LHR Airports Limited

Annual report and financial statements for the year ended 31 December 2014

Company registration number: 01970855

LHR Airports Limited

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LHR Airports Limited

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LHR Airports Limited

Strategic report

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

Principal activities
The Company is the parent company of Heathrow (DSH) Limited and an indirect holding company of Heathrow (SP) Limited, which is the parent company within a ring-fenced group that owns Heathrow airport ('Heathrow') and which additionally owns the company that operates the Heathrow Express rail link between Heathrow and Central London. The principal activity of the Company is to act as a service provider for Heathrow Airport Limited and Heathrow Express Limited, owned and operated by the Heathrow Airport Holdings Group

The Company employs all staff involved in running the operational activities of Heathrow Airport Limited and Heathrow Express Limited and also provides some corporate and centralised services to the these companies through Shared Services Agreements ('SSA'), although some of these activities are now performed by Heathrow Airport Limited.

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 2014, along with the key factors likely to impact the Group in 2015;

Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2014 and analysis of the financial position of the Company as at that date;

Leadership and Governance – description of the Board of Directors and the various Committees in Heathrow Airport Holdings Limited which provide overall leadership to the Heathrow group of companies; and

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

Business overview

Our business model
Heathrow is Europe's hub airport and the third largest airport in the world by passenger numbers. Heathrow is the only hub airport in London and the UK, which is the world's largest aviation market by some margin. Heathrow serves 75 direct destinations that are not served by any other UK airport and handles more than 80% of all long haul passengers flying to or from the UK.

Heathrow operates a hub model allowing it to offer a compelling, competitive range of routes and frequencies for the large London origin and destination aviation market. This enables airlines to fly to more destinations more frequently than could be supported by local demand alone. It is the most efficient way of connecting many different destinations and enables airlines to sustain routes and frequencies that could not otherwise be supported.

Heathrow competes for passengers with other European hub airports, including Amsterdam Schiphol airport, Frankfurt airport, Paris Charles de Gaulle airport and Madrid Barajas airport. Heathrow also competes with Dubai International airport, Istanbul airport and Doha airport, for transfer traffic between North America, from and to Africa and Asia.

Heathrow is the UK's most important port carrying more than one-quarter of UK exports and more freight by value than Felixstowe and Southampton combined. The bulk of cargo and mail at the airport is carried in the cargo holds of passenger flights rather than by dedicated cargo flights.

The company generates aeronautical revenue from fees charged to airlines primarily for passenger facilities; take-off and landing and aircraft parking. Non-aeronautical income is generated from retail concession fees, car parking income, Heathrow Express rail operations and other services supplied by Heathrow.

Our 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.

Business overview *continued*

Our strategy *continued*

To support and develop Heathrow airport's role as a hub, the company 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.

Our priorities

Beat the plan

To secure future investment, we will beat the Q6 business plan and deliver a competitive return to shareholders by growing revenue, reducing costs and delivering investments efficiently.

Transform customer service

To deliver the world's best passenger experience, we will work with the Heathrow community to transform the service we give to passengers and airlines, punctuality and resilience.

Win support for expansion

To connect Britain to the world for future generations, we will win support for expansion of Heathrow from our local community, airlines, shareholders, politicians and regulators.

Mojo

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.

Our regulatory environment

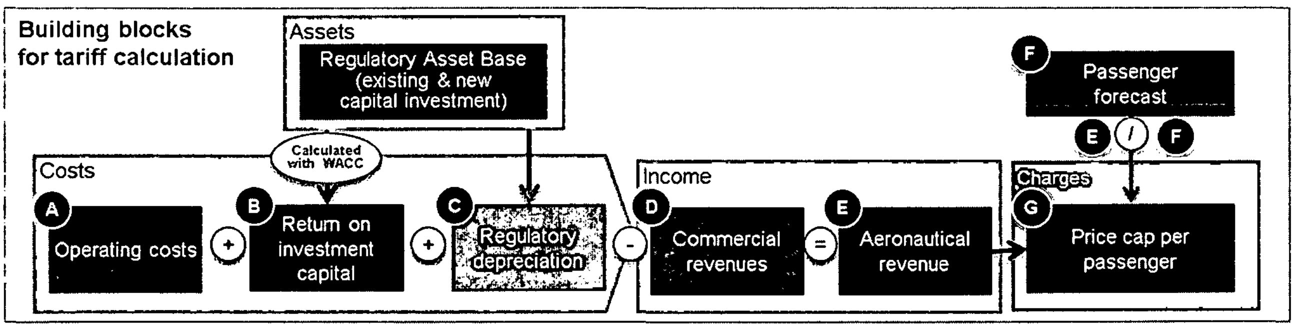
Heathrow is subject to economic regulation by the Civil Aviation Authority ('CAA'), which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection.

As the economic regulator for UK airports, the CAA assesses the market power of airports and if, as is the case with Heathrow, the CAA determines that an airport holds significant market power, the airport is regulated by means of a license, which includes a price cap on Heathrow's airport charges.

The Price Cap

In setting the price cap, the CAA determines the regulated revenue requirement. In simple terms, this is calculated as the sum of forecast operating expenditure less other revenue plus a return that is derived by applying the cost of capital determined by the CAA on the forecast Regulatory Asset Base (RAB) (taking into account forecast capital expenditure) and a regulatory depreciation allowance. The resulting regulated revenue requirement effectively determines the total income that can be raised from airport charges levied on the airlines using the airport. The regulated revenue requirement is divided by forecast passenger numbers which, subject to smoothing the progression of charges across the regulatory period, establishes the airport charges price cap expressed as a maximum allowable yield per passenger.

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



The CAA sets the maximum level of airport charges for Heathrow, generally for five year periods, known as quinquennia. Heathrow's current regulatory period is for four years and nine months from 1 April 2014 to 31 December 2018 in order to align Heathrow's financial and regulatory years.

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

Business overview *continued*
Our regulatory environment *continued*

The Price Cap continued
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.

The price control conditions set by the CAA include the following components for the maximum allowable yield:

- A mechanism designed to adjust the maximum allowable yield within the relevant quinquennium for either additional or reduced security costs incurred as a result of new UK or European Commission security directives issued by or through the UK Government.
- A mechanism designed to correct for any under recovery (dilution) or over recovery (concentration) in airport charges compared to the annual maximum allowable yield per passenger.
- There is a capital expenditure "trigger" term built into the price control for Heathrow, with provision for the maximum allowable yield to be reduced if specified project milestones are not delivered on time.

Our income
Heathrow generates two primary types of income: aeronautical income, which is generated from fees charged to airlines for use of the Airport's facilities, and non-aeronautical income from a variety of sources.

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. Reduced charges are applied to passengers that transfer through the airport.

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, engine nitrogen oxide ('NOx') emissions and noise certification values. These charges are adjusted, where applicable, for the time of day.

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 and advertising revenue;
- the rental of airport premises such as aircraft hangars, cargo storage facilities, maintenance facilities and offices
- 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

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 2014 its runways operated at nearly 97.6% (2013: 97.5%) of their permitted capacity.

Terminals
Heathrow airport has five operational terminals. In June 2014, Terminal 2 was opened on time and on budget and attained a high safety record during the construction phase. The new terminal has the capacity to cater for up to 20 million passengers a year. Terminal 5 is the largest terminal and provides passenger capacity for up to 30 million passengers per year. Terminal 1 operations are being phased out and are budgeted to close in October 2015.

Heathrow's terminal capacity is expected to be approximately 85 million passengers per year once Terminal 1 operations are discontinued.

Strategic report

Infrastructure *continued*
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 delivery of the Terminal 3 integrated baggage system remains on track to start operation in 2015 and will be fully operational in May 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.

Cargo sheds at the airport are owned by third parties who lease space to cargo service providers.

Retail Facilities
Heathrow has a total of approximately 53,000 square metres of retail space served by over 120 retail clients operating almost 500 retail outlets. Terminal 5, with over 24,000 square metres of retail space, has significantly increased the airport's overall retail portfolio. Heathrow owns over 20,000 public car park spaces that are available to travellers and the general public. All terminals at Heathrow airport are served by car rental operators. The terminals and their approaches provide advertising space, which yields further income.

Management review

Review of the year
Heathrow performed strongly in 2014 delivering a solid financial performance and achieving the highest passenger satisfaction of all major European airports whilst handling more passengers than ever.

In July 2014, John Holland-Kaye became Chief Executive Officer and set out his ambition for Heathrow to become one of the best airports in the world. Heathrow took an important step in 2014, with passengers ranking Heathrow the number one major European airport. Passenger satisfaction hit a record high and 78% of passengers in 2014 rated their experience with the airport as 'Excellent' or 'Very Good' recognising the improvements delivered through the year including the opening of Terminal 2 and increased security lanes in Terminal 5 from December. Despite operating at full capacity, departure punctuality improved through the year with 78% of flights departing within 15 minutes of schedule as operational procedures improved across all stakeholders. As part of a programme to build greater operational resilience, a centralised airport operations control centre was opened in late 2014. The centre is focused on improving the flow of passengers, aircraft and bags through the end to end journey. The centre enhances operational awareness and collaboration and is leading to improved performance of the airport operation.

These achievements were all the more significant, as Heathrow welcomed a record 73.4 million passengers in 2014, over a million more than in 2013. New routes and additional flights were launched to mature and emerging long haul markets benefiting from the strength of efficient hub facilities. New destinations include Manila, Chengdu, Bogota and Austin, Texas and Air China consolidated its London operations into Heathrow.

By the end of 2014, Heathrow had more airlines operating Boeing 787s than any other airport globally, whilst the number of airlines operating Airbus 380s increased to seven, benefiting from the direct demand to use Heathrow and the hub capabilities for efficient transfers.

2014 was a milestone year in the transformation of Heathrow, with the opening of Terminal 2: The Queen's Terminal in June. The terminal is home to 26 airlines including Star Alliance airlines at Heathrow. The terminal provides the ability for airlines to operate with low minimum connecting times for transfer passengers, benefiting from the hub infrastructure. Together with Terminal 5, which has been the winner of the Skytrax World's Best Airport Terminal for three successive years, Heathrow now has two world-class terminals, giving the UK a world-class entry point.

Management review *continued*

Review of the year continued

A new period of economic regulation started in April and the business launched its five year plan to further improve the passenger experience and increase operational resilience whilst delivering a competitive cost of operation. The regulatory settlement is based on the delivery of £600 million of cost efficiencies between 2014 and 2018. A strong start has been made and the cost efficiencies secured in 2014 are projected to deliver approximately £280 million in savings for the period of the plan. In addition, revenue initiatives forecast to generate around £100 million have already been implemented.

Strategically, there was significant focus in 2014 on developing the proposals for expanding Heathrow. Heathrow is the UK's only hub airport, and together with its unique catchment area, airlines choose to operate 80% of the UK's scheduled long haul traffic at Heathrow. The airport is full and opportunities for airlines to start new routes to fast growing markets are constrained, with airlines often looking elsewhere in Europe rather than in the UK to build routes, resulting in important traffic flows bypassing the UK in turn undermining the UK's ability to access key emerging markets. Support for expanding Heathrow is growing locally and nationally and at the launch of its national consultation, the Airports Commission estimated that Heathrow expansion could bring benefits of up to £211 billion across the UK economy. These benefits include a combination of new trade opportunities and markets, supply chain employment, business creation and jobs across the UK. In the summer of 2015, the Airports Commission will make a final recommendation for expansion.

