

BAA (SH) plc
Annual report and financial statements
for the year ended 31 December 2011

BAA (SH) plc

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BAA (SH) plc

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BAA (SH) plc

Business review

BAA (SH) plc (the 'Company') is the holding company of BAA (SP) Limited ('BAA (SP)'), which itself is the holding company of a group of companies that owns Heathrow and Stansted airports and operates the Heathrow Express rail service between Heathrow and Paddington, London. BAA (SH) plc is an indirect subsidiary of BAA Limited ('BAA Group').

The consolidated financial statements of BAA (SH) plc and its subsidiaries (together 'BAA (SH)' or the 'Group') have been 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.

This business review is presented in three sections:

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

Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2011 and analysis of the financial position of the Group as at that date. The Group's accounting and reporting policies and procedures are also considered.

Corporate governance statement on internal controls and risk management – outline of the BAA Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the BAA Group Executive Committee.

Management review

Review of 2011

Key features of the year

2011 was a successful year for the Group with an overall recovery in traffic, including record traffic for Heathrow, and improvements in service standards. These factors, combined with higher tariffs at Heathrow, robust retail performance and continued cost control, enabled the Group to deliver a strong financial performance despite a challenging macro-economic background. This robust performance enabled the Group to continue investing in enhancing its airport infrastructure, particularly at Heathrow.

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

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

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

The Group continued significant investment at Heathrow with good progress made in constructing the new Terminal 2 which will be Heathrow's second new terminal in recent years. Nearly £950 million was invested in 2011, including nearly £900 million at Heathrow. The superstructure of the new Terminal 2 building was substantially complete by the end of 2011 and the next two years will be spent fitting out the new facility and undertaking operational readiness activities prior to operations commencing during 2014.

The Group has continued to challenge the Competition Commission's ('CC') requirement that it must sell Stansted airport. BAA issued proceedings at the Competition Appeal Tribunal ('CAT') for the judicial review of the CC's decision regarding material changes in circumstances since the CC's report of March 2009. The hearing to consider the case was held in December 2011 and in February 2012 the CAT rejected BAA's request. BAA is currently considering its position in light of the CAT's decision.

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

BAA (SH) plc

Management review *continued*

Key features of the year *continued*

Further progress has been made in strengthening the Group's capital structure through a number of financings that have raised approximately £3 billion in the last 12 months. The highlight was the inaugural US\$1 billion bond issue completed in June 2011. This has enabled BAA to decide in principle to commence paying dividends to its ultimate shareholders in 2012 for the first time since it was acquired by the Ferrovial-led consortium in 2006.

Passenger traffic trends

Passenger traffic for the year ended 31 December 2011 at the Group's airports is analysed below:

	Year ended 31 December 2011	Year ended 31 December 2010	Change ¹ (%)
Passengers by airport (millions)			
Heathrow	69.4	65.7	5.5
Stansted	18.0	18.6	(2.8)
Passengers by market served (millions)			
UK	6.2	6.6	(6.3)
Europe ²	44.5	42.8	4.0
Long haul	36.8	35.0	5.2
Total passengers¹	87.4	84.3	3.7

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

² Includes North African charter traffic.

In the year ended 31 December 2011, the Group's passenger traffic increased 3.7% to 87.4 million (2010: 84.3 million), with Heathrow's traffic up 5.5% to an all time annual record of 69.4 million passengers. Reported year on year performance partly reflects no recurrence of the exceptional events in 2010 being closure of airspace due to volcanic ash, airline industrial action affecting Heathrow and severe winter weather. Whilst some passengers affected by these disruptions will have completed their journeys later in 2010, these events are estimated to have resulted in the loss of up to a total of 2.8 million passengers. Adjusting for these factors, the Group's traffic is estimated to have increased by at least 0.4% in 2011.

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

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

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

Stansted's traffic declined 2.8% to 18.0 million passengers (2010: 18.6 million). This reflects no recurrence of the volcanic ash and severe winter weather disruptions in 2010 that resulted in the loss of approximately 0.4 million passengers. Adjusting for this, Stansted's traffic declined 5.0%, reflecting airlines' redeployment of capacity from the UK to other European markets. Much of the decline was in the domestic market, which declined 15.8% principally due to cessation of services to Belfast and Newcastle. Excluding the domestic market, traffic was down only 1.5% to 16.6 million passengers (2010: 16.8 million). Further, Stansted experienced record load factors through most of 2011 (80.8% compared to 78.8% in 2010) whilst traffic declined, suggesting gradually more positive demand dynamics.

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Management review *continued*

Transforming the Group's airports

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

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

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

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

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

Investment in modern airport facilities

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

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

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

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

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

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

BAA (SH) plc

Management review *continued*

Transforming the Group's airports continued

Investment in modern airport facilities continued

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

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

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

At Stansted the modest investment was focused in areas such as security search process improvement, upgrade of the airport operating system and new air bridges.

Service standards

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

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

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

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

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

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

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

At Stansted, departure punctuality also improved significantly to 88% (2010: 78%). The strength of this performance is reflected by the fact that Stansted was recognised by FlightStats as the third best performing airport globally for departure punctuality during November 2011. In addition, passengers passed through central security within the period prescribed under its service quality rebate scheme 97.9% (2010: 98.2%) of the time compared with the 95.0% service standard. Stansted also won several notable international awards in 2011, including the Skytrax 'world's best low-cost airport' award.

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Management review *continued*

Regulatory and governmental developments

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

There have been a number of developments in relation to the Competition Commission's ('CC') inquiry into the supply of UK airport services by BAA since the beginning of 2011. In February 2011, BAA was refused permission to appeal to the Supreme Court against the CC's March 2009 requirement that certain airports, including Stansted and either Edinburgh or Glasgow, be sold. In July 2011, the CC determined that there had been no material changes in circumstances that would give it cause to reconsider its March 2009 decision. In September 2011, BAA issued proceedings at the Competition Appeal Tribunal ('CAT') for the judicial review of the CC's decision regarding changes in circumstances. The hearing to consider the case was held in December 2011 and in February 2012 the CAT rejected BAA's request. BAA is currently considering its position in light of the CAT's decision.

Meanwhile, in October 2011, the CC decided to reverse the order of disposals so that the disposal of either Edinburgh or Glasgow would precede that of Stansted. As a result, BAA decided to sell Edinburgh airport and has commenced its disposal process.

UK aviation policy developments

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

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

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

Modernisation of economic regulation of UK airports

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

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

Developments since beginning of 2012

In January 2012, passenger traffic across the Group's airports increased 0.7% to 6.2 million (2011: 6.2 million) with Heathrow delivering an all time record for January of 5.2 million passengers.

Outlook

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

Passenger traffic in early 2012 has been consistent with expectations with Heathrow achieving record traffic in January. Therefore at this stage the outlook for the Group's financial performance in 2012 remains consistent with guidance in the Investor Report distributed in December 2011.

BAA (SH) plc

Financial review

Introduction

The following financial review, based on the consolidated financial statements of the Group, provides commentary on the performance of the Group's airports. Consistent with statutory accounting and IFRS, the business review presented excludes operations that have been disposed of during the current or prior years.

Basis of preparation of statutory results

A number of significant events which are highlighted in the Management review and Financial review have impacted the way in which the statutory financial results for 2011 have been presented.

- *Exceptional items and certain re-measurements* - these include the following before tax:
 - £40 million net exceptional pensions charge;
 - £46 million of fair value gains arising from the revaluation of investment property;
 - £46 million of fair value losses on financial instruments; and
 - £11 million relating to an impairment charge on the Airtrack rail project which the Group has decided not to pursue.

Basis of presentation of financial results

The profit and loss account below is derived from the statutory format on page 23 in order to enable a better understanding of the results of the Group's operations.

Summary performance

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m	Change %
Continuing operations			
Revenue	2,280	2,074	9.9
Adjusted operating costs ¹	(1,148)	(1,107)	3.7
Adjusted EBITDA²	1,132	967	17.1
Exceptional items – pensions	(40)	90	n/a
Exceptional items – other	-	(13)	n/a
EBITDA	1,092	1,044	4.6
Fair value gain on investment properties	46	31	48.4
Depreciation and amortisation – ordinary	(513)	(481)	6.6
Depreciation and impairment – exceptional	(11)	(19)	(42.1)
Operating profit - continuing operations	614	575	6.8
Impairment of property, plant and equipment – exceptional	-	(149)	n/a
Net finance cost	(802)	(733)	9.4
Fair value loss on financial instruments	(46)	(36)	27.8
Loss before tax	(234)	(343)	(31.8)
Tax credit	190	123	54.5
Loss for the year from continuing operations	(44)	(220)	(80.0)
Net profit from discontinued operations ³	8	16	(50.0)
Consolidated loss for the year	(36)	(204)	(82.4)

¹ Adjusted operating costs are stated before depreciation, amortisation and exceptional items.

² Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation, exceptional items and certain re-measurements.

³ Includes a release of provision relating to the disposal of Gatwick airport.

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Financial review *continued*

Revenue

In the year ended 31 December 2011, revenue from continuing operations increased 9.9% to £2,280 million (2010: £2,074 million). This reflects increases of 14.4%, 9.0% and 0.4% in aeronautical, retail and other income respectively.

	Year ended 31 December 2011	Year ended 31 December 2010	Change %
	£m	£m	
Aeronautical income	1,276	1,115	14.4
Retail income	519	476	9.0
Other income	485	483	0.4
Total revenue	2,280	2,074	9.9

Aeronautical income

Aeronautical income increased 14.4% to £1,276 million (2010: £1,115 million). Average aeronautical income per passenger increased 10.4% to £14.60 (2010: £13.22).

Aeronautical income summary (by airport)

	Aeronautical income			Per passenger ¹		
	Year ended 31 December 2011	Year ended 31 December 2010	Change %	Year ended 31 December 2011	Year ended 31 December 2010	Change %
	£m	£m		£m	£m	
Heathrow	1,149	991	16.0	16.57	15.08	9.9
Stansted	127	124	2.4	7.03	6.66	5.6
Total	1,276	1,115	14.4	14.60	13.22	10.4

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

At Heathrow, the growth primarily reflects passenger traffic trends as well as the headline 6.2% and 12.2% increases in its tariffs from 1 April 2010 and 1 April 2011 respectively. This has been partially offset by lower than expected yields since April 2011, particularly due to a different passenger mix (higher proportion of European traffic) and a higher proportion of quieter aircraft than assumed when tariffs for the current regulatory year were determined. These factors led to aeronautical income being approximately £25 million lower than expected during the year ended 31 December 2011. This shortfall (or yield dilution) will be recovered through the 'K factor' true-up mechanism in the year commencing 1 April 2013. At Stansted, with its year on year decline in traffic, growth in aeronautical income reflects principally the fact that whilst the change in the headline tariff for the year to 31 March 2011 was -1.3%, from 1 April 2011 it was 6.33%. The headline maximum allowable yields at Heathrow and Stansted will increase by 12.7% and 6.83% respectively from 1 April 2012.

Retail income

The Group's retail business continued to perform well with net retail income ('NRI') per passenger increasing 5.5% to £5.58 (2010: £5.29) in the year ended 31 December 2011, led by Heathrow where NRI per passenger was up 5.3%.

This performance was based on gross retail income increasing 8.9% to £519 million (2010: £476 million) and NRI increasing 9.6% to £488 million (2010: £445 million).

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

	Year ended 31 December 2011	Year ended 31 December 2010	Change %
Retail income (£m)	519	476	9.0
Less: retail expenditure (£m)	(31)	(31)	0.0
Net retail income (£m)	488	445	9.6
Passengers (million) ¹	87.4	84.3	3.7
Net retail income per passenger^{1,2}	£5.58	£5.29	5.5

¹ Percentage change calculated using un-rounded passenger and net retail income per passenger numbers.

² Net retail income per passenger calculated using un-rounded passenger numbers.

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Financial review *continued*

Revenue *continued*

Analysis of net retail income

	Year ended 31 December 2011	Year ended 31 December 2010	Change
	£m	£m	%
Car parking	83	74	12.2
Duty and tax-free	126	114	10.5
Airside specialist shops	92	83	10.8
Bureaux de change	48	44	9.1
Catering	46	41	12.2
Landside shops and bookshops	26	25	4.0
Advertising	30	30	0.0
Car rental	15	15	0.0
Other	22	19	15.8
Total	488	445	9.7

At Heathrow, gross retail income increased 10.7% to £435 million (2010: £393 million) and NRI per passenger increased 5.4% to £5.95 (2010: £5.64). The performance was led by duty and tax-free, airside specialist shops, catering and car parking. The strong in-terminal performance has been delivered whilst undertaking a major refurbishment of Terminal 3's retail facilities where disruption was at its height during the summer months. Year on year trading performance also benefited from a further shift in passenger mix from domestic to international passengers

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

Stansted's gross retail income increased 0.1% to £83 million (2010: £83 million), a good performance given passenger trends which meant that NRI per passenger increased 3.4% to £4.16 (2010: £4.02). Growth in Stansted's retail income reflects performance particularly in car parking due to achieving higher yields per user with bureaux de change and advertising also supporting the recent positive retail performance. These improvements were partially offset by reductions elsewhere, particularly in duty and tax-free shopping.

Other income

Income from activities other than aeronautical and retail increased 0.4% to £485 million (2010: £483 million). This partly reflects rail income increasing 7.9% to £111 million (2010: £103 million) due to Heathrow Express passenger numbers increasing 5.1% to 6.22 million (2010: 5.92 million) and higher revenues from increased passenger volumes on the Piccadilly line extension to Terminal 5. Property rental income also increased 1.8% to £110 million (2010: £108 million) due to rent reviews implemented from April 2010. The remaining revenue streams included in other income declined 3.0% principally due to the conclusion in 2010 of most of the agreements with Gatwick to provide transitional services following its disposal in late 2009.

Adjusted operating costs

Adjusted operating costs exclude depreciation, amortisation and exceptional items.

In the year ended 31 December 2011, adjusted operating costs increased 3.7% to £1,148 million (2010: £1,107 million).

	Year ended 31 December 2011	Year ended 31 December 2010	Change
	£m	£m	%
Employment costs	339	316	7.3
Maintenance expenditure	137	135	1.5
Utility costs	111	115	(3.5)
Rents and rates	129	117	10.3
General expenses	233	233	0.0
Retail expenditure	31	31	0.0
Intra-group charges/other	168	160	5.0
Total	1,148	1,107	3.7

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Financial review *continued*

Adjusted operating costs *continued*

The main drivers of the increased adjusted operating costs were higher employment costs and rents and rates. Employment costs were up 7.4% reflecting principally pay rises and increased headcount. The higher employee numbers are particularly due to increased airfield security personnel at Heathrow and more mobile sales assistants that have helped support growth at Heathrow Express. The increased employment costs also reflected increased overtime and use of temporary staff to support record traffic levels at Heathrow through the summer.

