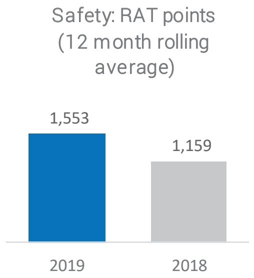
Highlights

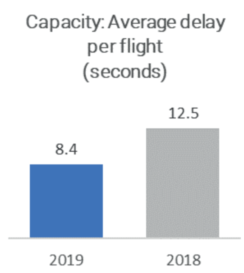
Financial highlights (year ended 31 March)

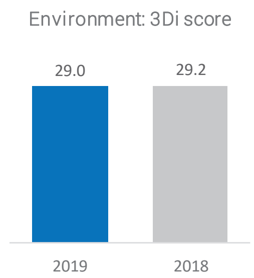
£m (unless specified)	2020	2019	Change (%)
Revenue	892.1	885.7	+0.7%
Profit before tax[a]	25.3	98.2	-74.2%
Capital expenditure	158.5	156.5	+1.3%
Net debt[b]	170.7	73.9	+131.0%
Gearing[c] (%)	29.0%	25.7%	+12.8%
Dividends	59.0	59.0	no change

[a] Profit before tax for the year ended 31 March 2020 is after a goodwill impairment charge of £49.0m (2019: nil)
[b] Excludes derivative financial instruments
[c] Ratio of NERL's net debt (as defined by its licence) to regulatory assets

Operational highlights







Note: the operational metrics shown above are measured on a calendar year basis for regulatory purposes.

- We handled 2.48m flights (2019: 2.54m) in the financial year. There was a steep reduction in March 2020 as governments sought to control the outbreak of Covid-19.
- One risk-bearing airprox[1] was attributed to our operation during the financial year (2019 restated: one).
- Our North Atlantic en route service began using space-based surveillance, with the aim of improving safety, flight efficiency and reducing emissions.
- We rejected the Civil Aviation Authority's (CAA) price control for Reference Period 3 (RP3: 2020-2024) leading to a referral to the Competition and Markets Authority (CMA). CMA's findings upheld key elements of our referral while sustaining other aspects of the CAA's proposals. However, many of their findings have been overtaken by the impacts of Covid-19 on the sector. The CAA will need to redetermine the price control by the start of 2023.
- In conjunction with the CAA and the Department for Transport, we established the Airspace Change Organising Group (ACOG) to coordinate essential airspace modernisation in RP3 across the industry.
- The MOD renewed its military area radar contract to 2030 and the Aberdeen Glasgow and Southampton airports group extended its ATC contract to 2029.
- Our response to Covid-19 was to protect staff and continue to ensure a safe operation while controlling our expenditure and managing our liquidity and, in August 2020, we secured an additional £380m bank facility.

[1] A number of explanatory notes are provided on page 148 of this report. Abbreviations used in this report are provided on page 147.

Contents

Who we are

NATS provides Air Traffic Control (ATC) services to aircraft flying in airspace over the UK and the eastern part of the North Atlantic, and at 13 UK airports. It also provides other ATC and related services to customers in the UK and overseas. Further information is provided in the description of our business model.

Our purpose

Advancing aviation, keeping the skies safe.

Our objectives

- Deliver a safe, efficient and reliable service every day.
- Deliver SESAR[2] and transform the business for the future.
- Win and retain commercial business.

Our values

- We are safe in everything we do.
- We rise to the challenge.
- We work together.

Our business model

We generate income from ATC and related services mainly conducted through NERL and NATS Services.

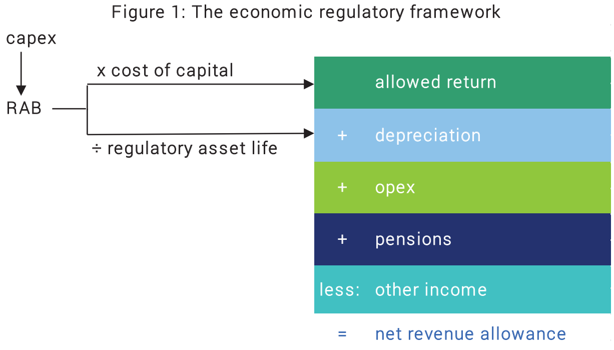
NERL

NERL is our core business and is the sole provider of ATC services for aircraft flying en route in UK airspace and the eastern part of the North Atlantic. It operates under a licence granted under the Transport Act 2000 and is economically regulated by the CAA and, until January 2021, the EC's Single European Sky (SES).

Under the regulatory framework, the CAA establishes revenue allowances for a price control period which remunerate 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. For Reference Period 2 (2015-2019), the CAA set the cost of capital at 5.9% (pre-tax real).

The RAB represents the value ascribed to the capital employed in the regulated businesses. Income from other 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 price

Figure 1: The economic regulatory framework



control period. This model is illustrated in Figure 1.

The CAA's price control also sets targets, and provides incentives, for service, environmental performance, capital investment and gearing levels.

If regulatory assumptions are borne out and NERL efficiently meets its targets then NERL would earn a return at the cost of capital. It can out-perform if it is more cost efficient than the CAA's assumptions, finances at lower cost, if traffic volumes (after risk sharing - see below) are higher than forecast or if it beats service targets. NERL would earn lower returns if the opposite applied.

Regulatory mechanisms mitigate the impact of variations in traffic volumes, inflation and pension contributions from the level assumed and result in adjustments to charges in future periods.

NATS Services

NATS Services operates in contestable markets and services UK and international customers. It earns c94% of its revenue in the UK and c73% from UK Airports.

The UK Airports service provides ATC to 13 major UK airports as well as engineering support and airport optimisation services. The company's strategy is to win and retain UK ATC service or engineering support contracts by developing price competitive and innovative solutions.

NSL provides ATC and related engineering services to the UK MOD mainly through the Project Marshall contract that is delivered in partnership with Thales by our Aquila joint venture. Other UK Business includes aeronautical information management, design and data services, consultancy and ATC training to airlines and airspace users.

Our International activities focus on providing the same range of services to the Asia Pacific and Middle East markets and is also targeted to specific international airports and ANSPs.

Our investments include: FerroNATS, which provides ATC services to airports in Spain; Searidge Technologies, a Canadian provider of digital tower technology; and a minority interest in Aireon which provides space-based air traffic surveillance.

Chairman's statement

Covid-19

From late February 2020 it became clear that Covid-19 would have a very significant impact on commercial airlines and airport operators on which we depend for the majority of our income. The company has endured several demand shocks over the years: the 9/11 terrorist attacks; volcanic ash; the global financial crisis and Gulf wars, but none has posed such a significant threat and level of uncertainty to its business model. While the regulatory framework largely protects our revenue, the reduction in profit for the year to £25.3m (2019: £98.2m) in large part reflected our assessment of the likely impact of Covid-19 on the value of our assets and investments, and is explained in the Financial review.

Since the outbreak the Board's primary focus has been to both challenge and support the Executive management in responding rapidly to protect the company's staff, ensuring a continued safe operation, and securing additional funding to meet the immediate shortfall in cash receipts from reduced air travel and agreement by Eurocontrol to allow airlines an extended period to settle their earlier ATC charges. The latter was partially mitigated by funding advances Eurocontrol put in place to make some payment to air navigation service providers (ANSPs). The actions we took, which are explained later in this report, should ensure that the company is well placed financially and operationally to respond to and support a recovery in air traffic demand.

While the timing, rate and extent of that recovery remains uncertain, the Board is confident that the regulatory framework underpinned by government obligations within the Transport Act 2000 will continue to ensure that the company is able to finance its licensed activities. This confidence is reinforced by the support shown by our lenders in agreeing a new £380m bank facility in August 2020.

Reference Period 3 (2020-2024)

There have been a number of other key events which have influenced the Board agenda during the year, the most significant of which was the proposed regulatory settlement for RP3.

In 2018 we put forward to the CAA a business plan for RP3 which we believed met customer priorities for safety, service, technology change and airspace modernisation.

However, the CAA's decision on the national performance plan for RP3 did not in our view provide for the necessary resources or overall balance of risk for us to deliver the service and essential airspace transformation required by our customers and the travelling public. The Board rejected the CAA's decision leading to a referral to the CMA. The CMA's findings upheld key elements of the company's referral, while sustaining other aspects of the CAA's proposals, although many of their findings have now been overtaken by the impact of Covid-19.

The practical effect of this is that the CMA's final determination is for a three-year settlement for 2020 to 2022, whereby NERL's charges will be set initially as if Covid-19 had not occurred but with the CAA taking a view subsequently as part of an RP3 reset on the appropriate recovery of revenue allowances. This provides both NERL and its customers with certainty until the impact on the industry and its recovery can be better understood.

The CAA intends to reset NERL's RP3 price control before the end of 2022. This will clearly have to reflect changes in stakeholder priorities following Covid-19 including essential airspace modernisation which can only be delivered as a collaboration of ACOG, NATS, airlines, airports, the regulator and the UK government – many of which may have fundamentally different priorities as a result of the impact of Covid-19 on their activities.

Safety performance

Safety is always the Board's highest priority. During the financial year, the UK Airprox Board attributed two risk-bearing airprox events to NATS, one of which occurred in the 2018/19 financial year. These incidents are extremely rare and, as one would expect, a structured and thorough investigation process has been undertaken to identify causal factors and implement recommendations, reviewed by the Board and its Safety Review Committee. The Board also considered NATS' safety performance generally, its safety culture and emerging risks from new classes of airspace user, such as drones and commercial space operations.

