# HEATHROW AIRPORT LIMITED

## Report and Financial Statements
## for the year ended 31 December 2008

Company Registration Number 1991017

# REPORT AND FINANCIAL STATEMENTS

# FOR THE YEAR ENDED 31 DECEMBER 2008

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# OFFICERS AND PROFESSIONAL ADVISERS

## DIRECTORS

| | |
|---|---|
| Luis Sanchez Salmeron | |
| Jose Leo | |
| Robert D Herga | Alternate to Jose Leo |

## SECRETARY

| | |
|---|---|
| Shu Mei Ooi | Appointed 28 November 2008 |

## REGISTERED OFFICE

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## INDEPENDENT AUDITORS

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## BANKERS

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# BUSINESS REVIEW

Heathrow Airport Limited ('the Company') operates Heathrow Airport and Heathrow Express ('HEX'), the express rail service between Heathrow and Central London.

During the year the Company acquired the Heathrow Express Operating Company.

This business review is presented under three sections:-

**Management review** – overview of the year ended 31 December 2008.

**Financial performance** – presentation and explanation of the key drivers behind the underlying financial performance reported for the year ended 31 December 2008 and analysis of the financial position of the Company as at that date.

**Risk management** – outline of the Group's approach to risk management, sources of assurance and highlight of the key business risks identified by the Group Executive Committee.

## MANAGEMENT REVIEW AND OUTLOOK

### Review of 2008

As part of the wider BAA Limited group corporate re-organisation and refinancing, ownership of the Company was transferred from London Airports 1992 Limited to BAA Airports Limited (formerly known as BAA Limited) at open market value on 31 January 2008. BAA Airports Limited subsequently sold its interest in the Company to BAA Limited (formerly known as Airport Development and Investment Limited). BAA Limited then sold its interest in the Company to another subsidiary company, BAA (AH) Limited, which forms part of the long term financing ring fenced group under the immediate parent undertaking of BAA (SP) Limited.

On 7 August 2008 the Company acquired from BAA Airports Limited, ownership of Heathrow Express Operating Company Limited ('HEX Opco') at the deemed fair market value of £3.8 million, equivalent to the net book value of HEX Opco. The purchase consideration was settled in cash.

In 2008, the most significant development in Heathrow Airport's facilities was the commissioning of Terminal 5, the first new terminal at the airport for over 20 years. Despite the difficulties surrounding its opening, Terminal 5 is now providing airlines and passengers with a world-class service. Independent surveys rank it amongst the best airport terminal facilities in Europe in overall passenger satisfaction.

The opening of Terminal 5 has also provided the spare capacity at Heathrow to enable the Company to invest in improving service across the whole airport in the next few years. Over the period from April 2008 to 31 March 2013, the Company expects to invest £4.3 billion (at 2007/08 prices) at Heathrow, with the most significant investment relating to construction of the new Terminal 2A and its satellite Terminal 2B, which will replace the existing Terminal 2 and, on completion, deliver facilities of equivalent standard to Terminal 5. Terminals 3 and 4 will also be extensively refurbished to raise standards to similar levels to Terminal 5. There will also be substantial investment in improving baggage connections across the airport. This investment programme has been agreed with airlines and the Civil Aviation Authority ('CAA') as part of the capital expenditure process.

# BUSINESS REVIEW (continued)

## MANAGEMENT REVIEW AND OUTLOOK (continued)

### Review of 2008 (continued)

Since the opening of Terminal 5, a number of airlines have successfully relocated their Heathrow operations to different terminals. These moves have been co-ordinated in a series of planned switches with British Airways moving the majority of their flights from other Heathrow terminals to Terminal 5 in four stages, the last taking place on 22 October 2008. Other notable moves included United Airlines and Air New Zealand relocating their respective fleets from Terminal 3 to Terminal 1 on 4 July 2008. All moves were completed with no significant impact on Heathrow operations. The Airline Relocation Program will continue into 2009 with more moves planned through the year.

This investment programme will strengthen Heathrow's position as a leading global hub airport and on completion will result in:

- 70% of Heathrow's passengers travelling through new or recently constructed terminals with the remaining 30% of passengers using significantly refurbished terminals
- Joint location of members for each of the major global airline alliances, providing a unique platform for Heathrow's airline customers to enhance efficiency and profitability

On 15 January 2009, the Secretary of State for Transport confirmed the UK Government's support for the addition of a third runway at Heathrow with additional terminal facilities. It is expected that this will allow maximum air transport movements at Heathrow to increase from 480,000 currently to 605,000 by around 2020 subject to achieving noise and air quality standards.

***Service standards***

Consistent delivery of high service standards is a key strategic priority for the Company, underpinning the experience of passengers and airlines and supporting the Company's long term growth ambitions. Major service improvements in 2008 included the impact of Terminal 5's commissioning and occupation and the benefit of operating at Heathrow under the strengthened service quality rebate scheme applying from 1 April 2008.

Following the initial difficulties immediately after its opening in March 2008, service at Terminal 5 has improved substantially with overall passenger satisfaction, as measured by Airline Council International's Airport Service Quality ('ASQ') survey for the fourth quarter of 2008, rated amongst the best European airport terminal facilities. In the same survey, Heathrow overall has moved above several competing major European hub airports in overall passenger satisfaction compared to its position a year earlier.

The service quality rebate scheme applying at Heathrow from 1 April 2008 was strengthened to include new elements, higher standards for existing parts of the schemes, increased penalties for not achieving standards and bonuses where out-performance is achieved consistently across the airport.

# BUSINESS REVIEW (continued)

## MANAGEMENT REVIEW AND OUTLOOK (continued)

### Review of 2008 (continued)

Further evidence of improving service standards can be seen from the rapid reduction in rebates paid by Heathrow following the introduction of the stricter scheme. The level of rebates in the nine months to 31 December 2008 was £4.7 million with the level of rebates declining from £2.9 million in the 3 months to 30 June 2008 to just £1.2 million and £0.6 million in the two subsequent quarterly periods.

One of the most visible service standards relates to security queuing times. These have improved significantly and security queues for direct passengers were below five minutes for 98.6% of the time at Heathrow in the nine months to 31 December 2008 compared with the required 95.0% service standard.

***Passenger traffic trends***

Heathrow's traffic performance softened as the year progressed reflecting the increasingly difficult global economic environment, with performance earlier in the year also affected by the aviation industry's need to adjust to high fuel prices. Heathrow's performance was consistent with that across the European aviation industry, whereby long haul traffic maintained its recent trend of outperforming other market segments and continued growing despite the difficult market conditions. This is beneficial for the Company's financial performance as long haul traffic generates higher levels of aeronautical and retail income. However, other market segments were more affected, including domestic and other short haul services.

Long haul passenger numbers increased 3.5% to 35.0 million (2007: 33.8 million), reflecting both the transfer of some US traffic from Gatwick due to the EU-US Open Skies Agreement and growth on other long haul routes. Transfer traffic increased to 36% of Heathrow's total traffic (2007: 34%), the percentages are calculated by taking the average of the Quality Service Measure ('QSM') and the Retail Profiler surveys. Long haul growth partially offset weaker domestic and other short haul services with Heathrow's total passenger traffic declining 1.4% to 66.9 million (2007: 67.9 million).

During the year Heathrow Express service carried a total of 4.93 million passengers, 3.1% below the previous year's total of 5.1 million. Heathrow Connect passengers increased from 0.31 million passengers in 2007 to 0.49 million. Across both services, passenger numbers increased marginally from 5.40 million in 2007 to 5.42 million in 2008.

# BUSINESS REVIEW (continued)

## MANAGEMENT REVIEW AND OUTLOOK (continued)

### Review of 2008 (continued)

***Retail activities***

Retail activities have proved resilient to the worsening economic environment reflecting a number of factors specific to Heathrow Airport. These include the significant recent expansion and upgrade of Heathrow's retail facilities. In particular, Heathrow Terminal 5 has 23,000m$^2$ of the highest quality retail space at Heathrow out of the airport's total of 66,000m$^2$. Terminal 5 has only welcomed its full complement of passengers since October 2008 when British Airways completed its planned moves from other terminals. Elsewhere the launch of Terminal 1's common user lounge in June 2008 (providing domestic passengers with access to the same retail offer as international passengers) also helped to support retail performance.

The principal drivers of retail spend at Heathrow Airport are time spent in departure lounge areas and passenger propensity to spend. Improvements to the end-to-end passenger experience (including security queuing) have led to a better propensity to spend and recent exchange rate movements have increased the attractiveness of product pricing to non-UK based passengers. The change in the passenger mix towards more long haul passengers, who tend to have earlier check in times combined with more efficient check in procedures giving more time in lounges, have contributed to the increased retail spend. These factors, taken with the significant improvements to the catering and retail offer, led by Terminal 5, have led to increases in the number of passengers spending amongst both UK and foreign passengers.

***Regulatory developments***

*Competition Commission inquiry into the supply of UK airport services by BAA*

On 19 March 2009, the Competition Commission ('CC') concluded its investigation on the supply of airport services by BAA in the UK. Its report calls for structural and behavioural remedies as well as recommendations on regulatory and policy matters for consideration by other governmental bodies.

Suggested behavioural remedies for Heathrow include strengthening consultation processes with the airlines and provisions on quality of service. The structural remedies include the disposal of Gatwick and Stansted to different purchasers as well as one of either Edinburgh or Glasgow airport within two years. The CC expect them to be sold in sequence, beginning with Gatwick, then Stansted, followed by either Edinburgh or Glasgow.

The CC has also recommended that the Department for Transport ('DfT') consider adopting a licence based regime of economic regulation of UK airports.

BAA Limited has two months from the publication date to decide whether to lodge a legal appeal.

# BUSINESS REVIEW (continued)

## MANAGEMENT REVIEW AND OUTLOOK (continued)

### Review of 2008 (continued)

*Department for Transport ('DfT') review of UK airport economic regulation*

The DfT is currently conducting a review of the economic regulation of all UK airports and its most recent consultation process commenced on 9 March 2009. This is expected to be followed by the issue of the DfT's final decision on the new regulatory proposals in the autumn of 2009. Implementation of the final proposals will require changes in law which are unlikely to occur before mid-2010 with the exact timing being subject to parliamentary time being found to enact the necessary legislative changes. Implementation of the new law would follow some time thereafter as further consultation on the specifics of each initial licence is contemplated.

The DfT has indicated that the key policy objectives of the review will include improving the passenger experience (in particular a stronger focus on putting the passenger first across the whole journey). It will also seek to encourage appropriate and timely investment in additional capacity to help deliver economic growth in line with wider Government policy and address the wider environmental impacts of aviation and airport development.

It is anticipated that the regulatory review will result in the introduction of a licensing regime similar to that operating in many regulated industries, which would reflect a spectrum of proportionate regulation with appropriate application to airports. The DfT is aiming to establish a regulatory environment that more explicitly supports the financial profile of efficient airport operators for which, among other features, it is proposing the introduction of a new duty on the regulator to ensure licence holders can finance their activities. The DfT is also consulting on the merits of concepts that are common in other regulated industries, including the introduction of a special administration regime in a limited number of airports.

Whilst there may be a change in law prior to the end of the price control period in 2013 for Heathrow, the DfT has made clear that the tariff arrangements for this period will not be re-opened.

# BUSINESS REVIEW (continued)

## MANAGEMENT REVIEW AND OUTLOOK (continued)

### Review of 2008 (continued)

*Aeronautical charges at Heathrow for 5 years to 31 March 2013 ('fifth quinquennium' or 'Q5')*

In March 2008, the CAA published its price control review for Heathrow for the five years to 31 March 2013 ('quinquennium 5'). In its proposals, a pre-tax real cost of capital of 6.2% at Heathrow was assumed. It set the maximum growth in aeronautical charges per passenger for Heathrow at RPI+23.5% for the year to 31 March 2009 and RPI+7.5% per annum for the remainder of Q5.

