

News release

24 February 2017

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Heathrow (SP) Limited

Results for the year ended 31 December 2016

- Heathrow delivered even better value to a record 75.7 million passengers (+1.0%) in 2016. Passenger charges fell by 1.0% and Heathrow retained its position as Europe's best hub for the third year running
- Strong financial performance underpins expansion plans with revenue of £2,807 million (+1.5%) and Adjusted EBITDA of £1,682 million (+4.8%) reflecting continued cost control and strong retail income growth
- Heathrow continues to deliver for the UK with a 3.0% increase in cargo volumes promoting British trade growth, support for British jobs with a £674 million investment in the airport and new services to Jakarta, San Jose, Santiago and Inverness
- Heathrow expansion moved into the delivery phase as the Government announced its support for a third runway and launched a 4-month public consultation on a National Policy Statement
- A more resilient UK economy boosted passenger volumes at the end of 2016, with the trend continuing into the early weeks of 2017

At or for year ended 31 December	2016	2015	Change (%)
<i>(£m unless otherwise stated)</i>			
Revenue	2,807	2,765	1.5
Adjusted EBITDA ⁽¹⁾	1,682	1,605	4.8
Cash generated from operations	1,652	1,592	3.8
Cash flow after investment and interest ⁽²⁾	387	361	7.2
Pre-tax profit ⁽³⁾	267	223	19.7
Heathrow (SP) Limited consolidated net debt ⁽⁴⁾	11,908	11,745	1.4
Heathrow Finance plc consolidated net debt ⁽⁴⁾	13,005	12,670	2.6
Regulatory Asset Base	15,237	14,921	2.1
Passengers (m) ⁽⁵⁾	75.7	75.0	1.0
Retail revenue per passenger (£) ⁽⁵⁾	8.09	7.58	6.7

Notes 1-5: see page 2

John Holland-Kaye, Chief Executive Officer of Heathrow, said:

"2016 was a milestone year for Heathrow. I am very proud of what our 76,000 colleagues have achieved. We gave better service at lower cost to a record number of passengers and helped British businesses across the country trade more with the rest of the world.

"We have started the planning process for expansion and are preparing the skills and the supply chain we will need to build it sustainably and affordably. Heathrow is delivering for Britain."

Notes

- (1) Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation, certain re-measurements and exceptional items
- (2) Cash flow after investment and interest is cash generated from operations after net capital expenditure and net interest paid
- (3) Pre-tax profit before exceptional items and certain re-measurements
- (4) Nominal net debt excluding intra-group loans and including inflation-linked accretion
- (5) Changes in passengers and retail revenue per passenger are calculated using unrounded passenger numbers

Heathrow (SP) Limited owns Heathrow airport and together with its subsidiaries is referred to as the Group. Heathrow Finance plc, also referred to as Heathrow Finance, is the parent company of Heathrow (SP) Limited.

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Conference call to be held for creditors and credit analysts on 24 February 2017 at 3.00pm (UK time), 4.00pm (Central European time), 10.00am (Eastern Standard Time), hosted by John Holland-Kaye, Chief Executive Officer and Javier Echave, Chief Financial Officer.

Dial-in details: UK local/standard international: +44 (0)20 3139 4830; North America: +1 718 873 9077. Participant PIN code: 53511830#

The presentation can be viewed at the Investor Centre at heathrow.com/company and online during the event at:

<https://arkadin-event.webex.com/arkadin-event/onstage/g.php?MTID=ea623dd416f2a02c641dc3801823bc78b>

using event password: 680374.

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Heathrow (SP) Limited

Consolidated results for the year ended 31 December 2016

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1 Review of the year

Heathrow saw excellent progress in 2016 towards its vision to give passengers the best airport service in the world. There was significant momentum in all four of its priorities: making Heathrow a great place to work, transforming the service to passengers and airlines, beating the business plan over the current regulatory period and winning support for expansion. These priorities are underpinned by a simple business logic that engaged people deliver great service which in turn delivers financial returns and Heathrow's licence to grow.

Heathrow's people are measurably more engaged. In the latest internal survey 78% of colleagues rated themselves engaged – up 10 points in 4 years. And Heathrow has been recognised as one of the top 30 UK companies in an annual national survey by The Sunday Times. Engagement efforts took many forms. All managers have participated in leadership and values training. Heathrow raised over £250,000 for the Duke of Edinburgh scheme with people participating in a range of community or personal challenges such as running the runway and a mass cycle race against a plane to New York. Heathrow signed a long term partnership with Hong Kong airport, one of the world's leading hub airports, which includes long term exchange of talented managers and in-depth peer reviews of core processes.

Heathrow is serving passengers better. Heathrow's people delivered the best ever result in the global Airport Service Quality survey of 4.19 in Q4 2016. This was supported by record baggage performance with 986 bags for every thousand passengers travelling as intended. Punctuality of flights also improved supported by airfield improvements, close work with airlines and innovative air traffic control. Skytrax's survey of over 16 million passengers yet again rated Heathrow the best airport in Western Europe and Terminal 5 the best airport terminal in the world.

In 2016, a record 75.7 million passengers flew through Heathrow, this was up 1.0% on 2015 and the sixth successive annual record. Major airlines added more seats per aircraft while also introducing cleaner, quieter and more efficient new generation aircraft such as the Boeing 787 Dreamliner and Airbus A350 to grow capacity at the airport. Airlines are also adding new destinations from Heathrow, with recent or imminent new long haul routes including Ahmedabad, Jakarta, New Orleans, Portland, Salt Lake City, San Jose (California), Santiago and Tehran.

Cost efficiency is as important to beating the plan as volume growth. Total cost efficiencies of over £500 million out of a target of £600 million to the end of 2018 have been secured. Savings were achieved in energy bills, key contracts and people costs. The latter included further reducing senior manager roles and increasing the proportion of people on new contracts. Over £200 million of incremental commercial revenue streams out of a target of £300 million have also been developed over the same period. Across the year revenue grew 1.5% to £2.8 billion and Adjusted EBITDA was up 4.8% to nearly £1.7 billion. In addition £1.6 billion in debt financing was raised in the year as Heathrow continues to capitalise on opportunities in the global debt capital markets.

The government supported expansion of Heathrow in October 2016. Expansion will connect all of Britain to the world, bringing up to 180,000 new jobs and £211 billion of economic growth across the UK. The decision was supported by a wide coalition built up over years. A new runway will be built to the north-west of the existing airport which will allow 260,000 more flights at Heathrow by 2030. Heathrow will also consult on adding 25,000 extra flights from 2021 on the existing runways, while reducing noise for local people, to give Britain a 'Brexit Boost' of jobs and growth as soon as possible. Heathrow is now working toward planning approval by 2020. Heathrow intends to deliver a world leading and ambitious airport that is affordable and financeable. It must also balance national and local economic gain with environmental impacts. Heathrow is seeking to deliver sustainable growth that ensures the careers of even more people, the growth of local communities and continued business success.

2 Key business developments

2.1 Passenger traffic

Heathrow's passenger traffic by geographic segment for the year ended 31 December 2016:

<i>(Millions)</i>	2016	2015	Change (%) ⁽¹⁾
UK	4.6	5.1	(9.6)
Europe	31.7	31.2	1.8
North America	17.2	17.3	(0.5)
Asia Pacific	10.8	10.5	2.8
Middle East	7.0	6.4	8.8
Africa	3.2	3.3	(4.1)
Latin America	1.2	1.2	1.4
Total passengers⁽¹⁾	75.7	75.0	1.0

(1) Calculated using unrounded passenger numbers

For the year ended 31 December 2016, traffic grew 1.0% to a record 75.7 million passengers (2015: 75.0 million) on a total of 470,764 passenger flights (2015: 469,671). The 2016 leap year contributed over 0.2% to the growth. The average number of seats per passenger aircraft increased 1.3% to 211.5 (2015: 208.7) and the average load factor was slightly lower at 76.0% (2015: 76.5%). On eight separate days (2015: 5 days) over a quarter of a million passengers used Heathrow. 2016 was the sixth successive year of record traffic at Heathrow. Traffic increased early in the year, softened either side of the EU referendum and then ended the year strongly.

