AIRPORTS COUNCIL INTERNATIONAL

ACI EUROPE

ECONOMICS REPORT 2013



This report is sponsored by

Vienna International Airport

Vienna Airport is characterised by a combination of the following factors:

- the geographical situation of Vienna Airport in central Europe
- an ideal road infrastructure with motorways linking western and eastern Europe
- flights to more than 240 destinations, of which 40 are located in eastern Europe
- high passenger service quality, e.g. minimum transfer time of only 25 minutes
- transfer function in particular for destinations in eastern Europe
- complete infrastructure and ongoing structural adaptation to future needs
- leading position in passenger and freight handling

Vienna Airport is one of the most important hubs for the growing number of destinations in central and eastern Europe. Its growth strategy is also based on positive development of demand for flights to destinations in Asia and the Middle East and the above-average expansion of low-cost carriers. Vienna Airport was the point of arrival or departure for some 22.2 million passengers in 2013 and it provided service to 231 thousand flights.



All photos in this report: © Vienna Airport

INTRODUCTION

For the fifth year, ACI EUROPE presents its Economics Report on the key financial and economic characteristics of the European airport industry. The report again provides an overview of the developments in such diverse categories as revenues, costs and profitability of European airport operators. The results of the ACI EUROPE Economics Report 2013 point to an industry which has weathered the financial and economic storms of recent years, but one which has also had to adapt and change, not least in relation to operating costs and capital investment plans.

The Report also sheds light on the significant difference in trading conditions facing EU and non-EU airports, which, while in part a reflection of contemporary trading conditions, was also very much due to more deep-rooted structural economic differences, and as such is likely to remain a reality for some time to come.

CONTENTS

The ACI EUROPE Economics Report 2013 highlights key developments in the following main fields:

- **Traffic Development:** In 2012 strong passenger growth at non-EU airports (+8.8%) was dragged down by stagnation within the EU (+0.2%) , with traffic weakening in both segments as the year progressed;
- **Aeronautical Revenue:** A decrease in real-term per passenger aeronautical revenues across Europe (-0.3%), with a limited increase within the EU, and significant decreases at non-EU airports. Airport charges continued to shift towards a more favourable structure for airlines, with a further emphasis on passenger-related charges, and continued substantial subsidisation of airport charges with revenues from other commercial activities;
- **Non-Aeronautical Revenue:** Real, per-passenger decreases across the industry (-1.7%), with the largest decrease being felt by non-EU airports and flat growth within the EU;
- **Operating Expenditure:** Discipline continued to prevail as per-passenger real operating expenditure remained broadly flat (+0.1%);
- **Capital Expenditure:** 2012 capital expenditure continued the decline of recent years, although longer-term capital expenditure plans look more promising;
- **Capital Costs:** 2012 brought some relief to European airports as interest rates subsided, but capital costs remain far above the historical levels of the pre-crisis years, with capital costs remaining +7.5% above 2009 levels, even in real per passenger terms;
- **Profitability:** EU airports saw an improvement in operating margins, however the sector continues to make an economic loss, with returns not reflecting the scale of investment required in airport assets.



1

BUSINESS CONTEXT

The year 2012 cannot be spoken of without making reference to the reality of a 'two-speed Europe'. This applies more generally to wider economic conditions, but was strikingly so for the aviation sector. Indeed the extent to which this was the case required a revised look at aggregate financial results for the year – headline financial results are better understood if they are divided into separate figures for EU and non-EU airports.

It was also necessary to consider results both in real and per-passenger terms, rather than the nominal aggregate approach of previous years, given the different prevailing economic conditions in the EU and non-EU areas. In terms of traffic figures, this divide continued throughout 2012, reflecting both prevailing economic conditions as well as more deep-seated structural differences – in particular the maturity of the market and associated weakening growth in the propensity to fly within the EU, versus significant unrealised growth potential in many non-EU markets. Given this it seems likely that the 'two speed' nature of Europe's airport industry will continue to prevail, if perhaps not to the same dramatic extent, in the coming years.

The year 2012 cannot be spoken of without making reference to the reality of a 'two-speed Europe'. This applies more generally to wider economic conditions, but was strikingly so for the aviation sector.

Within the Eurozone, the continued crisis continued to weigh down confidence throughout 2012, and while the July ECB promise 'to do whatever it takes' did bring stability, it took until 2013 for this to start to be felt in the real economy.

The story of the European economy in 2012 remains primarily that of the EU and specifically the eurozone, with larger emerging economies such as Turkey and Russia adversely impacted, but ultimately shaking off such woes to continue their stronger upward trajectory on the back of longer-term convergence economics and reasonably strong commodity prices.

Within the Eurozone, the continued crisis continued to weigh down confidence throughout 2012, and while the July ECB promise 'to do whatever it takes' did bring stability, it took until 2013 for this to start to be felt in the real economy.

Pan-European aggregate passenger traffic growth of +1.8% was built upon healthy growth of +8.8% at non-EU airports, but equally was based upon anaemic growth of just +0.2% at EU airports, which continued to account for the bulk of traffic in Europe[1].

Nevertheless the trend in passenger traffic for the year in both zones was negative, with both EU and non-EU airport groups recording significantly weaker growth at the end of 2012 compared to the start. Indeed EU traffic slipped into recession, recording negative passenger growth of -3.1% in December 2012.

Freight figures for 2012 remained in the red for almost the entire year, with an almost imperceptible recovery towards the end of the year - insufficient to avoid an overall annual decline in freight traffic of -2.8%.

Within the European aviation sector, airlines continued to manage capacity very tightly, with the difference in passenger (+1.8%) and movement developments (-2.1%) meaning more cautious deployment of aircraft. This was accompanied by the high profile collapses of Malev and Spanair in early 2012, and a weakening of legacy carrier profitability in particular, although this was mitigated by key low cost carriers, which reported healthy returns. A continued increase in both the level and volatility of oil prices post-crisis further weakened the sector, although an average 55% increase in the share prices of European airlines through 2012[2] suggested that opportunities in the market remained for those airlines which were in a position to seize them, with investor confidence being won by those with successful business models as well as by those which demonstrated a credible commitment to restructuring efforts.

2013 however saw the positive undercurrents of 2012 come to fruition, although overall passenger traffic growth of +2.8% remained of a two-speed nature. EU airports experienced traffic increases of +1% while non-EU airports saw equivalent growth of +9.6%. Both areas saw a significant strengthening in traffic results as the year progressed.

Freight traffic, though heading in the right direction, remained weak, with 2013 end-of-year growth of just +0.8%, possibly reflecting specific conditions in the cargo industry as much as wider economic conditions.

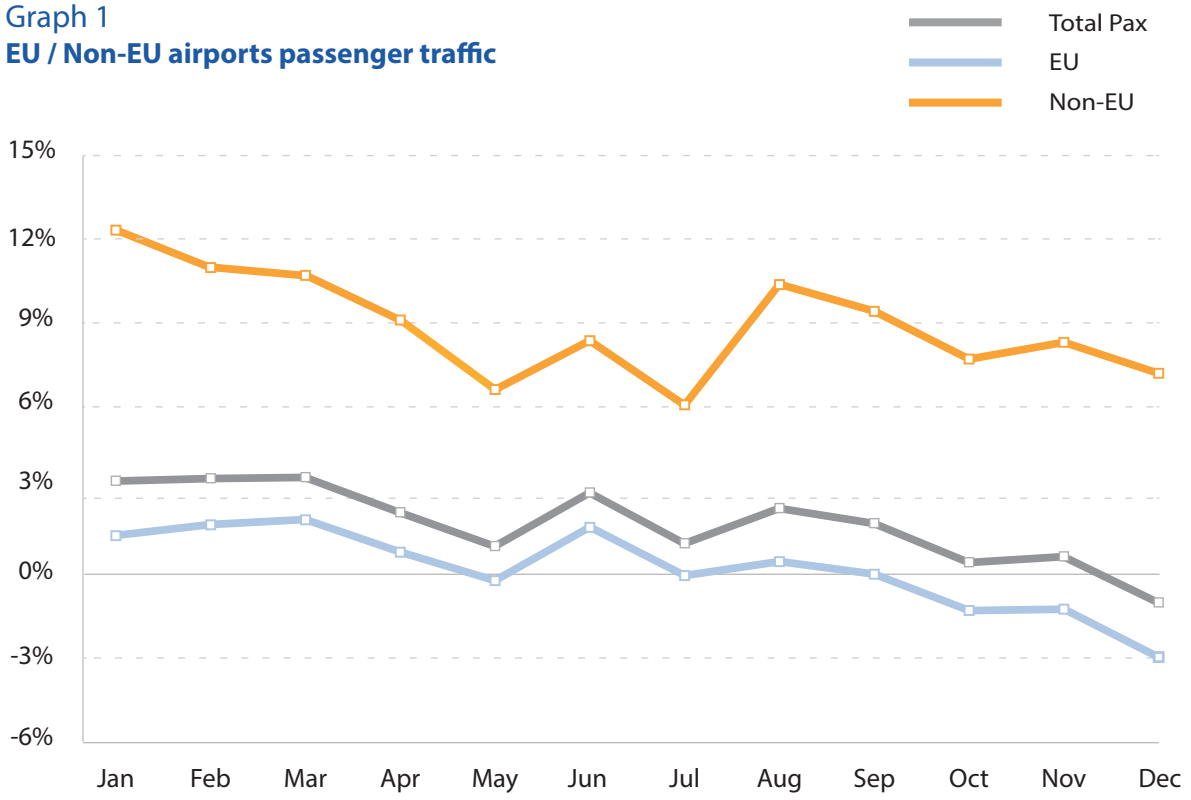
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[1] In 2012 in Europe, EU traffic accounted for 85.7% of the total, with non-EU traffic accounting for 14.3%.

[2] *'What problems? Most of CAPA's Top 20 European airline stocks outperformed the market in 2012',* CAPA Centre for Aviation, Jan 2013 – available at http://centreforaviation.com/analysis/what-problems-most-of-capas-top-20-european-airline-stocks-outperformed-the-market-in-2012-93942.

