BAA (SP) Limited

Annual report and financial statements for the year ended 31 December 2010

Company registration number: 06458621

BAA (SP) Limited

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BAA (SP) Limited

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BAA (SP) Limited

Business review

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

The consolidated financial statements of BAA (SP) Limited and its subsidiaries (together 'BAA (SP)' or the 'Group') have been prepared in accordance with United Kingdom Generally Accepted Accounting Practice ('UK GAAP'). The accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

This business review is presented in three sections:
Management review – overview of the year ended 31 December 2010, along with the key factors likely to impact the Group in 2011.
Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2010 and analysis of the financial position of the Group as at that date. The Group's accounting and reporting policies and procedures are also considered.
Internal controls and risk management – outline of the BAA Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the BAA Group Executive Committee.

Management review

Review of 2010

Key features of the year

2010 was marked by contrasting fortunes for the Group. The global economic recovery underway following the credit crisis gained momentum, resulting in strong underlying growth in passenger traffic at Heathrow. Heathrow's performance reflects its significantly greater exposure to global economic trends than other UK airports given it is the UK's only hub airport and handles approximately 70% of all UK long haul air traffic. The improving global economic background enabled the Group to deliver a good financial performance despite a number of exceptional external events.

The first of these was the closure of UK and European airspace due to ash from a volcanic eruption in Iceland which resulted in Heathrow and Stansted closing from 15 April 2010 to 20 April 2010. Further, during the first half of 2010, British Airways' cabin crew took industrial action on 22 days which resulted in a total of 34 days' service disruption at Heathrow.

Finally, the airports experienced the disruptive effects of the coldest December in the UK since records began, being particularly affected in early December and in the week leading up to Christmas. Severe winter weather was also experienced across much of north west Europe and the north eastern seaboard of the US at various times during the month that also had an impact on traffic at the Group's airports. Given the degree of disruption caused at Heathrow by the weather immediately before Christmas, BAA appointed an external international panel of experts, led by BAA non-executive director Professor David Begg, to establish what lessons could be learnt from the disruption in order that the airport can better prepare and respond to future adverse weather conditions. The panel is due to report in March 2011.

During 2010, the UK's new coalition government reversed the previous government's support for new runways at Heathrow and Stansted and as a result the airports stopped pursuing planning applications for their third and second runways respectively.

The Group continued significant investment at Heathrow with good progress made in constructing the new Terminal 2 which will be Heathrow's second new terminal in recent years after a period of over twenty years since Terminal 4 opened. Nearly £850 million was invested at the Group's two airports in 2010, including over £800 million at Heathrow.

Significant progress was made in 2010 in extending the Group's debt maturities, with a wide range of investors attracted to supporting Heathrow's long-term investment plans through five major new debt financings completed by the Group and BAA (SH) that raised approximately £2.0 billion. This enabled repayment of the majority of their short-term maturities and enhanced BAA's overall capital structure.

Passenger traffic trends

Passenger traffic for the year ended 31 December 2010 at the Group's airports is analysed below:

	Year ended 31 December 2010	Year ended 31 December 2009	Change[1] (%)
Passengers by airport (millions)			
Heathrow	**65.7**	65.9	(0.2)
Stansted	**18.6**	20.0	(7.0)
Passengers by market served (millions)			
UK	**6.6**	7.2	(8.1)
Europe[2]	**42.8**	43.5	(1.8)
Long haul	**35.0**	35.2	(0.5)
Total passengers[1]	**84.3**	85.9	(1.8)

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

In the year ended 31 December 2010, combined passenger traffic at Heathrow and Stansted declined 1.8% to 84.3 million (2009: 85.9 million). Year on year performance reflects a number of exceptional events including closure of airspace due to volcanic ash, airline industrial action affecting Heathrow and severe winter weather as well as the macroeconomic environment. Whilst some passengers affected by these disruptions will have completed their journeys later in 2010, these events resulted in the loss of up to an estimated total of 2.8 million passengers of which 2.4 million were at Heathrow. Adjusting for these factors, the Group's traffic is estimated to have increased by up to 1.5%.
At Heathrow, where traffic trends are more influenced by global economic factors than at Stansted, reported traffic declined 0.2% to 65.7 million (2009: 65.9 million) but adjusting for the factors outlined above, its traffic is estimated to have increased by up to 3.4%. Heathrow's underlying growth accelerated as the year progressed driven particularly by European scheduled traffic and renewed confidence amongst business travellers. The strength of Heathrow's underlying performance is reflected in it achieving several all time traffic records including the busiest day in history, the two busiest months ever and five successive months from July to November achieving record traffic for that particular month.

Management review *continued*

Passenger traffic trends continued
Recent growth at Heathrow has been led by origin and destination traffic that increased to 65% of Heathrow's total traffic in the year ended 31 December 2010 (2009: 63%).

Stansted's reported traffic declined 7.0% to 18.6 million (2009: 20.0 million). Adjusting for disruption due to volcanic ash and severe winter weather, its traffic is estimated to have fallen no more than 4.8%. The underlying decline reflects inter-related capacity reductions by airlines and renewed economic uncertainty in the UK that particularly affected the outbound leisure market, a key part of Stansted's traffic.

In terms of traffic trends by market served during 2010, across the two airports, North Atlantic and emerging market long haul traffic as well as European scheduled traffic outperformed. Of particular note, within Europe, traffic with Switzerland increased by 11.1%, Italy by 7.0% and Germany by 1.8% whilst in emerging markets such as South America and South Asia there were increases of 8.1% and 1.1% respectively. Whilst there was a noticeable recovery in the second half, domestic traffic underperformed partly reflecting airlines' tendency to focus service reductions on their domestic route network when there is disruption such as industrial action and adverse weather.

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

In particular, the Group's key strategic objective is to ensure Heathrow becomes the UK's gateway to the world and Europe's hub of choice by making every journey better. Significant progress has been made in delivering this objective over the last few years with the opening of Terminal 5 which passengers rate amongst the best airport terminals in Europe. Heathrow's significant investment continued in 2010 and in particular good progress was made in constructing the new Terminal 2 which will be Heathrow's second new terminal in recent years after a period of over twenty years since Terminal 4 opened. In addition, the Group will continue to invest in Stansted to enhance its facilities.

There has also been consistent improvement in service standards, most clearly illustrated by Heathrow moving from being ranked fourth as recently as 2008 for overall passenger satisfaction amongst the top five European airports to being in the top two consistently through 2010.

Investment in modern airport facilities
The Group's capital investment programme continues to be focused on the transformation of Heathrow, particularly on delivering modern terminal facilities and other investments targeting improvements in the passenger experience. The main projects in 2010 included construction work on the new Terminal 2 and integrated baggage systems and near completion of Terminal 5C. Over £800 million was invested at Heathrow in 2010 and the level of investment is expected to increase substantially over 2011 and 2012 particularly as work on construction of the new Terminal 2 intensifies.

In relation to the new Terminal 2, significant progress was made in 2010 following closure of the previous terminal in late 2009. Demolition of the old terminal was completed in September 2010. The scope of the new terminal was clarified in consultation with airlines including in relation to the specification of the multi-storey car park and how it is connected to the terminal and the existing road system as well as the scope of the baggage systems. Good progress was also made in constructing the new terminal that is now clearly visible to airport users. By the end of 2010, six of the building's 12 steel cores had been erected and the first roof sections were in place. The shell of the main Terminal 2 building is expected to be completed in early 2012. Following completion of the first phase of the terminal's satellite building in 2009 (which is currently in use via Terminal 1), site clearance works in 2010 enabled work to commence on the second phase of the satellite building. The initial focus has been on constructing the basement to house the tracked transit system station and tunnels that will connect the satellite to the main terminal building.

Construction activities at Terminal 5C (Terminal 5's second satellite building) are largely complete and operational readiness activities have commenced in conjunction with British Airways. It is anticipated that the new satellite will be fully operational before the peak summer traffic season in 2011. On opening, the satellite building, which is already providing remote stand capability for Terminal 5, will provide an additional 12 pier served stands, improving the passenger experience by reducing the frequency with which passengers have to be transported in buses between Terminal 5 and their aircraft.

The new Heathrow transfer baggage tunnel linking Terminals 3 and 5 has now been fitted out with an automated baggage transfer system. Work continues to complete the interface building between the tunnel and the Central Terminal Area.

At Stansted, levels of investment are subdued reflecting limited investment in the current regulatory period on the existing facilities and the ending of work on a potential new runway given the new UK government's opposition to the development of new runways in the South East of England. The modest investment on existing facilities is focused largely on refurbishing infrastructure and other areas such as planning and security compliance.

Service standards
The Group continues to focus on delivering consistently high service standards across its airports, a key strategic priority. It also expects improving service standards to play a key part in driving cost efficiency.

Heathrow's strong focus on operational performance in recent years continues to be reflected in the improving trend in its ratings for overall passenger satisfaction in Airport Council International's Airport Service Quality survey. In the survey for the fourth quarter of 2010, Heathrow achieved an overall passenger satisfaction score of 3.80 compared to 3.78 for the same quarter of 2009, maintaining its position in the top two of the major European hub airports that it achieved throughout 2010.

In the year ended 31 December 2010 many service standards at Heathrow and Stansted were influenced by the exceptional events discussed above.In relation to departure punctuality, the proportion of aircraft departing within 15 minutes of schedule at Heathrow was 71% (2009: 77%) and at Stansted was 78% (2009: 82%). Punctuality statistics were affected in 2010 across the European aviation industry by two periods of prolonged severe winter weather in January and December and extensive European air traffic control strikes. More specific to Heathrow, its punctuality was also affected by the British Airways industrial action in the first half of the year.

Management review *continued*

Service standards continued
Heathrow's baggage misconnect rate improved to 18 per 1,000 passengers (2009: 19). The improvement on 2009 is notable given the challenges faced during two periods of prolonged severe winter weather in January and December and from the record levels of passenger traffic through the third quarter of 2010.

On security queuing, passengers passed through central security within periods prescribed under service quality rebate schemes 97.5% (2009: 97.9%) of the time at Heathrow and 98.2% (2009: 99.4%) of the time at Stansted. This compares with 95.0% service standards in both cases.

Regulatory developments
Competition Commission inquiry into the supply of UK airport services by BAA
In March 2009, the Competition Commission ('CC') published its final decision in relation to its investigation into the supply of UK airport services by BAA. The key structural remedy called for the disposal of certain airports including Stansted.

The CC's decision was initially overturned by the Competition Appeals Tribunal but was upheld by the Court of Appeal in October 2010 and, in February 2011, BAA was refused permission to appeal to the Supreme Court. BAA is disappointed by this decision and continues to make the case to the CC that the circumstances in which they found reason to force the sale of certain of its airports have changed significantly since early 2009 and should certainly be reviewed given the policy of the new UK coalition government to rule out new runway capacity in the South East of England.

Following the Court of Appeal decision, interim undertakings relating to the governance and monitoring of Stansted (as well as Edinburgh and Glasgow airports) have been reinstated and the CC is considering responses to a consultation as to whether there have been material changes in circumstances that might lead to it amending the scope of the remedies requiring that BAA divest Stansted airport (as well as either Edinburgh or Glasgow airport) contained in its final decision in March 2009. The CC has indicated that it expects to issue its provisional decision on its consultation during March 2011.

Airport economic regulation review and potential extension of Heathrow's current regulatory period
The new UK government confirmed its approach to reforming the economic regulation of airports that built on proposals published by the Department for Transport in December 2009. It provides clarity on the package of measures to be included in the proposed new Airport Economic Regulation bill (the 'Bill') to promote both the interests of passengers and investment in the UK's airports. The measures, which were announced in July 2010, will provide important reassurance for the Group's debt investors. They include:

- a primary duty for the Civil Aviation Authority ('CAA') to promote the interests of passengers. It will also have a supplementary duty to ensure that licence holders are able to finance their activities;
- a minimum credit worthiness requirement for licensed airports;
- ring fencing provisions similar to those in place in other regulated sectors but with initial derogations from some of the provisions (including restrictions on the granting of security to lenders) where the costs of introduction would exceed their benefits;
- a requirement on the CAA to apply agreed tests when considering the removal of an airport's derogations and an appeals process that is aligned with the wider licence modification process; and
- a requirement for airports to put in place continuity of service plans.

The government also confirmed the earlier decision not to bring in a special administration regime and that it will not change the basis on which the current price caps at Heathrow and Stansted are set.

In February 2011, the CAA launched a consultation on the potential extension of Heathrow's current regulatory period by one year to 31 March 2014. This reflects the fact that the Bill is unlikely to be introduced into parliament before the 2012 session and the CAA's desire that the Bill is enacted prior to determining the terms for the next regulatory period. The consultation is due to conclude in March 2011.

Government announcements on new runways and high speed rail
The UK's new coalition government announced that it will not support the development of new runways in the South East of England but confirmed its support for the proposed high speed rail link between London and Birmingham together with closer assessment of the merits of a direct connection to Heathrow.

The Group expects a direct high speed rail link to Heathrow would reduce journey times from the Midlands and north of England thereby increasing demand to use Heathrow by capturing UK passengers that currently travel via other European hubs. Capacity should also be increased by allowing domestic slots serviced by relatively small aircraft to be rotated onto long haul routes serviced by larger aircraft.

As a result of the government's position on runways, in May 2010 Heathrow and Stansted stopped pursuing planning applications for new runways. The decision on runways is expected to reduce financing requirements over the next few years. As a result of this decision, the Group made impairment charges in respect of runway planning application costs and the value of properties and land purchased in relation to potential future runway development. These accounting charges will not impact the airports' regulatory asset bases, the Group's financial ratios or the generation of future cash flows. In addition, the airports' exposure to passenger volume risk is limited by the five year regulatory cycle. In any event further growth is expected without new runways even at Heathrow where higher load factors and capacity utilisation and increased use of larger aircraft provide growth opportunities.

Developments since beginning of 2011
In January 2011, combined passenger traffic across the Group's airports increased 2.5% to 6.2 million (2010: 6.0 million) due partly to underlying growth and partly adverse weather conditions that impacted performance in January 2010 more than in 2011. Adjusting for the weather disruption in both January 2010 and January 2011, it is estimated that traffic would have increased between 1.0% and 1.2%.
In January 2011, Capgemini was selected as preferred supplier for the outsourcing of a range of IT services currently provided by the BAA Group's own IT department. These services, which include application management, support of end user devices, IT infrastructure management and telecoms support, will be provided under an initial five year contract. The arrangement will involve a transition programme during 2011 which will include the transfer (to Capgemini), retention or redundancy of employees within the BAA Group's IT department and result in one off incremental operating costs during 2011. It is intended that the outsourcing will not change the ownership of BAA's IT assets.

Management review *continued*

Developments since beginning of 2011 *continued*
In February 2011, the CAA launched a consultation regarding the potential extension of the current Heathrow regulatory period by one year to 31 March 2014. The intention of the extension is principally to provide more time for the new Airport Economic Regulation bill to be implemented so that it can be utilised as a basis for determining the terms of the settlement for the next regulatory period. BAA is currently in discussion with the Heathrow airline community and the CAA about this potential extension. The consultation is due to conclude in March 2011.

From 1 April 2011, Heathrow airport will be restructuring how it recovers the maximum allowable yield for its aeronautical income. Whilst there will be no change in the overall amount of income earned, the proposals will encourage better environmental performance and reinforce Heathrow's position as the UK's only hub airport. The main changes will see the departing passenger charge amended from three tiers for domestic, Irish and international passengers to two tiers for European and intercontinental passengers, the introduction of discounts for transfer passengers and a significant increase in the minimum departure charge per aircraft.