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

Partially offsetting the increased employment and rents and rates costs was a reduction in utility costs towards the end of the year due to the mild autumn and reduced unit prices. In addition, general expenses and maintenance costs reflect no recurrence of the previously reported estimated £7.8 million cost of the severe winter weather in December 2010.

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

Adjusted operating costs for 2011 were lower than forecast in the Investor Report issued in December 2011 reflecting particularly reduced intra-group charges and the lower utility costs and general expenses referred to above.

Adjusted EBITDA

In the year ended 31 December 2011, Adjusted EBITDA increased 17.1% to £1,132 million (2010: £967 million), resulting in an Adjusted EBITDA margin of 49.7% (2010: 46.6%).

The significant increase in Adjusted EBITDA from 2010 reflects improved underlying traffic, increased aeronautical and retail income per passenger, continued cost control and no recurrence of 2010's volcanic ash, strike and severe winter weather disruptions. Taking into account the financial impact of disruptions in 2010, previously estimated at £58 million, Adjusted EBITDA increased 10.5% to £1,132 million (2010: £1,025 million).

Adjusted EBITDA at Heathrow (including Heathrow Express Operating Company Limited) increased 18.7% to £1,045 million (2010: £881 million). The significant increase in Heathrow's Adjusted EBITDA reflects the factors referred to above in relation to the growth in the Group's Adjusted EBITDA. Stansted's Adjusted EBITDA increased 0.9% to £87 million (2010: £86 million) due principally to higher tariffs and increased car parking and other income partially offset by increased employment costs.

Exceptional items - pensions

Items within operating profit include a £40 million non-cash pension related charge (2010: £90 million credit). This includes the Group's share of the movement in BAA Airports Limited defined benefit pension scheme, Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits as well as a re-allocation between entities of pension balances.

Exceptional items - other

In 2010, there was a £13 million charge relating primarily to a restructuring process to reduce the size and cost of overhead functions following the sale of Gatwick airport in 2009.

Fair value gain on investment property valuation

Investment properties were valued at a fair value at 31 December 2011 by CB Richard Ellis, Chartered Surveyors and Strutt & Parker, Chartered Surveyors (2010: CB Richard Ellis, Chartered Surveyors and Strutt & Parker, Chartered Surveyors). Strutt & Parker were responsible solely for the valuation of residential properties at Stansted. Investment property comprises mainly car parks and airside assets at the Group's airports and is considered less vulnerable to market volatility. The investment property valuation as at 31 December 2011 resulted in a gain of £46 million (2010: £31 million gain).

Depreciation and amortisation - ordinary

Depreciation and amortisation for the year ended 31 December 2011, excluding exceptional charges, was 6.6% higher at £513 million (2010: £481 million) driven by depreciation commencing on Heathrow Terminal 5C, the second satellite to Terminal 5, during the course of the year. It also reflects higher depreciation on Heathrow Terminal 1 asset additions given the impact on their economic life of the expected second phase of Terminal 2. There was also the full year effect of depreciation of investment in 2010 on IT assets and Heathrow baggage search equipment, the refurbished Heathrow Terminal 4 check-in facilities and bringing into use, initially connected to Terminal 1, the first phase of the satellite building for the new Terminal 2.

Net finance cost

Net finance cost is discussed together with net interest paid under 'Net finance cost and net interest paid'.

BAA (SH) plc

Financial review *continued*

Fair value loss on financial instruments

A net fair value loss of £46 million (2010: £36 million) on financial instruments has been recognised as financing costs in the Income statement. This loss related primarily to index-linked swaps internally designated to hedge the Group's bond issues which do not achieve hedge accounting under IFRS as the accounting standards do not contemplate achieving hedge accounting using these products. The index-linked swaps also provide a commercial hedge of the Group's RPI linked revenue.

Taxation

The tax credit recognised for the year ended 31 December 2011 was £190 million (2010: £123 million). Based on a loss before tax for the period of £234 million (2010: £343 million), this results in an effective tax credit rate of 81.2 % (2010: 35.8%).

The Finance Act 2011 enacted a reduction in the main rate of UK corporation tax from 27% to 26% with effect from 1 April 2011 and from 26% to 25% with effect from 1 April 2012. As a result the Group's deferred tax balances, which were previously provided at 27%, have been re-measured at the rate of 25% in the year ended 31 December 2011. This has resulted in a reduction in the net deferred tax liability of £139 million, with £138 million credited to the income statement and £1 million credited to reserves.

Excluding the impact of the change in tax rate, the tax credit recognised for the year on ordinary activities of £52 million (2010: £51 million) results in an effective tax credit rate of 22.2% (2010: 14.9%). The tax credit is less than implied by the statutory rate of 26.5% (2010: 28%) primarily due to the release of prior year deferred tax provisions. Refer to Note 5 of the Group financial statements.

Net profit from discontinued operations

During 2011, £8 million excess provisions for Gatwick disposal costs were released to the profit and loss account. This related to costs expected to be associated with the disposal including legal fees and other separation costs. The £16 million gain on disposal in 2010 reflected the shortfall between assets and liabilities transferred to the pension scheme of Gatwick's purchaser being lower than expected, and the receipt of a further £1 million on the finalisation of Gatwick's balance sheet at completion of the disposal.

Dividend

No dividend was paid or declared in the year ended 31 December 2011 (2010: £nil)

Summary cash flow

	Year ended 31 December 2011	Year ended 31 December 2010
	£m	£m
Cash generated from continuing operations	1,057	918
Taxation	(27)	(17)
Net cash flow from operating activities	1,030	901
Capital expenditure	(864)	(841)
Release of provisions on discontinued operations	(6)	(125)
Proceeds from issuance of bonds	1,508	1,155
Net movement in other borrowings	(1,197)	(1,214)
Net interest paid	(375)	(398)
Prepayment of derivative interest	-	(37)
Cancellation of derivatives	(114)	(74)
Settlement of accretion on index-linked swaps	(15)	-
Restricted cash	-	143
Issuance of ordinary share capital	-	317
Net decrease in cash and cash equivalents	(33)	(173)

Cash flow from operating activities

Net cash inflow from operations in the year ended 31 December 2011 increased 15.1% to £1,057 million (2010: £918 million) which compares with Adjusted EBITDA of £1,132 million (2010: £967 million). The improved conversion of Adjusted EBITDA to operating cash flow in 2011 primarily reflects a one-off £47 million improvement in working capital following the implementation of a new BAA group cash management process that has resulted in cash in transit to the Group being received faster. Excluding this effect, as in 2010, operating cash flow was around £50 million less than Adjusted EBITDA, principally reflecting cash pension contributions being higher than the profit and loss account charge.

Capital expenditure

In the year ended 31 December 2011, the cash flow impact of the Group's capital investment programme was £865 million (2010: £841 million) with £844 million at Heathrow (2010: £819 million) and £21 million at Stansted (2010: £22 million).

BAA (SH) plc

Financial review *continued*

Capital expenditure *continued*

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

Pension scheme

At 31 December 2011, the BAA Airports Limited defined benefit pension scheme had a surplus of £39 million as measured under IAS 19, of which £32 million is attributable to the Group under the Group's shared services agreement. This compares with a scheme deficit of £44 million at 31 December 2010. The change from a scheme deficit to a surplus is due principally to employer cash contributions being greater than the current service charge since the increase in the value of the scheme assets is offset by increased liabilities. It also reflects a £26 million credit due to the change in obligation from RPI to CPI for certain defined benefit pension scheme members' future pension entitlements.

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

As part of the triennial valuation process, the BAA Group will pay £97 million per annum into the scheme from 2012 to 2014. This compares with a total contribution of £80 million per annum paid from 2009 to 2011. The amount being paid in each of the next three years includes £24 million which is aimed to eliminate the deficit over a period of 9 years. All but approximately £15 million of the new annual amount will be met by the Group's airports.

Net debt and liquidity

The analysis below focuses on the Group's external debt. It includes all the components used in calculating gearing ratios under the Group's financing agreements including index-linked accretion.

During 2011, the Group's nominal net debt increased 5.7% to £10,992 million at 31 December 2011 from £10,401 million at 31 December 2010. The increase in net debt primarily reflects two factors: capital investment at Heathrow exceeding the Group's post-interest cash flow; and accretion on the Group's index-linked swaps and bonds. .

The Group's nominal net debt at 31 December 2011 comprised £8,133 million outstanding under bond issues, £2,539 million outstanding under various loan facilities, £349 million in index-linked derivative accretion and cash at bank and term deposits of £29 million (compared with cash and cash equivalents of £34 million shown on the balance sheet). Nominal net debt comprised £9,418 million in senior net debt and £1,025 million in junior debt (both held at BAA (SP)'s subsidiaries) together with £549 million in net debt held at the Company.

The accounting value of the Group's net debt at 31 December 2011 excluding accrued interest was £10,750 million (2010: £10,331 million).

The average cost of the Group's external gross debt at 31 December 2011 was 4.30% (2010: 4.55%), taking into account the impact of interest rate, cross currency and index-linked hedges but excluding index-linked accretion. Including index-linked accretion the Group's average cost of debt at 31 December 2011 was 6.46% (2010: 5.68%). The increase in the average cost of debt (including index-linked accretion) is the result of a number of factors including the replacement of short-term bank debt with higher cost bond debt and the impact of high current inflation on the accretion payable on index-linked swaps and bonds.

At 31 December 2011, the Group had approximately £1.4 billion in undrawn bank facilities and cash resources. Since the beginning of 2012, the Group has raised approximately £1.5 billion (see "Recent financing activity" below for more details) and also repaid a Euro-denominated bond that reached maturity in February 2012 amounting to £680 million in Sterling terms. Taking into account these transactions, the Group currently has sufficient liquidity to meet all its obligations in full including capital investment, debt service costs and debt maturities until the final maturity of its revolving capital expenditure facility in August 2013. On completing the refinancing of that facility, the Group's liquidity horizon is expected to extend significantly.

Recent financing activity

During 2011, the Group strengthened its capital structure by completing approximately £1.5 billion in long-term bond issues. The highlight of this activity was the Group's debut US\$1 billion bond completed successfully in June 2011 despite testing market conditions. This was an important strategic development, diversifying the Group's financing options by providing access to a substantial new investor base. The transaction provides a platform from which to develop over time a significant US dollar issuance programme that supplements issuance programmes in other currencies.

In addition, two sterling bond issues were completed in May 2011 raising close to £900 million. Together, these three new issues enabled the Group to repay in full its bank refinancing facility in September 2011. Finally, in December 2011 the Company entered into a new £50 million 8 year loan facility.

BAA (SH) plc

Financial review *continued*

Recent financing activity *continued*

Since the beginning of 2012, the Group has continued to be active in the capital markets, completing a number of transactions. These have been a CHF400 million bond issue placed with a largely new investor base for the Group in Switzerland, a €700 million bond, a £600 million bond and a €50 million private placement. In addition, a €1,000 million bond was repaid in February 2012.

In the remainder of 2012, the financing priorities for the Group will be to increase further the undrawn balance under its £2.7 billion revolving capital expenditure facility principally through continued capital markets issuance, potentially including further currency diversification beyond Sterling, Euro, US dollars and Swiss francs. The Group also intends to complete the refinancing of its capital expenditure facility (extending its term significantly beyond the current maturity date of August 2013).

Regulatory Asset Base ('RAB')

Set out below are RAB figures for Heathrow and Stansted at 31 December 2010 and 31 December 2011. RAB figures are utilised in calculating gearing ratios under the Group's financing agreements.

	Heathrow £m	Stansted £m	Total £m
31 December 2010	11,449	1,327	12,776
31 December 2011	12,490	1,360	13,850

The increase in the total RAB during 2011 reflected the addition of approximately £935 million in capital expenditure partially offset by regulatory depreciation of around £555 million. Variation in RAB profiling adjustments added a further £75 million to the closing RAB whilst inflation resulted in a net positive indexation adjustment of approximately £620 million during the year.

Net finance costs and net interest paid

In the year ended 31 December 2011, the Group's net finance costs before certain re-measurements were £802 million (2010: £733 million), which included £1,024 million (2010: £890 million) of interest on external bonds and bank debt and related derivatives and £25 million (2010: £28 million) of financing facility fees and other items. These charges were partially offset by £220 million (2010: £162 million) in finance income and £27 million (2010: £23 million) in capitalised interest.

Underlying net finance costs were £752 million (2010: £665million), after adjusting for £27 million (2010: £23 million) in capitalised interest and £77 million (2010: £91 million) in non-cash amortisation of financing fees and bond fair value adjustments. The increased underlying net finance costs in 2011 is due to a number of factors, including the overall increase in net debt and the average cost of debt, both referred to in "Net debt and liquidity" above.

Net interest paid in the year ended 31 December 2011 was £375 million (2010: £398 million). This consisted of £347 million (2010: £326 million) net interest paid by the Company's subsidiaries and £28 million (2010: £72 million) paid by the Company. The increase in net interest paid by the Company's subsidiaries between 2010 and 2011 primarily reflects the refinancing of loan facilities with bonds on which coupons were first paid in 2011 together with the impact of increased net debt. This was partially offset by the benefit to net interest paid of additional index-linked swaps entered into since November 2010. The lower interest paid on the Company's debt in 2011 is due to the decrease in the amount of the debt following the partial re-payment of £1 billion in September 2010, financed by new and existing facilities in BAA (SP).

Net interest paid is lower than net finance costs primarily due to an amortisation charge of £62 million (2010: £141 million) in net finance costs relating to prepayments of derivative interest made in earlier periods and a £247 million non-cash charge (2010: £119 million charge) relating to accretion on index-linked instruments. In addition, there is the non-cash amortisation of financing fees and bond fair value adjustments partially offset by capitalised interest.

Financial ratios

The Group continues to operate comfortably within required financial ratios.

At 31 December 2011, the Group's gearing ratio (nominal net debt to RAB) was 79.3% (2010: 81.4%) compared with the 90.0% covenant level under its financing agreements. The reduction in gearing ratios since 31 December 2010 reflects primarily the retention of operating cash flow in the Group and the benefit to the RAB of inflation. BAA (SP)'s senior and junior gearing ratios were 68.0% and 75.4% respectively (2010: 68.8% and 77.7% respectively) compared with trigger levels of 70.0% and 85.0% under its financing agreements.

