Flybe Group Limited

Annual report and consolidated financial statements

Registered number 1373432

31 March 2008

Contents

Chairman's statement

1. Overview

I am delighted to report on a transformational year for Flybe - a year in which we became one of Europe's largest and most profitable regional airlines

The key highlights were

- Profit before tax of £35 4 million, as adjusted to exclude net exceptional, integration and restructuring costs of £5 0 million ('adjusted profit before tax')
- Growth in turnover of 45 8% to £535 9 million
- Growing the passenger volume to 7 0 million passengers
- Growing ancillary revenues per passenger by 30% to £7 97
- Continued rationalisation of our fleet towards achieving the two fleet strategy
- Successful integration of BA Connect into Flybe, and cost savings and synergy benefits delivered in line with target

In addition to the highly complex challenge of integrating BA Connect, Flybe faced some considerable external challenges during the year such as the doubling of the Government Airport Departure Tax in early 2007, the security attack on one of the key regional airports, Glasgow, the reduction in discretional spend available to the consumer, and the unprecedented rise in the cost of jet fuel

Taking all of these factors into consideration, delivering record results in the year of integrating BA Connect is an outstanding achievement

2. Financial performance 2007/08

Profit and loss account

During the year in which we successfully integrated BA Connect, Flybe delivered its best ever financial performance

- Increased passenger volumes from 5 2 million to 7 0 million
- Turnover increased from £367 5 million to £535 9 million
- Cost of sales, excluding net exceptional, integration and restructuring costs of £5 5m (*2006/07 £10 9m*), increased from £311 8 million to £444 5 million
- Gross profit, excluding net exceptional, integration and restructuring costs, of £91 4 million (*2006/07 £55 7m*), giving a gross margin of 17 1% (*2006/07 15 1%*)
- Operating profit for the year, excluding net exceptional, integration and restructuring costs of £7 4 million (*2006/07 £12 5 million*), rose from £17 6 million to £38 2 million, an operating margin of 7 1% (*2006/07 4 8%*)
- After net exceptional, integration and restructuring costs, operating profit was £30 8 million *(2006/07 £5 1 million)*
- Net interest paid in the year was £2 9 million (*2006/07 £2 3 million*)
- Adjusted profit before tax of £35 4 million, compared with an adjusted profit of £15 3 million in the previous year, an improvement of £20 1 million

Chairman's statement *(continued)*

- After deducting net exceptional, integration and restructuring costs of £5 0 million, profit before tax was £30 4 million *(2006/07 exceptional and restructuring costs £31 5 million, leaving a loss before tax of £(16 2) million)*

- There was a deferred tax credit of £4 5 million for the year *(2006/07 charge £(3 7) million)*, leaving a profit after tax for 2007/08 of £34 9 million *(2006/07 loss after tax £(19 9) million)*

Cash reserves

Our cash reserves at the end of the year stood at £67 4 million, a decrease of £68 8 million on the 31 March 2007 balance of £136 2 million However, the March 2007 balance included £96 0 million of cash funding received from British Airways upon the acquisition of BA Connect (on 5 March 2007), which was intended to cover specific commitments relating to operating cost inefficient 50-seat jets, retirement of aircraft and other restructuring matters

As set out in the Financial Review, we generated cash from underlying operations of £46 3 million during the year As expected and planned, we incurred integration and restructuring costs of £77 0 million – these costs were fully funded in cash from British Airways as part of the BA Connect acquisition We also had net expenditure on fixed assets and financing of £38 1 million, including £4 2 million on our new base maintenance premises, Hangar 1 New Walker Hangar and £8 4m for the redemption of preference shares

It is now six years since we changed the business model to Flybe from the legacy regional airline, British European During this time, we have been given constant support by our majority shareholder, the Walker Trust ('the Trust')

Prior to 2002, on behalf of the airline, the Trust acquired 5 112-seat BAe146-300 series aircraft to facilitate the airline's growth, leasing the aircraft to the airline In 2001/02, the industry endured the effects of the September 11 terrorist attacks and the airline suffered from the low cost airline entry into the UK domestic market This combination of events led to the Trust needing to inject £22 5 million into the business (by way of preference shares) - since that time they have also provided the capital funding required to develop the new hangar facilities at our maintenance base in Exeter

I am delighted to report that, in May 2008, we completed the final £14 1 million redemption of preference shares and have as a result repaid all funding provided by the Trust, including the BAe146 aircraft and Hangar 1 This was a landmark achievement for the 'New' Flybe - I congratulate the management team for this achievement, and once again thank the Trust for their unstinting support

3 The 'New' Flybe

Regional airline

We believe the business model which Flybe has created is unique and quite distinct from low cost or legacy airlines Flybe is now a substantial niche airline and has become one of the largest and most successful regional airlines in Europe

Our core strategies of network, product and brand positioning are driven by a clear segmentation of our target market, serving regional and island communities Approximately 80% of our routes cross water and none of our routes have a surface journey equivalent of less than 3 hours Both of these factors contribute to making surface travel an unlikely competitor

In the regional communities, Flybe is considered a necessary form of transport, enabling quick and efficient communications for business and social reasons, as opposed to a discretional travel provider which is the primary role of many other carriers

The majority of our customers travel with us regularly, and consequently our network has been designed with a very high frequency bias Over 80% of capacity is deployed on frequencies of 2 or more per day, with approximately 50% on 4 or more flights daily A small proportion of capacity (less than 16%) is dedicated to the discretional and very price sensitive traveller on frequencies of 1 a day or less

Chairman's statement *(continued)*

Following the acquisition of BA Connect, Flybe's market presence has spread considerably, including substantial growth in the North West of England and continued growth in our network to and from Scotland In addition, the airline now has a significant network from the UK regions to the major commercial centres of Europe, serving 33 European airports in 2007/08

Key differentiators

As a result of the majority of our customers being regular travellers with us, the airline has placed a great emphasis on delivering a high standard of customer service There is also a product designed specifically for the business traveller which offers many features required by this sector of the market, including access to executive lounges at most airports, greater ticket flexibility and a larger weight allowance for checked-in and hand luggage

In 2002 Flybe, unlike the major low cost airlines, retained its association with the travel trade and also the global distribution systems ('GDS') used by travel agents and airlines around the world Consequently we have ensured that every potential customer can access a Flybe flight either using the internet or GDS from anywhere in the world In addition, Flybe retained a sales force which was dedicated to service the needs of commercial users and agencies This has proved extremely beneficial in helping retain the former BA Connect corporate customer base

All of these features have proved very important in developing the former BA Connect routes, where many of the European markets were new to the Flybe product and brand

Resilience

At a time of considerable uncertainty in the airline sector and the economy generally, we believe many of the features referred to above give Flybe a greater degree of resilience than those airlines whose revenues are more heavily dependant upon the discretional traveller

4. Operational review

i) The integration of BA Connect

The acquisition of BA Connect was an ambitious and significant strategic step for Flybe 18 months on, it is clear that this was a transformational acquisition which has enabled Flybe to become one of Europe's largest and most profitable regional airlines

The key objective was to use the opportunity of making the combined business a much stronger airline by undertaking a comprehensive review of the cost base and networks of the two airlines and removing significant uneconomic capacity – over 20% of the combined network This rationalisation in 2007 in the regional marketplace, a year ahead of the downturn in the macro-economic environment, has left Flybe well placed to prosper in the current market conditions

Despite this reduction of the combined capacity, Flybe is now a much larger airline, and in 2007/08 it operated 168 routes from 23 UK and 33 European airports and over 470 flights each weekday Flybe is now the leading UK domestic regional carrier with over 35% of the domestic market outside of London

Through the strength of its profit, passenger base, route network and cash reserves, Flybe is a much stronger and more resilient airline as a result of the acquisition of BA Connect

Chairman's statement *(continued)*

There were five key objectives we set for the integration of BA Connect in 2007/08, namely

a) Deliver synergy benefits of circa £40 million

During the lengthy due diligence phase of the acquisition, the management team gained a very comprehensive understanding of BA Connect and identified clear cost saving and synergy plans which could be put into action immediately in order to ensure this key objective was met

We took the difficult decisions to close the Isle of Man maintenance base and finance function, the Head Office at Manchester and the Operations Centre at Birmingham

The integration review resulted in the removal of various uneconomic routes including the entire Bristol base, which suffered from heavy losses Over 20% of the combined Flybe and BA Connect capacity was removed in the first year after acquisition

The other cost considerations included negotiation of better airport discounts through the greater combined volumes of passengers, the re-negotiation of various supplier contracts, and the application of the Flybe business model and operating procedures

In addition, it was recognised that the application of Flybe's ancillary revenue programme to the former BA Connect operations would generate significant additional revenues

However, we also identified there would be the need for some cost escalation We invested significant funds into the development and strengthening of our Human Resources function We recognised that growing the staff from 1,700 to 3,000, with the associated and complex restructuring requirements, would need considerable investment We also appreciated that we would need to review some aspects of the terms and conditions of various work groups

The targeted net benefit from cost savings and synergies of circa £40 million has been achieved, turning a combined pro forma loss for Flybe and BA Connect in 2006/07 of £29 million into a profit in 2007/08 (before negative goodwill amortisation, and integration and restructuring costs) of £10 million

b) Retain the former BA Connect customer base

A potential business risk was the loss of passengers who had been used to travelling under the British Airways brand and its associated product portfolio, and who might resist flying under the Flybe brand with its quite different product

A great deal of effort was made across the company to ensure the risk of this was minimised

I am pleased to report that on those routes where BA Connect operated in isolation from Flybe, we not only retained the passenger volumes but also achieved slightly higher net revenues

c) Retain former BA Connect staff

There were a large number of highly experienced, well trained and professional staff within BA Connect and it was important that as many of these staff as possible were retained, whilst understanding the need for fundamental changes to some of the operating practices to which many staff had been accustomed

However we also realised that Flybe would need to review its terms and conditions in order to meet the needs of both the combined staff and the financial objectives of the business There were many discussions and meetings with the various unions and staff associations during this process and it is a credit to all of those involved that the transition has gone so smoothly Many staff gained from the acquisition in terms of earnings, revised work practices, promotion prospects, career development and long term job security Some challenges still remain in this area but I acknowledge with great thanks the efforts, co-operation and very positive attitude of the 3,000 staff employed by Flybe

Chairman's statement *(continued)*

It was also recognised that the closures of the various departments would result in up to 500 redundancies with the company taking every possible opportunity to assist in their re-employment In the event, 492 staff were made redundant

It should be noted that all former BA Connect staff had to be retrained onto Flybe's operating procedures This enormous task was completed on time under the supervision of the regulatory authority, the Civil Aviation Authority This was a remarkable achievement and is testament to the dedication and professionalism of the staff and management

The newly strengthened Human Resources department under the direction of Simon Charles was key to managing this process of integration

d) Dispose of the 16 owned 50-seat jets

The operation of 50-seat jets simply does not work financially within the Flybe business model and it was stated from the outset that the 28 Embraer 145 ('E145') 50-seat jets operated by BA Connect (16 owned, 12 leased) would be substituted with the Bombardier Q400 turboprop aircraft as soon as possible

As part of the acquisition negotiation, Flybe had ensured that there would be a very low financial risk in the disposal of the 16 owned E145s, with British Airways providing £34 million in guaranteed funding to cover the anticipated shortfall arising from declining market values of these aircraft I am pleased to report that the entire fleet of 16 owned aircraft were sold within 4 months of the acquisition under a sale and lease back arrangement at a price within the cash support provided by British Airways

