

**NATS Holdings Limited**  
Annual Report and Accounts  
Year ended 31 March 2016

Company Number: 04138218

## Who we are

**NATS Holdings Limited** (NATS) is an air traffic control (ATC) services provider which owns two principal operating subsidiaries: NATS (En Route) plc and NATS (Services) Limited.

**NATS (En Route) plc** (NERL) is our core business and the sole provider of ATC services for aircraft flying 'en route' in UK airspace and the eastern part of the North Atlantic. It is regulated by the Civil Aviation Authority (CAA) within the framework of the European Commission's (EC) Single European Sky (SES) and operates under licence from the Secretary of State for Transport. It operates from two ATC centres; Swanwick in Hampshire and Prestwick in Ayrshire.

**NATS (Services) Limited** (NATS Services) provides ATC at 14<sup>1</sup> UK airports, and to Gibraltar and three other airfields under the UK MOD's Project Marshall contract. It also provides engineering, consultancy (including training) and aviation information management services to UK and overseas customers and to the UK MOD. FerroNATS, a joint venture with Ferrovial Servicios SA, provides air traffic services at 9 airports in Spain. Aquila, a joint venture with Thales UK Limited, is fulfilling the Project Marshall<sup>2</sup> contract.

## Our purpose

We keep the skies safe and deliver the best possible customer experience.

## Our objectives

- Delivering a safe, efficient and reliable service every day.
- Delivering SESAR<sup>3</sup> and transforming the business for the future.
- Winning and retaining commercial business.

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<sup>1</sup> A number of explanatory notes are provided on page 122 of this report

## Financial highlights

Financial year ended 31 March (£m unless otherwise specified)	2016	2015	Change %
Revenue	898.1	922.4	-2.6
Profit before tax, goodwill impairment & exceptional redundancy costs (in 2015)	137.1	226.5	-39.5
Profit before tax	44.4	200.3	-77.8
Capital expenditure	147.6	153.5	-3.8
Net debt <sup>1</sup>	303.3	378.7	-19.9
Gearing <sup>2</sup> (%)	49.1%	53.4%	-8.1
Dividends	81.7	77.0	+6.1

<sup>1</sup> Excludes derivative financial instruments

<sup>2</sup> Ratio of the net debt to regulatory assets of the economically regulated business (NERL)

## Delivering a safe, efficient and reliable service

- We handled 2.3 million flights (2015: 2.2 million) and maintained our safety record. Average en route delay per flight was 4.3 seconds (2015: 2.2 seconds).
- We are enabling annual emissions savings of 1.1 million tonnes of CO<sub>2</sub> (34,000 tonnes more than in 2015), worth around £111m in fuel savings to airline customers.
- We took over the ATC for two military airfields and upgraded radio and tower systems at a number of MOD sites in support of Aquila's Project Marshall contract.

## Delivering SESAR and transforming the business

- We have a clear technical and operational transition programme to integrate and deploy SESAR technology.
- Milestones we completed included the transition to the temporary operations room at Swanwick and starting to use our new flight data processing system (iTEC<sup>4</sup>) in the Scottish Flight Information Region.

## Winning and retaining commercial business

- We renewed ATC contracts with Aberdeen, Belfast International, Glasgow, Heathrow and Southampton. We were awarded the ATC contract by George Best Belfast City Airport.
- The Gatwick ATC service was smoothly transferred to a new provider.
- We deployed Time-Based Separation (TBS) at Heathrow airport, significantly enhancing performance on the windiest days.
- We grew our international business.

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## Chairman's statement

### Financial performance

Calendar year 2015 was the first full year of Regulatory Reference Period 2 (RP2: 2015 to 2019). As foreshadowed in last year's report, the results this year reflect the challenging regulatory settlement for RP2 and the more competitive environment for our airport ATC business. Our results show reduced revenues of £898m (2015: £922m) and a significantly lower profit before tax of £44m (2015: £200m), after anticipated increases in pension and depreciation charges, and a £93m (2015: £17m) goodwill impairment charge. Our cost base has been progressively reduced in anticipation of the lower revenues we now face, enabling NATS (En Route) plc (NERL) to achieve a modest outperformance of its regulatory rate of return in the first year of RP2.

In May 2016, the company paid a first interim dividend for 2016/17 of £24.0m which mainly reflects a proportion of the allowance for shareholder return that the CAA made in the prices that NERL is permitted to charge in RP2. The company paid dividends of £81.7m during the 2015/16 financial year which also reflected some dividends from accumulated retained earnings not distributed in earlier regulatory reference periods, noting that NERL paid no dividends to shareholders from the date of the PPP until October 2008.

### Safety and operations

We have maintained our excellent safety record, providing a resilient service with little air traffic delay and achieved a number of important capital investment milestones. I am pleased to report that a number of airport operators awarded their tower contracts to NATS this year. We also transitioned air

traffic control operations smoothly to the new provider at Gatwick airport.

### Our strategic objectives

Our direction is now very clear as we progress through RP2:

- deliver a safe, efficient and reliable service from our air traffic control centres and airport towers;
- transform the business through the integration and deployment of Single European Sky ATM Research programme (SESAR) technologies; and
- win and retain commercial UK business and explore sound international opportunities as they arise.

The most far reaching objective is deploying SESAR technology to improve the way Europe's airspace is managed. We have a clear technical and operational transition plan and have started to deliver this challenging and major programme of work.

### Independent Enquiry actions

We have discharged the 21 NATS related recommendations resulting from the Independent Enquiry into the December 2014 technical failure at Swanwick. In addition, we are working with the CAA on the five joint recommendations which are expected to complete in 2017, subject to stakeholder consultation.

### EU referendum

During the year the Board considered how the referendum on continued UK membership of the European Union (EU) will affect the Company. If the United Kingdom votes to remain in a reformed EU, we do not anticipate a significant impact on NATS activities or business risks from the changes agreed with EU partners. If the United Kingdom votes to leave the European Union



then, in the longer-term, the impact of this decision depends to a large extent on the type of relationship that is forged between the UK and the EU. However, we do not expect that it will have a significant impact on NATS activities provided the UK continues to participate in the Single European Sky project (SES). However, in the shorter-term the initial uncertainty and market volatility that might result (e.g. exchange rates) could affect the demand for air travel and therefore our future revenue, although any changes would be mitigated by traffic volume risk sharing arrangements.

#### **Defined benefit pension scheme**

Trustees of the defined benefit pension scheme are performing their formal triennial valuation as at 31 December 2015. The funding position is likely to show a materially higher deficit than the last valuation due to continued challenging market conditions. Actions are in place, through the economic regulatory framework and from cash reserves to enable the company to meet likely increases in contributions. The Trustees are expected to complete their valuation later this year.

#### **HM Government's shareholding**

In his Autumn Statement, the Chancellor of the Exchequer announced that HM Government would explore the sale of its 49% shareholding in NATS. The Board is being kept informed of this review, but understand that no final decision has yet been made.

#### **Governance**

In October, the Board confirmed Martin Rolfe's appointment as Chief Executive Officer after a rigorous search involving internal and external candidates. Since his appointment

he has set a new tone with employees, customers and other external stakeholders. Derek Provan joined the Board this year and brings the benefit of his experience of airfield operations at Heathrow. He replaced Roger Cato who stood down after serving for 13 years. I would like to thank Roger for his valuable contributions to the Board, Safety Review, Technical Review and Nominations committees.

#### **Outlook for 2017**

We knew that RP2 would bring challenges. Our regulatory targets for 2017 are even more demanding than for 2016. Traffic volumes are growing, which is positive but also presents a challenge in terms of airspace capacity and society's tolerance for overflight noise. We will seek to improve how we engage with the range of stakeholder views and seek to address them as we make our case for airspace modernisation. We also remain acutely aware that we are not the only choice of air traffic service provision for UK airports and will continue to strive to provide the safest and most efficient service possible to all customers.

NATS is well equipped to meet these challenges.

I would like to extend my appreciation to the management team and all of our employees for their hard work and commitment to the company's success.

**Dr Paul Golby, CBE,  
Chairman**



## Chief Executive's review

This has been a year of many firsts: the first full year of RP2; the first year of implementing our SESAR deployment strategy; and the first year of our strategic partnership with Heathrow. It is also the end of my first year as Chief Executive Officer, with my new management structure now in place.

### Overview of performance

We expected our profitability to be lower this year for the reasons given by the Chairman. We therefore took the right actions over the last two years to reduce costs.

Last summer I set out our priorities for the year (see table below). I am pleased to report that we achieved most of these.

We handled 2.28 million flights in the year, 3% more than 2015. This was another very safe year for our ATC provision with no risk-bearing Airprox<sup>5</sup> incident attributable to NATS. Overall we performed better than 2013 but not quite as well as 2014 which was a particularly good year. We continue to look for ways to reduce safety risk and introduced measures over the winter which improved our safety performance at airports. Benchmarking against our peers confirms we are meeting, and in some cases setting, best practice.

Unauthorised infringements of controlled airspace account for about 30% of NATS safety risk and we are actively working with the CAA and the Airport Operators Association (AOA) to tackle hotspots around key airfields. While good progress has been made engaging with the general

aviation community, this has not achieved the level of improvement we believe is essential. We have worked with the CAA to establish an approach which includes tougher CAA enforcement action against repeat offenders and increased funding for tools and technology to detect infringers and to support pilots, including their training. We also see a need for a greater focus on drones, including technical solutions to assist detection, alongside a regulatory policy that recognises their increased use for commercial and recreational purposes.

Our overall, Air Traffic Flow Management (ATFM) delay<sup>6</sup> for the financial year was 4.3 seconds per flight (2015: 2.2 seconds). While this is marginally higher than last year it is seven times better than the European average. A significant contributor to our good performance this year has been Time-Based Separation (TBS). NATS deployment of this capability is a world first, and has improved landing rates at Heathrow airport in conditions of strong headwinds, significantly enhancing performance during some of the windiest days. It has fundamentally, and safely, changed the management of airport approach and won several industry awards in its first year of operation. Our primary objective will always be keeping the skies safe while delivering the best possible service – this means ensuring that we employ the best technology that we can. Our ambition for our regulated business is to provide our



Priorities for 2015/16	How we did
<b>Safety &amp; resilience:</b> Continue to provide safe and resilient air traffic services from our 14 UK airports and two en route centres.	✓
<b>Temporary Operations room:</b> Transition to the temporary operations room in Swanwick, the first stage of the SESAR deployment plan.	✓
<b>iTEC:</b> Deploy and operate iTEC in the Scottish upper airspace.	✓
<b>Airport contracts:</b> Renew or win three or more UK airport contracts.	✓
<b>Project Marshall:</b> Start the Marshall Programme ATC and technical services at Middle Wallop/Netheravon & Shawbury.	✓
<b>Overseas revenue:</b> Achieve overseas revenue target in our focus regions.	✗

customers 'One Operation from Two Centres on a Common Platform'. This will enable us to replace our legacy systems with new technology that is easier and more cost effective to maintain, allowing us to be more agile and responsive to customer needs. SESAR technology will also enable us to increase our airspace capacity to accommodate rising traffic levels and interoperate fully with other European ANSPs. This year we developed the transition sequence for deploying SESAR technology. We achieved the first milestone by moving the Swanwick area control and military operations into a temporary operations room while we refit the main operations room. The second major milestone was achieved with iTEC entering limited service for Scottish upper airspace, a clear step towards trajectory-based operations (more accurate and dynamic flight profiles coordinated between stakeholders).

In service of the UK's aviation strategy, we delivered the first stage of our airspace modernisation programme (LAMP<sup>7</sup> phase 1a) but further stages have been paused. The pace of progress now depends on the political will to support its wider benefits. Airspace change is a challenge for the aviation industry, particularly in the face of concerns about aircraft noise and pending the decision on runway capacity in the South East. We are investing heavily in engaging with local communities most likely to be impacted by airspace change to try to find the best solutions for local communities, airlines, the travelling public and NATS. We are working hard to make our airport service proposition even more compelling. This was reflected in important contract renewals from Aberdeen, Belfast International, Glasgow, Heathrow and Southampton, and the winning of George Best Belfast City Airport.



Edinburgh airport is tendering its next ATC contract, which we will be competing to retain. We also supported Gatwick airport with the transition of its ATC service to its new provider, and have seconded NATS staff to support that service.

Our support to Project Marshall, awarded in 2014 by the MOD to Aquila, our joint venture with Thales UK, has started positively. We now provide the ATC service at Middle Wallop and Netheravon airfields and are upgrading and maintaining radio and tower systems at a number of MOD sites.

In Europe, our FerroNATS joint venture handles 20% of Spanish airport air traffic movements and is meeting all of its operational performance targets. We are continuing to develop our other international business and this year generated revenue of £7.6m (2015: £4.1m). The Asia Pacific region performed a little better than expected while the lower oil price has reduced opportunities in the Middle East for now.

### **Our purpose and objectives**

Since taking over as CEO and following my engagement with some 2,000 staff last summer, it was clear that a more engaging and effective articulation of our purpose and strategic objectives was necessary. I am now working with my executive team to achieve this. Our strategic objectives are clear, my executive team is focused on delivering our day to day operations, delivering the SESAR technology and related business change; and winning and retaining

commercial business.

### **Our priorities for 2017**

- Provide safe and resilient air traffic services from our airports and centres.
- Achieving two SESAR milestones: to complete the introduction of iTEC into Scottish Upper Airspace; and to deploy and operate electronic flight strips in limited operational service in Swanwick Terminal Control.
- Achieve a Mode-S Surveillance radar capability for Project Marshall.
- Establish a remote tower capability for airport ATC operations.
- Establish further strategic partnerships with our airport customers.

Overall, we made good progress in meeting our objectives in 2015/16 which gives me further confidence that we can rise to the challenges we face as we transform the business in RP2. Above all, I would like to thank all our employees for their dedication again this year.

**Martin Rolfe**

**Chief Executive Officer**

## Financial review

Financial year ended 31 March	2016	2015
	£m	£m
Revenue	898.1	922.4
Profit before tax & goodwill impairment, & exceptional redundancy costs (in 2015)	137.1	226.5
Profit before tax	44.4	200.3
Profit after tax	27.6	156.9
Dividends	81.7	77.0

The group reported a profit before tax of £44.4m compared with £200.3m in 2015. Profit before tax and goodwill impairment was £137.1m (2015: £226.5m before tax, goodwill impairment, and exceptional redundancy costs). A reduction in revenue and profit was signalled in last year's annual report, which referenced the impact of lower prices for UK en route and airports services, higher accounting pension costs and depreciation charges. The factors impacting the results are as follows:

	£m	Profit before tax £m
2015 profit before tax		200.3
<b>Revenue changes</b>		
Airspace		
UK en route revenue	(32.2)	
Service performance incentive	(1.1)	
Other revenue changes (net)	7.0	
	(26.3)	
Airports	(15.3)	
Engineering	14.6	
Other UK business	(0.8)	
International	3.5	
	(24.3)	
<b>Operating cost changes</b>		
Staff pension costs	(30.5)	
Other staff costs	(4.8)	
Non-staff costs (net of other income)	(20.2)	
Depreciation & amortisation, net of grants	(18.5)	
Disposal of assets	7.3	
	(66.7)	
Goodwill impairment	(75.7)	
Exceptional redundancy costs	9.2	
	(66.5)	
<b>Finance cost changes</b>		
Fair value movement on derivative contract		1.1
<b>Results of associates &amp; joint ventures</b>		0.5
<b>2016 profit before tax</b>		<b>44.4</b>

## Regulatory return

We assess the performance of NERL's regulated activities by reference to the regulatory settlement. For the first year of RP2 (calendar year 2015), NERL achieved a pre-tax real return of 6.94% compared with the regulatory return of 5.86% assumed in the regulatory settlement. This was mainly achieved through service performance incentives and operating cost efficiencies which offset a lower rate of traffic volume increase than previously assumed.

While this is a good start to the reference period, the modest out-performance from service incentives and cost efficiencies will be challenging to maintain. We expect traffic volumes to continue to grow at a time when we will be deploying SESAR through RP2, which will put pressure on service performance. We will also bear the costs of running legacy systems during the period of transition to SESAR technology.

## Comparison between reported profit and regulatory return

The profits reported in these financial statements are prepared in accordance with IFRS and policies described in note 2 to these accounts. As described below, the CAA applies an economic regulatory building block model which is mainly cash-based. It can give rise to some significant differences between reported operating profit and regulatory return, mainly due to:

- lower historical cost depreciation compared with regulatory depreciation which is indexed to inflation; and



- lower accounting pension costs using best estimate assumptions prescribed by accounting standards compared with cash contributions agreed with Trustees, which include a margin for prudence.

This difference in basis explains why NERL's reported operating profit before goodwill impairment is some £67m higher than its regulatory profit, on the calendar year basis reported for its regulatory accounts.

### Revenue

Revenue at £898.1m (2015: £922.4m) was £24.3m lower. This included a full year's impact of the RP2 settlement, which applied from January 2015. UK en route revenue was lower by £32.2m as regulatory allowances reflected the CAA's challenging cost efficiency targets and a lower cost of capital in RP2. Revenue from UK airport ATC services was also lower by £15.3m reflecting price reductions and the loss of the Birmingham and Gatwick contracts.

These reductions were partly offset by growth in engineering income, largely from work performed for our Aquila joint venture's Project Marshall contract. Revenue from our contract with the MOD and from European organisations also improved.

### Operating costs

Operating costs, before goodwill impairment, as well as exceptional redundancy costs in 2015, were £736.3m (2015: £669.6m).

The increase in staff costs was largely due to higher pension charges. Before redundancy-related past service costs,

these were £30.5m higher at £140.6m (2015: £110.1m) principally due to an increase in the accrual rate for the defined benefit pension scheme to 45.4% (2015: 32.5%), before salary sacrifice.

	2016	2015
	£m	£m
Staff costs	(439.1)	(403.8)
Non-staff costs	(176.3)	(156.1)
Asset related charges	(128.0)	(109.5)
Profit/(loss) on disposal of assets	7.1	(0.2)
Operating costs	(736.3)	(669.6)

The average number of staff employed during the year was 4,164 (2015: 4,342) and those in post at 31 March 2016 decreased by 2.5% to 4,144 (2015: 4,252).

Non-staff costs (net) at £176.3m (2015: £156.1m) were £20.2m higher than the previous year. This mainly reflects the increase in activity to support Project Marshall and SESAR deployment. It also includes some property charges from airport operators this year, which are charged back to them through our ATC contract. The company also relocated staff following the closure of its office near Heathrow.

Asset related charges (net), mainly depreciation and amortisation, increased to £128.0m (2015: £109.5m): during 2015 we re-assessed the remaining economic lives of some assets to reflect the timing of deployment of SESAR technology. The profit for the year also included gains of £7.1m from asset disposals (2015: loss £0.2m).

**Goodwill impairment and exceptional redundancy costs (in 2015)**

	2016	2015
	£m	£m
Goodwill impairment	(92.7)	(17.0)
Exceptional redundancy costs	-	(9.2)
Total before tax	(92.7)	(26.2)

A goodwill impairment charge of £92.7m was recognised this year (2015: £17.0m) by NERL, our economically regulated business. It does not impact its cash flows or its regulatory profit. The impairment charge reflects an assessment of: opportunities to outperform regulatory targets in RP2; our assessment of any potential premium that a purchaser might pay for a controlling interest; our latest forecasts of traffic volumes relative to the RP2 settlement; and our ability to recover true-ups in relation to certain regulatory revenue allowances (e.g. pension costs). The carrying value of goodwill is intrinsically linked to NERL's regulatory settlements and its regulatory asset base (RAB) in particular. NERL's RAB is uplifted annually for inflation and increases with capital expenditure and reduces by regulatory depreciation. Regulatory depreciation is a source of revenue allowances (explained in the description of NERL's business model). During RP2, NERL's capital investment is projected to be less than regulatory depreciation. As a result, the RAB is expected to contract in real terms. Consideration is also given to opportunities to outperform regulatory settlements and any premium which a purchaser would be willing to pay for a controlling interest by reference to the

projected financial return indicated by the company's business plan and UK and European market transactions in utilities and airport operators.

One-off redundancy costs of £9.2m were incurred in 2015 by NATS Services as it reorganised its activities to improve its competitiveness.

**Share of results of joint ventures and associates**

	2016		2015	
	Total	Group's share	Total	Group's share
	£m	£m	£m	£m
<b>Turnover</b>				
FerroNATS	9.7	4.9	10.4	5.2
Aquila	74.4	37.2	28.0	14.0
ESSP	47.7	8.0	49.7	8.3
	<u>131.8</u>	<u>50.1</u>	<u>88.1</u>	<u>27.5</u>
<b>Profit after tax</b>				
FerroNATS	1.1	0.6	0.9	0.5
Aquila	0.9	0.5	0.3	0.1
ESSP	2.7	0.4	2.1	0.4
	<u>4.7</u>	<u>1.5</u>	<u>3.3</u>	<u>1.0</u>
<b>Net assets</b>				
FerroNATS	3.3	1.7	2.0	1.0
Aquila	1.5	0.7	0.5	0.2
ESSP	7.4	1.2	5.2	0.9
	<u>12.2</u>	<u>3.6</u>	<u>7.7</u>	<u>2.1</u>

The group recognised £1.5m (2015: £1.0m) for its share of the post-tax profits of its two joint ventures: FerroNATS and Aquila, and its associate European Satellite Services Provider SAS (ESSP). FerroNATS has performed broadly in line with the previous year while Aquila, which was established for the Project Marshall contract it won in the previous year, has now started to upgrade the MOD's ATC infrastructure.

**Net finance costs**

Overall, net finance costs of £26.2m were £1.1m less than the prior year (2015: £27.3m) and mainly reflected the change in market value of the index-linked swap derivative contract.



The swap was taken out in 2003 as an economic hedge of NERL's revenue allowance for financing charges, which is linked to inflation. It does not qualify for hedge accounting under international accounting standards, and changes in its fair value are recognised in the income statement. The fair value varies with changes in the market's expectations of inflation and swap discount rates over the time to expiry of the contract in 2026, and can be volatile. This year, changes in market conditions resulted in a slightly greater reduction in the swap's market value liability than the prior year, resulting in a credit of £2.6m (2015: £1.5m credit).

Excluding the swap, net finance costs were unchanged at £28.8m (2015: £28.8m). The benefit of lower bond interest following repayments of bond principal was offset by the cost of refinancing bank facilities and lower interest earned on cash balances.

### **Taxation**

The tax charge of £16.8m (2015: £43.4m) was at an effective rate of 37.8% (2015: 21.7%). This is higher than the headline rate of 20%, mainly reflecting the goodwill impairment charge, which is not tax deductible, partly offset by the deferred tax impact of the reduction in the corporation tax rate to 18% from April 2020. The further reduction to 17%, announced in the March 2016 Budget, will not be recognised until Finance Bill 2016 has been substantially enacted.

NATS' taxes generally arise in the UK, though it undertakes business in other countries. Wherever we operate we organise our operations to pay the correct and appropriate amount of tax at the right time, according to relevant national laws, and ensure compliance with the group's tax policies and guidelines.

During the year the company paid UK corporation tax of £29.8m (2015: £34.6m) and foreign tax of £0.6m (2015: £0.1m). The company also pays other taxes such as employer's national insurance contributions and business rates, a significant cost each year.

The group's tax strategy is reviewed annually by our Tax Committee and covers the application of all direct and indirect taxes to our business including corporation tax, payroll taxes and value added tax. The Tax Committee reports to the Audit Committee and comprises the Finance Director, the Head of Tax and other senior finance professionals and takes advice from a professional firm.

We have a positive working relationship with HM Revenue & Customs and we are committed to transparency in all tax matters. This includes annual meetings with HMRC to review the group's performance and its business strategy.

### **Dividends**

In May 2016, the company paid a first interim dividend of £24.0m which mainly reflects a proportion of the allowance for shareholder return that the CAA made in the prices that NERL is permitted to charge in RP2. The company paid dividends of £81.7m during the 2015/16

financial year which also reflected some dividends from accumulated retained earnings not distributed in earlier regulatory reference periods, noting that NERL paid no dividends to shareholders from the date of the PPP until October 2008.

### Balance sheet

The change in financial position since the start of the year reflects an improvement in the accounting measurement of the defined benefit pension scheme IAS19 funding position (net of related deferred tax), capital investment and retained earnings. These, as well as movements in cash, borrowings and derivatives, are explained in this review.

	2016	2015
	£m	£m
Goodwill	209.3	302.0
Tangible and intangible fixed assets	994.5	977.3
Other non-current assets	29.0	67.4
Cash and short term deposits	257.1	267.0
Derivatives (net)	(128.3)	(128.6)
Pension scheme deficit	(77.4)	(353.0)
Borrowings	(560.4)	(645.7)
Deferred tax liability	(70.5)	(19.2)
Other net liabilities	(39.5)	(33.5)
Net assets	<b>613.8</b>	433.7

### Capital investment

	2016	2015
	£m	£m
SESAR Deployment	80.7	51.5
Airspace	8.6	18.0
Infrastructure	15.1	26.3
Operational systems	19.7	32.6
Other	10.8	13.0
<b>Regulatory capex</b>	<b>134.9</b>	141.4
Military systems	4.2	6.1
Other non-regulatory capex	8.5	6.0
<b>Capital investment</b>	<b>147.6</b>	153.5

We plan to invest £575m (in 2012 prices) in our regulatory assets during RP2 and we spent £134.9m (2015: £141.4m) in 2016. This included investment in the following priorities: the temporary operations room at Swanwick, the delivery of iTEC into service in Scottish upper airspace, both part of SESAR deployment, airspace modernisation (LAMP phase 1a) and an enhanced data and voice communications network.

A focus of our strategy is to accelerate the delivery of new SESAR technology while reducing investment in legacy systems in order to improve cost efficiency and enable greater customer benefit sooner.

### Defined benefit pensions

Most staff still benefit from a final salary defined benefit scheme (the NATS Section of the CAA Pension Scheme or CAAPS). It was closed to new members in 2009 but has 3,324 active members, 2,413 pensioners and 1,189 deferred members. Staff who are not members of this scheme are able to benefit from a defined contribution scheme. More information on our pension arrangements and their governance is provided in note 30 to the consolidated financial statements.

#### a. Accounting position under IAS19

At 31 March 2016, measured under international accounting standards and the associated best estimate assumptions, the defined benefit scheme was in deficit with liabilities (£4,760.0m) exceeding assets (£4,682.6m) by £77.4m (2015:



£353.0m).

<b>Defined benefit scheme liability</b>	<b>£m</b>
At 1 April 2015	(353.0)
Charge to income statement	(132.7)
Actuarial gains/(losses):	
- on scheme assets	(140.1)
- on scheme liabilities	428.1
Employer contributions*	120.3
At 31 March 2016	(77.4)
Represented by:	
Scheme assets	4,682.6
Scheme liabilities	(4,760.0)
Deficit	(77.4)

\* including salary sacrifice

Given the size of the scheme relative to the group, changes in market conditions can have relatively large impacts on the results and financial position. The IAS19 accounting standard requires discount rates for valuing pension obligations to be based on AA corporate bonds. Since 2015 the yield (in real terms) on these has increased by 35 basis points, leading to a corresponding reduction in pension liabilities. Asset values were broadly unchanged from the prior year.

#### **b. Funding valuation and future funding obligations**

The funding of the defined benefit scheme is subject to agreement between the company and the scheme's Trustees and is determined based on the conclusion of each triennial valuation conducted by the Trustees. This valuation uses a wide range of assumptions for measuring pension liabilities and legislation requires a margin for prudence. As a result the triennial valuation gives rise to a different valuation than that disclosed under international accounting standards.

The last triennial valuation was as at 31 December 2012 and reported a deficit of

£382.6m. The contributions agreed with Trustees included an 11-year deficit recovery plan requiring payments of £26.6m in the 2014, £28.6m in the 2015 and £29.3m in the 2016 calendar years. In addition, future service contributions were paid at a rate of 36.7% of pensionable pay (excluding salary sacrifice) until 1 January 2015 when these reduced to 29.4%, reflecting the cap on pensionable pay rises and the Trustees' decision to move to CPI-linked indexation of future service from 1 November 2013. Overall, excluding salary sacrifice contributions of £14.7m (2015: £15.2m) and redundancy past service costs for the defined benefit scheme of £0.8m (2015: £2.2m), the group's contributions in this financial year of £104.8m (2015: £121.3m) represented 41% of pensionable pay (2015: 45%).

The Trustees are now undertaking their next triennial valuation as at 31 December 2015 and are expected to complete this in the final calendar quarter of 2016. The company expects that this will report a materially larger deficit compared with the results of the 31 December 2012 triennial valuation and the accounting basis for measuring the funding position in our accounts. This will lead to higher pension contributions in RP2 which the group has adequate resources to finance and which are taken into account in dividend distribution policies.

**Net debt**

	Cash and short-term investments £m	Borrowings £m	Net debt £m
Balance at 31 March 2015	267.0	(645.7)	(378.7)
Cash flow	(9.2)	89.3	80.1
Short-term deposits	(0.8)	-	(0.8)
Non-cash movements	0.1	(4.0)	(3.9)
<b>Balance at 31 March 2016</b>	<b>257.1</b>	<b>(560.4)</b>	<b>(303.3)</b>

During the year we refinanced NERL's bank facilities to provide committed funding throughout RP2 (2015 – 2019). NERL agreed facilities of £400m, £125m more than previously, with an initial maturity date of 31 July 2020 with an option for extending these arrangements for a further two years (i.e. to 31 July 2022). At 31 March 2016, NERL had drawn £95.0m or 24%, leaving significant headroom should further drawings be required. In addition to this bank facility NERL has a bond with a balance of £467.4m at the year end (2015: £498.0m). More information is provided in note 17 to the consolidated financial statements.

At 31 March 2016, borrowings were £560.4m (2015: £645.7m) and cash and investments decreased to £257.1m (2015: £267.0m). Net debt decreased by £75.4m to £303.3m (2015: £378.7m).

**Cash flow**

Cash and cash equivalents decreased by £9.1m to £228.2m (2015: £237.3m).

	2016 £m	2015 £m
Net cash from operating activities	341.7	283.8
Net cash used in investing activities	(148.8)	(145.9)
Net cash used in financing activities	(202.1)	(112.2)
(Decrease)/increase in cash and cash equivalents <sup>1</sup>	(9.1)	25.7
Cash and cash equivalents at end of year	228.2	237.3

<sup>1</sup>Including exchange of £0.1m

Net cash from operating activities was £341.7m (2015: £283.8m). This increase in cash flow reflected lower future service contributions to the defined benefit

pension scheme from 1 January 2015 (reflecting the cap on pensionable pay rises and the Trustees' decision to move to CPI-linked indexation of future service), lower redundancy payments, higher customer receipts and less tax and operating expenditure. Cash from operations helped the group to finance its capital investment and to service debt obligations. The group repaid bond principal of £30.8m and lowered drawn bank facilities by £56.6m.

**Outlook for 2017**

We expect our revenue next year to be broadly in line with 2016, with increased revenue from flights and our contract with Aquila offsetting further price reductions and the loss of airport ATC contract income. We also expect earnings before interest, tax, depreciation and amortisation to be broadly stable.

**Nigel Fotherby,**  
**Finance Director**



**Going concern**

The group's business activities, together with the factors likely to affect its performance and financial position, its cash flows, liquidity position and borrowings are set out in the review above.

In addition, note 19 to the financial statements describes the group's objectives, policies and processes for managing its capital and its financial risks; and details its financial instruments and hedging activities.

At 31 March 2016, the group had cash of £257.1m and access to undrawn committed bank facilities of £305.0m that are available until July 2020. The group's forecasts and projections, which reflect its expectations for RP2 and taking account of reasonably possible changes in trading performance, show that the group should be able to operate within the level of its existing facilities for the foreseeable future. The UK en route business also benefits from some protections against traffic volume risk afforded by its price control conditions. Other sources of income are generated mainly from long term contracts, some of which were renewed in the year. As a result, the directors believe that the group is well placed to manage its business risks.

