

26 September 2011

Simon Robertson  
Chief Financial Officer  
Auckland International Airport Limited  
PO Box 73020  
Auckland

Dear Simon,

**1. Cost of Capital: Auckland International Airport Ltd's Disclosure Financial Statements for the year ended 30 June 2007**

You have requested Auckland UniServices Ltd ("Auckland UniServices") to:

- Determine the post-corporate tax weighted average cost of capital ("WACC") that the Commerce Commission of New Zealand ("Commerce Commission") would have estimated for Auckland International Airport Ltd's ("AIAL" or the "Company") Identified Airport Activities as at 21 June 2007 consistent with its recent Input Methodologies (Airport Services) Reasons Papers, December 2010 ("IM Reasons Paper") and Decision No. 709 – Input Methodologies Determination applicable to Specified Airport Services pursuant to Part 4 of the Commerce Act 1986, dated 22 Dec 2010 ("Decision 709"); and
- Compare this post-corporate tax WACC to AIAL's WACC in its Disclosure Financial Statements for its Identified Airport Activities in respect of the year ended 30 June 2007.

**2. Determination Date of the WACC being 21 June 2007**

Under the Airport Authorities Act 1966 and subsequent amendments, AIAL is required to consult with its substantial customers ("Airlines") on the pricing of its Identified Airport Activities. This consultation must be with a frequency of at least every five years.

AIAL's Disclosure Financial Statements for the 2007 year states the WACC for its Identified Airport Activities as at 21 June 2007 is determined on a forward looking basis for aeronautical pricing purposes over the pricing period from 1 September 2007 through to 30 June 2012.

From a practical perspective it is necessary to determine the WACC and set prices prior, but as close as reasonably possible, to the start of the next price-review date.

### 3. Definition of Cost of Capital

AIAL uses the generally accepted approach to calculate the post-corporate tax WACC. The post-corporate tax definition of WACC is:

$$WACC = k_e \frac{E}{V} + k_d (1 - t_c) \frac{D}{V}$$

$k_e$	=	cost of equity capital
$k_d$	=	cost of debt
$E/V$	=	“market” value of equity/total firm value
$D/V$	=	“market” value of debt/total firm value
$t_c$	=	corporate tax rate

The cost of equity capital model (“CAPM”) is:

$$k_e = r_f (1 - T_i) + \beta_L (TAMRP)$$

Where, in addition to the terms already defined:

$r_f$	=	The risk free rate
$T_i$	=	The average (across equity investors) of their marginal tax rates on ordinary income
$\beta_L$	=	Levered beta
$TAMRP$	=	Tax-Adjusted Market Risk Premium

### 4. Commerce Commission’s Approach in its IM Reasons Paper and Decision 709 to determine a post-corporate tax WACC

The Commerce Commission in its IM Reasons Paper and Decision 709 uses the same form of the CAPM and post-corporate tax WACC definition as set out in AIAL’s Disclosure Financial Statements for the 2007 year.

### 5. AIAL’s vs. Commission’s Mid-Point Determination of WACC

AIAL’s Disclosure Financial Statements for the 2007 year provide a WACC range between 8.67% and 10.88% for the year ended 30 June 2008, when the assumed corporate tax rate is 33%.<sup>1</sup> The WACC distribution is calculated with reference to a range for the tax-adjusted market risk premium, debt premium, debt to debt plus equity ratio and the asset beta, as follows:

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<sup>1</sup> From 1 July 2009 the corporate tax rate decreased to 30%, which results in a small increase in the post-corporate tax WACC. The conclusions that we reach in this report are not sensitive to this change in the corporate tax rate.

Parameter	Range
Risk free rate	7.26%
Aggregate tax rates for investors on debt	33%
Asset Beta	0.50 - 0.70
Tax-adjusted market risk premium	7.0% - 8.0%
Debt margin	1.29% - 1.39%
Debt to Value ratio	35% - 45%
Corporate tax rate	33%

We take the mid-point of each of the parameter input estimates in AIAL's Disclosure Financial Statements for the 2007 year and compare this to the mid-point estimate that the Commerce Commission would have derived by applying the input methodologies in its IM Reasons Paper and Decision 709.<sup>2</sup>

The table below shows that AIAL's midpoint determination of the post-corporate tax WACC for its Identified Airport Activities as at 21 June 2007 was 9.72%. This compares to our calculation of the Commerce Commission's post-corporate tax WACC mid-point estimate of 9.11% under its IM Reasons Paper and Decision 709.

