

British Midland PLC and subsidiary undertakings

**Directors' report and consolidated
financial statements**

Registered number 02107441

31 December 2003



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Company information

Directors	Sir Michael Bishop CBE (Chairman) A Reid CA GN Elliott CBE FCA (non-executive) G Reitan (Norway) (non-executive) R Teckentrup (Germany) (non-executive) C Spohr (Germany) (non-executive) NO Turner TJ Bye	- appointed 1 January 2003 - appointed 1 January 2003
Secretary and registered office	TJ Bye Donington Hall Castle Donington Derby DE74 2SB	
Registered number	02107441	
Auditors	KPMG LLP St Nicholas House Park Row Nottingham NG1 6FQ	
Bankers	National Westminster Bank Plc Colmore Centre 103 Colmore Row Birmingham B3 3NS	

Directors' report

The directors present their report and the consolidated financial statements for the year ended 31 December 2003.

Business review

The principal activity of the group is that of airline operator.

	2003 £000	2002 £000
Turnover	772,223	723,756
Loss before taxation	<u>(9,859)</u>	<u>(19,563)</u>

Dividends and transfers to reserves

No dividend is proposed in respect of the year ended 31 December 2003 (2002: *£nil*).

The loss for the financial year of £5,221,000 has been offset against reserves (2002: *loss of £11,748,000*).

Directors and their interests

The directors who served during the year are as set out on page 1. The interests of the directors in the shares of the company were as follows:

	Ordinary shares as at 31 Dec 03	Ordinary shares as at 31 Dec 02
Sir Michael Bishop CBE	32,544,147	32,544,147
A Reid	-	-
GN Elliott CBE	-	-
G Reitan	-	-
R Teckentrup	-	-
C Spohr	-	-
NO Turner - appointed 1 January 2003	-	-
TJ Bye - appointed 1 January 2003	-	-

The interest of The BBW Partnership Limited in the issued share capital of British Midland PLC has been ascribed to Sir Michael Bishop CBE by virtue of the provisions of section 13 paragraph 5 of the Companies Act 1985.

The interests of the directors in the shares of The BBW Partnership Limited, the ultimate parent company, are disclosed in the financial statements of that company.

Employees

The group recognises the importance of promoting and maintaining good communications with its employees. During the year regular meetings were held with employee representatives.

The group continues to employ disabled persons and affords them the same training, career development and promotional opportunities as for all other employees and provides all possible assistance to persons temporarily or permanently disabled whilst in the group's employment.

Directors' report *(continued)*

Other substantial shareholdings

Twenty percent of the issued share capital of the company is held by Scandinavian Airlines System Denmark Norway Sweden and a further thirty percent, less 1 share, by Deutsche Lufthansa Aktiengesellschaft.

Creditor payment policy

It is the group's policy to pay suppliers in accordance with the terms agreed provided that the supplier has also complied with the relevant terms and conditions. The trade creditors at 31 December 2003 represented 44 days (2002: 47 days) of annual purchases.

By order of the board


TJ Bye
Secretary

2 April 2004

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and group and of the profit or loss for that period. In preparing those 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 accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.



KPMG LLP

St Nicholas House
Park Row
Nottingham
NG1 6FQ

Independent auditors' report to the members of British Midland PLC

We have audited the financial statements on pages 6 to 27.

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 are responsible for preparing the directors' report and, as described on page 4, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

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 if, in our opinion, the directors' report is not consistent with the financial statements, if 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 transactions with the group is not disclosed.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards 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 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 of the state of the affairs of the company and the group as at 31 December 2003 and of the loss of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

*Chartered Accountants
Registered Auditor*

2 April 2004

Consolidated profit and loss account
for the year ended 31 December 2003

	<i>Note</i>	2003 £000	2002 £000
Turnover	2	772,223	723,756
Cost of sales		(699,679)	(650,719)
Gross profit		<u>72,544</u>	<u>73,037</u>
Administrative expenses		(85,063)	(94,707)
Operating loss		<u>(12,519)</u>	<u>(21,670)</u>
Profit on disposal of fixed assets		51	1,427
Other interest receivable and similar income	3	4,416	4,141
Interest payable and similar charges	4	(1,807)	(3,461)
Loss on ordinary activities before taxation	5	<u>(9,859)</u>	<u>(19,563)</u>
Tax on loss on ordinary activities	6	4,638	7,815
Loss on ordinary activities after taxation and accumulated loss for the financial year	20	<u>(5,221)</u>	<u>(11,748)</u>

In both the current and preceding year, the company made no material acquisitions and had no discontinued operations.