The entire E145 fleet is now held on operating leases and these aircraft will be returned as they are replaced with the planned Q400 aircraft deliveries The programme will be completed by October 2009 at which time our fleet composition will be 60 Bombardier Q400 and 14 Embraer 195 aircraft, with an average fleet age of less than 3 years

e) Enhance Flybe's product offering

The Flybe product was already different from the low cost airline model in that we offered a product tailored specifically for the business traveller – flexible tickets, lounge access, frequent flyer programmes and preferential service standards

However it was recognised that the customer base had changed considerably as a result of the BA Connect acquisition, with a significantly higher proportion of business travellers During the year, we have therefore developed the product offering further by introducing 9 new executive lounges at key airports, a computerised frequent flyer programme, on-line seat selection and check-in, and self service check-in kiosks supported by dedicated customer service staff at key airports

The integration of the two businesses resulted in substantial alterations at the various outstations, with changes in contractors, facilities and in some cases, moving to new terminals

This was an intensive period of change and product upgrade and my thanks go to all the teams involved

ii) Safety

Safety is our prime concern and the responsibility for this rests with each and every employee irrespective of their role or position

The overview of safety is managed through the Safety Committee which is chaired by Peter Smith, one of our Non-Executive Directors who has considerable aviation experience Peter is supported on the Safety Committee by another Non-Executive Director, Alan Smith

Currently, with over 500 departures every weekday there are various issues, of differing degrees of severity, which need to be dealt with on a daily basis The various departments, management teams and supervisory committees have managed the process in a highly professional manner and have minimised the inconvenience to our customers as much as possible

Chairman's statement *(continued)*

iii) Fuel prices

Clearly the current high price of jet fuel has placed enormous pressure across the industry, including Flybe It is the volatility as much as the price itself which has proved so problematic to the airline industry

I am pleased to report that the significant investment in new aircraft combined with a clear hedge strategy has reduced the impact on Flybe of this unprecedented increase in the cost of fuel

The decision to invest in the new fleet of 78-seat Bombardier Q400 and 118-seat Embraer 195 aircraft has provided significant benefits in terms of reduction in fuel burn This improved efficiency will continue through the fleet substitution programme, which will be completed in 2009/10 If, in 2007/08, we operated the same fleet as we had in 2002, our fuel burn would have been 28% higher, with an increased fuel cost of circa £33 million

At $1,250 per tonne, fuel represents less than 25% of our total costs, and we believe this to be one of the lowest percentages of any airline

With regard to our hedging policy, our objective is to smooth the cost of fuel and to de-risk the cost escalation as far as possible, thereby enabling the Commercial team to price our product before the selling season commences The Fuel Committee will continue to monitor the effectiveness of its policies and to benchmark these against our competitors

iv) Loganair franchise

In January 2008, we announced an agreement for Loganair to become our first franchise partner

Loganair was founded in 1962 and has become the quintessential Scottish brand With 340 employees, headquartered in Glasgow and serving Scotland's Highlands and Islands as well as Northern Ireland and Dublin, Loganair has operated under a BA franchise since 1994 with 0 5 million passengers carried on 26 routes from 16 airports with 15 aircraft Tickets under the new agreement went on sale from July 2008 and Loganair will begin flying in Flybe colours from the start of the 2008 Winter Season on 26 October 2008

The deal will provide significant profitability for Flybe and opens up an extended network to Loganair passengers

Once operations commence in October, the franchise will mean that, in Scotland, Flybe will have 55 routes, carry 3 0 million passengers and become the 2nd largest airline in Scotland

5 The Board and management organisation

Andrew Knuckey, Chief Financial Officer and Mike Rutter, Chief Commercial Officer were appointed to the Group Board in April 2007

The other executive members of the Group Board are Mark Chown, Deputy Chairman and Director of Corporate Strategy and Andrew Strong, Chief Operating Officer The Executive team had worked together previously on the Operating Board and I greatly appreciate the very considerable efforts they have made individually and collectively to ensure we deliver our objectives

This is the second year of working with four independent Non-Executive Directors who were recruited in 2006 I would place on record my sincere thanks and appreciation for the support, guidance and challenges they offered to me and my fellow Chief Officers I have no doubt that we are a better managed company through their efforts and contributions

Simon Charles, Director of Human Resources, has made a very positive contribution to the company through his efforts and role on the Operating Board The integration would have been much more challenging and less successful had it not been for Simon and his new team

I am very pleased to report that Mark Elkins, who has been a key figure in the development of our IT strategy and function within Flybe for many years, has been appointed as Director of IT This is an excellent example of career progression within Flybe and I am confident that Mark will make a very positive contribution to the Operating Board

Chairman's statement *(continued)*

I am delighted to say that at the 2007 International Air Show in Paris, the management of Flybe were awarded the much coveted prize of 'Management Team of the Year' by Flight International, a magazine highly respected throughout the international aviation industry

6 Corporate and social responsibility

i) Staff training and development

With over 3,000 staff, many of whom fulfil highly technical and safety related roles, it is essential that Flybe operates a very high standard of skills training The training function has been developed over many years by individual departments and we now plan to bring this together into a new Training Academy to be located at Exeter This will ensure substantial benefits in terms of quality of training and overall costs of delivery

The Training Academy is working closely with Government departments and both Exeter University and Exeter College to develop long term training for all staff

The company is participating in recent Government initiatives to develop Skills Training and Vocational Training Awards Flybe fully supports the principle that vocational training is key to the personal development of all staff, and believes that such training should be recognised across all industry and commerce as having a similar value to academic achievements

In order to achieve this 'currency' in vocational training, all such training must be undertaken to an established and recognised standard, with formal auditing to ensure consistent delivery of such standards The official body which has been given responsibility for overseeing this by Government is the Quality and Curriculum Authority ('QCA'), which currently undertakes this role throughout the educational system in England up to and including A-level academic qualifications

I am pleased to report that the QCA has audited Flybe's Training Academy and has recognised the standards being delivered by awarding the Academy the status of being able to train and award vocational qualifications up to and including a Vocational Degree

Flybe was the first non-academic training establishment within the UK to be awarded this status

Although this new scheme is at an early stage in its development programme, we fundamentally believe in vocational training for all employees and it is our determined commitment to ensure that staff are assisted and encouraged to enter such a training scheme

ii) Environmental responsibilities

Flybe acknowledges that it has a responsibility to minimise the impact our aircraft have on the environment We recognise the concerns of local communities who live adjacent to regional airports in terms of noise generated from aircraft movements and also the impact on the environment through the amounts of carbon emitted during flight

Flybe has minimised its impact by investing over £1 billion in a new fleet of aircraft which offer the combination of low noise emissions and low fuel consumption

Flybe was the first airline on the world to introduce an 'Ecolabel' for its aircraft which has been designed to provide customers with a range of information regarding the noise and carbon emissions for each flight The label identifies the noise rating and also the emissions made during the normal take off and landing cycle of a flight and also the carbon emissions for the total flight based on a range of distances The procedure adopted has been subject to an independent assurance process by Deloitte & Touche

The concept of an Ecolabel was first introduced to consumers on a broad base in the white goods industry and more recently in the car industry We hope that other airlines and aircraft manufacturers will adopt this scheme Indeed, in February 2008, the House of Commons Treasury Select Committee urged other airlines to follow Flybe's lead in this field of providing information to consumers regarding the environmental impact of their flight

Chairman's statement *(continued)*

Flybe continues to pursue other environmental issues in addition to minimising its aircraft emissions through good practices in our aircraft maintenance and general facilities

7. Summary

As can be seen from the details of this annual report, the financial year to March 2008 has been a transformational one for Flybe

Flybe is now a strong, resilient and defensible business It is one of the largest and most profitable regional airlines in Europe and has become a leader in its sector

The management and staff have demonstrated their capability and willingness to deal with significant challenges during the last year I would like to place on record my sincere thanks to everyone for their magnificent efforts in delivering a substantial financial result and a very successful integration

There are undoubted challenges facing the airline industry this year due to record fuel prices and serious concerns over the economy Whilst Flybe is not immune to these very significant challenges, we believe we are better insulated than many of our competitors through the combination of the strength of the brand, the nature of our route network where over 80% of the routes cross water and 80% of the capacity is targeted towards business and other regular travellers (and less than 16% targeted towards the leisure sector), a very fuel efficient and modern fleet, and a mature hedging policy for both fuel and foreign currency

Our task will be to ensure that Flybe remains competitive and profitable during the coming year and is well placed to maximise the opportunities which will surely come as the industry enters a period of consolidation

Jim French
Chairman and Chief Executive Officer

3rd September 2008

Financial review

Flybe achieved record results in the year to 31 March 2008, recording an underlying profit before tax of £35 4m, 131 4% higher than 2006/07, equating to a profit per seat of £3 29, compared with £1 96 in 2007/08 In my comments below, I have provided financial information in a revised format to provide a better indication of overall financial performance and to reflect how the business is managed and measured on a day-to-day basis

1. Summary profit and loss account

	2007/08 £m	*2006/07 £m*	*Change %*
Passenger revenue	451 3	308 4	46 3
Ancillary revenue	52 7	30 2	74 5
Other revenue	31 9	28 9	10 4
Turnover	**535 9**	**367 5**	**45 8**
Operating costs	(436 7)	(312 9)	(39 6)
Underlying EBITDAR **	**99 2**	**54 6**	**81 7**
Ownership costs	(63 8)	(39 3)	(62 3)
Underlying profit before tax*	**35 4**	**15 3**	**131.4**
Integration and restructuring costs	(5 0)	(31 5)	
Profit/(loss) before tax	**30 4**	**(16 2)**	
Taxation	4 5	(3 7)	
Profit/(loss) for the year	**34 9**	**(19 9)**	
Underlying EBITDAR margin**	***18.5%***	***14 9%***	***24 2 %***
Underlying profit before tax margin*	***6.6%***	***4.2%***	***57 1%***
Key performance indicators			
Profit before tax per seat (underlying) (£)*	*3 29*	*1 96*	*67 9*
Profit/(loss) before tax per seat (headline) (£)	*2 83*	*(2 08)*	*n/a*
Revenue per seat (£)	*49 85*	*47 12*	*5 8*
Cost per seat (£)	*46 56*	*45 16*	*(3 1)*
Cost per seat excluding fuel (£)	*38 63*	*38 14*	*(1 3)*
Output measures			
Seats flown (millions)	*10 7*	*7 8*	*37 2*
Passengers (millions)	*7 0*	*5 2*	*34 6*
Number of aircraft owned/leased at end of year	*80*	*81*	*(1)*
Sectors (thousands)	*144 0*	*90 0*	*60 0*
Flight hours (thousands)	*137 4*	*84 5*	*62 6*

*Underlying financial performance excludes the effect of net exceptional, integration and restructuring costs of £5 0m (*2006/07 £31 5m*)

**Underlying EBITDAR is made up as follows

	£m	*£m*
Operating profit pre net exceptional, integration and restructuring costs	38 2	17 6
Depreciation of tangible fixed assets	16 2	11 6
Aircraft operating lease rentals	44 8	25 4
	99 2	54 6