Passengers had even greater choice in 2016, with new airlines, new destinations and more seats available per flight. In March 2016, Garuda followed in the steps of Vietnam Airlines and Air China and became the latest airline to move services from Gatwick to Heathrow, bringing Jakarta as a new destination at Heathrow. Other new long haul routes introduced in 2016 were Ahmedabad, Salt Lake City, San Jose (California) and Tehran.

Intercontinental traffic was the key driver of traffic growth in 2016, increasing 1.7%, with more flights operated and more seats per flight. A380 long haul aircraft now account for up to 26 departures per day by up to nine airlines.

Intercontinental traffic growth was particularly robust on routes serving the Middle East where passenger numbers increased 8.8% reflecting more flights and larger aircraft, including additional A380 services from Emirates, Etihad and Qatar Airways and British Airways' relaunched Tehran service. Momentum in this region increased in the second half of the year. The rise in Asia Pacific traffic of 2.8% included substantial growth on existing routes serving Thailand, China, Vietnam and the Philippines and new services to Indonesia. In the first quarter of the year, increased services to North America supported continued traffic growth with this region although geopolitical and macro-economic factors saw traffic soften as the year progressed. Latin American traffic grew 1.4% mainly reflecting modest remaining year on year benefits from Avianca's route to Colombia launched in 2014. There should be a further boost to traffic with this region in 2017 given British Airways launch in January of a regular flight between Heathrow and Santiago in Chile. African traffic was lower partly reflecting Virgin Atlantic's schedule changes in 2015.

European passengers increased by 1.8% although short haul traffic overall was only marginally higher year on year with growth in continental European traffic, driven by British Airways increasing seat capacity, largely offset by reduced UK traffic principally due to Virgin Little Red ending operations in 2015.

Over a quarter of the UK's non-EU exports by value pass through Heathrow today. Cargo volumes passing through Heathrow increased 3.0% in 2016 to 1.54 million metric tonnes (2015: 1.50 million tonnes). There were particularly notable increases in cargo volumes on Hong Kong, China and Vietnam.

2.2 Transforming customer service

Heathrow delivered its best ever passenger service in 2016 with a record 84% of passengers surveyed rating their overall experience as 'Excellent' or 'Very Good' (2015: 81%). Heathrow has now achieved a score above 4.00 in the Airport Service Quality ('ASQ') survey directed by Airports Council International ('ACI') for twelve successive quarters culminating in its highest ever quarterly score of 4.19 in the fourth quarter of 2016. Heathrow has been ranked first among major European hub airports for service quality in this survey for ten successive quarters.

The high service standards have resulted in Heathrow being named 'Best Airport in Western Europe' for the second consecutive year at the Skytrax World Airport Awards. The award, voted for globally by passengers, came in addition to Terminal 5 being named the world's 'Best Airport Terminal' and Heathrow 'Best Airport for Shopping' for the fifth and seventh consecutive years respectively. In addition, the new Plaza Premium Lounge in Terminal 2 was voted the world's best independent airport lounge in the same awards. For the first time, Heathrow received the prestigious accolade of 'Europe's Best Airport' (with over 40 million passengers) in the 2016 ASQ awards. Heathrow also received ACI Europe's Best Airport Award (with over 25 million passengers) for the third time. Heathrow's success was also recognised at the latest Frontier Awards where the airport won the categories of 'Operator of the Year' and 'Marketing Campaign of the Year by an Airport'.

Improvements to passengers' journeys through the airport continue. An additional escalator was opened in Terminal 5, improving operational flexibility and resilience. Passengers continue to enjoy efficient queuing to pass through security, passing through central security within the five minute period prescribed under the Service Quality Rebate scheme 97.0% of the time (2015: 97.4%) compared with a 95% service standard. The service quality regime penalty threshold was not triggered in 2016 in respect of any performance standard.

As part of the focus on increasing the resilience of operations, the final two of four new enhanced Instrument Landing Systems (eILS) were implemented at Heathrow. The eILS is based on new navigation technology and provides Heathrow with the capability to increase the number of aircraft that can land in low visibility giving improved safety, resilience and punctuality to airfield operations.

Heathrow had its busiest days ever in 2016 and achieved strong levels of service, with departure punctuality (the proportion of aircraft departing within 15 minutes of schedule) improving to 78.8% (2015: 78.1%). This reflects investments to improve operational resilience, including introducing time-based separation of aircraft on windy days in 2015. Further work on widening taxiways during 2016 to support increasing A380 operations also enabled more efficient use of the airfield. Baggage performance also improved significantly with the misconnect rate down to 14 bags per 1,000 passengers (2015: 17). The best ever monthly misconnect performance of 9 bags per 1,000 passengers was achieved in October 2016.

2.3 Beating the plan

Heathrow's business plan for the current regulatory period is intended to improve customer service, strengthen operational resilience and deliver an ambitious programme of cost efficiencies and revenue growth. Work continues to secure cost efficiencies and over £500 million of efficiencies have now been secured, out of the target £600 million for the period to the end of 2018. A three year pay offer was agreed in 2016 and further contract improvements have been secured with suppliers.

The benefits of investment in Terminal 5 retail outlets and new car parking capacity continue to flow through strongly with over £200 million secured out of the £300 million incremental commercial revenue target set for the regulatory period.

In March 2016, the CAA published its "Strategic Themes for the Review of Heathrow Airport's Charges (H7)" document. The document sets out the CAA's key milestones and details four key priorities for the next regulatory period (H7). The four priorities are 'empowering consumers and furthering their interests',

'incentivising the right consumer outcomes', 'increasing airport operational resilience' and 'promoting cost efficiency and financeability'. Heathrow responded to the CAA's consultation in April.

In addition, in July 2016, the CAA launched a consultation on the potential extension of Heathrow's current Q6 regulatory period in order, particularly, to reduce the risk that the process for agreeing the terms for the next regulatory period is sub-optimal due to uncertainty regarding potential new runway capacity. Following this process, on 21 December 2016, the CAA issued a formal notice to modify Heathrow's economic licence by extending Heathrow's current regulatory period by one year to 31 December 2019, rolling over the current price control of RPI-1.5% for the additional year.

2.4 Investing in Heathrow

In 2016, Heathrow invested over £650 million across the airport campus, improving the passenger experience and airport resilience, enhancing baggage resilience and working through a broad asset replacement programme. Passengers should benefit from improved baggage connection reliability following the opening of the Terminal 3 integrated baggage facility and see reduced baggage disruption as facilities are made more resilient. Security processes have been strengthened and made more efficient with more body scanners installed across terminals and additional automated immigration gates introduced. Also, passengers connecting through Terminal 5 should now experience an improved connection experience with the installation of an additional escalator.

The retail proposition at Terminal 4 is currently in the final stages of being significantly refreshed. The restaurant and bar group, Drake & Morgan, opened their first airport unit, 'The Commission'. Terminal 4's luxury stores, such as Harrods, Burberry and Cartier, are also being re-developed with five new luxury brands introduced, two of which are new to Heathrow. The luxury retail redevelopment in Terminal 5 has now been matched by the introduction of an enhanced food and beverage offer.

Airfield improvements continue to meet increased A380 operations with taxiway widening projects and stand modifications substantially completed. Winter operations will benefit from improved de-icing facilities and enhanced runway landing systems should assist arrivals punctuality. The refurbishment and enhancing of the main road access tunnels into the central terminal area will be completed in the coming months.

2.5 Responsible Heathrow

Giving passengers the best airport service in the world relies on managing the airport responsibly. Responsible Heathrow 2020 is Heathrow's commitment to supporting the UK and local economies whilst managing its impacts on communities and the environment. Building on progress achieved through Responsible Heathrow, during 2016 Heathrow consulted with leading sustainability experts and NGOs, the airport business community and local stakeholders to develop a new sustainability strategy. The plan sets long term, ambitious goals which demonstrate Heathrow's commitment to being a leader in sustainability.

