ACI EUROPE
AIRPORTS COUNCIL INTERNATIONAL

ACI EUROPE
ECONOMICS REPORT 2012

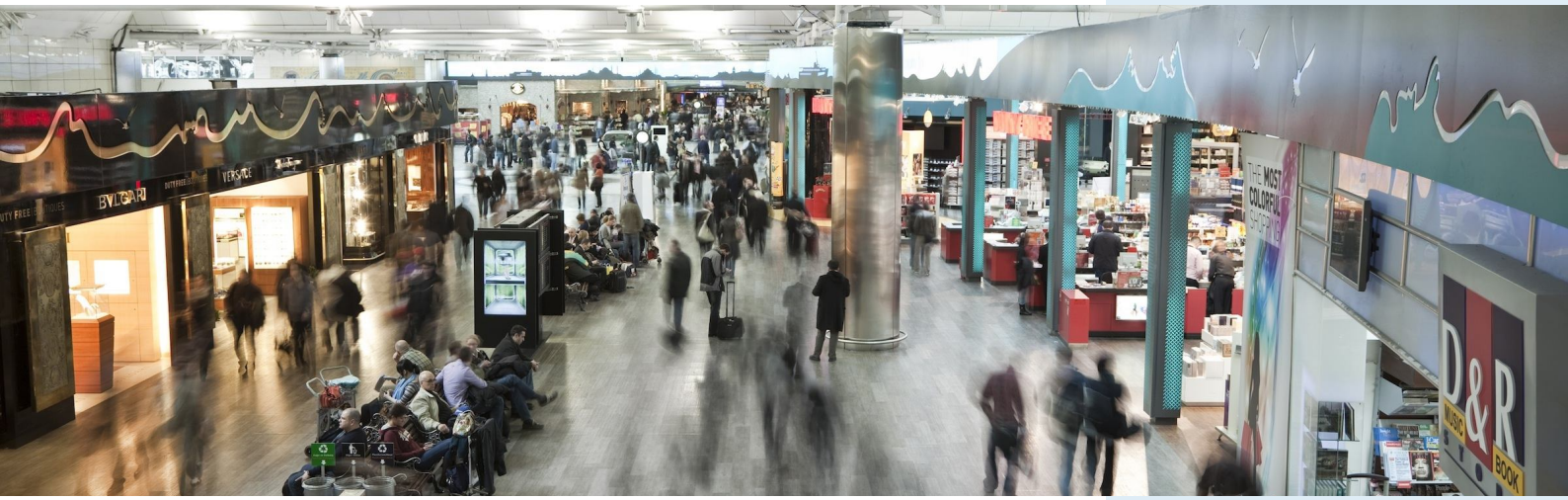


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INTRODUCTION

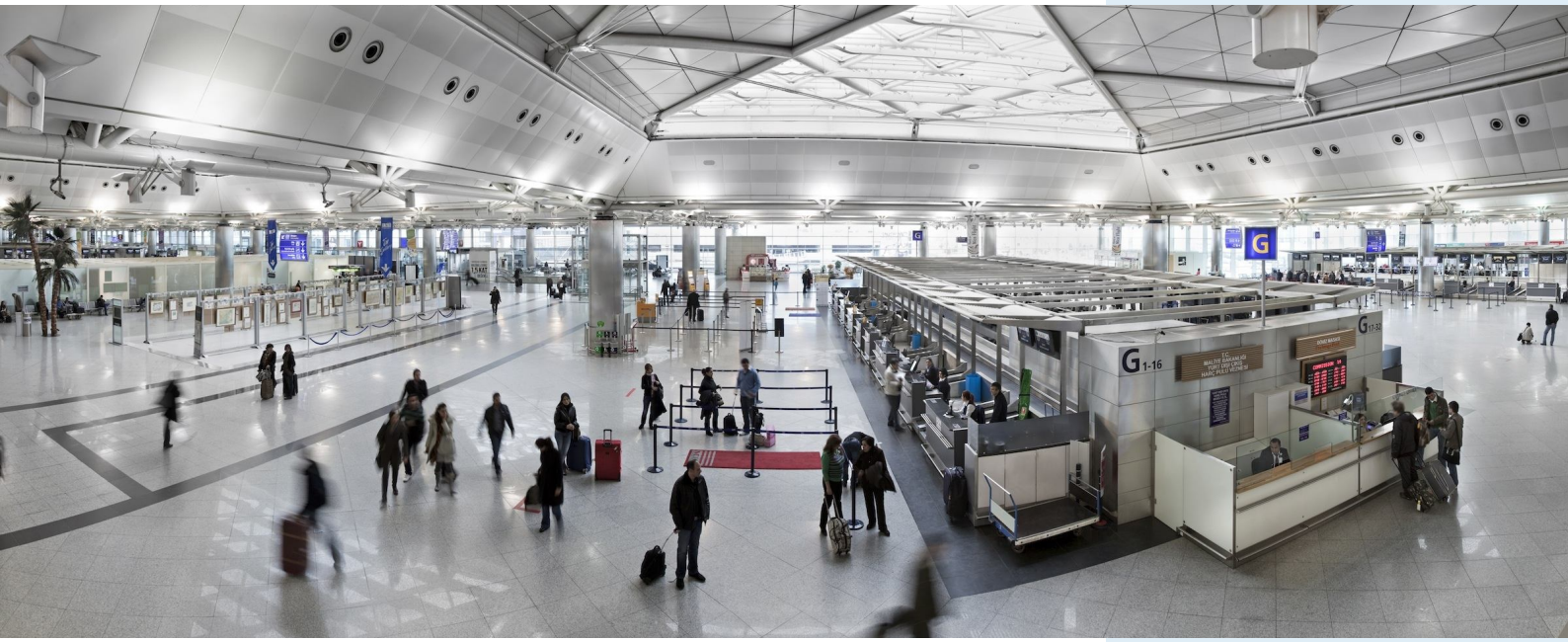
For the fourth time, ACI EUROPE presents its ECONOMICS REPORT on the key financial and economic characteristics of the European airport industry.

This edition of the report provides an overview of the developments in such diverse categories as revenues, costs and profitability of European airport operators. At first glance the 2012 ECONOMICS REPORT reflects a continued recovery of air traffic in Europe after the crisis years of 2008-2009. However, an examination of the associated financial performance of airports reveals far more uncertain times, with increased competitive pressures combining with higher capital costs to squeeze airport margins.

CONTENTS

The ACI EUROPE ECONOMICS REPORT 2012 highlights key developments in the following main economic fields:

- **Traffic development:** Solid passenger growth in 2011, but signs of the coming slowdown in 2012 already being felt.
- **Airport income:** Revenues increasing in line with traffic growth.
- **Aeronautical revenues:** Increase in aeronautical revenues slightly above traffic growth, but on a passenger basis increases remain below inflation.
- **Non-aeronautical revenues:** Airports' non-aeronautical activities resilient in the face of weakened consumer confidence, allowing subsidisation of airlines by airports to continue.
- **Airport operating costs:** Extension and consolidation of 2010 efficiency gains but sustainability concerns emerging.
- **Capital expenditure:** Record highs in the costs of capital left cuts to planned investment as the only option available to many airports.
- **Total costs & profitability:** 42.5% of European airports were loss-making in 2011 compared to 48% in 2010.



KEY THEME - STRAIN

The dynamic traffic growth of 2011 masks considerable strain, with Europe's airports caught between significant demand and supply-side pressures.

On the demand side, while revenue developments are in line with traffic growth, after two years of decreases in airport charges aeronautical revenues on a per passenger basis remain broadly static, as airports respond to strong competitive pressures within the industry. With regard to non-aeronautical revenues, the continued propensity of passengers and other airport visitors to spend represents a considerable achievement in itself, in light of the challenging trading conditions and weak consumer sentiment.

On the supply-side, operating costs are being cut where possible, but the fixed nature of many airport costs means that there is limited room for manoeuvre. Capital costs are at record levels after the crisis years, and are even less controllable than operating costs. In many cases the only option available to airports is to cut back on investment – a strategy which cannot be sustained indefinitely.

Airports are responding well to the strain imposed by this hostile cost environment. However after continued cost cutting, the sustainability of this trend must be considered. This concerns not only the impact upon service quality levels and capacity, but also upon the viability of individual airports as businesses.

The results of this strain are being felt on European airports' financial results. Reasonable levels of profitability cannot be automatically assumed, with the industry on average making a return on capital which is not sustainable. This is also evident to the rating agencies, which have been adjusting individual airports' ratings accordingly.

Continued cost cutting impacts not only service quality and capacity levels, but also the viability of individual airports as businesses.