Financial review *(continued)*

Turnover

Passenger revenue

Passenger revenue grew 46 3% to £451 3 million, largely as a result of the acquisition of BA Connect with the resulting increase in seats flown from 7 8 million to 10 7 million A small reduction in load factor (predominantly due to lower load factors on BA Connect acquired routes) meant that total passengers increased by 34 6% to 7 0 million The majority of this growth was in (a) the UK domestic market and (b) UK regional to European city routes

Average passenger yields in the year increased by 6 7% per seat to £42 18, or 8 7% per passenger to £64 47 This primarily reflects the higher proportion of business orientated routes now operated, following the acquisition of BA Connect

Flybe has a dedicated revenue management team who monitor occupancy levels and ticket yields on every flight an a real-time basis This enables us to maximise the profitability on each flight and also to minimise the risk of loss-making flights and routes

Ancillary revenue

Ancillary revenues have continued to contribute significantly to our profit improvement Total ancillary revenues increased by 74 5% to £52 7 million, or £1 91 to £7 97 per flown passenger The biggest contributor to this improvement was the introduction of our ancillary revenue business model on the former BA Connect routes

Other revenue

Other revenue predominantly comprises third party turnover generated by our base engineering facility, based in Exeter

Costs

At Flybe, a key part of our financial strategy is to continue to manage our cost base and improve unit cost efficiencies

As expected, total costs per seat increased in the year by 3 1% to £46 56 This anticipated increase was due to absorbing the higher cost base of BA Connect (acquired in March 2007), in particular its cost inefficient 50-seat jets – our average seats flown per sector reduced from 87 in 2006/07 to 75 in 2007/08 Importantly however, on a like for like basis, if we compare our 2007/08 costs per seat to a pro forma combined unit cost for Flybe and BA Connect in 2006/07, total costs per seat have decreased by 10 9% Our planned fleet substitution programme will present us with further opportunities to reduce our costs per seat in future years

We also focus on unit costs excluding fuel, because the significant volatility in Flybe's fuel cost is largely dictated by external economic and political factors On this basis, total costs per seat excluding fuel increased by 1 3% to £38 63 (for the reasons outlined above) As above, if we compare our 2007/08 costs per seat excluding fuel to a pro forma combined unit cost (excluding fuel) for Flybe and BA Connect in 2006/07, total costs per seat have decreased by 10 6%

Flybe's total costs for 2007/08 are reduced by amortisation of negative goodwill of £25 2m (2006/07 £2 0m) Negative goodwill of £44 8m arose on the acquisition of BA Connect, and primarily this represented cash funding provided by British Airways as compensation for operating cost inefficient 50-seat jets until fully substituted by 78-seat turbo-props Negative goodwill will be fully amortised upon completion of this substitution, which is scheduled for the summer of 2009 The profit and loss credit arising from the amortisation of negative goodwill provides a contribution towards the additional seat costs (of c£15 per seat) of operating 50-seat regional jets rather than 78-seat turbo-props

Financial review *(continued)*

Over the next year, our fleet substitution plan provides the main opportunity for unit cost savings Our operating fleet at 31 March 2008, and that planned by October 2009, is as follows

Aircraft type	*31 Mar 08 Actual*	*31 Oct 09 Planned*
Bombardier Q400 turboprops – 78 seats	37	60
Embraer 145 regional jets – 49 seats	23	-
Embraer 195 regional jets – 118 seats	10	14
BAe 146-300 regional jets – 112 seats	1	-
	71	74

This represents a planned increase in seat capacity of 19 4% over the 20 month period Most importantly, every substitution of a 49-seat regional jet with a 78-seat turbo-prop gives us a 59% increase in seats at a significantly lower variable unit operating cost

We continue to review all areas of costs, with the target of continuing reductions in overall costs per seat

2. Summary balance sheet

	2007/08 £m	*2006/07 £m*	*Change %*
Fixed assets			
Airport slots	7 6	-	n/a
Negative goodwill	(17 6)	(42 1)	58 2
Tangible assets	153 7	180 8	(15 0)
	143 7	**138.7**	**3 6**
Net working capital	(24 0)	(29 3)	18 1
Cash at bank and in hand	67 4	136 2	(50 5)
Borrowings	(138 1)	(209 0)	33 9
Other non-current liabilities	(37 0)	(61 6)	40 0
Net assets/(liabilities)	**12 0**	**(25.0)**	**n/a**
Share capital and premium	1 0	1 0	-
Reserves	11 0	(26 0)	n/a
	12.0	**(25 0)**	**n/a**

Balance sheet highlights

- Airport slots of £7 6 million represent certain airport landing slots acquired both on the acquisition of BA Connect (at valuation) and from other airlines during the year (at cost)

- Negative goodwill is detailed in section 1 of this Financial Review The balance at 31 March 2008 was £(17 6) million and it is anticipated that the majority of this will be amortised in 2008/09

- Tangible fixed assets reduced by £27 1 million to £153 7 million – major movements were as follows

    - Acquisition of 4 Bombardier Q400 aircraft Since the year end, 2 of these aircraft have been sold and leased back under 10 year operating leases During the year, Flybe took delivery of 15 new aircraft (8 Q400s, 7 Embraer 195s) - 11 on operating lease and 4 debt financed Q400s

Financial review *(contınued)*

- Acquısıtıon of Hangar 1 of the New Walker Hangar ın Exeter

- Dısposal of 16 owned Embraer 145 50-seat regıonal jets – these aırcraft were dısposed ın a packaged sale and leaseback deal ın June/July 2007 Under the terms of the transactıon, the average lease perıod for each aırcraft ıs 14 months, whıch coıncıdes wıth the antıcıpated operatıng requırement untıl the aırcraft are substıtuted by Bombardıer Q400 78-seat turbo-props Total net proceeds on the dısposal of these 16 aırcraft were £33 6 mıllıon less than the debt outstandıng – thıs shortfall was fully funded by Brıtısh Aırways as part of the BA Connect acquısıtıon ın March 2007

- Dısposal of 4 BAe 146 regıonal jets

o Net workıng capıtal has decreased by £5 3 mıllıon to £(24 0) mıllıon Durıng the year, £8 4 mıllıon of preference shares held by Rosedale Avıatıon Holdıngs Lımıted (our majorıty shareholder) were redeemed The balance of £14 1m was redeemed ın May 2008

o Flybe's cash flow for 2007/08 ıs analysed ın sectıon 3 of thıs Fınancıal Revıew

o The major component of the reductıon of £70 9 mıllıon ın borrowıngs to £(138 1) mıllıon relates to the dısposal of the 16 Embraer 145s and the repayment of the assocıated debt

o Other non-current lıabılıtıes have reduced by £24 6 mıllıon to £(37 0) mıllıon

- Some £20 4 mıllıon of thıs reductıon relates to the utılısatıon of BA Connect-related restructurıng provısıons set up at 31 March 2007

- In addıtıon, the defined benefit pensıon scheme (acquıred as part of the BA Connect transactıon) had an FRS 17 deficıt of £(3 3) mıllıon at 31 March 2007 As at 31 March 2008, thıs had moved to a surplus of £3 9 mıllıon – the scheme has now been closed to future benefit accrual and therefore thıs surplus has not been recognısed as an asset

Financial review *(continued)*

3. Summary cash flow

		2007/08
	£m	£m
Cash at beginning of year		**136 2**
– including £96 0m from British Airways for restructuring and integration costs		
Planned restructuring and integration costs *– funded by BA*		
Embraer 145 loan repayment, net of proceeds	(33 6)	
Restructuring and integration costs (less sale of fixed assets of £2 0 million)	(18 2)	
Negative goodwill amortisation	(25 2)	
– funded (as seat compensation for operating E145 aircraft) by BA in 2006/07		
		(77 0)
Opening cash excluding the impact of restructuring and integration		**59 2**
Cash flow from operations		
Profit before tax (before restructuring costs)	35 4	
Depreciation	16 2	
Working capital movements	(5 3)	
		46 3
Financing and non-operating cash flows		
Acquisition of fixed assets	(54 8)	
Proceeds from sale of fixed assets	2 2	
Loans to finance fixed assets	44 1	
Loan repayments	(21 2)	
Redemption of preference shares	(8 4)	
		(38.1)
Balance at end of year		**67 4**
Changes in net debt		
At beginning of year		(72 8)
Net cash outflow		(68 8)
Reduction in financing		70 9
Net debt at end of year		**(70.7)**

- Our opening cash position of £136 2m included £96 0m received from British Airways on the acquisition of BA Connect – this funding was to meet various restructuring and integration costs, including
  - Operating cost inefficient Embraer 145 49-seat regional jets, until replaced with Q400 78-seat turboprops,
  - Disposing of 16 owned Embraer 145 aircraft, with estimated negative equity of c£34 million,
  - Redundancy and property exit costs
- During the year, we utilised £77 0 million of this cash on planned restructuring and integration costs
- This left an adjusted opening cash balance excluding planned restructuring and integration costs of £59 2 million
- We generated £46 3 million of cash flow from operations during the year
- Net financing and non-operating cash outflows totalled £38 1 million in the year This included £8 4 million of preference share redemption
- Net debt improved by £2 1 million to £70 7 million at 31 March 2008

Financial review *(continued)*

4. Fuel and foreign exchange

Fuel

Fuel is a significant cost to Flybe, being 17 0% of our cost base in 2007/08 During the past 10 years, the price of fuel has been subject of significant volatility and this has continued in the first half of 2008/09

The significant and ongoing investment in new aircraft, combined with a formal hedge policy, has helped limit the impact on Flybe of both volatility and unprecedented increases in the price of jet fuel

The decision to invest in the new fleet of 78-seat Bombardier Q400 and 118-seat Embraer 195 aircraft continues to provide significant benefits in terms of fuel consumption As an example, as we have now started substituting the Embraer 145 49-seat regional jets with Q400s, our fuel burn per available seat kilometre for the 4 months to July 2008 has reduced by 4 8% from the same time last year

The objective of our fuel hedge policy is to smooth the cost of fuel over time and to de-risk the cost escalation as far as possible, thereby enabling the Commercial team to price our product before the selling season commences The policy is to buy 5% monthly tranches over a 12 month period, starting 2 years ahead of flying, thus ensuring we are 60% hedged 12 months in advance, to buy the remaining 30% 3-4 months in advance of the forthcoming season, and to leave 10% unhedged

We have established a Fuel Committee, which meets on a monthly basis and has responsibility for implementing the above fuel hedge policy, reviewing the effectiveness of the policies and benchmarking these against competitors and recommending any changes to the Group Board

Looking at 2008/09 and beyond, at $1,250 per tonne, fuel represents less than 25% of Flybe's total costs, and we believe this to be one of the lowest percentages of any airline

Foreign exchange

Flybe has significant US Dollar denominated costs relating to the purchase price of aircraft, operating leases thereon, maintenance reserve payments, engine maintenance costs and fuel purchases The US Dollar is subject to significant volatility against Sterling

Flybe has established a foreign exchange hedge policy for US Dollar, whereby hedging is built up in 5% monthly tranches, so we are circa 80% hedged 15-18 months ahead The treasury team then buys US Dollars at, or close to, the relevant transaction period to take us to a 100% hedged or bought position

In 2008/09, we have circa 85% of our estimated US Dollar exposure hedged at a blended rate of $1 99 For 2009/10, our hedge book stands at circa 66% of our estimated US Dollar spend, at a blended rate of $1 96