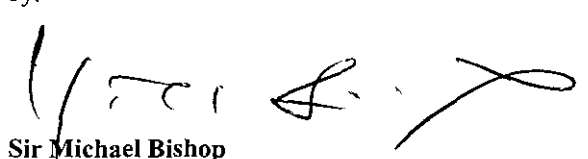
Consolidated statement of total recognised gains and losses
for the year ended 31 December 2003

	2003 £000	2002 £000
Loss for the financial year	(5,221)	(11,748)
Exchange movements	(3,574)	(2,111)
Deferred tax effect of exchange movements	809	(5,338)
	<hr/>	<hr/>
Total gains and losses recognised since last annual report	(7,986)	(19,197)
	<hr/>	<hr/>

Consolidated balance sheet
as at 31 December 2003

	Note	2003 £000	2002 £000
Fixed assets			
Intangible assets	10	1,149	1,231
Tangible assets	11	250,551	275,075
Investments	12	8,631	8,921
		<hr/>	<hr/>
		260,331	285,227
Current assets			
Stocks		15,515	15,060
Debtors	13	70,389	70,263
Cash at bank and in hand		119,886	122,319
		<hr/>	<hr/>
		205,790	207,642
Creditors: amounts falling due within one year	14	(199,615)	(196,830)
		<hr/>	<hr/>
Net current assets			
Due within one year		(2,056)	(758)
Debtors due after one year	13	8,231	11,570
		<hr/>	<hr/>
		6,175	10,812
		<hr/>	<hr/>
Total assets less current liabilities		266,506	296,039
Creditors: amounts falling due after more than one year	15	(167,467)	(185,702)
Provisions for liabilities and charges	17	(48,828)	(52,140)
		<hr/>	<hr/>
Net assets		50,211	58,197
		<hr/>	<hr/>
Capital and reserves			
Called up share capital	18	16,272	16,272
Balance arising on reorganisation	19	(12,143)	(12,143)
Share premium	20	7,568	7,568
Statutory reserve	20	387	387
Profit and loss account	20	38,127	46,113
		<hr/>	<hr/>
Equity shareholders' funds		50,211	58,197
		<hr/>	<hr/>

These financial statements were approved by the board of directors on 2 April 2004 and were signed on its behalf by:


Sir Michael Bishop
Director

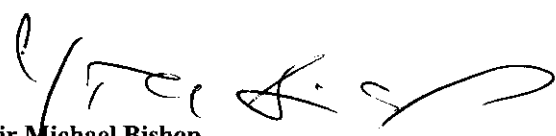

Austin Reid
Director

Balance sheet

as at 31 December 2003

	Note	2003 £000	2002 £000
Fixed assets			
Investments	12	31,654	31,654
Creditors: amounts falling due within one year	14	(5,353)	(5,989)
Net current liabilities		(5,353)	(5,989)
Total assets less current liabilities and net assets		26,301	25,665
Capital and reserves			
Called up share capital	18	16,272	16,272
Share premium	20	7,568	7,568
Profit and loss account	20	2,461	1,825
Equity shareholders' funds		26,301	25,665

These financial statements were approved by the board of directors on 2 April 2004 and were signed on its behalf by:


Sir Michael Bishop
Director


Austin Reid
Director

Consolidated cash flow statement
for the year ended 31 December 2003

	<i>Note</i>	2003 £000	2002 £000
Cash inflow from operating activities	21	27,630	48,209
Returns on investments and servicing of finance	23	2,033	(1,174)
Capital expenditure and financial investment	23	(32,027)	(2,801)
Cash (outflow)/inflow before use of liquid resources and financing		(2,364)	44,234
Financing	23	5,200	(20,096)
Increase in cash		2,836	24,138

Reconciliation of net cash flow to movement in net debt

	2003 £000	2002 £000
Increase in cash in the year	2,836	24,138
Cash (inflow)/outflow from change in debt and lease financing	(5,200)	20,096
Change in net debt resulting from cash flows	(2,364)	44,234
Translation differences	17,767	20,041
Movement in net debt in year	15,403	64,275
Net debt at 1 January	(76,353)	(140,628)
Net debt at 31 December	22	(60,950)

Reconciliation of movements in equity shareholders' funds
for the year ended 31 December 2003

	Group		Company	
	2003	2002	2003	2002
	£000	£000	£000	£000
(Loss)/profit for the financial year	(5,221)	(11,748)	636	299
Other recognised gains and losses relating to the year	(2,765)	(7,449)	-	-
Net (reduction in)/addition to equity shareholders' funds	(7,986)	(19,197)	636	299
Opening equity shareholders' funds	58,197	77,394	25,665	25,366
Closing equity shareholders' funds	50,211	58,197	26,301	25,665

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the group's financial statements. The group has followed the transitional arrangements of FRS 17 'Retirement benefits' in these financial statements.

