Heathrow Finance plc

Annual report and financial statements for the year ended 31 December 2013

Company registration number: 06458635

Heathrow Finance plc

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Heathrow Finance plc

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Heathrow Finance plc

Strategic report

Heathrow Finance plc (the 'Company') is the holding company of Heathrow (SP) Limited ('Heathrow (SP)') which itself is the holding company of a group of companies that owns Heathrow airport and operates the Heathrow Express rail service between Heathrow and Paddington, London. Heathrow Finance plc is an indirect subsidiary of the Heathrow Airport Holdings Limited group ('Heathrow Airport Holdings Group').

On 28 February 2013, the Group sold Stansted airport to Manchester Airports Group for a cash consideration of £1.5 billion.

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

This strategic report is presented in three sections:
Management review – overview of the year ended 31 December 2013, along with the key factors likely to impact the Group in 2014.
Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2013 and analysis of the financial position of the Group as at that date. The Group's accounting and reporting policies and procedures are also considered.
Internal controls and risk management – outline of the Heathrow Airport Holdings Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the Heathrow Airport Holdings Group Executive Committee.

Management review
Review of 2013
Key features of the year
2013 was a positive year for the business marked by a number of key milestones. Passenger satisfaction at Heathrow reached record levels and for the first time Heathrow welcomed over 72 million passengers to the airport. Strong financial performance underpinned the on-going transformation of the airport, most notably marked by the completion on time of Terminal 2's construction phase. In 2013, Heathrow became the full focus of the business as Stansted airport was sold for £1.5 billion. The independent Airports Commission published its interim findings and shortlisted Heathrow's proposal for hub expansion, recognising the need for new airport capacity in the South East of England.

Heathrow continues to progress in making every journey better. A key independently measured score for passenger satisfaction beat its previous annual high with 75% of Heathrow's passengers rating their experience in 2013 as excellent or very good. Skytrax named Heathrow Terminal 5 the World's Best Airport Terminal for the second year running and declared Heathrow the World's Best Airport Shopping. Airports Council International also named Heathrow as Europe's Best Airport with more than 25 million annual passengers.

Almost 470,000 flights departed and landed at Heathrow in 2013, 10,000 below the maximum permitted. Despite operating close to full capacity, Heathrow delivered a robust overall operational performance in 2013. On average, aircraft were larger and fuller than in previous years, which led to a growth in traffic of 3.4%, to a record 72.3 million passengers.

Heathrow continued to invest heavily in transforming the airport, spending £1.3 billion in 2013. The new Terminal 2 has been the cornerstone of investment, completing construction of a main terminal building, a satellite terminal building, a car park and an energy centre. It will be known as 'Terminal 2: The Queen's Terminal' in honour of Her Majesty Queen Elizabeth II, and will be home to 26 airlines. Operations begin on 4 June 2014 with United Airlines, followed by a phased move of airlines until November 2014.

The next regulatory period for Heathrow's economic regulation ('Q6') begins on 1 April 2014. Following constructive engagement with airlines, Heathrow developed a five-year business plan. The plan set out operational and capital programmes to continue the transformation of Heathrow, focusing on service delivery and improving the experiences of passengers, whilst delivering operating efficiencies.

Following two phases of consultation on the plan, the CAA gave notice in January 2014, of its intention to set a maximum allowable yield per passenger of RPI minus 1.5% per year, with an assumed capital plan of £2.8 billion. On 13 February 2014, the CAA formally granted Heathrow's licence to charge fees for the provision of airport services and this will take effect from 1 April 2014. The CAA has set a tough settlement for Q6 which Heathrow is reviewing in detail.

Management review *continued*

Review of 2013 *continued*
Key features of the year continued
At the end of 2012 the UK government established the Airports Commission to examine the requirement for additional airport capacity to maintain the UK's position as Europe's most important aviation hub. In December 2013 the Commission published its interim report and stated that there is a clear case for at least one net additional runway in London and the South East by 2030. Heathrow's proposal for a third runway to the north west of the airport was shortlisted.

This option would raise the capacity at Heathrow to 740,000 flights a year, from the current limit of 480,000. It would cater for 130 million passengers and allow the UK to compete with international rivals as well as providing capacity for the foreseeable future. With the proposed north west third runway there will be 15% fewer people within Heathrow's noise footprint in 2030 than today. This is due to its position further from London, quieter new generation aircraft and changes in operating procedures. The company welcomes the inclusion of Heathrow in the shortlist and has begun working with local authorities, communities and other stakeholders, to refine the runway option, including public consultation.

The Commission will explore all options on its shortlist in more detail ahead of its full report due by the summer of 2015.

Passenger traffic
Heathrow's passenger traffic by geographic segment for the year ended 31 December 2013:

Passengers by geographic segment (millions)	**Year ended 31 December 2013**	Year ended 31 December 2012	Change[1] %
UK	**5.0**	4.7	5.9
Europe	**29.9**	28.7	4.4
North America	**16.7**	16.3	2.4
Asia Pacific	**10.3**	9.8	5.3
Middle East	**5.9**	5.6	4.4
Africa	**3.5**	3.9	(10.2)
Latin America	**1.1**	1.0	5.7
Total passengers[1]	**72.3**	70.0	3.4

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

For the year ended 31 December 2013, Heathrow's traffic increased 3.4% to a record 72.3 million passengers (2012: 70.0 million), with an average load factor of 76.4% (2012: 75.6%) and 202.8 average seats per aircraft (2012: 197.4). The rate of growth in traffic was boosted by the non-recurrence of the dip in demand experienced during the Olympic Games in 2012, estimated at around 720,000 passengers. Taking this into account, the underlying rate of growth for the year was in the region of 2.3%.

On a regional basis, Europe generated the most significant increase in traffic, with over 1.2 million additional passengers. This in part reflects the dampened demand in 2012 caused by the Olympics, which was more pronounced in short haul traffic. The underlying growth in the region reflects the integration of bmi routes into British Airways. UK traffic grew by 5.9% to 5.0 million passengers (2012: 4.7 million) partly reflecting the launch of UK domestic services by Virgin Atlantic Little Red at the start of the summer.

Long haul traffic performed well in most regions. Asia Pacific traffic increased 5.3% to 10.3 million passengers (2012: 9.8 million), as airlines launched new routes and frequencies including growth in China and India. Middle East traffic increased 4.4% to 5.9 million passengers (2012: 5.6 million) with larger aircraft and passenger growth from Emirates, Etihad and Saudi Airlines. The Americas benefitted from fuller planes, with the rate of growth in North American traffic increasing through the year, leading to an overall rise in passengers of 2.4% and Latin American traffic increased 5.7% to 1.1 million passengers (2012: 1.0 million).

Note: Since the start of 2013, Heathrow has changed the reporting of traffic statistics by geographic segment to make it consistent with international practice.

Transforming the Group's airport
Enhancing Heathrow's facilities
Heathrow's investment programme in 2013 continued the transformation of the airport, with principal focus on the construction of the new Terminal 2. The terminal is to be named Terminal 2: The Queen's Terminal in honour of Her Majesty Queen Elizabeth II who opened the original Terminal 2 sixty years ago. It will be home to all 23 Star Alliance airlines operating at Heathrow as well as Aer Lingus, germanwings and Virgin Atlantic Little Red.

Management review *continued*

Transforming the Group's airport continued

Enhancing Heathrow's facilities continued

The £2.5 billion investment in Terminal 2 comprises a main terminal building and a satellite building, together with a multi-storey short-stay car park, as well as an energy centre that supports the Terminal 2 campus and the wider airport. 24 fully serviced and fuelled aircraft stands, including seven A380 compatible stands, have been constructed together with taxiways that surround the buildings. Services have been installed to the buildings and surrounding infrastructure. Remaining activities include commissioning lifts, escalators and fire alarms; completing non-passenger facing areas, and modifications due to the change in airline occupancy driven by the end of bmi operations following its acquisition by British Airways.

The project moved on time from the construction phase to the operational readiness phase in November 2013. Extensive trials and familiarisation activities are underway, to ensure operational readiness of the facility and of the 24,000 people from 160 different organisations that will work at Terminal 2. Operations start on 4 June 2014 with United Airlines, followed by a phased move of airlines into the terminal over the following six months.

In addition, significant investment continues on Heathrow's baggage infrastructure. The underground automated baggage system between Terminal 3 and Terminal 5 is now fully operational. Delivery of the Terminal 3 integrated baggage system remains on track to start operation in 2015. The integrated baggage system is housed in a separate building and will provide Terminal 3 with an integrated departing and transferring baggage system. The building has been made weather-tight and the baggage system is now being assembled inside the building.

Heathrow's southern runway was resurfaced during 2013 with works carried out during night closures of the runway. The northern runway will be resurfaced in 2014.

Service standards

Heathrow's focus on transforming the experience of passengers travelling through the airport continued to receive significant endorsement from the travelling public in 2013.

In the 2013 Skytrax World Airport Awards, Terminal 5 was named the World's Best Airport Terminal for the second consecutive year and Heathrow was declared the World's Best Airport Shopping. Heathrow was also named among Skytrax top 10 global airports for the first time. Separately in June, Heathrow was named Best Airport in the 2013 ACI Europe Awards: Europe's Best Airport (with over 25 million annual passengers).

Underpinning these endorsements, in the independent Airport Service Quality survey, directed by Airports Council International ('ACI'), 75% of Heathrow passengers surveyed rated their experience as 'Excellent' or 'Very Good', beating the previous annual high of 73% in 2012. In addition, Heathrow achieved its highest ever overall passenger satisfaction score of 3.99 for the first two quarters of 2013 and 3.97 in the final quarter. As a result, Heathrow achieved a record overall performance of 3.97 in 2013, reflecting a notable improvement over last year (2012: 3.94).

In relation to individual service standards, during the year ended 31 December 2013, departure punctuality (the proportion of aircraft departing within 15 minutes of schedule) was 77% (2012: 78%). Heathrow's baggage misconnect rate was 14.5 per 1,000 passengers (2012: 15.0). On security queuing, passengers passed through central security within the five minute period prescribed under the service quality rebate scheme 90.9% of the time (2012: 92.8%) compared with a 95% service standard. The security queue experience remains a key priority of the business and a range of initiatives have been implemented to improve performance. In order to meet increased passenger volumes, additional security officers are being recruited and further security lanes are being introduced during 2014.

Regulatory and governmental developments

Heathrow's development for the next 5 years

The next regulatory period ('Q6') for economic regulation of Heathrow begins on 1 April 2014. Following constructive engagement with airlines, Heathrow proposed a five-year business plan in January 2013, which set out its operational and capital plan to continue the transformation of Heathrow, focusing on service delivery and improving the passenger experience, whilst delivering operating efficiencies and a fair return on investment. Following publication of the Business Plan, Heathrow has been engaged in the consultation process run by the CAA throughout 2013.

On 30 April 2013, the CAA published Initial Proposals for Q6 proposing price controls, a change to the maximum allowable yield per passenger of RPI minus 1.3% per year and a draft licence. In response to the Initial Proposals, Heathrow refreshed its plans which included increased efficiency savings of £427 million and updated passenger forecasts. The CAA published Final Proposals for Q6 on 3 October 2013 which proposed a change to the maximum allowable yield per passenger of RPI +0% per year and assumed a capital investment plan of £2.885 billion.

On 10 January 2014, the CAA gave notice of its proposed licence to Heathrow under the Civil Aviation Act 2012, under which the maximum allowable yield per passenger will be RPI minus 1.5% per year (RPI minus 1.2% per year on a five-year adjusted basis), with an assumed capital plan of £2.81 billion (£2.95 billion on a five-year adjusted basis). The main changes to the CAA's previous proposal were an increase of 5.7 million passengers to the traffic forecast and a 25 basis point reduction in the assumed cost of capital. In addition, the duration of the next regulatory period has been amended to 4 years and 9 months, to align the regulatory year with Heathrow's financial year.

Management review *continued*

Regulatory and governmental developments continued

Heathrow's development for the next 5 years continued

On 13 February 2014, the CAA formally granted Heathrow's licence to charge fees for the provision of airport services and this will take effect from 1 April 2014, when the previous regulatory settlement will end. Heathrow and other parties with a qualifying interest have until 27 March 2014 to seek permission to appeal the decision on the price controls.

Airports Commission

At the end of 2012 the UK government established the Airports Commission, chaired by Sir Howard Davies. The Airports Commission was tasked with examining the requirement for additional airport capacity to maintain the UK's position as Europe's most important aviation hub. On 17 July 2013, Heathrow submitted three third runway options for the Airports Commission to consider. The options were located to the north west, south west or north of the existing airport.

On 17 December 2013, the Commission published its interim report on the steps needed to maintain the UK's global hub status. The Commission stated that there is a clear case for at least one net additional runway in London and the South East by 2030 and shortlisted potential sites for further analysis and assessment: 1) a 3,500 metre runway proposed by Heathrow to the north west of the airport; 2) a separate proposal by Heathrow Hub Limited to lengthen Heathrow's existing northern runway to 6,000 metres; and 3) a new runway at Gatwick Airport south of the existing runway. In addition, the Commission recommended short-term actions to improve the use of existing runway capacity in the next 5 years.

Heathrow's north west third runway option would raise the capacity at Heathrow to 740,000 flights a year, from the current limit of 480,000. It would cater for 130 million passengers annually compared to 80 million today, allowing the UK to compete with international rivals and providing capacity for the foreseeable future and is designed to evolve to four runways if required.

The north west runway option is to the west of the short third runway proposal under the 2003 Air Transport White Paper. With a north west third runway there will be 15% fewer people within Heathrow's noise footprint in 2030 than today. This is due to its positioning further from London, quieter new generation aircraft and changes in operating procedures. The option maintains the principle of runway alternation to provide periods of respite from noise for all communities around Heathrow.

Construction of the new runway could be completed in six years with an estimated earliest operational date of 2026 at an estimated cost of £17 billion, of which £11 billion relates to airport infrastructure. The proposal is based on private funding of the core airport infrastructure, investment over approximately 15 years, on the basis of an appropriate regulatory regime in place to give long-term visibility of returns to investors commensurate with risk. The remaining £6 billion comprises £2 billion of surface access costs and £4 billion of environmental or community costs, which may be more appropriately funded by Government.

The company welcomes the inclusion of Heathrow in the shortlist and is reviewing the detail of the Commission's report. Heathrow has begun working with local authorities, communities and other stakeholders to refine the runway option, including a first public consultation which started on 3 February. A refined proposal will be submitted to the Airports Commission in May 2014. The Airports Commission is due to report its final findings in summer 2015.

Outlook

Heathrow expects continued growth in revenue, Adjusted Earnings Before Interest, Tax, Depreciation and Amortisation ('EBITDA') and operating cash flow in 2014, primarily driven by higher passenger traffic, increased aeronautical charges and operating efficiencies, which in combination will mitigate costs related to operating an additional terminal once Terminal 2 opens.

Traffic momentum in early 2014 has remained strong and the incremental change to the tariff formula for the regulatory period beginning 1 April 2014, recently announced by the CAA, does not materially impact previously published 2014 forecasts.

Therefore at this early stage in the year, other than Terminal 2 operational readiness costs now being classified as exceptional items, the outlook for 2014 remains consistent with the guidance set out in the December 2013 Investor Report.

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 operations.

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 2013 have been presented.

- *Discontinued operations*
  - On 28 February 2013 the Group completed the disposal of Stansted airport to Manchester Airports Group for a cash consideration of £1.5 billion. Stansted airport had been classified as held for sale in 2012.
  - As required under IFRS the results and performance of Stansted airport are included in the results and cash flows of discontinued operations which are reported separately at the foot of the Group's Consolidated income statement and Consolidated statement of cash flows.

- *Continuing operations exceptional items and certain re-measurements* - these include the following before tax:
  - £66 million net exceptional pensions charge;
  - £22 million relating to reorganisation costs (including severance and pensions payments);
  - £16 million relating to Terminal 2 operational readiness costs associated with managing the opening of Terminal 2;
  - £62 million of fair value gains arising from the revaluation of investment property; and
  - £81 million of fair value losses on financial instruments

Basis of presentation of financial results
In order to provide a more meaningful comparison of performance between 2012 and 2013, the review focuses on the Group's continuing operations by excluding Stansted from current and prior year operating financial information.

From 1 January 2013, the reporting of certain intra-group services has changed, impacting both reported revenue and costs. Prior to this date, the Group incurred the costs of providing certain services to the Heathrow Airport Holdings Group. The related intra-group transactions were separately recorded by the Group firstly as Other Income for charges made by it to LHR Airports Limited ('LHR Airports'), the Heathrow Airport Holdings Group's shared services provider, and secondly as Intra-group charges made by LHR Airports for the part of the charges attributable to the Group's airports, including Heathrow. From 1 January 2013, only services provided to non-Heathrow airports are charged out, with the corresponding settlement reported in Other Income. Consequently the 2013 amounts for Other Income and General Expenses are not directly comparable with 2012 amounts.

