# BAA (SH) plc

## (Formerly BAA (SH) Limited)

## Annual report and financial statements

## for the year ended 31 December 2010

Company registration number: 06458635

# BAA (SH) plc (formerly BAA (SH) Limited)

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# BAA (SH) plc (formerly BAA (SH) Limited)

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# BAA (SH) plc (formerly BAA (SH) Limited)

## Business review

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

BAA (SH) Limited re-registered as a public company under the name of BAA (SH) plc on 15 October 2010.

The consolidated financial statements of BAA (SH) plc and its subsidiaries (together 'BAA (SH)' or the 'Group') have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('EU'). The accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

This business review is presented in three sections:
**Management review** – overview of the year ended 31 December 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.
**Corporate governance statement on internal controls and risk management** – outline of the BAA Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the BAA Group Executive Committee.

## Management review

**Review of 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.

***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 external 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 revenue 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 revenue, 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 Group is on track to deliver the expected growth.

# BAA (SH) plc (formerly BAA (SH) 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. Consistent with statutory accounting and IFRS, the business review presented excludes operations that have been disposed of during the current or prior years.

**Basis of preparation of statutory results**
A number of significant events which are highlighted in the Management review and Financial review have impacted the way in which the statutory financial results for 2010 have been presented.

- *Exceptional items and certain re-measurements* - these include the following:
  - £149 million relating to the write-off of runway planning application costs and write down of properties and land purchased in relation to potential future runway development prior to their transfer to investment property;
  - £90 million credit for the change in the Group's share of the BAA group's defined benefit pension scheme deficit at year end;
  - £31 million of fair value gains arising from the revaluation of investment property;
  - £36 million of fair value losses on financial instruments;
  - £19 million relating to accelerated depreciation on Heathrow Terminal 1; and
  - £13 million relating to reorganisation costs (including severance and redundancy).

**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 revenue, aeronautical income, retail income, other income, adjusted operating costs, Adjusted EBITDA and exceptional items 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 % |
|---|---|---|---|
| **Continuing operations** | | | |
| Revenue | 2,074 | 1,978 | 4.9 |
| Adjusted operating costs[1] | (1,107) | (1,093) | 1.3 |
| **Adjusted EBITDA[2]** | 967 | 885 | 9.3 |
| Exceptional items – pensions | 90 | (218) | n/a |
| Exceptional items – other | (13) | 1 | n/a |
| **EBITDA** | 1,044 | 668 | 56.3 |
| | | | |
| Fair value gain/(loss) on investment properties | 31 | (93) | n/a |
| Depreciation and amortisation – ordinary | (481) | (456) | 5.5 |
| Depreciation – exceptional | (19) | (55) | (65.5) |
| **Operating profit - continuing operations** | 575 | 64 | 798.4 |
| | | | |
| Impairment of property, plant and equipment – exceptional | (149) | - | n/a |
| Net finance cost | (733) | (637) | 15.1 |
| Fair value loss on financial instruments | (36) | (120) | (70.0) |
| **Loss before tax** | (343) | (693) | (50.5) |
| Tax credit | 123 | 164 | (25.0) |
| **Loss for the year from continuing operations** | (220) | (529) | (60.3) |
| | | | |
| Net profit/(loss) from discontinued operations | 16 | (120) | n/a |
| **Consolidated loss for the year** | (204) | (649) | (68.6) |

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

**Revenue**
In the year ended 31 December 2010, revenue from continuing operations increased 4.9% to £2,074 million (2009: £1,978 million). This reflects increases of 2.0%, 8.2% and 8.5% 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** | 1,093 | 2.0 |
| Retail income | **476** | 440 | 8.2 |
| Other income | **483** | 445 | 8.5 |
| **Total revenue** | **2,074** | 1,978 | 4.9 |

# BAA (SH) plc (formerly BAA (SH) Limited)

## Financial review *continued*

**Revenue *continued***

***Aeronautical income***

Aeronautical income increased 2.0% to £1,115 million (2009: £1,093 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** | 961 | 3.1 | **15.08** | 14.58 | 3.4 |
| Stansted | **124** | 132 | (6.1) | **6.66** | 6.62 | 0.7 |
| **Total** | **1,115** | 1,093 | 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.

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 £13 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 8.2% to £476 million (2009: £440 million) and NRI increasing 9.9% to £445 million (2009: £405 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** | 440 | 8.2 |
| Less: retail expenditure (£m) | **(31)** | (35) | (11.4) |
| **Net retail income (£m)** | **445** | 405 | 9.9 |
| 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 | **74** | 67 | 10.4 |
| Duty and tax-free | **114** | 101 | 12.9 |
| Airside specialist shops | **83** | 66 | 25.8 |
| Bureaux de change | **44** | 43 | 2.3 |
| Catering | **41** | 36 | 13.9 |
| Landside shops and bookshops | **25** | 26 | (3.8) |
| Advertising | **30** | 32 | (6.3) |
| Car rental | **15** | 14 | 7.1 |
| Other | **19** | 20 | (5.0) |
| **Total** | **445** | 405 | 9.9 |

At Heathrow, gross retail income increased 12.0% to £393 million (2009: £351 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 5.7% to £83 million (2009: £88 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.

**Revenue *continued***

***Other income***

Income from activities other than aeronautical and retail increased 8.5% to £483 million (2009: £445 million). This reflects rail income increasing 13.2% to £103 million (2009: £91 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 £160 million (2009: £152 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 16.7% to £112 million (2009: £96 million) due to £17 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%.

***Underlying revenue***

In the year ended 31 December 2010, revenue from continuing operations increased 4.9% to £2,074 million (2009: £1,978 million). To determine underlying revenue growth it is necessary to adjust for an additional £13 million in aeronautical income earned at Heathrow in 2009 above underlying levels due to phasing of tariff increases differing from the normal pattern and £17 million of non-recurring income generated in 2010 from the provision of various services to Gatwick airport under transitional services agreements.

Year on year revenue 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 revenue was affected by a combined estimated £38 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 million was due to reduced revenue.

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 revenue in the year ended 31 December 2010 is estimated to have increased by up to 7.3% to £2,108 million (2009: £1,965 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 1.3% to £1,107 million (2009: £1,092 million).

| | **Year ended 31 December 2010 £m** | Year ended 31 December 2009 £m | Change % |
|---|---|---|---|
| Employment costs | **316** | 291 | 8.6 |
| Maintenance expenditure | **135** | 147 | (8.2) |
| Utility costs | **115** | 126 | (8.7) |
| Rents and rates | **117** | 129 | (9.3) |
| General expenses | **233** | 237 | (1.7) |
| Retail expenditure | **31** | 35 | (11.4) |
| Intra-group charges/other | **160** | 128 | 25.0 |
| **Total** | **1,107** | 1,093 | 1.3 |

The main drivers of increased adjusted operating costs were higher employment costs and intra-group charges. Employment costs increased 8.6% to £316 million (2009: £291 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 £11 million relative to last year due to revised actuarial assumptions. Intra-group charges/other costs increased 23.1% to £160 million (2009: £130 million) primarily reflecting central overheads being allocated across a smaller business base following the sale of Gatwick (£28 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 £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 2.9% to £1,089 million (2009: £1,121 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 9.3% to £967 million (2009: £885 million), resulting in an Adjusted EBITDA margin of 46.6% (2009: 44.7%).

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 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 million (2009: £845 million), resulting in an underlying Adjusted EBITDA margin of 49.1% (2009: 42.7%).

Adjusted EBITDA at Heathrow (including Heathrow Express Operating Company Limited) increased 12.5% to £881 million (2009: £783 million). Stansted's Adjusted EBITDA declined 15.7% to £86 million (2009: £102 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 £91 million pre-tax charge (2009: £272 million) to the income statement in respect of exceptional items, including impairment charges and other one-off items for continuing operations with a £58 million credit (2009: £218 million charge) included in operating profit and a charge of £149 million (2009: £nil) below operating profit.

Items within operating profit included a £90 million non-cash pension related credit (2009: £218 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 £19 million (2009: £55 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 £13 million charge relating primarily to a restructuring process to reduce the size and cost of overhead functions following the sale of Gatwick airport in 2009.

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 million made of which £104 million related to the write-off of planning application costs and £45 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).

**Fair value gain on investment property valuation**
Investment properties were valued at a 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. Investment property comprises mainly car parks and airside assets at the Group's airports and is considered less vulnerable to market volatility. The investment property valuation as at 31 December 2010 resulted in a gain of £31 million (2009: £93 million loss).

**Depreciation and amortisation**
Depreciation and amortisation for the year ended 31 December 2010, excluding exceptional charges, was 5.5% higher at £481 million (2009: £456 million) due, for example, to depreciation commencing on significant recent investment in IT assets and Heathrow baggage search equipment, the refurbished Heathrow Terminal 4 check-in facilities and the first phase of the satellite building for the new Terminal 2 at Heathrow.

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

**Fair value loss on financial instruments**
A net fair value loss of £36 million (2009: £120 million loss) on financial instruments has been recognised as financing costs in the Income statement. This loss related primarily to index-linked swaps internally designated to hedge the Group's bond issues which do not achieve hedge accounting under IFRS as the accounting standards do not contemplate achieving hedge accounting using these products. The index-linked swaps also provide a commercial hedge of the Group's RPI linked revenue.

**Taxation**
The tax credit recognised for the year was £123 million (2009: £164 million). Based on a loss before tax for the year of £343 million (2009: £693 million), this results in an effective tax rate of 35.8% (2009: 23.7%).

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 £73 million, with £72 million credited to the income statement and £1 million credited to reserves.

**Net profit from discontinued operations**
The £16 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 million on the finalisation of Gatwick's balance sheet at completion of the disposal.

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

# BAA (SH) plc (formerly BAA (SH) Limited)

## Financial review *continued*

**Summary cash flow**

| | **Year ended 31 December 2010 £m** | Year ended 31 December 2009 £m |
|---|---|---|
| Cash generated from continuing operations | **918** | 851 |
| Taxation – group relief (paid)/received | **(17)** | 50 |
| Cash generated from discontinued operations | **-** | 132 |
| **Net cash flow from operating activities** | **901** | 1,033 |
| Capital expenditure | **(841)** | (876) |
| Investing activities of discontinued operations[1] | **(125)** | 1,234 |
| Proceeds from issuance bonds | **1,155** | 925 |
| Net movement in other borrowings | **(1,214)** | (661) |
| Net interest paid | **(398)** | (487) |
| Prepayment of derivative interest | **(37)** | (114) |
| Cancellation of derivatives | **(74)** | (43) |
| Restricted cash | **143** | (143) |
| Proceeds from issue of ordinary shares | **317** | 283 |
| Financing activities of discontinued operations | **-** | (1,093) |
| **Net (decrease)/increase in cash and cash equivalents** | **(173)** | 58 |

[1] 2010 includes Gatwick related pension costs, disposal costs and proceeds from disposal of operations. Refer to the Consolidated statement of cash flows 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 7.9% to £918 million (2009: £851 million) which compares with Adjusted EBITDA of £967 million (2009: £885 million). Operating cash flow was less than Adjusted EBITDA mainly due to cash contributions to pension schemes exceeding the pension charge to the Income statement by £33 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 million in capital expenditure (2009: £1,003 million including £127 million at Gatwick) with £819 million at Heathrow (2009: £818 million) and £22 million at Stansted (2009: £58 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 £44 million as measured under IAS 19, of which £37 million is attributable to the Group under the BAA group's shared services agreement. This compares with a total scheme deficit of £256 million at 31 December 2009. The reduction in the scheme deficit is due principally to the benefit of the £105 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. 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 2.5% from £10,143 million at 31 December 2009 to £10,401 million at 31 December 2010. The increase in net debt reflects capital investment at Heathrow exceeding the Group's cash flow after payment of interest.

The Group's nominal net debt at 31 December 2010 comprised £6,605 million outstanding under bond issues, £1,298 million outstanding under the bank refinancing facility, £2,433 million outstanding under other bank facilities, £132 million in index-linked derivative accretion and cash and cash equivalents of £67 million. Nominal net debt comprised £8,793 million in senior net debt and £1,128 million in junior debt (both held at BAA (SP)'s subsidiaries) together with £480 million in net debt held at the Company.