Basis of accounting

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

Basis of consolidation

Details of subsidiaries are given in note 25. The consolidated financial statements have been prepared from the financial statements of the company and its subsidiaries, all of which have been drawn up for the year ended 31 December 2003. As permitted by section 230 of the Companies Act 1985, a separate profit and loss account dealing with the results of the holding company only has not been presented.

Except where merger accounting is adopted any difference between the assets of subsidiaries acquired and the purchase consideration is capitalised. Positive goodwill is written off by equal annual instalments over its estimated useful life.

Depreciation

Aircraft and technical spares are depreciated using a straight line basis calculated to write down their cost to the current estimated residual values on the anticipated date of withdrawal from service or disposal. These estimates are reviewed regularly and adjusted as appropriate.

Depreciation rates:

Asset type

Aircraft	7 years to residual value
Rotables	5 - 15 years

The aircraft which the group owns are expected to have an operational life of between 15 and 23 years. However, the group has a policy of operating recently manufactured aircraft. Depreciation is charged to reduce the net book value of an aircraft to its estimated resale value over the period of ownership.

All other plant and equipment is depreciated on a straight line basis over five years except for motor vehicles (four years) and certain computer equipment which is depreciated over three years.

Freehold premises are being written down at 2% on cost per annum on the structure of the building and at 20% on cost per annum on refurbishments. Leasehold properties and improvements are written down over 5 to 20 years.

Stocks

Stocks consist of raw materials, consumable spares and sundry supplies, and are valued at the lower of cost and net realisable value.

Notes (continued)

1 Accounting policies (continued)

Aircraft maintenance costs

For owned aircraft, the costs of periodic aircraft overhauls are capitalised within fixed assets. Depreciation, in addition to that charged against the original capital value, is then charged against these maintenance assets at a variable rate dependant on the actual usage of the aircraft, such that, over time, the depreciation charge will match the related maintenance expenditure.

Provisions for periodic overhaul costs on an aircraft held under an operating lease are made with reference to the number of hours flown or similar basis over the period to the next major overhaul.

Routine maintenance is expensed in the year in which it is incurred.

Foreign currency translations

Monetary assets and liabilities denominated in foreign currencies are expressed at the rate prevailing at the balance sheet date or at the contracted rate where applicable. Transactions during the year denominated in foreign currencies are translated using the rate prevailing at the date the transaction occurred, or at the contracted rate where applicable.

The group operates aircraft which are purchased and sold in US dollars. Aircraft which are purchased are funded through dollar denominated loans. On the future disposal of the aircraft, the dollar proceeds will be used to repay the balances remaining on the dollar loans. The group considers that a natural hedge exists and therefore under SSAP 20, both owned aircraft and associated loans are re-translated to the year end exchange rate with the resultant differences being taken to reserves. Associated tax movements are also taken to reserves.

Leased assets

Annual rentals payable or receivable under operating leases are charged or credited to the profit and loss account on a straight line basis over the lease term.

Introductory costs

Introductory costs on aircraft fleet additions and new routes are written off as incurred.

Deferred taxation

The charge for taxation is based on the profit or loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is recognised, with discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Fixed asset investments

Fixed asset investments are stated at cost less provision made for impairment in the carrying value.

Notes (continued)

1 Accounting policies (continued)

Pension costs

The group operates a funded defined benefit pension scheme, and contributes to this scheme in accordance with recommendations from independent actuaries. Contributions are charged to the profit and loss account so as to spread the costs over the remaining working lives of the employees with the group.

The group also operates a defined contribution pension scheme. Contributions are charged to the profit and loss account as they are incurred.

2 Turnover

It is the view of the directors that all activities of the group fall within one class of business, that of airline operator.

Analysis of turnover by geographical area:

	2003 £000	2002 £000
Within the British Isles	329,705	314,688
Between British Isles and Europe	381,544	353,332
Other	60,974	55,736
	<hr/> 772,223	<hr/> 723,756
	<hr/>	<hr/>

Turnover within the British Isles comprises revenue from domestic flights. Turnover between the British Isles and other areas comprises revenue from inbound and outbound flights between the British Isles and other areas.