Passenger traffic

Heathrow's passenger traffic by geographic segment for the year ended 31 December 2014:

Passengers by geographic segment (millions)	**Year ended 31 December 2014**	Year ended 31 December 2013	Change[1] %
UK	**5.3**	5.0	5.5
Europe	**30.0**	29.9	0.2
North America	**17.0**	16.7	1.7
Asia Pacific	**10.4**	10.3	1.5
Middle East	**6.0**	5.9	3.4
Africa	**3.5**	3.5	(0.2)
Latin America	**1.1**	1.1	6.3
Total passengers[1]	**73.4**	72.3	1.4

[1] These figures have been calculated using un-rounded passenger numbers.

For the year ended 31 December 2014, Heathrow's traffic increased 1.4% to 73.4 million passengers (2013: 72.3 million). The average load factor rose to 76.6% (2013: 76.4%), the average number of seats per passenger aircraft increased to 204.5 (2013: 202.8) and the airport operated at 98.1% of its maximum flight capacity (2013: 97.8%).

New routes and additional flights have been launched to emerging markets and other long haul destinations. Despite capacity constraints, these are made possible by the unique passenger catchment together with the modern infrastructure to enable smooth connections. New destinations include Manila, Chengdu, Bogota and Austin, Texas and Air China consolidated all its London operation into Heathrow. In addition, British Airways announced the start of a new service to Kuala Lumpur and Vietnam Airlines announced that it will move its entire London operations from Gatwick airport to Heathrow and increase frequencies in 2015.

Long haul demand grew in most regions with intercontinental traffic up 1.9%. North America benefited from new destinations and increased frequencies on existing routes, resulting in a rise of 1.7%. Traffic on routes serving the Middle East grew by 3.4% reflecting increased flights and higher load factors. Traffic to and from Asia Pacific destinations grew by 1.5%, supported by increased frequencies on existing Asian routes. Latin American traffic grew 6.3% reflecting the new route to Colombia, increased flights to Mexico and growth in Brazil.

European traffic was up 0.2% year on year, retaining the step change in traffic that these markets experienced in 2013. Domestic traffic grew strongly with an increase of 5.5%.

With over a quarter of UK exports passing through Heathrow, cargo volume at Heathrow increased a further 5.3% to 1.5 million metric tonnes in 2014, with notable increases on China, Hong Kong, Brazil and USA.

Service standards

Heathrow's quality of service and facilities continued to receive strong endorsement. In the 2014 Skytrax World Airport Awards, Terminal 5 was named the world's 'Best Airport Terminal' for the third year in a row and Heathrow was named the 'Best Airport for Shopping' for the fifth consecutive year. The Skytrax World Airport Awards are independent of any airport input and assess customer service and facilities across 388 airports providing an impartial benchmark of airport excellence and quality.

Management review *continued*

Service standards continued

Heathrow achieved its highest ever overall passenger satisfaction in the independent Airport Service Quality (ASQ) survey directed by Airports Council International (ACI), averaging 4.04 (2013: 3.97) out of 5.00 and the first year in which passenger satisfaction was above 4.00 in every quarter. The score reflects strong overall operational performance, near-record levels of punctuality and strong levels of satisfaction across key passenger service attributes. In addition, 78% of passengers surveyed in 2014 rated their experience as 'Excellent' or 'Very Good'.

In relation to individual service standards, in 2014, departure punctuality (the proportion of aircraft departing within 15 minutes of schedule) was 78% (2013: 77%). Heathrow's baggage misconnect rate was 19 per 1,000 passengers (2013: 14), in part reflecting service interruptions to the baggage systems in the summer.

Passengers passed through central security within the five minute period prescribed under the Service Quality Rebate scheme 96.1% of the time (2013: 90.9%) compared with a 95% service standard. For Heathrow's current regulatory period, the Civil Aviation Authority ('CAA') has raised standards for certain elements of the service quality scheme to build on improvements made through the last regulatory period. The standards for measuring security queues will move to a 'per passenger' basis once queue measurement automation is introduced. The standard will require 99% of passengers to pass through security within 10 minutes.

As part of a programme to build greater operational resilience, a centralised airport operations control centre was opened in late 2014. The centre is focused on improving the flow of passengers, aircraft and bags, through the end to end journey. The centre enhances operational awareness and collaboration and is leading to improved performance of the airport operation.

Terminal 2: The Queen's Terminal

Heathrow delivered the latest stage in its transformation, with the opening of the multi-billion pound Terminal 2: The Queen's Terminal in June 2014.

Her Majesty the Queen officially opened the terminal on 23 June 2014, accompanied by HRH the Duke of Edinburgh. The original Terminal 2, opened by Her Majesty the Queen in 1955, was Heathrow's first terminal and was designed to deal with 1.2 million passengers a year. The new multi-billion pound terminal has the capacity to cater for up to 20 million passengers a year. Airlines and passengers benefit from state of the art facilities that include main terminal and satellite buildings, a multi-storey short-stay car park and an energy centre supporting Terminal 2 and the wider airport. The terminal and satellite buildings include 24 aircraft stands of which seven stands are capable of handling the increasing number of A380 aircraft operating at Heathrow.

The terminal is now home to 23 Star Alliance member airlines operating at Heathrow together with Aer Lingus, Virgin Atlantic Little Red and Germanwings. The phased transition of airlines into the terminal began on 4 June and completed on-time on 23 October with approximately 350 daily arrivals and departures now being handled by the new facilities. Co-location of the Star Alliance airlines at Heathrow provides the opportunity to enhance efficiencies through use of common facilities, processes and personnel. It also enhances the scope for closer commercial co-operation between alliance members by, for example, capitalising on competitive minimum connection times to attract greater volumes of transfer passengers. Both these features will further strengthen Heathrow's competitive position.

The success of the opening phase of the terminal's operation is reflected in it achieving an average 4.23 ASQ score in the second half of 2014. This score would place Heathrow Terminal 2 as the best airport in Europe if it were a standalone airport.

Together with Terminal 5, Heathrow now has two world-class terminals, giving a world-class entry point to the UK. The opening of Terminal 2 is the culmination of an £11 billion capital investment at Heathrow over the last decade that has transformed Heathrow's infrastructure and positioned it strongly to continue its role as a leading global hub airport for the benefit of the whole of the UK in the coming decades.

Heathrow's business plan

Heathrow's business plan for the latest period of economic regulation ('Q6') which began on 1 April 2014 and runs until 31 December 2018 focuses on delivering a noticeably better passenger experience, ensuring a continued focus on improved resilience and capacity availability and delivering a competitive cost of airport operation.

The price controls set by the CAA for Q6 permit an annual change to the maximum allowable yield per passenger of RPI minus 1.5%. The settlement assumes modest traffic growth of around 1% per annum, averaging 73 million annual passengers, after allowance for demand shocks. Given the constraint on capacity at Heathrow, growth in passengers is expected to be supported by larger and fuller aircraft.

Management review *continued*

Heathrow's business plan continued

Building on 2014, in nominal terms, for the four years from 2015 to 2018, revenue is forecast to rise at a compound annual growth rate of around 2% whilst operating costs remain broadly flat resulting in approximately 4% compound annual growth in Adjusted EBITDA (earnings before interest, tax, depreciation, amortisation, certain re-measurements and exceptional items).

The settlement for the Q6 period assumes delivery of £600 million of cost efficiencies between 2014 and 2018. Plans are in place to deliver around half of the savings from employment costs; these include corporate centre headcount reductions, slower wage growth, provision of more sustainable pension benefits, increased productivity and broader market-alignment of employment terms. Most of the remainder of the savings will be delivered through improved supplier terms across the airport operation and corporate centre.

In 2014, the business has focused on securing early sustainable savings and revenue growth. The cost efficiencies secured to date are projected to deliver approximately £280 million in savings for the period of the plan, these include approximately £80 million in employment cost efficiencies and initiatives totalling around £200 million with suppliers.

Revenue initiatives secured to date are forecast to generate around £100 million. These include successful car park revenue management with the introduction of a wider product range, together with yield and demand management. Retail concessions are being negotiated on an on-going basis and in October Heathrow extended agreements with World Duty Free by six and a half years which deliver immediate benefit.

Investing in Heathrow

Building on the £11 billion investment programme over the last 10 years, Heathrow invested close to £730 million in 2014. Capital expenditure in cash terms was £853 million and reflects the timing difference between completion of assets in 2013 and corresponding supplier payments in 2014.

Completion of Terminal 2 accounted for a third of capital expenditure in 2014. The remainder included investment in Heathrow's baggage infrastructure, the refurbishment of tunnels to the Central Terminal Area, asset replacement and investment in operational resilience. Night-time resurfacing of the northern runway took place over the summer and completed on time at the end of September. Improvements to passenger experience included the expansion of security lanes in Terminal 5 and a new designer retail offering in Terminal 5, strengthening its position as an unrivalled airport shopping experience.

In March 2015 the £0.5 billion Terminal 3 Integrated Baggage facility will start initial operations and will be fully operational in May 2016. The automated baggage handling facility combines process enhancements with advancements in technology to create an integrated, efficient and user friendly operation for Terminal 3. It is a key step in moving Heathrow towards the goal of fully integrated and inter-connected baggage facilities across all terminals. Once fully operational the facility will provide increased baggage handling capacity for Terminal 3, reduced misconnection rates, faster transfers between Terminal 3 and Terminal 5 and improved working conditions for handling baggage. Passengers will benefit from early bag check-in with capacity for almost 5,000 early bags.

Capital expenditure for the Q6 regulatory period from 1 April 2014 to 31 December 2018 is currently forecast to be £2.6 billion. In line with the regulatory settlement, the capital programme may increase to up to £3.3 billion. This is subject to further scoping of the remaining individual projects and approval of the corresponding business cases. The capital programme is primarily focused on maintenance and compliance related projects, together with sustaining and improving the passenger experience. As well as Terminal 3 Integrated Baggage, the capital plan also includes a £1 billion programme of asset management and replacement projects and a £320 million project to implement latest generation hold baggage screening equipment to comply with EU directives. Capital spend in 2015 is forecast to be in the region of £580 million.

Airports Commission

At the end of 2013, the Airports Commission, chaired by Sir Howard Davies, published its interim report stating that there is a clear case for at least one net additional runway in London and the South East by 2030. Heathrow's proposal for a third runway to the north west of the existing airport facilities is shortlisted for further appraisal along with another option at Heathrow and one at Gatwick.

Heathrow's expansion proposal raises the airport's capacity to 740,000 flights a year, from the current limit of 480,000, catering for up to 130 million passengers annually. Expansion would allow the UK to compete with international rivals and provide capacity for the foreseeable future. Heathrow expects expansion to involve an investment of £16 billion over 15 years.

Management review *continued*

Airports Commission continued

During 2014 Heathrow held public consultations and worked with local authorities, communities and other stakeholders and submitted a refreshed proposal to the Airports Commission reflecting input received. This proposal improved on the July 2013 plan with further reduction of noise impact, improved road capacity, reduced congestion impacts and faster delivery of hub capacity at a competitive world-class airport. On-going consultation with stakeholders has led to further refinements of the proposal. In February 2015, Heathrow unveiled plans to provide noise insulation to homes if the Government gives planning approval for a third runway and subject to CAA approval. The noise insulation offer goes above and beyond UK policy requirements, expands on Heathrow's previous proposals and is comparable to those offered by other European hub airports. In total, Heathrow estimates that over £700 million could be spent, an increase of over £450 million from that previously offered by Heathrow in its May 2014 submission to the Airports Commission, and an increase of over £610 million from previous proposals for a third runway.