Brexit

The UK Government has confirmed that the UK will no longer participate in the EC's Single European Sky or European Aviation Safety Agency (EASA) after the transition period ends in December 2020. This means that economic and safety regulatory decisions will be taken by the CAA in the future, including the revised price control for RP3. In practice we expect close European and global alignment and cooperation in aviation safety and air traffic management to continue. We are also planning on the basis that measures put forward by the UK and the EU will ensure that flights can continue in any Brexit scenario.

Dividends

The Board considers dividends in May and November each year and in the last financial year paid £59.0m (2019: £59.0m). The Board will not be paying a dividend while the new bank facility, which expires in July 2022, remains in place.

Governance, Board and employees

This year the Board adopted the new Corporate Governance Code which places greater emphasis on the relationship between the company, shareholders and stakeholders. Our stakeholders are very important to us and we remain committed to maintaining regular open dialogue and effective communication with them. On page 28 we set out our key stakeholders and how we have engaged with them to ensure that their views are being listened to by the Board.

During the year, our discussions around RP3 and the response to Covid-19 are examples of how the Board has had regard to section 172 of the Companies Act 2006. In these discussions we considered the broader implications of our decisions, not just for shareholders but for our employees and a wider group of stakeholders, together with the likely consequences of our decisions in the longer term.

Alistair Borthwick joined the company as Chief Financial Officer in August 2019 from energy business SSE, following Nigel Fotherby's retirement. Alistair was appointed to the Board in October 2019 and has been leading the company's financial response to Covid-19.

It has been a particularly challenging period for our employees and on behalf of the Board I would like to express my deepest thanks to all of them for their dedication and commitment.

Dr Paul Golby, CBE FREng
Chairman

Chief Executive's review

Covid-19

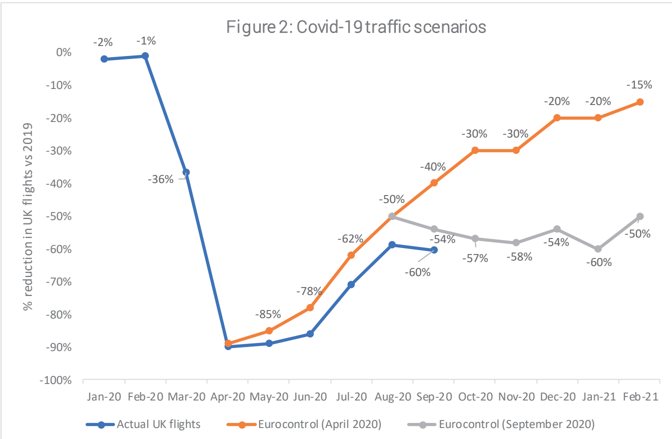
Covid-19 is presenting an unprecedented challenge to the aviation sector, in terms of its impact on the demand for air travel and the level of uncertainty of its recovery. As provider of the essential ATC service our role throughout this crisis has been to continue to provide customers and the public with the safe and resilient service they expect and to ensure that we are well placed to facilitate the recovery.

The UK's aviation sector was most affected from early March onwards as governments introduced measures to contain the virus and by the end of the month UK flight volumes fell to around 10% of the previous year and remained at this level through April and May 2020 (see Figure 2).

As it became apparent that the UK would be significantly affected by the virus, we took rapid action on three priorities: 1) protecting the health, safety and wellbeing of our workforce (see below) while maintaining a safe and resilient air traffic control service for our airline and airport customers; 2) preserving our liquidity in the face of a loss of income to ensure the viability of our business for all stakeholders; and 3) securing a revised regulatory settlement for RP3 which provides a balanced plan for dealing with a post Covid-19 operating environment.

In the Financial review we explain in more detail the liquidity challenge, our response, and the £380m of new funding which provides us with headroom to deal with a more prolonged period of recovery. One important consideration in conserving liquidity was our capital investment programme. From the commencement of lockdown in the UK, we reduced the number of contractors utilised, reprioritised work and redeployed our own employees. However, as the impact of Covid-19 on the industry became more apparent we suspended all capital investment for a six-month period, with the exception of critical sustainment activities. While our customers' focus is currently on managing the financial impact on their businesses, airspace modernisation (see Business review) remains a priority for them as it will make airspace more efficient and resilient and improve their environmental performance. It is important therefore, that we take some time now to reshape our capital programme for the future so that we can take advantage of lower traffic to make the airspace and technology changes that will deliver the benefits our customers need. Our hope is that we can still deliver some changes to our technology and airspace before significant traffic volumes return. Of course, we cannot predict the pace of recovery, and therefore we need to be agile as to when we resume the programmes to take advantage of the lower traffic.

Outlook for recovery in traffic



Projections for the aviation industry's recovery from Covid-19 vary widely but there is general agreement that its timing and extent depends on the containment of the health crisis, the loosening of travel restrictions and border closures and the restoration of passenger confidence to resume flying.

While it remains difficult to predict the rate of recovery in air traffic volumes, we do not anticipate a recovery to somewhere close to 2019 levels until 2023 at the earliest. There is no single industry view of the path to recovery and with Covid-19 still prevalent the outlook remains uncertain. Eurocontrol, Europe's network manager, has recently updated its near-term scenario (see Figure 2) which assumes a coordinated response between European governments and institutions. The most recent scenario suggests air traffic volumes will stabilise at around 60% below 2019 levels this winter. We developed our own internal scenario for planning our finances and managing liquidity which is somewhat more pessimistic.

In September 2020 UK flight volumes appeared to level off at around 60% below September 2019 levels, which was slightly better than our internal scenario. Airlines will soon publish their winter schedules which will be indicative of the level of passenger demand and the trajectory of the recovery in flight volumes in the short term. We anticipate that traffic volumes will remain flat through the winter period.

We are closely engaged with the Department for Transport and the CAA to support the safe, coordinated recovery of operations as traffic begins to increase.

Our workforce

I am immensely grateful to, and proud of, our people who have maintained the UK's essential ATC service during the pandemic. I cannot think of a better example of how our people embody the company's values. Our overriding priority from the start of the Covid-19 outbreak was the health and safety of the group's workforce. At the outset we took protective measures to ensure operational staff attending our centres and airports could operate under social distancing rules and to provide resilience to the service. We closed our training and simulations capability and stopped all but essential onsite maintenance. We also closed our corporate centre, initiating working from home for all non-operational staff enabled by the digital workspace we implemented earlier in the year. This has allowed us to continue to collaborate and communicate effectively during the crisis, including regular updates to staff on business developments from me and my executive team. It is clear that our digital workspace has enabled a more flexible way of working for much of the workforce and I intend to integrate the positive aspects of this fully into our future operating model.

I am also grateful to staff who were furloughed during this period of uncertainty as this enabled us to use the government's job retention scheme. At the peak over 3,000 staff were furloughed.

We have also conducted regular wellbeing surveys to enables us to gauge how best to support staff through this challenging period and we are now starting to develop plans for what a return to the office might look like, though we do not expect large numbers to return to our sites before early 2021.

It is never desirable to have to announce job reductions, but there is no escape from the fact that there are going to be fewer flights and therefore less company income for a number of years. Customers and the regulator will expect and require us to play our part to support the recovery through efficient pricing, consistent with a smaller business than the RP3 performance plan assumed. As a result, in August 2020 we announced a voluntary redundancy programme, and we will not be recruiting until at least next summer.

Notwithstanding Covid-19 and the challenging operating environment, our people strategy remains to attract, develop and retain the highly skilled and increasingly diverse workforce we need to meet the demands of our industry.

Economic regulation

Last autumn, the Board took the difficult decision to reject the CAA's decision for NERL's price control for Reference Period 3 (RP3: 2020 to 2024), which led to a reference to the Competition and Markets Authority (CMA) by the CAA. We did so because we could not conceive of a plan that would deliver the operational service, technology change and airspace modernisation that was needed by the aviation industry with the resources that the CAA was proposing, and for this reason we believed the plan was not in the public interest. Also, accepting the plan and then failing to deliver it would have significantly damaged our reputation and put us at risk of a breach of our licence. Until Covid-19, the CMA reference was a key priority for NERL's executive team and its Board. It is clear that our concerns and the evidence we presented was understood and acknowledged by the CMA in their conclusions. We did not persuade the CMA of our arguments in all the areas of dispute with the CAA. However, the CMA's decision sets important principles in key areas such as capital expenditure governance, cost of capital, the recovery of satellite data charges relating to the Oceanic service and the extent of NERL's ability to generate non-regulated income. The CMA's decision, while in many areas overtaken by Covid-19, continues to set us a stretching plan but addresses some of our concerns about the balance of funding for that plan.