The activities of the group are managed and administered on a central basis within the British Isles. As a result it would not be possible to provide a meaningful analysis of the operating results and net assets of the group on a route by route basis. Consequently the operating results and net assets of the group are not shown across the geographical areas defined.

3 Other interest receivable and similar income

	2003 £000	2002 £000
Bank interest	3,718	3,492
Other	698	649
	<hr/> 4,416	<hr/> 4,141
	<hr/>	<hr/>

Notes (continued)

4 Interest payable and similar charges

	2003 £000	2002 £000
On bank loans and overdrafts whenever repayable and other loans wholly repayable within 5 years	912	473
On other loans repayable after more than five years	895	2,988
	<u>1,807</u>	<u>3,461</u>

5 Loss on ordinary activities before taxation

	2003 £000	2002 £000
<i>Loss on ordinary activities before taxation is stated after charging/(crediting) the following:</i>		
Amortisation of goodwill (note 10)	82	82
Depreciation of tangible fixed assets (note 11)	34,656	31,516
Hire of plant, machinery and aircraft	106,759	103,610
Other operating leases payable	10,763	10,721
Auditors' remuneration: - audit fee	87	85
- other fees	100	303
Net gain on foreign currency exchange	(3,140)	(4,621)
	<u>(3,140)</u>	<u>(4,621)</u>

The fees paid to the auditors in respect of audit services to the company were £5,000 (2002: £5,000).

6 Tax on loss on ordinary activities

	2003 £000	2002 £000
<i>Amounts (credited)/charged in the year:</i>		
Corporation tax - group relief	(70)	-
- prior year	(1,070)	-
	<u>(1,140)</u>	<u>-</u>
Deferred tax - origination and reversal of timing differences	(5,631)	(3,052)
- reduction in discount	1,324	575
	<u>(5,447)</u>	<u>(2,477)</u>
<i>Shown in the financial statements as:</i>		
Tax credit on loss on ordinary activities	(4,638)	(7,815)
Tax (credit)/charge on exchange movements within the statement of total recognised gains and losses	(809)	5,338
	<u>(5,447)</u>	<u>(2,477)</u>

Notes (continued)

6 Tax on loss on ordinary activities (continued)

Factors affecting the tax credit for the current year

The current tax credit for the year is lower (2002: lower) than the standard rate of corporation tax in the UK of 30% (2002: 30%). The differences are explained below:

	2003 £000	2002 £000
<i>Current tax reconciliation:</i>		
Loss on ordinary activities before tax	(9,859)	(19,563)
	<hr/>	<hr/>
Current tax at 30% (2002: 30%)	(2,958)	(5,869)
<i>Effects of:</i>		
Expenses not deductible for tax purposes	765	666
Capital allowances claimed for the period in excess of depreciation	1,310	(4,837)
Foreign exchange movements	-	5,338
Other timing differences	1,091	(472)
Tax losses carried forward	-	5,460
Utilisation of brought forward losses	(278)	(286)
Adjustments in respect of prior years	(1,070)	-
	<hr/>	<hr/>
Total current tax credit	(1,140)	-
	<hr/>	<hr/>

On submission of the 2002 corporation tax computation capital allowances were disclaimed. This has the effect of reducing tax losses and reducing the accelerated capital allowance position. There was no net effect on the overall deferred tax position.

7 Profit on ordinary activities attributable to the shareholders

Of the group profit attributable to shareholders, a profit of £636,000 (2002: £299,000 profit) is dealt with in the financial statements of the holding company.

8 Staff numbers and costs

	2003 Number	2002 Number
<i>The average number of persons employed by the group during the year was:</i>		
Flight deck and cabin crew	1,888	1,715
Service	1,376	1,512
Other	1,239	1,349
	<hr/>	<hr/>
	4,503	4,576
	<hr/>	<hr/>
	£000	£000
<i>The aggregate payroll costs of these persons were:</i>		
Wages and salaries	108,810	109,717
Social security costs	10,540	9,829
Other pension costs	9,302	8,486
	<hr/>	<hr/>
	128,652	128,032
	<hr/>	<hr/>

Notes (continued)

9 Emoluments of directors

	2003 £000	2002 £000
Directors' emoluments	1,139	813

The aggregate emoluments of the highest paid director were £421,000 (2002: £399,000). He is a member of a defined benefit scheme and began receiving his pension in 2002.

