

BAA (SH) LIMITED
Annual Report

For the year ended
31 December 2008

BAA (SH) LIMITED

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BAA (SH) LIMITED

Officers and Professional Advisors

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L Sanchez Salmeron (appointed 20 December 2007)
J Leo (appointed 20 December 2007)

Secretary

S Ooi (appointed 28 November 2008)

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BAA (SH) LIMITED

Business Review

BAA (SH) Limited ('BAA SH' or 'the Company' and together with its subsidiaries, 'the Group') is the holding company of BAA (SP) Limited ('BAA SP'), which itself is the holding company for the Security Group that owns the Designated Airports comprising the UK regulated airports of Heathrow, Gatwick and Stansted. It also operates the Heathrow Express rail service between Heathrow and Paddington, London. In addition BAA (SP) Limited is the holding company of BAA Funding Limited, which is the bond issuer for the Security Group. BAA (SH) Limited is an indirect subsidiary of BAA Limited (formerly Airport Development and Investment Limited) ('BAA' together with its subsidiaries, 'the BAA Group').

The Company was incorporated on 20 December 2007. During 2008, as part of the group's wider BAA refinancing and related reorganisation, the company acquired the BAA (SP) Limited Group which had already been formed as part of the reorganisation and is the owner of the Designated Airports. In addition, £1.6 billion of Subordinated Debt, previously held at BAA Limited, was transferred to BAA (SH) Limited and on-lent to BAA (SP) Limited in the form of a debenture.

The financial statements of the Group are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements. In order to present a true and fair view of BAA SH the abovementioned sale and purchase transaction or group reorganisation, has been merger accounted. Comparative financial information has been provided as if the Group had always existed in its current form.

The ultimate UK parent undertaking of the Company and its subsidiaries was before, and remains after the BAA group reorganisation, FGP Topco Limited.

On 17 September 2008, BAA announced plans to sell Gatwick airport given the Competition Commission's provisional findings in its inquiry on the supply of airport services by BAA in the UK. A number of bids were recently received relating to the proposed disposal which are currently being reviewed. A further announcement about the disposal process will be made at the appropriate time.

On 7 August 2008, Heathrow Airport Limited acquired from BAA Airports Limited, a fellow group company, ownership of Heathrow Express Operating Company Limited. As this transaction is not deemed to be part of the group reorganisation process referred to above, the Group has applied acquisition accounting in relation to this transaction.

This business review is presented under three sections:

Management review and outlook – overview of the year ended 31 December 2008, along with the key factors likely to impact the Group in 2009.

Financial performance – presentation and explanation of the key drivers behind the adjusted financial performance reported for the year ended 31 December 2008 and analysis of the financial position of the Group as at that date. The Group's accounting and reporting policies and procedures are also considered.

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

Transforming the Group's airports

The Group's strategy is to deliver sustained improvements in passengers' experience and airlines' operations through a combination of substantial investment in modern airport facilities and improved service standards. It also intends to deliver further investment targeted at enhancing capacity to meet the expected continued growth in air travel.

This strategy will ensure that its airports provide customers with superior facilities relative to competitors in the UK and elsewhere, particularly in Europe, encouraging greater utilisation of the Group's airports by passengers and supporting the Group's long term growth ambitions.

Developing modern airport facilities

In 2008, the most significant development in the Group's airport facilities was the commissioning of Terminal 5 at Heathrow, the first new terminal at the airport for over 20 years. Despite the difficulties around 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 for overall passenger satisfaction.

The opening of Terminal 5 has also provided the spare capacity at Heathrow to enable the Group to invest in improving service across the whole airport in the next few years. Over the five year period to 31 March 2013, the Group expects to invest £4.8 billion (in 2008/09 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 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').

These investments 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 the Group's airline customers to enhance efficiency and profitability

The recent confirmation by the Secretary of State for Transport of the UK government's support for the development of a third runway with additional terminal facilities is a key step towards ensuring Heathrow continues to play a key role in meeting long term aviation demand in the UK and the development of the wider UK economy.

The Group is committed to transforming other airports in its portfolio. For example, in 2008 £114 million was invested at Stansted which included in particular the extension to its arrivals area to provide additional capacity and enhanced retail layout. Plans for the longer term growth of Stansted were supported by approval in October 2008 to increase passenger traffic levels at the airport, using existing facilities, from 25 million to 35 million per annum.

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Management review and outlook (continued)

Review of 2008 (continued)

There are also plans to expand capacity at Stansted beyond a passenger throughput of 35 million per annum through the provision of a second runway and terminal (Stansted Generation 2) which will have an initial capacity for about 10 million passengers per annum. A planning application for the development was submitted in 2008 and announcement of the start date of the related public enquiry is currently outstanding, pending the government's consideration of the implications for the timing of the inquiry of a potential change of ownership of Stansted as a result of the Competition Commission's recommendation that BAA should divest, amongst others, Stansted Airport.

Service standards

Consistent delivery of high service standards is a key strategic priority for the Group, underpinning the experience of passengers and airlines and supporting the Group's long term growth ambitions. Major service improvements in 2008 included the impact of Terminal 5's commissioning and occupation and the benefits of operating at Heathrow and Gatwick under the strengthened service quality rebate schemes 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, ranking it amongst the best airport terminal facilities in Europe. 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. Gatwick's rating has also improved relative to the prior year.

The service quality rebate schemes applying at Heathrow and Gatwick from 1 April 2008 were 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 an airport. Stansted was also focused on preparing for the introduction of the new service quality rebate scheme that has applied at Stansted Airport since 1 April 2009.

Further evidence of improving service standards can be seen from the rapid reduction in rebates paid by Heathrow and Gatwick following the introduction of these stricter schemes. The level of rebates (net of bonuses earned) in the nine months to 31 December 2008 was £7.8 million with the level of rebates declining from £4.7 million in the 3 months to 30 June 2008 to just £2.3 million and £0.8 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% and 95.2% of the time at Heathrow and Gatwick respectively in the nine months to 31 December 2008 compared with the required 95.0% service standard.

Passenger traffic trends

Trends in passenger traffic for 2008 across the Group's airports as well as by market served are compared against performance in 2007 in the table below.

(figures in millions unless stated otherwise)	Year ended 31 December 2008	Year ended 31 December 2007	Change (%) ¹
Passengers by airport			
Heathrow ²	66.9	67.9	(1.4)
Gatwick	34.2	35.2	(2.8)
Stansted	22.3	23.8	(6.0)
Total passengers¹	123.4	126.8	(2.6)
Passengers by market served			
UK	11.7	12.3	(5.6)
Europe ³	68.5	70.5	(2.9)
Long haul	43.3	43.9	(1.5)
Total passengers¹	123.4	126.8	(2.6)

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

² These numbers do not include passengers of the Heathrow Express and Heathrow Connect rail services which increased by 0.3% to 5.42 million passengers during the year (2007: 5.40 million).

³ Includes North African charter traffic.

Traffic performance across all the Group's airports 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. Across the European aviation industry, long haul traffic maintained its recent trend of outperforming other market segments and continued growing despite the difficult market conditions. The Group benefited from this trend particularly at Heathrow, where long haul traffic increased, reflecting its position as a major global hub airport for long haul services. This is also beneficial for the Group's financial performance as long haul traffic generates higher levels of aeronautical and retail income. However, other market segments were more affected, including the charter market and domestic and other short haul services.

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Management review and outlook (continued)

Review of 2008 (continued)

Overall, passenger traffic across all three of the Group's airports declined 2.6% in 2008 to 123.4 million (2007: 126.8 million).

At Heathrow, 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%). 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).

Gatwick saw passenger numbers decline 2.8% to 34.2 million (2007: 35.2 million) reflecting the loss, starting in April 2008, of approximately 40% of its US services to Heathrow. It also lost traffic later in the year as a result of the collapse of three carriers (XL Airways, Zoom Airlines and Sterling Airlines). These losses were in part offset by a surge in new services to Ireland and the take up of vacated slots by existing low cost airlines. At Stansted, passenger numbers declined 6.0% to 22.3 million (2007: 23.8 million) due to major airlines reducing operations in the face of weakening demand and high fuel prices and the collapse of carriers such as Maxjet and Eos Airlines.

Across the Group's airports, long haul traffic declined just 1.5% to 43.3 million passengers (2007: 43.9 million), with North Atlantic routes seeing a 1.7% reduction and other long haul destinations performing slightly better, with a 1.3% decline. The strongest growing regional markets were the Middle East and South America which were up 4.0% and 5.1% respectively on 2007. European passenger traffic declined 2.9% to 68.5 million (2007: 70.5 million) particularly due to weakness in the charter market. Domestic traffic declined 5.6% to 11.7 million passengers (2007: 12.3 million).

Retail activities

The Group's retail activities proved resilient in 2008 to the worsening economic environment reflecting a number of factors specific to the Group's airports.

These include the significant recent expansion and upgrade of the Group's retail facilities. In particular, Heathrow Terminal 5 has 23,000m² of the highest quality retail space at Heathrow out of the airport's total of 66,000m². Terminal 5 has only welcomed its full complement of passengers since October 2008 when British Airways completed its planned moves from other terminals. Elsewhere at Heathrow, 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. Other recent increases and improvements in retail facilities across the Group's airports include the South Terminal departure lounge extension at Gatwick and the new arrivals area at Stansted.

The principal drivers of retail spend in the Group's airports 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, and combined with more efficient check in procedures, giving more time in lounges, have also 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 participation (proportion who buy) and spend per passenger 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 final report called for structural and behavioural remedies as well as providing recommendations on regulatory and policy matters for consideration by other governmental bodies.

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. They are expected to be sold in sequence, beginning with Gatwick followed by Stansted followed by either Edinburgh or Glasgow.

Suggested behavioural remedies for Heathrow include strengthening consultation processes with the airlines and provisions on quality of service which have been already largely implemented. The CC has also recommended that the Department for Transport ('DfT') consider adopting a licence based regime of economic regulation of UK airports.

On 18 May 2009, BAA applied to the Competition Appeal Tribunal to review the CC's report on two separate grounds. The first was that the report is affected by apparent bias because of links between a member of the CC panel and an organisation interested in acquiring the airports that BAA is required to sell. The second was that the CC failed to take into account the adverse financial impact of introducing competition, in particular by requiring BAA to sell three airports within two years in the current financial and economic circumstances.

Gatwick disposal

Given the CC's findings earlier in its investigation, on 17 September 2008, BAA announced plans to sell Gatwick airport. A number of bids were recently received relating to the proposed disposal which are currently being reviewed. The sale process is continuing notwithstanding the application to the Competition Appeal Tribunal and a further announcement about the disposal process will be made at the appropriate time.

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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 with its current consultation process continuing until 5 June 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 key objectives of the review include improving the passenger experience (in particular a stronger focus on putting the passenger first across the whole journey). It is also seeking to encourage appropriate and timely investment in additional capacity to help deliver economic growth in line with wider Government policy and to address the wider environmental impacts of aviation and airport development.

The regulatory review is likely to lead to 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. It is also aiming to establish a regulatory environment that more explicitly supports the financial profile of efficient airport operators for which, among other features, introduction of a new duty on the regulator to ensure licence holders can finance their activities is proposed. The DfT is also consulting on the merits of introducing a special administration regime for a limited number of major airports.

Whilst there may be a change in law prior to the end of the current price control periods for the Group's airports, the DfT has made clear that tariff arrangements for these periods will not be re-opened.

Aeronautical charges at Heathrow and Gatwick for five years to 31 March 2013 ('fifth quinquennium' or 'Q5')

In March 2008, the CAA published its price control review for Heathrow and Gatwick for the five years to 31 March 2013. In its proposals, a pre-tax real cost of capital of 6.2% at Heathrow and 6.5% at Gatwick 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. For Gatwick, the corresponding figures are RPI+21.0% and RPI+2.0% per annum.

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
Heathrow	£10.36	£12.80	£13.72	£14.76	£15.84	£16.99
Gatwick	£5.61	£6.79	£6.92	£7.06	£7.20	£7.34

The significant one-off increase in the aeronautical charges reflects the major capital programmes being undertaken by the Group at Heathrow and Gatwick 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 Group 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 and £0.70 per passenger at Heathrow and Gatwick respectively.

The higher charges for Q5 were 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.

Aeronautical charges at Stansted for five years to 31 March 2014

In March 2009, the Civil Aviation Authority ('CAA') issued its final price determination on aeronautical charges to apply at Stansted airport for the five years to 31 March 2014. Key features of the CAA's proposals include a permitted real pre-tax return on capital of 7.1% and maximum allowable aeronautical charges of £6.53 (in 2008/09 prices) per passenger for two years then increasing to £6.85 by 2013/14.

The CAA's proposals are based on a £90 million capital plan, in 2007/08 prices, primarily on Stansted's existing facilities, over the five years to 31 March 2014. The settlement includes the costs of the planning enquiry relating to Stansted Generation 2. However, the costs of constructing the runway and terminal following planning approval would require the re-opening of the price control at the appropriate time.

Approval for increased traffic at Stansted

On 9 October 2008, the Group's planning application to increase the number of air transport movements ('ATMs') permitted at Stansted was approved by the Secretary of State for Transport and the Secretary of State for Communities and Local Government. The new limit has been increased by 9.5% to 264,000 ATMs per year from 241,000. The Group expects this approval to allow annual passenger throughput to grow from around 25 million to around 35 million if all available ATMs are utilised by airlines operating at Stansted.

Reorganisation and Refinancing

In August 2008, BAA Limited successfully completed a corporate reorganisation and implemented a new financing structure for the group. Details of the refinancing are described below:

- A corporate reorganisation occurred to enable separate ownership and financing of the three London airports (the 'Designated Airports') of Heathrow, Gatwick and Stansted and BAA's other UK airports of Edinburgh, Glasgow, Aberdeen and Southampton.
- 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'), £0.4 billion of drawn loan facilities from the European Investment Bank and £4.5 billion of bonds assumed by BAA Funding Limited ('BAA Funding Limited Bonds') in exchange for bonds previously issued by BAA Airports Limited (formerly BAA Limited and prior to that, at the date of the issue of the bonds, the former BAA plc). BAA Funding Limited is the vehicle for future bond issuance (the 'Issuer').
- BAA (SP) Limited became a direct wholly-owned subsidiary of BAA (SH) Limited to which the Subordinated Facility of £1.566 billion (£1.966 billion prior to the refinancing) was migrated from BAA Limited (formerly Airport Development and Investment Limited). BAA (SH) Limited is itself an indirect wholly-owned subsidiary of BAA Limited and its ultimate parent company in the United Kingdom is FGP Topco Limited.

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Management review and outlook (continued)

Review of 2008 (continued)

Tax changes

The Finance Act 2008 implemented the phased removal and abolition of Industrial Building Allowances ('IBAs') which had been announced in the 2007 Budget. As a result the Group has been obliged to recognise an exceptional accounting loss in the form of a non-cash charge for deferred tax amounting to £1,175 million (£106 million of which relates to discontinued operations). This accounting impact will be neutral in the long term as the loss will be offset in future years by reduced charges for deferred tax. The cash impact of the abolition of IBAs on the Group in 'quinquennium 5' is not material due to the transitional period regime applicable to 2011 and the low taxable income base of the Group. 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 £370 million.

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.

Deferral of commencement of Stansted Generation 2 public enquiry

The start of the public enquiry relating to the Stansted Generation 2 planning application was deferred from its original date of 15 April 2009. Announcement of a revised start date of the inquiry is currently outstanding, pending the government's consideration of the implications for the timing of the inquiry of a potential change of ownership of Stansted as a result of the Competition Commission's recommendation that BAA should divest, amongst others, Stansted Airport.

2009 traffic trends

In the four months ended 30 April 2009, the Group's airports reported a decline in passenger traffic of 7.8% to 34.6 million (2008: 37.6 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 the Group's airports were 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 6.4%, which represents a slight improvement on the traffic trend seen in the fourth quarter of 2008 when year on year passenger traffic declined 7.1%.

Amongst the individual airports, Heathrow saw reported and underlying traffic declines of 4.0% and 2.6% respectively, a resilient performance in challenging economic circumstances reflecting Heathrow's position as a major global hub airport for long haul services and an increase in the proportion of transfer traffic through the airport.

Gatwick experienced reported and underlying traffic declines of 11.5% and 10.2% whilst Stansted saw reported and underlying declines of 14.0% and 12.7%.

Results of BAA (SP) Limited for the three months ended 31 March 2009

On 5 May 2009 BAA (SP) Limited, the direct wholly owned subsidiary of BAA (SH) Limited, announced unaudited consolidated financial results for the three months ended 31 March 2009 prepared and presented under UK GAAP. These showed revenue increasing by 15.5% to £522.0 million (2008: £452.0 million) and Adjusted EBITDA (earnings before interest, tax, depreciation and amortisation and exceptional items) increasing 27.9% to £185.8 million (2008: £145.3 million). The performance reflected higher tariffs, robust retail performance and cost control offsetting lower passenger numbers.

Financial performance

Introduction

The following financial review, based on the consolidated financial statements of the Group, provides commentary on the performance of its airports during 2008. Whilst the Group represented by BAA (SH) and its subsidiaries did not exist until 2008, its accounts have been prepared including the adoption of merger accounting in relation to the group reorganisation that occurred in March 2008 and the refinancing completed in August 2008. This has enabled comparative financial information for 2007 to be provided as if the Group had always existed. The ultimate UK parent undertaking of the Group and its subsidiaries was before, and remains after the group reorganisation, FGP Topco Limited.

In order to provide a better understanding of the results of BAA SH and its subsidiaries, the following business commentary is on the adjusted performance which excludes the impact of certain re-measurements and exceptional items.

Statutory operating profit

Statutory operating profit fell by £230 million to £110 million (2007: £340 million).

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Financial performance (continued)

Basis of preparation of statutory results

Some of the significant events and programmes that are highlighted in this Business Review have particular impacts on the way in which the statutory financial results for 2008 have been presented. The main areas of impact were:

- Discontinued operations – On 17 September 2008, as a result of the CC's provisional findings in its inquiry into the supply of airport services by BAA in the UK, plans to sell Gatwick airport were announced. Therefore Gatwick airport has been classified as held-for-sale at the year end. As required under International Financial Reporting Standards ('IFRS'), the financial results of these operations have been classified as discontinued operations and reported separately in the statutory income statement and cash flow statement.
- Exceptional items and certain re-measurements (excluding Gatwick) include the following:
 - £1,069 million deferred tax charge arising as a consequence of the abolition of the Industrial Buildings Allowances
 - £147 million of fair value losses arising from the revaluation of investment property
 - £106 million principally relating to accelerated depreciation on Heathrow Terminals 1 and 2, and Heathrow Terminal 5 operational readiness/launch costs
 - £87 million of fair value gains on derivative financial instruments
 - £13 million relating to accumulated past service pension costs

Basis of preparation of adjusted financial results

In order to provide a clearer indication of the performance of the businesses of the Group owned for the whole of 2008, the following commentary on revenue, operating costs and operating profit is based on the Adjusted performance of the Group. Adjusted is before exceptional items and certain re-measurements but adding back Gatwick.