In the year ended 31 December 2011, the Group's interest cover ratio (the ratio of cashflow from operations (excluding cash exceptional items) less tax paid less 2% of RAB to interest paid) was 2.17x (2010: 1.55x) compared with the 1.00x covenant level under its financing agreements. The improvement in the interest cover ratios from 2010 reflects primarily the increased cashflow from operations generated by the Group in 2011. BAA (SP)'s senior and junior interest cover ratios were 2.76x and 2.34x (2010: 2.08x and 1.85x respectively) compared with trigger levels of 1.40x and 1.20x under its financing agreements. Cash exceptional items excluded in determining 2011 interest cover ratios included the one-off working capital benefit referred to in 'Cash flow from operating activities' above.

BAA (SH) plc

Financial review *continued*

Accounting and reporting policies and procedures

The consolidated results in the financial statements for the year ended 31 December 2011 are presented on an IFRS basis as adopted by the European Union, along with the comparative information for the year ended 31 December 2010. The Group's accounting policies and areas of significant accounting judgements and estimates are detailed within the Group financial statements. The Company accounts are stated under United Kingdom Generally Accepted Accounting Practice ('UK GAAP').

BAA (SH) plc

Corporate governance statement on internal controls and risk management

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

Internal controls

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

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

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

In addition, the AAC:

- considers the appointment of the external auditor, making appropriate recommendations to the Board, and assesses the independence of the external auditor;
- ensures that the provision of non-audit services does not impair the external auditor's independence or objectivity;
- discusses with the external auditor, before the audit commences, the nature and the scope of the audit and reviews the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements;
- reviews external auditor management letters and responses from management;
- has a standing agenda to meet privately with the external auditor ie independent of the Company's executive directors; and
- reviews the scope, operations and reports of the BAA Group's Internal Audit function on the effectiveness of systems for internal financial control, financial reporting and risk management.

Risk management

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

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

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

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

BAA (SH) plc

Corporate governance statement on internal controls and risk management *continued*

Risk management *continued*

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

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

Safety risks

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

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

Security risks

Security risks are regarded as critical risks to manage throughout the Group. The Group mitigates these risks 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, including the police and UK Border Agency building a framework to establish joint accountabilities for airport security and shared ownership of risk, thus ensuring security measures remain both flexible and proportionate to the prevailing threat environment.

Regulatory environment, legal and other reputational risks

Civil Aviation Authority ('CAA') economic regulation

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

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

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 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 Group breaching these regulations. Refer to the Management review section for details on the current process to modernise the economic regulation of UK airports and the Competition Commission's inquiry into the supply of UK airport services by BAA.

Capacity shortfall

Failure to secure necessary planning permissions could lead to the Group having insufficient capacity to meet the demands of the industry resulting in increased congestion and declining passenger service. The UK government's policy on airport capacity changes has a significant influence on the Group's ability to secure necessary planning permissions and develop capacity. The 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. In addition, investment in additional capacity at the Group's airports will be partly dependent on an appropriate level of investment incentives being provided in future regulatory settlements.

Existing planning approvals provide for passenger traffic to grow to approximately 90 million and 35 million at Heathrow and Stansted respectively.

Environmental risks

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

BAA (SH) plc

Corporate governance statement on internal controls and risk management *continued*

Commercial and financial risks

Operational disruption

There are a number of circumstances that can pose short-term risks to the normal operations of the Group's airports such as shocks to the macroeconomic environment, terrorism, wars, airline bankruptcies, human health scares, weather conditions and natural disasters whose cause may be remote from the location of the Group's airports. These conditions can have a particularly significant impact on an airport such as Heathrow where, due to operating close to full capacity, there is negligible spare capacity to utilise in recovering from some of the above conditions. Where possible the Group seeks to anticipate the effects of these events on its operations and also maintains contingency plans to minimise disruption wherever possible.

Capital projects

The BAA Group recognises that failure to control key capital project costs and delivery could damage its financial standing and reputation. The BAA Group mitigates this risk through adherence to a robust project process and by a system of assurance, consisting of project and programme reviews before approval and during construction. The process is continually improved incorporating lessons learnt and "best practice" distilled from knowledge sharing with other client programmes, expertise within its supply chain and guidance from professional bodies.

Changes in demand

The risk of unanticipated long-term changes in passenger demand for air travel could lead to misaligned operational capacity within the BAA Group. Since it is not possible to identify the timing or period of such an effect, the BAA 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. The Heathrow pay agreement reached in early 2011 established the pay structure for 2011, 2012 and 2013 - the next pay negotiations are planned for January 2014. The Group could also be exposed in the short-term to the effect of industrial action involving other key stakeholders in the aviation sector such as airlines, air traffic controllers, baggage handlers and the UK Border Agency.

Treasury

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

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

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

(a) Interest rates

The Group maintains a mix of fixed and floating rate debt. As at 31 December 2011, fixed rate debt after hedging with derivatives represented 85% of the Group's total external nominal debt.

(b) Inflation

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

(c) Foreign currency

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

(d) Funding and liquidity

The Group has established both investment grade (at BAA (SP) level) and sub-investment grade (at BAA (SH) level) financing platforms for its Designated airports. The BAA (SP) platform supports bank term debt, bank revolving credit facilities including a revolving capital expenditure facility, bank liquidity facilities, various other loan facilities and sterling and foreign currency capital markets issuance. All debt is secured and can be issued in either senior (A-/A-) or junior (BBB/BBB) format. Covenants are standardised wherever possible and are monitored on an on-going basis with formal testing reported to the AAC, the Board and the Executive Committee.

The BAA (SH) platform is rated BB+/Ba3 and supports both loan and bond debt.

BAA (SH) plc

Corporate governance statement on internal controls and risk management *continued*

Commercial and financial risks *continued*

Treasury *continued*

(d) *Funding and liquidity continued*

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

The Group has positive cashflows before capital expenditure and maintain at least 12 months' headroom under its revolving capital expenditure facility. As at 31 December 2011, the Group's cash and cash equivalents were £34 million, undrawn headroom under bank credit facilities was £1,355 million and undrawn headroom under the bank liquidity facility was £524 million.

(e) Counterparty credit

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

The Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short- and long-term credit ratings. Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with short-term credit ratings below A-2/F1. The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with a long-term credit rating below BBB+ (S&P)/A (Fitch).

On behalf of the Board



José Leo
Director

28 February 2012

BAA (SH) plc

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2011.

Principal activities

The principal activity of BAA (SH) plc is as the holding company of BAA (SP) Limited. BAA (SP) Limited is the holding company for BAA (AH) Limited, owner of the designated airports (Heathrow and Stansted airports), and BAA Funding Limited, the bond issuer for the Group's investment grade financing platform.

A review of the progress of the Group's business during the year, the key performance indicators, internal controls, principal business risks and likely future developments are reported in the Business review on pages 2 to 18.

Results and dividends

The loss after taxation for the financial year amounted to £36 million (2010: £204 million). No dividends were paid during the year (2010: £nil). The statutory results for the year are set out on page 23.

Directors

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

José Leo
Frederick Maroudas

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 on 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 has 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. The Group's investment in learning and development is guided by senior line managers who ensure that the Group provides the learning opportunities to support the competencies that are 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, 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 and an intranet. The Group also operates frameworks for consultation and is committed to managing people through change fairly.

Together these arrangements aim to provide a common awareness amongst employees of the financial and economic factors affecting the performance of their business. Bonuses paid to employees reflect the financial performance of the business. In addition, senior management participate in a long-term incentive plan which also rewards based on BAA Group performance.

Supplier payment policies

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

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

The Group had 28 days purchases outstanding at 31 December 2011 (2010: 14 days) based on the average daily amount invoiced by suppliers during the year.

BAA (SH) plc

Directors' report *continued*

Donations

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

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

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

Corporate governance statement on internal controls and risk management

The Group actively manages all identified corporate risks and has in place a system of internal controls designed to mitigate these risks. Details of the Group's internal controls and risk management policies can be found on pages 15 to 18 in the Corporate governance statement on internal controls and risk management section of the Business review.

Financial risk management objectives and policies

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 and 18 in the Corporate governance statement on internal controls and risk management section of the Business review.

Post balance sheet events

In February 2012, the Competition Appeal Tribunal ('CAT') rejected the BAA Group's request that it should review the Competition Commission's July 2011 decision that there had been no material changes in circumstances that would give it cause to reconsider its March 2009 decision, particularly that the BAA Group should dispose of Stansted airport. The BAA Group is currently considering its position in light of the CAT's decision.

Directors' indemnity

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

Auditor

Pursuant to the provisions of section 489 of the Companies Act 2006, a resolution relating to the reappointment of the auditor Deloitte LLP will be put to shareholders within the period set out in section 489.

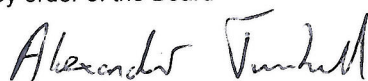
Statement of disclosure of information to the Auditor

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

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

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

By order of the Board



Alexander Turnbull
Company Secretary

28 February 2012
Company registration number: 06458635

Directors' responsibilities statement

The Directors are responsible for preparing the Annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the Group financial statements in accordance with IFRS as adopted by the European Union and the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group and Company for that period.

In preparing the Group financial statements, International Accounting Standard ('IAS') 1 requires that directors:

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

In preparing the parent company financial statements, the Directors are required to:

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

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

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

By order of the Board



Alexander Turnbull
Company Secretary

28 February 2012

BAA (SH) plc

Independent auditor's report to the members of BAA (SH) plc

We have audited the Group financial statements of BAA (SH) plc for the year ended 31 December 2011 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of financial position, the Consolidated statement of changes in equity, the Consolidated statement of cash flows, the Accounting policies, the Significant accounting judgements and estimates and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the European Union.

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

Respective responsibilities of directors and auditor

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2011 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us report to you if, in our opinion:

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

Other matter

We have reported separately on the parent company financial statements of BAA (SH) plc for the year ended 31 December 2011.



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

28 February 2012

BAA (SH) plc

Consolidated income statement for the year ended 31 December 2011

	Note	Year ended 31 December 2011			Year ended 31 December 2010		
		Before certain re-measurements £m	Certain re-measurements ¹ £m	Total £m	Before certain re-measurements £m	Certain re-measurements ¹ £m	Total £m
Continuing operations							
Revenue	1	2,280	-	2,280	2,074	-	2,074
Operating costs	2	(1,712)	-	(1,712)	(1,530)	-	(1,530)
Other operating costs							
Fair value gain on investment properties	8	-	46	46	-	31	31
Operating profit	1	568	46	614	544	31	575
<i>Analysed as:</i>							
Operating profit before exceptional items		619	46	665	486	31	517
Exceptional items	3	(51)	-	(51)	58	-	58
Exceptional impairment of property, plant and equipment	3	-	-	-	(149)	-	(149)
Financing							
Finance income	4a	220	-	220	162	-	162
Finance costs	4a	(1,022)	-	(1,022)	(895)	-	(895)
Fair value loss on financial instruments	4b	-	(46)	(46)	-	(36)	(36)
		(802)	(46)	(848)	(733)	(36)	(769)
Loss before tax		(234)	-	(234)	(338)	(5)	(343)
Taxation credit/(charge)		59	(7)	52	47	4	51
Change in tax rate		117	21	138	62	10	72
Taxation credit	5	176	14	190	109	14	123
(Loss)/profit for the year from continuing operations		(58)	14	(44)	(229)	9	(220)
Net profit from discontinued operations ²	6	8	-	8	16	-	16
Consolidated loss for the year		(50)	14	(36)	(213)	9	(204)

¹ Certain re-measurements consist of fair value gains and losses on investment property revaluations and disposals, gains and losses arising on the re-measurement and disposal of 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 and the related tax impact of these and similar cumulative prior year items.

² Includes a release of provision relating to the disposal of Gatwick airport.

BAA (SH) plc

Consolidated statement of comprehensive income for the year ended 31 December 2011

	Note	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Loss for the year		(36)	(204)
Other comprehensive income:			
Cash flow hedges			
Losses taken to equity	22	(295)	(172)
Transferred to income statement	22	78	107
Change in tax rate	16, 22	1	1
Tax relating to indexation of operating land	16, 22	3	(1)
Other comprehensive loss for the year net of tax		(213)	(65)
Total comprehensive loss for the year		(249)	(269)

The cash flow hedge items in the statement above are disclosed net of tax. The income tax relating to each component of other comprehensive income is disclosed in Note 22.

BAA (SH) plc

Consolidated statement of financial position as at 31 December 2011

	Note	31 December 2011 £m	31 December 2010 £m
Assets			
Non-current assets			
Property, plant and equipment	7	10,426	10,013
Investment properties	8	2,282	2,218
Intangible assets	9	54	51
Derivative financial instruments	14	369	552
Prepayments	11	11	28
		13,142	12,862
Current assets			
Inventories	10	8	5
Trade and other receivables	11	389	361
Derivative financial instruments	14	171	-
Cash and cash equivalents	12	34	67
		602	433
Total assets		13,744	13,295
Liabilities			
Non-current liabilities			
Borrowings	13	(9,912)	(10,359)
Derivative financial instruments	14	(1,082)	(573)
Deferred income tax liabilities	16	(1,595)	(1,880)
Provisions	17	(4)	(5)
Trade and other payables	18	(1)	(3)
		(12,594)	(12,820)
Current liabilities			
Borrowings	13	(1,076)	(198)
Provisions	17	(29)	(81)
Current income tax liabilities		(27)	(36)
Trade and other payables	18	(457)	(350)
		(1,589)	(665)
Total liabilities		(14,183)	(13,485)
Net liabilities		(439)	(190)
Equity			
Capital and reserves			
Share capital	19	3,109	3,109
Revaluation reserve	20	365	365
Merger reserve	20	(1,771)	(1,771)
Fair value reserve	21	(396)	(175)
Retained earnings	23	(1,746)	(1,718)
Total equity		(439)	(190)

These financial statements of BAA (SH) plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 28 February 2012. They were signed on its behalf by:



José Leo
Director



Frederick Maroudas
Director

BAA (SH) plc

Consolidated statement of changes in equity for the year ended 31 December 2011

	Note	Attributable to owners of the Company					Total equity £m
		Share capital £m	Revaluation reserve ¹ £m	Merger reserve £m	Fair value reserve £m	Retained earnings £m	
1 January 2010		2,792	365	(1,771)	(108)	(1,476)	(198)
Comprehensive income:							
Loss for the year		-	-	-	-	(204)	(204)
Other comprehensive income:							
Fair value losses on cash flow hedges net of tax	22	-	-	-	(65)	-	(65)
Change in tax rate		-	-	-	(2)	3	1
Tax relating to indexation of operating land	16,22	-	-	-	-	(1)	(1)
Total comprehensive income					(67)	(202)	(269)
Transactions with owners/fellow subsidiaries:							
Proceeds from shares issued	19	317	-	-	-	-	317
Capital distribution	23	-	-	-	-	(16)	(16)
Tax on capital contribution	23	-	-	-	-	(24)	(24)
Total transactions with owners/fellow subsidiaries		317	-	-	-	(40)	277
1 January 2011		3,109	365	(1,771)	(175)	(1,718)	(190)
Comprehensive income:							
Loss for the year		-	-	-	-	(36)	(36)
Other comprehensive income:							
Fair value losses on cash flow hedges net of tax	22	-	-	-	(217)	-	(217)
Change in tax rate	16	-	-	-	(4)	5	1
Tax relating to indexation of operating land	16,22	-	-	-	-	3	3
Total comprehensive income		-	-	-	(221)	(28)	(249)
31 December 2011		3,109	365	(1,771)	(396)	(1,746)	(439)

¹ The revaluation reserve relates to the historic revaluation of investment properties. Current revaluations of investment properties are included in the Consolidated income statement.