The resulting impact on the maximum allowable yield per passenger (in 2007/08 prices) is as follows:

| 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
|---|---|---|---|---|---|
| £10.36 | £12.80 | £13.72 | £14.76 | £15.84 | £16.99 |

The significant one-off increase in the aeronautical charges reflects the major capital programmes being undertaken by the Company in addition to the increased expenditure required to meet the new security regime. Further, between 2007/08 and 2008/09 this reflects a rebasing of tariffs to include costs previously charged to airlines by National Air Traffic Services ('NATS') for aerodrome navigation services and by the Company separately from the aeronautical charges for both baggage infrastructure services and fuel levy. The total amount included in the new tariffs for these services is £1.08 per passenger at Heathrow. The higher charges for Q5 are being phased in during the first regulatory year to 31 March 2009, meaning that in the year to 31 December 2008 the full benefit was not enjoyed.

### Refinancing

In August 2008, BAA Limited completed a permanent refinancing of the acquisition financing originally put in place at the time of the Ferrovial-led consortium's acquisition of BAA in 2006. The terms of the refinancing are described in more detail in Note 16 on page 51 and are summarised below:

- A corporate reorganisation occurred to enable separate ownership and financing of the three London airports (the 'Designated Airports') of Heathrow, Gatwick and Stansted.
- The Designated Airports became indirect wholly-owned subsidiaries of BAA (SP) Limited, forming a sub-group in which a ring fenced investment grade long term financing platform was established.
- The financing established within this sub-group included £4.4 billion of drawn bank facilities ('Refinancing Facility), £2.75 billion of capital expenditure and working capital facilities ('Initial Credit Facility') and £0.4 billion of drawn loan facilities from the European Investment Bank.
- Financing of the BAA (SP) Group is managed centrally. In particular, as of December 2008 Heathrow had £3,363.6 million of third party borrowings, £4,436.2 million of borrowings owed to BAA Funding Limited, a fellow BAA (SP) Group undertaking, which

# BUSINESS REVIEW (continued)

## FINANCIAL PERFORMANCE FOR THE YEAR

### Review of 2008 (continued)

is the issuer of bonds of the ring-fenced sub-group and on-lends the funds to the Company, and £45.8 million receivable from BAA (SP) Limited one of the Company's parent Companies.

### Developments since beginning of 2009

*Heathrow third runway*

On 15 January 2009, the Secretary of State for Transport confirmed the UK Government's support for the addition of a third runway at Heathrow with additional terminal facilities. It is expected that this will allow maximum air transport movements at Heathrow to increase from 480,000 currently to 605,000 by around 2020 subject to achieving noise and air quality standards. The next step in the process for the potential development of the third runway and additional terminal facilities is to prepare appropriate plans with a view to obtaining the necessary planning permissions and other consents.

*2009 traffic trends*

In the four months ended 30 April 2009, Heathrow's reported passenger traffic declined 4.0% to 20.0 million (2008: 20.9 million). In order to properly assess performance relative to the prior year it is necessary to take into account the fact that in early February Heathrow was disrupted by severe winter weather and that the 2009 period had one fewer day due to the leap year in 2008. After adjusting for these factors, the underlying passenger traffic decline is estimated to have been 2.6%, a resilient performance in challenging economic circumstances and reflecting the strength of Heathrow's position as a global hub airport for long haul services. This underlying performance is also an improvement on the traffic trend seen in the fourth quarter of 2008 when year on year passenger traffic declined 3.6%.

## BUSINESS REVIEW (continued)

### FINANCIAL PERFORMANCE FOR THE YEAR (continued)

#### Adjusted performance

The commentary below, in respect of operating costs and operating profit, is based on the adjusted performance (excluding depreciation and exceptional costs) of the Company. The commentary on all other aspects of the Company's results is based on the statutory financial information.

#### Heathrow Express

During the year the company acquired HEX Opco. Heathrow is entitled to all receipts and income relating to Heathrow Express. The day-to-day operation of the Heathrow Express is undertaken by HEX Opco on behalf of Heathrow. For providing these services, Heathrow pays HEX Opco a management fee and reimburses all of its operating costs.

#### Turnover

In the year to 31 December 2008, the Company's turnover increased 18.9% to £1,575.6 million (2007: £1,324.8 million). This increase reflects a 31.6% rise in aeronautical income, a 1.1% increase in gross retail income and 12.7% increase in other sources of income compared to 2007, despite a 1.4% reduction in passengers.

| | **31 December 2008 £m** | 31 December 2007 £m | Change (%) |
|---|---|---|---|
| Aeronautical income | **835.3** | 634.6 | 31.6 |
| Retail income | **328.5** | 324.9 | 1.1 |
| Operational facilities and utilities income | **130.7** | 115.9 | 12.8 |
| Property rental income | **90.1** | 81.8 | 10.1 |
| HEX rail income | **86.1** | 79.5 | 8.3 |
| Other income | **104.9** | 88.1 | 19.1 |
| **Total turnover** | **1,575.6** | 1,324.8 | 18.9 |

*Aeronautical income*

In the year to 31 December 2008, the Company's aeronautical income increased 31.6% to £835.3 million (2007: £634.6 million), driven by the revised tariffs announced by the CAA for the five year regulatory period commencing on 1 April 2008. A significant element of the increase in aeronautical income reflected the inclusion in the regulatory settlement of the costs of the heightened security regime in place since 2006. In addition, £36.2 million of the increase in aeronautical income reflected a rebasing of tariffs to include costs previously charged to airlines by NATS for aerodrome navigation services ('ANS'). The tariffs were also rebased to include services previously charged by the Company separately from the aeronautical charges for both baggage infrastructure services and fuel levy.

The higher aeronautical tariffs applying from 1 April 2008 are being phased in over the first year to 31 March 2009 so that only by that date will the full amounts be recovered.

# BUSINESS REVIEW (continued)

## FINANCIAL PERFORMANCE FOR THE YEAR (continued)

*Retail income*

The Company's gross retail income in the year to 31 December 2008 increased 1.1% to £328.5 million (2007: £324.9 million). On a comparable basis, derived by deducting cost of sales from gross income to adjust principally for changes in car parking contractual arrangements which moved from a concession basis to a contract basis at the start of 2008, net retail income ('NRI') declined 1.2% to £309.2 million (2007: £313.1 million) with an increase of 0.2% in NRI per passenger more than offset by a 1.4% reduction in passenger numbers.

| | **31 December 2008 £m** | 31 December 2007 £m | Change (%) |
|---|---|---|---|
| Gross retail income | | | |
| Car parking | **66.8** | 67.8 | (1.5) |
| Duty and tax-free | **78.4** | 74.5 | 5.2 |
| Airside specialist shops | **56.5** | 53.2 | 6.2 |
| Bureaux de change | **28.4** | 29.2 | (2.7) |
| Catering | **26.1** | 26.0 | 0.4 |
| Landside shops and bookshops | **20.6** | 20.7 | (0.5) |
| Advertising | **25.5** | 25.8 | (1.2) |
| Car rental | **9.9** | 10.6 | (6.6) |
| Other | **16.3** | 17.1 | (4.7) |
| **Total gross retail income** | **328.5** | 324.9 | 1.1 |
| | | | |
| Retail expenditure | **(19.3)** | (11.8) | 63.6 |
| Net retail income ('NRI') | **309.2** | 313.1 | (1.2) |
| Passengers (m) | **66.9** | 67.9 | (1.4) |
| NRI per passenger | **£4.62** | £4.61 | 0.2 |

By activity, the main growth driver in retail performance in the year to 31 December 2008 was airside and landside shops (including duty and tax free) where turnover increased 4.8% to £155.5 million (2007: £148.4 million) or 5.9% per passenger. Car parking turnover was £66.8 million (2007: £67.8 million) with the reduction due to a shift towards public transport and lower domestic passengers. Reductions in retail income in areas such as bureaux de change and advertising resulted largely from disruption due to significant terminal refurbishment and airline moves between terminals.

*Other income categories*

Income from areas other than aeronautical and retail activities increased 12.7% in the year to 31 December 2008 to £411.8 million (2007: £365.3 million). This increase reflected in particular a 19.1% increase in other income to £104.9 million (2007: £88.1 million) driven by £7.8 million of income from the introduction of services provided for passengers with reduced mobility ('PRM') which were previously directly sourced by the airlines. In addition, compared to 2007, operational facilities and utilities income increased 12.8% to £130.7 million (2007: £115.9 million), rail income from Heathrow Express increased 8.3% to £86.1 million (2007: £79.5 million) and property rental income increased 10.1% to £90.1 million (2007: £81.8 million).

# BUSINESS REVIEW (continued)

## FINANCIAL PERFORMANCE FOR THE YEAR (continued)

### Adjusted operating costs

Adjusted operating costs (excluding depreciation and exceptional costs) are presented as this better reflects the underlying performance of the business. In the year to 31 December 2008 adjusted operating costs increased 36.6% to £941.2 million (2007: £689.1 million). Note that the costs presented in the table below include HEX operating costs plus a 7.5% management fee and are presented as part of Other intra-group charges.

Analysis of adjusted operating costs:

| | **31 December 2008 £m** | 31 December 2007 £m | Change (%) |
|---|---|---|---|
| Staff costs | **269.3** | 212.8 | 26.6 |
| Maintenance expenditure | **108.8** | 86.3 | 26.1 |
| Utility costs | **80.5** | 67.3 | 19.6 |
| Rent and rates | **92.0** | 65.7 | 40.0 |
| General expenses[1] | **167.6** | 60.9 | 175.2 |
| Retail expenditure | **19.3** | 11.8 | 63.6 |
| Other intra-group charges | **202.9** | 184.0 | 10.3 |
| Profit on disposal of tangible fixed assets | **0.8** | 0.3 | 166.7 |
| **Total** | **941.2** | 689.1 | 36.6 |

1 Net of capitalised costs of £31.4 million (2007: £29.5 million)

There was a 26.6% increase in staff costs to £269.3 million (2007: £212.8 million) which related primarily to the opening of Terminal 5 and the costs of increased numbers of security personnel that were required to achieve the security service standards under the new Service Quality Rebate ('SQR') scheme. The increases in maintenance expenditure, utility costs and rent and rates reflects the opening of Terminal 5, higher unit costs for utility services and increased maintenance costs partly driven by the new SQR scheme.

The increase in general expenses reflected £47.1 million in additional costs relating to the first year of providing ANS and services for PRM which were previously sourced directly by the airlines. These are reimbursed through aeronautical charges for ANS and other income for PRM of £8.7 million as mentioned above. The remaining increase in general expenses was principally due to the cost of operating a five terminal airport. In particular, staff bussing, forecourt operations, cleaning, policing and inter-terminal baggage transfer costs saw significant increases due to the opening of Terminal 5 in March 2008. There were also higher payments under the SQR scheme reflecting tougher standards introduced from 1 April 2008.

# BUSINESS REVIEW (continued)

## FINANCIAL PERFORMANCE FOR THE YEAR (continued)

### Exceptional costs

In the year to 31 December 2008, the Company incurred £113.2 million in exceptional costs (2007: £154.2 million) charged within operating profit. An additional £103.9 million (2007: £nil) of refinancing fees relating primarily to initially undrawn facilities, were written off within net interest payable.

The exceptional costs charged within operating profit included £21.8 million in operational readiness costs for Terminal 5, £11.8 million of accumulated historical pension costs which had not been previously charged by BAA Airports Limited and were charged after the Company entered into the Shared Services Agreement (refer to Note 1 and Note 17) and a £4.0 million release of a 2006 provision for staff reorganisation. Also charged within operating profit was £83.6 million in accelerated depreciation relating to the shortened asset lives of Terminals 1 and 2 given the Terminal 2A development.

### Adjusted EBITDA, adjusted operating profit and operating profit

Adjusted EBITDA, i.e. earnings before interest, tax, depreciation and amortisation and exceptional items, in the year to 31 December 2008 was £634.4 million (2007: £635.7 million).

