



9 August 2023

Mr Geoff Brooke  
Senior Economist  
New Zealand Commerce Commission

By email: [im.review@comcom.govt.nz](mailto:im.review@comcom.govt.nz)

Dear Geoff,

**RE: Part 4 Input Methodologies Review 2023 – Qantas Group Cross Submission**

The Qantas Group (**Qantas**) welcomes the opportunity to provide a response to submissions made by airports and their investors on 19 July 2023 regarding the New Zealand Commerce Commission's (**NZCC**) Draft Decision on WACC input methodology (IM).

The Draft Decision has elicited a strong response from airports and their investors. We note the duplication of responses from airports and their proxy advisors, including the submission of the same template letter from 8 airports, as well as 3 submissions from representatives of Wellington Airport.<sup>1</sup>

As requested by the NZCC, and given the short timeframe for responses, we focus our cross-submission on the key arguments made by various airports and their 'experts' and seek to set out the critical inconsistencies and errors within, as well as confirming the economically sound approach in the Draft Decision. Our submission demonstrates that:

1. the Draft Decision is not a departure from well-established precedent;
2. the Draft Decision applies an appropriate asset beta methodology;
  - 2.1 the NZCC has proposed a suitable sample set;
  - 2.2 Auckland Airport's asset beta is an aberration;
3. the IM set out in the Draft Decision will not lead to under investment and will benefit consumers:
  - 3.1 the airport industry can sustain this change and continue to invest;
  - 3.2 airport projected earnings are well above their regulated asset base;
  - 3.3 aligning regulatory WACCs with airport cost of capital will result in more efficient investment;
  - 3.4 right-sizing investment will benefit consumers;
  - 3.5 this is borne out through real world case studies; and
4. the Perth Airport judgment is not an applicable precedent.

Set out in **Attachment A** below is Qantas' response to the misconceptions put forward by critics of the Draft Decision, where such criticisms relate to the purpose under Part 4 of the *Commerce Act 1986*. Our response to some of the less relevant and more distracting arguments put forward by those critics

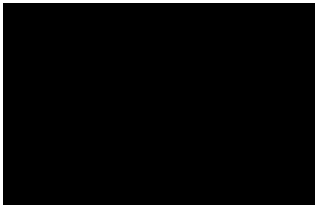
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<sup>1</sup> Wellington Airport; as well as from Infratil and Morrison & Co- in the capacity as investors in Wellington Airport

but that sit outside of the remit of the IMs is included at **Attachment B**. Additionally, at **Attachment C**, we have outlined the index providers country risk classifications.

In accordance with the NZCC's clear request, this response is a rebuttal of the arguments put forward by airports and their investors. However, this cross-submission should be read in conjunction with our submission of 19 July 2023. We submit that the NZCC should at least maintain their Draft Decision and confirm their findings in their final decision.

Qantas welcomes the opportunity to discuss any aspect of this cross-submission.



Seb Mackinnon  
Head of Commercial Airports

## Attachment A

### 1. The NZCC Draft Decision is not a departure from well-established precedent

*Critics of the Draft Decision say that it represents a departure from well-established precedent, and will reduce confidence to invest in New Zealand.*

*This claim is simply not true. The NZCC should ignore baseless assertions in fulfilling its primary objectives of the IM review as set out in Part 4.*

CEG has indicated in their submission that the Draft Decision “involves a significant departure from previously well-established regulatory precedent”<sup>2</sup> the effect of which reduces “the final asset beta... by more than 25% relative to the level of compensation that would have prevailed had established regulatory practice been maintained.”<sup>3</sup>

The IMs are relatively recent, created in 2010. The first review occurred in 2016, and the current review represents only the second review in the history of IMs in New Zealand. Despite the short period of time the IMs have been in operation, the NZCC has recognised that “the environment in which regulated suppliers are operating has changed significantly since our last review of Input Methodologies (IMs) in 2016 and continues to evolve.”<sup>4</sup> Given the significant changing environment, and new evidence now available, it is only right that the regulator undertakes a comprehensive review of the evolving regulatory environment.

The purpose of a review of the input methodologies every 7 years is to confirm that the overarching objectives of the IMs (Part 4 of the *Commerce Act*) are still being achieved, and consider new evidence to assess if there are more effective ways to meet these objectives. Given the monopoly nature of airports, the IM review ensures the long-term benefit to consumers of airport services, through encouraging innovation and investment, improved efficiency, provision of quality services, sharing of benefits of efficiency gains with consumers, and limiting the extraction of excessive profits.

The assertion by some critics that the regime is “well-established” is questionable, given this is only the second review since inception. Also, the critic’s attitude overlooks the intent of a meaningful review of the regime. Modernising the methodology to calculate an asset beta is not a radical change and instead reflects regulatory trends and changes in the economic environment. The Draft Decision demonstrates that the NZCC has undertaken a genuine review of the IMs rather than merely automatically adopting past practices.

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<sup>2</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0014/323150/NZ-Airports-Association-CEG-Critique-of-2023-IM-Draft-Decision-on-Asset-Beta-for-NZ-Airports-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0014/323150/NZ-Airports-Association-CEG-Critique-of-2023-IM-Draft-Decision-on-Asset-Beta-for-NZ-Airports-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf) page 4

<sup>3</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0014/323150/NZ-Airports-Association-CEG-Critique-of-2023-IM-Draft-Decision-on-Asset-Beta-for-NZ-Airports-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0014/323150/NZ-Airports-Association-CEG-Critique-of-2023-IM-Draft-Decision-on-Asset-Beta-for-NZ-Airports-Submission-on-IM-Review-2023-Draft-Decisions-19-July-2023.pdf) page 4

<sup>4</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/318666/Part-4-IM-Review-2023-Draft-decision-Summary-and-context-paper-14-June-2023.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/318666/Part-4-IM-Review-2023-Draft-decision-Summary-and-context-paper-14-June-2023.pdf) page 5

## 2. The Draft Decision applies an appropriate asset beta methodology

*Critics of the Draft Decision claim that the methodology proposed by the NZCC to determine a suitable comparator set is flawed. In particular, they say that:*

- *A larger “universe of comparables” is better than a narrower sample; and alternatively*
- *Auckland airport’s asset beta provides the best benchmark*

*These submissions are served by self-interest and are simply incorrect. In particular:*

- *There is strong regulatory consensus to seek relevant comparator sets, having regard to relevant domestic and international comparators (including country and other measures);*
- *A wider comparator set does not inherently reduce volatility, and in any event it is not appropriate to widen the set to include irrelevant benchmarks; and*
- *Auckland Airport’s asset beta exhibits unusual characteristics, notwithstanding its long-term track record as a high earning, low risk investment. It is therefore not a useful comparator.*

### 2.1 The NZCC has proposed a suitable sample set

All pricing regulators have the objective to ensure that the sample of comparators is relevant to the domestic regulatory regime. Qantas endorses the underlying principles of selecting a comparator set that meets that objective by filtering for factors such as business environment, relative risk and robustness of data.

Qantas believes the NZCC IM draft methodology on asset beta selection is suitable, and it is incorrect to claim it is a major departure from global regulatory consensus and economic theory. Qantas has conducted analysis as outlined in this submission, looking across different regulatory bodies and examining empirical asset beta data, including an evaluation of Auckland Airport. This confirms that:

- There is strong global regulatory consensus that a comparable selection needs to be similar to the domestic market;
- Sample similarities are more important than sample size, with the median sample size being 10;
- Country risk filters and market classifications provided by index providers produce an accurate assessment of country market risk;
- Empirical information, as presented in Qantas' first submission (dated 17 February 2023), shows a strong correlation between asset beta and the maturity of a market (market classification); and
- Auckland Airport's empirical asset beta continues to display aberrations and should not be used as a benchmark to cross-check the validity of the NZCC comparator set.

As seen below there is strong regulatory consensus for selecting comparable firms with similar economic conditions:

- The Economic Regulation Authority in Western Australia (**ERA**) requires that comparators are located in “a similarly developed country to Australia in order to capture the risks faced ... countries, such as the United States, United Kingdom, New Zealand and Canada are an acceptable proxy to the risks faced by an Australian passenger rail operator. These countries have similar economic, political and social conditions ...”;<sup>5</sup>
- The NSW Independent Pricing and Regulatory Tribunal (**IPART**) “seeks markets that approximate Australia’s sovereign characteristics”. This includes considering if the government bond and equity markets are “sufficiently deep and liquid”;<sup>6</sup>

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<sup>6</sup> IPART (2019), Estimating Equity Beta

- According to the Queensland Competition Authority (**QCA**), “firms originating from developed countries are preferable to those from developing or emerging economies, as the former are more likely to operate within a more stable political and business environment and are subject to a well-developed system of property rights and legal protections. However, if ... we are still concerned with the size of our industry sample, we will turn to investigate firms operating in developing countries to potentially generate a larger sample. In investigating firms operating in developing countries, we will have particular regard to country-specific factors that may make inclusion of certain firms unsuitable”;<sup>7</sup>
- The Commission for Aviation Regulation in Ireland (**CAR**) uses a narrow comparator sample (12 airports), drawing on airports from countries that are in the European economic zone or have similar general economic characteristics (Australia and New Zealand). The CAR also includes unlisted regulated airports within their comparator sample, relying on the regulatory beta decision rather than empirical data; and
- The Civil Aviation Authority in the UK (**CAA**) uses a much stricter filtering process to arrive at a small comparator sample that it considers to be most similar to Heathrow (3 airports) and excludes several comparators from certain countries.

As Qantas stated in its initial submission, a country risk filter is an important first step in reducing an exhaustive comparable basket and is used in some form by the majority of regulators. We also see unanimous market classifications definitions across index providers that are underpinned by strong substantiation and analysis.

As seen in the table below, regulators commonly apply country filters. Importantly, the majority of regulators in developed markets seek to set filters to ensure that comparators are only sourced from developed markets.

