



Heathrow – CAA Initial Q6 Price Cap Proposals Bondholder and Lender Update

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9 May 2013

Heathrow
Making every journey better

Our vision is to be the UK's direct connection to the world and Europe's hub of choice by *making every journey better*

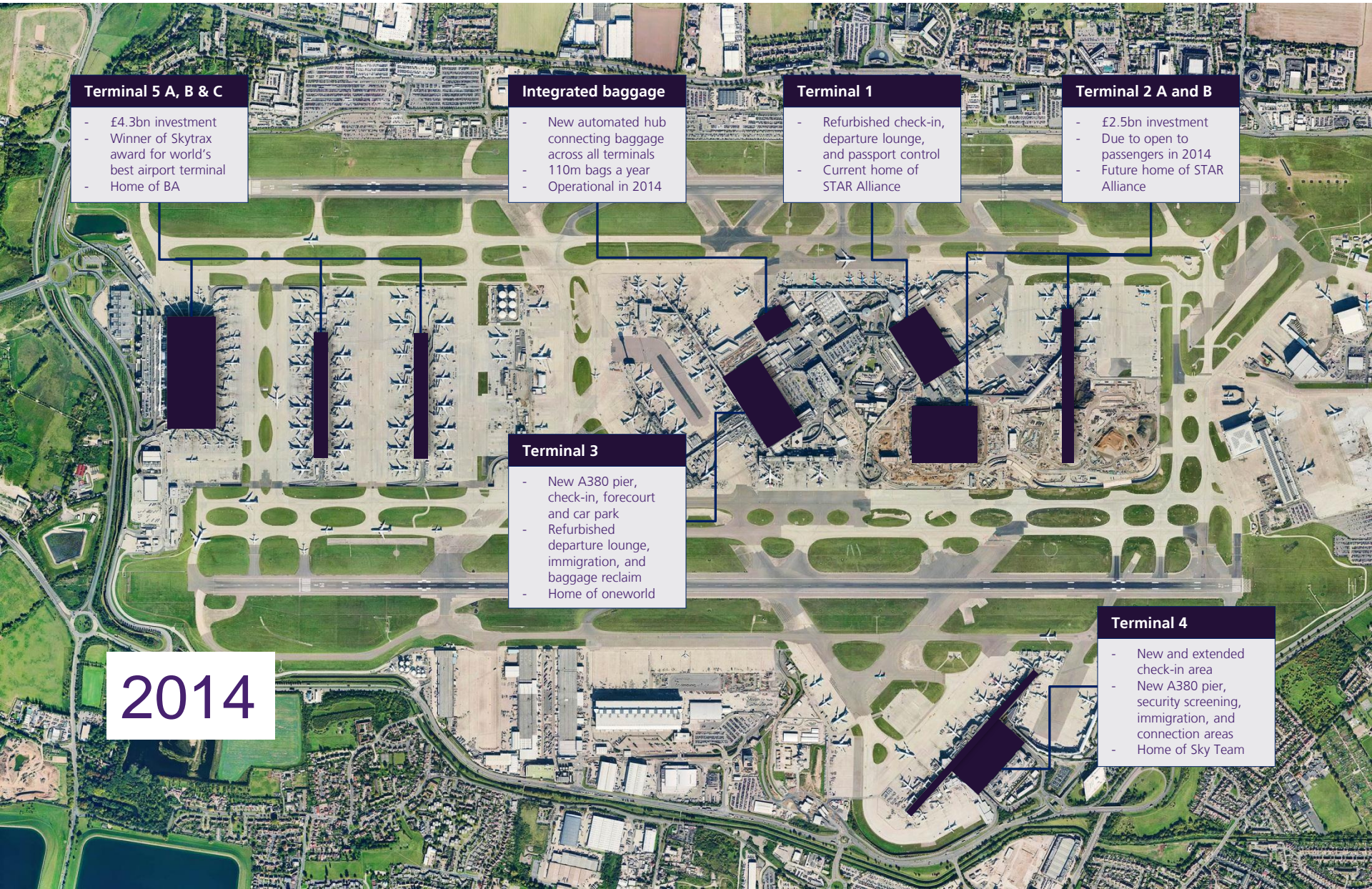
Our priorities for Q6

1. Deliver a noticeably better *'hub of choice'* passenger experience
2. Deliver improved resilience and sufficient capacity
3. Ensure a competitive total cost of operation