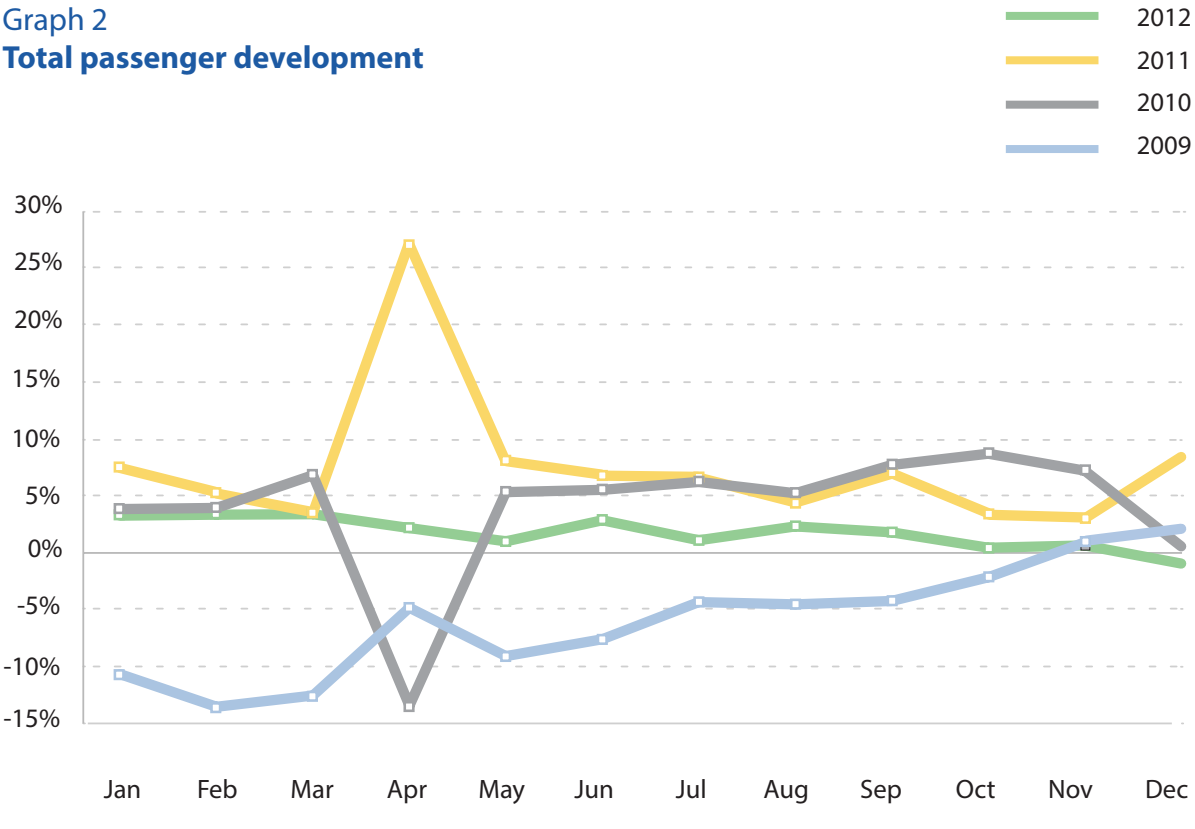
Graph 1

EU / Non-EU airports passenger traffic

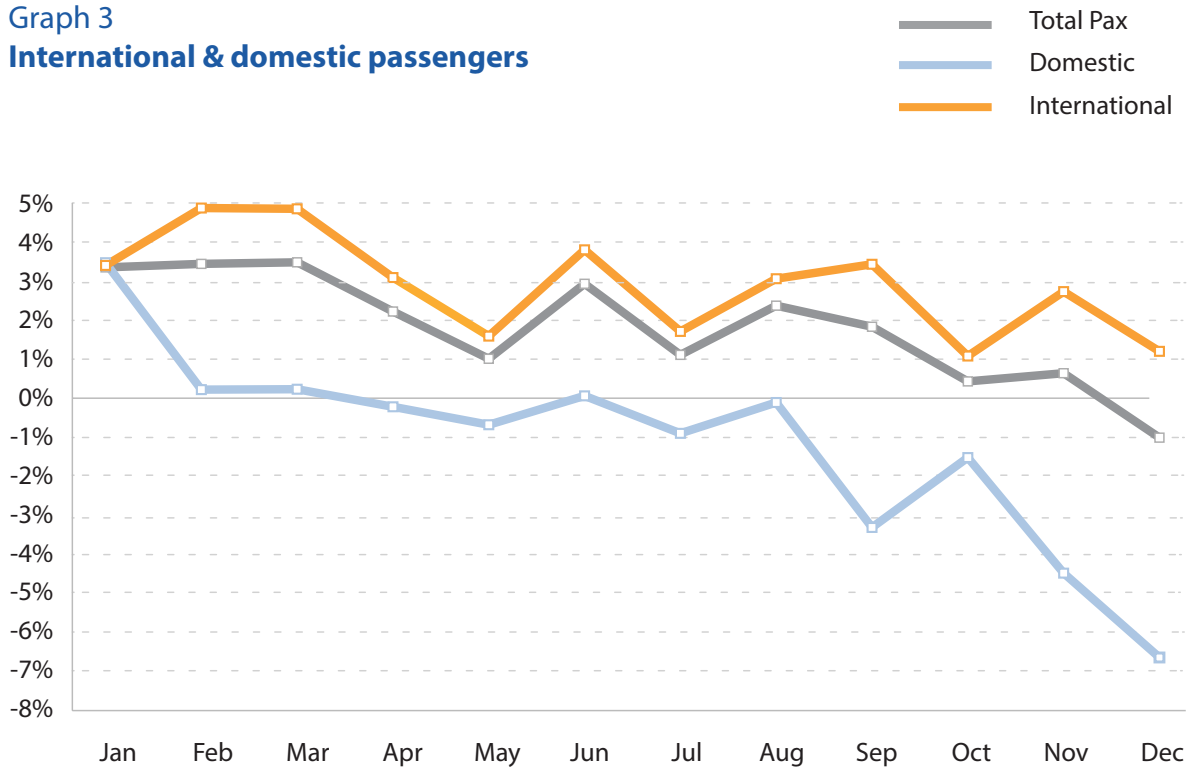


Graph 2

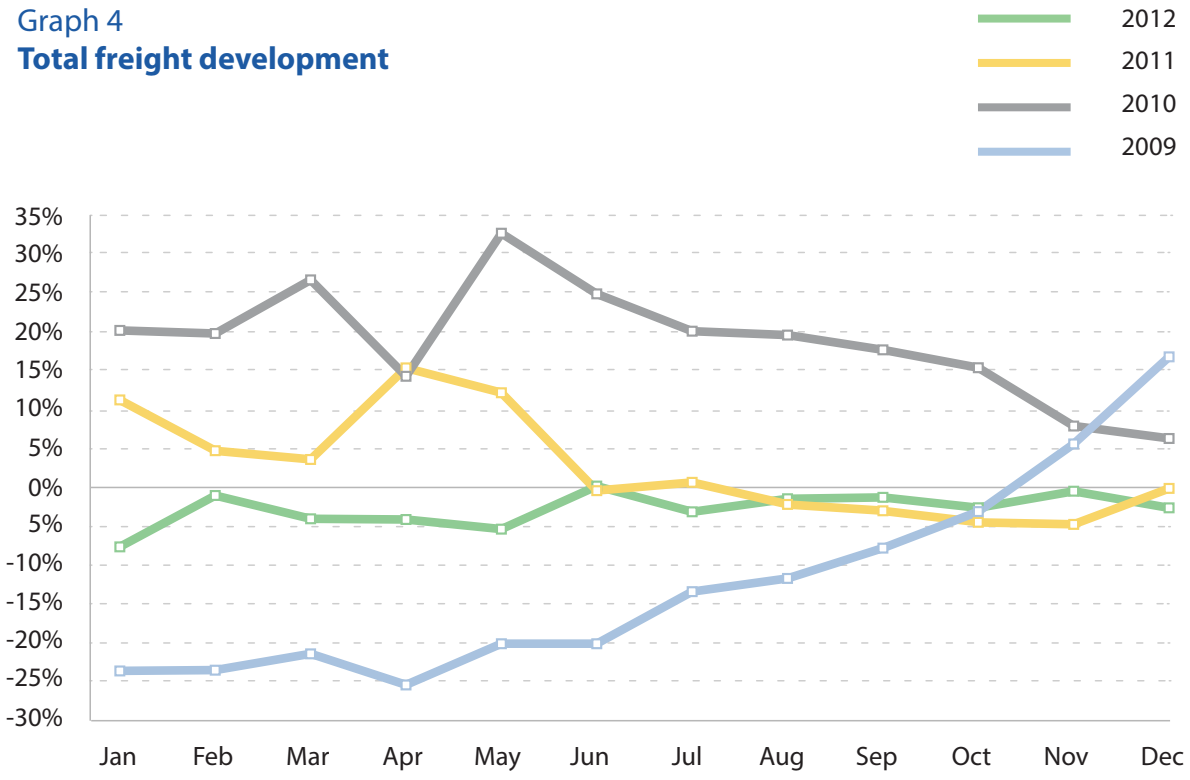
Total passenger development



Graph 3
International & domestic passengers



Graph 4
Total freight development





2

AIRPORT REVENUE

Total European airport operator revenues reached €34.7 billion in 2012, representing a nominal increase of +3.6% and a real per passenger decline of -1.1%.

Real per passenger change in total revenues

Overall	EU	Non-EU
-1.1%	+1.3%	-10.3%

Total European airport operator revenues reached €34.7 billion in 2012, representing a nominal increase of +3.6% and a real per passenger decline of -1.1% once inflation is accounted for. For EU airports this was a +1.3% increase in real per passenger overall revenues and a significant -10.3% decline for non-EU airports.

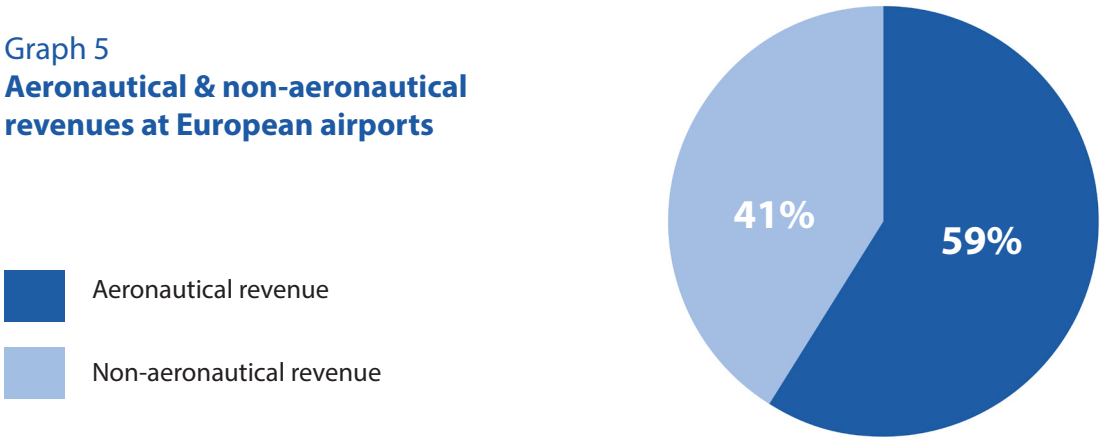
This reflected broadly stable airport charges in real terms as weak demand kept prices static, and that same weak demand feeding through into consumer sentiment - also undermining commercial revenue generation. Non-EU airports in particular experienced real term decreases in per passenger revenues across both aeronautical and commercial revenues, which had consequences for their bottom lines. EU airports fared better, able to maintain revenue levels in line with traffic growth and subsequently with operating expenditure levels.

Table 1
Distribution of revenues at all European airports in 2012

TOTAL REVENUES	€34.7 billion	100%	excl GH
AERONAUTICAL REVENUE	€16.9 billion	49%	59%
NON-AERONAUTICAL REVENUE[3]	€12.0 billion	35%	41%
GROUND-HANDLING REVENUE	€1.7 billion	5%	
OTHER[4]	€4.0 billion	12%	

When ground handling and 'other revenues' are separated[5], it can be seen that aeronautical revenues – i.e. charges paid by airlines and passengers - made up 59% of overall airport revenues in 2012, compared to 41% being generated by commercial revenues (from retail, car parking, etc.). The ratio is in line with 2011 levels.

