Corporate Profile

The only asset of BAA(SH) plc ("BAA SH") is its shares in BAA (SP) Limited ("BAA SP"). BAA SP is a holding company which owns the companies that own London Heathrow Airport ("LHR") and London Stansted Airport ("STN"). LHR also owns the Heathrow Express rail link. Both LHR and STN are subject to economic regulation on the UK regulated price-cap utility model, with charges set by the UK Civil Aviation Authority (the "CAA"). For the year end Dec 2011, LHR accounted for 92% of BAA SP group EBITDA and STN for 8%. BAA SH is indirectly owned by BAA Limited ("BAA"), which owns a number of other airports in the UK. BAA is in turn currently owned by SPVs controlled by (i) Ferrovial S.A., a major Spanish construction and concession owning group (49.9%), (ii) Caisse de dépôt et placement du Québec, a Canadian institutional investor (26.5%), (iii) the Government of Singapore Investment Corporation (17.7%), and (iv) Alinda Capital Partners (5.9%).

The BAA SP group is financed via debt provided through a ring-fenced secured debt financing structure (the "BAA SP SDF"). BAA SP can only provide cash to service debt at BAA SH if it complies with the financial terms of the BAA SP SDF. BAA SH debt holders benefit from a security interest in BAA SH's shares in BAA SP. BAA SH is financed by GBP325m 7.125% Senior Secured Notes due Mar 2017 (the "BAA SH Notes") and a GBP175m loan facility due Nov 2015 together with a further £50m loan facility due Dec 2019 (the "BAA SH Loans").

Rating Rationale

The Ba1 Corporate Family Rating of BAA SH reflects a Probability of Default Rating of Ba2 and a 35% Family-wide loss given default assumption. The Corporate Family Rating is an opinion of the BAA SH group's ability to honour its financial obligations and is assigned to BAA SH as if it had a single class of debt and a single consolidated legal structure. The Ba3 / LGD-5(85%) rating of the BAA SH Notes reflects the structural subordination of the BAA SH Notes and the BAA SH Loans in the BAA SH group structure versus the BAA SP SDF.

BAA SH's Ba1 Corporate Family Rating reflects (i) its ownership of Heathrow, which is one of the world's most important hub airports and the largest European airport, (ii) the relatively resilient traffic characteristics of Heathrow which together with the Stansted traffic profile affords some portfolio benefits, (iii) the long established framework of economic regulation that pertains to Heathrow which will evidence some changes but which is not expected to be fundamentally altered, (iv) the significant capital expenditure programme at Heathrow, (v) the debt levels carried by the BAA SH group together with the features of the BAA SP SDF which puts certain constraints around management activity, and (vi) the protective features of the BAA SH Notes which effectively limits BAA SH's activities to its investment in BAA SP.

Rating Drivers

The key rating drivers that may be subject to change in the future are (i) the future development of LHR and the associated capital expenditure programme, which may be substantially lower than at present, or be more complex if a third runway at LHR is built, and (ii) the outcome of future regulated charge decisions by the CAA, in particular following expected changes to the legal framework within which charge levels will be set.

In Mar 2009, the Competition Commission (the "CC"), the UK's competition authority, issued a report requiring that BAA dispose of two of its London airports (as well as one of its Scottish airports) for competition reasons. BAA contested this decision at an appeal body, the Competition Appeal Tribunal. The Competition Appeal Tribunal upheld this appeal on the basis that one of the CC members that conducted the enquiry may have had a bias due to a conflict of interest. The CC appealed BAA's appeal decision and in the meantime the requirement for BAA to dispose of two of its London airports was rescinded pending a final resolution. Nevertheless, BAA has sold one of the London airports, Gatwick Airport, a sale concluded in Dec 2009. On 13 Oct 2010, the Court of Appeal reversed the Competition Appeal Tribunal decision. BAA sought a judicial review of this decision but this was rejected. Therefore, there is now a very high likelihood that BAA will be required to sell STN, although the CC has said that this need only occur after BAA has sold another airport (not part of the BAASH group), which is to be Edinburgh Airport. Given the size of LHR relative to STN, a sale should not result in a significant deterioration in the credit quality of BAA SH. Nevertheless, the sale of STN would create a further independent potential competitor to some of LHR's traffic.

