Heathrow Finance plc

(Formerly BAA (SH) plc)
Annual report and financial statements
for the year ended 31 December 2012

Company registration number: 06458635

Heathrow Finance plc (Formerly BAA (SH) plc)

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Heathrow Finance plc (Formerly BAA (SH) plc)

Business review

Heathrow Finance plc (the 'Company' formerly BAA (SH) plc) is the holding company of Heathrow (SP) Limited ('Heathrow (SP)' formerly BAA (SP) Limited) 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. Heathrow Finance plc is an indirect subsidiary of the Heathrow Airport Holdings Limited group ('Heathrow Airport Holdings Group', formerly BAA Limited).

On 15 October 2012 it was announced that the BAA name would cease being used. This change was implemented for a number of reasons including the fact that Heathrow will account for more than 95% of the former BAA group once Stansted is sold. As a result, whilst the brands and related legal entity names (such as Heathrow Airport Limited, Stansted Airport Limited and Heathrow Express Operating Company Limited) of individual airports are being retained, the names of many of the holding companies in the business assumed the Heathrow brand. The change saw BAA (SH) plc become Heathrow Finance plc on 12 October 2012.

The consolidated financial statements of Heathrow Finance plc and its subsidiaries (together 'Heathrow Finance' 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 2012, along with the key factors likely to impact the Group in 2013.
Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2012 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.
Internal controls and risk management – outline of the Heathrow Airport Holdings Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the Heathrow Airport Holdings Group Executive Committee.

Management review

Review of 2012

Key features of the year
2012 saw significant progress across a wide range of important issues for the business. This included another year of record passenger satisfaction for Heathrow, as well as delivering an outstanding welcome for thousands of Olympic and Paralympic athletes. This was particularly notable as it was achieved whilst managing record passenger traffic at one of the world's busiest airports.

The year was also notable for progress in the UK hub airport capacity debate, the importance of which is underlined by the fact that in 2012 Heathrow once again operated close to its maximum permitted annual flight numbers. The hub airport model used by Heathrow and its competitors uses transfer passengers to support flights to long haul destinations which would not be viable using local demand alone. But unlike its rivals in France, Germany, the Netherlands and Dubai, Heathrow is full and its capacity constraints prevent any meaningful increase in the numbers of flights and routes. This means the country's ability to trade with emerging economies is constrained, with potential long-term consequences for UK trade, jobs and economic growth.

At the start of 2012, whilst the importance of hub airport capacity was beginning to be accepted by the UK government, a third runway at Heathrow was not one of the options under consideration. However, the year ended with the establishment of an independent commission tasked with looking at options for maintaining the UK's status as an international aviation hub. The Group will make submissions to the Airports Commission during 2013.

After challenging for a number of years the proportionality of the disposal remedies imposed by the Competition Commission resulting from its inquiry into the supply of UK airport services by the Group, a disposal process for Stansted airport commenced in August 2012 which led to the announcement since the period end that the airport is being sold to Manchester Airports Group for £1,500 million.

Work intensified through the year both within Heathrow and in consultation with its airline community and the Civil Aviation Authority on defining how the airport will develop during the next five year regulatory period (Q6), which begins on 1 April 2014. In particular, constructive engagement with Heathrow's airline community assessed key themes such as capital investment, traffic forecasts, operating costs and commercial revenue opportunities. The regulatory engagement process to date culminated with publication since the year end of Heathrow's full business plan for Q6. This period is expected to see Heathrow delivering further significant enhancements to the passenger experience, whilst delivering improved value for money through greater efficiency and productivity and driving further real growth in its commercial offering.

Management review *continued*

Review of 2012 *continued*

Key features of the year continued

The Group continued to invest significantly in Heathrow's transformation with over £1 billion spent at the airport during 2012. The centrepiece of the investment programme continued to be the construction of the new Terminal 2. Work will intensify during 2013 on fit-out and operational readiness with operations due to commence in little over a year from now. The scale of investment at Heathrow in recent years is underlined by Terminal 2 being the airport's second new terminal in recent years after a gap of over 20 years between the opening of Terminals 4 and 5.

The Group's financing position was transformed in 2012 with over £3 billion raised in multiple capital markets transactions and the successful refinancing of the Group's core revolving credit and liquidity facilities. This marked the culmination of a programme that has seen the Group raise nearly £8 billion since late 2009 enabling full repayment of loan facilities put in place in the 2008 refinancing and putting the Group in its strongest liquidity position for many years. In addition, the Group continued to attract investment from leading global equity investors with a 30% shareholding in the business purchased by Qatar Holding (20%) and China Investment Corporation (10%), the Qatari and Chinese sovereign wealth funds.

At the same time as all the critical initiatives outlined above were delivered, the Group produced a robust financial performance despite the enduring challenges of subdued economic growth and continued pressure on consumer and business confidence in the world's developed economies.

It was against this background, together with the stabilisation of its financing position outlined above, that the Group was able to continue investing in the business with confidence and commence dividend payments to its ultimate shareholders 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 2012 at the Group's airports is analysed below:

	Year ended 31 December 2012	Year ended 31 December 2011	Change[1] (%)
Passengers by airport (millions)			
Heathrow	**70.0**	69.4	0.9
Stansted	**17.5**	18.0	(3.2)
Total passengers[1]	**87.4**	87.4	0.0
Passengers by market served (millions)			
UK	**5.9**	6.2	(3.6)
Europe[2]	**44.5**	44.5	0.1
Long haul	**37.0**	36.8	0.5
Total passengers[1]	**87.4**	87.4	0.0

[1] These figures have been calculated using un-rounded passenger numbers.
[2] Includes North African charter traffic.

In the year ended 31 December 2012, the Group's passenger traffic was flat at 87.4 million. Adjusting for the fact that 2012 was a leap year, there was a modest year on year decline of 0.3%. The performance was driven by Heathrow where passenger traffic was up 0.9% to 70.0 million (2011: 69.4 million), its second successive calendar year traffic record.

Heathrow's traffic in 2012 was characterised by record load factors (75.6% versus 75.2% in 2011) and more seats per passenger aircraft (197.4 versus 194.8 in 2011). These are the key drivers of the modest growth that can be expected in Heathrow's traffic for as long as it operates with its current capacity constraints where there is negligible opportunity to increase flight numbers which, whilst falling marginally to 471,341 compared to 476,197 in 2011, are very close to the cap of 480,000 flights per annum. The proportion of transfer traffic at Heathrow was 35% (2011: 35%).

Whilst underlying demand at Heathrow was firm through 2012, reported performance fluctuated through the year. There was year on year growth in the first quarter but a modest decline in the second quarter, partly reflecting issues such as the leap year and the different timing of Easter relative to 2011. In the third quarter, Heathrow's traffic was impacted in July and August by over 400,000 passengers compared to the same period of 2011 by the London 2012 Olympics, which resulted in UK based travellers staying in the country to enjoy the Games and non-UK travellers avoiding travel to the UK due to concerns over disruption caused by the Games. After that traffic growth resumed with monthly records in September, November and December.

On a regional basis, Heathrow's performance was led by North Atlantic traffic which increased 3.2% to 16.3 million passengers (2011: 15.8 million). Traffic with other long haul destinations declined marginally, down 0.4% to 20.3 million passengers (2011: 20.4 million). Strength in services with Brazil (due to increased services), the Middle East (due partially to recovery from the unrest in the region that impacted 2011) and the Far East (due partly to recovery from 2011's Japanese tsunami) was offset particularly by weakness in African and Indian traffic due to airlines reducing or ceasing services.

Review of 2012 *continued*

Passenger traffic trends continued

Heathrow's European traffic increased modestly, up 0.5% to 28.6 million passengers (2011: 28.5 million), with significant variances in performance between markets, reflecting the macro-economic environment across Europe. There was good performance in markets such as Germany, Norway, the Netherlands and Belgium offset by weakness in markets such as Italy, Greece and Portugal. Domestic traffic was up slightly, by 0.5% at 4.7 million passengers (2011: 4.7 million).

Stansted's traffic declined 3.2% to 17.5 million passengers (2011: 18.0 million). The year was notable for a return to growth after the summer following several years of consistent declines. This is reflected in a traffic decline of 4.6% in the nine months to 30 September 2012 turning into an increase of 1.8% in the fourth quarter. This was due to year on year capacity additions by Ryanair for the current winter season. Stansted's core European scheduled market saw traffic decline only 0.3% to 14.1 million passengers (2011: 14.1 million), with 5.3% growth in the fourth quarter. Traffic declines in other markets were driven mostly by cessation of a limited number of services. Stansted's 2012 average load factor was 81.0% (2011: 80.8%).

Transforming the Group's airports

The Group's key strategic objective is for Heathrow to become the UK's direct connection to the world and Europe's hub of choice by making every journey better. A key enabler in delivering these objectives is Heathrow's continued focus on transforming passengers' and airlines' experience of using the airport through both investment in modern terminal facilities and related infrastructure and improving service standards. This will ensure customers enjoy a superior airport experience relative to competitors, encouraging greater utilisation of Heathrow and supporting its long-term growth ambitions.

Significant further progress was made 2012 in both the transformation of Heathrow's infrastructure and further improving service standards.

The current centrepiece of Heathrow's infrastructure transformation is the construction of the new Terminal 2, which is due to open in mid-2014. Once open, more than 60% of passengers using Heathrow will enjoy some of the newest airport facilities in the world.

Alongside the transformation of Heathrow's infrastructure, there was further clear progress in improving service standards during 2012 with record overall passenger satisfaction achieved, a particularly notable achievement given the Olympics, record traffic volumes and the challenges of building the new Terminal 2 in the live operating environment of one of the world's busiest airports. In addition, Terminal 5 was voted the world's best airport terminal.

Investment in modern airport facilities

Heathrow's capital investment programme achieved a number of significant milestones in 2012 with the main projects including construction work on Terminal 2 as well as the development of baggage systems and a major refurbishment programme at Terminal 4. As expected, investment at Heathrow increased significantly in 2012 (over £1.1 billion) compared to 2011 (over £800 million). The level of investment is expected to continue at an elevated level in 2013 as progress is made towards opening Terminal 2.

The new Terminal 2 building was made weather-tight in early 2012. This enabled significant progress on the terminal fit-out to be completed during the year. By the year end, installation of the internal walls, glass wall linings and conglomerate floor was well underway. In addition, delivery of terminal systems, including outbound baggage systems, escalators and lifts, was making good progress with commissioning of certain elements of the systems underway by year end. Installation of the information control system is now progressing, with IT systems cabling having commenced on all levels of the building and hand over of communications rooms IT fit-out underway.

The second phase of the satellite Terminal 2B was made weather-tight in September 2012. Fit-out is progressing with the creation of internal walls, glass wall linings and the wooden linings to the arrivals corridor and installation of escalators, lifts and travelators. March 2012 saw excavation completed for the extensive basement and tunnel structures to house the tracked transit train and baggage systems that will connect the satellite to the main building once the main terminal's second phase is constructed. The passenger tunnel linking the main building with the satellite is formed with work underway on its fit out.

Good progress is being made in constructing the 'nodes' to connect the main terminal and satellite buildings to air bridges through which passengers board or leave aircraft.

Management review *continued*

Review of 2012 *continued*
Transforming the Group's airports continued
There has also been significant progress on Terminal 2's multi-storey car park. The main access ramp to the car park's upper level is substantially in place, connecting the car park and existing road network. The structure of the western section of the car park is completed and the eastern section is progressing to plan. The structures for the car park's lifts and staircases as well as passenger walkways between the car park and the terminal building are under construction.

Terminal 2's construction is expected to be completed in late 2013 with operations commencing in mid-2014.

In Heathrow's baggage investment programme, the new underground automated baggage transfer system between Terminals 3 and 5 became operational. Elsewhere, the superstructure, roof and cladding for the building to house Terminal 3's new integrated baggage system are virtually complete. Baggage and IT systems are now being installed with the overall system expected to become operational in 2015.

Refurbishment works in Terminal 4's departure lounge were completed in 2012. The project has renewed floor tiling, refurbished gate areas, provided new seating, decluttered signage and provided a feature ceiling with LED lighting reducing energy consumption whilst enhancing the lounge area.

Refurbishment (including resurfacing) of Heathrow's southern runway will start in Spring 2013. The works will be carried out during night closures of the runway. The northern runway will be refurbished in 2014.

Service standards
The Group's focus on delivering transformational change in passengers' experience of its airports continues to receive significant endorsement from the travelling public, demonstrating that passengers are noticing the improvements made by the airports.

In April 2012 Heathrow Terminal 5 was named the world's best airport terminal in the 2012 SKYTRAX World Airport Awards. More recently, Heathrow achieved an all-time record overall passenger satisfaction score of 3.96 in the Airport Service Quality ('ASQ') survey (produced by Airports Council International) for the third quarter of 2012. This reflected in particular the success of the airport in delivering an outstanding welcome for thousands of Olympic and Paralympic athletes. Over 2012 as a whole Heathrow also achieved its highest ever average score of 3.94 (2011: 3.88) in the quarterly ASQ surveys.

In relation to individual service standards, punctuality remained at historically high levels in 2012 with 78% (2011: 79%) of aircraft departing within 15 minutes of schedule at Heathrow and 88% (2011: 88%) at Stansted. Further, Heathrow's baggage misconnect rate was 15 per 1,000 passengers (2011: 15).

On security queuing, in 2012 passengers passed through central security within periods prescribed under service quality rebate schemes 92.8% (2011: 96.9%) of the time at Heathrow and 98.0% (2011: 97.9%) of the time at Stansted. This compares with 95% service standards. Whilst the reduced security queuing performance at Heathrow in 2012 reflected additional security procedures introduced in the fourth quarter of the year, performance has improved since the beginning of 2013.

Sale of Stansted airport
After challenging for a number of years the proportionality of the disposal remedies imposed by the Competition Commission resulting from its inquiry into the supply of UK airport services by the Group, a disposal process for Stansted airport commenced in August 2012 which led to the announcement since the period end that the airport is being sold to Manchester Airports Group for £1,500 million. The sale is expected to complete by the end of February 2013.

Proceeds from the disposal are expected to be used principally to repay debt within the Group.

Management review *continued*

Regulatory and governmental developments

UK aviation policy developments

The main development in UK aviation policy in the last year related to the debate on hub airport capacity, the importance of which is underlined by the fact that in 2012 Heathrow, the UK's only hub airport, once again operated close to its maximum permitted annual flight numbers. The hub airport model used by Heathrow and its competitors uses transfer passengers to support flights to long haul destinations which would not be viable using local demand alone. But unlike its rivals in France, Germany, the Netherlands and Dubai, Heathrow is full and its capacity constraints prevent any meaningful increase in the numbers of flights and routes. This means the country's ability to trade with emerging economies is constrained with long-term consequences for UK trade, jobs and economic growth.

