

Response to the CAA's Initial Proposals on the WACC for Gatwick

Note prepared for British Airways¹

June 2013

Overview

The CAA recently released its initial proposals for the economic regulation of Gatwick Airport Limited (GAL) from April 2014, including an estimate of the appropriate weighted average cost of capital (WACC). In relation to the WACC, the CAA commissioned an independent report which recommended that GAL's WACC was in the range 4.5% to 6.1% and the CAA's initial proposal for the pre-tax real WACC was 5.65%. This compares to an effective rate of 6.3% in Q5 and was based on a number of identified changes since the previous determination, including:

- A change in the notional gearing level to 45% equity finance and 55% debt finance (from a previous 40% equity and 60% debt);
- A significant fall in the cost of debt as interest rates have declined; and
- A lowering of the corporation tax rate compared to Q5 (with signals that further reductions will occur during Q6).

We agree that Gatwick's WACC for Q6 should reflect any changes to the rate of corporation tax to avoid generating windfall gains for GAL and should also reflect the lower cost of debt since Q5. However, we think that there are two key assumptions that need to be considered further. In particular, these assumptions are that:

- Gatwick's relative systematic riskiness has not changed since the Q5 determination - with implications for the equity beta and the notional level of gearing; and
- Gatwick is a small regulated entity - with implications for its ability to issue debt without an issuance premium (based on higher fees) and the notional level of gearing.

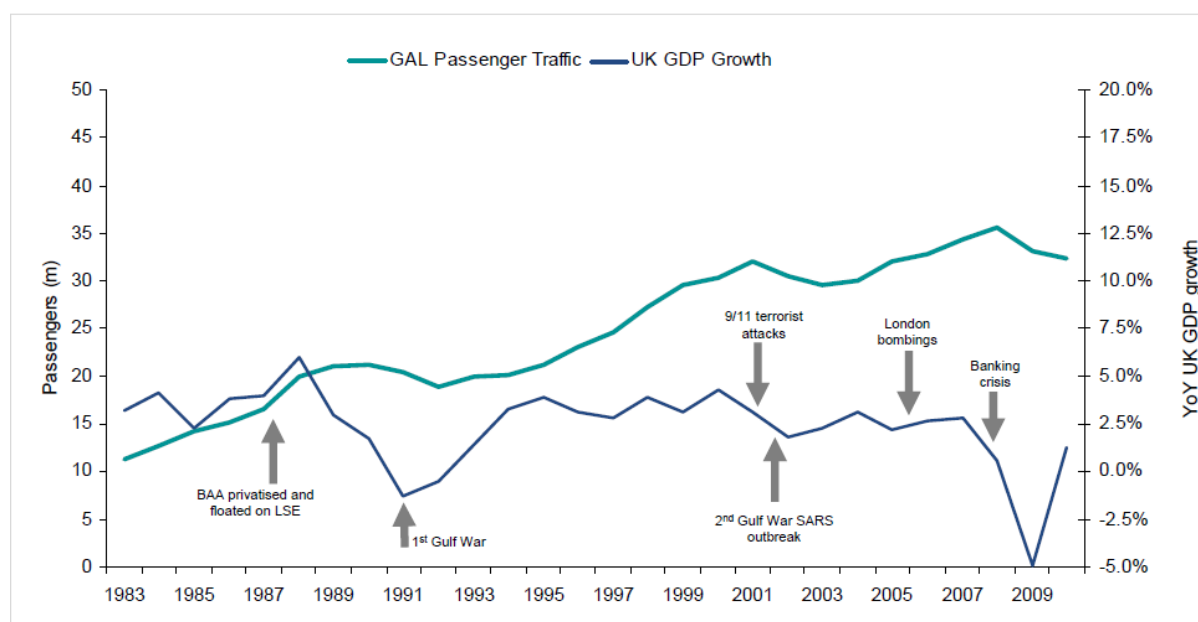
In the remainder of this note we therefore consider the appropriateness of these assumptions.

