

NATS (En Route) plc
Financial statements
for the year ended 31 March 2012

Company Number: 04129273

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Deloitte LLP

This review presents a summary of the operating performance and results, financial position and cash flows of NATS (En Route) plc (NERL) for the year ended 31 March 2012.

Highlights

- ◆ NERL handled just under 2.2 million flights (2011: 2.1 million) and maintained its safety record, with no risk-bearing airprox attributable to the company. Average delay per flight was 7.0 seconds, up on 2011 (4.2 seconds) as we successfully implemented a significant systems upgrade. This is about 12.5% of the equivalent European average.
 - ◆ By providing customers with more efficient flight profiles NERL enabled savings of an additional 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 at average fuel prices of £655 per tonne (2011: £7.5m at average fuel prices of £620 per tonne).
 - ◆ We are the first 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%).
 - ◆ Revenues increased by £80m to £696m (2011: £616m) mainly due to net increases in mainly cash-based regulatory revenue allowances following the price control review for 2011 to 2014. Profit before tax also improved by £84m to £155m (2011: £71m), largely due to this factor.
 - ◆ In line with its capital investment plan for the year, the company invested £127m (2011: £122m) in air traffic control infrastructure and systems which will benefit customers.
 - ◆ Net debt at £648m (2011: £652m) was £4m 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 £45m (2011: £35m).
- We maintained our high safety standards and continued our focus on mitigating areas of safety risk. Our attributable average ATFM delay¹ was

¹ ATFM 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

7.0 seconds per flight (2011: 4.2 seconds), about 12.5% of the equivalent European average, and this was achieved while delivering new technology into the operation. We have made a good start in delivering the performance targets set by the Civil Aviation Authority (CAA) 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. 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.

Financially, NERL delivered its best performance since the Public Private Partnership was established, reporting turnover of £695.6m (2011: £615.7m) and a pre-tax profit of £154.8m (2011: £70.8m). As explained below, the exceptional increase in profit mainly arises from the price control review for 2011-2014 (CP3). This reset the mainly

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.

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.

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 believe these developments will provide the NATS Group 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 the NATS group to

demonstrate its ability to gain 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 the NATS group is well placed to provide.

Many ANSPs and airports will implement major airspace improvements and systems developments over the next decade providing opportunities for the NATS group to help transition new equipment and facilities into operational service given the group's experience in this area. Cutbacks in defence budgets are also encouraging innovative thinking in the future provision of military air traffic service provision. NERL 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 the NATS group's capability.

In response to these trends the NATS group has developed a clear and compelling strategy which retains and builds on the success of its existing businesses to realise the opportunities that we believe these changes will present.

NERL's contribution to this vision and strategy is first and foremost to continue to deliver a safe and efficient service to

its en route customers, meet the targets set by the economic regulator, drive innovation and cost efficiency in its business and through European partnerships, and play a leading role in operational and technological developments of the Single European Sky project. This is essential not only to maintain its UK market position but also, in line with the group's strategy, to demonstrate NATS' capabilities to new customers. With these challenges in mind the group's vision is: *"To be the acknowledged global leader in innovative air traffic solutions and airport performance"*.

In line with this strategy, in order to provide greater clarity to its customers of the capabilities offered under the NATS brand, the NATS group has reorganised its economically regulated (NERL) and its other businesses by service line. These include service lines for NATS Airspace, which is essentially the NERL business, as well as: 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.

Safety

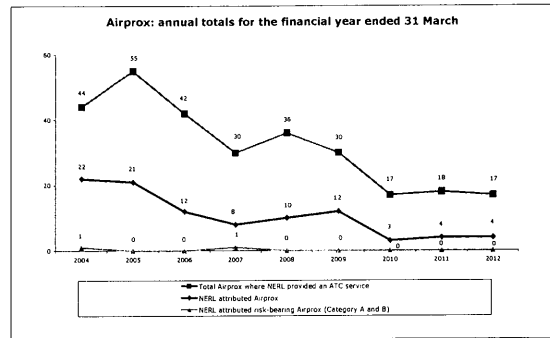
Our first priority is the safety of aircraft and the travelling public. We have an international reputation for our approach to safety management, our well established safety culture and our excellent safety record.

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. The 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 NERL 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 NERL has achieved its target of no category A or B Airprox³ attributable to NERL and our strategic safety target to March 2015 is to maintain this record along with a further 10% reduction in our Weighted SSE index.

² An aircraft deviation of 300 feet or more 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.



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

In April NERL launched its Strategic Plan for Safety, a high level summary of NERL's 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 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.

NERL has won awards this year for safety innovations for AWARE, the GPS-based moving map application that helps 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.

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 NERL 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 having won the Jane's ATC Environment Award and the company 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. NERL 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 March 2012 fuel price and exchange rates, assumed at £655 per metric tonne of fuel (2011: £7.5m at £620 per metric tonne of fuel).

The company has also contributed to the NATS Group delivering a 25% reduction in its carbon footprint over the past four years. The environmental impacts of its 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. The miles travelled by our staff have also been reduced: by 42% for business and by 25% for commuting. The improvements made have led directly to savings, with the reductions in energy consumption alone saving over £2m a year.

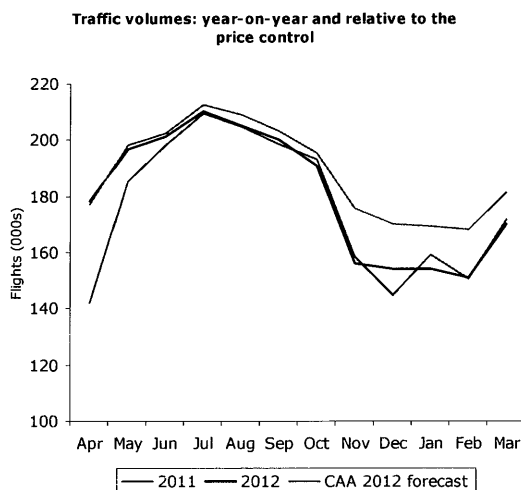
Looking forward, capital investment for energy efficiency projects has been set aside which will help achieve a further 20% reduction (from a March 2011 baseline) in energy consumption by the end of 2014. In addition we have set a target to further reduce water consumption by 10% and for maintaining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

Delivering our economically regulated services

UK aviation continued to suffer from the weak economic environment. Although the volume of flights handled increased by 2.4% to just under 2.2 million, 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%.

	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	2,167	2,116	2.4%
Oceanic traffic (flights)			
Chargeable flights	402	388	3.7%

Chargeable service units for the year were also 4.2% 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 the CAA used 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 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.



Mindful of the difficulties that the weak economic environment means for our customers, we continued to focus on maintaining excellent 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.

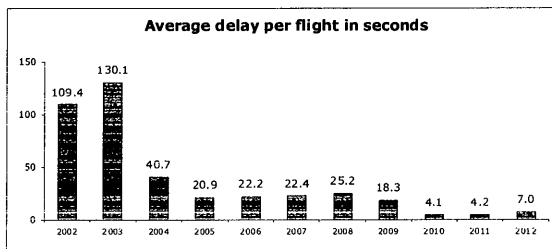
The CP3 review set tough calendar year service performance standards for average delay per flight attributable to NERL (the T1 metric⁴), the impact of delay (T2) which incentivises low delay at peak periods and avoidance of long delays and a delay variability score (T3) which ensures a focus on technical and staffing resilience. We were able to meet these challenges.

⁴ T1 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.

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 7.0 seconds (2011: 4.2 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 NERL (2011: 99.6%).



Note: The data for years 2002 to 2006 is attributable to the NATS group and from 2007 is NERL attributable.

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.

Underpinning NERL's success is a focus on the customer, which differentiates it as an air navigation service provider. The company continues to strive to improve customer service and we are pleased to report that it received its best ever customer satisfaction score in its annual survey with 81.1% of customers satisfied or highly satisfied with the 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.

People and investment

Our 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 our 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.

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) have prepared National Performance Plans with targets consistent with EU-wide aims. The CAA's economic regulator's decision for CP3 constitutes the majority of the economic component of the UK's RP1 National Performance Plan. Preparation for setting RP2 (2015-19)⁵ targets has already begun and the company 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 to customers 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. NERL 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 phases in particular – this is a key alliance for NERL in shaping our European future and one which is chaired by the NATS Group's CEO.

We are also building relationships with other ANSPs 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

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

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.

