

Heathrow Finance plc
Annual report and financial statements
for the year ended 31 December 2018

Heathrow Finance plc

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Heathrow Finance plc

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Heathrow Finance plc

Strategic report

Heathrow Finance plc (the 'Company' or 'Heathrow Finance') 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 ('Heathrow') and operates the Heathrow Express rail service. Heathrow Finance plc is an indirect subsidiary of the Heathrow Airport Holdings Limited group (the 'HAH Group').

The consolidated financial statements of Heathrow Finance and its subsidiaries (together 'Heathrow Finance' or the 'Group') are prepared in accordance with International Financial Reporting Standards ('IFRSs') 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 five sections:

Business overview – an overview of the business model and strategy of the Group;

Management review – overview of the year ended 31 December 2018, along with an outlook for 2019;

Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2018 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;

Leadership and governance – description of the Board of Directors (the 'Board') of HAH Limited and Committees of the Board which provide overall leadership to the HAH Group; and

Internal controls and risk management – outline of the HAH Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the HAH Group Executive Committee and Board.

Business overview

Heathrow's business model

Heathrow is one of the best-connected hub airports in the world, with 84 global airlines operating regular scheduled flights to 203 destinations. Heathrow is the primary airport in London which is the world's largest origin and destination aviation market with over 150 million passengers travelling to and from London annually. With 80.1 million passengers in 2018, Heathrow is Europe's busiest airport and the world's seventh busiest airport.

Heathrow provides service to a range of market segments, including business and leisure travellers, direct and transfer passengers and long and short-haul routes, operated by a diversified range of major airlines. As well as earning income from services to airlines, Heathrow also generates revenue from a variety of other sources, including concession fees from retail operators, income from car parks, advertising revenue, the rental of airport premises, the provision of facilities and services and the Heathrow Express rail service.

Heathrow has maintained a strong focus over recent years on operational performance, improving the passenger experience and investing in new and upgraded facilities. This focus and investment has resulted in Heathrow being named 'Best Airport in Western Europe' by Skytrax for the fourth consecutive year in 2018, as well the 'World's Top Airport Terminal' for Terminal 2, and 'World's Best Airport Shopping' for the ninth consecutive year.

Heathrow is subject to economic regulation by the Civil Aviation Authority ('CAA') which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection. The Economic regulation provides significant cash flow predictability within each regulatory period, which usually last five years.

Heathrow's strategy

Heathrow's strategy is focused on developing the airport's position from one of the best airports in Europe to one of the best in the world. Heathrow's vision is to give passengers the best airport service in the world, and is underpinned by four strategic priorities:

Mojo: To be a great place to work, Heathrow will help its people fulfil their potential and to work together to lead change across Heathrow with energy and pride.

Transform customer service; To deliver the world's best passenger experience, Heathrow will work with the Heathrow community to transform the service it gives to passengers and airlines, improving punctuality and resilience.

Beat the plan; Aiming to beat the business plan for the current regulatory period and deliver a competitive return to shareholders by growing revenue, reducing costs and delivering investments efficiently.

Sustainable growth: To operate and grow Heathrow airport sustainably, now and in the future.

Heathrow Finance plc

Strategic report *continued*

Business overview *continued*

Heathrow's Infrastructure

The Group has invested almost £11 billion transforming Heathrow's infrastructure over the last decade including £793 million invested in 2018 alone (2017: £687 million).

Runways

Heathrow airport has two parallel runways. These generally operate in 'segregated mode', with arriving aircraft allocated to one runway and departing aircraft to the other. The airport is permitted to schedule up to 480,000 air transport movements per year and in 2018 it operated at 98.5% (2017: 98.8%) of this limit.

Terminals

Each of Heathrow's four operational terminals is either new or recently refurbished. The busiest terminals are Terminal 2 and 5. Terminal 2, which opened in June 2014, handled 18.5 million passengers in 2018 (2017: 17.8 million) and Terminal 5 handled 32.8 million passengers in 2018 (2017: 32.3 million). Heathrow airport's terminal capacity is currently estimated to be 85 million passengers per year.

Baggage systems

Significant investment has been made in Heathrow's baggage infrastructure including the underground automated baggage system between Terminal 3 and Terminal 5 and the Terminal 3 integrated baggage system which became fully operational in April 2016.

Cargo and mail carriers

Cargo and mail carriers are responsible for handling merchandise and packages at Heathrow airport, including delivery to cargo warehouses, customs procedures and clearance, aircraft loading and unloading, sorting and transport to the destination. The bulk of cargo and mail at the airport is carried in the cargo holds of passenger flights rather than by dedicated cargo flights.

Expansion of Heathrow – sustainable growth

Heathrow has been operating close to its permitted limit on annual aircraft movements for several years and is the busiest airport in the world with two or fewer run-ways. As a result, for a significant period, management has been considering how to deliver sustainable growth and increased airport capacity in a way which delivers greater benefits as the country's only Hub airport, whilst mitigating the adverse impacts of expansion, particularly on local communities. The UK Parliament voted overwhelmingly in favour of the Airport's National Policy Statement ('NPS') in June 2018, and Heathrow has made significant progress on plans to deliver the sustainable growth under the terms of the NPS. A more detailed update is included in the Management review section of this Strategic report.

Heathrow's regulatory environment

Heathrow is subject to economic regulation by the Civil Aviation Authority ('CAA'), which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection.

The Economic regulation sees the CAA setting the maximum level of airport charges for Heathrow, generally for five-year regulatory periods, using a per passenger 'price cap' mechanism ("RPI +/- X") which incorporates an allowed return on the Regulatory Asset Base ('RAB'). For the current regulatory period, this mechanism means the maximum allowable yield per passenger changes from 1 January each year by RPI minus 1.5% (RPI as at prior year April). The building blocks of this "Single Till" calculation are shown below. The CAA first determines the regulated 'revenue requirement'. This is calculated as the sum of forecast operating expenditure less non-aeronautical revenue, plus the required return (using the cost of capital determined by the CAA) on the forecast RAB taking into account forecast capital expenditure, plus regulatory depreciation the resulting revenue requirement divided by forecast passenger numbers produces the per passenger maximum allowable yield.

Heathrow's current regulatory period ('Q6') initially ran from 1 April 2014 to 31 December 2018 and was subsequently extended to 31 December 2019 under the same price control. Further information on the regulatory environment beyond 2019 is included in the Management review section of the Strategic report.

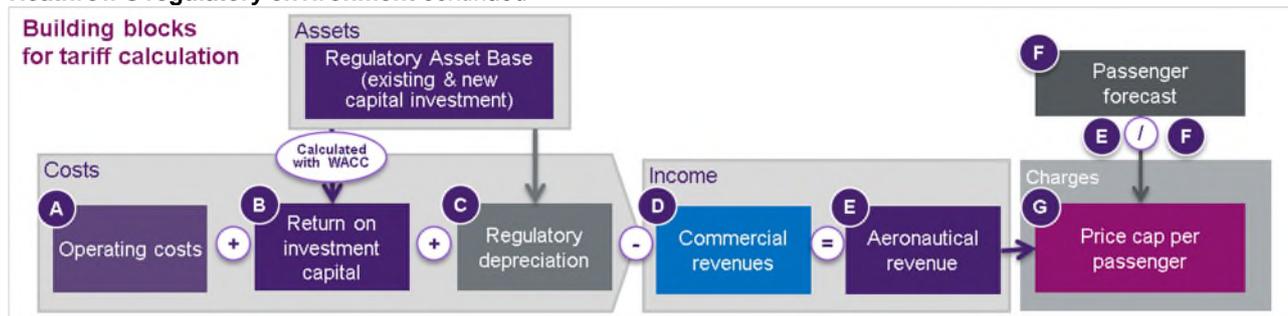
Heathrow's regulation is consistent with the economic regulation of other UK regulated industries (such as telecoms and the energy sector). This form of economic regulation is sometimes referred to as 'incentive regulation', in that Heathrow has an incentive to outperform the economic settlement by attracting more passengers, reducing operating costs or delivering higher commercial revenues. In the opposite case, Heathrow must absorb negative financial impact, with no adjustment for shortfalls in passenger numbers or additional costs unless agreed with the CAA, such as where Heathrow incurs additional security costs above an established threshold when implementing new security directives imposed by the EU or the UK Government. There is a mechanism (the 'K' factor) designed to correct for any under recovery (dilution) or over recovery (concentration) in charges compared to the maximum allowable yield, which may arise due to changes in passenger mix or load factors compared to those forecast at the time of price setting the during the prior year.

Heathrow Finance plc

Strategic report *continued*

Business overview *continued*

Heathrow's regulatory environment *continued*



Heathrow's income

Heathrow generates two primary types of income: *aeronautical income*, which is generated from fees charged to airlines for use of the airport's facilities, and *non-aeronautical income* from all other sources.

Aeronautical income

Aeronautical income reflects the fees charged by Heathrow to the airport's airline customers. These charges cannot exceed the regulated maximum allowable yield per passenger. The tariff structure can vary in consultation with stakeholders, but includes three key elements:

Passenger charges, based on the number of passengers per aircraft and levied in respect of all departing passengers. There is no charge in respect of crew members. Charges vary by route area: European, domestic and Rest-of-world.

Landing charges, levied for substantially all aircraft (with certain diplomatic and other flights being exempted). These are calculated in accordance with the certified maximum take-off weight and adjusted, where applicable, in accordance with each aircraft's noise-rating, emissions, and the time of day.

Parking charges, levied for each 15-minute slot after 30 and 90 minutes (narrow and wide-bodied aircraft respectively).

Non-aeronautical income

Non-aeronautical income is generated from a variety of sources. These include concession fees from retail operators; direct income from car parks, advertising revenue, VIP products, the rental of airport premises such as aircraft hangars, warehouses, cargo storage facilities, maintenance facilities, offices and airline lounges, the provision of facilities such as baggage handling and passenger check-in and fare revenue from the Heathrow Express rail service.

Alternative Performance Indicators (APMs)

Heathrow uses many performance indicators and metrics across the business to monitor and drive improvements in safety, efficiency and passenger experience. These are aligned to the four strategic objectives outlined in the Business overview (page 2). The indicators are set primarily at the beginning of a Regulatory period so that performance can be reliably and consistently tracked against the Regulatory settlement, and many have been tracked consistently across several regulatory periods. Most of the indicators and metrics used and disclosed in this report are also used widely across the Airport industry and so enable management and stakeholders to compare Heathrow performance against other similar airports.

A number of financial measures are included which have been categorised as Alternative Performance Measures (APMs) as per the European Securities and Markets Authority (ESMA) guidelines on use of non-GAAP Financial Measures. An APM in this report is a financial measure other than a measure defined under IFRS, used by Heathrow management when these measures provide stakeholders with useful and appropriate information. The Group uses such measures to measure operating performance and liquidity, in presentations to the Board and as a basis for strategic planning and forecasting, as well as monitoring certain aspects of its operating cash flow and liquidity. The Directors believe that these and similar measures are used widely by certain investors, securities analysts and other interested parties as supplemental measures of performance and liquidity.

The APMs may not be comparable to other similarly titled measures used by other companies and have limitations as analytical tools and should not be considered in isolation or as a substitute for analysis of the Group's operating results as reported under IFRS. An explanation of the relevance of each of the non-GAAP measures, a reconciliation of the non-GAAP measures to the most directly comparable measures calculated and presented in accordance with IFRS and a discussion of their limitations is set out below. The Group does not regard these non-GAAP measures as a substitute for, or superior to, the equivalent measures calculated and presented in accordance with IFRS or those calculated using financial measures that are calculated in accordance with IFRS.

Heathrow Finance plc

Strategic report *continued*

Business overview *continued*

Alternative Performance Indicators (APMs) *continued*

Primary financial statement format

The primary financial statements are prepared in accordance with IFRS as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 December 2018.

A columnar approach has been adopted in the Consolidated Income Statement (page 39) and the impact of certain items is shown in a separate column. This column includes certain re-measurements as listed in (i) and (ii), which management separates from the underlying operations of the Group. Also, this column indicates exceptional items as listed in (iii) and the effect on taxation of change in tax rates in (iv) and (v) below. By isolating certain re-measurements and exceptional items, management believe the underlying results provides the reader with an understanding of the performance of the Group by concentrating on the matters over which it exerts most influence, whilst recognising that information on these additional items is available with the financial statements should the reader wish to refer to them.

The column “certain re-measurements and exceptional items’ in the Consolidated Income Statement contains the following:

- fair value gains of losses on investment properties held by the Group,
- derivative financial instruments and the fair value gains or losses on any underlying hedged items that a part of a fair value hedging relationship,
- exceptional items,
- the associated tax impacts of the items in (i), (ii) and (iii) above, and
- the impact on deferred tax balances of known future changes in tax rates

The Group has defined the following financial measures as APMs derived from IFRS;

APM	Definition and use
EBITDA	<i>Earnings before interest, taxes, depreciation and amortisation</i> Used as a metric to track the operational performance of Heathrow including Revenue and Operating Costs before depreciation and amortisation. The Group presents EBITDA because it is widely used by securities analysts, investors and other interested parties to evaluate the profitability of companies. EBITDA eliminates potential differences in performance caused by variations in capital structures (affecting net finance costs), tax positions (such as the availability of net operating losses against which to relieve taxable profits), the cost and age of tangible assets (affecting relative depreciation expense) and the extent to which intangible assets are identifiable (affecting relative amortisation expense) EBITDA for the year-ended 31 December, 2018 was £1,951 million (2017: £1,909 million).
Adjusted EBITDA	<i>Adjusted Earnings before interest, taxes, depreciation, amortisation and certain re-measurements</i> Management uses Adjusted EBITDA to monitor performance of our segments and is therefore the measure of segment profit that the Group presents under IFRS. Adjusted EBITDA s also presented on a consolidated basis because management believes it is important to consider our profitability on a basis consistent with that of our operating segments. When presented on a consolidated basis, adjusted EBITDA is a non-GAAP measure. Management believes that adjusted EBITDA should therefore, be made available to securities analysts, investors and other interested parties to assist in their assessment of the trading performance of our business. Adjusted EBITDA is calculated by excluding certain remeasurements from EBITDA, namely the fair value movements on Investment properties which are mainly market driven and over which management has little influence. Adjusted EBITDA for the year-ended 31 December, 2018 was £1,837 million (2017: £1,760 million).
Adjusted operating profit	Adjusted Operating Profit is Profit before Finance costs and tax and certain re-measurements, namely the fair value movements on Investment properties. The reconciliation to IFRS is shown on the face of the Consolidated income statements. Adjusted operating profit for the year-ended 31 December, 2018 was £1,091 million (2017: £1,066 million).
Adjusted profit before tax	Adjusted Profit before tax is Profit before tax and certain re-measurements, namely the fair value movements on Investment properties and the fair value movements on financial instruments. The reconciliation to IFRS is shown on the face of the Consolidated income statements. Adjusted profit before tax for the year-ended 31 December, 2018 was £336 million (2017: £241 million).
Adjusted profit after tax	Adjusted Profit after tax is Profit before certain re-measurements, namely the fair value movements on Investment properties and the fair value movements on financial instruments and related tax charges or credits. The reconciliation to IFRS is shown on the face of the Consolidated income statements. Adjusted profit after tax for the year-ended 31 December, 2018 was £264 million (2017: £187 million).

Heathrow Finance plc

Strategic report *continued*

Alternative Performance Indicators (APMs) *continued*

The Group has defined the following financial measures as APMs derived from IFRS *continued*

Underlying net Finance costs	<p>Underlying net Finance costs are adjusted for capitalised borrowing costs and amortisation of finance fees and discounts. Management believes underlying net finance costs provide a year on year comparison of financing costs before accounting adjustments.</p> <p>The reconciliation from total finance costs to total Finance costs before certain re-measurements is shown on the face of the Consolidated income statement. The reconciliation from total Finance costs before certain re-measurements to Underlying Net Finance costs is shown on page 15. Underlying net Finance costs for the year-ended 31 December, 2018 were £782 million (2017: £838 million).</p>
Retail income per passenger	<p><i>Total Retail income divided by (unrounded) total number of departing and arriving passengers</i></p> <p>A widely used indicator for Airport commercial activities, used by management to drive lower the amount of required income needed through aeronautical charges.</p>

Regulatory performance measures

These regulatory performance measures are used to monitor progress against our regulatory settlements and other strategic objectives. As the regulatory performance measures are directly related and specifically defined within our Economic regulation, it would not make sense to use IFRS measures to track against our regulatory settlement.

RAB	<p><i>Regulatory Asset Base</i></p> <p>The regulated asset base is used in the Economic regulation pricing formula. It is a regulatory construct representing the invested capital on which Heathrow will earn a return. By investing efficiently in the Airport in consultation with our stakeholders, we add to the RAB over time. The RAB is reconciled to GAAP Fixed Assets in the separately published Regulatory Accounts. It is used in key financial ratios and the Regulatory accounts.</p> <p>The RAB at 31 December, 2018 was £16,200 million (2017: £15,786 million).</p>
Gearing and Regulatory Asset Ratios	<p><i>Gearing ratios</i></p> <p>Under the Group's financing agreements, gearing ratios are calculated by dividing consolidated nominal net debt by RAB. The Groups objectives when managing capital are to safeguard the Groups ability to continue as a going concern in order to provide return for shareholders, benefits to other stakeholders and to maintain an optimal capital structure. Amongst other methods, the Group monitors its capital using its gearing ratios. Like other regulated industries in the UK, gearing is referenced by the ratio of Consolidated nominal net debt to the RAB.</p> <p><i>Regulatory Asset Ratio (RAR)</i></p> <p>A trigger event at Class A and Class B and financial covenant at Heathrow Finance; Class A RAR trigger ratio is 72.5%; two Class B triggers apply: at Heathrow Finance it is 82.0% and at Heathrow (SP) Limited it is 85.0%; Heathrow Finance RAR covenant is 90.0% until Heathrow Finance 2019 Notes either mature, are repaid or consent is obtained to change covenant level from when covenant moves to 92.5%.</p>

Non-financial performance indicators

	Definition
ATM	<p><i>Air Transport Movement</i></p> <p>Commercial flights including schedules, used as a metric to track the operational performance of the Heathrow including schedules, charter and cargo, but excluding empty position movements or private aircraft. Passenger ATMs exclude cargo flights.</p>
ASQ	<p><i>Airport Service Quality</i></p> <p>An independent quarterly survey-based rating of Airports, administered by the Airports Council International. The score ranges from 1 to 5.</p>
Baggage Connection	<p><i>Percentage of connecting bags which travel with their passenger</i></p> <p>Shown either as a % or as number of bags per 1,000.</p>
Departure punctuality	<p><i>Percentage of flights departing within 15 minutes of scheduled departure time</i></p>
Security Queuing	<p><i>Percentage of departing passengers passing through security within a five minutes period</i></p> <p>This is prescribed under the CAA Service Quality Rebate Scheme to identify certain service standards that passengers should expect from Heathrow.</p>

Heathrow Finance plc

Strategic report *continued*

Management review

Review of the year

We continued to deliver strong performance in 2018 and welcomed a record 80 million passengers travelling through the UK's only hub airport, up 2.7% on last year. We are one of only seven airports in the world to have exceeded 80 million passengers in a single year, and the only airport to achieve this milestone with only 2 runways. Whilst continuing to deliver growth, we also sustained our high customer satisfaction scores and were named 'Best Airport in Western Europe' for the fourth year running, and 'Best Airport for Shopping' for the ninth year in the most recent Skytrax World Airport Awards.

We also progressed the four strategic priorities underpinning our vision to give our passengers the Best Airport Service in the World; making Heathrow a great place to work, transforming our service to passengers and airlines, beating the business plan over the current regulatory period and operating and growing Heathrow sustainably today and in the future.

Critical to the success of our vision is attracting, retaining and developing high quality talent. This is why making Heathrow a great place to work and creating careers where people can fulfil their potential is at the very heart of our strategy. In 2018 an outstanding 472 colleagues were promoted and 755 colleagues attended training to advance their managerial skills.

We delivered outstanding service to our passengers during our busiest year ever. We achieved an excellent 4.15 out of 5.0 score in the global Airport Service Quality (ASQ) survey in 2018 as well as maintaining our high levels of successful baggage connections and departures punctuality. In addition, reflecting the success of our pricing strategy to boost domestic connectivity, short haul traffic grew by 2.2% and intercontinental by 3.1%. Intercontinental growth continued to be driven by routes to North America through increased flight frequency and aircraft size, while passenger numbers to-and-from the Asia Pacific region also grew strongly driven by our new Chinese routes.

As part of our Heathrow 2.0 plan for sustainable growth, we released our Carbon Neutral Growth Roadmap, setting out a comprehensive set of measures that will become our plan for how, over the next decade, we will deliver our aspiration to make growth from our new runway carbon neutral. We also launched our Living Wage Roadmap, which shows how we will ensure that our supply chain will guarantee their employees the Living Wage. Building on Heathrow achieving Living Wage accreditation in 2017, the Roadmap sets ambitious goals for 100% of target contracts to be amended by the end of 2020.

Despite continuing to invest in winter resilience, special passenger assistance, security and expansion, we have continued to deliver declining costs per passenger. On the revenue side, aeronautical revenues grew by 1.7% compared to 2017 despite a delivering a 1% reduction in aeronautical revenue per passenger. Retail revenues grew by 8.6% as passengers responded strongly to several successful retail initiatives. We saw more passengers participating in our retail offering with each spending more. As a result of these dynamics, total revenues were almost £3 billion, up 3% on 2017. We raised close to £2.3 billion of debt financing globally in 2018, further strengthening our liquidity position and providing additional duration and diversification to our £14 billion consolidated debt.

2018 also saw the commencement of our plans to deliver expansion following the UK Parliament passing the airports National Policy Statement in June by a substantial majority.

We continue engaging with our regulator and airline stakeholders to define the regulatory framework that will enable expansion that is affordable, sustainable and financeable. Following the launch of our initial planning consultation in January 2018, we also launched a consultation on airspace changes in January 2019 and are making final preparations for the statutory consultation on our masterplan for expansion in mid-2019. These consultations provide an opportunity for our local community and other stakeholders to help us shape Heathrow's future.

Key business developments

Mojo

We are committed to making Heathrow a great place to work. We provide an environment where colleagues feel safe, proud, motivated and enjoy what they do. We continue to enhance our leadership capabilities and provide great career opportunities supported by some of the best development and training. In 2018, 472 colleagues were promoted and 755 colleagues attended training to advance their managerial skills.

We take a pragmatic and proactive approach to improving our Health and Safety credentials through engaging our colleagues. We have seen a positive shift in our culture and behaviours which remains a significant driver in achieving great results and preventing or reducing the likelihood of incidents occurring. In 2018, our lost time injuries metric improved to 0.33 (2017: 0.48).

Transform customer service

In 2018, we continued to deliver strong levels of service across the passenger journey. Over the period, average service standards reduced slightly compared to 2017 as a result of one of the worst winters in recent years and strong passenger growth putting pressure on some key processes such as check-in, security, immigration and baggage. Despite this, our service standards remained high throughout the year, with limited or no disruption to our operations.

Heathrow Finance plc

Strategic report *continued*

Management review *continued*

Key business developments *continued*

Transform customer service *continued*

In 2018, we achieved an ASQ score of 4.15 (2017: 4.16) out of 5.00 compared to 3.97 just five years ago. In addition, 81.9% of passengers surveyed rated their Heathrow experience 'Excellent' or 'Very good' (2017: 82.5%) illustrating the strength and resilience of our operations. As part of our drive to provide the best airport service in the world, we introduced our 'Service Signatures' programme highlighting a set of behaviours that help guide the way in which we all deliver an even better service to our passengers, customers and colleagues.

Key service standard performance indicators ⁽¹⁾	2018	2017
ASQ ²	4.15	4.16
Baggage connection ²	98.8%	99.0%
Departure punctuality ²	77.6%	80.2%
Security queuing ²	96.8%	97.3%

¹ For the twelve months ended 31 December 2018

² Airport service quality (ASQ), percentage of connecting bags travelling with the passenger (Baggage connection), percentage of flights departing within 15 minutes of schedule (Departure punctuality) and percentage of passengers passing through central security within five-minute period (Security queuing)

Investing in Heathrow

We invested £666 million in 2018 (2017: £604 million) on a variety of programmes to improve the passenger experience, airport resilience and work through a broad asset replacement programme. We also continue to develop our plans for expanding Heathrow for which investment amounted to an additional £127 million in the year (2017: £83 million).

Safety continued to be the priority for Heathrow and 2018 was the busiest and safest year in the quinquennium for our capital investment teams working across the airport, with the best ever performance on Safe Days (no. of days without a lost-time incident), peaking at 148 (2017: 112).

The next stage of Passenger Flow Monitoring went live, continuing the focus on passenger experience improvements by enabling the Airport Operations Centre to monitor passenger numbers and flow, predict congestion in key areas and direct resources in the most efficient and effective way possible. The roll out of self-service bag drop facilities maintained its momentum with 48 units going live in Terminals 5 alone.

We completed a significant project to install Oyster card electronic passenger gates at the Heathrow terminals of Heathrow Express enabling easier transfer for our passengers to-and-from London, and have received all relevant approvals to install the gates at Paddington during 2019.

The Hold Baggage Screening (HBS) upgrade works progressed well in 2018. Terminal 2 was certified as Standard 3 Department for Transport (DfT) compliant and Terminal 5 met the DfT target of 83% screened at Standard 3 by September 2018. The Terminal 5 programme remains on plan for the target of 100% screening at Standard 3 by April 2019.

Beat the plan

New intercontinental routes

We added 6 new direct routes to growth cities in China, doubling the number of connections from Heathrow, the UK's only hub and primary gateway airport to China. New routes were also announced to North America, with British Airways adding a new direct route to Pittsburgh and American Airways a new route to Phoenix, both commencing in April 2019.

Record passenger traffic

During 2018, we welcomed a record 80.1 million passengers, an increase of 2.7% on 2017 (2017: 78.0 million). December 2018 was the 26th consecutive month of record passenger numbers. Aircraft continue to fly fuller, with load factors increasing to 79.4% (2017: 78.0%). The average number of seats per passenger aircraft increased to 213.4 (2017: 212.3) driven by aircraft upgrades on European and Middle Eastern routes.

Reflecting the success of our pricing strategy to boost domestic connectivity, short haul traffic grew by 2.2% and intercontinental by 3.1%. Intercontinental growth continued to be driven by routes to North America through increased flight frequency and aircraft size, while passenger numbers to-and-from the Asia Pacific region also grew strongly driven by our new Chinese routes and increased frequencies to India.

Heathrow Finance plc

Strategic report *continued*

Management review *continued*

Beat the plan *continued*

Record passenger traffic *continued*

Passengers (Millions)	2018	2017	Var % ⁽¹⁾
UK	4.8	4.8	(0.1)
Europe	33.3	32.4	2.6
North America	18.1	17.4	4.3
Asia Pacific	11.5	11.3	2.4
Middle East	7.7	7.6	0.5
Africa	3.3	3.2	5.3
Latin America	1.4	1.3	4.4
Total passengers ⁽¹⁾	80.1	78.0	2.7

⁽¹⁾ Calculated using unrounded passenger figures

Key traffic performance indicators	2018	2017	Var %
Passenger ATM ⁽¹⁾	472,744	471,082	0.4
Load factors (%) ⁽¹⁾	79.4	78.0	1.8
Seats per ATM	213.4	212.3	0.5
Cargo tonnage ('000)	1,685	1,698	(0.8)

¹ Passenger air traffic movements (ATM) includes commercial flights including scheduled, chartered and cargo and excluding positioning and private flights, Load factor is a percentage of seats filled by passengers.