	Number of directors
<i>Retirement benefits are accruing to the following number of directors under:</i>	
Defined benefit schemes	3 1

10 Intangible assets

Group	Goodwill £000
<i>Cost:</i>	
At 1 January 2003 and 31 December 2003	1,633
<i>Provisions for amortisation and impairment:</i>	
At 1 January 2003	402
Amortisation charged in the year	82
At 31 December 2003	484
<i>Net book value:</i>	
At 31 December 2003	1,149
At 31 December 2002	1,231

Goodwill relates to the purchase of British Midland Regional Limited. This company was acquired by the group on 31 December 1997. The goodwill arising is being written off over 20 years on a straight line basis, as this is considered to be the period over which benefits will be derived.

Notes (continued)

11 Tangible fixed assets

Group	Property		Aircraft, engines and spares			Plant and machinery	Motor vehicles	Payments on account	Total
	Freehold property £000	Short leasehold and leasehold improvements £000	Sub-Total £000	Refurbishment of operating aircraft £000	Owned £000	Sub-Total £000	Owned £000	£000	£000
<i>Cost:</i>									
At 1 January 2003	9,498	30,784	40,282	15,926	276,382	292,308	482	14,158	408,969
Exchange movements	-	-	-	-	(24,903)	(24,903)	-	(563)	(25,466)
Additions	-	765	765	1,921	25,894	27,815	8	-	31,506
Transfers	-	-	-	1,048	7,511	8,559	-	(8,559)	-
Disposals	-	-	-	(2,805)	(3,199)	(6,004)	(83)	-	(6,222)
At 31 December 2003	9,498	31,549	41,047	16,090	281,685	297,775	407	5,036	408,787
<i>Accumulated depreciation:</i>									
At 1 January 2003	3,103	16,829	19,932	12,148	58,556	70,704	290	-	133,894
Exchange movements	-	-	-	-	(4,125)	(4,125)	-	-	(4,125)
Charged in year	200	2,529	2,729	3,072	22,852	25,924	29	-	34,656
Transfers	-	-	-	524	(524)	-	-	-	-
Disposals	-	-	-	(2,805)	(3,199)	(6,004)	(55)	-	(6,189)
At 31 December 2003	3,303	19,358	22,661	12,939	73,560	86,499	264	-	158,236
<i>Net book value:</i>									
At 31 December 2003	6,195	12,191	18,386	3,151	208,125	211,276	143	5,036	250,551
At 31 December 2002	6,395	13,955	20,350	3,778	217,826	221,604	192	14,158	275,075

Notes (continued)

11 Tangible fixed assets (continued)

- (a) During the current year the directors have re-assessed the estimated residual value of certain aircraft, both upwards and downwards. The net effect of this change is to reduce the depreciation charge for the year by £800,000.
- (b) At 31 December 2003 the group had authorised and contracted for capital commitments totalling £37,864,000 (2002: £57,892,000).
- (c) Freehold property includes £1,031,000 (2002: £1,031,000) relating to land which is not depreciated.

12 Investments

	Group	Company
	Unlisted £000	Subsidiary undertakings £000
Cost at 1 January 2003	8,921	31,654
Transfer to debtors	(290)	-
	<hr/>	<hr/>
Cost at 31 December 2003	8,631	31,654
	<hr/>	<hr/>
Net book value at 31 December 2003	8,631	31,654
	<hr/>	<hr/>
Net book value at 31 December 2002	8,921	31,654
	<hr/>	<hr/>

The unlisted investment represents a 14% holding in the ordinary share capital of The Airline Group Limited.

13 Debtors

	Group	
	2003 £000	2002 £000
<i>Amounts falling due within one year:</i>		
Trade debtors	30,468	40,882
Amounts owed by parent company	70	-
Other debtors	3,562	3,051
Prepayments and accrued income	28,058	14,760
	<hr/>	<hr/>
	62,158	58,693
	<hr/>	<hr/>
<i>Amounts falling due after more than one year:</i>		
Prepayments and accrued income	8,231	11,570
	<hr/>	<hr/>
	70,389	70,263
	<hr/>	<hr/>

Notes (continued)

14 Creditors: amounts falling due within one year

	Group		Company	
	2003	2002	2003	2002
	£000	£000	£000	£000
Bank loans and overdrafts	13,369	12,970	-	-
Trade creditors	76,791	66,306	-	-
Amounts owed to subsidiary undertakings	-	-	5,343	5,528
Corporation tax	-	1,070	-	-
Other tax and social security	2,655	2,891	-	-
Other creditors	53	454	-	454
Accruals and deferred income	106,747	113,139	10	7
	<u>199,615</u>	<u>196,830</u>	<u>5,353</u>	<u>5,989</u>

The loans are secured on the aircraft which form the object of the relevant loan.