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, NERL 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 open, 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 at Swanwick, 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

The company reported a profit before tax of £154.8m (£70.8m) which is summarised in the table below:

	2012 £m	2011 £m
Turnover	695.6	615.7
Operating profit		
- Operating profit before exceptional items	202.4	131.5
- Exceptional operating costs (net)	(1.7)	(8.0)
	200.7	123.5
Profit before taxation		
- Profit before tax and exceptional items	156.5	78.8
- Exceptional items (net)	(1.7)	(8.0)
	154.8	70.8
Profit after tax		
- Profit after tax before exceptional items	128.8	66.9
- Exceptional items (net)	(1.3)	(5.8)
	127.5	61.1

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		70.8
Add back exceptional items		8.0
2011 profit before tax & exceptional items		78.8
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	(4.2)	
		74.2
North Atlantic ATS:		
Net increase in revenue allowance (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
Cost changes		
Operating costs (excluding items below)		(12.7)
Depreciation & amortisation, net of deferred grants	(5.3)	
Asset impairment charges	9.7	
Loss on disposal of assets	(0.7)	
		3.7
Change in fair value of index-linked swap contract	5.3	
Other finance costs (net)	1.5	
		6.8
2012 profit before tax & exceptional items		156.5
2012 exceptional items		(1.7)
2012 profit before tax		154.8

The main revenue changes were:

- the outcome of the CP3 price control reviews of UK and North Atlantic en route services (as explained below); and
- lower bonuses associated with tougher service performance targets.

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 above 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

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 en route, 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 the 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

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.

These have the effect of increasing revenues in 2012.

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.

UK air traffic services

UK air traffic services		
	2012	2011
	£m	£m
Turnover	668.8	594.6
Operating costs	(385.0)	(371.6)
Depreciation, amortisation, impairment and deferred grants	(88.2)	(93.3)
Exceptional items	(1.6)	(7.8)
Operating profit	194.0	121.9
Chargeable Service Units (000)	9,676	9,377

UK air traffic services 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	2011
	£m	£m
UK en route services	575.0	504.0
Support services to MoD	46.1	44.6
London approach services	10.6	8.4
North Sea helicopters	8.5	8.3
Other external	13.0	12.9
	653.2	578.2
Services to other group companies	15.6	16.4
UK air traffic services	668.8	594.6

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 above.

UK en route revenues increased by £71.0m in the year to £575.0m (2011: £504.0m) reflecting the 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.

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 and this 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, rose by £2.1m to £474.8m (2011: £472.7m) 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 £194.0m (2011: £121.9m), £72.1m higher than the prior year.

North Atlantic air traffic services

North Atlantic air traffic services

	2012	2011
	£m	£m
Turnover	26.8	21.1
Operating costs	(15.9)	(15.9)
Depreciation, amortisation, impairment and deferred grants	(4.1)	(3.4)
Exceptional items	(0.1)	(0.2)
Operating profit	6.7	1.6
Chargeable flights (000)	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 £0.6m to £20.1m (2011: £19.5m) due mainly to higher asset depreciation charges.

Overall, North Atlantic air traffic services generated an operating profit of £6.7m (2011: £1.6m).

Review of operating costs

Before exceptional items and asset-related charges, operating costs increased by £12.7m to £399.9m (2011: £387.2m).

	2012 £m	2011 £m
Before exceptional items:		
Employee costs	(272.8)	(261.9)
Services and materials	(47.8)	(49.1)
Repairs and maintenance	(26.8)	(26.3)
External research and development	(0.2)	(0.1)
Other operating charges (net)	(52.3)	(49.8)
	(399.9)	(387.2)
Depreciation, amortisation and impairment	(92.9)	(98.1)
Deferred grants	0.6	1.4
Loss on disposal of non-current assets	(1.0)	(0.3)
Operating costs	(493.2)	(484.2)
Exceptional operating items (net)	(1.7)	(8.0)

Employee costs of £272.8m (2011: £261.9m) increased by 4.2% on the previous year and accounted for 55.3%

(2011: 54.1%) of the company's total operating costs.

Pension charges (before redundancy-related past service) were £6.7m higher at £64.2m (2011: £57.5m) mainly due to an increase in the accrual rate for the defined benefit scheme to 24.1%, before salary sacrifice (2011: 21.8%). 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 3,440 (2011: 3,539) and those in post at 31 March 2012 fell by 94 (2.7%) to 3,420 (2011: 3,514).

Non-staff costs at £127.1m (2011: £125.3m) increased by £1.8m or 1.4%. The prior year included a one-off write-off 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 £92.9m (2011: £98.1m) were £5.2m 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.

Exceptional items

The results included exceptional staff redundancy costs of £3.1m (2011: £6.1m) and £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 £45.9m (2011: £52.7m) 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 £27.7m (2011: £11.9m) represents an effective rate of 17.7% (2011: 15.1%). 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 and a prior year adjustment. After exceptional items, the tax charge represents an effective rate of 17.6% (2011: 13.7%).

Dividends

During the year the company paid two interim dividends totalling £45.0m. In May 2012 the Board declared and paid an interim dividend for the year ending 31 March 2013 of £28.5m.

Balance sheet

The company's balance sheet can be summarised as follows:

	2012 £m	2011 £m
Goodwill	351.0	351.0
Tangible and intangible fixed assets	874.1	840.5
Other non-current assets	47.3	46.7
Cash and short-term deposits	102.2	83.7
Other net current assets/(liabilities)	19.0	(3.8)
Pension scheme (deficit)/surplus	(28.8)	36.2
Derivatives	(126.3)	(113.0)
Borrowings	(749.8)	(735.3)
Other non-current liabilities	(108.0)	(126.5)
Net assets	<u>380.7</u>	<u>379.5</u>

Shareholders' funds increased by £1.2m to £380.7m during the year. This reflects total comprehensive income for the year attributable to equity shareholders as shown on page 31 less dividends of £45.0m.

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, explained above, and changes in the deferred tax liability given the change in the pension financial position.

Capital expenditure

The company invested £127.3m in the year, £5.4m more than the previous year, in the following activities:

	2012	2011
	£m	£m
Airspace Development	3.9	2.0
Centre Systems Software Development	39.9	51.7
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	17.3	12.7
Safety Nets and Airspace Efficiency	4.0	1.2
	<u>127.3</u>	<u>121.9</u>

The company continued to invest in its future centres systems which included: the finalisation 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 controller workstation. The level of investment in centre systems software development 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 company's share of the NATS group's defined benefit pension scheme was in deficit, with liabilities exceeding assets by £28.8m (2011: £36.2m 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 pension scheme actuary's 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%. NERL's share of this deficit is c.75% or £263m. NATS agreed a schedule of contributions 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 (NERL's share being c. £1.5m), increasing by 3.5% in January 2012.

Overall the company paid cash contributions to the defined benefit scheme of £109.0m (2011: £94.0m). This amount included £11.9m (2011: £11.5m) 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.

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.

The gross borrowings of the company at £749.8m were £14.5m higher than the previous year (2011: £735.3m). Cash and investments increased by £18.5m to £102.2m (2011: £83.7m). Overall, net debt decreased by £4.0m to £647.6m (2011: £651.6m).

Movements in net debt

	Cash and short-term investments		Borrowings	Net debt
	£m	£m		
Balance at 31 March 2011	83.7	(735.3)		(651.6)
Cash flow	4.4	(13.7)		(9.3)
Short-term investments	14.1	-		14.1
Non-cash movements	-	(0.8)		(0.8)
Balance at 31 March 2012	102.2	(749.8)		(647.6)

Cash flow

Overall, the company's balance of cash and cash equivalents increased by £4.4m in the year to £71.7m (2011: £67.3m).

	2012 £m	2011 £m
Cash generated from operations	218.9	163.4
Taxation	(15.2)	(4.9)
Net cash from operating activities	203.7	158.5
Interest received	0.9	0.9
Capital expenditure net of cost of disposals	(121.1)	(119.7)
Changes in short term investments	(14.1)	(0.9)
Net cash outflow from investing activities	(134.3)	(119.7)
Interest paid net of receipt from derivative financial instruments	(33.7)	(31.2)
Bank and other loans	28.8	30.2
Loans advanced by fellow subsidiary	(0.9)	0.4
Repayment of bond principal	(14.2)	-
Dividends paid	(45.0)	(35.0)
Net cash outflow from financing activities	(65.0)	(35.6)
Increase in cash and cash equivalents	4.4	3.2

Net cash from operating activities at £203.7m was £45.2m higher than 2011 (2011: £158.5m), mainly reflecting the higher revenue allowances explained above which were partly offset by the settlement of non-staff costs and higher pension contributions. This enabled the company to largely finance its capital investment, service its debt obligations

and pay a dividend to its parent. Drawings on bank loans of £28.8m ensured that the company maintained its cash holding levels, in accordance with its liquidity risk management policy.

Principal risks and uncertainties

The operational complexities inherent in the business leave NERL exposed to a number of significant risks. The company 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 risks and uncertainties described below are the ones that may have the most significant impact on the long-term value of the company. The list is not intended to be exhaustive.

The company carries out detailed risk management reviews to ensure that the risks are mitigated where possible. The principal operational risks and uncertainties of the company are:

The risk of aircraft collision

A loss of separation attributable to NERL that results in a collision in the air or on the ground would significantly impact on NERL's 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 the company 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 NERL has invested in developing contingency arrangements, as explained above.

