Non-aeronautical concession agreements

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ACI Asia-Pacific

May 2022

1. **Background information: ACI and ANARA sub-committee**

2. **State of the industry: pandemic, geopolitics, global economy and impact on traffic and revenues**

3. **Business models between airport operators and concessionaires**

4. **Airport concession agreements – fixed versus variable minimum annual guarantee (MAG)**

5. **Emerging trends, role of China and other topics**

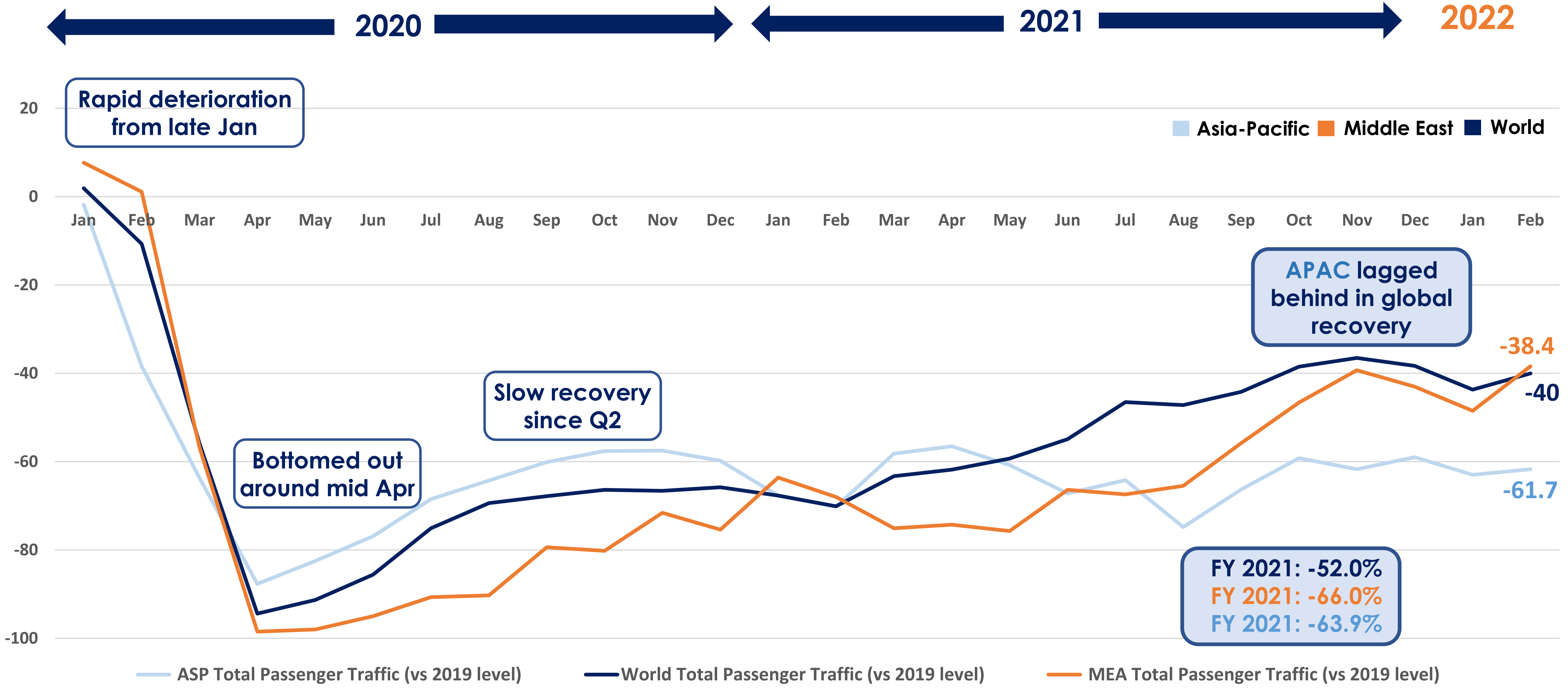
Background information

- **Airports Council International (ACI)** represents the collective interests of airports around the world to **promote excellence** in the aviation industry. We do this by working with governments, regional ACI members, experts, and international organizations like ICAO to develop **policies**, **programs**, and **best practic**es that advance airport **standards** globally.
- Key advocacy areas: safety, security, IT, facilitation, sustainability and **economics**
- Economics: cover aeronautical and **non-aeronautical** areas
- **ANARA**: sub-committee for Airports Non-Aeronautical Revenues and Activities

The voice of the world's airports

2020-2021 passenger traffic trending (World, Asia-Pacific and Middle East)

(% change vs 2019 level)

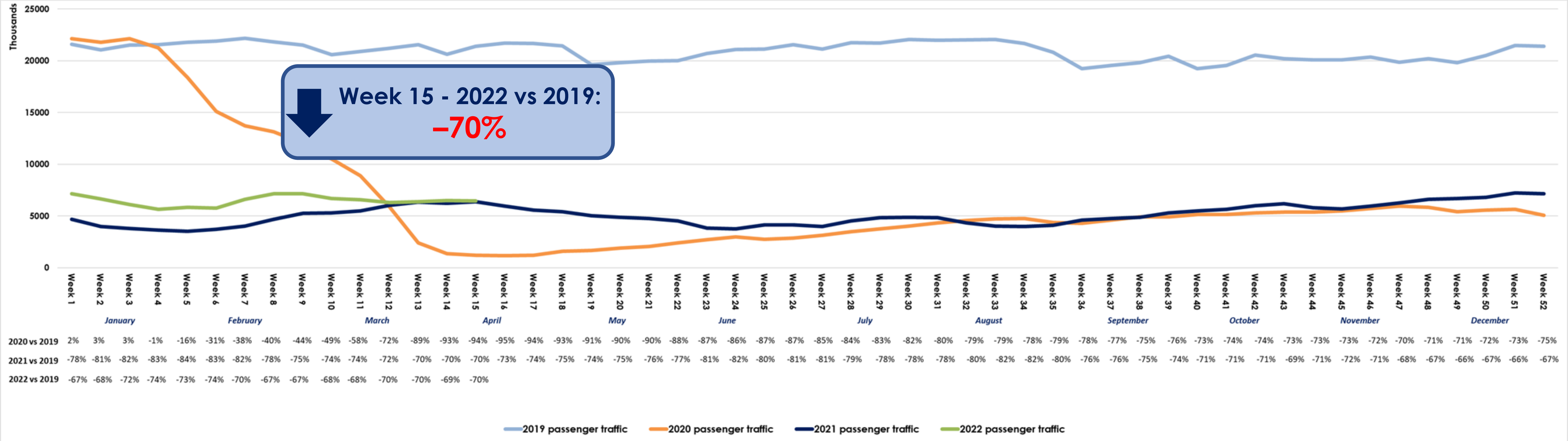


Source: Flash Reports, ACI World

Where we are at the recovery (2019-2022)

