

ANNUAL REPORT AND FINANCIAL STATEMENTS 2019

HEATHROW FINANCE PLC ANNUAL
REPORT AND ACCOUNTS

COMPANY REGISTRATION NUMBER:
06458635



OUR PURPOSE

TO MAKE EVERY
JOURNEY BETTER

OUR VISION

TO GIVE PASSENGERS
THE BEST AIRPORT SERVICE
IN THE WORLD

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STRATEGIC REPORT


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AT A GLANCE

Heathrow flies into the 2020s having landed nine consecutive years of growth

Heathrow soared to the best year in its history welcoming a record 80.9 million passengers in 2019 (+1% vs 2018). The share of UK exports handled through Heathrow increased to 40%, strengthening our position as the UK's biggest port. Despite record performance, the case for a new runway at Heathrow was strengthened as new figures revealed Paris Charles de Gaulle is set to overtake Heathrow as Europe's largest airport within the next two years.



80.9m
(+1.0%) passengers



New investments and cutting-edge technology boost passenger experience

Visitors to the UK have received a first-class welcome following Heathrow's investment of over £12 billion in private money to boost the experience – including building Terminal 2 and rolling out e-Gates, enhanced security scanners and a new digital tower. Skytrax crowned Heathrow's terminals as world's best seven times in the last ten years, with 82% of passengers rating Heathrow as "Excellent" or "Very Good".



Healthy financial performance

Heathrow remains in strong financial health: revenues climbed 3.4% to £3.1 billion on the back of increased demand to fly – supporting an additional £856 million of investment into the airport in 2019. Adjusted EBITDA rose 4.5% to £1.9 billion. Remaining competitive in the lead-up to expansion continues to be a priority: strict operating cost discipline while prioritising service, operational resilience and investment in growth has driven adjusted costs per passenger pre IFRS 16 up 5.1% to £14.86. Strong balance sheet and liquidity position extended to October 2021.



Expansion of Heathrow

Heathrow intends to submit its expansion planning application towards the end of 2020 after unveiling detailed investment plans in 2019 that focused on securing lower airfares and more airline competition.



Heathrow eyes zero-carbon future after starting 2020s on carbon-neutral footing

In January, Heathrow became carbon-neutral and started working towards operating zero-carbon airport infrastructure by the mid-2030s. It remains clear that unless expansion meets strict environmental targets, no additional capacity can or will be used.

KEY FINANCIAL INDICATORS

REVENUE

£3,070m

Revenue is an indicator of Heathrow's top-line growth. It consists of aeronautical income, which is generated from fees charged to airlines for use of the airport's facilities, and retail and other income from a variety of other sources. Passenger growth continued to contribute to increases in revenue which grew 3.4% in the year.

2019	3,070
2018	2,970
2017	2,884

ADJUSTED EBITDA¹

£1,920m

Adjusted EBITDA is an indicator of how Heathrow is delivering top-line revenue growth while remaining efficient and controlling operating costs. Adjusted EBITDA is profit before interest, taxation, depreciation, amortisation and fair value gains and losses on investment properties. A focus on efficiency combined with revenue growth resulted in adjusted EBITDA growth of 4.5%.

2019	1,920
2018	1,837
2017	1,760

PROFIT BEFORE TAX

£578m

Profit before tax is a measure of total return generated before taxation. Profit before tax grew by 17.8% in the year.

Profit before tax includes non-cash fair value movements on investment properties and financial instruments. These movements can cause significant fluctuations year on year.

2019	578
2018	491
2017	605

REGULATORY ASSET BASE¹

£16,598m

The Regulatory Asset Base (RAB) is a regulatory construct, based on predetermined principles not based on IFRS. It represents the capital invested in Heathrow for which we earn a regulated return. By investing efficiently in our airport, and constructively engaging with airlines, we add to our RAB over the long-term and this in turn contributes to delivering shareholder value.

Heathrow continues to invest in its operations and the RAB increased 2.5% in the year.

2019	16,598
2018	16,200
2017	15,786

CONSOLIDATED NOMINAL NET DEBT¹

£14,361m

Consolidated nominal net debt is a measure of indebtedness used by our financiers.

Net debt increased in the period reflecting continued investment in Heathrow.

2019	14,361
2018	13,980
2017	13,673

KEY OPERATIONAL INDICATORS

PASSENGERS

80.9m

The sum of all arriving and departing passengers.

To beat our plan, we aim to maximise the number of passengers we serve in a year while providing best possible service. We welcomed a record 80.9 million passengers travelling through the UK's only hub airport, up 1.0% on last year.

2019	80.9
2018	80.1
2017	78.0

PASSENGER SATISFACTION

4.17

An independent passenger satisfaction survey that compares Heathrow's performance against 350 airports worldwide. Passengers rate their experience with a score out of 5.00, where one is 'poor' and five is 'excellent'. Our vision is to give passengers the best airport service in the world. We achieved a record high level of passenger satisfaction in 2019.

2019	4.17
2018	4.15
2017	4.16

DEPARTURE PUNCTUALITY

78.5%

The number of flights that depart from their stand within 15 minutes of the scheduled time.

Departure punctuality improved to 78.5% in the current year, contributing to our plan to transform customer service.

2019	78.5%
2018	77.6%
2017	80.2%

BAGGAGE CONNECTION

99.0%

To improve service for every 1,000 passengers (direct and connecting) we measure the percentage who successfully travelled with their bags on the same flight. We put a great passenger experience at the heart of what we do; our operational ambition is 'every passenger, every bag, every time'.

99.0% of bags successfully connected in the current year.

2019	99.0%
2018	98.8%
2017	99.0%

LOST-TIME INJURIES

0.34

We measure the number of lost-time injuries for every 100,000 hours worked in the last 12 months. In their working life a person works an average of 100,000 hours.

We want everyone at Heathrow to go home safe and well to their loved ones at the end of each day. Lost time from injuries was broadly stable in 2019 at 0.34.

2019	0.34
2018	0.33
2017	0.48

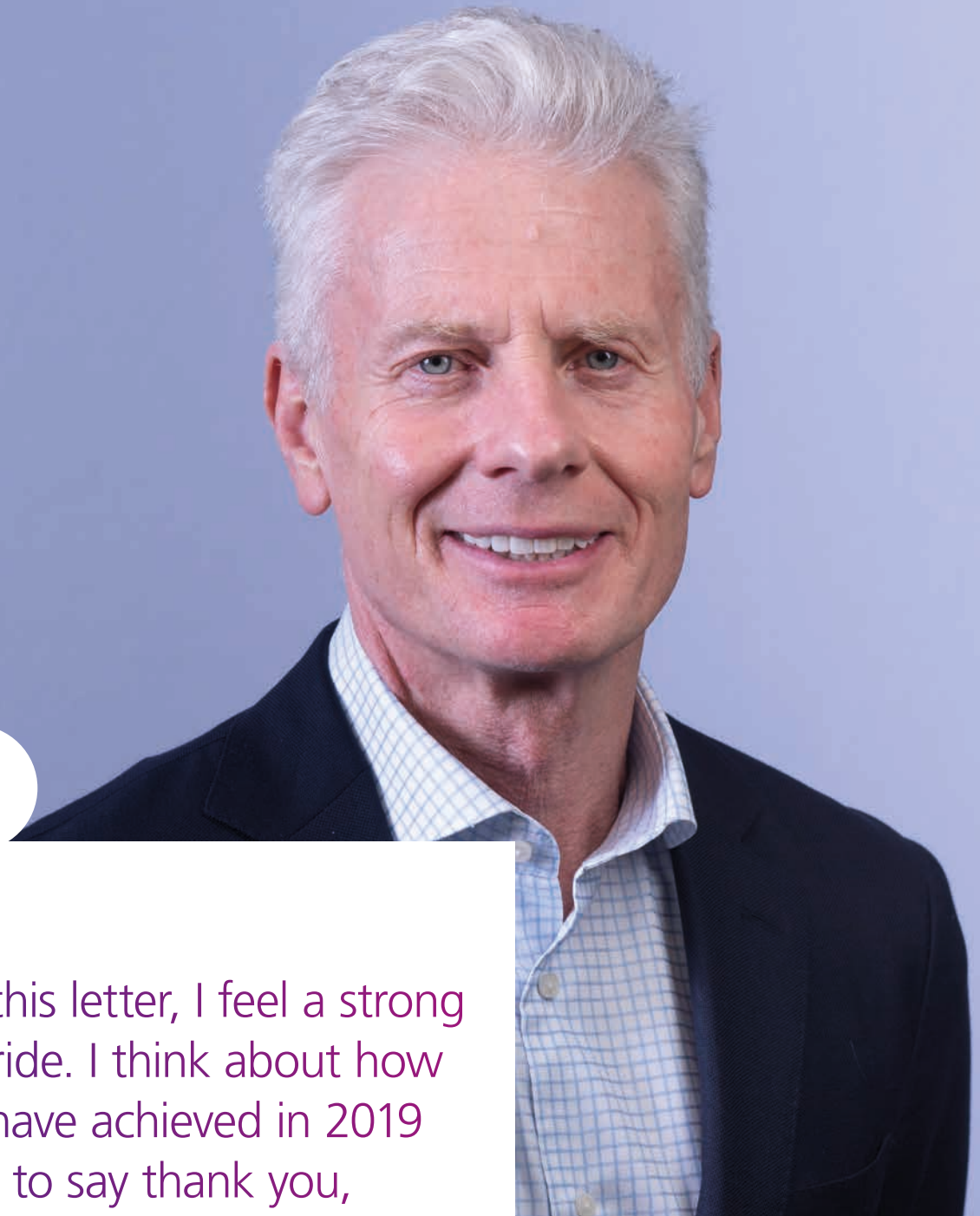
¹ Alternative Performance Measures (APMs): the performance of the Group is assessed using a number of APMs. Management believe the APMs provides investors with an understanding of the underlying performance of the Group, while recognising that information on these additional items is available within the financial statements should the reader wish to refer to them. APMs are discussed in detail and defined on page 185 of the financial statements.

CHAIRMAN'S LETTER



Dear All,

As I write this letter, I feel a strong sense of pride. I think about how much we have achieved in 2019 and I want to say thank you, with deep gratitude to our nearly 7,000 colleagues and to our broader Team Heathrow - 76,000 colleagues strong today.



Each and every one of you has been and will continue to be instrumental in making every passenger journey better.

2019 marks the end to an excellent decade of delivery for Heathrow. Over the decade, Heathrow has welcomed an additional 15 million annual passengers (23% up in an already congested airport) and opened Terminal 2, The Queen's Terminal which is now ranked by passengers as one of the best airport terminals in the world and the global benchmark for airport sustainable facilities, powered entirely by renewable energy. We served as Britain's front door as the United Kingdom welcomed the world's athletes and many excited fans ahead of the London 2012 Olympics, a very important milestone for me personally. Over the decade, we welcomed over 740 million passengers while becoming a much more efficient and resilient business. Our talented entrepreneurs and companies expanded their trade and thrived globally through the 16.6 million tonnes of cargo that travel through Heathrow, the biggest port in the United Kingdom. Since 2009, adjusted operating costs per passenger have decreased 24% in real terms, while at the same time, our ASQ service levels increased from 3.78 to 4.17. We were also able to more than double our Adjusted EBITDA. Recognised as the best airport in Western Europe and amongst the top 10 globally, we are very proud of our transformation which was facilitated by over £12 billion of private investment and no cost to the taxpayer.

We continue delivering on our promises of being an exemplar employer and neighbour, with the airport leading the way on the London Living Wage accreditation and supporting many young apprentices from the local area in their training and career development through our Heathrow Academy. The decade concluded with Parliament making a landmark decision that would transform the airport's future, as MPs overwhelmingly voted in favour of expansion. We are confident that our expansion plan is sustainable, affordable,

financeable and deliverable. After completing the consultation on our Draft Preferred Masterplan and issuing our Initial Business Plan, our plans to deliver the so desperately needed airport capacity are ready to go.

Climate change is at the forefront of our mind. We are committed to growing sustainably and I am proud that we started this new decade by becoming one of the first major airports to go carbon-neutral. The solution to this complex and existential threat must come from the aviation industry itself, with well-informed authorities prepared to enforce action firmly if we don't deliver as a community at speed. We are determined that Heathrow will take a lead in reducing the emissions our sector makes, not just by continuing to transform our business, but by using our scale and influence to jointly define a new paradigm for the way our supply chain, airlines and airports around the world operate.

2020 opens a new decade and it is with excitement that I look forward to the opportunities ahead of us. By the end of this new decade of delivery, a third runway would have given Britain more hub capacity, making this country a winner and one of the best-connected in the world. An expanded Heathrow will create more much needed global connections between our country and the big economies of the 21st century – the United States of America, India and China - and unlock materially cheaper airfares for passengers by bringing more airline competition and choice. Our expansion will deliver significant economic benefits to all the U.K. including thousands of new skilled jobs at no cost to the taxpayer and will put all of Britain at the heart of global trade in a way that aligns with the Committee on Climate Change's net zero 2050 target.

2019 has been the best year ever for Heathrow and the service we have offered to our customers. The 2020s promise to be another exciting decade for Heathrow, so fasten your seat belts and prepare for another extraordinary journey with us.

LORD PAUL DEIGHTON
Chairman



HISTORY OF HEATHROW

For over 70 years, we have been an integral part of the UK and its history. From a private airfield to one of the world's busiest international hub airports, a lot has changed in that time.

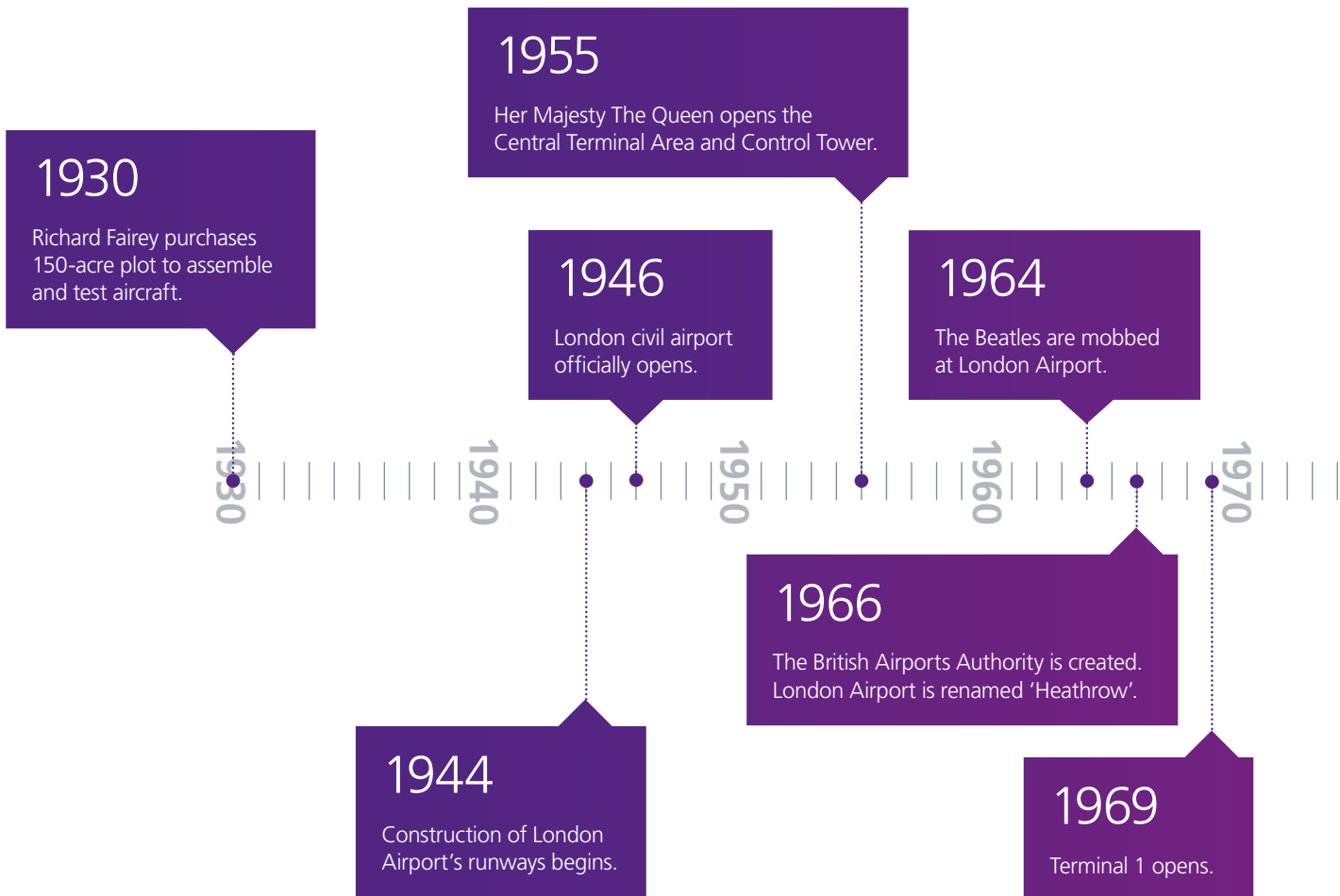
In 1930, British aero engineer and aircraft builder Richard Fairey paid the Vicar of Harmondsworth £15,000 for a 150-acre plot to build a private airport to assemble and test aircraft.

During World War II the government requisitioned land in and around the ancient agricultural village of Heath Row, including Fairey's Great West Aerodrome, to build RAF Heston, a base for long-range troop-carrying aircraft bound for the Far East. An RAF-type control tower was constructed and a 'Star of David' pattern of runways laid, the longest of which was 3,000 yards long and 100 yards wide.

Work demolishing Heath Row and clearing land for the runways started in 1944. However, by the time the war had ended the RAF no longer needed another aerodrome and it was officially handed over to the Air Ministry as London's new civil airport on 1 January 1946. The first aircraft to take off from Heathrow was a converted Lancaster bomber called Starlight that flew to Buenos Aires.

The early passenger terminals were ex-military marquees which formed a tented village along the Bath Road. To reach aircraft parked on the apron, passengers walked over wooden duckboards to protect their footwear from the muddy airfield. There was no heating in the marquees, which meant that during winter it could be bitterly cold. By the close of our first operational year, 63,000 passengers had travelled through London's new airport.

By 1951 passengers had risen to 796,000 and British architect Frederick Gibberd was appointed to design permanent buildings for the airport.



The focal point of Gibberd's plan was a 122ft-high control tower. There was also a passenger terminal called the Europa Building (later renamed Terminal 2) and an office block called the Queens Building.

In 1969, Terminal 1 opened, by which time five million passengers a year were passing through the airport as the jet age arrived with Boeing 707s, VC10s and Tridents taking travellers from Heathrow to and from all parts of the world.

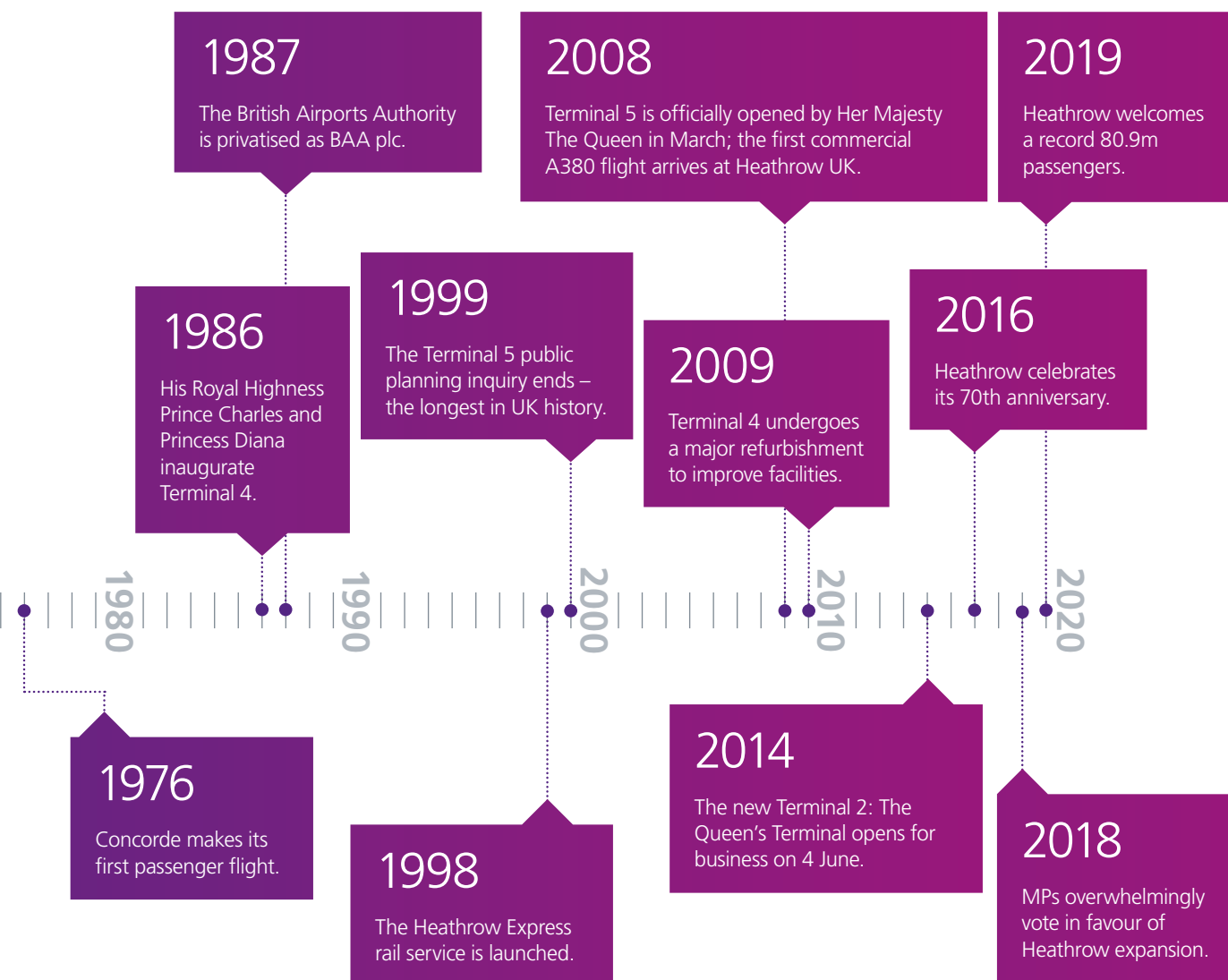
The 1970s marked the decade when the world became even smaller thanks to Concorde and wide-body jets such as the Boeing 747. As the decade drew to a close, 27 million passengers were using Heathrow annually. Demand for air travel also created the need for another terminal, Terminal 4, which opened for business in 1986.

By the time we celebrated our 60th anniversary in 2006 we had served around 1.4 billion passengers on over 14 million flights.

Terminal 5 opened in March 2008 and marked the beginning of an exciting new chapter for Heathrow. The brand-new Terminal 2: The Queen's Terminal opened for business on 4 June 2014.

Today, as recognised by Skytrax, we are the best airport in Western Europe and amongst top 10 globally. We are also one of the world's busiest international airports, and the UK's only hub airport, with over 80 million passengers travelling through the airport annually on services offered by 82 airlines travelling to over 200 destinations in over 80 countries.

We look forward to continuing our story, and continuing to connect all of the UK to global growth.

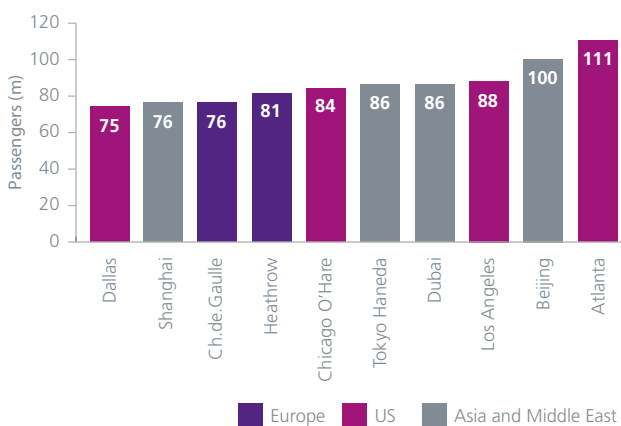


OUR BUSINESS



WHAT WE DO

We are a service business which seeks to give passengers the best airport service in the world. We are the UK's only hub airport. Hub airports combine direct passengers, transfer passengers and freight to enable long-haul aircraft to fly to destinations all over the world. These destinations could not be served by point-to-point airports which rely on local demand alone. We currently are the busiest passenger airport in Europe and the seventh busiest airport globally.



Top 10 busiest global airports 12 months to 31 December 2019

In 2019, we served a record 80.9 million passengers (2018: 80.1 million) completing our ninth consecutive year of passenger growth.

We serve a range of market segments, including business and leisure travellers, direct and transfer passengers, and long and short-haul routes operated by a diverse range of major airlines. As well as earning aeronautical income from airlines, we also generate income from a variety of other sources. They include concession fees from retail operators, income from car parks, advertising revenue, rents from property space and income from the provision of airport facilities and transportation services, notably the Heathrow Express rail service.

We maintain a strong focus on operational performance, improving the passenger experience and investing in new and upgraded facilities. This focus and investment has resulted in Heathrow being named 'Best Airport in Western Europe' by Skytrax for the fifth consecutive year and 'World's Best Airport Shopping' for the tenth consecutive year in 2019.

Sustainability is core to our growth strategy. We have launched Heathrow 2.0, a long-term sustainability strategy which sets out a series of ambitious targets to deliver sustainable growth and to drive positive change throughout the aviation industry, as well as at the airport itself.

As part of our Heathrow 2.0 plan for sustainable growth, we have recently published our new carbon plan showing how we will act over the next ten years, alongside airlines, manufacturers, governments and passengers. It includes clear goals that will help us to get our own emissions to net-zero, help the whole industry achieve a net-zero future and use our scale to help the wider economy decarbonise too.

Further details of our commitment to sustainable growth can be found on pages 30 to 47.

INVESTMENT AND INFRASTRUCTURE

We have invested over £12 billion of private money at no cost to taxpayers transforming Heathrow's infrastructure since privatisation in 2006, including £856 million invested in 2019 (2018: £793 million).

To support and develop Heathrow's role as the UK's only hub airport, we will continue to enable the success of the major network airlines operating at Heathrow. We will do so by investing in further capacity, operational flexibility and resilience.

Improving the passenger experience is supported by ongoing investment in modern airport facilities and operating processes.

Terminals

Each of our four operational terminals is either new or recently refurbished. The busiest terminals are Terminals 2 and 5. Terminal 2, which opened in June 2014, served 18.9 million passengers in 2019 (2018: 18.5 million) and Terminal 5 served 32.8 million passengers in 2019 (2018: 32.8 million). Our total terminal capacity is currently estimated to be 85 million passengers per year.

We have a total of approximately 58,600 square metres of retail space served by over 450 retail outlets.

Runways

Our two parallel runways generally operate in 'segregated mode', with arriving aircraft allocated to one runway, and departing aircraft to the other. To mitigate noise impact to residents living below the approach and departure routes, the runways for arriving and departing aircraft are normally swapped at around 15:00 each day, or as weather conditions dictate.

The airport is permitted to schedule up to 480,000 air-traffic movements (ATMs) per year. In 2019 we operated at 99.1% (2018: 99.1%) of this cap.

Other infrastructure

We own railway infrastructure including stations, tunnels, rolling stock and track from Heathrow as far as Airport Junction on the Great Western Mainline.

We also own public car-park spaces that are available to passengers and the general public. The terminals and their approaches provide advertising space, which yields further income.

REGULATORY ENVIRONMENT

We are subject to economic regulation by the Civil Aviation Authority (CAA), which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection. As the economic regulator for UK airports, the CAA assesses the market power of airports and if an airport passes the market power test(s) set out in the Civil Aviation Act 2012 (the 'Civil Aviation Act'), the airport is regulated by means of a licence. Heathrow has been determined, by the CAA, to hold significant market power and operates under a licence granted by the CAA in February 2014. The licence includes a price cap on Heathrow's airport charges.

The economic regulation is designed to allow the UK's regulated airports to generate revenues which are sufficient to finance their operating and capital expenditure requirements, and provide a regulated rate of return on their RAB. Each regulatory period usually lasts five years.

The Economic regulation sees the CAA setting the maximum level of airport charges for Heathrow using a per-passenger price-cap mechanism (RPI +/- X) which incorporates an allowed return on the RAB.

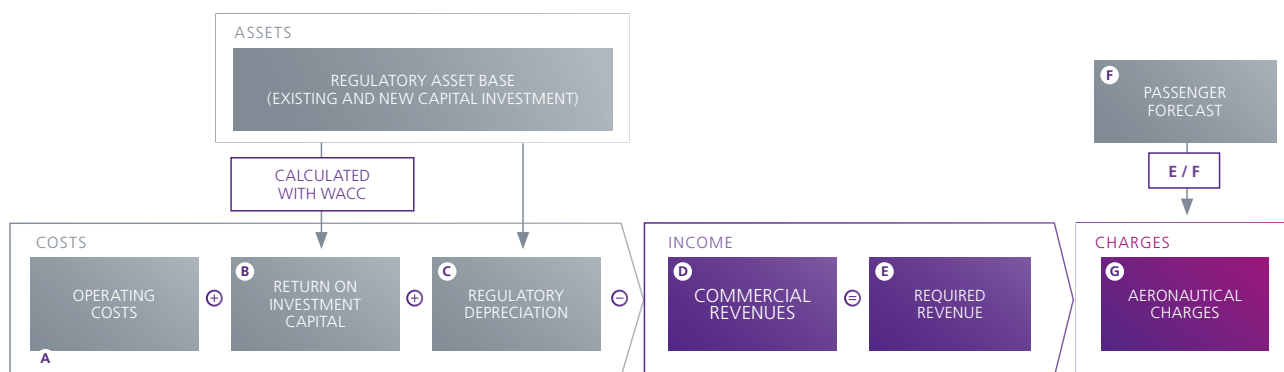
The building blocks of this 'Single Till' calculation are illustrated on the following page. The CAA first determines the regulated 'revenue requirement'. This is calculated as the sum of all our forecast costs (including operating expenditure, the required return using the cost of capital determined by the CAA on the forecast RAB and regulatory depreciation) less projected non-aeronautical revenue. The resulting revenue requirement is divided by forecast passenger numbers to produce the per passenger maximum allowable yield.

Our regulation is consistent with the economic regulation of other UK regulated industries (such as telecoms and the energy sector). This form of economic regulation is sometimes referred to as 'incentive regulation', in that Heathrow has an incentive to invest in better facilities for consumers and outperform the economic settlement by attracting more passengers, reducing operating costs or delivering higher commercial revenues. In the opposite case, we must absorb negative financial impact, with no adjustment for shortfalls in our passenger numbers or additional costs unless agreed with the CAA.

The regulatory environment provides cash flow predictability which supports external investment. Other key factors and protections include:

- The CAA has the statutory duty to set a return that secures financeability of our operations.
- Building blocks rebase at the start of every regulatory period which restricts long term risk exposure.
- Certainty and defined timing for recoverability of capital investments through the RAB.
- Pricing and asset value linked to inflation (RPI).
- Some protection against exceptional circumstances, for example changes in security regulation proposed by the government, changes in traffic mix, intra-period movements in property rates costs and capital investment risk in early phases of maturity.

OUR BUSINESS (CONTINUED)



Building blocks for maximum allowable yield calculation

2019 REGULATORY DEVELOPMENTS

In November, the CAA extended our economic licence until the end of 2021 to better align the next regulatory period (H7) with the overall expansion timetable and related statutory process. The period encompassing 2020 and 2021 is known as Interim H7 (iH7). A Commercial Airline Agreement defining the rebate on aeronautical charges that will be applicable during iH7. This agreement is reflected in the extended licence.

The agreement is built by overlaying fixed and volume-based rebates onto an extension of the existing RPI-1.5% price path and regulatory framework. The deal aims to incentivise airlines to maximise the use of current congested capacity ahead of new capacity being released.

Later in December, we submitted our Initial Business Plan (IBP) to the CAA. Expansion will unlock material reductions in airfares by injecting airline competition and choice. The plan is sustainable, affordable, financeable and deliverable and sets out our aspirations to offer what we understand consumers want while addressing the constraints from our other key stakeholders including our airline partners, local communities, colleagues and investors. Through engagement, we have identified two bookend options contrasting cost and service. The first option prioritises savings by releasing additional capacity faster while the second option prioritises service with more emphasis on rail and service improvements. Through expansion, it is estimated that airfare savings could be between £21 to £142 per ticket depending on which option is chosen. Our plan also proposes an evolution to the regulatory framework by extending the price control period to 15 years. The longer horizon aims to balance predictability, risk and flexibility. We propose fixing the cost of equity for the duration of the price control while implementing periodic or performance-based resets for some building blocks such as passenger forecasts, operating expenses and commercial revenue to ensure creditors don't take additional risk. Feedback on our IBP is being collected from the Consumer Challenge Board, our airline partners and other key stakeholders at the time of this report. This feedback will be reflected in our Final Business Plan ('FBP') due to be published in the second half of 2020.

Lastly, in January 2020 the CAA published a further consultation on the regulatory framework and financial issues related to H7. The CAA outlines the importance of setting price control arrangements that are consistent with our credit rating commitments and the importance of providing longer

term regulatory certainty. It also signalled that it will use the most up to date information from the Competition and Markets Authority regarding the National Air Traffic Services '(NATS)' En-route Limited (NERL)'s case when defining the WACC for H7. We continue engaging on these issues with the CAA and will respond to the consultation by 5 March 2020.

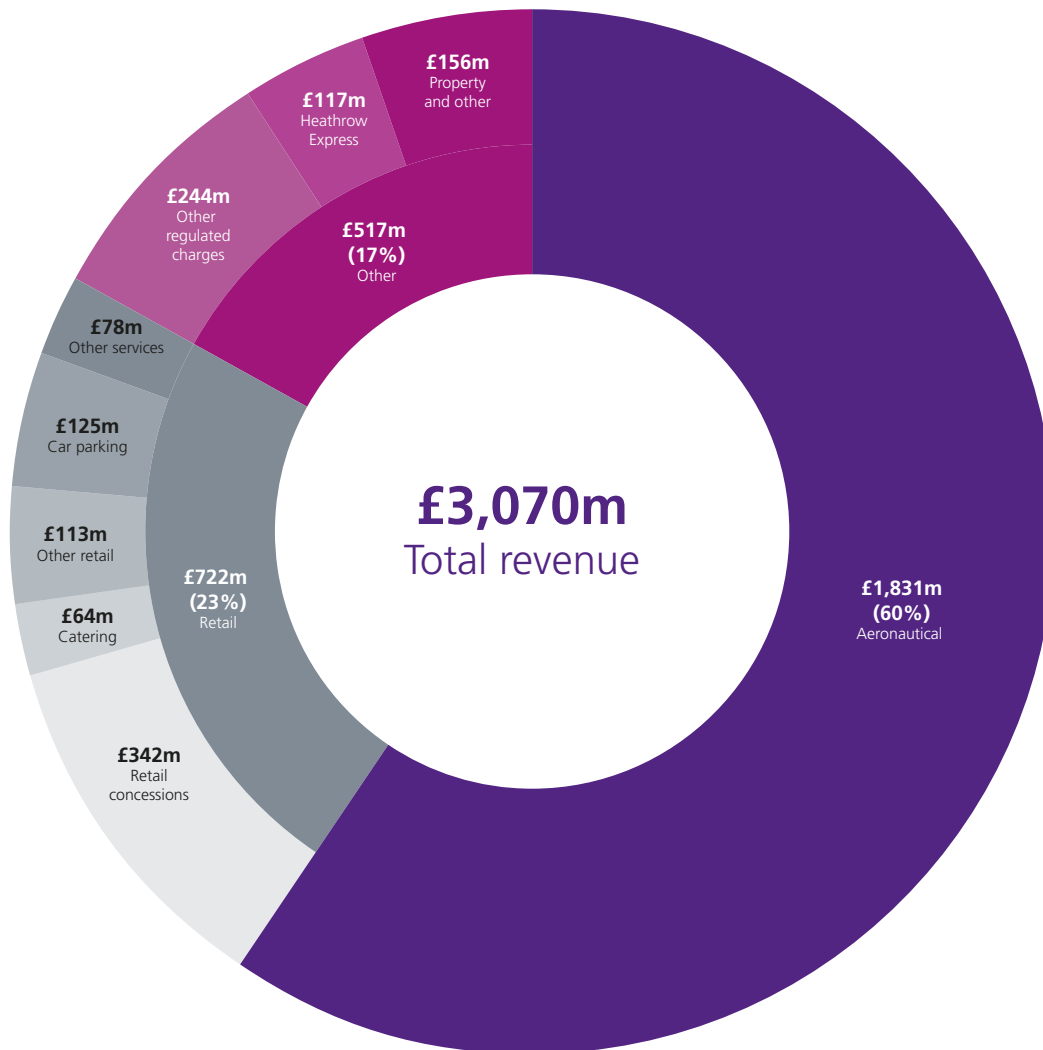
SUMMARY OF CURRENT REGULATORY AND LEGAL CHALLENGES TO EXPANSION

The publication of the CAA policy document (December 2019) on the early design and construction costs associated with expanding Heathrow – category B and early category C costs – represents further progress towards providing the regulatory certainty necessary to deliver an expanded Heathrow. We are concerned though that some proposals do not represent a balanced set of incentives needed for investment. This will be reflected in our upcoming response to the consultation. A final decision and policy statement from the CAA is currently expected to be received in April or May 2020.

The Court of Appeal judgement is awaited on the current judicial review proceedings against the Secretary of State for Transport relating to the Government's decision to designate the Airports National Policy Statement. We remain of the view that a robust process has been applied to date, including the extensive evidence gathered by the independent Airports Commission, multiple rounds of public consultation and the overwhelming vote in Parliament.

If the appeal were to go against the Secretary of State for Transport, depending on the detail of the judgement, we will carefully consider our next course of action.

We have concluded expansion is probable and therefore it is appropriate to have recognised £450m of spend to date as an asset in the course of construction. Our current plan assumes that investment will continue growing in 2020 to c£1 billion as set out in the Investor Report published on 20 December 2019. If either the policy statement setting out the CAA's final decisions does not resolve our concerns, or the Airports National Policy Statement is set aside in the event of an adverse court judgement against the Secretary of State for Transport, a reassessment of the probability of expansion occurring would take place. If the likelihood of expansion occurring were no longer considered probable, the expansion related capital investment incurred as of the date of reassessment would be required to be impaired and expensed to the income statement.



It should also be noted that we expect most of the assets will remain in the Regulatory Asset Base and continue to generate a return through the regulatory framework.

GENERATING REVENUE

We generate two primary types of income: aeronautical income, which is generated from fees charged to airlines for use of the airport's facilities, and retail and other income from a variety of other sources.

AERONAUTICAL INCOME

Aeronautical income reflects the fees charged by Heathrow to the airport's airline customers. The tariff structure can vary in consultation with stakeholders, but includes three key elements:

Passenger charges, based on the number of passengers per aircraft, and levied in respect of all departing passengers. There is no charge for crew members. Charges vary by route area (European, domestic and rest-of-world) and type (transfer and non-transfer passengers).

Landing charges, levied for substantially all aircraft (with certain diplomatic and other flights being exempted). These are calculated in accordance with the certified maximum take-off weight, and adjusted, where applicable, in accordance with each aircraft's noise-rating, emissions and the time of day. Incentives are provided for quiet, and clean, aircraft. Airlines pay a penalty for movements in the core night period (23.30-06.00).

Parking charges, levied for each 15-minute slot after 30 and 90 minutes (narrow and wide-bodied aircraft respectively).

RETAIL AND OTHER INCOME

The 'Single Till' means that higher retail and other income reduces per-passenger charges. Retail and other income is generated from a variety of sources. These include:

- Concession fees from retail operators.
- Direct income from car parks, advertising revenue and premium products.
- The rental of airport property space such as aircraft hangars, warehouses, cargo storage facilities, maintenance facilities, offices and airline lounges.
- The provision of facilities such as baggage handling and passenger check-in.
- Fare revenue from the Heathrow Express rail service.

OPERATING REVIEW



Within two years, Charles de Gaulle will overtake Heathrow as the biggest airport in Europe. Heathrow's new runway is ready to turn 'global Britain' into more than just a campaign slogan. It's the key to the UK's success after Brexit and will ensure we stay ahead of our European rivals. Expansion will be built within legally-binding environmental targets, creating lower airfares for passengers, connecting every corner of Britain to global growth and all at no cost to the taxpayer. It's time to get on with it.

JOHN HOLLAND-KAYE
Chief Executive Officer



REVIEW OF THE YEAR

2019 marked the end of a transformational decade for Heathrow as we welcomed a record 80.9 million passengers. Our traffic grew by nearly 25% in the past ten years and we significantly enhanced our passenger experience despite being severely capacity-constrained. Over £12 billion of private money made all of this possible. We invested in our colleagues, in better facilities, better processes and resilience. We have also taken a leading role in tackling one of the biggest challenges of our times: climate change. All of this paid off for our passengers and has earned us a place among the best-rated airports in the world today. This is a position of which we can be proud but cannot take for granted. To continue delivering our vision and give passengers the best airport service in the world, we need to expand Heathrow. The last decade was pivotal in that process: we won the parliamentary vote for Heathrow expansion, we are finalising our Masterplan and we continue working with our regulator, airline partners, local communities and investors to deliver this once-in-a-generation project.

Zooming into 2019, we continued progressing on all four strategic priorities underpinning our vision to give passengers the best airport service in the world: making Heathrow a great place to work, transforming customer service, beating the business plan and sustainable growth.

Our colleagues are fundamental to the success of our vision, which is why making Heathrow a great place to work and creating careers where people can fulfil their potential remains at the very heart of our strategy. In the last 12 months, 1,648 colleagues (2018: 755) attended training to advance their managerial skills and 210 colleagues (2018: 263) were promoted. 1,093 apprenticeships were created as we progressed on our goal to deliver 10,000 apprenticeships by 2030. Since becoming a fully accredited London Living Wage employer in 2017, we continued making progress with our direct supply-chain colleagues: 64 contracts out of 108 have now been updated. Overall, 74% of our colleagues (2018: 73%) agreed that Heathrow is a great place to work.

Investments to transform customer service delivered successful results too. We achieved an all-time high 4.17 out of 5.00 score in the global Airport Service Quality (ASQ) survey over 2019. We also achieved some of the highest levels of baggage connections and departures punctuality in our history. For the fifth year running, Heathrow was named 'Best Airport in Western Europe' as well as 'Best Airport for Shopping' for the tenth year in the most recent Skytrax World Airport Awards.

2019 HIGHLIGHTS

80.9m

Nine years of consecutive passenger growth

£3.1bn

Revenue up 3.4% on last year

210

Colleagues promoted

1,648

Colleagues attended managerial skills training

4.17

Passenger satisfaction (ASQ)

2019 was our ninth consecutive year of passenger growth as we welcomed 80.9 million passengers through the only hub airport in the world's largest aviation market, up 1.0% compared to 2018. We continued to beat the plan with £3.1 billion revenue, up 3.4% on last year. Operating costs remained tightly controlled whilst gearing up for growth. We continued to prioritise safety, security, service and resilience. This drove a 5.1% increase in adjusted operating costs per passenger pre IFRS 16. Our adjusted EBITDA rose 4.5% to £1.9 billion as a result. We raised £2.1 billion of debt financing globally in 2019 including a 15-year €650m bond issuance and our inaugural JPY transaction in December. Financing activities highlighted global investors' continued confidence in Heathrow's credit and kept cementing strong financial foundations ahead of expansion.

We contribute proactively in the delivery of the UN Sustainable Development Goals by 2030 and have achieved significant milestones to grow Heathrow sustainably today and in the future. We made further progress on decarbonising the airport's infrastructure: in January 2020 we became carbon-neutral. We are working towards operating zero-carbon airport infrastructure by the mid-2030s, and have shared our plan to play our part in decarbonising the aviation industry over the coming decades. We were delighted to see our achievements recognised by edie's 'Mission Possible: Sustainable Business of the Year' award.

OPERATING REVIEW (CONTINUED)

In late 2019, we published our Initial Business Plan, another significant milestone in expanding the airport. It outlines how we will invest to deliver expansion and unlock material reduction in airfares by introducing additional airline competition and choice over the next 15 years. The plan is built on strongly-evidenced consumer views and includes two 'bookend' options which contrast service and cost by prioritising service or savings. We remain on track to submit our DCO application later in 2020. We continue engaging with our regulator and airline stakeholders to define the regulatory framework that will enable an expansion that is sustainable, affordable, financeable and deliverable.

KEY MANAGEMENT CHANGES

Management changes this year include Fidel Lopez resigning as a Non-Executive Director of the Board on 30 January 2019. He was replaced by Maria Casero on the same date. RT Hon Ruth Kelly was appointed as a Non-Executive Director of the Board on 8 April 2019. Rachel Lomax stepped down from the HAHB Board on 23 February 2020, having served just over nine years on the Board.

OUTLOOK

The outlook for our adjusted EBITDA performance in 2020 remains materially consistent with the forecast set out in the Investor Report published on 20 December 2019. We also forecast to maintain comfortable covenant headroom.

We are concerned about the global impact of the COVID-19 virus and are closely monitoring its impact on our business and stakeholders. At this point, and based on our central case, we do not expect this to have a material negative impact on our financial results. We will continue to monitor the situation carefully over the coming months and will provide updates in our quarterly results and semi-annual investor report.

2020 marks the beginning of an ambitious decade, with new private investment helping us to deliver a third runway which will give the UK's hub airport more capacity than our competitors in France or Germany, making us one of the best-connected airports in the world. Regular, direct flights to all the major cities in the US, India and China – the great economies of the 21st century – linked via the expanded hub at Heathrow to the regions and nations of the UK will ensure the whole of the country is at the heart of global trade. We look forward to delivering this economic growth that will help level up the UK in a way that unlocks an even better experience for passengers through cheaper tickets, and which, crucially, aligns with the Committee on Climate Change's net-zero 2050 target.

JOHN HOLLAND-KAYE

Chief Executive Officer

25 February 2020



OUR STRATEGY

Our vision is to give passengers the best airport service in the world.

HEATHROW'S STRATEGIC FRAMEWORK

Who we are

Our strategic framework ensures that our purpose is at the heart of what we do. It reminds us of our priorities and values which reflect a simple business logic: engaged people deliver excellent service. Excellent service is our differentiator that makes passengers more likely to choose Heathrow again.











What we want

Our Strategic Brief sets out our high-level aspirations for the future of Heathrow for all our strategic stakeholder groups. Our Client Brief translates the aspirations for our stakeholder groups held in the Strategic Brief into specific requirements.

How we are going to achieve it

Our Masterplan is our long-term, high-level development plan agreed with our stakeholders. Our Management Business Plan contains the actions and resources we need to deliver our strategy. Our Initial and Final Business Plan reflects consumers views and provide the plan and building blocks for the next regulatory period.



WHO WE ARE	VISION	To give passengers the best airport service in the world
	PURPOSE	Making every journey better
	PRIORITIES	   
	VALUES	     
WHAT WE WANT	STRATEGIC BRIEF	Our high-level aspirations for the future of Heathrow for all our strategic stakeholder groups
	CLIENT BRIEF	Translates the aspirations for our stakeholder groups held in the Strategic Brief into specific requirements
HOW WE ARE GOING TO ACHIEVE IT	MASTERPLAN	The long-term plan for the layout of an expanded Heathrow
	MANAGEMENT AND INITIAL/FINAL BUSINESS PLAN	The consumer outcomes, action and resources we need to deliver our strategy including over the next regulatory period



ANDREW MACMILLAN
Chief Strategy Officer

OUR STRATEGY (CONTINUED)

Our priorities explained



MOJO

To be a great place to work, we will help our colleagues fulfil their potential and work together to lead change across Heathrow with energy and pride.



TRANSFORM CUSTOMER SERVICE

To deliver the world's best passenger experience, we will work with the Heathrow community to transform the service we give to passengers and airlines, improving punctuality and resilience.



BEAT THE PLAN

To secure future investment, we will 'beat the plan' and deliver a competitive return to shareholders by growing revenue, reducing costs and delivering investments efficiently.



SUSTAINABLE GROWTH

To grow and operate our airport sustainably, now and in the future.

Our values explained



KEEPING EVERYONE SAFE

We look after everyone. We never compromise on safety or security and do the job properly first time, every time. We're committed to safety as the foundation of an efficient operation and a secure airport. We know safety and security are essential for a great passenger experience.



TREATING EVERYONE WITH RESPECT

We celebrate diversity and respect others. We're friendly, polite and considerate. We value everyone's contribution. We support our people so they can care for others.



GIVING EXCELLENT SERVICE

We put a great passenger experience at the heart of what we do. We take time to understand what our passengers and our airlines really want. We are the best we can be and deliver what we promise.



WORKING TOGETHER

We're one airport team. We develop excellent working relationships and bring out the best in each other. We work constructively with each other and our airlines, partners and local communities. We look for win-win outcomes that benefit Heathrow and our partners.



IMPROVING EVERY DAY

We aim higher. We all play our part in achieving great financial results. We always look to keep things simple, reduce costs and improve efficiency. We regard every pound spent as if it were our own.



DOING THE RIGHT THING

We're honest, open and fair, and act with integrity. We're responsible in the way we do business. We challenge the status quo, tell it like it is and speak out if we have a concern. We have the tough conversations, make the right decisions, stand by our word and do what we say we will.



OUR STAKEHOLDER GROUPS

The strategic framework also sets our aspirations for each of the five strategic stakeholder groups (passengers, colleagues, airlines, investors, UK communities and environment) and the key components of our Heathrow Ecosystem (statutory authorities, supply chain and commercial partners).

The full Strategic Brief can be found on our website at: <https://www.heathrow.com/company/about-heathrow/company-information/heathrows-strategic-brief>



OUR STRATEGY (CONTINUED)

PERFORMANCE AGAINST STRATEGIC PRIORITIES



MOJO

We want Heathrow to be a great place to work. We provide an environment where colleagues feel safe, proud, motivated and enjoy what they do. In 2019 74% (2018: 73%) of colleagues agreed Heathrow is a great place to work through our Mini Pulse survey. We continued

building strong leadership capability in 2019, 210 colleagues (2018: 263) were promoted and 1,648 colleagues (2018:755) attended training and development programmes.

We want everyone to go home safe and well to their loved ones. In 2019, our lost-time injuries metric was broadly stable at 0.34 (2018: 0.33). Targeted action plans are in place to drive down injuries such as sharps-related injuries and those sustained while searching vehicles at control posts.

We have recently agreed a pay deal with our unions. The deal secures stable and fair terms and conditions for our colleagues until 2022 while remaining competitive.

We delivered...

- Awarded a £10m share in success pay-out to front line colleagues.
- Provided 1,648 colleagues with managerial skills training.
- Continued progress on moving our direct supply chain to London Living Wage.
- Set up the Colleague Engagement Forum, empowering colleagues across the business to help make Heathrow a great place to work.
- Awarded Disability Confident Leader status.
- Created a cancer support network.

...and we will do more

- Transition 100% of suppliers to London Living Wage.
- Invest in our future workforce through apprenticeships.

PERFORMANCE INDICATORS

Lost-time Injuries¹

2019	0.34
2018	0.33
2017	0.48

Colleague engagement¹

2019	74%
2018	73%
2017	74%

¹ Number of lost-time injuries for every 100,000 hours worked (Lost-time injuries); mini-Pulse colleague survey results (Colleague engagement).





TRANSFORM CUSTOMER SERVICE

We continue to deliver strong levels of service across our passengers' journey. Our service standards remain high, despite passenger growth putting pressure on some key processes such as check-in, security, immigration, and baggage.

