19 July 2023

Charlotte Reed
Input Methodologies Manager
Commerce Commission New Zealand

By Email: im.review@comcom.govt.nz

Dear Charlotte,

RE: Part 4 Input Methodologies Review 2023 – Draft decision

The Qantas Group (Qantas) welcomes the opportunity to comment on the New Zealand Commerce Commission's (NZCC) Draft Decision on Part 4 Input Methodologies Review 2023. In this submission Qantas will focus on the Cost of Capital paper as it relates to airports.

The approach taken by the NZCC was thorough and transparent and Qantas broadly agrees with the Commission's Draft Decision in respect of key WACC parameters and supporting methodologies.

Qantas supports the change in methodology to an airport comparator set underpinned by a substantive filtering process, which is more aligned to regulatory consensus and reflects a suite of airports that is more similar to those operating in a New Zealand environment.

Notwithstanding this, Qantas sees opportunity to enhance the Final Decision by addressing abnormalities within the asset beta data presented by the NZCC in its Draft Determination, specifically:

1. Auckland Airport's equity beta is impacted by its overweight position within the NZX50 underpinned by the limited market diversification within the index; and in any event
2. A downward adjustment for Auckland Airport remains appropriate, as there continues to be evidence that airports with high level of aeronautical cashflows have lower asset betas.

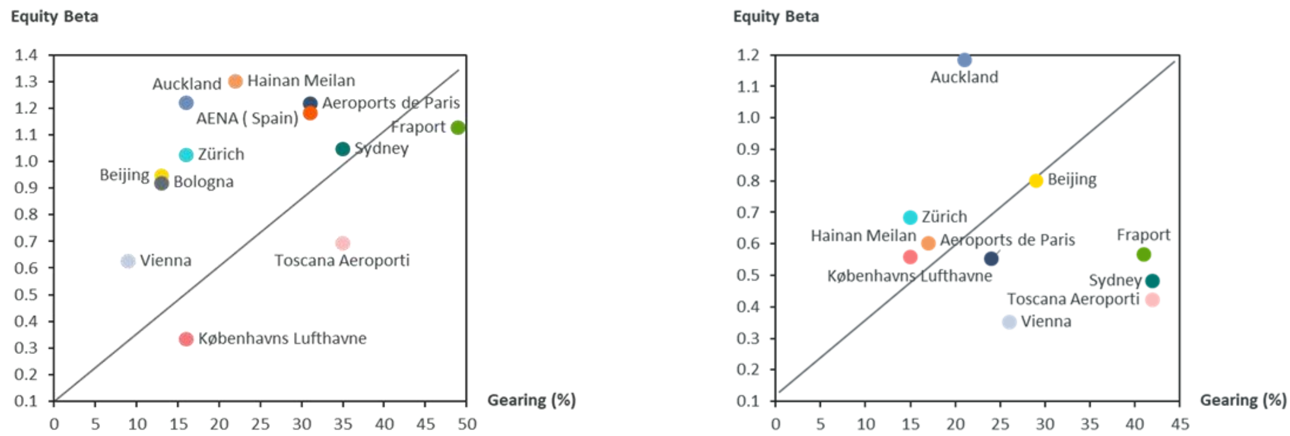
Auckland Airports overrepresentation in NZX50 index

We note that the NZCC's Draft Decision has not used a market diversification filter, where it would be appropriate to do so. In its filtering approach the NZCC has omitted Bologna Airport and included Auckland Airport in its place. This inclusion is not consistent with an appropriate filter application.

Auckland Airport comprises 6% of the NZX50 index and is the second largest stock by market capitalisation as at 18 July 2023. As discussed in Qantas' response to CEPA's report, the lack of market diversification in the NZX50 index driven by Auckland Airport's share of the index distorts its equity beta estimate and introduces an upward bias (as can be seen in Figure 1 below).

Figure 1: 5-year equity beta against gearing[1] for developed market classification (including Bologna Airport)

