

Heathrow Airport Limited
Annual report and financial statements
for the year ended 31 December 2017

Heathrow Airport Limited

Contents

Officers and professional advisers	1
Strategic report	
Business overview	2
Management review	6
Financial review	11
Leadership and Governance	16
Internal controls and risk management	18
Directors' report	24
Directors' responsibilities statement	27
Independent auditor's report	28
Financial statements	
Income statement	30
Statement of comprehensive income	31
Statement of financial position	32
Statement of changes in equity	33
Accounting policies	34
Significant accounting judgements and estimates	44
Notes to the financial statements	45

Heathrow Airport Limited

Officers and professional advisers

Directors

Ross Baker
Stuart Birrell
Javier Echave
Emma Gilthorpe
John Holland-Kaye
Carol Hui
Andrew Macmillan
Derek Provan
Paula Stannett

Registered office

The Compass Centre
Nelson Road
Hounslow
Middlesex
TW6 2GW

Independent auditor

Deloitte LLP
Statutory Auditor
2 New Street Square
London, United Kingdom
EC4A 3BZ

Bankers

Lloyds Bank plc
1st Floor
10 Gresham Street
London
EC2V 7AE

Heathrow Airport Limited

Strategic report

Heathrow Airport Limited (the 'Company') is an indirect subsidiary of Heathrow Airport Holdings Limited. The Company's financial activities are aligned with Heathrow Airport Holdings Limited and the wider Heathrow Airport Holdings Limited Group (the 'the Group') and also with the Heathrow (SP) Limited Group, which is the intermediate parent undertaking of the smallest group to consolidate these financial statements.

The financial statements of Heathrow Airport Limited are prepared in accordance with United Kingdom Generally Accepted Accounting Practice – Financial Reporting Standard 102 ('FRS 102'). The accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

This strategic report is presented in five sections:

Business overview – an overview of the business model and strategy of the Company;

Management review – overview of the year ended 31 December 2017, along with the key factors likely to impact the Company in 2018;

Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2017 and analysis of the financial position of the Company as at that date. The Company's accounting and reporting policies and procedures are also considered;

Leadership and governance – description of the Board of Directors (the 'Board') of Heathrow Airport Holdings Limited and Committees of the Board which provide overall leadership to the Group; and

Internal controls and risk management – outline of the Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the Group Executive Committee and Board.

Business overview

Heathrow's business model

Heathrow is one of the best connected hub airports in the world, with 81 global airlines operating regular scheduled flights to 204 destinations. Heathrow is the primary airport in London, which is the world's largest origin and destination aviation market with over 160 million passengers travelling to and from London annually. With 78.0 million passengers in 2017, Heathrow is Europe's busiest airport and the world's seventh busiest airport.

Heathrow provides service to a range of market segments, including business and leisure travellers, direct and transfer passengers on long and short-haul routes, operated by a diversified range of major airlines. As well as earning income from services to airlines, Heathrow also generates revenue from a variety of sources, including concession fees from retail operators, income from car parks, advertising revenue, the rental of airport premises, the provision of facilities and services and the Heathrow Express rail service.

Heathrow has maintained a strong focus over recent years on operational performance, improving the passenger experience and investing in new and upgraded facilities. Heathrow has invested over £10 billion transforming the airport over the last decade. The focus and investment has resulted in Heathrow being named 'Best Airport in Western Europe' by Skytrax for the third consecutive year in 2017 and achieving top ranking among major European hub airport in terms of overall passenger satisfaction for thirteen successive quarters.

Heathrow is subject to economic regulation by the Civil Aviation Authority ('CAA'), which sets caps on the amount that Heathrow can charge airlines for using its facilities. This price setting mechanism provides significant cash flow predictability within each regulatory period which usually lasts five years and may be extended. The current regulatory period was initially set to last from 1 April 2014 to December 2018. In 2016, the CAA formally extended the current regulatory period by one additional year to the end of December 2019 rolling forward the existing price control. In 2017, the regulator's latest consultation stated that a further extension of the current regulatory period to at least the end of 2020 is expected to be needed. The CAA is expected to provide further clarity on the price control that will apply to the latest further extension in 2018.

Heathrow's strategy

Heathrow's strategy is focused on developing the airport's position from one of the best airports in Europe to one of the best in the world. Heathrow's vision is to give passengers the best airport service in the world.

To support and develop Heathrow airport's role as a hub, the Group will continue enabling the success of the major network airlines operating at Heathrow by investing in further capacity, operational flexibility and resilience at sustainable charges for airline customers.

For both local and transfer passengers, Heathrow is working continuously to make every journey better through improved service standards to ensure it remains passengers' preferred airport. Improving the passenger experience is supported by on-going investment in modern airport facilities and operating processes.

Heathrow Airport Limited

Strategic report *continued*

Business overview *continued*

Heathrow's priorities *continued*

Heathrow's vision is to deliver the best airport service in the world and is underpinned by four strategic priorities:

Mojo

To be a great place to work, Heathrow will help its people fulfil their potential and work together to lead change across Heathrow with energy and pride.

Transform customer service

To deliver the world's best passenger experience, Heathrow will work with the Heathrow community to transform the service it gives to passengers and airlines, improving punctuality and resilience.

Beat the plan

Aiming to beat the business plan for the current regulatory period and deliver a competitive return to shareholders by growing revenue, reducing costs and delivering investments efficiently.

Sustainable growth

To operate and grow Heathrow airport sustainably, now and in the future.

Infrastructure

The Group has invested over £10 billion transforming Heathrow's infrastructure over the last decade including £687 million invested in 2017 (2016: £674 million).

Runways

Heathrow airport has two parallel runways. These generally operate in 'segregated mode', with arriving aircraft allocated to one runway and departing aircraft to the other. The airport is permitted to schedule up to 480,000 air transport movements per year and in 2017, it operated at 98.8% (2016: 98.6%) of this limit.

Terminals

Each of Heathrow's four operational terminals is either new or recently refurbished. The busiest terminals are Terminal 2 and 5. Terminal 2, which opened in June 2014, handled 17.8 million passengers in 2017 (2016: 16.5 million) and complements the award winning Terminal 5 which handled 32.3 million passengers in 2017 (2016: 31.9 million).

Heathrow airport's terminal capacity is currently estimated to be 85 million passengers per year.

Baggage systems

In parallel with the work on Heathrow's terminals, significant investment was made in Heathrow's baggage infrastructure including the underground automated baggage system between Terminal 3 and Terminal 5 and the Terminal 3 integrated baggage system which became fully operational in April 2016.

Cargo and mail carriers

Cargo and mail carriers are responsible for handling merchandise and packages at Heathrow airport, including delivery to cargo warehouses, customs procedures and clearance, aircraft loading and unloading, sorting and transport to the final destination. The bulk of cargo and mail at the airport is carried in the cargo holds of passenger flights rather than by dedicated cargo flights.

Certain cargo sheds at the airport are owned by third parties who lease space to cargo service providers. Heathrow also provides cargo sheds and other accommodation and facilities which are leased, or separately billed on a use basis, to cargo-service providers.

Expansion of Heathrow

Heathrow has been operating close to its permitted limit on annual flights for a number of years and is the busiest airport in the world with two or fewer runways, based on its mode and hours of operations. As a result, for a significant period of time, it has been considering ways to deliver sustainable growth, by expanding its runway capacity in order to deliver even greater benefits as the country's only hub airport, whilst mitigating the effects of expansion particularly on local communities.

The UK government established the Airports Commission in 2012 to identify and recommend options to maintain the UK's position as Europe's most important aviation hub. In July 2015, the Airports Commission recommended the expansion of Heathrow airport through the construction of a new runway immediately to the north west of the existing airport, together with associated infrastructure such as new terminal capacity and taxiway systems. In October 2016, the UK government announced its decision to support the expansion of Heathrow airport. The proposed expansion of Heathrow airport is expected to deliver at least 260,000 additional flights per annum which could result in annual passenger numbers increasing to approximately 130 million over time, compared to 78.0 million in 2017.

Heathrow Airport Limited

Strategic report *continued*

Business overview *continued*

Expansion of Heathrow *continued*

A broad range of workstreams involving various stakeholders is now underway initially aimed at Heathrow obtaining the necessary formal policy support from the UK government and consents to enable Heathrow to proceed with the required construction programme.

Heathrow's regulatory environment

Heathrow is subject to economic regulation by the Civil Aviation Authority ('CAA'), which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection.

The CAA sets the maximum level of airport charges for Heathrow, generally for five-year regulatory periods using a per passenger price cap mechanism known as RPI +/- X, which incorporates an allowed return on the Regulatory Asset Base ('RAB'). Heathrow's current regulatory period ('Q6') initially ran from 1 April 2014 to 31 December 2018. On 21 December 2016, the CAA issued a formal notice under section 22(6) of the Civil Aviation Act 2012 to modify the licence issued to Heathrow, by extending Heathrow's current regulatory period by one year so that it will end on 31 December 2019 and rolling over the current price control of RPI-1.5% for the additional year.

In June 2017, the CAA published a consultation document entitled "Consultation on core elements of the regulatory framework to support capacity expansion at Heathrow". This consultation included a decision by the CAA to further extend the Q6 regulatory period by at least a year to 31 December 2020 with an option to extend the Q6 regulatory period further depending on the overall timeline for the expansion of Heathrow Airport. In a further consultation document published by the CAA in December 2017, it indicated that its preferred approach to the price control that will apply during 2020 and beyond is to combine a headline RPI-0.0% tariff. The CAA expects to make a final decision on the price control for the extended Q6 period and whether the duration should be 12-months or longer as soon as is practicable in 2018 with appropriate licence modifications implemented in 2019.

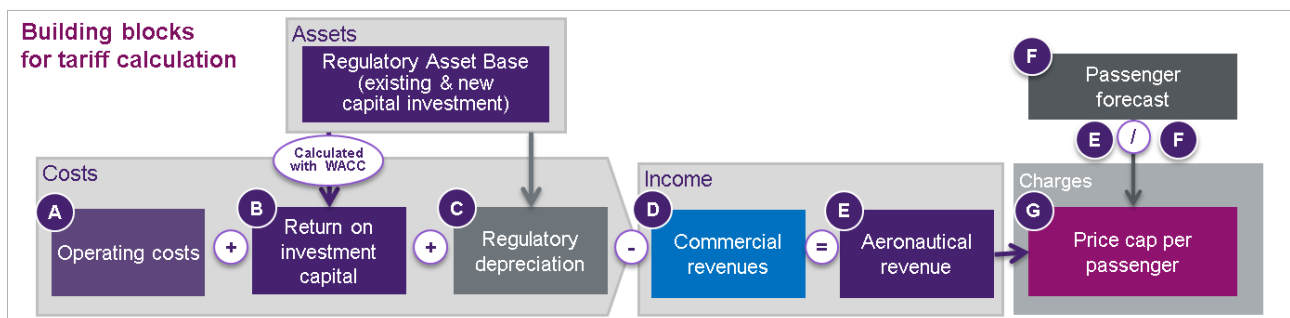
Heathrow's regulation is consistent with the economic regulation of other UK regulated industries (such as telecoms and the energy sector). This form of economic regulation is also sometimes referred to as incentive regulation, in that Heathrow has an incentive to outperform the price control by means of attracting more passengers, reducing operating costs or delivering higher commercial revenues than forecast. If the opposite is the case, then Heathrow has to absorb the cost or lower revenue. There is no adjustment for shortfalls in passenger numbers or additional costs (with the primary exception of where Heathrow incurs additional security costs, above an established threshold, when implementing new security directives imposed by the EU or the UK Government).

The Price Cap

The price cap for Heathrow is based on a RAB methodology using a "single till" building block approach. The single till takes into account revenue and costs from both aeronautical and non-aeronautical activities when setting the price caps for a regulatory period.

In setting the price cap, the CAA determines the regulated revenue requirement. This is calculated as the sum of forecast operating expenditure less other revenue plus the required return (using the cost of capital determined by the CAA) on the forecast RAB taking into account forecast capital expenditure, plus regulatory depreciation and plus or minus any profiling adjustment. The profiling adjustment is a mechanism used to smooth changes in charges that might otherwise occur as a result of major investments. The resulting aeronautical revenue requirement effectively amounts to the total income from airport charges.

This methodology for deriving the aeronautical revenue requirement can be represented by the following simplified diagram:



Since the start of the current regulatory period, the maximum allowable yield (the amount of income generated from regulated airport charges on a per passenger basis) changes from 1 January each year by RPI minus 1.5%, based on RPI from the previous April.

Heathrow Airport Limited

Strategic report *continued*

Business overview *continued*

Heathrow's regulatory environment *continued*

In setting the price cap the CAA takes its own view of the scope for future efficiency savings, the appropriate level of capital expenditure and the rate of growth in demand for airport services.

While the price cap places a limit on the increase in the airport charges yield, Heathrow has the discretion on whether to price to the maximum permitted level. Therefore, Heathrow can choose to price charges below the cap. For example, if there is unused capacity, Heathrow could choose to set prices below the cap in order to stimulate demand.

The price cap takes certain elements into account in the maximum allowable yield. These include an adjustment for additional or reduced security costs as a result of new UK or European security directives; reductions where capital expenditure project milestones are not delivered; a 2017 business rates revaluation factor and a service quality rebate scheme. In addition there is a mechanism known as the "K factor" which is designed to correct for any under recovery (dilution) or over recovery (concentration) in airport charges compared to the annual maximum allowable yield per passenger. Under or over recoveries generally arise due to changes in passenger mix or average load factors compared to those forecast at the time prices were prospectively set for the relevant year.

Heathrow's income

Heathrow generates two primary types of income: aeronautical income, which is generated from fees charged to airlines for use of the airport's facilities, including passenger fees, landing charges and aircraft parking charges, and non-aeronautical income from a variety of sources, including concession fees from retail operators, direct income from car parks and advertising and income from other services supplied by Heathrow.

Aeronautical income

Aeronautical income reflects the charges levied by Heathrow on the airport's airline customers. These charges (tariffs) cannot exceed the regulated maximum allowable yield per passenger. The tariff structure through which the aeronautical income is recovered from airlines includes three key elements:

Passenger fees

- Fees per passenger are based on the number of passengers on board an aircraft and are levied in respect of all departing passengers. There is no charge in respect of crew members working on flights.
- Three levels of charge based on route area: European, domestic and rest of world. Transfer and transit passengers benefit from a discount.

Landing charges

- Landing charges are levied for substantially all aircraft (with certain diplomatic and other flights being exempted). These are calculated in accordance with the certified maximum take-off weight of the aircraft and are banded into categories for aircraft weighing less than and those weighing more than sixteen tonnes, which includes nearly all commercial aircraft. These charges are adjusted, where applicable, in accordance with each aircraft's noise-rating, its emissions and the time of day, with landing charges being higher during peak traffic times than off-peak traffic times.

Parking charges

- Aircraft parking charges are levied for each 15 minute slot after 30 minutes (for narrow-bodied aircraft) and 90 minutes (for wide-bodied aircraft).

Non-aeronautical income

Heathrow generates non-aeronautical income from a variety of sources. These include concession fees from retail operators; direct income from car parks, advertising revenue and VIP products; the rental of airport premises such as aircraft hangars, warehouses, cargo storage facilities, maintenance facilities, offices and airline lounges; the provision of facilities such as baggage handling and passenger check-in; and fare revenue from the operation of the Heathrow Express rail service.

Heathrow Airport Limited

Strategic report *continued*

Management review

Review of the year

2017 was a record year at Heathrow during which we made excellent progress toward delivering our vision: to give passengers the best airport service in the world. We maintained strong momentum across the four priorities underpinning our vision: making Heathrow a great place to work, transforming our service to passengers and airlines, beating the business plan over the current regulatory period and operating and growing Heathrow sustainably today and in the future.

The success of our vision is bound to attracting, retaining and developing high quality talent. This is why making Heathrow a great place to work and creating careers where people can fulfil their potential is at the very heart of our strategic priorities. In 2017, 74% of our colleagues (2016: 78%) rated themselves engaged: a particularly strong outcome as the company wide survey was run as an industrial action ballot was taking place. Heathrow was also voted one of The Sunday Times' Top 30 Best Big Companies to Work For. We took great pride in becoming the UK's first airport to be a fully accredited London Living Wage employer. We rolled out our Digital Workplace to our central functions as we continue evolving toward a more agile responsive organisation, further empowering our colleagues.

We delivered an outstanding service to our passengers during our busiest year on record. We achieved an excellent 4.18 out of 5.0 score in the global Airport Service Quality survey in Q4 2017 while we achieved record levels of baggage connections and departures punctuality. Passengers voted Heathrow 'Best Airport in Western Europe' for the third year running and 'Best Airport for Shopping' globally for the eighth consecutive year at the 2017 Skytrax World Airport Awards. Lastly, we were named the world's best airport for security in the inaugural awards from International Airport Review.

In 2017, a record 78.0 million passengers chose to travel through Heathrow, up 3.1% on 2016 - the single best endorsement of our strategy. This was our seventh successive annual record and was enabled by record load factors. Passengers benefitted from an even greater choice in terms of destinations with new long haul services to Barbados, New Orleans, Portland, Qingdao and Santiago. Heathrow also delivered for the UK, supporting British trade with a significant increase in cargo volumes, up 10.2% on last year.

2017 was also about continuing to beat the plan on both revenues and costs as we remain well on track to deliver £900 million of revenue and cost improvements over the current regulatory period to the end of 2018. Our strong focus on operating efficiencies continued with headline operating costs down marginally despite welcoming an additional 2.3 million passengers and a significant pick up in inflation. On the revenue side, we are seeing more passengers participating in our retail offering and each of them is spending more. As a result of all these dynamics, revenues were up 2.7% to £2.9 billion. We raised over £1.0 billion in debt financing paving the way to simpler debt financing arrangements and enhancing our resilience ahead of expansion.

Heathrow's expansion really moved into delivery mode in 2017 following the Government's backing for our plans in late 2016. We are already making good progress toward delivering this once-in-a-generation boost for Britain's economy, one that will help secure the country's economic future as an outward looking nation. The government considers Heathrow expansion as strategically important for the UK and intends to submit its Airports National Policy Statement, the key legislative enabler for expansion, to a vote in Parliament in the first half of 2018. We continue engaging with our regulator and airline stakeholders to define the regulatory framework that will enable expansion that is affordable, sustainable and financeable. Finally, in January 2018, we launched our first planning consultation. The consultation outlines our emerging proposals and options to deliver an expanded Heathrow while keeping our commitments to local communities and meeting strict environmental tests. It is the opportunity for our local community and the broader public to help us shape Heathrow's future.

Key business developments

Mojo

We are committed to making Heathrow a great place to work and our efforts are showing results. In 2017 our colleagues voted us one of The Sunday Times' Top 30 Best Big Companies to Work For.

Our commitment to personal development saw 211 colleagues promoted internally, demonstrating that our focus on retaining and developing talent is working, with a further 3,191 taking part in training and personal growth programmes. We also launched five diversity networks, so colleagues can be their best by being themselves.

Our new Digital Workplace rolled out, helping those who work here to connect – on any device, anywhere, at any time, and we launched a salary sacrifice scheme for green cars, giving colleagues big discounts on sustainable travel.

Our commitment to giving something back saw 932 colleagues and Team Heathrow partners take part in events to raise over £350,000 for our charity partners. These events included our annual midnight marathon on our northern runway and 'race the plane', where 351 participants from Team Heathrow raced an Air Canada flight to Toronto on exercise bikes, raising £101,000 in the process.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Key business developments *continued*

Transform customer service

In 2017, we continued to deliver a world-class passenger service achieving a record annual average score of 4.16 out of 5.0 and an excellent 4.18 out of 5.0 score in the fourth quarter in the global Airport Service Quality ('ASQ') survey. Heathrow has been ranked first among major European hub airports for service quality in this survey for thirteen successive quarters. In addition, 82% of passengers surveyed rated their Heathrow experience 'Excellent' or 'Very Good' (2016: 84%).

Heathrow received other recognitions for its high service standards, being named the 'Best Airport in Western Europe' for the third consecutive year at the Skytrax World Airport Awards. The award, voted for globally by passengers, came in addition to Heathrow being voted 'Best Airport for Shopping' for the eighth consecutive time.

Improving passengers' journeys through the airport remains one of our key priorities. Passengers continue to enjoy efficient queuing to pass through security, passing through central security within the five minute period prescribed under the Service Quality Rebate ('SQR') scheme 97.3% of the time (2016: 97.0%) compared with a 95% service standard. The service quality regime penalty threshold was not triggered in 2017 in respect of any performance standard and for the first time in the current regulatory period, we earned a modest level of bonuses under the SQR scheme.

Punctuality improved with a record 80.2% of flights departing within 15 minutes of schedule (2016: 78.8%). Baggage performance improved significantly with the misconnect rate down to 10 bags per 1,000 passengers (2016: 14), reflecting our enhanced operational resilience. Heathrow achieved its best ever monthly baggage performances of 7 bags per 1,000 passengers in February 2017 and 8 bags per 1,000 passengers in 3 other separate months, beating the previous record of 9 bags per 1,000 passengers set in October 2016.