At the same time that the CC issued a report into its initial thinking on the ownership of BAA's airports in Apr 2008, the UK Government announced a review of the regulation of UK airports. This review has culminated in a Draft Aviation Bill published in Nov 2011. The Draft Aviation Bill does not propose fundamental changes to the price-cap RAB based regulation currently pertaining to LHR and STN of itself, although it does propose the introduction of a licence regime for major airports and gives greater freedom to the CAA to determine which airports should be subject to economic regulation and the most appropriate form of economic regulation for each airport subject to a licence. In addition, there is a change of emphasis of the CAA's duties. The introduction of the regulatory changes of themselves should not alter BAA SH's credit profile. LHR and STN's charges are currently subject to review every 5 years and are exposed to changes of view of the CAA with regard to, but not limited to, the cost of capital, traffic level assumptions, and more fundamentally how the regulatory building blocks are determined. Capital expenditure obligations are determined by LHR and STN after consultation with their airline customers, and appropriate allowances set by the CAA. A productive and constructive approach between the airports and the airlines is therefore important, which has generally been the case at LHR but less so at STN. With regard to LHR, Moody's would expect the regulatory approach of the CAA to be broadly as has been the case over the past 20 years under the new legal regime.

LHR is currently undergoing a significant capital expenditure programme with the construction of a new Terminal 2 (2A and 2B) which will become operational in 2013/14. This continues a substantial programme which follows on from the construction of LHR Terminal 5 which opened in 2008. Following the opening of Terminal 2A and 2B, ongoing capital expenditure to upgrade and improve infrastructure will still be significant but will step down in complexity. However, the programme will step up again in size and complexity if LHR is to build a third runway. This is not likely to be progressed in the near term as there is no political consensus for it. However, at some point this may come back on the agenda, particularly if air travel volumes start to evidence the higher growth rates seen prior to 2008 for a period of time.

Structural Considerations

The BAA SH Notes and the BAA SH Loans rank pari passu and are subject to the terms of an Intercreditor Agreement which regulates their rights with regard to each other and any future holder of BAA SH debt, and provides for the sharing of the security granted to the BAA SH debt holders. BAA SH debt holders benefit from a pledge of all of the shares in BAA SP (BAA SH's only material asset) and a pledge of shares in BAA SH. Moody's considers that the BAA SP SDF isolates the credit profile of LHR and STN from that of the wider BAA group. While there is a certain reliance on the wider BAA group for operational support, this is considered acceptable within the context of the rating levels. This together with the security granted to the BAA SH debt holders should isolate BAA SH from the risks of failure of the wider BAA group, and enables Moody's to ignore any debt in the wider BAA group when assessing the rating of BAA SH. There are certain restrictions on the raising of further debt by BAA SH.

The BAA SP group is financed via the BAA SP SDF. BAA SP can only service debt at BAA SH if it complies with the financial terms of the BAA SP SDF. The BAA SP SDF provides for the issuance of two tranches of debt, called ("Class A Debt") and ("Class B Debt"). Class B Debt is subordinated to Class A Debt. The terms of the BAA SP SDF limit the amount of Class A Debt and Class B Debt that can be issued by BAA SP through a requirement to maintain certain Net Debt to RAB ratios and interest cover ratios.

