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KANNUR
International Airport

Ref: KIAL/FIN/26/2018-19
Date: 22 October 2018

The Secretary,
Airports Economic Regulatory Authority of India,
AERA Building,
Administrative Complex,
Safdarjung Marg,
New Delhi – 110 003.

Dear Madam,

Sub: Response to Stakeholder comments to Consultation Paper No. 16 / 2018-19 dated 14th September 2018 issued in the matter of determination of Aeronautical Tariffs in respect of Kannur International Airport Limited (KIAL) for the first control period (1st April 2018 – 31st March 2023)

We enclose herewith our comments/responses to the comments received from Indian Oil, HPCL and Federation of Indian Airlines as detailed below.

Yours truly,
For KANNUR INTERNATIONAL AIRPORT LIMITED

S JAYAKRISHNAN
Chief Financial Officer

भारतीय विमानपत्तन आर्थिक विनिमायक प्राधिकरण
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तारीख 25/10/2018

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KIAL

KANNUR INTERNATIONAL AIRPORT LIMITED
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Summary of key comments made	KIAL submission/ response
Hindustan Petroleum Corporation Limited – Fuel Throughput charges should be prospective only	Charges will be applied prospectively after AERA Order on Aeronautical charges
Indian Oil Corporation Limited 1. Fuel Throughput rates quite high as compared to nearby airport – Calicut. 2. Other charges pertaining to ATF to be finalised. 3. FTP charge should be prospective.	1. KIAL has submitted the Aeronautical charges proposed considering Cochin as benchmark. Considering the high RAB due to a new Airport, unlike Calicut Airport, and considering the ARR to be recovered by way of charges, the charges have been proposed to recover its huge capital investment. The model of Fuel Farm in Kannur Airport is 'Open Access Model' unlike Calicut Airport. 2. We understand that BPCL Kannur Fuel Farm Private Limited has filed its tariff submissions for other charges relating to ATF to the Authority for review. 3. Charges will be applied prospectively after AERA Order on Aeronautical charges
Federation of Indian Airlines	
Page 3 – "...Copies of submissions made by KIAL not shared..."	KIAL has made various submissions as specified in the Consultation Paper. These relates to updates considering the updated Airport commissioning date and the clarifications and details as required by the Authority. The updated submissions together with the required clarifications have been analysed by the Authority in the Consultation Paper.
Page 5 – "...Authority has *simplicitor* accepted KIAL's claims under the MYTP without independent financial study and prudence check or commissioning experts..."	The Authority has reviewed the submissions provided by KIAL and sought clarifications and additional details as deemed necessary which was analysed by the Authority.
Page 6 – "...such an approach by the Authority wherein the pre -determined tariff (based on Cochin airport) when factored with estimated traffic is generating lower revenue as compared to ARR (under the AERA Guidelines) and consequently resulting in a shortfall, is flawed and needs to be discarded..." "...If current shortfall is to be recovered from airlines and passengers through increase in tariffs, the rates will be higher than that of other comparable airports (Cochin, Trivandrum and Calicut) and hence it is submitted that the viability and affordability of the KIA for the airlines and passengers will be significantly hampered..." "...FIA submits that the Authority should expressly review the measures to contain the 'shortfall' by adjusting the current building blocks of ARR of KIAL (as discussed in the issues mentioned below)..."	Kannur International Airport is a new Airport being commissioned by KIAL. Considering the huge capital investment together with the estimated passenger traffic being lower in the initial period of operations, the resultant tariff, if the entire Aggregate Revenue Requirement is divided by the estimated traffic would lead to higher computed charges, which as stated by FIA also, would impact the viability of KIAL and the affordability. Hence KIAL had proposed to keep tariff similar to Cochin Airport. The shortfall in collection is expected to be collected in later periods where the passenger traffic is expected to increase. It is an established practice, as has been also done in certain AAI Airports that the shortfall in collection, when it is not possible to be recouped is carried forward for recovery in future.

