)	(0.2)
Operating profit	6.8	1.6
Chargeable flights ('000s)	402	388

North Atlantic air traffic services are en route services provided by NERL in the Shanwick Oceanic Control Area (part of the North Atlantic where the UK provides navigation services by international agreement). The charges for these services are levied on a per flight basis and are subject to a separate economic regulatory formula which allows for the annual adjustment of prices by the movement in the RPI less a 4% efficiency factor. Revenues for this financial year were re-set following the CP3 review and at £26.1m (2011: £20.6m) were £5.5m higher than the prior year as the price controlled rate per flight increased to £64.92 from £53.20. Chargeable flight volumes increased by 3.7% to 402,261 (2011: 388,013). Other income, from a height monitoring service, generated £0.7m (2011: £0.5m).

Costs, including asset-related charges and exceptional items, increased by £0.5m to £20.0m (2011: £19.5m) due mainly to higher asset depreciation charges.

Overall, North Atlantic air traffic services generated an operating profit of £6.8m (2011: £1.6m).

CHIEF EXECUTIVE'S REVIEW

Airport air traffic services

	2012 £m	2011 £m
Turnover	162.1	159.0
Operating costs	(122.2)	(122.0)
Depreciation, amortisation, impairment and deferred grants	(3.0)	(3.1)
Exceptional items	(0.3)	(3.0)
Operating profit	<u>36.6</u>	<u>30.9</u>

NATS Services provides airport air traffic control services at 15 of the UK's major airports and at Gibraltar and provides engineering services to airport operators in the UK and abroad. Revenues from these services improved by £3.1m to £162.1m (2011: £159.0m). This mainly reflected improved revenues from airport contract renewals, an increase in the earned value assessed on certain airport contracts and to indexation uplifts on contracts. Approach services revenues previously generated from Luton and London City are now reported as part of the London Approach service, as explained above.

Costs decreased by £2.6m to £125.5m (2011: £128.1m), mainly due to lower staff redundancy costs.

Overall, operating profit for airport air traffic services at £36.6m (2011: £30.9m) was £5.7m better than the prior year.

Other revenues

NATS Services and the group's other businesses also generated revenues of £22.8m (2011: £19.0m) from other engineering, consultancy, training and airport data management services provided to customers in the UK and overseas. These services generated an operating profit of £1.7m (2011: £3.5m), £1.8m lower than the prior year, mainly reflecting the costs of generating new business and an asset impairment charge of £0.5m.

CHIEF EXECUTIVE'S REVIEW

We can confidently move ahead with the growth phase of our business.

Summing up

We remain focused on the fundamentals for success – delivering the highest standards of safety, environmental and service performance cost-effectively to our customers. Increasingly, within Europe, we will achieve these by working collaboratively with other ANSPs under the EC's Single European Sky initiative.

The targets for the next regulatory control period (Reference Period 2) will begin to take shape during summer 2013. Our task is to continue to demonstrate the economic value that we bring to our customers and show that we can do so cost-effectively, and meet the very tough targets that we expect the EU to set for RP2. As the only privately owned ANSP in Europe and one that has become significantly more cost-effective since privatisation, we will also be looking to ensure that the targets set give appropriate consideration to financeability and the progress we have already made on cost efficiency.

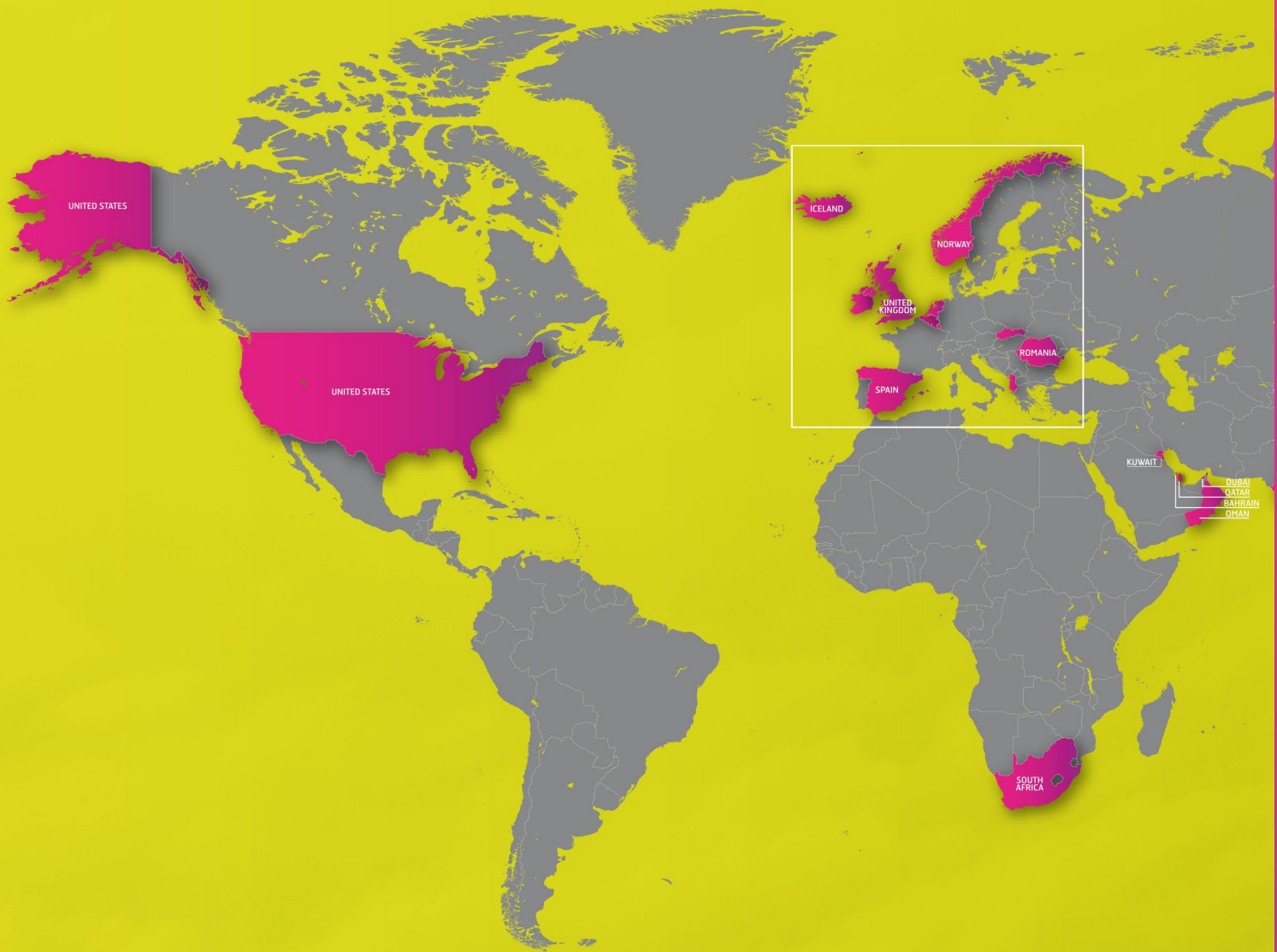
Our performance this year puts us in a good position for RP2. We have also made excellent progress in generating business in new markets and, with a clear strategy and operating under the NATS brand, we have made a good start towards achieving our vision for 2015.

Last, but by no means least, NATS has a great team. Wherever I go in our business I'm impressed by the motivation and commitment of our people, whether they're managing the safety of our customer airlines, improving customer service, delivering innovative technological solutions, maintaining our infrastructure or providing support to these areas. It's a tribute to them that we can confidently move ahead with the growth phase of our business and the kind of strength you would expect from a company with ambitions to be the acknowledged global leader in innovative air traffic solutions and airport performance.



Richard Deakin
Chief Executive Officer

Providing services worldwide



Europe

- Albania**
Consultancy (economic)
Operational support (new centre)
- Belgium**
Eurocontrol consultancy
- Gibraltar**
– Air traffic control & medical services
– Hazard analysis
- Iceland**
Onward routed radar data feed
- Ireland**
Airport capacity studies
- Italy**
Navigational aids installation
Taranto Airport
- Luxembourg**
Air Traffic Safety Electronic
Personnel course material developed for Eurocontrol
- Netherlands**
Onward routed radar data feed (Eurocontrol)

- Norway**
– ATC supervisor training for Avinor
AS ATS data services
– Aviation data and specialist ATC training services
- Romania**
– ATC refresher training for Romatsa
– Ab-initio refresher training services
- Slovakia**
– Ab-initio safety management training
– Ab-initio controller training
- Spain**
– ITEC partnership with DFS, AENA, LVNL, Indra
– Galileo Services consolidation
– ferroNATS to provide ATS at ten airfields
- United Kingdom**
– Tower air traffic and engineering services at 15 of the UK's busiest airports
– Control tower fit out i.e. Jersey, Manchester and Newcastle Airports
– World first environmental metric and performance scheme to drive down carbon emissions and fuel costs

Asia / Middle East

- Bahrain**
– Airport capacity study
– Procedure design work
- Brunei**
ATCO and supervisor training
- Dubai**
– Operational performance summary for Dubai International
– Concept of operations and procedure design for the new Al Maktoum International Airport
- Hong Kong**
Airspace re-design and ATC training services for Civil Aviation Department
- India**
Capacity enhancement study to analyse reducing congestion, enhancing productivity and increasing operational efficiency at Mumbai and Delhi International Airports

- Japan**
Airport capacity modelling and analysis to help the design and development of Narita
- Kuwait**
– Single Runway Operations consultancy contract for Kuwait International Airport
– AIM roadmap for the Kuwait Directorate General of Civil Aviation
- Oman**
Airspace design, safety management and transition support for Directorate General of Meteorology and Air Navigation (Oman)
- Qatar**
Two year airspace design and implementation consultancy project at the New Doha International Airport
- Singapore**
Terminal airspace design and ATC system surveillance trackers' performance projects underway

North America

- USA**
– Technical support services to commission FAA en route infrastructure
– Transatlantic networking of SWIM enabling technologies (eg. A-CDM)

Africa

- South Africa**
Procedure design for ATNS South Africa around 2010 World Cup

Australasia

- Australia**
– Airport capacity benchmarking and operational performance analysis for four airports: Brisbane, Melbourne, Perth, Sydney
– Programme management enhancement for Air Services Australia







FINANCIAL REVIEW

The group reported a profit before tax of £194.5m (2011: £106.1m) which is summarised in the table below:

	2012 £m	2011 £m
Turnover	864.9	777.3
Operating profit		
- Operating profit before exceptional items	241.6	169.2
- Exceptional operating costs (net)	(2.1)	(11.4)
	239.5	157.8
Profit before taxation		
- Profit before tax and exceptional items	196.6	117.5
- Exceptional items (net)	(2.1)	(11.4)
	194.5	106.1
Profit after tax		
- Profit after tax before exceptional items	158.5	95.1
- Exceptional items (net)	(1.5)	(8.2)
	157.0	86.9

The following table explains the improvement in profit before tax for the year. With 2012 being the first full year of CP3, this shows the effects of the net increase in revenue allowances (which are mainly cash-based) and the effect of re-aligning the regulator's traffic forecasts to ensure recovery of the cost base:

	£m	Profit before tax £m
2011 profit before tax		106.1
Add back exceptional items		11.4
2011 profit before tax & exceptional items		117.5
Revenue changes		
UK ATS:		
Net increase in revenue allowances (including profiling and inflation)	46.3	
Effect of resetting unit rate to reflect CP3 traffic forecast (see commentary below)	37.1	
Service performance incentive	(5.0)	
Other revenue changes	(3.4)	
		75.0
North Atlantic ATS:		
Net increase in revenue allowances (including profiling and inflation)	1.8	
Effect of resetting unit rate to reflect CP3 traffic forecast (see commentary below)	3.5	
Other revenue changes	0.4	
		5.7
Airport ATS & other		6.9
Cost changes		
Operating costs (excluding items below)		(18.5)
Depreciation & amortisation, net of deferred grants	(5.0)	
Asset impairment charges	9.1	
Loss on disposal of assets	(0.8)	
		3.3
Change in fair value of index-linked swap contract	5.3	
Other finance costs (net)	1.5	
		6.8
Results of associates and joint ventures		(0.1)
2012 profit before tax & exceptional items		196.6
2012 exceptional items		(2.1)
2012 profit before tax		194.5

FINANCIAL REVIEW

The main revenue changes were:

- ▶ the outcome of the CP3 price control reviews of UK and North Atlantic en route services (as explained below), combined with lower bonuses associated with tougher service performance targets; and
- ▶ increased income from renewal and growth in airport, engineering and consultancy contracts and services.

The main cost changes were:

- ▶ higher staff costs with pay and pension cost increases partially offset by headcount reductions;
- ▶ lower asset impairment charges partially offset by higher depreciation charges from investments in new technology;
- ▶ a lower charge for the change in the market value of the index-linked swap contract; and
- ▶ lower redundancy and relocation costs (reported as exceptional items).

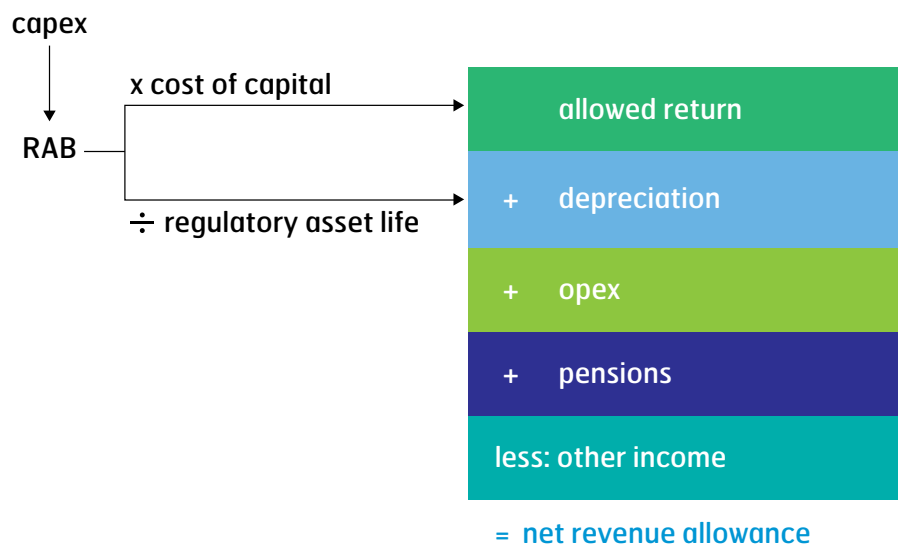
As the table on page 37 shows, the revenue increase following the CP3 price control review contributed significantly to the improvement in profit before tax. After briefly summarising how price controls are set, the commentary below describes the reasons for the revenue increase and highlights the main differences between reported profit and regulatory returns.

Economic regulatory framework and price controls

NATS' economically regulated subsidiary, NATS (En Route) plc (NERL), provides en route air traffic services under a licence granted by the Secretary of State under the Transport Act 2000. The Act gives the Civil Aviation Authority (CAA) the role of economic regulator. UK and North Atlantic en route, London Approach and North Sea helicopter advisory services are subject to economic regulation.

Following consultations with airlines and other stakeholders, the CAA establishes revenue allowances for price control periods (normally for five year periods, though CP3 is four years to align with European Reference Period 1) for the economically regulated services.

These are set at levels designed to remunerate NERL's efficient investment (capex), operating costs (opex), pensions and an allowed return on the capital invested in the regulatory asset base (RAB) to recover the cost of capital. The RAB, which represents the value ascribed by the CAA to the capital employed in our regulated businesses, is adjusted to reflect asset additions, disposal proceeds, regulatory depreciation and the rate of inflation. Certain other income generated outside of the economically regulated activities is deducted under a 'single till', leaving a net revenue allowance. This is recovered through prices based on the traffic forecast adopted by the CAA for the control period. This regulatory model is illustrated below.



FINANCIAL REVIEW

As reported last year, the price control for CP3 secured revenues of £2.2bn (expressed by the CAA in 2008/09 prices) and provides a pre-tax real return on the RAB of 7.0% p.a.. This headline cost of capital is adjusted by the CAA to 6.8% to allow for the re-investment of surplus cash during each year. If the CAA's regulatory and other assumptions are borne out in practice, then a return of 6.8% p.a. would result.

The CAA's CP3 decision also provides three key risk mitigations: a risk sharing mechanism to protect against certain variations in traffic volumes from the level assumed by the CAA; a true-up to charges in subsequent control periods where cash contributions to the defined benefit pension scheme differ from the CAA's forecast; and a target and cap on the level of NERL's gearing set at 60% and 65% of net debt to RAB, respectively. Revenues may be adjusted within the control period for service performance incentives, traffic volume risk sharing and for changes in inflation from the level forecast by the CAA.

Reset of revenue allowances for CP3

Revenue allowances are reset by the CAA at the beginning of each control period. This is necessary to reflect the new net revenue requirement needed to cover the efficient costs of investment and operations, and return for the new control period. These changes are reflected in re-pricing which will also reflect the new traffic forecasts.

This process can result in material changes in revenue, for example in circumstances where declining traffic in the previous control period has resulted in a significant under-recovery of costs.

For 2012, UK and North Atlantic air traffic revenues increased by £80.7m for the following main reasons:

- ▶ higher net revenue allowances to reflect the new projected efficient investment and operating costs, including pensions and returns and price profiling changes by the CAA from CP2 to CP3. Although operating costs are reducing in line with CAA targets, investment and pension costs have increased between control periods, the latter driven by market conditions. Revenue allowances also reflect higher inflation than assumed by the CAA; and
- ▶ at the beginning of each new control period the price (unit rate) is calculated based on new traffic forecasts. The effect of resetting unit rates has accounted for £40.6m of the increase in revenues. Note: lower than forecast traffic at the end of CP2 led to an under-recovery of the net revenue allowance in that period.

All these have the effect of increasing revenues in 2012. Other factors impacting on revenues, including activities which are not subject to economic regulation, are explained in the business review of segmental performance above.

Comparison between reported profit and regulatory return

The profits reported in these financial statements are prepared in accordance with International Financial Reporting Standards and policies described in note 2 to these accounts. As described above, the CAA applies an economic regulatory building block model. This is mainly cash-based. It can give rise to some significant differences between reported operating profit and regulatory return. The main reasons include:

- ▶ lower historical cost depreciation compared with regulatory depreciation which is indexed to enable the replacement of the capital investment base; and
- ▶ lower accounting pension costs using best estimate assumptions prescribed by accounting standards compared with the cash contributions agreed with Trustees which include a margin for prudence.

This difference in basis explains why, generally, under the CAA's own assumptions 2012 reported profit is some c. £100m higher than regulatory return. This regulatory view is set out in NERL's audited published regulatory accounts.

FINANCIAL REVIEW

Review of operating costs

Before exceptional items and asset-related charges, operating costs increased by £18.5m to £526.3m (2011: £507.8m).

	2012 £m	2011 £m
Before exceptional items:		
Employee costs	(372.9)	(357.2)
Services and materials	(77.7)	(76.4)
Repairs and maintenance	(34.1)	(33.0)
External research and development	(0.3)	(0.2)
Other operating charges (net)	(41.3)	(41.0)
	(526.3)	(507.8)
Depreciation and amortisation	(93.0)	(88.7)
Asset impairment charges	(4.0)	(13.1)
Deferred grants	1.0	1.7
Loss on disposal of non-current assets	(1.0)	(0.2)
Operating costs	(623.3)	(608.1)

Employee costs of £372.9m (2011: £357.2m) increased by 4.4% on the previous year and accounted for 59.8% (2011: 58.7%) of the group's operating costs. Pension charges (before redundancy-related past service costs) were £9.0m higher at £84.6m (2011: £75.6m) mainly due to an increase in the accrual rate to 24.1%, before salary sacrifice (2011: 21.8%), for the defined benefit pension scheme. This reflected the scheme's financial position at the start of the year and actuarial assumptions. The remainder of the net increase in employee costs represented higher pay and National Insurance offset by fewer staff employed in the year. The average number of staff employed during the year was 4,533 (2011: 4,652) and those in post at 31 March 2012 fell by 84 (1.8%) to 4,519 (2011: 4,603).

Non-staff costs at £153.4m (2011: £150.6m) increased by £2.8m or 1.9%. This included costs associated with higher engineering revenues. Also, the prior year included one-off write-offs of £2.6m of revenue following a renegotiation of contract terms and of bad debts of £1.1m that the company had expected to be able to recover through the price control review.

Depreciation, amortisation and impairment charges of £97.0m (2011: £101.8m) were £4.8m lower than the previous year. The prior year included an impairment charge of £12.9m following a review of the strategy for developing the next generation of the company's flight data processing systems. This offset the impact of higher depreciation and amortisation arising from the introduction of new technology in the year, including iFACTS.



FINANCIAL REVIEW

Exceptional items

The results included exceptional staff redundancy costs of £3.5m (2011: £9.5m) and a £1.4m credit (2011: £1.9m charge) relating to the relocation of staff as site moves have been achieved at lower cost than expected.

Net finance costs

Net finance costs at £45.1m (2011: £51.9m) were £6.8m lower than last year. This is mainly accounted for by the movement in the market value liability of the index-linked swap contract. The charge for this movement of £16.9m was £5.3m lower than previously (2011: £22.2m) primarily because the mark-to-market last year reflected an increase in the interest rate payable due to a reduction in the credit rating of the swap guarantor.

Taxation

The tax charge, before exceptional items, of £38.1m (2011: £22.4m) was at an effective rate of 19.4% (2011: 19.1%). This is lower than the 2011/12 headline rate of corporation tax of 26% due to the deferred tax impact of a reduction in the corporation tax rate to 24% from April 2012 as announced in the Budget. After exceptional items, the tax charge represents an effective rate of 19.3% (2011: 18.1%).

Dividends

During the year the company paid two interim dividends for 2012 totalling £50.7m. In May 2012 the Board declared and paid an interim dividend for the year ending 31 March 2013 of £30.0m.

Balance sheet

The group balance sheet can be summarised as follows:

	2012 £m	2011 £m
Goodwill	351.0	351.0
Tangible and intangible fixed assets	889.7	859.8
Other non-current assets	49.3	48.2
Cash and short-term deposits	218.2	183.9
Other net current assets	25.5	16.8
Derivatives (net)	(126.2)	(113.0)
Pension scheme (deficit)/surplus	(37.8)	48.0
Borrowings	(727.3)	(711.9)
Provisions	(6.2)	(18.2)
Other non-current liabilities	(110.2)	(137.4)
Net assets	526.0	527.2

Shareholders' funds reduced by £1.2m to £526.0m during the year. This reflects total comprehensive income for the year attributable to equity shareholders as shown on page 91 less dividends of £50.7m.

Movements in fixed assets, pensions and cash and borrowings are explained below. Other significant changes in the financial position include the movement on derivative financial instruments and changes in the deferred tax liability arising from the change in the pension financial position.