Despite turnover increasing by 18.9%, adjusted EBITDA remained at similar levels to the prior year. The key drivers for this were:-

- Significant additional employment and other costs associated with operating Terminal 5
- Increased general and maintenance expenses to achieve higher service standards
- Increased employment costs driven by an increase in security personnel to reflect and achieve enhanced service standards and security requirements
- Increased aeronautical charges to reflect the higher cost structure, including those highlighted above, only applying from 1 April 2008
- The higher aeronautical charges applying from 1 April 2008 being phased such that only by 31 March 2009 will the full amounts have been recovered

Adjusted operating profit (i.e. operating profit before exceptional items) in the year to 31 December 2008 was £288.1 million (2007: £432.1 million). In addition to the factors affecting adjusted EBITDA, the reduction in adjusted operating profit reflects significantly higher depreciation of £346.3 million (2007: £203.6 million) (excluding accelerated depreciation treated as an exceptional item) primarily associated with bringing Terminal 5 into operation.

Operating profit for the year to 31 December 2008 was £174.9 million (2007: £277.9 million) with the lower reduction from the prior year relative to adjusted operating profit reflecting lower exceptional costs within operating profit (2008: £113.2 million; 2007: £154.2 million).

# BUSINESS REVIEW (continued)

## FINANCIAL PERFORMANCE FOR THE YEAR (continued)

### Adjusted EBITDA, adjusted operating profit and operating profit (continued)

A reconciliation between statutory operating profit and adjusted EBITDA is provided below.

| | **31 December 2008 £m** | 31 December 2007 | Change (%) |
|---|---|---|---|
| Adjusted EBITDA | **634.4** | 635.7 | (0.2) |
| Depreciation | **(346.3)** | (203.6) | 70.1 |
| Adjusted operating profit | **288.1** | 432.1 | (33.3) |
| Exceptional items: | | | |
| Accelerated depreciation | **(83.6)** | (66.3) | 26.1 |
| Other exceptional items (refer to Note 4) | **(29.6)** | (87.9) | (66.3) |
| Operating profit | **174.9** | 277.9 | (37.1) |

### Capital expenditure

Capital expenditure at Heathrow in 2008 was £792.6 million in total. The major projects at Heathrow included the building of a tunnel between the main Terminal 5 building and its new satellite terminal ('T5C') for a connected baggage system, continued work on T5C and the purchase of an old control tower, which was the last part of land within the Central Terminal Area that was not owned by the Company and is key for future transformation plans. There were various other projects in the rest of the Heathrow campus, such as the Terminal 1 check-in refurbishment and creation of a common departure lounge in Terminal 1 for bmi and Aer Lingus.

### Regulatory asset base

The Regulatory Asset Base (RAB) of the Company is provided to the CAA and published as at 31 March each year in the regulatory accounts. The RAB is also determined at 31 December each year for the purposes of calculating the Regulatory Asset Ratio (the ratio of net debt to RAB) under its financing arrangements. The RAB is rolled forward between each date according to a formula set out by the CAA. Set out below is the historic RAB figure as at 31 March 2008 from its regulatory accounts along with the historic figure at 31 December 2008 and forecast figure at 31 December 2009.

| | **RAB** |
|---|---|
| | £m |
| **31 March 2008** | 9,232 |
| **31 December 2008** | 9,661 |
| **31 December 2009** | 10,510 |

# BUSINESS REVIEW (continued)

## RISK MANAGEMENT

Risk management is a key element of the BAA Limited (the 'Group') operations. This has been centrally managed as part of the Group which includes Heathrow Airport Limited ('the Company') and in addition, the Company has a fully dedicated senior team which implements and manages risk closely following the Group's guidelines. The Executive Committee and Board referred to in the notes below relates to the Executive Committee and Board of BAA Limited.

Risk management in the Group facilitates the identification, evaluation and effective management of the threats to the achievement of the 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 and security, environmental, commercial, financial, reputational and legal risks with the framework ensuring that the Group's financial aspirations are not pursued at the expense of risk management, thus delivering a balanced control of risk, using formal risk management processes.

A key element of the risk management process is the risk-profiling methodology. This determines the threats to the achievement of business objectives and day to day operations in terms of likelihood and consequence at both inherent and residual level, after taking account of mitigating and controlling actions. Details are maintained in a hierarchy of risk registers used as the basis for regular review of risk management at Executive Committee and Board level. The risk registers are also used to inform 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 and properly embed risk management within these operations. The operation of the process and the individual registers are subject to review by the Group's Business Assurance 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.

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

**Safety and security risks**

Safety and security risks are regarded as an important risk to manage. The Company mitigates this risk 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, police and the Armed Forces to match security measures to a level commensurate with the current raised threat environment.

Assurance is provided through management reporting processes and a specialist compliance audit function, reporting directly to the Health, Safety, Security and Environment Committee.

# BUSINESS REVIEW (continued)

## RISK MANAGEMENT (continued)

### Regulatory environment, legal and reputational risks

**CAA regulation**

The Company's operations are subject to regulatory review by the CAA and CC every five years. The risk of an adverse outcome from the five-yearly review 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. Further, a settlement has just been reached with regard to the five years to 31 March 2014.

Part of the regulatory framework is the Company's involvement in constructive engagement with the airlines. In order to manage the risk of adverse airline relations, all airlines have been invited to participate at all stages and to be represented on all fora – eg joint steering groups. When feedback was sought or processes measured, independent third parties have been utilised for data gathering and analysis to ensure confidentiality and neutrality of interpretation. In addition, key stakeholders are engaged on a joint planning basis which provides the airlines with the opportunity of airing views and sharing plans, thereby ensuring their ongoing requirements are articulated and understood.

**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.

**Capacity shortfall**

Failure to secure necessary planning permissions would lead to the Company having insufficient capacity to meet the expected demands of the industry resulting in increased congestion and declining passenger service. 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. However, it should be noted that, despite the mitigating action taken by management and a planned capital investment programme, which will provide additional capacity, it is anticipated that demand will continue to exceed available capacity in London throughout the next ten years. In addition, the investment in additional capacity at the Company's airports is dependent on the outcome of the regulatory settlements in 2013. Existing planning approvals provide for approximate passenger traffic growth at Heathrow (including Terminal 5) to 90 million.

The UK Government's Aviation White Paper *'The Future of Air Transport'* ('the White Paper') was published in December 2003 and clarified the Government's policies regarding airport expansion for the whole of the country. It emphasised the need for airport operators to invest in delivering new capacity. The Company recognises a need to manage airport development following the White Paper in a way that does not lead to a loss of public or political confidence in BAA. To mitigate this risk, a dedicated project team (with relevant expertise and disciplines) have been established to work closely with local communities,

# BUSINESS REVIEW (continued)

## RISK MANAGEMENT (continued)

### Regulatory environment, legal and reputational risks (continued)

airlines and other interested parties.

**Environment**
Environmental risks need to be managed as they have the potential to impact the Company's reputation, and licence to operate and to grow. The Company mitigates these risks at a number of levels, including environmental management systems and training programmes embedded with operations, clear environmental strategies, resource conservation initiatives, proactive and progressive influencing of third parties, stakeholder engagement and community relations programmes. The Company works closely with a range of stakeholders to ensure that the Company reacts effectively to the challenges posed by the environmental agenda.

### Commercial and financial risks

**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 continually enhanced project process and by systems of project reviews before approval, during construction and after project completion. In addition, specific additional controls developed by the group for Heathrow Terminal 5 were introduced, including the strengthening of the project management team and the commitment of dedicated specialist internal audit and risk management resources to reinforce assurance to the Board. All projects include an allowance for risk and opportunity.

**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 Company 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. A three year Pay Agreement was reached in August 2006 covering negotiated grades within the Company and new negotiations are taking place in 2009 for the next pay deal. The Company could also be exposed in the short term to the effect of industrial action at key clients (i.e. airlines).

# BUSINESS REVIEW (continued)

## RISK MANAGEMENT (continued)

The Company's financial risk management objectives are aligned with those of its immediate parent company, BAA (AH) Limited, and also BAA (SP) Limited, which is the most immediate of the Company's parent companies that prepares consolidated financial statements. The treasury policies of the BAA (SP) Limited group of companies are detailed in the "Risk Management" section on page 21 of the BAA (SP) Limited financial statements for the year ended 31 December 2008 and, for the wider BAA Group, on page 17 of the BAA Limited annual report.

The Company's principal financial instruments comprise external borrowings, derivatives and amounts due to/from other BAA Group undertakings, including BAA Funding Limited and BAA (SP) Limited. All of these instruments are centrally managed for the BAA (SP) Group and allocated to each of it's airports. Facility limits and covenants are set for the BAA (SP) Group as a whole. The Company does not use financial instruments for speculative purposes.

The main risks arising from the Company's financial instruments are market risk (primarily fair value interest rate risk and cash flow interest rate risk), price risk, credit risk and liquidity risk.

### Cash flow interest rate risk

The Company's cash flow interest rate risk arises primarily from its third party borrowings issued at variable interest rates. In accordance with the wider BAA Group policy of maintaining a high level of fixed rate borrowings and the hedging restrictions of the Refinancing Facilities, the Company has entered into floating to fixed interest rate swaps to protect against cash flow interest rate risk.

### Fair value interest rate risk

The Company is exposed to fair value interest rate risk on fixed interest rate Borrower Loan Agreement Advances from BAA Funding Limited, a fellow BAA (SP) Group undertaking, totalling £2,042.8 million (nominal value £2,293 million). In accordance with the wider BAA Group policy of maintaining a high level of fixed rate borrowings and the hedging restrictions of the Refinancing Facilities, the Company does not manage this fair value interest rate risk.

### Price risk

The Company is exposed to RPI price risk on Borrower Loan Agreement (BLA) advances from BAA Funding Limited totalling £2,394.4 million (nominal value £2,206 million). These advances bear a fixed real (excluding inflation) interest rate but the principal amount of the advances is increased in line with cumulative movements in the UK RPI index. The RPI price risk on these BLA advances mirrors the RPI risk on third party RPI index linked derivatives, totalling £2,206 million, held by BAA Funding Limited. As at 31 December 2008, if the RPI index had been 1% higher, with all other variables remaining constant, pre-tax profit for the year would have decreased by £5.4 million and the impact on the current year hedge reserve in equity would be nil (2007: decrease in equity £10.2 million). However, if the RPI index had been 1% lower, with all other variables remaining constant, pre-tax profit for the year would have increased by £5.3 million and the impact on current year hedge reserve in equity would be nil (2007: increase in equity £10.6 million).

# BUSINESS REVIEW (continued)

## RISK MANAGEMENT (continued)

### Credit risk

Credit risk arises from cash and cash equivalents, derivative financial assets and accounts receivable. The Company has no significant concentrations of credit risk. The Company'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 and ensuring only counterparties within defined credit risk parameters are used. The credit risks of the BAA Group are further discussed in its financial statements and the directors do not consider that the Company faces any additional significant credit risks.

### Liquidity risk

At 31 December 2008, the Company, together with Gatwick Airport Limited and Stansted Airport Limited (both fellow subsidiary companies of BAA (AH) Limited and BAA (SP) Limited had £2.45 billion of undrawn joint committed capex borrowing facilities available. In addition, the Company had a further £0.05 billion committed working capital borrowing facility available, jointly with all four of the other BAA Group undertakings listed above. All conditions precedent in respect of the above facilities had been satisfied. Further details of these facilities are provided in Note 16.

### Security and guarantees

The Company has guaranteed certain of the financial obligations of BAA (SH) Limited. Details of these guarantees are provided in Note 22.

On behalf of the Board

**Jose Leo**
**Director**
14 May 2009

# REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements for the year ended 31 December 2008.

## PRINCIPAL ACTIVITIES

Heathrow Airport Limited ('Heathrow') operates Heathrow Airport and Heathrow Express, the express rail service between Heathrow and Central London. Heathrow is entitled to all receipts and income relating to Heathrow Express but the day-to-day operation of Heathrow Express is undertaken by HEX Opco on behalf of Heathrow. For providing these services, Heathrow pays HEX Opco 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 18.

## RESULTS AND DIVIDENDS

No ordinary dividend was proposed or paid during the year (2007: 18.924p per share amounting to £71,950,000).