Over a million passengers with reduced mobility travelled through Heathrow in 2017. Last summer, we agreed new service levels with our supplier that took effect in January 2018; they will enhance our performance and transform these passengers' experience. In September 2017, we also launched an improvement plan which includes steps we are now taking to better monitor and report our performance, conduct accredited disability awareness training and engage with disability groups going forward.

Beat the plan

Q6 business plan

Our business plan for the current regulatory period ('Q6') is intended to improve customer service, strengthen operational resilience and deliver an ambitious programme of cost efficiencies and revenue growth.

We are on track to substantially deliver the cost efficiencies and additional commercial revenues built into our plan. As a result, by the end of 2018, we will have secured £900 million of incremental EBITDA over the period.

Passenger traffic

Heathrow's passenger traffic by geographic segment for the year ended 31 December 2017:

<i>Passengers by geographic segment (millions)</i>	Year ended 31 December 2017	Year ended 31 December 2016	Change¹ %
UK	4.8	4.6	3.3
Europe	32.4	31.7	2.4
North America	17.4	17.2	1.1
Asia Pacific	11.3	10.8	4.5
Middle East	7.6	7.0	9.5
Africa	3.2	3.2	0.2
Latin America	1.3	1.2	5.5
Total passengers¹	78.0	75.7	3.1

¹These figures have been calculated using un-rounded passenger numbers.

In the year ended 31 December 2017, we welcomed a record breaking 78.0 million passengers (2016: 75.7 million), a rise of 3.1% on prior year on a total of 471,082 passenger flights (2016: 470,764). Our traffic growth was primarily enabled by average load factor increasing by 2 percentage points to 78.0% (2016: 76.0%) partly driven by an increase in UK inbound demand, influenced by the depreciation of sterling, particularly from the Middle East and Asia Pacific. The average number of seats per passenger aircraft rose 0.4% to 212.3 (2016: 211.5). The increase in the number of flights reflects the immediate benefit of a scheme we launched in the fourth quarter of 2017 to boost utilisation of our limited spare capacity which drove a net increase in the final quarter of over 1,300 flights.

Passengers benefitted from an even greater choice in 2017 with new domestic services operated by Flybe, new international destinations including Barbados, New Orleans, Portland, Qingdao and Santiago and more services and additional seats per flight to the Middle East and Asia.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Key business developments *continued*

Passenger traffic *continued*

Intercontinental traffic was the key geographic driver of our traffic growth, increasing 3.6%, with load factors improving significantly. Intercontinental traffic growth was particularly robust on routes serving the Middle East where passenger numbers increased 9.5% supported by flights and larger aircraft, including additional A380 services from Emirates, Etihad and Qatar Airways, and more flights, including additional services from Oman Air. The 4.5% rise in Asia Pacific traffic was driven by substantial growth in load factor on existing routes serving Malaysia and new or increased services to Thailand, Philippines and Vietnam. North American traffic rose 1.1% mainly benefitting from increased load factors. Latin American traffic grew 5.5%, due to more flights and fuller aircraft serving the region.

European traffic increased by 2.4% due to fuller, larger planes with notable growth on routes to Italy, Russia, Belgium, Denmark, Netherlands and Portugal with over 70,000 extra passengers in each market. Flybe's new Scottish services contributed to the 3.3% growth in domestic traffic. In January 2018, Heathrow announced a £15 discount on airport charges for domestic flights, a 50% increase in the discount put in place in 2017. The new initiative will provide even better value to our passengers and support our plans to enhance domestic connectivity by making domestic routes more commercially viable for our airlines.

Over 30% of the UK's non-EU exports by value pass through Heathrow today. In the twelve months ended 31 December 2017, cargo volumes were up 10.2% to 1.7 million tonnes, one of the strongest periods in the last 5 years in terms of year on year growth, with notable increases on North America and the Middle East.

Investing in Heathrow

We invested £687 million in 2017 on a variety of programmes to improve the passenger experience, airport resilience and work through a broad asset replacement programme. We also continued to develop our plans for expanding Heathrow for which investments amounted to approximately £80 million in 2017. We expect expansion-related capital investment to increase to around £150 million to £175 million in 2018.

Passengers have benefited from improvements delivered in Terminal 4 including increased space in the immigration hall to ease congestion and the opening of a new Gucci store marking the completion of the luxury retail redevelopment. In Terminal 5, premium passengers are enjoying the new 'First Wing' offering a fast track route with dedicated security lanes to British Airways' lounge. In Terminal 5 as well, the final self-boarding gate of the first tranche of works was completed and won the 'Best Gate Initiative' at the 2017 Future Travel Experience Global Conference. The self-boarding gates will help reduce boarding times as we continue extending automation across the passenger journey and further enhance efficiency for airlines. New combined body-scanner/metal detectors were also installed in Terminal 5 to enhance the transfer security experience. Airfield improvements continued to meet increased A380 operations with additional taxiway widening and stand modifications now substantially completed. The upgrade of the hold baggage screening machines, which is our largest single investment of the current regulatory period, continues to be delivered across all terminals with a portion of bags in Terminal 5 already being screened through the new security machines. Lastly, in relation to expansion, our key investment was into finalising a review of all the components and options that will underpin the expanded infrastructure. This work informed the preparation of our first planning consultation launched in January 2018.

Sustainable growth

Heathrow 2.0

In 2017, we launched our sustainability leadership plan 'Heathrow 2.0' which aspires to make the airport a centre of excellence in sustainable aviation. Our strategy sets out ambitious goals to reduce the airport's and the industry's environmental impacts while maximising economic opportunities across the UK.

We want Heathrow to be a great place to work and to create careers, not just jobs, so that the people who work here can fulfil their potential. One of our flagship goals is to facilitate 10,000 apprenticeships by 2030 to help people develop skilled and sustainable careers. Since 2004, the Heathrow Academy has helped over 3,600 local residents find work, 5,800 advance into further training and over 1,500 into apprenticeships.

We want Heathrow to be a great place to live and to work better with our neighbours to improve their quality of life, particularly relating to noise and air quality. One of our key goals is to encourage the use of the quietest aircraft available, operated with the least noise impact practicable within an agreed noise envelope. Over the past 30 years, Heathrow's passenger numbers have more than doubled, while its noise footprint has decreased to its smallest levels yet. Independent analysis showed that in 2017, 15% fewer households were impacted by noise than in 2006. From 1 January 2018, Heathrow increased environmental charges by 7%, incentivising airlines to deploy their cleaner and quieter aircraft at Heathrow. In 2017, we also made progress in reducing the number of late runners with a decrease of 29% to 235 flights operating after 11:30pm (2016: 330 flights).

We want Heathrow to be part of a thriving, sustainable economy and to create opportunities for sustainable businesses to deliver a stronger future for the UK. In November 2017, Heathrow became a fully accredited Living Wage Employer, recognised by the Living Wage Foundation. This will see 3,200 airport workers receive the living wage by the end of 2020. Heathrow is also committed to exceed the criteria for accreditation by encouraging other businesses based at the airport to take a similar stance.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Key business developments *continued*

Sustainable growth *continued*

Heathrow 2.0 *continued*

We want Heathrow to lead the way in preventing slavery and human trafficking. As an international travel hub, Heathrow has a unique responsibility to maintain a leadership role in combatting modern slavery and human trafficking. Our goals include working with our supply chain and Team Heathrow to tackle modern slavery and human trafficking in all their forms and to operate Heathrow as a Responsible Gateway – a place that strives to end trafficking of people. Heathrow maintains effective systems, controls and internal policies to prevent slavery and human trafficking in its business and supply chain. In June 2017, we published our first Modern Slavery Statement. We also launched the Responsible Gateway Forum. Chaired by Heathrow Travel Care, the forum works collaboratively with third parties including the Metropolitan Police, Border Force and specialist NGOs to improve the detection of, and support for, vulnerable travellers. Through Heathrow 2.0 we will build new partnerships, run campaigns and provide training to our employees and the wider Heathrow community to increase awareness and take further action to combat human rights abuses. Our Modern Slavery Policy sets out Heathrow's approach to preventing modern slavery and human trafficking within our business and supply chain and clarifies each individual's role in complying with applicable laws and safeguarding vulnerable persons against modern slavery and human trafficking. Our Whistleblowing Policy is aimed largely at our employees (permanent or temporary), but also applies to consultants, agency workers and contractors working at Heathrow. This policy encourages individuals to report any wrongdoing, including slavery and human trafficking.

Finally, we want Heathrow to play a role in ensuring that we have a world worth travelling and to deliver fair and sustainable air travel for future generations to enjoy. Our aspiration is to make growth from our new runway carbon neutral and we will publish a Carbon Neutral Roadmap in 2018. We also have a goal that no illegal wildlife or animal products should pass through Heathrow. As the only airport signatory to the Buckingham Palace Declaration, we want to encourage others to sign up and raise awareness with passengers, colleagues, the cargo community and the global community about the impact of trade in endangered wildlife. In 2017, we worked with UK Border Force and IAG Cargo to support United for Wildlife's 'United for Elephants' campaign and raise awareness of critically endangered species with passengers.

Expansion

Key Heathrow developments

Our expansion plans remain on track to deliver a once-in-a-generation boost for Britain's economy in a way that is affordable, financeable and sustainable.

On 17 January 2018, Heathrow launched a 10-week consultation on options for expansion which will run until 28 March. The consultation is a major milestone in the delivery of an expanded Heathrow and is expected to be one of the largest consultations ever in the UK – including 40 events across areas close to Heathrow. The consultation is composed of two parts – the first relating to the physical options needed to deliver and operate an expanded Heathrow and the second on the design principles for the new airspace required to operate an expanded Heathrow. It is an opportunity for the public to help shape at an early stage how the future expanded airport will look and operate. The feedback from this consultation will help Heathrow determine a preferred masterplan which will be presented to the public for a second, statutory consultation in 2019 after which Heathrow will prepare a final planning application known as a Development Consent Order which is expected to be submitted to the Planning Inspectorate in 2020.

Heathrow confirmed in December 2017 that it could deliver an expanded airport for £2.5 billion less than the plans submitted to the Airports Commission – bringing the total cost of the project down to £14 billion and contributing to meeting the government's challenge to expand whilst keeping airport charges close to current levels. The physical options related to this emerging scheme are among those included in the consultation referenced above.

Work continues to develop an efficient, affordable and sustainable expansion supply chain. In 2017, Heathrow kicked off its search for four logistics hubs which will ultimately help manufacture and assemble components of an expanded Heathrow. Over 120 sites applied and after an initial review, Heathrow long-listed 65 sites for further consideration in 2018. The final locations will pioneer offsite manufacturing, helping to reduce local disruption and environmental impacts whilst spreading jobs created from expanding Heathrow across the UK.

Heathrow's successful Business Summits programme continued to grow in 2017 with seven events taking place across the UK offering small and medium businesses the chance to meet face-to-face with Heathrow's top suppliers and become part of the airport's multi-billion-pound supply chain. The Business Summits programme is set to grow even further in 2018, with 10 events scheduled across the UK.

Governmental developments

In 2017, the government confirmed expanding Heathrow as strategically important for the UK. The Department for Transport launched two public consultations on a draft Airports National Policy Statement ('NPS') which will set the policy framework for expansion. The first consultation ran from February to May with the second following between October and December after updated evidence on aviation demand forecasts and the government's final air quality plan became available.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Key business developments *continued*

Expansion *continued*

Governmental developments *continued*

The government is currently reviewing this feedback and has committed to submitting the final NPS to a vote in Parliament in the first half of 2018. In parallel, the Transport Select Committee launched its own inquiry into the revised NPS in October. It is expected to provide its final recommendation on the revised draft NPS to the Department for Transport this spring following input from a series of public evidence sessions.

Expanding Heathrow remains widely supported, particularly in Parliament, with the latest polling showing that over 70% of MPs back the project. In addition, both the Scottish and Welsh Governments, the DUP, major business groups including the CBI, BCC and FSB, union bodies including Unite, GMB and the TUC and airlines like easyJet and Flybe continue to support expanding Heathrow.

CAA consultation

During 2017, the CAA has further developed its thinking regarding the next regulatory period (H7) which would comprise a significant proportion of the expansion investment phase. The CAA launched two consultations, one in June 2017 'Consultation on the core elements of the regulatory framework to support capacity expansion at Heathrow' and the other in December 2017 'Economic regulation of capacity expansion at Heathrow – policy update and consultation'. Responses to the second consultation are due by 2 March 2018.

The CAA's fundamental objective in developing the H7 regulatory framework is to ensure that it appropriately balances affordability and financeability considerations.

In both consultations, the CAA is clear that the regulatory framework for expansion should build on the strengths which have evolved through thirty years of regulation, including continued use of the regulatory asset base ('RAB') as the cornerstone of the regulatory framework and a single till approach to determine tariffs.

The consultation states that a further extension of Q6 to at least the end of 2020 is expected to be needed, with the CAA emphasising the need for flexibility, in particular the potential need to further extend Q6 to better align the start of H7 with commencement of the expansion construction programme. In terms of economics beyond 2019, in its latest consultation the CAA expresses a preference for a headline price of RPI-0% while various options are being considered to reflect performance on building blocks such as passenger volumes, operating costs, commercial revenues and potentially the cost of debt component of the weighted average cost of capital ('WACC'). Heathrow is considering its response to this area.

The consultations have addressed many aspects of Heathrow's regulation through expansion including various issues related to financeability and financial resilience such as preliminary views on cost of capital, inflation and debt indexation, minimum creditworthiness, gearing caps and strengthened liquidity requirements.

The current consultation includes preliminary work by PwC on defining Heathrow's allowed WACC in H7 although the CAA specified this analysis does not represent its own views. PwC suggests a real 'vanilla' (pre-tax debt and post-tax equity) WACC range of 2.8-4.6% in a 3-runway scenario, estimated to be equivalent to 3.3-5.3% on a consistent basis with the 5.35% applicable in Q6. The preliminary cost of capital for H7 versus Q6 largely reflects two opposing factors, lower cost of debt and equity (driven by market parameters) offset by a risk premium related to expansion. The CAA acknowledges that given expansion's incremental risks the scale of the premium in Heathrow's allowed cost of capital will be subject to significant further work over the coming years. As it stands, PwC's preliminary analysis presents various methodological flaws and erroneous assumptions which Heathrow will address in its response.

In terms of defining the cost of debt allowance included in the WACC, the CAA's initial view is to introduce indexation to a relevant benchmark for just new debt while the cost of embedded debt would continue to be determined as a fixed allowance.

With regards to inflation indexation, the CAA has confirmed a gradual transition to consumer price index ('CPI') rather than retail price index ('RPI') based regulation. Its initial policy for H7 is to continue to use RPI to calculate both the WACC and RAB but it leaves open whether RPI or CPI is used to calibrate the H7 price control, for example, the tariff formula.

Away from financeability matters, the CAA provides further details on the definition and information requirements applying for early category C costs (costs related to land acquisition, detailed surveying or design or very early construction) that may be incurred before planning consent is granted. Heathrow expects these costs to amount to several hundred million pounds between 2018 and 2020.

The CAA plans to provide additional clarity on the regulatory framework in April 2018 and September 2018 when it publishes its next consultation papers.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Key business developments *continued*

Expansion *continued*

Brexit

We are encouraged by the progress made by the government in its Brexit negotiations toward agreeing a transitional period with its European counterparts. As the UK charts its new path outside the European Union as an outward looking nation, it remains particularly important that the country secures continued access to the single European aviation market with around 35% of Heathrow's traffic to and from European Union member countries. In addition, Heathrow will continue to advocate a deal that maintains efficient flows of both people and goods that will ensure continued access to skills and efficient immigration and cargo processing.

Key management changes

On 22 January 2018, Heathrow announced that Chris Garton will be joining the company as Chief Operating Officer ('COO') in the spring. He held a similar position for nine years at Dubai Airport until late 2016. He was most recently Director of Asset Management at Associated British Ports. During his career, Chris has also held a number of roles in engineering and change management at Gatwick Airport, Ineos and ICI.

Chris's imminent arrival at Heathrow follows the appointment of Derek Provan, who has been interim COO since October 2017, as Chief Executive Officer of AGS Airports.

Financial review

Introduction

The following financial review, based on the financial statements of the Company, provides commentary on the performance of the Company's operations.

Basis of presentation of financial results

The Company has prepared its financial statements and financial review in accordance with FRS 102.

The presentation of retail revenue has been changed to more closely reflect the way in which the retail activities are managed. Retail revenues are now presented under five categories: retail concessions, catering, other retail, car parking and other services. Airside specialist shops and duty and tax-free activities drive most of retail concessions revenues. Other retail revenues include advertising and bureau de change while other services income comes primarily from VIP and fast track services and car rental. Recategorised historical values for the new categories are outlined in Appendix 2 and are also available in excel format on the Heathrow investor centre website.

Summary performance

In the year ended 31 December 2017 the Company's operating profit before certain re-measurements was £1,061 million (2016: £1,011 million) and its profit after tax was £649 million (2016: £48 million).

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Excluding certain re-measurements		
Revenue	2,828	2,760
Operating costs before depreciation and amortisation	(1,076)	(1,080)
Adjusted EBITDA¹	1,752	1,680
Depreciation and amortisation	(691)	(669)
Adjusted operating profit²	1,061	1,011
Net finance costs	(554)	(480)
Adjusted profit before tax³	507	531
Tax charge on profit before certain re-measurements	(119)	(143)
Including certain re-measurements		
Fair value gain on investment properties	149	44
Fair value gain/(loss) on financial instruments	148	(474)
Tax (charge)/credit on certain re-measurements	(36)	64
Tax credit relating to change in tax rate	-	26
Profit after tax	649	48

1 Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation and certain re-measurements.

2 Adjusted operating profit is adjusted EBITDA including depreciation and amortisation.

3 Adjusted profit before tax is adjusted operating profit after deducting net finance costs.

For the year ended 31 December 2017, Adjusted EBITDA was £1,752 million (2016: £1,680 million) and EBITDA was £1,901 million (2016: £1,724 million) after adjusting for fair value gain/(loss) on investment properties. Management uses Adjusted EBITDA to monitor performance of the segments as it believes it more appropriately reflects the underlying

Heathrow Airport Limited

Strategic report *continued*

Financial review *continued*

Summary performance *continued*

financial performance of the Group's operations. On a monthly basis management review results, paying particular attention to the airport operations over which it exercises control on a day-to-day basis.

Certain re-measurements comprise fair value movements on investment properties, which are mainly market-driven and over which management has little influence; fair value gains and losses on financial instruments which are subject to external financial market fluctuations; tax associated with these items and the effects of changes in tax rates, which are set by statute.

By isolating certain re-measurements, management believes the underlying results provide the reader with a clearer understanding of the performance of the Group, by concentrating on the matters over which it exerts influence, whilst recognising that information on these additional items is available within the financial statements, should the reader wish to refer to them.

Revenue

In the year ended 31 December 2017, revenue increased 2.5% to £2,828 million (2016: £2,760 million).

	Year ended 31 December 2017	Year ended 31 December 2016	Change
	£m	£m	%
Aeronautical	1,716	1,699	1.0
Retail	659	612	7.7
Other	453	449	0.9
Total revenue	2,828	2,760	2.5

Aeronautical

In the year ended 31 December 2017, aeronautical revenue increased 1.0% to £1,716 million (2016: £1,699 million). Heathrow delivered better value for passengers and airlines with lower charges as average aeronautical revenue per passenger declined 2.0% to £22.00 (2016: £22.45).

Traffic growth of 3.1% generated £51 million incremental revenue. This was offset by a lower price due to the regulatory RPI-1.5% pricing formula and adjustments to reflect lower capital expenditure than forecast in the original regulatory settlement. Yield dilution in the period compounded by concentration in the same period last year resulted in £20 million lower revenue.

Retail

In the year ended 31 December 2017, retail revenue increased 7.7% to £659 million (2016: £612 million). Retail revenue per passenger rose 4.5% to £8.45 (2016: £8.09).

	Year ended 31 December 2017	Year ended 31 December 2016	Change
	£m	£m	%
Retail concessions	304	275	10.5
Catering	56	49	14.3
Other retail	109	110	(0.9)
Car parking	120	114	5.3
Other services	70	64	9.4
Total retail revenue	659	612	7.7

Growth in retail income reflected primarily the increased passenger traffic in the period combined with greater airside participation (up 2 percentage points versus 2016) as well as increased retail spend per participating passenger. Retail concessions grew by 10.5% reflecting the benefit, particularly in duty and tax-free and airside specialist shops, from depreciation of sterling since June 2016, although, as expected, this trend has moderated since the anniversary of the depreciation. The redevelopment of Terminal 4's luxury retail offering, completed in late 2016, also contributed to this growth.

Catering also saw strong growth from increased passenger traffic, the redevelopment of Terminal 5 catering outlets and more passengers choosing to buy food from terminals before boarding their flights. In other retail activities, growth in advertising revenues was offset by some underperformance in bureau de change as a result of increasing competition. Car parking rose 5.3% driven by increased passenger numbers and a more dynamic pricing strategy. Higher car rental revenue from a change in arriving passenger mix and increased volumes in VIP services drove other services income up 9.4%.