In summary, there is evidence to suggest that the airport is not as risky (in relative terms) as the CAA's analysis suggests. A particular one-off factor affecting demand variability at Gatwick during Q5 was the introduction of the EU-US Open Skies Agreement on 30 March 2008 and removing such non-systematic events reveals a much less volatile pattern of demand. In addition, long term trends are reducing demand risk at Gatwick, with a greater share of robust airlines based at the airport and the stability of the airport's business being confirmed in statements by Gatwick's management.² This is shown by the chart below of Gatwick's historical resilience to downturns in the UK economy.

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² Gatwick (2011) 'Gatwick Airport Bond Investor Presentation: February 2011.' Available at: http://www.gatwickairport.com/Documents/business_and_community/Investor%20relations/Investor%20Presentation%20FINAL%2015-2-2011.pdf

Figure 1.1: Stability of Gatwick's passenger numbers



Source: Gatwick (2011) Gatwick Airports Bond Investor Presentation: February 2011

Evidence from the Competition Commission (CC) and other regulators also suggests that Gatwick does not require a higher cost of capital to account for its smaller size compared to Heathrow as it is of sufficient scale not to merit such adjustments.

As set out in more detail in CEPA's overview note, we have revised the range and point estimate for Gatwick, with our current estimate for Gatwick being set out in Table 1.1. This is based on further analysis following the CAA's initial proposals and the arguments set out in this note.

Table 1.1: Range and point-estimate for Gatwick

Element	Low	High	Comment
Risk-free rate (%)	1.5	1.75	Unchanged
ERP (%)	5.0	5.0	Unchanged
Equity beta	1.0	1.0	Reduced given recent evidence
Post-tax Cost of Equity (%)	6.50	6.75	
Tax rate (%)	20.2	20.2	Calculation in line with CAA approach
Pre-tax cost of equity (%)	8.15	8.46	
Cost of debt (%)	2.5	2.5	Starting value for our indexation approach – no justification for Gatwick to have a higher value than Heathrow
Gearing (%)	60.0	60.0	No justification for reducing this value.
Pre-tax WACC (%)	4.76	4.88	
Mid-point (%)		4.8	The appropriate point trading off various stakeholder perspectives

The CAA's initial proposal of 5.65% lies outside the revised range and well above the midpoint of 4.82%. This suggests that the combination of a high cost of equity, a low level of notional gearing and additions to the overall cost of debt to cover Gatwick's assumed issuance costs lead to a cost of capital that is overly generous. During Q6 this could lead to unnecessarily high costs for consumers, amounting to around £100m³. An overly generous WACC can also incentivise wasteful over-investment in capital that results in long term structural inefficiency and high costs to users that future regulators cannot easily correct.

Demand risk at GAL

On the likely relative riskiness of Gatwick in Q6 we think that the CAA's analysis could be taken one step further. The CAA's initial WACC is based on the conclusion that the systematic riskiness of GAL has not changed since the CAA and CC's analysis for Q5. This result was considered against the alternative that GAL may be riskier in Q6, as had been proposed by GAL itself. We consider that there is a second alternative – that risks for GAL have fallen since the Q5 determination.

In examining the systematic riskiness of Gatwick, the perceived level of demand risk at GAL is a key element in the estimation of a higher WACC as compared to Heathrow – having implications for both the equity beta and for the level of gearing. We examine each of these elements of the WACC in turn.

Impact on the equity beta

PwC estimated that GAL's asset beta was unchanged from the Q5 determination and remained within the range 0.46 to 0.58.⁴ Similarly, the CAA concluded that:

*“the available evidence supports PwC's view that there has been no material change in GAL's beta since the Q5 determination, and the estimate of 0.46 to 0.58 is appropriate for its asset beta in Q6”.*⁵

Evidence used to support this conclusion included an examination of both changes in asset betas for comparator airports; and the drivers of systematic risk. CEPA's note titled *“Equity beta for Heathrow and Gatwick in Q6”* examines changes in asset betas for comparator airports. In this note we look more carefully at the analysis on the drivers of systematic risk.