Summary of key comments made	KIAL submission/ response
Page 8 - 10 – "...The Authority has rightly proposed to exclude cost of land from additions to RAB until a decision on treatment of land cost is finalized Consultation Paper No. 04/2018-19 "In the matter of Determination of Fair Rate of Return (FRoR) to be provided on Cost of Land incurred by various Airport Operators of India" dated 23.04.2018..." "...ceiling cost per sq. metre for terminal building is INR 65,000. However, in the case of KIAL, the per sq. metre rate was noted to be INR 180,843 (Integrated terminal building area of 9 lakh sq. feet as per Table 1 of Consultation Paper, equivalent to 83,612.74 sq. metres). This is almost 2.75 times of the capital expenditure as per Normative Order. Also, as per Para 7.8 of CP 5/2014-15, cost of per sq. meter of a modern airport terminal building varies between INR 43,333 per sq. mtr (Cochin) to INR 145,000 (Bangalore). Hence, the cost per sq. meter of the terminal building in KIAL is significantly higher than this range..." '... FIA would not be able to comment on whether Normative Order No. 07/2016-17 has been considered by the Authority while accepting KIAL's submission with respect to capital costs towards runway, roads and culverts. As per the said order, the cost per sq. meter should not exceed INR 4,700 per sq. meter..." "...Interest during construction (IDC) has been considered by the Authority on an "as is basis". Further, the Authority has not provided any details of IDC of INR 172.21 crores (c. 8.20% of the total cost submitted by KIAL) have been furnished in the Consultation Paper for stakeholder's review..." "...Pre-operative expenses of INR 105 crores (c. 5.00% of total cost submitted by KIAL) seems to be on adhoc basis and has not been evaluated/discussed by the Authority in the Consultation Paper..." "...Largest component of plant & machinery costs is mentioned as 'Other Equipment' worth INR 160.42 crores (c. 9% of the capital expenditure accepted by AERA) without any further details of the type of equipment..." "...FIA submits that the Authority ought to confine itself to the normative norms i.e. Normative Order No. 07/2016-17 while determining the capital expenditure/RAB for the 1st control period at the time of passing order..."	KIAL, in its response to the Consultation Paper has submitted and requested for return to be provided on land and the same is not repeated herein. FIA's analysis of per sq. ft cost is incorrect. "Building" as considered by FIA includes other costs relating to: a) Site development and earth filling b) Boundary Wall c) Ancillary building d) Drainage and Ducts e) Power and other equipment outside Terminal Building, etc. KIAL has submitted detailed analysis on how the estimated costs are within the range of normative costs as considered by the Authority in its Normative Cost Order, which has been reviewed in detail by the Authority. Interest During Construction is calculated in the business model based on draw down. Pre-Operative expenses are considered based on approved budgets and actuals are in line with the estimates. These costs are all proposed to be trued up by the Authority based on actual costs capitalised and audited.
Page 10 – "...The Authority has proposed to carry out a technical study on the area between Aeronautical and Non-Aeronautical for next control period, this approach of the Authority will result in significant delay in testing of actual	Allocation of Capital and Operating Costs between Aeronautical and Non-Aeronautical is done as an estimate which is broadly in line with AAI airports, BIAL etc.

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allocation ratios and during which passengers and airlines will be burdened by high tariffs..."	Airport Operations and Terminal building usage for Non-Aero activities also would need to be stabilised for evaluation of allocation ratios.
Page 11 – "...FIA would like to highlight that return on RAB is c. 67% of the total ARR for the first control which is significantly higher than the share of return on RAB at other airports..."	Proportion of RAB on Total ARR would vary based on various factors, including the timing of investment, whether it is a new airport or existing airport, other factors impacting ARR etc. Hence, it may not be possible to have a benchmark for the Return on RAB being considered as a % to total ARR.
Page 11 – "...Authority has not scrutinized the reasonableness of operating expenditure and proposed true up in the second control period. Lower Operating expenditure per passenger of the other airports of same state has been presented but not considered in proposed Operating expenditure. Authority has accepted allocation ratio submitted by KIAL and no independent study is proposed in the Consultation Paper..." Page 15 – "...Authority has not evaluated benchmarks in detail and has accepted a high operating expenditure contributing towards the shortfall in ARR. However, considering the shortfall in ARR, the Authority should consider lowest opex per passenger reflecting in comparable airports..." Page 13 – "...Authority has presented and compared these benchmarks, but not applied these benchmarks in proposing the operating expenditure of KIAL and rather relied upon KIAL's submission. FIA has analysed opex per passenger for 1st year control period of KIAL with that of Cochin and Calicut rather than comparing opex of first six months of operations of KIAL..." "...Aero operating expenditure be considered at 80% in the 1st control period to reduce ARR & minimize shortfall. Further, the Authority needs to conduct independent study for allocation of operating expenditure which may be used for truing up in the 2nd control period..."	While Operating Expenditure/ Non-Aeronautical Revenue per passenger could be a point of comparison across airports, the same may not be fully comparable between an established and running airport and a new airport where the existing airport is expected to have an established traffic base. Certain costs in Airport Operations may be fixed and hence, where there is higher traffic, the per passenger cost could appear to be lower in certain airports. KIAL has provided basis for estimation of costs and the actual trend of costs would be known once the Airport has been commissioned and is in operation for some time. KIAL has therefore requested the Authority to true up the costs based on actuals. Operating expenditure per year compared by Authority considers estimated annual cost divided by Annual number of passengers and hence is correct. Allocation of Capital and Operating Costs between Aeronautical and Non-Aeronautical is done as an estimate which is broadly in line with certain AAI airports, BIAL etc. Airport Operations and Terminal building usage for Non-Aero activities also would need to be stabilised for evaluation of allocation ratios.
Page 16 and 17 – "...Steady growth in the average retained earnings as part of the equity portion, which decreases the debt equity ratio and in turn increases FRoR by virtue of a higher cost of equity (16.00%) than cost of debt (10.05%)..." "...Debt repayments as submitted by KIAL have been accepted without any detailed discussion in the Consultation Paper. No repayment schedule of such debts has been discussed for stakeholder	KIAL has submitted details of the loan taken, proposed repayment schedule etc. which has been evaluated and considered by the Authority. The same has also been factored in the Business Plan to estimate the Forecast Debt and Equity ratios. KIAL requests the Authority to true up the FRoR based on change in cost of debt and the actual Debt : Equity ratios.

