AIRPORTS COUNCIL INTERNATIONAL

ACI EUROPE
ECONOMICS REPORT 2014



This report is sponsored by

VINCI AIRPORTS

VINCI Airports, an emerging leader in the international airport sector, manages the development and operations of 24 airports: 11 in France, 10 in Portugal (including the hub of Lisbon with 18 million passengers) and 3 in Cambodia. Served by over 100 airlines, VINCI Airports' network handles 47 million passengers annually in 2014, with a turnover of € 717 million. Through its expertise as a comprehensive integrator and the professionalism of its 5,250 employees, VINCI Airports develops, finances, builds and operates airports, leveraging its investment capability, international network and know-how to optimize management of existing airport infrastructure, facility extensions and new construction.

VINCI Airports, Aéroports de Paris and Astaldi, under the consortium Nuevo Pudahuel selected by the Chilean government, will take on the operation of Santiago de Chile's Arturo-Merino Benítez International Airport in October 2015, for a duration of 20 years. Arturo-Merino Benítez airport is the 6th largest airport in South America with 16.1 million passengers served in 2014, including about 50% of international passengers.

Acteur international du secteur aéroportuaire, VINCI Airports assure le développement et l'exploitation de 24 aéroports, dont 11 en France, 10 au Portugal (dont le hub de Lisbonne avec 18 millions de passagers) et 3 au Cambodge. Desservies par plus de 100 compagnies aériennes, l'ensemble des plates-formes VINCI Airports a totalisé un trafic annuel de 47 millions de passagers en 2014, avec un chiffre d'affaires de 717 millions d'euros. Grâce à son expertise d'intégrateur global, VINCI Airports, fort de ses 5 250 collaborateurs, développe, finance, construit, exploite des aéroports, et apporte sa capacité d'investissement, son réseau international et son savoir-faire dans l'optimisation de la gestion de plates-formes existantes, de projets d'extension ou de construction complète d'infrastructure aéroportuaire.

A compter du 1er octobre 2015 et pour une durée de 20 ans, VINCI Airports, Aéroports de Paris et Astaldi, réunis au sein du consortium Nuevo Pudahuel, sélectionné par le gouvernement chilien, opèreront l'aéroport international Arturo Merino Benítez de Santiago du Chili, 6ème aéroport d'Amérique du Sud avec 16,1 millions de passagers accueillis en 2014, dont près de la moitié de passagers internationaux.

www.vinci-airports.com

All photos in this report: © VINCI Airports

VINCI AIRPORTS
AT A GLANCE...

A GROUP WITH AN INTERNATIONAL DIMENSION

OVER 450 DESTINATIONS WORLDWIDE

24
AIRPORTS
WORLDWIDE



47
MILLION
PASSENGERS IN 2014

UP 9% FROM 2013

2014 TOTAL PASSENGERS PER YEAR
BY AIRPORT AND GROWTH RATE

CONTENTS

The ACI EUROPE Economics Report 2014 highlights key developments in the following main fields:

- **Traffic Development:** A continued divide between EU and non-EU airports, but with a gradually strengthening recovery for EU airports as the year progressed;
- **Aeronautical Revenue:** A small decrease in real-term per passenger aeronautical revenues across Europe, reflecting airport's reduced pricing power;
- **Non-Aeronautical Revenue:** A worrying decrease in non-aeronautical earnings, reflecting both challenging trading conditions as well as on-going structural shifts in consumer behaviour;
- **Operating Expenditure:** A continued focus on cost control with another year of decreased operating expenditure;
- **Capital Expenditure:** Growth in capital expenditure has yet to resume following the retrenchment in response to increased financing costs;
- **Capital Costs:** The reduction in capital costs is further embedded but interest expenses remain above pre-crisis levels, undermining airport operators' ability to invest.
- **Profitability:** European airports saw a healthy increase both in EBIDTA and net profits, allowing the industry to earn a reasonable return relative to the volume of investment made. This was facilitated by a reduction in operating and capital costs, and in the face of weaker revenues.



1

BUSINESS CONTEXT

As with previous years, the on-going divide between EU and non-EU economies continues to create two very different sets of trading conditions for airports within these countries. In addition, the recovery experienced by EU countries in particular throughout the year led to a demand for air services which contrasted quite starkly from that of the first half of the year.

Looking first at EU markets, 2013 was clearly a year of growth, with the EU economy ultimately recording a real GDP increase of +0.1%[1], up from an equivalent decrease of -0.4% in 2012, and following an earlier forecast by the European Commission that the area would contract mildly[2]. This emergence from recession was facilitated by the calm created after the European Central Bank's commitment *'to do whatever it takes'* which settled the markets, and allowed external trade to begin to boost national economies - paving the way for domestic demand and investment to re-emerge further down the line.

Looking at EU markets, 2013 was clearly a year of growth, with the EU economy ultimately recording a real GDP increase of +0.1%[1], up from an equivalent decrease of -0.4% in 2012.

[1] *'European Economic Forecast – Spring 2014'*, European Commission, March 2014 – available at: http://ec.europa.eu/economy_finance/publications/european_economy/2014/pdf/ee3_en.pdf.
[2] *'European Economic Forecast – Spring 2013'*, European Commission, February 2013 – available at: http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee2_en.pdf.

European air traffic passenger levels responded to the economic conditions, starting 2013 with negative growth in January, but turning positive after the first quarter, and ultimately reaching monthly growth of +5.5% by December. This led to an overall yearly increase in passenger traffic of +2.8% in 2013.

Nevertheless the recovery remained fragile, with the Netherlands, Spain and Italy all still recording decreases in real GDP in 2013, and Germany and France only achieving very weak growth. Economic sentiment recovered at a gradual pace, with continued high unemployment slowing down the return of consumer confidence in particular.

Beyond the EU, economic growth was stronger, with Russia and Turkey reporting annual real GDP increases of +1.3% and +4% respectively, while the mature European Free Trade Association[3] (EFTA) markets of Norway and Switzerland reported growth of +2% and +0.6%. However the trend was in some ways the reverse of that within the EU, with domestic demand supporting Turkish, Swiss and Norwegian growth, and Russian growth on a downward trajectory throughout 2013.

With external demand propping up EU economies in particular, and increasingly supporting EFTA economies as the year progressed, the performance of the world economy and key trading partners played an important role in European economic conditions in 2013. Stronger than expected real GDP growth in the US and Japan, of +1.9% and +1.5% respectively, helped EU exports, as did growth in the emerging economies of China (+7.7%), India (+3.9%) and Brazil (+2.3%), even if this was slower than anticipated in some cases.

European air traffic passenger levels responded to the economic conditions, starting 2013 with negative growth in January, but turning positive after the first quarter, and ultimately reaching monthly growth of +5.5% by December. This led to an overall yearly increase in passenger traffic of +2.8% in 2013. Passenger growth also mirrored economic trends within the EU and non-EU markets, with passenger numbers surging through the year at EU airports, while staying strong but broadly flat at their non-EU counterparts. Passenger traffic was generally equally strong against airports of all size, in part reflecting a general recovery, but also reflecting steeper earlier declines in traffic at the smaller airports in particular.

Table 1
Passenger Traffic Developments in 2013, by Airport Category

Group 1 over 25 mppa	**Group 2** 10-25 mppa	**Group 3** 5-10 mppa	**Group 4** less than 5 mppa
+2.6%	+3.4%	+2.8%	+2.9%

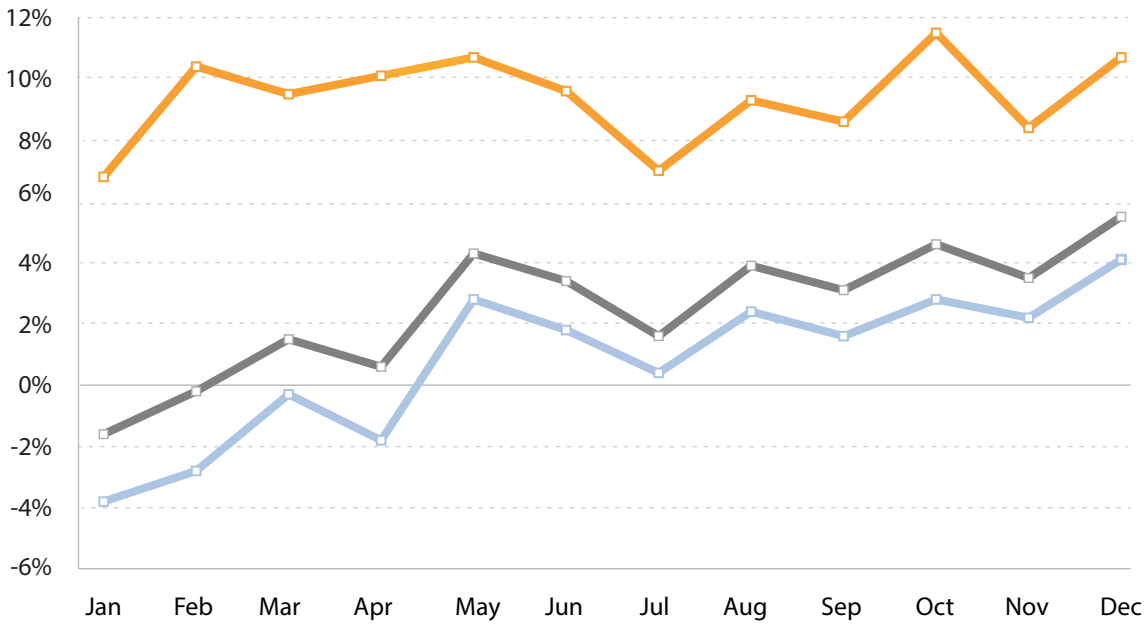
While the link between passenger traffic growth and underlying economic conditions remains a close one, there were some specificities which came into play.

[3] Comprised of Norway, Iceland, Switzerland and Liechtenstein.

Legacy airlines in particular were very cautious in their deployment of capacity, with IAG, Air France-KLM and Lufthansa decreasing their medium/short haul capacity by -1.9%, -2.1% and -2.6% respectively in 2013[4]. This was part of a longer-term trend whereby many airlines avoid competing on capacity, and instead focused on raising their yields in core markets. This retrenchment by the legacy airlines to trunk routes and primary cities has limited growth potential at regional airports in particular. Indeed, much of the growth in 2013 came not from European legacy carriers but from low cost carriers as well as Turkish and Gulf airlines.

While passenger traffic grew by +2.8%, aircraft movements actually declined by -1.2% in 2013, resulting in less aircraft packed with more passengers, and subsequently leading to an +4% increase in the average number of passengers per flight.

Graph 1
EU/Non-EU Airports Passenger Traffic Developments, 2013



This European airline behaviour had implications for Europe's connectivity – European direct connectivity actually declined in 2013, with the Middle East and Africa being the only world regions with which Europe improved direct connectivity. Connectivity within Europe declined in terms of direct, indirect, total and hub connectivity.