The loss after taxation for the financial year amounted to £237.1 million (2007: profit of £174.1 million).

## BOARD OF DIRECTORS

The directors who served during the year and since the year end are as follows:

| | |
|---|---|
| Jose Leo | |
| Luis Sanchez Salmeron | |
| Robert D Herga | alternate to Jose Leo |
| Stephen K J Nelson | resigned 31 March 2008 |
| Mark W Bullock | resigned 31 May 2008 |

## DIRECTORS' INTERESTS

None of the directors held interests in the ordinary shares of the Company at the year end.

## EMPLOYEES

The Company has no direct employees. The staff are employed by BAA Airports Limited which is the Company's intermediate parent company.

# REPORT OF THE DIRECTORS (continued)

## PAYMENT PRACTICE

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 13 days purchases outstanding at 31 December 2008 (2007: 20 days) based on the average daily amount invoiced by suppliers during the year.

## FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company's financial risk management objectives and policies can be found on pages 16 to 18 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, but without prejudice to any indemnity to which the person concerned might otherwise be entitled, 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 judgment 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.

## DISCLOSURE OF INFORMATION FOR AUDITORS

The directors are satisfied that the auditors are aware of all information relevant to the audit of the Company's financial statements for the year ended 31 December 2008 and that they have taken all the steps that they ought to have taken as directors in order to make them aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

## REPORT OF THE DIRECTORS (continued)

### AUDITORS

Pursuant to the provisions of section 487(2) of the Companies Act 2006, PricewaterhouseCoopers LLP will automatically be re-appointed as Auditors of the Company.

By order of the Board

**Shu Mei Ooi**
Company Secretary

14 May 2009

Registered Office:
130 Wilton Road
London
SW1V 1LQ

# STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

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 applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice (UK GAAP)). The financial statements are required by law to 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 those financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State that the Company's financial statements comply with applicable UK GAAP, 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, in which case there should be supporting assumptions or qualifications as necessary.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that 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 1985. 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 maintenance and integrity of the BAA website which includes information related to the Company is the responsibility of the directors. The work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board.

**Shu Mei Ooi**
Company Secretary

14 May 2009

# INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HEATHROW AIRPORT LIMITED

We have audited the financial statements of Heathrow Airport Limited for the year ended 31 December 2008 which comprise Profit and Loss Account, Statement of Total Recognised Gains and Losses, Reconciliation of Movements in Shareholders' Funds, the Balance Sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

**Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the annual report and financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Report of the Directors is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Report of the Directors, the Statement of Directors Responsibilities and the Business Review. We consider the implications for our report if we become aware of any apparent misstatements with the financial statements. Our responsibilities do not extend to any other information.

**Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

# INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF HEATHROW AIRPORT LIMITED (continued)

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**Opinion**

In our opinion:

- The financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2008 and of its loss for the year then ended;

- The financial statements have been properly prepared in accordance with the Companies Act 1985; and

- The information given in the Report of the Directors is consistent with the financial statements.

PricewaterhouseCoopers LLP.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

14 May 2009

# PROFIT AND LOSS ACCOUNT
## For the year ended 31 December 2008

| | Notes | Year ended 31 December 2008 £m | Year ended 31 December 2007 £m |
|---|---|---|---|
| **Turnover – continuing operations** | 2 | **1,575.6** | 1,324.8 |
| Operating costs - ordinary | 3 | **(1,287.5)** | (892.7) |
| Operating costs - exceptional | 4 | **(113.2)** | (154.2) |
| Total operating costs | | **(1,400.7)** | (1,046.9) |
| **Operating profit – continuing operations** | | **174.9** | 277.9 |
| Net interest payable and similar charges – ordinary | 6 | **(444.2)** | (185.6) |
| Net interest payable and similar charges - exceptional | 4 | **(103.9)** | - |
| **(Loss)/profit on ordinary activities before taxation** | | **(373.2)** | 92.3 |
| Tax credit on (loss)/profit on ordinary activities | 7 | **136.1** | 81.8 |
| **(Loss)/profit on ordinary activities after taxation** | 20 | **(237.1)** | 174.1 |

The notes on pages 28 to 62 form an integral part of these financial statements.

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

There are no material differences between profit on ordinary activities before taxation and the retained profit for the year and their historical cost equivalents.

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
**For the year ended 31 December 2008**

| | Notes | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|---|
| (Loss)/profit for the financial year | 20 | **(237.1)** | 174.1 |
| Unrealised revaluation deficit | 20 | **(59.1)** | (45.8) |
| Revaluation adjustment | 9/20 | **(2.1)** | (6.0) |
| Total recognised gains and losses relating to the year | | **(298.3)** | 122.3 |

## RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS
**For the year ended 31 December 2008**

| | Notes | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|---|
| (Loss)/profit for the financial year | 20 | **(237.1)** | 174.1 |
| Dividends paid | 8/20 | **-** | (71.9) |
| Retained (loss)/profit for the financial year | | **(237.1)** | 102.2 |
| Revaluation deficit | 20 | **(59.1)** | (45.8) |
| Revaluation adjustment | 9/20 | **(2.1)** | (6.0) |
| Net movement in shareholders' funds | | **(298.3)** | 50.4 |
| Opening shareholders' funds | | **1,968.6** | 1,918.2 |
| Closing shareholders' funds | | **1,670.3** | 1,968.6 |

The notes on pages 28 to 62 form an integral part of these financial statements.

# BALANCE SHEET
## As at 31 December 2008

| | Notes | 31 December 2008 £m | 31 December 2007 £m |
|---|---|---|---|
| **FIXED ASSETS** | | | |
| Tangible assets | 9 | **9,842.4** | 9,427.9 |
| Investments | 10 | **3.8** | - |
| | | **9,846.2** | 9,427.9 |
| **CURRENT ASSETS** | | | |
| Stocks | 11 | **3.2** | 2.0 |
| Debtors: due within one year | 12 | **474.0** | 586.8 |
| : due after more than one year | 12 | **60.1** | 379.9 |
| Current asset investments | 13 | **142.1** | - |
| **TOTAL CURRENT ASSETS** | | **679.4** | 968.7 |
| **CREDITORS: amounts falling due within one year** | 14 | **(538.7)** | (7,794.1) |
| **NET CURRENT ASSETS/(LIABILITIES)** | | **140.7** | (6,825.4) |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **9,986.9** | 2,602.5 |
| **CREDITORS: amounts falling due after more than one year** | 15 | **(7,762.5)** | (18.8) |
| **Provisions for liabilities** | 17 | **(554.1)** | (615.1) |
| **NET ASSETS** | | **1,670.3** | 1,968.6 |
| **CAPITAL AND RESERVES** | | | |
| Called up share capital | 18 | **380.2** | 380.2 |
| Share premium account | 19 | **23.2** | 23.2 |
| Revaluation reserve | 20 | **1,067.4** | 1,128.6 |
| Profit and loss reserve | 20 | **199.5** | 436.6 |
| **TOTAL SHAREHOLDERS' FUNDS** | | **1,670.3** | 1,968.6 |

The notes on pages 28 to 62 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 14 May 2009 and were signed on its behalf by:

**Jose Leo**
**Director**

**Luis Sanchez Salmeron**
**Director**

# NOTES TO THE FINANCIAL STATEMENTS
## For the year ended 31 December 2008

### 1. ACCOUNTING POLICIES

**Basis of preparation**

These financial statements have been prepared under historical cost convention, as modified by the revaluation of certain tangible fixed assets in accordance with the Companies Act 1985 and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice (UK GAAP)) except as set out within the accounting policies note.

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.

Consequently the directors have reviewed the cash flow projections of the BAA SP Group of which Heathrow forms part, taking into account:

- the forecast passenger numbers, turnover and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the Group's funding structure following the refinancing in August 2008 and the significant committed facilities that are available to the Company and to the Group (see Note 16).

As a result of the review, having made appropriate enquiries of management and allowing for headroom to accommodate a reasonable downside scenario (including a fall in passenger numbers), the directors have a reasonable expectation that sufficient funds will be available to meet the Company's funding requirement over the coming twelve month period. All of the Group's financial covenants of which the Company forms part (see note 16) have been met and are forecast to be met for the foreseeable future.

The principal accounting policies are set out below.

**Consolidated financial statements**

The Company has taken advantage of the exemption provided by section 228 of the Companies Act 1985 from the requirement to prepare consolidated financial statements as it is a wholly owned subsidiary of FGP Topco Limited and it and its subsidiary undertakings are included in the consolidated financial statements of that company for the year ended 31 December 2008. The results are also included in the consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2008 (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) Limited and BAA Limited for the year ended 31 December 2008. 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.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 1. ACCOUNTING POLICIES (continued)

**Turnover**

Turnover is recognised in accordance with Financial Reporting Standard ('FRS') 5 'Reporting the substance of transactions', net of VAT, and comprises primarily of:

- Airport and other traffic charges
  - Passenger charges levied on departing passengers
  - Aircraft landing charges levied according to weight on landing
  - Aircraft parking charges based on a combination of weight and time parked
  - Other charges levied for passenger and baggage handling when these services are rendered

- Property and operational facilities
  - Property letting sales, recognised on a straight-line basis over the term of the rental period
  - Usage charges made for operational systems (e.g. check-in desks), recognised as each service is provided
  - Proceeds from the sale of trading properties, recognised on the unconditional completion of the sale
  - Other invoiced sales, recognised on the performance of the service

- Retail
  - Concession fees based upon turnover certificates supplied by concessionaires.

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

**Exceptional items**

Exceptional items are material items of income and expense that, because of the unusual nature and expected infrequency of the events giving rise to them, merit separate presentation to allow an understanding of the Company's financial performance.

Such events may include gains or losses on disposal of businesses or assets, major reorganisation of business, closure or mothballing of terminals and those costs incurred in bringing new airport terminal complexes and airfields to operational readiness that are not able to be capitalised as part of the project. Additional details of items disclosed as exceptional are provided in Note 4.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 1. ACCOUNTING POLICIES (continued)

**Fixed assets**

(i) Operational assets

Terminal complexes, airfield assets, plant and equipment, rail assets and Company occupied properties are stated at cost less accumulated depreciation. 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. 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.

(ii) Investment properties

Investment property, which is property held to earn rentals and/or capital appreciation, is valued at the balance sheet date at open market value. All investment properties are revalued annually by the directors and at least once every five years by external valuers. 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.

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

In accordance with Statement of Standard Accounting Practice ('SSAP') 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 1985 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.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 1. ACCOUNTING POLICIES (continued)

**Fixed assets (continued)**

(iii) 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 follows:

| | |
|---|---|
| • 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 |
| • Airport tunnels, bridges and subways | 50 - 100 years |
| • Runway surfaces | 10 - 15 years |
| • Runway bases | 100 years |
| • Taxiways and aprons | 50 years |
| • Railways: | |
|     • Rolling stock | 8 - 40 years |
|     • Tunnels | 100 years |
|     • Track metalwork | 5 - 10 years |
|     • Track bases | 50 years |
|     • Signals and electrification work | 40 years |
| • Motor vehicles | 4 - 8 years |
| • Office equipment | 5 - 10 years |
| • Computer equipment | 4 - 5 years |
| • Computer software | 3 - 7 years |
| • Short leasehold properties | over period of lease |

# NOTES TO THE FINANCIAL STATEMENTS (continued)
# For the year ended 31 December 2008

## 1. ACCOUNTING POLICIES (continued)

### Impairment of assets

The Company assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company makes an estimate of the asset's recoverable amount. Where the asset does not generate cash flows that are 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. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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.

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.

### Capitalisation of interest

Interest payable is charged as incurred except where the borrowing finances tangible fixed assets in the course of construction. Such interest is capitalised once planning permission has been obtained and a firm decision to proceed has been taken until the asset is complete and ready for use. It is then charged to the profit and loss account as depreciation over the life of the relevant asset.

### Investments

Investments held as fixed assets are stated at cost less provision for any impairment in the investment value.