At the start of 2012, whilst the importance of hub airport capacity was beginning to be accepted by the UK government, a third runway at Heathrow was being excluded as a potential solution. However, during the year the government established the independent Airports Commission, chaired by Sir Howard Davies, which has been tasked with identifying and recommending the options for maintaining the UK's status as an international aviation hub. It is expected to do this by assessing the UK's international connectivity needs and recommending the optimum approach for meeting these.

The Commission is expected to produce an interim report by the end of 2013 which will set out its assessment of the evidence on the nature, scale and timing of the steps needed to maintain the UK's global hub status; and its recommendations for immediate actions to improve the use of existing runway capacity in the next five years consistent with credible long term options. A final report is then expected by summer 2015 which will set out the Commission's assessment of the options for meeting the UK's international connectivity needs, including their economic, social and environmental impact and its recommended solution.

The Group will make submissions to the Airports Commission during 2013.

Defining Heathrow's development for the next 5 years

Work intensified through the year within Heathrow and in consultation with its airline community and the Civil Aviation Authority ('CAA') on defining how the airport will develop during the next five year regulatory period (Q6), which begins on 1 April 2014.

In particular, constructive engagement with Heathrow's airline community assessed key themes such as capital investment, traffic forecasts, operating costs and commercial revenue opportunities. The regulatory process also included publication in July 2012 of the airport's initial business plan for Q6 the content of which has been superseded since the year end by the publication of an updated full business plan. Since publication of the initial business plan, Heathrow has reduced the expected cost of airlines operating at Heathrow during Q6 primarily by identifying further opportunities to enhance efficiencies and productivity. This is reflected in a proposed tariff profile, assuming no initial adjustment for the significantly lower than forecast passenger numbers at the end of the current regulatory period, of RPI+5.9% compared to RPI+6.8% in the initial business plan.

The next regulatory period is expected to see Heathrow delivering further significant enhancements to the passenger experience, whilst delivering improved value for money for example through greater efficiency and productivity and driving further real growth in its commercial offering.

Heathrow's full business plan includes a traffic forecast consistent with that in the July 2012 initial business plan showing modestly increasing passenger traffic over the next regulatory period that, after an allowance for shocks, averages around the airport's current un-shocked traffic performance. Heathrow believes it is essential to properly reflect the likely impact on passenger traffic over any medium or long-term horizon from potential shocks given that historically they have impacted its traffic by an average of close to 1.5%.

The full business plan also outlines Heathrow's proposed capital investment plan ('CIP') for 2014-2019. The CIP is aligned to Heathrow's masterplan that envisages the continuation of the process of building terminal and satellite capacity perpendicular to the airport's two runways that started with construction of Terminal 5 and is currently also being implemented in the new Terminal 2. The CIP foresees continued passenger experience improvements, ensuring there are sufficient facilities to handle expected growth in passenger numbers and aircraft size and enabling a competitive cost of operation at Heathrow based on a capital spend over the 5 years of approximately £3 billion (in 2011/12 prices).

Management review *continued*

Regulatory and governmental developments continued

Defining Heathrow's development for the next 5 years continued

The key elements of the CIP relate to the new Terminal 2, the Terminal 3 integrated baggage system, Heathrow's financial contribution to Crossrail (subject to regulatory approval), installation of new baggage screening technology required by 2018 and upgrades and resurfacing of runways and taxiways.

Terminal 2 is expected to open in the early months of Q6 and will involve a significant number of airline moves. In the first part of Q6, it is expected that the pier that currently connects Terminal 1 to the Terminal 2 satellite building will be demolished, opening up the taxiway between Terminal 2 and its satellite building. This will also enable two extra pier served stands to be added on to the satellite building.

Towards the end of Q6, the CIP assumes that work will commence on design, site clearance and enabling works for phase 2 of Terminal 2. This phase is expected ultimately to involve the demolition of Terminal 1, extension of the main terminal building, construction of a new satellite Terminal 2C, installation of a terminal baggage system and completion of tracked transit train and baggage facilities linking the main terminal building with the satellites.

Following publication of the full business plan, the next steps in the regulatory review process are for the CAA to complete its own research and analysis, following which it is expected to publish its initial price cap proposals in April 2013 for consultation. Final price cap proposals are expected to be published in October 2013.

Modernising the economic regulation of UK airports

The new Civil Aviation Act 2012 ('the Act') became law at the end of 2012 when it received Royal Assent and replaced the Airports Act 1986 as the key piece of legislation relating to the economic regulation of UK airports. The Act introduces a new single primary duty for the CAA to promote the interests of existing and future end consumers of passenger and freight services, wherever appropriate by promoting effective competition. This primary duty is supported by various supplementary duties including to ensure an efficient airport operator is able to finance the activities that are subject to the relevant licence obligations.

The Act will also bring into effect an economic licensing regime for airports similar to the regulatory framework in place in certain other regulated sectors such as water and energy. As a regulated airport, Heathrow will require a licence and initial licences will be issued by the CAA.

The licensing regime is currently being developed, with Heathrow's initial draft licence due to be published by the CAA in April 2013 for consultation alongside its publication of initial price cap proposals for Q6. The licence is expected to include scope for financial penalties, for example, in the event of a breach of certain licence conditions. Heathrow is also expected to be obliged to consult stakeholders on future plans for investment and operation of the airport, to report on environmental performance, to comply with service standards and other conditions and measures designed to ensure the effective economic regulation of the airport.

The licensing regime is also expected to include conditions relating to licensed airports' financial resilience, for example a minimum credit rating requirement, consistent with the themes proposed by the Department for Transport in 2009.

Developments since beginning of 2013

In January 2013, the sale of Stansted airport was announced to Manchester Airports Group for £1,500 million. For more information see 'Sale of Stansted airport' above.

In addition, in January 2013 Heathrow's passenger traffic increased 0.3% to 5.18 million (2012: 5.17 million), an all time record for the month.

Outlook

This year is expected to see strong growth in Heathrow's revenue, Adjusted EBITDA and operating cash flow driven principally by increases in aeronautical tariffs. Heathrow also intends to make significant progress in completing the new Terminal 2 with construction due to be complete by the end of 2013 and the terminal becoming operational in mid-2014.

Passenger traffic in early 2013 has been consistent with expectations with record traffic at Heathrow in January. Therefore at this stage early stage of the year, the outlook for the Group's financial performance in 2013 remains consistent with guidance in the Investor Report issued in December 2012.

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.

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 2012 have been presented.

- *discontinued operations*
- On 20 August 2012, the Group announced plans to sell Stansted airport and therefore it has been classified as held-for-sale at the year end. As required under IFRS, the results and performance of Stansted airport are included in the results and cash flows of discontinued operations which are reported separately at the foot of the Group's Consolidated income statement and Consolidated statement of cash flows.
- Discontinued operations include £9 million of fair value losses arising from the revaluation of investment properties related to Stansted airport.
- Discontinued operations also include £31 million exceptional pensions charge being Stansted's share of the movement in the LHR Airports Limited defined benefit pension scheme, Unfunded Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities.

- *continuing operations exceptional items and certain re-measurements* - these include the following before tax:
- £152 million net exceptional pensions charge;
- £50 million of fair value gains arising from the revaluation of investment property;
- £108 million of fair value gains on financial instruments; and
- £5 million impairment of property, plant and equipment as a result of a change in the expected future use of automated immigration systems at Heathrow

Basis of presentation of financial results

In order to provide a clearer indication of the Group's performance between 2012 and 2011, consistent with that in the 2011 financial review, the information presented below focuses on the adjusted performance of the Group's continuing operations combined with Stansted airport (the 'Combined Operations'). A reconciliation from the statutory results has been provided below.

Reconciliation of Statutory to Combined Operations

Year ended 31 December 2012	Statutory £m	Stansted airport £m	Combined Operations £m
Revenue	2,222	242	2,464
Operating costs	(1,527)	(174)	(1,701)
Exceptional items	(152)	(31)	(183)
Fair value gain/(loss) on investment properties	50	(9)	41
Operating profit	**593**	**28**	**621**
Exceptional impairment	(5)	-	(5)
Exceptional disposal costs	-	(4)	(4)
Net finance costs	(712)	(19)	(731)
Fair value gain on financial instruments	108	4	112
Profit before tax	**(16)**	**9**	**(7)**
Taxation credit	122	1	123
Profit after tax	**106**	**10**	**116**

Heathrow Finance plc (Formerly BAA (SH) plc)

Financial review *continued*

Reconciliation of Statutory to Combined Operations *continued*

Year ended 31 December 2011	Statutory £m	Stansted airport £m	Combined Operations £m
Revenue	2,046	234	2,280
Operating costs	(1,472)	(189)	(1,661)
Exceptional items	(44)	(7)	(51)
Fair value gain/(loss) on investment properties	47	(1)	46
Operating profit	**577**	**37**	**614**
Net finance costs	(782)	(20)	(802)
Fair value loss on financial instruments	(46)	-	(46)
(Loss)/profit before tax	**(251)**	**17**	**(234)**
Taxation credit	171	19	190
(Loss)/profit after tax	**(80)**	**36**	**(44)**
Profit for the year from other discontinued operations			8
Consolidated loss for the year			**(36)**

Summary performance

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m	Change %
Combined Operations			
Revenue	**2,464**	2,280	8.1
Adjusted operating costs[1]	**(1,200)**	(1,148)	4.5
Adjusted EBITDA[2]	**1,264**	1,132	11.7
Exceptional items – pensions	**(183)**	(40)	357.5
EBITDA	**1,081**	1,092	(1.0)
Fair value gain on investment properties	**41**	46	(10.9)
Depreciation and amortisation – ordinary	**(501)**	(513)	(2.4)
Depreciation and impairment – exceptional	**-**	(11)	(100.0)
Operating profit	**621**	614	1.1
(Loss)/gain on disposal of airports	**(4)**	-	n/a
Impairment of property, plant and equipment – exceptional	**(5)**	-	n/a
Net finance cost	**(731)**	(802)	(8.9)
Fair value gains/(loss) on financial instruments	**112**	(46)	n/a
Loss before tax	**(7)**	(234)	(97.0)
Taxation credit	**123**	190	(35.3)
Profit/(loss) for the year from Combined Operations	**116**	(44)	n/a
Net profit from other discontinued operations	**-**	8	n/a
Consolidated profit/(loss) for the year	**116**	(36)	n/a

[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.

Revenue – Combined operations
In the year ended 31 December 2012, revenue increased 8.1% to £2,464 million (2011: £2,280 million). This reflects increases of 10.7%, 4.4% and 4.9% in aeronautical, retail and other income respectively.

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m	Change %
Aeronautical income	**1,413**	1,276	10.7
Retail income	**542**	519	4.4
Other income	**509**	485	4.9
Total revenue	**2,464**	2,280	8.1

Financial review *continued*

Revenue – Combined operations *continued*
Aeronautical income
In the year ended 31 December 2012, aeronautical income increased 10.7% to £1,413 million (2011: £1,276 million) and average aeronautical income per passenger increased 10.7% to £16.16 (2011: £14.60).

Aeronautical income summary (by airport)

	Aeronautical income			Per passenger[1]		
	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m	Change %	**Year ended 31 December 2012 £**	Year ended 31 December 2011 £	Change %
Heathrow	**1,280**	1,149	11.4	**18.29**	16.57	10.4
Stansted	**133**	127	4.7	**7.64**	7.03	8.7
Total	**1,413**	1,276	10.7	**16.16**	14.60	10.7

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

At Heathrow, the growth primarily reflected the headline 12.2% and 12.7% tariff increases from 1 April 2011 and 1 April 2012 respectively supported by the modest increase in passenger traffic. This has been partially offset by lower than expected yields particularly due to factors such as more quieter aircraft, a higher proportion of transfer passengers and a lower contribution from aircraft parking charges than assumed when tariffs were set. These factors led to aeronautical income being approximately £40 million lower than expected in the year ended 31 December 2012. This shortfall (or yield dilution) will be recovered through the 'K factor' true-up mechanism in the years commencing 1 April 2013 and 1 April 2014.

At Stansted, growth in aeronautical income reflected the headline 6.33% and 6.83% tariff increases from 1 April 2011 and 1 April 2012 respectively together with reduced tariff discounts, partially offset by lower traffic.

The headline maximum allowable yield at Heathrow will increase by 10.4% from 1 April 2013.

Retail income
The Group's retail business enjoyed another good year in 2012 with a 4.4% increase in net retail income per passenger to £5.82 (2011: £5.58) driving 4.4% growth in retail income to £542 million (2011: £519 million).

By category the performance was led by duty and tax-free, airside specialist shops, bureaux de change and catering whilst by airport the Group's performance was driven by Heathrow.

The table below reconciles retail income with net retail income and net retail income per passenger.

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

	Year ended 31 December 2012	Year ended 31 December 2011	Change %
Retail income (£m)	**542**	519	4.4
Less: retail expenditure (£m)	**(33)**	(31)	6.5
Net retail income (£m)	**509**	488	4.3
Passengers (million)[1]	**87.4**	87.4	-
Net retail income per passenger - total[1 2]	**£5.82**	£5.58	4.4
Heathrow	**£6.21**	£5.95	4.4
Stansted	**£4.27**	£4.16	2.8

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.

Heathrow's retail income increased 5.7% to £460 million (2011: £435 million) and NRI per passenger increased 4.4% to £6.21 (2011: £5.95). The underlying growth in Heathrow's net retail income per passenger was slightly higher (around 5.5%) after adjusting for one-off benefits and Olympic-related income.

Financial review *continued*

Revenue – Combined operations *continued*
Heathrow's duty and tax-free and airside specialist shops continued to see increases in the average spend of passengers purchasing items in the in-terminal retail facilities. This was driven by factors including an increased proportion of higher spending non-EU passengers, refurbishment of Terminal 3's airside shops and enhancements to World Duty Free's stores in Terminals 3 and 4. In airside specialist shops, trading was particularly buoyant in the luxury and fashion segments.

A strong performance in bureaux de change at Heathrow was due primarily to improvements in contract terms with business partners. Catering income grew well ahead of passenger growth due to rebalancing of the portfolio towards premium outlets, enhanced contractual terms and a general focus on speed and quality of service. Finally in advertising, income growth was due to Olympic related sales.

Stansted's retail income decreased 1.9% to £82 million (2011: £83 million), outperforming the 3.2% decline in Stansted's passenger traffic. Combined with retail expenditure reducing to £7 million (2011: £8 million), this resulted in NRI per passenger increasing 2.8% to £4.27 (2011: £4.16). Catering, landside shops and bookshops and other retail income increased year on year although this was more than offset by declines elsewhere, particularly in car parking and duty and tax-free.