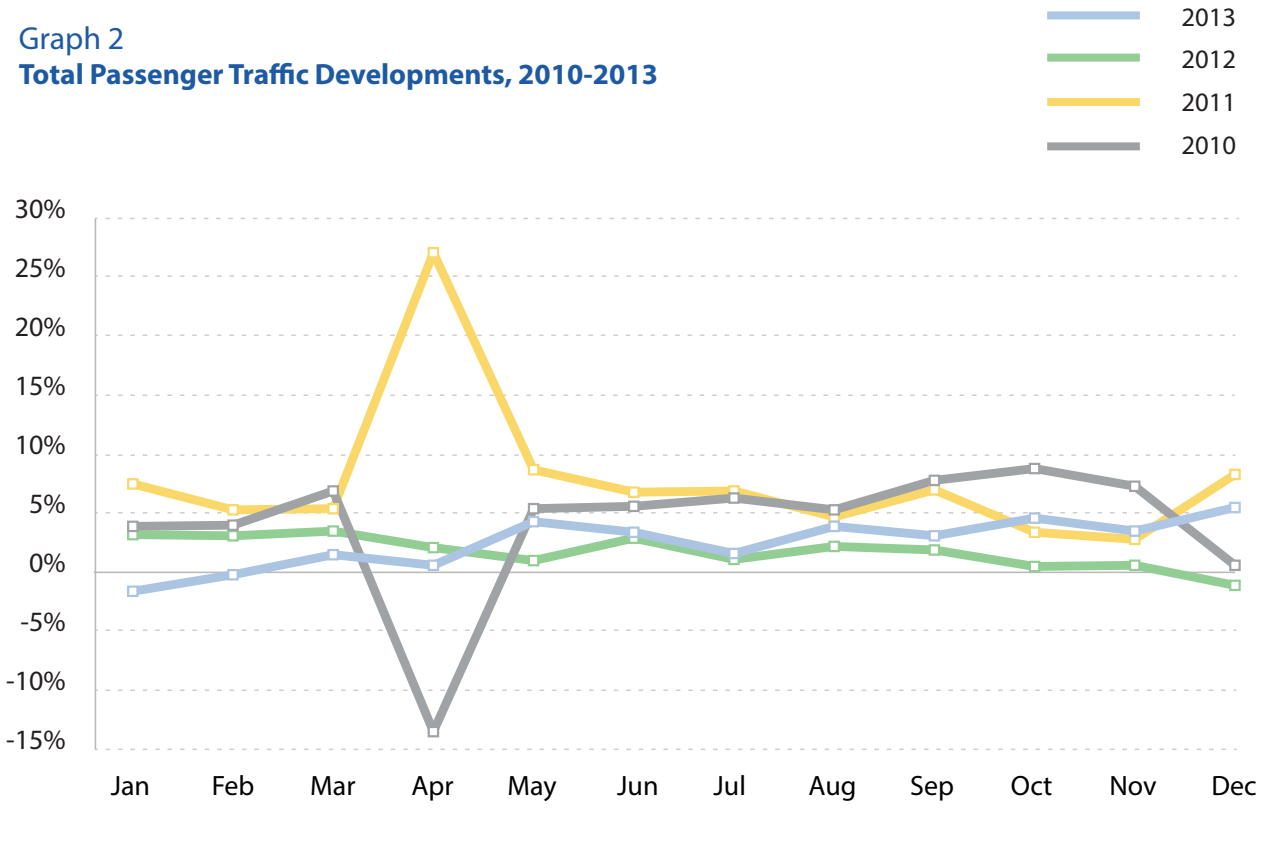
[4] *'State of the Airport Industry'* presentation, Olivier Jankovec, ACI EUROPE, April 2013 – available at https://prezi.com/o1yzlswauv43/final-state-of-the-industry-aci-europe-airport-trading-conference-exhibition-in-hamburg-23-april-2013/.

However the moves had positive financial implications for the airline industry, with European legacy carrier's average share price rising by 48% across the year[5]. In parallel low cost carriers continued to perform well, with end-of-year closing price up 31%, 93% and 19% on opening prices in January, for Ryanair, easyJet and Norwegian Air Shuttle respectively[6].

Table 2
European Airport Connectivity, 2013 versus 2012

	Airport Connectivity	Direct Connectivity	Indirect Connectivity
EU	-0.5%	-2.6%	+0.5%
Non-EU	+5.5%	+5.8%	+5.3%
Overall Europe	+0.6%	-0.8%	+1.4%

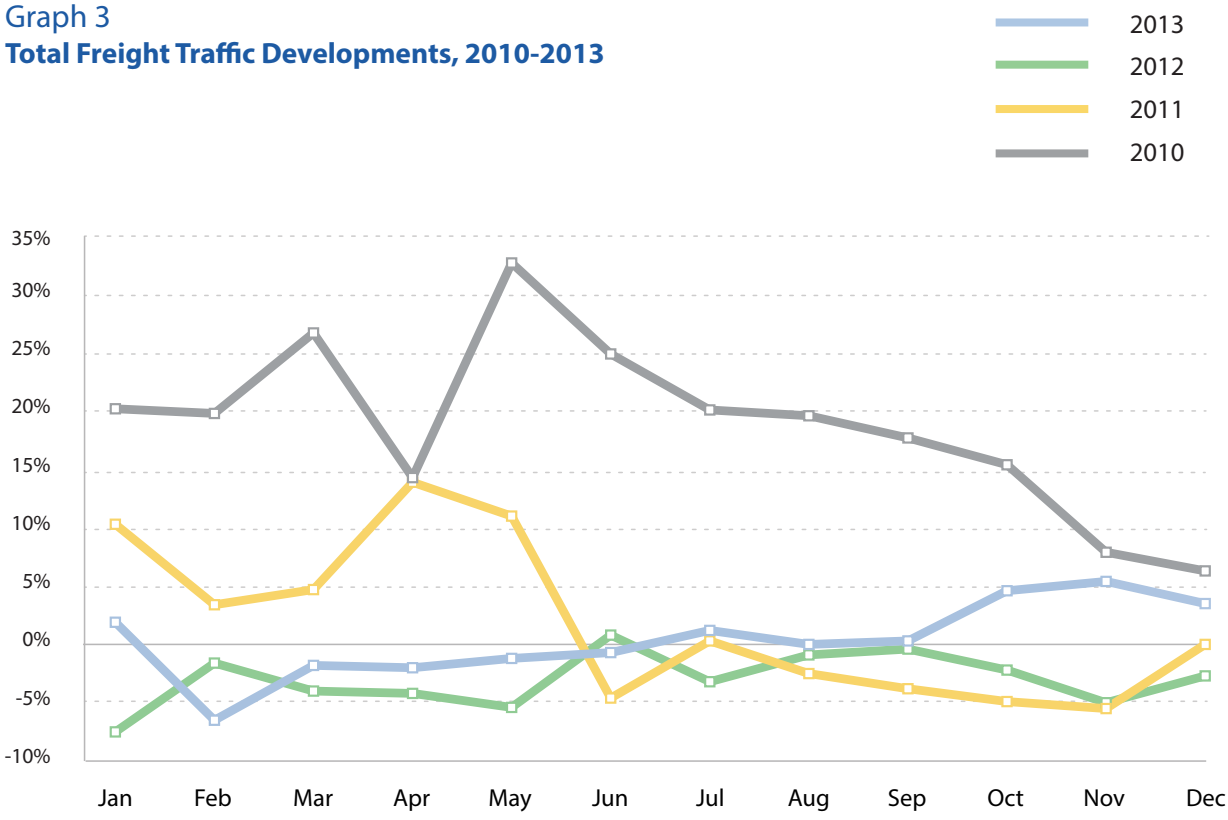
Graph 2
Total Passenger Traffic Developments, 2010-2013



[5] *'Airline Financial Monitor – November-December 2013',* IATA – available at: http://www.iata.org/what-wedo/Documents/economics/Airlines-Financial-Monitor-Dec-13.pdf.
[6] According to Ryanair share price tracker – available at: http://investor.ryanair.com/share-price/.

Freight growth was weak through the year, delivering an overall annual increase of only +0.8%. The trend in freight followed that of passenger growth, albeit on a more subdued scale, with negative growth recorded in the first half of the year, and stronger growth only really arriving in the final months of 2013. However this was a marked improvement on the previous year, where overall freight declined by -2.8% in 2012, and represents a return to growth after a decline which began as far back as the first half of 2010. The trends largely reflect broader macro-economic forces, with a slow and fragile recovery of consumer confidence after the emergence of renewed crisis in early 2011. However this trend also reflects structural change in the market, with air freight coming under pressure from a glut of cargo shipping capacity, and a shift away from just-in-time production following the Japanese earthquake, tsunami and subsequent Fukushima meltdown.

Graph 3
Total Freight Traffic Developments, 2010-2013



2014 saw the positive trends solidify further, in spite of continued Eurozone uncertainty and an economic recovery which could best be described as tepid. Air passenger traffic outpaced economic growth, with an overall increase of +5.4%, comprised of +4.9% growth in the EU and +7.3% within non-EU countries. This strong EU performance was particularly noteworthy, given the maturity of the market and the much-discussed structural weaknesses of the Eurozone in particular.

Encouragingly, aircraft movements rose by +2.6% which translated into an increase in European Airport Connectivity of +3%.

Finally, freight traffic rose by a healthier +3.6%, with similar performances between EU and non-EU airports.



2

AIRPORT REVENUES

2.1. TOTAL REVENUES

European airports generated overall revenues of €36.4 billion in 2013, representing a decrease of -3.9% in real per passenger terms on 2012. This followed an equivalent decrease of -1.1% in the previous year. This meant that after inflation is accounted for, European airports only generated an additional +0.3% in total revenues from each passenger, compared to 2008 levels.

This decline was felt across Europe, with the inter-related trends of higher competitive pressures and weaker demand in the first half of the year working together to supress revenues across both the aeronautical and the non-aeronautical strands of the business. In addition airport charges at larger airports were likely to be set in the first half of the year, and may not have taken into account the more positive business climate that subsequently prevailed in the second half of the year.

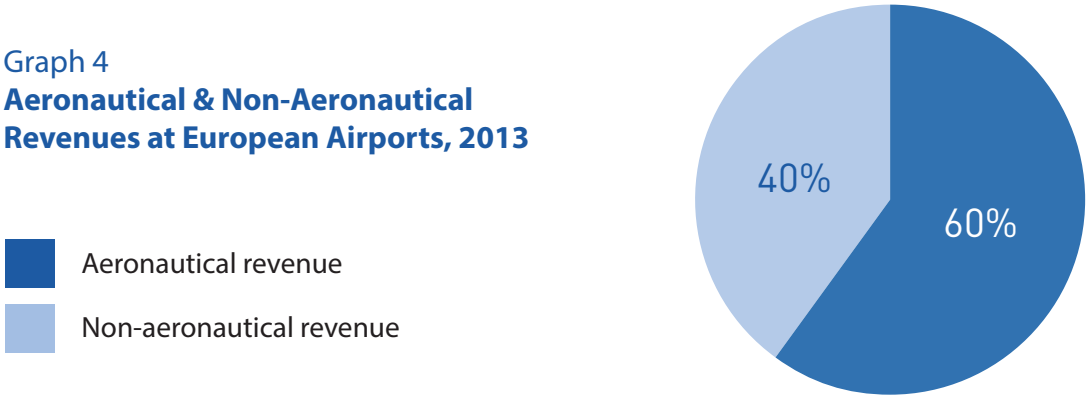
European airports generated overall revenues of €36.4 billion in 2013, representing a decrease of -3.9% in real per passenger terms on 2012.