From 1 January 2013, the classification in the income statement, of the Group's share of the financial return on the LHR Airports defined benefit pension scheme assets has been reported in net finance costs, where previously it was reported in employment costs. In order to reflect the change in accounting policy, employment costs, operating costs, Adjusted EBITDA, operating profit and net finance costs have been restated. For 2012, the restatement removes a credit of £16 million related to the defined benefit pension scheme from employment costs and restates it between finance income and exceptional pension charge. There is no impact on the statement of financial position or cash flows of the Group from this change.

Heathrow Finance plc

Financial review *continued*

Summary performance

Continuing operations	Year ended 31 December 2013 £m	Restated[1] Year ended 31 December 2012 £m
Revenue	**2,474**	2,222
Adjusted operating costs [2]	**(1,064)**	(1,069)
Adjusted EBITDA [3]	**1,410**	1,153
Exceptional items: other	**(38)**	-
Exceptional items: pensions	**(66)**	(138)
EBITDA	**1,306**	1,015
Fair value gain on investment properties	**62**	50
Depreciation and amortisation – ordinary	**(450)**	(474)
Operating profit	**918**	591
Impairment of property, plant and equipment – exceptional	**-**	(5)
Net finance cost	**(646)**	(710)
Fair value (loss)/gain on financial instruments	**(81)**	108
Profit/(loss) before taxation	**191**	(16)
Taxation credit	**123**	122
Profit from continuing operations	**314**	106
Net profit from discontinued operations	**422**	15
Consolidated profit for the year	**736**	121

1 Restated, see note on Changes in accounting policies.
2 Adjusted operating costs are stated before depreciation, amortisation and exceptional items.
3 Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation and exceptional items.

Revenue

In the year ended 31 December 2013, Heathrow's revenue increased 11.3% to £2,474 million (2012: £2,222 million).

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m	Change %
Aeronautical income	**1,523**	1,280	19.0
Retail income	**487**	460	5.9
Other income	**464**	482	(3.7)
Total revenue	**2,474**	2,222	11.3

Aeronautical income

Heathrow's aeronautical income increased 19.0% to £1,523 million (2012: £1,280 million). Average aeronautical income per passenger increased 15.1% to £21.06 (2012: £18.29).

The performance reflects passenger traffic growth and increases in headline tariffs. In addition, since the second quarter of 2013 the growth also reflects recovery of yield dilution in the 2011/12 regulatory year through the 'K' factor mechanism. This is combined with yield concentration in 2013 and the non-recurrence of substantial yield dilution experienced in 2012.

Financial review *continued*

Revenue *continued*
Retail income
In the year ended 31 December 2013, Heathrow's retail income increased 5.9% to £487 million (2012: £460 million). Net retail income ('NRI') grew 6.2% to £461 million (2012: £434 million) and NRI per passenger rose 2.6% to £6.37 (2012: £6.21).

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m	Change %
Car parking	**91**	82	11.0
Duty and tax-free	**126**	122	3.3
Airside specialist shops	**96**	92	4.3
Bureaux de change	**45**	44	2.3
Catering	**39**	38	2.6
Other retail income	**90**	82	9.8
Gross retail income	**487**	460	5.9
Retail expenditure	**(26)**	(26)	-
Net retail income	**461**	434	6.2

The main segments of growth in retail income in 2013 were car parking and car rental which generated an additional £12 million. Growth in airside specialist shops income was driven by luxury retail shops which strengthened during 2013, having experienced a soft start to the year, the growth helped to offset the impact from the unplanned closure of HMV stores which went into administration in early 2013.

The rate of growth in NRI per passenger is likely to have been impacted by the shift in mix towards European traffic, as traditionally such passengers have a lower propensity to spend in Heathrow's retail outlets.

Other income
Increases in rail income, property rental and operational facilities and utilities income totalled £11 million. These increases were offset by a reduction of £29 million in other income which primarily related to a change in the way in which the recharge of intra-group services is recorded.

Adjusted operating costs
Adjusted operating costs exclude depreciation, amortisation and exceptional items.

In the year ended 31 December 2013, adjusted operating costs reduced by 0.4% to £1,064 million (2012: £1,069 million).

	Year ended 31 December 2013 £m	Restated[1] Year ended 31 December 2012 £m	Change %
Employment costs	**392**	382	2.6
Maintenance expenditure	**164**	154	6.5
Utility costs	**85**	87	(2.3)
Rents and rates	**116**	124	(6.5)
General expenses	**281**	296	(5.1)
Retail expenditure	**26**	26	-
Total	**1,064**	1,069	(0.4)

[1] Restated, see note on Changes in accounting policies.

The main drivers of change in adjusted operating costs were higher employment costs and maintenance expenses, mainly offset by lower reported, general expenses. On a comparable basis between 2013 and 2012, adjusted for the one-off Olympic Games costs and aligning the basis of general expenses, underlying operating costs increased.

Employment costs continue to be a focus for the business, and major restructuring activities are taking place to deliver Heathrow's business plan for the next five years and on-going business efficiency. The Group achieved efficiencies in 2013 through management pay freezes and headcount savings, these partially offset contractually agreed pay increases and bonuses.

During the year Heathrow consolidated its baggage system maintenance contracts to a single supplier. The increase of £10 million in maintenance costs in part reflects a one-off charge relating to these contract changes. The contract has already started to deliver savings in employment costs and general expenses and is expected to deliver around £100 million savings through the next regulatory period.

Financial review *continued*

Adjusted operating costs *continued*

General expenses were broadly flat on an underlying basis after removing the Olympic costs from 2012 and taking account of the change in the recharge of intra-group services following the disposal of Stansted Airport. In 2013, extra costs were incurred in ensuring operations were maintained during adverse weather in January.

Other cost benefits were achieved when annual inflation-linked rises in property rates were offset by one-off credits awarded from recent rates valuation assessments.

Adjusted EBITDA

In the year ended 31 December 2013, Adjusted EBITDA increased 22.3% to £1,410 million (restated 2012: £1,153 million), resulting in an Adjusted EBITDA margin of 57% (restated 2012: 52%).

The increase in Adjusted EBITDA from 2012 principally reflects the increase in aeronautical income through passenger traffic growth and increases in headline tariffs.

In the year ended 31 December 2013, restructure charges incurred in delivering the operating efficiency programme and costs associated with Terminal 2 preparation are classified as exceptional items.

The restructure charges and Terminal 2 operational readiness costs will continue to be treated as exceptional items in 2014. The forecasts for Adjusted EBITDA that were published in December 2013 included these costs in operating expenses. Therefore this treatment will drive a higher Adjusted EBITDA in 2013 and 2014 than previously published whilst the impact is cash flow neutral.

Exceptional items

In the year ended 31 December 2013, there was a net exceptional pre-tax charge of £104 million (2012: £138 million) to the income statement. The exceptional charge relates to the pension scheme charges, restructure charges and preparation costs for the opening of Terminal 2.

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Restructure	**(22)**	-
Terminal 2 operational readiness	**(16)**	-
Pension	**(66)**	(138)
Exceptional pre-tax charge	**(104)**	(138)

Exceptional items: pensions

A non-cash pension charge of £66 million (2012: £138 million) arose principally from Heathrow's share of the increase in liabilities under the LHR Airports Limited defined benefit pension scheme since 31 December 2012, driven by movements in actuarial assumptions.

Exceptional items: other

A significant restructure of the organisation began in 2013 as part of the programme to deliver operational efficiencies during Heathrow's next regulatory period. In 2013, £22 million of restructure costs were provided for. Due to the size and nature of the programme, these charges are classified as exceptional operating items.

Terminal 2 operational readiness costs mainly relate to familiarisation, induction and training activities and the ramp up of operational costs following the move of Terminal 2 from the construction phase to the operational phase. In 2013 operational readiness costs of £16 million were incurred.

Fair value gain on investment property valuation

Investment properties were valued at a fair value at 31 December 2013 by CBRE Limited, Chartered Surveyors. Investment property comprises mainly airport car parks and airside assets and is considered less vulnerable to market volatility. The investment property valuation as at 31 December 2013 resulted in a gain of £62 million (2012: £50 million).

Depreciation and amortisation

Depreciation and amortisation for the year ended 31 December 2013, excluding exceptional charges, was 5.1% lower at £450 million (2012: £474 million). This was due in part to the disposal of Stansted and the cessation of depreciation under IFRS at the point of held for sale.

Net finance cost

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

Financial review *continued*

Fair value movements on financial instruments

A net fair value loss of £81 million (2012: gain of £108 million) on financial instruments has been recognised as financing costs in the Income statement. The non-cash, fair value loss is principally due to changes in the mark-to-market value of index-linked swaps. The mark-to-market value of index-linked swaps had been positively impacted during 2012 by the expectation that the Office for National Statistics (ONS) would alter the calculation methodology for the Retail Price Index. The announcement by the ONS in early 2013 not to alter the methodology led to a reversion in 2013 to higher RPI expectations. The fair value loss on index-linked swaps in 2013 was partially offset by positive mark-to-market movements on interest-rate swaps arising from recent higher interest rate expectations and a greater amount of these swaps no longer being hedge accounted.

Taxation

The tax credit recognised for the year ended 31 December 2013 was £123 million (2012: £122 million). This reflects a tax charge arising on ordinary activities of £38 million (2012: £12 million credit) together with a tax credit of £161 million (2012: £110 million) due to the impact on the deferred tax liabilities of the reductions in the main rate of UK corporation tax.

The Finance Act 2013 enacted reductions in the main rate of UK corporation tax from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015. As a result, the Group's deferred tax balances, which were previously provided for at 23%, have been re-measured at the rate of 20%. This has resulted in a reduction in the net deferred tax liability of £150 million, with £161 million credited to the income statement and £11 million charged to equity.

The tax charge for the year on ordinary activities of £38 million (2012: £12 million credit) results in an effective tax rate of 19.9% (2012: 75.0% negative effective tax rate). The tax charge is less than implied by the statutory rate of 23.25% (2012: 24.5%) primarily due to non taxable income. Refer to Note 5 of the Group financial statements.

The Group’s disposal of Stansted airport has no associated tax charge as it qualifies for the Substantial Shareholding Exemption.

Discontinued operations

Discontinued operations included the results of Stansted airport in 2013. Profits in 2013 were £422 million, which included a gain of £415 million on its disposal on 28 February 2013.

Summary cash flow

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Cash generated from Operations[1]	**1,414**	1,163
Taxation	**(32)**	(31)
Net cash flow from operating activities	**1,382**	1,132
Dividends paid	**(700)**	(346)
Capital expenditure	**(1,288)**	(1,157)
Disposal proceeds and investing activities of discontinued operations	**1,410**	(5)
Movement in bonds	**349**	2,677
Net movement in other borrowings and other financing items	**(408)**	(1,718)
Net interest paid	**(509)**	(401)
Cancellation and restructuring of derivatives	**(2)**	(76)
Settlement of accretion on index-linked swaps	**(177)**	(80)
Financing activities of discontinued operations	**-**	(21)
Net increase in cash and cash equivalents	**57**	5

1 Includes £7 million (2012: £82 million) in relation to Stansted airport.

Cash flow from continuing operating activities

Net cash inflow from continuing operations in the year ended 31 December 2013 increased 30.2% to £1,407 million (2012: £1,081 million) which compares with Adjusted EBITDA of £1,410 million (2012: £1,153 million). The operating cash flow was £3 million lower than Adjusted EBITDA principally as a result of pension cash contributions being higher than pension service charges and a cash outflow relating to exceptional Terminal 2 operational readiness costs, partially offset by an increase in amounts due to LHR Airports Limited.

Capital expenditure

In the year ended 31 December 2013, the cash flow impact of capital investment was £1,288 million, of which £1,283 million related to Heathrow (2012: £1,157 million, including £1,141 million at Heathrow).

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

Financial review *continued*

Dividend/controlled payments

In the year ended 31 December 2013, controlled payments of £700 million (2012: £346 million) were made out of the Group.

The Group's ultimate shareholders received £255 million (2012: £240 million) in quarterly dividend payments. A further £300 million return was made to shareholders on their historic investment in Stansted airport following its disposal. These dividends were funded by controlled payments from the Group, except for £48 million which was funded from cash resources outside the Heathrow Finance group.

After taking account of the £507 million in controlled payments utilised in paying shareholder dividends, a further £193 million in controlled payments were made relating to servicing of debt elsewhere in the FGP Topco Limited group ('FGP Topco Group') and rebalancing of debt at different levels of the FGP Topco Group's capital structure.

This included £95 million used to repay part of the £600 million ADI Finance 1 Limited ('ADIF1') facility, which was replaced by facilities of £505 million at ADI Finance 2 Limited ('ADIF2') in July 2013 and £39 million to meet external interest payments on ADIF1 and ADIF2 loan facilities.

Pension scheme

At 31 December 2013, the LHR Airports Limited defined benefit pension scheme had a deficit of £93 million (2012: £103 million) as measured under IAS 19, of which £81 million (2012: £76 million) was attributable to the Group under the Group's shared services agreement with LHR Airports Limited. The increase in the Group's share of the deficit is mainly due to a larger proportion of the overall Heathrow Airport Holdings Group deficit being attributed to the Group following the disposal of Stansted.

The trustees of the LHR Airports Limited defined benefit pension scheme and the Heathrow Airport Holdings Group concluded the pension scheme's 30 September 2010 triennial valuation in December 2011 and agreed a schedule of cash contributions of £97 million per annum (of which £24 million relates to deficit recovery) that became effective from 1 January 2012. Following the disposal of Edinburgh airport, the schedule of cash contributions was reduced to £94 million per annum from January 2013 with a further reduction to £87 million per annum from January 2014 following the sale of Stansted airport. Approximately £77 million in cash contributions will be met by Heathrow.

Net debt and liquidity

During 2013, the Group's nominal net debt decreased 0.5% to £12,025 million at 31 December 2013 from £12,086 million at 31 December 2012. The lower net debt reflects debt repayment from the proceeds of the sale of Stansted airport together with operating cash flow more than offsetting the very substantial capital investment at Heathrow during 2013, interest payments, accretion on the Group's index-linked swaps and bonds and distributions made out of the Group.

The Group's nominal net debt at 31 December 2013 comprised £11,214 million under bond issues, £458 million under various loan facilities, £448 million in index-linked derivative accretion and cash at bank and term deposits of £95 million. Nominal net debt comprised £9,864 million in senior net debt and £1,400 million in junior debt (both held at the Company's subsidiaries) together with £761 million in net debt held at the Company.

The accounting value (which includes £96 million statement of financial position cash and cash equivalents) of the Group's net debt excluding accrued interest was £11,445 million at 31 December 2013 (2012: £11,574 million).

The average cost of the Group's external gross debt at 31 December 2013 was 4.54% (2012: 4.37%), taking into account the impact of interest rate, cross-currency and index-linked hedges but excluding index-linked accretion. Including index-linked accretion, the Group's average cost of debt at 31 December 2013 was 6.02% (2012: 5.86%). The change in the average cost of debt is mainly due to an increase in the Group's proportion of fixed rate debt through the use of interest rate swaps.

At 31 December 2013, the Group had approximately £2.2 billion in undrawn loan facilities and cash resources. Since the beginning of 2014, the Group has completed further debt financings and repaid or partially cancelled existing debt facilities. Taking this into account, together with expected operating cashflow over the period, the Group expects to have sufficient liquidity to meet all its obligations in full, including capital investment, debt service costs, debt maturities and distributions, until early 2016.

Financial review *continued*

Recent financing activity
The recent focus of the Group's financing activities has been to take advantage of attractive financing market conditions during 2013 to refinance existing debt, optimise the Group's long-term cost of debt and extend its debt maturity profile. This activity has further strengthened the long term financing platform established in recent years.

The Group completed nearly £1.0 billion of new debt financings in the year including in particular a £750 million 33 year Class A bond issue by Heathrow Funding Limited, which had the lowest coupon of any long dated sterling bond issue ever completed by the Group, at 4.625%.

Further, Heathrow completed £275 million of Class A and Class B revolving credit facilities (including £100 million of Class B facilities completed since the end of 2013) at lower cost than the equivalent tranches under its core revolving credit facilities. Also since the end of 2013, Heathrow Funding Limited placed £200 million in Class A index-linked bonds with 18, 25 and 35 year maturities with a single investor.

The Group has actively taken steps to repay relatively expensive debt as it has put in place more attractively priced new financing. It has taken advantage of the £275 million in new revolving credit facilities referred to above to reduce its more expensive core revolving credit facilities by £200 million since the beginning of 2014. In addition, Heathrow's previous Class B term loan facility due September 2014, which amounted to £150 million at the end of 2012, was repaid in full during 2013.

This financing activity has enabled the Group to increase the average life of its external debt from 9.9 years at 31 December 2012 to 11.0 years at 31 December 2013 with the amount of debt falling due within 3 years being £2.1 billion compared to £1.8 billion at the end of 2012.