Andrew Knuckey
Chief Financial Officer

3rd September 2008

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 March 2008

Principal activities

The principal activities of the group throughout the year were those of an airline operator and the provision of aircraft technical support services The principal activity of the company was that of investment holding

Business review

The group results for the year are shown in the profit and loss account on page 20 of these financial statements

The information that fulfils all the requirements of the Enhanced Business Review, together with the information given below, can be found in the Chairman's Statement and Financial Review on pages 1 to 14 which is incorporated in this report by reference

Directors

The directors who held office during the year were as follows

J French	(Chairman)
MJH Chown	(Deputy Chairman)
DM Brown	
D Longbottom	
CT Scott	
CE Simpson	(resigned 4 April 2007)
A Smith	
P Smith	
A Strong	
RA Knuckey	(appointed 4 April 2007)
MD Rutter	(appointed 4 April 2007)

Dividends

The directors do not recommend the payment of a final dividend (*2007 £nil*)

Employee share scheme

In 2005, the company established an unapproved share scheme, the Flybe Employees' Share Scheme ('the Scheme') The trustees of the Scheme may from time to time invite qualifying employees to acquire beneficial interests in a given number of shares in the company held in the Employees' trust so that, if the employees remain employed by Flybe, there will be an opportunity to sell their shares if there is a flotation or trade sale Qualifying employees include those who have been continuously employed for a minimum of three years, and more senior or technically skilled employees who qualify by reason of their grade and a minimum period of continuous service

Distributions of interests in shares to qualifying employees were approved and made in June 2005, November 2006 an April 2007 There are no plans to make further distributions

Directors' report *(continued)*

Employees

It is the policy of the group to ensure that employees are aware of their individual roles and responsibilities and are informed about the trading performance and progress of the group The group ensures that the disabled continue to receive consideration for employment which is equal to that given to the able-bodied, taking account of their particular abilities and job requirements All possible efforts are made to maintain continuity of employment for existing employees who become disabled

Political and charitable contributions

The group made no political or charitable contributions during the year *(2007 £nil)*

Principal risks

The principal risks of the business include passenger volumes and yields, fuel prices, selection of routes, investment in new aircraft, maintenance of the brand, and the successful integration of the BA Connect business These matters are discussed in more detail in the Chairman's Statement and Financial Review on pages 1 to 14

Financial risk

The group is exposed to financial risks in respect of foreign exchange, interest rates, liquidity and fuel prices, which are also addressed in the Chairman's Statement A more detailed description of each risk, together with our policy for managing that risk, is given below

Foreign exchange the group purchases aircraft, spare parts and fuel in US dollars To mitigate this risk, the group enters into a series of forward contracts in order to gain certainty over a significant proportion of its future dollar payments

Interest rates the group has borrowings in order to finance the purchase of aircraft and engines To mitigate interest rate risk, the group enters into a series of contracts to gain certainty over a significant proportion of its future interest payments

Liquidity the group maintains adequate cash holdings to meet its short-term creditors as they fall due The group also arranges to borrow funds in order to finance purchases of aircraft and engines

Fuel prices the group purchases fuel on the open market from recognised fuel suppliers in order to operate its fleet of aircraft To mitigate fuel price risk, the group enters into forward contracts to gain certainty over a significant proportion of its future short-term fuel payments

Derivatives and other financial instruments

The group's principal financial instruments, other than the derivatives described above, comprise aircraft mortgages, finance leases, cash and other short-term deposits The main purpose of these financial instruments is to provide finance for the group's operations The group also has various other financial instruments, such as trade debtors and trade creditors, that arise directly from its operations

Outstanding derivative transactions at the year-end relate to foreign currency and aviation fuel hedging instruments The purpose of these is to manage the currency risks and fuel price arising from the group's operations and sources of finance The group's treasury policy permits the use of such instruments to manage these risks It is the group's policy that no trading in financial instruments shall be undertaken

As described in note 35, the fair value of the group's derivatives at 31 March 2008 was an asset of £4,988,000 *(2007 £3,126,000 liability)*

Post balance sheet events

In May 2008, the company repaid £14,090,000 of preference shares to its shareholders, representing all preference shares in issue at 31 March 2008 Full details of the repayment are set out in Note 38 to these financial statements

Directors' report *(continued)*

Auditors

Each of the persons who is a director at the date of approval of this report confirms that

(1) so far as the director is aware, there is no relevant audit information (as defined in the Companies Act 1985) of which the company's auditors are unaware, and

(2) the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information (as defined) and to establish that the company's auditors are aware of that information

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985

Deloitte & Touche LLP have indicated their willingness to continue as the company's auditors and a resolution for their reappointment is to be proposed at the forthcoming Annual General Meeting

By order of the board

RA Knuckey
Company Secretary

Jack Walker House
Exeter International Airport
Exeter, Devon
EX5 2HL
3rd September 2008

Statement of directors' responsibilities in respect of the directors' report and the financial statements

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 United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) The financial statements are required by law to give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The directors are responsible for keeping proper accounting records that 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 1985 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

Independent auditors' report to the members of Flybe Group Limited

We have audited the group and parent company financial statements (the ''financial statements'') of Flybe Group Limited for the year ended 31 March 2008 which comprise the Consolidated Profit and Loss Account, the Consolidated Statement of Total Recognised Gains and Losses, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement and the related notes 1 to 38 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985 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 auditors' 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

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985 We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited financial statements We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any further information outside the Annual Report

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 March 2008 and of the group's profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' report is consistent with the financial statements

Deloitte & Touche LLP Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Bristol, United Kingdom

5th September 2008

Consolidated profit and loss account
For the year ended 31 March 2008

	Note	Before integration & restructuring 2008 £000	Integration & restructuring (see notes 3 & 4) 2008 £000	Total 2008 £000	2007 £000
Turnover – *continuing operations*	*1*	535,864	-	**535,864**	367,474
Amortisation of negative goodwill	*2*	*25,205*	*-*	***25,205***	*2,005*
Other cost of sales	*4*	*(469,665)*	*(4,955)*	***(474,620)***	*(313,808)*
Exceptional cost of sales	*3*	*-*	*(537)*	***(537)***	*(10,903)*
Cost of sales		(444,460)	(5,492)	**(449,952)**	(322,706)
Gross profit		91,404	(5,492)	**85,912**	44,768
Other administrative expenses		*(53,206)*	*(1,941)*	***(55,147)***	*(38,070)*
Exceptional administrative expenses	*3*	*-*	*-*	***-***	*(1,602)*
Administrative expenses	*4*	(53,206)	(1 941)	**(55,147)**	(39,672)
Operating profit before exceptional items		*38,198*	*(6,896)*	***31,302***	*17,601*
Exceptional items	*3*	*-*	*(537)*	***(537)***	*(12,505)*
Operating profit – *continuing operations*		38,198	(7,433)	**30,765**	5,096
Loss on sale of subsidiary	*18*	(134)	-	**(134)**	-
Profit on sale of fixed assets		174	-	**174**	-
Restructuring credit/(charge)	*3*	-	2,418	**2,418**	(18,977)
Profit/(loss) on ordinary activities before interest		38,238	(5,015)	**33,223**	(13 881)
Interest receivable and similar income	*7*	5,921	-	**5,921**	1,145
Interest payable and similar charges	*8*	(8,772)	-	**(8,772)**	(3,461)
Profit/(loss) on ordinary activities before taxation	*2*	35,387	(5,015)	**30,372**	(16,197)
Tax credit/(charge) on profit/(loss) on ordinary activities	*9*			**4,482**	(3,694)
Profit/(loss) for the financial year	*23*			**34,854**	*(19,891)*

Consolidated statement of total recognised gains and losses
For the year ended 31 March 2008

	Note	2008 £000	2007 £000
Profit/(loss) for the financial year		**34,854**	(19,891)
Actuarial gain recognised in the pension schemes	*19*	1,841	1,419
Total recognised gains and losses for the financial year		36,695	(18,472)

Consolidated balance sheet
As at 31 March 2008

	Note	2008 £000	2007 £000
Fixed assets			
Intangible assets			
Airport slots	*10*	**7,618**	-
Negative goodwill	*10*	**(17,637)**	(42,092)
Tangible assets	*11*	**153,743**	180,790
		143,724	138,698
Current assets			
Stocks	*13*	**7,330**	7,020
Debtors – due within one year	*14*	**77,015**	85,165
Debtors – due after more than one year	*14*	**21,536**	15,585
Cash at bank and in hand		**67,449**	136,212
		173,330	243,982
Creditors amounts falling due within one year	*15*	**(173,139)**	(200,278)
Net current assets		**191**	43,704
Total assets less current liabilities		**143,915**	182,402
Creditors amounts falling due after more than one year	*16*	**(103,814)**	(153,516)
Provisions for liabilities	*17*	**(28,056)**	(50,531)
Net assets/(liabilities) excluding pension liabilities		**12,045**	(21,645)
Pension liabilities			
Defined benefit scheme net liability	*19*	**-**	(3,336)
Net assets/(liabilities) including pension liabilities		**12,045**	(24,981)
Capital and reserves			
Called up share capital	*22*	**22**	22
Share premium account	*23*	**992**	992
Merger reserve	*23*	**6,691**	6,691
Capital redemption reserve	*23*	**8,400**	-
Profit and loss account	*23*	**(4,060)**	(32,686)
Shareholders' funds/(deficit)	*24*	**12,045**	(24,981)

These financial statements were approved by the board of directors on 3rd September 2008 and were signed on its behalf by

J French
Director

RA Knuckey
Director

Company balance sheet
As at 31 March 2008

	Note	2008 £000	2007 £000
Fixed assets			
Investments	12	**33,191**	33,191
Current assets			
Debtors – due within one year	14	**89**	39
Debtors – due after more than one year	14	**100**	-
Cash at bank and in hand		**36**	3,953
		225	3,992
Creditors amounts falling due within one year	15	**(16,809)**	(25,048)
Net current liabilities		**(16,584)**	(21,056)
Net assets		**16,607**	12,135
Capital and reserves			
Called up share capital	22	**22**	22
Share premium account	23	**992**	992
Merger reserve	23	**6,691**	6 691
Capital redemption reserve	23	**8,400**	-
Profit and loss account	23	**502**	4,430
Shareholders' funds	24	**16,607**	12,135

These financial statements were approved by the board of directors on 3rd September 2008 and were signed on its behalf by

J French
Director

RA Knuckey
Director

Consolidated cash flow statement

For the year ended 31 March 2008

	Note	**2008** **£000**	2007 £000
Cash inflow from operating activities before integration and restructuring	*27*	**21,886**	33,604
Cash outflow from integration and restructuring	*27*	**(22,316)**	(3,187)
Cash (outflow)/inflow from operating activities	*27*	**(430)**	30,417
Returns on investments and servicing of finance	*28*	**(2,759)**	(5,368)
Taxation	*29*	**-**	-
Capital expenditure	*30*	**4,019**	(41,255)
Acquisitions and disposals	*31*	**735**	93,580
Cash inflow before financing		**1,565**	77,374
Financing	*32*	**(70,328)**	26 141
(Decrease)/increase in cash in the year	*33*	**(68,763)**	103,515

Notes

(forming part of the financial statements)

1 Accounting policies

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

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards, and in accordance with the historical cost accounting convention

The company has taken advantage of the exemption conferred by FRS8 'Related party disclosures' not to disclose transactions with its wholly owned subsidiaries