Passenger traffic trending (selected airports in Asia-Pacific and Middle East)

2020 Week 1 – 2022 Week 15
30 Dec 19 – 10 Apr 22



	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10	Week 11	Week 12	Week 13
2020 vs 2019	2%	3%	3%	-1%	-16%	-31%	-38%	-40%	-44%	-49%	-58%	-72%	-89%
2021 vs 2019	-78%	-81%	-82%	-83%	-84%	-83%	-82%	-78%	-75%	-74%	-74%	-72%	-70%
2022 vs 2019	-67%	-68%	-72%	-74%	-73%	-74%	-70%	-67%	-67%	-68%	-68%	-70%	-70%

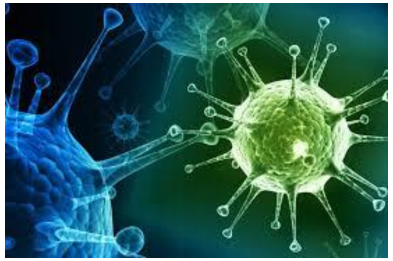
	Week 14	Week 15	Week 16	Week 17	Week 18	Week 19	Week 20	Week 21	Week 22	Week 23	Week 24	Week 25	Week 26
2020 vs 2019	-93%	-94%	-95%	-94%	-93%	-91%	-90%	-90%	-88%	-87%	-86%	-87%	-87%
2021 vs 2019	-70%	-70%	-73%	-74%	-75%	-74%	-75%	-76%	-77%	-81%	-82%	-80%	-81%
2022 vs 2019	-69%	-70%											

	Week 27	Week 28	Week 29	Week 30	Week 31	Week 32	Week 33	Week 34	Week 35	Week 36	Week 37	Week 38	Week 39
2020 vs 2019	-85%	-84%	-83%	-82%	-80%	-79%	-79%	-78%	-79%	-78%	-77%	-75%	-76%
2021 vs 2019	-81%	-79%	-78%	-78%	-78%	-80%	-82%	-82%	-80%	-76%	-76%	-75%	-74%
2022 vs 2019													

	Week 40	Week 41	Week 42	Week 43	Week 44	Week 45	Week 46	Week 47	Week 48	Week 49	Week 50	Week 51	Week 52
2020 vs 2019	-73%	-74%	-74%	-73%	-73%	-73%	-72%	-70%	-71%	-71%	-72%	-73%	-75%
2021 vs 2019	-71%	-71%	-71%	-69%	-71%	-72%	-71%	-68%	-67%	-66%	-67%	-66%	-67%
2022 vs 2019													

Uncertainties…

Vaccine effectiveness



COVID-19 new variants

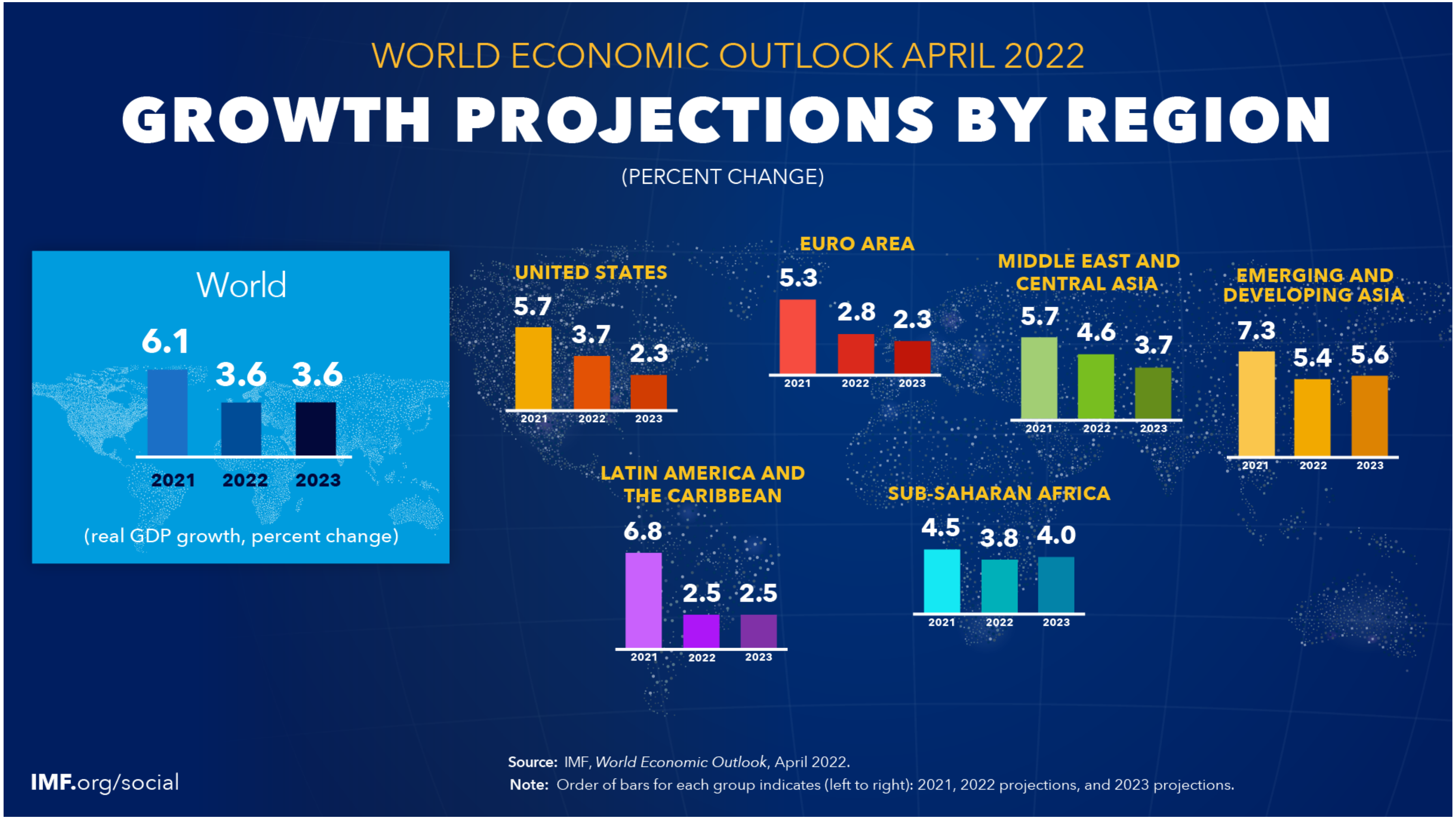
Tightened travel restrictions

Lockdowns (again…)