On Gatwick's exposure to systematic risk, PwC's conclusion that Gatwick remained relatively riskier than Heathrow and that the extent of the gap was the same as in Q5 was based mainly on an analysis of the demand risk faced by the airport (as shown by the volatility of passenger numbers and air traffic movements). This is demonstrated in PwC's conclusion that:

*“The cost of equity is the lowest for Heathrow, among other things, reflecting its lower exposure to demand risk. Gatwick has a higher risk profile than Heathrow, but to a lesser extent than Stansted which is most exposed to demand risk”*⁶

We have undertaken further analysis on passenger numbers at Gatwick to examine whether anything can be said about the relative systematic demand risk faced by Gatwick and Heathrow since the Q5 determination.⁷

³ The difference in regulated revenue requirement between a WACC of 4.82% and 5.65% assuming all other elements of the CAA's proposed price cap remain as proposed.

⁴ The range for the equity beta proposed by PwC was 0.9 to 1.17 which is lower than the range for Q5 (1.0 to 1.3) but this is a result of the assumed lower level of notional gearing rather than the change in the underlying asset beta.

⁵ CAA (2013) “Economic regulation at Gatwick from April 2014: initial proposals”, at p.168

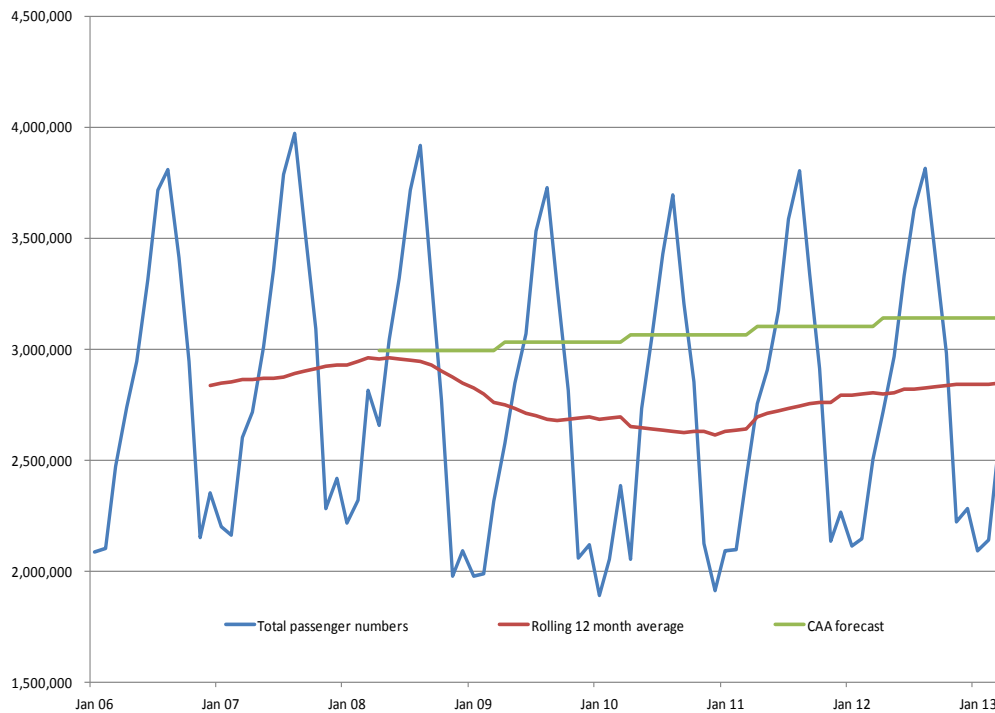
⁶ PwC (2013) “Estimating the cost of capital in Q6 for Heathrow, Gatwick and Stansted: A report prepared for the Civil Aviation Authority (CAA)”

⁷ While we acknowledge that relative risks may be higher at Gatwick than at Heathrow, particularly due to Heathrow's hub status, we are suggesting that the gap between the relative risks has lessened since the Q5 determination was made.