Other income
Income from activities other than aeronautical and retail increased 5.0% to £509 million (2011: £485 million). This was driven particularly by operational facilities and utilities income increasing 9.6% to £173 million (2011: £158 million) due mainly to higher demand, back billing and increases in tariffs for electricity. The increase in other income also reflected rail income increasing 4.4% to £116 million (2011: £111 million) and recovery of Olympics baggage related costs.

Adjusted operating costs – Combined operations
Adjusted operating costs exclude depreciation, amortisation and exceptional items to provide a more meaningful comparison of the Group's operating costs.

In the year ended 31 December 2012, adjusted operating costs increased 4.5% to £1,200 million (2011: £1,148 million).

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m	Change %
Employment costs	**369**	339	8.8
Maintenance expenditure	**149**	137	8.8
Utility costs	**109**	111	(1.8)
Rents and rates	**144**	129	11.6
General expenses	**246**	233	5.6
Retail expenditure	**33**	31	6.5
Intra-group charges/other	**150**	168	(10.7)
Total	**1,200**	1,148	4.5

On an underlying basis, there was strong discipline in controllable costs given the impact on reported adjusted operating costs of Olympic-related activities, higher pension-related charges and the full year effect of additional infrastructure (Terminal 5C). In addition, the Group had to absorb contractual inflation adjustments to the cost of provision to the business of various services.

There were approximately £25 million in Olympic-related costs (approximately £16 million net of revenue benefits) such as the costs of Heathrow's temporary Olympic terminal, professional consultants, baggage, uniforms and staff bonuses and overtime costs.

Whilst reported employment costs were up 8.8%, adjusting for factors such as higher non-cash defined benefit pension service charges and one-off costs related to the Olympics, they increased by around 5%. Increased maintenance expenditure was mainly due to the cost of the temporary Olympic terminal at Heathrow and the impact of adverse winter weather in February 2012. Increases in rents and rates were driven primarily by inflation-linked increases in property rates and additional rateable property such as Terminal 5C that was only open for part of the comparative period. The growth in general expenses reflected increases across a range of areas including air traffic control, insurance, cleaning, service quality rebates and the Olympics. Partially offsetting these increases were reduced intra-group charges, particularly reflecting success in reducing central services costs.

The year on year increase in adjusted operating costs moderated significantly through the year with an 8.1% increase at the half year turning into a 4.5% increase for the full year. Outturn costs for the year were also lower than earlier expectations. These trends reflected particularly larger than expected reductions in intra-group charges.

Financial review *continued*

Adjusted EBITDA – Combined operations
In the year ended 31 December 2012, Adjusted EBITDA increased 11.7% to £1,264 million (2011: £1,132 million), resulting in an Adjusted EBITDA margin of 51.3% (2011: 49.6%).

The significant increase in Adjusted EBITDA from 2011 reflects the effect of achieving revenue growth of 8.1% whilst limiting the increase in adjusted operating costs to 4.5%.

Adjusted EBITDA at Heathrow (including Heathrow Express Operating Company Limited) increased 12.0% to £1,170 million (2011: £1,045 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 8.0% to £94 million (2011: £87 million) due principally to increased aeronautical income, driven by higher tariffs partially offset by reduced passenger traffic, resulting in an overall increase in its revenues whilst operating costs were held flat year on year.

Exceptional items (pensions) – Combined operations
Items within operating profit include a £182 million non-cash pension related charge (2011: £40 million). This includes the Group's share of the movement in the LHR Airports Limited defined benefit pension scheme deficit or surplus and Unfunded Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities.

Fair value gain on investment property valuation – Combined operations
Investment properties were valued at a fair value at 31 December 2012 by CB Richard Ellis, Chartered Surveyors and Strutt & Parker, Chartered Surveyors. Strutt & Parker were responsible solely for the valuation of residential properties and agricultural land 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 2012 resulted in a gain of £41 million (2011: £46 million).

Depreciation and amortisation – Combined operations
Depreciation and amortisation for the year ended 31 December 2012, excluding exceptional charges, was 2.4% lower at £501 million (2011: £513 million). This was due in part to the cessation of depreciation charges under IFRS after Stansted airport was classified as held-for-sale in August 2012.

Exceptional impairment of property, plant and equipment – Combined operations
In the year ended 31 December 2012, an impairment of £5 million was recognised at Heathrow as a result of a change in the expected future use of automated immigration systems in advance of their anticipated sale. This accounting charge is not expected to have an impact on these costs remaining in the airport's regulatory asset base.

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

Fair value gain on financial instruments – Combined operations
A net fair value gain of £112 million (2011: loss of £46 million) on financial instruments has been recognised as financing costs in the Income statement. This gain related primarily to index-linked swaps internally designated to hedge the Group's bond issues which do not achieve hedge accounting under IFRS. The index-linked swaps also provide a commercial hedge of the Group's RPI linked revenue.

Taxation – Combined operations
The tax credit recognised for the period ended 31 December 2012 was £123 million (2011: £190 million). This reflects a tax charge arising on ordinary activities of £10 million (2011: £52 million credit) and a tax credit of £133 million (2011: £138 million) due to the impact on deferred tax liabilities of reductions in the main rate of UK corporation tax.

The Finance Act 2012 enacted a reduction in the main rate of UK corporation tax to 24% with effect from 1 April 2012 and to 23% with effect from 1 April 2013. As a result the Group's deferred tax balances, which were provided at 25%, have been re-measured at the rate of 23%. This has resulted in a reduction in the net deferred tax liability of £128 million, with £133 million credited to the income statement and £5 million charged to equity.

The tax charge recognised for the year on ordinary activities of £10 million (2011: £52 million credit) results in a negative effective tax rate of 142.9% (2011: 22.2% effective tax rate). The tax charge is more than the credit implied by the statutory rate of 24.5% (2011: 26.5%) primarily due to non-deductible expenses partly offset by the release of prior year tax provisions. Refer to Note 5 of the Group financial statements.

Net profit from discontinued operations
There was a net profit from other discontinued operations of £nil (2011: £8 million).

Financial review *continued*

Dividend
A dividend of £346 million was paid in the year ended 31 December 2012 (2011: £nil).

Summary cash flow – Combined Operations

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Cash generated from Combined Operations[1]	**1,163**	1,131
Taxation	**(31)**	(27)
Net cash flow from operating activities	**1,132**	1,104
Dividends paid	**(346)**	-
Capital expenditure	**(1,157)**	(864)
Release of provisions on discontinued operations	**(5)**	(6)
Movement in bonds	**2,677**	1,508
Net movement in other borrowings and other financing items	**(1,721)**	(1,271)
Net interest paid	**(419)**	(375)
Cancellation and restructuring of derivatives	**(76)**	(114)
Settlement of accretion on index-linked swaps	**(80)**	(15)
Net increase/(decrease) in cash and cash equivalents	**5**	(33)

[1] Includes £81 million (2011: £86 million) in relation to Stansted airport.

Cash flow from combined operating activities
Net cash inflow from operations in the year ended 31 December 2012 increased 10.0% to £1,163 million (2011: £1,131 million) which compares with Adjusted EBITDA of £1,264 million (2011: £1,132 million). The reduced conversion of Adjusted EBITDA to operating cash flow compared to 2011 reflects three factors: the absence of the exceptional £47 million working capital benefit recorded in 2011, a larger difference between the cash contributions to the defined benefit pension scheme and the net service charge to the income statement and a stronger underlying working capital performance in 2011.

Capital expenditure – Combined operations
In the year ended 31 December 2012, the cash flow impact of the Group's capital investment programme was £1,157 million (2011: £865 million) with £1,141 million (2011: £844 million) at Heathrow and £16 million (2011: £21 million) at Stansted.

The most significant areas of capital expenditure at Heathrow were on the new main Terminal 2 building, the second phase of Terminal 2's satellite building and the new integrated baggage system for Terminal 3.

Pension scheme
At 31 December 2012, the LHR Airports Limited defined benefit pension scheme had a deficit of £103 million as measured under IAS 19, of which £92 million was attributable to the Group under its shared services agreement with LHR Airports Limited. This compares with a scheme surplus of £39 million at 31 December 2011 of which £32 million was attributable to the Group. The change from a scheme surplus to a deficit is due principally to a fall in the net discount rate applied to the scheme liabilities.

The trustees of the LHR Airports Limited defined benefit pension scheme and the Group concluded the pension scheme's 30 September 2010 triennial valuation in December 2011 and agreed a schedule of cash contributions of £97 million per annum (out of which £24 million related to deficit reduction) that became effective from 1 January 2012. Following the disposal of Edinburgh Airport Limited, the cash contributions have been reduced to £94 million per annum for 2013 and 2014. All but approximately £10 million of the new annual amount will be met by the Group's airports.

Financial review *continued*

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 2012, the Group's nominal net debt increased 9.9% to £12,086 million at 31 December 2012 from £10,992 million at 31 December 2011. The increase in net debt primarily reflects three factors: funding of capital investment at Heathrow; making dividend payments; and inflation accretion on the Group's index-linked swaps and bonds.

The Group's nominal net debt at 31 December 2012 comprised £10,840 million under bond issues, £839 million under various loan facilities, £445 million in index-linked derivative accretion and cash at bank and term deposits of £38 million (compared with cash and cash equivalents of £37 million shown on the statement of financial position). Nominal net debt comprised £9,810 million in senior net debt and £1,550 million in junior debt (both held at Heathrow (SP)'s subsidiaries) together with £726 million in net debt held at the Company.

The accounting value of the Group's net debt at 31 December 2012 excluding accrued interest was £11,548 million (2011: £10,750 million).

The average cost of the Group's external gross debt at 31 December 2012 was 4.37% (2011: 4.30%), 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 2012 was 5.86% (2011: 6.46%). The decrease in the average cost of debt (including index-linked accretion) is mainly due to lower inflation at 31 December 2012 than at 31 December 2011.

At 31 December 2012, the Group had approximately £1.7 billion in undrawn bank facilities and cash resources. Since the beginning of 2013, the Group has announced the sale of Stansted airport which is expected to generate significant net proceeds to the Group. Taking this into account, together with expected operating cashflow over the period, the Group expects to have sufficient liquidity to meet all its obligations in full, including capital investment, debt service costs, debt maturities and distributions, until mid-2015.

Recent financing activity
The Group's financing position was transformed in 2012 with over £3 billion raised in multiple capital markets transactions and the successful refinancing of the Group's core revolving credit and liquidity facilities. This marked the culmination of a programme that has seen the Group raise nearly £8 billion since late 2009, enabling full repayment of loan facilities put in place in the 2008 refinancing and putting the Group in its strongest liquidity position for many years.

Twelve capital markets transactions were completed by the Group in 2012 across a range of currencies, ratings levels and formats. Highlights included a £275 million seven year bond issued by the Company and £1 billion in Class B issuance by Heathrow Funding Limited through two transactions – a £600 million twelve year bond and a £400 million eight year bond. There were also debut offerings by Heathrow Funding Limited in both Swiss francs (CHF400 million five year Class A bond) and Canadian dollars (C$400 million seven year Class A bond). Other notable Class A transactions included a €700 million five year bond, a £180 million ten year index-linked single investor private placement and a US$500 million three year bond that builds on the Group's presence in the US market established in 2011.

In 2012, the Group also completed the refinancing of its revolving credit and liquidity facilities. The new facilities were well oversubscribed with approximately £4 billion of commitments from 17 existing and new relationship banks from across the globe. This enabled the size of the new facilities to be increased to £2.75 billion. They comprise a £2.0 billion revolving credit facility (split £1.5 billion Class A and £400 million Class B general purposes facilities; and £100 million Class A working capital facility); and £750 million standby liquidity facilities. The new facilities mature in June 2017 and the Class A and B tranches of the revolving credit facility carry margins of 150 basis points and 225 basis points respectively.

The financing programme implemented over the last 3 years has transformed the financing position of the Group. Recent progress is evident from the fact that between 31 December 2011 and 31 December 2012 the Group has diversified its sources of funding in the bond markets from three currencies to five, increased the average life of its external debt from 9.5 years to 9.8 years and reduced the amount of debt falling due within 3 years from £3.7 billion to £1.8 billion.

The Group expects the scale and focus of its capital markets activities to evolve going forward. In particular, it expects funding requirements to moderate materially, to an average of less than £1.5 billion per annum, over the coming years. This reflects the repayment of loan facilities referred to above as well as an expectation of both a more moderate capital programme and continued increases in operating cash flow at Heathrow through to the end of its next regulatory period in 2019. The proceeds from the sale of Stansted will reduce financing needs even further over the next 12 months.

Financial review *continued*

Regulatory Asset Base ('RAB')

Set out below are RAB figures for Heathrow and Stansted at 31 December 2011 and 31 December 2012. RAB figures are utilised in calculating gearing ratios under certain of the Group's financing agreements.

	Heathrow £m	Stansted £m	Total £m
31 December 2011	12,490	1,360	13,850
31 December 2012	13,471	1,343	14,814

The increase in the total RAB during the year ended 31 December 2012 reflected capital expenditure of approximately £1,180 million; inflation indexation of around £435 million; offset by regulatory depreciation of around £605 million; RAB profiling adjustments of around £45 million; and a modest amount of disposals.

Net finance costs and net interest paid – Combined operations

In the year ended 31 December 2012, the Group's net finance costs before certain re-measurements were £731 million (2011: £802 million), which included £1,061 million (2011: £1,024 million) of interest on external bonds and bank debt and related derivatives and £20 million (2011: £25 million) of financing facility fees and other items. These charges were partially offset by £250 million (2011: £220 million) in finance income and £100 million (2011: £27 million) in capitalised interest.

Underlying net finance costs were £748 million (2011: £752 million), after adjusting for £100 million (2011: £27 million) in capitalised interest and £83 million (2011: £77 million) in non-cash amortisation of financing fees and bond fair value adjustments. The slight decrease in underlying net finance costs in 2012 primarily reflected lower accretion on index-linked instruments due to lower inflation and increased interest receivable due to a higher average amount of index-linked swaps largely offset by the effect of the increase in net debt.

Net interest paid in the year ended 31 December 2012 was £419 million (2011: £375 million). This consisted of £379 million (2011: £347 million) net interest paid by the Company’s subsidiaries and £40 million (2011: £28 million) paid by the Company. The increase in net interest paid is due primarily to the overall increase in net debt and timing differences.

Net interest paid is lower than net finance costs primarily due to an amortisation charge of £38 million (2011: £62 million) in net finance costs relating to prepayments of derivative interest made in earlier periods and a £191 million (2011: £247 million) non-cash charge relating to accretion on index-linked instruments. This is partially offset by the net effect of capitalised interest and the non-cash amortisation of financing fees and bond fair value adjustments.

Financial ratios - Combined operations

The Group continues to operate comfortably within required financial ratios.