As highlighted last year, the Group expects the scale of its funding requirements to remain relatively modest, at an average of less than £1.5 billion per annum, over the coming years. This reflects a reduced capital programme and continued increases in operating cash flow at Heathrow through its next regulatory period ending in 2018.

Regulatory Asset Base ('RAB')
Heathrow's RAB at 31 December 2013 was £14,585 million compared to £13,471 million at 31 December 2012. Stansted's RAB at 31 December 2012, which was used in determining the Group's gearing at that date, was £1,343 million. RAB figures are utilised in calculating gearing ratios under the Group's financing agreements.

The increase in Heathrow's RAB during the year ended 31 December 2013 reflected the addition of approximately £1.3 billion in capital expenditure and indexation adjustments of around £370 million. The increases were partially offset by regulatory depreciation of around £585 million and a modest amount of asset disposals and RAB profiling adjustments.

Net finance costs and net interest paid
In the year ended 31 December 2013, the Group's net finance costs before certain re-measurements were £646 million (2012: £710 million). A reconciliation from net finance costs on the income statement to net interest paid on the cash flow statement is provided below:

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Net finance costs before certain re-measurements	**(646)**	(710)
Amortisation of financing fees, discounts and fair value adjustments	**42**	79
Borrowing costs capitalised	**(164)**	(100)
Underlying net finance costs	**(768)**	(731)
Non-cash accretion on index-linked instruments	**202**	191
Other movements	**57**	139
Net interest paid	**(509)**	(401)

Underlying net finance costs were £768 million (restated 2012: £731 million), after adjusting for £164 million (2012: £100 million) in capitalised interest and £42 million (2012: £79 million) in non-cash amortisation of financing fees, discounts and bond fair value adjustments.

Net interest paid in the year ended 31 December 2013 was £509 million (2012: £401 million). This consisted of £466 million (2012: £361 million) net interest paid by the Company's subsidiaries and £43 million (2012: £40 million) paid by the Company. The increase in net interest paid partly reflects the first time payment of coupons on bond issues completed in 2012. In addition, the shift from floating rate loans to fixed rate bonds contributed to this increase.

Financial review *continued*

Net finance costs and net interest paid *continued*

Net interest paid is lower than net finance costs primarily due to a £202 million (2012: £191 million) non-cash charge relating to accretion on index-linked instruments and an amortisation charge of £nil (2012: £38 million) in net finance costs relating to prepayments of derivative interest made in earlier periods. This is partially offset by the net effect of capitalised interest and the non-cash amortisation of financing fees and bond fair value adjustments.

Financial ratios

The Group continues to operate comfortably within required financial ratios.

At 31 December 2013, the Group's gearing ratio (nominal net debt to RAB) was 82.4% (2012: 81.6%) compared with the 90.0% covenant level under its financing agreements. Heathrow (SP)'s senior and junior gearing ratios were 67.6% and 77.2% respectively (2012: 66.2% and 76.7% respectively) compared with trigger levels of 70.0% and 85.0% under its financing agreements.

The disposal of Stansted and subsequent use of disposal proceeds resulted in a modest reduction in gearing. The net increase in Heathrow (SP)'s and Heathrow Finance's gearing since 31 December 2012 is therefore primarily due to the effect of the controlled payments linked to partial repayment of the previous loan facility at ADI Finance 1 Limited.

In the year ended 31 December 2013, the Group's interest cover ratio (the ratio of cashflow from operations (excluding cash exceptional items) less tax paid less 2% of RAB to interest paid) was 2.22x (2012: 2.08x) compared with the 1.00x covenant level under its financing agreements. Heathrow (SP)'s senior and junior interest cover ratios were 3.08x and 2.43x (2012: 2.62x and 2.30x respectively) compared with trigger levels of 1.40x and 1.20x under its financing agreements. In 2012 and 2013 there were exceptional cash costs of £4 million and £16 million respectively.

Accounting and reporting policies and procedures

The consolidated results in the financial statements for the year ended 31 December 2013 are presented on an IFRS basis as adopted by the European Union, along with the comparative information for the year ended 31 December 2012. 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').

Corporate governance statement on internal controls and risk management

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

Internal controls

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

The key features of the Heathrow Airport Holdings Group's internal control and risk management systems in relation to the financial reporting process include:

- a group-wide comprehensive system of financial reporting and financial planning and analysis;
- documented procedures and policies;
- defined and documented levels of delegated financial authority;
- an organisational structure with clearly defined and delegated authority thresholds and segregation of duties;
- a formal risk management process that includes the identification of financial risks;
- detailed reviews by the Executive Committee and the Board of monthly management accounts measuring actual performance against both budgets and forecasts on key metrics;
- AC review of financial results press releases and key interim and annual financial statements, before submission to the Board, scrutinising amongst other items
    - compliance with accounting, legal, regulatory and lending requirements
    - critical accounting policies and the going concern assumption
    - significant areas of judgement;
- independent review of controls by the Internal Audit function, reporting to the AC; and
- a confidential whistleblowing process.

In addition, the AC:

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

Risk management

The Group's risk management process is used to facilitate the identification, evaluation and effective management of the threats to the achievement of the Group's purpose, vision, objectives, goals and strategies. The vision of risk management is to embed the awareness of risk at all levels of the organisation, in such a way that day-to-day activities are managed effectively and all significant business decisions are risk-informed.

The risk management process is evidenced in risk registers which are used as the basis for regular review of risks and their management, up to Executive Committee level. The risk registers are also used to inform decisions relating to the procurement of insurance cover. The risk management process also supports clear accountabilities, processes and reporting formats that deliver efficient and effective management assurance to the Board to ensure statutory compliance whilst supporting business units to successfully manage their operations.

The operation of the risk management process and the individual risk registers are subject to periodic review by the Internal Audit function, whose primary responsibility is to provide independent assurance to the Board that the controls put in place by management to mitigate risks are working effectively.

Assurance is provided through the management reporting processes and reports to the AC including the Sustainability and Operational Risk Committee.

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

Risk management *continued*
The principal corporate and reputational risks as identified by the Executive Committee are:

Safety risks
Health and safety is a core value of the business and the Group actively promotes the role of safety leadership in creating a safety culture that is intolerant of accidents and incidents.

The Group's Safety Management System includes risk assessment processes for all activities entailing significant risk and proportionate control measures employed to safeguard everyone impacted by the Group's business. The Group also operates robust asset management processes to ensure property and equipment remains safe. Governance, led by the airports' senior management teams, and assurance processes are used to ensure the aforementioned remain effective and to encourage continuous improvement.

Security risks
Security risks are regarded as critical risks to manage throughout the Heathrow Airport Holdings Group. The Group mitigates these risks by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading-edge security technology. The Group works closely with government agencies, including the police and the Border Force building a framework to establish joint accountabilities for airport security and shared ownership of risk, thus ensuring security measures remain both flexible and proportionate to the prevailing threat environment.

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

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

Competition rules
The penalties for failing to comply with the 1998 Competition Act and relevant EU law are recognised as risks to manage within the Group, given its position in certain markets. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, reduces the risk of the Group breaching these regulations.

Capacity shortfall
Failure to secure necessary planning permissions could lead to the Group having insufficient capacity to meet the demands of the industry resulting in increased congestion. The UK government's policy on airport capacity changes has a significant influence on the Group's ability to secure necessary planning permissions and develop capacity. The Group mitigates this risk through extensive consultation with community groups and authorities at a local level and active participation in government consultations and other advisory groups. In addition, investment in additional capacity at Heathrow 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 at Heathrow.

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

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

Risk management *continued*
Commercial and financial risks
Operational disruption
There are a number of circumstances that can pose short-term risks to normal airport operations 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 affected airport. These conditions can have a particularly significant impact on an airport such as Heathrow where, due to operating close to full capacity, there is negligible spare capacity to utilise in recovering from some of the above conditions. Where possible the Group seeks to anticipate the effects of these events on its operations and also maintains contingency plans to minimise disruption wherever possible.

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

Opening a new Terminal
Opening a new airport terminal is a complex process that requires detailed planning and at Terminal 2 this is being managed through a seven month operational readiness phase, which began in November 2013, and includes fit-out, trials and training.

Operational readiness trials range from individual unit tests to end-to-end process trials involving large numbers of volunteers acting as passengers. The trials aim to ensure that the terminal is fit for purpose at every stage of the passenger journey from car park arrival, check-in, baggage drop and boarding through to arrivals and baggage reclaim. IT and baggage systems are being assured under proving trials. Change control processes are in place for covering the systems of Heathrow, the airlines and other key users of the terminal.

Trials are also in place to ensure existing operational resilience arrangements deployed when disruption occurs work in the new Terminal 2.

An induction programme will be undertaken for the 24,000 employees from approximately 160 organisations that will be involved in operating Terminal 2.

Risk to opening is also being managed through a phased move of airlines into Terminal 2 over a six month period. The terminal will open with a single airline and 36 flights on the first day of operation. This will be followed by a further 10 move sequences, typically every 2-3 weeks, over the following six months for the remaining 25 airlines.

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

Industrial relations
The risk of industrial action by key staff that affects critical services, curtails operations and has an adverse financial and reputational impact on the Group is recognised. The Group has a range of formal national and local consultative bodies to discuss pay, employment conditions and business issues with the Trade Unions. The Heathrow pay agreement reached in early 2011 established the pay structure for 2011, 2012 and 2013 - the next round of pay negotiations have commenced and presents a significant challenge given the outcome of Heathrow’s most recent economic regulatory review. The Group could also be exposed in the short-term to the effect of industrial action involving other key stakeholders in the aviation sector such as airlines, air traffic controllers, baggage handlers and Border Force.

Treasury
The Board approves prudent treasury policies and delegates certain responsibilities including changes to treasury policies, the approval of funding and the implementation of funding and risk strategy to the Heathrow Finance Committee. Senior management directly control day to day treasury operations on a centralised basis.

The treasury function is not permitted to speculate in financial instruments. Its purpose is to identify, mitigate and hedge treasury-related financial risks inherent in the Heathrow Airport Holdings Group’s business operations and funding. To achieve this, the Heathrow Airport Holdings Group enters into interest rate swaps, index-linked swaps, cross-currency swaps and foreign exchange contracts to protect against interest rate, inflation and currency risks.

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

Risk management *continued*
Commercial and financial risks continued
Treasury continued
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 2013, fixed rate debt after hedging with derivatives represented 94% of the Group's total external nominal debt.

(b) Inflation
The Group mitigates the risk of mismatch between Heathrow's aeronautical income and regulatory asset base, which are directly linked to changes in the retail prices index, and nominal debt and interest payments, by the use of index-linked instruments.

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

(d) Funding and liquidity
The Group has established both investment grade (at the Heathrow (SP) level) and sub-investment grade (at the Heathrow Finance level) financing platforms for Heathrow. The Heathrow (SP) platform supports term loans, various revolving loan facilities, including revolving credit facilities, working capital facilities and liquidity facilities and sterling and foreign currency capital markets issuance. All debt is secured and can be issued in either senior (A-/A-) or junior (BBB/BBB) format. Covenants are standardised wherever possible and are monitored on an on-going basis with formal testing reported to the AC, the Board and Executive Committee.

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

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

The Group has positive cash flows before capital expenditure and maintains at least 12 months' headroom under its revolving credit facilities. As at 31 December 2013, the Group's cash and cash equivalents were £96 million, undrawn headroom under revolving credit facilities was £2,095 million and undrawn headroom under liquidity facilities was £750 million.

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

The Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short- and long-term credit ratings. Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with short-term credit ratings lower than A-2/F1. The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with a long-term credit rating below BBB+ (S&P)/A (Fitch).

On behalf of the Board

José Leo
Director

3 March 2014

Heathrow Finance plc

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2013.

Principal activities
The principal activity of Heathrow Finance plc is as the holding company of Heathrow (SP) Limited. Heathrow (SP) Limited is the holding company for Heathrow (AH) Limited, and the owner of Heathrow airport and Heathrow Funding Limited, the bond issuer for the Group's investment grade financing platform.

A review of the progress of the Group's business during the year, the key performance indicators, internal controls, principal business risks and likely future developments are contained in the Strategic report on pages 2 to 17.

Results and dividends
The profit after taxation for the financial year amounted to £736 million (2012: £121 million).

Dividends of £700 million were paid during the year (2012: £346 million). The Company made quarterly dividends of £207 million to fund dividends to its ultimate shareholders. A further £300 million return was made to the Company's ultimate shareholders on their historic investment in Stansted airport following its disposal. The remaining £193 million related to servicing of external debt at the Company's holding companies and rebalancing the amount of external debt between the Company's holding companies and subsidiaries.

The statutory results for the year are set out on page 23.

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

José Leo
Andrew Efiong

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

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

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

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

Employee involvement and consultation is managed in a number of ways including employee surveys, team updates, briefings, road shows and an intranet. Collective bargaining takes place with the unions Unite, PCS and Prospect for those employee groups for which these unions are recognised. The Group also operates frameworks for consultation and is committed to managing people through change fairly.

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

Supplier payment policies
The Group complies with the UK government's better payment practice code which states that responsible companies should:

- agree payment terms at the outset of a transaction and adhere to them;
- provide suppliers with clear guidance on payment procedures;
- pay bills in accordance with any contract agreed or as required by law; and
- advise suppliers without delay when invoices are contested and settle disputes quickly.

The Group had 17 days purchases outstanding at 31 December 2013 (2012: 7 days) based on the average daily amount invoiced by suppliers during the year.

Directors' report *continued*

Donations

The charitable donations the Group is required to disclose for the year amounted to £1,861,450 (2012: £1,242,560). The beneficiaries of charitable donations, the relevant amounts donated and the activities of these beneficiaries are as follows:

Hillingdon Communities Trust	£1,000,000	Heathrow Airport Limited made a 15 year commitment ending in 2017 to make an annual grant of £1 million to the Hillingdon Communities Trust. The deed of gift to the Trust carries a requirement that grants must benefit the community in the southern part of the Borough of Hillingdon including Hayes (the wards of Botwell, Townfield and Pinkwell, West Drayton, Yiewsley and the Heathrow Villages.
Communities Trust	£750,000	Provides support for local community projects close to Heathrow Airport Holdings' airports with a priority on funding projects linked to education, the environment and economic generation.
Whizz-Kidz	£96,450	The principal objectives of the charity are to change the lives of mobility-impaired children and young people in the UK, by providing them with the best possible mobility equipment, training and advice.
The Groundwork South Trust	£15,000	To provide conservation, protection and improvement to the natural environment as well as implement recreational solutions which enhance social welfare in the community and also provide advancement in public education of environmental and sustainability issues.

During the year Heathrow Airport Limited donated £5,000 in sponsorship money to assist in funding the West London Jobs and Apprenticeships Fair 2013, which was recorded as a political donation on the Electoral Commission's register of political donations. This payment is disclosed as a political donation for the purposes of these annual financial statements in accordance with legal obligations.

The rules surrounding what may be classified as a political donation under the Political Parties, Elections and Referendums Act 2000 and Part 14 of the Companies Act 2006 are complex. It is against the Group's policy to make political donations; however, to ensure that the Group is protected against any inadvertent minor breaches of the relevant rules, as in the case disclosed above, the Group obtained the appropriate shareholder approval in February 2012 to commit up to a maximum of £60,000 of such expenditure (in aggregate) over the following four years.

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 14 to 17 in the Corporate governance statement on internal controls and risk management section of the Strategic report.

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 16 and 17 in the Corporate governance statement on internal controls and risk management section of the Strategic report.

Directors' indemnity

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

Directors' report *continued*

Auditor

Pursuant to the provisions of section 485 of the Companies Act 2006, a resolution relating to the reappointment of the auditor Deloitte LLP will be proposed within the period set out in section 485 or, Deloitte LLP will be deemed re-appointed where no such resolution is proposed, following the period set out in section 485 in accordance with section 487.

Statement of disclosure of information to the Auditor

Each of the persons who is a director at the date of approval of this Annual report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

By order of the Board

Alexander Turnbull

Alexander Turnbull
Company Secretary

3 March 2014

Company registration number: 06458635

Heathrow Finance plc

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 Heathrow website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board

Alexander Turnbull

Alexander Turnbull
Company Secretary

3 March 2014

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

We have audited the Group financial statements of Heathrow Finance plc for the year ended 31 December 2013 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of financial position, the Consolidated statement of changes in equity, the Consolidated statement of cash flows, the Accounting policies, the Significant accounting judgements and estimates and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and IFRS as adopted by the European Union.

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

Respective responsibilities of directors and auditor

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements, and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatement or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic report and the Directors' report for the financial year for which the Group financial statements are prepared is consistent with the Group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the parent company financial statements of Heathrow Finance plc for the year ended 31 December 2013.