Graph 5
Aeronautical & non-aeronautical revenues at European airports



[3] Including non-operating income.
[4] E.g. Terminal Navigation Charge (if applicable), facility management, special guest services, other operating income.
[5] 'Other revenues' cannot be readily categorised and ground handling activities in particular do not reflect the revenue situation at most European airports.

This is of course of direct benefit to both airlines and passengers, as they are benefiting from effective subsidies, and paying far less than the associated costs for the facilities and services they are using. Subsidisation of aeronautical charges by airports is a function of two main and interrelated market forces:

- European airports are now operating in a competitive environment and are therefore incentivised to use whatever means are available to offer the best possible value proposition to their customers – both airlines and passengers;
- Airports operate in a two-sided market – this means that there are positive synergies between aeronautical activities and commercial activities. I.e. the more passengers an airport has, the more commercial revenues can be generated. This provides airports with a natural incentive to boost traffic volumes with competitive airport charges.

2.1. AERONAUTICAL REVENUE

Real per passenger change in aeronautical revenues

Overall	EU	Non-EU
-0.3%	+1.8%	-4.3%

In 2012, European aeronautical revenues amounted to €16.9 billion, a +4.4% increase in nominal terms. In the context of traffic growth and sample inflation, this equates to a slightly negative (-0.3%) change in the real term level of aeronautical revenues per passenger.

Splitting down into EU and non-EU airports, EU airports experienced a real term increase in per passenger aeronautical revenues of +1.8%, as the industry, while working within a context of weak demand, sought to further secure the financial stability achieved in 2011, and prepare for medium-term investment plans, which are markedly more ambitious than those of recent years – see Section 3.2.

Meanwhile non-EU airports, passing on the economies of scale associated with operating in a higher growth environment, saw a significant reduction in the real per passenger aeronautical revenues, by -4.3%. However, headline aeronautical revenue levels, while instructive, do not give the full picture.

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

Aeronautical income is derived from the revenues which passengers and airlines pay for use of terminal and airfield services and infrastructure, such as terminal fees, and aircraft parking and landing fees. One important split within this group is between airline-related and passenger-related charges.

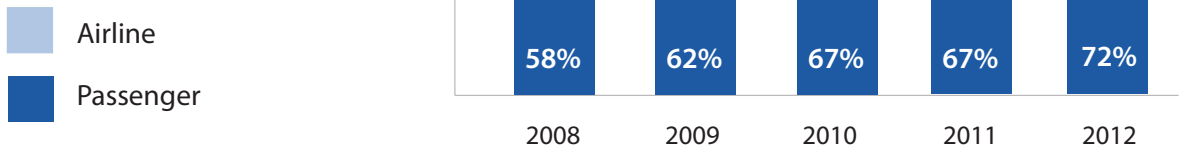
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Airline-related charges are paid directly by the airline for the use of primarily airfield and apron facilities and services, such as the runway, aircraft parking stands and in some cases airbridges. Of these the runway and parking charge typically deliver the bulk of these revenues.

Passenger-related charges are paid by the passenger to the airport, primarily for use of passenger processing facilities and service quality provision. As recommend by the International Civil Aviation Organisation (ICAO) these fees are collected via the airline, to avoid causing unnecessary administrative burden and disruption to passengers. However regardless of the channel, these fees are paid by the passenger, and are not costs incurred by the airlines, who are simply passing through the revenues.

Graph 6
Change in distribution of passenger and airline-related revenues, 2008-2012



Indeed, airlines benefit from this industry practice. Firstly there is a time lag between the payment of the passenger charge to the airline, and the airline's transfer of these revenues to the airport. This allows airlines additional liquidity, and the benefit from the interest earned on the sums. In addition, it is a reality today in Europe that passengers are often disincentivised to claim their entitled refunds on airport charges and government taxes, should they subsequently not travel on their purchased flight. In such cases the airline is able to keep additional revenues, which are not returned to the passenger, nor passed onto the airport. It is unclear exactly how much this revenue amounts to, but one company has estimated that European airlines in 2013 kept €4.1 billion worth of uncollected taxes, fees and charges which passengers were entitled to have refunded[6].

Beyond the above mentioned benefits, airlines have a more fundamental reason to favour a higher weighting on passenger-related charges than on

[6] *'European Airlines Retain €4.1 bn Passengers' Taxes and Charges in 2013',* AirtaxBack, February 2014 – available at http://airtaxback.com/index.cfm?fuseaction=news_article&id=63&cid=68&type=&-type_id=1.

airline-related charges. It is a more favourable trade off for them between what they pay, and what the passenger pays.

In addition, a higher proportion of passenger-related charges creates direct risk sharing between the airport and airline – when passenger numbers drop, so too does the revenue received by the airport. This might not be the case if charges were levied exclusively on runway use, for example, where an airport would receive the same revenues from a full aircraft as from an empty aircraft.

It is for this reason, in response to the specific demands of airlines and with wider market pressures which these demands aggregate to, that airports have been placing increasing weight on passenger-related charges and less on airline-related charges.

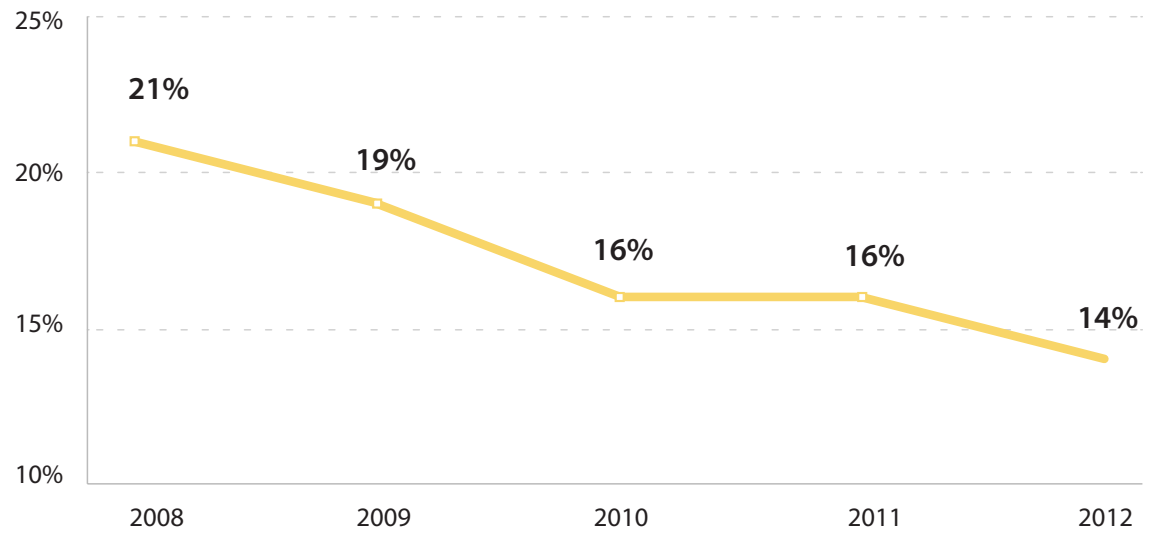
Excluding cargo revenues, passenger-related charges now account for 72% of all aeronautical revenues, versus 28% for airlines. This is a seismic shift from an equivalent ratio of 58:42 back in 2008, and represents a significant transfer of business risk from airlines to airports. This is a legitimate development in an increasingly competitive industry, and represents the market allocating risk to those who are best placed to bear it. However such welcome developments are only tenable if there is an equivalent shift in approaches to economic regulation, to ensure that both airports and airlines are properly incentivised to engage constructively in these market dynamics.

As a result of these developments, airlines have been paying less and less of the revenues necessary to maintain airport operations, let alone expansion. In 2012 airline-related aeronautical revenues accounted for 14% of overall airport revenues, down from 21% in 2008. In public statements by airlines concerning airport charges, it should always be remembered that airlines are only paying 14 cents out of each euro necessary to operate and expand airport infrastructure.

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Graph 7

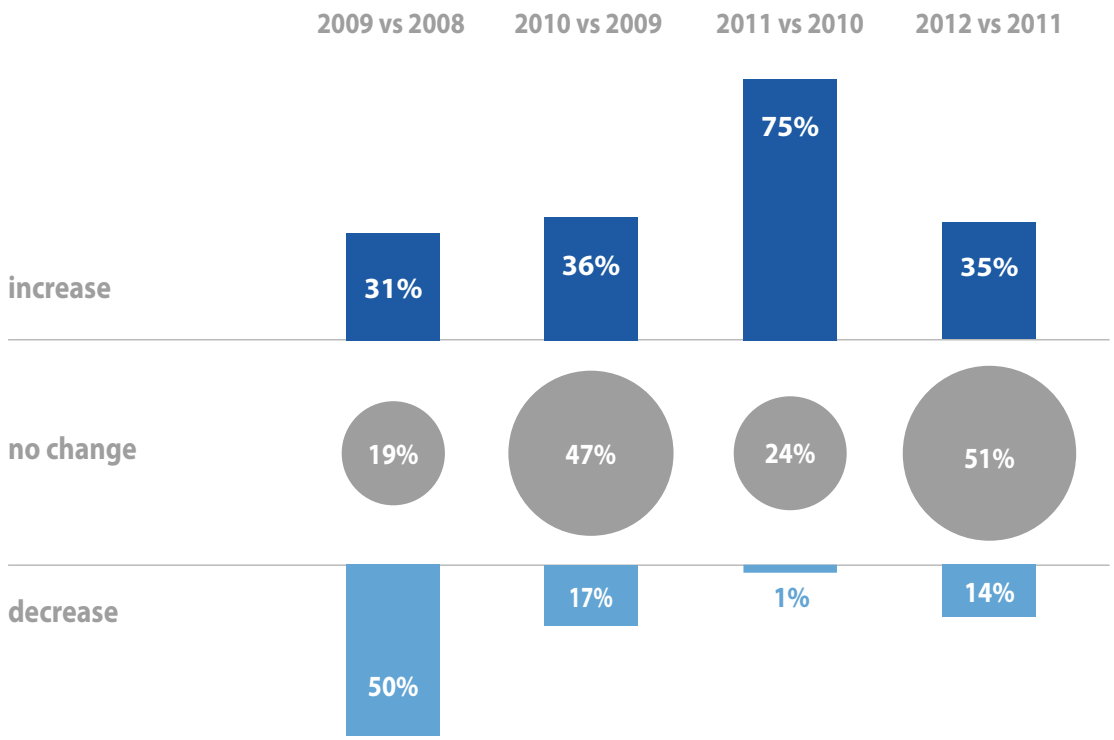
Revenue from airline-related charges as a % of total airport revenues, 2008-2012



2.1.2. AIRPORT CHARGES

In 2012, 65% of airports in Europe froze or decreased airport charges, in response to weak market demand. While 35% of airports increased charges, these charges were nominal, and so in practice may have been decreases or freezes in real terms. The real term per-passenger -0.3% decrease in aeronautical revenues across the industry suggests that this was indeed the case at many airports.

Graph 8
Change in overall level of airport charges 2009-2012



It must also be remembered that headline charges often do not reflect the actual payments made by airlines and ultimately by passengers. Unbundling of airport charges means that airlines have an increased choice as to which infrastructure and services they use, and how much they consequently pay in airport charges. In addition just over 90%[7] of airports reported having some form of incentive schemes – which offer airlines reductions for achieving a range of agreed targets, such as the launching of new routes and increasing frequencies, or more recently for maintaining or even limiting reductions in their overall traffic levels. While designed to encourage growth, these schemes effectively amount to reductions on the headline level of airport charges. These are not just positive optional initiatives by airports, but are in many cases a necessity due to significant competitive pressures amongst airports for airline capacity.