The regulatory framework was never designed for an event as unprecedented as Covid-19 but provision exists for regulatory settlements to be re-set following major traffic shocks, and this is the case for RP3. The process for this review will not be known until CAA undertakes its consultation. However, we anticipate that this review will enable us to develop and consult on a new business plan with our stakeholders which will reflect their views and priorities for the remainder of the RP3 period. Our fundamental strategy remains to modernise our technology, in line with SESAR principles and to enable airspace transformation that will deliver significant benefits to customers. However, we recognise that this must be set within a very different economic climate. Despite the near-term uncertainty for the recovery of air traffic volumes and the regulatory framework for RP3, the long-term fundamentals of our business remain sound. Over the next twelve months we will engage our stakeholders to understand their priorities post-Covid-19. As the regulatory commitment to the traffic risk sharing mechanism indicates, there are limits to the extent that air traffic costs can respond to changes in traffic volumes. Nevertheless, we wish to use the room for manoeuvre that we have and have started to re-size our business to reflect a lower level of demand for our service over the next few years. In doing so we are considering the needs of all our stakeholders, including our airline customers, the travelling public and the workforce, ensuring that the decisions we make support the recovery in aviation and are in service of the long-term success of the company. We provide an essential public service and we are resolutely committed to delivering our strategy to advance aviation and keep the skies safe in the interests of all stakeholders.

Martin Rolfe, FRAeS
Chief Executive

Business review

In addition to developments outlined by the Chief Executive, up until the full impact of Covid-19 became apparent, we had made considerable progress towards achieving other priorities for 2019/20 which are summarised here.

Delivering a safe, efficient and reliable service every day from our airports and centres

	2020	2019	Change
	('000s)	('000s)	%
Chargeable Service Units*	12,166	12,167	-
UK flights	2,483	2,544	(2.4%)
Oceanic flights	493	502	(1.8%)

* a CSU is a function of aircraft weight and distance flown in UK airspace, and is the billing unit for UK en route charges.

Until the global spread of Covid-19 and the measures by governments to contain it caused a dramatic reduction in the demand for air travel in 2020, we were handling record flight volumes. However, we ended the financial year having handled 2.48 million flights, which was 2.4% below the previous year (2019: 2.54 million).

Service performance (by calendar year)	2019		2018	
	Target	Actual	Target	Actual
C1: avg. En route delay at FAB level (seconds)	15.6	13.2	15.6	16.9
C2: avg. delay per flight (seconds)	10.8	8.4	10.8	12.5
C3: delay impact (score)	24.0	15.8	26.0	17.0
C4: delay variability (score)	2,000.0	63.0	2,000.0	16.1
C3Di: 3Di metric (score)	26.3-29.1	29.0	26.7-29.5	29.2

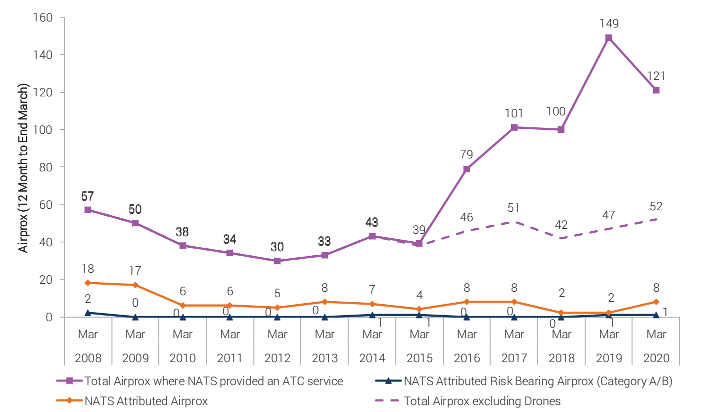
The C1 metric is a Functional Airspace Block (FAB) level target introduced for RP2.
C3 target is the C3 Upper target adjusted for traffic based CY 2019 actual traffic.

Our service performance improved on the prior year and we met the regulator's 2019 calendar year targets[3]. We achieved an average delay per flight of 8.4 seconds (2018 calendar year: 12.5 seconds) and a flight efficiency 3Di score[4] of 29.0 (2018 calendar year: 29.2).

For calendar year 2019 and Reference Period 2 (2015 to 2019) we achieved the regulator's safety targets, which were based on: the effectiveness of safety management; the use of the Risk Analysis Tool (RAT) to assess the severity of safety events[5]; and the extent of Just Culture training.

For RP2 we also set ourselves an ambitious internal target to achieve 1,119 RAT points (as a proxy measure for safety risk) to drive the appropriate safety culture across the business. For calendar year 2019 we were not able to meet this and recorded 1,553 points (calendar year 2018: 1,159 points) mainly from a higher volume of low severity safety events in the airspace and runway incursions at airports, due to higher traffic volumes and better monitoring and reporting. The relationship between traffic volumes and safety is complex but the industry rule of thumb is that as traffic doubles safety incidents increase four-fold. When we set the target we assumed that traffic would grow by 13% during RP2 but higher actual growth meant that we effectively set ourselves the task of delivering a c22% safety improvement over the 5-year period. Notwithstanding that we were unable to meet this stretching internal target, the considerable work that has been undertaken to meet the target will enable long term improvement and has undoubtedly created a safer operation than had we not set such a stretching target.

Figure 3: Airprox
Financial Years Ending 31 March



We also measure our safety performance over a financial year based on airprox incidents, which are assessed independently by the UK Airprox Board.

This year the UK Airprox Board considered that two risk-bearing Category B airprox[1] were attributable to NATS, one of which arose in the 2018/19 financial year but was only reviewed by the UK Airprox board in this financial year. The growth in traffic volumes during the period was a likely contributing factor but when these rare incidents arise we study them carefully and embed lessons learned in our operational procedures and training.

Overall, there was a reduction in the number of airprox during the year, reversing the trend since 2015. This mainly reflected a fall in Remotely Piloted Aircraft Systems (RPAS or drone) related events following a range of measures to improve awareness and training of drone users, which we have been a part of with the CAA, together with the effect of changes in legislation. We have also continued to collaborate with the industry on technology to monitor and respond to drone activity.

Finally, we were encouraged to see a decrease in the number of infringements of controlled airspace during the year, supported by our focused engagement with the general aviation community. To sustain this trend and reduce the number of incidents, we will continue to support the implementation of the mandatory identification of all aircraft in UK airspace and the CAA's initiatives and focus on other improvement activities that we can undertake.

Space-based surveillance of the North Atlantic

The North Atlantic is the world's busiest area of oceanic airspace. Since March 2019 we have operated the service using space-based surveillance from a network of Iridium satellites. We are using Automatic Dependent Surveillance - Broadcast (ADS-B) data provided by Aireon[6] to deliver a real-time picture of the exact position of every aircraft operating across the North Atlantic, with updates provided about every eight seconds. Prior to this customers received a procedural service reliant on a rigid route structure with speed and separation restrictions and periodic position updates provided by pilots.

ADS-B has enabled us to reduce the longitudinal spacing between aircraft from between 40 to 80 nautical miles (nm) down to 14 nm and to offer airlines that were previously assigned fixed speeds and flight levels more flexible flight paths and optimum trajectories. We have also reduced the lateral separation minima.

These improvements in flight efficiency provide immediate fuel cost savings to airlines and long-term environmental benefits by reducing CO_2 emissions. The ability to safely reduce the separation between aircraft also provides more capacity for us to handle future traffic growth. While significant safety and environmental benefits are derived from this technology, we recognise that the satellite data charge is an additional cost to airline customers. The CAA will be reviewing later in RP3 the progress made in delivering the benefits of ADS-B which, in our view, will now need to take due account of the much lower levels of traffic experienced than were forecast.

Airspace modernisation

Existing airspace and the route network structures that support ATM are in need of modernisation if we are to meet the development expectations of airports, improve environmental performance, enhance services to commercial and general aviation and integrate new airspace users such as drones. The core elements of this programme are airspace changes across the south east, Scotland and

Manchester regions which will deliver significant environmental benefit through: fuel saving and aircraft noise mitigation; free route airspace in the upper airspace; and enhanced arrival tools to reduce airborne delay into our major airports.

The programme requires the engagement and full support of Government, the CAA, airports, airlines, business and general aviation. At the request of the Secretary of State for Transport, we set up the Airspace Change Organising Group (ACOG), which is an independent group within NATS. It is headed by Mark Swan, formerly Group Director of Safety and Airspace Regulation at the CAA, and a member of its Board, and it is overseen by a cross-industry steering committee chaired by Sir Timothy Anderson, formerly Chief Operating Officer of Flybe. ACOG will create and maintain a single coordinated implementation masterplan which will be subject to review by the CAA, in consultation with the Secretary of State. Over the next decade, it is planning to coordinate more than 15 airspace change projects across 14 airports and higher level airspace and it will engage with a wide range of stakeholders, including representatives of communities and other airspace users.

While customers agreed that this programme of change was a priority for RP3, we will re-assess the scope and cost of our plans (and those of ACOG) with customers and the CAA through the consultation on a revised RP3 plan to ensure that investment is realigned with airspace user demand as the sector recovers after Covid-19.

During the year we improved the route connectivity to and from Birmingham Airport and provided more flexibility for Heathrow arrivals. We are also redesigning the route structures for Luton and Stansted airports, which are currently shared, to provide each airport with its own arrivals route and holding procedure. We will be holding public consultations with those affected.

Commercial developments

We were delighted that the Ministry of Defence (MOD) renewed its Future Military Area Radar Service (FMARS) contract with us for a further nine years from the existing contract end date until 2030. This allows the MOD to continue to share NERL's technical infrastructure and operations rooms in Swanwick, which is the backbone of our joint civil and military approach to ATC. This also means airline customers will continue to benefit from a lower charge, as the costs of our ATC infrastructure are shared with MOD.

