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AIRPORTS COUNCIL INTERNATIONAL

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Capt Kapil Chaudhary
Secretary
Airports Economic regulatory Authority of India
AERA Building
Administrative Complex,
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New Delhi-110003
India

OSD-II - On leave
DGM(ER)
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Determination of Aeronautical Tariff in respect of IGI Airport, New Delhi for the 1st Regulatory Period (01.04.2009 – 31.03.2014)

Dear Capt. Chaudhary,

Airports Council International (ACI) welcomes the opportunity to present this written submission to the Airports Economic Authority of India (AERA) on the Determination of Aeronautical Tariff in respect of IGI Airport, New Delhi for the 1st Regulatory Period (01.04.2009 – 31.03.2014).

Regulation post privatization

We urge AERA to consider the fact that the private airport operators entered into the concession on the basis of the terms of the agreements signed by them. AERA was setup post the execution of the agreements and any change in regulation contrary to the terms of the concession should be avoided as this would result in ambiguity for all the involved stakeholders.

Considering that India needs to attract private investment for the development of its airport infrastructure, we believe the right message should be sent in order to encourage private investments rather than raise concerns about the certainty of the regulatory environment.

Cost of equity

In order to attract global investors, the opportunities available investing in India's airports must allow them the possibility of achieving attractive returns.

For example, in Greece a 15% RoE is assured to the private investors despite a mere 2.4% inflation currently. The difference of approximately 7% in inflation, as compared to 9.3% inflation in India, should be adequately factored while arriving at the fair RoE.

We understand that AERA has taken average beta of airport companies from developing and mature economies. It is however worthwhile to note here that the perceived risk profile of investment options varies vastly between asset classes from economies at different levels of maturity. It is important to note that the current beta adopted by AERA of 0.5 is similar to betas adopted for Heathrow and Gatwick (0.47 and 0.52) which are much more mature markets devoid of any cyclic effect compared to Delhi airport. As such we believe the selection of beta for Delhi airport should be reconsidered.

Finally, we would like to point out that, as outlined by the UK's CAA, investing in the business of airport operations is considered riskier than other sectors (beta of 0.4 for utilities versus an average of 0.5 for international airports or even 0.61 for Stansted airport).

Quasi Equity

On the subject of treatment of Refundable Security Deposits (RSDs) as Quasi Equity, it should be appreciated that the airport operator was under no compulsion to invest the money received from deposits in building the airport infrastructure. These funds, having been applied for the purposes of project financing, are akin to equity infusion by the JVC, and hence should attract similar rates of return as equity. Therefore, we suggests AERA to consider providing appropriate equity related returns to RSDs.

RAB

We understand that certain capex was disallowed bringing down the approved project cost. This disallowance should ideally have resulted in a change in the asset mix (aero vs. non-aero) which is used to allocate the operating expenses.

As this capex was on non-aero assets, any disallowance would increase the asset mix in favour of aero assets. It logically follows that the split of operating costs between aero and non-aero should also be done on the basis of this revised split. This is particularly significant in a hybrid-till regime where a part of the non-aero revenues is used to subsidize aero operations. Therefore, we strongly advise taking the revised asset mix for operating cost allocation purposes as well.

Valuation of assets taken over during privatization

It is an international common practice to value the assets taken over during privatization at market value or replacement value or depreciated value adjusted to inflation. This methodology was followed at airports at Brussels, Sydney, New Zealand, etc. to cite a few examples.

However, we understand that, for the purpose of calculation of Hypothetical RAB, the value proposed by AERA seems to be significantly out of line with the fair value of these assets. Therefore, we suggest to AERA to revisit the basis of this valuation of Hypothetical RAB. Moreover, we believe this should be done on efficient cost basis and any duplication of manpower cost, arising due to concession requirements, should be eliminated.

CPI – X

Best international practices in calculating the X-factor suggest that it is judicious to exclude inflation in its calculation and hence arrive at the real value of X. However, AERA has included inflation in some components in the calculation of X. Thus, we would recommend AERA to revisit this and adopt the more appropriate treatment by considering CPI as an add-on after computing X.

Traffic

We understand AERA proposes a 15% increase in traffic for FY13 and FY14. In our opinion, these are extremely aggressive estimates given the economic downturn globally.