The accounting value of the Group's net debt at 31 December 2010 excluding accrued interest was £10,331 million (2009: £10,235 million).

The average cost of the Group's external gross debt at 31 December 2010 was 4.55% (2009: 5.62%), 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.

**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. The Group raised approximately £2.0 billion of new financing, repaying the majority of its short-term maturities, including the Company's previous £1.57 billion debt facility, and enhancing the Group's overall capital structure.

## Financial review *continued*

**Financing activities *continued***

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 million tranche of a £500 million equity injection announced in November 2009. A further £100 million was injected in September 2010.

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 its revolving capital expenditure facility, from BAA (SP) to the Company. The Company 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 the Company's previous debt facility was completed with a £175 million loan facility and a £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 | 10,453 | 1,278 | 11,731 |
| 31 December 2010 | 11,449 | 1,327 | 12,776 |

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 finance costs and net interest paid**

In the year ended 31 December 2010, the Group's net finance costs before certain re-measurements were £733 million (2009: £637 million), which included £890 million (2009: £789 million) of interest on external bonds and bank debt and related derivatives and £28 million (2009: £21 million) of financing facility fees and other items. These charges were partially offset by £162 million (2009: £151 million) in finance income and £23 million (2009: £22 million) in capitalised interest. The increased net finance costs in 2010 largely reflect the net £123 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 £36 million (2009: £120 million).

Net interest paid in the year ended 31 December 2010 was £398 million (2009: £487 million). This consisted of £326 million (2009: £383 million) net interest paid by the Company's subsidiaries and £72 million (2009: £104 million) paid by the Company. The reduction in net interest paid by the Company's subsidiaries between 2009 and 2010 primarily reflects the 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 Company's debt 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 finance costs primarily due to an amortisation charge of £141 million (2009: £140 million) in net finance costs relating to prepayments of derivative interest implemented principally in earlier periods and a £119 million non-cash charge (2009: £16 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 gearing ratio (nominal net debt to RAB) was 81.4% compared with the 90.0% covenant level under the Company's financing agreements. BAA (SP)'s senior and junior gearing ratios were 68.8% and 77.7% respectively compared with trigger levels of 70.0% and 85.0%.

In the year ended 31 December 2010, the Group's interest cover ratio (the ratio of cashflow from operations less tax paid less 2% of RAB to interest paid) was 1.55x compared with the 1.00x covenant levels under the Company's financing agreements. BAA (SP)'s senior and junior interest cover ratios were 2.08x and 1.85x compared with trigger levels of 1.40x and 1.20x.

**Accounting and reporting policies and procedures**

This annual report complies with the European regulation to report consolidated financial statements in conformity with IFRS from 1 April 2005 onwards. The consolidated results in the financial statements for the year ended 31 December 2010 are presented on an IFRS basis as adopted by the European Union, along with the comparative information for the year ended 31 December 2009. The Group's accounting policies and areas of significant accounting judgements and estimates are detailed within the Group financial statements. The Company accounts are stated under United Kingdom Generally Accepted Accounting Practice ('UK GAAP').

# BAA (SH) plc (formerly BAA (SH) Limited)

## Corporate governance statement on internal controls and risk management

Internal control and risk management are key elements of the BAA Limited Group's (the 'BAA Group') corporate operations of which the Group forms part. Risk is centrally managed for the Group as part of 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. The scope of the operations of the AAC also includes BAA (SH).

**Internal controls**

The directors are responsible for the system of internal controls designed to mitigate the risks faced by the Company (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 interim and annual reporting, including press releases;
- 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 interim and annual financial statements, and 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.

## Corporate governance statement on 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 (SH) plc (formerly BAA (SH) Limited)

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

***Commercial and financial risks continued***

*Treasury*

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

The treasury function is not permitted to speculate in financial instruments. Its purpose is to identify, mitigate and hedge treasury related financial risks inherent in the 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 76% 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 both investment grade (at BAA (SP) level) and sub-investment grade (at BAA (SH) level) financing platforms for its airports. The BAA (SP) 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 both senior (A-/A-) and 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.

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

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

The Group has positive cash flows before capital expenditure and maintains at least 12 months' headroom under the revolving capital expenditure facility. As at 31 December 2010, cash at bank was £67 million, undrawn headroom under bank credit facilities was £1,450 million and undrawn headroom under bank liquidity facilities was £524 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 cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short- and long-term credit ratings. Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with 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 short- and long-term credit ratings below BBB+/A.

On behalf of the Board

**José Leo**
Director

22 February 2011

# BAA (SH) plc (formerly BAA (SH) 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 (SH) plc is as the holding company of BAA (SP) Limited. BAA (SP) Limited is the holding company for BAA (AH) Limited, owner of the designated airports (Heathrow and Stansted airports) and BAA Funding Limited, the bond issuer of the Security 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 £204 million (2009: £649 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. Alexander Turnbull was appointed as Company Secretary upon re-registration of the Company as a plc on 15 October 2010.

**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.

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

# BAA (SH) plc (formerly BAA (SH) Limited)

## 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 Corporate governance statement on 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.

By order of the Board

**Alexander Turnbull**
Company Secretary

22 February 2011

Company registration number: 06458635

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

In preparing the Group financial statements, International Accounting Standard ('IAS') 1 requires that directors:
- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

In preparing the parent company financial statements, the directors are required to:
- select suitable accounting policies and then apply them consistently;
- make 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.

By order of the Board

**Alexander Turnbull**
Company Secretary

22 February 2011

## BAA (SH) plc (formerly BAA (SH) Limited)

### Independent auditors' report to the members of BAA (SH) plc

We have audited the Group financial statements of BAA (SH) plc for the year ended 31 December 2010 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of financial position, the Consolidated statement of changes in equity, the Consolidated statement of cash flows, the Accounting policies, the Significant accounting judgements and estimates and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an 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 its loss for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

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

**Matters on which we are required to report by exception**
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us report to you if, in our opinion:

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

**Other matter**
We have reported separately on the parent company financial statements of BAA (SH) plc for the year ended 31 December 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 (SH) plc (formerly BAA (SH) Limited)

## Consolidated income statement for the year ended 31 December 2010

| | Note | Year ended 31 December 2010 Before certain re-measurements £m | Year ended 31 December 2010 Certain re-measurements[2] £m | Year ended 31 December 2010 Total £m | Restated[1] Year ended 31 December 2009 Before certain re-measurements £m | Restated[1] Year ended 31 December 2009 Certain re-measurements[2] £m | Restated[1] Year ended 31 December 2009 Total £m |
|---|---|---|---|---|---|---|---|
| **Continuing operations** | | | | | | | |
| **Revenue** | *1* | **2,074** | **-** | **2,074** | 1,978 | - | 1,978 |
| Operating costs | *2* | **(1,530)** | **-** | **(1,530)** | (1,821) | - | (1,821) |
| Other operating costs | | | | | | | |
| Fair value gain/(loss) on investment properties | *8* | **-** | **31** | **31** | - | (93) | (93) |
| **Operating profit/(loss)** | *1* | **544** | **31** | **575** | 157 | (93) | 64 |
| *Analysed as:* | | | | | | | |
| Operating profit/(loss) before exceptional items | | **486** | **31** | **517** | 429 | (93) | 336 |
| Exceptional items | *3* | **58** | **-** | **58** | (272) | - | (272) |
| **Exceptional impairment of property, plant and equipment** | *3* | **(149)** | **-** | **(149)** | - | - | - |
| **Financing** | | | | | | | |
| Finance income | *4a* | **162** | **-** | **162** | 151 | - | 151 |
| Finance costs | *4a* | **(895)** | **-** | **(895)** | (788) | - | (788) |
| Fair value loss on financial instruments | *4b* | **-** | **(36)** | **(36)** | - | (120) | (120) |
| | | **(733)** | **(36)** | **(769)** | (637) | (120) | (757) |
| **Loss before tax** | | **(338)** | **(5)** | **(343)** | (480) | (213) | (693) |
| Taxation credit | *5* | **109** | **14** | **123** | 114 | 50 | 164 |
| **Loss for the year from continuing operations** | | **(229)** | **9** | **(220)** | (366) | (163) | (529) |
| Net profit/(loss) from discontinued operations[3] | *6* | **16** | **-** | **16** | (84) | (36) | (120) |
| **Consolidated loss for the year** | | **(213)** | **9** | **(204)** | (450) | (199) | (649) |

[1] The presentation of balances for the year ended 31 December 2009 has been restated to be consistent with current year disclosures.
[2] Certain re-measurements consist of fair value gains and losses on investment property revaluations and disposals, gains and losses arising on the re-measurement and disposal of financial instruments, together with the associated fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship and the related tax impact of these items.
[3] Includes the results of Gatwick airport as a result of its classification as discontinued operations.

# BAA (SH) plc (formerly BAA (SH) Limited)

## Consolidated statement of comprehensive income for the year ended 31 December 2010

| | Note | **Year ended 31 December 2010 £m** | Year ended 31 December 2009 £m |
|---|---|---|---|
| **Loss for the year** | | **(204)** | (649) |
| | | | |
| **Other comprehensive income:** | | | |
| Cash flow hedges | | | |
| (Loss)/gain taken to equity | *23* | **(172)** | 14 |
| Transferred to income statement | *23* | **107** | 208 |
| Change in tax rate | *17,23* | **1** | - |
| Indexation of operating land | *17,23* | **(1)** | 3 |
| **Other comprehensive (loss)/income for the year net of tax** | | **(65)** | 225 |
| **Total comprehensive loss for the year** | | **(269)** | (424) |

Items in the statement above are disclosed net of tax. The income tax relating to each component of other comprehensive income is disclosed in Note 23.

# BAA (SH) plc (formerly BAA (SH) Limited)

## Consolidated statement of financial position as at 31 December 2010

| | Note | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 7 | **10,013** | 9,940 |
| Investment properties | 8 | **2,218** | 2,084 |
| Intangible assets | 9 | **51** | 55 |
| Derivative financial instruments | 15 | **552** | 683 |
| Trade and other receivables | 11 | **28** | 49 |
| | | **12,862** | 12,811 |
| **Current assets** | | | |
| Inventories | 10 | **5** | 5 |
| Trade and other receivables | 11 | **361** | 307 |
| Restricted cash | 12 | **-** | 143 |
| Cash and cash equivalents | 13 | **67** | 240 |
| | | **433** | 695 |
| **Total assets** | | **13,295** | 13,506 |
| **Liabilities** | | | |
| **Non-current liabilities** | | | |
| Borrowings | 14 | **(10,359)** | (10,434) |
| Derivative financial instruments | 15 | **(573)** | (338) |
| Deferred income tax liabilities | 17 | **(1,880)** | (2,027) |
| Provisions | 18 | **(5)** | (18) |
| Trade and other payables | 19 | **(3)** | (5) |
| | | **(12,820)** | (12,822) |
| **Current liabilities** | | | |
| Borrowings | 14 | **(198)** | (195) |
| Provisions | 18 | **(81)** | (322) |
| Current income tax liabilities | | **(36)** | (29) |
| Trade and other payables | 19 | **(350)** | (336) |
| | | **(665)** | (882) |
| **Total liabilities** | | **(13,485)** | (13,704) |
| **Net liabilities** | | **(190)** | (198) |
| **Equity** | | | |
| **Capital and reserves** | | | |
| Share capital | 20 | **3,109** | 2,792 |
| Revaluation reserve | 21 | **365** | 365 |
| Merger reserve | 21 | **(1,771)** | (1,771) |
| Fair value reserve | 22 | **(175)** | (108) |
| Retained earnings | 24 | **(1,718)** | (1,476) |
| **Total equity** | | **(190)** | (198) |

These financial statements of BAA (SH) plc (Company registration number: 06458635) 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 (SH) plc (formerly BAA (SH) Limited)

