

Review of the business

The group, branded London City Airport, operates London City Airport (LCY). LCY is the UK's leading business airport serving over 30 destinations across the UK and Europe and connections to the rest of the world through major European hubs. The only airport actually in London, London City Airport is just two miles from the site of the 2012 Olympic Games; three miles from Canary Wharf and six miles from the City of London.

The airport's location on the doorstep of London's financial district is considered vital to business and plays an integral part in contributing to the eastbound growth of the UK's capital city. London City Airport receives considerable support from the business community who recognise the convenient location and ease of use with faster check-in times than any other London airport.

The aviation industry and London City Airport in particular are indicators of general economic conditions and, after many years of unparalleled growth at the airport, it has not remained immune to the current economic climate. In 2010 the airport handled 2.8m passengers, approximately the same amount as the prior year. Corporate aviation movements handled by the airport were nearly 7,400 in the year ended 31 December 2010, representing a 4% decrease on 2009.

Principal route network changes in the year were the introduction of premium leisure summer routes to Majorca and Ibiza by BA and to Brive and Deauville by Cityjet along with the cessation of the Dusseldorf route by Lufthansa and the Plymouth/Newquay service by Air South West. The British Airways all business service connecting London City Airport and New York JFK, which started in September 2009, continued throughout the year.

During 2010 LCY undertook a £7m expansion of its terminal building to provide a significantly enlarged security search area as well as additional space and comfort for passengers in the departure lounge. This facility was completed in February 2011 and fully operational in March 2011.

In July 2009, the London Borough of Newham (LBN) approved the airport's planning application, increasing the number of permitted flight movements from 80,000 to 120,000 per annum. Two environmental groups (Fight the Flights and Friends of the Earth) challenged LBN's approval process under a Judicial Review in 2010 which was unsuccessful. Their application to the High Court for leave to appeal in early 2011 was also dismissed in February 2011. In March 2011 they applied to the Appeal Court for permission to appeal against the result of the Judicial Review which was rejected in May 2011. They have until mid June 2011 to request an oral hearing of their application to appeal.

Key financial and other performance indicators

	Year ended 31/12/2010	Year ended 31/12/2009
Total passenger (000's)	2,793	2,802
Aircraft movements (scheduled and general)	67,917	75,678
Group turnover (£m)	75.2	77.4
(Loss) / profit before tax (£m)	(5.6)	0.6

Group turnover decreased by 3% reflecting the impact of the reduced activity levels in the year.

Future prospects

In early 2011 the airport continues to feel the impact of reductions in the winter 2010/11 schedules. Balanced against this British Airways have converted options on a further two Embraer E190 aircraft which will come into service at LCY in H2 2011. In 2011 the impact of the factors above is expected to result in overall scheduled aircraft movement volumes broadly flat at 60,000 movements. With continued strong load factors we expect passenger numbers to grow to c2.9m in 2011 and that EBITDA performance should show some marginal growth over the 2010 actual level of performance.

Employees

The group regularly reviews employment practices to ensure good working relations and equal opportunity based on fairness, equality and inclusiveness. The group continues to invest in training to ensure that they have the necessary management, technical and commercial skills to provide the best possible service to our customers and passengers.

LCY continue to maintain a positive relationship with all of its employees and actively encourages communication through a variety of channels. The Staff Association structure and regular management and team briefings form a major part of the communication channel with employees.

Additionally the regular Chronicle staff newsletter and a dedicated Intranet site play important roles in our communications with employees. LCY continues to recruit locally, with over 70% of staff living within 5 miles of the site, providing socio-economic benefits in a deprived part of London.

Environmental

LCY is dedicated to providing its customers with efficient airport services while at the same time managing programmes to limit the impact of its operations on its neighbours and the environment. LCY works closely with its neighbours to maximise the positive impact of its operation for local communities, creating exciting career opportunities and developing transport links with surrounding areas.

