



CAA Final Proposals for Q6 Regulatory Period Bondholder and Lender Update

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Heathrow Alternative Business Plan builds on transformation undertaken over last 10 years

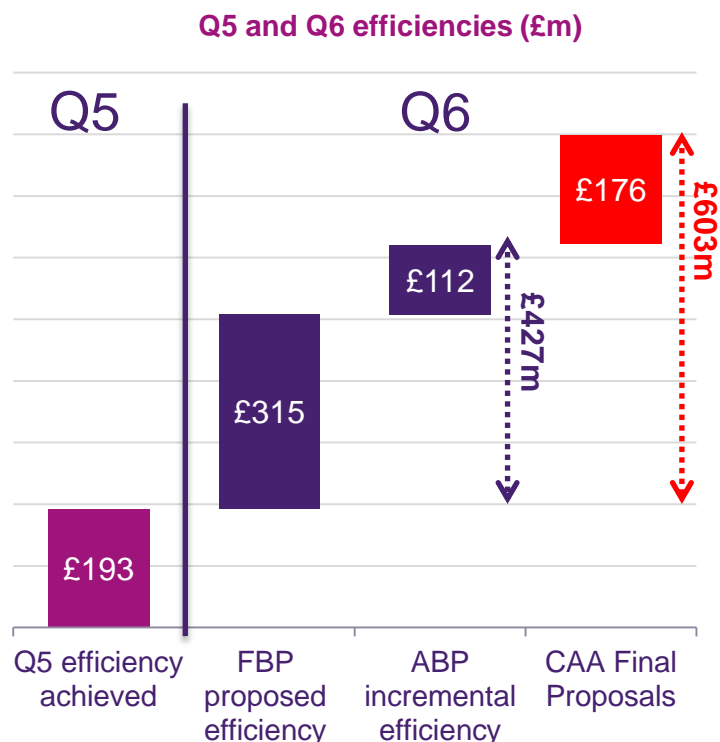
- Further enhances passenger experience, improves resilience and offers a competitive total cost of operation
- Supports single-till with further growth in world leading non-aeronautical activities
- Operating cost efficiencies of £427 million across Q6
- £3 billion capital plan with fair and reasonable settlement
- Proposed price control RPI +4.6%

CAA Final Proposals

- Proposed price control RPI+0%. Average airport charge over Q6 of £20.65
- Pre-tax, real WACC assumed at 5.6% over Q6 (previously 5.35%)
- Passenger forecast of 359.2 million including factor for external shocks
- Total non-aeronautical income includes £66 million stretch
- Operating efficiencies £603 million, £176 million higher than Heathrow plan
- Capital investment plan of £2.885 billion
- Main differences between price control of Alternative Business Plan and CAA Final Proposals:
 - CAA targets higher opex savings which accounts for 0.8pts of difference in 'X'
 - CAA continues to assume a lower cost of capital which accounts for 3.4pts of difference in 'X'
- Reopening of settlement unchanged from Q5, with no specific triggers

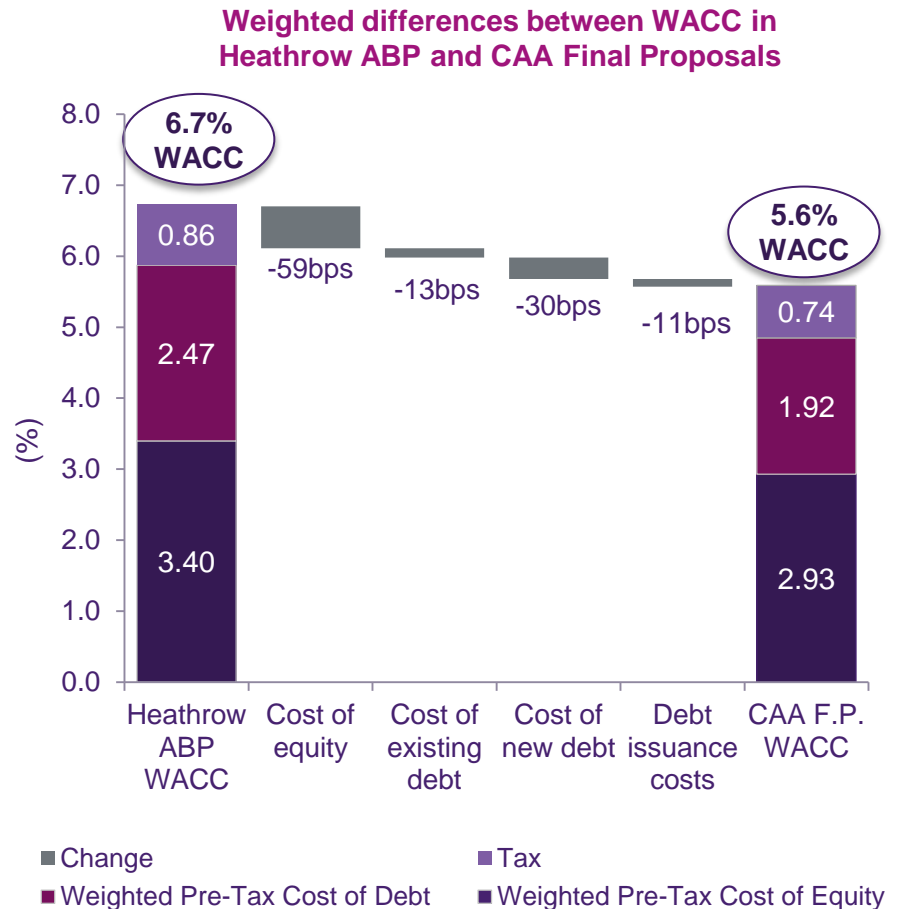
Operating efficiencies key to ongoing transformation - CAA Final Proposals challenging given pace of delivery

