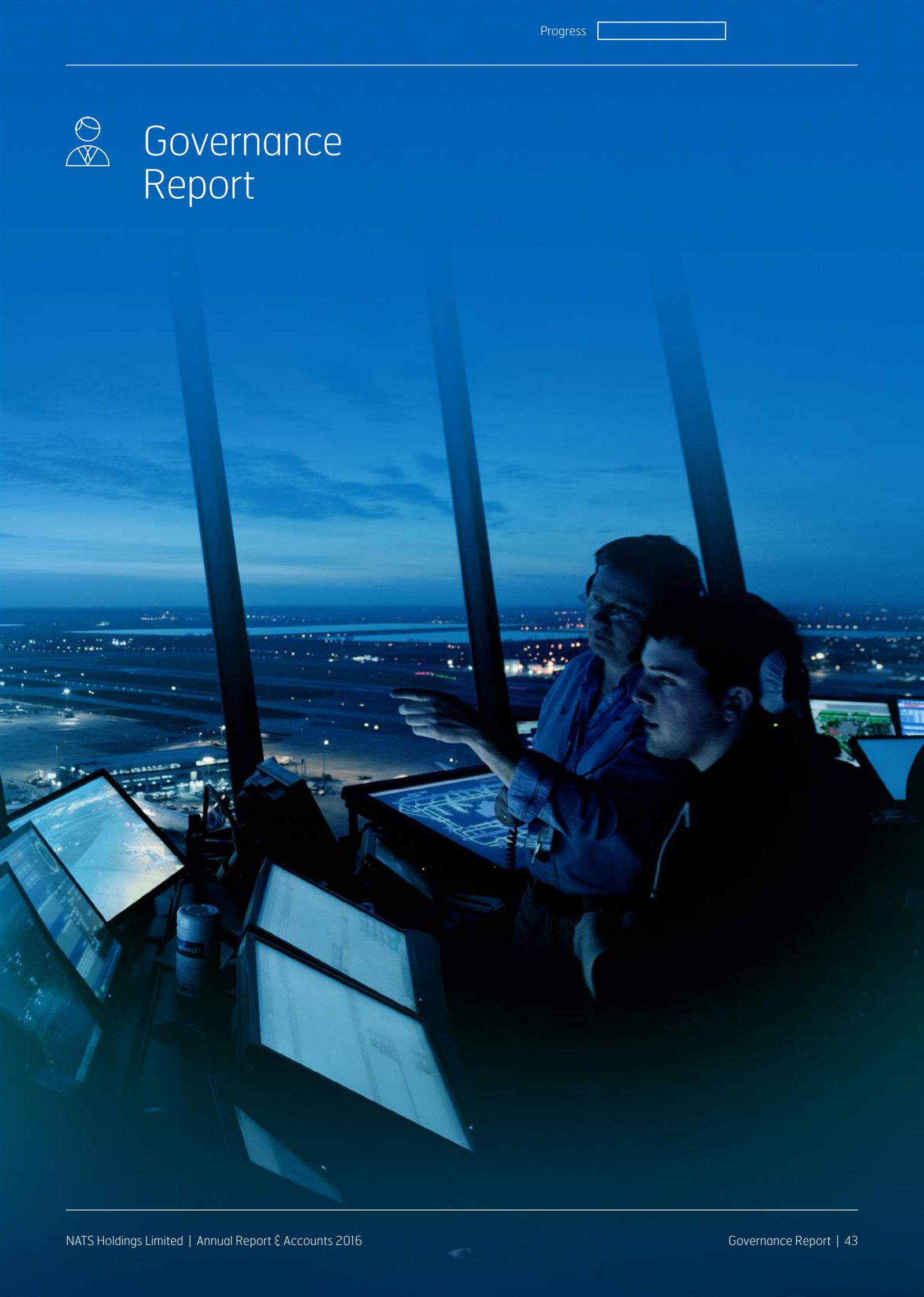




Governance Report



Directors of NATS Holdings Limited

Director's biographies

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

Chairman



Dr Paul Golby CBE FREng

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

Executive Directors



Martin Rolfe, Chief Executive Officer

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



Nigel Fotherby, Finance Director

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

Directors of NATS Holdings Limited

(continued)

Non-Executive Directors



Dr Harry Bush CB

Harry is Vice-Chairman of UCL Hospitals NHS Foundation Trust. He spent most of his career in HM Treasury where he focused latterly on policies towards growth, science funding and privatisation and private finance. He was UK Director at the European Investment Bank from 2001 to 2002. Harry left HM Treasury in 2002 to join the CAA Board as Group Director Economic Regulation responsible for the economic regulation of the designated airports and NATS, as well as the CAA's economic analysis generally. He was a member of Eurocontrol's Performance Review Commission from 2005 to 2009 and of the UK's Commission for Integrated Transport from 2006 to 2010. Since leaving the CAA in 2011 Harry has been a consultant on economic regulation, undertaking assignments across a range of industries in the UK and overseas. He is a Fellow of the Royal Aeronautical Society and a Member of the Council of Management of the Regulatory Policy Institute, Oxford. Harry is a director of The Airline Group (AG) and NATS Employee Sharetrust Limited and a member of the Audit Committee.