1. BUSINESS CONTEXT

While at an aggregate level the year 2011 was a positive one for European airports in terms of traffic, in reality it was a year defined by growing weakness of demand beneath the surface. The air traffic recovery from the crisis years of 2008 & 2009 gained pace, with passenger traffic growth of **+7.3%** strongly outperforming European GDP growth. However, at the same time the continued development of the Eurozone crisis and wider weaker external demand caused industrial sentiment across all sectors to turn significantly negative. This was matched by consistently negative consumer sentiment, which in reality never fully recovered from the initial crisis years.[1]

As a result strong passenger traffic headlines masked more worrying developments which directly impacted airports. The beginnings of a two-speed European aviation market emerged, with non-EU airports recording growth almost twice that of EU airports. Growth in freight – a reliable indicator of future economic activity – turned negative in June 2011 and alternated between monthly retraction and stagnation as the year progressed. Sure enough passenger traffic began to slide as 2012 unfolded.

In parallel aircraft movements continued to grow at a slower pace than passenger traffic, at **+4.1%**, reflecting airline's continued focus on yield above capacity. This means a weakened relationship between passenger growth and aeronautical revenue growth. This was an important component within wider demand-side pressures which airports had to respond to in 2011.

2012 saw the warning signs of 2011 come to pass, with overall passenger growth of just **+1.8%.** EU airport traffic slipped into recession in November 2011, and stagnated across the year with growth of just **+0.2%**, in comparison with growth of **+8.8%** at non-EU European airports.

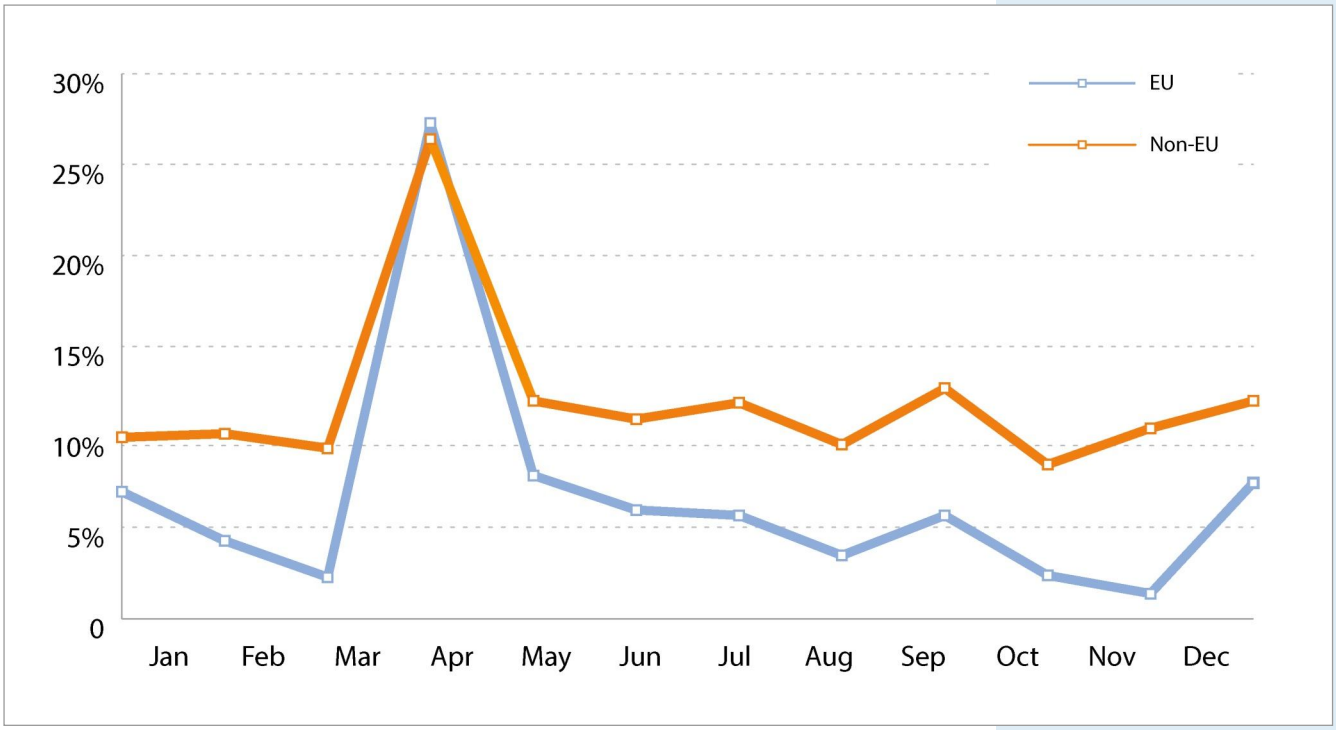
Freight in 2012 remained in decline with overall negative growth of **-2.8%** versus 2011, suggesting that the prospects for a return to growth remain elusive. This was confirmed in 2013 by the return of the worst uncertainties of the Eurocrisis in the aftermath of the Cyprus bailout, and reinforced ACI EUROPE predictions that with no signs of any imminent improvement, traffic developments are likely to get worse before they get better.

The beginnings of a two-speed European aviation market emerged.

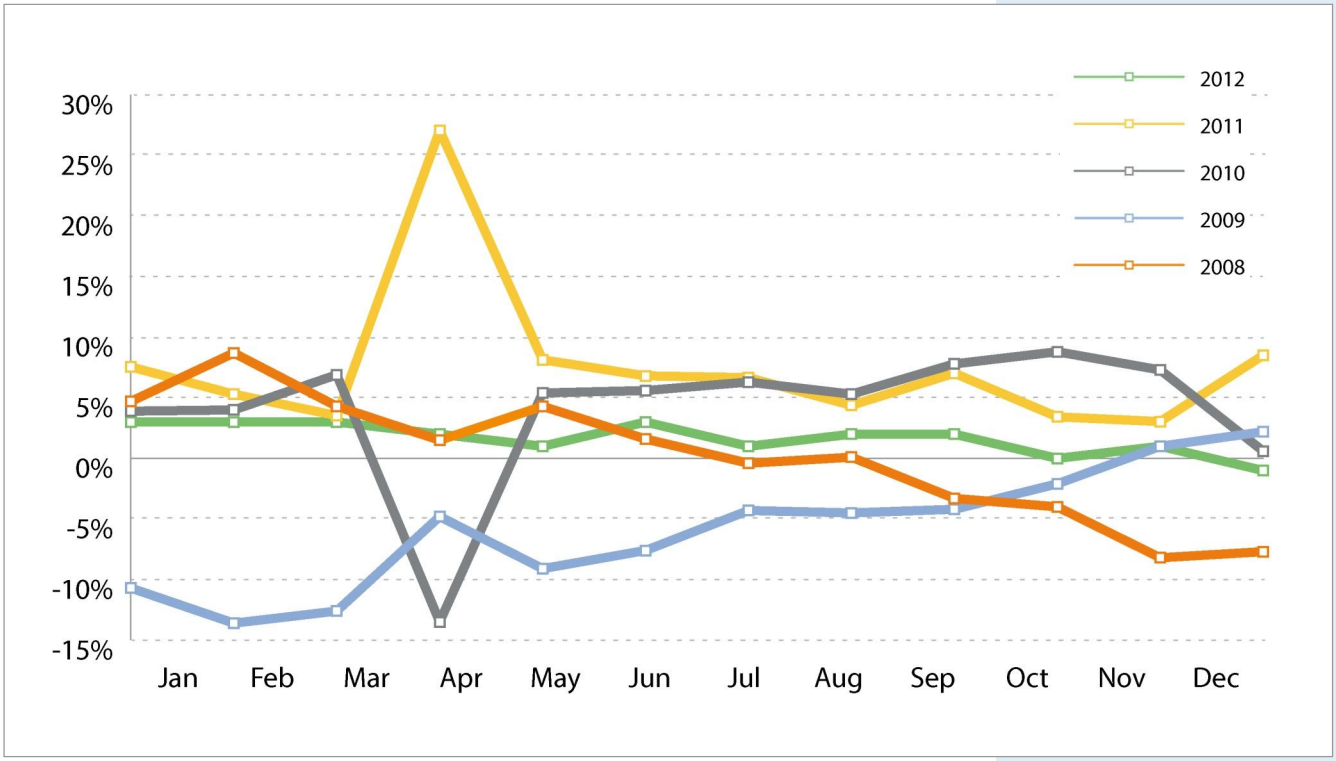
Growth in freight turned negative in June 2011. Sure enough passenger traffic began to slide as 2012 unfolded.