Outlook
The Group expects the recovery in underlying passenger traffic in 2010 to continue in 2011. 2011 is also expected to see higher aeronautical tariffs, particularly at Heathrow, and further improvements in retail income. Whilst increased turnover will be partially offset by increased operating costs, particularly associated with the one-off cost of various IT, operational and commercial initiatives that will deliver future operational and financial benefits, this year is expected to see strong growth in turnover, Adjusted EBITDA and operating cash flow. There is also expected to be a significant step up in investment at Heathrow.

Traffic trends in the early weeks of 2011 have been consistent with the Group's expectations and therefore at this stage of the year the outlook for financial performance in 2011 remains consistent with guidance in the Investor Report distributed in December 2010.

BAA (SP) Limited

Financial review

Introduction
The following financial review, based on the consolidated financial statements of the Group, provides commentary on the performance of the Group's airports.

Basis of preparation of statutory results
BAA (SP) Limited is the holding company of a group of companies that owns Heathrow and Stansted airports and operates the Heathrow Express rail service. The Group's statutory accounts are prepared under UK GAAP including the adoption of merger accounting.

Basis of presentation of financial results
In order to provide a more meaningful comparison of Group performance between 2009 and 2010, the information presented under turnover, aeronautical income, retail income, other income, adjusted operating costs, Adjusted EBITDA, exceptional items and operating profit focuses on the Group's continuing operations and excludes Gatwick airport which was sold on 3 December 2009.

Summary performance

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Change %
Group turnover – total	**2,074.3**	2,417.9	(14.2)
Group turnover – discontinued operations	**-**	(440.3)	n/a
Group turnover – continuing operations	**2,074.3**	1,977.6	4.9
Adjusted operating costs – continuing operations[1]	**(1,107.4)**	(1,092.4)	1.4
Adjusted EBITDA – continuing operations[2]	**966.9**	885.2	9.2
Operating gain/(costs) – exceptional – continuing operations	**77.2**	(217.3)	n/a
EBITDA – continuing operations	**1,044.1**	667.9	56.3
Depreciation – ordinary – continuing operations	**(476.7)**	(452.7)	5.3
Depreciation – exceptional – continuing operations	**(18.7)**	(54.6)	(65.8)
Operating profit – continuing operations	**548.7**	160.6	241.7
Operating profit – discontinued operations	**-**	95.1	n/a
Operating profit – total	**548.7**	255.7	114.6
Gain/(loss) on disposal of Gatwick airport – discontinued operations	**16.2**	(277.3)	n/a
Impairment of fixed assets – exceptional – continuing operations	**(149.3)**	-	n/a
Net interest payable and similar charges	**(696.4)**	(682.9)	2.0
Fair value loss on financial instruments	**(35.8)**	(117.4)	(69.5)
Total net interest payable and similar charges	**(732.2)**	(800.3)	(8.5)
Loss on ordinary activities before taxation	**(316.6)**	(821.9)	(61.5)
Tax (charge)/credit on loss on ordinary activities	**(5.2)**	137.9	n/a
Loss on ordinary activities after taxation	**(321.8)**	(684.0)	(53.0)

[1] Adjusted operating costs are stated before depreciation, amortisation and exceptional items.
[2] Adjusted EBITDA is earnings before interest, tax, depreciation, amortisation and exceptional items.

Turnover
In the year ended 31 December 2010, turnover from continuing operations increased 4.9% to £2,074.3 million (2009: £1,977.6 million). This reflects increases of 2.0%, 8.4% and 8.4% in aeronautical income, retail income and other income respectively.

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Change %
Aeronautical income	**1,115.0**	1,092.7	2.0
Retail income	**476.3**	439.5	8.4
Other income	**483.0**	445.4	8.4
Total turnover	**2,074.3**	1,977.6	4.9

Aeronautical income
Aeronautical income increased 2.0% to £1,115.0 million (2009: £1,092.7 million). Average aeronautical income per passenger increased 3.9% to £13.22 (2009: £12.73).

Aeronautical income summary (by airport)

	Aeronautical income			**Per passenger[1]**		
	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Change %	**Year ended 31 December 2010 £**	Year ended 31 December 2009 £	Change %
Heathrow	**991.3**	960.7	3.2	**15.08**	14.58	3.4
Stansted	**123.7**	132.0	(6.3)	**6.66**	6.62	0.7
Total	**1,115.0**	1,092.7	2.0	**13.22**	12.73	3.9

[1] Aeronautical income per passenger figures calculated using un-rounded passenger numbers and change in aeronautical income per passenger figures calculated using the resulting un-rounded aeronautical income per passenger figures.

Financial review *continued*

Turnover *continued*
Aeronautical income continued
At Heathrow, aeronautical income increased 3.2% with income in 2010 benefiting from the increase in tariffs that occurred on both 1 April 2009 and 2010 which was partially offset by the combined effects of disruption caused by volcanic ash, airline industrial action and severe winter weather. At Stansted, aeronautical income declined 6.3%, less than the decline in passengers, reflecting lower tariff discounts. The delay in introducing higher tariffs applying at Heathrow from 1 April 2008 boosted aeronautical income in 2009 by an estimated £12.5 million above underlying levels. Adjusting for this, Heathrow's aeronautical income is estimated to have increased 4.5%.

Retail income
The Group's retail business delivered an exceptional performance in 2010 with improved demand for the retail offering reflected in net retail income ('NRI') per passenger increasing 12.1% to £5.29 (2009: £4.72). The performance was led by Heathrow where NRI per passenger was up 14.4%.

This performance was based on gross retail income increasing 8.4% to £476.3 million (2009: £439.5 million) and NRI increasing 10.1% to £445.7 million (2009: £404.9 million).

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

	Year ended 31 December 2010	Year ended 31 December 2009	Change %
Retail income (£m)	**476.3**	439.5	8.4
Less: retail expenditure (£m)	**(30.6)**	(34.6)	(11.6)
Net retail income (£m)	**445.7**	404.9	10.1
Passengers (million)[1]	**84.3**	85.9	(1.8)
Net retail income per passenger [1 2]	**£5.29**	£4.72	12.1

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

Analysis of net retail income

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Change %
Car parking	**73.9**	67.0	10.3
Duty and tax-free	**113.5**	100.6	12.8
Airside specialist shops	**83.4**	66.3	25.8
Bureaux de change	**44.4**	42.6	4.2
Catering	**40.5**	35.5	14.1
Landside shops and bookshops	**25.0**	26.4	(5.3)
Advertising	**30.5**	31.6	(3.5)
Car rental	**15.1**	14.3	5.6
Other	**19.4**	20.6	(5.8)
Total	**445.7**	404.9	10.1

At Heathrow, gross retail income increased 11.9% to £393.2 million (2009: £351.5 million) and NRI per passenger increased 14.4% to £5.64 (2009: £4.93). Most areas of the retail business performed well, with the main growth drivers through the year being airside specialist shops and duty and tax-free. In addition, there were increasing signs of recovery in car parking as the year progressed.

Heathrow's excellent retail performance reflects the increase in the proportion of higher spending origin and destination passengers from 63% in 2009 to 65% in 2010. This benefits both the in-terminal and car parking elements of retail income. The performance also reflects the greater numbers of passengers utilising Terminal 4 following relocation of airlines prior to Terminal 2's closure who are benefiting from its upgraded retail facilities completed as part of the terminal's recent refurbishment. Further, various initiatives by the Group supported growth including advertising campaigns such as 'West End for less' highlighting the value proposition of Heathrow's retail outlets, more in-terminal sales support and actively managing the mix of concessionaires. Growth in passenger spend was particularly strong in the luxury segment of Heathrow's airside retail outlets, consistent with recent trading performance reported by many luxury fashion retailers.

During 2010, the quality of Heathrow's retail offering was independently endorsed when it was the global winner of the Best Airport for Tax-Free Shopping award in the Business Traveller Awards 2010 and received a similar award in the Skytrax World Airports Awards.

Stansted's gross retail income declined 5.6% to £83.1 million (2009: £88.0 million), a resilient performance given passenger trends which meant that NRI per passenger increased 0.5% to £4.02 (2009: £4.00). Growth in Stansted's NRI per passenger reflects particularly performance in airside specialist shops and catering with net car parking income per passenger stabilising after a significant period of weakness.

Other income
Income from activities other than aeronautical and retail increased 8.4% to £483.0 million (2009: £445.4 million). This reflects rail income increasing 12.6% to £103.0 million (2009: £91.5 million) due to passenger numbers increasing 9.4% to 5.92 million (2009: 5.41 million) as well as improved yields. Growth in rail passenger numbers reflects the shift in Heathrow airport passenger mix relative to the comparative period towards origin and destination traffic, introduction of additional rail ticket sales activities within the airport and disruptions to alternative rail services to and from central London.

Income from activities other than aeronautical and retail also reflects operational facilities and utilities income increasing 5.3% to £159.6 million (2009: £151.6 million) due primarily to under-recovery of check-in and baggage system costs in the prior year.

In addition, intra-group and other income increased 17.3% to £112.1 million (2009: £95.6 million) due to £16.5 million of income from the provision of various transitional services to Gatwick airport that is largely non-recurring as most of the transitional services agreements terminated in 2010. Adjusting for this factor, income from activities other than aeronautical and retail increased by an estimated 4.7%.

Turnover *continued*

Underlying turnover

In the year ended 31 December 2010, turnover from continuing operations increased 4.9% to £2,074.3 million (2009: £1,977.6 million). To determine underlying turnover growth it is necessary to adjust for an additional £12.5 million in aeronautical income earned at Heathrow in 2009 above underlying levels due to phasing of tariff increases differing from the normal pattern and £16.5 million of non-recurring income generated in 2010 from the provision of various services to Gatwick airport under transitional services agreements.

Year on year turnover performance was also affected by the various exceptional external events that impacted the business during 2010. At the time of the airport closures caused by ash from an Icelandic volcano and the industrial action by British Airways' cabin crew, the Group's turnover was affected by a combined estimated £38.1 million. In addition, of the total impact on the Group's profits of approximately £20 million from the severe winter weather in December, it is estimated that £12.1 million was due to reduced turnover.

Whilst recognising that some passengers whose journeys were affected by the disruption from volcanic ash and industrial action by British Airways' cabin crew will have completed their planned journeys later in 2010, adjusting for the items outlined above, underlying turnover in the year ended 31 December 2010 is estimated to have increased by up to 7.3% to £2,108.0 million (2009: £1,965.1 million).

Adjusted operating costs

Adjusted operating costs exclude depreciation, amortisation and exceptional items to provide a more meaningful comparison of the Group's recurring expenditure year on year.

In the year ended 31 December 2010, adjusted operating costs increased 1.4% to £1,107.4 million (2009: £1,092.4 million).

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Change %
Employment costs	**315.7**	290.9	8.5
Maintenance expenditure	**134.8**	147.3	(8.5)
Utility costs	**115.6**	125.5	(7.9)
Rents and rates	**117.0**	128.9	(9.2)
General expenses	**233.3**	235.5	(0.9)
Retail expenditure	**30.6**	34.6	(11.6)
Intra-group charges/other	**160.4**	129.7	23.7
Total	**1,107.4**	1,092.4	1.4

The main drivers of increased adjusted operating costs were higher employment costs and intra-group charges. Employment costs increased 8.5% to £315.7 million (2009: £290.9 million). The increase in employment costs was driven particularly by the reinstatement of performance related pay as well as additional defined benefit pension service charges of £10.8 million relative to last year due to revised actuarial assumptions. Intra-group charges/other costs increased 23.7% to £160.4 million (2009: £129.7 million) primarily reflecting central overheads being allocated across a smaller business base following the sale of Gatwick (£27.8 million of central overheads were charged to Gatwick in the year ended 31 December 2009).

The overall increase in adjusted operating costs was mitigated particularly by lower maintenance expenditure, reflecting closure of Terminal 2 in late 2009 and procurement savings, reduced utility costs and reduced rents and rates due to rationalisation of office space occupied by the Group supplemented by a rates rebate.

Adjusting for the increased pensions costs and re-allocated central overheads together with the estimated £7.8 million cost associated with the severe winter weather in December 2010 (which arose for example from providing hotel accommodation, catering and other care for the substantial number of stranded passengers), underlying adjusted operating costs declined 2.8% to £1,088.8 million (2009: £1,120.2 million). The disruption caused by volcanic ash and airline industrial action did not materially affect adjusted operating costs.

Adjusted EBITDA

In the year ended 31 December 2010, Adjusted EBITDA increased 9.2% to £966.9 million (2009: £885.2 million), resulting in an Adjusted EBITDA margin of 46.6% (2009: 44.8%).

Whilst recognising that some passengers whose journeys were affected by the disruption from volcanic ash and industrial action by British Airways' cabin crew will have completed their planned journeys later in 2010, these two disruptions together with the severe winter weather in December reduced Adjusted EBITDA in the year ended 31 December 2010 by up to £58.0 million. Taking into account these factors together with re-allocating central overheads and additional aeronautical income in 2009 and Gatwick transitional services income and increased pension costs in 2010, it is estimated that underlying Adjusted EBITDA increased by up to 20.6% to £1,019.2 million (2009: £844.9 million), resulting in an underlying Adjusted EBITDA margin of 48.3% (2009: 43.0%).

Adjusted EBITDA at Heathrow (including Heathrow Express Operating Company Limited) increased 12.5% to £880.7 million (2009: £782.8 million). Stansted's Adjusted EBITDA declined 15.8% to £86.2 million (2009: £102.4 million) due principally to weak underlying traffic trends compounded by the disruption caused by volcanic ash and severe winter weather.

Exceptional items (including depreciation and impairment charges)

In the year ended 31 December 2010, there was a total net £90.8 million pre-tax charge (2009: £271.9 million) to the profit and loss account in respect of exceptional items, including impairment charges and other one-off items for continuing operations with a £58.5 million credit (2009: £217.8 million charge) included in operating profit and a charge of £149.3 million (2009: £nil) below operating profit.

Financial review *continued*

Exceptional items (including depreciation and impairment charges) *continued*
Items within operating profit included a £89.9 million non-cash pension related credit (2009: £217.8 million charge) principally relating to the Group's share of the reduction in the BAA Group's defined benefit pension scheme deficit. The reduced pension scheme deficit reflects a number of factors discussed in more detail below in the Pension scheme section. In addition, there was a charge of £18.7 million (2009: £54.6 million) related to accelerated depreciation due to the shortened lives of certain existing assets at Heathrow given the new Heathrow Terminal 2 development. The accelerated depreciation charge has reduced from the prior year due to the full write-off of the old Terminal 2 by its closure in late 2009 and the charge relating to Terminal 1 no longer being treated as exceptional since the first quarter of 2010 as its remaining useful life was reassessed and extended. Finally, there was a £12.7 million charge relating primarily to a restructuring process to reduce the size and cost of overhead functions following the sale of Gatwick airport in 2009.