Analysis of passenger numbers

When examining fluctuations in demand at Gatwick, an analysis of raw passenger numbers can be misleading in terms of what it suggests about the volatility of demand. As can be seen in Figure 1.2, there is significant within-year variation in demand at Gatwick largely reflecting the pattern of travel at the airport. In Figure 1.2 the rolling 12 month average demonstrates much less volatility in passenger numbers. For comparison we have also included the forecast passenger numbers for Gatwick in Q5.⁸

Figure 1.2: Passenger numbers at Gatwick, monthly, 2006-2013



Source: CAA data, CEPA analysis

A specific one-off event that had a significant impact on passenger numbers at Gatwick in Q5 was the introduction of the EU-US Air Transport Agreement (“Open Skies”) on 30 March 2008. Prior to the Open Skies agreement UK air services to the US were governed by the Bermuda II agreement. Many routes between London and the US were not permitted to operate from Heathrow and only two US airlines and two UK airlines were designated to fly the permitted routes. This agreement resulted in many US flights being excluded from Heathrow and operating instead from Gatwick. With the introduction of the new agreement, all EU and US airlines could conduct flights to any US destination using Heathrow.⁹ This led to a shift in flights from Gatwick to Heathrow to take advantage of the relaxed restrictions.

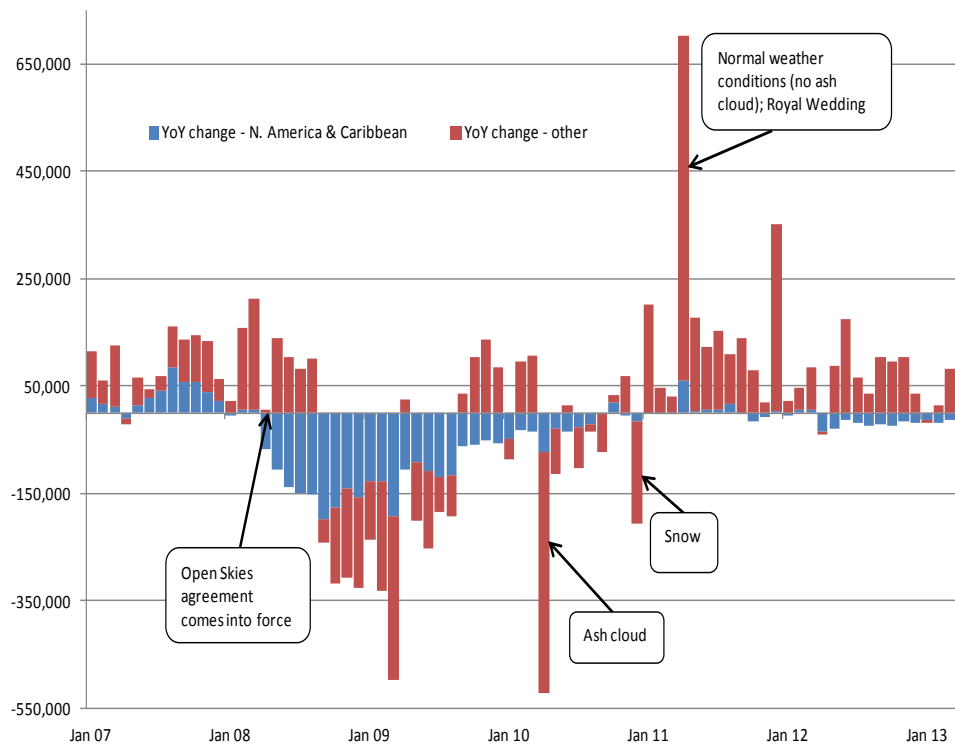
Given that the equity beta is intended to reflect the systematic risks faced by a company, it is important to consider whether any one-off non-systematic events may be impacting on the observed demand risk of a company. In the case of Gatwick, the significance of the Open Skies impact needs to be examined further and hence in Figure 1.3 we have separated out the impact of the change in passenger numbers from the North American & Caribbean market from changes in other passenger numbers. The figure also

⁸ Note that these were presented in the CAA Q5 proposals as annual totals and we have converted these into monthly figures assuming that travel is spread evenly across the 12 months. See CAA (2008) “Economic Regulation of Heathrow and Gatwick Airports 2008-2013 CAA decision”, p.48

⁹ Europa (2008) “The EU-US “Open Skies” Air Transport Agreement”

highlights a number of other non-systematic events that occurred during Q5, although it should be noted that these events will also have affected other airports in the UK, including Heathrow¹⁰.