### 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.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
# For the year ended 31 December 2008

## 1. ACCOUNTING POLICIES (continued)

### Deferred tax

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.

### Leases

(i) Company as lessor
Leases where the Company retains substantially all the risks and benefits of ownership are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying value of the leased asset and recognised over the lease term on the same basis as the income.

(ii) Company as lessee
Rental costs under operating leases are charged to the profit and loss account in equal annual amounts over the period of the lease.

### Shared Services Agreement

All employees 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 administrator of the related defined benefit and defined contribution pension plans and grants all employee benefits.

On 18 August 2008, the Company entered into a Shared Services Agreement ('SSA') under which BAA provides the Company with operational staff and corporate services.

*(i) Operational staff*
BAA Airports Limited charges the Company for the provision of services in relation to staff costs, including wages and salaries, superannuation 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 the employee share options. All of the amounts included in the abovementioned costs are settled in cash except for superannuation costs or costs related to hedging of share options, which are only settled when the cash outflow is requested by BAA Airports Limited.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 1. ACCOUNTING POLICIES (continued)

**Shared Services Agreement (continued)**

*(ii) 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 shared service agreement with a mark-up of 7.5% except for IT applications where full costs were recharged to the Company. The total mark-up charged to the Company amounted to £6.2 million during the year (2007: £5.7 million).

*(iii) Pension costs*
Under the Shared Services Agreement the Company's share of the current period service cost for the BAA Airports Limited pension schemes are recharged to the Company. Cash contributions are made directly to the pension trustee of the BAA Airports Limited defined benefit scheme on behalf of BAA Airports Limited. The Company also has a legal obligation to fund any pension deficit related to BAA Airports Limited pension plans under the Shared Services Agreement.

In the year to 31 December 2008 an amount of £11.8 million was recorded as a one-off exceptional past-service cost in the profit and loss account relating to unfunded pension schemes existing at BAA Airports Limited. However these amounts will not be settled until the cash outflows are required by BAA Airports Limited and are accordingly recorded as long term provisions, (Refer Note 17.)

**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 balance sheet date and are discounted to present value where the effect is material.

**Issue costs and arrangement fees**

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 instrument not been issued. These are accounted for as a deduction from the amount of consideration received and amortised under 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.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
# For the year ended 31 December 2008

## 1. ACCOUNTING POLICIES (continued)

### Cash and liquid resources

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 of term deposits less than one year (other than cash) and investments in money market managed funds.

### Derivative financial instruments

The derivative financial instruments by the Company are interest rate swaps. These are used to manage the interest rate risk of borrowings. Interest receivable on the instruments is calculated using a variable interest rate whereas interest payable is based on a fixed interest rate. The purpose of the swaps is to hedge the risk that arises from the borrowings with variable interest rates.

The derivative financial instruments are hedge accounted in accordance with FRS 4 and consequently accounted for on an accrual basis. The net interest payable or receivable on those derivatives are recorded as net against the interest on the underlying hedged item in the income statement. When derivatives are not in a hedge relationship the interest payable and receivable on those derivatives are recorded at their gross amount in finance costs and finance income in the income statement. The net interest payable or receivable accrual on derivatives are 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 on a straight-line basis over the term of the financial instruments.

### Debt and financial liabilities

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost unless part of a fair value hedge relationship. 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 method.

The borrowings from group undertakings represent the balance of the BLA payable from 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 effective interest rate method. The nominal amount of the RPI borrowings is accreted for the RPI component recognised within interest payable in the income statement.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
# For the year ended 31 December 2008

## 1. ACCOUNTING POLICIES (continued)

### Dividend distribution

A dividend distribution to the Company's shareholders is recognised as a liability in the Company's financial statements in the period in which the shareholders' right to receive payment of the dividend is established by approval of the dividend at the Annual General Meeting. Interim dividends are recognised when paid.

### Summary cash flow statement and related party disclosures

The Company is wholly owned by 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 2008. The results are also included in the audited consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2008 (intermediate parent entity and the smallest group to consolidate these financial statements for the full year). They are also included in the audited consolidated financial statements of BAA (SH) Limited and BAA Limited for the year ended 31 December 2008. 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)'. A summary cash flow statement has been included at Note 25.

The Company is also 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 shared service agreement between the Company and subsidiaries of the FGP Topco Group are disclosed in the notes to the financial statements.

### Significant accounting judgements and estimates

In applying the Company's accounting policies management have made estimates and judgements in the following area. Actual results may, however, differ from the estimates calculated and management believe that the following area presents the greatest level of uncertainty.

*Investment properties*

Investment properties were valued at fair value at 31 December 2008 by Drivers Jonas, Chartered Surveyors. These valuations were prepared in accordance with UK GAAP 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. Given recent market conditions and the decline in property prices, for the year ended 31 December 2008, independent valuations have been obtained for 100 percent of Investment properties.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
# For the year ended 31 December 2008

## 2. SEGMENTAL ANALYSIS

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.

| Turnover | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| Airport and other traffic charges[1] | **835.3** | 634.6 |
| Retail | **328.5** | 324.9 |
| Operational facilities and utilities | **130.7** | 115.9 |
| Property rental | **90.1** | 81.8 |
| HEX Rail income[2] | **86.1** | 79.5 |
| Other[3] | **104.9** | 88.1 |
| | **1,575.6** | 1,324.8 |

1 Included in airport and other traffic charges are £36.2 million (2007: £nil) in relation to recharging of aerodrome navigation services ('ANS') provided by NATS.

2 Heathrow Airport Limited is entitled to all receipts relating to HEX, but the day to day operation of Heathrow Express is undertaken by Heathrow Express Operating Company Limited (HEX Opco) on behalf of Heathrow Airport Limited for which a management fee is charged and included within 'other intra-group charges' – refer note 3.

3 Increases in 'other' mainly relates to a first time contribution from providing services for Passengers with Reduced Mobility (PRM).

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 3. OPERATING COSTS – ORDINARY

| | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| Wages and salaries | **205.1** | 156.3 |
| Social security costs | **16.0** | 12.6 |
| Pension costs | **31.1** | 31.5 |
| Other staff related costs | **14.1** | 10.9 |
| Share-based payments | **3.0** | 1.5 |
| **Staff costs**[1] | **269.3** | 212.8 |
| Retail expenditure | **19.3** | 11.8 |
| Depreciation – owned assets | **346.3** | 203.6 |
| Maintenance expenditure | **108.8** | 86.3 |
| Rent and rates | **92.0** | 65.7 |
| Utility costs – consumption | **53.4** | 46.0 |
| General expenses - police costs | **33.9** | 26.7 |
| General expenses – other[2] | **133.7** | 34.2 |
| Utility costs - distribution | **27.1** | 21.3 |
| Other intra-group charges[3] | **202.9** | 184.0 |
| | **1,286.7** | 892.4 |
| Loss on disposal of tangible fixed assets | **0.8** | 0.3 |
| | **1,287.5** | 892.7 |

1. Staff costs comprise of recharges from BAA Airports Limited for employee services to the Company. Refer to Shared Services Agreement accounting policy in note 1.
2. Increase in general expenses – other mainly relates to the first year of providing aerodrome navigation services, PRM, Construction Logistics and Queue Measurement. The remaining increase was due to the additional cost of operating the new T5 terminal.
3. Increase in Other intra-group charges includes £135.2 million in relation to corporate costs allocation under the SSA which have increased as a result of the additional provision of IT systems and support for T5. Other intra-group charges also includes Hex charges of £62.9 million which have also increased as a result of the cost of operating Heathrow Express services to T5.

| **Operating costs include:** | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| Training expenditure | **7.2** | 4.1 |
| Rentals under operating leases | | |
| - Plant and machinery | **27.3** | 21.5 |
| - Other operating leases | **16.6** | 9.7 |
| Services provided by the Company's auditor | | |
| - Fees payable for the audit | **0.1** | 0.1 |
| - Tax advisory work | **-** | 0.1 |

**Employee information**

The Company has no employees. All staff costs are borne by BAA Airports Limited which recharges all such costs directly to the Company as a part of the SSA as described in the Accounting Policies under the 'Shared Services Agreement'. Previously this was included in a

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 3. OPERATING COSTS – ORDINARY (continued)

management charge. The average number of employees of BAA Airports Limited engaged in the operation of Heathrow Airport during the year was 5,516 (2007: 4,545).

### 4. EXCEPTIONAL ITEMS

| | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| **Operating items** | | |
| Reorganisation (credit)/charge **(a)** | **(4.0)** | 43.1 |
| Exceptional depreciation **(b)** | **83.6** | 66.3 |
| Terminal 5 operational readiness costs **(c)** | **21.8** | 44.8 |
| Pension costs **(d)** | **11.8** | - |
| | **113.2** | 154.2 |
| **Interest payable and similar charges** | | |
| Refinancing fees written off **(e)** | **103.9** | - |

**(a)** A release of £4.0 million was credited during the year associated with restructuring programmes (2007: charge of £43.1 million). The amount released resulted from a higher staff turnover than historic experience and a lower than expected cost for each reduction in headcount. The charge in the year ended 31 December 2007 was in relation to severance and pension payments associated with the 'Simplify the Organisation' programme carried out during 2008-2009.

**(b)** With the anticipated development of Terminal 2A, Terminals 1 and 2 at Heathrow airport will be demolished necessitating an additional depreciation charge of £83.6 million in the year to 31 December 2008 (2007: £66.3 million) to reflect the shortened useful lives of the assets.

**(c)** Operational readiness costs of £21.8 million (2007: £44.8 million) relating to management of the opening of Heathrow Terminal 5 were incurred during the year

**(d)** £11.8 million (2007: £nil) of accumulated past service pension costs not previously charged to the Company by BAA Airports Limited in relation to Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits were incurred during the year. The Company's share of these costs have been allocated on the basis of earnings before interest, tax, depreciation and amortisation for the year ended 31 December 2008.

**(e)** Fees of £103.9 million (2007: £nil) were incurred during the year, in relation to facility and arrangement fees that are expensed under UK GAAP. These costs are mainly upfront fees paid for the initial credit facility (comprising of capital expenditure and working capital facilities), liquidity facility and costs attributed to future bond issuance. For further details of the borrowing facilities see Note 16.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
**For the year ended 31 December 2008**

## 5. DIRECTORS' EMOLUMENTS

| | **Year ended 31 December 2008 £'000** | Year ended 31 December 2007 £'000 |
|---|---|---|
| **Directors' emoluments** | | |
| Aggregate emoluments | **249** | 1,414 |
| Compensation for loss of office | **373** | 1,110 |
| | **622** | 2,524 |

| | **Year ended 31 December 2008 £'000** | Year ended 31 December 2007 £'000 |
|---|---|---|
| **Highest paid director's remuneration** | | |
| Total amount of emoluments and amounts (excluding shares) receivable under long-term incentive schemes | **622** | 2,203 |
| **Highest paid director's pension** | | |
| Accrued pension at end of the year | **20** | 137 |

| | **Year ended 31 December 2008** | Year ended 31 December 2007 |
|---|---|---|
| **Number of directors who:** | **No.** | No. |
| - are members of a defined benefit pension scheme | **2** | 3 |

S K J Nelson (until 31 March 2008) and L S Salmeron were directors of BAA Airports Limited during the year and their remuneration was paid by BAA Airports Limited and is disclosed in its financial statements. J Leo was a director of BAA Airports Limited until 18 September 2008 and then as a director of BAA Limited. His remuneration was paid by BAA Airports Limited and is disclosed within the respective financial statements for the period he was a director. The directors do not believe it is possible to apportion their remuneration to individual companies within the BAA Group based on services provided.