In 2019, we achieved a record ASQ rating of 4.17 out of 5.00 (2018: 4.15) compared to 3.84 out of 5.00 in 2010. In addition, 82% of passengers surveyed rated their Heathrow experience 'Excellent' or 'Very good' (2018: 82%). These scores illustrate not only the strength and resilience of our operations but also the benefits of our continued investments. For instance, passengers are enjoying upgraded Wi-Fi facilities and a transformed immigration experience as a result of newly installed e-Gates. Closure of the cargo tunnel caused connections satisfaction to decline to 4.14 out of 5.00 (2018:4.16).

We delivered...

- Received Skytrax award for the 'Best Airport in Western Europe' and 'Best terminal in the world'.
- Installed anti-drone systems.
- Upgraded the airport to superfast Wi-Fi.
- Installed new immigration e-Gates.
- Launched new routes increasing domestic connectivity (eg Newquay, Guernsey, Isle of Man).
- First full year of our Service Signatures programme which seeks to improve customer service.

...and we will do more

- Roll-out of end-to-end biometrics.
- Wider roll-out of advanced CT security scanners.

PERFORMANCE INDICATORS

Passenger satisfaction (ASQ)²

2019	4.17
2018	4.15
2017	4.16

Departure punctuality²

2019	78.5%
2018	77.6%
2017	80.2%

Security queuing²

2019	96.3%
2018	96.8%
2017	97.3%

Baggage connection²

2019	99.0%
2018	98.8%
2017	99.0%

Connections satisfaction (QSM)²

2019	4.14
2018	4.16
2017	4.16

² Airport service quality (ASQ); percentage of flights departing within 15 minutes of schedule (Departure punctuality); percentage of passengers passing through central security within five-minute period (Security queuing); percentage of connecting bags travelling with our passengers (Baggage connection); quality of service monitor (QSM).

OUR STRATEGY (CONTINUED)



BEAT THE PLAN

NEW INTERCONTINENTAL ROUTES

New routes were announced to North America by British Airways: Pittsburgh and Charleston. British Airways also announced new routes to Kansai,

Dammam and Valencia. We also had new routes announced to Bali from Garuda Indonesia and Sialkot from Pakistan International Airline.

RECORD PASSENGER TRAFFIC

During 2019, we welcomed 80.9 million passengers, an increase of 1.0% (2018: 80.1 million) and our ninth consecutive year of record passenger traffic. Aircraft continue to fly fuller, with load factors increasing to the highest we have ever seen at 80.0% (2018: 79.4%). Nevertheless one in five seats remain empty, which provides a significant growth opportunity prior to expansion. The average number of seats

per passenger aircraft also increased to 213.7 (2018: 213.4) driven by aircraft upgrades on European and Middle Eastern routes throughout the year.

Intercontinental traffic grew by 2.2%. Intercontinental growth continues to be driven by North America, through increased load factors and frequencies, additional services and new routes such as Pittsburgh and Charleston. Africa traffic also grew strongly due to additional services to Marrakesh, Seychelles, Durban and Johannesburg. Middle East traffic increased due to larger aircraft and increased load factors. Asia Pacific traffic declined due to Jet ceasing operations early in the year. Short-haul traffic declined slightly by 0.3% driven by European traffic with a number of carriers reducing services. Domestic traffic grew 0.9% with new routes to Newquay, Guernsey and Isle of Man.

Our cargo volumes declined 6.6% compared to 2018 reflecting the general weakness in the global market in 2019. Our cargo operation reached capacity in 2018 and we do not expect volumes to increase materially until the capacity constraints are resolved by expanding Heathrow.

We delivered...

- Agreed commercial airline deal which incentivises load factor.
- Grew passengers numbers to 80.9 million.
- Submitted our Initial Business Plan to CAA which covers a 15 year price control period.
- Re-launched Heathrow.com and a new digital led shopping experience.

...and we will do more

- Submit our Final Business Plan.
- Prepare the business for growth referred to as 'Project Magenta'.
- Seek further cost efficiencies and benefit from the economies of scale which come from growth.

Passengers (millions)	2019	2018	Var. %
UK	4.8	4.8	0.9
Europe	33.2	33.3	(0.5)
North America	18.8	18.1	4.1
Asia Pacific	11.4	11.5	(1.1)
Middle East	7.8	7.7	1.2
Africa	3.5	3.3	5.3
Latin America	1.4	1.4	2.3
Total passengers¹	80.9	80.1	1.0

¹ Calculated using unrounded passenger figures.

² Passenger air-traffic movements (ATM) includes commercial flights including scheduled, chartered and cargo and excluding positioning and private flights; load factor is a percentage of seats filled by passengers.

³ Further analysis can be found in the Financial Review on page 51.

Key traffic performance indicators	2019	2018	Var. %
Passenger ATM ²	473,233	472,744	0.1
Load factors (%) ²	80.0	79.4	0.7
Seats per ATM	213.7	213.4	0.2
Cargo tonnage ('000)	1,587	1,700	(6.6)

PERFORMANCE INDICATORS³

Adjusted EBITDA £m

2019	1,920m
2018	1,837m
2017	1,760m



SUSTAINABLE GROWTH

Heathrow 2.0 is our sustainability strategy. It represents a step-change for our business and captures the momentum of an industry-wide shift towards a sustainable future for aviation. Heathrow 2.0 and performance indicators for sustainable growth are discussed in detail in the following section on pages 30 to 47.

We delivered...

- Launched Way2Go a new initiative to cut colleague car use.
- Became the first airport to be a certified sustainable fish airport.
- Added new bus and coach routes.
- Engaged in statutory Masterplan and Airspace Change consultations.
- Achieved carbon-neutral airport infrastructure.

...and we will do more

- World's first airport Ultra Low Emission Zone plans.
- 2019 Sustainability Report to be published.
- Investment in UK natural climate solutions.
- DCO submission.



SUSTAINABILITY HERO

JASVINDER GILL
SECURITY MANAGER

"I formed 'The Sustainability Squad' - group of campus security colleagues committed to making a difference. We're looking to introduce reusable alternatives to single use plastic cups and coffee cups at Campus."

OUR COMMITMENT TO SUSTAINABLE GROWTH



CAROL HUI
Chief of Staff and General Counsel

Heathrow expansion will connect all of Britain to global growth, putting it at the heart of the global economy for generations to come.

But this cannot be achieved at any cost. We need to grow sustainably – delivering the global connections that Britain needs while having a positive impact on local communities and helping to decarbonise the aviation industry. This is what our customers and colleagues expect.

Heathrow 2.0 is our plan for sustainable growth. It sets out how we will improve life for colleagues and communities, contribute to a thriving economy, and help to tackle global challenges including climate change. It supports the ambitions set out in our Initial Business Plan and will help us meet the expectations of our stakeholders, maintain support for our expansion and retain our licence to operate while reducing environmental and social risks to our business.

HEATHROW 2.0 STRATEGY OVERVIEW

Our plan has four pillars, underpinned by 12 objectives and a range of goals and indicators. It covers our own business as well as our role in driving change across the wider industry. It shows how we aim to go beyond mitigation and deliver positive impacts that enable us and those around us to thrive.



In February we were delighted to receive edie's 2019 Mission Possible: Sustainable Business of the Year Award in recognition of our Heathrow 2.0 efforts so far. We were also shortlisted as a finalist for the Business in the Community Responsible Business of the Year 2019 award which recognises businesses taking pioneering steps in sustainability.

SUSTAINABILITY REPORT

In this report we have included 2019 progress against a selection of our 10 flagship goals (the key targets and aspirations from Heathrow 2.0). Our full report on progress and challenges across all 10 flagship goals and 12 objectives of Heathrow 2.0 will be published later in 2020. Our Sustainability Reports are available at www.heathrow.com.

SUSTAINABLE DEVELOPMENT GOALS

The United Nations' Sustainable Development Goals (SDGs) were launched in 2015. They are a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity. To show how our commitments within Heathrow 2.0 support the 17 goals, we have summarised which goals apply to each of the four pillars within this report.

SUSTAINABILITY CULTURE

We have embedded sustainability into our culture through a Leading Sustainable Growth programme for managers and through our governance structures to drive progress on our targets. We are also integrating sustainability into the management of each department to help make it part of our culture across Heathrow. Key aspects include:

- **HAHL Board of Directors¹:** Our Board receives monthly written updates on sustainability performance and risks, and in addition discusses proposed new targets and plans. The H AHL Board¹ also has a dedicated sub-committee which discusses sustainability issues quarterly: the Sustainability and Operational Risk Committee.
- **Executive team:** Our Chief Executive and the Executive leadership team provide strategic direction for the delivery of Heathrow 2.0 through their functions. The Executive team reviews progress against our flagship goals monthly.
- **Our Sustainability Leadership Team:** Ensures that Heathrow 2.0 is embedded and implemented across the business. Its members are senior departmental leaders.
- **Functional leadership:** Each Heathrow function has a senior sustainability lead, selected from the leadership team and accountable for delivery of the department's annual sustainability improvement plan.

¹ The H AHL Board is the Board of Directors of Heathrow Airport Holdings Limited as defined on page 78.

A GREAT PLACE TO WORK

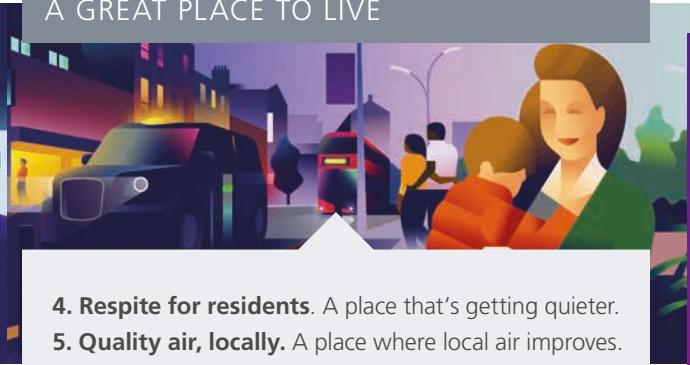


- 1. Safe and well.** A place where everyone can get to their destination and return home, safe and well.
- 2. Careers, not just jobs.** A place where anyone can reach their potential.
- 3. Culture of sustainability.** A place that lives and breathes sustainability.

Heathrow 2.0: 2019 Achievements

- There were 1,093 apprenticeships starting in 2019 (exceeding our target of 400). 175 were facilitated through the Heathrow Academy.
- Increased the percentage of women in senior management from 33% to 35% and increased the percentage of colleagues from black, Asian and minority ethnic (BAME) backgrounds in senior management from 15% to 17%.
- Raised awareness with colleagues and local schools to celebrate the gifts, talents and employability of people with neuro-developmental conditions.

A GREAT PLACE TO LIVE



- 4. Respite for residents.** A place that's getting quieter.
- 5. Quality air, locally.** A place where local air improves.
- 6. Sustainability communities.** A place where local people shape their future.

Heathrow 2.0: 2019 Achievements

- Announced the world's first airport Ultra Low Emission Zone (ULEZ) to be introduced in 2022 to discourage older, more polluting passenger cars and private hire vehicles from using the roads around Heathrow, improving air quality and reducing congestion.
- Launched Way2Go, a new colleague initiative to help all Team Heathrow colleagues find cheaper, smarter, healthier and greener ways to get to work including car sharing, public transport, cycling and walking.
- The latest noise contour report showed a continued reduction of the overall noise levels with the smallest ever noise footprint (note the most recent available report is from 2018).

A THRIVING SUSTAINABLE ECONOMY

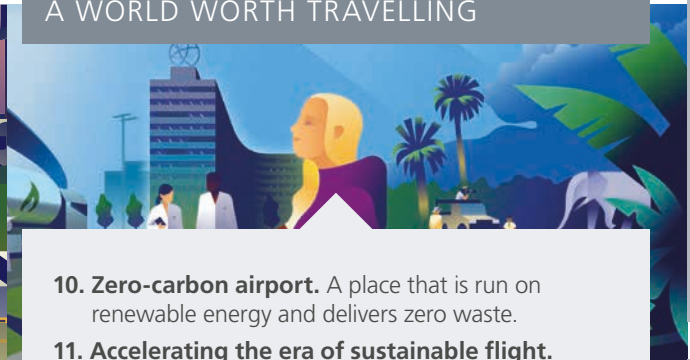


- 7. Connecting the UK.** A place that provides a gateway hub for the UK to the world, and the world to the UK.
- 8. The next economy.** A place that nurtures small and medium sized businesses and social enterprises.
- 9. Sustainable supply chain.** A place that drives change throughout our supply chain.

Heathrow 2.0: 2019 Achievements

- 64 out of 108 contracts were amended to ensure workers in our supply chain receive the London Living Wage, exceeding our target of 49. Over an estimated 1,300 Team Heathrow colleagues benefited from a salary uplift as a result.
- Delivered the third 'World of Opportunity' SME grant scheme, awarding £40,000 in vital seed money to 20 firms to fund international trade missions and foreign market research.
- Became the world's first Sustainable Fish Airport, with all retail business partners at Heathrow adopting a sustainable fish buying policy. This covers four million meals per year.

A WORLD WORTH TRAVELLING



- 10. Zero-carbon airport.** A place that is run on renewable energy and delivers zero waste.
- 11. Accelerating the era of sustainable flight.** A place where innovators work together to deliver carbon-neutral growth.
- 12. Responsible gateway.** A place that strives to end trafficking of people and wildlife.

Heathrow 2.0: 2019 Achievements

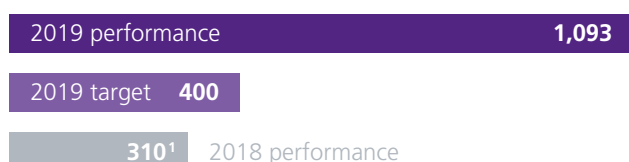
- In 2020, Heathrow became carbon neutral by offsetting our 2018 emissions for the energy used in our terminals.
- Enabled over £500,000 of investment in sustainable innovation projects through direct and partnership funding via our Heathrow Centre of Excellence for Sustainability.
- Trialled new technology to help turn unrecyclable plastic waste into low-carbon fuels.

OUR COMMITMENT TO SUSTAINABLE GROWTH (CONTINUED)

A GREAT PLACE TO WORK

We believe the places we work should provide people with opportunities.

We want everyone who works here to feel they can be happy, motivated and developed in ways which encourage them to flourish.



Total Team Heathrow number of apprenticeships²



Number of apprenticeships arranged through the Heathrow Academy³

CAREERS, NOT JUST JOBS

Flagship goal: 10,000 apprenticeships by 2030 to help people develop skilled and sustainable careers.

Apprenticeships play an important role in building the UK's skills base. To help us achieve our goal of 10,000 apprenticeships by 2030, we launched and funded a shared apprenticeship scheme with our construction supply chain in early 2019. A first for a UK airport, this will allow apprentices at Heathrow to establish a broad range of skills and experience by working with multiple companies to complete their apprenticeship. We also launched a skills partnership to offer over 80 apprenticeship qualifications.

918 apprenticeship starts were independently facilitated by Team Heathrow companies in 2019. These were mainly delivered through a new cabin crew apprenticeship programme that began in 2019. 175 people started their apprenticeships through the Heathrow Academy during 2019. This included 55 apprenticeships with Heathrow Airport Ltd, 29 through the shared apprenticeship scheme and 91 with Team Heathrow companies, facilitated through the Heathrow Academy. This brings the total number of apprenticeship starts to 1,093, far exceeding our target of 400.

Heathrow is developing an apprenticeship delivery plan that will highlight the required number of apprenticeships, in what areas, the level of qualification and when these will be required to meet our goal of 10,000 apprenticeships by 2030.

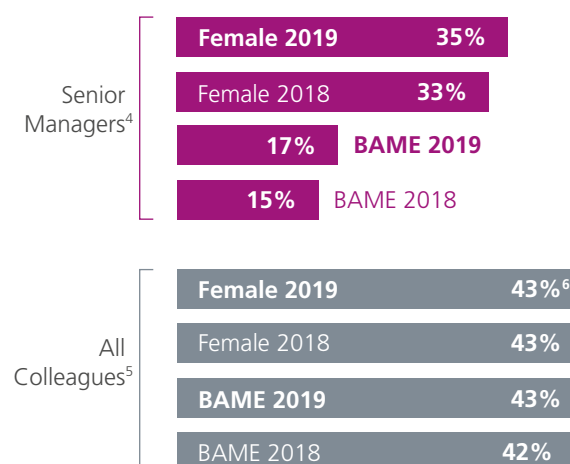
DIVERSITY AND INCLUSION

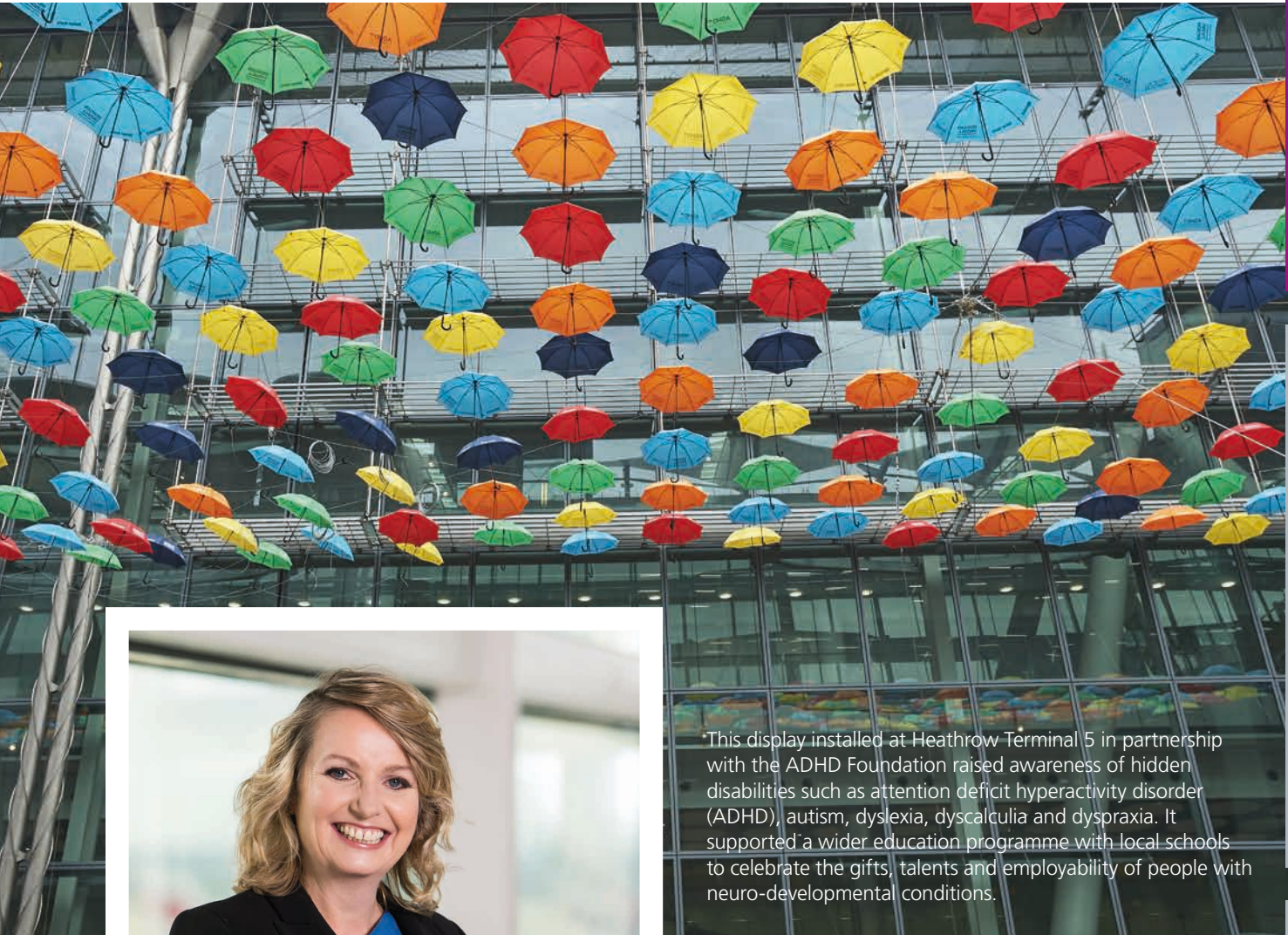
We have a flagship goal to reflect local diversity at every level by 2025 so that we can become a truly great place to work whilst helping local people find careers that can fulfil their potential. During 2019 we agreed a strategy to meet this ambitious goal and we are putting in place actions and measures to progress this.

Our diversity networks help us promote an inclusive culture through events, fundraising and awareness campaigns. They include: Proud, our LGBT+ network; HAND, Heathrow Airport's Network for Disability; en-haNCE our culture and ethnicity network; and Altitude, our gender equality network. Each network has an executive sponsor who acts as mentor and supports the successful implementation of network projects. Network meetings are regularly attended by our CEO and members of our Executive team.

Our 2019 gender pay gap report shows our gap is below the national average. Our mean gender pay gap is 9.8% (compared to 10.5% in 2018) and our median pay gap is 3.0% (compared to 0.6% in 2018). We are making progress to address our gender pay gap, in particular improving female representation in more senior, higher paid roles, by recruiting and promoting women into these roles. We have progressed, but there is still more to do.

While we're proud of these improvements, we are aware that women and colleagues from black, Asian and minority ethnic (BAME) backgrounds remain under-represented in our senior leadership, accounting for 35% and 17% respectively of the most senior roles in 2019. Addressing this is a priority and our approach is summarised in our Sustainability Report.





This display installed at Heathrow Terminal 5 in partnership with the ADHD Foundation raised awareness of hidden disabilities such as attention deficit hyperactivity disorder (ADHD), autism, dyslexia, dyscalculia and dyspraxia. It supported a wider education programme with local schools to celebrate the gifts, talents and employability of people with neuro-developmental conditions.

PAULA STANNETT
Chief People Officer

1 We have restated our data for 2018 which was previously reported as 159 to include additional apprenticeships by Team Heathrow companies
 2 This now reflects additional apprenticeships reported by Team Heathrow companies that were not included in the 2018 Sustainability Report
 3 Measured by number of apprenticeship starts
 4 Executive to band C
 5 All directly employed colleagues of the Heathrow Airport Holdings Limited Group as defined on page 78.
 6 Calculated from total number of colleagues employed by Heathrow Airport Holdings Limited during 2019. The gender pay gap reports 42% which represents colleagues employed at April 2019.

OUR COMMITMENT TO SUSTAINABLE GROWTH (CONTINUED)

A GREAT PLACE TO LIVE



We want to be a responsible neighbour that benefits our local community. We're working with airlines and other partners to reduce the impact of noise and emissions from Heathrow and to support projects that improve quality of life around the airport.

RESPIRE FOR RESIDENTS

Flagship goal: Halve the number of flights on non-disrupted days which operate late after 23.30

2019 performance	257
2019 target	219
2018 performance	268

Late-running aircraft¹

To reduce noise disturbance, we incentivise the use of quieter aircraft and quieter operational procedures, and we work to reduce late-running flights at night. We did not meet our 2019 target due to the influence of factors such as increased air traffic across Europe, air-traffic control resourcing challenges, weather, aircraft technical issues delaying departures as well as capacity restrictions across multiple air-traffic sectors. We have made progress towards our end goal, which is to at least halve the number of flights, to 165, that operate after 23.30 on non-disrupted days. In 2019, 257 flights departed after 23.30 which was a 4% improvement on 2018. In 2019 there were 119 nights with no flights, arrivals or departures between 23.30 and 04.30 (2018: 115). In 2019 we changed the landing noise fee so that it has been divided into landing and departure noise fees. Airlines now pay a factor of five penalty for movements in the core night period (23.30-06.00).

The Heathrow 'Fly Quiet and Green' quarterly league table, recognises the best-performing airlines for noise and emissions, and encourages improvement. The results show that 60% of movements were by aircraft in the quietest chapter and under 1% in the noisiest chapter, demonstrating airlines are swapping in newer, quieter and more efficient aircraft to their fleets, and improving how they fly to Heathrow to decrease noise and emissions.

QUALITY AIR, LOCALLY

We're working to improve air quality for the communities around Heathrow through our Emissions Strategy and Action Plan. This commits us to: improve efficiency and minimise fuel use; employ the latest technologies; and use our size and scale to encourage others to act.

Road vehicles are the main source of local air pollution. We have a goal of 50% of airport passenger journeys made

by public transport by 2030, so local areas can thrive without increased congestion. We will report on progress in our next Sustainability Report.

In May, we announced the world's first airport Ultra Low Emission Zone (ULEZ). From 2022, the Heathrow ULEZ will discourage older, more polluting passenger cars and private hire vehicles from using the roads around Heathrow through charges, improving air quality and reducing congestion. It's the first step towards a wider Vehicle Access Charge (VAC) scheme that will be introduced in the future.

The money raised through the ULEZ will help fund measures to improve sustainable transport modes and public transport access as part of our expansion.

We also have a goal to cut colleague car trips by 25% by 2030. In October 2019 Heathrow launched a new colleague campaign, Way2Go, to help all Team Heathrow colleagues find cheaper, smarter, healthier and greener ways to get to work whether that's car sharing, public transport, cycling or walking. Nearly 2,000 colleagues signed up to receive updates on sustainable travel options and we met with 25 of the largest Team Heathrow companies to discuss how we can work together to change commuting behaviours.

The campaign helps Heathrow to meet our external Airports National Policy Statement (ANPS) targets as well as helping colleagues save money, cut their carbon footprint and boost their physical and mental wellbeing – whether it's for one journey a month or the last mile every day.

To improve the public transport options for colleagues, we have delivered, in partnership with operators, new routes. These include the RA2 to Guildford, the X442 shuttle between Staines and Terminal 5, an extension of the 102 which restores direct connections to Buckinghamshire and launched the 459 serving Iver, Langley and Colnbrook.

To tackle emissions from airside activities, we will establish an airside ultra-low emissions zone by 2025. We have consulted with our airside partners on the standards that we'll require from vehicles in 2025.

SUSTAINABLE COMMUNITIES

We aim to have a positive impact on the communities around Heathrow, supporting projects that make local areas better places to live.

Our Princes Lakes site, for example, includes over 100 acres of woodland and lakes. We have been improving habitats for wildlife on the site through working with the Surrey Wildlife Trust grazing programme and local Scouting and Beaver groups. In recognition of this work, the site received a Biodiversity Legacy Award in 2019 from the Construction Industry Research and Information Association (CIRIA). Heathrow also received the Wildlife Trust's benchmark award for the 12th year running. This represents the long-term commitment we have to our local environment.

¹ Unscheduled departing aircraft operating after 12.30 on non-disrupted days, with the goal seeking to at least halve the number by 2022

A THRIVING SUSTAINABLE ECONOMY



More than 400 businesses operate from or supply goods and services to Heathrow, but our influence stretches far beyond our boundary. As the UK's only hub airport, we have a critical role to play in the national economy – both today and in the future. We want to use our influence to drive change that is ethical, low-carbon and sustainable.

CONNECTING THE UK

By 2033, we want the UK's 100 largest towns and cities to be connected to Heathrow, through direct coach, rail services, and domestic air routes.

In December, we increased our surface-access connectivity to the UK; we are now connected to 64 of the UK's 100 largest towns and cities, with Warrington and Southport now connected via a new coach service, and Lincoln and Harrogate connected through a change to the London North Eastern Railway train timetable. We also launched a new connection to Guildford, thanks to a new RailAir coach link with First Bus. The hourly service connects Heathrow with Guildford train station and is timed to coincide with fast trains from the south.

THE NEXT ECONOMY

Small and medium-sized businesses (SMEs) play an important role in the UK economy as job creators and sources of innovation. We support them to join our supply chain and to showcase their products to Heathrow passengers.

We held our 23rd annual flagship Heathrow Business Summit. This followed a year-long tour consisting of 11 Business Summits in cities across the UK, including Edinburgh, Newcastle, Stoke, Belfast and Cardiff, in conjunction with local business organisations and supported by the Department for International Trade (DIT). These provided opportunities for over 870 SMEs to meet with our largest suppliers and professional trade advisers, and to find out about opportunities around the country connected to Heathrow's expansion.



SUSTAINABILITY HERO

SAM HAVARD
SENIOR ACCOUNT MANAGER

"I worked with our retailers to switch all coffee cups to recyclable paper versions to reduce our single-use plastic waste."

Through our World of Opportunity programme, we also partnered with the DIT to offer 20 SMEs across the UK a grant and export advice to expand their business overseas. This year's winners included a Yorkshire-based family business that produces a range of premium honeycomb chocolate; a Scottish business aiming to simplify access to space; a South West-based pet food business and a social enterprise creating a range of ethically designed, light-reflective adaptable accessories for cyclists and outdoor enthusiasts.

SUSTAINABLE SUPPLY CHAIN

Flagship goal: All our direct supply-chain colleagues working at Heathrow will be transitioned to be paid the London Living Wage by the end of 2020, and we will encourage commercial partners and our supply chain to work towards the London Living Wage, while continuing to give affordable service to our customers.

2019 performance

64

2019 target

49

2018 performance N/A

London living-wage contracts²

We've been a London Living Wage employer since 2017. As we work to move all our direct supply-chain colleagues at Heathrow to the London Living Wage by 2020, we are also removing the use of zero-hours contracts. We have exceeded our target by updating 64 out of 108 supplier contracts included in the scope of our London Living Wage Roadmap, uplifting an estimated 1,300 Team Heathrow colleagues to the Living Wage and protecting an estimated 1,275 through contractual changes during 2019.

SUSTAINABLE RETAIL EXPERIENCE

In 2019, Heathrow became the world's first Sustainable Fish Airport, recognised by Sustain (the alliance for better food and farming). All 37 retail and food suppliers at the airport have signed up, meaning that four million fish meals served at Heathrow each year will now be more sustainably sourced.

² The number of amended and renegotiated contracts to be London Living Wage compliant, with the goal of all direct supply-chain colleagues working at Heathrow to be transitioned by the end of 2020.

OUR COMMITMENT TO SUSTAINABLE GROWTH (CONTINUED)

A WORLD WORTH TRAVELLING

Our world is a joy to travel. But we must do more to protect it if we want to keep enjoying all it has to offer. First and foremost, we have to address carbon. The UK aviation sector including Heathrow has committed to net-zero emissions even as we grow. Heathrow is using its scale and influence globally to lead change towards that goal. The enemy is not aviation but carbon. The UK industry's pathway shows how we can protect the benefits that aviation brings in a world without carbon. As Heathrow we've also set a goal to operate a zero-carbon airport.



SUSTAINABILITY HERO

ALAN SABLE
SECURITY MANAGER

"I launched Heathrow's first hard hat recycling scheme. Over 600 hats have been recycled, with £6k raised for charity!"



SUSTAINABILITY HERO

NZINGA ORGILL
INNOVATION MANAGER

"I ran a trial to develop the world's first electric driverless baggage dolly. We're hoping it will improve efficiency while reducing our emissions."





Heathrow Centre of Excellence working with Lancashire Wildlife Trust on our first restoration project at Little Woollen Moss, part of Chat Moss, a larger wetland area west of Manchester.

OUR CARBON STRATEGY



Climate change is the greatest challenge facing our generation. The goal could not be clearer: we need to get the global economy to net-zero by 2050, if not earlier. That includes the aviation industry.

Aviation is a force for good in the world, helping power economic growth and bring people and cultures together. Heathrow matters because of our role connecting the UK to global growth. Aviation is not the enemy – carbon is.

At Heathrow, we will not shy away from the challenge to protect the benefits of aviation in a world without carbon. Action here matters not just because we must help the UK achieve its net-zero target, but because we can use our status as a major global hub airport to accelerate change in our industry and around the world.

We know that change is possible. While UK passenger numbers have grown by 25% since 2005, there has been a 3% reduction in carbon emissions. However, our ambition must be greater, and the whole aviation industry must make progress faster with the help of Government.

The whole UK aviation sector – airlines, airports and manufacturers – has recently committed to reach net-zero emissions by 2050. That is the target that the Intergovernmental Panel on Climate Change (IPCC) recommend is required to stand the best chance of limiting temperature rises to 1.5 degrees. It is the target that the UK Government has set. Sustainable Aviation's "Pathway to Net-Zero" shows that target can be met even as the industry and Heathrow grow, through a mix of cleaner aircraft and engines, new sustainable fuels and high-quality greenhouse gas removals.

The 2020s is the critical decade in the fight against climate change. The action we all take over the next ten years will determine whether we can reverse the climate emergency.

Definitions

Carbon-Neutral

To offset residual carbon emissions, credits can be purchased from carbon removal projects (such as afforestation) or from paying for activity in other sectors that reduces carbon emissions elsewhere, for example paying for renewable energy projects to replace the burning of fossil fuels.

We became carbon-neutral for airport infrastructure in January 2020.

Net-Zero

This means that the maximum feasible emission-reductions of carbon have been made, and any residual emissions are counterbalanced by an equal volume of carbon removals achieved by purchasing offset credits.

By the end of 2020 we will publish our plan to achieve net-zero for airport infrastructure as soon as possible. Sustainable Aviation has also committed the UK aviation industry to achieving net-zero by 2050.

Zero-carbon airport infrastructure

Generating no carbon from the energy used to run Heathrow, including all our buildings and fixed assets. We are working towards becoming a zero-carbon airport by the mid-2030s.

That's why we have recently published our new carbon plan showing how we will act over the next ten years, alongside airlines, manufacturers, governments and passengers. It includes clear goals that will help us to get our own emissions to net-zero, help the whole industry achieve a net-zero future and use our scale to help the wider economy decarbonise too.

TARGET NET-ZERO: OUR CARBON PLAN

Finishing the job of getting our own house in order

1. We will keep investing until all our airport infrastructure and vehicles are zero-carbon.

Working with our Team Heathrow partners and with passengers to eliminate carbon on the ground

2. We will support business partners to ensure vehicles at Heathrow meet ultra-low emissions standards by 2025 as a step toward a full zero carbon fleet in the future.
3. We will make it easier for the 76,000 people who work at Heathrow, our passengers and all those who travel in our local area to reduce their emissions from travel on the ground.
4. We will become a world-leader in low-carbon construction, setting a clear baseline and ambitious reduction targets to reduce embodied carbon from expansion of the airport. We will offset residual emissions.

Working with our industry partners, Government and passengers to decarbonise flight

5. We will work to build a global aviation industry 'high ambition coalition' with the aim of agreeing a global net-zero emissions target at the ICAO general assembly in 2022.
6. We will help accelerate the production and use of Sustainable Alternative Fuels (SAFs).
7. We will support the development of technologies which can get aviation to fully zero-carbon flight.

Removing carbon from the atmosphere

8. We will help passengers to offset their flights and increase our own investment in natural and technological solutions to remove carbon from the air until aviation reaches net-zero carbon.

We will keep evolving this plan and testing ourselves to go further wherever possible, working with airlines, airports, manufacturers, government and academics to consider what further steps we can take together.

We believe there is scope for the Government to help the aviation industry move faster by supporting the development of new zero-carbon technologies, developing a clear net-zero standard, investing in new public rail schemes and incentivising the development and take-up of more sustainable aviation fuel – for example, through the Air Passenger Duty and promoting offsetting.

To find out more about our Target Net Zero plan visit <http://www.heathrow.com/net-zero>



TOWARDS A NET-ZERO UK

We welcome the UK Government's announcement of a legally binding target of net-zero emissions by 2050 and the Committee on Climate Change's recommendation to include aviation in this target. Our carbon targets are consistent with this objective, and, together with 203 other airports, we support ACI-Europe's (Airports Council International) commitment to achieve net-zero carbon emissions by 2050.

The ACI-Europe commitment also called for the global aviation sector to commit to net-zero. IAG, our largest airline customer, was the first airline group worldwide to commit to net-zero carbon for flight by 2050 and several airlines including Qantas, Etihad and easyJet have also announced such targets. We are working with them, and others to make this the standard in global aviation, to take the carbon out of flying and remove any competitive distortions.

Together with other members, we also support the UK Sustainable Aviation coalition's commitment, announced in January 2020, for UK aviation to achieve net-zero emissions by 2050.

OUR COMMITMENT TO SUSTAINABLE GROWTH (CONTINUED)

Low-carbon aviation in action: highlights of our progress so far



We continue to make progress to cut our own emissions and work with our industry partners to do the same. We also want to be at the forefront of helping people travel in a smarter and cleaner way, helping to catalyse change across the aviation industry. Here are some of the highlights of our progress in 2019.

FINISHING THE JOB OF GETTING OUR OWN HOUSE IN ORDER

We have cut emissions from energy used to power and heat Heathrow by well over 90% since 1990. Heathrow now runs entirely on renewable electricity and green gas. Some of our heat and power is generated on site from one of the UK's largest biomass boilers, run on sustainable woodchip from the local region. Our goal is to operate fully zero-carbon infrastructure by the mid-2030s. To do that we will switch to an electric heat pump system to warm and cool the airport and switch all our vehicles to electric too.

WORKING WITH OUR TEAM HEATHROW PARTNERS AND PASSENGERS TO CUT CARBON ON THE GROUND

MORE EFFICIENT AIRCRAFT MOVEMENT

We are working with airlines and NATS on ways to cut emissions from aircraft. They include encouraging airlines to use a reduced number of engines to taxi to and from the runway, adopting smart airfield design to decrease taxiing distance, using plug-in power and improving take-up of pre-conditioned air (PCA) for aircraft at the gate.

LEADING THE CHARGE TOWARDS ELECTRIC TRAVEL

We have invested over £7 million to build one of the biggest electric-vehicle charging networks in Europe, and we are giving away up to £1million in landing fees to the first airline to fly a commercial, electric or hybrid service from Heathrow.

WORKING WITH OUR PARTNERS TO DECARBONISE FLIGHT

ENCOURAGING GREENER AND QUIETER AIRCRAFT

64% of flights landing at Heathrow are made by the newest and greenest aircraft. Airlines can benefit from landing fees up to 11 times cheaper by utilising greener and quieter aircraft, steering them towards better choices for people and planet.

SUPPORTING SUSTAINABLE FUELS PILOT PROJECTS

Our 2019 Innovation Prize, worth £30,000, attracted 34 entries on the theme of zero-carbon air travel. The winning entry was research by University College London and specialist catalyst company Catal, to turn unrecyclable plastic waste – including food packaging and plastic film – into a chemical feedstock that could be used for a range of potential products including low-carbon fuels.

RESTORING ENGLISH PEATLAND TO OFFSET OUR CARBON EMISSIONS

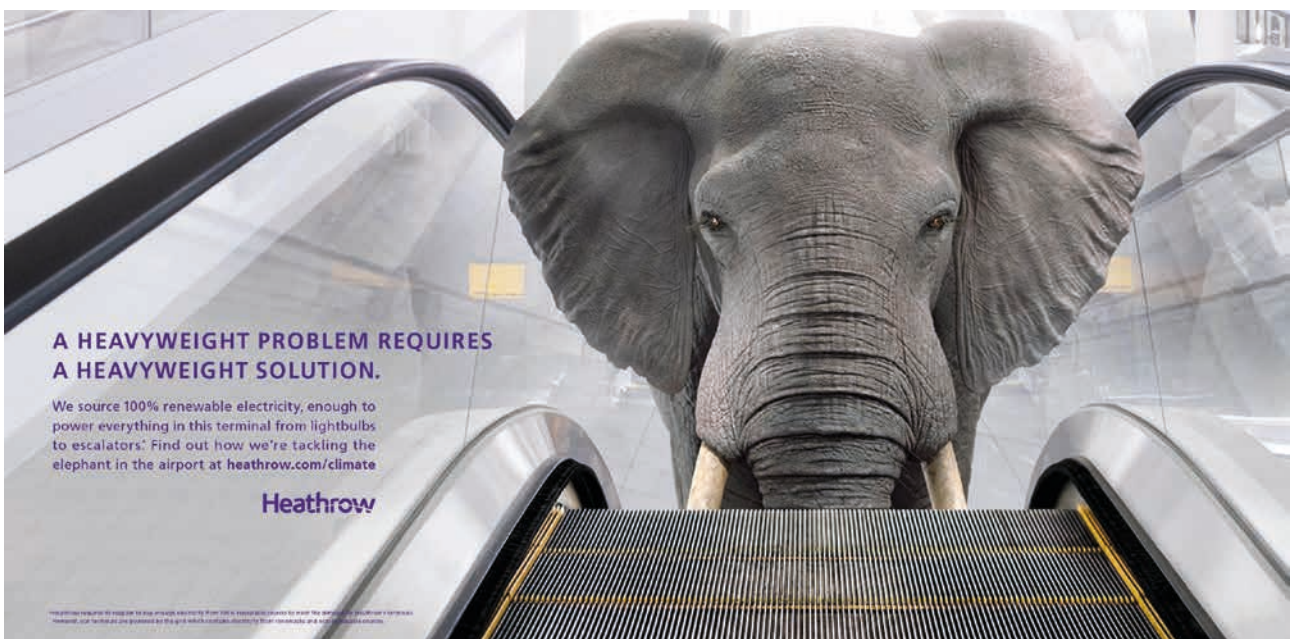
We are restoring English peatlands - a type of natural habitat critical for biodiversity - to take carbon out of the air. Our first unique project with Lancashire Wildlife Trust, covering 70 hectares, is expected to sequester more than 22,000 CO2 tonnes over 30 years.

ENGAGING PASSENGERS

We want to make it easier for customers to reduce the carbon impact of their flights. In early 2020, we launched a consumer offsetting platform – making it quick and easy for customers to purchase carbon offsets to cover their flights. The offsets will support a reforestation program in Uganda and a wind farm in Costa Rica.

We also ran an awareness campaign to highlight the work we're doing on climate change and show people how they can get involved.

These adverts are part of our carbon campaign for our passengers, which we launched in January 2020. The campaign focuses on how Heathrow is tackling the elephant in the airport - climate change.

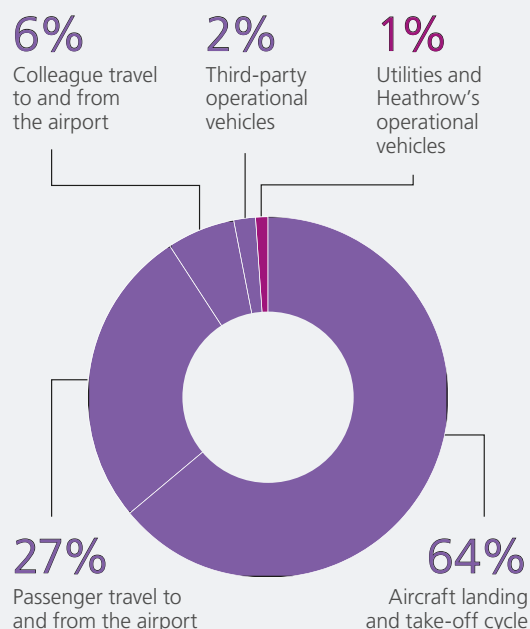


OUR CARBON FOOTPRINT

We monitor our carbon footprint and report on our greenhouse gas emissions annually. This helps us to identify opportunities to reduce our emissions and work towards our aim of zero-carbon airport infrastructure by the mid 2030s.

The data in this report is for 2018. Our carbon footprint data for 2019 will be published later in 2020. Calculating our footprint relies, in part, on external data sets which are not yet available.

This footprint follows Airports Council International's (ACI) Airport Carbon Accreditation guidance, so includes emissions from our infrastructure, travel to and from the airport and aircraft in the landing and take-off (LTO) cycle. It does not account for emissions from aircraft in cruise, which account for 89% of Heathrow's total emissions (based on 2016 emissions).



Emission source	Greenhouse gas emissions (tCO ₂ e)		
	2016	2017	2018
SCOPE 1	30,239	26,691	26,246 ¹
SCOPE 2 <i>(electricity consumption - market based)</i>	63,393	15,680	0
SCOPE 2 ² <i>(Grid electricity consumption - location based)</i>	121,049	97,408	79,921
SCOPE 3	2,083,077	2,006,786	2,062,895
Total³	2,176,708	2,049,157	2,089,141

¹ A reduction of 2,105 tonnes was attributed to purchasing Renewable Gas Guarantee of Origin certificates (RGGOs)

² Following the Greenhouse Gas Protocol these scope 2 emissions are reported together, however location based emissions are not included within total emissions.

³ Excludes Scope 2 (Grid electricity consumption – location based).

Our scope 1 and 2 footprint reflects our operational control both at the airport and off-site – including our parking-pod test track and Business Support Centre (BSC) – and aligns with the Greenhouse Gas Protocol (GHGP), which provides accounting and reporting standards, as well as sector guidance. Market-based emissions for grid electricity have been used to calculate total emissions.

Scope 2 market-based emissions for 2018 were nil. This is because our electricity was sourced using a Renewable Energy Guarantee of Origin (REGO) backed contract. The REGO certificate covers Heathrow Airport Limited, our parking-pod test track and BSC (in Glasgow), all of which fall under Scope 2 electricity.

Our scope 3 footprint includes emissions that Heathrow doesn't control but can influence. Such emissions include passenger and colleague surface access and emissions from aircraft in the LTO cycle. Our scope 3 footprint does not currently include supply-chain emissions, specifically from freight and logistics activity. However, we are currently mapping out these emissions as part of our Carbon Trust supply-chain accreditation.



HOW WE PERFORMED IN 2018

Our carbon footprint increased by 1.95% year-on-year but decreased by 4% over two years.

Carbon emissions we control (approximately 1%) fell due to improvements in energy efficiency and our purchase of renewable electricity.

Heathrow uses only 100%, REGO-certified renewable electricity, with wind as the main source – so everything from the check-in screens to last-minute, pre-flight phone battery top-ups is powered by 100% renewable electricity. With 124 solar panels on its roof, and its own biomass boiler powered by waste wood chips from woodlands in southern England, Terminal 2 is generating its own green energy too.

Carbon emissions that we influence (approximately 99%) increased year-on-year due to increases in areas such as

passenger and colleague travel to the airport. There was a small rise in emissions from aircraft in their landing and take-off (LTO) cycle, in line with a slight increase in the number of flights.

We offset any scope 1 and 2 carbon (and scope 3 business travel) emissions, that we can't yet eliminate, by purchasing carbon credits. For our 2018 emissions, we purchased 27,244 carbon credits to offset Heathrow's gas, electricity, operational vehicles and business travel, making Heathrow carbon-neutral for our scope 1 and 2 emissions. We have also purchased carbon credits to offset anticipated emissions for 2019 to 2021.

Further details can be found in our carbon-footprint report at www.heathrow.com.

OUR COMMITMENT TO SUSTAINABLE GROWTH (CONTINUED)

EXPANSION



Heathrow is the UK's only hub airport, serving more than 80 million passengers last year and providing over 75% of the UK's long-haul connections. We also play a vital role in trade; we're the UK's largest port by value, handling over £118 billion in total value of non-EU trade in the last year. However, Heathrow has been operating at 99% capacity for more than a decade. While competitor hub airports across Europe and beyond have been expanding their networks, Heathrow's growth, and consequently the UK's growth, has been constrained.



Our draft preferred Masterplan proposes a new full-length runway to the north-west.

BENEFITS INCLUDE:

- 10,000 apprenticeships by 2030.
- Up to 40,000 new local jobs during construction and operation of the expanded airport.
- Supply-chain opportunities spread across the UK, including four logistics hubs.
- At least 260,000 additional ATMs.
- Up to 40 new long-haul trading routes.
- Doubles current cargo capacity for British exporters.
- Economic growth and benefits for UK PLC.

EXPANDING HEATHROW IN THE RIGHT WAY

Air Noise	Air Quality	Surface Access	Carbon
<p>6.5 hour ban on scheduled night flights.</p> <p>Fewer people impacted by noise contour than in 2013.</p> <p>Greatly expanded noise insulation programme for eligible properties.</p>	<p>Heathrow Ultra Low Emissions Zone by 2022.</p> <p>Expanded infrastructure for charging electric and hybrid vehicles.</p> <p>Vehicle access charge.</p> <p>Surface Access Strategy implementation.</p> <p>Implement our no traffic pledge.</p>	<p>25% reduction in colleague car trips by 2030 and 50% by 2040</p> <p>At least 50% of our journeys made to the airport by public transport by 2030 and at least 55% by 2040.</p> <p>Improving bus and rail connectivity.</p>	<p>Delivered carbon-neutral airport operations.</p> <p>Committed to achieving zero-carbon airport infrastructure by 2050 but working towards achieving this sooner, by the mid-2030s.</p> <p>Aspire for carbon-neutral growth from the new runway.</p>

Expanding Heathrow will connect all of the UK to global growth for generations to come. We would be one of the best-connected countries in the world, with regular direct flights to all the major cities in the United States, China and India, the great economies of the 21st century.

Heathrow Expansion will add up to 40 new long haul routes; it will create new domestic routes so all parts of the UK can connect to the world via the UK's hub; and it will double cargo capacity to help British businesses get their goods to key markets. The construction and operation of an expanded Heathrow will generate tens of billions of pounds in GDP and tens of thousands of jobs across the country, while pioneering off-site manufacturing through a network of four Logistics Hubs located across the UK. For passengers, new capacity will drive down airfares through greater competition and more choice of airlines and destinations.

On a local level, expansion means 10,000 apprenticeships and up to 40,000 new local jobs, so future generations can fulfil their career potential at an expanded Heathrow. Our plans include transformational investment in our local area to strengthen transport connections, education and skills opportunities, and the creation of new green spaces to bring communities closer together and improve quality of life.

In 2018, MPs voted overwhelmingly in support of the Airports National Policy Statement at a ratio of almost 4:1, which was then designated by Government. Since then, we've refined our plans through consultation and engagement with local communities, airlines, passengers, and a wide range of other stakeholders. We look forward to submitting our application for Development Consent towards the end of 2020, and expect our new runway to open between early 2028 and late 2029.

KEY EXPANSION DEVELOPMENTS

Heathrow expansion took a significant step forward in 2019 as we completed our statutory consultation after unveiling our Draft Preferred Masterplan for the project. The consultation outlined the latest plans for our future airport, how we propose to operate and manage our growth and how we will ensure a sustainable, affordable, financeable and deliverable expanded Heathrow at no cost to the taxpayer. We are now working to finalise the Masterplan and will hold a further eight-week public consultation between April and June before submitting our DCO application towards the end of 2020. Our DCO application will detail how the airport proposes to expand and connect all of Britain to global growth, whilst meeting the requirements of the Airports National Policy Statement. It will also restate our commitment to ensuring an expanded Heathrow meets strict environmental targets, delivers tens of thousands of new high-skilled jobs and honours the commitments the airport has made to local communities. We remain committed to the long-term sustainable expansion of Heathrow. A key component of this is set out in our proposals for an Environmentally Managed Growth framework. It sets out our proposals for how our growth would be managed in accordance with strict environmental limits on air quality, surface access, noise and carbon. The framework supports growth in flights at the airport while ensuring our environmental performance stays within maximum limits. We are also committed to reducing the impact of construction on the local environment, by adopting innovative construction practices including our logistics hubs – four off-site centres for pre-assembly and consolidation located across the UK – to help us deliver expansion sustainably and efficiently.



EMMA GILTHORPE
Executive Director Expansion

OUR COMMITMENT TO SUSTAINABLE GROWTH (CONTINUED)

OUR CHARITY PARTNERSHIPS



Our Team Heathrow colleagues raising money for all three of our main charity partners, at our Midnight Marathon event in 2019.

As the UK's leading airport, we have a responsibility to not only reduce the negative impacts we create for our stakeholders, but to deliver a positive future as well. Working with three chosen charity partners and overseen by our Charities and Communities Committee, we raise funds, donate time and meet the shared objectives of colleague and passenger engagement and our community strategy in order to deliver our Heathrow 2.0 sustainability commitments. Our charity partners are:

- CARE International UK - our international partner
- Duke of Edinburgh Awards Scheme – our national partner
- Heathrow Community Trust – our local partner

In 2019 we donated £0.9 million (2018: £1.0 million) and we also leveraged¹ funds totalling £0.6 million from colleague fundraising, passenger donations and donations from other airport companies.

¹ Leverage is a measure of additional resources contributed to charities from sources other than the company.