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 NERL's revenues resulting from changes in flight planning behaviour. NERL 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 regulator in making the CP3 price determination. This in turn could impair shareholder returns. NERL 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. NERL has mature project management processes and industry experts to mitigate this risk.

Electronic and other external threats

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

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

centre and the undertaking of speculative transactions is not permitted.

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

- ◆ currency risk: the company'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 company's most significant currency exposure arises because UK en route charges, which contribute 83% (2011: 82%) 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 £106.6 (net) were outstanding (2011: £104.6m 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 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 to 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.

- ◆ counterparty risk: as at 31 March 2012 the company had cash and deposits (shown as short-term investments) totalling £102.2m (2011: £83.7m). 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, as at 31 March 2012 the company had cash and short-term deposits totalling £102.2m. Included in cash of £71.7m is a liquidity reserve account balance of £21.3m held to provide liquidity in the event of certain pre-defined circumstances, particularly to ensure compliance with financial covenants. The short-term deposit of £30.5m represents a debt service reserve account to fund bond principal, interest and fees scheduled for payment in the 6 months ending 30 September 2012. The company's policy is to hold free cash equivalent to between one and two months' of projected UK en route services revenue (being between £48m and £96m for the year ending 31 March 2012) and to use surplus cash to reduce borrowings.
- ◆ funding risk: the policy of the company is to ensure that committed funding is available at a competitive cost to meet its anticipated needs for the period covered by its 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 company'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 £211m of which £171m were scheduled to mature in November 2012 and £40m in April 2013. In May 2012 NERL agreed new facilities of £275m expiring in December 2016.

Going concern

The company's business activities, together with the factors likely to affect its performance and the financial position of the company, its cash flows, liquidity position and borrowings are set out above. In addition, note 18 to the financial statements describes the company'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 company holds adequate levels of cash holdings and in May 2012 it agreed new bank facilities of £275m which expire in December 2016. The company's forecasts and projections, which reflect the outcome of the CP3 review, taking account of reasonably

possible changes in trading performance show that the company 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. The company 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 company 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 company, 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.

Summing up

We remain focussed 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.

Last, but by no means least, the company has a great team. In my short period with the company, I have been 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 next phase of our business and it's the kind of strength you would expect from a company that shares the NATS group's ambition to be the acknowledged global leader in innovative air traffic solutions and airport performance.

Martin Rolfe

Managing Director, NERL

Report of the directors

The directors present their report and the audited accounts for the year ended 31 March 2012.

Principal activities and business review

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

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

The company is subject to regulation in accordance with the Air Traffic Services Licence which was originally issued in March 2001 and has been modified on a number of occasions.

A review of the company's activities and performance during the year, including principal risks and uncertainties, is contained in the Business and Financial Review on pages 1–24.

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

Results and dividends

The results for the year are shown in the income statement on page 31.

The Board declared and paid two interim dividends totalling £4.50 per share (totalling £45m).

In May 2012 the Board declared an interim dividend for the year ended 31 March 2013 of £2.85 per share (totalling £28.5m) which was paid to its parent company in May 2012.

Charitable donations

The company made aggregate donations of £67,680 (2011: £26,100).

Use of financial instruments

The company uses financial instruments to manage financial risk. The accounting policies and notes to the financial statements, set out below, explain the financial risk management objectives and policies of the company and describe exposures to credit and other risks.

Employees

Contracts of employment with staff are held by the company's parent company, NATS. NATS continues its commitment to the involvement of employees in the decision making process through

effective leadership at all levels in the organisation. Staff are frequently involved through direct discussions with their managers, cross company work groups and local committees. Regular staff consultations cover a range of topics affecting the workforce, including such matters as unit and corporate performance and business plans. The NATS group CEO and the company's Managing Director maintain visibility with staff through visits to NATS sites where they talk to them about current business issues and take 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 NATS' policy to establish and maintain competitive pay rates which take full account of the different pay markets relevant to its operations. In return, employees are expected to perform to the required standards and to provide the quality and efficiency of service expected by its customers.

NATS is an equal opportunities employer. Its policy is designed to ensure that no applicant or employee receives less favourable treatment than any other on the grounds of sex, 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.

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

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

Policy and practice on payment of creditors

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

The average number of days taken to pay suppliers calculated in accordance with the requirements of the Companies Act 2006 is 50 days (2011: 64 days).

Directors and their interests

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

John Devaney

Richard Deakin

Nigel Fotherby

Ian Mills (resigned 26 September 2011)

Martin Rolfe (appointed 26 March 2012)

None of the directors had any interests in the share capital of the company. The interests of the directors in the ordinary shares of the company's parent undertaking are explained in the accounts of NATS Holdings Limited.

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.

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.

The financial statements have been prepared on a going concern basis, as explained in note 2 to the accounts.

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.

By order of the Board



Richard Churchill-Coleman
Secretary
28 June 2012

Registered office

4000 Parkway, Whiteley, Fareham,
Hampshire, PO15 7FL

Registered in England and Wales
Company Number: 04129273

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

We have audited the financial statements of NATS (En Route) plc for the year ended 31 March 2012 which comprise the income statement, the statement of comprehensive income, the balance sheet, the statement of changes in equity, the cash flow statement and the related notes 1 to 28. 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 auditors

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 the financial statements

In our opinion the financial statements:

- ◆ give a true and fair view of the state of the company's affairs as at 31 March 2012 and of its profit 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 financial statements, the company in addition to applying IFRSs as adopted by the European Union, has 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.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion 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.

Independent auditor's report

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; or
- the financial statements 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

Income statement

for the year ended 31 March 2012

	Notes	Year ended 31 March 2012			Year ended 31 March 2011		
		Before exceptional items	Exceptional items (Note 6a)	Total	Before exceptional items	Exceptional items (Note 6a)	Total
		£m	£m	£m	£m	£m	£m
Revenue	4	695.6	-	695.6	615.7	-	615.7
Staff costs	7	(272.8)	(3.1)	(275.9)	(261.9)	(6.1)	(268.0)
Services and materials		(47.8)	-	(47.8)	(49.1)	-	(49.1)
Repairs and maintenance		(26.8)	-	(26.8)	(26.3)	-	(26.3)
External research and development		(0.2)	-	(0.2)	(0.1)	-	(0.1)
Depreciation, amortisation and impairment	6b	(92.9)	-	(92.9)	(98.1)	-	(98.1)
Loss on disposal of non-current assets		(1.0)	-	(1.0)	(0.3)	-	(0.3)
Other operating charges		(52.9)	1.4	(51.5)	(49.8)	(1.9)	(51.7)
Other operating income		0.6	-	0.6	-	-	-
Deferred grants released	6b	0.6	-	0.6	1.4	-	1.4
Net operating costs		(493.2)	(1.7)	(494.9)	(484.2)	(8.0)	(492.2)
Operating profit	6	202.4	(1.7)	200.7	131.5	(8.0)	123.5
Investment revenue	8	4.8	-	4.8	2.1	-	2.1
Finance costs	9	(50.7)	-	(50.7)	(54.8)	-	(54.8)
Profit before tax		156.5	(1.7)	154.8	78.8	(8.0)	70.8
Tax	10	(27.7)	0.4	(27.3)	(11.9)	2.2	(9.7)
Profit for the year attributable to equity shareholders		128.8	(1.3)	127.5	66.9	(5.8)	61.1

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

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		127.5	61.1
Other comprehensive (expense)/income for the year			
Actuarial loss on defined benefit pension scheme	25	(109.4)	(56.3)
Change in fair value of hedging derivatives		3.7	(3.6)
Transfer to income statement on cash flow hedges		(3.4)	2.3
Deferred tax relating to components of other comprehensive (expense)/income	21	27.8	14.9
		(81.3)	(42.7)
Total comprehensive income for the year attributable to equity shareholders		46.2	18.4