FINANCIAL REVIEW

Capital expenditure

The group invested £127.9m in the year, £5.4m more than the previous year, in the following activities:

	2012 £m	2011 £m
Airspace development	3.9	2.0
Centre systems software development	39.9	51.3
Communications navigation and surveillance infrastructure	23.1	16.2
Development of Oceanic systems	1.7	1.3
Facilities management	6.1	10.6
New common workstation	5.1	0.8
Flight data processing	25.6	25.4
Military	0.6	-
Replacement of radar sites	17.1	12.7
Safety nets and airspace efficiency	4.0	1.2
Airports	0.7	0.8
Other	0.1	0.2
	127.9	122.5

The group continued to invest in its future centres systems which include: the completion of the interim future area control tools project (iFACTS) which introduced automated trajectory prediction, enhanced safety and reduced controller workload; electronic flight data (EFD) which replaces paper flight data strips with electronic strips; the development of the next generation flight data processing system which will be compatible with European systems; and the next generation of the controller workstation. The level of investment in centre systems software was lower than the prior year following the completion of iFACTS enabling changes. Additional investment in the year reflected work to replace the equipment at radar sites and communications navigation and surveillance infrastructure, including expenditure on new business systems.

Pensions

At 31 March 2012, measured under international accounting standards requiring best estimate assumptions, the pension scheme was in deficit with liabilities exceeding assets by £37.8m (2011: £48.0m surplus). This reflects the reduction in discount rates due to market conditions from 5.45% to 5.05%, resulting in an increase in pension liabilities, which offset asset growth.

The scheme actuary's last triennial valuation was performed as of 31 December 2009. This valuation, which is for funding purposes, uses assumptions which include a margin for prudence and leads to a lower valuation than under international accounting standards. The valuation reported a deficit of £351.1m in scheme assets to liabilities (equivalent to a funding ratio of 89%) and a future service cost of 36.7%. NATS agreed a schedule of contribution with Trustees such that normal contributions for the year were paid at a rate of 36.7% of staff pensionable pay and deficit recovery payments at £2m per month, increasing by 3.5% in January 2012. Overall the group paid contributions of £143.5m (2011: £123.1m) to the defined benefit scheme, including £15.5m (2011: £15.1m) of pay sacrificed by employees in return for pension contributions. Excluding the effect of salary sacrifice, employer cash contributions were paid at a rate of 45.5% (2011: 38.4%) of pensionable pay.

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Funding and treasury management

In May 2012 NERL refinanced its bank facilities (£171m expiring in November 2012; £40m expiring in April 2013) with a £275m facility expiring in December 2016. This comprises a £245m revolving term loan facility and a £30m revolving credit facility.

At 31 March 2012, the gross borrowings of the group at £727.3m were £15.4m higher than the previous year (2011: £711.9m). Cash and investments increased by £34.3m to £218.2m (2011: £183.9m). Overall, net debt decreased by £18.9m to £509.1m (2011: £528.0m).

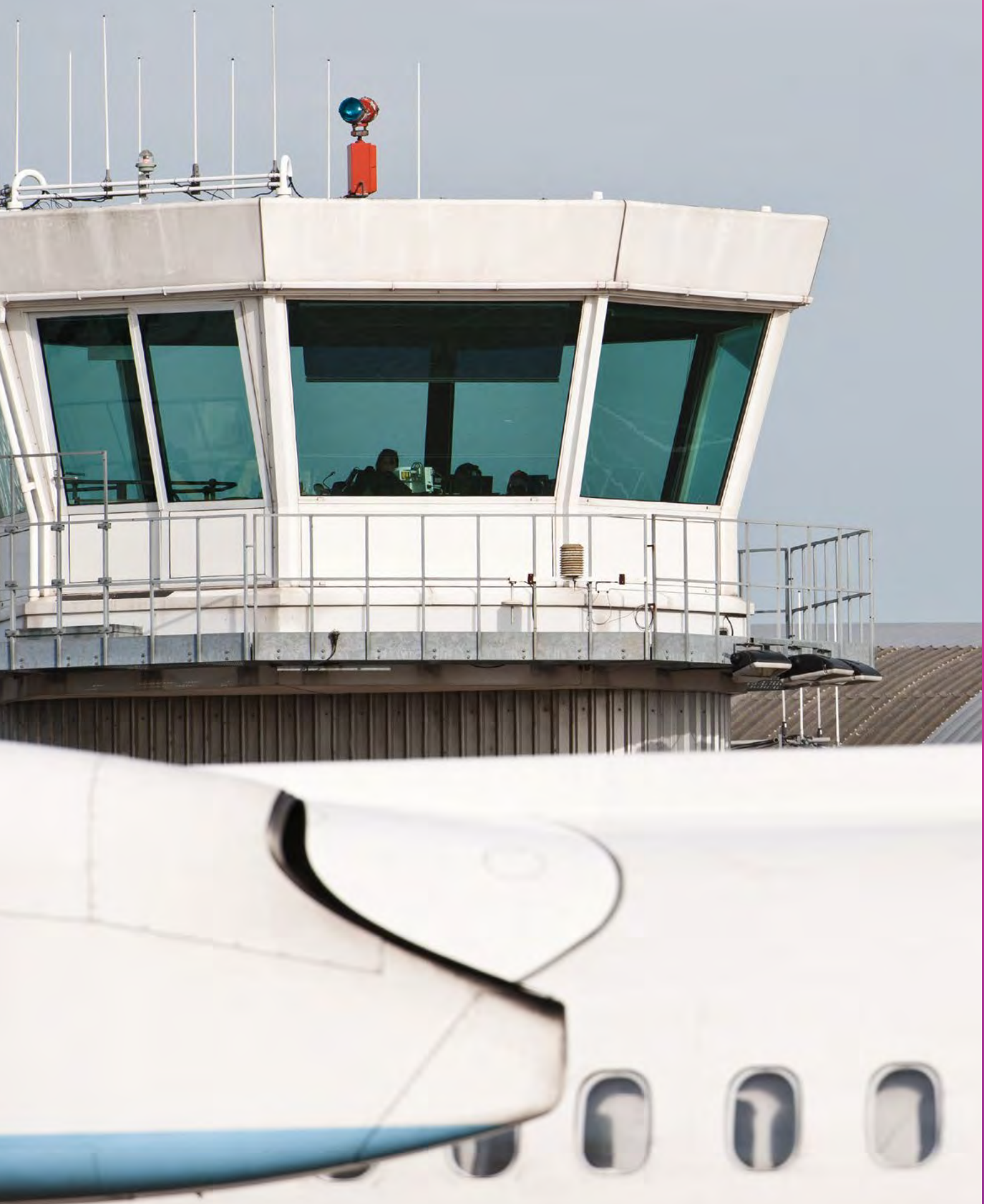
Movements in net debt			
	Cash and short-term investments £m	Borrowings £m	Net debt £m
Balance at 31 March 2011	183.9	(711.9)	(528.0)
Cash flow	20.2	(14.6)	5.6
Short-term deposits	14.1	-	14.1
Non-cash movements	-	(0.8)	(0.8)
Balance at 31 March 2012	218.2	(727.3)	(509.1)

Cash flow

Overall, the group's balance of cash and cash equivalents increased by £20.2m in the year to £187.7m (2011: £167.5m).

Net cash from operating activities at £224.1m were £41.5m higher than 2011 (2011: £182.6m), mainly reflecting the higher revenue allowances explained above. This enabled the group to finance its capital investment, service its debt obligations and pay dividends to shareholders. Drawings on bank loans of £28.8m ensured that the group maintained its cash holding levels, in accordance with its liquidity risk management policy.

Cash flows	2012 £m	2011 £m
Cash generated from operations	247.7	193.8
Taxation	(23.6)	(11.2)
Net cash from operating activities	224.1	182.6
Interest received	1.4	1.4
Capital expenditure (net of costs of disposal)	(121.5)	(120.4)
Investment in joint venture	(0.3)	(0.1)
Changes in short-term investments	(14.1)	(0.9)
Net cash outflow from investing activities	(134.5)	(120.0)
Interest paid	(35.6)	(33.7)
Interest received on derivative financial instruments	2.3	2.8
Repayment of bond principle	(14.2)	-
Bank drawings and other loans	28.8	30.2
Dividends paid	(50.7)	(40.0)
Net cash outflow from financing activities	(69.4)	(40.7)
Increase in cash and cash equivalents	20.2	21.9



FINANCIAL REVIEW

Principal risks and uncertainties

The operational complexities inherent in the business leave NATS exposed to a number of significant risks. The group has maintained a focus on mitigating those risks although many remain outside of our control – for example changes in governmental regulation, security threats, environmental factors and the impact of longevity and financial markets on pension funding.

The Board believe that the risks and uncertainties described below are the ones that may have the most significant impact on the long-term value of NATS. The list is not intended to be exhaustive.

The group carries out detailed risk management reviews to ensure that the risks are mitigated where possible. A more detailed summary of our internal control and risk management processes is set out in the Corporate Governance statement on page 52.

The principal operational risks and uncertainties of the group are described at high level in the Chief Executive's business review and above. Specifically, these are:

The risk of aircraft collision

A loss of separation attributable to NATS that results in a collision in the air or on the ground would significantly impact on NATS' reputation as a provider of safe air traffic services. This could result in a loss of revenue in the short-term as investigations take place and the loss of future contracts. If notice was given by the Secretary of State requiring NERL to take action as a result of the collision and NERL was unable or failed to comply with the notice then ultimately this could result in revocation of NERL's air traffic services licence. To mitigate this risk NATS has developed a strategic plan for safety and maintains a safety risk management system.

Loss of service from an air traffic control centre

A loss of service from a centre would result in a loss of revenues as flow management procedures would be introduced to maintain safety standards. The extent of loss would depend on the time necessary to resume a safe service. To this end NATS has invested in developing contingency arrangements.

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Environmental impacts on the provision of air traffic services

External environmental events such as a volcanic ash cloud create areas of airspace in which aircraft may not wish or may not be permitted to fly. Such events could increase the air traffic management complexity in managing uncertain traffic flows and impact on NATS' revenues resulting from changes in flight planning behaviour. NATS is working closely with the regulator, airlines and other key stakeholders in the mitigation of these risks.

Pension scheme funding

Adverse movements in pension asset and liability values arising from factors such as lower investment returns, lower real interest rates and increasing longevity may increase the size of the pension deficit. Current economic conditions with weak equity markets and with long dated index-linked gilt yields at all time low levels can be expected to worsen scheme funding. The next triennial valuation will be at 31 December 2012. Management regularly reviews the financial position of the defined benefit pension fund and is consulted by Trustees on the design of the risk reduction strategies that are in place. The scheme was closed to new entrants in 2009 and pensionable pay rises have been capped for existing members.

Industry outlook

Poor market and economic conditions can reduce NERL's revenues to levels below those assumed by the economic regulator in making the CP3 price determination. This in turn could impair shareholder returns. NATS monitors the key industry indicators on a monthly basis against CP3 forecasts and has taken action in the past to realign its cost base with lower revenues. As explained in the opening part of this financial review, NERL has traffic volume risk sharing arrangements that mitigate revenue reductions to a large extent.

Key programme and project risks

The complex and unique nature of some of NERL's technology projects create an inherent risk of project overruns, delayed benefits and damage to reputation with customers and other stakeholders. NATS has mature project management processes and industry experts to mitigate this risk.

Electronic and other external threats

NATS has security processes, procedures and risk mitigation plans to address potential electronic and other external threats.

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Employee relations

Industrial action could result in reduced air traffic service provision which adversely impacts on service performance. Every effort is made to maintain good employee relations at all times, including through our Working Together programme, to ensure the delivery of an efficient operational service and associated support.

Olympics 2012

The 2012 Olympic and Paralympic Games are expected to generate abnormal flows of air traffic and will require enhanced security arrangements. NATS has operational, project and communications plans in place to ensure that it has the capability to manage both the abnormal air traffic and the security arrangements for the Games period in conjunction with other relevant bodies. These plans include the implementation of temporary airspace changes, staff simulator training and live exercises with the security services in advance of the Games.

Operational staffing

Projecting operational manpower requires assumptions to be made in respect of the rates of validation of air traffic controllers, staff retirement intentions following changes to age legislation and efficiency assumptions associated with the introduction of new technology. As a result of these uncertainties, manpower plans may lead to a greater supply of operational staff and therefore higher than expected operating costs than the requirement on which NERL's CP3 revenue allowances were based. Principal mitigations include using long-term predictive information to inform the requirement for trainee air traffic controllers, managing the level of air traffic controller resource and using operational staff to support both the investment and growth programmes.

Financial risks

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

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

▶ **currency risk:** the group's objective is to reduce the effect of exchange rate volatility on short-term profits. Transactional currency exposures that could significantly impact the income statement are hedged, typically using forward sales of foreign currencies. The group's most significant currency exposure arises because UK en route charges, which contribute 66% (2011: 65%) of total turnover, are set in sterling but are billed and collected in euros by applying a conversion rate determined monthly by Eurocontrol, which administers the UK en route revenue collection. The resultant currency risk is materially eliminated by entering into forward foreign exchange contracts. At the year end, forward foreign currency transactions entered into to buy and sell sterling, designated as cash flow hedges, equivalent to £113.6m (net) were outstanding (2011: £103.5m (net)) as detailed in note 18.

▶ **interest rate and inflation risk:** the group's policy is to achieve an efficient mix of funding at fixed rates of interest, floating rates of interest and rates indexed to retail prices. NERL's strategy is to hedge a proportion of net debt in order to reduce its exposure to interest rate risk on its cash holdings. Throughout the last two five-year price control periods (2001-2010), NERL's revenues were linked to the movement in the retail price index (RPI) on an RPI-X basis. To achieve an economic hedge of the impact of inflation on NERL's regulated revenue, an index-linked swap with a notional principal of £200m was entered into in August 2003 whereby NERL receives fixed interest and pays interest at a rate adjusted for the movement in RPI. From 2011, under the CP3 price control (2011-2014), these revenues were linked to movements in the consumer price index (CPI). For CP3, the CAA provided NERL with a hedging allowance to compensate for the change in inflation base from RPI to CPI. The swap does not qualify for hedge accounting under international accounting standards and is classified as held for trading. As such, movements in the fair value are taken to the income statement. As at 31 March 2012 (after derivatives), approximately 89.4% (2011: 90.9%) of NERL's net debt was either at fixed rates or at rates indexed to inflation.

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- ▶ **counterparty risk:** as at 31 March 2012 the group had cash and deposits (shown as short-term investments) totalling £218.2m (2011: £183.9m). To minimise risk, funds may only be invested in high quality liquid investments. Credit risk associated with the investment of surplus funds (and from the use of interest rate and currency hedging derivatives) is managed by setting limits for counterparties based on their credit rating. An aggregate limit has also been established for each counterparty.
- ▶ **liquidity risk:** in addition to undrawn committed bank facilities totalling £62.7m at 31 March 2012, the group had cash and short-term deposits totalling £218.2m. Included in cash of £187.7m is a liquidity reserve account balance held by NERL of £21.3m to provide liquidity in the event of certain pre-defined circumstances, particularly to ensure compliance with financial covenants. The short-term deposit of £30.5m represents a debt service reserve account held by NERL to fund bond principal, interest and fees scheduled for payment in the 6 months ending 30 September 2012. The group's policy is to hold free cash within NERL equivalent to between one and two months' of projected UK en route services revenue (being between £48m and £96m for 2012) and to use surplus cash to reduce borrowings. The policy for NATS Services is to hold sufficient cash to fund new business development opportunities in line with targets approved by the Board and to meet pension obligations as they fall due.
- ▶ **funding risk:** the policy of the group is to ensure that committed funding is available at a competitive cost to meet its anticipated needs for the period covered by its business plan. This is achieved by maintaining a portfolio of debt diversified by source and maturity and ensuring it has access to long-term funding to finance its long-term assets. Hence, the group's borrowings include a £600m amortising bond (the first principal repayment of £14.2m was made on 31 March 2012) issued by NERL with a final maturity date of 2026. At 31 March 2012 NERL had bank facilities totalling £211.0m of which £171.0m were scheduled to mature in November 2012 and £40.0m in April 2013. In May 2012 NERL agreed new facilities of £275m expiring in December 2016.

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Going concern

The group's business activities, together with the factors likely to affect its performance and the financial position of the group, its cash flows, liquidity position and borrowings are set out in the Business and financial review above. In addition, note 18 to the financial statements describes the group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposure to credit risk and liquidity risk.

The group holds adequate levels of cash and in May 2012 it agreed new bank facilities of £275m which expire in December 2016. The group's forecasts and projections, which reflect the outcome of the CP3 review, taking account of reasonably possible changes in trading performance show that the group should be able to operate within the level of its existing facilities for the foreseeable future. The UK en route business also benefits from some protections against traffic volume risk afforded by its price control conditions. Other sources of income are generated mainly from long-term contracts, many of which were renewed in the year.

The group also continues to actively reduce its operating cost base to provide mitigation for future revenue shortfalls and cost pressures from legacy pension arrangements. As a result, the directors believe that the group is well placed to manage its business risks successfully despite the uncertain current economic outlook.

The directors have formed a judgement that taking into account the financial resources available to the group, it has adequate resources to continue to operate for the foreseeable future and have therefore adopted the going concern basis in the preparation of the financial statements for the year ended 31 March 2012.



Nigel Fotherby
Finance Director

CORPORATE GOVERNANCE

Code of Best Practice

NATS is committed to maintaining the highest standards of corporate governance. The Strategic Partnership Agreement (SPA) between the Secretary of State for Transport, The Airline Group Limited (AG) and BAA Airports Limited requires the company and the directors, so far as reasonably practicable in light of the strategic partnership arrangements, to adhere to current best practice guidance in corporate governance.

The financial year ended 31 March 2012 is the first for which the 2010 UK Corporate Governance Code applies. Where the new Code has required changes to governance arrangements these have been implemented from 1 April 2011, to ensure compliance throughout the year under review.

Whilst NATS has applied the principles of the Corporate Governance Code to the extent considered appropriate by the Board, a number of principles and provisions in the Code are not relevant to the partnership nature of NATS' ownership. The principal areas where NATS does not comply are summarised below.

Corporate Governance Code A.3.1:

The Chairman is nominated by AG, his appointment being subsequently approved by the Secretary of State for Transport. He therefore does not fully meet the independence criteria as set out in the Code, and this affects NATS' compliance with a number of Code provisions. He is, however, regarded in practice as the most independent Board member in terms of the Code criteria.

Corporate Governance Code A.4.1, B.1:

The arrangements for appointing non-executive directors, as set out in the SPA, are such that none of the directors meet the Code's criteria for independence. This affects NATS' ability to comply with a number of the Code's provisions, including the requirement to appoint a senior independent director. In practice, the Chairman is considered to be the most independent of the directors.

Corporate Governance Code B.2.1, D.2.1:

Details of the work of the Nomination and Remuneration Committees are set out below. However the manner in which directors are appointed, as noted above, means that these committees' processes do not fully comply with the Code as regards independence.



CORPORATE GOVERNANCE

Corporate Governance Code B.3.2:

The AG nominee directors and Partnership directors do not have service contracts with NATS and, as a result, the terms and conditions of appointment cannot be made available for inspection. The Partnership directors are engaged on three-year fixed-term contracts and have letters of appointment from the Department for Transport. The Chairman has a service contract with NATS, details of which are explained in the Remuneration Committee report.

Corporate Governance Code B.7:

The non-executive directors are appointed by the shareholding groups and are therefore subject to the relevant shareholding group's selection processes, rather than those included in the provisions of the Corporate Governance Code. They are therefore not subject to periodic re-election as stipulated by Section B.7 of the Code, although Partnership directors are appointed by the Government on three-year fixed-term contracts, which is in line with the maximum period between re-election as recommended in B.7.1.

Corporate Governance Code D.1:

The level of remuneration for non-executive directors was initially determined on completion of the PPP transaction. Subsequent changes are disclosed within the Remuneration Committee report.

Corporate Governance Code Part E:

Within the PPP structure, there are no institutional or public shareholders. However, the nature of the Strategic Partnership is such that the shareholders have representatives amongst the directors, with whom they enjoy a close working relationship. All non-executive directors are invited to relay the views of their respective shareholders into Board discussions. In addition, the Chairman is in regular contact with the shareholders. The Board is therefore able to take decisions in the best interests of the company, having taken account of the views of the shareholders.

CORPORATE GOVERNANCE

The roles of the Chairman and Chief Executive Officer

The Chairman of the NATS group is responsible for the leadership of the Board and for its governance. He has no day-to-day involvement in the running of the group.

During the year under review the Chief Executive Officer, Richard Deakin, had direct charge of the executive management of the NATS group.

The Board

The Board provides leadership and direction and is responsible for ensuring that the NATS group is run safely, efficiently, effectively and legally, with appropriate internal controls to safeguard shareholders' investments and group assets. The Boards of the subsidiary companies are accountable to the NATS Holdings Board for all aspects of their business activities.

The Board currently comprises a non-executive Chairman and twelve directors, made up as follows:

Executive directors

- ▶ Chief Executive Officer;
- ▶ Finance Director; and
- ▶ Managing Director, Services.

Non-Executive directors

- ▶ Three Partnership directors, appointed by the Crown Shareholder;
- ▶ Five non-executive directors appointed by AG, including the International Air Transport Association (IATA) representative; and
- ▶ One non-executive director appointed by BAA.

Brief biographies of the directors are provided on pages 76 to 80. All directors have access to the advice and services of the General Counsel and Company Secretary, Richard Churchill-Coleman, who acts as Secretary to the Board. If necessary, in furtherance of their duties, directors may take independent professional advice at the group's expense.

CORPORATE GOVERNANCE

All non-executive directors are considered by the Board to be independent of the company management. However, they are not considered independent under the terms of the Corporate Governance Code due to their appointment by specific shareholders. Consequently, it is not possible to identify a senior independent director to whom concerns can be conveyed by the shareholders but the Chairman, John Devaney, is regarded in practice as the independent member of the Board. The non-executive directors occasionally meet with the Chairman but without the executive directors present, although no such meeting was held on a formal basis during the year.

Shareholders' meetings are held twice a year, linked to the planning and reporting cycles, and provide the principal shareholders with an opportunity to participate in the development of the company's long-term strategy. The two meetings during the year under review were the Annual General Meeting held on 29 July 2011 and a further meeting on 27 January 2012.

Shareholders may also meet informally with the Chairman, Chief Executive Officer, Finance Director or other members of the executive management teams upon request.

The Board met 7 times during the year with each member attending as follows:

Name	Number of meetings attended
John Devaney	7/7
Richard Deakin	7/7
Nigel Fotherby	7/7
Paul Reid ¹	5/5
Ian Mills ²	3/3
Giovanni Bisignani	4/7
Roger Cato	7/7
Baroness Dean of Thornton-le-Fylde	7/7
Barry Humphreys	7/7
Andy Lord	6/7
Peter Read	7/7
Sigurd Reinton	7/7
Nigel Turner	7/7
Andrew White	7/7

¹ Paul Reid was appointed to the Board on 30 June 2011

² Ian Mills resigned from the Board on 26 September 2011

CORPORATE GOVERNANCE

The Board has adopted a schedule of matters reserved for its decision and has put in place arrangements for financial delegations to ensure that it retains overall control of the business. Matters reserved for the Board include the monitoring of NATS' safety performance, appointments to the NATS executive team, and issues with political, regulatory or public relations implications.

