

**Heathrow Airport Limited**  
**Annual report and financial statements**  
**for the year ended 31 December 2011**

# Heathrow Airport Limited

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# Heathrow Airport Limited

## Officers and professional advisers

### Directors

José Leo  
John Holland-Kaye  
Steven Morgan  
Terence Morgan  
Normand Boivin

### Registered office

The Compass Centre  
Nelson Road  
Hounslow  
Middlesex  
TW6 2GW

### Independent auditor

Deloitte LLP  
Chartered Accountants and Statutory Auditor  
2 New Street Square  
London  
EC4A 3BZ

### Bankers

The Royal Bank of Scotland plc  
135 Bishopsgate  
London  
EC2M 3UR

# Heathrow Airport Limited

## Business review

Heathrow Airport Limited (the 'Company') operates Heathrow airport ('Heathrow') and Heathrow Express ('HEX'), the express rail service between Heathrow and Central London. The Company is entitled to all receipts and income relating to HEX but the day-to-day operation of HEX is undertaken by Heathrow Express Operating Company Limited on behalf of the Company.

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

This business review is presented under three sections:

**Management review** – overview of the year ended 31 December 2011, along with the key factors likely to impact the Company in 2012.

**Financial review** – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2011 and analysis of the financial position of the Company as at that date.

**Risk management** – outline of the BAA Group's approach to risk management, sources of assurance and highlights of the key business risks identified by the BAA Group Executive Committee which are managed by the Company.

## Management review

### Review of 2011

#### **Key features of the year**

2011 was a successful year with the most notable achievement being Heathrow delivering record traffic at the same time as seeing improvements in service standards. These factors, combined with higher tariffs, robust retail performance and continued cost control, enabled the Company to deliver a strong financial performance despite a challenging macro-economic background. This robust performance enabled the Company to continue investing in enhancing its airport infrastructure.

Heathrow enjoyed a strong year including achieving an all time annual traffic record of 69.4 million passengers compared with the previous record of 67.9 million set in 2007. The Company also used a record 99.2% of its maximum permitted annual arrivals and departures in 2011. This means the airport is effectively operating at full capacity, preventing airlines from developing new routes from the UK to emerging market destinations such as Manila, Shenzhen and Jakarta.

There have recently been signs of the UK government acknowledging the problem. Ministers are shortly to consult on the future of UK aviation including specifically the issue of hub capacity constraints. At this time a third runway at Heathrow is not one of the options being considered. However, an increasing number of aviation stakeholders and commentators believe that all options for increasing aviation hub capacity should be considered and that both short and long term solutions must be developed.

Heathrow also maintained its recent momentum in improving important operational metrics. This included delivering its best punctuality performance in over a decade and achieving its highest ever overall passenger satisfaction. In addition, the airport's ability to respond to adverse weather and other disruptions has been significantly enhanced as a result of progress in implementing the recommendations of the Begg Report produced following the disruption caused by winter weather in December 2010.

Significant investment continued at Heathrow with good progress made in constructing the new Terminal 2 which will be the airport's second new terminal in recent years. The superstructure of the new Terminal 2 building was substantially complete by the end of 2011 and the next two years will be spent fitting out the new facility and undertaking operational readiness activities prior to operations commencing during 2014.

During the year, the Company's current regulatory period was extended by one year to 31 March 2014 to provide more time for new legislation related to the economic regulation of UK airports to be implemented and then utilised in establishing the terms of the next regulatory settlement for the airport. The draft Civil Aviation Bill was published in late 2011 and introduced into Parliament in early 2012.

#### **Passenger traffic trends**

In the year ended 31 December 2011, Heathrow's passenger traffic increased 5.5% to 69.4 million (2010: 65.7 million), an all time annual record. Reported year on year performance partly reflects no recurrence of the exceptional events in 2010 being closure of airspace due to volcanic ash, airline industrial action and severe winter weather.

# Heathrow Airport Limited

## Management review *continued*

### Review of 2011 *continued*

#### *Passenger traffic trends continued*

In achieving an all time annual traffic record, Heathrow reported eight monthly records with July being its busiest month in history. Adjusting for 2010's disruptions outlined above, which resulted in Heathrow losing up to 2.4 million passengers, its traffic is estimated to have increased by at least 1.9% in 2011.

Heathrow's performance reflects its position as a major European hub and its broad international links in both European and long haul markets. Growth was particularly strong with countries such as the United States, Germany, Switzerland, France and Brazil. Of Heathrow's major markets, European traffic showed the most significant year on year growth, increasing 7.6% to 28.5 million passengers (2010: 26.5 million). North Atlantic traffic also performed robustly, increasing 7.5% to 15.8 million passengers (2010: 14.7 million) driven by the success of American Airlines' and British Airways' joint transatlantic services launched in March 2011 and new routes introduced by Delta Air Lines. However, Heathrow's domestic traffic lagged the airport's overall performance, declining 2.9% to 4.7 million passengers (2010: 4.8 million) largely reflecting cessation of bmi's Glasgow service.

The proportion of origin and destination traffic at Heathrow remained constant in 2011 versus 2010 at 65%. Heathrow also operated 99.2% of its maximum allowed 480,000 annual arrivals and departures meaning it effectively operated at full capacity. At the same time it also experienced the highest ever load factor on aircraft operating to and from the airport of 75.2% (2010: 75.1%).

#### *Transforming Heathrow*

The Company has continued to implement its strategy to improve passengers' experience and airlines' operations through sustained substantial investment in modern airport facilities and improved service standards. This will ensure customers enjoy superior facilities relative to competitors, encouraging greater utilisation of the airport and supporting its long-term growth ambitions.

Heathrow is the third largest airport in the world and the largest globally for international traffic, with 7 of the top 10 long haul intercontinental routes passing through the airport. Reflecting this pivotal market position, the Company's key strategic objective is to enhance Heathrow's leading position in the global aviation industry and particularly its long-standing role as the UK's gateway to the world.

Substantial progress in delivering this objective is being made, with the UK's largest private sector investment programme rapidly transforming passengers' and airlines' experience of using Heathrow. Terminal 5 was the airport's first new terminal for over 20 years when it opened in 2008 and is now rated by passengers as the best airport terminal in Europe. It is the global hub of British Airways who have achieved significant efficiency gains from this world class facility.

Airlines strongly support continued significant investment in Heathrow to underpin its long term future. The current focus is on the construction of the new Terminal 2, which is due to open in 2014. Once open, around 70% of passengers using Heathrow will enjoy some of the newest airport facilities in the world.

Alongside the transformation of Heathrow's infrastructure, there has also been consistent improvement in service standards. Further clear progress was made during 2011, a particularly notable achievement given both record traffic volumes and the challenges of building the new Terminal 2 in the live operating environment of one of the world's largest airports. Most importantly, during 2011 Heathrow achieved its highest ever overall passenger satisfaction in the Airport Service Quality survey, consolidating its position in the top two of the five biggest European airports on this measure.

#### *Investment in modern airport facilities*

Significant milestones have been achieved in the last year in Heathrow's capital investment programme with the main projects including construction work on Terminal 2 and baggage systems as well as completion of Terminal 5C. Over £900 million was invested at Heathrow in 2011 with over 50% of the spend relating to the new Terminal 2. The level of investment is expected to increase substantially over 2012 and 2013 as progress is made towards opening Terminal 2. This will support thousands of high value jobs over the next few years.

In relation to the new Terminal 2, at the beginning of 2011 the main terminal building consisted of a small part of its steel framework but rapid development means the terminal superstructure is now complete and the building weather-tight. This has enabled significant progress to be made on the terminal's interior including completion of the floor structures and installation of major mechanical and electrical equipment. Fit out of terminal systems is also underway including outbound baggage systems, escalators and travelators.

# Heathrow Airport Limited

## Management review *continued*

### Review of 2011 *continued*

#### *Investment in modern airport facilities continued*

Extensive work on the terminal's aircraft stands has included installation of fuel, drainage, water, electrical and communications services. Construction of the concrete pavement also commenced.

Significant progress was also made during 2011 on building the second phase of Terminal 2's satellite building (Terminal 2B) with construction of the extensive basement structures to house the tracked transit train and baggage systems. This will connect the satellite to the main building, once the main terminal's second phase is constructed. Construction of the satellite's steel framework commenced in 2011 with the northern section weather-tight by the end of the year and the southern section due to be completed in the coming months. The whole second phase of the satellite building is expected to be weather-tight in late 2012. During 2012 construction of the satellite's aircraft stands and taxiways is expected to commence.

Contracts were signed in March 2011 for the construction of Terminal 2's multi-storey car park and work on site commenced in May 2011. The first columns for the car park's arrivals and departures ramps have been constructed. Design work for the car park structure is complete.

Terminal 5C became operational in June 2011 providing Terminal 5 with an additional 12 pier served stands linked to the main Terminal 5 building by a tracked transit train system. One of the key benefits of Terminal 5C is to reduce the incidence of passengers having to be transported by bus between Terminal 5 and their aircraft and the proportion of aircraft operating from remote stands at Terminal 5 has reduced from nearly 20% prior to Terminal 5C's opening to just over 10% at the end of 2011.

In relation to Heathrow's baggage systems, 2011 saw the final stages of the construction and commissioning of the underground automated baggage transfer system between Terminals 3 and 5. Operational trials are currently taking place with full live operation of the facility expected shortly.

Elsewhere in Heathrow's baggage investment programme, the most significant development during 2011 was the commencement of construction of a new integrated baggage system for Terminal 3.

Following the severe winter weather in December 2010, Heathrow completed nearly £20 million in capital investment in implementing the recommendations of the subsequent winter resilience enquiry. Amongst other things, this has enabled the airport to increase substantially the number of vehicles available for snow clearance. Further investment is expected relating to Heathrow's resilience in 2012, for example in relation to a new command and control centre.

#### *Service standards*

The year saw Heathrow perform strongly across many key service areas and these improvements have been reflected in higher than ever passenger satisfaction scores in independent surveys. The absence in 2011 of the major weather related disruption seen in 2010 contributed to this performance, but there was also significant success in driving underlying improvements.

In relation to individual service standards, Heathrow achieved its highest annual departure punctuality, as measured by the proportion of aircraft departing within 15 minutes of schedule, in over a decade of 79% (2010: 71%). Other than less weather disruption, the performance reflects initiatives such as closer monitoring of performance with airlines and NATS, greater scrutiny of underperforming airlines, reducing flows in peak periods of the day, more resilient operating procedures in poor weather, improved co-ordination with other local airspace users and enhanced infrastructure flexibility following completion of Terminal 5C and additional taxiways capable of handling the largest aircraft such as the A380.

Heathrow's baggage misconnect rate improved to 15 bags per 1,000 passengers (2010: 18) during 2011 with its best ever monthly baggage misconnect performance in April (11 bags per 1,000 passengers) and consistently good performance across the year.

On security queuing, passengers passed through central security within the period prescribed under Heathrow's service quality rebate scheme 96.9% (2010: 97.5%) of the time compared with the 95.0% service standard. The service standard is measured monthly at an individual terminal level and there were two breaches in the year, both at Terminal 5 (in July and December), partly reflecting record traffic flows. Additional security lines are being introduced to mitigate the risk of this happening in future.

# Heathrow Airport Limited

## Management review *continued*

### Review of 2011 *continued*

#### **Service standards *continued***

It is clear from independent surveys that passengers are noticing these improvements with Heathrow achieving in 2011 its highest ever overall passenger satisfaction (and 3 of its 4 highest ever scores) in the global Airport Service Quality survey (produced by Airports Council International). The average of its scores in this quarterly survey during 2011 was 3.88 (2010: 3.84). These results consolidate Heathrow's position in the top two of the five biggest European airports on this measure.

In July 2011, the South East Airports Taskforce, sponsored by the Department for Transport, recommended that consideration be given to Heathrow having greater operational freedom to prevent or mitigate disruption. For example, this might involve simultaneous use of both runways for arrivals and departures in such circumstances, within the existing overall cap on aircraft movements. An initial trial of runway use in this manner concluded in February 2012 with another trial expected during summer 2012. If implemented permanently, such measures should improve areas such as punctuality and baggage misconnects as well as bringing environmental benefits such as reduced stacking.

Heathrow's ability to respond to adverse weather conditions and other disruptions has been significantly enhanced during 2011 as a result of progress on implementing the recommendations of the Begg Report produced following the disruption caused by winter weather in December 2010.

