Chief Executive's review

Managing the impact of Covid and the uncertainty it created was the defining theme of the last financial year and continues to be our focus.

We responded quickly and effectively to restrictions caused by the pandemic, particularly in operational areas and found new ways of working during this period.

Restrictions on air travel to control the pandemic led to a 73% fall in the volume of flights we handled in the year. This significantly impacted our liquidity and our price control is now being redetermined by the CAA. However, the actions we have taken to maintain a resilient operation, support our customers, secure our long-term finances and reduce our cost base ensure that we are well placed to support the recovery in air travel. And in spite of the challenges we faced, we continued to demonstrate our capabilities by delivering a new digital tower service to London City Airport, implementing our intelligent approach tool at Toronto and Amsterdam airports and securing a new 10-year contract from Gatwick Airport from October 2022.

There is some unavoidable overlap in this report with the 2020 annual report and accounts, with the latter only issued in October 2020. In this standalone report we review the whole of the last financial year, comment on events up to publication as well as the near-term outlook and our strategic objectives, which were updated following Covid.

When it became apparent that the UK would be significantly affected by the virus in the first quarter of 2020, we established three urgent priorities: 1) protecting the health, safety and wellbeing of our workforce while maintaining a safe and resilient air traffic control service for our airline and airport customers; 2) preserving our liquidity in the face of a loss of income to ensure the viability of our business for all stakeholders; and 3) securing a revised regulatory settlement for RP3 which provides a balanced plan for dealing with a post Covid operating environment.

Our performance in respect of each of these is discussed below and in the relevant sections of the Business and Financial review.

Our workforce

It goes without saying that our first priority following the outbreak of Covid was to protect our workforce. Unlike many businesses for whom staff home working is feasible, our ATC service and related engineering activities cannot be delivered anywhere other than at our air traffic control centres or at airport towers. We ensured operational staff working from our two air traffic control centres, and at airports where we provide an ATC service, could do so under social distancing rules. We closed all non-critical training and simulations capability and stopped all but essential onsite maintenance and initiated working from home for all non-operational staff enabled by our digital workspace.

We established a Pandemic Working Group chaired by our Chief Medical Officer, Dr Rae Chang, which put in place the necessary arrangements to keep those on site safe and provide guidance and support to those working remotely on how to stay safe As a result we experienced very few cases of Covid across the workforce but where these did arise staff and managers responded quickly to contain any onward transmission. The Board and Executive also recognised early on for the need to support the emotional well-being of our staff, whether at work or at home. We conducted regular wellbeing surveys to enable us to gauge how best to support staff through this challenging period and put in place additional wellbeing services and employee assistance programmes to provide that support. Communication from the Executive team was further enhanced by methods such as Teams

Live events and Yammer chats to ensure staff felt well informed and supported.

Inevitably in the circumstances we also had to assess the size of the workforce and reduce that in line with demand where possible while preserving our ability to support the recovery in air travel.

Low flight volumes and the suspension of the capital investment programme resulted in large numbers of staff being furloughed under the job retention scheme, nearly 60% at the peak, helping us to reduce costs wherever possible. However we also had to overcome the complexity of ensuring that air traffic controllers maintained their validity when combining periods of furlough alongside attendances in a low traffic environment.

After a careful assessment of our future staffing we concluded there was no realistic scenario in which we would need further ab initio trainees until 2022 at the earliest. As a result, unfortunately we had to release a number of trainees. We did help some trainees find new roles within the organisation and we have maintained an outreach programme for those who left so that they can return when demand returns.

We also undertook a voluntary redundancy programme which saw nearly 400 staff leave the organisation. This only applied to non-operational staff to ensure that we preserved the operational staff skills to protect the recovery. On present forecasts we do not anticipate any significant recruitment until summer 2022 at the earliest.

As restrictions ease, with some signs of what we hope will be a recovery in air travel from this summer, we are well advanced in our plans for more agile ways for staff to balance home and office-based working ahead of the return to office life for non-operational staff.

In the face of the many challenges over the last year, I am immensely grateful to all our colleagues for the part they have played in maintaining the UK's essential ATC service during the pandemic and ensuring that we are soundly based to support recovery.

Impact of Covid

The clearest articulation of the impact of Covid on air traffic is the volume of flights in UK airspace since January 2020 as a percentage of 2019 levels (see figure 2).