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

3 March 2014

Heathrow Finance plc

Consolidated income statement for the year ended 31 December 2013

	Note	Year ended 31 December 2013 Before certain re-measurements £m	Year ended 31 December 2013 Certain re-measurements[3] £m	Year ended 31 December 2013 Total £m	Restated[1,2] Year ended 31 December 2012[1] Before certain re-measurements £m	Restated[1,2] Year ended 31 December 2012[1] Certain re-measurements[3] £m	Restated[1,2] Year ended 31 December 2012[1] Total £m
Continuing operations							
Revenue	*1*	**2,474**	**-**	**2,474**	2,222	-	2,222
Operating costs	*2*	**(1,618)**	**-**	**(1,618)**	(1,681)	-	(1,681)
Other operating costs							
Fair value gain on investment properties	*1(c)*	**-**	**62**	**62**	-	50	50
Operating profit		**856**	**62**	**918**	541	50	591
Analysed as:							
Operating profit before exceptional items		**960**	**62**	**1,022**	679	50	729
Exceptional items	*3*	**(104)**	**-**	**(104)**	(138)	-	(138)
Exceptional impairment	*3*	**-**	**-**	**-**	(5)	-	(5)
Financing							
Finance income		**229**	**-**	**229**	252	-	252
Finance costs		**(875)**	**-**	**(875)**	(962)	-	(962)
Fair value (loss)/gain on financial instruments		**-**	**(81)**	**(81)**	-	108	108
	4	**(646)**	**(81)**	**(727)**	(710)	108	(602)
Profit/(loss) before tax		**210**	**(19)**	**191**	(174)	158	(16)
Taxation before change in tax rate		**(20)**	**(18)**	**(38)**	19	(7)	12
Change in tax rate		**143**	**18**	**161**	95	15	110
Taxation	*5*	**123**	**-**	**123**	114	8	122
Profit/(loss) for the year from continuing operations		**333**	**(19)**	**314**	(60)	166	106
Net profit/(loss) from discontinued operations	*6*	**422**	**-**	**422**	35	(20)	15
Consolidated profit/(loss) for the year		**755**	**(19)**	**736**	(25)	146	121

1 The adoption of IAS 19R has affected the measurement and presentation of pension-related gains and losses. Refer to the Accounting policies for further details.

2 The adoption of IAS 12A has affected the measurement of deferred tax on investment properties. Refer to the Accounting policies for further details

3 Certain re-measurements consist of fair value gains and losses on investment property revaluations and disposals, gains and losses arising on the re-measurement and disposal of financial instruments, together with the associated fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship and the related tax impact of these and similar cumulative prior year items.

Heathrow Finance plc

Consolidated statement of comprehensive income for the year ended 31 December 2013

	Note	**Year ended 31 December 2013 £m**	Restated[1] Year ended 31 December 2012 £m
Profit for the year		**736**	121
Other comprehensive income:			
Cash flow hedges[2]			
Gains/(losses) taken to equity	*23*	**173**	(287)
Transferred to income statement	*23*	**(10)**	239
Change in tax rate[3]	*16,23*	**(11)**	(5)
Tax relating to indexation of operating land[2]	*16,23*	**(1)**	-
Other comprehensive loss for the year net of tax		**151**	(53)
Total comprehensive profit for the year		**887**	68

1 The adoption of IAS 12A has affected the measurement of deferred tax on investment properties. The adoption of IAS 19R has affected the measurement and presentation of pension-related gains and losses. Refer to the Accounting policies for further details.
2 Elements that may be recycled to the consolidated income statement in future periods were £164 million gain (2012: £48 million loss)
3 Elements that may not be recycled to the consolidated income statement in future periods were £12 million gain (2012: £5 million gain)

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

Heathrow Finance plc

Consolidated statement of financial position as at 31 December 2013

	Note	31 December 2013 £m	Restated[1] 31 December 2012 £m	Restated[1] 1 January 2012 £m
Assets				
Non-current assets				
Property, plant and equipment	7	**11,387**	10,413	10,426
Investment properties	8	**1,918**	1,815	2,282
Intangible assets	9	**107**	77	54
Derivative financial instruments	14	**165**	306	369
Trade and other receivables	11	**112**	99	85
		13,689	12,710	13,216
Current assets				
Inventories	10	**9**	7	8
Trade and other receivables	11	**314**	258	315
Derivative financial instruments	14	**135**	-	171
Cash and cash equivalents	12	**96**	37	34
		554	302	528
Assets classified as held-for-sale	19	**-**	1,331	-
Total assets		**14,243**	14,343	13,744
Liabilities				
Non-current liabilities				
Borrowings	13	**(10,938)**	(11,159)	(9,912)
Derivative financial instruments	14	**(1,137)**	(1,094)	(1,082)
Deferred income tax liabilities	16	**(1,073)**	(1,170)	(1,550)
Provisions	17	**(12)**	(5)	(4)
Trade and other payables	18	**(3)**	(4)	(1)
		(13,163)	(13,432)	(12,549)
Current liabilities				
Borrowings	13	**(869)**	(711)	(1,076)
Derivative financial instruments	14	**(2)**	(39)	-
Provisions	17	**(115)**	(97)	(29)
Current income tax liabilities		**(17)**	(23)	(27)
Trade and other payables	18	**(562)**	(450)	(457)
		(1,565)	(1,320)	(1,589)
Liabilities associated with assets classified as held-for-sale	19	**-**	(263)	-
Total liabilities		**(14,728)**	(15,015)	(14,138)
Net liabilities		**(485)**	(672)	(394)
Equity				
Capital and reserves				
Share capital	20	**3,109**	3,109	3,109
Revaluation reserve	21	**-**	-	365
Merger reserve	21	**(994)**	(1,771)	(1,771)
Fair value reserve	22	**(310)**	(455)	(396)
Retained earnings	24	**(2,290)**	(1,555)	(1,701)
Total equity		**(485)**	(672)	(394)

1 The adoption of amendments to IAS 12 has impacted the measurement of deferred tax on investment properties. Refer to the Accounting policies for further details.

The financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 3 March 2014. They were signed on its behalf by:

José Leo
Director

Andrew Efiong
Director

Heathrow Finance plc

Consolidated statement of changes in equity for the year ended 31 December 2013

		Attributable to owners of the Company (restated[1])					
	Note	Share capital £m	Revaluation reserve[1] £m	Merger reserve £m	Fair value reserve £m	Retained earnings £m	Total equity £m
1 January 2012 (audited)		3,109	365	(1,771)	(396)	(1,746)	(439)
Effect of change in accounting policy for IAS 12 A		-	-	-	-	45	45
1 January 2012 (restated)		3,109	365	(1,771)	(396)	(1,701)	(394)
Comprehensive income:							
Profit for the year		-	-	-	-	121	121
Other comprehensive income:		-	-	-	-	-	-
Fair value losses on cash flow hedges net of tax		-	-	-	(48)	-	(48)
Change in tax rate	*16,22*	-	-	-	(11)	6	(5)
Dividends paid	*24*	-	-	-	-	(346)	(346)
Total comprehensive income		-	-	-	(59)	(219)	(278)
Realisation of revaluation reserve[2]	*21*	-	(365)	-	-	365	-
1 January 2013		**3,109**	**-**	**(1,771)**	**(455)**	**(1,555)**	**(672)**
Comprehensive income:							
Profit for the year		**-**	**-**	**-**	**-**	**736**	**736**
Other comprehensive income:							
Fair value gains on cash flow hedges net of tax		**-**	**-**	**-**	**163**	**-**	**163**
Change in tax rate	*16,22*	**-**	**-**	**-**	**(18)**	**7**	**(11)**
Tax relating to indexation of operating land		**-**	**-**	**-**	**-**	**(1)**	**(1)**
Dividends paid	*24*	**-**	**-**	**-**	**-**	**(700)**	**(700)**
Realisation of merger reserve	*21*	**-**	**-**	**777**	**-**	**(777)**	**-**
Total comprehensive income		**-**	**-**	**777**	**145**	**(735)**	**187**
31 December 2013		**3,109**	**-**	**(994)**	**(310)**	**(2,290)**	**(485)**

1 The adoption of IAS 12A has affected the measurement of deferred tax on investment properties. The adoption of IAS 19R has affected the measurement and presentation of pension-related gains and losses. Refer to the accounting policies for further details.

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

Heathrow Finance plc

Consolidated statement of cash flows for the year ended 31 December 2013

	Note	**Year ended 31 December 2013 £m**	Year ended 31 December 2012 £m
Cash flows from operating activities			
Cash generated from continuing operations	*26*	**1,407**	1,081
Taxation - Group relief paid		**(32)**	(31)
Cash generated from discontinued operations		**7**	82
Net cash from operating activities		**1,382**	1,132
Cash flows from investing activities			
Purchase of:			
Property, plant and equipment		**(1,212)**	(1,096)
Investment properties		**(31)**	(9)
Intangible assets		**(49)**	(36)
Proceeds from sale of:			
Property, plant and equipment		**4**	-
Investing activities of discontinued operations		**1,410**	(21)
Net cash used in investing activities		**122**	(1,162)
Cash flows from financing activities			
Dividends paid		**(700)**	(346)
Proceeds from issuance of bonds		**745**	3,357
Repayment of bonds		**(396)**	(680)
Repayment of Class B facility		**(150)**	(475)
(Repayment)/drawdown of capital expenditure facility		**-**	(1,395)
(Repayment)/drawdown of revolving credit facilities		**(227)**	307
Drawdown/(repayment) of subordinated facilities		**35**	(98)
Repayment of facilities and other items		**(66)**	(57)
Cancellation and restructuring of derivatives		**(2)**	(76)
Settlement of accretion on index-linked swaps		**(177)**	(80)
Interest paid		**(509)**	(401)
Financing activities of discontinued operations		**-**	(21)
Net cash (used in)/from financing activities		**(1,447)**	35
Net increase in cash and cash equivalents		**57**	5
Cash and cash equivalents at beginning of year		**39**	34
Cash and cash equivalents at end of year		**96**	39
Represented by:			
Cash and cash equivalents – continuing operations	*12*	**96**	37
Cash and cash equivalents – discontinued operations		**-**	26
Overdrafts – continuing operations	*13*	**-**	(24)
Cash and cash equivalents at end of year		**96**	39

Accounting policies for the year ended 31 December 2013

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

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

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

A columnar approach has been adopted in the income statement and the impact of three principal groups of items is shown in a separate column ('certain re-measurements'). This allows the presentation of the performance of the business before these specific fair value gains and losses. These items are:
i. fair value gains and losses on investment property revaluations and disposals;
ii. derivative financial instruments and the fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship; and
iii. the associated tax impacts of the items in (i) and (ii) above.

Going concern
The directors have prepared the financial statements on a going concern basis which requires the directors to have a reasonable expectation that the Group, as part of the Heathrow Airport Holdings Limited group (the 'Heathrow Airport Holdings Group'), has adequate resources to continue in operational existence for the foreseeable future. The Company forms part of the Heathrow Airport Holdings Group, the level at which financial risks are managed for the Company.

Consequently the directors have reviewed the cash flow projections of the Heathrow Airport Holdings Group taking into account:
- the forecast revenue and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall Heathrow Airport Holdings Group liquidity position, including remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and its ability to access debt markets (refer to Net debt and liquidity and Recent financing activities in the Financial review section).

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

Changes in accounting policy and disclosures
(a) Amended standard adopted by the Group

The Group has adopted the amended IFRSs as of 1 January 2013 that did not have a material impact on the Group's financial statements.

The Amendments to IAS 19 Employee Benefits ('IAS 19R') has impacted the presentation of pensions related gains and losses in the income statement , it was considered appropriate to amend the presentation of the Group's share of the net finance income and expected return on assets relating to the LHR Aiprorts Limited defined benefit pension scheme. Previously the amount was presented as a component of employment costs.

For the restated year ended 31 December 2012, a credit of £16 million in employment costs has been restated between £2 million of net pension finance income and £14 million reduction of exceptional pension charge. There was no change in the statement of financial position or cash flow as a result of implementing IAS 19R.

The adoption of Amendments to IAS 12 Income Taxes - Deferred Tax: Recovery of Underlying Assets ('IAS 12A') impacted the measurement of deferred tax on investment properties. For the restated net assets at 31 December 2012, this reduced deferred income tax liabilities by £40 million (1 January 2012: £35 million)

The application of IFRS 13 Fair Value Measurement resulted in an additional £5 million charge recognised in profit and loss before tax.

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

Accounting policies for the year ended 31 December 2013 *continued*

Changes in accounting policy and disclosures *continued*

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

The following standards, amendments and interpretations, which have not been applied in these financial statements, were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IFRS 9 Financial Instruments;
- IFRS 14 Regulatory Deferral Accounts;
- IAS 19 Defined Benefit Plans: Employee Contributions (amendments); and
- Improvements to IFRS 2010-2012 and 2011-2013.

The adoption of IFRS 9 Financial Instruments may widen the ability to hedge accounting within the group financial statements, although it has been noted that endorsement of IFRS 9 for use within the EU has been postponed. The Group does not fall within the scope of IFRS 14 Regulatory Deferral Accounts as it is neither a first time adopter of IFRS nor allowed to account for regulatory deferral account balances under our previous GAAP.

The Group does not expect the adoption of any of the other standards listed above to have a material impact on the Group financial statements.

Business combinations

Basis of consolidation

The Group financial statements consolidate the financial statements of Heathrow Finance plc and all its subsidiaries.

The Group was formed in 2008 as part of a wider Heathrow Airport Holdings Group refinancing and group reconstruction. In 2008 the Company acquired Heathrow (SP) Limited which owns Heathrow airport. The Group also operates the Heathrow Express rail service between Heathrow and Paddington, London. Heathrow (SP) Limited is also the holding company of Heathrow Funding Limited, which is the bond issuer for the Group's investment grade financing platform.

Subsidiaries

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

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

Segment reporting

The Group's operating segments are organised according to their regulatory environment, type of operation, geographic location and funding arrangements. The operating segments are primarily Heathrow and Heathrow Express ('HEX') which are organised and managed separately on the basis of the above operating environment. As such, the following operating segments are reported to the Board on a monthly basis:

- Designated group (price regulated airports of Heathrow and HEX rail operations);
- other operations (corporate activities and other commercial operations); and
- Discontinued operations; Stansted relating to 2012 and the two month period in 2013.

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 and consists primarily of:

Aeronautical

- Passenger charges based on the number of departing passengers on departure.
- Aircraft landing charges levied according to noise, emissions and weight recognised on landing.
- Aircraft parking charges based on a combination of weight and time parked as provided.
- Other charges levied for passenger and baggage operations when these services are rendered.

Retail

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

Accounting policies for the year ended 31 December 2013 *continued*

Revenue *continued*

Property and operational facilities

- Property letting rentals recognised on a straight-line basis over the term of the rental period.
- Proceeds from the sale of trading properties, recognised on the unconditional completion of the sale.
- Usage charges made for operational systems (e.g. check-in desks), recognised as each service 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.

Grants and contributions

On occasion, the Group may receive grants to provide financial incentives to improve airport infrastructure considered to be in the best interest of the public.

Exceptional items

The Group separately presents certain items on the face of the income statement as exceptional. Exceptional items are material items of income or expense that, because of their size or incidence, merit separate presentation to allow an understanding of the Group's financial performance.

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

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

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

Finance income

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

Borrowing costs

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

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

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

Assets classified as held-for-sale

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

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

Discontinued operations

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

Accounting policies for the year ended 31 December 2013 *continued*

Property, plant and equipment

Operational assets

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

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

Depreciation

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

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

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

Accounting policies for the year ended 31 December 2013 *continued*

Property, plant and equipment *continued*

Impairment of assets

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

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

Investment properties

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

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

Internally-generated intangible assets

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

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

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

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

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

Leases

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

Group as a lessee

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

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

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

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

Accounting policies for the year ended 31 December 2013 *continued*

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

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

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

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

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

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

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

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

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

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

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

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

Accounting policies for the year ended 31 December 2013 *continued*

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

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

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

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

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

Trade and other payables
Trade and other payables are not interest bearing and are stated at their fair value and subsequently measured at amortised cost using the effective interest rate method.

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

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

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

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

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

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

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

Accounting policies for the year ended 31 December 2013 *continued*

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

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

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

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

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

Accounting for changes in credit risk
Accounting standards require that the fair value of financial instruments reflects their credit quality, and also changes in credit quality where there is evidence that this has occurred. Where material, the credit risk associated with the Group's derivatives is reflected in its derivative valuations. This credit factor is adjusted over time to reflect the reducing tenor of the instrument and is updated where the credit associated with the derivative has clearly changed based on market transactions and prices.

Embedded derivatives
As required by IAS 39 *Financial Instruments: Recognition and Measurement* embedded derivatives are assessed on the initial recognition of the underlying host contract. Where the economic characteristics and risks of the embedded derivative are closely related to the economic characteristics and risks of the host contract no bifurcation of the embedded derivative from the host contract is undertaken.

Shared Services Agreement ('SSA')
All employees of the Group are employed by LHR Airports Limited ('LHR Airports') with the exception of non-senior management at Heathrow Express Operating Company Limited ('HEX'). LHR Airports grants all employee benefits and sponsors the defined benefit pension schemes while Heathrow Airport Limited ('HAL') incurs any staff related costs.