Heathrow Airport Limited

Strategic report *continued*

Financial review *continued*

Revenue *continued*

Other

In the year ended 31 December 2017, other revenue increased 0.9% to £453 million (2016: £449 million).

	Year ended 31 December 2017	Year ended 31 December 2016	Change
	£m	£m	%
Other regulated charges	240	232	3.4
Rail passenger revenue	10	13	(23.1)
Property and other	203	204	(0.5)
Total other revenue	453	449	0.9

Other regulated charges reflect a pass through to airlines of Heathrow's costs in areas such as baggage system operations and maintenance and utilities. The year on year performance reflects increased baggage income from higher traffic volumes, income from under recovery of 2016 costs, offset by lower consumption of utilities at reduced prices. Performance elsewhere in other revenue reflects strong traffic growth at Heathrow Express, driven by the introduction of a more sophisticated pricing strategy and 7% growth in passenger numbers versus 2016.

Operating costs

In the year ended 31 December 2017, operating costs excluding depreciation and amortisation decreased by 0.4% to £1,076 million (2016: £1,080 million) as cost efficiencies across a range of areas have offset the impacts of higher passenger numbers and inflation. Management excludes depreciation, amortisation and exceptional items from operating costs for the purposes of calculating Adjusted EBITDA.

	Year ended 31 December 2017	Year ended 31 December 2016	Change
	£m	£m	%
Employment	349	349	-
Operational	241	257	(6.2)
Maintenance	164	164	-
Business rates	124	127	(2.4)
Utilities	86	72	19.4
Other	112	111	0.9
Operating costs before depreciation and amortisation	1,076	1,080	(0.4)
Depreciation and amortisation	691	669	3.3
Total operating costs	1,767	1,749	1.0

The non-repeat of 2016 organisational change costs and benefits of cost efficiencies in people-related areas was offset by managing higher passenger numbers whilst maintaining service and resilience, a pay rise coming into effect in July 2017 and the costs of voluntary severance schemes across a range of operational areas to enable future efficiencies. A combination of benefits from the renegotiated NATS contract, efficiencies from other third party suppliers and lower insurance costs in the year drove operational costs down.

Higher utility costs are due to the non-recurrence of a one-off credit in 2016 following the renegotiation of a contract for the provision of electricity distribution infrastructure services. The recurrent benefits from this renegotiation and focus on energy demand management continued to drive underlying savings year on year.

Other costs were in line with 2016, with higher costs of winter resilience offset by various efficiencies and the fact that in relation to expansion, following the UK Government's decision in late 2016 to support Heathrow expansion, costs have started to be capitalised rather than being expensed.

Operating profit

For the year ended 31 December 2017, the Company recorded an operating profit before certain re-measurements of £1,061 million (2016: £1,011 million).

	Year ended 31 December 2017	Year ended 31 December 2016	Change
	£m	£m	%
Adjusted EBITDA	1,752	1,680	4.3
Depreciation and amortisation	(691)	(669)	3.3
Operating profit before certain re-measurements	1,061	1,011	4.9
Fair value gain on investment properties	149	44	238.6
Operating profit	1,210	1,055	14.7

In the year ended 31 December 2017, Adjusted EBITDA (before certain re-measurements) increased by 4.3% to £1,752 million (2016: £1,680 million), resulting in an Adjusted EBITDA margin of 60.6% (2016: 60.1%). Depreciation and amortisation increased to £691 million (2016: £669 million), driven by a number of new assets coming into operational use during the year as the Q6 programme of capital projects nears completion. Fair value gain on investment properties,

Heathrow Airport Limited

Strategic report *continued*

Financial review *continued*

Operating profit *continued*

which are mainly market driven and over which management has little influence, increased to £149 million (2016: £44 million). Investment properties were valued at fair value at 31 December 2017 by CBRE Limited, Chartered Surveyors (2016: CBRE Limited, Chartered Surveyors). Also, during the year ended 31 December 2017, operating profit increased by 14.7% to £1,210 million (2016: £1,055 million), resulting in an operating profit margin of 42.8% (2016: 38.2%).

Taxation

All Heathrow companies operate not only within the UK's tax laws, but also within the spirit of them and do not structure transactions in a way which gives a tax result contrary to the intentions of Parliament. All Heathrow company profits are subject to UK corporation tax.

The total tax charge recognised for the year ended 31 December 2017 was £155 million (2016: £53 million). Based on a profit before tax for the year of £804 million (2016: £101 million), this results in an effective tax rate of 19.3% (2016: 52.5%).

The total tax charge before certain re-measurements for the year ended 31 December 2017 was £119 million (2016: £143 million) which includes a £12 million prior year deferred tax credit adjustment (2016: £4 million prior year deferred tax debit adjustment and £1m current tax debit adjustment) relating primarily to accelerated capital allowances. Based on a profit before tax and certain re-measurements of £507 million (2016: £531 million), this results in an effective tax rate of 23.5% (2016: 26.9%). The tax charge is more than implied by the statutory rate of 19.25% (2016: 20%) primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

In addition, there was a £36 million tax charge (2016: £64 million tax credit) reflecting the tax impact arising from fair value gains on investment property revaluations and fair value gains/losses on financial instruments, along with any associated prior year adjustments.

Further details supporting these amounts are shown in Note 4 to the financial statements.

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further reduction in the main rate of corporation tax to 17% from 1 April 2020. The effects of these rate reductions were reflected in the deferred tax balances in the 2016 financial statements.

In November 2017 the Finance (No.2) Act 2017 received Royal Assent, giving effect to a new interest deductibility regime. This regime is in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). As a result of the new legislation, from 1 April 2017, interest deductions are limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public infrastructure exemption (PIE). Heathrow will be protected from the 30% of tax based EBITDA cap as a result of applying either the PIE or GRR therefore no interest disallowance has been reflected in the 2017 tax charge (2016: nil).

As a business, Heathrow has high infrastructure costs and of these a significant proportion now attracts no tax deduction. For those that do attract a tax deduction there is a timing difference between the accounting depreciation of these assets (the asset cost is charged to the income statement over the useful life of the asset as depreciation on a straight line basis, which is not deductible for tax purposes) and the tax relief available for capital expenditure (capital allowances, being tax relief provided in law, spread over a number of years), which generates significant deferred tax liabilities within the Group, reflecting future tax payable as these assets depreciate.

Profit/(loss) for the year

	Year ended 31 December 2017	Year ended 31 December 2016	Change %
	£m	£m	
Operating profit	1,210	1,055	14.7
Net finance costs	(554)	(480)	15.4
Fair value gain(loss) on financial instruments	148	(474)	131.2
Profit before tax	804	101	696.0
Tax charge	(155)	(53)	192.5
Profit for the year	649	48	1,252.1

In the year ended 31 December 2017, the Company recorded an operating profit of £1,210 million (2016: £1,055 million).

In the year ended 31 December 2017, the Company recorded a profit before tax of £804 million (2016: £101). The movement of £703 reflects an increase in operating profit of £155 million, partly offset by net finance cost being £74 million higher (reflecting higher index linked accretion due to higher inflation index rate in period). In addition, fair value gains on financial instruments reflect a favourable movement of £622 million, driven primarily by a decrease in the long term GBP RPI curve and an increase in the long term LIBOR curve, compared to the previous year.

Heathrow Airport Limited

Strategic report *continued*

Financial review *continued*

Capital expenditure

In the year ended 31 December 2017, additions to fixed assets were £682 million (2016: £680 million). Capital investment is managed at an SP Group level where funding is raised through the Heathrow (SP) financing platform for capital projects which meet the appropriate investment appraisal criteria.

Pension scheme

Heathrow operates a defined benefit pension scheme, the BAA Pension Scheme, which closed to new members in June 2008. At 31 December 2017, the defined benefit pension scheme, as measured under IAS 19, was funded at 97.1% (2016: 98.1%). This translated into a deficit of £124 million (2016: £79 million deficit). The £45 million increase in deficit in the year is primarily due to net actuarial losses of £65 million. In 2017, Heathrow contributed £49 million (2016: £59 million) into the defined benefit pension scheme including £23 million (2016: £25 million) in deficit repair contributions.

The deterioration in the scheme actuarial position was driven by a fall in the net discount rate, derived from corporate bond yields, of 0.15% and returns on scheme assets being lower than allowed for in the income statement.

Recent financing activity

Heathrow continues to focus on maintaining a strong liquidity position and optimising its long-term cost of debt whilst ensuring duration, diversification and resilience in its debt financing. Heathrow's debt financing strategy for the remainder of its current regulatory period is expected to have a strong focus on ensuring its relatively limited funding requirements are targeted at maintaining its presence in existing public markets whilst capitalising selectively on private placement opportunities.

During 2017, Heathrow raised over £1.0 billion of debt financing globally comprising just over £700 million in Class A debt, a £275 million bond issued by Heathrow Finance and a £75 million term loan facility initially held at ADIF2 which will migrate to Heathrow Finance by 2019. Completion of the Heathrow Finance bond and the ADIF2 term loan facility will enable Heathrow to simplify its debt financing from four layers to three no later than 2019.

In terms of Class A debt, the highlight of the year was the issue in June 2017 of a €500 million, 15 year public bond with a fixed rate coupon of 1.875% which further strengthened Heathrow's presence in this market. Also in June 2017, a £100 million private placement from non-sterling sources which was signed in March 2017 was drawn and will mature in 2033 and 2037. In March 2017, Heathrow drew in full a £418 million term loan initially signed with a group of banks in June 2016 and increased by £68 million in early 2017. Finally, in July 2017 Heathrow entered into a £100 million 7 year term loan facility that is expected to be drawn later in 2018.

In May 2017, Heathrow Finance returned to the bond market for the first time since October 2014, raising £275 million in a highly successful 10 year public bond with a fixed rate coupon of 3.875%. In June 2017, the last undrawn £75 million of Heathrow Finance term loans agreed in 2016 was drawn. In December 2017, Heathrow drew £275 million in loan facilities that were temporarily repaid in June 2017 in order to optimise interest costs in 2017.

During 2017, Heathrow repaid €700 million (£584 million) and CHF400 million (£272 million) Class A bonds in January 2017 and February 2017 respectively. These payments were made to Heathrow Funding Limited, which in turn repaid the external Class A bonds. In March 2017, Heathrow Finance repaid a £265 million bond. Finally, £310 million of loan facilities at ADIF2 were repaid in July 2017. Since the start of 2018, Heathrow has repaid a €750 million (£510 million) Class A bond earlier in February 2018.

Looking ahead, Heathrow's 2018 debt financing targets are expected to be similar in scale to 2017.

Financial ratios

Heathrow Airport Limited continues to operate comfortably within required financial ratios. Gearing ratios under the Group's financing agreements are calculated by dividing consolidated nominal net debt by Heathrow's Regulatory Asset Base ('RAB') value. At 31 December 2017, Heathrow's RAB was £15,786 million (2016: £15,237 million).

At 31 December 2017, the Group's senior (Class A) and junior (Class B) gearing ratios were 67.3% and 78.4% respectively (2016: 66.7% and 78.2% respectively) compared with trigger levels of 70.0% and 85.0% under its financing agreements. Note that the Group's senior gearing trigger level increases from 70.0% to 72.5% with effect from 1 April 2018.

Outlook

Traffic trends in the early weeks of 2018 have been consistent with expectations and forecast Adjusted EBITDA for 2018 remains consistent with the guidance set out in the investor report published in December 2017 of £1,830 million.

2018 should also see a number of developments in relation to Heathrow's expansion including the conclusion of Heathrow's first planning consultation in March, further regulatory updates starting in April and the Parliament vote on the final National Policy Statement by the end of June.

Heathrow Airport Limited

Strategic report *continued*

Leadership and governance

The discussion in this section is extracted from the financial statements of Heathrow Airport Holdings Limited, since the functions of the Board and Board Committees of Heathrow Airport Holdings Limited are applied equally to this Company.

Board of Directors of Heathrow Airport Holdings Limited

The Board consists of the Chief Executive Officer, the Chief Financial Officer and Non-Executive Directors. Board Meetings are attended also by the Company Secretary. More than half of the board are Non-Executive Directors. The majority of the Non-Executive Directors are shareholder representatives. The remaining minority are independent Non-Executive Directors.

The Board determines the Heathrow Airport Holdings Group's long-term strategy, to ensure that the Group acts ethically and has the necessary resources to meet its objectives, to monitor performance and to ensure the Group meets its responsibilities as a leading airport company.

Board Committees

Audit Committee

The Audit Committee members include a chairman appointed by the Board of Directors and three shareholder Non-Executive Directors, who also attend the Board.

Of the four members of the Audit Committee all, including the Chair, are non-executive directors. Together they have appropriate competence in accounting and auditing.

The Audit Committee is a sub-committee of the Board and its responsibilities include:

- considering the appointment of the external auditor, taking into account relevant ethical guidance and assessing the independence of the external auditor ensuring that key audit personnel are rotated at appropriate intervals (including overseeing the process for selecting the external auditor and making recommendations to the Board);
- recommending the audit fee to the Board for approval and pre-approving any fees in respect of non-audit services provided by the external auditor and ensuring that the provision of non-audit services does not impair the external auditor's independence or objectivity;
- discussing with the external auditor the nature and the scope of the audit and reviewing the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements;
- reviewing reports on the effectiveness of systems for internal financial control, financial reporting and risk management;
- monitoring the integrity of the financial statements of the Group and reviewing, and challenging where necessary, the actions and judgements of management, in relation to the interim and annual financial statements and any press release related to those statements;
- reviewing Internal Audit reports to the Audit Committee on the effectiveness of the Heathrow Airport Holdings Group's systems for internal control, financial reporting and risk management;
- reviewing the external auditor's management letter and management's responses;
- considering management's response to any major external or internal Audit recommendations;
- approving the appointment and dismissal of the Director of Internal Audit, Risk and Assurance;
- reviewing Heathrow's procedures for handling allegations from whistle-blowers;
- reviewing the ethics policy and monitoring its application throughout the business, considering any ethical issues which arise as a result of audit findings;
- overseeing all press releases relating to external financial results; and
- reviewing Heathrow's tax policy and insurance strategy and arrangements.

Nomination Committee

The Nomination Committee members include the Chairman of the Board, an independent Non-Executive Director and four shareholder Non-Executive Directors who attend the Board.

The Nomination Committee is a sub-committee of the Board and its responsibilities include:

- identifying and recommending for the consideration of the Board all new appointments of independent Non-Executive directors; and
- ensuring a formal, rigorous and transparent procedure is followed for the appointment of new independent Non-Executive directors to the Board.

Remuneration Committee

The Remuneration Committee members include a chairman appointed by the Board, three shareholder Non-Executive Directors who attend the Board and one independent Non-Executive Director.

The Remuneration Committee is a sub-committee of the Board and its responsibilities include approvals of:

Heathrow Airport Limited

Strategic report *continued*

Leadership and governance *continued*

Board Committees *continued*

Remuneration Committee *continued*

- the remuneration policy of the members of the Executive Committee and Senior Managers;
- the compensation packages of the members of the Executive Committee (other than the Chief Executive Officer) including salary, bonus, pensions and other incentive compensation;
- the contractual terms for the members of the Executive Committee and independent Non-Executive Directors;
- the design and terms of bonus plans including approval of off-cycle bonus payments outside bonus guidelines including sign on, retention and guaranteed bonuses;
- the design and terms of long term incentive plans; and
- succession planning for the members of the Executive Committee.

Finance Committee

The Finance Committee members include a chairman appointed by the largest shareholder of FGP Topco Limited, the Chief Executive Officer, the Chief Financial Officer and a Non-Executive Director representing each shareholder entitled to appoint a director to the Board.

The Finance Committee is a sub-committee of the Board and also acts as a forum for obtaining consents required from the shareholders of FGP Topco Limited.

The Finance Committee is responsible for approving various matters relating to the Group's debt financing arrangements prior to their implementation including approval for:

- any prospectus or other listing document required in relation to the issuance of any capital markets instruments or any formal information memorandum in relation to borrowing by any member of the Group;
- the borrowing of any money or the assumption of any indebtedness by any member of the Group (including by way of the issue of securities) in excess of certain financial thresholds;
- the refinancing of any existing indebtedness in respect of any member of the Group in excess of certain financial thresholds;
- the making of any repayments of principal in addition to scheduled principal payments on any debt that may be owing by any member of the Group; and
- other than as required by the financing arrangements of any member of the Group, the making of any material loan or advance or giving of any guarantee, indemnity or provision of any credit, in each case in excess of certain financial thresholds.

Executive Committee

The Executive Committee consists of the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, the Chief Information Officer, the Chief of Staff and Group General Counsel, the Chief People Officer, Expansion Director, Chief Commercial Officer and Chief Strategy Officer.

The Executive Committee is the management committee of the Chief Executive and is responsible for, among other things, developing, reviewing and refreshing medium and long term Group business strategies, policies and development plans for Board approval, agreeing short-term tactics and action plans to ensure their delivery and reviewing the principal risks and the risk management framework.

Executive Risk Committee

The Risk Committee is chaired by the Chief of Staff and Group General Counsel and consists of the Chief Financial Officer, the Chief Operating Officer, the Director of Expansion and the Strategy Director. It is responsible for reviewing the effectiveness of the risk management strategy and framework and for reviewing the principal risks. The Risk Committee is a sub-committee of the Executive Committee.

Sustainability and Operational Risk Committee

The Sustainability and Operational Risk Committee (formerly the Responsible Heathrow and Operational Risk Committee) is chaired by an independent Non-Executive Director and its members include the Chief Executive Officer and three shareholder Non-Executive Directors who attend the Board.

The Sustainability and Operational Risk Committee is a sub-committee of the Board and its responsibilities include:

- reviewing Heathrow's policies, conduct, performance and risk management approach against sustainability goals and operational activities;
- reviewing and challenging the performance and conduct of the Group relating to operational risks and delivery of sustainability goals;
- monitoring and challenging management over the effectiveness of the relevant internal control systems and having access to any audit or assurance report it considers relevant;
- reviewing and assessing management's response to significant operational incidents and having access to any accident and investigation report it considers relevant; and
- monitoring and challenging the appropriateness of Sustainability and operational risk assurance strategies and plans, the execution and results of such plans, and relevant communications.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management

Internal controls and risk management are key elements of the Group's corporate operations. Risk is centrally managed within the Group as part of Corporate Services provided under the Shared Services Agreement ('SSA') by a fully dedicated senior team. The Corporate risk management function, sets the strategy for risk management to provide the necessary framework to ensure that key risks are managed and embeds a sustainable risk management culture that views the execution of risk management processes and practices across Heathrow as a key enabler to Heathrow achieving its business objectives.

Internal controls

The directors are responsible for the system of internal controls designed to mitigate the risks faced by the Group and for reviewing the effectiveness of the system. This is implemented by applying the Group internal control procedures, supported by a Code of Professional Conduct Policy, appropriate segregation of duties controls, organisational design and documented procedures. These internal controls and processes are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against material misstatements or loss.

The key features of the Group's internal control and risk management systems in relation to the financial reporting process include:

- a group-wide comprehensive system of financial reporting and financial planning and analysis;
- documented procedures and policies;
- defined and documented levels of delegated financial authority;
- an organisational structure with clearly defined and delegated authority thresholds and segregation of duties;
- a formal risk management process that includes the identification of financial risks;
- detailed reviews by the Executive Committee and the Board of monthly management accounts measuring actual performance against both budgets and forecasts on key metrics;
- Audit Committee review of press releases and key interim and annual financial statements, before submission to the Board, scrutinising amongst other items;
 - compliance with accounting, legal, regulatory and lending requirements
 - critical accounting policies and the going concern assumption
 - significant areas of judgement and estimates;
 - key financial statement risk areas as reported further below in the report;
- independent review of controls by the Internal Audit function, reporting to the AC; and
- a confidential whistleblowing process.

Risk management

Our aim is to gain a deep understanding of the principal risks we face at all levels of the business and to focus management attention on effective mitigation of these risks as well as a review of over-the-horizon emerging risks which may impact the business and strategy of Heathrow.

We continue to roll out a risk improvement plan which is focussed on improving accountability for end-to-end risk management at all levels and drive improvements in our risk culture. The risk improvement plan covers all the key elements of an effective risk management framework including risk leadership, informed risk decision making, competency and risk skills, governance including timeliness and transparency of risk information and clarity of accountability for managing risks. We assess and monitor our risk maturity across all key areas and drive improvements where required.

Principal risks

Our principal risks are aligned to our 4 strategic priorities as follows:

- to be a great place to work, we will help our people fulfil their potential and work together to lead change across Heathrow with energy and pride;
- to give passengers the best airport service in the world we'll work with the Heathrow community to transform the service we give to passengers and airlines, improving punctuality and resilience;
- to secure future investment we will beat the Q6 business plan and deliver a competitive return to our shareholders by growing our revenue, reducing costs and delivering investments more efficiently; and
- to grow and operate our airport sustainably, now and in the future.