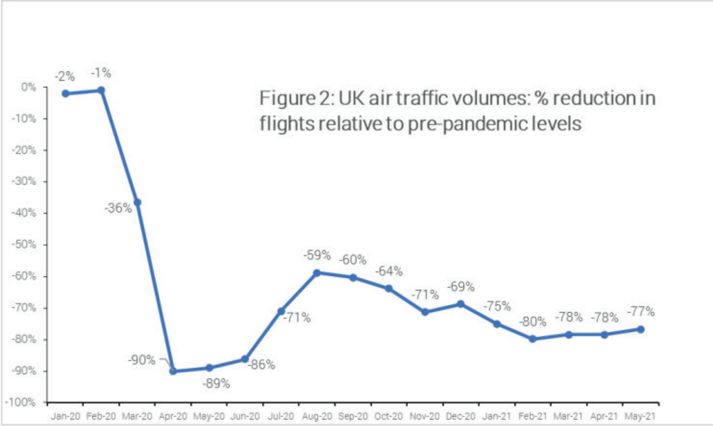


Figure 2: UK air traffic volumes: % reduction in flights relative to pre-pandemic levels

Following the restrictions in air travel in March 2020 and the first national lockdown, airlines grounded most of their fleets in April and May. As restrictions gradually eased in June and July there was some recovery to 40% levels by September before this reversed as tiered restrictions were introduced in October followed by a second lockdown in November for England alongside circuit-breakers in other home nations. The emergence of a new variant of Covid in December led to more countries banning air travel from the UK and traffic volumes remained at around 20% following the third national lockdown later that month. We have seen only a slight pick-up since 17 May 2021, given the limited number of destinations on the green list so far but we are well prepared as further destinations are approved.

The reduction in flight volumes resulted in much lower receipts from en route charges prompting us to take rapid action to preserve liquidity by reducing costs and pausing capital investment, except for critical sustainment activity, for a six-month period.

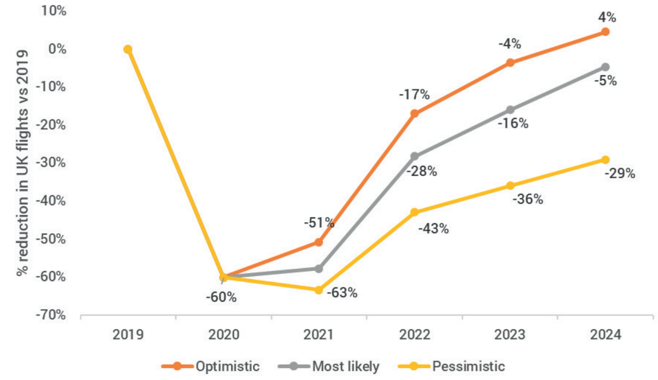
Our economic regulatory framework provides a defined level of protection from traffic shortfalls enabling these to be recovered through subsequent charges, as appropriate for critical national infrastructure which is required to be available at all times. However, the scale of the reduction of air traffic has been unprecedented. Covid emerged during the period when the CMA was considering the referral of the CAA's price control decision for RP3 (2020-2024). The CMA decided that its impact would be too difficult to assess properly as part of its determination and that the CAA should review these matters when better information was available. The CAA will now be reassessing years 2020 to 2022 (see below) and will determine a new 5-year price control from 2023 when there should be more certainty on the shape of the recovery of air travel.

Preparing for a recovery in air travel

Covid is not going away easily and with countries at different stages in their vaccine programmes or dealing with surges in infection rates and new variants we can expect travel restrictions to be eased at different rates. This means that airline flight schedules are likely to be subject to uncertain and intermittent demand and requiring frequent amendment. In addition a number of logistical issues still need to be addressed such as waiting times at UK airports for arriving passengers. All of this mean that we cannot be certain of the volumes to expect this summer.

This continuing uncertainty is borne out by the scenarios underlying the latest outlook (May 2021; figure 3) from Eurocontrol, Europe's air traffic control network manager, which plots different paths to recovery based on vaccine progress and by States adopting consistent and coherent

Figure 3: Eurocontrol 4-year forecast scenarios
% reduction on 2019 flights



measures to support the aviation industry and ensure that passengers feel safe to fly again. The most likely forecast scenario indicates traffic at 95% of 2019 levels by 2024. However, it is clear from discussions with our customers and other stakeholders that we must not be a brake on any potential recovery of the sector and therefore for this summer we have planned our service to handle traffic volumes at up to 75% of 2019 levels. This will ensure we can handle peak demand and provide capacity if and when more destinations are approved, anticipating that airlines will be able to respond to pent up demand very quickly. While we do not know which additional routes may open, assuming that routes and schedules are not dissimilar to 2019, we will be able to handle this level of traffic with current social distancing measures in place in our operations rooms if required.