Our airports business was awarded a contract extension by the Aberdeen, Glasgow and Southampton airports group (AGS) to 2029. AGS has exciting plans for the future and we are very pleased to have been chosen to support them. We are also working with Toronto Pearson Airport and Amsterdam's Schiphol Airport to deploy our Intelligent Approach system, that dynamically separates arrivals by time instead of distance, thereby cutting headwind delays and improving airport punctuality.

Enhancements to our Demand Capacity Balancing tool were implemented at Heathrow, delivering an increased level of control over aircraft arriving into the airfield and a closer link between Heathrow and our Terminal Control at Swanwick when applying flow regulation.

One of our aims this year was developing the digital tower ATC service for London City Airport. We achieved site acceptance testing on the operational systems and we will evaluate the timing of the deployment as Covid-19 restrictions are lifted.

Financial review

Results overview

Group profit before tax at £25.3m (2019: £98.2m) was £72.9m lower than last year's result. This reflected the impact of Covid-19 on the carrying values of goodwill (see below) which was impaired by £49m, our investments in Aireon and Searidge being written down by £10.6m based on slower growth in new business alongside an increase in bad debt exposure of £17.5m reflecting the financial distress within the wider aviation sector from the collapse in demand for air travel (including the failure of Flybe). Higher staff costs were also incurred in the year from the investment in operational staff to meet the growth in traffic volumes expected prior to Covid-19 as well as higher pension costs (see below). Partly offsetting these factors were: improved revenue from our international operations and lower asset depreciation charges reflecting the timing of ATC system deployments.

	£m	£m
2019 profit before tax		98.2
Revenue changes		
Airspace	1.7	
Airports	(5.7)	
International	10.2	
Other service lines	0.2	
		6.4
Operating cost changes		
Staff costs (excluding pensions)	(8.1)	
Pension costs	(13.5)	
Expected credit losses	(17.5)	
Depreciation and impairment, net of grants	13.6	
Other	(0.8)	
		(26.3)
Goodwill impairment		(49.0)
Finance cost changes		
Fair value movement on financial instruments	5.1	
Fair value movement on Aireon investment	(3.4)	
Other net finance costs	(1.5)	
		0.2
Results of associates & joint ventures		
Searidge impairment	(5.2)	
Share of result of other investments	1.0	
		(4.2)
2020 profit before tax		25.3

After the tax charge, which is explained below, the group reported a loss of £1.3m (2019: profit of £82.3m).

Our response to the impact of COVID-19

The impact of Covid-19 on the results for 2019/20 is explained above. However, the most significant continuing impact has been the shortfall since the start of 2020/21 in NERL's revenue receipts for en route charges due to the reduction in air traffic volumes and the effect of significantly extending the period by which airlines settle their air traffic control charges, the latter only partly mitigated by advances provided by Eurocontrol. As a result, we assessed that NERL's revenue receipts would be lower by £439m in 2020/21 and by £245m in 2021/22 than if traffic volumes been in line with the CAA's RP3 assumption, although these would be largely recovered in later years under the traffic risk sharing mechanism of the regulatory framework.

In response, we conserved cash of £200m through a number of measures including: freezing recruitment, staff pay restraint and releasing most external contractors; furloughing staff under the government's job retention scheme; working closely with our suppliers to manage working capital; and deferring £70m of capital investment. Separately, we drew down £395m from our available bank facilities to secure liquidity.

Finally, and most significantly, in August 2020 we agreed additional bank facilities for NERL of £380m through to July 2022, in line with the duration of the existing bank facility. The new facility was sized by reference to a range of traffic scenarios, with headroom for a delay in recovery.

The combination of these actions provides the company with liquidity to withstand a prolonged and uncertain recovery in air traffic volumes ahead of a re-set of the regulatory settlement for RP3, and the recovery of revenue shortfalls under the traffic risk sharing mechanism. With respect to the latter, as explained in our Viability Statement we fully expect that the re-set will provide a balanced business plan which is aligned with our customers' priorities and flight schedules, taking account of the CMA's findings, the pre-existing commitment to traffic risk sharing and the financeability duties placed on the CAA under the Transport Act 2000.

Through a voluntary redundancy programme in August 2020, we have also taken early action to re-align our cost base to ensure we are well placed to support the recovery in the aviation sector and ahead of the re-set of the regulatory settlement for RP3. The cost of this programme is estimated at £75m.

New accounting standard

The adoption of IFRS 16: *Leases* during the year increased net debt at 31 March 2020 by £70.0m and required recognition of right of use assets of £61.3m (net of previously accrued lease incentives). The standard also resulted in lower operating rental costs for the year by £7.7m, offset by £7.2m of higher depreciation and £1.9m of higher interest cost.

Regulatory return

In the 2019 calendar year, NERL achieved a pre-tax real return of 4.6% (2018 calendar year: 7.1%) compared with the expected regulatory return of 5.9% in the RP2 Performance Plan. This under-performance reflected the investment we made during the last two years of RP2 to increase our operational staff and to accelerate the technology change and airspace programmes to meet the projected growth in air traffic volumes the aviation sector anticipated for RP3 and beyond.

Notwithstanding this investment, over the five-year period of RP2, NERL achieved a return of 7.6%, mainly reflecting the faster growth in air traffic volumes than CAA forecast, which generated higher revenue.

Comparison of reported profit and regulatory return

Profit reported in these financial statements is 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. This 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;
- goodwill impairment, which is not remunerated by the regulator's building block model; 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.

Regulatory accounts are also prepared on a calendar year basis. These differences mainly explain why NERL's reported operating profit before goodwill impairment of £49m is some £53m higher than its regulatory profit.

Revenue

	2020	2019
	£m	£m
Airspace	703.7	702.0
Airports	129.0	134.7
Defence	26.0	26.5
Other UK business	10.0	9.3
International	23.4	13.2
Total	892.1	885.7

Overall, revenue at £892.1m (2019: £885.7m) was broadly in line with last year. By service line the significant developments were:

Airspace: further real price reductions for our en route service in RP2 offset the benefit of higher traffic volumes than the CAA forecast. From January 2020 we were able to recover the cost of ADS-B satellite data charges for the North Atlantic en route service. We also provided additional services to the MOD.

Airports: our core airport contract income is indexed to inflation. This uplift was offset by a reduction in ad hoc engineering and project related activity.

Defence: our income reflects the performance of the Project Marshall[7] contract. Less revenue was recognised for the asset provision contract, reflecting the delivery schedule this year, while the scope of the service contracts was expanded.

Other UK business: overall revenue was in line with the prior year as we continued to support windfarm developers with services to mitigate their impacts on ATC systems.

International: revenue from the Asia Pacific region grew in the year reflecting continued good progress with the ATCO supply contract in Hong Kong and the Singapore digital tower prototype development. We also contracted to supply intelligent approach to Toronto International Airport and Amsterdam Airport Schiphol.

Operating costs

	2020	2019
	£m	£m
Staff costs	(468.0)	(446.4)
Non-staff costs	(192.3)	(183.9)
Depreciation and amortisation, net of grants	(134.6)	(141.1)
Profit on disposal of assets	1.0	2.1
Other operating income	4.4	6.1
Operating costs before goodwill impairment	(789.5)	(763.2)
Goodwill impairment charge	(49.0)	-
Total operating costs	(838.5)	(763.2)

Operating costs before goodwill impairment increased by £26.3m or 3.4% reflecting increases in staff and non-staff costs partly offset by lower asset depreciation. The principal reasons have been explained in the Results overview paragraph above.

The average number of employees during the year increased to 4,726 (2019: 4,464) as we invested in operational staff to support the growth in traffic volumes and accelerate the technology change programme.

Goodwill impairment

A goodwill impairment charge of £49.0m was recognised by NERL this year (2019: nil) to write down its carrying value to the recoverable amount (see notes 2 and 3 to the financial statements).

In assessing the recoverable amount, consideration is given to opportunities to outperform regulatory settlements and any premium above the value of the regulatory asset base (RAB) 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 recent UK and European market transactions in utilities and airport operators. As a result of the absence of market precedents supporting the level of premium since the outbreak of Covid-19, the RAB premium was reduced from 6% to 0%, resulting in the impairment charge. This charge does not impact NERL's cash flows or its regulatory return. The premium assumption will be assessed again for the review of carrying value in 2020/21.

Net finance costs and fair value movements on financial instruments

Net finance costs of £22.5m were £1.5m higher than last year (2019: £21.0m), including interest on lease liabilities following adoption of IFRS 16.

A net fair value charge of £3.2m (2019: £4.9m) was recognised this year. Of this amount, £5.3m (2019: £1.9m) was in respect of the equity investment in Aireon. This was based on an assessment of the company's plans and prospects, with slower growth assumed due to Covid-19, for the amount and timing of projected dividends.

Partly offsetting this was a fair value credit of £2.1m (2019: £3.0m charge) for the change in market value of the index-linked swap liability, which provides an economic hedge for NERL's revenue allowance for financing charges. The fair value is sensitive to market expectations of inflation and swap discount rates over the time to expiry of the contract in 2026.

Joint ventures, associates and other investments

The group recognised a net loss of £2.6m (2019: £1.6m profit) for the results of joint ventures and its associate. This mainly reflected a loss of £5.2m (2019: £0.1m profit) for Searidge Technologies as an impairment provision was recognised for an assumption of slower growth in new business due to Covid-19. The group's profit from other investments of £2.6m (2019: £1.5m) improved by £1.1m.

