29 June 2022

Jo Perry
Acting Head of Performance and Understanding
c/o infrastructure.regulation@comcom.govt.nz

Dear Jo

WELLINGTON AIRPORT PRICE SETTING EVENT REVIEW – CROSS SUBMISSION

1. This is Wellington International Airport Limited's (***WIAL's***) cross-submission in response to the Commission's consultation on WIAL's 2019-2024 price setting event (***PSE4***). This cross-submission does not include any confidential information.

2. We take considerable comfort from the fact that the submissions provided in response to the Commission's PSE4 consultation paper are relatively brief. That suggests there is a high degree of alignment between WIAL and its substantial customers regarding pricing for PSE4. That was our aim throughout the consultation process. As set out more fully in our pricing disclosures, we made a number of commercial concessions through the consultation process to facilitate consensus and support airlines through the acute phase of the pandemic.

3. In summary our view is:

    a. the submissions do not suggest the Commission should revisit its abbreviated consultation approach, or its overall conclusion that there are no significant concerns with WIAL's targeted profitability. While it is apparent that airlines and WIAL continue to differ on the approach to estimating WACC for airport ID purposes, these differences do not need to be resolved in the context of this process and can instead be addressed more fully as part of the IMs review; and

    b. airlines have confirmed they do not object to WIAL's approach to risk allocation, consistent with the Commission's assessment that the approach was reasonable.

No significant concerns with WIAL's targeted profitability

4. In our submission we supported the Commission's proposal to conduct an abbreviated consultation process focusing on targeted profitability and risk allocation.

5. Airline submitters are similarly comfortable with that abbreviated process. BARNZ and Air New Zealand have emphasised that, while this approach is pragmatic under the circumstances, quality, innovation and cost efficiency remain important considerations. We agree, and note that submitters have not raised concerns regarding these matters in response to the Commission's consultation. The Commission will presumably continue to focus on those matters as part of its review of annual information disclosures.

6. Airlines also do not appear to disagree with the Commission's overall conclusion that it does not have significant concerns with WIAL's targeted profitability. Air New Zealand and BARNZ have objected to

certain aspects of WIAL's methodology for estimating its WACC. However, as explained in our pricing disclosures, we responded to airline feedback in consultation by targeting a level of profitability materially below our own estimate of WACC. The difference between the Commission's revised WACC estimate (5.72%) and WIAL's targeted return on its total RAB (5.88%) is minimal. This is without making any adjustments to account for:

a. the appropriate debt premium in light of the average tenor of WIAL's debt;

b. potentially conservative assumptions in the Commission's cost of equity; and

c. material asymmetric risks.

7. As the Commission itself observed, given WACC is unobservable to both WIAL and the Commission, the Commission could not expect WIAL to exactly meet the Commission's own estimate. While the airlines' submissions raise important points regarding the approach to estimating WACC in an ID context, those submissions don't disturb the Commission's overall assessment of WIAL's targeted profitability.

8. As regards those remaining methodological differences:

a. BARNZ, supported by TDB Advisory, does not agree that a 0.03 uplift to beta is warranted as a result of increased operating leverage, but does accept that a 0.02 uplift may be justified; and

b. Air New Zealand and BARNZ argue that airports should not estimate WACC based on their actual debt costs.

9. We suggest those issues are best resolved in the context of the IMs review that the Commission has just commenced.

Risk allocation

10. None of the submitters have raised concerns regarding the allocation of risk in our PSE4 pricing decision. However, Air New Zealand and BARNZ have both observed that WIAL is in a unique position given the timing of our PSE4 pricing process and has accordingly been able to avoid losses.

11. WIAL proposed to hold prices at FY19 levels and apply a wash-up in later years because of the level of uncertainty around demand in April 2020. Given that uncertainty, there was an unacceptable risk that any passenger forecast we adopted would result in windfall gains or losses for either WIAL or airlines. Airlines also benefited as WIAL's approach avoided the risk that demand would recover more quickly than we might reasonably have forecast in April 2020 and therefore airlines would face a windfall loss.

12. The Covid pandemic has had a significant impact on WIAL as well as our airlines. As noted in our earlier submission we resized our operations due to the sharp reduction in passenger numbers and ongoing uncertainty of the pandemic. At the onset of the pandemic in April 2020 our traffic reduced to under 7,000 passengers for the month which was 1% of their pre Covid level and for the year ended 31 March 2021 passengers reached almost 3 million, which was 48% of their pre Covid levels. In addition to a 30% reduction in staff, operating and capital expenditure was significantly reduced. WIAL also undertook a range of measures to enhance its liquidity and overall financial resilience, including securing covenant waivers with banks and other lenders, increasing bank facilities from $100 million to $170 million and issuing retail bonds totalling $225 million. Our shareholders also provided equity commitments totalling $75.8m, giving confidence to our lenders and enabling us to proceed with essential operations and targeted investment.

13. Finally, we made a number of concessions to support airlines through this period, recognising the impact on our customers, including:

Wellington Airport
Main Terminal
PO Box 14175
Wellington 6241
New Zealand

Tel: 04 385 5100
Fax: 04 385 5139
mail@wellingtonairport.co.nz
wellingtonairport.co.nz

a. holding prices flat through FY21, which resulted in a substantial reduction in cashflow in that year; and

b. proposing a concessionary price path to minimise PSE4 price increases and defer a substantial amount of PSE4 revenue into PSE5. This results in an effective WACC for pricing assets for PSE4 of 5.43%.

14. Accordingly, while the timing of our PSE4 pricing decision meant we were able to respond to the developing pandemic, WIAL was also severely impacted. Our approach to pricing aimed to eliminate forecast risks that were exacerbated by the unique uncertainty of early 2020 and to support airlines through the acute phase of the pandemic.

15. If you should have any queries in relation to this submission please do not hesitate to contact me at [redacted]

Yours sincerely

[redacted]

Martin Harrington
Chief Financial Officer

Wellington Airport
Main Terminal
PO Box 14175
Wellington 6241
New Zealand

Tel: 04 385 5100
Fax: 04 385 5139
mail@wellingtonairport.co.nz
wellingtonairport.co.nz