BAA (SH) plc

Consolidated statement of cash flows for the year ended 31 December 2011

	Note	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Cash flows from operating activities			
Cash generated from continuing operations	25	1,057	918
Taxation - Group relief paid		(27)	(17)
Net cash from operating activities		1,030	901
Cash flows from investing activities			
Purchase of:			
Property, plant and equipment		(829)	(822)
Investment properties		(23)	-
Intangible assets		(12)	(19)
Release of provisions on discontinued operations		(6)	(125)
Net cash used in investing activities		(870)	(966)
Cash flows from financing activities			
Proceeds from issuance of bonds		1,508	1,155
Drawdown of Class B facility		-	625
Drawdown of capital expenditure facility		95	600
Drawdown of subordinated facilities		50	175
Repayment of subordinated facility		-	(1,566)
Repayment of facilities and other items		(1,342)	(1,048)
Prepayment of derivative interest		-	(37)
Cancellation of derivatives		(114)	(74)
Settlement of accretion on index-linked swaps		(15)	-
Interest paid		(375)	(399)
Interest received		-	1
Restricted cash		-	143
Proceeds from issue of ordinary shares		-	317
Net cash used in financing activities		(193)	(108)
Net decrease in cash and cash equivalents		(33)	(173)
Cash and cash equivalents at beginning of year		67	240
Cash and cash equivalents at end of year	12	34	67

BAA (SH) plc

Accounting policies for the year ended 31 December 2011

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of accounting

The Group financial statements are prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU') and prepared 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 Companies Act 2006.

Primary financial statements format

The primary financial statements are presented in accordance with 'IFRS' and International Accounting Standard ('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; and
- iii. the associated tax impacts of the items in (i) and (ii) above.

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.

Consequently the directors have reviewed the cash flow projections of the BAA Group taking into account:

- the forecast revenue and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall Group liquidity position, including the remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and its ability to access the debt markets (refer to Net Debt and liquidity and Recent financing activities in the Financial review).

Although the Group is in a net current liability position, the Directors have, as a result of the review, and having made appropriate enquiries of management, a reasonable expectation that sufficient funds will be available to meet the Group's funding requirement for the next twelve months from the Statement of financial position signing date.

Changes in accounting policy and disclosures

a) *New and amended standards adopted by the Group*

The Group has adopted the following new and amended IFRS as of 1 January 2011, none of which have had a material impact on the Group's financial statements.

- Amendment to IFRS 7 Financial Instruments: Disclosures - Transfers of Financial Assets
Amends the disclosure requirements where financial assets are transferred through a contractual right to receive the cash flows of that financial asset or assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.
- Amendment to IAS 24 Related Party Disclosures
The amendments to IAS 24 were limited in scope and provide relief for government-related entities in relation to the amount of information such entities need to provide in respect to related party transactions.
- Amendment to IAS 32 Classification of Rights Issues
The amendments to IAS 32, Classification of Rights Issues, changed certain definitions and presentation requirements.
- Amendment to IFRIC 14 Prepayments to a Minimum Funding Requirements
The amendments to IFRIC 14, which is itself an interpretation of IAS 19 Employee Benefits, applies in the limited circumstances when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements. The amendment permits such an entity to treat the benefit of such an early payment as an asset.

BAA (SH) plc

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

Changes in accounting policy and disclosures *continued*

- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
IFRIC 19 provides guidance on how an entity should account for transactions where a creditor accepts an entity's shares or other equity instruments to settle a financial liability in accordance with IAS 39 Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Presentation.
- Improvements to IFRSs issued by the IASB in May 2010 and endorsed by the EU on 18 February 2011

(b) Standards, amendment and interpretations to existing standards that are not yet effective and have not been adopted early by the Group

The following standards, amendments and interpretations, which have not been applied in these financial statements, were in issue but not yet effective (and in some cases had not yet been endorsed by the EU):

- IAS 27 Separate Financial Statements
- IAS 28 Investments in Associates and Joint Ventures
- IFRS 9 Financial Instruments
- IFRS 10 Consolidated Financial Statements
- IFRS 11 Joint Arrangements
- IFRS 12 Disclosure of Interests in Other Entities
- IFRS 13 Fair Value Measurement
- IAS 1 (amended) Financial Statement Presentation
- IAS 12 (amended) Deferred tax: Recovery of Underlying Assets
- IAS 19 (amended) Employee Benefits
- IAS 32 (amended) Offsetting Financial Assets and Financial Liabilities
- IFRS 7 (amended) Disclosures - Offsetting Financial Assets and Financial Liabilities

On 16 December 2011 the IASB deferred the mandatory effective date of IFRS 9 to 1 January 2015. The adoption of IFRS 9 will impact both the measurement and disclosures of financial instruments. No decision has been made by the Group regarding early adoption.

The directors do not expect that the adoption of the other standards listed above will have a material impact on the financial statements of the Group in future periods.

Business combinations

Basis of consolidation

The BAA (SH) plc group was formed in 2008 as part of a wider BAA group refinancing and group reconstruction. In 2008 the Company acquired BAA (SP) Limited that owns the Designated Airports comprising the UK regulated airports of Heathrow and Stansted. The Group 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 Group's investment grade financing platform.

The group reconstruction was accounted for using the merger method of accounting whereby the principles applied were as follows:

- the acquired entities results are included in the Group's consolidated financial statements 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; and
- no goodwill arises in merger accounting, the differences arising on consolidation are included in a merger reserve.

The Group applied acquisition accounting on the acquisition of Heathrow Express Operating Company Limited ('HEX') which took place on 7 August 2008 as this was not deemed to have been a part of the initial group reconstruction process.

Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Inter-group balances and transactions of the continuing operations are eliminated during the consolidation process. Transactions between continuing and discontinued operations that are expected to continue post sale are not eliminated from continuing operations in order to present the continuing operations on a basis consistent with the underlying trading.

BAA (SH) plc

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

Segment reporting

The Group's operating segments are organised according to their regulatory environment, type of operation, geographic location and funding arrangements. The operating segments are primarily the individual airports, and Heathrow Express ('HEX') which are organised and managed separately on the basis of the above operating environment. As such, the following operating segments are reported to the Board on a monthly basis:

- Designated group (price regulated airports of Heathrow and Stansted and HEX rail operations); and
- other operations (corporate activities and other commercial operations).

Revenue

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes.

Aeronautical

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

Retail

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

Property and operational facilities

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

Other

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

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 2011 (2010: £nil) 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 they are recognised as revenue in the period.

Exceptional items

On the face of the Income statement the Group presents exceptional items separately. Exceptional items are material items of income or expense that, because of their size or incidence, merit separate presentation to allow an understanding of the 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 costs incurred in bringing new airport terminal complexes and airfields to operational readiness that are not able to be capitalised as part of the project.

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

Finance income

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

BAA (SH) plc

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

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 year in which they are incurred.

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, the asset (or disposal group) is available for immediate sale in its present condition, management are committed to the sale and the sale is expected to be completed within one year of the date of classification.

Non-current assets (and disposal groups) classified as held-for-sale cease to be depreciated and are measured at the lower of carrying amount and fair value less selling costs.

Discontinued operations

Discontinued operations consist of business segments and other non-core assets that have either been sold during the year or are classified as held-for-sale at year end.

Property, plant and equipment

Operational assets

Terminal complexes, airfield assets, plant and equipment, rail assets and other land and buildings are stated at cost less accumulated depreciation and impairment losses.

Assets in the course of construction are stated at cost less provision for impairment. Assets in the course of construction are transferred to completed assets when substantially all the activities necessary to get the asset ready for use are complete. Where appropriate, cost includes borrowing costs capitalised, own labour costs of construction-related project management, and directly attributable overheads. 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.

Property, plant and equipment

Depreciation

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

<i>Terminal complexes</i>	<i>Fixed asset lives</i>
Terminal building, pier and satellite structures	20–60 years
Terminal fixtures and fittings	5–20 years
Airport plant and equipment	
Baggage systems	15 years
Screening equipment	7 years
Lifts, escalators and travelators	20 years
Other plant and equipment, including runway lighting and building plant	5–20 years
Tunnels, bridges and subways	50–100 years
Airport transit systems	
Rolling stock	20 years
Track	50 years
<i>Airfields</i>	
Runway surfaces	10–15 years
Runway bases	100 years
Taxiways and aprons	50 years
<i>Rail</i>	
Rolling stock	8–40 years
Tunnels	100 years
Track metalwork	5–10 years
Track bases	50 years
Signals and electrification work	40 years

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

Property, plant and equipment *continued*

Depreciation *continued*

Plant and equipment

Motor vehicles	4–8 years
Office equipment	5–10 years
Computer equipment	4–5 years
Computer software	3–7 years

Other land and buildings

Short leasehold properties	Over period of lease
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Asset residual values and useful lives are reviewed and adjusted, if appropriate, at each reporting date.

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 estimates the asset's recoverable amount. Where the asset does not generate cash flows independent of other assets, the recoverable amount of the cash-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of a cash-generating unit exceeds its recoverable amount, the cash-generating unit is considered impaired and is written down to its recoverable amount. Impairment losses 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.

Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation, is stated at fair value at the reporting date, as determined at the interim and full-year reporting dates by the Directors and by external valuers every year. 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.

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; and
- it is probable that the intangible asset created will generate future economic benefits; and
- 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.

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

BAA (SH) plc

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

Group as a lessee continued

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.

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

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. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income.

Inventories

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

Restricted cash

Cash that can only be used for a specific purpose or where access is restricted is classified as restricted cash.

Cash and cash equivalents

For the purposes of the Statement of cash flows, 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.

Deferred income

Contractual income is treated as deferred income and released to the income statement as earned.

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 reporting date and are discounted to present value where the effect is material.

Restructurings

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

Onerous contracts

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

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 the income statement, directly attributable transaction costs. After initial recognition, investments that are classified as 'held-for-trading' and 'available-for-sale' are measured at fair value. Fair value gains or losses on investments held-for-trading are recognised in the income statement. 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

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

Investments *continued*

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

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 a business after deducting all of its liabilities.

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 rate 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 the statement of financial position 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 rate method.

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 re-measured 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 exposure to changes in the fair value of the hedged asset or liability; or
- cash flow hedges, where they hedge exposure to variability in cash flows that are 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, both at hedge inception and on an ongoing basis, its assessment of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

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

Derivative financial instruments and hedging activities *continued*

The fair value of a hedging derivative is classified as a non-current asset or liability when the remaining maturity is more than 12 months and as a current asset or liability where it is less than 12 months. Derivatives that do not qualify for hedge accounting and which are not held for trading purposes are classified based on their maturity.

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.

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 rate method is used is amortised in the income statement over the period to maturity.

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. 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.

Derivatives at fair value through the income statement

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of 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 is recorded net of 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.

Accounting for changes in credit risk

Accounting standards require that the fair value of financial instruments reflects their credit quality, and also changes in credit quality where there is evidence that this has occurred. Where material, the credit risk associated with the Group's derivatives is reflected in its derivative valuations. This credit factor is adjusted over time to reflect the reducing tenor of the instrument and is updated where the credit associated with the derivative has clearly changed based on market transactions and prices.

Embedded derivatives

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

Shared Services Agreement ('SSA')

All employees of the Group are employed directly by BAA Airports Limited with the exception of the majority of Heathrow Express Operating Company Limited ('HEX') employees. BAA Airports Limited also acts as the provider of corporate and administrative services to the Group, grants all employee benefits and administers and sponsors the related pension plans.

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

Operational staff

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

BAA (SH) plc

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

Corporate and centralised services

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

Pension costs

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

The Group's airports and HEX have had a legal obligation since August 2008 to fund or benefit from their share of the BAA Airports Limited defined benefit pension scheme deficit or surplus and Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits pension related liabilities under the SSA. These provisions or assets are based on the relevant share of the actuarial deficit or surplus and allocated on the basis of pensionable salaries. Movements in these provisions or assets are recorded as exceptional items due to their size and nature and will only be settled when the cash outflows are requested by BAA Airports Limited.

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

Current and deferred income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries where the Group's subsidiaries 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's 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 substantively enacted, by the reporting 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.

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.

Dividend distribution

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

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 Company'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 retranslated into Sterling at the rates of exchange ruling at the reporting date. Differences arising on translation are charged or credited to the income statement, except when deferred in equity as qualifying cash flow hedges.

BAA (SH) plc

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

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 believes that the following areas present the greatest level of uncertainty.

Investment properties

Investment properties were valued at fair value at 31 December 2010 and 31 December 2011 by CB Richard Ellis, Chartered Surveyors and Strutt & Parker, Chartered Surveyors. Strutt & Parker were responsible solely for the valuation of residential property at Stansted. The valuations were prepared in accordance with relevant accounting standards and the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. Independent valuations have been obtained for 100% of the investment properties. Approximately 76% of the investment properties comprise car parks and airside assets at the Group's airports that are considered less vulnerable to market volatility than the overall market.