- Delivering Q5 operating efficiencies
 - exit Q5 achieving the CAA's efficiency target for operating expenses
 - opex per passenger down 8% since 2008
- ABP opex efficiencies of £427m
 - equivalent to 2.0% pa compound reduction, excluding structural factors
 - reduction in controllable costs of 3.1% pa compound
- CAA opex efficiencies of £603m
 - further efficiencies assume additional wage reductions, removal of non-wage 'glide path' and stretch targets
 - rates risk-sharing mechanism added
- Final Proposals very challenging given proposed scale and speed



Movement in cost of capital, but still materially lower than Heathrow expected

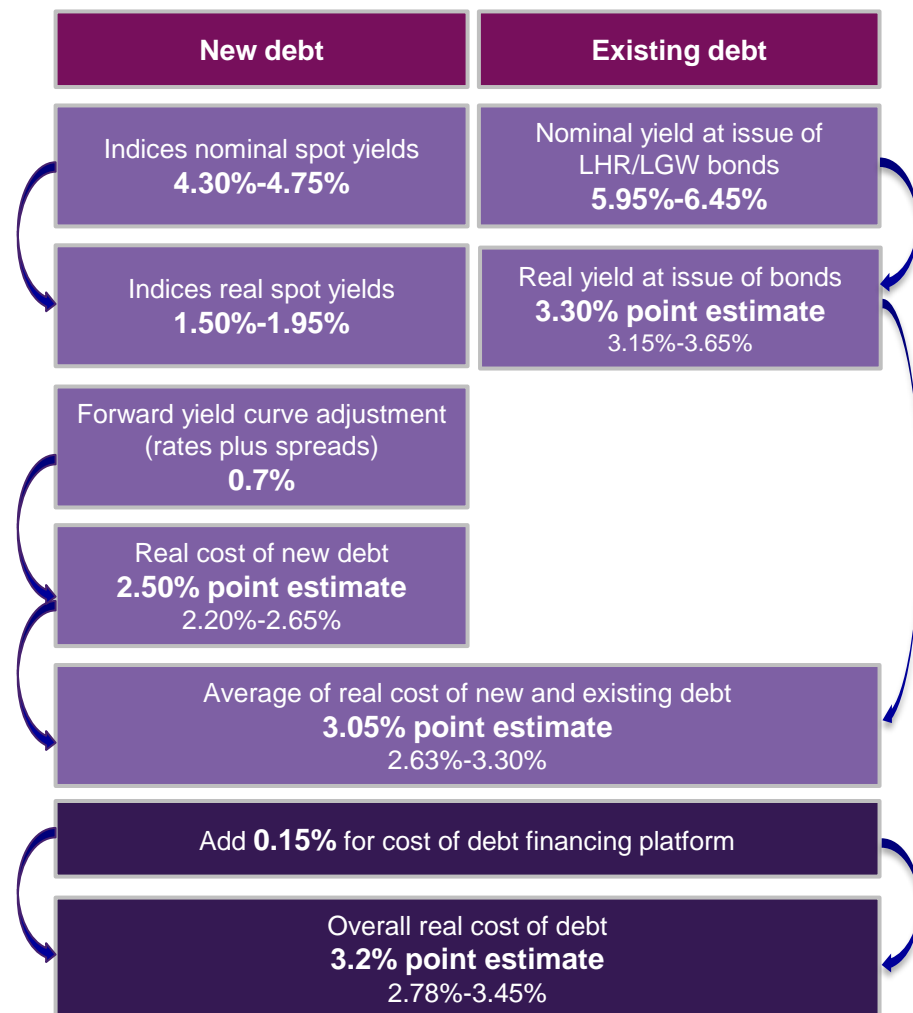
- Final Proposals assume 5.6% weighted average cost of capital
 - Initial Proposals allowed 5.35% WACC
- Cost of equity differences remain, still over 100bps apart
 - equity market returns remain below UK regulatory precedent
 - inconsistent with risk hierarchy of UK regulated businesses
- Cost of debt increased, but remain apart, impacted by:
 - credit spreads
 - risk-free rate
 - cost of debt financing platform
- CAA not pursuing debt indexation