**Source: ACI Asia-Pacific survey of preliminary total passenger traffic data from 30 airports in Asia-Pacific and Middle East (these airports collectively serve around 29% of passenger traffic in the region)*

The Voice of Asia-Pacific Airports

Global economy: projections 2022-2023

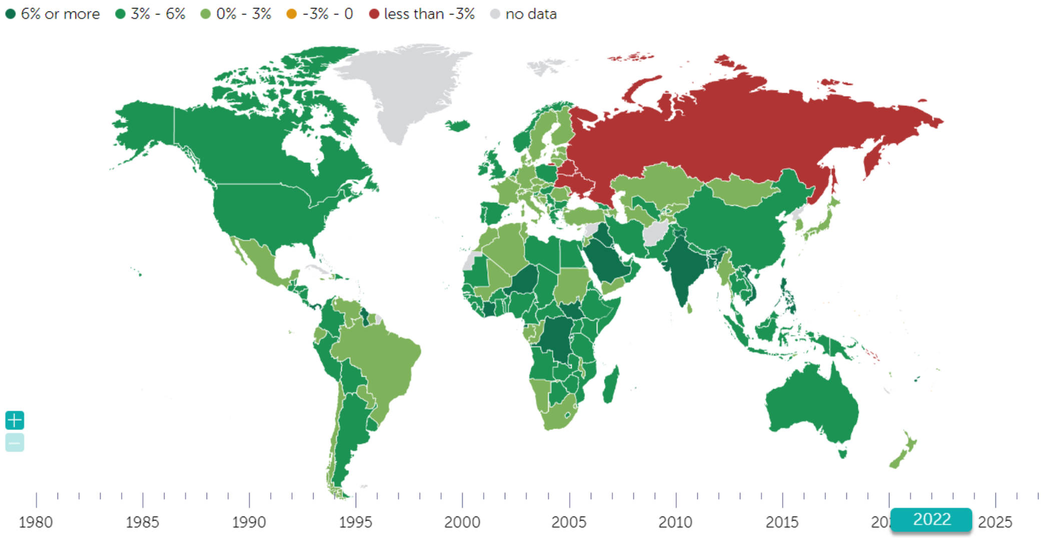


The war sets back the global recovery, but Asia-Pacific and Middle East are better positioned to circumvent the economic downturn.

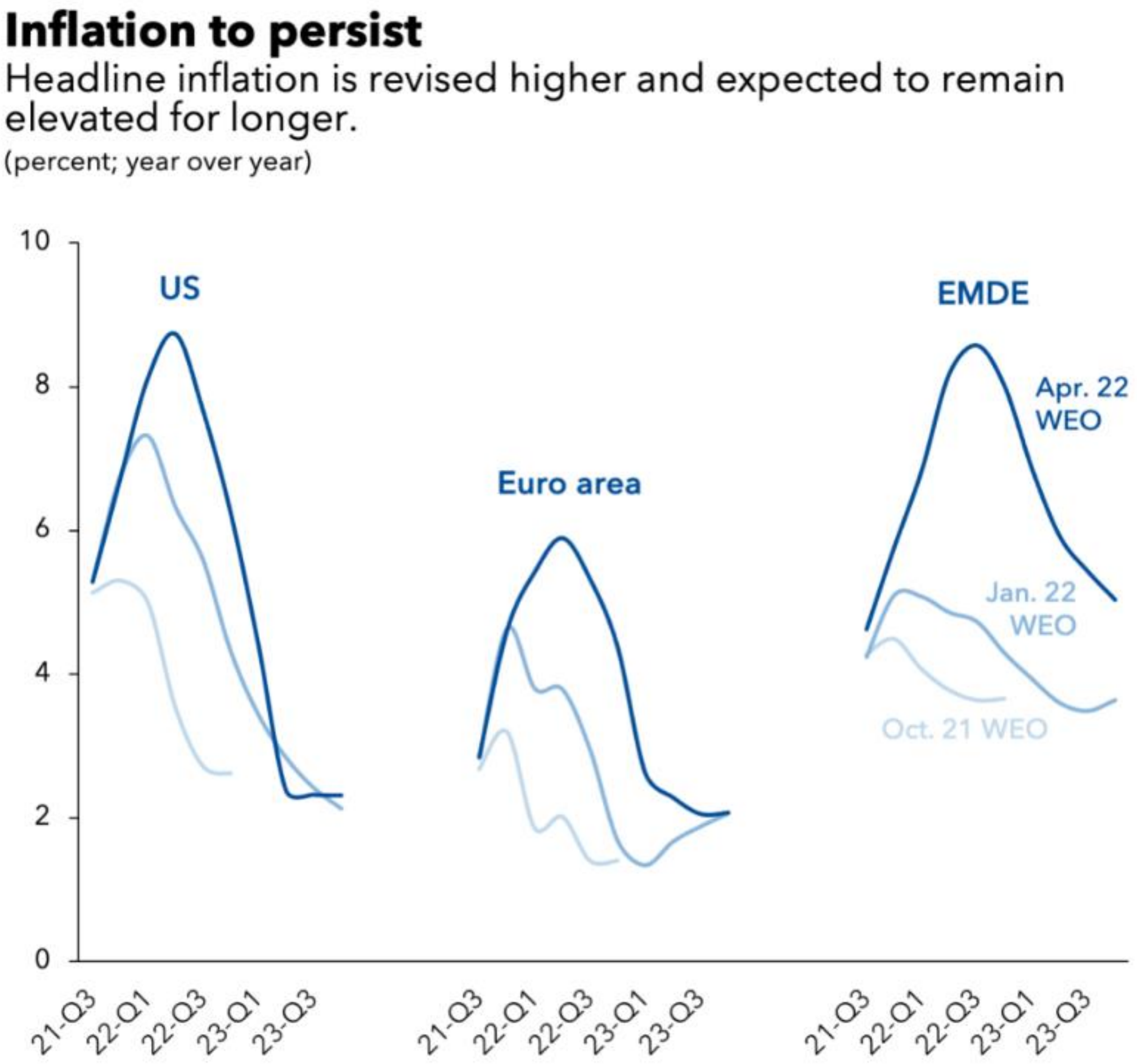
Global economy: policy dilemma

*“The war in Ukraine has exacerbated two difficult policy trade-offs: between **tackling inflation** and **safeguarding the recovery**; and between supporting the vulnerable and rebuilding fiscal buffers.”*