Summary Adjusted performance¹

	Year ended 31 December 2008	Year ended 31 December 2007	Change %
Adjusted revenue (£ million)	2,292	1,976	16.0
Adjusted EBITDA (£ million)	915	905	1.2
Adjusted operating profit (£ million)	485	607	(20.1)
Passenger traffic (million)	123.4	126.8	(2.6)
Net retail income (£ million)	554	553	0.2
Net retail income per passenger ²	£4.49	£4.36	2.9

Summary statutory results for the period

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m	Change %
Revenue – continuing operations	1,827	1,566	16.7
Operating profit before exceptional items and certain re-measurements	373	510	(26.9)
Operating profit before certain re-measurements	257	353	(27.2)
Operating profit	110	340	(67.6)
Net financing costs	(499)	(195)	155.9
(Loss) / profit before tax	(389)	145	(368.3)
(Loss) / profit after tax – continuing operations	(1,342)	199	(774.4)
Net (loss) / profit from discontinued operations	(92)	74	(224.3)
Consolidated (loss) / profit for the period	(1,434)	273	(625.3)
Cash generated from continuing operations	638	654	(2.4)
Net cash from operating activities	758	806	(6.0)
Capital expenditure ³	919	976	(5.8)
Net debt ⁴	10,151	10,042	1.1

¹ Adjusted performance includes Gatwick and is stated before exceptional items and certain re-measurements.

² Defined as net retail income divided by the number of passengers with percentage change calculated using unrounded numbers.

³ Capital expenditure includes intangible assets and excludes Gatwick.

⁴ Continuing operations excluding interest payable.

BAA (SH) LIMITED

Financial performance (continued)

Reconciliation of statutory results to adjusted operating profit performance

The directors consider that reporting revenue and operating profit before exceptional items and certain re-measurements more accurately reflects the underlying performance of the Group's business. As such, Adjusted revenue and operating profit have been determined by adjusting for these items as well as by adding back Gatwick to the statutory results:

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m	Change %
Revenue			
Statutory (a)			
Gatwick	1,827	1,566 ¹	16.7
Adjusted revenue (d)	465	410	13.4
Operating costs	2,292	1,976	16.0
Statutory (b)			
Net exceptional items	1,570	1,213 ¹	29.4
Gatwick (excluding exceptional items)	(116)	(157)	(26.1)
Adjusted operating costs (e)	353	313	12.8
Other operating income	1,807	1,369	32.0
Statutory (c)			
Certain re-measurements	(147)	(13) ¹	1030.8
Adjusted other operating income (f)	147	13	(1030.8)
Operating profit	-	-	-
Statutory (a - b + c)	110	340 ¹	(67.6)
Adjusted operating profit (d - e + f)	485	607	(20.1)

¹ Comparative income statement information includes Gatwick in discontinued operations

Revenue

Adjusted revenue during the year increased 16.0% to £2,292 million (2007: £1,976 million). This increase reflects a 28.8% rise in aeronautical income, a 2.6% increase in gross retail income and 6.7% increase in other income compared to 2007, despite a 2.6% reduction in passengers. These revenue streams are discussed further in the following sections of this financial performance commentary.

	Year ended 31 December 2008 £m	Year ended 31 December 2007 ¹ £m	Change %
Aeronautical income	1,209	939	28.8
Retail income	591	576	2.6
Other income ²	492	461	6.7
Total	2,292	1,976	16.0

¹ Comparative income statement information includes Gatwick in discontinued operations.

² Other income includes railway revenue of £86 million (2007: £80 million).

BAA (SH) LIMITED

Financial performance (continued)

Aeronautical income

Aeronautical income increased 28.8% to £1,209 million for the year ended 31 December 2008 (2007: £939 million). The average aeronautical income per passenger increased 32.2% to £9.79 (2007: £7.41).

Aeronautical income summary (by airport)

	Aeronautical income			Per passenger ¹		
	Year ended 31 December 2008	Year ended 31 December 2007	Change %	Year ended 31 December 2008	Year ended 31 December 2007	Change %
	£m	£m		£	£	
Heathrow	835	634	31.8	12.48	9.34	33.7
Gatwick	228	178	28.6	6.68	5.05	32.4
Stansted	145	127	14.2	6.50	5.34	21.7
Total airports	1,209	939	28.8	9.79	7.41	32.2

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

Growth in aeronautical income was driven by revised tariffs proposed by the CAA for Heathrow and Gatwick for the five year regulatory period commencing on 1 April 2008. As a result, aeronautical income at these airports increased by 30.9% to £1,063 million (2007: £812 million). A significant element of the increase in aeronautical income at Heathrow and Gatwick reflected the inclusion in the regulatory settlement of the costs of the heightened security regime in place since 2006. In addition, £49 million of the increase reflected a rebasing of tariffs to include costs previously charged to airlines by NATS for aerodrome navigation services. The tariffs at Heathrow and Gatwick were also rebased to include services previously charged by the Group outside the aeronautical charges for both baggage infrastructure services and fuel levy.

At Stansted, aeronautical income increased by 14.2% to £145 million (2007: £127 million) primarily as a result of certain discounts on its aeronautical charges ceasing to apply from 1 April 2007.

Retail income

The Group's gross retail income increased 2.6% to £591 million (2007: £576 million). On a comparable basis, derived by deducting cost of sales from gross income to adjust principally for changes in car parking contractual arrangements, net retail income ('NRI') increased 0.2% to £554 million (2007: £553 million). NRI per passenger rose 2.9% to £4.49 against £4.36 for the comparative year.

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

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

	Year ended 31 December 2008	Year ended 31 December 2007	Change ¹ %
	£m	£m	
Gross retail income	591	576	2.6
Less retail expenditure	(37)	(23)	60.9
Net retail income	554	553	0.2
Passengers (million)	123.4	126.8	(2.6)
Net retail income per passenger ¹	£4.49	£4.36	2.9

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

BAA (SH) LIMITED

Financial performance (continued)

Analysis of net retail income

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m	Change %
Car parking	128	134	(4.5)
Duty and tax free	127	124	2.4
Airside specialist shops	79	74	6.8
Bureaux de change	51	53	(3.8)
Catering	53	52	1.9
Landside shops and bookshops	42	41	2.4
Advertising	34	32	6.3
Car rental	16	16	-
Other retail	24	27	(11.1)
Total	554	553	0.2

NRI per passenger was stable or improved across all the Group's airports, with Gatwick enjoying the strongest growth of 7.2% and Stansted 4.7% growth. Heathrow maintained NRI per passenger despite a decline in car parking income due to a shift towards public transport and lower domestic passengers and a year of disruption as significant terminal refurbishment and airline moves between terminals occurred.

By activity, the main driver of the retail performance in the year to 31 December 2008 was airside and landside shops (including duty free) where revenue increased 3.8% to £248 million (2007: £239 million) or 6.6% per passenger. Airside specialist shops performed particularly well. Car parking revenue was £128 million (2007: £134 million) with the reduction due to the factors outlined above in relation to Heathrow.

Other income

Other income increased 6.7% in the year to 31 December 2008 to £492 million (2007: £461 million). This increase reflected in particular £12 million in income resulting 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 rail income from the Heathrow Express and Heathrow Connect rail services increased 8.3%.

Operating costs

The Group's Adjusted Operating Costs for the year ended 31 December 2008 were £1,807 million (31 December 2007: £1,369 million).

Adjusted operating costs

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m	Change %
Staff costs	446	372	19.9
Rents and rates	130	99	31.3
Utility costs	82	72	13.9
Maintenance expenditure	163	125	30.4
Retail expenditure	37	23	60.9
Depreciation and amortisation	430	298	44.3
Other costs ¹	519	380	36.6
Group adjusted operating costs	1,807	1,369	32.0

¹ Includes £74 million (2007: £nil) related to re charging of aerodrome navigation services ('ANS') provided by NATS and the cost of services for passengers with reduced mobility ('PRM').

Adjusted operating costs, excluding depreciation and amortisation, in the year to 31 December 2008 increased 28.6% to £1,377 million (2007: £1,071 million). There was a 19.9% increase in staff costs to £446 million (2007: £372 million) concentrated primarily at Heathrow, which in addition to the opening of Terminal 5 was related to the costs of increased numbers of security personnel that were required to achieve the security service standards under the new Service Quality Rebate ('SQR') schemes. The increases in rents and rates, utility costs and maintenance expenditure reflects the opening of Terminal 5, higher unit costs for utility services and increased maintenance costs partly driven by the new SQR schemes. Retail expenditure increased due to increased expenditure relating to changes in the contractual structure for car parking contracts. Other costs include an additional £74 million in costs relating to aerodrome navigation services ('ANS') and services for PRM which were sourced previously directly by the airlines. These are reimbursed through aeronautical charges for ANS and other income for PRM, as mentioned above. Other costs also reflects increased cleaning cost of £13 million due to principally inclusion of Terminal 5 operations in 2008 in addition to running the other four Heathrow terminals.

BAA (SH) LIMITED

Financial performance (continued)

Adjusted EBITDA

Adjusted EBITDA for the year to 31 December 2008 increased 1.3% to £916 million (2007: £904 million).

Performance by segment

On a segmental basis, Adjusted revenue and Adjusted EBITDA are set out below:

Adjusted segmental analysis

	Year ended 31 December 2008		Year ended 31 December 2007		Adjusted Revenue %	Change Adjusted EBITDA %
	Adjusted Revenue £m	Adjusted EBITDA ¹ £m	Adjusted Revenue £m	Adjusted EBITDA ¹ £m		
Heathrow ^{2,3}	1,568	635	1,324	636	18.4	0.2
Gatwick	465	159	410	154	13.4	3.3
Stansted	259	117	242	114	7.0	2.6
Other operations ⁴	-	5	-	-	-	-
Total	2,292	915	1,976	905	16.0	1.3

¹ Adjusted EBITDA is earnings before interest, tax, depreciation, amortisation and exceptional items.

² Heathrow Express and Heathrow Connect rail services are included within the Heathrow Airport segment. The rail contribution to Heathrow's revenue and adjusted EBITDA for the year was £86 million (2007: £80 million) and £5 million (2007: £21 million) respectively.

³ This amount excludes £8 million intercompany revenue received from Heathrow Express Operating Company Limited (HEX), as it is eliminated at Heathrow Airport Limited level since HEX was acquired by Heathrow Airport Limited during the year.

⁴ Other operations consist of HEX, BAA Funding Limited, BAA (AH) Limited, BAA (SP) Limited and BAA (SH) Limited, parent entity as well as inter-company elimination.

Statutory results

Exceptional items

Exceptional items are based on statutory results rather than adjusted results and relate to continuing operations.

There were a total of £116 million in net pre-tax exceptional charges to the income statement in 2008 (2007: £157 million). This is mainly due to £84 million of accelerated depreciation relating to the shortened asset lives of Terminals 1 and 2 at Heathrow given the Terminal 2A development, £22 million of Terminal 5 operational readiness costs, £13 million of pension charge. In addition, there was a £1,069 million deferred tax charge arising as a consequence of the abolition of Industrial Buildings Allowances ('IBAs').

Taxation

A number of changes to the UK corporation tax system were announced in the March 2007 Budget statement, some of which were enacted in the 2007 Finance Act and some in the 2008 Finance Act (refer to Review of 2008 section).

In particular, the UK Government announced that Industrial Buildings Allowances ('IBAs') would be abolished over three years from 1 April 2008. As a consequence, the Group has been obliged to recognise in 2008 an exceptional accounting loss in the form of a non-cash charge for deferred tax amounting to £1,175 million (£106 million of which relates to discontinued operations) following substantive enactment which occurred in July 2008. In effect, this accounting charge reflects as a one off loss the forfeiture of all the future tax relief on expenditure which was incurred before substantive enactment. There is no impact on cash in 2008 and the accounting impact will be neutral in the long term as the loss will unwind over the life of the underlying assets.

The cash impact of the abolition of IBAs on the Group in 'quinquennium 5' is not material due to the transitional period regime applicable to 2011 and the low taxable income base of the Group. 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), following the CC's comments in its report to the CAA dated 28 September 2007. Under the existing regulatory framework, the present value of the reduced cash flows for the existing assets would be approximately £370 million.

This loss has been recorded in accordance with IAS 12 – Income Taxes. However, the accounting treatment at present required for the abolition of IBAs differs significantly from that expected in the new IAS 12. The current exposure draft (issued in March 2009) indicates that a loss would not be required to be booked.

Before certain re-measurements, the ordinary tax credit for the period was £94 million (2007: £2 million). As well as the tax credit associated with losses before certain re-measurements, a tax credit of £22 million (2007: £52 million) has been recognised within certain re-measurements. This comprises of a deferred tax credit of £47 million arising from losses on investment properties and a tax charge of £25 million arising from gains on derivative financial instruments.

BAA (SH) LIMITED

Financial performance (continued)

Certain re-measurements

There was a net total of £60 million in certain re-measurement losses (pre-tax) which consists of £147 million in net fair value losses on investment property (excluding Gatwick) and £87 million in net fair value gains on derivative financial instruments.

Investment property valuation

Investment properties were valued at a fair value at 31 December 2008 by Drivers Jonas, Chartered Surveyors and Strutt and Parker, Chartered Surveyors. Investment property comprises mainly car parks and airside assets at the Group's airports and they are considered less vulnerable to market volatility. The investment property valuation (including Gatwick) at 31 December 2008 resulted in a loss of £190 million including £43 million related to discontinued operations (2007: £26 million including a gain of £39 million related to discontinued operations which is offset by losses in other operations). Refer to Note 10 of the financial statements.

Derivative financial instruments

A net fair value gain of £87 million on financial derivatives has been recognised within financing in the income statement (2007: £nil). This gain related primarily to index-linked swaps which are internally designated to hedge the BAA Funding Limited bonds but do not achieve hedge accounting under IFRS. The index-linked swaps also provide a commercial hedge of future RPI linked revenue.

Net finance costs

The Group's net finance costs, before fair value gain on financial instruments, were £586 million (2007: £195 million), after capitalised interest of £96 million (2007: £256 million). The higher annualised year on year net finance cost is primarily due to a lower capitalised interest charge. Capitalised interest reflects the Group's ongoing capital investment programme and related assets under construction, particularly Terminal 5 at Heathrow. The higher net finance cost also reflects £59 million of interest payable on the Subordinated Facility now held at BAA (SH) Limited which was held at BAA Limited in the prior year. The £1,600 million BAA (SP) Limited debenture recognised in borrowings as at 31 December 2007 is a result of the application of merger accounting with no interest charge impact in the year ended 31 December 2007.

Net interest paid

Net interest paid in the year to 31 December 2008 was £79 million (2007: £nil).

Dividend

BAA (SH) Limited paid an interim dividend of £702 million (28p per ordinary share) on 18 August 2008. Prior year dividend payments relate to payments made by Heathrow Airport Limited, Gatwick Airport Limited and Stansted Airport Limited to their previous immediate parent entity amounting to £151 million.

Summary cash flow

	Year ended 31 December 2008	Year ended 31 December 2007
	£m	£m
Cash generated from continuing operations	638	654
Taxation – group relief received	21	-
Cash generated from discontinued operations	136	152
Net cash from operating activities	795	806
Capital expenditure	(919)	(976)
Investing activities of discontinued operations ¹	(114)	(89)
Acquisition of Heathrow Express Operating Company Limited	(4)	-
Dividends paid	-	(151)
Net cash inflow from financing activities	424	410
Net increase in cash and cash equivalents	182	-

Balance sheet

At 31 December 2008, the Group had net liabilities of £57 million (2007: net assets of £2,406 million).

Balance sheet position

	31 December 2008	31 December 2007
	£m	£m
Total assets	15,307	14,625
Net (liabilities) / assets	(57)	2,406
Gross debt	10,318	10,042
Cash and cash equivalents	167	-
Net debt¹	10,151	10,042
Undrawn committed facilities	2,500	-

¹ Excluding interest payable, intra-group borrowings and debt and cash held by entities classified as assets held for sale. The balance as at 31 December 2007 includes £1,566 million due to the BAA (SP) Limited debenture treated as if it had been issued in the prior year as a result of the application of merger accounting.

BAA (SH) LIMITED

Financial performance (continued)

Capital expenditure

In 2008, the Group's airports incurred £1,034 million in capital expenditure (2007: £1,066 million) with £805 million at Heathrow, £115 million at Gatwick and £114 million at Stansted.

The major projects at Heathrow included the building of a tunnel between Terminal 5 and Terminal 3 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 Group 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.

At Gatwick major developments included completing the South Terminal departure lounge extension and starting the upgrade of the transit system that operates between the North Terminal and South Terminal.

At Stansted there was £61 million of expenditure on the existing infrastructure including the extension of the arrivals area to provide a better layout for capacity and retail. In addition, there was £38 million of expenditure for the Stansted Generation 2 project.

Regulatory Asset Base

The Regulatory Asset Base ('RAB') of the Group's airports is provided to the CAA and published as at 31 March each year in the regulatory accounts of Heathrow, Gatwick and Stansted airports. The RAB is also determined at 31 December each year for the purposes of calculating debt cover ratios under the Group's debt financing arrangements. The RAB is rolled forward between each date according to a formula set out by the CAA. Set out below are historic RAB figures for the three airports at 31 March 2008, from their regulatory accounts ended 31 December 2008.

	Heathrow	Gatwick	Stansted	Total
	£m	£m	£m	£m
31 March 2008	9,232	1,560	1,185	11,977
31 December 2008	9,661	1,578	1,222	12,461

Financing - excluding interest payable

Gross debt at 31 December 2008 was £10,318 million (2007: £10,042 million). At 31 December 2008, net debt was £10,151 million (31 December 2007: £10,042 million). The Group had outstanding interest rate swaps, including those held in Gatwick Airport Limited, of £4.4 billion, index-linked swaps of £2.2 billion and cross-currency swaps of £1.7 billion (in respect of €1 billion 2012, €750 million 2014 and €750 million 2018 bonds). The mark to market valuation of these derivatives at 31 December 2008 implied a net asset of £302 million (31 December 2007: a net asset of £nil).

Movement in gross debt – excluding interest payable

Below is a table summarising movements in gross debt of continuing operations in the period:

	£m
Gross debt 31 December 2007	10,042
Repayment of intercompany loans	(8,476)
Repayment of bank loans	(18)
Increase in bonds	4,499
Increase in bank loans	3,785
Increase in capex facilities	250
Fair value revaluation ¹	386
Issue fees	(181)
Amortisation of transaction costs, premiums and discounts	31
Gross debt 31 December 2008	10,318

¹ Foreign exchange revaluation of Euro denominated bonds

Liquidity

As at 31 December 2008, the Group had cash and cash equivalents of £167 million excluding cash held in assets held for sale (2007: £nil) and undrawn committed facilities of £2,500 million (2007: £nil).

Security and Guarantees

Heathrow Airport Limited, 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 at BAA SH under the Subordinated Facility. Each Obligor has also provided a guarantee in respect of the obligations of the other Obligors.

BAA (DSH) Limited (immediate parent entity of BAA (SH) Limited) and its subsidiaries (other than BAA Funding Limited and Heathrow Airport Community Board Insulation Limited), together with ADI Finance 2 Limited, BAA Limited, BAA Airports Holdco Limited and BAA Airports Limited are guarantors under the Subordinated Facility. All the guarantors, apart from ADI Finance 2 Limited, are party to transaction security which secures liabilities arising under the Subordinated Facility.

BAA (SH) LIMITED

Financial performance (continued)

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 Obligors, such right ranking *pari passu* with the Class A creditors of the Obligors.

BAA Airports Limited (formerly BAA Limited) has provided a guarantee to Deutsche Trustee Company Limited (the Bond Trustee) for itself and on behalf of the BAA Guaranteed Bondholders in respect of bonds with a final legal maturity of no later than 2018 issued by BAA Funding Limited.

BAA Funding Limited has provided security to the Bond Trustee (as trustee for the Issuer Secured Creditors).

Heathrow Airport Limited, 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.

Covenants

The Subordinated Facility contains customary restrictions on change of control and distributions to shareholders as well as financial covenants. Under this facility, the Group is required to maintain certain debt cover and a cash flow cover ratio. The required levels as at 31 December 2008 were less than 1:1 for the debt cover ratio and a minimum of 1.05:1 for the cash flow cover ratios.

The BAA Funding Limited Bonds, Refinancing Facilities and the Initial Credit Facilities used to fund capital expenditure are required to comply with the covenants under the Common Terms Agreement ('CTA'). 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 the Subordinated Facility 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 forecast 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.