The directors have formed a judgement that, taking into account the financial resources available, the group has adequate resources to continue to operate for a period of at least twelve months from the date of approval of the financial statements, and have therefore adopted the going concern basis in the preparation of the financial statements.

**Viability statement**

In accordance with provision C.2.2. of the UK Corporate Governance Code, the directors have assessed NATS viability over the three years ending 31 March 2019. This is based on three years of the group's business plan and represents a period for which there is greater certainty over forecasting assumptions. The business plan is updated annually and reflects the group's strategy and its financial plans. The assessment of viability has been made with reference to NATS current position and future prospects, its business strategy and available financial resources. Specific consideration has been given to the outlook for en route air traffic volumes, the terms of the group's airport ATC contracts, including their length, and their renewal prospects, and expected contributions to the defined benefit pension scheme which will be based on the valuation as at 31 December 2015 to be completed by Trustees in the last quarter of 2016.

The directors also assessed the potential financial and operational impacts in plausible downside scenarios of the principal risks and uncertainties set out on page 25 and the effectiveness of currently available mitigating actions. Based on this assessment, the directors have a reasonable expectation that NATS will be able to continue in operation and meet liabilities falling due up to 31 March 2019.

In making this statement the directors have also assumed that the impact of the 23 June 2016 UK referendum decision on the European Union will not have a material adverse impact on the company's operating and financial performance over the period of assessment.

## Key performance indicators

We adopt a number of financial and non-financial key performance indicators (KPIs) that enable us to track progress against our business plan objectives and which are relevant to the different activities of our principal operating subsidiaries: NERL and NATS Services. For NERL, KPIs are largely aligned with the Single European Sky (SES) key performance areas ensuring management focus on meeting safety, service quality, environmental and cost efficiency targets. For NATS Services, the focus of management is on safety, customer service and on growing the business profitably. A number of the metrics are also used to set targets for remuneration purposes and so align incentives with business objectives.

### NATS' actual performance relating to financial and non-financial KPIs

Description	Financial year 2016 or calendar year 2015	Financial year 2015 or calendar year 2014
<b>Financial KPIs</b>		
Profit before tax: NATS group	£44.4m	£200.3m
NERL	£22.4m	£172.7m
NATS Services	£22.3m	£27.9m
<b>Non-financial KPIs</b>		
<b>Safety performance:</b>		
NATS Group: category A or B Airprox <sup>5</sup> attributable to NATS (financial year)	nil	1
Calendar year metrics:		
NATS Group KPI: RAT <sup>8</sup> points (12 month rolling)	1,497	1,099
NERL KPI: RAT points (per 100,000 flights, 12 month average)	38.3	29.4
NSL KPI: RAT points (per 100,000 flights, 12 month average)	34.5	22.7
<b>Service performance &amp; resilience:</b>		
NATS Group: customer satisfaction score (%)	85%	84%
<b>NERL KPIs</b>		
Average delay (seconds per flight, financial year)	4.3	2.2
Average delay (seconds per flight, calendar year)	2.4	2.2
Impact score <sup>9</sup> (weighted seconds per flight, calendar year)	5.2	4.2
Variability score <sup>10</sup> (weighted seconds per flight, calendar year)	14.2	195.2
3Di <sup>11</sup> Score (calendar year)	30.1	29.8 (restated)
<b>Environmental performance (financial year):</b>		
NATS Group KPI: enabled fuel CO <sub>2</sub> reduction (cumulative % vs 2006 baseline)	4.3%	4.2% (restated)



## Safety

### Safety performance

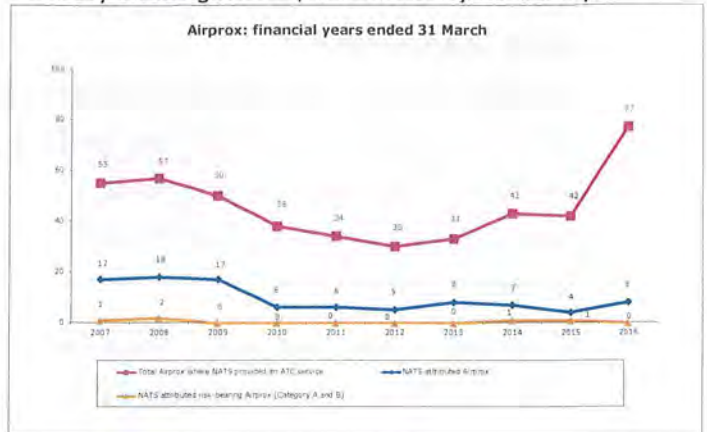
Our priority is the safety of aircraft and the travelling public. Our commitment to improving operational safety performance is embedded in our RP2 plan. This targeted a reduction in safety risk (defined as the accident risk per flight) of 13% by the end of RP2 for our en route ATC service, in line with predicted traffic growth. We have set the same target for our airports ATC service.

To monitor our performance against this target we measure the severity and risk of air traffic management (ATM) incidents using the Risk Analysis Tool (RAT). On a 12-month rolling basis to the end of calendar year 2015 our performance generated a RAT score<sup>8</sup> of 1,497 relative to the target of below 1,209. While this performance is not meeting the challenging target we set ourselves, overall we performed better than calendar year 2013 but not quite as well as 2014, which was a particularly good year. In response to the RAT score we conducted a detailed review of our performance and implemented further safety improvements over the winter, particularly at airports, which is starting to show a positive impact.

This financial year there were no category A or B Airprox<sup>5</sup> events attributable to NATS (2015: one). The overall number of Airprox events was 77 (2015: 42), with eight attributable to NATS. The increase in Airprox overall was mainly driven by events involving Remotely Piloted Aircraft Systems (RPAS or drones).

From January 2015, the SES performance scheme set three targets to be met by the

end of RP2, based on: the effectiveness of safety management, the severity of safety



Safety statistics for 2016 include NATS assessment of the outcome of UK Airprox Board reviews

events and the extent of Just Culture<sup>12</sup> training. We are on track to meet all three targets by 2017, well before the end of the reference period.

### Managing safety & change

Our approach to safety is underpinned by a commitment to continually improve our operational safety performance and minimise our contribution to the risk of an aircraft accident. We do this through a formalised, explicit and proactive approach to safety management.

We prepare Safety Cases that analyse and assess the impact of changes in people, technology, operational software and airspace structures to provide assurance that such changes are safe to implement. For the same reason, we also conduct hazard analysis on any changes to ATC procedures. Additionally, we seek to optimise operational staff performance through annual training, competency assessments and the development of new systems.

Over the next five years we expect significant changes to our operational environment as we deploy SESAR technology so this year we assessed the safety improvements that this



programme will deliver, and identified the safety case activities required.

### Safety improvements

The most significant operational risks we deal with are infringements of controlled airspace, level busts<sup>13</sup>, issues on the ground at airports, including runway-related events, and human performance.

The number of risk-bearing level bust events reduced by almost 30% during the 2015 calendar year, with the total number of events reducing by 8%. We have continued to work with the CAA and airlines to ensure best practice is followed by both pilots and controllers.

We continue to focus on infringements of controlled airspace by engaging with airfields and flying clubs, as well as the CAA and airport operators. Although the number of infringements reduced slightly to around 630 in calendar year 2015, the number of risk bearing events has increased by 10% over the same period.

The UK's Airspace Infringement Working Group (AIWG) in conjunction with the Airport Operators Association (AOA) and NATS has focused its prevention activity on the areas of highest risk. Disappointingly, this has not led to a reduction in infringements. In conjunction with the CAA and the leading general aviation organisations we are exploring measures to improve this situation and we expect the actions described in the Chief Executive's review to take place in 2016/17.

At airports, we responded to an increase in runway events in the first half of the year with more rigorous training, including further continuous professional development, and

this has improved performance. We are also continuing to trial runway incursion sensors at Manchester and Aberdeen to assist in the development of automated runway incursion warning systems. While other ground events at airports do not contribute to the RAT assessment risk these generate additional workload and complexity in the ATC operation and are therefore a focus for NATS. For example, we have been engaging with CAA and airport operators on strategies to reduce pushback and taxi errors.

Effective human performance is a critical element of ATM safety and we have introduced a programme to enhance this which covers: a 'back to basics' focus on core skills required for avoidance action and defensive controlling; operational preparedness and familiarisation; and refresher training on airspace, operating procedures and equipment as we introduce new SESAR technology.

### Single European Sky (SES)

The Single European Sky (SES) is a European initiative to improve the way Europe's airspace is managed. Its purpose is to modernise Europe's airspace structures, air traffic management technologies and associated operational procedures so as to ensure forecast growth in air traffic can be met, safely and sustainably, whilst reducing costs and improving environmental performance.

### Deploying Single European Sky ATM Research (SESAR) technology

The European Commission's (EC) SESAR programme is now in the deployment phase whereby the concepts and technologies developed and validated through the SESAR



Joint Undertaking, a collaboration of airport operators, ANSPs and aviation industry suppliers, are introduced into operation across Europe. The EC appointed the SESAR Deployment Alliance to the role of SESAR Deployment Manager (SDM) in December 2014 to coordinate this deployment. The SDM is an alliance of the largest European ANSPs (including NATS), four airlines and 25 airports.

NATS aims to be at the forefront of efforts to improve the management of Europe's airspace to secure benefits for customers as early as practicable. For the reasons given in the Chief Executive's review above, deploying SESAR is a significant part of our capital investment plan for RP2 and the early part of RP3, and we have already achieved a number of important milestones. The EC is aiming for the initial SESAR projects to be deployed by 2025.

SESAR is already delivering direct benefits to our customers through the Time-Based Separation (TBS) and Extended Arrival Manager tools. For TBS, NATS' involvement in a SESAR airports work package helped us to build on that SESAR initial research, in partnership with Lockheed Martin. The deployment of TBS at Heathrow is expected to save 80,000 minutes of delay per year at the world's busiest dual-runway airport.

The Extended Arrival Manager project led directly to operational trials of Heathrow XMAN (cross-border arrivals management), whereby neighbouring ANSPs slow down Heathrow arrivals when runway capacity delays of seven minutes or more are predicted. This delivers significant fuel, cost and environmental savings to customers.

European funding is available through the Innovation & Networks Executive Agency (INEA) to support the deployment of SESAR technology. INEA provided £11m in the year towards our investments. Access to this support ultimately reduces the costs we need to recover from our airline customers.

### **UK aviation strategy**

The UK's Future Airspace Strategy (FAS) is designed to modernise airspace and the air transport route network to meet SES objectives. It includes the airspace managed jointly by the UK and Ireland FAB. It is part of the Government's transport policy and involves NATS, airlines, airports and other aviation stakeholders. The most significant modernisation of airspace will be in the South East of England where London's five big airports and many smaller aerodromes create some of the world's busiest and most complex skies and in the growth areas in the North of England around Manchester, Liverpool and Leeds.

We delivered the first phase of modernisation this year, including changes to arrival and departure routes for London City and Stansted with new higher level routes over the sea replacing some previously over land and new routes enabling aircraft to climb to higher altitudes more quickly. Both of these changes reduce overflight noise for local communities.

However, our plans for RP2 anticipated a more significant programme of airspace modernisation to enable us to deliver more fuel efficient flight profiles for customers. It is now apparent that the industry is facing some significant challenges in delivering this airspace modernisation in the face of changing government and CAA policy, public



opposition to changing aircraft noise patterns, particularly in the London TMA<sup>14</sup>, and in the light of a still pending decision on runway capacity in the South East.

Progressing with the original airspace modernisation plan in these circumstances would not generate the benefits required and our customers are understandably disappointed. Therefore, we have consulted our customers on a revised plan which will now focus on other smaller airspace changes to upper airspace levels which could be introduced in RP2 earlier than the original programme. This should go a long way to achieving cumulative fuel savings in RP2 similar to the levels originally planned. We will then develop proposals for modernising lower airspace levels in RP3, subject to revised government policy on airspace modernisation and clarity on runway capacity.

We are actively engaged with the Department for Transport, the CAA and the aviation industry to determine the most appropriate response to the airspace challenges the industry faces.

### Economic regulation

In the UK, the principal regulatory developments in the year relate to airspace strategy and governance and ring-fencing, which are relevant to NERL, and to airport ATC (or Terminal Air Navigation Services - TANS), which is relevant to NATS Services. In Europe, the EC is in the early stages of preparation for RP3 by releasing a public consultation on its evaluation of RP1. It also issued a white paper on its objectives for RP3 in June 2016.

In light of the challenges facing the industry to deliver the UK's Future Airspace Strategy,

the CAA has enhanced the requirements relating to NERL's annual service and investment plan consultation with customers, to include an independent review of progress against plans. The basis for a specific licence requirement for NERL to set out detailed plans to raise the UK Transition Altitude<sup>15</sup> to 18,000 feet by 2018 and implement the terminal airspace redesign associated with LAMP, is being reviewed by CAA. These changes are not in NERL's direct control and are dependent on public consultation and other stakeholders.

In 2013 CAA raised a concern that arrangements for governance and ring-fencing of NERL may need to be strengthened to ensure that users are adequately protected from risks which arise outside of the regulated business, and this year it completed its review. The company has agreed to make changes to NERL's Board arrangements and to enhance its reporting on the adequacy of its resources to deliver its licence obligations.

The UK market for Terminal Air Navigation Services (TANS) is subject to the market conditions test within EC SES Regulations. If conditions are not met TANS are subject to economic regulation. Last year the UK made its submission to the EC on the existence of SES market conditions for TANS. The Commission's decision on this is awaited.

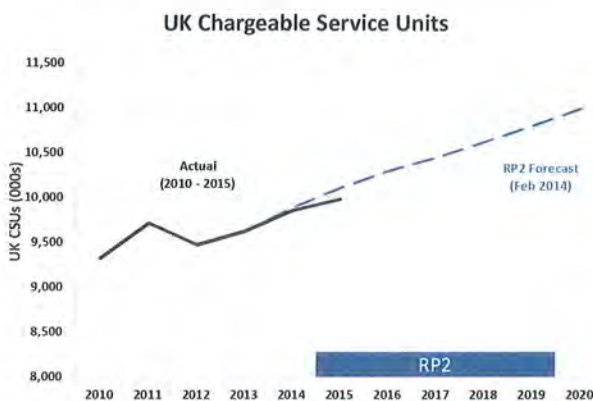
## Outlook for air traffic

	2016 ( <sup>'000s</sup> )	2015 ( <sup>'000s</sup> )	Year on year change %
<b>Chargeable Service Units</b>	<b>10,102</b>	9,815	2.9%
<b>Total UK traffic (flights):</b>			
Domestic	377	375	0.5%
North Atlantic	333	321	3.7%
Other	1,568	1,520	3.2%
Total	<b>2,278</b>	2,216	2.8%
<b>Oceanic traffic (flights)</b>			
Chargeable flights	<b>447</b>	418	6.9%



Overall, the volume of UK flights handled by NATS increased by 2.8%, reflecting an improving economic outlook. Domestic flights saw a small increase, with Flybe starting services from London City.

Chargeable service units<sup>16</sup> (CSUs) benefited less from growth in transatlantic flights as these took more southerly routes due to the jet stream, which led to shorter distances flown in UK airspace.



The RP2 settlement was based on a STATFOR<sup>17</sup> (February 2014) forecast that assumed flight volumes and CSUs would grow by 1.9% and 1.8% per annum on average respectively, with traffic levels returning to the pre-financial crisis peak (2007) shortly after the end of RP2. While flight volumes have grown by more than the RP2 forecast, the growth in CSUs has been less than the regulatory settlement assumed. For this reason, the company's revenue since the start of RP2 to 31 March 2016 has been £5m less than the settlement allowance.

The STATFOR (February 2016) forecast is for CSUs to be 0.4% higher than the RP2 forecast for the RP2 period.

Historically, the growth in demand for air travel has been closely linked to the strength of the global economy and, for UK air traffic, to that of the UK, US and Eurozone. The UK economy grew by 2.3% in 2015 and is

forecast to grow by 2.1% in 2016 (source: Oxford Economics), supported by lower oil prices and low inflation. The US economy continued to grow during 2015 based on strong domestic economic fundamentals and is expected to see growth of 2% during 2016. Eurozone economies also continue to build momentum with a weaker euro supporting stronger exports. Recent reductions in oil prices have reduced the cost of air travel and are contributing to passenger demand. The Middle East market continues to grow.

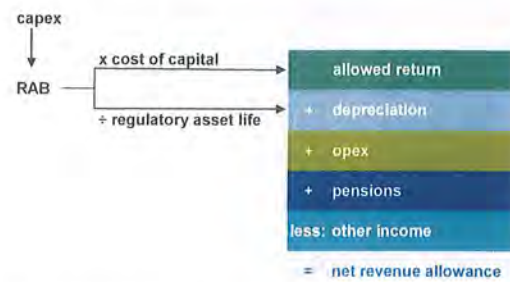
However there remain significant risks to this outlook. The potential impact of the UK's EU referendum decision on the UK economy and on the demand for air travel is uncertain. There are also risks to growth from a weaker outlook for emerging markets, with the slowdown in growth in China, and the recessions in Brazil and Russia likely to have an adverse impact on demand for air travel, although the IATA forecasts are still showing strong demand from passengers in these regions. Finally, there is also a risk from the potential escalation of conflicts in the Middle East.

## Our business model

We generate our income from the provision of ATC and related services. Our activities are mainly conducted through NERL and NATS (Services).

NERL is the sole provider of air traffic control services for aircraft flying en route in UK airspace and the eastern part of the North Atlantic. It operates under a licence granted by the Secretary of State under the Transport Act 2000. The Act gives the CAA the role of economic regulator. En route, London Approach and North Sea helicopter advisory services are regulated by this licence. NERL also provides the MOD with engineering, surveillance and communications services.

The CAA establishes revenue allowances for NERL's economically regulated services under SES legislation. These remunerate NERL's efficient investment (capex), operating costs (opex), pensions and an allowed return on the capital invested in the Regulatory Asset Base (RAB) to recover the cost of capital. The RAB, which represents the value ascribed to the capital employed in the regulated businesses, is adjusted to reflect asset additions, disposal proceeds, regulatory depreciation and the rate of inflation. Income generated outside of NERL's economically regulated activities is deducted under a 'single till', leaving a net revenue allowance. A price per service unit is set to recover this based on forecast traffic for the reference period. This regulatory model is illustrated below.



The price control for RP2 was based on total revenues of £2.7bn (expressed by the CAA in 2012 prices) and provides for a real pre-tax cost of capital of 5.9%. The CAA also sets targets, and provides incentives, for service and environmental performance. If regulatory and other assumptions are borne out in practice, then NERL would earn a return of 5.9% p.a. It can earn additional returns if it outperforms the CAA's assumptions by being more cost efficient, by financing its business at lower cost, if traffic volumes (after risk sharing - see below) are higher than forecast or if it outperforms service targets. NERL would earn lower returns if the opposite applied. The EC legislation provides: a risk-sharing mechanism to protect against certain variations in traffic volumes from the level assumed; an adjustment to charges for differences between actual inflation and assumed inflation; and an adjustment to charges in subsequent reference periods where cash contributions to the defined benefit pension scheme differ from those assumed due to unforeseen financial market conditions. The CAA also sets a target and cap on the level of NERL's gearing at 60% and 65% of net debt to RAB, respectively. Charges may be adjusted on a year 'n+2 basis' for service performance incentives, traffic volume risk-sharing and for inflation.



NATS Services is organised between UK and international activities. The former represents about c. 95% of its revenue. It provides Airports ATC, engineering, information, consultancy and training services to its customers which include UK airport operators, the MOD, airlines, windfarms and other airspace users. Airports ATC and related engineering services are provided to 14 of the UK's civil airports, and Gibraltar and three airfields under the UK military's Project Marshall contract (Wattisham, Netheravon and Middle Wallop). The UK has 128 civil licensed aerodromes and of these 110 self-provide the service. Of the rest, 14 are outsourced to NATS Services and four to two other providers. NATS Services operates in a contestable market and faces competition from other Air Navigation Service Providers (ANSPs). As noted above, large UK airports fall within the scope of European SES regulations. FerroNATS, our 50:50 joint venture, provides a service to 9 airports in Spain.

Our engineering services deliver complex turnkey engineering projects. Our competence is in maintaining and developing communications, navigation and surveillance solutions. We provide services to airports, the MOD, windfarms and construction companies, mainly integrating new infrastructure at airports. Our principal competitors include systems integrators, equipment manufacturers and specialist engineering consultancies.

Our expertise in information services derives from managing aeronautical and air navigation services data, charting and other

services. These services are provided to commercial airlines, windfarms and other airspace users.

Our consultancy expertise has evolved from our operational ATC experience and enables us to optimise the safety and operational performance of airports or ANSPs by providing practical advice on maximising the capacity of airport and airspace infrastructure. The consultancy market includes other environmental, engineering and infrastructure consultancy firms. NATS also provides training services which are in competition with those also offered by other ANSPs and specialist colleges.

We are uniquely placed to help airline and airport customers to realise value by making both airspace and airfield services more efficient. We understand the complex interactions at each stage of a flight between airlines, airport operators and ANSPs, including in some of the busiest airspace in the world. We understand the benefit we can provide from fuel efficient flight profiles, approaches and departures, minimising delay, and through arrival and departure management. Our en route operation provides a seamless transition between the North Atlantic and UK en route services. We recognise that airport tower services are an intrinsic part of overall performance and our experiences at Heathrow, Gatwick and other airports demonstrate our ability to optimise runway performance and apron efficiency. This benefits airport operators, their investors, and the airlines.

## Principal risks and uncertainties

The operational complexities inherent in the business leave NATS exposed to a number of significant risks and uncertainties. Our risk management process has identified the key risks that the Board believes are likely to have the most significant impact on our business, financial position, results and reputation based on the severity and likelihood of risk exposure. Risks are reviewed and re-assessed regularly and reflect the Board's assessment as at the date of this report. The list is not intended to be exhaustive.

The group has maintained a focus on mitigating these risks, although many remain outside of our control – for example changes in regulation, security threats, environmental factors and the impact of longevity and financial markets on pension funding.

A summary of internal control and risk management processes is on pages 48 and 49.

### **Safety: the risk of an aircraft accident**

A loss of separation attributable to NATS that results in an accident in the air or on the ground would significantly impact NATS and its reputation as a provider of safe air traffic services. This could result in loss of revenue in the short term as investigations take place and the loss of future contracts due to reputational damage. If notice was given by the Secretary of State

requiring NERL to take action as a result of the accident and NERL was unable or failed to comply with the notice then ultimately this could result in revocation of NERL's air traffic services licence.

As a provider of a safety critical service, safety is the company's highest priority. To further embed our existing safety culture across the organisation and to mitigate safety risk, NATS operates and continues to refine and develop its strategic plan for safety and maintains a safety risk management system. The latter includes investigations and reviews of operational safety performance and individual incidents to identify and respond to contributors of safety risk.

### **Maintaining continuous operations**

#### **a. Loss of service from ATC centre**

A loss of service would result in a loss of revenue as flow management procedures would be introduced to maintain safe separation. The extent of loss would depend on the time necessary to resume a safe service and the resultant level of air traffic delay. To this end NATS has contingency arrangements which enable the recovery of its service capacity. These arrangements were reviewed in light of the recommendations of the Independent Enquiry into the December 2014 technical failure.

#### **b. Operational systems resilience**

Operational service provision is increasingly dependent on the



performance and resilience of engineering systems and communications, surveillance and flight data infrastructure. A number of mechanisms exist to identify systems resilience risks. These include regular reviews of system health through a series of structured questions with evidence-based outcomes. In addition, tactical issues are assessed following engineering updates to NATS' Safety Tracking and Reporting System to determine whether immediate escalation is required and to identify any emerging trends requiring investigation. Further mitigations have been considered following the recommendations of the Independent Enquiry.

### **Political environment and economic regulation**

Policy decisions by the regulator, the UK government and the European Commission directly affect our businesses. Changes in policy decisions may impact on the group's ability to meet the requirements of the UK and EC's aviation policies. We seek to mitigate this risk by providing independent input to policy studies (such as that conducted by the Airports Commission) and lobbying for policy guidance where we believe this is required (such as airspace strategy). Also, the group's air traffic services operate under a European regulatory regime which requires key performance areas to be met. Failure to meet these safety, service and efficiency targets

could damage our reputation and lead to even more challenging regulatory arrangements.

The company's regulatory objectives include airspace design changes which are dependent on a stable and clearly defined aviation policy for the UK and agreement following public consultation and support from airport operators. The company is seeking to mitigate regulatory risk by aiming to achieve its RP2 targets through equivalent environmental and fuel saving benefits via a package of other airspace changes.

Finally, the UK market for Terminal Air Navigation Services (TANS) is subject to the market conditions test within EC SES Regulations. If conditions are not met TANS are subject to economic regulation. Last year the UK made its submission to the EC on the existence of SES market conditions for TANS. The Commission's decision on this is awaited.

### **Defined benefit pension scheme**

Adverse movements in pension asset and liability values arising from factors such as lower investment returns, lower real interest rates and improving life expectancy may increase the size of the pension deficit and result in significant contributions to fund pension benefits. Management regularly reviews the financial position of the defined benefit scheme and is consulted by Trustees on the design of the risk reduction strategies that are in place. The scheme was closed to new

entrants in 2009, pensionable pay rises are capped and future service benefits are linked to the Consumer Prices Index. The Trustees are undertaking a formal triennial valuation of the funding of the defined benefit scheme as at 31 December 2015. The company expects this to report an increase in the funding deficit and for additional contributions to be necessary. The company has adequate financing arrangements and cash reserves in place to cover expected increases in contributions during the remainder of RP2.

### **Industry outlook and the impact of the UK's referendum on Europe**

Poor market and economic conditions can reduce NERL's revenues to levels below those assumed by the economic regulator in making the RP2 price determinations. This in turn could impair shareholder returns. NATS monitors the key industry indicators on a monthly basis against RP2 forecasts and has taken action in the past to realign its cost base with lower revenues. As explained above, NERL has traffic volume risk-sharing arrangements that mitigate revenue reductions to a large extent.

If the UK votes to remain in a reformed EU, we do not anticipate a significant impact on NATS activities or business risks from the changes agreed with EU partners.

If the UK votes to leave the European Union, in the longer-term, the impact of this decision depends to a large extent on the type of relationship that is forged

between the UK and the EU. However, we do not expect that it will have a significant impact on NATS activities provided the UK continues to participate in the Single European Sky project (SES): our plans assume we deliver the SESAR technology in order to benefit our customers. It is also possible that progress with airspace policy may be slower than we hoped for in RP2 as the Government turns its attention to developing the new relationship with Europe and more globally.

However, in the shorter-term the initial uncertainty and market volatility that could result (e.g. exchange rates) could affect the demand for air travel and therefore our future revenue although any changes would be mitigated by traffic volume risk sharing arrangements.

### **Security: electronic and other external and internal threats**

Malicious attack, sabotage or other intentional acts, including breaches of our cyber security, could damage our assets or otherwise significantly impact on our service performance. NATS seeks to mitigate these risks through its business continuity controls, staff awareness training and cyber and physical security processes and procedures, including monitoring political stability and security risks in countries where it conducts its business. The company has enhanced the physical security of its principal sites and is continuing to enhance its cyber-security processes and controls. The



company maintains a close liaison with the majority of Home Office Constabularies as well as Government security agencies and departments including security advice from the Centre for the Protection of National Infrastructure.

### **Employee relations**

The deployment of SESAR technology and the group's response to the challenging competitive environment in the UK and overseas will require changes across our organisation. Industrial action could result in reduced air traffic service provision which adversely impacts on service performance. Every effort is made to maintain good employee relations at all times, including through our Working Together programme, to ensure the delivery of an efficient operational service and associated support. NATS has been negotiating with its recognised trades unions on a one year pay offer for 2016. Results of the customary ballot on this will be known in July.

### **Technology**

The deployment of new SESAR technology and retirement of legacy systems could affect the group's ability to maintain a continuous service during transition and require additional costs to sustain legacy systems and support deployment. NATS maintains programme and project governance and risk management processes which are overseen by the Executive and Board,

including the Technical Review Committee.

### **Other matters:**

#### **a. Sale of HM Government shareholding**

Following an announcement that the HM Government shareholder is exploring the sale of its shareholding in NATS, the company is undertaking a review of the potential business impacts arising from this. This includes the impacts on key stakeholders and implications for financing arrangements, capital structure and credit ratings.

#### **b. Financial risks**

In addition to the top risks set out above, the main financial risks of the group relate to the availability of funds to meet business needs (including meeting obligations to the pension scheme), the risk of default by counterparties to financial transactions, and fluctuations in interest and foreign exchange rates. A detailed description of each of these risks and specific mitigations are set out in note 19.

## Service line performance

We organise our activities according to service lines, which reflect the products and services that we offer. A brief description is provided under the section entitled 'Our business model'. This section explains the financial and operational performance of each service. The principal financial measures are revenue and contribution. The former includes intra-group revenue, while the latter reflects the operating costs which managers are able to influence directly. A reconciliation of service line contribution to operating profit is provided in the notes to the financial statements.

### NATS Airspace

	2016	2015
<b>Financial performance:</b>		
Revenue (£m)	715.3	738.5
Service line contribution (£m)	323.1	380.2
Capital expenditure (£m)	144.6	152.3
<b>Operational performance:</b>		
Flights handled ('000s)	2,278	2,216
Risk-bearing airprox (no.)	nil	1
Average delay per flight (seconds)	4.3	2.2
Enabled fuel savings (tonnes)	11,000	189,000

NATS Airspace includes all of NERL's economically regulated activities. It generated revenue of £715.3m, a 3.1% reduction on the previous year. This mainly reflected a full year's impact of the RP2 price reductions which applied to UK en route services from January 2015. This was partly offset by some improvement in revenue from North Atlantic en route activities, due mainly to better traffic volumes, and from the MOD and European organisations.

Service line contribution of £323.1m (2015: £380.2m) was 15.0% lower. In addition to the reduction in revenue,

this mainly reflected higher pension costs, lower capitalised internal labour and an increase in contractor costs.

The benefit of reductions in headcount offset other net staff cost increases.

The level of delay attributable to NATS Airspace for the financial year was 4.3 seconds per flight (2015: 2.2 seconds), with 99.6% of flights not delayed (2015: 99.8%). Some additional delay arose from the implementation of airspace changes in last quarter of the financial year.

Service performance incentives are assessed on a calendar year basis and although performance for calendar year 2015 was broadly consistent with that of 2014, the tightening of service targets meant the incentive recognised in revenue of £4.6m was £1.1m lower.

Service performance: calendar years	2015		2014	
	Target	Actual	Target	Actual
C1: avg. En route delay at FAB level (secs)	15.0	4.8	-	-
C2: avg. delay per flight (secs)	10.2	2.4	8.3	2.2
C3: delay impact (score)	22.3	5.2	23.4	4.2
C4: delay variability (score)	2,000.0	14.2	1,400.3	195.2
C3Di: 3Di metric (score)	29.7	30.1	23.0	29.8

The C1 metric is a Functional Airspace Block (FAB) level target introduced for RP2.

In addition to measures of delay, we are targeted on flight efficiency (the environmental performance of our network). For the 2015 calendar year our performance at 30.1 was broadly in line with the target of 29.7<sup>11</sup>. Over the five years of RP2 the targets require a reduction in the 3Di score from 29.7 to 27.7. This progression assumes that planned airspace changes are achieved, a challenge the industry is facing and which is discussed above.



Working with NAVCANADA we are trialling the first Reduced Lateral Separation (RLAT) track in the North Atlantic airspace we each manage. RLAT reduces the distance between aircraft, increasing the number of tracks available. This adds capacity, improves efficiency and environmental benefits by giving more capacity on optimum routings and levels within the airspace. Only suitably equipped aircraft will take part in the trial.

We deliver short term tactical benefits to customers from changes to procedures. This year we enabled fuel savings of 11,000 tonnes (2015: 189,000 tonnes) worth £3.5m to our customers (based on an average fuel price of £315 per tonne over the year). The flight efficiency metric is discussed in more detail under People and Responsible Business.