Following detailed independent assessments that indicated expansion at Heathrow would result in up to £211 billion of economic benefit and create 180,000 jobs across the UK, the Airports Commission launched a 12-week national consultation on 11 November 2014. The consultation invited views and conclusions in respect of the three short-listed options; comments on the Commission's appraisal and overall approach; and comments on how the Commission carried out its appraisal of 16 specific topics.

At the close of the Commission's national consultation, Heathrow saw wide-ranging support from across Britain for its expansion plans, including 32 chambers of commerce representing every UK region, together with unions Unite and GMB, leading businesses and local residents. The Commission will now take account of responses in its final report which is expected in Summer 2015.

Key management changes

On 1 July 2014, John Holland-Kaye became Chief Executive Officer of Heathrow replacing Colin Matthews. John was responsible for delivering the £1 billion annual investment in transforming Heathrow, including the new Terminal 2: The Queen's Terminal. John joined the company in May 2009 as Commercial Director and was responsible for the major growth in retail income and improved passenger experience during the last regulatory period. John was previously Divisional CEO with Taylor Wimpey PLC, Operations Director at Taylor Woodrow PLC and Divisional Managing Director at Bass Brewers Limited.

In his first month as CEO John set out his ambition for Heathrow to become one of the world's best airports and set out four strategic priorities. The first is to 'beat the settlement', instilling a culture to deliver to plan and stretch for more; the second is to 'transform customer service', improving the experience for all users of Heathrow; the third is to 'win support for expansion' the case becomes increasingly urgent and the decision is critical to the UK. The final strategic aim is known as 'mojo', the aim of which is to make the company a place where people are proud to work, where there are diverse career opportunities for people working at Heathrow and for Heathrow to become an aspirational place to work for future generations.

On 1 October 2014, Heathrow announced that José Leo will stand down as Chief Financial Officer in March 2015 after over eight years at the company. José joined Heathrow in 2006 and has successfully transformed Heathrow's finances, implementing Heathrow's long-term financing platform, raising well over £11 billion of funding and establishing a strong reputation in global markets for transparent financial management of the business. José will remain as Chief Financial Officer until March 2015.

José will be succeeded as Chief Financial Officer by Michael Uzielli. Michael is currently Finance Director at British Gas where he has helped drive revenue growth, championed a cost focus to increase efficiency, restructured the company's pension schemes and led a highly engaged finance team. His work has also involved building strong relationships with the Government and energy industry regulators. Michael has experience of the aviation industry having previously worked for British Airways as well as at Schroders.

LHR Airports Limited

Strategic report *continued*

Financial Review

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

	Year ended 31 December 2014 £m	Restated Year ended 31 December 2013 £m
Turnover	**456**	457
Operating costs – ordinary	**(456)**	(460)
Operating costs – exceptional	**(8)**	(22)
Operating gain – exceptional	**209**	96
Operating profit	**201**	71
Net interest receivable and similar income	**649**	633
Fair value gain on financial instruments	**1**	12
Other income	**852**	698
Profit on ordinary activities before taxation	**1,703**	1,414
Tax credit on profit on ordinary activities	**95**	124
Profit on ordinary activities after taxation	**1,798**	1,538

Turnover
Turnover decreased negligibly to £456 million (2013: £457 million). Turnover is derived mostly from recharging Heathrow Airport Limited and Heathrow Express Operating Company Limited for central support services.

Operating costs – ordinary
Ordinary operating costs have decreased 1% to £456 million (2013: £460 million) for the year ended 31 December 2014.

Operating costs – exceptional
In 2014, £8 million of restructuring costs were incurred due to a significant restructure of the organisation that began in 2013 as part of the programme to deliver operational efficiencies during Heathrow's next regulatory period. Due to the size and nature of the programme, these charges are classified as exceptional operating items.

Operating gain - exceptional
The exceptional operating gain has increased to £201 million (2013: £74 million) for the year ended 31 December 2014. This credit reflects an increase in the amount receivable by the Company from the entities which are party to the SSAs due to movements in the LHR Airports Limited defined benefit pension scheme, Unfunded Unapproved Retirement Benefit Scheme ('UURBS') and Post-Retirement Medical Benefits ('PRM') pension-related liabilities.

Net interest receivable
Net interest receivable has increased 3% to £649 million (2013: £633 million) for the year ended 31 December 2014, in line with the intercompany receivable upon which interest accrues.

Fair value movements on financial instruments
A fair value gain of £1 million (2013: £12 million gain) on financial instruments has been recognised in the profit and loss account. The fair value gain is principally due to the increase in the underlying share price raising the value of equity swaps.

Other income
Other income relates to dividends received from Heathrow (DSH) Limited and dividends received from a number of non-trading subsidiaries following simplification of the group structure.

Pension scheme
The BAA pension scheme had a deficit of £199 million (2013: £93 million) as measured under FRS 17 *Retirement Benefits*. The majority of the increase in the deficit is due to a reduction in the discount rate applied to the defined benefit scheme obligation, as well the impact of alignment of mortality assumptions with the basis of the latest triennial valuation. These increases were partially offset by asset returns.

The UURBS and PRM pension related liabilities had a deficit of £29 million at 31 December 2014 (2013: £28 million).

Strategic report *continued*

Financial Review *continued*
Pension scheme *continued*
On 7 January 2015, the trustee of LHR Airports Limited defined benefit pension scheme (BAA Pension Trust Company Limited) concluded the triennial valuation of the defined benefit pension scheme. The valuation was carried out as at 30 September 2013 and indicated a scheme deficit of £300 million calculated using the trustee's actuarial assumptions. LHR Airports Limited agreed an increase to its deficit recovery payment from £24 million per year to £27 million per year until 31 December 2023. In respect of future accrual of benefits and expenses LHR Airports Limited will contribute an equivalent to 33.3% of basic salary and shift pay, which is estimated to be £46 million in 2015.

An actuarial loss of £198 million (2013: £76 million), in relation to the BAA Pension Scheme, is recorded in the statement of recognised gains and losses. This loss arose as a result of a reduction in the net discount rate to 3.55% (2013: 4.55%), fall in expected inflation rate to 3.20% (2013: 3.40%) and an increase in the long-term rate of improvement, in relation to mortality, to 1.5% (2013: 1.0%) offset by asset returns in excess of interest income on plan assets.

Share reduction
During the year the nominal value of shares was reduced from £1 per ordinary share to £0.000001 per ordinary share by way of a reduction of capital supported by solvency statement, in accordance with Companies Act 2006 sections 642 to 644. The surplus arising from this capital reduction (£1,567 million of share capital and £325 million of share premium) has been credited to the profit and loss reserve and is considered distributable as a matter of law.

Employee numbers
In 2014 the average number of employees fell to 7,403 (2013: 8,477). This reduction is principally due to discontinued operations following the sale of Aberdeen, Glasgow and Southampton airports on 18th December 2014.

Leadership and governance

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

Board of Directors of Heathrow Airport Holdings Limited
The Board of Directors 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 of Directors of Heathrow Airport Holdings determines the 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.

Audit Committee of Heathrow Airport Holdings Limited
The Audit Committee members include a chairman appointed by the Board of Directors, the Company Secretary and three shareholder representatives, who also attend the Board of Directors.

The Audit Committee is a sub-committee of the Board of Directors of Heathrow Airport Holdings Limited and is responsible for:

- considering the appointment of the external auditor, making appropriate recommendations to the Board and assessing the independence of the external auditor;
- ensuring that the provision of non-audit services does not impair the external auditor's independence or objectivity;
- discussing with the external auditor, before the audit commences, 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 external auditor management letters and responses from management;
- a standing agenda to meet privately with the external auditor independent of Heathrow Airport Holdings Limited's executive directors; and
- reviewing the scope, operations and reports of the Heathrow Airport Holdings Group's Internal Audit function on the effectiveness of systems for internal financial control, financial reporting and risk management.

Nomination Committee
The Nomination Committee members include the Chairman of the Board, an independent Non-Executive Director and board members assigned by the shareholders of FGP Topco Limited.

The Nomination Committee is a sub-committee of the Heathrow Airport Holdings Limited Board of Directors.

Leadership and Governance *continued*
Nomination Committee *continued*
The Committee:
- identifies, recommends and considers all new appointments of independent Non-Executive Directors to the Board of Directors and its sub-committees; and
- ensures a formal, rigorous and transparent procedure in the appointment of independent Non-Executive Directors to the Board of Directors.

Remuneration Committee of Heathrow Airport Holdings Limited
The Remuneration Committee members include a chairman appointed by the Board of Directors, the Company Secretary, three shareholder representatives and one independent Non-Executive Director. The Remuneration Committee members are all members of the Board of Directors.

The Remuneration Committee is a sub-committee of the Board of Directors of Heathrow Airport Holdings Limited.

Subject to any Decisions of the Committee and the Shareholders' Agreement, the Committee's specific responsibilities include the approval 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 CEO) 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 payment 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.

The Committee's specific responsibilities include making proposals to the Board on:
- the salary level, bonuses and other benefits for the CEO (subject to any Decisions of the Committee and the Shareholders' Agreement); and
- the recruitment and appointment of independent Non-Executive Directors.

Finance Committee of Heathrow Airport Holdings Limited
The Finance Committee members include a chairman appointed by the largest shareholder of FGP Topco Limited, the Chief Executive Officer, the Chief Financial Officer, the Company Secretary and Non-Executive Directors/shareholder representatives who are each assigned by shareholders of FGP Topco Limited. The Finance Committee members are all members of the Board of Directors.

The Finance Committee is a sub-committee of the Heathrow Airport Holdings Limited Board of Directors. The Finance Committee acts on behalf of the Board of Directors of Heathrow Airport Holdings Limited and the shareholders of FGP Topco Limited.

The Committee is required to give approval to various matters relating to the Group's debt financing arrangements prior to their implementation. These include any repayments of principal in addition to scheduled principal payments on any debt; creation of new security interests; any entering into or material change, amendment or variation to any material financing arrangement; and the refinancing of any material existing indebtedness. In addition, the Committee is required to approve prior to its issue 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.

Safety and Operational Risk Committee of Heathrow Airport Holdings Limited
The Heathrow Safety and Operational Risk Committee is chaired by an independent Non-Executive Director. The secretary is the Head of Sustainability and Environment. Members include the Chief Executive Officer and three shareholder representatives.

The Safety and Operational Risk Committee is a sub-committee of the Heathrow Airport Holdings Limited Board of Directors.

The Committee shall:
- Review and challenge the performance and conduct of the Company relating to sustainability and operational risk;
- Monitor and challenge the effectiveness of the sustainability and operational risk internal control system and have access to any audit, incident and investigation report it considers relevant;
- Discuss and assess with the Company management the adequacy of the Company's sustainability and operational risk management and those internal control systems;
- Review and assess management's response to significant incidents and sustainability/operational risk audit findings and recommendations; and
- Monitor and challenge the appropriateness of sustainability and operational risk assurance strategies and plans, the execution and results of such plans and relevant communications.