[7] ACI EUROPE Airport Charges Survey 2014.

It is these market realities and facts on the ground which ensured that aeronautical revenues per passenger – an effective measure of the actual level of airport charges paid in practice – actually decreased by -0.3% in 2012.

2.2. GROUND HANDLING REVENUE

Ground handling revenues decreased nominally by -2% in 2012, to €1.7 billion. In real per passenger terms this equated to a significant decrease of -6.6%.

Real per passenger change in ground handling revenues

Overall	EU	Non-EU
-6.6%	-4.6%	-7.7%

Ground handling revenues decreased nominally by -2% in 2012, to €1.7 billion. In real per passenger terms this equated to a significant decrease of -6.6%. Of this there was a -7.7% decrease at non-EU airports, compared to a -4.6% decrease at EU airports, which face EU obligatory minimum levels of intra-airport competition for the provision of ground handling services. This has seen airport share of the ground handling market decrease from 25% to 16% since the introduction of the EU requirements[8]. In this context current and future moves by the EU to strengthen these rules[9] should be reflected upon, to ensure that renewed regulatory intervention is really necessary.

Ground handling is now performed only by a minority of European airports. Airport providers of ground handling services often find themselves at a structural disadvantage in the new market, as they typically provide these services only in their own airport. This means that they have none of the advantages associated with larger pan-European independent ground handlers, which can offer airlines single-contracts for multiple destination airports, and have major economies of scale associated with the ability to spread large capital purchases (aircraft tugs, loading equipment, etc.) and other fixed costs over multiple locations and larger customer bases. Indeed, this reality has been instrumental in driving many airport providers out the market.



[8] *'ACI EUROPE Position on Requirements for a Performing Ground Handling Market',* ACI EUROPE, October 2011 – available at https://www.aci-europe.org/component/downloads/downloads/3096.html.
[9] *'Proposal for a Regulation of the European Parliament and of the Council on ground handling services at Union airports and repealing Council Directive 96/67/EC', European Commission',* December 2011 – available at http://eur-lex.europa.eu/legal-content/EN/ALL/;jsessionid=6yG2Ty7BHy34wpd1NmN-PQ0B7JyZQbLt8DNwRF26FLzv8QtxFkjt9!-2071777494?uri=CELEX:52011PC0824.

In 2012 commercial revenues at European airports reached €12 billion. Once changes in non-operating income are controlled for, a +3% nominal increase, and a -1.7% decrease in real per passenger terms, is revealed.

2.3. NON-AERONAUTICAL REVENUE

Real per passenger change in non-aeronautical revenues

Overall	EU	Non-EU
-1.7%	0.0%	-4.0%

A core component of airport revenues are those revenues derived from non-aeronautical sources such as retail, car parking, advertising and real estate. As was seen in Section 2, these play a core role in airport financing, allowing users – both passengers and airlines – to pay only a fraction of the costs underlying the services and facilities the use.

In 2012 commercial revenues at European airports reached €12 billion. Once changes in non-operating income are controlled for[10], a +3% nominal increase, and a -1.7% decrease in real per passenger terms, is revealed. Non-EU airports experienced a reasonable nominal increase, but once passenger growth and inflation were accounted for, this equated to a -4.0% decrease in commercial revenue levels. EU airports also performed weakly, recording flat growth (0%) in real per passenger term.



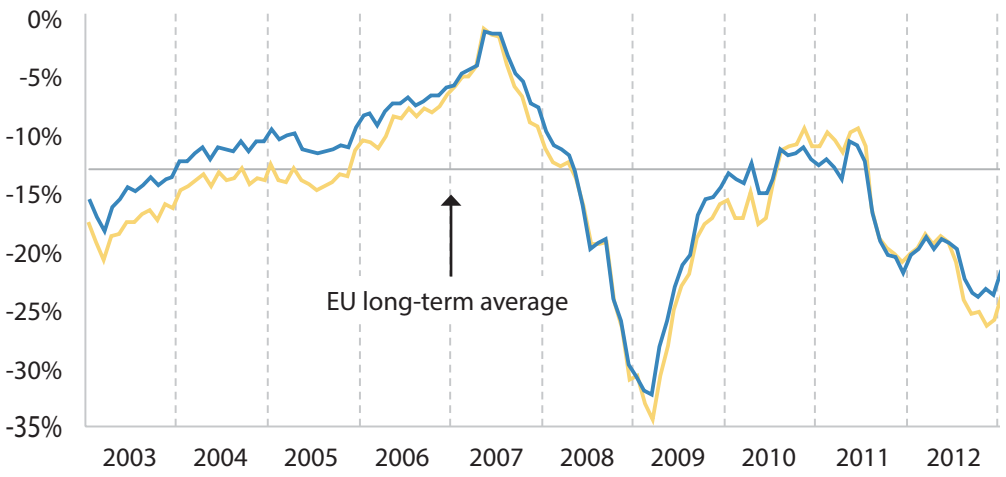
[10] To ensure that comparisons with previous years concern the performance of commercial revenues exclusively.

These weaker results stem from a number of factors:

- **Weak consumer sentiment**

  The European Commission estimates of consumer confidence indicators remained 20-25% below average levels throughout 2012. While there were some positive moves in the early part of the year, these quickly turned negative, and it was only in December 2012 that consumer confidence 'improved markedly' as the resulting market confidence began to be felt by EU consumers[11]. This improvement would only be felt in 2013, with the return of positive passenger traffic growth.

Graph 9
Flash Consumer Confidence Indicator for EU and Euro Area



Source: *'Flash Consumer Confidence Indicator for EU and Euro Area'* European Commission, January 2013 – available at http://ec.europa.eu/economy_finance/db_indicators/surveys/documents/2013/fcci_2013_01_en.pdf

The main non-EU markets all experienced weak or negative consumer sentiment also, with a Nielsen global consumer confidence poll finding depressed consumer confidence even in the last quarter of 2012, with only 10 of the 58 countries surveyed reporting scores of above 100[12] (100 is the baseline which distinguishes between consumer optimism and pessimism). Large global trading partners of Europe recorded quite negative results - the Middle East & Africa region reported a score of 96, as did Latin America. More seriously, North America – the global region to which Europe is most connected via air- recorded a quite negative confidence score of just 89.

This mix of both domestic and international uncertainty made trading conditions very challenging, particularly in the luxury good categories of the travel retail sector.

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[11] *'Flash Consumer Confidence Indicator for EU and Euro Area'* European Commission, January 2013 – available at http://ec.europa.eu/economy_finance/db_indicators/surveys/documents/2013/fcci_2013_01_en.pdf.

[12] *'Global Consumer Confidence Measures at 91 in Q4 2012',* Nielsen Press Release, March 2013 – available at http://www.nielsen.com/us/en/press-room/2013/global-consumer-confidence-measures-at-91-in-q4-2012.html.

Retail revenues – the largest category of non-aeronautical revenues at 41% – outperformed per passenger growth in 2012 (+4.7%), as airports succeeded in fending off some of the competitive pressures coming from online sales and high street shopping.

- **Market maturity**

  As can be seen in the graph on page 19 the relative proportion of non-aeronautical revenues earned from different commercial revenue sources has stayed largely constant, reflecting the relative maturity of the market, and the lack of 'low hanging fruit' or straightforward reforms and innovations which can unlock new revenue growth streams. This means that the maintenance or increase in per-passenger spend requires considerable commercial acumen, which will generally deliver minor incremental growth rather than large structural jumps in revenues. In addition much of these innovations will be quickly adopted by competitors, thus restricting the rewards available to the original innovator.

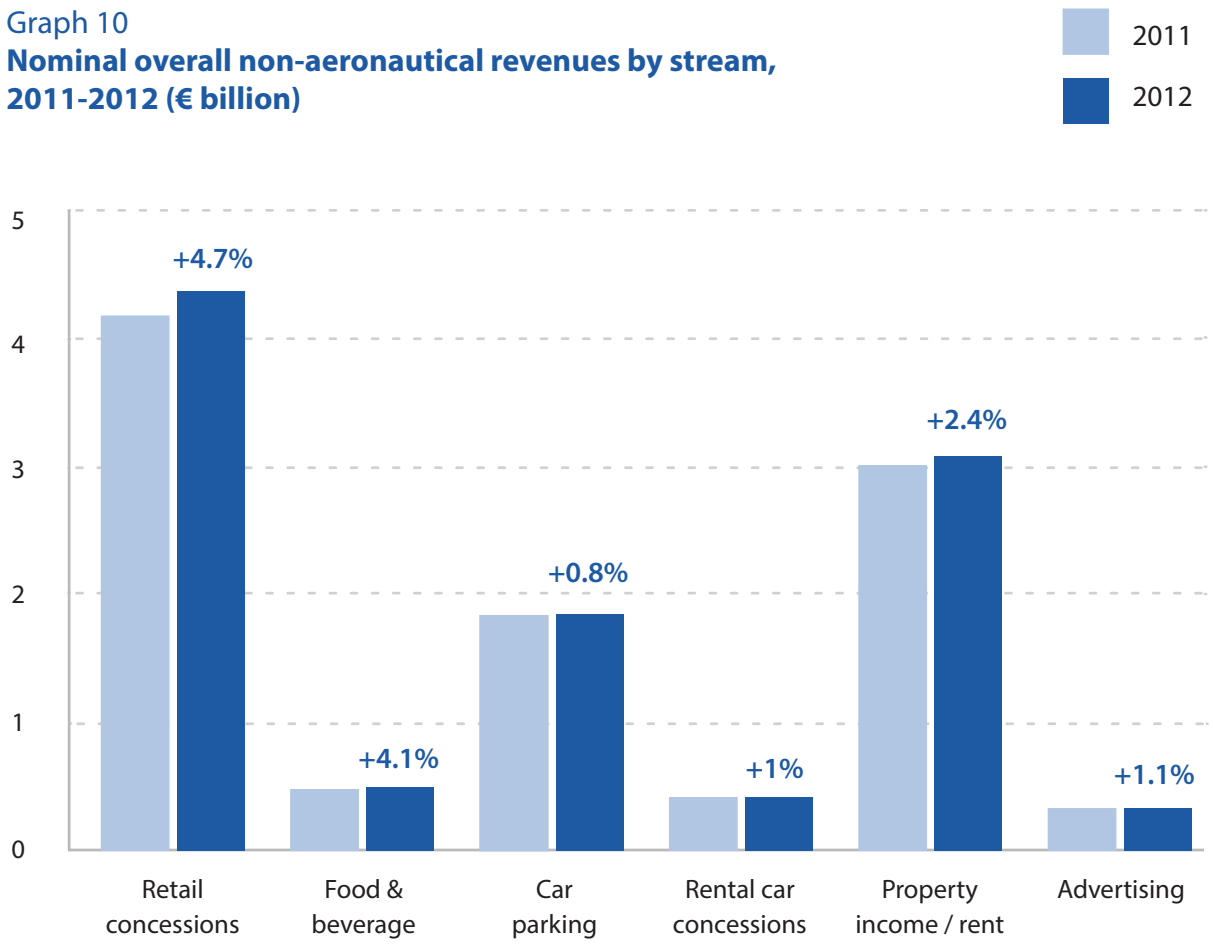
  It must also be pointed out that these competitors are no longer just other airports or travel retailers, but also wider online sales channels, including the online presence of 'high-street' shops and brands. With passengers demanding readily available wifi in airports, they are also more than ever able to physically browse products in airport shops, and to then digitally compare against online equivalent products and indeed order these products online if the price offering is more attractive. In addition to possible savings, passengers are spared the inconvenience of traveling with their products, the risk of complications associated with security, and the uncertainty associated with airline baggage policies. This will continue to represent a growing threat to the typical airport business model, with potential implications for all players in the aviation sector.