Our customers also set us targets under our Operational Partnership Agreement (OPA) to achieve short term operational improvements. This year, through its Flight Efficiency Partnership sub-group, the OPA set a target of enabling 10,000 tonnes of fuel savings per annum and a stretch of 15,000 tonnes. NATS exceeded the target by enabling 11,000 tonnes per annum. The OPA also set a stretch target to minimise the duration of short term Air Traffic Flow and Capacity Management regulations and this was achieved.

NATS Airspace invested £144.6m (2015: £152.3m) on its air traffic control infrastructure in the year. Of most significance was progress with SESAR projects, including the next generation of flight data processing systems (iTEC) which was deployed in limited service by the Prestwick centre.

### NATS Airports

	2016	2015
<b>Financial performance:</b>		
Revenue (£m)	173.4	190.1
Service line contribution (£m)	40.0	61.7
Capital expenditure (£m)	1.0	0.3
<b>Operational performance:</b>		
Airports served: UK (no.)	15*	16
Airports served: Overseas, incl. JV (no.)	10	10
Risk-bearing airprox (no.)	nil	nil

\* served in the year. Gatwick transitioned out in March 2016 and transfers to NATS were: two military airfields (in April 2016) and Belfast City (in July 2016)

NATS Airports represents the performance of our UK airport contracts, military airfields and share of the FerroNATS joint venture. Revenue decreased by 8.8% to £173.4m (2015: £190.1m). This mainly reflected price reductions and the loss of contracts with Birmingham (from April 2015) and Gatwick (from March 2016). Revenue reduction and higher staff pension costs were the principal reasons for the lower service line contribution of £40.0m (2015: £61.7m).

Our strategic objective is to win and retain UK airport contracts. In this respect we achieved a number of important airport contract renewals including Aberdeen, Belfast International, Glasgow, Heathrow and Southampton. Sumburgh approach radar and East Shetland basin ATC and engineering services were also renewed. We were also awarded the ATC contract

by George Best Belfast City Airport, where we have been providing engineering services since 2008.

Last summer we established a strategic partnership with Heathrow which has at its heart a set of working principles and specific incentivised targets in areas from delay performance and service resilience, through to aircraft noise reduction. Our joint objectives are to drive year on year performance through innovations in service and technology, to realise improvements for airlines and deliver a world class passenger experience for the travelling public. This year we helped Heathrow improve its safety, punctuality and resilience through the introduction of enhanced Instrument Landing System (eILS) on its two westerly runways to improve landing rates in low visibility and it was the first airport in the world to introduce Time-Based Separation, significantly improving performance on windy days.

We also transitioned air traffic control operations smoothly and seamlessly to the new provider at Gatwick and since 31 March have also taken on the operation of two MOD airfields under Project Marshall for the Aquila joint venture.

We continued to provide a safe service at airports with no risk-bearing airprox during the year.

## NATS Engineering

	2016	2015
<b>Financial performance:</b>		
Revenue (£m)	32.0	17.3
Service line contribution (£m)	4.5	4.3
Capital expenditure (£m)	1.0	0.2
<b>Significant milestones:</b>		
TBS Heathrow (Full Operational Service)		May
27R Enhanced Instrument Landing System at Heathrow		August
27L Enhanced Instrument Landing System at Heathrow		September
Electronic flight progress strips at Newcastle		September
VHF Radio Communications System at RAF Shawbury		January
Frodsham (Mersey) Windfarm Mitigation Radar		March

Revenue grew by £14.7m to £32.0m (2015: £17.3m) in the year due mainly to engineering support provided to the Aquila joint venture for its Project Marshall contract. Service line contribution of £4.5m (2015: £4.3m) was broadly in line with the prior year reflecting lower margin on the Aquila support.

We provide engineering services to a number of airports at which NATS Services does not provide the ATC service. This year we worked with Newcastle to install electronic flight progress strips into its ATC operation, improving efficiency and reducing controller and pilot workload, and fully integrating its operation into the en route network.

We continue to support windfarm operators and agreed turbine mitigation services for Tormywheel Wind Farm that will see a new radar system at Edinburgh airport and surveillance solutions for Frodsham Wind Farm at both Chester and Liverpool airports.



**Other NATS service lines**

	2016	2015
<b>Financial performance:</b>		
Revenue (£m)	22.4	19.9
- Other UK business	14.8	15.7
- International	7.6	4.2
Service line contribution (£m)	(0.9)	5.2
- Other UK business	0.8	5.4
- International	(1.7)	(0.2)
Capital expenditure (£m)	1.0	0.7
<b>Secured order value:</b>		
UK contracts (£m)	49.0	40.5
Overseas contracts (£m)	8.1	5.8

Other UK business includes consultancy and information services and International mainly represents our operations in the Asia Pacific and Middle East.

The major part of other UK business revenue is derived from the production of aeronautical data, services to windfarm developers and to help improve airport performance. Revenue at £14.8m (2015: £15.7m) was lower than the prior year. These activities generated a service line contribution of £0.8m (2015: £5.4m) reflecting higher contract support and bid costs associated with the development of this business.

International revenues have grown to £7.6m (2015: £4.2m), with the Asia Pacific region performing better than expected. We are finding fewer opportunities in the Middle East at the moment. At a service line contribution level our international activities are reporting a loss of £1.7m (2015: £0.2m loss) as we continue to build our presence in these regions.

## People

If we are to achieve our operational and financial performance targets it is essential that our employees have a clear understanding of our business direction and strategy. For this reason, the Executive team visited every unit in a series of road shows to explain our priorities and to hear what staff have to say about NATS. As a direct result of those meetings, we will be revising our purpose and values over the summer to make these more engaging for staff.

Enhancing this personal and direct dialogue is key to helping all our people to understand better how NATS works as a business, the constraints under which NATS operates and the people flexibility that will be essential to our future success. New thinking about how we continue to deliver performance improvements will be required from every team member in order to continue to improve our performance and meet regulatory and customer expectations.

We are also thinking differently about how we deliver ATC and technical training to our customers and, in time, to our operational staff. This year we endorsed a Foundation Degree in Air Traffic Management at Kingston University which forms the first two years of a BSc in Aviation Studies. The course is only available to trainees of NATS customers and in the future may also be available to NATS trainees. NATS is teaching specific modules of the degree programme

combining academic rigour with workplace learning. The programme will give students external recognition of their qualifications and an excellent grounding to become controllers of the future. The first students on the programme are from Avinor, the Norwegian ANSP.

NATS has been active in supporting young people interested in STEM subjects (science, technology, engineering and mathematics) through various schemes for some time, and this year we committed to support University Technical College (UTC) Portsmouth. The school will open in September 2017 and will offer 14-19 year old students the opportunity for a technical education alongside their general education. NATS will provide support to the engineering faculty through a variety of means, from direct contribution into the curriculum design to mentoring of students.

## Responsible business

We are helping the aviation industry to build a more sustainable future by limiting and, where possible, reducing the impact of air traffic operations on the environment.

Our Chief Executive has responsibility for the group's environment policy, which is underpinned by an ISO 14001 certified Environmental Management System (EMS). The policy's governance is set and monitored by a Steering group, reporting in to the Executive team and is available on our website. Here, we report on the targets agreed



<b>Energy &amp; environmental performance</b> (financial year unless stated otherwise)	<b>2016</b>	<b>2015</b>
Enabled ATM related CO <sub>2</sub> emission reduction	4.3%	4.2%
3Di score (calendar year)	30.1	29.8
Energy consumption (MWh)	60,404	60,975
Scope 1 emissions (tonnes CO <sub>2</sub> e)	3,183 <sup>^</sup>	3,189
Scope 2 emissions (tonnes CO <sub>2</sub> e)	27,934 <sup>^</sup>	30,138
Intensity metric: (tonnes CO <sub>2</sub> e per £m of revenue)	34.6 <sup>^</sup>	36.1
Water consumption (m <sup>3</sup> )	49,645 <sup>^</sup>	47,032

The data has been collected using the operational control approach and covers the UK sites of NATS Holdings Limited and its AQUILA joint venture, which is based at NATS head office. Data for 2015 has been restated following implementation of the GHG Protocol and additional internal verification procedures. Certain environmental performance metrics in the table above as at 31 March 2016 have been subject to external assurance by PricewaterhouseCoopers LLP ('PwC'). PwC have carried out a limited assurance engagement on selected 2016 metrics marked with an ^ . A copy of the assurance opinion is available at <http://www.nats.aero/environment/cr>, as well as the basis of preparation for the selected energy and environmental performance metrics above.

with the regulator, commitments to our customers and the material environmental impacts of our operations. Our Responsible Business report is available on our website.

**Minimising the environmental impact of ATM**

How NATS manages the UK’s airspace directly affects airline customers, airports, their communities, the MOD and other users. We strive to balance the traffic requirements of our customers with the environmental impact of our operations, including aircraft noise for local communities. Modernising the airspace network, designed in the 1960s, is essential if we are to deliver meaningful service improvement. As explained elsewhere in this report, we can only deliver this with the support of all stakeholders.

Actions taken to minimise the environmental impact of our operations in the last year are set out below.

**a. ATM-related CO<sub>2</sub> emissions**

In 2006, we became the first ANSP to commit to reduce ATM-related CO<sub>2</sub> emissions, by an average of 10% per flight by 2020, for UK and North Atlantic airspace and airport tower services. To date, NATS has reduced emissions by an average of 4.3% per flight.

Working directly with our airline customers through the Flight Efficiency Partnership, NATS has delivered incremental adjustments to improve the efficiency of certain operational procedures. Together with tactical improvements, these helped save a further 34,000 tonnes of ATM-related CO<sub>2</sub> emissions in the year, with 1.1 million tonnes of CO<sub>2</sub> emissions cumulatively now being saved annually. This is equivalent to £111m in enabled airline fuel savings<sup>18</sup>.

**b. Airspace efficiency**

In 2012, NATS and the CAA agreed a methodology for measuring airspace efficiency, called 3Di. This helps us assess day-to-day progress towards ATM-related CO<sub>2</sub> emissions reduction. The 2015 calendar year average 3Di score was 30.1, just behind the target of 29.7 and within the service performance range set by the economic regulator. We continue to identify and target improvements in airspace efficiency.

**c. Aircraft noise**

NATS continues to work closely with industry partners in Sustainable Aviation (SA) on noise mitigation policy, as well as directly with individual airports and community representatives. We share our expertise in service of supporting agreed local noise mitigation.

Our performance on enabling continuous descent operations at airports, through our work with SA, made further progress this year and was re-accredited for the "Engaging Customers on Sustainability Award" as part of Business in the Community's Responsible Business Award.

We recognise the direct and indirect impact that aviation has on local communities and the need for us, as one of the key industry stakeholders to understand, and where possible, mitigate their concerns. Our aim is to help balance the needs of airlines, airports and the local communities, and find compromises that can work for all

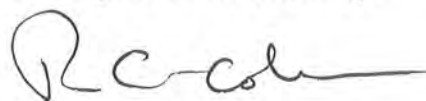
parties. Part of our aim is to help people understand the complexities of managing a geographically constrained airspace over a densely populated country in a world where more and more people want and expect to fly. It is our hope that this understanding provides a foundation on which we can make changes to the airspace that benefit as many citizens as possible in a fair and balanced way: both those that want to travel, and those that are affected by aircraft noise. Only through engagement of all parties: government, regulators, airlines, airports and communities, can this succeed.

**Minimising the environmental impact of our estate**

NATS is part of the government's Carbon Reduction Commitment Energy Efficiency Scheme and the Energy Savings Opportunity Scheme. Swanwick air traffic control centre is also part of the EU Energy Trading System.

We began the rollout of our EMS in 2013 and achieved ISO 14001 certification in 2014 for our head office and we plan to roll out the EMS across other sites over the next year.

*The Strategic report was approved by the Board of directors on 20 June 2016 and signed on its behalf by:*



**Richard Churchill-Coleman**  
**Secretary**



## Director's biographies

The directors and officers of NATS Holdings Limited who were serving as at the date of approval of the accounts were as follows:

### Chairman

#### **Dr Paul Golby CBE FREng**

Paul served as Chief Executive Officer of E.ON UK plc from 2002 to 2011 and is a Fellow of the Royal Academy of Engineering. He is Chairman of Costain, the Engineering and Physical Sciences Research Council and a non-executive director of National Grid plc. Paul chairs the Nomination Committee and is a member of the Audit Committee. Paul also attends the Remuneration Committee, Safety Review Committee and Technical Review Committee by invitation.

### Executive Directors

#### **Martin Rolfe, Chief Executive Officer**

Martin took up the post of Chief Executive in May 2015 having been Managing Director, Operations since 2012, with responsibility for NATS' economically regulated UK and North Atlantic services. An engineer by training, Martin holds a Master's degree in Aerospace Systems Engineering from the University of Southampton. He has 20 years of experience in the defence and aerospace industry, and prior to joining NATS was the Managing Director of Lockheed Martin's Civil Division with responsibility for worldwide Air Traffic Management programmes as well as UK government business. Martin has also

worked for the European Space Agency and Logica plc.

#### **Nigel Fotherby, Finance Director**

Nigel joined NATS in 1999 as Finance Director and led the Finance team through the transition to PPP (2001) and, following the events of 9/11, the financial restructuring and refinancing of NERL in 2003. In addition to his responsibilities for finance, Nigel leads NERL's economic regulatory team and represented the company in the economic regulator's review of NERL's charges for CP3 and RP2. Previously, he worked for Lex Service plc as Finance Director of its retail group and then for BT Cellnet, where he was Deputy Finance Director. He began his career with Coopers & Lybrand where he qualified as a Chartered Accountant.

### Non-Executive Directors

#### **Dr Harry Bush CB**

Harry is Vice-Chairman of UCL Hospitals NHS Foundation Trust. He spent most of his career in HM Treasury where he focused latterly on policies towards growth, science funding and privatisation and private finance. He was UK Director at the European Investment Bank from 2001 to 2002. Harry left HM Treasury in 2002 to join the CAA Board as Group Director Economic Regulation responsible for the economic regulation of the designated

airports and NATS, as well as the CAA's economic analysis generally. He was a member of Eurocontrol's Performance Review Commission from 2005 to 2009 and of the UK's Commission for Integrated Transport from 2006 to 2010. Since leaving the CAA in 2011 Harry has been a consultant on economic regulation, undertaking assignments across a range of industries in the UK and overseas. He is a Fellow of the Royal Aeronautical Society and a Member of the Council of Management of the Regulatory Policy Institute, Oxford. Harry is a director of The Airline Group (AG) and NATS Employee Sharetrust Limited and a member of the Audit Committee.

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

Brenda is Chairman of Empiric Student Property plc and a member of Group Board of Places for People. She is Chairman of the Advisory Board of Runways UK. She was previously Chair of the Freedom to Fly Coalition, the Armed Forces Pay Review Body, the Housing Corporation, Covent Garden Marketing Authority, a non-executive director of Taylor Wimpey plc and General Secretary of the Society of Graphical and Allied Trades. Brenda was created a life peer in 1993 and sits on the Labour benches in the House of Lords. Brenda is a director of, and chairs, the NATS Employee Sharetrust

and is a member of the Remuneration Committee.

### **Will Facey**

Will is the Director for Network Operations at easyJet Airline Company. He joined easyJet in 2008 having previously worked for DHL Express for 20 years. His last role within DHL was as the Director of Network Control for the European overnight delivery network. Previous positions included a mix of operational leadership and European regional functional roles. He has spent most of his working career based in continental Europe – primarily in Denmark and Belgium and moved back to the UK to take up the role with easyJet. Will is a director of AG and a member of the Safety Review Committee.

### **Richard Keys**

Richard is a non-executive director of Sainsbury's Bank plc, Wessex Water Services Limited and the Department for International Development. He was previously a Council member of the University of Birmingham. He retired from PricewaterhouseCoopers in 2010 where he was a former senior partner and Global Chief Accountant. Richard chairs the Audit Committee and is a member of the Nomination Committee and Technical Review Committee.

### **Andy Lord**

Andy graduated from Manchester University in 1992 with an honours degree in Mechanical Engineering,



having joined British Airways in 1989. He moved to Operations in 2004 having held various roles in Engineering and Flight Operations and is still the only non-flying manager in BA's history to have held the position of Chief Pilot. Andy was appointed Director of Operations in January 2009 as a member of the British Airways Executive Leadership Team. He was responsible for BA's network operations, airport customer service and ground safety, business reliance and operational IT systems. He was a non-executive Board member of BA CityFlyer, and is a director of AG, and chairs the Remuneration Committee.

**Gavin Merchant**

Gavin joined Universities Superannuation Scheme (USS) in 2011 as Senior Investment Manager with responsibility for sourcing, evaluating and monitoring co-investments within the infrastructure portfolio. Gavin serves on a number of portfolio company boards for USS as well as a number of advisory boards for infrastructure funds. Gavin has worked in the infrastructure sector in the UK and Australia for 15 years. Prior to joining USS, Gavin was a Director at Equitix Limited. Gavin graduated with an honours degree in Law from the University of Edinburgh and is a member of the Institute of Chartered Accountants of Scotland. Gavin is a director of AG and a member of the Remuneration Committee.

**Iain McNicoll CB CBE**

Iain served 35 years in the Royal Air Force, retiring in 2010 as an Air Marshal. In his last appointment he was responsible for generating and delivering all of the RAF's front line operational capability. He was a member of the Air Command main Board and co-chaired the principal Board sub-committee. He had RAF responsibility for all safety and environmental matters, and was the RAF's first Chief Information Officer. Iain is now an aerospace, defence and security consultant. He is a Fellow of the Royal Aeronautical Society and a Chartered Director Fellow of the Institute of Directors. Iain chairs the Safety Review Committee and is a member of the Technical Review Committee.

**Derek Provan**

Derek is Airside & Expansion Operations Director at Heathrow, responsible for the operation of Heathrow's airfield and Air Traffic management policy, and is leading Heathrow's Expansion programme to deliver increased airport capacity and the future operating models for an expanded Heathrow. He is active in numerous aviation forums within the UK and is founding member of the Performance Based Regulation Industry Group working with the CAA to ensure that the industry forms an integral part of future regulation in UK Aviation. He is a

member of the Safety Review Committee.

### **Peter Read**

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

### **Tony Tyler**

Tony is the Director General and CEO of International Air Transport Association (IATA) with over three decades of airline industry experience. Prior to

joining IATA, Tony built his career at John Swire & Sons in Hong Kong. He joined the company in 1977 and in 1978 moved within the Swire Group to Cathay Pacific Airways, rising to the position of Chief Executive (2007 to 2011). Tony graduated from Oxford University in Jurisprudence. At IATA, he works from both its main offices in Montreal, Canada and Geneva, Switzerland. He is a Fellow of the Royal Aeronautical Society.

### **Officer**

#### **Richard Churchill-Coleman, Legal Director**

Richard is Legal Director which includes the role of Company Secretary. He joined NATS in June 2007 from TUI Northern Europe Limited where he held the position of Group Legal Counsel. Richard has more than 30 years' experience in the aviation industry having begun his career as an undergraduate aerospace engineer with British Aerospace plc before qualifying as a solicitor with Norton Rose and subsequently as a Chartered Secretary. Richard has previously held positions at Thomsonfly, Virgin Atlantic Airways and DHL Worldwide Express and holds a private pilot's licence.



## NATS Governance framework

### Introduction

NATS was formed as a Public Private Partnership in July 2001. In addition to its memorandum and articles, a key element in its governance structure is the Strategic Partnership Agreement (SPA) between its main shareholders: the Secretary of State for Transport; The Airline Group Limited (AG); and LHR Airports Limited (LHRA) (previously BAA Limited).

The SPA sets out the relative responsibilities of the signatories and, in particular, requires the group and the directors to adhere to the UK Corporate Governance Code so far as reasonably practicable and save to the extent inconsistent with the other provisions of the SPA.

### The Board and Directors

Ultimate responsibility for the governance of NATS rests with the Board of NATS Holdings Limited, which provides strategic direction and leadership and is responsible for ensuring that the NATS group is run safely, efficiently, effectively and legally, with appropriate internal controls to safeguard shareholders' investment and group assets.

The boards of the subsidiary companies within the group are accountable to the NATS Holdings Board for all aspects of their business activities.

As at the date of approval of the accounts, the NATS Holdings Limited

Board comprised a non-executive Chairman and 12 directors, as follows:

#### **Executive Directors**

- Chief Executive Officer (CEO); and
- Finance Director.

#### **Non-Executive Directors**

- a non-executive Chairman, appointed by AG, subject to the prior approval of the Crown Shareholder;
- six further non-executive directors appointed by AG, including the International Air Transport Association (IATA) representative;
- three non-executive Partnership directors, who are appointed by the Crown Shareholder; and
- one non-executive director appointed by LHRA.

### Changes to the Directors

From 1 April 2015 to the date of approval of the accounts, the following changes to the directors were made:

<b>Executive Director</b>	
<i>Richard Deakin</i>	Resigned 18 May 2015
<b>Non-executive LHRA Directors</b>	
Roger Cato	Resigned 31 December 2015
Derek Provan	Appointed 28 January 2016

Martin Rolfe was appointed CEO following Richard Deakin's resignation.

### The roles of the Chairman, Chief Executive Officer and executive management

The Chairman of the NATS group is responsible for the leadership of the Board and for its governance. He has no day-to-day involvement in the running of the group. Day-to-day management of the NATS group is the responsibility of the CEO, Martin Rolfe, supported by the

NATS executive team. The NATS executive team is responsible for delivering NATS' overall strategy. To achieve its strategic priorities the executive team has recently been structured as follows:

- CEO;
- Finance Director;
- Operations Director;
- Safety Director;
- Commercial Director;
- HR & Corporate Services Director;
- Delivery Director;
- Communications Director; and
- Legal Director.

### **The responsibilities of the Board**

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

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

#### ***Partnership and AG directors***

- adoption of the business plan;
- entry into significant debts, charges or contingent liabilities;
- major agreements outside the ordinary course of business;

- significant litigation proceedings; and
- external investments, and acquisition and disposal of material assets.

#### ***LHRA director***

- acquisition or disposal of any asset representing more than 10% of the total assets of the business;
- any aspects of the business plan which could adversely affect NERL's service to UK airports; and
- disposal of NATS Services shares by NATS.

### **Access to legal and professional advice**

All directors have access to the advice and services of the Legal Director, Richard Churchill-Coleman, who acts as Secretary to the Board. If necessary, in furtherance of their duties, directors may take independent professional advice at the group's expense.

### **Board meetings**

The Board routinely meets seven times per year in January, March, May, June, July, September and November, and supplements these scheduled meetings with additional meetings as business priorities require. During this year, the Board met seven times with each member (who served as a director during the year) attending as follows:



Name	Number of meetings attended / Number of eligible meetings
Paul Golby	7/7
Martin Rolfe	6/7
Nigel Fotherby	6/7
Harry Bush	7/7
Baroness Dean of Thornton-le-Fylde	6/7
Will Facey	6/7
Richard Keys	5/7
Andy Lord	6/7
Iain McNicoll	7/7
Gavin Merchant	5/7
Derek Provan	0/1
Peter Read	6/7
Tony Tyler	6/7
Richard Deakin	0/1
Roger Cato	5/6

The non-executive directors meet with the Chairman, but without the executive directors present, before and after each Board meeting.

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

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

## The Board's performance

### **Board effectiveness review**

The Board is committed to continuous improvement and a performance evaluation of the Board, its committees, and the Chairman is conducted each year. This year, the Board effectiveness review was administered externally (as recommended every three years under the Corporate Governance Code) by Board Evaluation Limited using structured questionnaires. The results were assessed by the Board at its 7 April 2016 meeting and appropriate actions agreed.

### **Director induction**

Following their appointment, the Company Secretary consults with new directors on the scope of induction to NATS which they require and a personalised induction programme is developed.

During the year, such a programme was started for Derek Provan. This programme included briefings on governance and the NATS business, presentations from relevant executive management, and visits to key operational centres. In addition to an induction programme, all Board members are briefed on a continuing basis on key business issues.

### **The Board's Committees**

The Board has established five standing committees which operate within approved terms of reference. The committee structure comprises the:

- Audit Committee;

- Nomination Committee;
- Remuneration Committee;
- Safety Review Committee; and
- Technical Review Committee.

The number of meetings held by the principal Board committees, and attendance by non-executive director committee members, is provided in the table below:

	Number of meetings attended / Number of eligible meetings				
	Audit	Nomination	Remuneration	Safety Review	Technical Review
Paul Golby	4/4	2/2			
Harry Bush	4/4				
Roger Cato		1/2		1/3	2/2
Baroness Dean of Thornton-le-Fylde			5/6		
Will Facey				4/4	
Richard Keys	4/4	2/2			2/2
Andy Lord			6/6		
Iain McNicoll				4/4	3/3
Gavin Merchant			6/6		
Derek Provan					
Peter Read		2/2			3/3
Tony Tyler					

The terms of reference for the Board and its committees are available to all staff and shareholders and can be made available externally with the agreement of the Legal Director. Reports from each of the standing committees are set out on pages 46 to 67. However, in addition to the standing committees, from time to time the Board may form committees on an ad hoc basis to deal with specific business issues. During the year the Board formed an ad hoc committee to review Non-Executive Director fees, based on a benchmarking report from

New Bridge Street as remuneration advisors to the company.

**Meetings with shareholders**

A shareholders meeting is held once a year and provides the group with an opportunity to update the shareholders on the progress of the annual business plan and long term strategy. The meeting was the Annual General Meeting held on 30 July 2015. Shareholders may also meet informally with the Chairman, CEO, Finance Director and other members of executive management upon request.

Due to the manner in which non-executive directors are appointed by the shareholders under the SPA, there is no senior independent director.

**Compliance with the UK Corporate Governance Code**

NATS is committed to maintaining the highest standards of corporate governance. The SPA requires the group and the directors to adhere to the UK Corporate Governance Code so far as reasonably practicable and save to the extent inconsistent with the other provisions of the SPA. For the financial year ended 31 March 2016, the applicable standard is the 2014 UK Corporate Governance Code (the Code). NATS has applied the principles of the Code to the extent considered appropriate by the Board throughout the year ended 31 March 2016. However, a number of principles and provisions in the Code are not relevant to the partnership nature of the NATS group



ownership and the principal areas where NATS did not comply are summarised below.

**Corporate Governance Code A.3.1: Independence of the Chairman**

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

**Corporate Governance Code A.4.1, B.1: Independence of Directors and appointment of Senior Independent Director**

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

**Corporate Governance Code B.2.1, D.2.1: Composition of the Nomination and Remuneration Committees**

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

**Corporate Governance Code B.3.2: The terms and conditions of non-executive directors**

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

**Corporate Governance Code B.7: Re-election of Directors**

The non-executive directors are appointed by the shareholding groups and are therefore subject to the relevant shareholding groups' selection processes, rather than those included in the provisions of the Code. They are therefore not subject to periodic re-election as stipulated by Section B.7 of the Code, although Partnership directors are appointed by the Government on three-year fixed-term contracts. This aligns with the recommendation in B.7.1 that the maximum period between re-election is three years, reducing to one year for non-executive directors who have served longer than nine years. Brenda Dean has a one year contract from 2015 which will bring her total tenure to 10 years in 2016 as she has been in post since 2006. Her tenure is

due to expire on 25 July 2016 and a process for appointing her replacement is currently underway.

The tenure of non-executive directors is as follows:

Name	Date of appointment	Years of service to 31/3/16*
Paul Golby	1/9/14	1 year 7 months
Harry Bush	27/5/14	1 year 10 months
Roger Cato**	28/4/03	12 years 6 months
Baroness Dean of Thornton-le-Fylde	24/7/06	9 years 8 months
Will Facey	27/11/14	1 year 5 months
Richard Keys	1/9/13	2 years 7 months
Andy Lord	26/2/09	7 years 1 month
Iain McNicoll	1/9/13	2 years 7 months
Gavin Merchant	20/3/14	2 years
Derek Provan	28/1/16	2 months
Peter Read	23/9/02	13 years 6 months
Tony Tyler	1/7/13	2 years 9 months

\* Years of service to resignation, if earlier.

\*\* Served until 31 December 2015.

The group is mindful of the principles behind the guidance in the Code relating to directors who have served longer than nine years.

### **Corporate Governance Code Section E: Relations with shareholders**

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

'Meetings with shareholders' section above.



## **Audit Committee report**

### **The role of the Audit Committee**

The Audit Committee meets four times per year. It is chaired by Richard Keys; Paul Golby and Harry Bush are the remaining two members of the Committee. The Committee members all have wide-ranging commercial and management experience and Richard Keys, a former audit partner at PricewaterhouseCoopers LLP (PwC) has recent, relevant financial and audit experience. The Audit Committee members maintain their competence in the sector and on company specific issues (such as pensions) through targeted training and briefing at Committee meetings.

The CEO, Finance Director, Group Financial Controller, Head of Internal Audit, NATS Risk Manager and the external auditors are invited to attend each meeting by standing invitation.

Part of each meeting is set aside as required for members of the Committee to hold discussions without executive management present, including holding separate discussions with the external and internal auditors.

The duties of the Committee include:

- monitoring the integrity and compliance of the group's financial statements;
- reviewing the effectiveness of the external auditors and the Internal Audit department;
- reviewing the scope and results of internal and external audit work; and

- reviewing NATS' systems of internal controls and risk management.

The Committee makes recommendations to the Board on matters relating to the appointment, independence and remuneration of the external auditors and, to ensure independence, monitors the extent of non-audit services provided by the external auditors (as explained below). The Committee also reviews whistleblowing arrangements under which staff may confidentially raise concerns about possible improprieties in financial reporting or other matters.

### **Main activities of the Committee during the year**

#### **a. Financial reporting**

The primary role of the Committee in relation to financial reporting is to review with both management and the external auditors the annual financial statements of the group and its subsidiaries and NERL's regulatory accounts, having regard as appropriate to:

- the suitability of accounting policies adopted by the group;
- the clarity of disclosures and compliance with Companies Act legislation and financial reporting standards, including the requirements of NERL's air traffic services licence; and
- whether significant estimates and judgements made by management are appropriate.



In addition, the Committee assists the Board in its assessment of whether the Annual Report and Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy.

To aid its reviews the Committee considers reports from the Finance Director and reports from the external auditors on the outcome of the annual audit.

The Committee considered the following significant accounting judgements and sources of estimation uncertainty in the year:

### **The carrying values of goodwill, other intangible and tangible assets**

The group has goodwill of £209m, other intangible assets of £440m and tangible assets of £555m. As we explain in our accounting policies, goodwill, intangible and tangible assets are tested annually for impairment.

The judgement in relation to the carrying value of these assets relate to: the assumptions underlying the calculation of value in use, including the extent to which business plan cash flow projections are achievable taking account of the outcome of regulatory reference period reviews; and assessing net realisable values, including the extent of any premium to regulatory asset values.

The Committee addressed these matters by considering: NERL's revenue

allowances and the cash flows implied by the Reference Period 2 (RP2) settlement, for determining value in use; the cost of capital assumption used to discount value in use; the value of NERL's regulatory assets, including the scope for out-performance of regulatory settlements as well as premia to regulatory assets implied by market transactions in regulated entities, for determining net realisable value and value in use; the outcome of internal asset impairment reviews; and appropriate sensitivities. Further information is provided in notes 13, 14 and 15 to the accounts.

### **Retirement benefits**

The pension funding position determined under international accounting standards requires a number of actuarial assumptions to be made, including judgements in relation to long term interest rates, inflation, longevity, salary growth and investment returns.

The Audit Committee reviews the basis for determining these assumptions annually and takes account of the Trustees' last triennial valuation (as at 31 December 2012) and assumptions. The Audit Committee also considered the status of the Trustees' valuation at 31 December 2015 which will be finalised in the last calendar quarter of 2016, and the adequacy of the group's funding arrangements to meet expected increases in contributions. It also considered the adequacy of explanations and disclosures of the different basis of valuation of the Trustees funding



assessment and the balance sheet position under international accounting standards. The final calculations in respect of the defined benefit pension scheme are performed by a qualified actuary, independent of the scheme. Note 30 sets out the main actuarial assumptions used, including sensitivity analysis.