#### **Regulatory and governmental developments**

##### *UK aviation policy developments*

On election in 2010, the new UK government ruled out the development of any new runways in South East England, an area with chronic airport capacity issues given Heathrow and Gatwick, the UK's two largest airports, are the world's busiest two runway and single runway airports respectively with Heathrow operating at 99.2% of its maximum permitted capacity in 2011. This has severely restricted route development to key emerging market destinations such as Manila, Shenzhen and Jakarta.

Since the election, there has been increasing debate about the need for the UK economy to be rebalanced towards manufacturing and to focus on developing trade with faster growing emerging market economies that are increasingly the engine of global economic growth. In parallel, there has been greater recognition of the need to stimulate economic growth and job creation. Modernisation of the UK's transport infrastructure is seen as a key enabler and contributor to this process. In the context of the aviation sector, it is also increasingly accepted that the development of hub airport capacity, as uniquely provided by Heathrow, is the optimal way to ensure the UK enjoys the connectivity with emerging market economies that will support the UK's long-term economic prosperity.

There have recently been signs of the UK government acknowledging the airport capacity issue and seeking to improve connectivity with emerging markets. Ministers are shortly to begin a consultation on the future of aviation in the UK that is intended to address specifically the issue of hub airport capacity constraints. At this time a third runway at Heathrow is not one of the options being considered. However, an increasing number of stakeholders and commentators believe that all options for increasing aviation hub capacity should be considered and that both short and long term solutions must be developed.

##### *Modernisation of economic regulation of UK airports*

In March 2011, the Government confirmed its intention to implement reforms to the framework for the economic regulation of UK airports, as set out in its July 2010 statement, which largely built on proposals published by the Department for Transport in December 2009. Reflecting a desire that the terms of Heathrow's next regulatory settlement are established using the new regulatory framework, following consultation with Heathrow and its airline community, the Civil Aviation Authority announced the extension of Heathrow's current regulatory period by one year from 31 March 2013 to 31 March 2014. During the one year extension, Heathrow's aeronautical tariffs will continue to be determined using the existing RPI + 7.5% formula. In addition, Heathrow agreed with its airline community a cap on its capital programme for the extension year of £735 million (in 2007/08 prices).

In November 2011, the Government moved to the next stage in implementing the proposed new regulatory framework with publication of the draft Civil Aviation Bill for pre-legislative scrutiny including by the Transport Select Committee. The bill was introduced into Parliament on 19 January 2012.

# Heathrow Airport Limited

## Management review *continued*

### Developments since beginning of 2012

In January 2012, passenger traffic at Heathrow increased 2.3% to 5.2 million (2010: 5.1 million) which was an all time record for January.

### Outlook

This year is expected to see strong growth in turnover, Adjusted EBITDA and operating cash flow driven principally by increases in aeronautical tariffs. Heathrow also intends to make significant progress on the construction of the new Terminal 2 with capital investment forecast to increase materially on 2011. Heathrow is also focused on ensuring it delivers on the important role in the overall London 2012 Games experience that it will play as the arrival and departure point for most athletes and visitors.

Passenger traffic in early 2012 has been consistent with expectations with Heathrow achieving record traffic in January. Therefore at this stage the outlook for the Company's financial performance in 2012 remains consistent with expectations.



# Heathrow Airport Limited

## Financial review

The following financial review provides commentary on the performance of the Company during 2011.

### Basis of presentation of financial results

The table below summarises the Company's financial performance in 2011 and includes comparative information for 2010.

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m	Change %
<b>Turnover</b>	<b>2,047.2</b>	1,855.5	10.3
Adjusted operating costs <sup>1</sup>	<b>(1,008.0)</b>	(980.4)	2.8
<b>Adjusted EBITDA<sup>2</sup></b>	<b>1,039.2</b>	875.1	18.8
Operating (costs)/gain – exceptional	<b>(33.1)</b>	62.0	n/a
<b>EBITDA</b>	<b>1,006.1</b>	937.1	7.4
Depreciation – ordinary	<b>(468.3)</b>	(436.4)	7.3
Depreciation and impairment – exceptional	<b>(11.0)</b>	(18.7)	(41.2)
<b>Operating profit</b>	<b>526.8</b>	482.0	9.3

<sup>1</sup> Adjusted operating costs are stated before depreciation, amortisation and exceptional items.

<sup>2</sup> Adjusted EBITDA is earnings before interest, tax, depreciation, amortisation and exceptional items.

### Turnover

In the year ended 31 December 2011, the Company's turnover increased 10.3% to £2,047.2 million (2010: £1,855.5 million). This reflects increases of 16.0% and 10.7% in aeronautical and retail income and a 1.9% decrease in other income.

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m	Change %
Aeronautical income	<b>1,149.6</b>	991.3	16.0
Retail income	<b>435.4</b>	393.2	10.7
	<b>1,585.0</b>	1,384.5	14.5
<i>Other sources of income:</i>			
Operational facilities and utilities income	<b>148.0</b>	149.4	(0.9)
Property rental income	<b>102.1</b>	100.1	2.0
Rail income	<b>111.1</b>	103.0	7.9
Other income	<b>101.0</b>	118.5	(14.8)
<b>Total other sources of income</b>	<b>462.2</b>	471.0	(1.9)
<b>Total turnover</b>	<b>2,047.2</b>	1,855.5	10.3

### Aeronautical income

Aeronautical income increased by 16.0% to £1,149.6 million (2010: £991.3 million). Aeronautical income per passenger increased 9.9% to £16.57 (2010: £15.08). The growth primarily reflects passenger traffic trends as well as the headline 6.2% and 12.2% increases in Heathrow's tariffs from 1 April 2010 and 1 April 2011 respectively. This has been partially offset by lower than expected yields since April 2011, particularly due to a different passenger mix (higher proportion of European traffic) and a higher proportion of quieter aircraft than assumed when tariffs for the current regulatory year were determined. These factors led to aeronautical income being approximately £25 million lower than expected during the year ended 31 December 2011. This shortfall (or yield dilution) will be recovered through the 'K factor' true-up mechanism in the year commencing 1 April 2013.

### Retail income

The Company's retail business continued to perform well with net retail income ('NRI') per passenger increasing 5.3% to £5.95 (2010: £5.64) in the year ended 31 December 2011.

This performance was based on gross retail income increasing 10.7% to £435.4 million (2010: £393.2 million) and NRI increasing 11.2% to £412.6 million (2010: £371.1 million).

# Heathrow Airport Limited

## Financial review *continued*

### Turnover *continued*

#### Retail income *continued*

The tables below reconcile gross retail income with net retail income and analyse net retail income by activity.

#### Reconciliation of gross retail income with net retail income and net retail income per passenger

	Year ended 31 December 2011	Year ended 31 December 2010	Change %
Gross retail income (£m)	435.4	393.2	10.7
Less: retail expenditure (£m)	(22.8)	(22.1)	3.2
Net retail income (£m)	412.6	371.1	11.2
Passengers (m) <sup>1</sup>	69.4	65.7	5.5
<b>Net retail income per passenger<sup>1,2</sup></b>	<b>£5.95</b>	<b>£5.64</b>	<b>5.3</b>

<sup>1</sup> Percentage change calculated using un-rounded numbers.

<sup>2</sup> Net retail income per passenger calculated using un-rounded passenger numbers.

#### Analysis of net retail income

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m	Change %
Car parking	57.6	48.0	20.0
Duty and tax-free	114.3	101.1	13.1
Airside specialist shops	85.2	76.7	11.1
Bureaux de change	39.6	36.7	7.9
Catering	36.0	30.9	16.5
Landside shops and bookshops	21.2	20.3	4.4
Advertising	27.9	28.4	(1.8)
Car rental	13.1	12.7	3.1
Other	17.7	16.3	8.6
<b>Total</b>	<b>412.6</b>	<b>371.1</b>	<b>11.2</b>

Heathrow's strong retail performance was led by duty and tax-free, airside specialist shops, catering and car parking. The strong in-terminal performance has been delivered whilst undertaking a major refurbishment of Terminal 3's retail facilities where disruption was at its height during the summer months. Year on year trading performance also benefited from a further shift in passenger mix from domestic to international passengers.

Strength in duty and tax-free partly reflects the new walk through area in the World Duty Free store in Terminal 3 and extension of the store in Terminal 5. In airside specialist shops, trading in the luxury segment has remained robust in recent months despite the more cautious macroeconomic environment. Catering had a buoyant year reflecting active rebalancing of the portfolio towards premium outlets, enhanced contractual terms and focus on speed of service. Strength in car parking reflected increased usage, tariff increases and strength in premium services (short stay, business and valet parking services).

#### Other income

Income from activities other than aeronautical and retail decreased 1.9% to £462.2 million (2010: £471.0 million). This partly reflects rail income increasing 7.9% to £111.1 million (2010: £103.0 million) due to Heathrow Express passenger numbers increasing 5.1% to 6.22 million (2010: 5.92 million) and higher revenues from increased passenger volumes on the Piccadilly line extension to Terminal 5. Property rental income also increased 2.0% to £102.1 million (2010: £100.1 million) due to rent reviews implemented from April 2010. The remaining revenue streams included in other income declined 14.8% principally due to the conclusion in 2010 of most of the agreements with Gatwick to provide transitional services following its disposal in late 2009.

# Heathrow Airport Limited

## Financial review *continued*

### Adjusted operating costs

Adjusted operating costs exclude depreciation and exceptional items.

In the year ended 31 December 2011, adjusted operating costs increased 2.8% to £1,008.0 million (2010: £980.4 million).

	Year ended 31 December 2011	Year ended 31 December 2010	Change
	£m	£m	%
Employment costs	262.1	245.8	6.6
Maintenance expenditure	110.6	109.2	1.3
Utility costs	89.1	93.7	(4.9)
Rents and rates	113.2	101.6	11.4
General expenses	188.8	188.6	0.1
Retail expenditure	22.8	22.1	3.2
Intra-group charges/other <sup>1</sup>	221.6	219.1	1.1
(Profit)/loss on disposal of tangible fixed assets	(0.2)	0.3	n/a
<b>Total</b>	<b>1,008.0</b>	<b>980.4</b>	<b>2.8</b>

<sup>1</sup> Intra-group charges/other include HEX operating costs plus a 10% mark-up and a mark-up of 7.5% on corporate and centralised services provided by BAA Airports Limited in accordance with the Shared Services Agreement.

The main drivers of the increased adjusted operating costs were higher employment costs and rents and rates. Employment costs were up 6.6% reflecting principally pay rises and increased headcount. The higher employee numbers are particularly due to increased airfield security personnel at Heathrow and more mobile sales assistants that have helped support growth at Heathrow Express. The increased employment costs also reflected increased overtime and use of temporary staff to support record traffic levels at Heathrow through the summer.

Higher rents and rates costs reflected a five yearly rates revaluation effective from April 2010, an annual rates increase from April 2011 and no recurrence of the rates rebate recorded in 2010.

Partially offsetting the increased employment and rents and rates costs was a reduction in utility costs towards the end of the year due to the mild autumn and reduced unit prices.

During 2011 the BAA Group outsourced to Capgemini a range of IT services that were previously provided by the BAA Group's own IT department. These services, which include application management, support of end user devices, IT Infrastructure management, and telecoms support are provided under an initial five year contract. During 2011, the one-off incremental costs of transition were offset by cost savings under the new outsourcing arrangements.

### Adjusted EBITDA

In the year ended 31 December 2011, Adjusted EBITDA increased 18.8% to £1,039.2 million (2010: £875.1 million), resulting in an Adjusted EBITDA margin of 50.8% (2010: 47.2%).

The significant increase in Adjusted EBITDA from 2010 reflects improved underlying traffic, increased aeronautical and retail income per passenger, continued cost control and no recurrence of 2010's volcanic ash, strike and severe winter weather disruptions.

### Operating profit

The Company recorded an operating profit for the year ended 31 December 2011 of £526.8 million (2010: £482.0 million). Relative to Adjusted EBITDA, operating profit includes £468.3 million in depreciation (2010: £436.4 million). In addition, it reflects a net £44.1 million exceptional charge included in operating profit (2010: £43.3 million credit). A reconciliation between Adjusted EBITDA and statutory operating profit is provided below.