At 31 December 2012, the Group’s gearing ratio (nominal net debt to RAB) was 81.6% (2011: 79.4%) compared with the 90.0% covenant level under its financing agreements. Heathrow (SP)’s senior and junior gearing ratios were 66.2% and 76.7% respectively (2011: 68.0% and 75.4% respectively) compared with trigger levels of 70.0% and 85.0% under its financing agreements. The increase in the Group’s and Heathrow (SP)’s junior gearing ratios since 31 December 2011 was primarily due to the increase in net debt discussed in “Net debt and liquidity” above.

In the year ended 31 December 2012, 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 2.08x (2011: 2.17x) compared with the 1.00x covenant level under its financing agreements. Heathrow (SP)’s senior and junior interest cover ratios were 2.62x and 2.30x (2011: 2.76x and 2.34x 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 a one-off working capital benefit of £47 million. In addition, in 2011 and 2012 there were reorganisation cash costs of £5 million and £4 million respectively.

Accounting and reporting policies and procedures

The consolidated results in the financial statements for the year ended 31 December 2012 are presented on an IFRS basis as adopted by the European Union, along with the comparative information for the year ended 31 December 2011. 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’).

Heathrow Finance plc (Formerly BAA (SH) plc)

Corporate governance statement on internal controls and risk management

Internal control and risk management are key elements of the Heathrow Airport Holdings Limited group's (the 'Heathrow Airport Holdings 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 Heathrow Airport Holdings Group's guidelines. The Executive Committee, Board and Audit Committee ('AC') referred to below relate to the Executive Committee, Board and AC of Heathrow Airport Holdings Limited. The scope of the AC also includes Heathrow Finance plc.

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 Heathrow Airport Holdings Group internal control procedures, supported by a Code of Professional Conduct Policy, appropriate segregation of duties controls, organisational design and documented procedures. These internal controls and processes are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against material misstatements or loss.

The key features of the Heathrow Airport Holdings 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;
- AC review of financial results 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 to the AC; and
- a confidential whistleblowing process.

In addition, the AC:

- 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 independent of the Company's executive directors; and
- reviews the scope, operations and reports of the Heathrow Airport Holdings Group's Internal Audit function on the effectiveness of systems for internal financial control, financial reporting and risk management.

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

Risk management
The Group has updated its approach to risk management and issued a new risk management policy. The Group's risk management process is used to facilitate 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 day-to-day activities are managed effectively and all significant business decisions are risk-informed.

The risk management process is evidenced in risk registers which are used as the basis for regular review of risks and their management, up to Executive Committee level. The risk registers are also used to make informed decisions relating to the procurement of insurance cover. The risk management process also supports 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 risk management process and the individual risk registers are subject to periodic review by the Internal Audit function, whose primary responsibility is to provide independent assurance to the Board that the controls put in place by management to mitigate risks are working effectively.

Assurance is provided through reports to the AC, the management reporting processes and a specialist compliance audit function which reports directly to the Sustainability and Operational Risk 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 actively promotes the role of safety leadership in creating a safety culture that is intolerant of accidents and incidents.

The Group's Safety Management System includes risk assessment processes for all activities entailing significant risk and proportionate control measures employed to safeguard everyone impacted by the Group's business. The Group also operates robust asset management processes to ensure property and equipment remains safe. Governance, led by the airports' senior management teams, 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 Heathrow Airport Holdings 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 Group works closely with government agencies, including the police and the UK Border Force 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 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 are 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 on-going 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, reduces the risk of the Group breaching these regulations.

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

Regulatory environment, legal and other reputational risks *continued*

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. 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.

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.

Development

The Group recognises that failure to control key development costs and delivery could damage its financial standing and reputation. The 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 Group. Since it is not possible to identify the timing or period of such an effect, the Group carries out evaluations through a series of scenario planning exercises.

Industrial relations

The risk of industrial action by key staff that affects critical services, curtails operations and has an adverse financial and reputational impact on the Group is recognised. The Group has a range of formal national and local consultative bodies to discuss pay, employment conditions and business issues with the Trade Unions. 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 Force.

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

Commercial and financial risks continued

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 Heathrow Airport Holdings Group's business operations and funding. To achieve this, the Heathrow Airport Holdings 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 2012, fixed rate debt after hedging with derivatives represented 80% 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 Heathrow (SP) level) and sub-investment grade (at Heathrow Finance level) financing platforms for its airports. The Heathrow (SP) platform supports bank term debt, bank revolving credit facilities 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 AC, the Board and Executive Committee.

The Heathrow Finance platform is rated BB+/Ba3 and supports both loan and bond debt.

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

The Group has positive cash flows before capital expenditure and maintains at least 12 months' headroom under its revolving credit facility. As at 31 December 2012, the Group's cash and cash equivalents were £39 million, undrawn headroom under revolving credit facilities was £1,693 million and undrawn headroom under facility was £750 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 lower than 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).

On behalf of the Board

José Leo
Director

22 February 2013

Heathrow Finance plc (Formerly BAA (SH) plc)

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2012.

Principal activities
The principal activity of Heathrow Finance plc is as the holding company of Heathrow (SP) Limited. Heathrow (SP) Limited is the holding company for Heathrow (AH) Limited, owner of the designated airports (Heathrow and Stansted airports), and Heathrow 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 19.

Results and dividends
The profit after taxation for the financial year amounted to £116 million (2011: £36 million loss).

On 21 June 2012 the shareholders and directors of Heathrow Airport Limited approved a capitalisation of the revaluation reserve of £718,000,000 reducing the revaluation reserve and increasing share capital to enable a share capital reduction and payment of dividends.

Dividends of £346 million were paid during the year (2011: £nil).

The statutory results for the year are set out on page 25.

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

José Leo	
Frederick Maroudas	Resigned 8 October 2012
Andrew Efiong	Appointed 8 October 2012

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, road shows and an intranet, while collective consultation takes place with the unions such as Unite and Prospect for a proportion of employees. 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, some senior management participate in a long-term incentive plan which also rewards based on 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.

Supplier payment policies *continued*

The Group had 7 days purchases outstanding at 31 December 2012 (2011: 28 days) based on the average daily amount invoiced by suppliers during the year.

Donations

The Group's charitable donations for the year amounted to £1,242,560 (2011: £1,013,000). The main beneficiaries of charitable donations, the relevant amounts donated and the main activities of these beneficiaries are as follows:

Hillingdon Communities Trust	£1,000,000	Heathrow Airport Limited has made a 15 year commitment to make an annual grant of £1 million to the Hillingdon Communities Trust. The deed of gift to the Trust carries a requirement that grants must benefit the community in the southern part of the Borough of Hillingdon including Hayes (the wards of Botwell, Townfield, Pinkwell, West Drayton, Yiewsley and Heathrow Villages).
Independent Transport Commission	£50,000	Researches the economic, social and environmental aspects of transport and travel providing insight and analysis on the long-term strategic issues that may face Heathrow airport.
MacMillan Cancer Support	£30,600	Supports individuals in the fight against cancer providing financial and emotional support while hosting national fundraising and awareness events.
Heathrow Travel-care	£12,000	Provides counselling or assistance to passengers and airport staff.

In addition to the donations above, the Heathrow Airport Holdings Group contributes to a number of charitable causes through Communities Trust; in 2012 £750,000 was allotted to the fund.

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 2012 (2011: £nil) that falls within this category.

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 16 to 19 in the 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 18 and 19 in the Corporate governance statement on internal controls and risk management section of the Business review.

Post balance sheet events

After challenging for a number of years the proportionality of the disposal remedies imposed by the Competition Commission resulting from its inquiry into the supply of UK airport services by the Group, a disposal process for Stansted airport commenced in August 2012 which led to the announcement since the year end that the airport is being sold to Manchester Airports Group for £1,500 million. The sale is expected to complete by the end of February 2013.

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.

Directors' report *continued*

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

22 February 2013

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 Heathrow 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

22 February 2013

Independent auditor's report to the members of Heathrow Finance plc

We have audited the Group financial statements of Heathrow Finance plc for the year ended 31 December 2012 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 Group'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 2012 and of its profit 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 to report to you if, in our opinion:

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

Other matter
We have reported separately on the parent company financial statements of Heathrow Finance plc for the year ended 31 December 2012.

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

22 February 2013

Heathrow Finance plc (Formerly BAA (SH) plc)

Consolidated income statement for the year ended 31 December 2012

		Year ended 31 December 2012			Restated[1] Year ended 31 December 2011		
	Note	**Before certain re-measurements £m**	**Certain re-measurements[2] £m**	**Total £m**	Before certain re-measurements £m	Certain re-measurements[2] £m	Total £m
Continuing operations							
Revenue	*1*	**2,222**	**-**	**2,222**	2,046	-	2,046
Operating costs	*2*	**(1,679)**	**-**	**(1,679)**	(1,516)	-	(1,516)
Other operating costs							
Fair value gain on investment properties	*1(c)*	**-**	**50**	**50**	-	47	47
Operating profit	*1*	**543**	**50**	**593**	530	47	577
Analysed as:							
Operating profit before exceptional items		**695**	**50**	**745**	574	47	621
Exceptional items	*3*	**(152)**	**-**	**(152)**	(44)	-	(44)
Exceptional impairment	*3*	**(5)**	**-**	**(5)**	-	-	-
Financing							
Finance income	*4(a)*	**250**	**-**	**250**	220	-	220
Finance costs	*4(a)*	**(962)**	**-**	**(962)**	(1,002)	-	(1,002)
Fair value gain/(loss) on financial instruments	*4(b)*	**-**	**108**	**108**	-	(46)	(46)
		(712)	**108**	**(604)**	(782)	(46)	(828)
(Loss)/profit before tax		**(174)**	**158**	**(16)**	(252)	1	(251)
Taxation before change in tax rate		**15**	**(7)**	**8**	54	(3)	51
Change in tax rate		**99**	**15**	**114**	105	15	120
Taxation	*5*	**114**	**8**	**122**	159	12	171
(Loss)/profit for the year from continuing operations		**(60)**	**166**	**106**	(93)	13	(80)
Net profit/(loss) from discontinued operations	*6*	**35**	**(25)**	**10**	43	1	44
Consolidated (loss)/profit for the year		**(25)**	**141**	**116**	(50)	14	(36)

[1] Comparative income statement information restated to include Stansted airport in discontinued operations. See Note 6.
[2] 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.

Heathrow Finance plc (Formerly BAA (SH) plc)

Consolidated statement of comprehensive income for the year ended 31 December 2012

	Note	**Year ended 31 December 2012 £m**	Year ended 31 December 2011 £m
Profit/(loss) for the year		**116**	(36)
Other comprehensive income:			
Cash flow hedges[1]			
Losses taken to equity	*23*	**(287)**	(295)
Transferred to income statement	*23*	**239**	78
Change in tax rate[2]	*16,23*	**(5)**	1
Tax relating to indexation of operating land[2]	*16,23*	**-**	3
Other comprehensive loss for the year net of tax		**(53)**	(213)
Total comprehensive profit/(loss) for the year		**63**	(249)

[1] Elements that may be recycled to the consolidated income statement in future periods were £48 million loss (2011: £217 million)
[2] Elements that may not be recycled to the consolidated income statement in future periods were £5 million loss (2011: £4 million gain)

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 23.

Heathrow Finance plc (Formerly BAA (SH) plc)

Consolidated statement of financial position as at 31 December 2012

	Note	**31 December 2012 £m**	31 December 2011 £m
Assets			
Non-current assets			
Property, plant and equipment	*7*	**10,413**	10,426
Investment properties	*8*	**1,815**	2,282
Intangible assets	*9*	**77**	54
Derivative financial instruments	*14*	**306**	369
Trade and other receivables	*11*	**99**	85
		12,710	13,216
Current assets			
Inventories	*10*	**7**	8
Trade and other receivables	*11*	**258**	315
Derivative financial instruments	*14*	**-**	171
Cash and cash equivalents	*12*	**37**	34
		302	528
Assets classified as held-for-sale	*19*	**1,331**	-
Total assets		**14,343**	13,744
Liabilities			
Non-current liabilities			
Borrowings	*13*	**(11,159)**	(9,912)
Derivative financial instruments	*14*	**(1,094)**	(1,082)
Deferred income tax liabilities	*16*	**(1,210)**	(1,595)
Provisions	*17*	**(5)**	(4)
Trade and other payables	*18*	**(4)**	(1)
		(13,472)	(12,594)
Current liabilities			
Borrowings	*13*	**(711)**	(1,076)
Derivative financial instruments	*14*	**(39)**	-
Provisions	*17*	**(97)**	(29)
Current income tax liabilities		**(23)**	(27)
Trade and other payables	*18*	**(450)**	(457)
		(1,320)	(1,589)
Liabilities associated with assets classified as held-for-sale	*19*	**(273)**	-
Total liabilities		**(15,065)**	(14,183)
Net liabilities		**(722)**	(439)
Equity			
Capital and reserves			
Share capital	*20*	**3,109**	3,109
Revaluation reserve	*21*	**-**	365
Merger reserve	*21*	**(1,771)**	(1,771)
Fair value reserve	*22*	**(455)**	(396)
Retained earnings	*24*	**(1,605)**	(1,746)
Total equity		**(722)**	(439)

The financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 22 February 2013. They were signed on its behalf by:

José Leo
Director

Andrew Efiong
Director

Heathrow Finance plc (Formerly BAA (SH) plc)

Consolidated statement of changes in equity for the year ended 31 December 2012

		Attributable to owners of the Company					
	Note	Share capital £m	Revaluation reserve[1] £m	Merger reserve £m	Fair value reserve £m	Retained earnings £m	Total equity £m
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		-	-	-	(217)	-	(217)
Change in tax rate	*16*	-	-	-	(4)	5	1
Tax relating to indexation of operating land	*16,23*	-	-	-	-	3	3
Total comprehensive income		-	-	-	(221)	(28)	(249)
1 January 2012		**3,109**	**365**	**(1,771)**	**(396)**	**(1,746)**	**(439)**
Comprehensive income:							
Profit for the year		**-**	**-**	**-**	**-**	**116**	**116**
Other comprehensive income:							
Fair value losses on cash flow hedges net of tax		**-**	**-**	**-**	**(48)**	**-**	**(48)**
Change in tax rate	*16,24*	**-**	**-**	**-**	**(11)**	**6**	**(5)**
Dividends paid	*24*	**-**	**-**	**-**	**-**	**(346)**	**(346)**
Total comprehensive income		**-**	**-**	**-**	**(59)**	**(224)**	**(283)**
Realisation of revaluation reserve	*21*	**-**	**(365)**	**-**	**-**	**365**	**-**
31 December 2012		**3,109**	**-**	**(1,771)**	**(455)**	**(1,605)**	**(722)**

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

Heathrow Finance plc (Formerly BAA (SH) plc)

Consolidated statement of cash flows for the year ended 31 December 2012

	Note	**Year ended 31 December 2012 £m**	Restated[1] Year ended 31 December 2011 £m
Cash flows from operating activities			
Cash generated from continuing operations	*26*	**1,081**	1,045
Taxation - Group relief paid		**(31)**	(27)
Cash generated from discontinued operations		**82**	86
Net cash from operating activities		**1,132**	1,104
Cash flows from investing activities			
Purchase of:			
Property, plant and equipment		**(1,096)**	(808)
Investment properties		**(9)**	(23)
Intangible assets		**(36)**	(12)
Investing activities of discontinued operations		**(21)**	(27)
Net cash used in investing activities		**(1,162)**	(870)
Cash flows from financing activities			
Dividends paid		**(346)**	-
Drawdown of revolving credit facility		**307**	-
Proceeds from issuance of bonds		**3,357**	1,508
Repayment of bonds		**(680)**	-
Repayment of Class B facility		**(475)**	-
(Repayment)/drawdown of capital expenditure facility		**(1,395)**	95
(Repayment)/drawdown of subordinated facilities		**(98)**	50
Repayment of facilities and other items		**(57)**	(1,342)
Increase in amounts owed by group undertakings		**-**	(74)
Cancellation and restructuring of derivatives		**(76)**	(99)
Settlement of accretion on index-linked swaps		**(80)**	(15)
Interest paid		**(401)**	(356)
Financing activities of discontinued operations		**(21)**	(34)
Net cash from/(used in) financing activities		**35**	(267)
Net increase/(decrease) in cash and cash equivalents		**5**	(33)
Cash and cash equivalents at beginning of year		**34**	67
Cash and cash equivalents at end of year		**39**	34
Represented by:			
Cash and cash equivalents – continuing operations	*12*	**37**	34
Cash and cash equivalents – discontinued operations	*19*	**26**	-
Overdrafts – continuing operations	*13*	**(24)**	-
Cash and cash equivalents at end of year		**39**	34

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.