Leadership and Governance ***continued***
Executive Committee of Heathrow Airport Holdings Limited

The Executive Committee consists of the Chief Executive Officer, the Chief Financial Officer, the General Counsel and Directors of Corporate Affairs, HR, IT, Operations, Procurement and Strategy, Planning and Regulation.

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

The Executive Committee develops and recommends to the Board short, medium and long-term business development strategies. It ensures the delivery of agreed strategies by providing guidance, approvals, governance and monitoring.

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 the corporate services provided under the Shared Services Agreement ('SSA') by a fully dedicated senior team which implements and manages risk closely, setting the guidelines for the Group. The Executive Committee, Board and Audit Committee ('AC') referred to below relate to the Executive Committee, Board, Finance Committee and AC of Heathrow Airport Holdings Limited. Of the four members of the AC 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 Group and for reviewing the effectiveness of the system. This is implemented by applying the HAHL Group internal control procedures, supported by a Code of Professional Conduct Policy, appropriate segregation of duties controls, organisational design and documented procedures. These internal controls and processes are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against material misstatements or loss.

The key features of the HAHL 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;
- AC 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

The principal risks identified by the Executive Committee are:

Safety and security
We have a statutory and moral responsibility to ensure aviation security and safeguard the welfare and safety of staff, business partners and the public who may be affected by our activities. We recognise that a failure to exercise this responsibility effectively also risks operational disruption, inconvenience to passengers and long-term damage to our reputation.

The Company'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 HAHL Group's business. The HAHL Group 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 the aforementioned remain effective and to encourage continuous improvement.

Security risks are mitigated by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading edge security technology. The HAHL Group works closely with airlines and government agencies including the police building a framework to establish joint accountabilities for airport security and

Risk management *continued*
Safety and security continued
shared ownership of risk, thus ensuring security measures remain both flexible and proportionate to the prevailing threat environment.

Strategy, regulation and competition
Heathrow airport is operating its' runways at close to full capacity and failure to secure necessary planning permissions 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 provide input to the on-going relevance of our strategy but this has to remain in the context of the UK government's policy on airport capacity which has a significant influence on the HAHL Group's ability to secure necessary planning permissions and develop capacity. We undertake extensive consultation with community groups and authorities at a local level and are active participants in government consultations and other advisory groups.

Existing planning approvals provide for passenger traffic to grow to approximately 90 million.

Operations at Heathrow airport are currently subject to economic regulatory review by the CAA normally every five years. The risk of an adverse outcome from these 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.

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 processes 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 on-going requirements are articulated and understood.

The penalties for failing to comply with the 1998 Competition Act and relevant EU law are recognised as risks to manage within the HAHL Group, given its position in certain markets. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, reduces the risk of the HAHL Group breaching these regulations.

Operational resilience
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 HAHL 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.

The risk of industrial action by key staff that affects critical services, curtails operations and has an adverse financial and reputational impact on the HAHL Group is recognised. The HAHL Group has a range of formal national and local consultative bodies to discuss pay, employment conditions and business issues with the Trade Unions. The Heathrow pay agreement reached in early 2014 established the pay structure for 2014 and 2015 - the next round of pay negotiations will again need to reflect the outcome of the most recent economic regulatory review. We could also be exposed to the effect of industrial action involving other key stakeholders in the aviation sector, in the UK and overseas, such as airlines, air traffic controllers, baggage handlers and Border Force.

Through a series of programmes we seek to keep a competent, flexible and motivated workforce that can respond to a changing business and operating environment. By driving engagement in our people we will achieve our goals and give excellent passenger service, avoid safety and security incidents, protect resilience and deliver successful change.

Corporate social responsibility
We understand the importance to our business of the communities in which we operate, and through consultation and engagement seek to ensure that their concerns are taken into account in the operation and planning of Heathrow. We undertake procurement responsibly and encourage trade and employment opportunities with the local communities. Progressive influencing of third parties, stakeholder engagement and community relations programmes are also established.

Environmental risk has the potential to impact negatively upon the HAHL Group's reputation and jeopardise its licence to operate and to grow. Proactive environmental management systems and employee training programmes are embedded within operations through clear environmental strategies and resource conservation initiatives. We work closely with a range of stakeholders to ensure that we react effectively to the challenges posed by the environmental agenda.

Risk management ***continued***

Management of change

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 the HAHL Group. Since it is not possible to identify the timing or period of such an effect, the HAHL Group carries out evaluations through a series of scenario planning exercises.

Heathrow recognises that failure to control key development costs and delivery could damage its financial standing and reputation. The HAHL Group mitigates this risk 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.

Supply chain

Understanding the possible impact on airport operations and passenger experience of its' own and others' supply chains, 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.

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

(a) Interest rates
The HAHL Group maintains a mix of fixed and floating rate debt. As at 31 December 2014, fixed rate debt after hedging with derivatives represented 97% of the Group's total external nominal debt.

(b) Inflation
The HAHL 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 HAHL Group uses cross-currency swaps to hedge all interest and principal payments on its foreign currency debt. The HAHL 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 HAHL 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 on-going basis with formal testing reported to the AC, 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 HAHL Group is not exposed to excessive refinancing risk in any one year.

The HAHL 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 2016. As at 31 December 2014, cash and cash equivalents and term deposits were £436 million, undrawn headroom under revolving credit facilities was £1,525 million and undrawn headroom under liquidity facilities was £750 million.

LHR Airports Limited

Strategic report *continued*

Risk management *continued*
Financial stability continued

(e) Counterparty credit
The HAHL 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 HAHL 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 no cash or cash equivalents are placed with counterparties with short-term credit ratings lower than A-2/F1. The HAHL 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)/A (Fitch).

On behalf of the Board

José Leo
Director

18 March 2015

Company registration number: 01970855

LHR Airports Limited

Directors' report

The Directors present their annual report and the audited financial statements for LHR Airports Limited (the 'Company') for the year ended 31 December 2014.

A review of the progress of the Company's business during the year, internal controls and risk management, principal business risks and likely future developments are contained in the Strategic report on page 2 to 16.

Results and dividends
The profit after taxation for the financial year amounted to £1,798 million (2013: £1,538 million).

Dividends of £4,014 million were paid during the year (2013: £688 million).

The Company made quarterly dividends totalling £295 million to fund dividends to its ultimate shareholders, as well as a further £219 million distributed to shareholders in December 2014. The remaining £3,500 million related to a non cash dividend paid to Heathrow Holdco Limited, the purpose of which was the reorganisation of upstream loans within the HAHL Group.

During the year the nominal value of shares was reduced from £1 per ordinary share to £0.000001 per ordinary share by way of a reduction of capital supported by solvency statement, in accordance with Companies Act 2006 sections 642 to 644. The surplus arising from this capital reduction (£1,567 million of share capital and £325 million of share premium) has been credited to the profit and loss reserve and is considered distributable as a matter of law.

The statutory results for the year are set out on page 21

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

Ian Ballentine	
Normand Boivin	
Neil Clark	
Emma Gilthorpe	
Clare Harbord	
John Holland-Kaye	
Carol Hui	
José Leo	
Jim O'Sullivan	Resigned 31 December 2014
Paula Stannett	
Fidel Lopez	Resigned 1 September 2014
Colin Matthews	Resigned 30 June 2014

Employment policies
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 and that their training and career development needs are carefully managed. 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 also operates frameworks for consultation and is committed to managing people through change fairly.

LHR Airports Limited

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. 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.

Subsequent events
In January 2015, the trustee of the defined benefit pension scheme concluded the triennial valuation of the scheme. The valuation was carried out as at 30 September 2013 and indicated a scheme deficit of £300 million calculated using the trustee's actuarial assumptions. LHR Airports Limited agreed an increase to its annual deficit recovery payment from £24 million to £27 million until 2023. In respect of future accrual of benefits, LHR Airports Limited will contribute approximately 33% of basic salary and shift pay, which is estimated to be £46 million in 2015.

On 26 February 2015, the board approved the payment of a £70 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) Limited for £70 million.

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/her in defending any proceedings in which judgement is given in his favour, or in which he/she is acquitted or in connection with any application in which relief is granted to him/her 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/her 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 auditor is unaware; and
- the Director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

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

On behalf of the Board

José Leo
Director

18 March 2015

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). 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 judgments 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

José Leo
Director

18 March 2015

LHR Airports Limited

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

We have audited the parent company financial statements of LHR Airports Limited for the year ended 31st December 2014 which comprise the Company balance sheet, the Accounting policies and the related notes 1 to 22. 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).

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 auditor
As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the parent company 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 parent company 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 parent 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 parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2014 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 matter prescribed by the Companies Act 2006
In our opinion 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 parent company financial statements.

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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; 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.

Andrew J. Kelly FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK

18 March 2015

Profit and loss account for the year ended 31 December 2014

	Note	**Year ended 31 December 2014 £m**	Restated Year ended 31 December 2013 £m
Turnover[1]	*1*	**456**	457
Operating costs – ordinary[1]	*2*	**(456)**	(460)
Operating costs – exceptional: restructuring	*3*	**(8)**	(22)
Operating gain – exceptional [1]	*3*	**209**	96
Total operating costs		**(255)**	(386)
Operating profit		**201**	71
Interest receivable and similar income	*4*	**712**	702
Interest payable and similar charges	*4*	**(63)**	(69)
Fair value gain on financial instruments	*4*	**1**	12
Other income	*5*	**852**	698
Profit on ordinary activities before taxation		**1,703**	1,414
Tax credit on profit on ordinary activities	*6*	**95**	124
Profit on ordinary activities after taxation	*19*	**1,798**	1,538

[1] Turnover and operating costs for 2013 have been restated in order to show the exceptional costs for restructuring separately.

All profits and losses recognised during the current and prior years were from continuing operations.

There were no material differences between the profit on ordinary activities before taxation and the retained profit for the year and their historical cost equivalents.

LHR Airports Limited

Statement of total recognised gains and losses for the year ended 31 December 2014

	Note	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Profit for the financial year	*19*	**1,798**	1,538
Deferred tax credit/(charge) on items transferred directly to equity[1]		**40**	(11)
Other net recognised losses relating to the year:			
Actuarial loss (gross of deferred tax)[2]	*14*	**(201)**	(74)
Other gain/(loss)		**1**	(1)
		(160)	(86)
Total recognised gains relating to the year		**1,638**	1,452

[1] This includes a deferred tax credit of £40 million (2013: £16 million charge) relating to retirement benefit obligations and unfunded pension scheme obligations.
[2] This includes a £198 million actuarial loss relating to the BAA Defined Benefit pension scheme and a £3 million actuarial loss relating to the UURBS and PRM schemes.

Reconciliation of movements in shareholder's funds for the year ended 31 December 2014

	Note	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Profit for the financial year	*19*	**1,798**	1,538
Dividends paid	*19*	**(4,014)**	(688)
Other net recognised losses relating to the year:			
Actuarial loss (gross of deferred tax)[2]	*14*	**(201)**	(74)
Other gain/(loss)		**1**	-
Deferred tax credit/(charge) on items transferred directly to equity[1]		**40**	(11)
Net movement in shareholder's funds		**(2,376)**	765
Opening shareholder's funds		**11,027**	10,262
Closing shareholder's funds		**8,651**	11,027

[1] This includes a deferred tax credit of £40 million (2013: £16 million charge) relating to retirement benefit obligations and unfunded pension scheme obligations.
[2] This includes a £198 million actuarial loss relating to the BAA Defined Benefit pension scheme and a £3 million actuarial loss relating to the UURBS and PRM schemes.