	Year ended 31 December 2011	Year ended 31 December 2010	Change
	£m	£m	%
Adjusted EBITDA	1,039.2	875.1	18.8
Depreciation	(468.3)	(436.4)	7.3
Exceptional items – pensions	(33.3)	74.7	n/a
Exceptional items – accelerated depreciation and impairment	(11.0)	(18.7)	(41.2)
Exceptional items – reorganisation and other	0.2	(12.7)	n/a
<b>Operating profit</b>	<b>526.8</b>	<b>482.0</b>	<b>9.3</b>

# Heathrow Airport Limited

## Financial review *continued*

### Depreciation

Depreciation for the year ended 31 December 2011, excluding exceptional charges, was 7.3% higher at £468.3 million (2010: £436.4 million) driven by depreciation commencing on Heathrow Terminal 5C, the second satellite to Terminal 5, during the course of the year. It also reflects higher depreciation on Heathrow Terminal 1 asset additions given the impact on their economic life of the expected second phase of Terminal 2. There was also the full year effect of depreciation of investment in 2010 on IT assets and Heathrow baggage search equipment, the refurbished Heathrow Terminal 4 check-in facilities and bringing into use, initially connected to Terminal 1, the first phase of the satellite building for the new Terminal 2.

### Exceptional items: pensions

Items within operating profit include a £33.3 million non-cash pension related charge (2010: £74.7 million credit). This includes the Company's share of the movement in BAA Airports Limited defined benefit pension scheme, Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits as well as a re-allocation of pension balances between entities.

### Exceptional items: accelerated depreciation and impairment

The accelerated depreciation and impairment charge of £11.0 million (2010: £18.7 million – accelerated depreciation) in 2011 was in relation to an impairment charge on the Airtrack rail project which the Company has decided not to pursue. In 2010, the accelerated depreciation charge was due to the shortened lives of certain existing assets at Heathrow given the new Heathrow Terminal 2 development.

### Exceptional items: other

The £0.2 million credit in 2011 was due to the release of provisions that were no longer required. The reorganisation costs in 2010 related primarily to various restructuring processes designed to reduce the size and cost of overhead functions following the sale of Gatwick airport in 2009.

### Capital expenditure

In the year ended 31 December 2011, the cash flow impact of the Company's capital investment programme was £843.8 million in capital expenditure at Heathrow.

The most significant areas of capital expenditure were on the new main Terminal 2 building, the second phase of the satellite building for the new Terminal 2, information technology, the transfer baggage tunnel between Terminals 3 and 5 and Terminal 5C.

### Pension scheme

At 31 December 2011, the BAA Airports Limited defined benefit pension scheme had a surplus of £38.7 million as measured under IAS 19, of which £26.9 million is attributable to the Company under the Shared Services Agreement. This compares with a scheme deficit of £43.6 million at 31 December 2010. The change from a scheme deficit to a surplus is due principally to employer cash contributions being greater than the current service charge since the increase in the value of the scheme assets was offset by increased liabilities. It also reflects a £26 million credit due to the change in obligation from RPI to CPI for certain defined benefit pension scheme members' future pension entitlements.

The scheme's trustees have recently concluded the triennial valuation of the defined benefit pension scheme and agreed with the BAA Group a schedule of cash contributions to be made to the scheme by the BAA Group from January 2012. The valuation was carried out as at 30 September 2010 and indicated a scheme deficit of £275 million calculated using the trustees' actuarial assumptions.

As part of the triennial valuation process, the BAA Group will pay £97 million per annum into the scheme from 2012 to 2014. This compares with a total contribution of £80 million per annum paid from 2009 to 2011. The amount being paid in each of the next three years includes £24 million which is aimed to eliminate the deficit over a period of 9 years. The Company will contribute its share of this amount, estimated at approximately £71 million per annum, to the pension scheme in the year ended 31 December 2012.

# Heathrow Airport Limited

## Financial review *continued*

### Regulatory Asset Base ('RAB')

Set out below are RAB figures of the Company at 31 December 2010 and 31 December 2011. RAB figures are utilised in calculating gearing ratios (Regulatory Asset Ratios ('RAR')) under certain of the BAA Group's financing agreements.

	<b>RAB</b>
	<b>£m</b>
31 December 2010	11,448.7
31 December 2011	12,490.2

The increase in the total RAB during 2011 reflected the addition of approximately £915 million in capital expenditure partially offset by regulatory depreciation of around £515 million. Variation in RAB profiling adjustments added a further £80 million to the closing RAB whilst inflation resulted in a net positive indexation adjustment of approximately £560 million over the period.

### Accounting and reporting policies and procedures

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain tangible fixed assets in accordance with the Companies Act 2006 and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice ('UK GAAP')). The Company's accounting policies and areas of significant accounting judgements and estimates are detailed within the Company financial statements.

# Heathrow Airport Limited

## Risk management

Risk management is a key element of the BAA Limited group's (the 'BAA Group') corporate operations of which the Company forms a part. Risk is centrally managed for the BAA Group as part of the corporate services provided under the Shared Services Agreement ('SSA') (refer to the Accounting policies). In addition, the Company has a fully dedicated senior team which implements and manages risk closely, following the BAA Group's guidelines. The Executive Committee, Board and Audit and Assurance Committee ('AAC') referred to below relate to the Executive Committee, Board and AAC of BAA Limited.

Risk management in the BAA Group facilitates the identification, evaluation and effective management of the threats to the achievement of the BAA Group's purpose, vision, objectives, goals and strategies. The vision of risk management is to embed the awareness of risk at all levels of the organisation, in such a way that all significant business decisions are risk-informed. Particular emphasis is given to safety, security, environment, reputation, operations and finance in pursuit of the BAA Group's strategic framework.

A key element of the risk management process is the method of profiling risk. This determines the threats to the achievement of business objectives and day to day operations in terms of likelihood and consequence at inherent and residual level. The process takes into account mitigating and controlling actions. Details are maintained in risk registers which are used as the basis for regular review of risk management at Executive Committee level. The risk registers are also used to make informed decisions relating to the procurement of insurance cover.

The risk management process is also aimed at defining and implementing clear accountabilities, processes and reporting formats that deliver efficient and effective management assurance to the Board to ensure statutory compliance whilst supporting business units to successfully manage their operations.

The operation of the process and the individual registers are subject to periodic review by the BAA Group's Internal Audit function, whose primary responsibility is to provide independent assurance to the Board that the controls put in place by management to mitigate risks are working effectively.

Assurance is provided through management reporting processes and a specialist compliance audit function, reporting directly to the Sustainability and Operational Risk Committee (2010: Health, Safety, Security and Environment Committee).

The principal corporate and reputational risks as identified by the Executive Committee are:

### **Safety risks**

Health and safety is a core value of the business and the Company operates a safety management system built around risk assessment, inspection, asset stewardship, governance and assurance.

Risk assessment is undertaken for all activities entailing significant risk and proportionate control measures employed to safeguard everyone impacted by our business. The Company also operates robust asset selection and inspection and maintenance programmes to ensure property and equipment remain safe. Governance, led by the Senior Management Team, and assurance processes are used to ensure the aforementioned remain effective and to encourage continuous improvement.

### **Security risks**

Security risks are regarded as critical risks to manage throughout the BAA Group. The Company mitigates these risks by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading-edge security technology. The Company works closely with government agencies, including the police and UK Border Agency 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.

### **Regulatory environment, legal and other reputational risks**

#### *Civil Aviation Authority ('CAA') regulation*

As noted previously, the Company's operations are currently subject to economic regulatory review by the CAA normally every five years. The risk of an adverse outcome from these reviews is mitigated as far as possible by a dedicated project team which ensures full compliance with formal regulatory requirements, establishes a sound relationship with the regulator and advises the Executive Committee and Board on regulatory matters.

Part of the regulatory framework is the Company's engagement with its airline customers. In order to manage the risk of adverse airline relations, all airlines are invited to be represented on engagement fora – eg joint steering groups. When feedback is sought or processes measured, robust processes 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 Airport Limited

## Risk management *continued*

### **Regulatory environment, legal and other reputational risks continued**

#### *Competition rules*

The penalties for failing to comply with the 1998 Competition Act and relevant EU law are recognised as risks to manage within the Company, given its position in certain markets. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, has reduced the likelihood of the Company breaching these regulations. Refer to the Management review section for details on the current Department for Transport regulatory review.

#### *Capacity shortfall*

Failure to secure necessary planning permissions could lead to the Company having insufficient capacity to meet the demands of the industry resulting in increased congestion and declining passenger service. The UK government's policy on airport capacity changes has a significant influence on the Company's ability to secure necessary planning permissions and develop capacity. The Company mitigates this risk through extensive consultation with community groups and authorities at a local level and active participation in government consultations and other advisory groups. In addition, investment in additional capacity at Heathrow will be partly dependent on an appropriate level of investment incentives being provided in future regulatory settlements.

Existing planning approvals provide for passenger traffic to grow to approximately 90 million at Heathrow.

#### *Environmental risks*

Environmental risk is managed throughout the BAA Group as it has the potential to impact negatively upon the BAA Group's reputation and jeopardise its licence to operate and to grow. The Company controls and mitigates these risks at a number of levels. Proactive environmental management systems and employee training programmes are embedded within operations through clear environmental strategies and resource conservation initiatives. Progressive influencing of third parties, stakeholder engagement and community relations programmes are also established. The Company works closely with a range of stakeholders to ensure that it reacts effectively to the challenges posed by the environmental agenda.

### **Commercial and financial risks**

#### *Operational disruption*

There are a number of circumstances that can pose short-term risks to the normal operations of Heathrow 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 the location of the airport. These conditions can have a particularly significant impact as Heathrow has negligible spare capacity to utilise in recovering from some of the above conditions. Where possible the Company seeks to anticipate the effects of these events on its operations and also maintains contingency plans to minimise disruption wherever possible.

#### *Capital projects*

The Company recognises that failure to control key capital project costs and delivery could damage its financial standing and reputation. The Company mitigates this risk 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.

#### *Changes in demand*

The risk of unanticipated long-term changes in passenger demand for air travel could lead to misaligned operational capacity within the Company. Since it is not possible to identify the timing or period of such an effect, the Company carries out evaluations through a series of scenario planning exercises.

#### *Industrial relations*

The risk of industrial action by key staff that affects critical services, curtails operations and has an adverse financial and reputational impact on the BAA Group is recognised. The Company has a range of formal national and local consultative bodies to discuss pay, employment conditions and business issues with the Trade Unions. The Heathrow pay agreement reached in early 2011 established the pay structure for 2011, 2012 and 2013 – the next pay negotiations are planned for January 2014. The Company could also be exposed in the short term to the effect of industrial action involving other key stakeholders in the aviation sector such as airlines, air traffic controllers, baggage handlers and the UK Border Agency.

#### *Treasury*

The Company's financial risk management objectives are aligned with BAA Limited, and also with BAA (SP) Limited, which is the parent undertaking of the smallest group to consolidate these financial statements and the level at which financial risks for the Company are managed. The treasury policies of the BAA (SP) Limited group (the 'SP Group') are set out below.

The Board approves prudent treasury policies and delegates certain responsibilities to senior management who directly control day-to-day treasury operations on a centralised basis.

# Heathrow Airport Limited

## Risk management *continued*

### *Commercial and financial risks continued*

#### *Treasury continued*

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 BAA Group's business operations and funding. To achieve this, the BAA Group enters into interest rate swaps, index-linked swaps, cross-currency swaps and foreign exchange contracts to protect against interest rate and currency risks.

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

(a) Interest rates

The SP Group maintains a mix of fixed and floating rate debt. As at 31 December 2011, fixed rate debt after hedging with derivatives represented 87% of the SP Group's total external nominal debt.

(b) Inflation

The SP Group mitigates the risk of mismatch between its airports' aeronautical income and regulatory asset bases, which are directly linked to changes in the retail prices index, and nominal debt and interest payments by the use of inflation-linked instruments.

(c) Foreign currency

The SP Group uses cross-currency swaps to hedge all interest and principal payments on its foreign currency debt. The SP 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 SP Group has established an investment grade financing platform for its airports. This platform supports bank term debt, bank revolving credit facilities including a revolving capital expenditure facility, bank liquidity facilities, various other loan 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 on-going basis with formal testing reported to the AAC, the Board and the 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 SP Group is not exposed to excessive refinancing risk in any one year.

The SP Group has positive cash flows before capital expenditure and maintains at least 12 months' headroom under the revolving capital expenditure facility. As at 31 December 2011, cash and current asset investments were £33.2 million, undrawn headroom under bank credit facilities was £1,355.0 million and undrawn headroom under bank liquidity facility was £524.5 million.

(e) Counterparty credit

The SP 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 SP Group maintains a prudent split of cash and current asset investments 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 no cash or current asset investments are placed with counterparties with short-term credit ratings lower than A-2/F1. The SP 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)/A (Fitch).