Major deliveries

- Terminal 2 opens 2014
- Terminal 3 integrated baggage

Heathrow has invested £11bn between 2003 and 2014 – one of the UK's largest private-sector investments



Terminal 5 A, B & C

- £4.3bn investment
- Winner of Skytrax award for world's best airport terminal
- Home of BA

Integrated baggage

- New automated hub connecting baggage across all terminals
- 110m bags a year
- Operational in 2014

Terminal 1

- Refurbished check-in, departure lounge, and passport control
- Current home of STAR Alliance

Terminal 2 A and B

- £2.5bn investment
- Due to open to passengers in 2014
- Future home of STAR Alliance

Terminal 3

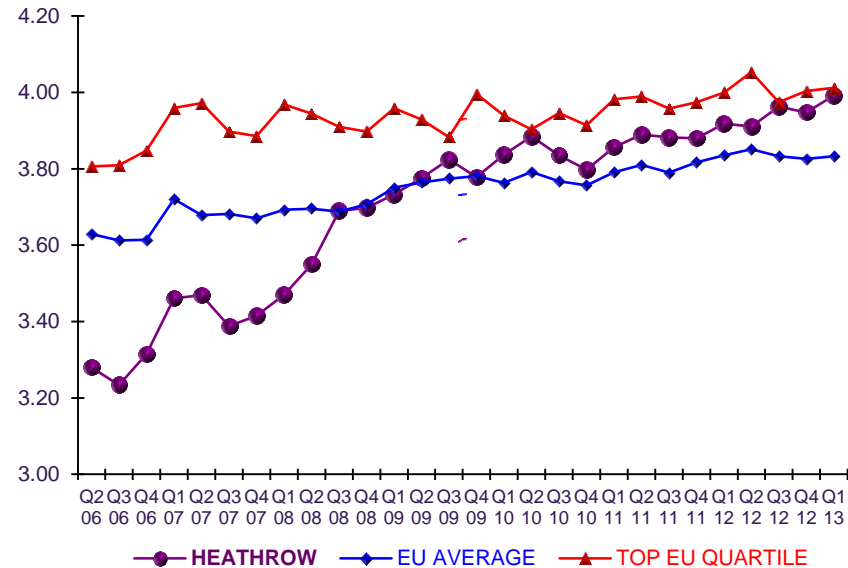
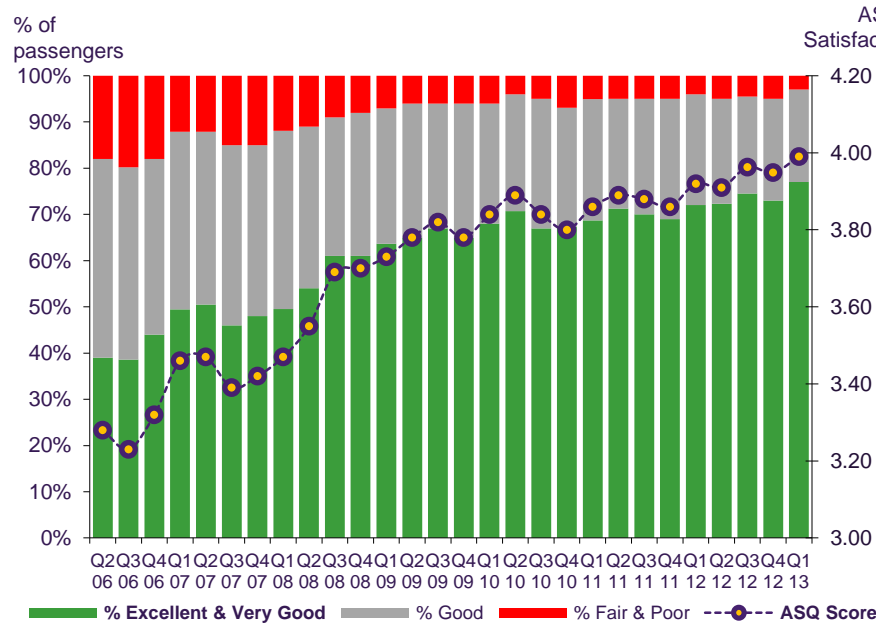
- New A380 pier, check-in, forecourt and car park
- Refurbished departure lounge, immigration, and baggage reclaim
- Home of oneworld