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

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



Will Facey

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

Directors of NATS Holdings Limited

(continued)

Non-Executive Directors



Richard Keys

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



Andy Lord

Andy graduated from Manchester University in 1992 with an honours degree in Mechanical Engineering, having joined British Airways in 1989. He moved to Operations in 2004 having held various roles in Engineering and Flight Operations and is still the only non-flying manager in BA's history to have held the position of Chief Pilot. Andy was appointed Director of Operations in January 2009 as a member of the British Airways Executive Leadership Team. He was responsible for BA's network operations, airport customer service and ground safety, business reliance and operational IT systems. He was a non-executive Board member of BA CityFlyer, and is a director of AG, and chairs the Remuneration Committee.



Gavin Merchant

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



Directors of NATS Holdings Limited

(continued)

Non-Executive Directors



Iain McNicoll CB CBE

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



Derek Provan

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



Peter Read

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



Directors of NATS Holdings Limited

(continued)

Non-Executive Directors



Tony Tyler

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

Officer



Richard Churchill-Coleman, Legal Director

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



Governance report

NATS Governance framework

Introduction

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

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

The Board and Directors

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

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

As at the date of approval of the accounts, the NATS Holdings Limited Board comprised a non-executive Chairman and 12 directors, as follows:

Executive Directors

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

Non-Executive Directors

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

Changes to the Directors

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

| Executive Director | |
|------------------------------|---------------------------|
| Richard Deakin | Resigned 18 May 2015 |
| Non-executive LHRA Directors | |
| Roger Cato | Resigned 31 December 2015 |
| Derek Provan | Appointed 28 January 2016 |

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

The roles of the Chairman, Chief Executive Officer and Executive Management

The Chairman of the NATS group is responsible for the leadership of the Board and for its governance. He has no day-to-day involvement in the running of the group. Day-to-day management of the NATS group is the responsibility of the CEO, Martin Rolfe, supported by the NATS executive team. The NATS executive team is responsible for delivering NATS' overall strategy. To achieve its strategic priorities the executive team has recently been structured as follows:

- > Chief Executive Officer;
- > Finance Director;
- > Operations Director;
- > Safety Director;
- > Commercial Director;
- > HR & Corporate Services Director;
- > Delivery Director;
- > Communications Director; and
- > Legal Director.

Governance report

(continued)

The responsibilities of the Board

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

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

Partnership and AG directors

- > adoption of the business plan;
- > entry into significant debts, charges or contingent liabilities;
- > major agreements outside the ordinary course of business;
- > significant litigation proceedings; and
- > external investments, and acquisition and disposal of material assets.

LHRA director

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

Access to legal and professional advice

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

Board meetings

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

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

Governance report (continued)

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

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

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

The Board's performance

Board effectiveness review

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

Director induction

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

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

The Board's committees

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

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

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

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



Governance report (continued)

The terms of reference for the Board and its committees are available to all staff and shareholders and can be made available externally with the agreement of the Legal Director. Reports from each of the standing committees are set out on pages 56 to 73. However, in addition to the standing committees, from time to time the Board may form committees on an ad hoc basis to deal with specific business issues. During the year the Board formed an ad hoc committee to review non-executive director fees, based on a benchmarking report from New Bridge Street as remuneration advisors to the company.

Meetings with shareholders

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

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

Compliance with the UK Corporate Governance Code

NATS is committed to maintaining the highest standards of corporate governance. The SPA requires the group and the directors to adhere to the UK Corporate Governance Code so far as reasonably practicable and save to the extent

inconsistent with the other provisions of the SPA. For the financial year ended 31 March 2016, the applicable standard is the 2014 UK Corporate Governance Code (the Code). NATS has applied the principles of the Code to the extent considered appropriate by the Board throughout the year ended 31 March 2016. However, a number of principles and provisions in the Code are not relevant to the partnership nature of the NATS group ownership and the principal areas where NATS did not comply are summarised below.

Corporate Governance Code A.3.1: Independence of the Chairman

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

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

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

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

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

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

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

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

The non-executive directors are appointed by the shareholding groups and are therefore subject to the relevant shareholding groups' selection processes, rather than those included in the provisions of the Code. They are therefore not subject to periodic re-election as stipulated by Section B.7 of the Code, although Partnership directors are appointed by the Government on three-year fixed-term contracts. This aligns with the



Governance report

(continued)

recommendation in B.7.1 that the maximum period between re-election is three years, reducing to one year for non-executive directors who have served longer than nine years. Brenda Dean has a one year contract from 2015 which will bring her total tenure to 10 years in 2016 as she has been in post since 2006. Her tenure is due to expire on 25 July 2016 and a process for appointing her replacement is currently underway.