The exceptional items below operating profit in 2010 related to impairment charges arising from the Group's decision not to pursue planning applications for new runways at Heathrow and Stansted given that the UK's new coalition government does not support the development of new runways in the South East of England. There was a total impairment charge of £149.3 million made of which £104.4 million related to the write-off of planning application costs and £44.9 million to the write down in the value of domestic properties and land purchased by both airports falling within the planned expanded airport boundaries prior to their transfer to investment properties. This accounting treatment has no impact on these costs being included in the airports' regulatory asset bases and has no cash impact. In addition, it will not affect future cash flow generation, consistent with CAA guidance (other than £37 million of Stansted planning application costs previously disallowed by the CAA).

Operating profit
The Group recorded an operating profit from continuing operations for the year ended 31 December 2010 of £548.7 million (2009: £160.6 million). Relative to Adjusted EBITDA, operating profit includes £476.7 million in depreciation (2009: £452.7 million). In addition, it reflects a net £58.5 million exceptional credit included in operating profit (2009: £271.9 million charge). A reconciliation between Adjusted EBITDA and statutory operating profit is provided below.

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	Change %
Adjusted EBITDA	**966.9**	885.2	9.2
Depreciation	**(476.7)**	(452.7)	5.3
Exceptional items – pensions	**89.9**	(217.8)	n/a
Exceptional items – accelerated depreciation	**(18.7)**	(54.6)	(65.8)
Exceptional items – other	**(12.7)**	0.5	n/a
Operating profit	**548.7**	160.6	241.7

Gain on disposal of Gatwick airport
The £16.2 million gain on disposal in 2010 reflects the shortfall between assets and liabilities transferred to the pension scheme of Gatwick's purchaser being lower than expected, and the receipt of a further £1.4 million on the finalisation of Gatwick's balance sheet at completion of the disposal.

Taxation
The tax charge recognised for the year ended 31 December 2010 was £5.2 million (2009: £137.9 million credit). Based on a loss before tax for the period of £316.6 million (2009: £821.9 million), this results in a negative effective tax rate of -1.6% (2009: 16.8%).

The tax charge is less than the credit implied by the statutory rate of 28% (2009: 28%). This is primarily due to the non-deductibility for tax purposes of the impairment charge for the year and to a deferred tax charge related to accelerated depreciation in 2010 and prior years on assets with shortened lives. Improved information is now available on the tax classification of these assets and the calculation of deferred tax has been adjusted accordingly.

The Finance (No. 2) Act 2010 enacted a reduction in the main rate of UK corporation tax from 28% to 27% with effect from 1 April 2011. As a result, the Group's deferred tax balances, which were provided at 28%, have been re-measured at the rate of 27% for the year ended 31 December 2010. This has resulted in a reduction in the net deferred tax liability of £10.4 million, with £12.2 million credited to the profit and loss account and £1.8 million charged to reserves.

Dividend
No dividend was paid or declared in the year ended 31 December 2010 (2009: £nil).

Financial review *continued*

Summary cash flow

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Net cash inflow from operating activities – continuing operations	**918.5**	802.3
Net cash inflow from operating activities – discontinued operations	**-**	189.4
Net cash inflow from operating activities – total	**918.5**	991.7
Net interest paid	**(393.8)**	(512.9)
Taxation – Group relief (paid)/received	**(17.1)**	24.0
Cash flow after interest and tax	**507.6**	502.8
Net capital expenditure	**(841.1)**	(1,002.8)
Pension and other payments related to disposal of Gatwick airport	**(125.3)**	1,360.5
Net cash (outflow)/inflow before management of liquid resources and financing	**(458.8)**	860.5
Management of liquid resources	**193.5**	(77.4)
Prepayment of derivative interest	**(36.7)**	(114.2)
Cancellation of derivatives	**(73.9)**	(43.3)
Proceeds of equity issue	**217.4**	282.6
Movement in borrowings and other financing flows[1]	**160.6**	(929.2)
Increase/(decrease) in cash	**2.1**	(21.0)

[1] Refer to the Consolidated cash flow statement in the Group financial statements for further details.

Cash flow from operating activities

Net cash inflow from continuing operations in the year ended 31 December 2010 increased 14.5% to £918.5 million (2009: £802.3 million) which compares with Adjusted EBITDA of £966.9 million (2009: £885.2 million). Operating cash flow was less than Adjusted EBITDA mainly due to cash contributions to pension schemes exceeding the pension charge to the profit and loss account by £32.5 million and the cash nature of the restructuring exceptional item detailed above.

The improvement in operating cash flow between 2009 and 2010 reflects the increase in Adjusted EBITDA together with an improved working capital performance.

Capital expenditure

In the year ended 31 December 2010, the Group invested £841.1 million in capital expenditure (2009: £1,002.8 million including £127.1 million at Gatwick) with £818.7 million at Heathrow (2009: £817.8 million) and £22.4 million at Stansted (2009: £57.9 million).

Investment at Heathrow focused on work on the new Terminal 2 and its satellite building which gained momentum through the year. It also reflects continued work on Terminal 5C which was nearing substantial completion at the year end. The third major Heathrow project during 2010 was the tunnel between Terminals 3 and 5 which will transport baggage for transfer passengers. Other investment included refurbishment of several areas in both Terminals 3 and 4 (security search, immigration hall and baggage reclaim) and further works on the taxiway system to enable the A380 aircraft to access all necessary airside areas.

There was modest investment at Stansted with the conclusion of expenditure on a potential new runway given the new UK government's opposition to the development of new runways in the South East of England. Other investment focused on planning and security compliance and refurbishing existing infrastructure.

Pension scheme

At 31 December 2010, the BAA defined benefit pension scheme had a deficit of £43.6 million as measured under IAS 19, of which £36.6 million is attributable to the Group under the BAA group's shared services agreement. This compares with a total scheme deficit of £255.6 million at 31 December 2009. The reduction in the scheme deficit is due principally to the benefit of the £104.7 million commutation payment into the scheme that arose due to the Gatwick sale and returns on the scheme assets increasing to £213 million compared to £74 million in 2009.

Net debt

The analysis below focuses on the Group's external debt and excludes restricted cash and the debenture between BAA (SP) and its immediate parent company BAA (SH) plc (formerly BAA (SH) Limited) ('BAA (SH)'). It includes all the components used in calculating gearing ratios under the Group's financing agreements including index-linked accretion.

During 2010, the Group's nominal net debt increased 15.6% from £8,579.0 million at 31 December 2009 to £9,921.2 million at 31 December 2010. The majority of the increase was due to the £1,000.0 million distributed from BAA (SP) to BAA (SH) discussed below.

The Group's nominal net debt at 31 December 2010 comprised £6,279.9 million outstanding under bond issues, £1,298.3 million outstanding under the bank refinancing facility, £2,257.7 million outstanding under other bank facilities, £132.4 million in index-linked derivative accretion and cash and current asset investments of £47.1 million. Nominal net debt comprised £8,793.2 million in senior net debt and £1,128.0 million in junior debt.

The accounting value of the Group's net debt at 31 December 2010 was £9,910.5 million (2009: £8,725.7 million).

The average cost of the Group's external gross debt at 31 December 2010 was 4.44% (2009: 5.81%) taking into account the impact of interest rate, cross-currency and index-linked hedges but excluding index-linked accretion. The significant reduction in the cost of debt from the prior year reflects completion of approximately £2 billion in index-linked derivatives during 2010 on which only the real rate cost is included in determining the above cost of debt.

Financial review *continued*

Financing activities
The Group continued to make strong progress in extending its debt maturities during 2010, attracting a wide range of investors to support its long-term investment plans at Heathrow through a number of major new debt financings. Together, the Group and BAA (SH) raised approximately £2.0 billion of new financing, repaying the majority of their short-term maturities, including BAA (SH)'s previous £1.57 billion debt facility, and enhancing the Group's overall capital structure.

Major financings in 2010 included a £625 million four-year Class B loan facility, an inaugural £400 million eight-year Class B bond issue and a €500 million six-year Class A bond issue. Bond issuance proceeds were used, together with retained excess cash flow, to repay the refinancing facility to below £1.3 billion, as a result of which the previous block on dividend payments by the Group has been removed. The Group's capital structure was also enhanced by the completion in January 2010 of the final £217.4 million tranche of a £500 million equity injection announced in November 2009.

The Group took advantage of its significant recent deleveraging and increased debt headroom to upstream the proceeds of the Class B loan facility, together with drawings of £375 million under the Group's revolving capital expenditure facility, to BAA (SH). BAA (SH) used the funds, together with £100 million injected from BAA's sale of its interest in the APP joint venture, to repay £1,100 million of its previous debt facility. Repayment of BAA (SH)'s previous debt facility was completed with a £175 million loan facility and £325 million bond issue.

The Group has no significant debt maturities in 2011. It expects, however, to continue to raise finance from the capital markets to fund its ongoing investment programme and meet its next major debt maturities in 2012. The Group also expects to increase the undrawn balance (£1.4 billion at 31 December 2010) under its £2.7 billion revolving capital expenditure facility. As in 2010, the Group expects to be active across a variety of markets, including not only Euro and Sterling but also US dollars.

Regulatory Asset Base ('RAB')
Set out below are RAB figures for Heathrow and Stansted at 31 December 2009 and 31 December 2010. RAB figures are utilised in calculating gearing ratios under the Group's financing agreements.

	Heathrow £m	Stansted £m	Total £m
31 December 2009	10,452.9	1,277.6	11,730.5
31 December 2010	11,448.7	1,327.3	12,776.0

The increase in the total RAB during 2010 reflected the addition of approximately £835 million in capital expenditure partially offset by regulatory depreciation of around £515 million. Variation in RAB profiling adjustments added a further £155 million to the closing RAB whilst inflation resulted in a net positive indexation adjustment of approximately £570 million over the period.

Net interest payable and net interest paid
In the year ended 31 December 2010, the Group's net interest payable was £696.4 million (2009: £682.9 million) excluding fair value losses on financial instruments. Underlying net interest payable was £654.6 million (2009: £622.5 million), excluding £22.7 million (2009: £23.9 million) in capitalised interest and £64.5 million (2009: £84.3 million) in non-cash amortisation of financing fees and bond fair value adjustments. The increased underlying interest payable in 2010 largely reflects the net £123.1 million adverse movement in accretion under index-linked derivatives between 2009 and 2010 resulting from the shift from negative inflation in 2009 to positive inflation in 2010.

Within interest payable is also recorded a non-cash net fair value loss on financial instruments of £35.8 million (2009: £117.4 million).

Net interest paid in the year ended 31 December 2010 was £393.8 million (2009: £512.9 million). This consisted of £326.2 million (2009: £383.3 million) paid in relation to external debt and £67.6 million (2009: £129.6 million) under the debenture between BAA (SP) and BAA (SH). The reduction in net interest paid on external debt between 2009 and 2010 primarily reflects higher average net debt prior to the sale of Gatwick near the end of 2009 and reduced payments on derivatives following interest prepayments and conversion of some swaps onto a forward starting basis. The higher interest paid on the debenture in 2009 primarily reflects interest paid in January 2009 in respect of a longer than usual interest period that had started in August 2008 when interest rates were significantly higher than they have been since.

Net interest paid is lower than net interest payable primarily due to an amortisation charge of £140.6 million (2009: £139.6 million) in net interest payable relating to prepayments of derivative interest implemented principally in earlier periods and a £118.6 million non-cash charge (2009: £15.8 million credit) mainly relating to accretion on index-linked instruments. In addition, there is the non-cash amortisation of financing fees and bond fair value adjustments offset by capitalised interest.

Financial ratios
The Group continues to operate comfortably within required financial ratios.

At 31 December 2010, the Group's senior and junior gearing ratios (nominal net debt to RAB) were 68.8% and 77.7% respectively compared with trigger levels of 70.0% and 85.0% under its financing agreements.

In the year ended 31 December 2010, the Group's senior and junior interest cover ratios (the ratio of cashflow from operations less tax paid less 2% of RAB to interest paid) were 2.08x and 1.85x compared with trigger levels of 1.40x and 1.20x under its financing agreements.

Accounting and reporting policies and procedures
These consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain tangible fixed assets and financial instruments in accordance with the Companies Act 2006 and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice ('UK GAAP')). The Group's accounting policies and areas of significant accounting judgements and estimates are detailed within the Group financial statements. The Company accounts are stated under UK GAAP.

BAA (SP) Limited

Internal controls and risk management

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

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

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

- a group-wide comprehensive system of financial reporting and financial planning and analysis;
- documented procedures and policies;
- defined and documented levels of delegated financial authority;
- an organisational structure with clearly defined and delegated authority thresholds and segregation of duties;
- a formal risk management process that includes the identification of financial risks;
- detailed reviews by the Executive Committee and the Board of monthly management accounts measuring actual performance against budgets and previous forecasts on key metrics;
- Board review of press releases;
- board review of interim and annual reporting;
- independent review of controls by the Business Assurance function, reporting directly to the AAC; and
- a confidential whistleblowing process.

Before submission to the Board, the AAC reviews any related press releases scrutinising amongst other items:

- compliance with accounting, legal, regulatory and lending requirements;
- critical accounting policies and the going concern assumption; and
- significant areas of judgement.

In addition, the AAC:

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

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

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

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

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

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

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

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

Internal controls and risk management *continued*

Risk management *continued*
Security risks
Security risks are regarded as important risks to manage throughout the BAA Group. The BAA Group mitigates this risk by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading-edge security technology. The BAA Group works closely with government agencies, including the police and the UK Border Agency, to match security measures to a level commensurate with the current raised threat environment.

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

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

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

Competition rules
The penalties for failing to comply with the 1998 Competition Act and relevant EU law are recognised as risks to manage within the Group, given its position in certain markets. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, has reduced the likelihood of the Group breaching these regulations. Refer to the Management review section for details on the current Department for Transport regulatory review and the Competition Commission's inquiry into the supply of UK airport services by BAA.

Capacity shortfall
Failure to secure necessary planning permissions could lead to the Group having insufficient capacity to meet the demands of the industry resulting in increased congestion and declining passenger service. The UK government's policy on airport capacity changes has a significant influence on the Group's ability to secure necessary planning permissions and develop capacity. The Group mitigates this risk through extensive consultation with community groups and authorities at a local level and active participation in government consultations and other advisory groups. In addition, investment in additional capacity at the Group's airports will be partly dependent on an appropriate level of investment incentives being provided in future regulatory settlements.

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

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

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

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

Changes in demand
The risk of unanticipated long-term changes in passenger demand for air travel could lead to misaligned operational capacity within the BAA Group. Since it is not possible to identify the timing or period of such an effect, the BAA Group carries out evaluations through a series of scenario planning exercises.

Industrial relations
The risk of industrial action by key staff that affects critical services, curtails operations and has an adverse financial and reputational impact on the BAA Group is recognised. The BAA Group has a range of formal national and local consultative bodies to discuss pay, employment conditions and business issues with the Trade Unions. The 2011 pay negotiations started in late January 2011. The BAA Group could also be exposed to the effect of industrial action involving other key stakeholders in the aviation sector such as airlines, air traffic controllers and baggage handlers.

BAA (SP) Limited

Internal controls and risk management *continued*

Commercial and financial risks continued
Treasury
The Board approves prudent treasury policies and delegates certain responsibilities to senior management who directly control day-to-day treasury operations on a centralised basis.

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

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

(a) Interest rates
The Group maintains a mix of fixed and floating rate debt. As at 31 December 2010, fixed rate debt after hedging with derivatives represented 79% of the Group's total external nominal debt.