No directors exercised share options during the year. No directors received or had shares receivable to them under a Long Term Incentive Scheme. One director (2007: one director) did not receive any emoluments in their capacity as a director of the Company.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 6. NET INTEREST PAYABLE AND SIMILAR CHARGES - ORDINARY

| | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| **Interest payable** | | |
| EIB on lending agreement with BAA Limited | - | 1.1 |
| Interest on borrowings from other group undertakings[1] | **444.4** | 454.8 |
| Interest on bank borrowings | **94.6** | - |
| Commitment Fees | **10.0** | - |
| Interest payable on derivatives not in a hedge relationship | **2.8** | - |
| Dividend payable on £0.01 irredeemable preference shares each 9.564p per share (2007: 8.938p per share) | **2.1** | 2.0 |
| Provisions: Terminal 5 land purchase and Cross Border | **15.0** | 5.3 |
| | **568.9** | 463.2 |
| **Interest receivable** | | |
| Interest receivable from other group undertakings[1] | **(17.5)** | (25.7) |
| Net interest receivable on derivatives in a hedge relationship | **(11.4)** | - |
| Interest receivable on derivatives not in a hedge relationship | **(3.2)** | - |
| Interest receivable on money markets and bank deposits | **(1.0)** | - |
| | **(33.1)** | (25.7) |
| Derivative fair value amortisation | 0.5 | - |
| Foreign currency revaluation gains | (0.5) | - |
| Less: capitalised borrowing costs | (91.6) | (251.9) |
| **Net interest payable** | **444.2** | 185.6 |

1 These amounts largely relate to interest accrued on balances due from/to BAA Airports Limited prior to refinancing in August 2008. Also included is £1.3 million relating to interest accrued on post refinancing balances due from/to BAA (SP) Limited. Refer to notes 12 and 14 for details.

Borrowing costs included in the cost of qualifying assets (i.e. capitalised borrowing costs) arose on the general borrowing pool and are calculated by applying an average capitalisation rate of 6.89% (2007: 5.95%) to expenditure incurred on such assets.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 7. TAX ON PROFIT ON ORDINARY ACTIVITIES

| | Note | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|---|
| **Current tax** | | | |
| Group relief (receivable)/payable | | **(39.1)** | 6.1 |
| Adjustments in respect of prior periods | | **(19.9)** | (12.6) |
| Total current tax | | **(59.0)** | (6.5) |
| **Deferred tax** | | | |
| Origination and reversal of timing differences | | **(77.1)** | 34.1 |
| Abolition of industrial building allowance (IBA) balancing adjustments – impact on deferred tax liabilities | | **-** | (71.0) |
| Change in tax rate – impact on deferred tax liabilities | | **-** | (38.4) |
| Total deferred tax | 17 | **(77.1)** | (75.3) |
| **Tax credit on (loss)/profit on ordinary activities** | | **(136.1)** | (81.8) |

**Reconciliation of tax charge**

The standard rate of current tax for the year, based on the UK standard rate of corporation tax is 28.5% (2007: 30%). The actual tax charge for the current and prior year differs from the standard rate for the reasons set out in the following reconciliation:

| | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| (Loss)/profit on ordinary activities before tax | **(373.2)** | 92.3 |
| Tax on (loss)/profit on ordinary activities at 28.5% (2007: 30%) | **(106.4)** | 27.7 |
| Effect of: | | |
| Permanent differences | **(3.8)** | 1.4 |
| Depreciation for the year in excess of capital allowances | **96.8** | 49.2 |
| Capitalised interest | **(25.2)** | (70.6) |
| Impact of change in tax rate | **-** | (1.5) |
| Other short term timing differences | **(0.5)** | (0.1) |
| Adjustments to tax credit in respect of prior periods | **(19.9)** | (12.6) |
| Current tax credit for the year | **(59.0)** | (6.5) |

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 7. TAX ON PROFIT ON ORDINARY ACTIVITIES (continued)

The standard rate of corporation tax in the UK changed from 30% to 28% with effect from 1 April 2008. Accordingly, the Company's losses for this accounting period are taxed at an effective rate of 28.5% and will be taxed at 28% in the future.

Other than this change, and the unprovided deferred tax discussed in Note 17, there are no items which would materially affect the future tax charge.

The accounting impact of the abolition of Industrial Building Allowances (IBAs) in the financial statements of the Company, prepared under UK GAAP, is significantly different to that disclosed in the consolidated financial statements of BAA Limited, which were prepared under IFRS. Under UK GAAP, the accounting impact of the abolition of balancing adjustments for IBAs (in respect of prior claims) resulted in a release of a deferred tax liability of £71 million in the year ended 31 December 2007. This contrasts with IFRS where BAA Limited has been obliged to recognise a deferred tax charge equivalent to the loss of future tax relief on expenditure already incurred.

The cash impact of the abolition of for IBAs on the Company in 'quinquennium 5' is not expected to be material due to the transitional period regime applicable to 2011 and the low taxable income base of the Company. The impact of the abolition on future periods is uncertain due to the potential regulatory change to a post-tax allowed return (as is the case in other regulated industries). Under the existing regulatory framework, and assuming no further changes, the present value on the reduced cash flows for the existing assets would be approximately £340 million.

### 8. DIVIDENDS

| | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| **Equity - Ordinary** | | |
| Interim dividend for the year ended 31 December 2008 – £nil (2007: 18.9p per share). | - | 71.9 |

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 9. TANGIBLE ASSETS

| | Investment properties £m | Land held for development £m | Terminal complexes £m | Airfields £m | Rail assets £m | Group occupied properties £m | Plant equipment & other assets £m | Assets in the course of construction £m | Total £m |
|---|---|---|---|---|---|---|---|---|---|
| **Cost or valuation** | | | | | | | | | |
| 1 January 2008 | 1,349.5 | 62.7 | 2,805.4 | 597.1 | 679.2 | 53.1 | 317.5 | 5,328.8 | **11,193.3** |
| Additions at cost | 0.2 | - | 8.3 | - | - | - | 3.1 | 781.0 | **792.6** |
| Transfers to completed assets | 247.7 | - | 3,577.3 | 313.4 | 685.4 | 5.9 | 84.5 | (4,914.2) | **-** |
| Interest capitalised | - | - | - | - | - | - | - | 91.6 | **91.6** |
| Intercompany transfers | - | - | - | (0.1) | - | (0.4) | (0.5) | 22.8 | **21.8** |
| Disposals | - | - | (0.1) | (0.3) | (7.7) | (0.4) | (1.5) | - | **(10.0)** |
| Reclassification | (2.4) | - | - | - | - | 2.4 | - | - | **-** |
| Revaluation | (51.0) | (8.1) | - | - | - | - | - | - | **(59.1)** |
| Revaluation adjustment (Note 20) | - | - | - | - | - | (2.1) | - | - | **(2.1)** |
| **31 December 2008** | **1,544.0** | **54.6** | **6,390.9** | **910.1** | **1,356.9** | **58.5** | **403.1** | **1,310.0** | **12,028.1** |
| **Depreciation** | | | | | | | | | |
| 1 January 2008 | - | - | 1,218.6 | 132.1 | 181.6 | 18.0 | 215.1 | - | **1,765.4** |
| Charge for the year | - | - | 314.6 | 28.2 | 36.0 | 3.2 | 47.9 | - | **429.9** |
| Disposals | - | - | - | (0.2) | (7.5) | (0.2) | (1.1) | - | **(9.0)** |
| Intercompany transfers | - | - | - | - | - | (0.2) | (0.4) | - | **(0.6)** |
| **31 December 2008** | **-** | **-** | **1,533.2** | **160.1** | **210.1** | **20.8** | **261.5** | **-** | **2,185.7** |
| **Net Book Value** | | | | | | | | | |
| **31 December 2008** | **1,544.0** | **54.6** | **4,857.7** | **750.0** | **1,146.8** | **37.7** | **141.6** | **1,310.0** | **9,842.4** |
| 31 December 2007 | 1,349.5 | 62.7 | 1,586.8 | 465.0 | 497.6 | 35.1 | 102.4 | 5,328.8 | 9,427.9 |

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 9. TANGIBLE ASSETS (continued)

**Valuation**

Investment properties and land held for development were valued at open market value at 31 December 2008 by Drivers Jonas, Chartered Surveyors at £1,598.6 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 deficit of £59.1 million has been recognised in the revaluation reserve.

Remaining group occupied properties, terminal complexes, airfield infrastructure, plant and equipment, and other assets, have been shown at historical cost.

**Capitalised interest**

Included in the cost of assets after depreciation are interest costs of £918.6 million (2007: £862.7 million). £91.6 million (2007: £251.9 million) has been capitalised in the year at a capitalisation rate of 6.89% (2007: 5.95%) based on a weighted average cost of borrowings.

A tax deduction of £88.4 million (2007: £251.9 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.

**Historical cost**

The historical cost of investment properties and land held for development at 31 December 2008 was £531.1 million (2007: £283.6 million).

**BAA Group occupied properties**

BAA Group occupied properties are freehold except for certain short leasehold properties with a net book value at 31 December 2008 of £17.3 million (2007: £17.3 million).

# NOTES TO THE FINANCIAL STATEMENTS (continued)
# For the year ended 31 December 2008

## 9. TANGIBLE ASSETS (continued)

### Leased assets

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

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| Cost or valuation | **2,136.6** | 1,675.6 |
| Accumulated depreciation | **(126.9)** | (106.9) |
| Net book amount | **2,009.7** | 1,568.7 |

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

### Assets in the course of construction

Assets in the course of construction includes the second satellite under construction for Terminal 5 (T5C), the future satellite for Terminal 2 as well as Terminal 4 Extension and Terminal 3 refurbishment, amongst others.

### Land acquisition

Included in the net book value of assets is £179.0 million (2007: £179.0 million) for the acquisition of land for the construction of Terminal 5. The operational assets employed by the vendor of this land have been relocated and the acquisition cost represents the present value of the estimated deferred payments to be made over 35 years (from the date of acquisition) to the vendor in compensation for relocation. The present value of the outstanding deferred consideration is included within provisions in the balance sheet (Note 17).

### Security

BAA Airports Limited granted security over the Company's assets as disclosed in the BAA Airports Limited (formerly BAA Limited) Group's report and accounts as at 31 December 2007. Subsequent to the completion of the refinancing transactions the securities were released and transferred to other group companies. Details of these are provided in Note 22.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 10. INVESTMENTS

| | £m |
|---|---|
| Cost as at 1 January 2008 | - |
| Additions | 3.8 |
| **Cost as at 31 December 2008** | **3.8** |

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

On 7 August 2008 the Company acquired, from BAA Airports Limited, a fellow group company, the ownership of Heathrow Express Operating Company Limited (HEX Opco) at the market value of £3.8 million, equivalent to the net book value of HEX Opco. The purchase consideration was settled in cash.

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.

### 11. STOCKS

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| Raw materials and consumables | **3.2** | 2.0 |

The replacement cost of raw materials and consumables at 31 December 2008 and 31 December 2007 was not materially different from the amount at which they are included in the accounts.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 12. DEBTORS

| | 31 December 2008 £m | 31 December 2007 £m |
|---|---|---|
| **Due within one year:** | | |
| Trade debtors | **172.0** | 105.5 |
| Amounts owed by group undertakings – interest bearing[1] | **45.8** | 435.7[2] |
| Amounts owed by group undertakings – interest free[3] | **40.9** | - |
| Amounts owed by group undertakings – pensions[4] | **3.9** | - |
| Other debtors | **27.9** | 25.3 |
| Prepayments | **26.4** | 20.3 |
| Group relief | **23.1** | - |
| Net interest receivable on derivative financial instruments | **33.9** | - |
| Derivative interest prepayment | **100.1** | - |
| | **474.0** | 586.8 |
| **Due after more than one year:** | | |
| Loan to group undertaking | **-** | 379.9[2] |
| Derivative financial instruments[5] | **6.4** | - |
| Derivative interest prepayment | **53.7** | - |
| | **60.1** | 379.9 |
| | **534.1** | 966.7 |

1 Amount owed by group undertakings – interest bearing mostly relates to loans being made to BAA (SP) Limited post refinancing in August 2008. This amount is repayable on demand and accrues interest at a fixed rate of +7.57%.

2 The amount outstanding at 31 December 2007 was fully settled on refinancing in August 2008. Refer to Note 6 for interest accrued on the balance during the current year, prior to settlement.

