SECURING THE UK'S REGIONAL AIRPORTS

Thank you for joining our live webinar.

We hope you found the discussion useful, and we would welcome any queries.

The following pages of this document include some key resources cited by our panellists, alongside some further analysis.

Louise Congdon
Managing Partner
York Aviation

Nick Ogden
Partner
Pinsent Masons

James Brass
Partner
York Aviation

Alasdair Weir
Partner
Pinsent Masons

Pinsent Masons

York Aviation

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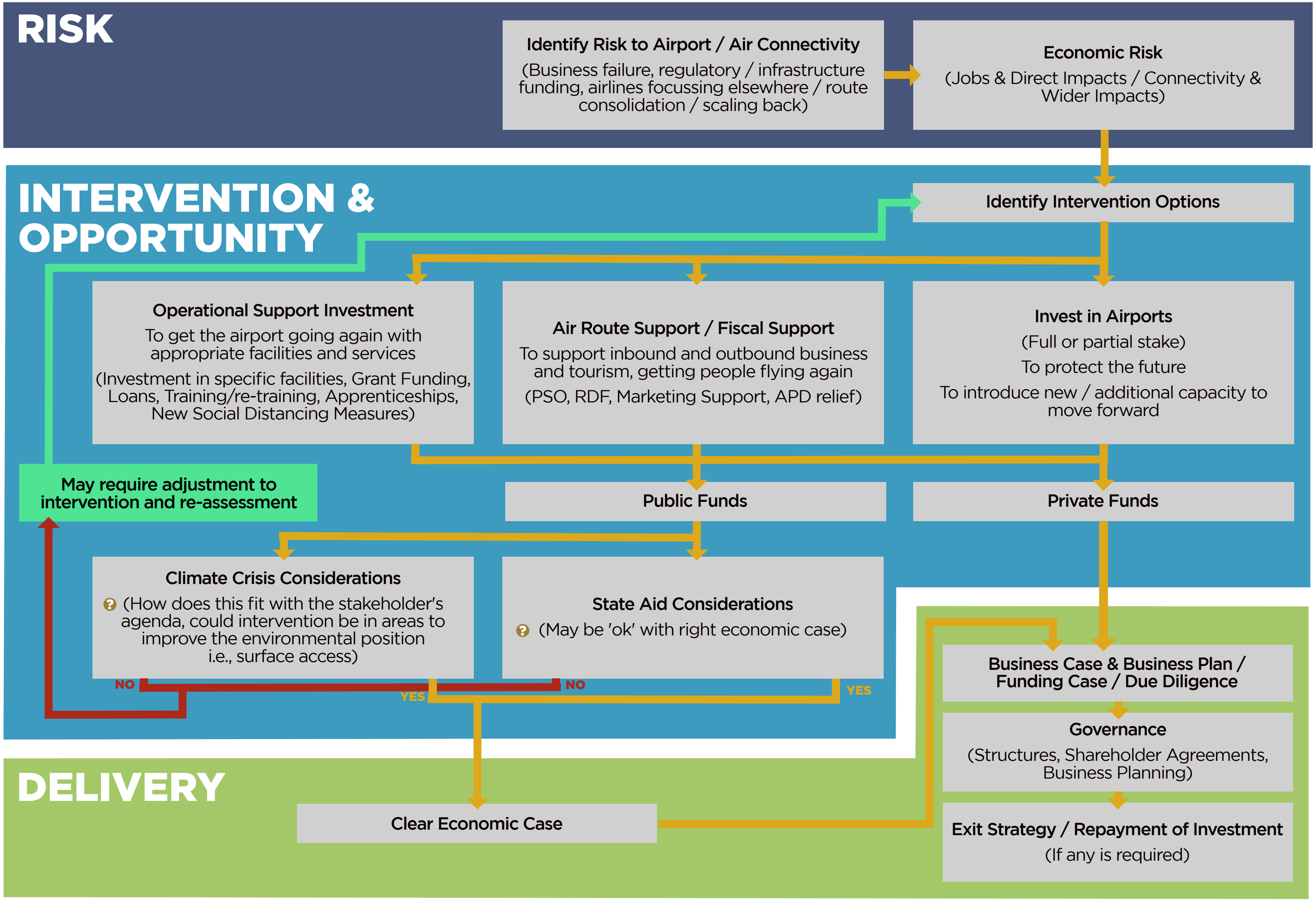
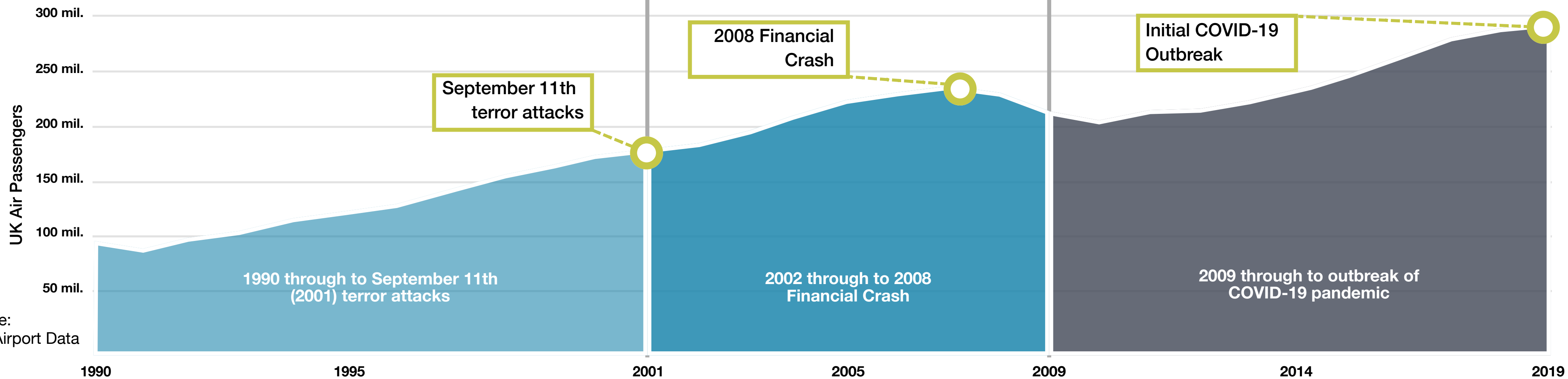