Sustainable growth

Heathrow 2.0

As part of our Heathrow 2.0 plan for sustainable growth we released our Carbon Neutral Growth Roadmap in November 2018. This set out a comprehensive set of measures that will become our plan for how, over the next decade, we will deliver our aspiration to make growth from our new runway carbon neutral. The Roadmap outlines four key action areas including cleaner aircraft technology, improvements to airspace and ground operations, sustainable aviation fuels and carbon offsetting methods. As an important step towards encouraging the development of commercial electric technology, in October we announced that the first electric-hybrid aircraft to be put into regular service at Heathrow will not have to pay landing charges for a year, a prize worth nearly £1 million.

2018 was a busy year for our charity partnerships as we launched a new partnership with CARE International UK. Through colleague and passenger fundraising, we are supporting CARE's 'Lend with care' programme which enables donors to make loans to entrepreneurs in developing countries, helping them to build a business and to lift themselves and their families out of poverty. We also ran our third 'Race the Plane' event, with funds raised benefitting the Duke of Edinburgh's Award Scheme and the Heathrow Community Fund. Over 400 cyclists raced a United Airlines flight from Heathrow to New York, with the teams working together to complete 30-minute sessions on stationary bikes outside Terminal 2. The teams managed to beat the plane, raising over £100,000 in the process.

In November we held the annual flagship Heathrow Business Summit, welcoming over 250 local small and medium enterprises (SMEs) to discuss contract opportunities with our business partners, as well as to gain insight on how businesses can export their products through Heathrow. We also progressed toward our commitment to open four Logistics Hubs across the UK to support delivery of Heathrow expansion, with airport delegates visiting all 65 interested sites on the longlist. The shortlist will be announced in Spring 2019.

We also launched our Living Wage Roadmap, which shows how we will ensure that our supply chain will guarantee their employees the Living Wage. Building on Heathrow achieving Living Wage accreditation in 2017, the Roadmap sets ambitious goals for 100% of target contracts to be amended by the end of 2020.

Throughout 2018, we have been considering how we can best engage our passengers with our sustainability strategy. Building on some detailed research carried out at the start of the year, in November we launched a campaign to highlight some of our key areas of focus and the actions passengers can take to contribute. For example, we have raised awareness that passengers can bring their own water bottles with them when they travel through Heathrow as we free refill points after security, helping to reduce single-use plastic bottles. We've partnered with 'Refill' to ensure directions to all refill points at the airport are included on their free-to-use smart phone app.

Heathrow Finance plc

Strategic report *continued*

Management review *continued*

Sustainable growth *continued*

Task force for climate related financial disclosures (TCFD)

We take seriously our responsibility to help develop a transparent, consistent and effective system for climate related financial disclosures. We already publish substantial quantities of information in publicly available sustainability reports, including in our Climate Change Adaptation report, in annual Sustainability Progress reports, and in our Carbon Footprint reporting. We will expand and improve our climate related disclosures within our Annual Report and financial statements in 2019 and beyond to ensure Heathrow provides clear and useful disclosures relevant to the lifespan of an Expanded Heathrow.

Key Expansion developments

We continue to make significant progress in expanding the airport following the overwhelming vote in Parliament in favour of the Airports National Policy Statement ('NPS') in June 2018. Initial ground surveys at 650 sites across the land required for the project have been completed and the airport is moving towards confirming its preferred masterplan. We have incorporated feedback from a successful initial public consultation at the start of 2018 and will hold two consultations in 2019 to seek further views on the plans. The first of those consultations on airspace and future runway operations is open until 4th March 2019 and will be followed by a consultation in June 2019 which will detail our preferred masterplan. The announcement of these consultations comes as the latest independent polling from Populus released in September 2018 continued to show that more local residents around Heathrow support than oppose Heathrow Expansion, a result which has been consistent since polling started in 2015. After reviewing and assessing feedback from the two consultations in 2019, we will prepare a final masterplan and submit a development consent order application to the Secretary of State in 2020, commencing a consenting process which will take a fixed period of 18 months. If Heathrow is granted development consent, the new runway is expected to open in 2026.

We are continuing strong engagement with businesses across the UK. We hosted 10 regional Business Summits in 2018 at various locations across the UK. These summits help to increase the number of SMEs in the airport's multi-billion-pound supply chain. We also launched an Innovation Partnership program inviting innovative ideas to help deliver the expansion plans more affordably and sustainably. After reviewing over 150 submissions we have announced a shortlist of 37 from varying contributors including local authorities, retail businesses and airline partners, which are now being developed into business cases for final consideration.

We remain committed to delivering a sustainable, affordable and financeable expanded airport. Heathrow's expansion programme will be entirely privately funded at no cost to the taxpayer. We are also committed to maintaining existing strong investment grade credit ratings throughout the period of expansion. We are confident that we can expand the airport whilst keeping passenger charges close to 2016 levels, representing value for money for consumers and meeting the Government's affordability challenge. Our proposals to expand Heathrow intend to unlock billions of pounds in Economic growth for the UK, create tens of thousands of new skilled jobs across the regions, meet tough environmental and noise limits, open up to 40 new long-haul trading links, improve domestic connectivity and secure a skills legacy for future generations. Over the next 12 months alone, we expect to sign around £150 million worth of contracts with British businesses, creating up to 900 new jobs and 200 new apprenticeships.

In parallel with the ongoing development consent process outlined above, we will continue to participate in the judicial review proceedings relating to the Government's decision to designate the Airports NPS, the hearing for which has now been set for March 2019. Securing consent for large-scale infrastructure projects often involves judicial review and we remain fully confident that the Government's decision-making process was robust. The Airports NPS was overwhelmingly approved by a significant cross-party majority in Parliament. To date, there have been no successful challenges against the designation of a NPS.

Regulatory developments

The CAA's fundamental objective in developing the framework for the next regulatory period (known as H7) is to strike an appropriate balance between affordability and financeability to support capacity expansion in the best interest of consumers. Guided by this objective, the CAA continues to progress its thinking on the H7 framework with a new consultation launched in October 2018: 'Economic regulation of capacity expansion at Heathrow: policy update and consultation' (CAP1722). In this consultation the CAA discusses a number of areas, outlined below;

- a) H7 is due to start in January 2022 and the CAA confirms that Heathrow should produce a Business Plan for H7 by the end of 2019 to commence the price setting process.
- b) The CAA assesses that there are merits to the case for a potential modification to Heathrow's license by means of a new condition promoting economy and efficiency in the operation, maintenance and development of the airport.
- c) The CAA provides a further update on its approach to issues raised by potential alternative arrangements for delivering new capacity at Heathrow airport.
- d) The CAA also consults on its decision regarding its surface access policy and confirms the "user pays" principle.

Heathrow Finance plc

Strategic report *continued*

Management review *continued*

Regulatory developments *continued*

Finally, alongside the consultation documents, the CAA published a report assessing representations on scarcity rents accruing to airlines operating at Heathrow. The report acknowledges the existence of scarcity rents and considers that further work is required to establish the value. It also dismisses the position that scarcity rents are competed away on a route by route basis. The CAA plans to provide additional clarity on the regulatory framework in Q2 2019 upon publication of the next consultation papers.

Delivering an affordable expanded Heathrow is a very important issue for consumers and airlines. We have worked closely with our airline partners to refine our master plan to meet the Government's challenge to deliver expansion with average charges close to 2016 levels in real terms. In addition to the work under way on the H7 framework, based on an MoU agreed with major carriers, a Formal Agreement has been finalised between Heathrow and airline lawyers on the airline charges to be applied prior to the start of H7. Under the Formal Agreement, we will offer a rebate to all airlines depending on actual passenger traffic volumes. The rebate creates an incentive for airlines to make better use of our existing capacity by way of a volume discount while also providing downside protection in the event that volumes were to fall below current levels prior to 2022. Another benefit of the Formal Agreement is that it will enable all parties to concentrate on the longer term aim of securing a regulatory settlement for H7 which will support affordable and financeable expansion of Heathrow. The deal remains subject to consultation with the CAA and is not intended to replace the standard regulatory process for H7 which will continue in line with the CAA timetable.

Brexit

We continue to monitor progress made by the UK Parliament as it debates the proposed Withdrawal Agreement. While the continued delays in reaching an agreement increase uncertainty for UK businesses, the aviation industry remains well positioned as a result of the EU aviation contingency plans.

These plans ensure that in a no deal scenario and subject to a reciprocal offer by the UK, airlines will be able to continue to fly between the EU and UK. In addition, UK citizens will be permitted to travel visa free in the EU for up to 90 days and the EU will continue to recognise the UK for the 'EU One Stop Aviation Security Regime'. While these contingency arrangements are only intended to be in place until the end of 2019, if enacted we anticipate that there will be very little, if any, impact on flights if the UK departs the EU without a deal.

Separately, the UK Government is continuing work to implement replacement Air Service Agreements (ASAs) for the 17 countries which are currently covered by the UK's membership of the EU. The Government has already indicated that a number of these ASAs, including the agreement with the US, have been agreed and the remaining agreements will be put in place well in advance of the termination of the EU contingency plans or the UK leaving the EU. These new ASAs, combined with the existing 111 bilateral agreements with international destinations, will ensure that the vast majority of traffic at Heathrow is unaffected by the outcome of the negotiations on the transition agreement.

We have a unique position as we are the UK's only hub airport and global gateway. We benefit from a very well diversified traffic mix, more stable passenger traffic and demand than any other European airport and a robust regulatory framework. We have taken an extremely responsible approach to both operational and financial planning for 2019. Extensive operational contingency plans have been developed which will help to minimise any potential impact on passengers. In addition to maintaining substantial headroom to our covenant levels, we raised close to £2.3 billion from global investors in 2018. This extends our liquidity horizon until March 2021 and ensures that Heathrow has sufficient resources to cope with a no-deal Brexit and still meet its obligations, including progressing our expansion plans.

Heathrow Finance plc

Strategic report *continued*

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 presentation of financial results

Heathrow Finance consolidated financial statements are prepared under International Financial Reporting Standards ('IFRSs').

Summary performance

In the year ended 31 December 2018, the Group's operating profit before certain re-measurements was £1,091 million (2017: £1,066 million) and its profit after tax including certain re-measurements was £412 million (2017: £503 million profit). Key performance indicators are shown below and described in more detail on pages 5 and 6.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Revenue	2,970	2,884
Operating costs before depreciation and amortisation	(1,133)	(1,124)
Adjusted EBITDA¹	1,837	1,760
Depreciation and amortisation	(746)	(694)
Adjusted operating profit²	1,091	1,066
Net finance costs before certain re-measurements	(755)	(823)
Adjusted profit before tax³	336	243
Tax charge on profit before certain re-measurements	(72)	(54)
Adjusted profit after tax³	264	189
Including certain re-measurements		
Fair value gain on investment properties	117	149
Fair value gain on financial instruments	38	213
Tax charge on certain re-measurements	(7)	(48)
Profit after tax	412	503

¹ Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation and certain re-measurements.

² Adjusted operating profit is adjusted EBITDA including depreciation and amortisation.

³ Adjusted profit is profit before re-measurements and tax thereon.

For the year ended 31 December 2018, Adjusted EBITDA was £1,837 million (2017: £1,760 million) and EBITDA was £1,954 million (2017: £1,909 million) after adjusting for fair value gain/(loss) on investment properties of £117 million (2017: £149 million).

Management uses Adjusted EBITDA to monitor performance of the segments as it believes it more appropriately reflects the underlying financial performance of the Group's operations. On a monthly basis management review results, paying particular attention to the airport operations over which it exercises control on a day-to-day basis.

Certain re-measurements comprise fair value movements on investment properties, which are mainly market-driven and over which management has little influence; fair value gains and losses on financial instruments which are subject to external financial market fluctuations; tax associated with these items and the effects of changes in tax rates, which are set by statute.

Revenue

In the year ended 31 December 2018, revenue increased 3.0% to £2,970 million (2017: £2,884 million).

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m	Change %
Aeronautical	1,745	1,716	1.7
Retail	716	659	8.6
Other	509	509	0.0
Total revenue	2,970	2,884	3.0

Aeronautical income continues to benefit from record traffic growth offset by recoverable yield dilution as airlines employ cleaner and quieter aircraft as incentivised by our tariff structure. We continue to deliver strong value for passengers with average aeronautical revenue per passenger decreasing by 1% to £21.78. (2017: £22.00).

Heathrow Finance plc

Strategic report *continued*

Financial review *continued*

Revenue *continued*

	Year ended 31 December 2018	Year ended 31 December 2017	Change
	£m	£m	%
Retail concessions	323	304	6.3
Catering	61	56	8.9
Other retail ¹	128	109	17.4
Car parking	126	120	5.0
Other services ²	78	70	11.4
Total retail revenue	716	659	8.6

¹ Other retail mainly consists of Bureaux de Change, Advertising, left luggage and vending.

² Other services mainly includes Car rental, Fast Track services and VIP charges.

Retail revenue growth was strong across all revenue streams, with retail concession reflecting higher passenger numbers as well as our 'call-to-gate' initiative which increases passenger dwell time in the departure lounges. Retail concessions were additionally boosted by the roll out of new digital capability on the online Heathrow boutique, allowing customers to reserve and collect their shopping, with 52 brands now offering this service. Catering also benefitted from the call-to-gate initiative, and strong performance in the year was further enhanced by refurbishments in Terminals 3 and 5, as well as 'Grab & Go' offerings for passengers to take meals with them on their flights. Other retail reflects a significant increase in advertising income due mainly to improved utilisation of advertising sites. Retail revenue per passenger rose 5.8% to £8.94 (2017: £8.45).

	Year ended 31 December 2018	Year ended 31 December 2017	Change
	£m	£m	%
Other regulated charges	243	240	1.3
Heathrow Express	123	127	(3.1)
Property and other	143	142	0.7
Total other revenue	509	509	0.0

Other revenue remained consistent with last year. Other regulated charges grew through more passengers resulting in more bags being processed. Heathrow Express revenue declined with the cession of Heathrow connect services.

Operating costs before depreciation and amortisation

Operating costs excluding depreciation and amortisation increased 0.8% to £1,133 million (2017: £1,124 million). Operating costs per passenger excluding depreciation and amortisation declined by 1.9% to £14.14 (2017: £14.41).

	Year ended 31 December 2018	Year ended 31 December 2017	Change
	£m	£m	%
Employment	378	374	1.1
Operational	264	252	4.8
Maintenance	176	176	0.0
Business rates	122	126	(3.2)
Utilities and Other	193	196	(1.5)
Operating costs before depreciation and amortisation	1,133	1,124	0.8

Operating cost increases were primarily driven by expansion and investment in safety, security and resilience. In the early part of the year, we spent over £5 million in ensuring operations ran with limited disruption during one of the worst winters in recent years. We also increased investment in our special assistance services, security costs to aid operational resilience and upgrading drone defence capabilities.

On a per passenger basis, costs have declined through cost efficiencies in people-related areas and a decline in Business Rates, offsetting increased pension charges including a one-off Guaranteed Minimum Payment equalisation of past service costs, and higher staff numbers to manage service and resilience while passenger numbers continue to increase.

Operating profit before certain re-measurements

In the year ended 31 December 2018, the Group recorded an operating profit before certain re-measurements of £1,091 million (2017: £1,066 million). Adjusted EBITDA increased 4.4% to £1,837 million (2017: £1,760 million), resulting in an Adjusted EBITDA margin of 61.9% (2017: 61.0%). Depreciation and amortisation increased to £746 million (2017: £694 million).

Heathrow Finance plc

Strategic report *continued*

Financial review *continued*

Operating profit before certain re-measurements *continued*

	Year ended 31 December 2018	Year ended 31 December 2017	Change
	£m	£m	%
Adjusted EBITDA	1,837	1,760	4.4
Depreciation and amortisation	(746)	(694)	7.5
Operating profit before certain re-measurements	1,091	1,066	2.3

Taxation

The tax charge for the period, before certain re-measurements, was £72 million (2017: £54 million) resulting in an effective tax rate of 21.4% (2017: 22.4%), compared to the UK statutory rate of 19% (2017: 19.25%). The effective tax rate being higher than the statutory rate reflects the fact that a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief. The total tax charge for the year was £79 million (2017: £102 million). For the period ended 31 December 2018, the Group paid £70 million (2017: £53 million) in corporation tax.

Summary cash flow

In the year ended 31 December 2018, there was an increase of £72 million in cash and cash equivalents compared with an increase of £237 million in 2017.

At 31 December 2018, the Group had £715 million (2017: £535 million) of cash, cash equivalents and term deposits of which, cash and cash equivalents were £595 million (2017: £523 million).

Cash generated from operations

In the year ended 31 December 2018, cash generated from operations increased 3.3% to £1,790 million (2017: £1,732 million). The following table reconciles Adjusted EBITDA to cash generated from operations.

	Year ended 31 December 2018	Year ended 31 December 2017
	£m	£m
Adjusted EBITDA	1,837	1,760
Increase in receivables and inventories ¹	(46)	(7)
Increase/ in payables	14	8
Increase/(decrease) in provisions	-	(7)
Difference between pension charge and cash contributions	(15)	(22)
Cash generated from operations	1,790	1,732

¹ Excludes movement in group deposits

Restricted payments

In the year ended 31 December 2018, our ultimate shareholders received £500 million in dividends (2017: £525 million) reflecting the continued strong performance of the business. This made up a substantial proportion of the total controlled payments paid from Heathrow Finance plc in the year which amounted to £422 million net or £497 million gross. Other than payments to fund dividends to ultimate shareholders, net controlled payments related principally to funds available of £75 million of loan facilities from ADI Finance 2 Limited ('ADIF2') and £3 million (2017: £11 million) of interest payments at ADIF2.

Recent financing activity

We have raised close to £2.3 billion of debt financing globally in 2018, further strengthening our liquidity position and providing additional duration and diversification to our £14 billion debt portfolio. Of the £2.3 billion of debt financing raised, just over £1,124 million was in Class A debt excluding extensions to existing facilities, £381 million in Class B debt and £786 million of new debt at Heathrow Finance.

Class A financing activity included:

- a £145 million 18-year Class A US private placement and a £55 million US Private Placement due in 2043,
- a C\$400 million 10-year public bond and a second C\$400 million 12-year bond issuance (the first issuance by a UK based company with a maturity date beyond 10 years in the Canadian market),
- a £160 million 40-year Class A inflation-linked bond,
- a A\$175 million 10-year Class A bond (our first issuance in the Australian market),
- a £200 million 10-year Class A term loan facility with Export Development Canada ('EDC'), the Canadian Export Credit Agency with a 12 month availability period,
- an amendment to an existing £418 million term loan facility to extend its maturity from March 2020 to October 2021, and
- restructuring of the £600 million liquidity facility to a 5-year rolling facility.

Heathrow Finance plc

Strategic report *continued*

Financial review *continued*

Recent financing activity *continued*

Class B financing activity included:

- a) a £255 million in private placements which mature between 2036 and 2041, and
- b) a dual-tranche £126 million inflation-linked bond with maturities of 15 year and 18 year which will fund in March 2020.

Finally, financing activity at Heathrow Finance included:

- a) a £300 million 5.5-year bond, and
- b) £486 million in loan facilities which will be drawn between 2018 and 2020

Subsequent to the year-end, we also issued an irrevocable redemption notice for our 2019 Heathrow Finance bond on 28 January 2019.

Financing position

Net debt and liquidity

At 31 December 2018, Group's nominal net debt was £13,980 million (31 December 2017: £13,673 million). It comprised £12,585 million in bond issues, £1,622 million in other term debt and £488 million in index-linked derivative accretion. This was offset by £715 million in cash and cash equivalents and term deposits. Nominal net debt comprised £11,054 million in senior net debt and £1,353 million in junior debt at the Company's subsidiaries and £1,573 million at the Company itself.

The average cost of the Group's nominal gross debt at 31 December 2018 was 3.73 % (31 December 2017: 3.92%). This includes interest rate, cross-currency and index-linked hedge impacts and excludes index-linked accretion. Including index-linked accretion, the Group's average cost of debt at 31 December 2018 was 5.31% (31 December 2017: 5.62%). The reduction in the average cost of debt since the end of 2017 is mainly due to:

- a) the replacement in 2018 of relatively high cost maturing legacy debt with newer lower cost debt; and
- b) recent moves in inflation with the retail price index ('RPI') inflation falling from a high of 3.9% in September 2017 to 3.4% in June 2018.

The average life of Group's gross debt as at 31 December 2018 was 11.1 years (2017: 11.4 years).

Nominal debt excludes any restricted cash and the debenture between Heathrow SP and Heathrow Finance. It includes all components used in calculating gearing ratios under Group's financing agreements including index-linked accretion.

The accounting value of Group's net debt was £13,712 million at 31 December 2018 (2017: £13,597 million). This includes £715 million of cash and cash equivalents and term deposits as reflected in the statement of financial position and excludes accrued interest.

We have sufficient liquidity to meet its forecast needs in full until March 2021. This includes forecast capital investment (including expected investment over the period related to potential expansion), debt service costs, debt maturities and distributions. This liquidity position takes into account £2.9 billion in undrawn loan facilities and term debt as well as cash resources at 31 December 2018 together with expected operating cash flow over the period.

Debt at Heathrow Finance plc

The consolidated nominal net debt of Heathrow Finance increased to £13,980 million (2017: £13,674 million). This comprised the Heathrow SP's £12,407 million nominal net debt, Heathrow Finance's nominal gross debt of £1,577 million and cash held at Heathrow Finance of £4 million.

Net finance costs and net interest paid

In the year ended 31 December 2018, the Group's net finance costs before certain re-measurements, from operations, were £755 million (2017: £825 million) and net interest paid was £532 million (2017: £549 million). 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 2018 £m	Year ended 31 December 2017 £m
Net finance costs before certain re-measurements	755	825
Amortisation of financing fees and other items	(23)	(33)
Borrowing costs capitalised	50	46
Underlying net finance costs	782	838
Non-cash accretion on index-linked instruments	(254)	(270)
Other movements	4	(19)
Net interest paid	532	549

Heathrow Finance plc

Strategic report *continued*

Financial review *continued*

Net finance costs and net interest paid *continued*

Underlying net finance costs were £782 million (2017: £838 million) after adjusting for capitalised borrowing costs of £50 million (2017: £46 million) and non-cash amortisation of financing fees, discounts and fair value adjustments of debt of £23 million (2017: £33 million). The increase in underlying net finance costs reflects higher index-linked accretion due to higher inflation in the period.

Net interest paid was £532 million (2017: £549 million) of which £475 million (2017: £495 million) was paid by the Company's subsidiaries and £57 million (2017: £54 million) was paid by the Company.

Net interest paid is lower than underlying net finance costs primarily due to a £254 million (2017: £270 million) non-cash charge relating to accretion on index-linked instruments

Certain re-measurements include a £38 million fair value gain on financial instruments (2017: £213 million) driven mainly by an increase in long term Libor interest rate expectations.

Financial ratios

The Group continues to operate comfortably within required financial ratios. Gearing ratios under the Group's financing agreements are calculated by dividing using consolidated nominal net debt to Heathrow's Regulatory Asset Base ('RAB') value. At 31 December 2018, Heathrow's RAB was £16,200 million (2017: £15,786 million).

Group's senior (Class A) and junior (Class B) gearing ratios were 68.2% and 76.6% respectively (31 December 2017: 67.3% and 78.4% respectively). Heathrow Finance's gearing ratio was 86.3% (31 December 2017: 86.6%).

Pension scheme

Heathrow operates a defined benefit pension scheme (the BAA Pension Scheme) which closed to new members in June 2008. At 31 December 2018, the defined benefit pension scheme as measured under IAS 19 was funded at 100.7% (31 December 2017: 97.1%). This translated into a surplus of £28 million (31 December 2017: £124 million deficit). The £152 million increase in surplus in the year is primarily due to net actuarial gains of £141 million, attributable to an increase in the net discount rate of 0.45% over the year offset by assets having underperformed relative to the discount rate. In 2018, Heathrow contributed £48 million (31 December 2017: £50 million) into the defined benefit pension scheme including £23 million (31 December 2017: £23 million) in deficit repair contributions. Management believes that the scheme has no significant plan specific or concentration risks.

Outlook

The outlook for Adjusted EBITDA performance in 2019 remains consistent with the forecast set out in the Investor Report published on 20 December 2018. We also forecast to maintain comfortable covenant headroom.

2019 will see significant progress on our expansion plans including the recent launch of a consultation on airspace change in January and the launch of the formal statutory consultation on our expansion masterplan in June.

Key management changes

Chris Garton joined the company as Chief Operating Officer ('COO') in April 2018. He held a similar position for nine years at Dubai Airport until late 2016. He was most recently Director of Asset Management at Associated British Ports. During his career, Chris has also held a number of roles in engineering and change management at Gatwick Airport, Ineos and ICI. Mr Garton replaced Mr Derek Provan, who had been interim COO since October 2017.

Heathrow Finance plc

Strategic report *continued*

Leadership and governance

The discussion in this section is extracted from the financial statements of Heathrow Airport Holdings Limited, since the functions of the Board and Board Committees of Heathrow Airport Holdings Limited are applied equally to this Company.

Board of Directors of Heathrow Airport Holdings Limited

The Board consists of the Chief Executive Officer, the Chief Financial Officer and Non-Executive Directors. Board Meetings are attended also by the Company Secretary. More than half of the board are Non-Executive Directors. The majority of the Non-Executive Directors are shareholder representatives. The remaining minority are independent Non-Executive Directors.

The Board determines the Heathrow Airport Holdings Group's long-term strategy, to ensure that the Group acts ethically and has the necessary resources to meet its objectives, to monitor performance and to ensure the Group meets its responsibilities as a leading airport company.

Board Committees

Audit Committee

The Audit Committee members include a chairman appointed by the Board of Directors and three shareholder Non-Executive Directors, who also attend the Board. Together they have appropriate competence in accounting and auditing.

