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CREDIT OPINION
31 January 2022

Update

Rate this Research

RATINGS

Heathrow Finance plc

Domicile	London, United Kingdom
Long Term Rating	Ba2
Type	LT Corporate Family Ratings
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Heathrow Finance plc

Update to credit analysis

Summary

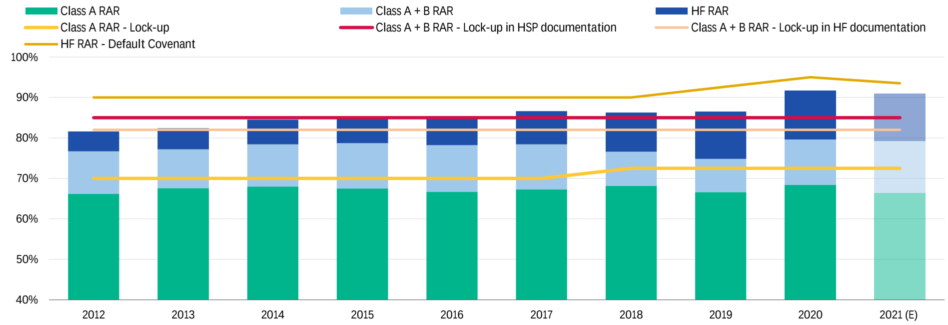
Heathrow Finance plc (HF)'s credit quality takes account of (1) its ownership of London Heathrow (LHR), which is one of the world's most important hub airports and the largest UK airport; (2) its long established framework of economic regulation, although with uncertainty around the future level of charges pending final regulatory determination; (3) LHR's resilient traffic characteristics before the pandemic; (4) its highly-leveraged financial profile; (5) the features of the Heathrow SP (HSP) secured debt financing structure which puts certain constraints around management activity, together with the protective features of the HF Debt which effectively limit HF's activities to its investment in HSP; and (6) the group's strong liquidity.

HF's credit quality is exposed to the risks associated with the coronavirus outbreak, which has resulted in a severe reduction in passenger traffic, with uncertain recovery prospects. Given traffic declines, the company's cash flows have been significantly reduced despite cuts in operating costs and investments. An increase in the group's debt burden has been limited by the equity injection from HF's intermediate holding company. While traffic will be an important driver of the group's revenue, there are significant downside risks linked to the consequences of the coronavirus pandemic, particularly in the context of the emergence of the Omicron variant and the increase in the number of cases and continued restrictions to travel. Furthermore, any improvement in Heathrow's earnings will depend on the level of airport charges which are yet to be set by the Civil Aviation Authority (CAA).

Exhibit 1

Traffic declines have weighed on the group's leverage

Class A, class B and HF Net Debt/RAB (as per covenant calculation)



[1] RAR - Regulatory Asset Ratio.
[2] The estimates represent Moody's view; not the view of the issuer.
Source: Company, Moody's Investors Service

Credit strengths

- Ownership of London Heathrow, one of the world's most important hubs and the largest European airports
- Long established framework of economic regulation
- Resilient traffic characteristics before the pandemic
- Good liquidity profile and debt financing structure exhibiting protective features

Credit challenges

- Significant traffic declines due to the coronavirus pandemic and travel restrictions with uncertain pace of traffic recovery
- Uncertainty around the regulatory outcome, given a wide range of draft proposals
- High financial leverage

Rating outlook

The negative outlook reflects the continued risks to HF's credit profile linked to the significant uncertainties around traffic recovery prospects and the H7 final regulatory determination.

Factors that could lead to an upgrade

Given the negative outlook, upward rating pressure is unlikely in the near term. However, the outlook could be stabilised if (1) traffic recovery looked more certain; (2) it appeared more certain that the company would be able to maintain a financial profile commensurate with the current rating; and (3) the company's liquidity was solid.

Positive rating pressure would only develop if, following the lifting of border and travel restrictions, the control of the coronavirus pandemic and a return to more normal traffic performance, the company's financial profile and key credit metrics sustainably strengthened, resulting in the restoration of appropriate headroom under its Net Debt/RAB covenant and an Adjusted Interest Coverage Ratio (AICR) consistently higher than 1.0x, while continuing to maintain a good liquidity profile.

Factors that could lead to a downgrade

Downward pressure on HF's ratings could develop if (1) it were to exhibit a financial profile leading to an AICR level continuously below 1.0x; (2) the group reported a permanently impaired flexibility versus its event of default financial covenants or a risk of extended covenant breaches; (3) the liquidity profile deteriorated significantly; or (4) it appeared likely that the coronavirus outbreak had a more severe or sustained detrimental impact on traffic levels.

Key indicators

Exhibit 2

Heathrow Finance plc

Key indicators

	2016	2017	2018	2019	2020	2021E
(FFO + Interest Expense) / Interest Expense	2.3x	2.0x	2.3x	2.4x	0.6x	0.5x - 0.7x
FFO / Debt	6.8%	6.1%	6.8%	6.5%	-1.4%	-1.5% - -1.3%
Debt Service Coverage Ratio	1.9x	1.8x	1.9x	1.7x	0.3x	0.2x - 0.4x
RCF / Debt	2.3%	3.8%	3.5%	3.7%	-2.0%	-1.5% - -1.3%
Net Debt / RAB	85.4%	86.6%	86.3%	86.5%	91.7%	90% - 92%
Adjusted ICR	1.3x	1.1x	1.3x	1.3x	-0.7x	-0.8x - -0.6x

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] The estimates represent Moody's view; not the view of the issuer.
Source: Moody's Financial Metrics, Moody's Investors Service

Profile

The only asset of Heathrow Finance plc (HF) is its shares in Heathrow SP (HSP), a holding company which in turn owns the company that owns London Heathrow airport, Europe's busiest airport in terms of total passengers before the pandemic. The airport serves different types of passengers, including leisure and business travelers, as well as those traveling to visit friends and relatives.