In 2016, Heathrow delivered a number of initiatives and commitments that lay the foundation for the launch of the new plan and for strong performance in sustainable growth at Heathrow.

Heathrow's Noise Action Plan adopted by Government sets out over 40 actions to manage noise impacts. As part of this, in August 2016, Heathrow launched its second Blueprint for Noise Reduction. Key elements include introducing lower charges for the quietest types of aircraft (Chapter 14), such as the A350. This will make Heathrow the first airport in the world to differentiate charges for such aircraft. Another world first, Heathrow launched xPlane; enabling local residents to access flight data specific to their location and carry out their own comparative analysis.

Reducing the impact of night flights is also a key aspect of the noise blueprint. As part of this, Heathrow strives to minimise the number of aircraft departures after 11.30pm. In 2016, there were 330 such departures. Finally, as part of planning for future expansion of Heathrow, it is proposed that the new

runway is sited 1 mile further west than Heathrow's two existing runways to reduce the noise impact of aircraft on their final descent into the airport over central London. Heathrow aims to delay the start of early arrivals from 4.30am to 5.30am once planning approval for expansion is obtained.

Heathrow's 2016 blueprint for reducing emissions sets out a plan for working with partners to reduce emissions from aircraft, vehicles and buildings, as well as Heathrow's commitment to play its part in ensuring air quality limits in the local area are met. Progress has been made in several areas including increasing the range of electric vehicles in use on the airport and investing in infrastructure to help achieve Heathrow's aspiration to become an Ultra-Low Emission Zone (ULEZ). There are currently over 30 electric vehicles in the fleet or on order and approximately £400,000 was invested in 2016 to install electric vehicle chargers, with a further £1 million funding approved. During 2016, Heathrow also joined the Office for Low Emission Vehicles' Go Ultra Low Company initiative which requires large companies to convert at least 5% of their vehicles to electric by 2020.

Heathrow's energy footprint continues to shrink. The 2020 target of 6.5kWh per passenger was achieved in 2016, driven by the on-going reduction in electricity consumption due to Energy Demand Management works, such as installing nearly 100,000 LED lights across the airport, compared to 75,000 at the end of 2015. In 2016 Heathrow won the Onsite Energy Efficiency category at the Edie Environment and Energy Awards, in recognition of its energy efficiency programme which cut electricity use by 27GWh in 2015, as well as being shortlisted for the ACI Europe 2016 Eco-innovation Award.

Reflecting its commitment to be a responsible gateway to the world, in 2016 Heathrow became the first airport to sign the Buckingham Palace Declaration, a landmark agreement to shut down illegal wildlife trafficking routes. Heathrow also launched the Responsible Gateway Forum which works collaboratively with third parties including the Metropolitan Police, Border Force and specialist NGOs to tackle issues around the detection of and support for vulnerable travellers.

June saw the launch of Heathrow's Skills Task Force - an independent taskforce chaired by Lord Blunkett - to provide strategic advice and guidance in developing a comprehensive employment and skills strategy for the Heathrow area that will ensure the business, including its supply chain, has the skills needed to build and operate an expanded airport.

Finally, in 2016, "Sustainable Growth" became one of Heathrow's four strategic priorities, in recognition of its commitment to operate and grow the airport sustainably, now and in the future.

2.6 Expansion

On 25 October 2016, Heathrow welcomed the Government's decision to support its expansion and confirmed it will begin work to deliver the new runway that will connect all of Britain to the world, bringing new jobs and economic growth to every nation and region of the UK. A new third runway to the north west of Heathrow will deliver a world leading, ambitious and affordable plan which balances the huge national and local economic gain from expansion with the environmental impacts.

The Government's decision follows the unanimous and unambiguous recommendation of the Airports Commission in July 2015 after a two and a half year, £20 million study. A third runway will bring huge benefits to everyone in Britain, creating up to 180,000 jobs and £211 billion of growth across the country. As the UK charts a new course outside the EU, it will enable up to 40 new long-haul trading routes and support Britain's exporters to reach the fastest growing markets in the world. To give Britain a 'Brexit Boost' and unlock jobs and growth across the country sooner, Heathrow will consult on plans to bring in 25,000 extra flights per year from 2021.

In July 2016, the Civil Aviation Authority ('CAA') commenced consultation on the regulatory treatment of costs incurred in obtaining the development consent order ('DCO') required to proceed with expansion (so called 'Category B' costs). Heathrow currently estimates £250-300 million of such costs will be incurred primarily between 2017 and 2020. Following responses to its initial consultation, in November 2016, the CAA issued its final proposals in relation to these costs.

Subsequently, Heathrow's licence has been modified to enable it to recover up to £10 million per annum of Category B costs through aeronautical income shortly after they are incurred. The CAA's proposals on other aspects of Category B costs, to be finalised in February 2017, include mechanisms that allow (i) costs in excess of £10 million per annum to be added to the regulatory asset base ('RAB'), (ii) the regulatory cost of capital to accrue on the costs once added to the RAB, (iii) recovery of the costs following receipt of the DCO and (iv) risk sharing under which either 105% or 85% of costs added to the RAB will be recovered if the DCO is granted or not granted, respectively.

In January 2017, the CAA initiated consultation on its key priorities and timetable for the development of the regulatory framework for Heathrow's expansion and in particular, the regulatory treatment of costs and financing of the construction programme (so called 'Category C' costs). Four key priorities are expected to be considered: (i) the expansion scheme must be designed to promote the interests of consumers by engaging with airlines in a transparent and effective manner, (ii) cost estimates must be robust and their regulatory treatment must incentivise timely and efficient delivery of the project, (iii) Heathrow must develop proposals for efficient financing while the regulatory framework needs to be consistent with efficient financing, affordability and financeability and (iv) affordability and financeability principles must apply to both existing operations and new runway and capacity expansion. Responses to this consultation are due by 14 March 2017 and a further consultation on the regulatory framework is expected in June 2017. In addition, the CAA intends to publish an update on the business plan expectations and outcomes for the next regulatory period in April 2017.

In February 2017, the Government published its draft Airports National Policy Statement ('NPS') outlining its policy for Heathrow's expansion. The publication started a 16-week public consultation on the draft NPS. A number of planning requirements are being consulted on, which are reflected in Heathrow's plans, including providing compensation to communities affected by the expansion, purchasing properties affected by the scheme at a 25% premium, implementing measures mitigating noise including a six and a half hour ban on scheduled night flights, setting specific mode share targets to curb impacts on air quality and demonstrating the scheme can be delivered in compliance with legal requirements on air quality. A final version of the NPS is expected to be submitted to a vote in Parliament during winter 2017/18.

In addition, Heathrow will run the first of two public consultations later this year as it develops its DCO for submission to the Planning Inspectorate.

2.7 Key management changes

On 22 June 2016, Paul Deighton succeeded Sir Nigel Rudd as Chairman of the board of Heathrow Airport Holdings Limited.

On 10 November 2016, Heathrow announced Javier Echave as Chief Financial Officer, who had acted as interim since the departure of Michael Uzielli in May 2016.

3 Financial review

3.1 Basis of presentation of financial results

Heathrow (SP) Limited ('Heathrow (SP)') is the holding company of a group of companies that owns Heathrow airport and operates the Heathrow Express rail service (the 'Group'). Heathrow (SP) consolidated accounts are prepared under International Financial Reporting Standards ('IFRS').

3.2 Income statement

3.2.1 Overview

In the year ended 31 December 2016, the Group's operating profit before certain re-measurements was £1,013 million (2015: £923 million) and its loss after tax was £144 million (2015: £664 million profit).