Olivier Fortin (Chair)	Non-Executive Director
Jorge Gil	Non-Executive Director
Akbar Al Baker	Non-Executive Director
Ernesto Lopez	Non-Executive Director

The Audit Committee is a sub-committee of the Board and its responsibilities include:

- considering the appointment of the external auditor, taking into account relevant ethical guidance and assessing the independence of the external auditor ensuring that key audit personnel are rotated at appropriate intervals (including overseeing the process for selecting the external auditor and making recommendations to the Board),
- recommending the audit fee to the Board for approval and pre-approving any fees in respect of non-audit services provided by the external auditor and ensuring that the provision of non-audit services does not impair the external auditor's independence or objectivity,
- discussing with the external auditor the nature and the scope of the audit and reviewing the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements,
- reviewing reports on the effectiveness of systems for internal financial control, financial reporting and risk management;
- monitoring the integrity of the financial statements of the Group and reviewing, and challenging where necessary, the actions and judgements of management, in relation to the interim and annual financial statements and any press release related to those statements,
- reviewing Internal Audit reports to the Audit Committee on the effectiveness of the Heathrow Airport Holdings Group's systems for internal control, financial reporting and risk management,
- reviewing the external auditor's management letter and management's responses,
- considering management's response to any major external or internal Audit recommendations,
- approving the appointment and dismissal of the Director of Internal Audit, Risk and Assurance,
- reviewing Heathrow's procedures for handling allegations from whistle-blowers,
- reviewing the ethics policy and monitoring its application throughout the business, considering any ethical issues which arise as a result of audit findings,
- overseeing all press releases relating to external financial results,
- reviewing Heathrow's tax policy and insurance strategy and arrangements,
- reviewing the results of the Data Protection Officer's data privacy compliance monitoring programme and ensuring that the Data Protection Office is adequately resourced to carry out its tasks,
- considering the adequacy of management's response to any major data privacy non-compliance findings as a result of monitoring activities,
- ensuring that the accounts are fair, balanced and understandable, and
- considering any other topics, as defined by the Board.

Nomination Committee

The Nomination Committee members include the Chairman of the Board, an independent Non-Executive Director and four shareholder Non-Executive Directors who attend the Board.

Paul Deighton (Chair)	Chairman of the Board
Jorge Gil	Non-Executive Director
Akbar Al-Baker	Non-Executive Director
Stuart Baldwin	Non-Executive Director
Mike Powell	Non-Executive Director
Rachel Lomax	Non-Executive Director

Heathrow Finance plc

Strategic report *continued*

Leadership and governance *continued*

Board Committees *continued*

Nomination Committee *continued*

The Nomination Committee is a sub-committee of the Board and its responsibilities include:

- identifying and recommending for the consideration of the Board all new appointments of independent Non-Executive directors; and
- ensuring a formal, rigorous and transparent procedure is followed for the appointment of new independent Non-Executive directors to the Board.

Remuneration Committee

The Remuneration Committee members include a chairman appointed by the Board, three shareholder Non-Executive Directors who attend the Board and one independent Non-Executive Director.

Jorge Gil (Chair)	Non-Executive Director
Ernesto Lopez	Non-Executive Director
Stuart Baldwin	Non-Executive Director
Ahmed Al-Hammadi	Non-Executive Director
Rachel Lomax	Non-Executive Director

The Remuneration Committee is a sub-committee of the Board and its responsibilities include approvals of:

- the remuneration policy of the members of the Executive Committee and Senior Managers,
- the compensation packages of the members of the Executive Committee (other than the Chief Executive Officer) including salary, bonus, pensions and other incentive compensation,
- the contractual terms for the members of the Executive Committee and independent Non-Executive Directors,
- the design and terms of bonus plans including approval of off-cycle bonus payments outside bonus guidelines including sign on, retention and guaranteed bonuses,
- the design and terms of long term incentive plans, and
- succession planning for the members of the Executive Committee.

Finance Committee

The Finance Committee members include a chairman appointed by the largest shareholder of FGP Topco Limited, the Chief Executive Officer, the Chief Financial Officer and a Non-Executive Director representing each shareholder entitled to appoint a director to the Board.

The Finance Committee is a sub-committee of the Board and also acts as a forum for obtaining consents required from the shareholders of FGP Topco Limited.

The Finance Committee is responsible for approving various matters relating to the Group's debt financing arrangements prior to their implementation including approvals of:

- any prospectus or other listing document required in relation to the issuance of any capital markets instruments or any formal information memorandum in relation to borrowing by any member of the Group,
- the borrowing of any money or the assumption of any indebtedness by any member of the Group (including by way of the issue of securities) in excess of certain financial thresholds,
- the refinancing of any existing indebtedness in respect of any member of the Group in excess of certain financial thresholds,
- the making of any repayments of principal in addition to scheduled principal payments on any debt that may be owing by any member of the Group,
- other than as required by the financing arrangements of any member of the Group, the making of any material loan or advance or giving of any guarantee, indemnity or provision of any credit, in each case in excess of certain financial thresholds,
- the creation of, or the granting of any permission to create, any mortgage, charge, encumbrance or other security interest on any uncalled capital or on any asset, in each case in excess of certain financial thresholds,
- any material change, amendment or variation to any of the financing arrangements of any member of the group or any request for any waiver thereunder or any entry into any new loan or loan facility, in each case in excess of certain financial thresholds,
- the entry into any new Non-Investment Grade Debt facility, and
- the bi-annual publication of investor reports in respect of Heathrow (SP) Limited and Heathrow Finance plc, pursuant to the requirements of the Common Terms Agreement and the Heathrow Finance financing arrangements.

Heathrow Finance plc

Strategic report *continued*

Leadership and governance *continued*

Board Committees *continued*

Executive Committee

The Executive Committee consists of the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, the Chief Information Officer, the Chief of Staff and Group General Counsel, the Chief People Officer, Expansion Director, Chief Commercial Officer and Chief Strategy Officer.

The Executive Committee is the management committee of the Chief Executive and is responsible for, among other things, developing, reviewing and refreshing medium and long term Group business strategies, policies and development plans for Board approval, agreeing short-term tactics and action plans to ensure their delivery and reviewing the principal risks and the risk management framework.

Executive Risk Committee

The Risk Committee is chaired by the Chief of Staff and Group General Counsel and consists of the Chief Financial Officer, the Chief Operating Officer, the Expansion Director and the Chief Strategy Officer. It is responsible for reviewing the effectiveness of the risk management strategy and framework and for reviewing the principal risks. The Risk Committee is a sub-committee of the Executive Committee.

Sustainability and Operational Risk Committee

The Sustainability and Operational Risk Committee (formerly the Responsible Heathrow and Operational Risk Committee) is chaired by an independent Non-Executive Director and its members include the Chief Executive Officer and three shareholder Non-Executive Directors who attend the Board.

David Begg (Chair)	Non-Executive Director
John Holland-Kaye	Chief Executive Officer
Jorge Gil	Non-Executive Director
Olivier Fortin	Non-Executive Director
Akbar Al-Baker	Non-Executive Director

The Sustainability and Operational Risk Committee is a sub-committee of the Board and its responsibilities include:

- reviewing Heathrow's policies, conduct, performance and risk management approach against sustainability goals and operational activities;
- reviewing and challenging the performance and conduct of the Group relating to operational risks and delivery of sustainability goals;
- monitoring and challenging management over the effectiveness of the relevant internal control systems and having access to any audit or assurance report it considers relevant;
- reviewing and assessing management's response to significant operational incidents and having access to any accident and investigation report it considers relevant; and
- monitoring and challenging the appropriateness of Sustainability and operational risk assurance strategies and plans, the execution and results of such plans, and relevant communications.

Heathrow Finance plc

Strategic report *continued*

Internal controls and risk management

Internal controls and risk management are key elements of the Group's corporate operations. Risk is centrally managed within the Group as part of Corporate Services provided under the Shared Services Agreement ('SSA') by a fully dedicated senior team. The Corporate risk management function, sets the strategy for risk management to provide the necessary framework to ensure that key risks are managed and embeds a sustainable risk management culture that views the execution of risk management processes and practices across Heathrow as a key enabler to Heathrow achieving its business objectives.

Internal controls

The directors are responsible for the system of internal controls designed to mitigate the risks faced by the Group and for reviewing the effectiveness of the system. This is implemented by applying the 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 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;
- Audit Committee review of 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 and estimates;
 - key financial statement risk areas as reported further below in the report;
- independent review of controls by the Internal Audit function, reporting to the AC; and
- a confidential whistleblowing process.

Risk management

Our aim is to gain a deep understanding of the principal risks we face at all levels of the business and to focus management attention on effective mitigation of these risks as well as a review of over-the-horizon emerging risks which may impact the business and strategy of Heathrow.

We continue to roll out a risk improvement plan which is focussed on improving accountability for end-to-end risk management at all levels and drive improvements in our risk culture. The risk improvement plan covers all the key elements of an effective risk management framework including risk leadership, informed risk decision making, competency and risk skills, governance including timeliness and transparency of risk information and clarity of accountability for managing risks. We assess and monitor our risk maturity across all key areas and drive improvements where required.

Principal risks

Our principal risks are aligned to our 4 strategic priorities as follows:

- to be a great place to work, we will help our people fulfil their potential and work together to lead change across Heathrow with energy and pride;
- to give passengers the best airport service in the world we'll work with the Heathrow community to transform the service we give to passengers and airlines, improving punctuality and resilience;
- to secure future investment we will beat the Q6 business plan and deliver a competitive return to our shareholders by growing our revenue, reducing costs and delivering investments more efficiently; and
- to grow and operate our airport sustainably, now and in the future.

The principal risks identified by the Executive Committee are:

Business resilience

Business resilience risks can relate to Heathrow's assets, infrastructure, human or electronic processes or systems, the failure of which, by accident or deliberate act, could result in prolonged periods of interruption to critical services/operations and passenger experience. There are a number of circumstances that can pose short-term risks to the normal operations at the airport 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 Heathrow's location. These conditions can have a particularly significant impact where, due to operating close to full capacity, there is negligible spare capacity to utilise in recovering from some of the above conditions.

Heathrow Finance plc

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Principal risks *continued*

Where possible the Group seeks to anticipate the effects of these events on its operations and also maintains contingency plans to minimise disruption and passenger inconvenience working as necessary with those parties who have direct contractual responsibility. Through a series of programmes the Group seeks to keep a competent, flexible and motivated workforce that can respond to a changing business and operating environment. By driving engagement in its people the Group will achieve its goals and give excellent passenger service, avoid safety and security incidents, protect resilience and deliver successful change.

People

Heathrow employs around 6,700 colleagues and, in a complex business such as Heathrow's, there are risks associated with recruiting, screening, motivating, developing and training employees on a large scale, as well as rewarding appropriately and retaining critical talent and ensuring succession plans are in place.

Heathrow has a transparent recruitment process and is committed to recruiting diverse talented individuals from all sectors of the community. Heathrow has committed to reflecting local diversity at all levels in the company by 2025. At all stages of the recruitment and selection process, interviewing and selection will always be carried out without regard to gender, sexual orientation, disability, marital status, colour, race, ethnic origins, religion or religious belief or age. Any candidate with a disability will not be excluded unless it is clear that the candidate is unable to perform a duty which is intrinsic to the role, having taken into account any reasonable adjustments. Reasonable adjustments to the recruitment process will be made to ensure an applicant is not disadvantaged due to his/her disability. All successful external candidates are subject to a criminal records check and the appropriate security clearance as required by the role.

Heathrow has strategies and policies in place to engage and motivate its colleagues so they are excited and challenged by their work environment, accountable and compliant with internal governance, policies and procedures. Heathrow provides great career opportunities, development and training, retaining talent and knowledge and preventing single points of failure.

Anti-corruption and anti-bribery matters

Heathrow takes a zero-tolerance approach to bribery and corruption, and is committed to conducting its business in an honest and ethical manner, in compliance with the Bribery Act 2010 (the "Bribery Act") and applicable anti-bribery and anti-corruption laws. Breach of anti-bribery provisions by Heathrow employees, paid or voluntary agents, consultants or suppliers could result in Heathrow breaching the Bribery Act by failing to prevent an act of bribery being committed. If Heathrow is found guilty of such an offence, Heathrow could face an unlimited fine, exclusion from tendering for public companies, as well as significant reputational damage. As such, Heathrow embeds and maintains robust Anti-Bribery, Gifts & Hospitality Policy and Guidance (the "Anti-Bribery Policy") and other effective systems and controls to prevent bribery and corruption at Heathrow. All employees and third parties associated with Heathrow are required to conduct themselves according to the standards set out in the Anti-Bribery Policy. Any breach of the Anti-Bribery Policy will result in disciplinary action, and, if appropriate, in instant dismissal and referral to the relevant law enforcement authorities. In addition, our Whistleblowing Policy encourages individuals to report any wrong-doing which extends to bribery and corruption matters. All whistleblowing reports are treated in the strictest confidence and are investigated fully with appropriate actions taken.

Corporate social responsibility

Heathrow understands the importance to its business of the communities in which it operates, and through consultation and engagement seeks to ensure that their concerns are taken into account in the operation and planning of Heathrow. It may restrict opportunities to grow and threaten Heathrow's social license to operate if local communities do not believe the airport is managed responsibly or that its economic benefits are optimised without prioritising profits over the long-term interests of local communities.

Environmental risk has the potential to impact negatively upon Heathrow's reputation and jeopardise its licence to operate and to grow.

The Group undertakes procurement responsibly and encourages trade and employment opportunities for local communities. Progressive influencing of third parties, stakeholder engagement and community relations programmes are also established.

Proactive environmental management systems and employee training programmes are embedded within operations through clear environmental strategies and resource conservation initiatives. The Group works closely with a range of stakeholders to ensure that it reacts effectively to the challenges posed by the environmental agenda.

Heathrow Finance plc

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Stakeholders

Poor interactions and relationships with key stakeholders including partners, suppliers and airlines could negatively impact passenger experience, airport operations, financial performance and Heathrow's reputation.

Heathrow aims to manage its contracts effectively and share with airport partners the information it may hold about their service providers. This is underpinned by robust and responsible procurement practices which consider the resilience and sustainability of suppliers before contracts are commenced with them, as well as frequent monitoring of their operational performance once they commence business with the airport.

Legal, regulation and compliance

Operations at Heathrow airport are currently subject to economic regulatory review by the CAA normally every five years. Its principal risks relate to changes in economic regulations, non-compliance with these and other regulations, licence conditions, financing covenants, contractual requirements and penalties for failing to comply with competition and relevant EU law. Failure to comply with laws and regulations can have far reaching consequences, including loss of licence, penalties, claims and litigation, reputational damage and loss of stakeholder confidence.

The risk of an adverse outcome from economic regulatory 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. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, reduces the risk of Heathrow breaching laws, regulations and contractual requirements.

Health and safety

Heathrow has a statutory and moral responsibility to ensure that it safeguards the welfare and safety of its people, business partners and the public who may be affected by its activities. Heathrow recognises that a failure to exercise this responsibility effectively also risks operational disruption, inconvenience to passengers and long-term damage to its reputation.

Heathrow'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 airport's business. Heathrow also operates robust asset management processes to ensure property and equipment remains safe. Governance, led by the airport's senior management teams, and assurance processes are used to ensure that controls around health and safety risks remain effective and continuous improvement is encouraged.

Security

Heathrow is responsible for ensuring that its assets, infrastructure, human and electronic systems and processes meet the minimum statutory requirements to protect aviation security, deliver high security standards and build confidence with regulators, airlines and passengers. It also needs to ensure that its assets, infrastructure, human and electronic systems are protected from theft, damage or intrusion.

Security risks, including cyber security, terrorism risks, and information security are mitigated by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading edge security technology. Heathrow works closely with airlines and government agencies including the police 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.

Strategic direction and management of change

Heathrow airport is operating its runways at close to full capacity and failure to secure the necessary Development Consent Order, following a robust consultation process, for the third runway, for which Heathrow is the preferred choice of the UK Government, could lead to increased congestion, passenger delay and lack of opportunity for the UK.

Monitoring developments in the global aviation market and the levels of passenger satisfaction with different airports around the world provides input to the ongoing relevance of the Group's strategy. The Group also needs to influence the pace and direction of changes to regulations, legislation, government policy, aviation and the wider economy and ensure that it does not lose airlines' support for expansion.

Heathrow recognises that failure to control key development costs and delivery could damage its financial standing and reputation. There are risks that projects fail to deliver to the agreed quality, specification, time and budget as well as risks that the benefits of change are not realised, return on investments not realised and transformation not delivered.

The planning process for all major national infrastructure projects in the UK sets out a number of steps that the Group needs to go through to obtain development consent to expand Heathrow: a National Policy Statement, a Development Consent Order and public consultation before a final decision is taken by the UK Government for the third runway. The Group's planning process is well underway and it is building an organisation and expertise to ensure this process runs

Heathrow Finance plc

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Strategic direction and management of change *continued*

smoothly. Heathrow will undertake extensive consultations with community groups and authorities at a local level and is an active participant in government consultations and other advisory groups.

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 Heathrow. 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. Risks associated with the uncertainties arising from the current Brexit negotiations are monitored and managed as far as possible including putting in place contingency plans.

The regulatory framework requires formal engagement with airline customers. Helping manage the risk of adverse airline relations, all airlines are invited to be represented on engagement fora – e.g. joint steering groups. When feedback is sought or processes are measured, robust steps have been put in place to ensure confidentiality and neutrality of interpretation. In addition, key stakeholders are engaged on a joint planning basis which provides airlines with the opportunity to air views and share plans, thereby ensuring their ongoing requirements are articulated and understood.

Heathrow mitigates project risks 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.

Brexit

We continue to monitor progress made by the UK Parliament as it debates how to progress towards Brexit. While the continued delays in reaching an agreement increase uncertainty for UK businesses, the aviation industry remains well positioned as a result of the EU aviation contingency plans.

Heathrow has established a cross-functional Brexit team, reporting to the Executive committee and Board, which has implemented a structured approach to the identification and management of all risks related to Brexit. Heathrow has focused on the management of risks associated with the outcome of the Withdrawal Agreement negotiations and government votes.

Identified risks specific to Heathrow include impacts on Airline operations, disruption to our passengers and immigration, cargo operations, our supply chain, and our people. We have made preparations to ensure the continued safe and secure operation for passengers with a plan jointly created with stakeholders to deliver a predictable and appropriate passenger experience and which minimizes the pre- and post-Brexit impacts. Specific activities include:

- close collaboration in contingency planning across the aviation sector, agencies and Government,
- advancing proposals for automating immigration process for specific nations,
- funding settled status for our non-UK EU national workers,
- commitment to the prompt payment code for our supply chain,
- advanced procurement of key operational stores,
- continued commitment and assurance on major capital programmes to our supply chain,
- contingency fallback plans for our key suppliers, and
- reviewed operational contingency and readiness plans

In parallel, the UK Government is continuing work to implement replacement Air Service Agreements for the 17 countries which are currently covered by the UK's membership of the EU. If the outcome of the negotiations is a 'no deal' exit without a withdrawal agreement then, subject to a reciprocal offer by the UK, UK airlines will be able to continue to fly between the EU and UK. In addition, UK citizens will be permitted to travel visa free in the EU for up to 90 days and the EU will continue to recognise the UK for 'EU One Stop Aviation Security Regime'.

Whilst these contingency arrangements are only intended to be in place until the end of 2019, if enacted, we anticipate that there will be very little, if any, impact on flights in the event that MPs vote against the Withdrawal Agreement. The Government has already indicated that a number of these ASA's, including the agreement with the US, have been agreed and the remaining agreements will be put in place well in advance of the termination of the EU contingency plans or the UK leaving the EU. These new ASA's, combined with the existing 111 bilateral agreements with international destinations, will ensure that the vast majority of traffic at Heathrow is unaffected by the outcome of the negotiations on the transition agreement.

In the more extreme scenario, a portion of Heathrow traffic (flying between UK and EU) may stop flying for a short period of time and there may be capacity reductions for an extended period. We have conducted stress testing in this scenario, including impacts on costs and revenue, and financing our capital investment program and this showed we have significant resilience to this outcome. This analysis has been presented to the Board.

Heathrow Finance plc

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Financial stability

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 Group's business operations and funding. To achieve this, the 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.

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 2018, fixed rate debt after hedging with derivatives represented 90% (2017: 97%) 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 issuance 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. The Heathrow Finance platform is rated BB+/Ba3 and supports both loan and bond debt. Covenants are standardised wherever possible and are monitored on an ongoing basis with formal testing reported to the Audit Committee, the Board and Executive Committee.

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

Heathrow Finance has positive cash flows after capital expenditure and interest and expects to have sufficient liquidity to meet all its obligations in full, including capital investment, debt service costs, debt maturities and distributions, up to March 2021. As at 31 December 2018, the Group had cash and cash equivalents and term deposits of £715 million, undrawn headroom under revolving credit facilities of £1,150 million, committed debt financing to be drawn after 31 December 2018 of £1,053 million and undrawn headroom under liquidity facilities of £595 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 generally no cash or cash equivalents are placed with counterparties with short-term credit ratings lower than A-2 (S&P)/F1 (Fitch). 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)/BBB+ (Fitch).

Heathrow Finance plc

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Financial statements risk

The Audit Committee reviewed critical accounting judgements and key sources of estimation uncertainty outlined in the “Accounting policies” section of the financial statements. Based on the discussion with the management, work and

recommendation of the Group finance function and input from external auditor, the Committee considered that the most significant financial statements risk matters are as follows:

(i) *Classification of costs between operating expenditure and capital expenditure*

The Group has a substantial Q6 capital programme which has been agreed with the regulator (the Civil Aviation Authority) and therefore incurs significant expenditure investing in assets to improve operational performance, airport resilience and passenger experience. Since October 2016, the Group has also begun investing in Expansion.

Only those costs which satisfy the requirements of IAS16 ‘Property, Plant and Equipment’ should be capitalised, which in some cases requires management judgement. Controls and processes related to capital expenditure are directed by the Fixed Asset Steering Group (chaired by the CFO), which reports regularly to the Audit Committee through formal Committee papers and provides them with the opportunity to scrutinise and challenge the judgement made.

The Group has a Property, plant and equipment (“PP&E”) Accounting Policy, which outlines the requirements for costs to be eligible for capitalisation and a separate Capitalised Interest Policy which applies to interest costs incurred whilst a project is under construction. Both the PP&E Accounting Policy and the Capitalised Interest Policy are formally published on and communicated to management and employees via the Group’s intranet site. These policies are applied and their application is monitored on a regular basis to ensure that all costs eligible for capitalisation and interest costs incurred whilst a project is under construction are correctly capitalised. The PP&E Accounting Policy has been updated to ensure clarity around the treatment of costs relating to Expansion.

Each capital project follows a defined project governance process. This includes a Financial Assurance Review by the Heathrow Finance department which concludes on the appropriate accounting treatment in accordance with the Group’s capitalisation policy for the expenditure to be incurred on the project. The project governance process also includes each project being reviewed and approved by the relevant Governance Groups, including the Heathrow Investment Committee for significant projects.

The spend on the project is reviewed and approved by appropriate delegated financial authorities ensuring the correct classification of cost. The Programme Management Office (PMO) is responsible for tracking and monitoring spend against the project cost plan, and when the project is completed a final review of costs incurred is carried out by Finance before transferring the capital cost of the project to the Fixed Asset Register.

Heathrow is currently in the process of obtaining a Development Consent Order (DCO) for Expansion. Particular emphasis is being placed on ensuring that capitalised costs will deliver future economic benefit and are directly attributable to obtaining DCO, through regular reviews and senior leadership involvement. The CAA and independent consultants have also been engaged in reviewing planned and actual capitalised costs (ex ante and ex post) to ensure that they are efficient, incremental, and directly attributable to obtaining DCO. During the year ended 31 December 2018, the Group recorded £127 million of such expansion related costs in assets in the course of construction (2017: £83 million)

(ii) *Hedge accounting*

The Group designates certain derivative financial instruments as cash flow hedges where they hedge exposure to variability in cash flows of existing liability or forecast transaction. Significant changes in the expected quantum of future Sterling refinancing may lead to insufficient Sterling borrowings to support components of the cash flow hedge reserve, requiring the recycling of the cash flow hedge reserves through income statement.

Certain ineffectiveness can arise during the hedging process. The main sources of hedge ineffectiveness are considered to be timing differences, credit risk adjustments and currency basis.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for cash flow hedge accounting, any cumulative gain or loss in equity remains in equity and is recycled on a straight line basis as the forecast transaction is recognised in the income statement. When or if a forecast transaction is no longer expected to occur, the cumulative gain or loss in equity is immediately recycled through the income statement.

Heathrow Finance plc

Strategic report *continued*

Internal controls and risk management *continued*

Risk management *continued*

Financial statements risk *continued*

The Group documents as follows:

- at 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;
- both at inception and on an ongoing basis, its assessment of whether the derivative financial instruments used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

On a quarterly basis, management:

- compares existing and historic hedging arrangements against expectations of future refinancing of Sterling denominated borrowings;
- reviews floating Sterling debt supporting the existing Cash Flow Hedge Reserve ('CFHR') to ensure the debt is greater than swap notional, which supports the existing designations.

On a quarterly basis, management provides updates to the Audit Committee on CFHR and its assumptions.

(iii) Fair value of derivative financial instruments

The Group holds a substantial derivative financial instruments portfolio comprising interest rate swaps, cross currency swaps, and index-linked swaps which are accounted for at fair value. In determining the fair value, judgement is used to determine the recovery rate and associated reduction in credit risk of super senior ranking derivatives (interest rate and index-linked swaps). Due to the significance of the Group's derivative financial instruments and the related estimation uncertainty, there is a risk that derivative financial instruments are not valued based on appropriate assumptions and / or estimates.

The valuation of the Group's derivative financial instruments is determined through the application of a discounted cash flow approach and the use of inputs based on observable market data where these are available. The fair value of cross-currency, interest rate and index-linked swaps is calculated as the present value of the estimated future cash flows based on observable yield curves. The credit risk associated with the Group's derivative financial instruments is updated monthly based on current market data. The recovery rate and associated reduction in credit risk of super senior ranking derivatives (interest rate and index-linked swaps) is validated quarterly with a counterparty bank.

(iv) Fair value of investment properties

The Group holds a variety of investment properties that are accounted for at fair value. In determining the fair value, judgement is required with regard to a number of valuation assumptions that include property rental growth rate, operating cost and expected yields.

Independent valuations are obtained for all investment properties. The valuations are prepared in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations are 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) is capitalised using yields derived from market evidence. This market evidence also takes into account planned transactions and use of the property.

The report was approved and authorised by the Board and was issued on behalf of the Board.



Javier Echave
Director

20 February 2019

Heathrow Finance plc

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2018.

Principal activity

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, owner of Heathrow Airport Limited, operator of the Heathrow Express rail service and owner of Heathrow Funding Limited, the bond issuer of the Group.

A review of the progress of the Group's business during the year, the key performance indicators, internal controls, principal business risks and likely future developments are contained in the Strategic report on pages 2 to 26.

Results and dividends

The profit after taxation for the financial year amounted to £412 million (2017: £503 million profit).

Dividends of £497 million (2017: £335 million) were paid to Heathrow (DSH) Limited during the year. The dividend payments were utilised primarily to fund dividends to the Group's ultimate shareholders and to repay and service external debt at the Group's holding companies.

The statutory results for the year are set out on page 39.

Directors

The directors who served during the year and since the year end, except where noted, were as follows:

Yuanyuan Ding	Appointed 27 March 2018
Javier Echave	
Andrew Efiog	Resigned 23 March 2018
Nicholas Golding	

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, 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.

Colleagues with disabilities 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 in line with the Equality Act (2010). Where employees have become disabled during the course of employment, the Group endeavours to ensure continuing employment in line with the Reasonable Adjustments Policy as agreed between the Group and the recognised Trade Unions (Unite, PCS and Prospect).

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 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. A Share In Success saver scheme in which eligible employees can save money which the company matches as a contribution in line with business performance has been in place since 2015. In addition, some senior management participate in long-term incentive plans which also rewards based on group performance.