Table 3
Distribution of Total Revenues at European Airports, 2013 (€ billion)

TOTAL REVENUES	36.4	100%	excl GH
AERONAUTICAL REVENUE	17.5	48%	60%
NON-AERONAUTICAL REVENUE[7]	11.5	32%	40%
GROUND-HANDLING REVENUE	1.8	5%	
OTHER[8]	5.6	15%	

Looking at the distribution of revenues at European airports, and stripping away ground handling and 'other' revenues, it becomes clear that the core aviation business is heavily supported by non-aeronautical activities, such as car parking and retail. These account for 40% of revenues, allowing a significant subsidisation of the prices passengers and airlines pay for the use of airport facilities and services. This is broadly in line with results in recent years, and can be a considered a structural feature of the European aviation industry.

Graph 4
Aeronautical & Non-Aeronautical Revenues at European Airports, 2013



2.2. AERONAUTICAL REVENUES

Aeronautical revenues are earned primarily from charges for use of the runway, aircraft parking and terminal facilities, paid by the passenger and airlines. In 2013 European airports recorded aeronautical revenues of just under €17.5 billion, representing a decrease of -0.8% in real per passenger terms. This followed an equivalent decrease of -0.3% the previous year. Within this there was some divergence, with EU airports reporting an increase in aeronautical

[7] Including non-operating income.
[8] E.g. Terminal Navigation Charge (if applicable), facility management, special guest services, other operating income.

revenues and non-EU airports recording a substantial decrease. Aggregate figures within the EU were impacted in part by increases at Italian airports, where regulatory developments finally allowed an upward adjustment in the level of airport charges, following many years of price freezes. This steadily eroded the ability of these airports to operate to a sufficient level of quality, and to invest in future facilities.

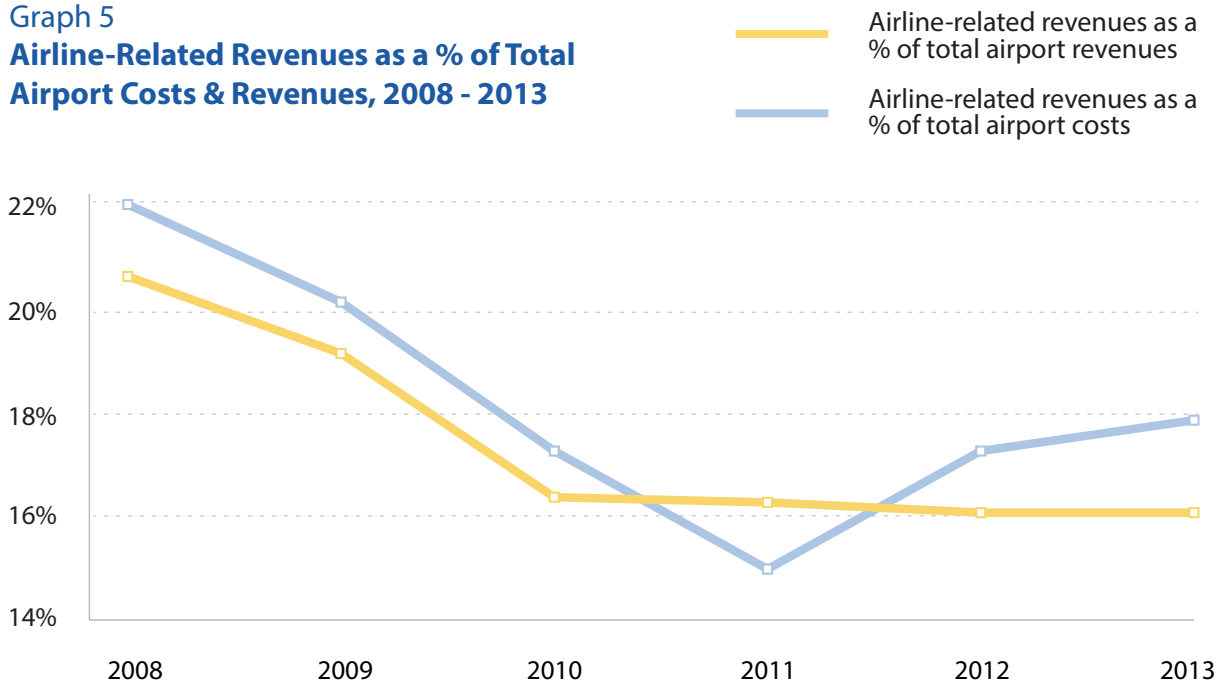
Weak demand and tougher competitive pressures, in conjunction with more extensive and innovative discounts on charges, has meant that per unit airport aeronautical revenue generation has been negative or stagnant in real terms over the previous years. As a result, aeronautical revenues were still -1.1% below 2008 equivalent levels, 5 years after the crisis first broke.

Within aeronautical revenues, only a part of these are actually paid by the airline. This sub-component comes from airline-related charges, which airlines pay for use of the runway, the parking of the aircraft, and other aircraft-related infrastructure at the airport. In recent years there has been a shift away from these charges in favour of passenger charges, which although collected via the airline are actually paid by the passenger to the airport, primarily for use of the airport terminal. In recent years some airlines have strongly favoured a shift towards lower airline-related charges and correspondingly higher passenger-related charges. As a result of this, in conjunction with wider downward pressure on airport charges overall, airlines now only contribute only 16% of total European airport revenues. Pre-crisis, this figure was 21%. To fund necessary infrastructure and services of sufficient quality, airports have increasingly turned towards the passenger and commercial activities as sources of revenues. This trend seems to have reached the limits of sustainability, with no significant changes in recent year being observed. It remains to be seen whether it is really feasible for airlines to make such a small direct contribution towards the upkeep and maintenance of facilities which they use so intensively.

Weak demand and tougher competitive pressures, in conjunction with more extensive and innovative discounts on charges, has meant that per unit airport aeronautical revenue generation has been negative or stagnant in real terms over the previous years.

Graph 5

Airline-Related Revenues as a % of Total Airport Costs & Revenues, 2008 - 2013



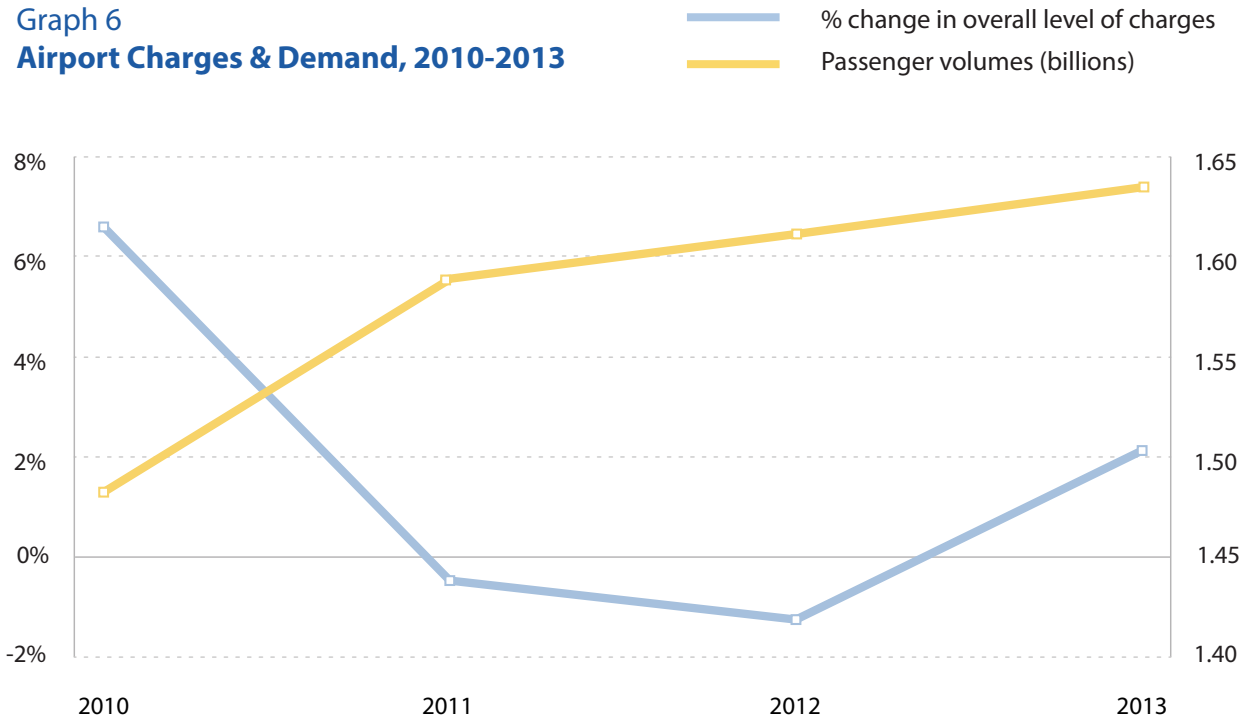
In the context of passenger-related charges, the issue of airlines refunding taxes and airport charges to passengers who do not take their flight is of increasing importance. This is particularly the case in light of the increased pressure on some airports to increase the passenger-related charge as a means of reducing airline-related charges.

Air fares have in recent years been made less transparent and less readily-understandable by the addition of a range of extra but non-avoidable fees, for fuel, taxes and a range of other miscellaneous 'charges'. The components of these often remain unidentified, but they generally are declared to include airport charges. This lack of price transparency blunts inter-airline competition, but does mean that the passenger is entitled to a refund of these additional charges, if they do not fly. In practice, it can prove extremely difficult for the passenger to secure what is rightfully theirs. Long waiting periods on the phone, unnecessarily cumbersome administrative requirements and 'processing fees' all work to ensure that the passenger rarely sees their refund. It has been estimated that European airlines benefit by up to €3.5 billion each year in this manner[9].

2.3. AIRPORT CHARGES

In 2013 European airport operators increased headline airport charges by an average of +2.1% after inflation. This followed 2 years of successive real term decreases (-0.5% in 2011 & -1.25% in 2012) and can be considered as an adjustment towards a more realistic and sustainable level of pricing after several years of retrenchment post-crisis.

Graph 6
Airport Charges & Demand, 2010-2013



[9] Estimated according to 'Airtaxback' – methodological approach available at: http://www.airtaxback.com/FAQs.

Indeed, the adjustment was minimal. Although 82% of airports increased charges, the majority of these did so by less than national levels of inflation.

It should also be noted that the European averages are in part impacted by the introduction of a new regulatory framework at Italian airports, after 10 years of inertia in which charges were frozen, and effectively decreasing in real terms. This represented therefore a return to a more commercially-sustainable level of pricing at the affected airports.

It is worth noting that while headline airport charges increased, the resulting aeronautical revenues actually declined for airports. This reflects 2 key trends. Firstly airlines are using airport facilities more efficiently, via more passengers per movement and are subsequently being rewarded via lower airport charges bills. Secondly, and most importantly, the headline level of airport charges is becoming increasingly irrelevant, as airports and airlines work on ever-more generous and innovative incentive schemes. Typically such initiatives allow airlines to benefit from lower airport charges, in return for the delivery of, or the commitment to deliver, specific numbers of passengers or additional connectivity to the airport.

Typically these discounts are applied via 2 approaches:

- Formal, open-to-all incentive schemes: Such schemes are essentially extensions to the standard one-size-fits-all approach to airport charges, where a common 'menu' of charges is offered to all airlines, irrespective of size, growth prospects or business models. Such incentive schemes typically reward airlines for delivering specific passenger numbers, or specific increases in passenger numbers, as well as the commencement of new routes and/or services. These are more common where airlines' and airports' ability to negotiate is constrained by more intrusive economic regulatory regimes.