HF is indirectly owned by Heathrow Airport Holdings Limited (HAH). HAH is ultimately owned 25% by Ferrovial S.A. (a Spanish infrastructure & construction company), 20% by Qatar Holding LLC (a sovereign wealth fund), 12.62% by Caisse de depot et placement du Quebec (a pension fund), 11.2% by the Government of Singapore Investment Corporation (a sovereign wealth fund), 11.18% by Alinda Capital Partners (an infrastructure fund), 10% by China Investment Corporation (a sovereign wealth fund) and 10% by the University Superannuation Scheme (a pension scheme).

Detailed credit considerations

Ownership of Heathrow, one of the world's most important hub airports and the largest European airport

The HF group owns LHR in perpetuity, with all key aviation infrastructure controlled by its management. The company owning LHR, Heathrow Airport Limited (HAL), is a general limited liability company that has no particular legal restrictions in relation to its business activities. However, HAL is subject to regulatory oversight, which places some constraints on its operations and capital expenditure.

LHR serves London and the South East of England directly, one of Europe's most economically robust areas with GDP per capita well above the European average. The economic base has a good level of diversity, which is underpinned by London's status as one of the leading world cities from an economic, political and cultural perspective.

In 2019, Heathrow handled 80.9 million passengers (PAX). This represented around 45% of the London air travel market. However, this somewhat understates LHR's position because of its role as the UK and Europe's largest hub airport. Before the pandemic, London Heathrow was the largest European airport by number of passengers. It ranked ahead of other large hub airports in Paris, Amsterdam, Frankfurt and Madrid. In 2019, LHR accounted for 27% of total UK passenger volumes and handled approximately 72% of all of the UK's scheduled long-haul traffic. LHR serves a geographical area much wider than London. While Heathrow has underperformed some of the other European hubs since the start of the pandemic, it remains a key airport for handling passenger traffic.

LHR is exposed to some transmodal competition, in particular from rail. Domestic air services compete with rail, and the Eurostar rail service competes very effectively with airlines on the London-Paris, London-Brussels and, to a lesser extent, London-Amsterdam routes. Rail competition with airlines may increase in the future as other high speed rail destinations are added to serve London in addition to the Eurostar's route network and (in the longer term) there is potential for some competition from domestic high speed rail services.

Significant traffic declines due to the coronavirus pandemic and travel restrictions with uncertain pace of traffic recovery

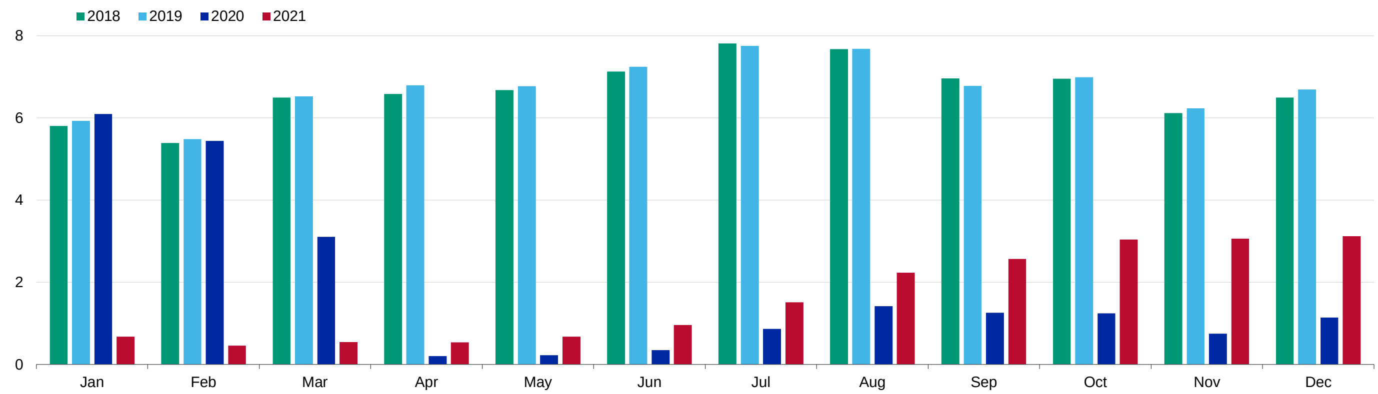
HF's credit profile reflects the uncertainties linked to the impact of the coronavirus pandemic and travel restrictions on traffic.

Before the pandemic, LHR traffic had grown at a reasonably constant annual rate of around 2% on average over the previous 10 years. Much of the airport's historical resilience reflected the capacity constraints LHR operated under, which meant that the airport suffered lower declines than other comparable airports at times of weak economic activity. Under strong economic conditions, however, the airport's ability to accommodate additional traffic was restricted.

Traffic at LHR has been severely impacted by the pandemic and the introduction of travel restrictions. An increasing number of cases prompted a number of countries globally to implement international travel bans starting from March 2020, when the UK government advised against any non-essential travel. While such restrictions were gradually eased, passenger volumes remained subdued, with LHR reporting traffic at 16% of the pre-pandemic levels between July-September. Overall, in 2020 Heathrow's traffic declined by 73%. The airport handled 22.1 million PAX.

Air travel remained restricted last year, although some relaxation of international travel rules and high pent-up demand resulted in a pick up in passenger volumes last summer. However, LHR's performance continued to be affected by the changing UK travel rules. In particular, the pick up in traffic in the peak summer months was fairly low as Heathrow reported passenger volumes at some 24% of the pre-pandemic levels. While this was an improvement on the previous year, the overall traffic remained heavily down. In 2021, LHR's traffic was some 76% below the pre-pandemic levels and 12% lower than in 2020.