Balance sheet

at 31 March 2012

	Notes	2012 £m	2011 £m
Non-current assets			
Goodwill	12	351.0	351.0
Other intangible assets	13	258.3	229.1
Property, plant and equipment	14	615.8	611.4
Retirement benefit asset	25	-	36.2
Trade and other receivables	15	47.3	46.7
		<u>1,272.4</u>	<u>1,274.4</u>
Current assets			
Trade and other receivables	15	126.5	111.4
Short term investments	18	30.5	16.4
Cash and cash equivalents	18	71.7	67.3
Derivative financial instruments	17	0.2	0.2
		<u>228.9</u>	<u>195.3</u>
Total assets		<u>1,501.3</u>	<u>1,469.7</u>
Current liabilities			
Trade and other payables	19	(95.5)	(105.6)
Current tax liabilities		(10.4)	(4.2)
Borrowings	16	(176.7)	(14.2)
Provisions	20	(1.6)	(5.4)
Derivative financial instruments	17	(126.5)	(113.2)
		<u>(410.7)</u>	<u>(242.6)</u>
Net current (liabilities)/assets		<u>(181.8)</u>	<u>(47.3)</u>
Non-current liabilities			
Trade and other payables	19	(12.2)	(7.8)
Borrowings	16	(573.1)	(721.1)
Retirement benefit obligations	25	(28.8)	-
Deferred tax liability	21	(95.5)	(117.4)
Provisions	20	(0.3)	(1.3)
		<u>(709.9)</u>	<u>(847.6)</u>
Total liabilities		<u>(1,120.6)</u>	<u>(1,090.2)</u>
Net assets		<u>380.7</u>	<u>379.5</u>
Equity			
Called up share capital	22	10.0	10.0
Hedge reserve		(0.2)	(0.5)
Special reserves		33.7	33.7
Other reserves		18.2	20.1
Retained earnings		319.0	316.2
Total equity		<u>380.7</u>	<u>379.5</u>

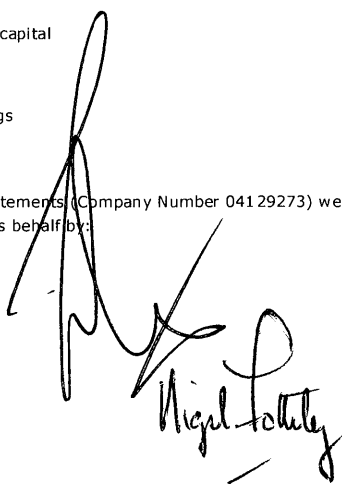
The financial statements (Company Number 04129273) were approved by the Board of directors and authorised for issue on 28 June 2012 and signed on its behalf by:

Chairman

John Devaney

Finance Director

Nigel Fotherby



Statement of changes in equity

for the year ended 31 March 2012

	Equity attributable to equity holders of the Company					Total £m
	Share capital £m	Special reserve £m	Hedge reserve £m	Other reserves £m	Retained earnings £m	
At 1 April 2010	10.0	33.7	0.5	24.8	327.1	396.1
Profit for the year	-	-	-	-	61.1	61.1
Other comprehensive expense for the year net of tax	-	-	(1.0)	(4.7)	(37.0)	(42.7)
Total comprehensive (expense)/income for the year	-	-	(1.0)	(4.7)	24.1	18.4
Dividends paid	-	-	-	-	(35.0)	(35.0)
At 31 March 2011	<u>10.0</u>	<u>33.7</u>	<u>(0.5)</u>	<u>20.1</u>	<u>316.2</u>	<u>379.5</u>
At 1 April 2011	10.0	33.7	(0.5)	20.1	316.2	379.5
Profit for the year	-	-	-	-	127.5	127.5
Other comprehensive income/(expense) for the year net of tax	-	-	0.3	(1.9)	(79.7)	(81.3)
Total comprehensive income/(expense) for the year	-	-	0.3	(1.9)	47.8	46.2
Dividends paid	-	-	-	-	(45.0)	(45.0)
At 31 March 2012	<u>10.0</u>	<u>33.7</u>	<u>(0.2)</u>	<u>18.2</u>	<u>319.0</u>	<u>380.7</u>

Other reserves arose on completion of the PPP transaction in July 2001. The special reserve arose from a capital reduction in May 2003.

Cash flow statement

for the year ended 31 March 2012

		Year ended 31 March 2012	Year ended 31 March 2011
Notes	£m	£m	
Net cash inflow from operating activities	23	<u>203.7</u>	<u>158.5</u>
Cash flows from investing activities			
Interest received		0.9	0.9
Purchase of property, plant and equipment and other intangible assets		(120.9)	(119.7)
Cost of disposing of property, plant and equipment		(0.2)	-
Changes in short term investments		(14.1)	(0.9)
Net cash outflow from investing activities		<u>(134.3)</u>	<u>(119.7)</u>
Cash flows from financing activities			
Interest paid		(35.3)	(34.0)
Interest received on derivative financial instruments		1.6	2.8
Bank and other loans		28.8	30.2
Loans advanced by fellow subsidiary		(0.9)	0.4
Repayment of bond principal		(14.2)	-
Dividends paid		(45.0)	(35.0)
Net cash outflow from financing activities		<u>(65.0)</u>	<u>(35.6)</u>
Increase in cash and cash equivalents during the year		4.4	3.2
Cash and cash equivalents at 1 April		<u>67.3</u>	<u>64.1</u>
Cash and cash equivalents at 31 March		<u><u>71.7</u></u>	<u><u>67.3</u></u>
Net debt (representing borrowings net of cash and short term investments)		<u><u>(647.6)</u></u>	<u><u>(651.6)</u></u>

1. General information

NATS (En Route) plc (NERL) is a 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 28. The nature of the company'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 company operates.

2. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company'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 23. The financial information has been prepared in accordance with International Financial Reporting Standards (IFRSs). The financial statements have also been prepared in accordance with IFRSs and International Financial Reporting Interpretation Committee (IFRIC) interpretations as endorsed by the European Union and therefore the company 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: 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: 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: 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 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. 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.

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 company 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 company in future periods.

IFRS 7: *Financial Instruments: Disclosures*. This amendment requires additional disclosures around transactions with financial assets, where the entity retains an interest in the financial asset, the company 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 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 company is The Airline Group hence the company 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*

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 company.

IFRS 12: *Disclosure of Interests in Other Entities* - will impact the disclosures documenting the basis of control conclusions around company 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 impact of these items.

IAS 19 (Revised): *Employee benefits* - will require disaggregation of defined benefit costs into components, 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.

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

In addition, the company entered into a Management Services Agreement with NATS Limited on 25 July 2001. This agreement provides for the provision by NATS Limited of personnel and central services to the company. The cost of

central services is recharged on the basis of a fair allocation of costs taking into account the most important drivers for the services provided. The company is responsible for paying to NATS Limited an amount equal to the aggregate of all costs incurred by NATS Limited in connection with the employment of the personnel together with appropriate staff related costs and expenses and disbursements.

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

- ◆ training services
- ◆ radar data services at NATS Services airports
- ◆ engineering and software support services
- ◆ research and development for NATS Services airports division and business development division; and
- ◆ other services to NATS Services business development division (for example - consultancy and engineering services).

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

- ◆ North Sea helicopter advisory service
- ◆ air traffic services in certain sectors
- ◆ services to London Approach service (engineering services and use of communications facilities)
- ◆ accommodation and support services to NERL units sited on NATS Services Heathrow premises; and
- ◆ miscellaneous other services.

The company commenced trading from 26 July 2001.

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

Operating profit

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

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 NERL air traffic services licence (including volume risk sharing, service performance incentives and inflation adjustments) 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.

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 NERL 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 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 investment revenue, finance expenses and income tax expenses. Assets and liabilities are presented to the Executive team on a company level basis. Unallocated assets and liabilities comprise balances relating to taxation, short term investments, cash and cash equivalents, 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.

Goodwill

Goodwill arising on consolidation in relation to NERL, 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 the company 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 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.

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 company 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.

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 NERL 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 NERL, 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.

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 company's development activities is

recognised only if all of the following conditions are met:

- ◆ an asset is created that can be identified (such as software and new processes)
- ◆ 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 company 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 company 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 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 (nil 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.

Share-based payments

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

In 2001, the company's parent established an All-Employee Share Ownership Plan for the benefit of its employees to hold 5% of the share capital of NATS Holdings.

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 company provides finance to NESL (NATS Employee

Sharetrust Limited) to enable the trust company to meet its obligations to repurchase vested or eligible shares from employees.

The company'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.

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 company's financial statements as outlined in note 10, subject to the impact of other developments in the company's tax position which may reduce the beneficial effect of this in the company'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.

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 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.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Deferred tax in the income statement 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.

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

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 company enters into forward contracts (see below for details of the company'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 providing benefits based on final pensionable pay. The assets of the scheme are held in a separate trustee administered fund. Pension costs are assessed in accordance with the advice of a qualified actuary using the Projected Unit Credit Method. Actuarial valuations are carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and presented in the statement of 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 scheme assets as reduced by the present 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 company has a present obligation as a result of a past event, and it is probable that the company 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 company's balance sheet when the company 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

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.

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 company 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 company's activities expose it primarily to the financial risks of changes in interest rates, inflation and foreign currency exchange rates. The company uses interest rate and index-linked swap contracts and forward foreign exchange contracts to hedge these exposures. These are disclosed in note 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 company's policies approved by the board of directors, which provides written principles on the use of financial derivatives. The company 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 company 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.