**Table 1: Index providers country classification – Comparison with regulatory precedent**

Country classification <sup>8</sup>	Countries	AER	CAA	ICRC <sup>9</sup>	ERA	QCA	CNMC <sup>10</sup>	CAR	ESC <sup>11</sup>	ACCC <sup>12</sup>	IPART <sup>13</sup>
<b>Developed</b>	Australia, New Zealand, Hong Kong, Japan, USA, UK, Austria, Denmark, France, Germany, Italy, Spain, Switzerland	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
<b>Advanced emerging</b>	Malaysia, Mexico, Thailand, Turkiye								✓	✓	✓
<b>Secondary emerging</b>	India										✓
<b>Frontier</b>	Vietnam										✓
<b>Other</b>	Malta, Serbia,										

<sup>7</sup> QCA (2021),Rate of return review p. 73.

<sup>8</sup> MSCI, S&P and FTSE use consistent definitions for country filters, as set out in Attachment C

<sup>9</sup> Independent Competition and Regulatory Commission

<sup>10</sup> Spanish National Markets and Competition Commission

<sup>11</sup> Essential Services Commission (**ESC**)

<sup>12</sup> Australian Competition and Consumer Commission (**ACCC**)

<sup>13</sup> IPART only shows an illustrative example

	China A-shares										
<b>No. of comparators</b>		9	3 or more	16	5 or more	39	4	12	9 or more	5 or more	35

Regulators also consistently apply additional filters. While the exact classification criteria sometimes vary, these classifications generally capture similar factors, including:

- Equity market size and liquidity, including bid - ask spread, size of free float, # of days trading;
- Equity market accessibility, including openness to foreign investors and cross-border capital flows; and
- Market efficiency, sophistication and stability – e.g. trading mechanisms and settlement times, transaction costs, availability of investment instruments, institutional stability and regulatory monitoring of the stock market.

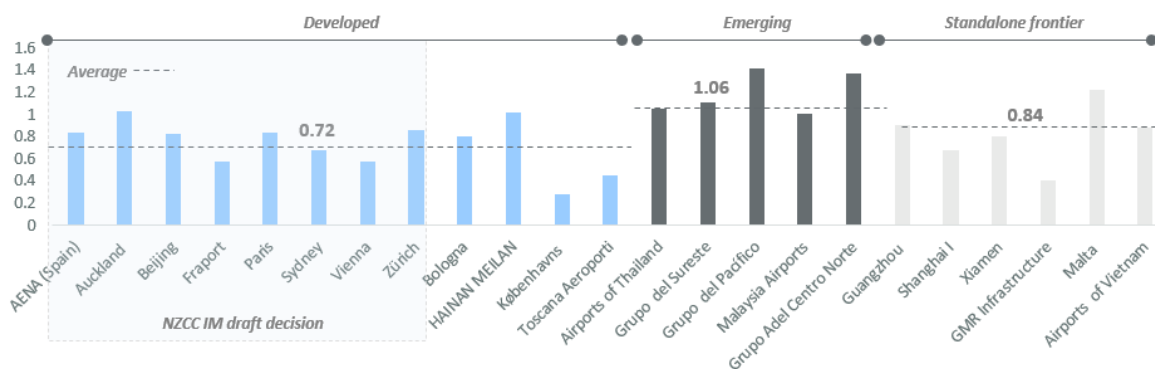
Some examples are set out in the table below.

**Table 2: Additional filtering used by regulators**

Additional filters	AER	CAA	ICRC	ERA	QCA	CNMC	CAR	ESC	ACCC	IPART
<b>Size</b>				✓	✓			✓		
<b>Free float</b>		✓								
<b>Share of index</b>		✓								
<b>Liquidity</b>		✓				✓		✓		✓

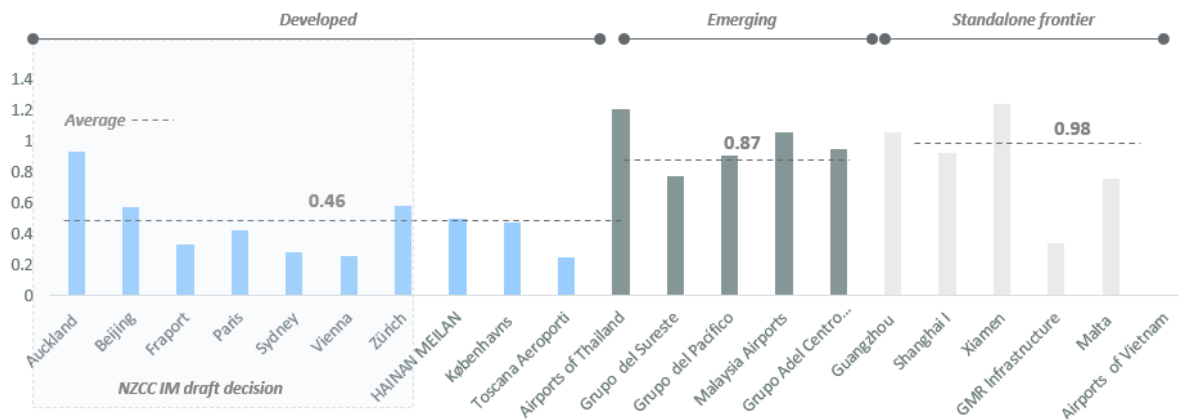
As set out in figures 1 and 2 below, over the last two 5-year periods, developed stocks have largely remained within the same grouping vs emerging and standalone frontier markets. This table also shows the strong correlation between market classification and asset beta.

**Figure 1: 2017-2022 asset betas by market classification<sup>14</sup>**



<sup>14</sup> CEPA (2023), Cost of Capital inputs

Figure 2: 2012-2017 asset betas by market classification<sup>15</sup>



There has been a strong preference from regulators to choose relevant comparators rather than simply choosing the broadest or largest sample. The concept of broadening a sample set by including irrelevant data points is simply flawed. In addition, assertions from airports and CEG that selection of a broader sample set results in less volatility is factually incorrect.

## 2.2 Auckland Airport's asset beta is an aberration

Notwithstanding assertions from various critics of the Draft Decision, Auckland Airport is not a reliable comparator:

- It has been excluded as a comparator by the CAA, on the basis that its beta may be unreliable;
- It has become increasingly over-represented in the NZ50 in recent years, which is likely to create upward bias in its asset beta;
- It has high non-aeronautical income streams that make it less representative of a typical monopoly airport stock; and therefore
- It has a high observed asset beta despite demonstrating characteristics of being a low-risk investment (including the generation of stable earnings over time and low gearing).

Auckland Airport has continued to be used by the airports as the “litmus test” in assessing if the NZCC IM comparable basket makes sense.

Qantas acknowledges the theoretical attractiveness of suggesting that Auckland Airport should be considered as the primary or only comparator in the NZCC basket, given its status as the only listed New Zealand Airport. However, its observed beta properties continue to show aberrations, and it is not a reliable comparator.

We note that Auckland Airport dominates the NZX which distorts its beta as an estimate of its systematic risk. We note also that Auckland Airport's revenue is primarily driven from non-aeronautical sources. Qantas supports the NZCC principle of trying to isolate aeronautical services systematic risk from total risk, and we believe this cannot be done accurately using Auckland Airport as a proxy for comparisons of risk within New Zealand.

<sup>15</sup> CEPA (2023), Cost of Capital inputs

Qantas is not alone in stating that Auckland Airport does not accurately capture its systematic risk. The CAA has also acknowledged the unreliability of its beta estimate. In its most recent WACC determination, the CAA noted that:

“Auckland Airport is traded on the NZX exchange, a market which is not highly diversified. For example, Auckland Airport alone makes up 6% of the NZX. Hence, movements in the market index may be driven by movements specific to Auckland Airport, creating circularity in the Auckland Airport beta calculation and may bias our estimate of its systematic risk.”<sup>16</sup>

**Table 3: Diversification by global indexes<sup>17</sup>**

Index	Number of Constituents	Top 10 Constituents (% market capitalization)	Airport included in Top 10
STOXX 600	600	Below 20%	None
All Ordinaries	498	Above 40%	None
NZX All	120	Above 50%	Auckland

CAA also acknowledges that Auckland Airport has a portfolio of other business activities, including its sizeable commercial property portfolio, which contributes a significant proportion to its earnings. CAA finally determines that “given Auckland beta does not capture aviation risk alone, and since the estimate of its beta may be unreliable, we exclude it from our comparator list”.<sup>18</sup>

The aberration in Auckland Airport’s asset beta is also explained by Dr Martin Lally in his paper, “The effect of an asset’s market weight on its beta: implications of international markets”. Whilst CEG’s assertion that a higher market weight should pull a stocks equity beta closer to one is theoretically correct, Dr Lally suggests that this is not necessarily the case. Dr Lally states:

“The analysis suggests that even if a firm’s set of risk characteristics remains constant, changes in market weight can cause dramatic shifts in its beta”.<sup>19</sup>

As shown in Figure 3 below, Dr Lally’s paper provides an illustrative curve that demonstrates that as market weight increases the stock equity beta ( $B_{jm}$ ) might initially increase towards/above one, then reach a maximum, and then decline towards one. Dr Lally highlights that considerations of market weight needs to be made when interpreting measured equity betas. “Put another way, when market weight is non-trivial, a given set of firm risk characteristics ... does not imply a unique value for systematic risk. Thus, it is possible for a firm to go from a low beta stock to a high beta stock with little change in its volatility ... the volatility of the rest of the market ... or its correlation with other stocks ...”<sup>20</sup>.

<sup>16</sup> Flint (2021), “Estimating Heathrow’s beta post COVID-19” p.40.

<sup>17</sup> Flint (2021), “Estimating Heathrow’s beta post COVID-19” p.40.

<sup>18</sup> Flint (2021), “Estimating Heathrow’s beta post COVID-19” p.40.