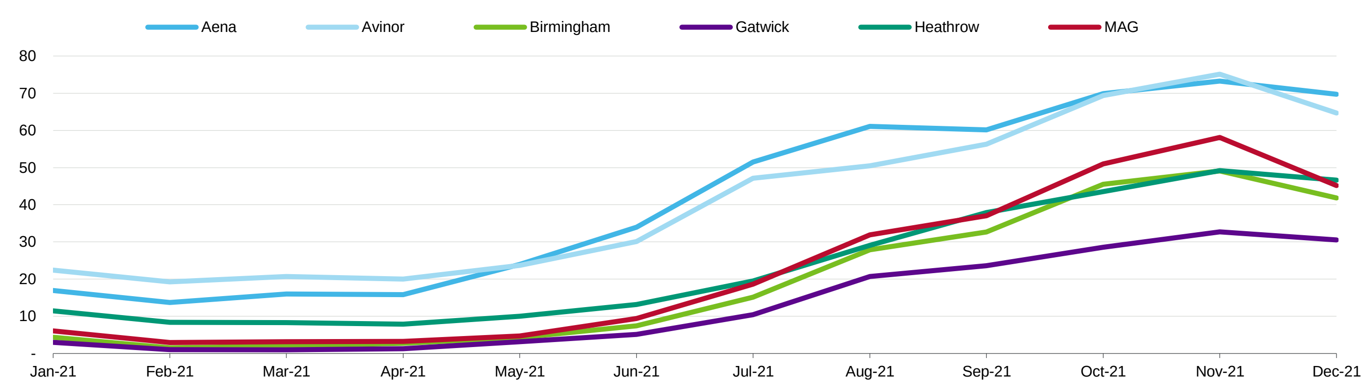
Exhibit 3
LHR's traffic has been significantly down on pre-pandemic levels
Monthly traffic, in million PAX



Source: Heathrow, Moody's Investors Service

LHR's traffic performance has been weaker than that of many European airports, given changing UK travel rules. Passenger volumes started to pick up more strongly once the UK traffic light system was removed in October but improvement in traffic was hindered by the emergence of the Omicron variant and the rising number of COVID cases. These developments resulted in a softening of traffic towards the end of last year. In particular, Heathrow said that these developments resulted in the cancellation of some 600 thousand trips in December alone.

Exhibit 4
Heathrow, together with other UK airports, has underperformed our rated European airports
Monthly traffic versus 2019, index



Source: Companies, Moody's Investors Service

Our central scenario assumes that Heathrow's traffic will remain below the pre-coronavirus levels until at least 2024. (See Airports — Europe: 2022 Outlook revised to positive in wake of traffic recovery, November 2021). There is, however, significant uncertainty around the timing and profile of any recovery, in particular in the context of the emergence of the Omicron variant and the increase in the number of cases and restrictions to travel.

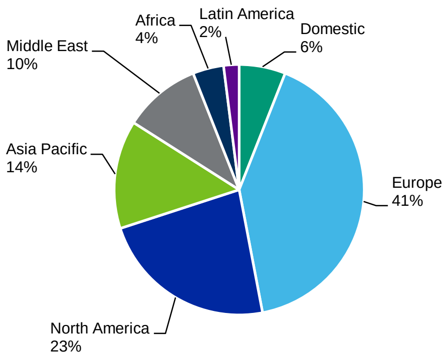
Fairly high exposure to business travel with significant share of non-European traffic

LHR exhibits a fairly material exposure to long haul traffic as well as business travel, which is expected to rebound more slowly and with greater uncertainty than leisure travel.

Non-European routes account for the majority of LHR's traffic, which has weighed on the speed of recovery given that European routes have been the primary driver of growth in passenger volumes since the start of the pandemic. In particular, the US route is the biggest market for Heathrow, accounting for 20% of total traffic in 2019. However, the US denied entry to non-US citizens – subject to certain exemptions – arriving from the UK from March 2020 to November last year. (See Airlines & Airports – Europe and US: New US travel rules a major credit positive for European long-haul airlines, airports, September 2021). These travel rules negatively affected Heathrow's traffic compared with other European airports focused mainly on the domestic and intra-Europe routes.

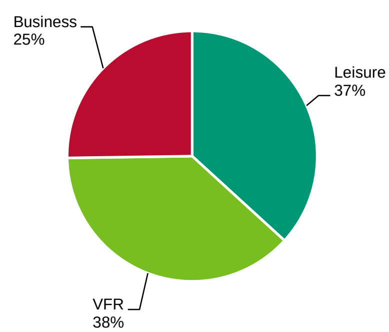
LHR has a fairly high exposure to the business travel segment, which accounted for 25% of the total before the pandemic. We expect leisure and visiting friends and relatives (VFR) traffic to recover more quickly than business travel, which will be held back by changes in working patterns, use of technology and companies' focus on reducing costs (see Airlines – Global: Business travel faces higher substitution risk post-COVID, but airlines will adapt, March 2021). While there could be a stronger rebound in business travel in the near term, these dynamics will impact the pace of recovery at LHR.

Exhibit 5
Heathrow has a material exposure to long haul markets
Passenger traffic breakdown, data for 2019



Source: CAA, Moody's Investors Service

Exhibit 6
LHR has a fairly high exposure to business travel
Passenger traffic breakdown, data for 2019



VFR — visiting friends and relatives
Source: CAA, Moody's Investors Service

Exposure to British Airways as the main carrier

British Airways Plc (Ba2 negative) is LHR's biggest carrier accounting for more than 40% of total traffic in 2019. The airline is responsible for the majority of the airport's transfer traffic, which amounted to close to 25% before the pandemic. This makes LHR exposed to British Airways' strategy and financial health and the airport's ability to offer an attractive and competitive environment for transfer passengers.