The tenure of non-executive directors is as follows:

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

* Years of service to resignation, if earlier.

** Served until 31 December 2015.

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

Corporate Governance Code Section E: Relations with shareholders

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





Reports from Board Committees

Audit Committee report

The role of the Audit Committee

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

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

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

The duties of the Committee include:

- > monitoring the integrity and compliance of the group's financial statements;
- > reviewing the effectiveness of the external auditors and the Internal Audit department;
- > reviewing the scope and results of internal and external audit work; and
- > reviewing NATS' systems of internal controls and risk management.

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

Main activities of the Committee during the year

a. Financial reporting

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

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

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

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

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

The carrying values of goodwill, other intangible and tangible assets

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

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



Reports from Board Committees (continued)

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

Retirement benefits

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

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

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

Revenue recognition and the recoverability of revenue allowances

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

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

b. Internal control

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

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

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

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



Reports from Board Committees

(continued)

c. Risk management

Risk management is essential in seeking to minimise the threat that an event or action might have on the group's ability to achieve its objectives and to execute its strategies effectively. Successful risk management ensures that the group is able to consistently deliver services to its customers and meet the needs and expectations of its shareholders in a fast changing and uncertain environment.

The Board takes the management of risk very seriously, paying particular attention to areas such as safety, service delivery, operating efficiency, pension funding, financial control, project delivery, regulatory compliance, financing and IT systems.

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

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

d. Internal audit

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

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

e. External audit

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

f. Non-audit work performed by the external auditors

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

Reports from Board Committees

(continued)

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

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

Richard Keys

Chairman of the Audit Committee

Nomination Committee report

The role of the Nomination Committee

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

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

Main activities of the Committee during the year

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

The appointment of Derek Provan was made by LHRA.

The Committee undertook an assessment of the performance and renewal considerations with respect to the current Partnership Directors for the purpose of the Chairman advising the Secretary of State on Partnership Director recruitment or re-appointment.

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

Paul Golby

Chairman of the Nomination Committee



Reports from Board Committees (continued)

Remuneration Committee report

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

Purpose and responsibilities

The Committee meets when necessary and is responsible for:

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

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

Activities in the year

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

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

Membership

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

Advisers and other attendees

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

The company also takes external advice on various aspects of remuneration policy and competitive pay levels from independent consultants. New Bridge Street (NBS), part of Aon Hewitt, are independent advisers to the Committee. NBS has no other commercial relationship with the company. NBS is a member of the Remuneration Consultants Group and is a signatory to its code of conduct.

Remuneration policy

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

Reports from Board Committees (continued)

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

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

Executive directors

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

- > annual salary;
- > pension and life assurance and income protection;

- > annual performance related incentive scheme;
- > long term performance related incentive scheme;
- > All-Employee Share Ownership Plan; and
- > other benefits: including company car or car allowance and medical insurance.

Full details of directors' remuneration paid in relation to 2015/16 are set out on page 65.

Salaries

Salary policy summary

The Committee determines, where appropriate, annual increases to executive directors' salaries having regard to their experience, responsibility, individual contribution, market comparatives and pay increases elsewhere in the group.

Operation

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

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

Implementation for 2016/17

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

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

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

Pensions and life assurance

Pension and life assurance policy summary

To provide income in retirement through either Defined Benefit (pre April 2009) or Defined Contribution (post April 2009) pension schemes. Both schemes provide life assurance and ill-health provisions or income protection.

Operation

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

Reports from Board Committees

(continued)

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

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

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

Implementation for 2016/17

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

Annual incentive scheme

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

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

In addition, the Committee also reviewed the operation of the Company Performance Related Pay (CPRP) and concluded that the executive team would no longer be eligible

to participate in this scheme. In summary, the CPRP is linked to the achievement of the company's annual EBITDA target in line with the annual business plan. The scheme pays out up to a maximum of £1,042 per full time employee for 105% achievement of EBITDA regardless of seniority, grade or salary level, payable in July 2016 (subject to company financial performance). The second cycle of the scheme paid out £1,027 per full time employee in July 2015.

AMPRPS policy summary

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

Operation

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

AMPRPS is paid entirely in cash.

The Committee may determine that vesting should not be applied for any particular participant(s) should the Committee consider that individual performance or other circumstances makes this an appropriate outcome. It is anticipated that this power would only be exercised in exceptional circumstances when the Committee decides that there has been or could be significant damage to the reputation of the company either during the performance years or as a result of the award. In these cases, the decision would

be referred to the non-executive directors of the Board for ratification. In addition, a claw-back provision applies whereby individuals are liable to repay or forfeit some or all of their AMPRPS if there is a material misstatement of results.

Performance metrics

Company performance: 75% of maximum

Personal performance: 25% of maximum

Further details of the targets set for 2015/16 are provided in the outcome section on page 64.