Cost of debt assumptions revisited in Final Proposals

- CAA Final Proposals assume 3.2% cost of debt
 - increased from 2.86% in Initial Proposals
 - range increased to 2.78%-3.45% (Initial Proposals: 2.3%-3.0%)
- Methodology mainly consistent with Initial Proposals, key changes:
 - applies greater weight to existing debt
 - removes non-sterling bonds from assessment
 - increases forward curve adjustment

CAA cost of debt assessment



Allowed cost of debt assumes only modest increase in future rates and understates true cost to the business

- Inadequate reflection of rising rate environment
 - subjective view that 100bps rise in gilt yields will see only 80bps rise in corporate yields
 - change to data cut-off date
- Cost of debt understated by only referencing sterling market
 - Heathrow bears additional cost from need to issue debt outside Sterling
- Allowance for New Issue Premium ('NIP') on new debt withdrawn
 - PWC previously estimated NIP at 40-50 bps, although incorrectly annuitised over 10 years
 - PWC reassessed existence of NIP and concluded it should be withdrawn, based on flawed comparison of historical new issue yields to secondary trading indices
 - Heathrow previously provided market evidence to CAA of 'basic' NIP of 15-20bps; NIP averaged 20bps on last 3 Heathrow Class A sterling bonds
- Cost to maintain required Revolving Credit Facility remains understated

Key milestones

2013

4 November – Responses to CAA Final Proposals

2014

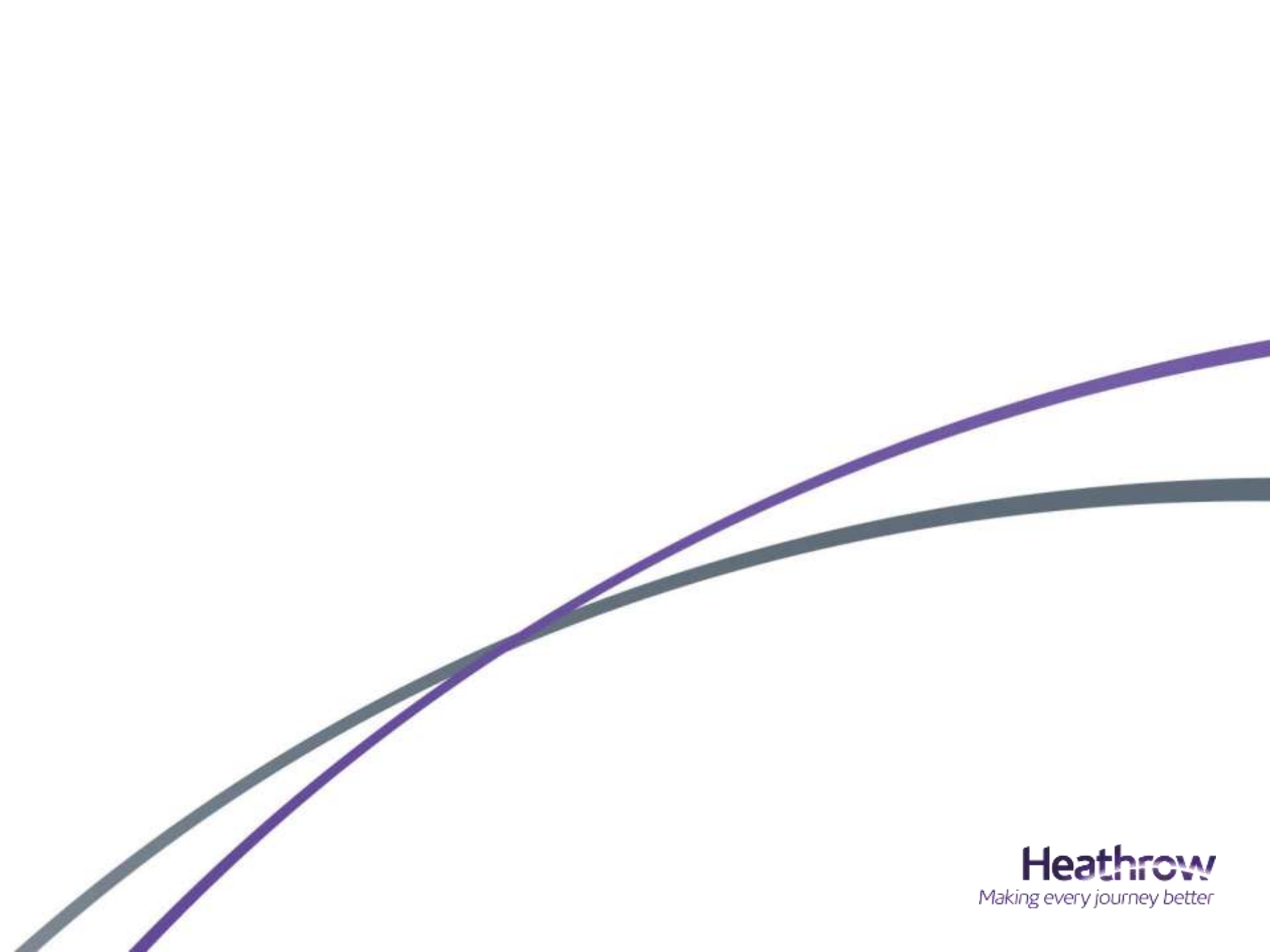
9 January – CAA Decision (including Notice to Grant Licence)