CARE International

CARE International is a charity that works around the globe in 100 countries to save lives, defeat poverty and achieve social justice. Our partnership enables our passengers and colleagues to support entrepreneurs living in poverty around the world, through the 'Lendwithcare' initiative. 'Lendwithcare' is an online lending platform that allows you to personally give entrepreneurs much-needed access to credit and training. This money is then used to help change the lives of those living in poverty. CARE receives donations from our passengers and money generated through fundraising by Heathrow colleagues and others.

In 2019 passengers donated £286,000 and a further £38,000 was leveraged¹ from colleague and Team Heathrow fundraising.



Heathrow Community Trust

Heathrow Community Trust is an independently run grant-making charity.

The Trust's grant programme funds projects that improve quality of life for communities near the airport. It also supports colleague volunteering and fundraising to improve the community where they live or a cause that they believe in.

As well as input funding from Heathrow, the Trust receives noise fines levied on airlines when they break noise regulations, donations from other companies associated with the airport and money generated through fundraising by Heathrow colleagues and others.

In 2019 we gave £725,000 and a further £107,000 was leveraged¹ from colleague and Team Heathrow fundraising.



The Duke of Edinburgh's Award

The Duke of Edinburgh's Award (DofE) programme transforms young people's confidence, skills and wellbeing.

Our partnership gives colleagues the chance to challenge themselves to do their own Gold DofE Award and to participate in fundraising events that unlock their own potential, building self-belief and team-working abilities. This includes taking on challenges and offering work experience days for local young people.

DofE receives a combination of input funding from Heathrow and money generated through fundraising by Heathrow colleagues and others.

In 2019 we gave £200,000 and a further £142,000 was leveraged¹ from colleague and Team Heathrow fundraising.

FUNDRAISING

We helped to leverage¹ funds worth **£263,000** from colleagues and fundraising events, **£286,000** from passenger donations and **£41,000** from other airport companies. These funds were largely split between our three main charity partners, with £17,000 donated to other charities.

Events in 2019 included Midnight Marathon where over 400 Team Heathrow colleagues took part, raising over £50,000.

FINANCIAL REVIEW



Heathrow remains in strong financial health. Passenger growth supported a 3.4% increase in revenue.

A focus on efficiency, combined with revenue growth resulted in adjusted EBITDA increasing 4.5% to £1.9bn. Heathrow continues to invest in its future, and £856 million was invested into the airport this year. Strong balance sheet with liquidity extended to October 2021 after raising £2.1bn in global capital markets.

JAVIER ECHAVE
Chief Financial Officer



Year ended 31 December	2019 £m	2018 £m
Revenue	3,070	2,970
Adjusted operating costs ¹	(1,150)	(1,133)
Adjusted EBITDA²	1,920	1,837
Depreciation and amortisation	(774)	(746)
Adjusted operating profit³	1,146	1,091
Net finance costs before certain remeasurements	(739)	(755)
Adjusted profit before tax	407	336
Tax charge on profit before certain remeasurements	(111)	(72)
Adjusted profit after tax⁴	296	264
Including certain remeasurements		
Fair value gain on investment properties	43	117
Fair value gain on financial instruments	128	38
Tax charge on certain remeasurements	(29)	(7)
Profit after tax	438	412

1. Adjusted operating costs excludes depreciation, amortisation and fair value adjustments on investment properties.

2. Adjusted EBITDA is profit before interest, taxation, depreciation, amortisation and fair value adjustments on investment properties.

3. Adjusted operating profit excludes fair value adjustments on investment properties.

4. Adjusted profit before and after tax excludes fair value adjustments on investment properties and financial instruments and associated tax.

BASIS OF PRESENTATION OF FINANCIAL RESULTS

Heathrow Finance plc (the 'Company' or 'Heathrow Finance') is the holding company of a group of companies (the 'Group'), which includes Heathrow Airport Limited (HAL) which owns and operates Heathrow airport, and Heathrow Express Operating Company Limited (Hex Opco) which operates the Heathrow Express rail service. Heathrow Finance's consolidated financial statements are prepared under International Financial Reporting Standards (IFRS).

Management use Alternative Performance Measures (APMs) to monitor performance of the segments as it believes this more appropriately reflects the underlying financial performance of the Group's operations. A reconciliation of our APMs has been included on page 185.

SUMMARY PERFORMANCE

In the year ended 31 December 2019, the Group's revenue climbed 3.4% to £3,070 million (2018: £2,970 million). Adjusted EBITDA increased 4.5% to £1,920 million (2018: £1,837 million), and its profit after tax increased 6.3% to £438 million (2018: £412 million).

Following the adoption of IFRS 16, £52 million of operational lease costs are now reported below EBITDA. Prior to the adoption of IFRS 16 these costs would have been included in operating costs and within EBITDA. Adjusted EBITDA excluding the application of IFRS 16 has increased 1.7% to £1,868 million (2018: £1,837 million).

FINANCIAL REVIEW (CONTINUED)

REVENUE

In the year ended 31 December 2019, revenue increased 3.4% to £3,070 million (2018: £2,970 million).

Year ended 31 December	2019 £m	2018 £m	Var %
Aeronautical	1,831	1,745	4.9
Retail	722	716	0.8
Other	517	509	1.6
Total revenue	3,070	2,970	3.4

Aeronautical revenue has increased by 4.9% compared to 2018. Aeronautical revenue per passenger increased 3.9% to £22.64 (2018: £21.78). A combination of record passenger traffic, favourable mix of passengers and recovery of prior-year yield dilution continue to be key drivers of growth. This has been partially offset by the introduction of our new commercial airline deal, providing a saving of £0.55 per passenger on airline charges.

RETAIL REVENUE

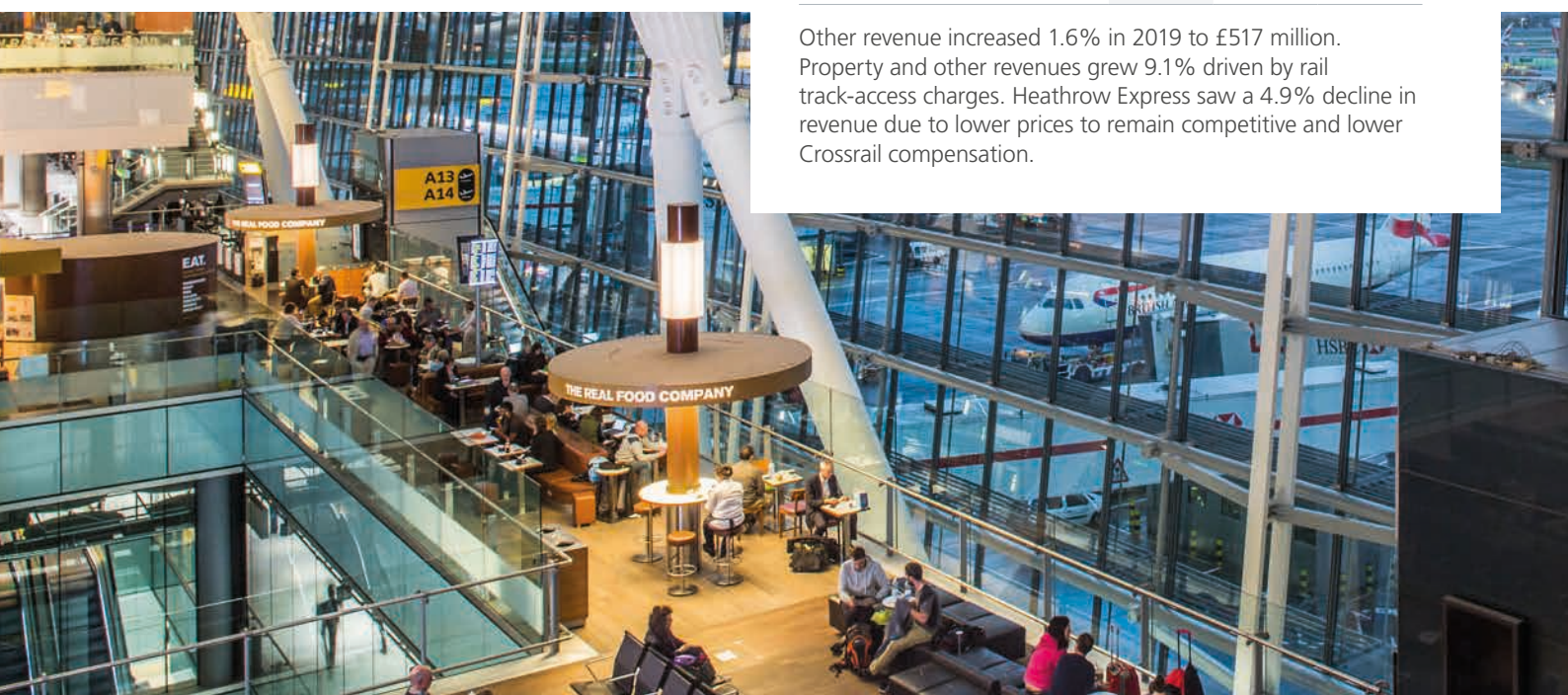
Year ended 31 December	2019 £m	2018 £m	Var %
Retail concessions	342	323	5.9
Catering	64	61	4.9
Other retail	113	128	(11.7)
Car parking	125	126	(0.8)
Other services	78	78	0.0
Total retail revenue	722	716	0.8

Retail revenue has grown by 0.8%, retail revenue per passenger remained flat at £8.93 (2018: £8.94). Growth was led by retail concessions and catering, reflecting record passenger traffic. The pound weakening against both the Euro and US Dollar also contributed in driving retail concessions. Other retail revenue declined due to bureaux customers favouring alternative methods of prebooked currency, and a one off contractual benefit received in 2018 which will not reoccur. Excluding the one off contractual benefit in 2018, retail revenue per passenger would have increased by 1.0% to £8.93 (2018: £8.83).

OTHER REVENUE

Year ended 31 December	2019 £m	2018 £m	Var %
Other regulated charges	244	243	0.4
Heathrow Express	117	123	(4.9)
Property and other	156	143	9.1
Total other revenue	517	509	1.6

Other revenue increased 1.6% in 2019 to £517 million. Property and other revenues grew 9.1% driven by rail track-access charges. Heathrow Express saw a 4.9% decline in revenue due to lower prices to remain competitive and lower Crossrail compensation.



ADJUSTED OPERATING COSTS

Adjusted operating costs increased 1.5% to £1,150 million (2018: £1,133 million). Adjusted operating costs per passenger increased by 0.6% to £14.22 (2018: £14.14).

Year ended 31 December	2019 £m	2018 £m	Var %
Employment	378	378	-
Operational	279	264	5.7
Maintenance	173	176	(1.7)
Rates	118	122	(3.3)
Utilities and Other	202	193	4.7
Adjusted operating costs	1,150	1,133	1.5

Following the adoption of IFRS 16, £52 million of operational lease costs are now reported below adjusted operating profit. Of the £52 million, £24 million would have been located within operational costs, £2 million within maintenance costs and £26 million within utilities. Excluding the application of IFRS 16, adjusted operating costs are up 6.1% to £1,202 million, and on a per-passenger basis up 5.1% to £14.86.

Operational costs have increased as we gear up for growth with investment in expansion, security, resilience and passenger experience. We spent more on services for passengers with reduced mobility, upgrading drone defence capabilities, implementing new hold-baggage screening and investing in our IT systems. Utilities costs also increased due to a rise in government levies on usage, whilst overall consumption declined.



OPERATING PROFIT AND ADJUSTED EBITDA

In the year ended 31 December 2019, operating profit decreased 1.6% to £1,189 million (2018: £1,208 million). The decrease was due to a lower gain in the non-cash fair value of our investment properties offset by the favourable impact of operational lease costs now reported below operating profit.

Year ended 31 December	2019 £m	2018 £m
Operating profit	1,189	1,208
Depreciation and amortisation	774	746
EBITDA	1,963	1,954
Fair value gain on investment properties	(43)	(117)
Adjusted EBITDA	1,920	1,837
Impact of IFRS 16 ¹	(52)	-
Adjusted EBITDA excl. impact of IFRS 16¹	1,868	1,837

¹ Following the adoption of IFRS 16, £52m of operational lease costs are now being reported below EBITDA. Prior to the adoption of IFRS 16 these costs would have been included in operating costs, above EBITDA

Depreciation and amortisation increased to £774 million (2018: £746 million) impacted by an additional £35 million of depreciation due to the transition to IFRS 16.

Fair value gain on investment properties decreased to £43 million (2018: £117 million) due to a smaller increase in the value of our car parks compared to 2018.

Adjusted EBITDA increased 4.5% to £1,920 million (2018: £1,837 million), resulting in an adjusted EBITDA margin of 62.5% (2018: 61.9%). Adjusted EBITDA excluding the application of IFRS 16 has increased 1.7% to £1,868 million. (2018: £1,837 million).

FINANCIAL REVIEW (CONTINUED)

PROFIT AFTER TAX

For year ended 31 December 2019, the Group recorded a profit before tax of £578 million (2018: £491 million profit). Profit after tax increased 6.3% to £438 million (2018: £412 million profit).

Year ended 31 December	2019 £m	2018 £m
Operating Profit	1,189	1,208
Net finance costs before certain remeasurements	(739)	(755)
Fair value gain on financial instruments	128	38
Profit before tax	578	491
Taxation Charge	(140)	(79)
Profit after tax	438	412

Net finance costs before certain remeasurements decreased to £739 million (2018: £755 million) due to RPI growth rate for the 12 months to December 2019 falling to 2.2%, down from 3.2% in the same prior period.

Fair value gains on financial instruments increased to £128 million (2018: £38 million) as a result of a decrease in long term inflation expectations.

TAXATION

The total tax charge for the year ended 31 December 2019 is £140 million (year ended 31 December 2018: £79 million), representing the sum of the tax charge on profits before certain remeasurements and the tax charge on certain remeasurements. The tax charge before certain remeasurements for the year ended 31 December 2019 was £111 million (2018: £72 million), resulting in an effective tax rate of 27.3% (year ended 31 December 2018: 21.4%). The effective tax rate being higher than (2018: higher than) the statutory rate of 19% (2018: statutory rate of 19%) primarily reflects the fact that a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief. For the period, the Group paid £98 million (year ended 31 December 2018: £70 million) in corporation tax.

CASH FLOW

At 31 December 2019, the Group had £1,570 million (2018: £715 million) of cash and cash equivalents and term deposits, of which cash and cash equivalents were £845 million (2018: £595 million). As we transition into a period of intense investment, surplus funds are managed through a variety of investment products in line with policy thresholds to maximise available returns.

CASH GENERATED FROM OPERATIONS

In the year ended 31 December 2019, cash generated from operations increased 8.4% to £1,941 million (2018: £1,790 million). This continues to demonstrate our strong ability to convert operating profit into cash. The following table reconciles adjusted EBITDA to cash generated from operations.

Year ended 31 December	2019 £m	2018 £m
Cash generated from operations	1,941	1,790
<i>Exclude</i>		
(Decrease)/increase in receivables and inventories ¹	(56)	46
Decrease/(increase) in payables	5	(14)
Decrease in provisions	8	-
Difference between pension charge and cash contributions	22	15
Adjusted EBITDA	1,920	1,837

¹ Includes movement in intra-group deposits

CAPITAL EXPENDITURE

Total capital expenditure in 2019 was £856 million (2018: £793 million). We invested £620 million (2018: £666 million) in a variety of programmes to improve the passenger experience, airport resilience and for asset replacement. We also progressed our plans to expand Heathrow with investment of an additional £236 million in the period (2018: £127 million).

We continued to invest in airfield and resilience programmes. Work is underway to meet the next-generation security requirements mandated by the Department for Transport (DfT). Significant investment continues in automating the passenger journey with the roll-out of self-bag drops and self-boarding gates across all terminals. Further investment has also been made to increase capacity in Terminal 5, with 20 new carriages now on order to double the capacity on the Track Transit System, linking the main terminal to satellite buildings. The Hold Baggage Screening (HBS) upgrade works are progressing well, with the Terminal 5 programme now fully complete. The works in Terminal 4 are progressing well and scheduled to achieve the DfT compliance date in September 2020.

Expansion-related capital expenditure includes Category B costs associated with the consent process and also includes early Category C costs predominantly relating to early design costs.

Since 2016, Heathrow has invested £361m in Category B costs and £89m in Category C costs, a total of £450m that is carried in our balance sheet as assets in the course of construction. By the end of 2020, it is currently forecast that this asset under the course of construction will increase to c£1bn as set out in the Investor Report published on 20 December 2019.

As outlined in our summary of current regulatory and legal challenges to expansion, if the likelihood of expansion occurring was no longer probable, capital expenditure would be required to be impaired. This would significantly reduce the available distributable reserves of Heathrow Airport Limited (the legal entity holding the asset). Based on distributable reserves as at the 31 December 2019 the potential impairment would not result in negative distributable reserves within Heathrow Airport Limited.

It should also be noted that the non-cash impairment recognised under IFRS is separate to the Regulatory Asset Base. Should a planning decision or the appeal to the Judicial review go against us we expect that most of the assets will remain in the Regulatory Asset Base and continue to generate a return through the regulatory framework. As a result, key covenant ratios would not be materially affected as they are based on the Regulatory Asset Base and income excluding exceptional items.

RESTRICTED PAYMENTS

The financing arrangements of the Group and Heathrow Finance plc ("Heathrow Finance") restrict certain payments unless specified conditions are satisfied. These restricted payments include, among other things, payments of dividends, distributions and other returns on share capital, any redemptions or repurchases of share capital, and payments of fees, interest or principal on any intercompany loans.

In the year ended 31 December 2019, controlled payments paid by Heathrow Finance amounted to £452 million (net) or £468 million (gross) excluding cash pushed down to Heathrow Finance.

Net restricted payments included:

- a) £466 million payment to fund the majority of the £500 million (2018: £500 million) dividends paid to ultimate shareholders reflecting the continued strong performance of the business.
- b) £2 million (2018: £3 million) payment to fund interest at ADIF2.
- c) A net cash inflow of £16 million (2018: net cash inflow of £75 million) to Heathrow Finance.

RECENT FINANCING ACTIVITY

Continued confidence and support for our credit through expansion enabled us to raise £2.1 billion of debt in 2019. This funding underpins our robust liquidity position and provides additional duration and diversification to our £14 billion debt portfolio. 2019 funding activities comprised around £1 billion in Class A, including a JPY note representing our eighth currency of issuance, £75 million in Class B and £1 billion of debt raised at Heathrow Finance.

Class A financing activities included:

- a) A €650 million 15-year Class A bond maturing in 2034.
- b) A €86 million 20.5-year Class A zero coupon bond maturing in 2039.
- c) A CHF210 million 7.5-year Class A bond maturing in 2026, marking our 3rd Swiss franc issuance.
- d) A £140 million Class A term debt maturing in 2037.
- e) The repayment of our \$400m CAD bond.
- f) An inaugural JPY10 billion 20-year Class A note maturing in 2039.

Class B financing activities included:

- a) A £75 million 15-year Class B private placement maturing in 2035 to be drawn in April 2020.

Financing activities at Heathrow Finance included:

- a) £700 million new loan facilities, with various maturities out to 2035, which are partially drawn.
- b) A £300 million 10-year Heathrow Finance bond maturing in 2029.
- c) The early repayment of £267 million 2019 Heathrow Finance bond on the 4th March 2019.
- d) The repayment of £325 million of term loans.
- e) The migration of £75 million raised by ADIF2 to Heathrow Finance in March 2019.

Our revolving credit facilities were amended to include direct link to ESG factors and extended to 2023.

FINANCIAL REVIEW (CONTINUED)

FINANCING POSITION

DEBT AND LIQUIDITY

At 31 December 2019, Heathrow Finance's consolidated nominal net debt was £14,361 million (31 December 2018: £13,980 million). It comprised £13,272 million in bond issues, £2,309 million in other term debt, £345 million in index-linked derivative accretion and £5 million of additional lease liability post transition to IFRS 16. This was offset by £1,570 million in cash and cash equivalents and term deposits. Nominal net debt comprised £11,055 million in senior net debt, £1,357 million in junior debt at the Company's subsidiaries and £1,949 million net debt at the Company itself.

The average cost of Heathrow Finance's nominal gross debt at 31 December 2019 was 3.56% (31 December 2018: 3.73%). This includes interest rate, cross-currency and index-linked hedge costs and excludes index-linked accretion. Including index-linked accretion, Heathrow Finance's average cost of debt at 31 December 2019 was 4.73% (31 December 2018: 5.31%). The reduction in the average cost of debt since the end of 2018 is mainly due to:

- a) Recent financing activities at a lower cost.
- b) Falling RPI inflation, which reduced index-linked swap accretion.

The average life of Heathrow Finance's gross debt as at 31 December 2019 was 11.1 years (31 December 2018: 11.1 years).

Nominal net debt excludes any restricted cash and the debenture between Heathrow SP and Heathrow Finance. It includes all the components used in calculating gearing ratios under Heathrow SP's financing agreements including index-linked accretion and additional lease liabilities entered since the transition to IFRS 16.

The accounting value of Heathrow Finance's net debt was £14,614 million at 31 December 2019 (31 December 2018: £13,712 million). This includes £1,570 million of cash and cash equivalents and term deposits, and £384 million lease liabilities as reflected in the statement of financial position and excludes accrued interest.

We have sufficient liquidity to meet all our forecast needs until October 2021. This includes forecast capital investment (including projected expansion related investments as per our investor report published on 20 December 2019), debt service costs, debt maturities and distributions. This liquidity position takes into account £3.7 billion in undrawn loan facilities, bonds and term debt to be drawn as well as cash resources at 31 December 2019 together with expected operating cash flow over the period.

FINANCIAL RATIOS

Heathrow SP and Heathrow Finance continue to operate comfortably within required financial ratios. Gearing ratios are calculated by dividing consolidated nominal net debt by Heathrow's Regulatory Asset Base (RAB).

At 31 December 2019, Heathrow's RAB was £16,598 million (31 December 2018: £16,200 million). Heathrow SP's senior (Class A) and junior (Class B) gearing ratios were 66.6% and 74.8% respectively (31 December 2018: 68.2% and 76.6% respectively) with respective trigger levels of 72.5% and 85%. Heathrow Finance's gearing ratio was 86.5% (31 December 2018: 86.3%) with a covenant of 92.5%. The covenant at Heathrow Finance changed earlier in the year from 90% to 92.5% due to the redemption of the 2019 notes at Heathrow Finance. Lower gearing ratios at Class A and Class B reflect some debt reallocation between the ring-fenced group, Heathrow SP, and Heathrow Finance as we build toward expansion. To complement this first step and deliver our commitment to maintain our existing investment grade ratings, we expect our existing cautious approach to balance sheet management to further focus on cash-flow driven metrics.

PENSION SCHEME

We operate a defined-benefit pension scheme (the BAA Pension Scheme), which closed to new members in June 2008. At 31 December 2019, the defined benefit pension scheme, as measured under IAS 19, was funded at 100.8% (2018: 100.7%). This translated into a surplus of £33 million (2018: £28 million surplus). The £5 million increase in the surplus in the 12 months is primarily due to actuarial losses of £17 million, attributable to a decrease in the discount rate of 0.90% over the 12 months and offset by contributions in excess of current service cost of £22 million. At 31 December 2019, we contributed £47 million (2018: £48 million) into the defined-benefit pension scheme including £23 million (2018: £23 million) in deficit-repair contributions. Management believes that the scheme has no significant plan-specific or concentration risks.

The triennial valuation (as at 30 September 2018) has been completed and agreed by the Trustees of the scheme and LHR Airports Limited, setting out the contributions needed to cover the costs of the benefits that active members will build up in the future, and additional cash contributions from Heathrow to make up the shortfall between liabilities calculated on a technical provisions basis and assets at that date. Cash contributions of £20 million per year from 1 October 2019 (£23 million per year before 1 October 2019) are expected to eliminate the shortfall within four years.

JAVIER ECHAVE
Chief Financial Officer

25 February 2020



OUR APPROACH TO CAPITAL ALLOCATION

For Heathrow to generate stable long-term returns, significant investment is required. To make these investments we must ensure that we have access to appropriate capital in both the short and long term.

Our primary sources of capital are;

1. equity investment from our shareholders,
2. debt provided by third parties, and
3. cash generated from our operations.

Decisions related to the efficient deployment of capital consider the following;

1. retaining a strong balance sheet,
2. maintaining investment in the business, and
3. providing the our ultimate shareholders with a fair return on their investment.

RETAINING A STRONG BALANCE SHEET

We generate high quality operating cash flows. As a result, we have good liquidity and have been able to maintain a positive net current asset position.

We seek to ensure that we continue to maintain a strong balance sheet, so that we can comply with debt covenant requirements, regulatory restrictions and respond to economic risks in the long term.

As part of achieving this objective we are subject to regulation from the CAA. Directors are required to submit a "Certificate of Adequacy of Resources" to confirm that we expect to have sufficient financial resources, after taking into account any dividend or other distribution which might reasonably be expected to be declared, any amounts of principal and interest due under any loan facilities and any actual or contingent risks which could reasonably be material to their consideration, sufficient financial and other resources and financial and operational facilities to enable us to continue to provide airport operation services for a period of at least two years.

MAINTAINING OUR INVESTMENT IN THE BUSINESS

We use our internal cashflow generation and capital markets (debt and equity) to continue to invest in the airport. Since private ownership we have invested over £12 billion of private money.

Our stakeholders benefit from the investment into the UK's only hub airport. We submitted our Initial Business Plan to the CAA in December 2019 which describes our plans to deliver further investments to improve customer service, increase efficiency, and expand the airport in a sustainable way.

We are incentivised to continue to invest and generate long term returns, through economic regulation from the CAA, which allows a return on efficient investments. When this return is sufficient, it allows us to access capital markets and obtain the finance required to invest.

Proposed future investment and consideration of the ability to access suitable funds are monitored and managed through Heathrow's short-term Management Business Plan and its longer term Initial Business Plan and investments are dependent on reaching satisfactory regulatory terms with our regulator.

PROVIDING THE GROUP'S ULTIMATE SHAREHOLDERS WITH A FAIR RETURN ON THEIR INVESTMENT.

To access equity investment we are required to offer a fair return to shareholders. Where we have met our balance sheet requirements and have concluded we have suitable capital to meet our investment plans, the Directors seek to provide shareholders with a fair return through a dividend payment while delivering our commitment to maintain our current investment grade credit rating.

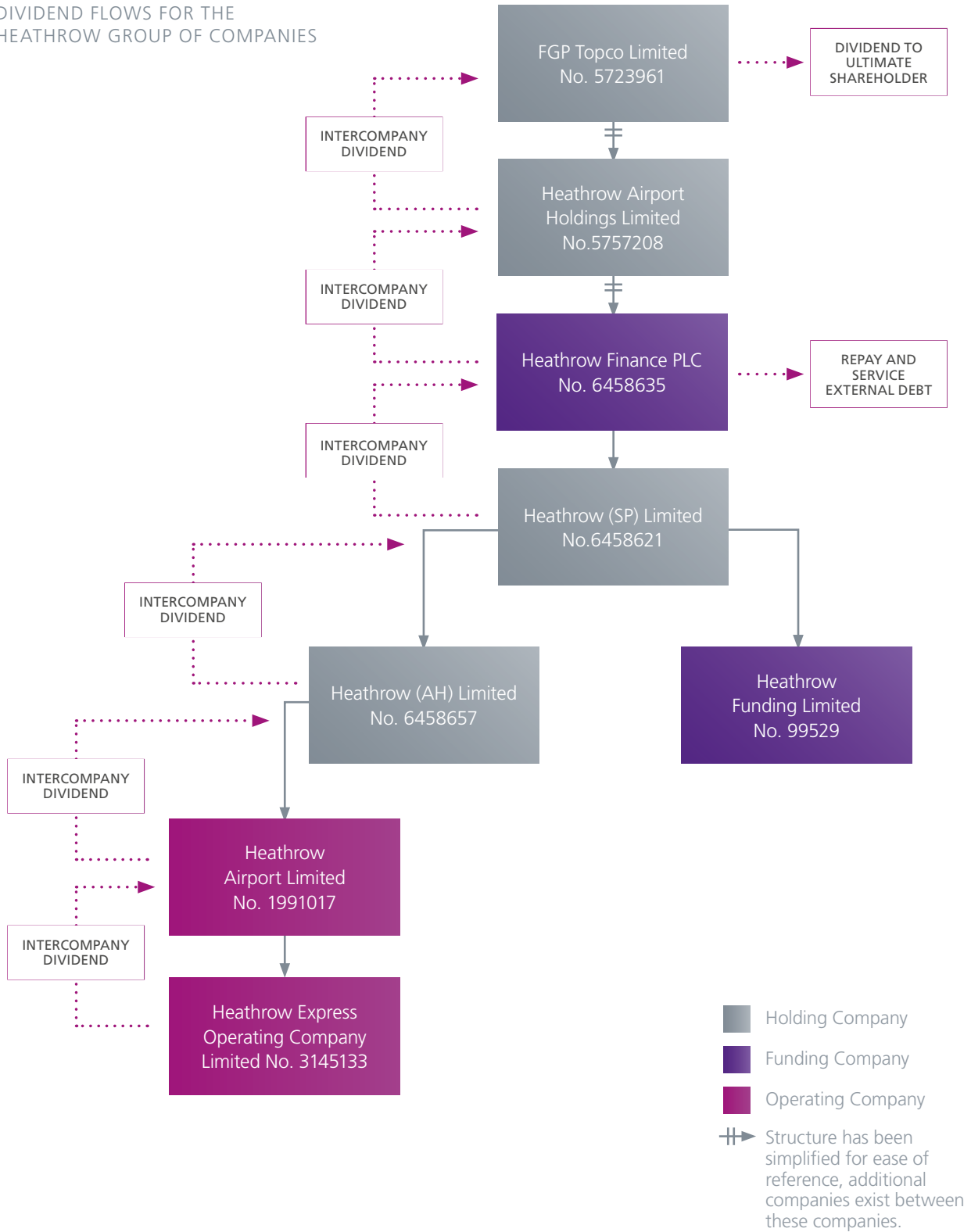
At times of significant investment, the Directors may seek additional capital from its shareholders. To obtain the capital, the Directors are required to demonstrate that they can continue to provide a fair future return in exchange for this investment.

The Directors of each of the companies within the Heathrow group of companies consider the Group's capital structure and distributable reserves before proposing dividends. Dividends are only paid where Heathrow has generated enough allowable distributable reserves.

Dividends are paid up through the structure of the Heathrow group of companies to fund dividends to the Group's ultimate shareholders and to repay and service external debt at the Group's holding companies. The flow of dividends through the Heathrow group of companies is illustrated in the simplified diagram on the opposite page.

Dividends of £468 million (2018: £497 million) were paid to Heathrow (DSH) Limited during the year. These were used to fund dividends of £500 million (2018: £500 million) to Heathrow's ultimate shareholders.

DIVIDEND FLOWS FOR THE HEATHROW GROUP OF COMPANIES



OUR APPROACH TO TAXATION

We have a corporate responsibility to collect and pay tax, and have been working hard to promote tax transparency and build trust with our stakeholders.

Our operations, whilst large, are conducted entirely from the UK with no overseas operations. Accordingly, Heathrow pays a range of UK taxes, such as corporation tax, employment taxes and stamp-duty land tax, and it is one of the biggest business rates payers in the country, paying c.£1 billion into the public purse over the past decade.

Heathrow operates not only within the UK's tax laws, but also within the spirit of them. All profits are subject to UK corporation tax, and no funds are routed through tax havens. Heathrow has no investments outside the UK that are not subject to UK tax.

APPROACH TO RISK MANAGEMENT AND GOVERNANCE

Heathrow's tax strategy was approved by the HAHL Board¹ in October 2019. Heathrow's tax strategy confirms:

- How Heathrow ensures the right processes and controls are in place to manage potential tax risks.
- Heathrow's commitment to pay UK tax in accordance with all applicable laws and regulations without the use of arrangements that are contrary to the intentions of Parliament.
- Heathrow's low tax-risk-appetite and commitment to preventing the facilitation of tax evasion.
- Heathrow's commitment to engage with HMRC in an open and transparent manner.



Overall responsibility for Heathrow's tax strategy sits with the Board. The Chief Financial Officer, in his capacity as Senior Accounting Officer, is accountable for ensuring Heathrow has a tax strategy which is appropriate for the recording and delivery of tax obligations. This strategy is reviewed and approved by the Audit Committee on behalf of the Board.

¹ The HAHL Board is the Board of Directors of Heathrow Airport Holdings Limited as defined on page 78.

Given the scale of Heathrow's operations, it is important to ensure the right processes and controls are in place to manage potential tax risks. To achieve this, we ensure that the appropriate policies, processes and systems are in place and that these are reviewed for operational effectiveness.

We are vigilant in the creation and maintenance of robust processes for recording the right amount of tax while ensuring that we are adequately staffed with clearly defined roles and each individual has the required skills and support to carry out their role effectively. Regular training is provided to ensure the team is capable of managing the tax risks, including the encouragement of appropriate skills across the business. Where necessary, external tax advice is sought to ensure that the correct amount of tax is considered in relation to any business restructure, complex transaction or legislative change.

The Audit Committee periodically reviews tax matters affecting Heathrow. Any concerns are addressed in a tax-risk register that evaluates identified risks and supports the development of a response strategy to address the given item. All risks are monitored and controlled as appropriate.

ATTITUDE TOWARDS TAX PLANNING

Heathrow pays UK tax in accordance with all laws and regulations. As part of the business and commercial operations, Heathrow seeks to utilise available tax reliefs, incentives and exemptions in line with both the intent and letter of tax legislation whilst having no involvement in tax planning other than that which arises from genuine commercial activity. This means that Heathrow will not structure transactions in a way which gives a tax result contrary to the intentions of Parliament nor adopt measures to manage its effective tax rate.

ACCEPTED LEVEL OF RISK

Heathrow's tax strategy supports our responsible business strategy. It is focused on ensuring both tax and tax risks are managed to provide sustainable outcomes. As a result, Heathrow has a low tax-risk appetite. The approach is to mitigate any risk by taking reasonable care whilst also considering Heathrow's brand reputation and the wider airport community. Heathrow is also committed to ensuring that tax evasion is not facilitated and has implemented procedures to prevent such behaviour.

APPROACH TO HM REVENUE & CUSTOMS (HMRC)

Heathrow seeks to have an open and transparent relationship with HMRC, creating and maintaining mutual trust.

The tax team is responsible for supporting the business in meeting its tax obligations in an open and transparent manner, ensuring that any inadvertent errors identified are disclosed to HMRC as soon as reasonably practical and processes are put in place to prevent repetition.

Heathrow seeks to engage in relevant Government-initiated tax consultations to ensure that the views of business are represented.

OUR APPROACH TO RISK MANAGEMENT



Identifying, understanding and managing risk is fundamental to our strategy and success.

The Heathrow Risk and Assurance Management system (HRAM) is an enterprise risk management system that is embedded Group-wide with the principal aim of providing oversight and governance of the key risks that we face, and to monitor upcoming and emerging risks. The HRAM provides guidance on how risks should be identified, mitigated, reviewed and reported within Heathrow.

Over the past year we have sought to improve the HRAM, and we will continue to improve our risk processes in 2020. These enhancements build on the current risk-management structure to enhance the data quality, completeness of risk information and control measurement in addition to improving the overall reporting integrity. In particular an ongoing process of bottom-up reviews with each of the Heathrow business functions has been taking place during 2019 and will continue into 2020. These reviews identify new and emerging risks which are then documented in each of the function's risk registers. In addition to bottom-up reviews, principal risks have been identified at a Group level ensuring a comprehensive top-down and bottom-up approach to risk identification.

The HAHL Board¹ has overall responsibility for the HRAM framework, establishing the Group's risk appetite and for reviewing the effectiveness of the risk-response system. There are two HAHL Board¹ sub-committees which are responsible for risk: the Audit Committee, which reviews the effectiveness

of systems for internal financial control, and the Sustainability and Operational Risk Committee, which reviews the effectiveness of operational reporting and performs an oversight review of the performance against sustainability goals and operational targets.

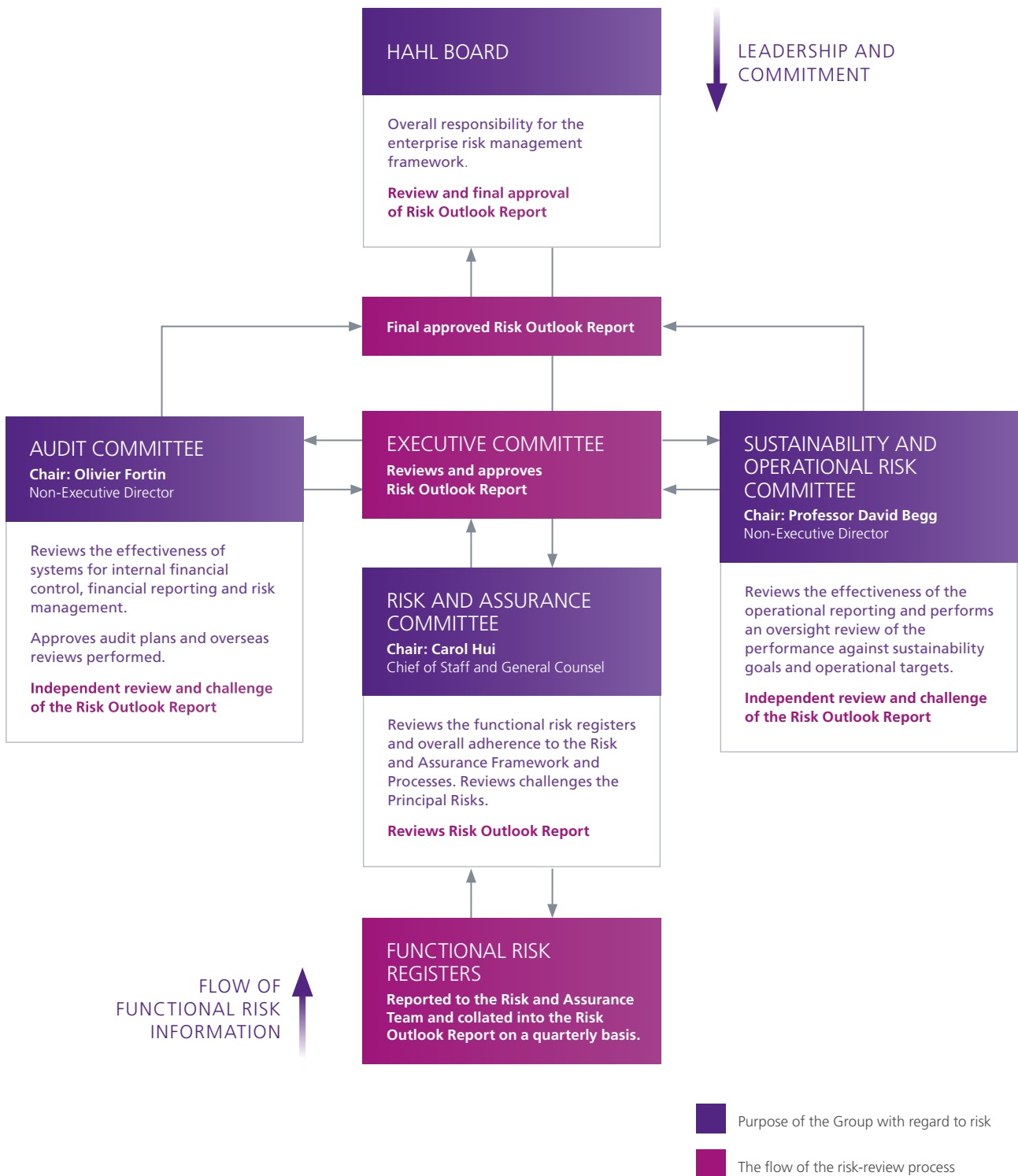
Risks identified by each of Heathrow's business functions are formally reported to the central Risk and Assurance Team on a quarterly basis by each function's 'risk champion'. Risks are analysed and evaluated to assess the residual risk, ie the risk after mitigating actions and controls. The most significant risks are collated and reported to the Risk and Assurance Committee, a sub-committee of the Executive Committee. The risks are then reviewed by the Executive Committee before being submitted to the Audit Committee and Sustainability and Operational Risk Committee for independent review and challenge.

The final Heathrow risk report is then reviewed and approved by the HAHL Board¹ on a quarterly basis.

A Principal Risk is a risk that has been identified by the HAHL Board¹, its formal committees, the Executive Committee, or the Risk and Assurance Committee, as an important risk that fundamentally affects the business's ability to deliver on its overarching objectives. A Principal Risk is assessed according to the likelihood, consequence and velocity by which the risk may impact Heathrow.

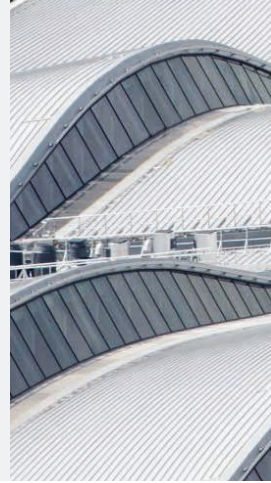
¹ The HAHL Board is the Board of Directors of Heathrow Airport Holdings Limited as defined on page 78.

RISK MANAGEMENT

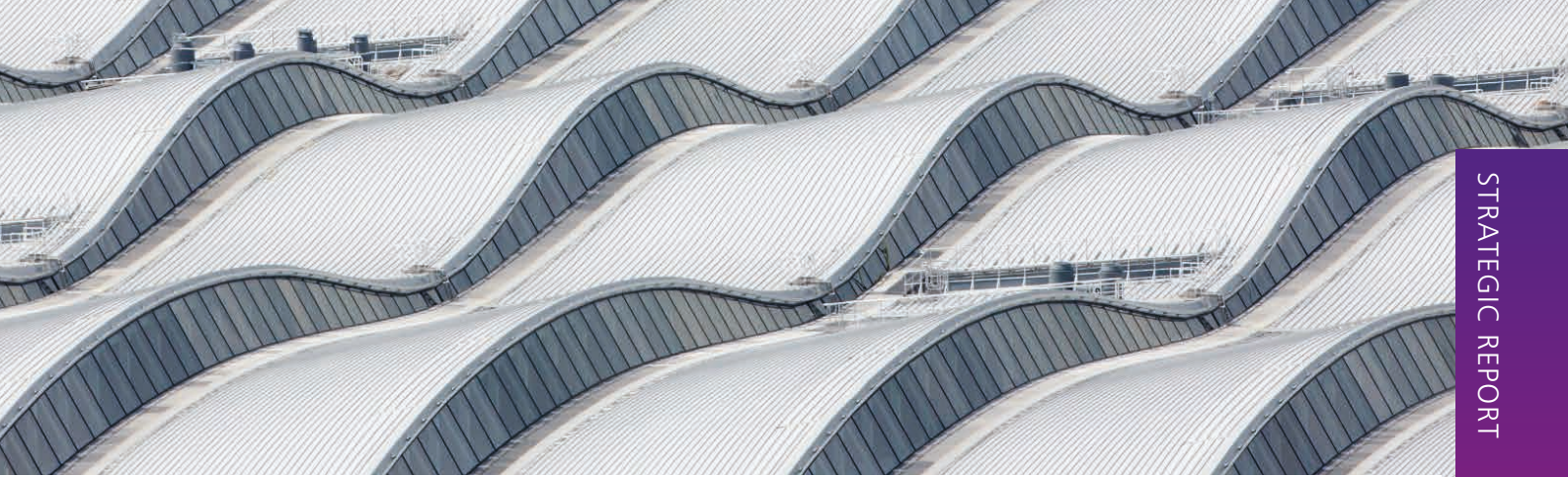


























OUR PRINCIPAL RISKS

The risks outlined are the principal strategic, corporate and operational risks identified during the year. This is a current point-in-time assessment of the risk profile that the Group faces as at 25 February 2020. As the risk environment evolves these risks are being constantly reviewed and updated.



PRINCIPAL RISK	Climate change and carbon targets	A safe and secure operating environment	Ability to access finance	Enable capacity – airspace and surface access	Information security
DETAIL	<p>Climate-related risk has been split into two areas:</p> <p>Physical risks – Heathrow’s operational resilience to the impact of climate change.</p> <p>and</p> <p>Transitional risks – the inability to meet our obligations as a responsible business regarding our own and UK/global carbon targets which could result in fines, reputational damage and negatively impact expansion plans.</p> <p>These risks are as discussed further in the TCFD section on page 67.</p>	<p>We have a statutory and moral responsibility to ensure that we safeguard the welfare and safety of our people, business partners and the public who may be affected by our activities.</p> <p>Failure to operate a safe environment risks damage to the health and wellbeing of a stakeholder, operational disruption, inconvenience to passengers and long-term damage to our reputation.</p> <p>The UK threat level is substantial. We are responsible for ensuring that our assets, infrastructure, human and electronic systems and processes meet requirements to protect aviation security, deliver high security standards and build confidence with regulators, airlines and passengers.</p>	<p>We need to continue to be able to access finance to fund our current operations and future expansion plans.</p>	<p>To enable growth, changes to airspace capacity are required to be granted. External stakeholders who influence this process include: residents, government and external lobbying bodies. In addition, to enable the desired growth, access to the airport must be increased in a sustainable way.</p> <p>There is a risk that changes to airspace capacity are not granted and that demands for surface access cannot be met.</p> <p>Inability to meet Surface Access thresholds set in the ANPS would mean an inability to release ATMs under ‘Environmentally Managed Growth’ framework.</p>	<p>Information security, primarily at risk of malicious cyber-attack is a continued risk given the size and breadth of our network and operating environment.</p>
RISK MITIGATION STRATEGY	<p>Sustainability has been embedded into all governance structures within Heathrow.</p> <p>Proactive environmental management systems and employee training programmes occur within all of our operations which set clear environmental strategies and resource conservation initiatives.</p> <p>We have launched Heathrow 2.0 and work closely across functions to ensure sustainable growth is achieved. We are reducing carbon emissions that we control, and our airport operations have become carbon-neutral. We are working towards achieving zero-carbon airport infrastructure by the mid 2030s, while working with the aviation industry to reach net-zero emissions from all flights departing the UK by 2050.</p>	<p>Our safety management system includes risk assessment processes for all activities that have significant risk and ensures proportionate control measures are used. Governance, led by our senior management teams, and assurance processes are used to ensure that controls around health-and-safety risks remain effective and continuous improvement is encouraged.</p> <p>In the current year our safety improvement team has initiated a new ‘4 pillar’ safety plan which is designed to improve the fundamental building blocks of a safe operating environment. The overall Operational Health and Safety Policy has also been updated and improved.</p> <p>We work with government agencies to ensure security procedures are appropriate and mitigate evolving threats. Procedures are subject to review through the internal controls mechanism and via independent scrutiny from the CAA.</p> <p>Post year end the emergence and spread of the coronavirus is a new risk. We are carefully monitoring developments to understand the potential risks to our business and stakeholders. We will take suitable mitigating actions where they are available and provide further updates to our stakeholders as the situation develops. Trading updates can be found on our website as part of our annual outlook communication, quarterly results and semi-annual investor reports.</p>	<p>We produce long-term forecasts which include consideration of significant downside risk to enable our management to conclude that covenant terms are likely to be met, and that we have the ability to access additional future finance as required.</p> <p>We have invested in a suitably skilled Treasury and Investment team who have robust procedures in place to ensure that the best quality investment decisions are made, and that investments can be appropriately financed.</p> <p>Realisation of Principal and other risks could deteriorate quality of our credit rating and increase this risk.</p>	<p>The potential capacity restraints are a key priority within the expansion and commercial functions which have dedicated teams, with robust workstreams, working directly with key stakeholders to develop proposals and strategies to increase capacity.</p> <p>Delay in the delivery of surface access and airspace changes could defer or reduce the release of ATMs and reduce the ability to monetise the benefits of expanded capacity.</p>	<p>We are implementing an improved cyber-security programme to comply with ISO 27001 Information Security. Mandatory training has been rolled out, and multiple awareness campaigns have been initiated which will continue throughout 2020.</p>
LINK TO STRATEGIC PRIORITIES					



Regulation requirements 	Obtaining a development consent order 	External change and innovation 	Political environment 	Ineffective organisation – systems/people 	Competition 
<p>We are currently subject to economic regulatory review.</p> <p>Changes to economic regulation could materially impact the performance of the business.</p> <p>Failure to comply with laws and regulations could result in loss of licence, penalties, claims and litigation, reputational damage and loss of stakeholder confidence.</p>	<p>We are operating our two runways at close to full capacity. Failure to secure the necessary Development Consent Order for the third runway could lead to increased congestion, passenger delay and lack of opportunity for the UK.</p>	<p>The technological world is constantly changing; new innovations have changed the way consumers do business.</p> <p>Our stakeholders are impacted by such innovations and there is a risk we do not evolve our proposition to meet new demands.</p>	<p>Our expansion of the airport is reliant on political support.</p> <p>Changes to the government, and therefore to government priorities, can impact material decisions that are taken by us.</p> <p>The UK referendum decision on Brexit has the potential to impact airline operations which may cause disruption to our passengers, impact immigration, cargo operations, our supply chain, and our people.</p>	<p>Systems</p> <p>We are constantly adapting to our internal and external requirements. As we continue to grow, existing systems and processes become unsuitable and need to evolve to meet the needs of our business.</p> <p>People</p> <p>We rely on our people to ensure that we operate effectively. External and internal requirements put pressure on colleagues and, during 2019, there was the additional risk of a threat of industrial action.</p>	<p>We compete against other airports both within the UK and across the world for passengers; some make marginal choices, particularly connecting passengers, about which route to fly. We are also in competition against other business in the UK for finite resources, infrastructure development potential and political will; all of which will be required to successfully expand. With expansion, consideration continues to be given to third party proposals to build and/or operate parts of the airport infrastructure.</p>
<p>The risk of an adverse outcome from economic regulatory reviews is mitigated as far as possible by a dedicated regulatory team which ensures full compliance with regulatory requirements, establishes a sound relationship with the regulator and advises the Executive Committee and HAHL Board¹ on regulatory matters.</p> <p>The regulatory framework requires formal engagement with airline customers. All airlines are invited to be represented on engagement forums – for example joint steering groups. In addition, key stakeholders are engaged on a joint planning basis which provides the opportunity to air views and share plans, thereby ensuring their ongoing requirements are articulated and understood.</p> <p>It has been concluded expansion is probable and therefore it is appropriate to have recognised £450m of spend to date as an asset in the course of construction, current spending plans forecast the investment will continue growing in 2020 to c£1bn. There is regulatory uncertainty in the short term due to an upcoming decision from the CAA on the proposed regulatory framework and completion of a judicial review of the Airports National Policy Statement. If as a result of either of these events, expansion was reassessed as being no longer considered probable, expansion related capital investment would be required to be impaired and expensed to the income statement.</p>	<p>We have put in place a robust process to ensure that we comply with the planning process. Extensive stakeholder surveys take place to ensure that we listen and respond to our communities' and stakeholders' needs and concerns. We remain of the view that a robust process was applied to the designation of the Airports National Policy Statement, including the extensive evidence gathered by the independent Airports Commission, multiple rounds of public consultation and the overwhelming vote in Parliament. We will continue to communicate externally the benefits of a third runway and sustainable growth at Heathrow for the whole of the UK.</p> <p>The Court of Appeal judgement is awaited on the current judicial review proceedings against the Secretary of State for Transport relating to the Government's decision to designate the Airports National Policy Statement. If the ANPS is set aside in the event of an adverse court judgement against the Secretary of State, and the likelihood of expansion occurring was no longer probable, up to £450 million of the capital expenditure spent as at 31 December 2019 would be required to be impaired and expensed to the income statement.</p>	<p>We review external markets and innovation initiatives to ensure we understand their impact, mitigate the risk and embrace change, working alongside our stakeholders as required.</p> <p>Emerging risks from external change are also included in our Executive Team's review of emerging risks as part of the risk-management process.</p>	<p>We continue to make a strong case for Heathrow's place in aviation and the wider economy and the part it plays in Global Britain, and we explain the benefits that expansion will bring. Whilst a change in the government's focus cannot be controlled, risk is monitored and proposed mitigating actions agreed in advance where necessary.</p> <p>We have established a cross-functional Brexit team, reporting to the Executive Committee and HAHL Board¹, which has implemented a structured approach to the identification and management of all risks related to Brexit.</p> <p>At midnight on 31 January 2020, the UK formally left the EU and the withdrawal agreement came into force. From 1 February 2020, the UK entered a transition period until 31 December 2020 to negotiate trade and other areas with the EU. During this transition period, travel arrangements will continue as normal.</p> <p>We have made preparations to ensure the continued safe and secure operation for passengers with a plan jointly created with stakeholders to deliver a predictable and appropriate passenger experience which minimises the pre and post Brexit impacts.</p>	<p>Systems</p> <p>We continuously review systems and processes to ensure they meet the needs of our business. Where benefits exceed the cost, we invest in new systems. In the current year we have launched a project to upgrade our financial system to support working in a simpler, easier, more agile and cost-effective way.</p> <p>People</p> <p>We continue to invest in our people and have a strategy to ensure the development of talent. Policies are in place to engage and motivate our colleagues so they are excited and challenged by their work environment and accountable and compliant with internal governance, policies and procedures. We provide great career opportunities, development and training, retaining talent and knowledge and preventing single points of failure. We were pleased that unions recently accepted a revised pay deal.</p>	<p>As we remain under pressure to stay affordable, our commercial strategies are important in retaining key passenger groups. Having a structure to ensure ease of access to reasonably priced public transport routes in and out of the airport will also be important.</p> <p>To build and maintain the coalition of support for our expansion, we must emphasise our economic importance to the UK and demonstrate that our expansion is compatible with the UK's climate change policy.</p> <p>When considering any third party proposals we will work with relevant authorities, and independently, to ensure scrutiny. Our primary focus is to ensure there would be no degradation to the experience of our passengers and colleagues and that continuity of safe, secure and efficient airport operations is maintained in the interests of all air transport users, whilst allowing the timely privately financed delivery of expansion in compliance with all ANPS requirements.</p> <p>We will seek assurance that due process is followed by any such third party, with an equivalent level of rigour, independent scrutiny, comprehensive consultation and constructive engagement as has been the case with our expansion programme.</p>
	   	 	  	   	   

¹ The HAHL Board is the Board of Directors of Heathrow Airport Holdings Limited as defined on page 78.