UK Regional Airports: Market Overview

	1990 - 2001	2002 - 2008	2009 - 2019
Market Dynamics	The dynamics of the aviation industry were relatively static and had followed the same patterns for decades. Demand for air travel increased steadily from 1990 as businesses began to globalise and increases in personal wealth and disposable income boosted leisure flying.	Growth in demand for air travel stalled in the wake of the September 11th terror attacks in 2001. As LCCs grew, there was significant market stimulation and growing expectations of lower fares overall. Stimulation led to completely new markets between secondary airports. These carriers were true market disruptors.	Air travel demand again declined following the 2008 Financial Crash, and took approximately 5 years to recover back to pre-recession levels. Continued switch of demand towards LCCs. Demand was strong towards the latter part of the decade, reaching nearly 300m pax in 2019.
Airlines	The airline market was primarily populated by well established flag carriers, secondary full service airlines, regional carriers and a wide range of charter operators. Outside of Europe, routes were still largely covered by intergovernmental bilateral agreements. Low cost carriers (LCCs) were in their infancy in Europe towards the end of this period.	Incumbent carriers scaled back their operations in response to the fall in demand following September 11th, often focusing on key hubs. A number of airlines exited the market. LCCs took advantage of this opportunity to scale up and establish themselves in the market.	LCCs were initially the only real drivers of growth post-recession. They increasingly adapted their model to chase yield as well as volume. This led to a focus on more primary airports, when deals could be done. Initially, this allowed consolidation of demand at these airports. By the end of the period, this led to something of a return to historic dynamics between carriers, but with the retained expectation of lower fares overall.
Airports	The London airports and the ***core regional airports*** (e.g. Manchester, Birmingham, Glasgow) served the majority of air passengers. British Airways had an extensive set of bases across these airports. ***Secondary regional airports*** were well served by an extensive regional airline network as well as charter services. Most airports had relatively high aeronautical charges.	Many larger airports were wedded to traditional charging structures, leading to their continued use by traditional airlines, which generated little growth in many cases. Regional airports willing to do deals on charges benefited with unprecedented growth. As aeronautical revenues fell, so the emphasis for successful commercial revenue strategies developed.	Many secondary regional airports saw dramatic falls in their throughout initially, and many saw little or no growth over the whole period. Others were recovering in the later half of the period. Primary airports that were willing to do deals saw rapid growth. The focus on non-aeronautical revenues continued.



