GATWICK AIRPORT LIMITED
REGULATORY ACCOUNTS
FOR THE YEAR ENDED 31 MARCH 2012

CONTENTS **Page**

Financial review

General overview

The Civil Aviation Authority ("CAA"), as part of its preparations for any regulation beyond the end of Q5, requires Gatwick Airport Limited ("the Company") to participate in constructive engagement with the airlines operating at Gatwick Airport ("Gatwick"). To facilitate this, the Company has provided to the airlines and the CAA its initial business plan for the period to 2020. The Company will engage with airlines throughout the calendar year 2012 on the contents of its business plan and the outputs of the engagement will be used, as appropriate, by the CAA to inform any future proposals for economic regulation at Gatwick.

Gatwick Airport operates in a competitive market. Passengers have a choice as to which airport they fly from and airlines have alternative bases from which to operate. The Company's strategy for the airport is to transform the passenger experience and improve efficiency for the airlines and the airport itself, thereby improving its competitiveness in the London airport market. A key element of the Company's strategy is to build and maintain strong relationships with its airline customers, regulators and other stakeholders.

The Company has set out its ambition – "competing to grow and become London's airport of choice" – and has established six strategic priorities to which the Company's activities are aligned. These priorities are to:

- deliver the best passenger experience: by listening to our passengers and delivering the kind of service that will make them choose to fly from Gatwick;
- help our airlines grow: by understanding airlines' goals and developing commercial partnerships;
- increase value and efficiency: by maximising income, lowering our operating costs and driving capital efficiency;
- protect and enhance our reputation: by building strong and constructive relationships with our stakeholders based on openness and trust;
- build a strong EH&S culture: by maintaining a relentless focus on achieving zero incidents; and
- develop the best people, processes & technology: by investing in high-performing people, continuous improvement and the right systems.

Passengers for the year totalled 33.8 million, down 3.4 million or 9.1% versus the CAA forecast 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").

Relative to the CAA forecast, the shortfall in passenger numbers had an estimated £50.0m adverse impact on total revenue, which was mitigated by good operational performance and tight cost control. 'Regulatory operating profit' was £123.7m, £13.3m below the CAA forecast.

During the year 31 March 2012, the Company completed the separation of its information technology ("IT") environment from BAA, the last remaining of the transitional services provided by BAA post-sale. The separation was completed in October 2011 and it was at that point that the Company was no longer reliant on BAA.

The weighted average Regulated Asset Base ("RAB") was £2,093.2m, £183.9m lower than the forecast. This results in a return of 5.9% on the return on the 'weighted average RAB', which compares with the CAA forecast of 6.0%.

Financial review (continued)

Passenger Numbers

Total passenger numbers for the year were 33.8 million, 9.1% below the CAA forecast, and 6.9% up on the prior year. The performance against the CAA forecast reflects the impact of the economic downturn during the first four years of Q5.

Adjusting for one-off events in the prior year, most notably the eruption of Eyjafjallajökull in Iceland, underlying traffic growth is estimated as 3.0%. The prior year was also affected by industrial action at British Airways, operational issues across easyJet's network, continental European air traffic control strikes and heavy snowfall across the UK in November and December 2010.

Gatwick saw underlying year-on-year passenger growth in each month in the year compared to the same month in the prior year.

Revenue

Overall
Relative to the CAA forecast, the 9.1% shortfall in passenger numbers had an estimated £50.0m adverse impact on total revenue. The inclusion of £4.5m of income from passenger with reduced mobility ("PRM") activities (not included in the CAA forecast), limited this difference in total revenue to £46.6m, 8.5% below the CAA forecast.

Airport charges
Airport charges were £26.4m or 8.9% lower than CAA forecast. Of this, £27.1m was due to lower traffic volumes, which was marginally offset by £2.3m of income not included in the CAA forecast, largely from positioning flights, and an estimated £1.0m over-recovery in aeronautical charges (the out-turn aeronautical yield being higher due to a change in mix of passengers in the year and lower than expected remote stand rebates).

Retail and car parking income
The revenue generated from retail and car parking activities was £160.2m, which was £17.6m or 9.9% lower than CAA forecast. The 9.1% shortfall in passengers was the driver of an estimated £16.2m adverse impact compared to the CAA forecast. The other significant factor driving a decrease in retail income was the redevelopment projects in the North and South Terminals which have resulted in the temporary closure of retail outlets from September 2011.

Competitive pressures in car parking meant car parking income per passenger continued to under-perform versus the CAA forecast.