Recent Developments

RESULTS FOR 12 MONTHS ENDING 31 DEC 2011 – RECOVERY BUT STILL BELOW REGULATORY ASSUMPTIONS

On 22 February 2012, BAA SP published its results for the 12 months ending 31 Dec 2011, reporting a 10% increase in revenues and 17% increase in EBITDA pre-exceptional items. The BAA SP and BAA SH financial statements have now also been published. The 2011 performance was driven predominantly by a 3.7% increase in passenger numbers and a significant increase in aviation charges. LHR passenger numbers increased by 5.5% a performance somewhat in line with that seen by other major European hub airports and evidencing continued good growth from the passenger declines over the last recession. However, STN saw a 2.8% decline over the same period, continuing a trend of declining passenger volumes seen since 2008. Peak to trough passenger decline at STN is now 24%, and it's not certain when this trend will bottom out. The increase in aviation charges is in accordance with the LHR regulatory settlement and will be used to meet the increased regulatory depreciation charges that arise from the recent and significant investment in T5. While results are overall encouraging, evidencing a recovery from the more difficult times in 2008/9, BAA SH is still producing consolidated pre tax losses given that passenger volumes and hence revenues are still some way below the assumed levels set out in LHR and STN's regulatory settlement (Moody's estimates that LHR passenger volumes for the regulatory year ending Mar 2012 were approximately 8% lower than the regulatory assumptions, and STN's will be about 25% lower). The lower LHR traffic volumes together with the negative revenue adjustment embedded within the current regulatory settlement for over-recovery of revenues in the previous regulatory period, has meant that LHR has not been able to cover the cost of debt for the current regulatory period to date. Hence overall, BAA SH's Adjusted Interest Cover Ratio (AICR) as calculated by Moody's has been less than 1.0 times over the last couple of years The negative revenue profiling adjustment drops out for the current year and beyond and this will help BAA SH's interest cover metrics going forward. As at 31 Dec 2011, BAA report that BAA SH has a Net Debt to RAB ratio of 79% although expected to rise to 83% by Dec 2012, in line with Moody's expectations.

COMPETITION COMMISSION REQUIRMENT TO SELL STANSTED CREATES SOME DOWNSIDE RISKS

On 7 Oct 2011, the CC reversed the order in which it would require the wider BAA group to dispose of a Scottish airport (not part of the BAA SH group) and STN. As previously highlighted, Moody's believes that a sale of STN will be broadly neutral given its small size and hence moderate contribution to profitability and cash flows. Nevertheless, the price achieved from such a sale will be important in determining the overall impact on BAA, and continued declines in STN passenger volumes suggest a downside risk associated with the sale for BAA. However, the extra time that BAA will now have to hold STN before a sale becomes mandatory will give further time for STN traffic volumes to recover if they are going to do so before a sale process is initiated.

CONTINUED ACCESS TO DEBT MARKETS EVIDENCED

BAA has had regular access to the debt markets throughout 2011 and into 2012 and has raised a significant amount of capital markets debt with sizeable transactions, including a first time USD1 billion 10 year fixed rate bond, a GBP750m 30 year fixed rate bond in 2011, and a sizeable EUR denominated bond in 2012. This capital markets activity has enabled BAA SP to repay its bank term loans as envisaged as part of its 2008 refinancing. Nevertheless, given BAA's continuing capital expenditure programme and significant annual debt maturities continued and reliable debt market access is very important for BAA.

Liquidity Profile

BAA SH's first debt maturity will be in November 2015. In the meantime, interest payments will need to be met from cash received from BAA SP, there are no certain other sources of cash available and no specific liquidity is kept at BAA SH. BAA SP will not be permitted to upstream cash to BAA SH if it fails to meet certain tests, generally performance related, but also related to the maintenance of adequate liquidity at BAA SP.

The liquidity of the BAA SH group as a whole is considered satisfactory for at least the next 12 months. Operating cash flow after tax is significant and positive in each quarter, with a peak over the summer months of each year. Capital expenditure commitments are significant, but refinancing activity has reduced debt refinancing risk, the EUR1000m bond that was due in Feb 2012 is already refinanced. Apart from modest EIB loan repayments due over the next 12 months, the next sizeable debt maturity for BAA is a GBP400m bond due in Nov 2013.

As at 31 Dec 2011, BAA SP had modest cash and cash equivalents of £34m, but also had GBP1,355m of undrawn commitment under its £2,750m of standby committed facilities maturing in Aug 2013, together with **GBP524m** of liquidity facilities dedicated and available to meet interest payments on BAA SP SDF Class A Debt and Class B Debt.

BAA reports that as at 31 Dec 2011 its financial ratios were at levels that gave it reasonable headroom against Financial Covenants, and that Financial Covenants were met as at the last testing date of June 2011 (for the period to 31 Dec 2010).

DETAILED RATING CONSIDERATIONS

BAA SH has been scored in accordance with Moody's rating methodology for operational airports outside of the US (May 2008). Scoring is as follows.

Governance & Rate Setting:

BAA is a general limited liability company that has no particular legal restrictions in relation to its business activities. It is also not subject to any particular provision that would imply bankruptcy remoteness. However, LHR and STN are subject to regulatory oversight, which places some constraints on operations and capital expenditure.