In addition to the schedule of matters reserved to the Board, specific matters are reserved for Partnership directors, AG directors and the BAA director. These include the following:

Partnership and The Airline Group directors

- ▶ Adoption of the business plan;
- ▶ Entry into significant debts, charges or contingent liabilities;
- ▶ Major agreements outside the ordinary course of business;
- ▶ Significant litigation proceedings; and
- ▶ External investments, and acquisitions and disposals of material assets.

BAA directors

- ▶ Acquisition or disposal of any asset representing more than 10% of the total assets of the business;
- ▶ Any aspects of the business plan which could adversely affect NATS (En Route) plc's service to UK airports; and
- ▶ Disposal of NATS (Services) Limited shares by NATS.

The Board has established five standing committees, operating within approved terms of reference. The committee structure comprises an Audit Committee, Nomination Committee, Remuneration Committee, Safety Review Committee and Technical Review Committee.

The number of meetings held by the principal Board committees, and individual directors' attendance, is provided in the table below:

	Audit	Nomination	Remuneration	Safety Review	Technical Review
No. of meetings	3	2	9	4	2
John Devaney	3/3	2/2			
Roger Cato		2/2		4/4	2/2
Baroness Dean of Thornton-le-Fylde			9/9		
Barry Humphreys			9/9		
Andy Lord			8/9		
Peter Read		2/2		4/4	2/2
Sigurd Reinton	2/3	2/2			
Nigel Turner	3/3				
Andrew White				4/4	2/2

CORPORATE GOVERNANCE

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

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

A performance evaluation of the Board, its committees and the Chairman was conducted during the year. This Board Effectiveness Review was managed by the Company Secretary and based around responses to a structured set of questions to reflect the views of all Board members. The results of the most recent review were assessed at the May 2012 Board meeting.

Executive Management

During the year under review, the day-to-day management of the NATS group was the responsibility of the Chief Executive Officer, Richard Deakin, supported by the NATS executive team.

The NATS executive team is responsible for setting NATS' overall strategy, which currently focuses on defending and growing the business whilst improving the organisation's capabilities. In order to achieve these strategic priorities the executive team is currently structured as follows:

- ▶ Chief Executive Officer;
- ▶ Finance Director;
- ▶ Safety Director;
- ▶ Managing Director, Services;
- ▶ Managing Director, Operations;
- ▶ Human Resources Director;
- ▶ Communications Director; and
- ▶ General Counsel and Company Secretary.

CORPORATE GOVERNANCE

Audit Committee

The Audit Committee meets three times per year. It is chaired by the non-executive Chairman John Devaney; Sigurd Reinton and Nigel Turner are the remaining two members of the Committee. The members all have wide-ranging commercial and management experience. Mr Turner has recent, relevant financial experience.

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

Part of each meeting is set aside, if required, for members of the Committee to hold discussions without executive management present.

The duties of the Committee include monitoring the integrity and compliance of the company's financial statements, reviewing the effectiveness of the internal audit department and external auditor, reviewing the scope and results of internal and external audit work and reviewing internal controls and risk management. The Committee also advises on matters relating to the appointment, independence and remuneration of the external auditor, and reviews arrangements under which staff may confidentially raise concerns about possible improprieties in financial reporting or other matters. The Committee monitors the extent of non-audit services provided by the external auditor to ensure independence.

Nomination Committee

The Nomination Committee is chaired by the non-executive Chairman John Devaney and comprises three further non-executive directors, Peter Read, Sigurd Reinton and Roger Cato. The Committee may invite executives and advisors to attend meetings as appropriate.

The Committee meets when considered necessary by its members. During the year under review it met twice; in June 2011 to discuss Board appointments, and in November 2011 to discuss two executive appointments.

As noted above, appointments to the Board are made by the relevant sponsoring shareholder under the terms of the SPA. The Committee has the task of evaluating the balance of skills, knowledge and expertise required on the Board and making recommendations to the shareholders with regard to any changes. It also reviews the succession plans for directors and senior executives. The committee's terms of reference require it to give due regard to the benefits of diversity, including gender, on the Board.

CORPORATE GOVERNANCE

Remuneration Committee

The Remuneration Committee of the Board is chaired by Barry Humphreys and comprises two further non-executive directors, Baroness Dean of Thornton-le-Fylde and Andy Lord. The Committee meets when necessary and is responsible for determining the company's policy on directors' remuneration and approving remuneration and incentive payments for senior managers, including the criteria for establishing performance targets. The terms of reference for the Committee require it to ensure the company's remuneration policy complies with the current Corporate Governance Code. No director is involved in deciding his or her own remuneration.

The Chief Executive Officer and Human Resources Director are invited to attend meetings of the Committee together with other executives and advisers as appropriate.

Safety Review Committee

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

CORPORATE GOVERNANCE

The Committee is chaired by Andrew White, and there are two other non-executive directors as members, Peter Read and Roger Cato. The following are invited to attend each meeting by standing invitation:

- ▶ Chief Executive Officer;
- ▶ Director of Safety, NATS;
- ▶ Managing Directors of Services and Operations; and
- ▶ Operations Directors of Swanwick, Prestwick and Airports.

The Head of Corporate Security formally reports to the Committee on the security arrangements in NATS twice per annum.

The Committee takes advice from the following special advisers, who are invited to each meeting by standing invitation:

- ▶ Professor James Reason, formerly Professor of Psychology at Manchester University and an expert on human factors; and
- ▶ Don Lloyd, Vice-President and head of the health, safety, security and environment function for BG Group, and an associate professor in risk management at Brunel University.

Technical Review Committee

This Committee's role is to support the Board in the monitoring and development of adequate and cost-effective technical systems and services in support of operations. The Committee is chaired by Peter Read and there are two other non-executive directors as members, Andrew White and Roger Cato. The Chief Executive Officer, Managing Director of Operations, and senior technologists are invited to each meeting by standing invitation.

The Committee takes advice from the following special advisers, who are invited to each meeting by standing invitation:

- ▶ Dr Nigel Horne, a former interim Director of Engineering at NATS who has also held senior positions within GEC plc, KPMG and Alcatel Ltd;
- ▶ Roger Graham, former Chairman and CEO of the BIS Group and an adviser to companies in the internet sector; and
- ▶ David Mann, former CEO and Deputy Chairman of Logica Group.

Financial Reporting and Internal Control

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

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

CORPORATE GOVERNANCE

Risk Management

Risk management is essential in seeking to minimise the threat that an event or action might have on the group's ability to achieve its objectives and to execute its strategies effectively. Successful risk management ensures that the group is able to deliver services to its customers and meet the needs and expectations of its shareholders in a fast changing and uncertain environment.

This system for the identification, evaluation and management of risks is embedded within the group's management, business planning and reporting processes, and accords with the Corporate Governance Code and is aligned with the ISO 31000 risk management standard.

The Board formally reviews the 'Top Risks' to NATS and the risk management process on a rolling basis. This is complemented by detailed risk identification at divisional level which is recorded and measured in a controlled and managed enterprise-wide database.

The Audit Committee and Board have assessed the group's 'Top Risks' and performance against these during the year ended 31 March 2012 and agreed actions for the 'Top Risks' for the year ending 31 March 2013. Reports to the Audit Committee on the process of risk management and internal control are supplemented by regular monthly

reporting to the Managing Director Operations, Managing Director Services, and the NATS executive teams which address business controls and the progress of mitigating actions associated with NATS' risks.

The company's Internal Audit Department reviews the controls in place to manage NATS' business risks, which includes reviews of internal financial control. The results of audits and action plans are reported as appropriate to relevant Board directors, executive members, senior managers, and local managers.

The company's performance is reviewed monthly by the relevant executive team and the Board. This includes reviewing performance against operational targets, including those relating to safety, delays, project performance and risk management, and against financial targets, including revenue and capital budgets.

The Board takes the management of risk seriously, paying particular attention to areas such as safety, service delivery, operating efficiency, financial control, project delivery, regulatory compliance and IT systems. Inevitably, NATS takes a special interest in the risk management of safety and service delivery.

Safety

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

Non-audit work performed by the external auditor

From time-to-time the external auditor performs non-audit services for the group. Part of the Audit Committee's remit is to ensure that such engagements do not impair the auditor's objectivity or independence. The principal non-audit services performed by Deloitte LLP in the year ended 31 March 2012 were taxation advice relating to the establishment of the new salary sacrifice car scheme and certification of certain expenditure incurred in relation to work undertaken by NATS for the European Commission. The cost of these services is set out in note 6 of the 'Notes forming part of the consolidated accounts'.



REMUNERATION COMMITTEE REPORT

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

Information not subject to audit

Membership and responsibilities of the Remuneration Committee

The Remuneration Committee is comprised entirely of non-executive directors: Barry Humphreys (Chairman), Baroness Brenda Dean and Andy Lord.

Where appropriate, the Committee takes advice on specific issues from the Chief Executive Officer, the HR Director and independent consultants. The independent consultants advising the Committee are Kepler Associates, who have no other connection with the company. Kepler Associates supported the Committee with its review of performance incentive plan arrangements.

The Committee met nine times in the year and is responsible for:

- ▶ Approving, on behalf of the Board, the arrangements for determining the remuneration, benefits in kind and other terms of employment for the Chairman and executive directors and the company's Personal Contract Group staff (comprising members of the executive team and other senior staff whose terms of employment are not subject to negotiation with the recognised Trades Unions through collective bargaining);
- ▶ Approving company incentive targets and individual performance objectives for executive directors and other members of the executive team;
- ▶ Considering and approving a statement of remuneration policy;
- ▶ Confirming details of the remuneration of each director for inclusion in the annual report and accounts; and
- ▶ Confirming pay packages for executive team members.

REMUNERATION COMMITTEE REPORT

Performance management

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

Managers' rewards are related not only to what they achieve but to how they achieve it through their people (informed by staff opinion surveys). Managers understand that they are expected to achieve outstanding results to gain substantial payment of performance related incentives.

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

Policy on pay

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

The level of executive directors' remuneration takes into account competitive practice across a recently reviewed group of comparator companies (which is based on organisations from whom NATS might seek to recruit employees) together with the need to attract and retain employees. Executive directors are rewarded on the basis of responsibility, competence and contribution, and salary increases take account of pay awards made elsewhere in the group. Performance-related elements form a substantial part of the total remuneration package and are designed to align the interests of directors with those of shareholders. Performance is measured against a portfolio of key business objectives and payment is made only for performance beyond that expected of directors as part of their normal responsibilities.

REMUNERATION COMMITTEE REPORT

Employment contracts

Richard Deakin's employment contract provides for 12 months' notice in the event of termination by the company. Paul Reid was appointed a director of NATS Holdings Limited on 15 July 2011. Nigel Fotherby and Paul Reid have employment contracts which provide for 6 months' notice from the company. Ian Mills resigned as a director of NATS Holdings Limited on 26 September 2011.

John Devaney has a fixed term contract with the company which was due to expire on 30 June 2012. This contract has been extended and now provides for 6 months' notice of termination from the company or Mr Devaney. However, the contract includes a long stop termination date of 1 July 2014 to comply with the UK Corporate Code limitation of 9 years service for a Chairman.

Except for Roger Cato, the BAA nominee director, other non-executive directors do not have contracts with the company. Roger Cato has a contract specifying the remuneration he receives from the company, which is terminable at BAA's discretion or through resignation.

Remuneration packages

The remuneration package for executive directors is reviewed each year and consists of annual salary; pension and life assurance; annual and long-term performance related incentive schemes; All-Employee Share Ownership Plan; company car; and medical insurance. Their annual performance related incentive scheme is consistent with the overall performance related incentive scheme for all Personal Contract Group staff (see below). For executive directors the Long-Term Incentive Plan is based 75% on financial performance and 25% on achievement against strategic objectives assessed over a rolling 3 year period.

Full details of directors' remuneration for 2012 are set out on page 70.

REMUNERATION COMMITTEE REPORT

Salaries

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

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

The Partnership directors and the BAA director each received annual remuneration of £36,000 in the financial year. AG directors received no remuneration for their services to the NATS Board. However, a payment of £180,000 per annum (equivalent to £36,000 each for the services of five directors) is made direct to AG in lieu of remuneration for these directors. This sum is used to fund the activities of AG.

Pensions and life assurance

Executive directors' pensions and life assurance are based on salary only, with bonuses and other discretionary benefits excluded. There are two principal methods of securing pensions for executive directors. The first is through the Civil Aviation Authority Pension Scheme (CAAPS), a defined benefit scheme. All executive directors except Richard Deakin are members of CAAPS. The second method is through the NATS Defined Contribution Pension Scheme which came into operation on 1 April 2009. Richard Deakin is a member of this scheme.

Following the PPP, the CAA Pension Scheme (CAAPS) remains one scheme, although from 31 March 2001, it has been split into two sections. The NATS section of CAAPS was closed to new entrants with effect from 1 April 2009.

Non-executive directors do not participate in CAAPS.

REMUNERATION COMMITTEE REPORT

Company performance related incentive schemes

The Committee oversees a scheme of objective setting and related bonus arrangements. An annual performance related incentive scheme is in place for executive directors and all staff in the Personal Contract Group. In addition, a Long-Term Incentive Plan is in place for executive directors and members of the NATS executive team. Non-executive directors do not participate in either of these schemes which are designed to:

- ▶ Ensure rigour and differentiation in the system of performance related incentive scheme rewards; and
- ▶ Drive up management performance.

The annual performance related incentive scheme opportunity is set at a range of levels for Personal Contract Group staff depending on role responsibilities and accountabilities; generally in the range from 15% to 45% of salary (70% for the CEO). For the group in general, 40% of the performance related incentive scheme is determined by company performance on key targets and the remaining 60% is dependent on individual performance against targets and leadership behaviours. For directors of the company and members of the executive team, more weighting is given to company performance: 75% with 25% dependent on personal performance. The scheme incorporates an overarching event clause whereby a reduced or zero payment will be made if there has been an incident which is sufficiently serious, in the view of the majority of non-executive Board members, to justify such action.

The long-term incentive scheme for executive directors and members of the NATS executive team is based on the achievement of a set of financial and strategic targets for rolling 3 year periods commencing 1 April 2011. The scheme provides for a deferred performance related payment in the event of achieving profitability, growth and efficiency targets, all subject to an overarching event clause and adjusted to take account of traffic levels.

Employee Share Plan

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

The NATS All-Employee Share Ownership Plan is designed to give every member of staff (including executive directors but not non-executive directors) an equal opportunity to acquire a stake in the future success of the company. The share plan holds 5% of the shares in NATS and is administered by a special trustee company with three directors – one each appointed by HM Government, AG and the Trades Unions (collectively known as the Trustee). Baroness Brenda Dean chairs the Trustee meetings.

Richard Deakin currently holds 400 shares, Nigel Fotherby holds 2,377 shares and Paul Reid holds 2,377 shares.

The current HM Revenue and Customs approved valuation, for the period 1 January 2012 to 30 June 2012, values the shares at 395p each.

Barry Humphreys



REMUNERATION COMMITTEE REPORT

Audited information Directors' remuneration

Emoluments (excluding pension arrangements which are reported in the tables below) of the Chairman and directors were as follows:

	Notes	Salary or fees (*) £000	Benefits (*) £000	Performance related payments (*) £000	Compensation for loss of office £000	Total 2012(*) £000	Total 2011(*) £000
Chairman							
John Devaney		160	-	-	-	160	160
Executive directors							
Richard Deakin		412	25	299	-	736	698
Nigel Fotherby	1	250	17	316	-	583	331
Paul Reid	2	150	14	68	-	232	-
Non-executive directors							
Baroness Dean of Thornton-le-Fylde		36	-	-	-	36	36
Sigurd Reinton		36	-	-	-	36	36
Andrew White		36	-	-	-	36	36
Barry Humphreys	3	-	-	-	-	-	-
Andy Lord	3	-	-	-	-	-	-
Peter Read	3	-	-	-	-	-	-
Nigel Turner	3	-	-	-	-	-	-
Giovanni Bisignani	3	-	-	-	-	-	-
Roger Cato		36	-	-	-	36	36
Former directors							
Ian Mills	4	110	5	163	453	731	333
Ian Hall		-	-	-	-	-	308
Lawrence Hoskins		-	-	-	-	-	619
		<u>1,226</u>	<u>61</u>	<u>846</u>	<u>453</u>	<u>2,586</u>	<u>2,593</u>

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

- As disclosed in last year's Annual Report and Accounts, in June 2011 Nigel Fotherby received £202,800 under his long-term incentive plan which vested in January 2011. This amount is included within performance related payments.
- Paul Reid was appointed to the Board on 30 June 2011, accordingly his emoluments up to this date are not included within the table above.
- These directors are appointed by The Airline Group (AG) who charged NATS a total of £45,000 per quarter (2011: £45,000 per quarter) for the services of the directors.
- Ian Mills resigned from the Board on 26 September 2011 and left the company on that day. As disclosed in last year's Annual Report and Accounts, in June 2011 he received £111,600 under his long-term incentive plan for the period he served as a director. In addition he received £51,550 for his long-term incentive plan for the period prior to his appointment as a director. These amounts are included within performance related payments.

REMUNERATION COMMITTEE REPORT

Audited information

Directors' remuneration continued

Interests of the directors in long-term incentive schemes:

From April 2011, the company operated a long-term incentive scheme entitling the three executive directors to performance related pay contingent on achieving a set of financial and strategic targets for the three years ending 31 March 2014. Under this scheme Richard Deakin has the potential to earn 90% of his average annual salary for the period and Nigel Fotherby and Paul Reid 62.5% each of their average annual salaries for the period. As the outcome of the long-term incentive scheme will not be known until March 2014, and therefore the directors' entitlements under this scheme, no amounts are reported in this respect.

In addition, and as disclosed in last year's Annual Report and Accounts, Richard Deakin is entitled to £143,250 under a long-term incentive plan which vested on 31 March 2011, and which is payable in April 2013.

Payments made under long-term incentive schemes are included in the emoluments table above when paid.

Pensions of the directors who were members of the CAA Pension Scheme were as follows:

	Notes	Accrued entitlement at 31 March 2011 £000	Real change in accrued pension £000	Inflation £000	Accrued entitlement at 31 March 2012 £000	Transfer value at 31 March 2012 £000	Transfer value at 31 March 2011 £000	Director's contributions in year £000	Cost of benefits accrued during year £000
Executive directors									
Nigel Fotherby	1	43	4	2	49	1,315	925	-	108
Ian Mills	1,2	23	5	2	30	743	461	-	133
Paul Reid	1	76	4	4	84	1,638	1,093	-	84
		<u>142</u>	<u>13</u>	<u>8</u>	<u>163</u>	<u>3,696</u>	<u>2,479</u>	<u>-</u>	<u>325</u>

The transfer values disclosed above do not represent a sum paid or payable to the individual director. Instead they represent a potential liability of the pension scheme. The movement in transfer values in the year reflects changes in market conditions (interest rates and inflation) used to value pension obligations.

1 The NATS Section of the Civil Aviation Authority Pension Scheme operates a salary sacrifice arrangement which commenced on 1 April 2009.

All three directors are members of this arrangement and so have not directly paid contributions to the Scheme.

2 Ian Mills resigned from the Board and left the company on 26 September 2011.

Richard Deakin is a member of the company's defined contribution pension scheme, whose terms are explained in note 27 to the financial statements. The company paid contributions of £39,780 and Richard sacrificed salary of £29,835 to the defined contribution pension scheme in the year. In addition, in the 2013 financial year, the company will pay arrears of contributions in line with Richard's contractual entitlement of £47,515 and Richard will sacrifice salary of £23,758 to the defined contribution scheme, relating to the period since Richard joined the company on 1 March 2010 to 31 December 2011.



REMUNERATION COMMITTEE REPORT

Audited information

Directors' remuneration continued

Aggregate emoluments disclosed above do not include any amounts for the value of shares awarded under the company's All-Employee Share Ownership Plan. Details of shares sold during the year are as follows:

Name of Director	Shares sold	Share price at date of sale £	Gain on sale £
Ian Mills	600	3.55	1,670

Ian Mills disposed of his shareholding in NATS in the year. The gain on sale is net of amounts paid to acquire partnership shares.

Details of shares held by directors who served during the year are as follows:

Name of Director	Exercisable (brought forward)	Date from which exercisable:			Total holding (number of shares)	Value at 31 March 2012 (at £3.95 each) £	Value at 31 March 2011 (at £3.50 each) £
		10/01/2013 (brought forward)	17/09/2014 (brought forward)	28/02/2016 (brought forward)			
Richard Deakin	200	-	-	200	400	1,580	1,400
Nigel Fotherby	1,757	220	200	200	2,377	9,389	8,320
Paul Reid	1,757	220	200	200	2,377	9,389	8,320
	<u>3,714</u>	<u>440</u>	<u>400</u>	<u>600</u>	<u>5,154</u>	<u>20,358</u>	<u>18,040</u>

No shares were granted during the year. In September 2011 employees including executive directors, were offered the option to participate in an award of up to 200 partnership shares each at fair value (being the lower of the share price at the start of the accumulation period of £3.55 and the end of the accumulation period, to be determined) by deductions from gross salary over a 12 month accumulation period which will end in August 2012. Participants will also receive one free matching share for every partnership share purchased. Each of the executive directors is participating in this award.

The executive directors received dividends based on their shareholdings as of May and November 2011.

OUR KEY PERFORMANCE INDICATORS

We adopt a number of financial and non-financial key performance indicators (KPIs) that enable us to track progress against our business plan objectives and which are relevant to the different activities of our principal operating subsidiaries: NERL and NATS Services. These metrics are also used to set targets for remuneration purposes and so align the interests of managers across the company with our business strategies and the needs of our stakeholders (see Remuneration Committee report, page 64).

NATS' actual performance against financial and non-financial KPIs

Description	As at 31 March 2012	As at 31 March 2011
Financial KPIs		
Management EBITDA ¹ – NERL	£291.9m	£260.9m
Management EBITDA ¹ – NATS Services	£45.4m	£39.2m
<p>¹ Management earnings before interest, tax, depreciation and amortisation (EBITDA) is stated before exceptional costs, the cost of employee shares, certain variances between actual and budgeted revenues and pension costs, the costs of business development and gains or losses on asset sales. This definition of profit reflects performance that managers are able to control. For the economically regulated business (NERL), the management focus is on meeting service quality, environmental and cost efficiency targets. For NATS Services, the focus of management is on growing the business profitably.</p>		
Non-financial KPIs		
Safety:		
Category A or B Airprox ² attributable to NERL or NATS Services	Nil	Nil
Service performance:		
Average delay per flight (seconds) – NERL	7.3	4.3
Attributable delay of > 15 minutes between 05:00 and 08:59 (local time) – NERL	1,577	975
Staff attributable delay (minutes) – NERL	81,569	15,293
Service quality penalties at BAA airports (% of contract revenue) – NATS Services	0.02%	0.01%
Customer satisfaction score (%) – NERL	81%	81%
Environmental performance:		
Enabled fuel saving (tonnes) – NERL	25,000	12,000

² An Airprox is a situation in which, in the opinion of a pilot or controller, the distance between aircraft as well as their relative positions and speeds have been such that the safety of the aircraft involved was or may have been compromised. The severity of these incidents is assessed periodically by the UK Airprox Board, an independent body, in the interests of enhancing flight safety.