Figure 1.3: Year-on-year changes in passenger numbers at Gatwick, 2007-2013

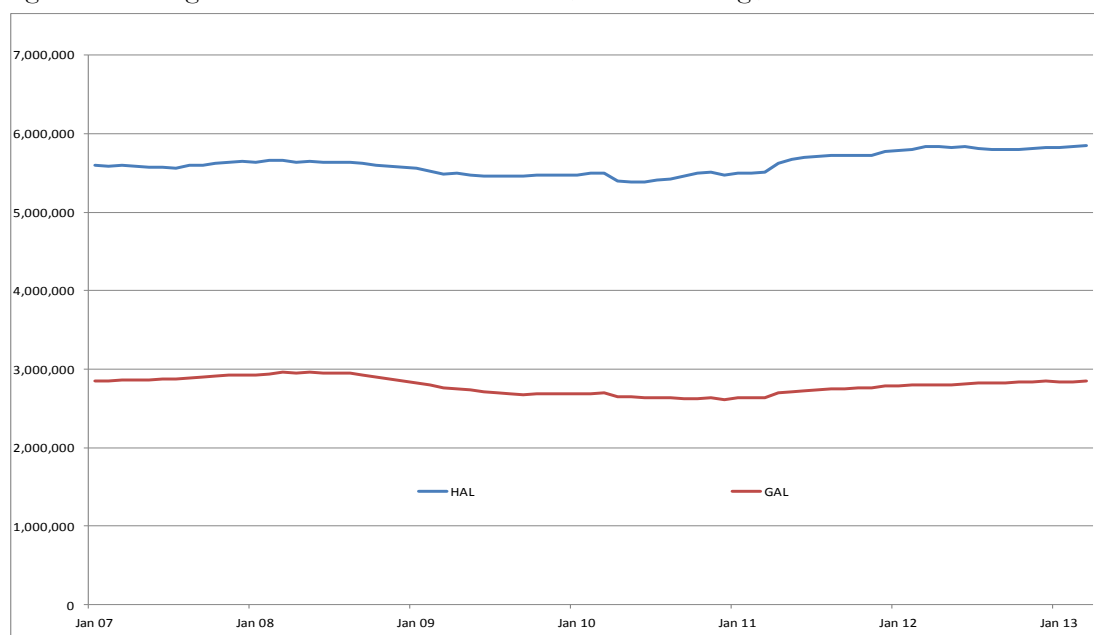


Source: CAA data, CEPA analysis

A further interesting analysis is to compare the 12 month rolling averages for Heathrow and Gatwick over the Q5 period. As shown in Figure 1.4, the movements in passenger numbers at the two airports are very similar over the period, with the dip in the 2008 to 2010 period at Gatwick (which also occurred at Heathrow) accentuated by the Open Skies agreement. Hence it is difficult to conclude with certainty that Gatwick is significantly more volatile or risky than Heathrow.

¹⁰ In the case of volcanic ash, the UK authorities have developed new procedures, so the impact of any future events would be far less severe. The same is true for snowfall, as a result of significant investment by the airport in snow clearing equipment during Q5.

Figure 1.4: Passenger numbers at Heathrow and Gatwick, 12 month average, 2007 to 2013



Source: CAA data, CEPA analysis

British Airways (BA) has carried out further analysis using TMS data¹¹ to assess the effects of Bermuda II and other effects. This analysis is included in Annex 1. BA's analysis notes that a particular strength for Gatwick airport's business is in shorthaul flights and that these flights have grown to account for 70% of Gatwick's passengers. Despite this, BA's analysis suggests that the growth in shorthaul flights has been more than offset in passenger number terms by the decline following the end of Bermuda II. This accounted for much of the decline in 2008/09 passenger numbers and was the dominant factor in smaller declines in 2009/10 and 2010/11. BA's analysis finds that the fall in traffic volumes resulted from a reduction in airline capacity rather than a fall in demand. By March 2013, all US airlines had withdrawn from Gatwick¹². The resilience of Caribbean routes though would lend credence to the argument that systematic volatility is exaggerated.