Additional disclosures on risk management and hedging of borrowings are included in Notes 16 and 17.

Contingent liabilities

The Group has external contingent liabilities, comprising letters of credit, performance/surety bonds, performance guarantees and other items arising in the normal course of business amounting to £317 million at 31 December 2008 (2007: £7 million).

Included in the above, in July 1998, BAA Airports Limited and Heathrow Airport Limited entered into a cross-border lease and leaseback in relation to the Heathrow Express rolling stock owned by Heathrow Airport Limited. The companies guarantee payments that are defeased by a deposit of US\$59.4 million with Rabobank and US\$15 million in US Government securities. In addition, they guarantee early termination payments. The amount payable under this guarantee at 31 December 2008 was US\$12.3 million. The cross border lease transaction was terminated on 13 January 2009 with Heathrow Airport Limited making a termination payment of US\$3.3 million.

easyJet have obtained leave to bring a judicial review of the CAA's price cap determination for Gatwick Airport for Q5. The easyJet challenge relates principally to the amount of operating expenditure allowed. They maintain the CAA has not had sufficient regard to the recommendations of the Competition Commission and has unfairly and unlawfully allowed security cost submitted at a late stage of the review. The case was heard in the High Court in March 2009 with judgement expected shortly. If easyJet are successful it is likely the issue will be remitted to the CAA for their reconsideration. Should the CAA determine that the airport charges cap should be lower Gatwick Airport Limited would be required to rebate the amount of airport charges levied in excess of the amended cap. On the basis of legal advice received the Board is confident no such rebate will arise.

Under the Shared Service Agreement hedging costs incurred by BAA Airports Limited in relation to the Employee Share Ownership Plan (ESOP) may be recharged to the Group's airports. At 31 December 2008, the ESOP swap held in BAA Airports Limited had a fair value loss of £117 million. The Group may be obliged to settle its share of these amounts (£102 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.

Accounting and reporting policies and procedures

This annual report complies with the European regulation to report consolidated financial statements in conformity with International Financial Reporting Standards ('IFRS') from 1 April 2005 onwards. The consolidated results in the financial statements for the year ended 31 December 2008 are presented on an IFRS basis as adopted by the European Union, along with the comparative information for the year ended 31 December 2007. BAA (SH) Limited entity accounts are stated under UK GAAP. The Group's accounting policies and areas of significant accounting judgements and estimates are detailed within the financial statements.

BAA (SH) LIMITED

Risk management

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

Risk management in the BAA Group facilitates the identification, evaluation and effective management of the threats to the achievement of the BAA Group's purpose, vision, objectives, goals and strategies. The vision of risk management is to embed the awareness of risk at all levels of the organisation, in such a way that all significant business decisions are risk-informed. Particular emphasis is given to safety and security, environmental, commercial, financial, reputational and legal risks with the framework ensuring that the BAA 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 BAA 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 throughout the BAA Group. The BAA Group mitigates this risk by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading-edge security technology. The BAA Group 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.

Regulatory environment, legal and reputational risks

CAA regulation

As noted previously, the BAA Group's operations at Heathrow, Gatwick and Stansted airports are subject to regulatory review by the Civil Aviation Authority and Commerce Commission 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.

Part of the regulatory framework is the Group's involvement in constructive engagement with the airlines. In order to manage the risk of adverse airline relations, 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 BAA Group, 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 BAA Group breaching these regulations. Refer to the 'Review of 2008' section for details on the regulatory process and the Competition Commissions inquiry into the supply of airport services by BAA in the UK.

Capacity shortfall

Failure to secure necessary planning permissions would lead to the BAA Group having insufficient capacity to meet the expected demands of the industry resulting in increased congestion and declining passenger service. The BAA Group 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 Group's airports is dependent on the outcome of the regulatory settlements in 2013 for Heathrow and Gatwick and 2014 for Stansted.

Existing planning approvals provide for approximate passenger traffic growth at Heathrow (including Terminal 5) to 90 million, Gatwick to around 40 million and Stansted to around 35 million. BAA has announced details of its development proposal for Stansted Generation 2 ('SG2'). This proposal includes the provision of a second runway and terminal and will have an initial capacity for about 10 million passengers per annum. The planning application for this proposal is subject to a public inquiry the start date of which is expected to be announced by the government after consideration of the implications for the timing of the inquiry of a potential change of ownership of Stansted as a result of the Competition Commission's recommendation that BAA should divest, amongst others, Stansted Airport.

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 BAA Group 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, separate dedicated project teams (with relevant expertise and disciplines) for Heathrow and Stansted have been established to work closely with local communities, airlines and other interested parties.

BAA (SH) LIMITED

Risk management (continued)

Environment

Environmental risks need to be managed throughout the BAA Group as they have the potential to impact the BAA Group's reputation, and its licence to operate and to grow. The BAA Group 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 BAA Group works closely with a range of stakeholders to ensure that it reacts effectively to the challenges posed by the environmental agenda.

Commercial and financial risks

Capital projects

BAA recognises that failure to control key capital project costs and delivery could damage its financial standing and reputation. It 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 based on the Terminal 5 experience, specific additional controls 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. Similar controls will also be adopted for the Stansted Generation 2 and Heathrow Terminal 2A developments. 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 BAA Group. Since it is not possible to identify the timing or period of such an effect, the Group carries out evaluations through a series of scenario planning exercises.

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 Group is recognised. The Group 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 Group and new negotiations are currently taking place regarding a new pay deal covering the period from 1 April 2009 to 31 December 2009. The union negotiators have recommended that in a forthcoming ballot the relevant employees accept the proposals agreed with BAA. The Group could also be exposed in the short term to the effect of industrial action at key clients (i.e. airlines).

Treasury

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

Treasury operates on a centralised non-speculative risk basis. The treasury function is not permitted to speculate in financial instruments. Its purpose is to identify, mitigate and hedge treasury related financial risks inherent to the BAA Group's business operations. To achieve this, the BAA Group enters into interest rate swaps, cross currency swaps, index -inked swaps and foreign exchange spot and forward/swap transactions to protect against interest rate risk, foreign currency risk and future RPI related revenue. The primary treasury related financial risks faced by the Group which are the focus of treasury policies are summarised below:

(a) Interest rates

The Group maintains a mix of fixed and floating rate debt. At 31 December 2008, the level of fixed rate debt after hedging with derivatives was 76%.

(b) Foreign currency

For debt raised in foreign currencies, the Group uses cross-currency swaps to hedge the related interest and principal payments and 100% of the exposure is hedged in this way, subject to a de minimis limit. The Group uses foreign currency forward contracts to hedge material capital expenditure in foreign currencies once a project is certain to proceed. As at 31 December 2008, there were no significant unmatched exposures.

(c) Funding and liquidity

To ensure continuity of funding and flexibility, debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year. In August 2008, BAA Limited successfully completed a corporate reorganisation and implemented a new financing structure for the group. Details of the refinancing are described below:

- A corporate reorganisation occurred to enable separate ownership and financing of the three London airports (the 'Designated Airports') of Heathrow, Gatwick and Stansted and BAA's other UK airports of Edinburgh, Glasgow, Aberdeen and Southampton (the 'Non-designated Airports').
- 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'), £0.4 billion of drawn loan facilities from the European Investment Bank, and £4.5 billion of bonds assumed by BAA Funding Limited ('BAA Funding Limited Bonds') in exchange for bonds previously issued by BAA Airports Limited (formerly BAA Limited and prior to that, at the date of the issue of the bonds, the former BAA plc). BAA Funding Limited is the vehicle for future bond issuance (the 'Issuer').
- BAA (SP) Limited became a direct wholly-owned subsidiary of BAA (SH) Limited to which the Subordinated Facility of £1.566 billion (£1.966 billion prior to the refinancing) was migrated from BAA Limited (formerly Airport Development and Investment Limited). BAA (SH) Limited is itself an indirect wholly-owned subsidiary of BAA Limited and its ultimate parent company in the United Kingdom is FGP Topco Limited.

Risk management (continued)

(d) Covenants

Covenants are standardised wherever possible and are monitored on an ongoing basis with formal testing reported to the Board and Executive Committee. The Group continues to comply with all borrowing obligations and financial covenants.

(e) Counterparty credit

The Group's exposure to credit related losses, in the event of non-performance by counterparties to financial instruments, is mitigated by limiting exposure to any one party or instrument.

The Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short and long term credit ratings. Investment activity is reviewed on a regular basis and no cash and cash equivalents are placed with counterparties with credit ratings lower than A- / A-1. The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are held with counterparties with a credit rating below BBB+ / A.

By order of the Board



Jose Leo
Director

29 May 2009

BAA (SH) LIMITED

Report of the Directors

BAA (SH) Limited Annual Report 31 December 2008

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

Principal activities

BAA (SH) Limited ('BAA SH' or 'the Company' and, together with its subsidiaries 'the Group') is the holding company of BAA (SP) Limited ('BAA SP'), which is a holding company itself for the Security Group that owns the Designated Airports comprising the UK regulated airports of Heathrow, Gatwick and Stansted and operates the Heathrow Express rail service between Heathrow and Paddington, London. BAA (SP) Limited is also the holding company of BAA Funding Limited, which is the bond issuer for the Security Group. The principal activities of the Group are the provision and management of airport facilities in the UK. The Group is also involved in airport-related property development. BAA (SH) Limited is an indirect subsidiary of BAA Limited. The ultimate UK parent undertaking of the Company and its subsidiaries was before, and remains after the group reorganisation discussed on page 7, FGP Topco Limited.

A review of the progress of the Group's business during the year, the key performance indicators, principal business risks and likely future developments are reported in the Business Review on pages 4 to 16.

Results and Dividends

The statutory results for the year are set out on page 24. Interim dividends of £702 million were paid on 18 August 2008.

Employment Policies

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

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

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

Disabled persons have equal opportunities when applying for vacancies, with due regard to their aptitudes and abilities. The Group has further procedures to ensure that disabled colleagues are fairly treated and that their training and career development needs are carefully managed. Where employees have become disabled during the course of employment with the Group, the Group endeavours to ensure continuing employment through the arrangement of appropriate training.

Employee involvement and consultation is managed in a number of ways including employee surveys, team updates, briefings, roadshows, staff newspapers and an intranet. The Group also operates frameworks for consultation in all the businesses where it has a majority shareholding. The Group is committed to managing people through change carefully and fairly.

Together these arrangements aim to provide a common awareness amongst employees of the financial and economic factors affecting the performance of their business. There is a high level of participation in the Group's employment benefits scheme, the Executive Share Option Plan and the Bonus Saver Plan, which provides for employees and directors to be rewarded based on the Group's performance.

Directors

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

L Sánchez Salmerón	Appointed 20 December 2007
J Leo	Appointed 20 December 2007
SJK Nelson	Appointed 20 December 2007 and resigned 31 March 2008
Instant Companies Limited	Appointed 20 December 2007 and resigned 20 December 2008

Company Secretary

S Ooi	Appointed 28 November 2008
S Welch	Appointed 28 November 2008
Swift Incorporation Ltd	Appointed 20 December 2007 and resigned 20 December 2008

Directors' interests

None of the directors had any interests in the ordinary shares of the Company at the end of the period or had interests in any of the Company's subsidiaries at any time during the period. None of the directors had a material interest in any contract of significance with the Company or any of its subsidiary undertakings during the year.

Directors' indemnity

The Company's Articles of Association provide that, subject to the provisions of the Companies Act, but without prejudice to any protection from liability which might otherwise apply, every director of the Company shall be indemnified out of the assets of the Company against any loss or liability incurred by him in defending any proceedings in which 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.

BAA (SH) LIMITED

Report of the directors

BAA (SH) Limited Annual Report 31 December 2008

Donations

The Group's charitable donations for the year amounted to £372,055 (2007: £391,462).

The main beneficiaries of charitable donations, the relevant amounts donated and the main activity of these beneficiaries are as follows:

Charity: Heathrow Travelcare	£147,393	Provides counselling or assistance to passengers and airport staff
Charity: Green corridor	£77,400	Uses environmental initiatives to address issues affecting disadvantaged youth and marginalised communities.

The Group incurs expenditure which may be classified as political donations under the Political Parties, Elections and Referendums Act 2000 (the relevant provisions of which are now contained in Part XA of the Companies Act 1985). At the 2006 Annual General Meeting, BAA obtained a renewed shareholders' approval under this Act to commit up to a maximum of £60,000 of such expenditure (in aggregate) over the following four years. In the Company's view there was no expenditure in the year to 31 December 2008 that falls within this category.

Payment policy

The Company complies with the UK Government's better payment practice code which states that responsible companies should:

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

The Company's trade payables balance during the year was £nil (2007: £nil).

Financial risk management

The Group's financial risk management objectives and policies, including hedging policies along with the Group's exposure to risk can be found on pages 17 to 19 in the Risk Management section of the Business Review.

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure. Refer note 15 for further disclosure on the Group's financial covenants.

Audit information

The directors are satisfied that the auditors are aware of all information relevant to the audit of the Group's Consolidated Financial Statements for the year to 31 December 2008 and that they have taken all steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditor

Pursuant to section 485(3) of the Companies Act 2006, the auditors will be deemed to be appointed and PricewaterhouseCoopers LLP therefore will continue in office.

By order of the Board



Shu Mei Ooi
Company Secretary

29 May 2009

Registered Office:
130 Wilton Road
London
SW1V 1LQ

BAA (SH) LIMITED

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 Group and the parent Company 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 prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and the parent company financial statements in accordance with the applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice (UK GAAP)). In preparing the group financial statements, the directors have also elected to comply with IFRS's, issued by the International Accounting Standards Board (IASB). The Group and Parent company financial statements are required by law to give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Company and the Group for that period.

In preparing those financial statements, the directors are required to:

- Select suitable accounting policies and apply them consistently
- Make judgements and estimates that are reasonable and prudent
- State that the Group and parent company financial statements comply with IFRSs as adopted by the European Union and IFRS's issued by the IASB, and with regard to the parent company financial statements that applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements
- Prepare the group and parent company financial statements on the going concern basis unless it is inappropriate to presume that the Group and parent 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 ensuring proper accounting records that disclose, with reasonable accuracy, the financial position of the Group and enable them to ensure that the financial statements comply with the Companies Act 1985 and with regards to the Group's financial statements, Article 4 of the IAS Regulations. They are responsible for safeguarding the assets of the Company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The maintenance and integrity of the BAA website 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.

The above statement should be read in conjunction with the statement of the auditors' responsibilities set out on page 23 for the Group and page 65 for the parent company.

By order of the board



Shu Mei Ooi
Company Secretary

29 May 2009

Independent auditors' report to the members of BAA (SH) Limited

We have audited the Group financial statements of BAA (SH) Limited for the year ended 31 December 2008 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cash flow statement, the accounting policies, the significant accounting judgements and estimates and the related notes. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of BAA (SH) Limited for the year ended 31 December 2008.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group 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 Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Report of the Directors is consistent with the Group financial statements. The information given in the Report of the Directors includes specific information presented in the Business Review that is cross referred from the Report of the Directors.

In addition we report to you if, in our opinion, 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 Group 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 or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

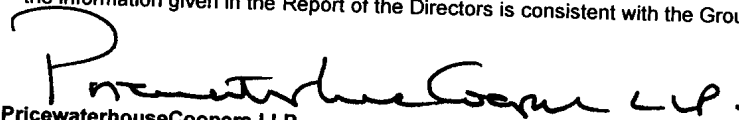
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment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

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 Group 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 Group financial statements.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its loss and cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Report of the Directors is consistent with the Group financial statements.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

29 May 2009

BAA (SH) LIMITED

Consolidated income statement for the year ended 31 December 2008

	Note	Year ended 31 December 2008			Year ended 31 December 2007 ²		
		Before certain re-measurements ¹ £m	Certain re-measurements ¹ £m	Total £m	Before certain re-measurements ¹ £m	Certain re-measurements ¹ £m	Total £m
Continuing operations							
Revenue	1	1,827	-	1,827			
Operating costs	2	(1,570)	-	(1,570)	1,566	-	1,566
Other operating costs					(1,213)	-	(1,213)
Fair value losses on investment properties	10	-	(147)	(147)	-	(13)	(13)
Operating profit	1	257	(147)	110	353	(13)	340
<i>Analysed as:</i>							
Operating profit before exceptional items		373	(147)	226	510	(13)	497
Exceptional items	4	(116)	-	(116)	(157)	-	(157)
		257	(147)	110	353	(13)	340
Financing							
Finance income	5a	65	-	65	-	-	-
Finance costs	5a	(651)	-	(651)	-	-	-
Fair value gains on derivative financial instruments	5b	-	87	87	(195)	-	(195)
Loss before tax		(329)	(60)	(389)	158	(13)	145
Taxation – ordinary	6	94	22	116	2	52 ⁴	54
Taxation – exceptional ³	6	(1,069)	-	(1,069)	-	-	-
Taxation (charge)/credit		(975)	22	(953)	2	52	54
(Loss) / profit for the period from continuing operations		(1,304)	(38)	(1,342)	160	39	199
Net (loss) / profit from discontinued operations	7	(65)	(27)	(92)	46	28	74
Consolidated (loss) / profit for the year		(1,369)	(65)	(1,434)	206	67	273
Interim dividends paid during the year	8	(702)	-	(702)	(151) ⁵	-	(151)

¹ Certain re-measurements (including those of associates and joint ventures) consist of fair value gains and losses on investment property revaluations and disposals and the gains and losses arising on the re-measurement and disposal of derivative financial instruments, together with the associated fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship, together with the related tax impact of these items.

² Comparative income statement information includes Gatwick in discontinued operations.

³ Total exceptional deferred tax charge of £1,175 million related to the abolition of Industrial Buildings Allowances, of which £106 million relates to discontinued operations.

⁴ Includes a tax credit of £48 million due to a change in the UK corporation tax rate from 30% to 28% which took effect from 1 April 2008.

⁵ This amount includes £65 million relating to Gatwick Airport Limited.

BAA (SH) LIMITED

Consolidated statement of recognised income and expense for the year ended 31 December 2008

	Note	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Cash flow hedges			
Losses taken to equity	24	(24)	-
Transferred to income statement	24	(434)	-
Deferred tax credit on items transferred directly to equity	18/24/25	131	4
Net (expense)/income recognised directly in equity		(327)	4
(Loss)/ profit for the year	25	(1,434)	273
Total recognised (expense) / income for the year		(1,761)	277

BAA (SH) LIMITED

Consolidated balance sheet as at 31 December 2008

	Note	As at 31 December 2008 £m	As at 31 December 2007 £m
Assets			
Non-current assets			
Property, plant and equipment	9	9,687	10,446
Investment properties	10	2,153	2,740
Intangible assets	11	65	64
Derivative financial instruments	16	830	-
Trade and other receivables	13	-	574
		12,735	13,824
Current assets			
Inventories	12	5	8
Trade and other receivables	13	397	793
Derivative financial instruments	16	138	-
Cash and cash equivalents	14	167	-
		707	801
Assets classified as held-for-sale	21	-	801
Total assets		1,865	-
Liabilities			
Non-current liabilities			
Borrowings ¹	15	(10,275)	(1,813)
Derivative financial instruments	16	(354)	-
Deferred income tax liabilities	18	(2,116)	(1,490)
Provisions	19	(109)	(97)
Trade and other payables	20	(6)	(12)
		(12,860)	(3,412)
Current liabilities			
Borrowings ¹	15	(222)	(8,230)
Derivative financial instruments	16	(312)	-
Provisions	19	(46)	(56)
Current income tax liabilities	20	(9)	(10)
Trade and other payables	20	(396)	(511)
		(985)	(8,807)
Liabilities associated with assets classified as held-for-sale	21	-	801
Total liabilities		(1,519)	-
Net (liabilities) / assets		(15,364)	(12,219)
		(57)	2,406
Equity			
Capital and reserves			
Ordinary shares			
Revaluation reserve	22	2,509	2,509
Fair value and other reserves	23	365	365
Merger reserves	24	(330)	-
Retained earnings	24	(2,865)	(2,865)
Total Equity	25	264	2,397
		(57)	2,406

¹ Interest payable is included within current borrowings.