Our pause last summer in capital investment enabled us to engage with customers and other stakeholders on the options open to us to reshape our capital programme to support their priorities post Covid while delivering a resilient and safe service into the future. Customers endorsed the continued need to invest in new systems to support our operations including our En Route and Voice programmes which are central to our SESAR[4] commitment, initially providing new controller tools and capabilities to our operation and delivering a single, modern common technology platform. Our short-term focus for the 2021 calendar year is to operate our new systems for short periods during low traffic volumes before a full transition in 2023, along with the first trial of our main voice system and operational deployment of our second voice communications system.

London City Airport goes digital

In January London City became the first major commercial airport in the UK to switch its air traffic control provision from a visual control room based at the airport to a digital tower, which is operated from our Swanwick centre. This marks a significant achievement for the airport and for our business. In normal times delivering a project of this scale and complexity would have been a significant achievement. That this was delivered during the pandemic makes it even more impressive.

On a related note, our joint venture, Searidge Technologies, won a commercial bid to provide a digital tower for the Hong Kong International Airport Authority. This contract will position them very strongly in the digital tower market for large airports.

Our role in a sustainable future

Airspace modernisation, particularly around London and the south east where carbon inefficient flight paths and aircraft holding are most prevalent, will play an important part in the industry's decarbonisation plan and will be a focus for us and our customers in the next few years. We welcome the government's pledge of £5.5m to support airport operators with their airspace modernisation projects, which were put on hold due to Covid. This will help to ensure this critical programme of work for the future of UK aviation can start up again.

Covid has fundamentally changed so much in our day to day lives, but the pandemic has not downgraded the imperative of addressing the climate emergency across all areas of our economy and society. We had already, pre-Covid, committed to play our part in aviation's roadmap towards decarbonising aviation by 2050 and that pledge remains. Discussions within the industry and with other stakeholders on the restart of aviation have emphasised using this opportunity to focus on environmental performance and there is no doubt that we have to take specific action to reduce the environmental impact of aviation in the coming decade to avoid our industry becoming socially unacceptable and misaligned with the UK's commitments on climate change.

One of our responses to this challenge has been to put in place programmes and targets that will reduce carbon emissions from operating our business to zero by 2035. Clearly, this will mean a significant shift in emphasis for all of us in the company towards ensuring our day to day activities align with this objective.

When it comes to the operational impact of aviation, zero carbon solutions for flight are still a long way off and until then there will inevitably have to be a balance between the environment and air traffic capacity. We will continue to focus on enhancing the sustainability of our service while still meeting the capacity requirements of our customers.

To support the industry with its roadmap to decarbonising by 2050, we have made our 3Di environmental insight tool freely available to aviation stakeholders to use to track their carbon efficiency. We developed 3Di in 2012 when we became the first air traffic service provider to be financially incentivised on our environmental performance. It has enabled us to measure the efficiency of all flights in our airspace and identify improvements. We have prepared a technical guide to the use of 3Di and provided technical webinars for stakeholders interested in using the tool to support their work to deliver emissions reductions through more fuel efficient flight profiles. We hope sharing this technology and experience might help others to identify improvements in their own operations. Climate change is an existential threat, and such near-term action is needed ahead of more fundamental downstream changes in technologies which might offer sustainable aviation solutions.

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As the Chairman has explained, we disagree with the CAA's findings that NERL was in breach of its licence as a result of staffing delay in 2019 and early 2020. However, as we now recalibrate our business plan ahead of the redetermination of the price control from 2023, we will consider the extent of additional resilience we require and we will be looking to the CAA for clear guidance on service performance targets at the network level and an updated approach at a sector level as well as more financial flexibility to meet operational resourcing needs. This is necessary to ensure that we are able to support a recovery in air traffic which will inevitably have more peaks and troughs in demand across our network than pre-pandemic as travel restrictions are lifted and airlines and airport operators respond accordingly.

Concluding remarks

My hope is that this time next year I will be able to report that the worst of the pandemic is behind us and that alongside our stakeholders we have been able to return our focus to meeting a growing demand for international travel, modernising airspace and delivering on our environmental commitments.

The immediate priority is for the recovery in air travel and we are well placed to support this. We have retained the essential skills required and reduced our cost base and strengthened our liquidity, which will support in delivering a safe and resilient service as the industry recovers.

This is also an opportunity to build back better and we recognise we play an important role in delivering a more sustainable future alongside the industry. This must be accompanied by a new price control that provides the right level of resources to deliver the operational service, technology change and airspace modernisation to meet stakeholder priorities.

As I have said before, we provide an essential public service and we are resolutely committed to delivery of our strategy to advance aviation and keep the skies safe in the interests of all stakeholders.

Martin Rolfe, FRAeS

Chief Executive