TASK FORCE ON CLIMATE RELATED FINANCIAL DISCLOSURES (TCFD)

In June 2017, the Financial Stability Board released its final report on the recommendations of the Task Force on Climate-related Financial Disclosures. We recognise the importance of these disclosures and are committed to implementing the recommendations in full.

We have included information in various parts of this report relating to how we are managing our climate impact and how our business is evolving in response to the risks we see arising from climate change.

We are a member of the Prince of Wales Accounting for Sustainability Project (A4S) and we have adopted the A4S maturity criteria to assess and benchmark our progress in implementing the TCFD recommendations. We have achieved an 'intermediate level' of maturity in our first year and will aim to apply all of the recommendations of the Task Force in our 2020 report. We will continue to refine our approach thereafter as our understanding of the financial risks and opportunities of climate change become clearer.

The table on page 66 shows how our disclosures map against the TCFD recommendations and where relevant information can be found in this report.

In partnership with the Cambridge University Institute of Sustainable Leadership, we are funding a research fellow who will undertake world-leading research on climate-risk scenario analysis. The research project is focused on the nexus of Physical and Transition risk and the findings will help to improve both the aviation industry's understanding, and its ability to assess, the risks that climate change will bring to aviation and airports.

GOVERNANCE

Climate change poses a risk to our business and it is a standing item on the H AHL Board's¹ agenda.

The H AHL Board¹ receives monthly updates on climate strategy from the Sustainability and Environment Director, and climate change is included as an agenda item at Board and Executive strategy days.

The H AHL Board¹ reviews principal risks that have been reviewed by the Executive Committee, Sustainability and Operational Risk Committee and Risk and Assurance Committee.

Climate change is also a standing agenda item at the Sustainability and Operational Risk Committee, a sub-committee of the H AHL Board¹ and chaired by an Independent Non-Executive Director. Its members include the Chief Executive Officer and three shareholder Non-Executive Directors. Its responsibilities include:

- Reviewing Heathrow's policies, conduct, performance and risk-management approach against sustainability goals and operational activities.
- Reviewing and challenging the performance and conduct of Heathrow relating to operational risks and the delivery of sustainability goals.
- Monitoring and challenging the appropriateness of sustainability and operational risk-assurance strategies and plans, the execution and results of such plans, and relevant communications.

¹ The H AHL Board is the Board of Directors of Heathrow Airport Holdings Limited as defined on page 78.

STRATEGY

One of our four strategic priorities is Sustainable Growth and our Heathrow 2.0 sustainability plan, launched in 2017, sets out how we will deliver this priority. Heathrow 2.0 is integrated within our overall business strategy and business plan. More information is available in the 'Our commitment to sustainable growth' section of this report. The full Heathrow 2.0 plan is available at <https://www.heathrow.com/company/about-heathrow/heathrow-2-0-sustainability-strategy>.

Climate change is a significant sustainability issue for aviation and therefore it is a theme that runs throughout Heathrow 2.0. We have committed to decarbonising our infrastructure and we are working towards becoming a zero carbon airport by the mid 2030s. We are also taking a leading role in promoting a net-zero carbon target for the aviation industry, and supporting airlines, manufacturers and other stakeholders to decarbonise air travel.

We have summarised below the parts of the Heathrow 2.0 plan that address aspects of climate change:

Objective 3 - Empowering our colleagues to deliver change.

Objective 5 - Addressing the challenges of vehicles and passenger transportation.

Objective 7 - Increasing UK access to Heathrow via sustainable means and addressing climate change adaptation.

Objective 9 - Reducing carbon emissions in our supply chain and supplier adaptation to climate change.

Objective 10 – Tackling carbon emissions in our infrastructure and operating a zero-carbon airport before 2050.

Objective 11 - Tackling carbon emissions from aviation.

Heathrow 2.0 covers our own business as well as the role we will play in driving change across the wider industry. It shows how we aim to go beyond mitigation and deliver positive impacts that enable us and those around us to thrive.

TASK FORCE ON CLIMATE RELATED FINANCIAL DISCLOSURES (TCFD) (CONTINUED)

Disclosure recommendation	Section Reference	Page
Governance		
Describe the Board's oversight of climate-related risks and opportunities	Our commitment to sustainable growth	30
	How we manage our risks	60-61
Describe management's role in assessing and managing climate-related risks and opportunities	Our commitment to sustainable growth	30
	How we manage our risks	60-61
Strategy		
Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term	TCFD	67-71
Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning	Our commitment to sustainable growth	30
	TCFD	65
Describe the resilience of the organisation's strategy, taking into consideration different future climate scenarios, including a 2°C or lower scenario	TCFD	67-71
Metrics		
Disclose the metrics used by the organisation to assess climate-related risks and opportunities	TCFD	66
Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks	Our commitment to sustainable growth	42
Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	Our commitment to sustainable growth	38-43
Risk		
Describe the organisation's processes for identifying and assessing climate-related risks.	Our commitment to sustainable growth	30
	How we manage our risks	60-61
Describe the organisation's processes for managing climate-related risks	Our commitment to sustainable growth	30
	Our principle risks	62
Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management	How we manage our risks	60-61

METRICS AND TARGETS

We have included a number of relevant carbon metrics in the sustainability review section on page 42. In addition, we disclose progress against our ten Heathrow 2.0 flagship goals. More detailed progress updates for individual goals and targets are available in our sustainability reports published on our website. The 2019 Sustainability Report will be published later in 2020.

We have publicly committed to setting a climate-science-aligned target using the Science Based Targets initiative (SBTi) criteria. We are currently developing carbon targets that are aligned to limiting temperature rises to 1.5 degrees. Our targets will be published in 2020.

CLIMATE-RELATED RISKS

Our assessment of climate-related financial risks has been aligned to two climate-related scenarios as follows:

1. A 1.5°C scenario. This is the most optimistic outcome based on recent Intergovernmental Panel on Climate Change (IPCC) reports, which envisages a full and global transition to a low-carbon economy by 2100. In order to achieve this scenario, the global economy must achieve net-zero carbon emissions by 2050 according to the IPCC's analysis.
2. A 3.5°C scenario. This scenario is a projection of how much the world will be warmed by 2100 based on current trends and practices (if no further action is taken to mitigate climate change).

In the table below, we have summarised the climate-related risks that could have a material effect on Heathrow along with our initial assessment of the relative significance of each risk to our business. Our assessment of physical risks under both 1.5°C and 3.5°C scenarios has been informed by our 'Climate Change Adaptation and Resilience report' available at www.heathrow.com/content/dam/heathrow/web/common/documents/company/heathrow-2-0-sustainability/further-reading/climate-change-adaptation-report-2016.pdf. More work is required to fully understand and assess each risk in detail. In the following pages we explain the risks, how they apply to Heathrow and what we are doing to mitigate the risks and their effects.

		1.5 Degree Scenario	3.5 Degree Scenario
Physical Risks	Description	Inherent risk rating	Inherent risk rating
Property	Physical damage to Heathrow property due to extreme weather events.	○	●
Operations	Increased operational costs and increased flight disruption.	○	●
Network	Changes to profitability of flight routes and unfavourable changes to Heathrow network.	○	●
Destinations	Change in demand for certain flight destinations due to a changing local climate.	○	●
Transition Risks	Description	Inherent risk rating	Inherent risk rating
Technology	The adoption of new technologies and the increasing use of alternative fuels by airlines require investment in changes to current airport infrastructure.	○	○
Market	Reduced demand for air travel due to changing customer sentiment. Increased competition from lower-carbon modes of transport.	●	●
Carbon policy and regulations	Carbon policies, including taxes that will lead to increased ticket pricing; carbon caps, limiting airport growth.	●	●
Reputation	Passengers and investors show a preference for airlines and airports with smaller climate impacts affecting market share and the cost of capital.	●	●

Inherent risk rating

- Lower inherent risk – Risk is unlikely to have a significant impact on the aviation sector or wider economy.
- Mid inherent risk – Risk could have a measurable impact on the aviation industry or wider economy.
- Higher inherent risk – Risk could have severe impacts on the industry or wider economy.

PHYSICAL RISKS



Property

RISK DESCRIPTION

Our assets may be subject to damage in the event of extreme weather. Climate change could result in:

- Increased risk of surface and/or structural failure.
- Impeded accessibility due to impacts on road and rail network.
- Increased risk of flooding and water quality impacts.
- Overheating of buildings and aircraft and an increased risk of fire on hot days.

AVIATION CONTEXT

- Predicted rises in mean temperatures could see a rise of up to 7.1°C in mean summer temperature and a 60% increase in annual heavy rainfall days.
- Both would require improvements in environmental risk management at a local level, particularly fire, flooding and water quality impacts.
- The cost of making these improvements would be higher under a 3.5°C scenario compared to a 1.5°C scenario, where current provisions are largely adequate.

CONSIDERATIONS FOR HEATHROW

- According to DEFRA data, Heathrow is in an area of low subsidence risk and is not particularly exposed to groundwater swells, also it is not coastal. These factors insulate it well from flood risk overall.
- APOC is an operational control centre set up in 2014 that allows Heathrow to respond rapidly to changing conditions enhancing preparedness.



Operations

RISK DESCRIPTION

- Increased frequency of extreme weather events, such as heavy rainfall and storms, could result in unfavourable conditions for the operation of aircraft and runways. These may result in delays and/or cancellations.
- Extreme weather events such as flooding or wind have the potential to cause damage to critical infrastructure, including the electricity network, roads and connecting rail transport.

AVIATION CONTEXT

- High winds, turbulence and a stronger jet stream could increase delays, maintenance requirements and fuel burn.
- Airlines have already noticed a material increase in cancellations and supply-chain disruptions due to more frequent hurricanes.

CONSIDERATIONS FOR HEATHROW

- The main risk to Heathrow is an increased operating cost to manage more frequent periods of disruption. Under a 3.5°C scenario the projected increased frequency of storms and hurricanes may present a material operational risk for long-haul flights departing from, or arriving at, Heathrow.



Network

RISK DESCRIPTION

- Climate-change impacts may result in increased turbulence or unfavourable flying conditions that may affect the routing, attractiveness or viability of some flight paths.

AVIATION CONTEXT

- The global aviation network is complex and interconnected and changes to routing decisions cannot currently be predicted with any certainty.
- This risk is more impactful for airlines than airports, as they may have to consider alternative routes due to climate-change factors.

CONSIDERATIONS FOR HEATHROW

- Network changes could affect Heathrow's route network, flight schedules and the duration of flights.
- There is potential for more routes to require transfers via hub airports such as Heathrow if weather patterns render some routes prohibitive, but this is unpredictable and difficult to quantify.



Destinations

RISK DESCRIPTION

- The long-term impacts of changing weather patterns may influence the attractiveness (and even existence) of certain destinations.
- Impacts, such as rising sea levels, changing temperatures, flooding, droughts, forest fires, heat waves and reduced snow cover in ski destinations could impact customer demand.
- Climate change could also make certain destinations more attractive or accessible to visitors, for example a longer summer season in some countries.

AVIATION CONTEXT

- In a 3.5°C scenario, many destinations become untenable or less attractive as travel destinations because they are exposed to a higher risk of extreme weather events, especially hurricanes.
- More broadly, this scenario is likely to involve significant challenges for the global economy and hence impacts on demand for aviation.
- A 1.5°C scenario would see comparatively minimal change in the makeup of destinations from today.

CONSIDERATIONS FOR HEATHROW

- Some Heathrow destinations may see fewer visitors as they suffer from the negative effects of climate-change. There may be an increase in travel to other destinations as the climate becomes warmer.
- The broad range of global destinations that Heathrow serves mitigates the impact of this risk to some degree.

TRANSITION RISKS



Technology

RISK DESCRIPTION

- Companies may consider increasing the use of alternative/sustainable fuels in order to reduce their impact on the climate requiring supply chain and infrastructure changes.
- The development of electric aircraft technology is evolving and there is growing interest from airlines which may require investment in electrical infrastructure.

AVIATION CONTEXT

- The increasing use of sustainable aviation fuels by airlines will require supply-chain and infrastructure changes. Significant infrastructure changes at airports are not anticipated to increase the uptake of sustainable aviation fuels. Sustainable aviation fuels will require carefully considered policy support to overcome current production and price hurdles and avoid unintended consequences.
- There is currently limited but growing understanding of the infrastructure requirements to support the adoption of electric aircraft.
- It is assumed that the majority of the cost of technology transition will fall to airlines and aircraft manufacturers and will ultimately be paid by passengers.

CONSIDERATIONS FOR HEATHROW

- We will need to ensure that we are capable of quickly adapting to the evolving technological and commercial needs of airlines.
- Our approach to supporting decarbonisation of aviation addresses cleaner aircraft technology and sustainable fuels; including a review of potential infrastructure requirements and incentives for airlines.



Market

RISK DESCRIPTION

- Passengers may become more concerned about the environment and carbon emissions associated with flying.
- Passengers may start to prefer alternative forms of transportation.
- Passengers may choose to fly shorter distances, thereby affecting Heathrow's existing network.
- Some businesses are already adopting virtual meetings as an alternative communications method which may lessen the need for business travel.

AVIATION CONTEXT

- Although the impact on overall market demand is still limited, awareness of the 'flygskam'/flight shaming movement is growing as some consumers opt for more sustainable forms of transportation such as rail.
- Growth in this public sentiment may encourage regulators to target the industry with taxes and legislation.

CONSIDERATIONS FOR HEATHROW

- As a hub airport, Heathrow provides a substantial amount of long-haul connectivity which is not easily substituted by other modes of transport.
- However, rail is likely to provide an alternative to some domestic and short-haul journeys where good alternative services are available.
- There is an opportunity to differentiate our brand by showing leadership, innovation and action to mitigate climate impacts.



Carbon policy & regulation

RISK DESCRIPTION

- Governments often seek to address emissions through policies to price carbon, including emissions trading schemes. The cost of carbon emissions to private companies has continued to rise globally, especially in the EU.
- Over time, carbon prices are likely to rise, potentially significantly. This will stimulate the development of cleaner technologies and fuels but may also have an impact on demand for aviation.
- If UK and/or European policy moves significantly ahead of international approaches could lead to a sustained competitive disadvantage for UK aviation.

AVIATION CONTEXT

- Climate policy is a significant potential risk for the industry.
- Airlines face significant financial risk from carbon taxation and regulation which may impact their continued ability to operate profitably.
- If higher carbon prices are passed on to passengers, they have the potential to impact future demand for flights.
- Potential aviation demand-management policies are being discussed in the UK and a number of countries in Europe. If not properly designed these policies could potentially have a significant impact on passenger demand without directly incentivising decarbonisation of the sector.

CONSIDERATIONS FOR HEATHROW

- Our local competitors are subject to the same carbon regulations, prices and frameworks.
- As part of the Airports National Policy Statement that supports expansion at Heathrow we are required to demonstrate that expansion would not result in a material increase in the UK's carbon emissions.
- A reduction in overall UK air traffic due to carbon reduction efforts is considered more likely to affect markets that cater for domestic or short-haul flights, as journeys are more easily substituted by alternatives.



Reputation

RISK DESCRIPTION

- Increasing awareness about the role of air transportation in climate change is likely to lead to stakeholders becoming more concerned about environmental impacts of flying. They may demonstrate a greater preference for airports and airlines with smaller environmental impacts.
- Investors are increasingly embedding environmental, social and governance (ESG) considerations into investment decisions. This may affect the attractiveness of investments in more carbon-intensive industries, including air travel.

AVIATION CONTEXT

- Consumer behaviour is an opportunity as well as a risk; passengers could be attracted to specific airlines or airports if they establish a place in the market by demonstrating investment, innovation and action to mitigate climate impacts.

CONSIDERATIONS FOR HEATHROW

- ESG restrictions or criteria may lead to Heathrow becoming a less attractive investment and as a result may increase our cost of capital.

SECTION 172(1) STATEMENT

Section 172 of the Companies Act 2006 requires a director of a company to act in the way he or she considers, in good faith, would most likely promote the success of the company for the benefit of its members as a whole.

In doing so section 172 requires a director to have regard (amongst other matters) to:

- a. The likely consequences of any decisions in the long-term.
- b. The interests of the company's employees.
- c. The need to foster the company's business relationships with suppliers, customers and others.
- d. The impact of the company's operations on the community and environment.
- e. The desirability of the company maintaining a reputation for high standards of business conduct.
- f. The need to act fairly as between members of the company.

In discharging our section 172 duty we, the directors of the Company, have regard to the factors set out above. We also have regard to other factors which we consider relevant to the decision being made. We acknowledge that every decision we make will not necessarily result in a positive outcome for all of our stakeholders. By considering the Company's vision, purpose and values together with its strategic priorities, as shown in our Strategic Framework on page 23, and having a process in place for decision-making we aim to ensure that our decisions are consistent and predictable.

As is normal for large companies, we delegate authority for day-to-day management of the Company and its subsidiaries to the Executive Committee and then engage management in setting, approving and overseeing execution of the business strategy and related policies. The corporate governance structure and group policies are set by the Board of Heathrow Airport Holdings Limited (the HAHL Board). We ensure that when we are applying these group policies we have due regard to our fiduciary duties and responsibilities. The HAHL Board also reviews health and safety, financial and operational performance, legal and regulatory compliance, business strategy; key risks; stakeholder-related matters; diversity and inclusivity; environmental matters; and corporate responsibility.

The Company's key stakeholders are its passengers, communities and the environment, colleagues, airlines, investors, suppliers and commercial partners and regulators. The views of and the impact of the Company's activities on those stakeholders are an important consideration for the directors when making relevant decisions. While there are cases where the board itself judges that it should engage directly with certain stakeholder groups on certain issues, the size and spread of both our stakeholders and the Heathrow Airport Holdings Limited Group (the HAHL Group) means that generally our stakeholder engagement best takes place at an operational or HAHL Group level. We find that, as well as being a more efficient and effective approach, this also helps

us achieve a greater positive impact on environmental, social and other issues than by working alone as an individual company. For details of some of the engagement that takes place at an operational or HAHL Group level with the Company's stakeholders, so as to encourage the directors to understand the issues to which they must have regard, please see the HAHL stakeholder table on the following pages.

During the period we received information to help us understand the interests and views of the Company's key stakeholders and other relevant factors when making decisions. This information was distributed in a range of different formats including in reports and presentations on our financial and operational performance, non-financial KPIs, risk, ESG (Environmental, social and corporate governance) matters and the outcomes of specific pieces of engagement (for example, the results of customer and supplier surveys and focus groups). As a result of this we have had an overview of engagement with stakeholders and other relevant factors which allows us to understand the nature of the stakeholders' concerns and to comply with our section 172 duty to promote success of the company.

We set out below some examples of how we have had regard to the matters set out in section 172(1)(a) - (f) when discharging our section 172 duty and the effect of that on decisions taken by us.

KEY DECISIONS MADE BY THE DIRECTORS OF THE COMPANY

1) Capital allocation

Each quarter the directors of the Company consider the Group's capital structure and capital allocation when proposing dividends. Details of our approach to capital allocation are set out on page 56 where we explain our long-term approach to allocating capital and the payment of dividends.

In 2019 the directors of the Company recommended dividend payments to Heathrow (DSH) Limited of £468 million (2018: £497 million). In making this decision the Board considers a range of factors. These include the long-term viability of the Company, its expected cash flow and financing requirements, the strength of the Group's balance sheet, the balance of current and forecast distributable reserves (including stress-testing to key risks), the potential impact on credit metrics and the ongoing need for the business to support the safe and efficient operations over the long term.

2) Borrowings

As required, the directors of the Company review and approve commercial terms for borrowing. In approving terms, the directors seek to ensure that appropriate funds are available to continue to invest in airport services, at a minimal cost and for a suitable period of time.

KEY DECISIONS MADE BY THE H AHL BOARD

1) Colleague Relations Strategy

The H AHL Board reviewed Heathrow's people performance measures for 2018 and discussed and approved the Colleague relations strategy for 2019, which is a key part of Mojo, our number one business priority. The purpose of the Colleague relations strategy is to increase engagement levels by making improvements in the interests of the H AHL Groups' employees. The plans focused on three key areas; leadership, management capability and employee wellbeing. We have continued to roll out our leadership development programme 'leading for Sustainable growth' to all leaders in the H AHL Group. We have also developed a leadership framework with the aim for managers to use it as an upskilling tool to build management capability. We have developed a systematic approach to health and wellbeing which is regularly reviewed and endorsed by the Sustainability and Operational Risk Committee. In 2019 we set up an employee engagement forum to provide additional voice for colleagues to raise and discuss improvements with management. Feed-back from our colleagues has resulted in a number of improvements being made, which include modernising rest room facilities for our operational colleagues, dedicating more space to enable colleagues to meet regularly with management and the development of a new mobile application that allows colleagues to book leave on the move and swap shifts.

2) Climate Strategy

The H AHL Board approved Heathrow's climate strategy, which would enable the launch of Heathrow's net zero plan in January 2020. The strategy means that Heathrow would be carbon-neutral, in respect of its own infrastructure, from January 2020. This would be achieved through purchasing green gas and offsetting our very low remaining emissions through UK natural climate solutions. For Sustainable Alternative Fuels, we will advocate a combination of a fuel mandate and APD/landing charge discounts. For offsetting, we have launched a partnership with "CHOOOSE", one of a new generation of consumer-focused offsetting platforms. We want every passenger travelling through Heathrow to have the opportunity to offset, however we plan do this in a way that we can step back as airlines step in.

3) Regulatory Strategy & IBP

The H AHL Board approved Heathrow's Initial Business Plan for the 2020's, which shows how we will deliver the global connections that Britain needs in a way that is sustainable, affordable, deliverable and financeable. The real prize for consumers will be lower airfares achieved by introducing greater competition and choice between airlines. The plan also supports our airline customers' growing commitment to decarbonising and net-zero flight. The plan has been developed using consumer and stakeholder insights. Horizon, an online community of 3007 current and 601 potential Heathrow users, has been central to our engagement programme. The Consumer Challenge Board (CCB) has also helped shape our consumer engagement strategy and provided independent challenge on the use of our consumer research and engagement in our business planning. The CCB

has challenged our research and engagement work programme, aspects of the research, how we have interpreted the results and how we are reflecting them in our plans. To date, we have completed approximately 30 additional separate pieces of research specifically focused on the development of the H7 business plan and Masterplan and in response to feedback and challenges from the CCB. An example of such feedback that changed our approach is to enhance our definition of vulnerability to go further than just mobility issues and the standard Passengers with Restricted Mobility (PRM) legislation. The CCB suggested we followed best practice from other sectors and helped us develop our new framework.

4) Expansion and Masterplan

The H AHL Board reviewed Heathrow's readiness to proceed through the M4 Masterplan gateway which formed the basis of our statutory Airport Expansion Consultation (AEC) held between June and September 2019. The M4 Masterplan also formed the basis of our Initial Business Plan for the 2020s, the purpose of which is outlined in Key Decision 3 above. The preferred Masterplan at this gateway was a detailed description and illustration of our proposed scheme and provided a greater level of detail on the expansion of Heathrow for our communities, the environment, our passengers, colleagues and airlines. As part of this review, the H AHL Board had oversight of our key AEC documentation, including our scheme development report (articulating how we arrived at the preferred Masterplan), construction proposals, future runway operations proposals, surface access proposals, earth growth proposals, and our economic development framework. In addition, the H AHL Board had oversight of our proposals for mitigating the effects of expansion, including our preliminary environmental information report, plans for compensation, property policies, and our environmentally managed growth framework. We received c.11,000 responses to our AEC which, together with stakeholder feedback, will be used to inform our M5 Masterplan gateway and Development Consent Order application towards the end of 2020.

5) Brexit Contingency Planning

The H AHL Board approved Heathrow's Brexit contingency planning, preparation and communication strategy. With each Brexit date, Heathrow made preparations for potential scenarios, including a no deal. Our planning engaged our colleagues from the EU, supporting applications for settled status. Our communication strategy kept our stakeholders and customers informed. Our plans included close engagement with local authorities for broader resilient preparedness, sharing our operational plans for assurance to our local communities and any environmental impacts. We will continue to engage closely with our colleagues, stakeholders and local authorities to maintain robust plans which incorporate changes as the negotiations progress. Our contingency plans will continue to be updated and reviewed by the H AHL Board in preparation for the next date as Parliament and the EU negotiate on the final deal.

SECTION 172(1) STATEMENT (CONTINUED)

This section sets out the details of some of the engagement that takes place at an operational or HAML Group level with the Company's key stakeholders. Not all information is reported directly to the HAML Board and not all engagement takes place directly with the HAML Board. However, the output of this engagement informs business-level decisions, with an overview of developments and relevant feedback being reported to the HAML Board and/or its committees.

PRINCIPAL RISK	Passengers	Communities and the environment	Colleagues
WHY WE ENGAGE	Understanding our passengers changing needs and behaviours helps us to achieve our vision to give passengers the best airport service in the world.	Working with communities at local, regional and national levels enables us to deliver on the objectives of Heathrow 2.0, our sustainability leadership plan.	We will only deliver our vision if we recruit, skill and retain the best people and develop a flexible, motivated, efficient, diverse and engaged team. Engaged employees deliver excellent service.
HOW WE ENGAGE	<p>Passenger interactions at the airport and satisfaction surveys drive KPIs which measure how successful we are and provide feedback on the impact of our decisions.</p> <p>We use consumer research groups to engage and shape the key decisions we make. Horizon is an online community of 3007 current and 601 potential Heathrow users which can be used when making real time decisions.</p> <p>We use social media, our website, the Official Heathrow traveller blog, email communication's and the Heathrow App to communicate directly with our passengers.</p> <p>The Consumer Challenge Board (CCB). The CCB help shape our passenger engagement strategy by providing independent challenge on the use of our passenger research and engagement in our business planning.</p>	<p>Heathrow Strategic Planning Group represents many of the local authorities and other public organisations responsible for planning the land use, transport, environment, economic development and sustainable development of the sub-region surrounding Heathrow Airport. It works proactively to shape proposals for expansion of the airport to ensure these are sustainably planned, maximise the benefits and minimise the impacts felt across the area.</p> <p>Local Focus Forum is a quarterly meeting that we host, made up of resident associations and local councillors from the villages bordering Heathrow, where we share information about pending developments and operational impacts that might affect the local area and give residents the opportunity to raise queries of concerns.</p> <p>Heathrow Community Noise Forum is a group made up of local councillors and residents from 12 boroughs around Heathrow affected by noise from the airport. It seeks members' inputs in the planning and communication of the modernisation of Heathrow's airspace.</p> <p>Heathrow Community Engagement Board is an independent body that has been established to give those who live, work and travel through Heathrow more influence over how the airport operates today and how it may grow in the future.</p> <p>Charity partnership with CARE International UK; The Duke of Edinburgh's Award programme; Heathrow Community Trust.</p> <p>We also use social media, our website, the Official Heathrow traveller blog, email communication's and the Heathrow App to communicate directly with our communities. Further information can also be found at https://www.heathrowexpansion.com/local-community.</p> <p>Further information on our engagement on the environment can be found in the sustainability section of this report from page 30 to 47 and at https://www.heathrow.com/company/community-and-environment/heathrow-2-0/reports-and-further-reading.</p>	<p>The Colleague Engagement Forum allows colleagues from across the business at all levels can have their say and help make Heathrow a great place to work.</p> <p>The People Leadership Forum works with partners to create an agile, diverse, inclusive and skilled workforce that has access to quality careers, employment and training opportunities.</p> <p>Employee InPulse surveys help measure progress made with our engagement plans and make sure we're moving in the right direction.</p> <p>Our diversity networks help us promote an inclusive culture through events, fundraising and awareness campaigns. They include: Proud, our LGBT+ network; HAND, Heathrow Airport's Network for Disability; en-hANCE our culture and ethnicity network; and Altitude, our gender equality network.</p> <p>Heathrow Skills Taskforce advises us on the skills and training programmes we need to make Heathrow's expansion a success.</p> <p>We monitor Colleague safety through KPI reporting and take action to continuously improve the safety of our working environment.</p> <p>Heathrow has regular team updates, and briefings, the HUB intranet portal includes a CEO blog and other communications.</p>

LINK TO STRATEGIC PRIORITIES



Investors	Airlines	Suppliers and commercial partners	Regulator
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Understanding the needs of investors helps us to access a cost-effective, stable, diversified financing base for the business and to make Heathrow an attractive global infrastructure investment.

Airlines and their customers are at the heart of the Heathrow proposition. It is important that we understand their needs and deliver the right operating environment for our airlines.

The service provided to passengers is the combination of a highly complex and interconnected system of services from different organisations. Heathrow works collaboratively and in partnership with all the organisations in this ecosystem to deliver our vision.

Heathrow is subject to economic regulation by the Civil Aviation Authority (CAA), which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection.

Shareholders controlling 10 per cent or more of the issued ordinary shares of FGP Topco Limited are entitled to appoint one Non-Executive Shareholder Director to the HAHL Board for every 10 per cent held.

We provide quarterly financial updates, semi-annual investor reports and debt investor presentations.

We provide an annual report and accounts, which include optional enhanced disclosures.

We perform investor roadshows and make prospectus documents available. We have ongoing dialogue with current and potential investors.

We liaise with credit rating agencies to ensure we understand the impact of our strategic decisions on their assessment.

We provide ESG reporting which integrates Heathrow 2.0 KPIs into our future financing plans.

Further information can be found at our Heathrow corporate website <https://www.heathrow.com/company/investor-centre>.

Heathrow Leadership Group works collaboratively through a Joint Steering Board to improve the end-to-end passenger experience at Heathrow. The group comprises the Chief Executives of Heathrow, British Airways, Virgin Atlantic, NATS and the CAA. It meets quarterly under the Chairmanship of Heathrow's CEO.

We engage formally with airlines throughout the year on key areas including: operational and passenger experience, the expansion of Heathrow and pricing and governance around capital spend. This is augmented with further bespoke engagement on a range of issues as an airline or as an airport community as is necessary.

Quarterly joint executive meetings take place with customers.

The CEO regularly visits major current and potential international airlines.

The Working Together Charter is a foundation for building better relationships between Heathrow and our Suppliers with the purpose to support Heathrow and Supplier colleagues to work together and fulfil our vision to give passengers the best airport service in the world.

Team Heathrow Annual Conference has become the premier gathering for our top strategic supply-chain partners and procurement professionals. This event allows us to showcase our success stories, network with peers and develop strategic partnerships.

Heathrow Business Summits give participants the chance to meet and collaborate with Heathrow's key suppliers, regional SMEs, fellow Team Heathrow colleagues and retail partners across Heathrow.

The Heathrow Sustainability Partnership is a group of companies representing all sectors at the airport, all working hard to improve Heathrow's sustainability performance.

The Clean Vehicles Partnership works with companies at Heathrow to reduce emissions from their fleet operations.

We meet regularly with the CAA to discuss all issues relating to the regulated elements of Heathrow.

We respond to various CAA publications related to the economic regulation of the airport. This includes regulatory price control reviews and expansion related matters.

As part of our licence we are required to publish various regulatory documents.

Regulatory reporting through the Annual Regulatory Accounts.



SECTION 02

GOVERNANCE

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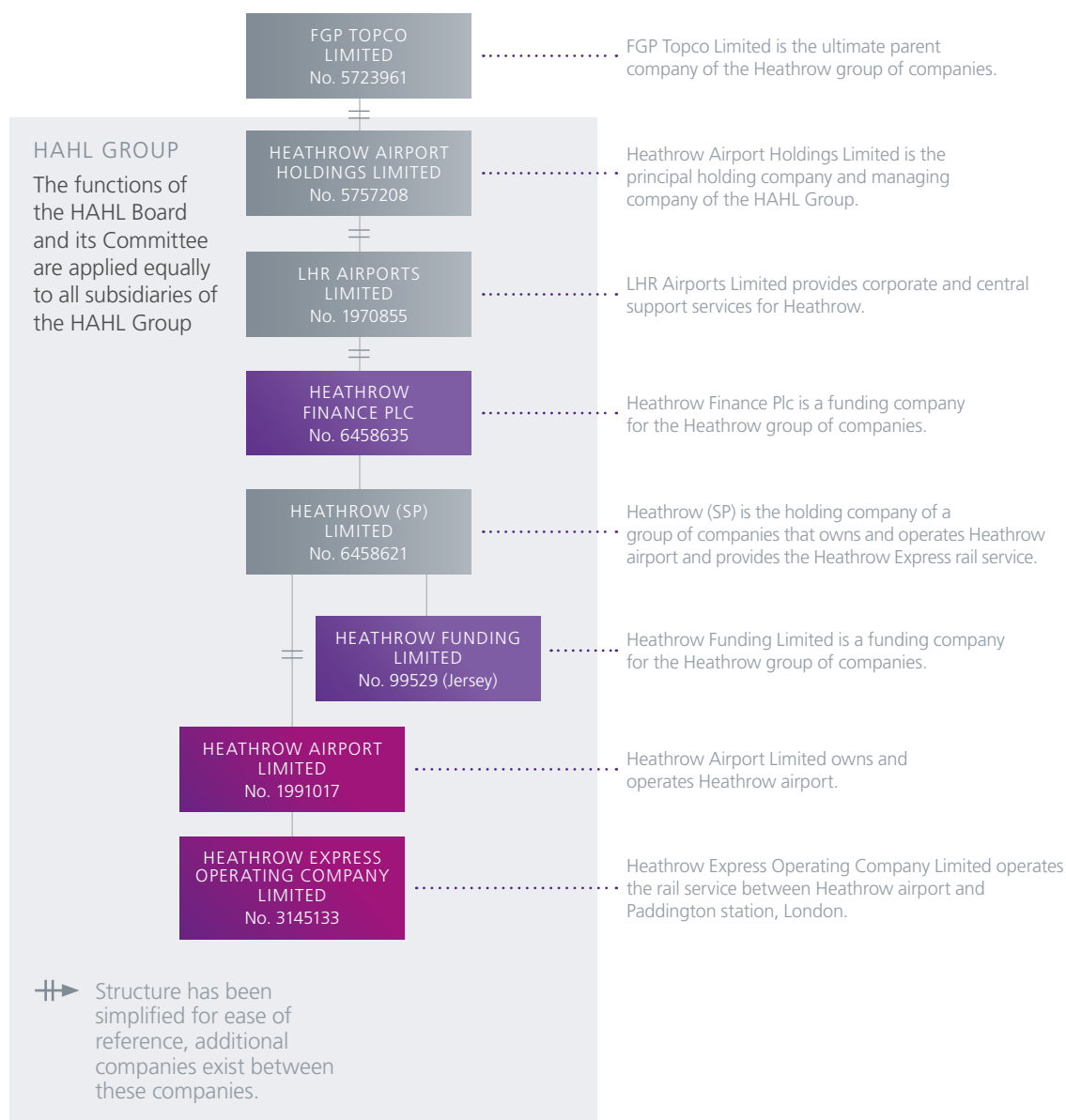
GROUP STRUCTURE

Heathrow Finance plc (the 'Company' or 'Heathrow Finance') is the holding company of Heathrow (SP) Limited, which itself is the holding company owner of a group of companies that owns Heathrow Airport ('Heathrow') and operates the Heathrow Express Rail Service. Heathrow Finance is an indirect subsidiary of the Heathrow Airport Holdings Limited group (the 'HAHL Group').

The Board of Directors of Heathrow Airport Holdings Limited (the 'HAHL Board') determines the long-term strategy of the HAHL Group, ensuring that it acts ethically, has the necessary resources to meet its objectives, monitor performance, and meet its responsibilities as a major airport group.

As the functions of the HAHL Board and its committees are applied equally to all subsidiaries of the HAHL Group, including Heathrow Finance, the discussion in the Corporate Governance section relating to the governance structure and composition of the HAHL Board and its committees has been extracted from the financial statements of Heathrow Airport Holdings Limited.

The ultimate parent company of the HAHL Group is FGP Topco Limited. A simplified structure of FGP Topco Limited and its subsidiaries along with their principal activities within the HAHL Group is illustrated in the diagram below.



OUR OWNERS

The HAHL Group is owned by a consortium of investors (the 'Shareholders') who hold shares in FGP Topco Limited. Details of the Shareholders' equity interests, as at 31 December 2019, are shown in the table below:

Shareholder	% held
Ferrovial Hubco Netherlands B.V. (an indirect subsidiary of Ferrovial, S.A., Spain)	25.00%
Qatar Holding LLC Qatar Holding Aviation (a wholly-owned subsidiary of Qatar Holding LLC)	20.00%
Caisse de dépôt et placement du Québec (CDPQ)	12.62%
GIC Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of GIC)	11.20%
Alinda QS Airports UK, LP (investment vehicle managed by Alinda Capital Partners),	11.18%
China Investment Corporation (CIC) Stable Investment Corporation (an investment vehicle of the China Investment Corporation)	10.00%
Universities Superannuation Scheme (USS) USS Buzzard Limited (wholly-owned by the Universities Superannuation Scheme)	10.00%

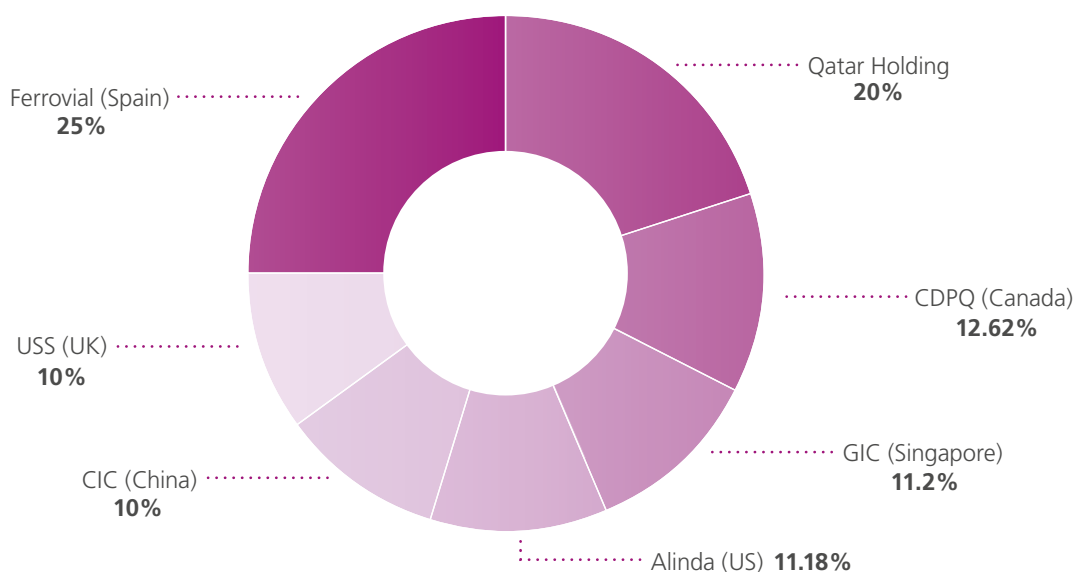
Shareholders' Agreement

All the Shareholders are party to a Shareholders' Agreement which determines certain governance procedures in the HAHL Group. Under the terms of the Shareholders' Agreement, each Shareholder, controlling ten per cent or more of the issued ordinary shares of FGP Topco Limited, is entitled to appoint one director to the HAHL Board for every 10 per cent they hold. There are also a limited number of matters reserved for approval by the Shareholders. Although these matters are reserved to the Shareholders, the HAHL Board would expect to express a view to the Shareholders before any decisions were taken.

Governance arrangements resulting from the Heathrow Group's secured financing platform

In 2008, a secured financing platform was put in place. As part of these arrangements, the Group entered into a Common Terms Agreement (CTA) with its debt investors. The CTA sets out the terms and conditions of the Group's borrowing and the ongoing management of its secured financing platform. The CTA also sets out the financial and non-financial covenants that must be complied with in relation to the financing platform. The CTA restricts amendments to the Articles of Association of companies in the Group without obtaining prior consent from the Security Trustee.

The governance measures put in place in 2008 are designed to ensure that the Group has the means to conduct its regulated business separately from other companies within the Heathrow Group, and that all dealings between other companies within the Heathrow Group are on an arm's-length basis.



HAHL BOARD OF DIRECTORS

HAHL BOARD OF DIRECTORS CHAIRMAN, EXECUTIVE DIRECTORS, COMPANY SECRETARY



LORD PAUL DEIGHTON
CHAIRMAN Appointed June 2016

N

Lord Deighton is best-known for delivering the 2012 London Olympic Games to international acclaim as CEO of LOCOG (London Organising Committee of the Olympic Games), enhancing the UK's reputation for infrastructure service-delivery and generating national pride. He was Commercial Secretary to the Treasury and was responsible for the UK's National Infrastructure Plan, focusing on getting major projects built, benefits captured, attracting capital into the UK from across the world and creating the right environment for continued infrastructure investment. Lord Deighton also had a very successful career at Goldman Sachs. He is now guiding Heathrow through its next phase of development to fulfil Heathrow's vision of giving passengers the best airport service in the world.



JOHN HOLLAND-KAYE
CHIEF EXECUTIVE OFFICER Appointed July 2014

F S

John joined the company as a Commercial Director in May 2009. From November 2012, John was Development Director and was responsible for delivering the £1 billion annual investment in transforming Heathrow, including the new Terminal 2: The Queen's Terminal, which opened on 4 June 2014. He was previously Divisional CEO with Taylor Wimpey Plc. Prior to that, John was Managing Director, National Sales Division, of Bass Brewers, and has also worked as a strategy consultant with LEK Consulting for a number of high-profile businesses. He is a member of HRH The Prince of Wales Sustainable Markets Council, DEFRA's Council for Sustainable Business and Chairs Business in the Community's (BITC) Employment and Skills Leadership Team.



JAVIER ECHAVE
CHIEF FINANCIAL OFFICER Appointed November 2016

F

Javier joined Heathrow in January 2008 and was closely involved in establishing the current capital structure and positioning Heathrow as a strong credit in the financial markets. Over a four-year period up to 2016, as Finance Director for Operations and Performance, Javier played a key role in the delivery of a cost-efficiency programme and in ensuring a rigorous appraisal of a multi-billion capital investment plan.



CAROL HUI
CHIEF OF STAFF AND GENERAL COUNSEL Appointed Company Secretary April 2009

Carol was appointed Chief of Staff from 1 January 2017. She is responsible for legal affairs, business assurance, external and internal communications, sustainability and environment. She joined Heathrow in March 2009 as General Counsel. Carol has extensive senior executive experience in transport, oil and gas and infrastructure industries and was a corporate finance lawyer at Slaughter and May. She has received numerous awards in her career including from the Financial Times, The Lawyer, Sinopro and PwC.

HAHL BOARD OF DIRECTORS INDEPENDENT NON-EXECUTIVE DIRECTORS



PROFESSOR DAVID BEGG
INDEPENDENT NON-EXECUTIVE DIRECTOR Appointed November 2010

S

David has extensive expertise in the transport sector and is a Non-Executive Board Member of FirstGroup; Chairman of the Northern Way Transport Compact.; Chairman of the British Chamber of Commerce Infrastructure Commission, Chief Executive of Portobello Partnership, a member of the High Speed Rail 2 External Challenge Group; Advisor to the Greater Manchester Transport Executive; publisher and contributor at the Transport Times magazine; and Visiting Professor in Sustainable Transport at Plymouth University. He was previously Chairman of the Commission for Integrated Transport, an independent advisory board to the Government, and Chairman of Tube Lines, the company responsible for maintenance and upgrade work on three London Underground lines.



RT. HON RUTH KELLY
INDEPENDENT NON-EXECUTIVE DIRECTOR Appointed April 2019

A

Ruth's previous roles include Secretary of State for Transport and Financial Secretary to the Treasury and thus brings a wealth of political, transport and financial experience to Heathrow. This will help Heathrow build on its role as the UK's only hub airport – providing new trading global links post-Brexit and delivering world-class passenger service.



RACHEL LOMAX
INDEPENDENT NON-EXECUTIVE DIRECTOR Appointed November 2010

N R

Rachel has 40 years' experience in policy-making, at the heart of the British economy. Rachel served as Deputy Governor of the Bank of England from 2003 until 2008. Before joining the Bank, she was Permanent Secretary of three government departments, including the Department of Work and Pensions and the Welsh Office as well as the Department for Transport. Her earlier career was spent at the Treasury, the Cabinet Office and the World Bank. Rachel was also a Non-Executive Director of HSBC. She is currently Acting Chair of the British Council and is a Non-Executive Director of Serco. Rachel stepped down from the HAH Board on 23 February 2020, after having served for nine and a half years on the Board.

COMMITTEE KEY

C Committee chair **A** Audit committee **N** Nominations committee **F** Finance committee **S** Sustainability and Operations Risk committee **R** Remuneration committee

HAHL BOARD OF DIRECTORS NON-EXECUTIVE SHAREHOLDER DIRECTORS



HIS EXCELLENCY AKBAR AL BAKER
NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed January 2013

(A) (N) (F) (S)

Akbar has been the Chief Executive Officer of Qatar Airways since 1997. He also led the development of the multi-billion dollar Hamad International Airport, which opened in April 2014. Mr Al Baker is a graduate of Commerce and Economics, and holds a private pilot's licence. He is also CEO of several divisions of Qatar's national airline – being Qatar Airways Holidays, Qatar Aviation Services, Qatar Duty Free Company, Doha International Airport, Qatar Distribution Company, Qatar Executive, Oryx Rotana Hotel and Qatar Aircraft Catering Company. **Alternate:** Ali Bouzarif (appointed January 2018).



AHMED AL-HAMMADI
NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed February 2018

(F) (R)

Ahmed is Head of the Active Investments department for the Qatar Investment Authority. He oversees QIA's direct sector teams as well as fund investments in the Equity, Fixed Income, Hedge Funds, Private Equity and Real Estate asset classes. Prior to joining QIA, Ahmed worked at EFG-Hermes, a regional asset manager and, before that, at consulting firm Booz & Co. advising financial-services clients on strategy, private-equity investment opportunities, and organisation structures. Ahmed is a graduate of the Wharton School at the University of Pennsylvania and has obtained his MBA from the Harvard Business School.

Alternate: Deven Karnik (appointed September 2014).



STUART BALDWIN
NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed April 2006

(N) (F) (R)

Stuart is Managing Director and Head, Infrastructure Group of GIC. Stuart has served as a director on a number of portfolio company boards for GIC as well as a number of advisory boards for private equity and infrastructure funds. He is currently a director at Terminal Investment Limited Sarl and Raffles Infra Holdings. **Alternate:** Alexander Leonard (appointed April 2018 and resigned December 2019). Kamil Burganov (appointed January 2020).



CHRIS BEALE
NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed October 2011

(F)

Chris is the Managing Partner of Alinda Capital Partners, an independent investment firm with over \$7.4 billion in equity commitments to infrastructure investments. Alinda's investors are predominantly pension funds for public-sector and private-sector employees. Prior to founding Alinda in 2005, he led the world's largest infrastructure finance business as global head of project finance at Citigroup. He was also global head of project finance at Morgan Stanley and Credit Suisse First Boston. **Alternate:** Sam Cox (appointed November 2012).



MARIA CASERO
NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed January 2019

Maria is People, Communications and Asset Management director for Ferrovial Airports and Ferrovial Power Infrastructure. She joined the Group in 2008. Maria has more than 30 years' experience in the aviation industry in Europe, Latin America and the United States. Before joining Ferrovial, she was the Human Resources and International Communications Director at Carlson Wagonlit Spain. Between 1992 and 2006, she held various leadership positions in British Airways. She began her professional career as an Accounting Manager at American Airlines. **Alternate:** Gonzalo Velasco Zabalza (appointed February 2017); Ignacio Aitor Garcia Bilbao and Ignacio Madridejos Fernández (appointed January 2020).



OLIVIER FORTIN

NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed October 2015

(A) (F) (S)

Olivier is a director in the CDPQ team based in London and is an experienced asset manager and infrastructure investor in the UK and Continental Europe. Previously he was working with AMP Capital, and prior to that with MAp Airports and Macquarie Capital Funds. He has been involved with Brussels, Copenhagen, Bristol, Rome and Newcastle airports. He also sits on the supervisory board of Budapest Airport.



JORGE GIL

NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed December 2012

(A) (N) (F) (S) (R)

Jorge is the Chief Executive Officer Ferrovial Aeropuertos. Jorge joined the Ferrovial group in 2001, as the Structured Finance Director (until 2007) and then the Corporate and Business Development Director (2007-2010) of Cintra. He was a member of the Executive Committee of Cintra and a board member of various companies (407-ETR, Chicago Skyway, Indiana Toll Road and SH-130). In November 2010 he joined the financial department of Ferrovial as Capital Markets and Finance Director of Ferrovial, with responsibility for the financing and treasury of the Group and for the Investor Relations Department. Jorge began his career in the banking industry at The Chase Manhattan Bank in Spain, working in Corporate Finance and M&A.

Alternate: Inigo Meiras (appointed December 2012 and resigned September 2019). Ignacio Aitor Garcia Bilbao, Gonzalo Velasco Zabalza and Ignacio Madrdejos Fernández (appointed January 2020).



ERNESTO LÓPEZ MOZO

NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed October 2009

(A) (F) (R)

Ernesto is Ferrovial's Chief Financial Officer. Ernesto joined Ferrovial from Telefonica, having previously held positions at JP Morgan and Santander. **Alternate:** Ignacio Aitor Garcia Bilbao (appointed March 2013); Ignacio Madrdejos Fernández and Gonzalo Velasco Zabalza (appointed January 2020).