<sup>19</sup> Lally, Swidler (2002), The effect of an assets market weight on beta, p. 162

<sup>20</sup> Lally, Swidler (2002), The effect of an assets market weight on beta, p. 167,169



Figure 3: Relationship between beta and market weight<sup>21</sup>

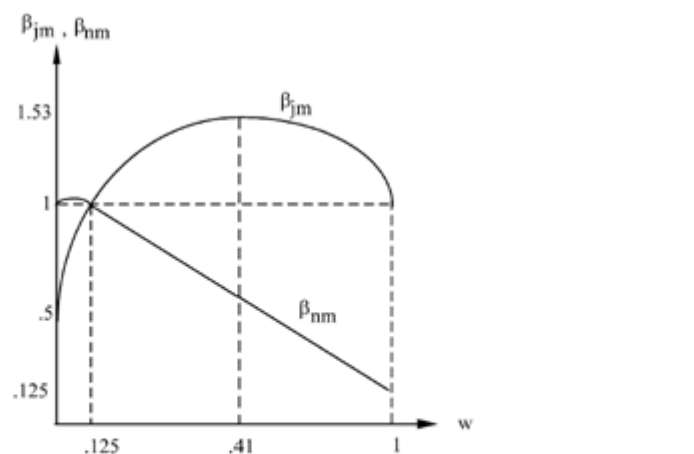


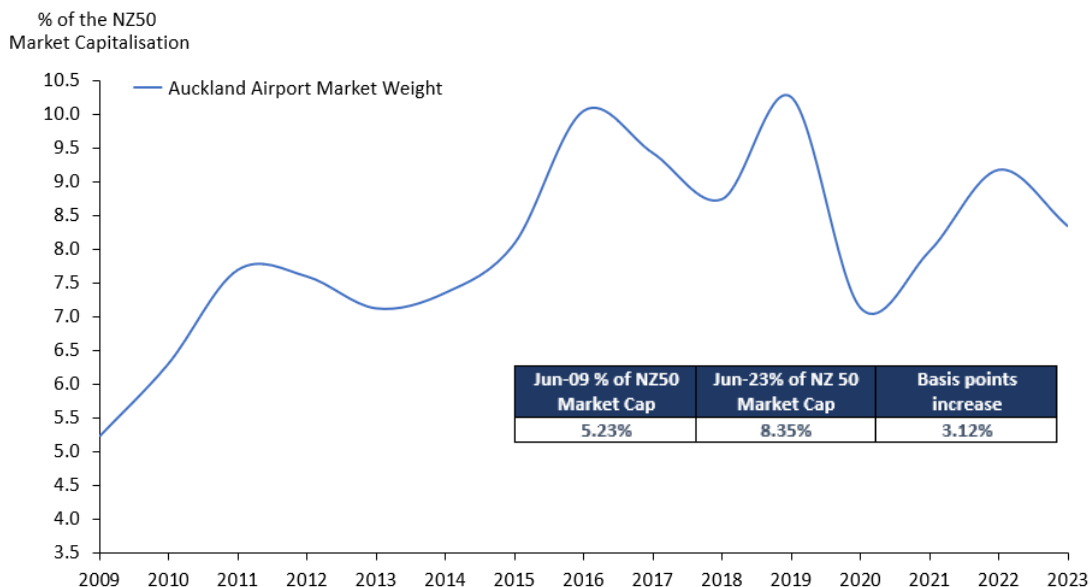
Fig. 1. The relationship between beta and market weight. This figure shows the relationship between asset  $j$ 's market weight  $w$  and its beta against the market portfolio,  $\beta_{jm}$ , and also the relationship between  $w$  and the beta of portfolio  $n$  (the market exclusive of  $j$ ) against the market portfolio, denoted  $\beta_{nm}$ . The figure assumes that asset  $j$ 's beta against  $n$ ,  $\beta_{jn}$ , is 0.5 and that  $j$ 's variance is four times that of  $n$ .

Qantas additionally has undertaken its own analysis (available upon request) that illustrates the concerns with the reliability issues within Auckland Airport's asset beta observations, finding that:

- Auckland Airport market capitalisation and weight within in the index has grown steadily over time;
- Volatility of earnings seem consistent and display similarities with other non-cyclical type industries;
- Correlation exists between beta and non-aeronautical revenues; **but**
- Auckland Airport's equity beta behaves in strange ways when compared to other NZ20 stocks.

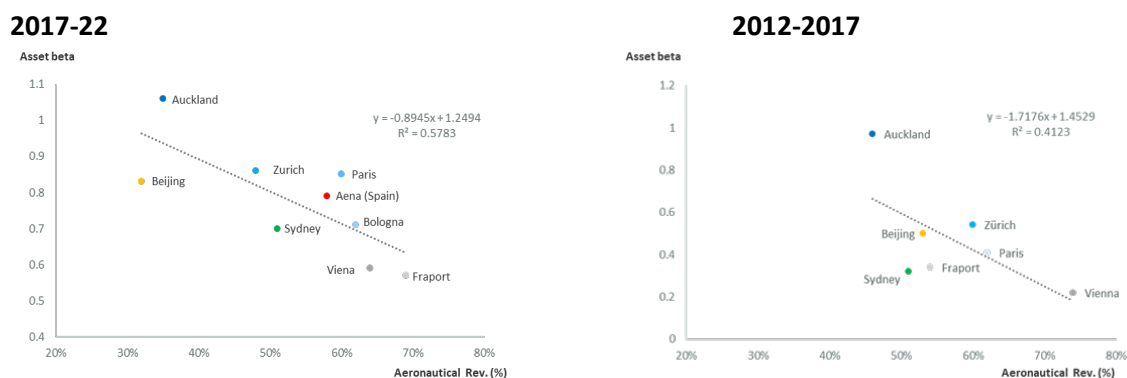
Auckland Airport's market capitalisation has increased by 540% since 2009, compared with an increase in the NZ50 index over the same period of 330%. Auckland Airport's share of the NZ50 has increased from 5.2% to 8.4% over this period – thereby risking an increase in beta as per Dr Lally's illustrative example between beta and market weight.

Figure 4: Market capitalisation weight of Auckland Airport and NZ50 over time<sup>22</sup>



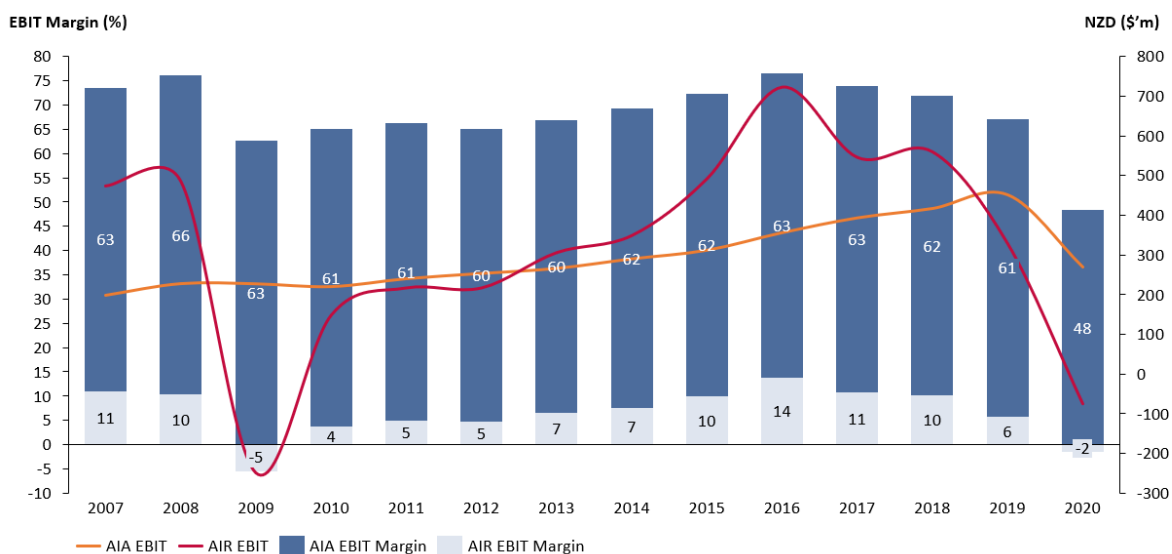
In our initial submission, Qantas noted the importance of considering non-aeronautical revenue when assessing asset beta. We noted that there appeared to be a strong correlation between Auckland Airport’s large non-aeronautical business and its beta. For completeness, we have repeated the relevant tables from that submission below.

**Figure 5: 5-year asset beta<sup>23</sup> against aeronautical revenue<sup>24</sup> for NZCC basket (including Bologna Airport)**



Auckland Airport has enjoyed steady earnings growth, including through the Global Financial Crisis. This displays similar characteristics to other counter cyclical stock such as utilities that typically have lower betas.

**Figure 6: NPAT and EBIT margin for Auckland Airport vs Air New Zealand over time<sup>25</sup>**



Strangely, Auckland Airport utilises very low gearing ratio of 20% (2015-2020) despite having an observed equity beta of 1.33, compared with the average of NZX20 utilities and industrial stock of

<sup>23</sup>Calculated from using gearing and asset beta data from CEPA’s Cost of capital report (March 2023) using the Myers & Brealey formula for re-leveraging. Table A3

<sup>24</sup>Calculated from using gearing and asset beta data from CEPA’s Cost of capital report (March 2023) using the Myers & Brealey formula for re-leveraging. Table A3

<sup>25</sup> S&P Cap IQ EBIT excluding Unusual Items e.g. PP&E and investment property revaluations

0.93<sup>26</sup>. Finance theory would indicate that a lowly geared business such as Auckland Airport would have a respectively low beta, but this is not the case.