Taxation

The tax charge of £26.6m (2019: £15.9m) includes current tax of £2.3m (2019: £4.5m) and deferred tax of £24.3m (2019: £11.4m). Overall, the charge was at an effective rate of 105.1% (2019: 16.2%). This is significantly higher than the headline rate of 19%, mainly reflecting the goodwill impairment charge which is not tax deductible and the deferred tax impact of the government's decision to maintain the rate of corporation tax at 19% from April 2020, rather than lower it to 17% as had been legislated previously. 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. The group's UK corporation tax payments were reduced to nil (2019: refund of £0.8m) as the company claims R&D allowances for the capital investment to develop ATC systems.

The group also pays other taxes such as employer's national insurance contributions, business rates and the apprenticeship levy, which are significant costs. The group's tax strategy can be viewed at www.nats.aero.

Balance sheet

	2020	2019
	£m	£m
Goodwill	149.3	198.3
Tangible and intangible fixed assets	1,091.7	1,064.2
Right-of-use assets	61.3	-
Investments	48.1	50.9
Pension scheme surplus/(deficit)	232.0	(22.1)
Other non-current assets	38.9	54.8
Cash and short term deposits	585.5	261.0
Derivatives (net)	(104.7)	(119.8)
Borrowings	(686.2)	(334.9)
Lease liabilities	(70.0)	-
Deferred tax liability	(165.8)	(97.8)
Other net liabilities	(270.8)	(276.6)
Net assets	909.3	778.0

The increase in net assets in the year mainly reflects the change from a deficit to a surplus in the IAS 19 funding position of the defined benefit pension scheme, which reported a surplus of £232.0m (2019: deficit £22.1m - see below) and dividends paid in the year.

Capital investment

	2020 £m	2019 £m
SESAR deployment	113.7	113.2
Airspace modernisation	10.0	7.5
Infrastructure	10.8	14.4
Operational systems	6.6	5.0
Other	6.4	8.3
Regulatory capex	147.5	148.4
Military systems	2.5	1.6
Other non-regulatory capex	8.5	6.5
Capital investment	158.5	156.5

Until the outbreak of Covid-19 in the UK became apparent, we maintained our investment in the technology and transformation programme to deploy new ATC equipment and software based on customer priorities for RP3. Since the outbreak of Covid-19, all but essential and sustaining capital investment has been suspended for six months to protect liquidity and to enable the scope of plans to be reviewed against the revised priorities of our customers and the regulator, a process which is likely to lead to an ongoing lower rate of investment than planned pre-Covid.

Defined benefit pensions

The group operates a final salary defined benefit pension scheme with 1,911 employee members at 31 March 2020 (2019: 1,990). The scheme was closed to new entrants in 2009 and a defined contribution scheme was put in place. More information on our pension arrangements is provided in note 33 to the financial statements.

a. IAS 19 charge and funding position

The cost (including salary sacrifice and past service) of defined benefit pensions at £73.9m (2019: £66.3m) reflected a higher accrual rate of 42.1% (2019: 35.9%) of pensionable pay, reflecting lower real interest rates at the start of the financial year.

IAS 19 pension surplus	£m
At 1 April 2019	(22.1)
Charge to income statement*	(73.9)
Actuarial gains/(losses):	
- on scheme assets	(181.4)
- on scheme liabilities	409.6
Employer contributions*	99.8
At 31 March 2020	232.0
Represented by:	
Scheme assets	4,672.1
Scheme liabilities	(4,440.1)
Surplus	232.0

* including salary sacrifice

At 31 March 2020, the scheme's assets exceeded its liabilities by £232.0m (2019: £22.1m deficit) as measured under International Accounting Standards (IAS 19) using best estimate assumptions. The real yield on AA corporate bonds used to value RPI-linked pension obligations increased by 50 basis points during the year, which reduced liabilities by more than the fall in asset values. The size of the scheme relative to the group means changes in financial market conditions can have relatively large impacts on the results and financial position.

b. Trustee valuation and funding obligations

The funding of the defined benefit scheme is subject to agreement between the company and the scheme's Trustees based on the outcome of their formal valuation. This valuation uses a wide range of financial and demographic assumptions for measuring pension liabilities and legislation requires a margin for prudence. As a result, the Trustees' valuation gives a different outcome to the valuation under IAS 19 for the company's financial statements.

The Trustees completed a formal valuation at 31 December 2017 which reported a funding deficit of £270.4m. The scheme's actuary also determined that the cost of employee benefits accruing in future was 41.8% of pensionable earnings (excluding salary sacrifice). Contributions have reflected this from January 2020 as well as a recovery plan agreed with

Trustees which aims to repair the deficit by December 2026. During the year the company made deficit contributions of £37.7m (2019: £41.1m).

NERL's contributions were higher than the regulator assumed for RP2. To the extent that this was caused by changes in financial market conditions, we expect to recover these through higher prices in RP3 and in subsequent reference periods. NATS Services will meet its share of NATS' obligations from its cash reserves.

Trustees will undertake their next formal valuation at 31 December 2020.

Net debt and cash flows

	Cash and short-term investments	Borrowings (including lease liabilities)	Net debt
	£m	£m	£m
Balance at 31 March 2019	261.0	(334.9)	(73.9)
Lease liabilities under IFRS 16	-	(75.3)	(75.3)
Cash flow	324.4	(344.3)	(19.9)
Non-cash movements	0.1	(1.7)	(1.6)
Balance at 31 March 2020	585.5	(756.2)	(170.7)

In order to provide liquidity to mitigate the anticipated reduction in en route revenue receipts following the outbreak of Covid-19, NERL drew down £395m of its £400m bank facilities. At 31 March 2020, the balance outstanding on NERL's amortising bond was £293.2m (2019: £336.2m). As a result, at 31 March 2020 the group had borrowings of £756.2m (2019: £334.9m), including IFRS 16 lease liabilities and held cash and short-term investments of £585.5m (2019: £261.0m). Net debt increased to £170.7m (2019: £73.9m), mainly due to the IFRS 16 lease liabilities.

In August 2020, NERL agreed additional bank facilities of £380m. These facilities are coterminous with the existing bank borrowings, expiring in July 2022. More information is provided in note 19 to the financial statements.

The group generated £217.1m of cash (2019: £294.5m) from its operating activities, which was lower than the previous year. This mainly reflected lower cash receipts from a reduction in the en route unit charge and some increase in operating expenditure payments. The prior year's investing activities included the purchase of an interest in Aireon for £51.1m while capital expenditure was broadly in line with the prior year. Dividends, which were paid in May 2019 and November 2019, were maintained at £59m.

Alistair Borthwick

Chief Financial Officer

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 this Strategic report. In addition, note 3 to the financial statements describes critical judgements and key sources of estimation uncertainties and note 22 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 2020, the group had cash of £585.5m and access to undrawn committed bank facilities of £5m until July 2022. In August 2020 the group secured an additional bank facility of £380m also available until July 2022 and which is undrawn at the date of approval of these accounts. Alongside the bank facility, lenders agreed to the waiver of certain financial covenants which would otherwise be tested within the going concern period.

Management have prepared and the directors have reviewed cash flow forecasts covering a period of at least 12 months from the date of approval of these financial statements. The directors have had regard to reasonably possible changes in trading performance as well as severe traffic volume scenarios individually and in combination. These reflect the significant estimation uncertainty as to the timing, rate and extent of recovery in air traffic volumes and the severity of a second wave Covid-19 pandemic, alongside unforeseen costs arising from other principal risks. The directors have also considered, through a reverse stress test, the point at which a financial covenant not currently waived would be breached. The group's cash flow forecasts, taking account of reasonably plausible downside scenarios, show that the group and company should be able to operate within the level of its available bank facilities and within its financial covenants for the foreseeable future.

Accordingly, the directors have formed the judgement that, taking into account the financial resources available, the range of reasonably possible future traffic volume scenarios and potential mitigating actions that could be taken, together with the duties of the CAA and Secretary of State for Transport referred to in the Viability statement, there is no material uncertainty which may cast significant doubt on the group's ability to continue as a going concern. The directors consider the group and company have 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

The directors have assessed the viability of the group based on its current position and future prospects, its business strategy and available financial resources. The directors have also assessed the potential financial and operational impacts in plausible downside scenarios of the principal risks and uncertainties facing the business, set out on page 20 and the effectiveness of currently available mitigating actions. In particular the directors assessed the solvency and liquidity risks arising from Covid-19, including a second wave alongside a combination of other risk factors materialising, which the Board considered represented a reasonable worst-case scenario, as well as a reverse stress test. On the basis of this assessment, the directors have a reasonable expectation that the group will be able to continue in operation and meet its liabilities falling due over the three-year period to October 2023.

This period of assessment reflects NERL's three-year price control to 31 December 2022 resulting from the CMA's review of the CAA's 2019 RP3 decision, which applies until the CAA re-determines the RP3 price control to take account of the impact of Covid-19 on air traffic volumes and NERL's operations.

Notwithstanding the significant estimation uncertainty as to the timing, rate and extent of recovery in air traffic volumes, the Board considers that there is greater certainty around forecasting assumptions over a three-year period than a longer period, taking into account the CAA's proposed consultation on the redetermination for RP3 which the Board expects will be undertaken in 2021.

