LHR Airports Limited
Annual report and financial statements for the year ended 31 December 2016

Company registration number: 01970855

LHR Airports Limited

Contents

LHR Airports Limited

Officers and professional advisers

Directors
Ross Baker
Stuart Birrell
Normand Boivin
Javier Echave
Emma Gilthorpe
John Holland – Kaye
Carol Hui
Andrew Macmillan
Paula Stannett

Registered office
The Compass Centre
Nelson Road
Hounslow
Middlesex
TW6 2GW

Independent auditors
Deloitte LLP
Statutory Auditor
2 New Street Square
London
EC4A 3BZ

Bankers
Lloyds Bank plc
1st Floor
10 Gresham Street
London
EC2V 7AE

LHR Airports Limited

Strategic report

LHR Airports Limited (the 'Company') is an indirect subsidiary of Heathrow Airport Holdings Limited ('HAHL') which is the parent undertaking of the smallest group to consolidate these financial statements (the 'Heathrow Airport Holdings Group' or 'HAH Group').

Principal activities
The Company is the parent company of Heathrow (DSH) Limited and an indirect holding company of Heathrow (SP) Limited. Heathrow (SP) Limited is the parent company within a ring-fenced group that owns Heathrow Airport ('Heathrow') and the Heathrow Express rail link between Heathrow and Central London. The principal activity of the Company is to provide or source service providers, for Heathrow Airport Limited ('HAL') and Heathrow Express Operating Company Limited. The Company provides limited corporate and centralised services to these companies through Shared Services Agreements ('SSA')

Following the sale of Aberdeen, Glasgow and Southampton Airports by the HAH Group, the Company's relationship with HAL, as an agent, was assessed. Please refer to the revenue accounting policy on page 27 which explains in more detail the concept of principal and agent under which the Company now operates.

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 2016, along with the key factors likely to impact the HAH Group in 2017;

Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2016 and analysis of the financial position of the Company as at that date;

Leadership and governance – description of the Board of Directors (the 'Board') of Heathrow Airport Holdings Limited ('HAHL') 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 airport ('Heathrow') is one of the best connected hub airports in the world, with 81 global airlines operating regular scheduled flights to almost 200 destinations. Heathrow is the primary airport in the world's largest aviation market – demand to fly to and from London is 15% higher than the next largest city. With 75.7 million passengers in 2016, Heathrow is Europe's busiest and the world's seventh busiest airport.

Heathrow has maintained a strong focus over recent years on operational performance, improving the passenger experience and investing in new and upgraded facilities. Heathrow has invested approximately £11 billion transforming the airport over the last decade. The focus and investment has resulted in Heathrow Airport being named 'Best Airport in Western Europe' by Skytrax for the second consecutive year in 2016 and becoming the top performing major European hub airport in terms of overall passenger satisfaction.

Heathrow provides service to a range of market segments, including business and leisure travellers, direct and transfer passengers on long- and short-haul routes, operated by a diversified range of major airlines. Heathrow is subject to economic regulation by the Civil Aviation Authority, which sets caps on the amount that Heathrow can charge airlines for using its facilities. This price setting mechanism provides significant cash flow predictability within each regulatory period, with the current regulatory period now ending December 2019 following its recent one year extension. As well as earning income from services to airlines, Heathrow also generates revenue from a variety of 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'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.

Strategic report *continued*

Business overview *continued*

Heathrow's strategy *continued*

To support and develop Heathrow airport's role as a hub, the Group will continue enabling the success of the major network airlines operating at Heathrow by investing in further capacity, operational flexibility and resilience at sustainable charges for airline customers.

For both local and transfer passengers, Heathrow is working continuously to make every journey better through improved service standards to ensure it remains passengers' preferred airport. Improving the passenger experience is supported by on-going investment in modern airport facilities and operating processes.

Heathrow's priorities

Heathrow aims to deliver the best airport service in the world and has four strategic priorities going forward to help achieve this aim:

Mojo

To be a great place to work, Heathrow will help its people fulfil their potential and 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'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 CAA sets the maximum level of airport charges for Heathrow, generally for five-year regulatory periods using a per passenger price cap mechanism known as RPI +/- X, which incorporates an allowed return on the Regulatory Asset Base ('RAB'). Heathrow's current regulatory period ('Q6') initially ran from 1 April 2014 to 31 December 2018. On 21 December 2016, the CAA issued a formal notice under section 22(6) of the Civil Aviation Act 2012 to modify the licence issued to Heathrow, by extending Heathrow's current regulatory period by one year so that it will end on 31 December 2019 and rolling over the current price control of RPI-1.5% for the additional year.

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 also sometimes referred to as incentive regulation, in that Heathrow has an incentive to outperform the price control by means of attracting more passengers, reducing operating costs or delivering higher commercial revenues than forecast. If the opposite is the case, then Heathrow has to absorb the cost or lower revenue. There is no adjustment for shortfalls in passenger numbers or additional costs (except where Heathrow incurs additional security costs, above an established threshold, when implementing new security directives imposed by the EU or the UK Government).

The Price Cap

The price cap for Heathrow is based on a RAB methodology using a "single till" building block approach. The single till takes into account revenue and costs from both aeronautical and non-aeronautical activities when setting the price caps for a regulatory period.