Maximum AMPRPS opportunity

Chief Executive Officer: 70% of salary

Finance Director: 55% of salary

Implementation for 2016/17

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

Performance targets are set in line with business strategy and will be set out, to the extent they are not commercially sensitive, in next year's report.

Reports from Board Committees

(continued)

Long-term incentive scheme

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

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

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

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

LTIP policy summary

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

Operation

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

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

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

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

Performance metrics

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

Maximum LTIP opportunity

Chief Executive Officer: 110% of salary

Finance Director: 90% of salary

Implementation for 2016/17

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

Cycle 5 award

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

Cycle 6 award

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

Reports from Board Committees

(continued)

All-Employee Share Plan

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

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

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

Employment contracts

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

Non-Executive directors

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

The Partnership directors each received annual remuneration of £36,000 in the financial year. AG directors received no remuneration for their services to the NATS Board. However, a payment of

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

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

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

Remuneration paid in 2015/16

Directors' remuneration

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

Annual management performance related pay scheme outcome for 2015/16

Targets relating to the company element of the AMPRPS for 2015/16 were almost fully achieved (yielding 67.92% out of an available 75% of the award) and personal performance ratings for the Board ranged between 20% and 25% (out of an available 25%).

The AMPRPS targets feature four key measures:

- > group EBITDA – c.85% of the available weighting achieved;
- > customer delay measures - exceeded the stretch target;
- > Customer Survey outcomes from the Airlines, Airports & MOD surveys - the amalgamated score results in a pay out of c.80% for this element; and
- > operational measures relating to key NERL and NSL milestones - these elements have been achieved and as such will pay out in full.

Long-term incentive scheme outcome for 2015/16

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

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

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

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

Reports from Board Committees

(continued)

Audited information

Directors' remuneration

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

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

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

1 Benefits paid to the Chairman and non-executive directors represent the reimbursement of travel costs.

2 These directors participated in a pension salary sacrifice arrangement. Therefore contributions paid to the pension scheme via salary sacrifice have been deducted from salary figures. The contributions paid via salary sacrifice are included within the pension figures reported in the analysis of pensions below.

3 Martin Rolfe was appointed interim Chief Executive Officer (CEO) on 18 May 2015 and his annual salary increased from £241,904 to £300,000 on that date. On 13 October 2015 Martin was appointed CEO on an annual salary of £400,000 and received a bonus of £50,000 for his service as interim CEO, which is reported within performance related payments.

4 These directors are appointed by The Airline Group (AG) who charged NATS a total of £45,000 per quarter (2015: £45,000 per quarter) for the services of the directors.

5 Derek Provan was appointed to the Board on 28 January 2016 by LHR Airports Limited (LHRA). He receives no fees for his services to NATS from NATS.

6 Roger Cato resigned from the Board on 31 December 2015. He received three months pay in lieu of notice.

7 Richard Deakin resigned as a director on 18 May 2015 and left the company on 30 June 2015. His emoluments in the 2016 financial year included a contractual entitlement to six months pay in lieu of notice in addition to his contractual pay from 1 April to 30 June 2015.

Reports from Board Committees

(continued)

Audited information

Directors' remuneration (continued)

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

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

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

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

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

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

| | 2016 £000 | 2015 £000 |
|----------------|--------------|--------------|
| Nigel Fotherby | 114 | 88 |

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

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

Reports from Board Committees

(continued)

Audited information

Directors' remuneration (continued)

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

| Name of Director | Shares sold No. | Share price at date of sale £ | Gain on sale £ |
|------------------|--------------------|--|----------------------|
| Richard Deakin | 1,100 | 4.30 | 2,968 |

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

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

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

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

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

Andy Lord

Chairman of the
Remuneration Committee



Reports from Board Committees (continued)

Safety Review Committee report

Role of the Committee

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

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

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

- > Chairman of the NATS Board;
- > Chief Executive Officer;
- > Safety Director;
- > Operations Director;
- > Delivery Director;
- > Commercial Director;
- > Directors Swanwick, Prestwick and Airports; and
- > Directors Safety Operations, Delivery and Corporate Safety & Quality.

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

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

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

Main activities during the year

a. Operational safety

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

- > **Infringements of controlled airspace:**
The CAA has the lead responsibility and, whilst NATS can, and has, taken mitigating actions to protect aircraft operating within controlled airspace from infringing aircraft, solutions to the root causes require the authority of the regulator. The Committee has continued to support the NATS Board and Executive in engaging with the CAA. Prevention activity focussed on infringement hotspots has continued, including engagement with local flying communities. However, progress has not been as fast as any of the parties would like, so a further range of actions have been proposed by the CAA, including robust licensing action, improved initial and refresher training for General Aviation pilots, and a trial of a 'cooperative known traffic environment' in the Southampton area. We will continue to support these projects, and maintain a close dialogue with the CAA.