15 Creditors: amounts falling due after more than one year

	Group	
	2003	2002
	£000	£000
<i>Loans repayable:</i>		
Within one to two years	17,104	17,541
Within two to five years	50,186	44,710
After more than five years	100,177	123,451
	<u>167,467</u>	<u>185,702</u>

The loans are secured on the aircraft which form the object of the relevant loan.

A loan for £24.0 million (2002: £26.7 million) has been guaranteed by Lufthansa and is not secured on any assets of the group.

The total amount repayable by instalments after 31 December 2003 in respect of loans and obligations under finance leases and hire purchase contracts which expire after more than five years is £158,626,000 (2002: £188,813,000) of which £100,177,000 (2002: £123,451,000) falls due after more than five years from the balance sheet date.

Interest on principal loans is at rates varying from 0.99% to 3.85% per annum.

Notes (continued)

16 Operating lease commitments

The minimum non-cancellable operating lease payments to which the group was committed, as at 31 December, to pay during the following year, analysed into the year in which the lease commitment expires, are as follows:

	Land and buildings		Other assets	
	2003 £000	2002 £000	2003 £000	2002 £000
<i>Lease expiry within:</i>				
One year	645	650	7,132	7,307
Two to five years	325	352	50,924	51,814
More than five years	2,792	2,809	19,487	29,135
	<hr/>	<hr/>	<hr/>	<hr/>
	3,762	3,811	77,543	88,256
	<hr/>	<hr/>	<hr/>	<hr/>

17 Provisions for liabilities and charges

The Group

	Mainten- ance £000	Deferred taxation £000	Total £000
At 1 January 2003	39,230	12,910	52,140
Profit and loss account - charged/(credited) in the year	20,453	(3,498)	16,955
Statement of total recognised gains and losses - credited in the year	-	(809)	(809)
Utilised	(19,458)	-	(19,458)
	<hr/>	<hr/>	<hr/>
At 31 December 2003	40,225	8,603	48,828
	<hr/>	<hr/>	<hr/>

The elements of deferred taxation are as follows:

	2003 £000	2002 £000
Difference between accumulated depreciation and capital allowances	14,391	26,739
Tax losses carried forward	-	(6,289)
Other timing differences	(2,285)	(3,213)
ACT recoverable	(708)	(208)
	<hr/>	<hr/>
Undiscounted provision	11,398	17,029
Discount	(2,795)	(4,119)
	<hr/>	<hr/>
Discounted provision	8,603	12,910
	<hr/>	<hr/>

The Company

There is no liability for deferred taxation.

On submission of the 2002 corporation tax computation capital allowances were disclaimed. This has the effect of reducing tax losses and reducing the accelerated capital allowance position. There was no net effect on the overall deferred tax position.

Notes (continued)

18 Share capital

	2003 £000	2002 £000
<i>Authorised:</i>		
68,987,590 ordinary shares of 25p each	17,247	17,247
<i>Issued and fully paid:</i>		
65,088,293 ordinary shares of 25p each	16,272	16,272

19 Balance arising on reorganisation

Group	2003 £000	2002 £000
At 1 January and 31 December 2003	(12,143)	(12,143)

The balance arose in 1987 following the reorganisation of the group and formation of British Midland PLC. It represents the difference between the nominal value of shares issued in British Midland PLC and the nominal value of shares in British Midland Holdings Limited acquired in exchange.

20 Reserves

	Group and Company £000
Share premium account	
At 1 January and 31 December 2003	7,568
Statutory reserve	Group £000
At 1 January and 31 December 2003	387

This reserve arises as a result of a statutory transfer from the profit and loss account reserve of the group's insurance subsidiary. It may only be distributed upon the fulfilment of certain conditions with the approval of the Isle of Man Insurance Authority.

	Group		Company
	2003 £000	2002 £000	2003 £000
Profit and loss account			2002 £000
At 1 January	46,113	65,310	1,825
(Accumulated loss)/retained profit for the financial year	(5,221)	(11,748)	636
Exchange movements	(2,765)	(7,449)	-
At 31 December	38,127	46,113	2,461

Notes (continued)

21 Reconciliation of operating loss to net cash inflow from operating activities

	2003 £000	2002 £000
Operating loss	(12,519)	(21,670)
Depreciation	34,656	31,516
Amortisation of goodwill	82	82
Maintenance charge	20,453	43,049
Maintenance provisions utilised	(19,458)	(33,903)
(Increase)/decrease in stock	(455)	597
Decrease in debtors	477	23,829
Increase in creditors	4,394	4,709
	<hr/>	<hr/>
Net cash inflow from operating activities	27,630	48,209
	<hr/>	<hr/>