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

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

(c) Funding and liquidity
The Group has established an investment grade financing platform for its airports. This platform supports bank term debt, bank revolving credit facilities including a revolving capital expenditure facility, bank liquidity facilities and sterling and foreign currency capital markets issuance. All debt is secured and can be issued in either senior (A-/A-) or junior (BBB/BBB) format. Covenants are standardised wherever possible and are monitored on an ongoing basis with formal testing reported to the Board and Executive Committee.

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

The Group has positive cash flows before capital expenditure and maintains at least 12 months' headroom under the revolving capital expenditure facility. As at 31 December 2010, cash and current asset investments were £47.1 million, undrawn headroom under bank credit facilities was £1,450.0 million and undrawn headroom under bank liquidity facilities was £524.5 million.

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

The Group maintains a prudent split of cash and current asset investments 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 current asset investments are placed with counterparties with credit ratings lower than A-2/F1. The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with long-term credit ratings below BBB+/A.

On behalf of the Board

José Leo
Director

22 February 2011

BAA (SP) Limited

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2010.

Principal activities
The principal activity of BAA (SP) Limited is as the holding company of BAA (AH) Limited, owner of the designated airports (Heathrow and Stansted airports) and BAA 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 reported in the Business review on pages 2 to 14.

Results and dividends
The loss after taxation for the financial year amounted to £321.8 million (2009: £684.0 million). No dividends were paid during the year (2009: £nil). The statutory results for the year are set out on page 19.

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

José Leo
Frederick Maroudas

Company secretary
Pursuant to Section 270 of the Companies Act 2006, a private company registered within England or Wales is not required to have a Company Secretary. The Company has availed itself of this exemption and consequently on 31 August 2010 Shu Mei Ooi resigned.

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

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

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

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

Employee involvement and consultation is managed in a number of ways including employee surveys, team updates, briefings, roadshows and an intranet. The Group also operates frameworks for consultation and is committed to managing people through change fairly.

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

Supplier payment policies
The Group complies with the UK government's better payment practice code which states that responsible companies should:
- agree payment terms at the outset of a transaction and adhere to them;
- provide suppliers with clear guidance on payment procedures;
- pay bills in accordance with any contract agreed or as required by law; and
- advise suppliers without delay when invoices are contested and settle disputes quickly.

The Group had 14 days purchases outstanding at 31 December 2010 (2009: 6 days) based on the average daily amount invoiced by suppliers during the year.

Donations
The Group's charitable donations for the year amounted to £0.2 million (2009: £0.3 million). The main beneficiaries of charitable donations, the relevant amounts donated and the main activities of these beneficiaries are as follows:

Charity: Heathrow Travelcare	£150,000	Provides counselling and assistance to passengers and airport staff.
Charity: The Thames Valley Groundwork Trust Limited	£28,000	Promotes social, economic and environmental improvements.

The Group incurs expenditure which may be classified as political donations under the Political Parties, Elections and Referendums Act 2000. At the 2006 Annual General Meeting, BAA obtained a renewed shareholders' approval under this Act to commit up to a maximum of £60,000 of such expenditure (in aggregate) over the following four years. In the Group's view there was no expenditure in the year ended 31 December 2010 (2009: £nil) that falls within this category.

Internal controls and risk management
The Group actively manages all identified corporate risks and has in place a system of internal controls designed to mitigate these risks. Details of the Group's internal controls and risk management policies can be found on pages 12 to 14 in the Internal controls and risk management section of the Business review.

Directors' report *continued*

Financial risk management objectives and policies
The Group's financial risk management objectives and policies, including hedging policies along with the Group's exposure to risk can be found on pages 13 and 14 in the Internal controls and risk management section of the Business review.

Post balance sheet events
On 17 February 2011, BAA was refused permission to appeal to the Supreme Court ('SC') in what would have been the latest stage of a legal process underway since the Competition Commission ('CC') published in March 2009 its decision relating to its investigation into the supply of UK airport services by BAA. The key structural remedy in the CC's decision called for the disposal of certain airports including Stansted and either Edinburgh or Glasgow. The consequences of the SC's decision for airport disposals are unclear as the CC has stated that it does not expect to publish until March 2011 its provisional decision from its recent consultation as to whether there have been material changes in circumstances since its original decision in March 2009 that might lead it to amend the scope of the remedies requiring BAA to dispose of certain airports. In addition, BAA continues to consider its options in terms of next steps in this process.

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

Auditors
Pursuant to the provision of section 485(4) of the Companies Act 2006, an ordinary resolution was made by the directors to appoint Deloitte LLP as Auditors of the Company for the year ended 31 December 2010.

Statement of disclosure of information to the Auditors
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 auditors are unaware; and
- the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are 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.

On behalf of the Board

José Leo
Director

22 February 2011

Company registration number: 06458621

BAA (SP) Limited

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 and parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group and Company for that period.

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

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

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

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

On behalf of the Board

José Leo
Director

22 February 2011

BAA (SP) Limited

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

We have audited the Group financial statements of BAA (SP) Limited for the year ended 31 December 2010 which comprise the Consolidated profit and loss account, Consolidated statement of total recognised gains and losses, Consolidated note of historical cost profits and losses, Consolidated reconciliation of movements in shareholder's funds, Consolidated balance sheet, Consolidated cash flow statement, the Accounting policies, the Significant accounting judgements and estimates and the related notes 1 to 29. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements
In our opinion the Group financial statements:
- give a true and fair view of the state of the Group's affairs as at 31 December 2010 and of the its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:
- adequate accounting records have not been kept, or the returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter
We have reported separately on the parent company financial statements of BAA (SP) Limited for the year ended 31 December 2010.

Andrew J. Kelly

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

22 February 2011

BAA (SP) Limited

Consolidated profit and loss account for the year ended 31 December 2010

	Note	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 £m
Turnover – continuing operations	*1*	**2,074.3**	1,977.6
Turnover – discontinued operations	*1*	**-**	440.3
Total turnover		**2,074.3**	2,417.9
Operating costs – ordinary	*2*	**(1,584.1)**	(1,891.5)
Operating gain/(costs) – exceptional: pensions	*3*	**89.9**	(217.8)
Operating costs – exceptional: other	*3*	**(31.4)**	(52.9)
Total operating costs		**(1,525.6)**	(2,162.2)
Operating profit – continuing operations	*1*	**548.7**	160.6
Operating profit – discontinued operations	*1*	**-**	95.1
Total operating profit		**548.7**	255.7
Impairment of fixed assets – exceptional	*3*	**(149.3)**	-
Gain/(loss) on disposal of Gatwick airport – discontinued operations	*3*	**16.2**	(277.3)
Interest receivable	*4*	**162.2**	154.7
Interest payable and similar charges	*4*	**(858.6)**	(837.6)
Fair value loss on financial instruments	*4*	**(35.8)**	(117.4)
Net interest payable and similar charges		**(732.2)**	(800.3)
Loss on ordinary activities before taxation		**(316.6)**	(821.9)
Tax (charge)/credit on loss on ordinary activities	*5*	**(5.2)**	137.9
Loss on ordinary activities after taxation	*23*	**(321.8)**	(684.0)

BAA (SP) Limited

Consolidated statement of total recognised gains and losses for the year ended 31 December 2010

	Note	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 £m
Loss for the financial year	*23*	**(321.8)**	(684.0)
Unrealised gain/(loss) on revaluation of investment properties	*20*	**28.5**	(130.3)
Realised loss on revaluation of tangible fixed assets		**-**	(0.6)
(Losses)/gains on cash flow hedges taken directly to equity	*22*	**(99.3)**	305.1
Deferred tax credit/(charge) arising on cash flow hedges taken directly to equity	*22*	**25.1**	(85.5)
Realisation of profit and loss reserve – tangible fixed assets		**-**	0.6
		(45.7)	89.3
Total recognised losses for the year		**(367.5)**	(594.7)

Consolidated note of historical cost profits and losses for the year ended 31 December 2010

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Reported loss on ordinary activities before taxation	**(316.6)**	(821.9)
Adjusted for:		
Realisation of revaluation reserve – Gatwick disposal	**-**	461.7
Historical cost loss on ordinary activities before taxation	**(316.6)**	(360.2)
Historical cost loss on ordinary activities after taxation	**(321.8)**	(222.3)

The effects of fair value accounting for derivative financial instruments have been excluded from the reconciliation of the reported loss on ordinary activities before taxation to the equivalent historical cost amount.

Consolidated reconciliation of movements in shareholder’s funds for the year ended 31 December 2010

	Note	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 £m
Loss for the financial year	*23*	**(321.8)**	(684.0)
Other recognised gains and losses relating to the year (net)		**(45.7)**	89.3
Proceeds of ordinary shares issued for cash	*18*	**0.4**	0.6
Premium on ordinary shares issued	*19*	**217.0**	282.0
Capital distribution	*23*	**(16.1)**	-
Tax on capital contribution	*23*	**(23.9)**	-
Net movement in shareholder’s funds		**(190.1)**	(312.1)
Opening shareholder’s funds		**826.0**	1,138.1
Closing shareholder’s funds		**635.9**	826.0

BAA (SP) Limited

Consolidated balance sheet as at 31 December 2010

	Note	31 December 2010 £m	31 December 2009 £m
Fixed assets			
Tangible fixed assets	*6*	**11,678.2**	11,473.8
Financial assets – derivative financial instruments	*15*	**551.7**	683.0
Total fixed assets		**12,229.9**	12,156.8
Current assets			
Stocks	*7*	**5.5**	4.9
Debtors	*8*	**357.7**	303.2
Financial assets – derivative financial instruments	*15*	**0.1**	0.3
Current asset investments	*9*	**41.0**	234.5
Restricted cash	*10*	**-**	143.0
Cash at bank and in hand	*11*	**6.1**	4.0
Total current assets		**410.4**	689.9
Current liabilities			
Creditors: amounts falling due within one year	*12*	**(586.2)**	(558.6)
Net current (liabilities)/assets		**(175.8)**	131.3
Total assets less current liabilities		**12,054.1**	12,288.1
Creditors: amounts falling due after more than one year	*13*	**(11,060.1)**	(10,830.9)
Deferred tax	*16*	**(271.1)**	(291.4)
Provisions for liabilities and charges	*17*	**(87.0)**	(339.8)
Net assets		**635.9**	826.0
Capital and reserves			
Called up share capital	*18*	**11.0**	10.6
Share premium reserve	*19*	**499.0**	282.0
Revaluation reserve	*20*	**1,470.9**	1,442.4
Merger reserve	*21*	**(4,535.6)**	(4,535.6)
Fair value reserve	*22*	**(174.7)**	(100.5)
Profit and loss reserve	*23*	**3,365.3**	3,727.1
Total shareholder's funds		**635.9**	826.0

These financial statements of BAA (SP) Limited (Company registration number: 06458621) were approved by the Board of Directors and authorised for issue on 22 February 2011. They were signed on its behalf by:

José Leo
Director

Frederick Maroudas
Director

BAA (SP) Limited

Consolidated cash flow statement for the year ended 31 December 2010

	Note	Year ended 31 December 2010 £m	Restated[1] Year ended 31 December 2009 £m
Net cash inflow from operating activities	*26*	**918.5**	991.7
Return on investment and servicing of finance			
Interest received		**0.8**	0.3
Interest paid		**(394.6)**	(513.2)
Net cash outflow from returns on investments and servicing of finance		**(393.8)**	(512.9)
Taxation – Group relief (paid)/received		**(17.1)**	24.0
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(841.1)**	(1,003.0)
Sale of tangible fixed assets		**-**	0.2
Net cash outflow for capital expenditure and financial investment		**(841.1)**	(1,002.8)
Acquisition and disposals			
Disposal of subsidiary – proceeds		**1.4**	1,418.6
Cash at bank and in hand transferred on disposal of subsidiary		**-**	(39.0)
Disposal of subsidiary – pension and disposal costs	*3*	**(126.7)**	(19.1)
Net cash (outflow)/inflow from acquisitions and disposals		**(125.3)**	1,360.5
Net cash (outflow)/inflow before use of liquid resources and financing		**(458.8)**	860.5
Management of liquid resources			
Decrease/(increase) in short-term deposits	*9*	**193.5**	(77.4)
Net cash inflow/(outflow) from management of liquid resources		**193.5**	(77.4)
Financing			
Issuance of bonds	*14*	**830.1**	925.2
Drawdown of Class B facility	*14*	**625.0**	-
Drawdown of capital expenditure facility	*14*	**600.0**	450.0
Repayment of facilities and other items	*14*	**(1,037.5)**	(2,161.4)
Repayment of amount owed to parent company	*14*	**(1,000.0)**	-
Prepayment of derivative interest		**(36.7)**	(114.2)
Cancellation of derivatives		**(73.9)**	(43.3)
Restricted cash	*10*	**143.0**	(143.0)
Issuance of ordinary share capital	*18,19*	**217.4**	282.6
Net cash inflow/(outflow) from financing		**267.4**	(804.1)
Increase/(decrease) in cash	*11*	**2.1**	(21.0)

Reconciliation to net debt

Net debt at 1 January	*26*	**(10,291.5)**	(11,225.5)
Increase/(decrease) in cash	*11*	**2.1**	(21.0)
Movement in liquid resources	*9*	**(193.5)**	77.4
Movement in borrowings	*14*	**(1,017.6)**	786.2
Movement in inter-company borrowings	*14*	**1,000.0**	-
Other non-cash changes	*26*	**(64.5)**	(84.2)
Fair value adjustments	*26*	**88.7**	175.6
Net debt at 31 December	*26*	**(10,476.3)**	(10,291.5)

[1] The presentation of certain balances for the year ended 31 December 2009 has been restated to be consistent with current year disclosures.

Accounting policies for the year ended 31 December 2010

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

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

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

As a result of the review, having made appropriate enquiries of management, the directors have a reasonable expectation that sufficient funds will be available to meet the Group's funding requirement for the next twelve months from the balance sheet signing date.

Basis of consolidation
The Group financial statements consolidate the financial statements of BAA (SP) Limited and all its subsidiaries.

The BAA (SP) Limited Group was formed in 2008 as part of the wider BAA group refinancing and group reconstruction. In 2008 the Company acquired BAA (AH) Limited, which owns the Designated Airports comprising the UK regulated airports of Heathrow and Stansted. The Group also operates the Heathrow Express rail service between Heathrow and Paddington, London. BAA (SP) Limited is the holding company of BAA Funding Limited, which is the bond issuer for the Security Group.

The group reconstruction was accounted for using the merger method of accounting whereby the principals applied were as follows:
- the acquired entities' results are included in the Group's consolidated financial statements as if the entities had always been combined and comparative amounts prepared accordingly;
- the Group does not restate assets and liabilities to their fair values. Instead, the Group incorporates the assets and liabilities at the amounts recorded in the books of the acquired company adjusted only to achieve harmonisation of accounting policies; and
- no goodwill arises in merger accounting, the differences arising on consolidation are included in a merger reserve.

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

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

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

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

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

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

Exceptional items
The Group presents, on the face of the profit and loss account, disclosure of exceptional items. Exceptional items are material items of income and expense that, because of the unusual nature and expected infrequency of the events giving rise to them, merit separate presentation to allow an understanding of the Group's financial performance.

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

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

Provisions to recognise the Group's liability to fund the BAA Airports Limited defined benefit pension scheme deficit under the Shared Services Agreement are also treated as an exceptional item. Refer to the Shared Services Agreement accounting policies.

Interest income
Interest 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. Interest 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.