Specific consideration has been given to:

- Covid-19: the consequences for the group's en route and airport ATC income of a second wave pandemic on the aviation sector and the reasonably possible mitigating actions available to the group to manage its financial resources;
- The pre-existing regulatory commitment to a traffic risk sharing mechanism and the redetermination of the RP3 price control, taking into account the general duties of the CAA and the Secretary of State for Transport under the Transport Act 2000 to exercise their functions in the manner they think best calculated to secure that NERL will not find it unduly difficult to finance its licenced activities;
- The term of NERL's bank facilities: the directors have a reasonable expectation that NERL will meet the conditions of its banking covenants, and be able to obtain additional waivers in the event of a severe and prolonged traffic downside, and to raise funds in the capital market or through government support measures to repay bank facilities expiring in July 2022;
- Defined benefit pensions: the trustee's formal valuation at 31 December 2020 and agreement to a new schedule of contributions. The directors consider that NERL's contributions will be recovered through prices in RP3 and future reference periods, including additional contributions arising from unforeseen changes in financial market conditions since the CAA's 2019 RP3 decision, while contributions from NATS Services will be met from operating cash flows.

Principal risks and uncertainties

The Board takes the management of risk very seriously, paying particular attention to key risk areas. The system for the identification, evaluation and management of emerging and principal risks is embedded within the group's management, business planning and reporting processes, accords with the Code, and is aligned with the ISO31000 risk management standard. Detailed risk identification, assessment, and control mapping is carried out at business unit, departmental, and executive levels and is recorded and measured in a structured and controlled 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, risk tolerance, business controls and the progress of mitigating actions associated with NATS' risks. Regular reviews are also carried out by the Audit, Safety and Transformation Committees in accordance with their remits, as reported in later sections.

Taking into account the work of the Committees, the Board formally reviews emerging and principal risks and the risk management processes and mitigations in place on a six monthly basis. In addition, monthly Executive reports to the Board identify by exception any changes in inherent or residual 'top risks' particularly if the change means a risk falls outside agreed tolerance.

Safety risks remain a priority for the business and as such are considered at every Board meeting in addition to the regular six-month review.

Our risk management framework has identified the key risks that the Board believes are likely to have the most significant potential impact on our business, financial position, results and reputation based on the severity and likelihood of risk exposure and has undertaken a robust assessment of those that would threaten its business model, future performance, solvency or liquidity.

The list below is not intended to be exhaustive and reflects the Board's assessment as at the date of this report. NATS processes categorise risks according to their linkage to strategic objectives. The risks outlined are the most important safety, strategic, operational, transformation and financial risks currently facing the company in seeking to achieve its strategic objectives (other risk categories assessed by the Board are commercial, governance and legal risks). The group focuses 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.

These risks, including the impact of Covid-19 and risks to our finances, are reflected in and have been considered in assessing viability and going concern as explained on page 18. Further explanation of the impact of Covid 19 on specific key risks is also included under those risks in the commentary which follows. An explanation of the estimation uncertainties arising from Covid 19 is included in note 3 of the financial statements. A summary of internal control and risk management processes is on page 43.

Safety: the risk of an aircraft accident

A failure of NATS ATM controls that results in an accident in the air or on the ground would significantly impact NATS and its reputation. The reputational damage could result in the loss of future contracts and a reduction in revenue. If notice were given by the Secretary of State requiring NERL to take action as a result of the accident and NERL were unable or failed to comply then ultimately this could result in revocation of NERL's 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 maintains a Strategy for the Future Safety of ATM to 2030 and an Implementation Plan. The group also maintains an explicit Safety Management System. The latter includes investigations and reviews of operational safety performance and individual incidents to identify and respond to contributors to safety risk.

The impact of the Covid-19 pandemic has been analysed to understand and manage the hazards. Key issues identified are i) managing the safety of the operation during periods of very low traffic volume by maintaining controller vigilance, ii) managing the skills competency of controllers and engineers to ensure a safe operation as traffic volumes recover and iii) adjusting the operation for traffic patterns and densities which may have changed significantly.

Strategy: political environment and Brexit

The UK government determines the UK's aviation policy, including the framework for the future provision of ATC. In addition, international policy and legislative decision makers also define aviation and ATM-related policies or regulations, which the company is required to follow. These policy decisions directly affect our businesses and changes in policy may affect the group's ability to meet policy requirements. We seek to mitigate these risks by providing independent input to policy studies, lobbying for policy guidance and taking a leadership role where we believe this is required both domestically (such as UK airspace policy and airspace modernisation) and internationally and responding to industry consultations. For example, we outlined earlier in this report the importance of proceeding with airspace modernisation and the role of ACOG in the broader project management and coordination role of modernising flight paths both in airspace above 7,000 ft and airspace below this level, which remains the responsibility of others to design and deliver. Achieving this will require cross-industry support and the engagement and full support of the UK Government and the CAA. Our ability, and that of the UK, to influence EU developments post Brexit will be curtailed.

Strategy: regulatory settlement

NERL's ability to fulfil the safety, capacity. environmental and cost efficiency targets and other obligations of its licence requires a balanced price control settlement from the CAA. Based on CAA's RP3 decision, NERL could not conceive a viable plan that would deliver the operational service, technology change and airspace modernisation that was needed by the aviation industry with the resources and the risks that the CAA was proposing and did not accept that plan, leading to the referral to the CMA. Accepting the plan and then failing to deliver it would also have significantly damaged NERL's reputation and put it at risk of a breach of the licence.

In seeking to mitigate such regulatory risks, NATS maintains engagement with CAA at CEO and Board level on a regular basis. NERL's regulatory strategy is overseen by a Board committee, and day to day oversight is provided by the CFO.

The financial impact of Covid-19 on the aviation sector has resulted in greater stakeholder attention to the regulatory protections in place for ANSPs. While the CMA's findings improve NERL's position for RP3 from the CAA's decision, its review has been overtaken by

Covid-19. This means that the CAA will need to reset the price control by the start of 2023. We are awaiting a CAA policy statement in respect of this reset, which will also require a sufficiently reliable traffic forecast on which to base a reliable plan. NERL will seek to engage proactively with the CAA and stakeholders on the timing and format of that review.

Operational: business continuity

A catastrophic event has the potential to disrupt the ATC operation and its ability to resume a safe service to an acceptable performance level within a pre-defined period. While a resilience plan is required by NERL's licence, this has been expanded to cover all NATS operations.

Resilience is considered for people, operational technical systems and facilities using NATS incident management processes to assess timely and effective responses. The NATS resilience policy programme assesses, documents and tests resilience capability in order to prevent and mitigate such disruptions.

The outbreak of Covid-19 is being managed under NATS business continuity incident management procedures. The potential risk of a loss of operational staff at the outset of the pandemic was mitigated initially by the lower traffic volumes, before strict social distancing measures, separate rosters and absence tracking measures could be implemented.

Operational: physical security

The most significant physical security risk is an internal threat which would impact on reputation, operational effectiveness and the wellbeing of the workforce.

NATS seeks to mitigate this risk by operating a range of security measures founded on national security vetting of the workforce. The threat is overseen by a steering group which assesses personnel security using a CPNI model and through developing risk assessments for all roles in NATS. Insider issues are included within employee awareness training.

During the period of the Covid-19 pandemic site security has been a focus and work has continued with all key emergency services and support agencies.

Operational: systems security

A malicious cyber-attack could affect the integrity, availability or resilience of NATS operational ATC and business IT systems adversely impacting the provision of a safe and efficient ATC service and resulting in additional regulatory scrutiny.

NATS seeks to mitigate the risk through robust security controls, including identity and access management and security patching, staff training, security monitoring and incident management.

The risk has elevated slightly since Covid-19 due to home working and is being managed by raising staff awareness of cyber threats. Close working relationships are maintained between NATS and the UK's security services, including the National Cyber Security Centre to minimise the risk of a damaging cyber attack.

Operational: employee relations

Employee relations if not managed sensitively could have a significant impact on our service performance. Therefore, every effort is made to continue to build and sustain good employee relations, including joint working groups with union representatives as part of an employee relations improvement project.

The impact of Covid-19 on the workforce and the company's financial position has required more dialogue with trades unions on a range of challenging issues, including staff redundancies. These matters have the potential to increase the risk of industrial action. The company continues to maintain close dialogue with unions representatives through the Working Together approach.

Transformation: schedule delivery

The complex deployment of new DSESAR technology and retirement of legacy systems could affect our ability to maintain service levels during transition and require additional costs to sustain legacy systems and support deployment during this period.

We maintain good programme governance and risk management processes overseen by the executive, the Transformation Review Committee and the Board. We have adopted industry best practice, by using a Portfolio, Programme and Project (P3O) approach to our RP3 portfolio.

As noted in the Chief Executive's review, we responded to the impact of Covid-19 on the company's liquidity and the likely future capacity requirements of airline customers by suspending all but critical sustainment capital investment for a six-month period. The scope of the capital programme and associated risks is subject to ongoing review and is likely to lead to a lower rate of investment than planned pre-Covid.

Financial: defined benefit pension scheme

Adverse movements in the value of scheme assets and liabilities arising from factors such as lower investment returns, lower real interest rates and improving life expectancy may increase the size of the funding deficit and result in significant contributions to fund pension benefits. The Trustees will determine the funding position at their next formal valuation as at 31 December 2020, reflecting market conditions then.

