Managing Infrastructure Costs

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The airline financial outlook remains very bleak.

Despite all efforts to:

a) Reduce costs: – 40% in operating costs achieved in 2021Q1 vs 2020Q1
b) Raise commercial loans: airlines have now amassed a huge debt burden over $650 bn
c) Secure government aid: $227 bn since beginning of pandemic

Airlines are still facing:

a) Net losses - $47.7 bn
b) Operating margin of -9.4%
c) $81 bn in cash burn for 2021

The airline industry will remain on a financial knife edge in 2021 and very likely beyond. We need all industry partners to work to the same goal to restore industry’s financial health if we are to come out of this together and have a sustainable recovery for the industry overall.
The whole aviation industry is in crisis. Everybody needs to reduce costs, improve efficiency and review financing to repair the financial damage caused by COVID-19.

Regrettably, many airports and ANSPs, particularly those with market power, are simply relying on recovering net losses or even their full foregone revenues through higher charges to airlines and passengers.

In cases they are simply relying on cost recovery as if the pandemic never happened.

These types of increases will only have further negative impact on airline financial survival, more costs to consumers (ticket prices) and therefore the delay overall recovery of the industry.
At some of the world’s largest airports
- We need the right decisions from regulators and decision-makers

While not all airports or ANSPs are hiking charges - some are doing the right thing to avoid these situations – many of the large airports are (because they see they can - being in a monopolistic situation). This risks the good work done by others towards building a successful industry post pandemic.

Just looking at the four examples– if allowed to pass through they would create over $10 bn in additional costs for airlines and passengers and heavily impact an already fragile industry. We rely on good decisions from regulators.

Even in the case examples given we are still expecting to see continued pushes from AENA Spanish Airports - the DGAC has yet to make a decision on AENA’s request to recover "lost revenues" due to COVID up to EUR 2.4bn

And for Heathrow Airport Limited - HAL has not desisted from pursuing a $3.2bn RAB adjustment (even though it is planning to issue dividends in 2022)

If airports are allowed to get away with this, we will see very big increases in charges and costs in passengers.
We are also seeing aggressive pushes by ANSPs to recover lost revenues that will affect the long-term sustainability of the industry post pandemic.

What is happening with ANSPs in the EU Single European Sky charging scheme in particular is very concerning:

- Since the onset of the pandemic, although operations were dramatically reduced, costs were only reduced by less than 2%.
- Providers did secure some loan facilities earlier in the pandemic, mainly through the help of Eurocontrol, but in fact we are now looking at proposed 40% increases in charges. Instead of increasing charges, much of this can be financed by new loans or bonds.
- And worst of all – ANSPs want to recover nearly all of the revenues they had hope to normally receive if the pandemic had not happened. Airlines and passengers are being expected to pay for services that were not received, at a cost totaling over EUR7.8bn.
- Very few have sought government aid with some openly resisting or wanting to take the easy option to charge airlines and passengers more - ANS are state essential services and should seek financial aid from governments.
- States must do more to avoid this situation (so far only Belgium Norway Spain and Sweden will provide some support).
We need urgent action from ANSPs, national governments and the European Commission to avoid this catastrophic situation.
Airline government aid cannot bail out the industry
- Excluding wages support, ~70% of aid to airlines is debt based

Since the outbreak of the pandemic, $227bn in financial has been granted to airlines but:

- Over $80 bn of that is in employment support – packages which would broadly be available to airports and ANSPs if they wanted to take advantage of them and certainly not transferrable to other parts of the value chain
- Of the remainder, around 70% is in the form of new debt - airlines will need to pay back these loans often at commercially equivalent rates
- That leaves around $47 bn in cash or equity support from governments (even this can so easily be wiped out with some of the increases already mentioned)
- Furthermore aid packages given are based on the financial survival of the airline – not the industry supply chain.

Airports and ANSPs need to take action, in the same way airlines and other suppliers have had to.
Everyone in the supply chain needs to take due responsibility and action to achieve a sustainable restart for all aviation stakeholders.

There are 5 clear actions all infrastructure providers should undertake.

1. Except that the market has dramatically changed - it is not possible to assume business as usual
2. Urgent cost control measures have to be implemented - not just for 2020/21 but also for coming years to support a sustainable recovery
3. Shareholders need to provide financial support to their airports and ANSPs – especially has they would have benefited from stable returns before the pandemic. Furthermore, airports and ANSPs have good access to commercial loans and money markets
4. Government aid should be used to the maximum extent – airports and ANSPs are closer to governments and should be able to secure support
5. Blaming regulation is a false argument – regulated airports and ANSPs would have been profitable before the crisis and will return to financial sustainability. What is need is to agree the exceptional measures needed to get through the pandemic.
Airport and ANSPs cannot simply expect the pain of the pandemic to be transferred to airlines and passengers. What is needed is no different from the action which has already been undertaken by airlines and many other partners across the supply chain.
Every aviation stakeholder has been impacted by the crisis

- Providers can’t expect profits during this crisis
- Financial returns granted pre-crisis for accepting risk
- Provider need to adjust investment plans to new market outlook
- Financing from other sources need to be fully explored

All stakeholders are in this together and each has to play its part to support not hinder recovery

Expectations for returns need to be managed for the coming years as the aviation market is not expected to recover to pre pandemic levels until 2023.

In such a situation providers should also review their investment plans. For example, both airports and ANSPs in South Africa have significantly reduced their investment plans to recalibrate to the new traffic outlook. We need all providers to ensure their capacity plans are better aligned to new market realities.