[1] European Business Cycle Indicators, European Commission, December 2011 http://ec.europa.eu/economy_finance/publications/cycle_indicators/2011/pdf/4_en.pdf

Graph 1
EU & non-EU growth in Europe 2011 (year-on-year)

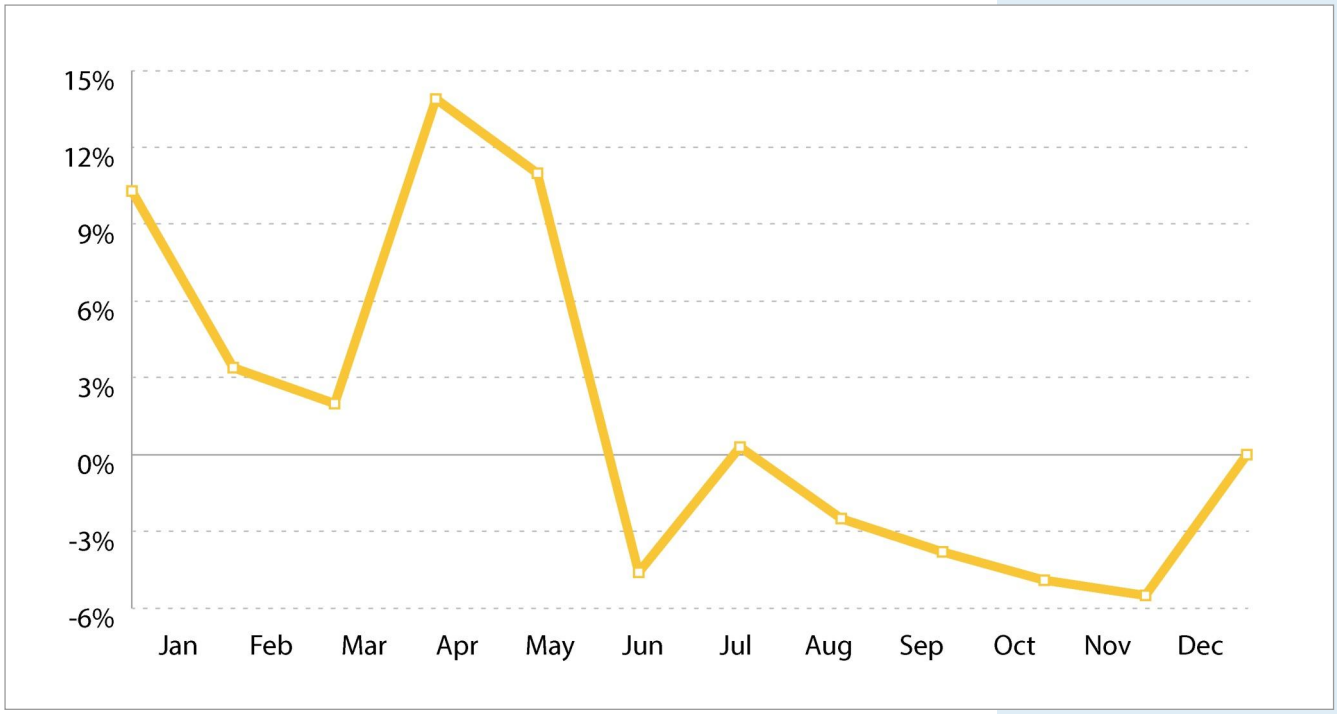


Graph 2
Overall passenger growth in Europe 2011 (year-on-year)[2]

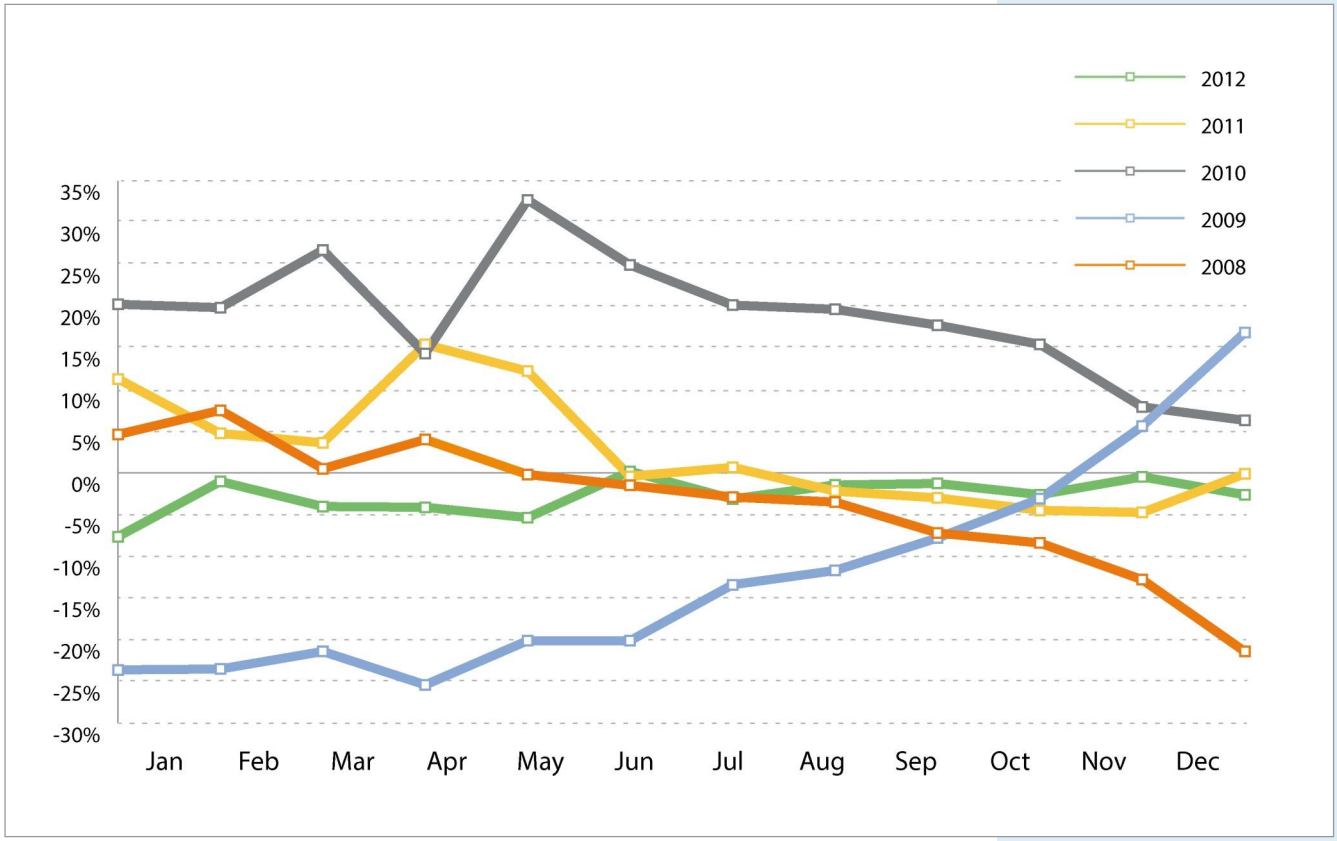


[2] ACI EUROPE and ACI WORLD traffic reports.

Graph 3
Overall freight growth in Europe 2011 (year-on-year)



Graph 4
Overall freight growth in Europe (year-on-year)





2. AIRPORT INCOME

Total European airport operator revenues reached **€33.2 billion** in 2011. This represents an increase of 9% on 2010, and is broadly in line with the highly dynamic traffic growth of that year.

Airport income usually stems from four categories of income: Aeronautical revenues, non-aeronautical revenues, 'other' revenues which cannot be readily categorised[3] and ground handling revenues. It should be noted that ground handling services are directly provided only by a minority of airports in Europe, and do not reflect the situation at the typical European airport. To obtain meaningful and relevant results, 'other' revenues and ground handling revenues are excluded from the further analysis of aeronautical and non-aeronautical revenues in the framework of this report.