The principal risks identified by the Executive Committee are:

Business resilience

Business resilience risks can relate to Heathrow's assets, infrastructure, human or electronic processes or systems, the failure of which, by accident or deliberate act, could result in prolonged periods of interruption to critical services/operations and passenger experience. There are a number of circumstances that can pose short-term risks to the normal operations at the airport such as shocks to the macroeconomic environment, terrorism, wars, airline bankruptcies, human health scares, weather conditions and natural disasters whose cause may be remote from Heathrow's location. These conditions can have a particularly significant impact where, due to operating close to full capacity, there is negligible spare capacity to utilise in recovering from some of the above conditions.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

Business resilience *continued*

Where possible the Group seeks to anticipate the effects of these events on its operations and also maintains contingency plans to minimise disruption and passenger inconvenience working as necessary with those parties who have direct contractual responsibility. Through a series of programmes the Group seeks to keep a competent, flexible and motivated workforce that can respond to a changing business and operating environment. By driving engagement in its people the Group will achieve its goals and give excellent passenger service, avoid safety and security incidents, protect resilience and deliver successful change.

People

Heathrow employs around 6,500 colleagues and, in a complex business such as Heathrow's, there are risks associated with recruiting, screening, motivating, developing and training employees on a large scale, as well as rewarding appropriately and retaining critical talent and ensuring succession plans are in place.

Heathrow has a transparent recruitment process and is committed to recruiting diverse talented individuals from all sectors of the community. Heathrow has committed to reflecting local diversity at all levels in the company by 2025. At all stages of the recruitment and selection process, interviewing and selection will always be carried out without regard to gender, sexual orientation, disability, marital status, colour, race, ethnic origins, religion or religious belief or age. Any candidate with a disability will not be excluded unless it is clear that the candidate is unable to perform a duty which is intrinsic to the role, having taken into account any reasonable adjustments. Reasonable adjustments to the recruitment process will be made to ensure an applicant is not disadvantaged due to his/her disability. All successful external candidates are subject to a criminal records check and the appropriate security clearance as required by the role.

Heathrow has strategies and policies in place to engage and motivate its colleagues so they are excited and challenged by their work environment, accountable and compliant with internal governance, policies and procedures. Heathrow provides great career opportunities, development and training, retaining talent and knowledge and preventing single points of failure.

Anti-corruption and anti-bribery matters

Heathrow takes a zero-tolerance approach to bribery and corruption, and is committed to conducting its business in an honest and ethical manner, in compliance with the Bribery Act 2010 (the "Bribery Act") and applicable anti-bribery and anti-corruption laws. Breach of anti-bribery provisions by Heathrow employees, paid or voluntary agents, consultants or suppliers could result in Heathrow breaching the Bribery Act by failing to prevent an act of bribery being committed. If Heathrow is found guilty of such an offence, Heathrow could face an unlimited fine, exclusion from tendering for public companies, as well as significant reputational damage. As such, Heathrow embeds and maintains robust Anti-Bribery, Gifts & Hospitality Policy and Guidance (the "Anti-Bribery Policy") and other effective systems and controls to prevent bribery and corruption at Heathrow. All employees and third parties associated with Heathrow are required to conduct themselves according to the standards set out in the Anti-Bribery Policy. Any breach of the Anti-Bribery Policy will result in disciplinary action, and, if appropriate, in instant dismissal and referral to the relevant law enforcement authorities. In addition, our Whistleblowing Policy encourages individuals to report any wrong-doing which extends to bribery and corruption matters. All whistleblowing reports are treated in the strictest confidence and are investigated fully with appropriate actions taken.

Corporate social responsibility

Heathrow understands the importance to its business of the communities in which it operates, and through consultation and engagement seeks to ensure that their concerns are taken into account in the operation and planning of Heathrow. It may restrict opportunities to grow and threaten Heathrow's social license to operate if local communities do not believe the airport is managed responsibly or that its economic benefits are optimised without prioritising profits over the long-term interests of local communities.

Environmental risk has the potential to impact negatively upon Heathrow's reputation and jeopardise its licence to operate and to grow.

The Group undertakes procurement responsibly and encourages trade and employment opportunities for local communities. Progressive influencing of third parties, stakeholder engagement and community relations programmes are also established.

Proactive environmental management systems and employee training programmes are embedded within operations through clear environmental strategies and resource conservation initiatives. The Group works closely with a range of stakeholders to ensure that it reacts effectively to the challenges posed by the environmental agenda.

Operational risks to the delivery of Responsible Heathrow goals are reviewed and monitored by a separate committee of the Board.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Principal risks *continued*

Stakeholders

Poor interactions and relationships with key stakeholders including partners, suppliers and airlines could negatively impact passenger experience, airport operations, financial performance and Heathrow's reputation.

Heathrow aims to manage its contracts effectively and share with airport partners the information it may hold about their service providers. This is underpinned by robust and responsible procurement practices which consider the resilience and sustainability of suppliers before contracts are commenced with them, as well as frequent monitoring of their operational performance once they commence business with the airport.

Legal, regulation and compliance

Operations at Heathrow airport are currently subject to economic regulatory review by the CAA normally every five years. Its principal risks relate to changes in economic regulations, non-compliance with these and other regulations, licence conditions, financing covenants, contractual requirements and penalties for failing to comply with competition and relevant EU law. Failure to comply with laws and regulations can have far reaching consequences, including loss of licence, penalties, claims and litigation, reputational damage and loss of stakeholder confidence.

The risk of an adverse outcome from economic regulatory reviews is mitigated as far as possible by a dedicated project team which ensures full compliance with regulatory requirements, establishes a sound relationship with the regulator and advises the Executive Committee and Board on regulatory matters. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, reduces the risk of Heathrow breaching laws, regulations and contractual requirements.

Health and safety

Heathrow has a statutory and moral responsibility to ensure that it safeguards the welfare and safety of its people, business partners and the public who may be affected by its activities. Heathrow recognises that a failure to exercise this responsibility effectively also risks operational disruption, inconvenience to passengers and long-term damage to its reputation.

Heathrow's Safety Management System includes risk assessment processes for all activities entailing significant risk and proportionate control measures employed to safeguard everyone impacted by the airport's business. Heathrow also operates robust asset management processes to ensure property and equipment remains safe. Governance, led by the airport's senior management teams, and assurance processes are used to ensure that controls around health and safety risks remain effective and continuous improvement is encouraged.

Security

Heathrow is responsible for ensuring that its assets, infrastructure, human and electronic systems and processes meet the minimum statutory requirements to protect aviation security, deliver high security standards and build confidence with regulators, airlines and passengers. It also needs to ensure that its assets, infrastructure, human and electronic systems are protected from theft, damage or intrusion.

Security risks, including cyber security, terrorism risks, and information security are mitigated by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading edge security technology. Heathrow works closely with airlines and government agencies including the police building a framework to establish joint accountabilities for airport security and shared ownership of risk, thus ensuring security measures remain both flexible and proportionate to the prevailing threat environment.

Strategic direction and management of change

Heathrow airport is operating its runways at close to full capacity and failure to secure the necessary Development Consent Order, following a robust consultation process, for the third runway, for which Heathrow is the preferred choice of the UK Government, could lead to increased congestion, passenger delay and lack of opportunity for the UK.

Monitoring developments in the global aviation market and the levels of passenger satisfaction with different airports around the world provides input to the on-going relevance of the Group's strategy. The Group also needs to influence the pace and direction of changes to regulations, legislation, government policy, aviation and the wider economy and ensure that it does not lose airlines' support for expansion.

Heathrow recognises that failure to control key development costs and delivery could damage its financial standing and reputation. There are risks that projects fail to deliver to the agreed quality, specification, time and budget as well as risks that the benefits of change are not realised, return on investments not realised and transformation not delivered.

The planning process for all major national infrastructure projects in the UK sets out a number of steps that the Group needs to go through to obtain development consent to expand Heathrow: a National Policy Statement, a Development Consent Order and public consultation before a final decision is taken by the UK Government for the third runway.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Principal risks *continued*

Strategic direction and management of change *continued*

The Group's planning process is well underway and it is building an organisation and expertise to ensure this process runs smoothly. Heathrow will undertake extensive consultations with community groups and authorities at a local level and is an active participant in government consultations and other advisory groups.

The risk of unanticipated long-term changes in passenger demand for air travel could lead to a shortfall in revenue and misaligned operational capacity within Heathrow. Since it is not possible to identify the timing or period of such an effect, the Group carries out evaluations through a series of scenario planning exercises. Risks associated with the uncertainties arising from the current Brexit negotiations are monitored and managed as far as possible including putting in place contingency plans.

The regulatory framework requires formal engagement with airline customers. Helping manage the risk of adverse airline relations, all airlines are invited to be represented on engagement fora – e.g. joint steering groups. When feedback is sought or processes are measured, robust steps have been put in place to ensure confidentiality and neutrality of interpretation. In addition, key stakeholders are engaged on a joint planning basis which provides airlines with the opportunity to air views and share plans, thereby ensuring their ongoing requirements are articulated and understood.

Heathrow mitigates project risks through adherence to a robust project process and by a system of assurance, consisting of project and programme reviews before approval and during construction. The process is continually improved incorporating lessons learnt and "best practice" distilled from knowledge sharing with other client programmes, expertise within its supply chain and guidance from professional bodies.

Financial stability

The Board approves prudent treasury policies and delegates certain responsibilities including changes to treasury policies, the approval of funding and the implementation of funding and risk strategy to the Heathrow Finance Committee. Senior management directly control day-to-day treasury operations on a centralised basis.

The treasury function is not permitted to speculate in financial instruments. Its purpose is to identify, mitigate and hedge treasury-related financial risks inherent in the Group's business operations and funding. To achieve this, the Group enters into interest rate swaps, index-linked swaps, cross-currency swaps and foreign exchange contracts to protect against interest rate, inflation and currency risks.

The primary treasury-related financial risks faced by the Group are:

(a) Interest rates

The Group maintains a mix of fixed and floating rate debt. As at 31 December 2017, fixed rate debt after hedging with derivatives represented 97.0% of the Group's total external nominal debt.

(b) Inflation

The Group mitigates the risk of mismatch between Heathrow's aeronautical income and regulatory asset base, which are directly linked to changes in the retail prices index, and nominal debt and interest payments, by the issuance of index-linked instruments.

(c) Foreign currency

The Group uses cross-currency swaps to hedge all interest and principal payments on its foreign currency debt. The Group uses foreign exchange contracts to hedge material capital expenditure in foreign currencies once a project is certain to proceed.

(d) Funding and liquidity

The Group has established both investment grade (at the Heathrow (SP) level) and sub-investment grade (at the Heathrow Finance level) financing platforms for Heathrow. The Heathrow (SP) platform supports term loans, various revolving loan facilities including revolving credit facilities, working capital facilities and liquidity facilities, and Sterling and foreign currency capital markets issuance. All debt is secured and can be issued in either senior (A-/A-) or junior (BBB/BBB) format. Covenants are standardised wherever possible and are monitored on an ongoing basis with formal testing reported to the Audit Committee, the Board and Executive Committee.

Although there can be no certainty that financing markets will remain open for issuance at all times, debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year.

The Group has positive cash flows after capital expenditure and interest and expects to have sufficient liquidity to meet all its obligations in full, including capital investment, debt service costs, debt maturities and distributions, up to

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Principal risks *continued*

Financial stability *continued*

September 2019. As at 31 December 2017, cash and cash equivalents, and term deposits of £567million, undrawn headroom under revolving credit facilities of £1,150 million, committed term debt financing to be drawn after 31 December 2017 of £175 million and undrawn headroom under liquidity facilities of £600 million.

(e) Counterparty credit

The Group's exposure to credit related losses, in the event of non-performance by counterparties to financial instruments, is mitigated by limiting exposure to any one party or instrument. The Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short- and long-term credit ratings. Investment activity is reviewed on a regular basis and generally no cash or cash equivalents are placed with counterparties with short-term credit ratings lower than A-2(S&P)/F1(Fitch). The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with a long-term credit rating below BBB+ (S&P)/BBB+ (Fitch).

Financial statements risk

The Audit Committee reviewed critical accounting judgements and key sources of estimation uncertainty outlined in the "Accounting policies" section of the financial statements. Based on the discussion with the management, work and recommendation of the Group finance function and input from external auditor, the Committee considered that the most significant financial statements risk matters are as follows:

(i) Classification of costs between operating expenditure and capital expenditure

The Group has a substantial Q6 capital programme which has been agreed with the regulator (the Civil Aviation Authority) and therefore incurs significant expenditure investing in assets to improve operational performance, airport resilience and passenger experience. Since October 2016, the Group has also begun investing in Expansion.

Only those costs which satisfy the requirements of IAS16 'Property Plant and Equipment' should be capitalised, which in some cases requires management judgement. Controls and processes related to capital expenditure are directed by the Fixed Asset Steering Group (chaired by the CFO), which reports regularly to the Audit Committee through formal Committee papers and provides them with the opportunity to scrutinize and challenge the judgement made.

The Group has a Property, plant and equipment ("PP&E") Accounting Policy, which outlines the requirements for costs to be eligible for capitalisation and a separate Capitalised Interest Policy which applies to interest costs incurred whilst a project is under construction. Both the PP&E Accounting Policy and the Capitalised Interest Policy are formally published on and communicated to management and employees via the Group's intranet site. These policies are applied and their application is monitored on a regular basis to ensure that all costs eligible for capitalisation and interest costs incurred whilst a project is under construction are correctly capitalised. The PP&E Accounting Policy has been updated to ensure clarity around the treatment of costs relating to Expansion.

Each capital project follows a defined project governance process. This includes a Financial Assurance Review by the Heathrow Finance department which concludes on the appropriate accounting treatment in accordance with the Group capitalisation policy for the expenditure to be incurred on the project. The project governance process also includes each project being reviewed and approved by the relevant Governance Groups, including the Heathrow Investment Committee for significant projects.

The spend on the project is reviewed and approved by appropriate delegated financial authorities ensuring the correct classification of cost. The Programme Management Office (PMO) is responsible for tracking and monitoring spend against the project cost plan, and when the project is completed a final review of costs incurred is carried out by Finance before transferring the capital cost of the project to the Fixed Asset Register.

Heathrow is currently in the process of obtaining a Development Consent Order (DCO) for Expansion. Particular emphasis is being placed on ensuring that capitalised costs will deliver future economic benefit and are directly attributable to obtaining DCO, through regular reviews and senior leadership involvement. The CAA and independent consultants have also been engaged in reviewing planned and actual capitalised costs (ex ante and ex post) to ensure that they are efficient, incremental, and directly attributable to obtaining DCO. During the year ended 31 December 2017 the Group recorded £83 million (2016: £9 million) of such expansion related costs in assets in the course of construction.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Principal risks *continued*

Financial statements risk *continued*

(ii) Fair value of derivative financial instruments

The Group holds a substantial derivative financial instruments portfolio comprising interest rate swaps, cross currency swaps, and index-linked swaps which are accounted for at fair value. In determining the fair value, judgement is used to determine the recovery rate and associated reduction in credit risk of super senior ranking derivatives (interest rate and index-linked swaps). Due to the significance of the Group's derivative financial instruments and the related estimation uncertainty, there is a risk that derivative financial instruments are not valued based on appropriate assumptions and / or estimates.

The valuation of the Group's derivative financial instruments is determined through the application of a discounted cash flow approach and the use of inputs based on observable market data where these are available. The fair value of cross-currency, interest rate and index-linked swaps is calculated as the present value of the estimated future cash flows based on observable yield curves. The credit risk associated with the Group's derivative financial instruments is updated monthly based on current market data. The recovery rate and associated reduction in credit risk of super senior ranking derivatives (interest rate and index-linked swaps) is validated quarterly with a counterparty bank.

In 2017, management was successful in improving the automation of the Treasury Accounting System (Reval). Key benefit includes the automation of the credit risk adjustments which forms part of the monthly derivative valuation process. Minimal manual input is now required.

(iii) Fair value of investment properties

The Group holds a variety of investment properties that are accounted for at fair value. In determining the fair value, judgement is required with regard to a number of valuation assumptions that include property rental growth rate, operating cost and expected yields.

Independent valuations are obtained for all investment properties. The valuations are prepared in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations are carried out having regard to comparable market evidence relevant to each specific property or class of properties.

In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) is capitalised using yields derived from market evidence. This market evidence also takes into account planned transactions and use of the property.

On behalf of the Board



John Holland-Kaye
Director

28 March 2018

Heathrow Airport Limited

Directors' report

The Directors present their annual report and the audited financial statements for Heathrow Airport Limited (the 'Company') for the year ended 31 December 2017.

Principal activities

Heathrow provides service to a range of market segments, including business and leisure travellers, direct and transfer passengers on long and short-haul routes, operated by a diversified range of major airlines. Heathrow generates revenue from a variety of sources, including services to airlines, concession fees from retail operators, income from car parks, advertising revenue, the rental of airport premises and the provision of facilities and services.

A review of the progress of the Company's business during the year, the key performance indicators, internal controls, principal business risks and likely future developments are reported in the strategic report on pages 2 to 23.

No significant changes to the activities of the Company are expected in the foreseeable future.

Results and dividends

The profit after taxation for the financial year amounted to £649 million (2016: £48 million).

Dividends of £277 million were paid during the year (2016: £594 million). The dividend payments were utilised primarily to fund dividends to the Company's ultimate shareholders and to service external debt held by one of the Group's holding companies.

Directors

The Directors who served during the year and since the year end, except where noted, were as follows:

Ross Baker	(appointed 01 January 2017)
Ian Ballentine	(resigned 01 January 2017)
Stuart Birrell	
Normand Boivin	(resigned 03 October 2017)
Javier Echave	
Emma Gilthorpe	
Clare Harbord	(resigned 01 January 2017)
John Holland-Kaye	
Carol Hui	
Andrew Macmillan	(appointed 01 January 2017)
Derek Provan	(appointed 03 October 2017)
Paula Stannett	

Going Concern

The financial statements have been prepared on a going concern basis, which requires the Directors to have a reasonable expectation that the Company, as part of the Heathrow Airport Holdings Limited group (the Group'), has adequate resources to continue in operational existence for the foreseeable future. The going concern accounting policy on page 34 provides more detail.

Employment policies

As disclosed in note 2, although all the employees are legally employed by LHR Airports Limited, the Company makes all employment decisions.

The Company's employment policies are regularly reviewed and updated to ensure they remain effective. The Company's overall aim is to create and sustain a high performing organisation by building on the commitment of its people.

The Company has defined a set of guiding principles to ensure fair recruitment and selection. The Company continues to aim to recruit, retain and develop high calibre people and has talent and succession management programmes for managerial roles.

The Company is committed to giving full and fair consideration to applicants for employment. Every applicant or employee will be treated equally whatever their race, nationality, ethnic or national origin, sex, marital status, sexual orientation, religious belief, disability, age or community background. The Company actively encourages a diverse range of applicants and commits to fair treatment of all applicants. The Company's investment in learning and development is guided by senior line managers who ensure that the Company provides the learning opportunities to support the competencies that are seen as key to the Company's success.

Heathrow Airport Limited

Directors' report *continued*

Employment policies *continued*

Disabled persons have equal opportunities when applying for vacancies, with due regard to their aptitudes and abilities. The Company has further procedures to ensure that disabled colleagues are fairly treated in line with the Equality Act (2010). Where employees have become disabled during the course of employment, the Company endeavours to ensure continuing employment through the arrangement of appropriate training.

Employee involvement and consultation is managed in a number of ways including employee surveys, team updates, briefings, road shows and an intranet. Collective bargaining takes place with the unions Unite, PCS and Prospect for those employee groups for which these unions are recognised. The Company is committed to managing people through change fairly.

Together these arrangements aim to provide a common awareness amongst employees of the financial and economic factors affecting the performance of their business. Bonuses paid to employees reflect the financial performance of the business. A Share in Success saver scheme in which eligible employees can save money which the company matches as a contribution in line with business performance has been in place since 2015. In addition, some senior management participate in a long-term incentive plan which also rewards based on group performance.

Donations

The Company's charitable donations for the year amounted to £2 million (2016: £2 million). The beneficiaries of charitable donations, the relevant amounts donated and the activities of these beneficiaries are as follows:

Hillingdon Community Trust £1,000,000
(charity number: 1098235)

Heathrow Airport Limited made a 15 year commitment ending 2017 to make an annual grant of £1 million to the Hillingdon Community Trust. The deed of gift to the Trust carries a requirement that grants must benefit the community in the southern part of the Borough of Hillingdon including Hayes (the wards of Botwell, Townfield and Pinkwell, West Drayton, Yiewsley and the Heathrow Villages).

LHR Airport Communities Trust £700,000
(charity number: 1058617)

Heathrow Airport Limited made a donation to the charity LHR Airport Communities Trust, an independently run grant-making charity which operates the Heathrow Community Fund.

The fund also received income from the proceeds of noise fines collected by Heathrow. Through the fund grant programme the charity supports significant and positive change for communities near the airport, with a priority on funding projects linked to education, the environment and economic regeneration. The charity also supports airport staff volunteering and fundraising to improve their community for a cause they believe in.

Heathrow continued fundraising for the benefit of Oxfam during the year, which represented the fourth year of the charity partnership with Oxfam. In April 2017, Heathrow passed the fantastic milestone of having raised £1 million for Oxfam since the beginning of the partnership and in 2017, a total of £363,423 was raised.

Internal controls and risk management

The Company actively manages all identified corporate risks and has in place a system of internal controls designed to mitigate these risks. Details of the Company's internal controls and risk management policies can be found on pages 18 to 23 in the internal controls and risk management section of the Strategic report.