Year ended 31 December	2016 £m	2015 £m
Excluding exceptional items and certain re-measurements		
Revenue	2,807	2,765
Operating costs before depreciation and amortisation	(1,125)	(1,160)
Adjusted EBITDA⁽¹⁾	1,682	1,605
Depreciation and amortisation	(669)	(682)
Adjusted operating profit	1,013	923
Net finance costs	(746)	(700)
Adjusted profit before tax	267	223
Tax charge on profit before exceptional items and certain re-measurements	(67)	(54)
Including exceptional items and certain re-measurements		
Exceptional items	-	236
Fair value gain on investment properties	44	95
Fair value (loss)/gain on financial instruments	(524)	148
Tax credit/(charge) on exceptional items & certain re-measurements	83	(88)
Tax credit relating to change in tax rate	53	104
(Loss)/profit after tax	(144)	664

(1) Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation, certain re-measurements and exceptional items. Management uses Adjusted EBITDA to monitor the performance of the segments as it believes it more accurately reflects the underlying financial performance of the Group's operations. For the year ended 31 December 2016, Adjusted EBITDA was £1,682 million (2015: £1,605 million) and EBITDA was £1,726 million (2015: £1,936 million).

3.2.2 Revenue

In the year ended 31 December 2016, revenue increased 1.5% to £2,807 million (2015: £2,765 million).

Year ended 31 December	2016 £m	2015 £m	Change (%)
Aeronautical	1,699	1,699	-
Retail	612	568	7.7
Other	496	498	(0.4)
Total revenue	2,807	2,765	1.5

3.2.2.1 Aeronautical

In the year ended 31 December 2016, aeronautical revenue was flat at £1,699 million (2015: £1,699 million) as Heathrow delivered better value for passengers and airlines with lower charges as average aeronautical revenue per passenger declined 1.0% to £22.45 (2015: £22.67).

Traffic growth of 1.0% generated £16 million incremental revenue and yield concentration, due primarily to more long haul and origin and destination passengers and a greater proportion of departing passengers than expected, also boosted year on year performance. These factors were offset by a lower maximum allowable yield due to the RPI-1.5% tariff formula, the non-recurrence of significant K factor recovery in 2015 and adjustments to reflect lower capital expenditure than forecast in the original regulatory settlement.

3.2.2.2 Retail

In the year ended 31 December 2016, retail revenue increased 7.7% to £612 million (2015: £568 million). Retail revenue per passenger rose 6.7% to £8.09 (2015: £7.58).

Year ended 31 December	2016 £m	2015 £m	Change (%)
Duty and tax-free	138	128	7.8
Airside specialist shops	115	100	15.0
Bureaux de change	50	53	(5.7)
Catering	49	45	8.9
Other retail income	86	75	14.7
Car parking	114	107	6.5
Other services	60	60	-
Total retail revenue	612	568	7.7

Retail performed strongly in 2016 following the major redevelopment of luxury stores in Terminal 5 including new brands which have strengthened Heathrow's unrivalled airport shopping experience. Performance in duty and tax-free stores has continued to improve following extensive store refurbishment in Terminals 4 and 5. Catering has grown in the year as a result of new and refurbished outlets and increases in passenger participation. Car parking also performed well, with continued take-up of Heathrow's expanded car parking product range and successful yield management. Growth in retail income accelerated in the second half of the year, particularly in areas such as duty and tax-free and airside specialist shops, driven by the depreciation of sterling following the EU referendum in late June 2016. Redevelopment of luxury stores in Terminal 4 was largely completed in late 2016 and started contributing to overall retail performance.

3.2.2.3 Other

In the year ended 31 December 2016, other revenue fell 0.4% to £496 million (2015: £498 million).

Year ended 31 December	2016 £m	2015 £m	Change (%)
Other regulated charges	232	239	(2.9)
Heathrow Express	134	132	1.5
Property and other	130	127	2.4
Total other revenue	496	498	(0.4)

Other regulated charges reflect a pass through to airlines of Heathrow's costs in areas such as baggage system operations and maintenance and utilities so the year on year reduction reflects not only lower costs but better value for airlines. Performance elsewhere in other revenue reflects growth from Heathrow Express, partly driven by the introduction of a more sophisticated pricing strategy, and additional property revenue supported by the opening of new independent lounges in Terminals 3 and 4.

3.2.3 Operating costs

In the year ended 31 December 2016, operating costs excluding depreciation, amortisation and exceptional items decreased 3.0% to £1,125 million (2015: £1,160 million).

Year ended 31 December	2016 £m	2015 ⁽¹⁾ £m	Change (%)
Employment	373	384	(2.9)
Operational	265	253	4.7
Maintenance	176	187	(5.9)
Business rates	128	123	4.1
Utilities	74	92	(19.6)
Other	109	121	(9.9)
Total operating costs	1,125	1,160	(3.0)

⁽¹⁾ For the year ended 31 December 2015, £11 million of costs previously included under 'Other' have been re-classified into 'Operational' to be consistent with current year disclosure.

Employment costs benefited from previously announced changes to the defined benefit pension scheme as well as take-up of voluntary severance programmes, lower new starter pay levels, lower headcount, automation and other workforce efficiencies, partially offset by higher costs for implementing organisational change. Higher operational costs reflect increased investment in operational resilience partially offset by improved service driving lower service quality rebates and savings from the re-negotiated NATS contract for providing aerodrome navigation services. The rise in business rates reflects general national trends with Heathrow remaining one of the UK's highest business rate payers. Other costs reflect savings across consultancy, marketing and general expenditure.

Significantly lower utilities costs particularly reflect a re-negotiated contract for the provision of electricity distribution infrastructure services due to a combination of recurrent cost savings and a one-off credit of £14 million related to prior periods. A focus on energy demand management continues to drive savings in electricity consumption. For example, Heathrow is the first European hub airport to install LED lighting on all aircraft stands. The number of LED light installations across the Heathrow campus is approaching 100,000, compared to 75,000 at the end of 2015. Additionally, since Terminal 2's opening, Heathrow has generated around 5GWh of electricity on-site, from solar panels and a biomass renewable energy facility.

3.2.4 Operating profit before certain re-measurements

For the year ended 31 December 2016, the Group recorded an operating profit after exceptional items but before certain re-measurements of £1,013 million (2015: £1,159 million).

Year ended 31 December	2016 £m	2015 £m	Change (%)
Adjusted EBITDA	1,682	1,605	4.8
Depreciation and amortisation	(669)	(682)	(1.9)
Exceptional items	-	236	n.m
Operating profit before certain re-measurements	1,013	1,159	(12.6)

In the year ended 31 December 2016, Adjusted EBITDA (before certain re-measurements and exceptional items) increased 4.8% to £1,682 million (2015: £1,605 million), resulting in an Adjusted EBITDA margin of 59.9% (2015: 58.0%). Depreciation and amortisation decreased to £669 million (2015: £682 million) mainly due to the decommissioning of Terminal 1 during 2015 and some Terminal 2 and 5 assets being reassessed in the year as having longer useful economic lives. This decrease is partly offset by the accelerated depreciation of Terminal 3 to reflect the Airport Masterplan.

3.2.5 Exceptional items

In the year ended 31 December 2016, there were no exceptional items (2015: £236 million credit).

Year ended 31 December	2016 £m	2015 £m
Pension scheme: changes to terms	-	236
Exceptional pre-tax credit	-	236

In 2015, changes were agreed to the Group's defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members which resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under IAS19, and was classified as an exceptional item in the income statement. There was no immediate cash flow impact as a result of these changes.

3.2.6 Taxation

For the year ended 31 December 2016, the profit before tax and certain re-measurements and exceptional items of £267 million (2015: £223 million) resulted in a tax charge of £67 million (2015: £54 million). This results in an effective tax rate of 25.1% (2015: 24.2%), compared to the UK statutory rate of 20% (2015: 20.25%). The effective tax rate is higher than the statutory rate due to non-deductible expenses and the fact that a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

The total tax credit recognised was £69 million (2015: £38 million charge) which includes the impact of the change in future UK tax rates, certain re-measurements and exceptional items.

3.3 Cash flow

3.3.1 Summary cash flow

In the year ended 31 December 2016, there was an increase of £108 million in cash and cash equivalents compared with a decrease of £94 million in 2015.