  Nevertheless retail revenues – the largest category of non-aeronautical revenues at 41% – outperformed per passenger growth in 2012 (+4.7%), as airports succeeded in fending off some of the competitive pressures coming from online sales and high street shopping.

  Non-EU airports remain more reliant upon retail revenues (54% of commercial revenues versus 39% of EU commercial revenues) in part reflecting the more favourable trading conditions for the consumer goods and retail markets in transitioning economies of Europe as well as less diversification in commercial revenue generation, compared to Western Europe[13]. In contrast, EU airports derive more income from property (33% of commercial revenues versus 11% of non-EU commercial revenues) perhaps reflecting the larger and more mature aviation market, and the increased presence of economic activities which are indirectly associated with aviation activities, such as business parks or airport cities. This difference may also be due to EU airport more recent moves to target non-traditional markets, such as residents in their communities and so-called 'meeters and greeters' with more extensive landside commercial zones available to the general public and positioned as a destinations in their own right.

[13] See *'Industries in 2014 - A special report from The Economist Intelligence Unit',* The Economist Intelligence Unit, 2013 – available at www.eie.com/industry.

Graph 10
Nominal overall non-aeronautical revenues by stream, 2011-2012 (€ billion)

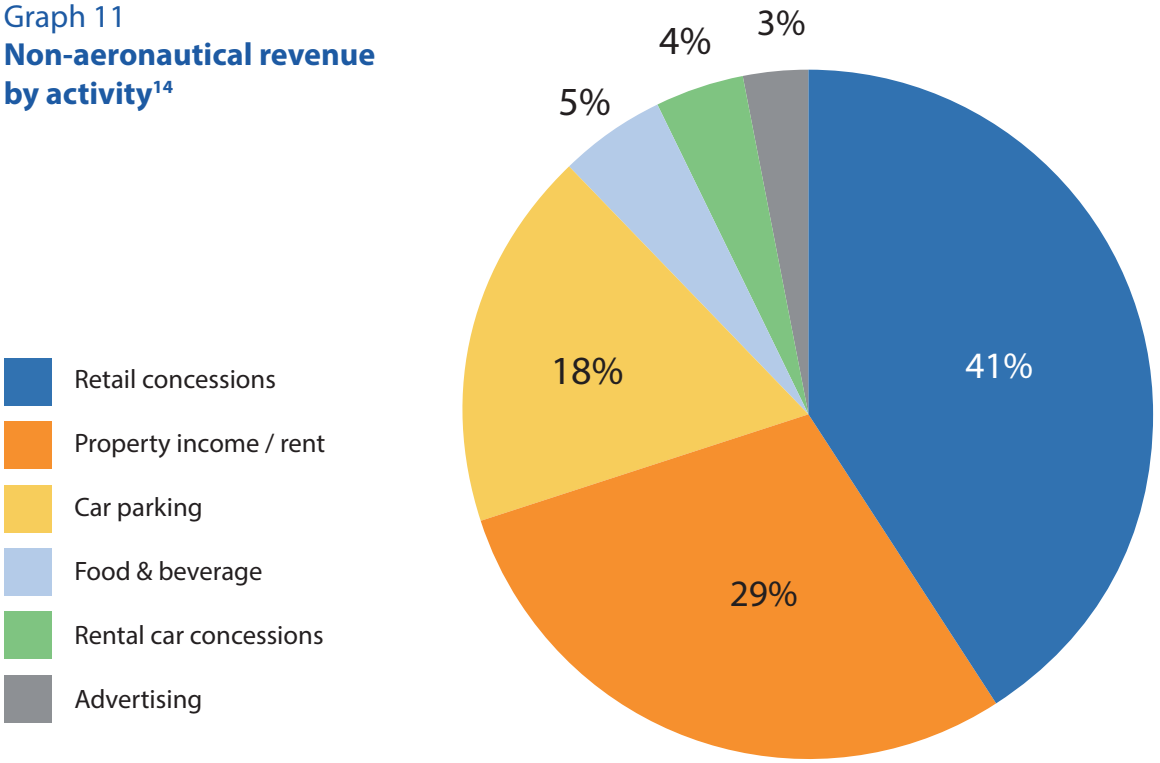


- **Structural weakness in individual non-aeronautical activities**

  2012 saw weak nominal growth and negative real per passenger growth in the two fields of car parking (+0.8%) and rental concessions (+1%). These overall figures were mitigated by reasonable growth in non-EU markets, while EU markets saw decreases even in nominal terms.

  Long considered a staple of airport revenues, car parking and leasing is no longer the revenue generator of previous years, due to policies to increase public transport connections and a move away from use of private vehicles as well as the proliferation of independent off-site car parking sites. It should be noted that airlines are increasingly forming contracts with these off-site car parking operators. This involves taking a concession to advertise the independent car parking services to their passengers online and inflight, bypassing the airport in the process. This is another example of the increased negotiating power that airlines can have vis-à-vis airports.

Graph 11
Non-aeronautical revenue by activity[14]



When all the different airport revenue streams are factored in, it can be seen that passenger-related services (passenger-related airport charges, and the revenues from retail, food & beverage and car parking) accounted for 54% of overall revenues in 2012 (up from 51% in 2011).

[14] Excluding non-operating income.



3

AIRPORT COSTS

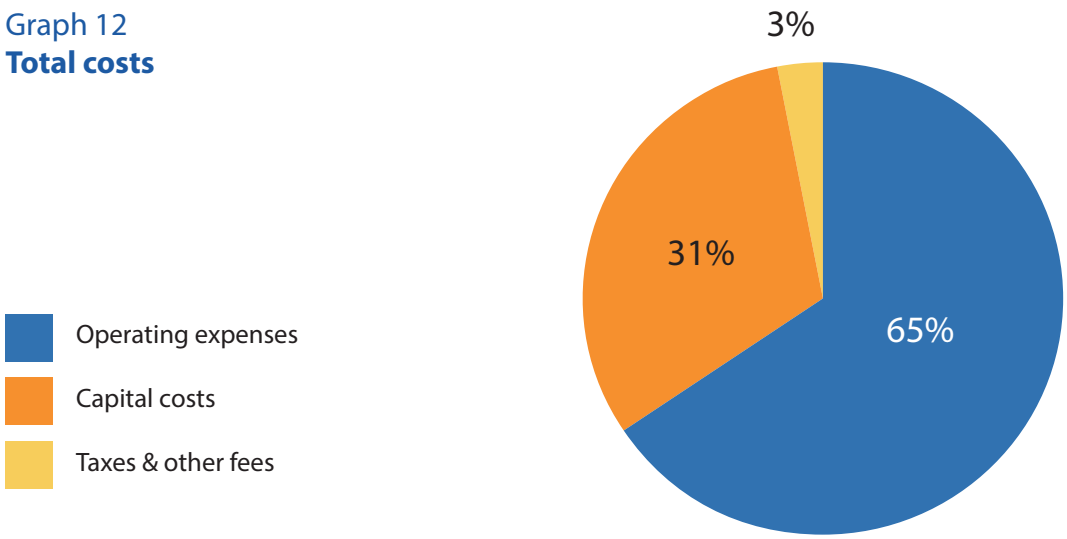
In 2012, total costs amounted to €32.1 billion - an increase of +2.5% in nominal terms and a decrease of -2.2% in real per passenger terms. This equated to a -0.2% decrease in the EU and a substantial -4.5% decrease at non-EU airports, in real per passenger terms.

Real per passenger change in total costs

Overall	EU	Non-EU
-2.2%	-0.2%	-4.5%

In 2012, total costs amounted to €32.1 billion - an increase of +2.5% in nominal terms and a decrease of -2.2% in real per passenger terms. This equated to a -0.2% decrease in the EU and a substantial -4.5% decrease at non-EU airports, in real per passenger terms.

Graph 12
Total costs



3.1. OPERATING EXPENSES

Real per passenger change in Operating Expenditure (OPEX)[15]

Overall	EU	Non-EU
+0.1%	+1.2%	+1.2%

In 2012 operating expenditure at European airports reached €20.9 billion – an increase of +4.2% on 2011 levels in nominal terms. In real per passenger terms, this represented almost flat growth of +0.1% as airports continued to consolidate savings and cost efficiencies made during the crisis years.

Within this both EU and non-EU airports recorded a small real per-passenger change of +1.2% each, although nominal overall changes were quite different, given the varying traffic growth and inflation experienced by the two airport segments.

The nature of airport finances is such that many operating costs are fixed in nature – particularly when they concern regulatory compliance and/or the scale of the airport infrastructure in question – and so as with previous years cost savings are extremely focused in nature, as airports concentrated on those savings that they had the genuine ability to deliver.

[15] In overall nominal terms, changes in operating expenses for all airports, EU airports and non-EU airports were +2.4%, +2.7% and 4.3% respectively. The real per passenger change for all airports is lower than the equivalent figure for EU and non-EU airports due to diverging passenger growth and inflation figures.

The cost discipline exercised by European airports in both 2011 and 2012 was following significant cost cutting in the immediate pre-crisis years, meaning that the savings that were delivered have been maintained even as demand recovers.