Terminal 4

- New and extended check-in area
- New A380 pier, security screening, immigration, and connection areas
- Home of Sky Team

2014

Heathrow is changing...better passenger experience with levels of satisfaction rising in Q1 2013 to an all time high



'Very Good' or 'Excellent' ratings have risen substantially from 39% in 2006 to 77% in Q1 2013.

Our investment has moved Heathrow towards Top Quartile of European airports for overall passenger satisfaction

Q6 Financials: Heathrow Full Business Plan vs CAA Initial Proposal

- Key differences:

- cost of capital
- operating expenses

- Other impacts:

- higher traffic forecasts
- higher commercial revenue
- reduction of RAB

	Heathrow FBP	CAGR ¹	CAA IP	CAGR ¹
Price cap per passenger	RPI +5.9%	-	RPI -1.3%	-
Passengers (m)	355.2	0.4%	358.4	0.5%
Aeronautical income (£m)	10,212	6.1%	8,615	-0.9%
Non aeronautical income (£m)	4,753	1.6%	4,838	2.1%
<i>Average net retail income per passenger (£)</i>	<i>6.54</i>	<i>1.8%</i>	<i>6.67</i>	<i>2.4%</i>
Operating costs (£m)	5,234	-0.2%	5,017	-1.8%
Capital investment (£m)	3,005	-	3,005	-
Average RAB (£m)	13,749	-	13,688	-
WACC	7.1%	-	5.35%	-

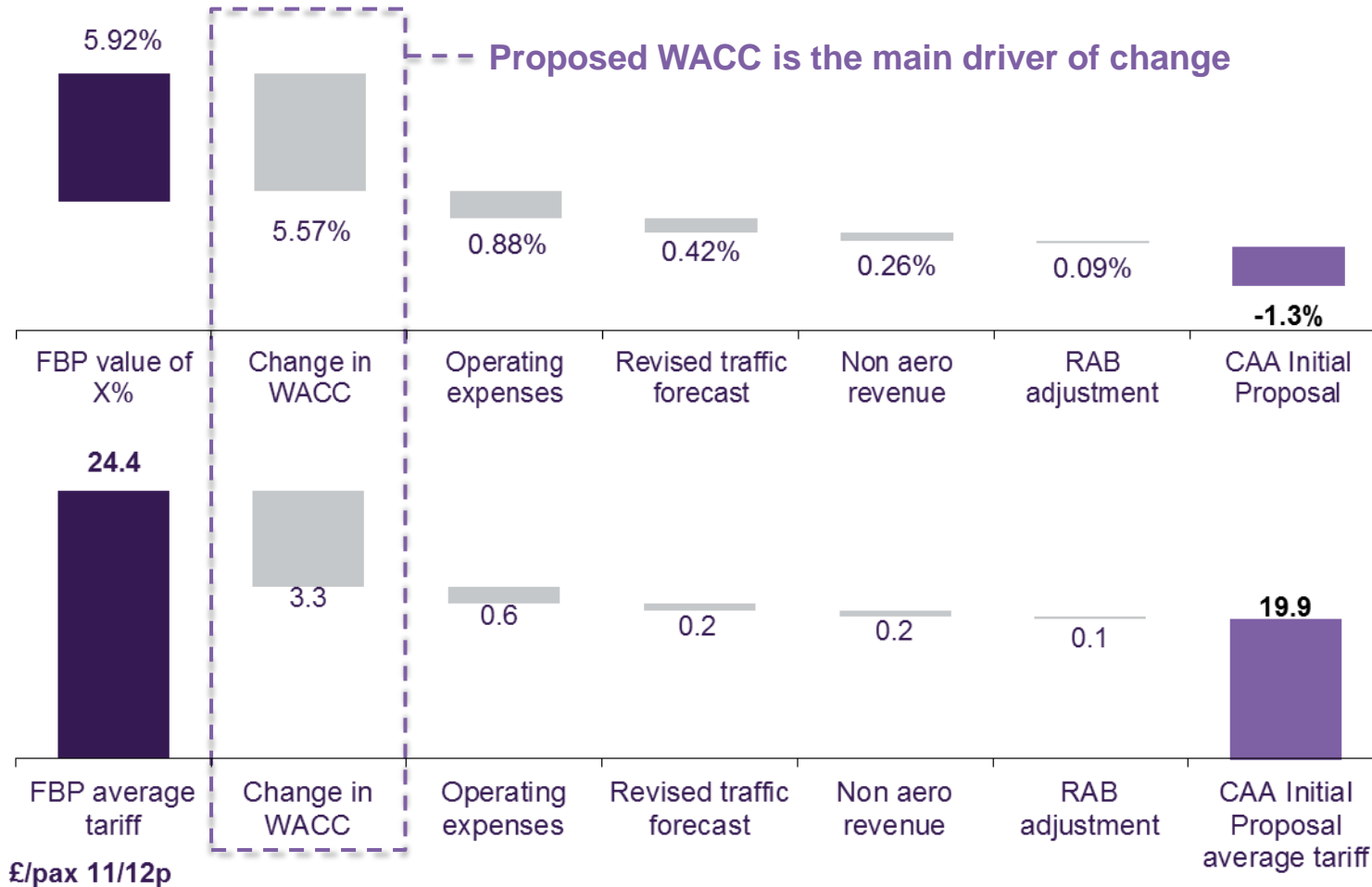
¹ CAGR: compound annual growth rate over Q6, against 2013/14(E)