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 base, market premiums for regulated businesses and the outcome of the regulatory price control determination for Control Period 3. 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 company 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 company's defined benefit pension scheme which affect the balance sheet position and the company's reserves and income statement. Refer to note 25 of the notes to the accounts for a summary of the main assumptions. Actual outcomes may differ materially from the assumptions used and may result in volatility in the net pension scheme asset/liability.

Capital investment programme

The company is undertaking a significant capital investment programme to upgrade existing air traffic control infrastructure. This programme requires the company 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.

4. Revenue

An analysis of the company'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
Inter-company income	15.6	16.4
	<u>695.6</u>	<u>615.7</u>

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 company'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 a £3.4m loss (2011: £2.3m gain).

5. Business and geographical segments**Business segments**

For management reporting purposes, the company is currently organised into two business areas.

Principal activities are as follows:

UK air traffic services represent the provision of en route air traffic services within UK air space, including air traffic services for helicopters operating in the North Sea, approach services for London airports, services to the Ministry of Defence and miscellaneous activity connected to the en route business. North Atlantic air traffic services provide en route air traffic services for the North Atlantic, including an altitude calibration service.

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

Information about each business area is presented below.

Year ended 31 March 2012	<u>UK air traffic services</u> £m	<u>North Atlantic air</u> £m	<u>Total</u> £m
Revenue			
Revenue from external customers	653.2	26.8	680.0
Revenue from internal customers	<u>15.6</u>	<u>-</u>	<u>15.6</u>
	<u>668.8</u>	<u>26.8</u>	<u>695.6</u>
Segmental operating profit	<u>194.0</u>	<u>6.7</u>	<u>200.7</u>
Investment revenue			4.8
Finance costs			<u>(50.7)</u>
Profit before tax			154.8
Tax			<u>(27.3)</u>
Profit for the period			<u>127.5</u>
Other information			
Exceptional costs (net)	1.6	0.1	1.7
Capital expenditure	125.5	1.8	127.3
Depreciation and amortisation	85.5	4.0	89.5
Impairment losses recognised in income	3.3	0.1	3.4
Deferred grants released	(0.6)	-	(0.6)
Balance sheet			
Segmental assets	<u>1,371.0</u>	<u>27.9</u>	1,398.9
Unallocated corporate assets			<u>102.4</u>
Total assets			<u>1,501.3</u>
Segmental liabilities	<u>(133.4)</u>	<u>(4.9)</u>	(138.3)
Unallocated corporate liabilities			<u>(982.3)</u>
Total liabilities			<u>(1,120.6)</u>

5. Business and geographical segments (continued)

Year ended 31 March 2011	UK air traffic services £m	North Atlantic air traffic services £m	Total £m
Revenue			
Revenue from external customers	578.2	21.1	599.3
Revenue from internal customers	16.4	-	16.4
	<u>594.6</u>	<u>21.1</u>	<u>615.7</u>
Segmental operating profit	<u>121.9</u>	<u>1.6</u>	123.5
Investment revenue			2.1
Finance costs			(54.8)
Profit before tax			70.8
Tax			(9.7)
Profit for the period			<u>61.1</u>
Other information			
Exceptional costs	7.8	0.2	8.0
Capital expenditure	119.4	2.5	121.9
Depreciation and amortisation	81.6	3.4	85.0
Impairment losses recognised in income	13.1	-	13.1
Deferred grants released	(1.4)	-	(1.4)
Balance sheet			
Segmental assets	<u>1,354.8</u>	<u>31.0</u>	1,385.8
Unallocated corporate assets			83.9
Total assets			<u>1,469.7</u>
Segmental liabilities	<u>(116.4)</u>	<u>(3.6)</u>	(120.0)
Unallocated corporate liabilities			(970.2)
Total liabilities			<u>(1,090.2)</u>

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

Geographical segments

The following table provides an analysis of the company'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	302.2	266.6
Rest of Europe	231.9	207.5
North America	117.0	102.2
Other	44.5	39.4
Total	<u>695.6</u>	<u>615.7</u>

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

Information about major customers

Included in revenues arising from UK air traffic services are revenues of £69.1m (2011: £58.1m) which arose from the company'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
Voluntary redundancy costs (including pension augmentation costs, see note 7a)	3.1	6.1
Relocation of staff and offices to 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>1.7</u>	<u>8.0</u>

6. Operating profit for the year (continued)**b Other items**

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

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
CAA regulatory charges	5.2	5.0
Depreciation of property, plant and equipment	71.6	74.1
Impairment of property, plant and equipment	1.6	(0.1)
Amortisation of intangible assets	17.9	10.9
Impairment of intangible assets	1.8	13.2
Deferred grants released	(0.6)	(1.4)
Research and development costs	6.9	12.4
Auditors remuneration for audit services (see below)	-	-

Fees payable to Deloitte LLP and their associates for non-audit services to the company are not required to be disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

Government grants relating to the purchase of property, plant and equipment and Ministry of Defence (MoD) 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.

Transactions with group companies

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Net charges for services provided by parent undertaking	11.1	11.2
Charges for services provided by other group companies	17.2	15.8

In addition to the staff costs referred to in note 7a below, NERL is responsible under the Management Services Agreement (MSA) for reimbursing NATS Limited for all other staff related costs which it incurs on behalf of the employees seconded to NERL. Under the Inter Company Services Agreement (ICSA) NATS Services provides certain services to NERL. The MSA and ICSA are explained in more detail in note 2.

7. Staff costs**a. Staff costs**

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Salaries and staff costs were as follows:		
Wages and salaries	220.1	218.2
Social security costs	23.1	20.8
Pension costs (note 7b)	66.4	62.0
	309.6	301.0
Less: amounts capitalised	(33.7)	(33.0)
	275.9	268.0

Wages and salaries includes redundancy costs of £0.9m (2011: £1.9m), share-based payment charges, other allowances and holiday pay. Pension costs include £2.2m (2011: £4.5m) for redundancy-related augmentation payments which staff elected to receive in lieu of severance payments.

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

b. Pension costs

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Defined benefit pension scheme costs (note 25)	64.6	61.2
Defined contribution pension scheme costs	1.8	0.8
	66.4	62.0

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	1,349	1,383
Air traffic service assistants	606	671
Engineers	816	829
Others	669	656
	3,440	3,539

8. Investment revenue

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Interest on bank deposits	0.7	0.9
Other	4.1	1.2
	<u>4.8</u>	<u>2.1</u>

9. Finance costs

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Interest on bank overdrafts, loans and hedging instruments	1.0	1.5
Bond and related costs including financing expenses	32.1	30.8
Other	0.4	-
Interest payable on intercompany loans	0.3	0.3
	<u>33.8</u>	<u>32.6</u>
Loss on derivatives not qualifying for hedge accounting	16.9	22.2
	<u>50.7</u>	<u>54.8</u>

10. Tax

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Current tax (including a charge of £3.3m in respect of prior years, 2011: charge of £0.1m)	(21.4)	(8.6)
Deferred tax (see note 21)	(5.9)	(1.1)
	<u>(27.3)</u>	<u>(9.7)</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	154.8		70.8	
Tax on profit on ordinary activities at standard rate in the UK of 26% (2011: 28%)	(40.2)	(26.0%)	(19.8)	(28.0%)
Tax effect of change in corporation tax rate from 26% to 24% (2011: 28% to 26%)	8.0	5.2%	10.3	14.6%
Tax effect of prior year adjustments	3.3	2.2%	0.1	0.1%
Tax effect of other permanent differences	1.6	1.0%	(0.3)	(0.4%)
Tax charge for year at an effective tax rate of 17.6% (2011: 13.7%)	<u>(27.3)</u>	(17.6%)	<u>(9.7)</u>	(13.7%)
Deferred tax credit taken directly to equity (see note 21)	<u>(27.8)</u>		<u>(14.9)</u>	

11. Dividends

	Year ended 31 March 2012 £m	Year ended 31 March 2011 £m
Amounts recognised as distributions to equity holders in the year		
First interim dividend of £3.72 per share (2011: £1.50 per share) paid in May 2011	37.2	15.0
Second interim dividend of £0.78 per share (2011: £2.00 per share) paid in November 2011	7.8	20.0
	<u>45.0</u>	<u>35.0</u>

In May 2012, the Board declared an interim dividend for 2013 of £2.85 per share (totalling £28.5m), which was paid to the company's parent in May 2012.

12. Goodwill

£m

At 31 March 2012 and 31 March 2011

351.0

The company tests goodwill annually for impairment, or more frequently if there are indications that good will 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 company'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 discount rate is a pre-tax nominal rate of 9.99% (2011: 10.69%). See note 3.