## Consolidated statement of changes in equity for the year ended 31 December 2010

| | | Attributable to owners of the Company | | | | | |
|---|---|---|---|---|---|---|---|
| | Note | Share capital £m | Revaluation reserve[1] £m | Merger reserve £m | Fair value reserve £m | Retained earnings £m | Total equity £m |
| 1 January 2009 | | 2,509 | 365 | (2,865) | (330) | 264 | (57) |
| Comprehensive income: | | | | | | | |
| Loss for the year | | - | - | - | - | (649) | (649) |
| Other comprehensive income: | | | | | | | |
| Profit on re-measurement of the following: | | | | | | | |
| Cash flow hedges net of tax | *23* | - | - | - | 222 | - | 222 |
| Transferred from merger reserve to retained earnings | | - | - | 1,094 | - | (1,094) | - |
| Indexation of operating land | *17,23* | - | - | - | - | 3 | 3 |
| Total comprehensive income | | - | - | 1,094 | 222 | (1,740) | (424) |
| Transactions with owners: | | | | | | | |
| Proceeds from shares issued | | 283 | - | - | - | - | 283 |
| Total transactions with owners | | 283 | - | - | - | - | 283 |
| 1 January 2010 | | 2,792 | 365 | (1,771) | (108) | (1,476) | (198) |
| **Comprehensive income:** | | | | | | | |
| Loss for the year | | **-** | **-** | **-** | **-** | **(204)** | **(204)** |
| **Other comprehensive income:** | | | | | | | |
| Loss on re-measurement of the following: | | | | | | | |
| Cash flow hedges net of tax | *23* | **-** | **-** | **-** | **(65)** | **-** | **(65)** |
| Change in tax rate | *17* | **-** | **-** | **-** | **(2)** | **3** | **1** |
| Indexation of operating land | *17,23* | **-** | **-** | **-** | **-** | **(1)** | **(1)** |
| **Total comprehensive income** | | **-** | **-** | **-** | **(67)** | **(202)** | **(269)** |
| **Transactions with owners/fellow subsidiaries:** | | | | | | | |
| Proceeds from shares issued | *20* | **317** | **-** | **-** | **-** | **-** | **317** |
| Capital distribution | *24* | **-** | **-** | **-** | **-** | **(16)** | **(16)** |
| Tax on capital contribution | *24* | **-** | **-** | **-** | **-** | **(24)** | **(24)** |
| **Total transactions with owners/fellow subsidiaries** | | **317** | **-** | **-** | **-** | **(40)** | **277** |
| **31 December 2010** | | **3,109** | **365** | **(1,771)** | **(175)** | **(1,718)** | **(190)** |

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

# BAA (SH) plc (formerly BAA (SH) Limited)

## Consolidated statement of cash flows for the year ended 31 December 2010

| | Note | Year ended 31 December 2010 £m | Restated[1] Year ended 31 December 2009 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from continuing operations | *26* | **918** | 851 |
| Taxation - group relief (paid)/received | | **(17)** | 50 |
| Cash generated from discontinued operations | | **-** | 132 |
| **Net cash from operating activities** | | **901** | 1,033 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of: | | | |
| Property, plant and equipment | | **(822)** | (836) |
| Investment properties | | **-** | (24) |
| Intangible assets | | **(19)** | (16) |
| Investing activities of discontinued operations and disposal proceeds | | **(125)** | 1,234 |
| **Net cash (used in)/from investing activities** | | **(966)** | 358 |
| | | | |
| **Cash flows from financing activities** | | | |
| Proceeds from issuance of bonds | | **1,155** | 925 |
| Drawdown of Class B facility | | **625** | - |
| Drawdown of capital expenditure facility | | **600** | 450 |
| Drawdown of subordinated facility | | **175** | - |
| Repayment of subordinated facility | | **(1,566)** | - |
| Repayment of facilities and other items | | **(1,048)** | (1,111) |
| Prepayment of derivative interest | | **(37)** | (114) |
| Cancellation of derivatives | | **(74)** | (43) |
| Interest paid | | **(399)** | (487) |
| Interest received | | **1** | - |
| Restricted cash | *12* | **143** | (143) |
| Proceeds from issue of ordinary shares | *20* | **317** | 283 |
| Financing activities of discontinued operations | | **-** | (1,093) |
| **Net cash used in financing activities** | | **(108)** | (1,333) |
| **Net (decrease)/increase in cash and cash equivalents** | | **(173)** | 58 |
| Cash and cash equivalents at beginning of year | | **240** | 182 |
| **Cash and cash equivalents at end of year** | *13* | **67** | 240 |

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

# BAA (SH) plc (formerly BAA (SH) Limited)

## 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 consistently applied to all the years presented, unless otherwise stated.

**Primary financial statements format**
The primary financial statements are presented in accordance with International Financial Reporting Standards ('IFRS') and International Accounting Standard ('IAS 1') 'Presentation of Financial Statements'.

A columnar approach has been adopted in the income statement and the impact of three principal groups of items is shown in a separate column ('certain re-measurements'). This allows the presentation of the performance of the business before these specific fair value gains and losses. These items are:

i fair value gains and losses on investment property revaluations and disposals;
ii derivative financial instruments and the fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship; and
iii the associated tax impacts of the items in (i) and (ii) above.

**Basis of accounting**
The Group financial statements are prepared in accordance with IFRS as adopted by the European Union ('EU') and under the historical cost convention, except for investment properties, available-for-sale assets, derivative financial instruments and financial liabilities that qualify as hedged items under a fair value hedge accounting system. These exceptions to the historic cost convention have been measured at fair value in accordance with IFRS and as permitted by the Fair Value Directive as implemented in the Companies Act 2006.

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

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

- the forecast revenue and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall Group liquidity position, including 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).

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

**Changes in accounting policy and disclosures**
(a) *New and amended standards adopted by the Group*
The Group has adopted the following new and amended IFRS as of 1 January 2010, none of which have had a material impact on the Group's financial statements.

- IFRS 3(2008) Business Combinations, IAS 27(2008) Consolidated and Separate Financial Statements and IAS 28(2008) Investments in Associates
  This standard has introduced a number of changes in the accounting for business combinations when acquiring a subsidiary or an associate. IFRS 3(2008) has also introduced additional disclosure requirements for acquisitions.

- Amendment to IFRS 2 Share-based Payment
  IFRS 2 has been amended, following the issue of IFRS 3(2008), to confirm that the contribution of a business on the formation of a joint venture and common control transactions are not within the scope of IFRS 2.

- Amendment to IAS 17 Leases
  IAS 17 has been amended such that it may be possible to classify a lease of land as a finance lease if it meets the criteria for that classification under IAS 17.

- Amendment to IAS 39 Financial Instruments: Recognition and Measurement
  IAS 39 has been amended to state that options contracts between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date are not excluded from the scope of the standard.

- IFRIC 17 Distributions of Non-cash Assets to Owners
  The Interpretation provides guidance on when an entity should recognise a non-cash dividend payable, how to measure the dividend payable and how to account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable when the payable is settled.

- IFRS 2 (amended) Group Cash-settled Share-based Payment Transactions
  The amendment clarifies the accounting for share-based payment transactions between group entities.

(b) *Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Group*
The following standards, amendments and interpretations, which have not been applied in these financial statements, were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IFRS 9 Financial Instruments
- IAS 24 (amended) Related Party Disclosures
- IAS 32 (amended) Classification of Rights Issues
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
- IFRIC 14 (amended) Prepayments of a Minimum Funding Requirement
- Improvements to IFRS (May 2010)

**Changes in accounting policy and disclosures *continued***

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

The adoption of IFRS 9 will impact both the measurement and disclosures of financial instruments. No decision will be made by the Group on early adoption until all phases of the standard are complete.

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

**Business combinations**

***Basis of consolidation***

The Group financial statements consolidate the financial statements of BAA (SH) plc and all its subsidiaries.

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

***Subsidiaries***

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

The acquisition of subsidiaries by the Group is accounted for using the acquisition method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree. All acquisition-related costs are expensed.

Where applicable, the consideration for the acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition-date fair value. Subsequent changes in such fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments. Measurement period adjustments are adjustments that arise from additional information during the 'measurement period', which cannot exceed one year from the acquisition date, about facts and circumstances that existed at the acquisition date. All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounted for in accordance with relevant IFRS. Changes in the fair value of contingent consideration classified as equity are not recognised.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 'Business Combinations' are recognised at their fair values at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognised and measured in accordance with IAS 12 'Income Taxes' and IAS 19 'Employee Benefits' respectively;
- liabilities or equity instruments related to the replacement by the Group of an acquiree's share-based payment awards are measured in accordance with IFRS 2 'Share-based Payment'; and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' are measured in accordance with that Standard.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

The results of subsidiaries acquired or sold are consolidated for the periods from or to the date on which control passed to or from the Group.

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

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest (if any) in the entity over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the Group's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree (if any), the excess is recognised immediately in income statement as a bargain purchase gain.

**Segment reporting**
For the purposes of Group reporting, the reportable segments are consistent with those operating segments reported upon on a monthly basis to the chief operating decision-maker. The chief operating decision maker is considered to have responsibility for allocating resources and assessing performance of the operating segments and has been identified as the Board.

The Group's operating segments are organised according to their regulatory environment, type of operation and geographical location. The operating segments are primarily the individual airports, and Heathrow Express ('HEX') which are organised and managed separately on the basis of the above operating environment. As such, the following operating segments are reported to the Board on a monthly basis:
- designated group (price regulated airports of Heathrow and Stansted and HEX rail operations);
- other operations (corporate activities and other commercial operations); and
- discontinued operations (Gatwick airport).

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

***Aeronautical***
- Passenger charges based on the number of departing passengers on departure.
- Aircraft landing charges levied according to weight on landing.
- Aircraft parking charges based on a combination of weight and time parked.
- Other charges levied for passengers 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 (e.g. check-in desks), recognised as each service period is provided.
- Other invoiced sales, recognised on the performance of the service.

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

***Government grants***
On occasion, the Group may receive grants to provide financial incentives to improve airport infrastructure considered to be in the best interest of the public. No such grants have been received in 2010. Grants received are treated as deferred income until such time as the terms of the grant are satisfied at which time they are recognised as revenue in the period.

**Exceptional items**
The Group presents, on the face of the income statement, disclosure of exceptional items. Exceptional items are material items of income or 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 that do not qualify as discontinued operations, major reorganisation of businesses, closure or mothballing of terminals and costs incurred in bringing new airport terminal complexes and airfields to operational readiness that are not able to be capitalised as part of the project.

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

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.

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

**Borrowing costs**
Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until the asset is complete and ready for use. Such borrowing costs are capitalised once planning permission has been obtained and/or where projects are in the early stages of planning but the directors are satisfied that the necessary consents will be received. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the income statement in the year in which they are incurred.

**Assets classified as held-for-sale**
Non-current assets and disposal groups are classified as held-for-sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable, the asset (or disposal group) is available for immediate sale in its present condition, management are committed to the sale and the sale is expected to be completed within one year of the date of classification.

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

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

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

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

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

| *Terminal complexes* | *Fixed asset lives* |
|---|---|
| Terminal building, pier and satellite structures | 20–60 years |
| Terminal fixtures and fittings | 5–20 years |
| Airport plant and equipment | |
| Baggage systems | 15 years |
| Screening equipment | 7 years |
| Lifts, escalators and travelators | 20 years |
| Other plant and equipment, including runway lighting and building plant | 5–20 years |
| Tunnels, bridges and subways | 50–100 years |
| Airport transit systems | |
| Rolling stock | 20 years |
| Track | 50 years |
| | |
| *Airfields* | |
| Runway surfaces | 10–15 years |
| Runway bases | 100 years |
| Taxiways and aprons | 50 years |
| | |
| *Rail* | |
| Rolling stock | 8–40 years |
| Tunnels | 100 years |
| Track metalwork | 5–10 years |
| Track bases | 50 years |
| Signals and electrification work | 40 years |
| | |
| *Plant and equipment* | |
| Motor vehicles | 4–8 years |
| Office equipment | 5–10 years |
| Computer equipment | 4–5 years |
| Computer software | 3–7 years |
| | |
| *Other land and buildings* | |
| Short leasehold properties | Over period of lease |

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

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

**Property, plant and equipment *continued***

***Impairment of assets continued***

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

**Investment properties**

Investment property, which is property held to earn rentals and/or for capital appreciation, is stated at fair value at the reporting date, as determined at the interim and full-year reporting dates by the directors and by external valuers every year. Gains or losses arising from changes in the fair value of investment property are recognised in the income statement in the period in which they arise.

Gains or losses on disposal of an investment property are recognised in the income statement on the unconditional completion of the sale.