Year ended 31 December	2016 £m	2015 £m
Cash generated from operations	1,652	1,592
Taxation:		
Corporation tax paid	(45)	(24)
Group relief (paid)/received	(15)	14
Net cash from operating activities	1,592	1,582
Purchase of property, plant and equipment	(660)	(595)
Purchase of investment properties	-	(7)
Purchase of intangible assets	(14)	(25)
Decrease/(increase) in term deposits	170	(380)
Increase in group deposits	(26)	(29)
Interest received	4	5
Net cash used in investing activities	(526)	(1,031)
Dividends paid to Heathrow Finance plc	(596)	(380)
Increase in amount owed to Heathrow Finance plc	260	48
Proceeds from issuance of bonds, term notes and other financing	919	1,172
Repayment of bonds and facilities and other financing items	(778)	(663)
Swap restructuring	20	-
Settlement of accretion on index-linked swaps	(188)	(213)
Interest paid	(595)	(609)
Net cash used in financing activities	(958)	(645)
Net increase/(decrease) in cash and cash equivalents	108	(94)
Cash generated from operations after capital expenditure and net interest paid	387	361

At 31 December 2016, the Group had £660 million (2015: £720 million) of cash, cash equivalents and term deposits, of which cash and cash equivalents comprised £280 million (2015: £172 million).

3.3.2 Cash generated from operations

In the year ended 31 December 2016, cash generated from operations increased 3.8% to £1,652 million (2015: £1,592 million). The following table reconciles Adjusted EBITDA to cash generated from operations.

Year ended 31 December	2016 £m	2015 £m
Adjusted EBITDA (before certain re-measurements and exceptional items)	1,682	1,605
(Increase)/decrease in receivables and inventories ¹	(19)	24
Increase/(decrease) in payables	13	(20)
Increase in provisions	7	5
Difference between pension charge and cash contributions	(31)	(22)
Cash generated from operations	1,652	1,592

(1) Excludes movement in group deposits

3.3.3 Dividends/restricted payments

The financing arrangements of the Group and Heathrow Finance restrict certain payments unless specified conditions are satisfied. These restricted payments include, among other things, payments of dividends, distributions and other returns on share capital, any redemptions or repurchases of share capital, and payments of fees, interest or principal on any intercompany loans.

In the year ended 31 December 2016, Heathrow's ultimate shareholders received £325 million in dividends (2015: £300 million) reflecting the continued strong performance achieved by the business including delivering better value for airlines and passengers and significantly improving service. This made up a substantial proportion of the total restricted payments paid from Heathrow (SP) Limited in the year which amounted to £406 million (net) or £666 million (gross). Other than payments made to fund dividends to ultimate shareholders, net restricted payments related principally to meeting £70 million (2015: £65 million) of interest on the debenture between Heathrow (SP) and Heathrow Finance plc and £29 million (2015: £33 million) of interest payments at ADI Finance 2 Limited.

3.4 Pension scheme

Heathrow operates a defined benefit pension scheme, the BAA Pension Scheme, which closed to new members in June 2008. At 31 December 2016, the defined benefit pension scheme, as measured under IAS 19, had a deficit of £79 million (2015: £104 million surplus). The £183 million change in the year is primarily due to net actuarial losses of £219 million, partly offset by contributions in excess of current service cost of £34 million, including £25 million for agreed deficit repair contributions.

The deterioration in the scheme actuarial position was driven by a fall in the net discount rate, particularly corporate bond yields which fell significantly following the EU referendum. As a result, Heathrow's IAS19 pension liabilities have increased by £822 million, whilst assets have increased by £603 million, partly offsetting the increase in liabilities and reflecting the value of having a significant proportion of the scheme's assets that perform in a manner expected to be consistent with key drivers of change in the scheme's liabilities.

In July 2016, the trustee of the BAA Pension Scheme concluded a formal actuarial valuation of the scheme. The valuation was carried out as at 30 September 2015 and took into account changes implemented to reduce the scheme's liabilities. These changes were the introduction of an annual cap on future increases in pensionable pay for active members and a reduction in both the accrual rate for future service and inflationary increases for those future service pensions whilst in payment. The valuation indicated a scheme deficit of £228 million calculated using the agreed actuarial assumptions. As part of the process, LHR Airports Limited agreed a reduction to its annual deficit repair contribution from £27 million to £23 million that is intended to eliminate the deficit by 2022. The process also resulted in a reduction in ongoing cash contributions from 33% to 23% of pensionable salary, consistent with the

efficiency targets under the current regulatory settlement. The reduction in cash contributions into the scheme applied from 1 July 2016 and is estimated at £12 million per annum.

3.5 Recent financing activity

Heathrow continues to focus on maintaining a strong liquidity position and optimising its long-term cost of debt as well as ensuring duration, diversification and resilience in its debt financing. Heathrow's recent financing strategy has looked to balance certainty of term funding, particularly to meet £1.1 billion in debt maturities in the first quarter of 2017, with the cost of carrying substantial cash on balance sheet. This has been achieved partly by securing term debt with delays between commitment and drawing.

In 2016, Heathrow raised approximately £1.6 billion of debt financing globally from a diverse range of sources. In January 2016, it consolidated its presence in the Swiss franc bond market, raising CHF400 million in an 8 year public bond with a fixed rate coupon of 0.5%. In June 2016, a £350 million 3.75 year term loan was signed with an initial group of 5 banks which is expected to be drawn by the end of the first quarter of 2017. Also in July 2016, a £400 million, 33 year public bond with a fixed rate coupon of 2.75% was issued, extending Heathrow's maturity profile. In August 2016, a £90 million private placement from non-sterling sources which was signed in April 2016 was drawn and matures in 2032. In December 2016, a NOK1 billion private placement which was signed in July 2016 was drawn and matures in 2029.

At Heathrow Finance, a £150 million, 12 year term loan agreed earlier in the year was drawn in December 2016. In addition, Heathrow Finance entered into £200 million in 7-10 year term loans which are expected to be drawn in 2017.

Given the strength of its liquidity position, Heathrow has cancelled £250 million of its £1.4 billion core revolving credit facilities. The maturity of these facilities has also been extended by a year to October 2021. Further, £130 million of its £750 million liquidity facilities have been cancelled as Heathrow continues to focus on the efficiency of its financing arrangements for itself and counterparties.

Heathrow repaid £300 million and €500 million (£434 million) bonds in March 2016 and October 2016 respectively. Also during 2016, £195 million of term loan facilities at ADI Finance 2 Limited were repaid which are being replaced by debt raised at Heathrow Finance as Heathrow evolves to a simpler debt capital structure.

Since the start of 2017, Heathrow has also repaid €700 million (£584 million) and CHF400 million (£272 million) bonds in January 2017 and February 2017 respectively.

Heathrow currently expects to raise no more than £750 million in senior (Class A) term debt in 2017.

3.6 Financing position

3.6.1 Debt and liquidity at Heathrow (SP) Limited

The Group's nominal net debt increased 1.4% to £11,908 million at 31 December 2016 (2015: £11,745 million) and comprised £11,951 million in bonds, £438 million in term debts and £179 million in index-linked derivative accretion offset by £660 million cash at bank and term deposits. Nominal net debt comprised £10,168 million in senior net debt and £1,740 million in junior debt.

The average cost of the Group's nominal gross debt at 31 December 2016 was 4.08% (2015: 4.36%). 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 2016 was 5.22% (2015: 4.95%). The reduction in the average cost of debt excluding index-linked accretion since the end of 2015 is mainly due to the maturity on 31 March 2016 of a bond with a 12.45% coupon and the increased cost of debt including index-linked accretion reflects higher inflation at the end of 2016 compared to the end of 2015.

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

The accounting value of the Group's net debt was £12,189 million at 31 December 2016 (2015: £11,114 million). This includes £280 million of cash and cash equivalents and £380 million of term deposits, as reflected in the statement of financial position, and excludes accrued interest.

