

**GATWICK AIRPORT LIMITED
REGULATORY ACCOUNTS
FOR THE YEAR ENDED 31 MARCH 2010**

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GATWICK AIRPORT LIMITED REGULATORY ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2010

Financial review

General overview

During the year ended 31 March 2010, Gatwick Airport Limited (“the Company”) underwent significant change in preparation for its sale. On 3 December 2009, BAA (AH) Limited (“BAA”) completed the sale of the Company to Ivy Bidco Limited, a UK incorporated company. Ivy Bidco Limited is ultimately owned by a consortium through a number of UK and overseas holding companies and limited liability partnerships.

In tandem with separation from BAA, the Company continued to focus on improving service standards for passengers at Gatwick Airport (“Gatwick”) (“the airport”), working closely with the airlines to ensure that the Company is investing in the right facilities and driving efficiencies throughout the operation. This was against a backdrop of an ongoing tough economic climate.

The Company’s strategy is to transform the passenger experience and improve efficiency for the airlines as well as the airport itself thereby improving its competitiveness in the London airport system. A key element of the Company’s strategy is to improve Gatwick’s relationships with its airline customers, regulators and other stakeholders.

Passengers for the year totalled 32.4 million, down 4.0 million versus the Civil Aviation Authority (“CAA”) forecast detailed in the CAA’s document entitled ‘Economic Regulation of Heathrow and Gatwick Airports 2008-2013, CAA Decision, 11 March 2008’ (“the 2008 Decision”). Relative to the CAA forecast, the shortfall in passenger volume had an estimated £47.2m adverse impact on total revenue, which was mitigated by good operational performance, strong commercial income and tight cost control. ‘Regulatory operating profit (before operating costs – exceptional)’ was £90.3m, £39.1m below the CAA forecast. In addition, exceptional operating costs of £120.0m were incurred which resulted in a ‘regulatory operating loss’ of £29.7m.

The weighted average Regulated Asset Base (“RAB”) was £1,660.1m, £136.2m lower than the forecast. This results in a return on the ‘weighted average RAB (before operating costs – exceptional)’ of 5.4% and a negative return of 1.8% on the return on the ‘weighted average RAB’.

Passenger numbers

Total passenger numbers for the year were 32.4 million, down 4.0 million or 11% against the CAA forecast, and 2% on the prior year. This reflects the result of the economic downturn and the full year impact of North Atlantic traffic transferring to Heathrow as a result of Open Skies. This impact was lessened by the strong growth Gatwick has experienced in European scheduled traffic from new routes and increased frequencies to European destinations.

Revenue

Airport charges

The downturn in passengers had a significant impact on aircraft charges revenue which was £29.1m below the CAA forecast, of which £29.8m was volume related, marginally offset by a favourable mix variance (concentration) of £0.7m.

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Business review (continued)

Retail

The revenue generated from retail activities was £151.2m, a shortfall of £7.0m or 4% against the forecast. The 11% shortfall in passengers had a £17.4m adverse impact which was mitigated by strong underlying retail performance with duty free, airside specialist shops, catering and other retail showing improved performance. This was driven by the provision of improved offerings in both terminals, the full-year impact of the South Terminal international departure lounge (“IDL”) extension and strong operational performance, notwithstanding the constraints imposed in the South Terminal due to the opening of the new security lanes which open onto the upper floor of the IDL. The improved performance was supported by Gatwick’s own summer and winter marketing campaigns.

Lower car parking income has been driven by an increase in advanced bookings at a lower yield, as well as by a shift to alternative transport methods.

Property

Property income (excluding utilities) generated in the year was £26.8m, £2.1m higher than the CAA forecast, despite a challenging market which has seen local prices fall and voids increase. This was partly due to the inclusion of BAA income post sale of £0.4m (previously included in Other Income), the conclusion of a back-dated rent negotiation of £0.4m, and strong marketing activity to attract tenants that might have otherwise gone elsewhere.

Income generated from the specified charge for utilities was £8.6m, £0.2m below the CAA forecast. This income did not reflect the sharp increase in costs incurred by the Company in the year.

Other

Income generated in the year from ‘other’ activities was £30.5m, £0.3m below the CAA forecast.