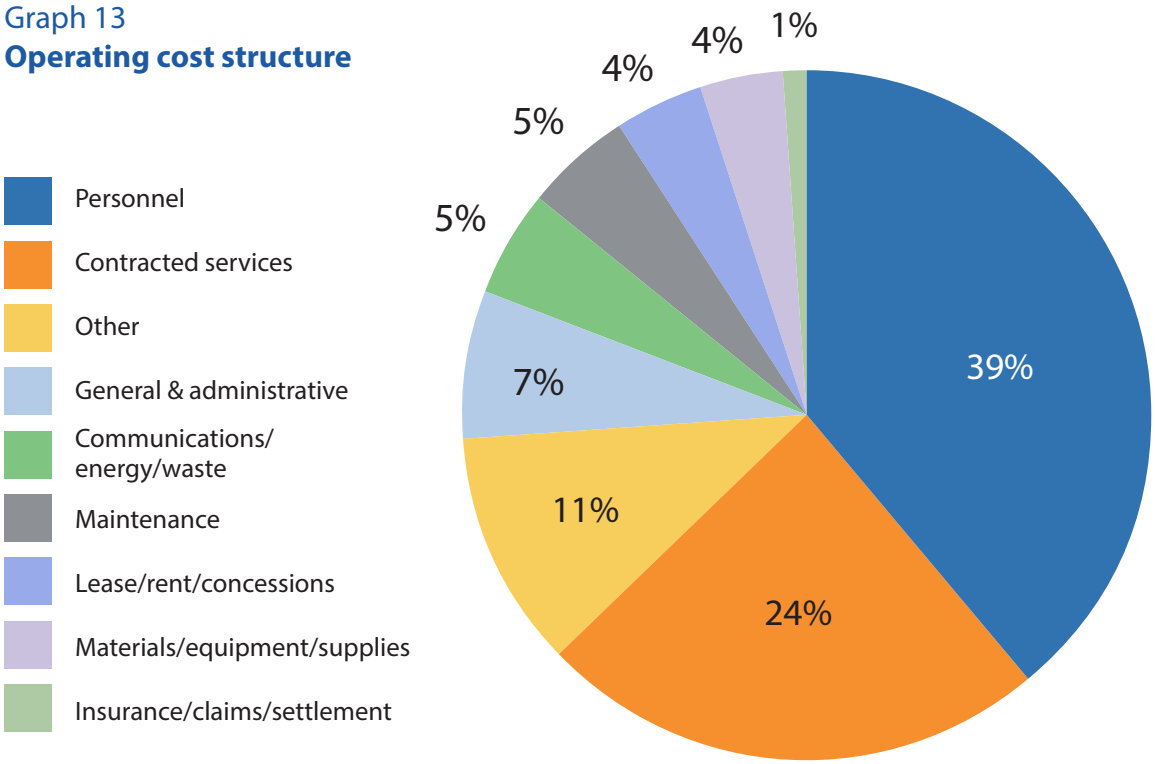
Personnel costs offer a good example of this. Since 2009 per passenger personnel costs have decreased by -18% in real terms. Personnel costs continue to represent by far the largest operating cost centre and so this has translated into significant absolute savings. This has also been in part achieved by switching to increased use of outsourcing and contracting, ensuring that sufficient labour is in place to maintain service levels, but in a more flexible and cost-effective manner.

This meant that overall European airports delivered in a sustainable manner a major real per unit cost decrease of -12% in overall labour costs (personnel and contracted services expenses) since 2009.

Interestingly and perhaps unsurprisingly, when it comes to overall labour costs, these account for circa 55% of the overall operating costs of non-EU airports, compared to an equivalent figure of 64% for their EU counterparts. This reflects significantly lower wage levels in these emerging markets and represents a considerable competitive advantage, particularly for airports offering a transfer product, where service quality is a key component of the value proposition, and where the physical presence of staff can make such a significant difference to the passenger experience.

Similar per passenger real term cost savings have also been achieved since 2009 in areas such as 'materials/equipment/supplies' (-33%) and 'communications/ energy/waste' (-22%) - again in those areas where savings where possible.

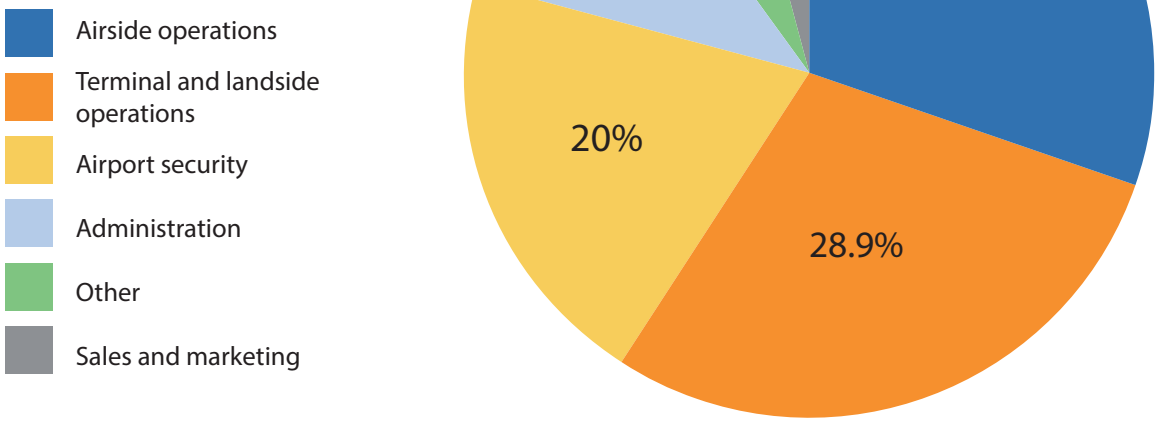
Graph 13
Operating cost structure



When costs are considered from a functional perspective, some results in 2012 can be seen as part of a wider trend. Specifically 'airside operations' and 'terminal and landside operations' now account for a combined 59% of overall costs, up from 54% in 2010 and just 43% in 2009. This represents a major shift, and is a clear consequence of the cost cutting of recent years, as operating expenses are now incurred as part of a far more concentrated focus on the end-product for airline and passenger customers.

The elimination of controllable costs can be particularly seen in the major decrease in the presence of administrative costs (11% of overall costs versus 19% in 2009).

Graph 14
Functional operating cost areas



The ACI EUROPE Economics Report 2012 drew attention to the significant drop in the 'marketing and sales' budget in 2011, citing this as an area where cost cutting could be unsustainable and counterproductive if it undermined future traffic growth prospects. Happily this trend seems to have been reversed, with a healthy increase in associated costs, even in per unit real terms. This has restored 'sales and marketing' cost centre to its previous position of 4% of overall costs.

Considering the costs and revenues, it can be seen that in 2012 airline-related charges covered only 22.5% of total airport operating costs. This is a decrease on 2011 levels and again a significant shift from 2008, when the equivalent figure was 31%.

All the indicators show that the last number of years has seen a major transfer of risk from the airline business to the airport business. In 5 years of ACI EUROPE reporting, it is clear that the airport industry consistently and strongly subsidises the airlines' use of infrastructure and services, and that this is a structural component of the aviation sector in Europe.

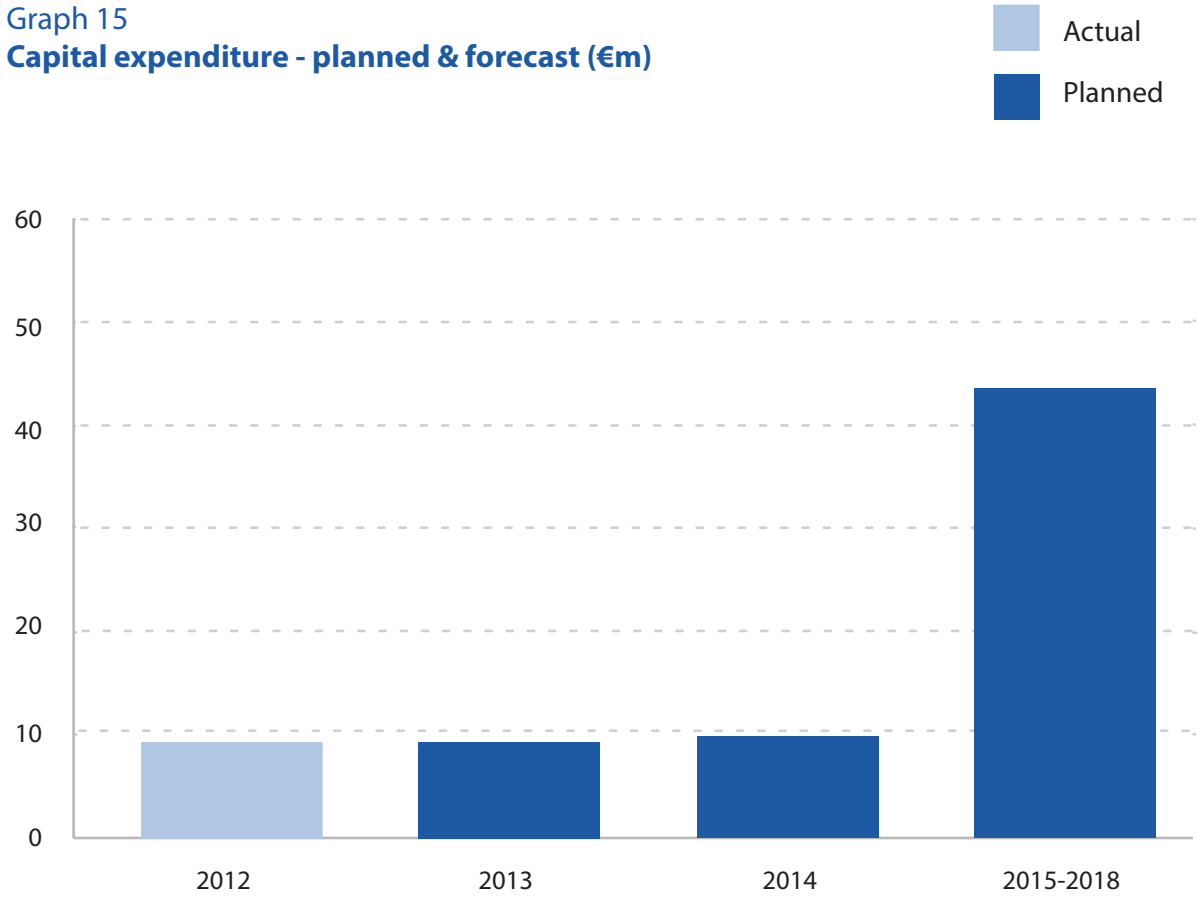
Most tellingly, it remains the case that, even when passenger-related charges are factored in, aeronautical revenues (i.e. airport charges) continue to under recover operating costs by over €4 billion each year.

Capital costs typically account for approximately 30% of overall costs annually.

3.2. CAPITAL EXPENDITURE

Investment in new and existing infrastructure has always been a core responsibility of airport operators, and a responsibility which comes with a considerable financial burden – capital costs typically account for approximately 30% of overall costs annually. Demand forecasts indicate that this responsibility will only increase with time. Levels of capital expenditure are therefore not only an indicator of the health of the industry, but have significant implications for its ability to cater for future passenger and airline demands, both in terms of accommodating flights and maintaining reasonable levels of service quality.

Graph 15
Capital expenditure - planned & forecast (€m)



Immediate capital expenditure has decreased significantly, with €9.3 billion being spent in 2012 – a -10.5% reduction compared to 2011, in real per passenger terms.

EUROCONTROL's latest 'Challenges of Growth 2013' study still envisages that by 2035 up to 12% of demand – representing 237 million passengers - will remain unaccommodated because of a lack of airport capacity - with all the associated significant loss of employment and economic growth for surrounding regions national economies.

In this context, immediate capital expenditure has decreased significantly, with €9.3 billion being spent in 2012 – a -10.5% reduction compared to 2011, in real per passenger terms. The equivalent change for EU airports was -6.3%, and was -26.2% for non-EU airports. However this is an outcome of plans which were devised during previous years of weaker growth and financial performance. More promising were longer-term capital expenditure forecasts, which have improved slightly on 2011 estimates. This may reflect the fact that data was gathered in the second half of 2013, meaning that plans for future capital expenditure may have subsequently been revised upwards in light of 2013's more positive economic news.

In 2011 it was envisaged that capital expenditure in 2013 would be €11.3 billion – against a 2012 forecast of €9.5 billion. However in 2011 it was forecast that between 2014 and 2017 capital expenditure would amount to €26.9 billion, compared to a 2012 far higher spending estimate of just over €43 billion for the 2015-2018 period.

