MENZIES AVIATION

Date: 28th August 2023

Director (P&S, Tariff)
Airports Economic Regulatory Authority of India (AERA)
AERA Administrative Complex
Safdarjung Airport
New Delhi - 110003.

Sub: Response to stakeholder comments of Bangalore International Airport Limited (BIAL) dated 17 August 2023 and Federation of Indian Airlines (FIA) dated 18 August 2023 in response to the Consultation Paper No. 06/2023-24 dated 28 July 2023

Ref: Consultation Paper No. 06/2023-24 dated 28 July 2023 for determination of tariff for Cargo Handling Services for Menzies Aviation (Bengaluru) Private Limited (MABPL) at Kempegowda International Airport (KIA), Bengaluru for the First Control Period (FY 2023-24 to FY 2027-28)

Dear Sir,

Please find below our responses on the specific proposals contained in the above-mentioned responses to the Consultation Paper for the kind consideration of the Authority:

A. Response to the comments of BIAL

1) On – *'Uniform Price Increase for Airlines and Shippers/Agents'*
MABPL concurs with BIAL in this regard and has separately submitted its views in detail as part of the response to stakeholder comments.

The lack of negotiating flexibility on part of MABPL renders current revenue projections by the Authority unlikely. Therefore, in line with the competitive spirit, with which BIAL had envisaged a dual-operator system, the two cargo operators should have uniformity in terms of flexibility of pricing, and tariff hikes.

MABPL, would therefore, request the Authority to allow for a tariff revision that is consistent across the two cargo operators.

2) On – *'Estimated Loss, Risk of Exit of Global Players and Cost of Personnel'*
Firstly, MABPL would like to thank BIAL for recognizing the global positioning of MABPL and believing that it will introduce best practices and improve operational efficiencies, in line with the vision and policies of the respected Government of India.

MABPL concurs with BIAL's views on the estimated losses, risk of exit of global players and personnel cost. MABPL would like to reiterate that given the current tariff structures, the revenues projections are unlikely to be achieved. The amount of risk carried, the magnitude of the infrastructure deployed and the quality of services targeted – all make a ~6% profit margins over a period of five years a cause of concern.

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In line with the vision of introducing market efficiencies and global quality standards, MABPL had worked rigorously to find the talent that could bring to life BIAL's vision. As mentioned rightly by our respected Airport Operator, while this talent is among the best and the brightest, they need to compensated as per market standards. Further clamping down would hinder MABPL's capability to fairly compensate and therefore retain its workforce, which can seriously hurt the cargo operations at BIAL.

3) On – *'Treatment of security deposit'*

MABPL concurs with BIAL in this regard and has separately submitted its views in detail as part of the response to stakeholder comments.

MABPL would request the Authority to treat the security deposit in line with the guidelines by the Hon'ble TDSAT.

B. Response to the comments of FIA

1) On – *'Introduction: Review of Tendering Process: (Refer 1.1.1, 1.1.3 & 1.1.4 of the CP)'*

Primarily, MABPL would like to highlight that the structuring of tendering process is not under the purview of regulation under the Authority, and hence falls outside the scope of this discussion.

However, MABPL would still like to highlight that Menzies is the second largest service provider globally by the number of airports served. Menzies CHQ provides an unmatched, cost-effective expertise by leveraging its learnings from more than 60+ countries Operations. Such an international presence, expertise and in-depth understanding of the business is what allows Menzies to operate with world class efficiency.

2) On – *'Cargo Volume Projections :(Refer 3.1.2, 3.1.4, 3.2.4 & 3.2.6 and Table 4 & 5 of the CP)'*

MABPL has determined the growth rate in traffic for both domestic and international cargo volumes projections at BIAL based on the pre-COVID cargo traffic growth rate. Thus, it has not considered the COVID impacted period in its traffic projections.

For the international traffic, MABPL is operating in a competitive environment. While MABPL is a new entrant, actual cargo operations since 24 May 2023 have helped them form a clear picture regarding its international market share for the control period. MABPL submits that all major international airlines have already entered into SGHA agreements with term period ranging between 3 to 5 years. Since majority of the international airlines are allied with either of the two cargo operators for at least three/five years, MABPL's market share in the month of July, 2023 is unlikely to change over the control period. Thus, market share in the month of July, 2023 represents the accurate allocation of international cargo traffic excluding cold chain and express cargo between the two cargo operators. Based on the above, MABPL has revised its international traffic projections as part of its response to the stakeholder comments as given below.

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Particulars	FY24*	FY24 (annual)	FY25	FY26	FY27	FY28
International cargo traffic handled by MABPL (MT)	84,833	100,308	106,326	112,706	119,468	126,637
Growth rate (%)			6%	6%	6%	6%

MABPL would highlight that a large international carrier has shifted its cargo handling operator from MABPL to its competitor from 1st July 2023 onwards. The share of the cargo carried by this international carrier in total international traffic of MABPL was ~19% (~21,600 MT annually). To account for this change, it is of utmost importance for MABPL that the Authority considers the revised traffic forecast. MABPL would further highlight that its traffic forecast proposed for the first control period is still higher than the traffic forecast approved for its competitor which had also assumed a 50% market share as stated in para 3.5.2 of their order implying that the traffic assumptions of MABPL are more optimistic for the same cargo market.