All figures in 2011/12 prices

Heathrow

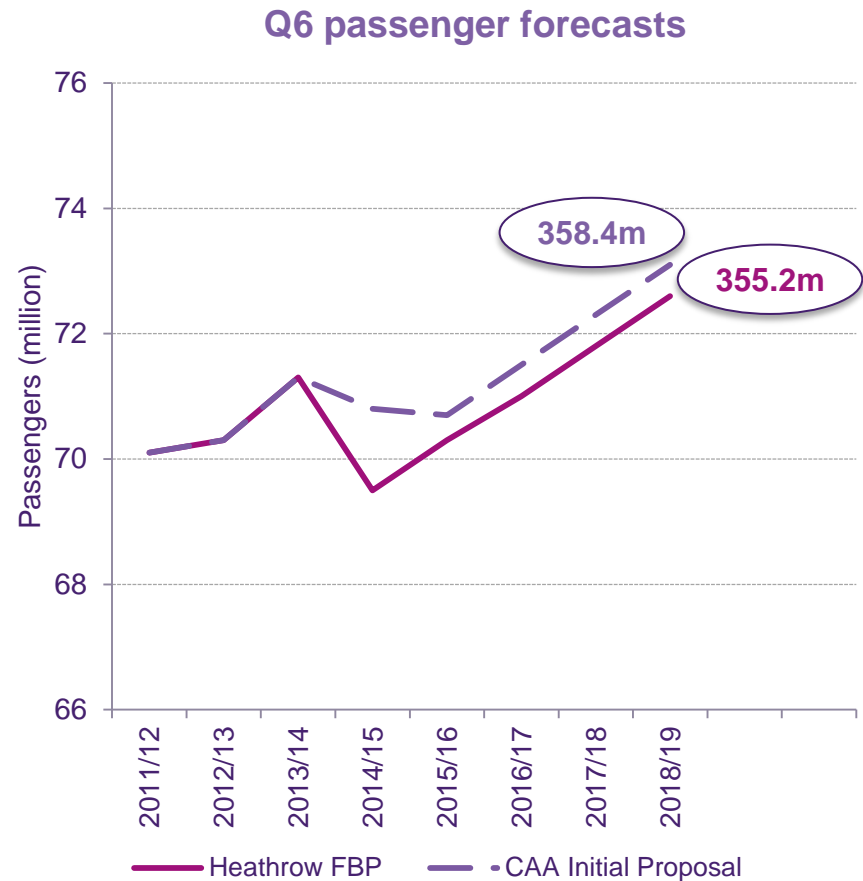
Making every journey better

Bridging price cap and average Q6 tariff to CAA Initial Proposal



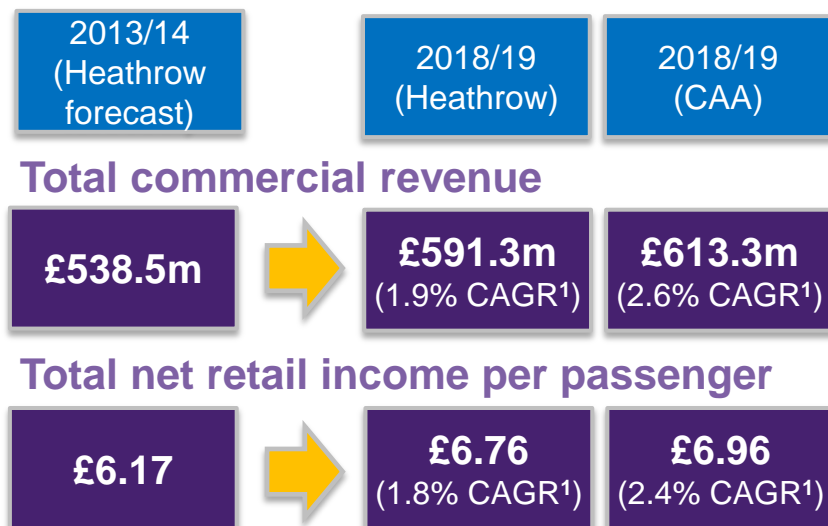
Passenger forecast factors for 'external shocks'

- Passenger numbers running 10% lower than CAA's Q5 forecast
- Heathrow absorbed the £650 million impact on revenue in Q5
- Worked with airlines to agree forecasting methodology
- Incorporation of shocks accepted by CAA, but reduced shock impact:
 - CAA initial proposals **358.4m** passengers



Commercial revenues

- Planned Q6 growth in commercial revenue comes on top of strong historic performance
- >80% of commercial revenue is retail income
- Heathrow forecast performance drivers
 - base growth (e.g. global GDP)
 - impacts of known events (e.g. Terminal 2 opening, tobacco advertising legislation)
 - capital solutions (e.g. Terminal 5 luxury and ebusiness developments)
- CAA stretch targets primarily in concession margins, tobacco impact and car parking
- No account taken of recent possible retail slowdown



¹ CAGR: compound annual growth rate over Q6, against 2013/14(E)

All figures in 2011/12 prices

Operating expenses

- Heathrow Q6 FBP keeps operating costs flat on a real basis
- Q6 upward cost pressures...
 - Terminal 2 opening
 - significant rises in property rates
- ...more than offset by Heathrow's planned cost efficiencies
 - £248 million: including pay and productivity improvements; energy savings
 - £67 million reduction in pension costs
 - Terminal 1 closure
- CAA proposes further £217 million
 - challenging given proposed scale and speed plus level of 'uncontrollable' and pass-through costs
 - increases risk to service delivery

Q6 Operating expenses	Heathrow FBP	CAGR ¹
Security costs (£m)	723	-3.1%
Other operational staff (£m)	320	-4.2%
Facilities management (£m)	969	1.6%
Rent, rates & utilities (£m)	1,291	5.0%
Commercial & rail (£m)	519	-1.5%
Central support (£m)	520	-3.2%
Pensions (£m)	297	-6.2%
Other (£m)	598	-0.7%
TOTAL (£m)	5,234	-0.2%