#### **Revenue recognition and the recoverability of revenue allowances**

The economic regulatory price control for UK en route services allows for the recovery (or reimbursement) of revenue allowances where actual traffic volumes or inflation are different to the regulator's forecasts made at the start of the reference period, where actual service performance is different to the regulator's annual targets and for adjustments brought forward from the previous charge control period. NATS' policy is to recognise these revenue adjustments in the year of service, based on traffic, inflation and service performance experienced. Where regulatory revenue adjustments are assessed after the end of a reference period, their recoverability is dependent on the assessment of the economic regulator and recognised on this basis.

The Committee considered the relevant EC Charging Regulations and the conditions of NERL's air traffic services licence for RP2 in determining whether these revenue adjustments are recoverable. The recoverable revenue allowances are reported in note 16.

#### **b. Internal control**

The Board is responsible for the group's system of internal control and for reviewing its effectiveness.

NATS' system of internal control is designed to ensure that the significant financial, operational, safety, legal, compliance and business risks faced by the group are identified, evaluated and managed to acceptable levels. This system was in place during the year and up to the date of approval of the Annual Report and Accounts and was specifically considered for the year under review at its June 2016 Audit Committee meeting. However, as with all such systems, internal controls can provide reasonable but not absolute assurance against misstatement or loss.

The Audit Committee's work in the area of internal control includes reviewing reports by the internal and external auditors, reviewing reports of any attempted or actual frauds, receiving reports from the management's Tax and Treasury Committees, and consideration of the circumstances of whistleblowing reports.

This year, the Committee also considered the governance arrangements relating to NATS' joint ventures: FerroNATS Air Traffic Services SA and Aquila Air Traffic Management Services Limited, as well as NATS' involvement in the SESAR Deployment Manager Consortium.

#### **c. Risk management**

Risk management is essential in seeking to minimise the threat that an event or

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action might have on the group's ability to achieve its objectives and to execute its strategies effectively. Successful risk management ensures that the group is able to consistently deliver services to its customers and meet the needs and expectations of its shareholders in a fast changing and uncertain environment. The Board takes the management of risk very seriously, paying particular attention to areas such as safety, service delivery, operating efficiency, pension funding, financial control, project delivery, regulatory compliance, financing and IT systems.

This system for the identification, evaluation and management of risks is embedded within the group's management, business planning and reporting processes, accords with the UK Corporate Governance Code, and is aligned with the ISO 31000 risk management standard. Detailed risk identification is carried out at business unit and departmental levels and is recorded and measured in a controlled and managed enterprise-wide database. NATS' risks are mapped against risk tolerance statements which have been agreed by the Board. Risk update reports are submitted to the NATS Executive team which address changes in risk tolerance, business controls and the progress of mitigating actions associated with NATS' risks.

The Audit Committee reviews the processes in place to identify, assess, mitigate and manage risk in order to satisfy itself that they are appropriate

## Reports from Board Committees

and within the specified risk tolerance. The Board formally reviews the principal risks to NATS and the risk management processes and mitigations in place on a six monthly basis. The directors have carried out a robust assessment of the principal risks facing the business. In each monthly set of Executive reports to the Board, any changes in gross or residual risk of a 'top risk' will be highlighted by exception, but particularly if the change means a risk falls outside of the agreed tolerance. The Audit Committee and Board have assessed the group's principal risks and the performance against mitigation plans during the year ended 31 March 2016, and agreed the actions and mitigations in place for the principal risks as at the date of this report. The Audit Committee and the Board also reviews the extent of warranties and guarantees entered into by the company, with particular focus on any unlimited liability indemnities entered into as part of commercial arrangements.

### **d. Internal audit**

The group's Internal Audit department reviews the controls in place to manage NATS' business risks, which includes reviews of internal financial control. In order to access the specialist skills required to perform assessments across the wide range of areas in which NATS operates, the Internal Audit function is operated as a co-source arrangement with PwC.

The results of internal audits and agreed actions are reported as appropriate to



relevant directors, executives and managers. The Audit Committee also oversees and monitors the actions taken by management to address Internal Audit findings and considers the ongoing independence of Internal Audit. The Audit Committee oversees the performance of Internal Audit through the receipt of a report on its work presented to each Audit Committee meeting and agrees the annual work plan in the context of the group's audit and assurance universe.

### **e. External audit**

BDO LLP was re-appointed as external auditors at the Annual General Meeting on 30 July 2015. The Committee reviewed the performance and the continuing independence of BDO at its June meeting and recommended to the Board that BDO are re-appointed. Accordingly, a resolution recommending their re-appointment will be tabled at the AGM on 28 July 2016.

### **f. Non-audit work performed by the external auditors**

From time to time the external auditors perform non-audit services for the group. Part of the Audit Committee's remit is to ensure that such engagements do not impair the auditors' objectivity or independence. The Committee does this by implementing a policy on non-audit services and monitoring and/or approving work by the external auditors in accordance with this policy.

The principal non-audit services performed by BDO LLP in the year ended

31 March 2016 were expatriate tax services until 31 January 2016 and the provision of a payroll service in Gibraltar until 30 June 2015. Details of the cost of these services are set out in note 6 of the 'Notes forming part of the consolidated accounts'. BDO LLP had been engaged to provide these services prior to their appointment as external auditor and at the request of the Committee these services were re-tendered during the year.

The Committee considered the nature and cost of these services and concluded that they did not impair the independence of the external auditor.

### **Richard Keys**

#### **Chairman of the Audit Committee**

## **Nomination Committee report**

### **The role of the Nomination Committee**

The Nomination Committee is chaired by the non-executive Chairman Paul Golby and comprises two further non-executive directors, Peter Read and Richard Keys. Roger Cato was a member until December 2015. The Committee meets when considered necessary by its members and may invite executives and advisors to attend meetings as appropriate.

Appointments to the Board are made by the relevant sponsoring shareholder under the terms of the SPA. The Committee has the task of evaluating the balance of skills, knowledge and expertise required on the Board and making recommendations to the shareholders with regard to any changes. It also reviews succession plans for directors and senior executives.

### **Main activities of the Committee during the year**

During the year, the Committee met twice in October 2016 to consider the appointment of Martin Rolfe as CEO and subsequent executive team reorganisation proposals. It also considered non-executive director succession planning and non-executive director recruitment.

The appointment of Derek Provan was made by LHRA.

The Committee undertook an assessment of the performance and

renewal considerations with respect to the current Partnership Directors for the purpose of the Chairman advising the Secretary of State on Partnership Director recruitment or re-appointment.

The Committee's terms of reference require it to give due regard to the benefits of diversity, including gender on the Board.

### **Paul Golby Chairman of the Nomination Committee**



### Remuneration Committee report

This report has been prepared by the Remuneration Committee and approved by the Board. The information in this report is not subject to audit.

#### ***Purpose and responsibilities***

The Committee meets when necessary and is responsible for:

- considering and approving, on behalf of the Board, the arrangements for determining the remuneration, benefits in kind and other terms of employment for the Chairman and executive directors and the company's Personal Contract Group;
- considering and approving company incentive targets for executive directors and other members of the wider executive team;
- considering and approving a statement of remuneration policy;
- confirming details of the remuneration of each executive director for inclusion in the Annual Report and Accounts; and
- confirming pay packages for all executive team members.

The terms of reference for the Committee require it to ensure the company's remuneration policy complies with the current Corporate Governance Code, as far as practicable under the SPA. No director is involved in decisions relating to his or her own remuneration.

#### ***Activities in the year***

The Committee met six times in 2015/16 and its main activities during the year were to:

- review and approve the annual performance related pay targets for the executive team and Personal Contract Group;
- review and approve achievement of the Long Term Incentive Plan (LTIP) cycle 2 targets and resulting payments;
- agree changes to the structure of the LTIP for the executive team resulting in the implementation of cycles 5 and 6 (being 2 and 3 year plans respectively) from 1 April 2016;
- agree the Personal Contract Group and executive team pay review recommendations;
- review and update the terms of the executive team contracts in line with best market practice; and
- agree remuneration for new executive team roles and termination payments for departing executive team members.

#### ***Membership***

The Remuneration Committee of the Board is comprised entirely of non-executive directors. During the year, it was chaired by Andy Lord with Brenda Dean and Gavin Merchant as members. Paul Golby also attends the meeting (but is absent for discussion about his own remuneration).

#### ***Advisers and other attendees***

As appropriate, the CEO and HR & Corporate Services Director are invited to attend Committee meetings.

The company also takes external advice on various aspects of remuneration policy and competitive pay levels from

independent consultants. New Bridge Street (NBS), part of Aon Hewitt, are independent advisers to the Committee. NBS has no other commercial relationship with the company. NBS is a member of the Remuneration Consultants Group and is a signatory to its code of conduct.

### **Remuneration policy**

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

The level of executive directors' remuneration takes into account competitive practice across comparator companies (which are based on organisations, as agreed with the Committee, from which NATS might seek to recruit employees or which are similar to NATS in other respects) together with the need to attract and retain employees. Executive directors are rewarded on the basis of responsibility, competence and contribution, and salary increases take account of pay awards made elsewhere in the group. Performance-related elements form a substantial part of the total remuneration package and are

designed to align the interests of directors with those of shareholders and other stakeholders and to promote the long-term success of the company.

Performance is measured against a portfolio of key business objectives and payment is determined based on performance beyond that expected of directors as part of their normal responsibilities. In implementing this strategy the Committee adopts the principle that incentive scheme targets must be stretching and in line with the Board's agreed business plans and support the Board's strategic growth plans for NATS.

### **Executive directors**

The remuneration package for executive directors is reviewed each year and consists of, but is not restricted to:

- annual salary;
- pension and life assurance and income protection;
- annual performance related incentive scheme;
- long term performance related incentive scheme;
- All-Employee Share Ownership Plan; and
- other benefits: including company car or car allowance and medical insurance.

Full details of directors' remuneration paid in relation to 2015/16 are set out on page 59.

### **Salaries**

#### **Salary policy summary**

The Committee determines, where appropriate, annual increases to



executive directors' salaries having regard to their experience, responsibility, individual contribution, market comparatives and pay increases elsewhere in the group.

**Operation**

Executive directors' salaries are normally reviewed annually and fixed for the 12 months commencing on 1 April. The Committee takes into consideration:

- role, experience and performance of the individual;
- internal and external relative positioning for total reward; and
- the average budgeted increase in base salaries elsewhere in the group.

**Implementation for 2016/17**

In determining the base salaries for 2016/17, the Committee has determined that there will be no change in salaries from 1 April:

	Salaries effective 1 April (unless otherwise stated)	
	2016	2015
Martin Rolfe	£400,000	£400,000*
Nigel Fotherby	£291,719	£291,719

\* As noted in last year's report, with effect from 18 May 2015, Martin Rolfe was appointed as interim CEO. His salary for the period of this interim appointment was increased from £241,904 to £300,000. Effective from 13 October 2015, Martin was appointed CEO on a salary of £400,000.

**Pensions and life assurance**

**Pension and life assurance policy summary**

To provide income in retirement through either Defined Benefit (pre April 2009) or Defined Contribution (post April 2009)

pension schemes. Both schemes provide life assurance and ill-health provisions or income protection.

**Operation**

Executive directors' pensions and life assurance are based on salary only, with performance-related pay and other discretionary benefits excluded.

There are two principal methods of securing pensions for executive directors:

- the Civil Aviation Authority Pension Scheme (CAAPS), a defined benefit scheme. This scheme was closed to new participants on 1 April 2009; and
- the NATS Defined Contribution Pension Scheme which came into operation on 1 April 2009.

The Board approved a company-wide cash alternative payment scheme in lieu of pension contributions for those with total pension savings close to the Lifetime Allowance, which is also available to eligible executive directors.

**Implementation for 2016/17**

The schemes will operate as described above. Martin Rolfe is a member of the Defined Contribution pension scheme and has elected to take the cash alternative in lieu of pension contributions from April 2016. Nigel Fotherby is a member of CAAPS.

**Annual incentive scheme**

An Annual Management Performance Related Pay Scheme (AMPRPS) is in place for the executive team and all staff in the Personal Contract Group.

The Committee reviewed the operation of the AMPRPS in the year. The main conclusion of the review was the introduction of a claw-back facility, as described below.

In addition, the Committee also reviewed the operation of the Company Performance Related Pay (CPRP) and concluded that the executive team would no longer be eligible to participate in this scheme. In summary, the CPRP is linked to the achievement of the company's annual EBITDA target in line with the annual business plan. The scheme pays out up to a maximum of £1,042 per full time employee for 105% achievement of EBITDA regardless of seniority, grade or salary level, payable in July 2016 (subject to company financial performance). The second cycle of the scheme paid out £1,027 per full time employee in July 2015.

#### **AMPRPS policy summary**

The AMPRPS is designed to reward on-going delivery and contribution to strategic targets during a one-year period. Targets are set annually and are a mix of financial and personal performance.

#### **Operation**

AMPRPS payouts are determined by the Committee after the year end, based on performance against pre-determined financial and personal objectives. The Committee may apply discretion as appropriate.

AMPRPS is paid entirely in cash.

The Committee may determine that vesting should not be applied for any

particular participant(s) should the Committee consider that individual performance or other circumstances makes this an appropriate outcome. It is anticipated that this power would only be exercised in exceptional circumstances when the Committee decides that there has been or could be significant damage to the reputation of the company either during the performance years or as a result of the award. In these cases, the decision would be referred to the non-executive directors of the Board for ratification. In addition, a claw-back provision applies whereby individuals are liable to repay or forfeit some or all of their AMPRPS if there is a material misstatement of results.

#### **Performance metrics**

Company performance: 75% of maximum

Personal performance: 25% of maximum

Further details of the targets set for 2015/16 are provided in the outcome section on page 58.

#### **Maximum AMPRPS opportunity**

CEO: 70% of salary

Finance Director: 55% of salary

#### **Implementation for 2016/17**

The AMPRPS was reviewed by the Committee in early 2016. Other than the introduction of a claw-back provision (as described above), the AMPRPS will run on an unchanged basis.

Performance targets are set in line with business strategy and will be set out, to



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the extent they are not commercially sensitive, in next year's report.

### **Long-term incentive scheme**

A Long Term Incentive Plan (LTIP) is in place for members of the executive team.

During the year the Committee undertook a full and comprehensive review of the LTIP in order to ensure that the plan was more closely aligned to the market, retaining market comparative maximum award levels combined with greater stretch in target values with an overall aim of retaining broadly similar total reward levels to the previous scheme. A full description of how the revised LTIP structure will operate with effect from 1 April 2016 (cycle 5 onwards) is set out below. In summary, the main conclusions of the review were the introduction of:

- reward directly linked to the equity value of NATS through the award of notional shares and the operation of dividend equivalents in line with market practice;
- a longer vesting period which is phased over 3 to 5 years, with the option for the participant to stay invested for longer;
- fewer performance measures with strategic measures which capture three year performance;
- increased maximum award levels (as a % of salary) from 90% to 110% for the CEO and 75% to 90% for the FD in order to position total reward in line with benchmark comparators;

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- a scheme that reflects one NATS, with all participants having the same measures;
- recovery and withholding provisions apply; and
- transitional arrangements in place for cycle 5 award, which was delayed due to the review and cycle 6 award, which will both be awarded in April 2016.

### **LTIP policy summary**

The LTIP is designed to reward the achievement of a set of financial and strategic targets for rolling three year periods.

### **Operation**

Awards of notional shares are made annually with vesting dependent on the achievement of performance conditions over the three subsequent years.

To the extent that performance conditions are met awards will normally vest in three tranches, 50% in the third financial year, 25% in the fourth financial year and 25% in the fifth financial year. Transitional arrangements are in place for the cycle 5 award (see implementation for 2016/17 below).

Notional shares are linked to the NATS All-Employee Share Ownership Plan share price and participants receive cash payments in relation to the value at the time of vesting.

Recovery and withholding provisions apply to the LTIP at the discretion of the Committee in the event of material misstatement of results, an error in the calculation of outcome or in instances of individual gross misconduct.

**Performance metrics**

Profitability, growth and strategic targets will be set out (to the extent they are not commercially sensitive at the time an award vests). These will be subject to the overarching event clause and adjusted to take account of traffic levels.

**Maximum LTIP opportunity**

CEO: 110% of salary

Finance Director: 90% of salary

**Implementation for 2016/17**

Cycle 5 awards, which were due to be made in 2015, were delayed due to the LTIP review, therefore transitional arrangements are in place for cycle 5 awards, with both cycle 5 and cycle 6 awards being made in April 2016.

**Cycle 5 award**

The cycle 5 award was made in April 2016. This award will be subject to a two year performance period, with 75% of the award vesting on the third anniversary of grant and 25% of the award vesting on the fourth anniversary of grant. Performance metrics will be linked to profitability, growth and strategic targets.

**Cycle 6 award**

The cycle 6 award was also made in April 2016. This award will be subject to a three year performance period, with 50% of the award vesting on the third anniversary of grant, 25% of the award vesting on the fourth anniversary of grant and 25% of the award vesting on the fifth anniversary of grant.

Performance metrics will be linked to profitability, growth and strategic targets.

**All-Employee Share Plan**

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

At the date of this report, Martin Rolfe holds 300 shares and Nigel Fotherby holds 2,777 shares.

The current HM Revenue and Customs approved valuation, for the period 1 January 2016 to 30 June 2016, values the shares at £4.20 each.

**Employment contracts**

The employment contracts of Martin Rolfe and Nigel Fotherby provide for 12 months' notice in the event of termination by the company and the executive director.

**Non-Executive directors**

Charges for the services of non-executive directors are determined in agreement with the relevant sponsoring body - the Department for Transport in the case of the Partnership directors and AG in the case of AG directors.

The Partnership directors each received annual remuneration of £36,000 in the financial year. AG directors received no



remuneration for their services to the NATS Board. However, a payment of £180,000 per annum is made direct to AG in lieu of remuneration for these directors. This sum is used to fund the activities of AG. Roger Cato received direct remuneration for his services to NATS as LHRA director until his date of resignation at the end of December 2015. Derek Provan was appointed to this role from 28 January 2016 and is employed and remunerated by LHRA as part of his contract.

Paul Golby has a contract specifying the remuneration he receives from the company, being £160,000 on an annualised basis.

The Partnership directors are normally engaged on three-year fixed-term contracts and have letters of appointment from the Department for Transport.

### **Remuneration paid in 2015/16**

#### ***Directors' remuneration***

As noted in last year's report with effect from 18 May 2015 Martin Rolfe was appointed as interim CEO. Martin was appointed to the role of CEO on 13 October 2015 and he received a completion bonus of £50,000.

#### ***Annual management performance related pay scheme outcome for 2015/16***

Targets relating to the company element of the AMPRPS for 2015/16 were almost fully achieved (yielding 67.92% out of an available 75% of the award) and

personal performance ratings for the Board ranged between 20% and 25% (out of an available 25%).

The AMPRPS targets feature 4 key measures:

- Group EBITDA – c85% of the available weighting achieved;
- Customer delay measures - exceeded the stretch target;
- Customer Survey outcomes from the Airlines, Airports & MOD surveys - the amalgamated score results in a pay out of c80% for this element; and
- Operational measures relating to key NERL and NSL milestones - these elements have been achieved and as such will pay out in full.

#### ***Long-term incentive scheme outcome for 2015/16***

The strategic targets for cycle 3 (FMARS and Free Route Airspace) have been delivered, and as such will pay out in full (25%) for this cycle.

The NSL cumulative revenue and EBITDA values have not met the threshold target set for this cycle and therefore will not pay out for these measures (total 40% of total cycle value).

NERL regulatory return has achieved its stretch value target, and as such will pay out in full (35%) for this cycle.

This results in a total pay out of 60% of the maximum achievable for cycle 3, which will be payable in June 2016.

## Audited information

**Directors' remuneration**

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

	Notes	Salary or fees <sup>(1)</sup> £000	Pay in lieu of notice <sup>(1)</sup> £000	Benefits <sup>(1)</sup> £000	Performance related payments <sup>(1)</sup> £000	Long term incentive plan <sup>(1)</sup> £000	Total 2016 <sup>(1)</sup> £000	Total 2015 <sup>(1)</sup> £000
<b>Chairman</b>								
Dr Paul Golby CBE	1	160	-	5	-	-	165	101
<b>Executive directors</b>								
Martin Rolfe	2, 3	319	-	14	268	121	722	416
Nigel Fotherby	2	281	-	13	147	129	570	512
<b>Non-executive directors</b>								
Baroness Dean of Thornton-le-Fylde	1	36	-	-	-	-	36	38
Richard Keys	1	36	-	1	-	-	37	36
Iain McNicoll CB CBE	1	36	-	1	-	-	37	38
Andy Lord	4	-	-	-	-	-	-	-
Gavin Merchant	4	-	-	-	-	-	-	-
Peter Read	4	-	-	-	-	-	-	-
Tony Tyler	4	-	-	-	-	-	-	-
Dr Harry Bush CB	4	-	-	-	-	-	-	-
Will Facey	4	-	-	-	-	-	-	-
Derek Provan	5	-	-	-	-	-	-	-
<b>Former directors</b>								
Roger Cato	6	27	9	-	-	-	36	38
Richard Deakin	2, 7	111	251	5	-	-	367	943
John Devaney	1	-	-	-	-	-	-	67
		1,006	260	39	415	250	1,970	2,189

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

- 1 Benefits paid to the Chairman and non-executive directors represent the reimbursement of travel costs.
- 2 These directors participated in a pension salary sacrifice arrangement. Therefore contributions paid to the pension scheme via salary sacrifice have been deducted from salary figures. The contributions paid via salary sacrifice are included within the pension figures reported in the analysis of pensions below.
- 3 Martin Rolfe was appointed interim Chief Executive Officer (CEO) on 18 May 2015 and his annual salary increased from £241,904 to £300,000 on that date. On 13 October 2015 Martin was appointed CEO on an annual salary of £400,000 and received a bonus of £50,000 for his service as interim CEO, which is reported within performance related payments.
- 4 These directors are appointed by The Airline Group (AG) who charged NATS a total of £45,000 per quarter (2015: £45,000 per quarter) for the services of the directors.
- 5 Derek Provan was appointed to the Board on 28 January 2016 by LHR Airports Limited (LHRA). He receives no fees for his services to NATS from NATS.
- 6 Roger Cato resigned from the Board on 31 December 2015. He received three months pay in lieu of notice.
- 7 Richard Deakin resigned as a director on 18 May 2015 and left the company on 30 June 2015. His emoluments in the 2016 financial year included a contractual entitlement to six months pay in lieu of notice in addition to his contractual pay from 1 April to 30 June 2015.

## Interests of the directors in the Long Term Incentive Plan (LTIP):

From April 2011, the company introduced a rolling three year executive LTIP, entitling the executive directors to performance related pay contingent on achieving financial and strategic targets. Cycle 3 commenced in April 2013 and vested on 31 March 2016.

The maximum entitlement of the executive directors for each cycle as a percentage of average annual salary is shown below:

	Cycles 3 & 4
Martin Rolfe	75%
Nigel Fotherby	75%

The outcome of the LTIP is not known until the end of each cycle. Accordingly, the emoluments table will reflect amounts when qualifying conditions in relation to each cycle are met. The table values above reflect the outcome of LTIP Cycle 3.



## Audited information

**Directors' remuneration continued**

Nigel Fotherby is a member of the CAA Pension Scheme, a defined benefit pension scheme. The value of his accrued pension benefit in the year was as follows:

	2016 £000	2015 £000
Nigel Fotherby	114	88

The pension value represents the additional benefit accrued in the year (excluding inflation as measured by the Consumer Prices Index (CPI)) multiplied by a factor of 20. The value is inclusive of contributions paid by the employer on behalf of Nigel Fotherby via a salary sacrifice arrangement.

The principal terms of the company's defined contribution scheme are explained in note 30 to the financial statements. Martin Rolfe is a member of the scheme. Richard Deakin was a member until his departure from NATS on 30 June 2015. The company paid contributions in the year for Martin Rolfe of £40,713 and for Richard Deakin of £66,051. Under the company's pension salary sacrifice arrangement, Martin and Richard sacrificed £20,357 and £10,993 of their salary in lieu of pension contributions respectively to the defined contribution pension scheme in the year.

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

Name of Director	Shares sold	Share price at date of sale £	Gain on sale £
Richard Deakin	1,100	4.30	2,968

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

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

Name of Director	Date from which exercisable:				Total holding (number of shares)	Value at 31 March 2016 (at £4.20 each) £	Value at 31 March 2015 (at £4.30 each) £
	Exercisable (brought forward)	29/02/2016 (brought forward)	25/09/2017 (brought forward)	29/05/2019 (brought forward)			
Martin Rolfe	150	-	-	150	300	1,260	1,290
Nigel Fotherby	2,377	200	200	-	2,777	11,663	11,941
	2,527	200	200	150	3,077	12,923	13,231

No shares were granted during the year. In October 2015 employees including executive directors, were offered the option to participate in an award of up to 150 partnership shares each at fair value (being the lower of the share price at the start of the accumulation period of £3.95 and the end of the accumulation period, to be determined) by deductions from gross salary over a 12 month accumulation period which will end in September 2016. Participants will also receive one free matching share for every partnership share purchased. Both of the executive directors are participating in this award.

The executive directors received dividends during the financial year based on their shareholdings as of May and November 2015.

## Andy Lord Chairman of the Remuneration Committee

## Safety Review Committee report

### Role of the Committee

The Safety Review Committee supports the Board in discharging its accountabilities for the safe provision of operational air traffic services, monitoring NATS' safety performance, and for security arrangements across NATS. It meets quarterly as a formal committee and receives separate in-depth briefings as required. Its remit includes the requirements to:

- monitor and review the effectiveness of the safety arrangements in place in the group;
- review the delivery of the group's safety and security objectives through its operations, structures and processes;
- review the group's safety performance;
- monitor the implementation of safety enhancement programmes; and
- make recommendations to the Board for improving the group's safety and security management systems.

The Committee is chaired by Iain McNicoll and there are two other non-executive directors as members: Will Facey and Derek Provan. Derek Provan joined the Committee in March 2016, replacing Roger Cato. The following are invited to attend each meeting by standing invitation:

- Chairman of the NATS Board;
- CEO;

- Safety Director;
- Operations Director;
- Delivery Director;
- Commercial Director;
- Directors Swanwick, Prestwick and Airports; and
- Directors Safety Operations, Delivery and Corporate Safety & Quality.

The Head of Facilities Management and the Chief Information Officer formally report to the Committee on the security arrangements in NATS twice per annum.

During the year, the Committee took advice from the following special advisers, who were invited to each meeting by standing invitation:

- Dr Don Lloyd, Director Health & Safety and Environment for Genel Energy plc and Visiting Professor in Risk at Brunel University;
- Professor Don Harris, Professor of Human Factors, Faculty of Engineering and Computing at Coventry University; and
- Captain John Monks, Head of Aviation Safety, British Airways.

### Main activities during the year

#### a. Operational safety

As part of its safety governance and oversight of the NATS operations, the Committee receives regular in-depth reports and briefings on safety performance and associated improvement activities. Key topics throughout the last year were:



## Governance

- **Infringements of controlled airspace:** The CAA has the lead responsibility and, whilst NATS can, and has, taken mitigating actions to protect aircraft operating within controlled airspace from infringing aircraft, solutions to the root causes require the authority of the regulator. The Committee has continued to support the NATS Board and Executive in engaging with the CAA. Prevention activity focussed on infringement hotspots has continued, including engagement with local flying communities. However, progress has not been as fast as any of the parties would like, so a further range of actions have been proposed by the CAA, including robust licensing action, improved initial and refresher training for General Aviation pilots, and a trial of a 'cooperative known traffic environment' in the Southampton area. We will continue to support these projects, and maintain a close dialogue with the CAA.
- **Operational Safety Performance Reviews:** In light of an increase in safety risk, a comprehensive programme of performance reviews has been conducted each quarter. The Committee has supported this detailed approach and the actions that have been identified to strengthen improvement activities. The reviews will continue in 2016/17.
- **Safety Strategy and Safety Plan:** The delivery of the NATS Safety

## Reports from Board Committees

Strategy and Plan have continued, with briefings on Human Performance enhancement particularly during change, the risks and benefits from the technology and airspace change programme, and the existing and developing procedural and technical mitigations to the risk of inadvertent entry onto an active runway.

- **Review of NATS vulnerability to a catastrophic event instigated by a member of staff or contractor:** The Committee supported the Executive in conducting this review and agree with the findings that susceptibility to such events is well understood and that appropriate mitigations are in place.
- **RPAS:** Remotely Piloted Aircraft Systems were identified as a risk in the 2014 NATS Safety Plan. The Committee has been briefed on the increasing numbers of events and the significant activity being undertaken on what is rapidly emerging as a key feature of the ATM environment.
- **European Regulation:** As part of the Committee's assurance that future risks and opportunities are being managed, we have been briefed on emerging European aviation safety legislation. Whilst such changes are a longer term issue, the potential to affect the way in which we implement safety management in NATS is significant. The Committee will continue to monitor the developments in safety regulation.

### b. Corporate / physical security (external threats)

NATS' Corporate Security department provides assurance reports, covering all aspects of physical security, internal and external threats to NATS, vetting, travel security, data protection and crisis management (incorporating business continuity). The principal focus for the Committee in the past year has been:

- **Governance:** This ensures and maintains engagement at all levels of the business, from business area to Executive and Board level. Reporting to the Committee is on a bi-annual basis, in June and December, where confirmation is provided that governance processes are in place and are robust.
- **Travel Security:** The Committee has been briefed on the NATS response to security events in Paris and Brussels including appropriate travel restrictions and the established approval and escalation procedures following any major incident. Further assurance of the travel security risk assessments for locations that NATS staff travel to, the use of Hostile Environment training and the development of an online travel risk tool that will quickly identify the location of NATS staff, have been provided.
- **Crisis/Incident Management:** The Committee has supported the continued work of the Executive and operational leadership teams in fully

embedding Crisis/Incident

Management policies and procedures in the culture of the organisation.

Detailed Gold, Silver and Bronze

Team procedures are in place and

regular exercising of Gold and Silver

Teams has taken place. In

conjunction with the CAA, NATS

hosted an aviation wide crisis

management exercise, which was well received.

- **Vetting:** Security vetting continues to be the foundation of our protection from the 'insider' threat. Vetting clearance times during 2015 averaged 22 days, significantly better than the majority of vetting agencies.
- **Security Awareness:** Face to face security awareness presentations to staff and contractors have been conducted across NATS sites. Police and security agencies have commented favourably on the content and delivery. The RUN, HIDE, TELL methodology has been well received by staff.
- **Intruder Testing:** A programme of intruder testing has been completed, with a marked improvement on previous tests (in 2014) and showed that no institutional systemic failures exist in the security teams.

### c. Cyber security

As the sole provider of UK en route air traffic management, NATS is part of the UK's critical national infrastructure.

NATS is increasingly diverse in its business operations, with activities



## Governance

underway in the UK and expanding into overseas territories. NATS relies on effective digital operations to deliver services and therefore places a very high priority on cyber security. It is recognised that NATS must be prepared for a variety of threats from a multitude of sources. NATS remains committed to the active management of cyber security risks and has, over the past 12 months, made significant progress:

- NATS achieved its goal of ISO 27001 certification, the international standard of information security management, and the scope will be increased over time.
- The cyber-aware culture of NATS has improved, with staff having undertaken mandatory security awareness training. The innovative culture change models used by NATS, and the measurable outcomes, resulted in NATS being awarded "Security Awareness Program of the Year" at the 2015 UK Cyber Security Awards. The programme will continue in the coming year.
- In order to enhance NATS ability to identify external cyber-attacks, the Security Incident & Event Management (SIEM) system has been expanded through a partnership with Lockheed Martin. This system will continue to be enhanced, underpinning the deployment and monitoring of additional cyber-controls.

