



APAO/AERA/ 2022-23

Date: 3rd September 2022

Shri Ram Krishan,
Director (P&S, Tariff),
Airports Economic Regulatory Authority of India (AERA),
AERA Administrative Complex,
Safdarjung Airport,
New Delhi – 110003

Subject: APAO response to Consultation Paper No. 7/2022-23 dated 5th August 2022 in the matter of determination of aeronautical tariff for Mangaluru International Airport Limited for the First Control Period (01.04.2021-31.03.2026)

Dear Sir,

As the apex industry association of all the major private airports operating in India, APAO is pleased to share its response on the proposals in the above-mentioned CP for the kind consideration of the Authority.

Mangaluru International Airport Limited (MIAL) is one of the airports which was privatized recently and started commercial operations under the new operator from 31st October 2020.

The Covid Pandemic had severely impacted the aviation sector in the last two and half years leading to an unprecedented fall in passenger traffic across the world. The fall in traffic and various lockdowns have adversely impacted the airport sector and the impact is much higher for smaller airports like MIAL.

Given the above background, we would like to highlight our inputs on certain key issues.

1. Intangible assets (Pre-COD expenses) not allowed for purpose of tariff determination

As per the terms of the concession agreement, the senior management staff of AAI of the rank of deputy General Manager and above were to remain deputed at the Airport for a period not exceeding 3 months from the Commercial Operation Date (COD) and that their costs had to be borne by AAI. Authority has used this as the argument as the basis for not allowing Intangible Assets for the purpose of tariff determination. The fact is that **intangible assets are expenses which were incurred by Adani Group entities before the COD** for the seamless transition from AAI to the Private Airport Operator. Our view is that all the activities which were carried out by the Airport Operator (AO) prior to COD could have been done either by the AO employees or domain experts services availed by MIAL. Senior personnel of AAI had no role in this transition as they were responsible for carrying out their

respective roles assigned to them by AAI. Further Concession Agreement also provides for fulfillment of various obligations to be performed by the Concessionaire at CoD. So, MIAL was bound to perform these activities and there was need to incur costs for the same.

As we know AAI is contemplating the next round of bidding of the regional Airports. Clarity on this matter will be of immense importance to the prospective bidders. We expect AERA to play a vital role in clarifying its stand on the matter which will also give assurance to the interested bidders that the obligations under the Concession Agreement are paramount and need to be adhered to.

We understand that Intangible assets have been capitalized in the books of Airport Operator. It would be AERA's prerogative to allow these expense as either Capital Expenditure or Operating Expenditure.

2. Restricting R&M expenses to 6% of opening RAB

AERA has restricted the R&M expenses to lower of 6% of opening RAB or submission of airport operator. This approach is against the spirit of AERA Act. As per section 13 of the AERA Act, Authority has to ensure economic and viable operation of the airports. Further, cost for improving the efficiency has also to be considered for determination of tariff of aeronautical services.

Relevant extract from AERA Act is as follows: -

13. Functions of Authority – (1) The Authority shall perform the following functions in respect of major airports, namely: -

(a) to determine the tariff for the aeronautical services taking into consideration-

- (i) the capital expenditure incurred and timely investment in improvement of airport facilities;;
- (ii) the service provided, its quality and other relevant factors;
- (iii) the cost for improving efficiency;*
- (iv) economic and viable operations of major airports*

By restricting these expenses, we humbly submit that the Authority is acting in contravention to the mandate of the AERA Act.

Further AERA guidelines which provide for the detailed framework of how the Authority will determine the tariff also does not provide any capping of R&M expenses to 6%. Restricting the expenses will compromise the operations as Airport operator as they will not able to incur more than what has been allowed by Authority.

Interestingly, in this case two Airport operators are involved Pre-COD and Post-COD. Both understand the intricacies and needs of repair and maintenance which an airport requires and have accordingly provided for the same for safe and efficient running of the airport. Linking the same to plain mathematical formula (% of net RAB) might result in over projection or under projection of these expenses with no linkage of the same to actual R&M needs of each individual airport.