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	48.3	31.8	18.6	147.4	246.1
Additions internally generated	2.3	-	0.1	15.1	17.5
Additions externally acquired	2.6	1.1	-	33.1	36.8
Disposals during the year	(0.5)	(0.3)	(1.0)	-	(1.8)
Transfers during the year	2.0	0.5	1.1	(4.3)	(0.7)
At 1 April 2011	54.7	33.1	18.8	191.3	297.9
Additions internally generated	4.2	0.3	1.0	10.4	15.9
Additions externally acquired	2.4	6.5	0.1	27.1	36.1
Disposals during the year	-	(1.2)	-	(2.7)	(3.9)
Transfers during the year	77.2	2.1	1.1	(83.3)	(2.9)
At 31 March 2012	138.5	40.8	21.0	142.8	343.1
Accumulated amortisation					
At 1 April 2010	20.0	12.8	8.1	5.4	46.3
Charge for the year	5.5	3.8	1.6	-	10.9
Impairment provision recognised in income statement	-	-	-	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	25.5	16.5	9.7	17.1	68.8
Charge for the year	11.4	4.9	1.6	-	17.9
Impairment provision recognised in income statement	-	-	-	1.8	1.8
Utilisation of impairment provision	-	-	-	(2.7)	(2.7)
Disposals during the year	-	(1.0)	-	-	(1.0)
At 31 March 2012	36.9	20.4	11.3	16.2	84.8
Carrying amount					
At 31 March 2012	101.6	20.4	9.7	126.6	258.3
At 31 March 2011	29.2	16.6	9.1	174.2	229.1

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

14. Property, plant and equipment

	Freehold land & buildings £m	Improvements to leasehold land & buildings £m	Air traffic control systems, plant and equipment £m	Vehicles, furniture & fittings £m	Assets in course of construction and installation £m	Total £m
Cost						
At 1 April 2010	222.8	38.2	1,101.7	14.7	122.3	1,499.7
Additions during the year	1.0	0.1	14.1	0.7	51.7	67.6
Disposals during the year	-	(0.1)	(34.3)	(0.1)	-	(34.5)
Other transfers during the year	0.2	-	12.9	0.2	(12.6)	0.7
At 1 April 2011	224.0	38.2	1,094.4	15.5	161.4	1,533.5
Additions during the year	2.2	0.3	27.7	0.7	44.4	75.3
Disposals during the year	(0.4)	-	(117.7)	(1.5)	(3.0)	(122.6)
Other transfers during the year	4.6	1.0	119.2	2.0	(123.9)	2.9
At 31 March 2012	230.4	39.5	1,123.6	16.7	78.9	1,489.1
Accumulated depreciation and impairment						
At 1 April 2010	84.0	23.3	763.6	8.4	3.2	882.5
Provided during the year	6.9	1.3	64.6	1.3	-	74.1
Provisions for impairment	-	-	-	-	(0.1)	(0.1)
Utilisation of impairment provision	-	-	-	-	(0.1)	(0.1)
Disposals during the year	-	(0.1)	(34.2)	-	-	(34.3)
At 1 April 2011	90.9	24.5	794.0	9.7	3.0	922.1
Provided during the year	6.9	1.5	62.0	1.2	-	71.6
Provisions for impairment	-	-	1.5	-	0.1	1.6
Utilisation of impairment provision	-	-	(1.5)	-	(3.1)	(4.6)
Disposals during the year	(0.3)	-	(115.6)	(1.5)	-	(117.4)
At 31 March 2012	97.5	26.0	740.4	9.4	-	873.3
Carrying amount						
At 31 March 2012	132.9	13.5	383.2	7.3	78.9	615.8
At 31 March 2011	133.1	13.7	300.4	5.8	158.4	611.4

The group conducts annual reviews of the carrying values of its property, plant, equipment and intangible assets. During the year, net impairment charges of £3.4m (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.

During the year the company 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*.

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

15. Financial and other assets

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

Trade and other receivables

	2012 £m	2011 £m
Non-current		
Prepayments	0.2	-
Accrued income	47.1	46.7
	47.3	46.7
Current		
Receivable from customers (gross)	50.8	54.1
Allowance for doubtful debts	(4.3)	(5.2)
	46.5	48.9
Other debtors	2.3	3.8
Prepayments	5.3	5.5
Accrued income	72.4	53.2
	126.5	111.4

The average credit period taken on sales of services is 29 days (2011: 29 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 £4.3m (2011: £5.2m). 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 which is evidence of a reduction in the recoverability of the cash flows.

15. Financial and other assets (continued)

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.

Ageing of past due but not impaired trade receivables

	2012 £m	2011 £m
30-90 days	0.1	0.4
91 -365 days	0.1	0.1
	<u>0.2</u>	<u>0.5</u>

Movement in the allowance for doubtful debts

	2012 £m	2011 £m
Balance at the beginning of the year	5.2	5.0
Increase in allowance recognised in the income statement	0.6	0.8
Exchange movement in the year	(0.3)	(0.1)
Amounts written off as irrecoverable	(1.2)	(0.5)
	<u>4.3</u>	<u>5.2</u>

In determining the recoverability of a trade receivable the company 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: £4.5m) which are in administration, receivership or liquidation. The impairment recognised represents the carrying amount of these trade receivables. The company does not hold any collateral over these balances.

Ageing of impaired receivables

	2012 £m	2011 £m
30-90 days	0.1	0.3
90-365 days	1.4	1.3
More than 365 days overdue	2.8	3.6
	<u>4.3</u>	<u>5.2</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 company 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 £270.5m (2011: £236.3m).

16. Borrowings

	2012 £m	2011 £m
Unsecured loans		
Intercompany loan	22.5	23.4
Secured loans		
£600m 5.25% Guaranteed Secured Amortising Bonds 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>754.7</u>	<u>740.8</u>
Unamortised bond issue costs	(4.9)	(5.5)
	<u>749.8</u>	<u>735.3</u>
Amounts due for settlement within 12 months	<u>176.7</u>	<u>14.2</u>
Amounts due for settlement after 12 months	<u>573.1</u>	<u>721.1</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 £210.95m committed bank facilities are similarly secured. Further security provisions are also provided by NATS Holdings Limited and 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.

16. Borrowings (continued)

Undrawn committed facilities	2012 £m	2011 £m
Less than one year	22.7	34.3
Between one and two years	40.0	51.4
	62.7	85.7

NERL has, as at 31 March 2012, outstanding drawings of £148.3m on its committed facilities. The bank facilities expire as follows: £171.0m in November 2012; and the balance of £40.0m in April 2013. In May 2012, NERL has agreed new bank facilities of £275m, which expire in December 2016.

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)	0.2	0.2
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	(126.1)	(109.2)
	(126.5)	(113.2)

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			Total	2011			Total
	Level 1	Level 2	Level 3		Level 1	Level 2	Level 3	
Financial assets								
Derivative financial instruments in designated hedge accounting relationships	-	0.2	-	0.2	-	0.2	-	0.2
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	-	(126.1)	-	(126.1)	-	(109.2)	-	(109.2)
	-	(126.5)	-	(126.5)	-	(113.2)	-	(113.2)

There were no transfers between individual levels in the year.

18. Financial instruments**Capital risk management**

The company manages its capital to ensure that it is able to continue as a going concern, to meet its obligations under its air traffic services licence and to provide returns to stakeholders. The capital structure of the company consists of debt, as disclosed in note 16, cash and cash equivalents and short term investments, as explained in this note and equity attributable to shareholders as disclosed in the statement of changes in equity.

External capital requirements

The 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 company to target a credit profile that exceeds BBB-/Baa3.

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

Gearing ratio

Consistent with seeking to maintain an investment grade credit rating, the company sets a gearing target measured as the ratio of net debt to the regulatory asset base (RAB). Following the price control review for the four calendar years 2011 to 2014, the economic regulator (the CAA) has set NERL a gearing target of 60% and a cap of 65% of net debt to RAB with a requirement if this cap is exceeded for NERL to halt distributions and to remedy the position.

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	48.8	52.7
Cash and cash equivalents and short term investments	102.2	83.7
Derivative financial instruments in designated hedge accounting relationships	0.2	0.2
	<u>151.2</u>	<u>136.6</u>
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	(797.2)	(798.3)
	<u>(923.7)</u>	<u>(911.5)</u>

Other financial liabilities at amortised cost include balances for trade and other payables (excluding accruals and deferred income), 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: loss of £22.2m).

Financial risk management objectives

The treasury function is mandated by the Board of NATS Holdings Limited 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 company. 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 company's activities include market risk (including currency risk, cash flow interest rate risk and inflation risk), credit risk and liquidity risk.

Market risk

The company'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 company 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 company's principal exposure to foreign currency transaction risk is in relation to UK en route services revenues, accounting for 83% of turnover (2011: 82%). 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 the company, forward foreign currency contracts are entered into. The company seeks to hedge 90% of the UK en route income that is forecast to arise by entering into forward foreign exchange contracts on a quarterly basis.