- Bilateral commercial contracts: Such arrangements are individually-negotiated deals between an airport and an individual airline. They are typically commercially sensitive, and therefore confidential, as they reflect the future business plans of the airline in question. Although driven by the same market forces as those that drive the establishment of formal schemes, commercial contracts are both more flexible and more tailored to individual circumstances. They are therefore likely to be more efficient in terms of encouraging growth and optimal use of airport facilities. To date such negotiated approaches are not explicitly facilitated by regulatory frameworks in many jurisdictions, in spite of the substantial benefits. This means that such arrangements are less prevalent at larger airports, compared to formal incentive schemes.

The discounts offered to airlines are substantial. Overall figures can be difficult to source, but the 2014 ACI EUROPE Airport Charges Survey found that 84% of European airports offer some form of discount to airlines, either via formal incentive schemes or commercial contracts. Typical discounts on headline airport charges within formal incentive schemes amounted to -18.7%. Various criteria for discounts, existed, with most relating to the achievement of traffic growth targets.

The 2014 ACI EUROPE Airport Charges Survey found that 84% of European airports offer some form of discount to airlines, either via formal incentive schemes or commercial contracts. Typical discounts on headline airport charges within formal incentive schemes amounted to -18.7%.

Revenues collected by European airports from ground handling activities declined again in 2013, to €1.8 billion, representing a -7.9% in real per passenger terms. This follows an equivalent decline in the previous year.

Whether headline levels of airport charges continue to decline in importance relative to what airlines are actually paying will depend on regulators taking a more progressive approach and facilitating airports in their efforts to offer innovative and growth-inducing offers. It will also depend upon the willingness of airlines to genuinely engage with airports in their efforts, and to grow and make commitments to use spare airport capacity.

Finally, cargo charges in 2013 decreased by -4.2% in real per-unit terms. However cargo charges are already very low – European airports only collected a total €136.9 million in cargo revenues. This is in spite of the fact that these airports handle 22.4% of the value of all extra-EU trade, worth €779.2 billion, through their facilities each year[10].

2.4. GROUND HANDLING REVENUES

Revenues collected by European airports from ground handling activities declined again in 2013, to €1.8 billion, representing a -7.9% in real per passenger terms. This follows an equivalent decline in the previous year.

Few large European airports are now engaged in ground handling activities. Those smaller airports which are still providing such services are in many cases forced to, as their lack of scale makes them unattractive to third party independent handlers. In the absence of handling these airports would not be able to accommodate commercial air services, and as a result ground handling is a loss-making activity for most of these airports.

Following the liberalisation of the European ground handling market in the 1990s, airport participation has shrunk significantly. Airlines, who had previously dominated the market, also saw their position retreat. The space has been filled by independent third party handlers, who – unlike airport handling companies – have been able benefit from significant economies of scale due to their pan-European network. These networks have also enabled them to sign multi-airport contracts – a very attractive proposition for airlines. This effect has only been further magnified by consolidation within the industry in recent years.



[10] *'EU Transport in Figures – Statistical Pocketbook 2014',* European Commission, 2014, page 29 – available at: http://ec.europa.eu/transport/facts-fundings/statistics/doc/2014/pocketbook2014.pdf.

2.5. NON-AERONAUTICAL REVENUES

In 2013 European airports reported a significant real-term decrease in non-aeronautical revenues of -9.9% on a per passenger basis, earning a total of just over €11.5 billion. This followed an equivalent decrease of -1.7% in the preceding year.

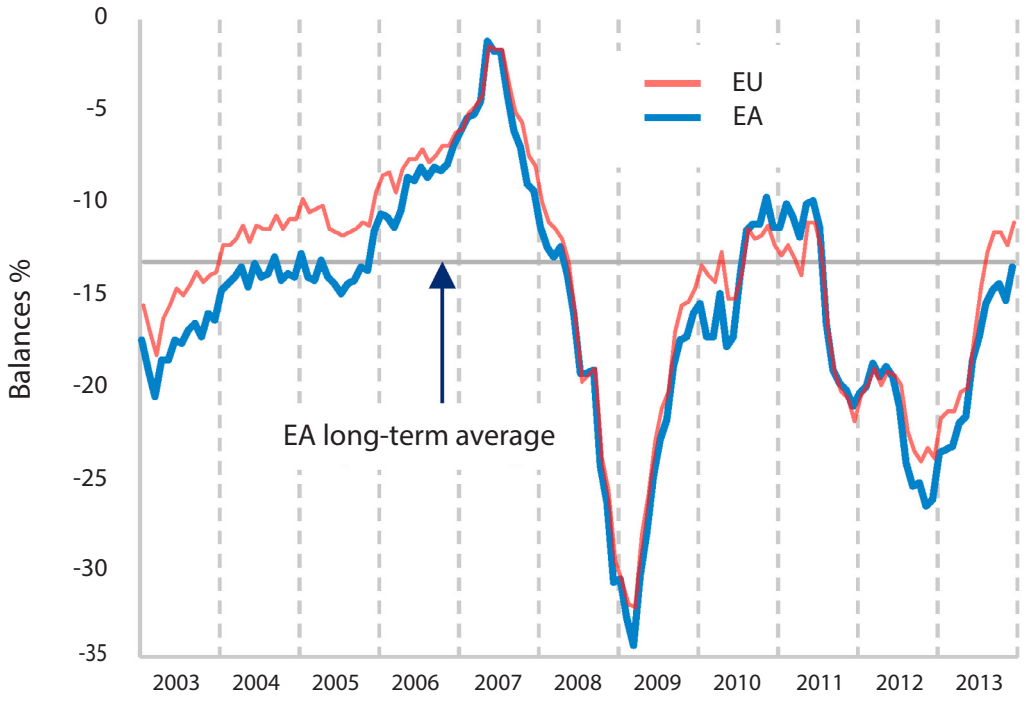
Non-aeronautical activities are crucial for airports to finance the on-going operating and expansion of the airport. Also known as 'commercial activities', these include areas such as retail, car parking, advertising and property rental income. The associated revenues compensate for the limited aeronautical income which does not come close to covering the associated operating costs alone, to say nothing of capital costs.

The decrease in per passenger revenues stemmed from three key factors – two concerning macroeconomic climate and one of a more structural nature, within the European aviation sector.

- **Weaker consumer sentiment**

  While economic performance steadily improved across Europe throughout 2013, this took time to gather speed and to pass on to household spending. This limited not only consumer's propensity to fly, but also their willingness to spend once they arrived at the airport.

Graph 7
EU & Eurozone Consumer Confidence, 2003-2013[11]



[11] *'Business & Consumer Survey Results'* European Commission, December 2013, Graph 4 – available at: http://ec.europa.eu/economy_finance/db_indicators/surveys/documents/2013/esi_2013_12_en.pdf.

Consumer confidence across the EU - but particularly within eurozone economies - entered 2013 at very low values. This reflected uncertainty over employment prospects, as well as lower disposable income and significant debts within many households across the continent.

As can clearly be seen from Graph 7, consumer confidence across the EU - but particularly within eurozone economies (EA) - entered 2013 at very low values. This reflected uncertainty over employment prospects, as well as lower disposable income and significant debts within many households across the continent. While confidence improved quite substantially across the year, the initial low levels meant that by the end of the year, consumer sentiment had only just reached its long-term average.

As many airport purchases are discretionary and belonging to upmarket categories, sales would tend to be more than proportionately affected by a wider slow-down in consumption more generally.

- **A Stronger Euro**

  As the economic environment strengthened in 2013, so too did the value of the euro. After several years of weakening as the European debt-crisis mounted, the euro rallied following the ECB's commitment *'to do whatever it takes',* and by December 2013 the euro was +4.9% above the level that it had been a year prior[12].

  A stronger euro makes visits to the area less attractive, and goods sold within the area relatively more expensive, for visitors from other countries. Given that the travel retail by its nature has a large proportion of non-EU passengers, and that they are more inclined to shop given duty-free arrangements, currency fluctuations can have a significant impact on airport revenues.

- **Structural Changes in the Non-Aeronautical Business**

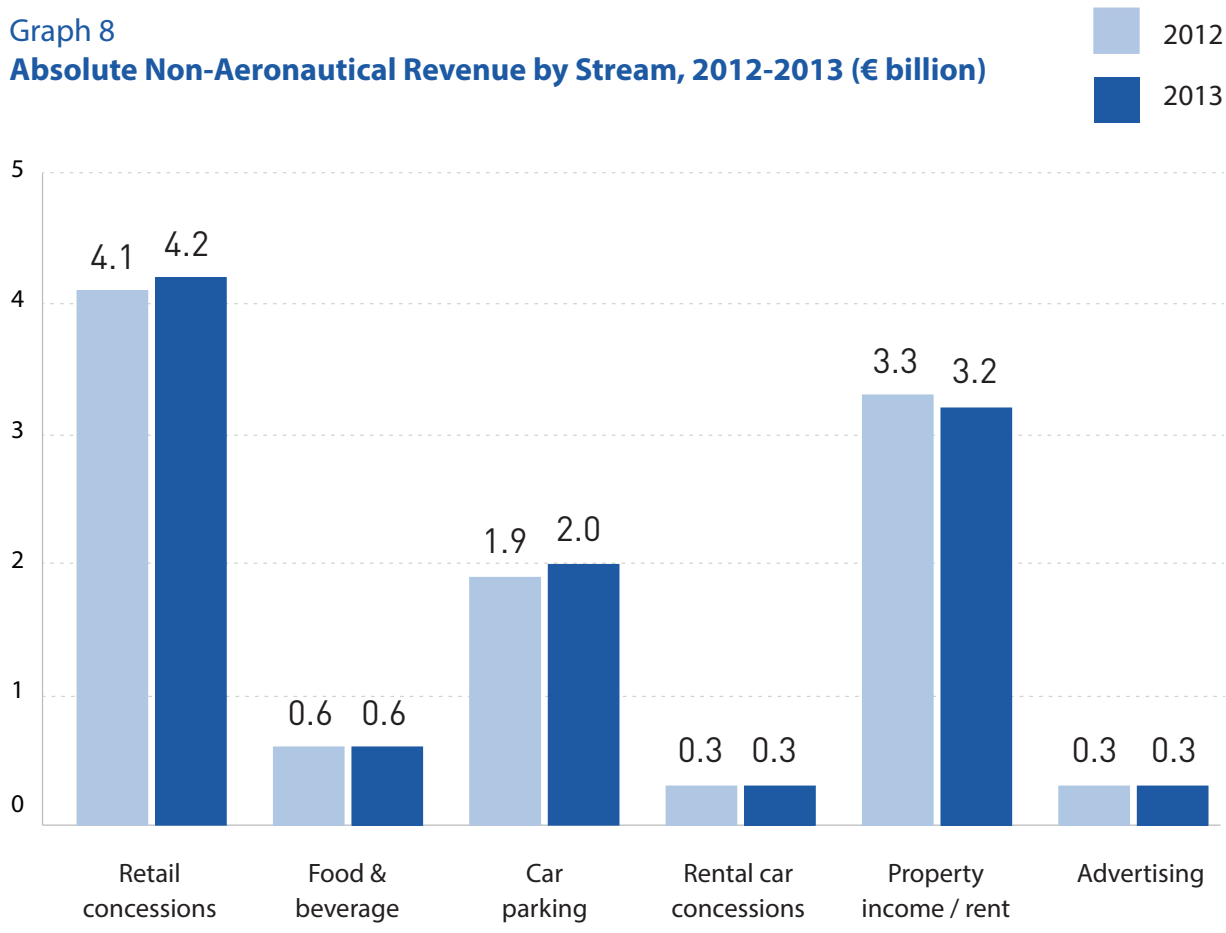
  While non-aeronautical activities were once considered as 'easy money' for the airport business, market maturity, shifts in consumer patterns and competition from new digital channels have all contributed to a reality which is today very far from these earlier conceptions.