R&M needs of each airport operator depends on various factors which are unique to them, by using the same standard template of projecting these expenses for different airports is not an appropriate approach.

3. Inflation considered at 4.9%

AERA has decide to consider WPI inflation at 4.9% for the First Control Period based on average of the median WPI inflation forecasts of the 4th quarter of FY 2020-21 and of FY 2021-22 given in the 69th round of survey of professional forecasters on macroeconomic indicators of RBI

Inflation has emerged as a major concern over the last few months. The situation is such that the Reserve Bank of India (RBI) has signaled a shift in focus from reviving growth to mitigating risks posed by inflation. Retail inflation numbers have remained above the Reserve Bank of India's (RBI) upper tolerance limit of 6 per cent.

Unprecedented inflation all over the world and specifically in India in last few quarters has resulted in huge increase in rates of the raw materials and labor which will eventually result in higher O&M expenses and capital expenditure for the airport

We request AERA to consider the latest inflation numbers for forecasting the expenses of the airport.

4. Cost of debt

MIAL has taken debt from group company Adani Airport Holdings Limited (AAHL) which in turn has availed borrowing from global institutions. Debt was availed by holding company AAHL at rate of 12% which is market driven rate as per risk perceived by investors of airport business of Adani Group. We believe that smaller airports like Mangalore cannot raise debt on their own as no investors will be willing to take such a risk. It is an innovative and cost-efficient measure to take consolidated debt at holding company level instead of obtaining debt at single Airport level which will be costly and lack economies of scale.

AERA has proposed cost of borrowing to be considered at 9% p.a. being the average of other five PPP airports viz. DIAL, MIAL (Mumbai), GHIAL, BIAL and CIAL (ranges from 7.80% to

10.30%). This approach is erroneous and penalizing Mangaluru airport and the same will result in MIAL generating returns below its cost of capital and a loss-making proposition, which is not the intent of AERA guidelines, NCAP, and against vision of GOI to incentivize the private investments in the airport sector

We earnestly request Authority to consider 12% as cost of debt for the 1st control period and true up of the same in the subsequent control period.

5. Cost of Equity

In this regard it may be pertinent to mention that to attract investors in the airport development it is essential to accord an optimal rate of return for equity investments. The Ministry of Civil Aviation had appointed SBI-CAPS to conduct a study in order to arrive at an optimal rate of return on equity to cover the risks of an investor. The results of the study indicated that the rate of return for the airport operator considering all risks should be in the range of 18.5% to 20.5%. However, the Authority considered return on equity at 15.18% for MIAL based on average of cost of equity allowed by AERA for 5 PPP airports which is far less than the assessment done by the Ministry through SBICAPS. Therefore, it is suggested that the airport operators be accorded adequate return, in this regard Authority should allow the Return on Equity requested by the respective airport operators of 17.50% which is lesser than the assessment of SBI CAPS. Further, IIM B while evaluating beta for return on equity for PPP airports has majorly considered developed countries. In order to arrive at a true reflection of risk the Authority should have used beta of developing countries similar to India.

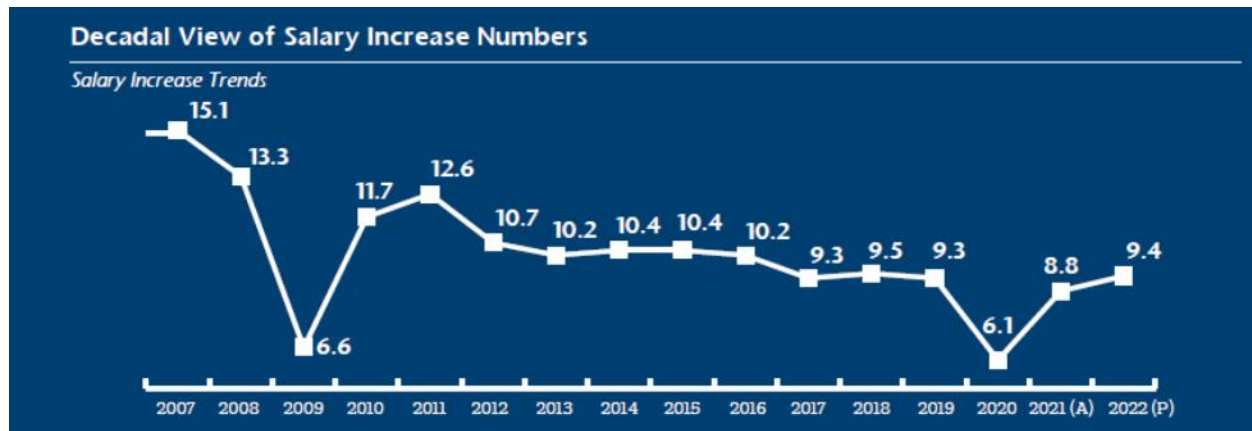
6. Rationalization in Employee numbers and salary increase not allowed as per projections of Airport Operator