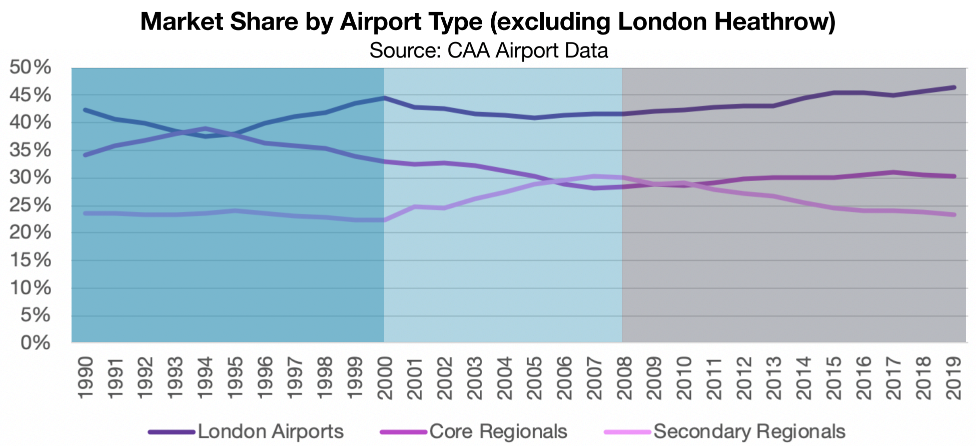
Source:
CAA Airport Data

UK Regional Airports: Market Overview

Low Cost Carriers' use of Secondary Regional Airports

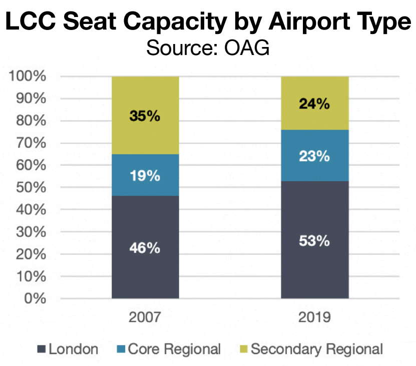
The prevailing market dynamics in the wake of the September 11th terror attacks in 2001 allowed for LCCs to carve out a unique business model and to exploit gaps in the market left by incumbent carriers who had scaled back their networks for survival.

The use of secondary regional airports was a key component in the initial business models used by the LCCs, driven by the opportunities for lower aeronautical charges. The effect was stimulation of many wholly new routes between secondary points.

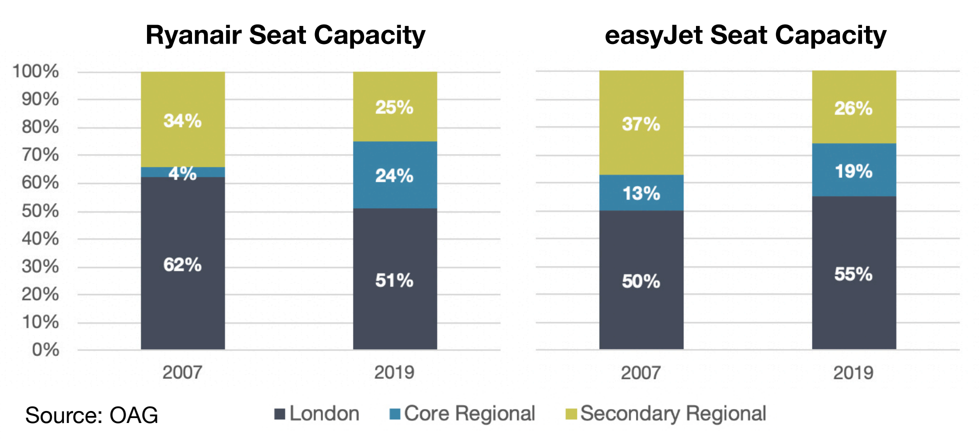


Following the 2008 Financial Crisis, LCCs scaled back their networks from secondary regional airports in search of higher yields that were available on route pairs between first and second tier cities.