On 18 August 2008, HAL and HEX entered into a SSA with LHR Airports by which the latter became the shared services provider for the Group. 2013 saw a change in the way in which costs were incurred with HAL incurring the cost of it's operational staff and corporate services, these services are recharged to the relevant Heathrow Airport Holdings Group airport in accordance with the SSA.

Operational staff
The Group's airport incur the cost of staff which are contractual employed by LHR Airports Limited but provide services to the operation of the airport. Charges in relation to staff costs, include wages and salaries, pension costs, medical costs and redundancy payments, as well as any other of its associated expenses properly incurred by the employees of LHR Airports Limited in providing the services. These costs include the cost of purchase of any shares in relation to share options granted and any hedging costs related to employee share options.

Corporate and centralised services
During 2013, LHR Airports transferred various central services to HAL such as IT applications, general business services, procurement and financial accounting. Under the new structure the majority of costs previously incurred by LHR Airports are now borne by HAL and the element relating to airports other than Heathrow are subsequently recharged to LHR Airports with a mark up of 7.5% consistent with the SSA. LHR Airports then recharge the other airports without a mark up. This change in methodology is allowed internally under paragraph 22.8 of the SSA which allows Heathrow Airport Holdings Limited to sub-contract any of the operating companies to perform all or any portion of the Centralised Airport Services or Corporate Services.

Accounting policies for the year ended 31 December 2013 *continued*

Shared Services Agreement ('SSA') *continued*

Pension costs

Under the SSA the current period service cost for the LHR Airports pension schemes are recharged to HAL and HEX on the basis of their pensionable salaries. This charge is included within Operating costs - ordinary. Cash contributions are made directly by HAL and HEX to the LHR Airports pension schemes on behalf of LHR Airports.

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

As more than one employer participates in the LHR Airports defined benefit pension scheme and each employer is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis, the Group accounts for the scheme in accordance with the SSA. Additionally the Group discloses information about the total scheme surplus or deficit.

Current and deferred income tax

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

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

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

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

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

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

Share capital

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

Dividend distribution

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

Foreign currency

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

Transactions denominated in foreign currencies are translated into the functional currency of the entity using the exchange rates prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into Sterling at the rates of exchange ruling at the reporting date. Differences arising on translation are charged or credited to the income statement, except when deferred in equity as qualifying cash flow hedges.

Significant accounting judgements and estimates for the year ended 31 December 2013

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 as at 31 December 2013 at fair value by CBRE Limited, Chartered Surveyors. The valuations were prepared in consideration of IFRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. Approximately 83% (2012: 79%) of the investment properties comprise airport car parks and airside assets that are considered less vulnerable to market volatility than the overall market. Independent valuations were obtained for 100% of the investment properties. Strutt & Parker, Chartered Surveyors were used in addition to CBRE Limited in 2012 and were responsible solely for the valuation of residential property and agricultural land at Stansted airport.

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

Hedge accounting
Certain interest rate swaps are designated in a cash flow hedge relationship to hedge the exposure to variability in cash flows of existing liabilities and forecast transactions. This is based on management's expectation that it is highly probable that future sterling funding issuances will be used to refinance existing debt. As at 31 December 2013, £418 million of fair value losses (2012: £582 million) on these derivatives have been deferred into the cash flow hedge reserve.

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

Fair value of derivative financial instruments
The fair value of derivative financial instruments is calculated using a discounted cash flow approach and using inputs based on observable market data. Where material, the credit risk associated with the derivatives is reflected in the calculation methodology. Judgement is used to determine whether the credit risk associated with the derivatives has changed materially over time based on market transactions and prices and, where this is the case, the credit factor is adjusted in the valuation calculation.

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

Capitalisation
Management are required to make judgements in relation to the capitalisation of costs. This relates to both when amounts may begin to be capitalised, where there may be doubt about planning consent or the ultimate completion of the asset, and in relation to the nature of costs incurred. Examples where judgement has been exercised in the year include capitalised interest, where judgement is exercised in relation to the applicable interest rate and the assessment of Assets In the Course of Construction ('AICC'), projects on hold, and operational readiness activities where judgement is exercised to determine costs that are directly attributable to the assets under construction.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2013

1 Segment information

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

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

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

The performance of Stansted airport, which was classified as held-for-sale in 2012 and sold in February 2013, is distinguished from the performance of continuing Group operations through its classification as discontinued operations.

Table (a) details total revenue from external customers for the year ended 31 December 2013 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 2012.

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

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

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

Table (a)	**Segment revenue**					**EBITDA**		
Year ended 31 December 2013	**Aero-nautical**	**Retail**	**Property & facilities**	**Other**	**Total revenue from external customers**	**Pre exceptional items**	**Operating exceptional items**	**Post exceptional items**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Heathrow	**1,523**	**487**	**269**	**71**	**2,350**	**1,404**	**(104)**	**1,300**
Heathrow Express	**-**	**-**	**-**	**124**	**124**	**6**	**-**	**6**
Continuing operations	**1,523**	**487**	**269**	**195**	**2,474**	**1,410**	**(104)**	**1,306**
Reconciliation to statutory information								
Unallocated income and expenses								
Depreciation and amortisation[1] (Note 1 Table 1 (c))								**(450)**
Operating profit (before certain re-measurements)								**856**
Fair value gain on investment properties (certain re-measurements)								**62**
Operating profit								**918**
Finance income								**229**
Finance costs								**(875)**
Fair value loss on financial instruments (certain re-measurements)								**(81)**
Profit before tax								**191**
Taxation before certain re-measurements								**123**
Taxation (certain re-measurements)								**-**
Taxation								**123**
Profit for the year – continuing operations								**314**
Net profit from discontinued operations								**422**
Consolidated profit for the year								**736**

1 Depreciation and amortisation includes an impairment of investment property at Heathrow of £2 million (year ended 31 December 2012:£nil).

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

1 Segment information *continued*

Revenue of approximately £729 million (2012: £693 million) was derived from a single external customer and is primarily included within the Heathrow segment above.

Table (b) Year ended 31 December 2012	Aero-nautical	Retail	Property & facilities	Other	Total revenue from external customers	Pre exceptional items	Operating exceptional items	Restated[1,2] Post exceptional items
	£m	£m	£m	£m	£m	£m	£m	£m
Heathrow	1,280	460	265	101	2,106	1,147	(138)	1,009
Heathrow Express	-	-	-	116	116	6	-	6
Continuing operations	1,280	460	265	217	2,222	1,153	(138)	1,015
Reconciliation to statutory information								
Unallocated income and expenses								
Depreciation and amortisation (Note 1 Table 1 (c))								(474)
Operating profit (before certain re-measurements)								541
Fair value gain on investment properties (certain re-measurements)								50
Operating profit								591
Exceptional impairment								(5)
Finance income								252
Finance costs								(962)
Fair value gain on financial instruments (certain re-measurements)								108
Loss before tax								(16)
Taxation before certain re-measurements								114
Taxation (certain re-measurements)								8
Taxation								122
Profit for the year – continuing operations								106
Net profit from discontinued operations								15
Consolidated profit for the year								121

1 The adoption of IAS 19R has affected the measurement and presentation of pension-related gains and losses. Refer to the Accounting policies for further details.

2 The adoption of IAS 12A has affected the measurement of deferred tax on investment properties. Refer to the Accounting policies for further details

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

1 Segment information *continued*

Table (c)

	Year ended 31 December 2013			Year ended 31 December 2012		
	Depreciation & amortisation[1] £m	**Fair value gain/(loss)[2] £m**	**Profit on disposal £m**	Depreciation & amortisation[1] £m	Fair value gain/(loss)[2] £m	Profit on disposal £m
Heathrow	**(408)**	**62**	**-**	(432)	50	-
Heathrow Express	**(42)**	**-**	**-**	(42)	-	-
Continuing operations	**(450)**	**62**	**-**	(474)	50	-
Discontinued operations	**-**	**-**	**415**	(27)	(9)	-
Total Group	**(450)**	**62**	**415**	(501)	41	-

1 Includes intangible amortisation charge of £19 million (2012: £9 million)
2 Reflects fair value gains and losses on investment properties only.

Table (d)

	31 December 2013			31 December 2012		
	Assets[1] £m	**Liabilities £m**	**Capital expenditure[2] £m**	Assets[1] £m	Liabilities £m	Capital expenditure[2] £m
Heathrow	**12,710**	**(595)**	**1,309**	11,567	(513)	1,144
Heathrow Express	**1,023**	**(6)**	**11**	1,012	(5)	16
Stansted	**-**	**-**		-	-	-
Other operations	**-**	**(5)**		-	(20)	-
Discontinued operations	**-**	**-**		-	-	14
Assets classified as held for sale	**-**	**-**	**-**	1,331	(263)	-
Total operations	**13,733**	**(606)**	**1,320**	13,910	(801)	1,174
Unallocated assets and liabilities:						
Cash and borrowings	**96**	**(11,807)**		37	(11,870)	-
Derivative financial instruments	**300**	**(1,139)**		306	(1,133)	-
Taxation	**-**	**(1,090)**		-	(1,193)	-
Amounts owed from group undertakings	**114**	**(86)**		90	(18)	-
Total Group	**14,243**	**(14,728)**		14,343	(15,015)	1,174

1 Segment assets include primarily airport runways and facilities.
2 Capital expenditure excludes the impact of capital creditors.

(e) Revenue and non-current asset information by geographical segment
Heathrow Finance plc is domiciled in the UK. All revenue from external customers comes from the UK which for the year ended 31 December 2013 was £2,474 million (2012: £2,222 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 £13,450 million (2012: £12,330 million). There are no non-current assets held outside the UK (2012: £nil).

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

2 Operating costs – continuing operations

	Year ended 31 December 2013 £m	Restated[1] Year ended 31 December 2012 £m
Operating costs (including exceptional items) include the following:		
Employment costs[2]		
Wages and salaries	**297**	241
Social security	**33**	23
Pensions	**65**	48
Contract and agency staff	**24**	8
Other staff related		
Net exceptional pension charge	**66**	138
Reorganisation costs	**35**	-
Other	**27**	10
	547	468
Depreciation and amortisation		
Depreciation of property, plant and equipment[3]	**431**	461
Amortisation of intangible assets - software	**19**	13
	450	474
Other operating costs		
Maintenance expenditure	**177**	137
Utility costs	**89**	89
Rents and rates	**121**	128
General expenses	**185**	134
Retail expenditure	**26**	26
Police	**29**	29
Aerodrome navigation service charges	**55**	54
Intra-group charges/other	**27**	170
Own work capitalised[4]	**(88)**	(28)
Total operating costs	**1,618**	1,681
Analysed as:		
Adjusted operating costs	**1,064**	1,069
Depreciation and amortisation (excluding exceptional depreciation)	**450**	474
Exceptional costs[5]	**104**	138
Total operating costs	**1,618**	1,681

1 The presentation of employment costs for the year ended 31 December 2012 has been restated for a change in accounting policy as explained in the accounting policies note.
2 Employment costs include recharges from LHR Airports Limited for employee services to the Group. Refer to the SSA section in the Accounting policies.
3 Depreciation of property, plant and equipment includes a £2 million (2012:£nil) impairment charge.
4 Own work capitalised includes £50 million (2012: £10 million) in relation to employment costs including contract and agency staff.
5 Exceptional costs include a £66 million charge (2012: £138 million) in relation to pensions. Refer to Note 3.

Rentals under operating leases

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Operating costs include:		
Plant and machinery	**31**	37
Other	**18**	17
	49	54
Property lease and sub lease charges - minimum lease payments	**18**	17

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

2 Operating costs – continuing operations *continued*

For 2013 changes to the wider Heathrow group, including the disposal of Stansted Airport, have led to Heathrow incurring more of its operating costs directly, rather than through intra-group recharges. Operating costs have been presented above in a manner consistent with that presented in previous years. However, to enable more meaningful comparison the cost items have also been presented below by their underlying nature after taking into account the changes to group recharges and capitalisation of certain cost items.

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Employment costs[1]	**392**	382
Maintenance expenditure	**164**	154
Utility costs	**85**	87
Rents and rates	**116**	124
General expenses	**281**	296
Retail expenditure	**26**	26
Depreciation	**450**	474
Operating costs	**1,514**	1,543
Exceptional costs	**104**	138
Total operating costs	**1,618**	1,681

[1] The presentation of employment costs for the year ended 31 December 2012 has been restated for a change in accounting policy as explained in the accounting policies note.

Auditor's remuneration

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

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Fees payable to the Company's auditor for the audit of the Heathrow Finance plc group annual accounts		
Audit of the Company's subsidiaries pursuant to legislation	**0.4**	0.5
Total audit fees	**0.4**	0.5
Fees payable to the Company's auditor and their associates for other services specific to the Heathrow Finance plc group		
Audit related assurance services	**0.3**	0.2
Other tax services	**0.1**	-
Other assurance services	**0.2**	0.3
Total non-audit fees	**0.6**	0.5
Total fees	**1.0**	1.0

[1] The presentation of the 31 December 2012 numbers has been restated to be consistent with amended disclosure requirements.
[2] Corporate finance fees largely relate to reporting accountant work (required to be performed by the auditor) associated with supporting the raising of external finance within the group.

Employee numbers

The Group has no employees other than the majority of HEX employees which in 2013 averaged 444 (2012: 447). Other staff engaged in the operation of Heathrow are employed by LHR Airports Limited while Heathrow Airport Limited incurs the related staff costs. The average number of employees of LHR Airports Limited engaged in the Group's continuing operations during the year was 5,921 (2012: 5,278). A further 1,035 (2012: 1,115) were employed in discontinued operations. Changes to the structure of operational staff and corporate services, referred to in the accounting policies, resulted in centralised service staff being associated to the operation of Heathrow therefore increasing the employee numbers for 2013.

Directors' remuneration

José Leo was a director of a number of companies within the Heathrow Airport Holdings Group during the year. His remuneration for the year ended 31 December 2013 was disclosed in the financial statements of Heathrow Airport Holdings Limited, the directors do not believe it is possible to accurately apportion his remuneration to individual companies based on services provided. Andrew Efiong was a director of a number of companies within the Heathrow Airport Holdings Group. He was paid by, but is not a director of, Heathrow Airport Limited. The directors do not believe it is possible to accurately apportion his remuneration to other individual companies within the Group based on services provided.

2 Operating costs – continuing operations *continued*

Directors' remuneration continued

During the year, none of the directors (2012: none) had retirement benefits accruing to them under a defined benefit pension scheme and one of the directors (2012: one) had retirement benefits accruing to them under a defined contribution pension scheme.

None of the directors (2012: none) exercised any share options during the year in respect of their services to the Heathrow Airport Holdings Group and no shares (2012: none) were received or became receivable under long term incentive plans.

3 Exceptional items

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Other operating costs	**(38)**	-
Pension charge	**(66)**	(138)
Total operating exceptional items	**(104)**	(138)
Exceptional impairment	**-**	(5)
Taxation on exceptional items	**22**	33
Total exceptional items after tax	**(82)**	(110)

Operating costs – exceptional: pension

During 2013 there was a net exceptional pension charge of £66 million (2012: £138 million). This includes the Group's share of the movement in the LHR Airports Limited defined benefit pension scheme deficit, Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical benefits pension related liabilities.

Operating costs – exceptional: other

Costs associated with the Group's change programmes amounting to £22 million were charged in the year (2012: £nil). The charge relates to severance and pension payments associated with a restructuring programme being carried out in 2013 and 2014.

Operational readiness costs of £16 million are associated with managing the opening of Terminal 2 and primarily are for familiarisation, induction and training and the ramp up of operational costs as Terminal 2 moves from the construction phase to the operational phase.

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

4 Financing

(a) Net finance costs before certain re-measurements

	Note	Year ended 31 December 2013 £m	Restated[1] Year ended 31 December 2012 £m
Finance income			
Interest receivable on derivatives not in hedge relationship		**227**	250
Net pension finance income		**-**	2
Interest on deposits		**2**	-
		229	252
Finance costs			
Interest on borrowings:			
Bonds and related hedging instruments[2]		**(618)**	(595)
Bank loans and overdrafts and related hedging instruments		**(111)**	(154)
Interest payable on derivatives not in hedge relationship[3]		**(290)**	(294)
Facility fees and other charges		**(16)**	(19)
Net pension finance costs		**(3)**	-
Unwinding of discount on provisions		**(1)**	-
		(1,039)	(1,062)
Less: capitalised borrowing costs[4]	*7*	**164**	100
		(875)	(962)
Net finance costs before certain re-measurements		**(646)**	(710)

1 The presentation of pension finance income has been restated for a change in accounting policy as explained in the accounting policies note.
2 Includes accretion of £20 million (2012: £18 million) on index-linked bonds.
3 Includes accretion of £182 million (2012: £173 million) on index-linked swaps.
4 Capitalised interest included in the cost of qualifying assets arose on the general borrowing pool and is calculated by applying an average capitalisation rate of 6.04% (2012: 4.75%) to expenditure incurred on such assets.