Financial review (continued)

Property Income

Property income (excluding the specified charges relating to utilities income and “intra-group income”) totalled £26.3m. This is £1.2m below the CAA forecast (although £5.7m lower than the CAA forecast for overall property income, taking into account the £4.5m of intra-group property income forecast under “other income” below). The year-on-year decrease of £0.6m is due largely to a reduction in office space following the removal of an office block that is being developed as a hotel in the North Terminal.

Income from the specified charge for utilities totalled £8.0m, which is lower than the CAA forecast of £9.7m due to lower consumption of electricity resulting from reduced occupancy.

Other Income.

Income from ‘other’ activities totalled £34.0m, £0.5m below the CAA forecast. Higher income from staff identity card and vehicle fuel sales, resulting from higher demand, has been partially offset by lower income from check-in and baggage and staff car park passes which have been impacted by lower passenger traffic than the CAA forecast.

Following the change in ownership in December 2009, the Company receives no intra-group income. Included in the CAA forecast for other income was £4.5m of intra-group income (largely property income relating to office accommodation taken by other BAA group functions as discussed above).

Offsetting this shortfall is £4.5m of income from the provision of PRM services, which was not included in the CAA forecast.

Expenditure

Overall

A detailed analysis of costs against the 2008 Decision is complex because of the separation of the Company from BAA in December 2009. While under BAA ownership, a number of services were performed centrally and recharged through ‘intra-group costs’. These activities are now undertaken directly by the Company and as such, some costs forecast within ‘intra-group costs’ are now incurred within other categories. Further, many activities were migrated from BAA at different points during the current and prior years, and not just at the point of sale. The CAA forecast does not reflect the change in ownership nor the consequent separation of activities at different points in time. This is explained further below.

‘Operating costs’ were £280.9m, £33.9m below the CAA forecast. This reflects the savings made in intra-group charges, following the change in ownership, being greater than the offsetting increase in staff and IT costs as the Company separated from BAA. Also included are PRM costs of £6.1m which are not included in the CAA forecast. Excluding these costs, underlying ‘operating costs’ are £40.0m below the CAA forecast.

Financial review (continued)

Staff Costs

Staff costs were £12.9m higher than the CAA forecast. Ongoing efficiency improvements in operational areas have reduced staff levels year-on-year, but there have been increases in other areas. The introduction of new security lanes and processes in the South Terminal has facilitated a reduction in the number of crew required for each lane and driven year-on-year reductions in security staff. Non-security staff levels are higher than those included in the CAA forecast, as the Company completed the separation from BAA and developed the stand-alone capability to perform functions that had previously been undertaken centrally by BAA.

The Company is directly incurring greater staff and contractor costs than the forecast associated with the capital investment programme post separation, including the separation of the Company's IT environment from BAA. The increase in staff costs associated with aspects of the capital investment programme are offset by the subsequent capitalisation of these costs (recognised in 'other costs' below). The capitalisation of staff costs increased to £20.9 million.

Allowing for the increase in staff costs that are subsequently capitalised, staff costs were approximately £8.0m lower than the CAA forecast, which is consistent with the trend in prior years.

Maintenance , Equipment and IT costs

Maintenance, equipment and IT costs totalled £35.2, £3.7m higher than the CAA forecast.

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. IT costs incurred directly and included in maintenance, equipment and IT costs totalled £12.1m. Further costs have been incurred in by way of a Transitional Service Agreement ("TSA") with BAA as the Company completed the separation of its IT infrastructure, and these costs are included in 'other costs'.

Rent & Rates

Rent and rates were £26.8m for the year, £4.9m lower than forecast due to the periodic review of rateable poundage in the year ending 31 March 2012 not being as high as expected.

Utility Costs

Utility costs incurred in the year totalled £30.2m, which was largely consistent with the CAA forecast.

Police costs

Police costs for the year totalled £12.7m, £1.6m below the CAA forecast. Constructive dialogue with the Sussex Police has led to a small year-on-year reduction.

Financial review (continued)

Other Costs & Intra-group costs.
Following the change in ownership, the Company now no longer incurs intra-group charges from BAA. The costs previously charged by BAA are now incurred directly by the Company, particularly in staff and IT costs (discussed above), and in ‘other costs’ by way of the TSA with BAA. The last remaining operational IT element of the TSA expired in October 2011 when the Company’s IT systems separation had completed. TSA charges of £2.4 million were incurred during the year and are included within ‘other costs’.

‘Other costs’ totalled £35.5, £6.2m below the CAA forecast. The CAA forecast does not include £6.1m relating to PRM costs or the £2.4m TSA charges. It also does not include the credit for the capitalisation of staff costs of £20.9m (discussed in staff costs above). Adjusting for these, ‘other costs’ were £7.0m more than the CAA forecast, due largely to higher than forecast marketing and professional consultants costs incurred during the year.

Aerodrome navigation service costs were £16.7m, which was comparable with the prior year but £1.7m lower than the CAA forecast.