22 Analysis of changes in net debt

	At 1 Jan 03 £000	Cash flows £000	Exchange adjustments £000	At 31 Dec 03 £000
Cash at bank and in hand	122,319	2,836	(5,269)	119,886
	<hr/>	<hr/>	<hr/>	<hr/>
Debts due after one year	(185,702)	(3,297)	21,532	(167,467)
Debts due within one year	(12,970)	(1,903)	1,504	(13,369)
	<hr/>	<hr/>	<hr/>	<hr/>
		(5,200)	23,036	
	<hr/>	<hr/>	<hr/>	<hr/>
Total	(76,353)	(2,364)	17,767	(60,950)
	<hr/>	<hr/>	<hr/>	<hr/>

Notes (continued)

23 Analysis of cash flows for headings netted in the cash flow statement

	2003 £000	2002 £000
Returns on investments and servicing of finance		
Interest received	4,173	3,364
Interest paid	(2,140)	(4,538)
	<hr/>	<hr/>
Net cash inflow/(outflow) from returns on investments and servicing of finance	2,033	(1,174)
	<hr/>	<hr/>
Capital expenditure and financial investment		
Purchase of tangible fixed assets	(32,111)	(8,381)
Sales of tangible fixed assets	84	5,580
	<hr/>	<hr/>
Net cash outflow for capital expenditure and financial investment	(32,027)	(2,801)
	<hr/>	<hr/>
Financing		
New borrowings	20,228	-
Repayment of amounts borrowed	(15,028)	(20,096)
	<hr/>	<hr/>
Net cash inflow/(outflow) from financing	5,200	(20,096)
	<hr/>	<hr/>

24 Pensions

The group operates a funded, defined benefit, pension scheme, the British Midland Airways Pension & Life Assurance Scheme. The assets of the scheme are held separately from those of the company and are invested with insurance companies / investment managers. Contributions to the scheme are charged to the profit and loss account so as to spread the cost of the pensions over the employees' remaining working lives with the company. The contributions are determined by an independent qualified actuary on the basis of triennial valuations using the projected unit method. The most recent valuation was at 1 August 2002. The assumptions which have the most significant effect on the result of the valuation are those relating to the growth of investments and the rates of increases in salaries. It was assumed that investment returns would be 8.0% (post retirement investment return 5.6%) and that salaries would increase by 2.5% in 2004 and 3.5% thereafter. Pension increases in payment were assumed to increase at either 2.5% or 3.0% depending on the membership category.

The pension charge for the period (excluding members own contributions) was £9,302,000 (2002: £8,486,000). A pension prepayment included within debtors, at 31 December 2003 amounted to £2,025,000 (2002: £2,250,000) and is being spread over the remaining service lives of the employees in the scheme.

The most recent actuarial valuation showed that the value of the schemes' investments was 78% of the value of the benefits that had accrued to members. The contributions of the group and employees during 2003, as a percentage of annual earnings, range between 10.0% and 19.7% and 6.2% and 10.0% respectively.

At the date of the latest actuarial valuation the market value of the Scheme's assets was £122,712,000.

Notes (continued)

24 Pensions (continued)

Additional FRS 17 disclosures

Whilst the company continues to account for pension costs in accordance with SSAP 24 'Accounting for pension costs', under FRS 17 'Retirement benefits', the following transitional disclosures are required.

The company operates a defined benefit scheme called the British Midland Airways Limited Pension & Life Assurance Scheme.

An actuarial valuation was carried out as at 1 August 2002 and has been updated on an approximate basis to 31 December 2003 by a qualified independent actuary. The major assumptions used by the actuary were:

Actuarial assumptions	31 December 2003	31 December 2002	31 December 2001
Discount rate	5.50%	5.60%	6.08%
Salary escalation (including merit increases)	0% up to 1 April 2004, thereafter 2.60%	0% up to 1 April 2004, thereafter 2.47%	2.60%
Inflation assumption	2.60%	2.47%	2.60%
Rate of increase to deferred pensions	2.60%	2.47%	2.60%
Limited price indexation	2.60%	2.47%	2.60%
Expected return on scheme assets	7.05%	7.15%	6.60%

Balance sheet items	31 December 2003 £000	31 December 2002 £000	31 December 2001 £000
Total market value of scheme assets	149,629	121,103	136,778
Present value of scheme liabilities	(213,129)	(178,803)	(155,943)
Deficit in the scheme	(63,500)	(57,700)	(19,165)
Related deferred tax asset	19,050	17,310	5,750
Net pension deficit	(44,450)	(40,390)	(13,415)