The scheme was closed to new entrants in 2009, pensionable pay rises are capped through an agreement with our trades unions and future service benefits are linked to the Consumer Prices Index. NATS regularly reviews the scheme's funding position and is consulted by Trustees on the design of risk reduction strategies. Also, subject to regulatory review, NERL is able to recover increases in contributions from changes in unforeseen financial market conditions. NATS Services maintains adequate cash reserves to meet its share of pension contributions. The directors monitor the funding position of the scheme. The group's financing arrangements and cash reserves, its projected operating cash flows and mechanisms within the established economic regulatory framework for recovery of such costs enable the group to meet the contributions required.

Financial: other 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 22.

Responsible business

Our investors, customers, suppliers and other stakeholders are aware of the need for, and benefits of, NATS as a responsible business. Our commitment to the welfare of society, including our employees, and the natural world is an increasingly important measure of our overall performance. We recognise the growing expectations of the public and policymakers to transparent reporting on our outcomes.

Scope of non-financial information statement

This statement focuses on the most material employee and environmental matters which have an indirect financial impact on our business. Our gender pay report[8] and a slavery and human trafficking statement[9] are published on our website.

Governance

The NATS board is ultimately responsible for non-financial policy and performance. The Board has reviewed how it has applied the principles of the Code of Corporate Governance in each of the main areas of culture, workforce and stakeholders, remuneration and succession, and diversity. The Board receives regular updates throughout the year on these topics and formally reviews the approach annually. In addition to the Board, the Executive and various sub-groups monitor health and safety, employee relations and environment matters.

Strategy

We have adopted an industry-leading approach to being a responsible business, including how we manage and report our impacts. Specific measures include:

- Developing and implementing appropriate policies, codes and management systems, including a Responsible Business policy[10] and individual strategies within our 10-year business transformation programme, Destination 2030;
- Monitoring performance and practices across our business and our supply chain;
- Undertaking internal and external audits;
- Raising awareness of responsibilities among employees and developing training;
- Managing relevant risks and monitoring weak signals; and
- Transparently reporting non-financial performance information to our customers, key stakeholders and the public each year.

We maintain a range of certified ISO (or equivalent) management systems, which are externally assessed, including ISO 31000 (risk management) and ISO 14001 (environment management). The Audit Committee oversees all verification and assurance activity.

a. Employee policies and outcome

Our services are dependent on the skill and professionalism of our workforce. They make a critical difference to our success, and our investment in them protects and strengthens our safety and business culture. We operate a Just Safety culture, enabling employees to raise safety related matters without fear of reprisal. Through our Working Together partnership with trade unions we have an open dialogue with employee representatives which enables us to understand their concerns. This is supplemented with employee relations surveys, as part of an established employee relations improvement programme. We have developed polices to enhance workplace standards, for example, introducing a respect at work policy and new approaches to conflict resolution. In addition, we have an established employee engagement strategy across NATS with opinion surveys that touch the whole organisation.

Through membership of organisations such as Business in the Community and Women in Science, Technology and Engineering we have used benchmarking and other diagnostics to drive improvement initiatives. The Board takes account of the matters raised by employees. For example, in the year we focussed on improving workforce diversity and mental health and wellbeing. The latter has been a particular focus since the outbreak of Covid-19 which has required most staff to work from home. Through our work with the trade unions we have modernised a range of internal polices including management of performance, attendance and long-term absence and conflict resolution.

b. Environment policies and outcome

Concerns about sustainability (particularly climate change) have increasingly been driving societal and political action. The Covid-19 pandemic has further intensified pressure on the aviation sector as governments and the public have called into question economic support for carbon intense industries. Improving the sustainability of our business can also reduce costs as we consume fewer resources and work in more efficient ways. One of the material ways we can add value to our customers and society is to ensure our airspace is as efficient as possible to reduce aircraft fuel burn and emissions.

Our sustainability strategy encompasses initiatives on sustainable consumption and procurement, energy efficiency, reductions in greenhouse gas (GHG) emissions linked to a new net zero emissions commitment, climate change adaptation and biodiversity improvements across our business and estate. It also includes initiatives to improve airspace efficiency, minimise aircraft noise and to work with industry partners on a net zero emissions roadmap.

Annually we assess the effectiveness of our policies and actions in managing our environmental obligations.

Risk management: environment matters

Our approach to identifying, evaluating and managing risks is explained in Principal risks and uncertainties above. That also describes employee relations risk. Summarised below are risks relating to environmental matters.

We have a single environment risk which covers such matters as environmental compliance, pollution, climate change and noise and our actions to mitigate these to deliver our sustainability strategy, make environmental improvement and meet external expectations.

We take responsibility for reducing the environmental impact of our business on the ground and in the air, working closely with other aviation stakeholders on noise and CO_2 emissions. We also monitor the likely impact climate change will have on our business.

Air traffic control can influence aviation CO_2 and non-CO_2 emissions, noise and other environmental impacts. We seek to minimise this impact as much as possible both strategically and tactically, for example by using Intelligent Approach and cross border arrivals management at airports and space-based ADS-B to improve the efficiency of the Oceanic airspace we manage. Some of the innovative solutions we develop with our key suppliers can also develop into commercial opportunities which we offer to airlines, airports and others.

Metrics and targets

a. Employee matters

Gender pay reporting has established benchmarks against which we will monitor the impact of our actions to address gender imbalance over the longer term, accepting that this will require structural improvement in the number of females attracted to STEM-based careers and more widely to the aviation industry. When we are able to restart our early career programmes we will continue to focus particular attention on our processes for attracting and selecting candidates, to ensure these are gender neutral and consistent with a broader diversity strategy which supports progress on BAME and female representation at all levels of our workforce. Our objective is to bring the best diverse talent into our organisation and support individuals to reach their full potential.

b. Environment

Our environmental performance continues to improve, both on the ground and in airspace.

Airspace efficiency (3Di)

We are set annual targets by the CAA on airspace efficiency, measured by a three-dimensional inefficiency score metric (3Di). The target becomes more challenging each year. For the 2019 calendar year we remained within the regulator's target range. The CAA has set ambitious 3Di targets for RP3 and we are updating our plans to deliver against these, taking into account the outcome of the CMA process and the impact of Covid-19 on the industry.

Greenhouse gas emissions (GHG)

Airspace improvements made this year avoided 30,737 tonnes of CO_2 emissions. This also represented savings of £4.5m in fuel costs for airlines. In the period since 2008, we have reduced average CO_2 emissions per flight in UK airspace by 7.0% against our ambitious target of 10% by 2020. Our energy consumption remained steady in the year, reflecting the development of new ATC systems which are being run alongside the legacy systems these are replacing. However, as a result of investment in renewable energy, our total market-based emissions have continued to drop. For the second year running we were awarded a B rating by CDP[11] for our disclosure of GHG emission information, awareness and management of environmental risk.

We have adopted a net zero emissions target, aiming for a 35% reduction by 2030 and 100% by 2050 across each of our GHG emissions sources (excluding scope 3 category 11) as part of a wider sustainability strategy and we are working closely with others across the UK aviation industry to play our part in contributing to the UK's net zero commitment.

Aircraft noise

We continue to work closely with the Department for Transport, the CAA, the Independent Commission on Civil Aviation Noise and the industry to minimise the impact of aircraft noise on communities. We are supporting Manchester and Gatwick airports on new specific operational initiatives to trial in order to reduce noise, in addition to ongoing support for Heathrow airport.

Supporting information

The Responsible Business statement and the environment metrics reported below have been prepared in accordance with non-financial information reporting guidance from the Financial Reporting Council, the European Commission, the Climate Disclosure Standards Board (CDSB) and the Task Force on Climate-related Financial Disclosures. An operational control approach is taken to non-financial information using the same boundary as NATS Holding Limited.

Description	FY 2019/20 (or CY 2019)	FY 2018/19 (or CY 2018)
Service performance and resilience		
3Di (calendar year)	29.0	29.2
Environmental performance		
Scope 1 emissions (location-based tonnes CO_2e)	3,477	4,094
Scope 1 emissions (market-based tonnes CO_2e)	1,306	4,094
Scope 2 emissions (location-based tonnes CO_2e)	15,301	16,561
Scope 2 emissions (market-based tonnes CO_2e)	1,064	21,024
Total scope 1 + 2 emissions (location-based tonnes CO_2e)	18,779	20,654
Total scope 1 + 2 emissions (market-based tonnes CO_2e)	2,370	25,118
Total scope 1 + 2 intensity metric (location-based tonnes CO_2e per £m of revenue)	21.0	23.3
Total scope 1 + 2 intensity metric (market-based tonnes CO_2e per £m of revenue)	2.7	28.4
Progress against 10% enabled ATM-related CO_2 emissions reduction target	7.0%	6.9%
Scope 4 (Modelled enabled ATM-related CO_2 reduction in tonnes)	30,737	121,788^
Water consumption (m^3)	54,500	75,750^
Energy consumption (gas + electricity) MWh	71,686	71,262

^ restated due to inclusion of additional information, improvements to modelling accuracy and data quality.

Modelled enabled ATM-related CO_2 reductions represent the saving in CO_2 emissions from improvements to the ATM network, such as technical changes which enable us to provide more fuel-efficient flight profiles, based on projections of the volume of flights likely to take advantage of the improvements. The enabled reduction in emissions is reported in full in the year in which the improvement is made. This is modelled based on industry best practice and is outlined in detail in our GHG report, available at www.nats.aero/environment/cr.