Regulated Asset Base

The closing Regulatory Asset Base (“RAB”) as at 31 March 2012 has increased 10.8% to £2,200.9 million, which is £152.2 million lower than the CAA forecast, largely due to the phasing of the capital investment programme in the first four years of Q5. Actual capital expenditure in the year was £239.2 million, bringing total Q5 expenditure to £756.8 million compared to the CAA forecast of £885.4 million.

Performance Report

	Note	Actual '000s	CAA Forecast '000s
Terminal passengers	1	**33,819**	**37,200**
		£m	**£m**
Revenue			
Revenue from airport charges	2	271.3	297.7
Other revenue	3	231.4	252.2
Total revenue		**502.7**	**549.9**
Expenditure			
Operating costs	4	280.9	314.8
Assumed Ordinary Depreciation	5 , 6	98.1	98.1
Total expenditure		**379.0**	**412.9**
Regulatory operating profit	6	**123.7**	**137.0**
Capital expenditure	1 , 8	**239.2**	**167.4**
Opening RAB		**1,985.5**	**2,201.1**
Closing RAB	8	**2,200.9**	**2,353.1**
Weighted average RAB		**2,093.2**	**2,277.1**
Return on weighted average RAB		**5.9%**	**6.0%**

The notes on pages 7 to 15 form part of these regulatory accounts.

These regulatory accounts were approved by the Board of Directors on 22 June 2012 and signed on behalf of the Board.

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 9 to 18 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 source of data used in the preparation of these accounts is the audited financial statements for the year ended 31 March 2012 ("the audited financial statements").

(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.

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 2011/12 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 audited financial statements of the Company for the year ended 31 March 2012. Adjustments have been made to align the presentation of actual results to that in the 2008 Decision. The principal adjustments are:

- retail and car parking costs, principally car park management fees, are netted off against income;
- operational facilities income, principally check-in and baggage rents income, are re-categorised to 'Other revenue' from 'Property and operational facilities';
- service quality rebates are excluded from operating costs;
- gains or losses on asset disposals are excluded from operating costs; and
- finance lease income has been reclassified from 'net interest payable and similar charges – ordinary' to Property income.

(e) Indexation

The CAA forecasts have been derived by indexing forward the forecasts to 2011/12 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 2011/12 using the average RPI for 2011/12, and the RAB using the RPI at 31 March 2012.

In accordance with the 2008 Decision, the CAA forecast for airport charges has been derived by indexing forward, on a cumulative basis, to August 2010.

Notes to the performance report (continued)

2. AIRPORT CHARGES

	Actual 2012 £m	CAA Forecast 2012 £m
Revenue from passenger flights	269.0	297.7
Revenue from non passenger flights	2.3	-
Revenue from airport charges	271.3	297.7

3. OTHER REVENUE

	Actual 2012 £m	CAA Forecast 2012 £m
Other traffic charges	2.9	2.7
Retail and car parking income	160.2	177.8
Property	34.3	37.2
Other	34.0	34.5
Other revenue	**231.4**	**252.2**

Reconciliation to the audited financial statements

Other revenue		231.4
Airport charges		271.3
Retail and car parking costs netted off against revenue		15.0
Finance lease income reclassified to Property income	(a)	(0.3)
Revenue per the audited financial statements		**517.4**

(a) During the year the Company granted a long-term lease for the use of an investment property as a hotel. The lease is classified as a finance lease for accounting purposes, which resulted in the disposal of the investment property from tangible fixed assets and the recognition of a finance lease receivable. The related income is no longer classified as Property income for accounting purposes and is recognised in ‘net interest payable and similar charges – ordinary’ in the Company’s audited financial statements. To reflect the spirit of the transaction, for the purposes of the RAB and the Regulatory Accounts, the investment property has not been considered to be a disposal from the RAB, and the related income has be reclassified from ‘Net interest payable and similar charges – ordinary’ in the audited financial statements to Property income in these Regulatory Accounts.

Notes to the performance report (continued)

4. OPERATING COSTS

	Actual 2012 £m	CAA Forecast 2012 £m
Staff costs	140.5	127.6
Maintenance, equipment and IT costs	35.2	31.5
Rent and rates	26.8	31.7
Utility costs	30.2	30.8
Police costs	12.7	14.3
Other costs	35.5	41.7
Intra-group costs	-	37.2
	280.9	314.8
Less service quality rebates	-	-
Adjusted 'operating costs'	**280.9**	**314.8**

Reconciliation to the audited financial statements

Adjusted 'operating costs'		280.9
Service quality rebates (a)	(a)	-
Statutory depreciation		105.3
Retail and car parking costs netted off against revenue		15.0
'Operating costs – ordinary' per the audited financial statements		**401.2**

(a) Service quality rebates of £0.3 million for the year have been offset by credits from insurance proceeds and a release of an accrual from the prior year.