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

	31 December 2003 Expected rate of return % pa	31 December 2003 £000	31 December 2002 Expected rate of return % pa	31 December 2002 £000	31 December 2001 Expected rate of return % pa	31 December 2001 £000
Equities	7.70%	112,147	8.00%	85,781	7.04%	101,443
Bonds	5.10%	37,588	5.10%	35,273	5.56%	31,697
Cash	2.60%	(106)	2.50%	49	2.60%	3,638
Total market value of assets	7.05%	149,629	7.15%	121,103	6.60%	136,778

Notes (continued)

24 Pensions (continued)

If the company had adopted the full requirements of FRS17 the following entries would have been made:

Analysis of amount charged to operating profit

	2003 £000	2002 £000
Current service cost	7,458	6,241
Settlement	-	(645)
Past service cost	275	-
	<hr/>	<hr/>
Total operating charge	7,733	5,596
	<hr/>	<hr/>

Analysis of amount charged to other finance income

	2003 £000	2002 £000
Expected return on pension scheme assets	8,952	9,293
Interest on pension scheme liabilities	(10,204)	(9,707)
	<hr/>	<hr/>
Total financing costs	(1,252)	(414)
	<hr/>	<hr/>

Analysis of amount recognised in statement of total recognised gains and losses ('STRGL')

	2003 %	2003 £000	2002 %	2002 £000
Actual return less expected return on pension scheme assets		11,383		(32,672)
Percentage of scheme assets	7.6%		27.0%	
Experience gains/(losses) arising on pension scheme liabilities		(5,859)		(3,236)
Percentage of scheme liabilities (at present value)	2.7%		1.8%	
Changes in financial assumptions underlying pension scheme liabilities		(11,154)		(5,020)
Percentage of scheme liabilities (at present value)	5.2%		2.8%	
		<hr/>		<hr/>
Actuarial loss recognised in the STRGL		(5,630)		(40,928)
		<hr/>		<hr/>

Percentages above are given as a proportion of scheme assets or liabilities as appropriate.

Notes (continued)

25 Subsidiary undertakings

British Midland PLC has the following interests in the ordinary share capital of its subsidiary undertakings, all of which have contributed to the assets and results of the group:

	Direct or indirect % owned	Where registered	Nature of business
BMI Airways Limited *	100	England and Wales	Dormant
British Midland Airways Limited	100	England and Wales	Airline operator
British Midland Holdings Limited	100	England and Wales	Investment company
Diamond Insurance Company Limited	100	I.o.M.	Insurance underwriting company
International Cargo Marketing Limited *	100	England and Wales	Dormant
BM Handling Services Limited *	100	England and Wales	Dormant
British Midland Engineering Limited *	100	England and Wales	Dormant
bmibaby Limited (formerly BM Aviation Services Limited)	100	England and Wales	Dormant
British Midland Regional Limited *	100	Scotland	Dormant

* Indirect subsidiary undertaking of British Midland PLC.

26 Related party transactions

Scandinavian Airlines System Denmark, Norway, Sweden ('SAS')

The group had net receipts of £26,289,000 (2002: £36,720,000) in respect of interline billing, other passenger revenue sharing arrangements, handling and other services from SAS and its subsidiaries. The net balance owing to the group at 31 December 2003 was £322,000 (2002: £6,126,000).

Deutsche Lufthansa Aktiengesellschaft ('Lufthansa')

The group had net receipts of £4,678,000 (2002: £27,340,000) in respect of interline billing, wet leasing, handling and other passenger revenue sharing arrangements from Lufthansa and its subsidiaries. The net balance owing to the group at 31 December 2003 was £6,537,000 (2002: £6,504,000).

A loan for £24.0 million (2002: £26.7 million) taken out by British Midland Airways Limited has been guaranteed by Lufthansa.

27 Commitments

A substantial portion of capital expenditure, leasing commitments, fuel and other purchases are payable in US Dollars. Forward purchase contracts amounting in aggregate to US\$503 million (2002: US\$381 million) outstanding at 31 December 2003, have been placed to cover part of the exposure risk.

Capital commitments are disclosed in note 11.

28 Ultimate holding company

The ultimate holding company is The BBW Partnership Limited, registered in England and Wales. The results of the group are included in the consolidated financial statements of that company, and copies of the financial statements can be obtained from the Registrar of Companies, Crown Way, Cardiff.