In accordance with section 230(4) of the Companies Act 1985, Flybe Group Limited is exempt from the requirement to present its own profit and loss account The parent company made a profit for the year of £4,141,000 *(2007 loss of £1,000)*

Basis of consolidation

The group accounts consolidate the accounts of Flybe Group Limited and all its subsidiary undertakings

Unless otherwise stated, the acquisition method of accounting has been adopted Under this method, the results of subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal

Negative goodwill

Negative goodwill arising on consolidation in respect of acquisitions, representing any excess of the fair value of the identifiable assets and liabilities acquired over the consideration given, is included within fixed assets and released to the profit and loss account in the periods over which the assets associated with the negative goodwill are utilised in the business, currently estimated to be three years

Investments

In the company's financial statements, investments in subsidiary undertakings, associates and joint ventures are stated at cost less provision for impairment Income from investments relate to dividends received which are recognised at the date the dividend distribution is formally approved

Intangible fixed assets

Airport landing and take-off slots are valued at cost or initially at fair value if acquired as part of a business Airport slots are considered to have an indefinite life and are not amortised Instead, they are subject to an annual impairment review and a provision is booked for any identified impairment

Notes *(continued)*

1 Accounting policies *(continued)*

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment Depreciation is provided by the group to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows

Freehold land	-	nil
Freehold and short leasehold buildings	-	10% per annum/lease term
Plant and equipment	-	10% - 50% per annum
Motor vehicles	-	20% - 25% per annum
Aircraft	-	7% - 20% per annum
Rotable aircraft parts (included within aircraft caption)	-	10% - 15% per annum

Estimated residual values are set at the acquisition of the asset and are reviewed annually, with reference to external valuations, to ensure that they are achievable If estimated residual values are found to have diminished, then this change is allowed for in the depreciation charged over the remaining useful economic life of the asset

An element of the cost of new aircraft is attributed on acquisition to prepaid maintenance of its engines and airframe and is amortised over a period ranging from one to five years from the date of purchase Subsequent costs incurred which provide enhancement to future periods, such as long-term scheduled maintenance and major overhauls of aircraft, are capitalised and amortised over the length of the period benefiting from those enhancements All other costs relating to maintenance are charged to the profit and loss account as incurred

Interest costs incurred on borrowings that specifically fund progress payments on assets under construction, principally aircraft, are capitalised up to the date of completion and included as part of the asset

Impairment

At each balance sheet date, the group reviews the carrying amounts of its tangible fixed assets 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 loss (if any)

Recoverable amount is the higher of fair value less costs to sell and value in use In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted

If the recoverable amount of an asset is estimated to be less that its carrying amount, the carrying amount of the asset is reduced to its recoverable amount An impairment loss is recognised as an expense immediately

Leases

Where the group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a 'finance lease' The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter Future instalments under such leases, net of finance charges, are included within creditors Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element, which reduces the outstanding obligation for future instalments

All other leases are accounted for as 'operating leases' and the rental charges are charged to the profit and loss account on a straight-line basis over the life of the lease

Notes *(continued)*

1 Accounting policies *(continued)*

Stocks

Stocks are stated at the lower of cost or net realisable value as follows

Aircraft rotables

These comprise aircraft parts that have a renewable time/usage life, which upon expiry are required by the Civil Aviation Authority to be serviced by approved engineers Such parts are stated at the lower of cost or net realisable value

Aircraft consumables

These comprise aircraft parts having a non-renewable life These are valued at the lower of cost or net realisable value for each separately identified batch purchased

Work in progress

Engine overhaul and maintenance work in progress valuation is based upon direct cost together with attributable overheads and profit is based on the stage of completion of the contract Materials issued from stores are valued as detailed above Other direct materials are valued at actual cost Labour and attributable overhead rates are based upon normal levels of activity

Leased aircraft maintenance costs

Provision is made for costs of overhaul and major checks on aircraft held under operating leases on the basis of hours flown or cycles and sectors operated during the year, and is designed to provide for the likely cost of bringing all life limited parts on aircraft back to the condition existing when the aircraft was leased Hand-back conditions on certain operating leases are projected to the end of the underlying lease period, and the financial impact recognised over the term of the operating lease

These provisions are a consequence of aircraft rectification obligations placed on the group by the operating lease agreements

Taxation

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

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered Deferred tax assets and liabilities are not discounted

Notes *(continued)*

1 Accounting policies *(continued)*

Turnover

Turnover (excluding value added tax and its overseas equivalent) comprises

Airline operations

Scheduled and charter passenger ticket sales, net of passenger taxes and discounts, are recorded in a 'forward sales' account and are included in creditors, within deferred income, until recognised as revenue when transportation occurs For flights purchased by members of the 'Frequent Flyer Program', an element of revenue representing the sales value of flights which these customers may take in future at no cost is deferred and recognised when the related free flights have been taken The amount of deferral is based on the value of an equivalent flight Unused tickets are recognised as revenue when the right to travel expires and the group's obligation to refund ceases, which is determined by the terms and conditions of these tickets

Ancillary revenues, comprising principally baggage carriage, advanced seat assignment, commissions, change fees and credit card fees, are recognised as revenue on the date the right to receive consideration occurs In respect of credit card fees, this occurs when each flight is booked and paid for For the remaining ancillary revenue, this occurs on the date of transportation, as this is when the service is generally provided

Commission received from the issue of Flybe branded credit cards by a third party provider is allocated between the sales value of free flights and revenue Revenue associated with free flights is recognised when the related flights are taken and remaining revenue is recognised on receipt, provided that it is not refundable and there are no further obligations on the group

Cargo revenues are recognised in the period when the services are provided

Technical support services

These represent the amounts derived from the provision of goods and services to customers during the year, including aircraft maintenance, overhauls and the associated rotable and consumable parts

The amount of profit attributable to the stage of completion of an engine and maintenance overhaul contract is recognised when the outcome of the contract can be foreseen with reasonable certainty Turnover for such contracts is stated at the cost appropriate to the stage of completion plus attributable profits, less amounts recognised in previous years Provision is made for any losses as soon as they are foreseen

Share-based payments

The group has applied the requirements of FRS 20 'Share-based payments' The group issues equity-settled share-based payments to certain employees Equity-settled share based payments are measured at fair value, excluding the effect of non market-based vesting conditions, at the date of the grant The fair value determined at the grant date is expensed to the profit and loss account evenly over the vesting period, based on the group's estimate of shares that will eventually vest and adjusted for the effect of non market-based vesting conditions

Exceptional items

Exceptional items are material items which derive from events or transactions that fall within the ordinary activities of the group and which individually or, if of a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view Items which relate to ongoing operations are recorded within the operating result for the year Those items which relate to a fundamental restructuring of the business are recorded as a separate item after operating profit

Cash and liquid resources

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand This balance includes 'restricted cash' which represents funds held by the group in bank accounts, however, funds cannot be withdrawn until certain conditions have been fulfilled The aggregate 'restricted funds' balance is disclosed by way of note within the cash flow notes to these financial statements

Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market

Notes *(continued)*

1 Accounting policies *(continued)*

Post retirement benefits

The group operates four defined contribution pension schemes The assets of the schemes are held separately from those of the group in independently administered funds The amount charged to the profit and loss account represents the contributions payable to the schemes in respect of the accounting period

The group operates a defined benefit scheme Amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments, which are included as part of staff costs Past service costs are recognised immediately in the profit and loss account if the benefits have vested If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs The interest cost and the expected return on assets are shown as a net amount of other finance costs or credits adjacent to interest Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses

Defined benefit schemes are funded, with the assets of the scheme held separately from those of the group, in separate trustee administered funds Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities The actuarial valuations are obtained at least triennially and are updated at each balance sheet date The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet

Segmental analysis

The segmental analysis by activity and geographical market, as required by Statement of Standard Accounting Practice No 25, has not been disclosed as in the opinion of the directors it would be seriously prejudicial to the interests of the group

Government grants

Government grants related to tangible fixed assets are treated as deferred income and released to the profit and loss account over the expected useful lives of the assets concerned

Provisions

Provisions are recognised when the group has a present obligation as a result of a past event, it is probable that the group will have to settle the obligation and a reliable estimate can be made of the amount of the obligation The amount recognised is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation Where a provision is measured using future cash flows estimated to settle the present obligation, the carrying amount is the present value of those cash flows, discounted at a rate representing the risk inherent in the liability

Derivative financial instruments

The group uses derivative contracts to reduce exposure to foreign exchange and fuel price risk The company does not hold or issue derivative financial instruments for speculative purposes

Fuel

The company has not adopted the fair value accounting rules of FRS25 and FRS26 and recognises gains and losses of fuel derivative contracts as they mature

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction or, if hedged, at the rate of exchange under the related forward currency contract Monetary assets and liabilities denominated in foreign currencies which are not hedged are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account

Notes *(continued)*

2 Profit/(loss) on ordinary activities before taxation

	2008 £000	2007 £000
Profit/(loss) on ordinary activities before taxation is stated after charging/(crediting)		
Depreciation of tangible fixed assets		
Owned	**14,930**	6,890
Leased	**1,296**	4,695
Impairment recognised in respect of five owned aircraft (2007 seven)	**2,321**	10,903
Profit on the disposal of fixed assets	**(174)**	(66)
Amortisation of negative goodwill	**(25,205)**	(2,005)
Operating leases		
- Land and buildings	**3,028**	2,353
- Plant and machinery	**148**	126
- Aircraft	**44,758**	25,409
Exchange (gains)/losses	**(1,108)**	516

Auditors' remuneration

	2008 £000	2007 £000
Fees payable to the company's auditors and their associates for the audit of the company's annual financial statements	**5**	5
Audit of financial statements of subsidiaries pursuant to legislation	**145**	145
Non statutory audit of interim financial statements	**180**	-
Total audit fees	**330**	150
Amounts receivable by auditors and their associates in respect of		
Tax services	**85**	120
All other services	**140**	657
Total non-audit fees	**225**	777

Other services relate to advice given regarding preparation of draft IFRS financial statements, restructuring the group to facilitate dividend payments within the group and advice given regarding the closure to contributions of the defined benefits pension scheme In 2007, £630,000 of services were provided to the group in relation to the acquisition of British Regional Air Lines Group Limited on 5 March 2007

Notes *(continued)*

3 Exceptional items

	2008 £000	2007 £000
Exceptional items reported in operating profit		
Impairment of aircraft	**(2,321)**	(10,903)
Costs associated with acquisition	**-**	(1,602)
Reversal of a fair value provision for lease rentals	**1,784**	-
	(537)	(12,505)

	2008 £000	2007 £000
Restructuring credit/(charge) reported below operating profit		
Redundancy and similar costs	**-**	(7,649)
Vacant property provision	**876**	(2,031)
Onerous training contract	**-**	(1,734)
Onerous aircraft leases which exceed operational requirements	**1,542**	(5,987)
Media costs associated with restructuring	**-**	(1,126)
Other	**-**	(450)
	2,418	(18,977)

On 5 March 2007, the group acquired the business of British Regional Air Lines Group Limited As part of that acquisition, a significant restructuring programme commenced with the object of harmonising the group's fleet of aircraft, employment terms and operational facilities Provision was made for the estimated costs of this restructuring in the financial statements for the year ended 31 March 2007 and adjustments to those estimates are included in the results for the current accounting period