In 2007, before the 2008 Financial Crash, 35% of LCC seat capacity across the UK was at secondary regional airports, falling to just 24% by 2019. Given reductions in capacity by mainline carriers, will LCCs respond by filling these voids at primary airports first?



This shift in strategy by the LCCs to consolidate growth away from secondary regional airports following the 2008 Financial Crash is clear when analysing changes in seat capacity from two of the largest LCCs in the UK market, Ryanair and easyJet.



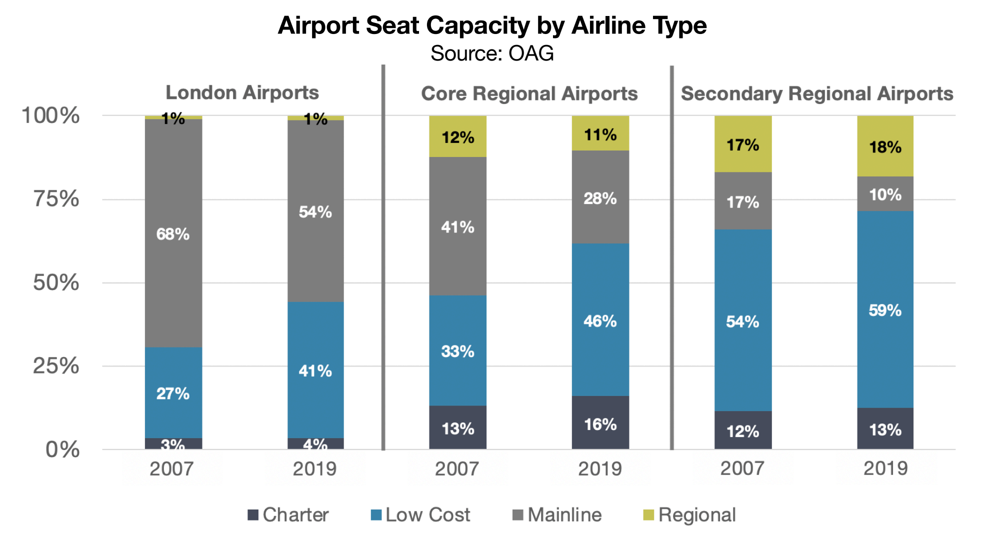
In 2007, both carriers based approximately one third of their total seat capacity at secondary regional airports, with both carriers each reducing capacity to approximately one quarter in 2019.

In Ryanair's case, growth in seat capacity was strongest at core regional airports, where the carrier increased seat capacity by approximately 20% between 2007 and 2019. Ryanair's seat capacity at London airports and secondary regional airports each decreased by approximately 10%.

easyJet, however, increased seat capacity at London airports by approximately 5% between 2007 and 2019. This reflects the carrier's continued growth at Gatwick, and to a lesser extent, Stansted and Luton, in addition to a new operating base at Southend. easyJet's seat capacity growth at core regional airports has not been as strong as Ryanair's, totalling approximately 6% between 2007 and 2019.

Regional Airports: Moving Forward

As LCCs have shifted the majority of growth away from secondary regional airports since the 2008 Financial Crash, the London airports and core regional airports have become increasingly dependent on LCCs. But the dependence of secondary regional airports has also grown.



This may bode well for core regional airports as the industry rebuilds itself in the wake of COVID-19, as LCCs generally have larger cash reserves relative to mainline and regional carriers, and are therefore more likely to survive the impact of COVID-19.

In the short term, there is potential that price will become a key competitive factor as airlines initially focus on growth and this could benefit secondary regional airports in the initial phase of recovery. However, a strengthened focus on yield is likely to follow in the medium to longer term.

Regional airports of all sizes are likely to have to work hard to maintain share in the medium to long term, particularly if economic recovery continues to favour the London area.

Moving Forward from COVID-19

It is clear that 2020 will be a difficult year for all airports, regardless of their size or other characteristics. As demand for air travel begins to slowly recover, all airports will be focussing on securing the critical mass required to cover their operations.