Table 1
Distribution of revenues at all European airports in 2011

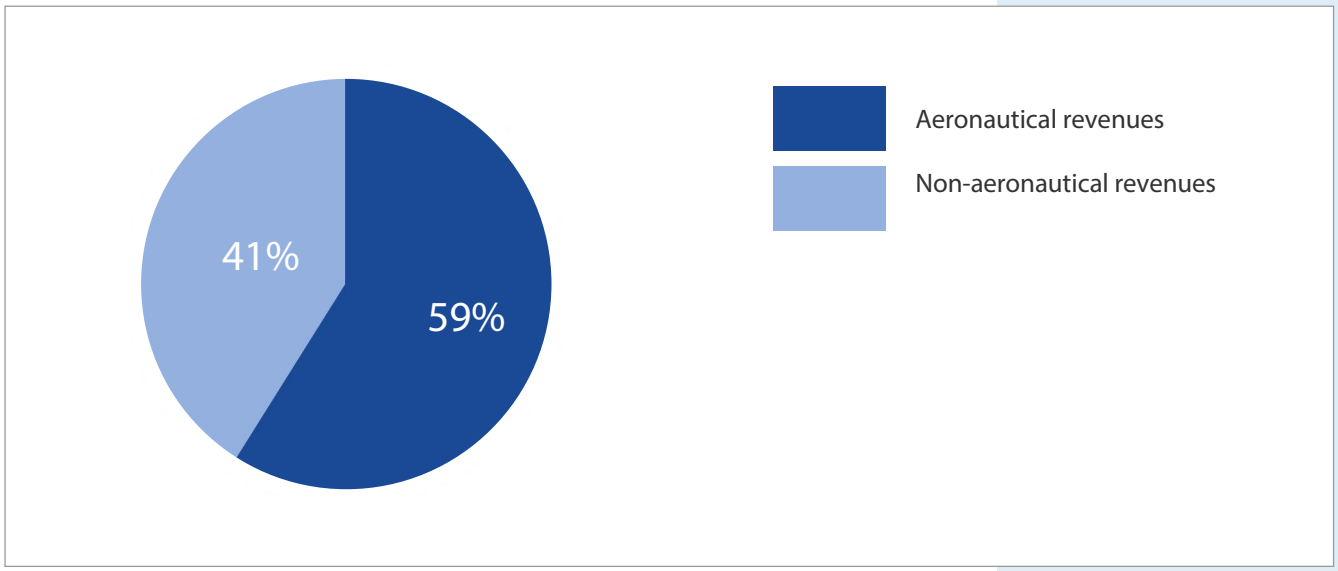
TOTAL REVENUES	€33.2 billion	100%
AERONAUTICAL REVENUE	€16.2 billion	49% (59% excl. GH & Other)
NON-AERONAUTICAL REVENUE	€11.2 billion	34% (41% excl. GH& Other)
GROUND-HANDLING REVENUE	€2.2 billion	6%
OTHER REVENUES	€3.6 billion	11%

[3] E.g. terminal navigation charges for some airports, facility management, special guest services, cleaning charges, etc.

Aeronautical revenues, i.e. charges paid by airlines and passengers, accounted for 59% of total airport revenues in 2011, whereas **non-aeronautical revenues** such as retail concession, car parking or food and beverage income, represented 41% of total airport revenues in 2011[4].

Airport finances depend heavily upon such revenues to keep airport charges competitive, to fund day to day operations and to finance infrastructure investment. This means that airlines pay only a fraction of the necessary revenues, with the end user – the passenger – being the ultimate beneficiary.

Graph 5
Aeronautical & non-aeronautical revenues at European airports



2.1 AERONAUTICAL REVENUES

In 2011 European airport aeronautical revenues reached **€16.2 billion**, constituting an increase of +9% compared to last year, in the context of an increase in passenger numbers of +7.3%.

Aeronautical revenues are composed of a number of different charges that relate to the operation of the airfield and the terminal. They can be split in **two major categories**: **airline-related charges** levied on a per aircraft basis, and **passenger-related charges** levied on a per passenger basis.

Airline-related charges are paid **by the airline** for the use of the runway (landing charges), the parking of the aircraft (parking charges) and other aircraft-related infrastructure at the airport. The landing charge is usually based on the weight of the aircraft.

[4] Excluding ground handling and other revenues -as other revenues cannot be readily categorised and as ground handling activities in particular do not reflect the revenue situation at most European airports.

Passenger-related charges are paid **by the passenger** to the airport, mainly for the use of the terminal. However, to simplify passenger processing at the airport, these charges are included in the ticket price and transferred by the airline to the airport, as recommended by ICAO in its Policy Guidance document 9082. They are therefore only pass-through costs for airlines and are **not** part of their operating costs – hence the requests of many airlines to put more weight on passenger-related charges in an airport's charges structure. Furthermore, a portion of these charges are actually retained by airline and neither transferred to the airports nor refunded to passengers - in the absence of any legal basis. This often is the case when a passenger does not show up for a flight, for example.

Passenger-related charges accounted for 67% of total aeronautical revenues, while airline-related charges represented only 33%.

The bulk of aeronautical revenues are now generated by the passenger.

2.1.1 THE RATIO OF AIRLINE-RELATED TO PASSENGER-RELATED CHARGES

The trend of putting more weight on passenger-related charges in the charges structures of European airports has continued in 2011. A higher proportion of passenger-related charges in an airport's charges structure creates **direct risk-sharing between the airport and the airlines**. This allows the airlines to pay a lower charge for the overall aircraft movement (lower landing and parking charges), while at the same time ensuring that the impact of any decline in passenger numbers is felt by the airport rather than the airline.

This risk-sharing behaviour between airlines and airports is also evident in the proliferation of incentive schemes, in which airports offer airlines discounts on airport charges, linked to the achievement of traffic targets. The risks associated with attempting to grow passenger numbers (or in some circumstances to maintain passenger numbers) are split between airline and airport. Such developments are evidence of the further development of airport competition, and the concessions which airports must make to retain airline custom.

Excluding 'other revenues', passenger-related charges accounted for 67% of total aeronautical revenues, while airline-related charges represented only 33% of the aeronautical revenues at European airports. Since 2008, this ratio has shifted significantly towards passenger-related charges – **the bulk of aeronautical revenues are now generated by the passenger**.

Table 2
Components of aeronautical revenues 2008-2011 (in %)

	Passenger-related charges	Aircraft-related charges
2008	58%	42%
2009	61.5%	38.5%
2010	67%	33%
2011	67%	33%

Another key driver of the further shift away from airline-related charges consists of requests from certain airlines to unbundle passenger-related services, i.e. to pay for parts of airport infrastructure on a strict per-use basis (baggage sorting systems, air bridges etc.). This has been particularly the case for LCCs in recent years. Whereas a per-aircraft charge does not allow for a separate billing of these services, passenger-related charges can reflect this differentiation. While this approach affords additional flexibility to airport users, it is also the case that there are invariably winners and losers amongst airlines at individual airports. Airports are therefore often constrained in their ability to substantially unbundle charges – either by the dominance of individual airlines/airline groups, by regulatory requirements to avoid discrimination between users, or by airports' own business models, which do not favour such an approach. In addition such a charging method is not always applicable in an industry where users often share common space and facilities such as Centralized Infrastructure.[5]

Airline related charges only accounted for 16% of airport income in 2011.

This increasing flexibility in the structure of airport charges, in combination with the impact of non-aeronautical revenues on the level of airport charges, means that **airline-related charges only accounted for 16% of airport income in 2011** – similar to the equivalent figure in 2010 and a significant decrease compared to the figure of 19% in the preceding year.

2.1.2 THE DEVELOPMENT OF AIRPORT CHARGES IN 2011

In 2009 and 2010, 69% and 64% of airports lowered or kept stable airport charges respectively, in response to extremely difficult trading conditions. However, the improvement in the trading environment in 2011 allowed airports to return charges levels to a more long-term sustainable position. 75% of airports increased their airport charges in 2011- in particular in response to continued upward pressures on capital costs, which account for approximately a third of the industry's cost base.

Table 3
% of airports increasing, decreasing or leaving static airport charges 2009-2011

Airport charges	2009	2010	2011
Increase	31%	36%	75%
No change	19%	47%	24%
Decrease	50%	17%	1%

[5] Centralized Infrastructure refers to ground handling services whose complexity, costs or environmental impact does not allow for division or duplication, such as baggage sorting, de-icing, water purification and fuel-distribution systems (EU Ground Handling Directive 96/67/EC).

However it should be noted that the sizes of these increases were extremely limited across the industry. Average aeronautical revenue per passenger – an indicator of the average level of charges – increased only by **+2.2%**. Taking inflationary pressures into account[6], such an increase was likely to be static or negative in real terms.

This significant discipline on prices, particularly in the context of 2 preceding years where the majority of airports lowered or froze prices, can be attributed to the continued growing impact of airport competition[7]. European airports face market pressures from a number of different directions:

Passenger's ability to switch:
• 63% of European citizens live within 2 hours drive of at least 2 airports;
• 50% of local departing passengers have a choice of more than one reasonable alternative flight from a different airport to their destination;
• 62% of passengers transferring through Europe have a realistic alternative hub airports to choose from

Airline's ability to switch:
• route openings and closings account for circa 20% and 15% of the market, as airlines pick and choose the most profitable routes;
• 15 instances of 'dehubbing' have occurred in Europe since 2000

Airline buyer power:
• 84% of European airports with more than 1m passengers cater for an airline which has more than 40% of that airport's capacity;
• 74% of intra-European routes are served by an individual airline

The ability of both passengers and airlines to switch, in combination with the dominant position airlines can enjoy at individual airports, means that airports are constrained in what cost pressures they can pass on to users via higher airport charges. If prices increase unreasonably, passengers and airlines can take their custom elsewhere, depriving the airport of both aeronautical and non-aeronautical revenues, while still leaving them with significant fixed costs.