  Car parking and car rental concessions, while still a core revenue stream for airports, can no longer be taken for granted as a consistent source of business. Real per-passenger revenues from each fell by -3.6% and -4.2% in 2013 alone. Compared to 2008 levels, revenues are down -14% and -25.1%, respectively.

[12] *'Monthly Bulletin December'* European Central Bank, 2013, page 21 – available at: https://www.ecb.europa.eu/pub/pdf/mobu/mb201312en.pdf p.21.

Graph 8

Absolute Non-Aeronautical Revenue by Stream, 2012-2013 (€ billion)



Despite the modernisation of this activity, with airports outsourcing and introducing innovations such as dynamic pricing, online sales and airline-partnership, car parking revenues in particular have continued to decline. This reflects tough competition from off-site car parks operated by 3rd parties and continued improvement in public service access to airports. In the future, new technologies such as ride- and car-sharing services may further erode revenues from this segment.

Advertising income has also declined, by -10.4% in 2013, and by a massive -35.4% since 2008. Advertising activities are often disproportionately impacted during times of low economic sentiment. However, it may be that the democratisation of air travel has resulted in a passenger demographic which is not quite as valuable to advertisers as it once was. This is another area where no amount of airport operator innovation and fresh thinking will fully compensate for structural changes in the market.

As a result of these declines, recent years have seen revenues from retail concessions and food and beverage steadily taking a higher proportion of overall airport non-aeronautical revenues –up to 46% in 2013. However, in these areas airports also face challenges, both new and existing, with only food & beverage managing to hold per passenger revenues steady in 2013. In comparison revenues from retail concessions decreased by -0.9% in 2013.

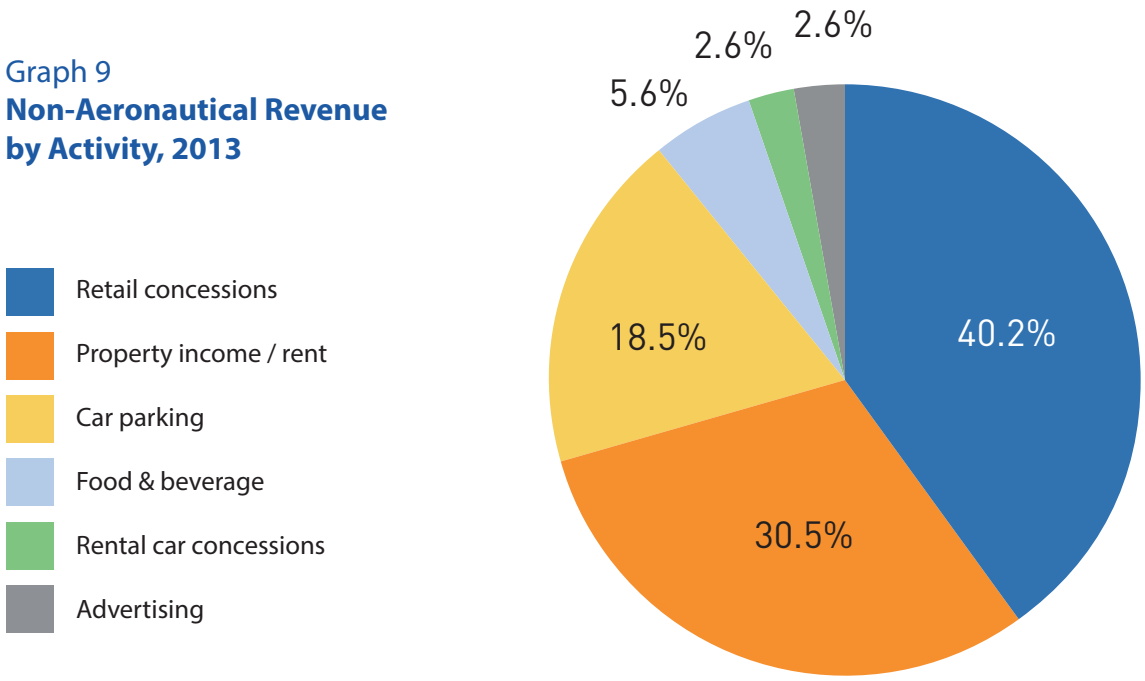
For airports and retailers, it is increasingly difficult to convey a sense of occasion, or a 'wow-factor' which would otherwise encourage more discretionary spending.

The democratisation of air travel has not only widened the range of demographic groups which pass through airports – it has also increased the number of repeat passengers. For airports and retailers, it is increasingly difficult to convey a sense of occasion, or a 'wow-factor' which would otherwise encourage more discretionary spending. This normalisation of air travel means that airports now face competition not only from other airports, but also from the high street and digital channels. Passengers are increasingly willing to use their time in the airport to browse, but then to complete the transaction at their destination, or after they have returned home.

This is just one element of a wider trend which is only set to grow– airport retailing operations are increasingly competing against online sources, with passengers in some cases actually making online purchases on their mobile devise, in the airport shops, after having selected their product from the airport's range. Indeed airports are in some way facilitating this trend, as wider inter-airport competition has required operators to introduce free wifi at many airports across Europe.

Airports also face challenges within the wider aviation sector, both commercial and regulatory. While restrictive baggage allowances by some airlines – who compete against airports for retail sales – have declined, they have not entirely gone away, and in the absence of legal protection for passengers, can be introduced again at any moment. Such practices, as well as causing passenger anxiety, can dramatically impact sales at the airport, with the resulting passenger uncertainty hitting sales even at airports where these punitive restrictions are not in place.

Graph 9
Non-Aeronautical Revenue by Activity, 2013





3

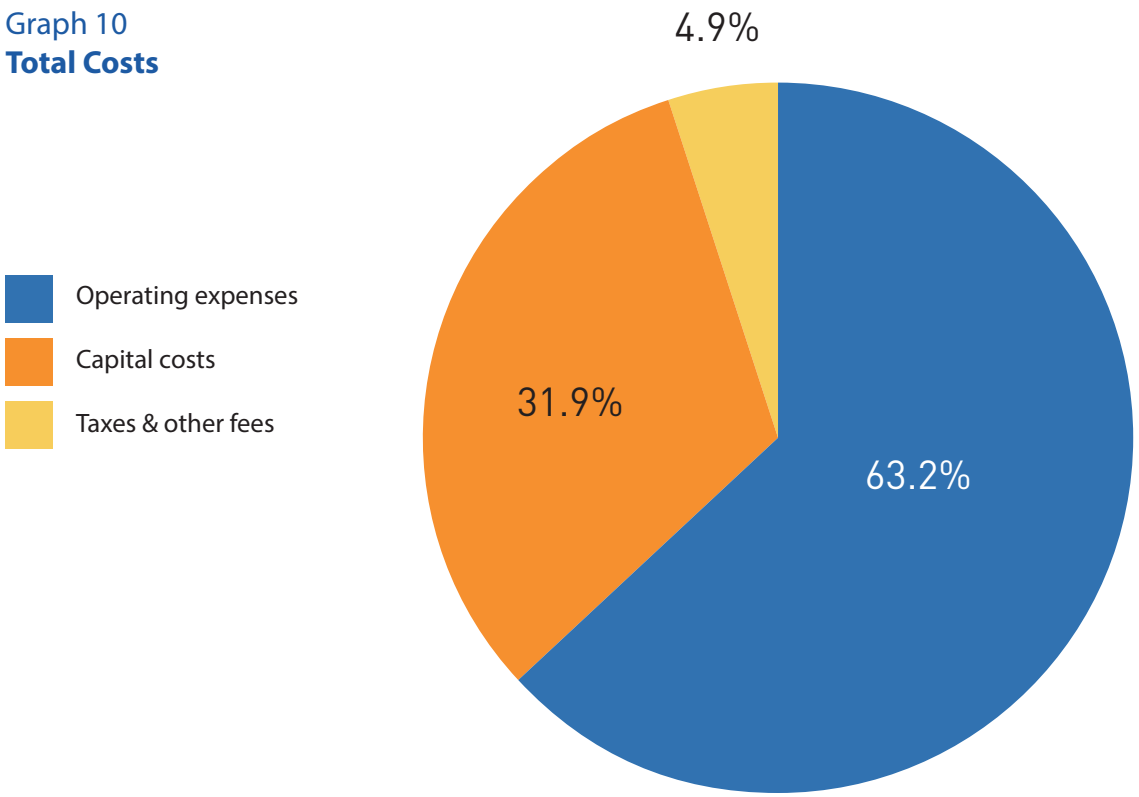
AIRPORT COSTS

3.1. TOTAL COSTS

European airports reduced overall costs to €32.7 billion in 2013, representing a decrease of -6.9% in real per passenger terms on 2012. The reduction was broadly equivalent across capital and operating costs, although this was partially offset by a significant increase in taxes paid. Both EU and non-EU experienced major cost reductions; though this was particularly the case for the latter, as healthy traffic growth allowed a reduction in per-unit costs.

European airports reduced overall costs to €32.7 billion in 2013, representing a decrease of -6.9% in real per passenger terms on 2012.

Graph 10
Total Costs



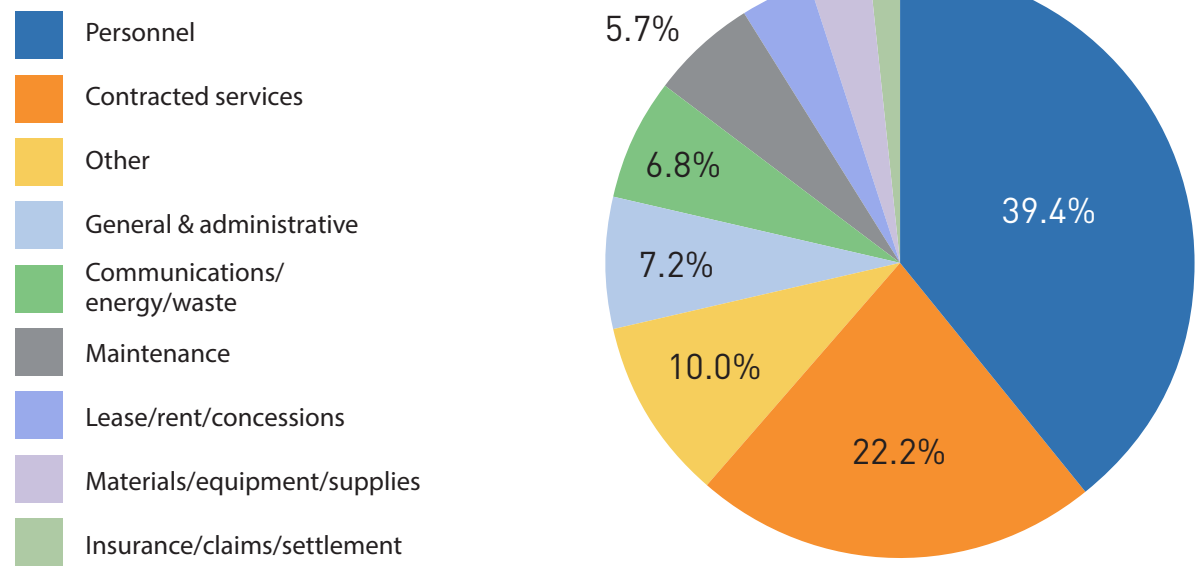
3.2. OPERATING COSTS

Operating costs reduced by an impressive -7.5% in real per passenger terms, with European airports incurring operating expenses of €20.7 billion in 2013. As with total costs, this was particularly pronounced at non-EU airports. This was a significant decrease, particularly in light of the decreases and stable operating costs in recent years. With 2013 operating expenses now -13.9% lower than 2008 levels, further decreases in operating expenses will only become more challenging.