Financial risk management objectives and policies

The Company's financial risk management objectives and policies, including hedging policies, along with the Company's exposure to risk, can be found on pages 18 to 23 in the Internal controls and risk management section of the Strategic report.

Directors' indemnity

The Company's Articles of Association provide that, subject to the provisions of the Companies Act 2006, but without prejudice to any protection from liability which might otherwise apply, every director of the Company shall be indemnified out of the assets of the Company against any loss or liability incurred by him in defending any proceedings in which judgement is given in his favour, or in which he is acquitted or in connection with any application in which relief is granted to him by the court for any negligence, default, breach of duty or breach of trust by him in relation to the Company or otherwise in connection with his duties or powers or office.

Heathrow Airport Limited

Directors' report *continued*

Auditor

Pursuant to the provisions of section 485 of the Companies Act 2006, a resolution relating to the reappointment of the auditor Deloitte LLP will be proposed within the period set out in section 485 or, Deloitte LLP will be deemed re-appointed where no such resolution is proposed, following the period set out in section 485 in accordance with section 487.

Statement of disclosure of information to the Auditor

Each of the persons who is a director at the date of approval of this Annual report confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

On behalf of the Board



Javier Echave
Director

28 March 2018

Company registration number: 01991017

Heathrow Airport Limited

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law 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 United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 102 – "The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland" ('FRS 102'). 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 Company and of the profit or loss of the Company for that period.

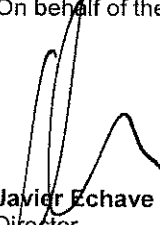
In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company 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 company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

On behalf of the Board



Javier Echave
Director

28 March 2018

Heathrow Airport Limited

Independent auditor's report to the members of Heathrow Airport Limited for the year ended 31 December 2017

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Heathrow Airport Limited (the 'company') which comprise:

- the income statement;
- the statement of comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- Significant accounting judgements and estimates;
- accounting policies; and
- the related notes 1 to 25.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the

Heathrow Airport Limited

Independent auditor's report to the members of Heathrow Airport Limited for the year ended 31 December 2017 *continued*

Responsibilities of directors *continued*

directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

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

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the 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.

We have nothing to report in respect of these matters.



Jacqueline Holden FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

28 March 2018

Heathrow Airport Limited

Income statement for year ended 31 December 2017

	Year ended 31 December 2017			Year ended 31 December 2016			
	Note	Before certain re-measurements £m	Certain re-measurements ¹ £m	Total £m	Before certain re-measurements £m	Certain re-measurements ¹ £m	Total £m
Continuing operations							
Revenue	1	2,828	-	2,828	2,760	-	2,760
Operating costs	2	(1,767)	-	(1,767)	(1,749)	-	(1,749)
Other operating items							
Fair value gain on investment properties	6	-	149	149	-	44	44
Operating profit		1,061	149	1,210	1,011	44	1,055
Financing							
Finance income		165	-	165	152	-	152
Finance costs		(719)	-	(719)	(632)	-	(632)
Fair value gain/(loss) on financial instruments		-	148	148	-	(474)	(474)
	3	(554)	148	(406)	(480)	(474)	(954)
Profit before tax		507	297	804	531	(430)	101
Tax charge before change in tax rate		(119)	(36)	(155)	(143)	64	(79)
Change in tax rate		-	-	-	-	26	26
Taxation	4	(119)	(36)	(155)	(143)	90	(53)
Profit for the year		388	261	649	388	(340)	48

¹ Certain re-measurements consist of: fair value gains on investment property revaluations and disposals; gains and losses arising on the re-measurement and disposal of financial instruments, the effects of the changes in tax rate and the associated tax impact of these.

Heathrow Airport Limited

Statement of comprehensive income for the year ended 31 December 2017

	<i>Note</i>	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Profit for the year		649	48
<i>Items that will not be subsequently reclassified to the consolidated income statement:</i>			
Actuarial loss on pensions			
Gain on plan assets ¹	15	62	501
Increase in scheme liabilities ¹	15	(116)	(688)
Tax relating to indexation of operational land	20	2	1
Change in deferred tax due to tax rate change ²		-	6
Other comprehensive loss for the year net of tax		(52)	(180)
Total comprehensive income/(loss) for the year		597	(132)
Attributable to owners of the parent		597	(132)

¹ Items in the statement above are disclosed net of tax.

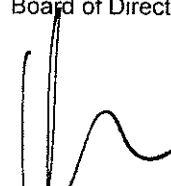
² The change in tax rate relates to deferred tax on pensions and investment property

Heathrow Airport Limited

Statement of financial position as at 31 December 2017

	Note	31 December 2017 £m	31 December 2016 £m
Assets			
Non-current assets			
Property, plant and equipment	5	11,307	11,306
Investment properties	6	2,350	2,200
Intangible assets	7	175	122
Investment in subsidiary	8	42	42
Trade and other receivables	10	2,694	1,711
		16,568	15,381
Current assets			
Inventories	9	11	11
Trade and other receivables	10	598	703
Term deposits	11	12	125
Cash and cash equivalents	11	233	279
		854	1,118
Total assets		17,422	16,499
Liabilities			
Non-current liabilities			
Borrowings	12	(11,620)	(11,552)
Derivative financial instruments	13	(1,092)	(1,086)
Deferred income tax liabilities	14	(387)	(352)
Retirement benefit obligations	15	(158)	(114)
Provisions	16	(8)	(9)
Trade and other payables	17	(31)	(32)
		(13,296)	(13,145)
Current liabilities			
Borrowings	12	(1,168)	(1,080)
Derivative financial instruments	13	(3)	-
Provisions	16	(6)	(12)
Current income tax liabilities		(24)	(18)
Trade and other payables	17	(495)	(484)
		(1,696)	(1,594)
Total liabilities		(14,992)	(14,739)
Net assets		2,430	1,760
Equity			
Capital and reserves			
Share capital	18	10	10
Share premium	19	350	-
Revaluation reserve	20	598	457
Retained earnings	21	1,472	1,293
Total shareholder's equity		2,430	1,760

These financial statements of Heathrow Airport Limited (Company registration number: 01991017) were approved by the Board of Directors and authorised for issue on 28 March 2018. They were signed on its behalf by:


Javier Echave
 Director


John Holland-Kaye
 Director

Heathrow Airport Limited

Statement of changes in equity for the year ended 31 December 2017

	Notes	Share capital £m	Share premium £m	Revaluation reserves £m	Profit and loss reserve £m	Total £m
31 December 2015		473	-	768	1,243	2,484
Profit for the year					48	48
Other comprehensive income						
Actuarial loss on retirement benefit schemes:						
Gain on plan assets					501	501
Increase in scheme liabilities					(688)	(688)
Tax relating to indexation of operational land				1	-	1
Change in tax rate				4	2	6
Total comprehensive income		-	-	5	(137)	(132)
Other movements						
Transfer between reserves - investment property fair value movements ¹	6			44	(44)	-
Deferred tax on investment properties ¹				(3)	3	-
Deferred tax change in rate (investment properties and operational land)				9	(9)	-
Impairment recycled to income statement				2	-	2
Total other movements		-	-	52	(50)	2
Transactions with owners						
New shares issued	18,20	368		(368)		-
Reduction of nominal share capital from 30p to 0.35p	21	(831)		-	831	-
Dividends paid	21				(594)	(594)
Total transactions with owners		(463)	-	(368)	237	(594)
31 December 2016		10	-	457	1,293	1,760
Profit for the year					649	649
Other comprehensive income						
Actuarial loss on retirement benefit schemes:						
Gain on plan assets					62	62
Increase in scheme liabilities					(116)	(116)
Tax relating to indexation of operational land	20			2	-	2
Total comprehensive income				2	595	597
New shares issued	19	-	350	-	-	350
Transfer between reserves - investment property fair value movements ¹				149	(149)	-
Deferred tax on investment properties ¹	20			(10)	10	-
Total transfer to revaluation reserve		-	-	139	(139)	-
Transactions with owners						
Dividends paid	22				(277)	(277)
Total transactions with owners					(277)	(277)
31 December 2017		10	350	598	1,472	2,430

¹ Movements in the valuation of investment properties recorded to the income statement are transferred to the revaluation reserve with the associated deferred tax liability. Details of the amount of deferred tax associated to investment properties are in Note 14.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017

The principal accounting policies applied in the preparation of these financial statements of Heathrow Airport Limited (the 'Company') are set out below. These policies have been consistently applied to all the years presented, unless stated otherwise.

Statement of compliance

These financial statements have been prepared and approved by the Directors in compliance with Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' ('FRS 102').

The Company

The Company is a limited liability company incorporated in the United Kingdom and registered in England and Wales. The registered office is The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

Basis of accounting

The Company financial statements are prepared in accordance with FRS 102 and are presented on the basis of the historical cost convention, except for investment properties and derivative financial instruments which have been measured at fair value in accordance with FRS 102 and as permitted by the Fair Value Directive as implemented in the Companies Act 2006.

The financial statements are presented in Sterling and are rounded to the nearest million pounds (£m), except when otherwise noted.

The Company has adopted the following standards that are relevant to these financial statements instead of those of FRS 102:

- IAS 39 'Financial Instruments: Recognition and Measurement', as endorsed by the European Union ('EU');
- IFRS 8 'Operating Segments' as endorsed by the EU, as permitted by FRS 102 Section 1 paragraph 5 ('FRS 102.1.5')

Individual entity financial statements

The Company has taken the advantage of the exemption provided by Section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it is a wholly-owned subsidiary of FGP Topco Limited and its subsidiary undertakings are included in the consolidated financial statements of that company for the year ended 31 December 2017. The financial statements present information about the Company as an individual entity only and not as a group.

Primary financial statements format

The primary financial statements are prepared in accordance with FRS 102, as it applies to the Company financial statements for the year ended 31 December 2017, as per Section 301(A) under FRS 102.

A columnar approach has been adopted in the income statement and the impact of certain items is shown in a separate column. This column includes certain re-measurements as listed in (i) and (ii) below, which management separates from the underlying operations of the Group. Also, this column includes exceptional items as listed in (iii) and the effect on taxation of changes in tax rates in (iv) and (v) below. By isolating certain re-measurements and exceptional items, management believes the underlying results provides the reader with a more meaningful and understanding of the performance of the Group, by concentrating on the matters over which it exerts influence, whilst recognising that information on these additional items is available within the financial statements, should the reader wish to refer to them

The column 'certain re-measurements' in the income statement contains the following items:

- fair value gains and losses on investment property revaluations and disposals;
- derivative financial instruments and the fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship;
- exceptional items;
- the associated tax impacts of the items in (i), (ii) and (iii); and
- the impact on deferred tax balances of known future changes in tax rates.

Going concern

The Directors have prepared the financial statements on a going concern basis which requires the Directors to have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. The Company forms part of the Heathrow (SP) Limited group (the 'SP Group'), which is the smallest group to consolidate these financial statements, and the level at which financial risks are managed for the Company.

Consequently the Directors have reviewed the cash flow projections of the SP Group, of which the Company forms part, taking into account:

- the forecast turnover and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall SP Group liquidity position, including cash resources, the remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and its ability to access the debt markets.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Going concern *continued*

Whilst the Company is in a net current liability position, as a result of the review, and having made appropriate enquiries of management, the Directors have a reasonable expectation that sufficient funds will be available to meet the Company's funding requirement for the twelve months following the date when the financial statements were authorised for issue.

Changes in accounting policy and disclosures

Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Company are as follows:

IFRS 9 financial instruments

IFRS 9 is effective for periods beginning on or after 1 January 2018. The Company has elected the option under FRS 102 to apply IAS 39 Financial instruments: Recognition and Measurement to its financial instruments and will elect to apply IFRS 9 once it becomes effective. The standard addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces rules for hedge accounting and a new impairment model for financial assets.

The Company has reviewed its financial assets and liabilities and is expecting no material impact following impact from the adoption of the new standard on 1 January 2018 as noted below:

The Company's financial assets include cash and cash equivalents (including short term deposits), loans to third parties, trade and other receivables, intercompany loan receivables, and other debtors. These financial assets will continue to be measured at amortised cost as is currently adopted under IAS 39 as they will meet the condition for classification at amortised cost under IFRS 9. Accordingly, the Company does not expect the new guidance to affect the classification and measurement of these financial assets.

There is no impact on the Company's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Company does not have any such liabilities. The derecognition rules have been transferred from IAS 39 and have not been changed.

The new hedge accounting rules will align the accounting for hedging instruments more closely with the Company's risk management practices. As a general rule, more hedge relationships might be eligible for hedge accounting, as the standard introduces a more principles-based approach. The Company is currently assessing whether hedge accounting can be applied under IFRS 9 for its index linked swap portfolio.

The new impairment model requires the recognition of impairment provisions based on expected credit losses (ECL) rather than only incurred credit losses as is the case under IAS 39. It applies to financial assets classified at amortised cost, debt instruments measured at fair value through other comprehensive income (FVOCI), contract assets under IFRS 15, lease receivables loan commitments and certain financial guarantee contracts. Based on the assessment undertaken to date it is anticipated that the application of ECL of IFRS 9 will result in an increase in the impairment recognition of £3.1 million in relation to the Company's intercompany receivables which is not material.

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Company's disclosure about its financial instruments particularly in the year of the adoption of the new standard.

Segment reporting

Information reported to the Board for the purposes of resource allocation and assessment of segmental performance relates to the operations of Heathrow.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes and consists primarily of:

Aeronautical

- Aircraft landing charges levied according to noise, emissions and weight recognised on landing.
- Aircraft parking charges based on time parked and whether aircraft are wide or narrow bodied as provided.
- Passenger charges based on the number of departing passengers on departure.
- Other charges levied for passenger and baggage operations when these services are rendered.

Retail

- Concession fees from retail and commercial concessionaires at the airport are based upon reported revenue by concessionaires, taking into account contracted minimum guarantees where appropriate, and are recognised in the period to which they relate.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Retail *continued*

- Car parking income is recognised on the date of arrival at the car park, in the case of pre-booked parking, or on the date of departure from the car park in the case of pay-on-exit, in accordance with operator management fee arrangements.

Other Regulated Charges ('ORCs')

- Usage charges made for operational systems (e.g. check-in desks), recognised as each service is provided.
- Charges related to passengers with restricted mobility and various other services recognised at the time of delivery.
- Other invoiced sales, recognised on the performance of the service.

Other

- Property letting rentals recognised on a straight-line basis over the term of the rental period.
- Proceeds from the sale of trading properties, recognised on the unconditional completion of the sale.
- Rail ticket sales; where tickets are booked in advance the revenue is recognised when the ticket is first used. Where tickets are bought at a rail station, the revenue is recognised immediately at the point of sale.

Contributions

On occasion, the Company may receive grants to improve airport infrastructure considered to be in the best interest of the public. These are recorded as reductions in the cost of the property, plant and equipment to which they relate.

Exceptional items

The Company separately presents certain items on the face of the income statement as exceptional. Exceptional items are material items of income or expense that, because of their size or incidence, merit separate presentation to allow an understanding of the Company's financial performance.

Such events may include gains or losses on the disposal of businesses or assets that do not qualify as discontinued operations, major reorganisation of businesses, closure or mothballing of terminals and costs incurred in bringing new airport terminal complexes and airfields to operational readiness that are not able to be capitalised as part of the project.

Additional details of exceptional items are provided as and when required.

Finance income

Finance income is recognised when it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably. Interest receivable is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the asset's net carrying amount on initial recognition.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until the asset is complete and available for use. Such borrowing costs are capitalised whilst projects are in progress.

Where assets in the course of construction are financed by specific borrowing facilities the interest rate relating to those specific borrowing facilities is used to calculate the amount to capitalise, otherwise an interest rate based on the weighted average cost of debt is used. Capitalisation of interest ceases once the asset is complete and available for use. Interest capitalised is then charged to the income statement as a depreciation expense over the life of the relevant asset.

All other borrowing costs, including costs incurred in respect of the maintenance of the Company's credit setting, are recognised in the income statement in the year in which they are incurred.

Internally-generated intangible assets

Development expenditure incurred in respect of individual projects is capitalised when the future economic benefit of the project is probable and is recognised only if all of the following conditions are met:

- the Company can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the Company can demonstrate how the intangible asset created will generate future economic benefits;
- the Company has available the resources to complete the asset;
- the Company intends to complete that asset and has the future ability to sell or use the asset; and
- the development cost of the intangible asset can be measured reliably.

Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be held at cost less any accumulated amortisation and impairment. Amortisation begins when development is complete and the asset is ready for use.

This type of expenditure primarily relates to internally developed software and website projects and these are amortised on a straight-line basis over their useful lives of three to seven years. During the period of development, the asset is tested for impairment annually.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Internally-generated intangible assets *continued*

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred. Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Purchased intangible assets (software costs)

Computer software costs principally relate to operating and financial software. These assets are amortised over a period of between four and fifteen years, based on the life of the relevant licence or other agreement. Amortisation for the year is charged on a straight-line basis, through operating costs. The assets are assessed for impairment whenever there is indication that the intangible asset may be impaired.

Tangible fixed assets

Operational assets

Terminal complexes, airfield assets, plant and equipment, rail assets and other land and buildings are stated at cost less accumulated depreciation and accumulated impairment losses. An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected. Any gain or loss arising on the derecognition of the asset is included in the income statement in the period of derecognition.

Assets in the course of construction are stated at cost less any impairment. Assets in the course of construction are transferred to completed assets when substantially all the activities necessary to get the asset ready for use are complete and the asset is available for use. Where appropriate, cost includes borrowing costs capitalised (see "Borrowing Costs" policy), own labour costs of construction-related project management and directly attributable overheads. Costs associated with projects that are in the early stages of planning are capitalised where the directors are satisfied that it is probable the necessary consents will be received and the projects will be developed to achieve a successful delivery of an asset such that future commercial returns will flow to the Group. The Group reviews these projects on a regular basis to determine whether events or circumstances have arisen that may indicate that the carrying amount of the asset may not be recoverable, at which point the asset would be assessed for impairment.

Heathrow Expansion

Assets in the course of construction include qualifying costs in respect of the Heathrow Expansion following the Government decision in October 2016 in favour of Heathrow, and subsequent Board decision to apply for the Development Consent Order, October 2016.

These two events were considered by management to be a trigger point for the expansion project to proceed. Management subsequently announced publicly that the Group would apply for planning permission, in the belief that it is highly probable that expansion at Heathrow will be realised. As a result, the Group has started to capitalise eligible costs as 'assets in the course of construction'.

The costs which are directly associated with, and solely for the purposes of, seeking planning consent for the delivery of new runway capacity through the Development Consent Order process are capitalised as they are directly attributable to the final design and construction of the expanded Heathrow assets. These costs include Environmental Impact Assessments, Statutory consultation, and Master plan options.

In the context of FRS 102 Section 18 (see Accounting Policy – Internally-generated intangible assets), October 2016 is also considered to be the point at which Expansion moved from the Research phase to the Development phase, and therefore development expenditure is capitalised where it meets the criteria of Section 18 of FRS 102.

Research costs, together with Expansion costs incurred by Heathrow during the Airports Commission process and before Heathrow was named as the preferred location for new runway capacity in October 2016 were expensed in the period they were incurred.

Depreciation

Depreciation is provided on operational assets, other than land and assets in the course of construction, to write off the cost of the assets less estimated residual value by equal instalments over their expected useful lives as set out below:

<i>Terminal complexes</i>	<i>Useful lives</i>
Terminal building, pier and satellite structures	20 - 60 years
Terminal fixtures and fittings	5 - 20 years
Airport plant and equipment:	
Baggage systems	15 years
Screening equipment	7 years
Lifts, escalators and travelators	20 years
Other plant and equipment including runway lighting and building plant	5 - 20 years
Tunnels, bridges and subways	50 - 100 years
Airport transit systems	

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Depreciation *continued*

Rolling stock	20 years
Track	50 years
<i>Airfields</i>	
Runway surfaces	10 - 15 years
Runway bases	100 years
Taxiways and aprons	50 years
<i>Rail</i>	
Rolling stock	8 - 40 years
Tunnels	100 years
Track metalwork	5 - 10 years
Track bases	50 years
Signals and electrification work	40 years
<i>Plant equipment and other assets</i>	
Motor vehicles	4 - 8 years
Office equipment	5 - 10 years
Computer equipment	4 - 5 years
<i>Other land and buildings</i>	
Short leasehold properties	3 - 20 years
Leasehold improvements	lower of useful economic life or period of lease

In certain circumstances, the asset life may fall outside of the boundaries disclosed above.

Asset residual values and useful lives are reviewed and adjusted, if appropriate, at each reporting date.

Impairment of assets

The Company assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. Where the asset does not generate cash flows independent of other assets, the recoverable amount of the cash-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of a cash-generating unit exceeds its recoverable amount, the cash-generating unit is considered impaired and is written down to its recoverable amount.

Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation, is initially measured at cost and subsequently stated at fair value at the reporting date as determined by the Directors and supported by external valuations every year when the fair value can be reliably measured. Gains or losses arising from changes in the fair value of investment property are recognised in the income statement in the period in which they arise.