Taking inflationary pressures into account, the change in aeronautical revenues per passenger was likely to be static or negative in real terms.

[6] EU inflation was 3.1% in 2011, according to Eurostat: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&language=en&pcode=tec00118&tableSelection=1&footnotes=yes&labeling=labels&plugin=1

[7] See 'Airport Competition in Europe' study: https://www.aci-europe.org/component/downloads/downloads/3302.html. Podcast available at: http://www.youtube.com/watch?v=HkdaEKzDFC8

2.2 NON-AERONAUTICAL REVENUES

As is evidenced in Section 2.1, increased competitive pressures mean that airports can no longer count upon aeronautical charges to cover the associated costs. Consequently, **the charges paid by airlines for the use of airport facilities and services do not cover the full costs of the infrastructure and the operation of the airport**.

As individual airports price competitively so as not lose traffic to their competitors, non-aeronautical revenues play a key role in subsidising aeronautical services and facilities.

Therefore, non-aeronautical revenues are vital for the economic viability of any airport. This is particularly the case for airports with a high proportion of LCC traffic – in return for very low airport charges, these carriers pledge to bring additional passengers to an airport. Those passengers supposedly generate significant additional non-aeronautical revenues for the airport through purchases in shops and other services at the airport (e.g. car parking) although some airports consider that LCC passengers have a lower propensity to spend than their long-haul and full service counterparts. This suggests that the key driver of such low airport charges is the pressure of airport competition rather than promises of major non-aeronautical revenue streams.

Against this background, the on-going practice of several LCCs to restrict the carry-on luggage allowance to one single bag and to prohibit additional separate shopping bags from airport retail exposes the dominance of these airlines' positions, which is the real driver of the LCC-airport relationship.

It should be noted that even in a dual till environment where aeronautical and non-aeronautical revenues are kept separate, non-aeronautical revenues significantly reduce operating costs for aircraft operators at an airport. Profits from non-aeronautical revenues are often reinvested in airport infrastructure, reducing the need for airports to borrow money on capital markets and thus lowering capital costs for the airport. In addition, such profits result in better credit ratings, again leading to lower costs of capital.

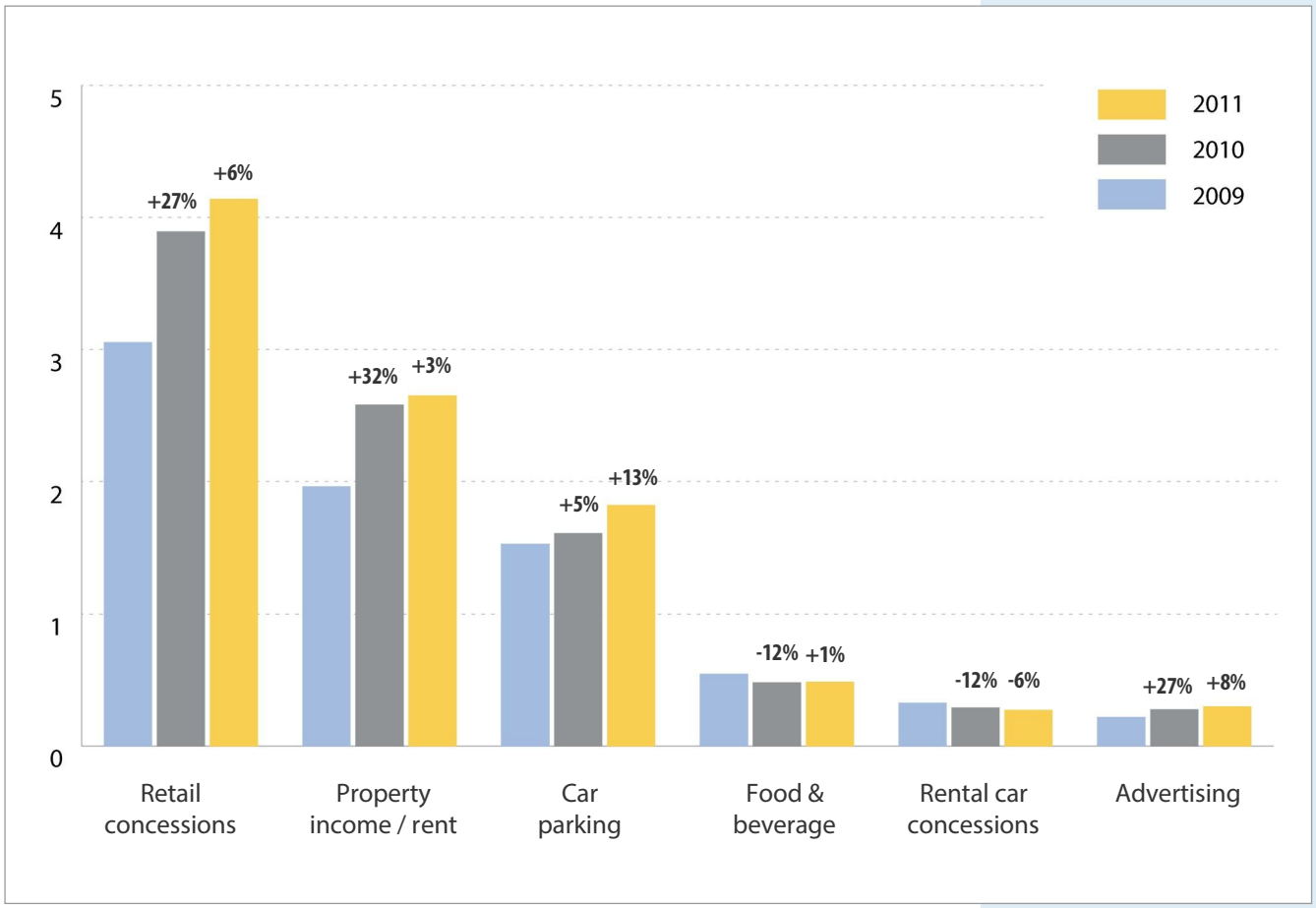
In the year 2011, non-aeronautical revenues at European airports amounted to **€11.2 billion**. After adjusting for a methodological change in the data collection[8], the change in the level of non-aeronautical revenues is broadly consistent with the wider changes in passenger traffic and aeronautical revenues. Such an increase reflected the fact that passenger propensity to spend remained broadly stable – a significant achievement by airports and their commercial partners in light of the challenging retail environment and weak consumer sentiment.

The single largest category in non-aeronautical revenues remains income from airport retail concession, accounting for **43%** of non-aeronautical revenues. The following categories include property & rent (**27%**) and car parking (**19%**). Revenues increased in all categories in absolute numbers, except rental car concessions.

Passenger propensity to spend remained broadly stable – a significant achievement in light of the challenging retail environment and weak consumer sentiment.

[8] A revision to the methodology behind the collection of airport economic data led to many airports categorising a significant volume of revenues as other. This consequently impacted the reported revenue figures for the aeronautical and non-aeronautical categories.

Graph 6
Performance of individual non-aeronautical revenue streams at European airports 2009–2011 (€bn)



When the breakdown of non-aeronautical revenues is compared with previous years[9] it is clear that the proportion of revenue from the different non-aeronautical areas has remained very stable. This is an indication of the maturity of these markets, making the maintaining and uplifting in per-passenger spends a challenge requiring considerable commercial flair and acumen, even in the absence of challenging trading conditions.

[9] Taking into account the methodological changes

Table 4
Non-aeronautical revenues by source 2011

Non-aeronautical revenues[10]	100%
Retail concessions	43%
Food & beverage	5%
Car parking	19%
Rental car concessions	3%
Property income / rent	27%
Advertising	3%

[10] Excluding non-operating income & 'other' revenues

When factoring in all sources of airport revenues, income from passenger-related services (passenger-related charges, revenues from retail concession/food & beverage and car parking) constitute the majority of revenues at European airports – **51%** of all revenues. This is one of the primary reasons which allows airlines to contribute only 16% of the overall revenues that airports generate in total.