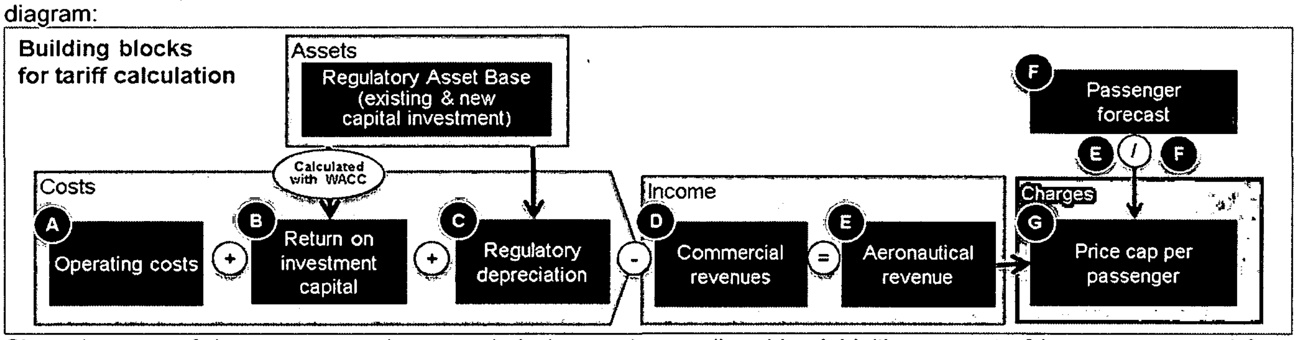
In setting the price cap, the CAA determines the regulated revenue requirement. This is calculated as the sum of forecast operating expenditure less other revenue plus the required return (using the cost of capital determined by the CAA) on the forecast RAB taking into account forecast capital expenditure, plus regulatory depreciation and plus or minus any profiling adjustment. The profiling adjustment is a mechanism used to smooth changes in charges that might otherwise occur as a result of major investments. The resulting aeronautical revenue requirement effectively amounts to the total income from airport charges.

Business overview *continued*

Heathrow's regulatory environment *continued*

The Price Cap continued

This methodology for deriving the aeronautical revenue requirement can be represented by the following simplified diagram:



Since the start of the current regulatory period, the maximum allowable yield (the amount of income generated from regulated airport charges on a per passenger basis) changes from 1 January each year by RPI minus 1.5%, based on RPI from the previous April.

In setting the price cap the CAA takes its own view of the scope for future efficiency savings, the appropriate level of capital expenditure and the rate of growth in demand for airport services.

While the price cap places a limit on the increase in the airport charges yield, Heathrow has the discretion on whether to price to the maximum permitted level. Therefore, Heathrow can choose to price charges below the cap. For example, if there is unused capacity, Heathrow could choose to set prices below the cap in order to stimulate demand.

The price cap takes certain elements into account in the maximum allowable yield. These include an adjustment for additional or reduced security costs as a result of new UK or European security directives; reductions where capital expenditure project milestones are not delivered; a 2017 business rates revaluation factor and a service quality rebate scheme. In addition there is a mechanism known as the "K factor" which is designed to correct for any under recovery (dilution) or over recovery (concentration) in airport charges compared to the annual maximum allowable yield per passenger. Under or over recoveries generally arise due to changes in passenger mix or average load factors compared to those forecast at the time prices were prospectively set for the relevant year.

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, including passenger fees, landing charges and aircraft parking charges, and non-aeronautical income from a variety of sources, including concession fees from retail operators, direct income from car parks and advertising and income from other services supplied by Heathrow.

Aeronautical income

Aeronautical income reflects the charges levied by Heathrow on the airport's airline customers. These charges (tariffs) cannot exceed the regulated maximum allowable yield per passenger.

The tariff structure through which the aeronautical income is recovered from airlines includes three key elements:

Passenger fees

- Fees per passenger are based on the number of passengers on board an aircraft, and are levied in respect of all departing passengers. There is no charge in respect of crew members working on flights.
- Three levels of charge based on route area: European domestic and rest of world. Transfer and transit passengers benefit from a discount.

Landing charges

- Landing charges are 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 of the aircraft and are banded into categories for aircraft weighing less than and those weighing more than sixteen tonnes, which includes nearly all commercial aircraft. These charges are adjusted, where applicable, in accordance with each aircraft's noise-rating, its emissions and the time of day, with landing charges being higher during peak traffic times than off-peak traffic times.

Strategic report *continued*

Business overview *continued*

Our regulatory environment *continued*

The Price Cap continued

Parking charges

- Aircraft parking charges are levied for each 15 minute slot after 30 minutes (for narrow-bodied aircraft) and 90 minutes (for wide-bodied aircraft).

Non-aeronautical income

Heathrow generates non-aeronautical income from a variety of sources. These include concession fees from retail operators; direct income from car parks, advertising revenue and 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 operation of the Heathrow Express rail service.

Infrastructure

The Group has invested £11 billion transforming Heathrow's infrastructure over the last decade, with £674 million invested in 2016 (2015: £627 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 2016 its runways operated at 98.6% (2015: 98.3%) of this limit.

Terminals

Each of Heathrow's four operational terminals is either new or recently refurbished. Terminal 2, which opened in June 2014, handled 16.5 million passengers in 2016 (2015: 16.7 million) and complements the award winning Terminal 5 and handled 31.9 million passengers in 2016 (2015: 33.1 million). Terminal 1 operations were discontinued in June 2015.

Heathrow airport's terminal capacity is currently estimated to be 85 million passengers per year.

Baggage systems

In parallel with the work on Heathrow's terminals, significant investment continues in Heathrow's baggage infrastructure. The underground automated baggage system between Terminal 3 and Terminal 5 is now fully operational, and the Terminal 3 integrated baggage system started operating in March 2015 and was 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 final 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.

Certain cargo sheds at the airport are owned by third parties who lease space to cargo service providers. Heathrow also provides cargo sheds and other accommodation and facilities which are leased, or separately billed on a use basis, to cargo-service providers.

Management review

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 José (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.

Management review *continued*

Review of the year continued

Passenger traffic

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

Passengers by geographic segment (millions)	**Year ended 31 December 2016**	Year ended 31 December 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] These figures have been calculated using un-rounded 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 José (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.

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'.

Management review *continued*

Transforming customer service continued

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.

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.

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.

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.

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.

Management review *continued*

Expansion *continued*

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.

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 Chief Financial Officer since the departure of Michael Uzielli in May 2016.

Financial review

Introduction
The following financial review, based on the financial statements of the Company, provides commentary on the performance of the Company's operations.

Basis of presentation of financial results
The Company has prepared its financial statements and financial review in accordance with FRS102.