**Intangible assets**

***Internally-generated intangible assets***

Development expenditure incurred in respect of individual projects is capitalised when the future economic benefit of the project is probable and is recognised only if all of the following conditions are met:

- an intangible asset is created that can be separately identified, and
- it is probable that the intangible asset created will generate future economic benefits, and
- the development cost of the intangible asset can be measured reliably.

This type of expenditure primarily relates to internally developed software and website projects and these are amortised on a straight-line basis over their useful lives of three to seven years.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

**Leases**

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

***Group as a lessee***

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

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

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

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

***Group as a lessor***

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

**Inventories**

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

**Restricted cash**

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

**Cash and cash equivalents**

For the purposes of the Statement of cash flows, cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments and bank overdrafts, where offset is allowed.

**Deferred income**

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

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

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

**Financial instruments**
***Trade and other receivables***
Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost, using the effective interest rate method, less provision for impairment.

***Investments***
On initial recognition, financial assets are measured at fair value, plus, in the case of investments not at fair value through the income statement, directly attributable transaction costs. After initial recognition, investments that are classified as ‘held-for-trading’ and ‘available-for-sale’ are measured at fair value. Fair value gains or losses on investments held-for-trading are recognised in the income statement. Fair value gains or losses on available-for-sale investments are recognised in a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative fair value gain or loss previously reported in equity is included in the income statement. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indication that the security is impaired. If impairment is indicated, the cumulative fair value gain or loss previously reported in equity is included in the income statement.

Assets classified as ‘loans and receivables’ or ‘held-to-maturity’ are recognised in the statement of financial position at their amortised cost, using the effective interest rate method, less any provision for impairment.

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as ‘loans and receivables’ and are carried at amortised cost using the effective interest rate method. Non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group’s management has the positive intent and ability to hold to maturity are classified as ‘held-to-maturity’ and are carried at amortised cost using the effective interest rate method. For investments carried at amortised cost, gains and losses are recognised in the income statement when the investments are de-recognised or impaired, as well as through the amortisation process.

For investments that are traded in an active market, fair value is determined by reference to quoted market bid prices at the reporting date. For investments where there is no quoted market price, fair value is determined by using valuation techniques, such as estimated discounted cash flows, or by reference to the current market value of similar investments.

Purchases and sales of investments are recognised on trade-date being the date on which the Group commits to purchase or sell the asset.

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

***Financial liabilities and equity***
Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of a business after deducting all of its liabilities.

***Borrowings***
Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost unless part of a fair value hedge relationship. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest rate method. Borrowings being novated or cancelled and re-issued, with a substantial modification of the terms, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, with any resulting gain or loss recognised in the income statement.

***Bonds issue costs***
Prepaid fees in relation to the future issuance of debt are held on the statement of financial position on the basis that such issuance is considered probable. If issues do not occur, or are deemed not to be probable, such fees are recognised in the income statement.

***Trade and other payables***
Trade and other payables are non-interest bearing and are stated at their fair value and subsequently measured at amortised cost using the effective interest rate method.

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

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

The Group designates certain derivatives as either:

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

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

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

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

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

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

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

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

***Derivatives at fair value through the income statement***
Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of these derivative instruments are recognised immediately in the income statement.

When derivatives are designated in a fair value hedge or a cash flow hedge of interest rate risk, the net interest payable or receivable on those derivatives is recorded net of the interest on the underlying hedged item in the income statement. When derivatives are not in a hedge relationship the fair value changes on these derivatives are recognised within fair value gains/(losses) on financial instruments in the income statement. The interest payable and receivable on those derivatives are recorded at their gross amount in finance costs and finance income in the income statement.

**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.

**Shared Services Agreement *continued***

***Pension costs continued***

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 – Pensions, and will only be settled when the cash outflows are requested by BAA Airports Limited.

**Current and deferred income tax**

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries where the Group's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Group's financial statements. Deferred income taxation is not provided on the initial recognition of an asset or liability in a transaction, other than a business combination, if at the time of the transaction there is no effect on either accounting or taxable profit or loss.

Deferred income taxation is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

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

Income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

**Share capital**

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

**Dividend distribution**

A dividend distribution to the Company's shareholder is recognised as a liability in the Group's financial statements in the period in which the shareholder's right to receive payment of the dividend is established 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 income statement, except when deferred in equity as qualifying cash flow hedges. Translation differences on non-monetary items, such as equities classified as available-for-sale investments, are recognised in equity within the fair value reserve.

# BAA (SH) plc (formerly BAA (SH) 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 IFRS and the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. 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, £107 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 million (2009: £98 million) of fair value losses on these derivatives have been deferred into the cash flow hedge reserve.

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

**Fair value of derivative financial instruments**

The fair value of derivative financial instruments is 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.

# BAA (SH) plc (formerly BAA (SH) Limited)

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

### 1 Segment information

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

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

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

In 2009 the Group formally disposed of Gatwick airport. The performance of Gatwick airport is distinguished from the performance of continuing Group operations in the annual report through classification as discontinued operations.

Table (a) details total revenue from external customers for the year ended 31 December 2010 and is broken down into aeronautical, retail, property and facilities and other in respect of the reportable segments. No information in relation to inter-segmental revenue is disclosed as it is not considered material. Also detailed within table (a) is EBITDA on a pre and post exceptional basis.

Table (b) details comparative information to table (a) for the year ended 31 December 2009.

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

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

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

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

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

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

[2] Relates to the sale of Gatwick airport on 3 December 2009, refer to Note 6.

Revenue of approximately £487 million (2009: £478 million) was derived from a single external customer and is primarily included within the Heathrow segment above. In 2009, £52 million was derived from the same customer by discontinued operations.

# BAA (SH) plc (formerly BAA (SH) Limited)

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

### 1 Segment information *continued*

| Table (b) | Segment revenue | | | | | EBITDA | | |
|---|---|---|---|---|---|---|---|---|
| Year ended 31 December 2009 | Aero-nautical £m | Retail £m | Property & facilities £m | Other £m | Total revenue from external customers £m | Pre exceptional items £m | Operating exceptional items[1] £m | Post exceptional items £m |
| Heathrow | 961 | 352 | 240 | 91 | 1,644 | 744 | (181) | 563 |
| Heathrow Express | - | - | - | 91 | 91 | 39 | - | 39 |
| Stansted | 132 | 88 | 19 | 4 | 243 | 102 | (36) | 66 |
| **Total** | 1,093 | 440 | 259 | 186 | 1,978 | 885 | (217) | 668 |
| **Reconciliation to statutory information** | | | | | | | | |
| **Unallocated income and expenses** | | | | | | | | |
| Depreciation and amortisation | | | | | | | | (511) |
| **Operating profit** (before certain re-measurements) | | | | | | | | 157 |
| Fair value loss on investment properties (certain re-measurements) | | | | | | | | (93) |
| Finance income | | | | | | | | 151 |
| Finance costs | | | | | | | | (788) |
| Fair value loss on financial instruments (certain re-measurements) | | | | | | | | (120) |
| **Loss before tax** | | | | | | | | (693) |
| Taxation | | | | | | | | 114 |
| Taxation (certain re-measurements) | | | | | | | | 50 |
| **Taxation** | | | | | | | | 164 |
| **Loss for the year – continuing operations** | | | | | | | | (529) |
| Net loss from discontinued operations[2] | | | | | | | | (120) |
| **Consolidated loss for the year** | | | | | | | | (649) |

[1] Operating exceptional items for statutory reporting purposes include £55 million accelerated depreciation (included within depreciation and amortisation above) as compared to £nil for segmental reporting.

[2] Includes the results of Gatwick airport, refer to Note 6.

**1 Segment information *continued***

| Table (c) | Year ended 31 December 2010 | | | Year ended 31 December 2009 | | |
|---|---|---|---|---|---|---|
| | **Depreciation & amortisation[1]** | **Fair value gain/(loss)[2]** | **Profit on disposal** | Depreciation & amortisation[1] | Fair value loss[2] | Loss on disposal |
| | **£m** | **£m** | **£m** | £m | £m | £m |
| Heathrow | **(418)** | **35** | **-** | (431) | (52) | - |
| Heathrow Express | **(41)** | **-** | **-** | (41) | - | - |
| Stansted | **(41)** | **(4)** | **-** | (39) | (41) | - |
| Continuing operations | **(500)** | **31** | **-** | (511) | (93) | - |
| Discontinued operations | **-** | **-** | **16** | - | (49) | (161) |
| **Total Group** | **(500)** | **31** | **16** | (511) | (142) | (161) |

[1] Includes intangible amortisation charge of £23 million (2009: £27 million) and for Heathrow includes exceptional depreciation of £19 million (2009: £55 million), refer to Note 3.
[2] Reflects fair value gains and losses on investment properties only.

| Table (d) | 31 December 2010 | | | 31 December 2009 | | |
|---|---|---|---|---|---|---|
| | **Assets[1]** | **Liabilities** | **Capital expenditure** | Assets[1] | Liabilities | Capital expenditure |
| | **£m** | **£m** | **£m** | £m | £m | £m |
| Heathrow | **10,118** | **(382)** | **768** | 9,750 | (564) | 707 |
| Heathrow Express | **1,084** | **(8)** | **11** | 1,118 | (8) | 14 |
| Stansted | **1,347** | **(33)** | **18** | 1,495 | (70) | 52 |
| Total | **12,549** | **(423)** | **797** | 12,363 | (642) | 773 |
| Other operations | **-** | **(16)** | **-** | 1 | (39) | - |
| **Total operations** | **12,549** | **(439)** | **797** | 12,364 | (681) | 773 |
| Unallocated assets and liabilities: | | | | | | |
| Cash and borrowings | **67** | **(10,557)** | | 383 | (10,629) | |
| Derivative financial instruments | **552** | **(573)** | | 683 | (338) | |
| Taxation | **-** | **(1,916)** | | - | (2,056) | |
| Amounts owed from group undertakings | **127** | **-** | | 76 | - | |
| **Total Group** | **13,295** | **(13,485)** | **797** | 13,506 | (13,704) | 773 |

[1] Segment assets include primarily airport runways and facilities.

**(e) Revenue and non-current asset information by geographical segment**
BAA (SH) plc is domiciled in the UK. All revenue from external customers comes from the UK which for the year ended 31 December 2010 was £2,074 million (2009: £1,978 million). The breakdown of the major components of total revenue from external customers is shown in tables (a) and (b) above.

The total of non-current assets excluding financial instruments, deferred tax assets and post-employment benefit assets is £12,310 million (2009: £12,128 million). There are no non-current assets held outside the UK (2009: £nil).

### 2 Operating costs – continuing operations

| | Year ended 31 December 2010 £m | Restated[1] Year ended 31 December 2009 £m |
|---|---|---|
| Operating costs (including exceptional items) include the following: | | |
| Employment costs[2] | | |
| Wages and salaries | **244** | 233 |
| Social security | **20** | 20 |
| Pensions | **30** | 18 |
| Share-based payments | **3** | 4 |
| Contract and agency staff | **9** | 7 |
| Other staff related | | |
| Share of BAA Group's change in pension deficit | **(90)** | 218 |
| Reorganisation costs /(income) | **13** | (1) |
| Other | **10** | 10 |
| | **239** | 509 |
| Depreciation and amortisation | | |
| Depreciation of property, plant and equipment | **477** | 484 |
| Amortisation of intangible assets - software | **23** | 27 |
| | **500** | 511 |
| Other operating costs | | |
| Maintenance expenditure | **135** | 147 |
| Utility costs | **116** | 126 |
| Rents and rates | **117** | 129 |
| General expenses | **133** | 132 |
| Retail expenditure | **31** | 35 |
| Police | **36** | 39 |
| Aerodrome navigation service charges | **64** | 65 |
| Intra-group charges/other | **176** | 147 |
| Own work capitalised[3] | **(17)** | (19) |
| **Total operating costs** | **1,530** | 1,821 |
| Analysed as: | | |
| Adjusted operating costs | **1,107** | 1,093 |
| Depreciation and amortisation (excluding exceptional depreciation) | **481** | 456 |
| Exceptional (credit)/costs[4] | **(58)** | 272 |
| **Total operating costs** | **1,530** | 1,821 |

[1] The presentation of certain balances for the year ended 31 December 2009 has been restated to be consistent with current year disclosures.
[2] Employment costs include recharges from BAA Airports Limited for employee services to the Group. Refer to the SSA section in the Accounting policies.
[3] Own work capitalised includes £6 million (2009: £4 million) in relation to employment costs including contract and agency staff.
[4] Exceptional (credit)/costs includes £90 million credit (2009: £218 million cost) in relation to pensions, £19 million (2009: £55 million) cost in relation to accelerated depreciation and £13 million cost (2009: £1 million credit) in relation to reorganisation. Refer to Note 3.