Taxation

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

Hedge accounting

Interest rate swaps are designated in a cash flow hedge relationship to hedge the exposure to variability in cash flows of existing liabilities and forecast transactions. This is based on management's expectation that it is highly probable that future sterling funding issuances will be used to refinance existing debt. As at 31 December 2011, £528 million of fair value losses (2010: £227 million) on these derivatives have been deferred into the cash flow hedge reserve.

Management compares on a regular basis existing hedging arrangements against expectations for future financing. If there were significant changes in the expected quantum of future sterling financing, this may require the recycling of the cash flow hedge reserve through the income statement.

Fair value of derivative financial instruments

The fair value of derivative financial instruments is calculated using a discounted cash flow approach and using inputs based on observable market data. Where material, the credit risk associated with the derivatives is reflected in its calculation methodology. Judgement is used to determine whether the credit risk associated with the derivatives has changed materially over time based on market transactions and prices and, where this is the case, the credit factor is adjusted in the valuation calculation.

BAA (SH) plc

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

1 Segment information

Management has determined the reportable segments of the business based on those contained within the monthly reports reviewed and utilised by the Board for allocating resources and assessing performance. These segments are organised according to their regulatory environment, type of operation, geographic location and funding arrangements.

The performance of the above segments is measured on a revenue and EBITDA basis, before certain re-measurements, and both pre and post exceptional items.

The reportable segments derive their revenues from a number of sources including aeronautical, retail, property and facilities (including property income and utilities income) and other (including rail income) products and services and this information is also provided to the Board on a monthly basis.

Table (a) details total revenue from external customers for the year ended 31 December 2011 and is broken down into aeronautical, retail, property and facilities and other in respect of the reportable segments. No information in relation to inter-segmental revenue is disclosed as it is not considered material. Also detailed within table (a) is EBITDA on a pre and post exceptional basis.

Table (b) details comparative information to table (a) for the year ended 31 December 2010.

Table (c) details depreciation and amortisation, fair value adjustments and profit and loss on disposals by reportable segment. The fair value adjustment information is not provided to the Board by reportable segment, but is included in this note to the accounts as additional information.

Table (d) details asset, liability and capital expenditure information by reportable segment. The assets and liabilities information by segment is not provided to the Board.

Table (a) Year ended 31 December 2011	Segment revenue				Total revenue from external customers £m	EBITDA		
	Aero- nautical £m	Retail £m	Property & facilities £m	Other £m		Pre exceptional items £m	Operating exceptional items ¹ £m	Post exceptional items £m
Heathrow	1,150	436	250	99	1,935	982	(33)	949
Heathrow Express	-	-	-	111	111	63	-	63
Stansted	127	83	18	6	234	87	(7)	80
Total	1,277	519	268	216	2,280	1,132	(40)	1,092

Reconciliation to statutory information

Unallocated income and expenses

Depreciation and amortisation [Note 1 Table 1 (c)]	(524)
Operating profit (before certain re-measurements)	568
Fair value gain on investment properties (certain re-measurements)	46
Exceptional impairment of property, plant and equipment	-
Finance income	220
Finance costs	(1,022)
Fair value loss on financial instruments (certain re-measurements)	(46)
Loss before tax	(234)
Taxation	176
Taxation (certain re-measurements)	14
Taxation	190
Loss for the year – continuing operations	(44)
Net profit from discontinued operations ²	8
Consolidated loss for the year	(36)

¹ Operating exceptional items for statutory reporting purposes include £11 million in relation to an accelerated depreciation and impairment charge incurred in the Airtrack project which the Group has decided not to pursue (included within depreciation and amortisation above) as compared to £nil for segmental reporting.

² Includes a release of provision relating to the disposal of Gatwick airport, refer to Note 6.

Revenue of approximately £550 million (2010: £487 million) was derived from a single external customer and is primarily included within the Heathrow segment above.

BAA (SH) plc

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

1 Segment information *continued*

Table (b) Year ended 31 December 2010	Segment revenue					EBITDA		
	Aero- nautical £m	Retail £m	Property & facilities £m	Other £m	Total revenue from external customers £m	Pre exceptional items £m	Operating exceptional items ¹ £m	Post exceptional items £m
Heathrow	991	393	249	109	1,742	825	62	887
Heathrow Express	-	-	-	103	103	56	-	56
Stansted	124	83	18	4	229	86	15	101
Total	1,115	476	267	216	2,074	967	77	1,044

Reconciliation to statutory information

Unallocated income and expenses

Depreciation and amortisation [Note 1 Table 1 (c)]	(500)
Operating profit (before certain re-measurements)	544
Fair value gain on investment properties (certain re-measurements)	31
Exceptional impairment of property, plant and equipment	(149)
Finance income	162
Finance costs	(895)
Fair value loss on financial instruments (certain re-measurements)	(36)
Loss before tax	(343)
Taxation	109
Taxation (certain re-measurements)	14
Taxation	123
Loss for the year – continuing operations	(220)
Net profit from discontinued operations ²	16
Consolidated loss for the year	(204)

¹ Operating exceptional items for statutory reporting purposes include £19 million accelerated depreciation (included within depreciation and amortisation above) as compared to £nil for segmental reporting.

² Includes a release of provision relating to the disposal of Gatwick airport, refer to Note 6.

BAA (SH) plc

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

1 Segment information *continued*

Table (c)	Year ended 31 December 2011			Year ended 31 December 2010		
	Depreciation & amortisation ¹	Fair value gain/(loss) ²	Profit on disposal	Depreciation & amortisation ¹	Fair value loss ²	Loss on disposal
	£m	£m	£m	£m	£m	£m
Heathrow	(441)	47	-	(418)	35	-
Heathrow Express	(42)	-	-	(41)	-	-
Stansted	(41)	(1)	-	(41)	(4)	-
Continuing operations	(524)	46	-	(500)	31	-
Discontinued operations	-	-	8	-	-	16
Total Group	(524)	46	8	(500)	31	16

¹ Includes intangible amortisation charge of £9 million (2010: £23 million) and for Heathrow includes £11 million in relation to an accelerated depreciation and impairment charge (2010: £19 million accelerated depreciation) incurred on the Airtrack rail project which the Group has decided not to pursue. Refer to Note 3.

² Reflects fair value gains and losses on investment properties only.

Table (d)	31 December 2011			31 December 2010		
	Assets ¹ £m	Liabilities £m	Capital expenditure ² £m	Assets ¹ £m	Liabilities £m	Capital expenditure ² £m
Heathrow	10,678	(431)	904	10,118	(382)	768
Heathrow Express	1,049	(6)	11	1,084	(8)	11
Stansted	1,320	(27)	19	1,347	(33)	18
Total	13,047	(464)	934	12,549	(423)	797
Other operations	-	(1)	-	-	(16)	-
Total operations	13,047	(465)	934	12,549	(439)	797
Unallocated assets and liabilities:						
Cash and borrowings	34	(10,988)	-	67	(10,557)	-
Derivative financial instruments	540	(1,082)	-	552	(573)	-
Taxation	-	(1,622)	-	-	(1,916)	-
Amounts owed from group undertakings	123	(26)	-	127	-	-
Total Group	13,744	(14,183)	934	13,295	(13,485)	797

¹ Segment assets include primarily airport runways and facilities.

² Capital expenditure excludes the impact of capital creditors

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

BAA (SH) plc is domiciled in the UK. All revenue from external customers comes from the UK which for the year ended 31 December 2011 was £2,280 million (2010: £2,074 million). The breakdown of the major components of total revenue from external customers is shown in tables (a) and (b) above.

The total of non-current assets excluding financial instruments, deferred tax assets and post-employment benefit assets is £12,773 million (2010: £12,310 million). There are no non-current assets held outside the UK (2010: £nil).

BAA (SH) plc

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

2 Operating costs – continuing operations

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Operating costs (including exceptional items) include the following:		
Employment costs ¹		
Wages and salaries	264	244
Social security	24	20
Pensions	30	30
Share-based payments	-	3
Contract and agency staff	6	9
Other staff related		
Net exceptional pension charge/(credit)	40	(90)
Reorganisation costs	-	13
Other	15	10
	379	239
Depreciation and amortisation		
Depreciation of property, plant and equipment	515	477
Amortisation of intangible assets - software	9	23
	524	500
Other operating costs		
Maintenance expenditure	137	135
Utility costs	111	116
Rents and rates	129	117
General expenses	133	133
Retail expenditure	31	31
Police	36	36
Aerodrome navigation service charges	63	64
Intra-group charges/other	192	176
Own work capitalised ²	(23)	(17)
Total operating costs	1,712	1,530
Analysed as:		
Adjusted operating costs	1,148	1,107
Depreciation and amortisation (excluding exceptional depreciation)	513	481
Exceptional costs/(credit) ³	51	(58)
Total operating costs	1,712	1,530

¹ Employment costs include recharges from BAA Airports Limited for employee services to the Group. Refer to the SSA section in the Accounting policies.

² Own work capitalised includes £7 million (2010: £6 million) in relation to employment costs including contract and agency staff.

³ Exceptional costs/(credits) and impairment charge (2010: £19 million accelerated depreciation) includes £40 million charge (2010: £90 million credit) in relation to pensions, £11 million cost in relation to an accelerated depreciation and £nil million cost (2010: £13 million cost) in relation to reorganisation. Refer to Note 3.

Rentals under operating leases

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
<i>Operating costs include:</i>		
Plant and machinery	35	34
Other	15	13
	50	47
Property lease and sub lease charges - minimum lease payments	15	13

BAA (SH) plc

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

2 Operating costs – continuing operations *continued*

Auditor's remuneration

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

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Fees payable to the Company's auditor for the audit of the BAA (SH) plc group annual accounts		
Audit of the Company's subsidiaries pursuant to legislation	0.5	0.4
Total audit fees	0.5	0.4
Fees payable to the Company's auditor and their associates for other services specific to the BAA (SH) plc group		
Tax services	0.2	-
Information technology services – pre-appointment ¹	-	0.9
Information technology services – post-appointment ¹	0.2	0.2
Corporate finance services ²	0.3	-
Other services	0.1	-
Total non-audit fees	0.8	1.1
Total fees	1.3	1.5

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

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

Employee numbers

The Group has no employees other than the majority of HEX employees which in 2011 averaged 435 (2010: 411). Other staff engaged in the operation of the Group's airports are employed by BAA Airports Limited which bears the related staff costs and recharges all such costs directly to the Group's airports. The average number of employees of BAA Airports Limited engaged in the Group's operations during the year was 6,403 (2010: 6,269).

Directors' remuneration

Jose Leo was a director of a number of companies within the BAA Group, including BAA Airports Limited, during the year. His remuneration for the year ended 31 December 2011 was apportioned based on services provided to BAA Limited and is disclosed within its financial statements. Frederick Maroudas was a director of a number of companies within the BAA Group. He was paid by, but is not a director of, BAA Airports Limited. The directors do not believe it is possible to accurately apportion his remuneration to individual companies within the BAA Group based on services provided.

During the year, none of the directors (2010: none) had retirement benefits accruing to them under a defined benefit scheme and one of the directors (2010: one) had retirement benefits accruing to them under a defined contribution scheme.

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

BAA (SH) plc

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

3 Exceptional items

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Pension (charge)/credit	(40)	90
Accelerated depreciation and impairment	(11)	(19)
Reorganisation costs	-	(13)
Total operating exceptional items	(51)	58
Exceptional impairment of property, plant and equipment	-	(149)
Taxation on exceptional items	10	(16)
Total exceptional items after tax	(41)	(107)

During 2011 there was a net exceptional pension charge of £40 million (2010: £90 million credit). This includes the Group's share of the movement in the BAA Airports Limited defined benefit pension scheme, Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits as well as a re-allocation of pension balances between entities.

The accelerated depreciation and impairment charge of £11 million (2010: £19 million – accelerated depreciation) in 2011 was in relation to an impairment charge on the Airtrack rail project which the Group has decided not to pursue. In 2010, the accelerated depreciation charge was due to the shortened lives of certain existing assets at Heathrow given the new Heathrow Terminal 2 development.

The reorganisation costs in 2010 related primarily to various restructuring processes designed to reduce the size and cost of overhead functions following the sale of Gatwick airport in 2009.

4 Financing

(a) Net finance costs before certain re-measurements

	Note	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Finance income			
Interest receivable on derivatives not in hedge relationship		220	160
Interest receivable from other group undertakings		-	1
Interest on deposits		-	1
		220	162
Finance costs			
Interest on borrowings:			
Bonds and related hedging instruments ¹		(488)	(391)
Bank loans and overdrafts and related hedging instruments		(189)	(285)
Interest payable on derivatives not in hedge relationship ²		(347)	(214)
Facility fees		(25)	(28)
		(1,049)	(918)
Less: capitalised borrowing costs ³	7	27	23
		(1,022)	(895)
Net finance costs before certain re-measurements		(802)	(733)

¹ Includes accretion of £15.4 million (2010: £11.8 million) on index-linked bonds.

² Includes accretion of £231.8 million (2010: £106.8 million) on index-linked swaps.

³ Borrowing costs included in the cost of qualifying assets (i.e. capitalised borrowing costs) are calculated by applying an average capitalisation rate of 2.08% (2010: 2.22%) to expenditure incurred on such assets.

(b) Fair value loss on financial instruments

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Interest rate swaps: cash flow hedge ¹	3	(6)
Index-linked swaps: not in hedge relationship ²	(89)	(36)
Cross-currency swaps: cash flow hedge ¹	12	6
Cross-currency swaps: fair value hedge ¹	31	1
Fair value re-measurements of foreign exchange contracts and currency balances	(3)	(1)
Fair value loss on financial instruments	(46)	(36)

¹ Hedge ineffectiveness on derivatives in hedge relationship.

² Reflects the impact on the valuation of movements in implied future inflation and interest rates.

BAA (SH) plc

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

5 Taxation – continuing operations

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
UK corporation tax		
Current tax at 26.5% (2010: 28%)	24	21
(Over)/under provision in respect of prior years	(6)	3
Deferred tax		
Current year	(84)	(70)
Prior year	14	(5)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	(138)	(72)
Taxation credit for the year	(190)	(123)

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Loss before tax	234	343

The tax on the Group's loss before tax differs from the theoretical amount that would arise by applying the UK statutory tax rate to the accounting losses of the Group:

Reconciliation of the tax credit

Tax calculated at the UK statutory rate of 26.5% (2010: 28%)	(62)	(96)
Adjustments in respect of current income tax of previous years	(6)	3
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	(138)	(72)
Non deductible expenses	2	47
Adjustments in respect of deferred income tax of previous years	14	(5)
Taxation credit for the year	(190)	(123)

6 Discontinued operations

Discontinued operations represents components of the Group that have disposed of. In accordance with IFRS 5 'Non-current Assets Held-for-Sale and Discontinued Operations', the results and cash flows of this 'disposal group' are reported separately from the performance of continuing operations at each reporting date.