**Table 4: Auckland Airport Equity beta & gearing comparisons to key NZX20 comparisons (2015-2020)<sup>27</sup>**

Company	Adjusted equity beta for gearing		Raw equity beta & gearing	
	Equity Beta	Gearing	Equity Beta	Gearing
Air New Zealand	1.43	20%	1.66	31%
Auckland International Airport	1.33	20%	1.33	20%
Fletcher Building	1.17	20%	1.22	23%
Meridian	1.02	20%	0.96	14%
Mainfreight	0.96	20%	0.86	11%
Gensis energy	0.82	20%	0.95	31%
Contact Energy	0.81	20%	0.89	27%
Mercury	0.81	20%	0.81	20%
Spark	0.75	20%	0.70	14%
Port Tauranga	0.74	20%	0.67	11%
Infratil	0.54	20%	0.98	56%
Vector	0.36	20%	0.49	42%
<b>NZ IM list (ex AIA)</b>	<b>0.83</b>	<b>20%</b>	<b>0.87</b>	<b>23%</b>

It is clear from the above information that Auckland’s asset beta is an aberration and is not an appropriate benchmark for assessing New Zealand airport systematic risk, as is the scope of the IM.

**3. The IM set out in the Draft Decision will not lead to under investment and will benefit consumers**

*Critics of the Draft Decision claim that proposed changes in the input methodology will lead to under-investment, and that consumers will not benefit from any changes.*

*This starts from a premise that any change to the status quo will result in under-investment, even if that status quo results in super-profits for monopoly airports and even if that status quo risks creating over-investment by monopoly airports. Both of those scenarios lead to inflated airport pricing, and risk leading to sub-optimal outcomes for the New Zealand economy more broadly.*

*Monopoly airports, including in New Zealand, consistently generate outsized returns. A review of relevant financial metrics benchmarks provides a reasonable reference point to suggest that those returns comfortably exceed airport cost of capital.*

*Although some airports have suggested that a reduction in asset beta would result in reduced investment, such an outcome is more likely to be a rightsizing from gold-plated investment rather than evidence of potential under-investment.*

*Consumers will benefit, in the event that investment does reduce to right-sized levels, as airlines have demonstrated through behaviour over many years.*

<sup>26</sup> Only for Utilities and Industrials businesses in the NZX20

<sup>27</sup> Calculated from Bloomberg data using the NZCC 2016 (IM) asset beta model for period 2015-2020

### 3.1 The airport industry can sustain this change and continue to invest

It is incorrect to assert that the IM as set out in the Draft Decision will lead to under-investment. Under the previous methodology, Auckland Airport enjoyed some of the best shareholder returns of any listed stocks. It is telling that airport submissions were silent on this in their submissions.

Qantas has taken a broad approach in analysing historic and future returns of airports to support our cross-submission response, through using:

- Historic return metric such as TSR, P/E and market capitalisation trends to identify holistic returns and distributions over time;
- Forward looking valuation comparables to identify ongoing investment expectations and impacts of COVID;
- Cross checking against a RAB multiple; and
- Understanding the underlying risk and return characterises of airports and airlines over time.

Between 2009 and 2020, Auckland Airport and Sydney Airport enjoyed Total Shareholder Return (TSR) of ~500% and ~300% respectively, translating to a compound annual return of 15% and 11%. During the same period, Qantas and Air New Zealand made returns of ~76% and 199% (as seen in table 5). Auckland Airport has also outpaced other blue-chip companies such as the Australian major banks (ASX: CBA, WBC, NAB, ANZ) and key New Zealand utilities providers (Spark and Vector). Auckland Airport has clearly “beaten the market” and has also performed better than other NZ regulated infrastructure assets - indicating that the regulatory regime has allowed investors access to above “normal returns” contrary to the Part 4 principle that monopoly suppliers should be “limited in their ability to extract excessive profits”.

**Table 5: Total Shareholder Return - Jun-09 to Jun-20**

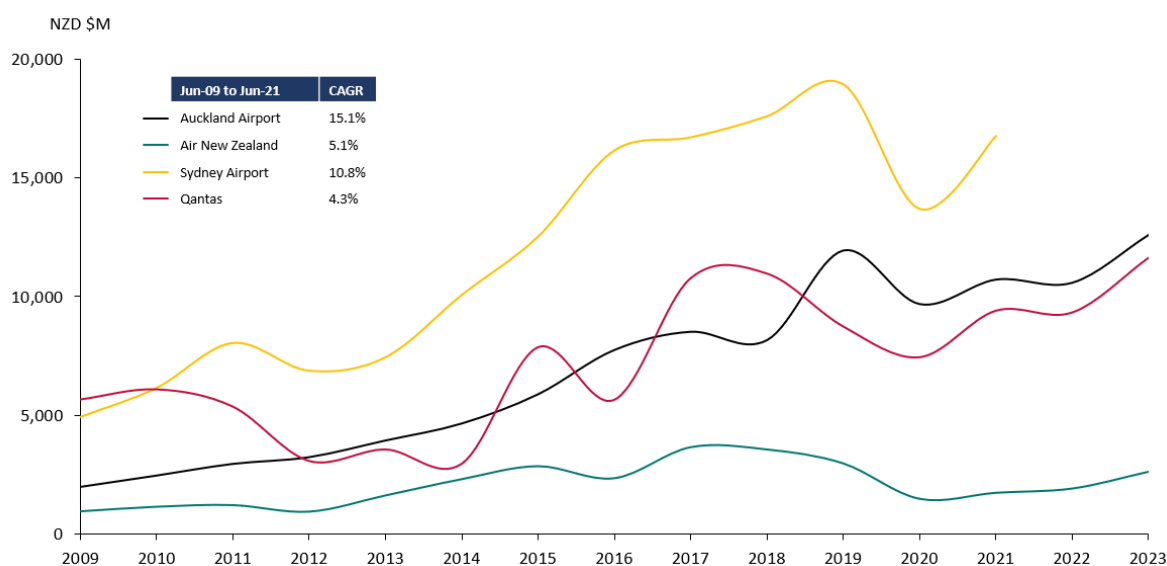
	Total shareholder return	Compound Annual Growth Rate
<u>ANZ Airports</u>		
Auckland Airport	350%	15%
Sydney Airport	224%	11%
<u>ANZ Airlines</u>		
Air New Zealand	199%	10%
Qantas	76%	5%
<u>Other NZCC Airports</u>		
Fraport	34%	3%
Vienna	227%	11%
Zurich	238%	12%
Aeroports de Paris	73%	5%
<u>Other comparators</u>		
Spark New Zealand	151%	9%
Infratil	248%	12%
Port Tauraga	615%	20%
Vector	160%	9%
Meridian*	157%	21%
CBA	148%	9%
NAB	47%	4%
Westpac	56%	4%
ANZ	87%	6%
ASX100	50%	4%
NZ50	155%	9%

\* Note: Meridian Total Shareholder Return and CAGR is from Jun-15 to Jun-20 as it listed in FY14

Airports have also experienced very strong growth in market capitalization over recent years. The chart below demonstrates this – illustrating compounded growth for Auckland Airport and Sydney

Airport of 15% and 11% respectively over the last 15 years. Notably, COVID –19 was a blip to Auckland Airport’s market capitalisation which has already recovered to historically high levels.

**Figure 7: Market Capitalisation: Jun-09 to Jun-23**



Qantas acknowledges that certain investment assets are riskier than others and investors need to be compensated for taking on this risk. Tables 4 and 5 demonstrates that Auckland Airport is a less risky investment proposition when compared to the NZX20. It defies well established finance theory that an asset such as an airport, a monopoly with counter cyclical properties, with a TSR that is ~200% (2009-2020) greater than the NZX50 and a debt burden of just 16%<sup>28</sup> should also have a beta in excess of 1.0. Further detail on Auckland Airport’s asset beta data aberrations can be seen in section 2.

There has been much debate on the purported long-term impacts of COVID to airport returns. However, future earnings expectations have not been hindered by COVID- 19 and have returned to historic norms. Also since COVID, forward looking valuation multiples such as EV/EBITDA and P/E have increased to pre-COVID levels, validating the ongoing expectations that airports will earn significant returns.

**Table 6: Forward 12 months EV/EBITDA outlook**

	2017 to 2019 EV/EBITDA <sup>29</sup>	FY24 Forward looking EV/EBITDA <sup>30</sup>
Group ADP	14.3	10.3
Fraport AG	11.9	11.3
AENA	14.7	10.1
Flughafen WIEN	11.1	10.8
Flugaven Zuerich	13.3	9.9
Auckland Airport	21.5	21.2
Sydney Airport	19.6	N/A

<sup>28</sup> As at 30 June 2023

<sup>29</sup> Bloomberg 12 month forward looking EV

<sup>30</sup> Bloomberg 12 month forward looking EV

### 3.2 Airport projected earnings are well above their regulated asset base

As referenced in Qantas’ last submission, a RAB multiple is perhaps the most appropriate financial valuation metric to cross-check reasonableness of an airport’s returns. A RAB of one effectively illustrates that a regulated business will deliver returns close to its true cost of capital (NPV neutral) and therefore can serve as a useful proxy of whether a regulator has been too generous or not. Through Qantas’ own analysis we have seen RAB multiples that could be greater than 2 for Auckland. Sydney Airport, a recent and geographically close example, had a projected range of 1.4-2.9x<sup>31</sup>. The table below further illustrates the above normal returns Auckland Airport has been able to extract from its regulatory asset base.

**Table 7: RAB multiple analysis**

	Enterprise value		RAB Jun-22 (Dec-22 for LHR) <sup>34</sup>	RAB Multiple range <sup>35</sup>
	Trailing EV <sup>32</sup>	Forward EV <sup>33</sup>		
Auckland Airport	12.5	16.0	NZ \$2.3bn	1.6 -2.2x
Sydney Airport	35.2	N/A	NZ \$3.8bn	1.4-2.9x
Heathrow (single till)	48.8 <sup>36</sup>	N/A	NZ \$37.4bn	1.3x

Furthermore, the stark difference in risk and return characteristics between airports and airlines is clear – as highlighted in Figure 8 below.