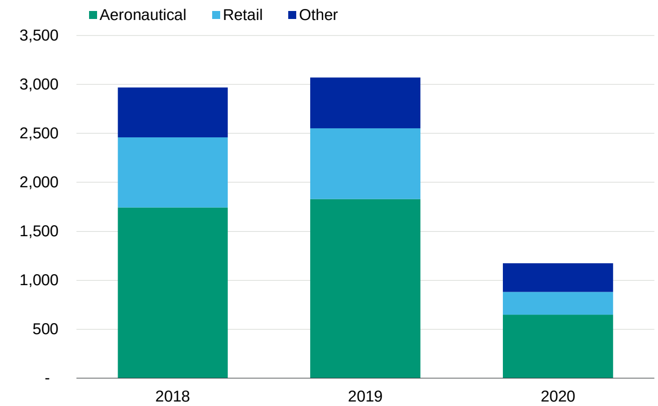
LHR holds, however, a strong position in the London system area, as evidenced by the consolidation of some airlines' operations, with Virgin Atlantic as an example, since the start of the pandemic. More generally we note that while Heathrow is dependent on airlines' ability to capture demand for travel, the airport also handles cargo traffic, which provides an additional level of diversification.

Traffic has been a key driver of aeronautical and commercial revenue

Before the pandemic, aeronautical revenue accounted for 60% of Heathrow's total revenue. Retail services contributed around 24% to the airport's income. Other revenue streams included property, rail income as well as other charges.

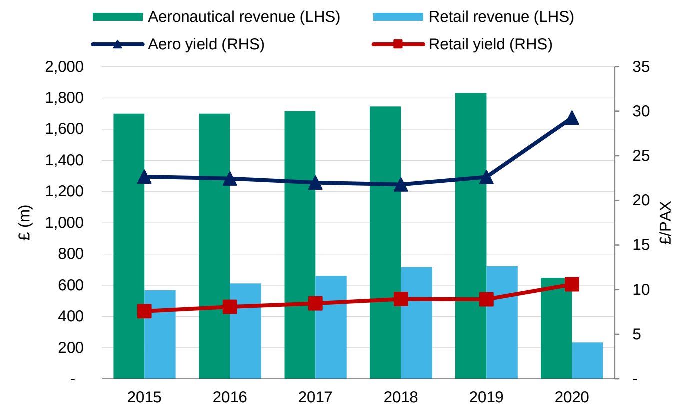
Heathrow's revenue breakdown in 2020 was different as revenue fell 62% on the previous year. While other income remained slightly more resilient, retail services revenue was down 68% in comparison with 2019 levels. Overall, the share of aeronautical revenue decreased to 55%. This performance was primarily driven by the significant reduction in passenger traffic, which was only slightly offset by an increase in certain charges and relatively stronger cargo operations, which benefited from an increase in online shopping during periods of lockdown.

Exhibit 7
Heathrow's revenue was down in 2020
Total revenue breakdown, in £ million



Other includes other regulated revenue.
Source: Company's accounts, Moody's Investors Service

Exhibit 8
Aeronautical yields were up in 2020
Evolution of yields and revenue



Other revenue and yields not included above.
Source: Company's accounts, Moody's Investors Service

Heathrow's aeronautical yields are the highest among our rated European airports, with airport charges significantly exceeding those at other rated UK airports, including in the London system area. (See Airports – UK: Traffic severely hit by COVID-19 and travel restrictions, with uneven recovery prospects, December 2020). In 2020, the increase in aeronautical yields reflected the unusually low passenger volumes as well as an increase in cargo movements, which are charged on a per movement basis. The level of aeronautical charges over the medium term remains uncertain, as explained below.

In 2020, Heathrow's non-aeronautical yield was up because of lower passenger volumes and revenue mix, including property income. However, we expect retail yields to be negatively impacted by the slower recovery in higher spending long-haul passengers and the UK government decision to abolish the VAT Retail Export Scheme (VAT RES) from January of last year. The VAT RES was an important purchase driver among international travellers who could reclaim VAT paid on items purchased when leaving the UK. Given that most goods in the UK are subject to a 20% VAT rate, this represented a significant saving especially in the high-value categories, such as luxury and technology. Heathrow believes that its retail income stream with a value of some £200 million annually may be impacted to some extent by the removal of the tax-free shopping.

Management actions and equity injection limited increase in net debt burden

Lower passenger volumes have resulted in some immediate volume-dependent savings. However, as the airport's costs are predominantly fixed, the company has undertaken a number of actions to preserve cash flow. These include cuts in operating expenditure (opex) and capital expenditure (capex).

In 2020, opex fell 21% to £905 million with management initiatives delivering net savings of £303 million coming from a company-wide pay reduction, restructuring of the organisation, operating on a smaller footprint with the consolidation of operations into two terminals and a single runway, renegotiating suppliers' contracts and stopping all non-essential costs. The use of the furlough scheme also helped to reduce staff costs by around £36 million. Reduction in capex was more significant as Heathrow scaled down its investments by cancelling or deferring around £700 million in spending.

The group's cash flows have been supported by a number of derivative transactions resulting in a significant reduction in net interest payments in 2021, and an equity injection. HF's intermediate holding company raised £750 million in additional funding, of which £600 million was downstreamed as equity to the HSP group. Heathrow used these proceeds to optimise working capital and chose to prepay early £282 million in operating costs due in 2021. The swap portfolio changes resulted in around £100 million in interest being prepaid ahead of last year.

Due to the combined effects of these initiatives, the group's monthly average cash burn was reduced to £88 million at the end of September 2021 from £170 million a year before. This represented a significant reduction when compared to the pre-pandemic management expectation of monthly cash burn in the region of £240 million. As a result, the group's net debt has increased by £1 billion to £15.4 billion as of end-September 2021.

Well-established regulatory framework but the future level of airport charges has yet to be set

Heathrow airport is subject to economic regulation by the CAA. It is a form of price cap regulation, whereby regulated revenues are defined as annual passenger price caps derived from dividing the sum of (1) the remuneration of an agreed regulatory asset base (RAB) at a predetermined weighted average cost of capital (WACC); (2) allowances for the recovery of asset depreciation and operating costs with some efficiency targets; and (3) the netting-off of non-aeronautical revenues, by annual passenger forecasts. At present the company retains passenger volume risk within each regulatory period, although the passenger volume assumptions used by the CAA to calculate aeronautical charges are rebased at the start of every regulatory period.