Accounting policies for the year ended 31 December 2012

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. 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 Heathrow Airport Holdings 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).

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

Changes in accounting policy and disclosures
a) *Amended standard adopted by the Group*
The Group has adopted the following amended IFRS as of 1 January 2012 that did not have a material impact on the Group's financial statements.
    - Amendment to IAS 1 Financial Statement Presentation – splits presentation of items recognised in Other Comprehensive Income between those recyclable to profit and loss and those that are not.

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 adopted 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
    - Transitional guidance (amendments to IFRS 10, IFRS 11 and IFRS 12)
    - IFRS 13 Fair Value Measurement
    - IAS 19 Revised Employee Benefits
    - IAS 32 (amended) Offsetting Financial Assets and Financial Liabilities
    - IFRS 7 (amended) Disclosures - Offsetting Financial Assets and Financial Liabilities
    - IFRS 1 (amended) Government Loans
    - Amendment to IAS 12 Deferred Tax: recovery of underlying assets – description of the impact of the changes
    - Improvements to IFRS 2009-2011

Accounting policies for the year ended 31 December 2012 *continued*

Changes in accounting policy and disclosures *continued*

The adoption of IAS 19 Revised will impact the presentation of pensions related gains and losses in the Income Statement and Statement of Other Comprehensive Income. For the restated year ended 31 December 2012, the lower expected return on assets will reduce the level of pension income that is recognised in profit and loss leading to a higher net expense of approximately £16 million before tax. The amounts recognised in Other Comprehensive Income will reduce by £16 million. There is no expected change in the statement of financial position as a result of implementing IAS19R.

The adoption of Amendment to IAS 12 will impact the measurement of deferred tax on investment properties. For the restated year ended 31 December 2012, this is expected to reduce the deferred tax liabilities by £54 million.

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 although the earliest mandatory effective date for any phase of IFRS 9 is 1 January 2015. 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 Group financial statements consolidate the financial statements of Heathrow Finance plc and all its subsidiaries.

The Group was formed in 2008 as part of a wider Heathrow Airport Holdings Group refinancing and group reconstruction. In 2008 the Company acquired Heathrow (SP) Limited known as the Security Group. The Security Group 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. Heathrow (SP) Limited is also the holding company of Heathrow Funding Limited, which is the bond issuer for the Group.

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.

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 HEX rail operations);
- other operations (corporate activities and other commercial operations); and
- Discontinued operations; Stansted relating to 2012.

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 revenue 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.

Accounting policies for the year ended 31 December 2012 *continued*

Revenue *continued*

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.

Grants and contributions

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.

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.

Provisions to recognise the Group's liability to fund the Heathrow Airport Holdings Group defined benefit pension scheme deficit and Unfunded Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities under the Shared Services Agreement are also treated as an exceptional item. Refer to the Shared Services Agreement accounting policy.

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

Borrowing costs

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

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

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.

Accounting policies for the year ended 31 December 2012 *continued*

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 and the asset is available for use. Where appropriate, cost includes borrowing costs capitalised, own labour costs of construction-related project management and directly attributable overheads. Projects that are in the early stages of planning are capitalised where the directors are satisfied that it is probable the necessary consents will be received and the projects will be developed to achieve a successful delivery of an asset such that future commercial returns will flow to the Group. The Group reviews these projects on a regular basis and at least every six months, to determine whether events or circumstances have arisen that may indicate that the carrying amount of the asset may not be recoverable, at which point the asset would be assessed for impairment.

Depreciation

Depreciation is provided on operational assets, other than land 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:

Terminal complexes	*Fixed asset lives*
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
Airfields	
Runway surfaces	10–15 years
Runway bases	100 years
Taxiways and aprons	50 years
Rail	
Rolling stock	8–40 years
Tunnels	100 years
Track metalwork	5–10 years
Track bases	50 years
Signals and electrification work	40 years
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
Leasehold improvements	Lower of useful economic life or period of lease

The asset’s residual values and useful lives are reviewed and adjusted, if appropriate, at each reporting date

Property, plant and equipment *continued*

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.

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 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 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.

Accounting policies for the year ended 31 December 2012 *continued*

Leases *continued*

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 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 rate 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 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 rate 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.

Accounting policies for the year ended 31 December 2012 *continued*

Financial instruments *continued*

Investments continued

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 provides a residual interest in the assets of a business after deducting all other liabilities.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings with a maturity date 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.

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.

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.

Accounting policies for the year ended 31 December 2012 *continued*

Financial instruments *continued*

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 hedge relationship, 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 by LHR Airports Limited with the exception of non-senior management at Heathrow Express Operating Company Limited. LHR Airports Limited also acts as the provider of corporate and administrative services to the Group, sponsors the defined benefit pension schemes and grants all employee benefits.

On 18 August 2008, the airports entered into a SSA with LHR 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

LHR 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 LHR 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 LHR Airports Limited.

Corporate and centralised services

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

Accounting policies for the year ended 31 December 2012 *continued*

Shared Services Agreement ('SSA') *continued*

Pension costs

Under the SSA the current period service cost for the LHR 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 and HEX to the LHR Airports Limited pension schemes on behalf of LHR Airports Limited.

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

As more than one employer participates in the LHR 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 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 Company'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.

Significant accounting judgements and estimates for the year ended 31 December 2012

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 a fair value at 31 December 2012 and 31 December 2011 by CBRE Limited and Strutt & Parker, Chartered Surveyors. Strutt & Parker were responsible solely for the valuation of residential property and agricultural land at Stansted. The valuations were prepared in consideration of the relevant accounting standards and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. Approximately 79% (2011: 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. Independent valuations were obtained for 100% of the investment properties.

Taxation
Provisions for tax contingencies require management to make judgements and estimates in relation to tax issues and exposures. Amounts provided are based on management's interpretation of country specific tax law and the likelihood of settlement. Tax benefits are not recognised unless the tax positions 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 2012, £582 million of fair value losses (2011: £528 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.

Classification of disposal group as held for sale
The Group exercises judgement to determine when groups of assets are actively marketed in accordance with IFRS 5 'Non-current assets held for sale and discontinued operations'. Assets, or groups of assets, are considered to be actively marketed once there is a board approval and an expectation of the disposal has been raised in those directly affected by the disposal.

Notes to the Group financial statements for the year ended 31 December 2012

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.

During the year, the Group classified Stansted airport as assets held-for-sale. The performance of this disposal group is distinguished from the performance of continuing Group operations in the annual report through classification as discontinued operations.

Table (a) details total revenue from external customers for the year ended 31 December 2012 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 2011.

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 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.

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

Table (a)	**Segment revenue**					**EBITDA**		
Year ended 31 December 2012	**Aero-nautical**	**Retail**	**Property & facilities**	**Other**	**Total revenue from external customers**	**Pre exceptional items**	**Operating exceptional items**	**Post exceptional items**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Heathrow	**1,280**	**465**	**265**	**96**	**2,106**	**1,163**	**(152)**	**1,011**
Heathrow Express	**-**	**-**	**-**	**116**	**116**	**6**	**-**	**6**
Continuing operations	**1,280**	**465**	**265**	**212**	**2,222**	**1,169**	**(152)**	**1,017**
Reconciliation to statutory information								
Unallocated income and expenses								
Depreciation and amortisation (Note 1 Table 1 (c))								**(474)**
Operating profit (before certain re-measurements)								**543**
Fair value gain on investment properties (certain re-measurements)								**50**
Exceptional impairment								**(5)**
Finance income								**250**
Finance costs								**(962)**
Fair value gain on financial instruments (certain re-measurements)								**108**
Loss before tax								**(16)**
Taxation before certain re-measurements								**114**
Taxation (certain re-measurements)								**8**
Taxation								**122**
Profit for the year – continuing operations								**106**
Net profit from discontinued operations								**10**
Consolidated profit for the year								**116**

1 Segment information *continued*

Revenue of approximately £693 million (2011: £550 million) was derived from a single external customer and is primarily included within the Heathrow segment above. A further £1 million (2011: £1 million) was derived from the same customer and included in discontinued operations.

Table (b) Restated[1] Year ended 31 December 2011	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[2] £m	Post exceptional items £m
Heathrow	1,150	436	250	99	1,935	982	(33)	949
Heathrow Express	-	-	-	111	111	64	-	64
Continuing operations	1,150	436	250	210	2,046	1,046	(33)	1,013
Reconciliation to statutory information								
Unallocated income and expenses								
Depreciation, amortisation and impairment (Note 1 Table 1 (c))								(483)
Operating profit (before certain re-measurements)								530
Fair value gain on investment properties (certain re-measurements)								47
Finance income								220
Finance costs								(1,002)
Fair value loss on financial instruments (certain re-measurements)								(46)
Loss before tax								(251)
Taxation before certain re-measurements								159
Taxation (certain re-measurements)								12
Taxation								171
Loss for the year – continuing operations								(80)
Net profit from discontinued operations								44
Consolidated loss for the year								(36)

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.

[2] Operating exceptional items for statutory reporting purposes include £11 million impairment (included within depreciation, amortisation and impairment above) as compared to £nil for segmental reporting.

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

1 Segment information continued

Table (c)

	Year ended 31 December 2012			Restated[1] Year ended 31 December 2011		
	Depreciation & amortisation[2] £m	Fair value gain/(loss)[3] £m	Profit on disposal £m	Depreciation & amortisation[2] £m	Fair value gain/(loss)[3] £m	Profit on disposal £m
Heathrow	**(432)**	**50**	**-**	(441)	47	-
Heathrow Express	**(42)**	**-**	**-**	(42)	-	-
Continuing operations	**(474)**	**50**	**-**	(483)	47	-
Discontinued operations	**(27)**	**(9)**	**-**	(41)	(1)	8
Total Group	**(501)**	**41**	-	(524)	46	8

[1] Comparative information has been restated to include Stansted airport in discontinued operations. See Note 6.
[2] Includes intangible amortisation charge of £9 million (2011: £13 million) and for Heathrow includes in 2011 £11 million in relation to an impairment charge incurred on the Airtrack rail project which the Group decided not to pursue. Refer to Note 3.
[3] Reflects fair value gains and losses on investment properties only.

Table (d)

	31 December 2012			31 December 2011		
	Assets[2] £m	Liabilities £m	Capital expenditure[3] £m	Assets[2] £m	Liabilities £m	Restated[1] Capital expenditure[3] £m
Heathrow	**11,567**	**(513)**	**1,144**	10,678	(431)	904
Heathrow Express	**1,012**	**(5)**	**16**	1,049	(6)	11
Stansted	**-**	**-**	**-**	1,320	(27)	-
Other operations	**-**	**(20)**	**-**	-	(1)	
Discontinued operations	**-**	**-**	**14**	-	-	19
Assets classified as held for sale[4]	**1,331**	**(273)**	**-**	-	-	-
Total operations	**13,910**	**(811)**	**1,174**	13,047	(465)	934
Unallocated assets and liabilities:						
Cash and borrowings	**37**	**(11,870)**	**-**	34	(10,988)	-
Derivative financial instruments	**306**	**(1,133)**	**-**	540	(1,082)	-
Taxation	**-**	**(1,233)**	**-**	-	(1,622)	-
Amounts owed from group undertakings	**90**	**(18)**	**-**	123	(26)	-
Total Group	**14,343**	**(15,065)**	**1,174**	13,744	(14,183)	934

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.
[2] Segment assets include primarily airport runways and facilities.
[3] Capital expenditure excludes the impact of capital creditors.
[4] At 31 December 2012 the assets and liabilities of Stansted airport have been classified within Assets classified as held for sale.

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

Heathrow Finance plc is domiciled in the UK. All revenue from external customers comes from the UK which for the year ended 31 December 2012 was £2,222 million (2011: £2,046 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 £12,330 million (2011: £12,773 million). There are no non-current assets held outside the UK (2011: £nil).

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

2 Operating costs – continuing operations

	Year ended 31 December 2012 £m	Restated[1] Year ended 31 December 2011 £m
Operating costs (including exceptional items) include the following:		
Employment costs[2]		
Wages and salaries	**241**	221
Social security	**23**	20
Pensions	**32**	25
Contract and agency staff	**8**	4
Other staff related		
Net exceptional pension charge	**152**	33
Other	**10**	13
	466	316
Depreciation and amortisation		
Depreciation of property, plant and equipment	**461**	474
Amortisation of intangible assets - software	**13**	9
	474	483
Other operating costs		
Maintenance expenditure	**137**	127
Utility costs	**89**	91
Rents and rates	**128**	115
General expenses	**134**	121
Retail expenditure	**26**	23
Police	**29**	29
Aerodrome navigation service charges	**54**	53
Intra-group charges/other	**170**	180
Own work capitalised[3]	**(28)**	(22)
Total operating costs	**1,679**	1,516
Analysed as:		
Adjusted operating costs	**1,053**	1,000
Depreciation and amortisation (excluding exceptional depreciation)	**474**	472
Exceptional costs[4]	**152**	44
Total operating costs	**1,679**	1,516

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.
[2] Employment costs include recharges from LHR Airports Limited for employee services to the Group. Refer to the SSA section in the Accounting policies.
[3] Own work capitalised includes £10 million (2011: £5 million) in relation to employment costs including contract and agency staff.
[4] Exceptional costs include a £152 million charge (2011: £33 million) in relation to pensions and a £nil (2011: £11 million) impairment charge. Refer to Note 3.