Some renewed optimism in longer term traffic growth, combined with more favourable financing conditions (see Section 3.3) has enabled European airports to again start planning for the longer-term capacity challenges, which while pushed out by the crisis years, remain a looming obstacle to growth in the future.



3.3. CAPITAL COSTS

In 2012 capital costs amounted to €10 billion in 2012, representing a nominal change of -1.9% and a real per passenger decrease of -6.5%.

Real per passenger change in capital costs

Overall	EU	Non-EU
-6.5%	-3.9%	-12.9%

Although uncertainties remain, it appears that 2011 represented a 'high water' mark in terms of European airport financing costs, with the industry now finally seeing a decrease in capital costs, after several years of severe upward pressure. In 2012 capital costs amounted to €10 billion in 2012, representing a nominal change of -1.9% and a real per passenger decrease of -6.5%.

The bulk of this reduction was driven by an easing in interest expenses, which declined by -9.4% in nominal terms on 2011 levels. On a real per passenger basis this equated to a welcome drop of -13.9%. Nevertheless this was in the context of equally dramatic hikes in recent years, and it remains telling that interest expenses as a proportion of overall expenses in 2012 (11%) remain above 2009 levels (9%).

While there was some variance between EU and non-EU airports, the borderless nature of capital meant that the impact of lower interest rates upon both groups was largely the same. However, interest expenses occupy a far larger proportion of EU airport cost bases (11%) than for non-EU airports (5%), reflecting in part the increased risks involved in investing in a lower-growth mature market environment.

Depreciation costs for the industry as a whole rose in nominal terms, but declined by -3.2% in real per passenger terms, reflecting passenger growth and some of the capital expenditure cuts of previous years.

Airport capital costs will first and foremost continue to be dictated by external financing costs. In this respect the crucial question for the industry will be whether the massive increases in these costs experienced in recent years represents a temporary change or a more structural shift. While European airports experienced welcome relief on this front in 2012, these developments occurred over the course of the year, and it is only when 2013 data is examined can it be confirmed that these financial pressures are fully in the rearview mirror.

While the crisis years may have abated, the different interest expenses faced by the EU and non-EU airports gives some indication as to challenge of financing large capital investments in fixed infrastructure, in an environment of slower growth. This is particularly relevant in a world where faster growth is not being forecast in the medium-term, and where concerns have now turned to 'secular stagnation' and disinflation. While these problems may drag upon economic activity more generally, the capital-intensive and fixed cost nature of the airport industry will leave it particularly exposed.

Taxes and other fees paid by European airport operators amounted to €1.1 billion in 2012 – representing a 15.4% increase in nominal terms, or a +10.5% increase in real per passenger terms.

As has been pointed out before, a 5% interest rate on a €1 billion airport terminal development project across 30 years will cost €65 million each year, ballooning to a total cost of €1.95 billion. However it this interest rate is increased to 15%, the same terminal project will come to a total cost of €4.5 billion[16]. This gives some indication of the massive impact financing costs can have on the financial viability of airport operators, as well as their ability to deliver quality facilities to the traveling public.

3.4. TAXES & OTHER FEES

Taxes and other fees paid by European airport operators amounted to €1.1 billion in 2012 – representing a 15.4% increase in nominal terms, or a +10.5% increase in real per passenger terms. This varied dramatically between EU and non-EU airports.

EU airports experienced a +18% increase in real per passenger terms while non-EU airports benefited from an equivalent -28.4% reduction. This was not just a reflection of non-EU airports making lower profits as taxes. In fact, taxes as a % of profits for these EU airports was almost four times that of non-EU airports, reflecting in part a higher rate of taxation in these countries. Indeed, this is part of a wider phenomenon where emerging economies see aviation as a key enabling sector to stimulate wider economic growth, rather than as a narrow means of collecting tax revenue directly. This translates to increased State support for the sector which encompasses, amongst other initiatives, lower taxation of the individual industry players. In the EU, taxation accounts for 3.4% of total airport industry revenues. In non-EU countries, the equivalent figure is only 2.1%.

There has been some recognition of the potential benefits of this approach in the EU, with a limited roll back of national aviation taxes which were imposed in recent years. Nevertheless the aviation sector in the EU remains considerably burdened by taxation – both direct and indirect- in an environment where it already faces considerable structural disadvantages compared to its emerging market competitors.

Overall, while both airport categories benefited from lower capital costs, non-EU airport in particular benefited in a major way from economies of scale associated with strong growth, as well as more supportive taxation regimes. It was this factor which allowed non-EU airports to record a -4.5% reduction in total costs, compared to an equivalent decline of just -0.2% for EU airports.

[16] *Current Trends in Financing Airport Infrastructure, AlixPartners presentation, October 2012.*



4

PROFITABILITY

In terms of margins, in 2012 European airports reported overall EBIDTA of €13.7 billion and overall net profits of €2.5 billion. This represented real per passenger changes of -2.8% and +13.6% respectively.

However experiences differed significantly between EU and non-EU airports, with EU airports benefiting from a real per passenger EBIDTA increase of +1.9% and an equivalent increase of +31% in net profits.

Meanwhile non-EU airports recorded a -16.2% real per passenger decrease in EBIDTA and a massive -33% decline in real net profit per passenger.

For EU airports the increase in Net Profitability can be attributed almost entirely to reduced capital costs, with discipline being maintained on operating revenues and costs.

Meanwhile at non-EU airports neither aeronautical nor non-aeronautical revenues kept up with traffic growth, but operating expenses were still pushed upwards by higher volumes. In essence any benefits associated with

In terms of margins, in 2012 European airports reported overall EBIDTA of €13.7 billion and overall net profits of €2.5 billion. This represented real per passenger changes of -2.8% and +13.6% respectively.

Significantly, in 2012 European airports reported a pre-tax ROIC of just 5% - well below the industry's pre-tax weighted average cost of capital and therefore again amounting to an economic loss for the industry.

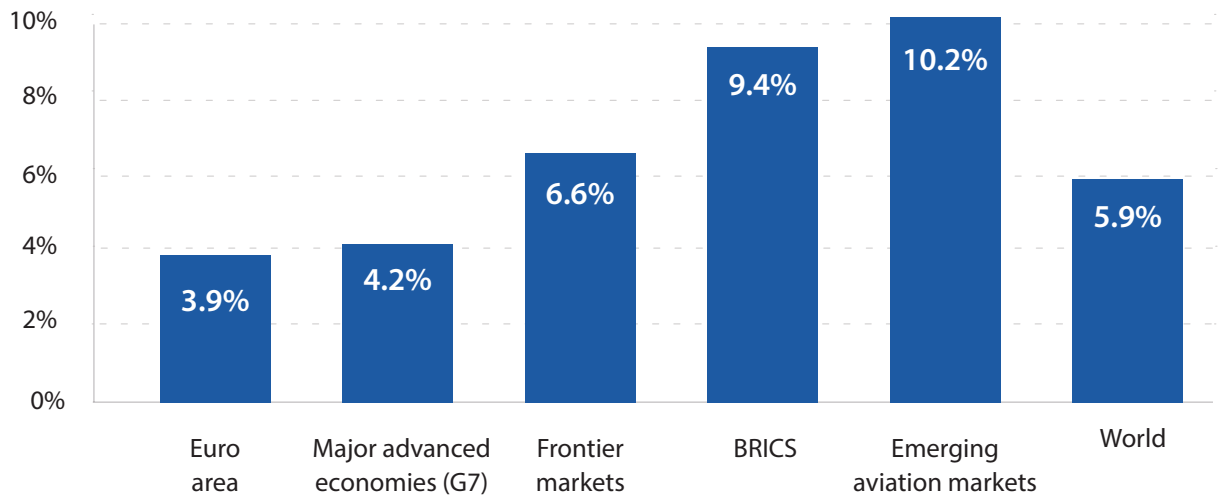
higher traffic levels were more than passed directly onto users. This reduced profitability may be a commercial or State strategy to boost traffic. It may also reflect the fact that these airports have lower historical investments to repay, given that they have only experienced large traffic volumes and growth rates in recent years, relative to their EU equivalents

However, as noted in last year's ACI EUROPE Economics Report, the key measure of airport profitability is not based on financial margins, but rather a measure of the rate of return being made on investments. Margins such as EBIDTA figures give limited insight, as they do not reflect the significant contemporary and historical capital investment which airports are required to make, in order to generate these margin. The collection of additional information from ACI EUROPE airport members means that it is now possible to report the industry's average Return on Invested Capital (ROIC), which considers the return airports generate for investors and lenders, relative to the scale of those investments and loans received by the airport.

Significantly, in 2012 European airports reported a pre-tax ROIC[17] of just 5% - well below the industry's pre-tax weighted average cost of capital and therefore again amounting to an economic loss for the industry. This result is also significantly lower than the equivalent ROIC for the global airport industry (5.9%) reflecting the combination of strong competitive forces and disproportionate level of economic regulation within Europe. Indeed, amongst various economic groupings of countries, Eurozone airports by far have the lowest ROIC, of just 3.9%.

Graph 16

Average return on invested capital by economic grouping



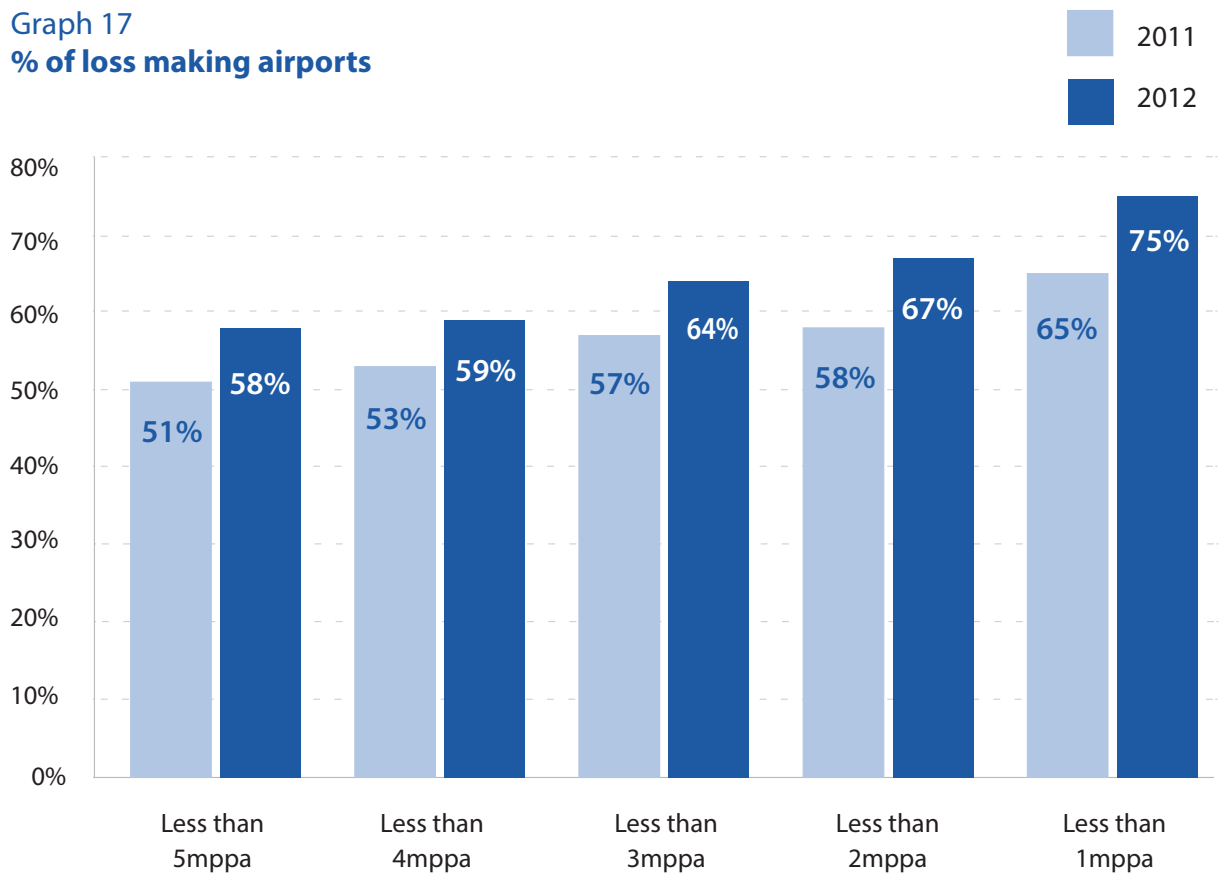
[17] Return on Invested Capital = (Net Profit + interest expense) / (Net Assets + non-current liabilities).