Discontinued operations
Discontinued operations consist of business segments and other non-core assets that have either been sold during the year or are expected to be sold before the earlier of three months after the balance sheet date and the date on which the financial statements are signed.

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

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

Investment properties
Investment property, which is property held to earn rentals and/or capital appreciation, is valued at the balance sheet date, as determined at the interim and full-year reporting dates by the directors and by external valuers every year. Any surplus or deficit on revaluation is transferred to the revaluation reserve with the exception of deficits below original cost which are expected to be permanent, which are charged to the profit and loss account in the period in which they arise.

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

In accordance with Statement of Standard Accounting Practice (SSAP) 19, 'Accounting for Investment Properties', no depreciation is provided in respect of freehold or long leasehold investment properties. This is a departure from the Companies Act 2006 which requires all properties to be depreciated. Such properties are not held for consumption but for investment and the directors consider that to depreciate them would not give a true and fair view. Depreciation is only one amongst many factors reflected in the annual valuation of properties and accordingly the amount of depreciation which might otherwise have been charged cannot be separately identified or quantified. The directors consider that this policy results in the accounts giving a true and fair view.

Capitalisation of interest
Interest payable resulting from financing tangible fixed assets whilst in the course of construction is capitalised once planning permission has been obtained and a firm decision to proceed has been taken. Capitalisation of interest ceases once the asset is complete and ready for use. Interest may be capitalised in the early stages of planning where the directors are satisfied that the necessary planning, building and resource consents will be received. Interest is then charged to the profit and loss account as a depreciation expense over the life of the relevant asset.

All other interest payable is recognised in the profit and loss account in the period in which it is 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:

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

Tangible fixed assets *continued*

Depreciation continued

Plant and equipment	*Fixed asset lives*
Motor vehicles	4–8 years
Office equipment	5–10 years
Computer equipment	4–5 years
Computer software	3–7 years
Other land and buildings	
Short leasehold properties	Over period of lease

Asset residual values and useful lives are reviewed and adjusted, if appropriate, at each reporting date.

Impairment of assets

The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. Where the asset does not generate cash flows independent of other assets, the recoverable amount of the income-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's net realisable value and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. Impairment losses of continuing operations are recognised in the profit and loss account in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount less any residual value, on a straight-line basis over its remaining useful life.

Leases

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

Group as a lessee

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

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

Operating lease payments are recognised as an expense in the profit and loss account on a straight-line basis over the lease term.

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

Group as a lessor

Leases where the Group retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating an operating lease are added to the carrying value of the leased asset and recognised over the lease term on the same basis as the rental income.

Stocks

Raw materials and consumables consist of engineering spares and other consumable stores and are valued at the lower of cost and net realisable value.

Debtors

Debtors are recognised initially at cost less any provision for diminution in value and subsequently measured at amortised cost, using the effective interest method, less any provision for impairment.

Restricted cash

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

Cash and current asset investments

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market. Liquid resources comprise of term deposits less than one year (other than cash) and investments in money market managed funds.

Trade creditors
Trade creditors are non-interest bearing and are stated at cost less any provision for diminution in value and subsequently measured at amortised cost, using the effective interest method.

Deferred income
Contractual income is treated as deferred income and released to the profit and loss account as earned.

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 profit and loss account 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 profit and loss account.

Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the reporting date and are discounted to present value where the effect is material.

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

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

Classification of financial instruments issued by the Group
Following the adoption of FRS 25 'Financial Instruments: Disclosure and Presentation', financial instruments issued by the Group are treated as equity (i.e. forming part of shareholder's funds) only to the extent that they meet the following two conditions:
(a) they include no contractual obligations upon the Company (or Group as the case may be) to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company (or Group); and
(b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

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

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

The Group is exempt from reporting information under FRS 29 'Financial Instruments: Disclosures' as its immediate parent, BAA (SH) plc (formerly BAA (SH) Limited), prepared group accounts in accordance with IFRS 7 'Financial Instruments: Disclosures'.

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

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

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

Derivative financial instruments and hedging activities
Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

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

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

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

Fair value hedge
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the profit and loss account, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

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

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

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

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the profit and loss account. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the profit and loss account.

Derivatives at fair value through the profit and loss account
Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of these derivative instruments are recognised immediately in the profit and loss account.

When derivatives are designated in a fair value hedge or a cash flow hedge of interest rate risk, the net interest payable or receivable on those derivatives is recorded net of the interest on the underlying hedged item in the profit and loss account. When derivatives are not in a hedge relationship, the fair value changes on these derivatives are recognised within net interest payable and other similar charges in the profit and loss account. The interest payable and receivable on those derivatives are recorded at their gross amount in interest payable and interest receivable in the profit and loss account.

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

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

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

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

Pension costs
Under the SSA the current period service cost for the BAA Airports Limited pension schemes are recharged to the Group's airports and HEX on the basis of their pensionable pay base. This charge is included within ordinary staff pension costs.

Cash contributions are made directly by the Group's airports and HEX to the pension trustee of the BAA Airports Limited defined benefit pension scheme on behalf of BAA Airports Limited and the related receivable from BAA Airports Limited, net of the current service cost charges to date, is recorded within Debtors – Amounts owed by group undertakings – pensions.

In addition, each airport and HEX also have a legal obligation since August 2008 to fund their share of the BAA Airports Limited pension deficit and Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits ('UURBS') (pension related liabilities) under the SSA. These provisions are based on the Group's share of the actuarial deficit. The share of the deficit has been allocated on the basis of pensionable salaries and recorded as an exceptional item due to its unusual nature. These provisions are recorded as Provisions for liabilities and charges – Pensions, and will only be settled when the cash outflows are requested by BAA Airports Limited.

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

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

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

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

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

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

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

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

Related party disclosures
The ultimate parent entity in the UK is FGP Topco Limited, a company registered in England and Wales. The results of the Group are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2010. The results are also included in the audited consolidated financial statements of BAA (SH) plc for the year ended 31 December 2010 (immediate parent entity). They are also included in the audited consolidated financial statements of BAA Limited for the year ended 31 December 2010.

The Company is exempt under the terms of FRS 8 'Related Party Disclosures' from disclosing related party transactions with entities that are related to, or part of the FGP Topco Limited Group. However, transactions and balances in relation to the provision of services under the SSA between the Group and subsidiaries of the FGP Topco Group are disclosed in the notes to the financial statements.

BAA (SP) Limited

Significant accounting judgements and estimates for the year ended 31 December 2010

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

Investment properties

Investment properties were valued at fair value at 31 December 2010 by CB Richard Ellis, Chartered Surveyors and Strutt & Parker, Chartered Surveyors (2009: Drivers Jonas, Chartered Surveyors and Strutt & Parker, Chartered Surveyors). Strutt & Parker were responsible solely for the valuation of residential properties at Stansted. The valuations were prepared in accordance with UK GAAP and the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. Independent valuations were obtained for 100% of the investment properties. Approximately 75% of the investment properties comprise car parks and airside assets at the Group's airports that are considered less vulnerable to market volatility than the overall market. In November 2010, following a change in strategy in respect of residential properties and land acquired for the purposes of runway developments, £106.9 million of properties and land previously recorded in Assets in the Course of Construction were transferred to Investment Property. This is on the basis that residential properties are currently proposed to be held for the longer term and achieve revenue through rentals or, with respect to Stansted properties, potential future disposal where the properties lie outside the projected future airport boundary.

Taxation

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

Hedge accounting

Interest rate swaps are designated in a cash flow hedging relationship to hedge the exposure to variability in cash flows of existing liabilities and forecast transactions. This is based on management's expectation that it is highly probable that future sterling funding issuances will be used to refinance existing debt. As at 31 December 2010, £227.4 million of fair value losses (2009: £98.1 million) on these derivatives have been deferred into the cash flow hedge reserve.

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

Fair value of derivative financial instruments

The fair value of derivative financial instruments is determined by using valuation techniques. The Group uses judgement to select a variety of methods and makes assumptions that are mainly based on market conditions existing at each reporting date. The valuation technique used by the Group is a discounted cash flow methodology.

Notes to the Group financial statements for the year ended 31 December 2010

1 Segment information

The Group's primary reporting format is business segments. The operating businesses are primarily the individual airports, which are organised and managed separately. All turnover originated in the UK.

	Turnover		Operating profit		Net assets	
	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m	**Year ended 31 December 2010 £m**	Year ended 31 December 2009 £m	**31 December 2010 £m**	31 December 2009 £m
Continuing operations						
Heathrow	**1,844.7**	1,734.6	**482.0**	127.7	**1,676.4**	1,563.7
Stansted	**229.6**	243.0	**61.0**	27.4	**933.5**	1,052.2
Other entities[1]	**-**	-	**5.7**	5.5	**(1,974.0)**	(1,789.7)
Other adjustments[2]	**-**	-	**-**	-	**-**	(0.2)
	2,074.3	1,977.6	**548.7**	160.6	**635.9**	826.0
Discontinued operations						
Gatwick	**-**	440.3	**-**	95.1	**-**	-
Total	**2,074.3**	2,417.9	**548.7**	255.7	**635.9**	826.0

[1] The 'Other entities' business segment includes Heathrow Express Operating Company Limited, BAA Funding Limited, BAA (AH) Limited and the parent entity BAA (SP) Limited.
[2] 'Other adjustments' relate to the elimination of inter-company transactions and consolidation adjustments.

Reconciliation of Adjusted EBITDA and operating profit

Adjusted EBITDA has been used to provide a clearer indication of the performance of the individual airports and to assist better comparison with the prior year. Adjusted EBITDA is earnings before interest, tax, depreciation, amortisation and exceptional items.

Year ended 31 December 2010	**Adjusted EBITDA £m**	**Operating exceptional items £m**	**Depreciation[1] £m**	**Operating profit £m**
Continuing operations				
Heathrow	**875.1**	**43.3**	**(436.4)**	**482.0**
Stansted	**86.2**	**15.1**	**(40.3)**	**61.0**
Other entities and adjustments[2]	**5.6**	**0.1**	**-**	**5.7**
	966.9	**58.5**	**(476.7)**	**548.7**
Discontinued operations				
Gatwick	**-**	**-**	**-**	**-**
Total	**966.9**	**58.5**	**(476.7)**	**548.7**

Year ended 31 December 2009	Adjusted EBITDA £m	Operating exceptional items £m	Depreciation[1] £m	Operating profit £m
Continuing operations				
Heathrow	777.2	(235.4)	(414.1)	127.7
Stansted	102.4	(36.4)	(38.6)	27.4
Other entities and adjustments[2]	5.6	(0.1)	-	5.5
	885.2	(271.9)	(452.7)	160.6
Discontinued operations				
Gatwick	157.3	1.2	(63.4)	95.1
Total	1,042.5	(270.7)	(516.1)	255.7

[1] Depreciation excluding exceptional accelerated depreciation.
[2] The 'Other entities and adjustments' business segment includes Heathrow Express Operating Company Limited, BAA Funding Limited, BAA (AH) Limited and the parent entity BAA (SP) Limited.

Notes to the Group financial statements for the year ended 31 December 2010 *continued*

2 Operating costs – ordinary

	Year ended 31 December 2010			Year ended 31 December 2009		
	Continuing £m	**Discontinued £m**	**Total £m**	Continuing £m	Discontinued £m	Total £m
Wages and salaries	**253.1**	**-**	**253.1**	238.7	81.5	320.2
Social security	**20.2**	**-**	**20.2**	19.5	6.3	25.8
Pensions	**29.6**	**-**	**29.6**	18.5	4.9	23.4
Other staff related	**9.7**	**-**	**9.7**	10.5	4.5	15.0
Share based payments	**3.1**	**-**	**3.1**	3.7	-	3.7
Employment costs[1]	**315.7**	**-**	**315.7**	290.9	97.2	388.1
Maintenance expenditure	**134.8**	**-**	**134.8**	147.3	24.0	171.3
Utility costs	**115.6**	**-**	**115.6**	125.5	27.2	152.7
Rents and rates	**117.0**	**-**	**117.0**	128.9	22.1	151.0
General expenses	**133.0**	**-**	**133.0**	131.4	43.8	175.2
Retail expenditure	**30.6**	**-**	**30.6**	34.6	14.1	48.7
Intra-group charges/other	**160.1**	**-**	**160.1**	129.8	26.5	156.3
Police	**35.9**	**-**	**35.9**	38.6	12.1	50.7
Aerodrome navigation service charges	**64.4**	**-**	**64.4**	65.5	16.0	81.5
Depreciation	**476.7**	**-**	**476.7**	452.7	63.4	516.1
Loss/(gain) on disposal of tangible fixed assets	**0.3**	**-**	**0.3**	(0.1)	-	(0.1)
	1,584.1	**-**	**1,584.1**	1,545.1	346.4	1,891.5

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

Rentals under operating leases

	Year ended 31 December 2010			Year ended 31 December 2009		
	Continuing £m	**Discontinued £m**	**Total £m**	Continuing £m	Discontinued £m	Total £m
Operating costs include:						
Plant and machinery	**34.3**	**-**	**34.3**	33.4	6.1	39.5
Other operating leases	**13.5**	**-**	**13.5**	31.5	0.8	32.3

Auditors' remuneration

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

	Year ended 31 December 2010			Year ended 31 December 2009		
	Continuing £m	**Discontinued £m**	**Total £m**	Continuing £m	Discontinued £m	Total £m
Fees payable to the Company's auditors for the audit of the BAA (SP) Limited Group annual accounts[1]						
Audit of the Company's subsidiaries, pursuant to legislation	**0.4**	**-**	**0.4**	0.2	0.1	0.3
Total audit fees	**0.4**	**-**	**0.4**	0.2	0.1	0.3
Fees payable to the Company's auditors and their associates for other services specific to the BAA (SP) Limited Group[1]						
Information technology services – pre appointment[2]	**0.9**	**-**	**0.9**	-	-	-
Information technology services – post appointment[2]	**0.2**	**-**	**0.2**	0.8	-	0.8
Other services pursuant to legislation	-	**-**	**-**	0.1	-	0.1
Corporate finance services	-	**-**	**-**	0.6	-	0.6
Other services	-	**-**	**-**	0.1	-	0.1
Total non-audit fees	**1.1**	**-**	**1.1**	1.6	-	1.6
Total fees	**1.5**	**-**	**1.5**	1.8	-	1.9

1 Auditors' remuneration for the year ended 31 December 2010 relates to Deloitte LLP following their appointment as auditors from 1 April 2010 (2009: PricewaterhouseCoopers LLP).

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

Employee numbers

The Group has no employees other than the majority of HEX employees which in 2010 averaged 411 (2009: 365). However, the staff costs for the Group's airports are borne by BAA Airports Limited which recharges all such costs directly to the Group's airports. The average number of employees of BAA Airports Limited engaged in the Group's continuing operations during the year was 6,269 (2009: 6,520). The number of employees engaged in discontinued operations was nil (2009: 2,274).

2 Operating costs – ordinary *continued*

Directors' remuneration

José Leo was a director of a number of companies within the BAA Group, including BAA Airports Limited, during the year. His remuneration was paid by BAA Airports Limited. Frederick Maroudas was a director of a number of companies within the BAA Group. He was paid by, but is not a director of, BAA Airports Limited. The directors do not believe it is possible to accurately apportion their remuneration to individual companies within the BAA Group based on services provided.