Our stakeholders	Why are they important to us?	How do we engage and have regard to their views in our decisions?
CUSTOMERS	A safe ATC service is an essential given for customers in the aviation industry to whom we provide our services and expertise, and the travelling public. Their requirements are key drivers of our business plan, defining demand for the ATC network, our staffing and capital investment.	We consult airspace users on their priorities and our plans before each reference period and bi-annually on our service performance, capital investment and our charges. When bidding for airport and other contracts we tender our cost effective and innovative solutions. Generally, we have good alignment on many of their priorities, but they do not always agree with our plans and we reflect on this and refine our plans accordingly. We have engaged since Covid-19, deferring settlement of charges, reducing cost, reassessing capital investment and preserving liquidity.
WORKFORCE	Our ATC service and infrastructure depends on the skill and professionalism of our workforce. They make a critical difference to our success, and our investment in them protects and strengthens our safety and business culture. Most of our employees are members of trades unions.	Through our Working Together partnership we have an open dialogue with trades unions. We receive feedback on pay and benefits, a safe and healthy working environment, flexible working, talent development and career opportunities, and a diverse and inclusive culture. We operate a Just Safety culture, enabling staff to raise safety matters and the company maintains a whistleblowing facility. Every few years we conduct an employee opinion survey. In the last year, and since Covid-19, the Board has increased its focus on mental health and wellbeing, as well as workforce diversity.
REGULATORS	Our regulators ensure we provide our service and develop our infrastructure in accordance with our ATC licence and international safety standards. Ensuring we fulfil our licence obligations and develop the business for the long-term ensures the success of the company for all our stakeholders.	The CAA consults stakeholders as our economic regulator on our price control before each new control period before determining the prices, safety, service performance and capital investment targets and incentives. This year the Board did not agree with the CAA's decision for RP3, leading to a referral to the CMA. The CAA's safety regulator oversees the safety integrity of our training, operational processes and technical systems and we receive recommendations on improvements, which we implement to ensure safety standards are met. The CAA approves changes to airspace design over the UK by reference to legal requirements including safety, environment and user need.
GOVERNMENT	The government sets UK Aviation Strategy which provides a long-term vision for the industry and a framework for future ATC provision.	The Chief Executive maintains a regular dialogue with the Department for Transport. The government engages on matters of aviation policy that affect NATS, including airspace modernisation, and (subject to Brexit) the UK's input to the EC's SES performance scheme.
SHAREHOLDERS	Our shareholders provide equity investment which finances our activities and enables us to invest in our ATC service and infrastructure, for which they expect returns. An employee share trust owns 5% of the company which enables them to share in the company's long-term success.	The Board meets with shareholders twice a year, including the Annual General Meeting. The Strategic Partnership Agreement enables shareholders to appoint representatives to the Board. Shareholders wish to see remuneration policies which drive executive management to deliver strong sustainable performance aligned with the interests of key stakeholders.
COMMUNITIES AND ENVIRONMENT	Local communities around airports expect the aviation sector to pay attention to aircraft noise and CO_2 emissions. Our ATC service can help mitigate some environmental impacts. We are a significant employer where our UK operations are based. Society expects improvements in sustainability, and we are committed to net zero greenhouse gas emissions from our estate by 2050.	Airspace changes must follow the CAA's guidance on public consultation of airspace use, aircraft movements and environmental impacts. Communities generally identify noise, tranquillity, fuel emissions, local air quality and other quality of life concerns. We work with communities affected by flights below 7,000ft at an early stage of any change, to ensure they have a voice in airspace design. Changes mean some communities may be subject to more overflights than previously, while others are no longer overflown. Following consultation, we appraise design options before making our recommendation to the CAA.
LENDERS	Our lenders provide debt finance that we repay over time and compensate by way of a commercial return. Access to debt finance is necessary to fund our business activities efficiently.	We meet with lenders at least annually to discuss our performance, business plan and capital investment. Lenders wish to understand the robustness of the company's financial strength over the long-term and the principal risks it faces. The importance of these relationships has been demonstrated by the need and ability to raise significant additional finance as a result of Covid-19.
SUPPLIERS	Our suppliers provide goods and services to maintain and develop our operation. Working closely with them minimises risk and combines our expertise to develop innovative ATC solutions.	Our supply chain management approach involves regular and ongoing engagement with suppliers for procurement. In addition, we engage on joint projects, hold supplier conferences and supplier workshops. Our joint interests are an open and constructive relationship based on fair terms, good contractual performance and high standards of business conduct.

Having regard to our stakeholders in Board decision-making

Section 172 (1) statement

The directors act in a way that they consider, in good faith, to be most likely to promote the success of the Company for the benefit of its members as a whole, and in doing so have regard, to the long-term success of the business, the way we work with a large number of important stakeholders, and the importance of maintaining high standards of business conduct and have regard to the impact of the company's operations on the community and the environment.

The Board takes account of the views and interests of a wide range of stakeholders, when making its decisions, and balances different stakeholder perspectives. Inevitably it is not possible to achieve outcomes which meet the interests of all stakeholders.

How our Board and its committees operate, and the way decisions are reached, including the matters discussed during the year, are set out in the Governance section on pages 31 to 70. Set out below are two examples which illustrate how the directors had regard to section 172(1).

The Board's consideration of the CAA's decision for RP3

In 2018 NERL developed a business plan for RP3 after extensive consultation with airline customers and other stakeholders. The Board considered this achieved a balanced set of safety and service outcomes and provided the financial resources to deliver a safe and efficient service day to day while enabling essential investment in ATC systems and airspace modernisation to meet the forecast growth in air traffic volumes. Following its consultation on NERL's plan, the CAA's decision in August 2019 provided revenue allowances for RP3 which were £200 million (2017 CPI prices) less and set more challenging targets and more rigid governance. After very careful consideration, the Board did not accept the CAA's decision as it did not consider this to be in the wider public interest and accepting the plan and then failing to deliver it would damage the company's reputation and risk a breach of licence.

In making its decision, the Board considered that the CAA's determination for RP3 would:

- exacerbate the challenge of achieving the requisite safety levels within the complex operating environment anticipated during RP3, to the detriment of a range of stakeholders;
- not enable the staffing and investment to deliver the technology change and airspace modernisation to meet the growth in air traffic volumes from airline and airport customers; reduce the environmental impact of aviation on communities; meet Government aviation policy objectives; and maintain high standards of operational resilience and performance for the flying public;
- adversely affect service quality, innovation and flexibility and NERL would not be able to meet the technology change milestones, leading to service penalties;
- not enable the technological improvements envisaged by NERL for the Oceanic service necessary to deliver safety, technological and operational benefits for airline customers;
- not provide shareholders with a rate of return that adequately reflects the cost of capital for an efficient air navigation service provider over the RP3 period;
- impose a disproportionate regulatory burden through new governance incentives which are neither necessary, justified or likely to deliver better outcomes.

The company has a consistent track record of delivering excellent service and reducing prices to customers, while always maintaining our focus on safety. With this deep understanding of our capabilities the Board concluded that the interests of its stakeholders would best be served by making the case to the CMA.

The Board's engagement with stakeholders during COVID-19

Following the outbreak of Covid-19, the Board established a committee to oversee the company's response. This committee has received updates and monitors measures taken to protect the company's workforce and ensure ATC service resilience and reviewed scenarios of air traffic volumes, liquidity projections and options for financing, cost saving actions and risks. The committee also considered the future economic regulatory framework.

As air traffic control is a critical part of the UK's national infrastructure, and the scale of impact of Covid-19 on the aviation sector, the company and the Board have engaged with a broad range of stakeholders though this crisis and provided updates on the matters set out above:

Workforce: since the crisis the safety and wellbeing of staff has been the company's priority. This has required changes to operational working practices, home working, a focus on wellbeing and regular communications on business developments. Critical facilities were identified for safety, hygiene and maintenance activities including control rooms and airport towers, engineering systems and key sites including data centres, radars, masts and towers. Consultations have taken place with trades unions on staff furloughing, pay and benefits, and voluntary redundancy;

Customers: have been briefed on the measures to ensure ATC service safety and resilience, the suspension of capital investment and actions to reduce the cost base. To support customers, the company deferred the settlement of charges and has passed on cost savings to airport customers. Feedback was received on the industry's views on the outlook for air traffic volumes;

Shareholders: the Board met with shareholders twice in the year and in July 2020. The Chairman wrote to shareholders at the outset of Covid-19 and the Board has provided more granular reports and forward-looking information to the strategic partners (see governance framework);

Lenders: regular engagement since the outset on the impact and actions being taken. Lenders provided liquidity through the existing bond, £400m bank facility and, since the year end, a new £380m bank facility.

Pension trustees: agreed to a short period of deferral of contributions to support liquidity. Trustees have been updated on the liquidity challenge and new funding to inform their assessment of the financial strength of the company to meet pension obligations.

The CAA and the Department for Transport: sought assurances on the safety and resilience of the ATC service, the ability to support repatriation and cargo flights and feedback on proposals to redetermine the RP3 settlement and Eurocontrol's proposal for deferring airline charges and advancing funds to air navigation service providers. We engaged in dialogue to understand the scope and availability of government sponsored finance.

Suppliers: the company has worked closely with suppliers to understand the resilience of the supply chain and support for the company's critical facilities and capital programme. Suppliers have supported measures to improve the company's working capital.

The Strategic report was approved by the Board of directors on 22 October 2020 and signed by order of the Board by:

Richard Churchill Coleman,

Secretary