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Revenue	**8**	21
Operating costs	**(10)**	(20)
Operating (loss)/profit	**(2)**	1
Net finance income	**368**	353
Other income	**616**	213
Profit on ordinary activities before taxation	**982**	567
Taxation credit	**-**	16
Profit for the year	**982**	583

Agent versus principal judgement
The Company is viewed by management as acting as principal in relation to the services of the Heathrow Airport Holdings Limited Board members and Ferrovial advisory services. These costs will continue to be recharged to Heathrow Airport Limited, the only remaining airport party to the Shared Services Agreement ('SSA') with a mark-up of 7.5%. Other services such as the employment related costs including the defined benefit pension scheme costs are now paid for and sourced directly by Heathrow Airport Limited, either without the Company's involvement or on a pass through fixed mark up only basis with the Company acting as an agent. This judgement was reached following consideration of whether the Company was exposed to the majority of the significant benefits and risks associated with the transaction.

Revenue
Revenue decreased to £8 million (2015: £21 million). Revenue is derived mostly from recharging Heathrow Airport Limited and Heathrow Express Operating Company Limited for central support services. Board costs decreased by £2 million due to reductions in the amount paid to senior management; in addition there was a net £6 million year on year credit to Board costs in respect of a £4m provision for an obligation relating to annual payments to senior management, which was made in the year ended 31 December 2015, of which £2 million was utilised and the remaining £2 million released to the income statement in 2016. Ferrovial costs also fell year on year by £2 million due to the termination of the Transitional Services Agreement ('TSA'). The remaining decrease in revenue year on year is due to a £3 million fall in other general expenses.

Operating costs
Ordinary operating costs decreased to £10 million (2015: £20 million) for the year ended 31 December 2016. This was due to the reasons mentioned above, namely the termination of the TSA agreement and reduction in board costs.

Net finance income
Net finance income has increased to £368 million (2015: £353 million) for the year ended 31 December 2016. This increase has arisen due to a 2015 downward recalibration of the interest rate relating to a 2014 intercompany loan balance, thus reducing the closing balance for the year ended 31 December 2015. Other than the 2015 adjustment net finance income has been steady year on year.

Other income
Other income chiefly relates to dividends received from Heathrow (DSH) Limited.

Employee numbers
In 2016 the average number of employees was 6 (2015: 7).The Directors note that although employees remain legally employed by the Company, Heathrow Airport Limited ('HAL') makes all employment decisions. Consequently employee numbers for those providing services to the operation of the airport are reported in the financial statements of Heathrow Airport Limited. Please refer to the Shared Services Agreement ('SSA') on pages 28 and 29 of the accounting policies section for further explanation.

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.

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; and
- 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.

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.

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.

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.

Leadership and governance *continued*

Board Committees *continued*

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 approval for:

- 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; and
- 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.

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 Company Secretary, the Chief People Officer, Expansion Director, Chief Commercial Officer and Chief Strategy Officer.

The Executive Committee is the management committee of the Chief Executive.

The Executive Committee 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 was set up during the year and is chaired by the General Counsel and Group Company Secretary and consists of the Chief Financial Officer, the Chief Operating Officer and the Procurement Director. 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.

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

- 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.

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.

Of the four members of the Audit Committee all, including the Chair, are non-executive directors. Together they have appropriate competence in accounting and auditing.

Internal controls
The directors are responsible for the system of internal controls designed to mitigate the risks faced by the Company and for reviewing the effectiveness of the system. This is implemented by applying the Company 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;
- 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 are rolling out a Risk Road Map for 2017/18 and beyond which will focus on improving accountability for enterprise risk management at all levels and drive improvements in our risk culture. The Risk Road Map will cover all the key elements of an effective enterprise 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 plan to 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.

Strategic report *continued*

Internal Controls and Risk Management *continued*

Principal risks ***continued***

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.

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 6,500 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 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.

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 HAH 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 HAH Group works closely with a range of stakeholders to ensure that it reacts effectively to the challenges posed by the environmental agenda.

Operational risks to the delivery of Responsible Heathrow goals are reviewed and monitored by a separate committee of the Board.

Stakeholders

Poor interactions and relationships with key stakeholder, 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.

Strategic report *continued*

Internal Controls and risk management *continued*
Principal risks *continued*
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 license, 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 and terrorism risks, 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 has already begun and it is building an organisation and expertise to ensure this process runs 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.

Internal controls and risk management *continued*

Principal risks *continued*

Strategic direction and management of change *continued*

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.

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.

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 HAH Group are:

(a) Interest rates
The HAH Group maintains a mix of fixed and floating rate debt. As at 31 December 2016, fixed rate debt after hedging with derivatives represented 95.7% of the Group's total external nominal debt.

(b) Inflation
The HAH 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 HAH 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 HAH Group has established both investment grade (at the Heathrow (SP) level) and sub-investment grade (at the Heathrow Finance level) financing platforms for Heathrow. The Heathrow (SP) platform supports term loans, various revolving loan facilities including revolving credit facilities, working capital facilities and liquidity facilities, and Sterling and foreign currency capital markets issuance. All debt is secured and can be issued in either senior (A-/A-) or junior (BBB/BBB) format. Covenants are standardised wherever possible and are monitored on an 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.

The HAH Group 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 December 2018. As at 31 December 2016, cash and cash equivalents, restricted cash and term deposits of £699 million, undrawn headroom under revolving credit facilities of £1,150 million, committed term debt financing to be drawn after 31 December 2016 of £550 million and undrawn headroom under liquidity facilities of £620 million.

Internal controls and risk management *continued*
Principal risks *continued*
Financial stability *continued*

(e) Counterparty credit
The HAH 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 HAH 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 HAH 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).

On behalf of the Board

Javier Echave
Director

31 July 2017

Directors' report

The Directors present their Annual report and the audited financial statements for the year ended 31 December 2016.