- Property related provisions established at March 2007 to provide for future rentals and dilapidations expenses have been reduced by £876,000 following agreement reached with landlords to end leases on a hangar and an administrative building earlier than previously anticipated

- During the year, the company was able to secure the early return of several aircraft so that part of the original provision is no longer required A credit to the profit and loss account of £3,326,000 has been made £1,784,000 of this provision relates to the reversal of a provision for lease rentals in excess of market value made as part of the acquisition and is recorded in operating profit £1,542,000 relates to the reversal of the provisions for onerous lease cost in excess of operational requirements

Also, as part of the same significant restructuring programme, 8 owned BAe 146 aircraft were withdrawn from service during the year An impairment of £2,321,000 (*2007 £10,903,000*) was recognised against the carrying value of 5 *(2007 7)* owned aircraft due to be disposed of by March 2009 This impairment has primarily resulted from the significant increase in fuel prices experienced, which in turn has led to a reduction in the recoverable amounts achievable on the open market for the fuel-inefficient aircraft at their expected disposal dates

The impact on tax of these items is a credit of £650,000 (2007 – credit of £3,271,000)

Notes *(continued)*

4 Integration and restructuring costs

The 2008 profit and loss account highlights further additional costs associated with integrating the operating practices of the BA Connect business acquired in 2007 These have been highlighted separately rather than as exceptional costs, as they are operating costs that are not expected to occur on the same scale in future years

Included within cost of sales are £4,955,000 of integration costs comprising

- £1,972,000 of costs associated with training pilots, cabin crew and engineering staff to operate new aircraft types following the acquisition,
- £2,459,000 of aircraft hire costs to cover normal flying schedules whilst the pilots are receiving the above conversion training, and
- £524,000 of other costs including payments to buy-out existing terms and conditions for certain incoming staff

Included within administrative costs are £1,941,000 of integration costs comprising

- £427,000 of employment retention costs paid to certain employees during the restructuring phase The redundancy and payment in lieu costs for these employees were provided for in full at 31 March 2007,
- £981,000 of HR, finance, legal and IT costs relating to administering the restructuring process, in particular closure of certain premises and administration of the redundancy programme, and
- £533,000 of legal and professional fees relating to the integration of the businesses

5 Remuneration of directors

	2008	2007
	£000	£000
Directors' emoluments	**1,601**	1,472
Company contributions to personal pension schemes	**80**	49

The aggregate emoluments of the highest paid director were £571,000 *(2007 £572,000)* and company pension contributions of £32,000 *(2007 £32,000)* were made to a personal pension scheme on his behalf

In 2008 pension contributions for four *(2007 two)* directors were made to defined contribution personal pension schemes on their behalf

Notes *(continued)*

6 Staff numbers and costs

The average number of persons employed by the group (including directors) during the year, analysed by category, was as follows

	Number of employees 2008	2007
Technical support services	**859**	616
Administration	**676**	475
Flight and maintenance	**1,662**	840
	3,197	1,931

The group's aggregate payroll costs (excluding redundancy restructuring charges) in respect of those persons were as follows

	2008 £000	2007 £000
Wages and salaries	**88,549**	52,379
Social security costs	**9,331**	5,409
Other pension costs (see note 19)	**4,923**	2,738
Share based payments (see note 20)	**331**	173
	103,134	60,699

In addition to the above, actuarial gains of £1,841,000 *(2007 £1,419,000 gains)* were recognised in the consolidated statement of total recognised gains and losses in respect of defined benefit pension schemes

The company had no employees in either financial year

7 Interest receivable and similar income

	2008 £000	2007 £000
Bank interest	**4,547**	1,051
Net return on pension scheme liabilities	**1,374**	94
	5,921	1,145

8 Interest payable and similar charges

	2008 £000	2007 £000
On bank loans and overdrafts	**9,695**	6,383
Less interest capitalised	**(1,416)**	(1,295)
Finance charges payable in respect of finance leases	**400**	1,425
Gains arising on retranslation of loans and deposits used to fund aircraft purchases	**(519)**	(3,052)
Unwinding of discount on provisions	**612**	-
	8,772	3,461

Notes *(continued)*

9 Taxation

Analysis of (credit)/charge in year	**2008 £000**	2007 £000
UK corporation tax		
Current tax on income for the year	**-**	-
Deferred tax (see note 17)		
Reversal of timing differences	**366**	4,590
Recognition of prior year tax losses	**(4,848)**	(896)
Tax (credit)/charge on profit/(loss) on ordinary activities	**(4,482)**	3,694

There is no corporation tax charge for the current financial year due to the availability of losses brought forward

Factors affecting the tax (credit)/charge for the year

The current tax charge for the year is lower *(2007 lower)* than the standard rate of corporation tax in the UK of 30% *(2007 30%)* The differences are explained below

	2008 £000	2007 £000
Current tax reconciliation		
Profit/(loss) on ordinary activities before tax	**30,372**	(16,197)
Current tax at 30% *(2007 30%)*	**9,112**	(4,859)
Effects of		
Expenses not deductible for tax purposes	**120**	5,400
Capital allowances in excess of depreciation	**(360)**	(2,919)
Income not taxable	**(7,019)**	(601)
Unrelieved tax losses	**(1,041)**	3,366
Origination and reversal of timing differences	**(1,292)**	(387)
Movement in deferred tax not recognised	**480**	-
Total current tax (see above)	**-**	-

Notes *(continued)*

10 Intangible fixed assets

	Airport slots £000	Negative goodwill £000
Cost		
At beginning of year	-	(44 097)
Fair value adjustments – revisions	4,400	(750)
Additions	3,218	-
At end of year	7,618	(44,847)
Amortisation		
At beginning of year	-	2,005
Release in year	-	25,205
At end of year	-	27,210
Net book value		
At 31 March 2008	**7,618**	**(17,637)**
At 31 March 2007	-	(42,092)

Airport slots represent amounts paid to third parties to secure permission to operate aircraft at UK and overseas airports at a designated time As explained in the accounting policy in note 1, airport slots are subject to an impairment review rather than amortisation

Negative goodwill arose on the acquisition of British Regional Air Lines Group Limited and its subsidiary companies on 5 March 2007 During the period, the group reviewed the fair values established at the time of the acquisition and have made the following adjustments to negative goodwill

	Negative goodwill £000
Cost	
As previously reported	(44,097)
Revisions	
Reduction in value of tangible fixed assets in respect of assets which have been determined to be obsolete or have lower fair values	1,431
Fair value of acquired landing and take off slots	(4,400)
Recognise maintenance deposits not previously recognised	(749)
Reduction in accrual for repayment of government grant	(180)
Increase in provision for aircraft hand-back liabilities	3,435
Reduction in provisions for property dilapidations	(287)
	(750)
As revised	(44,847)

Notes *(continued)*

10 Intangible fixed assets *(continued)*

The following table sets out the revised fair value of the net assets at the date of acquisition

	Fair value as previously reported	Fair value adjustments	Fair value restated
	£000	£000	£000
Fixed assets			
Tangible	64,375	(1,431)	62,944
Intangible	-	4,400	4,400
Current assets			
Stock	1,180	-	1,180
Debtors	31,156	-	31,156
Cash	96,520	749	97,269
Total assets	193,231	3,718	196,949
Liabilities			
Creditors	27,499	(180)	27,319
Debt	86,642	-	86,642
Provisions	20,359	3,148	23,507
Pension liability	5,000	-	5,000
Total liabilities	139,500	2,968	142,468
Net assets	53,731	750	54,481
Negative goodwill	(44,097)	(750)	(44,847)
Purchase consideration	9,634	-	9,634
Shares issued in consideration	6,694		6,694
Costs of acquisition	2,940		2,940
Purchase consideration and costs of acquisition	9,634		9,634

Notes *(continued)*

11 Tangible fixed assets

	Freehold land and buildings £000	Short leasehold buildings £000	Plant, equipment and motor vehicles £000	Aircraft £000	Total £000
Group					
Cost					
At beginning of year	2,274	6,350	14,613	237,688	260,925
Fair value adjustment – revision	38	-	(4)	(1,465)	(1,431)
Additions	4,764	123	4,633	42,074	51,594
Disposals	(2,004)	(38)	(2,062)	(61,757)	(65,861)
Sale of subsidiary (see note 18)	(67)	-	(19)	-	(86)
Transfers	6,160	(6,160)	-	-	-
At end of year	11,165	275	17,161	216,540	245,141
Depreciation					
At beginning of year	214	1,856	7,722	70,343	80,135
Charge for year	408	12	2,217	13,589	16,226
Impairment	-	-	-	2,321	2,321
On disposals	(5)	(3)	(818)	(6,379)	(7,205)
Sale of subsidiary (see note 18)	(63)	-	(16)	-	(79)
Transfers	1,782	(1,782)	-	-	-
At end of year	2,336	83	9,105	79,874	91,398
Net book value					
At 31 March 2008	**8,829**	**192**	**8,056**	**136,666**	**153,743**
At 31 March 2007	2,060	4,494	6,891	167,345	180,790

Included in the total net book value of aircraft is £nil *(2007 £26,827,000)* in respect of assets held under finance leases Depreciation for the year on these assets was £1,296,000 *(2007 £4,695,000)* Included in the total cost of aircraft is £750,000 *(2007 £1,042,000)* in respect of capitalised interest During the year, £1,417,000 was capitalised using interest rates between 6 4% and 7 2% The value of the land component of the freehold land and buildings is not available

Notes *(continued)*

12 Fixed asset investments

Company	**Shares in group undertakings £000**
Cost and net book value	
At beginning and end of year	33,191

Subsidiary undertakings (all wholly owned)

	Principal activities	**Country of incorporation**	**Class of share capital held**
Flybe Limited	Airline operator/aircraft technical support	Great Britain	Ordinary and preference
Walker Aviation Leasing (UK) Limited	Aircraft leasing	Great Britain	Ordinary
British Regional Air Lines Group Limited	Investment holding	Great Britain	Ordinary
British Regional Airlines Limited	Aircraft leasing	Great Britain	Ordinary
Flybe Leasing Limited (formerly BA Connect Limited)	Aircraft leasing	Great Britain	Ordinary and preference
Flybe (IoM) Limited (formerly BA Connect (IoM) Limited)	Non-trading	Isle of Man	Ordinary
Jersey European Airways Limited	Dormant	Jersey	Ordinary
JEA Engineering (UK) Limited	Dormant	Great Britain	Ordinary
Guide Leasing Limited	Dormant	Great Britain	Ordinary
Westcountry Aircraft Servicing Limited	Dormant	Great Britain	Ordinary
Deutsche European Limited	Dormant	Great Britain	Ordinary
BEA com Limited	Dormant	Great Britain	Ordinary
British European Air Limited	Dormant	Great Britain	Ordinary
British European Limited	Dormant	Great Britain	Ordinary
Irish European Limited	Dormant	Great Britain	Ordinary

Notes *(continued)*

12 Fixed asset investments *(continued)*

Subsidiary undertakings (all wholly owned)	Principal activities	Country of incorporation	Class of share capital held
British European Airlines Limited	Dormant	Great Britain	Ordinary
British European com Limited	Dormant	Great Britain	Ordinary
Flybe com Limited	Dormant	Great Britain	Ordinary
Jersey European Airways (UK) Limited	Dormant	Great Britain	Ordinary
Flybe Holdings Limited	Dormant	Great Britain	Ordinary
Walker Aviation Limited	Dormant	Great Britain	Ordinary