Reports from Board Committees (continued)

- > **Operational Safety Performance Reviews:** In light of an increase in safety risk, a comprehensive programme of performance reviews has been conducted each quarter. The Committee has supported this detailed approach and the actions that have been identified to strengthen improvement activities. The reviews will continue in 2016/17.
 - > **Safety Strategy and Safety Plan:** The delivery of the NATS Safety Strategy and Plan have continued, with briefings on Human Performance enhancement particularly during change, the risks and benefits from the technology and airspace change programme, and the existing and developing procedural and technical mitigations to the risk of inadvertent entry onto an active runway.
 - > **Review of NATS vulnerability to a catastrophic event instigated by a member of staff or contractor:** The Committee supported the Executive in conducting this review and agree with the findings that susceptibility to such events is well understood and that appropriate mitigations are in place.
 - > **RPAS:** Remotely Piloted Aircraft Systems were identified as a risk in the 2014 NATS Safety Plan. The Committee has been briefed on the increasing numbers of events and the significant activity being undertaken on what is rapidly emerging as a key feature of the ATM environment.
 - > **European Regulation:** As part of the Committee's assurance that future risks and opportunities are being managed, we have been briefed on emerging European aviation safety legislation. Whilst such changes are a longer term issue, the potential to affect the way in which we implement safety management in NATS is significant. The Committee will continue to monitor the developments in safety regulation.
- b. Corporate / physical security (external threats)**
- NATS' Corporate Security department provides assurance reports, covering all aspects of physical security, internal and external threats to NATS, vetting, travel security, data protection and crisis management (incorporating business continuity). The principal focus for the Committee in the past year has been:
- > **Governance:** This ensures and maintains engagement at all levels of the business, from business area to Executive and Board level. Reporting to the Committee is on a bi-annual basis, in June and December, where confirmation is provided that governance processes are in place and are robust.
 - > **Travel Security:** The Committee has been briefed on the NATS response to security events in Paris and Brussels including appropriate travel restrictions and the established approval and escalation procedures following any major incident. Further assurance of the travel security risk assessments for locations that NATS staff travel to, the use of Hostile Environment training and the development of an online travel risk tool that will quickly identify the location of NATS staff, have been provided.
 - > **Crisis/Incident Management:** The Committee has supported the continued work of the Executive and operational leadership teams in fully embedding Crisis/Incident Management policies and procedures in the culture of the organisation. Detailed Gold, Silver and Bronze Team procedures are in place and regular exercising of Gold and Silver Teams has taken place. In conjunction with the CAA, NATS hosted an aviation wide crisis management exercise, which was well received.
 - > **Vetting:** Security vetting continues to be the foundation of our protection from the 'insider' threat. Vetting clearance times during 2015 averaged 22 days, significantly better than the majority of vetting agencies.
 - > **Security Awareness:** Face to face security awareness presentations to staff and contractors have been conducted across NATS sites. Police and security agencies have commented favourably on the content and delivery. The RUN, HIDE, TELL methodology has been well received by staff.



Reports from Board Committees (continued)

- > **Intruder Testing:** A programme of intruder testing has been completed, with a marked improvement on previous tests (in 2014) and showed that no institutional systemic failures exist in the security teams.

c. Cyber Security

As the sole provider of UK en route air traffic management, NATS is part of the UK's critical national infrastructure. NATS is increasingly diverse in its business operations, with activities underway in the UK and expanding into overseas territories. NATS relies on effective digital operations to deliver services and therefore places a very high priority on cyber security. It is recognised that NATS must be prepared for a variety of threats from a multitude of sources. NATS remains committed to the active management of cyber security risks and has, over the past 12 months, made significant progress:

- > NATS achieved its goal of ISO 27001 certification, the international standard of information security management, and the scope will be increased over time.
- > The cyber-aware culture of NATS has improved, with staff having undertaken mandatory security awareness training. The innovative culture change models used by NATS, and the measurable outcomes, resulted in NATS being awarded "Security Awareness Program of the Year" at the 2015 UK Cyber Security Awards. The programme will continue in the coming year.

- > In order to enhance NATS ability to identify external cyber-attacks, the Security Incident & Event Management (SIEM) system has been expanded through a partnership with Lockheed Martin. This system will continue to be enhanced, underpinning the deployment and monitoring of additional cyber-controls.
- > Cyber-incident response processes were refined and rehearsed; table top exercises, have been held with the executives around cyber security events.
- > In preparation for the new EU Data Protection Directive, NATS undertook an inventory and analysis of the location and controls on sensitive personal data.
- > Several of NATS' key operational systems underwent a cyber-security review by the Department for Transport and other Government agencies.