On behalf of the Board



**José Leo**  
Director

2 March 2012



# 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 2011.

### Principal activities

The Company operates Heathrow airport and Heathrow Express, the express rail service between Heathrow airport and Central London. The Company is entitled to all receipts and income relating to Heathrow Express but the day-to-day operation of Heathrow Express is undertaken by Heathrow Express Operating Company Limited ('HEX') on behalf of the Company. For providing these services, the Company pays HEX a management fee and reimburses all of its operating costs.

A review of the progress of the Company's business during the year, the key performance indicators, principal business risks and likely future developments are reported in the Business review on pages 2 to 14.

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

### Results and dividends

The loss after taxation for the financial year amounted to £114.1 million (2010: £153.8 million). No ordinary dividends were proposed or paid during the year (2010: £nil). The statutory results for the year are set out on page 19.

### Directors

The directors who served during the year are as follows:

José Leo	
John Holland-Kaye	
Steven Morgan	
Nicholas Cullen	Resigned 30 June 2011
Terence Morgan	Appointed 10 June 2011
Normand Boivin	Appointed 29 August 2011

### Employment policies

The Company has no direct employees. The staff are employed by BAA Airports Limited, an intermediate parent company.

### Supplier payment policy

The Company complies with the UK government's Better Payment Practice Code which states that responsible companies should:

- agree payment terms at the outset of a transaction and adhere to them;
- provide suppliers with clear guidance on payment procedures;
- pay bills in accordance with any contract agreed or as required by law; and
- advise suppliers without delay when invoices are contested and settle disputes quickly.

The Company had 29 days purchases outstanding at 31 December 2011 (2010: 15 days) based on the average daily amount invoiced by suppliers during the year.

### Donations

The Company's charitable donations for the year amounted to £13,000 (2010: £178,000). The main beneficiaries of charitable donations, the relevant amounts donated and the main activities of these beneficiaries are as follows:

Charity: Groundwork Thames Valley	£13,000	Promotes conservation, protection and improvement of the physical/natural environment. Implements recreational/leisure solutions which enhance social welfare in the community. Advances public education in environmental/sustainability issues. Via a social enterprise, contributes to wider national strategies on crime reduction.
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In addition to the donations above, the BAA Group contributes to a number of charitable causes through BAA Communities Trust and Heathrow Travelcare.

The Company may incur expenditure which could be classified as political donations under the Political Parties, Elections and Referendums Act 2000 and Part 14 of the Companies Act 2006. The Company obtained a renewed shareholders' approval in February 2012 to commit up to a maximum of £60,000 of such expenditure (in aggregate) over the following four years. In the Company's view there was no expenditure in the year to 31 December 2011 (2010: £nil) that falls within this category.

### Risk management

The Company actively manages all identified corporate risks. Details of the Company's risk management policies can be found on pages 12 to 14 in the Risk management section of the Business review.

# Heathrow Airport Limited

## Directors' report

### Financial risk management objectives and policies

The Company's financial risk management objectives and policies, including hedging policies, can be found on pages 13 to 14 of the Risk management section of the Business review.

### 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.

### 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.

### 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 ought to have taken as a director in order to make himself 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



**José Leo**  
Director

2 March 2012

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). 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 judgments 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 BAA 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



**José Leo**  
Director

2 March 2012

# Heathrow Airport Limited

## Independent auditor's report to the members of Heathrow Airport Limited

We have audited the financial statements of Heathrow Airport Limited for the year ended 31 December 2011 which comprise the Profit and loss account, the Statement of total recognised gains and losses, the Reconciliation of movements in shareholder's funds, the Balance sheet, the Accounting policies, the Significant accounting judgements and estimates and the related notes 1 to 22. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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.

### Respective responsibilities of directors and auditor

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. Our responsibility is to audit and express opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

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

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

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

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you 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.



**Andrew J. Kelly** (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, UK

2 March 2012

# Heathrow Airport Limited

Profit and loss account for the year ended 31 December 2011

	Note	Year ended 31 December 2011 £m	Restated <sup>1</sup> Year ended 31 December 2010 £m
<b>Turnover</b>	1	<b>2,047.2</b>	1,855.5
Operating costs - ordinary	2	<b>(1,476.3)</b>	(1,416.8)
Operating (costs)/gain – exceptional: pensions	3	<b>(33.3)</b>	74.7
Operating costs – exceptional: other	3	<b>(10.8)</b>	(31.4)
<b>Total operating costs</b>		<b>(1,520.4)</b>	(1,373.5)
<b>Operating profit</b>		<b>526.8</b>	482.0
Impairment of fixed assets - exceptional	4	-	(29.9)
Net interest payable and similar charges	5	<b>(675.9)</b>	(575.6)
<b>Loss on ordinary activities before taxation</b>		<b>(149.1)</b>	(123.5)
Tax credit/(charge) on loss on ordinary activities	6	<b>35.0</b>	(30.3)
<b>Loss on ordinary activities after taxation</b>	17	<b>(114.1)</b>	(153.8)

<sup>1</sup> The presentation of exceptional items for the year ended 31 December 2010 has been restated and split between exceptional - pensions and exceptional - other to be consistent with current year disclosures.

All profits and losses recognised during the current and prior year are from continuing operations.

## Heathrow Airport Limited

### Statement of total recognised gains and losses for the year ended 31 December 2011

	Note	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
<b>Loss for the financial year</b>	17	<b>(114.1)</b>	(153.8)
Unrealised gain on revaluation of investment properties	7,17	47.1	34.2
Unrealised loss on revaluation of fixed assets	7,17	<b>(2.8) *</b>	(2.0)
<b>Total recognised losses relating to the year</b>		<b>(69.8)</b>	(121.6)

### Reconciliation of movements in shareholder's funds for the year ended 31 December 2011

	Note	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
<b>Loss for the financial year</b>	17	<b>(114.1)</b>	(153.8)
Unrealised gain on revaluation of investment properties	7,17	47.1	34.2
Unrealised loss on revaluation of fixed assets	7,17	<b>(2.8) *</b>	(2.0)
Capital contribution	17	-	74.0
Tax on capital contribution	17	-	(20.0)
Issue of ordinary share capital		-	217.4
<b>Net movement in shareholder's funds</b>		<b>(69.8)</b>	149.8
Opening shareholder's funds		<b>1,782.6</b>	1,632.8
<b>Closing shareholder's funds</b>		<b>1,712.8</b>	1,782.6

\*The revaluation has been debited to revaluation reserve as a previous unrealised gain was recognised while assets were included in investment properties prior to reclassification to other land and buildings.

There is no material difference between the historical cost profits and losses and the profit and loss account.


# Heathrow Airport Limited

Balance sheet as at 31 December 2011

	Note	31 December 2011 £m	31 December 2010 £m
<b>Fixed assets</b>			
Tangible assets	7	10,920.4	10,415.1
Investments	8	3.8	3.8
<b>Total fixed assets</b>		<b>10,924.2</b>	<b>10,418.9</b>
<b>Current assets</b>			
Stocks	9	6.0	3.6
Debtors: due within one year	10	324.3	432.8
: due after more than one year	10	1,756.5	1,729.5
Current asset investments	11	21.0	41.0
Cash at bank and in hand		2.6	-
<b>Total current assets</b>		<b>2,110.4</b>	<b>2,206.9</b>
<b>Current liabilities</b>			
Creditors: amounts falling due within one year	12	(1,305.3)	(546.6)
<b>Net current assets</b>		<b>805.1</b>	<b>1,660.3</b>
<b>Total assets less current liabilities</b>		<b>11,729.3</b>	<b>12,079.2</b>
Creditors: amounts falling due after more than one year	13	(9,783.3)	(9,947.1)
Provisions for liabilities and charges	15	(233.2)	(349.5)
<b>Net assets</b>		<b>1,712.8</b>	<b>1,782.6</b>
<b>Capital and reserves</b>			
Called up share capital	16	857.6	857.6
Share premium reserve	17	23.2	23.2
Revaluation reserve	17	1,099.5	1,055.2
Profit and loss reserve	17	(267.5)	(153.4)
<b>Total shareholder's funds</b>		<b>1,712.8</b>	<b>1,782.6</b>

The financial statements of Heathrow Airport Limited (Company registration number: 01991017) were approved by the Board of Directors and authorised for issue on 2 March 2012. They were signed on its behalf by:

  
 José Leo  
 Director

  
 John Holland-Kaye  
 Director

# Heathrow Airport Limited

## Accounting policies for the year ended 31 December 2011

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

### Basis of accounting

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain tangible fixed assets in accordance with the Companies Act 2006 and applicable United Kingdom Generally Accepted Accounting Practice.

### 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 BAA (SP) Limited 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 BAA (SP) Limited 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 BAA (SP) Limited group liquidity position, including the remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and ability to access the debt markets.

As a result of the review, 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 next twelve months from the balance sheet signing date.

### Financial statements

The Company has taken 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 2011. The results are also included in the consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2011 (intermediate parent entity and the smallest Company to consolidate these financial statements). They are also included in the audited consolidated financial statements of BAA (SH) plc (formerly BAA (SH) Limited) and BAA Limited for the year ended 31 December 2011. FGP Topco Limited is a company registered in England and Wales.

The financial statements present information about the Company as an individual entity only and not as a group.

### Turnover

Turnover 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 income**

- Passenger charges based on the number of departing passengers on departure.
- Aircraft landing charges levied according to noise, emissions and weight recognised on landing.
- Aircraft parking charges based on a combination of weight and time parked as provided.
- Other charges levied for passenger and baggage operation when these services are rendered.
- Other traffic charges

#### **Retail income**

- Concession fees from retail and commercial concessionaires at or around airports are based upon turnover certificate supplied by concessionaires and are recognised in the period to which they relate.
- Car parking income is recognised at the time of exiting the car park in accordance with operator management fee arrangements.

#### **Property and operational facilities**

- Property letting sales, 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.
- Usage charges made for operational systems (e.g. check-in desks), recognised as each service is provided.
- Other invoiced sales, recognised on the performance of the service.

#### **Rail**

- Turnover from ticket sales, recognised at the time of travel.

#### **Other**

- Charges related to passengers with restricted mobility and various other services, recognised at the time of delivery.



# Heathrow Airport Limited

**Accounting policies** for the year ended 31 December 2011 *continued*

## **Exceptional items**

The Company separately presents certain items as exceptional on the face of the profit and loss account. 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, 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.

Provisions to recognise the Company's liability to fund the BAA Limited group (the 'BAA Group') defined benefit pension scheme deficit under the Shared Services Agreement are also treated as an exceptional item. Refer to the Shared Services Agreement accounting policy.

Additional details of exceptional items are provided as and when required as set out in Notes 3 and 4.

## **Interest**

Interest payable and interest receivable are recognised in the profit and loss account in the period in which they are incurred.

## **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 impairment losses.

Assets in the course of construction are stated at cost less provision for 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. Where appropriate, cost includes borrowing costs capitalised, 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 Company. The Company reviews these projects on a regular basis, and at least every six months, 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.

### ***Investment properties***

Investment property, which is property held to earn rentals and/or for capital appreciation, is stated at fair value at the reporting date, as determined at the interim and full-year reporting dates by the directors and external valuers every year. Any surplus or deficit on revaluation is transferred to the revaluation reserve with the exception of deficits below original cost which are expected to be permanent, which are charged to the profit and loss account in the period in which they arise.

Profits or losses arising from the sale of investment properties are calculated by reference to book value and treated as exceptional items. Profits or losses are recognised on completion.

In accordance with Statement of Standard Accounting Practice 19 *Accounting for Investment Properties*, no depreciation is provided in respect of freehold or long leasehold investment properties. This is a departure from the Companies Act 2006 which requires all properties to be depreciated. Such properties are not held for consumption but for investment and the Directors consider that to depreciate them would not give a true and fair view. Depreciation is only one amongst many factors reflected in the annual valuation of properties and accordingly the amount of depreciation which might otherwise have been charged cannot be separately identified or quantified. The Directors consider that this policy results in the accounts giving a true and fair view.

### ***Capitalisation of interest***

Interest payable resulting from financing tangible fixed assets whilst in the course of construction is capitalised once planning permission has been obtained and a firm decision to proceed has been taken. Capitalisation of interest ceases once the asset is complete and ready for use. Interest may be capitalised in the early stages of planning where the directors are satisfied that the necessary planning, building and resource consents will be received. Interest is then charged to the profit and loss account as a depreciation expense over the life of the relevant asset.

All other interest payable is recognised in the profit and loss account in the period in which it is incurred.