Rentals under operating leases

	Year ended 31 December 2012 £m	Restated[1] Year ended 31 December 2011 £m
Operating costs include:		
Plant and machinery	**37**	26
Other	**17**	15
	54	41
Property lease and sub lease charges - minimum lease payments	**17**	15

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.

Notes to the Group financial statements for the year ended 31 December 2012 *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 LHR Airports Limited and recharged in accordance with the SSA as described within the Accounting policies.

	Year ended 31 December 2012 £m	Restated[1] Year ended 31 December 2011 £m
Fees payable to the Company's auditor for the audit of the Heathrow Finance plc group annual accounts		
Audit of the Company's subsidiaries pursuant to legislation	**0.5**	0.5
Total audit fees	**0.5**	0.5
Fees payable to the Company's auditor and their associates for other services specific to the Heathrow Finance plc group		
Audit related assurance services	**0.2**	0.1
Tax compliance services	**-**	0.1
Other tax services	**-**	0.1
Other assurance services	**0.3**	-
Corporate finance services[2]	**-**	0.3
Other services	**-**	0.2
Total non-audit fees	**0.5**	0.8
Total fees	**1.0**	1.3

[1] The presentation of the 31 December 2011 numbers has been restated to be consistent with amended disclosure requirements.
[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 2012 averaged 447 (2011: 435). Other staff engaged in the operation of the Group's airports are employed by LHR 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 LHR Airports Limited engaged in the Group's operations during the year was 5,278 (2011: 5,265). A further 1,115 (2011: 1,138) were employed at Stansted airport which is presented within discontinued operations.

Directors' remuneration

Jose Leo was a director of a number of companies within the Heathrow Airport Holdings Group, including LHR Airports Limited, during the year. His remuneration for the year ended 31 December 2012 was apportioned based on services provided to Heathrow Airport Holdings Limited (2011: Heathrow Airport Holdings Limited) and is disclosed within its financial statements. Andrew Efiong was a director of a number of companies within the Group. He was paid by, but is not a director of, LHR Airports Limited. The directors do not believe it is possible to accurately apportion his remuneration to individual companies within the Group based on services provided.

During the year, none of the directors (2011: none) had retirement benefits accruing to them under a defined benefit scheme and one of the directors (2011: one) had retirement benefits accruing to them under a defined contribution scheme.

None of the directors (2011: none) exercised any share options during the year in respect of their services to the Group and no shares (2011: none) were received or became receivable under long term incentive plans.

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

3 Exceptional items

	Year ended 31 December 2012 £m	Restated[1] Year ended 31 December 2011 £m
Pension charge	**(152)**	(33)
Other operating costs	**-**	(11)
Total operating exceptional items	**(152)**	(44)
Exceptional impairment	**(5)**	-
Taxation on exceptional items	**36**	8
Total exceptional items after tax	**(121)**	(36)

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.

During 2012 there was a net exceptional pension charge of £152 million (2011: £33 million). This includes the Group's share of the movement in the LHR Airports Limited defined benefit pension scheme, Unfunded Retirement Benefit Scheme and Post-Retirement Medical benefits pension related liabilities. For the year ended 31 December 2012 operating exceptional costs of £11 million were incurred, in relation to the Airtrack rail project which the group decided not to pursue.

4 Financing

(a) Net finance costs before certain re-measurements

	Note	Year ended 31 December 2012 £m	Restated[1] Year ended 31 December 2011 £m
Finance income			
Interest receivable on derivatives not in hedge relationship		**250**	220
		250	220
Finance costs			
Interest on borrowings:			
Bonds and related hedging instruments[2]		**(595)**	(488)
Bank loans and overdrafts and related hedging instruments		**(154)**	(171)
Interest payable on derivatives not in hedge relationship[3]		**(294)**	(347)
Facility fees and other charges		**(19)**	(23)
		(1,062)	(1,029)
Less: capitalised borrowing costs[4]	*7*	**100**	27
		(962)	(1,002)
Net finance costs before certain re-measurements		**(712)**	(782)

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.
[2] Includes accretion of £18 million (2011: £15 million) on index-linked bonds.
[3] Includes accretion of £173 million (2011: £232 million) on index-linked swaps.
[4] Capitalised interest included in the cost of qualifying assets arose on the general borrowing pool and is calculated by applying an average capitalisation rate of 4.75% (2011: 2.08%) to expenditure incurred on such assets. Following the significant refinancing activity during the year, the Group has reassessed the applicable pool of general borrowing costs upon which interest has been capitalised. This has led to an increase in the capitalised interest rate to 4.75% compared to 2.08% for the previous year.

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

	Year ended 31 December 2012 £m	Restated[1] Year ended 31 December 2011 £m
Interest rate swaps: cash flow hedge[2]	**(6)**	3
Index-linked swaps: not in hedge relationship[3]	**109**	(89)
Cross-currency swaps: cash flow hedge[2]	**2**	12
Cross-currency swaps: fair value hedge[2]	**3**	31
Fair value re-measurements of foreign exchange contracts and currency balances	**-**	(3)
Fair value gain/(loss) on financial instruments	**108**	(46)

[1] Comparative information restated to include Stansted airport in discontinued operations. See Note 6.
[2] Hedge ineffectiveness on derivatives in hedge relationship.
[3] Reflects the impact on the valuation of movements in implied future inflation and interest rates and accounting adjustment in respect of accretion.

5 Taxation – continuing operations

	Year ended 31 December 2012 £m	Restated[1] Year ended 31 December 2011 £m
UK corporation tax		
Current tax at 24.5% (2011: 26.5%)	**31**	23
Over provision in respect of prior years	**(2)**	(7)
Deferred tax		
Current year	**(37)**	(83)
Prior year	**-**	16
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	**(114)**	(120)
Taxation credit for the year	**(122)**	(171)

[1] Comparative information restated to include Stansted airport in discontinued operations..

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Loss before tax	**(16)**	(251)

The tax credit 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:

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Reconciliation of the tax credit		
Tax calculated at the UK statutory rate of 24.5% (2011: 26.5%)	**(4)**	(67)
Adjustments in respect of current income tax of previous years	**(2)**	(7)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	**(114)**	(120)
Non taxable income/non-deductible expense	**(2)**	7
Adjustments in respect of deferred income tax of previous years	**-**	16
Taxation credit for the year	**(122)**	(171)

Heathrow Finance plc (Formerly BAA (SH) plc)

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

6 Discontinued operations

During 2012 a sale process commenced for Heathrow Finance plc's interest in Stansted Airport Limited. It is anticipated that this transaction will be completed by the end of February 2013. The Group considers that this transaction satisfies the requirements of IFRS 5 - 'Non-current assets held-for-sale and discontinued operations'.

Net profit from discontinued operations

	Year ended 31 December 2012			Year ended 31 December 2011		
	Before certain re-measurements £m	**Certain re-measurements £m**	**Total £m**	Before certain re-measurements £m	Certain re-measurements £m	Total £m
Revenue	242	-	242	234	-	234
Operating costs						
Depreciation	(27)	-	(27)	(41)	-	(41)
Other	(178)	-	(178)	(155)	-	(155)
Other items						
Fair value loss on investment property	-	(9)	(9)	-	(1)	(1)
Operating profit from discontinued operations	**37**	**(9)**	**28**	38	(1)	37
Analysed as:						
Operating profit before exceptional items	**68**	**(9)**	**59**	45	(1)	44
Exceptional items	**(31)**	-	**(31)**	(7)	-	(7)
Exceptional disposal costs	(4)	-	(4)	8	-	8
Financing						
Finance costs	**(19)**	**-**	**(19)**	(20)	-	(20)
Fair value gain on financial instruments	**-**	**4**	**4**	-	-	-
Profit/(loss) before tax from discontinued operations	**14**	**(5)**	**9**	26	(1)	25
Taxation credit/(charge)	**21**	**(20)**	**1**	17	2	19
Net profit/(loss) from discontinued operations	**35**	**(25)**	**10**	43	1	44

Notes to the Group financial statements for the year ended 31 December 2012 *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 2011		8,377	1,235	586	88	1,368	1,557	13,211
Additions		3	-	8	-	-	885	896
Net transfers from investment properties	*8*	-	-	-	6	-	-	6
Transfers from/(to) completed assets		526	14	68	7	14	(629)	-
Borrowing costs capitalised	*4*	-	-	-	-	-	27	27
1 January 2012		**8,906**	**1,249**	**662**	**101**	**1,382**	**1,840**	**14,140**
Additions		**2**	**-**	**7**	**-**	**-**	**1,119**	**1,128**
Borrowing costs capitalised	*8*	**-**	**-**	**-**	**-**	**-**	**100**	**100**
Disposals		**(28)**	**(1)**	**(13)**	**-**	**(1)**	**-**	**(43)**
Net transfer to investment properties		**-**	**-**	**-**	**-**	**-**	**(64)**	**(64)**
Reclassifications		**113**	**(114)**	**(5)**	**(12)**	**(1)**	**19**	**-**
Transferred to assets held-for-sale	*6*	**(845)**	**(202)**	**(66)**	**(17)**	**-**	**(44)**	**(1,174)**
Transfer to completed assets		**405**	**6**	**14**	**11**	**-**	**(436)**	**-**
31 December 2012		**8,553**	**938**	**599**	**83**	**1,380**	**2,534**	**14,087**
Depreciation								
1 January 2011		(2,229)	(284)	(362)	(33)	(291)	-	(3,199)
Charge		(358)	(39)	(59)	(6)	(53)	-	(515)
1 January 2012		**(2,587)**	**(323)**	**(421)**	**(39)**	**(344)**	**-**	**(3,714)**
Depreciation charge		**(355)**	**(36)**	**(48)**	**(6)**	**(43)**	**-**	**(488)**
Impairment		**-**	**-**	**(3)**	**-**	**-**	**(2)**	**(5)**
Disposals		**28**	**1**	**13**	**-**	**5**	**-**	**47**
Reclassifications		**(43)**	**34**	**2**	**3**	**4**	**-**	**-**
Transferred to assets held-for-sale	*6*	**365**	**79**	**39**	**3**	**-**	**-**	**486**
31 December 2012		**(2,592)**	**(245)**	**(418)**	**(39)**	**(378)**	**(2)**	**(3,674)**
Net book value 31 December 2012		**5,961**	**693**	**181**	**44**	**1,002**	**2,532**	**10,413**
Net book value 31 December 2011		6,319	926	241	62	1,038	1,840	10,426

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value of £15 million (2011: £17 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 Terminal 3's new integrated baggage system.

7 Property, plant and equipment *continued*

Borrowing costs capitalised

The amount of borrowing costs included in the cost of Group assets was £1,234 million (2011: £1,192 million). Borrowing costs were capitalised at an average rate of 4.75% (2011: 2.08%).

A tax deduction of £100 million (2011: £27 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 2011		2,212	6	2,218
Additions		26	-	26
Transfers to/(from) completed assets		(5)	-	(5)
Net transfers from operational assets	*7*	(3)	-	(3)
Valuation gain		46	-	46
1 January 2012		**2,276**	**6**	**2,282**
Additions		**9**	**-**	**9**
Disposals		**(4)**	**-**	**(4)**
Net transfer from property, plant and equipment		**(1)**	**65**	**64**
Revaluation		**42**	**3**	**45**
Transfer to assets held-for-sale[1]		**(581)**	**-**	**(581)**
Transfer to completed assets		**6**	**(6)**	**-**
31 December 2012		**1,747**	**68**	**1,815**

[1] The amount transferred to assets held-for-sale includes a valuation loss of £5 million related to Stansted airport prior to its classification as discontinued operations in 2012. A further £4 million valuation loss relating to Stansted airport was recorded subsequently. See Note 6.

Airport investment properties were valued at fair value at 31 December 2011 and 2012 by CBRE Limited, Chartered Surveyors and Strutt & Parker, Chartered Surveyors. Strutt & Parker were responsible solely for the valuation of residential property and agricultural land at Stansted.

Details of the valuations performed are provided below:

	31 December 2012 £m	31 December 2011 £m
CBRE	**2,240**	2,195
Strutt & Parker	**84**	87
At professional valuation	**2,324**	2,282

All valuations were prepared in consideration of the relevant accounting standards and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence. 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 (2011: £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.

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

9 Intangible assets

	£m
Cost	
1 January 2011	222
Additions	12
1 January 2012	**234**
Additions	**37**
Disposals	**(6)**
31 December 2012	**265**
Amortisation	
1 January 2011	(171)
Charge for the year	(9)
1 January 2012	**(180)**
Disposals	**5**
Charge for the year	**(13)**
31 December 2012	**(188)**
Net book value 31 December 2012	**77**
Net book value 31 December 2011	54

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 £44 million (2011: £33 million).

10 Inventories

	31 December 2012 £m	31 December 2011 £m
Consumables	**7**	8

The total amount of inventories consumed in the year was £5 million (2011: £2 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 2012 £m	31 December 2011 £m
Non-current		
Prepaid debt fees[1]	**10**	11
Prepayments	**15**	-
Amount owed by group undertakings[2]	**74**	74
	99	85
Current		
Trade receivables	**166**	184
Less: provision for impairment	**(2)**	(2)
Trade receivables – net	**164**	182
Prepayments	**42**	30
Amounts owed by group undertakings	**16**	17
Amounts owed by group undertakings - pensions[3]	**-**	32
Other receivables	**36**	54
	258	315

[1] Prepaid debt fees largely relate to financing fees paid on facilities not yet drawn and are amortised over the term of the facility.
[2] Amounts owed by group undertakings largely relate to a loan advanced to Heathrow (DSH) Limited on an interest free basis.
[3] During 2012, LHR Airports Limited's defined benefit pension scheme went into a deficit position (2011: surplus) and as such, the share of the deficit allocated to the Airports and HEX sits within Provisions (2011: Debtors - Amounts owed by group undertakings – pensions).