In accordance with a long-term incentive scheme, a cash amount could be awarded to one of the two directors who held office during 2010 which would vest in 2012 contingent on achieving or surpassing EBITDA targets over a three year period. As the financial performance is uncertain at this stage no value in relation to this award is disclosed.

During the year, none of the directors (2009: none) had retirement benefits accruing to them under a defined benefit pension scheme and one of the directors (2009: one) had retirement benefits accruing to them under a defined contribution pension scheme.

No directors (2009: none) exercised any share options during the year and no shares (2009: none) were received or became receivable under long-term incentive plans.

3 Exceptional items

		Year ended 31 December 2010			Year ended 31 December 2009		
	Note	**Continuing £m**	**Discontinued £m**	**Total £m**	Continuing £m	Discontinued £m	Total £m
Operating costs – exceptional: pensions							
Pension credit/(charge)		**89.9**	**-**	**89.9**	(217.8)	-	(217.8)
Operating costs – exceptional: other							
Accelerated depreciation		**(18.7)**	**-**	**(18.7)**	(54.6)	-	(54.6)
Reorganisation (costs)/credit		**(12.7)**	**-**	**(12.7)**	0.5	1.2	1.7
Total operating exceptional items		**58.5**	**-**	**58.5**	(271.9)	1.2	(270.7)
Exceptional impairment of fixed assets	*6*	**(149.3)**	**-**	**(149.3)**	-	-	-
Gain/(loss) on disposal of Gatwick airport – discontinued operations		**-**	**16.2**	**16.2**	-	(277.3)	(277.3)
Total non-operating exceptional items		**(149.3)**	**16.2**	**(133.1)**		(277.3)	(277.3)
Taxation on exceptional items		**-**	**-**	**-**	-	-	-
Total exceptional items		**(90.8)**	**16.2**	**(74.6)**	(271.9)	(276.1)	(548.0)

During 2010 there was a net exceptional pension credit of £89.9 million (2009: £217.8 million charge). This included a £90.9 million credit (2009: £216.1 million charge) in relation to the push down of the Group's share of the reduction in the deficit on the BAA Airports Limited defined benefit pension scheme and £1.0 million (2009: £1.7 million) charge in relation to UURBS. For more information on pension costs charged in accordance with the SSA refer to the Accounting policies.

The £18.7 million (2009: £54.6 million) accelerated depreciation charge was due to the shortened lives of certain existing assets at Heathrow given the new Heathrow Terminal 2 development. The accelerated depreciation charge has reduced from the prior year due to the full write-off of the old Terminal 2 by its closure in late 2009 and the charge relating to Terminal 1 no longer being treated as exceptional since the first quarter of 2010 as its remaining useful life was reassessed and extended.

The reorganisation costs of £12.7 million in 2010 related primarily to a restructuring process to reduce the size and cost of overhead functions following the sale of Gatwick airport in 2009. The £1.7 million credit in 2009 was due to the release of provisions that were no longer required.

The £16.2 million gain on disposal in 2010 reflects the shortfall between assets and liabilities transferred to the pension scheme of Gatwick's purchaser being lower than expected, and the receipt of a further £1.4 million on the finalisation of Gatwick's balance sheet at completion of the disposal. In 2009 the loss on disposal of £277.3 million included an impairment charge of £225.0 million that was recognised prior to disposal because the carrying value of Gatwick airport's assets was greater than its expected recoverable amount less disposal costs at the time.

Notes to the Group financial statements for the year ended 31 December 2010 *continued*

4 Net interest payable and similar charges

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Interest receivable		
Interest receivable on derivatives not in hedge relationship	**160.3**	154.2
Interest receivable from other group undertakings	**1.1**	0.3
Interest on bank deposits	**0.8**	0.2
	162.2	154.7
Interest payable and similar charges		
Interest on borrowings:		
Bonds and related hedging instruments[1]	**(387.2)**	(332.5)
Bank loans and overdrafts and related hedging instruments	**(193.5)**	(313.3)
Interest payable on derivatives not in hedge relationship[1]	**(214.1)**	(98.5)
Facility fees	**(26.8)**	(26.8)
Interest on BAA (SP) Limited debenture	**(59.7)**	(86.8)
Interest payable to other group undertakings	**-**	(0.3)
Unwinding of discount on provisions	**-**	(3.3)
	(881.3)	(861.5)
Less capitalised interest[2]	**22.7**	23.9
	(858.6)	(837.6)
Net interest payable before fair value loss	**(696.4)**	(682.9)
Fair value loss on financial instruments		
Interest rate swaps: cash flow hedge[3]	**(6.3)**	21.1
Interest rate swaps: not in hedge relationship	**-**	1.9
Index-linked swaps: not in hedge relationship	**(35.5)**	(125.8)
Cross-currency swaps: cash flow hedge[3]	**6.0**	(12.0)
Cross-currency swaps: fair value hedge[3]	**0.7**	-
Fair value re-measurements of foreign exchange contracts and currency balances	**(0.7)**	(2.6)
	(35.8)	(117.4)
Net interest payable and similar charges	**(732.2)**	(800.3)

[1] Includes total accretion of £118.6 million loss (2009: £15.8 million gain), of which £11.8 million loss (2009: £0.4 million) arises from index-linked bonds and £106.8 million loss (2009: £16.2 million gain) from index-linked swaps.
[2] 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 2.22% (2009: 2.87%) to expenditure incurred on such assets.
[3] Hedge ineffectiveness on derivatives in hedge relationship.

5 Tax on loss on ordinary activities

	Note	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Current tax			
Current tax charge at 28% (2009: 28%)		**(21.2)**	(9.2)
Adjustments in respect to prior years		**(3.1)**	1.1
Total current tax		**(24.3)**	(8.1)
Deferred tax			
Origination and reversal of timing differences		**48.7**	149.8
Adjustments in respect to prior years		**(41.8)**	(3.8)
Change in UK Corporation tax rate - impact on deferred tax liabilities		**12.2**	-
Total deferred tax	*16*	**19.1**	146.0
Tax (charge)/credit on loss on ordinary activities		**(5.2)**	137.9

5 Tax on loss on ordinary activities *continued*

Reconciliation of tax charge

The standard rate of current tax for the year, based on the UK standard rate of corporation tax, is 28% (2009: 28%). The actual tax charge for the current period and prior period differs from the standard rate for the reasons set out in the following reconciliation:

	Year ended 31 December 2010 £m	Year ended 31 December 2009 £m
Loss on ordinary activities before tax	**(316.6)**	(821.9)
Tax calculated at the UK statutory rate of 28% (2009: 28%)	**88.6**	230.1
Effect of:		
Permanent differences	**(17.8)**	(12.4)
Non taxable income	**0.3**	0.5
Depreciation for the year in excess of capital allowances	**(91.2)**	(88.6)
Capitalised interest	**6.4**	6.1
Gain/(loss) on Gatwick disposal	**-**	(77.6)
Impairment costs	**(41.8)**	-
Other short-term timing differences	**34.3**	(67.3)
Adjustments in respect of current tax of previous periods	**(3.1)**	1.1
Current tax charge for the year	**(24.3)**	(8.1)

The standard rate of corporation tax in the UK will change to 27% with effect from 1 April 2011. Other than this change, and the unprovided deferred tax discussed in Note 16, there are no items which would materially affect the future tax charge.

6 Tangible fixed assets

	Note	Investment properties £m	Land held for development £m	Terminal complexes £m	Airfields £m	Rail assets £m	Other land and buildings £m	Plant, equipment and other assets £m	Assets in the course of construction £m	Total £m
Cost or valuation										
1 January 2010		1,995.7	88.7	7,770.5	1,132.6	1,361.5	101.7	555.9	1,336.0	**14,342.6**
Additions		-	-	2.9	0.4	-	-	6.5	787.3	**797.1**
Transfers to completed assets		106.9	-	157.4	108.9	6.5	0.9	40.8	(421.4)	**-**
Interest capitalised		-	-	-	-	-	-	-	22.7	**22.7**
Disposals[1]		-	-	(17.0)	(0.6)	-	(0.8)	(15.8)	(149.3)	**(183.5)**
Reclassifications		(9.2)	4.9	5.8	(7.1)	-	4.9	0.7	-	**-**
Inter-company transfers		-	-	-	-	-	-	1.1	-	**1.1**
Revaluation	*20*	36.0	(5.5)	-	-	-	-	-	-	**30.5**
Revaluation adjustment	*20*	-	-	-	-	-	(2.0)	-	-	**(2.0)**
31 December 2010		**2,129.4**	**88.1**	**7,919.6**	**1,234.2**	**1,368.0**	**104.7**	**589.2**	**1,575.3**	**15,008.5**
Depreciation										
1 January 2010		-	-	(2,001.0)	(248.7)	(251.2)	(25.7)	(342.2)	-	**(2,868.8)**
Charge		-	-	(344.4)	(39.1)	(40.2)	(5.8)	(65.9)	-	**(495.4)**
Impairment		-	-	-	-	-	-	-	(149.3)	**(149.3)**
Disposals[1]		-	-	17.0	0.6	-	0.8	15.5	149.3	**183.2**
Reclassifications		-	-	(3.2)	3.9	-	-	(0.7)	-	**-**
31 December 2010		**-**	**-**	**(2,331.6)**	**(283.3)**	**(291.4)**	**(30.7)**	**(393.3)**	**-**	**(3,330.3)**
Net book value 31 December 2010		**2,129.4**	**88.1**	**5,588.0**	**950.9**	**1,076.6**	**74.0**	**195.9**	**1,575.3**	**11,678.2**
Net book value 31 December 2009		1,995.7	88.7	5,769.5	883.9	1,110.3	76.0	213.7	1,336.0	**11,473.8**

[1] Disposals of assets in the course of construction removes the effect of the exceptional impairment charge for the write-off of planning application costs and write down in value of domestic properties and land at the reporting date balance. This is consistent with the transfer of the domestic properties and land, previously purchased by Heathrow and Stansted in relation to runway developments, to investment properties prior to the reporting date.

6 Tangible fixed assets *continued*

Valuation

Investment properties and land held for development were valued at open market value at 31 December 2010 by CB Richard Ellis, Chartered Surveyors at £2,130.1 million (2009: Drivers Jonas, Chartered Surveyors £2,072.6 million) and by Strutt & Parker, Chartered Surveyors at £87.4 million (2009: £11.8 million), resulting in a total valuation of £2,217.5 million (2009: £2,084.4 million). Strutt & Parker were responsible solely for the valuation of residential properties at Stansted. These valuations were prepared in accordance with the Appraisal and Valuation Manual issued by the Royal Institution of Chartered Surveyors taking account, inter alia, of planning constraints and reflecting the demand for airport related uses. As a result of the valuation, a surplus of £30.5 million (2009: deficit of £134.2 million) has been recognised in the revaluation reserve.

Remaining terminal complexes, airfields, rail assets, other land and buildings, plant, equipment and other assets have been shown at cost less accumulated depreciation.

Historical cost

The historical cost of investment properties and land held for development at 31 December 2010 was £746.6 million (2009: £641.3 million).

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value at 31 December 2010 of £19.0 million (2009: £20.6 million).

Assets in the course of construction

Assets in the course of construction primarily consist of projects at Heathrow for work on the new Terminal 2 and its satellite building, together with the substantial completion of work on Terminal 5C. In addition, the tunnel between Terminals 3 and 5 to transport baggage for transfer passengers is underway.

Capitalised interest

Included in the cost of assets after depreciation are interest costs of £943.1 million (2009: £959.4 million). £22.7 million (2009: £23.9 million) has been capitalised in the period at a capitalisation rate of 2.22% (2009: 2.87%) based on a weighted average cost of borrowings.

Capitalised interest of £22.7 million (2009: £23.9 million) has been treated as tax deductible in the period. Subsequent depreciation of the capitalised interest is disallowed for tax purposes. Consequently, the capitalised interest gives rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets.

Impairment

As a result of the change in UK government and its policy towards runway developments, BAA announced on 24 May 2010 that it was withdrawing its planning permission applications for Stansted Generation 2 and ceasing work on the development of the planning application for a third runway at Heathrow. As a result there was a total impairment charge of £149.3 million made of which £104.4 million related to the write-off of planning application costs and £44.9 million to the write down in the value of domestic properties and land purchased by both airports for development of future runways prior to their transfer to investment properties. The accounting treatment has no impact on these costs being included in the airports' regulatory asset bases and has no cash impact. In addition, it will not affect future cash flow generation, consistent with CAA guidance (other than £37 million of Stansted planning application costs previously disallowed by the CAA).

Leased assets

The Group has assets rented to third parties under operating leases as follows:

	31 December 2010 £m	31 December 2009 £m
Cost or valuation	**2,928.6**	2,784.6
Accumulated depreciation	**(196.4)**	(167.0)
Net book amount	**2,732.2**	2,617.6

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

7 Stocks

	31 December 2010 £m	31 December 2009 £m
Raw materials and consumables	**5.5**	4.9

The replacement cost of raw materials and consumables at 31 December 2010 and 31 December 2009 was not materially different from the amount at which they are included in the Balance sheet.

8 Debtors

	31 December 2010 £m	31 December 2009 £m
Trade debtors	**149.7**	182.4
Prepayments	**37.1**	28.2
Other debtors	**47.8**	19.7
Amounts owed by group undertakings[1]	**54.2**	36.5
Amounts owed by group undertakings – pensions[2]	**68.9**	36.4
	357.7	303.2

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

[2] Amounts owed by group undertakings – pensions is receivable from BAA Airports Limited, net of current service cost charges to date, due to cash contributions made directly by the Group's airports and HEX to the pension trustee of the BAA Airports Limited defined benefit pension scheme on behalf of BAA Airports Limited.

9 Current asset investments

	31 December 2010 £m	31 December 2009 £m
Short-term deposits	**41.0**	234.5

Board approved investment policies and relevant debt facility agreements provide counterparty investment limits based on short- and long-term credit ratings. Of these deposits, counterparties with a short-term credit rating of A-1+ held assets of £41.0 million as at 31 December 2010 (2009: A-1+ £145.7 million, A-1 £60.0 million and A-2 £28.8 million).

10 Restricted cash

	31 December 2010 £m	31 December 2009 £m
Restricted cash	**-**	143.0

At 31 December 2009, £143.0 million of proceeds from the sale of Gatwick airport were held in escrow to be used primarily to settle a commutation payment into the BAA Group's defined benefit pension scheme which was settled during 2010. Refer to Notes 17 and 23.

11 Cash at bank and in hand

	31 December 2010 £m	31 December 2009 £m
Cash at bank and in hand	**6.1**	4.0

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates and is subject to interest rate risk.

12 Creditors: amounts falling due within one year

	Note	31 December 2010 £m	31 December 2009 £m
Deferred income		**30.5**	30.1
Interest accruals		**161.9**	154.0
Trade creditors[1]		**124.6**	108.8
Corporation tax		**18.6**	18.6
Other tax and social security		**6.2**	6.3
Group relief payable		**17.6**	10.4
Other creditors		**6.9**	2.8
Amounts owed to group undertakings[2]		**0.4**	0.5
Capital creditors		**180.2**	185.6
Borrowings	*14*	**39.1**	41.4
Derivative financial instruments	*15*	**0.2**	0.1
		586.2	558.6

[1] Trade creditors are non-interest bearing and are generally on 30-day terms.

[2] Amounts owed to group undertakings largely relate to external payments made by BAA Airports Limited under the Shared Services Agreement on behalf of the Group's airports.