## Reports from Board Committees

- Cyber-incident response processes were refined and rehearsed; table top exercises, have been held with the executives around cyber security events.
- In preparation for the new EU Data Protection Directive, NATS undertook an inventory and analysis of the location and controls on sensitive personal data.
- Several of NATS' key operational systems underwent a cyber-security review by the Department for Transport and other Government agencies.

Cyber-security is a major challenge for all industries; threats constantly develop, and attacks, both targeted and non-targeted, are frequent. Security requires constant improvement, investment and vigilance. Through regular review of the strategy, and progress of the detailed cyber plan, the Committee has assured that a high level of protection of people, data, infrastructure and operations is maintained and that NATS has an active security management system.

**Iain McNicoll, CB CBE**  
**Chairman of the Safety Review**  
**Committee**

## **Technical Review Committee report**

### **The role of the Technical Review Committee**

The role of the Technical Review Committee is to support the Board in monitoring the development and introduction of cost effective technical systems and services in support of its operations. Its remit includes:

- ensuring that business objectives are clearly reflected in the requirements laid on technology programmes;
- reviewing the technical strategies proposed to meet the agreed requirements, with appropriate regard to other (European and worldwide) initiatives and developments, and the likely impact on service provided to customers;
- reviewing the effectiveness of the operations, programmes, structures and processes employed in delivering the group's technical objectives; and
- making recommendations to the Board on means for improving the group's technical systems, their implementation and performance.

The Committee is chaired by Peter Read and there are two other non-executive directors as members, Iain McNicoll and Richard Keys (who joined in November 2015). Roger Cato was also a member until December 2015. The following are invited to attend each meeting by standing invitation:

### **Reports from Board Committees**

- Delivery Director;
- Director, Operations Strategy; and
- Chief Systems Architect.

### **Main activities of the Committee during the year**

As part of its governance and oversight of the NATS operations, the Committee receives regular in-depth reports and briefings on the existing and planned investment programmes, and the technical risk profiles. The following issues have received focus by the Committee.

#### **Deploying SESAR**

SESAR is the European wide standard for future systems, designed to produce a step change in safety, performance, and efficiency. The main challenge in the years ahead is the introduction of SESAR compliant systems. Each of the main programme components represents a significant change to the operation and to the systems. The size and complexity of the composite programme brings an additional scale of risk to the business as a whole, which the Committee is committed to review on a continuing basis, in order to provide the necessary levels of reassurance to the Board. Key elements are:

#### **a. Interoperability Through European Collaboration (iTEC)**

This is the new generation of core flight data processing systems which will underpin all NATS future operations. The first deployment is now in progress in the Scottish Area Control Centre in Prestwick, with Limited Operational



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Service (LOS) achieved at Prestwick in January 2016. Full Operational Service (FOS) is expected this summer.

Subsequent 'builds' of iTEC will be deployed in London Area Control and Terminal Control later in the programme.

### **b. New controller workstation and other projects**

The new generation of workstations, closely linked to iTEC, will provide much of the additional functionality in support of the core system, integrating data from different systems and presenting it to controllers in a clear and consistent manner.

### **c. Transition Operations Room**

As part of the fundamental change in operating methodology a transitional operations room has been created to house London Area Control during the transition programme. This project was completed in November 2015 allowing the previous operations room to be re-used to construct the new combined operations room that will house the new system capabilities.

### **Airspace Change**

The second key element of NATS' investment programme is airspace change which allows the opportunity to deliver significant customer benefits by redesigning airspace routes and procedures whilst at the same time making use of the latest airborne and ground-based technology. However, a number of developments in the industry environment have given rise to

## Reports from Board Committees

challenges in the delivery of the airspace programme, particularly in lower level airspace. These include:

- Unprecedented public reaction to a change in noise patterns;
- Planned public consultation on both the Airspace Change process and the UK Government policies including the treatment of noise;
- Impending Government decision on runways in the South East; and
- Negative public reaction linked to uncertainty about runway expansion has severely limited airports' willingness to support LAMP developments.

As a result NATS has engaged with key stakeholders around the impact of these challenges and subsequently consulted customers around revisions to the planned delivery of major airspace changes as described below.

### **a. London Airspace Management Programme (LAMP)**

This programme involves the redesign of traffic flows in the South East airports area, in and beyond the London Terminal Movements Area. The fundamental change implied by this programme is for aircraft to be sequenced into an arrival stream which eliminates, as far as possible, the need for holding before commencing an approach.

The first Phase of this programme, LAMP 1a was successfully delivered into operation in February 2016 delivering a "Point Merge" approach system for London City Airport and a number of

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related changes. However, as a result of the challenges identified above, LAMP 2 will not now go ahead as planned. NATS hopes to deliver some of the higher level aspects of change during RP2, but the more controversial lower level airspace changes will be delayed until RP3.

### **b. Transition Altitude**

This is the point at which all aircraft change from standard pressure setting (at altitude) to sea level pressure (for local terrain clearance). A proposed alignment from various altitudes to a revised universal Transition Altitude (TA) at 18,000ft across Europe has been in discussion, although this seems unlikely to progress in the short term. The UK had been keen to proceed with raising the TA independently as an enabler to LAMP 2 and CAA have conducted a consultation on its implementation in UK airspace. However, the delays to LAMP have put this into question and it is now proposed that TA be implemented in RP3 a short time ahead of the main LAMP airspace changes. NATS and CAA are considering the option of implementing a harmonised TA at 6,000ft in the interim.

### **c. Time-Based Separation**

This concept changes the method of separation of aircraft on the approach to major airports from a distance base to a time base. It has been successfully implemented at Heathrow to good effect, thereby significantly reducing disruption and delays caused by strong weather conditions.

## Reports from Board Committees

### **Resilience**

Resilience of operational systems results from a combination of reliability and powers of recovery. Over many years NATS has been successful in implementing highly resilient systems, necessary to the fulfilment of its mission. The Committee is considering the subject in more depth as a result of a small number of significant recent events. The objective is to balance the levels of investment against realistic expectations of resilience in a complex systems environment.

### **Peter Read**

### **Chairman of the Technical Review Committee**



## Report of the directors

The directors present their annual report on the affairs of the group, together with the financial statements and the auditor's report for the year ended 31 March 2016.

The Governance report is set out on pages 40 to 45 and forms part of this report.

A review of the group's key business developments in the year and an indication of likely future developments is included within the Strategic report.

Information about the use of financial instruments by the group is given in note 19 to the financial statements.

### Dividends

During the year interim dividends of £54.4m (38.03 pence per share) and £27.3m (19.08 pence per share) were approved (2015: £77.0m). The Board recommends a final dividend for the year of £nil (2015: £nil).

In May 2016, the Board approved and the company paid an interim dividend of £24.0m (16.78 pence per share) for the year ending 31 March 2017.

### Directors and their interests

The directors of the company at the date of this report are set out on pages 36 to 39. Details of changes made to the Board during the year and to the date of this report are set out in the Governance report on page 40.

The interests of the directors in the share capital of the parent company, through their participation in the Employee Share Plan, are set out on page 60.

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

### Directors' indemnities

The company has made qualifying third party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report.

### Employees

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

all matters affecting employees. This has been enhanced through the Working Together programme aimed at working towards partnership principles as the basis for our relationship. Formal arrangements for consultation with staff exist through a local and company-wide framework agreed with the Trade Unions.

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

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

The group is also committed to improving employment opportunities for disabled people. The group will continue to promote policies and practices which provide suitable training and retraining, and development opportunities for disabled staff, including any individuals who become disabled, bearing in mind

their particular aptitudes and abilities and the need to maintain a safe working environment.

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

### **Going concern, viability statement and subsequent events**

The directors' assessment of going concern and their viability statement are set out on page 16. Subsequent events are disclosed in note 34 to the financial statements.

### **Directors' responsibilities**

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair



view of the state of affairs of the group and of the parent company, and of the profit or loss of the group and the parent company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group's transactions and disclose with reasonable accuracy at any time the financial position of the group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each person who is a director at the date of approval of these financial statements confirms that:

- so far as the director is aware, there is no relevant audit information of which the group's auditors are unaware; and
- the director has taken all the steps that he/she ought to have taken as director in order to make himself/herself aware of any relevant audit information and to establish that the group's auditors are aware of that information.

This information is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

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

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the group;

- the Strategic report includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that it faces; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the group's position and performance, business model and strategy.

**Auditor**

BDO LLP was appointed as auditor at the Annual General Meeting on 31 July 2015. A resolution to re-appoint BDO LLP will be proposed at the Annual General Meeting.

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



**Richard Churchill-Coleman**

**Secretary**

**20 June 2016**

**Registered office**

4000 Parkway, Whiteley, Fareham,  
Hampshire PO15 7FL

Registered in England and Wales  
Company No. 04138218



**Opinion on financial statements of NATS Holdings Limited**

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 March 2016 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

The financial statements comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and company balance sheets, the consolidated and company statement of changes in equity, the consolidated cash flow statement and the related notes.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

**Separate opinion in relation to IFRSs as issued by the IASB**

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

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

**Respective responsibilities of directors and auditor**

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

As a result of a contractual agreement between the company's shareholders requiring compliance with certain aspects of the UK Corporate Governance Code, the directors have included a corporate governance statement relating to the company's compliance with the UK Corporate Governance Code, a statement in relation to going concern, longer term viability and a directors' remuneration report and have asked us to report on these statements as if the company were listed.

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



**Our assessment of risks of material misstatement and overview of the scope of our audit**

A description of the scope of an audit of financial statements is provided on the FRC's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate).

We carried out full scope audits on all significant components which covered 99% of the group's revenue. We performed limited procedures on the remaining components.

Our group audit was scoped by obtaining an understanding of the group and its environment, including the group's system of internal control, and assessing the risks of material misstatement in the financial statements at the group level.

There has been no significant change in the group's operations nor in our assessment of materiality, therefore the assessed risks of material misstatement described below, which are those that had the greatest effect on the audit strategy, the allocation of resources in the audit and directing the efforts of the audit team, are the same risks as in prior year.

The Audit Committee's consideration of these matters is set out on pages 46 to 48.

Risk	How the scope of our audit responded to the risk
<p><b>Revenue recognition and the recoverability of the regulatory assets:</b></p> <p>The group generates revenue in relation to Airspace, Airports, Engineering and other services.</p> <p>In determining the revenues recognised, management makes key judgements about material revenue adjustments that are recoverable in subsequent accounting periods.</p>	<p>We have reviewed each significant revenue stream to ensure that we concur with the accounting policies applied.</p> <p>We have reviewed and tested each of the revenue streams to ensure that the revenue is being recognised in line with the group policy and in the case of NATS Airspace to ensure that it is in line with the provisions of the air traffic services licence, the regulatory charging mechanisms for the reference period and the RP2 settlement.</p> <p>We have specifically considered and challenged management over the recoverability of the accrued income as disclosed in note 16 to the financial statements, which at year end is split into four main categories: Eurocontrol accrued income for March 2016; the risk sharing revenue recognised due to low traffic volumes; the allowed inflationary adjustments; and the outstanding balance from prior periods.</p> <p>We have also reviewed individual judgements including the discount rate applied to revenue adjustments.</p>
<p><b>Pension scheme valuation:</b></p> <p>The NATS Holdings Limited group operates a defined benefit pension scheme, which is accounted for in accordance with IAS 19 'Employee Benefits' which require complex calculations and disclosures.</p> <p>Management make a number of judgements and actuarial assumptions which have a significant impact on the valuation of pension scheme assets and liabilities shown in the balance sheet and hence on the amounts shown in the consolidated income statement and the consolidated statement of comprehensive income.</p>	<p>We have reviewed the pension scheme data and accounting treatment and disclosures and considered them in light of the assumptions made under the most recent triennial valuation.</p> <p>We have worked with our pension specialists to assess the validity of assumptions applied, in particular discount and inflation rates, performed a detailed review of the scheme actuary's annual update valuation report and reviewed the pension scheme disclosures within the financial statements, reconciled the significant pension scheme cash flows and tested the commutation assumption used in valuing the scheme's liabilities.</p> <p>In addition we have performed audit procedures in order to substantiate the value of the scheme assets. This included selecting a sample of investments held at the balance sheet date and comparing their value to available market data.</p>



Risk	How the scope of our audit responded to the risk
<p><b>Carrying value of goodwill:</b></p> <p>In accordance with the group's accounting policies, management has undertaken an impairment review of the carrying value of goodwill by comparison with the recoverable amount. This has resulted in a charge to the consolidated income statement of £92.7m which reflects an assessment of: opportunities to outperform regulatory targets in regulatory reference period RP2; an assessment of any potential premium that a purchaser might pay for a controlling interest, latest forecasts of traffic volumes and allowed adjustments to future revenue for certain differences between actual costs and the economic regulator's previous estimates.</p> <p>In calculating an appropriate valuation for the recoverable amount of the regulatory business, the premium applied to the regulatory asset base (RAB) continues to be a key judgement, alongside the estimate of future cash flows.</p>	<p>We have reviewed and understood the terms and conditions of the current contract for RP2 and assessed the impact this has on management's assessment of the carrying amount of goodwill.</p> <p>We have reviewed and tested management's current assessment of the carrying amount of goodwill. We have reviewed with the assistance of our own specialists, the overall methodology, cash flow forecasts, discount rate assumptions and benchmarking available to support the RAB premium applied in determining terminal values and fair value less costs to sell.</p> <p>We tested the integrity of the model and considered the impact of various of management's sensitivity calculations.</p>
<p><b>Capital investment programme:</b></p> <p>The group invests significant sums in the sustainment and development of air traffic control infrastructure.</p> <p>A substantial proportion of the costs incurred are the amounts charged by staff employed by the group which are capitalised to specific projects.</p> <p>There is a risk that either time is not appropriately capitalised or the quantum of the labour rate used could be misstated.</p> <p>In addition, management makes judgements around the useful economic lives of currently deployed systems, assesses indicators of impairment and considers feasibility.</p>	<p>We have worked closely with the project managers outside of the group finance team in order to gain an understanding of the most significant capital projects, and how they contribute to the objectives of the business and assess them for impairment factors.</p> <p>We have carried out audit procedures on capitalised projects focusing on the appropriateness of the labour rates being used and the level of labour costs capitalised.</p> <p>We have also assessed management's judgement around the useful economic lives of currently deployed systems to ensure that the position taken is reasonable. We have also considered management's assessment of any indicators of impairment against the carrying value of property, plant and equipment, including the feasibility of assets under the course of construction. In addition we reviewed the appropriateness of capitalisation and that costs incurred are in line with contracts or subsequent variations.</p>



**Our application of materiality**

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. For planning, we consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements. In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

The materiality for the group financial statements as a whole was set at £8.9m. This was determined with reference to a benchmark of revenue (of which it represents one per cent), which we consider to be one of the principal considerations for members of the company in assessing the financial performance of the group.

Performance materiality was set at seventy five per cent of the above materiality levels.

Materiality levels are not significantly different from those applied in the previous year.

We agreed with the Audit Committee that we would report to the committee all individual audit differences in excess of £178,000. We also agreed to report differences below this threshold that, in our view, warranted reporting on qualitative grounds.

**Opinion on other matters prescribed by the Companies Act 2006**

In our opinion the information given in the strategic report and the report of the directors' for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Opinion on other matters**

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006 that would apply if the company was a listed company.

**Statement regarding the directors' assessment of principal risks, going concern and longer term viability of the company**

We have nothing material to add or to draw attention to in relation to:

- the directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures in the annual report that describe those risks and explain how they are being managed or mitigated;
- the directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; or the directors' explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.



**Matters on which we  
are required to report  
by exception**

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the Report and Accounts is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the company acquired in the course of performing our audit; or
- is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Report and Accounts is fair, balanced and understandable and whether the Report and Accounts appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

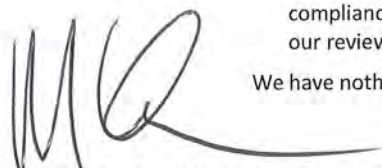
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

**Other matters**

We have also reviewed:

- the directors' statements on page 16, in relation to going concern and longer term viability; and
- the part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code specified for our review if the company was a listed company.

We have nothing to report in respect of these matters.



Malcolm Thixton (senior statutory auditor)  
for and on behalf of BDO LLP, statutory auditor  
Southampton  
United Kingdom

20 June 2016

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

**Consolidated income statement**

for the year ended 31 March

	Notes	2016		2015		Result for the year £m
		Result before goodwill impairment £m	Goodwill impairment £m	Result before goodwill impairment and exceptional redundancy costs £m	Goodwill impairment and exceptional redundancy costs £m	
Revenue	4	898.1	-	898.1	922.4	922.4
Staff costs	7	(439.1)	-	(439.1)	(403.8)	(413.0)
Services and materials		(87.6)	-	(87.6)	(74.7)	(74.7)
Repairs and maintenance		(42.3)	-	(42.3)	(40.6)	(40.6)
External research and development		-	-	-	(0.1)	(0.1)
Depreciation, amortisation and impairment	6	(128.7)	(92.7)	(221.4)	(110.3)	(127.3)
Profit/(loss) on disposal of non-current assets		7.1	-	7.1	(0.2)	(0.2)
Other operating charges		(49.5)	-	(49.5)	(44.8)	(44.8)
Other operating income		3.1	-	3.1	4.1	4.1
Deferred grants released	6	0.7	-	0.7	0.8	0.8
<b>Net operating costs</b>		<b>(736.3)</b>	<b>(92.7)</b>	<b>(829.0)</b>	<b>(669.6)</b>	<b>(695.8)</b>
<b>Operating profit</b>	6	<b>161.8</b>	<b>(92.7)</b>	<b>69.1</b>	<b>252.8</b>	<b>226.6</b>
Share of results of associates and joint ventures	32	1.5	-	1.5	1.0	1.0
Investment revenue	8	3.6	-	3.6	4.8	4.8
Fair value movement on derivative contract	9	2.6	-	2.6	1.5	1.5
Finance costs	10	(32.4)	-	(32.4)	(33.6)	(33.6)
<b>Profit before tax</b>		<b>137.1</b>	<b>(92.7)</b>	<b>44.4</b>	<b>226.5</b>	<b>200.3</b>
Tax	11	(16.8)	-	(16.8)	(45.3)	(43.4)
<b>Profit for the year attributable to equity shareholders</b>		<b>120.3</b>	<b>(92.7)</b>	<b>27.6</b>	<b>181.2</b>	<b>156.9</b>

**Consolidated statement of comprehensive income**

for the year ended 31 March

	Notes	2016 £m	2015 £m
<b>Profit for the year after tax</b>		<b>27.6</b>	<b>156.9</b>
<b>Items that will not be reclassified subsequently to profit and loss:</b>			
Actuarial gain/(loss) on defined benefit pension scheme	30	288.0	(374.4)
Deferred tax relating to items that will not be reclassified subsequently	23	(58.0)	75.2
<b>Items that may be reclassified subsequently to profit and loss:</b>			
Change in fair value of hedging derivatives		(2.3)	(1.3)
Transfer to income statement on cash flow hedges		7.4	(4.2)
Exchange differences arising on translation of foreign operations		(0.1)	-
Currency translation differences arising on consolidation of equity accounted foreign operations	32	0.2	(0.3)
Deferred tax relating to items that may be reclassified subsequently	23	(1.1)	1.2
<b>Other comprehensive income/(loss) for the year, net of tax</b>		<b>234.1</b>	<b>(303.8)</b>
<b>Total comprehensive income/(loss) for the year attributable to equity shareholders</b>		<b>261.7</b>	<b>(146.9)</b>



## Consolidated balance sheet

at 31 March

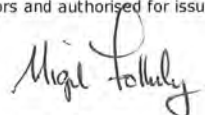
	Notes	2016 £m	2015 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Goodwill	13	209.3	302.0
Other intangible assets	14	439.5	382.8
Property, plant and equipment	15	555.0	594.5
Interests in associate and joint ventures	32	3.6	2.1
Loans to joint ventures	32	1.4	0.4
Trade and other receivables	16	24.0	64.9
Derivative financial instruments	18	0.2	-
		<u>1,233.0</u>	<u>1,346.7</u>
<b>Current assets</b>			
Loans to joint ventures	32	2.4	0.1
Trade and other receivables	16	235.6	207.7
Short term investments	19	28.9	29.7
Cash and cash equivalents	19	228.2	237.3
Derivative financial instruments	18	0.4	4.0
		<u>495.5</u>	<u>478.8</u>
		<u>1,728.5</u>	<u>1,825.5</u>
<b>Total assets</b>			
<b>Current liabilities</b>			
Trade and other payables	20	(171.0)	(147.7)
Current tax liabilities		(6.7)	(16.0)
Borrowings	17	(38.9)	(29.7)
Provisions	22	(8.7)	(10.7)
Derivative financial instruments	18	(7.8)	(3.6)
		<u>(233.1)</u>	<u>(207.7)</u>
		<u>262.4</u>	<u>271.1</u>
<b>Net current assets</b>			
<b>Non-current liabilities</b>			
Trade and other payables	20	(83.6)	(56.3)
Borrowings	17	(521.5)	(616.0)
Retirement benefit obligations	30	(77.4)	(353.0)
Deferred tax liability	23	(70.5)	(19.2)
Provisions	22	(7.5)	(10.6)
Derivative financial instruments	18	(121.1)	(129.0)
		<u>(881.6)</u>	<u>(1,184.1)</u>
		<u>(1,114.7)</u>	<u>(1,391.8)</u>
<b>Total liabilities</b>			
		<u>613.8</u>	<u>433.7</u>
<b>Net assets</b>			
<b>Equity</b>			
Called up share capital	24	140.6	140.6
Share premium account	25	0.4	0.4
AESOP reserve		(0.3)	(0.3)
Hedge reserve		-	(4.0)
Translation reserve		(0.2)	(0.3)
Other reserves		(34.7)	(34.7)
Retained earnings		507.9	332.0
		<u>613.7</u>	<u>433.7</u>
Equity attributable to the shareholders			
Non-controlling interest	26	0.1	-
		<u>613.8</u>	<u>433.7</u>
<b>Total equity</b>			

The financial statements (Company No. 04138218) were approved by the Board of directors and authorised for issue on 20 June 2016 and signed on its behalf by:

Paul Golby  
Chairman



Nigel Fotherby  
Finance Director



**Consolidated statement of changes in equity**

for the year ended 31 March

	Equity attributable to equity holders of the group								Total £m
	Share capital £m	Share premium account £m	AESOP reserve £m	Hedge reserve £m	Translation reserve £m	Other reserves <sup>1</sup> £m	Retained earnings £m	Non- controlling interest £m	
<b>At 1 April 2014</b>	140.6	0.4	(0.3)	0.3	-	(34.7)	551.3	-	657.6
Profit for the year	-	-	-	-	-	-	156.9	-	156.9
Other comprehensive loss for the year	-	-	-	(4.3)	(0.3)	-	(299.2)	-	(303.8)
Total comprehensive loss for the year	-	-	-	(4.3)	(0.3)	-	(142.3)	-	(146.9)
Dividends paid	-	-	-	-	-	-	(77.0)	-	(77.0)
<b>At 31 March 2015</b>	140.6	0.4	(0.3)	(4.0)	(0.3)	(34.7)	332.0	-	433.7
<b>At 1 April 2015</b>	140.6	0.4	(0.3)	(4.0)	(0.3)	(34.7)	332.0	-	433.7
Profit for the year	-	-	-	-	-	-	27.6	-	27.6
Other comprehensive income for the year	-	-	-	4.0	0.1	-	230.0	-	234.1
Total comprehensive income for the year	-	-	-	4.0	0.1	-	257.6	-	261.7
Adjustments arising from non-controlling interest	-	-	-	-	-	-	-	0.1	0.1
Dividends paid	-	-	-	-	-	-	(81.7)	-	(81.7)
<b>At 31 March 2016</b>	140.6	0.4	(0.3)	-	(0.2)	(34.7)	507.9	0.1	613.8

<sup>1</sup>Other reserves arose on the completion of the PPP transaction in July 2001.



**Consolidated cash flow statement**

for the year ended 31 March

	Notes	2016 £m	2015 £m
<b>Net cash from operating activities</b>	27	341.7	283.8
<b>Cash flows from investing activities</b>			
Interest received on short term investments		1.5	1.3
Purchase of property, plant and equipment and other intangible assets		(155.3)	(148.7)
Proceeds of disposal of property, plant and equipment		7.4	1.2
Investment in joint venture		-	(0.1)
Changes in short term investments		0.8	-
Dividend received from associate		0.2	0.2
Loan to non-controlling interest		(0.1)	-
(Loan to)/repayment from joint ventures		(3.3)	0.2
<b>Net cash outflow from investing activities</b>		(148.8)	(145.9)
<b>Cash flows from financing activities</b>			
Interest paid		(31.8)	(31.1)
Interest received on derivative financial instruments		0.6	0.7
Repayment of bond principal		(30.8)	(29.8)
Bank and other loans		(56.6)	25.0
Bank facility arrangement fees		(1.9)	-
Dividends paid		(81.7)	(77.0)
Proceeds on issue of shares to non-controlling interest		0.1	-
<b>Net cash outflow from financing activities</b>		(202.1)	(112.2)
<b>(Decrease)/increase in cash and cash equivalents during the year</b>		(9.2)	25.7
Cash and cash equivalents at 1 April		237.3	211.6
Exchange gains on cash and cash equivalents		0.1	-
<b>Cash and cash equivalents at 31 March</b>		228.2	237.3
<b>Net Debt</b> (representing borrowings net of cash and short term investments)		(303.3)	(378.7)

## 1. General information

NATS Holdings Limited is a private limited company incorporated in England and Wales and domiciled in the United Kingdom and acting under the Companies Act 2006. The address of the registered office is on page 71. The nature of the group's operations and its principal activities are set out in the Report of the directors and in the Strategic report.

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

## 2. Accounting policies

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

### *Basis of preparation and accounting*

The financial statements have been prepared on the going concern basis. For further detail please refer to page 16. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and International Financial Reporting Interpretations Committee (IFRIC) interpretations as endorsed by the European Union (EU) and therefore the group financial statements comply with Article 4 of the EU IAS Regulation. The financial information has also been prepared in accordance with IFRSs.

During the year, the group has adopted the amendments to IAS 19, on employee contributions in defined benefit plans. These amendments were to clarify how contributions from employees or third parties that are linked to service should be attributed to periods of service. The adoption of these amendments has not had a significant impact on the group's profit for the period, net assets or cash flows.

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

IFRS 9: *Financial Instruments*

IFRS 15: *Revenue from Contracts with Customers*

IFRS 16: *Leases*

IAS 1 (amendments): *Disclosure Initiative*

IAS 7 (amendments): *Disclosure Initiative*

IAS 12 (amendments): *Recognition of Deferred Tax Assets for Unrealised Losses*

IAS 16 and IAS 38 (amendments): *Clarification of Acceptable Methods of Depreciation and Amortisation*

IFRS 9: *Financial Instruments* deals with classification, measurement and derecognition of financial assets and liabilities, hedge accounting and introduces a new expected credit losses model. The standard is expected to have two main impacts on the group: the adoption of the expected loss impairment model in assessing the fair value of trade and contract receivables; and the option to recognise the impact of changes in own credit risk in other comprehensive income rather than the income statement. The standard is effective for reporting periods beginning on or after 1 January 2018 subject to EU endorsement. The group will assess the impact of IFRS 9 closer to the implementation date.

IFRS 15: *Revenue from Contracts with Customers* deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. The standard replaces IAS 18: *Revenue*, IAS 11: *Construction Contracts* and the related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018. The group has started to review all existing major contracts to ensure that the impact and effect of the new standard is fully understood and changes to the current accounting procedures are



highlighted and acted upon in advance of the effective date.

IFRS 16: *Leases* specifies how a group will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. The standard is effective for reporting periods beginning on or after 1 January 2019. The group has started to review all existing leases to ensure that the impact and effect of the new standard is fully understood and changes to the current accounting procedures are highlighted and acted upon in advance of the effective date.

The directors do not expect that the adoption of the other standards and interpretations listed above will have a material impact on the financial statements in future periods.

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

#### *Basis of consolidation*

The consolidated financial statements incorporate the financial statements of the company and entities controlled by the company (its subsidiaries). Control is achieved where the company has the power over the investee, exposure or rights to variable returns from involvement with the investee and the ability to use power over the investee to affect the amount of an investor's returns.

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

#### *Revenue recognition*

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

- ◆ Income from the rendering of services is recognised when the outcome can be reliably estimated and then by reference to the stage of completion of the transaction at the balance

sheet date and in accordance with NATS (En Route) plc's air traffic services licence (including volume risk sharing, service performance incentives, costs exempt from risk sharing and inflation adjustments) and airport contracts and other contracts. Amounts receivable include revenue allowed under the charge control conditions of the air traffic services licence and EC Charging Regulations.

- ◆ Sales of goods are recognised when they are delivered and title has passed.
- ◆ Dividend income is recognised when the shareholder's rights to receive payment have been established.
- ◆ Interest income is recognised on a time-proportion basis using the effective interest method. This is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

#### *Operating segments*

Operating segments are reported in a manner consistent with the internal reporting provided to the group's Executive team, which is considered to be the chief operating decision maker. An operating segment represents a service line that provides a core set of products or services to customers. Operating segment operating results are reviewed regularly by the Executive team to make decisions about resources to be allocated to the segment and to assess its performance, and for which discrete financial information is available.

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

Segment performance is assessed by service line revenue and contribution, where contribution represents revenue less costs directly attributed to individual service lines. Segment results that are reported to the Executive team include items directly attributed to a segment as well as those that can be allocated on a reasonable basis. Costs that are not attributed to service lines include the cost of central support functions, depreciation and amortisation (net of government grants), goodwill



impairment, employee share scheme costs, redundancy and relocation costs, above the line tax credits and any profit or loss on disposal of non-current assets.

#### *Exceptional items and goodwill impairment charges*

Exceptional items deemed as such by the directors by virtue of their nature or size, and goodwill impairment charges which may recur, are included under the statutory classification appropriate to their nature but are separately disclosed on the face of the income statement to assist in understanding the financial performance of the group.

#### *Operating profit*

Operating profit is stated after charging restructuring costs but before the group's share of results of joint ventures and associates, investment income, the fair value movement in the index-linked swap contract, finance costs and taxation.

#### *Goodwill*

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

Recoverable amount is the higher of net realisable value and value in use. Net realisable value is assessed by reference to the Regulatory Asset Bases (RABs) of the economically regulated activities. In assessing value in use, the estimated future cash flows (with a RAB terminal value) are discounted to their present value using the pre-tax nominal regulated rate of return. A premium is applied to the RAB (see note 3).

#### *Leases*

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks

and rewards of ownership to the lessee. All other items are classified as operating leases.

Assets held under finance leases are recognised as assets of the group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance expenses and a reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognised immediately in profit or loss, unless they are directly attributable to qualifying assets in which case they are capitalised in accordance with the group's policy on borrowing costs (see below).

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

#### *Property, plant and equipment*

Property, plant and equipment are stated at cost less accumulated depreciation and any provision for impairment in value. The cost of property, plant and equipment includes internal and contracted labour costs directly attributable to bringing the assets into working condition for their intended use.

Depreciation is provided on a straight-line basis to write off the cost, less estimated residual value, of property, plant and equipment over their estimated useful lives as follows:

- ◆ Leasehold land: over the term of the lease
- ◆ Freehold buildings: 10-40 years
- ◆ Leasehold buildings: over the remaining life of the lease to a maximum of 20 years
- ◆ Air traffic control systems: 8-15 years
- ◆ Plant and other equipment: 3-15 years
- ◆ Furniture, fixtures and fittings: 10 years
- ◆ Vehicles: 5 years.

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

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the



carrying amount of the asset and is recognised in income.

#### *Borrowing costs*

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

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

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

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

#### *Deferred grants and other contributions to property, plant and equipment*

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

are credited to income in the period to which they relate.