Gatwick airport was sold on 3 December 2009 for cash consideration of £1,445 million and deferred consideration of up to £55 million conditional on future traffic performance and the acquirer's future capital structure. At the time, certain provisions were recognised for costs associated with the disposal.

Net profit from discontinued operations

During 2011, £8 million excess provisions for Gatwick disposal costs were released to the income statement. This related to costs expected to be associated with the disposal including legal fees and other separation costs. The £16 million gain on disposal in 2010 reflected the shortfall between assets and liabilities transferred to the pension scheme of Gatwick's purchaser being lower than expected, and the receipt of a further £1 million on the finalisation of Gatwick's balance sheet at completion of the disposal. Both items are presented within the net profit from discontinued operations line as the original related costs and provisions were also recognised under the same caption.

BAA (SH) plc

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

7 Property, plant and equipment

	Note	Terminal complexes £m	Airfields £m	Plant and equipment £m	Other land and buildings £m	Rail £m	Assets in the course of construction £m	Total £m
Cost								
1 January 2010		8,229	1,134	558	83	1,362	1,326	12,692
Additions		3	-	7	-	-	768	778
Net transfers from/(to) investment properties	8	(1)	-	-	5	-	(107)	(103)
Transfers from/(to) completed assets		157	109	30	1	6	(303)	-
Borrowing costs capitalised	4	-	-	-	-	-	23	23
Disposals		(17)	(1)	(10)	(1)	-	(150)	(179)
Reclassifications		6	(7)	1	-	-	-	-
1 January 2011		8,377	1,235	586	88	1,368	1,557	13,211
Additions		3	-	8	-	-	885	896
Net transfers from/(to) investment properties	8	-	-	-	6	-	-	6
Transfers from/(to) completed assets		526	14	68	7	14	(629)	-
Borrowing costs capitalised	4	-	-	-	-	-	27	27
31 December 2011		8,906	1,249	662	101	1,382	1,840	14,140
Depreciation								
1 January 2010		(1,895)	(250)	(328)	(28)	(251)	-	(2,752)
Charge	2	(348)	(39)	(44)	(6)	(40)	-	(477)
Impairment		-	-	-	-	-	(149)	(149)
Disposals		17	1	11	1	-	149	179
Reclassifications		(3)	4	(1)	-	-	-	-
1 January 2011		(2,229)	(284)	(362)	(33)	(291)	-	(3,199)
Charge	2	(358)	(39)	(59)	(6)	(53)	-	(515)
31 December 2011		(2,587)	(323)	(421)	(39)	(344)	-	(3,714)
Net book value 31								
December 2011		6,319	926	241	62	1,038	1,840	10,426
Net book value 31 December 2010		6,148	951	224	55	1,077	1,558	10,013

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value of £17 million (2010: £19 million).

Assets in the course of construction

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

BAA (SH) plc

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

7 Property, plant and equipment *continued*

Borrowing costs capitalised

The amount of borrowing costs included in the cost of Group assets was £1,192 million (2010: £1,165 million). Borrowing costs were capitalised at an average rate of 2.08% (2010: 2.22%).

A tax deduction of £27 million (2010: £23 million) for capitalised borrowing costs was taken in the year. Subsequent depreciation of the capitalised borrowing costs is disallowed for tax purposes. Consequently, the capitalised borrowing costs give rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets.

Security granted by the Group over its assets, including property, plant and equipment, is disclosed in Note 13.

8 Investment properties

	Note	Airport investment properties £m	Assets in the course of construction £m	Total £m
Valuation				
1 January 2010		2,075	9	2,084
Transfers to/(from) completed assets		3	(3)	-
Net transfers from operational assets	7	103	-	103
Valuation loss		31	-	31
1 January 2011		2,212	6	2,218
Additions		26	-	26
Transfers to/(from) completed assets		(5)	-	(5)
Disposals		(3)	-	(3)
Valuation gain		46	-	46
31 December 2011		2,276	6	2,282

Airport investment properties were valued at fair value at 31 December 2010 and 2011 by CB Richard Ellis, Chartered Surveyors and Strutt & Parker, Chartered Surveyors. Strutt & Parker were responsible solely for the valuation of residential property at Stansted.

Details of the valuations performed are provided below:

	31 December 2011 £m	31 December 2010 £m
CB Richard Ellis	2,195	2,131
Strutt & Parker	87	87
At professional valuation	2,282	2,218

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.

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

Investment properties are let on either full repair and insuring leases, under which all outgoings are the responsibility of the lessee, or under tenancies, where costs are recovered through a service charge levied on tenants during their period of occupation. This service charge amounted to £2 million (2010: £2 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 13.

BAA (SH) plc

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

9 Intangible assets

	£m
Cost	
1 January 2010	208
Additions	19
Disposals	(5)
1 January 2011	222
Additions	12
31 December 2011	234
Amortisation	
1 January 2010	(153)
Charge for the year	(23)
Disposals	5
1 January 2011	(171)
Charge for the year	(9)
31 December 2011	(180)
Net book value 31 December 2011	54
Net book value 31 December 2010	51

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 £33 million (2010: £29 million).

10 Inventories

	31 December 2011 £m	31 December 2010 £m
Consumables	8	5

The total amount of inventories consumed in the year was £2 million (2010: £7 million).

There is no material difference between the statement of financial position value of inventories and their replacement cost.

11 Trade and other receivables

	31 December 2011 £m	31 December 2010 £m
Non-current		
Prepayments ¹	11	28
	11	28
Current		
Trade receivables	184	153
Less: provision for impairment	(2)	(3)
Trade receivables – net	182	150
Prepayments	30	37
Amounts owed by group undertakings ²	91	58
Amounts owed by group undertakings - pensions ³	32	69
Other receivables	54	47
	389	361

1 In 2011, non-current prepayments include £11 million refinancing fees paid in 2008 on facilities not yet drawn. Refinancing fees paid on facilities are amortised over the term of the facility. Non-current prepayments in 2010 also included amounts (£28 million) in respect of future bond issuances which were fully utilised during 2011.

2 Amounts owed by group undertakings largely relate to a loan advanced to BAA (DSH) Limited on an interest free basis.

3 Amounts owed by group undertakings – pensions represents the Group's airports share of the surplus in the BAA Airports Limited defined benefit pension scheme allocated to the airports and HEX on the basis of pensionable salaries of those employees being in the defined benefit pension scheme. See note 17 for further details.

BAA (SH) plc

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

11 Trade and other receivables *continued*

The fair value of 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.

As at 31 December 2011, trade receivables of £150 million (2010: £120 million) were fully performing. Trade receivables of £32 million (2010: £22 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 2011	Restated ¹ 31 December 2010
	£m	£m
Fully performing	150	120
Past due but not impaired :		
Not impaired but overdue by less than 30 days	24	16
Not impaired but overdue by between 30 and 60 days	3	3
Not impaired but overdue by more than 60 days	5	3
	32	22
Considered for impairment :		
Overdue by more than 90 days	2	11

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

	2011	2010
	£m	£m
1 January	3	3
Provision for receivables impairment	-	1
Receivables written off during the year as uncollectible	(1)	(1)
31 December	2	3

¹ The presentation of certain balances for the year ended 31 December 2010 has been restated to be consistent with current period disclosures.

As at 31 December 2011, trade receivables of £2 million (2010: £11 million) were considered for impairment of which £2 million (2010: £3 million) was provided for, with the remaining amount expected to be fully recovered. The individual impaired receivables mainly relate to customers who are in difficult economic situations. The creation and release of any provisions for impaired receivables have 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 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 15.

BAA (SH) plc

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

12 Cash and cash equivalents

	31 December 2011	31 December 2010
	£m	£m
Cash at bank and in hand	13	15
Short-term deposits	21	52
	34	67

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

For the purposes of the consolidated statement of cash flows, 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.

13 Borrowings

	31 December 2011	31 December 2010
	£m	£m
Current		
Secured		
Bank loans	39	39
BAA Funding Limited bonds		
3.975% €1,000 million due 2012	833	-
Total current (excluding interest payable)	872	39
Interest payable	204	159
Total current	1,076	198
Non-current		
Secured		
BAA Funding Limited bonds		
3.975% €1,000 million due 2012	-	832
5.850% £400 million due 2013	380	374
4.600% €750 million due 2014	589	594
12.450% £300 million due 2016	356	367
4.125% €500 million due 2016	396	410
4.600% €750 million due 2018	560	568
6.250% £400 million due 2018	394	394
9.200% £250 million due 2021	281	283
4.875% US\$1,000 million due 2021	679	-
5.225% £750 million due 2023	625	618
6.750% £700 million due 2026	685	684
7.075% £200 million due 2028	197	197
6.450% £900 million due 2031	841	840
3.334%+RPI £365 million due 2039 ¹ (2010: £235 million)	414	245
5.875% £750 million due 2041	733	-
Total BAA Funding Limited bonds	7,130	6,406
BAA (SH) plc bonds		
7.125% £325 million due 2017	318	317
Total bonds	7,448	6,723
Syndicated term facility	-	1,292
Capital expenditure facility	1,374	1,266
Subordinated facilities	220	171
Other bank loans	870	907
Total bank loans	2,464	3,636
Total non-current	9,912	10,359
Total borrowings (excluding interest payable)	10,784	10,398

¹ The existing index-linked bond was re-opened in May 2011 generating proceeds of £154.3 million.

The average cost of the Group's external gross debt at 31 December 2011 was 4.30% (2010: 4.55%), taking into account the impact of interest rate, cross currency and index-linked hedges but excluding index-linked accretion. Including index-linked accretion the Group's average cost of debt at 31 December 2011 was 6.46% (2010: 5.68%). The increase in the average cost of debt (including index-linked accretion) is the result of a number of factors including the replacement of short-term bank debt with higher cost bond debt and the impact of high current inflation on the accretion payable on index-linked swaps and bonds.

BAA (SH) plc

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

13 Borrowings continued

BAA Funding Limited bonds

The maturity dates of the BAA Funding Limited bonds listed above reflect their scheduled redemption dates that correspond to the maturity dates of the loans between Heathrow Airport Limited and BAA Funding Limited. The bonds are not callable in nature and are expected to be repaid on their scheduled redemption date. However, to meet rating agency requirements the bonds have a legal maturity that is two years later, except for the 6.250% £400 million 2018 bond, the scheduled redemption of which coincides with its legal maturity date.

Fair value of borrowings

	31 December 2011		31 December 2010	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Non-current				
Long-term debt	9,912	10,812	10,359	11,047

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.

Securities and guarantees

Heathrow Airport Limited, Stansted Airport Limited, HEX, BAA (SP) Limited and BAA (AH) Limited (together, the Obligors) have granted security over their assets to secure their obligations under their financing agreements. Each Obligor has also provided a guarantee in respect of the obligations of the other Obligors.

BAA (DSH) Limited and BAA (SH) plc have also granted security over their assets to secure their obligations under their financing agreements.

BAA Pension Trust Company Limited 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 senior (Class A) creditors to the Obligors.

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

Heathrow Airport Limited, Stansted Airport Limited and HEX have provided a guarantee in favour of The Royal Bank of Scotland plc as Borrower Account Bank in respect of their liabilities under the Borrower Account Bank Agreement.

Additional disclosures on risk management and hedging of borrowings are included in Notes 14 and 15.

BAA (SH) plc

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

14 Derivative financial instruments

31 December 2011	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Cross-currency swaps - cash flow hedge	680	171	-	171
Foreign exchange contracts - no hedge accounting	6	-	-	-
	686	171	-	171
Non-current				
Interest rate swaps - cash flow hedge	3,191	-	(434)	(434)
Cross-currency swaps - cash flow hedge	510	118	-	118
Cross-currency swaps - fair value hedge	1,568	251	(5)	246
Index-linked swaps - no hedge accounting	5,254	-	(643)	(643)
	10,523	369	(1,082)	(713)
Total	11,209	540	(1,082)	(542)
31 December 2010	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Foreign exchange contracts - no hedge accounting	10	-	-	-
	10	-	-	-
Non-current				
Interest rate swaps - cash flow hedge	3,000	-	(258)	(258)
Cross-currency swaps - cash flow hedge	1,190	358	-	358
Cross-currency swaps - fair value hedge	947	192	(19)	173
Index-linked swaps - no hedge accounting	4,114	2	(296)	(294)
	9,251	552	(573)	(21)
Total	9,261	552	(573)	(21)

Interest rate swaps

Interest rate swaps are maintained by the Group and designated as cash flow hedges, where they qualify, against variability in interest cash flows on current and future floating or fixed borrowings. 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.

Index-linked swaps

Index-linked swaps have been entered into to economically hedge debt instruments and RPI linked revenue.

Cross-currency swaps

Cross-currency swaps have been entered into by the Group to hedge currency risk, and in the case of cash flow hedges interest rate risk, on interest and principal payments on its foreign currency-denominated bond issues. The gains and losses deferred in equity on these swaps will be continuously released to the income statement over the period of the hedged risk. In 2011, non-current prepayments include £11 million refinancing fees paid in 2008 on facilities not yet drawn. Refinancing fees paid on facilities are amortised over the term of the facility. Non-current prepayments in 2010 also included amounts (£36 million) in respect of future bond issuances which were fully utilised during 2011. t over the period to maturity of the hedged bonds.

Foreign exchange contracts

Foreign exchange forward and swap contracts are used to manage exposures relating to future capital expenditure. Hedge accounting is not sought for these derivatives.

15 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, index-linked swaps, cross-currency swaps and foreign exchange contracts. The purpose of these transactions is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance.

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

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

BAA (SH) plc

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

15 Financial instruments *continued*

Financial risk management objectives and policies *continued*

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

Foreign exchange risk

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

As at 31 December 2011, with all other variables remaining constant, if Sterling strengthened or weakened by 10% against the Euro, annual pre-tax profit would have decreased or increased by £5 million and £7 million respectively (2010: £15 million decrease and £18 million increase, respectively).

As at 31 December 2011, with all other variables remaining constant, if Sterling strengthened or weakened by 10% against the USD, annual pre-tax profit would have increased or decreased by £1 million and £nil respectively (2010: £nil impact).