LHR Airports Limited

Balance sheet as at 31 December 2014

	Note	**31 December 2014 £m**	31 December 2013 £m
Fixed assets			
Tangible assets	*7*	**2**	2
Investments	*8*	**3,867**	5,459
Total fixed assets		**3,869**	5,461
Current assets			
Debtors (including amounts due after more than one year of £5,818 million (2013: £8,599 million))	*9*	**6,464**	9,193
Current asset investments	*10*	**18**	-
Cash at bank and in hand	*11*	**12**	8
Total current assets		**6,494**	9,201
Current liabilities			
Creditors: amounts falling due within one year	*12*	**(208)**	(613)
Net current assets		**6,286**	8,588
Total assets less current liabilities		**10,155**	14,049
Creditors: amounts falling due after more than one year	*13*	**(1,268)**	(2,882)
Provisions for liabilities and charges	*15*	**(14)**	(24)
Net assets (excluding pension balances)		**8,873**	11,143
Defined benefit pension scheme obligation	*14*	**(199)**	(93)
Other pension and post-retirement benefit obligations	*14*	**(23)**	(23)
Net assets		**8,651**	11,027
Capital and reserves			
Called up share capital	*16*	**-**	1,567
Share premium reserve	*17*	**-**	325
Other reserves	*18*	**52**	53
Profit and loss reserve	*19*	**8,599**	9,082
Total shareholder's funds		**8,651**	11,027

The financial statements of LHR Airports Limited (Company registration number: 01970855) were approved by the Board of Directors and authorised for issue on 18 March 2015. They were signed on its behalf by:

José Leo
Director

John Holland-Kaye
Director

Accounting policies for the year ended 31 December 2014

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 preparation
These financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain investments and financial instruments, in accordance with applicable Companies Act 2006 and United Kingdom Generally Accepted Accounting Practice ('UK GAAP').

Changes in accounting policies
There have been no changes in accounting policies during the financial year. From 1 January 2015, the Company will prepare the financial statements in accordance with FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland.*

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 remaining committed and uncommitted facilities available to it, its scheduled debt maturities, and its forecast financial ratios and its ability to access 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 next twelve months from the balance sheet signing date.

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 2014. The results are also included in the consolidated financial statements of Heathrow (SP) Limited, which is the intermediate parent entity and the smallest group to consolidate these financial statements, Heathrow Finance plc and Heathrow Airport Holdings Limited, for the year ended 31 December 2014.

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

Turnover
Turnover represents amounts receivable for services provided in the normal course of business, net of discounts, VAT and other sales-related taxes. This is mainly comprised of the recovery of costs from Heathrow Airport Holdings Group entities in accordance with the Shared Services Agreements ('SSAs').

Exceptional items
The Company separately presents certain items as exceptional on the face of the profit and loss account. 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.

Such events may include gains or losses on the disposal of businesses or assets, major reorganisation of business, closure or mothballing of terminals and costs incurred in bringing new airport terminal complexes and airfields to operational readiness that are not able to be capitalised as part of the project.

The share of the LHR Airports Limited defined benefit pension net actuarial gain or loss is also treated as exceptional. Refer to the Shared Services Agreement accounting policy.

Additional details of exceptional items are provided as and when required as set out in Note 3.

Interest
Interest payable and interest receivable are recognised in the profit and loss account in the period in which they are incurred.

Tangible fixed assets

Operational assets

Plant, equipment and other assets are stated at cost less accumulated depreciation and impairment losses.

Depreciation

Land is not depreciated.

Impairment of assets (excluding investment in subsidiaries)

The Company assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. Where the asset does not generate cash flows that are independent of other assets, the recoverable amount of the income-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's net realisable value and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a significant change in the circumstances underlying the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount less any residual value, on a straight-line basis over its remaining useful life.

Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Company as a lessee

Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term if there is no reasonable certainty that the Company will obtain ownership by the end of the lease term.

Operating lease payments are recognised as an expense in the profit and loss account on a straight-line basis over the lease term.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Company as a lessor

Leases where the Company retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating an operating lease are added to the carrying value of the leased asset and recognised over the lease term on the same basis as the rental income.

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.

Investments *continued*

Other investments are accounted for in accordance with FRS 26 *Financial Instruments: Recognition and Measurement* on the basis more fully set out below under 'Financial assets'.

Debtors

Debtors are recognised initially at cost less any provision for impairment.

Accounting policies for the year ended 31 December 2014 *continued*

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

Creditors
Creditors are recognised at cost.

Amounts owed to group undertakings
Amounts owed to group undertakings are recognised initially at fair value, net of transaction costs incurred. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest rate method.

Deferred income
Payments received in advance of services being provided is deferred and released to the profit and loss account as earned.

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.

Restructurings
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.

Financial assets
On initial recognition, financial assets are measured at fair value, plus, in the case of investments not at fair value through the profit or loss account, directly attributable transaction costs. After initial recognition, investments that are classified as 'held-for-trading' and 'available-for-sale' are measured at fair value. Fair value gains or losses on investments held-for-trading are recognised in the profit and loss account. Fair value gains or losses on available-for-sale investments are recognised in a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative fair value gain or loss previously reported in equity is included in the profit and loss account. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indication that the security is impaired. If impairment is indicated, the cumulative fair value gain or loss previously reported in equity is included in the profit and loss account.

Assets classified as 'loans and receivables' or 'held-to-maturity' are recognised on the balance sheet at amortised cost, using the effective interest rate method, less any provision for impairment.

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables' and are carried at amortised cost using the effective interest rate method. Non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intent and ability to hold-to-maturity are classified as 'held-to-maturity' and are carried at amortised cost using the effective interest rate method. For investments carried at amortised cost, gains and losses are recognised in the profit and loss account when the investments are de-recognised or impaired, as well as through the amortisation process.

For investments that are traded in an active market, fair value is determined by reference to quoted market bid prices at the reporting date. For investments where there is no quoted market price, fair value is determined by using valuation techniques, such as estimated discounted cash flows, or by reference to the current market value of similar investments.

Purchases and sales of investments are recognised on trade-date being the date on which the Company commits to purchase or sell the asset.

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

On 18 August 2008, the airports and HEX entered into a SSA with LHR Airports Limited by which the latter became the shared services provider for the Group. 2013 saw a change in the way in which costs were incurred with Heathrow

Accounting policies for the year ended 31 December 2014 *continued*

Shared Services Agreement ('SSA') ***continued***
Airport Limited incurring its cost of operational staff and corporate services, these services are charged to the relevant Heathrow Airport Holdings Group airport in accordance with the SSA.

Operational staff
The Group's airport 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, medical costs and redundancy payments, as well as any other associated expenses properly incurred by the employees of LHR Airports Limited in providing the services. These costs include the cost of purchase of any shares in relation to share options granted and any hedging costs related to employee share options.

Corporate and centralised services
During 2013, LHR Airports Limited transferred various central services to Heathrow Airport Limited such as IT applications, general business services, procurement and financial accounting. Under the new structure, costs previously incurred by LHR Airports Limited are now borne by Heathrow Airport Limited and the element relating to airports other than Heathrow are subsequently recharged to LHR Airports Limited with mark-up consistent with the SSA. LHR Airports Limited then recharge the other airports without a mark-up. This change in methodology is allowed under the SSA which permits any of the operating companies to perform all or any portion of the Centralised Airport Services or Corporate Services.

Pension costs
Heathrow Airport Limited and Heathrow Express Operating Company Limited ('HEX') have had an obligation since August 2008 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. These provisions or assets are 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 arise due to current service costs, net finance costs or income, employer cash contributions and actuarial gains or losses. Heathrow Airport Limited and HEX record their share of the net actuarial gain or loss for the year as an exceptional item due to their size and nature.

Employee benefits
The Company operates a defined contribution pension scheme for all 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 has no further payment obligations once the contributions have been paid.

The Company's primary defined benefit UK pension fund is a self-administered defined benefit scheme now closed to new employees. The defined benefit obligation or surplus is calculated quarterly by independent actuaries using the projected unit credit method. The difference between the market value of the assets of the scheme and the present value of accrued pension liabilities is shown as an asset or liability on the balance sheet. Any difference between the expected return on assets and that actually achieved is recognised in the statement of total recognised gains and losses as an actuarial gain or loss along with differences which arise from experience or assumption changes.

The amount of income or expenditure recognised in the profit and loss account as employment costs, in relation to the defined benefit pension scheme, comprises the current service costs and past service costs.

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

Further information on pension arrangements is set out in Note 14

Share-based payments
The Company historically operated an Executive Share Option Plan ('ESOP') to provide awards of options over Ferrovial S.A. shares that were generally reserved for full time directors and other senior employees. This plan was closed in 2009 and replaced by a Performance Cash Plan, which is based upon a 3-year set of objectives.

In accordance with FRS 20 *Share Based Payments*, the ESOP is accounted for as cash-settled share-based payment transaction in accordance with the grant being made over Ferrovial S.A. shares because the Company has an obligation to settle the share-based payment transaction in cash.

For cash-settled share-based payments, a liability is recognised for the services acquired, measured initially at the fair value of the liability. At the balance sheet date until the liability is settled, and at the date of settlement, the fair value of the liability is re-measured, with any changes in fair value recognised in profit or loss for the year.

Share-based payments *continued*
Options were granted with a fixed exercise price equal to the market price of the shares at the date of grant. The exercise period for each of the issues commenced three years from the option grant date and lasts for three years. Vesting of the options is subject to continued employment and the Heathrow Airport Holdings Group achieving targeted levels of EBITDA.

The Company has a number of cash-settled equity swaps that are treated as derivative financial instruments and are intended to hedge the future cash flows required on potential exercise of the options. The fair value of these equity swap arrangements is recorded in the balance sheet with the gain or loss incurred in the period recorded within the profit and loss account.

The remaining options under this arrangement have been exercised or have lapsed in 2014.

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 reserves. In this case, the tax is also recognised in reserves.

Current tax liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the 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 19 *Deferred Tax,* 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, at rates expected to apply when they crystallise based on current tax rates and law. 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. Deferred tax is not provided on timing differences arising from the revaluation of investment properties where there is no commitment to sell the asset.

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.

Foreign currency
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.

Transactions denominated in foreign currencies are translated into Sterling using the exchange rates prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into Sterling at the rates of exchange ruling at the reporting date. Differences arising on translation are charged or credited to the profit and loss account.

Cash flow statement and related party transactions
The ultimate parent entity in the UK is FGP Topco Limited, a company registered in England and Wales. The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2014. The results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2014 (intermediate parent entity and the smallest group to consolidate these financial statements). Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of accounting standard FRS 1 (Revised 1996) *Cash Flow Statements.*

The Company is exempt under the terms of FRS 8 *'Related Party Disclosures'* from disclosing related party transactions with entities that are wholly owned subsidiaries of the FGP Topco Limited group.

Significant accounting judgements and estimates for the year ended 31 December 2014

In applying the Company's accounting policies, management have made estimates and judgements in a number of key areas. Actual results may, however, differ from the estimates calculated and management believe that the following areas present the greatest level of uncertainty.