Principal activities

The Company is the parent company of Heathrow (DSH) Limited and an indirect holding company of Heathrow (SP) Limited. Heathrow (SP) Limited is the parent company within a ring-fenced group that owns Heathrow airport ('Heathrow') and the Heathrow Express rail link between Heathrow and Central London (the 'Group'). The principal activity of the Company is to provide, or source service providers, for Heathrow Airport Limited ('HAL') and Heathrow Express Operating Company Limited. The Company provides limited corporate and centralised services to these companies through Shared Services Agreements ('SSA').

A review of the progress of the Company'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 18.

Results and dividends

The profit after taxation for the financial year amounted to £982 million (2015: £583 million).

During the year ended 31 December 2016, the Company received dividends of £616 million (2015: £213 million) from its subsidiary, Heathrow (DSH) Limited and paid dividends of £528 million (2015: £232 million) to its parent, Heathrow Holdco Limited. The dividend payments were utilised primarily to fund dividends to the ultimate shareholders and to repay and service external debt at ADI Finance 2 Limited.

Directors

The Directors who served during the year and since the year end, except as noted, are as follows:

Ross Baker	Appointed 1 January 2017
Ian Ballentine	Resigned 1 January 2017
Stuart Birrell	
Normand Boivin	
Javier Echave	Appointed 24 November 2016
Emma Gilthorpe	
Clare Harbord	Resigned 1 January 2017
John Holland-Kaye	
Carol Hui	
Andrew Macmillan	Appointed 1 January 2017
Paula Stannett	
Michael Uzielli	Resigned 17 May 2016

Employment policies

The Company has 6 employees.

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

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

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

Disabled persons have equal opportunities when applying for vacancies, with due regard to their aptitudes and abilities. The Company 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 Company endeavours to ensure continuing employment through the arrangement of appropriate training.

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

Directors' report *continued*

Employment policies *continued*

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 a long-term incentive plan which also rewards based on group performance.

Supplier payment policies

The Company complies with the UK government's Better Payment Practice Code which states that responsible companies should:

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

Directors' indemnity

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

Auditor

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

Statement of disclosure of information to the Auditor

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

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

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

On behalf of the Board

Javier Echave
Director

31 July 2017

Company registration number: 01970855

LHR Airports Limited

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 financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 102 – "The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland" '(FRS 102'). 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 these 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.

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.

On behalf of the Board

Javier Echave
Director

31 July 2017

Independent auditor's report to the members of LHR Airports Limited

We have audited the financial statements of LHR Airports Limited for the year ended 31 December 2016 which comprise the Income statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity and the related notes 1 to 16. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".

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

Respective responsibilities of directors and auditors
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. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Opinion on financial statements
In our opinion the financial statements:
- give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion, 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 company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Jacqueline Holden

Jacqueline Holden FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
London, UK
31 July 2017

LHR Airports Limited

Income statement for the year ended 31 December 2016

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Revenue	*1*	**8**	21
Operating costs	*2*	**(10)**	(20)
Operating (loss)/profit		**(2)**	1
Financing			
Finance income	*3*	**389**	374
Finance costs	*3*	**(21)**	(21)
Net finance income		**368**	353
Other income	*4*	**616**	213
Profit on ordinary activities before taxation		**982**	567
Taxation credit	*5*	**-**	16
Profit for the year		**982**	583

LHR Airports Limited

Statement of comprehensive income for the year ended 31 December 2016

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Profit for the year		**982**	583
Other comprehensive income:			
Other gain [1]		-	5
Other comprehensive income for the year net of tax		-	5
Total comprehensive income for the year		**982**	588

[1] The £5 million gain in 2015 relates to an increase in the value of the available for sale investment in the National Air Traffic Services Holdings Limited ('NATS'), the UK's national air traffic services provider.

LHR Airports Limited

Statement of financial position as at 31 December 2016

31 December 2016 31 December 2015

	Note	31 December 2016 £m	31 December 2015 £m
Assets			
Non-current assets			
Property, plant and equipment	*6*	**-**	2
Investments in subsidiaries	*7*	**3,841**	3,841
Available for sale investments	*7*	**31**	31
Trade and other receivables	*8*	**5,794**	5,809
		9,666	9,683
Current assets			
Trade and other receivables	*8*	**1,147**	802
Cash and cash equivalents	*9*	**20**	12
		1,167	814
Total assets		**10,833**	10,497
Liabilities			
Non-current liabilities			
Deferred income tax liabilities	*10*	**(4)**	(5)
Provisions	*11*	**-**	(4)
Trade and other payables	*12*	**(1,169)**	(1,286)
		(1,173)	(1,295)
Current liabilities			
Trade and other payables	*12*	**(204)**	(200)
		(204)	(200)
Total liabilities		**(1,377)**	(1,495)
Net assets		**9,456**	9,002
Equity			
Capital and reserves			
Other reserves	*14*	**48**	48
Retained earnings		**9,408**	8,954
Total shareholder's equity		**9,456**	9,002

The financial statements of LHR Airports Limited (Company registration number: 01970855) were approved by the Board of Directors and authorised for issue on 31 July 2017. They were signed on its behalf by:

Javier Echave
Director

John Holland-Kaye
Director

LHR Airports Limited

Statement of changes in equity for the year 31 December 2016

	Share capital £m	Share Premium £m	Other Reserves £m	Retained earnings £m	Total £m
1 January 2015	-	-	43	8,603	8,646
Profit for the financial year	-	-	-	583	583
Other comprehensive income:					
Other gain				5	5
Total comprehensive income				588	588
Transfer to revaluation reserve					
Available for sale investment fair value movement			5	(5)	-
Other movement in retained earnings					
Transactions with owners					
Dividends paid [1]			-	(232)	(232)
Total transactions with owners	-	-	-	(232)	(232)
At 31 December 2015	**-**	**-**	**48**	**8,954**	**9,002**
Profit for the financial year			**-**	**982**	**982**
Total comprehensive income	**-**	**-**	**-**	**982**	**982**
Transactions with owners					
Dividends paid [2]			**-**	**(528)**	**(528)**
Total transactions with owners			**-**	**(528)**	**(528)**
At 31 December 2016			**48**	**9,408**	**9,456**

[1] During the year ended 31 December 2015, the Company paid dividends of £232 million to Heathrow Holdco Limited, being £70 million cash on 27 February 2015, £87 million cash on 30 June 2015 and £75 million cash on 24 July 2015.