The last regulatory period, the sixth quinquennium (Q6), came into effect in April 2014. It initially covered the period to 31 December 2018 but was later extended until the end of 2021, given the delay in the process linked to Heathrow's additional runway capacity. The extension was referred to as iH7 and was based on the same terms as Q6, i.e., a price path of RPI-1.5% (excluding the impact of an airlines commercial deal agreed following the company's outperformance until the start of the pandemic).

The new regulatory period, known as H7, was due to start on 1 January 2022. However, the process has been delayed by the pandemic and the uncertainty associated with Heathrow's traffic recovery.

In October 2021, the CAA published a consultation on its initial proposals for the next price control at Heathrow. The proposals included a potential range of airport charges for the next five-year period and an introduction of an interim price cap for 2022 pending finalisation of the full proposals. (See Heathrow Finance plc: CAA consultation on initial proposals for H7 price control recognises uncertainty around traffic recovery, October 2021).

The CAA initial proposals for the H7 control period included a range of airport charges from £24.5 to £34.4 per passenger (on average, in 2020 prices) under two scenarios based on upper and lower quartile assumptions for operating expenditures and commercial revenue, as well as the range of pre-tax weighted average cost of capital (WACC) of 4.4% and 7.1% accordingly. The range for aeronautical charges for the 2022-2026 period was fairly wide and considered provisional.

In the context of the uncertainty around traffic recovery, the CAA developed a number of new mechanisms and approaches for the H7 price control period. This includes a traffic risk sharing mechanism, a new approach to dealing with asymmetric risk and allowance for a more flexible approach to the capex programme, if traffic is significantly lower or higher than expected.

The CAA also proposed a “shock factor” in the passenger traffic forecasts, although it rejected the company's request for an adjustment to RAB to address the shortfall in the revenue in 2020 and 2021 because of the impact of the COVID-19 pandemic. The CAA said that there would be no additional adjustment to RAB on top of the £300 million allowed in April 2021.

Given an immediate need for the 2022 tariff decision, in December 2021, the CAA published its final decision on the interim price cap effective from 1 January. The charge was set at £30.19/PAX, which was an increase from around £19.4/PAX (excluding a temporary exceptional charge of £8.9/PAX) in 2021. This holding cap will be reviewed at the time of the final settlement later this year.

Heathrow submitted its updated business plan in December 2021. The CAA intends to publish its final proposals for the H7 price control and proposed licence modifications in March/April this year, with a final decision due in May/June.

The delay in the regulatory process and the resulting lack of visibility on the level of charges beyond this year, and for the regulatory period that has already started, is a departure from the past practice and adds to the uncertainty to Heathrow's credit profile.

Uncertainty around traffic and tariffs means that the range of outcomes for the group's financial profile is unusually wide

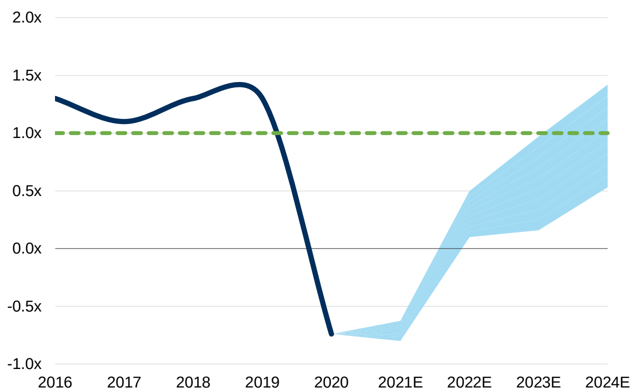
There are material differences between the CAA initial proposals and those submitted by Heathrow in its business plan. These include a number of inputs driving the calculation of allowed revenue and Heathrow's level of charges.

For example, Heathrow's initial business plan assumed investments of £2.7-4.5 billion (in 2020 prices), which compares with the CAA range of £1.6-3.1 billion (in 2020 prices) over the regulatory period. At the same time, the company's opex assumptions are above the CAA's upper quartile estimate and commercial revenue is below the regulator's lower quartile estimate. There are also material differences between the assumed traffic recovery, with the regulator assuming a stronger pick up in passenger volumes than Heathrow, as well as the level of WACC.

Management's view is that the company will not be able to deliver costs and commercial revenue at the level assumed by the regulator in the initial proposals. Since these are important revenue building block assumptions, this presents a risk around the group's ability to deliver financial profile in line with the regulatory settlement. We also recognise that any benefit of the traffic risk sharing mechanism would not be immediately reflected in cash flows, if the actual traffic performance were below the regulatory assumption.

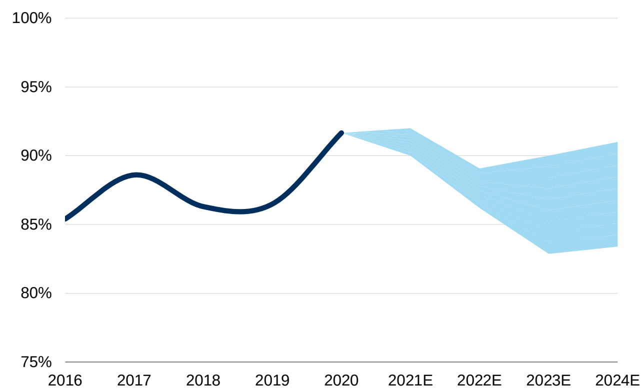
We have run a number of sensitivities to Heathrow's business plan using different assumptions on, *inter alia*, the level of airport charges and traffic. Our analysis suggests that the range of potential outcomes is subject to greater than usual uncertainty with the potential for the AICR to remain below 1x over the medium term. Still, the below estimates are for illustrative purposes only as the group's financial metrics could fall outside our estimated ranges, given the lack of clarity around the future regulatory determination and the uncertainty around traffic recovery. Furthermore, our analysis does not assume any equity support, given no publicly-stated commitment from Heathrow's ultimate shareholders.