At the same time the airport is determined to minimise any negative environmental impacts for people living and working in the area and continually implements and reviews schemes and processes such as Noise & Track Keeping, Sound Insulation, Waste Management, Air Quality Management and Safeguarding to achieve this.

Social and community

Since opening in 1987 London City Airport has developed a wealth of relationships with local communities and contributed significantly to the regeneration of the Docklands area. Through regular and voluntary interaction with community partners – residents, schools, colleges, charities, local businesses, landowners, developers and other stakeholders, as well as local boroughs – the airport works towards accomplishing its goal – to maintain constructive relationships with its neighbours and support local initiatives, whilst at the same time developing its business.

The airport's communities are encouraged to take an active interest in the operation. It is realised that neighbours are interested in the impact the airport's operation has on their lives and so communication and consultation with them is a priority. LCY delivers a quarterly community newsletter to 33,000 local homes to ensure local people are able to keep abreast of airport developments. This is also available on the group's website.

The airport has developed and implemented a comprehensive community relations programme that focuses primarily on local education and employment initiatives, but also includes staff volunteering and health and fitness programmes. A hands-on approach is taken alongside sponsorship to ensure that the knowledge, expertise and experience of airport staff at all levels contribute to the further development of the local area.

For example, during 2010, airport volunteers spent over 100 days delivering education activities alone. Investing in the local area, working to minimise the impacts of our business and maintaining an open dialogue with the community is key to shaping the future of London City Airport and the community in which we operate. Further details are available on the group's website.

In 2010 LCY won the Lord Mayor of London's Dragon Award which recognises the significant contribution and commitment the airport has made to the economic regeneration of London through one of its employment initiatives.

Efforts to employ the long-term unemployed have also been successful through LCY's award-winning into-work training programme. LCY also maintain a relationship with the London Health Commission and local Primary Care Trust and are dedicated to ensuring we support the ongoing good health of our teams.

Health and safety matters

With regard to Health and Safety, it is the policy of the group to seek to prevent all personal injuries, dangerous occurrences and damage to property. The group seeks to achieve this by ensuring that the Board and management recognise their commitment to the safety of LCY employees, and those who may be affected by operations under the group's control.

It is also the group's policy to ensure that all employees are aware that they have a legal and moral responsibility, for their own safety, for the safety of those who might be affected by their actions, and to co-operate with their employer in Health and Safety matters.

In order to monitor the group's Health and Safety policy, data is collected and monitored on the number, types and frequency of accidents and incidents in the workplace. Accident investigation is undertaken in the event of loss or damage to property and injury to persons to ensure root cause and corrective action is identified.

Regular internal audits, inspections and validations are undertaken of the airport's facilities, infrastructure and operating equipment together with periodic audits and inspections from external regulatory bodies.

Significant contractual and other relationships

The group has a number of important relationships with its customers, suppliers and bankers. These relationships are managed by key managers and directors of the individual businesses. The two primary areas of concentration of key relationships are;

- a) Revenue - Scheduled aviation revenue is principally derived from the three major airline alliances in Europe, namely Sky Team (Air France-KLM), oneworld (British Airways) and Star Alliance (Lufthansa/Swiss).**
- b) Debt finance - The group has arranged its debt finance through a syndicate of banks to access the level of funding required for its**

leveraged structure. For details of the finance accessed by the group see Note 20 of the financial statements.

Principal risks and uncertainties

The group's principal risks can broadly be defined as competitive, legislative and financial.

Competitive risks and market

The key competitive risks are derived from;

- a) **Passenger switching to other airports – Passengers can opt to fly from other London airports that serve similar destinations to LCY.**
- b) **Airline operators switching to other airports – Airline operators may choose to move operations to other airports, subject to operating slot availability at other locations.**

Legislative and planning risks

Specific legislative risks exist in areas covering the operations of the business from a health and safety, passenger screening and security and aerodrome operations perspective. Robust compliance and legal monitoring controls promote best practice throughout the organisation and minimise the group's exposure to non-compliance. The key bodies that regulate the operation of the airport are the Civil Aviation Authority and the Department for Transport.