Within this was intra-group income of £1.5m, which was £2.6m lower than the CAA forecast because of the separation from BAA. £0.4m income from BAA has been reflected in Property income following the separation as this is no longer an intra-group income.

Other income includes £4.8m of income from passenger with reduced mobility (“PRM”) activities, which were not included in the CAA forecast.

Other income reflects £2.1m lower staff car park income than forecast, which is due to both the decrease in volume and the agreement that the Company made with the airlines to phase in the agreed Q5 price increase more gradually than the CAA forecast.

Expenditure

Overall

‘Operating costs – ordinary’ were £292.3m, £7.4m above the CAA forecast. However, the forecast did not include either PRM costs or Service Quality Rebate (“SQR”) payments of £4.2m, and £2.7m respectively. Excluding these two costs, underlying ‘operating costs – ordinary’ are £0.5m or 0.2% above forecast.

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Business review (continued)

The detailed analysis of costs against the 2008 Decision is more complex because of the separation of the Company from BAA during the year. While under BAA ownership, a number of services were performed centrally and recharged through 'intra-group costs'. Activities were migrated from BAA at different points during the year and not just at the point of sale. The CAA's forecast does not reflect the change in ownership or the separation of activities at different points during the year. Therefore, some costs forecast within 'intra-group costs' have actually been incurred within other categories. This is explained further below.

Staff costs

Staff costs were £6.0m lower than the CAA forecast despite increases to non-security staff not anticipated in the CAA forecast. Allowing for the higher labour capitalisation (discussed below), on a comparable basis staff costs were approximately £10.0m lower than the CAA forecast. Staff costs comprise:

- (a) Security staff costs – staffing levels were below those included in the CAA forecast as the Company leveraged the opportunities created by the more flexible roster patterns introduced at the start of the year, meaning efficiencies were achieved earlier in Q5 than forecast. The continual review of rosters and implementation of a team leader structure within the operation allowed more effective and efficient operational processes to be embedded, and absenteeism to be actively managed. This, coupled with more effective use of front of house third-party resource (Blackjacks), resulted in costs being £15.1m lower than the CAA forecast. In addition, lower pension charges have been incurred in the year (although see 'operating costs – exceptional' below).
- (b) Non-security staff costs – staffing levels were 4% lower than those included in the CAA forecast, despite an increase in staff due to the separation from BAA as the Company developed the standalone capability to perform functions that had previously been undertaken centrally by BAA. Capital and information technology ("IT") staffing levels were also higher due to the phasing of the capital programme. £7.4m of staff costs have been capitalised, the offset of which is included within 'other costs'. Approximately £2.0m of this was included in the CAA forecast in intra-group costs.

Maintenance, equipment and IT costs

Maintenance, equipment and IT costs were £3.7m lower than the prior year but £0.8m higher than the CAA forecast, of which, £0.5m related to anti-icing media due to the adverse weather in the January and February. Following the sale of the Company, IT costs, which are included in intra-group costs in the CAA forecast, are incurred directly by the Company. Efficiency savings, both in terms of the operation and through procurement activity, have meant that underlying maintenance costs are lower than last year.

Rent & rates

Rent and rates were £1.9m lower than the CAA forecast following the conclusion of the annual rates review and the periodic review rateable poundage.

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Business review (continued)

Utility costs

Costs incurred in the year were £31.7m, £4.7m higher than the CAA forecast. This is largely due to the contract signed by the Company with Gaz de France for the supply of electricity for the period beginning on 1 April 2009 and ending on 31 March 2013. The contract is for the purchase of a fixed quantity of electricity and the price is fixed for the first three years. The actual consumption of electricity has fallen short of the contracted quantity and the market rate at which this surplus electricity can be sold back is currently substantially below the contracted fixed price. This requirement to purchase electricity in excess of current usage has led to the recognition of an onerous contract provision of £1.9m in the year.

As reflected in utility income, this increase was not passed onto airport users in the year.

Police costs

Police costs total 13.2m, £0.1m below the CAA forecast. Active negotiation with the Sussex Police has allowed costs to fall £0.6m compared to the prior year.