The financial statements set out on pages 24 to 63 were approved by the Board of directors and authorised for issue on 29 May 2009 and signed on behalf of the Board.


 Jose Leo
 Director


 Luis Sanchez Salmeron
 Director

BAA (SH) LIMITED

Consolidated cash flow statement for the year ended 31 December 2008

	Note	Year ended 31 December 2008 £m	Year ended 31 December 2007 ¹ £m
Operating activities			
Continuing operations			
Net (loss)/profit before tax		(389)	145
<i>Adjusted for:</i>			
Finance income			
Finance costs		(65)	-
Fair value gain on derivative financial instruments		651	195
Depreciation		(87)	-
Loss on disposal of property plant and equipment		467	308
Fair value loss on investment properties		1	1
		147	13
<i>Changes in working capital</i>			
Increase in stock and debtors			
Increase/(decrease) in creditors		(174)	(18)
Increase in provisions		68	(7)
		19	17
Cash generated from continuing operations		638	654
Taxation-group relief received ²		21	-
Cash generated from discontinued operations		136	152
Net cash from operating activities		795	806
Investing activities			
Purchase of:			
Property, plant and equipment		(891)	(967)
Investment properties		-	-
Intangible assets		(28)	(9)
Investing activities of discontinued operations		(114)	(89)
Net cash used in investing activities		(1,033)	(1,065)
Acquisition of Heathrow Express Operating Company Limited		(4)	-
Dividend paid		-	(151)
Financing activities			
Drawdown on refinancing facility		3,350	-
Drawdown on capex facility		250	-
Drawdown of EIB facility		435	-
Repayment of EIB facility		(18)	-
Payment of loan arrangement fees		(15)	-
(Decrease)/increase in amounts owed to group		(3,616)	393
Net interest paid		(79)	-
Financing activities from discontinued operations		117	17
Net cash generated from financing activities		424	410
Net increase in cash and cash equivalents		182	-
Cash and cash equivalents at beginning of period		-	-
Cash and cash equivalents at end of period		182	-

¹ Comparative income statement information includes Gatwick in discontinued operations.

² This amount includes £10 million group relief paid to Gatwick

For the purpose of the cash flow statement, cash and cash equivalents, with an original maturity of three months or less and held for the purpose of meeting short-term cash commitments, comprise:

- cash at bank and cash in hand
- short-term deposits
- money market funds
- cash balances held by operations classified as held-for-sale.

BAA (SH) LIMITED

Accounting policies

Basis of accounting

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and under the historical cost convention, except for investment properties, available-for-sale assets, derivative financial instruments and financial liabilities that qualify as hedged items under a fair value hedge accounting system. These exceptions to the historic cost convention have been measured at fair value in accordance with IFRS and as permitted by the Fair Value Directive as implemented in the amended Companies Act 1985.

The Group complies with both IAS 39 'Financial Instruments: Recognition and Measurement', as adopted by the EU and the full version of IAS 39 issued by the IASB.

Going concern

The directors have prepared the financial statements on a going concern basis which requires the directors to have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future.

In concluding that the going concern assumption is appropriate the directors have reviewed the cashflow projections of the Group taking into account:

- the forecast passenger numbers, revenue and operating cashflows from the underlying operations;
- the forecast level of capital expenditure; and
- the Group funding structure following the refinancing in August 2008 and the significant committed facilities that are available to the Group (note 15).

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 Group's funding requirement over the coming twelve month period. All of the Group's financial covenants (see note 15) have been met and are forecast to be met for the foreseeable future.

Application of accounting standards

At the date of approving these financial statements, IFRIC 14 'IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' was effective and has been adopted by the Group in these financial statements. Further, the following International Financial Reporting Interpretations Committee ('IFRIC') interpretations, which were effective in 2008 have not been applied in these financial statements as they were not relevant to the Group:

- IFRIC 12 'Service Concession Agreements'
- IFRIC 13 'Customer Loyalty Programmes'
- IFRIC 16 'Hedges of a Net Investment in a Foreign Operation'

At the date of approving these financial statements, the following IFRIC interpretations and IFRS have not been applied as they were not effective in 2008 and/or were not relevant to the Group:

- IFRIC 15 'Agreements for the Construction of Real Estate'; not yet effective.
- IFRIC 17 'Distributions of Non-cash Assets to Owners'; not yet effective.
- IFRS 8 'Operating segments' replaces IAS 14 – Segment Reporting and aligns the segments information on the same basis as that used for the internal reporting purposes. The standard is subject to endorsement by the EU. The expected impact is still being assessed in detail by management.
- IAS 1 'Presentation of Financial Statements - Comprehensive revision including requiring a statement of comprehensive income'; not yet effective.
- IAS 1 'Presentation of Financial Statements - Amendments relating to disclosure of puttable instruments and obligations arising on liquidation'; not yet effective.
- IAS 1 'Presentation of Financial Statements - Amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 16 'Property, Plant and Equipment - Amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 19 'Employee Benefits - Amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 23 'Borrowing Costs - Comprehensive revision to prohibit immediate expensing and amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 27 'Consolidated and Separate Financial Statements - Consequential amendments arising from amendments to IFRS 3, amendment relating to cost of an investment on first-time adoption and amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 28 'Investments in Associates - Consequential amendments arising from amendments to IFRS 3 and amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 29 'Financial Reporting in Hyperinflationary Economies - Amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 31 'Interests in Joint Ventures - Consequential amendments arising from amendments to IFRS 3 and amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 32 'Financial Instruments: Presentation - amendments relating to puttable instruments and obligations arising on liquidation'; not yet effective.
- IAS 36 'Impairment of Assets - amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 38 'Intangible Assets - amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.
- IAS 39 'Financial Instruments: Recognition and Measurement - Amendments resulting from May 2008 Annual Improvements to IFRSs and Amendments for eligible hedged items'; not yet effective.
- IAS 40 'Investment Property - Amendments resulting from May 2008 Annual Improvements to IFRSs'; not yet effective.

BAA (SH) LIMITED

Accounting policies (continued)

Basis of consolidation

The ultimate UK parent undertaking of BAA (SH) Limited and its subsidiaries was before and remains after the group reorganisation, FGP Topco Limited.

During 2008, as part of the Group refinancing the company acquired BAA (SP) Limited, the security Group that owns the Designated Airports comprising of the UK regulates airports of Heathrow, Gatwick, and Stansted. It also operates the Heathrow Express rail service between Heathrow and Paddington, London. BAA (SP) Limited is the holding company of BAA Funding Limited, which is the bond issuer for the security group. In addition, £1.6 billion of subordinated debt, previously held at BAA Limited, was transferred to BAA (SH) Limited and on-lent to BAA (SP) Limited in the form of a debenture.

The group reorganisation outlined above is outside of the scope of IFRS 3, Business Combinations, as the combining entities are both before and after the reconstruction ultimately controlled by the same party (FGP Topco Limited) and control was not transitory. Therefore in accordance with IAS 8 the directors have developed an appropriate accounting policy for common control transactions. The Group financial statements consolidate the financial statements of the Company and all its subsidiaries, using the merger method of accounting (also known as 'predecessor accounting'). The policies adopted and explained below are comparable to those under UK GAAP.

The predecessor accounting principles applied are as follows:

- The acquired entities results are included in the groups consolidated financial statement as if the entities had always been combined and comparative amounts prepared accordingly.
- The group does not restate assets and liabilities to their fair values. Instead, the group incorporates the assets and liabilities at the amounts recorded in the books of the acquired company adjusted only to achieve harmonisation of accounting policies.
- No goodwill arises in predecessor accounting, the differences arising on consolidation are included in a merger reserve.

Primary financial statements format

The IFRS primary financial statements are presented in accordance with IAS 1 'Presentation of Financial Statements'.

A columnar approach has been adopted in the income statement and the impact of three principal groups of items is shown in a separate column ('certain re-measurements'). This allows the presentation of the performance of the business before these specific fair value gains and losses (including those of associates). These items are:

- i Fair value gains and losses on investment property revaluations and disposals
- ii Derivative financial instruments and the fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship
- iii The associated tax impacts of the items in (i) and (ii) above.

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination, such as professional fees paid to accountants, legal advisers, valuers and other consultants to effect the combination. General administrative costs and other costs that cannot be directly attributed to the particular combination being accounted for are not included in the cost of the combination and are recognised as an expense when incurred.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 'Business Combinations' are recognised at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the costs of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the income statement.

The interest of minority shareholders in the acquiree is initially measured as the minority's proportion of the net fair value of the identifiable assets, liabilities and contingent liabilities recognised.

Segment reporting

The BAA Group is organised according to its regulatory environment, geographical location and type of operation. The operating businesses are primarily the individual airports, which are organised and managed separately. The secondary format is geographical segments based on the location of the business assets and operations.

BAA SH operations comprise the designated/regulated airports of:

- Heathrow
- Gatwick (currently held for sale)
- Stansted

Operations falling outside of the main business segments are reported as 'other operations'.

Revenue

Revenue is recognised in accordance with IAS 18 'Revenue' and comprises:

Airport and other traffic charges

Primarily:

- Passenger charges based on the number of departing passengers on departure
- 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

Retail

- Concession fees from retail and commercial concessionaires at or around airports are based upon turnover certificates supplied by concessionaires.

BAA (SH) LIMITED

Accounting policies (continued)

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 (eg check-in-desks), recognised as each service period 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.

Other

- Other income includes rail income from ticket sales, recognised at the time of travel.

Government grants

On occasion, the Group may receive grants to provide financial incentives to improve airport infrastructure considered to be in the best interest of the public. No such grants have been received in 2008 in relation to any UK airports. Grants received are treated as deferred income until such time as the terms of the grant are satisfied at which time it is recognised as revenue in the period.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until the asset is complete and ready for use. Such borrowing costs are capitalised once planning permission has been obtained and/or where projects are in the early stages of planning but the directors are satisfied that the necessary consents will be received. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the income statement in the period in which they are incurred.

Exceptional items

The Group presents, on the face of the income statement, disclosure for 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 Group's financial performance.

Such events may include gains or losses on the disposal of businesses or assets that do not qualify as discontinued operations, major reorganisation of businesses, closure or mothballing of terminals and 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.

Assets classified as held-for-sale

Non-current assets and disposal groups are classified as held-for-sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets (and disposal groups) classified as held-for-sale are not depreciated and are measured at the lower of their previous carrying amount and fair value less costs to sell.

Discontinued operations

Discontinued operations consist of business segments and other non-core assets that have either been sold during the period or are classified as held-for-sale at period end. The financial performance and cash flows of discontinued operations are separately reported.

Intangible assets

Internally-generated intangible assets

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

- An intangible asset is created that can be separately identified
- It is probable that the intangible asset created will generate future economic benefits
- The development cost of the intangible asset can be measured reliably.

This type of expenditure primarily relates to internally developed software and website projects and these are amortised on a straight-line basis over their useful lives of three to seven years.

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

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

BAA (SH) LIMITED

Accounting policies (continued)

Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation, is stated at fair value at the balance sheet date, as determined at the interim and full-year reporting dates by the directors and by external valuers at least once every five years. Gains or losses arising from changes in the fair value of investment property are recognised in the income statement in the period in which they arise.

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

Property, plant and equipment

Operational assets

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

Assets in the course of construction are stated at cost less provision for impairment. Assets in the course of construction are transferred to completed assets when substantially all the activities necessary to get the asset ready for use are complete. Where appropriate, cost includes borrowing costs capitalised, own labour costs of construction-related project management, and directly attributable overheads. Projects that are in the early stages of planning are capitalised where the directors are satisfied that it is probable the necessary consents will be received and the projects will be developed to achieve a successful delivery of an asset such that future commercial returns will flow to the Group. The Group reviews these projects on a regular basis, 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.

Depreciation

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

Fixed asset lives

Terminal complexes

Terminal building, pier and satellite structures	20–60 years
Terminal fixtures and fittings	5–20 years
Airport plant and equipment	
Baggage systems	15 years
Screening equipment	7 years
Lifts, escalators and travelators	20 years
Other plant and equipment, including runway lighting and building plant	5–20 years
Tunnels, bridges and subways	50–100 years

Airfields

Runway surfaces	
Runway bases	10–15 years
Taxiways and aprons	100 years

Rail

Airport transit systems	50 years
Rolling stock	
Track	20 years
Railways	50 years
Rolling stock	
Tunnels	8–40 years
Track metalwork	100 years
Track bases	5–10 years
Signals and electrification work	50 years

Plant and equipment

Motor vehicles	40 years
Office equipment	4–8 years
Computer equipment	5–10 years
Computer software	4–5 years

Other land and buildings

Short leasehold properties	3–7 years
	Over period of lease

Impairment of assets

The Group 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 Group 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 cash-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. 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 income statement 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.

BAA (SH) LIMITED

Accounting policies (continued)

Leases

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

Group as a lessee

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

Group as a lessor

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

Inventories

Inventories are stated at the lower of cost and net realisable value.

Provisions

Provisions are recognised when the Group 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.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments and bank overdrafts, where offset is allowed.

Financial instruments

Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost, using the effective interest method, less provision for impairment.

Investments

On initial recognition, financial assets are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. After initial recognition, investments that are classified as 'held-for-trading' and 'available for sale' are measured at fair value. Fair value gains or losses on investments held for trading are recognised in the income statement. Fair value gains or losses on available for sale investments are recognised in a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative fair value gain or loss previously reported in equity is included in the income statement. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indication that the security is impaired. If impairment is indicated, the cumulative fair value gain or loss previously reported in equity is included in the income statement.

Assets classified as 'loans and receivables' or 'held to maturity' are recognised on the balance sheet at their amortised cost, using the effective interest rate method, less any provision for impairment.

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

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

Purchases and sales of investments are recognised on trade-date being the date on which the Group commits to purchase or sell the asset.

Investments are classified as held-for-sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable, the asset is available for immediate sale in its present condition, management are committed to the asset disposal, and disposal is expected to be completed within 12 months. Assets classified as held-for-sale cease to be depreciated and are measured at the lower of carrying amount and fair value less selling costs.

Financial liabilities and equity

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

BAA (SH) LIMITED

Accounting policies (continued)

Borrowings

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 income statement over the period of the borrowings using the effective interest method. Borrowings being novated or cancelled and re-issued with a substantial modification of the terms, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, with any resulting gain or loss recognised in the income statement.

Bonds issue costs

Prepaid fees in relation to the future issuance of debt are held on balance sheet on the basis that such issuance is considered probable. If issues do not occur, or are deemed not to be probable, such fees are recognised in the income statement.

Trade and other payables

Trade and other payables are not interest bearing and are stated at their fair value and subsequently measured at amortised cost using the effective interest method.

Share capital

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

Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- fair value hedges, where they hedge the exposure to changes in the fair value of the hedged asset or liability; or
- cash flow hedges, where they hedge the exposure to variability in cash flows that are either attributable to a particular risk associated with any changes in the fair value of the hedged asset, liability or forecasted transaction.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Derivatives that do not qualify for hedge accounting are classified as a current asset or liability.

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The Group only applies fair value hedge accounting for hedging fixed interest rate risk on borrowings.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity.

(b) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. This accounting policy also relates to the scenario where by the forecast transaction is still expected to occur. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(c) Derivatives at fair value through profit or loss

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any these derivative instruments are recognised immediately in the income statement.

When derivatives are designated in a fair value hedge or a cash flow hedge of interest rate risk, 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 fair value changes on these derivatives are recognised within fair value gains/(losses) on financial instruments in the income statement. The interest payable and receivable on those derivatives are recorded at their gross amount in finance costs and finance income in the income statement.

In August 2008 as part of the BAA refinancing, a portion of the interest payable on some of the derivatives which were novated from BAA Limited and BAA Airports Limited to other companies in the BAA Group was paid prior to novation. The prepayment forms part of the fair value of these derivatives on their initial recognition in the new company.

BAA (SH) LIMITED

Accounting policies (continued)

Current and deferred income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company's subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Group financial statements. Deferred income taxation is not provided on the initial recognition of an asset or liability in a transaction, other than a business combination, if at the time of the transaction there is no effect on either accounting or taxable profit or loss.

Deferred income taxation is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income taxation is determined using the tax rates and laws that have been enacted, or substantially enacted, by the balance sheet date, and are expected to apply when the related deferred tax asset or liability is realised or settled.

Income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

Shared Service Agreement

All employees are employed directly by BAA Airports Limited which also acts as the provider of corporate and administrative services to the Group. 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 Group's airports entered into a Shared Service Agreement (SSA) with BAA Airports Limited by which the latter became the shared services provider for the Group with operational staff and corporate services.

(a) Operational staff

BAA Airports Limited charges the airports 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.

(b) 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 Group. The total mark-up charged to the Group amounted to £9 million during the year (2007: £8 million).

(c) Pension costs

Under the Shared Service Agreement the current period service cost for the BAA Airports Limited pension schemes are recharged to the Group. Cash contributions are made directly to the pension trustee of the BAA Airports Limited defined benefit scheme on behalf of BAA Airports Limited. The Group also has a legal obligation to fund any pension deficit related to BAA Airports Limited pension plans under the Shared Service Agreement. In the year to 31 December 2008 an amount of £13 million has been recorded as a one-off exceptional past-service cost in the income statement 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 19).

Dividend distribution

A dividend distribution to the Company's shareholders is recognised as a liability in the Group'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.

Foreign currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Sterling, which is the parent's functional currency.

Transactions denominated in foreign currencies are translated into the functional currency of the entity using the exchange rates prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the period-end. Differences arising on translation are charged or credited to the income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are recognised in equity within the fair value reserve.

Significant accounting judgements and estimates

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

White Paper

The UK Government's Aviation White Paper '*The Future of Air Transport*' ('the White Paper'), published on 16 December 2003, sets out the Government's policy for runway development in the UK. The Government chose a second runway at Stansted as its preferred location for the first new runway in the South East of England. The development of Stansted will be the subject of a planning inquiry, and BAA submitted its planning application to Uttlesford District Council on 11 March 2008. The costs incurred to date have been capitalised as part of the runway development costs. This is based on management's belief that it is virtually certain the necessary consents will be received and the project will be developed to achieve a successful delivery of an asset such that future benefits will flow to the Group.

Additionally, the Group has promoted three voluntary schemes to compensate those people living near Stansted Airport whose homes will be affected by the airport expansion. These costs have also been capitalised as part of the runway development costs.

Investment properties

Investment properties were valued at a fair value at 31 December 2008 by Drivers Jonas, Chartered Surveyors and Strutt and Parker, Chartered Surveyors. These valuations were prepared in accordance with IFRS 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.

Taxation

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

Hedge Accounting

From 1 October 2008, certain interest rate swaps for £1.8 billion notional were designated in a cash flow hedge relationship to hedge the exposure to variability in cash flows of existing liabilities and forecast transactions, based on management expectation that it is highly probable these derivatives will match future sterling funding issuances which will occur to refinance existing debt. In 2008, £301 million of fair value losses on these derivatives, arising from a reduction in UK interest rates have been recognised in the cash flow hedge reserve.

Management assesses on a regular basis the extent to which terms of future financing are expected to match the profiles of the hedges, and adjusts the accounting accordingly. Any such change in the expected financing may require the recycling of the cash flow hedge reserve through the income statement.