All of the above subsidiary undertakings are included in the consolidated financial statements

13 Stocks

	2008 £000	2007 £000
Group		
Work in progress	**1,480**	789
Goods for resale	**671**	938
Aircraft rotables	**-**	23
Aircraft consumables	**5,179**	5,270
	7,330	7,020

14 Debtors

	2008 £000	**2008 £000**	2007 £000	2007 £000
Group – due within one year				
Trade debtors	**33,485**		41,369	
Amounts recoverable on contracts	**1,398**		2,362	
Other taxation and social security	**3,774**		1,443	
Corporation tax	**-**		2	
Aircraft deposits	**22,776**		23,419	
Other debtors	**1,974**		6,034	
Prepayments and accrued income	**13,608**		10,536	
		77,015		85,165
Group – due after more than one year				
Aircraft deposits	**4,796**		2,310	
Other debtors	**2,942**		409	
Prepayments and accrued income	**13,797**		12,866	
		21,536		15,585
Company				
Amounts owed by group undertakings		**39**		39
Other debtors – due within one year		**50**		-
Other debtors – due after more than one year		**100**		-
		189		39

Notes *(continued)*

15 Creditors amounts falling due within one year

	Group		Company	
	2008	2007	**2008**	2007
	£000	£000	**£000**	£000
Preference shares classified as liabilities (see note 22)	**14,090**	22,490	**14,090**	22,490
Bank loans and overdrafts (see note 16)	**29,140**	28,834	-	-
Obligations under finance leases (see note 16)	-	11,853	-	-
Trade creditors	**23,895**	25,131	-	-
Amounts owed to group undertakings	-	-	**2,625**	108
Other creditors including taxation and social security				
Other taxation and social security	**21,224**	12,857	-	-
Other creditors	**4,114**	769	**10**	15
Accruals	**33,136**	38,200	**84**	2,435
Deferred income	**47,540**	60,144	-	-
	173,139	200,278	**16,809**	25,048

Bank loans are secured on the assets to which they relate For further details of these loans, see note 16

Notes *(continued)*

16 Creditors amounts falling due after more than one year

	Group		Company	
	2008	2007	**2008**	2007
	£000	£000	**£000**	£000
Secured bank loans	**94,910**	122,135	**-**	-
Obligations under finance leases	**-**	23,677	**-**	-
Deferred income	**8,904**	7,704	**-**	-
	103,814	153,516	**-**	-

The bank loans are repayable by instalments with £54,389,000 *(2007 £50,830,000)* falling due after five years Rates of fixed and variable interest charged on bank loans vary between 6 4% *(2007 3 98%)* and 7 2% *(2007 8 36%)* The bank loans are secured on the assets to which they relate

The maturity of bank loans is as follows

	2008	2007
	£000	£000
In one year or less, or on demand	**29,140**	28,834
Between one and two years	**7,545**	16,835
Between two and five years	**32,976**	54,470
In five years or more	**54,389**	50,830
	124,050	150,969

The maturity of obligations under finance leases is as follows

	2008	2007
	£000	£000
Within one year	**-**	11,853
In the second to fifth years	**-**	23,677
	-	35,530

The obligations under finance leases were secured on the assets to which they related

Notes *(continued)*

17 Provisions for liabilities

	Staff costs	Onerous leases	Property costs	Leased aircraft maintenance costs	Other	Deferred tax	**Total**
	£000	£000	£000	£000	£000	£000	**£000**
Group							
At beginning of year	7,649	18,223	2,601	11,936	450	9,672	**50,531**
Fair value adjustment - revisions	-	-	(287)	3,435	-	-	**3,148**
Restructuring credit	-	-	(876)	-	-	-	**(876)**
Charge/(credit) for the year in the profit and loss account	-	(3,326)	-	2,861	-	(4,482)	**(4,947)**
Reversal of discounting	-	612	-	-	-	-	**612**
Utilised during year	(7,585)	(6,244)	(1,222)	(4,995)	(366)	-	**(20,412)**
At end of year	**64**	**9,265**	**216**	**13,237**	**84**	**5,190**	**28,056**

Provisions for staff and other costs have been substantially utilised

Onerous leases and property costs provisions will be substantially utilised within two years, however, the final element of the onerous lease provisions will not be utilised until 2013

Provisions are made in respect of contractual obligations to maintain aircraft under operating lease contracts The amount and timing of the maintenance costs are dependent on future usage of the relevant aircraft Typically this will be written-off over a range of one to two years

For details of the deferred tax provisions, see note 21

Notes *(continued)*

18 Disposal of subsidiary undertaking

On 30 September 2007, the group sold its 100% interest in the ordinary share capital of Iscavia Limited The profit of Iscavia Limited up to the date of disposal was £101,000 and for its last financial year (to 31 March 2007) was £120,000 Net assets disposed of and the related sale proceeds were as follows

	£000
Fixed assets	7
Current assets	339
Creditors	(62)
Net assets	284
Loss on sale	(134)
Sale proceeds (satisfied by loan notes)	150

19 Pension liabilities

British Regional Air Lines Group Pension Scheme

Composition of the scheme

This scheme was acquired on 5 March 2007 as part of the acquisition of British Regional Air Lines Group Limited The scheme was closed to contributions during the year and its members now contribute to the group's defined contribution scheme

A formal actuarial valuation was carried out as at 1 April 2005 The results of this have been updated on an FRS 17 'Retirement Benefits' basis at 31 March 2007 and 31 March 2008 by an independent qualified actuary The service costs have been calculated using the Projected Unit method

Contributions of £nil were payable to the fund at year end *(2007 £367,000)*

The following assumptions have been adopted in determining the pension liability

	2008	2007
Discount rate	6 0%	5 2%
Expected return on scheme assets at start of period	6 7%	6 6%
Rate of increase in salaries	n/a	4 5%
Rate of increase in pensions in payment accrued before 1 October 2006	3 5%	3 0%
Rate of increase in pensions in payment accrued after 1 October 2006	2 5%	2 5%
Inflation assumption	3 5%	3 0%
Mortality table	PA92lc	PA92mc

The group expects to contribute nil % of pensionable salaries to the scheme in 2008/09

Notes *(continued)*

19 Pension liabilities *(continued)*

Scheme assets

The assets in the scheme and the expected rates of return were

	Long-term rate of return 31 March 2008	**Value at 31 March 2008 £000**	Long-term rate of return 31 March 2007	Value at 31 March 2007 £000
Equities	**8 0%**	**57,514**	7 5%	68,106
Bonds	**5.2%**	**47,365**	5 2%	38,019
Cash	**3 0%**	**307**	3 0%	366
Total market value of assets		**105,186**		106,491
Actuarial value of liability		**(101,240)**		(109,827)
Surplus/(deficit) in the scheme		**3,946**		(3,336)
Amount of surplus not recognised		**(3,946)**		-
Net pension liability		**-**		(3,336)

The rates quoted above are the expected net rates of return after allowance for expenses

Movements in the scheme liabilities during the period:

	£000
Liability at 31 March 2007	**(109,827)**
Current service cost	**(1,582)**
Member contributions paid	**(574)**
Interest cost	**(5,738)**
Curtailment	**963**
Benefits paid	**2,075**
Actuarial gain recognised in the consolidated statement of total recognised gains and losses	**13,443**
Liability at 31 March 2008	**(101,240)**

Movements in the scheme assets during the period:

	£000
Assets at 31 March 2007	**106,491**
Expected return on scheme assets	**7,112**
Employer contributions	**740**
Member contributions	**574**
Benefits paid	**(2,075)**
Actuarial loss recognised in the consolidated statement of total recognised gains and losses	**(7,656)**
Assets at 31 March 2008	**105,186**

Notes *(continued)*

19 Pension liabilities *(continued)*

Analysis of amount charged to operating profit:

	2008 £000	2007 £000
Current service cost	**1,582**	144
Curtailment	**(963)**	-
Total charged to operating profit	**619**	144

Analysis of amounts credited to net finance charges:

	2008 £000	2007 £000
Expected return on pension scheme assets	(7,112)	(557)
Interest on pension scheme liabilities	5,738	463
Net return	**(1,374)**	(94)

Analysis of amount recognised in consolidated statement of total recognised gains and losses:

	2008 £000	2007 £000
Actual return less expected return on pension scheme assets	**(7,656)**	1,413
Experience gain arising on scheme liabilities	**13,443**	6
Amount not recognised as an asset	**(3,946)**	-
Net gain recognised	**1,841**	1,419

History of experience gains and losses

	2008 £000	2007 £000
Actual return less expected return on scheme assets £000	**(7,656)**	1,413
Percentage of year-end scheme assets	***7%***	*1%*
Experience gains and losses arising on scheme liabilities £000	**13,443**	6
Percentage of present value of year-end scheme liabilities	***14%***	-
Amount not recognised as an asset	**(3,946)**	-
Actuarial gain recognised in consolidated statement of total recognised gains and losses £000	**1,841**	1,419
Percentage of present value of year-end scheme liabilities	***2%***	*1%*

Other schemes

The group also operates defined contribution pension schemes The pension cost charge for the period represents contributions payable by the group to the schemes and amounted to £4,304,000 *(2007 £2,594,000)*

There are no outstanding or prepaid contributions at either the beginning or the end of the financial year

Notes *(continued)*

20 Equity-settled share scheme

The Employees' Trust has a share distribution scheme for all employees whereby qualifying employees acquire beneficial interests at nil cost in a given number of shares in the company which are held in the Employees' Trust The employees will have an option to sell their shares if there is a flotation or trade sale The interests in the shares does not expire except that shares are forfeited if the employee leaves the group before a flotation or trade sale

Details of the shares in issue are as follows

	2008 Number of shares	2007 Number of shares
Outstanding at the beginning of the period	**90,864**	80,325
Granted during the period	**20,229**	17,502
Forfeited during the period	**(6,617)**	(6,963)
Exercised during the period	**-**	-
Expired during the period	**-**	-
Outstanding at the end of the period	**104,476**	90,864
Exercisable at the end of the period	**-**	-

The fair value of the share awards granted is determined with reference to the fair value of the shares at the date of grant Shares awarded in 2008 were granted with a fair value of £21 25 (*2007 £13 00*) per share

Under FRS20, Share-based payments, a charge of £331,000 (*2007 £173,000*) has been recognised in the profit and loss account of the group to reflect the fair value of the awards given

21 Deferred taxation

The elements of deferred taxation liability/(asset) are as follows

	Provided		Unprovided	
	2008 £000	2007 £000	**2008 £000**	2007 £000
Differences between accumulated depreciation and amortisation and capital allowances	**7,307**	11,375	**-**	8,976
Other timing differences	**-**	321	**6,388**	(67)
Tax losses	**(2,117)**	(2,024)	**(14,431)**	(4,805)
Undiscounted deferred tax liability/(asset)	**5,190**	9,672	**(8,043)**	4,104

No deferred tax asset has been recognised in respect of the pension liability or tax losses above due to uncertainty as to when these assets will be realised

Notes *(continued)*

22 Share capital

	2008 £000	2007 £000
Authorised, allotted, called up and fully paid		
654,150 ordinary shares of 1 pence each	**7**	7
1,445,850 'A' ordinary shares of 1 pence each	**15**	15
99,000,000 cumulative redeemable preference shares of 1 pence each	**990**	990
1,310,000,000 redeemable preference shares of 1 pence each (*2007 2,150,000,000*)	**13,100**	21,500
	14,112	22,512
Shares classified as liabilities	**14,090**	22,490
Shares classified as equity	**22**	22
	14,112	22,512