It is also an impressive result in light of the significant volume of regulatory-related costs that airports incur, in areas such as safety and security, which often cannot be avoided or meaningfully reduced. In particular some of these costs, such as with passenger screening, are linked to traffic volumes, and so do not readily lend themselves to savings associated with economies of scale.

Competitive pressures continue to ensure that European airports maintain a close focus on controlling costs, where they are in a position to do so. This is in spite of a return of healthier demand, and an improvement in the trading environment since the immediate crisis years, which triggered substantial cost reduction efforts.

Graph 11
Operating Cost Structure, 2013



This cost discipline is increasingly becoming engrained into the organisational structures and cultures of airport operators via specific performance management techniques.

A recent analysis of airport performance management by ACI EUROPE[13] found that while European airports had embraced a wide range of different approaches to performance management, reflecting their own individual business environment, the core competencies of planning, target setting, and performance measurement were well established across the continent. For example, practically all airports reported that they had some form of benchmarking (internal, external or both) in place.

Such approaches which consider the broader performance of the airport help ensure that these cost control measures have to date not come at the expense of the passenger experience. European airports have seen their average passenger satisfaction increase by 5% between 2008 and 2014 inclusive[14]. With some variation, this trend was generally observed across all measures of passenger satisfaction, as well as within all categories of airports sizes.

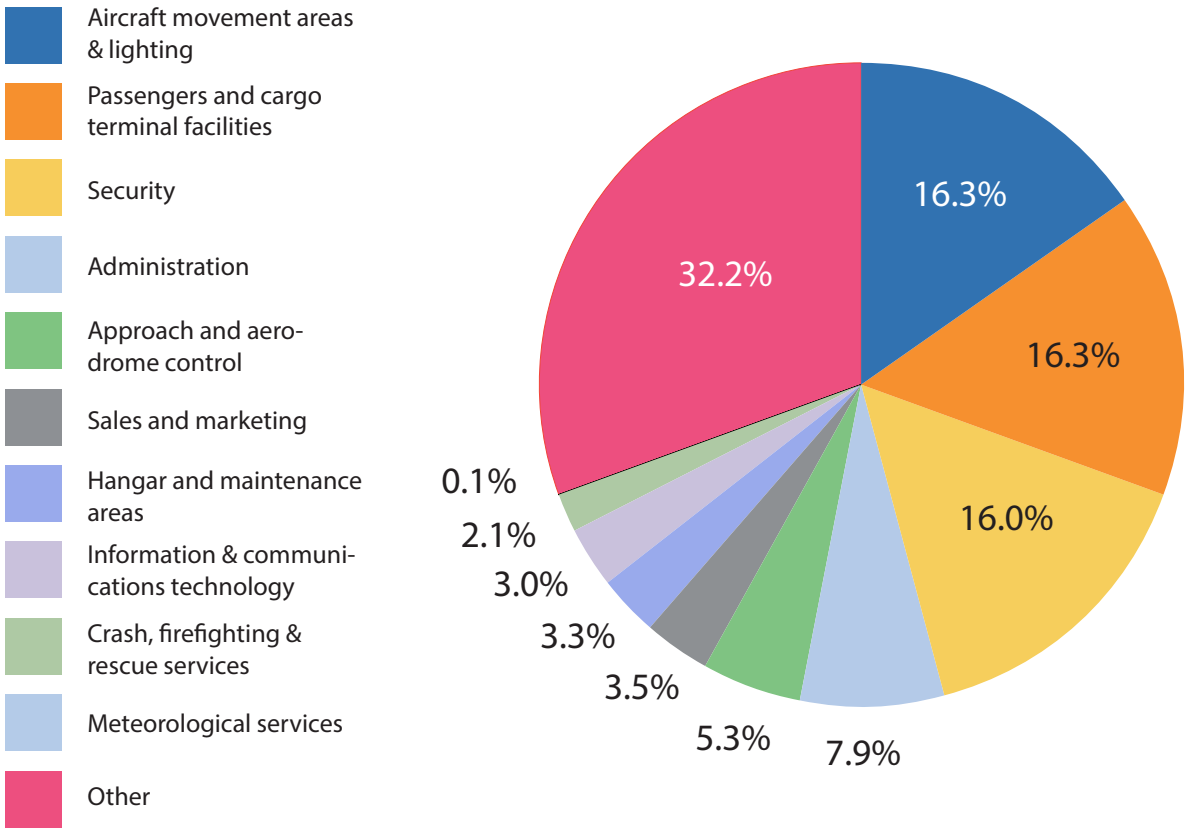
New digital tools are being embraced, with airports welcoming 80% of European passenger traffic offering some form of free wifi. Similarly 73% of passengers are going through an airport which is covered by an official branded smartphone App[15]. The industry has also recently released new Passenger Facilitation Guidelines[16], offering a holistic approach to passenger services at airports and reflecting the industry's transformation to a B-to-C focus.

---

[13] *'Performance Management at European Airports',* ACI EUROPE, February 2015 – available at: https://www.aci-europe.org/component/downloads/downloads/4204.html.
[14] Based on a sample of 43 European airports which participated in the Airport Service Quality programme consistently between 2008-2014. Passengers at participating airports provided their feedback via a standardised questionnaire on 8 elements of the passenger experience, such as 'Overall Satisfaction', 'Courtesy & Helpfulness of Airport Staff' and 'Cleanliness of Airport Terminal'.
[15] *'ACI EUROPE Digital Report 2014-2015'* ACI EUROPE, December 2014 – available at: https://www.aci-europe.org/component/downloads/downloads/4134.html.

However as with any product or service, the inherent trade-off between cost and quality can never be sidestepped indefinitely. With the low-hanging fruit already plucked, if airlines wish to see continued improvements in future it will be incumbent upon them to give a clearer articulation as to what combination of cost and quality they wish to see.

Graph 12
Functional Operating Cost Area, 2013



An examination of the cost centres shows a similar story to previous years – savings have been realised in those areas where airports have some degree of control. Labour costs, comprised of personnel and contracted services costs represent the largest cost, at 61% operating expenditure.

These components decreased by -8.7% and -8.9% respectively in 2013. As a result, personnel costs are -17.4% lower in real per passenger terms since 2008.

To a greater or lesser extent, reductions were reported across practically all cost centres. One notable exception was maintenance, which increased by +4.2% even after inflation and traffic growth were accounted for. This brought maintenance up to its highest proportion of operating costs in recent years.

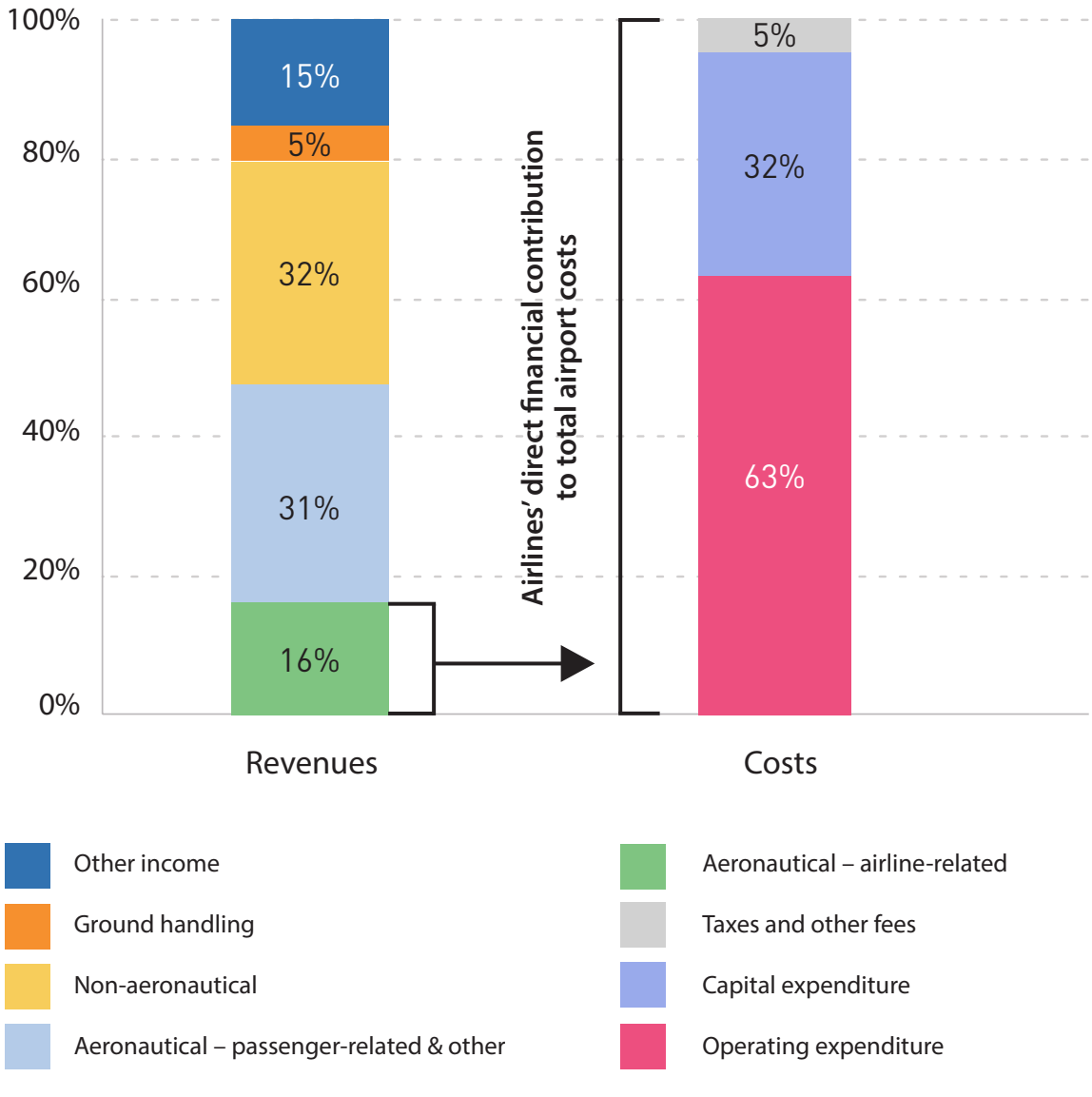
[16] *'Guidelines for Passenger Services at European Airports',* ACI EUROPE, June 2014 – available at: https://www.aci-europe.org/component/downloads/downloads/3879.html.

This deviation may be linked to airport capital expenditure, which continues to decline, if airports are under pressure to scale back investment and instead 'sweat' assets. While of short-term benefit, the longer term pressures upon Europe's airport infrastructure mean that this may not be sustainable in the longer term.

As a result of these cost control measures, revenues collected from aeronautical activities fall over €3 billion short of covering airport's operating expenses. This also means that not one cent of airport's capital costs are covered by the revenues from airport charges.