Table 5
Overview total airport revenues by source in 2011

Total airport revenues	100%
Aircraft/airline related revenue	16%
PAX related revenue	32%
Ground handling revenue	7%
Retail concessions	13%
Food & beverage	1%
Car parking	5%
Rental car concessions	1%
Property income / rent	8%
Advertising	1%
Other revenues	11%
Non-operating income	5%



3. AIRPORT COSTS

3.1 OPEX

In the reporting year 2011, total operating expenses of European airports amounted to **€19.8 billion**. This was an increase of +6% in the context of a passenger increase of +7.3%. This represented a further consolidation of the significant efficiency gains achieved by airports in 2010, meaning that since 2009 operating costs per passenger have decreased by -6%. Taking into account the considerable fixed compliance and traffic level-driven operating costs facing airports (such as safety and security), it can be seen that the industry was incredibly dynamic in reducing costs **in those areas where it had the ability to do so**. This helped mitigate against the massive increase in interest costs (+45% from 2009-2011) which airports experienced and ensured that airport charges remained competitive.

2011 can therefore be seen as a further expansion and consolidation of the efficiencies achieved in response to the immediate crisis years.

The largest single cost item at an airport remains staff costs, accounting for **37%** of total operating expenses. It should be noted that staff costs have decreased by -8% or €660 million compared to the year 2009 - a direct reflection of the cost cutting programs at many airports. This is even more remarkable when taking into account that the number of staff for many airport functions is significantly influenced by externally imposed regulatory requirements or traffic levels, which have increased by +12.5% across the 2 years. Therefore, a key challenge facing airports will be to maintain and further improve where necessary the levels of service quality which airlines and passengers have come to expect, while working with more limited resources.

It appears that airports are striving to meet this challenge by increased use of contracted services in place of direct personnel costs. This cost category experienced a rise to **€4.3bn** as airports made efforts to allow service levels to be maintained in a more efficient and flexible manner.

Costs associated with Maintenance and 'Materials/Equipment/Supplies' also experienced sharp drops on previous year figures, of **-29%** and **-22%** respectively.

Since 2009 operating costs per passenger have decreased by -6%. The industry has been incredibly dynamic in reducing costs where they had the ability to do so.

Airports limited flexibility in the areas where they can reduce costs has forced them to focus disproportionately upon labour and maintenance-related costs. While some steps can be taken to mitigate the adverse impact of these cutbacks upon service quality levels, the consequences cannot be avoided indefinitely. Cost cutting is in response to pressures from airlines – in the longer term there will be a need for extensive dialogue between airports and airlines as to where the trade-off needs to be made between low airport charges and reasonable service levels. This will require clear and constructive input from the airlines, and a solid commitment to the interests of the ultimate end user – the passenger.

There will be a need for extensive dialogue between airports and airlines as to where the trade-off needs to be made between low airport charges and reasonable service levels.

Table 6
Operating costs structure 2011

Total operating expenses	100%
Personnel	37%
Contracted services	22%
Materials/equipment/supplies	4%
Communications/energy/waste	6%
Insurance/claims/settlement	1%
Maintenance	5%
Lease/rent/concessions	5%
General & administrative	7%
Other	13%

By separating the total operating costs in **functional cost areas,** the results for 2010 show that terminal & landside operations constitute the most important cost category for European airports (**30%**). Security operations remain an important cost factor, accounting for **25%** of total operating costs. The forthcoming easing of restrictions on LAGs, with the requirement to buy equipment and change procedures, is likely to be the key determinant of this figure in 2013.

Administrative costs have gone down by **-4%** in 2011 compared to 2009, reflecting the efforts airports are making to focus on those areas where cost cutting is possible. More worryingly, sales and marketing costs have been reduced by -**16%** since 2009. Sales and marketing activities are essential to maintain and attract new traffic. In light of the cost structure facing airports, deteriorating traffic levels negatively impacts all users, as fixed costs have to be shared amongst a smaller pool. As with the decreases in labour and maintenance-related costs, the limited flexibility available to airports is forcing them to cut costs in a manner which may be unsustainable in the longer term.

While airports continue to 'trim the fat', any demands by airlines for further cost reductions must also be considered from a longer-term, more sustainable perspective- i.e. taking fully into account the ultimate impact on charges and levels of service quality.

Airline-related charges covered only 27% of airports' total operating expenses.

Table 7
Functional cost areas in 2011

Total operating expenses	100%
Airside operations	24%
Terminal and landside operations	30%
Airport security	25%
Administration	17%
Sales and marketing	3%
Other	1%

Consistent with 2010, **airline-related charges covered only 27% of airports' total operating expenses**. This ratio has decreased since the first edition of this report – from 31% in 2008. Indeed, European airports have an **under-recovery of almost €4 billion** of their operating expenses, even when all aeronautical revenues (including passenger-related) are factored in.

Similar results have now been found in all 4 ACI EUROPE Economics Reports, confirming the trend that airports systematically and structurally subsidise the airline industry. While regulatory-driven artificially low airport charges are responsible for some of this, across Europe it is clear that competitive forces are forcing this subsidisation of airline operations. When complaints are made about 'unreasonable' levels of airport charges, this salient fact should not be forgotten.

3.2 CAPITAL EXPENDITURE

In spite of current economic troubles, the looming capacity crunch at European airports remains a key strategic challenge facing Europe. In its latest long-term[11] forecast, EUROCONTROL expects air traffic to increase by 50% by 2035. Even after the impact on traffic volumes of almost 5 years of economic slump and stagnation, it is still expected that around 12% of 2035 demand will not be accommodated by European airports. Attempts to do so will result in congestion, delays and poor service quality for those air services that can be accommodated. Investment in new and existing infrastructure has always been a core responsibility of airport operators, and this responsibility will take on new significance in the years ahead. A supporting legal, financial and regulatory framework needs to be in place, to allow airports to deliver upon these obligations.

[11] Challenges of Growth 2013' EUROCONTROL, June 2013

Data from recent years suggests that at present this is not the case. After the dramatic forecast decrease of capital expenditure in both 2009 (**-€3.1** billion compared to 2008's forecast) and 2010 (**-€1.5** billion compared to 2009's forecast) the downward adjustment continued into 2011. Forecast capital expenditure in 2011 for 2012 was downgraded by **–€0.7bn** on the previous year's projections, while forecast spend for 2014-2017 was at €26.9bn compared to a 2011 forecast of €33.4bn for 2013-2016. This represents a decrease of **–€6.5bn**, which implies an annual decrease over twice as steep as that experienced in 2012.

Forecast spend for 2014-2017 was at €26.9bn compared to a 2011 forecast of €33.4bn for 2013-2016, representing a decrease of -€6.5bn.

Last year's Report envisaged a return to normal levels of capital expenditure by 2012. Clearly this year's figures show that there are no expectations of an uplift until at least the medium term. Given the significant and prevailing costs of capital (see below) and in view of the significant cuts being made to operating expenses, the danger now presents itself that the drop in European airport capital expenditure was not a dip but rather a long-term step decrease, in particular in response to a step increase in capital costs.

In the context of the capacity crunch and globalised competition from airports in neighbouring regions of the globe facilitated by newer aircraft technology, it is essential that European airports are empowered to expand to meet projected demand. Given the new costliness of private funding and the corresponding limits on its availability, decision makers must bear this in mind when determining how the industry is to grow, and specifically, when considering how public funding should be facilitated.

Table 8
Capital expenditure 2012-2016

CAPITAL EXPENDITURE OF EUROPEAN AIRPORTS	
2012	**€9.2 billion**
2013	**€11.3 billion**
2014-2017	**€26.9 billion**

3.3 CAPITAL COSTS & TOTAL COSTS

European airports are capital-intensive businesses, requiring major capital investments to finance new infrastructure and to modernize existing facilities. Access to capital markets is therefore fundamental in order to raise the necessary funds. In 2011 capital costs constituted 31% of total airport costs, and are therefore a key determinant of business viability.

The year 2011 saw a continued increase in capital costs, despite another period of lower capital expenditure undertaken by European airports. Overall, capital costs amounted to €9.4 billion. After a massive rise in 2010, this leaves capital costs in 2011 having risen by a shocking **+29%** in just 2 years**.**

Much of this was driven by rising interest costs, which shot up by +45% in the same period. A change in interest expenses can have a significant impact upon the cost of a project. For example, a 5% interest rate on a €1bn euro terminal across 30 years will cost €65m in interest per year, or €1.95bn in total. Whereas an interest rate of 15% on the same terminal produces an equivalent cost of €4.5bn[12].

In 2009, for every €1 European airports were paying in depreciation, there was an additional 48 cent being paid in interest costs. In 2011, the equivalent figure had increased to 58 cent per €1 of investment. In a multi-billion euro industry, this increase seriously erodes airport's ability to expand and improve infrastructure.