Airport operators are experts in their domain, and they understand much better about the operating requirements of the Airport. AERA has reduced the number of manpower without a justifiable reasoning. The reduction in manpower is made on the premise that it looks higher as per Authority point of view. It would be helpful if the Authority can publish its study about the manpower requirement based on size of the Airport.

AERA has only allowed 6% increase in salary which is very low given the current labor market conditions. According to global professional services firm Aon's 26th Salary increase Survey in India, organizations across industries project a 9.9 per cent salary increase in 2022, compared to 9.3 per cent in 2021. Salary increments in India will touch a five-year high of 9.9 per cent in 2022 as organizations are planning to invest in new-age capabilities to build a resilient workforce amid strong economic recovery and positive business sentiment. As per the survey, a positive business outlook is resulting in a higher number of double-digit increments. Around 88 per cent organizations foresee an

improvement in business outlook in 2022, 11 per cent higher from 2021, the survey said, adding that 33 per cent organizations are expected to give double-digit salary increases in 2022 -- an increase of 5 percentage points from 2021.

The salary increases across India in the last 10 years before Covid-19 is ranged from 12.6% to 9.3%.



7. Cost claimed towards technical services, PMC, Preliminaries and Pre-operatives, Contingencies, Statutory approvals, Labor cess, Site-preparation, Insurance etc.

AERA has allowed 8% of capex costs as cost claimed towards technical services, PMC, Preliminaries and Pre-operatives, Contingencies, Statutory approvals, Labour cess, Site-preparation, Insurance etc. as against 15% proposed by the airport operator.

Above reduction has been done on basis of costs allowed by AERA in the past while determining tariff of other PPP airports. Each airport has different infrastructure needs based on their location, traffic handling capacity, passenger mix, local culture. Authority itself has allowed these costs in the range from 8% to 11% which clearly establishes the fact the cost will vary depending on the needs of each airport. Based on their unique positioning, MIAL has determined these costs as 15% of total capex costs. **We request the Authority to approve the same while determining the tariff of MIAL.**

8. Deferment of ARR

In addition to above mentioned issues, Authority has proposed to carry forward some portion of the ARR to the next Control Period. We request Authority to consider cash flow requirements of the Mangaluru Airport while making a decision on the deferment of ARR, as it might affect the capacity of the Airport Operator to raise required debt to meet the much-

needed capex requirement of the Airport. **We request the Authority to take consent of the Airport Operator on the deferment and not take any decision unilaterally on the matter.** Deferment of ARR may not be interest of airport users as well as they will have to pay for any shortfall in ARR with higher amounts (with carrying costs) in the next Control Period.

9. Revision of Tariff

We also request the Authority to consider favorably Airport Operator's request to revisit the tariff card at the end of FY24 without undertaking a detailed tariff review.

We earnestly request the Authority to give a serious consideration to the points raised by us in the above response, before issue of final order determining the aeronautical tariff for Mangaluru International Airport Limited for the First Control Period.

In case any other information/ clarification is required in this connection, please inform the undersigned.

Thanking you.

Yours Sincerely

For The Association of Private Airport Operators (APAO)

A handwritten signature in black ink, appearing to read "Satyan Nayar".

Satyan Nayar

Secretary General

Mobile No: +91 98100 49839