On the comments to true-up the traffic forecast, MABPL would highlight that the Authority has applied Light Touch framework and thus, it does not have the benefit of the true-up in the following control periods. Therefore, any losses incurred will be borne solely by MABPL which will lead to financially unsustainable operations.

MABPL would therefore request the Authority to allow the traffic projections submitted by MABPL in its response to consultation paper.

3) On – *'Capital Expenditure (Capex), Regulatory Asset Base (RAB) and Depreciation: (Refer 4.1.1,4.1.3, 4.2.3,4.2.5 and Table 8)'*

MABPL would reiterate that the capital expenditure proposed is determined as per the 'Service Provider Right Holder' agreement with BIAL which mandates the construction of the greenfield domestic terminal and the expansion of the international cargo terminal. Further, MABPL has justified the capital expenditure along with its efficiency to the Authority in its MYTP and various responses to the queries from the Authority. To reiterate, the existing infrastructure at the cargo terminal has worn down over time, with some equipment as old as 16 years, as a result, certain OEM equipment cannot be maintained as they are no longer available in the market and therefore, the refurbishment of the existing cargo terminal is justified. Further, Kempegowda International Airport, Bengaluru is the third busiest airport in India, which is in the world's most populous and one of the fastest growing countries. It, therefore, needs to keep up with the latest technological equipment to ensure best-in-class customer experience and safety.

MABPL would also highlight that under the light touch approach, MABPL is not eligible for true-up in the second control period. Thus, MABPL has taken the risk of incurring the capital expenditure as per the SPRH agreement which needs to be adequately compensated during the first control period itself.

Therefore, MABPL submits to the Authority to consider the proposed capital expenditure as part of the first control period tariff determination.

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4) On – *'Fair Rate of Return (FRoR): (Refer 7.3.3 and Table 33 of the CP)'*

Normalizing MABPL's, a cargo operator, FRoR/cost of equity with other ISPs/ airport operators is not an ideal approach, as the risk adjustment for the two would be very different. MABPL has provided, in its MYTP and response to the consultation paper, the detailed computation of the cost of equity as per the CAPM model. The cost of equity after adjusting for the risks, came in at 21%, which resulted in an FRoR of ~16%. MABPL, thus, requests Authority to consider the FRoR as per its submission. Further, MABPL would highlight that the FRoR approved for DCSC (14%), MCSCAPL (14%), and MAFFPL (13.28%) is much higher than MABPL.

On the comments on the efficient O&M costs, MABPL would like to reiterate the clause 8.5.5 of Order No. 13/2023-24 released on 09/08/2023, where a comparison was done between the two operators at Bangalore Airport. It clearly depicts the efficiency of O&M at MABPL on per MT basis. Thus, MABPL has provided efficient O&M costs for the tariff determination exercise.

5) On – *'Abolishment of Royalty Charges/ Concession Fee'*

MABPL would like to highlight that the revenue share is as per the SPRH agreement entered by MABPL with BIAL for providing the cargo services at Bangalore Airport. This is also in line with the Order issued by the Authority - *In the matter of Capping the percentage of Royalty/Revenue Share payable to Airport Operator as a "Pass Through" Expenditure for the Independent Service Providers providing Cargo facility, Ground Handling and Supply of Fuel to the Aircraft at Major Airports.*

MABPL does not wish to comment on this as '*Abolishment of Royalty Charges/ Concession Fee*' is a non-regulatory matter and falls outside the scope of this discussion.

6) On – *Operating & Maintenance Expenditure ('O&M Expenses'): (Refer 5.3, 5.4 and Table 22 & 28 of the CP)'*

MABPL disagrees with the claim of 6% YoY increase in total personnel cost because it neither takes into account the annual hikes nor the increase in manpower. MABPL would reiterate its proposal for 16% YoY increase in manpower expenses based on standard 10% YoY increase in salaries and 6% YoY increase in manpower in line with the cargo traffic forecast. Not compensating employees in line with industry standards leads to employee dissatisfaction and retention issues within the workforce. The proposed growth rates are also in line with the growth rates approved for other cargo operators.

As for administrative, repairs and maintenance and utility expenses, normalizing other operators O&M growth rates with MABPL's cargo operations without contextualizing is not apt.

MABPL would also like to draw attention to the fact that R&M is benchmarked at 6% of RAB at other airports, whereas MABPL's is substantially lower. Also, R&M cost in FY24 is significantly low on account of new infrastructure.

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Similarly, for utility expenses, MABPL has based its estimates in line with the industrial rates, expansion in the cargo handling infrastructure and the growth in cargo volumes – which is the consistent practice across ISPs.

Components of administrative and general expenses have also been forecasted based on a host of factors such as expansion of the operations, inflation, traffic etc. Taking into account all the factors, the annual increase of ~11% is appropriate.