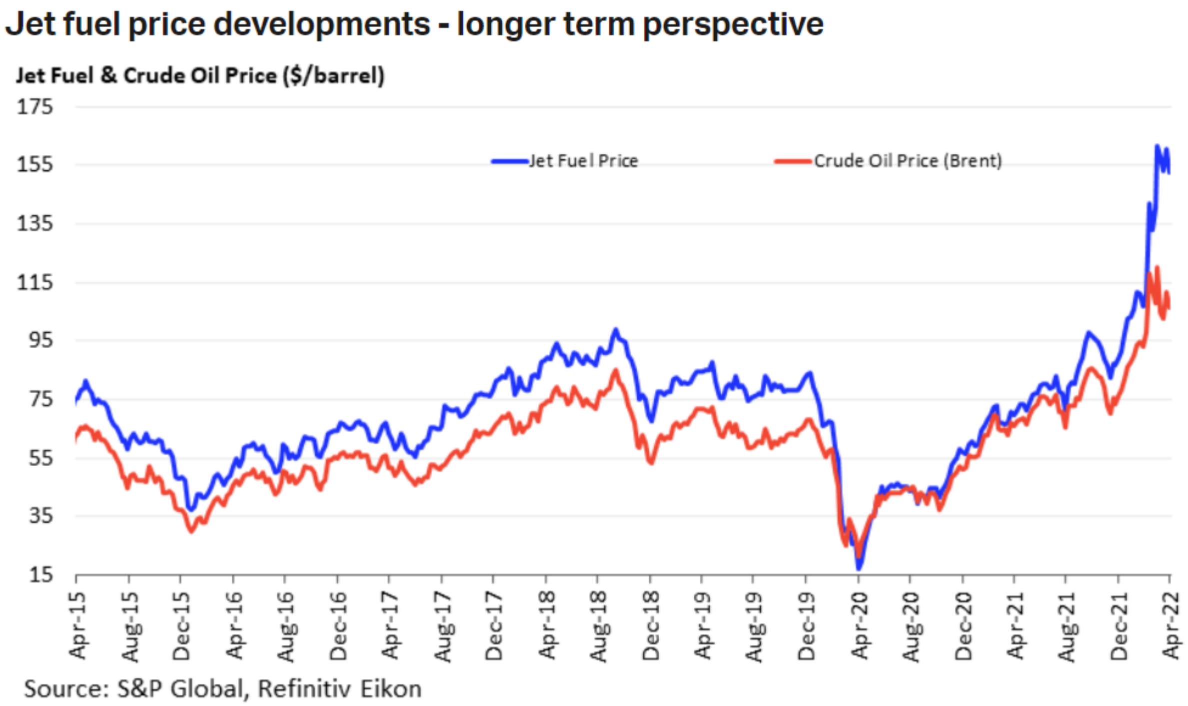
*“Multilateral efforts to respond to the humanitarian crisis, **prevent further economic fragmentation, maintain global liquidity, manage debt distress, tackle climate change**, **and end the pandemic** remain essential”*



Triple shock to the air transport ecosystem



Source: IMF



- COVID-19 pandemic
- Geopolitical tensions
- Pressures on global economy and high inflation

The airport business: first post-pandemic assessment

Estimated industry revenues and costs (millions US$)

	Total revenue	2020/2019 % change	Aeronautical revenue	2020/2019 % change	Non-aeronautical revenue	2020/2019 % change
Africa	2,100	-41.6%	1,300	-47.8%	700	-28.8%
Asia-Pacific	**21,800**	**-47.8%**	**9,200**	**-53.0%**	**11,100**	**-45.4%**
Europe	23,600	-57.8%	11,900	-64.8%	10,100	-51.2%
Latin America-Caribbean	5,100	-47.1%	3,100	-51.6%	1,600	-42.4%
Middle East	**3,800**	**-72.5%**	**1,900**	**-73.1%**	**1,700**	**-74.3%**
North America	29,100	-14.9%	13,800	-23.3%	8,600	-32.4%
World	**85,500**	**-43.4%**	**41,200**	**-50.4%**	**33,800**	**-45.3%**

- Airports in Asia-Pacific and Middle East lost 48% and 73% in total revenues, respectively, in 2020
- In Asia-Pacific, non-aeronautical revenues were slightly more resilient compared to aeronautical (45% vs -53%)
- In the Middle East, the decline in aeronautical and non-aeronautical revenues was comparable (-73% and -74%, respectively)

Source: ACI Airport Economics Report 2022

The airport business: KPIs per passenger

Year-over-year % change in key financial metrics (per passenger, 2020/2019)

	Total airport revenue	Operating revenue	Operating aeronautical revenue	Operating non-aeronautical revenue	Total operating expenses	Capital costs	Total cost (operating + capital costs)
Africa	-8.4%	-10.1%	-18.1%	11.8%	25.2%	21.5%	20.7%
Asia-Pacific	-5.1%	-7.5%	-14.4%	-0.4%	51.1%	95.1%	63.8%
Europe	41.4%	35.6%	18.1%	63.9%	165.6%	334.8%	214.1%
Latin America-Caribbean	29.5%	25.3%	18.3%	40.8%	68.4%	101.2%	82.4%
Middle East	-16.9%	-20.5%	-18.7%	-22.5%	42.7%	183.7%	84.0%
North America	48.4%	27.1%	33.7%	17.7%	63.2%	78.4%	69.7%
World	19.4%	9.2%	4.7%	15.4%	72.5%	129.3%	91.8%

- Deterioration of airport economics on a per-passenger basis:
  - Declines in revenue per passenger of 5% and 17% in Asia-Pacific and Middle East, respectively
  - Deeper drop in non-aeronautical revenues per passenger in the Middle East: -22.5%
  - Costs per passenger went up by 64% and 84% in Asia-Pacific and Middle East, respectively (even steeper increase in capital costs: almost doubled in ASP and almost tripled in the Middle East)

Source: ACI Airport Economics Report 2022

The airport business: in the red

Profitability measures (2020)

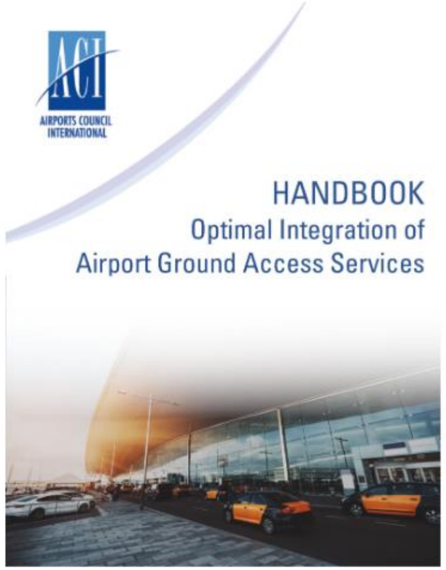
	ROA Return on assets (net profit/average total assets)	ROCE Return on capital employed (EBITDA/total assets minus current liabilities)	ROIC Return on invested capital (net profit + interest expense)/(net assets + long-term debt*)	ROIC*** Return on invested capital (net profit + interest expense)/(net assets + long-term debt*)
Africa	-0.8%	3.2%	-0.5%	-2.0%
Asia-Pacific	-2.0%	2.3%	-1.6%	-2.5%
Europe	-5.7%	0.7%	-4.9%	-5.7%
Latin America-Caribbean	-3.4%	7.4%	-0.2%	-2.0%
Middle East[1]	-12.2%	-9.5%	-20.5%	-21.4%
North America	-0.3%	6.1%	2.3%	-0.6%
World	-2.9%	2.9%	-1.6%	-3.1%