DIRECTORS OF NATS HOLDINGS LIMITED



John Devaney

John joined the Board in July 2005 and was appointed Chairman with effect from 1 September. He is also Chairman of National Express plc, Cobham plc and Tersus Energy plc.

John was appointed Managing Director, Eastern Electricity plc in 1992 and became Chief Executive in August 1993. Following the acquisition of Eastern by Hanson plc, John assumed the role of Chairman. From 1983 to 1988 John was President of Perkins Engines and from 1988 to 1992 he was the Chairman and CEO of Kelsey-Hayes Corporation. He was also Chairman of Exel from 1999 to 2002 and, until December 2007, was Chairman of telent plc, formerly Marconi, the global telecommunications equipment company. His previous non-executive directorships have included Northern Rock plc from 2007 to 2009, HSBC Bank from 1994 to 2000 and British Steel plc from 1998 to 1999. John chairs the Audit and Nomination Committees.



Richard Deakin

Richard was appointed as Chief Executive Officer of NATS on 1 April 2010. He was previously Senior Vice President of Thales Group's Air Systems Division based in Paris and, before that, was Managing Director of Thales Group's Aerospace Division in the UK. Richard has over 25 years experience of major programmes in the aerospace and defence industry sector with BAE Systems, TRW Aeronautical Systems, GKN Aerospace Services and Thales Group.

A Chartered Engineer, Richard holds a first-class honours degree in Aeronautical Engineering from Kingston University and an MBA from Cranfield School of Management. He is also a Fellow of the Royal Aeronautical Society, and was awarded an Honorary Doctorate in Engineering from Kingston University in January 2007.

The directors of the company at 28 June 2012 were:

DIRECTORS OF NATS HOLDINGS LIMITED



Nigel Fotherby

Nigel joined NATS in 1999 as Finance Director and led the Finance team through the transition to PPP (2001) and, following the events of 9/11, the financial restructuring and refinancing of NERL in 2003. In addition to his current responsibilities for finance, Nigel leads NERL's economic regulatory team and represented the company in the economic regulator's review of NERL's charges for Control Period 3. Previously, he worked for Lex Service plc as Finance Director of its retail group and then for BT Cellnet, where he was Deputy Finance Director. He began his career with Coopers & Lybrand where he qualified as a Chartered Accountant.



Paul Reid

Paul has over 23 years experience in air traffic management and was appointed NATS Services' Managing Director in April 2010, with responsibility for the Airports, Consultancy, Defence, Engineering and Information service lines, both in the UK and overseas.

After graduating from the air traffic college as top cadet Paul worked as an air traffic controller at both Glasgow and Heathrow airports. Having progressed into management he has held a number of senior positions within NATS including General Manager roles at London City airport, Gatwick airport and the Swanwick air traffic control centre and more recently Chief Operating Officer.



Giovanni Bisignani

Giovanni served as Director General and CEO of the International Air Transport Association (IATA) from June 2002 to July 2011. During his tenure with IATA he has completely restructured the Association to increase its relevance and speed in driving a broad agenda for industry change. He is also a member of the Board and Strategic, Remunerations and Nominating committees of SAFRAN Group.

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

DIRECTORS OF NATS HOLDINGS LIMITED



Peter Read

Peter held a number of senior positions with British Airways, most recently as Director of Heathrow from 1997 until 2003, and as Director of Operations until 2005. He joined BA in 1972 as a pilot and flew as a Captain until 1996. He subsequently held senior positions in engineering and flight operations, and in leading major business change programmes in cargo and BA corporate. During 2006 and 2007 Peter was employed as Director of Operations for Malaysia Airlines, responsible for all operational areas during a major reconstruction of the company. Peter acted as a Technical Advisor to the Board of Iberia on safety matters from 2005 to 2011. He is the Chairman of The Airline Group (AG) and is a member of the Safety Review Committee and Nomination Committee. He also chairs the Technical Review Committee.



Barry Humphreys

Barry spent his early career with the UK Civil Aviation Authority and at the time of his departure was Head of Air Services Policy. He retired in 2009 as Director of External Affairs and Route Development for Virgin Atlantic Airways. Barry is a Fellow of the Royal Aeronautical Society and formerly of the Chartered Institute of Logistics and Transport and the Tourism Society. He is currently an aviation consultant and the Chairman of the British Air Transport Association. He is also a director of AG. Among his charity work Barry is a trustee of the Loomba Trust and Chairman of the Advisory Council of the ISTAT Airlink. Barry chairs the Remuneration Committee.



Andy Lord

Andy graduated from Manchester University in 1992 with an honours degree in Mechanical Engineering, having joined British Airways in 1989 as part of the airline's sponsored Engineering Undergraduate programme. On completing his apprenticeship, Andy held a number of technical and design engineer positions before moving to Flight Operations in 1996. He has worked overseas and throughout the UK and is still the only non-flying manager in BA's history to have held the position of Chief Pilot. He moved to Operations in 2004.

As Director of Operations, Andy is responsible for the control and performance, safety, compliance and IT systems of the worldwide operation, corporate business resilience and delivery of customer service across the BA airport network, excluding Gatwick. He is a director of AG and an Associate Member of the Institute of Mechanical Engineers. Andy is a member of the Remuneration Committee.

DIRECTORS OF NATS HOLDINGS LIMITED



Nigel Turner

Nigel rejoined the Board at the beginning of 2008. He has been with bmi for over 20 years and was appointed as Chief Executive Officer in 2004 having previously held a number of senior positions within the company. Before joining bmi he worked for Next and Northern Foods. Nigel stood down as CEO in 2009 and took up the position of Deputy Chairman of bmi with effect from December 2009. Nigel was a main Board director of NATS from 2001 until the end of 2003 and was involved in AG's purchase of its controlling stake in the business. Nigel is a member of the Audit Committee and the Treasury Committee.

Nigel is also Deputy Chairman of Jetscape, an aircraft leasing company based in the USA and Chairman of Gyro-Jet, a manufacturer of aircraft.



The Rt. Hon Baroness Dean of Thornton-le-Fylde

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



Sigurd Reinton

Sigurd is a non-executive director of Monitor – the regulator of NHS service providers. He was Chairman of the London Ambulance Service NHS Trust for 10 years until 2009 and before that of Mayday University Hospitals NHS Trust. He was a member of the Board of the Ambulance Services Network of the NHS Confederation and a member of the Advisory Board of The Foundation. He was a member of the Council of the NHS Confederation from 1998 to 2007 and was the lead for London. He was previously a Director (senior partner) at McKinsey & Company. An instrument rated private pilot, Sigurd is a member of the Audit Committee and the Nomination Committee and chairs the NATS Stakeholder Council.

DIRECTORS OF NATS HOLDINGS LIMITED



Andrew White

Andrew enjoyed a full career in the Royal Air Force, rising to the rank of Air Vice Marshal. Prior to his retirement from the service in 2006, Andrew had responsibility for managing one third of the Royal Air Force's front line assets, including all military air traffic control in the UK. He was also a member of the Strike Command Management Board. After leaving the RAF Andrew became the CEO of the National Security Inspectorate; he retired from this position in December 2010. Andrew continues to fly as a RAF Reserve pilot. Andrew chairs the Safety Review Committee and is a member of the Technical Review Committee.



Roger Cato

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

Officers

Richard Churchill-Coleman

Richard is General Counsel and Company Secretary. He joined NATS in June 2007 from TUI Northern Europe Limited where he held the position of Group Legal Counsel. Richard has more than 20 years experience of working in the aviation industry having begun his career as an undergraduate aerospace engineer with British Aerospace plc before qualifying as a solicitor with Norton Rose and subsequently as a Chartered Secretary. Richard has previously held positions at Thomsonfly, Virgin Atlantic Airways and DHL Worldwide Express. Richard is a Member of the Royal Aeronautical Society.



REPORT OF THE DIRECTORS

The directors present their annual report on the affairs of the group, together with the financial statements and the auditor report for the year ended 31 March 2012. The Corporate Governance statement, which has not been subject to audit, is set out on pages 52 to 62 and forms part of this report.

Principal activities and business review

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

Reviews of the group's activities, including key performance indicators and comments on principal risks and uncertainties, during the year and of future developments are given in the Chairman's statement on pages 10-12 and the Business and Financial Review on pages 16-51.

Use of financial instruments

The company's operating subsidiaries, NATS (En Route) plc and NATS (Services) Limited, use financial instruments to manage financial risk. The accounting policies and notes to the financial statements explain the financial risk management objectives and policies of the company and describe exposures to credit and other risks.

Results and dividends

The group's results for the year are shown in the income statement on page 90. During the year interim dividends of £42.5m (29.71 pence per share) and £8.2m (5.73 pence per share) were approved (2011: £40.0m). The Board recommends a final dividend for the year of £nil (2011: £nil).

In May 2012, the Board approved and the company paid an interim dividend of £30.0m (20.97 pence per share) for the year ending 31 March 2013.

Charitable donations

The group made aggregate donations of £72,081 (2011: £35,682).

REPORT OF THE DIRECTORS

Employees

The group continues its commitment to the involvement of employees in the decision making process through effective leadership at all levels in the organisation. Staff are frequently involved through direct discussions with their managers, cross company work groups and local committees. Regular staff consultations cover a range of topics affecting the workforce, including such matters as corporate performance and business plans. The NATS CEO maintains high visibility with staff through visits to NATS sites where he talks to them about current business issues and takes questions in an open and straightforward manner. Also, employees' views are represented through an open dialogue with Prospect and the Public and Commercial Services Union (PCS), the recognised unions on all matters affecting employees. This has been enhanced 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 Trades Unions.

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

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

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

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

REPORT OF THE DIRECTORS

Policy and practice on payment of creditors

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

The average number of days taken to pay suppliers calculated in accordance with the requirements of the Companies Act 2006 is 44 days (2011: 54 days).

Going concern and subsequent events

The directors' assessment of going concern is explained in the financial review on page 51. Subsequent events are disclosed in note 30 to the financial statements.

Directors and their interests

The directors of the company as at 28 June 2012 are set out on pages 76 to 80. Ian Mills resigned from the Board on 26 September 2011. Paul Reid was appointed to the Board on 15 July 2011. All other directors served throughout the year.

The interests of the directors in the share capital of the parent company, through their participation in the Employee Share Plan, are set out on page 73.

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

Directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

- ▶ properly select and apply accounting policies;
- ▶ present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- ▶ provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- ▶ make an assessment of the company's ability to continue as a going concern.

REPORT OF THE DIRECTORS

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.

Each of the directors at the date of approval of this report confirms that so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware; and the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Auditor

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

Approved by the Board of Directors and signed on behalf of the Board by:



Richard Churchill-Coleman

Secretary

28 June 2012

Registered office

4000 Parkway, Whiteley, Fareham,
Hampshire PO15 7FL

Registered in England and Wales
Company No. 04138218

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NATS HOLDINGS LIMITED

We have audited the financial statements of NATS Holdings Limited for the year ended 31 March 2012 which comprise the group income statement, the group and company balance sheets, the group statement of comprehensive income, the group cash flow statement, the group and company statements of changes in equity and the related notes 1 to 30 of the group and 1 to 8 of the parent company. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- ▶ give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2012 and of the group's profit and the parent company's result for the year then ended;
- ▶ have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- ▶ have been prepared in accordance with the requirements of the Companies Act 2006.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 2 to the group financial statements, the group in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the financial statements comply with IFRSs as issued by the IASB.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NATS HOLDINGS LIMITED

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- ▶ the part of the Remuneration Committee report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- ▶ the information given in the Report of the directors' for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- ▶ adequate accounting records have not been kept by the parent company; or
- ▶ the parent company financial statements and the part of the Remuneration Committee report to be audited are not in agreement with the accounting records and returns; or
- ▶ certain disclosures of directors' remuneration specified by law are not made; or
- ▶ we have not received all the information and explanations we require for our audit.

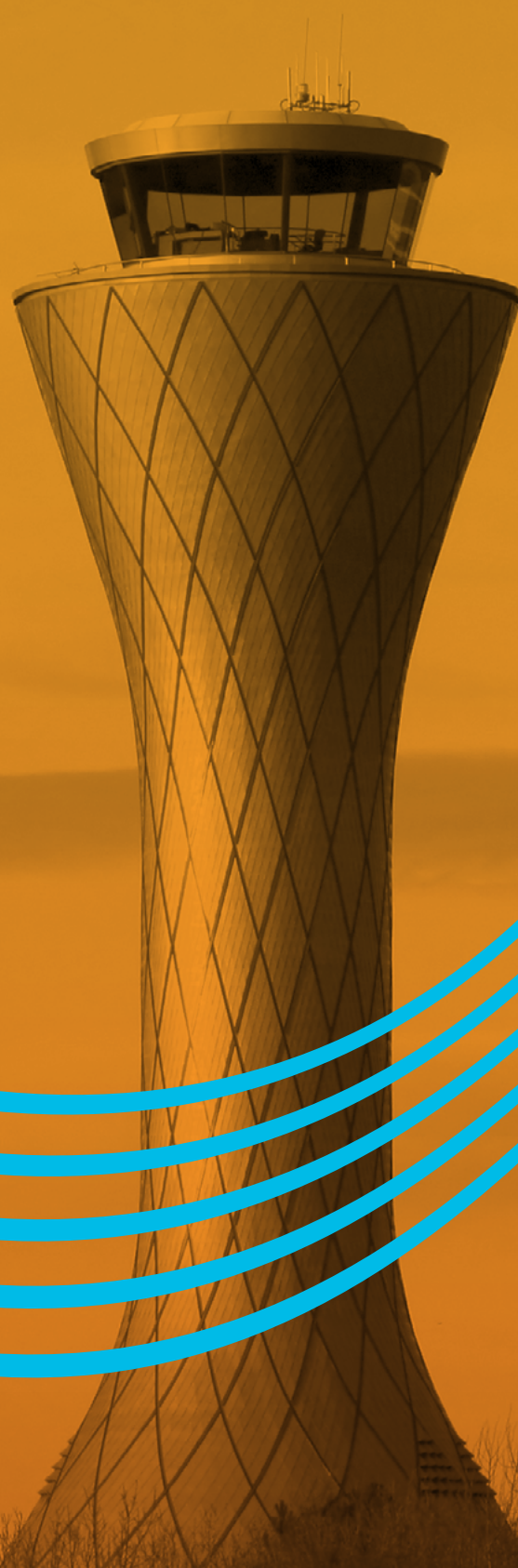


**John Clennett, Senior Statutory Auditor
for and on behalf of
Deloitte LLP**

*Chartered Accountants and
Statutory Auditor
Southampton, United Kingdom
28 June 2012*

Consolidated Financial Statements

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CONSOLIDATED FINANCIAL STATEMENTS

Consolidated income statement for the year ended 31 March 2012

	Year ended 31 March 2012			Year ended 31 March 2011			
	Notes	Before exceptional items £m	Exceptional items (note 6a) £m	Total £m	Before exceptional items £m	Exceptional items (note 6a) £m	Total £m
Revenue	4	864.9	-	864.9	777.3	-	777.3
Staff costs	7	(372.9)	(3.5)	(376.4)	(357.2)	(9.5)	(366.7)
Services and materials		(77.7)	-	(77.7)	(76.4)	-	(76.4)
Repairs and maintenance		(34.1)	-	(34.1)	(33.0)	-	(33.0)
External research and development		(0.3)	-	(0.3)	(0.2)	-	(0.2)
Depreciation, amortisation and impairment	6	(97.0)	-	(97.0)	(101.8)	-	(101.8)
Loss on disposal of non-current assets		(1.0)	-	(1.0)	(0.2)	-	(0.2)
Other operating charges		(41.9)	1.4	(40.5)	(41.0)	(1.9)	(42.9)
Other operating income		0.6	-	0.6	-	-	-
Deferred grants released	6	1.0	-	1.0	1.7	-	1.7
Net operating costs		(623.3)	(2.1)	(625.4)	(608.1)	(11.4)	(619.5)
Operating profit	6	241.6	(2.1)	239.5	169.2	(11.4)	157.8
Share of results of associates and joint ventures	29	0.1	-	0.1	0.2	-	0.2
Investment revenue	8	5.3	-	5.3	2.7	-	2.7
Finance costs	9	(50.4)	-	(50.4)	(54.6)	-	(54.6)
Profit before tax		196.6	(2.1)	194.5	117.5	(11.4)	106.1
Tax	10	(38.1)	0.6	(37.5)	(22.4)	3.2	(19.2)
Profit for the year attributable to equity shareholders		158.5	(1.5)	157.0	95.1	(8.2)	86.9

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

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of comprehensive income for the year ended 31 March 2012

	Notes	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Profit for the year after tax		157.0	86.9
Other comprehensive (expense)/income for the year net of tax			
Actuarial loss on defined benefit pension scheme	27	(144.7)	(75.4)
Change in fair value of hedging derivatives		3.7	(3.5)
Transfer to income statement on cash flow hedges		(3.3)	2.3
Deferred tax relating to components of other comprehensive (expense)/income	21	36.8	19.9
		<u>(107.5)</u>	<u>(56.7)</u>
Total comprehensive income for the year attributable to equity shareholders		<u>49.5</u>	<u>30.2</u>

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated balance sheet at 31 March 2012

	Notes	2012 £m	2011 £m
Assets			
Non-current assets			
Goodwill	12	351.0	351.0
Other intangible assets	13	261.8	230.7
Property, plant and equipment	14	627.9	629.1
Interest in associates and joint ventures	29	1.0	0.5
Retirement benefit asset	27	-	48.0
Trade and other receivables	15	48.3	47.7
		<u>1,290.0</u>	<u>1,307.0</u>
Current assets			
Trade and other receivables	15	162.9	152.8
Short-term investments	18	30.5	16.4
Cash and cash equivalents	18	187.7	167.5
Derivative financial instruments	17	0.3	0.2
		<u>381.4</u>	<u>336.9</u>
Total assets		<u>1,671.4</u>	<u>1,643.9</u>
Current liabilities			
Trade and other payables	19	(123.5)	(127.1)
Current tax liabilities		(13.9)	(8.9)
Borrowings	16	(176.7)	(14.2)
Provisions	20	(5.9)	(12.9)
Derivative financial instruments	17	(126.5)	(113.2)
		<u>(446.5)</u>	<u>(276.3)</u>
Net current (liabilities)/assets		<u>(65.1)</u>	<u>60.6</u>
Non-current liabilities			
Trade and other payables	19	(16.1)	(15.4)
Borrowings	16	(550.6)	(697.7)
Retirement benefit obligations	27	(37.8)	-
Deferred tax liability	21	(94.1)	(122.0)
Provisions	20	(0.3)	(5.3)
		<u>(698.9)</u>	<u>(840.4)</u>
Total liabilities		<u>(1,145.4)</u>	<u>(1,116.7)</u>
Net assets		<u>526.0</u>	<u>527.2</u>
Equity			
Called up share capital	22	140.6	140.6
Share premium account	23	0.4	0.4
AESOP reserve		(0.3)	(0.3)
Hedge reserve		(0.2)	(0.5)
Other reserves		(34.7)	(34.7)
Retained earnings		420.2	421.7
Total equity		<u>526.0</u>	<u>527.2</u>

The financial statements (Company No. 04138218) were approved by the Board of directors and authorised for issue on 28 June 2012 and signed on its behalf by:

John Devaney
Chairman



Nigel Fotherby
Finance Director



CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of changes in equity for the year ended 31 March 2012

	Equity attributable to equity holders of the Company						
	Share capital	Share premium account	AESOP reserve	Hedge reserve	Other reserves	Retained earnings	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 April 2010	140.6	0.4	(0.3)	0.4	(34.7)	430.6	537.0
Profit for the year	-	-	-	-	-	86.9	86.9
Other comprehensive expense for the year	-	-	-	(0.9)	-	(55.8)	(56.7)
Total comprehensive (expense)/ income for the year	-	-	-	(0.9)	-	31.1	30.2
Dividends paid	-	-	-	-	-	(40.0)	(40.0)
At 31 March 2011	<u>140.6</u>	<u>0.4</u>	<u>(0.3)</u>	<u>(0.5)</u>	<u>(34.7)</u>	<u>421.7</u>	<u>527.2</u>
At 1 April 2011	140.6	0.4	(0.3)	(0.5)	(34.7)	421.7	527.2
Profit for the year	-	-	-	-	-	157.0	157.0
Other comprehensive income/ (expense) for the year	-	-	-	0.3	-	(107.8)	(107.5)
Total comprehensive income for the year	-	-	-	0.3	-	49.2	49.5
Dividends paid	-	-	-	-	-	(50.7)	(50.7)
At 31 March 2012	<u>140.6</u>	<u>0.4</u>	<u>(0.3)</u>	<u>(0.2)</u>	<u>(34.7)</u>	<u>420.2</u>	<u>526.0</u>

Other reserves arose on the completion of the PPP transaction in July 2001.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated cash flow statement for the year ended 31 March 2012

	Notes	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Net cash from operating activities	24	224.1	182.6
Cash flows from investing activities			
Interest received on short-term investments		1.4	1.4
Purchase of property, plant and equipment and other intangible assets		(121.3)	(120.4)
Cost of disposal of property, plant and equipment		(0.2)	-
Investment in associate/joint venture		(0.3)	(0.1)
Changes in short-term investments		(14.1)	(0.9)
Net cash outflow from investing activities		(134.5)	(120.0)
Cash flows from financing activities			
Interest paid		(35.6)	(33.7)
Interest received on derivative financial instruments		2.3	2.8
Repayment of bond principal		(14.2)	-
Bank and other loans		28.8	30.2
Dividends paid		(50.7)	(40.0)
Net cash outflow from financing activities		(69.4)	(40.7)
Increase in cash and cash equivalents during the year		20.2	21.9
Cash and cash equivalents at 1 April		167.5	145.6
Cash and cash equivalents at 31 March		187.7	167.5
Net debt (representing borrowings net of cash and short-term investments)		(509.1)	(528.0)

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

1. General information

NATS Holdings Limited is a private limited company incorporated in England and Wales and domiciled in the United Kingdom and acting under the Companies Act 2006. The address of the registered office is on page 85. The nature of the group's operations and its principal activities are set out in the Report of the directors and in the Business and financial review.