#### *Investments in associates and joint ventures*

An associate is an entity over which the group is in a position to exercise significant influence, but not control, through participation in the financial and operating policy decisions of the investee.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

The results, assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting.

A joint venture is an arrangement in which two or more parties have joint control. The investors in the joint venture have rights to the net assets of the jointly controlled entity. The results of joint ventures are incorporated in these financial statements using the equity method of accounting.

Investments in associates and joint ventures are carried in the balance sheet at cost as adjusted by post-acquisition changes in the group's share of the net assets of the associate or joint venture, less any impairment in the value of individual investments.

#### *Non-current assets held for sale*

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

Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met when the sale is highly probable and the asset is available for immediate sale in its present condition.

Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

#### *Internally-generated intangible assets – research and development expenditure*

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

An internally-generated intangible asset arising from the group's development activities is

recognised only if all of the following conditions are met:

- ◆ the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- ◆ the intention to complete the intangible asset and use or sell it;
- ◆ the ability to use or sell the intangible asset;
- ◆ how the intangible asset will generate probable future economic benefits;
- ◆ the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- ◆ the ability to measure reliably the expenditure attributable to the intangible asset during its development.

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

#### *Impairment of tangible and intangible assets excluding goodwill*

At each balance sheet date, the group reviews the carrying amounts of its tangible and intangible assets, including those in the course of construction, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

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

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

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

#### *Emissions allowances*

Emissions allowances are recognised at cost. Emissions allowances granted free of charge are recognised at nil value on the balance sheet as an intangible asset. As carbon is produced and an obligation to submit allowances arises, a provision is created. The provision is measured at book value (nil or carrying amount of purchased emissions certificates) of the recognised emissions certificates. If there is an obligation that is not covered by allowances already on the balance sheet, the corresponding provision made is measured at current market prices.

#### *Amounts recoverable on contracts*

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

Where the outcome of a contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is



probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

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

#### *Share-based payments*

The group has applied the requirements of IFRS 2: *Share-Based Payments*.

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

Shares awarded by the Plan are treated as cash-settled liabilities. A liability is recognised for shares awarded over the period from award to when the employee becomes unconditionally entitled to the shares and are measured initially at their fair value. At each balance sheet date until the liability is settled, as well as at the date of settlement, the fair value of the liability is re-measured based on independent share valuations with any changes in fair value recognised in profit or loss for the year.

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

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

#### *Taxation*

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

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

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

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

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

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current liabilities and when they relate to taxes levied by the same taxation authority and the group intends to settle its current tax assets and liabilities on a net basis.

Under the Finance Act 2015 which was enacted on 26 March 2015, the corporation tax rate was reduced to 20% with effect from 1 April 2015 and under Finance (No. 2) Act 2015, which was enacted on 18 November 2015, the corporation tax will be reduced to 19% with effect from 1 April 2017 and 18% with effect from 1 April 2020. The future main tax rate reductions are expected to have a similar impact on the group's financial statements as outlined above, subject to the impact of other developments in the group's tax position which may reduce the beneficial effect of this in the group's tax rate.

#### *Foreign currency translation*

The individual financial statements of each group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each group company are expressed in pounds sterling, which is the functional currency of the group, and the presentation currency for the consolidated financial statements. For the purpose of presenting consolidated financial statements, the assets and liabilities of the group's foreign operations are translated at exchange rates prevailing at the balance sheet date. Income and expense items are translated at the average rates for the period, unless exchange rates fluctuate significantly during the period, in which case the exchange rate at the date of transactions is used. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity (attributed to non-controlling interests as appropriate).

In preparing the financial statements of the individual companies, transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Gains and losses arising on

retranslation are included in the income statement for the period.

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

#### *Retirement benefit costs*

The Civil Aviation Authority Pension Scheme is a funded defined benefit scheme. The assets of the scheme are held in a separate trustee administered fund. The cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at the end of each reporting period. Remeasurement comprising actuarial gains and losses and return on scheme assets (excluding interest) are recognised immediately in the balance sheet with a charge or credit to the statement of comprehensive income in the period in which they occur. Remeasurement recorded in the statement of comprehensive income is not recycled.

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

Net interest is calculated by applying the discount rate to the net defined benefit liability or asset. Defined benefit costs are split into three categories:

- current service cost, past service cost and gains and losses on curtailments and settlements;
- net interest expense or income; and
- remeasurement.

The retirement benefit obligation recognised in the balance sheet represents the deficit or surplus in the group's defined benefit scheme. Any surplus resulting from this calculation is limited to the present value of available refunds or reductions in future contributions to the scheme.

Since 2009, the group and Trustees have introduced a number of pension reforms, as explained in note 30. These include: closing the defined benefit scheme to new entrants with effect from 1 April 2009, and establishing a defined



contribution scheme for new entrants from 1 April 2009, limiting the rate of increase in pensionable pay and changing the indexation reference rate for future service.

Contributions to the defined contribution pension scheme are expensed as incurred.

#### *Provisions*

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

#### *Financial instruments*

Financial assets and financial liabilities are recognised on the group's balance sheet when the group becomes a party to the contractual provisions of the instrument. Detailed disclosures are set out in notes 16 to 21.

#### *Financial assets*

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

- loans and receivables;
- financial assets at fair value through the profit and loss;
- available for sale financial assets; and
- held to maturity investments.

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

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the time frame established by the market concerned, and are

initially measured at fair value plus transaction costs.

Other than loans and receivables the group does not have financial assets in other categories.

#### *Loans and receivables*

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

#### *Impairment of financial assets*

Financial assets are rigorously assessed for indicators of impairment at half year and year end. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

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

#### *Cash and cash equivalents*

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

#### *Financial liabilities*

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

#### *Fair value through the profit and loss*

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

statement incorporates any interest paid on the financial liability.

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

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

*Effective interest method*

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

*Equity*

Equity instruments are also classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

Equity instruments issued by the group are recorded at the proceeds received, net of direct issue costs.

*Derivative financial instruments and hedging activities*

The group's activities expose it primarily to the financial risks of changes in interest rates, inflation and foreign currency exchange rates. The group uses interest rate and index-linked swap contracts and forward foreign exchange contracts to hedge these exposures. These are disclosed in notes 18 and 19 to the accounts.

Under IFRS derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently measured at their fair value. The method of recognising the resulting gain or loss depends on whether the

derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

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

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognised directly in equity are reclassified into the income statement in the same period or periods during which the asset acquired or liability assumed affects profit or loss. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recycled to the income statement in the same period in which the hedged item affects the income statement.

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

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



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

### **3. Critical judgements and key sources of estimation uncertainty**

#### *Impairment of goodwill, intangible and tangible assets*

In carrying out impairment reviews of goodwill, intangible and tangible assets (including assets in the course of construction), a number of significant assumptions have to be made when preparing cash flow projections and assessing net realisable values. These include air traffic growth, service performance, future cash flows, the value of the regulated asset bases, market premiums for regulated businesses, NERL's Licence period and the outcome of the regulatory price control determinations. The market premium was assessed at the balance sheet date to be 5-6% (2015: 5-6%). If the actual outcome should differ or changes in expectations arise, impairment charges may be required which would materially impact on operating results. Refer to notes 13, 14 and 15.

#### *Retirement benefits*

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

A number of key assumptions have been made in calculating the fair value of the group's defined benefit pension scheme which affect the balance sheet position and the group's reserves and income statement. Refer to note 30 of the notes to the consolidated accounts for a summary of the main assumptions and sensitivities. Actual outcomes may differ materially from the assumptions used and may result in volatility in the net pension scheme position.

#### *Recoverability of revenue allowances*

The economic regulatory price controls for UK en route services established annual revenue

allowances that are recovered through a price based on the economic regulator's forecasts of traffic volumes and inflation made at the start of the price control period. Where traffic volumes or inflation differ from the regulator's forecasts, revenue actually recovered may be higher or lower than the revenue allowance. Where this is the case, the EU Charging Regulation requires an adjustment to be made to the price two years later to reflect any over or under-recovery. At the balance sheet date there were £63.2m recoverable allowances relating to previous price control periods (2015: £122.0m) and £14.3m of net payable allowances relating to the current price control period (2015: £0.3m of payable allowances). The legal right to recover the revenue adjustments discussed above is provided by the EC Charging Regulation and NERL's air traffic services licence. The company expects to recover these amounts through adjustments to prices in the current control period.

#### *Capital investment programme*

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

#### 4. Revenue

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

	2016 £m	2015 £m
Airspace	689.8	716.1
Airports	161.1	176.4
Engineering	30.2	15.6
Other UK Business	9.4	10.2
International	7.6	4.1
	<u>898.1</u>	<u>922.4</u>
Other operating income	3.1	4.1
Investment revenue (see note 8)	3.6	4.8
	<u>904.8</u>	<u>931.3</u>

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

A portion of the group's revenue from the provision of services denominated in foreign currencies is cash flow hedged. Included in revenue is the recycling of the effective amount of foreign currency derivatives that are used to hedge foreign currency revenue. The amount included in revenue is a £7.4m loss (2015: £4.2m gain).

#### 5. Business and geographical segments

##### Operating segments

The group's Executive team is considered to be the chief operating decision maker as defined by IFRS 8. The segmental analysis is based on the information that the Executive team uses internally for the purposes of evaluating the performance of operating segments and determining resource allocation between segments. The business is organised into service lines, each providing a core set of products to our customers: Airspace, Airports, Engineering, Other UK Business and International.

The performance of operating segments is assessed based on service line revenue and contribution. Service line contribution represents the revenue and costs which are directly attributed to a service line. Costs which are not directly attributed to a service line include: costs managed outside of service lines, depreciation and amortisation (net of government grants), goodwill impairment, profit/(loss) on disposal of non-current assets, employee share scheme costs, redundancy and relocation costs and above the line tax credits. A reconciliation of service line contribution to operating profit is set out below.

##### Principal activities

The following table describes the activities of each operating segment:

Airspace	This includes all of the group's economically regulated activities and encompasses en route, oceanic and terminal services provided from our Prestwick and Swanwick centres, together with all the supporting communications, navigation and surveillance infrastructure and facilities. Airspace includes air traffic services for helicopters operating in the North Sea, approach services for London airports, infrastructure services to the Ministry of Defence for their en route operations and European projects in conjunction with other air traffic organisations.
Airports	The provision of air traffic control and airport optimisation services at UK and international airports and engineering support services provided to contract airports.
Engineering	The provision of engineering services to other airport operators, construction companies and Air Traffic Management (ATM) industry suppliers, integrating new ATM infrastructure and new airports.
Other UK Business	Other services provided to UK customers including: Defence services, providing a range of services to military customers in the UK; Consultancy, offering airspace development, capacity improvement and training; and Information, providing data to enable future flight efficiency and flight optimisation.
International	The provision of air traffic control and related services (including consultancy, engineering, training and information services) to overseas customers.

A change to the service line management reporting structure was introduced from 1 April 2015. This reports International as a separate operating segment. As a result the prior period comparatives for the year ended 31 March 2015 have been presented on a consistent basis.

##### Revenue

Service line revenue includes intra-group revenue. This is eliminated in deriving the group's third party revenue below:

	2016			2015		
	Revenue £m	Intra-group revenue £m	External revenue £m	Revenue £m	Intra-group revenue £m	External revenue £m
Airspace	715.3	(25.5)	689.8	738.5	(22.4)	716.1
Airports	173.4	(12.3)	161.1	190.1	(13.7)	176.4
Engineering	32.0	(1.8)	30.2	17.3	(1.7)	15.6
Other UK Business	14.8	(5.4)	9.4	15.7	(5.5)	10.2
International	7.6	-	7.6	4.2	(0.1)	4.1
	<u>943.1</u>	<u>(45.0)</u>	<u>898.1</u>	<u>965.8</u>	<u>(43.4)</u>	<u>922.4</u>



**5. Business and geographical segments (continued)****Operating profit**

Service line contribution represents the revenue and costs which are directly attributed to a service line.

A reconciliation of service line contribution to operating profit is provided below:

	2016 £m	2015 £m
Airspace	323.1	380.2
Airports	40.0	61.7
Engineering	4.5	4.3
Other UK Business	0.8	5.4
International	(1.7)	(0.2)
<b>Service line contribution</b>	<b>366.7</b>	<b>451.4</b>
<b>Costs not directly attributed to service lines:</b>		
Depreciation and amortisation (net of deferred grants released)	(128.0)	(109.5)
Impairment of goodwill	(92.7)	(17.0)
Profit/(loss) on disposal of non-current assets	7.1	(0.2)
Employee share scheme credit	0.3	-
Redundancy and relocation costs	(6.5)	(10.8)
Other costs not directly attributed to service lines	(78.1)	(87.1)
Above the line tax credits	1.8	0.8
Less: share of results of associates and joint ventures	(1.5)	(1.0)
<b>Operating profit</b>	<b>69.1</b>	<b>226.6</b>

The performances of Airspace, Airports and Engineering include the group share of the results of European Satellite Service Providers SAS (ESSP SAS), FerroNATS Air Traffic Services SA and Aquila Air Traffic Management Services Limited respectively (see note 32). Other costs not directly attributed to service lines include corporate costs providing central support functions.

**Non-current assets additions**

The group reports additions to non-current assets by legal entity rather than by operating segment. Additions in NERL were £144.6m (2015: £152.3m) and in NATS Services £3.0m (2015: £1.2m).

**Geographical segments**

The following table provides an analysis of the group's revenue by geographical area based on the geographical location of its customers, and non-current assets (excluding financial assets) by geographical location:

	Revenue from external customers		Non-current assets	
	2016 £m	2015 £m	2016 £m	2015 £m
UK	485.5	492.6	1,205.0	1,281.3
Rest of Europe	251.2	261.2	4.0	1.7
North America	106.3	112.6	0.8	0.9
Other	55.1	56.0	0.1	-
	<b>898.1</b>	<b>922.4</b>	<b>1,209.9</b>	<b>1,283.9</b>

**Information about major customers**

Included in revenues arising from Airspace are revenues of £84.6m (2015: £83.4m - Airspace) which arose from the group's largest customer.

**6. Operating profit for the year**

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

**a. Goodwill impairment and exceptional redundancy costs**

NATS Services has undertaken a reorganisation, which included voluntary redundancies during the year ended 31 March 2015. These costs were considered to be exceptional.

	2016 £m	2015 £m
Goodwill impairment (see note 13)	92.7	17.0
Exceptional redundancy costs	-	9.2
	<b>92.7</b>	<b>26.2</b>

Exceptional redundancy costs include pension augmentation costs, see note 7a.

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

	2016 £m	2015 £m
CAA regulatory charges in respect of NERL's air traffic services licence	5.4	5.6
CAA regulatory charges for safety regulation at airports	3.1	3.2
Depreciation of property, plant and equipment	94.8	79.3
Impairment of property, plant and equipment	0.4	0.4
Amortisation of intangible assets	33.2	30.2
Impairment of intangible assets	0.3	0.4
Deferred grants released	(0.7)	(0.8)
Other redundancy costs	1.6	1.2
Staff relocation costs following site closure or contract termination	4.9	0.4
Research and development costs	12.1	7.9
Above the line tax credits relating to research and development costs	(1.8)	(0.8)
Auditor's remuneration for audit services (see below)	0.1	0.1

The analysis of auditor's remuneration is as follows:

	2016 £m	2015 £m
Fees payable to the company's auditor for the audit of the company's annual accounts	0.1	0.1
Fees payable to the company's auditor and their associates for other services to the group	-	-
- The audit of the company's subsidiaries	-	-
Total audit fees	0.1	0.1

Total non-audit fees of £82,058 (2015: £75,740) include tax services of £74,947 (2015: £63,740) and other services of £7,111 (2015: £12,000).

Total fees payable to the company's auditor for the audit of the subsidiary accounts was £23,800 (2015: £23,800).

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

Relocation costs are incurred as a result of the redeployment of staff following site closures or following contract termination. Credits are reported where costs incurred are lower than originally estimated. To the extent that staff cannot be redeployed, termination terms are agreed. In response to economic conditions and changes in technology, voluntary redundancy may also be offered to staff in some areas of the business.

Research and development costs represent internal labour costs incurred in support of research and development activities.

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

	2016 £m	2015 £m
Salaries and staff costs, including directors' remuneration, were as follows:		
Wages and salaries	309.4	315.1
Social security costs	34.0	33.6
Pension costs (note 7b)	141.4	112.4
	484.8	461.1
Less: amounts capitalised	(45.7)	(48.1)
	439.1	413.0

Wages and salaries include redundancy costs of £0.8m (2015: £8.1m), share-based payment credits or charges, other allowances and holiday pay.

Pension costs include £0.8m (2015: £2.3m) for redundancy related augmentation payments which staff elected to receive in lieu of severance payments.

**b. Pension costs**

	2016 £m	2015 £m
Defined benefit pension scheme costs (note 30)	132.7	105.0
Defined contribution pension scheme costs	8.7	7.4
	141.4	112.4

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

**c. Staff numbers**

	2016 No.	2015 No.
The monthly average number of employees (including executive directors) was:		
Air traffic controllers	1,636	1,748
Air traffic service assistants	635	701
Engineers	916	965
Others	977	928
	4,164	4,342



**8. Investment revenue**

	2016 £m	2015 £m
Interest on bank deposits	1.5	1.1
Other loans and receivables	2.1	3.7
	<u>3.6</u>	<u>4.8</u>

Interest on bank deposits has been earned on financial assets, including cash and cash equivalents and short term investments.

Other loans and receivables includes the effect of unwinding the discount on amounts receivable after more than one year.

**9. Fair value movement on derivative contract**

	2016 £m	2015 £m
Credit arising from change in the fair value of derivatives not qualifying for hedge accounting (before credit value adjustment)	3.8	1.8
Credit value adjustment on derivatives not qualifying for hedge accounting	(1.2)	(0.3)
	<u>2.6</u>	<u>1.5</u>

**10. Finance costs**

	2016 £m	2015 £m
Interest on bank overdrafts, loans and hedging instruments	1.1	1.4
Bond and related costs including financing expenses	28.2	29.1
Other finance costs	3.1	3.1
	<u>32.4</u>	<u>33.6</u>

Other finance costs includes the effect of unwinding the discount on amounts payable after more than one year.

**11. Tax**

	2016 £m	2015 £m
<b>Corporation tax</b>		
Current tax	25.5	36.1
Adjustments in respect of prior year	(1.5)	(0.5)
Foreign taxation	0.6	-
	<u>24.6</u>	<u>35.6</u>
<b>Deferred tax (see note 23)</b>		
Origination and reversal of temporary timing differences	(1.2)	7.6
Adjustments in respect of prior year	1.0	-
Effects of tax rate change on opening balance	(7.6)	0.2
	<u>(7.8)</u>	<u>7.8</u>
	<u>16.8</u>	<u>43.4</u>

Corporation tax is calculated at 20% (2015: 21%) of the estimated assessable profit for the year.

The charge for the year can be reconciled to the profit per the income statement as follows:

	2016 £m		2015 £m	
Profit on ordinary activities before tax	44.4		200.3	
Tax on profit on ordinary activities at standard rate in the UK of 20% (2015: 21%)	8.9	20.0%	42.1	21.0%
Tax effect of change in corporation tax from 20% to 18% (2015: 21% to 20%)	(7.6)	(17.1%)	-	-
Patent box	(1.2)	(2.7%)	(1.1)	(0.5%)
Profit on disposal of non-current assets	(1.4)	(3.2%)	-	-
Goodwill impairment	18.5	41.7%	3.6	1.8%
Tax effect of prior year adjustments: current tax	(1.5)	(3.4%)	(0.5)	(0.2%)
Tax effect of prior year adjustments: deferred tax	1.0	2.3%	-	-
Joint ventures and associates	(0.3)	(0.7%)	-	-
Unrecognised deferred tax assets on overseas subsidiaries	0.4	0.9%	-	-
R&D expenditure increased deductions	-	-	(0.1)	(0.1%)
Other permanent differences	-	-	(0.6)	(0.3%)
Tax charge for year at an effective tax rate of 37.8% (2015: 21.7%)	<u>16.8</u>	37.8%	<u>43.4</u>	21.7%
Deferred tax charge/(credit) taken directly to equity (see note 23)	<u>59.1</u>		<u>(76.4)</u>	

**12. Dividends**

	2016 £m	2015 £m
Amounts recognised as dividends to equity shareholders in the year:		
First interim dividend of 38.03 pence per share (2015: 35.65 pence per share) paid in June 2015	54.4	51.0
Second interim dividend of 19.08 pence per share (2015: 18.18 pence per share) paid in November 2015	27.3	26.0
	<u>81.7</u>	<u>77.0</u>

In May 2016, the Board approved and the company paid an interim dividend for the year ending 31 March 2017 of 16.78 pence per share, totalling £24.0m.

**13. Goodwill**

	£m
<b>Cost</b>	
At 31 March 2016 and 31 March 2015	351.0
<b>Accumulated impairment losses</b>	
At 1 April 2014	32.0
Impairment provision recognised in income statement	17.0
At 1 April 2015	<u>49.0</u>
Impairment provision recognised in income statement	92.7
At 31 March 2016	<u>141.7</u>
<b>Carrying amount</b>	
At 31 March 2016	<u>209.3</u>
At 31 March 2015	<u>302.0</u>

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

The carrying value is determined by reference to value in use calculations and the net realisable value of the regulatory asset bases of UK Air Traffic Services and North Atlantic Air Traffic Services, representing the cash generating units, including opportunities for out-performance of regulatory settlements and market premia for economically regulated businesses (assumed at 5%-6%, 2015: 5%-6%). The key assumptions for value in use calculations are the discount rate, future cash flows to the end of Reference Period 2 (31 December 2019) for both cash generating units as assumed in the group's business plans, and a terminal value at that date, reflecting the projected regulatory asset bases and a market premium, which is assessed annually. The group's business plans reflect the outcome of the RP2 price control review and include forecasts of traffic volumes, inflation and pension costs reflecting the current economic environment. The discount rate is a pre-tax nominal rate of 9.08% (2015: 9.42%) for cash flows arising in Reference Period 2. The value of the regulatory asset bases at the balance sheet date were £1,127.4m (2015: £1,175.4m). The impairment charge arose in the year following a reduction in value in use. Further details are provided on page 11 of the Strategic Report. See also note 3.



**14. Other intangible assets**

	Operational software £m	Non-operational software £m	Airspace and resectorisation £m	Assets in course of construction £m	Total £m
<b>Cost</b>					
At 1 April 2014	180.4	58.5	22.7	206.8	468.4
Additions internally generated	0.8	-	-	28.6	29.4
Additions externally acquired	9.6	4.6	1.4	34.2	49.8
Other transfers during the year	8.5	10.1	2.1	(16.5)	4.2
At 1 April 2015	199.3	73.2	26.2	253.1	551.8
Additions internally generated	0.4	0.5	-	29.5	30.4
Additions externally acquired	7.8	1.8	2.8	46.7	59.1
Other transfers during the year	14.6	2.2	17.3	(33.4)	0.7
At 31 March 2016	222.1	77.7	46.3	295.9	642.0
<b>Accumulated amortisation</b>					
At 1 April 2014	73.9	34.1	13.9	16.5	138.4
Charge for the year	19.4	9.0	1.8	-	30.2
Impairment provision recognised in income statement	-	-	-	0.4	0.4
At 1 April 2015	93.3	43.1	15.7	16.9	169.0
Charge for the year	21.0	9.9	2.3	-	33.2
Impairment provision recognised in income statement	-	-	-	0.3	0.3
Transfer of impairment provision	-	-	1.2	(1.2)	-
At 31 March 2016	114.3	53.0	19.2	16.0	202.5
<b>Carrying amount</b>					
At 31 March 2016	107.8	24.7	27.1	279.9	439.5
At 31 March 2015	106.0	30.1	10.5	236.2	382.8

An annual review is performed to assess the carrying value of other intangible assets, including assets in the course of construction. The accumulated amortisation of assets in the course of construction represents impairment provisions.

## 15. Property, plant and equipment

	Freehold land and buildings £m	Improvements to leasehold land and buildings £m	Air traffic control systems, plant and equipment £m	Vehicles, furniture and fittings £m	Assets in course of construction and installation £m	Total £m
<b>Cost</b>						
At 1 April 2014	240.0	52.8	1,244.9	19.7	47.1	1,604.5
Additions during the year	1.5	-	18.7	0.1	54.0	74.3
Disposals during the year	-	-	(1.5)	(0.1)	-	(1.6)
Other transfers during the year	0.2	-	16.9	0.2	(21.5)	(4.2)
At 1 April 2015	241.7	52.8	1,279.0	19.9	79.6	1,673.0
Additions during the year	1.3	0.4	29.7	2.3	24.4	58.1
Disposals during the year	-	(7.4)	(5.8)	-	-	(13.2)
Other transfers during the year	0.6	0.2	49.7	2.2	(53.4)	(0.7)
At 31 March 2016	243.6	46.0	1,352.6	24.4	50.6	1,717.2
<b>Accumulated depreciation and impairment</b>						
At 1 April 2014	106.1	37.9	843.4	12.6	0.4	1,000.4
Provided during the year	7.7	1.9	67.9	1.8	-	79.3
Impairment provision recognised in income statement	-	-	-	-	0.4	0.4
Disposals during the year	-	-	(1.5)	(0.1)	-	(1.6)
At 1 April 2015	113.8	39.8	909.8	14.3	0.8	1,078.5
Provided during the year	8.0	1.8	83.0	2.0	-	94.8
Impairment provision recognised in income statement	-	-	-	-	0.4	0.4
Transfer of impairment provision	-	-	0.1	-	(0.1)	-
Disposals during the year	-	(5.7)	(5.7)	(0.1)	-	(11.5)
At 31 March 2016	121.8	35.9	987.2	16.2	1.1	1,162.2
<b>Carrying amount</b>						
At 31 March 2016	121.8	10.1	365.4	8.2	49.5	555.0
At 31 March 2015	127.9	13.0	369.2	5.6	78.8	594.5

The group conducts annual reviews of the carrying values of its property, plant, equipment and intangible assets. During the year, impairment charges of £0.7m (2015: £0.8m) were made in respect of operational assets and assets in the course of construction reflecting a reassessment of certain projects and assets, and the likelihood of benefits being realised in full.

During the year the group capitalised £1.1m (2015: £1.2m) of general borrowing costs at a capitalisation rate of 2.2% (2015: 1.9%), in accordance with IAS 23: *Borrowing Costs*.

During the year, the group entered into a finance lease for certain network related assets. The fair value of the assets held under finance lease are £2.0m and are included within the additions for air traffic control systems, plant and equipment above.



**16. Financial and other assets**

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

**Trade and other receivables**

	2016 £m	2015 £m
<b>Non-current</b>		
Other debtors	0.4	0.3
Prepayments	2.5	2.5
Accrued income	21.1	62.1
	<u>24.0</u>	<u>64.9</u>
<b>Current</b>		
Receivable from customers gross	80.7	78.4
Allowance for doubtful debts	(4.6)	(4.4)
	<u>76.1</u>	<u>74.0</u>
Amounts recoverable under contracts	0.6	0.7
Other debtors	10.9	5.2
Prepayments	15.9	15.2
Accrued income	132.1	112.6
	<u>235.6</u>	<u>207.7</u>

The average credit period taken on sales of services is 30 days (2015: 29 days). Interest is charged by Eurocontrol to UK en route customers at 10.30% (2015: 10.24%) on balances outstanding after more than 30 days. All other balances are non-interest bearing. An allowance has been made for estimated irrecoverable amounts from sales to customers of £4.6m (2015: £4.4m). Full provision is made for receivables from UK en route customers that are overdue. Debts that are neither impaired nor overdue are assessed for credit quality and reviewed periodically. Receivables in respect of other customers are provided for where there is an identified loss event, such as administration, receivership or liquidation or where there is evidence of a reduction in the recoverability of the cash flows.

Accrued income which is non-current represents regulatory adjustments for calendar year 2015, the period January to March 2016 and revenues earned in previous regulatory control periods, which will be recovered after 31 March 2017 through 2017 and 2018 charges. Accrued income which is current includes unbilled revenues for services provided in March 2016, regulatory adjustments for calendar years 2014 and 2015 and revenues earned in previous regulatory control periods, which will be recovered by 31 March 2017 through 2016 and 2017 charges.

**Ageing of past due but not impaired trade receivables**

	2016 £m	2015 £m
31-90 days	0.2	0.7
91-365 days	0.1	0.9
> 365 days	0.2	0.1
	<u>0.5</u>	<u>1.7</u>

**Movement in the allowance for doubtful debts**

	2016 £m	2015 £m
Balance at the beginning of the year	4.4	4.8
Increase in allowance recognised in the income statement	0.7	0.4
Foreign exchange movement in the year	0.3	(0.4)
Amounts written off as irrecoverable	(0.8)	(0.4)
Balance at end of year	<u>4.6</u>	<u>4.4</u>

In determining the recoverability of a trade receivable the group considers any change in credit quality of the trade receivable from the date credit was initially granted up to the reporting date. The directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Included in the allowance for doubtful debts are individually impaired trade receivables with a balance of £2.8m (2015: £3.2m) which are in administration, receivership or liquidation. The impairment recognised represents the carrying amount of these trade receivables. The group does not hold any collateral over these balances.

**Ageing of impaired receivables**

	2016 £m	2015 £m
31-90 days	0.3	0.3
91-365 days	1.0	0.6
> 365 days	3.3	3.5
	<u>4.6</u>	<u>4.4</u>

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

**16. Financial and other assets (continued)****Cash and cash equivalents**

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

Overall, the maximum credit risk for the items discussed above and loans to joint ventures would be £502.1m (2015: £522.4m).

**17. Borrowings**

	2016 £m	2015 £m
<b>Secured loans at amortised cost</b>		
£600m 5.25% Guaranteed Secured Amortising Bond due 2026	467.4	498.0
Bank loans (variable rate revolving term loan and revolving credit facility expiring 2020)	95.0	152.0
	<u>562.4</u>	<u>650.0</u>
<b>Unsecured loans at amortised cost</b>		
Bank overdraft	0.4	-
Obligations under finance leases (see note 21)	2.0	-
	<u>564.8</u>	<u>650.0</u>
Gross borrowings	564.8	650.0
Unamortised bond issue costs	(2.7)	(3.2)
Unamortised bank facility arrangement fees	(1.7)	(1.1)
	<u>560.4</u>	<u>645.7</u>
Amounts due for settlement within 12 months	<u>38.9</u>	<u>29.7</u>
Amounts due for settlement after 12 months	<u>521.5</u>	<u>616.0</u>

The £600m 5.25% Guaranteed Secured Amortising Bond is secured by way of a debenture by which NERL grants its lenders a first legal mortgage over certain properties in England and Wales, a first fixed charge over all other real estate, plant and equipment and a floating charge over all other assets. Drawings of £95.0m made by NERL under its £400.0m committed bank facilities are similarly secured. Total assets of NERL as at 31 March 2016 were £1,510.5m (2015: £1,612.8m), including goodwill of £209.3m (2015: £302.0m). Further security provisions are also provided by NATS Holdings Limited and by NATS Limited.

The average effective interest rate on the bank loans in the year was 1.4% (2015: 1.6%) and was determined based on LIBOR rates plus a margin and utilisation fee.

Costs associated with the issue of the £600m bond are being amortised over the life of the bond. Costs incurred to refinance bank facilities are being amortised over the facility term. Costs not fully amortised at the date of subsequent refinancing are written off.

**Undrawn committed facilities**

	2016 £m	2015 £m
Undrawn committed facilities expire as follows:		
Between one and two years	-	123.0
Expiring in more than two years	305.0	-
	<u>305.0</u>	<u>123.0</u>

At 31 March 2016, NERL had outstanding drawings of £95.0m on its committed bank facilities. These facilities expire in July 2020.

NATS Services has an uncommitted overdraft facility of £1.0m that was undrawn as at 31 March 2016 and 31 March 2015 and is not included in the table above.