Exhibit 9
The range for the projected AICR is unusually wide
Historical and projected AICR



[1] The estimates reflect the potential range of outcomes for the consolidated group and not the regulated entity.
[2] For illustrative purposes as there is greater than usual uncertainty around projections.
Source: Moody's estimates

Exhibit 10
Leverage is also subject to material uncertainty
Historical and projected group net debt/RAB



[1[The estimates reflect the potential range of outcomes for the consolidated group and not the regulated entity. Our estimates do not incorporate any additional RAB adjustment.
[2] For illustrative purposes as there is greater than usual uncertainty around projections.
Source: Moody's estimates

Creditors have been supportive — HF has received covenant waivers into 2022

HF's debt documentation includes two financial covenants — Group Interest Cover Ratio (ICR) of 1.0x and Group RAR, calculated as net debt/RAB, of 92.5% as events of default. In addition, the group's debt documentation includes covenants at the level of HSP.

Exhibit 11
HF's debt is subject to two covenants as events of default

	Trigger event	Event of default
Group RAR	-	92.5%
Junior RAR	82.0%	-
Group ICR	-	1.0x

RAR — Regulatory Asset Ratio.
Source: Company, Moody's Investors Service

Exhibit 12
HSP's debt is subject to a number of covenants

	Trigger event	Event of default
Senior RAR	72.5%	92.5%
Junior RAR	85.0%	-
Senior Interest Cover Ratio	1.4x	-
Junior Interest Cover Ratio	1.2x	-
Average Senior ICR	-	1.05x

RAR — Regulatory Asset Ratio.
Source: Company, Moody's Investors Service

Since the start of the pandemic, HF has received a covenant waiver with respect to its Group ICR ratio twice, which is reflective of the supportive stance of creditors in what are unprecedented circumstances for the airport sector as a whole. HF's covenant waivers included testing dates in 2020 and 2021. In addition, the company's gearing covenant was increased to 95% for the testing date at 31 December 2020 and 93.5% for the testing date at 31 December 2021. The next testing date for the Group ICR and the Group RAR will be in December 2022.

The HSP group has not required any covenant waivers, with the event of default interest cover ratio based on a three-year average. The company's metric will be supported by the use of derivatives, which included a prepayment of £100 million in interest in 2020. While HSP's net interest paid was reduced by £358 million last year and the benefit of derivatives will continue this year, interest costs will increase over the medium term. We caution that such derivatives provide only a temporary relief and they have a potential of undermining the value of the financing structure, if used as an ongoing solution to a potential covenant breach.

In its update to the investor report published on 28 January, Heathrow indicated that – based on the interim 2022 price cap – the company does not expect to breach any of its covenants at the HSP group this year. The risk to HF's covenants would materialise if traffic were to reach 38.7 million PAX, which is 52% lower than in 2019.

Third runway project is on hold

Before the pandemic, LHR operated at almost full runway capacity, given the limit imposed on the number of air traffic movements per annum and the existence of a night time curfew. In addition, a restriction on the use of runways so that they can only be used in 'segregated alternate mode' is also in place to provide some noise respite to those living under the fly-paths of the airport.

In July 2015, the Airports Commission, an independent commission established to consider how the UK can "maintain its status as an international hub for aviation and immediate actions to improve the use of existing runway capacity in the next 5 years", made a clear and unanimous recommendation to the UK government in favour of Heathrow's expansion. The UK government announced its decision to support the plan in October 2016 and published a draft Airports National Policy Statement (NPS) in February 2017. Heathrow's expansion plan was passed through a vote in the UK Parliament in June 2018.

Notwithstanding these approvals, the process experienced a significant setback in February 2020, when the Court of Appeal ruled against the plan to build the runway due to the fact that the UK Government did not take into account, in its NPS and the associated decision to support LHR's expansion, its commitments to climate change objectives included in the Paris Agreement. Heathrow appealed the court ruling with the Supreme Court, which reinstated the policy support for expansion in the NPS, and the Government has since confirmed that the NPS remains current Government policy and decided that it is not appropriate to review it at this time.

Given the significant reduction in traffic since the start of the pandemic, Heathrow has paused its expansion programme. Under the current proposals by the CAA, the H7 regulatory period assumes that Heathrow will operate as a two-runway airport.

ESG considerations

The airport sector has been one of the sectors most significantly affected by the spread of the coronavirus outbreak, given its exposure to travel restrictions and sensitivity to consumer demand. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

The UK aviation sector has set a target of reaching net zero by 2050. LHR achieved carbon neutrality in 2020 and has committed to achieving zero-carbon infrastructure by the mid-2030s.