Other costs

Other costs total £59.1m, £21.4m above the CAA forecast. Of this difference, £2.7m and £4.2m relate to SQR and PRM costs respectively, which were not included in the CAA forecast. £5.1m relates to costs incurred with BAA post sale under a Transitional Service Agreement ("TSA"). Costs incurred under the TSA are costs for services that would previously have been included in, and therefore forecast in, intra-group costs. It also includes £8.8m of marketing costs, a proportion of which were included in intra-group costs in the CAA forecast.

£1.0m more than the CAA forecast has been spent on cleaning to improve service levels at Gatwick. An additional £3.9m costs have been incurred on insurance and consultancy, the former reflecting the loss of scale following separation from BAA. This higher level of expenditure combined with contractual increases such as NATS of £0.9m are offset by the higher staff capitalisation of £6.8m.

Intra-group costs

These total £23.1m, a saving of £11.5m to the CAA forecast. This saving recognises the transfer of TSA and marketing costs to 'other costs' and the transfer of people to 'staff costs'.

Operating costs – exceptional

'Operating costs – exceptional' total £120.0m, of which £111.0m is pension related. £104.7m recognises the commutation payment required to be made by the Company to the BAA pension scheme trustees in order to extinguish all the Company's liabilities under its participation in the BAA defined pension scheme. The remaining £6.3m pension costs include the initial recognition of the Company's new scheme and the write-off cost of assets relating to the Company's previous scheme. A further £9.0m has been incurred through the separation of the Company from BAA and the costs of a restructuring programme.

Regulated Asset Base

The closing RAB as at 30 March 2010 was £177.4m lower than the CAA forecast, primarily due to changes in the phasing of the capital programme, as the Company continues to actively consult with the airlines on the best options. Actual expenditure in Q5 is £172.9m below forecast (£96.6m in 2009 and £76.3m in 2010), with the rest of the difference due to indexation.

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Performance Report

	Note	Actual '000s	CAA Forecast '000s
Terminal passengers	1	32,397	36,400
		£m	£m
Revenue			
Net revenue from airport charges	2	241.6	270.7
Other revenue	3	219.6	224.9
Total revenue		461.2	495.6
Expenditure			
Operating costs – ordinary	4	289.6	284.9
Assumed Ordinary Depreciation	6 , 7	81.3	81.3
Total expenditure		370.9	366.2
Regulatory operating profit (before operating costs – exceptional)		90.3	129.4
Operating costs – exceptional	5	120.0	-
Regulatory operating (loss)/profit	7	(29.7)	129.4
Capital expenditure	1 , 9	181.4	257.7
Opening RAB		1,575.5	1,670.6
Closing RAB	9	1,744.6	1,922.0
Weighted average RAB		1,660.1	1,796.3
Return on weighted average RAB (before operating costs – exceptional)		5.4%	7.2%
Return on weighted average RAB		(1.8%)	7.2%

The notes on pages 6 to 14 form part of these regulatory accounts.

These regulatory accounts were approved by the Board of Directors on 26 July 2010 and signed on behalf of the Board.

**GATWICK AIRPORT LIMITED
REGULATORY ACCOUNTS
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Notes to the performance report

1. BASIS OF PREPARATION

Gatwick Airport Limited (“the Company”) is required to prepare Regulatory Accounts by the Airports Act 1986. The primary purpose of these accounts is to serve the process of regulation by the Civil Aviation Authority (“CAA”).

The CAA has determined that the Regulatory Accounts shall comprise a report in the format shown on pages 5 to 14 of this report. This in turn comprises the Performance Report which sets out actual performance for the year under review compared with the forecasts underlying the determination of the price cap for Gatwick Airport Limited. These forecasts are set out in the CAA’s document entitled ‘Economic Regulation of Heathrow and Gatwick Airports 2008-2013, CAA Decision, 11 March 2008’ (“the 2008 Decision”), following its quinquennial review. The Performance Report includes notes as agreed with the CAA which describe the derivation of key regulatory results, and, where relevant, adjustments to the statutory and management accounts of the Company.

The following explains the key underlying assumptions in the preparation of this report:

(a) Data sources

The principal sources of data used in the preparation of these accounts are the audited financial statements for the 15 month period ended 31 March 2010, unaudited interim financial statements for the three month period ending 31 March 2009, and unaudited management accounts for the 15 month period ended 31 March 2010 and for the three month period ended 31 March 2009.