All providers need to explore all other sources to support financial and avoid increases.
Cost of airport and ANSP infrastructure has risen steeply over the past

- Ability to reduce costs shown by some:
  - European Airports: 24% in operating costs 2020 vs 2019
  - European ANSPs: 22% for ANSPs outside European Performance Scheme
- Initial forecasts show increasing costs for 2022 almost back to 2019 levels

Over previous years the unit costs of infrastructure has been increasing and there have been numerous alarms raised from airlines to improve provider efficiency.

While some providers have argued costs cannot be reduced, others have shown it is possible through various initiatives, including temporarily closing facilities, rescheduling staff reviewing supply contracts.

Taking the case in Europe:
- We have seen reduction in European airports for operating costs but of course the range of reductions is very broad. (DAA – 47%)
- For European ANSPs we see a stark difference between those outside the EU performance scheme, who have achieved a reduction on 22% in operating costs, versus those in the scheme which have achieved less that 2% (this of course raises questions on the commitment to achieve efficiency from those in the scheme).

As in most cases we are already seeing costs returning back to normal and even increasing in cases.
Airport and ANSP shareholders need to support having benefited from previous returns

- Six of the largest European airports distributed dividends of ~ USD 12 billion over 5 years up to 2019
- Compensation for risk accepted in previous years
  - This risk cannot be transferred to consumers in 'bad' years

There is urgent need for the shareholders of airports and ANSPs to provide financial support if needed.

Just looking at the dividends paid out by major airports in Europe - these, over the last 5 years, will amount to more than the full revenue losses their providers will have incurred during the pandemic. They will therefore, by far exceed net financial losses incurred, and should be reason enough for shareholders to step in to shore-up on balance deficits.

These are essential and obvious actions for all shareholders of infrastructure providers but they are not happening because there is no pressure on providers to take necessary action. Some providers are even projecting to distribute dividends again from 2022 – even while pushing to increase charges to airlines.

Like in all other sectors, shareholders have to accept they have been compensated for risks in previous years. It cannot be the case that shareholders, including governments, take healthy dividends in good or normal years and expect airlines and passengers to pay for the bad years.
There is no systematic financial weakness across infrastructure providers

Example of credit rating adjustments for European airports

<table>
<thead>
<tr>
<th>Airport</th>
<th>From</th>
<th>To</th>
<th>Notches Rating</th>
<th>Notches SACP*</th>
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<tr>
<td>Flughafen Zurich AG</td>
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<td>Aeropuertos de Paris S.A.</td>
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<td>A/Negative/A-1</td>
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<td>-2</td>
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<td>A/Negative/A-1</td>
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<tr>
<td>Avinor AS</td>
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<td>A/Negative/A-1</td>
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<td>BB+/Developing/B</td>
<td>BB+/Developing/B</td>
</tr>
</tbody>
</table>

Source: S&P Global Ratings. Data as of March 15, 2021

* SACP – Stand alone credit profile
** AdR still issued a EUR500 million sustainability linked bond and has since moved to BBB-

- Short-term losses can be financed to limit impact on charges
- Financing available for investments and to support the green agenda
- Airports and ANSPs continue to be recognized as safe investments

Airports and ANSPs also have ready access to commercial debt facilities and capital markets - the cost of such financing is normally included in charges to airlines but this is a much better and more responsible action than simply trying to recover losses directly though charges.

With such facilities available, talk of an investment crunch or inability to finance green investments is simply not justified.

Major providers have issued bonds
- Fraport has issued a bond worth 1.15bn € at an annual yield below 2%.
- Schiphol issued a 750m € green bond with a 2% yield
- Aeroporti die Roma issued a 500m € sustainability linked bond with a yield of 1.8%
- NAV Canada - issued an additional $539M in bonds, in Feb. 2021

Providers have good access to money markets and the ability to raise new capital. Airports and ANSPs are still very much seen as investment grade’ investments and actually ratings are improving.

The picture would not look like this for airlines – they generally have lower credit ratings, in some cases have no ability to raise commercial loans while struggling with
depleting cash reserves.
There is a wide selection of government support packages for airports and ANSPs - mainly in the form of wage subsidy programs or dedicated programs like in:

- USA
- Germany, Italy or:
- Australia - the AARFP program for regional airports
- New Zealand - the ETC scheme

Various other airports have been successful in securing government funds to support liquidity and business operations in Europe - these funds are approved by the European Commission

In regions like Asia Pacific, there is more general support for airports and ANSPs, also to reduce the impact of existing charges to allow the continuity of airline operations.
It is not a surprise that we have continued excuses on regulatory frameworks or charge setting formula.

The pandemic could not have been foreseen during the development of any regulation or charges formula and the actions required are therefore broader for a balanced recovery of the industry.

The quest to remove or reduce regulation is primarily driven by strong airport operating companies that want to make more profit for shareholders at the expense of airlines and passengers. Regulation and effective charge setting oversight should always be focused on the best interest of the consumer and driving efficiency across the industry - it is therefore necessary across this industry segment to contain market power.

In fact, the pushes from providers to recover financial losses or full revenue losses straight from charges are representative of market power.
Summary

1. The COVID pandemic is an exceptional crisis
2. Urgent action needed from all stakeholders
3. Providers cannot rely on airlines to cover losses
4. They have the right channels to do this - incl. maximizing use of shareholder support/financing and government aid
5. Failure will delay recovery and hurt the industry in long term

Airlines and their passengers simply cannot cover the impact of the pandemic across the supply chain and government aid to airlines was never foreseen nor given to do that.

It is essential that a recovery is not constrained or jeopardized by increases in costs by one value chain segment, increases which can be avoided by other means.

Some providers have shown the right action but regrettably many are trying to increase charges without exploring options available.

Increasing charges now is the worst possible outcome and will mean consumers will end up paying the bill which will work against a sustainable recovery.