10 February – Notice Granting Licence

1 April – Start of Q6

Conclusion

- CAA's Final Proposals are an improvement on the Initial Proposals...
- ...however, the CAA's proposed cost of capital of 5.6% is below level at which Heathrow's shareholders have said that they are willing to invest
- Heathrow is committed to delivering an efficient business. Operating the airport safely and delivering high levels of passenger experience
- Inadequate returns deter investment, threaten the continued improvements in passenger experience, undermine hub competitiveness and disincentivise UK growth



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Appendix 1: Comparison of Heathrow plan and CAA Final Proposals

(£m unless stated) (5 year aggregate) (11/12 prices)	Heathrow Full Business Plan (Jan 2013) CAGR		CAA Initial Proposals (Apr 2013) CAGR		Heathrow Alternative Business Plan (Jul 2013) CAGR		CAA Final Proposals (Oct 2013) CAGR	
	Passengers	355.2m	0.4%	358.4m	0.5%	357.8m	0.5%	359.2
Aeronautical income	8,735	6.1%	7,138	-0.9%	8,478	4.9%	7,443	0.6%
Non aeronautical income	4,753	1.6%	4,838	2.1%	4,618	0.9%	4,650	1.2%
Operating costs	5,234	-0.2%	5,017	-1.8%	5,120	-0.8%	4,944	-2.0%
EBITDA	8,255	7.7%	6,960	1.9%	7,977	+6.4%	7,149	+2.8%
Capital investment (£bn)	3.0	-	3.0	-	3.0	-	2.9	-
Price cap per passenger p.a.	RPI +5.9%	-	RPI -1.3%	-	RPI +4.6%	-	RPI +0%	-
WACC (pre-tax real)	7.1%	-	5.35%	-	6.7%	-	5.6%	-

Notes, sources and defined terms

- Page 2
 - Note financial data shown in 2011/12 prices in line with regulatory procedure
 - Heathrow Alternative Business Plan – submitted to CAA in July 2013
- Page 3
 - Note financial data shown in 2011/12 prices in line with regulatory procedure
 - Source: Economic regulation at Heathrow from April 2014: final proposals. Issued by UK Civil Aviation Authority 3 October 2013
- Page 4
 - Note financial data shown in 2011/12 prices in line with regulatory procedure
 - FBP: Heathrow Full Business Plan. Submitted to CAA in January 2013
 - ABP: Heathrow Alternative Business Plan. Submitted to CAA in July 2013. Refreshes assumptions made in FBP.
 - CAA FP: CAA Final Proposals
- Page 5
 - Source: CAA Final Proposals supplementary document: “Estimating the cost of capital: a technical appendix to the CAA’s Final Proposal for economic regulation of Heathrow and Gatwick after April 2014” and PWC report: “Estimating the cost of capital for designated airports: a report prepared for the Civil Aviation Authority, October 2013”
- Page 6
 - Source: CAA Final Proposals supplementary document: “Estimating the cost of capital: a technical appendix to the CAA’s Final Proposal for economic regulation of Heathrow and Gatwick after April 2014” and PWC report: “Estimating the cost of capital for designated airports: a report prepared for the Civil Aviation Authority, October 2013”
 - Note on methodology: PWC produced an estimate of real cost of existing debt of 3.15%-3.65% based on yields at issue of Heathrow and Gatwick bonds and then allowing for a rating differential, CAA used a point estimate of 3.30% (see paragraph 6.67 of CAA document supplementary document)
 - Note on methodology: range of average real cost of new and existing debt uses an assumption of 50:50 existing and new debt at low end of range and 70:30 existing to new debt at high end of range. Point estimate of average real cost of new and existing debt (3.05%) is derived by applying 70:30 weights to point estimates of real cost of existing and new debt respectively
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 - Note financial data shown in 2011/12 prices in line with regulatory procedure
 - CAGR: compound annual growth rate over Q6, against 2013/14(E)

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