MIKE POWELL

NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed November 2014

(F) (N)

Mike is Head of Private Markets Group of USS Investment Management (USSIM), which is the wholly owned investment management subsidiary of the Universities Superannuation Scheme (USS). USSL is the corporate trustee of one of the largest private sector pension funds in the UK with assets under management of £68 billion as at 31 March 2019 and over 400,000 members across more than 350 universities and other higher education and associated institutions in the UK. USSL, through its investment manager, USSIM, is a long-term owner of assets with a strong track record of investing in infrastructure and infrastructure-like businesses. Mike has overall responsibility for the Private Markets Group and is Chairman of the Private Markets Investment Committee. He is also a member of the USSIM Executive Committee and Investment Policy Committee. Mike has served as a director on a number of portfolio company boards for USS as well as a number of advisory boards for private equity and infrastructure funds. Mike is also a member of the British Venture Capital Association Limited Partner Advisory Committee. **Alternate:** Tom Kelly (appointed October 2018).



DAVID XIE

NON-EXECUTIVE SHAREHOLDER DIRECTOR Appointed September 2018

(F)

David is a director of CIC Capital Corporation (CIC Capital), a wholly-owned subsidiary of China Investment Corporation (CIC). He is responsible for CIC Capital's infrastructure investments globally, in particular in transport, utilities and energy sectors. In addition to Heathrow, David also sits on the board of Cadent Gas and InterPark. Prior to joining CIC in 2011, David worked 11 years in various capacities at Merrill Lynch. David is a graduate of Pennsylvania State University and has an MBA degree from Georgetown University. **Alternate:** Jinhong Chen (appointed September 2018).

EXECUTIVE COMMITTEE



JOHN HOLLAND-KAYE
CHIEF EXECUTIVE OFFICER



JAVIER ECHAVE
CHIEF FINANCIAL OFFICER



CAROL HUI
CHIEF OF STAFF AND
GENERAL COUNSEL

For biographical details see page 80.



ROSS BAKER
CHIEF COMMERCIAL OFFICER

Ross was appointed Chief Commercial Officer in January 2017. Previously he was Heathrow's Director of Operations and, before that, Director of Strategy. Prior to joining Heathrow in 2011, Ross held a mix of advisory and aviation industry roles. At Bain & Company he advised on a mix of strategic, commercial and operational engagements. Prior to Bain, Ross spent a decade with British Airways where he held a range of operational and commercial-management roles in the UK and overseas.



STUART BIRRELL
CHIEF INFORMATION OFFICER

Stuart joined the Company as Chief Information Officer in June 2015. He previously held this role at Formula 1's McLaren Group where he built an integrated IT team of in-house experts and specialist suppliers to support the rapid growth of the business including new revenue streams. Stuart knows the airport industry well, having spent three successful years as CIO at Gatwick in the run up to, and after, the sale of the airport by Heathrow in 2009. At McLaren Group, he had experience of working in a high-performance environment, where you need extremely high levels of reliability and resilience. Stuart also brings expertise in the use of big data sets, cloud-based solutions and IT security in support of business growth and increased productivity.



CHRIS GARTON
CHIEF OPERATING OFFICER

Chris was appointed as Chief Operating Officer in April 2018. Prior to this, Chris held the equivalent role at Dubai Airport, where he played a key role in growing the annual number of passengers over a nine-year period. His most recent role was Director of Asset Management with Associated British Ports and during his career, Chris has also held a number of positions in engineering and change management at Gatwick Airport, Ineos and ICI. He has a first-class degree in engineering from London's Imperial College.



EMMA GILTHORPE
EXECUTIVE DIRECTOR EXPANSION

Emma was appointed as Executive Director Expansion in January 2017. Her responsibilities include Heathrow's expansion programme as well as master planning. Emma joined Heathrow in September 2009 as Regulatory Director and later became Strategy Director. She was previously BT plc's Group Director of Industry Policy and Regulation and has held a number of other senior regulatory and public-policy roles in Cable and Wireless.



ANDREW MACMILLAN
CHIEF STRATEGY OFFICER

Andrew was appointed Chief Strategy Officer in January 2017. He is responsible for company strategy, forecasting, regulation and corporate process improvement. He joined Heathrow in October 2009 and has worked in strategy, operational and regulatory roles, including leading submissions to the Airports Commission. He is a non-executive trustee of the BAA Pension Fund. Prior to Heathrow, he was with McKinsey and Company based in London and Tokyo, working on infrastructure, logistics and organisational transformation and mergers in Europe, the Middle East and Asia.



PAULA STANNETT
CHIEF PEOPLE OFFICER

Paula was appointed to HR Director in January 2013. She has worked at Heathrow for 13 years, most recently as HR Director for our Airports Division and Support Services, and previously as programme lead for Heathrow's Winter Resilience. Paula has a strong record of engaging staff to successfully put in place organisational change and improvement.

CHAIRMAN'S INTRODUCTION



LORD PAUL DEIGHTON
CHAIRMAN

As a Board, we remain committed to high standards of corporate governance and believe that these high standards are central to the effective management of the HAHL Group and to maintaining the confidence of our investors.

The following pages provide information on the composition of the HAHL Board and its governance structure and processes, together with reports from each of its committees.

For the year ended 31 December 2019, under the Companies (Miscellaneous Reporting) Regulations 2018, the HAHL Group has applied the Wates Corporate Governance Principles for Large Private Companies, published by the Financial Reporting Council (FRC) in December 2018.

The Wates Principles provide a framework for the HAHL Board to monitor corporate governance of the HAHL Group and see where governance standards can be raised to a higher level across the business. We believe this, in turn, will result in better engagement with our stakeholder base and ultimately build trust with our passengers, colleagues and investors. The governance framework will also provide the right environment for the HAHL Board to make decisions for the long-term success of Heathrow.

The table below summarises the six Wates Principles and indicates where more information can be found in the strategic and the governance reports. Throughout 2020, the HAHL Board will continue to review and challenge how the HAHL Group can continue to improve its corporate governance.

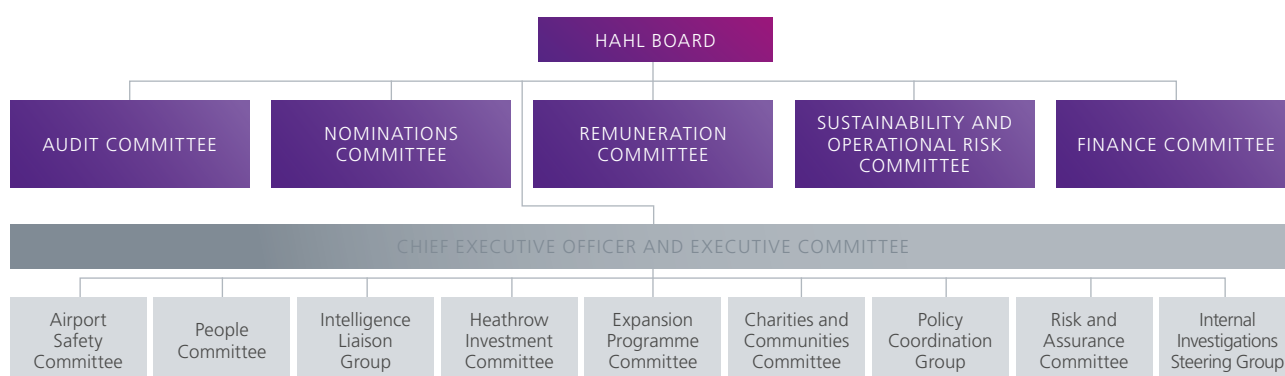
Principle	Summary	Page
Purpose and leadership	The HAHL Board determines the long-term strategy, direction and performance of the HAHL Group. Our vision is to give passengers the best airport service in the world and the HAHL Board is responsible for ensuring that values, strategy and culture are aligned with that purpose. The HAHL Group's strategic framework, shown in the Strategic Report page 23, embeds our vision, purpose, priorities and values with our strategic propositions as key elements to ensure our stakeholders' interests are central to our future developments at Heathrow.	22, 72, 86
Board composition	The HAHL Board comprises the Chairman, CEO, CFO, three Independent Non- Executive Directors and ten Shareholder Non-Executive Directors. The Independent Non-Executive Directors bring outside experience in aviation, transport and finance, and provide constructive challenge and influence. The composition of the HAHL Board is partly determined by the Shareholders' Agreement and it is considered to be in the best interests of the HAHL Group for the senior executives and each Shareholder to be represented at meetings. The HAHL Board is committed to improving its diversity in terms of gender, ethnicity, disability and age, and its Nominations Committee is responsible for reviewing diversity and succession planning.	90, 91, 93
Directors' responsibilities	The HAHL Group has a separate Chairman and CEO to ensure that the balance of responsibilities, accountabilities and decision making are effectively maintained. The HAHL Board receives regular reports on business, financial performance, passenger numbers, colleague issues and engagement, stakeholders and local communities and management of key business risks along with updates on activities and decisions of its committees. Non-Executive Directors provide constructive challenge to the Board's decision-making processes.	88- 90
Opportunity and risk	The HAHL Board seeks out opportunity while mitigating risk. Long-term strategic opportunities are highlighted in the annual Business Plan process presented to the HAHL Board. The Risk and Assurance Committee and the Executive Committee ensure that inherent and emerging risks are identified and managed appropriately and in a timely manner updating the risk register for any changes in underlying conditions. Operational and safety risks are regularly reviewed by the Sustainability and Operational Risk Committee and financial risks by the Audit Committee.	60, 94, 106
Remuneration	The Remuneration Committee has clearly defined terms of reference and is responsible for making recommendations to the HAHL Board concerning the HAHL Group's remuneration strategy, recruitment framework and long-term incentive plans for senior executives. The Committee takes advice from independent external consultants who provide updates on legislative requirements, best market practice and remuneration benchmarking. Pay is aligned with performance, taking into account fair pay and conditions across the company's workforce.	98
Stakeholder relationships and engagement	Central to our strategic framework, shown on page 23, is our high-level aspirations for the future of Heathrow for all our stakeholder groups. Our strategic priorities and values are how we deliver our vision. They reflect a simple business logic: engaged people deliver excellent service, which in turn delivers financial returns and growth in a sustainable way. The table within the section 172 (1) statement on pages 74 and 75 sets out the details of some of the engagement that takes place at an operational or HAHL Group level with key stakeholders.	22, 74

GOVERNANCE STRUCTURE

The HAHL Board determines the long-term strategy, direction and performance of the HAHL Group, including approval of the annual budget and management business plan. It is responsible for ensuring that the HAHL Group acts ethically and meets its legal and regulatory responsibilities, monitoring the HAHL Group’s performance and ensuring the HAHL Group has the necessary resources to meet its objectives.

Whilst the HAHL Board retains oversight and accountability for decision-making within the HAHL Group, responsibility for day-to-day management and decision-making is delegated to the CEO and the Executive Committee. The HAHL Board delegates specific responsibilities to its formal committees, which consist of individuals with the most appropriate knowledge, expertise, industry experience and independence.

The duties of the HAHL Board are executed partially through its five principal committees: Audit, Nominations, Remuneration, Sustainability and Operational Risk and Finance. These committees operate within defined terms of reference, which are reviewed regularly by the HAHL Board. The role of Company Secretary to the HAHL Board is performed by the Chief of Staff and General Counsel.



The HAHL Board receives regular reports on business and financial performance, employee issues and management of key business risks. The Chairmen of the Audit Committee and the Sustainability and Operational Risk Committee provide regular updates on matters discussed at those committees. Decisions from the Remuneration Committee are shared with the HAHL Board. The Finance Committee submits an annual update of its activity to the HAHL Board and minutes of the committee are shared on a regular basis. Where appropriate, recommendations are made by each of the HAHL Board committees so that final decisions can be taken by the HAHL Board. Members of the HAHL Board have the opportunity to attend monthly Shareholder Working Group sessions to receive more in-depth information about specific aspects of the business.

The Executive Committee is the forum of the senior executive management team of the HAHL Group. The HAHL Board delegates authority for day-to-day management of the HAHL Group to the Executive Committee, which meets weekly and is chaired by the Chief Executive Officer. In addition to the Chief Executive Officer, membership of the Executive Committee includes the Executive Directors responsible for each business function. Further information is shown on page 84.

The Executive Committee develops and recommends to the HAHL Board, medium and long-term business development strategies. They ensure the delivery of agreed strategies by providing guidance, approvals, governance and monitoring. The Executive Committee also considers health and safety, legal and regulatory matters, risk assurance and compliance, and reviews and approves all matters to be presented to the HAHL Board for its consideration or approval. There is a high level of interaction between the HAHL Board and the Executive Committee. Members of the Executive Committee provide presentations at board meetings on a regular basis and attend strategy days with the HAHL Board in order to review issues in more detail, plan and align views.

The Executive Committee delegates specific matters to a number of sub-committees whilst retaining overall accountability. The sub-committees consist of managers and other experts with appropriate knowledge, industry experience and expertise to make decisions and report back to the Executive Committee. Each sub-committee operates in accordance with terms of reference approved by the Executive Committee and is evaluated on a regular basis.

Executive sub-committees

AIRPORT SAFETY COMMITTEE

Responsible for reviewing Heathrow's responsibilities, strategies, policies, conduct, performance and risk-management approach. It covers all aspects of safety, including fire, physical health and safety, airside safety, psychological safety, environmental safety (compliance) and the potential impact on Heathrow's reputation arising from its performance in these respects. It is chaired by the Chief Financial Officer. Other members include the Chief Operating Officer, Chief Information Officer, Health and Safety Director and others.

PEOPLE COMMITTEE

Responsible for reviewing strategy in relation to people issues, including reviewing benefit schemes, living wage, gender pay-gap reporting and other people-related matters. It is chaired by the Chief People Officer. Other members include Chief Financial Officer, Chief of Staff and General Counsel, Reward Director, Finance Director and Head of People and others.

INTELLIGENCE LIAISON GROUP

Responsible for providing a secure forum to safely share secret, sensitive and often time-critical intelligence. It is chaired by the Director of Security. Other members consist of the Chief Executive Officer, Chief Operations Officer, Chief of Staff and General Counsel and Expansion Director.

HEATHROW INVESTMENT COMMITTEE

Acts under authority delegated by the Executive Committee as a single accountable forum on capital investment across Heathrow. It is chaired by the Chief Financial Officer. Other members consist of the Chief Information Officer, Chief Operations Officer, Chief Communications Officer, Chief Strategy Officer and Expansion Director.

EXPANSION PROGRAMME COMMITTEE

Responsible for oversight, steering and delivery of the Heathrow Expansion Programme. It is chaired by the Expansion Director. Membership includes the Expansion Programme Director and others.

CHARITIES AND COMMUNITIES COMMITTEE

Responsible for agreeing strategy and policy for charitable giving and oversight of investment in local communities at Heathrow. It is chaired by the Chief of Staff and General Counsel. Other members consist of the Chief Financial Officer, Chief People Officer and Expansion Director.

POLICY COORDINATION GROUP

A strategic, senior policy-forum that provides advice and recommendations on Heathrow's policy priorities and positions to the Executive Committee and HAHL Board, where necessary, and oversees the implementation of engagement plans. Chaired by the Chief of Staff and General Counsel. Other members include the Director of Communications, Sustainability & Environment Director, Head of Policy and Strategic Communications.

RISK AND ASSURANCE COMMITTEE

Responsible for reviewing the effectiveness of the risk-management strategy and framework, and for reviewing the principal risks. It is chaired by the Chief of Staff and General Counsel. Other members consist of the Chief Financial Officer and the Chief Strategy Officer.

INTERNAL INVESTIGATIONS STEERING GROUP

Responsible for setting and overseeing compliance with the governance framework for relevant internal investigations. It provides the Executive, HAHL Board and Audit Committees with assurance that Heathrow has appropriate procedures to ensure appropriate governance and conduct of internal investigations. It is chaired by the Chief of Staff and General Counsel. Other members consist of the People Director, Head of Security Intelligence, Director of Internal Audit, Risk and Assurance, Deputy General Counsel, Head of Legal Commercial and a designated independent Non-Executive Director.

CORPORATE GOVERNANCE

ROLES AND RESPONSIBILITIES

It is the HAHL Group's policy that the roles of the Chairman and Chief Executive Officer are separate, with their roles and responsibilities clearly divided. The key roles and responsibilities of the Directors of the HAHL Board are set out below:

CHAIRMAN

The Chairman is responsible for:

- Leading and managing the HAHL Board, its effectiveness and governance.
- Ensuring HAHL Board members are aware of and understand the views of key stakeholders.
- Helping set the tone from the top in terms of the purpose, goal, vision and values for the whole organisation.
- Creating the conditions for overall Board effectiveness.

CHIEF EXECUTIVE OFFICER

The Chief Executive Officer is responsible for the leadership and day-to-day management of the HAHL Group, with a scope covering operations, finance, regulation, asset management, customer services, information services, human resources, corporate communications and legal.

CHIEF FINANCIAL OFFICER

The Chief Financial Officer is responsible for the financial performance of the HAHL Group and supporting the Chief Executive Officer in developing and implementing strategy.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Independent Non-Executive Directors are responsible for providing constructive challenge and bringing independence to the HAHL Board and its decision-making process. Particularly:

- Bringing a wide range of skills and experience, including independent judgement on issues of strategy, performance and risk management.
- Scrutinising and challenging the performance of the HAHL Group's business.
- Assessing risk and the integrity of the financial information and controls.

NON-EXECUTIVE SHAREHOLDER DIRECTORS

The Non-Executive Shareholder Directors are appointed in accordance with the Shareholders' Agreement and are responsible for providing constructive challenge to the HAHL Board's decision-making processes.

COMPANY SECRETARY

The role of company secretary is performed by the Chief of Staff and General Counsel. The Company Secretary is available to all Directors and is responsible for information flows to the HAHL Board and advising the HAHL Board on corporate governance matters. Directors may also take professional advice at the Company's expense.

COMPOSITION OF THE H AHL BOARD AND ITS COMMITTEES

At the date of this report, the H AHL Board comprises the Chairman, three Independent Non-Executive Directors, ten Shareholder Non-Executive Directors and two Executive Directors – the Chief Executive Officer and the Chief Financial Officer.

The names and biographies of all directors of the H AHL Board are published on pages 80 to 83. Nine of the Non-Executive Shareholder Directors have formally approved alternates, who are also listed. The alternates are statutory directors of H AHL, who attend board and other meetings only when Shareholder Non-Executive Directors are unable to do so. The Executive and Non-Executive Directors are equal members of the H AHL Board and have collective responsibility for the H AHL Group's strategy and performance. Each H AHL Board Director has a clear understanding of their accountability and responsibilities.

Recommendations for the appointment of directors to the H AHL Board are made by the Nomination Committee. Appointments are made on merit and against objective criteria with due regard to diversity (including skills, experience and gender). Non-executive appointees are also required to demonstrate that they have sufficient time to devote to the role.

The Independent Non-Executive Directors bring outside experience in aviation, transport and finance. They provide constructive challenge and influence from outside the H AHL Group. The Chairman holds periodic meetings with all the Non-Executive Directors to discuss the performance of management and the H AHL Board, without the Executive Directors present.

The H AHL Board considered the Chairman, Lord Paul Deighton, to be independent in judgment and character on his appointment on 22 June 2016. The Rt. Hon. Ruth Kelly was appointed as an additional Independent Non-Executive Director on 8 April 2019.

The Chairman and each of the Independent Non-Executive Directors have letters of appointment with the H AHL Group rather than service contracts, which include the expected time commitment of the appointment.

The Directors are required to comply with Heathrow's group policies, including policies on Professional Conduct, Health and Safety, Conflicts of Interest and Anti-Bribery, Gifts and Hospitality.

The H AHL Board believe that its size and composition are appropriate to meet the strategic needs and challenges of the business and to enable effective decision-making. The composition of the H AHL Board is partly determined by the Shareholders' Agreement, which provides that each Shareholder controlling ten per cent or more of the issued ordinary shares of FGP Topco Limited, is entitled to appoint one director to the H AHL Board. It is considered to be in the interests of the H AHL Group for each Shareholder to be represented on the H AHL Board. In addition, there are four independent Non-Executive Directors whose purpose is to challenge and provide external expertise. The H AHL Board does not have a majority of independent Non-Executive Directors and it is felt that the numbers associated with ensuring a majority of independent Non-Executive Directors would make the H AHL Board unwieldy and unduly costly.

It is acknowledged that, although there is international diversity on the H AHL Board, there is a relative lack of gender diversity. The Board is committed to making the H AHL Group an ever-more inclusive environment, thereby fostering a more diverse workforce which should increase diversity at the most senior levels.

CORPORATE GOVERNANCE

2019 H AHL BOARD ACTIVITIES

The H AHL Board held 11 scheduled meetings during the year ended 31 December 2019 and two strategy days in conjunction with the Executive Committee. During the year the H AHL Board focused on a number of areas as set out below.

2019 H AHL Board activities

STRATEGY AND OPERATIONAL

- Considered operational and business performance.
- Received updates on material communications with regulators and considered the impact of changes in regulation and developing regulation affecting Heathrow expansion.
- Airport expansion.
- Industrial relations.
- Passenger growth strategy.
- Retail strategy.
- Initial Business Plan.

LEADERSHIP AND STAKEHOLDERS

- Approved the appointment of Maria Casero as a non-executive director and the appointment of the Rt Hon Ruth Kelly as an independent non-executive director.
- Approved the extension of appointments of Professor David Begg and Rachel Lomax as independent non-executive directors.
- Discussed the revised approach to workforce engagement.
- Considered updates on diversity and succession planning.

FINANCIAL PERFORMANCE

- Reviewed financial performance and forecasts.
- Considered and approved the 2019/20 budget.
- Reviewed and approved results announcements.
- Approved the payment of quarterly interim dividends.

GOVERNANCE

- Reviewed and approved the 2018 annual report and accounts.
- Considered the impact of new corporate governance requirements, including additional reporting requirements and the Wates Code.
- Considered output from the H AHL Board evaluation process.
- Considered and agreed key risks and their mitigation and control.
- Agreed Modern Slavery Act Statement.
- Approved 2018/19 Continuity of Service Plan.

CORPORATE GOVERNANCE EFFECTIVENESS

A comprehensive induction programme is provided for all new HAML Board Directors. Our Directors update their skills, knowledge and familiarity with the HAML Group by regularly meeting with senior management, attending operational site visits, strategy sessions with the Executive Committee and regular training sessions.

All HAML Board Directors have access to the advice and services of the Company Secretary and the Heathrow Group's Legal team. They may also take independent professional advice at the company's expense.

The Chairman and Company Secretary are responsible for ensuring that Directors receive accurate, timely and clear information. To ensure that adequate time is available for Board discussion and to enable informed decision-making, briefing papers are prepared and circulated to Directors a week prior to scheduled HAML Board meetings.

The HAML Board also receives regular and timely information (at least monthly) on all key aspects of the business, including health and safety, risks and opportunities, the financial performance of the business, strategy, operational matters, market conditions and sustainability, all supported by key performance indicators.

Key financial information is collated from the Heathrow Group's various accounting systems. The HAML Group's finance function is appropriately qualified to ensure the integrity of this information, and is provided with the necessary training to keep up to date with regulatory changes. Financial information is externally audited by Deloitte LLP on an annual basis, and financial controls are reviewed by the Group's internal audit function.

Other key information is prepared by the relevant internal function. Processes for collecting data, as well as the reporting of that data, are reviewed on a cyclical basis by the HAML Group's internal audit function with quarterly reporting provided to the Audit Committee.

The HAML Board considers the regular review of its function, Committees and Directors to be an essential element of good corporate governance and important for identifying key areas of focus for future improvement and for strengthening its overall performance. An externally facilitated assessment of the HAML Board and its Committees was conducted in October 2015 and informal self-assessments took place in September 2018 and November 2019. Areas covered included boardroom behaviours and dynamics, the number, structure and process around board meetings, board composition and structure and the interaction between the HAML Board and its formal committees.

The results of each evaluation were presented to the HAML Board for consideration and recommendations, with follow-up actions debated and adopted as appropriate. Overall, the reviews showed a consensus that the HAML Board is functioning well and is effective. No material shortcomings in relation to the operation of the HAML Board and its committees were highlighted by the reviews. The Chairman confirms that each director continues to make a valuable contribution to the HAML Board and, where relevant, its committees.

AUDIT COMMITTEE



OLIVIER FORTIN
CHAIR

OTHER COMMITTEE MEMBERS

- Jorge Gil
- His Excellency Akbar Al Baker
- Ernesto López Mozo
- Rt. Hon Ruth Kelly

INTRODUCTION

The Audit Committee reviews and reports to the HAHL Board on matters relating to financial reporting. It also reviews the role and independence of the external auditor.

ROLE AND RESPONSIBILITIES

The Audit Committee is a sub-committee of the HAHL Board and its responsibilities include:

- Considering the appointment of the external auditor, taking into account relevant ethical guidance and assessing the independence of the external auditor, ensuring that key audit personnel are rotated at appropriate intervals (including overseeing the process for selecting the external auditor and making recommendations to the HAHL Board).
- Recommending the audit fee to the HAHL Board for approval and pre-approving any fees in respect of non-audit services provided by the external auditor, and ensuring that the provision of non-audit services does not impair the external auditor's independence or objectivity.
- Agreeing with the external auditor the nature and the scope of the audit, and reviewing the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements.
- Reviewing reports on the effectiveness of systems for internal financial control, financial reporting and risk management.
- Monitoring the integrity of the financial statements of the HAHL Group, and reviewing and challenging, where necessary, the actions and judgements of management in relation to the interim and annual financial statements, and any press release related to those statements.
- Reviewing Internal Audit reports to the Audit Committee on the effectiveness of the HAHL Group's systems for internal control, financial reporting and risk management.
- Reviewing the external auditor's management letter and management's responses.
- Considering management's response to any major external or internal audit recommendations.
- Approving the appointment and dismissal of the Director of Internal Audit, Risk and Assurance.
- Reviewing Heathrow's procedures for handling allegations from whistleblowers.
- Reviewing the ethics policy and monitoring its application throughout the business, considering any ethical issues which arise as a result of audit findings.
- Overseeing all press releases relating to external financial results.
- Reviewing Heathrow's tax policy and insurance strategy and arrangements.
- Reviewing the results of the Data Protection Officer's data privacy compliance monitoring programme and ensuring that the Data Protection Office is adequately resourced to carry out its tasks.
- Considering the adequacy of management's response to any major data-privacy non-compliance findings as a result of monitoring activities.
- Ensuring that the accounts are fair, balanced and understandable.
- Considering any other topics, as defined by the HAHL Board.

2019 ACTIVITY

The Audit Committee held four meetings during the year and its main activities were:

FINANCIAL REPORTING

- Reviewed and recommended approval of the interim and preliminary results, draft annual report and the associated going-concern statements.
- Reviewed the annual statement of responsibility by management with respect to the internal controls environment.
- Reviewed financial resilience and assumptions used to support the going-concern statement.
- Reviewed Group accounting policies with emphasis on the impact of the IFRS 16 leasing standard which is applicable for the current year.
- Reviewed accounting developments and their impacts and significant accounting issues.

EXTERNAL AUDIT

- Considered reports by the external auditor on its audit and its review of the financial statements.
- Reviewed the external audit strategy and assessed effectiveness of the external audit.
- Reviewed and approved the proposed approach for transitioning our auditors in 2020.
- Reviewed audit and non-audit fees incurred in 2019.

INTERNAL AUDIT

- Approved the scope of the 2020 internal audit plan.
- Reviewed delivery of the 2019 internal audit plan and approved any material changes to it.
- Reviewed the conclusions, key findings and actions (remediation plans) from internal audits completed.
- Monitored progress of the implementation of actions from internal audit activity.
- Considered whether the internal audit function is adequately resourced.

RISK MANAGEMENT AND INTERNAL CONTROL

- Reviewed the effectiveness of risk management and internal governance for the HAML Group, particularly in relation to financial risks. Further detail on our approach to managing risk is included on page 60.
- Reviewed the effectiveness of Heathrow's internal control systems and application of internal financial reporting controls.
- Monitored progress and reviewed the approach to the upgrade of our general ledger and ERP system.
- Reviewed effectiveness of, and provided guidance to, Heathrow's Fixed Asset Steering Group.

GOVERNANCE AND OTHER

- Considered and approved our tax strategy and reviewed tax matters.
- Reviewed the Committee's terms of reference.
- Received corporate-governance updates.
- Reviewed Heathrow's procedures for handling allegations from whistleblowers and receiving reports from the Internal Investigations Steering Group.



AUDIT COMMITTEE (CONTINUED)

KEY JUDGEMENTS AND FINANCIAL REPORTING MATTERS

The Audit Committee reviewed critical accounting judgements and key sources of estimation uncertainty outlined in the 'Accounting policies' section of the financial statements. The Committee considered that the most significant financial statements' risk matters are as follows:

Key judgement and financial reporting matters	Audit committee review and conclusions
<p>Classification of costs between operating expenditure and capital expenditure</p> <p>The HAHL Group has a substantial capital programme which has been agreed with the regulator (the Civil Aviation Authority).</p> <p>Only those costs which satisfy the requirements of IAS16 'Property, Plant and Equipment' should be capitalised, which in some cases requires management judgement.</p>	<p>The Committee reviewed and approved the Group property, plant and equipment accounting policy.</p> <p>The Committee received regular updates of work undertaken by the Fixed Asset Steering Group (FASG), who are responsible for ensuring capitalised costs are appropriate, and challenged the FASG to ensure that processes and controls are further improved to deal with the increased capital spend associated with Heathrow expansion. As a result, additional financial controls were identified which will further improve our internal control environment. These will be embedded into our processes during 2020.</p> <p>The Committee reviewed Managements judgement that it remains probable that expansion of the airport will continue and therefore it is appropriate to have recognised £450m of spend to date as an asset in the course of construction.</p> <p>The Committee noted that there was a strong case for expansion and the benefits it will bring the UK. It noted this was evidenced by the UK parliament vote overwhelmingly supporting the Airports National Policy Statement in 2018. It also noted the recent CAA policy document on early design and construction costs, provided further progress towards agreeing the regulatory certainty necessary to deliver an expanded Heathrow. The Committee noted the detailed assessments undertaken by Heathrow Management on the affordability of the current Master Plan and the support that the project has from the Executive and Board of Heathrow. It also however noted there was still uncertainty both in the short and medium term. Notable uncertainty included agreement of a regulatory framework which includes the incentives needed for investment, the outcome of a judicial review which is currently taking place and the overall response to the DCO application once it is submitted.</p> <p>The Audit Committee agreed with Management and concluded it was probable expansion would occur. It therefore concluded it was appropriate to continue to recognise an asset in the course of construction.</p>
<p>Hedge accounting</p> <p>The HAHL Group designates certain derivative financial instruments as cash flow hedges.</p> <p>Significant changes in the expected quantum of future Sterling refinancing may lead to insufficient Sterling borrowings to support components of the cash flow hedge reserve, requiring the recycling of the cash flow hedge reserves through income statement.</p>	<p>The Committee sought quarterly updates on management assessments, including justification of the key assumptions which support the Cash Flow Hedge Reserve.</p>
<p>Fair value of derivative financial instruments</p> <p>The HAHL Group holds a substantial derivative financial instruments portfolio comprising interest rate swaps, cross currency swaps, and index-linked swaps which are accounted for at fair value.</p> <p>In determining the fair value, judgement is used to determine the recovery rate and associated reduction in credit risk of super senior ranking derivatives (interest rate and index-linked swaps).</p>	<p>The Committee requested quarterly updates on the estimated fair value of open derivatives and justification of the valuation estimate.</p> <p>The current-year fair value position was noted as being particularly volatile due to macroeconomic and political conditions in the UK. The Committee asked the Chief Financial Officer to monitor the fair value movements on a weekly basis and to include sufficient headroom when considering future distributable reserves. As a result, the Committee was able to be satisfied that the volatility was being appropriately managed and did not risk the financial stability of the HAHL Group.</p> <p>The Committee continues to support management in its discussion with the International Financial Reporting Interpretations Committee to clarify whether it is reasonable to designate index-linked swaps as an inflation hedge under IFRS 9.</p> <p>Further detail regarding the sensitivity of the year-end valuation to key assumptions can be found in note 15.</p>

Key judgement and financial reporting matters	Audit committee review and conclusions
<p>Fair value of investment properties</p> <p>The HAML Group holds a variety of investment properties that are accounted for at fair value. In determining the fair value, judgement is required with regard to a number of valuation assumptions that include property rental growth rate, operating cost and expected yields.</p>	<p>The Committee challenged and approved the key assumptions with reference to expert third-party valuation advice. The review included consideration of the sensitivity of the valuation to changes in the key assumptions.</p> <p>The Committee challenged the valuation of investment properties which may be removed as part of Heathrow expansion and received confirmation that under IAS40 any investment property removed would be transferred to property, plant and equipment at its fair value with no impact to reserves.</p> <p>The Committee continues to note the sensitivity of the valuation to key assumptions. Further detail of this can be found in note 8.</p>
<p>Valuation of the retirement-benefit obligation</p> <p>The HAML Group operates a defined-benefit pension scheme with both open and closed sections.</p> <p>Assessing the defined-benefit pension obligation requires significant estimate and judgement, in particular with regard to discount rate, inflation and mortality.</p>	<p>In the current year a Triennial pension review was performed. The Committee challenged key economic and mortality assumptions used in the IAS19 accounting and discussed this with external auditors. After receiving expert third-party advice the committee concluded that the assumptions were based on reasonable methodology and within an acceptable range.</p> <p>The Committee continues to note the sensitivity of the valuation to key assumptions. Further detail of this can be found in note 17.</p>

REMUNERATION COMMITTEE



JORGE GIL
CHAIR

OTHER COMMITTEE MEMBERS

- Ernesto López
- Stuart Baldwin
- Ahmed Al-Hammadi
- Rachel Lomax

INTRODUCTION

The Remuneration Committee is responsible for making recommendations to the HAHL Board concerning the Group's remuneration strategy, framework and policy, and approving the compensation packages for senior executives. In doing so, the Committee takes advice from independent external consultants who provide updates on legislative requirements, best market practice and remuneration benchmarking, drawing on evidence from across the sectors in which the company operates and from other sectors. The Remuneration Committee has clearly defined terms of reference.

The HAHL Group is an active equal opportunities employer. It promotes an environment free from discrimination, harassment and victimisation, where everyone receives equal treatment and career development regardless of age, gender, nationality, ethnic origin, religion, marital status, sexual orientation or disability. All decisions relating to employment practices (including remuneration) are objective, free from bias and based solely upon work criteria and individual merit.

Each year the Group publishes its Gender Pay Report which can be found at www.heathrow.com. Further details on our gender pay-gap can be found on page 32.

ROLES AND RESPONSIBILITIES

The Remuneration Committee is a sub-committee of the HAHL Board and its responsibilities include approvals of:

- The remuneration policy of the members of the Executive Committee and Senior Managers.
- The compensation packages of the members of the Executive Committee including salary, bonus, pensions and other incentive compensation.
- The contractual terms for the members of the Executive Committee and independent Non-Executive Directors.
- The design and terms of bonus plans.
- The design and terms of long-term incentive plans.
- The approval of the annual salary review of all employees on non-negotiated and negotiated grade (including budget level).

2019 ACTIVITIES

The Remuneration Committee held four scheduled meetings during the year, and its main activities were:

- Reviewed Heathrow reward offering and compared to the external market.
- Agreed the direction of development of the new reward strategy in 2020.
- Approved the launch of a new annual Share in Success Saver plan for the wider colleague population.
- Approved the payment of the 2018 annual bonus, the 2015 Share in Success (SIS) Grant and Saver Plans and the 2016 Performance Cash Plan (PCP).
- Approved the performance metrics and targets for 2019 annual bonus, 2019 SIS Grant and the 2019 wider colleague SIS Saver plan.
- Approved the 2019 Heathrow Gender Pay Gap; reviewed progress made to date and the associated action plan.
- Approved the budget for 2020 annual salary review for senior management grades.
- Discussed Environmental, Social and Governance (ESG) metrics for the annual bonus plan and SIS Saver and Grant plans, with a desire to include these in the future.

REMUNERATION AND COMPONENTS

The Remuneration Committee reviews the HAHL Group's remuneration structure each year to ensure that the framework supports Heathrow's strategic ambitions and rewards directors fairly for the contribution that they make to the business.

Remuneration is set with reference to the market and at a level that will enhance Heathrow's resources by attracting and retaining quality leaders who can deliver Heathrow's strategic ambitions in a manner consistent with its values, purpose and the interests of its shareholders.

The remuneration policy reflects the complexity and significance of one of the world's largest airports. Executive director's remuneration comprises a base salary, benefits, retirement provisions, annual bonus and long-term incentive plan (LTIP).

REMUNERATION COMMITTEE (CONTINUED)

EXECUTIVE AND WIDER WORKFORCE REMUNERATION POLICY TABLE

The Remuneration Committee takes into account fair pay and conditions across Heathrow's workforce when setting the executive directors' remuneration policy. Pay components vary by an individual's organisational band (level in the organisation), however, remuneration themes are broadly consistent across the wider workforce. The key components of the executive committee's remuneration relative to the wider workforce are summarised below:

Component and purpose in supporting business strategy	Executive committee ¹	Other management colleagues	Negotiated grade colleagues
<p>Base salary</p> <p>To secure and retain quality individuals to deliver Heathrow's strategy.</p>	<p>Base salaries are typically reviewed annually, and set taking into account:</p> <ul style="list-style-type: none"> The roles scope, responsibilities and accountabilities. Remuneration benchmarking and competitive market practice. Individual performance. Fair pay and conditions across Heathrow's workforce. 	<p>Base salaries are reviewed annually, and set taking into account:</p> <ul style="list-style-type: none"> The role's scope, responsibilities and accountabilities. Remuneration benchmarking and competitive market practice. Individual performance. Fair pay and conditions across Heathrow's workforce. 	<p>Frontline colleague salaries are subject to collective bargaining with Heathrow's recognised trade unions.</p>
<p>Benefits</p> <p>To comprise part of a market competitive remuneration package.</p>	<p>Benefits include cash travel allowance and private health care, life assurance and permanent health insurance.</p>	<p>Eligibility for benefits is determined by an individual's organisational band, and includes some or all of: cash travel allowance, private health care, life assurance and permanent health insurance.</p>	<p>Benefits include life assurance and permanent health insurance.</p>
<p>Retirement provisions</p> <p>To comprise part of a market competitive remuneration package, rewarding sustained contribution and encouraging retention.</p>	<p>Pension provision is available for all new colleagues through a Defined Contribution Pension Plan, established on 16 June 2008.</p> <p>Colleague contribution rates are either 3%, 5% and, 8% of base salary, matched with an employer contribution of 8%, 10%, 12% respectively.</p> <p>Alternatively, the Executive committee may also be offered a fixed percentage of their annual base salary. The Chief Executive Officer receives a supplement of 30% of annual base salary having been granted protection by HMRC for the Lifetime Allowance for pensions.</p>	<p>Pension provision is available for all new colleagues through a Defined Contribution Pension Plan, established on 16 June 2008.</p> <p>Colleague contribution rates are either 3%, 5% and, 8% of base salary, matched with an employer contribution of 8%, 10%, 12% respectively.</p> <p>The former Group defined benefit pension arrangement, the BAA Pension Scheme, was closed to new members on 15 June 2008. The Scheme remains open to future accrual for those contributing members who joined prior to the closure date.</p> <p>All colleagues impacted by the Lifetime Allowance or Annual Allowance may opt for an alternative cash allowance. This comprises of £10,000 payable as an Employer Pension Contribution, if applicable, with the balance payable as a salary supplement.</p>	<p>Pension provision is available for all new colleagues through a Defined Contribution Pension Plan, established on 16 June 2008.</p> <p>Colleague contribution rates are either 3%, 5% and, 8% of base salary, matched with an employer contribution of 8%, 10%, 12% respectively.</p> <p>The former Group defined benefit pension arrangement, the BAA Pension Scheme, was closed to new members on 15 June 2008. The Scheme remains open to future accrual for those contributing members who joined prior to the closure date.</p> <p>All colleagues impacted by the Lifetime Allowance or Annual Allowance may opt for an alternative cash allowance. This comprises of £10,000 payable as an Employer Pension Contribution, if applicable, with the balance payable as a salary supplement.</p>
<p>Annual bonus</p> <p>Motivates the achievement of Heathrow's strategic ambitions, linking this with annual measurable performance criteria and rewarding individual contributions to Heathrow success.</p>	<p>Executive directors participate in the Heathrow Bonus Plan. The plan is measured against targets for EBITDA (75% weighting) and Gross Operating Expenses (25% weighting).</p> <p>Subject to satisfying individual and financial performance criteria, the maximum incentive opportunity is 100% of base salary for the Chief Executive Officer. This is paid in March of the following year.</p>	<p>Management colleagues participate in the Heathrow Bonus Plan. The plan is measured against targets for EBITDA (75% weighting) and Gross Operating Expenses (25% weighting).</p> <p>Eligibility for annual bonus and target bonus opportunity is determined by an individual's organisational band. Subject to satisfying individual and financial performance criteria, the maximum bonus opportunity is 200% of target. This is paid in March of the following year.</p>	<p>Frontline colleagues participate in the Airport Profit Bonus with payment determined by EBITDA performance.</p>

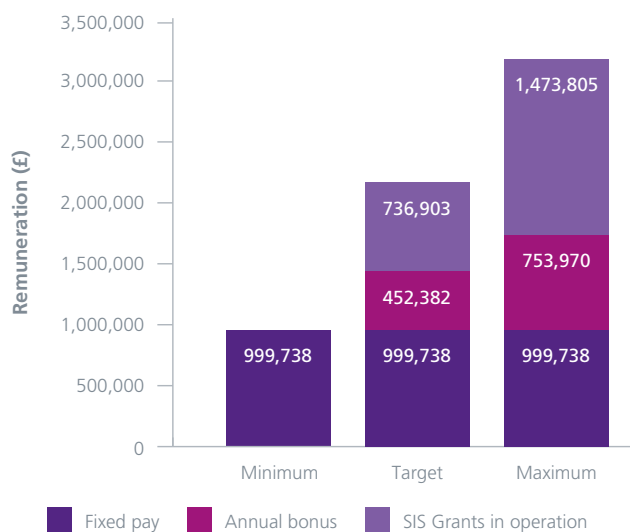
¹ Also applies to the directors of Heathrow Airport Ltd

Component and purpose in supporting business strategy	Executive committee ¹	Other management colleagues	Negotiated grade colleagues
<p>Long-term incentive plan</p> <p>Aligns the interests of executive directors with those of our ultimate shareholders, rewarding long-term sustainable results, creating shareholder value and encouraging retention.</p>	<p>Executive directors participate in the Heathrow Share in Success (SIS) Grant (Long-Term Incentive Plan) designed to reward the most senior leaders for the success of Heathrow over a three-year period. Executive directors are allocated an award with a maximum face value of 200% of base salary for the Chief Executive Officer at the start of the plan. Each executive director will receive a cash payment provided that Heathrow meets agreed performance conditions measured over a three-year period.</p> <p>The SIS Grant is measured against targets for EBITDA (40% weighting), Airport Service Quality (ASQ) score (30% weighting) and the return on Regulatory Assets Base (RAB) for our shareholders (30% weighting). For each performance metric, entry-level performance results in zero vesting, target-level performance results in 50% vesting and maximum level performance results in 100% vesting.</p> <p>There are currently three SIS Grants in operation:</p> <ul style="list-style-type: none"> • 2017 SIS Grant: performance measured over 2017 to 2019; payment in August 2020. • 2018 SIS Grant: performance measured over 2018 to 2020; payment in August 2021. • 2019 SIS Grant: performance measured over 2019 to 2021; payment in August 2022. <p>The Remuneration Committee can adjust the performance metrics and targets in appropriate circumstances, and may impose different eligibility and performance conditions on future awards.</p>	<p>Members of senior management participate in the Heathrow SIS Grant (Long-Term Incentive Plan) designed to reward the most senior leaders for the success of Heathrow over a three-year period. Senior Managers are allocated an award with a maximum face value determined by individual organisational band. Each participant will receive a cash payment provided that Heathrow meets agreed performance conditions measured over a three-year period.</p> <p>The SIS Grant is measured against targets for EBITDA (40% weighting), Airport Service Quality (ASQ) score (30% weighting) and the return on Regulated Assets Base (RAB) for our shareholders (30% weighting). For each performance metric, entry level performance results in zero vesting, target level performance results in 50% vesting and maximum level performance results in 100% vesting.</p> <p>There are currently three SIS Grants in operation:</p> <ul style="list-style-type: none"> • 2017 SIS Grant: performance measured over 2017 to 2019; payment in August 2020. • 2018 SIS Grant: performance measured over 2018 to 2020; payment in August 2021. • 2019 SIS Grant: performance measured over 2019 to 2021; payment in August 2022. <p>The Remuneration Committee can adjust the performance metrics and targets in appropriate circumstances and may impose different eligibility and performance conditions on future awards.</p> <p>Management colleagues not eligible to participate in the SIS Grant, are eligible to participate in the SIS Saver plan, where colleagues have the opportunity to save in return for a bonus, subject to company performance. To ensure all our colleagues are incentivised to deliver the same long-term goals, the targets for the performance metrics in the SIS Saver plan are aligned with the targets of the SIS Grant.</p> <p>There is currently one SIS Saver plan in operation:</p> <ul style="list-style-type: none"> • 2019 SIS: performance measured over 2019 to 2021; payment in July 2022. 	<p>In 2015 the SIS Saver was introduced to give colleagues an opportunity to benefit from exceeding business targets over the Q6 Regulatory Period and to ensure that the long-term incentive plans for all colleagues in Heathrow were aligned. Given the success of the 2015 SIS Saver, in supporting delivery of the Q6 plan and targets, which was reflected in the payout, the Remuneration Committee approved the introduction of a new three-year SIS Saver plan with the intention of launching a new plan annually.</p> <p>The wider colleague population are eligible to participate in the SIS Saver plan, where colleagues have the opportunity to save in return for a bonus, subject to company performance. To ensure all our colleagues are incentivised to deliver the same long-term goals, the targets for the performance metrics in the SIS Saver plan are aligned with the targets of the SIS Grant.</p> <p>There is currently one SIS Saver plan in operation:</p> <ul style="list-style-type: none"> • 2019 SIS: performance measured over 2019 to 2021; payment in July 2022.

REMUNERATION COMMITTEE (CONTINUED)

POTENTIAL REWARD OPPORTUNITIES AT DIFFERENT LEVELS OF PERFORMANCE

The graph below shows the Chief Executive Officer's total remuneration levels under the different performance scenarios: Minimum, Target and Maximum. The remuneration policy aligns a high proportion of total executive remuneration with the performance of the Group.



Minimum: Fixed pay comprising of current base salary, pension and benefits.

Target: Minimum plus target annual bonus and the SIS Grants in operation vest at the target level (annualised).

Maximum: Minimum plus maximum annual bonus and the SIS Grants in operation vest in full (annualised).



CHIEF EXECUTIVE OFFICER REMUNERATION

The table below presents the remuneration figures for the Chief Executive Officer for the years ended 31 December 2018 and 31 December 2019:

2019	Fixed Pay (£)				Performance Pay (£)			
	Salary/fees	Benefits	Pension	Sub-total	Annual bonus ¹	SIS Grant vesting ²	Sub-total	2019 total
Chief Executive Officer								
John Holland-Kaye	750,905	19,577	225,272	995,754	565,965	1,043,044	1,609,009	2,604,763

¹ Accrued annual bonus to be paid in March 2020.

² Expected 2017 SIS Grant to be paid in August 2020 (based on performance measured over the three 3 years 2017 to 2019).

2018	Fixed Pay (£)				Performance Pay (£)			
	Salary/fees	Benefits	Pension	Sub-total	Annual bonus ³	PCP and SIS Grant vesting ⁴	Sub-total	2018 total
Chief Executive Officer								
John Holland-Kaye	733,177	19,532	219,953	972,662	540,496	2,813,325	3,353,821	4,326,483

³ Actual annual bonus paid in March 2019.

⁴ Actual 2016 PCP, paid in August 2019 (based on performance measured over the three years 2016 to 2018), and SIS Grant paid in March 2019. The SIS was introduced in 2015 to reward colleagues based on the success of the Q6 Regulatory Period over the four-year period 2015 to 2018. The total amount paid in 2018 is therefore attributable to four years of performance.

Policy for Non-Executive Directors

The Chairman and Independent Non-Executive Directors receive fees for their services and are not eligible to participate in benefit, pension or bonus and other incentive plans. The Remuneration Committee approves the contractual terms, remuneration and compensation packages of the Chairman and Independent Non-Executive Directors. The Chairman and each of the Independent Non-Executive Directors have letters of appointment with the HAHL Group.

NOMINATIONS COMMITTEE



LORD DEIGHTON
CHAIR

OTHER COMMITTEE MEMBERS

- Jorge Gil
- His Excellency Akbar Al Baker
- Stuart Baldwin
- Mike Powell
- Rachel Lomax

INTRODUCTION

The Nominations Committee met three times during the year. In April it recommended the extension of the Chairman's appointment for a further period of 3 years from 1 May 2019 to 30 April 2022. The Committee also undertook a search for a new Independent Non-Executive Director and recommended the appointment of the Rt. Hon. Ruth Kelly to the HAHL Board in April 2019.

ROLES AND RESPONSIBILITIES

The Nominations Committee is a sub-committee of the HAHL Board and its responsibilities include:

- Identifying and recommending for the consideration of the HAHL Board all new appointments of Independent Non-Executive directors.
- Identifying and recommending for the consideration of the HAHL Board the appointment of the Chairman.
- Ensuring a formal, rigorous and transparent procedure is followed for the appointment of new independent Non-Executive directors to the HAHL Board.

FINANCE COMMITTEE



ERNESTO LÓPEZ
CHAIR

OTHER COMMITTEE MEMBERS

- John Holland-Kaye
- Javier Echave
- A Non-Executive Shareholder Director representing each shareholder entitled to appoint a director to the HAHL Board

INTRODUCTION

The Finance Committee acts as both a HAHL Board Committee for the approval of matters relating to the financing of the HAHL Group and a forum for obtaining consents required from the Shareholders of FGP Topco Limited pursuant to the Shareholders' Agreement.

ROLES AND RESPONSIBILITIES

The Finance Committee is a sub-committee of the HAHL Board and its responsibilities include:

- Any prospectus or other listing document required in relation to the issuance of any capital-markets instruments or any formal information memorandum in relation to borrowing by any member of the HAHL Group.
- The borrowing of any money or the assumption of any indebtedness by any member of the HAHL Group (including by way of the issue of securities) in excess of certain financial thresholds.
- The refinancing of any existing indebtedness in respect of any member of the HAHL Group in excess of certain financial thresholds.
- The making of any repayments of principal in addition to scheduled principal payments on any debt that may be owing by any member of the HAHL Group.
- Other than as required by the financing arrangements of any member of the HAHL Group, the making of any material loan or advance or giving of any guarantee, indemnity or provision of any credit, in each case in excess of certain financial thresholds.

- The creation of, or the granting of any permission to create, any mortgage, charge, encumbrance or other security interest on any uncalled capital or on any asset, in each case in excess of certain financial thresholds.
- Any material change, amendment or variation to any of the financing arrangements of any member of the HAHL Group or any request for any waiver thereunder or any entry into any new loan or loan facility, in each case in excess of certain financial thresholds.
- The entry into any new non-investment grade debt facility.
- Changes to Heathrow's treasury policies before going to the HAHL Board.
- The bi-annual publication of investor reports in respect of Heathrow (SP) Limited and Heathrow Finance plc, pursuant to the requirements of the Common Terms Agreement and the Heathrow Finance plc financing arrangements.
- The strategy for mitigating risks relating to the Group's financing arrangements as detailed in note 15.

2019 ACTIVITIES

The Finance Committee held ten scheduled meetings during the year, and its main activities were to approve:

- Debt funding for Heathrow, including bond issuances, credit facilities and private placements.
- Heathrow's Funding and Investment Engagement Plan.
- The Heathrow (SP) Limited and Heathrow Finance plc 2019 Investor Report.
- The base prospectuses for each of Heathrow Finance plc and Heathrow Funding Limited.