Similarly, airlines will be striving to attract passengers back on board their aircraft. In the short-term, airlines may stimulate the market with low fares in order to steadily grow their passenger numbers. Over time, their focus will shift to balancing costs and yields.

This gives way to a new fiercely competitive landscape, whereby airports may be expected to offer significantly reduced charges compared (temporary or long-term) to get aircraft on their tarmac and passengers through their terminal doors.

However, passenger demand is likely to initially rebound on key routes between high-yielding market pairs, such as routes that previously had high levels of business traffic or core leisure routes This could push LCCs towards London airports and core regional airports as they hunt whatever demand is present within the market, and taking advantage of wider catchment areas to consolidate demand onto fewer services. In turn, the business models of LCCs could drastically change again, as they reposition their product towards attracting higher yielding passengers. This may open opportunities for regional carriers at secondary airports, though often with much reduced capacity compared to an LCC offer on any given route.

Regional Airports: Moving Forward

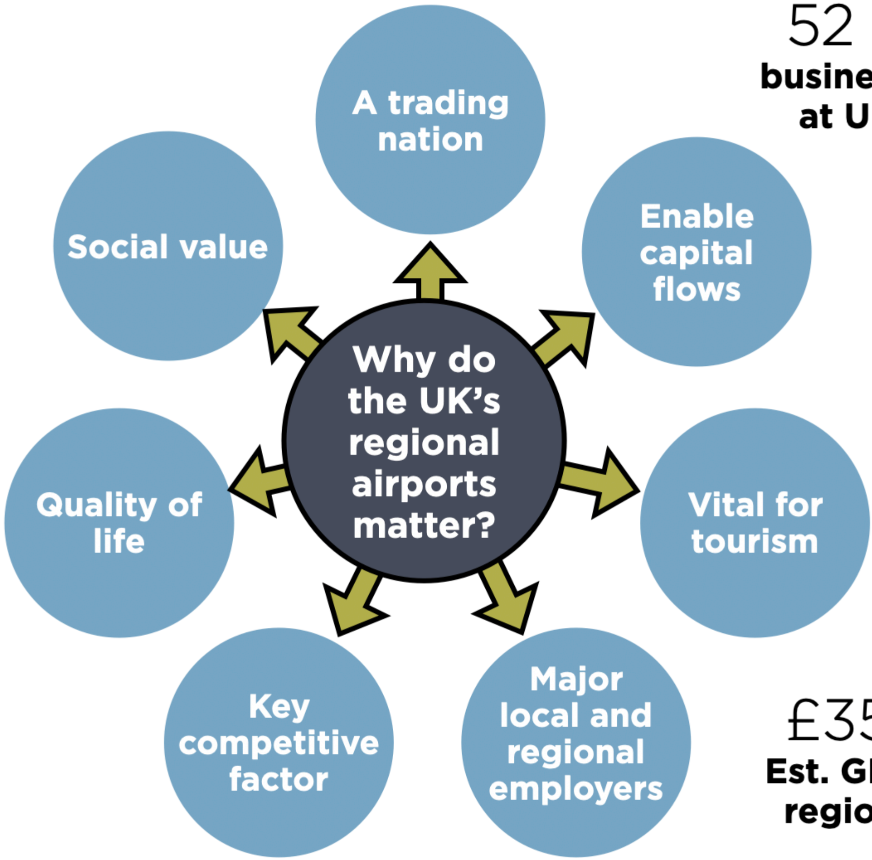
Why do the UK's Regional Airports Matter?

Our regional airports connect the UK's businesses and communities to the global economy, enabling inward and outward foreign investment and employment. The UK's regional airports support an estimated 190,000 jobs and contribute approximately £35 billion to GDP.

65%
Trade as % of GDP

190,000
Estimated UK jobs supported by regional airports

£1.4 tn
UK investments overseas



52 million
business travellers at UK airports

£1.5 tn
UK inward investment stock

76%
% of international visitors arriving by air

£35 billion
Est. GDP impact of regional airports

Final Thoughts

The connectivity and socio-economic benefits provided by our airports are fundamental to the success and prosperity of each region in the UK. Such benefits, and their significant catalytic impacts, demonstrate a possible need for public sector interventions to ensure airports can survive during these turbulent times - regardless of what moves airlines take in the short term to survive this crisis.