Gains or losses on disposal of an investment property are recognised in the income statement on the unconditional completion of the sale.

The revaluation reserve includes historic gains and losses on investment properties. Future gains and losses will be recognised in the income statement and transferred to the revaluation reserve. The gains and losses will remain in the revaluation reserve as a matter of course and will only be transferred to the profit and loss reserve as part of a capital reconstruction or on disposal of the investment property.

Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Company as a lessee

Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are charged directly against income. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term if there is no reasonable certainty that the Company will obtain ownership by the end of the lease term.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Company as a lessee *continued*

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Company as a lessor

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases and with the exception of investment properties discussed above, the assets are included in property, plant and equipment and depreciated over their estimated useful lives. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income.

Investment in subsidiary

Investments are held as fixed assets and are stated at cost less impairment and reviewed for impairment if there are indications that the carrying value may not be recoverable.

Inventories

Raw materials and consumables consist of engineering spares and other consumable stores. These are valued at the lower of cost and net realisable value.

Deferred income

Amounts received prior to the delivery of goods and services are recorded as deferred income and released to the income statement as the services are delivered or when the goods are delivered.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation at the reporting date and are discounted, where material, to present value using a current, pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Restructuring

A restructuring provision is recognised when the Company has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity.

Home loss payment

A home loss payments provision is recognised where, an obligation arises during the year, as a result of a past event. The home loss payment provision is in respect of historic property purchases and related expenditures created in 2016 specifically in respect of Heathrow Expansion, following the Government's decision in October 2016.

Financial instruments

The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2017. The results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2017 and the Company is taking advantage of the exemption under the terms of FRS 102 from disclosing Section 11 and 12 disclosure requirements.

Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at the lower of their original invoiced value and recoverable amount. Where the time value of money is material, receivables are carried at amortised cost. Provision is made when there is objective evidence that the Company will not be able to recover balances in full. Balances are written off when the probability of recovery is remote.

Investments

The Company has elected the option under FRS 102 to apply IAS 39 Financial Instruments: Recognition and Measurement to its financial instruments. Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets. The Company determines the classification of its financial assets at initial recognition.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Investments *continued*

On initial recognition, financial assets are measured at fair value, plus, in the case of investments not at fair value through the income statement, directly attributable transaction costs. After initial recognition, investments that are classified as 'held-for-trading' and 'available-for-sale' are measured at fair value. Fair value gains or losses on investments held-for-trading are recognised in the income statement.

Assets classified as 'loans and receivables' or 'held-to-maturity' are recognised in the statement of financial position at their amortised cost, using the effective interest method, less any provision for impairment.

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables' and are carried at amortised cost using the effective interest method. Non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intent and ability to hold-to-maturity are classified as 'held-to-maturity' and are carried at amortised cost using the effective interest method. For investments carried at amortised cost, gains and losses are recognised in the income statement when the investments are de-recognised or impaired, as well as through the amortisation process.

For investments that are traded in an active market, fair value is determined by reference to quoted market bid prices at the reporting date. For investments where there is no quoted market price, fair value is determined by using valuation techniques, such as estimated discounted cash flows, or by reference to the current market value of similar investments.

Investments are classified as held-for-sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable, the asset is available for immediate sale in its present condition, management are committed to the sale and the sale is expected to be completed within one year of the date of classification. Assets classified as held-for-sale cease to be depreciated and are measured at the lower of carrying amount and fair value less selling costs.

A financial asset is derecognised when i) the rights to receive cash flows from the asset have expired or, ii) the Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party.

The Company assess at each reporting date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Cash and cash equivalents

For the purposes of the balance sheet, cash and cash equivalents comprise cash at bank, cash in hand, repurchase agreements with an original maturity of three months or less and short-term deposits with an original maturity of three months or less. For the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts. Short-term deposits with an original maturity of over three months are shown within current trade and other receivables.

Financial liabilities and reserves

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that provides a residual interest in the assets of a business after deducting all of other liabilities.

Trade and other payables

Trade and other payables are non-interest bearing and are stated at their fair value and subsequently measured at amortised cost using the effective interest method.

Amounts owed to Group undertakings

Amounts owed to Group undertakings are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings being novated or cancelled and re-issued, with a substantial modification of the terms, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, with any resulting gain or loss recognised in the income statement.

Borrowings from Company undertakings include the balance of the Borrower Loan Agreements ('BLAs') payable by the Company to Heathrow Funding Limited. Advances under the BLAs are secured and are issued on substantially the same

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Borrowings *continued*

terms as the bonds issued by Heathrow Funding Limited. The advances are carried at amortised cost with the interest expense recognised using the effective interest method. The nominal amount of the index-linked borrowings is accreted for the RPI component recognised within interest payable in the income statement.

Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. Derivative financial instruments novated from other companies within the Heathrow Airport Holdings Limited Group (the 'Heathrow Airport Holdings Group') are transferred at fair value prevailing on that date.

The Company does not apply hedge accounting in relation to any of its derivative financial instruments. Changes in the fair value of these derivative instruments are recognised immediately in the income statement, within fair value gains/(losses) on financial instruments. The interest payable and receivable on those derivatives are recorded at their gross amount in interest payable and interest receivable in the income statement, respectively. Derivatives that do not qualify for hedge accounting and which are not held for trading purposes are classified on the balance sheet based on their maturity.

Accounting for changes in credit risk

Accounting standards require that the fair value of financial instruments reflects their credit quality, and also changes in credit quality where there is evidence that this has occurred. The credit risk associated with the Company's derivatives is updated monthly based on current market data.

Embedded derivatives

As required by IAS 39 embedded derivatives are assessed on the initial recognition of the underlying host contract. Where the economic characteristics and risks of the embedded derivative are closely related to the economic characteristics and risks of the host contract, no bifurcation of the embedded derivative from the host contract is undertaken.

Shared Services Agreement ('SSA')

All employees of the Company are legally employed by LHR Airports Limited. LHR Airports Limited also legally sponsors the defined benefit pension schemes while Heathrow Airport Limited incurs all employment related costs.

Following the disposal of Aberdeen, Glasgow and Southampton airports in December 2014 the Directors reassessed the Company's relationship with LHR Airports Limited, given that the sole operating airport is now Heathrow and noted the following:

- The SSA states that the operating entities, being only Heathrow Airport Limited, are responsible for pension costs on LHR Airports Limited's retirement benefit schemes;
- The Company is responsible for funding the retirement benefit schemes, paying employer contributions directly to the pension scheme; and
- Although employees remain legally employed by LHR Airports Limited, the Company makes all employment decisions. LHR Airports Limited is no longer considered to be providing a service, in relation to employees to the Company but is acting as an agent.

Consequently, from 1 January 2015, all employment related costs and the disclosures pertaining to the defined benefit pension scheme are presented in the financial statements of the Company as though it were principal.

Employment costs

The Company incurs the cost of people which are contractually employed by LHR Airports Limited but provide services to the operation of the airport. Employment costs include wages and salaries, pension costs, medical costs and redundancy payments, as well as any other associated expenses properly incurred by the employees of LHR Airports Limited in providing the services.

Centralised services

LHR Airports Limited is considered to be continuing acting as principal in relation to the services of the HAHL Board and Ferrovia advisory services. These costs are recharged to Heathrow Airport Limited (the only remaining airport party to the SSA) with a mark-up of 7.5%. Other services are paid for and sourced directly by Heathrow Airport Limited, either without the Company's involvement or on a pass through fixed mark up only basis (agent). This judgement has been reached following consideration of whether the Company is exposed to the majority of the risks and rewards associated with the centralised services provided by LHR Airports Limited.

Pension costs

The Directors have determined, after taking into account the Shared Service Agreement, employment relationships and the funding risk associated with the schemes, that Heathrow Airport Limited now acts as principal in relation to these schemes. As a result, from 1 January 2015 the Company has recognised an external asset or liability, in relation to the schemes, on its statement of financial position, as non-current under the caption of Retirement benefit surplus/obligations within Debtors and Creditors respectively instead of an intercompany liability. Additionally, it is now considered appropriate for the Company to record actuarial gains and losses on the external scheme within other comprehensive income rather than the income statement.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Pension costs *continued*

The cost of providing benefits under the defined benefit plan is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of the defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in profit or loss on a straight-line basis over the vesting period or immediately if the benefits have vested. When a settlement or curtailment occurs, the obligation and related plan asset are re-measured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long-term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year. The difference between the expected return on plan assets and the interest cost is recognised in the income statement as other finance revenue or cost.

Re-measurements, comprising actuarial gains and losses, the effect of an asset ceiling and the return on the net defined benefit liability (excluding amounts included in net interest) are recognised immediately in other comprehensive income in the period in which they occur. Re-measurements are not reclassified to the income statement in subsequent periods.

The defined benefit pension asset or liability in the balance sheet comprises the total for each plan of the present value of the defined benefit plan obligation (using a discount rate based on high-quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net benefit pension asset is restricted to the sum of any unrecognised past service costs and the present value of any amount the Group expects to recover by way of refunds from the plan or reductions in future contributions.

Contributions to defined contribution schemes are recognised in the income statement in the period in which they become payable.

Current and deferred taxation

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income. In this case, the tax is recognised in other comprehensive income.

Current tax liabilities are measured at the amount expected to be paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

In accordance with FRS 102 Section 29 timing differences, deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Deferred taxation is determined using the tax rates and laws that have been enacted, or substantively enacted, by the balance sheet date and are expected to apply in the periods in which the timing differences are expected to reverse.

Share capital

Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs allowing for any reductions in the par value. Where shares are issued above par value, the proceeds in excess of par value are recorded in the share premium reserve.

Preference shares

Preference shares are classified as liabilities when in substance the shares and the related dividends have terms similar to liabilities and not share capital. Features that indicate that presentation as a liability is appropriate include dividends that are payable for a fixed or determinable amount at a fixed or determinable future date and where redemption is at a predetermined amount and date or at the option of the preference shareholder and not at the discretion of the Company. Where presentation as a liability is considered appropriate, the associated dividend expense is shown within interest in the income statement.

Dividend distribution

A dividend distribution to the Company's shareholder is recognised as a liability in the Company's financial statements in the period in which the shareholder's right to receive payment of the dividend is established.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2017 *continued*

Foreign currency

The Company financial statements are presented in Sterling, which is the Company's functional currency.

Transactions denominated in foreign currencies are initially recorded in the entity's functional currency applying the spot exchange rate using the exchange rates prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into Sterling at the rates of exchange ruling at the reporting date. Differences arising on translation are charged or credited to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Related party disclosures

The Company is exempt under the terms of FRS 102 from disclosing related party transactions with entities that are wholly-owned subsidiaries of the FGP Topco Limited Group. Under FRS 102 it is also exempt from providing certain other disclosures regarding key management personnel.

Cash flow statement

The ultimate parent entity in the UK is FGP Topco Limited, a company registered in England and Wales.

The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2017. The results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2017 (intermediate parent entity and the smallest group to consolidate these financial statements). Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of accounting standard FRS 102 (1.12 (b) and (e)).

Heathrow Airport Limited

Significant accounting judgements and estimates for the year ended 31 December 2017

In applying the Company's accounting policies management have made judgements and estimates in a number of key areas. Actual results may, however, differ from the estimates calculated and management believes that the following areas present the greatest level of uncertainty.

Critical judgements in applying the Company's accounting policies

Capitalisation

Management are required to make judgements in relation to the capitalisation of costs. This relates to both when amounts may begin to be capitalised, where there may be doubt about planning consent or the ultimate completion of the asset, and in relation to the nature of costs incurred. Judgement has been exercised in the year including in relation to:

- capitalised interest, where judgement is exercised in relation to the applicable interest rate;
- the assessment of assets in the course of construction, including expansion costs;
- projects on hold and operational activities where judgement is exercised to determine costs that are directly attributable to the assets under construction; and
- when a project moves from the research phase (where costs must be expensed in the current period) to the development phase and hence may be capitalised as the future economic benefit of the project becomes probable and the principles of FRS 102 Section 18 are considered and applied.

Agent versus Principal

The presentation of certain costs including employment costs and pension costs which are a contractual obligation of LHR Airports Limited are presented as Operating costs of Heathrow Airport Limited in the 2017 financial statements based on an assessment of which entity is principal in relation to these transactions. This judgement is described in the accounting policies and is based on the balance of risks and rewards between group companies.

Key sources of estimation uncertainty

Fair value of derivative financial instruments

The fair value of derivative financial instruments is calculated using a discounted cash flow approach and using inputs based on observable market data. Judgement is used to determine the recovery rate and associated reduction in credit risk of super senior ranking derivatives.

Investment properties

Investment properties are fair valued by CBRE Limited, Chartered Surveyors. The valuations are prepared in consideration of FRS 102 and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations are carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) is capitalised using yields derived from market evidence. This market evidence also takes into account planned transaction and use of the property (for example the future expansion. Independent valuations are obtained for all investment properties. Management have reviewed the main assumptions underlying the valuation of Investment properties and the sensitivity analysis as included in Note 6.

Pensions

Certain assumptions have been adopted for factors that determine the valuation of the Company's liability for pension obligations at period end and charges to the income statement. The factors have been determined in consultation with the Company's actuary taking into account market and economic conditions. Changes in assumptions can vary from period to period as a result of changing conditions and other determinants which may cause increases or decreases in the valuation of the Company's liability for pension obligations. The objective when setting pension scheme assumptions for future periods is to reflect the expected actual outcomes, other than the discount rate which must be set by reference to the yield on high quality corporate bonds with a term consistent with the obligations. The impact of the change in assumptions on the valuation of the net financial position of the Company pension scheme is recorded as a net actuarial gain or loss and is reflected in the statement of comprehensive income. Further details are available in Note 15.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017

1 Segment information

As described in the accounting policies on page 35 to 43, the Company's operating revenue segments are aeronautical, retail, other regulated charges and other income.

The performance of these segments is measured on a revenue basis, before certain re-measurements and exceptional items.

The reportable segments derive their revenue from a number of sources including aeronautical, retail, property and facilities (including property income and utilities income), other regulated charges ('ORCs') and other products and services (including rail income for the year ended 31 December 2017) and this information is also provided to the Board on a monthly basis.

Table (a) details total revenue from external customers for the year ended 31 December 2017 and is broken down into aeronautical, retail, property and facilities, ORCs and other in respect of the reportable segments. No information in relation to inter-segmental revenue is disclosed as it is not considered material. Also detailed within table (a) is Adjusted EBITDA which is earnings before interest, tax, depreciation, amortisation, certain re-measurements and exceptional items.

Table (b) details comparative information to table (a) for the year ended 31 December 2016.

Table (c) details depreciation and amortisation, fair value adjustments and profit and loss on disposal by reportable segment.

Section (d) details revenue and non-current asset information by geographical segment.

Year ended 31 December 2017	Segment revenue				Total external revenue £m	Adjusted EBITDA ¹ £m
	Aeronautical £m	Retail £m	ORCs £m	Other £m		
Heathrow	1,716	658	240	214	2,828	1,752

Reconciliation to statutory information:

Unallocated income and expense	
Depreciation and amortisation (table (c))	(691)
Operating profit (before certain re-measurements)	1,061
Fair value gain on investment properties (certain re-measurements) (table (c))	149
Operating profit	1,210
Finance income	165
Finance costs	(719)
Fair value gain on financial instruments (certain re-measurements)	148
Profit before tax	804
Taxation before certain re-measurements	(119)
Taxation (certain re-measurements)	(36)
Taxation	(155)
Profit for the year	649

¹ Adjusted EBITDA is earnings before interest, tax, depreciation, amortisation, certain re-measurement and exceptional items.

Revenue of £901 million was derived from a single external customer and has been included within the aeronautical and other segments.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

1 Segment information *continued*

Table (b)	Segment revenue				Total external revenue £m	Adjusted EBITDA ¹ £m
	Aeronautical £m	Retail £m	ORCs £m	Other £m		
Year ended 31 December 2016						
Heathrow	1,699	612	232	217	2,760	1,680
Reconciliation to statutory information:						
Unallocated income and expense						
Depreciation and amortisation (table (c))						(669)
Operating profit (before certain re-measurements)						1,011
Exceptional items						
Fair value gain on investment properties (certain re-measurements) (table (c))						44
Operating profit						1,055
Finance income						
Finance costs						(632)
Fair value gain on financial instruments (certain re-measurements)						(474)
Profit before tax						101
Taxation before certain re-measurements						
Taxation (certain re-measurements)						(143)
Taxation						(53)
Profit for the year						48

¹ Adjusted EBITDA is earnings before interest, tax, depreciation, amortisation, certain re-measurement and exceptional items.

Revenue of £908 million was derived from a single external customer and has been included within the aeronautical and other segments.

Table (c)

	Year ended 31 December 2017		Year ended 31 December 2016	
	Depreciation & amortisation ¹ £m	Fair value gain ² £m	Depreciation & amortisation ¹ £m	Fair value gain ² £m
Heathrow	691	149	669	44
Total	691	149	669	44

¹ Includes intangible amortisation charge of £40 million (2016: £36 million).

² Reflects fair value gains on investment properties only.

(d) Revenue and non-current asset information by geographical segment

Heathrow Airport Limited is domiciled in the UK. All revenue from external customers comes from the UK which for the year ended 31 December 2017 was £2,828 million (2016: £2,760 million). The breakdown of the major components of total revenue from external customers is shown in tables (a) and (b) above.

Non-current assets excluding derivative financial instruments were £16,568 million (2016: £15,381 million). There were no non-current assets held outside the UK (2016: £nil).

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

2 Operating costs

Operating costs comprise:

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Employment		
Wages and salaries	304	300
Social security	33	30
Pension	39	37
Other staff related costs	23	21
Own staff costs capitalised	(50)	(39)
	349	349
Operational	243	257
Maintenance	164	164
Rates	124	127
Utilities	84	72
Other	112	111
Operating costs before depreciation, amortisation and exceptional items	1,076	1,080
Depreciation and amortisation		
Property, plant and equipment	651	633
Intangible assets	40	36
	691	669
Total operating costs	1,767	1,749

Rentals under operating leases

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
<i>Operating costs include:</i>		
Land and buildings ^{1,2}	29	17
Other ³	16	15
Total rentals under operating leases	45	32
Property lease and sub-lease charges – minimum lease payments	14	14

¹ The Company leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The amounts above are stated net of discounts.

² A significant portion of the operating rental costs relates to electricity supply equipment at the airport leased on agreement with UK Power Networks Services Limited ('UKPNS').

³ Others mainly comprises of wayleaves and easements.

Auditor's remuneration

Audit fees and non-audit fees for the SP Group for the current and preceding financial years were borne by the Company.

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Fees payable to the Company's auditor for the annual audit of the:		
Company's ultimate parent	0.1	0.1
Company's subsidiaries ¹	0.4	0.3
Total audit fees	0.5	0.4
Fees payable to the Company's auditor and their associates for other services specific to the Group		
Audit related assurance services	0.1	0.1
Other assurance services	0.1	0.1
Other services	0.1	-
Total non-audit fees	0.3	0.2
Total fees	0.8	0.6

¹ Fees payable to the Company's auditor for the audit of the Company's annual accounts was £71,000 (2016: £53,000).

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

Operating costs *continued*

Employee information

The Company has 6,121 employees (2016: 5,938). The Directors note that although the employees remain legally employed by LHR Airports Limited, the Company makes all employment decisions. Consequently, employee numbers for those providing services to the operation of the airport are reported in the financial statement of the Company and not in the financial statements of LHR Airports Limited.

Directors' remuneration

	Year ended 31 December 2017 £'000	Year ended 31 December 2016 £'000
Aggregate emoluments ^{1,2}	4,150	4,243
Value of Company pension contributions	60	212
Termination benefits	301	-
	4,511	4,455

¹ For the year ended 31 December 2017 salaries and benefits include salaries, allowances, Directors' fees, Company pension contributions, accrued bonuses and amounts payable under long-term incentive plans ('LTIP').

² £966,000 of bonus was paid in cash in 2017 (2016: £1,650,000).

John Holland-Kaye and Javier Echave were directors of a number of companies within the Heathrow Airport Holdings Group, including LHR Airports Limited, during the year. Their remuneration for the year ended 31 December 2017 was disclosed in the financial statements of Heathrow Airport Holdings Limited. The directors do not believe it is possible to accurately apportion their remuneration to individual companies based on services provided and therefore their remuneration is not included in the numbers above.

The Directors participate in various Long Term Incentive Performance Cash Plans. In respect of the Plans, a cash amount is granted which could vest in future periods contingent on achieving or surpassing Adjusted EBITDA, return on equity and other operational targets over a three year period. The Directors' remuneration in 2017 includes £495,000 in respect of LTIP which will be paid in 2019 if the targets are fully met. In 2017, £413,000 was paid.

	Year ended 31 December 2017 £'000	Year ended 31 December 2016 £'000
Highest paid director's remuneration		
Aggregate emoluments ^{1,2}	892	952
Value of Company pension contributions	-	27
	892	979

¹ For the year ended 31 December 2017 salaries and benefits include salaries, allowances, directors fees, Company pension contributions, accrued bonuses and amounts payable under long term incentive plans ('LTIP').