Additionally, planning risks exist in relation to the ability of the airport to secure planning permissions to facilitate future growth. Changes to the planning legislation, national aviation policy and the impact of anti-aviation pressure groups could impact the airport's ability to deliver the growth vision set out in its 2006 Master Plan. With its planning experience and resources, LCY is well placed to respond to these risks.

Financial risks

The group has established financial management control processes whose objective is to monitor the group's financial performance and risks and to ensure sufficient working capital exists.

- a) **Risk relating to leverage - As at 31 December 2010 the group had external debt of £440 million and is exposed to interest rate risk, liquidity risk and cash flow risk in respect of these borrowings. Throughout 2010 the group was compliant with its various financial agreements and maintained comfortable headroom over all financial covenant ratios.**

The group is exposed to interest rate risk on its debt which bears interest at variable rates. Increases in these rates result in increased interest expense and increased interest payment. The group controls these interest rate risks through the use of derivatives, specifically interest rate swaps.

The application of these derivatives economically converts the hedged portions of variable-interest debt from variable to fixed interest. As at 31 December 2010 78% of the corporate borrowings were hedged.

Liquidity risk is the risk that an entity may encounter difficulties in meeting obligations associated with financial liabilities. The group aims to mitigate liquidity risk by having a strong positive cash flow and has un-drawn overdraft facilities to manage liquidity risk.

Cash flow risk is the risk of exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability such as future interest payments. The group manages this risk through regular cash flow forecasts, monitoring and strict management of its working capital and planning for known significant cash flow movements.

b) Exposure to credit risk - Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Group policies are aimed at minimising such a risk by conducting credit checks where appropriate and by other established credit control procedures. Details of the group's debtors are shown in notes 15 and 16.

c) Other risk - The group places all its insurance with leading insurance companies. Obligatory insurances are placed as necessary at competitive rates. All other risks are assessed and identified and where appropriate, insurance cover is purchased, where available, to mitigate these risks. Insurances are reviewed, assessed and renewed on an annual basis.

Political and charitable contributions

The group has been a strong supporter of the local community and made charitable contributions of £67k during the year (2009 - £35k). The group did not make any political contributions.

Employment of disabled persons

The group continues its policy regarding the employment of disabled persons and of giving full and fair consideration to applications for employment made by disabled persons having regard to their aptitudes and abilities. Appropriate training is arranged for disabled persons, including retraining for alternative work of employees who become disabled, to promote their career development within the organisation.

Disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the company's auditor, each director has taken all the steps that he is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information.

Corporate governance

The Board comprises of a non-executive Chairman, six non-executive Directors and two Executive Directors from the company, being the Chief Executive Officer and Chief Finance Officer.

The Board meets regularly, normally monthly, and in addition, separate strategic discussions take place. Matters of significance are reserved for confirmation by the full Board. Matters not reserved for the Board may be delegated to senior management within clearly defined financial parameters.

The company has an Audit Committee which comprises of one Non Executive director from each shareholder and the non-executive Chairman, one of whom is appointed as Chairman. The Committee normally meets once a year. External auditors are invited to attend the meeting. The Committee has the authority to examine any matters relating to the financial affairs and internal controls of the group.

Group internal controls are monitored at management reviews which cover all operational and health and safety aspects of the company, independent audits, monthly business reviews, monthly reporting with performance measured against budgets and a comprehensive annual budget process which requires Board and business approval. In addition to the annual budget, a long term plan is continuously updated to reflect current performance and strategic aspirations.

In November 2008 the Walker Report was published, following a request by the British Venture Capital Association and certain major private equity firms. This report provided 'best practice' disclosure guidelines in the annual report and financial statements for those companies defined as UK portfolio companies and private equity firms. For this purpose LCY does not meet the definition of a UK portfolio company however the directors have welcomed this report and have adopted many of the disclosure recommendations.