Successful Investment Delivery

If the conclusion is that the best solution is an investment into the airport – whether through debt, equity or a hybrid or other structure – bringing that solution to completion requires careful navigation and the development of appropriate legal contractual frameworks, informed by a real understanding of the wider context of the aviation industry, will help deliver successful outcomes.

Ensuring the right level of scrutiny, understanding the key stakeholder landscape and creating the best legal structures are vital. Examples include:

Scrutiny

Whether the capital investment is coming from public or private finances – or both – the investment criteria will be subject to scrutiny, more so in the current environment:

- What is the investment case? Focused on continuing airport operations only or a wider investment case to realise long-term economic value from the entire airport estate? This could include land re-development (or sales) for use in industry, airport-related and other commercial services or even residential development.
- The investment case will drive the scope of the due diligence. The best due diligence exercises – legal, commercial and financial – are based on a clear scope with focused, outcomes related findings.
- The purpose of due diligence is not usually to provide commentary on every aspect of a business, but rather to identify those matters which go to value in the context of the particular investment case. An efficient, properly scoped diligence exercise is a good use of valuable time giving decision-makers the information they need to decide whether, and on what terms, to press forward, and informs operational needs.

Stakeholders

Identifying those stakeholders whose consent or support is required for the investment. Relevant stakeholders could include:

- Existing lenders to the airport. What rights do they have under the finance documents?
- Existing shareholders. What rights do they have under the shareholders' agreement and articles?
- Airport operator. Is this the same entity as the airport or the airport owner? If the operator is related to the existing owner, is that owner continuing to hold a stake in the airport and will the operational arrangements therefore remain in place on the same terms or at all?
- CAA. If operational arrangements are changing, or a transitional services arrangement is being entered into, this could well require engagement with the regulator (CAA) in respect of the aerodrome licence.
- Political and other approvals may be required with public sector investments. For example:
- Is Local Authority cabinet approval required?
- What powers (or basket of powers) is the Local Authority relying on to support the investment, eg general power of competence, well-being, investment powers etc?
- If the investment is from public funds, what are the State aid requirements, and how best to navigate them? Ideally, an investment would be structured so as not to constitute State aid (which needs approval).

Structure

It is very likely that any investment will come with further scrutiny across the lifetime of the investment. This is dealt within the structuring of the investment, particularly through governance requirements of the investor including:

- Agreeing business plans. If the investor is to be a "silent" partner – that is, not having operational control or a formal governance "presence" – it's typical for them to require that expenditure and key decisions are kept within the parameters of an agreed business plan.
- Shareholders' / Investment Agreements. As well as information provisions around business plans, budgets and monthly reports, shareholders' agreements for equity investments normally go further and set out provisions in respect of shareholder veto rights (for certain decisions outside of the ordinary course), anti-dilution protections and exit mechanics.
- Preferred (or deferred) status – some investments are made on the basis that they expect an accelerated return but are subject to a cap on total return; some investments may be deferred, in that they rank behind other forms of investment but, in compensation for that, enjoy a greater share of the "up side".
- Op-Co / Prop-Co structures. Sometimes, an investment is targeted to a particular aspect of the airport business or a related development opportunity. This may require a reorganisation of assets – for example land being hived off to a separate "Prop-Co" or "Dev-Co" – or a synthetic arrangement which achieves the same economic outcome – for example through a special class of linked shares.

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This webinar has been hosted in partnership between York Aviation and Pinsent Masons.

We would welcome the opportunity to discuss interventions and delivery on a case-by-case basis in greater detail, please find the panellists' contact details below.

York Aviation

Louise Congdon
Managing Partner
York Aviation

e: louise.congdon@yorkaviation.co.uk
t: (+44) 07554 130842

James Brass
Partner
York Aviation

e: james.brass@yorkaviation.co.uk
t: (+44) 07767 455614

Pinsent Masons

Nick Ogden
Partner
Pinsent Masons

e: nick.ogden@pinsentmasons.com
t: (+44) 07525 707988

Alasdair Weir
Partner
Pinsent Masons

e: alasdair.weir@pinsentmasons.com
t: (+44) 07766 558235