LHR and STN are subject to a framework of economic regulation that is considered appropriate and transparent. It is a form of price cap regulation that has proven to permit fair recovery of costs, is considered an appropriate mechanism for remunerating capital expenditure, and generates a reasonable return on capital. Moody's notes that the framework of economic regulation as it pertains to the regulated London airports (including LHR and STN) is subject to a review by UK Government but decisions published to date suggest that such changes are not likely to result in a material increase in regulatory risk.

BAA owns LHR and STN in perpetuity and all key aviation infrastructure is controlled by management.

Market Position:

LHR and STN serve London and the South east of England directly. However, LHR is also the UK's major gateway airport. F.y.e. Dec 2010, LHR accounted for 31% of total UK passenger volumes. Its large route network underpins this position. LHR therefore serves a geographical area much wider than London.

The London and south east economy represents one of Europe's most robust with GDP per capita above the European average. The economic base has a good level of diversity which is underpinned by London's status as one of the leading world cities from an economic, political and cultural perspective.

LHR and STN together account for approximately 66% of the London air travel market. It should be noted that this somewhat understates LHR's position because of its role as the UK (and Europe's) largest hub airport. Nevertheless, LHR (and in particular STN) is in competition with London Gatwick, London Luton and City Airport, at least for some traffic. LHR and STN are also exposed to some trans-modal competition, in particular from rail. Domestic air services compete with rail, and the Eurostar rail service competes very effectively with airlines on the London Paris and London Brussels routes. Rail competition with airlines may increase in future as other high speed rail destinations are added to serve London in addition to Eurostar's route network and (in the longer term) there is potential for competition with domestic high speed rail services. If BAA is required to sell STN then BAA SH's London market share will fall to about 52%.

Passenger & Airline Base:

For the purposes of the rating methodology, BAA SH is defined as a Hub Airport given that British Airways plc ("BA") operates a wide-ranging global route network from LHR that attracts connecting passengers from outside of the UK. BAA estimate that 35% of LHR's traffic is transfer traffic. When recognising that STN has very little transfer traffic, the % of total LHR and STN traffic that comprise transfer passengers will likely be less than 30%.

LHR and STN's combined traffic has grown at reasonably constant growth rates over the past 10 years. The standard deviation of the long term average annual passenger growth rate is 3.8% for LHR and STN combined. For LHR alone it is 2.8%. The increased volatility of STN traffic over the past few years (volume increases in the earlier years and volume declines in the later years) have offset the portfolio effect of having the two airports on this measure.

BA is the main airline serving LHR and the main airline providing LHR's transfer traffic. It is currently rated B1 with a positive outlook. BA merged with Iberia in Jan 2011, creating the International Airlines Group (IAG). It is not known for certain the percentage of LHR's transfer traffic that comprises IAG passengers but it is expected to be more than 50%. The score of Ba recognises that the percentage may be less than 75% given that LHR has a strong presence from the Star Alliance that may also account for a material share of transfer traffic. Following the sale of British Midland (BMI) to IAG by Lufthansa, IAG will entrench its position at LHR.

Operating Environment & Capital Programme:

Given its location on the edge of a built up area of west London, there are a number of restrictions that pertain to the operation of LHR. There is a limit on the number of air traffic movements per annum and there is a night time curfew. In addition there is currently a restriction on the use of runways so that they can only be used in 'segregated alternate mode'. In addition, in accordance with UK Government policy, future expansion at LHR (runways) could only be accommodated if noise and air quality targets can be met and public transport connections are improved. While this will not effect growth in passengers numbers in the short to medium term, it will impact growth levels in the future. Recognising the potential for an evolving position on the restrictions, BAA has been scored as having three restrictions (Baa score on the relevant sub-factor).

The capital expenditure programme at LHR only is considered for the purposes of rating methodology scoring. LHR has a substantial, and somewhat complex construction programme, albeit that there is nothing in the programme that should overly stress management. This will include the construction of a new large terminal complex (Terminals 2A and 2B). This programme will involve construction within the airport boundary and the management of a number of airline moves around LHR. The terminal will be of significant size and will involve the construction of all major terminal sub-systems. However, given that Terminal 5 was completed on time to budget the programme is expected to be within BAA's capabilities.