BAA (SH) LIMITED

Notes to the financial statements

1 Segment information

The Group's primary reporting format is by business segments with the operating businesses, primarily of the individual airports, being organised and managed separately. The secondary reporting format is by geographical segments based on the location of the business assets and operations.

The 'Other operations' business segment includes Heathrow Express Operating Company (HEX), BAA Funding Limited, BAA (AH) Limited and the parent entity BAA (SP) Limited.

Gatwick Airport Limited has been classified as assets held-for-sale on the balance sheet (as detailed in Note 21) and in discontinued operations in the income statement (Note 7) and cash flow statement.

Inter-segmental transactions are considered immaterial and are not analysed separately. Inter segment borrowings and interest costs are eliminated as all debt is managed centrally. The basis of recharges between the airports and corporate segments is performed on an objective basis in accordance with the Shared Service Agreement, entered into upon refinancing in August 2008.

The following tables present details of revenue, operating profit, profit before tax and certain asset and liability information in respect of the business and geographic segments. Whilst not required by IAS 14 'Segment Reporting', additional revenue disclosure is provided in respect of the revenue streams by nature.

All information relates to both continuing and discontinued operations, with the exception of income statement items which relate to continuing operations only.

(a) Business segments	Year ended 31 December 2008				Year ended 31 December 2007 ¹			
	Operating profit ²				Operating profit ²			
	Revenue £m	Before certain re- measurements £m	Certain re- measurements ³ £m	Total £m	Revenue £m	Before certain re- measurements £m	Certain re- measurements ³ £m	Total £m
Designated airports	1,827	253	(147)	106	1,566	353	(13)	340
Heathrow ^{4,5}	1,568	172	(59)	113	1,324	278	(46)	232
Stansted	259	81	(88)	(7)	242	75	33	108
Other operations ⁶	-	4	-	4	-	-	-	-
Total	1,827	257	(147)	110	1,566	353	(13)	340
Unallocated income and expenses								
Finance income		65	-	65		-	-	-
Finance costs		(651)	-	(651)		(195)	-	(195)
Fair value gains on derivative financial instruments		-	87	87		-	-	-
(Loss)/profit before tax		(329)	(60)	(389)		158	(13)	145
Taxation – ordinary		94	22	116		2	52 ⁷	54
Taxation – exceptional ⁷		(1,069)	-	(1,069)		-	-	-
Taxation		(975)	22	(953)		2	52	54
Net (loss) / profit for the period – continuing operations		(1,304)	(38)	(1,342)		160	39	199
Net loss/(profit) from discontinued operations		(65)	(27)	(92)		46	28	74
Net (loss)/profit for the year		(1,369)	(65)	(1,434)		206	67	273

¹ Comparative income statement information includes Gatwick in discontinued operations.

² After exceptional items.

³ Certain re-measurements consist of fair value gains and losses on investment property revaluations and disposals and the gains and losses arising on the re-measurement and disposal of derivative financial instruments, together with the associated fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship, together with the related tax impact of these items.

⁴ All rail income and associated costs are included in Heathrow.

⁵ This amount excludes £8 million inter-company revenue received from Heathrow Express Operating Company Limited ('HEX') as it is eliminated at Heathrow Airport Limited level since HEX was acquired by Heathrow Airport Limited during the year.

⁶ Other operations are HEX, BAA Funding Limited, BAA (AH) Limited and BAA (SP) Limited.

⁷ Total exceptional deferred tax charge of £1,175 million related to the abolition of Industrial Building Allowances, of which £106 million relates to discontinued operations.

⁸ Includes a tax credit of £48 million due to a change in the UK corporation tax rate from 30% to 28% which took effect from 1 April 2008.

BAA (SH) LIMITED

Notes to the financial statements (continued)

1 Segment information (continued)

(b) Business Segments	31 December 2008				31 December 2007 ¹			
	Assets £m	Liabilities £m	Capital Expenditure ² £m	Depreciation and Amortisation ³ £m	Assets £m	Liabilities £m	Capital Expenditure ² £m	Depreciation and Amortisation ³ £m
Designated airports	12,222	(551)	892	467	13,482	(624)	1,073	365
Heathrow	10,693	(505)	793	433	10,169	(473)	875	279
Gatwick	-	-	-	-	1,778	(89)	91	57
Stansted	1,529	(46)	99	34	1,535	(62)	107	29
Other operations	7	(6)	-	-	-	-	-	-
Assets classified as held for sale ⁴	1,850	(88)	124	47	-	-	-	-
Total operations	14,079	(645)	1,016	514	13,482	(624)	1,073	365
Unallocated assets and liabilities								
Cash, amounts due by group undertakings and borrowings ⁵	222	(11,539)			1,143	(10,043)		
Derivative financial instruments	968	(666)			-	-		
Taxation	38	(2,514 ⁶)			-	-		
Group	15,307	(15,364)	1,016	514	14,625	(12,219)	1,073	365

¹ Comparative income statement information includes Gatwick in discontinued operations.

² Includes capital expenditure additions of £28 million (31 December 2007: £9 million) relating to intangible assets.

³ Includes amortisation charge of £27 million (31 December 2007: £23 million) relating to intangible assets.

⁴ Includes discontinued operations in respect of capital expenditure and excludes Gatwick borrowings of £1,042 million and cash of £15 million and tax charges of £389 million.

⁵ Includes Gatwick cash of £15 million and borrowings of £1,042 million.

⁶ Includes Gatwick tax liability of £389 million.

(c) Business and geographical segments

	Year ended 31 December 2008					Year ended 31 December 2007 ¹				
	Retail £'000	Airport and other traffic charges £'000	Property and operational facilities £'000	Other £'000	Total £'000	Retail £'000	Airport and other traffic charges £'000	Property and operational facilities £'000	Other ¹ £'000	Total £'000
UK airports	419	980	240	188	1,827	416	761	218	171	1,566
Heathrow	328	835	221	184	1,568	325	634	198	167	1,324
Stansted	91	145	19	4	259	91	127	20	4	242
Other operations	-	-	-	-	-	-	-	-	-	-
Group	419	980	240	188	1,827	416	761	218	171	1,566

¹ Comparative income statement information includes Gatwick in discontinued operations.

The segmental information above analyses revenue by origin. Revenue by destination is not materially different to revenue by origin.

BAA (SH) LIMITED

Notes to the financial statements (continued)

1 Segment information (continued)

The total rental income derived from the Group's investment properties, included in the segmental disclosure above, is as follows:

	Year ended 31 December 2008 £m	Year ended 31 December 2007 ¹ £m
Retail	99	100
Property and operational facilities	48	27
Other	29	16
Total	176	143

Total contingency rent² and rents from indefinite tenancies³ recognised in revenue amounted to:

	Year ended 31 December 2008 £m	Year ended 31 December 2007 ¹ £m
Retail	99	100
Property and operational facilities	17	17
Total	116	117

¹ Comparative income statement information includes Gatwick in discontinued operations.

² Contingency rents represent concession fees received from retail and commercial concessionaires.

³ Indefinite tenancies are typically multi-let offices and industrial premises where a standard indefinite tenancy is used, which is determinable by the tenant on 3 months' notice at any time.

Services provided to tenants (service charges, maintenance rents and heating rents) earned revenue of £1.3 million (2007: £1.0 million).

Guaranteed minimum payments relating to certain investment properties are excluded from the definition of contingency rents and are disclosed within minimum rentals receivable under non-cancellable operating leases (Note 26).

BAA (SH) LIMITED

Notes to the financial statements (continued)

2 Operating costs – continuing operations

	Year ended 31 December 2008 £m	Year ended 31 December 2007 ¹ £m
Operating costs (including exceptional items) include the following:		
Staff costs ²		
Wages and salaries		
Social security	268	247
Pensions ³	21	16
Share-based payments	38	42
Other staff related	3	2
	31	13
Depreciation and amortisation	361	320
Depreciation of property, plant and equipment		
Amortisation of intangible assets	439	284
Software		
	27	24
Other operating costs	466	308
Loss on sale of:		
Property, plant and equipment		
Retail expenditure	1	1
Maintenance expenditure	22	14
Rent and rates	141	108
Utility costs (including distribution fees)	106	76
Police	94	82
Air navigation charges ⁴	42	34
General expenses ⁵	47	-
Other intra-group charges ⁶	123	59
	167	211
Total operating costs	743	585
Analysed as:	1,570	1,213
Adjusted operating costs		
Exceptional costs	1,454	1,056
	116	157
	1,570	1,213

¹ Comparative income statement information includes Gatwick in discontinued operations.

² Staff costs include recharges from BAA Airports Limited to the Group for employee services. Refer to Shared Service Agreement in the Accounting Policy note.

³ Pension costs comprise recharges from BAA Airports Limited for current service cost of the pension plan to the Group. Reductions in the current service costs recharged are related to the changes in the actuarial assumptions used to calculate the Group's current service cost (mostly due to the increase of the discount rate). However, the group reached an agreement with the pension trustees in respect of the cash contributions to be provided in the next three years (refer to note 26).

⁴ During the year, National Air Traffic Services ceased billing the airlines for aircraft handling within the airports landing and departure zone and now bill the BAA airports directly. BAA then recharges this to the airlines.

⁵ Increase in general expenses mainly contributed to £13.2m in cleaning, £9.1m in service quality rebates, £10.1m for noise and blight, £10.5m for connect/baggage and £9.9m for costs to provide services for Passengers with Restricted Mobility (PRM) which were sourced directly by the airlines in 2007.

⁶ This amount includes costs in relation to the corporate and centralised services under the Shared Service Agreement in accounting policies. The reduction in other intra-group charges during the year is mainly due to the elimination of intra-group charges made by HEX as it became part of the Group during the year. Intra-group charges made by HEX in the prior year were £55 million.

Exceptional items included within operating costs are analysed in Note 4.

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
The aforementioned charges include:		
Rentals under operating leases		
Plant and machinery		
Other	30	31
	25	11
Property lease and sub lease charges	55	42
Minimum lease payments		
	25	11

Property operating costs include £8.7 million (31 December 2007: £4.9 million) in respect of coaching and management fees relating to the provision of car parking facilities for airline and other airport workers. This amount is recovered through the sale of airport passes and is included within property and operational facilities income (Note 1(c)).

BAA (SH) LIMITED

Notes to the financial statements (continued)

2 Operating costs – continuing operations (continued)

Auditors' remuneration

Auditors' remuneration relates to fees paid to PricewaterhouseCoopers LLP.

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Fees payable to the Company's auditors of its subsidiaries for other services: audit of the Company's subsidiaries, pursuant to legislation	0.3	0.2
taxation services	-	0.1
	0.3	0.3

Auditors' remuneration includes services provided to both continuing and discontinued operations.

Services provided by the auditors in relation to the wider BAA Group's refinancing were borne by BAA Limited (formerly Airport Development and Investment Limited).

3 Employee information

Employee numbers

The Group has no employees. All staff costs are borne by BAA Airports Limited which recharges all such costs directly to the airports as described in the Accounting Policies under the 'Shared Service Agreement'. Previously this was included in a management charge. The average number of employees of BAA Airports Limited engaged in operations of the Group during 2008 was 9,308 (2007: 7,600).

Directors' remuneration

None of the directors who served BAA (SH) Limited during the year received emoluments from the Company.

During the year, one of the directors (2007: one) had retirement benefits accruing to them under BAA Airports Limited's defined benefits scheme.

4 Exceptional items

	Year ended 31 December 2008 £m	Year ended 31 December 2007 ¹ £m
Operating items		
Pension (a)		
Reorganisation income/(costs) (b)	(13)	-
	3	(51)
	(10)	(51)
Heathrow Terminals 1 and 2 accelerated depreciation (c)	(84)	(66)
Heathrow Terminal 5 launch / operational readiness costs (d)	(22)	(40)
	(106)	(106)
Total exceptional items before income tax		
Tax credit on exceptional items	(116)	(157)
Total exceptional items	33	45
	(83)	(112)

¹ Comparative income statement information includes Gatwick in discontinued operations

(a) £13 million (2007: £nil) of accumulated past service pension costs not previously charged to the Group by BAA Airports Limited in relation to the Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits was incurred as a consequence of the commitments entered into by the individual airports in the Shared Service Agreement in relation to pensions. The share of these costs have been allocated to the groups airports on the basis of pensionable salaries for the year ended 31 December 2008.

(b) A release of £3 million was credited during the year associated with restructuring programmes (2007: charge of £51 million). The amount released resulted from higher staff turnover than historic experience, lower than expected cost for each reduction in headcount and certain headcount reduction not being made due to the decision to sell Gatwick. The charge in the year ended 31 December 2007 was in relation to severance and pension payments associated with the 'Simplifying the Organisation' programme carried out during 2008-2009.

(c) With the anticipated development of Terminal 2A, Terminals 1 and 2 at Heathrow airport will be demolished necessitating an additional depreciation charge of £84 million in the year to 31 December 2008 (2007: £66 million) to reflect the shortened useful lives of the assets.

(d) Operational readiness costs of £22 million (2007: £40 million) relating to management of the opening of Heathrow Terminal 5 were incurred during the year.

BAA (SH) LIMITED

Notes to the financial statements (continued)

5 Financing – continuing operations

a) Net finance costs

	Year ended 31 December 2008	Year ended 31 December 2007 ¹
	£m	£m
Finance income		
Interest receivable on derivatives not in a hedging relationship	64	-
Interest on money market funds	1	-
	65	-
Finance costs		
Interest on borrowings:		
Bonds		
Bank loans & overdrafts	(116)	-
Interest payable on derivatives which do not qualify for hedge accounting	(162)	-
Facility fees	(49)	-
Interest on loan to parent	(24)	-
Unwinding of discount on Terminal 5 land purchase provisions	(381)	(446)
Total borrowing costs	(15)	(5)
Less: capitalised borrowing costs	(747)	(451)
	96	256
Net finance costs before certain re-measurements	(651)	(195)
	(586)	(195)

¹ Comparative income statement information includes Gatwick in discontinued operations.

The net finance costs above include financial results for continuing operations only. Finance income and finance costs from discontinued operations have been disclosed separately in Note 7.

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 6.92% (31 December 2007: 5.95%) to expenditure incurred on such assets.

b) Fair value (losses)/gains on financial instruments

	Year ended 31 December 2008	Year ended 31 December 2007 ¹
	£m	£m
Interest rate swaps: cash flow hedges ²	(24)	-
Interest rate swaps: not in hedge relationship	(13)	-
Index-linked swaps: not in hedge relationship	81	-
Cross currency interest rate swaps: cash flow hedges ²	35	-
Fair value re-measurements of foreign currency balances	8	-
Fair value gains on financial instruments in net finance costs	87	-

¹ Comparative income statement information includes Gatwick in discontinued operations

² Hedge ineffectiveness

BAA (SH) LIMITED

Notes to the financial statements (continued)

6 Taxation

	Year ended 31 December 2008 £m	Year ended ¹ 31 December 2007 £m
UK Corporation Tax		
Current tax at 28.5% (31 December 2007: 30%)		
Over provisions in respect of prior years	(70)	28
Deferred Tax	(20)	(13)
Current year		
Prior period	(39)	14
Change in UK corporation tax rate – impact on deferred tax assets and liabilities	13	13
Ordinary taxation credit for the year	-	(96)
Deferred tax	(116)	(54)
Current year		
Exceptional taxation charge for the year	1,069	-
	1,069	-

	Year ended 31 December 2008 £m	Year ended ¹ 31 December 2007 £m
Profit/(loss) before tax	(389)	145

The tax on the Group's profit/(loss) before tax differs from the theoretical amount that would arise by applying the UK statutory tax rate to the accounting profits/(losses) of the Group as follows:

	Year ended 31 December 2008 £m	Year ended ¹ 31 December 2007 £m
Reconciliation of the tax charge		
Tax calculated at the UK statutory rate of 28.5% (31 December 2007: 30%)		
Expenses not deductible for tax purposes	(110)	44
Change in UK corporation tax rate	-	(1)
Adjustments in respect of current income tax of previous years	1	(97)
Adjustments in respect of deferred income tax of previous years	(20)	(13)
Ordinary taxation credit for the year	13	13
	(116)	(54)
Deferred tax – impact arising from the abolition of Industrial Buildings Allowances	1,069	-
Exceptional taxation charge for the year	1,069	-
	1,069	-

¹ Comparative income statement information includes Gatwick in discontinued operations.

A number of changes to UK corporation tax system were announced in the March 2007 Budget statement; some of which were enacted in the 2007 Finance Act and some in the 2008 Finance Act.

In particular, the UK Government announced that Industrial Buildings Allowances ('IBAs') would be abolished over three years from 1 April 2008. As a consequence, the Group has been obliged to recognise in 2008 an exceptional accounting loss in the form of a deferred tax charge amounting to £1,175 million (£106 million of which relates to discontinued operations) following substantive enactment which occurred in July 2008. In effect, this accounting charge reflects as a one off loss the forfeiture of all the future tax relief on expenditure which was incurred before substantive enactment. There is no impact on cash in 2008 and the accounting impact will be neutral in the long term as the loss will unwind over the life of the underlying assets.

The cash impact of the abolition of IBAs on the Group in 'quinquennium 5' is not material due to the transitional period regime applicable to 2011 and the low taxable income base of the Group. 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), following the CC's comments in its report to the CAA dated 28 September 2007. Under the existing regulatory framework, the present value of the reduced cash flows for the existing assets would be approximately £370 million.

This loss has been recorded in accordance with IAS 12 – Income Taxes. However, the accounting treatment at present required for the abolition of IBAs differs significantly from that expected in the new IAS 12. The current exposure draft (issued in March 2009) indicates that a loss would not be required to be booked.

BAA (SH) LIMITED

Notes to the financial statements (continued)

7 Discontinued operations

During 2008 a sale process commenced for the Group's interest in Gatwick Airport Limited. The Group considers that this transaction satisfies the requirements of IFRS 5 - 'Non-current assets held-for-sale and discontinued operations'.

Net profit from discontinued operations

	Year ended 31 December 2008			Year ended 31 December 2007 ¹		
	Before certain re-measurements	Certain re-measurements	Total	Before certain re-measurements	Certain re-measurements	Total
	£m	£m	£m	£m	£m	£m
Revenue	465	-	465	410	-	410
Fair value (losses)/gains	-	(43)	(43)	-	39	39
Operating costs	(297)	-	(297)	(273)	-	(273)
Depreciation and amortisation	(47)	-	(47)	(57)	-	(57)
Other	(297)	-	(297)	(273)	-	(273)
Operating profit from discontinued operations	121	(43)	78	80	39	119
<i>Analysed as:</i>						
Operating profit before exceptional items	112	(43)	70	97	39	136
Exceptional items	9	-	8	(17)	-	(17)
Financing						
Finance income	3	-	3	5	-	5
Finance costs	(63)	-	(63)	(32)	-	(32)
Capitalised Interest	4	-	4	2	-	2
Net finance costs	(56)	-	(56)	(25)	-	(25)
Profit before tax from discontinued operations	65	(43)	22	55	39	94
Taxation – ordinary	(24)	16	(8)	(9)	(11)	(20)
Taxation – exceptional ²	(106)	-	(106)	-	-	-
Tax (charge)/credit on profit of discontinued operations	(130)	16	(114)	(9)	(11)	(20)
Net profit from discontinued operations	(65)	(27)	(92)	46	(11)	(20)
Interim dividends paid	-	-	-	65	-	65

¹ Comparative income statement information includes Gatwick in discontinued operations.

² Total exceptional deferred tax charge of £106 million related to the abolition of Industrial Buildings Allowances.

8 Dividends

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Equity dividends declared and paid during the year		
Interim dividends paid (see below)	702	121 ¹
Final dividend paid (see below)	-	30
	702	151

¹ This amount includes £65 million relating to Gatwick Airport.