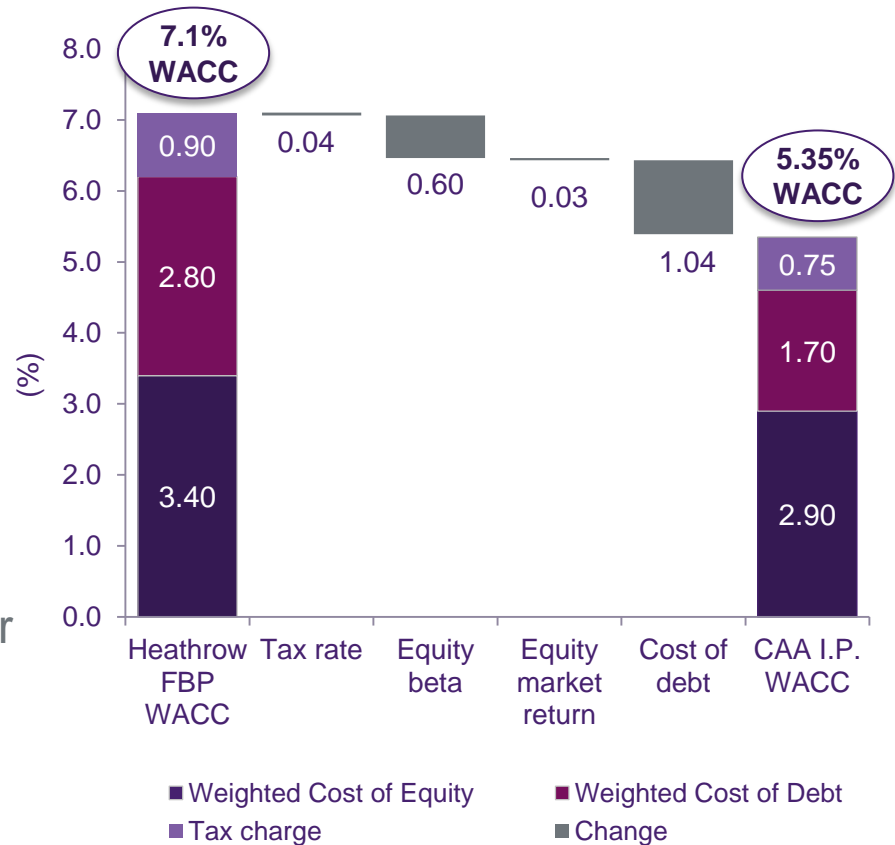
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WACC - introduction

- CAA WACC proposal 5.35% compares to Heathrow's 7.1%
- Key differences in cost of equity
 - equity beta
 - risk-free rate and equity risk premium
- Key differences in cost of debt
 - credit spreads
 - risk-free rate
 - cost of debt financing platform
- CAA proposal puts cost of capital for Heathrow in line with National Grid

Heathrow FBP WACC versus CAA IP WACC¹



¹ Adopts 80/20 weighting of CAA high-low range

Cost of equity

- Risk free rate + equity risk premium set below that of recent regulatory determinations
- CAA rolled forward from Q5 assumptions on beta
 - Heathrow bears asymmetric risk, reflected in Heathrow’s suggested equity beta of 1.3
 - CAA sympathetic to argument of asymmetry but not reflected in final figure
- CAA underestimate Heathrow’s equity risk, driving a WACC in line with less risky utilities