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 risk on its index-linked bond and derivatives held to economically hedge cash flows on debt instruments and RPI linked revenue. As at 31 December 2011, with all other variables remaining constant, if the RPI had increased or decreased by 10%, annual pre-tax profit would have decreased or increased by £207 million and £200 million respectively (2010: £171 million decrease and £165 million increase respectively).

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 2011, the Group's fixed floating interest rate profile, after hedging, on gross debt was 85:15 (2010: 76:24).

As at 31 December 2011, each 0.50% change in interest rates would have resulted in the following gain/(loss) to pre-tax profit and equity, due to movement in the finance income, finance cost and mark-to-market valuation of derivatives.:

	31 December 2011		31 December 2010	
	Income statement impact	Equity impact	Income statement impact	Equity impact
	£m	£m	£m	£m
0.50% increase	57	158	58	143
0.50% decrease	(61)	(169)	(60)	(119)

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- and long-term credit ratings. Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with short-term credit ratings below A-2/F1. The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with long-term credit ratings below BBB+ (S&P)/A (Fitch).

As at 31 December 2011, the Group had total credit risk with derivative counterparties of its interest rate swaps, index-linked swaps and cross-currency swaps of £540 million (2010: £552 million).

BAA (SH) plc

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

15 Financial instruments *continued*

Credit risk *continued*

Financial assets past due but not impaired are disclosed in Note 11 'Trade and other receivables'.

The maximum exposure to credit risk as at 31 December 2011 was £776 million (2010: £785 million).

Liquidity risk

Although there can be no certainty that financing markets will remain open for issuance at all times, debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year. Further details of the risk management objectives and policies can be found on pages 15 to 18 of the Internal controls and risk management section of the Business review.

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

	31 December 2011 £m	31 December 2010 £m
Floating rate facilities		
Expiring in one to two years	1,355	-
Expiring in more than two years	-	1,450

As at 31 December 2011, overdraft facilities of £10 million were available (2010: £10 million).

The tables below analyse the gross undiscounted contractual cash flows on the Group's financial liabilities and net settled derivative financial instruments as at 31 December to the contractual maturity date.

	31 December 2011			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Borrowing principal payments	719	1,830	2,164	6,001
Borrowing interest payments	559	516	1,307	3,583
Derivative financial instruments	(134)	79	45	(288)
Trade payables	136	-	-	-
Capital payables	250	-	-	-

	31 December 2010			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Borrowing principal payments	39	1,249	3,895	5,155
Borrowing interest payments	499	494	1,187	2,510
Derivative financial instruments	(73)	(61)	79	260
Trade payables	125	-	-	-
Capital payables	180	-	-	-

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 to the contractual maturity date.

	31 December 2011			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Cross-currency derivative payments	93	75	205	145
Cross-currency derivative receipts	(140)	(106)	(261)	(215)

	31 December 2010			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Cross-currency derivative payments	59	59	116	76
Cross-currency derivative receipts	(111)	(111)	(201)	(106)

BAA (SH) plc

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

15 Financial instruments *continued*

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. The Group regularly reviews and maintains or adjusts the capital structure as appropriate in order to achieve these objectives.

The Group monitors capital on the basis of its gearing ratio. Like other regulated utilities in the UK, gearing is measured by reference to the ratio of net debt to the Regulatory Asset Base ('RAB'). Net debt is the external consolidated nominal net debt at the entity within the part of the Group that the relevant debt facility sits.

There are gearing covenants in financing agreements at various levels including BAA (SH) plc and BAA (SP) Limited. Gearing ratios at each of these levels are set out below:

	31 December 2011	31 December 2010
Net debt to RAB at BAA (SH) group	0.79	0.81
Total net debt to RAB at BAA (SP) group	0.75	0.78
Senior net debt to RAB at BAA (SP) group	0.68	0.69

The decrease in gearing ratios at BAA (SH) group and BAA (SP) group is largely the result of cash flow being retained in the business and the impact of inflation on the RAB.

Financial instruments by category

The Group's financial instruments as classified in the financial statements as at 31 December can be analysed under the following categories:

	31 December 2011			Total £m
	Loans and receivables £m	Assets at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	
Derivative financial instruments	-	-	540	540
Cash and cash equivalents	34	-	-	34
Trade receivables	182	-	-	182
Other receivables	20	-	-	20
Total financial assets	236	-	540	776

	31 December 2011			Total £m
	Liabilities at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Other financial liabilities at amortised cost £m	
Borrowings	-	-	(10,784)	(10,784)
Derivative financial instruments	(643)	(439)	-	(1,082)
Trade payables	-	-	(136)	(136)
Capital payables	-	-	(250)	(250)
Total financial liabilities	(643)	(439)	(11,170)	(12,252)

	31 December 2010			Total £m
	Loans and receivables £m	Assets at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	
Derivative financial instruments	-	2	550	552
Cash and cash equivalents	67	-	-	67
Trade receivables	150	-	-	150
Other receivables	16	-	-	16
Total financial assets	233	2	550	785

BAA (SH) plc

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

15 Financial instruments *continued*

Financial instruments by category *continued*

	31 December 2010			Total £m
	Liabilities at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Other financial liabilities at amortised cost £m	
Borrowings	-	-	(10,398)	(10,398)
Derivative financial instruments	(296)	(277)	-	(573)
Trade payables	-	-	(125)	(125)
Capital payables	-	-	(180)	(180)
Total financial liabilities	(296)	(277)	(10,703)	(11,276)

At 31 December 2011, the Group 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.

Fair value estimation

Financial instruments that are measured in the Statement of financial position at fair value are classified by the following fair value measurement hierarchy:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices);
- Level 3 - inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

The fair value of financial instruments traded in active markets is based on quoted market prices at the reporting date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the group is the current bid price. These instruments are included in level 1.

The fair value of financial instruments that are not traded in an active market (such as derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- quoted market prices or dealer quotes for similar instruments;
- the fair value of cross-currency and interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves; and
- other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

At 31 December 2011, all of the resulting fair value estimates in the Group are included in level 2 (2010: all included in level 2).

16 Deferred income tax

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

	2011 £m	2010 £m
1 January	1,880	2,027
Credited to income statement ¹	(208)	(147)
(Credited)/charged to equity	(76)	1
Change in UK corporation tax rate - credited to equity	(1)	(1)
31 December	1,595	1,880

¹ Includes £138 million credit to income statement for change in tax rate from 27% to 25% effective 1 April 2012 (2010 includes a £72 million credit to income statement for change in tax rate from 28% to 27% effective 1 April 2011).

BAA (SH) plc

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

16 Deferred income tax *continued*

The amounts of deferred income tax provided are detailed below:

Deferred income tax liabilities

	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
1 January 2011	1,424	447	12	52	1,935
Credited to income statement	(198)	(4)	(3)	(13)	(218)
Credited to equity	-	(3)	-	-	(3)
Change in tax rate credited to equity	-	(5)	-	-	(5)
31 December 2011	1,226	435	9	39	1,709

Deferred income tax assets

	IAS 32/39 £m
1 January 2011	(55)
Charged to the income statement	10
Credited to equity	(73)
Change in tax rate charged to equity	4
31 December 2011	(114)

Deferred income tax (credited)/charged to equity during the year is as follows:

	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Cash flow hedge reserve	(69)	(22)
Tax relating to indexation of operating land	(3)	1
Retained earnings	(5)	21
	(77)	-

The Finance Act 2011 enacted a reduction in the main rate of UK corporation tax from 27% to 26% with effect from 1 April 2011 and from 26% to 25% with effect from 1 April 2012. As a result the Group's deferred tax balances, which were previously provided at 27%, have been re-measured at the rate of 25% in the year ended 31 December 2011. This has resulted in a reduction in the net deferred tax liability of £139 million (2010: £73 million), with £138 million (2010: £72 million) credited to the income statement and £1 million (2010: £1 million) credited to reserves.

17 Provisions

	Disposal of operations £m	Reorganisation costs £m	Pensions £m	Other £m	Total £m
1 January 2011	15	5	53	13	86
Utilised	(6)	(5)	-	(6)	(17)
Charged to income statement	-	3	5	-	8
Credited/released to income statement	(8)	-	(36)	-	(44)
31 December 2011	1	3	22	7	33
Current	1	3	22	3	29
Non-current	-	-	-	4	4
31 December 2011	1	3	22	7	33
Current	15	5	53	8	81
Non-current	-	-	-	5	5
31 December 2010	15	5	53	13	86

Disposal of operations

A provision is held for costs associated with the Group's disposal of Gatwick airport. All amounts are expected to be utilised in 2012.

BAA (SH) plc

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

17 Provisions *continued*

Reorganisation costs

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

Pensions

The £22 million closing provision (2010: £17 million) is held for historical accumulated past service pension costs borne by BAA Airports Limited in relation to the Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits. The movement in the year is due to the BAA Airports Limited defined benefit pension scheme moving from a deficit to a surplus position. As such the closing balance is included within Debtors - Amounts owed by group undertakings - pensions.

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

Other

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

18 Trade and other payables

	31 December 2011	31 December 2010
	£m	£m
Non-current		
Deferred income	1	3
	1	3
Current		
Deferred income	31	30
Trade payables ¹	136	125
Other tax and social security	8	6
Other payables	6	9
Capital payables	250	180
Amount owed to group undertakings - operating	26	-
	457	350

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

19 Share capital

	£
Authorised	
At 1 January 2011 and 31 December 2011: 9,000,000,000 ordinary shares of £1 each	9,000,000,000
Allotted and fully paid	
In issue at 1 January 2011 and 31 December 2011: 3,109,350,689 ordinary shares of £1 each	3,109,350,689

20 Other reserves

The revaluation reserve relates to the historic revaluation of investment properties that existed upon adoption of IFRS. Current revaluations of investment properties are included in the income statement.

The merger reserve relates to the Group reconstruction in 2008. Refer to the Basis of consolidation section of the Accounting policies.

21 Fair value reserve

	Cash flow hedge reserve £m
1 January 2011	(175)
Fair value losses	(393)
Transferred to income statement	103
Deferred tax on fair value loss	73
Change in tax rate	(4)
31 December 2011	(396)

BAA (SH) plc

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

22 Tax relating to components of comprehensive income

The tax credit/(charge) relating to components of other comprehensive income is as follows:

	Year ended 31 December 2011			Year ended 31 December 2010		
	Before tax £m	Tax credit/ (charge) £m	After tax £m	Before tax £m	Tax credit/ (charge) £m	After tax £m
Cash flow hedges						
Losses taken to equity	(393)	98	(295)	(236)	64	(172)
Transferred to income statement	103	(25)	78	147	(40)	107
Change in tax rate	-	1	1	-	1	1
Tax relating to indexation of operating land	-	3	3	-	(1)	(1)
Other comprehensive income	(290)	77	(213)	(89)	24	(65)
Current tax	-	-	-	-	-	-
Deferred tax	-	77	-	-	24	-
	-	77	-	-	24	-

23 Retained earnings

	£m
1 January 2010	(1,476)
Net loss for the year	(204)
Capital distribution ¹	(16)
Tax on capital contribution ²	(24)
Change in tax rate on investment properties	3
Tax relating to indexation of operating land	(1)
1 January 2011	(1,718)
Net loss for the year	(36)
Change in tax rate on investment properties	5
Tax relating to indexation of operating land	3
31 December 2011	(1,746)

¹ The capital distribution relates to the commutation payment of £105 million made by BAA (AH) Limited to BAA Airports Limited defined benefit pension scheme following the disposal of Gatwick airport. As a result of this payment, the benefit was proportionately allocated to Heathrow, Stansted, HEX and other BAA airports. The benefits received by Heathrow, Stansted and HEX are shown as an increase in the value of investment in these entities by BAA (AH) Limited which is eliminated on consolidation into the BAA (SH) Group. The remaining benefit of £16 million received by the other BAA airports outside the BAA (SH) Group is shown as a capital distribution.

² The tax on capital contribution is in relation to the benefit received by Heathrow, Stansted and HEX.

24 Commitments and contingent liabilities

Non-cancellable operating lease commitments – Group as a lessee

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

	31 December 2011		31 December 2010	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	12	50	12	46
Within two to five years	44	208	45	196
After five years	31	996	36	836
	87	1,254	93	1,078

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

A significant portion of the £1.3 billion commitments classified as 'Other' relates to electricity supply equipment at the airports leased on agreement with UK Power Networks Services Limited ('UPNS'). The lease expires in 2083. The amounts disclosed are the total estimated charges under the agreement including both the actual lease commitment and the significant maintenance element of the fee payable to UPNS as neither the Group nor UPNS are able to split the base fee between a 'capital' and 'maintenance' charge. The commitment has been discounted at the Group's incremental borrowing rate.

BAA (SH) plc

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

24 Commitments and contingent liabilities *continued*

Non-cancellable operating lease commitments – Group as a lessor

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

	31 December 2011		31 December 2010	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	72	-	79	-
Within two to five years	236	-	273	-
After five years	1,730	-	1,799	-
	2,038	-	2,151	-

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 terminable by the tenant on three months' notice at any time. However, it is common for the accommodation to remain let or be quickly re-let should it be vacated. For larger, stand alone premises, e.g. cargo sheds, longer leases of multiples of three years are used.

Car rental facilities are operated under concession agreements subject to minimum guaranteed payments and the amounts are included above. Concession contracts on the public car parks have largely been replaced by operator management fee arrangements across the Group's airports.

Non-cancellable electricity purchase commitment

Total future minimum electricity payments as at the year end are as follows:

	31 December 2011	31 December 2010
	£m	£m
Within one year	30	56
Within two to five years	5	35
	35	91

The Group has a contractual commitment to purchase electricity that is used to satisfy physical delivery requirements for electricity usage of the Group until March 2013. Such commitments are for the normal purchase, sale or usage of electricity and hence are accounted for as ordinary purchase contracts.