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

2. Accounting policies

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

Basis of preparation and accounting

The financial statements have been prepared on the going concern basis. For further detail please refer to page 51. The financial information has been prepared in accordance with International Financial Reporting Standards (IFRSs). The financial statements have also been prepared in accordance with IFRSs and International Financial Reporting Interpretations Committee (IFRIC) interpretations as endorsed by the European Union and therefore the group financial statements

comply with Article 4 of the EU IAS Regulation. In the current year, the following new and revised Standards and Interpretations have been adopted. Their adoption has not had any significant impact on the amounts reported in these financial statements.

IAS 1 (2011): *Presentation of Financial Statements* – this amendment clarified the position in circumstances where additional information is provided within the financial statements, requiring this information to be presented in accordance with IFRSs.

IAS 16 (2011): *Property, Plant and Equipment* – the amendment clarifies that any servicing equipment should be classified as property, plant and equipment when it is used during more than one period or as inventory otherwise. Within these financial statements, all servicing equipment is classified within property, plant and equipment.

IAS 32 (2011): *Financial Instruments: Presentation* – the amendment states that income tax relating to distributions to holders of an equity instrument and income tax relating to transaction costs of an equity transaction should be accounted for in accordance with IAS 12: *Income Taxes*.

As part of the Improvements to IFRSs (2010) the following amendments to Standards have been adopted:

Amendment to IFRS 3: *Business Combinations* – IFRS 3 has been amended such that only those non-controlling interests which are current ownership interests and which entitle their holders to a proportionate share of net assets upon liquidation can be measured at either fair value or the proportionate share of net identifiable assets. Other non-controlling interests are measured at fair value, unless another measurement basis is required by IFRSs. The investments that this will apply to is FerroNATS and ESSP. These investments will be measured at the proportionate share of net identifiable assets if they meet the requirements of the amended Standard, therefore the adoption of this amendment has not had any significant impact on the amounts reported in these financial statements.

Amendment to IFRS 7: *Financial Instruments: Disclosures* – the amendment clarifies the required level of disclosure around credit risk and collateral held and provides relief from disclosure of renegotiated financial assets.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

Amendments to IFRS 1: *Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters* – provides a limited exemption for first-time adopters from providing comparative fair value hierarchy disclosures under IFRS 7.

Amendments to IAS 1: *Presentation of Financial Statements* – the amendment clarifies that an entity may present the analysis of other comprehensive income by item either in the statement of changes in equity or in the notes to the financial statements. Within the group financial statements, the analysis of other comprehensive income is presented within the statement of changes in equity.

IAS 24 (2009): *Related Party Disclosures* – the revised Standard has a new, clearer definition of a related party, with inconsistencies under the previous definition having been removed.

The following Standards have been adopted early in the current year and have had no significant impact on these financial statements and are not expected to significantly impact on the financial statements of the group in future periods:

IFRS 7: *Financial Instruments: Disclosures* – this amendment requires additional disclosures around transactions with financial assets, where an entity retains an interest in the financial asset. The group does not hold any retained interest in financial assets, so no additional disclosure is required.

Amendment to IAS 24: *Related Party Disclosures* – the revision provides an exemption for government controlled or joint government controlled entities from disclosing related party transactions with other government controlled entities. The ultimate controlling party of the group is The Airline Group, hence the group is not able to apply the exemption.

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue, but not yet effective (and in some cases had not yet been adopted by the EU):

IFRS 1 (Amended): *Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters*

IFRS 9: *Financial Instruments*

IFRS 10: *Consolidated Financial Statements*

IFRS 11: *Joint Arrangements*

IFRS 12: *Disclosures of Interests in Other Entities* IFRS 13: *Fair Value Measurement*

IAS 1 (Amended): *Presentation of Items of Other Comprehensive Income*

IAS 12 (Amended): *Deferred Tax: Recovery of Underlying Assets*

IAS 19 (Revised): *Employee Benefits*

IAS 27 (Revised): *Separate Financial Statements*

IAS 28 (Revised): *Investments in Associates and Joint Ventures*

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

The directors do not expect that the adoption of the Standards listed above will have a material impact on the financial statements of the company in future periods, except as follows:

IFRS 9: *Financial Instruments* – this will impact both the measurement and disclosures of the financial instruments within the group.

IFRS 12: *Disclosure of Interests in Other Entities* – will increase the disclosures documenting the basis of control conclusions around group entities.

IAS 1: *Presentation of Financial Statements* – will result in separate disclosure for other comprehensive income items that will be reclassified as profit and loss in the future and those items that will not affect future profit and loss and the relative separate deferred tax impacts of these items.

IAS 19 (Revised): *Employee Benefits* – will require disaggregation of defined benefit costs into components within operating and finance costs, recognition of re-measurements in other comprehensive income and enhanced disclosures about the defined benefit scheme.

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

Basis of consolidation

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

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

Operating segments

Operating segments are reported in a manner consistent with the internal reporting provided to the company's Executive team, who is considered to be the chief operating decision maker. An operating segment is a component of NATS that engages in business activities from which it may earn revenues and incur expenses. Operating segments' operating results are reviewed regularly by the Executive team to make decisions about resources to be allocated to the segment and to assess its performance, and for which discrete financial information is available.

Inter-segment transfers or transactions are entered into under the normal commercial terms and conditions that would also be available to unrelated third parties.

Segment results, assets and liabilities that are reported to the Executive team include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated result items comprise the share of results of associates and joint ventures, investment revenue, finance expenses and income tax expenses. Unallocated assets and liabilities comprise balances relating to taxation, cash and cash equivalents and borrowings, derivative financial instruments, interest receivable and payable and dividends.

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment, and intangible assets.

Operating profit

Operating profit is stated after charging restructuring costs but before the group's share of results of associates, investment income, finance costs and taxation.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods or services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Revenue is recognised as follows:

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

Goodwill

Goodwill in relation to NATS (En Route) plc, being the excess of consideration over the values of the net assets acquired at the date of the Public Private Partnership (PPP), is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. For the purpose of impairment testing NATS assesses the carrying value of goodwill against the recoverable amount of the cash-generating unit to which goodwill has been allocated. Where the recoverable amount is less than the carrying value, the impairment loss is allocated to goodwill.

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

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other items are classified as operating leases.

The group does not have any finance leases.

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

Property, plant and equipment

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

- ▶ Leasehold land: over the term of the lease.
- ▶ Freehold buildings: 10-40 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: 3-15 years.
- ▶ Furniture, fixtures and fittings: 10 years.
- ▶ Vehicles: 5-8 years.

Freehold land and assets in the course of construction and installation are not depreciated.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in income.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

Borrowing costs

Following the introduction of IAS 23: *Borrowing Costs*, the costs of borrowings directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of the asset (i.e. there is no longer a choice to expense such costs). Qualifying assets are those which take a substantial time to get ready for intended use. These do not include assets which are ready for use when acquired.

For NATS this assumes qualifying assets relate to any additions to new projects that begin from 1 April 2009, included in assets under construction, and excludes acquisitions that are acquired in a state ready for use.

When funds are borrowed specifically for the purpose of acquiring or constructing a qualifying asset, the amount of borrowing costs eligible for capitalisation is the actual cost of borrowing incurred in the period. IAS 23 requires that where a qualifying asset is funded from a pool of general borrowings, the amount of borrowing costs eligible for capitalisation should be determined by applying an appropriate capitalisation rate (based on the weighted average of borrowing costs applicable to the general outstanding borrowings during the period) to the expenditure during the period, to determine the borrowing costs eligible for capitalisation.

For NATS, the percentage rate for interest capitalisation is calculated as a proportion of the interest costs to the average level of borrowings in the period that relate to qualifying capital expenditure. All qualifying capital expenditure is then inflated by this percentage which has the effect of capitalising related interest costs.

Deferred grants and other contributions to property, plant and equipment

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

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

Investments in associates and joint ventures

An associate or joint venture is an entity over which the group is in a position to exercise significant influence, but not control, through participation in the financial and operating policy decisions of the investee. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

The results and assets and liabilities of associates and joint ventures are incorporated in these financial statements using the equity method of accounting. Investments in associates and joint ventures are carried in the balance sheet at cost as adjusted by post-acquisition changes in the group's share of the net assets of the associate or joint venture, less any impairment in the value of individual investments.

Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

Internally-generated intangible assets – research and development expenditure

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

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

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

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

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the group reviews the carrying amounts of its tangible and intangible assets, including those in the course of construction, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the

asset is estimated in order to determine the extent of the impairment (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

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

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

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

Emissions allowances

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

Amounts recoverable on contracts

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

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the

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extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

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

Share-based payment

The company has applied the requirements of IFRS 2: *Share-based payment*.

In 2001, the company established an All-Employee Share Ownership Plan for the benefit of its employees to hold 5% of the share capital of NATS Holdings Limited. The Plan was initially established through the transfer of shares by the Crown Shareholder at the PPP to NATS Employee Sharetrust Limited (NESL) for £nil consideration. Following financial restructuring in March 2003, further shares were transferred to NESL by The Airline Group (AG) for £nil consideration and NESL was gifted cash of £279,264 to acquire additional shares to maintain the Plan's interest at 5% of the share capital of NATS Holdings Limited. The Plan is administered by NESL, a trustee company. The employee ordinary shares may only be owned by employee shareholders and can only be sold to the trust company.

Shares awarded by the Plan are treated as cash-settled liabilities. A liability is recognised for shares awarded over the period from award to when the employee

becomes unconditionally entitled to the shares and are measured initially at their fair value. At each balance sheet date until the liability is settled, as well as at the date of settlement, the fair value of the liability is re-measured based on independent share valuations with any changes in fair value recognised in profit or loss for the year.

In respect of the award schemes, the group provides finance to the NATS Employee Sharetrust to enable the trust company to meet its obligations to repurchase vested or eligible shares from employees.

The group's share of the costs of running the employee share trust is charged to the income statement.

Taxation

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

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying values of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities

are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

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

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current liabilities and when they relate

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to taxes levied by the same taxation authority and the group intends to settle its current tax assets and liabilities on a net basis.

On 26 March 2012 under the Provisional Collection of Taxes Act, the corporation tax rate was reduced to 24% with effect from 1 April 2012. The Government has also indicated that it intends to enact future reductions in the main UK tax rate of 1% each year down to 22% by 1 April 2014. The future 1% main tax rate reductions are expected to have a similar impact on the group's financial statements as outlined above, subject to the impact of other developments in the group's tax position which may reduce the beneficial effect of this in the group's tax rate. As the further reductions in UK corporate tax rates have not been substantively enacted at the balance sheet date, this is considered a non-adjusting event in accordance with IAS 10 and no adjustments have been made. The impact of any further reduction will be taken into account at subsequent reporting dates, once the change has been substantively enacted.

Foreign currency translation

Transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign

currencies are translated at the rates prevailing at the date when the fair value was determined. Gains and losses arising on retranslation are included in the income statement for the period.

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

Retirement benefit costs

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

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

The retirement benefit obligation recognised in the balance sheet represents the fair value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme

assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the scheme.

Provisions

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

Financial instruments

Financial assets and financial liabilities are recognised on the group's balance sheet when the group becomes a party to the contractual provisions of the instrument. Detailed disclosures are set out in notes 15 to 19.

Financial assets

Financial assets, other than hedging instruments, can be divided into the following categories:

- ▶ Loans and receivables
- ▶ Financial assets at fair value through the profit and loss
- ▶ Available for sale financial assets
- ▶ Held to maturity investments

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

Financial assets are assigned to different categories on initial recognition. The classification depends upon the nature and purpose of the financial asset. A financial instrument's category is relevant to the way it is measured and whether the resulting income is recognised through the income statement or directly in equity. Subsequent to initial recognition, financial assets are measured at either fair value or at amortised cost according to the category in which they are classified.

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the time frame established by the market concerned, and are initially measured at fair value plus transaction costs.

Loans and receivables

Trade receivables and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Receivables are measured at amortised cost using the effective interest method, less any impairment.

Impairment of financial assets

Financial assets are rigorously assessed for indicators of impairment at half year and year end.

Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Impairment losses on trade receivables are recognised using allowance accounts. When a trade receivable is considered irrecoverable, it is written off against the allowance account, any subsequent recoveries are credited to the allowance account. Changes in the allowance account are recognised in the income statement.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other highly liquid investments (with a maturity of 3 months or less) that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into. Financial liabilities are either financial liabilities at 'fair value through the profit and loss' or 'other financial liabilities'.

Fair value through the profit and loss

Financial liabilities at fair value through the profit and loss are measured initially at fair value and subsequently stated at fair value, with any resultant gain or loss recognised in the income statement. The net gain or loss recognised in the income statement incorporates any interest paid on the financial liability.

Other financial liabilities: including bank, other borrowings, loan notes and debt securities

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

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

Effective interest method

The effective interest method is a method of calculating amortised cost of a financial asset or financial liability and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset.

Equity

Equity instruments are also classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. Equity instruments issued by the company are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments and hedging activities

The group's activities expose it primarily to the financial risks of changes in interest rates, inflation and foreign currency exchange rates. The group uses interest rate and index-linked swap contracts and forward foreign exchange contracts to hedge these exposures. These are disclosed in note 17 and 18 to the accounts.

Under IFRS derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently measured at their fair

value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

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

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognised directly in equity are reclassified into the income statement in the same period or periods during which the asset acquired or liability assumed

affects profit or loss. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recycled to the income statement in the same period in which the hedged item affects the income statement.

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

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

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

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

3. Critical judgements and key sources of estimation uncertainty

Impairment of goodwill, intangible and tangible assets

In carrying out impairment reviews of goodwill, intangible and tangible assets (including assets in the course of construction), a number of significant assumptions have to be made when preparing cash flow projections and assessing net realisable values. These include air traffic growth, service performance, future cash flows, the value of the regulated asset bases, market premiums for regulated businesses and the outcome of the regulatory price control determinations. If the actual outcome should differ or changes in expectations arise, impairment charges may be required which would materially impact on operating results. A reduction in value in use of 3% (2011: net realisable value of 20%) or a reduction in market premium by 5% (2011: 7%) would result in the recoverable amount being equal to the carrying amount of goodwill. Refer to notes 12, 13 and 14.

Retirement benefits

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

income. To the extent that there is a net pension scheme asset, this assumes that economic benefit will arise, at least to the extent shown, from contributions to the pension scheme at a rate below the future cost of pension benefits.

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

Capital investment programme

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

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

4. Revenue

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

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
UK air traffic services	653.2	578.2
North Atlantic air traffic services	26.8	21.1
Airport air traffic services	162.1	159.0
Miscellaneous services	22.8	19.0
	864.9	777.3

All revenue is derived from continuing operations. Note 5 summarises the source of revenues by business and geographical segment. Other revenue is described on the face of the income statement and is included in note 8.

A portion of the group's revenue from the provision of services denominated in foreign currencies is cash flow hedged. Included in revenue is the recycling of the effective amount of foreign currency derivatives that are used to hedge foreign currency revenue. The amount included in revenue is £3.3m loss (2011: £2.3m gain).

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

5. Business and geographical segments (continued)

Year ended 31 March 2011	Economically regulated activities			Activities not economically regulated			Total
	UK air traffic services	North Atlantic air traffic services	Sub-total	Airport air traffic services	Miscellaneous services	Sub-total	
	£m	£m	£m	£m	£m	£m	£m
Revenue							
Revenue from external customers	578.2	21.1	599.3	159.0	19.0	178.0	777.3
Segment result	121.8	1.6	123.4	30.9	3.5	34.4	157.8
Operating profit							157.8
Share of results of associates and joint ventures							0.2
Investment revenue							2.7
Finance costs							(54.6)
Profit before tax							106.1
Tax							(19.2)
Profit for the year							86.9
Other information							
Exceptional items	7.8	0.2	8.0	3.0	0.4	3.4	11.4
Capital expenditure	119.0	2.5	121.5	0.8	0.2	1.0	122.5
Depreciation and amortisation	81.6	3.4	85.0	3.4	0.3	3.7	88.7
Impairment losses recognised in income	13.1	-	13.1	-	-	-	13.1
Deferred grants released	(1.4)	-	(1.4)	(0.3)	-	(0.3)	(1.7)
Balance sheet							
Assets							
Segment assets	1,359.3	31.3	1,390.6	53.6	15.6	69.2	1,459.8
Unallocated assets							184.1
Consolidated total assets							1,643.9
Liabilities							
Segment liabilities	(117.5)	(4.0)	(121.5)	(32.2)	(6.9)	(39.1)	(160.6)
Unallocated liabilities							(956.1)
Consolidated total liabilities							(1,116.7)

All assets are allocated to reportable segments with the exception of derivative financial instruments, interest receivable, short-term investments and cash and cash equivalents.

All liabilities are allocated to reportable segments with the exception of taxation, borrowings, derivative financial instruments, interest payable £0.1m (2011: £0.1m) and dividends payable.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

5. Business and geographical segments (continued)

Geographical segments

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

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
UK	466.6	424.0
Rest of Europe	233.9	210.2
North America	117.0	102.2
Other	47.4	40.9
Total	<u>864.9</u>	<u>777.3</u>

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

Information about major customers

Included in revenues arising from airport air traffic services are revenues of £100.7m (2011: £99.5m) which arose from the group's largest customer.

6. Operating profit for the year

Operating profit for the year has been arrived at after charging/(crediting):

a. Exceptional items

Redundancy and relocation costs

During the year staff relocation costs were incurred following the closure of air traffic control centres in previous years and the relocation of the Hurn staff following the closure of the training college at Hurn and the opening of a new training centre at the company's Corporate & Technical Centre. To the extent that staff could not be redeployed, termination terms were agreed. In response to the economic downturn and changes in technology, voluntary redundancy was also offered to staff in some areas of the business.

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Redundancy costs (including pension augmentation costs, see note 7a)	3.5	9.5
Relocation of staff to the Swanwick area	0.2	2.7
Relocation of staff to the Prestwick area	(1.3)	(2.6)
Relocation of staff from Hurn to the Corporate & Technical Centre	(0.3)	1.8
	<u>2.1</u>	<u>11.4</u>

The tax effect of the items above is shown as exceptional on the face of the income statement.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

6. Operating profit for the year (continued)

b. Other items	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
CAA regulatory charges in respect of NERL's air traffic services licence	5.2	5.0
CAA regulatory charges for safety regulation at airports	2.8	2.8
Depreciation of property, plant and equipment	74.6	77.5
Impairment of property, plant and equipment	1.6	(0.1)
Amortisation of intangible assets	18.4	11.2
Impairment of intangible assets	2.4	13.2
Deferred grants released	(1.0)	(1.7)
Research and development costs	7.0	12.5
Auditors' remuneration for audit services (see below)	0.2	0.2

The analysis of auditors' remuneration is as follows:

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Fees payable to the company's auditors for the audit of the company's annual accounts	0.2	0.1
Fees payable to the company's auditors and their associates for other services to the group		
- The audit of the company's subsidiaries	-	0.1
Total audit fees	0.2	0.2

Total non-audit fees of £60,769 (2011: £33,848) included tax services of £30,566 (2011: £18,573) and other services of £30,203 (2011: £15,275). Total fees payable to the company's auditors for the audit of the subsidiary accounts was £41,700 (2011: £51,700).

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

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

7. Staff costs

a. Staff costs

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Salaries and staff costs, including directors' remuneration, were as follows:		
Wages and salaries	292.6	291.7
Social security costs	30.6	27.5
Pension costs (note 7b)	87.0	80.7
	<u>410.2</u>	<u>399.9</u>
Less: amounts capitalised	(33.8)	(33.2)
	<u>376.4</u>	<u>366.7</u>

Wages and salaries include redundancy costs of £1.1m (2011: £4.7m), share-based payment charges, other allowances and holiday pay. Pension costs include £2.4m (2011: £5.1m) for redundancy related augmentation payments which staff elected to receive in lieu of severance payments.

b. Pension costs

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Defined benefit pension scheme costs for year (note 27)	84.6	79.6
Defined contribution pension scheme costs for year	2.4	1.1
	<u>87.0</u>	<u>80.7</u>

The company operates a salary sacrifice arrangement for staff pension contributions. Wages and salaries and pension costs reflect this arrangement.

c. Staff numbers

	Year ended 31 March 2012 No.	Year ended 31 March 2011 No.
The monthly average number of employees (including executive directors) was:		
Air traffic controllers	1,924	1,957
Air traffic service assistants	766	863
Engineers	954	970
Others	889	862
	<u>4,533</u>	<u>4,652</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

8. Investment revenue

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Interest on bank deposits	1.1	1.3
Other loans and receivables	4.2	1.4
	<u>5.3</u>	<u>2.7</u>

All investment revenue earned on financial assets has been earned on financial assets classified as loans and receivables, including cash and cash equivalents.

9. Finance costs

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Interest payable		
Interest on bank overdrafts, loans and hedging instruments	1.0	1.5
Bond and related costs including financing expenses	32.1	30.9
Other	0.4	-
	<u>33.5</u>	<u>32.4</u>
Loss on derivatives not qualifying for hedge accounting	16.9	22.2
	<u>50.4</u>	<u>54.6</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

10. Tax

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Current tax	(32.0)	(16.2)
Adjustments in respect of prior year	3.4	0.1
Deferred tax (see note 21)	(8.9)	(3.1)
	<u>(37.5)</u>	<u>(19.2)</u>

Corporation tax is calculated at 26% (2011: 28%) of the estimated assessable profit for the year.

	Year ended 31 March 2012 £m	%	Year ended 31 March 2011 £m	%
The charge for the year can be reconciled to the profit per the income statement as follows:				
Profit on ordinary activities before tax	<u>194.5</u>		<u>106.1</u>	
Tax on profit on ordinary activities at standard rate in the UK of 26% (2011: 28%)	(50.6)	(26.0)	(29.7)	(28.0)
Deferred tax effect of change in corporation tax rate from 26% to 24% from April 2012	7.8	4.0	-	-
Deferred tax effect of change in corporation tax rate from 28% to 26% from April 2011	-	-	10.8	10.2
Tax effect of prior year adjustments	3.4	1.7	0.1	0.1
Other permanent differences	1.9	1.0	(0.4)	(0.4)
Tax charge for year at an effective tax rate of 19.3% (2011: 18.1%)	<u>(37.5)</u>	(19.3)	<u>(19.2)</u>	(18.1)
Deferred tax credit taken directly to equity (see note 21)	<u>(36.8)</u>		<u>(19.9)</u>	

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

11. Dividends

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Amounts recognised as dividends to equity shareholders in the year:		
First interim dividend of 29.71 pence per share (2011: 13.98 pence per share) paid in May 2011	42.5	20.0
Second interim dividend of 5.73 pence per share (2011: 13.98 pence per share) paid in November 2011	8.2	20.0
	<u>50.7</u>	<u>40.0</u>

In May 2012, the Board declared and the company paid an interim dividend for the year ending 31 March 2013 of 20.97 pence per share, totalling £30.0m.