5. 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.

Notes to the performance report (continued)

6. REGULATORY OPERATING PROFIT

Reconciliation of operating profit between the audited financial statements and the Regulatory Accounts

	Actual 2012 £m
Operating profit per the audited financial statements	116.2
Statutory depreciation	105.3
Assumed Ordinary Depreciation per CAA (indexed)	(98.1)
Finance lease income reclassified to Property income	0.3
Regulatory operating profit	**123.7**

7. 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			**1,559.7**
Profiling adjustments (at average 2006/07 prices)		5.89%	-
Adjusted opening RAB at 1 April 2008			**1,559.7**

GATWICK AIRPORT LIMITED
REGULATORY ACCOUNTS
FOR THE YEAR ENDED 31 MARCH 2012

Notes to the performance report (continued)

8. CLOSING REGULATORY ASSET BASE AT 31 MARCH 2012

		Actual 2012 £m	CAA Forecast 2012 £m
Opening Basic RAB at 1 April 2011		1,993.0	2,208.6
Additions in year	(a)	239.2	167.4
Proceeds from disposal	(b)	(1.7)	-
Assumed Ordinary Depreciation		(98.1)	(98.1)
Indexation to 31 March 2012		73.2	79.9
Closing Basic RAB at 31 March 2012	Note 9	**2,205.6**	**2,357.8**
Cumulative profiling adjustment as determined by the CAA	(c)	(4.7)	(4.7)
Closing RAB at 31 March 2012		**2,200.9**	**2,353.1**

(a) Forecast additions in the year of £167.4 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 and proceeds from insurance claims.

(c) This includes a price profiling adjustment as determined by the CAA of £2.8 million indexed by RPI (2011: £1.4 million).

9. RECONCILIATION OF FIXED ASSETS IN THE AUDITED FINANCIAL STATEMENTS TO THE CLOSING RAB AT 31 MARCH 2012

		Actual 2012 £m
Net fixed assets per the audited financial statements at 31 March 2012		2,017.0
Difference between net fixed assets and RAB at 31 March 2008	(a)	(69.5)
Interest capitalised disallowed	(b)	(32.8)
Difference between net book value of disposals and proceeds	(c)	13.1
Revaluation in the audited financial statements	(d)	49.1
Indexation of RAB	(d)	237.0
Impairment in the audited financial statements	(e)	9.0
Difference between depreciation in the audited financial statements and Assumed Ordinary Depreciation	(f)	(17.3)
Closing Basic RAB at 31 March 2012		**2,205.6**

Notes to the performance report (continued)

9. RECONCILIATION OF FIXED ASSETS IN THE AUDITED FINANCIAL STATEMENTS TO THE CLOSING RAB AT 31 MARCH 2012 (continued)

These reconciling items are explained as follows:

(a) This reflects the difference between the net fixed asset value in the audited financial statements 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 audited financial statements 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 £11.7 million (2011: £13.1 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 audited financial statements. 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) Costs totalling £9.0 million were charged in the audited financial statements for impairment of fixed assets in current and prior years. The roll forward calculation for the RAB specified in Annex F of the 2008 Decision excludes impairment charges;

(f) This reflects the difference between the amount charged as depreciation in the audited financial statements and the Assumed Ordinary Depreciation allowed in the 2008 Decision and specified in Annex F of that Decision.

Notes to the performance report (continued)

10. 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 2011	226.5
Average RPI index for the year ended 31 March 2012	237.3
RPI index at 31 March 2008	212.1
RPI index at 31 August 2009	214.4
RPI index at 31 March 2011	232.5
RPI index at 31 March 2012	240.8
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 2012	15.44%
Increase from average 2007/08 to average 2011/12	13.78%
Increase from average 2011/12 to 31 March 2012	1.46%
Increase from 31 March 2011 to 31 March 2012	3.57%
Assumed increase to August 2007 per 2008 Decision	2.63%
Increase from 31 August 2009 to 31 August 2010	4.71%
Cumulative increase from 2008 Decision to 31 August 2010	11.14%

Notes to the performance report (continued)

11. RECONCILIATION OF OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES

		2012 £m
Operating profit per the audited financial statements	Note 6	**116.2**
Depreciation	Note 4, 5	**105.3**
Impairment of tangible fixed assets		**(0.2)**
Increase in stock and debtors		**(4.7)**
Decrease in creditors		**(11.1)**
Decrease in provisions		**(2.5)**
Increase in net pension asset		**(3.7)**
Net cash inflow from operating activities		**199.3**