Critical judgements in applying the group accounting policies

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

Taxation
Provisions for tax contingencies require management to make judgements and estimates in relation to tax issues and exposures. Amounts provided are based on management's interpretation of country specific law and the likelihood of settlement. Tax benefits are not recognised unless the tax positions will probably be sustained. In arriving at this position, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. All such tax provisions are included in current tax liabilities.

Turnover
The Company is viewed by management as acting as a principal in some exchange transactions with its customers, as in the case of inter-company recharges concerning payroll costs. In these circumstances 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. In contrast, other corporate costs recharged to Heathrow and Heathrow Express Limited include a fixed margin in accordance with the SSA, and in these cases the Company is viewed as acting as an agent. In such circumstances the relevant margin has been wholly recorded as a component of Turnover, and consequently no entry has been recorded within Operating Costs. This accounting treatment is in agreement with the accounting standard *Amendment to FRS 5 'Reporting the Substance of Transactions' : Revenue Recognition – November 2003,* and this 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 exchange transaction.

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.

Notes to the financial statements for the year ended 31 December 2014

1 Turnover

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 - ordinary

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Wages and salaries	**338**	345
Social security	**33**	34
Pensions[1]	**67**	71
Other staff related costs	**10**	5
Share-based payments	**1**	-
Employment costs[2]	**449**	455
General expenses	**7**	5
	456	460

[1] Pension costs in 2014 & 2013 relate to both the defined benefit and defined contribution schemes operated by the Company.
[2] Employment costs in 2014 & 2013 comprised employment costs of those involved in running the operational activities of the Airports. Refer to the SSA accounting policy.

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 (2013: £22,000) related to the audit of the Company's financial statements.

Employee information
All of the Company's employees were based in the United Kingdom and the average monthly number of employees (including executive directors) of the Company was as follows:

	Year ended 31 December 2014 Number	Year ended 31 December 2013 Number
Continuing operations		
Heathrow Airport and Heathrow Express Operating Company Limited[1]	**6,441**	6,271
Other operations	**8**	9
	6,449	6,280
Discontinued operations		
Airports[2]	**954**	2,197
	7,403	8,477

[1] The Heathrow Airport and Heathrow Express Operating Company Limited employee number - continuing operations has increased 2.7% from 2013 to 2014 due to a steady increase in the number of employees based at Heathrow Airport
[2] The Airports employee numbers – discontinued operations relate to the sale of Stansted Airport on 28 February 2013 and the sale of Aberdeen, Glasgow and Southampton Airports on 18 December 2014

2 Operating costs – ordinary *continued*

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 2014 was disclosed within the statutory financial statements of the following companies to which they primarily provide services: José Leo and Colin Matthews - Heathrow Airport Holdings Limited; Normand Boivin, Carol Hui, Clare Harbord, Emma Gilthorpe, Fidel Lopez, Paula Stannett, Ian Ballentine and Neil Clark – Heathrow Airport Limited as it is not considered possible to apportion their remuneration to different companies. Jim O'Sullivan is also a director of a number of companies within the Heathrow Airport Holdings Group but is not considered to primarily provide services to any company alone. John Holland-Kaye became a director of the Heathrow Airport Holdings Group on 1 July 2014; his remuneration from this date is disclosed in the financial statements of Heathrow Airport Holdings Limited and prior to this date is disclosed in the financial statements of Heathrow Airport Limited.

During the year, two of the directors (2013: four) had retirement benefits accruing to them under a defined benefits scheme and six of the directors (2013: six) had retirement benefits accruing to them under a defined contribution scheme.

One of the directors (2013: two) exercised share options during the year in respect of their services to the Heathrow Airport Holdings Group and no shares (2013: none) were received or became receivable under long term incentive plans.

3 Exceptional items

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Operating gain – exceptional: restructuring	**8**	22
Operating gain – exceptional : pensions	**201**	74
Total operating exceptional items	**209**	96
Tax credit on exceptional items	**(39)**	(15)
Total exceptional items after tax	**170**	81

Operating gain – restructuring

The exceptional operating gain of £8 million (2013: £22 million) for the year ended 31 December 2014 reflects the amount receivable by the Company from the entities which are party to the SSAs. This credit has arisen due to an additional charge of £8 million being recognised in 2014 relating to severance and pension payments associated with the re organisation programme being carried out in 2015.

Operating gain - pensions

The exceptional operating gain has increased to £201 million (2013: £74 million) for the year ended 31 December 2014. This credit reflects an increase in the amount receivable by the Company from the entities which are party to the SSAs due to movements in the LHR Airports Limited defined benefit pension scheme, Unfunded Unapproved Retirement Benefit Scheme ('UURBS') and Post-Retirement Medical Benefits ('PRM') pension-related liabilities.

Notes to the financial statements for the year ended 31 December 2014 *continued*

4 *Net interest receivable and similar income*

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Interest receivable and similar income		
Interest receivable from other group undertakings	**698**	689
Interest receivable on derivative financial instruments	**-**	1
Interest receivable on deposits	**-**	1
Interest from available-for-sale financial assets	**3**	3
Pension finance income[1]	**11**	8
	712	702
Interest payable and similar charges		
Interest on borrowings from other group undertakings	**(52)**	(61)
Pension finance cost recharge[1]	**(11)**	(8)
	(63)	(69)
Net interest receivable before fair value gain	**649**	633
Fair value gain on financial instruments		
Equity swaps	**1**	12
Net interest receivable and similar income	**650**	645

[1] This represents the pushdown of pension finance cost to Heathrow Airport Limited and Heathrow Express Operating Company Limited.

5 Other income

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Dividends received from subsidiaries[1]	**2,442**	700
Realisation of investment in subsidiaries[2]	**(1,581)**	-
Impairment of subsidiaries	**-**	(2)
Release of intercompany creditor in relation to a dissolved company [3]	**(9)**	-
	852	698

[1] Dividends received from Heathrow (DSH) Limited £437 million cash (2013:£700 million); BAA Italia SpA following dissolution during 2014 £11 million cash (2013: nil) and the following non trading subsidiaries of LHR Airports as a result of an internal reorganisation – all non-cash dividends : Scottish Airports Limited £44 million (2013: nil), BAA International Limited £34 million (2013: nil), BAA Partnership Limited £783 million (2013: nil), London Airports Limited £1,102 million (2013: nil) and BAA Lynton Developments Limited £31 million (2013: nil).

[2] 'Realisation of investment in subsidiaries' relates to the following non trading subsidiaries of LHR Airports Limited following an internal reorganisation: Scottish Airports Limited £40 million (2013: nil), BAA International Limited £27 million (2013: nil), BAA Partnership Limited £594 million (2013: nil), London Airports Limited £920 million (2013: nil).

[3] Release of intercompany creditor relates to the dissolution of BAA Italia SpA.

All non-cash dividends were ultimately settled through set off against intercompany payables with the same counterparty; any difference between the distribution received and the reduction in investments was recognised in the P&L reserve.

6 Tax on profit on ordinary activities

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Current tax	**8**	(110)
Group relief payable	**9**	134
Adjustments in respect of prior periods[1]	**(142)**	(146)
Total current tax credit	**(125)**	(122)
Deferred tax		
Origination and reversal of timing differences – non pension	**(8)**	9
Origination and reversal of timing differences – pension	**39**	6
Change in tax rate – non pension	**-**	2
Change in tax rate – pension	**-**	(20)
Adjustments in respect of prior periods	**(1)**	1
Total deferred tax charge/(credit)	**30**	(2)
Tax credit on profit on ordinary activities	**(95)**	(124)

[1] Adjustment in respect of the prior period relates mainly to worldwide debt cap calculations. At a Group level this adjustment nets to nil.

6 Tax on profit on ordinary activities *continued*

Reconciliation of tax credit

The standard rate of current tax for the year, based on the UK standard rate of corporation tax is 21.50% (2013: 23.25%). The actual tax charge for the current period and prior period differs from the standard rate for the reasons set out in the following reconciliation:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Profit on ordinary activities before tax	**1,703**	1,414
Tax on profit on ordinary activities at 21.5% (2013: 23.25%)	**366**	329
Effect of:		
Permanent differences	**(132)**	(115)
Non-taxable income	**(185)**	(163)
Temporary timing differences	**(32)**	(27)
Adjustments to tax charge in respect of prior periods[1]	**(142)**	(146)
Current tax credit for the year	**(125)**	(122)

[1] Adjustment in respect of the prior period relates mainly to worldwide debt cap calculations. At a Group level this adjustment nets to nil.

The Finance Act 2013 enacted reductions in the main rate of UK corporation tax from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015.These changes have been reflected above. Other than this change there are no items which would materially affect the future tax charge.

7 Tangible assets

	Operational land £m	**Plant, equipment and other assets £m**	**Total £m**
Cost			
1 January 2014	2	13	15
Disposals[1]	-	(13)	(13)
31 December 2014	**2**	**-**	**2**
Depreciation			
1 January 2014	-	(13)	(13)
Disposals[1]	-	13	13
31 December 2014	**-**	**-**	**-**
Net book value 31 December 2014	**2**	**-**	**2**
Net book value 31 December 2013	2	-	2

[1] Disposal relates to retirement of fully written down assets.

8 Investments

	Note	**Subsidiaries £m**	**Available for sale investments £m**	**Total £m**
Cost				
1 January 2014		5,431	23	5,454
Realisation of investment in subsidiaries	5	(1,590)	-	(1,590)
31 December 2014		**3,841**	**23**	**3,864**
Revaluation				
1 January 2014		-	5	5
Revaluation		-	(2)	(2)
31 December 2014		**-**	**3**	**3**
Net book value 31 December 2014		**3,841**	**26**	**3,867**
Net book value 31 December 2013		5,431	28	5,459

Notes to the financial statements for the year ended 31 December 2014 *continued*

8 *Investments continued*

Subsidiaries
The Company's principal subsidiaries whose financial position materially affects the Company are shown below:

Immediate 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

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.

Indirectly held subsidiaries are:

Subsidiary	Nature of Business	% of issued share capital held	Class of share
Heathrow Airport Limited	Airport Operator	100	Ordinary shares of £0.30 each
		100	Redeemable Preference shares of £1 each
		100	Irredeemable Preference shares of £0.01 each
Heathrow Express Operating Company Limited	Railway Operator	100	Ordinary shares of £1 each
Heathrow Funding Limited	Funding Company	100	Ordinary shares of £1 each
Heathrow (AH) Limited	Holding Company	100	Ordinary shares of £0.0015 each
Heathrow (SP) Limited	Holding Company	100	Ordinary shares of £0.0019 each
Heathrow Finance plc	Holding Company	100	Ordinary shares of £1 each

All subsidiaries are incorporated in the UK except Heathrow Funding Limited which is incorporated in Jersey.

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 2014. A rate of 10% (2013: 10%) has been used as the discount factor.

9 Debtors

	31 December 2014	31 December 2013
		£m
Due within one year		
Amounts owned by group undertakings – interest free[1]	**140**	167
Amounts owned by group undertakings – interest bearing[2]	**11**	10
Interest receivable from group undertakings[3]	**257**	278
Amounts owed by group undertakings – pensions[4]	**228**	123
Corporation tax receivable	**9**	16
	645	594
Due after more than one year		
Derivative financial instruments[5]	**-**	8
Amounts owed by parent undertaking[6]	**5,808**	8,589
Deferred tax (a)	**11**	2
	5,819	8,599
Total debtors	**6,464**	9,193

[1] 'Amounts owed by group undertakings – interest free' is made up of £19 million (2013: nil) receivable from its intermediate parent Non Des Topco Limited. This is as a result of Non Des Topco Limited taking on the liability of its former subsidiaries to LHR Airports Limited on their historic share of the group's defined benefit pension scheme liability following the sale of Aberdeen, Glasgow and Southampton Airports. The remaining £121 million (2013: £167 million) is in relation to loans receivable from the Company's subsidiaries, the largest of which being a £104 million loan with Heathrow Airport Limited (2013:£80 million).