# Heathrow Airport Limited

Accounting policies for the year ended 31 December 2011 *continued*

## Tangible fixed assets *continued*

### 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>Fixed asset 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, 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	
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>	
Railways	
Rolling stock	8 - 40 years
Tunnels	100 years
Track metalwork	5 - 10 years
Track bases	50 years
Signals and electrification work	40 years
 <i>Other land and buildings</i>	
Short leasehold properties	Over period of lease
 <i>Plant equipment and other assets</i>	
Motor vehicles	4 - 8 years
Office equipment	5 - 10 years
Computer equipment	4 - 5 years
Computer software	3 - 7 years

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

### Impairment of assets (excluding investment in subsidiaries)

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 income-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's net realisable value 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 an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. Impairment losses of continuing operations are recognised in the profit and loss account in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount less any residual value, on a straight-line basis over its remaining useful life.

# Heathrow Airport Limited

**Accounting policies** for the year ended 31 December 2011 *continued*

## **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**

Operating lease payments are recognised as an expense in the profit and loss account on a straight-line basis over the lease term.

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.

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, 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 Company retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. 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 and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as the rental income.

## **Investments**

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

## **Stocks**

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

## **Debtors**

Debtors are recognised initially at cost less any provision for impairment.

## **Cash and current asset investments**

Cash, for the purpose of the summary cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market. Liquid resources comprise term deposits of less than one year (other than cash) and investments in money market managed funds.

## **Amounts owed to group undertakings**

Amounts owed to group undertakings are recognised initially at fair value, net of transaction costs incurred. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest rate method.

## **Deferred income**

Contractual income is treated as deferred income and released to the profit and loss account as earned.

## **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 profit and loss account over the period of the borrowings using the effective interest rate method.

The borrowings from group undertakings include the balance of the Borrower Loan Agreement ('BLA') payable by the Company to BAA Funding Limited. The advances under the BLA are issued on substantially the same terms as the new bonds issued by BAA Funding Limited, taking into consideration the related hedging instruments. The advances are carried at amortised cost with interest expense recognised using the effective interest rate method. The nominal amount of the index-linked borrowings is accreted for the RPI component recognised within interest payable in the profit and loss account.

# Heathrow Airport Limited

**Accounting policies** for the year ended 31 December 2011 *continued*

## **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 and a reliable estimate can be made of the amount of the obligation. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the reporting date and are discounted to present value where the effect is material.

## **Restructurings**

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 on-going activities of the entity.

## **Onerous contracts**

Present obligations arising under onerous contracts are recognised and measured as provisions. An onerous contract is considered to exist where the Company has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

## **Issue costs and arrangement fees**

Immediately after issue, debt is stated at the fair value of the consideration received on the issue of the capital instrument after deduction of issue costs. The finance cost of the debt is allocated to periods over the term of the debt at an effective interest rate on the carrying amount.

Issue costs are those that are incurred directly in connection with the issue of a capital instrument, that would not have been incurred had the instruments not been issued. These are accounted for as a deduction from the fair value of consideration received and amortised using the effective interest rate method.

Facility and arrangement fees resulting from the negotiation of finance that do not qualify as issue costs are written off to the profit and loss account as incurred.

## **Derivative financial instruments**

The Company enters into derivative transactions, principally interest rate swaps and foreign exchange contracts. The purpose of these transactions is to manage interest rate and currency risks arising from the Company's operations and sources of finance.

The derivative financial instruments are hedge accounted in accordance with FRS 4 and consequently accounted for on an accruals basis. The net interest payable or receivable on those derivatives are recorded as net against the interest on the underlying hedged item in the profit and loss account. When derivatives are not in a hedge relationship the interest payable and receivable on those derivatives are recorded at their gross amount in interest payable and interest receivable in the profit and loss account, respectively. The net interest receivable or payable accrued on derivatives is included in current debtors or current creditors on the balance sheet.

Derivative financial instruments novated from other companies within the BAA Limited group are transferred at fair value prevailing on that date. Premiums payable or receivable are amortised over the term of the financial instruments.

## **Shared Services Agreement ('SSA')**

All employees of the Company are employed directly by BAA Airports Limited which also acts as the provider of corporate and administrative services to the Company. BAA Airports Limited is the sponsor of the related defined benefit pension schemes and grants all employee benefits.

On 18 August 2008, the Company entered into a SSA with BAA Airports Limited by which the latter became the shared services provider of operational staff and corporate services.

## **Operational staff**

BAA Airports Limited charges the Company for the provision of services in relation to staff costs, including wages and salaries, pension costs, medical costs and redundancy payments, as well as any other of its associated expenses properly incurred by the employees of BAA Airports Limited in providing the services. These costs include the cost of purchase of any shares in relation to share options granted and any hedging costs related to employee share options. All of the amounts included in the above-mentioned costs are settled in cash except for pension costs or costs related to hedging of share options, which are only settled when the cash outflow is requested by BAA Airports Limited.

# Heathrow Airport Limited

**Accounting policies** for the year ended 31 December 2011 *continued*

## **Shared Services Agreement *continued***

### **Corporate and centralised services**

BAA Airports Limited also provides centralised airport support including IT applications, general business services, procurement and financial accounting. These services are charged in accordance with the SSA with a mark-up of 7.5% except for IT applications, or sub-contractor costs, where only full costs are recharged to the Company.

### **Pension costs**

Under the SSA the current period service cost for the BAA Airports Limited pension schemes are recharged to the Company on the basis of pensionable salaries. This charge is included within Operating costs - ordinary. Cash contributions are made directly by the Company to the BAA Airports Limited pension schemes on behalf of BAA Airports Limited.

The Company has had an obligation since August 2008 to fund or benefit from its share of the BAA Airports Limited defined benefit pension scheme deficit or surplus and Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits pension related liabilities under the SSA. These provisions or assets are based on the relevant share of the actuarial deficit or surplus and allocated on the basis of pensionable salaries. Movements in these provisions or assets are recorded as exceptional items due to their size and nature.

As more than one employer participates in the BAA Airports Limited defined benefit pension scheme and each employer is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis, the Company accounts for the scheme in accordance with the SSA. Additionally the BAA Group discloses information about the total scheme surplus or deficit.

### **Current and deferred taxation**

The tax expense for the year comprises current and deferred tax. Tax is recognised in the profit and loss account, except to the extent that it relates to items recognised directly in reserves. In this case, the tax is also recognised in reserves.

Current tax liabilities are measured at the amount expected to be recovered from or 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 19, 'Deferred Tax', 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, at rates expected to apply when they crystallise based on current tax rates and law. 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 is not provided on timing differences arising from the revaluation of investment properties where there is no commitment to sell the asset.

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. Where the 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 a liability where in substance the shares and related dividends have terms similar to a liability and not share capital. Features that indicate that presentation as a liability is appropriate include a dividend that is 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 share holder. Where presentation as a liability is considered appropriate the associated dividend expense is shown within interest.

### **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. Interim dividends are recognised when paid.

## Heathrow Airport Limited

**Accounting policies** for the year ended 31 December 2011 *continued*

### **Foreign currency**

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates. The financial statements are presented in Sterling, which is the Company's functional currency.

Transactions denominated in foreign currencies are translated into Sterling 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 profit and loss account.

### **Cash flow statement and related party transactions**

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 2011. The results are also included in the audited consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2011 (intermediate parent entity and the smallest group to consolidate these financial statements). They are also included in the audited consolidated financial statements of BAA (SH) plc and BAA Limited for the year ended 31 December 2011. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 *Cash Flow Statements (revised 1996)*. Instead, a summary cash flow statement has been provided on a voluntary basis in a note to the financial statements.

The Company is exempt under the terms of FRS 8 *Related Party Disclosures* from disclosing related party transactions with entities that are related to, or part of, the FGP Topco Limited group. However, the transactions and balances in relation to the provision of services under the SSA between the Company and subsidiaries of the FGP Topco Limited group are disclosed in the notes to the financial statements.

## Heathrow Airport Limited

### **Significant accounting judgements and estimates** for the year ended 31 December 2011

In applying the Company's accounting policies management have made estimates and judgements 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.

#### **Investment properties**

Investment properties were valued at a fair value at 31 December 2011 and 31 December 2010 by CB Richard Ellis, Chartered Surveyors. The valuations were prepared in accordance with relevant accounting standards and the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. Independent valuations have been obtained for 100% of the investment properties. Approximately 78% of the investment properties comprise car parks and airside assets at Heathrow that are considered less vulnerable to market volatility than the overall market.

#### **Taxation**

Provisions for tax contingencies require management to make judgements and estimates in relation to tax issues and exposures. Amounts provided are based on management's interpretation of UK tax law and the likelihood of settlement. Tax benefits are not recognised unless the tax positions will probably be sustained. In arriving at this position, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. All such provisions are included in current tax creditors.

# Heathrow Airport Limited

## Notes to the financial statements for the year ended 31 December 2011

### 1 Segment information

The directors consider the business has only one segment. All of the Company's turnover arises in the United Kingdom and relates to continuing operations. Additional details of the turnover generated by each of the Company's key activities are given below:

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
<b>Turnover</b>		
Aeronautical income	1,149.6	991.3
Retail income	435.4	393.2
Operational facilities and utilities income	148.0	149.4
Property rental income	102.1	100.1
Heathrow Express rail income <sup>1</sup>	111.1	103.0
Other income	101.0	118.5
	<b>2,047.2</b>	<b>1,855.5</b>

<sup>1</sup> The Company is entitled to all receipts relating to Heathrow Express, but the day-to-day operation of Heathrow Express is undertaken by HEX on behalf of the Company for which a management fee is charged and included within 'Intra-group charges/other' in Note 2.

### 2 Operating costs - ordinary

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Wages and salaries	208.3	196.4
Social security	18.3	15.5
Pension	24.2	24.2
Other staff related costs	11.3	5.9
Share-based payments	-	3.8
Employment costs <sup>1</sup>	262.1	245.8
Maintenance expenditure	110.6	109.2
Utility costs	89.1	93.7
Rents and rates	113.2	101.6
General expenses	107.4	108.7
Retail expenditure	22.8	22.1
Intra-group charges/other	221.6	219.1
Police costs	28.8	28.3
Aerodrome navigation service charges	52.6	51.6
Depreciation	468.3	436.4
(Gain)/loss on disposal of tangible fixed assets	(0.2)	0.3
	<b>1,476.3</b>	<b>1,416.8</b>

<sup>1</sup> Employment costs include recharges from BAA Airports Limited for employee services to the Company. Refer to the SSA in the Accounting policies.

### Rentals under operating leases

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
<i>Operating costs include:</i>		
Plant and machinery	26.4	26.1
Other operating leases	14.4	12.9



# Heathrow Airport Limited

Notes to the financial statements for the year ended 31 December 2011 *continued*

## 2 Operating costs - ordinary *continued*

### Auditor's remuneration

Audit fees and non-audit fees for the current and preceding financial years were borne by BAA Airports Limited and recharged in accordance with the SSA as described within the Accounting policies.

	Year ended 31 December 2011 £'000	Year ended 31 December 2010 £'000
<b>Fees payable to the Company's auditor for the audit of the Company's annual accounts:<sup>1</sup></b>		
Audit of the Company pursuant to legislation	422	384
<b>Non audit fees payable to the Company's auditor and their associates for other services specific to the Company:</b>		
Other services pursuant to legislation	59	-
Tax services	144	-
Information technology services - pre appointment <sup>1</sup>	-	934
Information technology services - post appointment <sup>1</sup>	193	167
Corporate finance services <sup>2</sup>	328	-
Other services	67	-
<b>Total non-audit fees</b>	<b>791</b>	<b>1,101</b>
<b>Total fees</b>	<b>1,213</b>	<b>1,485</b>

<sup>1</sup> Prior to Deloitte LLP's appointment as auditor, Deloitte MCS Limited were engaged to assist management with the implementation of a new reporting and consolidation system. The majority of the work performed by Deloitte MCS Limited was undertaken before appointment of Deloitte LLP as external auditor on 1 April 2010.

<sup>2</sup> Corporate finance fees largely relate to reporting accountant work (required to be performed by the auditor) associated with supporting the raising of external finance within the group.

### Employee information

The Company has no employees. Staff engaged in the operation of Heathrow are employed by BAA Airports Limited which bears the related staff costs and recharges all such costs directly to the Company as a part of the SSA as described in the Accounting policies. The average number of employees of BAA Airports Limited engaged in the operation of Heathrow airport during the year was 5,265 (2010: 5,148). The number of employees does not include headcount related to central support functions for the Company which are rendered by BAA Airports Limited and charged as intra-group charges in accordance with the SSA.