<sup>31</sup> Qantas structured a low – high range by looking at historical and future looking enterprise value (EV), EBITDA and DCF model at the assumed NZCC draft WACC. Qantas looked to isolate the aeronautical component of enterprise value by estimating (%) the EBIT contribution between aeronautical and non-aeronautical services and then applied the aeronautical contribution % to calculate EV for aeronautical services. RAB’s were sourced from Auckland’s annual disclosure, Sydney: ACCC supplementary data base and Heathrow annual regulatory accounts. For AIAL forward estimates Qantas looked at forward looking EBIT/EBITA multiples from analyst notes.

<sup>32</sup> S&P Cap IQ, Sydney Airport, Heathrow (2022) recent valuation change

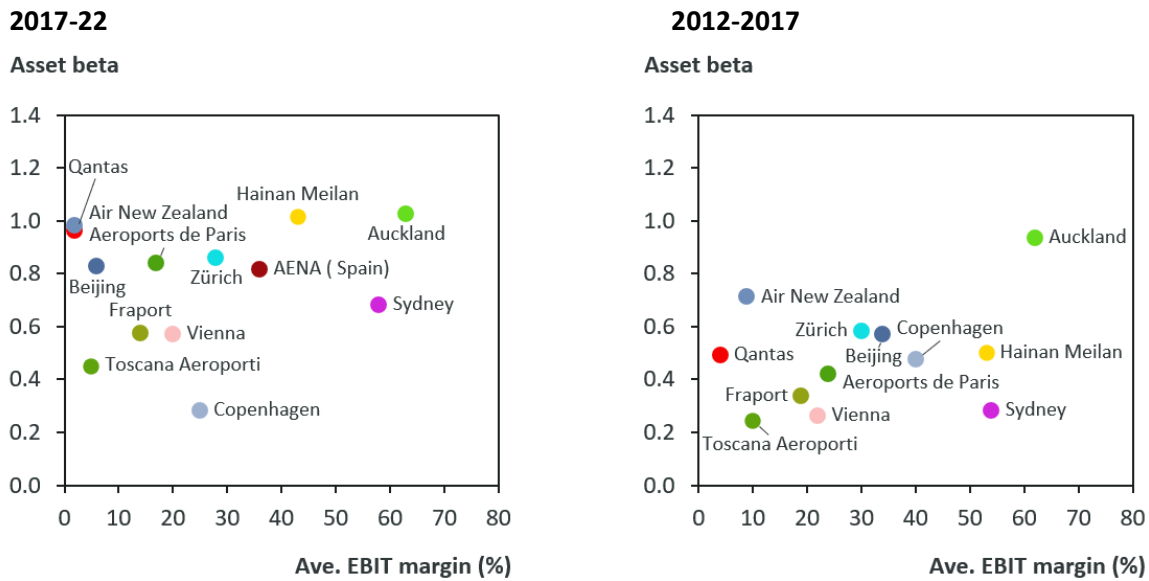
<sup>33</sup> Bloomberg (2023)

<sup>34</sup> Auckland: AIA Annual Disclosure; Sydney: ACCC Supplementary Database; Heathrow: Heathrow Regulatory Accounts

<sup>35</sup> Qantas calculated range from estimating the proportional aeronautical EV divided by aero RAB

<sup>36</sup> Trailing EV represents the latest valuation following the partial sale in 2022 for c.25 billion GBP translated to NZD

**Figure 8: 5-year asset beta against average EBIT margin for developed market classification (including Bologna Airport) <sup>37</sup>**



It is clear from this evidence that airports represent safe, low risk, high return investments for shareholders. It is clear that airport returns have outperformed most normal benchmarks over a long period of time (including through COVID), providing strong support to our submission that current regulatory returns exceed airport cost of capital. There is no evidence to suggest that lower WACC resulting from a revised IM will lead to unsatisfactory airport profits or unsatisfactory investment levels.

### 3.3 Aligning regulatory WACCs with airport cost of capital will result in more efficient investment

The overestimation of regulatory WACC relative to airport cost of capital creates an opportunity for supernormal profits to be earned, inefficiently enticing capital from other sectors, creating investor demand for unnecessary capital investment and unfairly burdening consumer prices. We have shown in Section 3.1 how valuations and returns in the airport sector are far greater than expected benchmarks, allowing significant excess for the sector to afford necessary investment.

The overestimation of the cost of capital strengthens incentives to over-invest beyond what consumers want or require, that is, “gold-plating”.

While airlines of course accept that development is required, the New Zealand aviation sector faces a major threat from gold-plating in the confirmed Auckland Airport capital development programme (including associated pricing). Both major domestic airlines are independently on the record in expressing the need for capacity to be delivered without adversely impacting affordability. Qantas believes that the terminal is far larger than required, and that suitable capacity could be built for under 40% of the proposed cost.

In their submission, Auckland Airport has stated a concern that, following the draft IM, many investors have called for a reduction in Auckland Airport’s capital program. Despite Auckland Airport’s objections, this is the right outcome. A recalibration of Auckland Airport’s capital program from a

<sup>37</sup> CEPA’s Cost of capital report (March 2023), Table A3, S&P Cap IQ

gold-plated white elephant to an efficiently designed airport expansion will over time lead to more capacity, lower fares and ultimately higher economic activity in New Zealand.

### 3.4 Right-sizing investment will bring benefits to consumers

Only monopoly airports would suggest that they should be able to hold on to super-profits in order to prevent their customers benefiting. In competitive markets, pricing in the short term is subject to market conditions and normal supply-demand economics. Input cost changes take time to flow to output prices because of inventory and time lags adjusting capacity. Over the longer term, input costs (and resultant profit margins) impact investment decisions, capacity and consumer price.

For an airline such as Qantas this means that:

- In the short term: pricing decisions are made in a competitive market, in which fleet supply is fixed but seats available for sale perish with every departure; and.
- In the long run: capacity adjusts as input costs impact actual performance and performance forecasts, leading to changes in route, network and fleet decisions.

Data from the Bureau of Infrastructure and Transport Economics (BITRE) confirms that airline fares in Australia have consistently declined in real terms over many years, as set out in the following charts. Airlines have continued to demonstrate that efficiencies are passed on to consumers, as would be expected in any competitive market.

#### Air fare index from Oct-1992 to Jul-2023, real

Business Class<sup>38</sup>

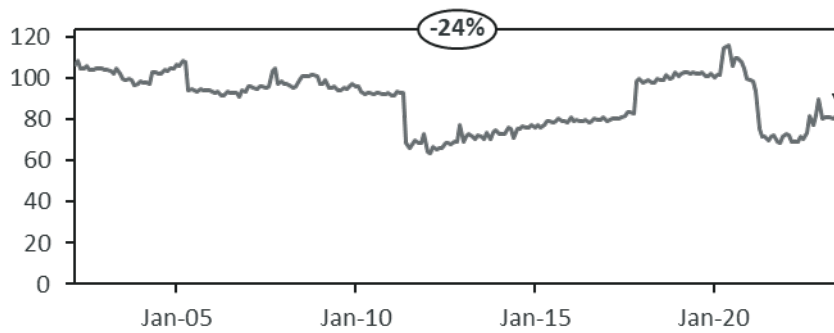


<sup>38</sup> Sourced from Bureau of Infrastructure and Transport Research Economics (BITRE). Business Class defined as business class fares for Qantas and Virgin Australia.



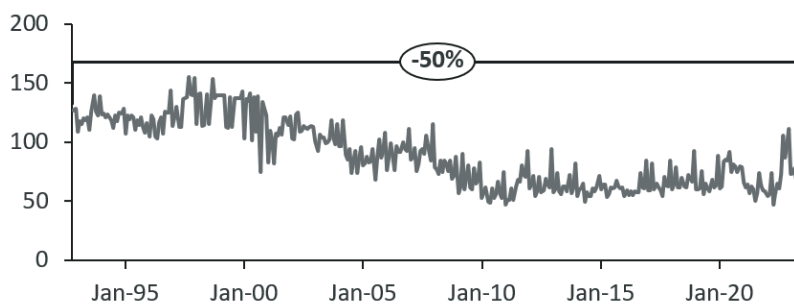
### Air fare index from Mar-2002 to Jul-2023, real

Restricted Economy<sup>39</sup>



### Air fare index from Oct-1992 to Jul-2023, real

Best Discount<sup>40</sup>



Airports themselves have acknowledged that passenger demand responds to airport charges. Intervistas submitted on this subject to the Australian Productivity Commission in 2018 on behalf of the Australian Airports Association, and Auckland Airport refers to price elasticity of demand impact analysis by the same firm in its recent pricing decision<sup>41</sup>. Contrary to their stated positions in their submissions in this IM review, airports agree that input costs will impact consumer demand over the medium and long term.

