SH&E International Air Transport Consultancy

The Future of Capacity, Airport Charges and Regulation

A Survey of European Airports for ACI Europe

Presentation by:

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Agenda

- The Survey
- Traffic Growth
- Airport Finances
- Economic Regulatory Oversight

Our Capital Needs and Regulatory Oversight Survey covered the whole of Europe, and is a definitive source of information

- Responses from airports handling 824 million passengers per annum (69% of ACI Europe membership)
- 24% of respondents were owned by the private sector, 62% by the public sector but operated as commercial companies, and the remainder owned and operated as departments by local or national governments
- 26% of airport operators were concessionaires and did not own the assets operated

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Continued growth in air traffic is foreseen

- Strong passenger growth rates forecast by most airports, averaging 4.7% per annum over next ten years
- Of the sample, the smallest airports (<5mppa) are most optimistic, forecasting passenger growth rates of 6.8% per annum, while the largest airports (>20mppa) predict 4.1% per annum
- Air Transport Movements are also expected to increase at 3.4% per annum to 2015 – so the number passengers per aircraft is expected to increase by 1.3% per annum
- 95% of airports expect Low Cost Carriers to grow at an above average rate, while traffic on ‘traditional’ short-haul airlines is expected to decline in market share terms
- Three quarters of respondents expect long haul market share to increase, perhaps a reflection of the EU’s liberalisation initiatives

Europe’s airports are planning to handle this growth

- 90% of respondents feel confident of providing sufficient capacity to meet growing demand

- This is of course subject to
  - agreeing the best development option
  - obtaining the many necessary permissions
  - finding the money to finance it

What’s going to happen to aeronautical charges?	
Go down	14%
Stay the same	16%
Go up	20%
Don’t know – analysis not complete	16%
Don’t know – regulatory uncertainty	34%

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Europe’s airports have made huge capital expenditures…

- Between 2000 and 2005, Europe’s airports spent an estimated €44.95 billion or €7.5 billion per annum on capital expenditure
- This equates to €7.25 per passenger per annum on average
- However, only half of this went to capacity expansion
  - maintenance and refurbishment expenditure was significant (25%)
  - the rest went on safety and security (10%), commercial projects (10%), and environmental measures (5%)

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…and are planning to continue to do so

- Airports are planning to invest €8.1 billion per annum to 2010
- This is set to increase to €8.5 billion per annum on average between 2010 and 2015
- Cumulative capex to 2015 is expected to be €82.6 billion, equivalent to €5.40 per passenger
- In the future, more capex (e.g. 59% between 2011 and 2015) will go on capacity expansion projects

How did the finances work in 2005?

Aeronautical Revenues
€10.10 per pax

Commercial Revenues
€7.40 per pax

Total Revenues
€17.50 per pax

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Operating Expenditure
€12.60 per pax

=

EBITDA
€4.90 per pax

What are airports doing with their €4.90 per passenger?

EBITDA — €4.90 per pax

Less

Depreciation and Amortisation — €2.97 per pax (€3.65 billion)

Assume Average Remaining Asset Life = 14 years
Implies Asset Base of €51.1 billion

Leaves

Return on Capital — €1.93 per pax (€2.37 billion)

Covers Interest and Dividends

Implies Cost of Capital of 4.6%

**This is a very low Cost of Capital,
certainly unachievable for the Private Sector, and
implying that airport users benefit at the expense of airport owners**

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And what does the future look like?

- Airport Privatisation is likely to continue
- Even if privatisation is not pursued in a particular country, owners are increasingly likely to apply private sector financial performance criteria

A private Sector WACC

WACC: Weighted Average Cost of Capital

Cost of Equity 10%

Assume 50:50 Gearing

Cost of Debt 5%

WACC

7.5%

c.f. UK CAA currently allows BAA a WACC of 7.75%

N.B. Pre-tax, real

Without any increase in the asset base, a private sector WACC would require extra revenue of €1.22 per passenger