### Directors' remuneration

	Year ended 31 December 2011 £'000	Year ended 31 December 2010 £'000
<b>Directors' remuneration</b>		
Aggregate emoluments <sup>1 2</sup>	1,707	915
Value of company pension contributions to defined contribution scheme	131	172
Termination benefits	398	-
	<b>2,236</b>	<b>1,087</b>

<sup>1</sup> For the year ended 31 December 2011 aggregate emoluments includes accrued salaries, allowances, bonuses and amounts payable under long term incentive plans ('LTIP').

<sup>2</sup> £624,000 of bonus was paid in cash in 2011 (2010: £nil).

Jose Leo was a director of a number of companies within the BAA Group, including BAA Airports Limited, during the year. His remuneration for the year ended 31 December 2011 was apportioned based on services provided to BAA Limited (2010: BAA Limited) and is disclosed within its financial statements.

The directors participate in various Long Term Incentive Performance Cash Plans operated by BAA Airports Limited. 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. For the year ended 31 December 2011, the directors' remuneration includes £147,000 payable in 2012 (2010: nil) in respect of the 2009 Plan after certain targets were met over the three year period from 2009 to 2011. As the financial performance in respect of the 2010 and 2011 Plans is uncertain at this stage, no value in relation to these awards is included above.

# Heathrow Airport Limited

Notes to the financial statements for the year ended 31 December 2011 *continued*

## 2 Operating costs - ordinary *continued*

### Directors' remuneration *continued*

	Year ended 31 December 2011 £'000	Year ended 31 December 2010 £'000
<b>Highest paid director's remuneration</b>		
Aggregate emoluments <sup>1 2</sup>	663	353
Value of company pension contributions to defined contribution scheme	32	71
	<b>695</b>	<b>424</b>

<sup>1</sup> For the year ended 31 December 2011 aggregate emoluments includes accrued salary, allowances, bonus and amounts payable under long term incentive plans ('LTIP').

<sup>2</sup> £264,000 of bonus was paid in cash in 2011 (2010: £nil).

The highest paid director participates in various Long Term Incentive Performance Cash Plans operated by BAA Airports Limited. 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. For the year ended 31 December 2011, the highest paid director's remuneration includes £69,000 payable in 2012 (2010: nil) in respect of the 2009 Plan after certain targets were met over the three year period from 2009 to 2011. As the financial performance in respect of the 2010 and 2011 Plans is uncertain at this stage, no value in relation to these awards is included above.

	Year ended 31 December 2011 Number	Year ended 31 December 2010 Number
<b>Number of directors who:</b>		
are members of a defined benefit pension scheme	1	-
are members of a defined contribution pension scheme	3	3

None of the directors (2010: none) exercised any share options during the year in respect of their services to the Company and no shares (2010: none) were received or became receivable under long term incentive plans.

## 3 Operating (costs)/gain - exceptional

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Pension (charge)/credit	(33.3)	74.7
Reorganisation credit/(costs)	0.2	(12.7)
Accelerated depreciation and impairment	(11.0)	(18.7)
	<b>(44.1)</b>	<b>43.3</b>

During 2011 there was a net exceptional pension charge of £33.3 million (2010: £74.7 million credit). This includes the Company's share of the movement in the BAA Airports Limited defined benefit pension scheme, the Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits as well as a re-allocation of pension balances between entities.

The £0.2 million reorganisation credit in 2011 was due to the release of provisions that were no longer required. The reorganisation costs in 2010 related primarily to various restructuring processes designed to reduce the size and cost of overhead functions following the sale of Gatwick airport in 2009.

The accelerated depreciation and impairment charge of £11.0 million (2010: £18.7 million – accelerated depreciation) in 2011 was in relation to an impairment charge on the Airtrack rail project which the Company has decided not to pursue. In 2010, the accelerated depreciation charge was due to the shortened lives of certain existing assets at Heathrow given the new Heathrow Terminal 2 development.

# Heathrow Airport Limited

Notes to the financial statements for the year ended 31 December 2011 *continued*

## 4 Non-operating costs – exceptional

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Exceptional impairment of fixed assets	-	29.9

As a result of the change in UK government and its policy towards runway developments, the Company announced on 24 May 2010 that it was ceasing work on the development of the planning application for a third runway at Heathrow. As a result, there was a total impairment charge of £29.9 million made of which £21.3 million related to the write-off of planning application costs and £8.6 million to the write down in the value of domestic properties purchased by the Company falling within the planned expanded airport boundary prior to their transfer to investment properties. This charge is not deductible for tax purposes. This accounting treatment has no impact on these costs being included in the airport's regulatory asset base and has no cash impact. In addition, it will not affect future cash flow generation, consistent with Civil Aviation Authority ('CAA') guidance.

## 5 Net interest payable and similar charges

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
<b>Interest receivable</b>		
Interest receivable from other group undertakings <sup>1</sup>	124.5	83.8
Interest receivable on bank deposits	0.2	0.3
	<b>124.7</b>	<b>84.1</b>
<b>Interest payable</b>		
Interest payable to other group undertakings <sup>2</sup>	(587.4)	(446.4)
Interest on bank borrowings	(79.1)	(99.2)
Facility fees and other charges	(21.5)	(23.1)
Net interest payable on derivative financial instruments	(62.6)	(100.9)
Dividend payable on irredeemable preference shares of £0.01 each: 5.012p per share (2010: 4.751p per share)	(1.1)	(1.0)
	<b>(751.7)</b>	<b>(670.6)</b>
Fair value loss on financial instruments	(75.8)	(11.5)
Interest capitalised <sup>3</sup>	26.9	22.4
	<b>(675.9)</b>	<b>(575.6)</b>

<sup>1</sup> These amounts relate primarily to interest accrued on balances due from BAA (SP) Limited (Note 10).

<sup>2</sup> These amounts relate mainly to interest due on the loan from BAA (AH) Limited and BLA with BAA Funding Limited (Note 14).

<sup>3</sup> Capitalised interest included in the cost of qualifying assets is calculated by applying an average capitalisation rate of 2.04% (2010: 2.15%) to expenditure incurred on such assets.

# Heathrow Airport Limited

Notes to the financial statements for the year ended 31 December 2011 *continued*

## 6 Tax on loss on ordinary activities

	Note	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
<b>Current tax</b>			
Group relief payable		57.9	48.4
Adjustments in respect of prior periods		(9.4)	3.4
<b>Total current tax charge</b>		<b>48.5</b>	51.8
<b>Deferred tax</b>			
Origination and reversal of timing differences:			
Current period		(68.3)	(52.8)
Prior period		6.1	41.6
Change in tax rate		(21.3)	(10.3)
<b>Total deferred tax</b>	15	<b>(83.5)</b>	(21.5)
<b>Tax (credit)/charge on loss on ordinary activities</b>		<b>(35.0)</b>	30.3

### Reconciliation of tax charge

The standard rate of current tax for the year, based on the UK standard rate of corporation tax, is 26.5% (2010: 28%). The actual tax charge for the current and prior years differs from the standard rate for the reasons set out in the following reconciliation:

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Loss on ordinary activities before tax	(149.1)	(123.5)
Tax on loss on ordinary activities at 26.5% (2010: 28%)	(39.5)	(34.6)
Effect of:		
Permanent differences	29.1	28.2
Depreciation for the year in excess of capital allowances	75.3	91.3
Capitalised interest	(6.7)	(6.3)
Other short term timing differences	(0.3)	(30.2)
Adjustments to tax charge in respect of prior periods	(9.4)	3.4
<b>Current tax charge for the year</b>	<b>48.5</b>	51.8

The tax credit recognised for the period was £35.0 million (2010: £30.3 million charge). Based on a loss before tax for the period of £149.1 million (2010: £123.5 million), this results in an effective tax credit rate of 23.5% (2010: negative effective tax rate of 24.5%).

The tax credit for the year ended 31 December 2011 is less than the credit implied by the statutory tax rate of 26.5%. If the release of deferred tax arising on the change in the statutory tax rate is excluded, the tax credit for the year is 9.2%, primarily due to permanent differences arising from non-qualifying depreciation.

For the period ended 31 December 2010 the recognition of a tax charge instead of a tax credit at the statutory rate of 28% was primarily due to the non-deductibility for tax purposes of the impairment charge for the year and to a deferred tax charge related to accelerated depreciation in 2010 and previous years on assets with shortened lives. Improved information was available on the tax classification of these assets and the calculation of deferred tax was therefore adjusted accordingly.

It was substantively enacted at the reporting date that the standard rate of corporation tax in the UK will change to 25% with effect from 1 April 2012. Further decrease to 24% and 23% with effect from 1 April 2013 and 2014 will occur. Other than this change and the unprovided deferred tax discussed in Note 15, there are no material items which would materially affect the future tax charge.

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 7 Tangible fixed assets

	Note	Investment properties £m	Land held for development £m	Terminal complexes £m	Airfield £m	Rail assets £m	Other land and buildings £m	Plant equipment & other assets £m	Assets in the course of construction £m	Total £m
<b>Cost or valuation</b>										
1 January 2011		1,585.0	42.4	7,144.4	1,044.1	1,368.0	88.9	530.8	1,526.9	13,330.5
Additions at cost		25.7	-	3.5	-	-	-	7.1	878.7	915.0
Transfers to completed assets		(0.1)	-	506.2	13.4	14.4	5.9	72.9	(612.7)	-
Interest capitalised	5	-	-	-	-	-	-	-	26.9	26.9
Disposals		(1.7)	-	(0.1)	-	-	-	(0.4)	-	(2.2)
Reclassifications		(5.6)	-	-	-	-	5.6	-	-	-
Revaluation	17	41.5	5.6	-	-	-	(2.8)	-	-	44.3
<b>31 December 2011</b>		<b>1,644.8</b>	<b>48.0</b>	<b>7,654.0</b>	<b>1,057.5</b>	<b>1,382.4</b>	<b>97.6</b>	<b>610.4</b>	<b>1,819.8</b>	<b>14,314.5</b>
<b>Depreciation</b>										
1 January 2011		-	-	(2,012.0)	(219.5)	(291.3)	(28.0)	(364.6)	-	(2,915.4)
Charge for the year		-	-	(327.5)	(32.3)	(52.2)	(5.3)	(61.9)	-	(479.2)
Disposals		-	-	0.1	-	-	-	0.4	-	0.5
<b>31 December 2011</b>		<b>-</b>	<b>-</b>	<b>(2,339.4)</b>	<b>(251.8)</b>	<b>(343.5)</b>	<b>(33.3)</b>	<b>(426.1)</b>	<b>-</b>	<b>(3,394.1)</b>
<b>Net book value 31 December 2011</b>		<b>1,644.8</b>	<b>48.0</b>	<b>5,314.6</b>	<b>805.7</b>	<b>1,038.9</b>	<b>64.3</b>	<b>184.3</b>	<b>1,819.8</b>	<b>10,920.4</b>
Net book value 31 December 2010		1,585.0	42.4	5,132.4	824.6	1,076.7	60.9	166.2	1,526.9	10,415.1

\*The revaluation has been debited to revaluation reserve as a previous unrealised gain was recognised while assets were included in investment properties prior to reclassification to other land and buildings.

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 7 Tangible fixed assets *continued*

### Valuation

Investment properties and land held for development were valued at open market value at 31 December 2011 by CB Richard Ellis, Chartered Surveyors (2010: CB Richard Ellis, Chartered Surveyors) at £1,692.8 million (2010: £1,627.4 million). These valuations were prepared in accordance with the Appraisal and Valuation Manual issued by The Royal Institution of Chartered Surveyors taking account, inter alia, of planning constraints and reflecting the demand for airport related uses. As a result of the valuation, a surplus of £47.1 million (2010: surplus of £34.2 million) has been recognised in the revaluation reserve.

Remaining terminal complexes, airfield infrastructure, plant and equipment and other land and buildings have been shown at historical cost.

### Historical cost

The historical cost of investment properties and land held for development at 31 December 2011 was £593.2 million (2010: £572.1 million).

### Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value at 31 December 2011 of £16.9 million (2010: £19.0million).

### Assets in the course of construction

Assets in the course of construction primarily consist of projects at Heathrow for work on the new Terminal 2 and its satellite building. They also include the baggage system between Terminals 3 and 5 to transport baggage for transfer passengers.

### Capitalised interest

Included in the net book value of fixed assets are interest costs of £871.9 million (2010: £881.7 million). £26.9 million (2010: £22.4 million) has been capitalised in the year at a capitalisation rate of 2.04% (2010: 2.15%) based on a weighted average cost of borrowings.