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

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Interest rate swaps: cash flow hedge[1]	**23**	(6)
Interest rate swaps: not in hedge relationship	**54**	-
Index-linked swaps: not in hedge relationship[2]	**(147)**	109
Cross-currency swaps: cash flow hedge[1]	**2**	2
Cross-currency swaps: fair value hedge[1]	**(14)**	3
Fair value re-measurements of foreign exchange contracts and currency balances	**1**	-
Fair value (loss)/ gain on financial instruments	**(81)**	108
Net finance costs	**(727)**	(602)

1 Hedge ineffectiveness on derivatives in hedge relationship.
2 Reflects the impact on the valuation of movements in implied future inflation and interest rates and accounting adjustment in respect of accretion.

5 Taxation on continuing operations

	Year ended 31 December 2013 £m	Restated[1] Year ended 31 December 2012 £m
UK corporation tax		
Current tax at 23.25% (2012: 24.5%)	**(24)**	(31)
(Under)/over provision in respect of prior years	**(2)**	2
Deferred tax		
Current year	**(17)**	41
Prior year	**5**	-
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	**161**	110
Taxation credit for the year	**123**	122

[1] The adoption of IAS 12A has affected the measurement of deferred tax on investment properties.

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Profit/(loss) before tax	**191**	(16)

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

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Reconciliation of the tax credit		
Tax calculated at the UK statutory rate of 23.25% (2012: 24.5%)	**(44)**	4
Adjustments in respect of current income tax of previous years	**(2)**	2
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	**161**	110
Non taxable income	**3**	6
Adjustments in respect of deferred income tax of previous years	**5**	-
Taxation credit for the year	**123**	122

The tax credit recognised for the year ended 31 December 2013 was £123 million (2012: £122 million). This reflects a tax charge arising on ordinary activities of £38 million (2012: £12 million credit) together with a tax credit of £161 million (2012: £110 million) due to the impact on the deferred tax liabilities of the reductions in the main rate of UK corporation tax.

The Finance Act 2013 enacted reductions in the main rate of UK corporation tax from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015. As a result, the Group's deferred tax balances, which were previously provided for at 23%, have been re-measured at the rate of 20%. This has resulted in a reduction in the net deferred tax liability of £150 million, with £161 million credited to the income statement and £11 million charged to equity.

The tax charge for the year on ordinary activities of £38 million (2012: £12 million credit) results in an effective tax rate of 19.9% (2012: 75.0% negative effective tax rate). The tax charge is less than implied by the statutory rate of 23.25% (2012: 24.5%) primarily due to non taxable income.

6 Discontinued operations

Discontinued operations represent 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 these 'disposal groups' are reported separately from the performance of continuing operations at each reporting date.

On 28 February 2013 the Group completed the sale of Stansted Airport Limited ('Stansted airport') to Manchester Airports Group for a cash consideration of £1.5 billion. Stansted airport has been classified within discontinued operations in 2012.

Net profit from discontinued operations

	Year ended 31 December 2013			Year ended 31 December 2012		
	Before certain re-measurements £m	**Certain re-measure ments £m**	**Total £m**	Before certain re-measurements £m	Certain re-measurements £m	Total £m
Revenue	**32**	**-**	**32**	242	-	242
Operating costs						
Depreciation	**-**	**-**	**-**	(27)	-	(27)
Other	**(18)**	**-**	**(18)**	(178)	-	(178)
Other items						
Fair value loss on investment property	**-**	**-**	**-**	-	(9)	(9)
Operating profit from discontinued operations	**14**	**-**	**14**	37	(9)	28
Analysed as:						
Operating profit before exceptional items	**14**	**-**	**14**	68	(9)	59
Exceptional items	**-**	**-**	**-**	(31)	-	(31)
Exceptional disposal costs	**-**	**-**	**-**	(4)	-	(4)
Profit/(loss) on disposal	**415**	**-**	**415**	-	-	-
Financing						
Finance costs	**(3)**	**-**	**(3)**	(19)	-	(19)
Fair value gain on financial instruments	**-**	**-**	**-**	-	4	4
Profit/(loss) before tax from discontinued operations	**426**	**-**	**426**	14	(5)	9
Taxation (charge)/credit	**(4)**	**-**	**(4)**	21	(15)	6
Net profit/(loss) from discontinued operations	**422**	**-**	**422**	35	(20)	15

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

6 Discontinued operations *continued*

Profit on disposal of Stansted

	Year ended 31 December 2013 £m
Cash consideration	**1,500**
Transaction and separation costs paid	(20)
Net cash consideration	**1,480**
Transaction and separation costs accrued	**(5)**
Net assets disposed	
Property, plant and equipment	(695)
Investment properties	(577)
Other assets	(30)
Cash and cash equivalents	(31)
Deferred income tax liabilities	217
Release of pension liability	15
Other liabilities	29
	(1,072)
Gain on transfer of retirement benefit obligations	**12**
Profit on disposal	**415**

Disposal proceeds and investing activities from discontinued operations

	Year ended 31 December 2013 £m
Net cash consideration (above)	1,480
Cash and cash equivalents disposed of with subsidiary undertaking	(31)
UURBS liability settled on disposal	(4)
Retirement benefit commutation paid to pension scheme	(35)
Disposal proceeds from discontinued operations	**1,410**

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

7 Property, plant and equipment

Cost	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
1 January 2012		8,906	1,249	662	101	1,382	1,840	14,140
Additions		2	-	7	-	-	1,119	1,128
Borrowing costs capitalised			-	-	-	-	100	100
Disposals		(28)	(1)	(13)	-	(1)	-	(43)
Net transfers to investment properties	*8*	-	-	-	-	-	(64)	(64)
Reclassifications		113	(114)	(5)	(12)	(1)	19	-
Transfer to assets held-for-sale		(845)	(202)	(66)	(17)	-	(44)	(1,174)
Transfer to completed assets		405	6	14	11	-	(436)	-
1 January 2013		**8,553**	**938**	**599**	**83**	**1,380**	**2,534**	**14,087**
Additions		**9**	**-**	**5**	**-**	**-**	**1,238**	**1,252**
Borrowing costs capitalised		**-**	**-**	**-**	**-**	**-**	**164**	**164**
Reclassifications		**65**	**128**	**(205)**	**25**	**16**	**(29)**	**-**
Disposals		**(94)**	**(1)**	**(45)**	**-**	**(31)**		**(171)**
Transfer from/(to) investment properties	*8*	**-**	**-**	**-**	**1**	**-**	**(11)**	**(10)**
Transfer to completed assets		**224**	**7**	**63**	**18**	**44**	**(356)**	**-**
31 December 2013		**8,757**	**1,072**	**417**	**127**	**1,409**	**3,540**	**15,322**
Depreciation								
1 January 2012		(2,587)	(323)	(421)	(39)	(344)	-	(3,714)
Depreciation charge		(355)	(36)	(48)	(6)	(43)		(488)
Impairment		-	-	(3)	-	-	(2)	(5)
Disposals		28	1	13		5	-	47
Reclassifications		(43)	34	2	3	4	-	-
Transferred to assets held-for-sale		365	79	39	3	-	-	486
1 January 2013		**(2,592)**	**(245)**	**(418)**	**(39)**	**(378)**	**(2)**	**(3,674)**
Depreciation charge		**(311)**	**(29)**	**(42)**	**(7)**	**(42)**	**-**	**(431)**
Reclassifications		**(106)**	**(36)**	**151**	**1**	**(10)**	**-**	**-**
Disposals		**92**	**-**	**45**		**31**	**2**	**170**
31 December 2013		**(2,917)**	**(310)**	**(264)**	**(45)**	**(399)**	**-**	**(3,935)**
Net book value 31 December 2013		**5,840**	**762**	**153**	**82**	**1,010**	**3,540**	**11,387**
Net book value 31 December 2012		5,961	693	181	44	1,002	2,532	10,413

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value of £17 million (2012: £15 million).

Assets in the course of construction

Assets in the course of construction primarily consist of projects for work on the new Terminal 2 and its satellite building. They also include the Terminal 3 Integrated baggage system which incorporates a new baggage facility.

7 Property, plant and equipment *continued*

Borrowing costs capitalised

The amount of borrowing costs included in the cost of Group assets was £1,064 million (2012: £1,234 million). Borrowing costs were capitalised at an average rate of 6.04% (2012: 4.75%).

A tax deduction of £164 million (2012: £100 million) for capitalised borrowing costs was taken in the year. Subsequent depreciation of the capitalised borrowing costs is disallowed for tax purposes. Consequently, the capitalised borrowing costs give rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets.

Security granted by the Group over its assets, including property, plant and equipment, is disclosed in Note 13.

8 Investment properties

	Note	**Airport investment properties £m**	**Assets in the course of construction £m**	**Total £m**
Valuation				
1 January 2012		2,276	6	2,282
Additions		9	-	9
Disposals		(4)	-	(4)
Net transfer from property, plant and equipment		(1)	65	64
Revaluation		42	3	45
Transfer to assets held-for-sale[1]		(581)	-	(581)
Transfer to completed assets		6	(6)	-
1 January 2013		**1,747**	**68**	**1,815**
Additions		**1**	**30**	**31**
Revaluation		**29**	**33**	**62**
Transfers to property, plant and equipment	*7*	**(1)**	**-**	**(1)**
Transfers from property, plant and equipment	*7*	**11**	**-**	**11**
31 December 2013		**1,787**	**131**	**1,918**

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

Airport investment properties were valued at fair value at 31 December 2013 by CBRE Limited, Chartered Surveyors. At 31 December 2012 investment properties were valued at fair value by CBRE Limited, Chartered Surveyors and Strutt & Parker, Chartered Surveyors. Strutt & Parker were responsible solely for the valuation of residential property and agricultural land at Stansted airport in 2012.

Details of the valuations performed are provided below:

	31 December 2013 £m	31 December 2012 £m
CBRE Limited	**1,787**	2,240
Strutt & Parker	**-**	84
At professional valuation	**1,787**	2,324

All valuations were prepared in consideration of IFRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. There were no restrictions on the realisability or remittance of income or proceeds on disposal. The fair value measurement hierarchy used in calculating fair value (refer to Note 15) has been classified as level 3. The higher the discount rate, terminal yield and expected vacancy rate, the lower the fair value. The higher the current and potential future income or rental growth rate, the higher the fair value.

The Group has historically had a low level of void properties.

Investment properties are let on either full repair and insuring leases, under which all outgoings are the responsibility of the lessee, or under tenancies, where costs are recovered through a service charge levied on tenants during their period of occupation. This service charge amounted to £1 million (2012: £2 million) for which a similar amount is included within operating costs.

Security granted by the Group over its assets, including investment properties, is disclosed in Note 13.

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

9 Intangible assets

	£m
Cost	
1 January 2012	234
Additions	37
Disposals	(6)
1 January 2013	**265**
Additions	**49**
Disposals	**(142)**
31 December 2013	**172**
Amortisation	
1 January 2012	(180)
Charge for the year	(13)
Disposals	5
1 January 2013	**(188)**
Disposals	**142**
Charge for the year	**(19)**
31 December 2013	**(65)**
Net book value 31 December 2013	**107**
Net book value 31 December 2012	77

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 £66 million (2012: £44 million).

10 Inventories

	31 December 2013 £m	31 December 2012 £m
Consumables	**9**	7

The total amount of inventories consumed in the year was £5 million (2012: £5 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 2013 £m	31 December 2012 £m
Non-current		
Prepaid debt fees[1]	**22**	10
Prepayments	**16**	15
Amount owed by group undertakings[2]	**74**	74
	112	99
Current		
Trade receivables	**178**	166
Less: provision for impairment	**(2)**	(2)
Trade receivables – net	**176**	164
Prepayments	**61**	42
Amounts owed by group undertakings	**40**	16
Other receivables	**37**	36
	314	258

1 Prepaid debt fees largely relate to financing fees paid on facilities not yet drawn and are amortised over the term of the facility.
2 Amounts owed by group undertakings largely relate to a loan advanced to Heathrow (DSH) Limited on an interest free basis.

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

11 Trade and other receivables *continued*

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

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

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

As at 31 December 2013, trade receivables of £169 million (2012: £154 million) were fully performing. Trade receivables of £6 million (2012: £6 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 2013 £m	31 December 2012 £m
Fully performing	**169**	154
Past due but not impaired :		
Not impaired but overdue by less than 30 days	**6**	2
Not impaired but overdue by between 30 and 60 days	**-**	3
Not impaired but overdue by more than 60 days	**-**	1
	6	6
Considered for impairment :		
Overdue by more than 90 days	**3**	6

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

	2013 £m	2012 £m
1 January	**2**	2
Receivables written off during the year as uncollectable	**-**	-
31 December	**2**	2

As at 31 December 2013, trade receivables of £4 million (2012: £6 million) were considered for impairment of which £2 million (2012: £2 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 Group is not exposed to significant foreign currency exchange risk as the majority of trade and other receivables are denominated in Sterling. Additional disclosure on credit risk management is included in Note 15.

12 Cash and cash equivalents

	31 December 2013 £m	31 December 2012 £m
Cash at bank and in hand	**21**	4
Short-term deposits	**75**	33
	96	37

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

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments, and bank overdraft. Cash and cash equivalents consist of:

	Note	**31 December 2013 £m**	31 December 2012 £m
Cash at bank and in hand		**21**	4
Short-term deposits		**75**	33
Bank overdraft	*13*	**-**	(24)
Cash classified as held-for-sale	*19*	**-**	26
		96	39

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

13 Borrowings

	31 December 2013 £m	31 December 2012 £m
Current		
Secured		
Loans	**39**	39
Heathrow Funding Limited bonds		
5.850% £400 million due 2013	**-**	389
4.600% €750 million due 2014	**564**	-
	603	428
Unsecured		
Bank overdrafts	**-**	24
Total current (excluding interest payable)	**603**	452
Interest payable	**266**	259
Total current	**869**	711
Non-current		
Secured		
Heathrow Funding Limited bonds		
4.600% €750 million due 2014	**-**	564
3.000% £300 million due 2015	**299**	299
2.500% US$500 million due 2015	**301**	306
12.450% £300 million due 2016	**332**	345
4.125% €500 million due 2016	**403**	388
4.375% €700 million due 2017	**581**	566
2.500% CHF400 million due 2017	**271**	268
4.600% €750 million due 2018	**576**	552
6.250% £400 million due 2018	**396**	396
4.000% CAD400 million due 2019	**225**	245
6.000% £400 million due 2020	**396**	396
9.200% £250 million due 2021	**266**	283
4.875% US$1,000 million due 2021	**608**	656
1.650%+RPI £180 million due 2022	**189**	184
5.225% £750 million due 2023	**640**	632
7.125% £600 million due 2024	**588**	588
6.750% £700 million due 2026	**686**	685
7.075% £200 million due 2028	**198**	198
6.450% £900 million due 2031	**845**	864
Zero-coupon €50 million due January 2032	**45**	42
Zero-coupon €50 million due April 2032	**45**	42
3.334%+RPI £460 million due 2039	**561**	545
5.875% £750 million due 2041	**736**	745
4.625% £750 million due 2046	**742**	-
Total Heathrow Funding Limited bonds	**9,929**	9,789
Heathrow Finance plc bonds		
7.125% £325 million due 2017	**320**	319
5.375% £275 million due 2019	**273**	273
Total Heathrow Finance plc bonds	**593**	592
Total bonds	**10,522**	10,381
Revolving credit facilities	**80**	290
Heathrow Finance loan facilities	**161**	125
Other loans	**175**	363
Total loans	**416**	778
Total non-current	**10,938**	11,159
Total borrowings (excluding interest payable)	**11,541**	11,611

The average cost of the Group's external gross debt at 31 December 2013 was 4.54% (2012: 4.37%), taking into account the impact of interest rate, cross-currency and index-linked hedges but excluding index-linked accretion. Including index-linked accretion, the Group's average cost of debt at 31 December 2013 was 6.02% (2012: 5.86%). The change in the average cost of debt is mainly due to an increase in the Group's proportion of fixed rate debt through the issuance of interest rate swaps.

13 Borrowings *continued*

Heathrow Funding Limited bonds

The maturity dates of the Heathrow Funding Limited bonds listed above reflect their scheduled redemption dates that correspond to the maturity dates of the loans between Heathrow Airport Limited and Heathrow Funding Limited. The bonds are not callable in nature and are expected to be repaid on their scheduled redemption date. However, to meet rating agency requirements the bonds have a legal maturity that is two years later, except for the 6.250% £400 million due 2018, 6.000% £400 million due 2020 and 7.125% £600 million due 2024 bonds, wherein the redemption dates coincide with their legal maturity dates.

Fair value of borrowings

	31 December 2013		31 December 2012	
	Book value £m	**Fair value[1] £m**	Book value £m	Fair value[1] £m
Non-current				
Long-term debt	**10,938**	**12,427**	11,159	13,038

[1] Fair value of borrowings are for disclosure purposes only. These instruments are classified as Level 1 as the fair values are based on quoted prices.