- The airport industry was loss-making in 2020 in all parts of the world
- In Asia-Pacific, airports generated negative ROIC of -2.5%
- In the Middle East, airports arrived to -21.4% ROIC

Source: ACI Airport Economics Report 2022

ANARA and its outputs

- **Check the link:**
  - https://store.aci.aero/product-category/economics-statistics/airports-non-aeronautical-revenue-and-activities/



Handbook: Optimal Integration of Airport Ground Access Services

Policy Paper: Sustainable Airport Ground Access

White Paper: Airport Concession Agreements

White Paper: Business Models between Airport Operators and Concessionaires

Business models between airport operators and concessionaires

- Concession agreements
  - Single-unit
  - Bundle concession
  - Master concession
- Types of concession fee models
  - Minimum annual guarantee (MAG) / fixed rent
  - Revenue share / rent as share of sales
  - Hybrid approach
  - Revenue share with tiered rent
  - Profit share / rent as share of operating profits

Other models

- Master concession
  - Master concession for one business line
  - Master concession for multiple business lines
  - Full master concession
- Joint venture
- Supply contract
- Management contract

Minimum annual guarantee (MAG)

FIXED MINIMUM ANNUAL GUARANTEE	
Pros	**Cons**
For the airport operator	
• Reliable revenue stream • Enhances the credit assessment for financers • Ensures minimal level of performance and commitment by concessionaire • Adds a level of certainty for an airport's minimum commercial revenues • Can build in gross-up clauses to continually push for increased performance	• If MAG is not set at an appropriate level, it could cause performance issues, i.e., too high – divert resources to pay; or too low – not enough incentive to continually improve • May not get best partner if RFP selection is overly weighted on financials • Grossed-up MAG can create challenging situations if there are any serious prolonged downturns in demand
For the concessionaire	
• Set to be realistic and to be surpassed by % rent – thus "minimum" terminology • Adds a level of certainty for concessionaire's minimum fixed costs	• Force majeure events not contemplated in lease could make MAG untenable for concessionaire (e.g., COVID-19) • Concessionaire may overbid and be stuck in a net loss-making situation which could impact performance • High fixed costs may result in the concessionaire having to terminate the contract and close the operation particularly for smaller operators who may not have the scale of business to be able to balance losses in other areas • Grossed-up MAG can create challenging situations if there are any serious prolonged downturns in demand

VARIABLE MINIMUM ANNUAL GUARANTEE	
Pros	**Cons**
For the airport operator	
• Airport participates in the upside as gross up is built into this model • Contracts would be less likely to become unviable for concessionaires and provides long-term stability • A more balanced scoring of the bids will lead to airports securing the best overall partner	• Creates revenue stream uncertainty for airport if no minimums resulting in higher downside risk • Makes financial planning more unpredictable for airport given the high fixed cost operations • Difficult to determine security deposits/letter of credit, when both are usually a function of a fixed MAG (e.g., six-month MAG) • Unclear how airports ensure concessionaires continually strive for improvement and growth • Cashflows to airport will be delayed as payments will be post month when passenger numbers are known vs. in advance with set MAG (though can be mitigated through an additional estimated traffic volume-based mechanism
For the concessionaire	
• Reduces risk for concessionaire – moves from fixed to variable cost overall • Adds certainty to concessionaire financial planning given the per passenger rate is fixed although overall payments to airport will be variable cost • Contracts are less likely to be terminated due to being unviable • More incentive to focus on design, service, standards, and innovation if there is a more balanced scoring mechanism	• Only works for concessions that have access to all passengers. There could be different MAGs depending on location, destination of passenger, etc. • There should be a clear definition of the passenger parameter in the contract (e.g., departing, international, per destination)

From traditional models to profit sharing: thinking outside the box

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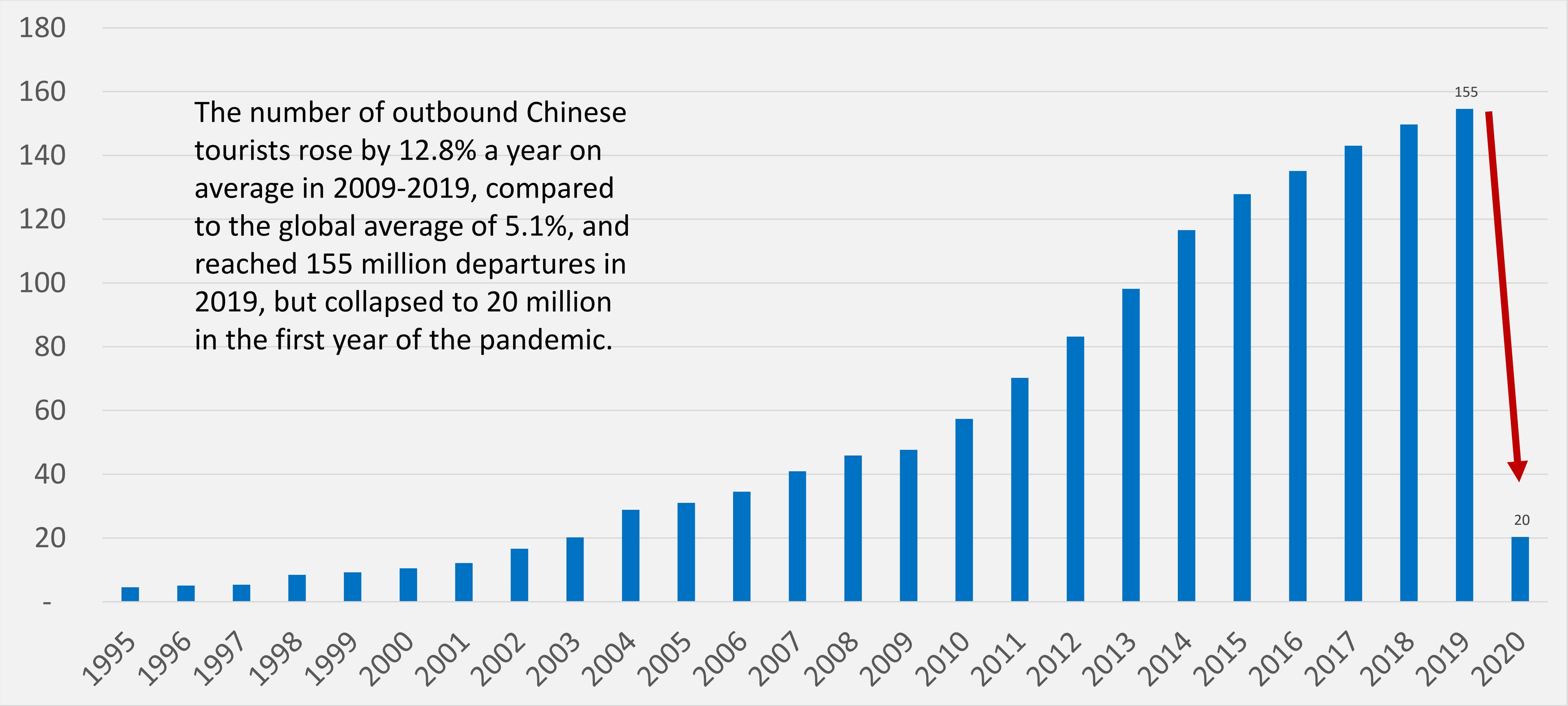
News