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

Iain McNicoll, CB CBE

Chairman of the Safety Review Committee

Technical Review Committee report

The role of the Technical Review Committee

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

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

Reports from Board Committees (continued)

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

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

Main activities of the Committee during the year

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

Deploying SESAR

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

a. Interoperability Through European Collaboration (iTEC)

This is the new generation of core flight data processing systems which will underpin all NATS future operations. The first deployment is now in progress in the Scottish Area Control Centre in Prestwick, with Limited Operational Service (LOS) achieved at Prestwick in January 2016. Full Operational Service (FOS) is expected this summer. Subsequent 'builds' of iTEC will be deployed in London Area Control and Terminal Control later in the programme.

b. New controller workstation and other projects

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

c. Transition Operations Room

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

Airspace Change

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

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

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

Reports from Board Committees (continued)

a. London Airspace Management Programme (LAMP)

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

The first Phase of this programme, LAMP 1a was successfully delivered into operation in February 2016 delivering a “Point Merge” approach system for London City Airport and a number of related changes. However, as a result of the challenges identified above, LAMP 2 will not now go ahead as planned. NATS hopes to deliver some of the higher level aspects of change during RP2, but the more controversial lower level airspace changes will be delayed until RP3.

b. Transition Altitude

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

c. Time-Based Separation

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

Resilience

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

Peter Read

Chairman of the Technical Review Committee



Report of the directors

Report of the directors

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

The Governance report is set out on pages 50 to 54 and forms part of this report.

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

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

Dividends

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

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

Directors and their interests

The directors of the company at the date of this report are set out on pages 44 to 48. Details of changes made to the Board during the year and to the date of this report are set out in the Governance report on page 50.

The interests of the directors in the share capital of the parent company, through their participation in the Employee Share Plan, are set out on page 67.

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

Directors' indemnities

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

Employees

The group continues its commitment to the involvement of employees in the decision making process through effective leadership at all levels in the organisation. Staff are frequently involved through direct discussions with their managers, cross company work groups and local committees. Regular staff consultations cover a range of topics affecting the workforce, including such matters as corporate performance and business plans. The NATS CEO maintains high visibility with staff through visits to NATS sites where he talks to them about current business issues and takes questions in an open and straightforward manner. Also, employees' views are represented through an open dialogue with Prospect and the Public and Commercial Services Union (PCS), the recognised unions on all matters affecting employees. This has been enhanced through the Working Together programme aimed at working towards partnership principles as the basis for our relationship. Formal arrangements for consultation with staff exist through a local and company-wide framework agreed with the Trade Unions.



Report of the directors (continued)

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

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

The group is also committed to improving employment opportunities for disabled people. The group will continue to promote policies and practices which provide suitable training and retraining, and development opportunities for disabled staff, including any individuals who become disabled, bearing in mind their particular aptitudes and abilities and the need to maintain a safe working environment.

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

Going concern, viability statement and subsequent events

The directors' assessment of going concern and their viability statement are set out on page 21. Subsequent events are disclosed in note 34 to the financial statements.

Directors' responsibilities

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

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

In preparing these financial statements, International Accounting Standard 1 requires that directors:

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

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

Report of the directors

(continued)

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

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

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

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

We confirm that to the best of our knowledge:

- > the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the group;
- > the Strategic report includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that it faces; and
- > the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the group's position and performance, business model and strategy.