***Rentals under operating leases***

| | Year ended 31 December 2010 £m | Year ended 31 December 2009 £m |
|---|---|---|
| *Operating costs include:* | | |
| Plant and machinery | **34** | 33 |
| Other | **13** | 32 |
| | **47** | 65 |
| Property lease and sub lease charges - minimum lease payments | **13** | 32 |

**2 Operating costs – continuing operations *continued***

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

Auditors' remuneration includes services provided to both continuing and discontinued operations.

***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).

***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 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 – continuing operations

| | Note | **Year ended 31 December 2010 £m** | Year ended 31 December 2009 £m |
|---|---|---|---|
| Pension credit/(charge) | | **90** | (218) |
| Accelerated depreciation | | **(19)** | (55) |
| Reorganisation (costs)/credit | | **(13)** | 1 |
| **Total operating exceptional items before income tax** | | **58** | (272) |
| Exceptional impairment of property, plant and equipment | *7* | **(149)** | - |
| Tax (charge)/credit on exceptional items | | **(16)** | 76 |
| **Total exceptional items** | | **(107)** | (196) |

During 2010 there was a net exceptional pension credit of £90 million (2009: £218 million charge). This included a £91 million credit (2009: £216 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 million (2009: £2 million) charge in relation to UURBS. For more information on pension costs charged in accordance with the SSA refer to the Accounting policies.

The £19 million (2009: £55 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 £13 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 million credit in 2009 was due to the release of provisions that were no longer required.

### 4 Financing – continuing operations

#### (a) Net finance costs before certain re-measurements

| | Note | **Year ended 31 December 2010 £m** | Year ended 31 December 2009 £m |
|---|---|---|---|
| **Finance income** | | | |
| Interest receivable on derivatives not in hedge relationship | | **160** | 151 |
| Interest on group borrowings | | **1** | - |
| Interest on deposits | | **1** | - |
| | | **162** | 151 |
| **Finance costs** | | | |
| Interest on borrowings: | | | |
| Bonds and related hedging instruments[1] | | **(391)** | (333) |
| Bank loans and overdrafts and related hedging instruments | | **(285)** | (368) |
| Interest payable on derivatives not in hedge relationship[1] | | **(214)** | (88) |
| Facility fees | | **(28)** | (18) |
| Unwinding of discount on provisions | | **-** | (3) |
| | | **(918)** | (810) |
| Less: capitalised borrowing costs[2] | *7* | **23** | 22 |
| | | **(895)** | (788) |
| **Net finance costs before certain re-measurements** | | **(733)** | (637) |

[1] Includes total accretion of £119 million loss (2009: £16 million gain), of which £12 million loss (2009: £nil) arises from index-linked bonds and £107 million loss (2009: £16 million gain) from index-linked swaps.

[2] Borrowing costs included in the cost of qualifying assets (i.e. capitalised borrowing costs) arose on the general borrowing pool and are calculated by applying an average capitalisation rate of 2.22% (2009: 2.87%) to expenditure incurred on such assets.

#### (b) Fair value loss on financial instruments

| | **Year ended 31 December 2010 £m** | Year ended 31 December 2009 £m |
|---|---|---|
| Interest rate swaps: cash flow hedge[1] | **(6)** | 21 |
| Index-linked swaps: not in hedge relationship | **(36)** | (126) |
| Cross-currency swaps: cash flow hedge[1] | **6** | (12) |
| Cross-currency swaps: fair value hedge[1] | **1** | - |
| Fair value re-measurements of foreign exchange contracts and currency balances | **(1)** | (3) |
| **Fair value loss on financial instruments** | **(36)** | (120) |

[1] Hedge ineffectiveness on derivatives in hedge relationship.

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

**5 Taxation – continuing operations**

| | Year ended 31 December 2010 £m | Year ended 31 December 2009 £m |
|---|---|---|
| UK corporation tax | | |
| Current tax at 28% (2009: 28%) | **21** | 9 |
| Under/(over) provision in respect of prior years | **3** | (1) |
| Deferred tax | | |
| Current year | **(70)** | (176) |
| Prior year | **(5)** | 4 |
| Change in UK corporation tax rate - impact on deferred tax assets and liabilities | **(72)** | - |
| **Taxation credit for the year** | **(123)** | (164) |

| | Year ended 31 December 2010 £m | Year ended 31 December 2009 £m |
|---|---|---|
| Loss before tax | **343** | 693 |

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

| ***Reconciliation of the tax credit*** | | |
|---|---|---|
| Tax calculated at the UK statutory rate of 28% (2009: 28%) | **(96)** | (194) |
| Adjustments in respect of current income tax of previous years | **3** | (1) |
| Change in UK corporation tax rate - impact on deferred tax assets and liabilities | **(72)** | - |
| Non deductible expenses | **47** | 27 |
| Adjustments in respect of deferred income tax of previous years | **(5)** | 4 |
| **Taxation credit for the year** | **(123)** | (164) |

**6 Discontinued operations**

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

Gatwick airport was sold on 3 December 2009 for cash consideration of £1,445 million and deferred consideration of up to £55 million conditional on future traffic performance and the acquirer's future capital structure. The impact of this disposal is reported below.

***Net profit/(loss) from discontinued operations***

| | **Year ended 31 December 2010** | | | Year ended 31 December 2009 | | |
|---|---|---|---|---|---|---|
| | **Before certain re-measurements £m** | **Certain re-measurements £m** | **Total £m** | Before certain re-measurements £m | Certain re-measurements £m | Total £m |
| **Revenue** | **-** | **-** | **-** | 440 | - | 440 |
| Operating costs | **-** | **-** | **-** | (281) | - | (281) |
| Other operating costs | | | | | | |
| Fair value loss on investment properties | **-** | **-** | **-** | - | (49) | (49) |
| **Operating profit/(loss)** | **-** | **-** | **-** | 159 | (49) | 110 |
| *Analysed as:* | | | | | | |
| Operating profit/(loss) before exceptional items | **-** | **-** | **-** | 158 | (49) | 109 |
| Exceptional items | **-** | **-** | **-** | 1 | - | 1 |
| **Financing** | | | | | | |
| Finance costs | **-** | **-** | **-** | (67) | - | (67) |
| | **-** | **-** | **-** | (67) | - | (67) |
| Profit/(loss) on disposal of operations | **16** | **-** | **16** | (161) | - | (161) |
| **Profit/(loss) before tax** | **16** | **-** | **16** | (69) | (49) | (118) |
| Taxation (charge)/credit | **-** | **-** | **-** | (15) | 13 | (2) |
| **Net profit/(loss) for the year** | **16** | **-** | **16** | (84) | (36) | (120) |

The £16 million profit 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 million on the finalisation of Gatwick's balance sheet at completion of the disposal. In 2009 the loss on disposal of £161 million included an impairment charge of £106 million on the investment in Gatwick airport up to the date of disposal and £55 million loss on disposal.

# BAA (SH) plc (formerly BAA (SH) Limited)

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

**7 Property, plant and equipment**

| | Note | Terminal complexes £m | Airfields £m | Plant and equipment £m | Other land and buildings £m | Rail £m | Assets in the course of construction £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| 1 January 2009 | | 7,615 | 1,106 | 466 | 70 | 1,357 | 1,515 | 12,129 |
| Additions | | 4 | - | 4 | - | - | 725 | 733 |
| Net transfers from/(to) investment properties | *8* | 3 | - | - | 16 | - | (21) | (2) |
| Transfers from/(to) completed assets | | 784 | 31 | 89 | 6 | 5 | (915) | - |
| Inter-company transfers | | (6) | - | - | - | - | - | (6) |
| Borrowing costs capitalised | *4* | - | - | - | - | - | 22 | 22 |
| Disposals | | (171) | (3) | (1) | (9) | - | - | (184) |
| **1 January 2010** | | **8,229** | **1,134** | **558** | **83** | **1,362** | **1,326** | **12,692** |
| Additions | | **3** | **-** | **7** | **-** | **-** | **768** | **778** |
| Net transfers (to)/from investment properties | *8* | **(1)** | **-** | **-** | **5** | **-** | **(107)** | **(103)** |
| Transfers from/(to) completed assets | | **157** | **109** | **30** | **1** | **6** | **(303)** | **-** |
| Inter-company transfers | | **-** | **-** | **1** | **-** | **-** | **-** | **1** |
| Borrowing costs capitalised | *4* | **-** | **-** | **-** | **-** | **-** | **23** | **23** |
| Disposals[1] | | **(17)** | **(1)** | **(11)** | **(1)** | **-** | **(149)** | **(179)** |
| Reclassifications | | **6** | **(7)** | **1** | **-** | **-** | **-** | **-** |
| **31 December 2010** | | **8,377** | **1,235** | **586** | **88** | **1,368** | **1,558** | **13,212** |
| **Depreciation** | | | | | | | | |
| 1 January 2009 | | (1,697) | (215) | (293) | (27) | (210) | - | (2,442) |
| Charge | *2* | (365) | (38) | (36) | (4) | (41) | - | (484) |
| Disposals | | 165 | 3 | 1 | 3 | - | - | 172 |
| Inter-company transfers | | 2 | - | - | - | - | - | 2 |
| **1 January 2010** | | **(1,895)** | **(250)** | **(328)** | **(28)** | **(251)** | **-** | **(2,752)** |
| Charge | *2* | **(348)** | **(39)** | **(44)** | **(6)** | **(40)** | **-** | **(477)** |
| Impairment | | **-** | **-** | **-** | **-** | **-** | **(149)** | **(149)** |
| Disposals[1] | | **17** | **1** | **11** | **1** | **-** | **149** | **179** |
| Reclassifications | | **(3)** | **4** | **(1)** | **-** | **-** | **-** | **-** |
| **31 December 2010** | | **(2,229)** | **(284)** | **(362)** | **(33)** | **(291)** | **-** | **(3,199)** |
| **Net book value 31 December 2010** | | **6,148** | **951** | **224** | **55** | **1,077** | **1,558** | **10,013** |
| Net book value 31 December 2009 | | 6,334 | 884 | 230 | 55 | 1,111 | 1,326 | 9,940 |

[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.

***Other land and buildings***

Other land and buildings are freehold except for certain short leasehold properties with a net book value of £19 million (2009: £21 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.

***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 million made of which £104 million related to the write-off of planning application costs and £45 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).

***Borrowing costs capitalised***

The amount of borrowing costs included in the cost of Group assets was £1,165 million (2009: £1,143 million). Borrowing costs were capitalised at an average rate of 2.22% (2009: 2.87%).

A tax deduction of £23 million (2009: £22 million) for capitalised borrowing costs was taken in the year. Subsequent depreciation of the capitalised borrowing costs is disallowed for tax purposes. Consequently, the capitalised borrowing costs give rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets.

Security granted by the Group over its assets, including property, plant and equipment, is disclosed in Note 14.

**8 Investment properties**

| | Note | Airport investment properties £m | Assets in the course of construction £m | Total £m |
|---|---|---|---|---|
| **Valuation** | | | | |
| 1 January 2009 | | 2,145 | 8 | 2,153 |
| Additions | | 4 | 18 | 22 |
| Transfers to/(from) completed assets | | 17 | (17) | - |
| Net transfers from operational assets | *7* | 2 | - | 2 |
| Valuation loss | | (93) | - | (93) |
| **1 January 2010** | | **2,075** | **9** | **2,084** |
| Additions | | **-** | **-** | **-** |
| Transfers to/(from) completed assets | | **3** | **(3)** | **-** |
| Net transfers from operational assets | *7* | **103** | **-** | **103** |
| Valuation gain | | **31** | **-** | **31** |
| **31 December 2010** | | **2,212** | **6** | **2,218** |

Airport 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.