The company paid an interim dividend of £702 million (28p per share) on 18 August 2008. Prior year dividend payments relate to payments made by Heathrow Airport Limited, Gatwick Airport Limited and Stansted Airport Limited to their previous immediate parent entity amounting to £151 million.

BAA (SH) LIMITED

Notes to the financial statements (continued)

9 Property, plant and equipment

Cost	Note	Terminal complexes £m	Airfields £m	Plant and equipment £m	Other land and buildings £m	Rail £m	Assets in the course of construction £m	Total £m
Balance 1 January 2007								
Additions		4,890	773	451	66	669	5,001	11,850
Net transfers from/(to) investment properties	10	1	-	1	-	-	1,062	1,064
Transfers from/(to) completed assets		290	198	46	17	11	(31)	(23)
Borrowing costs capitalised	5/7	-	-	-	-	-	(562)	-
Disposals		(4)	-	-	-	-	258	258
Transferred to assets held-for-sale	21	-	-	-	-	-	-	(4)
Balance 1 January 2008		5,177	971	498	91	680	5,728	13,145
Additions		9	-	3	-	-	976	988
Net transfers from/(to) investment properties	10	-	-	-	2	-	(259)	(257)
Transfers from/(to) completed assets		3,748	328	97	18	685	(4,876)	-
Inter-company transfers		-	-	-	-	-	22	22
Borrowing costs capitalised	5/7	-	-	-	-	-	100	100
Disposals		(4)	-	(2)	-	(8)	-	(14)
Reclassification		125	-	(10)	(12)	-	(103)	-
Transferred to assets held-for-sale	21	(1,440)	(193)	(120)	(29)	-	(73)	(1,855)
Balance 31 December 2008		7,615	1,106	466	70	1,357	1,515	12,129
Depreciation								
Balance 1 January 2007								
Charge		(1,639)	(212)	(346)	(15)	(149)	-	(2,361)
Disposals		(263)	(36)	(19)	(4)	(19)	-	(341)
Transferred to assets held for sale	21	3	-	-	-	-	-	3
Balance 1 January 2008		(1,899)	(248)	(365)	(19)	(168)	-	(2,699)
Charge		(375)	(40)	(30)	(5)	(36)	-	(486)
Disposals		4	-	2	-	8	-	14
Reclassification		2	-	21	(9)	(14)	-	-
Transferred to assets held for sale	21	571	73	79	6	-	-	729
Balance 31 December 2008		(1,697)	(215)	(293)	(27)	(210)	-	(2,442)
Net book value 31 December 2008		5,918	891	173	43	1,147	1,515	9,687
Net book value 31 December 2007		3,278	723	133	72	512	5,728	10,446

BAA (SH) LIMITED

Notes to the financial statements (continued)

9 Property, plant and equipment (continued)

Property, plant and equipment includes £179 million (2007: £179 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 (refer to note 19).

Assets in the course of construction include £167 million (2007: £129 million) in respect of the development of a second runway and related infrastructure at Stansted Airport. The costs consist of £79 million (2007: £63 million) incurred in respect of the initial planning application preparation and £88 million (2007: £66 million) in respect of the purchase of domestic properties that fall within the expanded airport boundary. This includes a provision of £5 million (2007: £4 million) for the additional 10% payable under the Home Value Guarantee Scheme (HVGS) once planning permission has been obtained. Assets in the course of construction also include the second satellite under construction for Terminal 5 (T5C), the future first satellite for Terminal 2 as well as Terminal 4 Extension and Terminal 3 refurbishments at Heathrow.

Other land and buildings are freehold except for certain short leasehold properties with a net book value of £20 million (2007: £17 million).

Borrowing costs capitalised

The amount of borrowing costs included in the cost of Group assets was £1,215 million (2007: £1,115 million). Borrowing costs were capitalised at an average rate of 6.92% (2007: 5.95%).

Capitalised interest of £96 million has been treated as tax deductible in the period.

Security granted by the Group over its assets, including property, plant and equipment, is disclosed in note 15.

10 Investment properties

	Note	Airport investment properties £m	Assets in the course of construction £m	Total £m
Valuation				
Balance 1 January 2007		2,685	8	2,693
Additions		-	-	-
Net transfers from operational assets	9	24	(1)	23
Disposals		(2)	-	(2)
Valuation gain		26	-	26
Balance 1 January 2008		2,733	7	2,740
Additions		-	-	-
Net transfers from operational assets	9	253	4	257
Disposals		-	-	-
Valuation loss [†]		(190)	-	(190)
Transfer (to)/from assets held-for-sale	21	(651)	(3)	(654)
Balance 31 December 2008		2,145	8	2,153

[†] Included within net loss from discontinued operations is £43 million relating to Gatwick Airport Limited.

Airport investment properties were valued at fair value at 31 December 2008 by Drivers Jonas, Chartered Surveyors and Strutt and Parker, Chartered Surveyors.

Details of the valuations performed are provided below:

	Note	31 December 2008 £m	31 December 2007 £m
Drivers Jonas		2,795	1,884
Strutt and Parker		12	13
At professional valuation		2,807	1,897
At directors' valuation		-	843
Less Transferred to Assets held-for-sale	21	(654)	-
		2,153	2,740

The investment properties held by Gatwick have been transferred to assets classified as held-for-sale at 31 December 2008 (Note 21).

BAA (SH) LIMITED

Notes to the financial statements (continued)

10 Investment properties (continued)

The investment properties held by Gatwick have been transferred to assets classified as held-for-sale at 31 December 2008.

All valuations were prepared in accordance with IFRS 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. There were no restrictions on the realisability or remittance of income or proceeds on disposal.

Void areas amounted to 38,385m² in the period (31 December 2007: 13,018m²) representing 3.15% (31 December 2007: 1.10%) of the Group's investment property portfolio.

Investment properties are let on either full repair and insuring leases, under which all outgoings are the responsibility of the lessee, or under tenancies, where costs are recovered through a service charge levied on tenants during their period of occupation. This service charge amounted to £3 million (31 December 2007: £4 million) for which a similar amount is included within operating costs.

Security granted by the Group over its assets, including investment properties, is disclosed in Note 15.

11 Intangible assets

	Note	£m
Cost		
Balance 1 January 2007		
Additions		166
Disposals		9
Transferred to assets held-for-sale	21	-
Balance 1 January 2008		-
Additions		175
Transferred to assets held-for-sale		28
Balance 31 December 2008		-
		203
Amortisation		
Balance 1 January 2007		
Charge for the year		(87)
Disposals		(24)
Balance 1 January 2008		-
Charge for the year		(111)
Transferred to assets held-for-sale	21	(27)
Balance 31 December 2008		-
Net book value 31 December 2008		(138)
Net book value 31 December 2007		65
		64

All intangible assets relate to capitalised computer software costs.

These software costs principally relate to operating and financial software. These assets are being amortised over a period of between three and seven years. Amortisation for the year has been charged through operating costs.

Software costs include assets in the course of construction of £12 million (2007: £15 million).

12 Inventories

	As at 31 December 2008 £m	As at 31 December 2007 £m
Consumables	5	8
	5	8

The total amount of inventories consumed in the year relating to continuing operations was £1 million (2007: £nil). The total amount of consumables consumed in the year relating to discontinued operations was £1 million (2007: £nil). There is no material difference between the balance sheet value of inventories and the replacement cost.

BAA (SH) LIMITED

Notes to the financial statements (continued)

13 Trade and other receivables

	31 December 2008 £m	31 December 2007 £m
Non-current		
Amounts owed from group undertakings	-	574 ²
Current		
Trade receivables		
Less: Provision for impairment	206	166
Trade receivables – net	(2)	(3)
Prepayments	204	163
Group tax relief receivable	78	28
Amounts owed from group undertakings ¹	38	-
Other receivables	40	569 ²
Total current	37	33
	397	793

¹ Amount owed by group undertakings largely relates to external payments received by BAA Airports Limited under the Shared Services Agreement on behalf of the Group's airports that will be remitted to the airports in due course. This amount is repayable on demand and accrues interest at Bank of England base rate +1.5%.

² These amounts were fully settled on refinancing in August 2008. Refer to Note 5 for interest accrued on the balance during the current year prior to settlement.

The fair values of loans, trade and other receivables are not materially different from the carrying value. Unless otherwise stated, trade and other receivables do not contain impaired assets. Trade receivables are non-interest bearing and are generally on 14 day terms. No collateral is held as security. There are no related party amounts in trade and other receivables.

As of 31 December 2008, trade receivables of £118 million (2007: £122 million) were fully performing. Trade receivables of £86 million (2007: £41 million) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The ageing analysis of these trade receivables is as follows:

	31 December 2008 £m	31 December 2007 £m
Up to 3 months	80	40
Over 3 months	6	1
	86	41

Additional disclosure on credit risk is included in Note 19.

Movements in the provision for impairment of trade receivables are as follows:

	£m
At 1 January 2007	-
Provision for receivables impairment	3
Receivables written off during the year as uncollectible	(2)
At 1 January 2008	1
Provision for receivables impairment	1
Receivables written off during the year as uncollectible	-
At 31 December 2008	2

As of 31 December 2008, trade receivables of £2 million (2007: £3 million) were considered for impairment of which an amount of £2 million (2007: £3 million) was provided with the remaining amount expected to be fully recovered. The individually impaired receivables mainly relate to customers who are in difficult economic situations. The creation and release of provisions for impaired receivables has been included in 'general expenses' in the income statement. Amounts charged to the provision account are generally written off when there is no expectation of recovery. The ageing of these receivables is as follows:

	31 December 2008 £m	31 December 2007 £m
3 to 6 months	2	3
	2	3

The Group is not exposed to significant foreign currency exchange risk as the majority of trade and other receivables are denominated in Sterling. Additional disclosure on credit risk management is included in Note 17.

BAA (SH) LIMITED

Notes to the financial statements (continued)

14 Cash and cash equivalents

	31 December 2008 £m	31 December 2007 £m
Cash at bank and in hand	25	-
Short-term deposits	142	-
	167	-

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

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments, and consists of:

	Note	31 December 2008 £m	31 December 2007 £m
Cash at bank and in hand		25	-
Short-term deposits		142	-
Cash and cash equivalents held by operations classified as held-for-sale	21	15	-
		182	-

At 31 December 2008, cash and cash equivalents classified as held-for-sale includes balances held by Gatwick Airport Limited, refer to note 21.

15 Borrowings

	31 December 2008 £m	31 December 2007 £m
Current		
Secured		
Bank Loans - EIB		
Unsecured	43	-
Amounts owed to group undertakings		
Intercompany loans ¹	-	7,030 ¹
Total current (excluding interest payable)	-	1,199 ¹
Interest payable	43	8,229
Total current	179	1
	222	8,230

Non-current

Secured

BAA Funding Limited bonds:

3.975% €1,000 million due 2012	893	-
5.850% £400 million due 2013	363	-
4.600% €750 million due 2014	656	-
12.450% £300 million due 2016	387	-
4.600% €750 million due 2018	628	-
9.200% £250 million due 2021	287	-
5.225% £750 million due 2023	606	-
7.075% £200 million due 2028	197	-
6.450% £900 million due 2031	837	-
Total BAA Funding Limited bonds	4,854	-
Senior Refinancing Facility	2,700	-
Junior Refinancing Facility	589	-
Subordinated Facility due 2011	1,563	-
Initial Credit Facility	197	-
Bank Loans - EIB	372	-

Unsecured

BAA (SP) Limited debenture

Amounts owed to group undertakings	-	1,600 ²
Total non-current	-	213¹
Total current and non-current (excluding interest payable)	10,275	1,813
	10,318	10,042

¹ These amounts were fully settled on refinancing in August 2008. Refer to Note 5 for interest accrued on the balance during the current year prior to settlement.

² Relates to the BAA (SP) Limited Debenture which has been treated as if it had been issued in the prior year as a result of the application of merger accounting. Refer to detail below.

BAA (SH) LIMITED

Notes to the financial statements (continued)

15 Borrowings (continued)

BAA Funding Limited bonds

In August 2008, as part of the BAA Limited refinancing, the bonds previously issued by BAA Airports Limited (formerly BAA Limited) were cancelled and replaced by new bonds issued by BAA Funding Limited. The BAA Funding Limited bonds were recognised at initial fair value and then subsequently carried at amortised cost using the effective interest rate method.

In August 2008, as part of the wider BAA refinancing, costs of £44 million were incurred in relation to the issue of bonds by BAA Funding Limited and these have been included in the carrying value of the bonds above. Bonds are carried at amortised cost using the effective interest rate method and the carrying value includes un-amortised transaction costs, premiums and discounts. The effective interest rate on the bonds varies between 6.28% and 7.75%.

The dates listed above for the BAA Funding Limited bonds correspond to the maturity dates of the loans between the airport operating company of Heathrow Airport Limited and the funding vehicle, BAA Funding Limited. Failure to repay these loans on their maturity date will be an event of default allowing BAA Funding Limited to take action under its loan agreement, such as appointing an administrative receiver to Heathrow Airport Limited.

The bonds issued by BAA Funding Limited have a legal maturity date two years after the maturity date of the corresponding loan with Heathrow Airport Limited. If Heathrow Airport Limited fails to repay its loans to BAA Funding Limited on their maturity dates then the corresponding bond of BAA Funding Limited will not be in default for at least another two years during which time the relevant bond will have a floating interest rate of Libor plus 4%.

Interest and principal payments on all Euro bonds are swapped to fixed Sterling payments through cross-currency and interest rate swaps. All BAA Sterling bonds bear fixed rate coupons.

Bonds issued under the £4.5 billion European Medium Term Note programme totalled £3,603 million. The carrying value of these bonds was £3,907 million as at 31 December 2008.

Refinancing Facilities

In August 2008 as part of the BAA refinancing, £3,400 million Senior refinancing facility and £1,000 million Junior refinancing facilities were drawn by Heathrow Airport Limited, Gatwick Airport Limited and Stansted Airport Limited (the "Borrowers"), in order to repay the Senior Facilities previously held by BAA Limited since its acquisition of the former BAA plc in 2006. The facilities held by Heathrow Airport Limited and Stansted Airport Limited included in borrowings above have the following partial maturities of £250 million in 2010, £1 billion in 2011, £1 billion in 2012, and £1.1 billion in 2013. The amount drawn by Gatwick Airport Limited (Senior £650 million, Junior £400 million) is classified as Assets Held for Sale as at 31 December 2008 and has maturities of £750 million in 2010, and £300 million in 2013.

The interest on these facilities is based on Libor with a margin of 2.00% on the Senior Facility and 2.75% on the Junior Facility as at 31 December 2008. The interest rate margin changes with the facility balances as follows:

Senior Facility		Junior Facility	
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, the contractual margin step ups on the Senior and Junior facilities are 0.25% in August 2010 and 0.25% each six months thereafter, provided that the aggregate increase in the margin shall be limited to 1.50% per annum.

The prepayment of the Senior Refinancing Facility and Junior Refinancing Facility regardless of where the facility is held, are based on the terms of the Refinancing Facility Agreement. This states that in the event of a disposal of an airport, the 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 RAR is no more than or equal to 0.70 and the Junior RAR 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.

The balance of the designated group Initial Credit Facility used to fund capital expenditure as at 31 December 2008 was £250 million. The interest rate on this facility is based on Libor with a margin of 2.00% as at 31 December 2008. In addition, there are contractual margin step ups of 0.25% in August 2010 and 0.25% each six months thereafter provided that the aggregate increase in the margin shall be limited to 1.50% per annum. If there is no balance outstanding on the Refinancing Facility the margin shall be 1.00%.

Subordinated Facility due 2011

The £2,000 million Subordinated Facility was drawn in full on 10 July 2006 by BAA Limited (formerly Airport Development and Investment Limited) and partially repaid in 2007. In August 2008, £400 million of this facility was repaid as part of the BAA refinancing and was also novated from BAA Limited to BAA (SH) Limited. The interest on the facility is based on Libor with a margin of 4.00% as at 31 December 2008 (2007: 4.00%).

Other Borrowings

Secured bank loans comprise £417 million (excluding capitalised debt costs) of European Investment Bank ('EIB') facilities split between current and non-current. The EIB facilities amortise over the period to 2022. The interest rate on these facilities is predominant floating, except for £13 million EIB principal which is fixed at 6.21%.

BAA (SH) LIMITED

Notes to the financial statements(continued)

15 Borrowings (continued)

BAA (SP) Limited Debenture

The BAA (SP) Limited Debenture was issued in January 2008 to BAA Airports Limited. At the balance in 31 December 2007 relates to this debenture which has been treated as if it had been issued in the prior year as a result of the application of merger accounting. On refinancing in August 2008, £34.2 million was repaid and the remaining balance novated from BAA Airports Limited to BAA (SH) Limited, and therefore eliminates in the Group as at 31 December 2008. The current balance payable from BAA (SP) Limited to BAA (SH) Limited is used to generate interest payment to BAA (SH) Limited in order to pay the external interest on the Subordinated Facility. The interest on the BAA (SP) Limited Debenture is 0.01% above the rate of the Subordinated Facility, and the debenture has a final redemption date of May 2011.

All of the above borrowings are recorded at amortised cost.

Amount owed to group undertakings and other intercompany loans

As at 31 December 2007, the amount owed to group undertakings of £7,030 million accrued interest at Bank of England base rate +1.5% and the intercompany loan of £1,199 million to BAA Airports Limited and London Airports 1992 Limited accrued interest at Bank of England base rate +1.0%. Amounts owed to group undertakings of £213 million accrued interest with fixed rates between 5.75% and 6.58%. These loans were all settled in full as part of the refinancing in August 2008.

Fair value of borrowings

	31 December 2008		31 December 2007	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Non-current				
Long-term debt	10,275	9,182	1,813	1,820
	10,275	9,182	1,813	1,820

The fair value of short-term borrowings approximates book value. Accrued interest is included as a current borrowings balance and not in the carrying amount of non-current borrowings. The fair values of listed borrowings are based on quoted prices. For unlisted borrowings, the Group establishes fair values by using valuation techniques such as discounted cash flow analysis. The fair value of non-current borrowings which have floating rate interest are assumed to equate to their current nominal value.

Covenants

The Subordinated Facility contains customary restrictions on change of control and distributions to shareholders as well as financial covenants. Under this facility, the Group is required to maintain certain debt cover and cash flow cover ratios. The required levels as at 31 December 2008 were less than 1:1 for the debt cover ratio and a minimum of 1.05:1 for the cash flow cover ratio.

The BAA Funding Limited bonds, Refinancing Facilities and the Initial Credit Facilities are required to comply with the covenants under the Common Terms Agreement (CTA). 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 the Subordinated Facility 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.

BAA (SH) LIMITED

Notes to the financial statements (continued)

15 Borrowings (continued)

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.

Additional disclosures on risk management and hedging of borrowings are included in Note 16 and 17.

Securities and guarantees

BAA (DSH) Limited (immediate parent entity of BAA (SH) Limited), Heathrow Airport Limited, 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 (at BAA (SH) Limited) under the Subordinated Facility.

BAA (DSH) Limited and its subsidiaries (other than BAA Funding Limited and Heathrow Airport Community Board Insulation Limited), plus ADI Finance 2 Limited, BAA Limited, BAA Airports Holdco Limited and BAA Airports Limited are guarantors under the Subordinated Facility. All the guarantors, apart from ADI Finance 2 Limited, are party to transaction security which secures liabilities arising under the Subordinated Facility.

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 Obligors, such right ranking *pari passu* with the Class A creditors of the Obligors.

BAA Airports Limited (formerly BAA Limited) has provided a guarantee to Deutsche Trustee Company Limited (the Bond Trustee) for itself and on behalf of the BAA Guaranteed Bondholders in respect of bonds with a final legal maturity of no later than 2018 issued by BAA Funding Limited.