Equity components in recent determinations

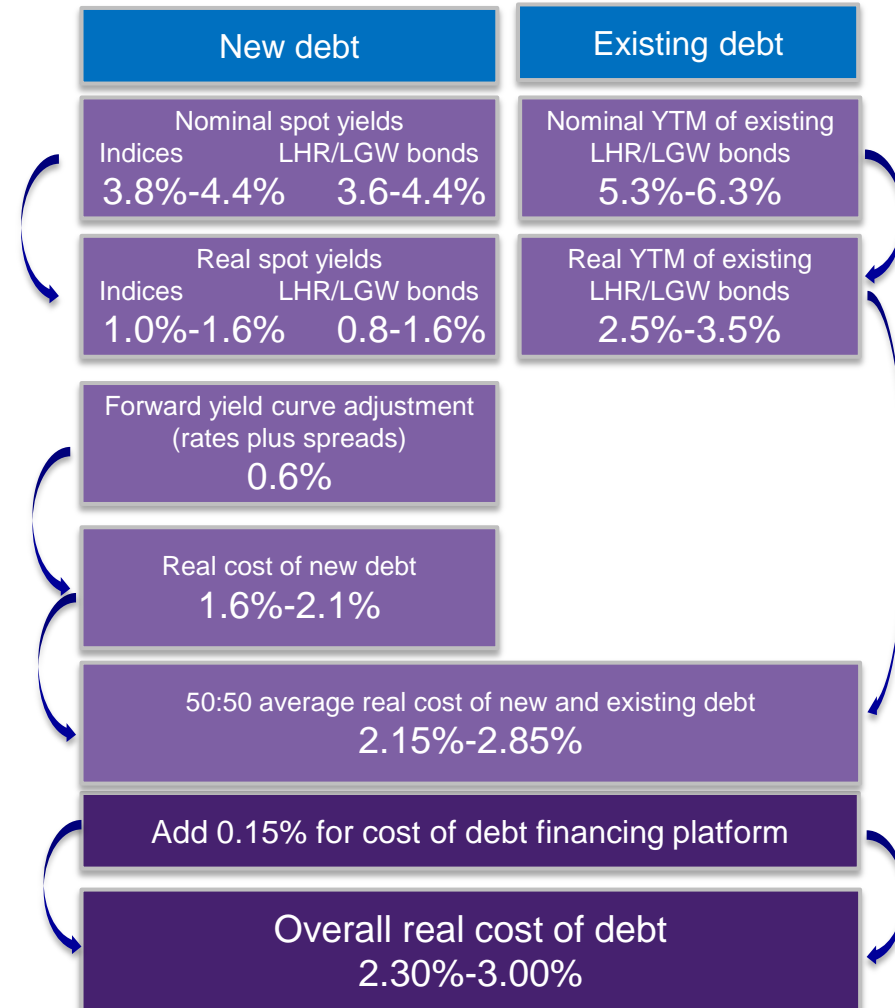
	CAA Initial Proposal ¹	NATS	Ofgem National Grid	Ofwat Water
Control period	Q6	2011-14	2013-21	2011-14
Equity risk premium	6.0%	5.25%	5.25%	5.4%
Risk free rate	0.65%	1.75%	2.0%	2.0%
Equity beta	1.10	1.35	0.95	0.9
Post tax cost of equity	7.25%	8.8%	7.0%	7.1%
Real vanilla WACC	4.62%	5.7%	4.6%	5.1%

¹ Adopts 80/20 weighting of CAA high-low range

Cost of debt

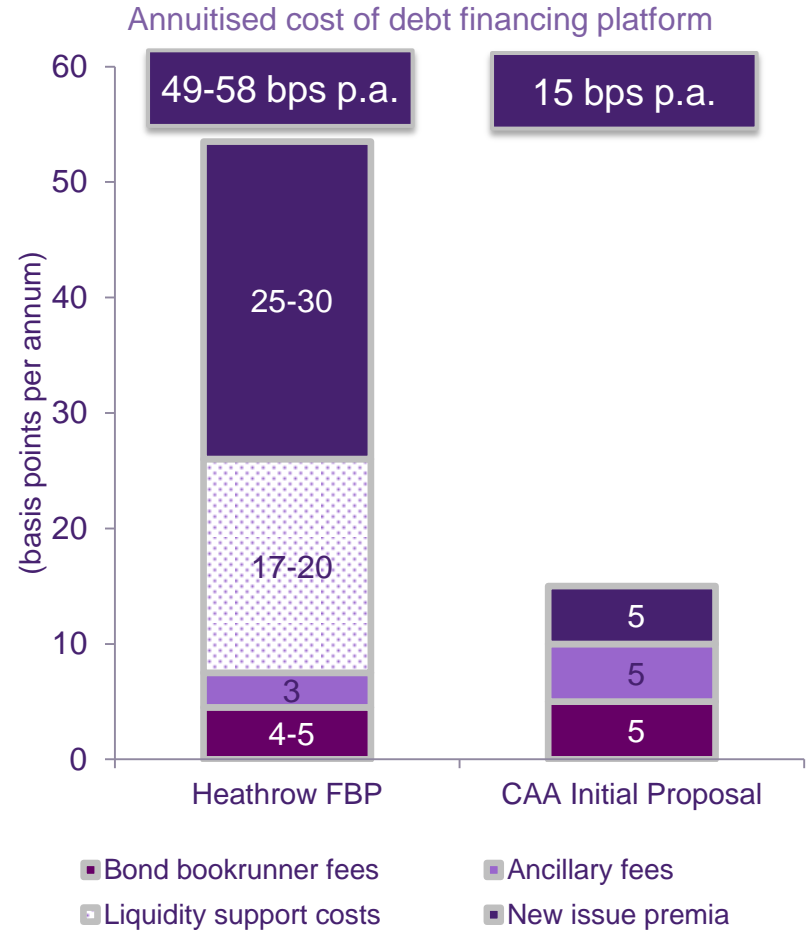
- CAA's 2.3%-3.0% real cost of debt compares to Heathrow's 4.6%
- Key issues
 - unprecedented low cost of debt for regulated business inconsistent with relative risk profile
 - cost of maintaining debt financing platform
- CAA methodology
 - 50:50 assumption for existing and new debt
 - new debt: use average of spot yields for relevant rated benchmark indices and Heathrow bonds and adjust for inflation and forward curve
 - existing debt: use yield to maturity of Heathrow bonds issued since 2008 and adjust for inflation
 - add 15 basis points allowance for cost of maintaining debt financing platform