Point Estimate WACC for AIAL's Identified Airport Activities as at 21 June 2007		
Parameter	Auckland Airport Disclosure Financial Statements	Commerce Commission under the IM Reasons Paper, 2010 and Decision 709
Risk free rate	7.26%	7.08%
Aggregate tax rates for investors on debt	33.0%	33.0%
Asset Beta	0.60	0.60
Equity Beta	1.00	0.72
TAMRP	7.50%	7.00%
Cost of equity	12.36%	9.78%
Cost of debt		
Debt margin (inclusive of debt premium for AIAL)	1.34%	1.25%
Debt Issuance Costs	n.a.	0.35%
Cost of debt pre tax	8.60%	8.68%
Corporate tax rate	33.0%	33.0%
WACC		
Debt to Value ratio	40.0%	17.0%
Equity to Value ratio	60.0%	83.0%
<b>Point estimate Post-tax WACC</b>	<b>9.72%</b>	<b>9.11%</b>

<sup>2</sup> Under the Commerce Commission's approach in its IM Reasons Paper and Decision 709 we derive the risk free rate using the annualised interpolated Government bond stock yields for 21 business days prior to 21 June 2007. The "term" of the risk free rate is five years. We also use the observed debt premium on AIAL's bonds maturing in July 2011 and November 2012 to calculate the debt premium under the Commission's approach in its IM Reasons Paper. However, data to calculate the debt premium was not available for all relevant business days.

## 6. WACC Range

### 6.1 AIAL's approach to determine a WACC range in its Disclosure Financial Statements for 2007.

AIAL's Disclosure Financial Statements for the 2007 provides a range for certain parameter inputs into WACC as noted above. Using this range of parameter inputs we calculate a "low" and "high" value for the post-corporate tax WACC.

### 6.2 Commerce Commission's approach

The Commission's approach in its IM Reasons Paper and Decision 709 is to develop a WACC range as follows:

- Determine a standard error for the following parameter inputs into WACC; the tax-adjusted market risk premium, the asset beta and the debt premium;<sup>3</sup>
- Determine the resultant standard error of the WACC in accordance with a prescribed analytical formula; and
- Derive a WACC range falling between the 25<sup>th</sup> and 75<sup>th</sup> percentile inclusive of the mid-point estimate of WACC.

### 6.3 Resultant WACC Range

AIAL's WACC range in its Disclosure Financial Statements for 2007, together with the Commerce Commission's 25<sup>th</sup> and 75<sup>th</sup> percentile WACC range, are provided in the tables below.

WACC Range - Auckland International Airport as at 21 June 2007			
Range	"Low"	Mid-point	"High"
Post-tax WACC	8.67%	9.72%	10.88%

WACC Range - Commerce Commission as at 21 June 2007			
Percentile	25%	50%	75%
Post-tax WACC	8.13%	9.11%	10.09%

The tables show that AIAL's WACC range for its Identified Airport Activities is marginally wider than the Commission's 25<sup>th</sup> and 75<sup>th</sup> percentile range.

<sup>3</sup> Our WACC range calculated under the approach in the Commerce Commission's IM Reasons Paper and Decision 709 assumes the same standard errors for the tax-adjusted market risk premium, the asset beta and the debt premium as provided in the Commerce Commission's Decision Number 727, "Determination of the Cost of Capital for Information Disclosure Year 2012 for Transpower New Zealand Limited, Suppliers of Gas Pipeline Services, and Suppliers of Specified Airport Services (June year-end) under Part 4 of the Commerce Act 1986, Pursuant to Decisions 709, 711, 712 and 713".

**7. Disclaimer**

This report by Auckland UniServices is prepared for AIAL. Auckland UniServices will not be liable for any loss or damage to any party that may rely on our report other than AIAL. In addition, we have no obligation to update our report or to revise the information contained therein because of events and transactions occurring subsequent to the date of this report.

Yours faithfully



Vivienne Hunt  
Business Manager  
Auckland UniServices Ltd