July 20th, 2021

Lagardère Travel Retail and Lima Airport Partners pioneer profit-sharing duty free agreement in Peru

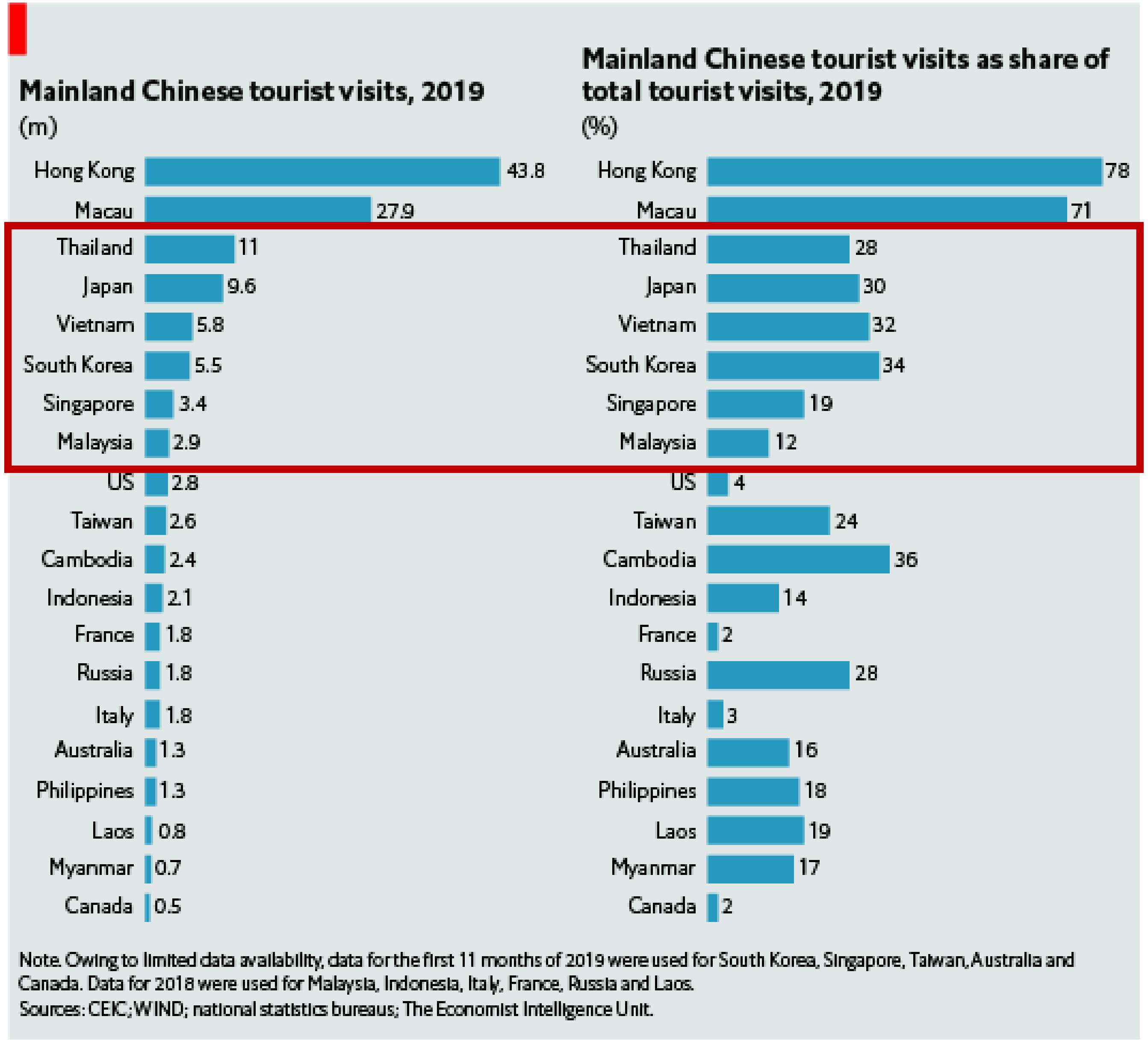
Lagardère Travel Retail and Lima Airport Partners (LAP), a Fraport company, are pioneering a new era for Travel Retail business models by signing a long-term concession contract based on profits sharing for the exclusive operation of Duty Free stores at Jorge-Chávez International Airport in Peru. This is the first large-scale implementation of a business model that has been widely discussed in the industry to better balance risks and benefits between the airport and retail operator. The goal is to unleash growth potential, even more relevant in the context of the Covid-19 pandemic and the resulting drop in global air traffic.