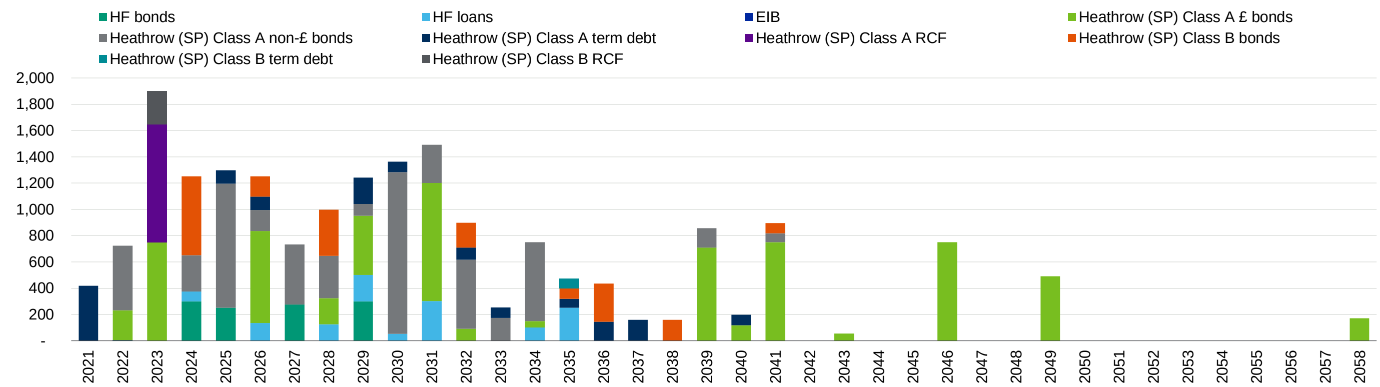
Liquidity

As of end-September 2021, the HF group's liquidity was excellent, supported by a cash balance of £4.1 billion, of which £259 million at the level of HF. The group had fully drawn on its committed bank lines, including RCF and working capital facility of £1.05 billion and £100 million respectively both due in 2023. Since then, the company has repaid the RCF in full.

HF has sufficient liquidity to service its debt in the near term, with annual cost at around £100 million. However, the HSP group's ability to upstream cash flows will be key to HF's liquidity over the medium term. The company's next debt maturity is in 2024, when its £300 million bond comes due.

The Heathrow group's debt maturities amount to around £740 million this year and £750 million in 2023. The group's debt repayments will increase to over £1.2 billion in 2024. Sizeable debt maturities present a risk, although we positively note the company's successful track record in raising funding well in advance of its upcoming debt maturities.

Exhibit 13
HF group will face large debt maturities in 2023
as of end-September 2021, in £ million



Heathrow repaid the RCF due in 2023 in November last year.
Source: Company, Moody's Investors Service

Structural considerations

HF's Corporate Family Rating (CFR) of Ba2 reflects a Probability of Default Rating of Ba3-PD and a 65% Expected Family Recovery Rate. The CFR is an opinion of the HF group's ability to honour its financial obligations and is assigned to HF as if it had a single class of debt and a single consolidated legal structure. The B1 rating of the HF Notes reflects the structural subordination of the HF Notes in the HF group structure versus the debt at Heathrow (SP) Limited (HSP).

HSP is financed via debt provided through a ring-fenced secured debt financing structure (the HSP SDF). The HSP SDF provides for the issuance of two tranches of debt, called Class A Debt and Class B Debt. Class B Debt is subordinated to Class A Debt. The terms of the HSP SDF limit the amount of Class A Debt and Class B Debt that can be issued by HSP through a requirement to maintain certain Net Debt to RAB ratios and Interest Cover Ratios.

The HF Debt is structurally subordinated to the Class A and Class B Debt and HSP can only provide cash to service debt at HF if it complies with the financial terms of the HSP SDF.

The HF Notes and the other HF Debt rank *pari passu* and are subject to the terms of an Intercreditor Agreement which regulates their rights with regard to each other and any future holder of HF Debt, and provides for the sharing of the security granted to the HF Debt holders. HF Debt holders benefit from a pledge of all of the shares in HSP (HF's only material asset) and a pledge of shares in HF.

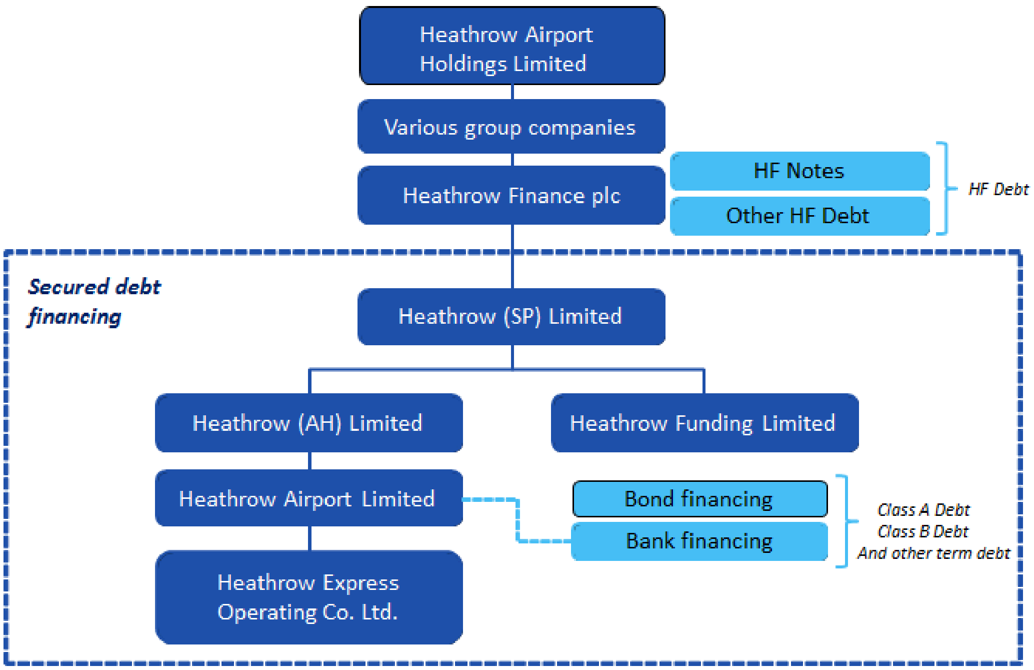
We consider that the HSP SDF isolates the credit profile of LHR from that of the wider Heathrow Airport Holdings Limited (HAH) group. While there is a certain reliance on HAH for operational support, this is considered acceptable within the context of the rating levels. This together with the security granted to the HF Debt holders should isolate HF from the risks of failure of the wider HAH group, and enables Moody's to ignore any debt in the wider HAH group when assessing the rating of HF. There are also certain restrictions on the raising of further debt by HF.