The fair value of short-term borrowings approximates book value. Accrued interest is included as a current borrowings balance and not in the carrying amount of non-current borrowings. The fair values of listed borrowings are based on quoted prices. For unlisted borrowings, the Group establishes fair values by using valuation techniques such as discounted cash flow analysis. The fair value of non-current borrowings which have floating rate interest are assumed to equate to their current nominal value.

Securities and guarantees

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

Heathrow (DSH) Limited and Heathrow Finance plc have also granted security over their assets to secure their obligations under their financing agreements.

BAA Pension Trust Company Limited is a Borrower Secured Creditor and has a right to receive up to £284 million out of the proceeds of enforcement of the security granted by the Obligors, such right ranking pari passu with the senior (Class A) creditors to the Obligors.

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

HAL and HEX have provided a guarantee in favour of The Royal Bank of Scotland plc as Borrower Account Bank in respect of their liabilities under the Borrower Account Bank Agreement.

Additional disclosures on risk management and hedging of borrowings are included in Notes 14 and 15.

14 Derivative financial instruments

31 December 2013	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Interest rate swaps	**123**	**-**	**(2)**	**(2)**
Cross-currency swaps	**513**	**135**	**-**	**135**
Foreign exchange contracts	**21**	**-**	**-**	**-**
	657	**135**	**(2)**	**133**
Non-current				
Interest rate swaps	**2,213**	**2**	**(213)**	**(211)**
Cross-currency swaps	**2,990**	**141**	**(69)**	**72**
Index-linked swaps	**5,266**	**22**	**(855)**	**(833)**
	10,469	**165**	**(1,137)**	**(972)**
Total	**11,126**	**300**	**(1,139)**	**(839)**

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

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

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

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

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

15 Financial instruments

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

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

The Group mitigates the risk of mismatch between Heathrow's 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 index-linked instruments.

15 Financial instruments *continued*

Financial risk management objectives and policies continued

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

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

Foreign exchange risk

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

As at 31 December 2013, with all other variables remaining constant, if Sterling strengthened or weakened by 10% against the Euro, annual pre-tax profit would have increased or decreased by nil (2012: £9 million decrease and £11 million increase respectively)

As at 31 December 2013, with all other variables remaining constant, if Sterling strengthened or weakened by 10% against the USD, annual pre-tax profit would have decreased or increased by £16 million and £4 million respectively (2012: £1 million decrease and £1 million increase respectively).

These movements arise principally because of the different accounting treatment of foreign currency borrowings versus the related hedging instruments. The Group is not materially exposed to foreign exchange risk on an economic basis.

Price risk

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

The Group is exposed to RPI risk on its index-linked bonds and derivatives held to economically hedge cash flows on debt instruments and RPI linked revenue. As at 31 December 2013, 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 £212 million and £202 million respectively (2012: £188 million decrease and £182 million increase respectively).

Cash flow and fair value interest rate risk

The Group's interest rate risk arises primarily from its borrowings. Borrowings issued at variable interest rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group's policy is to maintain a mix of fixed to floating rate debt within Board approved parameters such that a minimum of 75% of existing and forecast debt is at a fixed rate. To manage this mix, the Group enters into interest rate swaps. These swaps may be designated to hedge underlying debt obligations. The Group also uses floating rate interest bearing financial assets as a natural hedge of the exposure to fair value interest rate risk.

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

As at 31 December 2013, the Group's fixed floating interest rate profile, after hedging, on gross debt was 94:06 (2012: 80:20).

As at 31 December 2013, each 0.50% change in interest rates would have resulted in the following gain/(loss) to pre-tax profit and equity, due to movement in the finance income, finance cost and mark-to-market valuation of derivatives :

	31 December 2013		31 December 2012	
	Income statement impact £m	**Equity impact £m**	Income statement impact £m	Equity impact £m
0.50% increase	**152**	**73**	73	170
0.50% decrease	**(163)**	**(77)**	(78)	(180)

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

15 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 short-term credit ratings lower than A-2/F1. The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with long-term credit ratings below BBB+ (S&P)/A (Fitch).

As at 31 December 2013, the Group had total credit risk with derivative counterparties of its interest rate swaps, index-linked swaps and cross-currency swaps of £300 million (2012: £306 million).

Financial assets past due but not impaired are disclosed in Note 11 'Trade and other receivables'. The maximum exposure to credit risk as at 31 December 2013 was £573 million (2012: £561 million).

Liquidity risk
Although there can be no certainty that financing markets will remain open for issuance at all times, debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year. Further details of the risk management objectives and policies are disclosed in the Corporate Governance statement on internal controls and risk management section of the Strategic report.

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

	31 December 2013 £m	31 December 2012 £m
Floating rate facilities		
Expiring in one to two years	**95**	-
Expiring in more than two years	**2,000**	1,693
	2,095	1,693

As at 31 December 2013, overdraft facilities of £10 million were available (2012: £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 2013			
	Less than one year £m	**One to two years £m**	**Two to five years £m**	**Greater than five years £m**
Borrowing principal payments	**552**	**738**	**3,018**	**7,469**
Borrowing interest payments	**622**	**585**	**1,510**	**4,324**
Derivative financial instruments	**35**	**134**	**80**	**(168)**
Trade payables	**128**	**-**	**-**	**-**
Capital payables	**301**	**-**	**-**	**-**

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

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

15 Financial instruments *continued*

Liquidity risk continued

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

	31 December 2013			
	Less than one year £m	**One to two years £m**	**Two to five years £m**	**Greater than five years £m**
Cross-currency derivative payments	**119**	**109**	**232**	**55**
Cross-currency derivative receipts	**(153)**	**(120)**	**(283)**	**(97)**

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

Capital risk management

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

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

There are gearing covenants in financing agreements at various levels including Heathrow Finance plc and Heathrow (SP) Limited. Gearing ratios at each of these levels are set out below:

	31 December 2013	31 December 2012
Net debt to RAB at Heathrow Finance group	**0.82**	0.82
Total net debt to RAB at Heathrow (SP) group	**0.77**	0.77
Senior net debt to RAB at Heathrow (SP) group	**0.68**	0.66

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 2013			
	Loans and receivables £m	**Assets at fair value through income statement £m**	**Derivatives qualifying for hedge accounting £m**	**Total £m**
Derivative financial instruments	**-**	**24**	**276**	**300**
Cash and cash equivalents	**96**	**-**	**-**	**96**
Trade receivables	**176**	**-**	**-**	**176**
Other receivables	**1**	**-**	**-**	**1**
Total financial assets	**273**	**24**	**276**	**573**

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

15 Financial instruments *continued*

Financial instruments by category continued

	31 December 2013			
	Liabilities at fair value through income statement £m	**Derivatives qualifying for hedge accounting £m**	**Other financial liabilities at amortised cost £m**	**Total £m**
Borrowings[1]	**-**	**-**	**(11,541)**	**(11,541)**
Derivative financial instruments	**(954)**	**(185)**	**-**	**(1,139)**
Trade payables	**-**	**-**	**(128)**	**(128)**
Capital payables	**-**	**-**	**(301)**	**(301)**
Total financial liabilities	**(954)**	**(185)**	**(11,970)**	**(13,109)**

[1] Total borrowings excluding interest payable of £266 million (2012: £259 million). Refer to Note 13.

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

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

[1] At 31 December 2012, these balances included £26 million cash and cash equivalents, £27 million trade receivables, £15 million trade payables and £7 million capital payables classified as assets held-for-sale. Refer to Note 19.

At 31 December 2013, the Group has not designated any financial assets or financial liabilities at fair value through the income statement. The only financial assets and financial liabilities at fair value through the income statement are derivatives that do not qualify for hedge accounting.

Fair value estimation

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

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

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

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

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

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

15 Financial instruments *continued*

Fair value estimation *continued*

Specific valuation techniques used to value financial instruments include:

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

On a semi-annual basis, the Company reviews any material changes to the valuation techniques and market data inputs used. The potential impact to the fair value hierarchy is assessed if it is deemed a transfer. Significant transfers between levels are considered effective at the end of the reporting period.

At 31 December 2013, all of the resulting fair value estimates in the Group are included in level 2 (2012: all included in level 2).

16 Deferred income tax

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

	2013 £m	Restated[1] 2012 £m
1 January (restated)	**(1,170)**	(1,550)
(Charged)/credited to income statement[2]	**(12)**	27
Credited to income statement – change in tax rate[3]	**161**	129
(Charged)/credited to equity	**(41)**	15
Charged to equity – change in tax rate	**(11)**	(5)
Transferred to held-for-sale	**-**	214
31 December	**(1,073)**	(1,170)

[1] The adoption of IAS 12A has affected the measurement of deferred tax on investment properties.
[2] Includes £nil (2012: £14 million) tax charge relating to discontinued operations.
[3] Includes £nil (2012: £19 million) tax credit relating to discontinued operations.

The amounts of deferred income tax provided are detailed below:

Deferred income tax liabilities

	Excess of capital allowances over depreciation £m	Revaluations of investment property to fair value £m	Tax on rolled over gains £m	Post employment benefits £m	Other £m	Total £m
1 January 2013 (restated)	**(953)**	**(271)**	**(8)**	**-**	**(20)**	**(1,252)**
(Charged)/credited to income statement	**(54)**	**(2)**	**-**	**1**	**10**	**(45)**
Credited/(charged) to income statement – change in tax rate	**125**	**29**	**1**	**(2)**	**(2)**	**151**
Charged to equity	**-**	**(1)**	**-**	**-**	**-**	**(1)**
Credited to equity – change in tax rate	**-**	**7**	**-**	**-**	**-**	**7**
Transferred to deferred income tax assets	**-**	**-**	**-**	**1**	**-**	**1**
31 December 2013	**(882)**	**(238)**	**(7)**	**-**	**(12)**	**(1,139)**

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

16 Deferred income tax *continued*

Deferred income tax assets

	Financial instruments £m	Post employment benefits £m	Total £m
1 January 2013	**64**	**18**	**82**
Credited to the income statement	**33**	**-**	**33**
Credited to the income statement – change in tax rate	**10**	**-**	**10**
Charged to equity	**(40)**	**-**	**(40)**
Charged to equity – change in tax rate	**(18)**	**-**	**(18)**
Transferred from deferred income tax liability	**-**	**(1)**	**(1)**
31 December 2013	**49**	**17**	**66**

The amounts of deferred income tax restated are detailed below

Deferred income tax liabilities

	Excess of capital allowances over depreciation £m	Revaluations of investment property to fair value £m	Tax on rolled over gains £m	Post employment benefits £m	Other £m	Total £m
1 January 2012 (restated)	(1,226)	(390)	(9)	(8)	(31)	(1,664)
(Credited)/charged to income statement	50	(1)	-	29	4	82
Credited to income statement – change in tax rate	98	25	1	1	3	128
Credited to equity – change in tax rate	-	6	-	-	-	6
Transferred to held-for-sale	125	89	-	(4)	4	214
Transferred to deferred income tax assets	-	-	-	(18)	-	(18)
31 December 2012	**(953)**	**(271)**	**(8)**	**-**	**(20)**	**(1,252)**

Deferred income tax assets

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

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

	Year ended 31 December 2013 £m	Year ended 31 December 2012 £m
Cash flow hedge reserve	**(58)**	(4)
Tax relating to indexation of operating land	**(1)**	1
Retained earnings	**7**	(7)
	(52)	(10)

The Finance Act 2013 enacted reductions in the main rate of UK corporation tax from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015. As a result, the Group's deferred tax balances, which were previously provided for at 23%, have been re-measured at the rate of 20%. This has resulted in a reduction in the net deferred tax liability of £150 million, with £161 million credited to the income statement and £11 million charged to reserves.

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

17 Provisions

	Pensions £m	Disposal of operations £m	Reorganisation costs £m	Other £m	Total £m
Current	**95**	-	2	-	97
Non-current	**-**	-	-	5	5
1 January 2013	**95**	**-**	**2**	**5**	**102**
Charged to income statement	**-**	**8**	**3**	**-**	**11**
Utilised	**-**	**(3)**	**(5)**	**(1)**	**(9)**
Transfer in	**-**	**-**	**-**	**11**	**11**
Unwinding of discount	**-**	**-**	**-**	**1**	**1**
Movement in pensions	**11**	**-**	**-**	**-**	**11**
31 December 2013	**106**	**5**	**-**	**16**	**127**
Current	**106**	**5**	**-**	**4**	**115**
Non-current	**-**	**-**	**-**	**12**	**12**
31 December 2013	**106**	**5**	**-**	**16**	**127**

Disposal of operations
All provisions are for costs associated with the sale of Stansted airport on 28 February 2013. All amounts are expected to be utilised in 2014.

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. £22 million of provisions have been recognised in LHR Airports Limited in relation to activities undertaken by Heathrow Airport Limited because LHR Airports Limited, as the legal employer, has the obligation. The Group has recognised a corresponding intercompany creditor with LHR Airports which relate to severance and pension payments.

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

At 31 December 2013, £81 million represents the share of the LHR Airports Limited defined benefit pension scheme deficit (2012: £76 million). The remaining £25 million (2012: £19 million) is held for historical accumulated past service pension costs borne by LHR Airports Limited in relation to Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities.

Other
These provisions are largely due to onerous contracts, primarily relating to property leases.

18 Trade and other payables

	31 December 2013 £m	31 December 2012 £m
Non-current		
Deferred income	**3**	4
	3	4
Current		
Deferred income	**27**	31
Trade payables[1]	**128**	102
Other tax and social security	**10**	6
Other payables	**10**	30
Capital payables	**301**	263
Amount owed to group undertakings – operating[2]	**86**	18
	562	450

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

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

19 Assets held-for-sale

The major classes of assets and liabilities comprising the operations classified as assets held-for-sale at 31 December 2012 (2013: nil) are as follows:

	31 December 2012 £m
Property, plant and equipment	692
Investment property	577
Prepayments	3
Inventories	2
Trade and other receivables[1]	31
Cash at bank	26
Total assets classified as held-for-sale	1,331
Trade and other payables	(29)
Deferred tax liabilities	(214)
Provisions	(20)
Total liabilities classified as held-for-sale	(263)
Net assets of disposal group	1,068

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

On 20 August 2012 a sale process commenced for Heathrow Finance plc's interest in Stansted Airport Limited. The disposal process led to the announcement in 2013 that the airport was being sold to Manchester Airports Group for £1,500 million. This transaction was completed on 28 February 2013. The net assets of Stansted airport were classified as held-for-sale at 31 December 2012. The results and performance of discontinued operations have been disclosed in Note 6.

Movements in the normal course of business have occurred following the classification of Stansted airport to held-for-sale.

20 Share capital

	£
Authorised	
At 1 January 2013 and 31 December 2013: 9,500,000,000 ordinary shares of £1 each	9,500,000,000
Allotted and fully paid	
In issue at 1 January 2013 and 31 December 2013: 3,109,350,689 ordinary shares of £1 each	3,109,350,689
In issue at 31 December 2013 3,109,350,689 ordinary shares of £1 each	**3,109,350,689**

21 Other reserves

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

During 2012, the remaining revaluation reserve of £365,000,000 in Heathrow Finance plcs's group balance sheet was recognised in the profit and loss reserve. This was a result of capitalisation of Heathrow Airport Limited's revaluation reserve as approved by the the shareholders and directors of Heathrow Airport Limited.

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

	Merger reserve £m
1 January 2013	**(1,771)**
Transfer to profit and loss reserve[1]	**777**
31 December 2013	**(994)**

[1] Following the sale of Stansted Airport Limited in February 2013 the components of merger reserve attributed to that entity were realised.