Details of the valuations performed are provided below:

| | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|
| CB Richard Ellis | **2,131** | - |
| Drivers Jonas | **-** | 2,072 |
| Strutt & Parker | **87** | 12 |
| **At professional valuation** | **2,218** | 2,084 |

All valuations were prepared in accordance with IFRS and the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. There were no restrictions on the realisability or remittance of income or proceeds on disposal.

Void areas amounted to 8,333$m^2$ at the reporting date (2009: 8,007$m^2$) representing 0.79% (2009: 0.75%) of the Group's investment property portfolio.

Investment properties are let on either full repair and insuring leases, under which all outgoings are the responsibility of the lessee, or under tenancies, where costs are recovered through a service charge levied on tenants during their period of occupation. This service charge amounted to £2 million (2009: £3 million) for which a similar amount is included within operating costs.

Security granted by the Group over its assets, including investment properties, is disclosed in Note 14.

**9 Intangible assets**

| | £m |
|---|---|
| **Cost** | |
| 1 January 2009 | 203 |
| Additions | 18 |
| Disposals | (13) |
| **1 January 2010** | **208** |
| Additions | **19** |
| Disposals | **(5)** |
| **31 December 2010** | **222** |
| | |
| **Amortisation** | |
| 1 January 2009 | (138) |
| Charge for the year | (27) |
| Disposals | 12 |
| **1 January 2010** | **(153)** |
| Charge for the year | **(23)** |
| Disposals | **5** |
| **31 December 2010** | **(171)** |
| | |
| **Net book value 31 December 2010** | **51** |
| Net book value 31 December 2009 | 55 |

All intangible assets relate to capitalised computer software costs.

These software costs principally relate to operating and financial software. These assets are being amortised over a period of between three and seven years. Amortisation for the year has been charged through operating costs.

Software costs include assets in the course of construction of £29 million (2009: £20 million).

### 10 Inventories

| | **31 December 2010** **£m** | 31 December 2009 £m |
|---|---|---|
| Consumables | **5** | 5 |

The total amount of inventories consumed in the year relating to continuing operations was £7 million (2009: £6 million) and relating to discontinued operations was £nil (2009: £1 million).

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

### 11 Trade and other receivables

| | **31 December 2010** **£m** | 31 December 2009 £m |
|---|---|---|
| **Non-current** | | |
| Prepayments[1] | **28** | 49 |
| | **28** | 49 |
| **Current** | | |
| Trade receivables | **153** | 186 |
| Less: provision for impairment | **(3)** | (3) |
| Trade receivables – net | **150** | 183 |
| Prepayments | **37** | 28 |
| Amounts owed by group undertakings[2] | **58** | 40 |
| Amounts owed by group undertakings - pensions[3] | **69** | 36 |
| Other receivables | **47** | 20 |
| | **361** | 307 |

[1] Non-current prepayments of £28 million represent refinancing fees paid in 2008 on facilities not yet drawn and future bond issuances (2009: £49 million). Refinancing fees paid on facilities are amortised over the term of the facility whereas fees paid for future bond issuances will be allocated to the bonds when issued and amortised using the effective interest rate method.
[2] 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%.
[3] 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.

The fair value of trade and other receivables are not materially different from the carrying value.

Unless otherwise stated, trade and other receivables do not contain impaired assets.

Trade receivables are non-interest bearing and are generally on 14 day terms. No collateral is held as security.

As at 31 December 2010, trade receivables of £137 million (2009: £121 million) were fully performing. Trade receivables of £5 million (2009: £62 million) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The ageing analysis of these trade receivables is as follows:

| | **31 December 2010** **£m** | 31 December 2009 £m |
|---|---|---|
| Up to 3 months | **5** | 41 |
| Over 3 months | **-** | 21 |
| | **5** | 62 |

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

| | **2010** **£m** | 2009 £m |
|---|---|---|
| 1 January | **3** | 2 |
| Provision for receivables impairment | **1** | 1 |
| Receivables written off during the year as uncollectible | **(1)** | - |
| **31 December** | **3** | 3 |

As of 31 December 2010, trade receivables of £11 million (2009: £3 million) were considered for impairment of which £3 million (2009: £3 million) was provided for, with the remaining amount expected to be fully recovered. The individual impaired receivables mainly relate to customers who are in difficult economic situations. The creation and release of any provisions for impaired receivables have been included in 'general expenses' in the income statement. Amounts charged to the provision account are generally written off when there is no expectation of recovery.

The ageing of these trade receivables is as follows:

| | **31 December 2010** **£m** | 31 December 2009 £m |
|---|---|---|
| Over 3 months | **11** | 3 |

The Group is not exposed to significant foreign currency exchange risk as the majority of trade and other receivables are denominated in Sterling. Additional disclosure on credit risk management is included in Note 16.

### 12 Restricted cash

| | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|
| Cash account | **-** | 143 |

At 31 December 2009, £143 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 18 and 24.

### 13 Cash and cash equivalents

| | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|
| Cash at bank and in hand | **15** | 5 |
| Short-term deposits | **52** | 235 |
| | **67** | 240 |

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

For the purposes of the consolidated cash flow statement (excluding Gatwick airport disposal proceeds held in escrow in 2009), cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less held for the purpose of meeting short-term cash commitments and consists of:

| | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|
| Cash at bank and in hand | **15** | 5 |
| Short-term deposits | **52** | 235 |
| | **67** | 240 |

### 14 Borrowings

| | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|
| **Current** | | |
| **Secured** | | |
| Bank loans | **39** | 41 |
| **Total current (excluding interest payable)** | **39** | 41 |
| Interest payable | **159** | 154 |
| **Total current** | **198** | 195 |
| | | |
| **Non-current** | | |
| **Secured** | | |
| BAA Funding Limited bonds | | |
| 3.975% €1,000 million due 2012 | **832** | 842 |
| 5.850% £400 million due 2013 | **374** | 368 |
| 4.600% €750 million due 2014 | **594** | 613 |
| 12.450% £300 million due 2016 | **367** | 377 |
| 4.125% €500 million due 2016 | **410** | - |
| 4.600% €750 million due 2018 | **568** | 582 |
| 6.250% £400 million due 2018 | **394** | - |
| 9.200% £250 million due 2021 | **283** | 285 |
| 5.225% £750 million due 2023 | **618** | 612 |
| 6.750% £700 million due 2026 | **684** | 685 |
| 7.075% £200 million due 2028 | **197** | 197 |
| 6.450% £900 million due 2031 | **840** | 838 |
| 3.334%+RPI £235 million due 2039 | **245** | 234 |
| Total BAA Funding Limited bonds | **6,406** | 5,633 |
| | | |
| BAA (SH) plc bonds | | |
| 7.125% £325 million due 2017[1] | **317** | - |
| Total bonds | **6,723** | 5,633 |
| | | |
| Syndicated term facility | **1,292** | 2,254 |
| Capital expenditure facility | **1,266** | 652 |
| Subordinated facility[1] | **171** | 1,564 |
| Other bank loans | **907** | 331 |
| Total bank loans | **3,636** | 4,801 |
| **Total non-current** | **10,359** | 10,434 |
| **Total borrowings (excluding interest payable)** | **10,398** | 10,475 |

[1] During 2010 BAA (SH) repaid its previous £1.566 billion debt facility which was replaced principally by £1 billion of financing raised at BAA (SP) and a £325 million bond and £175 million loan raised by the Company.

**14 Borrowings *continued***

The average cost of the Group's external gross debt at 31 December 2010 was 4.55% (2009: 5.62%) 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.

***BAA Funding Limited bonds***

The maturity dates of the BAA Funding Limited bonds listed above reflect their scheduled redemption dates that correspond to the maturity dates of the loans between Heathrow Airport Limited and BAA Funding Limited. The bonds are not callable in nature and are expected to be repaid on their scheduled redemption date. However, to meet rating agency requirements the bonds have a legal maturity that is two years later, except for the 6.250% £400 million 2018 bond, the 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 | **10,359** | **11,047** | 10,434 | 10,821 |

The fair value of short-term borrowings approximates book value. Accrued interest is included as a current borrowings balance and not in the carrying amount of non-current borrowings. The fair values of listed borrowings are based on quoted prices. For unlisted borrowings, the Group establishes fair values by using valuation techniques such as discounted cash flow analysis. The fair 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 (DSH) Limited and BAA (SH) plc have also granted security over their assets to secure their obligations under their financing agreements.

BAA Pension Trust Company Limited (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.

Additional disclosures on risk management and hedging of borrowings are included in Notes 15 and 16.

**15 Derivative financial instruments**

| **31 December 2010** | **Notional £m** | **Assets £m** | **Liabilities £m** | **Total £m** |
|---|---|---|---|---|
| **Current** | | | | |
| Foreign exchange contracts - no hedge accounting | **10** | **-** | **-** | **-** |
| | **10** | **-** | **-** | **-** |
| **Non-current** | | | | |
| Interest rate swaps - cash flow hedge | **3,000** | **-** | **(258)** | **(258)** |
| Cross-currency swaps - cash flow hedge | **1,190** | **358** | **-** | **358** |
| Cross-currency swaps - fair value hedge | **947** | **192** | **(19)** | **173** |
| Index-linked swaps - no hedge accounting | **4,114** | **2** | **(296)** | **(294)** |
| | **9,251** | **552** | **(573)** | **(21)** |
| **Total** | **9,261** | **552** | **(573)** | **(21)** |

| 31 December 2009 | Notional £m | Assets £m | Liabilities £m | Total £m |
|---|---|---|---|---|
| Current | | | | |
| Foreign exchange contracts - no hedge accounting | 9 | - | - | - |
| | 9 | - | - | - |
| Non-current | | | | |
| Interest rate swaps - cash flow hedge | 4,225 | 3 | (166) | (163) |
| Cross-currency swaps - cash flow hedge | 1,703 | 652 | - | 652 |
| Index-linked swaps - no hedge accounting | 2,206 | 28 | (172) | (144) |
| | 8,134 | 683 | (338) | 345 |
| Total | 8,143 | 683 | (338) | 345 |

***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 ncome statement over the period of the hedged risk.

**15 Derivative financial instruments *continued***

***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 Income statement 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 Financial instruments**

***Financial risk management objectives and policies***

The Group's principal financial instruments (other than derivatives) comprise bank loans, listed bonds, cash and short-term deposits. The main purpose of these instruments is to raise finance for the Group's operations.

The Group also enters into hedging transactions, principally interest rate swaps, cross-currency swaps and foreign exchange contracts. The purpose of these transactions is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance.

The Group mitigates the risk of mismatch between 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.

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

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

***Foreign exchange risk***

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

As at 31 December 2010, with all other variables remaining constant, if Sterling strengthened or weakened by 10% against the Euro, annual pre-tax profit would have decreased or increased by £15 million and £18 million respectively (2009: £18 million decrease and £22 million increase respectively).

***Price risk***

The Group is not materially exposed to equity security price risk on investments held by the Group.

The Group is exposed to RPI risk on its index-linked bond and derivatives held to economically hedge cash flows on debt instruments and RPI linked revenue. As at 31 December 2010, with all other variables remaining constant, if the RPI had increased or decreased by 10%, annual pre-tax profit would have decreased or increased by £171 million and £165 million respectively (2009: £76 million decrease and £74 million increase respectively).

***Cash flow and fair value interest rate risk***

The Group's interest rate risk arises primarily from its borrowings. Borrowings issued at variable interest rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group's policy is to maintain a mix of fixed to floating rate debt within Board approved parameters such that a minimum of 70% of existing and forecast debt is at a fixed rate. To manage this mix, the Group enters into interest rate swaps. These swaps may be designated to hedge underlying debt obligations. The Group also uses floating rate interest bearing financial assets as a natural hedge of the exposure to fair value interest rate risk.

The Group may use forward-starting interest rate swaps to minimise exposure to cash flow interest rate risk for forecast issuance of debt.

As at 31 December 2010, the Group's fixed floating interest rate profile, after hedging, on gross debt was 76:24 (2009: 83:17).