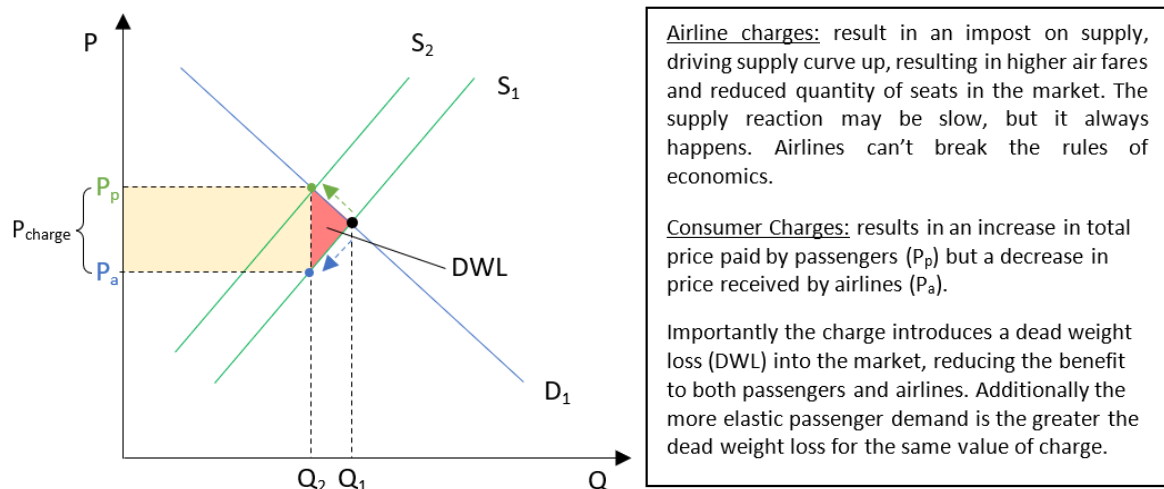
This is also supported by economic theory. We give the example of an increase in charges. The supply side response from the introduction of an additional passenger charge (or “tax”) results in the price paid by passengers increasing ( $P_p$  in the figure below) whilst the price received by the airlines decrease ( $P_a$ ). The difference between the two prices represents the additional fee. The demand curve remains unchanged in this example as the passengers’ willingness to pay the total fare remains unchanged. As shown below the imposition of a “tax” causes a reduction in the quantity of passengers in the market, as the airline’s return on some seats is now below their cost (including their target return on capital). Importantly the fee/tax introduces a dead weight loss (DWL) into the market, reducing the overall benefit to passengers and airlines. Furthermore, the more elastic passenger demand the greater the

<sup>39</sup> Sourced from BITRE. Restricted Economy defined as flexible-fees or restrictions apply fares and includes “Flex” fares for Qantas, Virgin Australia and Rex Airlines.

<sup>40</sup> Sourced from BITRE. Best Discount defined as cheapest fare (excluding baggage surcharges) and includes Qantas “Red e-Deal”, Virgin Australia “Choice”, Jetstar “Starter” and Rex Airlines “Community” fares.

<sup>41</sup><https://corporate.aucklandairport.co.nz/-/media/Files/Corporate/Investors/2023/Regulation/2023-Aeronautical-Pricing-Decision-June.ashx>

dead weight loss for the same value of fee/tax (this will impact the supply of low cost seats much more than it does premium price tickets). The inverse of this applies for cost reductions like airport charges.



Perishable inventory and a competitive market on any day will drive airlines to sell inventory at any fare above marginal cost and airlines manage that process with extensive optimisation through revenue management. When airport charges reduce, an airline's ability to pass the benefits on increases over time as they are able to migrate capacity from less profitable parts of their networks, increase staffing, ground readiness and aircraft utilisation and acquire fleet to take full advantage of the change.

When there is a negative demand impact, there can be a lag in visible impacts as airlines may wait to confirm demand impacts or look for alternative deployments of fleet and staff - and even then are unable to respond further until they can change their capacity settings.

At a national level, each NZ\$ reduction of airport charge can be expected to lower prices and drive a 0.8% increase in demand or 76,000 additional passengers across the total domestic market based on econometric modelling by BIS Oxford Economics (BISOE) using actual airline fare data and passenger levels in FY19. This data is available on request to BISOE from the New Zealand Competition Commission.

#### **4. Misrepresentation of Perth Airport judgement as an applicable precedent**

*Critics of the Draft Decision assert that the decision by the West Australian Supreme Court in Perth Airport Pty Limited v Qantas Airways Limited & Ors supports a broader comparator set that should be adopted by the NZCC.*

*That judgment is not a binding precedent in New Zealand, and is irrelevant other than to Perth Airport for a short period in 2018. Further, the decision on this issue is scant on reasons and therefore cannot be the basis for NZCC's review.*

Submissions by HRL Morrison & Co (**Morrison**), Wellington International Airport (**WIA**) and NZ Airports Association urge the NZCC to have regard to the decision of the Supreme Court of Western Australia (**WASC**) in Perth Airport Pty Limited v Qantas Airways Limited & Ors.<sup>42</sup> Those submissions do not

<sup>42</sup> Perth Airport Pty Limited v Qantas Airways Limited & Ors [2022] WASC 51

accurately reflect what the Court decided, and overstate its usefulness (and even relevance) to the NZCC.

Perth Airport Pty Limited (**PAPL**) commenced the proceedings against Qantas in an action under the common law known as “quantum meruit” to determine reasonable remuneration for a service in the absence of a contract. The Judgment determined, in early 2022, what was “a fair and reasonable price” for aeronautical services provided at Perth Airport during the final five and a half months of 2018. Under Australian (and New Zealand) law, the question of what is reasonable remuneration is a retrospective exercise and a question of fact.<sup>43</sup> Therefore, the WASC’s estimate of WACC and asset beta cannot be applied as a precedent to any other fact-pattern other than the provision of aeronautical services at Perth Airport from 1 July 2018 to 17 December 2018.

PAPL’s primary position in the proceedings was that the Court should not use a building block methodology. Instead, PAPL argued that Qantas ought to pay a weighted average of the prices negotiated between PAPL and other airlines operating from other terminals at Perth Airport, as indicative of a ‘market price’, a reference point that is commonly deployed in quantum meruit proceedings where the context is a competitive, rather than a monopoly, market for the services being provided. PAPL’s own submissions asserted that the Court should not have regard to a cost-based price (including cost of capital), in circumstances where a cost-based price was “theoretical” and “inexact”,<sup>44</sup> involving “multitudinous judgements”,<sup>45</sup> with Perth Airport’s costs being of “marginal relevance” when pricing aeronautical services.<sup>46</sup> This submission was supported by evidence from HoustonKemp, which characterised the task of using of a building block model, including determining WACC and asset beta, as “intractable”, with “wide bounds of uncertainty”: stating that “long run average cost cannot be calculated in practice”.<sup>47</sup> PAPL also argued that a reasonable price was to be determined by reference to the “economic profit” that Qantas earned per passenger on routes to and from Perth Airport.<sup>48</sup>

The Court disagreed with PAPL, rejecting HoustonKemp’s approach on how to estimate a fair and reasonable price for the services.<sup>49</sup> The Court instead accepted that PAPL had, and had likely exercised, substantial market power, and held that where there is no competitive market for the supply of services, reasonable remuneration should be assessed as the efficient cost of providing the services, an estimate of which could be derived using the building block methodology.<sup>50</sup> It found that it was necessary to ascertain Perth Airport’s long run average costs for the five and a half month period the subject of PAPL’s claim.<sup>51</sup>

In addition to the obvious error by Morrison & Co in implying that the NZCC is obliged to apply, or even consider, that decision as a precedent, the decision on inputs to the building block model cannot be applied in any meaningful way by the NZCC given the narrow facts considered in that case.. Further, none of the 1221 pages of expert evidence on asset beta before the Court have been provided by Morrison & Co to the NZCC for its own evaluation.

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<sup>43</sup> Judgment, [120].

<sup>44</sup> PAPL closing submissions dated 16 October 2021 (**PAPL Submissions**), [4].

<sup>45</sup> PAPL Submissions, [130].

<sup>46</sup> PAPL Submissions, [65].

<sup>47</sup> Court transcript, pp1605-1606

<sup>48</sup> PAPL submissions, [545]-[548].

<sup>49</sup> Judgment [536], [544], [547], [552], [560], [561], [598]-[600].

<sup>50</sup> Judgment, [601]-[602].

<sup>51</sup> Judgment, [120].

It is also important to note that the submissions made by Morrison and WIA mischaracterise and misdescribe the Judgment. Specifically:

- Qantas' expert's asset beta evidence was **not** "comprehensively rejected" as contended by Morrison<sup>52</sup>: the WASC adopted certain of the refinements to the comparator set advocated by NERA. Indeed, PAPL's expert accepted that the only relevant difference between him and Qantas' expert was the assessment of relative risk of Perth Airport, and the experts agreed that NERA's comparator set could equally be used "provided a robust relative risk assessment is performed".
- The court did not explain its view of the comparator set of airports advanced by Qantas' expert in the terms described by HoustonKemp (annexed to WIA's submission)<sup>53</sup>, ie. as referable to the ability to accommodate aircraft type; and
- The comparator set advanced by Qantas' expert was a set of 6 airports – Sydney Airport as the primary comparator and five "tier 2" comparators, with only 4 of those six airports comprising part of the NZCC Draft Decision's 8 airport comparator set.
- The Court did not, as HoustonKemp asserts, "reject" the importance of restricting the comparator sample to airports with similar country risks, as well as other characteristics such as demand and revenue risk and operating leverage".<sup>54</sup> The WASC's reasoning was barely articulated; the Court simply indicated that it had a "conceptual level" preference for PAPL's expert's approach.<sup>55</sup>
- For the same reasons, it is wrong (as Morrison asserts) to describe the WASC as having "emphatically rejected" Qantas' approach (a description more aptly reserved for the Court's rejection of HoustonKemp's pricing methodology propounded by PAPL).<sup>56</sup>

The NZCC should not, therefore, permit the WASC's analysis and factual findings to contaminate its decision-making.

Qantas and PAPL appealed aspects of the WASC's conclusions on WACC and asset beta respectively, although, by agreement, there was a mutual withdrawal of those appeals in late July 2023. There is a confidential commercial context to that agreement and mutual withdrawal, further limiting the precedential value of the trial decision.

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<sup>52</sup> Morrison Submissions, [16].

<sup>53</sup> HoustonKemp report, pages 17-18.

<sup>54</sup> HoustonKemp report, pages 17-18, 22.

<sup>55</sup> Judgment [265].

<sup>56</sup> Morrison Submissions [19]-[22].

## ATTACHMENT B

### Risks of underinvesting – Earwaker/Bush for New Zealand Airports Association

In their submission for the New Zealand Airports Association, John Earwaker and Harry Bush extol at length about the risks of under-investing. Importantly, at no point do the authors comment on the risks of over-investing. A curious omission for experts in this field.