22 Fair value reserve

	Fair value reserve £m
1 January 2013	**(455)**
Fair value gain	**203**
Deferred tax on fair value gain	**(40)**
Change in tax rate	**(18)**
31 December 2013	**(310)**

23 Tax relating to components of comprehensive income

The tax credit/(charge) relating to components of other comprehensive income is as follows:

	Year ended 31 December 2013			Year ended 31 December 2012		
	Before tax £m	**Tax credit/ (charge) £m**	**After tax £m**	Before tax £m	Tax credit/ (charge) £m	After tax £m
Cash flow hedges						
Gains/(losses) taken to equity	**216**	**(43)**	**173**	(373)	86	(287)
Transferred to income statement	**(13)**	**3**	**(10)**	310	(71)	239
Change in tax rate	**-**	**(11)**	**(11)**	-	(5)	(5)
Tax relating to indexation of operating land	**-**	**(1)**	**(1)**	-	-	-
Other comprehensive income	**203**	**(52)**	**151**	(63)	10	(53)
Current tax	**-**	**-**	**-**	-	-	-
Deferred tax	**-**	**(52)**	**-**	-	10	-
	-	**(52)**	**-**	-	10	-

24 Retained earnings

	£m
1 January 2012 (restated)	(1,701)
Net profit for the year	121
Dividends paid	(346)
Transfer from revaluation reserves to profit and loss reserves[1]	365
Change in tax rate on investment properties and operating land	6
1 January 2013 (restated)	**(1,555)**
Net profit for the year	**736**
Dividends paid[2]	**(700)**
Transfer from merger reserves to profit and loss reserves[3]	**(777)**
Change in tax rate on investment properties and operating land	**7**
Tax relating to indexation of operating land	**(1)**
31 December 2012	**(2,290)**

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

2 During the year ended 31 December 2013, Heathrow Finance plc paid dividends to Heathrow (DSH) Limited, which funded £207 million in quarterly dividends to Heathrow Finance plc's ultimate shareholders, a £300 million one-off return to the Company's ultimate shareholders relating to the sale of Stansted airport and £193 million related to servicing external debt at Heathrow Finance plc's holding companies and rebalancing the amount of external debt between Heathrow Finance plc's holding companies and subsidiaries. These dividends, totalling £700 million, comprised; £24 million on 24 January 2013, £99 million on 14 February 2013, £300 million on 15 March 2013, £64 million on 27 June 2013, £118 million on 11 July 2013, £48 million on 18 September 2013 and £47 million on 20 December 2013 (2012: Heathrow Finance plc paid dividends of £346 million to Heathrow (DSH) Limited, being £194 million on 15 March 2012, £20 million on 21 June 2012, £21 million on 10 August 2012, £60 million on 19 September 2012 and £51 million on 20 December 2012).

3 Following the sale of Stansted Airport Limited in February 2013 the components of merger reserve attributed to that entity were realised.

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

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 2013		31 December 2012	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**13**	**41**	14	50
Within two to five years	**42**	**136**	48	164
After five years	**17**	**544**	23	880
	72	**721**	85	1,094

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

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

Non-cancellable operating lease commitments – Group as a lessor

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

	31 December 2013		31 December 2012	
	Land and buildings £m	**Other £m**	Land and buildings £m	Other £m
Within one year	**93**	**-**	99	-
Within two to five years	**242**	**-**	259	-
After five years	**1,528**	**-**	1,638	-
	1,863	**-**	1,996	-

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

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

Non-cancellable electricity purchase commitment

The Group has a contractual commitment to purchase electricity that was used to satisfy physical delivery requirements for electricity usage of the Group until March 2013. The contract has now expired and so the outstanding commitment under the contact at 31 December 2013 was £nil (2012: £5 million).

Group commitments for property, plant and equipment

	31 December 2013 £m	31 December 2012 £m
Contracted for, but not accrued:		
Terminal 2	**58**	625
Baggage systems	**42**	52
Terminal restoration and modernisation	**37**	29
Capacity optimisation	**33**	20
IT projects	**15**	15
	185	741
Other projects	**24**	54
	209	795

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

Group commitments for property, plant and equipment continued
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 Heathrow where there is a £2.8 billion (in 2011/12 prices) capital investment programme in respect of the forthcoming regulatory period that now ends on 31 December 2018. Capital expenditure at Heathrow in the year ending 31 December 2014 is expected to be over £742 million. 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.

Other commitments
The Group has operated blight compensation schemes relating to properties that might be affected by potential future runway developments at Heathrow. However, these schemes were closed following the change in government policy in relation to runway developments in South East England. Heathrow had a remaining commitment to purchase one property at 31 December 2012, this was completed in May 2013.

In June 2006, the government concluded a night flights regime at Heathrow for the period 2006-12. Further consultations, and a review of aviation policy, which included reference to noise insulation and mitigation schemes, have extended the existing night flights regime until October 2017. Under the proposals there is an expectation that Heathrow will operate a voluntary scheme to mitigate the impact of aircraft noise. Heathrow has indicated that it will continue to offer a range of insulation schemes for both homes and community buildings that meet certain criteria. The Group is unable to quantify the future costs of this scheme as the take-up and the extent of any future work cannot be reliably measured. Costs under the scheme are recognised as incurred.

The trustees of the LHR Airports Limited defined benefit pension scheme and the Heathrow Airport Holdings Group concluded the pension scheme's 30 September 2010 triennial valuation in December 2011 and agreed a schedule of cash contributions of £97 million per annum (of which £24 million relates to deficit reduction) that became effective from 1 January 2012. Following the disposal of Edinburgh airport, the schedule of cash contributions was reduced to £94 million per annum from January 2013 with a further reduction to £87 million per annum from January 2014 following the sale of Stansted airport. Approximately £77 million in cash contributions will be met by Heathrow in 2014.

Contingent liabilities
The Group has external contingent liabilities, comprising letters of credit, performance/surety bonds, performance guarantees and other items arising in the normal course of business amounting to £1 million at 31 December 2013 (2012: £1 million).

26 Notes to the consolidated statement of cash flows
Reconciliation of net profit/(loss) before tax to cash generated from continuing operations

	Note	**Year ended 31 December 2013 £m**	Year ended 31 December 2012 £m
Operating activities			
Net profit/(loss) before tax		**191**	(16)
Adjustments for:			
Finance income	*4(a)*	**(229)**	(252)
Finance costs	*4(a)*	**875**	962
Fair value loss/(gain) on financial instruments	*4(b)*	**81**	(108)
Impairment		**-**	5
Depreciation	*2*	**431**	461
Amortisation	*2*	**19**	13
Fair value gain on investment properties	*1(c)*	**(62)**	(50)
Decrease/(increase) in trade and other receivables		**15**	(17)
Increase in inventories		**-**	(1)
Increase/(decrease) in trade and other payables		**1**	(14)
Decrease in provisions		**(4)**	(3)
Decrease in deferred income		**(1)**	(4)
Increase in intercompany payable		**51**	-
Difference between pension charge and cash contributions		**(27)**	(33)
Exceptional pension charge		**66**	138
Cash generated from continuing operations		**1,407**	1,081

Notes to the Group financial statements for the year ended 31 December 2013 *continued*

27 Related party transactions

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

	Year ended 31 December 2013 Purchase of goods and services £m	Year ended 31 December 2012 Purchase of goods and services £m
Ferrovial Agroman	**65**	93
Amey Community Limited	**22**	23
HETCo[1]	**333**	257
	420	373

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

	Year ended 31 December 2013 Sales to related party £m	Year ended 31 December 2012 Sales to related party £m
Harrods International Limited	**20**	-
Qatar Airways	**21**	-
	41	-

Balances outstanding with related parties were as follows:

	31 December 2013		31 December 2012	
	Amounts owed by related parties £m	**Amounts owed to related parties £m**	Amounts owed by related parties £m	Amounts owed to related parties £m
HETCo[1]	**-**	**27**	-	29

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

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

The Group enters into transactions with LHR Airports Limited in accordance with the SSA, as described in the Accounting Policies note. The amount expensed in the Group's income statement in relation to these charges is shown within Notes 2 and 3. Where the repayment terms and nature of settlement of the related statement of financial position amounts is known they are disclosed in the relevant statement of financial position caption, see notes 11 and 18. The Group also has other balances with other entities owned by FGP Topco Limited that are not eliminated on consolidation and that relate to previous group reconstructions and financing arrangements. Where known, the nature, settlement and terms of the arrangements are disclosed in Notes 11 and 18.

28 Ultimate parent undertaking and controlling party

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

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (25.00%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (13.29%), Baker Street Investment Pte Ltd (11.88%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. and Alinda Airports L.P. (11.18%) (investment vehicles managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (8.65%) (an investment vehicle of the Universities Superannuation Scheme).

The Group's results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2013, 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 2013.

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

29 Subsidiaries

The subsidiaries of the Group are as follows:

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

Airport owners and operators
Heathrow Airport Limited†

Other
Heathrow Funding Limited †#
Heathrow Express Operating Company Limited †

† Held by a subsidiary undertaking
# Incorporated in Jersey

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

30 Post balance sheet events

On 10 January 2014, the CAA gave notice of its proposed licence to Heathrow under the Civil Aviation Act 2012, under which the maximum allowable yield per passenger will be RPI minus 1.5% per year (RPI minus 1.2% per year on a five-year adjusted basis), with an assumed capital plan of £2.81 billion (£2.95 billion on a five-year adjusted basis). The main changes to the CAA's previous proposal were an increase of 5.7 million passengers to the traffic forecast, and a 25 basis point reduction in the assumed cost of capital. In addition, the duration of the next regulatory period has been amended to 4 years and 9 months, to align the regulatory year with Heathrow's financial year.

On 13 February 2014, the CAA formally granted Heathrow's licence to charge fees for the provision of airport services and this will take effect from 1 April 2014, when the previous regulatory settlement will end. Heathrow and other parties with a qualifying interest have until 27 March 2014 to seek permission to appeal the decision on the price controls.

A dividend of £67 million was declared on 20 February 2014 and subsequently paid on 21 February 2014.

Heathrow Finance plc

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

We have audited the parent company financial statements of Heathrow Finance plc for the year ended 31 December 2013 which comprise the Company balance sheet, the Accounting policies and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

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

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatement or inconsistencies we consider the implications for our report.

Opinion on financial statements
In our opinion the parent company financial statements:

- give a true and fair view of the state of the parent company's affairs as at 31 December 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

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

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

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

Other matter
We have reported separately on the Group financial statements of Heathrow Finance plc for the year ended 31 December 2013.

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

3 March 2014

Heathrow Finance plc

Company balance sheet as at 31 December 2013

	Note	**31 December 2013 £m**	31 December 2012 £m
Fixed assets			
Investment in subsidiary	*2*	**3,009**	3,009
Total non current assets		**3,009**	3,009
Current assets			
Debtors (due after more than one year £946m (2012: £942m))	*3*	**963**	960
Cash at bank and in hand		**2**	1
Total current assets		**965**	961
Creditors: amounts falling due within one year	*4*	**(16)**	(15)
Net current assets		**949**	946
Total assets less current liabilities		**3,958**	3,955
Creditors: amounts falling due after more than one year	*5*	**(754)**	(717)
Net assets		**3,204**	3,238
Capital and reserves			
Called up share capital	*6*	**3,109**	3,109
Profit and loss reserve	*7*	**95**	129
Total shareholder's funds		**3,204**	3,238

The financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 27 February 2014. They were signed on its behalf by:

José Leo
Director

Andrew Efiong
Director

Accounting policies for the year ended 31 December 2013

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

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

Going concern
The directors have prepared the financial statements on a going concern basis which requires the directors to have a reasonable expectation that the Company, as part of the Heathrow Airport Holdings Limited group (the 'Heathrow Airport Holdings Group'), has adequate resources to continue in operational existence for the foreseeable future.

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

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

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

Debtors
Debtors are recognised initially at cost less any provision for impairment.

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

Creditors
Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost unless part of a fair value hedge relationship. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest rate method.

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

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

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

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

Deferred tax is determined using the tax rates and laws that have been enacted, or substantively enacted, by the balance sheet date and are expected to apply in the periods in which the timing differences are expected to reverse.

Accounting policies for the year ended 31 December 2013 *continued*

Classification of financial instruments issued by the Company
In accordance with FRS 25 *Financial Instruments: Disclosure and Presentation*, financial instruments issued by the Company are treated as equity (i.e. forming part of shareholder's funds) only to the extent that they meet the following two conditions:

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

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

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

The Company is exempt from reporting information under FRS 29 *Financial Instruments: Disclosures* because the Company's consolidated financial statements are prepared in accordance with IFRS 7 *Financial Instruments: Disclosures*.

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

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

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

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

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

Cash flow statement and related party disclosures
The ultimate parent entity in the UK is FGP Topco Limited, a company registered in England and Wales. The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2013. The results are also included in the audited consolidated financial statements of Heathrow Finance plc for the year ended 31 December 2013 (the smallest group to consolidate these financial statements). They are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2013. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 '*Cash Flow Statements (revised 1996)'.*

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

Notes to the Company financial statements for the year ended 31 December 2013

1 Company result for the year

As permitted by section 408 of the Companies Act 2006, the profit and loss account of the Company is not presented as part of these financial statements. The profit of the Company for the year attributable to shareholders was £666 million (2012: £442 million).

2 Investment in subsidiary

	£m
1 January 2013 and 31 December 2013	**3,009**

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

3 Debtors

	31 December 2013 £m	31 December 2012 £m
Due within one year:		
Interest receivable from group undertakings	**18**	18
	18	18
Due after more than one year:		
Amounts owed by group undertakings - interest free[1]	**74**	74
Amounts owed by group undertakings - interest bearing[2]	**871**	868
	945	942
Total debtors	**963**	960

[1] Amount owed by group undertakings – interest free relates to the loan receivable from Heathrow (DSH) Limited.
[2] Amounts owed by group undertakings - interest bearing relates to the debenture payable by Heathrow (SP) Limited which is used to fund interest on the Company's bond and loan facilities. As at 31 December 2013, the rate on the debenture was 6.28% (2012: 6.83%).

4 Creditors: amounts falling due within one year

	31 December 2013 £m	31 December 2012 £m
Interest payable	**15**	11
Group relief payable	**1**	4
	16	15

5 Creditors: amounts falling due after more than one year

	31 December 2013 £m	31 December 2012 £m
Secured		
Bonds	**593**	592
Loan facilities	**161**	125
	754	717

As at 31 December 2013, the fair value of the non-current borrowings above was £806 million (2012: £759 million). The fair values of listed borrowings are based on quoted prices. The fair values of non-current borrowings which have floating rate interest are assumed to equate to their current nominal value.

Additional disclosures on risk management and hedging of borrowings are included in Notes 14 and 15 of the Group financial statements.

Notes to the Company financial statements for the year ended 31 December 2013 *continued*

6 Share capital

	£
Authorised	
At 1 January 2013 and 31 December 2013: 9,500,000,000 ordinary shares of £1 each	9,500,000,000
Called up, allotted and fully paid	
In issue at 1 January 2013 and 31 December 2013: 3,109,350,689 ordinary shares of £1 each	**3,109,350,689**

7 Profit and loss reserve

	£m
1 January 2013	**129**
Profit for the financial year	**666**
Dividends paid	**(700)**
31 December 2013	**95**

[1] During the year ended 31 December 2013, Heathrow Finance plc paid dividends to Heathrow (DSH) Limited, which funded £207 million in quarterly dividends to Heathrow Finance plc's ultimate shareholders, a £300 million one-off return to the Company's ultimate shareholders relating to the sale of Stansted airport and £193 million related to servicing external debt at Heathrow Finance plc's holding companies and rebalancing the amount of external debt between Heathrow Finance plc's holding companies and subsidiaries. These dividends, totalling £700 million, comprised; £24 million on 24 January 2013, £99 million on 14 February 2013, £300 million on 15 March 2013, £64 million on 27 June 2013, £118 million on 11 July 2013, £48 million on 18 September 2013 and £47 million on 20 December 2013 (2012: Heathrow Finance plc paid dividends of £346 million to Heathrow (DSH) Limited, being £194 million on 15 March 2012, £20 million on 21 June 2012, £21 million on 10 August 2012, £60 million on 19 September 2012 and £51 million on 20 December 2012).

8 Auditor's remuneration

Audit fees are recharged in accordance with the group SSAs into the operating entities. This entity is not an operating entity and is therefore not party to the SSAs and receives no recharge of the audit cost. However, the Company's auditor received £21,000 (2012: £21,000) as remuneration for the audit of the Company's financial statements, the cost of which is borne by LHR Airports Limited.

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

9 Employee information and directors' remuneration

Employee numbers
The Company has no employees (2012: nil).

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

10 Ultimate parent undertaking and controlling party

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

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (25.00%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (13.29%), Baker Street Investment Pte Ltd (11.88%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. and Alinda Airports L.P. (11.18%) (investment vehicles managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (8.65%) (an investment vehicle of the Universities Superannuation Scheme).

The Company's results are also included in the audited consolidated financial statements of Heathrow Finance plc for the year ended 31 December 2013, which is the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited and FGP Topco Limited for the year ended 31 December 2013.

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

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

Notes to the Company financial statements for the year ended 31 December 2013 *continued*

11 Post balance sheet events

On 10 January 2014, the CAA gave notice of its proposed licence to Heathrow under the Civil Aviation Act 2012, under which the maximum allowable yield per passenger will be RPI minus 1.5% per year (RPI minus 1.2% per year on a five-year adjusted basis), with an assumed capital plan of £2.81 billion (£2.95 billion on a five-year adjusted basis). The main changes to the CAA's previous proposal were an increase of 5.7 million passengers to the traffic forecast and a 25 basis point reduction in the assumed cost of capital. In addition, the duration of the next regulatory period has been amended to 4 years and 9 months, to align the regulatory year with Heathrow's financial year.

On 13 February 2014, the CAA formally granted Heathrow's licence to charge fees for the provision of airport services and this will take effect from 1 April 2014, when the previous regulatory settlement will end. Heathrow and other parties with a qualifying interest have until 27 March 2014 to seek permission to appeal the decision on the price controls.

A dividend of £67 million was declared on 20 February 2014 and subsequently paid on 21 February 2014.