The Group has no direct employees. The staff are employed by LHR Airports Limited, a fellow subsidiary entity of the Heathrow Airport Holdings group. The Group directly incurs the employment cost of services provided to the Group as stated in the Accounting policies on page 44.

Heathrow Finance plc

Directors' report *continued*

Donations

The Group's charitable donations for the year amounted to £1 million (2017: £2 million). The beneficiaries of charitable donations, the relevant amounts donated and the activities of these beneficiaries are as follows:

Beneficiaries	Contribution	Summary of activities
LHR Airport Communities Trust	£725,000	LHR Airport Communities Trust is an independently run grant-making charity which operates the Heathrow Community Fund (HCF). As well as input funding from Heathrow, the Trust receives noise fines levied on airlines when they break noise regulations and money generated through fundraising by Heathrow colleagues and others. The Trust's grant programme supports significant and positive improvement in quality of life for communities near the airport. It also supports colleague volunteering and fundraising to improve the community or a cause they believe in.
Duke of Edinburgh's Award Scheme	£200,000	The Duke of Edinburgh's Award (DofE) programme of volunteering and challenges transforms young people's confidence, skills and wellbeing. Our partnership gives colleagues the chance to unlock their potential. They can pick from a programme of DofE-themed activities designed to build self-belief and team-working abilities. This includes taking on challenges and offering work experience days for local young people. DofE receives a combination of input funding from Heathrow and money generated through fundraising by Heathrow colleagues and others.
Other	£30,000	In addition to our official charity partnerships, Heathrow occasionally gives discretionary funding on an ad-hoc basis and facilitates colleagues and passengers to support national charitable campaigns.

In 2018 Heathrow launched a new partnership with CARE International UK, specifically to enable Heathrow passengers and colleagues to support entrepreneurs living in poverty around the world, through the 'Lend with care' initiative. 'Lend with care' is an online lending platform that allows you to personally give entrepreneurs much-needed access to credit and training. This money is then used to help change the lives of those living in poverty. CARE receives donations from Heathrow's passengers and money generated through fundraising by Heathrow colleagues and others.

In 2018 Heathrow and Oxfam's 5-year partnership came to an end. The aim was to promote the idea of a shared global community. This reflected Heathrow's objective of being a responsible gateway to the world and Oxfam's role in supporting the most vulnerable people in over 90 countries. Many colleagues engage with the partnership through fundraising and participation in challenge events. Oxfam received donations from Heathrow's passengers and money generated through fundraising by Heathrow colleagues and others.

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 20 to 26 in the 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 20 to 26 in the Internal controls and risk management section of the Strategic report.

Non-Financial Reporting Requirements

We aim to meet all disclosure and reporting requirements relating to Non-Financial matters both with the Annual Report and Accounts and elsewhere in published information on the Heathrow.com website. The matters below are referenced to where further information can be found within this report.

• Environmental matters	Sustainable Growth Business Resilience	Page 9 Pages 20 to 23
• Colleagues	Corporate social responsibility Colleague Policies Health and Safety	Page 21 Page 21 and 27 Pages 7 and 22
• Anti-corruption and Bribery Policy		Page 21
• Social matters	Charitable Donations	Page 28
• Security of the Airport and Passengers		Page 22
• Leadership and Governance		Pages 17 to 20
• Description of Principal Risks	Business Risks Financial management risks	Pages 20 to 21 Pages 73 to 78
• Description of the Heathrow Business Model		Pages 2 to 5
• Non-financial performance indicators/APMs		Page 6
• Research and development and innovation		Page 10

Heathrow Finance plc

Directors' report *continued*

Subsequent events

Subsequent events are disclosed in note 27.

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 them in defending any proceedings in which judgement is given in their favour, or in which they are 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. This indemnity also applies to the directors who are directors of other companies within the group.

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.

After a comprehensive tender process the board have appointed PricewaterhouseCoopers (PwC) as auditor of the group for the financial year ending 31 December 2020.

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/she ought to have taken as a director in order to make himself/herself 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.

The report was approved and authorised by the Board and was issued on behalf of the Board.



Javier Echave
Director

 February 2019

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 International Financial Reporting Standards (IFRSs) 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), including FRS 101 "Reduced Disclosure Framework". 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 company and of the profit or loss of the company for that period.

In preparing the parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements 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.

In preparing the group financial statements, International Accounting Standard 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 IFRSs 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.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the 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 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 company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The report was approved and authorised by the Board and was issued on behalf of the Board.



Javier Echave
Director

20 February 2019

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018

Opinion

In our opinion:

- the financial statements of Heathrow Finance plc (the 'parent company') and its subsidiaries (the 'group') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board (IASB);
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the consolidated income statement;
- the consolidated statement of comprehensive income;
- the consolidated and parent company statements of financial position;
- the consolidated statement of changes in equity;
- the consolidated statement of cash flows;
- the group and parent statement of accounting policies;
- the group and parent significant accounting judgements and estimates; and
- the related notes to the consolidated financial statements 1 to 27 and to the parent company financial statements 1 to 11.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters

The key audit matters that we identified in the current year were:

- Property, plant and equipment: classification of costs and completeness of depreciation
- Financial instruments: derivative valuations and appropriateness of hedge accounting for new and restructured trades; and
- Valuation of investment properties: car parks

Within this report, any new key audit matters are identified with and any key audit matters which are the same as the prior year identified with.

Materiality

The materiality that we used for the group financial statements was £58.5 million which was determined on the basis of 3.2% of Adjusted EBITDA.

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018 *continued*

Scoping	We performed full scope audit procedures, which accounted for 100% of the Group's total net assets and 100% of the Group's EBITDA.
Significant changes in our approach	As at 31 December 2018, assets in course of construction have increased to £1,113 million (31 December 2017: £893 million). Therefore, in the current year we have increased the scope of the key audit matter in relation to Property, plant and equipment to include the completeness of depreciation. Apart from this, there have been no other significant changes to our audit approach.

Conclusions relating to going concern

We considered as part of our risk assessment the nature of the group, its business model and related risks including where relevant the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the directors' assessment of the group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the directors' plans for future actions in relation to their going concern assessment.

We have nothing material to report in respect of these matters.

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Property, Plant and Equipment: Classification of costs and completeness of depreciation

Key audit matter description In the year ended 31 December 2018, the Group has capitalised £768 million (2017: £683 million) of costs as shown in note 6.

We identified two key areas in relation to Property, Plant and Equipment:

Classification of costs: determining whether expenditure meets the capitalisation criteria, specifically with regard to whether they are operational or capital in nature, can involve significant management judgement when assessing whether capitalisation is in line with IAS 16 and the Group's accounting policy. Further, management incentivisation is linked to EBITDA, and as the allowed return is linked to the Regulated Asset Base, which is based on the fixed asset balance, we have assessed a potential fraud risk over inappropriate capitalisation.

Completeness of depreciation – determining when assets are 'ready for use' and requiring commencement of depreciation, particularly given the large number of projects, is complex. There are many assets ready for use, which are not included in the fixed asset register, and thus system-calculated depreciation is not possible. These assets require a manual process to ensure that depreciation is charged. Therefore, we have assessed completeness of depreciation in respect of assets in the course of construction as a key audit matter.

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018 *continued*

	<p>The Audit Committee's discussion of this key audit matter is set out on page 25 of the annual report. The Significant accounting judgements and estimates on page 61 also sets out the Group's critical judgements regarding capitalisation.</p>
<p>How the scope of our audit responded to the key audit matter</p>	<p>We performed the following audit procedures:</p> <ul style="list-style-type: none"> Assessed the design and implementation and tested the operating effectiveness of key controls surrounding the capitalisation of costs and the manual transfer process; For a sample of projects: <ul style="list-style-type: none"> examined management's assessment for capitalising costs against the requirements of IAS 16; challenged key assumptions and estimates in the capital project business case process, and evaluated whether there was appropriate capital project authorisation; challenged whether assets were ready for use; and verified a sample of capitalised costs invoice to assess whether they were appropriately accounted for, including costs associated with expansion. Audited management's capitalisation policy, including application, to and assess consistency with the requirements set out by IAS 16; Recalculated the depreciation charge for a sample of manually transferred assets from assets in the course of construction to the main asset pools; and Used analytics to recalculate the depreciation charge for the current year.
<p>Key observations</p>	<p>We are satisfied that costs have been appropriately capitalised in line with IAS 16. We are satisfied that assets 'ready for use' have started depreciating appropriately.</p>

Financial Instruments: derivative valuation and appropriateness of hedge accounting for new and restructured trades

<p>Key audit matter description</p>	<p>At 31 December 2018 the Group has total borrowings of £14,735 million (31 December 2017: £14,390 million). The Group has a net derivative liability of £1,019 million (2017: £852 million liability).</p> <p>IFRS 9 "Financial Instruments" requires derivatives to be accounted for at fair value with movements recognised in profit or loss, unless designated in a hedge relationship. Where possible, management has elected to apply hedge accounting. We have identified the following as key risks area, due to their complexity:</p> <ul style="list-style-type: none"> the valuation of financial instruments, specifically in relation to new and restructured trades; and the accounting impact of swap restructures and the eligibility of hedge accounting for new and restructured trades. <p>As noted on the Audit Committee section on page 25 and 26 of the Annual Report and page 61 in the Group's critical judgements. The Group holds a substantial derivative portfolio comprising interest rate swaps, cross currency swaps and retail price index ("RPI") swaps, which are recorded at fair value. These are held to mitigate interest rate and foreign exchange risk arising on material levels of debt due to the capital programme, as well as inflation risk which arises on inflation linked revenue.</p>
<p>How the scope of our audit responded to the key audit matter</p>	<p>We, with the involvement of our financial instruments' specialists performed the following audit procedures:</p>

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018 *continued*

	<ul style="list-style-type: none"> Assessed the design and implementation and tested the operating effectiveness of key controls relating to valuation of derivatives and hedge accounting; Performed an independent recalculation on all new trades and restructured swaps, including the credit risk adjustment in order to assess the appropriateness of the valuation; Performed a test on a sample basis of whether the criteria for hedge accounting has been met and assessed whether the hedges are effective – including all new and restructured hedges; Evaluated whether there is sufficient debt, of the correct type (sterling fixed or floating), to support the de-designated swaps that include amounts amortising from the cash flow hedge reserve; and <p>Tested the accounting entries for fair value calculations and hedge effectiveness, including the allocation between equity and the income statement.</p>
Key observations	<p>We are satisfied that the valuation of new trades and restructured swaps are reasonable.</p> <p>We are satisfied that hedged items have met the criteria for hedge accounting in line with IFRS 9.</p>
Valuation of Investment Property: Car Parks	
Key audit matter description	<p>As at 31 December 2018, the Group holds £2,472 million (31 December 2017: £2,350 million) of investment properties around Heathrow Airport including rental properties (residential and commercial), car parks, fuel farms and advertising sites.</p> <p>The car park portfolio totals 54% of the investment property balance as at 31 December 2018 (31 December 2017: 67%). In accordance with the Group's accounting policies, these assets are accounted for in accordance with IAS 40 "Investment Property". The risk is that properties are not fair valued using appropriate assumptions. We identified a key audit matter in relation to the valuation of the car parks due to the high levels of judgement required in management's discounted cash flow valuation method – specifically the growth rates applied.</p> <p>CBRE (management's valuer) apply a blanket growth rate of 2.5% (2017: 2%) on the car park cash flows. We consider this to require management judgement, firstly in the establishment of an appropriate growth rate, but also as each car park is separately operated and thus they will have different growth rates.</p> <p>The fair value gain impacts EBITDA and therefore we have assessed a fraud risk over inappropriate cash flow forecasts which are a key input for the valuation of the car parks.</p> <p>The Audit Committee's discussion of this key audit matter is set out on page 26 of the annual report. The Significant accounting judgements and estimates on page 61 also sets out the Group's key sources of estimation uncertainty for investment properties.</p>
How the scope of our audit responded to the key audit matter	<p>We, together with our Real Estate Valuations specialists have:</p> <ul style="list-style-type: none"> Assessed the design and implementation of key controls relating to valuation of car parks; held discussions with CBRE and management to understand changes to valuations and key assumptions, including consideration of the impact of Brexit; assessed CBRE's qualifications and independence as management's expert; reviewed the valuation approach used by CBRE including challenging their car park valuations, supporting information and market commentary; and <p>audited the information provided to CBRE on a sample basis to assess for accuracy.</p>
Key observations	<p>We are satisfied that the growth rate assumption on car parks is reasonable and that the valuations have been performed appropriately in line with IAS 40.</p>

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018 *continued*

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	£58.5 million (2017: £59.5 million)	£57.9 million (2017: £56.0 million)
Basis for determining materiality	Materiality has been determined on the same benchmark as the 2017 materiality and equates to 3.2% (2017: 3.4%) of Adjusted EBITDA. Adjusted EBITDA is before certain remeasurements, and include fair value gain on investment properties and fair value gains and losses on any underlying hedged items.	0.9% (2017: 0.9%) of net assets.
Rationale for the benchmark applied	The Group operates stable trading business. We have used a profit-adjusted measure of Adjusted EBITDA before exceptional items as the benchmark which reflects the Group's underlying trading performance and is consistent with the Group's internal and external reporting. In addition, we excluded exceptional items that cause potential volatility to the selected measure.	The main purpose of the parent company is investment holding and we have therefore used net assets as the benchmark.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £3.0 million (2017: £3.1 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our Group audit for the current and prior year was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we performed full scope audit procedures of all five subsidiaries of the group plus the parent company, which covered 100% of the Group's total net assets and EBITDA. The materiality applied to these subsidiaries ranged from £1.4 million to £57.9 million (2017: £1.5 million to £56.0 million). The Group team audits all of the subsidiaries directly.

At the Parent Company level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

We have nothing to report in respect of these matters.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018 *continued*

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management, internal audit and the audit committee, including obtaining and reviewing supporting documentation, concerning the group's policies and procedures relating to:
 - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
 - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
 - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- discussing among the engagement team and involving relevant internal specialists, including tax, financial instrument valuations, pensions, IT and real estate valuation specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas:
 - Plant, property and equipment – capitalisation of costs which directly impacts EBITDA and the Regulated Asset Base which is linked to business performance and the allowed return respectively; and
 - Valuation of Investment property – car park cash flow forecast accuracy impacts the fair value movement which directly impacts EBITDA
- obtaining an understanding of the legal and regulatory frameworks that the group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the group. The key laws and regulations we considered in this context included the UK Companies Act, tax legislation, Health and Safety at work Act 1994 and Employment law. In addition, compliance with terms of the Heathrow Airport Limited operating licence and the regulatory solvency requirements are fundamental to the Group's ability to continue as a going concern.

Audit response to risks identified

As a result of performing the above, we identified property, plant and equipment: classification of costs and completeness of depreciation and valuation of investment property: car parks as key audit matters. The key audit matters section of our report explains these matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018 *continued*

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and enquiring with management regarding any correspondence with HMRC, Civil Aviation Authority and Office of Rail and Road; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of this matter.

Other matters

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the Board of Directors on 14 July 2010 to audit the financial statements for the year ending 31 December 2010 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 9 years, covering the years ending 31 December 2010 to 31 December 2018.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

Heathrow Finance plc

Independent auditor's report to the members of Heathrow Finance plc for the year ended 31 December 2018 *continued*

Use of our report

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.

A handwritten signature in black ink, appearing to read 'Simon Cleveland', written in a cursive style.

Simon Cleveland FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
21 February 2019

Heathrow Finance plc

Consolidated income statement for the year ended 31 December 2018

	Note	Year ended 31 December 2018			Year ended 31 December 2017		
		Before certain re-measurements £m	Certain re-measurements ¹ £m	Total £m	Before certain re-measurements £m	Certain re-measurements ¹ £m	Total £m
Continuing operations							
Revenue	1	2,970	-	2,970	2,884	-	2,884
Operating costs	2	(1,879)	-	(1,879)	(1,818)	-	(1,818)
Other operating items							
Fair value gain on investment properties	7	-	117	117	-	149	149
Operating profit		1,091	117	1,208	1,066	149	1,215
Financing							
Finance income ³		27	-	27	15	-	15
Finance costs ³		(782)	38	(744)	(840)	215	(625)
	3	(755)	38	(717)	(825)	215	(610)
Profit before tax		336	155	491	241	364	605
Tax charge		(72)	(7)	(79)	(54)	(48)	(102)
Taxation charge	4	(72)	(7)	(79)	(54)	(48)	(102)
Profit for the year²		264	148	412	187	316	503

¹ Certain re-measurements consist of: fair value gains 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 associated tax impact of these.

² Attributable to owners of the parent.

³ Prior year finance income and finance costs have been restated by (£198) million and £198 million respectively to present interest payable and receivable on derivatives not in a hedge accounting relationship as a single unit of account (net) through finance cost.

Heathrow Finance plc

Consolidated statement of comprehensive income for the year ended 31 December 2018

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<i>Note</i>		
Profit for the year	412	503
<i>Items that will not be subsequently reclassified to the consolidated income statement:</i>		
Actuarial loss on pensions		
(Loss)/gain on plan assets ¹	21,20	(192)
Decrease/(increase) in scheme liabilities ¹	21,20	310
Tax relating to indexation of operational land	15,21,20	-
		62
		(116)
		2
<i>Items that may be subsequently reclassified to the consolidated income statement:</i>		
Cash flow hedges:		
Losses taken to equity ¹	20	(162)
Transfer to finance costs ¹	20	198
		(105)
		121
Other comprehensive profit/(loss) for the year net of tax	154	(36)
Total comprehensive income for the year	566	467
Attributable to owners of the parent	566	467

¹ Items in the statement above are disclosed net of tax. The tax relating to each component of other comprehensive income is disclosed in Note 20.

Heathrow Finance plc

Consolidated statement of financial position as at 31 December 2018

	Note	31 December 2018 £m	31 December 2017 £m
Assets			
Non-current assets			
Property, plant and equipment	6	11,575	11,481
Investment properties	7	2,472	2,350
Intangible assets	8	173	175
Retirement benefit surplus		28	-
Derivative financial instruments	13	543	444
Trade and other receivables	10	602	601
		15,393	15,051
Current assets			
Inventories	9	13	11
Trade and other receivables	10	391	320
Derivative financial instruments	13	-	170
Term deposits	11	120	12
Cash and cash equivalents	11	595	523
		1,119	1,036
Total assets		16,512	16,087
Liabilities			
Non-current liabilities			
Borrowings	12	(13,993)	(13,035)
Derivative financial instruments	13	(1,523)	(1,459)
Deferred income tax liabilities	15	(917)	(905)
Retirement benefit obligations	16	(32)	(158)
Provisions	17	(1)	(8)
Trade and other payables	18	(7)	(7)
		(16,473)	(15,572)
Current liabilities			
Borrowings	12	(742)	(1,355)
Derivative financial instruments	13	(39)	(7)
Provisions	17	(13)	(6)
Current income tax liabilities		(54)	(37)
Trade and other payables	18	(433)	(418)
		(1,281)	(1,823)
Total liabilities		(17,754)	(17,395)
Net liabilities		(1,242)	(1,308)
Equity			
Capital and reserves			
Share capital	19	3,109	3,109
Merger reserve		(994)	(994)
Cash flow hedge reserve		(216)	(252)
Retained earnings	21	(3,141)	(3,171)
Total shareholder's equity		(1,242)	(1,308)

These financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 20 February 2019. They were signed on its behalf by:


Javier Echave
 Director


Nicholas Golding
 Director

Heathrow Finance plc

Consolidated statement of changes in equity for the year ended 31 December 2018

	Note	Attributable to owners of the Company				Total equity £m
		Share capital £m	Merger reserve £m	Cash flow hedge reserve £m	Retained earnings £m	
1 January 2017		3,109	(994)	(268)	(3,287)	(1,440)
Comprehensive income:						
Profit for the year					503	503
Other comprehensive income:						
Fair value gains on cash flow hedges net of tax	20			16		16
Actuarial loss on pensions net of tax						
Gain on plan assets	21,20				62	62
Increase in scheme liabilities	21,20				(116)	(116)
Tax relating to indexation of operational land	15,21,20				2	2
Total comprehensive income				16	451	467
Transaction with owners:						
Dividends paid to Heathrow (DSH) Limited	21				(335)	(335)
Total transaction with owners					(335)	(335)
31 December 2017		3,109	(994)	(252)	(3,171)	(1,308)
Adjustment in respect of:						
Change in accounting policy - IFRS 15					(1)	(1)
Change in accounting policy - IFRS 9					(2)	(2)
1 January 2018 (re-stated)		3,109	(994)	(252)	(3,174)	(1,311)
Comprehensive income:						
Profit for the year					412	412
Other comprehensive income:						
Fair value gains on cash flow hedges net of tax	20			36		36
Actuarial gain on pensions net of tax						
Loss on plan assets	21,20				(192)	(192)
Decrease in scheme liabilities	21,20				310	310
Total comprehensive income				36	530	566
Transaction with owners:						
Dividends paid to Heathrow (DSH) Limited	21				(497)	(497)
Total transaction with owners					(497)	(497)
31 December 2018		3,109	(994)	(216)	(3,141)	(1,242)

Heathrow Finance plc

Consolidated statement of cash flows for the year ended 31 December 2018

	<i>Note</i>	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Cash flows from operating activities			
Cash generated from operations	23	1,790	1,732
Taxation:			
Corporation tax paid		(70)	(53)
Group relief paid		(13)	(7)
Net cash from operating activities		1,707	1,672
Cash flows from investing activities			
Purchase of:			
Property, plant and equipment		(768)	(669)
Investment properties		(4)	(1)
Intangible assets		(20)	(17)
(Increase)/decrease in term deposits ¹		(108)	368
Increase in group deposits ²		-	(495)
Interest received		2	3
Net cash used in investing activities		(898)	(811)
Cash flows from financing activities			
Dividends paid to Heathrow (DSH) Limited	21	(497)	(335)
Proceeds from issuance of bonds		1,061	718
Repayment of bonds		(910)	(1,122)
Drawdown of subordinated facilities		65	200
Issuance of term note		245	518
Repayment of facilities and other financing items		(132)	(41)
Increase in amount owed to Heathrow (DSH) Limited		75	-
Settlement of accretion on index-linked swaps		(110)	(10)
Interest paid		(534)	(552)
Net cash used in financing activities		(737)	(624)
Net increase in cash and cash equivalents		72	237
Cash and cash equivalents at beginning of year		523	286
Cash and cash equivalents at end of year	<i>11</i>	595	523

¹ Term deposits with an original maturity of over three months are invested at Heathrow Airport Limited.

² Group deposits are amounts settled with LHR Airports Limited and Heathrow (DSH) Limited during the year under the terms of the Shared Service Agreement.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018

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

Statement of compliance

The financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') and as adopted by the European Union ('EU').

The Group

The Company is the holding company of a group of companies that owns Heathrow Airport ('Heathrow') and operates Heathrow Express ('HEX'), the express rail service between Heathrow and central London. Heathrow Finance plc is a limited liability company, limited by shares, incorporated in Great Britain and registered in England and Wales, and domiciled in the UK. The Company is a private limited company and its registered office is The Compass Centre, Nelson Road, Hounslow, Middlesex TW6 2GW.

Basis of accounting

The Group financial statements are prepared in accordance with IFRSs as issued by the IASB and as adopted by the EU and prepared under the historic cost convention, except for investment properties, financial assets recorded at fair value, derivative financial instruments and financial liabilities that qualify as hedged items under fair value hedge accounting. 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.

The Group financial statements are presented in Sterling and are rounded to the nearest million pounds (£m), except when otherwise noted.

Primary financial statements format

The primary financial statements are prepared in accordance with IFRS as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 December 2018.

A columnar approach has been adopted in the income statement and the impact of certain items is shown in a separate column. This column includes certain re-measurements as listed in (i) and (ii) below, which management separates from the underlying operations of the Group. Also, this column includes exceptional items as listed in (iii) and the effect on taxation of changes in tax rates in (iv) and (v) below. By isolating certain re-measurements and exceptional items, management believes the underlying results provides the reader with a more meaningful understanding of the performance of the Group, by concentrating on the matters over which it exerts influence, whilst recognising that information on these additional items is available within the financial statements, should the reader wish to refer to them.

The column 'certain re-measurements and exceptional items' in the consolidated income statement contains the following items:

- 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;
- iii. exceptional items;
- iv. the associated tax impacts of the items in (i), (ii) and (iii) above; and
- v. the impact on deferred tax balances of known future changes in tax rates.

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 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/ Group liquidity position, including cash resources, the remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and its ability to access the debt markets (refer to Recent financing activities in the Financial review).

Whilst the Group is in a net 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 following the date when the Statement of financial position was signed.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Changes in accounting policy and disclosure

(a) Amended standards adopted by the Group

During the year, the Group has adopted a number of amendments to the IFRSs issued by the IASB that are mandatorily effective for accounting periods beginning on or after 1 January 2019.

Impact of initial application of IFRS 9 *Financial Instruments*

The Group has adopted IFRS 9 (as revised in July 2014) and the related consequential amendments to other IFRS Standards that are effective for an annual period that begins on or after 1 January 2018. As permitted by the transitional provisions of IFRS 9, the Group elected not to restate comparative figures. Any adjustments at the date of transition were recognised in the opening retained earnings and other reserves of the current period.

Additionally, the Group adopted consequential amendments to IFRS 7 *Financial Instruments: Disclosures* that were applied to the disclosures for 2018.

IFRS 9 introduces new requirements for the classification and measurement of financial assets and financial liabilities, impairment of financial assets, and rules for hedge accounting. Details of these new requirements as well as their impact on the Group's consolidated financial statements are described below.

(i) Classification and measurement of financial assets

Under IFRS 9, all the financial assets are measured at amortised cost, fair value through profit or loss or fair value through OCI on the basis of the Group's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.

The Group's financial assets include cash and cash equivalents (including short term deposits), loans to third parties, trade and other receivable, intercompany loan receivables, derivatives and other debtors. These financial assets continue to be measured at amortised cost as they meet the conditions under IFRS 9.

Investments classified as available-for-sale (AFS) are presented at fair value with changes recorded through other comprehensive income.

(ii) Impairment of financial assets

The new impairment model requires the recognition of impairment provisions based on expected credit losses (ECL). It applies to financial assets classified at amortised cost, debt instruments measured at FVOCI, contract assets under IFRS 15, lease receivables, loan commitments and certain financial guarantee contracts.

The introduction of new impairment model has an impact on the Group's trade receivables and investments in money market funds and deposits measured at amortised cost. For trade receivables, the Group applies a simplified model of recognising lifetime expected credit losses as these items do not have a significant financing component. Based on the assessment undertaken, the Group recorded an impairment loss of £2 million on its intercompany receivable / trade receivable on transition.

(iii) Hedge accounting

IFRS 9 contains new requirements on the application of hedge accounting. The new requirements look to align hedge accounting more closely with entities' risk management activities by increasing the eligibility of both hedged items and hedging instruments and introducing a more principles-based approach to assessing hedge effectiveness.

IFRS 9 introduces an optional treatment for cross currency swaps designated in hedge relationships, whereby the currency basis element can be bifurcated with changes in fair value recorded in other comprehensive income ("OCI"). The Group has not elected to apply this accounting treatment, but instead treated it as a source of ineffectiveness.