12. Goodwill

	£m
Carrying amount	
At 31 March 2012 and 31 March 2011	<u>351.0</u>

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

The carrying value is determined by reference to value in use calculations and the net realisable value of the regulated asset bases of the company's business segments, representing the cash-generating unit, including market premiums for regulated businesses (assumed at 10%, 2011: 10%). The key assumptions for value in use calculations are the discount rate, future cash flows to the end of the current regulatory control period (31 December 2014 for UK air traffic services and 31 March 2015 for North Atlantic air traffic services) as assumed in the group's business plans, and a terminal value at that date, reflecting the regulatory asset bases of £1,201.7m (2011: £1,304.5m) and a market premium which is assessed annually by reference to recent market transactions within the utility sectors. The company's business plans reflect the outcome of the latest price control review which included forecasts of traffic volumes reflecting the current economic environment. The carrying value of goodwill is not significantly impacted by changes in traffic volumes due to the risk sharing feature of the price control. The discount rate is a pre-tax nominal rate of 9.99% (2011: 10.69%). See note 3.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

13. Other intangible assets

	Operational software £m	Non- operational software £m	Airspace and resectorisation £m	Assets in course of construction £m	Total £m
Cost					
At 1 April 2010	48.5	32.1	18.6	148.7	247.9
Additions internally generated	2.3	-	0.1	15.2	17.6
Additions externally acquired	2.7	1.1	-	33.1	36.9
Disposals during the year	(0.5)	(0.2)	(1.0)	-	(1.7)
Other transfers during the year	3.3	0.5	1.1	(5.6)	(0.7)
At 1 April 2011	56.3	33.5	18.8	191.4	300.0
Additions internally generated	4.2	0.3	1.0	10.4	15.9
Additions externally acquired	2.4	6.5	0.1	27.3	36.3
Disposals during the year	-	(1.3)	-	(2.7)	(4.0)
Other transfers during the year	77.4	2.1	1.1	(80.7)	(0.1)
At 31 March 2012	140.3	41.1	21.0	145.7	348.1
Accumulated amortisation					
At 1 April 2010	20.1	12.9	8.1	5.4	46.5
Charge for the year	5.7	3.9	1.6	-	11.2
Provisions for impairment	-	-	-	13.2	13.2
Utilisation of impairment provision	(0.5)	(1.0)	-	-	(1.5)
Disposals during the year	0.5	0.9	-	(1.5)	(0.1)
At 1 April 2011	25.8	16.7	9.7	17.1	69.3
Charge for the year	11.8	5.0	1.6	-	18.4
Provisions for impairment	0.5	-	-	1.9	2.4
Utilisation of impairment provision	-	-	-	(2.7)	(2.7)
Disposals during year	-	(1.1)	-	-	(1.1)
At 31 March 2012	38.1	20.6	11.3	16.3	86.3
Carrying amount					
At 31 March 2012	102.2	20.5	9.7	129.4	261.8
At 31 March 2011	30.5	16.8	9.1	174.3	230.7

The accumulated amortisation of assets in the course of construction represents impairment provisions.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

14. Property, plant and equipment

	Freehold land and buildings £m	Improvements to leasehold land and buildings £m	Air traffic control systems, plant and equipment £m	Vehicles, furniture and fittings £m	Assets in course of construction and installation £m	Total £m
Cost						
At 1 April 2010	223.5	48.2	1,136.7	17.8	125.8	1,552.0
Additions during the year	1.0	0.1	14.4	0.7	51.8	68.0
Disposals during the year	-	(0.6)	(36.6)	(0.2)	-	(37.4)
Other transfers during the year	0.2	-	14.2	0.2	(13.9)	0.7
At 1 April 2011	224.7	47.7	1,128.7	18.5	163.7	1,583.3
Additions during the year	2.0	0.3	27.8	0.8	44.8	75.7
Disposals during the year	(0.4)	-	(117.8)	(1.5)	(3.1)	(122.8)
Other transfers during the year	4.6	1.0	118.4	2.0	(125.9)	0.1
At 31 March 2012	230.9	49.0	1,157.1	19.8	79.5	1,536.3
Accumulated depreciation and impairment						
At 1 April 2010	84.8	32.2	784.5	9.4	3.2	914.1
Provided during the year	6.9	1.5	67.6	1.5	-	77.5
Provisions for impairment	-	-	-	-	(0.1)	(0.1)
Utilisation of impairment provision	-	-	-	-	(0.1)	(0.1)
Disposals during the year	-	(0.6)	(36.5)	(0.1)	-	(37.2)
At 1 April 2011	91.7	33.1	815.6	10.8	3.0	954.2
Provided during the year	6.8	1.6	64.6	1.6	-	74.6
Provisions for impairment	-	-	1.5	-	0.1	1.6
Utilisation of impairment provision	-	-	(1.5)	-	(3.0)	(4.5)
Disposals during the year	(0.3)	-	(115.7)	(1.5)	-	(117.5)
At 31 March 2012	98.2	34.7	764.5	10.9	0.1	908.4
Carrying amount						
At 31 March 2012	132.7	14.3	392.6	8.9	79.4	627.9
At 31 March 2011	133.0	14.6	313.1	7.7	160.7	629.1

The group conducts annual reviews of the carrying values of its property, plant, equipment and intangible assets. During the year, impairment charges of £4.0m (2011: £13.1m) were made in respect of operational assets and assets in the course of construction reflecting a reassessment of certain projects and the likelihood of benefits being realised in full.

Assets no longer in service, which had an original cost of £114.4m and a nil net book value, were written off during the year.

During the year the group capitalised £1.0m (2011: £0.5m) of general borrowing costs at a capitalisation rate of 1.3% (2011: 1.8%), in accordance with IAS 23: *Borrowing Costs*.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

15. Financial and other assets

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

Trade and other receivables

	2012 £m	2011 £m
Non-current		
Other debtors	1.1	1.1
Accrued income	47.2	46.6
	<u>48.3</u>	<u>47.7</u>
Current		
Receivable from customers gross	61.6	62.7
Allowance for doubtful debts	(4.6)	(6.0)
	<u>57.0</u>	<u>56.7</u>
Amounts recoverable under contracts	4.2	5.4
Other debtors	3.7	7.0
Prepayments	11.8	11.3
Accrued income	86.2	72.4
	<u>162.9</u>	<u>152.8</u>

The average credit period taken on sales of services is 29 days (2011: 28 days). Interest is charged by Eurocontrol to UK en route customers at 11.00% (2011: 11.00%) on balances outstanding after more than 30 days. All other balances are non-interest bearing. An allowance has been made for estimated irrecoverable amounts from sales to customers of £4.6m (2011: £6.0m). Full provision is made for receivables from UK en route customers that are overdue. Debts that are neither impaired nor overdue are assessed for credit quality and reviewed periodically. Receivables in respect of other customers are provided for where there is an identified loss event, such as administration, receivership or liquidation or where there is evidence of a reduction in the recoverability of the cash flows.

Accrued income which is non-current represents revenues earned in the previous control period (CP2) which will be recovered over the current control period (CP3). Accrued income which is current includes unbilled revenues for services provided in March 2012 and regulatory adjustments to revenue for service performance, traffic volume risk sharing and inflation to reflect differences between actual outcomes and the CAA's CP3 assumptions.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

15. Financial and other assets (continued)

Ageing of past due but not impaired trade receivables

	2012 £m	2011 £m
30-90 days	0.2	0.9
91-365 days	0.5	0.7
	<u>0.7</u>	<u>1.6</u>

Movement in the allowance for doubtful debts

	2012 £m	2011 £m
Balance at the beginning of the year	6.0	5.7
Increase in allowance recognised in the income statement	0.6	0.9
Foreign exchange movement in the year	(0.3)	(0.1)
Release of provision	(0.5)	-
Amounts written off as irrecoverable	(1.2)	(0.5)
Balance at end of year	<u>4.6</u>	<u>6.0</u>

In determining the recoverability of a trade receivable the group considers any change in credit quality of the trade receivable from the date credit was initially granted up to the reporting date. Credit risk is mitigated in part by regulatory price control conditions that include within UK en route annual revenue allowances £1m to cover bad debts. Accordingly, the directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Included in the allowance for doubtful debts are individually impaired trade receivables with a balance of £3.7m (2011: £4.7m) which are in administration, receivership or liquidation. The impairment recognised represents the carrying amount of these trade receivables. The group does not hold any collateral over these balances.

Ageing of impaired receivables

	2012 £m	2011 £m
30-90 days	0.3	0.3
91-365 days	1.5	2.1
more than 365 days overdue	2.8	3.6
	<u>4.6</u>	<u>6.0</u>

The directors consider that the carrying amount of trade and other receivables approximates to their fair value.

Cash and cash equivalents

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

Overall, the maximum credit risk for the items discussed above would be £417.6m (2011: £373.1m).

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

16. Borrowings

Secured loans at amortised cost	2012 £m	2011 £m
£600m 5.25% Guaranteed Secured Amortising Bond due 2026	583.9	597.9
Bank loans (revolving term loan and revolving credit facility expiring 2012-2013)	148.3	119.5
Gross borrowings	<u>732.2</u>	<u>717.4</u>
Unamortised bond issue costs	<u>(4.9)</u>	<u>(5.5)</u>
	<u>727.3</u>	<u>711.9</u>
Amounts due for settlement within 12 months	<u>176.7</u>	<u>14.2</u>
Amounts due for settlement after 12 months	<u>550.6</u>	<u>697.7</u>

The £600m 5.25% Guaranteed Secured Amortising Bond is secured by way of a debenture by which NERL grants its lenders a first legal mortgage over certain properties in England and Wales, a first fixed charge over all other real estate, plant and equipment and a floating charge over all other assets. Drawings of £148.3m made by NERL under its £211.0m committed bank facilities are similarly secured. Further security provisions are also provided by NATS Holdings Limited and by NATS Limited. The carrying amount of the collateral provided as security for the £600m bond and bank borrowings is circa £1,381m (2011: £1,309m), including the carrying amount of balance sheet goodwill of £351.0m.

The average effective interest rate on the bank loans in the year was 1.4% (2011: 1.2%) and was determined based on LIBOR rates plus a margin.

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

Undrawn committed facilities	2012 £m	2011 £m
Undrawn committed facilities expire as follows:		
Less than one year	22.7	34.3
Between one and two years	<u>40.0</u>	<u>51.4</u>
	<u>62.7</u>	<u>85.7</u>

At 31 March 2012, NERL had outstanding drawings of £148.3m on its committed facilities. The bank facilities were scheduled to expire as follows: £171.0m in November 2012 and £40.0m in April 2013. In May 2012, NERL agreed new bank facilities of £275.0m which expire in December 2016.

NATS Services has an uncommitted overdraft facility of £1m that was undrawn as at 31 March 2012 and 31 March 2011 and is not included in the table above.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

17. Derivative financial instruments

Fair value of derivative financial instruments

	2012 £m	2011 £m
Current assets		
Derivative financial instruments in designated hedge accounting relationships		
Forward foreign exchange contracts (cash flow hedges)	<u>0.3</u>	<u>0.2</u>
Current liabilities		
Derivative financial instruments in designated hedge accounting relationships		
Forward foreign exchange contracts (cash flow hedges)	(0.4)	(4.0)
Derivative financial instruments classified as held for trading		
Index-linked swaps	<u>(126.1)</u>	<u>(109.2)</u>
	<u>(126.5)</u>	<u>(113.2)</u>

Further details on derivative financial instruments are provided in note 18. The index-linked swap is classified under international accounting standards as held for trading as it does not qualify for hedge accounting. The index-linked swap was taken out in August 2003 to hedge against the risk of low inflation and previously qualified as a hedge under UK generally accepted accounting principles prior to the group's adoption of international accounting standards.

Fair value measurements recognised in the balance sheet

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	2012				2011			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets								
Derivative financial instruments in designated hedge accounting relationships	<u>-</u>	<u>0.3</u>	<u>-</u>	<u>0.3</u>	<u>-</u>	<u>0.2</u>	<u>-</u>	<u>0.2</u>
Financial liabilities								
Derivative financial instruments in designated hedge accounting relationships	-	(0.4)	-	(0.4)	-	(4.0)	-	(4.0)
Derivative financial instruments classified as held for trading	<u>-</u>	<u>(126.1)</u>	<u>-</u>	<u>(126.1)</u>	<u>-</u>	<u>(109.2)</u>	<u>-</u>	<u>(109.2)</u>
	<u>-</u>	<u>(126.5)</u>	<u>-</u>	<u>(126.5)</u>	<u>-</u>	<u>(113.2)</u>	<u>-</u>	<u>(113.2)</u>

There were no transfers between individual levels in the year.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments

Capital risk management

The group manages its capital to ensure that entities in the group are able to continue as going concerns, to ensure that NERL is able to meet its obligations under the air traffic services licence, for NATS Services to meet obligations to its customers and to fund business development, and to provide returns to shareholders.

The capital structure of the group consists of debt as disclosed in note 16, cash and cash equivalents and short-term investments, as shown in this note, and equity attributable to shareholders as disclosed in the consolidated statement of changes in equity.

External capital requirements

NERL's air traffic services licence requires the company to use reasonable endeavours to maintain an investment grade issuer credit rating (BBB-/Baa3 or better). Separately, it is the objective of the group to target a credit profile for NERL that exceeds BBB-/Baa3.

As at 31 March 2012, NERL had a corporate rating of AA- negative outlook from Standard & Poor's (2011: AA- negative outlook) and A2 stable outlook from Moody's (2011: A2 stable outlook).

Gearing ratio

The group does not seek to maintain a target gearing level at group level but rather sets a gearing target for NERL, the economically regulated subsidiary, based on a ratio of net debt to its regulatory asset base (RAB). Following the price control review for the years 2011 to 2014, the CAA has set NERL a gearing target of 60% and a cap of 65% of net debt to RAB with a requirement for NERL to remedy the position if this cap is exceeded. NATS Services and NATS Limited, the group's intermediate holding company, have no borrowings.

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 2 to the financial statements.

Categories of financial instrument

The carrying values of financial instruments by category at 31 March was as follows:

	2012 £m	2011 £m
Financial assets		
Trade and other receivables, excluding prepayments and accrued income	66.0	70.2
Cash and cash equivalents and short-term investments	218.2	183.9
Derivative financial instruments in designated hedge accounting relationships	0.3	0.2
	284.5	254.3
Financial liabilities		
Derivative financial instruments in designated hedge accounting relationships	(0.4)	(4.0)
Derivative financial instruments classified as held for trading	(126.1)	(109.2)
Other financial liabilities at amortised cost	(758.6)	(760.0)
	(885.1)	(873.2)

Other financial liabilities at amortised cost includes balances for trade and other payables (excluding accruals and deferred income and including tax and social security), the bond, bank borrowings and other loans.

The index-linked swap is categorised as held for trading. The loss on the movement in its market value of £16.9m has been recorded in the income statement in the year (2011: £22.2m).

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Financial risk management objectives

The group's treasury function is mandated by the Board to manage financial risks that arise in relation to underlying business needs. The function provides services to the business, co-ordinates access to financial markets and monitors and manages financial risks relating to the operations of the group. The function has clear policies and operating parameters. The Treasury Committee provides oversight and meets three times a year to approve strategy and to monitor compliance with Board policy. The Treasury function does not operate as a profit centre and the undertaking of speculative transactions is not permitted. The principal financial risks arising from the group's activities include market risk (including currency risk, interest rate risk and inflation risk), credit risk and liquidity risk. NATS Limited and NATS Services had no borrowings. The principal financial risk in these entities is credit risk. Specific policies on interest rate and liquidity risk management apply principally to NERL.

Market risk

The group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates, interest rates and inflation rates. These risks are explained below. The group enters into a variety of derivative financial instruments to manage its exposure to these risks, including:

- forward foreign exchange contracts to hedge the exchange risk arising on services provided to UK en route customers that are billed in Euro, and purchases from foreign suppliers settled in foreign currencies;
- interest rate swaps to mitigate the risk of rising interest rates; and
- index-linked swaps to mitigate the risk of low inflation.

Foreign currency risk management

The group's principal exposure to foreign currency transaction risk is in relation to UK en route services revenue, accounting for 66% of the group's turnover (2011: 65%). Charges for this service are set in sterling, but are billed and collected in Euro by applying a conversion rate determined monthly by Eurocontrol, who administer the UK en route revenue collection. The conversion factor used is the average of the daily closing rates for the month prior to the billing period. To mitigate the risk that exchange rates move between the date of billing and the date on which the funds are remitted to NERL, forward foreign currency contracts are entered into. NERL seeks to hedge 90% of the UK en route income that is forecast to arise by entering into forward foreign exchange contracts on a monthly or quarterly basis.

The group also enters into contracts for the purchase and sale of goods and services with overseas suppliers and customers who operate in foreign currencies. To mitigate currency risk the contract value is hedged when a firm commitment arises, either through the use of forward foreign currency contracts or by purchasing foreign currency at spot rates on the date the commitment arises or by setting aside already available foreign currency.

The carrying amount of the group's foreign currency denominated monetary assets and monetary liabilities at 31 March was as follows:

	Assets		Liabilities	
	2012 £m	2011 £m	2012 £m	2011 £m
Euro	92.0	98.9	(3.1)	(6.4)
US Dollar	0.3	0.1	(0.1)	(0.1)
Canadian Dollar	0.3	-	(0.1)	(0.1)
Qatari Riyal	1.5	-	-	-
Norwegian Krone	0.1	0.2	(0.2)	(0.1)
Danish Krone	0.3	-	-	-
	<u>94.5</u>	<u>99.2</u>	<u>(3.5)</u>	<u>(6.7)</u>

The prior year balance has been re-stated to exclude accrued income balances that are recoverable in Euros in the future, but are currently denominated in GBP and the group will suffer no exchange rate risk until these balances are invoiced.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Foreign currency sensitivity analysis

The group holds foreign currency cash balances in Euro, US Dollars, Canadian Dollars, Qatari Riyals, Norwegian Krone and Danish Krone.

The following table details the group's sensitivity to a 10% increase or decrease in the value of sterling against relevant foreign currencies. 10% is the sensitivity rate that represents management's assessment of the reasonably possible change in foreign currency exchange rates in a financial year. The sensitivity analysis includes foreign currency cash balances, trade receivables, trade payables and forward foreign exchange contracts and adjusts their translation at the period end for a 10% change in foreign currency rates.

The table below shows the effect of a 10% strengthening of sterling against the relevant currency. A positive number below indicates an increase in profit and equity and a negative number a reduction in profit and equity. There would be an equal and opposite impact on profit and equity if sterling devalues by 10% against the relevant currency.

Currency	2012 Impact £m	2011 Impact £m
Euro	1.8	1.2
US Dollar	-	-
Canadian Dollar	(0.1)	-
Qatari Riyals	0.6	-
Norwegian Krone	-	-
Danish Krone	-	(0.1)
	<u>2.3</u>	<u>1.1</u>

The group's sensitivity to the Euro increased during the year reflecting an increase in Euro denominated monetary assets net of forward contracts taken out to hedge future purchase commitments. Exposure to the Qatari Riyal arises from new business generated in Qatar in the year. Exposure to other currencies has remained constant. NATS believes that this sensitivity analysis accurately reflects its inherent foreign exchange risk.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Forward foreign exchange contracts

The group entered into forward foreign exchange contracts to sell Euro forecast to be received from Eurocontrol in respect of UK en route revenues. In addition, the group entered into other forward foreign exchange contracts to fund purchases of equipment. The group has designated these forward contracts as cash flow hedges. The following contracts were outstanding at year end:

	2012				2011		
	£m	€m	Average exchange rate		£m	€m	Average exchange rate
Euro sold				Euro sold			
0-3 months	117.6	140.8	0.8354	0-3 months	113.0	132.4	0.8535
Over 3 months	-	-	n/a	Over 3 months	0.2	0.2	0.8703
	<u>117.6</u>	<u>140.8</u>	<u>0.8354</u>		<u>113.2</u>	<u>132.6</u>	<u>0.8536</u>
Euro bought	£m	€m		Euro bought	£m	€m	
0-3 months	2.5	2.1	0.8449	0-3 months	2.0	1.8	0.8691
Over 3 months	9.7	8.4	0.8622	Over 3 months	7.9	6.8	0.8661
	<u>12.2</u>	<u>10.5</u>	<u>0.8587</u>		<u>9.9</u>	<u>8.6</u>	<u>0.8686</u>
US Dollar bought	US\$m	£m		US Dollar bought	US\$m	£m	
0-3 months	0.2	0.1	0.6248	0-3 months	-	-	n/a
Canadian Dollar bought	C\$m	£m		Canadian Dollar bought	C\$m	£m	
0-3 months	0.6	0.4	1.6002	0-3 months	0.3	0.2	1.5584
Over 3 months	0.2	0.1	1.6330	Over 3 months	0.3	0.2	1.5770
	<u>0.8</u>	<u>0.5</u>	<u>1.6093</u>		<u>0.6</u>	<u>0.4</u>	<u>1.5437</u>
Qatari Riyal sold	£m	QARm		Qatari Riyal sold	£m	QARm	
0-3 months	1.1	6.4	5.7572	0-3 months	-	-	n/a
Over 3 months	6.4	36.9	5.7522	Over 3 months	-	-	n/a
	<u>7.5</u>	<u>43.3</u>	<u>5.7530</u>		<u>-</u>	<u>-</u>	<u>-</u>
Norwegian Krone bought	NOKm	£m		Norwegian Krone bought	NOKm	£m	
0-3 months	1.3	0.1	9.2310	0-3 months	-	-	n/a
Over 3 months	2.5	0.3	9.3409	Over 3 months	1.9	0.2	9.4465
	<u>3.8</u>	<u>0.4</u>	<u>9.3040</u>		<u>1.9</u>	<u>0.2</u>	<u>9.4465</u>
Danish Krone bought	DKKm	£m		Danish Krone bought	DKKm	£m	
0-3 months	-	-	n/a	0-3 months	2.7	0.3	8.7063
Over 3 months	-	-	n/a	Over 3 months	1.4	0.2	8.7056
	<u>-</u>	<u>-</u>	<u>-</u>		<u>4.1</u>	<u>0.5</u>	<u>8.7061</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

At 31 March 2012, the aggregate amount of the unrealised losses under forward foreign currency exchange contracts deferred in the hedge reserve relating to the exposure on these future transactions was £0.2m (2011: £0.5m unrealised losses). The majority of these contracts will mature within the first two months of the next financial year at which stage the amount deferred in equity will be realised in the income statement.

In addition to the above, NERL has entered into average rate forward agreements with a contract date after 31 March 2012 to sell Euro anticipated to be received in July 2012 in respect of UK en route revenues. The value of these cash flows is £48.2m. These contracts are also designated as cash flow hedges. They are not included in the table above.

Interest rate risk management

The group is exposed to interest rate risk to the extent that it holds borrowings at fixed, floating and index-linked interest rates. Its interest rate risk management policies, which are kept under continuous review, are specific to NERL. NATS Services and NATS, the intermediate holding company, had no borrowings at 31 March 2012 (2011: £nil).