On page 3 of their report, Earwaker and Bush comment that:

*“We recognise that the Commission has recently given the issue of WACC determination a great deal of thought in the context of electricity and gas network regulation. It concluded that there are good reasons to select a point estimate substantially above the mid-point of a calculated WACC range. These reasons related first and foremost to the costs that consumers can suffer:*

- *if a regulator inadvertently under-estimates the ‘true’ WACC;*
- *if this under-estimation causes a price-regulated firm to slow down or withdraw investment; and*
- *if this under-investment results in asset failures and other service quality failures.”*

In section 1 of their report Earwaker and Bush purport to present evidence that there has been significant under-investment over time. However, importantly, they make no attempt to link the claimed under-investment in UK airports to a failure of those airports to earn their true cost of capital. To the contrary, they clearly say that there has been no correlation between investment in UK airports and the return as allowed for those airports<sup>57</sup>.

Undeterred, Earwaker and Bush go on to say that:

*“However, what is important for the purposes of assessing the impacts of under-investment is not its cause but its effects, and therefore the potential lessons for assessment of risks around the setting of a WACC which insufficiently incentivises investment”<sup>58</sup>.*

It seems that Earwaker and Bush are saying that under-investment in UK airports over time (due to “shortcomings in planning and policy processes and from environmental and other constraints”) has had detrimental consumer impacts, and that therefore NZCC should not set a WACC below airport cost of capital. This is a fallacy of logic.

Firstly, Earwaker and Bush have not demonstrated that there has been under-investment in UK airports over time. They seem to rely on a statement by the UK Airports Commission that “London’s airports are, in the Airports Commission’s succinct summary, ‘still reliant on runway capacity which was built in the middle of the twentieth century’,”<sup>59</sup> but they do not ask whether runway capacity is fit for purpose.

Further, Earwaker and Bush appear to say in the absence of runway development London airports have consistently innovated over many years to improve productivity and ensure that London airports

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<sup>57</sup> Earwaker and Bush for NZ Airport Association – page 7: “The reasons for under-investment lay not in a shortfall in the returns allowed to the airports but in shortcomings in planning and policy processes and from environmental and other constraints”.

<sup>58</sup> Earwaker and Bush for NZ Airport Association – page 7

<sup>59</sup> Earwaker and Bush for NZ Airport Association – page 9

are the most efficient in the world. This is therefore evidence of efficient growth that delivers capacity, not evidence of a failing system. This is illustrated by the below quote from their report:

- “Airports have increasingly competed with one another to attract airlines in a way that has enabled the speedy development in the UK of different airline business models requiring different types of infrastructure and airport location.
- The result has been to increase usage of more ‘marginal’ London airports, providing alternatives to Heathrow and Gatwick and competition with them.
- Second, Heathrow and Gatwick have fulfilled commercial demands from airlines and filled up the available capacity, in the process sacrificing (particularly at Heathrow) both journey times (which are lengthened by the stacking required to manage throughput onto overly busy runways) and resilience, as the impact of disruption is increased the tighter the baseline capacity constraint.
- Third, London’s airports have operated scarce runway capacity as efficiently as possible through collaboration with airlines and air traffic control. Technical innovation continues with the introduction this year of Time Based Separation of aircraft (developed by NATS, the UK’s air traffic control organisation) which will reduce delays caused by the frequent strong head winds at Heathrow.
- In the assessment of the Airports Commission, 'The largest UK airports operate their runway infrastructure more efficiently than any others in the world'. However, with Heathrow 'effectively full' and Gatwick operating at more than 85 per cent of its capacity and completely full at peak times there is a limit to what efficient operation can achieve.”<sup>60</sup>

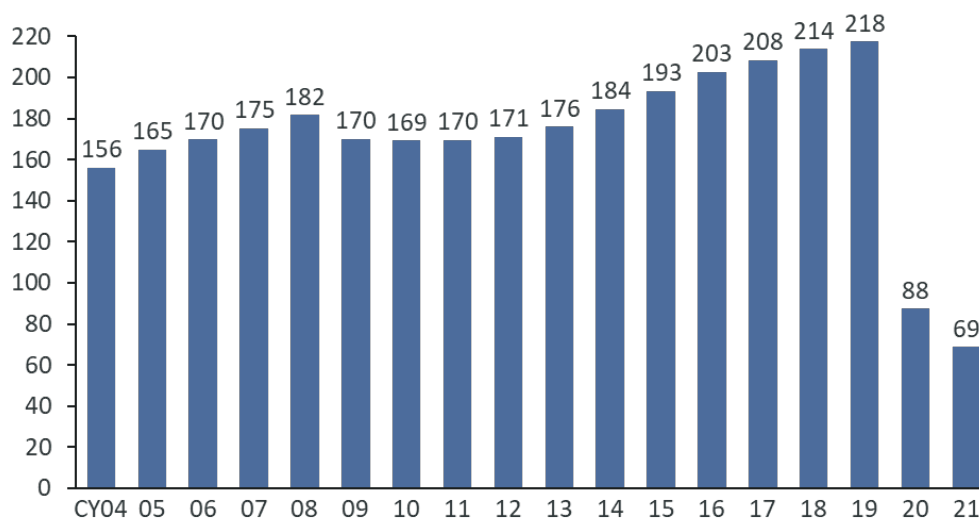
This is also borne out by data from Diio Mi and CAA UK, as set out in the table below.

### Capacity evolution across London Airports (CY04-21)

Millions of seats (LHR, STN, LGW, LTN, LCY, SEN)

CAGR%  
CY04-19

Total 2.2%



<b>Total Pax</b>	129	134	137	140	137	130	127	134	135	140	147	155	163	171	177	181	47	38
<b>Implied L.F.</b>	82%	81%	81%	80%	75%	77%	75%	79%	79%	79%	80%	80%	80%	82%	83%	83%	53%	56%

Thirdly, Earwaker and Bush say that under-investment has detrimental consumer impacts. They say that:

<sup>60</sup> Earwaker and Bush for NZ Airport Association – page 9

*“Frontier Economics has estimated that in 2012 ticket prices at Heathrow were on average 18 per cent higher than at other London airports and 23.8 per cent higher than at other European hub airports (even when controlling for other factors that might affect fare differentials).<sup>24</sup> Such figures will vary across the cycle (with recession diminishing excess demand) and with changing route patterns, but they are strongly indicative of passengers already bearing the costs of runway constraint.”<sup>61</sup>*

The experience of the Qantas Group over a long period of time is very different to those assertions. Services into London Heathrow were consistently our poorest performing routes for many years.<sup>62</sup> It required innovation through a new Perth hub to succeed.<sup>63</sup>

Therefore, our experience is that we have historically been unable to operate successful services into London Heathrow, through a combination of high airport charges and strong airline competition. Earwaker and Bush’s conclusions could not be more wrong. In fact, London Heathrow presents a good case study into the perils of excessive airport charging.

Finally, Earwaker and Bush say that their UK case study has demonstrated that NZCC should not set a WACC below airport cost of capital. But they provide no evidence that the NZCC has done this. As demonstrated in Attachment A, the NZCC Draft Decision will result in WACC outcomes more representative of airports’ cost of capital than current methodology.

Also, the critics posit that NZCC should set a WACC above airports’ cost of capital to create a buffer. This ignores the detrimental consumer impacts of over-investment as set out in this submission, and effectively seeks to guarantee super-profits to monopoly infrastructure companies.

### **New Zealand is not a Riskier Regulatory Environment than other Jurisdictions**

Qantas concurs with the Intelligent Investor that Auckland Airport is considered “a ‘regulated’ monopoly but its regulation is at the looser end of World Standards.”

Whilst the Information Disclosure has managed airports reasonably effectively on issues covered by the Information Disclosure and Input Methodologies regulations, even its core controls have started to lose effectiveness after COVID with airports transferring significant risk to airlines with wash-up mechanisms, and decoupling of capital consultations from pricing consultations.

Contrary to CEG’s point in paragraph 195, the planning consultation and pricing consultation obligations are separate in New Zealand. This enabled Auckland Airport to announce its capital decision separately from its pricing discussion.

The system has minimal controls in respect of capital expenditure, allowing airports to over-spend, as:

- a) New Zealand legislation requires airports to consult regarding capital programs and price, but does not link the two consultations and does not require airports to reach agreement on price;
- b) There is no objective or clarity around the objectives and requirements of consultation. This drives an environment more akin to courteous notification where at best airports respond on

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<sup>61</sup> Earwaker and Bush for NZ Airport Association – page 13

<sup>62</sup><https://www.forbes.com/sites/willhorton1/2019/08/31/qantas-is-finally-profitable-flying-to-london/?sh=6d968d1d289d>

<sup>63</sup><https://australianaviation.com.au/2016/10/qantas-chief-executive-alan-joyce-admits-london-route-is-a-challenge/>

- tokenistic issues in a mechanical way rather than engaging constructively on substantive issues that should be addressed;
- c) The requirement for costs to be efficient is not stated in the regulations or legislation. In the UK, it is embedded systematically in the CAA approach. In Australia it is in the Aeronautical Pricing Principles;
  - d) The Information Disclosure requirements are inadequate to provide for a conclusive challenge to capex. Airlines do not have access to design parameters, ground designs/drawings, airport design consultants, passenger processing forecasts, QS estimates or core designs; and
  - e) The timing of review is far too long after design decisions have been made (and often acted on) with the resultant pressure of sunk costs on any regulatory decisions/recommendations.

Our experience of recent consultations with NZ airports has been well below reasonable standards, characterised by an unwillingness to engage on the key issues. Any suggestion of onerousness of consultation in New Zealand can only arise from airports' dissonance of appearing to consult whilst having no genuine intent to reconsider gold-plating. It certainly does not arise from the ID and IM requirements which are no constraint in respect of airport planning. Compare this with a competitive market, where suppliers eagerly consult with their customers.

Wash-up or mid-term repricing mechanisms are in place at almost every airport that Qantas flies to in New Zealand. Some of these are even acknowledged in CEG's submission eg. paragraph 210 regarding Auckland's wash-up and Figure 5-1 regarding the Wellington Airport consultation process and later wash-up. Some of these pre-date COVID, and many are intended by airports to continue into the longer term (eg Auckland Airport PSE4).