**18. Derivative financial instruments****Fair value of derivative financial instruments**

	2016 £m	2015 £m
<b>Non-current assets</b>		
Derivative financial instruments in designated hedge accounting relationships		
Forward foreign exchange contracts (cash flow hedges)	0.2	-
	<u>0.2</u>	<u>-</u>
<b>Current assets</b>		
Derivative financial instruments in designated hedge accounting relationships		
Forward foreign exchange contracts (cash flow hedges)	0.4	4.0
	<u>0.4</u>	<u>4.0</u>



**18. Derivative financial instruments (continued)****Current liabilities**

Derivative financial instruments in designated hedge accounting relationships		
Forward foreign exchange contracts (cash flow hedges)	(4.1)	(3.6)
Derivative financial instruments classified as held for trading		
Index-linked swap	(3.7)	-
	<u>(7.8)</u>	<u>(3.6)</u>

**Non-current liabilities**

Derivative financial instruments in designated hedge accounting relationships		
Forward foreign exchange contracts (cash flow hedges)	-	(1.6)
Derivative financial instruments classified as held for trading		
Index-linked swap	(121.1)	(127.4)
	<u>(121.1)</u>	<u>(129.0)</u>

Further details on derivative financial instruments are provided in note 19. The index-linked swap is classified under international accounting standards as held for trading as it does not qualify for hedge accounting. The index-linked swap was taken out in August 2003 to hedge against the risk of low inflation and previously qualified as a hedge under UK generally accepted accounting principles prior to the group's adoption of international accounting standards.

**19. Financial instruments****Capital risk management**

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

The capital structure of the group consists of debt as disclosed in note 17, cash and cash equivalents and short term investments, as shown in this note, and equity attributable to shareholders as disclosed in the consolidated statement of changes in equity.

**External capital requirements**

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

As at 31 March 2016, NERL had a corporate rating of AA- from Standard & Poor's (2015: AA-) and A2 from Moody's (2015: A2).

**Gearing ratio**

The group does not seek to maintain a target gearing level at group level but rather sets a gearing target for NERL, the economically regulated subsidiary, based on a ratio of net debt to its regulatory asset base (RAB). In addition, the CAA has set NERL a gearing target of 60% and a cap of 65% of net debt to RAB with a requirement for NERL to remedy the position if this cap is exceeded. NERL's gearing ratio at 31 March 2016 was 49.1% (2015: 53.4%). As at 31 March 2016 NATS Limited had a bank overdraft of £0.4m (2015: £nil) and NATS Services and the other NATS subsidiaries have no borrowings.

**Significant accounting policies**

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

**Categories of financial instrument**

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

	2016 £m	2015 £m
<b>Financial assets</b>		
Loans and receivables, excluding prepayments	245.0	255.4
Cash and cash equivalents and short term investments	257.1	267.0
Derivative financial instruments in designated hedge accounting relationships	0.6	4.0
	<u>502.7</u>	<u>526.4</u>
<b>Financial liabilities</b>		
Derivative financial instruments in designated hedge accounting relationships	(4.1)	(5.2)
Derivative financial instruments classified as held for trading	(124.8)	(127.4)
Other financial liabilities at amortised cost	(747.3)	(814.5)
	<u>(876.2)</u>	<u>(947.1)</u>

Other financial liabilities at amortised cost includes balances for trade and other payables (excluding deferred income of £72.1m (2015: £39.5m) and including tax and social security), the bond and bank borrowings (excluding unamortised bond issue costs and bank facility arrangement fees).

The index-linked swap is categorised as held for trading. The credit on the movement in its market value of £2.6m has been recorded in the income statement in the year (2015: £1.5m credit).

## 19. Financial instruments (continued)

### Financial risk management objectives

The group's Treasury function is mandated by the Board to manage financial risks that arise in relation to underlying business needs. The function provides services to the business, co-ordinates access to financial markets and monitors and manages financial risks relating to the operations of the group. The function has clear policies and operating parameters. The Treasury Committee provides oversight and meets three times a year to approve strategy and to monitor compliance with Board policy. The Treasury function does not operate as a profit centre and the undertaking of speculative transactions is not permitted. The principal financial risks arising from the group's activities include market risk (including currency risk, interest rate risk and inflation risk), credit risk and liquidity risk. NATS Services had no borrowings. At 31 March 2016, NATS Limited had an overdraft of £0.4m (2015: £nil). The principal financial risk in these entities is credit risk. Specific policies on interest rate and liquidity risk management apply principally to NERL.

### Market risk

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

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

### Foreign currency risk management

The group's principal exposure to foreign currency transaction risk is in relation to UK en route services revenue, accounting for 64% of the group's turnover (2015: 66%). Charges for this service are set in sterling, but are billed and collected in euro by applying a conversion rate determined monthly by Eurocontrol, who administer the UK en route revenue collection. The conversion factor used is the average of the daily closing rates for the month prior to the billing period. To mitigate the risk that exchange rates move between the date of billing and the date on which the funds are remitted to NERL, forward foreign currency contracts are entered into. NERL seeks to hedge 95% of the UK en route income that is forecast to arise by entering into forward foreign exchange contracts on a monthly basis.

The group's international activities account for 0.8% of external revenue (2015: 0.4%). The group trades with and provides finance to its overseas joint ventures and subsidiaries. Where appropriate the transactions are conducted in sterling.

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

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

	Assets		Liabilities	
	2016 £m	2015 £m	2016 £m	2015 £m
Euro	98.7	90.0	(29.8)	(23.8)
US dollar	2.0	0.6	(4.0)	(0.1)
UAE dirham	1.0	0.6	(0.3)	(0.1)
Kuwaiti dinar	0.6	0.3	-	-
Singapore dollar	0.6	0.1	-	-
Canadian dollar	0.4	0.9	(0.2)	(0.7)
Omani rial	0.4	0.4	-	-
Qatari riyal	0.2	0.3	-	-
Philippine peso	0.2	-	-	-
Norwegian krone	0.1	0.1	(0.2)	-
Hong Kong dollar	0.1	-	(0.2)	-
Danish krone	0.1	-	-	(0.1)
	<u>104.4</u>	<u>93.3</u>	<u>(34.7)</u>	<u>(24.8)</u>

### Foreign currency sensitivity analysis

The group has assets and liabilities denominated in foreign currencies including cash balances of £5.6m at 31 March 2016 (2015: £4.8m) in euro, US dollars, Kuwaiti dinar, Canadian dollars, Omani rial, Norwegian krone, Qatari riyal and Danish krone. Furthermore, the group has entered into forward foreign currency contracts to hedge exchange risk relating to customer receipts and supplier costs which will arise in future periods. These contracts are not reflected on the balance sheet but are reported in the table below.

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



**19. Financial instruments (continued)**

The table below shows the effect of a 10% strengthening of sterling against the relevant currency (to the nearest £0.1m). A positive number below indicates an increase in profit and equity and a negative number a reduction in profit and equity. There would be an equal and opposite impact on profit and equity if sterling devalues by 10% against the relevant currency.

Currency	2016 Impact £m	2015 Impact £m
Euro	7.7	4.3
US dollar	(3.2)	(0.1)
Norwegian krone	(0.2)	-
Canadian dollar	(0.1)	-
UAE dirham	(0.1)	(0.1)
Kuwaiti dinar	(0.1)	-
	<u>4.0</u>	<u>4.1</u>

The group's sensitivity to the euro increased during the year reflecting a net increase in euro denominated monetary assets and a net increase in euro denominated forward contracts taken out to hedge future receipts. The group's sensitivity to the US dollar has increased during the year, reflecting a net decrease in US dollar denominated monetary assets and a net increase in US dollar denominated forward contracts taken out to hedge future payments to a US supplier, relating to the group's capital investment programme. Exposure to other currencies has remained fairly constant. NATS believes that this sensitivity analysis accurately reflects its inherent foreign exchange risk.

**Forward foreign exchange contracts**

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

2016				2015			
	£m	€m	Average exchange rate		£m	€m	Average exchange rate
<b>Euro sold</b>				<b>Euro sold</b>			
0-90 days	165.1	214.3	0.7704	0-90 days	160.2	215.6	0.7429
91-365 days	0.1	0.2	0.7417	91-365 days	-	-	n/a
> 365 days	0.5	0.6	0.7524	> 365 days	-	-	n/a
	<u>165.7</u>	<u>215.1</u>	<u>0.7703</u>		<u>160.2</u>	<u>215.6</u>	<u>0.7429</u>
<b>Euro bought</b>				<b>Euro bought</b>			
0-90 days	2.1	1.6	0.7630	0-90 days	15.9	12.4	0.7801
91-365 days	19.1	15.4	0.8075	91-365 days	47.5	38.9	0.8197
> 365 days	3.5	2.9	0.8197	> 365 days	-	-	n/a
	<u>24.7</u>	<u>19.9</u>	<u>0.8056</u>		<u>63.4</u>	<u>51.3</u>	<u>0.8093</u>
<b>US dollar bought</b>				<b>US dollar bought</b>			
0-90 days	3.3	2.3	1.4558	0-90 days	0.1	0.1	1.5320
91-365 days	16.1	11.0	1.4596	91-365 days	-	-	n/a
> 365 days	30.4	20.6	1.4726	> 365 days	-	-	n/a
	<u>49.8</u>	<u>33.9</u>	<u>1.4677</u>		<u>0.1</u>	<u>0.1</u>	<u>1.5320</u>
<b>Canadian dollar bought</b>				<b>Canadian dollar bought</b>			
> 365 days	1.6	0.8	1.9915	> 365 days	-	-	n/a
<b>Kuwaiti dinar sold</b>				<b>Kuwaiti dinar sold</b>			
0-90 days	-	-	n/a	0-90 days	0.3	0.1	0.4858
<b>Norwegian krone bought</b>				<b>Norwegian krone bought</b>			
0-90 days	0.1	0.8	12.3776	0-90 days	-	-	n/a
91-365 days	0.1	0.8	12.3760	91-365 days	-	-	n/a
	<u>0.2</u>	<u>1.6</u>	<u>12.3768</u>		<u>-</u>	<u>-</u>	<u>n/a</u>

At 31 March 2016, the aggregate amount of the unrealised loss under forward foreign exchange contracts deferred in the hedge reserve relating to the exposure on these future transactions was £nil (2015: £5.1m unrealised loss). The majority of these contracts will mature within the next financial year at which stage the amount deferred in equity will be realised in the income statement.

In addition to the above, NERL has entered into average rate forward agreements with a fixing date after 31 March 2016 to sell euro anticipated to be received in July 2016 in respect of UK en route revenues. The value of these cash flows is £63.6m. These contracts are also designated as cash flow hedges. They are not included in the table above.

**Interest rate risk management**

The group is exposed to interest rate risk to the extent that it holds borrowings at fixed, floating and index-linked interest rates. Its interest rate risk management policies, which are kept under continuous review, are specific to NERL. NATS Services had no borrowings at 31 March 2016 (2015: £nil). NATS Limited had an overdraft of £0.4m at 31 March 2016 (2015: £nil).

The group seeks to minimise NERL's exposure to movements in interest rates by ensuring NERL holds an appropriate balance of fixed, floating and index-linked debt as a percentage of its net debt by the use of interest rate swap contracts and index-linked swap contracts.

The group's exposure to interest rates on financial assets and financial liabilities is detailed in the liquidity risk management section of this note. The group held no interest rate swaps at 31 March 2016 (2015: none).

**19. Financial instruments (continued)****Economic interest rate exposure**

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

Currency	Cash			Short term deposits			Total £m
	Amount £m	Economic interest rate %	Average maturity days	Amount £m	Economic interest rate %	Average maturity days	
				2016			
Sterling	222.6	0.5	14	28.9	0.6	183.0	251.5
Euro	2.5	-	1	-	-	-	2.5
US dollar	1.6	-	1	-	-	-	1.6
Kuwaiti dinar	0.5	-	1	-	-	-	0.5
Canadian dollar	0.4	-	1	-	-	-	0.4
Omani rial	0.3	-	1	-	-	-	0.3
Norwegian krone	0.1	-	1	-	-	-	0.1
Qatari riyal	0.1	-	1	-	-	-	0.1
Danish krone	0.1	-	1	-	-	-	0.1
	<u>228.2</u>			<u>28.9</u>			<u>257.1</u>
				2015			
				Short term deposits			
Currency	Amount £m	Economic interest rate %	Average maturity days	Amount £m	Economic interest rate %	Average maturity days	Total £m
Sterling	232.5	0.5	10	29.7	0.6	183.0	262.2
Euro	3.2	-	1	-	-	-	3.2
US dollar	0.4	-	1	-	-	-	0.4
Kuwaiti dinar	0.1	-	1	-	-	-	0.1
Canadian dollar	0.7	-	1	-	-	-	0.7
Norwegian krone	0.1	-	1	-	-	-	0.1
UAE dirham	0.3	-	1	-	-	-	0.3
	<u>237.3</u>			<u>29.7</u>			<u>267.0</u>

The economic interest rate reflects the true underlying cash rate that the group was paying on its borrowings or receiving on its deposits at 31 March. The economic interest rate exposure of the group's loans is presented below with and without the effect of derivatives, as follows:

**Excluding derivatives**

	Total £m	Variable rate £m	Inflation rate £m	Fixed rate £m	Economic interest rate %	Weighted average time rate is fixed years
At 31 March 2016						
Sterling:						
5.25% guaranteed secured bonds	467.4	-	-	467.4	5.26%	5.7
Bank loans	95.0	95.0	-	-	1.11%	0.5
Obligations under finance leases	2.0	-	-	2.0	3.10%	4.9
Bank overdraft	0.4	0.4	-	-	1.50%	0.0
<b>Total</b>	<u>564.8</u>	<u>95.4</u>	<u>-</u>	<u>469.4</u>		
At 31 March 2015						
Sterling:						
5.25% guaranteed secured bonds	498.0	-	-	498.0	5.26%	6.3
Bank loans	152.0	152.0	-	-	1.55%	0.4
<b>Total</b>	<u>650.0</u>	<u>152.0</u>	<u>-</u>	<u>498.0</u>		

**Including derivatives**

	Total £m	Variable rate £m	Inflation rate £m	Fixed rate £m	Economic interest rate %	Weighted average time rate is fixed years
At 31 March 2016						
Sterling:						
5.25% guaranteed secured bonds	267.4	-	-	267.4	5.27%	5.7
5.25% guaranteed secured bonds	200.0	-	200.0	-	4.97%	0.5
Bank loans	95.0	95.0	-	-	1.11%	0.5
Obligations under finance leases	2.0	-	-	2.0	3.10%	4.9
Bank overdraft	0.4	0.4	-	-	1.50%	0.0
<b>Total</b>	<u>564.8</u>	<u>95.4</u>	<u>200.0</u>	<u>269.4</u>		
At 31 March 2015						
Sterling:						
5.25% guaranteed secured bonds	298.0	-	-	298.0	5.27%	6.3
5.25% guaranteed secured bonds	200.0	-	200.0	-	4.91%	0.5
Bank loans	152.0	152.0	-	-	1.55%	0.4
<b>Total</b>	<u>650.0</u>	<u>152.0</u>	<u>200.0</u>	<u>298.0</u>		

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



**19. Financial instruments (continued)**

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

	2016		2015	
	£m	%	£m	%
Net debt	303.3		378.7	
	£m	%	£m	%
Fixed (net of bond discount and issue costs)	266.7	87.9	294.8	77.8
Index-linked	200.0	65.9	200.0	52.8
Floating (net of cash, short term investments and facility costs)	(163.4)	(53.8)	(116.1)	(30.6)
	303.3	100.0	378.7	100.0

At 31 March 2016, NERL had net debt, including an intercompany loan of £22.5m, of £481.1m (2015: net debt £561.3m), NATS Limited held net cash of £5.4m (2015: cash £6.2m), NATS Services had cash of £147.7m (2015: cash £152.8m), NATSNav had cash of £0.8m (2015: cash £0.6m), NATS (USA) Inc had cash of £0.5m (2015: cash £0.2m), NATS Services DMCC had cash of £nil (2015: £0.3m), NATS Services (Asia Pacific) had cash of £0.6m (2015: £nil) and NATS Services LLC had cash of £0.3m (2015: £nil).

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

	2016		2015	
	£m	%	£m	%
Net debt	481.1		561.3	
	£m	%	£m	%
Fixed (net of bond discount and issue costs)	266.7	55.4	294.8	52.5
Index-linked	200.0	41.6	200.0	35.6
Floating (net of cash, short term investments and facility costs)	14.4	3.0	66.5	11.9
	481.1	100.0	561.3	100.0

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

**Interest rate sensitivity analysis**

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

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

	2016	2015
	Impact	Impact
	£m	£m
Cash at bank and short term deposits (2016: £257.1m, 2015: £267.0m)	2.6	2.7
Borrowings (2016: £95.4m, 2015: £152.0m)	(1.0)	(1.5)
	1.6	1.2

Overall the group's sensitivity to interest rates is slightly higher than prior year, reflecting net changes in cash and borrowing levels.

**Inflation rate risk**

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

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

**Inflation rate sensitivity analysis**

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

**19. Financial instruments (continued)**

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

	2016 Impact £m	2015 Impact £m
Change in swap interest and mark to market value	(18.4)	(21.4)

The mark to market value of the index-linked swap is also sensitive to the discount rates that are used to determine the net present value of the cash flows under the swap agreement. The discount rate is determined by reference to market yields on interest rate swaps. The effect of a 1% increase in the discount rate would be to increase profit and equity by £7.8m (2015: £9.5m). There would be an equal and opposite impact on profit and equity if discount rates decreased by 1%.

**Credit risk management**

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the group. The group's exposure to credit risk arises from the risk of default by customers on settlement of trade receivables and from the risk of a failure of a financial institution in which funds are invested for return or held for trading purposes or with whom derivative contracts are entered into. The risk of loss from default by customers and the mitigations against this risk are explained in note 16. With regard to funds or contracts held with financial institutions, the group's policy is to transact with counterparties that hold a minimum credit rating as supplied by independent rating agencies: Standard & Poor's, Moody's and Fitch Ratings.

The group's policy is to allocate limits to the value of investments, foreign exchange transactions and interest rate hedging transactions that may be entered into with a bank or financial institution and to allocate an aggregate credit risk limit. The limits are based upon the institution's credit rating with Standard & Poor's and Moody's; the Fitch rating is only used if one of these agencies does not provide a rating. Where there is a difference in the rating then the lowest rating is applied.

Currently, the group's investments take the form of bank time deposits and money market fund investments. Investments in bank time deposits with maturities up to 3 months and between 3 and 6 months are only entered into with institutions holding a long term minimum credit rating of A- and A+ respectively from Standard & Poor's or Fitch Ratings and A3 and A1 respectively from Moody's. However, dependent on market conditions, tighter restrictions on rating requirements and lower limits may be placed on the duration of deposits. Money market fund investments are restricted to AAA rated liquidity funds.

The table below sets out the investment limits that are applied to each institution based on its credit rating:

Rating (Standard & Poor's)	Limit per Institution £m
AAA	70.0
AA+	56.0
AA	42.0
AA-	28.0
A+	21.0
A	14.0
A-	10.5

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

Rating (Standard & Poor's)	2016			2015		
	Number of institutions	£m	By credit rating %	Number of institutions	£m	By credit rating %
AAA	5	110.7	43.1	5	107.5	40.3
AA-	3	55.1	21.4	3	46.8	17.5
A+	1	9.3	3.6	5	60.9	22.8
A	6	58.3	22.7	6	47.5	17.8
A-	2	10.8	4.2	1	4.3	1.6
BBB+	2	12.9	5.0	-	-	-
		257.1	100.0		267.0	100.0

One of the group's investments had been made with an institution that on 31 March 2016 was downgraded by Standard & Poor's to BBB+. This investment was redeemed at the end of the interest period. The remaining deposits of £2.9m with a BBB+ rated institution were held in various current accounts that are not subject to the above investment limits.

**Liquidity risk management**

The responsibility for liquidity risk management, the risk that the group will have insufficient funds to meet its obligations as they fall due, rests with the Board with oversight provided by the Treasury Committee. The group manages liquidity by maintaining adequate reserves and borrowing facilities by monitoring actual and forecast cash flows, including contributions to the defined benefit pension scheme, and ensuring funding is diversified by source and maturity and available at competitive cost. Specific liquidity policies are maintained for NERL. NATS Services had no debt at the year end. NATS Limited had an overdraft of £0.4m at 31 March 2016.

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

- maintain free cash equal to between one and two months of UK en route services revenues (see below). Free cash is defined as cash and cash equivalents and short term investments, excluding a debt service reserve account of £28.9m used to fund interest, fees and bond amortisation payments scheduled in the next six months and a liquidity reserve account of £21.3m held to provide liquidity in the event of certain pre-defined circumstances, particularly to ensure compliance with financial covenants;



**19. Financial instruments (continued)**

b. ensure access to bank facilities sufficient to meet 110% of forecast requirements that are not otherwise covered by operating cash flows or other sources of finance through the period of the business plan. At 31 March 2016 NERL had access to bank facilities totalling £400m available until 31 July 2020. The facilities comprise a £350m revolving term loan facility, a £45m revolving credit facility and a £5m overdraft facility;

c. ensure access to long term funding to finance its long term assets. This is achieved in the form of a £600m amortising sterling bond with a final maturity date of 2026;

d. ensure that the ratio of bank funding to total gross borrowings does not exceed 75%; and

e. maintain a portfolio of debt diversified by source and maturity. This is achieved through the issuance of a £600m sterling bond that started to amortise in 2012 and has a final maturity date of 2026 and by having available shorter dated committed bank facilities.

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

	2016 £m	2015 £m
Average monthly UK en route services income	48.3	51.0
Free cash at 31 March	51.2	55.9
Ratio of free cash to UK en route services income	1.1	1.1

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

	2016 £m	2015 £m
Bank borrowings	95.4	152.0
Gross borrowings	564.8	650.0
Bank borrowings as a percentage of gross borrowings	16.9%	23.4%

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

**Maturity of borrowings**

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

	2016				2015			
	Unsecured loans £m	Secured loans £m	Other liabilities £m	Total £m	Secured loans £m	Other liabilities £m	Total £m	
Due within one year or less	0.7	65.3	157.2	223.2	59.9	132.3	192.2	
Between one and two years	0.2	71.0	13.4	84.6	219.0	25.7	244.7	
Due between two and five years	0.7	281.7	5.2	287.6	195.9	4.3	200.2	
Due in more than five years	1.1	294.9	6.7	302.7	351.8	2.2	354.0	
	2.7	712.9	182.5	898.1	826.6	164.5	991.1	
Effect of interest, discount and unamortised bond issue and bank facility arrangement fees	(0.3)	(154.9)	-	(155.2)	(180.9)	-	(180.9)	
	2.4	558.0	182.5	742.9	645.7	164.5	810.2	

Other liabilities above include trade and other payables excluding deferred income of £72.1m (2015: £39.5m).

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

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

	Due within one year or less £m	Due between one and two years £m	Due between two and five years £m	Due in more than five years £m	Total £m
2016					
Net settled:					
Index-linked swap payable	(3.4)	(8.0)	(38.2)	(102.4)	(152.0)
Gross settled:					
Foreign exchange forward contract receivables	195.8	10.6	14.3	-	220.7
Foreign exchange forward contract payables	(200.2)	(10.6)	(14.0)	-	(224.8)
	(7.8)	(8.0)	(37.9)	(102.4)	(156.1)
2015					
Net settled:					
Index-linked swap receivable/(payable)	1.8	(2.4)	(30.5)	(125.6)	(156.7)
Gross settled:					
Foreign exchange forward contract receivables	191.6	12.3	2.5	-	206.4
Foreign exchange forward contract payables	(190.8)	(13.9)	(2.9)	-	(207.6)
	2.6	(4.0)	(30.9)	(125.6)	(157.9)

**19. Financial instruments (continued)****Fair value measurements**

The information set out below provides information about how the group determines fair values of various financial assets and financial liabilities.

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

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

**Fair value measurements recognised on the balance sheet**

	2016				2015			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Financial assets</b>								
Derivative financial instruments in designated hedge accounting relationships	-	0.6	-	0.6	-	4.0	-	4.0
<b>Financial liabilities</b>								
Derivative financial instruments in designated hedge accounting relationships	-	(4.1)	-	(4.1)	-	(5.2)	-	(5.2)
Derivative financial instruments classified as held for trading	-	(124.8)	-	(124.8)	-	(127.4)	-	(127.4)
	-	(128.9)	-	(128.9)	-	(132.6)	-	(132.6)

There were no transfers between individual levels in the year.

**Valuation techniques and key inputs**

The fair value of the financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the balance sheet date.

The fair values of the financial instruments held at fair value have been determined based on available market information at the balance sheet date and the valuation methodologies listed below:

- the fair values of forward foreign exchange contracts are calculated with reference to well recognised proprietary financial models used by bank counterparties, and verified using discounted cash flow modelling;
- the fair value of the index-linked swap is calculated by adding a credit value adjustment to an amount provided by bank counterparties using proprietary financial models. This is validated using discounted cash flow modelling and observable forward inflation indices at the reporting date and contracted inflation rates, discounted at a rate that reflects the credit risk of the various counterparties. The credit value adjustment is determined by the group to reflect own credit risk by reference to bank margins appropriate to NERL's credit rating;
- the fair value of the £600m bond has been derived from its externally quoted price.

Except as detailed in the following table, the directors consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values:

	Carrying amount		Fair value	
	2016 £m	2015 £m	2016 £m	2015 £m
<b>Financial liabilities</b>				
£600m 5.25% Guaranteed Secured Amortising Bond	(467.4)	(498.0)	(543.9)	(587.0)



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

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

	2016 £m	2015 £m
<b>Current</b>		
Trade payables	54.3	18.9
Other payables	3.3	3.2
Tax and social security	10.6	10.2
Accruals and deferred income		
deferred grants	0.7	0.7
other	102.1	114.7
	<u>171.0</u>	<u>147.7</u>
<b>Non-current</b>		
Other payables	16.7	2.2
Accruals and deferred income		
deferred grants	4.6	5.3
other	62.3	48.8
	<u>83.6</u>	<u>56.3</u>
	<u>254.6</u>	<u>204.0</u>

Trade payables and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 40 days (2015: 40 days). The directors consider that the carrying amount of the trade payables approximates to their fair value.

**21. Obligations under finance leases**

	Minimum lease payments		Present value of minimum lease payments	
	2016 £m	2015 £m	2016 £m	2015 £m
Within one year	0.3	-	0.2	-
In the second to fifth years inclusive	0.9	-	0.8	-
After five years	1.1	-	1.0	-
	<u>2.3</u>	<u>-</u>	<u>2.0</u>	<u>-</u>
Less: future finance charges	(0.3)	-	-	-
	<u>2.0</u>	<u>-</u>	<u>2.0</u>	<u>-</u>
Analysed as:			2016 £m	2015 £m
Current			0.2	-
Non-current			1.8	-
			<u>2.0</u>	<u>-</u>

The group entered into a finance lease arrangement for certain network equipment in the year. The term of this lease is 10 years. For the year ended 31 March 2016, the effective borrowing rate was 3.1%. All leases are on a fixed repayment basis.

The fair value of the group's lease obligations is approximately equal to their carrying amount.

**22. Provisions**

	Redundancy £m	Relocation £m	Other £m	Total £m
At 1 April 2015	11.1	0.4	9.8	21.3
Additional provision in the year	1.7	4.9	1.7	8.3
Release of provision in the year	(0.1)	-	(3.4)	(3.5)
Utilisation of provision	(8.3)	(1.4)	(0.2)	(9.9)
At 31 March 2016	<u>4.4</u>	<u>3.9</u>	<u>7.9</u>	<u>16.2</u>
				Total £m
Amounts due for settlement within 12 months				8.7
Amounts due for settlement after 12 months				7.5
				<u>16.2</u>

The redundancy provision represents the best estimate of the future cost of redundancy payments to employees that have committed to the redundancy terms at 31 March 2016. The ageing of the provision reflects the expected timing of employees leaving the group.

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

The other provisions represent the best estimate of other liabilities, including property-related costs. The ageing of the provision reflects the best estimate of when these potential liabilities will fall due.

**23. Deferred tax**

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

	Accelerated tax depreciation £m	Retirement benefits £m	Financial instruments £m	Other £m	Total £m
At 1 April 2014	102.1	(2.5)	(9.8)	(2.0)	87.8
Charge/(credit) to income	1.1	7.1	1.8	(2.2)	7.8
Credit to equity	-	(75.2)	(1.2)	-	(76.4)
At 31 March 2015	103.2	(70.6)	(9.2)	(4.2)	19.2
At 1 April 2015	103.2	(70.6)	(9.2)	(4.2)	19.2
(Credit)/charge to income	(7.9)	(2.5)	1.7	0.9	(7.8)
Charge to equity	-	58.0	1.1	-	59.1
At 31 March 2016	95.3	(15.1)	(6.4)	(3.3)	70.5

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

	2016 £m	2015 £m
Deferred tax liabilities	(95.3)	(103.2)
Deferred tax assets	24.8	84.0
	<u>(70.5)</u>	<u>(19.2)</u>

**24. Share capital**

	Authorised Number of shares	£m	Called up, allotted and fully paid Number of shares	£m
Ordinary shares of £1 each				
At 31 March 2016 and 31 March 2015	144,100,007	144.1	131,000,007	131.0
Ordinary A shares of 80 pence each				
At 31 March 2016 and 31 March 2015	54,272,594	43.4	12,048,193	9.6
		<u>187.5</u>		<u>140.6</u>

Each class of ordinary shares have the same voting rights and rights to dividends.

**Special share**

The authorised and issued share capital of NATS Holdings Limited includes one special rights redeemable preference share with a nominal value of £1. The share is redeemable at any time after the shareholding of the Crown falls below 25%. This share can only be held by a Minister of the Crown, the Treasury Solicitor or any other person acting on behalf of the Crown. The special shareholder is entitled to attend and speak at meetings. The special share does not carry any rights to vote at general meetings except in the following circumstances:

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

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

**25. Share premium account**

	£m
Balance as at 31 March 2016 and 31 March 2015	<u>0.4</u>

**26. Non-controlling interest**

The non-controlling interest (a 30% ownership interest in NATS Services LLC) recognised at the acquisition date was measured by reference to the fair value of the non-controlling interest and amounted to £0.1m (Omani rial 0.1m).

As at 31 March 2016, a loan to the non-controlling interest amounted to £0.1m (Omani rial 0.1m).



**27. Notes to the cash flow statement**

	2016 £m	2015 £m
Operating profit from continuing operations	69.1	226.6
Adjustments for:		
Impairment of goodwill	92.7	17.0
Depreciation of property, plant and equipment	94.8	79.3
Amortisation of intangible assets	33.2	30.2
Impairment losses	0.7	0.8
Deferred grants released	(0.7)	(0.8)
(Profit)/loss on disposal of property, plant and equipment	(7.1)	0.2
R&D above the line revenue adjustment	(1.8)	(0.8)
Adjustment for pension funding	12.4	(33.7)
Operating cash flows before movements in working capital	293.3	318.8
Decrease/(increase) in trade and other receivables	14.8	(17.2)
Increase in trade, other payables and provisions	64.0	16.9
Cash generated from operations	372.1	318.5
Tax paid	(30.4)	(34.7)
Net cash from operating activities	341.7	283.8

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

**28. Financial commitments**

	2016 £m	2015 £m
Amounts contracted but not provided for in the accounts	60.8	69.4
Minimum lease payments under operating leases recognised in the income statement	22.5	23.3

At the balance sheet date the group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2016 £m	2015 £m
Within one year	19.5	23.4
In the second to fifth years inclusive	35.1	49.7
After five years	57.3	25.7
	111.9	98.8

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

**Guarantees**

NATS Holdings Limited has given guarantees to the Ministry of Defence in relation to NERL's performance under its contract with the MOD.