As at 31 December 2010, each 0.50% change in interest rates would have resulted in the following gain/(loss) to pre-tax profit and equity, due to movements in the finance income, finance cost and mark-to-market valuation of derivatives:

| | **31 December 2010** | | 31 December 2009 | |
|---|---|---|---|---|
| | **Income statement impact £m** | **Equity impact £m** | Income statement impact £m | Equity impact £m |
| 0.50% increase | **58** | **143** | 28 | 150 |
| 0.50% decrease | **(60)** | **(119)** | (30) | (160) |

### 16 Financial instruments *continued*

***Credit risk***

Credit risk arises from cash and cash equivalents, derivative financial instruments and accounts receivable. The Group has no significant concentrations of credit risk. The Group's exposure to credit related losses, in the event of non-performance by counterparties to financial instruments, is mitigated by limiting exposure to any one party or instrument and ensuring only counterparties within defined credit risk parameters are used.

The Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short- and long-term credit ratings. Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with 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.

As at 31 December 2010, the Group had total credit risk with derivative counterparties of its interest rate swaps, index-linked swaps and cross-currency swaps of £552 million (2009: £683 million).

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

The maximum exposure to credit risk, excluding amounts owed by group undertakings, as at 31 December 2010 was £785 million (2009: £1,269 million).

***Liquidity risk***

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

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

| | **31 December 2010 £m** | 31 December 2009 £m |
|---|---|---|
| **Floating rate facilities** | | |
| Expiring in more than two years | **1,450** | 2,050 |

As at 31 December 2010, overdraft facilities of £10 million were available (2009: £10 million).

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

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

| | Restated[1] 31 December 2009 | | | |
|---|---|---|---|---|
| | Less than one year £m | One to two years £m | Two to five years £m | Greater than five years £m |
| Borrowing principal payments | 41 | 1,824 | 4,471 | 4,024 |
| Borrowing interest payments | 489 | 449 | 1,014 | 2,635 |
| Derivative financial instruments | (21) | - | 152 | 834 |
| Trade payables | 110 | - | - | - |
| Capital payables | 186 | - | - | - |

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

The tables below analyse the Group's derivative financial instruments which will be settled on a gross basis based on the remaining period as at 31 December to the contractual maturity date.

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

| | 31 December 2009 | | | |
|---|---|---|---|---|
| | Less than one year £m | One to two years £m | Two to five years £m | Greater than five years £m |
| Cross-currency derivative payments | 36 | 54 | 125 | 100 |
| Cross-currency derivative receipts | (96) | (96) | (219) | (122) |

**16 Financial instruments *continued***

***Capital risk management***

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure. The Group regularly reviews and maintains or adjusts its capital structure as appropriate in order to achieve these objectives.

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

There are gearing covenants in financing agreements at various levels, including the BAA (SH) and BAA (SP) consolidated groups. Actual gearing ratios at each of these levels are set out below:

| | **31 December 2010** | 31 December 2009 |
|---|---|---|
| Net debt to RAB at BAA (SH) group | **0.81** | 0.86 |
| Total net debt to RAB at BAA (SP) group | **0.78** | 0.73 |
| Senior net debt to RAB at BAA (SP) group | **0.69** | 0.67 |

The decrease in gearing ratio at BAA (SH) in 2010 is largely the result of cash flow being retained in the business and the impact of inflation on the RAB. The increase in total and senior net debt to RAB at BAA (SP) occurred due to payment of £1,000 million from BAA (SP) to BAA (SH) to enable repayment of the same amount of debt at BAA (SH) as well as (in the case of senior debt) treasury management to optimise use of the Group's lower cost senior debt.

***Financial instruments by category***

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

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

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

| | 31 December 2009 | | | |
|---|---|---|---|---|
| | Loans and receivables £m | Assets at fair value through income statement £m | Derivatives qualifying for hedge accounting £m | Total £m |
| Derivative financial instruments | - | 28 | 655 | 683 |
| Cash and cash equivalents | 383 | - | - | 383 |
| Trade receivables | 183 | - | - | 183 |
| Other receivables | 20 | - | - | 20 |
| Total financial assets | 586 | 28 | 655 | 1,269 |

| | Restated[1] 31 December 2009 | | | |
|---|---|---|---|---|
| | Liabilities at fair value through income statement £m | Derivatives qualifying for hedge accounting £m | Other financial liabilities at amortised cost £m | Total £m |
| Borrowings | - | - | (10,475) | (10,475) |
| Derivative financial instruments | (172) | (166) | - | (338) |
| Trade payables | - | - | (110) | (110) |
| Capital payables | - | - | (186) | (186) |
| Total financial liabilities | (172) | (166) | (10,771) | (11,109) |

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

At 31 December 2010, the Group has not designated any financial assets or financial liabilities at fair value through the income statement (2009: £nil). The only financial assets and financial liabilities at fair value through the income statement are derivatives that do not qualify for hedge accounting.

### 16 Financial instruments *continued*

***Fair value estimation***

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

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

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

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

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

Specific valuation techniques used to value financial instruments include:

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

At 31 December 2010, all of the resulting fair value estimates in the Group are included in level 2 (2009: all included in level 2).

### 17 Deferred income tax

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

| | **2010** **£m** | 2009 £m |
|---|---|---|
| 1 January | **2,027** | 2,116 |
| Disposal of operations | **-** | (3) |
| Credited to income statement[1] | **(147)** | (169) |
| Charged to equity | **1** | 83 |
| Change in UK corporation tax rate - credited to equity | **(1)** | - |
| **31 December** | **1,880** | 2,027 |

[1] Includes £72 million credit to income statement for change in tax rate from 28% to 27% effective 1 April 2011 (2009 includes a £3 million charge to income statement relating to discontinued activities).

The amounts of deferred income tax provided are detailed below:

***Deferred income tax liabilities***

| | **Excess of capital allowances over depreciation £m** | **Revaluations of investment property to fair value £m** | **Tax on rolled over gains £m** | **Other £m** | **Total £m** |
|---|---|---|---|---|---|
| 1 January 2010 | 1,582 | 457 | 12 | 4 | 2,055 |
| (Credited)/charged to income statement | (158) | (8) | - | 24 | (142) |
| Charged to equity | - | 1 | - | 24 | 25 |
| Change in tax rate credited to equity | - | (3) | - | - | (3) |
| **31 December 2010** | **1,424** | **447** | **12** | **52** | **1,935** |

***Deferred income tax assets***

| | **IAS 32/39 £m** |
|---|---|
| 1 January 2010 | (28) |
| Credited to the income statement | (5) |
| Credited to equity | (24) |
| Change in tax rate charged to equity | 2 |
| **31 December 2010** | **(55)** |

### 17 Deferred income tax *continued*

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

| | **Year ended 31 December 2010 £m** | Year ended 31 December 2009 £m |
|---|---|---|
| Cash flow hedge reserve | **(22)** | 86 |
| Indexation of operating land | **1** | (3) |
| Retained earnings | **21** | - |
| | **-** | 83 |

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 £73 million, with £72 million credited to the income statement and £1 million credited to reserves.

### 18 Provisions

| | **Disposal of operations £m** | **Reorganisation costs £m** | **Obligations under land purchase £m** | **Pensions £m** | **Other £m** | **Total £m** |
|---|---|---|---|---|---|---|
| 1 January 2010 | 35 | 8 | 38 | 231 | 28 | 340 |
| Utilised | (20) | (9) | (38) | - | (9) | (76) |
| Charged to income statement | - | 6 | - | - | 2 | 8 |
| Credited/released to income statement | - | - | - | (90) | (8) | (98) |
| Commutation payment benefit received | - | - | - | (88) | - | (88) |
| **31 December 2010** | **15** | **5** | **-** | **53** | **13** | **86** |
| | | | | | | |
| Current | 15 | 5 | - | 53 | 8 | 81 |
| Non-current | - | - | - | - | 5 | 5 |
| **31 December 2010** | **15** | **5** | **-** | **53** | **13** | **86** |
| | | | | | | |
| Current | 35 | 8 | 38 | 231 | 10 | 322 |
| Non-current | - | - | - | - | 18 | 18 |
| 31 December 2009 | 35 | 8 | 38 | 231 | 28 | 340 |

***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 £38 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 million (2009: £216 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 £17 million (2009: £15 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.

### 19 Trade and other payables

| | 31 December 2010 £m | Restated[1] 31 December 2009 £m |
|---|---|---|
| **Non-current** | | |
| Deferred income | **3** | 5 |
| | **3** | 5 |
| **Current** | | |
| Deferred income | **30** | 30 |
| Trade payables | **125** | 110 |
| Other tax and social security | **6** | 7 |
| Other payables | **9** | 3 |
| Capital payables | **180** | 186 |
| | **350** | 336 |

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

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

### 20 Share capital

| | £ |
|---|---|
| **Authorised** | |
| 9,000,000,000 ordinary shares of £1 each | **9,000,000,000** |
| **Allotted and fully paid** | |
| In issue at 1 January 2010: 2,791,980,374 ordinary shares of £1 each | 2,791,980,374 |
| Issue of 317,370,315 ordinary shares of £1 each | 317,370,315 |
| **In issue at 31 December 2010: 3,109,350,689 ordinary shares of £1 each** | **3,109,350,689** |

On 28 January 2010, the Company issued 217,370,315 ordinary shares of £1 each at par to BAA (DSH) Limited. 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 (SP) Limited completing the £500 million equity injection into BAA (SP) Limited announced in November 2009.

A further 100,000,000 ordinary shares of £1 each were issued at par to BAA (DSH) Limited on 10 September 2010.

### 21 Other reserves

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

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

### 22 Fair value reserve

| | Cash flow hedge reserve £m |
|---|---|
| 1 January 2010 | (108) |
| Fair value loss | (236) |
| Transferred to income statement | 147 |
| Deferred tax on fair value loss | 24 |
| Change in tax rate | (2) |
| **31 December 2010** | **(175)** |

### 23 Tax relating to components of comprehensive income

| | **Year ended 31 December 2010** | | | Year ended 31 December 2009 | | |
|---|---|---|---|---|---|---|
| | **Before tax £m** | **Tax (charge)/ credit £m** | **After tax £m** | Before tax £m | Tax (charge)/ credit £m | After tax £m |
| Cash flow hedges | | | | | | |
| (Loss)/gain taken to equity | **(236)** | **64** | **(172)** | 19 | (5) | 14 |
| Transferred to income statement | **147** | **(40)** | **107** | 289 | (81) | 208 |
| Change in tax rate | **-** | **1** | **1** | - | - | - |
| Indexation of operating land | **-** | **(1)** | **(1)** | - | 3 | 3 |
| **Other comprehensive income** | **(89)** | **24** | **(65)** | 308 | (83) | 225 |
| Current tax | **-** | **-** | **-** | - | - | - |
| Deferred tax | **-** | **24** | **-** | - | (83) | - |
| | **-** | **24** | **-** | - | (83) | - |

### 24 Retained earnings

| | £m |
|---|---|
| 1 January 2010 | (1,476) |
| Net loss for the year | (204) |
| Capital distribution | (16) |
| Tax on capital contribution | (24) |
| Change in tax rate on investment properties | 3 |
| Indexation of operating land | (1) |
| **31 December 2010** | **(1,718)** |

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

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

### 25 Commitments and contingent liabilities

***Non-cancellable operating lease commitments – Group as a lessee***

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

| | **31 December 2010** | | Restated[1] 31 December 2009 | |
|---|---|---|---|---|
| | **Land and buildings £m** | **Other £m** | Land and buildings £m | Other £m |
| Within one year | **12** | **46** | 12 | 44 |
| Within two to five years | **45** | **196** | 45 | 189 |
| After five years | **36** | **836** | 44 | 884 |
| | **93** | **1,078** | 101 | 1,117 |

[1] The presentation of balances as at 31 December 2009 has been restated to be consistent with current year disclosures.