SUSTAINABILITY AND OPERATIONAL RISK COMMITTEE



PROFESSOR DAVID BEGG
CHAIR

OTHER COMMITTEE MEMBERS

- John Holland-Kaye
- Jorge Gil
- Olivier Fortin
- His Excellency Akbar Al Baker

INTRODUCTION

The Sustainability and Operational Risk Committee reviews Heathrow's policies, conduct, performance and risk-management approach against the sustainability goals and operational objectives.

ROLES AND RESPONSIBILITIES

The Sustainability and Operational Risk Committee is a sub-committee of the H AHL Board and its responsibilities include:

- Reviewing Heathrow's policies, conduct, performance and risk-management approach against sustainability goals and operational activities.
- Reviewing and challenging the performance and conduct of the H AHL Group relating to operational risks and delivery of sustainability goals.
- Monitoring and challenging management over the effectiveness of the relevant internal control systems and having access to any audit or assurance report it considers relevant.
- Reviewing and assessing management's response to significant operational incidents and having access to any accident and investigation report it considers relevant.
- Monitoring and challenging the appropriateness of sustainability and operational risk assurance strategies and plans, the execution and results of such plans, and relevant communications.

2019 ACTIVITIES

The Sustainability and Operational Risk Committee held four scheduled meetings during the year, and its main activities were:

Safety

- Reviewed and advised on safety performance and the actions being taken to ensure compliance and improve fire, health and safety standards and to strengthen Heathrow's safety culture.
- Reviewed incidents, using the learnings to develop and promote best-in-class safety performance.
- Reviewed and advised on the progress of the health and wellbeing transformation agenda in three strategic areas; 'Your Mind Matters', 'Your Health Matters', 'Your Body Matters'.

Security

- Reviewed and advised on the cyber-security strategy, cyber incidents and mitigation initiatives.
- Reviewed and advised on aerodrome security threats, security-improvement deliverables and considered the learnings from external and in-house assessments.

Sustainability

- Reviewed and advised on delivery of Heathrow 2.0 targets, in particular, carbon, noise, air quality and waste, supported by a programme of internal and external engagement.
- Considered the programme of activity to embed Heathrow 2.0 strategy within the business.

Risk and assurance

- Reviewed the principal risks to ensure alignment with the corporate-governance framework and strategy.
- Provided challenge to the business with regards to audit and assurance reports.
- Reviewed and advised on Brexit contingency planning.

HEATHROW FINANCE PLC DIRECTORS' REPORT

The directors present their annual report and audited financial statements for the year ended 31 December 2019.

PRINCIPAL ACTIVITY

The principal activity of Heathrow Finance plc is as the holding company of Heathrow (SP) Limited, which itself is the holding company of a group of companies that owns Heathrow Airport Limited, operates the Heathrow Express rail service and owns of Heathrow Funding Limited, the bond issuer of the Group.

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 contained in the Strategic and Governance Reports.

RESULTS AND DIVIDENDS

The profit after taxation for the financial year amounted to £438 million (2018: £412 million profit).

Dividends of £468 million (2018: £497 million) were paid to Heathrow (DSH) Limited during the year. The dividend payments were used to fund dividends to the Group's ultimate shareholders.

The statutory results for the year are set out on page 122.

DIRECTORS

The directors who served during the year and since the year end, except where noted, were as follows:

Yuanyuan Ding (Sally)

Javier Echave

Nicholas Golding

COMPANY SECRETARY

Pursuant to section 270 of the Companies Act 2006, a private company registered in England and Wales is not required to have a company secretary.

EMPLOYMENT POLICIES

The Group has no direct employees. The staff are employed by LHR Airports Limited, a fellow subsidiary entity of the HAHL Group. The Group directly incurs the employment cost of services provided to the Group as stated in the Accounting policies on page 138.

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, 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.

STATEMENT OF CORPORATE GOVERNANCE ARRANGEMENTS

Details of corporate governance arrangements can be found on page 87.

EMPLOYEE ENGAGEMENT STATEMENT

Details of how the Directors have engaged with employees can be found in the section 172 (1) statement on page 74.

STAKEHOLDER ENGAGEMENT STATEMENT

Details of how the Directors have engaged with suppliers, customers and other stakeholders can be found in the section 172 (1) statement on pages 74 and 75.

SUBSEQUENT EVENTS

Subsequent events are disclosed in note 28.

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 them in defending any proceedings in which judgement is given in their favour, or in which they are acquitted or in connection with any application in which relief is granted to them by the court for any negligence, default, breach of duty or breach of trust by them in relation to the Company or otherwise in connection with their duties or powers or office. This indemnity also applies to the directors who are Directors of other companies within the Group.

HEATHROW FINANCE PLC DIRECTOR'S REPORT (CONTINUED)

Matters disclosed in strategic report	Page
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Non-financial performance indicators	185
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AUDITOR

After a comprehensive tender process, and recommendation made by the Audit Committee, the Board has appointed PricewaterhouseCoopers (PwC) as auditor of the Group for the financial year ending 31 December 2020.

Pursuant to the provisions of section 485 of the Companies Act 2006, a resolution relating to the appointment of the auditor PricewaterhouseCoopers (PwC) will be proposed within the period set out in section 485.

STATEMENT OF DISCLOSURE OF INFORMATION TO THE AUDITOR

Each of the persons who is a Director at the date of approval of this Annual Report confirms that:

- So far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware.
- The Director has taken all the steps that they ought to have taken as a Director in order to make themselves 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.

The report was approved and authorised by the Board and was issued on behalf of the Board.

JAVIER ECHAVE
DIRECTOR

25 February 2020

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 International Financial Reporting Standards (IFRSs) as adopted by the European Union, and the parent company's financial statements in accordance with United Kingdom generally accepted accounting practice (United Kingdom Accounting Standards and applicable law), including FRS 101 'Reduced Disclosure Framework'. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing 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.
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

In preparing the Group financial statements, International Accounting Standard 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 IFRSs 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.
- Make an assessment of the company's ability to continue as a going concern.

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

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

The report was approved and authorised by the Board and was issued on behalf of the Board.

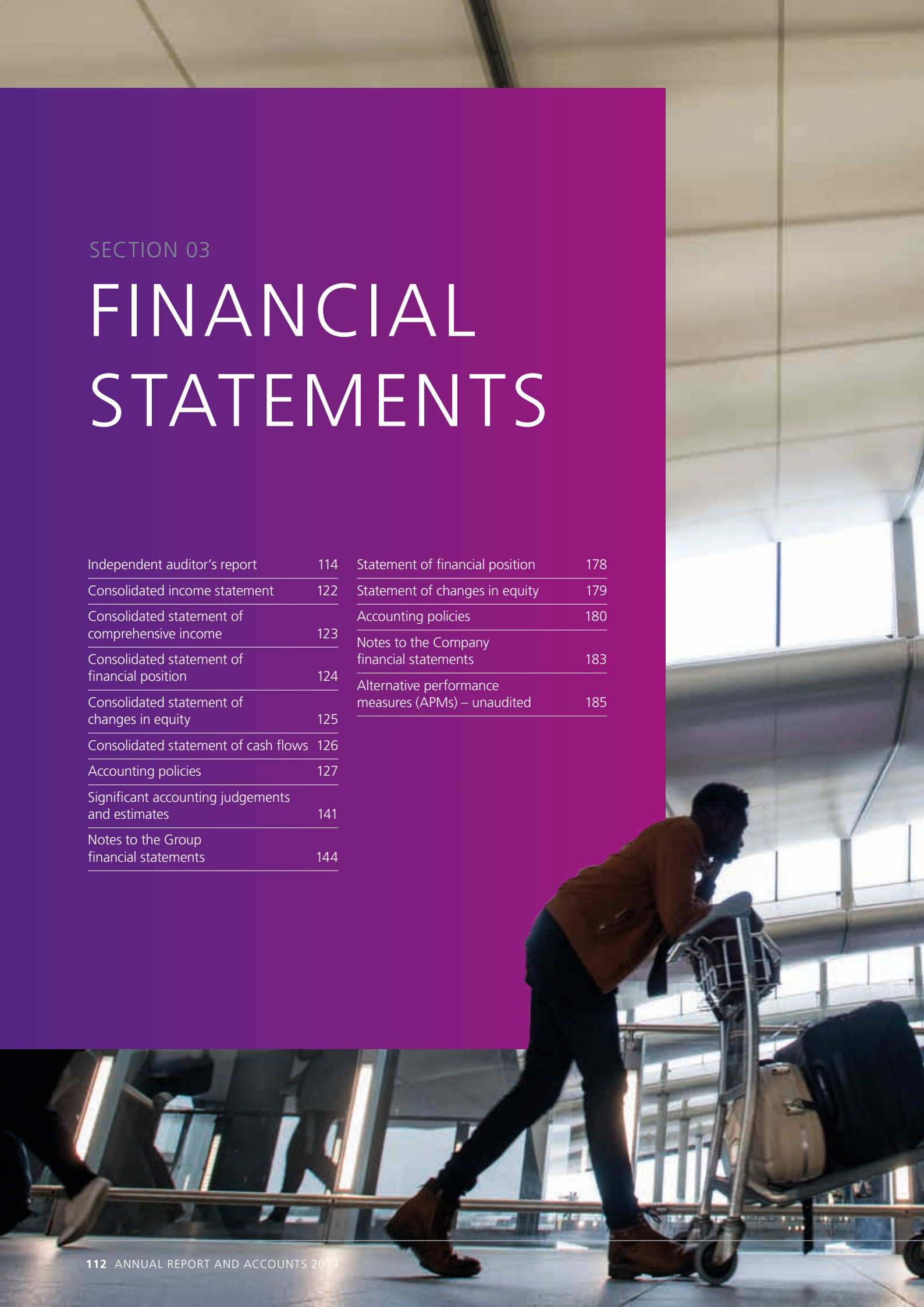
JAVIER ECHAVE
DIRECTOR

25 February 2020

SECTION 03

FINANCIAL STATEMENTS

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INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of Heathrow Finance plc (the 'parent company') and its subsidiaries (the 'group') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2019 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board (IASB);
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the consolidated income statement;
- the consolidated statement of comprehensive income;
- the consolidated and parent company statements of financial position;
- the consolidated and parent company statements of changes in equity;
- the consolidated cash flow statement;
- the group and parent company statement of accounting policies;
- the group and parent company significant accounting judgements and estimates; and
- the related notes to the consolidated financial statements 1 to 28 and to the parent company financial statements 1 to 11.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion




We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC *CONTINUED*

3. Summary of our audit approach

Key audit matters	<p>The key audit matters that we identified in the current year were:</p> <ul style="list-style-type: none">• Property, plant and equipment: classification of costs;• Financial instruments: derivative valuations and appropriateness of hedge accounting for new, restructured or amended trades; and• Valuation of investment properties: car parks. <p>Within this report, key audit matters are identified as follows:</p> <p>Newly identified</p> <ul style="list-style-type: none"> Increased level of risk Similar level of risk Decreased level of risk
Materiality	<p>The materiality that we used for the group financial statements was £51.9 million which was determined on the basis of 2.7% of Adjusted EBITDA.</p>
Scoping	<p>We performed full scope audit procedures, which accounted for 100% of the Group's net assets and 100% of the Group's EBITDA.</p>
Significant changes in our approach	<p>There have been no significant changes in our approach for the current year except for the following;</p> <p>Whilst our key audit matters are consistent with those reported in the prior year, the key audit matters Property, Plant & Equipment: Classification of Costs and Valuation of Investment Properties: Car Parks have been refined in the current year following the conclusion of our risk assessment procedures. In respect of Property, Plant & Equipment: Classification of costs, the element of the key audit matter which referred to the completeness of depreciation has been removed. In respect of the Valuation of Investment Properties: Car Parks, the key audit matter has been pinpointed to the appropriate estimation of revenue growth rates.</p>

4. Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC *CONTINUED*

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1. Property, Plant & Equipment: Classification of costs

Key audit matter description

In the year ended 31 December 2019, the Group has capitalised £849 million (2018: £768 million) of costs, excluding capitalised interest, including £236 million (2018: £127 million) in relation to Heathrow Expansion, as shown in note 6.

Determining whether expenditure meets the capitalisation criteria, specifically with regard to whether they are operational or capital in nature, can involve significant management judgement when assessing whether capitalisation is in line with IAS 16 and the Group's accounting policy. Higher capitalisation would increase EBITDA, which is linked to management incentivisation. It would also increase the Regulated Asset Base ('RAB') value, the RAB being the basis for determining the maximum level of airport revenues. Accordingly, we have assessed a potential fraud risk over inappropriate capitalisation.

The Audit Committee's discussion of this key audit matter is set out on page 96 of the annual report. Page 141 also sets out the Group's critical judgements and key sources of estimation uncertainty in applying the accounting policy in respect of capitalisation.

How the scope of our audit responded to the key audit matter

We performed the following audit procedures:

- Assessed the design and implementation and tested the operating effectiveness of key controls surrounding the capitalisation of costs; and
- For a sample of projects:
 - examined management's consideration of appropriate capitalisation, against the requirements of IAS 16 and management's capitalisation policy;
 - challenged key assumptions and estimates in the capital project business case process, through searching for and assessing both contradictory and corroborative evidence, and evaluated whether there was appropriate capital project authorisation; and
 - verified a sample of capitalised costs to invoice to assess whether they were appropriately accounted for, including costs associated with expansion.

Key observations

We are satisfied that costs have been appropriately capitalised in line with IAS 16.

5.2. Financial Instruments: derivative valuation and appropriateness of hedge accounting for new, restructured or amended trades

Key audit matter description

At 31 December 2019 the Group has total borrowings of £15,800 million (2018: £14,502 million). The Group has a net derivative liability of £743 million (2018: £1,019 million liability). The Group holds a substantial derivative portfolio comprising interest rate swaps, cross currency swaps and retail price index swaps, which are recorded at fair value. These are held to mitigate interest rate and foreign exchange risk arising on material levels of debt due to the capital programme, as well as inflation risk, which arises on inflation linked revenue.

IFRS 9 "Financial Instruments" requires derivatives to be accounted for at fair value with movements recognised in profit or loss, unless designated in a hedge relationship. Where possible, management has elected to apply hedge accounting. We have identified the following significant risks:

- Valuation of new, restructured or amended financial instruments - when entering into a new trade, or a restructuring or amendment occurs, the correct configuration of the derivative in the treasury management system is critical to ensure the valuation is accurate. Amendments can give rise to the de-recognition of the existing asset or liability and recognition of a new instrument. The risk of material misstatement is increased due to the notional value of the derivatives and the volume of restructures or amendments each year.
- Eligibility of hedge relationships for new, restructured and amended trades - demonstrating there is an economic relationship in the hedge test is complex.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC *CONTINUED*

Additionally, where hedge accounting is discontinued, judgement is required in whether amounts accumulated in the hedging reserve must be released to the P&L or amortised over the remaining life of the derivative.

The Audit Committee's discussion of this key audit matter is set out on page 96 of the annual report. Page 141 also sets out the Group's critical judgements and key sources of estimation uncertainty in applying accounting policy in respect of hedge accounting.

How the scope of our audit responded to the key audit matter

We, with the involvement of our financial instruments specialists performed the following audit procedures:

- Assessed the design and implementation and tested the operating effectiveness of key controls relating to valuation of derivatives and hedge accounting;
- Performed an independent recalculation on all new, restructured or amended swaps, including the credit risk adjustment in order to assess the appropriateness of the valuation and considered de-recognition, where applicable; and
- Tested all new, restructured or amended hedge relationships to determine if the criteria for hedge accounting were met and that hedges are effective.

Key observations

We are satisfied that the valuation of new, restructured and amended swaps are reasonable. We are satisfied that new, restructured and amended hedge relationships met the criteria for hedge accounting in line with IFRS 9.

5.3. Valuation of Investment Property: Car Parks

Key audit matter description

As at 31 December 2019, the Group holds £2,522 million (2018: £2,472 million) of investment properties around Heathrow Airport including rental properties (residential and commercial), car parks, fuel farms and advertising sites.

The car park portfolio totals 53% of the investment property balance as at 31 December 2019 (2018: 54%). In accordance with the Group's accounting policies, these assets are accounted for in accordance with IAS 40 "Investment Property". The risk is that properties are not fair valued using appropriate assumptions. We identified a key audit matter in relation to the valuation of the car parks due to the high levels of judgement required in management's discounted cash flow valuation method, being those taken by CBRE (management's valuer) to reflect the performance which would be achieved by a Reasonably Efficient Operator ("REO"), i.e. a third-party.

Specifically, judgement is exercised in determining an appropriate revenue growth rate. A rate of 2.5% (2018: 2.5%) has been assumed for the majority of car parks. Judgement has been exercised in the establishment of the rate applied and the broad application of this rate across the car park portfolio, as each car park is separately operated and thus varying growth rates could be achieved across the portfolio. The rate assumed is below that historically achieved, with the reduced rate representing the rate that a market participant would adopt on the basis of a REO operating each car park on an individual basis.

The fair value movements impact EBITDA and therefore we have assessed a fraud risk over inappropriate cash flow forecasts which are a key input for the valuation of the car parks.

The Audit Committee's discussion of this key audit matter is set out on page 97 of the annual report. Page 142 also sets out the Group's critical judgements and key sources of estimation uncertainty in applying accounting policy in respect of determining the fair value of investment properties.

How the scope of our audit responded to the key audit matter

We, together with our Real Estate Valuations specialists have:

- Assessed the design and implementation of key controls relating to valuation of car parks;
- Held discussions with CBRE and management to understand changes to valuations and key assumptions;
- Assessed CBRE's qualifications and independence as management's expert and read their terms of engagement to determine whether there were any matters that might affect their objectivity or may have imposed scope limitations upon their work;

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC *CONTINUED*

- Reviewed the valuation approach used by management and CBRE, including challenging their car park valuations, supporting information and market commentary through searching for and assessing both contradictory and corroborative evidence; and
- Tested the information provided to CBRE on a sample basis to assess the accuracy of the discounted cash flow calculations for car parks, including challenging adjustments made to establish those cash flows which could be achieved by a REO through searching for and assessing both contradictory and corroborative evidence.

Key observations

We are satisfied that that the judgements taken in respect of the determination of the revenue growth rate are reasonable and that the valuations have been performed appropriately in line with IAS 40.

6. Our application of materiality

6.1. Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	£51.9 million (2018: £58.5 million)	£51.4 million (2018: £58.0 million)
Basis for determining materiality	Materiality has been determined on the same benchmark as the 2018 materiality and equates to 2.7% (2018: 3.2%) of Adjusted EBITDA. Adjusted EBITDA is before certain remeasurements, and includes fair value gains on investment properties and fair value gains and losses on any underlying hedged items.	0.8% (2018: 0.9%) of net assets.
Rationale for the benchmark applied	The Group results largely reflect the trading operations of Heathrow Airport Limited, and associated financing. We have used a profit-adjusted measure of Adjusted EBITDA before exceptional items as the benchmark, which reflects the Group's underlying trading performance, and is consistent with the Group's internal and external reporting. No exceptional items have been recorded in the current year.	The main purpose of the parent company is investment holding and we have therefore used net assets as the benchmark.

6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Group performance materiality was set at 70% of group materiality for the 2019 audit (2018: 70%). In determining performance materiality, we considered factors including our ability to rely on internal controls across a number of areas of the audit, the stability of the business, the outcome of our risk assessment process, the level of errors identified in prior years, management's willingness to correct errors identified and the stability of the finance team.

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £2.6 million (2018: £3.0 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC *CONTINUED*

7. An overview of the scope of our audit

7.1. Identification and scoping of components

Our Group audit for the current and prior year was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we performed full scope audit procedures for all five subsidiaries (2018: five) of the group plus the parent company, which covered 100% of the Group's net assets (2018: 100%) and 100% of EBITDA (2018: 100%). The materiality applied to these subsidiaries ranged from £1.3 million to £51.4 million (2018: £1.4 million to £58.0 million). The Group team audits all of the subsidiaries directly.

8. Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

9. Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

10. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud and non-compliance with laws and regulations are set out below.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC *CONTINUED*

11.1. Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the group's documentation of their policies and procedures relating to:
 - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
 - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
 - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and involving relevant internal specialists, including tax, financial instrument valuations, pensions, IT and real estate valuation specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas:

- Property, plant and equipment – Higher capitalisation would increase EBITDA, which is linked to management incentivisation. It would also increase the RAB, the RAB being the basis for determining the maximum level of airport revenues; and
- Valuation of Investment property – Judgements exercised in estimating car park cash flow forecasts, including the application of an appropriate growth rate, impact the fair value calculation, and therefore the fair value movement which directly impacts EBITDA.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act as well as Pensions and Tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the group's ability to operate or to avoid a material penalty. These included Heathrow Airport Limited's operating licence, including its regulatory solvency, the Health and Safety at Work Act 1994 and Employment law.

11.2. Audit response to risks identified

As a result of performing the above, we identified property, plant and equipment: classification of costs and valuation of investment property: car parks as key audit matters related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the Civil Aviation Authority and Office of Rail and Road; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HEATHROW FINANCE PLC *CONTINUED*

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

13. Matters on which we are required to report by exception

13.1. Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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.

We have nothing to report in respect of these matters.

13.2. Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of this matter.

14. Other matters

14.1. Auditor tenure

Following the recommendation of the audit committee, we were appointed by the Board of Directors on 14 July 2010 to audit the financial statements for the year ending 31 December 2010 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 10 years, covering the years ending 31 December 2010 to 31 December 2019.

14.2. Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

15. Use of our report

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.

Simon Cleveland FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
25 February 2020

Heathrow Finance plc

Consolidated income statement for the year ended 31 December 2019

	Year ended 31 December 2019			Year ended 31 December 2018			
	Note	Before certain re-measurements	Certain re-measurements ¹	Total	Before certain re-measurements	Certain re-measurements ¹	Total
		£m	£m	£m	£m	£m	£m
Revenue	1	3,070	-	3,070	2,970	-	2,970
Operating costs	2	(1,924)	-	(1,924)	(1,879)	-	(1,879)
Other operating items							
Fair value gain on investment properties	8	-	43	43		117	117
Operating profit		1,146	43	1,189	1,091	117	1,208
Financing							
Finance income	3	35	-	35	27	-	27
Finance costs	3	(774)	128	(646)	(782)	38	(744)
Net finance costs		(739)	128	(611)	(755)	38	(717)
Profit before tax		407	171	578	336	155	491
Tax charge		(111)	(29)	(140)	(72)	(7)	(79)
Taxation charge	4	(111)	(29)	(140)	(72)	(7)	(79)
Profit for the year²		296	142	438	264	148	412

¹ Certain re-measurements consist of: fair value gains on investment property revaluations, gains and losses arising on the re-measurement 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 associated tax impact of these.

² Attributable to owners of the parent.

Heathrow Finance plc

Consolidated statement of comprehensive income for the year ended 31 December 2019

	Note	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Profit for the year		438	412
Items that will not be subsequently reclassified to the consolidated income statement:			
Actuarial gain/(loss) on pensions			
Gain/(Loss) on plan assets ¹	21,22	498	(192)
(Increase)/Decrease in scheme liabilities ¹	21,22	(509)	310
Items that may be subsequently reclassified to the consolidated income statement:			
Cash flow hedges:			
Losses taken to equity ¹	21	(3)	(162)
Transfer to finance costs ¹	21	32	198
Other comprehensive income for the year		18	154
Total comprehensive income for the year²		456	566

¹ Items in the statement above are disclosed net of tax. The tax relating to each component of other comprehensive income is disclosed in Note 21.

² Attributable to owners of the parent

Heathrow Finance plc

Consolidated statement of financial position as at 31 December 2019

		31 December 2019	31 December 2018
	Note	£m	£m
Assets			
Non-current assets			
Property, plant and equipment	6	11,728	11,575
Right of use assets	7	276	-
Investment properties	8	2,522	2,472
Intangible assets	9	176	173
Retirement benefit surplus	17	33	28
Derivative financial instruments	14	539	543
Trade and other receivables	11	601	602
		15,875	15,393
Current assets			
Inventories	10	13	13
Trade and other receivables	11	361	391
Term deposits	12	725	120
Cash and cash equivalents	12	845	595
		1,944	1,119
Total assets		17,819	16,512
Liabilities			
Non-current liabilities			
Borrowings	13	(15,396)	(13,993)
Derivative financial instruments	14	(1,227)	(1,523)
Lease liabilities	7	(346)	-
Deferred income tax liabilities	16	(943)	(917)
Retirement benefit obligations	17	(29)	(32)
Provisions	18	(1)	(1)
Trade and other payables	19	(6)	(7)
		(17,948)	(16,473)
Current liabilities			
Borrowings	13	(644)	(742)
Derivative financial instruments	14	(55)	(39)
Lease liabilities	7	(38)	-
Provisions	18	(8)	(13)
Current income tax liabilities		(39)	(54)
Trade and other payables	19	(430)	(433)
		(1,214)	(1,281)
Total liabilities		(19,162)	(17,754)
Net liabilities		(1,343)	(1,242)
Equity			
Capital and reserves			
Share capital	20	3,109	3,109
Merger reserve		(994)	(994)
Cash flow hedge reserve		(187)	(216)
Retained earnings	22	(3,271)	(3,141)
Total shareholder's equity		(1,343)	(1,242)

These financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 25 February 2020. They were signed on its behalf by:

Javier Echave
Director

Nicholas Golding
Director

Heathrow Finance plc

Consolidated statement of changes in equity for the year ended 31 December 2019

	<i>Note</i>	Attributable to owners of the Company				Total equity £m
		Share capital	Merger reserve	Cash flow hedge reserve	Retained earnings	
		£m	£m	£m	£m	
1 January 2018		3,109	(994)	(252)	(3,171)	(1,308)
Adjustment in respect of:						
Transition to IFRS 15 and 9					(3)	(3)
1 January 2018 restated		3,109	(994)	(252)	(3,174)	(1,311)
Comprehensive income:						
Profit for the year					412	412
Other comprehensive income:						
Fair value gains on cash flow hedges net of tax	21			36		36
Actuarial gain on pensions net of tax						-
Loss on plan assets	21				(192)	(192)
Decrease in scheme liabilities	21				310	310
Total comprehensive income				36	530	566
Transaction with owners:						
Dividends paid to Heathrow (DSH) Limited	22				(497)	(497)
Total transaction with owners					(497)	(497)
31 December 2018		3,109	(994)	(216)	(3,141)	(1,242)
Adjustment in respect of:						
Transition to IFRS 16					(89)	(89)
1 January 2019 restated		3,109	(994)	(216)	(3,230)	(1,331)
Comprehensive income:						
Profit for the year					438	438
Other comprehensive income:						
Fair value gain on cash flow hedges net of tax	21			29		29
Actuarial gain on pensions net of tax						
Gain on plan assets	21				498	498
Increase in scheme liabilities	21				(509)	(509)
Total comprehensive income				29	427	456
Transaction with owners:						
Dividends paid to Heathrow (DSH) Limited	22				(468)	(468)
Total transaction with owners					(468)	(468)
31 December 2019		3,109	(994)	(187)	(3,271)	(1,343)

Heathrow Finance plc

Consolidated statement of cash flows for the year ended 31 December 2019

	Note	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Cash flows from operating activities			
Cash generated from operations	24	1,941	1,790
Taxation:			
Corporation tax paid		(98)	(70)
Group relief paid		(15)	(13)
Net cash from operating activities		1,828	1,707
Cash flows from investing activities			
Purchase of:			
Property, plant and equipment		(848)	(768)
Investment properties		(7)	(4)
Intangible assets		-	(20)
Increase in term deposits ¹		(605)	(108)
Interest received		8	2
Net cash used in investing activities		(1,452)	(898)
Cash flows from financing activities			
Dividends paid to Heathrow (DSH) Limited	22	(468)	(497)
Proceeds from issuance of bonds		1,157	1,061
Repayment of bonds		(513)	(910)
Issuance of term notes		340	245
Drawdown of subordinated facilities		364	65
Repayment of facilities and other financing items		(27)	(132)
(Decrease)/Increase in amount owed to Heathrow (DSH) Limited		(75)	75
Settlement of accretion on index-linked swaps		(295)	(110)
Interest paid		(552)	(534)
Payment of lease liabilities		(50)	-
Consent fee payment ²		(7)	-
Net cash used in financing activities		(126)	(737)
Net increase in cash and cash equivalents		250	72
Cash and cash equivalents at beginning of year		595	523
Cash and cash equivalents at end of year	12	845	595

¹ Term deposits with an original maturity of over three months are invested at Heathrow Airport Limited.

² Payment in relation to investor's consent regarding IFRS 16 and lease liabilities.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019

The principal accounting policies applied in the preparation of these consolidated financial statements of Heathrow Finance plc (the 'Company') and its subsidiaries (together the 'Group') are set out below. These policies have been consistently applied to all the years presented, unless stated otherwise.

Statement of compliance

The Group's financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') and as adopted by the European Union ('EU').

The Group

The Company is the holding company of a group of companies that owns Heathrow Airport ('Heathrow') and operates Heathrow Express ('HEX'), the express rail service between Heathrow and central London. Heathrow Finance plc is a limited liability company incorporated in Great Britain and registered in England and Wales, and domiciled in the UK. Its registered office is The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

Basis of accounting

The Group's financial statements are prepared in accordance with IFRSs as issued by the IASB and as adopted by the EU and are prepared under the historic cost convention, except for investment properties, financial assets, derivative financial instruments and financial liabilities that qualify as hedged items under fair value hedge accounting. 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.

The Group financial statements are presented in Sterling and are rounded to the nearest million pounds (£m), except when otherwise noted.

Primary financial statements format

The Group's primary financial statements are prepared in accordance with IFRS as issued by the IASB and as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 December 2019.

A columnar approach has been adopted in the income statement and the impact of certain items is shown in a separate column. This column includes certain re-measurements as listed in (i) and (ii) below, which management separates from the underlying operations of the Group. Also, this column includes the effect on taxation of changes in tax rates in (iii) and (iv) below. By isolating certain re-measurements, management believes the results provides the reader with a more meaningful understanding of the performance of the Group, by concentrating on the matters over which it has most influence, whilst recognising that information on these additional items is available within the financial statements, should the reader wish to refer to them.

The column 'certain re-measurements' in the consolidated income statement contains the following items:

- i fair value gains and losses on investment property revaluations;
- ii derivative financial instruments and the fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship;
- iii the associated tax impacts of the items in (i) and (ii) above; and
- iv the impact on deferred tax balances of known future changes in tax rates.

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 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 cash resources, 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 Recent financing activities in the Financial 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 twelve months following the date when the Statement of financial position was signed.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Changes in accounting policy and disclosures

(a) Amended standards adopted by the Group

On 1 January 2019, the Group adopted IFRS 16 *Leases* for the first time. The nature and effect of the changes as a result of the adoption of this new accounting standard is described below.

General impact of application of IFRS 16

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements for both lessors and lessees. IFRS 16 superseded the current lease guidance including IAS 17 *Leases* and the related interpretations effective for accounting periods beginning on or after 1 January 2019.

IFRS 16 introduces significant changes to lessee accounting by removing the distinction between operating and finance leases and requiring the recognition of a right-of-use asset and a lease liability at the lease commencement for all leases, except for short-term leases and leases of low value assets.

The Group has chosen the modified retrospective approach of IFRS. The right of use assets are measured at either:

- an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments. This has been applied to majority of the leases.
- their carrying amount as if IFRS 16 had been applied since the lease commencement date, discounted by the Group's incremental borrowing rate as at 1 January 2019. Under this approach the cumulative effect of applying the standard as at 1 January 2019 is recorded as an adjustment to the opening balance of retained earnings. The Group has applied this methodology to a small number of leases.

Consequently, the Group has not restated the comparative financial information for the 2018 reporting period and continues to be reported under IAS 17. In contrast IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

Impact of the new definition of a lease

The Group has not made use of the practical expedient available on transition to IFRS 16 not to reassess whether a contract is or contains a lease. Accordingly, the definition of a lease in accordance with IFRS 16 has also been applied to those leases entered or modified before 1 January 2019.

The change in definition of a lease mainly relates to the concept of control. IFRS 16 distinguishes between leases and service contracts on the basis of whether the use of an identified asset is controlled by the customer. Control is considered to exist if the customer has:

- the right to obtain substantially all of the economic benefits from the use of an identified asset; and
- the right to direct the use of that asset.

The Group has applied the definition of a lease and related guidance set out in IFRS 16 to all lease contracts.

Impact on lessee accounting

IFRS 16 changed how the Group accounts for leases previously classified as operating leases under IAS 17.

On initial application of IFRS 16, for all leases with the exception of short-term leases (leases that are due to expire within 12 months – practical expedient allowed under IFRS 16) and low value leases, the Group has:

- recognised right-of-use assets and lease liabilities in the consolidated statement of financial position, initially measured at the present value of the future lease payments except for some large leases where right-of-use assets are measured as if IFRS 16 had been applied since the commencement date, discounted using the Group's incremental borrowing rate at the date of initial application; and
- recognised depreciation of right-of-use assets and interest on lease liabilities in the consolidated income statement from 1 January 2019;

For short-term and low-value assets leases, the Group has opted to recognise a lease expense on a straight-line basis or on a systematic basis as permitted by IFRS 16.

Under IFRS 16, right-of-use assets are tested for impairment in accordance with IAS 36 *Impairment of Assets*. This has replaced the previous requirement to recognise a provision for onerous lease contracts.

Under IAS 17, all lease payments on operating leases are presented as part of cash flows from operating activities. The impact of the changes under IFRS 16 is an increase in the cash generated by operating activities and an increase in the net cash used in financing activities.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Changes in accounting policy and disclosures *continued*
Impact on lessee accounting *continued*

The effect of adopting IFRS 16 is as follows:

Transition to IFRS 16

The impact of the transition on the opening consolidated statement of financial position is set out in the following table:

Reference	1 January 2019 £m	IFRS 16 adjustment £m	1 January 2019 under IFRS 16 £m
Assets			
Non-current assets			
Right of use asset (i)	15,393	-	15,393
	-	297	297
	15,393	297	15,690
Current assets	1,119	-	1,119
Total assets	16,512	297	16,809
Liabilities			
Non-current liabilities			
Lease liabilities (i)	(15,556)	-	(15,556)
Deferred income tax liabilities	-	(378)	(378)
	(917)	18	(899)
	(16,473)	(360)	(16,833)
Current liabilities	(1,281)		(1,281)
Lease liabilities (i)	-	(26)	(26)
	(1,281)	(26)	(1,307)
Total liabilities	(17,754)	(386)	(18,140)
Net liabilities	(1,242)	(89)	(1,331)
Equity			
Capital and reserves			
Retained earnings (i)	1,899	-	1,899
	(3,141)	(89)	(3,230)
Total shareholder's equity	(1,242)	(89)	(1,331)

(i) At 31 December 2018, the Group had non-cancellable operating lease commitments of £767 million. On application of IFRS 16 as at 1 January 2019, the Group has recognised right-of-use assets of £297 million, a corresponding lease liability of £404 million and deferred tax assets of £18 million in respect of all these leases with a resulting net adjustment of £89 million in the retained earnings. The impact of adopting IFRS 16 at 1 January 2019, the right-of-use assets and corresponding lease liability were previously reported in the 2018 financial statements as £344 million and £446 million. The reduction in lease liabilities and right of use assets has no impact on total cash flow or cash and cash equivalents for the year. The overstatement at transition was due to a delay to the start date of one of the lease contracts.

The following table provides a reconciliation of the Group's operating lease commitments as at 31 December 2018 to the total lease liability recognised on adoption of IFRS 16. The Group did not recognise any finance leases under IAS 17.

	£m
Operating lease commitments as at 31 December 2018	767
Effect of discounting ¹	(310)
Leases not recognised under IFRS 16	(53)
Lease liabilities recognised on adoption of IFRS 16	404

¹ The previously disclosed lease commitments were undiscounted, whilst the IFRS 16 obligations have been discounted based on the Group's incremental borrowing rate.

Other amendments

The following new accounting pronouncements were adopted by the Group to comply with amendments to IFRS. None of these had any significant impact on adoption:

- 2015-2017 Annual Improvements Cycle:

IFRS 3 Business Combinations: Previously held Interests in a joint operation

IFRS 11 *Joint Arrangements*: Previously held Interests in a joint operation

IAS 12 *Income Taxes*: Income tax consequences of payments on financial instruments classified as equity

IAS 23 *Borrowing Costs*: Borrowing costs eligible for capitalisation

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Other amendments *continued*

- Amendments to IFRS 9 *Financial Instruments* (Prepayments Features)
- Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures*
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement
- IFRIC 23 *Uncertainty over Income Tax Treatments*

(b) New accounting pronouncements, that are not yet effective and have not been adopted early by the Group, to be adopted on or after 1 January 2020

- Amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors*: Definition of Material
- Amendments to References to the Conceptual Framework
- Amendments to IFRS 3 *Business Combinations*: Definition of a business (not yet been endorsed by the EU)

The Group's financial reporting will be presented in accordance with the new standards above, which are not expected to have a material impact on the consolidated results, financial position or cash flows of the Group, from 1 January 2020.

(c) New accounting pronouncements, that are not yet effective, but have been adopted early by the Group, adopted on 1 January 2019

- Amendments to IFRS 9, IAS 39, and IFRS 7: Interest Rate Benchmark Reform

The Group has decided to early adopt IFRS 9, IAS 39, and IFRS 7 – Interest Rate Benchmark Reform amendments by the IASB, which was issued in September 2019 and provides exemptions from certain hedge accounting qualification requirements in IFRS 9 *Financial Instruments* in response to market-wide benchmark interest rate reform. The amendments permit an entity to assume no impact to existing hedge accounting relationships subject to the reform, thereby allowing a continuation of hedge accounting. The amendments apply to annual periods beginning on or after 1 January 2020.

The amendments IFRS 9, IAS 39, and IFRS 7 have been adopted retrospectively to hedging relationships that existed at the start of the reporting period or were designated thereafter.

Note 15 Financial instruments provides the required disclosures of the uncertainty arising from IBOR reform for hedging relationships for which the Group applied the reliefs.

Basis of consolidation

The Group financial statements consolidate the financial statements of Heathrow Finance plc and all its subsidiaries.

Subsidiaries

Subsidiaries are consolidated from the date of their acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. Control is defined as where the Group is exposed or has rights to variable returns from its involvement with the subsidiary and the ability to affect those returns through its power over the subsidiary.

Intra-group balances and transactions are eliminated during the consolidation process.

Segment reporting

Information reported to the Board of Directors for the purposes of resource allocation and assessment of segment performance relates to the operations of Heathrow and Heathrow Express.

Revenue from contracts with customers

Revenue from contracts with customers is recognised when control of the goods or services are transferred to the customer (i.e., when the Group delivers its performance obligation under the contract) at an amount that reflects the consideration to which the Group expects to be entitled in exchange for those goods or services.

The Group recognises revenue from the following major sources:

- Aeronautical income;
- Retail services;
- Other regulated charges;
- Car Parking; and
- Rail income.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Aeronautical income

Aeronautical income includes:

- Aircraft landing charges levied according to noise, emissions and weight recognised on landing.
- Aircraft parking charges based on time parked and whether aircraft are wide or narrow bodied as provided.
- Passenger charges based on the number of departing passengers on departure.
- Other charges levied for passenger and baggage operations when these services are rendered.

There are three separate performance obligations in respect of aeronautical charges, namely landing, parking and departing charges. These charges are separately identified in respect of any aircraft movement at the airport and the revenue is recognised on the day the movement takes place, therefore at a point in time. In addition, there are certain other regulated charges which are referred to below.

Retail services

Retail income include concession fees from retail and commercial concessionaires at the airport are based upon reported revenue by concessionaires, taking into account contracted minimum guarantees where applicable.

The performance obligation for this revenue stream is the provision of retail unit space to a third party for the purposes of selling or providing services to the passengers, in return for a fee, based either on a fixed rental fee, or a concession fee based on turnover. The revenue is recognised in the period that the sales occurred, therefore at a point in time.

Other Regulated Charges ('ORCs')

Revenue in relation to ORC's is derived from the recovery of certain costs incurred by the Airport. It includes:

- Usage charges made for operational systems (e.g. check-in desks), recognised as each service is provided.
- Charges related to passengers with restricted mobility and other services recognised at the time of delivery.
- Other invoiced sales: recognised on the performance of the service.

The Group typically satisfies its performance obligation as the service is provided. Revenue is recognised on the day the service takes place, therefore at a point in time.

Car parking

Car parking income is from the provision of parking services to customers, which include for Short Stay, Long Stay, Business parking and Storage. The Group considers the performance obligation is satisfied by the provision of a car park space for each day the car is parked, therefore the revenue is recognised over time.

Rail income

Heathrow Express derives its income from the sale of tickets to customers.

Revenue attributable to return tickets should be allocated to each journey and recognised on the day each journey takes place, therefore at a point in time. Heathrow Express is not able to track when each journey is undertaken and therefore has used sample data of historical journeys to estimate when each journey takes place.

The revenue is recognised by applying the below management assumptions to measure progress towards satisfaction of the performance obligation:

- 90% of single tickets are used in the month of sale.
- 80% of return tickets (50% outward and 30% return) are used in the month of sale.
- All multiple journey tickets are used within 6 months.

Contributions

On occasions, the Group may receive capital grants from public bodies to improve airport infrastructure considered to be in the best interest of the public. These are recorded as reductions in the cost of the property, plant and equipment to which they relate.

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, are capitalised as part of the cost of those assets, until the asset is complete and available for use. Such borrowing costs are capitalised whilst projects are in progress.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Borrowing costs *continued*

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, including costs incurred in respect of the maintenance of the Group's credit ratings, are recognised in the income statement in the period in which they are incurred.

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 accumulated impairment losses. An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected. Any gain or loss arising on the derecognition of the asset is included in the income statement in the period of derecognition.

Assets in the course of construction are stated at cost less any 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 (see "Borrowing Costs" policy), own labour costs of construction-related project management and directly attributable overheads. Costs associated with projects that are in the early stages of planning are capitalised where the directors are satisfied that it is probable the necessary consents will be received and the projects will be developed to achieve a successful delivery of an asset such that future benefits will flow to the Group. The Group reviews these projects on a regular basis 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.

Heathrow expansion

Assets in the course of construction include qualifying costs in respect of Heathrow expansion following the Government decision in October 2016 in favour of Heathrow, and subsequent Board decision in October 2016 to apply for the Development Consent Order.

These two events were considered by management to be a trigger point for the expansion project to proceed. Management subsequently announced publicly that the Group would apply for planning permission, in the belief that it is probable that expansion at Heathrow will be realised. As a result, the Group has started to capitalise eligible costs as 'assets in the course of construction'.

Costs which are directly associated with, and solely for the purposes of, seeking planning consent for the delivery of new runway capacity through the Development Consent Order process are capitalised as they are directly attributable to the final design and construction of the expanded Heathrow assets.

In assessing expansion costs, the Group has regard to IAS 38 (See Accounting policy – 'Internally-generated intangible assets') and considers October 2016 to be the point at which Expansion moved from the Research phase to the Development phase, and therefore development expenditure is capitalised in line with the principles of IAS 38.

Expansion costs incurred during the research phase for the Airports Commission process and before Heathrow was named as the preferred location for new runway capacity in October 2016, were expensed in the period incurred.

Depreciation

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

<i>Terminal complexes</i>	<i>Fixed asset lives</i>
Terminal building, pier and satellite structures	20–60 years
Terminal fixtures and fittings	5–20 years
<i>Airport plant and equipment</i>	
Baggage systems	15 years
Screening equipment	5–10 years
Lifts, escalators and travelators	20 years
Other plant and equipment, including runway lighting and building plant	5–20 years
Tunnels, bridges and subways	50–120 years
<i>Airport transit systems</i>	
Rolling stock	20 years
Track	50 years
<i>Airfields</i>	
Runway surfaces	10–15 years

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Depreciation *continued*

Runway bases	100 years
Taxiways and aprons	50 years
<i>Rail</i>	
Rolling stock	8–40 years
Tunnels	100 years
Track metalworks	5–10 years
Track bases	50 years
Signals and electrification work	40 years
<i>Plant and equipment</i>	
Motor vehicles	4–8 years
Office equipment	5–10 years
Computer equipment	4–5 years
<i>Other land and buildings</i>	
Short leasehold properties	3–20 years
Leasehold improvements	Lower of useful economic life or period of lease

In certain circumstances, the asset life may fall outside of the boundaries disclosed above.

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

Impairment of assets

The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when management deem impairment testing for an asset is necessary, the Group estimates the asset's recoverable amount. The 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. When performing this review, Heathrow is considered to form one cash generating unit (CGU) based on the interdependence of the airport cash flows and the functional organisational structure by which the airport is managed.

Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation, is initially measured at cost and subsequently stated at fair value at the reporting date, as determined by the directors and supported by external valuers. 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:

- the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale; and
- the Group can demonstrate how the intangible asset created will generate future economic benefits; and
- the Group has available the resources to complete the asset; and
- the Group intends to complete that asset and has the future ability to sell or use the asset; and
- the development cost of the intangible asset can be measured reliably.

Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be held at cost less any accumulated amortisation and impairment. Amortisation begins when development is complete and the asset is ready for use.

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. During the period of development, the asset is tested for impairment annually. Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Purchased intangible assets (software costs)

Computer software costs principally relate to operating and financial software. These assets are amortised on a straight line basis over their useful lives of between four and fifteen years. The assets are assessed for impairment whenever there is indication that the intangible asset may be impaired.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Leases

Group as a lessee

Group leases relates to the electricity distribution network at the airport, offices, warehouses, plant and equipment and track access.

At inception, the Group assess whether the contract contains a lease or is a lease. A lease is determined when the contract conveys the right to control of an identified asset for a period of time in exchange for consideration.

The Group recognises a right-of-use asset and a corresponding lease liability for all lease agreements in which the Group is the lessee at the lease commencement date.

The right-of-use asset is initially measured at cost, which comprises the initial lease liability adjusted for any lease payment made at or before the commencement date, plus any indirect initial costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The right-of-use assets are then subsequently depreciated using the straight-line method from the commencement date to the earlier of the lease term or useful life of the underlying asset. Right-of-use assets are reviewed for indicators of impairment.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted at the rate implicit in the lease, or, if the rate cannot be determined, the Group's incremental borrowing rate.

The incremental borrowing rate is based on the (i) reference rate, (ii) financing spread and (iii) lease specific adjustments. The reference rate is based on the UK Nominal Gilts aligned with the tenor of the lease observed at the time of signing the contract. The financing spread is based on the term of the debt, level of indebtedness, entity and economic environment. The lease specific adjustment is required if the term of the lease is out of the norm.

Lease payments included in the measurement of lease liabilities includes the following:

- Fixed payments including in-substance fixed payments
- Variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date
- The amount expected to be payable by the lessee under residual value guarantees

The Group remeasures the lease liability when there is a change in the future lease payments arising from a change in rate or index or, a modification to the lease that is not accounted for as a separate lease. In the latter case, the lease liability is remeasured by using a revised discount rate. When the lease liability has been remeasured, a corresponding adjustment is made to the carrying amount of the right-of-use asset or is recorded in the profit or loss account if the carrying amount of the right-of-use asset has been reduced to zero.

Short-term leases and leases of low-value assets

The Group has opted not to recognise right-of-use assets and lease liabilities for low value assets and short-term leases (defined as a lease with a lease term of 12 months or less). Instead, the lease payments are recognised as an operating expense on a straight-line basis over the length of the lease term or on a systematic basis.

Group as a lessor

The Group receives rental income from operating leases of its investment properties, space in the terminals and ancillary buildings.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

Cash and cash equivalents

For the purposes of the Statement of financial position, cash and cash equivalents comprise cash at bank, cash in hand, money market funds, repurchase agreements with an original maturity of three months or less and short-term deposits with an original maturity of three months or less. For the Consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Term deposits

Term deposits which include repurchase agreements, with an original maturity of over three months are shown separately on the Statement of financial position and Statement of cash flows.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Deferred income

Amounts received prior to the delivery of goods and services are recorded as deferred income and released to the income statement as they are provided.

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, where material, to present value using a current, pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Restructuring

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 ongoing activities of the entity.

Financial instruments

Recognition and derecognition

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the financial instrument.

Financial assets are derecognised when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and substantially all the risks and rewards are transferred.

A financial liability is derecognised when it is extinguished, discharged, cancelled or expires.

Classification and initial measurement of financial assets

Except for those trade receivables that do not contain a significant financing component and are measured at the transaction price in accordance with IFRS 15, all financial assets are initially measured at fair value adjusted for transaction costs (where applicable).

Financial assets, other than those designated and effective as hedging instruments, are classified into the following categories:

- amortised cost
- fair value through profit or loss (FVTPL)
- fair value through other comprehensive income (FVOCI).

The classification is determined by both:

- the entity's business model for managing the financial asset
- the contractual cash flow characteristics of the financial asset.

Subsequent measurement of financial assets

Financial assets at amortised cost

Financial assets are measured at amortised cost if the assets meet the following conditions (and are not designated as FVTPL):

- they are held within a business model whose objective is to hold the financial assets and collect its contractual cash flows
- the contractual terms of the financial assets give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at fair value through profit or loss (FVTPL)

Financial assets that are held within a different business model other than 'hold to collect' or 'hold to collect and sell' are categorised at fair value through profit and loss. Further, irrespective of business model financial assets whose contractual cash flows are not solely payments of principal and interest are accounted for at FVTPL.

All derivative financial instruments fall into this category, except for those designated and effective as hedging instruments, for which the hedge accounting requirements apply (see below).

Financial assets at fair value through other comprehensive income (FVOCI)

The Group accounts for financial assets at FVOCI if the assets meet the following conditions:

- they are held under a business model whose objective it is "hold to collect" the associated cash flows and sell and,

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Financial instruments *continued*

Subsequent measurement of financial assets *continued*

Financial assets at fair value through other comprehensive income (FVOCI) *continued*

- the contractual terms of the financial assets give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Any gains or losses recognised in other comprehensive income (OCI) will be recycled upon derecognition of the asset.

Impairment of financial assets

IFRS 9's impairment requirements use more forward-looking information to recognise expected credit losses – the 'expected credit loss (ECL) model'.

Instruments within the scope of the new requirements included loans and other debt-type financial assets measured at amortised cost and FVOCI, trade receivables, contract assets recognised and measured under IFRS 15 and loan commitments and some financial guarantee contracts (for the issuer) that are not measured at fair value through profit or loss.

Recognition of credit losses is no longer dependent on the Group first identifying a credit loss event. Instead the Group considers a broader range of information when assessing credit risk and measuring expected credit losses, including past events, current conditions, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the instrument.

In applying this forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk ('Stage 1');
- financial instruments that have deteriorated significantly in credit quality since initial recognition and whose credit risk is not low ('Stage 2'); and
- financial assets that have objective evidence of impairment at the reporting date ('Stage 3').

'12-month expected credit losses' are recognised for the first category while 'lifetime expected credit losses' are recognised for the second category.

Measurement of the expected credit losses is determined by a probability-weighted estimate of credit losses over the expected life of the financial instrument.

Trade and other receivables

Trade receivables, which generally have 14-day terms, are initially recognised at their transaction price. Balances are written off when the probability of recovery is remote.

The Group makes use of a simplified approach in accounting for trade and other receivables and records the loss allowance as lifetime expected credit losses. These are the expected shortfalls in contractual cash flows, considering the potential for default at any point during the life of the financial instrument.

The Group uses its historical experience, external indicators and forward-looking information to calculate the expected credit losses.

The Group assess impairment of trade receivables on a collective basis where they possess shared credit risk characteristics they have been grouped based on sector industry global default rates. Refer to Note 11 for a detailed analysis of how the impairment requirements of IFRS 9 are applied.

The assessment of impairment for trade receivables can either be individually or collectively and is based on how an entity manages its credit risk. As the Group has a small number of receivables with large value and these receivables are managed on an account basis (i.e. individually) it is therefore not appropriate to base the impairment on a provision matrix as such a matrix would unlikely be in line with the expected credit loss of the individual receivable.