[2] 'Amounts owed by group undertakings – interest bearing' is made up of loans with Heathrow Airport Limited and LHR Business Support Centre Limited totalling £4 million (2013 :£4 million) which have arisen over a number of years and accrue interest at 1.5% over Bank of England base rate with no fixed terms for repayment. In addition there is £7 million (2013: £6 million) due from Heathrow Enterprises Limited which accrues interest at 13%. All amounts are repayable on demand.

[3] This relates to £254 million (2013: £277 million) of interest receivable from Heathrow Holdco Limited and £3 million (2013: £1 million) of interest receivable from other subsidiaries.

[4] This balance represents amounts due to the Company from Heathrow Airport Limited and Heathrow Express Operating Company Limited in respect of the allocation of the deficit on the LHR Airports Limited defined benefit pension scheme, Unfunded Unapproved Retirement Benefit Scheme, and Post-Retirement Medical Benefits pension related liabilities.

[5] The Company previously entered into a number of equity swaps to hedge Ferrovial share price risk under the wider Heathrow Airport Holdings Group's Executive Share Option Plan ('ESOP'). The total ESOP derivative portfolio consists of nil million shares (2013:1 million shares) at a total mark to market asset of £nil million as at 31 December 2014 (2013: £8 million)

[6] 'Amounts owed by parent undertaking' relates to a loan to Heathrow Holdco Limited. This amount accrues interest at 6.65% at 31 December 2014 (2013: 8.24%).

On 31 October 2014 LHR Airports Limited paid a non cash dividend of £3,500 million to Heathrow Holdco Limited. The dividend was settled through set off against intercompany payables to Heathrow Holdco Limited.

(a) Analysis of deferred taxation (excluding pensions)

	£m
1 January 2014	2
Credited to profit and loss account	9
31 December 2014	**11**

Analysis of the deferred tax balances is as follows:

	31 December 2014	31 December 2013
	£m	£m
Excess of depreciation over capital allowances	**1**	2
Other short term timing differences	**9**	1
Derivative financial instruments	**1**	(1)
Deferred tax asset	**11**	2

Provision has been made for deferred taxation in accordance with FRS 19 *Deferred Tax*.

The Finance Act 2013 enacted a reduction in the main rate of corporation tax from 23% to 21% with effect from 1 April 2014 and from 21% to 20% with effect from 1 April 2015. These changes have been reflected above. Other than this change there are no other items which would materially affect the future tax charge.

10 Current asset investments

	31 December 2014 £m	31 December 2013 £m
Short term deposits	**18**	-

Board approved investment policies and relevant debt facility agreements provide counterparty investment limits based on short- and long-term credit ratings. Of these deposits, counterparties with a short-term credit rating of A-1 held assets of £18 million as at 31 December 2014 (2013: nil).

11 Cash at bank and in hand

	31 December 2014 £m	31 December 2013 £m
Cash at bank and in hand	**12**	8

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates and is subject to interest rate risk.

12 Creditors: amounts falling due within one year

	31 December 2014 £m	31 December 2013 £m
Trade creditors	**36**	40
Amounts owed to group undertakings – interest free	**119**	144
Amounts owed to group undertakings – interest bearing[1]	**26**	282
Group relief payable[2]	**16**	134
Dividends payable	**2**	4
Other creditors	**9**	9
	208	613

[1] 'Amounts owed to group undertakings – interest bearing' mainly includes balances owed to subsidiaries which accrue interest at 1.5% over Bank of England base rate.

[2] Group relief is payable to other entities in the wider Heathrow Airport Holdings Group who have surrendered losses to the Company in the period.

13 Creditors: amounts falling due after more than one year

	31 December 2014 £m	31 December 2013 £m
Amounts owed to group undertakings – interest free[1]	**211**	74
Amounts owed to group undertakings – interest bearing[2]	**1,057**	2,808
	1,268	2,882

[1] 'Amounts owed to group undertakings – interest free' includes a £74 million loan from Heathrow (DSH) Limited, a subsidiary of the Company (2013:74 million). Also included is £33 million (2013: nil) 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. The remaining balance of £104 million (2013: nil) is amounts from Non Des TopCo Limited using the proceeds from the disposal of Airports Holding NDH1 Limited.

[2] 'Amounts owed to group undertakings – interest bearing' include balances totalling £1,057 million (2013: £2,808 million) which accrue interest at 1.5% over the Bank of England base rate.

14 Retirement benefit obligations

The Company is the sponsor of the Defined Benefit ('DB') pension scheme, the Unfunded Unapproved Retirement Benefit ('UURBS') scheme and the Post-Retirement Medical Benefits ('PRM') scheme.

As part of the SSA, the operating entities of the group are required to fund their share of the retirement benefit schemes and are required to record their share of the deficit on these schemes as a liability in their financial statements. The operating entities, in the context of the SSA, as at 31 December 2014, are Heathrow Airport Limited (HAL) and Heathrow Operating Express Company Limited (HEX). The relevant share of the deficit on the retirement benefit schemes attributed to HAL is 99.7%. The remainder is allocated to HEX. The Company records the external deficit of the retirement benefit schemes but then pushes the deficit down the operating entities. The Company records a receivable from the operating entities in relation to the external deficit.

The relevant shares are based on the operating entities share of the total pensionable pay across all operating entities in the previous financial year.

14 Retirement benefit obligations *continued*

	31 December				
	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Fair value of plan assets	**3,274**	2,867	2,791	2,691	2,359
Benefit obligation	**(3,473)**	(2,960)	(2,894)	(2,652)	(2,403)
Gross (deficit)/surplus in BAA Pension Scheme	**(199)**	(93)	(103)	39	(44)
Related deferred tax asset[1]		-	-	-	-
Net (deficit)/surplus in BAA Pension Scheme	**(199)**	(93)	(103)	39	(44)
Unfunded pension obligations	**(23)**	(23)	(24)	(23)	(19)
Post-retirement medical benefits	**(6)**	(5)	(6)	(6)	(4)
Gross deficit on other pension and post-retirement benefit obligations	**(29)**	(28)	(30)	(29)	(23)
Related deferred tax asset[2]	**6**	5	7	7	6
Net deficit on other pension and post-retirement benefit obligations	**(23)**	(23)	(23)	(22)	(17)

[1] No deferred tax asset or liability has been recognised in the Company's balance sheet. The overall deferred tax asset associated with the BAA Pension Scheme deficit of £199 million (2013: £93 million) is £40 million (2013: £19 million) and this is disclosed separately within other group entities.

[2] A deferred tax asset has been recognised in the Company's balance sheet. The overall deferred tax asset associated with the UURBS and PRM schemes is £6 million (2013: £5 million).

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
BAA Pension scheme (Note 14(a))	**59**	63
Defined contribution schemes	**8**	7
Additional provision for unfunded schemes	**-**	1
Total operating charge to employment costs	**67**	71

(a) BAA Pension Scheme

The Company operates one main pension scheme for its UK employees, the BAA Pension Scheme (the 'Scheme'), which is a funded defined benefit scheme with both open and closed sections. The Scheme closed to employees joining the Heathrow Airport Holdings Group after 15 June 2008. The Scheme's assets are held separately from the assets of the Company and are administered by trustees.

The value placed on the liabilities of the scheme as at 31 December 2014 is based on the full actuarial valuation carried out at 30 September 2013. The liabilities have been updated by KPMG LLP, to take account of changes in economic and demographic assumptions, in accordance with FRS 17 *Employee Benefits*. The Scheme assets are stated at their bid value at 31 December 2014. The Company's accounting policy is to recognise actuarial gains and losses as they occur in the statement of total recognised gains and losses. These actuarial gains and losses are then recharged to the operating entities. The Company records this recharge as an exceptional item in its profit and loss account.

The financial assumptions used to calculate the Scheme assets and liabilities under FRS 17 are:

	31 December 2014 %	31 December 2013 %
Rate of increase in pensionable salaries	**4.7**	4.9
Increase to deferred benefits during deferment	**2.5**	2.4
Increase to pensions in payment:		
Open section	**3.1**	3.3
Closed section	**3.2**	3.4
Discount rate	**3.6**	4.6
Inflation assumption	**3.2**	3.4
Expected return on plan assets:		
Equities	**8.1**	8.1
Bonds	**3.8**	3.8
Cash	**n/a**	n/a

14 Retirement benefit obligations *continued*

The assumptions relating to longevity underlying the pension liabilities at the reporting date are based on standard actuarial mortality tables and include an allowance for future improvements in longevity. The assumptions are equivalent to a life expectancy for a 60 year old male pensioner of 27.1 years (2013: 26.7 years) and 29.6 years (2013: 28.2 years) from age 60 for a 40 year old male non-pensioner.

The accounting standard requires that the discount rate used to discount the liability, be determined by reference to market yields at the reporting date on high quality corporate bond investments. The currency and terms of these should be consistent with the currency and estimated term of the post-employment obligations. The discount rate has been based on the yield on AA-rated corporate bonds of a term similar to the liabilities.

The expected rate of inflation is an important assumption for the salary growth and pension increase assumptions. A rate of inflation is 'implied' by the difference between the yields on fixed and index-linked government bonds. To develop the expected long-term rate of return on assets assumption, the Heathrow Airport Holdings Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class.

For bond investments with fixed interest rates the expected yield is derived from their market value.

In respect of the equity investments, investment returns are variable and are generally considered 'riskier' investments. It is generally accepted that the return on equity investments contains a premium, the 'equity risk premium', to compensate investors for the additional risk of holding this type of investment. There is significant uncertainty about the size of this risk premium. The assumption chosen is within the range of long-term market expectations.

The expected return for each asset class was then weighted, based on the target asset allocation, to develop the expected long-term rate of return on assets assumption for the portfolio. This resulted in the selection of a 5.1% assumption (2013: 5.1%).

The amounts charged to profit and loss account, in relation to the BAA Defined Benefit ('DB') pension scheme, are as follows:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Current service cost	**57**	67
Past service cost[1]	**2**	4
Total charge to the profit and loss account	**59**	71

[1] Past service costs relate to abatement costs.

The amounts recognised in the statement of total recognised gains and losses in relation to the BAA DB pension scheme:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Actual return less expected return on plan assets	**381**	12
Experience gains and losses arising on the benefit obligation	**17**	(2)
Changes in assumptions underlying the present value of the benefit obligation	**(596)**	(86)
Actuarial loss recognised in the statement of recognised gains and losses[1 2]	**(198)**	(76)

[1] The actuarial loss, on the defined benefit pension scheme, recognised in the statement of total recognised gains and losses before tax is £198 million (2013: £76 million).

[2] Total cumulative actuarial losses recognised in equity were £554 million (2013: £360 million) on the defined benefit scheme.

The actual return on plan assets was £527 million (2013: £142 million).