Graph 13

Aeronautical Revenues versus Operating & Capital Costs in 2013





3.3. CAPITAL EXPENDITURE

In 2013 European airports spent €5.7 billion on capital projects. This compares to an equivalent spend of €8.2 billion in 2012, and therefore represents a real per passenger decrease of -32%.

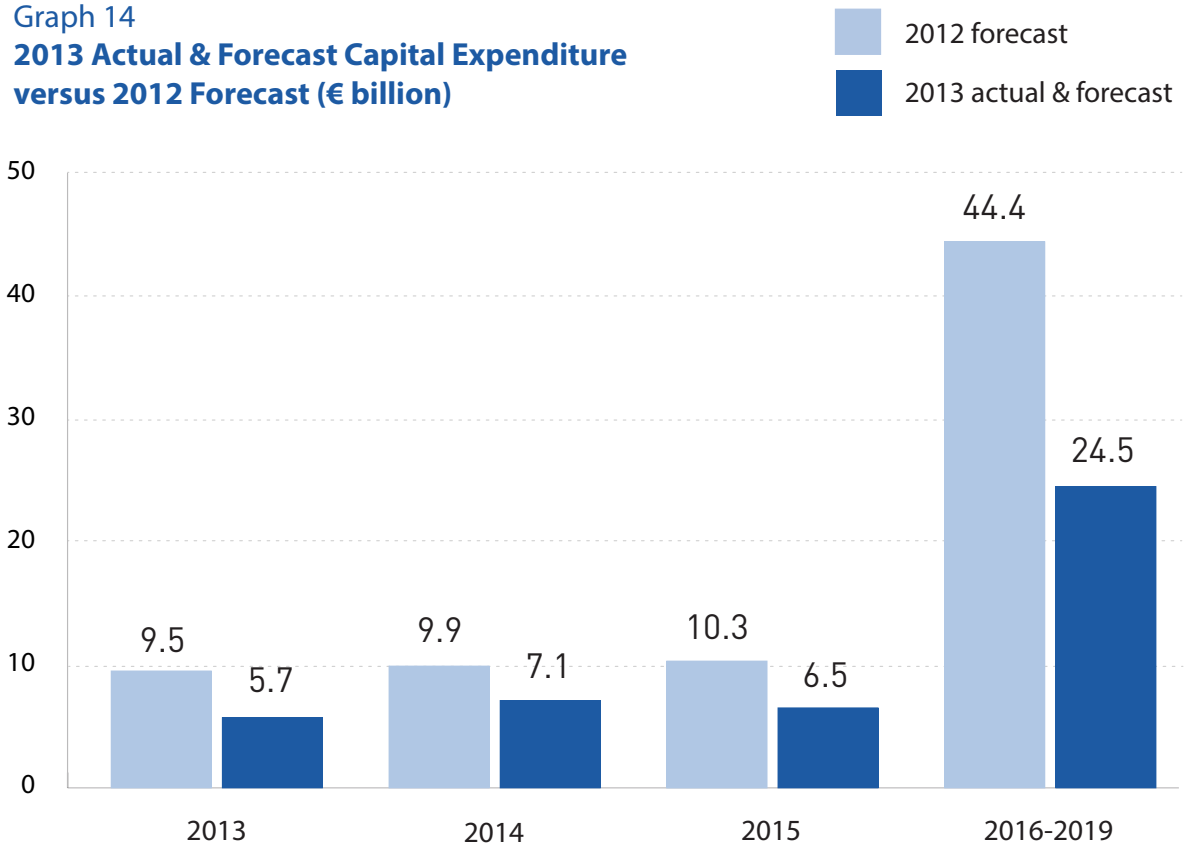
The lion's share of the capex spend went on aircraft movement area and terminal buildings. Within the investment in aircraft movement and terminal facilities, construction makes up the majority of expense (72%) while purchase of property, plant and equipment covers 13% of costs, with 'other' making up the remainder.

Table 4
% Breakdown of 2013 Capital Expenditure

Area of Capital Expenditure	€ billion
Aircraft movement areas	1.1
Terminal buildings	2.9
Equipment and vehicles	0.4
Other facilities	0.7

This downward shift in capital expenditure is part of a wider trend which has been observed in previous ACI EUROPE Economics Reports. Looking at this more broadly, it can be seen that 2013 actual capex spend and expectations for future capex spends consistently compares negatively to 2012 expectations.

Graph 14
2013 Actual & Forecast Capital Expenditure versus 2012 Forecast (€ billion)



This continued trend may at first glance seem odd, in light of improved trading conditions and lower interest costs. However, it must be considered in the context of developments on the revenue side of the business. Since the crisis real per-unit revenues have been either negative or flat over successive years. Even during periods of buoyant demand, revenues have not increased accordingly. This may reflect a structural shift in the European airport industry – if so then patterns of capital expenditure may have to shift structurally also.

Recent years have seen a major reduction in capital expenditure, in large part due to soaring interest costs associated with the financial crisis. The easing of these pressures however has not yet seen a corresponding resurgence in capital expenditure. Instead airports are remaining cautious and paying down still-significant debt levels (see Profitability section). If the industry's revenue generating ability is permanently weakened, then if follows that its ability to invest for the future will be correspondingly reduced also.

The European capacity crunch remains a major challenge to the sector and the wider European economy, with EUROCONTROL predicting that 12% of demand will be unaccommodated in 2035[17] due to insufficient airport capacity on the ground. To date planning restrictions and environmental impacts were seen as the major impediments to expansion – in the future it may well be the case that the financial case for necessary major projects will also present a barrier.

[17] *'Challenges of Growth 2013',* EUROCONTROL, June 2013 – available at: https://www.eurocontrol.int/sites/default/files/article/content/documents/official-documents/reports/201306-challenges-of-growth-2013-task-4.pdf.

3.4. CAPITAL COSTS

In 2013 European airports continued to enjoy relief in capital costs, as financial markets recovered from the 2008 crisis. Capital costs overall decreased by -7.2%, to just under €10.5 billion. There was a divergence between EU and non-EU airports in this respect however, with non-EU airports actually experiencing an increase in capital costs, even after traffic growth and inflation were accounted for.

However, while this relief was very welcome, airports continued to carry the burden of some of the longer-term adverse impacts of the financial crisis. Real per passenger capital costs are now +18% higher than they were in 2008 – which equates to an increase of +55.5% in nominal absolute terms. Such capital costs are largely outside the control of airports, which have to take market interest rates, and which have to plan for the longer-term to ensure that sufficient capacity of adequate quality is made available to airline and passenger customers.

Graph 15
Breakdown of Capital Costs, 2013*



**Figures have been rounded.*

Within capital costs, depreciation costs decreased by -6%, to €6.3 billion, while interest costs declined by a substantial -14.8% to €3.5 billion.

The decline in depreciation costs can be primarily attributed to the decrease in capital expenditure since the crisis, with airports investing less in infrastructure in response to higher financing costs and customer pressures to reduce costs. This can therefore be considered an on-going legacy of the crisis. All other things being equal, depreciation costs should increase as airports revert back to more sustainable levels of investment – however this may take several years to manifest itself clearly within annual financial figures.



The decrease in interest costs is clearly linked to the lower interest rates which became available on the market in preceding years.

In spite of the cut backs in capital expenditure, in 2013 airports were still paying 55 cents in interest for every euro they put back into infrastructure. The equivalent figure in 2009 (the earliest year for which data is available) was 48 cents. In the context of multi-million euro investments, this is a massive increase in financing costs.

In absolute terms, capital costs were still almost €4 billion higher in 2013 compared to 2008, despite the relief from 2012 onwards. That increase is broadly equivalent to the industry's annual revenues from retail. The reality is that these extra costs were absorbed by the airports and not passed onto customers. The intervening years have consistently seen:

- flat or negative per-unit aeronautical revenues;
- a renewed focus on non-aeronautical revenue generation in spite of tough trading conditions;
- major cuts to operating expenditure;
- reductions to capital investment and subsequently depreciation costs.

The airport industry has reacted strongly to these cost hikes - which were largely out of its control – to internalise the impact upon airline and passenger customers. This represents a remarkable effort by a capital-intensive industry, and yet is generally forgotten when airlines lobby at a national and European level for lower airport charges.

3.5. TAXES AND OTHER FEES

Taxes and other fees paid by European airports reached €1.6 billion in 2013 – a real per passenger increase of +4.5%. This average masked a strong divergence between EU and non-EU airports, with the former recording a strong increase in tax payments and the latter a dramatic decrease, even on an absolute basis.

While these diverging tax liabilities can in part be explained by differences in profitability, this is not the full story. In the EU taxes and other fees represented almost 45% of net profits. The equivalent figure for non-EU airports was 22%.



4

PROFITABILITY

In terms of margins, European airports experienced an increase of +1.4% in earnings before interest, depreciation, taxation and amortisation (EBIDTA). Within this EU airports experienced increased profitability, but non-EU airports recorded a decline. Overall EBIDTA in Europe stood at €15.7 billion.

In terms of net profits, European airports as a whole recorded a healthy increase of +36.1%, earning €3.6 billion after taxation in 2013.

These positive results can be attributed to strong continued operating cost control in the face of weak revenues, reduced capital investment in recent years and – crucially – a much-needed reduction in interest costs, which had sky-rocketed in recent years.

While these figures are positive, they are irrelevant if not considered in the context of the total investments being made into airports. As capital-intensive businesses, operating margins are less relevant where considered in isolation, as they do not factor in the significant capital costs incurred in generating these revenues.

European airports experienced an increase of +1.4% in earnings before interest, depreciation, taxation and amortisation. Overall EBIDTA in Europe stood at €15.7 billion.

Similarly, net profits can only be considered relative to the sums that were invested in the first place to generate these returns.

In this respect Return on Invested Capital (ROIC)[18] offers a proper insight into the profitability of European airports. From an investor's point of view, the ROIC measures the payment that both debt and equity holders would receive by providing their capital, with equity holders being compensated for taking on the risk. In 2013 the industry reported an ROIC of 6.8%. This is broadly in line with the corresponding cost of capital for airports, which is between 6-8%[19].

Overall European airports as a whole covered their costs in 2013, after having reported an economic loss in the previous year. This was attained by rigorous operating cost control and a fortuitous reduction in the cost of debt.

That said, EU airports recorded an average ROIC of just 5.7% while Eurozone airports recorded an equivalent result of just 5%. This reflects in part the weaker trading conditions which these airports cannot escape.

There is also another caveat to developments.

These improved results have been achieved in part by reducing capital expenditure in recent years, in response to the crisis and airline pressures. Airports operate on an investment cycle, and so for many airports necessary investment to put in place capacity and to maintain quality has been not avoided, but merely postponed. While airports may as a result be able to report healthier financial results, these results will not reflect the fact that a significant increase in capital expenditure is likely to be required in the years ahead – particularly at Europe's largest airports. As previously mentioned, EUROCONTROL predicts that 12% of air traffic demand will be unaccommodated by 2035 due to a lack of airport infrastructure.



[18] ROIC = (net profit+interest expense)/(net assets+ long-term debt) with non-current liabilities being used as a proxy for long-term debt.
[19] *'Profitability and the air transport value chain'* IATA, June 2013 – available at: https://www.iata.org/whatwedo/Documents/economics/profitability-and-the-air-transport-value%20chain.pdf.