Notes to the Group financial statements for the year ended 31 December 2012 *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 2012, trade receivables of £154 million (2011: £150 million) were fully performing. Trade receivables of £6 million (2011: £32 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 2012	31 December 2011
	£m	£m
Fully performing	**154**	150
Past due but not impaired :		
Not impaired but overdue by less than 30 days	**2**	24
Not impaired but overdue by between 30 and 60 days	**3**	3
Not impaired but overdue by more than 60 days	**1**	5
	6	32
Considered for impairment :		
Overdue by more than 90 days	**6**	2

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

	2012	2011
	£m	£m
1 January	**2**	3
Receivables written off during the year as uncollectable	**-**	(1)
31 December	**2**	2

As at 31 December 2012, trade receivables of £6 million (2011: £2 million) were considered for impairment of which £2 million (2011: £2 million) was provided for. 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.

12 Cash and cash equivalents

	31 December 2012	31 December 2011
	£m	£m
Cash at bank and in hand	**4**	13
Short-term deposits	**33**	21
	37	34

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 and bank overdraft, and consists of:

		31 December 2012	31 December 2011
	Note	**£m**	£m
Cash at bank and in hand		**4**	13
Short-term deposits		**33**	21
Bank overdraft	*13*	**(24)**	-
Cash classified as held-for-sale	*19*	**26**	-
		39	34

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

13 Borrowings

	31 December 2012 £m	31 December 2011 £m
Current		
Secured		
Bank loans - EIB	39	39
Heathrow Funding Limited bonds		
5.850% £400 million due 2013	389	-
3.975% €1,000 million due 2012	-	833
	428	872
Unsecured		
Bank overdrafts	24	-
Total current (excluding interest payable)	452	872
Interest payable	259	204
Total current	711	1,076
Non-current		
Secured		
Heathrow Funding Limited bonds		
5.850% £400 million due 2013	-	380
4.600% €750 million due 2014	564	589
3.000% £300 million due 2015	299	-
2.500% US$500 million due 2015	306	-
12.450% £300 million due 2016	345	356
4.125% €500 million due 2016	388	396
4.375% €700 million due 2017	566	-
2.500% CHF400 million due 2017	268	-
4.600% €750 million due 2018	552	560
6.250% £400 million due 2018	396	394
4.000% CAD400 million due 2019	245	-
6.000% £400 million due 2020	396	-
9.200% £250 million due 2021	283	281
4.875% US$1,000 million due 2021	656	679
1.650%+RPI £180 million due 2022	184	-
5.225% £750 million due 2023	632	625
7.125% £600 million due 2024	588	-
6.750% £700 million due 2026	685	685
7.075% £200 million due 2028	198	197
6.450% £900 million due 2031	864	841
Zero-coupon €50 million due January 2032	42	-
Zero-coupon €50 million due April 2032	42	-
3.334%+RPI £460 million (2011: £365 million) due 2039[1]	545	414
5.875% £750 million due 2041	745	733
Total Heathrow Funding Limited bonds	9,789	7,130
Heathrow Finance plc bonds		
7.125% £325 million due 2017	319	318
5.375% £275 million due 2019	273	-
Total bonds	10,381	7,448
Revolving credit facility	290	-
Capital expenditure facility	-	1,374
Subordinated facilities	125	220
Other bank loans	363	870
Total bank loans	778	2,464
Total non-current	11,159	9,912
Total borrowings (excluding interest payable)	11,611	10,784

[1] This index-linked bond was re-opened generating proceeds of £119 million in March 2012 (2011: £154 million in May 2011).

The average cost of the Group's external gross debt at 31 December 2012 was 4.37% (2011: 4.30%), 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 2012 was 5.86% (2011: 6.46%). The decrease in the average cost of debt (including index-linked accretion) is mainly due to lower inflation at 31 December 2012 than at 31 December 2011.

13 Borrowings continued

Heathrow Funding Limited bonds

The maturity dates of the Heathrow Funding Limited bonds listed above reflect their scheduled redemption dates that correspond to the maturity dates of the loans between Heathrow Airport Limited and Heathrow 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 due 2018, 6.000% £400 million due 2020 and 7.125% £600 million due 2024 bonds, wherein the redemption dates coincide with their legal maturity dates.

Fair value of borrowings

	31 December 2012		31 December 2011	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Non-current				
Long-term debt	**11,159**	**13,038**	9,912	10,812

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

Heathrow (DSH) Limited and Heathrow Finance 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 approximately £289 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.

Heathrow 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.

14 Derivative financial instruments

31 December 2012	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Index-linked swaps	**396**	**-**	**(39)**	**(39)**
Foreign exchange contracts	**34**	**-**	**-**	**-**
	430	**-**	**(39)**	**(39)**
Non-current				
Interest rate swaps	**2,336**	**-**	**(402)**	**(402)**
Cross-currency swaps	**3,503**	**290**	**(30)**	**260**
Index-linked swaps	**5,066**	**16**	**(662)**	**(646)**
	10,905	**306**	**(1,094)**	**(788)**
Total	**11,335**	**306**	**(1,133)**	**(827)**

31 December 2011	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Cross-currency swaps	680	171	-	171
Foreign exchange contracts	6	-	-	-
	686	171	-	171
Non-current				
Interest rate swaps	3,191	-	(434)	(434)
Cross-currency swaps	2,078	369	(5)	364
Index-linked swaps	5,254	-	(643)	(643)
	10,523	369	(1,082)	(713)
Total	11,209	540	(1,082)	(542)

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 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 RPI linked revenue and RAB.

Cross-currency swaps
Cross-currency swaps have been entered into by the Group to hedge currency risk on interest and principal payments on its foreign currency-denominated bond issues. The gains and losses deferred in equity on certain swaps in cash flow hedge relationships will be continuously released to the income statement over the period to maturity of the hedged bonds.

Foreign exchange contracts
Foreign exchange 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 its airports 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.

15 Financial instruments *continued*

Financial risk management objectives and policies continued

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

The main risks arising from the Group's financial instruments are market risk (including fair value interest rate, 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 the 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 2012, 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 £9 million and £11 million respectively (2011: £5 million decrease and £7 million increase, respectively).

As at 31 December 2012, 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 £1 million respectively (2011: £1 million increase and £nil decrease respectively).

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 bonds and derivatives held to economically hedge cash flows on debt instruments and RPI linked revenue. As at 31 December 2012, 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 £188 million and £182 million respectively (2011: £207 million decrease and £200 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 75% 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 2012, the Group's fixed floating interest rate profile, after hedging, on gross debt was 80:20 (2011: 85:15).

As at 31 December 2012, 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 2012		31 December 2011	
	Income statement impact £m	**Equity impact £m**	Income statement impact £m	Equity impact £m
0.50% increase	**73**	**170**	57	158
0.50% decrease	**(78)**	**(180)**	(61)	(169)

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.

15 Financial instruments *continued*

Credit risk continued

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 lower than 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 2012, the Group had total credit risk with derivative counterparties of its interest rate swaps, index-linked swaps and cross-currency swaps of £306 million (2011: £540 million).

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 2012 was £561 million (2011: £776 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 16 to 19 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 2012	31 December 2011
	£m	£m
Floating rate facilities		
Expiring in one to two years	**-**	1,355
Expiring in more than two years	**1,693**	-

As at 31 December 2012, overdraft facilities of £10 million were available (2011: £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 2012			
	Less than one year	**One to two years**	**Two to five years**	**Greater than five years**
	£m	**£m**	**£m**	**£m**
Borrowing principal payments	**435**	**702**	**3,005**	**7,644**
Borrowing interest payments	**615**	**594**	**1,556**	**3,770**
Derivative financial instruments	**82**	**12**	**111**	**(90)**
Trade payables[1]	**117**	**--**	**--**	**--**
Capital payables[1]	**270**	**--**	**--**	**-**

[1] Includes £15 million trade payables and £7 million capital payables classified as held-for-sale. Refer to Note 19.

	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	-	-	-

15 Financial instruments *continued*

Liquidity risk continued

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 2012			
	Less than one year £m	**One to two years £m**	**Two to five years £m**	**Greater than five years £m**
Cross-currency derivative payments	**120**	**120**	**291**	**96**
Cross-currency derivative receipts	**(152)**	**(152)**	**(336)**	**(358)**

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

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 Heathrow Finance plc and Heathrow (SP) Limited. Gearing ratios at each of these levels are set out below:

	31 December 2012	31 December 2011
Net debt to RAB at Heathrow Finance group	**0.82**	0.79
Total net debt to RAB at Heathrow (SP) group	**0.77**	0.75
Senior net debt to RAB at Heathrow (SP) group	**0.66**	0.68

The increase in gearing ratios at Heathrow Finance group and Heathrow (SP) group (junior gearing) is due to a combination of funding the capital investment at Heathrow, making dividend payments and inflation accretion on the Group's index-linked swaps and bonds.

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 2012			
	Loans and receivables £m	**Assets at fair value through income statement £m**	**Derivatives qualifying for hedge accounting £m**	**Total £m**
Derivative financial instruments	**-**	**16**	**290**	**306**
Cash and cash equivalents[1]	**63**	**-**	**-**	**63**
Trade receivables[1]	**191**	**-**	**-**	**191**
Other receivables	**1**	**-**	**-**	**1**
Total financial assets	**255**	**16**	**290**	**561**

15 Financial instruments continued

Financial instruments by category continued

	31 December 2012			
	Liabilities at fair value through income statement £m	**Derivatives qualifying for hedge accounting £m**	**Other financial liabilities at amortised cost £m**	**Total £m**
Borrowings	**-**	**-**	**(11,611)**	**(11,611)**
Derivative financial instruments	**(701)**	**(432)**	**-**	**(1,133)**
Trade payables[1]	**-**	**-**	**(117)**	**(117)**
Capital payables[1]	**-**	**-**	**(270)**	**(270)**
Total financial liabilities	**(701)**	**(432)**	**(11,998)**	**(13,131)**

[1] Includes £26 million cash and cash equivalents, £27 million trade receivables, £15 million trade payables and £7 million capital payables classified as assets held-for-sale. Refer to Note 19.

	31 December 2011			
	Loans and receivables £m	Assets at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Total £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			
	Liabilities at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Other financial liabilities at amortised cost £m	Total £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)

At 31 December 2012, 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.

15 Financial instruments *continued*

Fair value estimation *continued*

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 2012, all of the resulting fair value estimates in the Group are included in level 2 (2011: all included in level 2).

16 Deferred income tax

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

	2012 £m	2011 £m
1 January	**1,595**	1,880
Credited to income statement[1]	**(18)**	(70)
Credited to income statement – change in tax rate[2]	**(133)**	(138)
Credited to equity	**(15)**	(76)
Charged/(credited) to equity – change in tax rate	**5**	(1)
Transferred to held-for-sale	**(224)**	-
31 December	**1,210**	1,595

[1] Includes £19 million tax charge (2011: £3 million tax credit) relating to discontinued operations
[2] Includes £19 million (2011: £18 million) tax credit relating to discontinued operations

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**	**Post employment benefits £m**	**Other £m**	**Total £m**
1 January 2012	1,226	435	9	8	31	1,709
(Credited)/charged to income statement	(50)	10	-	(29)	(4)	(73)
(Credited)/charged to income statement – change in tax rate	(98)	(29)	(1)	(1)	(3)	(132)
Credited to equity – change in tax rate	-	(6)	-	-	-	(6)
Transferred to held-for-sale	(125)	(99)	-	4	(4)	(224)
Transferred to deferred income tax assets	-	-	-	18	-	18
31 December 2012	**953**	**311**	**8**	**-**	**20**	**1,292**

Deferred income tax assets

	Financial instruments £m	**Post employment benefits £m**	**Total £m**
1 January 2012	(114)	-	(114)
Charged to the income statement	55	-	55
Credited to equity	(15)	-	(15)
Credited to the income statement – change in tax rate	(1)	-	(1)
Charged to equity – change in tax rate	11	-	11
Transferred from deferred income tax liability	-	(18)	(18)
31 December 2012	**(64)**	**(18)**	**(82)**

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

16 Deferred income tax *continued*

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

	Year ended 31 December 2012 £m	Year ended 31 December 2011 £m
Cash flow hedge reserve	**(4)**	(69)
Tax relating to indexation of operating land	**1**	(3)
Retained earnings	**(7)**	(5)
	(10)	(77)

The Finance Act 2012 enacted a reduction in the main rate of UK corporation tax from 25% to 24% with effect from 1 April 2012 and from 24% to 23% with effect from 1 April 2013. As a result, the Group's deferred tax balances, which were previously provided at 25%, have been re-measured at the rate of 23% in the year ended 31 December 2012. This has resulted in a reduction in the net deferred tax liability of £128 million, with £133 million credited to the income statement and £5 million charged to reserves.

17 Provisions

	Disposal of operations £m	**Reorganisation costs £m**	**Pensions £m**	**Other £m**	**Total £m**
1 January 2012	1	3	22	7	33
Utilised	(1)	(3)	-	(5)	(9)
Charged to income statement	-	2	-	3	5
Movement in pensions	-	-	73	-	73
31 December 2012	**-**	**2**	**95**	**5**	**102**
Current	-	2	95	-	97
Non-current	-	-	-	5	5
31 December 2012	**-**	**2**	**95**	**5**	**102**
Current	1	3	22	3	29
Non-current	-	-	-	4	4
31 December 2011	1	3	22	7	33

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 2013.

Pensions

The closing provision is the share of the net deficit of the LHR Airports Limited defined benefit pension scheme and Unfunded Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities allocated to the Group's airports and HEX.

At 31 December 2012, £92 million represents the share of the LHR Airports Limited defined benefit pension scheme deficit (2011: surplus of £32 million classified in Debtors – Amounts owed by group undertakings – pensions). The remaining £23 million (2011: £22 million) is held for historical accumulated past service pension costs borne by LHR Airports Limited in relation to Unfunded Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities. The movement in the year is mainly due to the LHR Airports Limited defined benefit pension scheme moving from a surplus to a deficit position.

For more information on pension costs 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 2012 £m	31 December 2011 £m
Non-current		
Deferred income	**4**	1
	4	1
Current		
Deferred income	**31**	31
Trade payables[1]	**102**	136
Other tax and social security	**6**	8
Other payables	**30**	6
Capital payables	**263**	250
Amount owed to group undertakings – operating[2]	**18**	26
	450	457

1 Trade payables are non-interest bearing and are generally on 30-day terms.
2 Amounts owed to group undertakings largely relate to external payments made by LHR Airports Limited under the Shared Services Agreement on behalf of the Group's airports.

19 Assets held-for-sale

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

	£m
Property, plant and equipment	**692**
Investment property	**577**
Prepayments	**3**
Inventories	**2**
Trade and other receivables[1]	**31**
Cash at bank	**26**
Total assets classified as held-for-sale	**1,331**
Trade and other payables	**(29)**
Deferred tax liabilities	**(224)**
Provisions	**(20)**
Total liabilities classified as held-for-sale	**(273)**
Net assets of disposal group	**1,058**

1 Includes trade receivables of £27 million, £16 million were fully performing, a further £11 million were past due, up to 3 months, but not impaired and are expected to be fully recovered.