The revenue and expenditure in these Regulatory Accounts are reconciled to the financial statements for the 12 month period ended 31 March 2010. The financial statements for the 12 month period ended 31 March 2010 are referred to in these Regulatory Accounts as “the underlying accounts” and are derived by deducting the unaudited interim financial statements for the three month period ended 31 March 2009 from the audited financial statements for the 15 month period ended 31 March 2010.

(b) Terminal passengers

Terminal passenger numbers represent those passengers on commercial flights who physically pass through the airport’s passenger terminal facilities. This is consistent with the CAA’s definition in Annex 5 of its document entitled ‘Economic Regulation of BAA London Airports (Heathrow, Gatwick and Stansted) 2003-2008, CAA Decision, February 2003’ (“the 2003 Decision”). It excludes transit passengers. It also excludes passenger numbers for the following flight categories, which are included in the certificate of revenues from passenger flights provided annually to the CAA: air ambulance, government charter (troops and cargo), air taxi, general aviation, diplomatic and military.

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Notes to the performance report (continued)

1. BASIS OF PREPARATION (continued)

(c) The Regulatory Asset Base (“RAB”)

The CAA, in Annex F of its 2008 Decision, determined how the value of the RAB at 31 March 2008 should be calculated, and this is shown in note 8. The CAA further determined in Annex F how the value of the RAB should be rolled forward annually thereafter.

Capital expenditure in the year has been uplifted by the increase in RPI in accordance with Annex F of the 2008 Decision. Forecast capital expenditure has likewise been uplifted by the increase in RPI, from average 2007/08 prices (as in the 2008 Decision) to average 2009/10 prices, in accordance with CAA guidance.

The depreciation allowance has been set for each of the five years. This is referred to in Annex F of the 2008 Decision and in this report as ‘Assumed Ordinary Depreciation’;

Comparisons with the 2008 Decision have been made with the CAA ‘RAB’ forecasts. In that Decision the CAA adjusted the Basic RAB by including a profiling adjustment to arrive at a Closing RAB at each year end.

The Weighted Average RAB is calculated using the weighting formula adopted in the 2008 Decision. This equates to the sum of the closing balance multiplied by a factor of 0.5 and the opening balance multiplied by a factor of 0.5.

(d) Operating revenues and costs

Operating revenues and costs are taken from the underlying accounts and underlying accounting records of the Company. Adjustments have been made to align the presentation of actual results to that in the 2008 Decision. The principal adjustments are:

- retail costs, principally car park management fees, are netted off against income;
- operational facilities income, principally check in/baggage rents income, are re-categorised to ‘Other revenue’ from ‘Property and operational facilities’;
- service quality rebates are excluded from operating costs; and
- gains or losses on asset disposals are excluded from operating costs.

(e) Indexation

The CAA forecasts have been derived by indexing forward the forecasts to 2009/10 in accordance with the 2008 Decision. The appropriate RPI indices are shown in note 11. Profit and loss items except airport charges have been indexed forward to 2009/10 using the average RPI for 2009/10, and the RAB using the RPI at 31 March 2010.

In accordance with the 2008 Decision, the CAA forecast for airport charges has been derived by indexing forward, on a cumulative basis, to August 2008.

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Notes to the performance report (continued)

2. AIRPORT CHARGES

	Actual 2010 £m	CAA Forecast 2010 £m
Gross and net revenue from passenger flights	239.5	270.7
Net revenue from non passenger flights	2.1	-
	<u>241.6</u>	<u>270.7</u>

3. OTHER REVENUE

	Actual 2010 £m	CAA Forecast 2010 £m
Other traffic charges	2.5	2.4
Retail	151.2	158.2
Property	35.4	33.5
Other	30.5	30.8
	<u>219.6</u>	<u>224.9</u>

Reconciliation to the underlying accounts

Other revenue	219.6
Airport charges	241.6
Retail costs netted off against revenue	14.2
	<u>475.4</u>

Revenue per the underlying accounts

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Notes to the performance report (continued)