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

A significant portion of the £1.1 billion (2009: £1.1 billion) commitments classified as 'Other' relates to electricity supply equipment at the airports leased on agreement with UK Power Networks Services Ltd ('UPNS'). The lease expires in 2083. The amounts disclosed are the total estimated charges under the agreement including both the actual lease commitment and the significant maintenance element of the fee payable to UPNS as neither the Group nor UPNS are able to split the base fee between a 'capital' and a 'maintenance' charge. The commitment has been discounted at the Group's incremental borrowing rate

***Non-cancellable operating lease commitments – Group as a lessor***

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

| | **31 December 2010** | | 31 December 2009 | |
|---|---|---|---|---|
| | **Land and buildings £m** | **Other £m** | Land and buildings £m | Other £m |
| Within one year | **79** | **-** | 81 | - |
| Within two to five years | **273** | **-** | 257 | - |
| After five years | **1,799** | **-** | 1,629 | - |
| | **2,151** | **-** | 1,967 | - |

The Group uses a number of different leasing and contractual structures depending on the type and location of the investment property. Typically in multi-let offices and industrial premises a standard indefinite tenancy is used, which is terminable by the tenant on three months' notice at any time. However, it is common for the accommodation to remain let or be quickly re-let should it be vacated. For larger, stand alone premises, e.g. cargo sheds, longer leases of multiples of three years are used.

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

***Non-cancellable electricity purchase commitment***

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

| | **31 December 2010 £m** | 31 December 2009 £m |
|---|---|---|
| Within one year | **56** | 57 |
| Within two to five years | **35** | 74 |
| | **91** | 131 |

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.

**25 Commitments and contingent liabilities *continued***

***Group commitments for property, plant and equipment***

| | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|
| **Contracted for, but not accrued:** | | |
| T2A building - Heathrow | **788** | 11 |
| Terminal 2B phase 2 - Heathrow | **447** | 8 |
| T3 integrated baggage system - Heathrow | **64** | 1 |
| T1 baggage prolongation programme - Heathrow | **31** | - |
| Energy infrastructure - Heathrow | **30** | - |
| Post T5 transfer baggage system - Heathrow | **24** | - |
| Terminal 5C - Heathrow | **18** | 106 |
| Airside road and taxi lane underpass - Heathrow | **15** | - |
| T3 immigration hall - Heathrow | **15** | - |
| T5 phase 2 airfield and stand works - Heathrow | **5** | - |
| T4 baggage works - Heathrow | **4** | - |
| Control post programme - Heathrow | **4** | - |
| North west stands and taxi lanes - Heathrow | **-** | 10 |
| Eastern apron - Heathrow | **-** | 6 |
| | **1,445** | 142 |
| Other projects | **16** | 32 |
| | **1,461** | 174 |

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 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 million until the end of March 2014. Capital expenditure expected for Stansted during 2011 amounts to £19 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).

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 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.

### 25 Commitments and contingent liabilities *continued*

***Contingent liabilities***

The Group has external contingent liabilities, comprising letters of credit, performance/surety bonds, performance guarantees and other items arising in the normal course of business amounting to £269 million at 31 December 2010 (2009: £265 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 £76 million (2009: £70 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.

### 26 Notes to the consolidated statement of cash flows

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

| | Note | **Year ended 31 December 2010 £m** | Restated[1] Year ended 31 December 2009 £m |
|---|---|---|---|
| Operating activities | | | |
| Net loss before tax | | **(343)** | (693) |
| *Adjustments for:* | | | |
| Finance income | *4a* | **(162)** | (151) |
| Finance costs | *4a* | **895** | 788 |
| Fair value loss on financial instruments | *4b* | **36** | 120 |
| Property, plant and equipment impairment | *7* | **149** | - |
| Depreciation[2] | *2* | **458** | 429 |
| Amortisation | *2* | **23** | 27 |
| Exceptional costs[2] | *2,3* | **19** | 55 |
| Fair value (gain)/loss on investment properties | *8* | **(31)** | 93 |
| (Increase)/ decrease in trade and other receivables | | **(4)** | 97 |
| Increase /(decrease) in trade and other payables | | **20** | (81) |
| (Decrease)/increase in provisions | | **(17)** | 2 |
| Decrease in deferred income | | **(2)** | (21) |
| Difference between pension charge and cash contributions | | **(33)** | (32) |
| Exceptional pension (credit)/charge | | **(90)** | 218 |
| Cash generated from continuing operations | | **918** | 851 |

[1] The presentation of certain balances for the year ended 31 December 2009 has been restated to be consistent with current year disclosures.
[2] Heathrow Terminals 1 and 2 accelerated depreciation reported as exceptional items.

### 27 Related party transactions

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

| | **Year ended 31 December 2010 Sale of goods and services £m** | Year ended 31 December 2009 Sale of goods and services £m |
|---|---|---|
| Swissport / Groundstar | **3** | 2 |

| | **Year ended 31 December 2010 Purchase of goods and services £m** | Year ended 31 December 2009 Purchase of goods and services £m |
|---|---|---|
| Ferrovial Agroman | **59** | 96 |
| Amey Airport Services Limited | **-** | 4 |
| Amey Community Limited | **14** | 1 |
| HETCo[1] | **116** | - |
| | **189** | 101 |

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

**27 Related party transactions *continued***

Balances outstanding with related parties were as follows:

| | **31 December 2010** | | 31 December 2009 | |
|---|---|---|---|---|
| | **Amounts owed by related parties £m** | **Amounts owed to related parties £m** | Amounts owed by related parties £m | Amounts owed to related parties £m |
| Ferrovial Agroman | **-** | **4** | - | 1 |
| Amey Community Limited | **-** | **2** | - | - |
| HETCo[1] | **-** | **22** | - | - |
| | **-** | **28** | - | 1 |

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

**28 Ultimate parent undertaking and controlling party**

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

The ultimate parent entity in the UK is FGP Topco Limited, which is the parent undertaking of the largest group in the UK to consolidate these financial statements. The shareholders of FGP Topco Limited are 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 Limited 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 FGP Topco Limited for the year ended 31 December 2010.

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

**29 Subsidiaries**

The subsidiaries whose financial position materially affects the Group are as follows:

***Holding companies***

BAA (SP) Limited
BAA (AH) Limited †

***Airport owners and operators***

Heathrow Airport Limited†
Stansted Airport Limited†

***Other***

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

† Held by a subsidiary undertaking
# Incorporated in Jersey

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

**30 Subsequent 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 (SH) plc (formerly BAA (SH) Limited)

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# BAA (SH) plc (formerly BAA (SH) Limited)

## Independent auditors' report to the members of BAA (SH) plc

We have audited the parent company financial statements of BAA (SH) plc for the year ended 31 December 2010 which comprise the Company balance sheet, the Accounting policies and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an 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.

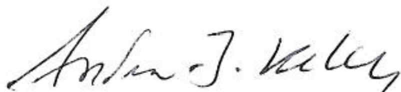
**Matters on which we are required to report by exception**

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 (SH) plc 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 (SH) plc (formerly BAA (SH) Limited)

## Company balance sheet as at 31 December 2010

| | Note | 31 December 2010 £m | 31 December 2009 £m |
|---|---|---|---|
| **Fixed assets** | | | |
| Investment in subsidiary | 2 | **3,009** | 2,792 |
| **Current assets** | | | |
| Debtors: due within one year | 3 | **8** | 16 |
| : due after more than one year | 3 | **566** | 1,566 |
| Cash at bank and in hand | | **20** | 1 |
| | | **594** | 1,583 |
| Creditors: amounts falling due within one year | 4 | **(6)** | (16) |
| **Net current assets** | | **588** | 1,567 |
| **Total assets less current liabilities** | | **3,597** | 4,359 |
| Creditors: amounts falling due after more than one year | 5 | **(488)** | (1,566) |
| **Net assets** | | **3,109** | 2,793 |
| **Capital and reserves** | | | |
| Called up share capital | 6 | **3,109** | 2,792 |
| Profit and loss reserve | 7 | **-** | 1 |
| **Total shareholder's funds** | | **3,109** | 2,793 |

These financial statements of BAA (SH) plc (Company registration number: 06458635) 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

## 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**
The Company re-registered as a public company under the name of BAA (SH) plc on 15 October 2010.

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

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

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

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

**Interest**
Interest payable and 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**
Borrowings 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.

**Classification of financial instruments issued by the Company**
Following the adoption of FRS 25 '(IAS 32) Financial instruments: Presentation', financial instruments issued by the Company are treated as equity (i.e. forming part of shareholder's funds) only to the extent that they meet the following two conditions:

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

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

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

### Classification of financial instruments issued by the Company *continued*

The Company is exempt from reporting information under FRS 29 'Financial instruments: disclosures' because the consolidated financial statements of BAA (SH) plc (formerly BAA (SH) Limited) is prepared in accordance with IFRS 7 'Financial Instruments: Disclosures'.

### Issue costs and arrangement fees

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 under 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.

### 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 (SH) plc 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 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 (SH) plc (formerly BAA (SH) 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 £1 million (2009: £nil).

### 2 Investment in subsidiary

| | £m |
|---|---|
| 1 January 2010 at cost | 2,792 |
| Additions | 217 |
| **31 December 2010 at cost** | **3,009** |

The Company's subsidiary undertaking is BAA (SP) Limited, which is incorporated in Great Britain and registered in England and Wales. Details of the principal subsidiary undertakings of the Group are provided in Note 29 of the BAA (SH) plc Group financial statements.

On 28 January 2010 the Company purchased an additional 217,370,315 ordinary shares of £0.0019 respectively in BAA (SP) Limited.

### 3 Debtors

| | **31 December 2010** | 31 December 2009 |
|---|---|---|
| | **£m** | £m |
| **Due within one year:** | | |
| Amounts owed by group undertakings - interest receivable | **8** | 16 |
| **Due after more than one year:** | | |
| Amounts owed by group undertakings - interest bearing | **566** | 1,566 |
| **Total debtors** | **574** | 1,582 |

Amounts owed by group undertakings - interest bearing relates to the debenture payable by BAA (SP) Limited which is used to fund interest on the Company's bond and subordinated facility. The interest on the debenture is set at 0.125% above all-in cost of funds for BAA (SH) plc 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.

### 4 Creditors: amounts falling due within one year

| | **31 December 2010** | 31 December 2009 |
|---|---|---|
| | **£m** | £m |
| Interest payable | **5** | 16 |
| Accrued expenditure | **1** | - |
| | **6** | 16 |

### 5 Creditors: amounts falling due after more than one year

| | **31 December 2010** | 31 December 2009 |
|---|---|---|
| | **£m** | £m |
| **Secured** | | |
| Bonds | **317** | - |
| Subordinated facility[1] | **171** | 1,566 |
| | **488** | 1,566 |

[1] During 2010 BAA (SH) repaid its previous £1.5 billion Subordinated facility which was principally replaced by £1 billion of financing raised at BAA (SP) and a £325 million bond and a £175 million loan raised by the Company.

As at 31 December 2010, the fair value of the non-current borrowings above was £499 million (2009: £1,566 million). The fair values of listed borrowings are based on quoted prices obtained from Bloomberg. The fair values of non-current borrowings which have floating rate interest are assumed to equate to their current nominal value.

Additional disclosures on risk management and hedging of borrowings are included in Notes 15 and 16 of the Group financial statements.

### 6 Share capital

| | £ |
|---|---|
| **Authorised** | |
| 9,000,000,000 ordinary shares of £1 each | **9,000,000,000** |
| **Called up, allotted and fully paid** | |
| In issue at 1 January 2010: 2,791,980,374 ordinary shares of £1 each | 2,791,980,374 |
| Issue of 317,370,315 ordinary shares of £1 each | 317,370,315 |
| **In issue at 31 December 2010: 3,109,350,689 ordinary shares of £1 each** | **3,109,350,689** |

On 28 January 2010, the Company issued 217,370,315 ordinary shares of £1 each at par to BAA (DSH) Limited. 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 (SP) Limited completing the £500 million equity injection into BAA (SP) Limited announced in November 2009.

A further 100,000,000 ordinary shares of £1 were issued at par to BAA (DSH) Limited on 10 September 2010.

### 7 Profit and loss reserve

| | £m |
|---|---|
| 1 January 2010 | 1 |
| Loss for the financial year | (1) |
| **31 December 2010** | - |

### 8 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 (SH) plc Group financial statements.

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

### 9 Employee information and directors' remuneration

***Employee numbers***

The Company has no employees (2009: nil).

***Directors' remuneration***

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

### 10 Ultimate parent undertaking and controlling party

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

The ultimate parent entity in the UK is FGP Topco Limited, which is the parent undertaking of the largest group in the UK to consolidate these financial statements. The shareholders of FGP Topco Limited are 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 (SH) plc 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 Limited and FGP Topco Limited for the year ended 31 December 2010.

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

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