13 Creditors: amounts falling due after more than one year

	Note	31 December 2010 £m	31 December 2009 £m
Deferred income		**2.7**	4.6
Borrowings	*14*	**10,484.3**	10,488.6
Derivative financial instruments	*15*	**573.1**	337.7
		11,060.1	10,830.9

14 Borrowings

	31 December 2010 £m	31 December 2009 £m
Current borrowings		
Secured		
Bank loans	**39.1**	41.4
Total current borrowings	**39.1**	41.4
Non-current borrowings		
Secured		
Syndicated term facility	**1,292.2**	2,253.8
Capital expenditure facility	**1,300.0**	700.0
Other bank loans	**907.2**	330.5
	3,499.4	3,284.3
Secured		
Bonds		
3.975% €1,000 million due 2012	**832.3**	841.8
5.850% £400 million due 2013	**373.9**	368.3
4.600% €750 million due 2014	**593.9**	612.7
12.450% £300 million due 2016	**367.2**	377.3
4.125% €500 million due 2016	**413.6**	-
4.600% €750 million due 2018	**567.6**	582.2
6.250% £400 million due 2018	**396.8**	-
9.200% £250 million due 2021	**282.8**	284.9
5.225% £750 million due 2023	**618.0**	611.5
6.750% £700 million due 2026	**689.4**	689.1
7.075% £200 million due 2028	**197.4**	197.4
6.450% £900 million due 2031	**839.5**	838.3
3.334%+RPI £235 million due 2039	**246.7**	235.0
	6,419.1	5,638.5
Unsecured		
BAA (SP) Limited debenture payable to BAA (SH) plc	**565.8**	1,565.8
Total non-current borrowings	**10,484.3**	10,488.6
Total borrowings	**10,523.4**	10,530.0

The average cost of the Group's external gross debt at 31 December 2010 was 4.44% (2009: 5.81%) taking into account the impact of interest rate, cross-currency and index-linked hedges but excluding index-linked accretion. The significant reduction in the cost of debt from the prior year reflects completion of approximately £2 billion in index-linked derivatives during 2010 on which only the real rate cost is included in determining the above cost of debt.

Syndicated term facility
The syndicated term facility has decreased during the year mainly due to the application of proceeds from bond issues in prepaying the facility.

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

Fair value of borrowings

	31 December 2010		31 December 2009	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Non-current				
Long-term debt	**10,484.3**	**11,114.1**	10,488.6	10,821.4

The fair value of short-term borrowings approximates book value. The fair values of listed borrowings are based on quoted prices. For unlisted borrowings, the Group establishes fair values by using valuation techniques such as discounted cash flow analysis. The fair values of non-current borrowings which have floating rate interest are assumed to equate to their current nominal value.

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

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

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

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

14 Borrowings *continued*

Liquidity

As at 31 December 2010, the Group had cash and liquid resources of £47.1 million (2009: £238.5 million) and undrawn committed facilities of £1,450.0 million (2009: £2,050.0 million).

15 Derivative financial instruments

31 December 2010	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Foreign exchange contracts – no hedge accounting	**10.0**	**0.1**	**(0.2)**	**(0.1)**
	10.0	**0.1**	**(0.2)**	**(0.1)**
Non-current				
Interest rate swaps – cash flow hedge	**3,000.3**	**-**	**(258.1)**	**(258.1)**
Cross-currency swaps – cash flow hedge	**1,190.4**	**358.4**	**-**	**358.4**
Cross-currency swaps – fair value hedge	**946.7**	**191.6**	**(18.9)**	**172.7**
Index-linked swaps – no hedge accounting	**4,113.9**	**1.7**	**(296.1)**	**(294.4)**
	9,251.3	**551.7**	**(573.1)**	**(21.4)**
Total	**9,261.3**	**551.8**	**(573.3)**	**(21.5)**

31 December 2009	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Foreign exchange contracts – no hedge accounting	9.5	0.3	(0.1)	0.2
Interest rate swaps – no hedge accounting	0.1	-	-	-
	9.6	0.3	(0.1)	0.2
Non-current				
Interest rate swaps – cash flow hedge	4,225.4	3.4	(165.8)	(162.4)
Cross-currency swaps – cash flow hedge	1,703.3	651.5	-	651.5
Index-linked swaps – no hedge accounting	2,205.9	28.1	(171.9)	(143.8)
	8,134.6	683.0	(337.7)	345.3
Total	8,144.2	683.3	(337.8)	345.5

Interest rate swaps

Interest rate swaps are maintained by the Group and designated as cash flow hedges where they qualify against variability in interest cash flows on current and future floating or fixed borrowings. The gains and losses deferred in equity on the cash flow hedges described above will be continuously released to the profit and loss account over the period of the hedged risk.

Index-linked swaps

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

Cross-currency swaps

Cross-currency swaps have been entered into by the Group to hedge currency risk on interest and principal payments on Euro-denominated bond issues. The gains and losses deferred in equity on these swaps will be continuously released to the profit and loss account over the period to maturity of the hedged bonds.

Foreign exchange contracts

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

16 Deferred tax

	Note	£m
1 January 2010		291.4
Released to profit and loss account[1]	*5*	(19.1)
Charged to profit and loss reserve	*23*	23.9
Credited to fair value reserve	*22*	(26.9)
Change in UK Corporation Tax rate - charge to equity	*22*	1.8
31 December 2010		**271.1**

[1] Includes £12.2 million credit to the profit and loss account for change in tax rate from 28% to 27% effective 1 April 2011.

16 Deferred tax *continued*

Analysis of the deferred tax balances is as follows:

	31 December 2010 £m	31 December 2009 £m
Excess of capital allowances over depreciation	**317.7**	369.6
Other timing differences	**(46.6)**	(78.2)
	271.1	291.4

	Un-provided 31 December 2010 £m	Un-provided 31 December 2009 £m
Tax on chargeable gains if investment properties were sold at their current valuations	**308.7**	314.5
Tax on rolled over gains if replacement assets were sold at their current valuations	**9.5**	9.9
	318.2	324.4

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

No provision has been made for deferred tax on gains recognised on revaluing investment properties to their market value or on the sale of properties where taxable gains have been rolled over into replacement assets. The total amount of tax unprovided for is £318.2 million (2009: £324.4 million). At present it is not envisaged that this tax will become payable in the foreseeable future.

The Finance (No. 2) Act 2010 enacted a reduction in the main rate of UK corporation tax from 28% to 27% with effect from 1 April 2011. As a result, the Group's deferred tax balances, which were provided at 28%, have been re-measured at the rate of 27% for the year ended 31 December 2010. This has resulted in a reduction in the net deferred tax liability of £10.4 million, with £12.2 million credited to the profit and loss account (Note 5) and £1.8 million charged to reserves (Note 22).

17 Provisions for liabilities and charges

	Disposal of operations £m	**Reorganisation costs £m**	**Obligations under land purchase £m**	**Pensions £m**	**Other £m**	**Total £m**
1 January 2010	34.8	8.2	37.5	231.8	27.5	339.8
Utilised	(19.8)	(8.9)	(37.5)	-	(9.3)	(75.5)
Charged to profit and loss account	-	6.1	-	-	2.5	8.6
Credited/released to profit and loss account	-	-	-	(89.9)	(7.4)	(97.3)
Commutation payment benefit received	-	-	-	(88.6)	-	(88.6)
31 December 2010	**15.0**	**5.4**	**-**	**53.3**	**13.3**	**87.0**

Disposal of operations

A provision is held for costs associated with the Group's disposal of Gatwick airport. All amounts are expected to be utilised in 2011.

Reorganisation costs

The costs associated with the Group's reorganisation programmes primarily relate to various restructuring processes designed to reduce the size and cost of overhead functions following the sale of Gatwick airport in December 2009. These costs are for severance and pension payments only and are expected to be utilised in 2011.

Obligations under land purchase

This provision related to the acquisition of land for the construction of Terminal 5. The operational assets employed by the vendor of this land were relocated and agreement was reached in January 2010 for a full and final payment of £37.5 million to be paid by Heathrow to the vendor. This amount was settled during the year.

Pensions

This provision represents the legal obligation the Group's airports and HEX have under the Shared Services Agreement to fund their share of BAA Airports Limited pension deficit and related pension liabilities, and will only be settled when the cash outflow is requested by BAA Airports Limited.

£36.6 million (2009: £216.1 million) of the provision relates to the push down of the Group's share of the deficit on the BAA Airports Limited defined benefit pension scheme. The provision has decreased because of the reduction in the deficit which is partly due to updated actuarial assumptions, particularly higher than expected investment returns. In addition, a commutation payment was made into the scheme following the disposal of Gatwick airport. The remaining £16.7 million (2009: £15.7 million) is held for historical accumulated past service pension costs borne by BAA Airports Limited in relation to the Unfunded Retirement Benefit Scheme and Post Retirement Medical Benefits.

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

Other

A provision is held for onerous contracts relating to energy purchases and property contracts. All amounts are expected to be utilised within four years.

18 Called up share capital

	£
Authorised	
9,000,000,000 ordinary shares of £0.0019 each	17,100,000
Allotted and fully paid	
In issue at 1 January 2010: 5,556,184,863 ordinary shares of £0.0019 each	10,556,751
Issue of 217,370,315 ordinary shares of £0.0019 each	413,004
In issue at 31 December 2010: 5,773,555,178 ordinary shares of £0.0019 each	**10,969,755**

On 28 January 2010, the Company issued 217,370,315 ordinary shares of £0.0019 each, at £1.00 each to BAA (SH) plc. On the same day the proceeds were utilised by the Company to purchase an additional 217,370,315 ordinary shares issued by its subsidiary BAA (AH) Limited completing the £500 million equity injection into BAA (SP) Limited announced in November 2009.

19 Share premium reserve

	£m
1 January 2010	282.0
Arising on issue on 28 January 2010	217.0
31 December 2010	**499.0**

20 Revaluation reserve

	£m
1 January 2010	1,442.4
Revaluation adjustments	(2.0)
Unrealised gain on revaluation of investment properties	30.5
31 December 2010	**1,470.9**

During the year previously recognised net valuation gain amounting to £2.0 million was released as a result of the reclassification of a number of investment properties to operational assets.

21 Merger reserve

	£m
1 January 2010 and 31 December 2010	**(4,535.6)**

Refer to the Basis of consolidation section in the Accounting policies.

22 Fair value reserve

	£m
1 January 2010	(100.5)
Cash flow hedges	
Fair value loss	(99.3)
Deferred tax on fair value loss	26.9
Change in tax rate	(1.8)
31 December 2010	**(174.7)**

23 Profit and loss reserve

	£m
1 January 2010	3,727.1
Loss for the year	(321.8)
Capital distribution	(16.1)
Tax on capital contribution	(23.9)
31 December 2010	**3,365.3**

The capital distribution relates to the commutation payment of £104.7 million made by BAA (AH) Limited to BAA Airports Limited defined benefit pension scheme following the disposal of Gatwick airport. As a result of this payment, the benefit was proportionately allocated to Heathrow, Stansted, HEX and other BAA airports. The benefits received by Heathrow, Stansted and HEX are shown as an increase in the value of investment in these entities by BAA (AH) Limited which is eliminated on consolidation into the BAA (SP) Group. The remaining benefit of £16.1 million received by the other BAA airports outside the BAA (SP) Group is shown as a capital distribution.

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

24 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 £269.4 million at 31 December 2010 (2009: £264.7 million).

Under the SSA, hedging costs properly incurred by BAA Airports Limited in relation to the Executive Share Option Plan (ESOP) may be recharged to the Group. At 31 December 2010, the ESOP swaps held in BAA Airports Limited had a fair value loss of £75.6 million (2009: £69.9 million). The Group may be obligated to settle its share of these amounts in the future, depending on a number of factors, including the number of options vesting, the number of options being exercised and the Ferrovial share price at exercise date. Accordingly, this is disclosed as a contingent liability and included in the amount above.

25 Commitments

Non-cancellable operating lease commitments – Group as a lessee

Annual commitments under non-cancellable operating leases expiring:

	31 December 2010		31 December 2009	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**0.2**	**0.1**	0.2	0.1
Within two to five years	**1.8**	**0.5**	1.5	1.1
After five years	**10.1**	**45.1**	9.9	54.4
	12.1	**45.7**	11.6	55.6

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

A significant portion of the £45.7 million (2009: £55.6 million) operating lease commitments classified as 'Other' relates to electricity supply equipment at the airports leased on agreement with UK Power Networks Services Limited ('UPNS'). The lease expires in 2083. The amounts disclosed are the total estimated charges under the agreement including both the actual lease commitment and the significant maintenance element of the fee payable to UPNS as neither the Group nor UPNS are able to split the base fee between a 'capital' and 'maintenance' charge. The commitment has been discounted at the Group's incremental borrowing rate.

Non-cancellable electricity purchase commitment

The Group has a contractual commitment to purchase electricity that is used to satisfy physical delivery requirements for electricity usage of the Group until March 2013. Such commitments are for the normal purchase, sale or usage of electricity and hence are accounted for as ordinary purchase contracts. At 31 December 2010 the estimated minimum commitment for the future purchase of electricity under this contract totalled £90.8 million (2009: £131.0 million).

Group commitments for capital expenditure

	31 December 2010 £m	31 December 2009 £m
Contracted for, but not accrued:		
T2A building – Heathrow	**788.5**	10.9
Terminal 2B phase 2 – Heathrow	**446.7**	7.5
T3 integrated baggage system – Heathrow	**64.3**	1.1
T1 baggage prolongation programme – Heathrow	**31.3**	-
Energy infrastructure – Heathrow	**29.8**	-
Post T5 transfer baggage system – Heathrow	**23.8**	-
Terminal 5C – Heathrow	**17.9**	105.5
Airside road and taxi lane underpass – Heathrow	**15.2**	-
T3 immigration hall – Heathrow	**14.8**	-
T5 phase 2 airfield and stand works – Heathrow	**5.5**	-
T4 baggage works – Heathrow	**3.8**	-
Control post programme – Heathrow	**3.6**	-
North west stands and taxi lanes – Heathrow	**-**	9.5
Eastern apron – Heathrow	**-**	5.6
	1,445.2	140.1
Other projects	**16.1**	31.6
	1,461.3	171.7

The figures in the above table are contractual commitments to purchase goods and services at the reporting date. The Group has in place long-term capital expenditure programmes at its airports. BAA's submission to the CAA in respect of the current regulatory period included capital expenditure for Heathrow of £4,401.0 million (2007/08 prices). In line with commitments with the regulator, capital expenditure at Heathrow in 2011 is forecast to be nearly £1.2 billion. Under the terms of regulation, rebates of aeronautical income are made if certain key projects are not delivered by specified dates. The amount of rebate is linked to the return Heathrow is estimated to earn on the anticipated cost of the project. The capital programme included in Stansted's current price determination foresees total investment of £125.1 million until the end of March 2014. Capital expenditure expected for Stansted during 2011 amounts to £19.1 million.

Other commitments

During the year there was a change in UK government and subsequently a government policy change in relation to runway developments. BAA announced that it was withdrawing its planning permission applications for Stansted Generation 2 and ceasing work on the development of the planning application for a third runway at Heathrow. Stansted already holds domestic properties and land purchased under voluntary schemes for those people living near Stansted Airport whose homes would be affected by the previous government airport expansion plans (the Home Value Guarantee Scheme, the Home Owners Support Scheme and the Special Cases Scheme). All three schemes were closed to new applicants during the year. As at the reporting date three property acquisitions were still to be completed. The current estimate of the net cost of the blight compensation schemes is up to £110 million. Total value to 31 December 2010 is £108 million (2009: £107 million).