Contracts for the supply of goods and services with overseas suppliers who invoice in foreign currency are also entered into. 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 company'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	91.1	97.5	(3.1)	(6.2)
US Dollar	-	-	-	(0.1)
Canadian Dollars	0.3	-	-	(0.1)
Danish Krone	0.1	-	-	-
	<u>91.5</u>	<u>97.5</u>	<u>(3.1)</u>	<u>(6.4)</u>

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

18. Financial instruments (continued)**Foreign currency sensitivity analysis**

The company holds foreign currency cash balances of £9.5m (2011: £11.8m) at 31 March 2012 in Euro also balances in Canadian Dollars and Danish Krone.

The following table details the 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	1.9	1.4
Canadian Dollars	(0.1)	-
Danish Krone	-	(0.1)
	<u>1.8</u>	<u>1.3</u>

The company's sensitivity to the Euro increased during the year reflecting an increase in Euro denominated monetary assets and a net reduction in forward contracts taken out to hedge future receipts and purchase commitments. NERL believes that this sensitivity analysis accurately reflects its inherent foreign exchange risk as the exposure to foreign exchange risk was broadly constant throughout the reporting period.

Forward foreign exchange contracts

Forward foreign exchange contracts were entered into during the year to sell Euro forecast to be received from Eurocontrol in respect of UK en route revenues. In addition, NERL has entered into other forward foreign exchange contracts to fund purchases of equipment. These forward exchange contracts have been designated 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						
0-3 months	117.6	140.8	0.8354	113.0	132.4	0.8535
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>0.8537</u>
Euro bought	€m	£m		€m	£m	
0-3 months	2.5	2.1	0.8449	2.0	1.8	0.8691
Over 3 months	9.7	8.4	0.8622	6.8	5.9	0.8721
	<u>12.2</u>	<u>10.5</u>	<u>0.8587</u>	<u>8.8</u>	<u>7.7</u>	<u>0.8714</u>
Canadian Dollar bought	C\$m	£m		C\$m	£m	
0-3 months	0.6	0.4	1.6002	0.3	0.2	1.5584
Over 3 months	0.2	0.1	1.6330	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>
Danish Krone bought	DKK m	£m		DKK m	£m	
0-3 months	-	-	-	2.7	0.3	8.7063
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>

At 31 March 2012, the aggregate amount of the unrealised losses under forward foreign exchange contracts deferred in the hedge reserve relating to the exposure on these future transactions was £0.2m (2011: £0.5m unrealised loss). The bulk of these contracts will mature within the first three months of the next financial year at which stage the amount deferred in equity will be realised in the income statement for hedges relating to revenue expenditure or capitalised and depreciated for those relating to capital expenditure.

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 totalling £48.2m in respect of UK en route revenues. These contracts are also designated as cash flow hedges. They are not included in the table above.

Interest rate risk management

NERL 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 are kept under continuous review.

The company seeks to limit exposure to movements in interest rates by ensuring that it 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 policy is to reduce the proportion of debt that is fixed for borrowings of longer maturity as follows:

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

Exposure to interest rates on financial assets and financial liabilities are detailed below. The company held no interest rate swaps at 31 March 2012 (2011: none).

18. Financial instruments (continued)

The following table shows the percentage of fixed, index-linked and floating rate debt as a percentage of 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>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, the company 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 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. There would be an equal and opposite impact on profit and equity if interest rates fell by 1%.

	2012	2011
	Impact	Impact
	£m	£m
Cash on deposit (2012: 102.2m, 2011: £83.7m)	1.0	0.8
Borrowings (2012: £170.8m, 2011: £142.9m)	<u>(1.7)</u>	<u>(1.4)</u>
	<u>(0.7)</u>	<u>(0.6)</u>

Overall the company's sensitivity to interest rates has increased marginally in the year, reflecting increases in borrowing levels.

Inflation rate risk

The regulatory charge control conditions that apply to the company'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 this income, in August 2003 coincident with the issue of its £600m 5.25% fixed rate bond, the company 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 from December 2010 paid interest at a rate of 3.43% adjusted for the movement in RPI (prior to this date it paid interest at a rate of 2.98%). 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 basis to a 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 have been entered into.

The value of the notional principal of £200m of the index-linked swap is also linked to movements in RPI. From 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 the company 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	2011
	Impact	Impact
	£m	£m
Change in index-linked 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%.

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. The 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 company'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 tables below set 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 and 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 company's deposits at 31 March by credit rating (Standard & Poor's):

Rating (Standard & Poor's)	Number of institutions	2012		Number of institutions	2011	
		£m	By credit rating %		£m	By credit rating %
AA-	-	-	-	1	17.8	21.3
A+	5	65.9	64.5	4	38.8	46.3
A	5	36.3	35.5	2	15.4	18.4
A-	-	-	-	2	11.7	14.0
		<u>102.2</u>	<u>100.0</u>		<u>83.7</u>	<u>100.0</u>

Liquidity risk management

The responsibility for liquidity risk management, the risk that the company will have insufficient funds to meet its obligations as they fall due, rests with the Board of NATS Holdings Limited with oversight provided by the Treasury Committee. The company 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.

The 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 and fees scheduled for payment 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.£171.0m available until November 2012, and £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 refinanced its existing bank facilities on 15 May 2012 with a £275m loan facility. The new facility expires on 21 December 2016 and comprises a £245m revolving term loan facility and a £30m revolving credit facility.
- 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 shorter dated committed bank facilities (as referred to above).

The following table shows the ratio of free cash to average monthly UK en route service income receipts during the year:

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

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

	2012 £m	2011 £m
Bank borrowings	148.3	119.5
Gross borrowings	754.7	740.8
Bank borrowings as a percentage of gross borrowings	<u>19.7%</u>	<u>16.1%</u>

18. Financial instruments (continued)**Maturity of borrowings**

The following table sets out the remaining contractual maturity of 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 company can be required to repay. The table includes both interest and principal cash flows.

	2012				2011			
	Unsecured loans £m	Secured loans £m	Other liabilities £m	Total £m	Unsecured loans £m	Secured loans £m	Other liabilities £m	Total £m
Due within one year or less	0.4	210.6	42.5	253.5	1.4	49.1	57.5	108.0
Between one and two years	0.4	58.2	-	58.6	0.7	182.7	-	183.4
Due between two and five years	1.8	179.7	-	181.5	3.3	171.1	-	174.4
Due in more than five years	31.4	547.8	-	579.2	35.0	607.7	-	642.7
	34.0	996.3	42.5	1,072.8	40.4	1,010.6	57.5	1,108.5
Effect of interest, discount and unamortised bond issue costs	(11.5)	(269.0)	-	(280.5)	(17.0)	(298.7)	-	(315.7)
	22.5	727.3	42.5	792.3	23.4	711.9	57.5	792.8

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

The following table sets out the maturity profile of the 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 company'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	Between one and two years	Due between two and five years	Due in more than five years	Total
	£m	£m	£m	£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	127.8	0.5	-	-	128.3
Foreign exchange forward contract payables	(127.6)	(0.5)	-	-	(128.1)
	2.7	2.3	1.2	(138.8)	(132.6)
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	121.7	0.2	-	-	121.9
Foreign exchange forward contract payables	(125.7)	(0.2)	-	-	(125.9)
	(1.1)	2.7	6.5	(132.2)	(124.1)

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 in the majority of cases 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, forecast RPI inflation rates and is then discounted to its 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	48.8	52.7	48.8	52.7
Cash and short term investments	102.2	83.7	102.2	83.7
Derivative financial instruments				
Forward foreign exchange contracts	0.2	0.2	0.2	0.2
	151.2	136.6	151.2	136.6
Financial liabilities				
Trade and other payables, excluding accruals and deferred income	(42.5)	(57.5)	(42.5)	(57.5)
£600m 5.25% Guaranteed Secured Amortising Bond	(583.9)	(597.9)	(666.5)	(618.3)
Bank loans	(148.3)	(119.5)	(148.3)	(119.5)
Intercompany loan	(22.5)	(23.4)	(22.5)	(23.4)
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)
	(923.7)	(911.5)	(1,006.3)	(931.9)

19. Financial and other liabilities**Trade and other payables**

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

	2012 £m	2011 £m
Current		
Trade payables	11.1	21.2
Amounts due to other group undertakings	31.1	35.9
Other payables	0.1	0.4
Accruals and deferred income		
- deferred grants	0.4	0.6
- other	52.8	47.5
	<u>95.5</u>	<u>105.6</u>
Non-current		
Amounts due to other group undertakings	0.1	-
Other payables	0.1	-
Accrual and deferred income		
- deferred grants	3.5	3.9
- other	8.5	3.9
	<u>12.2</u>	<u>7.8</u>
	<u>107.7</u>	<u>113.4</u>

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 50 days (2011: 64 days). This increase reflects the reduction in operating costs incurred during 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.