² £238,000 of bonus was paid in cash in 2017 (2016: £447,000).

The highest paid director also participates in various Long Term Incentive Performance Cash Plans. In respect of the Plans, a cash amount is granted which could vest in future periods contingent on achieving or surpassing EBITDA, Return on Equity and other operational targets over a three year period. The highest paid director's remuneration in 2017 includes £150,000 in respect of LTIP which will be paid in 2019 if the targets are fully met. In 2017, £125,000 was paid.

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Number of directors who are members of a:		
Defined benefit pension scheme	0	2
Defined contribution pension scheme	4	4

No directors (2016: none) exercised share options during the year in respect of their services to the Heathrow Airport Holdings Group and no shares (2016: none) were received or became receivable under long-term incentive plans.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

3 Financing

(a) Net finance costs before certain re-measurements

	Year ended 31 December 2017	Year ended 31 December 2016
Note	£m	£m
Finance income		
Interest receivable from group undertakings ¹	163	144
Interest on deposits	2	4
Net pension finance income	-	4
	165	152
Finance costs		
Interest payable to group undertakings ²	(735)	(642)
Interest on bank borrowings	(20)	(14)
Facility fees and other charges	(7)	(9)
Dividend payable on irredeemable preference shares ³	-	(1)
Net pension finance costs	(2)	-
Unwinding of discount	(1)	(1)
	(765)	(667)
Less: capitalised borrowing costs ⁴	5	46
	(719)	(632)
Net finance costs before certain re-measurements	(554)	(480)

¹ These amounts relate primarily to interest accrued on balances due from Heathrow (SP) Limited (Note 12).

² These amounts relate mainly to interest due on the Borrower Loan Agreement ('BLA') advances and back-to-back derivatives not in hedge relationship with Heathrow Funding Limited and interest on the loan from Heathrow (AH) Limited (Note 12).

³ Dividend payable for the year ended 31 December 2017 was 4.32p per share (2016: 4.55p per share).

⁴ Capitalised interest included in the cost of qualifying assets arose on the general borrowing pool and is calculated by applying an average capitalisation rate of 5.37% (2016: 4.89%) to expenditure incurred on such assets.

(b) Fair value gain/(loss) on financial instruments

	Year ended 31 December 2017	Year ended 31 December 2016
	£m	£m
Interest rate swaps	67	(124)
Index-linked swaps	81	(350)
Fair value gain/(loss) on financial instruments	148	(474)
Net finance costs	(406)	(954)

4 Taxation

	Year ended 31 December 2017	Year ended 31 December 2016
	£m	£m
UK corporation tax		
Current tax charge at 19.25% (2016: 20%)	(59)	(46)
Group relief payable	(49)	(54)
Under provision in respect of prior years	-	(1)
Deferred tax		
Current year (charge)/credit	(68)	40
Prior year credit/(charge)	21 ¹	(18)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	-	26
Taxation charge for the year	(155)	(53)

¹ Prior year credit for 2017 includes a £9m adjustment in relation to investment properties and a £12m adjustment for accelerated capital allowances.

The tax charge on the Company's profit before tax differs from the theoretical amount that would arise by applying the UK statutory tax rate to the accounting profits of the Company for the reasons as set out in the following reconciliation:

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

4 Taxation *continued*

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Profit before tax (before certain re-measurements)	507	531
Reconciliation of the tax charge		
Tax calculated at the UK statutory rate of 19.25% (2016: 20%)	(98)	(106)
Adjustments in respect of current income tax of previous years	-	(1)
Adjustments in respect of deferred income tax of previous years	12 ¹	(4)
Net non-deductible expenses	(33)	(32)
Tax charge before certain re-measurements excluding change in UK corporation tax rate	(119)	(143)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	-	26
Tax (charge)/credit on certain re-measurements	(36) ²	64
Taxation charge for the year	(155)	(53)

¹ Prior year adjustment in 2017 relates to accelerated capital allowances.

² This consists of the tax impact arising from fair value gains on investment property revaluations and fair value gains/losses on financial instruments, along with prior year adjustments for investment properties.

The total tax charge recognised for the year ended 31 December 2017 was £155 million (2016: £53 million). Based on a profit before tax for the year of £804 million (2016: £101 million), this results in an effective tax rate of 19.3% (2016: 52.5%).

The total tax charge before certain re-measurements for the year ended 31 December 2017 was £119 million (2016: £143 million) which includes a £12 million prior year deferred tax credit adjustment (2016: £4 million prior year deferred tax debit adjustment) relating primarily to accelerated capital allowances. Based on a profit before tax and certain re-measurements of £507 million (2016: £531 million), this results in an effective tax rate of 23.5% (2016: 26.9%). The tax charge is more than implied by the statutory rate of 19.25% (2016: 20%) primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

In addition, there was a £36 million tax charge (2016: £64 million tax credit) reflecting the tax impact arising from fair value gains on investment property revaluations and fair value gains/losses on financial instruments, along with any associated prior year adjustments.

Further details supporting these amounts are shown in Note 4 to the financial statements.

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further reduction in the main rate of corporation tax to 17% from 1 April 2020. The effects of these rate reductions were reflected in the deferred tax balances in the 2016 financial statements.

In November 2017 the Finance (No.2) Act 2017 received Royal Assent, giving effect to a new interest deductibility regime. This regime is in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). As a result of the new legislation, from 1 April 2017, interest deductions are limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public infrastructure exemption (PIE). Heathrow will be protected from the 30% of tax based EBITDA cap as a result of applying either the PIE or GRR and therefore no interest disallowance has been reflected in the 2017 tax charge (2016: nil).

Other than these changes there are no items which would materially affect the future tax charge.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

5 Property, plant and equipment

	Note	Terminal complexes £m	Airfields £m	Plant and equipment £m	Other land and buildings £m	Rail £m	Assets in the course of construction £m	Total £m
Cost								
1 January 2016		11,199	1,738	855	187	1,448	645	16,072
Additions		-	-	-	-	-	666	666
Borrowing costs capitalised	3	-	-	-	-	-	35	35
Disposals		(479)	(13)	(56)	(1)	-	-	(549)
Transfer to Intangibles		-	-	-	-	-	(13)	(13)
Reclassification		36	-	-	-	(36)	-	-
Transfer to completed assets		104	20	28	24	-	(176)	-
31 December 2016		10,860	1,745	827	210	1,412	1,157	16,211
Additions		-	-	-	-	-	682	682
Borrowing costs capitalised	3	-	-	-	-	-	46	46
Disposals		(78)	(10)	(25)	(5)	(7)	-	(125)
Transfer to intangible assets	7	-	-	-	-	-	(77)	(77)
Transfer to completed assets		495	331	89	-	1	(916)	-
31 December 2017		11,277	2,066	891	205	1,406	893	16,738
Depreciation								
1 January 2016		(3,533)	(387)	(369)	(55)	(480)	-	(4,824)
Depreciation charge		(464)	(46)	(70)	(10)	(42)	-	(632)
Disposals		479	13	56	1	-	-	549
Transfer to intangible assets		(1)	-	3	-	-	-	2
31 December 2016		(3,519)	(420)	(380)	(64)	(522)	-	(4,905)
Depreciation charge		(469)	(53)	(78)	(9)	(42)	-	(651)
Disposals		78	10	25	5	7	-	125
31 December 2017		(3,910)	(463)	(433)	(68)	(557)	-	(5,431)
Net book value								
31 December 2017		7,367	1,603	458	137	849	893	11,307
31 December 2016		7,341	1,325	447	146	890	1,157	11,306

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value at 31 December 2017 of £11 million (2016: £12 million).

Assets in the course of construction

The major balances in assets in the course of construction include Baggage programme projects to install the latest generation of Baggage screening machines, the Asset Management programme to replace assets at the end of their useful life, and the Airport resilience programme including tunnels and airfield improvements.

Borrowing costs capitalised

During the year ended 31 December 2017, borrowing costs of £46 million were capitalised (2016: £35 million). Capitalised borrowing costs were calculated by applying an average interest rate of 5.37% (2016: 4.89%) to expenditure incurred on qualifying assets.

A tax deduction of £46 million (2016: £35 million) for capitalised borrowing costs was taken in the year. Subsequent depreciation of the capitalised borrowing costs is disallowed for tax purposes. Consequently, the capitalised borrowing costs give rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

6 Investment properties

	Airport investment properties £m
Valuation	
1 January 2016	2,156
Revaluation	44
31 December 2016	2,200
Additions	1
Revaluation	149
31 December 2017	2,350

Investment properties were valued at fair value at 31 December 2017 by CBRE Limited, Chartered Surveyors (2016: CBRE Limited, Chartered Surveyors).

All valuations were prepared in consideration of FRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. There were no restrictions on the realisability or remittance of income or proceeds on disposal. The fair value measurement hierarchy used in calculating fair value (refer to Note 12) has been classified as level 3. The higher the discount rate and expected vacancy rate, the lower the fair value. The higher the current and potential future income or rental growth rate, the higher the fair value.

The Investment Property portfolio includes Car Parks (for travellers and employees) and Maintenance Hangars, which together account for 67% of the total investment property portfolio at 31 December 2017. All of the properties in the investment portfolio are owned freehold by HAL, with the possible exception of a couple of residential properties (which will be held long leasehold and in total will be worth less than £1m). As stated above, the valuations are based on assumptions relevant to the type of property being valued. Management have reviewed the assumptions, as described in the sensitivity analysis below, as prepared by CBRE Limited.

	Increase/(decrease) in asset valuation £m
Car parks	
Revenue growth rate	
+ 0.5% pa	84
- 0.5% pa	(80)
Operating costs	
+ 0.5% pa	(21)
- 0.5% pa	19
Maintenance Hangars	
Net Initial Yield	
+ 0.1% pa	(9)
- 0.1% pa	10

The sensitivities analysis above has been determined based on reasonably possible changes to the respective assumptions, holding all other assumptions constant.

The methodology used in arriving at the incremental changes shown above is consistent with that used for the valuation of car parks and maintenance hangars within the Investment Property portfolio at the year end.

The Company has historically had a low level of void properties.

Investment properties are let on either full repair and insuring leases, under which all outgoings are the responsibility of the lessee, or under tenancies, where costs are recovered through a service charge levied on tenants during their period of occupation. This service charge amounted to less than £1 million (2016: £1 million) for which a similar amount is included within operating costs.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £74 million. Direct operating expenses arising on the investment property, all of which generated rental income in the period, amounted to £1 million (2016: £1 million). The Group has entered into contracts for the maintenance of its investment property, which will give rise to an annual charge of less than £1 million (2016: £1 million).

Historical cost

The historical cost of investment properties and land held for development as at 31 December 2017 was £664 million (2016: £672 million).

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

7 Intangible assets

	£m
Cost	
1 January 2016	227
Additions	14
Transfers from property, plant and equipment	13
Disposals	(2)
31 December 2016	252
Additions	17
Transfers from property, plant and equipment (note 5)	77
Disposals	(16)
31 December 2017	330
Amortisation	
1 January 2016	(94)
Charge for the year	(36)
Disposals	2
Transfers from property, plant and equipment	(2)
31 December 2016	(130)
Charge for the year	(40)
Disposals	15
Transfers from property, plant and equipment	
31 December 2017	(155)
Net book value	
31 December 2017	175
31 December 2016	122

All intangible assets relate to capitalised computer software costs. These software costs principally relate to operating and financial software. These assets are being amortised over a period of between four and fifteen years. Amortisation for the year has been charged through operating costs.

8 Investment in subsidiary

	2017 £m	2016 £m
Cost at 1 January and 31 December	42	42

Subsidiary	Nature of business	% of share capital held	Class of share
Heathrow Express Operating Company Limited	Railway Operator	100	Ordinary shares of £1 each

Heathrow Express Operating Company Limited, a company registered in England and Wales, operates the express rail service between Heathrow and central London. The registered address of the company is The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

In the opinion of the directors, the aggregate value of the shares in the subsidiary undertaking is not less than the aggregate amount at which they are stated in the Company's statement of financial position. Investments are held as fixed assets and are stated at cost less impairment and reviewed for impairment if there are indications that the carrying value may not be recoverable.

9 Inventories

	31 December 2017 £m	31 December 2016 £m
Raw materials and consumables	11	11

The total amount of inventories consumed in the year was £6 million (2016: £6 million). There is no material difference between the statement of financial position value of inventories and their replacement cost.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

10 Trade and other receivables

	31 December 2017 £m	31 December 2016 £m
Non-current		
Amounts owed by group undertakings – interest bearing ¹	2,676	1,685
Prepaid debt fees ²	3	5
Prepayments	15	16
Other receivables	-	5
	2,694	1,711
Current		
Trade receivables	201	200
Less: provision for impairment	(2)	(1)
Trade receivables – net	199	199
Prepayments	24	23
Amounts owed by group undertakings – interest bearing ³	-	255
Amounts owed by group undertakings – interest free ⁴	-	26
Interest receivable	-	1
Interest receivable from group undertakings ⁵	357	196
Other receivables	18	3
	598	703
Total trade and other receivables	3,292	2,414

¹ Amounts owed by group – interest bearing represents a loan receivable from Heathrow (SP) Limited. It has a fixed interest rate of 7.57% pa and is repayable on 29 December 2026.

² Prepaid debt fees largely relate to financing fees paid on facilities not yet drawn and are amortised over the term of the facility.

³ Amounts owed by group undertakings – interest bearing represented a loan receivable from Heathrow (AH) Limited, which was repaid during the year.

⁴ Amounts owed by group undertakings – interest free largely relate to external payments received by LHR Airports Limited under the Shared Service Agreement on behalf of Heathrow that were paid during the year 2016.

⁵ Interest receivable from group undertakings relate primarily to interest accrued on balances due from Heathrow (SP) Limited.

11 Cash and cash equivalents and term deposits

	31 December 2017 £m	31 December 2016 £m
Cash at bank and in hand	39	9
Short-term deposits	194	270
Cash and cash equivalents	233	279
Term deposits	12	125
Cash and cash equivalents and term deposits	245	404

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates and is subject to interest rate risk. The fair value of cash and cash equivalents approximates to their book value.

12 Borrowings

	31 December 2017 £m	31 December 2016 £m
Current		
Secured		
Bank loans	33	36
BLA advances from Heathrow Funding Limited	957	856
Total current (excluding interest payable)	990	892
Interest payable – external	5	4
Interest payable – owed to group undertakings	173	184
Total current	1,168	1,080
Non-current		
Secured		
BLA advances from Heathrow Funding Limited	10,736	11,151
Bank loans	29	62
Class A1 term loan due 2020	416	-
Term note – 3.770% £100 million due 2026	100	100
Term note – 2.630% £80 million due 2030	80	80
Term note – 3.160% £90 million due 2032	89	89
Term note – 2.430% £80 million due 2033	80	-
Term note – 2.970% £70 million due 2035	70	70
Term note – 2.510% £20 million due 2037	20	-
Total non-current	11,620	11,552
Total borrowings	12,788	12,632

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

12 Borrowings *continued*

The table below analyses the contractual maturity of the Company's borrowings falling due after more than one year:

	31 December 2017	31 December 2016
	£m	£m
One to two years	266	964
Two to five years	2,691	1,843
Over five years	8,663	8,745
	11,620	11,552

Borrowings from group undertakings

Heathrow Funding Limited, a fellow subsidiary company, raises funds from external sources through the issuance of external bonds and use of external derivatives. The proceeds raised are distributed to the Company under the terms of the BLAs.

Advances under the BLAs are secured and are issued on substantially the same terms as the bonds issued by Heathrow Funding Limited, taking into consideration certain of the related hedging instruments. Interest rate swaps, index-linked swaps and cross-currency swaps are entered into by Heathrow Funding Limited to hedge the SP Group's exposures. Interest rate and index-linked derivatives are mainly passed through to the Company as back-to-back derivatives, or otherwise incorporated into the related BLAs. Cross-currency swaps are packaged with external non-sterling debt and passed through to the Company under the BLAs.

During the year, following new bonds issued by Heathrow Funding Limited, further advances were made to the Company for £440 million (2016: £825 million), net of transaction costs. In the same period, the Company made repayments of £856 million (2016: £734 million). The effective interest rate on the BLA advances varies between 0.55% and 7.39% (2016: 0.55% and 7.39%).

Facilities

All of the facilities are carried at amortised cost.

The Company had £1,250 million undrawn committed borrowing facilities available as at 31 December 2017 (2016: £1,500 million). In addition, as at 31 December 2017, there was an overdraft limit up to a maximum net overdraft balance of £10 million (2016: £10 million).

Securities and guarantees

The Company, Heathrow Express Operating Company Limited, Heathrow (SP) Limited and Heathrow (AH) Limited (together, the 'Obligors') have granted security to Deutsche Trustee Company Limited (in its capacity as the 'Borrower Security Trustee', for itself and as trustee for the Borrower Secured Creditors) over their property, assets and undertakings to secure their obligations under various financing agreements. Each Obligor has also guaranteed the obligations of each other Obligor under such financing agreements.

BAA Pension Trust Company Limited, as a trustee from time to time of the BAA Pension Scheme, is a Borrower Secured Creditor and ranks equally in an amount up to £284 million with senior (Class A) debt.

The Company and Heathrow Express Operating Company Limited have provided a guarantee and indemnity in favour of Lloyds Bank plc (in its capacity as the Borrower Account Bank) in respect of each other's obligations under the Borrower Account Bank Agreement and associated financing agreements.

13 Derivative financial instruments

31 December 2017	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Foreign exchange contracts	5	-	-	-
Interest rate swaps ¹	400	-	(3)	(3)
Index-linked swaps ²	-	-	-	-
Total current	405	-	(3)	(3)
Non-current				
Foreign exchange contracts	3	-	-	-
Interest rate swaps ¹	2,606	-	(482)	(482)
Index-linked swaps ²	4,081	-	(610)	(610)
Total non-current	6,690	-	(1,092)	(1,092)
Total derivative financial instruments	7,095	-	(1,095)	(1,095)

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

13 Derivative financial instruments *continued*

31 December 2016	Notional £m	Assets £m	Liabilities £m	Total £m
Non-current				
Interest rate swaps ¹	3,006	-	(552)	(552)
Index-linked swaps ²	3,981	-	(534)	(534)
Total derivative financial instruments	6,987	-	(1,086)	(1,086)

¹ £3,006 million (2016: £3,006 million) notional value of interest rate swaps relate to back-to-back hedges with Heathrow Funding Limited.

² £4,081 million (2016: £3,981 million) notional value of index-linked swaps relate to back-to-back hedges with Heathrow Funding Limited.

Derivative financial instruments at fair value

The Company enters into derivative transactions, principally interest rate swaps, index-linked swaps and foreign exchange contracts. The purpose of these transactions is to manage interest rate, inflation and currency risks arising from the Company's operations and sources of finance. The Company does not apply hedge accounting in relation to any of its derivative financial instruments.

Interest rate swaps

As at 31 December 2017, the total notional amount of back-to-back interest rate swaps was £3,006 million which had a mark-to-market liability of £485 million (2016: £3,006 million notional with a mark-to-market liability of £552 million).

Index-linked swaps

Index linked swaps have been entered into in order to economically hedge debt instruments and RPI linked revenue and the Regulated Asset Base ('RAB'). Heathrow Funding Limited has entered into index linked swaps with external counterparties which have been issued to the Company as back-to-back hedges and the total notional amount of back-to-back index linked swaps was £4,081 million which had a mark-to-market net liability of £610 million (2016: £3,981 million notional with a mark-to-market net liability of £534 million).

Financial instruments at fair value by category

All of the Company's financial assets and financial liabilities that are held at fair value are classified as derivative financial instruments, and are disclosed above.

Treasury risk management

The Company's financial risk management objectives are aligned with Heathrow Airport Holdings Limited, which is the level at which financial risks for the Company are managed. The treasury policies of the Heathrow Airport Holdings have been disclosed in the internal controls and risk management section of the Strategic report in its statutory annual report and financial statements.

Fair value estimation

The fair value of financial instruments that are not traded in an active market (such as derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates.

Specific valuation techniques used to value financial instruments include:

- market prices for credit spreads based on counterparty's credit default swap prices and the Company's bond spread;
- the fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves; and
- other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

14 Deferred income tax

The net movement on the deferred income tax account is as follows:

	2017 £m	2016 £m
1 January	352	445
Charged/(credited) to income statement	47	(48)
Credited to other comprehensive income	(12)	(45)
31 December	387	352

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

14 Deferred income tax *continued*

Analysis of the deferred tax balance is as follows:

	2017	2016
	£m	£m
Excess of capital allowances over depreciation	319	307
Retirement benefit obligations	(28)	(21)
Other timing differences	(7)	(5)
Derivatives	(125)	(149)
Revaluation of investment property to fair value	197	187
Tax on rolled over gains	8	8
Operational land	23	25
	387	352

Provision has been made for deferred taxation in accordance with FRS 102. Of the £387 million liability at 31 December 2017, we expect an £18 million increase in the next 12 months (excluding any reversal arising from future fair value adjustments, as these cannot be estimated).

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. The effects of these rate reductions were reflected in the deferred tax balances in the 2016 financial statements.