Given this new reality, and in the context of soaring interest costs, it is no surprise that in the November 2012 Industry Report Card from Standard & Poor's[13], of the 11 rated European airports, only 2 had a 'positive' rating, with 5 airports considered 'stable' and 4 with a 'negative' rating.

Standard & Poor's explicitly warns of the possibility of the sovereign debt crisis having a direct negative impact upon publically-owned airports via the solvency and possible downgrade of their owners, should European sovereign ratings fall further. This is potentially very significant in light of the fact that 78% of European airports are fully publically owned[14] and has the potential to burden the European airport industry with even higher capital costs in the immediate term.

In light of the high exposure of airports to changes in capital costs, any credit rating downgrades can be expected to have direct, significant cost implications. While airports will continue to make all efforts to curtail costs where possible, regulators and decision-makers need to accept that the industry will only remain sustainable so long as users pay a reasonable proportion of the unavoidable costs associated with the provision of the facilities and services which they benefit from.

Taxes and other fees paid by airport operators have decreased by 30% to **€0.8 billion**. This welcome development has helped relieve some of the pressure which airports have otherwise been facing. Nevertheless, this must be considered within the context of national aviation taxes, which although not directly visible on an airport's balance sheet, are having a serious dampening impact upon passenger traffic in certain EU countries – e.g. Austria, France, Germany and the UK.

Overall capital costs amounted to €9.4bn. After a massive rise in 2010, this leaves capital costs in 2011 having risen by a shocking +29% in just 2 years.

Table 9
Total costs in 2011

Total costs	100%
Operating expenses	66%
Capital costs	31%
Taxes & other fees	3%

[12] Current Trends in Financing Airport Infrastructure, AlixPartners presentation, October 2012
[13] Industry Report Card: European Airports Face The Recessions Ripple Effects, Standard & Poors, 6 November 2012
[14] The Ownership of Europes Airports, ACI EUROPE, 2010



4. PROFITABILITY

4.1 OVERALL NET PROFITABILITY

In 2011, 42.5% of European airports were loss-making.

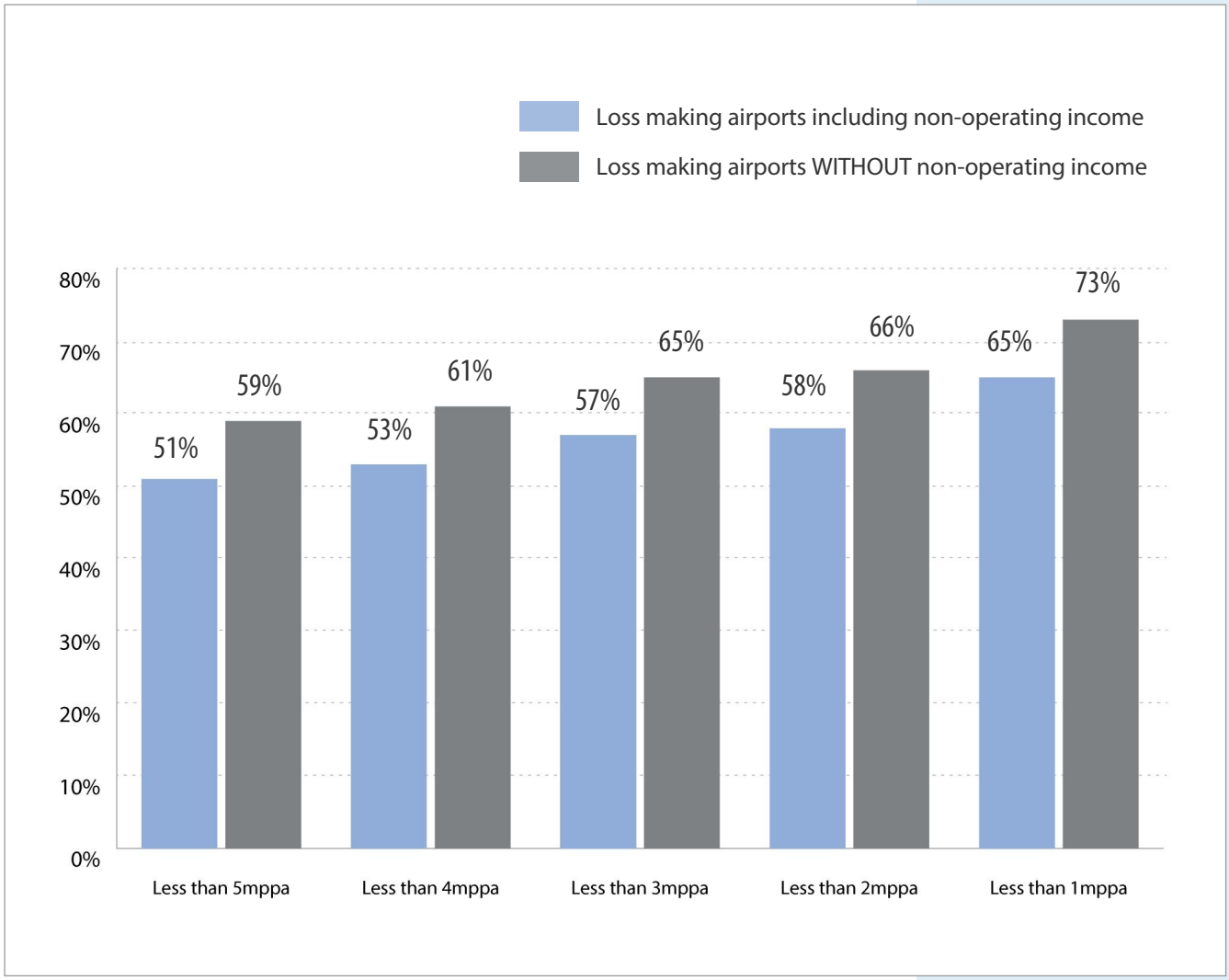
In 2011 the entire airport industry made an overall net profit of **€3.3bn**. While as a headline figure this may seem impressive, it must also be remembered that the profits are required to attract and retain investment, and therefore should be considered as a percentage of the overall investment into the industry. See Section 4.2 for further information on this.

In any case it is only the larger and medium sized airports which are generally able to generate reasonable profits. When European airports are considered on a size basis, it is clear that smaller airports – and in particularly those under 5mppa – are making very small returns on their efforts.

This explains why in 2011, **42.5%** of European airports were loss-making. This is a slight improvement on 2010 when 48% of airports were loss-making. In part this continued weakness reflects the difficult trading conditions which airports faced. However it is also a reflection of the reality that smaller airports are in many cases inherently unprofitable, due to their unavoidable cost structures, limited demand, vulnerability to the exercise of airline buyer power and inability to develop non aeronautical revenues.

This inherent unprofitability in combination with the important economic and social role which smaller airports play in their regions requires public funding to maintain these airports, as they fulfil a public service role which cannot be catered for by the private sector. Excluding non-operating income (where public support is accounted for) **50.9%** of European airports would be loss making. Indeed, without this non-operating income, the group of airports with less than 5 million passengers per annum would report losses as a whole. For this reason it is essential that EU state aid rules governing the availability of public funding are fully reflective of the economic reality within which these airports operate.

Graph 8
Profitability of regional airports below 5 million passengers in 2011



4.2 RETURN ON CAPITAL EMPLOYED

In 2011 a representative sample of European airports reported an average ROCE of just 4.3%.

Profitability cannot be considered purely in absolute terms. While EBITDA and net profit margins look impressive at first glance, the reality is that these figures are meaningless if not considered within the context of the significant capital investment which airports are required to make, in order to facilitate aviation activities. To give some understanding of the investment required to operate an airport, the new northwest runway which opened in October 2011 at Frankfurt Airport cost €760m to cover construction and ecological costs alone. This is completely isolated from the wider investment costs involved in landside access, terminal facilities, intermodal connections and other facilities[15].

Unlike airlines, airports generally do not have the option of leasing or selling assets. In order to secure the investment necessary to maintain and expand their businesses, airports require consistent and reasonable returns to remain sustainable, and to satisfy creditors and investors.

Given this, 'Return on Capital Employed' (ROCE) is a more appropriate and telling measure of airport profitability[16] than absolute EBITDA numbers. It measures the return that a company gets on its investment, which needs to be sufficient to cover the costs of securing capital for that investment. In 2011 a representative sample of European airports reported an average ROCE of just **4.3%**[17].