[2] During the year ended 31 December 2016, the Company paid dividends of £528 million to Heathrow Holdco Limited comprising £75 million on 22 February 2016, £8 million on 11 March 2016, £71 million on 23 June 2016, £151 million on 22 July 2016, £1 million on 16 September 2016, £121 million on 6 October 2016 and £101 on 21 December 2016.

Accounting policies for the year ended 31 December 2016

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

Basis of accounting
These financial statements have been prepared and approved by the directors in compliance with Financial Reporting Standard 102 - 'The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland' ('FRS 102') and with the Companies Act 2006.

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

The Company has taken advantage of certain disclosure exemptions in FRS 102 as its financial statements are included in the publicly available consolidated financial statements of FGP Topco Limited. These disclosure exemptions relate to the statement of cash flows and related party transactions. 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 has adopted IAS 39 *Financial instruments* in respect of its available for sale investment and is compliant with the disclosure requirements set out in FRS 102.11 and FRS 102.12.

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

Consequently the Directors have reviewed the cash flow projections of the Heathrow Airport Holdings Group taking into account:
- the forecast turnover and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall Heathrow Airport Holdings Group liquidity position, including the projected upstreams of cash 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.

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 twelve months following the date when the financial statements were authorised for issue.

Consolidated financial statements
The Company has taken advantage of the exemption provided by section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it is a wholly owned subsidiary of FGP Topco Limited and its subsidiary undertakings are included in the consolidated financial statements of that company for the year ended 31 December 2016. The results are also included in the consolidated financial statements of Heathrow Airport Holdings Limited ('HAHL'), which is the smallest group to consolidate these financial statements for the year ended 31 December 2016.

The financial statements present information about the Company as an individual entity only and not as a group.

Revenue
The Company acts as either principal or agent in transactions into which it enters. Turnover as shown in the Income statement consists of amounts due where the Company has exposure to the risks and rewards associated with the sale of goods, rendering of services and agency commission.

Following the disposal of Aberdeen, Glasgow and Southampton airports by the HAH Group, the Company is now viewed by management as acting as principal in relation to the services of the board members of HAHL and Ferrovial advisory services. These costs will continue to be recharged to Heathrow Airport Limited (the only remaining airport party to the SSA) with a mark-up of 7.5%. For these costs the Company has included the gross amount of its sales revenues within Turnover and the associated costs have been included within Operating Costs, both within the Income statement. Other services are now paid for and sourced directly by Heathrow Airport Limited, either without the Company's involvement or on a pass through fixed mark up only basis. Therefore, since the substance of the transaction is that the Company is acting as agent, it should report as turnover only the mark up receivable in return for its performance under the SSA.

The judgement has been reached following consideration of whether the Company has been exposed to the majority of the significant benefits and risks associated with the transactions.

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

Assets classified as available-for-sale
Available-for-sale investments are held at fair value where this can be reliably measured. Unless the valuation falls below its original cost, gains and losses arising from changes in fair value of available-for-sale assets are recognised directly in equity. On disposal the cumulative net gain or loss is transferred to the statement of comprehensive income. Valuations below cost are recognised as impairment losses in the income statement.

Financing
Finance costs and finance income are recognised in the income statement in the period in which they are incurred.

Tangible fixed assets
Land is not depreciated and is held at cost.

Impairment of assets (excluding investment in subsidiaries)
The Company assesses, at each reporting date, whether there is an indication that land may be impaired by reference to market value. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

Investments
Investments in subsidiary held as fixed assets are stated at cost and reviewed for impairment if there are any indications that the carrying value may not be recoverable. Reversals are recognised where there is a favourable change in the economic assumptions in the period since the provision was made.

Trade and other receivables
Trade and other receivables are recognised initially at cost less any provision for impairment.

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

Trade and other payables
Trade and other payables are recognised at cost.

Amounts owed to group undertakings
Amounts owed to group undertakings are repayable on demand and are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost.

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

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

Shared Services Agreement ('SSA')
All employees of the Heathrow Airport Holdings Limited group ('HAH Group') are employed by LHR Airports Limited with the exception of non-senior management at Heathrow Express Operating Company Limited, LHR Business Support Centre Limited and the Board Members of HAHL. LHR Airports Limited legally sponsors the defined benefit pension schemes while Heathrow Airport Limited incurs employment 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 a provider of services for the HAH Group.

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

Shared Services Agreement ('SSA') *continued*

- The SSA states that the operating entities, being only Heathrow Airport Limited, are responsible for pension costs on LHR Airports Limited's retirement benefit schemes,
- Heathrow Airport Limited 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, Heathrow Airport Limited makes all employment decisions. LHR Airports Limited is no longer deemed to be providing a service, but is acting as an agent.

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

Operational staff

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

Corporate and centralised services

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

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.

Following the disposal of Aberdeen, Glasgow and Southampton airports ('NDH1' group), the directors reassessed the Group's relationship with the legal sponsor of the retirement benefit schemes (the Company) 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 now acts as principal in relation to these schemes. As a result, the Company no longer recognises an external asset of liability, in relation to the schemes, on its Statement of financial position. Consequently, there is no pension note for LHR Airports Limited.

Employee benefits

The Company operates a defined contribution pension scheme for employees who joined the Company after 15 June 2008. The Company also has a defined contribution pension scheme in respect of employees of LHR Business Support Centre Limited. The total cost of defined contribution pension arrangements are expensed as employment costs. The Company also meets the costs of administration, but not investment, by way of an additional retrospective Employer Contribution in respect of the previous tax year.

The Company also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits were restricted by the Earnings Cap for pension purposes, as introduced by the Finance Act 1989. In addition, the Company provides post-retirement medical benefits to certain pensioners.