The group seeks to minimise NERL's exposure to movements in interest rates by ensuring NERL holds an appropriate balance of fixed, floating and index-linked debt as a percentage of its net debt by the use of interest rate swap contracts and index-linked swap contracts. The appropriate mix of fixed, floating and index-linked borrowing varies over time and reflects the certainty of future borrowing requirements and the prevailing interest rates. Recognising that long-term borrowing forecasts are inherently more uncertain than short-term forecasts, the group's policy, applied to NERL, is to reduce the level of fixed rate debt over time as per the following table:

Debt maturity	Fixed rate %	Index-linked %	Floating %
Within one year	40-70	30-50	0-30
Between one and two years	40-60	30-50	0-30
Between two and five years	30-50	30-50	10-40
After five years	20-40	30-70	10-50

The group's exposure to interest rates on financial assets and financial liabilities is detailed in the liquidity risk management section of this note. The group held no interest rate swaps at 31 March 2012 (2011: none).

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Economic interest rate exposure

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

Currency	2012						
	Cash			Short-term deposits			Total £m
	Amount £m	Economic interest rate %	Average maturity days	Amount £m	Economic interest rate %	Average maturity days	
Sterling	176.8	0.4	4	30.5	1.1	182	207.3
Euro	9.8	0.1	4	-	-	-	9.8
US Dollar	0.3	-	1	-	-	-	0.3
Canadian Dollar	0.3	-	1	-	-	-	0.3
Qatari Riyal	0.1	-	1	-	-	-	0.1
Norwegian Krone	0.3	-	1	-	-	-	0.3
Danish Krone	0.1	-	1	-	-	-	0.1
	<u>187.7</u>			<u>30.5</u>			<u>218.2</u>

Currency	2011						
	Cash			Short-term deposits			Total £m
	Amount £m	Economic interest rate %	Average maturity days	Amount £m	Economic interest rate %	Average maturity days	
Sterling	154.7	0.5	3	16.4	1.1	183	171.1
Euro	12.5	0.6	2	-	-	-	12.5
US Dollar	0.1	-	1	-	-	-	0.1
Norwegian Krone	0.2	-	1	-	-	-	0.2
	<u>167.5</u>			<u>16.4</u>			<u>183.9</u>

The economic interest rate reflects the true underlying cash rate that the group was paying on its borrowings or receiving on its deposits at 31 March.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

The economic interest rate exposure of the group's loans is presented below with and without the effect of derivatives, as follows:

Excluding derivatives

	Total £m	Variable rate £m	Inflation rate £m	Fixed rate £m	Economic interest rate %	Weighted average time for which rate is fixed years
At 31 March 2012						
Sterling:						
5.25% guaranteed secured bonds	583.9	-	-	583.9	5.27	8.0
Bank loans	148.3	148.3	-	-	1.50	0.4
Total	<u>732.2</u>	<u>148.3</u>	<u>-</u>	<u>583.9</u>		
At 31 March 2011						
Sterling:						
5.25% guaranteed secured bonds	597.9	-	-	597.9	5.27	9.0
Bank loans	119.5	119.5	-	-	1.34	0.5
Total	<u>717.4</u>	<u>119.5</u>	<u>-</u>	<u>597.9</u>		

Including derivatives

	Total £m	Variable rate £m	Inflation rate £m	Fixed rate £m	Economic interest rate %	Weighted average time for which rate is fixed years
At 31 March 2012						
Sterling:						
5.25% guaranteed secured bonds	383.9	-	-	383.9	5.28	8.0
5.25% guaranteed secured bonds	200.0	-	200.0	-	4.51	0.5
Bank loans	148.3	148.3	-	-	1.50	0.4
Total	<u>732.2</u>	<u>148.3</u>	<u>200.0</u>	<u>383.9</u>		
At 31 March 2011						
Sterling:						
5.25% guaranteed secured bonds	397.9	-	-	397.9	5.28	9.0
5.25% guaranteed secured bonds	200.0	-	200.0	-	4.40	0.5
Bank loans	119.5	119.5	-	-	1.34	0.5
Total	<u>717.4</u>	<u>119.5</u>	<u>200.0</u>	<u>397.9</u>		

The interest rate payable under the index-linked swap is adjusted semi-annually in line with the movement in RPI.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

The following table shows the percentage of fixed, index-linked and floating rate debt as a percentage of group net debt. Net debt is defined for this purpose as borrowings net of cash and short-term investments, as distinct from the definition used for financial covenants purposes.

	2012		2011	
	£m		£m	
Net debt	<u>509.1</u>		<u>528.0</u>	
	£m	%	£m	%
Fixed (net of bond discount and issue costs)	379.0	74.4	392.4	74.3
Index-linked	200.0	39.3	200.0	37.9
Floating (net of cash and short-term investments)	<u>(69.9)</u>	<u>(13.7)</u>	<u>(64.4)</u>	<u>(12.2)</u>
	<u>509.1</u>	<u>100.0</u>	<u>528.0</u>	<u>100.0</u>

At 31 March 2012, NERL had net debt, including an intercompany loan of £22.5m, of £647.6m (2011: net debt £651.6m), NATS Limited held cash balances of £5.2m (2011: cash £4.9m), NATS Services had cash of £110.6m (2011: cash £95.3m) and NATSNav had cash of £0.2m (2011: cash £0.04m).

The following table shows the percentage of fixed, index-linked and floating rate debt as a percentage of NERL net debt, reflecting the application of the interest rate risk management policies that are specific to NERL.

	2012		2011	
	£m		£m	
Net debt	<u>647.6</u>		<u>651.6</u>	
	£m	%	£m	%
Fixed (net of bond discount and issue costs)	379.0	58.5	392.4	60.2
Index-linked	200.0	30.9	200.0	30.7
Floating (net of cash and short-term investments)	<u>68.6</u>	<u>10.6</u>	<u>59.2</u>	<u>9.1</u>
	<u>647.6</u>	<u>100.0</u>	<u>651.6</u>	<u>100.0</u>

In order to reduce its exposure to interest rate risk on its cash balances, NERL adopts a strategy of hedging net debt rather than gross debt. This is an economic hedge whereby exposure to floating rate debt is offset by interest on cash balances.

Interest rate sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to interest rates on floating rate assets and liabilities. The analysis is prepared assuming the amount of assets or liabilities at the balance sheet date was in place for the whole year. A 1% increase or decrease is considered to represent management's assessment of the reasonably possible change in interest rates.

The following table shows the effect of a 1% increase in interest rates on the group's cash and floating rate bank loans on profit for the year and on equity. A positive number represents an increase in profit and equity and a negative number a decrease in profit and equity.

	2012 Impact	2011 Impact
	£m	£m
Cash on deposit (2012: £218.2m, 2011: £183.9m)	2.2	1.8
Borrowings (2012: £148.3m, 2011: £119.5m)	<u>(1.5)</u>	<u>(1.2)</u>
	<u>0.7</u>	<u>0.6</u>

Overall the group's sensitivity to interest rates is in line with the prior year, reflecting increases in both cash and borrowing levels.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Inflation rate risk

The regulatory charge control conditions that apply to NERL's UK en route and North Atlantic services determines a revenue allowance for financing charges that is linked to inflation. To achieve an economic hedge of part of this income, in August 2003 coincident with the issue of its £600m 5.25% fixed rate bond, NERL entered into an amortising index-linked swap with a notional principal of £200m for the period up to March 2017 reducing semi-annually thereafter and expiring in March 2026. Under the terms of this swap, NERL receives fixed interest at 5.25% and pays interest at a rate of 3.43% adjusted for the movement in RPI. The index-linked swap cannot be designated as a cash flow hedge under IFRS, although it provides an economic hedge of NERL's inflation-linked revenues.

From the start of Control Period 3 (January 2011) the reference to inflation was changed from an RPI-X basis to CPI basis. The CAA has provided NERL with a hedging allowance to compensate the company for the change in basis. NERL continues to monitor the progression of both RPI and CPI and as at 31 March 2012 no further inflation-linked derivatives were entered into.

The value of the notional principal of £200m of the index-linked swap is also linked to movements in RPI. Commencing on 31 March 2017, semi-annual payments will be made relating to the inflation uplift on the amortisation of the notional principal.

Inflation rate sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to breakeven inflation arising from the index-linked swap. The difference between fixed rate and index-linked gilts reflects the market's expectations of future RPI and is a proxy for the breakeven inflation rate. The analysis is prepared assuming that the index-linked swap at the balance sheet date was in place for the whole year. A 1% increase or decrease in breakeven inflation is considered to represent management's assessment of the reasonably possible change in inflation. An increase in the rate of RPI will increase the future index-linked payments that NERL is required to make under the swap contract and so impacts its mark to market value.

The following table shows the effect of a 1% increase in breakeven inflation on the amount of interest payable in respect of this swap and the impact on its value when marked to market. A positive number indicates an increase in profit and equity and a negative number a reduction in profit and equity. There would be an equal and opposite impact on profit and equity if breakeven inflation falls by 1%.

	2012 Impact £m	2011 Impact £m
Change in swap interest and mark to market value	<u>(30.0)</u>	<u>(29.4)</u>

The mark to market value of the index-linked swap is also sensitive to the discount rates that are used to determine the net present value of the cash flows under the swap agreement. The discount rate is determined by reference to market yields on interest rate swaps. The effect of a 1% increase in the discount rate would be to increase profit and equity by £13.3m (2011: £12.3m). There would be an equal and opposite impact on profit and equity if discount rates decreased by 1%.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the group. The group's exposure to credit risk arises from the risk of default by customers on settlement of trade receivables and from the risk of a failure of a financial institution in which funds are invested for return or held for trading purposes or with whom derivative contracts are entered into. The risk of loss from default by customers and the mitigations against this risk are explained in note 15. With regard to funds or contracts held with financial institutions, the group's policy is to transact with counterparties that hold a minimum credit rating as supplied by independent rating agencies, Standard & Poor's, Moody's Investors Service and Fitch Ratings.

The group's policy is to allocate limits to the value of investments, foreign exchange transactions and interest rate hedging transactions that may be entered into with a bank or financial institution and to allocate an aggregate credit risk limit. The limits are based upon the institution's credit rating with Standard & Poor's, Moody's and Fitch rating agencies. Where there is a difference in the rating then the lowest of the ratings is applied.

Currently, the group's investments take the form of bank time deposits. Investments in bank time deposits with maturities up to 3 months and between 3 and 6 months are only entered into with institutions holding a long-term minimum credit rating of A- and A+ respectively from Standard & Poor's or Fitch and A3 and A1 respectively from Moody's. During 2008 the group tightened its investment criteria and currently only places deposits that have a maturity in excess of seven days with banks rated AA- or better.

The table below sets out the limits that are applied to each institution based on its credit rating and the balances held at 31 March with those institutions:

Rating (Standard & Poor's)	Limit per institution £m
AAA	50.0
AA+	40.0
AA	30.0
AA-	20.0
A+	15.0
A	10.0
A-	7.5

The following table shows the distribution of the group's deposits at 31 March by credit rating (Standard & Poor's):

Rating (Standard & Poor's)	Number of institutions	2012 £m	By credit rating %	Limit utilised %	Number of institutions	2011 £m	By credit rating %	Limit utilised %
AAA	1	5.0	2.3	10.0	-	-	-	-
AA	-	-	-	-	2	27.0	14.7	54.0
AA-	3	41.2	18.9	68.6	1	17.8	9.6	89.0
A+	8	116.1	53.2	96.7	8	111.3	60.5	92.8
A	7	50.8	23.3	72.5	3	16.1	8.8	53.7
A-	1	5.1	2.3	67.9	2	11.7	6.4	78.0
		<u>218.2</u>	<u>100.0</u>			<u>183.9</u>	<u>100.0</u>	

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Liquidity risk management

The responsibility for liquidity risk management, the risk that the group will have insufficient funds to meet its obligations as they fall due, rests with the Board with oversight provided by the Treasury Committee. The group manages liquidity by maintaining adequate reserves and borrowing facilities by monitoring actual and forecast cash flows and ensuring funding is diversified by source and maturity and available at competitive cost. Specific liquidity policies are maintained for NERL, NATS Services and NATS Limited had no debt at the year end.

With regard to NERL, the group's policy is to:

- ▶ maintain free cash equal to between 1 and 2 months of UK en route services revenues (see below). Free cash is defined as cash and cash equivalents and short-term investments, excluding a debt service reserve account of £30.5m used to fund interest, fees and bond amortisation payments scheduled in the next six months and a liquidity reserve account of £21.3m held to provide liquidity in the event of certain pre-defined circumstances, particularly to ensure compliance with financial covenants;
- ▶ ensure access to bank facilities sufficient to meet 110% of forecast requirements that are not otherwise covered by operating cash flows or other sources of finance through the period of the business plan. At 31 March 2012 NERL had access to bank facilities totalling c.£170.95m available until November 2011 and c.£40.0m until April 2013. To ensure that committed funding is available at a competitive cost to meet its anticipated needs for the period covered by its CP3 business plan, the company replaced these facilities in May 2012 with facilities totalling £275.0m expiring in December 2016;
- ▶ ensure access to long-term funding to finance its long-term assets. This is achieved in the form of a £600m amortising sterling bond with a final maturity date of 2026;
- ▶ ensure that the ratio of bank funding to total gross borrowings does not exceed 75%; and
- ▶ maintain a portfolio of debt diversified by source and maturity. This is achieved through the issuance of a £600m sterling bond that started to amortise in 2012 and has a final maturity date of 2026 and by having available committed bank facilities. At 31 March 2012 facilities totalled c.£211.0m of which c.£170.95m was scheduled to expire in November 2012 and c.£40.0m in April 2013. In May 2012 new bank facilities were agreed totalling £275.0m, expiring in December 2016.

The following table shows the ratio of free cash in NERL to average monthly UK en route services income during the year:

	2012 £m	2011 £m
Average monthly UK en route services income	47.9	42.0
Free cash at 31 March	50.4	46.0
Ratio of free cash to UK en route services income	1.1	1.1

The following table shows the ratio of the group's bank borrowings to its gross borrowings at 31 March:

	2012 £m	2011 £m
Bank borrowings	148.3	119.5
Gross borrowings	732.2	717.4
Bank borrowings as a percentage of gross borrowings	20.3%	16.7%

It is company policy not to issue new guarantees in respect of the borrowings of subsidiaries or to allow the creation of any new mortgages or other charges over group assets.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Maturity of borrowings

The following table sets out the remaining contractual maturity of the group's non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the group can be required to repay. The table includes both interest and principal cash flows.

	2012			2011		
	Secured loans	Other liabilities	Total	Secured loans	Other liabilities	Total
	£m	£m	£m	£m	£m	£m
Due within one year or less	210.5	26.4	236.9	49.1	42.6	91.7
Between one and two years	58.2	-	58.2	182.7	-	182.7
Due between two and five years	179.7	-	179.7	171.1	-	171.1
Due in more than five years	547.8	-	547.8	607.7	-	607.7
	<u>996.2</u>	<u>26.4</u>	<u>1,022.6</u>	<u>1,010.6</u>	<u>42.6</u>	<u>1,053.2</u>
Effect of interest, discount and unamortised bond issue costs	(268.9)	-	(268.9)	(298.7)	-	(298.7)
	<u>727.3</u>	<u>26.4</u>	<u>753.7</u>	<u>711.9</u>	<u>42.6</u>	<u>754.5</u>

In order to manage the liquidity risk arising on the contractual maturity of its borrowings, it is the group's intent to replace bank facilities and bonds with facilities of a similar nature at least 12 months in advance of contractual maturity.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

The following table sets out the maturity profile of the group's derivative financial liabilities. Cash flows under the index-linked swap are not fixed and are subject to movements in inflation. Accordingly, the cash flows associated with the index-linked swap have been derived from the group's long-term forecasts of inflation as used for business planning purposes. The table shows undiscounted net cash inflows/(outflows) on these derivatives.

	Due within one year or less £m	Due between one and two years £m	Due between two and five years £m	Due in more than five years £m	Total £m
2012					
Net settled:					
Index-linked swap receivable/(payable)	2.5	2.3	1.2	(138.8)	(132.8)
Gross settled:					
Foreign exchange forward contract receivables	131.6	4.7	-	-	136.3
Foreign exchange forward contract payables	(131.7)	(4.6)	-	-	(136.3)
	<u>2.4</u>	<u>2.4</u>	<u>1.2</u>	<u>(138.8)</u>	<u>(132.8)</u>
2011					
Net settled:					
Index-linked swap receivable/(payable)	2.9	2.7	6.5	(132.2)	(120.1)
Gross settled:					
Foreign exchange forward contract receivables	122.9	0.2	-	-	123.1
Foreign exchange forward contract payables	(126.9)	(0.2)	-	-	(127.1)
	<u>(1.1)</u>	<u>2.7</u>	<u>6.5</u>	<u>(132.2)</u>	<u>(124.1)</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

18. Financial instruments (continued)

Fair value of financial instruments

The fair value of forward exchange contracts represents the unrealised gain or loss on revaluation of the contracts to year end exchange rates and is expected to be realised within one year. The fair value of the index-linked swap is determined independently by reference to contractual cash flows, the breakeven inflation rate which is calculated as the difference in yields on fixed interest and index-linked gilts of similar maturity to the swap contract and discounted to present value. The fair value of the £600m bond has been derived from its externally quoted price. The book values of other financial assets and liabilities approximate to their fair values because of their short maturities.

	Carrying amount		Fair value	
	2012 £m	2011 £m	2012 £m	2011 £m
Financial assets				
Trade and other receivables, excluding prepayments and accrued income	66.0	70.2	66.0	70.2
Cash and short-term investments	218.2	183.9	218.2	183.9
Derivative financial instruments				
– Forward foreign exchange contracts	0.3	0.2	0.3	0.2
	<u>284.5</u>	<u>254.3</u>	<u>284.5</u>	<u>254.3</u>
Financial liabilities				
Trade and other payables, excluding accruals and deferred income	(26.4)	(42.6)	(26.4)	(42.6)
£600m 5.25% Guaranteed Secured Amortising Bond	(583.9)	(597.9)	(666.5)	(618.3)
Bank loans and overdraft	(148.3)	(119.5)	(148.3)	(119.5)
Derivative financial instruments				
– Forward foreign exchange contracts	(0.4)	(4.0)	(0.4)	(4.0)
– Index-linked swap	(126.1)	(109.2)	(126.1)	(109.2)
	<u>(885.1)</u>	<u>(873.2)</u>	<u>(967.7)</u>	<u>(893.6)</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

19. Financial and other liabilities

Trade and other payables

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

	2012 £m	2011 £m
Current		
Trade payables	13.1	22.7
Other payables	3.4	10.7
Tax and social security	9.9	9.2
Accruals and deferred income		
- Deferred grants	0.8	0.9
- Other	96.3	83.6
	123.5	127.1
Non-current		
Accruals and deferred income		
- Deferred grants	8.7	7.6
- Other	7.4	7.8
	16.1	15.4
	139.6	142.5

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 44 days (2011: 54 days). This decrease reflects the reduction in operating costs incurred in the year and the timing of receipt of invoices for services received during the year. The directors consider that the carrying amount of the trade payables approximates to their fair value.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

20. Provisions

	Redundancy £m	Relocation £m	Other £m	Total £m
At 1 April 2011	11.5	6.6	0.1	18.2
Additional provision in the year	3.7	0.3	0.2	4.2
Release of provision in the year	(0.2)	(1.7)	-	(1.9)
Utilisation of provision	(10.8)	(3.5)	-	(14.3)
At 31 March 2012	<u>4.2</u>	<u>1.7</u>	<u>0.3</u>	<u>6.2</u>
				Total £m
Amounts due for settlement within 12 months				5.9
Amounts due for settlement after 12 months				<u>0.3</u>
				<u>6.2</u>

The redundancy provision represents the best estimate of the future cost of redundancy payments to employees that have committed to the group's redundancy programme at 31 March 2012. The ageing of the provision reflects the expected timing of employees leaving the group.

The relocation provision represents the best estimate of the future cost of relocating staff when the site they work at closes and they are relocated to another site. The ageing of the provision reflects the expected timing of the settlement of relocation costs.

The other provisions represent the best estimate of other liabilities. The ageing of the provision reflects the best estimate of when these potential liabilities will fall due.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

21. Deferred tax

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

	Accelerated tax depreciation £m	Retirement benefit asset £m	Financial instruments £m	Other £m	Total £m
At 1 April 2010	133.4	22.3	(13.4)	(3.5)	138.8
(Credit)/charge to income	(5.4)	9.8	(1.5)	0.2	3.1
Credit to equity	-	(19.6)	(0.3)	-	(19.9)
At 31 March 2011	128.0	12.5	(15.2)	(3.3)	122.0
At 1 April 2011	128.0	12.5	(15.2)	(3.3)	122.0
(Credit)/charge to income	(7.4)	15.3	0.1	0.9	8.9
(Credit)/charge to equity	-	(36.9)	0.1	-	(36.8)
At 31 March 2012	120.6	(9.1)	(15.0)	(2.4)	94.1

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

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Deferred tax liabilities	(120.6)	(140.5)
Deferred tax assets	26.5	18.5
	(94.1)	(122.0)

22. Share capital

	Authorised Number of shares	£m	Called up, allotted and fully paid Number of shares	£m
Ordinary shares of £1 each				
At 31 March 2012 and 31 March 2011	144,100,007	144.1	131,000,007	131.0
Ordinary A shares of 80 pence each				
At 31 March 2012 and 31 March 2011	54,272,594	43.4	12,048,193	9.6
		187.5		140.6

Special share

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

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

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

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

23. Share premium account

	£m
Balance as at 31 March 2012 and 31 March 2011	<u>0.4</u>

24. Notes to the cash flow statement

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Operating profit from continuing operations	239.5	157.8
Adjustments for:		
Depreciation of property, plant and equipment	74.6	77.5
Amortisation of intangible assets	18.4	11.2
Impairment losses	4.0	13.1
Deferred grants released	(1.0)	(1.7)
Loss on disposal of property, plant and equipment	1.0	0.2
Non-cash element of charge for pension costs	(58.9)	(43.5)
Operating cash flows before movements in working capital	277.6	214.6
Increase in trade and other receivables	(6.6)	(24.3)
(Decrease)/increase in trade and other payables	(23.3)	3.5
Cash generated from operations	247.7	193.8
Tax paid	(23.6)	(11.2)
Net cash from operating activities	<u>224.1</u>	<u>182.6</u>

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

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

25. Financial commitments

	2012 £m	2011 £m
Amounts contracted but not provided for in the accounts	<u>69.2</u>	<u>71.3</u>
Minimum lease payments under operating leases recognised in the income statement	<u>20.7</u>	<u>22.6</u>
At the balance sheet date the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:		
Within one year	22.7	23.0
In the second to fifth years inclusive	43.1	54.5
After five years	<u>41.3</u>	<u>47.3</u>
	<u>107.1</u>	<u>124.8</u>

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

Guarantees

NATS Holdings Limited has given guarantees to the Ministry of Defence in relation to NERL's performance under its contract with the MoD. NATSNav has given joint and several shareholder's guarantees up to €20m in favour of the European Commission, in respect of the contractual performance of ESSP SAS, in which NATSNav has a 16.67% interest.