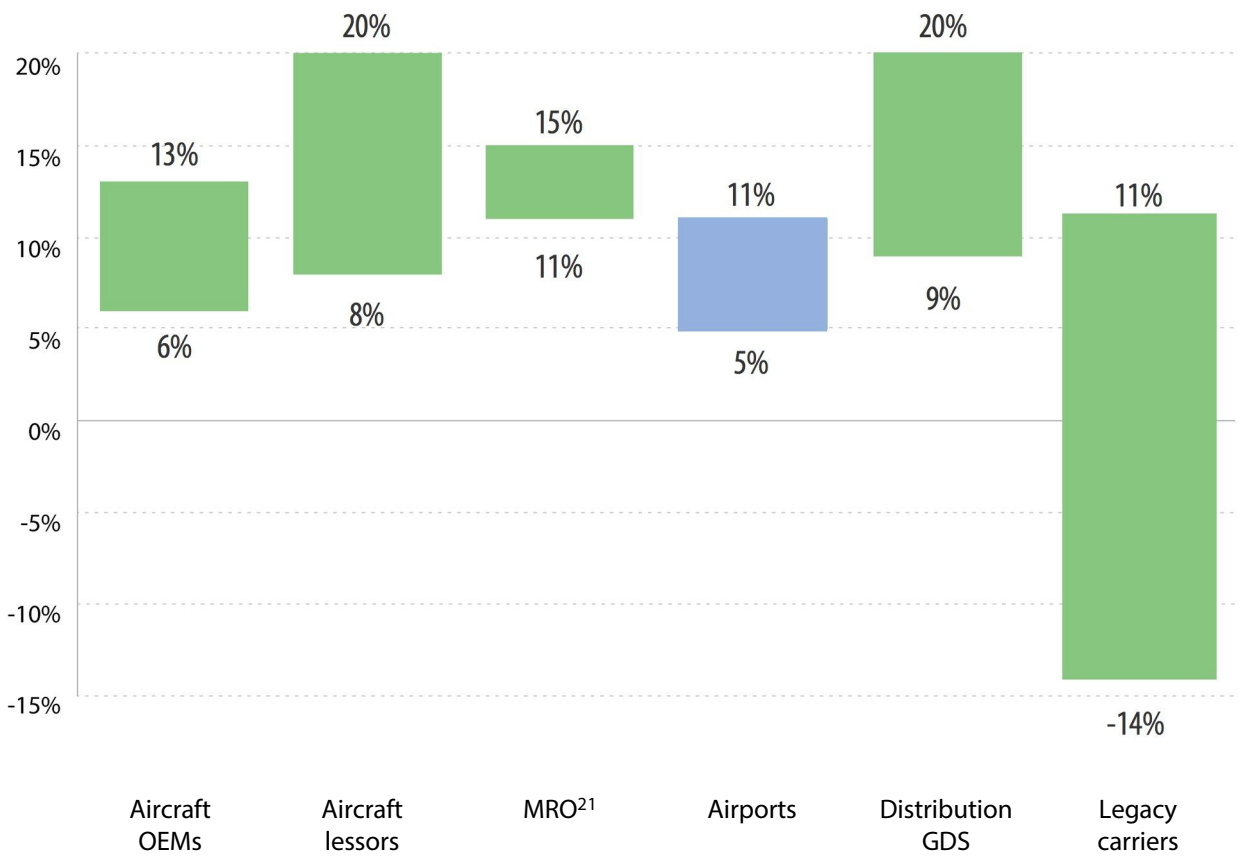
In a recent publication[18] the Association of European Airlines (AEA) implied that a ROCE of circa 7-10% was the minimum threshold for sustainability within the airline industry. For airports, economic regulators tend to allocate similar values to reflect airports' risk of investment[19], suggesting that despite positive operating margins, the industry as a whole made an economic loss (i.e. the returns on investments are not covering the associated capital costs of making those investments). This is a reality across the industry, with medium and larger airports also facing this situation.

The same AEA publication found that out of the wider aviation value chain, airports have the second worst median ROCE of all players.

[15] €7bn will be invested at Frankfurt Airport between 2007-2015.
[16] The UK Competition Commission has stated that it will normally consider profit levels, usually in terms of rates of return on capital in the market or markets concerned, as a further indicator of competitive conditions. Caution must be taken with comparison of ROCE figures as different accounting approaches can lead to different values.
[17] This compares to 2011 ROCE figures of 12.7% for easyJet, 3.3% for Lufthansa, 5.1% for IAG, -0.3% for Air France/KLM & 3.5% for IATA airlines as a group.
[18] Sustainable European Aviation, AEA & Seabury, November 2012
[19] For example, in 2008 the Civil Aviation Authority awarded to Heathrow a real pre-tax Weighted Average Cost of Capital (WACC) of 6.2% (9.2% when adjusted for inflation to be comparable with ROCE figures) and to Gatwick an equivalent WACC of 6.5% (9.5% when comparable with ROCE).

Graph 10

Typical average ROCE[20] for air transport sector according to AEA, 2004-2007 (in %)



Note: [20] Return on capital employed
[21] Maintenance, Repair, Overhaul

Source: AEA, IATA, WATS, Aerostrategy, Reuters, Airline Business, Thompson Financials, Company Annual Reports



5. OUTLOOK

ACI EUROPE expects weak passenger traffic growth +0.5% in 2013. Only very weak growth is predicted in freight traffic across 2013.

The year 2012 brought renewed retraction and damaging uncertainty to the European economy, and in particular to Eurozone economies. While Europe appears to have stepped back from the worst of the sovereign debt crisis in the second half of the year, the failure to deal with a long-festering situation in Cyprus in March 2013 dented confidence, and provided a reminder that blue skies cannot be expected anytime soon.

The outlook for the year 2013 is not positive, with considerable downside risk present. Even those observers taking the upside assumption that the worst of the Eurozone crisis is over, are forecasting a very gradual return to growth. Indeed the GDP decline of some Member States is not expected to bottom out until the second half of the year. The adjustments required of government, companies and households by austerity policies continue to dampen demand and a projected EU 27 unemployment rate of 11.1%[22] until 2014 is likely to reinforce this impact. While a political consensus seems to be emerging that austerity policies may not be sustainable, the promises of benefits associated with the resulting structural improvement in competitiveness have yet to felt by European consumers in a meaningful way.

Globally, the BRICs are no longer the force they were, and the US faces its own long struggle with austerity in the form of 'sequestration'. Oil prices, while remaining high, have declined somewhat from historic peaks in the face of this weakened global demand, but whether this will last long enough to deliver tangible benefits to the aviation industry remains to be seen.

While Europe has, as with previous years, focused on sustainable growth as the key policy priority for 2013, in practice any impact felt by the aviation industry has been limited. The continued work by the European Commission (EC) on external relations is to be welcomed. This involves extending aviation liberalisation beyond the EU, and promises to unlock significant potential growth in the medium term. However in the short term, more needs to be done to support European airports – this is especially evident when compared to the situation in non-European countries, where massive public funding of airport infrastructure is the norm rather than discouraged.

[22] European Economic Forecast Spring 2013 European Commission, March 2013

In particular there needs to be a recognition that certain airport projects cannot credibly be left entirely to the private sector, and EC State aid guidelines need to be sufficiently comprehensive to recognise this fact.

In parallel, national aviation taxes have not gone away – a particularly damaging drag on wider economic growth. A recent report[23] by Price Waterhouse Cooper showed that the abolition of the Air Passenger Duty tax in the UK would provide an initial short-term boost to the level of UK GDP of around 0.45% in the first 12 months, with an average of just under 0.3% per annum between 2013 and 2015.

Against this background, ACI EUROPE takes a cautious approach in its forecast for traffic development in 2013 – with EU passenger traffic in recession since October 2012 and no immediate recovery anticipated, ACI EUROPE expects weak passenger traffic growth of **+0.5%** in 2013. Freight traffic is of particular concern, declining by -2.8% 2012, with initial trends for 2013 not looking positive. In light of the global and European uncertainty, ACI EUROPE predicts only **very weak growth** in freight traffic across 2013.

[23] 'The Economic Impact of Air Passenger Duty – a study by PWC', February 2013

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ACI EUROPE is the European region of Airports Council International, the only worldwide professional association of airport operators. ACI EUROPE represents over 450 airports in 46 European countries. Member airports handle 90% of commercial air traffic in Europe, welcoming more than 1.5 billion passengers each year.

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EVERY FLIGHT BEGINS AT THE AIRPORT.

METHODOLOGY

The data used in the 2012 Report is based on the economic and financial results of European airports in the reporting year 2011. 213 airports responded to the survey conducted by ACI WORLD for the ACI ECONOMICS SURVEY 2011, representing 72.4% (1,362 million passengers) of total European passenger traffic. In addition, further information from different ACI EUROPE surveys supplemented the analysis in this report.

It should be noted that all data for 2011 was reported in US$, thus the comparability with previous years should be made with caution due to the on-going currency fluctuations. All data was converted into € based on the exchange rate as of 2 January 2013 (1€=1.2935 $).