2017-2022 **2012-2017**



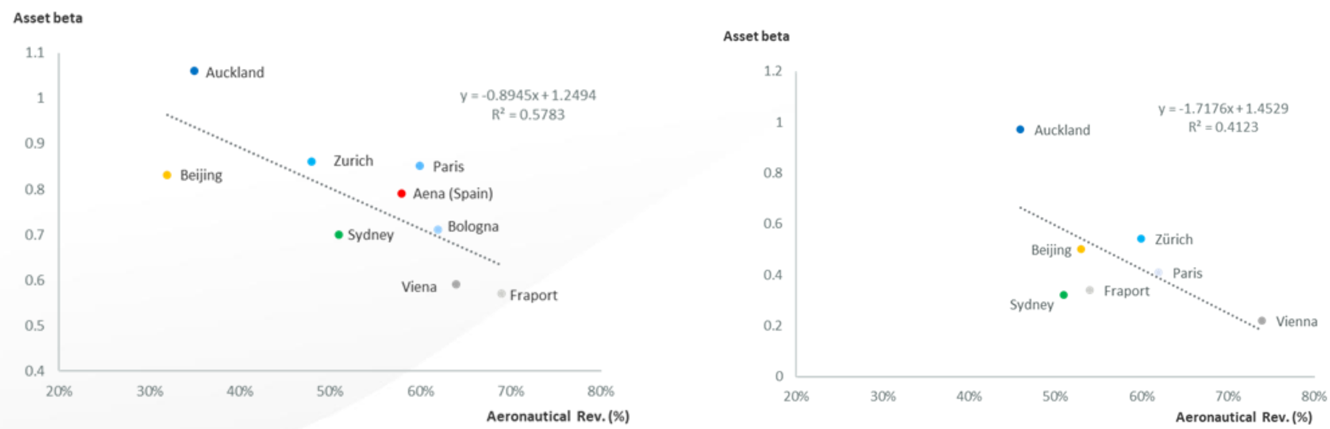
(1): Calculated from using gearing and asset beta data from CEPA's Cost of capital report (March 2023) using the Myers & Brealey formula for re-leveraging
Source: Annual Reports; Commerce Commission Cost of Capital Topic paper, Table A3

Aeronautical cashflow risk

Historically the NZCC had made a downward adjustment of 0.05 to asset beta to better reflect the lower risk of aeronautical services revenue when compared to non-aeronautical revenue. Qantas considers the adjustment remains justified. A comparison of asset beta to aeronautical services revenue shows that a trend exists for the NZCC's draft comparator set (see Figure 2 below). With the exception of Auckland Airport, most airports within the comparator set show a strong correlation between the percentage of contributions of aeronautical revenue and asset beta. With Auckland a significant outlier (32% aeronautical revenue contribution and asset beta >1.0), a downward adjustment for Auckland Airport is appropriate.

Figure 2: 5-year asset beta against aeronautical revenue[2] for NZCC basket (including Bologna Airport)

2017-2022[2] **2012-2017[3]**



(2): Aeronautical revenue is from financial year 2022 sourced from company financial statements; Asset beta is for 5 years (2017-2022) (3): Aeronautical revenue is from financial year 2017 sourced from company financial statements; Asset beta is for 5 years (2012-2017)
Source:2022 Annual Reports; Commerce Commission Cost of Capital Topic paper, Table A3

COVID premium application

Qantas agrees with the NZCC's approach to estimate the impact of COVID-19 on the asset beta for airports across the next regulatory period. As discussed in Qantas response to CEPA's report, Qantas supports BARNZ and the TDB approach to estimate the systematic risk across this period.

TAMRP, risk free rate and cost of debt

Qantas agrees that the TAMRP of 7.0% adequately captures New Zealand market returns and is aligned to New Zealand market participant expectations. Qantas agrees that the approach adequately captures both historical and forward-looking returns in the determination of the TAMRP. Additionally, Qantas agrees with holding the risk-free rate the same for debt and equity.

WACC estimate and reasonableness check

Qantas agrees with the Draft Decision's use of a midpoint WACC, which is aligned to global regulatory precedent. Notwithstanding this, Qantas recommends that the NZCC investigate the RAB multiple further.

The NZCC's RAB multiple range of 1.3-1.9x is high by industry standards and well above a reasonable range of 0.9-1.3x, as detailed in the AER 2018 WACC review.[4] A range consistently in excess of 1.0 signals that the current WACC outcomes may be too high (and well above that required to compensate investors for putting their capital at risk and to attract future investment).

Qantas' Input Methodologies recommendation

Qantas considers that an alternative approach is required to alleviate distortions in the asset beta estimation by:

1. Removing Auckland Airport from the comparator set as its asset beta is inflated, driven by its overweight position in the NZX50; or
2. Making a small downward adjustment to reflect Auckland Airport's relatively small airport service revenue contribution (32%) and elevated asset beta.

Qantas would welcome the opportunity to discuss any aspect of this submission with the NZCC.

[redacted]

Seb Mackinnon
Head of Commercial Airports

(4): AER, 2018. Explanatory notes (Darryl Biggar) – Understanding the role of RAB multiples in regulatory processes