Heathrow expects to have sufficient liquidity to meet all its obligations in full up to December 2018. The obligations include forecast capital investment (including expected investment over the coming years related to potential expansion), debt service costs, debt maturities and distributions. The liquidity forecast takes into account £2.4 billion in undrawn loan facilities and cash resources at 31 December 2016 as well as expected operating cash flow over the period.

3.6.2 Debt at Heathrow Finance plc

The consolidated nominal net debt of Heathrow Finance increased 2.6% to £13,005 million at 31 December 2016 (2015: £12,670 million). This comprises the Group's £11,908 million nominal net debt, Heathrow Finance's gross debt of £1,103 million and cash held at Heathrow Finance of £6 million.

3.6.3 Net finance costs and net interest paid

In the year ended 31 December 2016, the Group's net finance costs before certain re-measurements were £746 million (2015: £700 million) and net interest paid was £591 million (2015: £604 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	2016 £m	2015 £m
Net finance costs before certain re-measurements and exceptional items	746	700
Amortisation of financing fees and other items	(28)	(15)
Borrowing costs capitalised	35	22
Underlying net finance costs	753	707
Non-cash accretion on index-linked instruments	(139)	(74)
Other movements	(23)	(29)
Net interest paid	591	604

Underlying net finance costs were £753 million (2015: £707 million) after adjusting for capitalised borrowing costs of £35 million (2015: £22 million) and non-cash amortisation of financing fees, discounts and fair value adjustments of debt of £28 million (2015: £15 million). The year-on-year increase in underlying net finance costs primarily reflects higher index-linked accretion due to higher inflation during 2016 compared to 2015 partially offset by favourable pension-related charges and lower interest rates in the period.

Net interest paid in the period was £591 million (2015: £604 million) of which £521 million (2015: £539 million) related to external debt. The remaining £70 million (2015: £65 million) of interest paid related to the debenture between Heathrow (SP) and Heathrow Finance. The reduction in interest paid primarily reflects the ongoing process of new lower cost financing replacing more expensive legacy debt.

Net interest paid is lower than underlying net finance costs primarily due to non-cash accretion on index-linked instruments.

Included within certain re-measurements is a fair value loss on financial instruments of £524 million (2015: £148 million gain) driven by a combination of lower long-term sterling interest rates and higher inflation expectations.

3.6.4 Financial ratios

The Group and Heathrow Finance continue to operate comfortably within required financial ratios.

Gearing ratios under the Group's financing agreements are calculated by dividing consolidated nominal net debt by Heathrow's Regulatory Asset Base ('RAB') value. At 31 December 2016, Heathrow's RAB was £15,237 million (2015: £14,921 million).

At 31 December 2016, the Group's senior (Class A) and junior (Class B) gearing ratios were 66.7% and 78.2% respectively (2015: 67.5% and 78.7% respectively) compared with trigger levels of 70.0% and 85.0% under its financing agreements. Heathrow Finance's gearing ratio was 85.4% (2015: 84.9%) compared to a covenant level of 90.0% under its financing agreements.

In the year ended 31 December 2016, the Group's senior and junior interest cover ratios (the ratio of cash flow from operations (excluding cash exceptional items) less tax paid less 2% of RAB to interest paid) were 3.12x and 2.50x respectively (2015: 2.90x and 2.36x respectively) compared to trigger levels of 1.40x and 1.20x under its financing agreements. Heathrow Finance's interest cover ratio was 2.25x (2015: 2.12x) compared to a covenant level of 1.00x under its financing agreements.

3.7 Outlook

The early weeks of 2017 have been characterised by stronger than expected traffic volumes. Forecast Adjusted EBITDA for 2017 remains consistent with the guidance set out in the investor report published in December 2016 at £1,660 million.

Appendix 1 Financial information

Heathrow (SP) Limited

Consolidated income statement for the year ended 31 December 2016

	Note	Audited Year ended 31 December 2016			Audited Year ended 31 December 2015		
		Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items ^a £m	Total £m	Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items ^a £m	Total £m
Continuing operations							
Revenue	1	2,807	-	2,807	2,765	-	2,765
Operating costs	2	(1,794)	-	(1,794)	(1,842)	236	(1,606)
Other operating items							
Fair value gain on investment properties			44	44		95	95
Operating profit		1,013	44	1,057	923	331	1,254
Financing							
Finance income		218	-	218	252	-	252
Finance costs		(964)	-	(964)	(952)	-	(952)
Fair value (loss)/gain on financial instruments			(524)	(524)		148	148
Net finance costs	4	(746)	(524)	(1,270)	(700)	148	(552)
(Loss)/profit before tax		267	(480)	(213)	223	479	702
Tax credit/(charge) before change in tax rate		(67)	83	16	(54)	(88)	(142)
Change in tax rate		-	53	53	-	104	104
Taxation credit/(charge)	5	(67)	136	69	(54)	16	(38)
(Loss)/profit for the year		200	(344)	(144)	169	495	664

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

Heathrow (SP) Limited

**Consolidated statement of comprehensive income
for the year ended 31 December 2016**

	Audited Year ended 31 December 2016	Audited Year ended 31 December 2015
	£m	£m
(Loss)/profit for the year	(144)	664
Items that will not be subsequently reclassified to the consolidated income statement:		
Tax relating to retirement benefits ^a	-	(10)
Actuarial net (loss)/gain on retirement benefit schemes:		
Gain/(loss) on plan assets	501	(101)
(Increase)/decrease in scheme liabilities	(688)	98
Tax relating to indexation of operational land	1	-
Change in tax rate	6	7
Items that may be subsequently reclassified to the consolidated income statement:		
Cash flow hedges:		
Gain/(loss) taken to equity	264	(129)
Transferred to income statement	(241)	175
Change in tax rate	(7)	(9)
Other comprehensive (loss)/income for the year net of tax	(164)	31
Total comprehensive (loss)/income for the year^b	(308)	695

^a For the year ended 31 December 2015, related to a £50 million commutation payment for which the Group receives no tax relief.

^b Attributable to owners of the parent.

Heathrow (SP) Limited
Consolidated statement of financial position
as at 31 December 2016

	<i>Note</i>	Audited 31 December 2016 £m	Audited 31 December 2015 £m
Assets			
Non-current assets			
Property, plant and equipment		11,306	11,248
Investment properties		2,200	2,156
Intangible assets		122	133
Retirement benefit surplus		-	104
Derivative financial instruments		676	175
Trade and other receivables		27	23
		14,331	13,839
Current assets			
Inventories		11	11
Trade and other receivables		271	253
Derivative financial instruments		78	-
Term deposits		380	550
Cash and cash equivalents		280	172
		1,020	986
Total assets		15,351	14,825
Liabilities			
Non-current liabilities			
Borrowings	6	(13,240)	(12,212)
Derivative financial instruments		(1,419)	(1,100)
Deferred income tax liabilities		(849)	(1,016)
Retirement benefit obligation		(114)	(28)
Provisions		(9)	(2)
Trade and other payables		(8)	(11)
		(15,639)	(14,369)
Current liabilities			
Borrowings	6	(1,241)	(993)
Derivative financial instruments		-	(90)
Provisions		(12)	(5)
Current income tax liabilities		(30)	(31)
Trade and other payables		(408)	(412)
		(1,691)	(1,531)
Total liabilities		(17,330)	(15,900)
Net liabilities		(1,979)	(1,075)
Equity			
Capital and reserves			
Share capital		11	11
Share premium		499	499
Merger reserve		(3,758)	(3,758)
Cash flow hedge reserve		(268)	(284)
Retained earnings		1,537	2,457
Total shareholder's equity		(1,979)	(1,075)