4. OPERATING COSTS – ORDINARY

	Actual 2010 £m	CAA Forecast 2010 £m
Staff costs	113.7	119.7
Maintenance, equipment and IT costs	26.5	25.7
Rent and rates	25.0	26.9
Utility costs	31.7	27.0
Police costs	13.2	13.3
Other costs	59.1	37.7
Intra-group costs	23.1	34.6
	<u>292.3</u>	<u>284.9</u>
Less service quality rebates	(2.7)	-
	<u>289.6</u>	<u>284.9</u>

Reconciliation to the underlying accounts

Adjusted 'operating costs – ordinary'	289.6
Service quality rebates	2.7
Statutory depreciation	77.7
Loss on disposals of tangible fixed assets	0.3
Retail costs netted off against revenue	14.2
	<u>14.2</u>
'Operating costs – ordinary' per the underlying accounts excluding 'operating costs – exceptional'	<u>384.5</u>

5. OPERATING COSTS – EXCEPTIONAL

'Operating costs – exceptional' includes the following:

Pension costs	111.0
Reorganisation costs	2.0
Staff related separation costs	4.8
Other separation costs	2.2
	<u>2.2</u>
Total 'operating costs – exceptional'	<u>120.0</u>

For more information regarding the nature of the exceptional operating items, refer to the financial review or the Company's audited financial statements for the 15 month period ended 31 March 2010 (note: the financial statements for the 15 months ended 31 March 2010 include costs incurred in the 3 months to 31 March 2009 which are excluded from these Regulatory Accounts).

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Notes to the performance report (continued)

6. ASSUMED ORDINARY DEPRECIATION

The depreciation allowance was determined by the CAA in the 2008 Decision. This has been indexed to current year values in accordance with the methodology specified in Annex F of that document.

7. REGULATORY OPERATING LOSS

Reconciliation of operating loss between the underlying accounts and the Regulatory Accounts

	Actual 2010 £m
Operating loss per the underlying accounts	(29.1)
Statutory depreciation	77.7
Assumed Ordinary Depreciation per CAA (indexed)	(81.3)
Service quality rebates	2.7
Loss on disposals of tangible fixed assets	0.3
Regulatory operating loss	<u>(29.7)</u>

8. OPENING REGULATORY ASSET BASE AT 1 APRIL 2008

	£m	Increase in RPI to 31 March 2008	Adjusted RAB at 1 April 2008 £m
Forecast Basic RAB at 31 March 2008 in 2008 Decision (at average 2006/07 prices)	1,481.4	5.89%	1,568.7
Actual capital expenditure 2007/08	103.7	1.68%	105.5
Assumed capital expenditure for 2007/08 (at average 2006/07 prices)	(108.1)	5.89%	(114.5)
Adjusted opening Basic RAB at 1 April 2008			<u>1,559.7</u>
Profiling adjustments (at average 2006/07 prices)		5.89%	-
Adjusted opening RAB at 1 April 2008			<u>1,559.7</u>

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Notes to the performance report (continued)

9. CLOSING REGULATORY ASSET BASE AT 31 MARCH 2010

		Actual 2010 £m	CAA Forecast 2010 £m
Opening Basic RAB at 1 April 2009		1,580.8	1,675.9
Additions in year	(a)	181.4	257.7
Proceeds from disposal	(b)	-	-
Assumed Ordinary Depreciation		(81.3)	(81.3)
Indexation to 31 March 2010		72.6	78.6
		<u>1,753.5</u>	<u>1,930.9</u>
Closing Basic RAB at 31 March 2010	Note 10	<u>1,753.5</u>	<u>1,930.9</u>
Cumulative profiling adjustment as determined by the CAA	(c)	(8.9)	(8.9)
		<u>1,744.6</u>	<u>1,922.0</u>
Closing RAB at 31 March 2010		<u>1,744.6</u>	<u>1,922.0</u>

- (a) Forecast additions in the year, £257.7 million, have been calculated by indexing forward the forecasts in the 2008 Decision by RPI (note 1).
- (b) Proceeds from disposal comprise amounts from the sale of operating assets.
- (c) This includes a price profiling adjustment as determined by the CAA of £(3.6) million indexed by RPI (2009: £(5.3) million).