Stability of Business Model & Financial Structure:

BAA SH is prohibited from doing anything other than hold its investment in BAA SP. BAA SP may invest in activities outside of LHR and STN provided that the amount of such expenditure is less than 2% of the LHR and STN RAB.

Whether or not BAA SH can raise additional debt is essentially determined by the proposed Permitted Financial Indebtedness test in the BAA SH Notes terms and conditions. The BAA SH Notes' Permitted Financial Indebtedness tests are set at the following levels: (1) Group Net Debt: RAB <= 90%, and (2) Group Operating Cashflow to Group Net Interest Paid > = 1.0. BAA SH is expected to maintain a financial profile someway better than would be evidenced by these ratios. Therefore there is reasonable headroom to raise more debt.

To date BAA SP has not invested outside of LHR and STN. In fact the BAA group has been divesting non-core assets. Nevertheless, BAA SP has some flexibility to invest outside of the core operations.

Financial Metrics:

BAA SH has been scored on the basis of the financial metrics generated from the consolidated audited financial statements for the year ending Dec 2011 for illustrative purposes. These metrics produce a grid indicated rating of Ba3. BAA's financial metrics are expected to improve somewhat over the next couple of years as the negative revenue adjustment embedded within the current regulatory settlement for over-recovery of revenues in the previous regulatory period drops out (i.e. permitted aviation charges rise to a normalised level). Furthermore, once a settlement for the next regulatory period is defined, the traffic forecast used to calculate charges will reflect the then current traffic experience, which should improve BAA SH debt service metrics.

Uplift for Debt Structural Features and Rating Positioning:

Moody's has not given any specific additional uplift for debt structural features as these are minimal at the BAA SH level. However, the terms of the BAA SP SDF contain constraints on management such as a requirement to comply with a hedging policy, liquidity dedicated to meeting interest payments on BAA SP SDF debt, and reporting requirements. While such protections only benefit BAA SP debt holders directly, and they could in theory be waived by BAA SP financiers, they do provide some element of protection to BAA SH creditors by helping to protect the financial profile of BAA SP.

In addition, Moody's recognises that LHR and STN benefit from a long standing framework of economic regulation that may not be fully captured by the rating methodology, and the capacity constrained nature of LHR should suggest a robustness to downside traffic scenarios.

Furthermore, given the form of economic regulation, which is applied across many price capped entities in the UK, Moody's is able to make comparisons of relative credit quality between LHR / STN and the UK regulated utilities. Moody's employs credit metrics uniformly across such borrowers when measuring debt burdens, in particular focusing on two metrics, namely Net Debt/ Regulatory Asset

Base ("RAB") and an Adjusted Interest Cover Ratio (FFO less amounts needed to maintain the value of the RAB + Net Interest / Net Interest). Moody's concludes that BAA SH's credit profile for any given amount of debt is similar to, but marginally lower than, that exhibited by the typical UK water utility. Given the level of debt the BAA SH group is expected to carry in the future, a rating of Ba1 would be suggested when making such comparisons.

Rating Outlook

The rating outlook is stable. This reflects Moody's expectation that BAA's London airports will see low single digit growth overall in passenger volumes but significant increases in tariffs, and that the capital expenditure programme will continue to be managed effectively to accommodate the ramp up in work at LHR over the coming few years, both of which should ensure a financial profile in line with the current rating category. The outlook further assumes that BAA SP will continue to manage its debt raising programme in a way that minimises refinancing risk and allows it to comfortably meet new funding requirements. Although there is headroom under the BAA SH debt documentation to increase indebtedness at the BAA SH level, this is not expected to materialise over the time horizon of the rating.

What Could Change the Rating - Up

The Corporate Family Rating and rating of the BAA SH Notes could move up if the BAA SH group were to exhibit a financial profile that evidenced materially lower leverage than currently expected. This could be suggested by a Net Debt to RAB ratio likely to be permanently below 80% and an Adjusted Interest Cover Ratio of permanently more than 1.2 times.

What Could Change the Rating - Down

The Corporate Family Rating and rating of the BAA SH Notes could move down if the BAA SH group were to exhibit a financial profile that evidenced materially higher leverage than currently expected. This could be suggested by a Net Debt to RAB ratio consistently in the high 80s and an Adjusted Interest Cover Ratio of less than 1.0 times.

A sale of Stansted Airport, is not considered likely to cause a downwards move in the rating.