Heathrow (SP) Limited

**Consolidated statement of changes in equity
for the year ended 31 December 2016**

	Attributable to owners of the Company (Audited)					Total equity £m
	Share capital £m	Share premium £m	Merger reserve £m	Cash flow hedge reserve £m	Retained earnings £m	
1 January 2015	11	499	(3,758)	(321)	2,179	(1,390)
Comprehensive income:						
Profit for the year					664	664
Other comprehensive income:						
Fair value gains on cash flow hedges net of tax				46	-	46
Tax relating to retirement benefit					(10)	(10)
Actuarial loss on pension net of tax:						
Loss on plan assets					(101)	(101)
Decrease in scheme liabilities					98	98
Change in tax rate				(9)	7	(2)
Total comprehensive income				37	658	695
Transaction with owners:						
Dividends paid to Heathrow Finance plc					(380)	(380)
Total transaction with owners					(380)	(380)
31 December 2015	11	499	(3,758)	(284)	2,457	(1,075)
Comprehensive income:						
Loss for the year					(144)	(144)
Other comprehensive income:						
Fair value gains on cash flow hedges net of tax				23	-	23
Actuarial loss on pension net of tax:						
Gain on plan assets					501	501
Increase in scheme liabilities					(688)	(688)
Tax relating to indexation of operational land					1	1
Change in tax rate				(7)	6	(1)
Total comprehensive income				16	(324)	(308)
Transaction with owners:						
Dividends paid to Heathrow Finance plc					(596)	(596)
Total transaction with owners					(596)	(596)
31 December 2016	11	499	(3,758)	(268)	1,537	(1,979)

Heathrow (SP) Limited

**Consolidated statement of cash flows
for the year ended 31 December 2016**

	Note	Audited Year ended 31 December 2016 £m	Audited Year ended 31 December 2015 £m
Cash flows from operating activities			
Cash generated from operations	7	1,652	1,592
Taxation:			
Corporation tax paid		(45)	(24)
Group relief (paid)/received		(15)	14
Net cash from operating activities		1,592	1,582
Cash flows from investing activities			
Purchase of:			
Property, plant and equipment		(660)	(595)
Investment properties		-	(7)
Intangible assets		(14)	(25)
Decrease/(increase) in term deposits ¹		170	(380)
Increase in group deposits ²		(26)	(29)
Interest received		4	5
Net cash used in investing activities		(526)	(1,031)
Cash flows from financing activities			
Dividends paid to Heathrow Finance plc		(596)	(380)
Increase in amount owed to Heathrow Finance plc		260	48
Proceeds from issuance of bonds		829	1,022
Repayment of bonds		(734)	(619)
Issuance of term notes		90	150
Repayment of facilities and other items		(44)	(44)
Swap restructuring		20	-
Settlement of accretion on index-linked swaps		(188)	(213)
Interest paid		(595)	(609)
Net cash used in financing activities		(958)	(645)
Net increase/(decrease) in cash and cash equivalents		108	(94)
Cash and cash equivalents at beginning of year		172	266
Cash and cash equivalents at end of year		280	172

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

² Group deposits are amounts settled with LHR Airports Limited during the year under the terms of the SSA.

Heathrow (SP) Limited

General information and accounting policies for the year ended 31 December 2016

General information

The financial information set out herein does not constitute the Group's statutory financial statements for the year ended 31 December 2016 or 31 December 2015. Statutory financial statements for the year ended 31 December 2015 have been filed with the registrar of Companies on 20 March 2016. The annual financial information presented herein for the year ended 31 December 2016 is based on, and is consistent with, the audited consolidated financial statements of Heathrow (SP) Limited (the 'Group') for the year ended 31 December 2016. The auditors' report on the 2016 financial statements was unqualified, did not contain an emphasis of matter paragraph and did not contain any statements under section 498(2) or (3) of the Companies Act 2006.

Accounting policies

Basis of preparation

The consolidated financial statements of Heathrow (SP) Limited have been prepared in accordance with IFRS as issued by the International Accounting Standards Board ('IASB') and as adopted by the European Union ('EU') and prepared under the historical cost convention, except for investment properties, derivative financial instruments and financial liabilities that qualify as hedged items under a fair value hedge accounting system. These exceptions to the historical 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 accounting policies adopted in the preparation of this consolidated financial information are consistent with those applied by the Group in its audited consolidated financial statements for the year ended 31 December 2016.

Heathrow (SP) Limited

Notes to the consolidated financial information for the year ended 31 December 2016

1 Segment information

Management has determined the reportable segments of the business based on those contained within the monthly reports reviewed and utilised by the relevant Board for allocating resources and assessing performance. These segments relate to the operations of Heathrow and Heathrow Express.

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

The reportable segments derive their revenues from a number of sources including aeronautical, retail, other regulated charges ('ORCs') 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 2016 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 and a reconciliation to the consolidated loss for the period.

Table (b) details comparative information to table (a) for the year ended 31 December 2015.

Year ended 31 December 2016	Segment revenue				Total external revenue £m	Adjusted EBITDA £m
	Aero-nautical £m	Retail £m	ORCs £m	Other £m		
Heathrow	1,699	612	232	130	2,673	1,616
Heathrow Express				134	134	66
Continuing operations	1,699	612	232	264	2,807	1,682
Reconciliation to statutory information:						
Unallocated income and expense						
Depreciation and amortisation						(669)
Operating profit (before certain re-measurements and exceptional items)						1,013
Fair value gain on investment properties (certain re-measurements)						44
Operating profit						1,057
Finance income						218
Finance costs						(964)
Fair value loss on financial instruments (certain re-measurements)						(524)
Loss before tax						(213)
Taxation before certain re-measurements						(67)
Taxation (certain re-measurements)						136
Taxation						69
Loss for the year						(144)

Heathrow (SP) Limited

**Notes to the consolidated financial information
for the year ended 31 December 2016**

1 Segment information *continued*

Year ended 31 December 2015	Segment revenue				Total external revenue £m	Adjusted EBITDA £m
	Aero-nautical £m	Retail £m	ORCs £m	Other £m		
Heathrow	1,699	568	239	127	2,633	1,525
Heathrow Express				132	132	80
Continuing operations	1,699	568	239	259	2,765	1,605
Reconciliation to statutory information:						
Unallocated income and expense						
Depreciation and amortisation						(682)
Operating profit (before certain re-measurements and exceptional items)						923
Exceptional items						236
Fair value gain on investment properties (certain re-measurements)						95
Operating profit						1,254
Finance income						252
Finance costs						(952)
Fair value gain on financial instruments (certain re-measurements)						148
Profit before tax						702
Taxation before certain re-measurements and exceptional items						(54)
Taxation (certain re-measurements and exceptional items)						16
Taxation						(38)
Profit for the year						664

Heathrow (SP) Limited

**Notes to the consolidated financial information
for the year ended 31 December 2016**

2 Operating costs – ordinary

	Audited Year ended 31 December 2016 £m	Audited Year ended 31 December 2015 ¹ £m
Employment	373	384
Operational	265	253
Maintenance	176	187
Business rates	128	123
Utilities	74	92
Other	109	121
Total adjusted operating costs	1,125	1,160
Depreciation and amortisation	669	682
Operating costs before exceptional items	1,794	1,842
Exceptional items (Note 3)	-	(236)
Total operating costs	1,794	1,606

¹For the year ended 31 December 2015, £11 million of costs previously included under 'Other' have been re-classified into 'Operational' to be consistent with current year disclosure.

3 Exceptional items

	Audited Year ended 31 December 2016 £m	Audited Year ended 31 December 2015 £m
Pension credit: change to terms	-	(236)
Total operating exceptional items	-	(236)

Pensions

The Company agreed changes to the defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members which resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under IAS19, which was classified as an exceptional item in the income statement. There was no immediate cash flow impact as a result of these changes.