The terms of the HSP SDF also contain other constraints such as a requirement to comply with a hedging policy, liquidity dedicated to meeting interest payments on HSP SDF debt, and additional reporting requirements. While such protections only benefit HSP debt holders directly, and they could in theory be waived by HSP financiers, they do provide some element of protection to HF creditors by helping to protect the financial profile of HSP.

Exhibit 14

Heathrow Finance plc group structure

HF debt is structurally subordinated to HSP secured debt financing



Source: Moody's Investors Service

Rating methodology and scorecard factors

HF's Corporate Family Rating reflects our assessment of the company's business profile and financial performance in line with our Privately Managed Airports and Related Issuers Rating Methodology, published in September 2017.

Exhibit 15

Heathrow Finance plc - Rating Factors Grid

Privately Managed Airports and Related Issuers Industry [1][2]	Current FY 12/31/2020		Moody's Forward View of Dec-2023 As of January 2022 [3]	
Factor 1: Concession and Regulatory Frameworks (15%)	**Measure**	**Score**	**Measure**	**Score**
a) Ability to Increase Tariffs	A	A	A	A
b) Nature of Ownership / Control	Aaa	Aaa	Aaa	Aaa
Factor 2: Market Position (15%)				
a) Size of Service Area	Aa	Aa	Aa	Aa
b) Economic Strength & Diversity of Service Area	Aaa	Aaa	Aaa	Aaa
c) Competition for Travel	Baa	Baa	Baa	Baa
Factor 3: Service Offering (15%)				
a) Passenger Mix	Baa	Baa	Baa	Baa
b) Stability of traffic performance	Baa	Baa	Baa	Baa
c) Carrier Base	Aa	Aa	Aa	Aa
Factor 4: Capacity and Capital (5%)				
a) Ability to accommodate expected traffic growth	Baa	Baa	Baa	Baa
Factor 5: Financial Policy (10%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Factor 6: Leverage and Coverage (40%)				
a) (FFO + Cash Interest Expense) / (Cash Interest Expense)	0.6x	Caa	1.5x - 2.2x	Ba
b) FFO / Debt	-1.4%	Caa	2% - 5.5%	B
c) Moody's Debt Service Coverage Ratio	0.3x	Caa	1x - 1.6x	Caa/B
d) RCF / Debt	-2.0%	Caa	2% - 5.5%	B/Ba
Rating:				
Scorecard-Indicated Outcome Before Notch Adjustment		B2		Ba3/Ba2
Notch Lift	0	0	0	0
a) Scorecard-Indicated Outcome		B2		Ba3/Ba2
b) Actual Rating Assigned				Ba2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 31/12/2020. Credit metrics are based on a gross debt and do not positively factor in a significant amount of cash held on balance sheet.
[3] This represents Moody's forward view, not the view of the issuer, and unless noted in the text does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics

Ratings

Exhibit 16

Category	Moody's Rating
HEATHROW FINANCE PLC	
Outlook	Negative
Corporate Family Rating	Ba2
Senior Secured -Dom Curr	B1/LGD5

Source: Moody's Investors Service

Appendix

Exhibit 17

Peer comparison table

	Heathrow Finance plc Ba2 Negative			Royal Schiphol Group N.V. A1 Negative			Aeroporti di Roma S.p.A. Baa3 Positive		
(in GBP million)	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-18	FYE Dec-19	FYE Dec-20
Revenue	2,970	3,070	1,175	1,335	1,416	612	912	979	331
EBITDA	1,879	1,923	234	462	490	(140)	454	463	(23)
EBITDA margin %	63.3%	62.6%	19.9%	34.6%	34.6%	-22.8%	49.8%	47.3%	-6.8%
Funds from Operations (FFO)	1,023	1,070	(282)	419	467	(150)	385	375	(15)
Total Debt	15,122	16,343	19,544	2,339	2,366	4,388	1,315	1,299	2,150
(FFO + Interest Expense) / Interest Expense	2.3x	2.4x	0.6x	7.2x	7.4x	-0.8x	10.6x	10.5x	0.7x
FFO / Debt	6.8%	6.5%	-1.4%	18.1%	19.1%	-3.5%	29.7%	28.0%	-0.7%
RCF / Debt	3.5%	3.7%	-2.0%	12.4%	14.9%	-3.5%	12.7%	19.4%	-0.7%
Debt Service Coverage Ratio	1.9x	1.7x	0.3x	7.0x	8.6x	-0.7x	5.7x	5.6x	0.3x

All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade.
Source: Moody's Financial Metrics™

Exhibit 18

Heathrow Finance plc adjusted debt breakdown

(in GBP million)	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-20
As Reported Total Debt	**14,218**	**14,390**	**14,735**	**16,424**	**19,992**
Pensions	108	153	28	28	30
Leases	192	324	324	0	0
Non-Standard Adjustments	(547)	(181)	35	(109)	(478)
Moody's Adjusted Total Debt	**13,971**	**14,686**	**15,122**	**16,343**	**19,544**

All figures are calculated using Moody's estimates and adjustments. Non-standard adjustments include adjustments that use additional information to that disclosed in financial statements
Source: Moody's Financial Metrics™

Exhibit 19

Heathrow Finance plc adjusted FFO breakdown

(in GBP million)	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-20
As Reported Funds from Operations (FFO)	**1,601**	**1,671**	**1,739**	**1,777**	**158**
Pensions	34	24	22	26	20
Leases	20	33	33	0	0
Capitalized Interest	0	(46)	(50)	(44)	0
Alignment FFO	(133)	(236)	(189)	(128)	54
Unusual Items - Cash Flow	0	0	0	0	125
Non-Standard Adjustments	(578)	(549)	(532)	(561)	(639)
Moody's Adjusted Funds from Operations (FFO)	**944**	**897**	**1,023**	**1,070**	**(282)**

All figures are calculated using Moody's estimates and adjustments. Non-standard adjustments include adjustments that use additional information to that disclosed in financial statements
Source: Moody's Financial Metrics™

REPORT NUMBER 1314536