There is no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit and loss and the Group does not have any such liabilities. The derecognition rules have been transferred from IAS 39 and have not been changed.

The new standard introduces expanded disclosure requirements and changes in presentation. The below table shows information relating to financial assets that have been reclassified as a result of transition to IFRS 9.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Impact of initial application of IFRS 9 *Financial Instruments* *continued*

	Original IAS39 Category	New IFRS9 Category	Closing balance 31 December 2017 £m	Adoption of IFRS 9 £m	Opening balance 1 January 2018 (IFRS9) £m
Non-current financial assets					
Derivative Instruments	FVTPL	FVTPL	444	-	444
Other receivables	Amortised cost	Amortised cost	18	-	18
Current financial assets					
Trade and other receivables	Amortised cost	Amortised cost	258	(2)	256
Derivative instruments	FVTPL	FVTPL	170	-	170
Term deposits	Amortised cost	Amortised cost	12	-	12
Cash and cash equivalents	Amortised cost	Amortised cost	513	-	513
Total financial assets			1,415	(2)	1,413

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2018

	IAS39 Carrying amount 31 December 2017 £m	Reclassification	Re-measurement £m	IFRS9 Carrying amount 1 January 2018 £m	Retained earnings impact (IFRS9) £m
Fair value through profit or loss					
FVTPL in IAS 39	36	-	-	36	-
Derivative at fair value – hedge accounting applied	578	-	-	578	-
Total charge to fair value through profit and loss	614	-	-	614	-
Available for sale	-				
Amortised cost assets	801	-	(2)	799	(2)
Total financial assets	1,415	-	(2)	1,413	(2)

Impact of application of IFRS 15 *Revenue from Contracts with Customers*

In the current year, the Group has applied IFRS 15 Revenue from Contracts with Customers (as amended in April 2016) effective 1 January 2018 using the modified retrospective method of adoption. The Group elected to apply the standard to all contracts as at 1 January 2018.

The Group's accounting policies for its revenue streams are disclosed in detail below. Apart from providing more extensive disclosures for the Group's revenue transactions, the application of IFRS 15 has not had a significant impact on the financial position and/or financial performance of the Group. The opening balance transition adjustment relating to trade receivables affected by the move from IAS 18 to IFRS 15 as at 1 January 2018 is illustrated below.

Reference	1 January 2018 £m	IFRS 15 adjustment £m	1 January 2018 under IFRS 15 £m
Assets			
Non-current assets	15,051		15,051
Current assets	1,036		1,036
Total assets	16,087		16,087
Liabilities			
Non-current liabilities	(15,572)		(15,572)
Current liabilities	(1,823)	(1)	(1,824)
Total liabilities	(17,395)	(1)	(17,396)
Net liabilities	(1,308)	(1)	(1,309)
Total shareholder's equity	(1,308)	(1)	(1,309)

(i) Car Parking

It must be determined at contract inception whether the performance obligation, being the provision of a parking space for each day that the car is parked, is transferred over time or at a point in time. Due to the varying types of parking services on offer and the duration of stay in each individual case, the performance obligation is satisfied over time and not at a point in time. Control of a service refers to the ability to obtain substantially all the remaining benefits from the service and this would not occur at a point in time as cars can be parked for several days. Previously under IAS 18 revenue was recognised upon exit from a car park and this change in revenue recognition upon adoption of IFRS15 has resulted in a restatement of £0.5 million net of deferred tax charged to retained earnings at 1 January 2018.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Impact of application of IFRS 15 Revenue from Contracts with Customers *continued*

(ii) Rail Income

It must be determined at contract inception whether the performance obligation, being the provision of rail transport, is transferred over time or at a point in time. Each ticket, either within a carnet or the inward and outward legs on a return ticket, represents a separate performance obligation and revenue is recognised as each performance obligation is satisfied, being on the day of travel. Due to the varying types of tickets on offer and their validity from the date of sale, the performance obligation is satisfied using management assumptions as per the accounting policy. Previously, revenue was recognised when a ticket was first used and immediately when purchased at a station. This has resulted in a restatement of £0.9 million net of deferred tax charged to retained earnings at 1 January 2018.

Had the financial statements been prepared under IAS18 the impact for the year ended 31 December 2018 would be £0.1 million higher. All other revenue streams are recognised under a basis consistent with that previously reported.

The adoption of IFRS 15 did not have a material impact on OCI or the Group's cashflow.

Other amendments

The following amendments although relevant to the Group, have no impact on the Group's results for the reasons stated:

- Amendments to IAS 40: Transfer of Investment Property. The Group has adopted the amendments to IAS 40 Investment Property for the first time in the current year. The amendments clarify that a transfer to, or from, investment property necessitates an assessment of whether a property meets, or has ceased to meet, the definition of investment property, supported by observable evidence that a change in use has occurred. The amendments further clarify that the situations listed in IAS 40 are not exhaustive and that a change in use is possible for properties under construction (i.e. a change in use is not limited to completed properties).
- IFRIC 22 Foreign Currency Transactions and Advance Consideration: The interpretation clarifies how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

The Interpretation specifies that the date of transaction is the date on which the entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration. This clarification has no impact on the Group's results as the Group determines the date of transaction for advance payments in foreign currency in accordance with this clarification.

The following amendments are not applicable to the Group:

- Annual Improvement to IFRS Standards 2014 – 2016 Cycle: Amendments to IAS 12: Investments in Associates and Joint Ventures. The Group does not have any investment in Associates or Joint Ventures.

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

- IFRS 16 Leases;
- IFRS 17 Insurance Contracts;
- Amendment to IFRS 9: Prepayment Features with Negative Compensation;
- Amendment to IAS 28: Long-term Interests in Associates and Joint Ventures
- Annual Improvements to IFRS Standards 2015-2017 Cycle: Amendments to IFRS 3 *Business Combinations*, IFRS 11 *Joint Arrangements*, IAS 12 *Income Taxes* and IAS 23 *Borrowing Costs*;
- Amendment to IAS 19 *Employee Benefits*: Plan Amendment, Curtailment or Settlement;
- IFRS 19 *Consolidated Financial Statements* and IAS 28 (amendments): Sale or Contribution of Assets between an Investor and its Associates or Joint Venture; and
- IFRS 23: Uncertainty over Income Tax Treatments

IFRS 16 Leases

General impact of application of IFRS 16 Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective for accounting periods beginning on or after 1 January 2019. The date of initial application of IFRS 16 for the Group will be 1 January 2019.

The Group has chosen the simplified transition approach of IFRS 16 in accordance with IFRS 16:C5(b). Consequently, the Group will not restate the comparative information in the year of adoption.

In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

IFRS 16 Leases *continued*

Impact of the new definition of a lease

The Group will not make use of the practical expedient available on transition to IFRS 16 not to reassess whether a contract is or contains a lease. Accordingly, the definition of a lease in accordance with IFRS 16 will be also applied to those leases entered or modified before 1 January 2019.

The change in definition of a lease mainly relates to the concept of control. IFRS 16 distinguishes between leases and service contracts on the basis of whether the use of an identified asset is controlled by the customer. Control is considered to exist if the customer has:

- the right to obtain substantially all of the economic benefits from the use of an identified asset; and
- the right to direct the use of that asset.

The Group will apply the definition of a lease and related guidance set out in IFRS 16 to all lease contracts. In preparation for the first-time application of IFRS 16, the Group has carried out an implementation project. The project has shown that the new definition in IFRS 16 will not significantly change the scope of contracts that meet the definition of a lease for the Group.

Impact on Lessee Accounting

Operating leases

IFRS 16 will change how the Group accounts for leases previously classified as operating leases under IAS 17, which were off-balance sheet.

On initial application of IFRS 16, for all leases with exception to short term and low value leases (as allowed under IFRS 16), the Group will:

- recognise right-of-use assets and lease liabilities in the consolidated statement of financial position, initially measured at the present value of the future lease payments;
- recognise depreciation of right-of-use assets and interest on lease liabilities in the consolidated income statement; and
- separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within financing activities) in the consolidated cash flow statement.

Lease incentives (e.g. rent-free period) will be recognised as part of the measurement of the right-of-use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease liability incentive, amortised as a reduction of rental expenses on a straight-line basis.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 Impairment of Assets. This will replace the previous requirement to recognise a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as personal computers and office furniture), the Group will opt to recognise a lease expense on a straight-line basis as permitted by IFRS 16.

As at 31 December 2018, the Group has non-cancellable operating lease commitments of £767 million, see Note 22. A preliminary assessment indicates that on application of IFRS 16 as at 1 January 2019, the Group will recognise a right-of-use asset of £344 million, a corresponding lease liability of £446 million and deferred tax assets of £17 million in respect of all these leases with a resulting net adjustment of £85 million in the retained earnings.

The Group expects the impact on the income statement is to decrease operating expense by £53 million, to increase depreciation by £37 million and to increase interest expense by £18 million resulting in profit before tax to decrease by approximately £2 million for 2019 as a result of adopting the new rules.

Under IAS 17, all lease payments on operating leases are presented as part of cash flows from operating activities. The impact of the changes under IFRS 16 would be to increase the cash generated by operating activities and reduce net cash used in financing activities.

Finance leases

The main difference between IFRS 16 and IAS 17 with respect to assets formerly held under a finance lease is the measurement of the residual value guarantees provided by the lessee to the lessor.

The Group does not have any Finance leases as a lessee hence there will be no impact of this change to the Group on adoption of IFRS 16.

Impact on Lessor Accounting

Under IFRS 16, a lessor continues to classify leases as either finance leases or operating leases and account for those two types of leases differently. However, IFRS 16 has changed and expanded the disclosures required, in particular regarding how a lessor manages the risks arising from its residual interest in leased assets.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

IFRS 16 Leases *continued*

Impact on Lessor Accounting *continued*

As at 31 December 2018, the Group has non-cancellable operating leases as a lessor of £2,004 million, see Note 22. Going forward, additional disclosure will be made to comply with this change.

Basis of consolidation

The Group financial statements consolidate the financial statements of Heathrow (SP) Limited and all the entities it controls (its subsidiaries) drawn up to 31 December each year, including the merger reserve which was created in 2008 upon reorganisation of the current Group structure.

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 (AH) Limited, which owns the UK regulated airport Heathrow. 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 main bond issuer for the Group.

Subsidiaries

Subsidiaries are consolidated from the date of their acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. Control is defined as where the Group is exposed or has rights to variable returns from its involvement with the subsidiary and the ability to affect those returns through its power over the subsidiary. Intra-group balances and transactions are eliminated during the consolidation process.

Segment reporting

Information reported to the Board of Directors for the purposes of resource allocation and assessment of segment performance relates to the operations of Heathrow and Heathrow Express.

Revenue from Contracts with Customers

Revenue from contracts with customers is recognised when control of the goods or services are transferred to the customer (i.e., when the Group delivers its performance obligation under the contract) at an amount that reflects the consideration to which the Group expects to be entitled in exchange for those goods or services. There is no requirement to disclose information about remaining performance obligations as all contracts have an expected duration of less than one year.

The Group recognises revenue from the following major sources:

- Aeronautical income;
- Retail services;
- Other regulated charges;
- Car Parking; and
- Rail income.

Aeronautical income

Aeronautical income includes:

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

There are three separate performance obligations in respect of aeronautical charges, namely landing, parking and departing charges. These charges are separately identified in respect of any aircraft movement at the airport and the revenue is recognised on the day the movement takes place. In addition, there are certain other regulated charges which are referred to below.

Retail income

Retail income include concession fees from retail and commercial concessionaires at the airport are based upon reported revenue by concessionaires, taking into account contracted minimum guarantees where appropriate. The performance obligation for this revenue stream is the provision of retail unit space to a third party for the purposes of selling or providing services to the travelling public, in return for a fee, based either on a fixed rental fee, or a concession fee based on turnover. The retailer has the right to design and control the use of that space. As such, this concept under the retail contracts are aligned to a lease in nature, and therefore retail income is treated as lease income.

Other Regulated Charges ('ORCs')

Revenue in relation to ORC's (including those related to Aeronautical) is derived from the recovery of certain costs incurred by the Airport. It includes:

- Usage charges made for operational systems (e.g. check-in desks), recognised as each service is provided.
- Charges related to passengers with restricted mobility and other services recognised at the time of delivery.
- Other invoiced sales: recognised on the performance of the service.

The Group typically satisfies its performance obligation as the service is provided. Revenue is recognised on the day the service takes place, therefore at a point in time.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Revenue from Contracts with Customers *continued*

Car Parking

Car parking income is from the provision of parking services to customers, which include for Short Stay, Long Stay, Business parking and Storage. The Group considers the performance obligation is satisfied by the provision of a car park space for each day the car is parked, therefore the revenue is recognised for each day the car is parked.

Rail income

Heathrow Express derives its income from the sale of tickets to customers, which are of the following types:

- Single tickets valid on the date of travel specified on the ticket when purchased.
- Return tickets valid for 5 days from the specified date of travel on the ticket for the outward journey; and 30 days from the specified date of travel on the ticket for the return journey.
- Multiple journey (“carnet”) tickets valid for up to 12 months from the date of sale.

Revenue attributable to return tickets should be allocated to each journey and recognised on the day each journey takes place. Heathrow Express is not able to track when each journey is undertaken and therefore has used sample data of historical journeys to estimate when each journey takes place.

The revenue is recognised by applying the below management assumptions to measure progress towards satisfaction of the performance obligation:

- 90% of single tickets are used in the month of sale.
- 80% of return tickets (50% outward and 30% return) are used in the month of sale.
- All multiple journey (“carnet”) tickets are used within 6 months.

Contributions

On occasion, the Group may receive grants to improve airport infrastructure considered to be in the best interest of the public. These are recorded as reductions in the cost of the property, plant and equipment to which they relate.

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 capitalised as part of 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, including costs incurred in respect of the maintenance of the Group’s credit ratings, are recognised in the income statement in the year in which they are incurred.

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 accumulated impairment losses. An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected. Any gain or loss arising on the derecognition of the asset is included in the income statement in the period of derecognition.

Assets in-the-course of construction are stated at cost less any 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 (see “Borrowing Costs” policy), 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.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Property, plant and equipment *continued*

Heathrow expansion

Assets in the course of construction include qualifying costs in respect of Heathrow expansion following the Government decision in October 2016 in favour of Heathrow, and subsequent Board decision in October 2016 to apply for the Development Consent Order.

These two events were considered by management to be a trigger point for the expansion project to proceed. Management subsequently announced publicly that the Group would apply for planning permission, in the belief that it is highly probable that expansion at Heathrow will be realised. As a result, the Group has started to capitalise eligible costs as 'assets in the course of construction'.

The costs which are directly associated with, and solely for the purposes of, seeking planning consent for the delivery of new runway capacity through the Development Consent Order process are capitalised as they are directly attributable to the final design and construction of the expanded Heathrow assets. These costs include Environmental Impact Assessments, Statutory consultation, and Master plan options.

In assessing expansion costs, the Group has regard to IAS 38 (see Accounting policy - 'Internally-generated intangible assets') and considers October 2016 to be the point at which Expansion moved from the Research phase to the Development phase, and therefore development expenditure is capitalised in line with the principles of IAS 38.

Expansion costs incurred during the research phase for the Airports Commission process and before Heathrow was named as the preferred location for new runway capacity in October 2016, were expensed in the period in which they were incurred.

Depreciation

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

<i>Terminal complexes</i>	<i>Fixed asset lives</i>
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	50–120 years
Airport transit systems	
Rolling stock	20 years
Track	50 years
<i>Airfields</i>	
Runway surfaces	10–15 years
Runway bases	100 years
Taxiways and aprons	50 years
<i>Rail</i>	
Rolling stock	8–40 years
Tunnels	100 years
Track metalwork	5–10 years
Track bases	50 years
Signals and electrification work	40 years
<i>Plant and equipment</i>	
Motor vehicles	4–8 years
Office equipment	5–10 years
Computer equipment	4–5 years
<i>Other land and buildings</i>	
Short leasehold properties	3–20 years
Leasehold improvements	Lower of useful economic life or period of lease

In certain circumstances, the asset life may fall outside of the boundaries disclosed above.

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

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *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. The 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.

As at 31 December 2018, the level of the fair value hierarchy within which the fair value measurement is categorised in its entirety is Level 3, as described in Note 14 '*Financial Instruments*'.

Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation, is initially measured at cost and subsequently stated at fair value at the reporting date, as determined by the directors and supported 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:

- the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale; and
- the Group can demonstrate how the intangible asset created will generate future economic benefits; and
- the Group has available the resources to complete the asset; and
- the Group intends to complete that asset and has the future ability to sell or use the asset; and
- the development cost of the intangible asset can be measured reliably.

Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be held at cost less any accumulated amortisation and impairment. Amortisation begins when development is complete and the asset is ready for use.

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. During the period of development, the asset is tested for impairment annually.

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.

Purchased intangible assets (software costs)

Computer software costs principally relate to operating and financial software. These assets are amortised over a period of between four and fifteen years. Amortisation for the year is charged through operating costs on straight line basis. The assets are assessed for impairment whenever there is indication that the intangible asset may be impaired.

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 with a corresponding liability being recognised 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.

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Leases *continued*

Group as a lessee *continued*

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 over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Group as a lessor

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases and with the exception of investment properties discussed above, the assets are included in property, plant and equipment and depreciated over their estimated useful lives. 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. Cost is calculated using the weighted average method.

Cash and cash equivalents

For the purposes of the Statement of financial position, cash and cash equivalents comprise cash at bank, cash in hand, money market funds, repurchase agreements with an original maturity of three months or less and short-term deposits with an original maturity of three months or less. For the Consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Term deposits

Term deposits, which include repurchase agreements, with an original maturity of over three months are shown separately on the Statement of financial position and Statement of cash flows.

Deferred income

Amounts received prior to the delivery of goods and services are recorded as deferred income and released to the income statement as they are provided.

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, where material, to present value using a current, pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Restructuring

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

Home loss payments

A home loss payments provision is recognised where, an obligation arises during the year, as a result of a past event. The home loss payment provision is in respect of historic property purchases and related expenditures created in 2016 specifically in respect of Heathrow Expansion, following the Government's decision in October 2016.

Financial instruments

Recognition and derecognition

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the financial instrument.

Financial assets are derecognised when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and substantially all the risks and rewards are transferred.

A financial liability is derecognised when it is extinguished, discharged, cancelled or expires.

Classification and initial measurement of financial assets

Except for those trade receivables that do not contain a significant financing component and are measured at the transaction price in accordance with IFRS 15, all financial assets are initially measured at fair value adjusted for transaction costs (where applicable).

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Classification and initial measurement of financial assets *continued*

Financial assets, other than those designated and effective as hedging instruments, are classified into the following categories:

- amortised cost
- fair value through profit and loss (FVTPL)
- fair value through other comprehensive income (FVOCI).

The classification is determined by both:

- the entity's business model for managing the financial asset
- the contractual cash flow characteristics of the financial asset.

Subsequent measurement of financial assets

Financial assets at amortised cost

Financial assets are measured at amortised cost if the assets meet the following conditions (and are not designated as FVTPL):

- they are held within a business model whose objective is to hold the financial assets and collect its contractual cash flows
- the contractual terms of the financial assets give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding

Financial assets at fair value through profit and loss (FVTPL)

Financial assets that are held within a different business model other than 'hold to collect' or 'hold to collect and sell' are categorised at fair value through profit and loss. Further, irrespective of business model financial assets whose contractual cash flows are not solely payments of principal and interest are accounted for at FVTPL. All derivative financial instruments fall into this category, except for those designated and effective as hedging instruments, for which the hedge accounting requirements apply (see below).

Financial assets at fair value through other comprehensive income (FVOCI)

The Group accounts for financial assets at FVOCI if the assets meet the following conditions:

- they are held under a business model whose objective it is "hold to collect" the associated cash flows and sell and,
- the contractual terms of the financial assets give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Any gains or losses recognised in other comprehensive income (OCI) will be recycled upon derecognition of the asset.

Impairment of financial assets

IFRS 9's impairment requirements use more forward-looking information to recognise expected credit losses – the 'expected credit loss (ECL) model'.

Instruments within the scope of the new requirements included loans and other debt-type financial assets measured at amortised cost and FVOCI, trade receivables, contract assets recognised and measured under IFRS 15 and loan commitments and financial guarantee contracts (for the issuer) that are not measured at fair value through profit or loss.

Recognition of credit losses is no longer dependent on the Group first identifying a credit loss event. Instead the Group considers a broader range of information when assessing credit risk and measuring expected credit losses, including past events, current conditions, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the instrument.

In applying this forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk ('Stage 1') and
- financial instruments that have deteriorated significantly in credit quality since initial recognition and whose credit risk is not low ('Stage 2').
- 'Stage 3' would cover financial assets that have objective evidence of impairment at the reporting date.

'12-month expected credit losses' are recognised for the first category while 'lifetime expected credit losses' are recognised for the second category.

Measurement of the expected credit losses is determined by a probability-weighted estimate of credit losses over the expected life of the financial instrument.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Impairment of financial assets *continued*

Trade and other receivables

Trade receivables, which generally have 14-day terms, are initially recognised and carried at the lower of their original invoiced value and recoverable amount. Balances are written off when the probability of recovery is remote.

The Group makes use of a simplified approach in accounting for trade and other receivables and records the loss allowance as lifetime expected credit losses. These are the expected shortfalls in contractual cash flows, considering the potential for default at any point during the life of the financial instrument.

In calculating, the Group uses its historical experience, external indicators and forward-looking information to calculate the expected credit losses.

The Group assess impairment of trade receivables on a collective basis where they possess shared credit risk characteristics they have been grouped based on sector industry global default rates. Refer to Note 13 for a detailed analysis of how the impairment requirements of IFRS 9 are applied.

Intercompany loans receivable

Intercompany advances to other Group entities are all held till maturity, neither parties have an option to call or prepay the loan before the contracted maturity date.

Such assets are held under a business model to hold and collect contractual cash flows and therefore meet the Solely Payments of Principal and Interest (SPPI) test. No embedded derivatives are currently recognised in these advances, and the amortised cost classification is not impacted. All intercompany advances are assessed for impairment under the IFRS9 “expected credit losses model” (ECL).

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.

Classification and measurement of financial liabilities

The Group’s financial liabilities include borrowings, trade and other payables and derivative financial instruments.

Financial liabilities are initially measured at fair value, and, where applicable, adjusted for transaction costs unless the Group designated a financial liability at fair value through profit or loss.

Subsequently, financial liabilities are measured at amortised cost using the effective interest method except for derivatives and financial liabilities designated at FVTPL, which are carried subsequently at fair value with gains or losses recognised in profit or loss (other than derivative financial instruments that are designated and effective as hedging instruments).

All interest-related charges and, if applicable, changes in an instrument’s fair value that are reported in profit or loss are included within finance costs.

Borrowings

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

For index-linked borrowings, the nominal amount is adjusted for movements in the relevant price index. This accretion expense is recorded within finance costs in the income statement.

Debt issue costs

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

Trade and other payables

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

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Classification and measurement of financial liabilities *continued*

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.

Derivative financial instruments are accounted for at fair value through profit and loss except for derivatives designated as hedging instruments in cash flow hedge relationships, which require a specific accounting treatment.

To qualify for hedge accounting, the hedging relationship must meet all of the following requirements:

- there is an economic relationship between the hedged item and the hedging instrument
- the effect of credit risk does not dominate the value changes that result from that economic relationship

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 ongoing basis, its assessment of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of a 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.

Fair value hedge

All hedging relationships that were hedging relationships under IAS 39 at the 31 December 2017 reporting date meet the IFRS 9's criteria for hedge accounting at 1 January 2018 and are therefore regarded as continuing hedging relationships.

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 gains and losses on any underlying hedged items that are part of a fair value hedging relationship.

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 method is used is amortised in the income statement over the period to maturity.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. To the extent that the hedge is effective, changes in the fair value of derivatives designated as hedging instruments in cash flow hedges are recognised in other comprehensive income and included within the cash flow hedge reserve in equity. Any ineffectiveness in the hedge relationship is recognised immediately in profit or loss.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item affects profit or loss, as described in the Derivative Financial instruments note disclosure (Note 13).

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 or if 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 profit and loss

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 net amount in finance costs 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. The credit risk associated with the Group's derivatives is updated monthly based on current market data.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Shared Services Agreement ('SSA')

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

On 18 August 2008, Heathrow Airport Limited and Heathrow Express Operating Company Limited entered into a SSA with LHR Airports Limited by which the latter became the shared services provider for the Group.

Following the disposal of Aberdeen, Glasgow and Southampton airports in December 2014 the directors reassessed the Group's relationship with LHR Airports Limited, given that the sole operating airport is now Heathrow and noted the following;

- The SSA states that the operating entities, being only Heathrow Airport Limited from 1 January 2015, are responsible for pension costs on LHR Airports Limited's retirement benefit schemes,
- The Group is responsible for funding the retirement benefit schemes, paying employer contributions directly to the pension scheme, and
- Although employees remain legally employed by LHR Airports Limited, the Group makes all employment decisions. LHR Airports Limited is no longer deemed to be providing a service, substantive or otherwise in relation to employees, to the Group.

Consequently, from 1 January 2015, all employment related costs and the disclosures pertaining to the defined benefit pension scheme are presented in the financial statements of Heathrow Airport Limited and therefore the Group.

Employment costs

The Group's airport incurs the cost of people which are contractually employed by LHR Airports Limited but provide services to the operation of the airport. Charges in relation to employment costs include wages and salaries, pension costs, medical costs and redundancy payments, as well as any other associated expenses properly incurred by the employees of LHR Airports Limited in providing the services.

Centralised services

LHR Airports Limited is considered to be acting as principal in relation to the services of the Heathrow Airport Holdings Limited ('HAHL') Group CEO, the HAHL Group CFO, the HAHL Chairman and HAHL non-executive board members and Ferrovial advisory services. These costs are recharged to Heathrow Airport Limited (the only remaining airport party to the SSA) with a mark-up of 7.5%. Other services are paid for and sourced directly by Heathrow Airport Limited, either without LHR Airports Limited's involvement or on a pass through fixed mark up only basis (agent). This judgement has been reached following consideration of whether LHR Airports Limited has been exposed to the majority of the significant benefits and risks associated with the exchange transaction.

Pension costs

Heathrow Airport Limited and Heathrow Express Operating Company Limited ('HEX') have an obligation to fund or benefit from their share of the LHR Airports Limited defined benefit pension scheme (or 'BAA Pension Scheme') deficit or surplus and Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities under the SSA. Previously when part of a group with multiple operations, these provisions or assets were based on the relevant share of the scheme deficit or surplus and allocated on the basis of pensionable salaries. Movements in these provisions or assets arose due to current service costs, net finance costs or income, employer cash contributions and actuarial gains or losses. Heathrow Airport Limited and HEX recorded their share of the net actuarial gain or loss for the year as an exceptional item due to their size and nature.