Group commitments for property, plant and equipment

	31 December 2011	31 December 2010
	£m	£m
Contracted for, but not accrued:		
Terminal 2A building - Heathrow	631	788
Terminal 2B phase 2 - Heathrow	288	447
Terminal 2 Multi Storey car park -Heathrow	69	-
Terminal 3 integrated baggage system - Heathrow	39	64
Eastern Campus ICS - Heathrow	35	-
Terminal 1 transfer baggage system - Heathrow	13	-
Rolling Stock Refresh/ Rebrand - Heathrow Express	11	-
Minor asset replacement/refurbishment - Heathrow	10	-
Eastern Campus Leadership Team - Heathrow	8	1
Energy infrastructure - Heathrow	7	30
Major Foam Tenders - Stansted	3	-
Terminal 1, baggage prolongation programme - Heathrow	-	31
Terminal 3/5 transfer baggage system - Heathrow	-	24
Terminal 5C - Heathrow	-	18
	1,114	1,403
Other projects	46	58
	1,160	1,461

The figures in the above table are contractual commitments to purchase goods and services at the reporting date. The Group has in place long-term capital expenditure programmes at its airports. BAA's submission to the CAA, in respect of the current regulatory period included capital expenditure for Heathrow of £5,136 million (2007/08 prices) including a maximum of £735 million in the extra year (to 31 March 2014) added to Heathrow's current regulatory period during 2011. Capital expenditure at Heathrow in 2012 is forecast to be approximately £1.2 billion. Under the terms of regulation, rebates of aeronautical income are made if certain key projects are not delivered by specified dates. The amount of rebate is linked to the return Heathrow is estimated to earn on the anticipated cost of the project.

BAA (SH) plc

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

24 Commitments and contingent liabilities *continued*

Group commitments for property, plant and equipment continued

The capital programme included in Stansted's current price determination foresees total investment of £125 million until the end of March 2014. Capital expenditure at Stansted in 2012 is forecast to be approximately £20 million.

Other commitments

The BAA Group operates or in the recent past has operated blight compensation schemes relating to properties that might be affected by potential future runway developments at its airports. At both Heathrow and Stansted, there were schemes in operation as a result of the potential development of new runways but these schemes were closed following the change in government policy in relation to runway developments in South East England that occurred in 2010. Nevertheless, some residual commitments to purchase properties made before the relevant schemes were closed were fulfilled during 2011. All commitments have now been fulfilled at Stansted although commitments to purchase the final 26 properties near Heathrow remained outstanding at 31 December 2011. Properties purchased under these schemes are included within investment properties at a value of £125 million as at 31 December 2011 (2010: £108 million).

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

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

The January 2009 government announcement for adding capacity at Heathrow requires the 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 Group's obligations in implementing these schemes is uncertain.

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

As part of the triennial valuation process, the BAA Group will pay £97 million per annum into the scheme from 2012 to 2014. This compares with a total contribution of £80 million per annum paid from 2009 to 2011. The amount being paid in each of the next three years includes £24 million which is aimed to eliminate the deficit over a period of 9 years. All but approximately £15 million of the new annual amount will be met by the Group's airports.

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 £256 million at 31 December 2011 (2010: £269 million).

Under the SSA, hedging costs properly incurred by BAA Airports Limited in relation to the Executive Share Option Plan ('ESOP') may be recharged to the Group. At 31 December 2011, the ESOP swaps held in BAA Airports Limited had a fair value loss of £51 million (2010: £76 million). The Group may be obligated to settle its share of these amounts in the future, depending on a number of factors, including the number of options vesting, the number of options being exercised and the Ferrovial share price at exercise date. Accordingly, this is disclosed as a contingent liability and included in the amount above.

BAA (SH) plc

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

25 Notes to the consolidated statement of cash flows

Reconciliation of net loss before tax to cash generated from continuing operations

	Note	Year ended 31 December 2011 £m	Year ended 31 December 2010 £m
Operating activities			
Net loss before tax		(234)	(343)
<i>Adjustments for:</i>			
Finance income	4(a)	(220)	(162)
Finance costs	4(a)	1,022	895
Fair value loss on financial instruments	4(b)	46	36
Property, plant and equipment impairment		-	149
Depreciation ¹	2	504	458
Amortisation	2	9	23
Exceptional costs ¹	2,3	11	19
Fair value gain on investment properties	8	(46)	(31)
Increase in trade and other receivables		(102)	(4)
Increase in inventories		(3)	-
Increase in trade and other payables		26	20
Decrease in provisions		(8)	(17)
Decrease in deferred income		(1)	(2)
Difference between pension charge and cash contributions		(34)	(33)
Exceptional pension charge/(credit)		40	(90)
Exceptional working capital settlement of intercompany balance ²		47	-
Cash generated from continuing operations		1,057	918

¹ Heathrow Terminals 1 and 2 accelerated depreciation reported as exceptional items.

² Reflects a one-off £47 million improvement in working capital following the implementation of the new BAA Group cash management process that has resulted in cash in transit to the Group being received faster.

26 Related party transactions

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

	Year ended 31 December 2011 Sale of goods and services £m	Year ended 31 December 2010 Sale of goods and services £m
Swissport / Groundstar	1	3
	Year ended 31 December 2011 Purchase of goods and services £m	Year ended 31 December 2010 Purchase of goods and services £m
Ferrovial Agroman	39	59
Amey Community Limited	23	14
HETCo ¹	223	116
	285	189

¹ A joint venture between Ferrovial Agroman and Laing O'Rourke.

Balances outstanding with related parties were as follows:

	31 December 2011		31 December 2010	
	Amounts owed by related parties £m	Amounts owed to related parties £m	Amounts owed by related parties £m	Amounts owed to related parties £m
Ferrovial Agroman	-	-	-	4
Amey Community Limited	-	2	-	2
HETCo ¹	-	32	-	22
	-	34	-	28

¹ A joint venture between Ferrovial Agroman and Laing O'Rourke.

BAA (SH) plc

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

26 Related party transactions *continued*

The Group enters into transactions with BAA Airports Limited in accordance with the SSA, as described in the Accounting Policies note. The amount expensed in the Group's Income Statement in relation to these charges is shown within notes 2 and 3. Where the repayment terms and nature of settlement of the related balance sheet amounts is known they are disclosed in the relevant balance sheet caption, see notes 11 and 18. The group also has other balances with other entities owned by FGP Topco Limited that are not eliminated on consolidation and that relate to previous group reconstructions and financing arrangements. Where known, the nature, settlement and terms of the arrangements are disclosed in notes 11 and 18.

27 Ultimate parent undertaking and controlling party

The immediate parent undertaking of the Group is BAA (DSH) Limited, a company registered in England and Wales.

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

The Group's results are also included in the audited consolidated financial statements of BAA Limited for the year ended 31 December 2011, which is the parent undertaking of the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2011.

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

28 Subsidiaries

The subsidiaries of the Group are as follows:

Holding companies

BAA (SP) Limited
BAA (AH) Limited †

Airport owners and operators

Heathrow Airport Limited†
Stansted Airport Limited†

Other

BAA Funding Limited †#
Heathrow Express Operating Company Limited †
Heathrow Airport Community Board Insulation Limited †

† Held by a subsidiary undertaking

Incorporated in Jersey

Unless otherwise indicated, all subsidiaries are wholly owned, incorporated in Great Britain and registered in England and Wales.

29 Post balance sheet events

In February 2012, the Competition Appeal Tribunal ('CAT') rejected BAA's request that it should review the Competition Commission's July 2011 decision that there had been no material changes in circumstances that would give it cause to reconsider its March 2009 decision, particularly that BAA should dispose of Stansted airport. BAA is currently considering its position in light of the CAT's decision.

BAA (SH) plc

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BAA (SH) plc

Independent auditor's report to the members of BAA (SH) plc

We have audited the parent company financial statements of BAA (SH) plc for the year ended 31 December 2011 which comprise the Company balance sheet, the Accounting policies and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

Respective responsibilities of directors and auditor

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the parent company financial statements:

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

Opinion on other matters prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Other matter

We have reported separately on the Group financial statements of BAA (SH) plc for the year ended 31 December 2011.



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


28 February 2012

BAA (SH) plc

Company balance sheet as at 31 December 2011

	Note	31 December 2011 £m	31 December 2010 £m
Fixed assets			
Investment in subsidiary	2	3,009	3,009
Current assets			
Debtors: due within one year	3	86	8
: due after more than one year	3	598	566
Cash at bank and in hand		1	20
Total current assets		685	594
Creditors: amounts falling due within one year	4	(14)	(6)
Net current assets		671	588
Total assets less current liabilities		3,680	3,597
Creditors: amounts falling due after more than one year	5	(538)	(488)
Net assets		3,142	3,109
Capital and reserves			
Called up share capital	6	3,109	3,109
Profit and loss reserve	7	33	-
Total shareholder's funds		3,142	3,109

These financial statements of BAA (SH) plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 28 February 2012. They were signed on its behalf by:


José Leo
 Director


Frederick Maroudas
 Director

BAA (SH) plc

Accounting policies for the year ended 31 December 2011

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

Basis of preparation

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

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

The Company has adopted Financial Reporting Standard ('FRS') 25 'Financial instruments: Presentation' and FRS 26 'Financial instruments: recognition and measurement'. The adoption of these standards has had no impact on the results or net assets of the Company.

Turnover

Turnover represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes.

Interest

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

Investment in subsidiary

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

Debtors

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

Cash

Cash comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand when a right to offset exists.

Creditors

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost unless part of a fair value hedge relationship. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest rate 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 profit and loss account.

Current and deferred taxation

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

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

In accordance with FRS 19, 'Deferred Tax', deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax is not provided on timing differences arising from the revaluation of investment properties where there is no commitment to sell the asset.

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

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

BAA (SH) plc

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

Classification of financial instruments issued by the Company

In accordance with FRS 25 *Financial Instruments: Disclosure and Presentation*, financial instruments issued by the Company are treated as equity (i.e. forming part of shareholder's funds) only to the extent that they meet the following two conditions:

- (a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company ; and
- (b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for called up share capital and share premium reserve exclude amounts in relation to those shares.

Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges. Finance payments associated with financial instruments that are classified as part of shareholder's funds, are dealt with as appropriations in the reconciliation of movements in shareholder's funds.

The Company is exempt from reporting information under FRS 29 *Financial Instruments: Disclosures* because the Company's consolidated financial statements are prepared in accordance with IFRS 7 *Financial Instruments: Disclosures*.

Issue costs and arrangement fees

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

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

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

Share capital

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

Dividend distribution

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

Cash flow statement and related party disclosures

The ultimate parent entity in the UK is FGP Topco Limited, a company registered in England and Wales. The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2011. The results are also included in the audited consolidated financial statements of BAA (SH) plc for the year ended 31 December 2011 (the smallest group to consolidate these financial statements). They are also included in the audited consolidated financial statements of BAA Limited for the year ended 31 December 2011. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 '*Cash Flow Statements (revised 1996)*'.

The Company is exempt under the terms of FRS 8 *Related Party Disclosures* from disclosing related party transactions with entities that are related to, or part of, the FGP Topco Limited group.

BAA (SH) plc

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

1 Company result for the year

As permitted by section 408 of the Companies Act 2006, the profit and loss account of the Company is not presented as part of these financial statements. The profit of the Company for the year attributable to shareholders was £33 million (2010: £1 million).

2 Investment in subsidiary

	£m
1 January 2011 and 31 December 2011	3,009

The Company's subsidiary undertaking is BAA (SP) Limited, which is incorporated in Great Britain and registered in England and Wales. Details of the principal subsidiary undertakings of the Group are provided in Note 28 of the BAA (SH) plc group financial statements.

3 Debtors

	31 December 2011 £m	31 December 2010 £m
Due within one year:		
Amounts owed by group undertakings - interest free ¹	73	-
Interest receivable from group undertakings	13	8
	86	8
Due after more than one year:		
Amounts owed by group undertakings - interest bearing ²	598	566
Total debtors	684	574

¹ Amount owed by group undertakings – interest free relate to the loan receivable from BAA (DSH) Limited.

² Amounts owed by group undertakings - interest bearing relates to the debenture payable by BAA (SP) Limited which is used to fund interest on the Company's bond and subordinated facilities. As at 31 December 2011, the rate on the debenture was 6.91% (2010: 3.12%). The increase in the interest rate is primarily due to the issuance of higher yielding debt to replace the subordinated debt at BAA (SH) plc in the latter part of 2010.

4 Creditors: amounts falling due within one year

	31 December 2011 £m	31 December 2010 £m
Interest payable	11	5
Accrued expenditure	-	1
Group relief payable	3	-
	14	6

5 Creditors: amounts falling due after more than one year

	31 December 2011 £m	31 December 2010 £m
Secured		
Bonds	318	317
Subordinated facilities	220	171
	538	488

As at 31 December 2011, the fair value of the non-current borrowings above was £534 million (2010: £499 million). The fair values of listed borrowings are based on quoted prices. The fair values of non-current borrowings which have floating rate interest are assumed to equate to their current nominal value.

Additional disclosures on risk management and hedging of borrowings are included in Notes 14 and 15 of the Group financial statements.

BAA (SH) plc

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

6 Share capital

	£
Authorised	
At 1 January 2011 and 31 December 2011: 9,000,000,000 ordinary shares of £1 each	9,000,000,000
Called up, allotted and fully paid	
In issue at 1 January 2011 and 31 December 2011: 3,109,350,689 ordinary shares of £1 each	3,109,350,689

7 Profit and loss reserve

	£m
1 January 2011	-
Profit for the financial year	33
31 December 2011	33

8 Auditor's remuneration

Auditor's remuneration paid to Deloitte LLP for the performance of the statutory audit amounted to £20,000 (2010: £20,000). Audit fees and non-audit fees for the current financial year were borne by BAA Airports Limited and recharged in accordance with the Shared Services Agreement as described within the Accounting policies of the BAA (SH) plc Group financial statements.

Details of fees for other services are provided in Note 2 of the BAA (SH) plc Group financial statements.

9 Employee information and directors' remuneration

Employee numbers

The Company has no employees (2010: nil).

Directors' remuneration

Details of directors' remuneration for the year are provided in Note 2 of the BAA (SH) plc Group financial statements.

10 Ultimate parent undertaking and controlling party

The immediate parent undertaking is BAA (DSH) Limited, a company incorporated in Great Britain and registered in England and Wales.

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

The Company's results are also included in the audited consolidated financial statements of BAA (SH) plc for the year ended 31 December 2011, which is the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of BAA Limited and FGP Topco Limited for the year ended 31 December 2011.

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

BAA (SH) plc

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

11 Post balance sheet events

In February 2012, the Competition Appeal Tribunal ('CAT') rejected BAA's request that it should review the Competition Commission's July 2011 decision that there had been no material changes in circumstances that would give it cause to reconsider its March 2009 decision, particularly that BAA should dispose of Stansted airport. BAA is currently considering its position in light of the CAT's decision.

Registered office

BAA (SH) plc, The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW
Registered in England Number: 06458635