We would like to point out that ACI's latest traffic forecasts conducted in 2010 produced the following growth rates for total passenger traffic at Indian airports:

- 2013: 9.9%
- 2014: 9.8%
- 2019: 8.6%
- 2029: 6.5%
- CAGR 2009-2014: 11%
- CAGR 2009-2029: 8.2%

Considering that, historically, the growth rates at Delhi airport mirror the all-India growth, it is safe to assume that this correlation is likely to continue.

Under achievement of the traffic estimates will result in a significant shortfall in not just the aero revenues but also the non-aero revenues which are driven by footfalls as well.

In terms of ATM growth, in our assessment there is considerable over capacity in the market, as suggested by the load factors of the domestic airlines, which is one of the main reasons for the weak financial conditions of the airlines which have to keep prices low due to the stiff competition. Moreover, further investments in fleet expansion looks unlikely considering the financial distress that all carriers find themselves in.

We believe that the traffic forecasts used by AERA seem to be very aggressive and unrealistic. We would therefore urge the AERA to revisit the traffic assumptions and revise them downwards keeping in mind the above mentioned constraints.

Cargo traffic

The cargo traffic worldwide is showing signals of a slowdown.

Historically, cargo performance has been a precursor to economic upturn or downturn. A drop in cargo volumes point at falling domestic and international trade and hence lower manufacturing levels. This downturn in cargo would have an impact on other aspects of the airport revenues as well.

At Delhi airport also, downturn has been recorded in Cargo Traffic. A realistic traffic forecast is a must for ensuring viability of the airport as otherwise it will not be able to recover its costs.

Quality

We appreciate the fact that the Regulator has taken the view that the increase in tariff cannot be taken independently of the service quality provided by the operator. We support the Regulators view of close monitoring of the service level parameters. However, penalizing the operator on account of not meeting the set standards seems a harsh move as the concession agreements already have provisions of penalties levied on the operator in the case of under achievement. Additional penalty by the Regulator would lead to double penalty which would be unfair.

Also, the Regulator has proposed additional parameters to be monitored. It should be noted here that the quality parameters monitored at Delhi airport is far greater than the international standard which have relatively less number of parameters. Including additional parameters would increase the compliance costs and hence the overall operating costs of the airport which would in turn increase the tariff, which will be counterproductive.

Viability

Operating viability is paramount to ensure healthy inflow of private funds in future PPPs in infrastructure sector in India. It is public information that the Delhi airport operator is making heavy losses due to the increased cost of operating a huge facility while being able to charge the tariff as per the AAI rate card common for all airports, which we understand is not even in line with inflation. Even with the current increase in tariff as proposed by AERA, DIAL is expected to face liquidity issues in FY13 and FY14, which will jeopardize the viability of operations.

Non-aero estimates for the control period

We have noted that AERA has estimated the non-aero revenues for the control period 2009-2014 taking the year 2008-09 as the base. We also understand that the projections have been made using the passenger traffic growth rates plus an assumed increase in penetration of non-aero spends.

The accuracy of these projections is a concern as the airport already has noticed a significant difference in the actual non aero revenues for FY10 and FY11 as compared to the estimates made for these years. This also leads us to conjecture that the estimates for the next 2 years could also be significantly off the mark.

We believe that it is advisable to take actual data for the years for which it is available and then project it from that year onwards based on realistic assumptions.

This, in our view, would lead to the actual figures for the coming years to be more in line with what has been projected thus arriving at a more realistic scenario with respect to subsidization of aero activities.

High Airport Charges

Airlines have been raising the concern that Delhi Airport will be among the costliest airports. However one needs to understand that inclusion of ADF in airport charges comparison is not correct. This is a capital recovery and that too only for a short temporary period. This is not a charge on the airlines and does not hit their profitability.

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Further after 2014, when ADF is discontinued, the impact on passengers will come down significantly.

One time increase vs two step increase

A two-step increase has a very high tariff impact in the second year. This is not in the best interests of the airlines/passengers nor desirable for DIAL from a liquidity and viability perspective. We suggest it will be better to adopt a one-time increase which will be smoother for the airlines and passengers and will also improve the liquidity and viability of DIAL.

ACI thanks AERA for the opportunity to submit this submission and we look forward to continue its cooperation with AERA on economic and regulatory issues of the Indian airport industry.

Yours sincerely

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