Intercompany loans receivable

Intercompany advances to other Group entities are all held till maturity, neither parties have an option to call or prepay the loan before the contracted maturity date. Such assets are held under a business model to hold and collect contractual cash flows and therefore meet the Solely Payments of Principal and Interest (SPPI) test. No embedded derivatives are currently recognised in these advances, and the amortised cost classification is not impacted. All intercompany advances are assessed for impairment under the IFRS9 "expected credit losses model" (ECL).

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Financial instruments *continued*

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.

Classification and measurement of financial liabilities

The Group's financial liabilities include borrowings, trade and other payables and derivative financial instruments.

Financial liabilities are initially measured at fair value, and, where applicable, adjusted for transaction costs unless the Group designated a financial liability at fair value through profit or loss.

Subsequently, financial liabilities are measured at amortised cost using the effective interest method except for derivatives and financial liabilities designated at FVTPL, which are carried subsequently at fair value with gains or losses recognised in profit or loss (other than derivative financial instruments that are designated and effective as hedging instruments).

All interest-related charges and, if applicable, changes in an instrument's fair value that are reported in profit or loss are included within finance costs.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost unless part of a fair value hedge relationship. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings being novated or cancelled and re-issued, with a substantial modification of the terms, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, with any resulting gain or loss recognised in the income statement.

For index-linked borrowings, the nominal amount is adjusted for movements in the relevant price index. This accretion expense is recorded within finance costs in the income statement.

Debt issue costs

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

Trade and other payables

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

Derivative financial instruments are accounted for at fair value through profit and loss (FVTPL) except for derivatives designated as hedging instruments in cash flow hedge relationships, which require a specific accounting treatment.

To qualify for hedge accounting, the hedging relationship must meet all of the following requirements:

- there is an economic relationship between the hedged item and the hedging instrument
- the effect of credit risk does not dominate the value changes that result from that economic relationship.

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.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Financial instruments *continued*

Financial liabilities and equity *continued*

Sources of ineffectiveness

Certain ineffectiveness can arise during the hedging process. The main sources of hedge ineffectiveness are considered to be timing differences between entering into the hedged item and the hedging instruments, and credit risk.

The fair value of a 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.

Novation of financial instruments

Derivative financial instruments novated from other companies within the Heathrow Airport Holdings Group are transferred at fair value prevailing on that date.

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 gains and losses on any underlying hedged items that are part of a fair value hedging relationship.

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

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. To the extent that the hedge is effective, changes in the fair value of derivatives designated as hedging instruments in cash flow hedges are recognised in other comprehensive income and included within the cash flow hedge reserve in equity. Any ineffectiveness in the hedge relationship is recognised immediately in profit or loss.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item affects profit or loss, as described in the Derivative financial instruments note disclosure (Note 15).

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 or if 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 profit and loss

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 net amount in finance costs 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. The credit risk associated with the Group's derivatives is updated monthly based on current market data.

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 grants all employee benefits and sponsors the defined benefit pension schemes while Heathrow Airport Limited incurs any staff related costs.

On 18 August 2008, Heathrow Airport Limited and Heathrow Express Operating Company Limited entered into a SSA with LHR Airports Limited by which the latter became the shared services provider for the Group.

Following the disposal of Aberdeen, Glasgow and Southampton airports in December 2014 the directors reassessed the Group's relationship with LHR Airports Limited, given that the sole operating airport is now Heathrow and noted the following;

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Shared Services Agreement ('SSA') *continued*

- The SSA states that the operating entities, being only Heathrow Airport Limited from 1 January 2015, are responsible for pension costs on LHR Airports Limited's retirement benefit schemes,
- The Group is responsible for funding the retirement benefit schemes, paying employer contributions directly to the pension scheme, and
- Although employees remain legally employed by LHR Airports Limited, the Group makes all employment decisions. LHR Airports Limited is not deemed to be providing a service, substantive or otherwise in relation to employees, to the Group.

Employment costs

The Group's airport incurs the cost of people which are contractually employed by LHR Airports Limited but provide services to the operation of the airport. Charges in relation to employment costs include wages and salaries, pension costs, medical costs and redundancy payments, as well as any other associated expenses properly incurred by the employees of LHR Airports Limited in providing the services.

Retirement benefit obligations

LHR Airports Limited has both defined contribution and defined benefit pension schemes. LHR Airports Limited is an indirect parent of Finance Group (the 'Group'), and is the sponsor of the Defined Benefit ('DB') pension scheme, the Unfunded Unapproved Retirement Benefit ('UURBS') scheme and the Post-Retirement Medical Benefits ('PRM') scheme.

Following a decision to re-assess the Group's relationship with the legal sponsor of the retirement benefit schemes, it was determined that Heathrow Airport Limited, and therefore the Group, should act as the sponsor in relation to these schemes. As a result, the Group now recognises retirement benefit obligations within its financial statements.

Obligations for contributions to the defined contribution pension scheme are recognised as an expense in the income statement as incurred.

The cost of providing benefits under the defined benefit pension scheme is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of the defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight-line basis over the vesting period or immediately if the benefits have vested. When the benefit of a plan is changed or when a plan is curtailed, the resulting change that related to past service or the gain or loss on curtailment is recognised immediately in the Statement of profit or loss. When a settlement occurs, the obligation and related plan asset are remeasured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement occurs.

Net interest is calculated by applying a discount rate to the net defined benefit liability or asset.

The Group recognises actuarial gains and losses in full in other comprehensive income ('OCI') in the period in which they occur. Remeasurements of the net defined benefit liability are recognised immediately in OCI

The defined benefit pension asset or liability in the statement of financial position comprises the present value of the defined benefit plan obligation (using a discount rate based on high-quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net defined benefit pension asset is restricted to the sum of any unrecognised past service costs and the present value of any amount the Group expects to recover by way of refunds from the plan or reductions in future contributions.

Current and deferred income tax

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income. In this case, the tax is recognised in other comprehensive income.

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 reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

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, at rates expected to apply when they crystallise, based on current tax rates and law. 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.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Current and deferred income tax *continued*

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 tax assets and liabilities are not discounted.

Deferred income taxation is determined using the tax rates and laws that have been enacted, or substantively enacted during the year and are expected to apply in the periods in which the related deferred tax asset or liability is realised or settled.

Share capital

Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs, allowing for any reductions in the par value. 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 shareholders is recognised as a liability in the Group's financial statements in the period in which the shareholders' right to receive payment of the dividend is established.

Foreign currency

The consolidated financial statements are presented in Sterling, which is the parent company's functional currency.

Transactions denominated in foreign currencies are initially recorded in the entity's functional currency 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.

Heathrow Finance plc

Significant accounting judgements and estimates for the year ended 31 December 2019

In applying the Group's accounting policies, management have made judgements and estimates in a number of key areas. Actual results may differ from these estimates. The estimates and assumptions are reviewed on an on-going basis.

Critical judgements in applying the Group's accounting policies

Hedge accounting

Certain interest rate swaps are designated in a cash flow hedge relationship to hedge the exposure to variability in cash flows of forecast transactions or existing liabilities. Management compares on a regular basis existing and historic hedging arrangements against expectations for future Sterling re-financing. If there were significant changes in the expected quantum of future Sterling re-financing, then levels may be insufficient to support components of the cash flow hedge reserve, requiring the recycling of the cash flow hedge reserve through the income statement. As at 31 December 2019, £226 million of fair value losses (2018: £261 million) on these derivatives have been deferred into the cash flow hedge reserve.

The Group has chosen to apply the amendments to IFRS 9, IAS 39 and IFRS 7 Interest Rate Benchmark Reform, and will continue to apply these until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows that the Group is exposed ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date on which the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and the relevant spread adjustment. This will, in part, be dependent on the introduction of fall back clauses which have yet to be added to the Group's contracts and the negotiation with lender and bondholders.

Capitalisation

Management are required to make judgements in relation to the capitalisation of costs. This relates to both when amounts may begin to be capitalised, where there may be doubt about planning consent or the ultimate completion of the asset, and in relation to the nature of costs incurred. Judgement has been exercised in the year including in relation to:

- the assessment of assets in the course of construction, including expansion costs where judgement is exercised to determine costs that are directly attributable to the assets under construction;
- when a project moves from the research phase (where costs must be expensed in the current period) to the development phase and hence may be capitalised as the future economic benefit of the project becomes probable and the principles of IAS 38 are considered and applied.

In relation to Heathrow Expansion, judgement has been exercised in the determination that it is probable that Heathrow Expansion will go ahead. Management has concluded that it is improbable that the appeal of the Judicial review of the Airports National Policy Statement decisions will rule against the Government. Management has also concluded that the result of the UK 2019 General Election and related political uncertainty, as well as the uncertainty over the regulatory model to support investment and the response to CAA CAP 1871: Economic Regulation at Heathrow Airport, does not change the judgement. Accumulated Assets in the Course of Construction of £450 m related to Heathrow Expansion are recorded in the balance sheet at 31 December 2019.

Leases

The key judgements made in calculating the initial impact of adopting IFRS 16 in relation to leases include determining the lease term where extension or termination options exist. In such instances, all facts and circumstances that may create an economic incentive to exercise an extension option, or not exercise a termination option, have been considered to determine the lease term. Considerations include, the length of time remaining before the option is exercisable, current and future business needs and also the costs associated with any termination options or extension options. Extension periods (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). Management has made judgements around certain lease extension or termination options and the judgement is reassessed at each reporting period.

Judgement is required in determining the discount rate, which is based on the incremental borrowing rate. An increase in the discount rate would result in a lower value of the initial right-of-use asset and lease liability, lower depreciation expense and higher interest expense over the term of the lease.

Agent versus principal

The presentation of certain costs including employment costs and pension costs which are a contractual obligation of LHR Airports Limited are presented as Operating costs of the Group in the 2019 financial statements as Heathrow Airport Limited (part of the Group) is deemed to be the principal in relation to these transactions. This judgement is described in the accounting policies and is based on the balance of risks and rewards between group companies.

Heathrow Finance plc

Significant accounting judgements and estimates for the year ended 31 December 2019 *continued*

Critical judgements in applying the Group's accounting policies *continued*

Useful economic life (UEL) and depreciation

Calculation of depreciation and the retention of assets on the fixed asset register requires management to make judgements regarding the useful economic lives of fixed assets. These judgements are based on Heathrow's experience of similar assets, engineering data, and industry standards.

Where management identifies that actual UELs differ from those estimated, the UELs are adjusted in the period that the difference is identified. As Heathrow makes significant investment in PP&E during Expansion and continues to most efficiently utilise existing assets by extending lives where appropriate, the differences between the estimated and actual UELs could have a positive or negative impact on the financial statements.

Investment properties

Investment properties are fair valued by CBRE Limited, Chartered Surveyors. The valuations are prepared in consideration of IFRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations are carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) is capitalised using yields derived from market evidence. This market evidence also considers planned transactions and use of the property (for example the future expansion of Heathrow). Independent valuations are obtained for all investment properties.

Judgement is exercised in adjusting cash flows to reflect what a 'Reasonably Efficient Operator' would be able to achieve outside of the economies of scale achieved by Heathrow when operating a portfolio of car parks. These judgements are needed so that each car park can be valued on an individual basis and include judgements on the "Fair Maintainable Turnover" that would be achievable and a determination on the allocation of business rates and operating cost inefficiencies.

Heathrow Finance plc

Significant accounting judgements and estimates for the year ended 31 December 2019 *continued*

Key sources of estimation uncertainty

Investment properties

Management have reviewed the main assumptions underlying the valuation of Investment properties and provide sensitivity analysis based on reasonable possible changes to relevant assumptions. The main estimations made that have a significant risk of resulting in a material adjustment to the carrying amounts of investment properties within the next financial year have been assessed as those related to Car Parks

Car parks are valued individually based on actual data on revenue in the current year and expectations of future growth rates. Sensitivities have been run to analyse the impact of a reasonable change in growth rates and a reasonable change in base year revenue informed by discussions with CBRE and internal Heathrow car park experts. Estimations are also made concerning expectations of future growth rates of operating costs including business rates. The results of the sensitivities are shown in Note 8 to the accounts.

Retirement benefit obligations

Certain assumptions have been adopted for factors that determine the valuation of the Group's liability for pension obligations at period end and charges to the income statement. The assumptions have been determined in consultation with the Group's actuary considering market and economic conditions. Assumptions can vary from period to period because of changing conditions and other determinants which may cause increases or decreases in the valuation of the Group's liability for pension obligations.

The objective when setting pension scheme assumptions for future periods is to reflect the expected actual outcomes, other than the discount rate which must be set by reference to the yield on high quality corporate bonds with a term consistent with the obligations. The impact of the change in assumptions on the valuation of the net financial position of the Group pension scheme is recorded as a net actuarial gain or loss and is reflected in the statement of comprehensive income.

The triennial Trustee valuation of the scheme was completed during 2019 and included updates to mortality rates as well as other key demographic indicators, which have been used to inform management assumptions used at 31 December 2019.

Management have reviewed the main assumptions underlying the valuation of Retirement benefit obligations. The main estimations made that have a significant risk of resulting in a material adjustment to the carrying value of the assets and liabilities relating to the scheme have been assessed as: a) Discount rate, b) Inflation rates, and c) Mortality/Life expectancy changes.

Sensitivities have been run to analyse the impact of a reasonable change in these estimations informed by discussions with scheme actuaries KPMG and internal Heathrow experts. The results of the sensitivities are shown in Note 17 of the Annual Report and Accounts.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019

1 Segment information

As described in the accounting policies, the Group is organised into business units according to the nature of the services provided. Most revenue is derived from the activities carried out within the Airport. The exception to this is Heathrow Express, which is a separately identifiable operating segment under IFRS 8, with separately identifiable assets and liabilities, and hence management aggregates these units into two operating segments, as follows:

- Heathrow (Aeronautical and commercial operations within the Airport and its boundaries)
- Heathrow Express (Rail income from the Heathrow Express rail service between Heathrow and London)

The performance of the above segments is measured on a revenue and Adjusted EBITDA basis.

The reportable segments derive their revenues from a number of sources and this information is also provided to the Board on a monthly basis.

- Table (a) details total revenue from external customers for the year ended 31 December 2019 and is broken down into aeronautical, retail, ORCs 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 Adjusted EBITDA which is earnings before interest, tax, depreciation, amortisation and certain re-measurements.
- Table (b) details depreciation, amortisation and fair value adjustments.
- Table (c) details asset and liability information by reportable segment. The assets and liabilities information by segment is not provided to the Board on a monthly basis but is included in this note as additional information.
- Section (d) details revenue and non-current asset information by geographical segment.

Table (a)

	Year ended 31 December 2019	Restated Year ended 31 December 2018
	£m	£m
Segment Revenue Under IFRS 15		
Aeronautical		
Landing charges	549	482
Parking charges	74	67
Departing charges	1,208	1,196
Total Aeronautical revenue	1,831	1,745
Other regulated charges	244	243
Retail services revenue ¹	722	716
Property revenue ¹	25	20
Rail Income		
Heathrow Express	117	123
Other	23	14
<i>Revenue reported under IFRS 15</i>	2,962	2,861
Revenue recognised at a point in time	2,837	2,735
Revenue recognised over time	125	126
Total revenue reported under IFRS 15	2,962	2,861
Revenue reported under IFRS 16/IAS 17		
Property (lease-related income) ¹	108	109
Retail (lease-related income) ¹	-	-
Total revenue	3,070	2,970
Heathrow	2,953	2,847
Heathrow Express	117	123
Adjusted EBITDA		
Heathrow	1,859	1,772
Heathrow Express	61	65
Total adjusted EBITDA	1,920	1,837
Reconciliation to statutory information:		
Depreciation and amortisation	(774)	(746)
Operating profit (before certain re-measurements)	1,146	1,091

¹ 2018 comparatives have been restated for the reclassification of lease related income under IAS 17 – Leases to retail service income under IFRS 15 – Revenue from contracts with customers. The reclassification was made to reflect the nature of the underlying contract terms in retail services and property income. The impact of this is that £569 million was transferred from retail (lease related income) under IFRS 16 to Retail services under IFRS 15. £109 million was transferred from property revenue under IFRS 15 to property (lease-related income) under IAS 17.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

1 Segment information *continued*

Operating profit (before certain re-measurements)	1,146	1,091
Fair value gain on investment properties (certain re-measurements)	43	117
Operating profit	1,189	1,208
Finance income	35	27
Finance costs	(646)	(744)
Profit before tax	578	491

Revenue of £882 million (2018: £884 million) was derived from a single external customer and has been included within the Heathrow segment.

	Year ended 31 December 2019		Year ended 31 December 2018	
	Depreciation & amortisation ¹	Fair value gain ²	Depreciation & amortisation ¹	Fair value gain ²
	£m	£m	£m	£m
Heathrow	(719)	43	(675)	117
Rail and Heathrow Express	(55)	-	(71)	-
Total	(774)	43	(746)	117

¹ Includes intangible amortisation charge of £44 million (2018: £27 million).

² Reflects fair value gain on investment properties only.

	Year ended 31 December 2019		Year ended 31 December 2018	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Heathrow	14,102	(430)	13,880	(440)
Heathrow Express	652	(15)	670	(14)
Total operations	14,754	(445)	14,550	(454)
Unallocated assets and liabilities:				
Cash, term deposits and external borrowings	1,570	(16,040)	715	(14,660)
Retirement benefit obligations	33	(29)	28	(32)
Derivative financial instruments	539	(1,282)	543	(1,562)
Deferred and current tax liabilities	-	(982)	-	(971)
Amounts owed from/(to) group undertakings	647	-	676	(75)
Right of use assets and lease liabilities	276	(384)	-	-
Total	17,819	(19,162)	16,512	(17,754)

(d) 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 2019 was £3,070 million (2018: £2,970 million). The breakdown of the major components of total revenue from external customers is shown in tables (a) and (b) above.

Non-current assets excluding derivative financial instruments were £15,336 million (2018: £14,850 million). There were no non-current assets held outside the UK (2018: £nil).

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

2 Operating costs

Operating costs comprise:

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
Employment		
Wages and salaries	355	335
Social security	36	36
Pension	41	47
Other staff related costs	27	24
Own staff costs capitalised	(81)	(64)
	378	378
Operational	279	264
Maintenance	173	176
Business Rates	118	122
Utilities	71	90
Other	131	103
Operating costs before depreciation and amortisation	1,150	1,133
Depreciation and amortisation		
Property, plant and equipment	696	719
Right of use assets	35	-
Intangible assets	43	27
	774	746
Total operating costs¹	1,924	1,879

¹ Total operating costs include expenditure on research and development of £2 million (2018: £2 million)

Rentals under operating leases

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
<i>Operating costs include:</i>		
Land and buildings ¹	-	14
Others ²	-	40
Total rentals under operating leases	-	54

¹ In the year ended 31 December 2018, the Group leased various offices, warehouses and plant and machinery under non-cancellable operating lease agreements.

² A significant portion of the operating rental costs as "Others" relates to the electricity distribution network at the airport leased on agreement with UK Power Networks Services Limited 'UKPNS'.

From the year beginning 1 January 2019, operating lease costs are not presented in operating costs, see note 7. Refer to the changes in accounting policies and disclosures.

Auditor's remuneration

Audit fees and non-audit fees for the current and preceding financial years were borne by Heathrow Airport Limited. The audit fees of FGP Topco Group are also borne by Heathrow Airport Limited.

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
Fees payable to the Company's auditor for the annual audit of the:		
Company's ultimate parent	0.1	0.1
Company's subsidiaries ¹	0.4	0.4
Total audit fees	0.5	0.5

¹ Fees payable to the Company's auditor for the audit of the Company's financial statements was £74,000 (2018: £72,000).

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

2 Operating costs *continued*

Auditor's remuneration *continued*

Fees payable to the Company's auditor and their associates for other services specific to the Group

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
Audit related assurance services	0.5	0.1
Other services	0.1	-
Other assurance services	0.1	0.2
Total non-audit fees	0.7	0.3
Total fees	1.2	0.8

Non-audit fees predominantly relate to audit related assurance services provided in connection with the quarterly reviews of Heathrow (SP) Ltd.

Employee numbers

Heathrow Finance had a monthly average of 7,827 employees (2018: 7,141) of which 186 (2018: 398) are employees of HEX and the rest are legally employed by LHR Airports Limited. The Group makes all employment decisions; consequently, employee numbers for those providing services to the operation of the airport are reported in the financial statement of the Group and not in the financial statements of LHR Airports Limited.

Directors' remuneration

Javier Echave was a director of a number of companies within the Heathrow Airport Holdings Group during the year. His remuneration for the year ended 31 December 2019 was disclosed in the financial statements of Heathrow Airport Holdings Limited. Nicholas Golding and Sally Ding were directors of a number of companies within the Heathrow Airport Holdings Group. They were paid by, but are not directors of, Heathrow Airport Limited. The directors do not believe it is possible to accurately apportion their remuneration to individual companies within the Group based on services provided.

During the year, two of the directors (2018: two) had retirement benefits accruing to them under a defined benefit scheme and one of the directors (2018: two) had retirement benefits accruing to them under a defined contribution scheme.

3 Financing

Net finance costs before certain re-measurements

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
Finance income		
Interest on deposits	10	2
Interest receivable from group undertakings	25	25
Total finance income	35	27
Finance costs		
Interest on borrowings:		
Bonds and related hedging instruments ¹	(587)	(584)
Bank loans and overdrafts and related hedging instruments	(93)	(74)
Net interest payable on derivatives not in hedge relationship ²	(106)	(160)
Interest payable to group undertakings	(2)	(1)
Facility fees and other charges	(13)	(9)
Net pension finance costs	-	(4)
Finance cost on lease liabilities	(17)	-
	(818)	(832)
Less: capitalised borrowing costs ³	6	50
Total finance costs	(774)	(782)
Net finance costs before certain re-measurements	(739)	(755)

¹ Includes accretion of £35 million (2018: £47 million) on index-linked bonds.

² Includes accretion of £152 million (2018: £207 million) on index-linked swaps and including prepaid discount.

³ 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 4.98% (2018: 5.66%) to expenditure incurred on such assets.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

3 Financing *continued*

Certain re-measurements

Fair value gain/(loss) on financial instruments

Interest rate swaps: not in hedge relationship	(19)	83
Index-linked swaps: not in hedge relationship	172	(90)
Cross-currency swaps: ineffective portion of cash flow hedges	(1)	21
Cross-currency swaps: ineffective portion of fair value hedges	(33)	24
Cross-currency swaps: not in a hedge relationship	11	-
Foreign exchange contracts and currency balances	(2)	-
	128	38
Net finance costs	(611)	(717)

4 Taxation

	Year ended 31 December 2019			Year ended 31 December 2018		
	Before	Certain re-	Total	Before	Certain re-	Total
	certain re-measurements	measurements		certain re-measurements	measurement	
	£m	£m	£m	£m	£m	£m
UK corporation tax						
Current tax charge at 19% (2018: 19%)	(104)	(2)	(106)	(102)	(3)	(105)
Over provision in respect of prior years	8	-	8	5	-	5
Total current tax charge	(96)	(2)	(98)	(97)	(3)	(100)
Deferred tax						
Current year (charge)/credit	(14)	(28)	(42)	14	(21)	(7)
Prior year (charge)/credit	(1)	1	-	11	17	28
Total deferred tax (charge)/credit	(15)	(27)	(42)	25	(4)	21

The tax (charge)/credit on the Group's profit/(loss) before tax differs from the theoretical amount that would arise by applying the UK statutory tax rate to the accounting profits of the Group for the reasons as set out in the following reconciliation:

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
Profit before tax	578	491
Reconciliation of the tax charge		
Tax calculated at the UK statutory rate of 19% (2018: 19%)	(110)	(93)
Net non-deductible expenses	(41)	(19)
Adjustments in respect of current income tax of previous years	8	5
Adjustments in respect of deferred income tax of previous years	-	28
Effect of change in tax rate	3	-
Total tax charge	(140)	(79)

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

4 Taxation *continued*

The total tax charge recognised for the year ended 31 December 2019 was £140 million (2018: £79 million). Based on a profit before tax for the year of £578 million (2018: £491 million), this results in an effective tax rate of 24.2% (2018: 16.1%).

The total tax charge before certain re-measurements for the year ended 31 December 2019 was £111 million (2018: £72 million). Based on a profit before tax and certain re-measurements of £407 million (2018: £336 million), this results in an effective tax rate of 27.3% (2018: 21.4%). The tax charge for 2019 is more (2018: more) than implied by the statutory rate of 19% primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief. However, with the introduction of the new Structures and Building Allowance relief (SBA) (see below), a higher proportion of Heathrow's capital expenditure will qualify for tax relief in future years, which is expected to reduce the effective tax rate.

In addition, there was a £29 million tax charge (2018: £7 million tax charge) reflecting the tax impact arising from fair value gains on investment property revaluations and fair value gains on financial instruments, along with any associated prior year adjustments.

The headline UK corporation tax rate is 19% but is due to fall to 17% with effect from 1 April 2020. The effect of these rate reductions has been reflected in the deferred tax balances in the financial statements. Prior to the UK General Election held on 12 December 2019, the Conservative Party announced that it would maintain the UK corporation tax rate at 19%. However, as no legislation had been substantively enacted at the balance sheet date, this announcement has not been reflected in the deferred tax balances. Based on the current net deferred tax liability, a 19% corporation tax rate would increase the net deferred tax liability to an estimated £1,054 million, which would give rise to a £111 million deferred tax charge due to changes in tax rates.

In the November 2018 Budget the Government announced a new 2% flat rate Structures and Building Allowance relief (SBA) for non-residential structural property will be available where the construction contract is entered on or after 29 October 2018. Relief will be provided on eligible construction costs at an annual rate of 2% on a straight-line basis, effectively giving tax relief over a 50-year period. Heathrow is likely to benefit in future years from tax relief on expenditure which would not be eligible under current rules. At the balance sheet date, no material SBA-qualifying assets had been identified and brought into use.

Other than these changes, there are no items which would materially affect the future tax charge.

5 Dividends

During the year ended 31 December 2019, the Company paid dividends of £468 million (£0.05 per share) to Heathrow DSH being £2 million (£0.00 per share) on 1 March 2019, £100 million (£0.01 per share) on 11 March 2019, £83 million (£0.01 per share) on 27 June 2019, £100 million (£0.01 per share) on 2 July 2019, £183 million (£0.02 per share) on 20 December 2019.

During the year ended 31 December 2018, the Company paid dividends of £497 million (£0.05 per share) to Heathrow DSH being £113 million (£0.01 per share) on 21 February 2018, £111 million (£0.01 per share) on 27 June 2018, £114 million (£0.01 per share) on 23 July 2018, £159 million (£0.02 per share) on 20 December 2018.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

6 Property, plant and equipment

Note	Terminal	Airfields	Plant and	Other land and	Assets in the		Total
	complexes		equipment	buildings	Rail	course of	
	£m	£m	£m	£m	£m	construction	£m
Cost							
1 January 2018	11,871	1,706	891	205	1,421	893	16,987
Additions	-	-	-	-	-	768	768
Borrowing costs capitalised	3	-	-	-	-	50	50
Disposals	(3)	-	(10)	-	(15)	-	(28)
Transfer to intangible assets	9	-	-	-	-	(5)	(5)
Transfer to/(from) completed assets		376	(112)	260	44	(593)	-
31 December 2018	12,244	1,594	1,141	230	1,450	1,113	17,772
Additions	-	-	-	-	-	849	849
Borrowing costs capitalised	3	-	-	-	-	44	44
Disposals	(245)	(65)	(118)	(9)	(50)	-	(487)
Transfer to intangible assets	9	-	-	-	-	-	-
Transfer to/(from) completed assets		532	127	(27)	53	(739)	(44)
31 December 2019	12,531	1,656	996	274	1,410	1,267	18,134
Depreciation							
1 January 2018	(3,977)	(464)	(433)	(68)	(564)	-	(5,506)
Depreciation charge	(490)	(45)	(103)	(10)	(71)	-	(719)
Disposals	3	-	10	-	15	-	28
31 December 2018	(4,464)	(509)	(526)	(78)	(620)	-	(6,197)
Depreciation charge	(495)	(61)	(67)	(19)	(54)	-	(696)
Disposals	245	65	118	9	50	-	487
31 December 2019	(4,714)	(505)	(475)	(88)	(624)	-	(6,406)
Net book value							
31 December 2019	7,817	1,151	521	186	786	1,267	11,728
31 December 2018	7,780	1,085	615	152	830	1,113	11,575

A review of Nil Net book value assets was performed in the year which resulted in significant disposals at Nil Net book value.

Other land and buildings

Other land and buildings are freehold except for leasehold properties which are presented in note 7. Refer to the accounting policy for the changes in the accounting policies.

Assets in the course of construction

The major balances in assets in the course of construction include accumulated costs related to Heathrow Expansion, Baggage programme projects to install the latest generation of Baggage screening machines, the Asset Management programme to replace assets at the end of their useful life, an the Airport resilience programme including tunnels and airfield improvements.

Accelerated Depreciation

Depreciation in 2019 includes accelerated depreciation on Heathrow Express rolling stock (£28 million accelerated depreciation in rail assets) and the Tracked Transit System (£3 million accelerated depreciation in terminal complexes) of £31 million (2018: £41 million).

Borrowing costs capitalised

During the year ended 31 December 2019, borrowing costs of £44 million were capitalised (2018: £50 million). Capitalised borrowing costs were calculated by applying an average interest rate of 4.98% (2018: 5.66%) to expenditure incurred on qualifying assets.

A tax deduction of £44 million (2018: £50 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.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

6 Property, plant and equipment *continued*

Regulatory asset base (RAB)

RAB at December 2019 was £16,598 million (2018: £16,200 million).

Leased assets

The Group has assets rented to third parties under operating lease as follows:

	31 December 2019	31 December 2018
	£m	£m
Cost or valuation	609	601
Accumulated depreciation	(314)	(289)
Net book value	295	312

Securities granted by the Group over its assets, including property, plant and equipment, are disclosed in note 13.

7 Leases

Group as a lessee

The Group leases assets including land and buildings, vehicles, plant and equipment and rolling stock.

(i) Amounts recognised in the balance sheet

Right-of-use assets

	Land and Buildings	Plant and Equipment	Others ¹	Total
	£m	£m	£m	£m
Balance at 1 January 2019	50	2	245	297
Addition	-	6	-	6
Remeasurement	-	-	8	8
Depreciation charge for the year	(13)	(1)	(21)	(35)
Balance at 31 December 2019	37	7	232	276

¹ A significant portion of the leased assets classified under 'Others' category relates to the electricity distribution network at the Airport.

None of the leases expired during the year ended 31 December 2019.

Lease liabilities

	2019
	£m
Current	38
Non-current	346

Maturity analysis

	2019
	£m
Less than one year	38
One to five years	102
More than five years	244

The Group does not face a significant liquidity risk with regard to its lease liabilities. Lease liabilities are monitored within the Group's treasury function. Potential future increases in variable lease payments based on an index or rate are not included in the lease liability until they take effect. When adjustments to lease payments based on an index or rate take effect, the lease liability is reassessed and adjusted against the right-of-use asset.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

7 Leases *continued*

(ii) Amounts recognised in profit and loss

	2019
	£m
Depreciation expense of right-of-use assets	35
Interest expense on lease liabilities (included in finance cost)	17
Expense relating to short-term leases (included in operating cost)	2
Expense relating to variable payments not included in the measurement of the lease liability (included in operating cost)	5

(iii) Amounts recognised in statement of cash flows

The Group has some contracts that contain variable lease payment terms linked to the retail price index (RPI), aligned to the Group's regulatory environment which provides cash flow predictability through passenger pricing (revenue) linked to RPI. The breakdown of the lease payments are as follows:

	2019
	£m
Fixed payments	15
Variable payments	35
Total cash outflow relating to leases	50

Group as a lessor

Lease income from lease contracts where the Group is the lessor is as below

	2019
	£m
Operating lease	
Property (lease-related income)	108

Operating lease

The Group leases out a portion of its investment property. The Group has classified these as operating leases, because they do not transfer substantially all of the risks and rewards incidental to the ownership of the assets.

The following table sets out a maturity analysis of lease income, showing the undiscounted lease income to be received after the reporting date.

	31 December 2019	31 December 2018
	Land and buildings	Land and buildings
	£m	£m
Within one year	78	88
One to two years	61	68
Two to three years	55	58
Three to four years	48	53
Four to five years	42	46
More than five years	1,644	1,698

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

8 Investment properties

Airport investment properties

	£m
Valuation	
1 January 2018	2,350
Additions	4
Revaluation	117
Transfers from property, plant and equipment	1
31 December 2018	2,472
Additions	7
Revaluation	43
31 December 2019	2,522

Investment properties were fair valued at 31 December 2019 by an external valuer, CBRE Limited. The valuers are independent and have appropriate, recognised qualifications, and experience in the categories and location of the investment properties being valued.

Management conducts a detailed review of each property to ensure the correct assumptions have been used. Meetings with the valuers are held to review and challenge the assumptions used in the valuation.

All valuations were prepared in consideration of IFRS 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 relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. The fair value measurement hierarchy used in calculating fair value (refer to Note 15) has been classified as level 3. The higher the discount rate and expected vacancy rate, the lower the fair value. The higher the current and potential future income or rental growth rate, the higher the fair value.

The Investment Property portfolio includes Car Parks (for passengers and employees) and Maintenance Hangars, which together account for 71% (2018: 71%) of the fair value of the investment property portfolio at 31 December 2019. The valuation of Maintenance Hangars is largely based on long term contractual terms.

Increase/(decrease) in asset valuation

	£m
Car parks – Base revenue	
+2.0% pa	36
-2.0% pa	(36)
Car parks – Revenue growth	
+1.0% pa	131
-1.0% pa	(118)
Car parks - Operating costs growth	
+1.0% pa	(31)
-1.0% pa	36

The sensitivities analysis above relating to the valuation of car parks has been determined based on reasonably possible changes to the respective assumptions, holding all other assumptions constant. The methodology used in arriving at the incremental changes shown above is consistent with that used for the valuation at the year end.

The Group has historically had a low level of void properties. Investment properties which are let, are let either 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 less than £1 million (2018: less than £1 million) for which a similar amount is included within operating costs.

The property rental income earned by the Group from its investment property, amounted to £78 million (2018: £76 million). Direct operating expenses arising on the investment property, all of which generated rental income in the period, amounted to £1 million (2018: £1 million). The Group has entered into contracts for the maintenance of its investment property, which will give rise to an annual charge of less than £1 million (2018: less than £1 million).

Securities granted by the Group over its assets, including investment properties, are disclosed in Note 13.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

9 Intangible assets

	£m
Cost	
1 January 2018	329
Additions	20
Transfers from property, plant and equipment	5
Disposals	(2)
31 December 2018	352
Transfers from property, plant and equipment	44
Disposals	(88)
31 December 2019	308
Amortisation	
1 January 2018	(154)
Charge for the year	(27)
Disposals	2
31 December 2018	(179)
Charge for the year	(41)
Disposals	88
31 December 2019	(132)
Net book value	
31 December 2019	176
31 December 2018	173

All intangible assets relate to capitalised computer software costs. These software costs principally relate to operating and financial software, amortised over a period of between four and fifteen years. Amortisation for the year has been charged through operating costs. A review of Nil Net book value assets was performed in the year which resulted in significant disposals at Nil Net book value.

A review of Nil Net book value assets was performed in the year which resulted in significant disposals at Nil Net book value.

10 Inventories

	31 December 2019	31 December 2018
	£m	£m
Consumables	13	13

The total value of inventories consumed in the year was £5 million (2018: £7 million). There is no material difference between the value of inventories in the statement of financial position and their replacement cost.

11 Trade and other receivables

	31 December 2019	31 December 2018
	£m	£m
Non-current		
Prepaid debt fees ¹	4	6
Prepayments	14	13
Amounts owed by group undertakings	583	583
	601	602

¹ Prepaid debt fees largely relate to financing fees paid on facilities not yet drawn and are amortised over the term of the facility.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

11 Trade and other receivables *continued*

	31 December 2019	31 December 2018
	£m	£m
Current		
Trade receivables	136	120
Accrued income ²	47	126
Trade receivables and accrued income	183	246
Less: provision for impairment	(5)	(4)
Trade receivables and accrued income after impairment ³	178	242
Prepayments	35	35
Amounts owed by group undertakings ⁴	121	93
Other receivables	27	21
	361	391

² Accrued income is net of any amounts received in advance from customers and includes the provision for the iH7 Deal and the Aero Growth Incentive Deal.

³ Trade receivables and accrued income after impairment contain credit risk and is included in note 15, Financial instruments.

⁴ Amounts owed by group undertakings largely relate to external payments received by LHR Airports Limited under the Shared Services Agreement ('SSA') on behalf of Heathrow that will be remitted to Heathrow in due course. This amount is payable on demand and accrues interest at Bank of England base rate +1.5%.

The fair value of trade and other receivables are not materially different from the carrying value.

Note 15 includes disclosures relating to the credit risk exposures and analysis relating to the allowance for expected credit losses.

Trade receivables are non-interest bearing and are generally on 14-day terms. No collateral is held as security.

As at 31 December 2019, trade receivables of £101 million (2018: £88 million) were fully performing. Trade receivables of £35 million (2018: £32 million) were past due. These relate to a number of independent customers for whom there is no recent history of default. Refer to note 15, Financial instruments, for the aging profile of trade receivables under credit risk.

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

	£m
1 January 2018	4
Impairment for trade receivables	-
31 December 2018	4
Impairment for trade receivables	1
31 December 2019	5

As at 31 December 2019, trade receivables were considered for impairment under IFRS 9 resulting in an additional provision £1 million (2018: £nil). During the year ended 31 December 2018 and 2019, there were no write off on trade receivables. 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' within 'operating costs' in the consolidated income statement. Amounts charged to the provision account are written off when there is no expectation of recovery, with additional impairment for forward looking ECL and probable default.

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 and term deposits

	31 December 2019	31 December 2018
	£m	£m
Cash at bank and in hand	113	36
Short-term deposits	732	559
Cash and cash equivalents	845	595
Term deposits	725	120
Cash and cash equivalents and term deposits	1,570	715

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 to their book value.

Heathrow Airport Limited holds investments in term deposits, which have an original maturity of more than three months.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

12 Cash and cash equivalents and term deposits *continued*

For the purposes of the Consolidated statement of cash flows, cash and cash equivalents comprise cash at bank, cash in hand, money market funds, repurchase agreements with an original maturity of three months or less and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments, restricted cash and bank overdrafts.

13 Borrowings

	31 December 2019	31 December 2018
	£m	£m
Current		
Secured		
Heathrow Funding Limited bonds:		
4.000% C\$400 million due 2019	-	230
GBP400m 6.0% Class B bond due 2020	400	-
	400	230
Heathrow Finance plc bonds:		
5.375% £275 million due 2019	-	262
Total bonds	400	492
Heathrow Airport Limited loans	4	17
Total current (excluding interest payable)	404	509
Interest payable	240	232
Interest payable to Heathrow (DSH)	-	1
Total current	644	742
Non-current		
Secured		
Heathrow Funding Limited bonds:		
6.000% £400 million due 2020	-	399
9.200% £250 million due 2021	255	260
3.000% C\$450 million due 2021	260	256
4.875% US\$1,000 million due 2021	762	782
1.650%+RPI £180 million due 2022	218	213
1.875% €600 million due 2022	517	549
5.225% £750 million due 2023	703	691
7.125% £600 million due 2024	594	593
0.500% CHF400 million due 2024	307	310
3.250% C\$500 million due 2025	288	281
4.221% £155 million due 2026	155	155
0.450% CHF210 million due 2026	167	-
6.750% £700 million due 2026	690	690
2.650% NOK1,000 million due 2027	85	89
3.400% C\$400 million bond due 2028	234	232
7.075% £200 million due 2028	200	198
4.150% A\$175 million due 2028	103	99
2.500% NOK1,000 million due 2029	76	79
3.782% C\$400 million bond due 2030	233	229
1.500% €750 million due 2030	644	629
6.450% £900 million due 2031	855	853
Zero-coupon €50 million due January 2032	58	59
1.366%+RPI £75 million due 2032	87	85
Zero-coupon €50 million due April 2032	57	58
1.875% €500 million due 2032	421	447
1.875% €650 million due 2034	584	-
4.171% £50 million due 2034	50	50
Zero-coupon €50 million due 2034	49	50
1.061%+RPI £180 million due 2036	202	197
1.382%+RPI £50 million due 2039	57	56

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

13 Borrowings *continued*

	31 December 2019	31 December 2018
	£m	£m
Non-current borrowings <i>continued</i>		
Secured <i>continued</i>		
Zero-coupon €86 million due 2039	75	0
3.334%+RPI £460 million due 2039	637	624
0.800% JPY1,000 million due 2039	69	0
1.238%+RPI £100 million due 2040	113	111
5.875% £750 million due 2041	735	735
2.926% £55million due 2043	54	55
4.625% £750 million due 2046	741	742
1.372%+RPI £75 million due 2049	86	85
2.750% £400 million due 2049	392	392
0.147%+RPI £160 million due 2058	165	164
	11,978	11,497
Heathrow Finance plc bonds:		
4.750% £300 million due 2024	298	297
5.750% £250 million due 2025	249	248
3.875% £275 million due 2027	274	273
4.125% £300 million due 2029	299	0
	1,120	818
Total bonds	13,098	12,315
Heathrow Airport Limited debt:		
Class A1 term loan due 2020	418	418
Class A2 term loan due 2024	100	100
Class A3 term loan due 2029	200	-
Term note due 2026-2037	723	585
Loans	8	12
Heathrow Finance plc facilities	849	488
Total other debt	2,298	1,603
Borrowings from Heathrow (DSH)	-	75
Total non-current	15,396	13,993
Total borrowings (excluding interest payable)	15,800	14,502

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 6.000% £400 million due 2020, 7.125% £600 million due 2024, 4.221% £155 million due 2026 bonds and 1.061%+RPI £180 million due 2036 bonds wherein the redemption dates coincide with their legal maturity dates.

Fair value of borrowings

	31 December 2019		31 December 2018	
	Book value	Fair value ¹	Book value	Fair value ¹
	£m	£m	£m	£m
Current				
Short-term debt	404	408	509	518
Non-current				
Long-term debt	15,396	18,344	13,918	16,371
Borrowings from parent	-	-	75	75
	15,800	18,752	14,502	16,964

¹ Fair value of borrowings is for disclosure purposes only

Accrued interest is included as a current borrowings balance and not in the carrying amount of non-current borrowings. The fair value of listed borrowings are based on quoted prices at balance sheet date. For unlisted borrowings, the Group establishes fair values by using discounted cash flow analysis utilising yield curves derived from observable market data (Level 2). The fair value of borrowings which have floating rate interest are assumed to equate to their nominal value. At 31 December 2019, the fair value of debt classified as Level 1 and Level 2 was £15,533 million and £3,219 million respectively (2018: £14,112 million and £2,852 million respectively).

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

13 Borrowings *continued*

Fair value of borrowings *continued*

At 31 December 2019, total non-current borrowings due after more than 5 years was £10,883 million, comprising £9,182 million of bonds and £1,701 million in bank facilities, excludes lease liabilities.

The average cost of the Group's external gross debt at 31 December 2019 was 3.56% (2018: 3.73%), taking into account the impact of interest rate, cross-currency and index-linked hedges but excluding index-linked swap accretion. Including index-linked swap accretion, the Group's average cost of debt at 31 December 2019 was 4.73% (2018: 5.31%). The reduction in the average cost of borrowing including index-linked accretion is mainly due to the recent moves in inflation with the retail price index ('RPI') decrease in the RPI growth rate in the period reflected by an annualised increase of 2.2% in 2019 compared to an annualised increase of 3.2% in 2018.

Impact of fair value hedge adjustments

The nominal value of debt designated in fair value hedge relationship was GBP 250 million, EUR 2,000 million, US\$ 1,000 million, C\$ 1,470 million, CHF 610 million, A\$ 175 million, JPY 10 billion and NOK 2,000 million. Where debt qualifies for fair value hedge accounting, hedged item adjustments have been applied as follows:

	31 December 2019		31 December 2018	
	Nominal	Fair value adjustment ¹	Nominal	Fair value adjustment ¹
	£m	£m	£m	£m
Sterling debt	250	(4)	200	(2)
Euro denominated debt	1,615	(70)	1,498	26
USD denominated debt	621	(10)	621	-
CAD denominated debt	810	(3)	1,227	3
Other currencies debt	946	3	549	17
Designated in fair value hedge	4,242	(84)	4,095	44

⁽¹⁾ Fair value adjustment is comprised of fair value loss of £52 million (2018: £89 million gain) on continuing hedges and £32 million loss (2018: £45 million) on discontinued hedges

Securities and guarantees

Heathrow Airport Limited, Heathrow Express Operating Company Limited, Heathrow Finance plc and Heathrow (AH) Limited (together, the 'Obligors') have granted security to Deutsche Trustee Company Limited (in its capacity as the 'Borrower Security Trustee', for itself and as trustee for the Borrower Secured Creditors) over their property, assets and undertakings to secure their obligations under various financing agreements. Each Obligor has also guaranteed the obligations of each other Obligor under such financing agreements.

BAA Pension Trust Company Limited, as a trustee from time to time of the BAA Pension Scheme, is a Borrower Secured Creditor and ranks equally in an amount up to £284 million with senior (Class A) debt.

Heathrow Funding Limited has given Deutsche Trustee Company Limited (the 'Bond Trustee') a covenant to pay and discharge, when due, to each of the Issuer Secured Creditors (including Bondholders) all Issuer Secured Liabilities (including all amounts due under the Bonds). The Bond Trustee holds the benefit of that covenant on trust for itself and the Issuer Secured Creditors. Heathrow Funding Limited has also granted security to the Bond Trustee (for itself and as trustee for the Issuer Secured Creditors) over its property, assets, undertakings and rights to secure the covenant to pay and discharge the Issuer Secured Liabilities.

Heathrow Airport Limited and Heathrow Express Operating Company Limited have provided a guarantee and indemnity in favour of Lloyds Bank plc (in its capacity as the Borrower Account Bank) in respect of each other's obligations under the Borrower Account Bank Agreement and associated financing agreements.

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

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

14 Derivative financial instruments

	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2019				
Current				
Foreign exchange contracts	8	-	-	-
Interest rate swaps	738	-	(11)	(11)
Cross-currency swaps	-	-	-	-
Index-linked swaps	313	-	(44)	(44)
	1,059	-	(55)	(55)
Non-current				
Foreign exchange contracts	33	-	(2)	(2)
Interest rate swaps	1,572	-	(386)	(386)
Cross-currency swaps	4,551	482	(25)	457
Index-linked swaps	6,082	57	(814)	(757)
	12,238	539	(1,227)	(688)
Total	13,297	539	(1,282)	(743)
	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2018				
Current				
Foreign exchange contracts	11	-	-	-
Interest rate swaps	204	-	(5)	(5)
Cross-currency swaps	250	-	(19)	(19)
Index-linked swaps	124	-	(15)	(15)
	589	-	(39)	(39)
Non-current				
Interest rate swaps	2,309	-	(377)	(377)
Cross-currency swaps	3,685	502	(6)	496
Index-linked swaps	6,395	41	(1,140)	(1,099)
	12,389	543	(1,523)	(980)
Total	12,978	543	(1,562)	(1,019)

At 31 December 2019, total non-current notional value of Derivative financial instruments due in greater than 5 years was £9,057 million (2018: £9,171 million), comprising £5,311 million (2018: £5,496 million) of Index-linked swaps, £2,524 million (2018: £2,453 million) of Cross-currency swaps, and £1,222 million (2018: £1,222 million) of Interest rate swaps.

Interest rate swaps

Interest rate swaps are maintained by the Group and designated as hedges, where they qualify against variability in interest cash flows on current and future floating or fixed rate 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. The losses deferred of £20 million expected to be released in less than one year, £22 million between one and two years, £62 million between two and five years and £121 million over five years. Of the total amount deferred in other comprehensive income £206 million related to discontinued cash flow hedges.

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. The losses deferred of £0.5 million are expected to be released in less than one year, losses of £0.5 million between one and two years, £1.3 million between two and five years and gains of £1 million over five years.

Index-linked swaps

Index-linked swaps have been entered into in order to economically hedge RPI linked revenue and the Regulatory Asset Base ('RAB') but are not designated in a hedge relationship.

Foreign exchange contracts

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

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

15 Financial instruments

Financial risk management objectives and policies

The Group's principal financial instruments (other than derivatives) comprise loans, term notes, 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 Heathrow's aeronautical income and its regulatory asset base, which are directly linked to changes in the retail prices index, and nominal debt and interest payments by the use of index-linked instruments.

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.

As listed below, the Group is exposed to interest rate benchmarks within its hedge accounting relationships, which are subject to interest rate benchmark reform.

The Group is closely monitoring the market and the output from the various industry working groups managing the transition to new benchmark interest rates. This includes announcements made by LIBOR regulators. The FCA has made clear that, at the end of 2021, it will no longer seek to persuade, or compel, banks to submit to LIBOR.

In response to the announcements, the Group is assessing the impact of IBOR reform on the Group's hedges and the risk management strategy. Preparations are being made to deliver an action plan to enable a smooth transition to alternative benchmark rates. The Group aims to have its transition and fall-back plans in place by the end of 2020.

Below are details of the hedging instruments and hedged items in scope of the IFRS 9, IAS 39, and IFRS 7 Interest Rate Benchmark Reform amendments, by hedge type. The terms of the hedged items listed match those of the corresponding hedging instruments.

Hedge Type	Instrument Type	Maturing in	Nominal	Hedged Item
Fair value hedges	Receive GBP fixed, pay 6-month GBP LIBOR interest rate swaps	2021	GBP 167m	GBP fixed rate issued debt
		2021	GBP 226m	
	Receive NOK fixed, pay 6-month GBP LIBOR currency swaps	2027	NOK 1,000m	NOK fixed rate issued debt
		2029	NOK 1,000m	
	Receive USD fixed, pay 6-month GBP LIBOR currency swaps	2021	USD 1,000m	USD fixed rate issued debt
	Receive CAD fixed, pay 6-month GBP LIBOR currency swaps	2021	CAD 450m	CAD fixed rate issued debt
		2025	CAD 500m	
		2030	CAD 120m	
	Receive CHF fixed, pay 6-month GBP LIBOR currency swaps	2024	CHF 400m	CHF fixed rate issued debt
		2026	CHF 210m	
Receive EUR fixed, pay 6-month GBP LIBOR currency swaps	2022	EUR 600m	EUR fixed rate issued debt	
	2030	EUR 750m		
	2034	EUR 650m		
Receive AUD fixed, pay 6-month GBP LIBOR currency swaps	2028	AUD 175m	AUD fixed rate issued debt	
Receive JPY fixed, pay 6-month GBP LIBOR currency swaps	2039	JPY 10bn	JPY fixed rate issued debt	
Cash flow hedges	Receive 3-month GBP LIBOR, pay GBP fixed interest rate swap	2027	GBP 24m	GBP LIBOR debt
		2035	GBP 28m	
	Receive EUR fixed, pay GBP fixed ¹	2032	EUR 500m	EUR fixed rate issued debt
	Receive CAD fixed, pay GBP fixed ²	2028	CAD 400m	CAD fixed rate issued debt
		2030	CAD 280m	

¹ Derivatives fair valued by discounting at appropriate risk free rate – Libor 6 month, Cidor 3 month, Euribor 3 month

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Notes to the Group financial statements for the year ended 31 December 2019 *continued*

15 Financial instruments *continued*

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. The Group is not exposed to foreign exchange risk on borrowings after hedging. The Group is not materially exposed to foreign exchange risk on an economic basis.

Price risk

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 2019, with all other variables remaining constant, if the RPI had increased or decreased by 1%, annual pre-tax profit would have decreased or increased by £985 million and £887 million respectively (2018: £1,074 million and £954 million respectively). During 2019, the highest month-on-month RPI curve movement averaged 0.4% and the highest month-on-month movement for a given term (1-year) was 0.6%. Therefore 1% is considered to be reasonable and provides an appropriate stress test. Prior year sensitivities have been adjusted to present on a basis consistent with 2019.