BAA Funding Limited has provided security to the Bond Trustee (as trustee for the Issuer Secured Creditors).

Heathrow Airport Limited, 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.

Liquidity

As at 31 December 2008, the Group had cash and cash equivalents of £167 million excluding cash held by entities classified as assets held for sale (2007: £nil) and undrawn committed facilities of £2,500 million (2007: £nil).

BAA (SH) LIMITED

16 Derivative financial instruments

2008	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Forward foreign exchange contracts - no hedge accounting	45	7	-	7
Index-linked interest rate swaps - no hedge accounting	2,206	131	(312)	(181)
	2,251	138	(312)	(174)
Non-current				
Interest rate swaps - cash flow hedge	4,426	72	(354)	(282)
Cross-currency swaps - cash flow hedge	1,703	758	-	758
	6,129	830	(354)	476
At 31 December 2008	8,380	968	(666)	302

Any derivatives that are not in qualifying hedge relationships at the reporting date are presented as current irrespective of their maturities.

As part of the BAA refinancing in August 2008, some of the derivatives previously held at BAA Airports Limited (formerly BAA Limited) and BAA Limited (formerly Airport Development and Investment Limited) were novated into the Group.

Interest rate swaps

The fixed interest rates on the swaps vary from 4.7% to 5.5%. The floating rates for all interest rate swaps are based on three and six month Libor rates. In 2008 a £24 million loss was recognised in the income statement due to ineffectiveness in relation to the cash flow hedges as described above. In addition a £13 million loss was recognised in the income statement in relation to the swaps that did not qualify for hedge accounting during the period. The gains and losses deferred in equity on the cash flow hedges described above will be continuously released to the income statement over the period of the hedged risk.

During the period, swaps with a notional principal of £1,813 million were designated as cash flow hedges against interest rate risk on the Group's Refinancing Facility effective 1 October 2008.

In addition to the novated swaps, new interest rate swaps with notional amount totalling £113 million were also taken out during the period. These swaps, together with £400 million notional amount of interest rate swaps have been designated as a cash flow hedge against currency and interest rate risk on the €750 million bond due 2014 in conjunction with a cross currency swap (see below). The gains and losses deferred in equity on these swaps will be continuously released to the income statement over the period to maturity of the hedged bond. The fixed interest rates vary from 5.1% to 5.5% (2007: nil) and the floating rates are based on six month Libor.

New interest rate swaps with a total notional amount of £200 million were entered into during the year. The fixed interest rates vary from 5.2% to 5.4% (2007: nil) for all the swaps and the floating rates are based on three and six month Libor. These swaps have been designated as a cash flow hedge against interest rate risk on the Subordinated Facility during the period.

Index-linked swaps with a notional principal of £2,206 million (2007: £nil) were entered into to economically hedge cash flows on future issuance of index-linked debt and RPI based revenue. The real fixed interest rates, before applying RPI accretion, vary from 2.2% to 8.4% and the receive leg of the swaps was fixed at rates varying from 2.2% to 12.4%. Index-linked swaps did not qualify for hedge accounting during the period. A gain of £81 million was recognised in the income statement.

Cross currency swaps

Two cross currency swaps have been entered into by the Group to hedge currency and cash flow interest rate risk on the €1 billion bond due 2012 and the €750 million bond due 2018. Under the €1 billion (£680 million) swap, the Group receives Euro interest at a fixed rate of 4.0% and pays Sterling interest at fixed rates which vary from 5.2% to 5.4%, and under the €750 million (£510 million) swap, the Group receives Euro interest at a fixed rate of 4.6% and pays Sterling interest at fixed rates which vary from 5.5% to 5.7%. The gains and losses deferred in equity on these swaps will be continuously released to the income statement over the period to maturity of the hedged bonds.

In addition, the Group entered into a €750 million (£513 million) cross currency swap. Under this swap, the Group receives Euro interest at a fixed rate of 4.6% and pays Sterling interest at a variable rate based on six month Libor. This swap together with the £400 million interest rate swap (see above) novated from BAA Airports Limited and the new £113m interest rate swap, were designated as a cash flow hedge against currency and cash flow interest rate risk on the €750 million bond due 2014. The gains and losses deferred in equity on this swap will be continuously released to the income statement over the period to maturity of the hedged bond.

Foreign exchange contracts

Foreign exchange forward and swap contracts have been entered into buying US \$12 million (2007: nil), €28 million (2007: nil), Swiss Fr 8 million (2007: nil) and Polish PLN 1 million (2007: nil) against Sterling. The currency forwards and swaps are used to manage exposures relating to future capital expenditure although hedge accounting is not sought for these derivatives.

BAA (SH) LIMITED

Notes to the financial statements (continued)

17 Financial Instruments

Financial risk management objectives and policies

The Group's principal financial instruments (other than derivatives) comprise bank loans, listed bonds, cash and short-term deposits. The main purpose of these instruments is to raise finance for the Group's operations.

The Group also enters into derivative transactions, principally interest rate swaps, cross currency swaps and forward currency contracts. The purpose of these derivatives is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance.

The Group does not use financial instruments for speculative purposes. The treasury function operates on a centralised non-speculative risk basis. Its purpose is to identify, mitigate and hedge treasury-related financial risks inherent to the Group's business operations and funding.

The main risks arising from the Group's financial instruments are market risk (including fair value interest rate risk, foreign currency risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Board approves prudent treasury policies for managing each of the risks summarised below.

Foreign exchange risk

For debt raised in foreign currencies, the Group uses cross-currency swaps to hedge the related interest and principal payments and 100% of the exposure is hedged in this way, subject to a de minimis limit. The Group uses foreign currency forward contracts to hedge material capital expenditure in foreign currencies once a project is certain to proceed. As at 31 December 2008, there were no significant unmatched exposures.

As at 31 December 2008, if the Sterling had strengthened by 10% against the Euro, with all other variables remaining constant, pre-tax profit for the year would have decreased by £2 million (31 December 2007: increased by £3 million), and if the Sterling had weakened by 10% against the Euro, with all other variables remaining constant, pre-tax profit for the year would have increased by £3 million (31 December 2007: decreased by £4 million).

As at 31 December 2008, if the Sterling had strengthened by 10% against the USD, with all other variables remaining constant, pre-tax profit for the year would have increased by £0.3 million (31 December 2007: £nil effect on pre tax profit), and if the Sterling had weakened by 10% against the USD, with all other variables remaining constant, the pre-tax profit for the year would have decreased by £0.4 million (31 December 2007: £nil effect on pre tax profit).

Price risk

The Group is not materially exposed to equity security price risk on investments held by the Group.

The Group is exposed to RPI price risk on index-linked derivatives held to economically hedge cash flows on future issuance of index-linked debt and RPI based revenue. As at 31 December 2008, if the RPI Index had increased 10%, with all other variables remaining constant, pre-tax profit for the year would have decreased by £54 million and the impact on current year hedge reserve in equity would be nil (31 December 2007: nil impact on pre-tax profit and equity). If the RPI Index had decreased 10%, with all other variables remaining constant, pre-tax profit for the year would have increased by £53 million and the impact on current year hedge reserve in equity would be nil (31 December 2007: nil impact on pre-tax profit and equity).

Cash flow and fair value interest rate risk

The Group's interest rate risk arises primarily from its borrowings. Borrowings issued at variable interest rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group's policy is to maintain a mix of fixed to floating rate debt within Board approved parameters such that a minimum of 70% of existing and forecast debt is at a fixed rate. To manage this mix, the Group enters into interest rate swaps. These swaps may be designated to hedge underlying debt obligations. The Group also uses floating rate interest bearing financial assets as a natural hedge of the exposure to fair value interest rate risk.

The Group may use forward-starting interest rate swaps to minimise exposure to cash flow interest rate risk for future forecast issuance of debt.

As at 31 December 2008, the Group's fixed floating interest rate profile, after hedging, on net debt was 76:24. The Group had no external borrowings as of 31 December 2007.

As at 31 December 2008, if interest rates had moved by 0.50%, this would have resulted in the following gain/(loss) to pre-tax profit and equity, due to movement in the interest income, interest charge and mark-to-market valuation of derivatives.

	31 December 2008		31 December 2007	
	Income statement impact	Equity impact	Income statement impact	Equity impact
	£m	£m	£m	£m
0.50% increase	17	195	-	-
0.50% decrease	(18)	(214)	-	-

Credit risk

Credit risk arises from cash and cash equivalents, derivative financial instruments and accounts receivable. The Group has no significant concentrations of credit risk. The Group's exposure to credit related losses, in the event of non-performance by counterparties to financial instruments, is mitigated by limiting exposure to any one party or instrument and ensuring only counterparties within defined credit risk parameters are used.

The Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short-term and long-term credit ratings. Accordingly, at 31st December 2008, cash and cash equivalents were held with market counterparties with credit ratings ranging from AAA to A (Long Term) and A-1+ to A-1 (Short Term). Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with credit ratings lower than A- / A-1.

As at 31 December 2008, the Group had total credit risk with derivative counterparties of its interest rate swaps, index linked swaps and cross currency swaps of £961 million. Of these asset positions, the counterparties with credit rating of A+ had assets of £471 million, AA+ had assets of £104 million, AA had assets of £252 million and AA- had assets of £134 million. BAA Limited monitors the credit rating of the derivative counterparties on a daily basis and ensures no positions are held with counterparties with a credit rating of below BBB+/A. Financial assets past due but not impaired are disclosed in Note 13. The maximum exposure to credit risk as at 31 December 2008 is £1,209 million (2007: £196 million).

BAA (SH) LIMITED

Notes to the financial statements (continued)

17 Financial Instruments (continued)

Liquidity risk

The Group's objective is to ensure continuity of funding and flexibility, ensuring debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year.

The Group has the following undrawn committed borrowing facilities available at 31 December in respect of which all conditions precedent had been met at that date:

	31 December 2008	31 December 2007
	£m	£m
Floating rate facilities		
Expiring in more than two years	2,500	-

The above facilities were taken out during the year as part of BAA Refinancing. Refer to Note 15, Borrowings. As at 31 December 2008, overdraft facilities of £5 million were available (31 December 2007: £10 million).

The tables below analyse the Group's financial liabilities and net settled derivative financial liabilities based on the nominal balance as at 31 December to the contractual maturity date. The amounts disclosed are based on contractual undiscounted cash flows.

	31 December 2008			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Borrowing principal payments	43	1,041	6,409	3,638
Borrowing interest payments	620	586	1,168	2,134
Derivative financial instruments	(74)	(16)	104	309
Trade payables	110	-	-	-

	31 December 2007			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Borrowing principal payments	8,242	-	1,600	200
Borrowing interest payments	747	176	281	3
Trade payables	142	-	-	-

The tables below analyse the Group's derivative financial instruments which will be settled on a gross basis based on the remaining period as at 31 December 2008 and 31 December 2007 to the contractual maturity date.

	31 December 2008			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Cross currency derivative payment	44	44	167	143
Cross currency derivative receipts	(104)	(104)	(274)	(198)

	31 December 2007			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Cross currency derivative payment	-	-	-	-
Cross currency derivative receipts	-	-	-	-

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure.

Refer to Note 15 for further disclosure on the Group's compliance with financial covenants.

BAA (SH) LIMITED

Notes to the financial statements (continued)

17 Financial instruments (continued)

Financial Instruments by category

The financial instruments of the Group as classified in the financial statements as at 31 December, can be analysed under the following IAS 39 categories:

31 December 2008

	Loans and receivables	Assets at fair value through income statement	Derivatives qualifying for hedge accounting	Available- for-sale	Total
	£m	£m	£m	£m	£m
Derivative financial instruments	-	138	830	-	968
Trade receivables	204	-	-	-	204
Other receivables	37	-	-	-	37
Total Financial Assets	241	138	830	-	1,209

31 December 2008

	Liabilities at fair value through income statement	Derivatives qualifying for hedge accounting	Other financial liabilities	Total
	£m	£m	£m	£m
Borrowings	-	-	(10,318)	(10,318)
Derivative financial instruments	(312)	(354)	-	(666)
Trade payables	-	-	(110)	(110)
Total Financial Liabilities	(312)	(354)	(10,428)	(11,094)

31 December 2007

	Loans and receivables	Assets at fair value through income statement	Derivatives qualifying for hedge accounting	Available- for-sale	Total
	£m	£m	£m	£m	£m
Trade receivables	163	-	-	-	163
Other receivables	33	-	-	-	33
Total Financial Assets	196	-	-	-	196

31 December 2007

	Liabilities at fair value through income statement	Derivatives qualifying for hedge accounting	Other financial liabilities	Total
	£m	£m	£m	£m
Borrowings	-	-	(10,042)	(10,042)
Trade payables	-	-	(142)	(142)
Total Financial Liabilities	-	-	(10,184)	(10,184)

At 31 December 2008, the company has not designated any financial assets or financial liabilities at fair value through the income statement. The only financial assets and financial liabilities at fair value through the income statement are derivatives that do not qualify for hedge accounting.

BAA (SH) LIMITED

Notes to the financial statements (continued)

18 Deferred income tax

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

	Note	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Balance 1 January 2008			
Credited to income statement		1,490	1,551
Impact of abolition of Industrial Buildings Allowances – charged to income statement		(45) ¹	(57) ³
Credited to equity		1,175 ²	-
Transfer of subsidiary to asset held-for-sale	21	(131)	(4)
Balance 31 December 2008		(373)	-
		2,116	1,490

¹ Includes £18 million credit to income statement relating to discontinued operations.

² A number of changes to UK corporation tax were announced in the March 2007 Budget statement; some of which were enacted in the Finance Act 2008. The effect of the phased abolition of IBAs which was enacted in the 2008 Finance Act, has resulted in an increase in the deferred tax liability prior to substantive enactment which occurred in July 2008. The recognition of this liability has no cash impact and it will unwind over the life of the underlying assets.

³ Includes £11 million charge to income statement relating to discontinued operations.

The amounts of deferred income tax provided are detailed below:

Deferred income tax liabilities

Note	Excess of capital allowances over depreciation £m	Revaluations of investment property to fair value £m	Tax on rolled over gains £m	Other £m	Total £m
Balance 1 January 2007	779	736	13	23	1,551
Credited to income statement	(13)	(41)	(1)	(2)	(57)
Credited to equity	-	(4)	-	-	(4)
Balance 31 December 2007	766	691	12	21	1,490
(Credited)/charged to income statement	(54)	(62)	-	36	(80)
Impact of abolition of IBAs charged to income statement	1,175	-	-	-	1,175
Credited to equity	-	(3)	-	-	(3)
Transfer of subsidiary to asset held-for-sale	21	(218)	-	(5)	(373)
Balance at 31 December 2008	1,669	476	12	52	2,209

Deferred income tax assets

	IAS 32/39 £m	Total £m
Balance at 1 January 2008		
Credited to the income statement	-	-
Credited to equity	(35)	(35)
Balance 31 December 2008	128	128
	93	93

Deferred income tax credited to equity during the year is as follows:

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Fair value reserves in shareholders' equity		
Cash flow hedge reserve	128	-
Indexation – operational land	3	4
Total	131	4

BAA (SH) LIMITED

Notes to the financial statements (continued)

19 Provisions

	Note	Reorganisation £m	Obligations under land purchase £m	Pension £m	Other £m	Total £m
Balance at 1 January 2008						
Utilised		50	99	-	4	153
Charged/(released) to income statement		(8)	(1)	-	-	(9)
Capitalised in non-current assets		(15)	-	17	-	2
Unwinding of discount charged and capitalised		-	-	-	-	-
Transfer to liabilities held for sale	21	-	13	-	2	15
Balance 31 December 2008		(2)	-	(4)	-	(6)
		25	111	13	6	155
Current		25	8	13	-	46
Non-current		-	103	-	6	109
Balance 31 December 2008		25	111	13	6	155
Current		50	6	-	-	56
Non-current		-	93	-	4	97
Balance 31 December 2007		50	99	-	4	153

Reorganisation

The Group commenced implementing its restructuring programme 'Simplifying the Organisation' in late 2007. Costs associated with this programme are for severance and pension payments only. Amounts released resulted from higher staff turnover than historic experience, lower than expected cost for each reduction in headcount and certain headcount reduction not being made due to the decision to sell Gatwick. All amounts are expected to be utilised in 2009. See note 4 for further details.

Obligations under land purchase

This 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 the next 30 years to the vendor in compensation for this. The provision of £111 million (2007: £99 million), net of discount, is expected to be utilised according to the following profile:

	As at 31 December 2008 £m	As at 31 December 2007 £m
Within one year	8	6
One to two years	7	6
Two to five years	22	18
Five to ten years	26	26
Over ten years	48	43
	111	99

Pension

A provision of £17 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 Group's airports as a result of the Shared Service Agreement, as airports are committed to fund any unfunded pension plan obligation of BAA Airports Limited (refer to accounting policies for details). This provision is based on the Group'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.

Other

A provision of £5 million is held for the additional 10% payment due under a compensation scheme (once planning permission has been obtained) for the second runway and related infrastructure at Stansted Airport.

A provision of £2 million has been made for the early termination cost of a lease agreement entered into by the Group in 1998 in relation to rolling stock owned by the Group 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 (refer to note 26).

BAA (SH) LIMITED

Notes to the financial statements (continued)

20 Trade and other payables

	31 December 2008	31 December 2007
	£m	£m
Non-current		
Deferred income	6	12
Total non-current	6	12
Current		
Trade payables		
Group relief payable	110	142
Other tax and social security	-	52
Other payables	7	-
Capital payables	60	48
Total current	219	269
	396	511

Trade payables are non-interest bearing and are generally on 30-day terms. These include no related party transactions.

21 Asset held-for-sale

The major classes of assets and liabilities comprising the operations classified as held for sale are as follows:

	31 December 2008
	Gatwick
	£m
	Note
Property, plant and equipment	9
Investment property	10
Inventories	
Trade and other receivables	
Cash and cash equivalents	14
Total assets classified as held for sale	15
Trade and other payables	1,865
Current borrowings ¹	(82)
Non-current borrowings	(9)
Group relief payable	(1,033)
Deferred tax liabilities	(16)
Provisions	18
	19
Total liabilities classified as held for sale	(6)
Net assets of disposal Group	(1,519)
¹ Current borrowings relates to interest payable amounts.	346

During 2008 a sale process commenced for the Group's interest in Gatwick Airport Limited. The Group considers that this transaction satisfies the requirements of IFRS 5 - 'Non-current assets held-for-sale and discontinued operations'. As a consequence, assets and liabilities of £1,865 million and £1,519 million respectively have been reclassified as held-for-sale.

BAA (SH) LIMITED

Notes to the financial statements (continued)

22 Share capital

	£
9,000,000,000 ordinary shares of £1 each	9,000,000,000
Balance at incorporation and 31 December 2008	9,000,000,000
Authorised	
In issue at incorporation: 2 ordinary shares of £1 each	2
Issue of 2,509,350,687 ordinary shares of £1 each	2,509,350,687
In issue at 31 December 2008: 2,509,350,689 ordinary shares of £1 each	2,509,350,689

On 31 January 2008, there was an issue of 2,040,757,000 ordinary shares of £1 each and on 29 February 2008 there was a further issue of 468,593,687 ordinary shares of £1 each.

23 Revaluation reserve

	£m
Balance 1 January 2008 / 31 December 2008	365

The revaluation reserve relates to the historic revaluation of investment properties. Current revaluations of investment properties are included in the income statement.