14 Retirement benefit obligations *continued*
The actuarial loss on the defined benefit pension scheme of £198m (2013: £76m) resulted from a return of assets in excess of expectations amounting to £381m, a £17m experience gain as a result of the finalised actuarial funding valuation for the BAA Pension Scheme as at 30 September 2013, a £417m loss due to changes in financial assumptions and a £179m loss as a result of changes in demographic assumptions.

The actuarial loss as a result of changes in financial assumptions is mainly attributable to the fall in the discount rate by 1.05% to 3.55% (2013: 4.6%). The actuarial loss as a result of changes in demographic assumptions is mainly attributable to a 0.5% per annum increase in the mortality improvement assumption to 1.5% per annum (2013: 1.0% per annum).

The amounts recognised in the balance sheet are determined as follows:

	31 December 2014 £m	31 December 2013 £m
Fair value of plan assets		
Equities	**668**	724
Bonds	**1,123**	1,155
Other[1]	**1,483**	988
Total fair value of plan assets	**3,274**	2,867
Present value of benefit obligation	**(3,473)**	(2,960)
Gross deficit in scheme at 31 December	**(199)**	(93)
Deferred tax[2]	**-**	-
Liability recognised in the balance sheet	**(199)**	(93)

[1] 'Other' includes £275 million (2013: £119 million) of hedge funds and £1,208 million (2013: £709 million) of interest rate and inflation instruments.
[2] No deferred tax asset or liability has been recognised in the Company's balance sheet. The overall deferred tax asset associated with the BAA Pension Scheme deficit of £199 million (2013: £93 million) is £40 million (2013: £19 million) and this is disclosed separately within other group entities.

Analysis of movement in the benefit obligation:

	2014 £m	2013 £m
Benefit obligation at 1 January	**2,960**	2,894
Movement in the year:		
Current service cost	**58**	58
Past service gain[1]	**(31)**	(23)
Finance cost	**133**	122
Members' contributions	**8**	8
Actuarial loss	**596**	86
Settlement gain	**-**	(92)
Bulk liabilities transferred on sale of NDH1 group	**(135)**	-
Experience (gain)/ loss	**(17)**	2
Benefits paid (by pension fund and company)	**(99)**	(95)
Benefit obligation at 31 December	**3,473**	2,960

In January 2015, the trustee of the defined benefit pension scheme concluded the triennial valuation of the scheme. The valuation was carried out as at 30 September 2013 and indicated a scheme deficit of £300 million calculated using the trustee's actuarial assumptions. LHR Airports Limited agreed an increase to its annual deficit recovery payment from £24 million to £27 million until 2023. In respect of future accrual of benefits, LHR Airports Limited will contribute approximately 33% of basic salary and shift pay, which is estimated to be £46 million in 2015.

Movements in the fair value of the plan assets were as follows:

	2014 £m	2013 £m
Fair value of plan assets at 1 January	**2,867**	2,791
Income statement credit on plan assets	**146**	130
Return on assets in excess of income statement credit	**381**	12
Employer contributions (including benefits paid and reimbursed)	**108**	94
Administration expenses	**(5)**	(2)
Stansted commutation payment	**-**	35
Members' contributions	**8**	8
Bulk transferred assets for Edinburgh	**-**	(106)
Bulk transferred assets on sale of NDH1 group	**(132)**	-
Benefits paid (by pension fund and company)	**(99)**	(95)
Fair value of plan assets at 31 December	**3,274**	2,867

LHR Airports Limited

Notes to the financial statements for the year ended 31 December 2014 *continued*

14 Retirement benefit obligations *continued*

a) BAA Pension Scheme continued

History of experience gains and (losses):

	Year ended 31 December 2014	Year ended 31 December 2013	Year ended 31 December 2012	Year ended 31 December 2011	Year ended 31 December 2010
Difference between the expected and actual return on scheme assets:					
Amount £m	**381**	12	(29)	174	75
Percentage of scheme assets	**11.6**	0.4	(1.0)	6.5	3.2
Experience (losses) and gains on benefits obligations:					
Amount £m	**17**	(2)	5	(70)	20
Percentage of benefit obligation	**0.5**	(0.1)	0.2	(2.6)	0.8
Amount recognised in the statement of total recognised gains and (losses):					
Amount £m	**(198)**	(76)	(210)	10	62
Percentage of benefit obligation	**(5.7)**	(2.6)	(7.3)	0.4	2.6

The table below is provided to give an indication of the sensitivity of the retirement benefit obligation to changes in the discount rate:

	Annual impact in profit and loss account		**Impact in equity**	
	£m	**£m**	**£m**	**£m**
Sensitivity analysis based on change in discount rate	Before tax	After tax	Before tax	After tax
+0.50% discount rate	8	6	(318)	(254)
- 0.50% discount rate	(7)	(6)	366	293

The table below is provided to give an indication of the sensitivity of the retirement benefit obligation to changes in the inflation rate:

	Annual impact in profit and loss account		**Impact in equity**	
	£m	**£m**	**£m**	**£m**
Sensitivity analysis based on change in inflation rate	Before tax	After tax	Before tax	After tax
+ 0.50% inflation rate	5	4	293	234
- 0.50% inflation rate	(4)	(3)	(261)	(209)

A change in the mortality assumption causing a one year increase in life expectancy would have a £105 million impact on the defined benefit obligation and a £2 million impact on the forward looking service cost.

(b) Other pension and post-retirement liabilities

Defined contribution scheme
The Company operates a defined contribution scheme for all employees who joined after 15 June 2008. The total cost of defined contribution arrangements fully expensed against operating profit in the year is £8 million (2013: £7 million).

Unfunded Unapproved Retirement Benefit (UURBS) & Post-Retirement Medical (PRM) Schemes
The Company provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the scheme rules. In addition the Company provides post-retirement medical benefits to certain pensioners. The present value of the future liabilities under this arrangement of £6 million (2013: £5 million) is included in the balance sheet, along with provision for unfunded pension obligations of £23 million (2013: £23 million). The value of these unfunded pension obligations exclude the associated deferred tax asset of £6 million (2013: £5 million) and have been assessed by the actuary using the same assumptions as those used to calculate the Scheme's liabilities.

The finance cost in relation to the UURBS and PRM schemes amounted to £1.3m (2013: £1.3m). The Company does not book this finance cost in its profit and loss account. This finance cost is booked directly into the operating entities' profit and loss account. The external position on the UURBS and PRM schemes is adjusted for the finance cost, but there is no entry to the profit and loss account in the accounts of the Company.

14 Retirement benefit obligations *continued*
(b) Other pension and post-retirement liabilities *continued*

An experience gain of £1 million (2013: £2 million loss) arose due to an updated valuation of the UURBS and PRM scheme arrangements.

A net actuarial loss of £3 million (2013: £2 million gain) was recognised in relation to the UURBS and PRM schemes. This net loss consisted of a £2million loss as a result of changes in financial assumptions and a £1million loss from demographic assumptions changes.

Disposal of NDH1 Group
Southampton International Airport Limited, Aberdeen International Airport Limited and Glasgow Airport Limited were all sold by Non-Des Topco Limited on 18 December 2014. These disposals resulted in a £3m settlement gain and a £30m curtailment gain in relation to the defined benefit pension scheme. This gain was recorded in the profit and loss account of Non-Des Topco Limited as a profit on disposal of its subsidiary. The impact of the net £33m gain on the Company was a reduction in the external DB scheme deficit. This reduction was then passed on to the remaining operating entities in the group, being Heathrow Airport Limited and Heathrow Operating Express Company Limited.

15 Provisions for liabilities and charges

	Disposal of operations £m	Reorganisation costs £m	Total £m
1 January 2014	2	22	24
Utilised in the year	(2)	(16)	(18)
Charged in the year	-	8	8
31 December 2014	**-**	**14**	**14**

Reorganisation costs
The costs associated with the Heathrow Airport Holdings Group's reorganisation programmes primarily relate to various restructuring processes designed to reduce the size and cost of overhead functions. An additional charge of £8 million was recognised in 2014 relating to severance and pension payments associated with the reorganisation programme being carried out in 2015. This programme was approved by the relevant Board and raised the expectation in those affected by it prior to 31 December 2014.

16 Share capital

	£
Called up , allotted and fully paid	
1 January 2014:	
1,567,400,315 ordinary shares of £1	1,567,400,315
31 October 2014:	
4,741,720,337 bonus shares of £1	4,741,720,337
6,309,120,652 ordinary shares at £1 each	6,309,120,652
Capital reduction	(6,309,114,343)
6,309,120,652 ordinary shares at £0.000001 each at 31 December 2014	**6,309**

On 31 October 2014 LHR Airports Limited capitalised £4.7 billion of its unrealised profit and loss reserves by issuing fully paid up bonus shares.

Subsequently, the Company undertook a capital reduction supported by solvency statement in accordance with Companies Act 2006 sections 642 to 644.The nominal value of each share reduced from £1 to £0.000001.

17 Share premium reserve

	£m
1 January 2014	325
Capital reduction	(325)
31 December 2014	**-**

On 31 October 2014 LHR Airports Limited undertook a capital reduction supported by solvency statement in accordance with Companies Act 2006 sections 642 to 644.The share premium was cancelled in full.

18 Other reserves

	Available for sale investments £m	Capital redemption reserve £m	Total £m
1 January 2014	26	27	53
Revaluation adjustment	(1)	-	(1)
31 December 2014	**25**	**27**	**52**

19 Profit and loss reserve

	£m
1 January 2014	9,082
Profit for the financial year	1,798
Dividends paid[1]	(4,014)
Reduction of share capital[2]	1,567
Cancellation of share premium[2]	325
Other profit and loss reserve movement[3]	2
Actuarial loss on pensions gross of deferred tax	(201)
Deferred tax – current year tax movement on pensions	40
31 December 2014	**8,599**

1 During the year ended 31 December 2014, the Company paid dividends of £4,014 million to Heathrow Holdco Limited, being £63 million cash on 21 February 2014, £79 million cash on 27 June 2014, £66 million cash on 25 July 2014, £3,500 million non-cash on 31 October 2014, £87 million cash on 17 December 2014 and £219 million cash on 18 December 2014.
2 On 31 October 2014, the Company undertook a capital reduction supported by solvency statement in accordance with Companies Act 2006 sections 642 to 644, in order to reduce its share capital and cancel its share premium in full for the purpose of creating distributable reserves.
3 Relates to a movement in the provision for unclaimed dividend distributions.

20 Contingent liabilities

The Company has provided a guarantee to Deutsche Trustee Company Limited for itself and on behalf of the LHR Guaranteed Bondholders in respect of bonds issued by Heathrow Funding Limited with scheduled redemption dates up to and including 15 February 2018, other than any such bonds issued since 18 August 2008.

21 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. and Alinda Airports L.P. (11.18%) (investment vehicles 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 2014, 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 2014.

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.

Notes to the financial statements for the year ended 31 December 2014 *continued*

22 Post balance sheet events

In January 2015, the trustee of the defined benefit pension scheme concluded the triennial valuation of the scheme. The valuation was carried out as at 30 September 2013 and indicated a scheme deficit of £300 million calculated using the trustee's actuarial assumptions. LHR Airports Limited agreed an increase to its annual deficit recovery payment from £24 million to £27 million until 2023. In respect of future accrual of benefits, LHR Airports Limited will contribute approximately 33% of basic salary and shift pay, which is estimated to be £46 million in 2015.

On 26 February 2015, the board approved the payment of a £70 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) Limited for £70 million.