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 and 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.

As at 31 December 2019, the Group's fixed floating interest rate profile, after hedging, on gross debt was 88% (2018: 92%).

Each 1% change in interest rates would have resulted in the following gain/(loss) to pre-tax profit and equity, due to movements in the finance income, finance cost and mark-to-market valuation of derivatives:

	31 December 2019		31 December 2018	
	Income statement		Income statement	
	impact	Equity impact	impact	Equity impact
	£m	£m	£m	£m
1% increase	457	6	490	7
1% decrease	(513)	(7)	(557)	(8)

During 2019, the highest month-on-month 6-month GBP LIBOR curve movement was 0.5%; therefore 1% is considered to be reasonable and provides an appropriate stress test. Prior year sensitivities have been adjusted to present on a basis consistent with 2019.

Credit risk

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

The Group maintains a prudent split of cash and cash equivalents and term deposits 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 (S&P)/F1 (Fitch). 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)/BBB+ (Fitch).

As at 31 December 2019, the Group had credit risk on derivatives with asset mark to market of £539 million (2018: £543 million).

The maximum exposure to credit risk as at 31 December 2019 was £2,287 million (2018: £1,496 million).

The Group applies IFRS 9 for recognising lifetime expected credit losses for all trade receivables as these items do not have a significant financing component.

In measuring the expected credit losses, the trade receivables have been assessed on a collective basis as they possess shared credit risk characteristics. They have been grouped based on the days past due and, also according to the industry sector of the Group's customers.

The expected loss rates are based on Global industry default rates as well as the corresponding historical credit.

The historical rates are adjusted to reflect the loss given default factors affecting the customer's ability to settle the amount outstanding. However, given the short period exposed to credit risk, the impact of these macroeconomic factors has not been considered significant within the reporting period. Trade receivables are written off (i.e. derecognised) when there is no reasonable expectation of recovery, therefore moving from 'Stage 2' to 'Stage 3'.

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Notes to the Group financial statements for the year ended 31 December 2019 *continued*

15 Financial instruments *continued*

Credit risk *continued*

On the above basis the expected credit loss for trade receivables as at 31 December 2019 and 31 December 2018 was determined as follows:

31 December 2019	Current	1-30 days	31-60 days	61-90 days	Over 180 days	Total
	£m	£m	£m	£m	£m	£m
Trade receivables						
Gross carrying amount	101	25	2	2	6	136
Lifetime expected credit loss	(2)	(1)	-	-	(2)	(5)
Total adjusted receivables	99	24	2	2	4	131

31 December 2018	Current	1-30 days	31-60 days	61-90 days	Over 180 days	Total
	£m	£m	£m	£m	£m	£m
Trade receivables						
Gross carrying amount	88	13	7	1	11	120
Lifetime expected credit loss	(4)	-	-	-	-	(4)
Total adjusted receivables	84	13	7	1	11	116

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.

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

	31 December 2019	31 December 2018
	£m	£m
Floating rate facilities		
Expiring in more than two years and less than five years	1,150	1,150
Expiring in more than five years	633	672
	1,783	1,822

As at 31 December 2019, overdraft facilities of £10 million were available (2018: £10 million).

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

	31 December 2019			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Borrowing principal	404	1,539	2,713	11,114
Borrowing interest	632	592	1,515	3,883
Derivative financial instruments	144	(30)	(169)	(500)
Trade payables	159	-	-	-
Capital payables	137	-	-	-

	31 December 2018			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Borrowing principal	192	(37)	3,046	11,005
Borrowing interest	597	584	1,500	3,763
Derivative financial instruments	34	294	(245)	(744)
Trade payables	170	-	-	-
Capital payables	135	-	-	-

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

15 Financial instruments *continued*

Liquidity risk *continued*

The tables below analyse the expected gross undiscounted contractual cash flows as at 31 December of the Group's derivative financial instruments which will be settled on a gross basis based on the remaining period to the contractual maturity date. The table should be viewed in conjunction with the table presenting undiscounted cash flows on the Group's financial liabilities and net settled derivative financial instruments.

	31 December 2019			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Cross-currency derivative payments	124	131	263	480
Cross-currency derivative receipts	(126)	(130)	(222)	(744)

	31 December 2018			
	Less than one year	One to two years	Two to five years	Greater than five years
	£m	£m	£m	£m
Cross-currency derivative payments	110	103	239	405
Cross-currency derivative receipts	(110)	(101)	(206)	(421)

Capital risk management

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 Group that the relevant debt facility sits.

There are gearing covenants in financing agreements held by the Group. Gearing ratios achieved by the Group are set out below:

	31 December 2019	31 December 2018
Net debt to RAB at Heathrow Finance group	0.865	0.863
Total net debt to RAB at Heathrow (SP) Limited	0.748	0.766
Senior net debt to RAB at Heathrow (SP) Limited	0.666	0.682

Heathrow Finance's gearing ratio was 86.5% (31 December 2018: 86.3%) with a covenant of 92.5%. The covenant at Heathrow Finance changed earlier in the year from 90% to 92.5% due to the redemption of the 2019 notes at Heathrow Finance.

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 2019			
	Financial assets at amortised cost and cash equivalents	Assets at fair value through income statement	Derivatives qualifying for hedge accounting	Total
	£m	£m	£m	£m
Derivative financial instruments ^{1, 2}	-	76	463	539
Cash and cash equivalents	845	-	-	845
Trade receivables and accrued income after impairment	178	-	-	178
Term deposits	725	-	-	725
Total financial assets	1,748	76	463	2,287

¹ Designated in fair value hedges of interest rate risk with changes in fair value recognised in finance costs in the income statement of £457 million.

² Designated in cash flow hedges of interest rate risk with changes in fair value recognised in losses taken to equity in other comprehensive income of £6 million.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

15 Financial instruments *continued*

Financial instruments by category *continued*

31 December 2019				
	Liabilities at fair value through income statement	Derivatives qualifying for hedge accounting	Other financial liabilities at amortised cost	Total
	£m	£m	£m	£m
Borrowings	-	-	(15,800)	(15,800)
Derivative financial instruments ^{1, 2}	(1,236)	(46)	-	(1,282)
Trade payables	-	-	(159)	(159)
Capital payables	-	-	(137)	(137)
Total financial liabilities	(1,236)	(46)	(16,096)	(17,378)

¹ Designated in fair value hedges of interest rate risk with changes in fair value recognised in finance costs in the income statement of £25 million.

² Designated in cash flow hedges of interest rate risk with changes in fair value recognised in losses taken to equity in other comprehensive income of £21 million.

31 December 2018				
	Loans and receivables	Assets at fair value through profit and loss	Derivatives qualifying for hedge accounting	Total
	£m	£m	£m	£m
Derivative financial instruments	-	51	492	543
Cash and cash equivalents	595	-	-	595
Trade receivables and accrued income after impairment	242	-	-	242
Term deposits	120	-	-	120
Total financial assets	957	51	492	1,500

31 December 2018				
	Liabilities at fair value through income statement	Derivatives qualifying for hedge accounting	Other financial liabilities at amortised cost	Total
	£m	£m	£m	£m
Borrowings	-	-	(14,502)	(14,502)
Derivative financial instruments	(1,517)	(45)	-	(1,562)
Trade payables	-	-	(170)	(170)
Capital payables	-	-	(135)	(135)
Total financial liabilities	(1,517)	(45)	(14,807)	(16,369)

At 31 December 2019, 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); and
- Level 3 - inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

At 31 December 2019 and 2018, all fair value estimates on derivative financial instruments are included in level 2.

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. 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.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

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;
- market prices for credit spreads based on counterparty's credit default swap prices and company's bond spread;
- 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.

On a semi-annual basis, the Group reviews any material changes to the valuation techniques and market data inputs used. The potential impact to the fair value hierarchy is assessed if it is deemed a transfer. Significant transfers between levels are considered effective at the end of the reporting period. During the year there were no transfers between the levels in the fair value hierarchy.

The tables below present the Group's assets (other than investment properties) and liabilities that are measured at fair value as at 31 December:

	31 December 2019			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Assets at fair value through income statement	-	76	-	76
Derivatives qualifying for hedge accounting	-	463	-	463
Total assets	-	539	-	539
Liabilities				
Liabilities at fair value through income statement	-	(1,236)	-	(1,236)
Derivatives qualifying for hedge accounting	-	(46)	-	(46)
Total liabilities	-	(1,282)	-	(1,282)

	31 December 2018			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Assets at fair value through income statement	-	51	-	51
Derivatives qualifying for hedge accounting	-	492	-	492
Total assets	-	543	-	543
Liabilities				
Liabilities at fair value through income statement	-	(1,517)	-	(1,517)
Derivatives qualifying for hedge accounting	-	(45)	-	(45)
Total liabilities	-	(1,562)	-	(1,562)

16 Deferred income tax

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

	Note	2019 £m	2018 £m
1 January		(917)	(905)
(Charged)/credited to income statement		(42)	21
Charged to other comprehensive income	21	(2)	(33)
Credited to equity - IFRS 16 opening balance sheet adjustment		18	-
31 December		(943)	(917)
		2019	2018
		£m	£m
Deferred income tax liabilities		(1,077)	(1,052)
Deferred income tax assets		134	135
31 December		(943)	(917)

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

16 Deferred income tax *continued*

The movements in deferred income tax assets and liabilities during the financial year are shown below.

Deferred income tax liabilities

	Excess of capital allowances over depreciation	Revaluations of investment property to fair value	Revaluations of property, plant and equipment	Fair value of retail contracts	Post employment benefits	Other	Total
	£m	£m	£m	£m	£m	£m	£m
1 January 2018	(811)	(197)	(45)	(8)	-	(12)	(1,073)
Credited/(charged) to income statement	20	(17)	17	-	-	1	21
1 January 2019	(791)	(214)	(28)	(8)	-	(11)	(1,052)
(Charged)/credited to income statement	(19)	(6)	-	-	-	1	(24)
Transfer from deferred income tax assets	-	-	-	-	(1)	-	(1)
31 December 2019	(810)	(220)	(28)	(8)	(1)	(10)	(1,077)

Deferred income tax assets

	Financial instruments	Short-term timing differences	Post employment benefits	IFRS 16 leases	Total
	£m	£m	£m	£m	£m
1 January 2018	133	7	28	-	168
Credited/(charged) to income statement	6	(4)	(2)	-	-
(Charged)/credited to other comprehensive income	(7)	-	(26)	-	(33)
31 December 2018	132	3	-	-	135
Charged to income statement	(13)	-	(5)	-	(18)
(Charged)/credited to other comprehensive income	(6)	-	4	-	(2)
Credited to equity - IFRS 16 opening balance adjustment	-	-	-	18	18
Transfer to deferred income tax liabilities	-	-	1	-	1
31 December 2019	113	3	-	18	134

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

	Note	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Cash flow hedge reserve	21	(6)	(7)
Tax credit/(charge) on actuarial (loss)/gain	21	4	(26)
		(2)	(33)

The headline UK corporation tax rate is 19% but is due to fall to 17% with effect from 1 April 2020. The effect of these rate reductions has been reflected in the deferred tax balances in the financial statements. Prior to the UK General Election held on 12 December 2019, the Conservative Party announced that it would maintain the UK corporation tax rate at 19%. However, as no legislation had been substantively enacted at the balance sheet date, this announcement has not been reflected in the deferred tax balances. Based on the current net deferred tax liability, a 19% corporation tax rate would increase the net deferred tax liability to an estimated £1,054 million, which would give rise to a £111 million deferred tax charge due to changes in tax rates.

Deferred income tax assets have been recognised in respect of all temporary differences giving rise to deferred income tax assets where it is considered probable that there will be sufficient future taxable profit against which these assets will be recovered.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

17 Retirement benefit obligations

The Group has applied the requirements of the standard IAS 19 'Employee Benefits (Revised 2011)' ('IAS 19R') for the year ended 31 December 2019.

LHR Airports Limited, which is an indirect subsidiary of HAH Group (the 'Group'), is the sponsor of the Defined Benefit ('DB') pension scheme, the Unfunded Unapproved Retirement Benefit ('UURBS') scheme and the Post-Retirement Medical Benefits ('PRM') scheme. Following a decision to re-assess the Group's relationship with the legal sponsor of the retirement benefit schemes, it was determined that Heathrow Airport Limited, and therefore the Group, should act as sponsor in relation to these schemes. As a result, the Group now recognises retirement benefit obligations within its financial statements.

The Group's primary UK defined benefit pension fund is a self-administered defined benefit scheme (the 'BAA Pension Scheme' or the 'Scheme') now closed to new employees. As required by UK pension law, there is a Pension Trustee Board that, together with LHR Airports Limited, is responsible for governance of the Scheme. The employer's contributions are determined based on triennial valuations conducted on assumptions determined by the Trustee and agreed by LHR Airports Limited. The defined benefit obligation or surplus is calculated quarterly by independent actuaries.

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the rules of the Scheme. In addition, LHR Airports Limited provides post-retirement medical benefits to certain pensioners.

LHR Airports Limited operates a defined contribution pension scheme for all employees who joined the Group after 15 June 2008. The Group has no further payment obligations once the contributions have been paid. The total cost of defined contribution pension arrangements is fully expensed as employment costs.

Amounts arising from pensions related liabilities in the Group's financial statements

The following tables identify the amounts in the Group's financial statements arising from its pension related liabilities. Further details of each scheme (except defined contribution schemes) are within sections a) and b).

Income statement - pension and other pension related costs

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
Employment costs:		
Defined contribution schemes	15	13
BAA Pension Scheme	26	34
	41	47
Finance (credit)/charge - BAA Pension Scheme	(1)	3
Finance charge - Other pension and post retirement liabilities	1	1
Total pension costs	41	51

Other comprehensive income – (loss)/gain on pension and other pension related liabilities

	Year ended 31 December 2019	Year ended 31 December 2018
	£m	£m
BAA Pension Scheme (loss)/gain	(17)	141
Unfunded schemes	2	3
Actuarial (loss)/gain recognised before tax	(15)	144
Tax credit/(charge) on actuarial (loss)/gain	4	(26)
Actuarial (loss)/gain recognised after tax	(11)	118

Statement of financial position – net defined benefit pension surplus/(deficit) and other pension related liabilities

The net deficit or surplus of the LHR Airports Limited retirement benefit schemes, being the BAA Pension Scheme, Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical Benefit Scheme, are recognised within non-current assets or non-current liabilities if the pension schemes are in a surplus or deficit position respectively. The net surplus or deficit is presented below for the current and previous four financial years.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

17 Retirement benefit obligations *continued*

Statement of financial position – net defined benefit pension surplus/(deficit) and other pension related liabilities *continued*

	31 December				
	2019 £m	2018 £m	2017 £m	2016 £m	2015 £m
Fair value of plan assets	4,302	3,869	4,085	3,975	3,288
Benefit obligation	(4,269)	(3,841)	(4,209)	(4,054)	(3,184)
Surplus/(deficit) in BAA Pension Scheme	33	28	(124)	(79)	104
Unfunded pension obligations	(28)	(28)	(29)	(29)	(22)
Post-retirement medical benefits	(1)	(4)	(5)	(6)	(6)
Deficit in other pension related liabilities	(29)	(32)	(34)	(35)	(28)
Net surplus/(deficit) in pension schemes	4	(4)	(158)	(114)	76
Group share of net surplus/(deficit) in pension schemes	4	(4)	(158)	(114)	76

(a) BAA Pension Scheme

The BAA Pension Scheme is a funded defined benefit scheme with both open and closed sections. The Scheme closed to employees joining the Group after 15 June 2008. The Scheme's assets are held separately from the assets of the HAH Group and are administered by the trustee.

The value placed on the Scheme's obligations as at 31 December 2019 is based on the full actuarial valuation carried out at 30 September 2018. This has been updated at 31 December 2019 by KPMG LLP to take account of changes in economic and demographic assumptions, in accordance with IAS 19R. The Scheme assets are stated at their bid value at 31 December 2019. As required by IAS 19R, the Group recognises re-measurements as they occur in the statement of comprehensive income.

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Notes to the Group financial statements for the year ended 31 December 2019 *continued*

17 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

Analysis of movements in plan assets and defined benefit obligations

	2019	2018
	£m	£m
Fair value of plan assets at 1 January	3,869	4,085
<i>Income statement:</i>		
Interest income on plan assets	114	103
Administration costs	(3)	(3)
<i>Other comprehensive income:</i>		
Re-measurement gain/(loss) (return on assets in excess of interest income on plan assets)	413	(212)
Loss due to Bulk Purchase annuity	-	(23)
<i>Cash flows:</i>		
Employer contributions (including benefits paid and reimbursed)	49	48
Members' contributions	3	5
Benefits paid (by fund and Group)	(143)	(134)
Fair value of plan assets at 31 December	4,302	3,869
Defined benefit obligation at 1 January	(3,841)	(4,209)
<i>Income statement:</i>		
Current service cost	(23)	(26)
Past service cost	-	(5)
Interest cost	(113)	(106)
<i>Other comprehensive income:</i>		
Re-measurements of defined benefit obligation:		
Arising from changes in financial assumptions	(629)	376
Arising from changes in demographic assumptions	137	-
Experience gains	60	-
<i>Cash flows:</i>		
Members' contributions	(3)	(5)
Benefits paid (by fund and Group)	143	134
Defined benefit obligation at 31 December	(4,269)	(3,841)

The net actuarial loss before tax of £17 million (2018: £141 million net gain) for the BAA Pension Scheme resulted from an increase in obligations due to lower net discount rate of £629 million (2018: £376 million gain), partially offset by an increase in assets £413 million due to over performance relative to discount rates (2018: £235 million loss). In addition, there was a £137 million gain (2018: £nil) attributable to updated demographic assumptions and £60 million experience gains (2018: £nil)

The actuarial loss on change in financial assumptions is mainly attributable to a decrease in the net discount rate of 0.65% over the year, based on a discount rate assumption of 2.10% and an RPI inflation assumption of 3.15%. The discount rate used has decreased from 3.00% in 2018 to 2.10% in 2019 and is derived from the yield on 'high quality corporate bonds' of duration consistent with liabilities of the scheme. The discount rate is based on a full yield curve approach, a 'single agency' approach where the yield curve is constructed from the Merrill Lynch corporate bond universe with at least one AA rating from the main ratings agencies.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

17 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

Analysis of fair value of plan assets

	31 December 2019 £m	31 December 2018 £m
Fair value of plan assets ¹		
Equity	706	607
Property	147	139
Bonds	1,220	1,127
Cash	111	118
LDI	1,325	1,152
Buy in	322	299
Other	471	427
Total fair value of plan assets	4,302	3,869

¹ Included in the fair value of plan assets above is £303 million (7.1%) valued at publicly quoted market price.

BAA Pension Scheme

At 31 December 2019, the largest single category of investment was a liability driven investment ('LDI') mandate, with a value of £1,325 million (31% of the asset holding at 31 December 2019). The purpose of the Scheme entering into this mandate is to reduce asset/liability mismatch risk. At 31 December 2018, the largest single category of investment was an LDI mandate, with value of £1,152 million (30% of the asset holding at 31 December 2018).

LDI holdings are portfolios of interest rate and inflation derivatives which are intended to protect the Scheme from movements in interest rates and inflation, so that the fair value of this element of the portfolio moves in the same way as the fair value of Scheme's obligations.

Analysis of financial assumptions

The financial assumptions used to calculate Scheme assets and liabilities under IAS 19R were:

	31 December 2019 %	31 December 2018 %
Rate of increase in pensionable salaries	1.90	1.90
Increase to deferred benefits during deferment	2.40	2.65
Increase to pensions in payment:		
Open section	3.05	3.30
Closed section	3.15	3.40
Discount rate	2.10	3.00
Inflation assumption	3.15	3.40

The assumptions relating to longevity underlying the pension liabilities at the reporting date are in line with those adopted for the 2018 actuarial funding valuation, removing prudence, and are based on standard actuarial mortality tables with an allowance for future improvements in longevity. The assumptions are equivalent to a life expectancy for a 60 year old male pensioner of 26.8 years (2018: 27.2 years) and 27.9 years (2018: 29.5 years) from age 60 for a 40 year old male non-pensioner.

The expected rate of inflation is an important assumption for salary growth and pension increase. A rate of inflation is 'implied' by the difference between the yields on fixed and index-linked government bonds.

Interest income on the plan assets is calculated by multiplying the fair value of the plan assets by the discount rate discussed above.

As required under IAS 19R, interest income on the plan assets is calculated by multiplying the fair value of the plan assets by the discount rate discussed above.

Analysis of future cash flows

UK legislation requires that pension schemes are funded prudently. In September 2019, the trustee of the BAA Pension Scheme concluded a formal actuarial valuation of the Scheme as at September 2018. The next actuarial valuation of the BAA Pension Scheme will be measured as at 31 December 2021.

The September 2018 funding valuation identified a shortfall of £123 million, and LHR Airports have agreed deficit repair contributions of £20 million (previously £23 million) to eliminate the September 2018 funding valuation deficit by 2022.

The valuation also considered the cost of the benefits that will be built up over the remaining future lifetime of active members. The table below gives a breakdown of the future service cost at 30 September 2018 and the cost at 30 September 2015 for comparison. Active members pay contributions to the Scheme as a condition of membership.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

17 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

Analysis of future cashflows *continued*

Future service contributions over the future lifetime of active members whilst employed by the Group

	30 September 2018 % of base salary including shift pay	30 September 2015 % of base salary including shift pay
Cost of pension benefits	26.4	24.2
Plus Administration Expenses (including the PPF levy)	2.6	2.2
Less members' contributions	(3.4)	(3.4)
Employer future service contribution rate	25.6	23.0

Sensitivity analysis of significant assumptions

The following tables present a sensitivity analysis for each significant actuarial assumption showing how the defined benefit obligation would have been affected, before and after tax, by changes in the relevant actuarial assumptions that were reasonably possible at the reporting date.

The standard market practice is to include sensitivity to a change of between 0.1% and 1%. Therefore 0.5% is considered to be reasonable and in line with market practice.

The range of long term inflation and long dated AA bonds over 2019 were c.0.4% and 0.8% respectively, so the choice of 0.5% is deemed to be acceptable as pension sensitivities are aligned to historical trends.

	(Decrease)/increase in defined benefit obligation	
	Before tax £m	After tax £m
Discount rate		
+0.50% discount rate	(387)	(317)
-0.50% discount rate	445	365
Inflation rate		
+0.50% inflation rate	347	285
-0.50% inflation rate	(311)	(255)
Mortality		
Increase in life expectancy by one year	180	148

The sensitivity analysis is based on a change in one assumption while holding all other assumptions constant, therefore interdependencies between assumptions are excluded, with the exception of the inflation rate sensitivity which also impacts salary and pension increase assumptions. The analysis also makes no allowance for the impact of changes in gilt and corporate bond yields on asset values. The methodology applied is consistent to that used to determine the recognised pension liability.

The total contributions by the Company to the defined benefit pension scheme in 2020 are expected to be £47 million. The levels of contributions are based on the current service costs and the expected cash flows of the defined benefit pension scheme. The Company estimates the present value of the duration of the Scheme liabilities on average fall due over 21 years (2018: 21 years).

Management believes that the scheme has no significant plan specific or concentration risks.

(b) Other pension and post-retirement liabilities

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the Scheme rules. The unfunded pension obligations amount to £28 million (2018: £28 million) and are included in the statement of financial position.

In addition, LHR Airports Limited provides post-retirement medical benefits to certain pensioners. The present value of the future liabilities under this arrangement is £1 million (2018: £4 million) and this is also included in the statement of financial position. The value of these unfunded pensions has been assessed by the actuary using the same assumptions as those used to calculate the Scheme's liabilities.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

18 Provisions

	Reorganisation costs	Home loss payments	Other	Total
	£m	£m	£m	£m
Current	6	7	-	13
Non-current	-	-	1	1
1 January 2019	6	7	1	14
Utilised	(5)	(3)	-	(8)
Charged to income statement	4	-	-	4
Released to the income statement	(1)	-	-	(1)
31 December 2019	4	4	1	9
Current	4	4	-	8
Non-current	-	-	1	1
31 December 2019	4	4	1	9

Reorganisation costs

These are costs associated with the Company's reorganisation programmes primarily relating to restructuring processes designed to reduce the size and costs of various operational and overhead functions. The utilisation and release of the provision relates to the 2018 voluntary severance scheme in Airport Operations and Security. The charge relates to a provision established in 2019 primarily relating to Overhead functions.

The provision will be fully utilised in 2020.

Home loss payment

Between 2005 and 2011, the Company entered into a number of agreements (Property Market Support Bonds) to buy residential properties in the previous third runway blight area. The purchase price for these properties included a deferred 10% payment ("deferred payment") which was to be settled in cash when planning consent was obtained. In October 2016, the Government announced its decision in favour of expansion at Heathrow and following board approval, a public statement was issued by the Company stating its intention to apply for planning consent. Legal advice was that the Company would be required to pay the deferred payment. As a result, in the year ended 31 December 2016, the Company created a provision for the deferred payment equal to the amount it expects to pay of £7.5 million.

For the year ended 31 December 2019, the total amount utilised was £3.4m paid against 114 properties resulting in a closing balance of £4.1m. The company expects the Property Market Support Bond Home Loss Payments to be concluded during the first half of 2020.

Other

These provisions relate to insurance claims liability from incidents which occurred at Heathrow Airport.

19 Trade and other payables

	31 December 2019	31 December 2018
	£m	£m
Non-current		
Other payables	6	7
	6	7
Current		
Deferred income	62	49
Trade payables ¹	159	170
Other tax and social security	8	9
Other payables	7	11
Capital payables	137	135
Amount owed to group undertakings – operating ²	57	59
	430	433

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 Heathrow.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

20 Share capital

	£m
Authorised	
At 1 January and 31 December 2019	
9,500,000,000 ordinary shares of £1 each	9,500
Called up, allotted and fully paid	
At 1 January and 31 December 2019	
3,109,350,689 ordinary shares of £1 each	3,109

21 Tax relating to components of other comprehensive income

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

	Year ended 31 December 2019			Year ended 31 December 2018		
	Before tax	Tax credit/ (charge)	After tax	Before tax	Tax credit/ (charge)	After tax
	£m	£m	£m	£m	£m	£m
Cash flow hedges						
Loss taken to equity	(4)	1	(3)	(195)	33	(162)
Transferred to income statement	39	(7)	32	238	(40)	198
Actuarial (loss)/gain on pensions						
Gain on plan assets	614	(116)	498	(234)	42	(192)
Increase in scheme liabilities	(629)	120	(509)	378	(68)	310
Other comprehensive income/(loss)	20	(2)	18	187	(33)	154

22 Retained earnings

	Note	2019 £m	2018 £m
1 January as previously stated		(3,141)	(3,171)
Adjustment in respect of IFRS 15 and IFRS 9		-	(3)
Adjustment in respect of IFRS 16		(89)	-
1 January restated		(3,230)	(3,174)
Consolidated profit for the year		438	412
Dividends paid to Heathrow (DSH) Limited	5	(468)	(497)
Actuarial (loss)/gain on pensions	21	(15)	144
Tax credit/(charge) on actuarial (loss)/gain	21	4	(26)
31 December		(3,271)	(3,141)

23 Commitments and contingent liabilities

Non-cancellable lease commitments – Group as a lessee

From 1 January 2019, the Group has recognised lease liabilities for these leases under IFRS 16 for non-cancellable leases, except for short-term and low-value leases, see note 7 and accounting policies.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

23 Commitments and contingent liabilities *continued*

Group commitments for property, plant and equipment

	31 December 2019	31 December 2018
	£m	£m
Contracted for, but not accrued:		
Baggage systems	111	77
Terminal restoration and modernisation	168	174
Capacity optimisation	51	20
IT projects	15	20
Other projects	45	35
	390	326

The figures in the above table are contractual commitments to purchase goods and services at the reporting date.

Other commitments

Heathrow Airport Limited has a commitment to pay £80 million to the Department for Transport in relation to the Crossrail project in return for a service commitment for Crossrail to operate services to Heathrow for 15 years, with payment expected during 2020. The amount will be included as an intangible asset in the financial statements and will be added to the RAB in accordance with the Q6 regulatory settlement.

Following the Government decision in October 2016 for Heathrow as preferred option for expansion, the Company recognises that up to 62 residential property owners could exercise their right under the previous scheme for which bonds were issued, to redeem those bonds at some point in the future. The Company's best estimate of the total payment is £21 million based on a valuation in accordance with the terms set out in the bond contract and assumes all the bondholders will exercise their option to sell. Twelve houses were purchased in 2019 for a total cost of £6 million. Therefore, the number of properties where bondholders have yet to exercise the option to sell is 50 and the commitment remaining is £15 million.

Following the designation of the Airports National Policy Statement on 26th June 2018, Heathrow has signed a Blight indemnification agreement with the Department for Transport, such that the Company will take responsibility for any successful claims for statutory blight of residential property under certain conditions. The current estimate is that this would result in Heathrow's obligations to buy properties worth £9.5m. It is expected that the cost of purchased properties will be added to the RAB.

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 2019 (2018: £1 million).

24 Notes to the consolidated cash flow statement

Reconciliation of profit before tax to cash generated from continuing operations

		Year ended 31 December 2019	Year ended 31 December 2018
	Note	£m	£m
Operating activities			
Profit before tax		578	491
<i>Adjustments for:</i>			
Net finance costs	3	611	717
Depreciation	6	696	719
Amortisation on intangibles	9	43	27
Amortisation on right of use assets	7	35	-
Fair value gain on investment properties	8	(43)	(117)
<i>Working capital changes:</i>			
Increase/(Decrease) in trade and other receivables		56	(46)
(Decrease)/Increase in trade and other payables		(5)	14
Decrease in provisions		(8)	-
Difference between pension charge and cash contributions		(22)	(15)
Cash generated from continuing operations		1,941	1,790

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

24 Notes to the consolidated cash flow statement *continued*

Reconciliation in net debt

Net debt comprised the Group's consolidated borrowings, excluding interest accruals, net of cash and cash equivalents, term deposits and lease liabilities.

	1 January 2019	Cash flow	Transfers from non-current to current	Lease liabilities	Other non-cash changes ^{1,2}	31 December 2019
	£m	£m	£m	£m	£m	£m
Current debt	(509)	529	(404)	-	(20)	(404)
Non-current debt	(13,918)	(1,850)	404	-	(32)	(15,396)
Current lease liabilities	-	50	-	(88)	-	(38)
Non-current lease liabilities	-	-	-	(346)	-	(346)
Total financing liabilities excluding intercompany	(14,427)	(1,271)	-	(434)	(52)	(16,184)
Intercompany	(75)	75	-	-	-	-
Total financing liabilities	(14,502)	(1,196)	-	(434)	(52)	(16,184)
Cash and cash equivalents	595	250	-	-	-	845
Term deposits	120	605	-	-	-	725
Net debt including intercompany	(13,787)	(341)	-	(434)	(52)	(14,614)

¹ Relates to movements on foreign exchange gain on translations of foreign debt of £20 million

² relates to amortisation of issue costs, premiums and discounts of £16 million, foreign exchange gain on translations of foreign debt of £(153) million, fair value adjustments on hedged bonds of £129 million and accretion accruals of £39 million.

	1 January 2018	Cash flow	Transfers from non-current to current	Other non-cash changes ^{3,4}	31 December 2018
	£m	£m	£m	£m	£m
Current debt	(1,097)	1,042	(529)	75	(509)
Non-current debt	(13,035)	(1,371)	529	(41)	(13,918)
Net debt excluding intercompany	(14,132)	(329)	-	34	(14,427)
Intergroup funding	-	(75)	-	-	(75)
Total financing liabilities	(14,132)	(404)	-	34	(14,502)
Cash and cash equivalents	523	72	-	-	595
Term deposits	12	108	-	-	120
Net debt including intercompany	(13,597)	(224)	-	34	(13,787)

³ Relates to amortisation of issue costs, premiums and discounts of £2 million, foreign exchange gain on translations of foreign debt of £(77) million.

⁴ Relates to amortisation of issue costs, premiums and discounts of £19 million, foreign exchange gain on translations of foreign debt of £(18) million, fair value adjustments on hedged bonds of £(11) million and accretion accruals of £51 million.

Accounting value of closing net debt continues to include certain bonds which are reported at an amount of £84 million higher than their GBP equivalent cash redemption value as a result of hedge accounting under IFRS, together with bond issue/novation costs of (£111) million. In addition, where bonds are issued in currencies other than GBP, the Group has entered into foreign currency swaps to fix the GBP cash outflows on redemption. The impact of these swaps is not reflected in gross debt and would decrease GBP equivalent by £265 million, together with the RPI swap accretion of £345m, both of which are included in nominal net debt.

25 Related party transactions

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

	Year ended 31 December 2019	Year ended 31 December 2018
	Purchase of goods and services	Purchase of goods and services
	£m	£m
Amey OWR Ltd	1	1
Ferrovial Agroman	44	69
	45	70

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

25 Related party transactions *continued*

	Year ended 31 December 2019	Year ended 31 December 2018
	Sales to related party	Sales to related party
	£m	£m
Harrods International Limited	23	23
Qatar Airways	36	35
	59	58

Balances outstanding with related parties were as follows:

	31 December 2019	31 December 2018		
	Amounts owed by related parties £m	Amounts owed to related parties £m	Amounts owed by related parties £m	Amounts owed to related parties £m
Qatar Airways	2	-	2	-
	2	-	2	-

The related parties outlined above are related through ownership by the same parties. The transactions relate primarily to construction projects, loans and interest payable, and are conducted on an arm's length basis.

The Group enters into transactions with LHR Airports Limited in accordance with the Shared Services Agreement ('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 are known they are disclosed in the relevant statement of financial position caption, see Notes 11 and 19. 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 19.

26 Ultimate parent undertaking and controlling party

The immediate parent undertaking of the Group is Heathrow Finance plc, a company registered in England and Wales.

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the smallest and largest group to consolidate these financial statements. The shareholders of FGP Topco Limited all hold ordinary shares in the following proportion; Hubco Netherlands B.V. (25.00%) (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 (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of GIC), QS Airports UK, LP (11.18%) (investment vehicle managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (10.00%) (wholly-owned by the Universities Superannuation Scheme).

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 2019.

Copies of the financial statements of FGP Topco Limited, Heathrow Airport Holdings Limited and Heathrow Finance plc may be obtained by writing to the Company Secretarial Department at The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW. This is the registered office for the smallest and the largest undertaking to consolidate these financial statements.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2019 *continued*

27 Subsidiaries

The subsidiaries of the Group are as follows:

Holding company

Heathrow (SP) Limited

Heathrow (AH) Limited †

Airport owner and operator

Heathrow Airport Limited †

Other

Heathrow Funding Limited #

Heathrow Express Operating Company Limited †

† Held by a subsidiary undertaking

Incorporated in Jersey, but UK tax resident

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

The registered office of the Company's subsidiaries is the same as Heathrow Finance plc as set up below, with the exception of Heathrow Funding Limited whose registered office is IFC5, St Helier, Jersey, JE1 1ST, Channel Islands.

28 Subsequent events

On 20 February 2020, the Board approved the payment of a £107 million (£0.03 per share) dividend to the Company's parent, Heathrow Finance plc. A £107 million dividend receipt from the Company's subsidiary, Heathrow (AH) Limited, was also approved on 20 February 2020.

Registered office

Heathrow Finance plc, The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

Registered in England Number: 06458635

Heathrow Finance plc

Company statement of financial position as at 31 December 2019

	Note	31 December 2019 £m	31 December 2018 £m
Assets			
Non-current assets			
Investment in subsidiary	2	5,006	5,006
Trade and other receivables	3	3,095	2,773
		8,101	7,779
Current assets			
Trade and other receivables	3	142	125
Cash at bank and in hand		30	4
		172	129
Total assets		8,273	7,908
Liabilities			
Non-current liabilities			
Trade and other payables	4	(1,969)	(1,381)
Current liabilities			
Trade and other payables	4	(32)	(297)
Total liabilities		(2,001)	(1,678)
Net assets		6,272	6,230
Capital and reserves			
Called up share capital	5	3,109	3,109
Revaluation reserve	6	1,997	1,997
Profit and loss reserve	6	1,166	1,124
Total shareholder's funds		6,272	6,230

The profit of the Company for the year ended 31 December 2019 attributable to shareholders was £510 million (2018: £543 million).

The financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 25 February 2020. They were signed on its behalf by:

Javier Echave
Director

Nicholas Golding
Director

Heathrow Finance plc

Company statement of changes in equity as at 31 December 2019

	<i>Note</i>	Share capital £m	Revaluation reserve £m	Retained earnings £m	Total equity £m
1 January 2018		3,109	1,997	1,078	6,184
Total comprehensive income for the year					
Profit for the year				543	543
Transaction with owners					
Dividends paid to Heathrow (DSH) Limited	6			(497)	(497)
31 December 2018		3,109	1,997	1,124	6,230
Total comprehensive income for the year					
Profit for the year				510	510
Transaction with owners					
Dividends paid to Heathrow (DSH) Limited	6			(468)	(468)
31 December 2019		3,109	1,997	1,166	6,272

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019

The principal accounting policies applied in the preparation of the financial statements of Heathrow Finance plc (the 'Company') are set out below. These policies have been applied consistently 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 investment in subsidiary in accordance with the Companies Act 2006 and applicable accounting standards. They have been prepared by the Directors in accordance with FRS 101.

Under FRS 101, the Company has chosen to apply the recognition and measurement provisions of International Accounting Standard ('IAS') 27 'Separate Financial Statements', as endorsed by the European Union ('EU').

The Company has taken advantage of certain disclosure exemptions in FRS 101 as its financial statements are included in the publicly available consolidated financial statements of the Group. As such, the Company is exempt from presenting the Statement of cash flows and from the disclosures requirement to show related party transactions with entities that are wholly-owned subsidiaries of the Company. In addition, the Company has also taken advantage of disclosure exemption of the income statement as allowed by the Companies Act. Copies of those consolidated financial statements may be obtained by writing to the Company Secretarial Department at the Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

The Company is not a financial institution and is therefore able to take advantage of exemptions from specified requirements of, IFRS 7 'Financial Instruments', IFRS 13 'Fair Value Measurement', IFRS 15 'Revenue from Contracts with Customers', IFRS 16 'Leases', IAS 1 'Presentation of Financial Statements' and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

New Standards

The Group adopted IFRS 16 in accordance with IFRSs as issued by the IASB and this adoption has no impact on entity financial statements.

Going concern

The Directors have prepared the financial statements on a going concern basis which requires the Directors to have a reasonable expectation that the Company, as part of the Heathrow Airport Holdings Limited group (the 'HAH Group'), has adequate resources to continue in operational existence for the foreseeable future. The Company forms part of the HAH Group, the level at which financial risks are managed for the Company.

Consequently, the Directors have reviewed the cash flow projections of the HAH Group taking into account:

- the forecast turnover and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall HAH Group liquidity position, including cash resources, 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.

Interest

Interest payable and interest receivable are recognised in the income statement in the period in which they are incurred.

Investments in subsidiaries

Investments in subsidiaries are stated at cost and reviewed for impairment if there are any indications that the carrying value may not be recoverable. Reversals are recognised where there is a favourable change in the economic assumptions in the period since the provision was made.

Intercompany loans receivable

Intercompany advances to other Group entities are all held till maturity, neither parties have an option to call or prepay the loan before the contracted maturity date.

Such assets are held under a business model to hold and collect contractual cash flows and therefore meet the Solely Payments of Principal and Interest (SPPI) test. No embedded derivatives are currently recognised in these advances, and the amortised cost classification is not impacted. All intercompany advances are assessed for impairment under the IFRS9 "expected credit losses model" (ECL).

Cash

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

Heathrow Finance plc

Accounting policies for the year ended 31 December 2019 *continued*

Trade and other payables

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

Current taxation

The tax expense for the year comprises current tax. Tax is recognised in the income statement.

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 reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

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.

Share capital

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

Heathrow Finance plc

Significant accounting judgements and estimates for the year ended 31 December 2019

Critical judgements in applying the Company's accounting policies

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

Key sources of estimation uncertainty

Investment impairment review

The Company review the investments in subsidiary for impairment if there are any indications that the carrying value may not be recoverable. The carrying value of the investment is compared to the recoverable amount of the subsidiary and where a deficiency exists, an impairment charge is considered by management. The recoverable amount has been calculated using the fair value less cost to sell methodology. Fair value less cost to sell has been calculated based on discounted cash flow projections of the business.

Heathrow Finance plc

Notes to the Company financial statements for the year ended 31 December 2019

1 Company results for the year

As permitted by section 408 of the Companies Act 2006, the income statement of the Company is not presented as part of these financial statements. The profit of the Company for the year attributable to shareholders was £510 million (2018: £543 million).

2 Investments in subsidiaries

	£m
Cost	
1 January 2018 and 31 December 2019	5,006

The Company's subsidiary undertakings are Heathrow (AH) Limited, which is incorporated in Great Britain and registered in England and Wales, and Heathrow Funding Limited, which is incorporated in Jersey, Channel Islands, but is UK tax resident. Details of the principal subsidiary undertakings of the Group are provided in Note 27 of the Heathrow Finance plc group financial statements.

3 Trade and other receivables

	31 December 2019 £m	31 December 2018 £m
Current		
Interest receivable from group undertakings	91	74
Amounts owed by group undertakings - interest free	51	51
	142	125
Non-current		
Prepayments	1	-
Amounts owed by group undertakings - interest free ¹	74	74
Amounts owed by group undertakings - interest bearing ²	3,020	2,699
	3,095	2,773
Total debtors	3,237	2,898

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

²Amounts 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 2019, the rate on the debenture was 4.75% (2018: 4.86%). Also included is a loan advanced to Heathrow (DSH) Limited amounting to £508 million (31 December 2018: £508 million). As at 31 December 2019, the rate on the loan was 5.16% (2018: 5.20%).

4 Trade and other payables

	31 December 2019 £m	31 December 2018 £m
Non-current		
Bonds	1,119	818
Loan facilities	850	488
Amounts owed to group undertakings - interest bearing ¹	-	75
	1,969	1,381
Current		
Bonds	-	262
Interest payable	24	20
Group relief payable	8	15
	32	297

¹Interest bearing loan relates to the loan receivable from Heathrow (DSH) Limited. The rate on the loan in 2018 was margin of 3.5% and LIBOR. The loan was repaid in March 2019.

Heathrow Finance plc

Notes to the Company financial statements for the year ended 31 December 2019 *continued*

5 Share capital

£m

Authorised

At 31 December 2018 and 31 December 2019

9,500,000,000 ordinary shares of £1 each

9,500

Called up, allotted and fully paid

At 31 December 2018 and 31 December 2019

3,109,350,689 ordinary shares of £1 each

3,109

6 Dividends

During the year ended 31 December 2019, the Company paid dividends of £468 million (£0.05 per share) to Heathrow DSH being £2 million (£0.00 per share) on 1 March 2019, £100 million (£0.01 per share) on 11 March 2019, £83 million (£0.01 per share) on 27 June 2019, £100 million (£0.01 per share) on 2 July 2019, £183 million (£0.02 per share) on 20 December 2019.

During the year ended 31 December 2018, the Company paid dividends of £497 million (£0.05 per share) to Heathrow DSH being £113 million (£0.01 per share) on 21 February 2018, £111 million (£0.01 per share) on 27 June 2018, £114 million (£0.01 per share) on 23 July 2018, £159 million (£0.02 per share) on 20 December 2018.

7 Auditor's remuneration

Audit fees are recharged in accordance with the group Shared Service Agreements ('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 £32,000 (2018: £30,000) as remuneration for the audit of the Company's financial statements, the cost of which was borne by Heathrow Airport Limited. Details of fees for other services are provided in Note 2 of the Heathrow Finance plc group financial statements.

8 Employee information and directors' remuneration

Employee numbers

The Company has no employees (2018: none).

Directors' remuneration

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

9 Guarantees

Securities and guarantees

The Company, Heathrow Airport Limited, Heathrow Express Operating Company Limited and Heathrow (AH) Limited (together, the 'Obligors') have granted security to Deutsche Trustee Company Limited (in its capacity as the 'Borrower Security Trustee', for itself and as trustee for the Borrower Secured Creditors) over their property, assets and undertakings to secure their obligations under various financing agreements. Each Obligor has also guaranteed the obligations of each other Obligor under such financing agreements.

10 Subsequent events

On 20 February 2020, the Board approved the payment of a £107 million (£0.03 per share) dividend to the Company's parent, Heathrow Finance plc. A £107 million dividend receipt from the Company's subsidiary, Heathrow (AH) Limited, was also approved on 20 February 2020.

11 Ultimate parent undertaking

The immediate parent undertaking 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 smallest and largest group to consolidate these financial statements. The shareholders of FGP Topco Limited all hold ordinary shares in the following proportion; Hubco Netherlands B.V. (25.00%) (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 (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of GIC), QS Airports UK, LP (11.18%) (investment vehicle managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (10.00%) (wholly-owned by the Universities Superannuation Scheme).

The Company's results are also included in the audited consolidated financial statements of Heathrow Finance plc for the year ended 31 December 2019, which is the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of Heathrow Finance plc, Heathrow Airport Holdings Limited and FGP Topco Limited for the year ended 31 December 2019.

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

Registered office

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

Heathrow Finance plc

Alternative Performance Measures (APMs) - Unaudited

Alternative Performance Measures

The Group presents its results in accordance with International Financial Reporting Standards (IFRS). Management also use other financial measures not defined by the IFRS as APMs (Alternative Performance Measures). Management relies on these APMs for decision-making and for evaluating the Group's performance. Below we provide an explanation of each APM.

EBITDA

EBITDA is profit before interest, taxation, depreciation and amortisation. EBITDA is a useful indicator as it is widely used by investors, analysts and rating agencies to assess operating performance.

	2019	2018
	£m	£m
Profit for the year	438	412
Add: Tax charge	140	79
Add: Net finance cost	611	717
Operating profit	1,189	1,208
Add: depreciation and amortisation	774	746
EBITDA	1,963	1,954

Adjusted EBITDA

Adjusted EBITDA is profit before interest, taxation, depreciation, amortisation and fair value gains and losses on investment properties. Adjusted EBITDA is an approximation of pre-tax operating cash flow and reflects cash generation before changes in working capital and investment. The APM assists investors to value the business (valuation using multiples) and rating agencies and creditors to gauge levels of leverage by comparing Adjusted EBITDA with net debt

	2019	2018
	£m	£m
Profit for the year	438	412
Add: Tax charge	140	79
Add: Net finance cost	611	717
Operating profit	1,189	1,208
Add: depreciation and amortisation	774	746
Less: Fair value gains on investment property	(43)	(117)
Adjusted EBITDA	1,920	1,837

	2019	2018
	£m	£m
Cash generated from operations	1,941	1,790
(Increase) / decrease in trade and other receivables	(56)	46
Decrease / (increase) in trade and other payables	5	(14)
Decrease in provisions	8	-
Difference between pension charge and cash contributions	22	15
Adjusted EBITDA	1,920	1,837

Adjusted operating profit

Adjusted operating profit shows operating results excluding fair value adjustments. These are excluded as they can vary significantly from one year to the next due to market perceptions of the value of the property and the accounting method used to calculate the fair value. The adjusted measure is used to assess underlying performance of the trading business.

	2019	2018
	£m	£m
Operating profit ¹	1,189	1,208
Less: Fair value gains on investment property	(43)	(117)
Adjusted operating profit	1,146	1,091

¹ Operating profit is presented on the Group Income statement, it is not defined per IFRS, however it is a generally accepted profit measure

Heathrow Finance plc

Alternative Performance Measures (APMs) - Unaudited *continued*

Net finance costs before certain re-measurements

Net finance cost before certain re-measurements exclude fair value adjustments on financial instruments. Excluding fair value adjustments can be useful to investors and financial analysts when assessing the Group's underlying profitability, because they can vary significantly from one year to the next. A significant portion of the fair value adjustments on financial instruments occur due to the business entering into arrangements to hedge against future inflation. As these contracts do not meet hedge criteria under IFRS 9, fair value adjustments create significant volatility in our IFRS income statement.

	2019	2018
	£m	£m
Finance income	35	27
Finance cost	(646)	(744)
Net finance cost	(611)	(717)
Less: fair value gain arising on re-measurement of financial instruments	(128)	(38)
Net Finance cost before certain re-measurements	(739)	(755)

Adjusted profit before tax

Adjusted profit before tax (PBT) excludes fair value adjustments on investment properties and financial instruments. Excluding fair value adjustments can be useful to investors and financial analysts when assessing the Group's underlying profitability, because they can vary significantly from one year to the next.

	2019	2018
	£m	£m
Profit before tax	578	491
Less: fair value gain on investment properties	(43)	(117)
Less: fair value gain arising on re-measurement of financial instruments	(128)	(38)
Adjusted PBT	407	336

Adjusted profit after tax

Adjusted profit after tax (PAT) excludes fair value adjustments and the associated tax. Excluding fair value adjustments can be useful to investors and financial analysts when assessing the Group's underlying profitability, because they can vary significantly from one year to the next.

	2019	2018
	£m	£m
Profit after tax	438	412
Less: fair value gain on investment properties	(43)	(117)
Less: fair value gain arising on re-measurement of financial instruments	(128)	(38)
Add: tax on fair value gain on investment properties and re-measurement of financial instruments	29	7
Adjusted PAT	296	264

Heathrow Finance plc

Alternative Performance Measures (APMs) - Unaudited *continued*

Heathrow Finance plc consolidated nominal net debt

Consolidated nominal net debt is a measure of financial position used by our creditors when assessing covenant compliance.

Nominal net debt is short and long term debt less cash and cash equivalents and term deposits. It includes index linked swap accretion and hedging impact of cross currency interest rate swaps. It excludes additional lease liabilities recognised upon transition to IFRS 16, accrued interest, capitalised borrowing costs and intra-group loans.

	2019	2018
	£m	£m
Cash and cash equivalents	845	595
Term deposits	725	120
Current debt including lease liability	(442)	(509)
Non-current debt including lease liability	(15,742)	(13,918)
Net debt (excluding intercompany)	(14,614)	(13,712)
Index-linked swap accretion ⁽¹⁾	(345)	(488)
Impact of cross currency interest rate swaps ⁽²⁾	349	353
Bond issuance costs ⁽³⁾	(130)	(133)
Less: IFRS 16 lease liability at 31 December 2019 relating to pre-existing leases ⁽⁴⁾	379	-
Consolidated nominal net debt	(14,361)	(13,980)

⁽¹⁾ Index linked swap accretion is included in nominal net debt, amounts are reported within derivative financial instruments on the Statement of financial position.

⁽²⁾ Where bonds are issued in currencies other than GBP, the Group has entered into foreign currency swaps to fix the GBP cash outflows on redemption. The impact of these swaps is reflected in nominal net debt.

⁽³⁾ Capitalised bond issue costs are excluded from nominal net debt

⁽⁴⁾ The lease liability relating to leases that existed at the point of transition to IFRS 16 (1 January 2019) is excluded from nominal net debt. All new leases entered into post transition are included.

Regulatory Asset Base (RAB)

The regulated asset base is a regulatory construct, based on predetermined principles not based on IFRS. By investing efficiently in the Airport, we add to the RAB over time. The RAB represents the invested capital on which Heathrow are authorised to earn a cash return. It is used in key financial ratios and in our regulatory financial statements.

	2019	2018
	£m	£m
Regulatory Asset Base (RAB)	16,598	16,200

Regulatory gearing ratio

The regulatory gearing ratio is consolidated nominal net debt to the RAB. It is a financial indicator used by investors, financial analysts, rating agencies, creditors and other parties to ascertain a Group's debt position in regulated industries.

Gearing ratios	2019	2018
Total net debt to RAB	0.748	0.766
Senior net debt to RAB	0.666	0.682

**Heathrow Finance plc
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Company registration number: 06458635