20. Provisions

	Relocation £m	Other £m	Total £m
At 1 April 2011	6.6	0.1	6.7
Additional provision in the year	0.3	0.2	0.5
Release of provision in the year	(1.7)	-	(1.7)
Utilisation of provision	(3.6)	-	(3.6)
	<u>1.6</u>	<u>0.3</u>	<u>1.9</u>
At 31 March 2012			
			Total £m
Amounts due for settlement within 12 months			1.6
Amounts due for settlement after 12 months			0.3
			<u>1.9</u>

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 employees' relocation date.

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.

Redundancy costs are recharged by the company's parent through intercompany recharges and are not shown in NERL's balance sheet.

21. Deferred tax

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

	Accelerated tax depreciation £m	Retirement benefit (asset)/liability £m	Financial Instruments £m	Other £m	Total £m
At 1 April 2010	131.2	16.7	(13.5)	(3.2)	131.2
(Credit)/charge to income	(5.5)	7.3	(1.6)	0.9	1.1
Credit to equity	-	(14.6)	(0.3)	-	(14.9)
At 31 March 2011	125.7	9.4	(15.4)	(2.3)	117.4
At 1 April 2011	125.7	9.4	(15.4)	(2.3)	117.4
(Credit)/charge to income	(6.7)	11.5	0.2	0.9	5.9
(Credit)/charge to equity	-	(27.9)	-	0.1	(27.8)
At 31 March 2012	119.0	(7.0)	(15.2)	(1.3)	95.5

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:

	2012 £m	2011 £m
Deferred tax liabilities	(119.0)	(135.1)
Deferred tax assets	23.5	17.7
	(95.5)	(117.4)

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 2011 and 31 March 2012	10,000,000	10.0	10,000,000	10.0

23. Notes to the cash flow statement

	Year ended 31 March 2012	Year ended 31 March 2011
	£m	£m
Operating profit from continuing operations	200.7	123.5
Adjustments for:		
Depreciation of property, plant and equipment	71.6	74.1
Amortisation of intangible assets	17.9	10.9
Impairment loss	3.4	13.1
Deferred grants released	(0.6)	(1.4)
Loss on disposal of property, plant and equipment	1.0	0.3
Non-cash element of charge for pension costs	(44.4)	(32.8)
Operating cash flows before movements in working capital	249.6	187.7
Increase in trade and other receivables	(11.7)	(26.7)
(Decrease)/increase in trade and other payables and provisions	(19.0)	2.4
Cash generated from operations	218.9	163.4
Tax paid	(15.2)	(4.9)
Net cash from operating activities	203.7	158.5

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.

24. Financial commitments

	2012 £m	2011 £m
Capital commitments contracted but not provided for in the accounts.	69.2	71.1
Minimum lease payments under operating leases recognised in the income statement for the year.	6.3	6.5
At the balance sheet date the company had outstanding commitments to future minimum lease payments under non-cancellable operating leases, which fall due as follows:		
Within one year	6.4	6.3
In the second to fifth years inclusive	21.9	22.6
After five years	33.6	38.1
	61.9	67.0

Operating lease payments represent rentals payable by the company for certain of its properties, equipment used for air navigation, office equipment 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.

25. Retirement benefit scheme

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

The Civil Aviation 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 Ltd) 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 parent company 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' latest 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.

NATS Limited, the immediate parent of the company, is the employer of, and second to the company, all personnel who undertake the company's business. In that capacity, NATS Limited participates in the Civil Aviation Authority Pension Scheme and bears the employment (including pension) costs of those personnel.

The company pays fees to NATS Limited for the provision of services, including those of the staff. An element of those fees represents the employment costs (including pension contributions) of staff provided by NATS Limited to NERL. In that way, the existence of a pension deficit or surplus may have an indirect impact upon the company through variations in pension contributions and so the level of those fees.

Contributions to the pension scheme

During the year the company paid cash contributions to the scheme of £109.0m (2011: £94.0m). This amount included £11.9m (2011: £11.5m) 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 company 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, NERL's share being c. £1.5m, increasing these by 3.5% each January thereafter, under a deficit recovery plan agreed with the Trustees.

25. Retirement benefit scheme (continued)**Company's accounting valuation under international accounting standards**

The pension cost under IAS19: *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% S1PMA and 101% S1PFA 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% S1PMA and 101% S1PFA 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 respect of the defined benefit scheme are as follows:

	2012 £m	2011 £m
Current service cost	(90.4)	(82.1)
Past service cost	(2.2)	(4.5)
Expected return on scheme assets	159.2	145.7
Interest cost on scheme liabilities	<u>(131.2)</u>	<u>(120.3)</u>
Total defined benefit charge recognised in arriving at operating profit	<u>(64.6)</u>	<u>(61.2)</u>

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

	2012 £m	2011 £m
Actual return less expected return on scheme assets	(60.9)	79.8
Experience losses and gains arising on scheme liabilities	(2.6)	(20.9)
Changes in assumptions underlying the present value of the scheme liabilities	<u>(45.9)</u>	<u>(115.2)</u>
	<u>(109.4)</u>	<u>(56.3)</u>

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

	2012 £m	2011 £m
Fair value of scheme assets	2,573.1	2,433.8
Present value of defined benefit obligations	<u>(2,601.9)</u>	<u>(2,397.6)</u>
(Deficit)/surplus in scheme	<u>(28.8)</u>	<u>36.2</u>

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

	2012 £m	2011 £m
At 1 April	2,433.8	2,179.8
Expected return on scheme assets	159.2	145.7
Actuarial gains and losses	(60.9)	79.8
Contributions from company	109.0	94.0
Benefits paid	<u>(68.0)</u>	<u>(65.5)</u>
At 31 March	<u>2,573.1</u>	<u>2,433.8</u>

25. Retirement benefit scheme (continued)

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

	2012 £m	2011 £m
At 1 April	(2,397.6)	(2,120.1)
Current service cost	(90.4)	(82.1)
Past service costs	(2.2)	(4.5)
Interest cost	(131.2)	(120.3)
Actuarial gains and losses	(48.5)	(136.1)
Benefits paid	68.0	65.5
At 31 March	(2,601.9)	(2,397.6)

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

	Fair value of assets		Expected return	
	2012 £m	2011 £m	2012 %	2011 %
Equity instruments	1,369.4	1,278.3	7.10	7.35
Property and other assets	362.4	358.9	6.60	7.35
Bonds	771.2	753.5	3.45	4.70
Cash	70.1	43.1	3.45	4.70
	2,573.1	2,433.8	5.84	6.48

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 the company or debt instruments or any property occupied by, or other assets used by, the company.

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	(2,601.9)	(2,397.6)	(2,120.1)	(1,692.8)	(1,825.9)
Fair value of scheme assets	2,573.1	2,433.8	2,179.8	1,641.0	2,136.3
(Deficit)/surplus in the scheme	(28.8)	36.2	59.7	(51.8)	310.4
Experience adjustments in scheme liabilities					
Amount (£m)	(2.6)	(20.9)	164.0	33.1	73.7
Percentage of scheme liabilities	0.1%	0.9%	(7.7%)	(2.0%)	(4.0%)
Experience adjustments in scheme assets					
Amount (£m)	(60.9)	79.8	421.4	(653.6)	(129.8)
Percentage of scheme assets	(2.4%)	3.3%	19.3%	(39.8%)	(6.1%)

The actual return on scheme assets for the year ended 31 March 2012 was £98.3m (2011: £225.5m).

The estimated contributions expected to be paid to the scheme during the financial year ending 31 March 2013 is £106m, including salary sacrifice contributions estimated at £12m.

26. Related party transactions

The NATS group has four shareholders - the Crown, The Airline Group (AG), BAA Airports Limited and the NATS Employee Sharetrust Limited.

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 the AG have not exercised undue influence on the group or the company 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.

Trading transactions

	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 Ltd	-	0.2	0.1	-	-	-	-	-
Ministry of Defence (MoD)	46.5	45.1	5.0	3.5	4.9	4.7	7.8	4.3
Department for Transport (DfT)	3.1	0.4	-	-	-	-	-	-
Meteorological Office	-	0.4	0.6	0.7	0.4	-	-	0.1

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

Directors' remuneration

Remuneration payable to the highest paid director of the company in the year was £736,000 (2011: £698,000).

27. Parent undertaking

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

The company's ultimate controlling party is The Airline Group Limited a company incorporated in Great Britain and registered in England and Wales.

The largest and smallest group in which the results of the company are consolidated is that of which NATS Holdings Limited is the parent company. The consolidated accounts of NATS Holdings Limited can be obtained from the company's secretary, at its registered office, 4000 Parkway, Whiteley, Fareham, Hampshire, PO15 7FL.

28. Events after the reporting period

In May 2012, the Board declared an interim dividend for 2013 of £2.85 per share (totalling £28.5m) which was paid to its parent company in May 2012.

Also, in May 2012, the company agreed new bank facilities of £275m, which will expire in December 2016.