Current and deferred taxation

The tax expense for the year comprises current and deferred tax. Tax is recognised in the profit and loss account, except to the extent that it relates to items recognised directly in 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 paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

In accordance with FRS 102 Section 29 timing differences, deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements.

Current and deferred taxation *continued*

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

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

Share capital

Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs. Where the shares are issued above par value, the proceeds in excess of par value are recorded in the share premium reserve. Where a share capital reduction has taken place, shares are classified at their re nominalisation value.

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.

Significant accounting judgements and estimates for the year ended 31 December 2016

Key sources of estimation uncertainty

Investment valuation
The Company reviews investment in subsidiaries for impairment, or reversal of previous impairments, if there are any indications that the carrying values may not be recoverable or may have increased as a result of a favourable change in economic assumptions. 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 or reversal of previous impairments where a surplus exists. 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.

The Company's available for sale investment is valued by discounting the forecast dividend stream and an assigned terminal value for the equity investment. In 2016 a rate of 6.74% (2015: 7.46%) has been used as the discount factor.

Critical judgements in applying the group accounting policies

Presentation of revenue gross or net

A judgement has been made in relation to the Agent versus Principal presentation of accounting information in the 2016 financial statements, as described in the accounting policies

As described in the accounting policies, the Company is viewed by management as acting as principal in relation to the services of the board members of HAHL 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%. For these costs the Company has included the gross amount of its sales revenues within Turnover and the associated costs have been included within Operating Costs, both within the Profit and loss account. Other services are paid for and sourced directly by Heathrow Airport Limited, either without the Company's involvement or on a pass through fixed mark up only basis. Therefore, since the substance of the transaction is that the Company is acting as agent, it should report as turnover only the mark up receivable in return for its performance under the SSA.

The judgement has been reached following consideration of whether the Company has been exposed to the majority of the significant benefits and risks associated with the transactions.

Notes to the financial statements for the year ended 31 December 2016

1 Revenue
The directors consider the business has only one segment. All of the Company's revenue arises in the United Kingdom from other group companies under the terms of the SSA referred to in the statement of accounting policies

2. Operating costs
Operating costs comprise:

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Wages and salaries	**4**	4
Social Security	**1**	1
Other staff related costs	**(2)**	5
Employment costs	**3**	10
Other	**5**	10
Write off land assets	**2**	-
Total operating costs	**10**	20

Auditor's remuneration
Audit fees are paid for by the Company and are then recharged in accordance with the SSAs into the operating entities. Of the total audit fee £16,000 (2015:£16,000) related to the audit of the Company's financial statements.

Employee information
The Company has employees, all of whom were based in the United Kingdom and the average monthly number of employees (including executive directors) of the Company was 6 (2015: 7).

Following the disposal of Aberdeen, Glasgow and Southampton airports (together the 'NDH1 Group') in December 2014 the directors reassessed the Company's relationship with LHR Airports Limited, given that the sole operating airport is now Heathrow. The directors noted that although employees remain legally employed by LHR Airports Limited, the Company 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

Directors' remuneration
All of the directors were directors of a number of companies within the Heathrow Airport Holdings Group as well as LHR Airports Limited. Their remuneration for the year ended 31 December 2016 was disclosed within the statutory financial statements of the following companies to which they primarily provide services: John Holland-Kaye, Javier Echave and Michael Uzielli - Heathrow Airport Holdings Limited; Normand Boivin, Carol Hui, Clare Harbord, Emma Gilthorpe, Paula Stannett, Ian Ballentine and Stuart Birrell – Heathrow Airport Limited as it is not considered possible to apportion their remuneration to different companies.

During the year, two of the directors (2015: 2) had retirement benefits accruing to them under a defined benefits scheme and seven of the directors (2015: 7) had retirement benefits accruing to them under a defined contribution scheme.

None of the directors (2015: none) exercised share options during the year in respect of their services to the Heathrow Airport Holdings Group and no shares (2015: none) were received or became receivable under long term incentive plans.

3 Financing

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Finance income		
Interest receivable from other group undertakings	**388**	371
Interest receivable from available for sale financial assets	**1**	3
	389	374
Finance cost		
Interest payable to other group undertakings	**(21)**	(21)
Net finance income	**368**	353

4 Other income

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Dividends received from subsidiaries[1]	**616**	213

[1] During the year ended 31 December 2016, the Company received dividends of £616 million from Heathrow (DSH) Limited (2015: £209 million) and £nil million dividends from LHR Insurance services Limited (2015: £4 million).

5 Taxation

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
UK corporation tax		
Current tax at 20% (2015: 20.25%)	**-**	-
Group relief receivable	**(5)**	(11)
Under/(over) provision in respect of prior years	**5**	(14)
Deferred tax		
Current year	**-**	2
Prior year	**-**	6
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	**-**	1
Tax credit on profit on ordinary activities	**-**	(16)

The standard rate of current tax for the year, based on the UK standard rate of corporation tax, is 20% (2015: 20.25%). The actual tax charge for the current and prior years differs from the standard rate for the reasons set out in the following reconciliation:

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Profit on ordinary activities before tax	**982**	567
Reconciliation of the tax credit		
Tax charge calculated at the UK statutory rate of 20% (2015: 20.25%)	**196**	115
Effect of:		
Adjustments in respect of current tax of previous years	**5**	(14)
Non-taxable income	**(201)**	(124)
Adjustments in respect of deferred tax of previous years	**-**	6
Change in UK corporation tax rate-impact on deferred tax assets and liabilities	**-**	1
Taxation credit	**-**	(16)

The total tax charge recognised for the year ended 31 December 2016 was £nil (2015: £16 million credit). Based on a profit before tax for the year of £982 million (2015: £567 million), this results in an effective tax rate of 0.0% (2015: 2.8% negative).

Notes to the financial statements for the year ended 31 December 2016 *continued*

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 Company's deferred tax balances, which were previously provided at 18%, were re-measured at the rate at which the Company believes the timing differences will reverse.