[18] On estimate found that the creation of the Single European Aviation Market in 1993 led to an average annual growth rate in traffic between 1995 and 2004 that was almost double the rate of growth in the years 1990 to 1994 – *'The Economic Impact of Air Service Liberalisation',* InterVISTAS, 2006.

Within this overall European figure, EU airports recorded an ROIC of just 4.6%, while non-EU airports recorded an equivalent figure of 8.3%. The relatively higher ROIC for this segment is likely to be more so a reflection of limited historical investment. Non-EU markets have liberalized later, and in a less cohesive manner than occurred within the EU. This meant that significant traffic growth was not unlocked until later[18], with correspondingly lower investment needs. As these airports begin to face the traffic levels and associated capacity challenges of EU airports, the required investment should ensure that the asset base and debt both increase considerably and ROIC values will come into line with their EU counterparts. Already in 2012 capital expenditure as a % of overall revenues was significantly higher for non-EU airports (39%) than for EU airports (25%) as investment is increased, which will add to their asset bases considerably.

A healthy and profitable airport industry is central to the health of the wider aviation sector, and is an important objective to be realised. Capacity to accommodate future growth cannot be fully delivered if sufficient returns are not generated for those delivering the capacity. Indeed, it is important that long term profitability is realised by all segments of the aviation sector. This does not have to be a zero sum game. Where certain segments of the sector are unprofitable as a whole, the specific reasons for this should be identified and corrected, rather than advocating transfers of wealth from other segments of the sector. To do otherwise will allow the fundamental reasons for individual segment unprofitability to remain unaddressed, and will needlessly undermine the health of the aviation sector as a whole.

Graph 17
% of loss making airports



In 2012, 44% of European airports reported a net accounting loss.

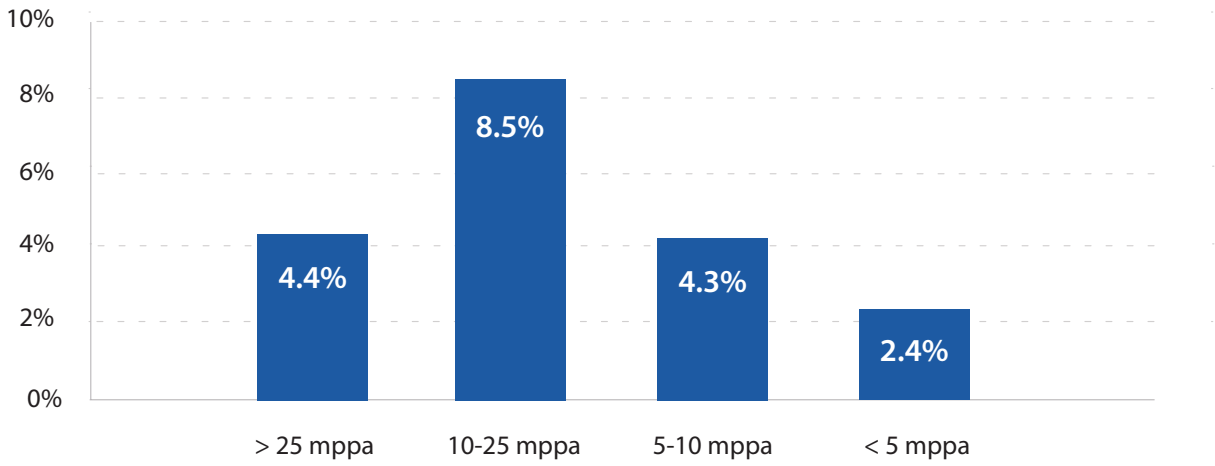
It should also not be forgotten that overall industry profitability has little bearing on the plight of smaller regional airports, which are structurally unable to cover their costs. The above graph shows that for these airports, 2012 was in fact a worse year than 2011, with more and more airports in each of the smaller size categories reporting losses.

This meant that in 2012, 44% of European airports reported a net accounting loss. This compares to an equivalent figure of 42.5% in 2011.

The above figures include non-operating income, which includes some subsidies and one-off revenue from asset divestment, meaning that the actual % of smaller airports in Europe which are recording operational losses is even higher.

It can be seen also in Graph 18 that while larger airports are more profitable than their smaller counterparts, the returns earned were still largely below their cost of capital also, with only airports with 10-25mppa approaching anything close to an economic profit.

Graph 18
Return on invested capital by airport size



While new EC State Aid Guidelines should bring more clarity to the public funding options available to these airports, those airports with between 200,000 and 700,000 passengers per annum remain in an unclear position, with final rules concerning the operation of these airports only expected in 2019. Any final decision should reflect the structural inability of these airports to cover their day-to-day operations. This is particularly the case in light of the slower growth which smaller airports have experienced in recent years, compared to their larger counterparts. For example direct connectivity of airports with less than 5mppa has in fact decreased by -3.4% since the crisis began in 2008[19].

[19] *'Regional Airports' Direct Connectivity Down -3.4% since 2008',* ACI EUROPE Press Release, May 2014 – available at https://www.aci-europe.org/component/downloads/downloads/3894.html.



5

CONCLUSION

5.1 OUTLOOK

2013 saw a gradual improving of economic conditions, as the underlying recovery which began in 2012 took a firmer hold. While some downside risks were avoided, the recovery remained a weak one.

European passenger traffic increased by +2.8% in 2013, with the division remaining between faster non-EU economies (traffic growth of +9.6%) compared to EU economies (traffic growth of +1%). Only very slow growth in freight (+0.8%) cast a cloud over developments.

2014 has started well within Europe. The news from Germany and the UK is positive. The various peripheral economies seem to be returning to stability, albeit at different stages in the process. However, more negative news from the core European economies of France, the Netherlands and Italy suggests that these positive indicators cannot be taken for granted just yet, and that frailty remains.

2013 saw a gradual improving of economic conditions, as the underlying recovery which began in 2012 took a firmer hold. While some downside risks were avoided, the recovery remained a weak one.

European passenger traffic, figures for the first quarter saw a promising increase of +4.6% (+3.3% in the EU and 9.2% at non-EU airports) .

Externally, despite some individual indicators, the US economy seems to be performing reasonably positively, although the picture remains mixed for emerging markets, with prospects varying from country to country. In addition, recent geo-political tensions have also yet to make their full economic impact known.

In terms of European passenger traffic, figures for the first quarter saw a promising increase of +4.6% (+3.3% in the EU and 9.2% at non-EU airports) while freight increased by +5.2% - a far healthier trend than in 2013. Movements, while still increasing less than passenger volumes, did register growth of +2.7%.

In some respects, while some uncertainty has diminished, this is in part because elements of the underlying risk in fact materialised. There are limited prospects for anything other than a slow recovery, with inflation -or rather the absence of sufficient inflation- remaining a concern for policy makers, given the potential for additional drag on already-weak growth. Slower growth seems here to stay for many European economies, with the EC forecasting 2014 growth of just 1.2% for the EU, 2.5% for Turkey, 2.3% for Russia, and 3.6% for the world economy as a whole, including all emerging economies.

Within the industry, continued healthier airline profits are to be welcomed[20], even if this increased sustainability comes at the cost of faster growth and increased negotiating power versus airports. Fuel prices remain the great unknown, with recent increases reflecting shorter term developments, rather than the continued underlying uncertainty as to whether we are entering an era of lower or higher oil prices. Against this background of limited positive news, ACI EUROPE has revised upwards its most recent forecasts and is now predicting growth of +3.5% for passengers, and +3% for freight through 2014.



[20] *'Industry on Track for Second Year of Improving Profits - Rising Fuel Costs Largely Offset by Increased Demand',* IATA Press Release, 12/03/14 – available at http://www.iata.org/pressroom/pr/Pages/2014-03-12-01.aspx.

5.2 IMPLICATIONS

In this context, the differing experiences of EU and non-EU airports become significant, and give some indication as to the direction the industry may well be continuing to head.

Airports in slower growth economies are marked by higher debt levels and more exposure to financial risks. The potential for cost savings are minor and incremental in the absence of significant economies of scale, and improvements in commercial revenue generation are marginal due to market maturity. The financing of capacity expansion is therefore far more challenging, involving difficult trade-offs. As a consequence, tensions within airport-airline relations cannot be soothed with the payoffs associated with high growth, as had been the case during pre-crisis years in countries such as Italy and Spain in particular.

While the slower growth in aviation activity which will be experienced within the 28 Member States presents challenges, the framework of the EU offers opportunities to avoid the slowest growth outcomes, and to mitigate some of the worst adverse impacts upon European citizens. While higher growth of the wider economy should of course be prioritised, the highly regulated nature of the aviation sector means that the correct policy decisions, tailored to the specificities of the industries involved, can have a major impact on growth prospects. EU decisions which facilitate the delivery of additional airport capacity where needed, which encourage competitiveness amongst airports, and which allow airports to deliver increased connectivity to the regions and States they serve will all help ensure that Europe's airports can, in a financially sustainable way, continue their strong contribution to society and the economy.

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METHODOLOGY

The data used in the 2013 Report is based on the economic and financial results of European airports in the reporting year 2012. 185 airports responded to the survey conducted by ACI WORLD for the ACI Economics Survey 2011, representing 72% (1.2million passengers) of total European passenger traffic.

In contrast with previous Reports, this year the Survey collected data not only for 2012, but also for 2011. This allowed comparisons to be made with 2011 data, using the same sample. This allows more reliable comparison between years within the Report, but does mean that the ACI EUROPE Economics Report 2013 cannot be directly compared with the previous year's edition.

For airports located in non-Eurozone countries, an exchange rate of €1 = $1.2848 was used.

Year-on-year changes in financial results are reported primarily in real terms. To do this an inflation index was constructed to reflect the composition of the specific sample. National inflation figures for the year 2012 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 2012 inflation rate of 2.9% for the sample as a whole, 1.8% for the EU, and 3.8% 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 44 European countries.

In 2012, member airports handled 90% of commercial air traffic in Europe, welcoming over 1.6 billion passengers, 16.7 million tonnes of freight and more than 16 million aircraft movements.

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