During the year, the company redeemed 840,000,000 redeemable preference shares of 1p each at par at a cash cost of £8,400,000 The redeemable preference shares are redeemable prior to a sale or listing No premium will be payable on redemption The redeemable preference shares have no dividend rights

Attached to the cumulative redeemable preference shares is a fixed cumulative preferential dividend at a rate of 0 1% per annum, payable annually on 1 June each year The cumulative redeemable preference shares are redeemable prior to a sale or listing The company may, with written consent of the 'A' ordinary shareholders, redeem the preference shares at any time No premium will be payable on redemption

In January and July of each year, both the redeemable preference shares and the cumulative redeemable preference shares are available for redemption (either in full or in part) subject to there being sufficient distributable reserves available The redeemable preference shares will be redeemed in priority to the cumulative redeemable preference shares

Voting rights are applied on a one vote per share basis, except in relation to the removal of a director, when the 'A' ordinary shares shall in aggregate carry three times the votes carried by all other shares

In the event of liquidation of the company, the assets of the company available for distribution shall be applied in the following order to holders of redeemable preference shares, cumulative redeemable preference shares, 'A' ordinary shares and finally to ordinary shares

23 Reserves

	Group				Company			
	Merger reserve £000	**Capital redem'n reserve £000**	**Share premium £000**	**Profit and loss account £000**	**Merger reserve £000**	**Capital redem'n reserve £000**	**Share premium £000**	**Profit and loss account £000**
At beginning of year	6,691	-	992	(32,686)	6,691	-	992	4,430
Profit for the year	-	-	-	34,854	-	-	-	4,141
Share based payments	-	-	-	331	-	-	-	331
Actuarial gain on defined benefit obligation	-	-	-	1,841	-	-	-	-
Redemption of preference shares	-	8,400	-	(8,400)	-	8,400	-	(8,400)
At end of year	**6,691**	**8,400**	**992**	**(4,060)**	**6,691**	**8,400**	**992**	**502**

The cumulative amount of goodwill resulting from acquisitions in earlier financial years which has been written off is £2,030,000 *(2007 £2,030,000)* This amount is net of goodwill attributable to businesses disposed of prior to the balance sheet date

Notes *(continued)*

24 Reconciliation of movements in shareholders' funds/(deficit)

	2008 £000	2007 £000
Group		
Profit/(loss) for the year	**34,854**	(19,891)
Credit to equity for equity settled share based payments	**331**	173
Actuarial gain recognised on the pension scheme	**1,841**	1,419
Share capital issued during year	-	4
Share premium issued during year	-	6,691
Opening shareholders' deficit	**(24,981)**	(13,377)
Closing shareholders' funds/(deficit)	**12,045**	(24,981)

	2008 £000	2007 £000
Company		
Profit/(loss) for the year	**4,141**	(1)
Credit to equity for equity settled share based payments	**331**	173
Share capital issued during year	-	4
Share premium issued during year	-	6,691
Opening shareholders' funds	**12,135**	5,268
Closing shareholders' funds	**16,607**	12,135

25 Contingent liabilities and guarantees

The group has given guarantees in favour of Lloyds TSB Cardnet, the company's credit card acquirers, for £14,000,000 *(2007 £12,000,000)*

The group has also placed bonds in favour of various handling agents, fuel suppliers and customs offices totalling £5,101,000 *(2007 £3,218,000)*

Notes *(continued)*

26 Commitments

Annual commitments under non-cancellable operating leases are as follows

	2008		2007	
	Land and buildings	**Other**	Land and buildings	Other
	£000	**£000**	£000	£000
Group				
Operating leases which expire				
Within one year	**1,296**	**5,992**	284	2,113
In the second to fifth years inclusive	**1,277**	**8,073**	365	12,550
Over five years	**512**	**46,350**	1,429	27,229
	3,085	**60,415**	2,078	41,892

Capital expenditure authorised and contracted for but not provided in the accounts as at 31 March 2008 amounts to US$579m (£291m) *(2007 US$593m, £302m)* This is in respect of 20 *(2007 14)* Bombardier Dash 8 Q400 aircraft and 3 *(2007 9)* Embraer 195 aircraft This amount is based on the gross cost of the aircraft The company has negotiated discounts which will reduce the total cost The aircraft are scheduled for delivery over the next three years It is intended that these aircraft will be financed partly though cash flow and partly through external financing and leasing arrangements

Capital expenditure authorised but not contracted for as at 31 March 2008 amounts to US$618m (£311m) *(2007 US$675m, £344m)* This is in respect of options entered into for 15 *(2007 14)* Bombardier Q400 aircraft and nine *(2007 12)* Embraer 195 aircraft on the same valuation basis as above

27 Reconciliation of operating profit/(loss) to operating cash (outflow)/inflow

	2008	2007
	£000	£000
Profit/(loss) before interest	**33,223**	(13,881)
Depreciation, amortisation and impairment charges	**(6,658)**	20 483
Profit on disposal of fixed assets	**(174)**	(66)
Increase in stocks	**(408)**	(1,184)
Loss on sale of subsidiary	**134**	-
Decrease/(increase) in debtors	**2,122**	(14,419)
(Decrease)/increase in creditors	**(5,420)**	22,737
(Decrease)/increase in provisions	**(23,249)**	16,747
Cash (outflow)/inflow from operating activities	**(430)**	30,417
Analysed as		
Net cash inflow from operating activities before integration and restructuring	**21,886**	33,604
Net cash flow from integration and restructuring	**(22,316)**	(3,187)
	(430)	30,417

Notes *(continued)*

28 Returns on investments and servicing of finance

	2008 £000	2007 £000
Interest received	**5,920**	1,051
Interest paid	**(8,279)**	(4 994)
Interest element of finance lease rental payments	**(400)**	(1,425)
Net cash outflow from returns on investments and servicing of finance	**(2,759)**	(5,368)

29 Taxation

	2008 £000	2007 £000
Corporation tax received	**-**	-

30 Capital expenditure

	2008 £000	2007 £000
Payments to acquire tangible fixed assets	**(54,811)**	(42,701)
Receipts from sale of tangible fixed assets	**58,830**	1,446
	4,019	(41,255)

31 Acquisitions and disposals

	2008 £000	2007 £000
Cost of investment in undertaking	**-**	(2,940)
Net cash balances acquired with undertaking	**749**	96,520
Net cash disposed of with undertaking	**(14)**	-
Net cash inflow from acquisitions and disposals	**735**	93,580

Notes *(continued)*

32 Financing

	2008 £000	2007 £000
Redemption of preference shares	**(8,400)**	-
New secured loans	**44,066**	63,561
Repayment of loans	**(70,464)**	(33,296)
Capital element of finance lease rental payments	**(35,530)**	(4,124)
	(70,328)	26,141

33 Reconciliation of net cash flow to movement in net debt

	2008 £000	2007 £000
(Decrease)/increase in cash in the year	**(68,763)**	103,515
Cash outflow/(inflow) from decrease in debt and lease financing	**70,328**	(26 141)
Movement in net debt resulting from cash flows	**1,565**	77,374
Loans acquired with undertaking	**-**	(84,789)
Net debt at the beginning of the year	**(72,777)**	(70,585)
Exchange rate adjustments	**521**	5,223
Net debt at the end of the year	**(70,691)**	(72,777)

34 Analysis of net debt

	At beginning of year £000	Cash flows £000	Other non-cash changes £000	**At end of year £000**
Cash at bank and in hand	136,212	(68,763)	-	**67,449**
Debt due after one year	(122,135)	-	27,225	**(94,910)**
Debt due within one year	(51,324)	34,798	(26,704)	**(43,230)**
Finance leases	(35,530)	35,530	-	-
	(208,989)	70,328	521	**(138,140)**
Total	(72,777)	1,565	521	**(70,691)**

Included within cash at bank and in hand is £8,130,000 (*2007 £37,603,000*) held in restricted accounts

Notes *(continued)*

35 Fair value of assets and liabilities

The group has derivative financial instruments that it has not recognised at fair value as follows

- Foreign currency derivatives with a mark-to-market net asset totalling £1,830,000 (*2007 £1,987,000 net liability*)
- Aircraft fuel derivatives mark-to-market with a net asset totalling £3,158,000 (*2007 £1,139,000 net liability*)

The foreign currency derivative instruments represent 137 open contracts comprising swaps, forwards and options with maturity dates ranging from April 2008 to August 2010 which are to purchase either US dollars or euros to meet business requirements

The fuel derivative instruments represent 42 open contracts comprising swaps, collars and options with maturity dates ranging from April 2008 to October 2009 which are to purchase aviation fuel

Both the foreign currency and the fuel derivatives are to meet demands stemming from the normal course of business and are utilised to manage and limit the risk of future fluctuations in currency values and fuel prices They are not used to generate speculative returns All open contracts are entered into with UK offices of recognised banks and financial institutions and are conducted on an open market basis

36 Related party transactions

During the year the group continued with a finance lease with Walker Aviation Finance Limited, a subsidiary of Rosedale (JW) Investments Limited, for three *(2007 three)* BAe 146-300 aircraft at an arm's length market rate The amount paid under the lease was £7,129,000 *(2007 £ 3,816,000)* and included a purchase option of £2,000,000 for each aircraft paid on 28 September 2007 This completes the lease arrangements with Walker Aviation Finance Limited

During the year the group provided services to Preston Travel (CI) Limited, a subsidiary of Rosedale (JW) Investments Limited, at an arm's length market rate The amount charged was £1,381,000 *(2007 £1,624,000)* and the outstanding amount at the year-end was £91,000 *(2007 £71,000)*

The following transactions with Edenfield Investments Limited and Wisbech Retail Limited are disclosed although there is no holding/subsidiary company relationship between these two companies and Rosedale (JW) Investments Limited These two companies are owned and controlled by the E J Walker 1964 settlement, established by the former wife of the late Mr Jack Walker, this trust is separate for tax purposes from the J Walker 1987 Settlement which controls Rosedale (JW) Investments Limited

- During the period the group purchased property services from Edenfield Investments Limited and from Wisbech Retail Limited at an arm's length market rate The amount paid was £527,000 *(2007 £624,000)* and £227,000 *(2007 £227,000)* respectively The group holds a deferred income balance of £50,500 at the balance sheet date regarding a rent–free period on a property leased from Wisbech Retail Limited *(2007 £53,400)*
- The group also made a payment of £4,200,000 to Edenfield Investments Limited to purchase hangar accommodation which is occupied by the group *(2007 £2,850,000 was paid as a capital contribution)*

37 Ultimate parent company and parent undertaking of larger group of which the company is a member

The directors regard Rosedale (JW) Investments Limited, incorporated in Jersey, as the ultimate parent company The ultimate controlling party is the J Walker 1987 Settlement

The results of the group are not consolidated into any other group

Notes *(continued)*

38 Post balance sheet events

In May 2008, British Regional Air Lines Group Limited was restructured following Court approval and a dividend of £15,000,000 was paid to Flybe Group Limited This dividend receipt allowed the company to redeem 99,000,000 cumulative redeemable preference shares of 1p each at par and 1,310,000,000 redeemable preference shares of 1p each at par The cash payment of £14,090,000 redeems all preference shares in issue at the time