As part of the tendering process for new contracts, the NATS group may be required to put in place a tender or bid guarantee which expires once the contract is awarded. Where tenders are successful, contractual terms may also require performance or advance payment guarantees. These guarantees vary in length depending on the life of the contract and may run until the expiry of the contract. The total guarantees provided in these respects at 31 March 2016 was £5.5m (2015: £4.9m).

## 29. Share based payments

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

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

Date of share awards	No. shares awarded to employees	No. employee shares outstanding at 31 March 2016	No. employee shares outstanding at 31 March 2015
<b>Free share awards</b>			
21 September 2001	3,353,742	347,558	376,757
20 October 2003	2,459,000	325,784	353,218
10 September 2004	1,966,000	500,611	546,818
11 January 2008	1,071,840	403,920	444,100
18 September 2009	963,200	465,655	527,371
<b>Partnership shares</b>			
1 March 2011	694,783	475,031	568,408
1 September 2012	714,959	597,969	628,257
30 May 2014	496,738	444,839	466,750
<b>Matching shares</b>			
1 March 2011	694,783	477,729	572,260
1 September 2012	714,959	598,369	628,257
30 May 2014	496,738	444,839	466,750
		5,082,304	5,578,946
Dividend shares issued on 28 June 2005	247,017	41,686	45,306
<b>Total employee shares in issue at 31 March</b>		<b>5,123,990</b>	<b>5,624,252</b>

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

	Movement in the no. of shares during the year ended 31 March 2016	Movement in the no. of shares during the year ended 31 March 2015
Balance at 1 April	5,624,252	5,427,477
Granted during the year	-	993,476
Forfeited during the year	(4,700)	(11,943)
Exercised during the year	(495,562)	(784,758)
<b>Balance at 31 March</b>	<b>5,123,990</b>	<b>5,624,252</b>

These shares are valued every six months by independent valuers using discounted cash flow and income multiple methods of valuation. As at 31 March 2016 the price of an employee share was valued at £4.20 (2015: £4.30). A valuation at 30 June 2015 valued the shares at £3.95. The liability on the balance sheet for the employee shares at 31 March 2016 was £21.1m (2015: £21.8m) included in other accruals and deferred income. The income statement includes income of £0.3m (2015: £nil). The payments made to employees for the shares they exercised during the year was £2.1m (2015: £3.4m).

## 30. Retirement benefit schemes

### Defined contribution scheme

The group provides a defined contribution scheme to all qualifying employees who are not members of the defined benefit scheme. The assets of the scheme are held separately from those of the group in funds under the control of a board of Trustees.

The group operates a salary sacrifice arrangement whereby employees sacrifice an element of their salary in favour of contributions to the pension scheme. NATS operates a number of contribution structures. In general, NATS matches employee contributions to the scheme in a ratio of 2:1, up to a maximum employer contribution of 18%. For the year ended 31 March 2016 employer contributions of £5.8m (2015: £5.0m), excluding employee salary sacrifice contributions of £2.9m (2015: £2.4m), represented 14.5% of pensionable pay (2015: 14.1%).

The defined contribution scheme had 825 members at 31 March 2016 (2015: 737).



**30. Retirement benefit schemes (continued)****Defined benefit scheme**

NATS Limited (formerly National Air Traffic Services Limited), the company's wholly-owned subsidiary, entered into a deed of adherence with the CAA and the Trustees of the Civil Aviation Authority Pension Scheme (CAAPS) whereby the company was admitted to participate in CAAPS from 1 April 1996. CAAPS is a fully funded defined benefit scheme providing benefits based on final pensionable salaries. At 31 March 2001, the business of NATS was separated from the CAA. As a consequence, NATS became a 'non associated employer' which requires the assets relating to the liabilities of NATS active employees at 31 March 2001 to be separately identified within the CAAPS. CAAPS was divided into two sections to accommodate this, namely the CAA section and the NATS section, and a series of common investment funds was established in which both sections participate for investment purposes. The assets and membership of the scheme prior to transfer were allocated between these sections in accordance with Statutory Instrument 2001 Number 853, Transport act 2000 (Civil Aviation Authority Pension Scheme) Order 2001. The assets of the scheme are held in a separate trustee administered fund. CAAPS is governed by a board of Trustees which is responsible for implementing the funding and investment strategy. The board comprises 6 employer (NATS and CAA) and 6 member-nominated trustees, as well as an independent chairman.

During 2009 the group introduced a number of reforms to manage the cost and risk of pensions. The defined benefit pension scheme was closed to new joiners with effect from 31 March 2009. In addition, from 1 January 2009, annual increases in pensionable salaries were limited to a maximum increase in the retail prices index (RPI) plus 0.5%. A defined contribution scheme was also introduced for new joiners (see above). Finally, pension salary sacrifice arrangements were introduced with effect from 1 April 2009.

During 2013 the group consulted on further pension reforms to mitigate rising pension costs. These included a change to the limit on annual increases in pensionable salaries to a maximum of the consumer prices index (CPI) plus 0.25%. In addition, the Trustees consulted members of the scheme on a change to the indexation of future service at CPI, rather than RPI. These reforms were agreed by staff.

The defined benefit scheme had the following membership at 31 March:

	2016 No.	2015 No.
Active members	3,324	3,477
Deferred members	1,189	1,157
Pensioners	2,413	2,308
	6,926	6,942

**Trustees' funding assessment**

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

The last Trustees' funding assessment of the NATS' section was carried out at 31 December 2012 and used the projected unit credit method. The assumptions which have the most significant effect on the result of the valuation are those relating to the rate of return on investments and the rates of increase in pensionable salaries and pensions. For the purpose of the Trustees' funding assessment, it was assumed that the annual investment returns before retirement will be 3.37% higher than the annual general increases in salaries (allowance is also made for further salary increases due to promotions) and the annual investment returns for pensions in payment will be 0.22% higher than the annual increases in pensions.

The market value of the NATS' section's assets as at 31 December 2012 was £3,527.5m. For the purpose of the Trustees' funding assessment assets were taken at market value. The shortfall of assets relative to the value of benefits that had accrued to existing members was £382.6m, corresponding to a funding ratio of 90.2%.

The 2012 valuation showed that, based on long term financial assumptions, the contribution rate required to meet future benefit accrual for RPI-linked benefits was 39.0% of pensionable salaries (33.3% employers and 5.7% employees) and for the CPI-linked benefits which accrue from 1 November 2013 was 34.4% of pensionable salaries (28.7% employers and 5.7% employees). In addition, NATS makes payments to the scheme to cover administration costs, including the Pension Protection Fund (PPF) levy, of 0.7% of pensionable salaries.

**Contributions to the pension scheme**

Following the 2012 valuation, NATS and the Trustees agreed a recovery plan which would see the funding deficit repaid by 2023. Under the schedule of contributions, normal contributions are paid at 36.7% of pensionable pay until 31 December 2014 and at 29.4% from 1 January 2015 to 31 December 2023. Deficit recovery contributions for the period 1 April 2013 until 31 December 2013 were made at £2.1m per month and at £2.2m per month for calendar year 2014 and £2.4m per month for calendar year 2015. These are being made at £2.4m per month for calendar year 2016 and increase by 2.37% annually thereafter.

During the year the group paid cash contributions to the scheme of £120.3m (2015: £138.7m). This amount included £14.7m (2015: £15.2m) of wages and salaries sacrificed by employees in return for pension contributions. Excluding the effect of salary sacrifice and past service costs, employer cash contributions were paid at a rate of 40.6% (2015: 45.0%) of pensionable pay.

The estimated contributions expected to be paid to the scheme during the financial year ending 31 March 2017 is £117.2m including salary sacrifice contributions estimated at £14.3m.

Contributions to the scheme are ultimately funded by NATS' two principal operating subsidiaries: NERL and NATS Services, in proportion to their pensionable payrolls.

**Company's accounting valuation under international accounting standards**

For the purpose of accounting for the scheme in these financial statements, the company obtains an updated valuation from a qualified independent actuary that is prepared in accordance with IAS 19: *Employee Benefits*.

This valuation differs from the Trustees' funding assessment explained above in a number of critical respects, including for example, differences in timing and frequency as well as in valuation assumptions. The Trustees' last funding assessment was prepared as at 31 December 2012, whereas the company's accounting valuation is prepared annually at 31 March. As a result, at each valuation date, the market conditions on which the assumptions are based will be different. Also, the assumptions adopted for the Trustees' funding assessment are set by the Trustees and include appropriate margins for prudence, whereas those adopted for the company's accounting valuation are prescribed by international accounting standards and reflect best estimates.

On transition to IFRS, NATS elected to adopt a 'clean start' approach which recognised all actuarial gains and losses at 1 April 2004, and NATS has reported under an immediate recognition approach in subsequent periods. If an accounting valuation reveals a surplus at the balance sheet date, this is recognised in full to the extent that it can be realised in full by the company.

**30. Retirement benefit schemes (continued)**

The Trustees' funding assessment was carried out as at 31 December 2012 and updated to 31 March 2016 for the company's accounting valuation under IAS 19 by a qualified actuary. The major assumptions used by the actuary for the purposes of the IAS 19 figures at the relevant year ends are set out in the table and narrative below:

	2016	2015	2014
RPI inflation	2.90%	2.95%	3.35%
CPI inflation	1.80%	1.85%	2.35%
Increase in:			
- salaries	1.80%	2.10%	2.60%
- deferred pensions	2.90%	2.95%	3.35%
- pensions in payment	2.90%	2.95%	3.35%
Discount rate for net interest expense	3.65%	3.35%	4.50%

The mortality assumptions have been drawn from actuarial tables 101% S1PMA light and 99% S1PFA light with future improvements in line with CMI 2011 projections for male/female members, subject to a long term improvement of 1.5% p.a. This is unchanged from 2015. These tables assume that the life expectancy, from age 60, for a male pensioner is 29.5 years and a female pensioner is 31.1 years. Allowance is made for future improvements in longevity, such that based on the average age of the current membership (45), when these members reach retirement, life expectancy from age 60 will have increased for males to 31.2 years and for females to 32.9 years.

The principal risks to the financial performance of the company arising from the scheme are in respect of:

- asset volatility: for accounting purposes, scheme liabilities are determined using a discount rate set by reference to high quality corporate bond yields. If scheme assets under-perform relative to this yield, this will create a deficit. As explained below, NATS and Trustees are reviewing measures to de-risk the scheme by investing more in assets which better match the liabilities.
- changes in bond yields: a decrease in the yield on high quality corporate bonds will increase scheme obligations, although this is partly mitigated by an increase in the value of the scheme's holdings of bonds.
- inflation risk: the scheme's benefit obligations are linked to inflation, and higher inflation will lead to higher liabilities. The majority of the scheme's assets (such as equities) are real in nature and so provide some inflation protection, but overall, an increase in inflation will adversely impact on the funding position.
- life expectancy (mortality): the majority of the scheme's obligations are to provide benefits for the life of a member, so an increase in life expectancy will result in an increase in the scheme's obligations.

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

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate (bond yields)	Increase/decrease by 0.5%	Decrease by 10.9%/increase by 12.8%
Rate of inflation	Increase/decrease by 0.5%	Increase by 12.6%/decrease by 10.9%
Rate of salary growth	Increase/decrease by 0.5%	Increase by 3.6%/decrease by 3.4%
Rate of mortality	1 year increase in life expectancy	Increase by 2.6%

Each sensitivity above is based on changing one assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to variations in significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at the end of the reporting period) has been applied as for calculating the liability recognised on the balance sheet.

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

	2016 £m	2015 £m
Current service cost	(120.1)	(103.5)
Past service cost	(0.8)	(2.2)
Net interest expense	(9.8)	2.6
Administrative expenses	(2.0)	(1.9)
Components of defined benefit costs recognised within operating profit	<u>(132.7)</u>	<u>(105.0)</u>

Remeasurements recorded in the statement of comprehensive income are as follows:

	2016 £m	2015 £m
Return on plan assets (excluding amounts included in net interest expense)	(140.1)	308.3
Actuarial gains and losses arising from changes in financial assumptions	425.7	(751.5)
Actuarial gains and losses arising from changes in demographic assumptions	-	-
Actuarial gains and losses arising from experience adjustments	2.4	68.8
	<u>288.0</u>	<u>(374.4)</u>

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

	2016 £m	2015 £m
Present value of defined benefit obligations	(4,760.0)	(5,050.2)
Fair value of scheme assets	<u>4,682.6</u>	<u>4,697.2</u>
Deficit in scheme	<u>(77.4)</u>	<u>(353.0)</u>



**30. Retirement benefit schemes (continued)**

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

	2016 £m	2015 £m
At 1 April	(5,050.2)	(4,178.7)
Current service cost	(120.1)	(103.5)
Past service cost	(0.8)	(2.2)
Interest expense on defined benefit scheme obligations	(166.7)	(185.7)
Actuarial gains and losses arising from changes in financial assumptions	425.7	(751.5)
Actuarial gains and losses arising from changes in demographic assumptions	-	-
Actuarial gains and losses arising from experience adjustments	2.4	68.8
Contributions from scheme members	(0.1)	(0.1)
Benefits paid	149.8	102.7
At 31 March	<u>(4,760.0)</u>	<u>(5,050.2)</u>

The average duration of the scheme's liabilities at the end of the year is 23.6 years (2015: 24.0 years). The present value of the defined benefit obligation can be analysed by member group as follows:

	2016 £m	2015 £m
Active members	2,517.2	2,794.2
Deferred members	429.5	442.9
Pensioners	1,813.3	1,813.1
	<u>4,760.0</u>	<u>5,050.2</u>

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

	2016 £m	2015 £m
At 1 April	4,697.2	4,166.4
Interest income on scheme assets	156.9	188.3
Return on plan assets (excluding amounts included in net interest expense)	(140.1)	308.3
Contributions from scheme members	0.1	0.1
Contributions from sponsoring company	120.3	138.7
Benefits paid	(149.8)	(102.7)
Administrative expenses	(2.0)	(1.9)
At 31 March	<u>4,682.6</u>	<u>4,697.2</u>

The major categories of scheme assets were as follows:

	2016 £m	2015 £m
Cash and cash equivalents	61.3	95.4
Equity instruments		
- UK	342.9	334.8
- Europe	96.1	97.0
- North America	281.4	285.5
- Japan	39.2	41.6
- Pacific (excluding Japan)	115.8	111.7
- Emerging markets	367.3	332.1
- Global	669.1	683.8
	<u>1,911.8</u>	<u>1,886.5</u>
Bonds		
- Corporate bonds	895.2	913.3
- Index-linked gilts over 5 years	1,161.4	1,154.7
	<u>2,056.6</u>	<u>2,068.0</u>
Other investments		
- Property	255.0	258.8
- Hedge funds	206.1	207.8
- Global tactical asset allocation	117.7	118.5
- Private equity funds	136.2	142.9
	<u>715.0</u>	<u>728.0</u>
Derivatives		
- Futures contracts	(62.1)	(80.7)
	<u>4,682.6</u>	<u>4,697.2</u>

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

### 30. Retirement benefit schemes (continued)

Virtually all equity and debt instruments have quoted prices in active markets. Investments are well diversified, such that the failure of any single investment would not have a material impact on the overall level of assets. A large portion of the assets consist of equities and bonds, although the scheme also invests in property, cash and investment (private equity and hedge) funds.

NATS and Trustees implemented a liability driven investment (LDI) programme in 2012 in order to hedge the impact of changes in inflation and interest rates on the value of the scheme's obligations, which are sensitive to inflation and movements in yields in the gilt market. The strategy includes establishing trigger levels which define the rates of interest and inflation rates at which hedging transactions will be executed. In addition, and as an acceleration of the existing strategy, NATS and Trustees agreed during 2014 to increase the level of hedging of interest rates and inflation to 50%, as measured on the Trustee funding basis. Swap transactions are executed with carefully scrutinised banks and collateral is provided in the form of index-linked gilts to protect against the unlikely event of default by a counterparty bank.

At NATS' request, Trustees have also considered further de-risking over time to protect the scheme from the impact of volatility in the value of return-seeking assets. This would involve progressively converting from return-seeking assets into hedging assets to increase the level of matching of the scheme's liabilities. As changing the mix of assets changes the returns achieved, this would impact on contributions payable. Before changing this strategy, NATS and Trustees are likely to consult with CAA on the implications for customers. The strategy will aim to maintain an appropriate balance between the potential impact on contributions and the reduction in volatility of return-seeking assets, and therefore reduced investment risk.

Derivative instruments are used by investment managers to reduce risk or gain exposure to investment classes without the requirement to hold the underlying investment. Trustees monitor derivative positions to ensure that, when combined with the underlying physical position, the aggregate falls within specified investment guidelines.

The actual return on scheme assets for the year ended 31 March 2016 was £16.8m (2015: £496.6m).

### 31. Related party transactions

The NATS group has four shareholders - the Crown, The Airline Group Limited (AG), LHR Airports Limited and the NATS Employee Sharetrust Limited. During the year transactions with the Crown have taken place with the Meteorological Office, the Department for Transport (DfT) and the Ministry of Defence (MOD). In addition there have been transactions with LHR Airports Limited and AG.

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

Contractual arrangements existed during the year between LHR Airports Limited and NATS Services in relation to air navigation services provided at Heathrow Airport. Aberdeen, Glasgow and Southampton airports were sold by LHR Airports Limited to AGS Airports Limited in December 2014.

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

#### Trading transactions

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

	Sales		Purchases		Amounts owed by related parties		Amounts owed to related parties	
	Year ended 31 March 2016	Year ended 31 March 2015	Year ended 31 March 2016	Year ended 31 March 2015	Year ended 31 March 2016	Year ended 31 March 2015	Year ended 31 March 2016	Year ended 31 March 2015
	£m	£m	£m	£m	£m	£m	£m	£m
LHR Airports Limited	56.0	80.2	7.9	8.1	4.7	6.0	-	-
Ministry of Defence (MOD)	49.3	51.0	3.7	4.1	5.4	5.9	36.2	29.7
The Airline Group Limited	-	-	0.2	0.2	-	-	-	-
Department for Transport (DfT)	0.6	0.6	-	-	-	-	-	-
Meteorological Office	0.3	0.3	0.7	0.6	-	-	0.1	0.1

Sales are made to related parties at the group's usual rates and purchases at market prices. The amounts outstanding are unsecured and will be settled in cash. No guarantees have been received. No provisions (2015: £nil) have been made for doubtful debts in respect of amounts owed by related parties.

#### Remuneration of key management personnel

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

	2016 £m	2015 £m
Short term employee benefits	6.2	6.6
Post-employment benefits	1.6	1.5
Other long term benefits	0.1	0.7
Termination benefits	0.7	-
	<u>8.6</u>	<u>8.8</u>



### 32. Subsidiaries, joint ventures and associates

The group's principal subsidiaries at 31 March 2016, all of which have been consolidated in these accounts were:

Name of company	Principal activity	Proportion of ordinary shares held	Proportion of voting rights held	Country of registration	Country of operation
NATS Limited*	Corporate services	100%	100%	England and Wales	United Kingdom
NATS (En Route) plc	En route air traffic services	100%	100%	England and Wales	United Kingdom
NATS (Services) Limited	Airport air traffic services	100%	100%	England and Wales	United Kingdom
NATS Solutions Limited	Airport air traffic services	100%	100%	England and Wales	United Kingdom
NATNav Limited	Satellite based navigation	100%	100%	England and Wales	United Kingdom
NATS Employee Sharetrust Limited	Corporate trustee of employee share plan	100%	100%	England and Wales	United Kingdom
NATS Services DMCC	ATM consultancy	100%	100%	UAE	UAE
NATS Services LLC	Air Traffic Management Consultancy	70%	70%	Oman	Oman
NATS Services (Asia Pacific) Pte. Limited	Airport air traffic related services	100%	100%	Singapore	Singapore
NATS (USA) Inc	Engineering and ATM consultancy	100%	100%	USA	USA
NATS Sverige AB	Airport air traffic services	100%	100%	Sweden	Sweden

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

The group had one associate and two joint ventures as at 31 March 2016, details are as follows:

Name of company	Principal activity	Date of acquisition	Proportion of ordinary shares held	Country of incorporation
European Satellite Services Provider SAS	Satellite based navigation	1 September 2008	16.67%	France
FerroNATS Air Traffic Services SA	Airport air traffic services	28 January 2011	50.00%	Spain
Aquila Air Traffic Management Services Limited	Air traffic management services	9 October 2014	50.00%	United Kingdom

#### Summarised financial information relating to the associate and joint ventures

##### European Satellite Services Provider SAS (ESSP)

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

The associate is accounted for using the equity method. Pursuant to the shareholder agreement, the group has the right to cast 16.67% of the votes at shareholder meetings. The financial year end is 31 December 2015. For the purposes of applying the equity method of accounting, the financial statements of ESSP for the year ended 31 December 2015 have been used (no adjustments are required to be made for the effects of significant transactions between that date and 31 March 2016).

Although the group holds less than 20% of the equity shares of ESSP, the group exercises significant influence by virtue of representation on the Board of directors, participation in policy making decisions of ESSP and the provision of essential technical information to ESSP.

Summarised financial information in respect of ESSP is set out below. These amounts have been prepared in accordance with French GAAP and converted from Euro, ESSP's functional currency.

##### FerroNATS Air Traffic Services SA

In January 2011, the group acquired 50% of the issued share capital of FerroNATS Air Traffic Services SA for a cash consideration of €0.1m (£0.1m). In June 2011 the group purchased an additional €0.4m (£0.3m) of share capital, maintaining a 50% holding of the issued share capital. FerroNATS is a joint venture with Ferrovial Servicios SA.

FerroNATS draws up its accounts as at 31 December. For the purpose of these financial statements management accounts have been used to derive its performance as at 31 March 2016.

During the year FerroNATS repaid loan finance of €0.6m (£0.4m) to the group (2015: €0.2m (£0.1m)). At 31 March 2016, the loan outstanding was €0.1m (£0.1m).

FerroNATS prepares its accounts in accordance with Spanish GAAP and its functional currency is the Euro.

##### Aquila Air Traffic Management Services Limited

In October 2014, the group acquired 50% of the issued share capital of Aquila Air Traffic Management Services Limited (Aquila) for a cash consideration of £0.1m. Aquila provides air traffic management services at military airfields in the delivery of Project Marshall for the Ministry of Defence. Aquila draws up its accounts to 31 March and therefore these accounts have been used to determine its performance for the financial year. It prepares its accounts under IFRS and its functional currency is pounds sterling.

During the year, Aquila drew down loan finance of £3.7m (2015: £nil) from the group.

**32. Subsidiaries, joint ventures and associates (continued)**

The summarised financial information above is reconciled to the carrying amount recognised in the consolidated financial statements as follows:

	2016			2015		
	Associate ESSP £m	Joint venture FerroNATS £m	Joint venture Aquila £m	Associate ESSP £m	Joint venture FerroNATS £m	Joint venture Aquila £m
Non-current assets	0.7	0.4	0.3	0.4	0.8	19.3
Current assets	24.3	5.5	28.1	27.1	4.1	-
Current liabilities	(15.7)	(2.6)	(24.0)	(21.3)	(2.2)	(18.8)
Non-current liabilities	(1.9)	-	(2.9)	(1.0)	(0.7)	-
Net assets of associate/joint venture	7.4	3.3	1.5	5.2	2.0	0.5
Group share	1.2	1.7	0.7	0.9	1.0	0.2
Revenue	47.7	9.7	74.4	49.7	10.4	28.0
Profit after tax for the year	2.7	1.1	0.9	2.1	0.9	0.3
Group share	0.4	0.6	0.5	0.4	0.5	0.1
Dividends received	(0.2)	-	-	(0.2)	-	-
Other comprehensive income/(loss)	0.1	0.1	-	(0.2)	(0.1)	-

**33. Ultimate controlling party**

There is no ultimate controlling party of NATS Holdings Limited. Under the shareholders' agreement, The Airline Group Limited and the Crown have similar reserve rights in respect of material decisions affecting the company.

**34. Events after the reporting period**

In May 2016, the Board approved and the company paid an interim dividend for the year ending 31 March 2017 of 16.78 pence per share, totalling £24.0m.



**Balance sheet**  
at 31 March

	Notes	2016 £m	2015 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Investments	4	141.0	141.0
<b>Net assets</b>		<b>141.0</b>	<b>141.0</b>
<b>Equity</b>			
Share capital	5	140.6	140.6
Share premium account	5	0.4	0.4
Retained earnings		-	-
<b>Total equity</b>		<b>141.0</b>	<b>141.0</b>

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

The financial statements (Company No. 04138218) were approved by the Board of directors and authorised for issue on 20 June 2016 and signed on its behalf by:

Paul Golby  
Chairman




Nigel Fotherby  
Finance Director

**Statement of changes in equity**  
at 31 March

	Share capital £m	Share premium £m	Retained earnings £m	Total £m
<b>At 1 April 2014</b>	140.6	0.4	-	141.0
Profit for the year	-	-	77.0	77.0
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	77.0	77.0
Dividends paid	-	-	(77.0)	(77.0)
<b>At 31 March 2015</b>	<b>140.6</b>	<b>0.4</b>	<b>-</b>	<b>141.0</b>
<b>At 1 April 2015</b>	140.6	0.4	-	141.0
Profit for the year	-	-	81.7	81.7
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	81.7	81.7
Dividends paid	-	-	(81.7)	(81.7)
<b>At 31 March 2016</b>	<b>140.6</b>	<b>0.4</b>	<b>-</b>	<b>141.0</b>



## Notes to the financial statements

### 1. Cash flow statement

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

### 2. Significant accounting policies

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

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

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

### 3. Profit for the year and dividends

Profit for the year has been arrived at after charging:

	2016 £m	2015 £m
Staff costs	-	-
Auditor's remuneration	-	-
	<u>          </u>	<u>          </u>
	2016 No.	2015 No.
Executive directors	2	2
Non-executive directors	11	11
	<u>          </u>	<u>          </u>
	13	13

The company incurred no charge to current or deferred taxes in the year (2015: £nil).

Dividends:	2016 £m	2015 £m
Amounts recognised as distributions to equity holders in the period:		
First interim dividend of 38.03 pence per share (2015: 35.65 pence per share) paid in June 2015	54.4	51.0
Second interim dividend of 19.08 pence per share (2015: 18.18 pence per share) paid in November 2015	27.3	26.0
	<u>          </u>	<u>          </u>
	81.7	77.0

### 4. Investments

	Investments in subsidiary undertakings  £m
Investments at 31 March 2016 and 31 March 2015	<u>          </u> 141.0

The company's investments in subsidiary undertakings are as set out in note 32 to the consolidated financial statements.

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

### 5. Share capital and share premium accounts

The movements on these items are disclosed in the consolidated statement of changes in equity and notes 24 and 25 of the consolidated financial statements.

### 6. Financial instruments

The company held no financial instruments at 31 March 2016 (2015: none).

### 7. Ultimate controlling party

There is no ultimate controlling party of NATS Holdings Limited. Under the shareholders' agreement, The Airline Group Limited and the Crown have similar reserve rights in respect of material decisions affecting the company.

### 8. Events after the reporting period

In May 2016, the Board approved and the company paid an interim dividend for the year ending 31 March 2017 of 16.78 pence per share, totalling £24.0m. The company recognised a dividend in May 2016 of £24.0m from its subsidiary, NATS Limited.

## Abbreviations and definitions

2015	Financial year ended 31 March 2015
2016	Financial year ended 31 March 2016
3Di	3 Dimensional Flight Efficiency Metric
AESOP	All-Employee Share Ownership Plan
AG	The Airline Group Limited
ANSP	Air Navigation Service Provider
AQUILA	Aquila Air Traffic Management Services Limited
ATC	Air Traffic Control
ATFM	Air Traffic Flow Management
ATM	Air Traffic Management
CAA	Civil Aviation Authority
CAAPS	Civil Aviation Authority Pension Scheme
CDO	Continuous Descent Operations
CEO	Chief Executive Officer
CP3	Control Period 3 (2011-2014)
CPI	Consumer Prices Index
DRA	Direct Route Airspace
EC	European Commission
ESSP	European Satellite Services Provider SAS
EU	European Union
FAB	Functional Airspace Block
FAS	Future Airspace Strategy
FerroNATS	FerroNATS Air Traffic Services SA
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IATA	International Air Transport Association
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
ISO	International Organisation for Standardisation
KPI	Key Performance Indicator
LAMP	London Airspace Management Programme
LHRA	LHR Airports Limited
LIBOR	London Interbank Offered Rate
LTIP	Long Term Incentive Plan
MOD	Ministry of Defence
NATS	NATS Holdings Limited and its subsidiaries, together the NATS group
NERL	NATS (En Route) plc
NESL	NATS Employee Sharetrust Limited
NHL	NATS Holdings Limited
OPA	Operational Partnership Agreement
PPP	Public Private Partnership
RAB	Regulatory Asset Base
RP1	Reference Period 1 (2012-2014)
RP2	Reference Period 2 (2015-2019)
RP3	Reference Period 3 (2020-2024)
RPI	Retail Prices Index
SDM	SESAR Deployment Manager
SES	Single European Sky
SESAR	SES ATM Research
SPA	Strategic Partnership Agreement
SSE	Safety Significant Event
TANS	Terminal Air Navigation Services
TBS	Time-Based Separation
USS	USS Sherwood Limited



## Explanatory notes

- 1 From 1 July 2016.
- 2 Project Marshall is a 22 year contract to transform the military's terminal Air Traffic Control technical services. It was initiated by the MOD to modernise ATM for over 100 MOD locations, of which over 60 are airfields or ranges, including overseas. It provides the foundation to deliver efficient and cost effective terminal ATM services and ensures that this capability keeps pace with modern regulatory demands and Single European Sky standards.
- 3 Single European Sky ATM Research: a programme to modernise Europe's airspace structure and air traffic management technologies.
- 4 interoperability Through European Collaboration.
- 5 An Airprox is a situation in which, in the opinion of a pilot or controller, the distance between aircraft as well as their relative positions and speeds have been such that the safety of the aircraft involved was or may have been compromised. The severity of these incidents is assessed periodically by the UK Airprox Board, an independent body, in the interests of enhancing flight safety.
- 6 ATFM or air traffic flow management delay represents the delay between the last take-off time requested by an airline and the take-off slot which is allocated when an air navigation service provider (ANSP) applies a flow restriction. Delay which is directly attributable to an ANSP includes staffing, capacity and systems-related delay. Delay which is not directly attributable to an ANSP, includes weather at airports and en route, and delay attributed to airport infrastructure. NATS determines its delay based on those factors which are directly attributable to its activities (i.e. staffing, capacity and systems-related) and has compared its performance with the equivalent European value.
- 7 London Airspace Management Programme.
- 8 The severity of ground and airborne incidents is scored against six criteria: minimum separation achieved; rate of closure; detection of potential conflict; plan to achieve required separation; execution of the plan; and recovery when separation is lost.
- 9 Impact score is a measure of delay placing greater weight on long delays and departures in the morning and the evening peaks.
- 10 Variability score is a daily excess delay score based on weighted delays exceeding pre-determined thresholds on a daily basis.
- 11 3Di scores and targets were re-calibrated for RP2 to reflect improvements in accuracy. For this reason 3Di scores are expected to be c.7 points higher in RP2 than RP1 (see Airspace service line performance summary).
- 12 Training to promote an atmosphere of trust where front line staff feel encouraged to provide essential safety-related information and with clear lines drawn between acceptable and unacceptable behaviour.
- 13 An aircraft deviation of 300 feet or more from its assigned level.
- 14 London Terminal Manoeuvring Area: the designated area of controlled airspace surrounding London airports and which forms part of the London Airspace Management Programme (LAMP).
- 15 The transition altitude is a published height above sea level at which pilots climbing to their cruising level change their barometric altimeter from the regional pressure setting to a common international standard setting.
- 16 Chargeable service units are the billing unit for recovering UK en route revenue allowances and a function of aircraft weight and distance flown.
- 17 STATFOR is the EUROCONTROL Statistics and Forecast Service.
- 18 Using an average fuel price of £315 per tonne for the financial year ended 31 March 2016.