3 Amount owed by group undertakings – interest free largely relates to external payment received by BAA Airports Limited under the Shared Service Agreement on behalf of the Company which will be allocated in due course.

4 Amounts owed by group undertakings – pensions relates to amounts receivable from BAA Airports Limited in respect of cash contributions made by the Company to the pension trustee in accordance with the Shared Services Agreement – refer Note 1 Accounting Policies – Shared Services Agreement, (iii) Pension Costs.

5 This relates to the unamortised portion of fair value of derivative financial instruments on the date of novation.

### 13. CURRENT ASSET INVESTMENTS

| | 31 December 2008 £m | 31 December 2007 £m |
|---|---|---|
| Short term deposits | **142.1** | - |

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 £32.1 million and A-1 held assets of £110.0 million as at 31 December 2008.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 14. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| Bank overdraft | **11.0** | - |
| Trade creditors | **92.5** | 89.4 |
| Capital creditors | **202.6** | 214.0 |
| Amounts owed to group undertakings – interest bearing | **-** | 6,241.0[1] |
| Amount owed to group undertaking – interest free[2] | **29.0** | - |
| Loans (refer below) | **-** | 1,198.8[1] |
| Borrowings (Note 16) | **43.3** | - |
| Corporation tax payable | **7.8** | 7.8 |
| Group relief payable | **-** | 6.1 |
| Other creditors | **11.3** | 3.9 |
| Other taxes and social security costs | **5.4** | 4.7 |
| Deferred income | **46.7** | 27.9 |
| Interest accrual | **89.1** | 0.5 |
| | **538.7** | 7,794.1 |

1 These amounts were fully settled on refinancing in August 2008. Refer to Note 6 for interest accrued on the balance during the current year prior to settlement.

2 Amount owed to group undertakings largely relates to external payments made by BAA Airports Limited under the Shared Service Agreement on behalf of Heathrow Airport Limited which will be settled in due course.

The loans from BAA Airports Limited and London Airports 1992 Limited were advanced as follows and settled in full during the year. Interest rates were fixed.

| | **Interest Rate** | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|---|
| Loans from BAA Airports Limited | 5.75% | - | 451.8 |
| Loans from BAA Airports Limited | 6.58% | - | 7.0 |
| Loans from London Airports 1992 Limited | 5.75% | - | 740.0 |
| | | - | 1,198.8 |

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 15. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

| | 31 December 2008 £m | 31 December 2007 £m |
|---|---|---|
| **Loans** | | |
| Loans from BAA Airports Limited | - | 13.2 |
| Loans from BAA Funding Limited (Note 16) | 4,436.2 | - |
| External borrowings (Note 16) | 3,320.3 | - |
| **Preference shares** | | |
| Redeemable preference shares | 0.1 | 0.1 |
| Irredeemable preference shares | 0.2 | 0.2 |
| **Derivative financial instruments**[1] | 1.9 | - |
| **Deferred income** | 3.8 | 5.3 |
| | 7,762.5 | 18.8 |

1 This relates to the unamortised portion of fair value of derivative financial instrument on the date of novation

BAA Airports Limited advanced the above loans to the Company under an 'on lending' agreement. Interest rates were fixed at 6.58% and were due to be repaid in 2010.

All loans were unsecured. The borrowings were repayable as follows:

| | 31 December 2008 £m | 31 December 2007 £m |
|---|---|---|
| In more than one year, but not more than two years | - | 7.0 |
| In more than two years, but not more than five years | - | 6.2 |
| | - | 13.2 |

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 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.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 16. BORROWINGS

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| **Current borrowings** | | |
| Secured bank loans - EIB | **43.3** | - |
| | **43.3** | - |
| Borrowings from group undertakings | **-** | 1,198.8 |
| **Total current borrowings** | **43.3** | 1,198.8 |
| | | |
| **Non-current borrowings** | | |
| Secured: | | |
| Borrower Loan Agreement advances from BAA Funding Limited | **4,436.2** | - |
| Senior Facility, Class A | **2,208.4** | - |
| Junior Facility, Class B | **490.3** | - |
| Initial Credit Facility | **250.0** | - |
| Bank loans - EIB | **371.6** | - |
| | **7,756.5** | - |
| Unsecured: | | |
| Borrowings from group undertakings: | | |
| Borrowings from BAA Airports Limited | **-** | 13.2 |
| **Total non-current** | **7,756.5** | 13.2 |
| **Total current and non-current borrowings** | **7,799.8** | 1,212.0 |

**Refinancing Facilities**

As described in the business review, the Company forms part of the Designated Group which has a specific ring-fenced financing structure and where facilities and covenants are at BAA (SP) group level. As such, when considering facilities drawn down by the Company, available facilities and covenant testing, due consideration must be given to the amounts drawn by its fellow subsidiary companies (Gatwick Airport Limited and Stansted Airport Limited).

In August 2008, the Company together with Gatwick Airport Limited and Stansted Airport Limited, ("the Designated Group"), drew loans under the Designated Group £4.4 billion Refinancing Facility in order to repay the Senior Facilities held by BAA Limited (formally ADIL).

The amounts and maturities of the Senior and Junior Refinancing Facilities drawn by each BAA (SP) group undertaking were:

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 16. BORROWINGS (continued)

| | Heathrow Airport Limited £m | Gatwick Airport Limited £m | Stansted Airport Limited £m | **Total £m** |
|---|---|---|---|---|
| Senior Facilities: | | | | |
| Due March 2010 | 150.0 | 650.0 | - | **800.0** |
| Due March 2011 | 250.0 | - | 500.0 | **750.0** |
| Due March 2012 | 750.0 | - | - | **750.0** |
| Due March 2013 | 1,100.0 | - | - | **1,100.0** |
| Total Senior Facilities | 2,250.0 | 650.0 | 500.0 | **3,400.0** |
| Junior Facilities: | | | | |
| Due March 2010 | - | 100.0 | 100.0 | **200.0** |
| Due March 2011 | 250.0 | - | - | **250.0** |
| Due March 2012 | 250.0 | - | - | **250.0** |
| Due March 2013 | - | 300.0 | - | **300.0** |
| Total Junior Facilities | 500.0 | 400.0 | 100.0 | **1,000.0** |
| Total Refinancing Facilities | 2,750.0 | 1,050.0 | 600.0 | **4,400.0** |

At 31 December 2008, the interest rate payable on these Facilities was equal to Libor plus a margin of 2.00% pa on the Senior Facility and 2.75% pa on the Junior Facility. The interest rate payable on these facilities is linked to the aggregate principal amount outstanding for the Designated Group as a whole, in accordance with the table below.

| **Senior Facility – Amount Outstanding** | | **Junior Facility – Amount Outstanding** | |
|---|---|---|---|
| Less than £1,200 million | 1.25% | Less than £330 million | 2.00% |
| Between £1,200 million and £2,200 million | 1.50% | Between £330 million and £660 million | 2.50% |
| Between £2,200 million and £3,200 million | 1.75% | Greater than £660 million | 2.75% |
| Greater than £3,200 million | 2.00% | | |

In addition, there are contractual margin step ups of 0.25% pa in August 2010 and 0.25% pa every six months thereafter, subject to the provision that the aggregate increase in the margin shall be limited to 1.50% pa.

The repayment of the Senior Refinancing Facility and Junior Refinancing Facility, regardless of where the facility is held within the BAA Group, is based on the terms of the Refinancing Facility Agreement. This states that repayment of the facilities are firstly applied in repayment of the initial credit facility to ensure the required capex headroom is met, then applied to refinancing facilities with a maturity date falling within 12 months of the date of prepayment and then applied to refinancing facilities in descending order of the final maturity date, until the Senior net indebtedness to total RAB is no more than or equal to 0.70 and the Junior net indebtedness to total RAB is no more than or equal to 0.85. The remaining proceeds are then applied to refinancing facilities in ascending order of the final maturity date. On disposal of Gatwick, 100% of the net proceeds are expected to be set against the refinancing facility.

## NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 16. BORROWINGS (continued)

At 31 December 2008, the aggregate amount outstanding under the £2.75 billion Designated Group Initial Credit Facility (comprising of the capital expenditure facility and working capital facility) used to fund capital expenditure was £250 million. On that date, the interest rate payable on this facility was equal to Libor plus a margin of 2.00% pa. In addition, there are contractual margin step ups of 0.25% pa in August 2010 and 0.25% pa every six months thereafter, subject to the proviso that the aggregate increase in the margin shall be limited to 1.50% pa. If there is no balance outstanding on the Refinancing Facilities the margin on the Initial Credit Facility shall be 1.00% pa.

As part of the refinancing in August 2008, the Company borrowed £435 million under a borrowing facility provided by the European Investment Bank ("EIB"), of which £417 million remained outstanding on 31 December 2008. The EIB facility is scheduled to be repaid at regular intervals over the period to 2019. The interest rate payable on the EIB facility is equal to Libor plus a margin of 0.40% pa, with the exception of a £13 million 6.212% fixed interest rate loan repayable in February 2010.

**Borrowings from group undertakings**

On 18 August 2008, £4.5 billion of existing bonds of BAA Airports Limited were cancelled and re-issued by BAA Funding Limited. In return an equivalent amount of financial indebtedness of the Company to BAA Airports Limited was cancelled and replaced by an Initial Borrower Loan Agreement (BLA) from BAA Funding Limited under which individual advances were made on substantially the same terms as the new Bonds issued on migration, after taking into account related interest rate, index linked and cross currency hedging instruments. The BLA advances from BAA Funding Limited to the Company are summarised below:

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| **Borrowings accreting in line with RPI** | | |
| Expiring in more than two years | **2,393.4** | - |
| **Fixed rate borrowings** | | |
| Expiring in more than two years | **2,042.8** | - |
| | **4,436.2** | - |

The effective interest rate on the new bonds and the BLA advances, after taking into account related hedging instruments, varies between 6.28% and 7.75%.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 16. BORROWINGS (continued)

All of the above facilities are carried at amortised cost.

The Company together with Gatwick Airport Limited and Stansted Airport Limited, had £2.5 billion undrawn committed borrowing facilities available at 31 December 2008 in respect of which all conditions precedent had been met at that date.

In addition there is a gross overdraft limit between Heathrow Airport Limited, Gatwick Airport Limited and Stansted Airport Limited up to a maximum gross balance of £75 million.

**Covenants**

The Refinancing Facilities and the Initial Credit Facilities used to fund capex, are required to comply with the covenants under the Common Terms Agreement (CTA) of the Designated Group. There are certain covenant threshold requirements under the CTA which must be maintained:

| | | Forecasting event | Trigger event | Financial covenant[1] |
|---|---|---|---|---|
| Senior Interest Cover Ratio | To be greater than | 1.60 | 1.40 | 1.05 |
| Junior Interest Cover Ratio | To be greater than | 1.40 | 1.20 | N/A |
| Senior Net Indebtedness to Total RAB (RAR) | To be less than | 0.70 | 0.70 | 0.925 |
| Junior Net Indebtedness to Total RAB (RAR) | To be less than | 0.85 | 0.85 | N/A |

[1] Three year period average for Interest Cover Ratio from the three year period ending 31 December 2012.

Following the occurrence of a Trigger Event (as defined above) which is continuing, the Obligors are prohibited from making certain payments ("Restricted Payments"), mainly in relation to payments in respect of subordinated debt and payments to other BAA group companies outside of the security group, and are obliged to make repayments of amounts outstanding under the senior debt facilities of the security group, equivalent to the amount of restricted payments that would otherwise have been made.

Following the occurrence of a Forecasting Event (as defined above) which is continuing, the Investor Report issued under the CTA shall disclose information of all forward looking ratios until the end of the current regulatory period, rather than just the 12 month forward looking ratio. In addition, the Investor Report and Compliance Certificate issued under the CTA shall disclose the forecasted restricted payments which are to be made within the 90 days commencing from the delivery of such report.