MABPL would like to reiterate the clause 8.5.5 of Order No. 13/2023-24 released on 09/08/2023, where a comparison was done between the two operators at Bangalore Airport. It clearly depicts the efficiency of O&M at MABPL on per MT basis.

7) On – *'Air Freight Station (AFS) :(Refer 6.1.1 of the CP)'*
MABPL proposes to accept the BUP Tariffs proposed by the Authority. MABPL also supports the efforts made by the Authority and industry to encourage BUP usage.

The arguments made by FIA regarding warehousing monopoly and airline self-handling are outside the scope of tariff determination process under the existing framework.

8) On – *'Aggregate Revenue Requirement :(Refer 7.2.1, 7.3.3, and Table 32 and 34 of the CP) and 'Profitability Analysis: (Refer 8.2.6 and Table 39 of the CP)'*

Revenue requirement is a function of the costs incurred. It is essential to note over the last decade inflation has grown significantly, especially in the COVID-years. While in most of the years, the rise in cost was offset by the increment in traffic, last three years that has not been the case. Studies show a significant increase in the cost of living in Bangalore over the last 10 years, which has led to an increase in salary expenditure. However, tariffs have not been revised for almost a decade.

MABPL would also like to respectfully disagree with the quote on 'Significant Profits'. Losses in the first year, followed by a ~6% margin for the entire control period already puts the sustainability and attractiveness for investors under scrutiny.

Particulars	FY24*	FY25	FY26	FY27	FY28	FCP
ARR (INR cr)	65.89	221.08	249.88	276.80	308.18	1216.67
Revenue after tariff increase (INR cr)	54.71	209.31	250.40	290.73	338.45	1230.63
PAT (INR cr)	-17.90	3.09	19.84	29.29	45.36	79.68
Margin (%) as per AERA	NA	1.44%	7.76%	9.89%	13.18%	6.34%

**Note: 10 month numbers*

Investors of airport cargo operators that have a reputation of bringing in world-class technological advancements, efficiency and digital transformations expect a higher risk-adjusted return. Under the proposed ARR, tariff hikes and profitability analysis, those returns are already constrained.

We would therefore, disagree with the claims on curtailing ARR, tariff hikes or FRoR on the grounds of 'Significant Profitability' as the profitability of the first control period is neither

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significant nor in line with other cargo operators in India or other major capital intensive projects of similar sizes. We also would like to stress that the profitability of broader airline operations and cargo operations are two different metrices and should not be seen synonymously.

Further, regarding the comment on competing modes of transport, MABPL notes that the differentiating factor between air cargo and other modes of transportation is not just cost. While the competition does exist, air cargo offers a magnitude of benefits over other transportation means (sea or road) such as speed and safety, which is a unique value add for customers wanting to transport their goods via air.

9) On – *'Annexure IV of the CP'*

MABPL disagrees with the comments regarding the tariff revision of the stakeholder and reiterates the reasons for tariff revision to have sustainable business operations:

1. Tariff rates were last revised by AERA for MABB (benchmarked rates) through Order no. 14/ 2013-14 in FY14, almost 10 years back.
2. MABPL shall incur the capital expenditure for greenfield domestic cargo terminal and expansion of international cargo terminal as per the terms of the SPRH agreement.
3. The operational expenditure for the first control period is also increasing on account of inflation and capital expansion projects.
4. Even after the proposed tariff increase by the Authority, the profit margin is ~6%, which is a cause of concern for our investors.
5. One of the major feedback items obtained from the stakeholders regarding a simplified tariff card has also been considered while preparation of the same.

MABPL, after reviewing the order for its competitor, has been compelled to request the Authority to allow different tariff revision in TSP and airline rates for the reasons given in our detailed response to the consultation paper.

On the point of the proposed increase in the special inbound cargo charges, MABPL would like to point out that no such separate 'Special' category existed for the inbound charges for the incumbent. Therefore, the charges for the 'Special' category were proposed by MABPL as part of this control period by benchmarking it with the tariffs of other incumbent cargo operator. The charges have been determined by applying the approved tariff hike (21% in FY24) by the Authority on the existing rates for special cargo of the other incumbent cargo operator. Hence, the claim of such increase in charges is not appropriate.

Further, regarding the comment on the competing modes of transport, MABPL notes that the differentiating factor between air cargo and other modes of transportation is not just cost. While the competition does exist, air cargo offers a magnitude of benefits over other transportation means (sea or road) such as speed and safety, which is a unique value add for customers wanting to transport their goods via air.

The combination of above factors, coupled with the profitability expected for the first control period, FIA's views on tariff hikes presents a conservative approach will create feasibility issues in the long term for MABPL. The tariff revision is well justified for a sustainable cargo operations.

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We would therefore request the Authority to consider the comments by MABPL. It is important that the interests of all stakeholders are aligned, as the Authority has done numerous times in the past.

Thanking you,

Yours faithfully,

Venkata Reddy Kunam

Head of Projects – India

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