Following the disposal of Aberdeen, Glasgow and Southampton airports (the 'NDH1' group) in December 2014, the directors reassessed the Group's relationship with the legal sponsor of the retirement benefit schemes (LHR Airports Limited) given that the HAH Group's sole operating airport is now Heathrow. The directors determined, after taking into account the Shared Service Agreement, employment relationships and the funding risk associated with the schemes, that Heathrow Airport Limited, and consequently the Group, now acts as principal in relation to these schemes. As a result, the Group now recognises an external asset or liability, in relation to the schemes, on its statement of financial position, as non-current under the caption of Retirement benefit surplus/obligations. Additionally, it is now considered appropriate for the Group to record actuarial gains and losses on the external scheme within other comprehensive income rather than the income statement.

The cost of providing benefits under the defined benefit pension scheme is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of the defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight-line basis over the vesting period or immediately if the benefits have vested. When a settlement or curtailment occurs, the obligation and related plan asset are remeasured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

Net interest is calculated by applying a discount rate to the net defined benefit liability or asset.

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Pension costs *continued*

The Group recognises actuarial gains and losses in full in other comprehensive income in the period in which they occur.

The defined benefit pension asset or liability in the statement of financial position comprises the total for each plan of the present value of the defined benefit plan obligation (using a discount rate based on high-quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net defined benefit pension asset is restricted to the sum of any unrecognised past service costs and the present value of any amount the Group expects to recover by way of refunds from the plan or reductions in future contributions.

Contributions to defined contribution pension schemes are recognised in the income statement in the period in which they become payable.

Current and deferred income tax

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income. In this case, the tax is recognised in other comprehensive income.

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 reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

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, at rates expected to apply when they crystallise, based on current tax rates and law. 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 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 tax assets and liabilities are not discounted.

Deferred income taxation is determined using the tax rates and laws that have been enacted, or substantively enacted, during the year and are expected to apply in the periods in which the related deferred tax asset or liability is realised or settled.

Share capital

Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs, allowing for any reductions in the par value. 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 shareholders is recognised as a liability in the Group's financial statements in the period in which the shareholders' right to receive payment of the dividend is established. Interim dividends are recognised when paid.

Foreign currency

The consolidated financial statements are presented in Sterling, which is the parent company's functional currency.

Transactions denominated in foreign currencies are initially recorded in the entity's functional currency 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.

Heathrow Finance plc

Significant accounting judgements and estimates for the year ended 31 December 2018

In applying the Group's accounting policies, management have made judgements and estimates 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.

Critical judgements in applying the Group's accounting policies

Hedge accounting

Certain interest rate swaps are designated in a cash flow hedge relationship to hedge the exposure to variability in cash flows of forecast transactions or existing liabilities. Management compares on a regular basis existing and historic hedging arrangements against expectations for future Sterling re-financing. If there were significant changes in the expected quantum of future Sterling re-financing, then levels may be insufficient to support components of the cash flow hedge reserve, requiring the recycling of the cash flow hedge reserve through the income statement. As at 31 December 2018, £261 million of fair value losses (2017: £303 million) on these derivatives have been deferred into the cash flow hedge reserve.

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. Judgement has been exercised in the year including in relation to:

- the assessment of assets in the course of construction, including expansion costs where judgement is exercised to determine costs that are directly attributable to the assets under construction;
- when a project moves from the research phase (where costs must be expensed in the current period) to the development phase and hence may be capitalised as the future economic benefit of the project becomes probable and the principles of IAS 38 are considered and applied;
- Assessing the useful economic life of an asset

Agent versus principal

The presentation of certain costs including employment costs and pension costs which are a contractual obligation of LHR Airports Limited are presented as Operating costs of the Group in the 2018 financial statements as Heathrow Airport Limited (part of the Group) is deemed to be the principal in relation to these transactions. This judgement is described in the accounting policies and is based on the balance of risks and rewards between group companies.

Lease classification

A lease contract is classified as an operating or a finance lease based on the substance of the contract and whether the Group or the lessor have the substantial risks and benefits incidental to the ownership of the leased asset.

The Group have a lease agreement with UK Power Networks Services Limited ('UKPNS' / 'Lessor') relating to the electricity distribution network at Heathrow. The lease expires in 2083. The group has determined this arrangement to be an operating lease rather than a finance lease under IAS 17. In this arrangement, the typical primary indicators of a finance lease under IAS 17 such as the lease term being for the major part of the economic life of the asset, the present value of the minimum lease payment amounts being substantially all of the fair value of the leased asset, appear to be met, largely due to the duration of the agreement. The substance of the agreement however results in significant risks and rewards associated with the ownership of electrical distribution network remaining with UKPNS. Other features within the contract that are more relevant in this lease determination include that the obligation to operate, maintain, insure and repair rests with the lessor rather than the Group. Accordingly, management believe an operating lease classification to be appropriate.

Key sources of estimation uncertainty

Investment properties

Investment properties are fair valued by CBRE Limited, Chartered Surveyors. The valuations are prepared in consideration of IFRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations are 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) is capitalised using yields derived from market evidence. This market evidence also considers planned transactions and use of the property (for example the future expansion of Heathrow). Independent valuations are obtained for all investment properties.

Management have reviewed the main assumptions underlying the valuation of Investment properties and the sensitivity analysis based on reasonable possible changes to relevant assumptions (Note 7).

The main estimations made that have a significant risk of resulting in a material adjustment to the carrying amounts investment properties within the next financial year have been assessed as those related to the two largest categories of Investment properties: a) Public and other Car Parks, and b) the large maintenance hangers leased to certain airlines, together representing 71% of the total value of Investment Properties at 31 December 2018.

Car parks are valued individually using actual data on revenue in the current year and expectations of future growth rates. Sensitivities have been run to analyse the impact of a reasonable change in growth rates and a reasonable impact on the

Heathrow Finance plc

Significant accounting judgements and estimates for the year ended 31 December 2018 *continued*

Key sources of estimation uncertainty *continued*

Investment properties *continued*

base revenue of Brexit, informed by discussions with CBRE and internal Heathrow property experts. The results of the sensitivities to future growth rates and base revenue estimations are shown in Note 7. Large maintenance hangers leased to certain airlines are valued individually using actual data on rental yields based on existing contracts, and comparison with relevant local and regional market data. The results of the sensitivities to rental yields are shown in Note 7.

Retirement benefit obligations

Certain assumptions have been adopted for factors that determine the valuation of the Group's liability for pension obligations at period end and charges to the income statement. The factors have been determined in consultation with the Group's actuary considering market and economic conditions. Changes in assumptions can vary from period to period because of changing conditions and other determinants which may cause increases or decreases in the valuation of the Group's liability for pension obligations. The objective when setting pension scheme assumptions for future periods is to reflect the expected actual outcomes, other than the discount rate which must be set by reference to the yield on high quality corporate bonds with a term consistent with the obligations. The impact of the change in assumptions on the valuation of the net financial position of the Group pension scheme is recorded as a net actuarial gain or loss and is reflected in the statement of comprehensive income.

Management have reviewed the main assumptions underlying the valuation of Retirement benefit obligations and the sensitivity analysis based on reasonable possible changes to relevant assumptions (Note 16).

The main estimations made that have a significant risk of resulting in a material adjustment to the carrying value of the assets and liabilities relating to the scheme have been assessed as: a) Discount rate, b) Inflation rates, and c) Life expectancy.

Sensitivities have been run to analyse the impact of a reasonable change in these estimations informed by discussions with scheme actuaries KPMG and internal Heathrow experts. The results of the sensitivities are shown in Note 16.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018

1 Segment information

As described in the accounting policies on page 44, the Group is organised into business units according to the nature of the services provided to Airport users. Most revenue is derived from the activities carried out within the Airport. The exception to this is Heathrow Express, which is a separately identifiable operating segment under IFRS 8, with separately identifiable assets and liabilities, and hence management aggregates these units into two operating segments, as follows;

- Heathrow (Aeronautical and commercial operations within the Airport and its boundaries)
- Heathrow Express (Rail income from the Heathrow Express rail service between Heathrow and London)

The performance of the above segments is measured on a revenue and Adjusted EBITDA basis.

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

- Table (a) details total revenue from external customers for the year ended 31 December 2018 and is broken down into aeronautical, retail, ORCs 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 Adjusted EBITDA which is earnings before interest, tax, depreciation, amortisation and certain re-measurements.
- Table (b) details depreciation, amortisation and fair value adjustments.
- Table (c) details asset and liability information by reportable segment. The assets and liabilities information by segment is not provided to the Board on a monthly basis but is included in this note as additional information.
- Section (d) details revenue and non-current asset information by geographical segment.

The comparative financial information has been re-presented. Tables (a) and (b) as disclosed within the 31 December 2017 financial statements have been combined into table (a) and revenue previously disclosed as Aeronautical, Retail, ORC's, and Other have been further disaggregated and incorporates the new requirements of IFRS 15. Tables previously presented as (c) and (d) have been re-presented in tables (b) and (c) respectively.

Table (a)

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Segment Revenue Under IFRS 15		
Aeronautical		
Landing charges	482	470
Parking charges	67	63
Departing charges	1,196	1,183
Total Aeronautical revenue	1,745	1,716
Other regulated charges	243	240
Retail revenue	147	127
Property revenue	129	133
Rail Income		
Heathrow Express	123	127
Other	14	9
<i>Revenue reported under IFRS 15</i>	2,401	2,352
Revenue recognised at a point in time	2,275	2,232
Revenue recognised over time	126	120
Total revenue reported under IFRS 15	2,401	2,352
Under IAS 17		
Retail (lease-related income)	569	532
Total revenue	2,970	2,884
Heathrow	2,847	2,757
Heathrow Express	123	127
Adjusted EBITDA		
Heathrow	1,772	1,688
Heathrow Express	65	72
Total adjusted EBITDA	1,837	1,760
Reconciliation to statutory information:		
Depreciation and amortisation	(746)	(694)
Operating profit (before certain re-measurements)	1,091	1,066
Fair value gain on investment properties (certain re-measurements)	117	149
Operating profit	1,208	1,215
Finance income ¹	27	15
Finance costs ¹	(744)	(625)
Profit before tax	491	605
Taxation charge	(79)	(102)
Profit for the period	412	503

¹ Prior year finance income and finance costs have been restated by (£198) million and £198 million respectively to present interest payable and receivable on derivatives not in a hedge accounting relationship as a single unit of account (net) through finance cost, and prior year finance costs includes £215 million fair value gain on financial instruments previously disaggregated.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

Revenue of £884 million (2017: £901 million) was derived from a single external customer and has been included within the Heathrow segment.

Table (b)

	Year ended 31 December 2018		Year ended 31 December 2017	
	Depreciation & amortisation ¹ £m	Fair value gain ² £m	Depreciation & amortisation ¹ £m	Fair value gain ² £m
Heathrow	(675)	117	(652)	149
Heathrow Express	(71)	-	(42)	-
Total	(746)	117	(694)	149

¹ Includes intangible amortisation charge of £27 million (2017: £40 million).

² Reflects fair value gain on investment properties only.

Table (c)

	Year ended 31 December 2018		Year ended 31 December 2017	
	Assets £m	Liabilities £m	Assets £m	Liabilities restated £m
Heathrow	13,880	(440)	13,401	(378)
Heathrow Express	670	(14)	887	(4)
Total operations	14,550	(454)	14,288	(382)
Unallocated assets and liabilities:				
Cash , term deposits and external borrowings	715	(14,660)	535	(14,390)
Retirement benefit obligations	28	(32)	-	(158)
Derivative financial instruments	543	(1,562)	614	(1,466)
Deferred and current tax liabilities	-	(971)	-	(942)
Amounts owed from/(to) group undertakings	676	(75)	650	(57)
Total	16,512	(17,754)	16,087	(17,395)

(d) 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 2018 was £2,970 million (2017: £2,884 million). The breakdown of the major components of total revenue from external customers is shown in tables (a) and (b) above.

Non-current assets excluding derivative financial instruments were £14,850 million (2017: £14,607 million). There are no non-current assets held outside the UK (2017: £nil).

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

2 Operating costs

Operating costs comprise:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Employment		
Wages and salaries	335	325
Social security	36	35
Pension	47	40
Other staff related costs	24	24
Own staff costs capitalised	(64)	(50)
	378	374
Operational	264	252
Maintenance	176	176
Rates	122	126
Utilities	90	86
Other	103	110
Operating costs before depreciation and amortisation	1,133	1,124
Depreciation and amortisation		
Property, plant and equipment	719	654
Intangible assets	27	40
	746	694
Total operating costs¹	1,879	1,818

¹ Total operating costs include expenditure on research and development of £2 million (2017: £2 million)

Rentals under operating leases

	Year ended 31 December 2018 £m	Year ended 31 December 2017 restated ³ £m
<i>Operating costs include:</i>		
Land and buildings ¹	14	15
Others ²	40	39
Total rentals under operating leases	54	54

¹ The Group leases various offices, warehouses and plant and machinery under non-cancellable operating lease agreements.

² A significant portion of the operating rental costs as "Others" relates to electricity distribution network at the airport leased on agreement with UK Power Networks Services Limited 'UKPNS'.

³ The amount for 2017 is restated to include Heathrow Express (HEX) track access lease and lease with UKPNS is re-classified from 'land and buildings' to 'others'.

Auditor's remuneration

Audit fees and non-audit fees for the current and preceding financial years were borne by Heathrow Airport Limited. The audit fees of FGP Topco Group are also borne by Heathrow Airport Limited.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Fees payable to the Company's auditor for the annual audit of the:		
Company's ultimate parent	0.1	0.1
Company's subsidiaries ¹	0.4	0.4
Total audit fees	0.5	0.5
Fees payable to the Company's auditor and their associates for other services specific to the Group		
Audit related assurance services	0.1	0.1
Other services	-	0.1
Other assurance services	0.2	0.1
Total non-audit fees	0.3	0.3
Total fees	0.8	0.8

¹ Fees payable to the Company's auditor for the audit of the Company's annual accounts was £72,000 (2017: £82,000).

Employee numbers

Heathrow Finance had a monthly average of 7,141 employees (2017 restated: 6,895) of which 398 (2017 restated: 461) are employees of HEX and the rest are legally employed by LHR Airports Limited. The Group makes all employment decisions; consequently, employee numbers for those providing services to the operation of the airport are reported in the financial statement of the Group and not in the financial statements of LHR Airports Limited.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

2 Operating costs *continued*

Directors' remuneration

Javier Echave and Emma Gilthorpe were directors of a number of companies within the Heathrow Airport Holdings Group during the year. Javier's and Emma's remuneration for the year ended 31 December 2018 was disclosed in the financial statements of Heathrow Airport Holdings Limited and Heathrow Airport Limited respectively. The directors do not believe it is possible to accurately apportion their remuneration to individual companies based on services provided. Andrew Efiang, Nicholas Golding and Yuanyuan Ding were directors of a number of companies within the Heathrow Airport Holdings Group. They were paid by, but are not directors of, Heathrow Airport Limited. The directors do not believe it is possible to accurately apportion their remuneration to other individual companies within the Group based on services provided.

During the year, two of the directors (2017: one) had retirement benefits accruing to them under a defined benefit scheme and two of the directors (2017: three) had retirement benefits accruing to them under a defined contribution scheme.

3 Financing

Net finance costs before certain re-measurements

	<i>Note</i>	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Finance income			
Interest on deposits		2	3
Interest receivable from group undertakings		25	12
Total finance income ⁴		27	15
Finance costs			
Interest on borrowings:			
Bonds and related hedging instruments ¹		(584)	(615)
Bank loans and overdrafts and related hedging instruments		(74)	(74)
Interest payable on external derivatives not in hedge relationship ²		(160)	(186)
Interest payable to group undertakings		(1)	-
Facility fees and other charges		(9)	(7)
Net pension finance costs		(4)	(3)
Unwinding of credit discount		-	(1)
		(832)	(886)
Less: capitalised borrowing costs ³	6	50	46
Total finance costs ⁴		(782)	(840)
Net finance costs before certain re-measurements⁴		(755)	(825)
Certain re-measurements			
Fair value gain/(loss) on financial instruments			
Interest rate swaps: not in hedge relationship		83	63
Index-linked swaps: not in hedge relationship		(90)	134
Cross-currency swaps: ineffective portion of cash flow hedges		21	4
Cross-currency swaps: ineffective portion of fair value hedges		24	14
		38	215
Net finance costs including certain re-measurements		(717)	(610)

¹ Includes accretion of £47 million (2017: £48 million) on index-linked bonds.

² Includes accretion of £207 million (2017: £222 million) on index-linked swaps.

³ 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 5.66% (2017: 5.37%) to expenditure incurred on such assets.

⁴ Prior year finance income and finance costs have been restated by (£198) million and £198 million respectively to present interest payable and receivable on derivatives not in a hedge accounting relationship as a single unit of account (net) through finance cost.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

4 Taxation

	Year ended 31 December 2018			Year ended 31 December 2017		
	Before certain re-measurements £m	Certain re-measurements £m	Total £m	Before certain re-measurements £m	Certain re-measurements £m	Total £m
UK corporation tax						
Current tax charge at 19% (2017: 19.25%)	(102)	(3)	(105)	(70)	(2)	(72)
Over provision in respect of prior years	5	-	5	-	-	-
Deferred tax						
Current year (charge)/credit	14	(21)	(7)	3	(54)	(51)
Prior year credit ¹	11	17	28	13	8	21
Taxation charge for the year	(72)	(7)	(79)	(54)	(48)	(102)

¹ Prior year credit for 2018 includes a £17 million adjustment in relation to revaluations of property, plant and equipment (2017 includes a £9 million adjustment primarily in relation to investment properties) and an £11 million (2017: £12 million) adjustment primarily for accelerated capital allowances.

The tax charge on the Group's profit before tax differs from the theoretical amount that would arise by applying the UK statutory tax rate to the accounting profits of the Group for the reasons as set out in the following reconciliation:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Profit before tax (before certain re-measurements)	336	241
Reconciliation of the tax charge		
Tax calculated at the UK statutory rate of 19% (2017: 19.25%)	(64)	(46)
Adjustments in respect of current income tax of previous years	5	-
Net non-deductible expenses	(22)	(21)
Effect of change in tax rate	(2)	-
Adjustments in respect of deferred income tax of previous years ¹	11	13
Total tax charge before certain re-measurements excluding change in UK corporation tax rate	(72)	(54)
Tax charge on certain re-measurements ²	(7)	(48)
Taxation charge for the year	(79)	(102)

¹ Prior year adjustment in 2018 relates primarily to accelerated capital allowances.

² This consists of the tax impact arising from fair value gains on investment property revaluations and fair value gains/losses on financial instruments and revaluations of property, plant and equipment.

The total tax charge recognised for the year ended 31 December 2018 was £79 million (2017: £102 million charge). Based on a profit before tax for the year of £491 million (2017: £605 million profit), this results in an effective tax rate of 16.1% (2017: 16.9%).

The total tax charge before certain re-measurements for the year ended 31 December 2018 was £72 million (2017: £54 million), which includes an £11 million prior year deferred tax credit adjustment (2017: £13 million prior year deferred tax credit adjustment) relating primarily to accelerated capital allowances. Based on a profit before tax and certain re-measurements of £336 million (2017: £241 million) this results in an effective tax rate of 21.4% (2017: 22.4%). The tax charge in 2018 is more (2017: more) than implied by the statutory rate of 19% (2017: 19.25%) primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

In addition, there was a £7 million tax charge (2017: £48 million tax charge) reflecting the tax impact arising from fair value gains on investment property revaluations and fair value gains/losses on financial instruments and a prior year adjustment relating to revaluations of property, plant and equipment.

The headline UK corporation tax rate was 20% up until 1 April 2017, when it reduced to 19%. This is due to fall to 17% with effect from 1 April 2020. The effect of these rate reductions has been reflected in the deferred tax balances in the financial statements.

In November 2017 the Finance (No.2) Act 2017 received Royal Assent, giving effect to a new interest deductibility regime. This regime is in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). As a result of the new legislation, from 1 April 2017, interest deductions are limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public infrastructure exemption (PIE). Heathrow is to a large extent protected from the 30% of tax based EBITDA cap therefore no material interest disallowance has been reflected in the 2018 tax charge (2017: less than £0.1 million).

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

4 Taxation *continued*

In the November 2018 Budget the Government announced a new 2% flat rate Structures and Building Allowance relief (SBA) for non-residential structural property will be available where the construction contract is entered on or after 29 October 2018. Relief will be provided on eligible construction costs at an annual rate of 2% on a straight-line basis, effectively giving tax relief over a 50-year period. Heathrow is likely to benefit from tax relief in future years from tax relief on expenditure which would not be eligible under current rules. Other than these changes, there are no items which would materially affect the future tax charge.

5 Dividends

During the year ended 31 December 2018, the Company paid dividends of £497 million (£0.05 per share) to Heathrow DSH being £113 million (£0.01 per share) on 21 February 2018, £111 million (£0.01 per share) on 27 June 2018, £114 million (£0.01 per share) on 23 July 2018, £159 million (£0.02 per share) on 20 December 2018.

During the year ended 31 December 2017, the Company paid dividends of £335 million (£0.04 per share) to Heathrow DSH being £85 million (£0.01 per share) on 23 February 2017 and £250 million (£0.03 per share) on 20 December 2017.

6 Property, plant and equipment

	Note	Terminal complexes £m	Airfields £m	Plant and equipment £m	Other land and buildings £m	Rail £m	Assets in the course of construction £m	Total £m
Cost								
1 January 2017		11,454	1,385	827	210	1,427	1,157	16,460
Additions		-	-	-	-	-	683	683
Borrowing costs capitalised	3	-	-	-	-	-	46	46
Disposals		(78)	(10)	(25)	(5)	(7)	-	(125)
Reclassification		-	-	-	-	-	(1)	(1)
Transfer to intangible assets	7	-	-	-	-	-	(76)	(76)
Transfer to completed assets		495	331	89	-	1	(916)	-
31 December 2017		11,871	1,706	891	205	1,421	893	16,987
Additions		-	-	-	-	-	768	768
Borrowing costs capitalised	3	-	-	-	-	-	50	50
Disposals		(3)	-	(10)	-	(15)	-	(28)
Reclassification		-	-	-	-	-	-	-
Transfer to intangible assets	7	-	-	-	-	-	(5)	(5)
Transfer to completed assets		376	(112)	260	25	44	(593)	-
31 December 2018		12,244	1,594	1,141	230	1,450	1,113	17,772
Depreciation								
1 January 2017		(3,583)	(421)	(380)	(64)	(529)	-	(4,977)
Depreciation charge		(472)	(53)	(78)	(9)	(42)	-	(654)
Disposals		78	10	25	5	7	-	125
31 December 2017		(3,977)	(464)	(433)	(68)	(564)	-	(5,506)
Depreciation charge		(490)	(45)	(103)	(10)	(71)	-	(719)
Disposals		3	-	10	-	15	-	28
31 December 2018		(4,464)	(509)	(526)	(78)	(620)	-	(6,197)
Net book value								
31 December 2018		7,780	1,085	615	152	830	1,113	11,575
31 December 2017		7,894	1,242	458	137	857	893	11,481

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value at 31 December 2018 of £11 million (2017: £11 million).

Assets in the course of construction

The major balances in assets in the course of construction include Baggage programme projects to install the latest generation of Baggage screening machines, the Asset Management programme to replace assets at the end of their useful life, and the Airport resilience programme including tunnels and airfield improvements.

Accelerated Depreciation

Depreciation in 2018 includes accelerated depreciation on Heathrow Express rolling stock (£28 million accelerated depreciation in rail assets) and the Temporary flight connection centre (£13 million accelerated depreciation in terminal complexes) of £41 million (2017: £nil).

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

6 Property, plant and equipment *continued*

Borrowing costs capitalised

During the year ended 31 December 2018, borrowing costs of £50 million were capitalised (2017: £46 million). Capitalised borrowing costs were calculated by applying an average interest rate of 5.66% (2017: 5.37%) to expenditure incurred on qualifying assets.

A tax deduction of £50 million (2017: £46 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, released each year in line with the depreciation charged on the relevant assets.

Regulatory asset base (RAB)

RAB at Dec 2018 was £16,200 million (2017: 15,786 million).

Leased assets

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

	31 December 2018	31 December 2017
	£m	£m
Cost or valuation	601	594
Accumulated depreciation	(289)	(251)
Net book value	312	343

Security granted by the Group over its assets, including property, plant and equipment, is disclosed in Note 11.

7 Investment properties

	Airport investment properties £m
Valuation	
1 January 2017	2,200
Additions	1
Revaluation	149
31 December 2017	2,350
Additions	4
Transfers from property, plant and equipment	1
Revaluation	117
31 December 2018	2,472

Investment properties were valued at fair value at 31 December 2018 by CBRE Limited, Chartered Surveyors (2017: CBRE Limited, Chartered Surveyors).

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. The fair value measurement hierarchy used in calculating fair value (refer to Note 14) has been classified as level 3. The higher the discount rate 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 Investment Property portfolio includes Car Parks (for passengers and employees) and Maintenance Hangars, which together account for 71% (2017: 67%) of the fair value of the investment property portfolio at 31 December 2018. As stated above, the valuations are based on assumptions relevant to the type of property being valued. Management have reviewed the assumptions, as described in the sensitivity analysis below prepared by CBRE limited, using a wider range of sensitivities than the prior year due to uncertainties identified in the UK property market as a result of Brexit.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

7 Investment properties *continued*

	Increase/(decrease) in asset valuation
Car parks – Base revenue	
+2.0% pa	36
-2.0% pa	(36)
Car parks – Revenue growth	
+0.5% pa	87
-0.5% pa	(83)
Maintenance Hangars – Net initial yield	
+0.5% pa	49
-0.5% pa	(64)

The sensitivities analysis above has been determined based on reasonably possible changes to the respective assumptions, holding all other assumptions constant. The methodology used in arriving at the incremental changes shown above is consistent with that used for the valuation of car parks and maintenance hangars within the Investment Property portfolio at the year end. 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 less than £1 million (2017: £1 million) for which a similar amount is included within operating costs.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £76 million (2017: £74 million). Direct operating expenses arising on the investment property, all of which generated rental income in the period, amounted to £1 million (2017: less than £1 million). The Group has entered into contracts for the maintenance of its investment property, which will give rise to an annual charge of less than £1 million (2017: £1 million). Security granted by the Group over its assets, including investment properties, is disclosed in Note 12 "Securities and guarantees".

8 Intangible assets

	£m
Cost	
1 January 2017	252
Additions	17
Transfers from property, plant and equipment	76
Disposals	(16)
31 December 2017	329
Additions	20
Transfers from property, plant and equipment	5
Disposals	(2)
31 December 2018	352
Amortisation	
1 January 2017	(130)
Charge for the year	(40)
Disposals	16
31 December 2017	(154)
Charge for the year	(27)
Disposals	2
31 December 2018	(179)
Net book value	
31 December 2018	173
31 December 2017	175

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 four and fifteen years. Amortisation for the year has been charged through operating costs.

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

9 Inventories

	31 December 2018	31 December 2017
	£m	£m
Consumables	13	11

The total amount of inventories consumed in the year was £7 million (2017: £6 million). There is no material difference between the statement of financial position value of inventories and their replacement cost.