Auditor

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

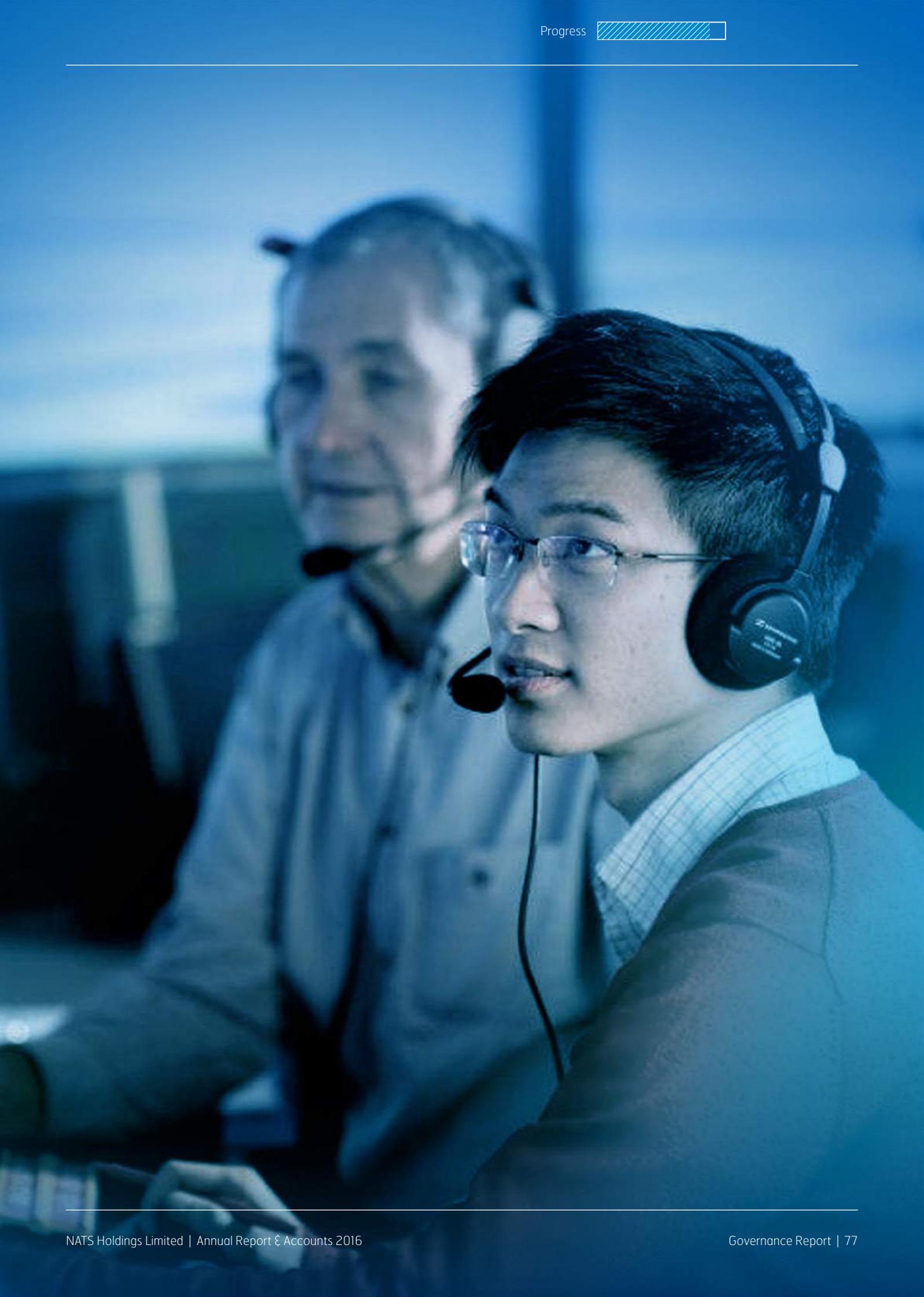
Approved by the Board of directors and signed on behalf of the Board by:



Richard Churchill-Coleman
Secretary
20 June 2016

Registered office
4000 Parkway, Whiteley, Fareham,
Hampshire PO15 7FL

Registered in England and Wales
Company No. 04138218





Independent auditor's report to the members of NATS Holdings Limited

Opinion on financial statements of NATS Holdings Limited

In our opinion:

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

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

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

Separate opinion in relation to IFRSs as issued by the IASB

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

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

Respective responsibilities of directors and auditor

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

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

Independent auditor’s report to the members of NATS Holdings Limited (continued)

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| <p>Respective responsibilities of directors and auditor (continued)</p> | <p>This report is made solely to the company’s members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company’s members those matters we are required to state to them in an auditor’s report and</p> | <p>for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company’s members as a body, for our audit work, for this report, or for the opinions we have formed.</p> |
| <p>Our assessment of risks of material misstatement and overview of the scope of our audit</p> | <p>A description of the scope of an audit of financial statements is provided on the FRC’s website at www.frc.org.uk/auditscopeukprivate.</p> <p>We carried out full scope audits on all significant components which covered 99% of the group’s revenue. We performed limited procedures on the remaining components.</p> <p>Our group audit was scoped by obtaining an understanding of the group and its environment, including the group’s system of internal control, and assessing the risks of material misstatement in the financial statements at the group level.</p> | <p>There has been no significant change in the group’s operations nor in our assessment of materiality, therefore the assessed risks of material misstatement described below, which are those that had the greatest effect on the audit strategy, the allocation of resources in the audit and directing the efforts of the audit team, are the same risks as in prior year .</p> <p>The Audit Committee’s consideration of these matters is set out on pages 56 and 57.</p> |

| Risk | How the scope of our audit responded to the risk |
|---|---|
| <p>Revenue recognition and the recoverability of the regulatory assets:</p> <p>The group generates revenue in relation to Airspace, Airports, Engineering and other services.</p> <p>In determining the revenues recognised, management makes key judgements about material revenue adjustments that are recoverable in subsequent accounting periods.</p> | <p>We have reviewed each significant revenue stream to ensure that we concur with the accounting policies applied.</p> <p>We have reviewed and tested each of the revenue streams to ensure that the revenue is being recognised in line with the group policy and in the case of NATS Airspace to ensure that it is in line with the provisions of the air traffic services licence, the regulatory charging mechanisms for the reference period and the RP2 settlement.</p> <p>We have specifically considered and challenged management over the recoverability of the accrued income as disclosed in note 16 to the financial statements, which at year end is split into four main categories: Eurocontrol accrued income for March 2016; the risk sharing revenue recognised due to low traffic volumes; the allowed inflationary adjustments; and the outstanding balance from prior periods.</p> <p>We have also reviewed individual judgements including the discount rate applied to revenue adjustments.</p> |