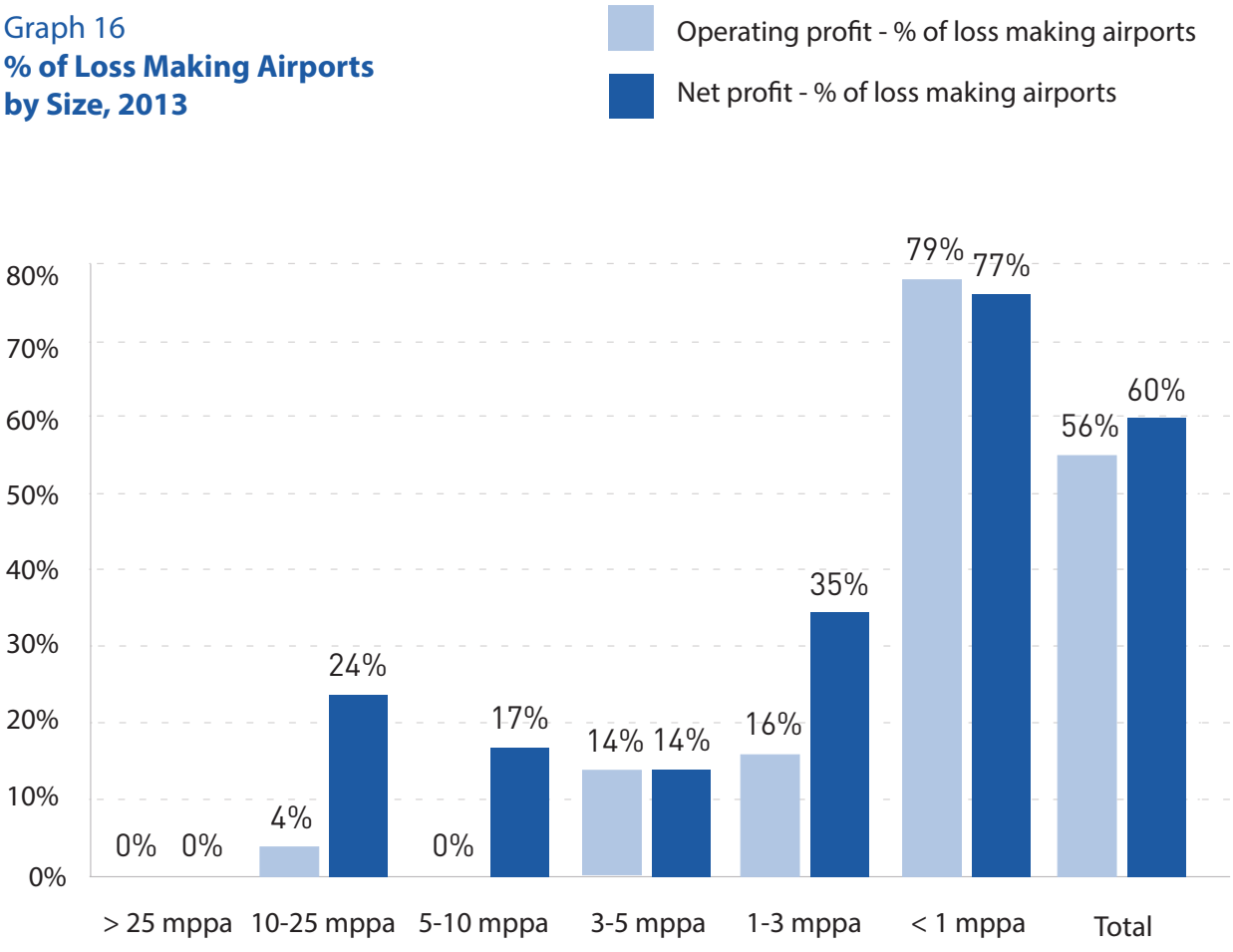
It should also be borne in mind that European airports already hold substantial levels of debt, at just over €79 billion for the industry as a whole. More encouragingly, 2013 outstanding debt was reduced by a significant -7% in real per passenger terms, however the current level of debt still stands at over 21 times total annual industry net profits.

Prudent paying down of debt combined with (at present) lower interest rates will facilitate airports' investment obligations, but the industry has become financially weaker in recent years, due a structural decline in its ability to generate revenues, and so any major capital expenditure will be more of a challenge than has been the case previously.

It must also be remembered that, while the industry as a whole is self-sustaining, the reality is that most airports are actually loss making.

Airports below a certain size are structurally unable to cover their costs, nor to generate any kind of return. These airports have absolutely no pricing power, very limited ability to generate non-aeronautical revenues, and high fixed capital and operating costs which cannot be spread across a wide traffic base.

Graph 16
% of Loss Making Airports by Size, 2013



In 2013, 56% of airports made an operating loss (i.e. negative EBIDTA) while 60% made a net loss[19]. This compares to equivalent figures of 54% and 62% in 2012.

In 2013, 56% of airports made an operating loss (i.e. negative EBIDTA) while 60% made a net loss[20]. This compares to equivalent figures of 54% and 62% in 2012.

As graph 16 shows, smaller airports are significantly more likely to be loss making. Indeed, airports with less than 1 million passenger per annum (ppa) are almost all loss making, with few exceptions.

The European Commission introduced new State Aid Guidelines in early 2014, which required all airports with between 200,000 and 3 million ppa to reduce and eliminate their dependence upon public financial support, over the next 10 years, with a final decision on those airports with less than 700,000 ppa in 2019.

Smaller airports are structurally unprofitable across the globe, with no evidence that the EU industry is in any way different. It seems highly unlikely that a functioning market can be created, purely by mandating it via Guidelines. The coming years will see a picture emerging of airports' financials, which will give an indication as to whether the EC has been successful or not in this regard. This should help ensure that any final decision in 2019 is both fact-based and realistic.

[20] The method for extrapolating the sample to account for this entire industry has been improved in this year's report. Now the sample is extrapolated according to their size category. This allows a more accurate figure to be derived, as to the total number of profitable and unprofitable airports.



5

OUTLOOK

2014 saw a slow recovery gradually take hold, with both the wider European economy and the aviation sector recording increasingly healthy growth through the year. Indeed, air traffic outperformed GDP growth at EU airports in particular, demonstrating the central role aviation plays in mature economies.

2015 has opened promisingly. The EU economy, already benefiting from a continued mild upturn, has been boosted by lower fuel prices and a weak euro which, in combination with reasonable global economic growth, has driven export activity forward in particular. European policy has swung firmly behind recovery efforts with the European Central Bank following up on its commitments, and unleashing quantitative easing, with a view to breaking the Eurozone economy out of its deflationary trap.

However the faster pace of growth in recent years will be tempered by the performance of the Russian economy, which has entered recession due to lower oil prices and economic sanctions, as well as an underlying weak productivity. In addition geopolitical tension and the eurozone crisis continue to present systematic risk.

2014 saw a slow recovery gradually take hold, with both the wider European economy and the aviation sector recording increasingly healthy growth through the year.

The latest EC forecasts are for 2015 GDP growth of +1.8% in the EU, with the global economy increasing by +3.5%. Within non-EU economies, Norway is expected to grow by +1.5%, Switzerland by +1.2% and Turkey by +3.2% - however Russia is set to suffer a reduction of -3.5% in GDP.

The latest EC forecasts are for 2015 GDP growth of +1.8% in the EU[21], with the global economy increasing by +3.5%. Within non-EU economies, Norway is expected to grow by +1.5%, Switzerland by +1.2% and Turkey by +3.2% - however Russia is set to suffer a reduction of -3.5% in GDP.

Within the European aviation sector, the trends are positive. Continuing a trend which began in 2014, airlines are starting to put capacity back onto the market. As a result the first quarter of 2015 witnessed an increase in passenger traffic of +5.2% with EU traffic increasing by an impressive +6% and non-EU traffic by a weaker +2.6%.

The extra capacity saw aircraft movements increase by +1.6% in the first quarter, and also saw a significant improvement in Europe's connectivity, of +8.9%. This was comprised of connectivity increases of +9.2% within the EU and +7.9% within non-EU countries[22].

Encouragingly, this increase has to date been achieved without an aggregate reduction in the number of passengers per movements, indicating that airlines are having some success in expanding without sacrificing their profitability in the process. However, this has to be considered in the wider context. Aircraft movements have been negative in recent year and so while the addition of capacity to the market is to be welcomed, it remains cautious and conservative in light of the growth in underlying passenger demand over the last number of years.

There are indications that the European airline industry is continuing to adopt behaviour which will allow more sustained profitability. The more considered deployment of capacity has been accompanied by (and to an extent facilitated) an unwillingness to pass on lower fuel costs to passengers in the form of lower air fares[23]. These lower costs are instead used to bolster airline profits. For the year to date European legacy carriers have increased their revenue passenger kilometres by +3.6%[24].

In light of the above, ACI EUROPE forecasts that passenger traffic growth in Europe in 2015 will amount to +5.5%.

---

[21] *'European Economic Forecast – Spring 2015',* European Commission - available at: http://ec.europa.eu/economy_finance/publications/european_economy/2015/pdf/ee2_en.pdf.
[22] *'Airport Industry Connectivity Report 2015',* ACI EUROPE, June 2015.
[23] '*Air fares unlikely to fall alongside oil prices, experts say',* Reuters, Jan 2015 – available at: http://www.reuters.com/article/2015/01/20/oil-airlines-fares-idUSL6N0UZ27I20150120.
[24] *'Airlines Financial Monitor March-April 2015',* IATA – available at: https://www.iata.org/whatwedo/Documents/economics/Airlines-Financial-Monitor-Apr-15.pdf.



METHODOLOGY

The data used in the 2014 Report is based on the economic and financial results of European airports in the reporting year 2013. 147 airports operators representing 205 airports in Europe responded to the survey conducted by ACI WORLD, representing just under 75% of total European passenger traffic, or just under 1.3 billion passengers.

As with last year's Report, the Survey collected data for both 2013 and for 2012. This allowed comparisons to be made with 2012 data, using the exact same sample. This allows more reliable comparison between years within the Report, but does mean that absolute figures within the ACI EUROPE Economics Report 2014 cannot be directly compared with equivalent figures within the previous year's edition.

All figures were converted into euros, where airports did not report in this currency. The exchange rates used were based on annual bilateral exchange rates for 2013, according to the European Central Bank.

Year-on-year changes in financial results are reported primarily in per-passenger real terms. A per-unit analysis provides a more accurate indication as to the annual developments of the industry's finances, as these would otherwise be masked by the strong impact of traffic volumes, which can vary considerably each year.

To report the figures in real terms, an inflation index was constructed to reflect the composition of the specific sample. National inflation figures for the year 2013 were sourced from the International Monetary Fund, and these were weighted according to the % of traffic represented by each country within the sample. This gave a 2013 inflation rate of 2.03% for the sample as a whole, 1.5% for the EU, and 4.49% for the non-EU block of countries.





AIRPORTS COUNCIL
INTERNATIONAL

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 45 European countries.

In 2013, our member airports handled over 90% of commercial air traffic in Europe, welcoming more than 1.7 billion passengers, 16.8 million tonnes of freight and 20.8 million aircraft movements.

www.aci-europe.org
Twitter: @ACI_EUROPE

Produced by ACI EUROPE. Designed by Caroline Terree.

© Copyright ACI EUROPE 2015

EVERY FLIGHT BEGINS AT THE AIRPORT.