CAA assumptions on cost of debt



Cost of maintaining debt financing platform

- Costs readily verifiable and significant detail provided to CAA
- Key issues
 - new issue premia treated as one-off rather than recurring
 - justification of higher Gatwick/Stansted allowance
 - liquidity support costs versus Q5 WACC ‘accounting’ adjustment
- In 2008, Severn Trent estimated costs at 20-30 basis points excluding new issue premia, consistent with Heathrow’s view
- Other regulators appear to have underestimated these costs historically



Our vision is to be the UK's direct connection to the world and Europe's hub of choice by *making every journey better*

- Heathrow is being transformed
 - £11 billion investment between 2003 and 2014
 - passengers say they notice the difference, Heathrow has moved from bottom quartile to top quartile in passenger satisfaction
- Q6 Business Plan continues the transformation
 - once Terminal 2 opens, more than 50% of passengers will use new facilities
 - £315 million savings deliver a competitive cost base for a world class airport
 - capital investment to deliver more for our airline customers
- CAA's Initial Proposal fails to recognise risk profile and fails to incentivise right behaviours in terms of investment and quality of service

Notes, sources and defined terms

- Page 4
 - ASQ is Airport Service Quality survey directed by Airports Council International. Survey scores can vary between 0 and 5 with 5 the best possible score
- Page 5
 - RAB: Regulatory Asset Base; FBP: full business plan
- Page 7
 - The £650 million revenue impact from lower passenger numbers is in 2007/08 prices
- Page 8
 - In addition to retail income, commercial revenue includes property income
 - Tobacco Display Act will result in tobacco products no longer being openly displayed from 2015
- Page 11
 - The real vanilla WACC is based on the pre-tax cost of debt and post-tax cost of equity
- Page 13
 - Page 23 of Severn Trent document : 'The world has turned: but which way' published in 2008

Appendix 1: Comparison of Heathrow and CAA WACC calculations

		Heathrow FBP	CAA IP ¹
Gearing	(A)	60%	60%
Risk-free rate	(B)	2.0	0.65
Debt premium	(C)	2.6	2.21
Pre-tax cost of debt	(D) = (B) + (C)	4.6	2.86
Equity Risk Premium	(E)	5.0	6.00
Equity Beta	(F)	1.3	1.10
Tax rate	(G)	21%	20.2%
Post-tax cost of equity	(H) = (B) + (E)*(F)	8.5	7.25
Vanilla real WACC	(A)*(D) + (1-A)*(H)	6.2	4.62
Pre-tax real WACC	(A)*(D) + (1-A)*(H)/(1-G)	7.1	5.35

¹ Adopts 80/20 weighting of CAA high-low range