Independent auditor's report to the members of NATS Holdings Limited

(continued)

| Risk | How the scope of our audit responded to the risk |
|--|---|
| <p>Pension scheme valuation:</p> <p>The NATS Holdings Limited group operates a defined benefit pension scheme, which is accounted for in accordance with IAS 19 'Employee Benefits' which require complex calculations and disclosures.</p> <p>Management make a number of judgements and actuarial assumptions which have a significant impact on the valuation of pension scheme assets and liabilities shown in the balance sheet and hence on the amounts shown in the consolidated income statement and the consolidated statement of comprehensive income.</p> | <p>We have reviewed the pension scheme data and accounting treatment and disclosures and considered them in light of the assumptions made under the most recent triennial valuation.</p> <p>We have worked with our pension specialists to assess the validity of assumptions applied, in particular discount and inflation rates, performed a detailed review of the scheme actuary's annual update valuation report and reviewed the pension scheme disclosures within the financial statements, reconciled the significant pension scheme cash flows and tested the commutation assumption used in valuing the scheme's liabilities.</p> <p>In addition we have performed audit procedures in order to substantiate the value of the scheme assets. This included selecting a sample of investments held at the balance sheet date and comparing their value to available market data.</p> |
| <p>Carrying value of goodwill:</p> <p>In accordance with the group's accounting policies, management has undertaken an impairment review of the carrying value of goodwill by comparison with the recoverable amount. This has resulted in a charge to the consolidated income statement of £92.7m which reflects an assessment of: opportunities to outperform regulatory targets in regulatory reference period RP2; an assessment of any potential premium that a purchaser might pay for a controlling interest, latest forecasts of traffic volumes and allowed adjustments to future revenue for certain differences between actual costs and the economic regulator's previous estimates.</p> <p>In calculating an appropriate valuation for the recoverable amount of the regulatory business, the premium applied to the regulatory asset base (RAB) continues to be a key judgement, alongside the estimate of future cash flows.</p> | <p>We have reviewed and understood the terms and conditions of the current contract for RP2 and assessed the impact this has on management's assessment of the carrying amount of goodwill.</p> <p>We have reviewed and tested management's current assessment of the carrying amount of goodwill. We have reviewed with the assistance of our own specialists, the overall methodology, cash flow forecasts, discount rate assumptions and benchmarking available to support the RAB premium applied in determining terminal values and fair value less costs to sell.</p> <p>We tested the integrity of the model and considered the impact of various management sensitivity calculations.</p> |



Independent auditor's report to the members of NATS Holdings Limited

(continued)

| Risk | How the scope of our audit responded to the risk |
|---|---|
| <p>Capital investment programme:</p> <p>The group invests significant sums in the sustainment and development of air traffic control infrastructure.</p> <p>A substantial proportion of the costs incurred are the amounts charged by staff employed by the group which are capitalised to specific projects.</p> <p>There is a risk that either time is not appropriately capitalised or the quantum of the labour rate used could be misstated.</p> <p>In addition, management makes judgements around the useful economic lives of currently deployed systems, assesses indicators of impairment and considers feasibility.</p> | <p>We have worked closely with the project managers outside of the group finance team in order to gain an understanding of the most significant capital projects, and how they contribute to the objectives of the business and assess them for impairment factors.</p> <p>We have carried out audit procedures on capitalised projects focusing on the appropriateness of the labour rates being used and the level of labour costs capitalised.</p> <p>We have also assessed management's judgement around the useful economic lives of currently deployed systems to ensure that the position taken is reasonable. We have also considered management's assessment of any indicators of impairment against the carrying value of property, plant and equipment, including the feasibility of assets under the course of construction. In addition we reviewed the appropriateness of capitalisation and that costs incurred are in line with contracts or subsequent variations.</p> |

Our application of materiality

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

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

Performance materiality was set at 75% of the above materiality levels.

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

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



Independent auditor's report to the members of NATS Holdings Limited

(continued)

Opinion on other matters prescribed by the Companies Act 2006

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

Opinion on other matters

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

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

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

- > the directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- > the disclosures in the annual report that describe those risks and explain how they are being managed or mitigated; and
- > the directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in

preparing them and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; or the directors' explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Matters on which we are required to report by exception

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

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

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



Independent auditor's report to the members of NATS Holdings Limited

(continued)

Matters on which we are required to report by exception (continued)

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

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

Other matters

We have also reviewed:

- > the directors' statements on page 21, in relation to going concern and longer term viability; and
- > the part of the corporate governance statement relating to the company's compliance with the provisions of the UK Corporate Governance Code specified for our review if the company was a listed company.

We have nothing to report in respect of these matters.

Malcolm Thixton

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

20 June 2016

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