As part of the tendering process for new contracts, the NATS group may be required to put in place a tender or bid guarantee which expires once the contract is awarded. Where tenders are successful, contractual terms may also require performance or advance payment guarantees. These guarantees vary in length depending on the life of the contract and may run until the expiry of the contract. The total guarantees provided in these respects at 31 March 2012 was £6.5m (2011: £2.0m).

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

26. Share based payments

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

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

Date of share awards	No. shares awarded to employees	No. employee shares outstanding at 31 March 2012	No. employee shares outstanding at 31 March 2011
Free share awards			
21 September 2001	3,353,742	534,153	570,495
20 October 2003	2,459,000	493,840	529,242
10 September 2004	1,966,000	841,130	908,729
11 January 2008	1,071,840	807,840	851,180
18 September 2009	963,200	807,200	851,800
Partnership shares			
01 March 2011	694,783	661,631	691,583
Matching shares			
01 March 2011	694,783	661,631	691,583
		4,807,425	5,094,612
Dividend shares issued on 28 June 2005	247,017	62,945	67,275
Total employee shares in issue at 31 March		4,870,370	5,161,887

The movement in the number of employee shares outstanding is as follows:

	Movement in the no. of shares during the year ended 31 March 2012	Movement in the no. of shares during the year ended 31 March 2011
Balance at 1 April	5,161,887	4,132,093
Granted during the year	-	1,389,566
Forfeited during the year	(20,850)	(20,823)
Exercised during the year	(270,667)	(338,949)
Balance at 31 March	4,870,370	5,161,887

These shares are valued every six months by independent valuers using discounted cash flow and income multiple methods of valuation. As at 31 March 2012 the price of an employee share was valued at £3.95 (2011: £3.50). A valuation at 30 June 2011 valued the shares at £3.55. The liability on the balance sheet for the employee shares at 31 March 2012 was £16.1m (2011: £12.7m) included in other accruals and deferred income. The payments made to employees for the shares they exercised during the year was £1.0m (2011: £0.9m).

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

27. Retirement benefit scheme

NATS Limited, the company's wholly-owned subsidiary, entered into a deed of adherence with the CAA and the Trustees of the Civil Aviation Authority Pension Scheme whereby the company was admitted to participate in the Civil Aviation Authority Pension Scheme from 1 April 1996. At 31 March 2001, the business of NATS was separated from the CAA. As a consequence, NATS became 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 was divided into two sections to accommodate this and a series of common investment funds established in which both sections will participate for investment purposes.

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

During 2009 the group introduced a number of reforms to manage the cost and risk of pensions. The defined benefit pension scheme was closed to new joiners with effect from 31 March 2009. In addition, from 1 January 2009, annual increases in pensionable pay were limited to a maximum increase in the retail price index (RPI) plus 0.5%. A defined contribution scheme was also introduced for new joiners. NATS has agreed to match employee contributions to this scheme at a ratio of 2:1, up to a total employer cost of 18%. Finally, pension salary sacrifice arrangements were introduced with effect from 1 April 2009.

A Trustees' funding assessment of the NATS section is prepared at least every three years by the pension scheme actuary at the request of the Trustees in order to establish the financial position of the NATS section and to determine the level of contributions to be paid by NATS in future.

For the purpose of accounting for the scheme in these financial statements, the company obtains an updated valuation from a qualified independent actuary that is prepared in accordance with international accounting standards.

The two valuations differ in a number of critical respects, including, for example, differences in timing and frequency as well as in valuation assumptions. The Trustees' last funding assessment was prepared as at 31 December 2009, whereas the company's accounting valuation is prepared annually at 31 March. As a result, at each valuation date, the market conditions on which the assumptions are based will be different. Also, the assumptions adopted for the Trustees' funding assessment are set by the Trustees and include appropriate margins for prudence, whereas those adopted for the company's accounting valuation are prescribed by international accounting standards and reflect best estimates.

Trustees' funding assessment

The last Trustees' funding assessment of the NATS' section was carried out at 31 December 2009 and used the projected unit credit method. The assumptions which have the most significant effect on the result of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. For the purpose of the Trustees' funding assessment, it was assumed that the annual investment returns before retirement will be 3.0% higher than the annual general increases in salaries (allowance is also made for further salary increases due to promotions) and the annual investment returns for pensions in payment will be 0.75% higher than the annual increases in pensions.

The market value of the NATS' section's assets as at 31 December 2009 was £2,793.9m. For the purpose of the Trustees' funding assessment assets were taken at market value. The assets were sufficient to cover 89% of the benefits that had accrued to existing members.

Contributions to the pension scheme

During the year the group paid cash contributions to the scheme of £143.5m (2011: £123.1m). This amount included £15.5m (2011: £15.1m) of wages and salaries sacrificed by employees in return for pension contributions. Excluding the effect of salary sacrifice, employer cash contributions were paid at a rate of 45.5% (2011: 38.4%) of pensionable pay. The group increased contributions from May 2010 to 36.7% of pensionable pay, equivalent to the future service cost and in response to the triennial valuation, NATS made further contributions of £2.0m per month from January 2011, increasing these by 3.5% each January thereafter, under a deficit recovery plan agreed with Trustees.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

27. Retirement benefit scheme (continued)

Company's accounting valuation under international accounting standards

The pension cost under IAS 19: *Employee Benefits*, relating to the scheme is assessed in accordance with the advice of independent qualified actuaries.

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

A Trustees' funding assessment was carried out as at 31 December 2009 and updated to 31 March 2012 for the company's accounting valuation under IAS 19 by a qualified actuary. The major assumptions used by the actuary for the purposes of the IAS 19 figures at the relevant year ends are set out in the table and narrative below:

	2012	2011	2010
Inflation	3.25%	3.45%	3.65%
Increase in:			
- salaries	3.25%	3.95%	4.15%
- deferred pensions	3.25%	3.45%	3.65%
- pensions in payment	3.25%	3.45%	3.65%
Expected return on:			
- equities	7.10%	7.35%	7.55%
- property and other assets	6.60%	7.35%	7.55%
- bonds	3.45%	4.70%	4.90%
Discount rate for scheme liabilities	5.05%	5.45%	5.65%

The mortality assumptions have been drawn from actuarial tables 82% SIPMA and 101% SIPFA with future improvements in line with 80%/60% long cohort projections for male/female members, subject to a minimum improvement of 1.25% (2011: 82% SIPMA and 101% SIPFA with future improvements in line with 80%/60% long cohort projections for male/female members, subject to a minimum improvement of 1.25%). These tables assume that the life expectancy, from age 60, for a male pensioner is 29.0 years and a female pensioner is 29.0 years. Allowance is made for future improvements in longevity, such that based on the average age of the current membership, when these members reach retirement, life expectancy from age 60 will have increased for males to 31.2 years and for females to 31.4 years.

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

Assumption:	Change in assumption:	Impact on scheme liabilities:
Discount rate	Increase/decrease by 0.5%	Decrease by 10.9%/increase by 12.9%
Rate of inflation	Increase/decrease by 0.5%	Increase by 12.4%/decrease by 11.0%
Rate of salary growth	Increase/decrease by 0.5%	Increase by 4.1%/decrease by 3.7%
Rate of mortality	1 year increase in life expectancy	Increase by 2.0%

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

	2012 £m	2011 £m
Current service cost	(119.1)	(108.5)
Past service cost	(2.4)	(5.1)
Expected return on scheme assets	210.7	195.4
Interest cost on scheme liabilities	(173.8)	(161.4)
Total defined benefit charge recognised in arriving at operating profit	<u>(84.6)</u>	<u>(79.6)</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

27. Retirement benefit scheme (continued)

Amounts taken to the statement of comprehensive income are as follows:

	2012 £m	2011 £m
Actual return less expected return on scheme assets	(111.8)	60.8
Experience gains and losses arising on scheme liabilities	27.4	16.1
Changes in assumptions underlying the present value of the scheme liabilities	(60.3)	(152.3)
	<u>(144.7)</u>	<u>(75.4)</u>

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

	2012 £m	2011 £m
Fair value of scheme assets	3,377.3	3,219.8
Present value of defined benefit obligations	<u>(3,415.1)</u>	<u>(3,171.8)</u>
(Deficit)/surplus in scheme	<u>(37.8)</u>	<u>48.0</u>

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

	2012 £m	2011 £m
At 1 April	3,219.8	2,923.3
Expected return on scheme assets	210.7	195.4
Actuarial gains and losses	(111.8)	60.8
Contributions from scheme members	0.1	0.1
Contributions from sponsoring companies	143.5	123.1
Benefits paid	<u>(85.0)</u>	<u>(82.9)</u>
At 31 March	<u>3,377.3</u>	<u>3,219.8</u>

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

	2012 £m	2011 £m
At 1 April	(3,171.8)	(2,843.4)
Current service cost	(119.1)	(108.5)
Past service costs	(2.4)	(5.1)
Interest cost	(173.8)	(161.4)
Actuarial gains and losses	(32.9)	(136.2)
Contributions from scheme members	(0.1)	(0.1)
Benefits paid	85.0	82.9
At 31 March	<u>(3,415.1)</u>	<u>(3,171.8)</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

27. Retirement benefit scheme (continued)

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

	Fair value of assets		Expected return	
	2012 £m	2011 £m	2012 %	2011 %
Equity instruments	1,797.5	1,691.1	7.10	7.35
Property and other assets	475.6	474.8	6.60	7.35
Bonds	1,012.3	996.8	3.45	4.70
Cash	91.9	57.1	3.45	4.70
	<u>3,377.3</u>	<u>3,219.8</u>	<u>5.84</u>	<u>6.48</u>

The overall expected rate of return on assets represents a weighting based on the expected return for each asset class and the value of investments in each asset class.

The scheme assets do not include any investments in the equity of group companies or debt instruments or any property occupied by, or other assets used by, the group.

The five year history of experience adjustments is as follows:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Present value of defined benefit obligations	(3,415.1)	(3,171.8)	(2,843.4)	(2,258.3)	(2,432.7)
Fair value of scheme assets	<u>3,377.3</u>	<u>3,219.8</u>	<u>2,923.3</u>	<u>2,188.9</u>	<u>2,846.2</u>
(Deficit)/surplus in the scheme	<u>(37.8)</u>	<u>48.0</u>	<u>79.9</u>	<u>(69.4)</u>	<u>413.5</u>
Experience adjustments in scheme liabilities					
Amount (£m)	<u>27.4</u>	<u>16.1</u>	<u>211.3</u>	<u>43.4</u>	<u>100.6</u>
Percentage of scheme liabilities	<u>(0.8%)</u>	<u>(0.5%)</u>	<u>(7.4%)</u>	<u>(1.9%)</u>	<u>(4.1%)</u>
Experience adjustments in scheme assets					
Amount (£m)	<u>(111.8)</u>	<u>60.8</u>	<u>578.0</u>	<u>(868.0)</u>	<u>(175.6)</u>
Percentage of scheme assets	<u>(3.3%)</u>	<u>1.9%</u>	<u>19.8%</u>	<u>(39.7%)</u>	<u>(6.2%)</u>

The actual return on scheme assets for the year ended 31 March 2012 was £98.9m (2011: £256.2m).

The estimated contributions expected to be paid to the scheme during the financial year ending 31 March 2013 is £143m, including salary sacrifice contributions estimated at £16m.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

28. Related party transactions

Since 26 July 2001, the NATS group has had four shareholders – the Crown, The Airline Group (AG), BAA Airports Limited and the NATS Employee Sharetrust Limited. During the year transactions with the Crown have taken place with the Meteorological Office, the Department for Transport (DfT) and the Ministry of Defence (MoD). In addition there have been transactions with BAA Airports Limited and AG.

AG is a consortium of seven airlines: British Airways plc, Deutsche Lufthansa AG, easyJet Airline Company Limited, Monarch Airlines Retirement Benefit Plan Limited, Thomas Cook Airlines Limited, Thomson Airways Limited and Virgin Atlantic Airways Limited. AG has a 42% stake in NATS Holdings Limited which it purchased through the PPP transaction in July 2001. The directors of NATS Holdings Limited are satisfied that the seven members of AG have not exercised undue influence on the group either acting individually or in concert and therefore the individual transactions with each member of AG have not been disclosed in this set of accounts.

Contractual arrangements exist between BAA Airports Limited and NATS Services in relation to air navigation services provided at Aberdeen, Edinburgh, Glasgow, Heathrow, Southampton and Stansted airports.

Transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the company and its subsidiaries are disclosed in the subsidiary companies' financial statements.

Trading transactions

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

	Sales		Purchases		Amounts owed by related parties		Amounts owed to related parties	
	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
BAA Airports Limited	102.6	100.8	9.5	8.7	9.6	13.6	4.9	7.2
Ministry of Defence (MoD)	53.8	49.1	5.0	3.5	5.4	5.4	7.8	4.3
The Airline Group	-	-	0.2	0.1	-	-	-	-
Department for Transport (DfT)	3.1	0.5	-	-	-	-	-	-
Meteorological Office	-	0.4	0.6	0.7	0.4	-	-	0.1

Sales are made to related parties at the group's usual rates and purchases at market prices. The amounts outstanding are unsecured and will be settled in cash. No guarantees have been received. No provisions (2011: £0.5m) have been made for doubtful debts in respect of amounts owed by related parties.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

28. Related party transactions (continued)

Remuneration of key management personnel

The remuneration of key management personnel of the group, is set out below in aggregate for each of the categories specified in IAS 24: *Related Party Disclosures*. Key management includes the Board of directors of the company and the group's principal subsidiaries. Further information about the remuneration of individual directors is provided in the audited part of the Remuneration Committee report.

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Short-term employee benefits	5.8	6.4
Post-employment benefits	0.8	0.8
Other long-term benefits	0.3	-
Termination benefits	1.0	0.3
Share scheme costs	0.1	0.1
	<u>8.0</u>	<u>7.6</u>

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

29. Subsidiaries, joint ventures and associates

The group's principal subsidiaries at 31 March 2012, all of which have been consolidated in these accounts were:

Name of company	Principal activity	Proportion of ordinary shares held	Proportion of voting rights held	Country of registration	Country of operation
NATS Limited*	Corporate services	100%	100%	England and Wales	United Kingdom
NATS (En Route) plc	En route air traffic services	100%	100%	England and Wales	United Kingdom
NATS (Services) Limited	Airport air traffic services	100%	100%	England and Wales	United Kingdom
NATNav Limited	Satellite based navigation	100%	100%	England and Wales	United Kingdom
NATS Employee Sharetrust Limited	Administration of employee share plan	100%	100%	England and Wales	United Kingdom
NATS (USA) Inc	Engineering and ATM consultancy	100%	100%	USA	USA
NATS Sverige AB	Airport air traffic services	100%	100%	Sweden	Sweden

* NATS Limited is held directly by NATS Holdings Limited. Other investments are held by subsidiaries.

The group had one associate and one joint venture as at 31 March 2012, details are as follows:

Name of company	Principal activity	Date of acquisition	Proportion of ordinary shares held	Country of incorporation
ESSP SAS	Satellite based navigation	1 September 2008	16.67%	France
FerroNATS Air Traffic Services SA	Airport air traffic services	28 January 2011	50.0%	Spain

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

29. Subsidiaries, joint ventures and associates (continued)

Summarised financial information relating to the associate and joint venture

	At 31 December 2011 £m	At 31 December 2010 £m
ESSP SAS		
Total assets	13.7	21.7
Total liabilities	(10.1)	(19.2)
Net assets	<u>3.6</u>	<u>2.5</u>
Group share of net assets of the associate	<u>0.7</u>	<u>0.4</u>
Revenue	35.8	32.2
Profit after tax	<u>1.3</u>	<u>0.9</u>
Group share of profit of the associate	<u>0.2</u>	<u>0.2</u>

On 1 September 2008, the group acquired 16.67% of the issued share capital of ESSP SAS for cash consideration of €0.2m (£0.1m).

Although the group holds less than 20% of the ordinary shares of ESSP SAS, NATS management has concluded that significant influence can be demonstrated as a result of:

- a. representation on the Board of directors;
- b. participation in policy making processes; and
- c. provision of essential technical information.

As the reporting date of ESSP SAS is 31 December 2011 the results have not been restated as the reporting date is within three months of the reporting date of the group. There have been no significant events within the last three months that should be included in these results.

	At 31 March 2012 £m
FerroNATS Air Traffic Services SA	
Total assets	1.0
Total liabilities	(0.5)
Net assets	<u>0.5</u>
Group share of net assets of the joint venture	<u>0.3</u>
Revenue	-
Loss after tax	<u>(0.1)</u>
Group share of loss of the joint venture	<u>(0.1)</u>

On 28 January 2011, the group acquired 50% of the issued share capital of FerroNATS Air Traffic Services SA for a cash consideration of €0.1m (£0.1m). In June 2011 the group purchased an additional €0.3m (£0.3m) of share capital, maintaining a 50% holding of the issued share capital.

NOTES FORMING PART OF THE CONSOLIDATED ACCOUNTS

30. Events after the reporting period

In May 2012, the Board declared and the company paid an interim dividend for the year ending 31 March 2013 of 20.97 pence per share, totalling £30.0m.

Also in May 2012 the company's subsidiary, NERL, agreed new bank facilities totalling £275.0m, expiring in December 2016.

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COMPANY ACCOUNTS

Balance sheet at 31 March 2012

	Note	2012 £m	2011 £m
Assets			
Non-current assets			
Investments	4	<u>141.0</u>	<u>141.0</u>
Net assets		<u>141.0</u>	<u>141.0</u>
Equity			
Share capital	5	140.6	140.6
Share premium account	5	0.4	0.4
Retained earnings		-	-
Total equity		<u>141.0</u>	<u>141.0</u>

The financial statements (Company No. 04138218) were approved by the Board of directors and authorised for issue on 28 June 2012 and signed on its behalf by:

John Devaney
Chairman



Nigel Fotherby
Finance Director



COMPANY ACCOUNTS

Statement of changes in equity at 31 March 2012

	Share capital £m	Share premium £m	Retained earnings £m	Total £m
At 1 April 2010	140.6	0.4	-	141.0
Profit for the year	-	-	40.0	40.0
Other comprehensive income/(expense) for the year	-	-	-	-
Total comprehensive income for the year	-	-	40.0	40.0
Dividends payable	-	-	(40.0)	(40.0)
At 31 March 2011	<u>140.6</u>	<u>0.4</u>	<u>-</u>	<u>141.0</u>
At 1 April 2011	140.6	0.4	-	141.0
Profit for the year	-	-	50.7	50.7
Other comprehensive income/(expense) for the year	-	-	-	-
Total comprehensive income for the year	-	-	50.7	50.7
Dividends payable	-	-	(50.7)	(50.7)
At 31 March 2012	<u>140.6</u>	<u>0.4</u>	<u>-</u>	<u>141.0</u>

NOTES FORMING PART OF THE COMPANY ACCOUNTS

1. Cash flow statement

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

2. Significant accounting policies

The separate financial statements of the company are presented as required by the Companies Act 2006. As permitted by that Act, the separate financial statements have been prepared in accordance with International Financial Reporting Standards.

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

Investments in subsidiaries are designated as held to maturity and stated at cost less, where appropriate, provisions for impairment. Income from subsidiaries is recognised when received.

3. Profit for the year and dividends

As permitted by section 408 of the Companies Act 2006 the company has elected not to present its own income statement for the year.

Profit for the year has been arrived at after charging:

	2012 £m	2011 £m
Staff costs	-	-
Auditors' remuneration	-	-

The company incurred no charge to current or deferred taxes in the year (2011: £nil).

	2012 £m	2011 £m
Dividends		
Amounts recognised as distributions to equity holders in the period:		
First interim dividend of 29.71 pence per share (2011: 13.98 pence per share) paid in May 2011	42.5	20.0
Second interim dividend of 5.73 pence per share (2011: 13.98 pence per share) paid in November 2011	8.2	20.0
	<u>50.7</u>	<u>40.0</u>

NOTES FORMING PART OF THE COMPANY ACCOUNTS

4. Investments

**Investments
in subsidiary
undertakings**
£m

Investments at 31 March 2012 and 1 April 2011

141.0

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

Pursuant to a loan agreement entered into by NATS (En Route) plc, the company has granted a legal mortgage and fixed charge over its shares in NATS Limited, NERL's parent company, and a floating charge over all other assets.

5. Share capital and share premium accounts

The movements on these items are disclosed in the consolidated statement of changes in equity and notes 22 and 23 of the consolidated financial statements.

6. Financial instruments

The company held no financial instruments at 31 March 2012 (2011: £ nil).

7. Ultimate controlling party

The ultimate controlling party of NATS Holdings Limited is The Airline Group Limited, a company incorporated in Great Britain and registered in England and Wales.

8. Events after the reporting period

In May 2012, the Board declared and the company paid an interim dividend for the year ending 31 March 2013 of 20.97 pence per share, totalling £30.0m.

Appendix

Abbreviations and definitions

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ABBREVIATIONS AND DEFINITIONS

2011	Financial year ended 31 March 2011
2012	Financial year ended 31 March 2012
3Di	3 Dimensional Inefficiency Score
AG	The Airline Group Limited
ANSP	Air navigation service provider
ATC	Air traffic control
ATM	Air traffic management
ATSOCAS	Air Traffic Service Outside Controlled Airspace
AWARE	NATS AWARE Airspace Warning Device
BAA	BAA Airports Limited
CAA	Civil Aviation Authority
CAAPS	Civil Aviation Authority Pension Scheme
CEO	Chief Executive Officer
CP3	Control Period 3 (2011-2014)
CPI	Consumer Price Index
EC	European Commission
EFD	Electronic Flight Data
ERAM	En Route Automation Modernisation
ETASS	En Route Technical Assistance Support Services
EU	European Union
FAA	Federal Aviation Administration
FAB	Functional Airspace Block
FABEC	FAB European Central
IAS	International Accounting Standard
IATA	International Air Transport Association

ABBREVIATIONS AND DEFINITIONS

ICAO	International Civil Aviation Organisation
iFACTS	Interim Future Area Control Tools Support
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standard
KPI	Key Performance Indicator
LIBOR	London Interbank Borrowing Rate
MoD	Ministry of Defence
NATS	NATS Holdings Limited and its subsidiaries, together the NATS group
NATSNav	NATS Nav Limited
NATS (Services)	NATS (Services) Limited
NERL	NATS (En Route) plc
NESL	NATS Employee Sharetrust Limited
NHL	NATS Holdings Limited
OPA	Operational Partnership Agreement
PPP	Public Private Partnership
RAB	Regulatory Asset Base
RP1	Reference Period 1 (2012-2014)
RP2	Reference Period 2 (2015-2019)*
RPI	Retail Price Index
SES	Single European Sky
SESAR	SES ATM Research
SJU	SESAR Joint Undertaking
SLAM	Sudden Loss and ATSOCAS Management
SPA	Strategic Partnership Agreement
SSE	Safety Significant Event

* The Performance Review Body of the Single European Sky is consulting on the length of this Reference Period which may be shorter than five years.