In December 2016 and January 2017 the UK government published draft legislation on the new interest deductibility regime, in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). In this, the new corporate interest restriction would be effective from 1 April 2017 and interest deductions would be limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public infrastructure exemption (PIE). Whilst the legislation could impact the future tax charge of the group, Heathrow expects to be largely protected from the 30% of tax EBITDA cap through the use of the PIE and GRR. Although the draft legislation was not included in Finance Act 2017, we expect the position to be clarified when the legislation is included in a new Finance Bill later in 2017.

6 Tangible fixed assets

The cost of land at 31 December 2016 was £nil million (2015: £2 million) following its write-off in the year.

7 Investments

	Subsidiaries £m	Available for sale investments £m	Total £m
Cost			
1 January and 31 December 2016	3,841	5	3,846
Revaluation			
1 January and 31 December 2016	-	26	26
Net book value 31 December 2016			
1 January and 31 December 2016	3,841	31	3,872

Notes to the financial statements for the year ended 31 December 2016 *continued*

Subsidiaries
The Company's subsidiaries are shown below:

Direct subsidiaries are:

Subsidiary	Nature of business	% of issued share capital held	Class of share
Heathrow (DSH) Limited	Holding Company	100	Ordinary shares of £1 each
Heathrow Enterprises Limited	Investment Company	100	Ordinary shares of £1 each
BAA Partnership Limited	Dormant	100	Ordinary shares of £0.000001 each
BAA General Partner Limited	Dormant	100	Ordinary share of £1
BAA Properties Limited	Dormant	100	Ordinary share of £1
LHR Insurance Services Limited[1]	Insurance	100 100	Ordinary shares of £1 each Redeemable Preference shares of £0.01 each
LHR Building Control Services Limited	Building construction	100	Ordinary shares of £1 each
LHR Business Support Centre Limited	Provision of support services	100	Ordinary shares of £1 each
BAA Lynton Management Limited	Dormant	100	Ordinary shares of £1 each
BAA Lynton Developments Limited	Dormant	100	Ordinary shares of £0.0001 each
LHR (IP Holdco) Limited	Dormant	100	Ordinary shares of £1 each
BAA Pension Trust Company Limited	Dormant	100	Ordinary shares of £1 each
9G Rail Limited	Dormant	100	Ordinary share of £1
World Duty Free Limited	Provision of funding to other Group companies	100	Ordinary shares of £0.023 each
Airport Property GP (No.1) Limited	Dormant	100	Ordinary shares of £1 each
Scottish Airports Limited[2]	Dormant	100	Ordinary shares of £0.00001 each
Airport Hotels General Partner Limited	Dormant	100	Ordinary shares of £1 each
London Airports 1992 Limited	Provision of funding to other Group companies	100	Ordinary shares of £1 each
London Airports Limited	Dormant	100	Ordinary shares of £0.000001 each
Sanfield Lynton Limited	Dormant	50	50 Ordinary shares of £1 each
BAA International limited	Dormant	100	Ordinary shares of £0.00001 each

[1] Incorporated in the Isle of Man, but all profit taxed in the UK as a Controlled Foreign Company, registered company address: Tower House, Loch Promenade, Douglas, Isle of Man, IM1 2LZ.
[2] Incorporated in Scotland, but UK tax resident, registered company address: Carlson House, Mossland Road, Hillington, Glasgow, G52 4XZ.

In the opinion of the Directors, the value of the shares in the subsidiary undertakings are not less than the amounts at which they are stated in the Company's Balance sheet.

Additionally, the Company's subsidiaries which are indirectly held as at 31 December 2016 are:

Indirect subsidiaries*:*

BMG (CO2) Limited	Heathrow (AH) Limited	The BMG (Ashford) LP
BMG (Ashford) General Partner Limited	Heathrow (SP) Limited	The BMG (Bridgend Phases II and III) LP
BMG (Ashford) Limited	Heathrow Airport Limited	The BMG (CO Phase IV) LP
BMG (Ashford) Partnership Trustco Limited	Heathrow Express Operating Company Limited	The BMG (Swindon Phases II and III) LP
BMG (Swindon Phases II & III) General Partner Limited	Heathrow Finance plc	Ultra Global Limited
BMG (Swindon) Limited	Heathrow Funding Limted[2]	BMG (Ashford) General Partner Limited
BMG Europe Limited[1]	LHR (Hong Kong) Limited	BMG (Cheshire Oaks) Limited
Devon Nominees Limited	London Airports 1993 Limited	BMG (Bridgend) Limited

[1] Incorporated in Jersey, but all profit taxed in the UK as a Controlled Foreign Company. Registered address: 13 Castle Street, St Helier, Jersey, JE4 5UT.
[2] Incorporated in Jersey, but UK tax resident. Registered address: 13 Castle Street, St Helier, Jersey, JE4 5UT.

Notes to the financial statements for the year ended 31 December 2016 *continued*

Unless otherwise indicated, all subsidiaries are wholly-owned, incorporated in Great Britain and registered in England and Wales with the registered address being The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

Available for sale investments
Available-for-sale investments relates to the Company's 4.19% equity interest in National Air Traffic Services Holdings Limited ('NATS'), the UK's national air traffic services provider.

The equity investment is valued by discounting the forecast dividend stream and an assigned terminal value to the equity in 2016. A rate of 6.74% (2015: 7.46%) has been used as the discount factor.