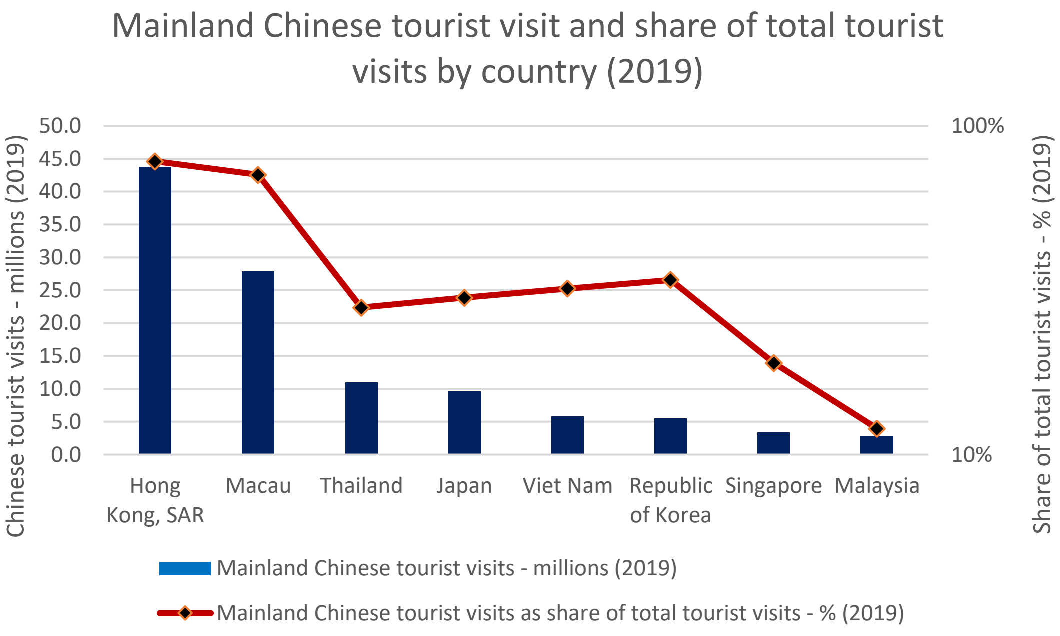
International tourism, number of departures - China (1995-2020, in millions)



Source: World Tourism Organization, Yearbook of Tourism Statistics, Compendium of Tourism Statistics and data files. Extracted from WorldBank, 2022.

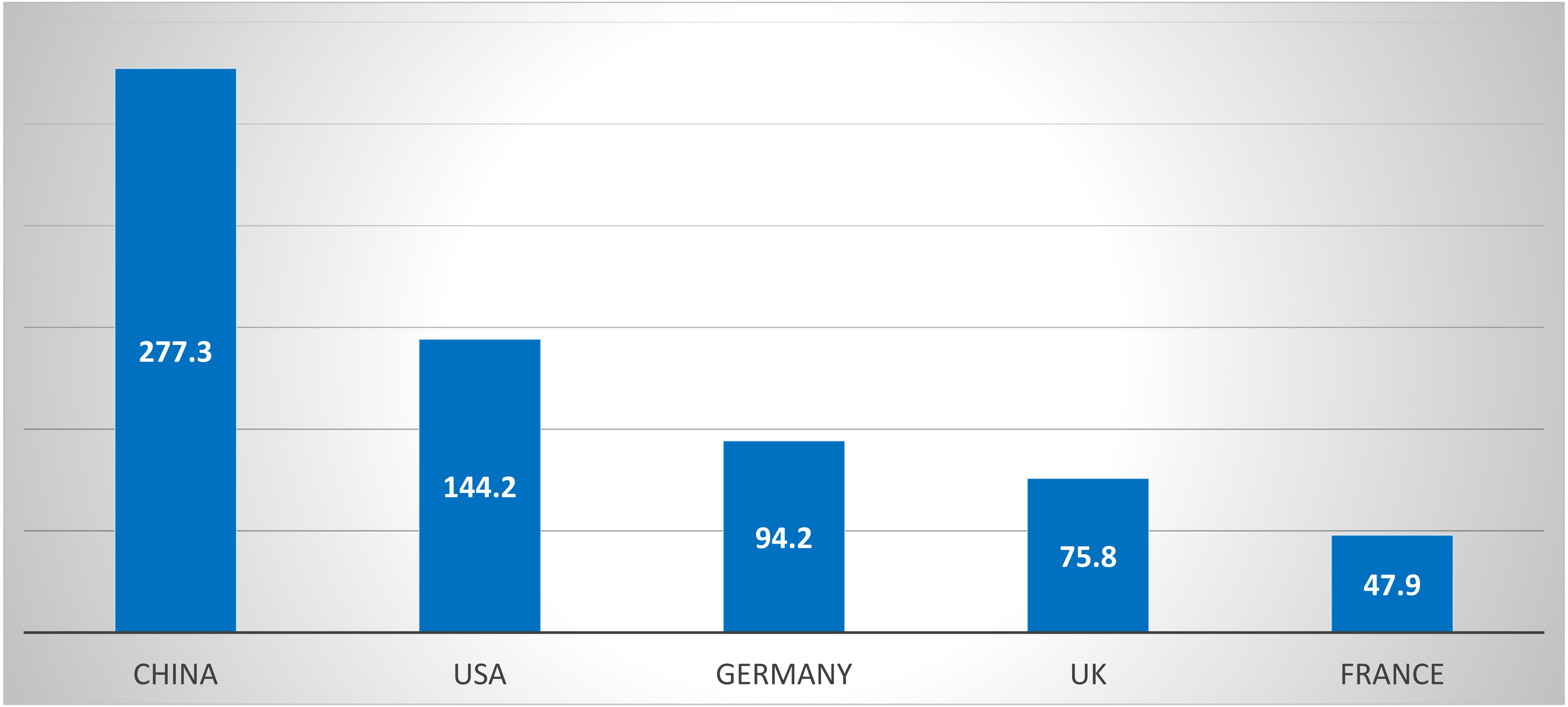
Top 20 popular tourist destinations for travelers from China (2019)





Travelers from China are critical for the aviation markets of **Thailand, Japan, Viet Nam, Republic of Korea, Singapore and Malaysia** and all other countries in Southeast Asia

Top 5 countries with the highest tourism spending (US$ billion), 2019



Source: UNWTO (2019)

Chinese outbound tourists – average spend per trip/per capita (share, %)

2%
≤ CNY 2,000
(USD 280)

8%
CNY 2,001–3,000
(USD 280–430)

29%
CNY 3,001–5,000
(USD 430–725)

43%
CNY 5,001–10,000
(USD 725–1,450)

18%
≥ CNY 10,000
(USD 1,450)

39%
Shopping

18%
Food and beverage

12%
Cultural Activities and entertainment

11%
Transport

10%
Accommodation

9%
Attraction tickets

1%
Others

~ USD 400-450 spend on shopping per trip/per capita

Source: UNWTO Library (2019) / Guidelines for Success in the Chinese Outbound Tourism Market

Attracting Chinese tourists in the post-pandemic era

Matrix showing attractiveness of destinations to Chinese tourists

(lower scores indicate greater attractiveness, with 1 being the most attractive)