Contrary to suggestions by CEG, there is no requirement for New Zealand airports to set pricing on a 5-yearly basis. That they do so is more likely evidence that airports see little harm in doing so, given the limited risk within their business models. In any event, the UK and Spain have five-year regulatory settlement periods without the flexibility that New Zealand Airports have to undertake an interim Price-Setting Event. In Australia, fixed settlement periods are not set at all.

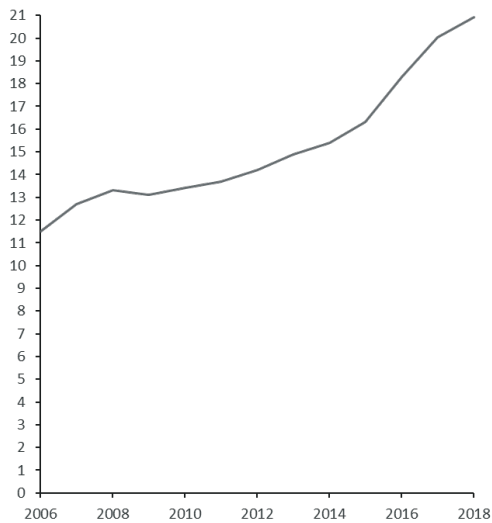
As set out in Attachment A, Auckland Airport demonstrates very few characteristics of a risky investment. It remains an exceptional over-performer having regard to all financial metrics, including TSR and RAB multiple.

Auckland Airport's passenger activity has also been remarkably stable over time. As demonstrated in the chart below, AKL had experienced consistent strong passenger growth over many years prior to COVID, with virtually no volatility.



## AKL passenger movements<sup>64</sup>, million pax

International and domestic, inbound and outbound



It is also misleading to suggest, as airports have, that Heathrow is an inherently lower risk airport than Auckland. For instance:

- Heathrow is subject to price controls, whereas Auckland is subject to information disclosure only;
- Heathrow operates a single till, whereas Auckland operates dual tills and has an extensive property portfolio;
- Heathrow's catchment is shared with three other airports; and
- Heathrow is subject to more competition, including direct rail connections into major cities in Europe.

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<sup>64</sup> New Zealand Ministry of Transport, international and domestic passenger arrivals and departures through airports.

## Incorrect assertions by airports and their proxies

Lastly to assist the NZCC, we also draw the NZCC’s attention to some additional inconsistencies and incorrect assertions made by airports and their proxies in their cross-submissions. We note that this is not a complete list.

Reference	Assertion	Qantas comments
CEG submission paragraph 63 - 65	<b>Auckland Airport is less capacity constrained than comparators.</b> “It can also be seen that the Draft Decision sample of companies own most of the highly capacity constrained airports and all of them are much more capacity constrained than AIAL or the average for New Zealand airports. On the basis of Heathrow’s capacity utilisation and the other considerations set out above, the UKCAA estimated a pre-pandemic asset beta for Heathrow of 0.50. By contrast, New Zealand airports have much lower levels of capacity constraints and have none of the other key risk reducing attributes described by CEPA above.”	We were surprised to read an assertion that Auckland Airport is less capacity constrained. Auckland Airport is about to embark on a major capital program notwithstanding opposition from Qantas and other major customers. According to the airport’s CEO, this is required on the basis that the airport is “nearing capacity, and it’s no longer fit for purpose and hasn’t been for some time” <sup>65</sup> . Only one of two possibilities can be true. Either: <ul style="list-style-type: none"> <li>• CEG’s analysis is flawed, and Auckland Airport is significantly capacity constrained; or</li> <li>• Auckland Airport intends to proceed with \$6bn in upgrades without agreement from its customers</li> </ul> Even if the latter is true, that is clear evidence that Auckland Airport is a low risk business (shown by the fact that the airport consider it a trivial risk of proceeding with a costly upgrade against customer wishes).
CEG submission paragraph 75 - 76	<b>Airports suffered significant dislocation as a consequence of the pandemic.</b> “However, the NZCC ultimately sets an asset beta of 0.35 for energy suppliers. The 0.35 estimate is arrived at by the NZCC adopting as the “top of its range” a 0.36 estimate that is based on 10 years of data that includes the COVID-19 period. This difference in treatment is striking in the context of the relative dislocation that airports and energy suppliers had as a result of the COVID-19 pandemic. As can be seen in Figure 2-5, AIAL’s revenues collapsed by more than two thirds during the pandemic while energy suppliers’ revenue (proxied by Vector) have no discernible pandemic effects.”	There can be no denying that COVID had a significant impact on all participants in aviation, airports included. It is far from clear however that investors perceived a significant increase in underlying risk of airport investment during or after COVID, noting that: <ul style="list-style-type: none"> <li>• Sydney Airport was sold in 2022 at a significant premium to enterprise value, at a near record valuation; and</li> <li>• Auckland Airport continues to trade at high RAB multiples, and its investors are willing to invest in capital programs that its customers do not want.</li> </ul> In a competitive environment, businesses are not able to invest in products that their customers do not want. That Auckland Airport chooses to do demonstrates that this airport, and airports generally, are atypically low risk businesses.
Auckland Airport submission	<b>The Draft Decision has caused investor alarm.</b> “Queries from Auckland Airport investors spiked immediately after the Draft Decision was released. Auckland Airport’s Chief Financial Officer fielded around 20 separate investor calls following the release. Investors unanimously urged Auckland Airport to reduce investment. In some cases investors called for aeronautical capital investment to entirely stop if the Commission retains the draft WACC methodology in its final IM determination.”	As noted elsewhere in this submission, Auckland Airport appears intent on proceeding with an unnecessary capex program that its customers do not want. It seems most likely that the reason for this is that Auckland Airport typically earns a return above its cost of capital. Although the Draft Decision was likely concerning for Auckland Airport management, it is unclear why the stated investor response is evidence of a flawed decision by the NZCC
Wellington Airport	<b>Airports are now required to determine bespoke asset betas.</b>	This statement seems to suggest that if the NZCC updates the Input Methodology for calculating asset beta that WLG will

<sup>65</sup> <https://themarketherald.com.au/building-the-gateway-new-zealand-needs-multi-billion-dollar-revamp-announced-for-auckland-airport-2023-03-20/>

<p>submission para 17</p>	<p>“The adoption of the Commission’s revised approach is likely to undermine effective consultation with airlines as it will increase the need for airports to determine and consult on bespoke asset beta and WACC estimates during each individual PSE. This is due to the sample used by the Commission being less reflective of New Zealand airports, leaving airports to determine how their own asset beta might differ from the Commission’s sample.”</p>	<p>be compelled to ignore this and instead use their own calculation. This statement appears to infer that WLG will need to do so based on a view that the Commission sample might not be representative of WLG airport. It is not clear why the selection of a different sample set by NZCC will immediately upend the entire airport consultation process, as suggested by WLG. This statement appears to be hyperbole at best or a threat at worst.</p>
<p>Wellington Airport reference to <i>Wellington International Airport Ltd &amp; Ors v Commerce Commission</i> [2013] NZHC 3289</p>	<p><b>The NZCC should follow the same arguments it put forward about comparator sets that it argued before the High Court in 2013</b></p>	<p>Qantas has set out in this Cross Submission the substantial arguments as to why the NZCC Draft Decision is economically sound. We have also noted in this submission that the process of the IM review allows for change of views if evidence and facts have changed. Relatedly we note it appears in the High Court decision that at that time the airports were arguing for a narrower comparator set which is contrary to their current position in this IM review.</p>

## ATTACHMENT C

### Index providers country risk classifications

Index providers	MSCI	S&P DJJ's Equity Market Classification	FTSE Equity Country Classification <sup>1</sup>
Developed	AENA Sydney Airport Flughafen Zurich Flughafen Wien Beijing Capital International Airport Aeroports de Paris Aeroporto G. Marconi di Bologna Auckland Airport Ferrovial Hainan Meilan International Airport Japan Airport Terminal Københavns Lufthavne SAVE Toscana Aeroporti	AENA Sydney Airport Flughafen Zurich Flughafen Wien Beijing Capital International Airport Aeroports de Paris Aeroporto G. Marconi di Bologna Auckland Airport Ferrovial Hainan Meilan International Airport Japan Airport Terminal Københavns Lufthavne SAVE Toscana Aeroporti	AENA Sydney Airport Flughafen Zurich Flughafen Wien Beijing Capital International Airport Aeroports de Paris Aeroporto G. Marconi di Bologna Auckland Airport Ferrovial Hainan Meilan International Airport Japan Airport Terminal Københavns Lufthavne SAVE Toscana Aeroporti
Emerging	Airports of Thailand Grupo Aeroportuario del Centro Norte Grupo Aeroportuario del Pacifico Grupo Aeroportuario del Sureste Malaysia Airports Holdings TAV Havalimanlari Holding Guangzhou Baiyun International Airport Shanghai International Airport Shenzhen Airport  Xiamen International Airport Co GMR Infrastructure	Airports of Thailand Grupo Aeroportuario del Centro Norte Grupo Aeroportuario del Pacifico Grupo Aeroportuario del Sureste Malaysia Airports Holdings TAV Havalimanlari Holding Guangzhou Baiyun International Airport Shanghai International Airport Shenzhen Airport  Xiamen International Airport Co GMR Infrastructure	Airports of Thailand Grupo Aeroportuario del Centro Norte Grupo Aeroportuario del Pacifico Grupo Aeroportuario del Sureste Malaysia Airports Holdings TAV Havalimanlari Holding Guangzhou Baiyun International Airport Shanghai International Airport Shenzhen Airport  Xiamen International Airport Co
Secondary/ Frontier	Aerodrome Nikola Tesla Malta International Airport Airports Corporation of Vietnam	Airports Corporation of Vietnam	Aerodrome Nikola Tesla Malta International Airport Airports Corporation of Vietnam