A tax deduction of £26.9 million (2010: £22.4 million) for capitalised interest was taken in the year. Subsequent depreciation of the capitalised interest is disallowed for tax purposes. Consequently, the capitalised interest gives rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets.

### Leased assets

The Company had assets rented to third parties under operating leases as follows:

	31 December 2011 £m	31 December 2010 £m
Cost or valuation	2,328.0	2,370.7
Accumulated depreciation	(199.1)	(191.5)
<b>Net book amount</b>	<b>2,128.9</b>	<b>2,179.2</b>

A significant proportion of freehold property is occupied by third parties under concession and management agreements.

## 8 Investments

	£m
Cost as at 1 January and 31 December 2011	3.8

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

In the opinion of the directors, the aggregate value of the shares in HEX is not less than the aggregate of the amount at which they are stated in the Company's Balance sheet.

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 9 Stocks

	31 December 2011	31 December 2010
	£m	£m
Raw materials and consumables	6.0	3.6

The replacement cost of raw materials and consumables at 31 December 2011 and 31 December 2010 was not materially different from the amount at which they are included in the Balance sheet.

## 10 Debtors

	31 December 2011	31 December 2010
	£m	£m
<b>Due within one year:</b>		
Trade debtors	150.6	119.9
Amounts owed by group undertakings – interest free <sup>1</sup>	38.3	107.7
Amounts owed by group undertakings – pensions <sup>2</sup>	26.9	57.2
Other debtors	49.5	44.6
Prepayments	27.2	32.6
Interest receivable	12.0	42.8
Net interest receivable on derivative financial instruments	19.8	7.8
Derivative interest prepayment	-	20.2
<b>Total debtors due within one year</b>	<b>324.3</b>	<b>432.8</b>
<b>Due after more than one year:</b>		
Amounts owed by group undertakings – interest free <sup>1</sup>	-	38.3
Amounts owed by group undertakings – interest bearing <sup>3</sup>	1,756.0	1,686.7
Derivative financial instruments (Note 13)	0.5	4.5
<b>Total debtors due after more than one year</b>	<b>1,756.5</b>	<b>1,729.5</b>
<b>Total debtors</b>	<b>2,080.8</b>	<b>2,162.3</b>

<sup>1</sup> Amounts owed by group undertakings – interest free largely relates to interest prepayments on the advances from BAA Funding Limited (Note 14) and external payments received by BAA Airports Limited under the SSA on behalf of the Company which will be remitted in due course.

<sup>2</sup> Amounts owed by group undertakings – pensions represents the Company's share of the surplus in the BAA Airports Limited defined benefit pension scheme allocated to the Company on the basis of pensionable salaries of those employees being in the defined benefit pension scheme. See Note 15 for further details.

<sup>3</sup> Amounts owed by group undertakings – interest bearing represents a loan receivable from BAA (SP) Limited. It has a fixed interest rate of 7.57%. Increase in the period is related to the restructuring of intercompany balances and external loans in the SP Group.

## 11 Current asset investments

	31 December 2011	31 December 2010
	£m	£m
Short term deposits	21.0	41.0

Board approved investment policies and relevant debt facility agreements provide counterparty investment limits based on short- and long-term credit ratings. Of these deposits, counterparties with a short term credit rating of A-1+ held assets of £21.0 million as at 31 December 2011 (2010: A-1+ held assets of £41.0 million)

# Heathrow Airport Limited

## Notes to the Financial Statements for the year ended 31 December 2011 *continued*

### 12 Creditors: amounts falling due within one year

	Note	31 December 2011 £m	31 December 2010 £m
Bank overdraft <sup>1</sup>		-	41.5
Trade creditors <sup>2</sup>		115.4	105.8
Capital creditors		245.4	172.8
Amounts owed to group undertakings – interest free <sup>3</sup>		10.2	14.3
Borrowings from group undertakings – interest bearing	14	691.5	16.3
External borrowings	14	39.1	39.1
Corporation tax payable		6.0	17.0
Group relief payable		32.2	39.2
Other creditors		16.6	5.9
Other taxes and social security costs		6.0	4.7
Deferred income		28.0	27.6
Net interest payable on derivative financial instruments		13.1	7.2
Interest accrual		101.8	55.2
		<b>1,305.3</b>	<b>546.6</b>

<sup>1</sup> The bank overdraft in 2010 is a notional pooling of funds by Heathrow and Stansted.

<sup>2</sup> Trade creditors are non-interest bearing and generally on 30-day terms.

<sup>3</sup> Amounts owed to group undertakings – interest free largely relate to external payments made by BAA Airports Limited under the SSA on behalf of the Company.

### 13 Creditors: amounts falling due after more than one year

	Note	31 December 2011 £m	31 December 2010 £m
Loans from BAA Funding Limited	14	7,350.3	6,346.2
External borrowings	14	2,265.0	3,499.4
Preference shares – redeemable <sup>1</sup>		0.1	0.1
Preference shares – irredeemable <sup>1</sup>		0.2	0.2
Derivative financial instruments		167.2	99.5
Deferred income		0.5	1.7
		<b>9,783.3</b>	<b>9,947.1</b>

<sup>1</sup> The Company has 100,000 £1 redeemable preference shares in issue which carry an entitlement to an annual dividend fixed by reference to the prospective real redemption rate, based on projected inflation rate of 3%, of 2.5% index linked 2016 UK gilts, uplifted for movements in the RPI. The preference shares of £1 are held by the immediate parent company, BAA (AH) Limited, and are redeemable by the Company on 16 January 2016 at £1.37 per share, uplifted for movements in the RPI. On a return of capital on winding up or capital reduction, the holders of the preference shares shall be entitled to a sum calculated in accordance with the Articles of Association, in priority to any payment to the holders of any other class of shares other than the holders of irredeemable preference shares. The Company also has 21,960,014 irredeemable £0.01 preference shares in issue which carry an entitlement to an annual dividend, uplifted by reference to the RPI. The holder of the preference shares shall only be entitled to attend and vote at General Meetings at which a resolution is proposed to abrogate, vary or modify their rights, in which case preference and ordinary shares shall carry equal voting rights. Both classes of preference shares are presented within creditors.

#### Derivative financial instruments not included at fair value

The Company enters into derivative transactions, principally interest rate swaps and foreign exchange contracts. The purpose of these transactions is to manage interest rate and currency risks arising from the Company's operations and sources of finance.

As at 31 December 2011, the Company had interest rate swap contracts outstanding with bank counterparties with notional values totalling £1,896.0 million (31 December 2010: £2,535.8 million). The swaps have fixed interest payments at rates varying from 2.2% to 5.6% and floating interest receipts based on three and six month Libor rates. At that date, these financial instruments had a mark-to-market liability of £300.8 million (2010: £195.3 million).

BAA Funding Limited had entered into derivative transactions with external counterparties, some of which were issued to the Company as back-to-back hedges. As at 31 December 2011, the total notional amount of these swaps was £4,021.8 million which had a mark-to-market liability of £217.7 million (31 December 2010: £1,908.0 million notional with a mark-to-market liability of £24.0 million).

The amounts recognised on the balance sheet in relation to these financial instruments represent accrued interest and accretion and unamortised portion of fair value on the date of novation. These are included in 'Net interest receivable on derivative financial instruments' and 'Derivative financial instruments' in Note 10 'Debtors' and 'Net interest payable on derivative financial instruments' (Note 12 'Creditors falling due within one year') and 'Derivative financial instruments' above.



# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 13 Creditors: amounts falling due after more than one year *continued*

Foreign exchange spot and forward/swap contracts are used to manage foreign currency exposures relating to future capital expenditure. As at 31 December 2011, the Company had various foreign exchange contracts with a total notional amount in Sterling terms of £4.3 million which had a fair value loss of £nil (31 December 2010: £10.0 million notional with a fair value loss of £0.1 million).

## 14 Borrowings

	31 December 2011 £m	31 December 2010 £m
<b>Current borrowings</b>		
<b>Secured</b>		
Bank loans	39.1	39.1
Borrower Loan Agreement advances from BAA Funding Limited	677.8	-
<b>Unsecured</b>		
Loan from BAA (AH) Limited	13.7	16.3
<b>Total current borrowings</b>	<b>730.6</b>	<b>55.4</b>
<b>Non-current borrowings</b>		
<b>Secured</b>		
Borrower Loan Agreement advances from BAA Funding Limited	7,350.3	6,346.2
Syndicated term facility	-	1,292.2
Capital Expenditure Facility	1,395.0	1,300.0
Other bank loans	870.0	907.2
<b>Total non-current borrowings</b>	<b>9,615.3</b>	<b>9,845.6</b>
<b>Total borrowings</b>	<b>10,345.9</b>	<b>9,901.0</b>

### Syndicated term facility

The Company forms part of the Designated Group which has a specific ring-fenced financing structure and where facility and covenants are at BAA (SP) Limited group level.

The syndicated term facility was repaid in full in September 2011 primarily using proceeds from bond issues.

### Borrowings from group undertakings

Unsecured borrowings from group undertakings represent the loan advanced by parent, BAA (AH) Limited, to the Company. The loan bears an interest rate of 7.57% per annum.

During the year, following new bond issues by BAA Funding Limited, further advances were made to the Company for a total amount of £1,507.0 million, net of transaction costs.

The effective interest rate on the BLA advances varies between 4.17% and 8.10%.

All of the above facilities are carried at amortised cost.

The Company, together with Stansted Airport Limited, had £1,355.0 million undrawn committed borrowing facilities available as at 31 December 2011 (2010: £1,450.0 million).

In addition, as at 31 December 2011, there was a gross overdraft limit between the Company and Stansted Airport Limited up to a maximum gross overdraft balance of £75.0 million (2010: £75.0 million).

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 15 Provisions for liabilities and charges

	Deferred tax (a) £m	Reorganisation costs (b) £m	Pension costs (c) £m	Other (d) £m	Total £m
1 January 2011	288.1	4.6	44.4	12.4	349.5
Utilised in the year	-	(3.9)	(30.4)	(7.2)	(41.5)
Charged to profit and loss account	-	3.2	3.6	0.3	7.1
Released to profit and loss account	(83.5)	-	-	-	(83.5)
Transferred in/(out)	-	-	-	1.6	1.6
<b>31 December 2011</b>	<b>204.6</b>	<b>3.9</b>	<b>17.6</b>	<b>7.1</b>	<b>233.2</b>

### (a) Deferred tax

Analysis of the deferred tax balances is as follows:

	31 December 2011 £m	31 December 2010 £m
Excess of capital allowances over depreciation	198.9	280.9
Other timing differences	5.7	7.2
	<b>204.6</b>	<b>288.1</b>

	Unprovided 31 December 2011 £m	31 December 2010 £m
Tax on chargeable gains if investment properties were sold at their current valuations	212.5	205.4
Tax on rolled-over gains if replacement assets were sold at their current valuations	5.0	5.5
	<b>217.5</b>	<b>210.9</b>

Provision has been made for deferred taxation in accordance with FRS 19, 'Deferred Tax'.

No provision has been made for deferred tax on gains recognised on revaluing investment properties to their market value or on the sale of properties where taxable gains have been rolled over into replacement assets. The total amount of tax unprovided for is £217.5 million (2010: £210.9 million). At present it is not envisaged that this tax will become payable in the foreseeable future.

The Finance Act 2011 enacted a reduction in the rate of corporation tax to 26% from 1 April 2011 and 25% from 1 April 2012. As a result the Company's deferred tax balances, which were previously provided at 27%, have been re-measured at the rate of 25%. This has resulted in a reduction in the net deferred tax liability of £21.3 million, with £21.3 million credited to the profit and loss account.

### (b) Reorganisation costs

The costs associated with the BAA Group's reorganisation programmes primarily relate to various restructuring processes designed to reduce the size and cost of overhead functions. These costs are for severance and pension payments only and are expected to be utilised in early 2012.

### (c) Pension costs

The £17.6 million closing provision (2010: £44.4 million) is held for historical accumulated past service pension costs borne by BAA Airports Limited in relation to the Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits. The movement in the year is due to the BAA Airports Limited defined benefit pension scheme moving from a deficit to a surplus position. As such the closing balance is included within Debtors - Amounts owed by group undertakings – pensions.

For more information on pension costs charged refer to the Accounting policies.

### (d) Other

These provisions are largely due to onerous contracts primarily relating to energy purchases and property leases. All amounts are expected to be utilised within three years.