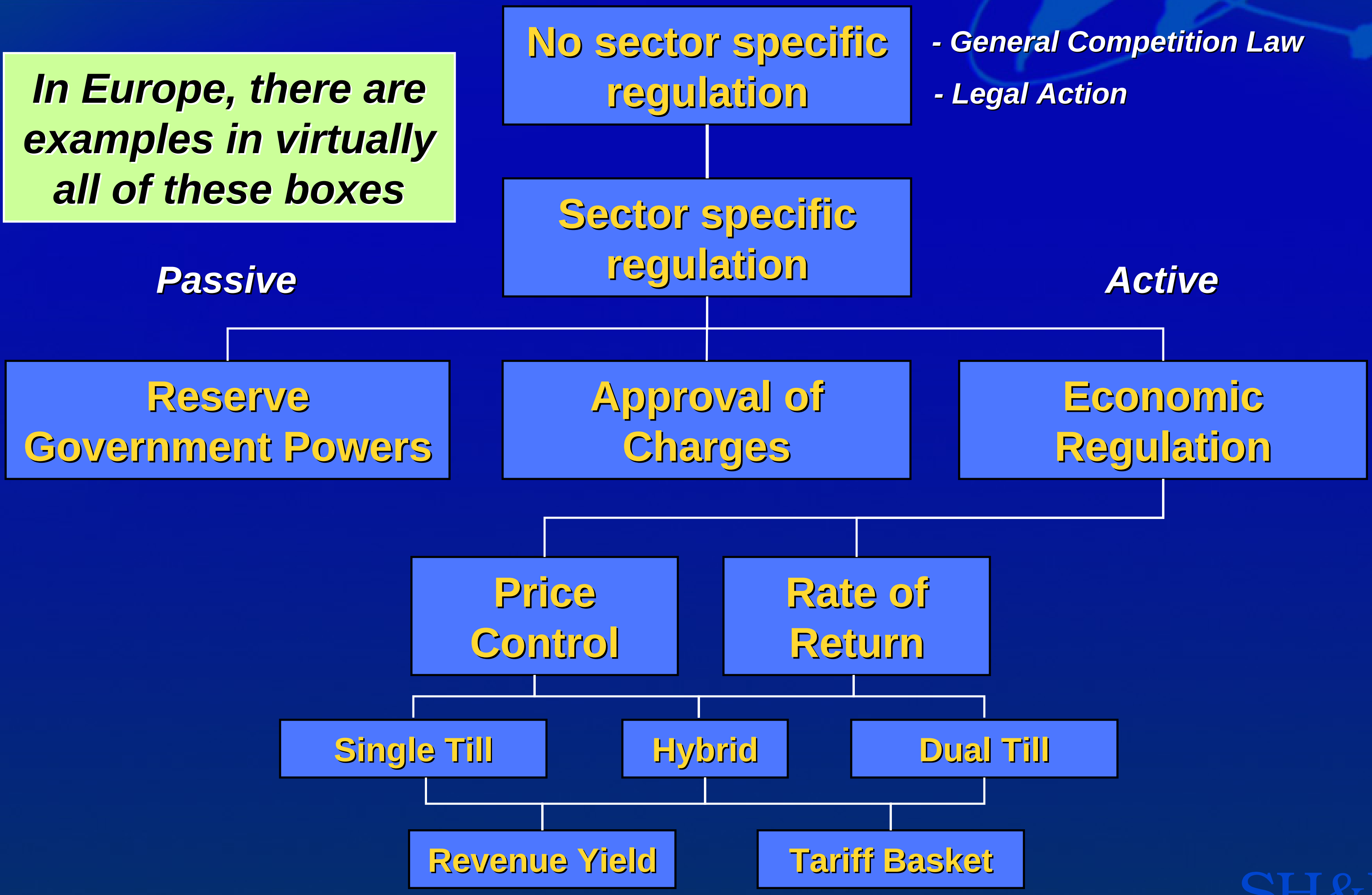
The Asset Base is of course going to increase with all that Capex

Total Capex over next ten years	€82.6 bn	
Assuming 28 year life, annual depreciation on new assets	€2.95 bn	€1.94 per pax
Weighted Average Cost of Capital	7.5%	
Cost to remunerate WACC per annum	€3.37 bn	€2.21 per pax
Total extra costs per annum	€6.32 bn	€4.15 per pax

With a capital intensive business, and limited options to reduce opex, overall airport operators are likely to have no choice but to increase aeronautical charges

The Regulatory Options Tree

In Europe, there are examples in virtually all of these boxes



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Economic Regulatory Oversight Arrangements are extremely varied throughout the EU

- The variation reflects the heterogeneity of cultures and heritages, needs and circumstances around the continent
- The majority of regimes involve approval following negotiation between airport, airlines and regulator, based on transparent criteria
- Only 15% involve no or automatic approval of airport charges
- Around a third of regimes use a regulatory formula, taking account of future traffic and finances
- The most sophisticated and oldest regime is in the UK

ICAO Guidelines provide the only common ground, although the EU Charges Directive will change that

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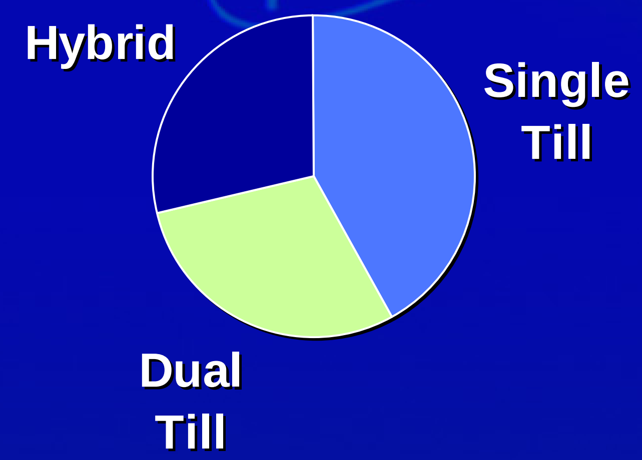
The variation in regulatory approach is seen in several different ways

- Approaches to regulation of prices are evenly spread between the three different possibilities
  - but if the Aeronautical Till is loss making, is it really Dual Till?



- The Regulatory Infrastructure (legislation, resources, competencies) does not exist in most countries to allow a roll-out of a UK-style price regulation

The UK model though perhaps the fairest, most transparent and most thorough, is not necessarily appropriate elsewhere

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Conclusions

- There is a multiplicity of airport structures throughout Europe
- Traffic growth is going to continue
  - everyone believes in Low Cost Carriers
  - traffic right liberalisation is expected to boost long haul
- Capital investment has been running at €7.5 billion per annum since 2000 (or about € 7.25 per passenger)
  - although only just over half has been on capacity expansion projects
- To support traffic growth, capital investment will continue at an average €8.3 billion per annum for the next ten years (at least)
- Current incomes appear to support a very low Cost of Capital, unacceptable to the private sector
- Airport users are benefiting from an under-recovery of capital costs, at the expense of airport owners

Conclusions (cont.)

- Privatisation is likely to continue
- Airport charges are likely to go up
- Economic regulatory arrangements and regulatory culture are extremely diverse throughout the EU: a "one size fits all" approach is unlikely to be appropriate
- There is little appetite for the export of a UK model for price regulation
- The costs of formal economic regulation are high
- The most sophisticated economic regulation recognising airport finances has allowed an increase in charges

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