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consultation. This results in decrease of the debt equity ratio and in turn increases FRoR by virtue of a higher cost of equity (16.00%) than cost of debt (10.05%)..." "...FRoR is high at 13.06% as the financing structure is more equity driven (debt equity ratio is 49:51) which is not very efficient also due to higher return of equity which is at 16%..." "...FIA submits that the Authority to consider the return of equity @ 14% and debt equity ratio at 60:40, in order to avoid overburdening of passengers and airlines. This will also ensure viability of operations of airport..." "...No true up has been proposed for the debt equity ratio in second control period..." "...Any security deposits to be received has not been considered by the Authority..." Page 19 and 20 – "...Authority to consider the return of equity @ 14% and debt equity ratio at 60:40, in order to avoid overburdening of passengers and airlines. This will also ensure viability of operations of airport..."	Considering normative gearing ratios would be against the interest of the investors who have contributed share capital to the Project. FRoR is higher due to the higher equity involvement in the Project, where the operations are yet to be demonstrated. Return on Equity at 14% is not justified considered the new airport and increased risks as has been detailed by the Authority. KIAL confirms that no significant security deposits have been received from any party to fund the Airport construction.
"...In key revenue heads such as duty-free shop, space lease rental, land lease revenue and advertisement revenue, there is a glaring discrepancy of projections of non-aero revenue per passenger as compared to other airports, wherein the non-aero revenue per passenger for such airports is 2x (duty free shop) to 25x (space lease rental) of the non-aero revenue per passenger for KIAL. It is submitted that Authority has considered non-aero revenue per passenger within benchmarks without any justifications thereof..." "...It was also noted that cross subsidization of non-aero revenue for KIAL represents a meagre 2% of the ARR as opposed to other benchmark airports which range from 8% (Trivandrum) to 17% (Cochin)..."	KIAL has submitted basis for estimating the Non-Aeronautical Revenue. Considering that Kannur International Airport is a new airport and considering the uncertain traffic and the need for operations to stabilise, Non-Aeronautical Revenues are expected to stabilise and improve once the Airport operations are stabilised. Considering the same, KIAL has requested the Authority to true up the Non-Aeronautical Revenues based on actuals.
Page 22 – "since the traffic projections are critical in ascertaining the tariffs, Authority must appoint an independent consultant to evaluate traffic forecasts submitted by KIAL, which is the role of the Authority rather relying on numbers proposed by operator. It is submitted that the detailed evaluation/study cannot be avoided in garb of truing up..."	Traffic projections have been made by an independent consultant, which has been submitted to the Authority. Considering the new airport, KIAL has requested for the traffic to be trued up based on actuals.
Page 22 – "...Authority has considered depreciation over 100% of the original cost, in contravention to	KIAL submits that as detailed in Consultation Paper 09/2017-18 in the matter of determination of

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Summary of key comments made	KIAL submission/ response
AERA Guidelines. Depreciation charge is also based on KIAL's submission..."	useful lives of Airport Assets, this has been left to the evaluation of individual Airport Operations. Policy adopted in financials would be adopted for the purpose of true up.
Page 24 – "...It is submitted that determination of aeronautical tariff warrants a comprehensive evaluation of the economic model and realities of the airport – both capital and revenue elements. AERA's approach of Hybrid Till for KIAL deserves to be discarded..."	FIA has made detailed submissions on manner of till to be adopted etc. These have been decided by Authority in its Order and hence are not detailed by KIAL in its submissions.