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 16 Share capital

	£
<b>Authorised</b>	
1 January and 31 December 2011:	
857,570,415 ordinary shares of £1 each	<b>857,570,415</b>
385,000,000 preference shares – redeemable of £1 each	<b>385,000,000</b>
500,000,000 preference shares – irredeemable of £0.01 each	<b>5,000,000</b>
	£
<b>Called up, allotted and fully paid</b>	
1 January and 31 December 2011:	
857,570,317 ordinary shares of £1 each	<b>857,570,317</b>
100,000 preference shares – redeemable of £1 each	<b>100,000</b>
21,960,014 preference shares – irredeemable of £0.01 each	<b>219,600</b>

The Company has 100,000 £1 redeemable preference shares in issue which carry an entitlement to an annual dividend fixed by reference to the prospective real redemption rate, based on projected inflation rate of 3%, of 2.5% index linked 2016 UK gilts, uplifted for movements in the RPI. The preference shares of £1 are held by the immediate parent company, BAA (AH) Limited, and are redeemable by the Company on 16 January 2016 at £1.37 per share, uplifted for movements in the RPI. On a return of capital on winding up or capital reduction, the holders of the preference shares shall be entitled to a sum calculated in accordance with the Articles of Association, in priority to any payment to the holders of any other class of shares other than the holders of irredeemable preference shares. The Company also has 21,960,014 irredeemable £0.01 preference shares in issue which carry an entitlement to an annual dividend, uplifted by reference to the RPI. The holder of the preference shares shall only be entitled to attend and vote at General Meetings at which a resolution is proposed to abrogate, vary or modify their rights, in which case preference and ordinary shares shall carry equal voting rights. Both classes of preference shares are presented within creditors.

## 17 Reserves

	Share premium reserve £m	Revaluation reserve £m	Profit and loss reserve £m	Total £m
1 January 2010	23.2	1,023.0	(53.6)	992.6
Loss for the financial year	-	-	(153.8)	(153.8)
Capital contribution	-	-	74.0	74.0
Tax charge on capital contribution	-	-	(20.0)	(20.0)
Unrealised gain on revaluation of investment properties	-	34.2	-	34.2
Unrealised loss on revaluation of fixed assets	-	(2.0)	-	(2.0)
<b>31 December 2010</b>	<b>23.2</b>	<b>1,055.2</b>	<b>(153.4)</b>	<b>925.0</b>

The capital contribution in 2010 relates to the reduction in the Company's share of the deficit of the BAA Airports Limited defined benefit pension scheme, following the commutation payment made by BAA (AH) Limited in to the scheme after the disposal of Gatwick airport.

	Share premium reserve £m	Revaluation reserve £m	Profit and loss reserve £m	Total £m
1 January 2011	23.2	1,055.2	(153.4)	925.0
Loss for the financial year	-	-	(114.1)	(114.1)
Unrealised gain on revaluation of investment properties	-	47.1	-	44.3
Unrealised loss on revaluation of fixed assets	-	(2.8)	-	-
<b>31 December 2011</b>	<b>23.2</b>	<b>1,099.5</b>	<b>(267.5)</b>	<b>855.2</b>

During the year, previously recognised net valuation losses amounting to £2.8 million (2010: losses of £2.0 million) were released as a result of the reclassification of a number of investment properties to operational assets.

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 18 Commitments

### Commitments for capital expenditure

Capital expenditure contracted commitments amount to £1,140.0 million (2010: £1,447.3 million).

	31 December 2011 £m	31 December 2010 £m
<b>Contracted for, but not accrued:</b>		
Terminal 2A building	631.2	788.5
Terminal 2B phase 2	287.5	446.7
Terminal 2 Multi Storey car park	69.2	-
Terminal 3 integrated baggage system	39.5	64.3
Eastern Campus ICS	34.5	-
Terminal 1 transfer baggage system	12.5	-
Minor asset replacement/refurbishment	10.2	-
Eastern Campus Leadership Team	8.3	1.0
Energy infrastructure	6.8	29.8
Terminal 1 baggage prolongation programme	-	31.3
Terminal 3/5 transfer baggage system	-	23.8
Terminal 5C	-	17.9
	<b>1,099.7</b>	<b>1,403.3</b>
Other projects	40.3	44.0
	<b>1,140.0</b>	<b>1,447.3</b>

### Commitments under operating leases

At 31 December 2011, the Company was committed to making the following payments during the next year in respect of operating leases:

	31 December 2011		31 December 2010	
	Land & buildings £m	Other leases £m	Land & buildings £m	Other leases £m
<i>Leases which expire:</i>				
within one year	0.1	0.1	0.2	-
within two to five years	1.6	0.6	1.5	0.4
after five years	10.4	31.7	9.9	28.3
	<b>12.1</b>	<b>32.4</b>	<b>11.6</b>	<b>28.7</b>

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 £31.7 million (2010: £28.3 million) operating lease commitments classified as 'other' relates to electricity supply equipment at the airport leased on agreement with UK Power Networks Services Limited ('UPNS'). 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 UPNS as neither the Company nor UPNS 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.

### Commitments under contractual obligations

The Company has a contractual commitment to purchase electricity that is used to satisfy physical delivery requirements for electricity usage of the Company until March 2013. Such commitments are for the normal purchase, sale or usage and hence are accounted for as ordinary purchase contracts. At 31 December 2011 the estimated minimum commitment for the future purchase of electricity under this contract totalled £30.5 million (2010: £77.8 million).

### Other commitments

The BAA Group operates or in the recent past has operated blight compensation schemes relating to properties that might be affected by potential future runway developments at certain of its airports. At Heathrow, there were schemes in operation as a result of the potential development of new runways but these schemes were closed following the change in government policy in relation to runway developments in South East England that occurred in 2010. Nevertheless, some residual commitments to purchase properties made before the relevant schemes were closed were fulfilled during 2011. Commitments to purchase the final 26 properties near Heathrow remained outstanding at 31 December 2011. Properties purchased under these schemes are included within investment properties at a value of £51.6 million as at 31 December 2011 (2010: £42.0 million).

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 18 Commitments *continued*

### Other commitments *continued*

The BAA Group is also required by the government to offer noise mitigation measures relating to existing airport activities. Based on the BAA Group's evaluation, payments under current noise schemes are estimated at £31 million spread over the five years commencing 2007. The schemes include the provision of noise insulation for community buildings and dwellings and assistance with the costs of relocation for dwelling owners. A review of the existing noise insulation and mitigation schemes commenced during 2010 and the BAA Group publically consulted on proposed amendments in 2011. During the course of 2012 the BAA Group expects to announce the outcome of the review and public consultation and launch any amendments to the current schemes.

In June 2006, the government announced its conclusions for the 2006-2012 night flights regime at the BAA Group's London airports. The regime committed BAA to introducing a new domestic noise insulation scheme at Heathrow to address the impact of night flights on local communities. The BAA Group estimates that payments under this scheme will total £62 million over the five years from 2008. The government was expected to consult on proposals for the post 2012 night flights regime during 2011. However that public consultation has been delayed and is now not expected until the end of 2012. Consequently a "rollover" of the existing restrictions is expected to be announced early in 2012. Until this consultation process is complete, the BAA Group is unable to quantify potential obligations under a future night flights regime.

The January 2009 government Announcement for Adding Capacity at Heathrow requires the BAA Group to review existing insulation and mitigation schemes; and to consider extending its noise insulation schemes to all community buildings and households in the new 57dBA contour that will experience an increase in noise of 3dBA or more. Until further consultation is carried out with the local communities, the significance of the BAA Group's obligations in implementing these schemes is uncertain.

The trustees of the BAA Airports Limited defined benefit pension scheme have recently concluded the triennial valuation of the scheme and agreed with the BAA Group a schedule of cash contributions to be made to the scheme by the BAA Group from January 2012. The valuation was carried out as at 30 September 2010 and indicated a scheme deficit of £275 million calculated using the trustees' actuarial assumptions.

As part of the triennial valuation process, the BAA Group will pay £97 million per annum into the scheme from 2012 to 2014. This compares with a total contribution of £80 million per annum paid from 2009 to 2011. The amount being paid in each of the next three years includes £24 million which is aimed to eliminate the deficit over a period of 9 years. The Company expects to contribute its share of this amount, estimated at approximately £71 million per annum, to the BAA Airports Limited defined benefit pension scheme in the year ended 31 December 2012.

## 19 Contingent liabilities

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 £47.8 million at 31 December 2011 (2010: £52.5 million).

In addition to the above, the Company together with Stansted Airport Limited ('STAL') has a jointly issued letter of credit amounting to £205.0 million under the Borrower Liquidity Facility Agreement, to cover interest payable to Supported Lenders.

The Company, together with STAL, HEX, BAA (SP) Limited and BAA (AH) Limited (together 'the Obligors') have granted security over their assets to secure their obligations to the Borrower Secured Creditors under their financing agreements. Each Obligor has also provided a guarantee in respect of the obligations of the other Obligors.

The Company, together with STAL and HEX have provided a guarantee in favour of The Royal Bank of Scotland plc as Borrower Account Bank in respect of their liabilities under the Borrower Account Bank Agreement.

BAA Pension Trust Company Limited has a right to receive up to £300 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.

Under the SSA, hedging costs properly incurred by BAA Airports Limited in relation to the Executive Share Option Plan ('ESOP') may be recharged to the Company. At 31 December 2011, the ESOP swaps held in BAA Airports Limited had a fair value loss of £55.3 million (2010: £75.6 million). The Company may be obligated to settle its share of these amounts in the future, depending on a number of factors, including the number of options vesting, the number of options being exercised and the Ferrovial share price at exercise date. Accordingly, this is disclosed as a contingent liability and included in the amount above.

# Heathrow Airport Limited

Notes to the Financial Statements for the year ended 31 December 2011 *continued*

## 20 Ultimate parent undertaking

The immediate parent undertaking is BAA (AH) Limited, a company registered in England and Wales.

The ultimate parent entity in the UK is FGP Topco Limited, which is the parent undertaking of the largest group in the UK to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (49.99%) (an indirect subsidiary of Ferrovial S.A., Spain), Britannia Airport Partners L.P. (26.48%) (a Caisse de dépôt et placement du Québec-controlled vehicle), Baker Street Investment Pte Ltd (17.65%) (an investment vehicle of the Government of Singapore Investment Corporation) and Alinda Airports UK L.P. and Alinda Airports L.P. (5.88%) (investment vehicles managed by Alinda Capital Partners).

The Company's results are also included in the audited consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2011, 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 BAA (SH) plc, BAA Limited and FGP Topco Limited for the year ended 31 December 2011.

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

## 21 Summary cash flow statement

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Operating profit	526.8	482.0
<i>Adjustments for:</i>		
Depreciation (including exceptional depreciation)	479.2	455.1
(Gain)/loss on disposal of tangible fixed assets	(0.2)	0.3
<i>Working capital changes:</i>		
Decrease/(increase) in stock and debtors	18.7	(4.4)
Increase in creditors	16.8	20.3
Decrease in provisions	(6.0)	(10.3)
Difference between pension charge and cash contributions	(29.8)	(26.9)
Exceptional pension charge/(credit)	33.3	(74.7)
<b>Net cash inflow from operating activities</b>	<b>1,038.8</b>	841.4
Net interest paid	(293.2)	(310.2)
Taxation - Group relief paid	(66.5)	(53.1)
Net capital expenditure	(843.8)	(818.7)
<b>Net cash outflow before use of liquid resources and financing</b>	<b>(164.7)</b>	(340.6)
<b>Management of liquid resources</b>		
Decrease in short term deposits	20.0	193.5
<b>Financing</b>		
Drawdown of bank loans	95.0	1,225.0
Repayment of bank loans and other items	(1,338.9)	(1,036.8)
Issuance of ordinary share capital	-	217.4
Cancellation of derivatives	(116.0)	(18.1)
Net movement in amounts with group undertakings	1,563.7	(270.6)
Settlement of accretion on index-linked instruments	(15.0)	-
<b>Increase/(decrease) in cash</b>	<b>44.1</b>	(30.2)

Liquid resources are defined in the Accounting policies under 'Cash and current asset investments'.

At 31 December 2010, there was an overdraft balance of £41.5 million included within 'Creditors: amounts falling due within one year'.

## 22 Post balance sheet events

In February 2012, the CAT rejected BAA Group's request that it should review the CC's July 2011 decision that there had been no material changes in circumstances that would give it cause to reconsider its March 2009 decision, particularly that the BAA Group should dispose of Stansted. The BAA Group has sought leave to appeal the CAT's decision.