10 Trade and other receivables

	31 December 2018	31 December 2017
	£m	£m
Non-current		
Prepaid debt fees ¹	6	4
Prepayments	13	15
Amounts owed by group undertakings	583	582
	602	601
Current		
Trade receivables	120	101
Accrued income ²	126	109
Trade receivables and accrued income	246	210
Less: provision for impairment	(4)	(2)
Trade receivables and accrued income after impairment	242	208
Prepayments	35	27
Amounts owed by group undertakings ³	93	68
Other receivables	21	17
	391	320

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 Accrued income is net of any amounts received in advance from customers.

³ Amounts owed by group undertakings largely relate to external payments received by LHR Airports Limited under the Shared Services Agreement on behalf of Heathrow that will be remitted to Heathrow in due course. This amount is payable on demand and accrues interest at Bank of England base rate +1.5%.

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

Note 14 includes disclosures relating to the credit risk exposures and analysis relating to the allowance for expected credit losses. The above comparative for impairment provisions refers to the IAS 39 measurement basis which applied an incurred loss model, whereas the current year applies IFRS 9 which is an expected loss model.

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

As at 31 December 2018, trade receivables of £88 million (2017: £87 million) were fully performing. Trade receivables of £32 million (2017: £14 million) were past due. 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 2018	31 December 2017
	£m	£m
Fully performing	88	87
Past due but not impaired:		
Not impaired but overdue by less than 30 days	13	4
Not impaired but overdue by between 30 and 60 days	7	-
Not impaired but overdue by more than 60 days	1	3
	21	7
Overdue by more than 90 days	11	7
Total trade receivables	120	101

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

	£m
1 January 2017	1
Provision for trade receivables	1
31 December 2017	2
Change in accounting standard – IFRS9	2
1 January 2018	4
Impairment for trade receivables (calculated under IFRS9)	-
31 December 2018	4

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

10 Trade and other receivables *continued*

As at 31 December 2018, trade receivables were considered for impairment under IFRS 9 resulting in an additional £2 million (2017: £nil million). During the period, the company made £nil write-offs of trade receivables (2017: £2 million) with all 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' within 'operating costs' in the consolidated income statement. Amounts charged to the provision account are generally written off when there is no expectation of recovery, with additional impairment for forward looking ECL and probable default.

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 14.

11 Cash and cash equivalents and term deposits

	31 December 2018	31 December 2017
	£m	£m
Cash at bank and in hand	36	54
Short-term deposits	559	469
Cash and cash equivalents	595	523
Term deposits	120	12
Cash and cash equivalents and term deposits	715	535

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 to their book value.

Heathrow Airport Limited holds investments in term deposits, which have an original maturity of more than three months.

For the purposes of the Consolidated statement of cash flows, cash and cash equivalents comprise cash at bank, cash in hand, money market funds, repurchase agreements with an original maturity of three months or less and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments, restricted cash and bank overdrafts.

12 Borrowings

	31 December 2018	31 December 2017
	£m	£m
Current		
Secured		
Heathrow Funding Limited bonds:		
4.600% €750 million due 2018	-	665
6.250% £400 million due 2018	-	399
4.000% C\$400 million due 2019	230	-
	230	1,064
Heathrow Finance plc bonds:		
5.375% £275 million due 2019	262	-
Total bonds	492	1,064
Heathrow Airport Limited loans	17	33
Total current (excluding interest payable)	509	1,097
Interest payable	232	258
Interest payable to Heathrow (DSH)	1	-
Total current	742	1,355
Non-current		
Secured		
Heathrow Funding Limited bonds:		
4.000% C\$400 million due 2019	-	235
6.000% £400 million due 2020	399	398
9.200% £250 million due 2021	260	266
3.000% C\$450 million due 2021	256	260
4.875% US\$1,000 million due 2021	782	746
1.650%+RPI £180 million due 2022	213	206
1.875% €600 million due 2022	549	545
5.225% £750 million due 2023	691	683
7.125% £600 million due 2024	593	592
0.500% CHF400 million due 2024	310	293
3.250% C\$500 million due 2025	281	286
4.221% £155 million due 2026	155	155
6.750% £700 million due 2026	690	689
2.650% NOK1,000 million due 2027	89	90
3.400% C\$400 million bond due 2028	232	-

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

12 Borrowings <i>continued</i>	31 December 2018		31 December 2017
		£m	£m
7.075% £200 million due 2028		198	198
4.15% A\$175 million due 2028		99	-
2.500% NOK1,000 million due 2029		79	81
3.782% C\$400 million bond due 2030		229	-
6.450% £900 million due 2031		853	851
1.500% €750 million due 2030		629	624
Zero-coupon €50 million due January 2032		59	57
1.366%+RPI £75 million due 2032		85	82
Zero-coupon €50 million due April 2032		58	56
1.875% €500 million due 2032		447	442
4.171% £50 million due 2034		50	50
Zero-coupon €50 million due 2034		50	49
1.061%+RPI £180 million due 2036		197	191
1.382%+RPI £50 million due 2039		56	55
3.334%+RPI £460 million due 2039		624	606
1.238%+RPI £100 million due 2040		111	107
5.875% £750 million due 2041		735	735
2.926% £55million due 2043		55	-
4.625% £750 million due 2046		742	742
1.372%+RPI £75 million due 2049		85	82
2.750% £400 million due 2049		392	392
0.147%+RPI £160 million due 2058		164	-
		11,497	10,844
Heathrow Finance plc bonds:			
5.375% £275 million due 2019		-	262
4.750% £300 million due 2024		297	-
5.750% £250 million due 2025		248	248
3.875% £275 million due 2027		273	273
		818	783
Total bonds		12,315	11,627
Heathrow Airport Limited debt:			
Class A1 term loan due 2020		418	416
Class A2 term loan due 2024		100	-
Term notes due 2026-2037		585	439
Loans		12	29
Heathrow Finance plc facilities		488	524
Total other debt		1,603	1,408
Borrowings from Heathrow (DSH)		75	-
Total non-current		13,993	13,035
Total borrowings (excluding interest payable)		14,502	14,132

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 6.000% £400 million due 2020, 7.125% £600 million due 2024, 4.221% £155 million due 2026 bonds and 1.061%+RPI £180 million due 2036 bonds wherein the redemption dates coincide with their legal maturity dates.

Fair value of borrowings

	31 December 2018		31 December 2017	
	Book value	Fair value ¹	Book value	Fair value ¹
	£m	£m	£m	£m
Current				
Short-term debt	509	518	1,097	1,084
Non-current				
Long-term debt	13,918	16,371	13,035	15,783
Borrowings from parent	75	75	-	-
	14,502	16,964	14,132	16,867

¹ Fair value of borrowings are for disclosure purposes only.

Accrued interest is included as a current borrowings balance and not in the carrying amount of non-current borrowings. The fair value of listed borrowings are based on quoted prices at balance sheet date. For unlisted borrowings, the Group establishes fair values by using discounted cash flow analysis utilising yield curves derived from observable market data (Level 2). The fair value of borrowings which have floating rate interest are assumed to equate to their nominal value.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

12 Borrowings *continued*

At 31 December 2018, the fair value of debt classified as Level 1 and Level 2 was £14,112 million and £2,852 million respectively (2017: £15,006 million and £1,862 million respectively).

The average cost of the Group's external gross debt at 31 December 2018 was 3.73% (2017: 3.96%), taking into account the impact of interest rate, cross-currency and index-linked hedges but excluding index-linked swap accretion. Including index-linked swap accretion, the Group's average cost of debt at 31 December 2018 was 5.31% (2017: 5.62%). The reduction in the average cost of debt excluding index-linked accretion is mainly due to the replacement of relatively high cost maturing legacy debt with newer lower cost debt in 2018 and recent moves in inflation with the retail price index ('RPI') inflation falling from a high of 3.9% in September 2017 to 3.4% in June 2018.

Impact of fair value hedge adjustments

The nominal value of debt designated in fair value hedge relationship was GBP 200 million, EUR 1,850 million, USD 1,000 million, CAD 1,750 million, CHF 400 million, AUD 175 million and NOK 2,000 million. Where debt qualifies for fair value hedge accounting, hedged item adjustments have been applied as follows:

	31 December 2018		31 December 2017	
	Nominal	Fair value adjustment ¹	Nominal	Fair value adjustment ¹
	£m	£m	£m	£m
Sterling debt	200	(2)	200	(4)
Euro denominated debt	1,498	26	1,498	19
USD denominated debt	621	-	621	(11)
CAD denominated debt	1,227	3	763	4
Other currencies debt	549	17	451	23
Designated in fair value hedge	4,095	44	3,533	31

¹ Fair value adjustment is comprised of fair value gain of £89 million on continuing hedges and £45 million loss on discontinued hedges.

Securities and guarantees

Heathrow Airport Limited, Heathrow Express Operating Company Limited, Heathrow (SP) Limited and Heathrow (AH) Limited (together, the 'Obligors') have granted security to Deutsche Trustee Company Limited (in its capacity as the 'Borrower Security Trustee', for itself and as trustee for the Borrower Secured Creditors) over their property, assets and undertakings to secure their obligations under various financing agreements. Each Obligor has also guaranteed the obligations of each other Obligor under such financing agreements.

Heathrow (DSH) Limited and Heathrow Finance plc have also granted security over all of their assets, which includes first priority security interests in the share capital of Heathrow Finance plc and its wholly-owned subsidiary, Heathrow (SP) Limited, to secure their obligations under their financing agreements. BAA Pension Trust Company Limited, as a trustee from time to time of the BAA Pension Scheme, is a Borrower Secured Creditor and ranks equally in an amount up to £284 million with senior (Class A) debt.

Heathrow Funding Limited has given Deutsche Trustee Company Limited (the 'Bond Trustee') a covenant to pay and discharge, when due, to each of the Issuer Secured Creditors (including Bondholders) all Issuer Secured Liabilities (including all amounts due under the Bonds). The Bond Trustee holds the benefit of that covenant on trust for itself and the Issuer Secured Creditors. Heathrow Funding Limited has also granted security to the Bond Trustee (for itself and as trustee for the Issuer Secured Creditors) over its property, assets, undertakings and rights to secure the covenant to pay and discharge the Issuer Secured Liabilities.

Heathrow Airport Limited and Heathrow Express Operating Company Limited have provided a guarantee and indemnity in favour of Lloyds Bank plc (in its capacity as the Borrower Account Bank) in respect of each other's obligations under the Borrower Account Bank Agreement and associated financing agreements. Additional disclosures on risk management and hedging of borrowings are included in Notes 13 and 14.

13 Derivative financial instruments

	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2018				
Current				
Foreign exchange contracts	11	-	-	-
Interest rate swaps	204	-	(5)	(5)
Cross-currency swaps	250	-	(19)	(19)
Index-linked swaps	124	-	(15)	(15)
	589	-	(39)	(39)
Non-current				
Foreign exchange contracts	-	-	-	-
Interest rate swaps	2,309	-	(377)	(377)
Cross-currency swaps	3,685	502	(6)	496
Index-linked swaps	6,395	41	(1,140)	(1,099)
	12,389	543	(1,523)	(980)
Total	12,978	543	(1,562)	(1,019)

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

13 Derivative financial instruments *continued*

31 December 2017	Notional £m	Assets £m	Liabilities £m	Total £m
Current				
Foreign exchange contracts	5	-	-	-
Interest rate swaps	400	-	(3)	(3)
Cross-currency swaps	510	170	-	170
Index-linked swaps	97	-	(4)	(4)
	1,012	170	(7)	163
Non-current				
Foreign exchange contracts	3	-	-	-
Interest rate swaps	2,513	-	(466)	(466)
Cross-currency swaps	3,374	408	(29)	379
Index-linked swaps	5,119	36	(964)	(928)
	11,009	444	(1,459)	(1,015)
Total	12,021	614	(1,466)	(852)

Interest rate swaps

Interest rate swaps are maintained by the Group and designated as hedges, where they qualify against variability in interest cash flows on current and future floating or fixed rate 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. The losses deferred of £34 million expected to be released in less than one year, £25 million between one and two years, £62 million between two and five years and £135 million over five years. Of the total amount deferred in other comprehensive income £238 million related to discontinued cash flow hedges.

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. The gains deferred of £7 million are expected to be released in less than one year, losses of £5 million between one and two years, £3 million between two and five years and £4 million over five years.

Index-linked swaps

Index-linked swaps have been entered into in order to economically hedge RPI linked revenue and the Regulatory Asset Base but are not designated in a hedge relationship.

Foreign exchange contracts

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

14 Financial instruments

Financial risk management objectives and policies

The Group's principal financial instruments (other than derivatives) comprise loans, term notes, 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 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.

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.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

14 Financial instruments *continued*

Foreign exchange risk *continued*

The Group is not exposed to foreign exchange risk on borrowings after hedging. The Group is not materially exposed to foreign exchange risk on an economic basis.

Price risk

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 2018, with all other variables remaining constant, if the RPI had increased or decreased by a factor of 10%, annual pre-tax profit would have decreased or increased by £370 million and £356 million respectively (2017: £235 million and £228 million respectively). During 2018, the highest month-on-month RPI curve movement averaged 4% and the highest month-on-month movement for a given term (1-year) was 12%. Therefore 10% is considered to be reasonable and provides an appropriate stress test.

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 and 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.

As at 31 December 2018, the Group's fixed floating interest rate profile, after hedging, on gross debt was 90:10 (2017: 97:03).

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

	31 December 2018		31 December 2017	
	Income statement impact £m	Equity impact £m	Income statement impact £m	Equity impact £m
0.50% increase	251	47	191	37
0.50% decrease	(265)	(50)	(201)	(36)

During 2018, the highest month-on-month 6-month GBP LIBOR curve movement was 0.21%; therefore 0.50% is considered to be reasonable and provides an appropriate stress test.

Credit risk

Credit risk arises from cash and cash equivalents, term deposits, 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 and term deposits 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 (S&P)/F1 (Fitch). 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)/BBB+ (Fitch).

As at 31 December 2018, the Group had credit risk on derivatives with asset mark to market of £543 million (2017: £614 million).

Financial assets past due but not impaired are disclosed in Note 10 'Trade and other receivables'. The maximum exposure to credit risk as at 31 December 2018 was £1,500 million (2017: £1,357 million) as disclosed in Note 14 'Financial instruments by category'.

The Group applies IFRS 9 for recognising lifetime expected credit losses for all trade receivables as these items do not have a significant financing component.

In measuring the expected credit losses, the trade receivables have been assessed on a collective basis as they possess shared credit risk characteristics. They have been grouped based on the days past due and, also according to the industry sector of the Group's customers.

The expected loss rates are based on Global industry default rates as well as the corresponding historical credit.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

14 Financial instruments *continued*

Credit risk *continued*

The historical rates are adjusted to reflect the loss given default factors affecting the customer's ability to settle the amount outstanding. However, given the short period exposed to credit risk, the impact of these macroeconomic factors has not been considered significant within the reporting period. Trade receivables are written off (ie derecognised) when there is no reasonable expectation of recovery, therefore moving from 'Stage 2' to 'Stage 3'.

On the above basis the expected credit loss for trade receivables as at 01 January 2018 and 31 December 2018 was determined as follows:

31 December 2018	Current	1-30 days	31-60 days	61-90 days	Over 180 days	Total
	£m	£m	£m	£m	£m	£m
Trade receivables						
Gross carrying amount	88	13	7	1	11	120
Lifetime expected credit loss	(4)	-	-	-	-	(4)
Total adjusted receivables	84	13	7	1	11	114
01 January 2018	Current	1-30 days	31-60 days	61-90 days	Over 180 days	Total
	£m	£m	£m	£m	£m	£m
Trade receivables						
Gross carrying amount	87	4	-	3	7	101
Lifetime expected credit loss	(2)	-	-	-	-	(2)
Total adjusted receivables	85	4	-	3	7	99

Liquidity risk

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

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

	31 December 2018 £m	31 December 2017 £m
Floating rate facilities		
Expiring in more than two years and less than five years	1,150	1,150
Expiring in more than five years ¹	672	100
	1,822	1,250

¹ £472 million of the amounts expiring greater than five years will be drawn between 2019 and 2020.

As at 31 December 2018, overdraft facilities of £10 million were available (2017: £10 million).

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

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

14 Financial instruments *continued*

Liquidity risk *continued*

31 December 2018				
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Borrowing principal	192	(37)	3,046	11,005
Borrowing interest	597	584	1,500	3,763
Derivative financial instruments	34	294	(245)	(744)
Trade payables	170	-	-	-
Capital payables	135	-	-	-

31 December 2017				
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Borrowing principal	943	529	2,770	9,736
Borrowing interest	608	547	1,420	3,865
Derivative financial instruments	101	7	103	(281)
Trade payables	175	-	-	-
Capital payables	134	-	-	-

The tables below analyse the expected gross undiscounted contractual cash flows as at 31 December of the Group's derivative financial instruments which will be settled on a gross basis based on the remaining period to the contractual maturity date. The table should be viewed in conjunction with the table presenting undiscounted cash flows on the Group's financial liabilities and net settled derivative financial instruments.

31 December 2018				
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Cross-currency derivative payments	110	103	239	405
Cross-currency derivative receipts	(110)	(101)	(206)	(421)

31 December 2017				
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Cross-currency derivative payments	86	71	169	245
Cross-currency derivative receipts	(123)	(92)	(206)	(500)

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 Group that the relevant debt facility sits.

There are gearing covenants in financing agreements held by the Group. Gearing ratios achieved by the Group are set out below:

	31 December 2018	31 December 2017
Net debt to RAB at Heathrow Finance group	0.86	0.87
Total net debt to RAB at Heathrow (SP) Limited	0.77	0.78
Senior net debt to RAB at Heathrow (SP) Limited	0.68	0.67

At 31 December 2018, the Group's senior (Class A) and junior (Class B) trigger levels were 72.5% and 85.0% under its financing agreements. Note that the Group's senior gearing trigger level increased from 70.0% to 72.5% on 1 April 2018. At 31 December 2018, Heathrow Finance's gearing covenant level was 90.0% under its financing agreements. Heathrow Finance's gearing covenant will increase to 92.5% from 1 September 2019.

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:

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

14 Financial instruments *continued*

Financial instruments by category *continued*

31 December 2018				
	Loans and receivables	Assets at fair value through income statement	Derivatives qualifying for hedge accounting	Total
	£m	£m	£m	£m
Derivative financial instruments ¹	-	51	492	543
Cash and cash equivalents	595	-	-	595
Trade receivables	242	-	-	242
Term deposits	120	-	-	120
Total financial assets	957	51	492	1,500

¹ Designated in fair value hedges of interest rate risk with changes in fair value recognised in the income statement of £492 million

31 December 2018				
	Liabilities at fair value through income statement	Derivatives qualifying for hedge accounting	Other financial liabilities at amortised cost	Total
	£m	£m	£m	£m
Borrowings	-	-	(14,502)	(14,502)
Derivative financial instruments ^{1,2}	(1,517)	(45)	-	(1,562)
Trade payables	-	-	(170)	(170)
Capital payables	-	-	(135)	(135)
Total financial liabilities	(1,517)	(45)	(14,807)	(16,369)

¹ Designated in fair value hedges of interest rate risk with changes in fair value recognised in the income statement of £6 million

² Designated in cash flow hedges of interest rate risk with changes in fair value recognised in other comprehensive income of £39 million.

31 December 2017				
	Loans and receivables	Assets at fair value through income statement	Derivatives qualifying for hedge accounting	Total
	£m	£m	£m	£m
Derivative financial instruments	-	36	578	614
Cash and cash equivalents	523	-	-	523
Trade receivables	208	-	-	208
Term deposits	12	-	-	12
Total financial assets	743	36	578	1,357

31 December 2017				
	Liabilities at fair value through income statement	Derivatives qualifying for hedge accounting	Other financial liabilities at amortised cost	Total
	£m	£m	£m	£m
Borrowings	-	-	(14,132)	(14,132)
Derivative financial instruments	(1,414)	(52)	-	(1,466)
Trade payables	-	-	(175)	(175)
Capital payables	-	-	(134)	(134)
Total financial liabilities	(1,414)	(52)	(14,441)	(15,907)

At 31 December 2018, 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); and
- Level 3 - inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

At 31 December 2018 and 2017, all fair value estimates on derivative financial instruments are included in level 2.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

14 Financial instruments *continued*

Fair value estimation *continued*

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. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

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

Specific valuation techniques used to value financial instruments include:

- quoted market prices or dealer quotes for similar instruments;
- 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 Group 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. During the year there were no transfers between the levels in the fair value hierarchy.

The tables below present the Group's assets (other than investment properties) and liabilities that are measured at fair value as at 31 December:

	31 December 2018			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Assets at fair value through income statement	-	51	-	51
Derivatives qualifying for hedge accounting	-	492	-	492
Total assets	-	543	-	543
Liabilities				
Liabilities at fair value through income statement	-	(1,517)	-	(1,517)
Derivatives qualifying for hedge accounting	-	(45)	-	(45)
Total liabilities	-	(1,562)	-	(1,562)
	31 December 2017			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Assets at fair value through income statement	-	36	-	36
Derivatives qualifying for hedge accounting	-	578	-	578
Total assets	-	614	-	614
Liabilities				
Liabilities at fair value through income statement	-	(1,414)	-	(1,414)
Derivatives qualifying for hedge accounting	-	(52)	-	(52)
Total liabilities	-	(1,466)	-	(1,466)

15 Deferred income tax

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

	2018 £m	2017 £m
1 January	(905)	(884)
Credited/(charged) to income statement	21	(30)
(Charged)/credited to other comprehensive income	(33)	9
31 December	(917)	(905)

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

15 Deferred income tax *continued*

Deferred tax is analysed as follows:

	2018 £m	2017 £m
Deferred income tax liabilities	(1,052)	(1,073)
Deferred income tax assets	135	168
31 December	(917)	(905)

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	Revaluations of property, plant and equipment £m	Tax on rolled over gains £m	Others £m	Total £m
1 January 2017	(816)	(187)	(47)	(8)	(12)	(1,070)
Credited/(charged) to income statement	5	(10)	-	-	-	(5)
Credited to other comprehensive income		-	2	-	-	2
31 December 2017	(811)	(197)	(45)	(8)	(12)	(1,073)
Credited/(charged) to income statement	20	(17)	17	-	1	21
31 December 2018	(791)	(214)	(28)	(8)	(11)	(1,052)

Deferred income tax assets

	Financial instruments £m	Short-term timing differences £m	Post employment benefits £m	Total £m
1 January 2017	160	5	21	186
(Charged)/credited to income statement	(24)	2	(3)	(25)
(Charged)/credited to other comprehensive income	(3)	-	10	7
31 December 2017	133	7	28	168
Credited/(charged) to income statement	6	(4)	(2)	-
Charged to other comprehensive income	(7)	-	(26)	(33)
31 December 2018	132	3	-	135

Deferred income tax credited to other comprehensive income during the year is as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Cash flow hedge reserve	(7)	(3)
Tax relating to indexation of operational land	-	2
Tax (charge)/credit on actuarial gain/(loss)	(26)	10
	(33)	9

The headline UK corporation tax rate was 20% up until 1 April 2017, when it reduced to 19%. This is due to fall to 17% with effect from 1 April 2020. The effect of these rate reductions has been reflected in the deferred tax balances in the financial statements. There are not considered to be any other known items which would materially affect the future tax charge.

Deferred income tax assets have been recognised in respect of all temporary differences giving rise to deferred income tax assets where it is considered probable that there will be sufficient future taxable profit against which these assets will be recovered.

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

16 Retirement benefit obligations

The Group has applied the requirements of the standard IAS 19 'Employee Benefits (Revised 2011)' ('IAS 19R') for the year ended 31 December 2018.

LHR Airports Limited, which is an indirect subsidiary of HAH Group (the 'Group'), is the sponsor of the Defined Benefit ('DB') pension scheme, the Unfunded Unapproved Retirement Benefit ('UURBS') scheme and the Post-Retirement Medical Benefits ('PRM') scheme. Following the decision of the directors in 2015 to re-assess the Group's relationship with the legal sponsor of the retirement benefit schemes, it was determined that Heathrow Airport Limited, and therefore the Group, should act as principal in relation to these schemes. As a result, the Group now recognises retirement benefit obligations within its financial statements.

The Group's primary UK defined benefit pension fund is a self-administered defined benefit scheme (the 'BAA Pension Scheme' or the 'Scheme') now closed to new employees. As required by UK pension law, there is a Pension Trustee Board that, together with LHR Airports Limited, is responsible for governance of the Scheme. The employer's contributions are determined based on triennial valuations conducted on assumptions determined by the Trustee and agreed by LHR Airports Limited. The defined benefit obligation or surplus is calculated quarterly by independent actuaries.

LHR Airports Limited operates a defined contribution pension scheme for all employees who joined the Group after 15 June 2008. The Group has no further payment obligations once the contributions have been paid. The total cost of defined contribution pension arrangements is fully expensed as employment costs.

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the rules of the Scheme. In addition, LHR Airports Limited provides post-retirement medical benefits to certain pensioners.

Amounts arising from pensions related liabilities in the Group's financial statements

The following tables identify the amounts in the Group's financial statements arising from its pension related liabilities. Further details of each scheme (except defined contribution schemes) are within sections a) and b).

Income statement - pension and other pension related liabilities costs

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Employment costs:		
Defined contribution schemes	13	10
BAA Pension Scheme	34	29
	47	39
Finance charge - BAA Pension Scheme	3	1
Finance charge - Other pension and post retirement liabilities	1	-
Total pension costs	51	40

Other comprehensive income – gain /(loss) on pension and other pension related liabilities

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
BAA Pension Scheme	141	(65)
Unfunded schemes	3	1
Actuarial gain/(loss) recognised before tax	144	(64)
Tax (charge)/credit on actuarial gain/(loss)	(26)	10
Actuarial gain/(loss) recognised after tax	118	(54)

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

Retirement benefit obligations *continued*

Amounts arising from pensions related liabilities in the Group's financial statements continued

Statement of financial position – net defined benefit pension (deficit)/surplus and other pension related liabilities

The net deficit or surplus of the LHR Airports Limited retirement benefit schemes, being the BAA Pension Scheme, Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical Benefit Scheme, are recognised within non-current assets or non-current liabilities if the pension schemes are in a surplus or deficit position respectively. The net surplus or deficit is presented below for the current and previous four financial years.

	31 December				
	2018	2017	2016	2015	2014
	£m	£m	£m	£m	£m
Fair value of plan assets	3,869	4,085	3,975	3,288	3,274
Benefit obligation	(3,841)	(4,209)	(4,054)	(3,184)	(3,473)
Surplus/(deficit) in BAA Pension Scheme	28	(124)	(79)	104	(199)
Unfunded pension obligations	(28)	(29)	(29)	(22)	(24)
Post-retirement medical benefits	(4)	(5)	(6)	(6)	(6)
Deficit in other pension related liabilities	(32)	(34)	(35)	(28)	(30)
Net (deficit)/surplus in pension schemes	(4)	(158)	(114)	76	(229)
Group share of net (deficit)/surplus in pension schemes	(4)	(158)	(114)	76	(229)

(a) BAA Pension Scheme

The BAA Pension Scheme is a funded defined benefit scheme with both open and closed sections. The Scheme closed to employees joining the Group after 15 June 2008. The Scheme's assets are held separately from the assets of the HAH Group and are administered by the trustee.