Similarly, as part of its commitment to the development of a third runway at Heathrow, the Group is operating two voluntary blight schemes (the Property Market Support Bond ('PMSB') for those properties within the indicative boundary of Runway 3/Terminal 6 and the Home Owners Support Scheme for those properties within the 66db leq contour for aircraft noise associated with Runway 3).

25 Commitments *continued*

Other commitments continued

These schemes were the subject of extensive public consultation by BAA. The terms and conditions of the scheme were published by Heathrow Airport Limited in 2005. The intention at that time was to “trigger” access to the schemes when BAA announced its intention to submit a planning application for the third runway. Following the January 2009 government announcement confirming policy support for a third runway the BAA Board decided to accept applications from home owners covered by PMSB to sell their properties under the scheme for one year. However, following the change in UK government and its policy towards runway developments, together with BAA’s announcement that it was ceasing work on the development of the planning application for a third runway, no new applications have been accepted after 22 June 2010. The current estimate of the cost of purchasing properties through to completion of applications received up to 22 June 2010 at the reporting date is estimated to be £42 million.

The Group is also required by the government to offer noise mitigation measures relating to existing airport activities. Based on the Group’s evaluation, payments under current noise schemes are estimated at £31 million spread over the five years commencing 2007. The schemes include the provision of noise insulation for community buildings and dwellings and assistance with the costs of relocation for dwelling owners. A review of the existing noise insulation and mitigation schemes commenced during 2010 and BAA is due to consult publicly during 2011.

In June 2006, the government announced its conclusions for the 2006-2012 night flights regime at the Group's London airports. The regime committed BAA to introducing a new domestic noise insulation scheme at Heathrow and Stansted to address the impact of night flights on local communities. The Group estimates that payments under this scheme will total £62 million over the five years from 2008. The government is expected to consult on proposals for the post 2012 night flights regime during 2011. Until this consultation process is complete, the Group is unable to quantify potential obligations under a future night flights regime.

The January 2009 government announcement ‘Adding Capacity at Heathrow’ requires the Group to review existing insulation and mitigation schemes; and to consider extending its noise insulation schemes to all community buildings and households in the new 57dBA contour that will experience an increase in noise of 3dBA or more. Until further consultation is carried out with the local communities, the significance of the Group’s obligations in implementing these schemes is uncertain.

In July 2008, the BAA Group reached agreement with the Trustee of the BAA Airports Limited defined benefit pension scheme to contribute £80.0 million per annum for a period of three years ending 31 December 2011. The Group expects to contribute its share of this amount to the pension scheme in the year ending 31 December 2011.

26 Notes to the consolidated cash flow statement

Net cash inflow from operating activities

	Year ended 31 December 2010 £m	Restated[1] Year ended 31 December 2009 £m
Continuing operations		
Operating profit	**548.7**	160.6
Adjustments for:		
Depreciation (including exceptional depreciation)	**495.4**	507.3
Loss/(gain) on disposal of fixed assets	**0.3**	(0.1)
Working capital changes:		
(Increase)/decrease in stock and debtors	**(4.5)**	16.6
Increase/(decrease) in creditors	**18.0**	(71.0)
(Decrease)/increase in provisions	**(17.0)**	2.9
Difference between pension charge and cash contributions	**(32.5)**	(31.8)
Exceptional pension (credit)/charge	**(89.9)**	217.8
Net cash inflow from continuing operations	**918.5**	802.3
Discontinued operations		
Operating profit	**-**	95.1
Adjustments for:		
Depreciation	**-**	63.4
Working capital changes:		
Decrease in stock and debtors	**-**	31.7
Increase in creditors	**-**	2.0
Decrease in provisions	**-**	(1.1)
Difference between pension charge and cash contributions	**-**	(1.7)
Net cash inflow from discontinued operations	**-**	189.4
Total net cash inflow from operating activities	**918.5**	991.7

[1] The presentation of certain balances for the year ended 31 December 2009 has been restated to be consistent with current year disclosures.

Operating cash flows include under continuing operations an outflow of £8.9 million (2009: £18.3 million) for reorganisation costs.

26 Notes to the consolidated cash flow statement *continued*

Reconciliation in net debt

	1 January 2010 £m	Cash flow £m	Other non-cash changes £m	Fair value movements £m	31 December 2010 £m
Cash at hand and in bank	4.0	2.1	-	-	**6.1**
Debt due within one year	(41.4)	260.2	(257.9)	-	**(39.1)**
Debt due after more than one year	(10,488.6)	(277.8)	193.4	88.7	**(10,484.3)**
Liquid resources	234.5	(193.5)	-	-	**41.0**
Net debt	**(10,291.5)**	**(209.0)**	**(64.5)**	**88.7**	**(10,476.3)**

Liquid resources are as defined in the Accounting policies under 'Cash and current asset investments'.

27 Ultimate parent undertaking and controlling party

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

The ultimate parent entity in the UK is FGP Topco Limited, which is the parent undertaking of the largest group in the UK to consolidate these financial statements. The shareholders of FGP Topco Limited are Finecofer S.L. (55.9%) (a subsidiary of Ferrovial S.A.), Britannia Airport Partners L.P. (26.5%) (a Caisse de dépôt et placement du Québec-controlled vehicle) and Baker Street Investment Pte Ltd (17.6%) (an investment vehicle of the Government of Singapore Investment Corporation). The ultimate parent entity of the majority shareholder is Ferrovial S.A. (Spain).

The Group's results are also included in the audited consolidated financial statements of BAA (SH) plc for the year ended 31 December 2010, which is the parent undertaking of the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of BAA Limited and FGP Topco Limited for the year ended 31 December 2010.

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

28 Subsidiaries

The Company's subsidiaries are as follows:

Holding companies
BAA (AH) Limited

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

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

† Held by a subsidiary undertaking
# Incorporated in Jersey

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

29 Post balance sheet events

On 17 February 2011, BAA was refused permission to appeal to the Supreme Court ('SC') in what would have been the latest stage of a legal process underway since the Competition Commission ('CC') published in March 2009 its decision relating to its investigation into the supply of UK airport services by BAA. The key structural remedy in the CC's decision called for the disposal of certain airports including Stansted and either Edinburgh or Glasgow. The consequences of the SC's decision for airport disposals are unclear as the CC has stated that it does not expect to publish until March 2011 its provisional decision from its recent consultation as to whether there have been material changes in circumstances since its original decision in March 2009 that might lead it to amend the scope of the remedies requiring BAA to dispose of certain airports. In addition, BAA continues to consider its options in terms of next steps in this process.

BAA (SP) Limited

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

We have audited the parent company financial statements of BAA (SP) Limited for the year ended 31 December 2010 which comprise the Company balance sheet, the Accounting policies and the related notes 1 to 12. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements
In our opinion the parent company financial statements:
- give a true and fair view of the state of the parent company's affairs as at 31 December 2010 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion the information given in the Directors' report for the financial year for which the parent company financial statements are prepared is consistent with the parent company financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter
We have reported separately on the Group financial statements of BAA (SP) Limited for the year ended 31 December 2010.

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

22 February 2011

BAA (SP) Limited

Company balance sheet as at 31 December 2010

	Note	31 December 2010 £m	31 December 2009 £m
Fixed assets			
Investments in subsidiaries	2	**6,045.6**	5,828.2
Current assets			
Debtors: due within one year	3	**68.1**	34.1
: due after more than one year	3	**600.0**	600.0
Cash at bank and in hand		**5.8**	-
		673.9	634.1
Creditors: amounts falling due within one year	4	**(60.4)**	(30.4)
Net current assets		**613.5**	603.7
Total assets less current liabilities		**6,659.1**	6,431.9
Creditors: amounts falling due after more than one year	5	**(2,593.5)**	(2,565.3)
Net assets		**4,065.6**	3,866.6
Capital and reserves			
Called up share capital	6	**11.0**	10.6
Share premium reserve	7	**499.0**	282.0
Profit and loss reserve	8	**3,555.6**	3,574.0
Total shareholder's funds		**4,065.6**	3,866.6

These financial statements of BAA (SP) Limited (Company registration number: 06458621) were approved by the Board of Directors and authorised for issue on 22 February 2011. They were signed on its behalf by:

José Leo
Director

Frederick Maroudas
Director

BAA (SP) Limited

Accounting policies for the year ended 31 December 2010

The principal accounting policies applied in the preparation of these financial statements 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 and in accordance with the Companies Act 2006 and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

Interest
Interest payable and receivable is charged or credited to the profit and loss account as incurred.

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

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

Debtors
Debtors are recognised initially at cost less any provision for diminution in value and subsequently measured at amortised cost, using the effective interest rate method, less provision for impairment.

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

Creditors
Amounts owed to group undertakings are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest rate method.

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

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

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

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

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

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

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

Cash flow statement and related party transactions
The ultimate parent entity in the UK is FGP Topco Limited, a company registered in England and Wales. The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2010. The results are also included in the audited consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2010 (the smallest group to consolidate these financial statements). They are also included in the audited consolidated financial statements of BAA (SH) plc and BAA Limited for the year ended 31 December 2010. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 ‘Cash Flow Statements (revised 1996)’.

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

BAA (SP) Limited

Notes to the Company financial statements for the year ended 31 December 2010

1 Company result for the year

As permitted by section 408 of the Companies Act 2006, the profit and loss account of the Company is not presented as part of these financial statements. The loss of the Company for the year attributable to shareholders was £18.4 million (2009: £864.4 million loss).

2 Investments in subsidiaries

	£m
Cost	
1 January 2010	7,156.2
Additions	217.4
31 December 2010	**7,373.6**
Impairment	
1 January and 31 December 2010	(1,328.0)
Net book value 31 December 2010	**6,045.6**
Net book value 31 December 2009	5,828.2

The Company's principal subsidiary undertakings are BAA (AH) Limited, which is incorporated in Great Britain and registered in England and Wales and BAA Funding Limited, which is incorporated in Jersey, Channel Islands. Details of the principal subsidiary undertakings of the Group are provided in Note 28 of the BAA (SP) Limited Group financial statements.

On 28 January 2010 the Company purchased an additional 217,370,315 ordinary shares in BAA (AH) Limited.

3 Debtors

	31 December 2010 £m	31 December 2009 £m
Due within one year:		
Amounts owed by group undertakings - interest receivable	**48.0**	2.5
Group relief receivable	**20.1**	31.6
	68.1	34.1
Due after more than one year:		
Amounts owed by group undertakings - interest bearing	**600.0**	600.0
Total debtors	**668.1**	634.1

Amounts owed by group undertakings - interest bearing represents a £600.0 million (2009: £600.0 million) loan to Stansted Airport Limited attracting floating rate interest based on a 6 month LIBOR + 6.53% margin as at 31 December 2010 (2009: 6 month LIBOR + 6.73% margin).

4 Creditors: amounts falling due within one year

	31 December 2010 £m	31 December 2009 £m
Amounts owed to group undertakings - interest payable	**60.4**	30.4

5 Creditors: amounts falling due after more than one year

	31 December 2010 £m	31 December 2009 £m
Amounts owed to group undertakings - interest bearing	**2,027.7**	999.5
Debenture payable to BAA (SH) plc	**565.8**	1,565.8
	2,593.5	2,565.3

Amounts owed to group undertakings in 2010 represent a £341.0 million loan payable to Stansted Airport Limited and a £1,686.7 million loan payable to Heathrow Airport Limited (2009: a £316.9 million loan payable to Stansted Airport Limited and a £682.6 million loan payable to Heathrow Airport Limited). All loans have a fixed interest rate of 7.57% (2009: 7.57%).

The debenture payable to BAA (SH) plc ('BAA (SH)') is used by BAA (SH) to pay the interest on its bond and subordinated facility. The interest on the debenture is set at 0.125% above the rate as notified by BAA (SH) (being the rate equal to BAA (SH)'s all-in cost of funds under the terms of its third party debt obligations, including any hedging arrangements). As at 31 December 2010, the rate on the debenture was 3.12% (2009: 4.57%). The debenture has a final redemption date of March 2017.

6 Share capital

	£
Authorised	
9,000,000,000 ordinary shares of £0.0019 each	**17,100,000**
Called up, allotted and fully paid	
In issue at 1 January 2010: 5,556,184,863 ordinary shares of £0.0019 each	10,556,751
Issue of 217,370,315 ordinary shares of £0.0019 each	413,004
In issue at 31 December 2010: 5,773,555,178 ordinary shares of £0.0019 each	**10,969,755**

On 28 January 2010, the Company issued 217,370,315 ordinary shares of £0.0019 each, at £1.00 each to BAA (SH) plc. On the same day the proceeds were utilised by the Company to purchase an additional 217,370,315 ordinary shares issued by its subsidiary BAA (AH) Limited completing the £500 million equity injection into BAA (SP) Limited announced in November 2009.

7 Share premium reserve

	£m
1 January 2010	282.0
Arising on issue on 28 January 2010	217.0
31 December 2010	**499.0**

8 Profit and loss reserve

	£m
1 January 2010	3,574.0
Loss for the financial year	(18.4)
31 December 2010	**3,555.6**

9 Auditors' remuneration

Auditors' remuneration paid to Deloitte LLP for the performance of the statutory audit amounted to £nil (2009: PricewaterhouseCoopers LLP £20,000). Audit fees and non-audit fees for the current financial year were borne by BAA Airports Limited and recharged in accordance with the Shared Services Agreement as described within the Accounting policies of the BAA (SP) Limited Group financial statements.

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

10 Employee information and directors' remuneration

Employee numbers

The Company has no employees (2009: nil).

Directors' remuneration

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

11 Ultimate parent undertaking

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

The ultimate parent entity in the UK is FGP Topco Limited, which is the parent undertaking of the largest group in the UK to consolidate these financial statements. The shareholders of FGP Topco Limited are Finecofer S.L. (55.9%) (a subsidiary of Ferrovial S.A.), Britannia Airport Partners L.P. (26.5%) (a Caisse de dépôt et placement du Québec-controlled vehicle) and Baker Street Investment Pte Ltd (17.6%) (an investment vehicle of the Government of Singapore Investment Corporation). The ultimate parent entity of the majority shareholder is Ferrovial S.A. (Spain).

The Company's results are also included in the audited consolidated financial statements of BAA (SP) Limited for the year ended 31 December 2010, which is the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of BAA (SH) plc, BAA Limited and FGP Topco Limited for the year ended 31 December 2010.

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

12 Post balance sheet events

On 17 February 2011, BAA was refused permission to appeal to the Supreme Court ('SC') in what would have been the latest stage of a legal process underway since the Competition Commission ('CC') published in March 2009 its decision relating to its investigation into the supply of UK airport services by BAA. The key structural remedy in the CC's decision called for the disposal of certain airports including Stansted and either Edinburgh or Glasgow. The consequences of the SC's decision for airport disposals are unclear as the CC has stated that it does not expect to publish until March 2011 its provisional decision from its recent consultation as to whether there have been material changes in circumstances since its original decision in March 2009 that might lead it to amend the scope of the remedies requiring BAA to dispose of certain airports. In addition, BAA continues to consider its options in terms of next steps in this process.

Registered office

BAA (SP) Limited, The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW
Registered in England Number: 06458621