During 2012 a sale process commenced for Heathrow Finance plc's interest in Stansted Airport Limited. It is anticipated that this transaction will be completed by the end of February 2013. The Group considers that this transaction satisfies the requirements of IFRS 5 - 'Non-current assets held-for-sale and discontinued operations'. As a consequence, assets and liabilities of £1,331 million and £273 million respectively have been reclassified as held-for-sale.

Heathrow Finance plc (Formerly BAA (SH) plc)

Notes to the Group financial statements for the year ended 31 December 2012 *continued*

20 Share capital

	£
Authorised	
At 1 January 2012 and 31 December 2012: 9,500,000,000 ordinary shares of £1 each	9,500,000,000
Allotted and fully paid	
In issue at 1 January 2012 and 31 December 2012: 3,109,350,689 ordinary shares of £1 each	3,109,350,689
In issue at 31 December 2012 3,109,350,689 ordinary shares of £1 each	**3,109,350,689**

21 Other reserves

The revaluation reserve relates to the historic revaluation of investment properties that existed upon adoption of IFRS.

On 21 June 2012 the shareholders and directors of Heathrow Airport Limited approved a capitalisation of £718,000,000 of Heathrow Airport Limited's revaluation reserve. This is considered to recognise all of the revaluation reserve in Heathrow Finance plc's group balance sheet as the amount related principally to historical revaluation at Heathrow Airport Limited.

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

22 Fair value reserve

	Fair value reserve £m
1 January 2012	(396)
Fair value losses	(373)
Transferred to income statement	310
Deferred tax on fair value loss	15
Change in tax rate	(11)
31 December 2012	**(455)**

23 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 2012			Year ended 31 December 2011		
	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	**(373)**	**86**	**(287)**	(393)	98	(295)
Transferred to income statement	**310**	**(71)**	**239**	103	(25)	78
Change in tax rate	**-**	**(5)**	**(5)**	-	1	1
Tax relating to indexation of operating land	**-**	**-**	**-**	-	3	3
Other comprehensive income	**(63)**	**10**	**(53)**	(290)	77	(213)
Current tax	**-**	**-**	**-**	-	-	-
Deferred tax	**-**	**10**	**-**	-	77	-
	-	**10**	**-**	-	77	-

24 Retained earnings

	£m
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
1 January 2012	(1,746)
Net profit for the year	116
Dividends paid	(346)
Transfer from revaluation reserves to profit and loss reserves[1]	365
Change in tax rate on investment properties and operating land	6
31 December 2012	**(1,605)**

[1] On 21 June 2012 the shareholders and directors of Heathrow Airport Limited approved a capitalisation of £718,000,000 of Heathrow Airport Limited's revaluation reserve. This is considered to recognise all of the revaluation reserve in Heathrow Finance plc's group balance sheet amounting to £365,000,000 as the amount related principally to historical revaluation at Heathrow Airport Limited.

25 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 2012		31 December 2011	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**14**	**50**	12	50
Within two to five years	**48**	**164**	44	208
After five years	**23**	**880**	31	996
	85	**1,094**	87	1,254

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 commitments classified as 'other' relates to electricity supply equipment at the airports leased on agreement with UK Power Networks Services Ltd ('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.

Non-cancellable operating lease commitments – Group as a lessor

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

	31 December 2012		31 December 2011	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**99**	**-**	72	-
Within two to five years	**259**	**-**	236	-
After five years	**1,638**	**-**	1,730	-
	1,996	**-**	2,038	-

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.

25 Commitments and contingent liabilities *continued*

Non-cancellable electricity purchase commitment

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

	31 December 2012 £m	31 December 2011 £m
Within one year	**5**	30
Within two to five years	**-**	5
	5	35

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 2012 £m	31 December 2011 £m
Contracted for, but not accrued:		
Terminal 2 - Heathrow	**625**	1,051
Western baggage product - Heathrow	**52**	46
Terminal restoration and modernisation - Heathrow	**29**	14
Capacity optimisation - Heathrow	**20**	8
IT projects - Heathrow	**15**	5
Major foam tenders – Stansted	**1**	3
Rolling Stock refresh/rebrand – Heathrow Express	**-**	11
	742	1,138
Other projects	**53**	8
	795	1,146

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. Heathrow has a £5.3 billion (in 2007/08 prices) capital investment programme in respect of the current regulatory period that now ends on 31 March 2014 following its extension by one year. Capital expenditure at Heathrow in the year ending 31 December 2013 is expected to be over £1.3 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.

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 2013 is forecast to be approximately £20 million.

Other commitments

The Group has operated blight compensation schemes relating to properties that might be affected by potential future runway developments at Heathrow and Stansted. However, these schemes were closed following the change in government policy in relation to runway developments in South East England. Heathrow has a remaining commitment to purchase one property at 31 December 2012. All properties purchased under these schemes are included within investment properties at a value of £129 million as at 31 December 2012 (2011: £125 million).

In June 2006, the government announced its conclusions for the 2006-2012 night flights regime at the Group's airports. The government was expected to consult on proposals for the post 2012 night flights regime during 2011. However, the government is conducting a consultation and review of aviation policy which includes reference to noise insulation and mitigation schemes. In addition they have announced that the existing night flights regime has been extended until October 2014. The process for replacing the existing night flights regime is expected to involve two stages, an initial consultation in 2012 and a further consultation in 2013 which will set out specific proposals for the new regime taking into account the revised aviation policy. Until these review processes are complete, the Group is unable to quantify potential future noise insulation and mitigation obligations.

The trustees of the LHR Airports Limited defined benefit pension scheme and the Group concluded the pension scheme's 30 September 2010 triennial valuation in December 2011 and agreed a schedule of cash contributions of £97 million per annum (out of which £24 million related to deficit reduction) that became effective from 1 January 2012. Following the disposal of Edinburgh Airport Limited, the cash contributions have been reduced to £94 million per annum for 2013 and 2014. All but approximately £10 million of the new annual amount will be met by the Group's airports.

25 Commitments and contingent liabilities *continued*

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 £1 million at 31 December 2012 (2011: £206 million).

26 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 2012 £m**	Restated[1] Year ended 31 December 2011 £m
Operating activities			
Net loss before tax		**(16)**	(251)
Adjustments for:			
Finance income	*4(a)*	**(250)**	(220)
Finance costs	*4(a)*	**962**	1,002
Fair value (gain)/loss on financial instruments	*4(b)*	**(108)**	46
Impairment		**5**	-
Depreciation[2]	*2*	**461**	463
Amortisation	*2*	**13**	9
Exceptional costs[2]	*2,3*	**-**	11
Fair value gain on investment properties	*1(c)*	**(50)**	(47)
Increase in trade and other receivables		**(17)**	(30)
Increase in inventories		**(1)**	(3)
(Decrease)/increase in trade and other payables		**(14)**	20
Decrease in provisions		**(3)**	(8)
(Decrease)/increase in deferred income		**(4)**	1
Difference between pension charge and cash contributions		**(49)**	(28)
Exceptional pension charge		**152**	33
Exceptional working capital settlement of intercompany balance[3]		**-**	47
Cash generated from continuing operations		**1,081**	1,045

[1] Comparative information has been restated to include Stansted airport in discontinued operations. See Note 6.
[2] Reflects £11 million accelerated depreciation presented within exceptional items.
[3] Reflects a one-off £47 million improvement in working capital following the implementation in 2011 of the new Heathrow Airport Holdings Group cash management process that resulted in cash in transit to the Group being received faster.

27 Related party transactions

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

	Year ended 31 December 2012 Sale of goods and services £m	Year ended 31 December 2011 Sale of goods and services £m
Swissport/Groundstar	**-**	1

	Year ended 31 December 2012 Purchase of goods and services £m	Year ended 31 December 2011 Purchase of goods and services £m
Ferrovial Agroman	**93**	39
Amey Community Limited	**23**	23
HETCo[1]	**257**	223
	373	285

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

Balances outstanding with related parties were as follows:

	31 December 2012		31 December 2011	
	Amounts owed by related parties £m	**Amounts owed to related parties £m**	Amounts owed by related parties £m	Amounts owed to related parties £m
Amey Community Limited	**-**	**-**	-	2
HETCo[1]	**-**	**29**	-	32
	-	**29**	-	34

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

The related parties outlined above are related through ownership by the same parties. The transactions relate primarily to construction projects.

The Group enters into transactions with LHR 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 statement of financial position amounts is known they are disclosed in the relevant statement of financial position 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.

28 Ultimate parent undertaking and controlling party

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

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (33.65%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (13.29%), Baker Street Investment Pte Ltd (11.88%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. and Alinda Airports L.P. (11.18%) (investment vehicles managed by Alinda Capital Partners) and Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation).

The Group's results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2012, 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 2012.

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

29 Subsidiaries

The subsidiaries of the Group are as follows:

Holding companies
Heathrow (SP) Limited
Heathrow (AH) Limited †

Airport owners and operators
Heathrow Airport Limited†
Stansted Airport Limited†

Other
Heathrow Funding Limited †#
Heathrow Express Operating Company 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.

30 Post balance sheet events

After challenging for a number of years the proportionality of the disposal remedies imposed by the Competition Commission resulting from its inquiry into the supply of UK airport services by the Group, a disposal process for Stansted airport commenced in August 2012 which led to the announcement since the year end that the airport is being sold to Manchester Airports Group for £1,500 million. The sale is expected to complete by the end of February 2013.

Heathrow Finance plc (Formerly BAA (SH) plc)

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Independent auditor's report to the members of Heathrow Finance plc

We have audited the parent company financial statements of Heathrow Finance plc for the year ended 31 December 2012 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 2012 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 Heathrow Finance plc for the year ended 31 December 2012.

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

22 February 2013

Heathrow Finance plc (Formerly BAA (SH) plc)

Company balance sheet as at 31 December 2012

	Note	**31 December 2012 £m**	31 December 2011 £m
Fixed assets			
Investment in subsidiary	*2*	**3,009**	3,009
Total non current assets		**3,009**	3,009
Current assets			
Debtors (due after more than one year £942m (2011: £672m))	*3*	**960**	684
Cash at bank and in hand		**1**	1
Total current assets		**961**	685
Creditors: amounts falling due within one year	*4*	**(15)**	(14)
Net current assets		**946**	671
Total assets less current liabilities		**3,955**	3,680
Creditors: amounts falling due after more than one year	*5*	**(717)**	(538)
Net assets		**3,238**	3,142
Capital and reserves			
Called up share capital	*6*	**3,109**	3,109
Profit and loss reserve	*7*	**129**	33
Total equity		**3,238**	3,142

The financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 22 February 2013. They were signed on its behalf by:

José Leo
Director

Andrew Efiong
Director

Accounting policies for the year ended 31 December 2012

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.

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

Investment in subsidiaries
Investment in subsidiaries 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.

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.

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

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 2012. The results are also included in the audited consolidated financial statements of Heathrow Finance plc for the year ended 31 December 2012 (the smallest group to consolidate these financial statements). They are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2012. 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.

Notes to the Company financial statements for the year ended 31 December 2012

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 £442 million (2011: £33 million).

2 Investment in subsidiary

	£m
1 January 2012 and 31 December 2012	**3,009**

The Company's subsidiary undertaking is Heathrow (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 30 of the Heathrow Finance plc group financial statements.

3 Debtors

	31 December 2012 £m	31 December 2011 £m
Due within one year:		
Interest receivable from group undertakings	**18**	12
	18	12
Due after more than one year:		
Amounts owed by group undertakings - interest free[1]	**74**	74
Amounts owed by group undertakings - interest bearing[2]	**868**	598
	942	672
Total debtors	**960**	684

[1] Amount owed by group undertakings – interest free relates to the loan receivable from Heathrow (DSH) Limited.
[2] Amounts owed by group undertakings - interest bearing relates to the debenture payable by Heathrow (SP) Limited which is used to fund interest on the Company's bond and loan facilities. As at 31 December 2012, the rate on the debenture was 6.83% (2011: 6.91%). The decrease in the interest rate is primarily due to the issuance by Heathrow Finance plc of a fixed rate bond with a lower coupon in December 2012 and lower Libor rates in the year on its loan facilities.

4 Creditors: amounts falling due within one year

	31 December 2012 £m	31 December 2011 £m
Interest payable	**11**	11
Group relief payable	**4**	3
	15	14

5 Creditors: amounts falling due after more than one year

	31 December 2012 £m	31 December 2011 £m
Secured		
Bonds	**592**	318
Loan facilities	**125**	220
	717	538

As at 31 December 2012, the fair value of the non-current borrowings above was £759 million (2011: £534 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.

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

6 Share capital

	£
Authorised	
At 1 January 2012 and 31 December 2012: 9,500,000,000 ordinary shares of £1 each	9,500,000,000
Called up, allotted and fully paid	
In issue at 1 January 2012 and 31 December 2012: 3,109,350,689 ordinary shares of £1 each	**3,109,350,689**

7 Profit and loss reserve

	£m
1 January 2012	33
Profit for the financial year	442
Dividends paid	(346)
31 December 2012	**129**

8 Auditor's remuneration

Audit fees are recharged in accordance with the group SSAs into the operating entities. This entity is not an operating entity and is therefore not party to the SSAs and receives no recharge of the audit cost. However, the Company's auditor received £21,000 (2011: £20,000) as remuneration for the audit of the Company's financial statements, the cost of which is borne by LHR Airports Limited.

Details of fees for other services are provided in Note 2 of the Heathrow Finance plc group financial statements.

9 Employee information and directors' remuneration

Employee numbers

The Company has no employees (2011: nil).

Directors' remuneration

Details of directors' remuneration for the year are provided in Note 2 of the Heathrow Finance plc group financial statements.

10 Ultimate parent undertaking and controlling party

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

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (33.65%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (13.29%), Baker Street Investment Pte Ltd (11.88%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. and Alinda Airports L.P. (11.18%) (investment vehicles managed by Alinda Capital Partners) and Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation).

The Company's results are also included in the audited consolidated financial statements of Heathrow Finance plc for the year ended 31 December 2012, which is the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited and FGP Topco Limited for the year ended 31 December 2012.

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

11 Post balance sheet events

After challenging for a number of years the proportionality of the disposal remedies imposed by the Competition Commission resulting from its inquiry into the supply of UK airport services by the Group, a disposal process for Stansted airport commenced in August 2012 which led to the announcement since the year end that the airport is being sold to Manchester Airports Group for £1,500 million. The sale is expected to complete by the end of February 2013.

Registered office

Heathrow Finance plc, The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW
Registered in England Number: 06458635