8 Trade and other receivables

	31 December 2016 £m	31 December 2015 £m
Current		
Amounts owed by group undertakings - interest free[1]	**119**	149
Amounts owed by group undertakings - interest bearing[2]	**7**	10
Interest receivable from group undertakings[3]	**1,016**	628
Group relief receivable	**5**	15
	1,147	802
Non-current		
Deferred tax[4]	**-**	1
Amounts owed by parent undertaking[5]	**5,794**	5,808
	5,794	5,809

[1] 'Amounts owed by group undertakings – interest free' comprises £119 million in relation to loans receivable from the Company's subsidiaries, the largest of which is a £68 million loan with Heathrow Airport Limited (2015: £119 million in loans receivable from the Company's subsidiaries, the largest of which being a £89 million loan with Heathrow Airport Limited, in addition to £30 million receivable from its intermediate parent Non Des Topco Limited).
[2] 'Amounts owed by group undertakings – interest bearing' comprises £7 million (2015: £7 million) due from Heathrow Enterprises Limited which accrues interest at 13%. All amounts are repayable on demand. The balance in 2015 included loans with Heathrow Airport Limited and LHR Business Support Centre Limited totalling £3 million which had arisen over a number of years and accrued interest at 1.5% over the Bank of England base rate.
[3] This relates to £1,010 million (2015: £624 million) of interest receivable from Heathrow Holdco Limited and £5 million (2015: £4 million) of interest receivable from other subsidiaries.
[4] The deferred tax asset in 2016 has been offset against the deferred tax liability. See note 10.
[5] 'Amounts owed by parent undertaking' relates to a loan to Heathrow Holdco Limited. This amount accrues interest at 6.65% at 31 December 2016 (2015: 6.65%).

9 Cash and cash equivalents

	31 December 2016 £m	31 December 2015 £m
Short term deposits	**20**	12

10 Deferred income tax liability

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

	31 December 2016 £m	31 December 2015[1] £m
1 January	**5**	5
Reallocation from trade and other receivables[1]	**(1)**	-
Deferred tax liability	**4**	5

[1] In 2015 there was a £1 million deferred tax asset relating to an excess of depreciation charges over capital allowances which was included in the 'Trade and other receivables' note. In addition, in 2015 there was a £5 million deferred tax liability relating to the available for sale investments which was reflected in the provisions for liabilities and charges note. In 2016 there was no movement on these two balances. The £1 million deferred tax asset (2015: £1 million) has been offset against the £5 million (2015: £5 million) deferred tax liability in 2016.

Analysis of the deferred tax liability is as follows:

	31 December 2016 £m	31 December 2015[1] £m
Excess of depreciation over capital allowances	**(1)**	-
Available for sale investments	**5**	5
Deferred tax liability (net)	**4**	5

Provision has been made for deferred taxation in accordance with FRS 102.

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 deferred tax balances, which were previously provided at 18%, were re-measured at the rate at which the Group believes the timing differences will reverse.

11 Provisions

	Other	Total
	£m	£m
1 January 2016	4	4
Utilised	(2)	(2)
Released in the year	(2)	(2)
31 December 2016	-	-

Other
The other provision relates to an income tax obligation relating to annual payments, which was made in the year ended 31 December 2015, of which £2 million was utilised and the remaining £2 million released to the income statement.

12 Trade and other payables

	31 December 2016 £m	31 December 2015 £m
Non-current		
Amounts owed to group undertakings - interest free[1]	**74**	211
Amounts owed to group undertakings - interest bearing[2]	**1,095**	1,075
	1,169	1,286
Current		
Trade creditors	**4**	11
Amounts owed to group undertakings – interest free[3]	**170**	159
Amounts owed to group undertakings – interest bearing[4]	**21**	21
Dividends payable	**2**	2
Other creditors	**7**	7
	204	200

[1] 'Amounts owed to group undertakings – interest free' includes a £74 million loan (2015: £74 million) from Heathrow (DSH) Limited, a subsidiary of the Company). In addition, the balance in 2015 included a loan of £33 million from Non Des Topco Limited in relation to the curtailment gain that arose on the LHR defined benefit pension scheme as a result of disposing of Airport Holdings NDH1 Limited and a loan of £104 million from Non Des Topco Limited using the proceeds from the disposal of Airports Holding NDH1 Limited.

[2] 'Amounts owed to group undertakings – interest bearing' comprise balances totalling £1,095 million (2015: £1,075 million) the majority of which accrue interest at 1.5% over the Bank of England base rate.

[3] 'Amounts owed to group undertakings – interest free' includes a £51 million loan (2015: £51 million) from Heathrow Finance Plc, a £41 million loan (2015: £38 million) from ADI Finance 2 and a £29 million loan with Heathrow Airport Holdings Ltd (2015: £29 million).

[4] 'Amounts owed to group undertakings – interest bearing' includes a balance of £7 million owed to subsidiaries which accrues interest at 1.5% over Bank of England base rate as well as £8 million loan with Heathrow Airport Holdings Ltd which accrues interest at 0.8% and a £6m loan with LHR Insurance Services which accrues interest at 1.51%

13 Share capital

	£
Called up, allotted and fully paid	
1 January and 31 December 2016	
6,309,120,652 ordinary shares at £0.000001 each at December 2016	**6,309**

14 Other reserves

	Available for sale investments £m	Capital redemption reserve £m	Total £m
1 January 2016 and 31 December 2016	21	27	48

15 Ultimate parent undertaking

The immediate parent undertaking of the Company is Heathrow Holdco Limited, a company registered in England and Wales.

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (25.00%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly-owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. (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 Company's results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2016, 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 2016.

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.

16 Subsequent events

On 23 February 2017, the board approved the payment of a £94 million dividend to the Company's parent, Heathrow Holdco Limited. This was mostly financed by the receipt of a dividend payment from the Company's subsidiary, Heathrow (DSH) Limited for £85 million.
On 28 June 2017, the board approved the payment of a £104 million dividend to the Company's parent, Heathrow Holdco Limited. This was financed by the receipt of a dividend payment from the Company's subsidiary, Heathrow (DSH) for £104 million.
On 20 June 2017 Alinda Airports UK L.P. acquired 357,901,364 Ordinary shares of £0.0024 each and 88 Deferred Ordinary shares of £0.10 each held by Alinda Airports L.P. in the capital of FGP Topco Limited.
On 12 July 2017, the board approved the payment of a £311 million dividend to the Company's parent, Heathrow Holdco Limited. This was financed by the receipt of a dividend payment from the Company's subsidiary, Heathrow (DSH) for £311 million.