15 Retirement benefit obligations

The Heathrow Airport Holdings Limited ('the Group') has applied the requirements of the standard IAS 19 'Employee Benefits (Revised 2011)' ('IAS 19R') for the year ended 31 December 2017. The total cost of defined contribution pension arrangements is fully expensed as employment costs.

Characteristics of the LHR Airports Limited related liabilities

LHR Airports Limited operates a defined contribution pension scheme for all employees who joined the Company after 15 June 2008. The Group has no further payment obligations once the contributions have been paid.

The Group's primary UK defined benefit pension fund is a self-administered defined benefit scheme (the 'BAA Pension Scheme' or the 'Scheme') now closed to new employees. As required by UK pension law, there is a Pension Trustee Board that, together with LHR Airports Limited, is responsible for governance of the Scheme.

The employer's contributions are determined based on triennial valuations conducted on assumptions determined by the Trustee and agreed by LHR Airports Limited. The defined benefit obligation or surplus is calculated quarterly by independent actuaries.

In July 2016, the trustee of the BAA Pension Scheme concluded a formal actuarial valuation of the Scheme. The valuation was carried out as at 30 September 2015 and took into account changes implemented to reduce the Scheme's liabilities. These were the introduction of an annual cap on future increases in pensionable pay for active members and a reduction in both the accrual rate for future service and inflationary increases for those service pensions whilst in payment. The valuation indicated a scheme deficit of £228 million calculated using the agreed actuarial assumptions. As part of the process, LHR Airports Limited agreed a reduction to its annual deficit repair contribution from £27 million to £23 million that is intended to eliminate the deficit by 2022. The process also resulted in a reduction in ongoing cash contributions from 33% to 23% of pensionable salary, consistent with the efficiency targets under the current regulatory settlement. The reduction in cash contributions into the Scheme applied from 1 July 2016 and is estimated at £12 million per annum. Apart from the changes mentioned above, there have been no further adjustments made to the measurement of the defined benefit obligation at the reporting date.

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the rules of the Scheme. In addition, LHR Airports Limited provides post-retirement medical benefits to certain pensioners.

Amounts arising from pensions related liabilities in the Company's financial statements

The following tables identify the amounts in the Company's financial statements arising from its pension related liabilities. Further details of each scheme (except defined contribution schemes) are within sections a) and b).

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

15 Retirement benefit obligations *continued*

Income statement - pension and other pension related liabilities costs

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Employment costs:		
Defined contribution schemes	10	10
BAA Pension Scheme	29	27
	39	37
Finance charge/(income) - BAA Pension Scheme	1	(5)
Total pension costs	40	32

Other comprehensive income – (loss)/gain on pension and other pension related liabilities

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
BAA Pension Scheme	(65)	(219)
Unfunded schemes	1	(7)
Actuarial loss recognised before tax	(64)	(226)
Tax credit on actuarial loss	10	39
Actuarial loss recognised after tax	(54)	(187)

Statement of financial position – net defined benefit pension (deficit)/surplus and other pension related liabilities

The net deficit or surplus of the LHR Airports Limited retirement benefit schemes, being the BAA Pension Scheme, Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical Benefit Scheme, are recognised within non-current assets or non-current liabilities if the pension schemes are in a surplus or deficit position respectively. The net surplus or deficit is presented below for the current and previous four financial years.

	31 December				
	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Fair value of plan assets	4,085	3,975	3,288	3,274	2,867
Benefit obligation	(4,209)	(4,054)	(3,184)	(3,473)	(2,960)
(Deficit)/surplus in BAA Pension Scheme	(124)	(79)	104	(199)	(93)
Unfunded pension obligations	(29)	(29)	(22)	(24)	(22)
Post-retirement medical benefits	(5)	(6)	(6)	(6)	(6)
Deficit in other pension related liabilities	(34)	(35)	(28)	(30)	(28)
Net (deficit)/surplus in pension schemes	(158)	(114)	76	(229)	(121)
Company share of net (deficit)/surplus in pension schemes	(158)	(114)	76	(229)	(106)

(a) BAA Pension Scheme

The BAA Pension Scheme, which is a funded defined benefit scheme with both open and closed sections. The Scheme closed to employees joining the Group after 15 June 2008. The Scheme's assets are held separately from the assets of the Group and are administered by the trustee.

The value placed on the Scheme's obligations as at 31 December 2017 is based on the full actuarial valuation carried out at 30 September 2015. This has been updated at 31 December 2017 by KPMG LLP to take account of changes in economic and demographic assumptions, in accordance with IAS 19R. The Scheme assets are stated at their bid value at 31 December 2017. As required by IAS 19R, the Company recognises re-measurements as they occur in the statement of comprehensive income.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

15 Retirement benefit obligations *continued*

Analysis of movements in plan assets and defined benefit obligations

	2017	2016
	£m	£m
Fair value of plan assets at 1 January	3,975	3,288
Income statement:		
Interest income on plan assets	108	124
Administration costs	(3)	(2)
Other comprehensive income:		
Re-measurement gain/(loss) (return on assets in excess of interest income on plan assets)	75	603
Cash flows:		
Employer contributions (including benefits paid and reimbursed)	50	59
Members' contributions	5	5
Benefits paid (by fund and Group)	(125)	(102)
Fair value of plan assets at 31 December	4,085	3,975
Defined benefit obligation at 1 January	(4,054)	(3,184)
<i>Income statement:</i>		
Current service cost	(26)	(25)
Interest cost	(109)	(120)
Other comprehensive income:		
Experience gains	-	53
Re-measurements of defined benefit obligation:		
arising from changes in demographic assumptions	-	2
arising from changes in financial assumptions	(140)	(877)
<i>Cash flows:</i>		
Members' contributions	(5)	(5)
Benefits paid (by fund and Group)	125	102
Defined benefit obligation at 31 December	(4,209)	(4,054)

For the year ended 31 December 2017 there were experience gains of £nil million (2016: £53 million).

The net actuarial loss before tax of £65 million (2015: £219 million net loss) resulted from a loss on change in assumptions of £140 million (2016: £875 million loss), partially offset by the actual return on assets being £75 million in excess (2016: £603 million in excess) of the income statement credit.

The actuarial loss on change in financial assumptions is mainly attributable to a decrease in the net yield of 0.15% over the year, based on a single equivalent discount rate assumption of 2.55% and an RPI inflation assumption of 3.40%. The discount rate used has decreased from 2.75% in 2016 to 2.55% in 2017. International Accounting Standard 19 (IAS 19) requires that this discount rate should be derived from the yield on 'high quality corporate bonds' of duration consistent with liabilities of the scheme. The discount rate is based on a full yield curve approach, a 'single agency' approach where the yield curve is constructed from the Merrill Lynch corporate bond universe with at least one AA rating from the main ratings agencies.

The single agency approach typically increases the discount rate in current market conditions, but the extent of the increase can vary over time. At the point we changed to this approach the effect on the discount rate was to reduce it by 0.2pp.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

15 Retirement benefit obligations *continued* Analysis of fair value of plan assets

	31 December 2017 £m	31 December 2016 £m
Fair value of plan assets		
Equity	540	476
Property	172	118
Bonds	1,405	1,095
Cash	59	153
LDI	1,579	1,583
Other	330	550
Total fair value of plan assets	4,085	3,975

At 31 December 2017, the largest single category of investment was a liability driven investment ('LDI') mandate, with a value of £1,579 million (39% of the asset holding at 31 December 2017). The purpose of the Scheme entering into this mandate is to reduce asset/liability mismatch risk. At 31 December 2016, the largest single category of investment was an LDI mandate, with value of £1,583 million (40% of the asset holding at 31 December 2016).

LDI holdings are portfolios of interest rate and inflation derivatives which are intended to protect the Scheme from movements in interest rates and inflation, so that the fair value of this element of the portfolio moves in the same way as the fair value of Scheme's obligations.

Analysis of financial assumptions

The financial assumptions used to calculate Scheme assets and liabilities under IAS 19R were:

	31 December 2017 %	31 December 2016 %
Rate of increase in pensionable salaries	1.90	1.90
Increase to deferred benefits during deferment	2.65	2.70
Increase to pensions in payment:		
Open section	3.30	3.35
Closed section	3.40	3.45
Discount rate	2.55	2.75
Inflation assumption	3.40	3.45

The assumptions relating to longevity underlying the pension liabilities at the reporting date are in line with those adopted for the 2015 actuarial funding valuation, and are based on standard actuarial mortality tables with an allowance for future improvements in longevity. The assumptions are equivalent to a life expectancy for a 60 year old male pensioner of 27.1 years (2016: 27.0 years) and 29.4 years (2016: 29.3 years) from age 60 for a 40 year old male non-pensioner.

The expected rate of inflation is an important assumption for the salary growth and pension increase assumptions. A rate of inflation is 'implied' by the difference between the yields on fixed and index-linked government bonds. As required under IAS 19R, interest income on the plan assets is calculated by multiplying the fair value of the plan assets by the discount rate discussed above.

Sensitivity analysis of significant assumptions

The following tables present a sensitivity analysis for each significant actuarial assumption showing how the defined benefit obligation would have been affected, before and after tax, by changes in the relevant actuarial assumptions that were reasonably possible at the reporting date.

	(Decrease)/increase in defined benefit obligation	
	Before tax £m	After tax £m
Discount rate		
+0.50% discount rate	(416)	(345)
-0.50% discount rate	483	401
Inflation rate		
+0.50% inflation rate	392	325
-0.50% inflation rate	(348)	(289)
Mortality		
Increase in life expectancy by one year	157	130

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

15 Retirement benefit obligations *continued*

The sensitivity analysis is based on a change in one assumption while holding all other assumptions constant, therefore interdependencies between assumptions are excluded, with the exception of the inflation rate sensitivity which also impacts salary and pension increase assumptions. The analysis also makes no allowance for the impact of changes in gilt and corporate bond yields on asset values. The methodology applied is consistent to that used to determine the recognised pension liability.

The total contributions by the Group to the defined benefit Scheme in 2018 are expected to be £51 million. The levels of contributions are based on the current service costs and the expected cash flows of the defined benefit Scheme. The Group estimates the present value of the duration of the Scheme liabilities on average fall due over 21 years (2016: 19 years).

(b) Other pension and post-retirement liabilities

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the Scheme rules. The unfunded pension obligations amount to £29 million (2016: £29 million) and are included in the statement of financial position.

In addition LHR Airports Limited provides post-retirement medical benefits to certain pensioners. The present value of the future liabilities under this arrangement is £5 million (2016: £6 million) and this is also included in the statement of financial position. The value of these unfunded pensions has been assessed by the actuary using the same assumptions as those used to calculate the Scheme's liabilities.

16 Provisions

	Reorganisation costs £m	Home loss payment £m	Other £m	Total £m
Current	12	-	-	12
Non-current	-	7	2	9
1 January 2017	12	7	2	21
Charged to income statement	8	-	-	8
Utilised	(10)	-	-	(10)
Released to income statement	(4)	-	(1)	(5)
31 December 2017	6	7	1	14
Current	6	-	-	6
Non-current	-	7	1	8
31 December 2017	6	7	1	14

Reorganisation costs

These are costs associated with the Company's reorganisation programmes primarily relating to restructuring processes designed to reduce the size and costs of overhead functions. The utilisation and release of the provision relates to severance and pension payments associated with the reorganisation programme carried out during 2016 and continuing into 2017. The charge relates to a provision established in 2017 for voluntary severance in engineering and baggage operational areas. The provision will be fully utilised in 2018.

Home loss payment

Between 2005 and 2011, the Company entered into a number of agreements to buy residential properties in the original third runway blight area. The purchase price for these properties included a deferred 10% payment ("deferred payment") which will be settled in cash when planning consent is obtained, expected to be around 2021. In October 2016, the Government announced its decision in favour of expansion at Heathrow and following board approval, a public statement was issued by the Company stating its intention to apply for planning consent, making it probable that the Company will be required to pay the deferred payment in the future. As a result, in the year ended 31 December 2016, the Company created a provision for the deferred payment equal to the amount it expects to pay of £7 million.

Other

During 2017, there was £1 million released relating to insurance claims and potential liabilities from incidents which occurred at Heathrow Airport.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

17 Trade and other payables

	31 December 2017 £m	31 December 2016 £m
Non-current		
Preference shares	23	23
Other payables	8	9
	31	32
Current		
Deferred income	33	30
Trade payables ¹	170	165
Other tax and social security	8	8
Group relief payable	49	54
Other payables	10	8
Capital payables	134	121
Amount owed to group undertakings – interest free ²	54	71
Amount owed to group undertakings – interest bearing ³	37	27
	495	484

¹ Trade payables are non-interest bearing and are generally on 30-day terms.

² Amounts owed to group undertakings – interest free largely relate to external payments made by LHR Airports Limited under the Shared Services Agreement on behalf of the Company.

³ Amounts owed to group undertakings – interest bearing relates to an interest bearing loan with Heathrow Express Train Operating Company Limited with an interest rate of Bank of England base rate + 1.5%

18 Share capital

Called up, allotted and fully paid

	Number	£m
Ordinary shares		
1 January 2017	2,802,236,984	10
Issued during the year ¹	1	-
31 December 2017	2,802,236,985	10
Preference shares²		
1 January and 31 December 2017		
21,960,014 preference shares – irredeemable of £0.01 each	21,960,014	219,600

As a result of the share issue in the year, the par value per share is now £0.0035.

¹ The Company allotted and issued 1 ordinary share of £0.0035, credited as fully paid up, to Heathrow AH Limited.

² Recorded within creditors (refer to Note 17).

19 Share premium reserve

	2017 £m
Share premium	350
1 January	-
Issued during the year ¹	350
31 December	350

¹ The Company allotted and issued 1 ordinary share of £0.0035, credited as fully paid up, to Heathrow (AH) Ltd, in exchange for the receipt of a total subscription amount of £350,029,036.34

20 Revaluation reserve

The revaluation reserve records gains and losses on investment properties and operational land. For movement during the year refer to the statement of changes in equity.

	£m
At 1 January 2017	457
Transfers from profit and loss reserve	-
Deferred tax on investment properties	(10)
Investment property fair value movement	149
Tax relating to indexation of operational land	2
At 31 December 2017	598

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

21 Retained earnings

Retained earnings relates to historical profits and losses of the Company, dividends distributions and transactions with shareholders. For movement during the year refer to the statement of changes in equity.

	Note	£m
At 1 January 2017		1,293
Profit for the year		649
Actuarial loss on retirement benefit schemes	15	(64)
Tax credit on actuarial loss	15	10
Transfers to revaluation reserve		(149)
Tax on revaluation properties		10
Dividends paid	22	(277)
At 31 December 2017		1,472

22 Dividends paid

During the year ended 31 December 2017, the Company paid dividends of £277 million (£0.10 per share) to Heathrow (AH) Limited comprising £84 million (£0.03 per share) on 23 February 2017 and £193 million (£0.07 per share) on 20 December 2017. (2016: £594 million (£0.21 per share) to Heathrow (AH) Limited, comprising £76 million (£0.03 per share) on 22 February 2016, £65 million (£0.02 per share) on 11 March 2016, £83 million (£0.03 per share) on 23 June 2016, £136 million (£0.05 per share) on 22 July 2016 and £124 million (£0.04 per share) on 16 September 2016 and 110 million (£0.04 per share) on 21 December 2016).

During the year, the Board has become aware of certain instances of technical breaches of Companies Act 2006 (and before that, the Companies Act 1985 that have arisen with regard to the dividends paid (in 2013 and 2014) by the company. The instances relate to where reliance was placed on accounts where the reserves shown in the balance sheet had been fully utilised by dividends paid between the balance sheet date and the date of distribution in question. The company at all times had sufficient profit and other distributable reserves to justify the payments of dividends. Since the time the breaches were discovered, the company have undertaken rectifications steps to regularise the position. The rectification did not require any adjustments to the accounts and did not have any effect on the company's financial position.

23 Commitments and contingent liabilities

Non-cancellable operating lease commitments – Company as a lessee

Total future minimum rentals payable as at the year end are as follows:

	31 December 2017		31 December 2016	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	13	27	14	26
Within two to five years	43	102	25	98
After five years	5	477	7	436
	61	606	46	560

The Company leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Company also leases plant and machinery under non-cancellable operating leases.

A significant portion of the commitments classified as 'other' relates to electricity supply equipment at Heathrow leased on agreement with UK Power Networks Services Limited ('UKPNS'). The lease expires in 2083. The amounts disclosed are the total estimated charges under the agreement including both the actual lease commitment and the significant maintenance element of the fee payable to UKPNS as neither the Company nor UKPNS are able to split the base fee between a 'capital' and 'maintenance' charge. The commitment has been discounted at the Company's incremental borrowing rate. Other commitments have increased from £560 million to £606 million in 2017 due to the change in assumptions used to calculate the net present value of the commitment under the UKPNS contract.

Non-cancellable operating lease commitments – Company as a lessor

Total future minimum rentals receivable as at the year end are as follows:

	31 December 2017	31 December 2016
	Land and buildings £m	Land and buildings £m
Within one year	95	92
Within two to five years	243	205
After five years	1,711	1,709
	2,049	2,006

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

23 Commitments and contingent liabilities *continued*

Non-cancellable operating lease commitments – Company as a lessor *continued*

The Company uses a number of different leasing and contractual structures depending on the type and location of the investment property. Typically in multi-let offices and industrial premises a standard indefinite tenancy is used, which is terminable by the tenant on three months' notice at any time. However, it is common for the accommodation to remain let or be quickly re-let should it be vacated. For larger, stand-alone premises, e.g. cargo sheds, longer leases of multiples of three years are used. Car rental facilities are operated under concession agreements subject to minimum guaranteed payments and the amounts are included above. Public car parks are covered by a single management contract.

Commitments for capital expenditure

	31 December 2017	31 December 2016
	£m	£m
Contracted for, but not accrued:		
Baggage systems	155	157
Terminal restoration and modernisation	101	173
Tunnel refurbishment	-	8
IT projects	21	28
Capacity optimisation	23	33
	300	399
Other projects	23	16
	323	415

The figures in the above table are contractual commitments to purchase goods and services at the reporting date. Capital expenditure for the Q6 regulatory period from 1 April 2014 to 31 December 2018 is currently forecast to be £2.9 billion. The capital programme may increase up to £3.3 billion, in line with the regulatory settlement. This is subject to further scoping of the remaining individual projects and approval of the corresponding business cases. The capital programme is primarily focused on maintenance and compliance related projects, together with sustaining and improving the passenger experience. The capital plan for the period includes a £1 billion programme of asset management projects and a project to implement latest generation hold baggage screening equipment to comply with EU directive. Capital spend in 2017 is forecast to be in the region of £700 million.

Other commitments

Following the Government decision in October 2016 for Heathrow as preferred option for expansion, the Company recognises that up to 64 residential property owners could exercise their right under the previous scheme for which bonds were issued, to redeem those bonds at some point in the future. The Company's best estimate of the total payment is £21m based on a valuation in accordance with the terms set out in the bond contract, and assumes all 64 bondholders will exercise their option to sell. The option to sell is contingent on planning permission for the third runway, therefore no provision has been recognised.

Heathrow Airport Limited has a commitment to pay £87 million in 2018 to the Department for Transport in relation to the Crossrail project in return for a service commitment for Crossrail to operate services to Heathrow for 15 years. It is expected that the amount will be included in the Regulatory Asset Base.

The Company has contingent liabilities, comprising letters of credit, performance/surety bonds, performance guarantees and other items arising in the normal course of business amounting to £1 million at 31 December 2017 (2016: £1 million).

The Company, Heathrow Express Operating Company Limited, Heathrow (SP) Limited and Heathrow (AH) Limited (together, the 'Obligors') have granted security over their assets to secure their obligations under their financing agreements. Each Obligor has also provided a guarantee of the obligations of the other Obligors.

BAA Pension Trust Company Limited is a Borrower Secured Creditor and has a right to receive up to approximately £284 million out of the proceeds of enforcement of the security granted by the Obligors, such right ranking *pari passu* with the senior (Class A) creditors to the Obligors.

The Company and Heathrow Express Operating Company Limited have provided a guarantee in favour of Lloyds bank plc as Borrower Account Bank in respect of their liabilities under the Borrower Account Bank Agreement.

24 Ultimate parent undertaking and controlling party

The immediate parent undertaking of the Company is Heathrow (AH) Limited, a company registered in England and Wales.

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (25.00%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly-owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of GIC), Alinda Airports UK L.P. (11.18%) (an investment vehicle managed by Alinda Capital Partners), Stable Investment

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2017 *continued*

24 Ultimate parent undertaking and controlling party *continued*

Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (10.00%) (wholly-owned by the Universities Superannuation Scheme).

The Company's results are also included in the audited consolidated financial statements of Heathrow (SP) Limited for the year ended 31 December 2017, which is the parent undertaking of the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of Heathrow Finance plc and Heathrow Airport Holdings Limited for the year ended 31 December 2017.

Copies of the financial statements of FGP Topco Limited, Heathrow Airport Holdings Limited, Heathrow Finance plc and Heathrow (SP) Limited may be obtained by writing to the Company Secretarial Department at The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

25 Subsequent event

On 21 February 2018, the Board approved the payment of a £112.30 million dividend to the Shareholders.