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Notes to the performance report (continued)

10. RECONCILIATION OF FIXED ASSETS IN THE UNDERLYING ACCOUNTS TO THE CLOSING RAB AT 31 MARCH 2010

		Actual 2010 £m
Net fixed assets per the underlying accounts at 31 March 2010		1,735.5
Difference between net fixed assets and RAB at 31 March 2008	(a)	(69.5)
Interest capitalised disallowed	(b)	(8.0)
Difference between net book value of disposals and proceeds	(c)	0.2
Revaluation in the underlying accounts	(d)	43.2
Indexation of RAB	(d)	66.3
Difference between depreciation in the underlying accounts and Assumed Ordinary Depreciation	(e)	(14.2)
Closing Basic RAB at 31 March 2010		<u>1,753.5</u>

These reconciling items are explained as follows:

- (a) This reflects the difference between the net fixed asset value in the underlying accounts of £1,629.2 million and the assessed value of the Basic RAB at 31 March 2008 of £1,559.7 million (note 8). This comprises:
- (i) a reduction of £45.4 million in respect of interest capitalised from 1 April 1995 to 31 March 2008 in statutory fixed assets valuations but excluded from the RAB calculation;
 - (ii) an addition of £155.1 million in respect of the difference between the value of asset revaluations in the statutory accounts and the indexation uplifts provided in the regulatory accounts to 31 March 2008;
 - (iii) a reduction in respect of the difference between depreciation in the underlying accounts and Assumed Ordinary Depreciation of £86.8 million;
 - (iv) a reduction of £45.4 million in respect of pensions disallowed by the regulator; and
 - (v) a reduction of £47.0 million in respect of other valuation differences.
- (b) Interest costs amounting to £4.2 million (2009: £3.8 million) were capitalised in the year. The roll forward calculation for the RAB specified in Annex F of the 2008 Decision excludes capitalised interest;
- (c) Statutory asset valuations are derived after deducting the net book value of assets disposed of during the year. The RAB value specified in Annex F of the 2008 Decision is derived by deducting the proceeds of asset disposals;
- (d) Investment properties and land held for development are subject to annual revaluation in the underlying accounts. Remaining assets are held at depreciated historic cost. The RAB is revalued annually by reference to the Retail Prices Index ("RPI") as specified in Annex F of the 2008 Decision;
- (e) This reflects the difference between the amount charged as depreciation in the underlying accounts and the Assumed Ordinary Depreciation allowed in the 2008 Decision and specified in Annex F of that Decision.

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Notes to the performance report (continued)

11. INDEXATION

The following indices have been used for revaluing forecasts:

Average RPI index for the year ended 31 March 2007	200.3
Average RPI index for the year ended 31 March 2008	208.6
Average RPI index for the year ended 31 March 2009	214.8
Average RPI index for the year ended 31 March 2010	215.8
RPI index at 31 March 2008	212.1
RPI index at 31 August 2008	217.2
RPI index at 31 March 2009	211.3
RPI index at 31 March 2010	220.7
Increase from average 2008/09 to 31 March 2009	(1.62%)
Increase from average 2006/07 to 31 March 2008	5.89%
Increase from average 2007/08 to 31 March 2008	1.68%
Increase from average 2007/08 to 31 March 2010	5.8%
Increase from average 2009/10 to 31 March 2010	2.29%
Increase from average 2007/08 to average 2009/10	3.44%
Increase from 31 March 2009 to 31 March 2010	4.45%
Assumed increase to August 2007 per 2008 Decision	2.63%
Increase from 31 August 2007 to 31 August 2008	4.78%
Cumulative increase from 2008 Decision to 31 August 2008	7.54%

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Notes to the performance report (continued)

12. RECONCILIATION OF OPERATING LOSS TO NET CASH FLOW FROM OPERATING ACTIVITIES

		2010 £m
Operating loss per the underlying accounts	Note 7	(29.1)
Depreciation	Note 7	77.7
Loss on disposal of fixed assets		0.3
Non cash movement in derivative financial instruments		(5.2)
Increase in stock and debtors		(2.0)
Increase in creditors		108.1
Increase in provisions		41.6
Decrease in net pension liability		(6.4)
Net cash inflow from operating activities		<u>185.0</u>