Number of Chinese visitors, 2019 rank	Economy	Overall weighted score	Expected date of widespread vaccination (quarter)	Using Chinese vaccine? (0=Yes, 5=No)	Ease of visa application for Chinese citizens, 2019	Covid cases per million people (as at April 30th)	Population density	Top source of tourists other than China, 2019	Second top source of tourists other than China, 2019
1	Hong Kong	4	Q4 2021	0	1	2	5	Taiwan	Macau
2	Macau	4	Q4 2021	0	1	1	5	Hong Kong	Taiwan
12	Cambodia	4	Q3 2023	0	1	2	3	Vietnam	Thailand
23	Laos	4	2025 or later	0	1	1	2	Thailand	Vietnam
15	UAE	5	Q3 2021	0	1	4	3	India	Saudi Arabia
9	Malaysia	5	Q3 2022	0	1	3	3	Singapore	Indonesia
3	Thailand	5	Q3 2022	0	1	2	3	Malaysia	Russia
34	Maldives	6	Q3 2021	0	1	4	5	India	Germany
31	New Zealand	6	Q1 2022	5	1	2	2	Australia	US
32	Turkey	6	Q1 2022	0	1	4	3	Russia	Germany
29	Egypt	6	Q4 2022	0	1	3	3	Germany	Ukraine
14	Indonesia	6	Q2 2023	0	1	3	5	Malaysia	Singapore
7	Singapore	7	Q4 2021	5	2	3	5	Indonesia	India
18	Australia	7	Q1 2022	5	3	2	1	New Zealand	US
5	South Korea	7	Q2 2022	5	2	3	5	Japan	Taiwan
4	Japan	7	Q3 2022	5	2	3	5	South Korea	Taiwan
6	Vietnam	7	Q3 2022	5	1	1	4	South Korea	Russia
19	Philippines	7	Q4 2023	0	1	3	5	South Korea	US
25	Myanmar	7	2025 or later	0	1	3	2	France	US

Key factors:

- Widespread vaccination
- Acceptance of Chinese vaccines
- Ease of visa applications for Chinese citizens
- Covid cases per million people

Source: adapted from the Economist Intelligence Unit [local statistics bureaus, local news sources; World Bank)

The post-COVID-19 travel retail landscape

- Enthusiasm for international travel suggests there is a strong pent-up demand.
- Travel is likely to become more “special” again – fewer trips overall, longer duration, with more family members going, with higher spending
- Propensity to shop when travelling remains strong, but travellers will change how and where they shop in response to COVID-19.
- Travelers are realigning their shopping priorities post-pandemic - very broadly: travelers are more likely to use shopping to experience and understand cultures in the coming years, not shop mindlessly, buy brands, and accumulate “stuff”
- The realignment of shopping priorities is causing a dramatic change in traveler shopping personas – Brand Buyers and Bargain Shoppers, previously the most prevalent types, are in short supply and Destination Shoppers and Cultural Explorers have exploded in size

Source: Horizon Consumer Science, Dr. Ian Cesa (2022)

Sustainability in travel retail

LIQUOR AND CONFECTIONERY

GREEN LIGHT

COVID-19 HASN'T DERAILED TRAVEL RETAIL'S DRIVE TOWARDS MORE SUSTAINABLE PACKAGING

Report Joe Bates

The news earlier this year that Diageo's Johnnie Walker whisky, the best-selling spirit in duty free, was to launch a limited-edition, plastic-free bottle made from wood pulp would have been unthinkable a decade ago. It's a sign of how far sustainability has come in that time - from a fringe issue to a burning hot topic, a cross-generational concern, which has only grown stronger during the pandemic.

"Sustainability has become a hot topic for all of our clients and that includes travel retail," confirms **Rowena Curlewis, CEO** of international drinks design agency **Denomination**. "However with travel retail situated at the gates of what is, let's admit, an industry creating significant environmental damage globally, the topic is even hotter. We can see the efforts the travel retail sector is taking to propel sustainability efforts, particularly in the design and construction of its physical spaces.

"We see installations built using sustainable and reusable and local materials. Renewable energy is being used to power the environments. Communication via digital is replacing physical sales materials, and there has been a big emphasis on cutting down of single-use plastic."

WE WANT TO ENCOURAGE A SUSTAINABLE VALUE CHAIN IN WHICH WE WORK CLOSELY WITH OUR SUPPLIERS AND PARTNERS - GEBR HEINEMANN

Over the past two decades, premiumisation has been the dominant trend in the travel-retail drinks sector and ostentatious luxury packaging involving crystal decanters and heavy, wooden gift boxes have become commonplace, especially for Cognac and Scotch whisky. So can super-premium and ultra-premium drinks packaging become more sustainable without losing its refined, aspirational appeal?

"More sustainable elements can work for luxury brands, but it requires some consumer education and bravery from brands to move away from traditional luxury codes," argues **Tom Hearn, Director** at international design agency **Nude Brand Creation,** whose long list of past drinks clients includes Midleton, Martell, Ballantine's and Havana Club. "Brands need to educate consumers on why new materials are being used and the benefits of using them. Arguably, luxury brands are better placed to do this than more mainstream ones. Consumers are willing to pay more for luxury products and therefore brands have the budgets to invest in new sustainable materials."

Denomination's Lewis points out it is now possible to

MAKING AN ECO-SHIFT

The challenging world situation hasn't deadened consumer - or brand - desire to make an eco-shift. Next year Nestle International Travel Retail (NITR) is transitioning its entire Smarties range (top and bottom images) to recyclable packaging, while Ricola (pack shot) has already removed aluminium foil from its sugar-free 75 tins to make them more eco-friendly. Accolade Wines (centre) is aiming to make its entire UK wine portfolio carbon-neutral by the end of 2020.

create a luxury look in a more sustainable way. "Many suppliers are proactively advising on how to use materials in a more sustainable way in order to ensure that conventional luxury cues are maintained. Hot foiling, for example, is both recyclable and repulpable. The process utilises the majority of the foil ribbon by indexing small increments, and so waste is reduced.

"That said, we are starting to see a movement towards a different approach to luxury, one which is more environmentally friendly, and natural in feel," she adds. "Seedlip's gift set packaging made from mushrooms is a great example; Larry Cherubino's egg-carton gift box for his £60 wine Uovo is another. Runiart's new eco-packaging using plastic free and lighter "second skin" feels luxurious, but in a more contemporary, natural way.

2020 has been a dreadfully disruptive year for the travel retail industry but the need for more sustainably packaged products remains a priority for many retailers. "Switching to sustainable packaging is a significant step towards preservation of our environment and is highly recommended," says **Sharon Beecham, VP President - Purchasing** at **Dubai Duty Free** (DDF).

"We discuss this with our suppliers regularly to find out what their current status is in terms of the strategy their company has for sustainability and to update us regularly. The purpose being for them to be aware of the importance of this to DDF. If the suppliers have any significant initiatives, we try and support this within our retails shops."

"Basically, all brand manufacturers have to improve their packaging significantly regarding sustainability and plastic," insists **Nina Semprecht, Head of Corporate Communications** at **Gebr Heinemann**, adding: "We appreciate that many of our partners are working on solutions in this area. Hence, we are on