All covenants have been tested and complied with as at 31 December 2008.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 17. PROVISIONS FOR LIABILITIES

| | Deferred tax (a) £m | Obligations under land purchase (b) £m | Reorganisation Costs (c) £m | Cross Border Lease (d) £m | Pension Costs (e) £m | Total £m |
|---|---|---|---|---|---|---|
| 1 January 2008 | 488.3 | 99.1 | 27.7 | - | - | 615.1 |
| (Credited)/charged to profit and loss account (Note 7/4) | (77.1) | - | (4.0) | - | 11.8 | (69.3) |
| Utilised in the year | - | (1.4) | (5.3) | - | - | (6.7) |
| Unwinding of discount charged and capitalised (Note 6) | - | 12.8 | - | 2.2 | - | 15.0 |
| **31 December 2008** | **411.2** | **110.5** | **18.4** | **2.2** | **11.8** | **554.1** |

### (a) Deferred Taxation

Analysis of the deferred tax balances are as follows:

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| Excess of capital allowances over depreciation | **412.2** | 489.7 |
| Other timing differences | **(1.0)** | (1.4) |
| | **411.2** | 488.3 |

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| Tax on chargeable gains if investment properties were sold at their current valuations | **222.8** | 239.3 |
| Tax on rolled-over gains if replacement assets were sold at their current valuations | **5.7** | 5.7 |
| | **228.5** | 245.0 |

Provision has been made for deferred taxation in accordance with FRS 19.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 17. PROVISIONS FOR LIABILITIES (continued)

**(a) Deferred Taxation (continued)**
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. Taxable gains will crystallise only if the property were sold without it being possible to claim rollover relief. The total amount of tax unprovided for is £228.5 million (2007: £245 million). At present it is not envisaged that this tax will become payable in the foreseeable future.

**(b) Obligations under land purchase**
Provision relates to the acquisition of land for the construction of Terminal 5. The operational assets employed by the vendor of this land have been relocated, and provision has been made for the present value of the estimated payments to be made over 29 years to the vendor in compensation for this. The provision of £111 million (2007: £99 million), net of discount, is expected to be utilised accordance to the following profile:

| | 31 December 2008 £m | 31 December 2007 £m |
|---|---|---|
| Within one year | **7.5** | 6.2 |
| One to two years | **7.3** | 6.1 |
| Two to five years | **22.1** | 18.6 |
| Five to ten years | **25.9** | 25.7 |
| Over ten years | **47.7** | 42.5 |
| | **110.5** | 99.1 |

**(c) Reorganisation costs**
The Company commenced implementing its restructuring programme 'Simplifying the Organisation' in late 2007. Costs associated with this and other restructuring programmes are for severance and pension payments only. The amount released resulted from higher staff turnover than historic experience and lower than expected cost for each reduction in headcount. All amounts are expected to be utilised in 2009. See note 4 for further details.

**(d) Cross Border Lease**
A provision of £2.2 million (2007: £nil) has been made for the early termination of a lease agreement entered into by the Company in 1998 in relation to rolling stock owned by the Company and operated by its subsidiary company, Heathrow Express Operating Company Limited. On 13 January 2009, the lease agreement was terminated, as a result of a credit rating downgrade of a third party obligor under the lease agreement.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 17. PROVISIONS FOR LIABILITIES (continued)

**(e) Pension Costs**

A provision of £11.8 million (2007: £nil) 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 was made in the year. This provision, which was held by BAA Airports Limited in previous years has been charged to the Company as a result of the Shared Services Agreement, as BAA SP's airports are committed to fund any unfunded pension plan obligation of BAA Airports Limited (refer to Note 1 for details). This provision is based on the Company's share of the unfunded scheme valuation performed for BAA Airports Limited and will only be settled when the cash outflow is requested by BAA Airports Limited.

### 18. CALLED UP SHARE CAPITAL

| | **31 December 2008 £m** | 31 December 2007 £m |
|---|---|---|
| **Authorised** | | |
| 380,200,100 ordinary shares of £1 each | **380.2** | 380.2 |
| **Called up, allotted and fully paid** | | |
| 380,200,002 ordinary shares of £1 each | **380.2** | 380.2 |

### 19. SHARE PREMIUM ACCOUNT

| | **2008 £m** |
|---|---|
| **1 January 2008 and 31 December 2008** | **23.2** |

### 20. RESERVES

| | **Profit and loss reserve £m** | **Revaluation Reserve £m** | **Total £m** |
|---|---|---|---|
| 1 January 2008 | 436.6 | 1,128.6 | 1,565.2 |
| Loss for the financial year | (237.1) | - | (237.1) |
| Revaluation deficit | - | (59.1) | (59.1) |
| Revaluation adjustment | - | (2.1) | (2.1) |
| **31 December 2008** | **199.5** | **1,067.4** | **1,266.9** |

During the year, previously recognised valuation gains amounting to £2.1 million were released as a result of the reclassification of a number of investment properties to BAA Group occupied properties.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
# For the year ended 31 December 2008

## 21. COMMITMENTS

### Capital

Capital expenditure contracted commitments amount to £81.8 million (2007: £109.9 million).

### Commitments under operating leases

At 31 December 2008, the Company was committed to making the following payments during the next year in respect of operating leases.

| | **Land & buildings 31 December 2008 £m** | **Other leases 31 December 2008 £m** | Land & buildings 31 December 2007 £m | Other leases 31 December 2007 £m |
|---|---|---|---|---|
| Leases which expire: | | | | |
| - within one year | **1.6** | **0.2** | 0.5 | 0.1 |
| - within two to five years | **2.6** | **1.0** | 3.7 | 1.0 |
| - after five years | **4.9** | **26.6** | 4.9 | 26.6 |
| | **9.1** | **27.8** | 9.1 | 27.7 |

### Other commitments

In June 2006, the UK Government announced its conclusions for 2006-2012 night flights regime at BAA Group's London airports. The regime commits BAA to introducing a new domestic noise insulation scheme at Heathrow, Gatwick and Stansted to address the impact of night flights on local communities. Based on the BAA Group's evaluation, payments under this scheme are estimated to total £62.0 million, spread over the five year period commencing 2008. The maximum expected payment in relation to Heathrow is £59.7 million.

In addition, there are live blight schemes to support the market for housing in areas identified for potential future runways at Heathrow airport. Obligations under these schemes will only crystallise once the Company announces its intention to pursue a planning application for a new runway. In respect of Heathrow, the government has announced support for the need for a third runway at Heathrow and the Company is now reviewing the implications of the announcement with the intention of reaching a point where we will announce an intention to submit a planning application. This is likely to occur within the next eighteen months.

The January 2009 Government Announcement for Adding Capacity at Heathrow requires the 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 which will experience an increase in noise of 3dBA or more.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 21. COMMITMENTS (continued)

Until further consultation is carried out with the local communities, the consequence of the significance of the costs related to the implementation of these schemes remain uncertain. As a result it is too early to quantify the Company's potential obligations under these schemes.

In July 2008, the wider BAA Group reached agreement with the Trustee of the BAA Airports Limited defined benefit pension scheme to contribute the lesser of £80 million per annum and the annual cost of accruing benefits (as calculated using the FRS 17 accounting standard) for a period of three years ending 31 December 2011. The Company expects to contribute approximately £43 million to the pension plan in the year ending 31 December 2009.

### 22. 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 £79 million at 31 December 2008 (2007: £7 million).

In addition to the above, in August 2008, the Company together with Gatwick Airport Ltd and Stansted Airport Ltd jointly issued a letter of credit amounting to £205 million under the Borrower Liquidity Facility Agreement, to cover interest payable to Supported Lenders.

The Company, together with Gatwick Airport Limited, Stansted Airport Limited, Heathrow Express Operating Company Limited, 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 the August 2008 refinancing documents and to the Subordinated Creditors under the Subordinated Facility Agreement dated April 2006. Each Obligor has also provided a guarantee in respect of the obligations of the other Obligors.

The Company, together with Gatwick Airport Limited, Stansted Airport Limited and Heathrow Express Operating Company Limited have provided a guarantee in favour of The Royal Bank of Scotland plc as Borrower Account Bank in respect of the liabilities of those companies under the Borrower Account Bank Agreement.

BAA Pension Trustee Company Limited (the BAA Pension Trustee) is a Borrower Secured Creditor and has a right to receive up to £300 million out of the proceeds of enforcement of the security granted by the Company as an Obligor, such right ranking *pari passu* with the Class A creditor of the Obligors.

Under the Shared Service Agreement hedging costs properly incurred by BAA Airports Limited in relation to the Employee Share Ownership Plan (ESOP) may be recharged to the Company. At 31 December 2008, the ESOP swap held in BAA Airports Limited had a fair value loss of £117 million. The Company may be obligated to settle its share of these amounts (approximately £65 million) 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.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 23. ULTIMATE PARENT UNDERTAKING AND CONTROLLING ENTITY

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 and the ultimate parent of FGP Topco Limited is Grupo Ferrovial, S.A. (Spain), which is the largest group to consolidate these financial statements.

The Company's results are also included in the consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2008, 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) Limited, BAA Limited and FGP Topco Limited for the year ended 31 December 2008.

Copies of the financial statements of FGP Topco Limited, BAA Limited, BAA (SH) Limited and BAA (SP) Limited may be obtained by writing to the Company Secretary at 130 Wilton Road, London, SW1V 1LQ.

### 24. QUASI SUBSIDIARIES

The Company and its intermediate parent, BAA Limited, have entered into a cross border lease and leaseback establishing a special purpose vehicle, Paddington Railcars Company Limited ('PRC') to act as an intermediate entity under various leasing arrangements. The Company has entered into an agreement to lease to and lease back from PRC the assets comprising the Heathrow Express rolling stock. The net book value of these assets at 31 December 2008 is £39.0 million (2007: £43.0 million). Since the activities of PRC are effectively under the direct control of the Company under the terms of the lease agreement, PRC is deemed a quasi-subsidiary of the Company. On 13 January 2009, the lease agreement was terminated, as a result of a credit rating downgrade of a third party obligor under the lease agreement.

PRC's results are included in the consolidated financial statements of BAA Limited for the year ended 31 December 2008.

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 25. SUMMARY CASH FLOW STATEMENT

| | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| **Net cash inflow from operating activities** | **532.5** | 581.2 |
| Net interest paid | **(131.6)** | - |
| Corporation tax received/(paid) | **16.0** | (11.3) |
| Dividends paid | **-** | (71.9) |
| Net capital expenditure | **(792.9)** | (878.8) |
| **Cash (outflow)/inflow before use of liquid resources and financing** | **(376.0)** | (380.8) |
| **Management of liquid resources** | | |
| Increase in short-term deposits | **(142.1)** | - |
| **Financing** | | |
| Long-term bank loans | **3,391.7** | - |
| Short-term bank loans | **43.3** | - |
| Repayment of short-term bank loans | **(17.6)** | - |
| Payment of loan arrangement fees | **(14.8)** | - |
| Decrease in amounts owed to group undertakings | **(2,895.5)** | 380.8 |
| **Movement in cash in the year** | **(11.0)** | - |

# NOTES TO THE FINANCIAL STATEMENTS (continued)
## For the year ended 31 December 2008

### 25. SUMMARY CASH FLOW STATEMENT (continued)

**Reconciliation of operating profit to net cash inflow from operating activities**

| | **Year ended 31 December 2008 £m** | Year ended 31 December 2007 £m |
|---|---|---|
| Operating profit | **174.9** | 277.9 |
| Depreciation – ordinary | **346.3** | 203.6 |
| Depreciation – exceptional | **83.6** | 66.3 |
| Increase in stock and debtors | **(120.0)** | (9.5) |
| Increase in creditors | **45.8** | 32.2 |
| Loss on tangible fixed asset disposals | **0.8** | 0.3 |
| Increase in provisions | **1.1** | 10.4 |
| Net cash inflow from operating activities | **532.5** | 581.2 |

**Note**
For the purpose of the summary cash flow statement, the movement in inter-company balances before the refinancing date are shown within the (decrease)/increase in amounts owed to group in the financing section of the cash flow as interest was charged/credited on the outstanding balance.

All amounts owed to BAA Airports Limited as at 31 July 2008 have been fully settled during the refinancing process.