24 Fair value and other reserves

	Merger reserves £m	Cash flow hedge reserve £m	Total £m
Balance at 1 January 2008			
Fair value losses	(2,865)	-	(2,865)
Transferred to income statement	-	(24)	(24)
Deferred tax on fair value losses	-	(434)	(434)
Balance 31 December 2008	(2,865)	128	(3,195)

25 Retained earnings

	£m
Balance 1 January 2008	2,397
Net loss for the year	(1,434)
Dividends paid during the year	(702)
Indexation – operational land	3
Balance 31 December 2008	264

BAA (SH) LIMITED

Notes to the financial statements (continued)

26 Commitments and contingent liabilities

Non-cancellable operating lease commitments – Group as a lessee

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

	31 December 2008		31 December 2007	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	14	38	10	45
Within two to five years	41	149	26	177
After five years	46	2,549	28	2,654
	101	2,736	64	2,876

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

The significant portion of the £2.7 billion operating lease commitments classified as 'other' is electricity supply equipment at the airports leased under a 75-year agreement with London Electricity Supply, ('LES'). The amounts disclosed are the total estimated charges under the agreement and thus include both the actual lease commitment and the significant maintenance element of the fee payable to LES as both the Group and LES are unable to split the base fee between a 'capital' and 'maintenance' charge.

Non-cancellable operating lease commitments – Group as a lessor

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

	31 December 2008		31 December 2007	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	83	-	94	-
Within two to five years	244	-	250	-
After five years	538	-	428	-
	865	-	772	-

The Group uses a number of different leasing and contractual structures depending on the type and location of the investment property. Typically in multi-let offices and industrial premises a standard indefinite tenancy is used, which is determinable by the tenant on three months' notice at any time.

However, it is common for the accommodation to remain let or be quickly re-let should it be vacated. For larger, stand alone premises, e.g. cargo sheds, longer leases of multiples of three years are used.

Public car parks and car rental facilities are operated under concession agreements subject to minimum guaranteed payments, the amounts for which are included above.

Group commitments for property, plant and equipment

	31 December 2008 £m	31 December 2007 £m
Contracted for, but not accrued:		
Terminal 5, Heathrow airport	-	38
Terminal 4 - airline relocations	6	-
Eastern Apron Heathrow	6	-
Terminal 5C	6	-
Heathrow - Terminal 2B North East Stands (Heathrow Eastern Campus programme)	6	-
Post T5 Transfer	5	-
Gatwick Landside Inter Terminal Transit System	16	-
Passenger Search X-Ray Heathrow	14	20
South Terminal extension - Stansted	-	7
East terminal extension - Heathrow	-	6
	-	5
Other projects	53	76
	71	76
	124	152

The figures represented in the above table are contractual commitments to purchase goods and services at the balance sheet date. The Group has in place long-term capital expenditure programmes covering its airports. BAA's submission to the CAA in respect of quinquennium 5 included capital expenditure for Heathrow and Gatwick of £4,787 million and £920 million (2007/08 prices) respectively. In line with commitments with the regulator, capital expenditure expected for Heathrow and Gatwick during 2009 amounts to £1,016 million and £210 million respectively. Under the terms of regulation, penalties are incurred if certain key projects are not delivered by a specified date. The amount of the penalty is linked to the return BAA is estimated to earn on the anticipated cost of the project.

BAA (SH) LIMITED

Notes to the financial statements (continued)

26 Commitments and contingent liabilities (continued)

The White Paper sets out the Government's policy for runway development in the UK. The Government chose a second runway at Stansted as its preferred location for the first new runway in the South East of England. The development of Stansted will be the subject of a planning inquiry, and the Group submitted its planning application to Uttlesford District Council on 11 March 2008 and the announcement of the start date of the related public enquiry is currently outstanding, pending the government's consideration of the implications for the timing of the inquiry of a potential change of ownership of Stansted as a result of the Competition Commission's recommendation that BAA should divest, amongst others, Stansted Airport. The anticipated costs of preparing the planning applications and taking those applications up to the commencement of the inquiry were approximately £90 million. These costs are being capitalised as part of the runway and infrastructure development costs (as detailed in Note 9). Total costs incurred to 31 December 2008 are £79 million (2007: £63 million).

As part of its commitment to the Stansted development, the Group is operating three voluntary blight schemes (the Home Value Guarantee Scheme (HVGS), the Home Owners Support Scheme and the Special Cases Scheme) for those people most affected by the airport expansion. The current estimate of the net cost of the blight and compensation schemes is up to £110 million (with approximately £96 million being incurred in the regulatory period to 31 March 2009). These costs are being capitalised as part of the runway development costs (as detailed in Note 9). Total value to 31 December 2008 is £88 million (2007: £66 million), including a £5 million provision for the additional 10% payment which will become due under the HVGS blight scheme once planning permission has been obtained for the second runway at Stansted.

The White Paper also commits the Group (and other airport operators) to offering noise mitigation measures for existing airports and voluntary blight schemes for future airport activity at the larger UK airports (those with more than 50,000 air transport movements a year). The Group carried out a detailed examination of these White Paper provisions and consulted extensively with local communities at its airports on the implementation of potential schemes. Based on the Group's evaluation, payments under the White Paper current noise schemes are estimated at £31 million spread over the five years commencing 2007. The schemes include the provision of noise insulation for community buildings and dwellings, and assistance with the costs of relocation for dwelling owners.

In June 2006, the Government announced its conclusions for the 2006-2012 night flights regime at BAA'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 Group's evaluation, payments under this scheme are estimated to total £62 million, spread over the five year period commencing 2008.

In addition, there are live blight schemes to support the market for housing in areas identified for potential future runways at Heathrow and Gatwick airports. Obligations under these schemes will only crystallise once the Group announces its intention to pursue a planning application for a new runway. In the case of Gatwick airport, this is unlikely in the short-term. In respect of Heathrow, the government has announced support for the need for a third runway at Heathrow and the Group is now reviewing the implications of the announcement with the intention of reaching a point where it will announce an intention to submit a planning application.

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 that will experience an increase in noise of 3dBA or more.

Until further consultation is carried out with the local communities, the significance of the costs related to the implementation of these schemes remain uncertain. It is too early to quantify the Group's potential obligations under these schemes.

Contingent liabilities

The Group has external contingent liabilities, comprising letters of credit, performance/surety bonds, performance guarantees and other items arising in the normal course of business amounting to £317 million at 31 December 2008 (2007: £7 million).

Included in the above, in July 1998, BAA Airports Limited and Heathrow Airport Limited entered into a cross-border lease and leaseback in relation to the Heathrow Express rolling stock owned by Heathrow Airport Limited. The companies guarantee payments that are defeased by a deposit of US\$59.4 million with Rabobank and US\$15 million in US Government securities. In addition, they guarantee early termination payments. The amount payable under this guarantee at 31 December 2008 was US\$12.3 million. The cross border lease transaction was terminated on 13 January 2009 with Heathrow Airport Limited making a termination payment of US\$3.3 million.

easyJet have obtained leave to bring a judicial review of the CAA's price cap determination for Gatwick Airport for Q5. The easyJet challenge relates principally to the amount of operating expenditure allowed. They maintain the CAA has not had sufficient regard to the recommendations of the Competition Commission and has unfairly and unlawfully allowed security cost submitted at a late stage of the review. The case was heard in the High Court in March 2009 with judgement expected shortly. If easyJet are successful it is likely the issue will be remitted to the CAA for their reconsideration. Should the CAA determine that the airport charges cap should be lower Gatwick Airport Limited would be required to rebate the amount of airport charges levied in excess of the amended cap. On the basis of legal advice received the Board is confident no such rebate will arise.

Under the shared service agreement hedging costs incurred by BAA Airports Limited in relation to the Employee Share Ownership Plan (ESOP) may be recharged to the Group's airports. At 31 December 2008, the ESOP swap held in BAA Airports Limited had a fair value loss of £117 million. The Group may be obligated to settle its share of these amounts (£102 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.

BAA (SH) LIMITED

Notes to the financial statements (continued)

27 Related party transactions

During the year the Group entered into the following transactions with related parties:

Sale of goods and services

	Year ended 31 December 2008	Year ended 31 December 2007
	£m	£m
Swissport/Groundstar	4	4
	4	4

Purchase of goods and services

	Year ended 31 December 2008	Year ended 31 December 2007
	£m	£m
Ferrovial Agroman	26	-
Amey Airport Services Limited	1	-
	27	-

Balances outstanding with related parties were as follows:

	31 December 2008		31 December 2007	
	Amounts owed from related parties £m	Amounts owed to related parties £m	Amounts owed from related parties £m	Amounts owed to related parties £m
Swissport/Groundstar	1	-	1	-
	1	-	1	-

28 Ultimate parent undertaking and controlling party

The immediate parent undertaking during the financial year is BAA (DSH) 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 smallest and largest Group to consolidate these financial statements.

The Company's results are also included in the consolidated financial statements of BAA Limited (formerly known as Airport Development and Investment Limited) and FGP Topco Limited for the year ended 31 December 2008.

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

BAA (SH) LIMITED

Notes to the financial statements (continued)

29 Principal subsidiaries

The principal subsidiaries whose financial position materially affects the Group are as follows:

Holding companies

BAA (AH) Limited †
BAA (SP) Limited

Airport owners and operators

Heathrow Airport Limited †
Gatwick Airport Limited †
Stansted Airport Limited †

Other

BAA Funding Limited †#
Heathrow Express Operating Company Limited †

† Held by a subsidiary undertaking
Incorporated in Jersey

Unless otherwise indicated, all subsidiaries are wholly owned and are incorporated and operate in the United Kingdom.

BAA Airports Limited and Heathrow Airport 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 the various lease agreements. Since the activities of PRC are effectively under the direct control of Heathrow Airport Limited under the terms of the lease agreement, PRC is deemed a quasi-subsi- diary of the Company and its profit, assets, liabilities and cash flows have been consolidated into the Group.

BAA (SH) LIMITED

Financial statements

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BAA (SH) LIMITED

Independent auditors' report to the members of BAA (SH) Limited

We have audited the parent company financial statements of BAA (SH) Limited for the period ended 31 December 2008 which comprise the balance sheet, accounting policies and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Group financial statements of BAA (SH) Limited for the period ended 31 December 2008.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the parent company 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 parent company 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 parent company financial statements give a true and fair view and whether the parent company financial statements have been 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 company financial statements. The information given in the Report of the Directors includes that specific information presented in the Business Review that is cross referred from the Report of the Directors.

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 parent company 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 or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

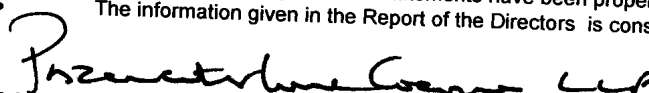
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements. It also includes an assessment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

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 parent company 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 parent company financial statements.

Opinion

In our opinion:

- The parent company 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;
- The parent company 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 parent company financial statements.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
29 May 2009


BAA (SH) LIMITED

Company balance sheet as at 31 December 2008

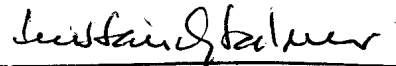
31 December
2008
£m

	Notes	
Fixed assets		
Investment in subsidiaries	2	2,509
		2,509
Current assets		
Debtors:		
Amount due within one year	3	76
Amount due after one year	3	1,566
		1,642
Creditors: amounts falling due within one year		
Borrowings	4	(75)
Net current assets		1
Total assets less current liabilities		4,076
Creditors: amounts falling due after more than one year		
Borrowings	4	(1,566)
Net assets		2,510
Capital and reserves		
Called up share capital		2,509
Profit and loss reserve	5	1
Equity shareholders' funds	6	2,510

The financial statements were approved by the Board of directors and authorised for issue on 29 May 2009 and signed on behalf of the Board.



Jose Leo
Director



Luis Sanchez Salmeron
Director

BAA (SH) LIMITED

Accounting policies

Basis of accounting

These financial statements are prepared under the historical cost convention, as modified by the revaluation of certain tangible fixed assets in accordance with the Companies Act 1985 and the following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

The Company has not presented a cash flow statement or provided details of related party transactions as permitted under FRS 1 (revised) 'Cash Flow Statements' and FRS 8 'Related Party Disclosures' respectively.

Revenue

Revenue is recognised on an accrual basis in accordance with Financial Reporting Standard (FRS) 5 'Reporting the substance of transactions', net of VAT.

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/or where projects are in the early stage of planning but the Directors are satisfied that the necessary consents will be received. The interest is then charged to the profit and loss account as depreciation over the life of the relevant asset.

Issue costs

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.

Investments in subsidiary undertakings

Investments in subsidiary undertakings, are stated at cost and reviewed for impairment if there are indications that the carrying value may not be recoverable.

Investments in subsidiary undertakings includes interest free loans to subsidiaries, that have no fixed repayment date.

Deferred taxation

In accordance with FRS 19, 'Deferred tax' deferred tax is provided in full on timing differences that 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 the obligation crystallises, 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.

Dividend distribution

A dividend distribution to the Company's shareholders is recognised as a liability in the 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.

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 cash-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. 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.

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.

Financial instruments

Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost, using the effective interest method, less provision for impairment.

BAA (SH) LIMITED

Accounting policies (continued)

Investments

On initial recognition, financial assets are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. After initial recognition, investments that are classified as 'held-for-trading' and 'available-for-sale' are measured at fair value. Fair value gains or losses on investments held-for-trading are recognised in the profit and loss account. Fair value gains or losses on available-for-sale investments are recognised in a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative fair value gain or loss previously reported in equity is included in the profit and loss account.

Assets classified as 'held-to-maturity' or 'loans and receivables' are recognised on the balance sheet at their amortised cost, using the effective interest rate method, less any provision for impairment.

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

Purchases and sales of investments are recognised on trade-date being the date on which the Company commits to purchase or sell the asset.

Financial instruments

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred 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 income statement over the period of the borrowings using the effective interest method

Trade and other payables

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

Share capital

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

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangement entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities.

Financial risk management objectives and policies

The Company's principal financial instruments comprise external borrowings, namely the Subordinated Facility, and amounts due from other Group undertakings, including the Company's subsidiary, BAA (SP) Limited.

The Company does not use financial instruments for speculative purposes. The treasury function operates on a centralised non-speculative risk basis. Its purpose is to identify, mitigate and hedge residual treasury related financial risks inherent to the Group's business operations in accordance with the Group's treasury policies.

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), credit risk and liquidity risk.

Cash flow interest rate risk

The Company's interest rate risk arises primarily from its borrowings issued at variable interest rate. This risk is mitigated through the Company's receivables from other Group undertakings issued on the same interest rate and terms, plus a small margin, as the Subordinated Facility external borrowings.

Credit risk

Credit risk arises from cash and cash equivalents. 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.

Liquidity risk

The Company has no significant concentrations of liquidity risk.

The Company has provided joint transaction security, together with the other Subordinated Facility Obligors which secures liabilities arising under the Subordinated Facility Agreement. The company is also a joint guarantor under the Subordinated Facility Agreement.

BAA (SH) LIMITED

Notes to the financial statements

1 Company result for the period

The Company was incorporated on 20 December 2007 and therefore the accounts have been prepared for the period from 20 December 2007 to 31 December 2008.

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the Company is not presented as part of these financial statements. The profit of the Company for the period attributable to shareholders was £1 million.

2 Investments - subsidiaries

	Subsidiaries £m	Total £m
Cost at incorporation		
Balance at 20 December 2007		
Additions	-	-
Balance at 31 December 2008	2,509	2,509
	2,509	2,509

Additions in the period represent £2,509 million relating to the investment in BAA (SP) Limited.

The Company's subsidiaries are as follows:

Holding companies

BAA (AH) Limited †
BAA (SP) Limited

Airport owners and operators

Heathrow Airport Limited †
Gatwick Airport Limited †
Stansted Airport Limited †

Other

BAA Funding Limited †#
Heathrow Express Operating Company Limited †

† Held by a subsidiary undertaking

Incorporated in Jersey

Unless otherwise indicated, all subsidiaries are wholly owned and are incorporated and operate in the United Kingdom.

BAA Airports Limited and Heathrow Airport 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 the various lease agreements. Since the activities of PRC are effectively under the direct control of Heathrow Airport Limited under the terms of the lease agreement, PRC is deemed a quasi-sub subsidiary of the Company and its profit, assets, liabilities and cash flows have been consolidated into the Group's financial statements.

3 Debtors

	31 December 2008 £m
Due within one year	
Amounts owed by group undertakings	75
Group relief receivable	1
	76
Due after one year	
Amount owed by group undertaking	1,566

Amounts owed by group undertakings included in debtors due within one year are interest free and repayable on demand.

Amounts owed by group undertakings included in debtors due after more than one year relate to unsecured loan notes originally issued by BAA Airports Limited, redeemable no later than 5 May 2011.

BAA (SH) LIMITED

Notes to the financial statements (continued)

4 Borrowings

31 December 2008
£m

Current	
Interest payable	
Total current (interest payable)	75
	75
Non-current	
Secured	
Subordinated Facility due 2011	
Total non-current	1,566
	1,566
Total current and non-current (excluding interest payable)	1,566

Subordinated Facility

The £2,000 million Subordinated Facility was drawn in full on 10 July 2006, by BAA Limited (formerly Airport Development and Investment Limited) and partially repaid in 2007. In August 2008, £400 million of this facility was repaid as part of the BAA refinancing and was also novated from BAA Limited to BAA (SH) Limited. The interest on the facility is based on Libor with a margin of 4.00% as at 31 December 2008 (31 December 2007: 4.00%).

Fair value of borrowings	Book value	31 December 2008
	£m	Fair value £m
Non-current		
Long term debt		
Total non-current	1,566	1,566
	1,566	1,566

The fair value of short-term borrowings approximates to book value. Accrued interest is included as a current borrowings balance and not in the carrying amount of non-current borrowings. The fair values of listed borrowings are based on quoted prices. For unlisted borrowings, the Group establishes fair values by using valuation techniques such as discounted cash flow analysis. The fair value of non-current borrowings which have floating rate interest are assumed to equate to their current nominal value.

Covenants

The Subordinated Facility contains customary restrictions on change of control and distributions to shareholders as well as financial covenants. Under this facility, the Group is required to maintain certain debt cover and cover ratios. The required levels as at 31 December 2008 were less than 1:1 for the debt cover ratio and a minimum of 1.05:1 for the cover ratio. All covenants have been tested and complied with as at 31 December 2008.

Additional disclosures on risk management and hedging of borrowings are included in Notes 16 and 17 of the Group financial statements.

5 Share capital

	£
Authorised	
9,000,000,000 ordinary shares of £1 each	
Balance at incorporation and 31 December 2008	9,000,000,000
	9,000,000,000
Allotted and fully paid	
In issue at incorporation: 2 ordinary shares of £1 each	2
Issue of 2,509,350,687 ordinary shares of £1 each	
In issue at 31 December 2008: 2,509,350,689 ordinary shares of £1 each	2,509,350,687
	2,509,350,689

On 31 January 2008, there was an issue of 2,040,757,000 ordinary shares of £1 each and on 29 February 2008 there was a further issue of 468,593,687 ordinary shares of £1 each.

BAA (SH) LIMITED

Notes to the financial statements (continued)

6 Profit and loss reserve

	£m
Balance at incorporation	-
Retained earnings for the financial period	1
Balance at 31 December 2008	1

7 Dividends paid and proposed

Details of dividends paid for the period are provided in Note 8 of the Group financial statements.

8 Auditor's remuneration

Auditor's remuneration paid to PricewaterhouseCoopers LLP for the performance of the statutory audit amounted to £20,000. Details of fees for other services are provided in Note 2 of the Group financial statements.

9 Employee information and Director's remuneration

Employee numbers

The Company has no employees.

Directors' remuneration

None of the directors who served BAA (SH) Limited during the period received emoluments from the Company.

During the period, one of the directors (2007: one) had retirement benefits accruing to them under a defined benefits scheme.

Registered office

BAA (SH) Limited, 130 Wilton Road, London SW1V 1LQ
Registered in England No. 06458635