Heathrow (SP) Limited

**Notes to the consolidated financial information
for the year ended 31 December 2016**

4 Financing

	Audited Year ended 31 December 2016 £m	Audited Year ended 31 December 2015 £m
Finance income		
Interest receivable on derivatives not in hedge relationship	209	247
Interest on deposits	5	5
Net pension finance income	4	-
	218	252
Finance costs		
Interest on borrowings:		
Bonds and related hedging instruments ¹	(591)	(583)
Bank loans and overdrafts and related hedging instruments	(56)	(50)
Interest payable on derivatives not in hedge relationship ²	(275)	(259)
Facility fees and other charges	(9)	(7)
Net pension finance costs	-	(4)
Interest on debenture payable to Heathrow Finance plc	(67)	(70)
Unwinding of discount on provisions	(1)	(1)
	(999)	(974)
Less: capitalised borrowing costs ³	35	22
	(964)	(952)
Net finance costs before certain re-measurements	(746)	(700)
Fair value (loss)/gain on financial instruments		
Interest rate swaps: ineffective portion of cash flow hedges	-	(1)
Interest rate swaps: not in hedge relationship	(122)	35
Index-linked swaps: not in hedge relationship	(436)	87
Cross-currency swaps: ineffective portion of cash flow hedges	10	(10)
Cross-currency swaps: ineffective portion of fair value hedges	24	37
	(524)	148
Net finance costs	(1,270)	(552)

¹ Includes accretion of £26 million (2015: £9 million) on index-linked bonds.

² Includes accretion of £113 million (2015: £65 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 4.89% (2015: 5.20%) to expenditure incurred on such assets.

Heathrow (SP) Limited

**Notes to the consolidated financial information
for the year ended 31 December 2016**

5 Taxation

	Audited Year ended 31 December 2016			Audited Year ended 31 December 2015		
	Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items £m	Total £m	Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items £m	Total £m
UK corporation tax						
Current tax charge at 20% (2015: 20.25%)	(56)	(2)	(58)	(55)	-	(55)
Under provision in respect of prior years	(1)	-	(1)	(4)	-	(4)
Deferred tax						
Current year credit/(charge)	(8)	89	81	1	(88)	(87)
Prior year (charge)/credit	(2)	(4)	(6)	4	-	4
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	-	53	53	-	104	104
Taxation credit/(charge) for the year	(67)	136	69	(54)	16	(38)

The tax credit/(charge) on the Group's (loss)/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 set out in the following reconciliation:

	Audited Year ended 31 December 2016 £m	Audited Year ended 31 December 2015 £m
Profit before tax (before certain re-measurements and exceptional items)	267	223
Reconciliation of the tax charge		
Tax calculated at the UK statutory rate of 20% (2015: 20.25%)	(53)	(45)
Adjustments in respect of current income tax of previous years	(1)	(4)
Net non-deductible expenses	(11)	(9)
Adjustments in respect of deferred income tax of previous years	(2)	4
Total tax charge before certain re-measurements and exceptional items excluding change in UK corporation tax rate	(67)	(54)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	53	104
Tax credit/(charge) on certain re-measurements and exceptional items ¹	83	(88)
Taxation credit/(charge) for the year	69	(38)

¹This consists of the tax impact arising from fair value gains/losses on investment property revaluations and fair value gains/losses on financial instruments, along with any associated prior year adjustments.

The total tax credit recognised for the year ended 31 December 2016 was £69 million (2015: £38 million charge). Based on a loss before tax for the year of £213 million (2015: £702 million profit), this results in an effective tax rate of 32.4% (2015: 5.4%).

Excluding the impact of the change in tax rate, the total tax charge, before certain re-measurements and exceptional items for the year ended 31 December 2016 was £67 million (2015: £54 million) based on profit before tax, certain re-measurements and exceptional items of £267 million (2015: £223 million), this results in an effective tax rate of 25.1% (2015: 24.2%). The tax charge is more (2015: more) than implied by the statutory rate of 20% (2015: 20.25%) primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. Consequently the Group's significant deferred tax balances, which were previously provided at 18%, were re-measured at the future tax rate at which the Group believes the timing differences will reverse. This has resulted in a net reduction in the deferred tax liability and a corresponding net deferred tax credit of £53 million being recognised in the income statement.

In December 2016 and January 2017 the UK government published draft legislation on a new interest deductibility regime, in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). It has been announced that, effective from 1 April 2017, interest deductions will be limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public benefit infrastructure exemption (PBIE). Whilst the legislation could impact the future tax charge of the Group, Heathrow expects to be largely protected from the 30% of tax based EBITDA cap through the use of the PBIE and GRR. The position will be clarified when the legislation is enacted later in 2017.

Other than these changes, there are no items which would materially affect the future tax charge.

Heathrow (SP) Limited

**Notes to the consolidated financial information
for the year ended 31 December 2016**

6 Borrowings

	Audited 31 December 2016 £m	Audited 31 December 2015 £m
Current borrowings		
Secured		
Bonds:		
12.450% £300 million due 2016	-	303
4.125% €500 million due 2016	-	366
4.375% €700 million due 2017	598	-
2.500% CHF400 million due 2017	318	-
	916	669
Heathrow Airport Limited loans	36	39
Total current (excluding interest payable)	952	708
Interest payable – external	266	259
Interest payable – owed to group undertakings	23	26
Total current	1,241	993
Non-current borrowings		
Secured		
Bonds:		
4.375% €700 million due 2017	-	516
2.500% CHF400 million due 2017	-	271
4.600% €750 million due 2018	627	527
6.250% £400 million due 2018	399	398
4.000% C\$400 million due 2019	240	195
6.000% £400 million due 2020	398	397
9.200% £250 million due 2021	272	271
3.000% C\$450 million due 2021	274	225
4.875% US\$1,000 million due 2021	833	703
1.650%+RPI £180 million due 2022	199	195
1.875% €600 million due 2022	534	453
5.225% £750 million due 2023	669	659
7.125% £600 million due 2024	591	590
0.500% CHF400 million due 2024	314	-
3.250% C\$500 million due 2025	303	248
4.221% £155 million due 2026	155	155
6.750% £700 million due 2026	692	691
2.650% NOK1,000 million due 2027	93	77
7.075% £200 million due 2028	198	198
2.500% NOK1,000 million due 2029	85	-
1.500% €750 million due 2030	614	504
6.450% £900 million due 2031	850	854
Zero-coupon €50 million due January 2032	52	43
1.366%+RPI £75 million due 2032	79	77
Zero-coupon €50 million due April 2032	52	43
4.171% £50 million due 2034	50	50
Zero-coupon €50 million due 2034	46	39
1.061%+RPI £180 million due 2036	183	115
1.382%+RPI £50 million due 2039	53	51
3.334%+RPI £460 million due 2039	587	576
1.238%+RPI £100 million due 2040	103	101
5.875% £750 million due 2041	738	741
4.625% £750 million due 2046	742	741
1.372%+RPI £75 million due 2049	79	77
2.750% £400 million due 2049	392	-
	11,496	10,781

Heathrow (SP) Limited

**Notes to the consolidated financial information
for the year ended 31 December 2016**

6 Borrowings *continued*

	Audited 31 December 2016 £m	Audited 31 December 2015 £m
Secured <i>continued</i>		
Heathrow Airport Limited debt:		
Term note: 3.770% £100 million due 2026	100	100
Term note: 2.630% £80 million due 2030	80	79
Term note: 3.160% £90 million due 2032	89	-
Term note: 2.970% £70 million due 2035	70	70
Loans	62	98
Unsecured		
Debenture payable to Heathrow Finance plc	1,343	1,084
Total non-current	13,240	12,212
Total borrowings (excluding interest payable)	14,192	12,920

7 Cash generated from operations

	Audited Year ended 31 December 2016 £m	Audited Year ended 31 December 2015 £m
Operating activities		
(Loss)/profit before tax	(213)	702
<i>Adjustments for:</i>		
Net finance costs	1,270	552
Depreciation and amortisation	669	682
Fair value gain on investment properties	(44)	(95)
<i>Working capital changes:</i>		
(Increase)/decrease in inventories and trade and other receivables	(19)	24
Increase/(decrease) in trade and other payables	13	(20)
Increase in provisions	7	5
Difference between pension charge and cash contributions	(31)	(22)
Exceptional pension credit: change to terms	-	(236)
Cash generated from operations	1,652	1,592