The value placed on the Scheme's obligations as at 31 December 2018 is based on the full actuarial valuation carried out at 30 September 2015. This has been updated at 31 December 2018 by KPMG LLP to take account of changes in economic and demographic assumptions, in accordance with IAS 19R. The Scheme assets are stated at their bid value at 31 December 2018. As required by IAS 19R, the Group recognises re-measurements as they occur in the statement of comprehensive income.

Bulk Purchase Annuity Policy

On 24 May 2018, the BAA Pension scheme entered into an insurance annuity contract with Legal and General in respect of a proportion of its current pensioners. The annuity policy is recognised as a plan asset with a value equal to the value of the underlying obligations.

Guaranteed Minimum Pension ('GMP') Equalisation

A past service cost of £5.3 million has been recognised in the income statement, reflecting an estimate of the impact of allowing for the equalization of GMPs. This follows a case brought before the High Court by the Trustees of the Lloyds Bank Pension Schemes, judgement of which was delivered on October 2018.

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

16 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

Analysis of movements in plan assets and defined benefit obligations

	2018 £m	2017 £m
Fair value of plan assets at 1 January	4,085	3,975
<i>Income statement:</i>		
Interest income on plan assets	103	108
Administration costs	(3)	(3)
<i>Other comprehensive income:</i>		
Re-measurement gain/(loss) (return on assets in excess of interest income on plan assets)	(212)	75
Loss due to Bulk Purchase annuity	(23)	-
<i>Cash flows:</i>		
Employer contributions (including benefits paid and reimbursed)	48	50
Members' contributions	5	5
Benefits paid (by fund and Group)	(134)	(125)
Fair value of plan assets at 31 December	3,869	4,085
Defined benefit obligation at 1 January	(4,209)	(4,054)
<i>Income statement:</i>		
Current service cost	(26)	(26)
Past service cost	(5)	-
Interest cost	(106)	(109)
<i>Other comprehensive income:</i>		
Re-measurements of defined benefit obligation: arising from changes in financial assumptions	376	(140)
<i>Cash flows:</i>		
Members' contributions	(5)	(5)
Benefits paid (by fund and Group)	134	125
Defined benefit obligation at 31 December	(3,841)	(4,209)

The net actuarial gain before tax of £141 million (2017: £65 million net loss) resulted from a gain in change in assumptions of £376 million (2017: £140 million loss), partially offset by the asset loss of £235 million over the year, which includes a £23 million loss due to the Bulk Purchase Annuity transacted in Q2 (2017: £75 million return on assets in excess of the income statement credit).

The actuarial gain on change in financial assumptions is mainly attributable to an increase in the net yield of 0.45% over the year, based on a single equivalent discount rate assumption of 3.00% and an RPI inflation assumption of 3.40%. The discount rate used has increased from 2.55% in 2017 to 3.00% in 2018 and is derived from the yield on 'high quality corporate bonds' of duration consistent with liabilities of the scheme. The discount rate is based on a full yield curve approach, a 'single agency' approach where the yield curve is constructed from the Merrill Lynch corporate bond universe with at least one AA rating from the main ratings agencies. There were no changes attributable to demographic assumptions.

Analysis of fair value of plan assets

	31 December 2018 £m	31 December 2017 £m
Fair value of plan assets ¹		
Equity	607	540
Property	139	172
Bonds	1,127	1,405
Cash	118	59
LDI	1,152	1,579
Other	726	325
Total fair value of plan assets	3,869	4,085

¹Included in the fair value of plan assets above is £957.7 million (24.8%) valued at publicly quoted market price.

At 31 December 2018, the largest single category of investment was a liability driven investment ('LDI') mandate, with a value of £1,152 million (30% of the asset holding at 31 December 2018). The purpose of the Scheme entering into this

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

16 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

Analysis of fair value of plan assets *continued*

mandate is to reduce asset/liability mismatch risk. At 31 December 2017, the largest single category of investment was an LDI mandate, with value of £1,579 million (39% of the asset holding at 31 December 2017).

LDI holdings are portfolios of interest rate and inflation derivatives which are intended to protect the Scheme from movements in interest rates and inflation, so that the fair value of this element of the portfolio moves in the same way as the fair value of Scheme's obligations.

Analysis of financial assumptions

The financial assumptions used to calculate Scheme assets and liabilities under IAS 19R were:

	31 December 2018	31 December 2017
	%	%
Rate of increase in pensionable salaries	1.90	1.90
Increase to deferred benefits during deferment	2.65	2.65
Increase to pensions in payment:		
Open section	3.30	3.30
Closed section	3.40	3.40
Discount rate	3.00	2.55
Inflation assumption	3.40	3.40

The assumptions relating to longevity underlying the pension liabilities at the reporting date are in line with those adopted for the 2015 actuarial funding valuation and are based on standard actuarial mortality tables with an allowance for future improvements in longevity. The assumptions are equivalent to a life expectancy for a 60 year old male pensioner of 27.2 years (2017: 27.1 years) and 29.5 years (2017: 29.4 years) from age 60 for a 40 year old male non-pensioner.

The expected rate of inflation is an important assumption for the salary growth and pension increase assumptions. A rate of inflation is 'implied' by the difference between the yields on fixed and index-linked government bonds.

Interest income on the plan assets is calculated by multiplying the fair value of the plan assets by the discount rate discussed above.

As required under IAS 19R, interest income on the plan assets is calculated by multiplying the fair value of the plan assets by the discount rate discussed above.

Sensitivity analysis of significant assumptions

The following tables present a sensitivity analysis for each significant actuarial assumption showing how the defined benefit obligation would have been affected, before and after tax, by changes in the relevant actuarial assumptions that were reasonably possible at the reporting date.

The standard market practice is to include sensitivity to a change of between 0.1% and 1%. Therefore 0.5% is considered to be reasonable and in line with market practice.

The range of long term inflation and long dated AA bonds over 2018 were c.0.2% and 0.4% respectively, so the choice of 0.5% is deemed to be acceptable as pension sensitivities are aligned to historical trends.

	(Decrease)/increase in defined benefit obligation	
	Before tax	After tax
	£m	£m
Discount rate		
+0.50% discount rate	(368)	(302)
-0.50% discount rate	426	350
Inflation rate		
+0.50% inflation rate	345	283
-0.50% inflation rate	(309)	(254)
Mortality		
Increase in life expectancy by one year	134	110

The sensitivity analysis is based on a change in one assumption while holding all other assumptions constant, therefore interdependencies between assumptions are excluded, with the exception of the inflation rate sensitivity which also impacts salary and pension increase assumptions. The analysis also makes no allowance for the impact of changes in gilt and corporate bond yields on asset values. The methodology applied is consistent to that used to determine the recognised pension liability.

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

16 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

Sensitivity analysis of significant assumptions *continued*

The total contributions by the Company to the defined benefit pension scheme in 2019 are expected to be £48 million. The levels of contributions are based on the current service costs and the expected cash flows of the defined benefit pension scheme. The Company estimates the present value of the duration of the Scheme liabilities on average fall due over 21 years (2017: 21 years).

Management believes that the scheme has no significant plan specific or concentration risks.

(b) Other pension and post-retirement liabilities

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the Scheme rules. The unfunded pension obligations amount to £28 million (2017: £29 million) and are included in the statement of financial position.

In addition, LHR Airports Limited provides post-retirement medical benefits to certain pensioners. The present value of the future liabilities under this arrangement is £4 million (2017: £5 million) and this is also included in the statement of financial position. The value of these unfunded pensions has been assessed by the actuary using the same assumptions as those used to calculate the Scheme's liabilities.

17 Provisions

	Reorganisation costs £m	Home loss payments £m	Other £m	Total £m
Current	6	-	-	6
Non-current	-	7	1	8
1 January 2018	6	7	1	14
Charged to income statement	6	-	-	6
Utilised	(5)	-	-	(5)
Released to the income statement	(1)	-	-	(1)
31 December 2018	6	7	1	14
Current	6	7	-	13
Non-current	-	-	1	1
31 December 2018	6	7	1	14

Reorganisation costs

These are costs associated with the Company's reorganisation programmes primarily relating to restructuring processes designed to reduce the size and costs of overhead functions. The utilisation and release of the provision relates to the 2017 voluntary severance scheme in engineering and baggage operational areas. The charge relates to a provision established in 2018 for voluntary severance in Airport Operations and Security. The provision will be fully utilised in 2019.

Home loss payments

Between 2005 and 2011, the Company entered into a number of agreements to buy residential properties in the original third runway blight area. The purchase price for these properties included a deferred 10% payment ("deferred payment") which will be settled in cash when planning consent is obtained, expected to be around 2021. In October 2016, the Government announced its decision in favour of expansion at Heathrow and following board approval, a public statement was issued by the Company stating its intention to apply for planning consent, making it probable that the Company will be required to pay the deferred payment in the future. As a result, in the year ended 31 December 2016, the Company created a provision for the deferred payment equal to the amount it expects to pay of £7 million which is expected to be utilised in 2019.

Other

These provisions relate to insurance claims liability from incidents which occurred at Heathrow airport and are not expected to be paid in the next twelve months.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

18 Trade and other payables

	31 December 2018	31 December 2017
	£m	£m
Non-current		
Other payables	7	7
	7	7
Current		
Deferred income	49	33
Trade payables ¹	170	175
Other tax and social security	9	9
Other payables	11	10
Capital payables	135	134
Amount owed to group undertakings – operating ²	59	57
	433	418

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 Heathrow.

19 Share capital

	£m
Authorised	
At 1 January and 31 December 2018	
9,500,000,000 ordinary shares of £1 each	9,500
Called up, allotted and fully paid	
At 1 January and 31 December 2018	
3,109,350,689 ordinary shares of £1 each	3,109

20 Components of other comprehensive income

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

	Year ended 31 December 2018			Year ended 31 December 2017		
	Before tax £m	Tax (charge)/ credit £m	After tax £m	Before tax £m	Tax (charge)/ credit £m	After tax £m
Cash flow hedges						
(Losses)/gains taken to equity	(195)	33	(162)	(127)	22	(105)
Transferred to income statement	238	(40)	198	146	(25)	121
Actuarial gain/(loss) on pensions	144	(26)	118	(64)	10	(54)
Tax relating to indexation of operational land	-	-	-	-	2	2
Other comprehensive (loss)/ income	187	(33)	154	(45)	9	(36)

21 Retained earnings

	2018 £m	2017 £m
1 January	(3,171)	(3,287)
Adjustment in respect of IFRS15 and IFRS9	(3)	-
1 January restated	(3,174)	(3,287)
Consolidated profit for the year	412	503
Dividends paid to Heathrow (DSH) Limited (Note 5)	(497)	(335)
Tax relating to indexation of operational land	-	2
Actuarial gain/(loss) on pensions (Note 16)	144	(64)
Tax (charge)/credit on actuarial (profit)/loss (Note 20)	(26)	10
31 December	(3,141)	(3,171)

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

22 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 2018		31 December 2017	
	Land and buildings £m	Other £m	Land and buildings £m	Other restated £m
Within one year	14	38	13	28
Within two to five years	41	166	44	132
After five years	5	503	5	485
	60	707	62	645

The Group leases various offices, warehouses, plant and machinery under non-cancellable operating lease agreements.

A significant portion of the commitments classified as 'other' relate to the 'UKPNS Lease'. 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 UKPNS, as neither the Group nor UKPNS are able to split the base fee between a 'capital' and 'maintenance' charge. This is because the component parts within the distribution network will be replaced throughout the arrangement.

In prior year, the disclosure of the UKPNS Lease commitment was discounted at the Group's incremental borrowing rate as the estimated future cashflow included the year on year expected change in RPI. This approach was adopted as, due to the unusual and long-term nature of the lease, management believed it better represented the present value of the expected total cost of the lease. In the current year, the total commitment under the lease reflects the undiscounted cash flow and exclude the expected future RPI impact to more closely align with the requirements of IAS 17. The 2017 disclosure is restated accordingly.

Commitments total have increased from £645 million in 2017 to £707 million in 2018 mainly due to a new lease with First Great Western Limited signed on 17 April 2018 to replace the Heathrow Express trains owned by the group with new trains from First Great Western Limited.

Non-cancellable operating lease commitments – Group as a lessor

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

	31 December 2018	31 December 2017
	Land and buildings £m	Land and buildings £m
Within one year	88	95
Within two to five years	225	243
After five years	1,698	1,711
	2,011	2,049

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. Public car parks are covered by a single management contract.

Group commitments for property, plant and equipment

	31 December 2018	31 December 2017
	£m	£m
Contracted for, but not accrued:		
Baggage systems	77	155
Terminal restoration and modernisation	174	101
Capacity optimisation	20	23
IT projects	20	21
Other projects	35	23
	326	323

The figures in the above table are contractual commitments to purchase goods and services at the reporting date. Capital expenditure for the Q6 regulatory period from 1 April 2014 to 31 December 2018 was £2.9 billion (excluding expansion related costs). The Q6 capital programme was primarily focussed on maintenance and compliance related projects,

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

22 Commitments and contingent liabilities *continued*

Group commitments for property, plant and equipment *continued*

together with sustaining and improving the passenger experience. Capital spend in 2019 is forecast to be in the region of £700 million (excluding expansion related costs).

Other commitments

Heathrow Airport Limited has a commitment to pay £77 million to the Department for Transport in relation to the Crossrail project in return for a service commitment for Crossrail to operate services to Heathrow for 15 years, with payment expected during 2019. The amount will be included as an intangible asset in the financial statements and will be added to the RAB in accordance with the Q6 regulatory settlement.

Following the Government decision in October 2016 for Heathrow as preferred option for expansion, the Company recognises that up to 62 residential property owners could exercise their right under the previous scheme for which bonds were issued, to redeem those bonds at some point in the future. The Company's best estimate of the total payment is £21 million based on a valuation in accordance with the terms set out in the bond contract and assumes all 64 bondholders will exercise their option to sell. 2 houses were purchased in 2018 for a total cost of £1 million.

Following the designation of the Airports National Policy Statement on 26th June 2018, Heathrow has signed a Blight indemnification agreement with the Department for Transport, such that the Company will take responsibility for any successful claims for statutory blight of residential property under certain conditions. During the time between NPS designation and DCO consent is achieved, it is estimated that between 5% and 25% of the total eligible population may serve successful Blight notices. This would result in Heathrow's obligation to purchase properties at an estimated cost between £11m to £53m (based on expected 5%-25% take-up respectively). The cost includes an unaffected market value of the property plus 25% home loss payment and other costs. If all the relevant residential property owners were to submit a valid Blight claim, the Company's best estimate of the total payment is £212 million. It is expected that the cost of purchased properties will be added to the RAB.

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 2018 (2017: £1 million).

23 Notes to the consolidated cash flow statement

Reconciliation of net profit before tax to cash generated from continuing operations

	Note	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Operating activities			
Profit before tax		491	605
<i>Adjustments for:</i>			
Finance costs ¹	3	744	625
Finance income	3	(27)	(15)
Fair value gain on investment properties	1,7	(117)	(149)
Depreciation	2,6	719	654
Amortisation	2,8	27	40
Increase in trade and other receivables and inventories		(46)	(7)
Increase in trade and other payables		14	8
Decrease in provisions		-	(7)
Difference between pension charge and cash contributions		(15)	(22)
Cash generated from continuing operations		1,790	1,732

¹ Prior year finance income and finance costs have been restated by (£198) million and £198 million respectively to present interest payable and receivable on derivatives not in a hedge accounting relationship as net through finance cost.

Reconciliation in net debt

Net debt comprised the Group's consolidated borrowings, excluding interest accruals, net of cash and cash equivalents and term deposits.

	1 January 2018 £m	Cashflow £m	Transfers from non-current to current £m	Other non-cash changes ¹ £m	31 December 2018 £m
Cash and cash equivalents	523	72	-	-	595
Term deposits	12	108	-	-	120
Current debt	(1,097)	1,042	(529)	75	(509)
Non-current debt	(13,035)	(1,371)	529	(41)	(13,918)
Net debt	(13,597)	(149)	-	34	(13,712)
Intergroup funding	-	(75)	-	-	(75)
Net debt including intercompany	(13,597)	(224)	-	34	(13,787)

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Notes to the Group financial statements for the year ended 31 December 2018 *continued*

23 Notes to the consolidated cash flow statement *continued*

Reconciliation in net debt *continued*

	1 January 2017 £m	Cashflow £m	Transfers from non-current to current £m	Other non-cash changes ¹ £m	31 December 2017 £m
Cash and cash equivalents	286	237	-	-	523
Term deposits	380	(368)	-	-	12
Current debt	(1,217)	1,157	(1,059)	22	(1,097)
Non-current debt	(12,717)	(1,429)	1,059	52	(13,035)
Net debt	(13,268)	(403)	-	74	(13,597)

¹ Relates to amortisation of issue costs, premiums and discounts, foreign exchange translations of foreign debt, fair value adjustments on hedged bonds and accretion accruals.

24 Related party transactions

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

	Year ended 31 December 2018 Purchase of goods and services £m	Year ended 31 December 2017 Purchase of goods and services £m
Amey OWR Ltd	1	2
Ferrovial Agroman	69	61
	70	63

	Year ended 31 December 2018 Sales to related party £m	Year ended 31 December 2017 Sales to related party £m
Harrods International Limited	23	23
Qatar Airways	35	35
	58	58

Balances outstanding with related parties were as follows:

	31 December 2018		31 December 2017	
	Amounts owed by related parties £m	Amounts owed to related parties £m	Amounts owed by related parties £m	Amounts owed to related parties £m
Qatar Airways	2	-	2	-
	2	-	2	-

The related parties outlined above are related through ownership by the same parties. The transactions relate primarily to construction projects, loans and interest payable, and are conducted on an arm's length basis.

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 are known they are disclosed in the relevant statement of financial position caption, see Notes 10 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 10 and 18.

Heathrow Finance plc

Notes to the Group financial statements for the year ended 31 December 2018 *continued*

25 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 smallest and largest group to consolidate these financial statements. The shareholders of FGP Topco Limited all hold ordinary shares in the following proportion; 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 (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of GIC), QS Airports UK, LP (11.18%) (an investment vehicle managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (10.00%) (wholly-owned by 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 2018, 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 2018.

Copies of the financial statements of FGP Topco Limited, Heathrow Airport Holdings Limited and Heathrow Finance plc may be obtained by writing to the Company Secretarial Department at The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW. This is the registered office for the smallest and the largest undertaking to consolidate these financial statements.

26 Subsidiaries

The subsidiaries of the Group are as follows:

Holding companies

Heathrow (SP) Limited
Heathrow (AH) Limited †

Airport owner and operator

Heathrow Airport Limited †

Other

Heathrow Funding Limited †#
Heathrow Express Operating Company Limited †

† Held by a subsidiary undertaking

Incorporated in Jersey, but UK tax resident

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

The registered office of the Company's subsidiaries is the same as Heathrow Finance plc as set up below, with the exception of Heathrow Funding Limited whose registered office is 13 Castle Street, St Helier, Jersey, JE4 5UT, Channel Islands.

27 Subsequent events

On 20 February 2019, the Board approved the payment of a £101.78 million dividend to the Company's parent, Heathrow (DSH) Limited. A £101.78 million dividend receipt from the Company's subsidiary, Heathrow SP Limited, was also approved on 20 February 2018.

On the 29 January 2019, we issued an irrevocable redemption notice for our 2019 Heathrow Finance plc high yield bond, with the redemption date not less than 30 day and not more than 60 days after notice of redemption.

Registered office

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

Heathrow Finance plc

Company statement of financial position as at 31 December 2018

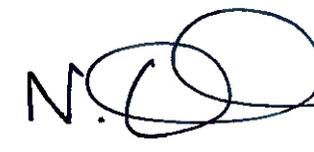
	Note	31 December 2018 £m	31 December 2017 £m
Assets			
Non-current assets			
Investment in subsidiary	2	5,006	5,006
Trade and other receivables	3	2,773	2,410
		7,779	7,416
Current assets			
Trade and other receivables	3	125	91
Cash at bank and in hand		4	10
		129	101
Total assets		7,908	7,517
Liabilities			
Non-current liabilities			
Trade and other payables	4	(1,381)	(1,307)
Current liabilities			
Trade and other payables	4	(297)	(26)
Total liabilities		(1,678)	(1,333)
Net assets		6,230	6,184
Capital and reserves			
Called up share capital	5	3,109	3,109
Revaluation reserve	6	1,997	1,997
Profit and loss reserve	6	1,124	1,078
Total shareholder's funds		6,230	6,184

The profit of the Company for the year attributable to shareholders was £543 million (2017: £1,129 million).

The financial statements of Heathrow Finance plc (Company registration number: 06458635) were approved by the Board of Directors and authorised for issue on 20 February 2019. They were signed on its behalf by:



Javier Echave
Director



Nicholas Golding
Director

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

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 investment in subsidiary in accordance with the Companies Act 2006 and applicable accounting standards. They have been prepared by the directors in accordance with FRS 101.

Under FRS 101, the Company has chosen to apply the recognition and measurement provisions of International Accounting Standard ('IAS') 27 'Separate Financial Statements', as endorsed by the European Union ('EU').

The Company has taken advantage of certain disclosure exemptions in FRS 101 as its financial statements are included in the publicly available consolidated financial statements of the Group. As such, the Company is exempt from presenting the Statement of cashflows and from the disclosures requirement to show related party transactions with entities that are wholly owned subsidiaries of the Company. In addition, the Company has also taken advantage of disclosure exemption of the income statement as allowed by the Companies Act. Copies of those consolidated financial statements may be obtained by writing to the Company Secretarial Department at the Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

The Company is not a financial institution and is therefore able to take advantage of exemption from all requirements of, IFRS 7 'Financial Instruments, IFRS 13 'Fair Value Measurement', IFRS 15 'Revenue from Contracts with Customers', IAS 1 'Presentation of Financial Statements' and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

The Group adopted IFRS 9 and IFRS 15 in accordance with IFRSs as issued by the IASB and this adoption has no impact on entity financial statements.

We consider that the disclosures required in the statement of changes in equity are satisfied by reference to Notes 1,5 and 6.

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 'HAH Group'), has adequate resources to continue in operational existence for the foreseeable future. The Company forms part of the HAH Group, the level at which financial risks are managed for the Company.

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

- the forecast turnover and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall HAH Group liquidity position, including cash resources, the remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and its ability to access the debt markets.

Whilst the Company is in 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 Company's funding requirement for the next twelve months from the balance sheet signing date.

Interest

Interest payable and interest receivable are recognised in the income statement in the period in which they are incurred.

Investments in subsidiaries

Investments in subsidiaries are stated at cost and reviewed for impairment if there are any indications that the carrying value may not be recoverable. Reversals are recognised where there is a favourable change in the economic assumptions in the period since the provision was made.

Intercompany loans receivable

Intercompany advances to other Group entities are all held till maturity, neither parties have an option to call or prepay the loan before the contracted maturity date.

Such assets are held under a business model to hold and collect contractual cash flows and therefore meet the SPPI test. No embedded derivatives are currently recognised in these advances, and the amortised cost classification is not impacted. All intercompany advances are assessed for impairment under the IFRS9 "expected credit losses model" (ECL).

Cash

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

Heathrow Finance plc

Accounting policies for the year ended 31 December 2018 *continued*

Trade and other payables

Amounts owed to group undertakings are recognised initially at fair value, net of transaction costs incurred. 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 method.

Current taxation

The tax expense for the year comprises current tax. Tax is recognised in the income statement.

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 reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

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.

Share capital

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

Heathrow Finance plc

Significant accounting judgements and estimates for the year ended 31 December 2018

In applying the Company's accounting policies, management have made judgements and estimates 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.

Critical judgements in applying the Company's accounting policies

There are no critical judgements for the Company.

Key sources of estimation uncertainty

Investment impairment review

The Company reviews investment in subsidiary for impairment if there are any indications that the carrying value may not be recoverable. The carrying value of the investment is compared to the recoverable amount of the subsidiary and where a deficiency exists, an impairment charge is considered by management. The recoverable amount has been calculated using the fair value less cost to sell methodology. Fair value less cost to sell has been calculated based on discounted cash flow projections of the business.

Heathrow Finance plc

Notes to the Company financial statements for the year ended 31 December 2018 *continued*

1 Company results for the year

As permitted by section 408 of the Companies Act 2006, the income statement of the Company is not presented as part of these financial statements. The profit of the Company for the year attributable to shareholders was £543 million (2017: £1,129 million).

2 Investments in subsidiaries

	£m
1 January 2018 and 31 December 2018	5,006

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 26 of the Heathrow Finance plc group financial statements.

3 Trade and other receivables

	31 December 2018 £m	31 December 2017 £m
Current:		
Interest receivable from group undertakings	74	40
Amounts owed by group undertakings - interest free	51	51
	125	91
Non-current		
Amounts owed by group undertakings - interest free ¹	74	74
Amounts owed by group undertakings - interest bearing ²	2,699	2,336
	2,773	2,410
Total debtors	2,898	2,501

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 2018, the rate on the debenture was 4.86% (2017: 5.13%). Also included is a loan advanced to Heathrow (DSH) Limited amounting to £508 million (31 December 2017: £508 million). As at 31 December 2018, the rate on the loan was 5.20%.

4 Trade and other payables

	31 December 2018 £m	31 December 2017 £m
Non-current		
Bonds	818	783
Loan facilities	488	524
Amounts owed to group undertakings - interest bearing ¹	75	-
	1,381	1,307
Current		
Bonds	262	-
Interest payable	20	19
Group relief payable	15	7
	297	26

¹ Interest bearing loan relates to the loan receivable from Heathrow (DSH) Limited. The rate on the loan was margin of 3.5% and LIBOR.

5 Share capital

	£m
Authorised	
At 31 December 2017 and 31 December 2018 9,500,000,000 ordinary shares of £1 each	9,500
Called up, allotted and fully paid	
At 31 December 2017 and 31 December 2018 3,109,350,689 ordinary shares of £1 each	3,109

6 Reserves

	Revaluation reserve £m	Profit and loss reserve £m	Total £m
1 January 2017	1,997	284	2,281
Profit for the financial year		1,129	1,129
Dividends paid ¹		(335)	(335)
31 December 2017	1,997	1,078	3,075
Profit for the financial year		543	543
Dividends paid (Note 5)		(497)	(497)
31 December 2018	1,997	1,124	3,121

Heathrow Finance plc

Notes to the Company financial statements for the year ended 31 December 2018 *continued*

7 Auditor's remuneration

Audit fees are recharged in accordance with the group Shared Service Agreements ('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 £30,000 (2017: £40,000) as remuneration for the audit of the Company's financial statements, the cost of which was borne by LHR Airports Limited.

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

8 Employee information and directors' remuneration

Employee numbers

The Company has no employees (2017: none).

Directors' remuneration

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

9 Guarantees

Securities and guarantees

The Company and Heathrow (DSH) Limited have granted security over all of their assets, which includes first priority security interests in the share capital of the Company and its wholly-owned subsidiary, Heathrow (SP) Limited, to secure their obligations under their financing agreements.

10 Subsequent events

On 20 February 2019, the Board approved the payment of a £101.78 million dividend to the Company's parent, Heathrow (DSH) Limited. A £101.78 million dividend receipt from the Company's subsidiary, Heathrow SP Limited, was also approved on 20 February 2019.

11 Ultimate parent undertaking

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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

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Registered in England Number: 06458635