Other issues

In addition to the demand risk analysis above, there are a number of other factors suggesting that the volume risk for Gatwick is less than is suggested by an analysis of passenger numbers alone. Some of these factors were noted by the CAA in their analysis and include:

- airlines dampen the risk by cutting yields in the short run;
- the CAA re-sets the price cap every five years or so;
- management can take action to limit the volatility of returns (even if there are changes in passenger numbers); and¹³
- commercial and other revenues account for a significant proportion of overall revenue and these are less affected by a downturn¹⁴.

¹¹ TMS data uses the best available source of data (IATA, AEA or CAA) and also excludes staff passengers. It is the data used by BA for its own commercial planning.

¹² The source for this is British Airways and Gatwick Airport Bond Investor presentation February 2011.

¹³ CAA (2013) "Economic regulation at Gatwick from April 2014: initial proposals", at p.166

Impact on gearing

In its initial proposals, the CAA suggested that the appropriate notional gearing level for GAL was 55%. This compares to a notional level of gearing of 60% applied in Q5 for GAL and HAL and being suggested again for HAL in Q6. A number of reasons were presented for the lower level of gearing. One of these was that the monthly and annual variation in demand was lower at Heathrow than at Gatwick.¹⁵ The analysis above suggests that careful analysis is required in order to make assumptions about the volatility of demand at Gatwick and Heathrow. In particular, systematic risk should not be assessed using data that has not been adjusted for non-systematic events. In addition, Gatwick has itself made the case to its investors for gearing to rise to 65% and the financing agreements set a limit of 70%¹⁶.

The relative size of Gatwick

Gatwick's smaller size relative to Heathrow was seen as requiring a lower level of notional gearing and an additional uplift for debt issuance costs. However, while it is undoubtedly true that Gatwick is a smaller airport than Heathrow, it is not an insignificant enterprise. At the end of 2012, the closing RAB for Gatwick was £2,200.9 million and the CAA's initial proposals for Q6 suggest a capex program of £793.9 million. Hence while we understand the importance of ensuring that a regulated entity is able to finance its activities, Gatwick's size does not suggest that a special allowance or premium in the cost of capital is required to ensure financeability and indeed to add a premium based on Gatwick's size would go against the approach taken by the CC in the Bristol Water case (see below). Premiums for small companies have been applied by UK regulators, such as for water-only companies in the water sector. However, the size of these companies was significantly less than Gatwick, with regulated capital values in the millions rather than billions (details are provided below).

Impact on gearing

The PwC report suggests that Gatwick is a smaller standalone business by comparison to Heathrow and that this may impact on the airport's resilience and ability to achieve a particular credit rating. This is seen as a valid reason for a difference between Heathrow and Gatwick's relative gearing and for setting a lower level of gearing at Gatwick.¹⁷ However, the CAA's report also notes the need to balance the financeability of a regulatory settlement and not setting the gearing figure so low that the price cap is higher than necessary and shareholders benefit at the expense of users.¹⁸ The discussion above suggests that Gatwick's size is significant enough not to require a specific 'small company' adjustment to the level of gearing. This conclusion is backed by the fact that Gatwick has already "*carried out most of its financing needs for Q6*".¹⁹

Impact on the cost of debt

PwC uplifted its cost of debt estimates to provide for debt issuance fees – by 0.15% for HAL and 0.20% for GAL. The additional uplift for GAL was based on the airport not being able to issue debt with the

¹⁴ The source for this is the Gatwick Airport Bond Investor presentation February 2011 and Javelin report (June 2013) for the Gatwick ACC airlines.

¹⁵ PwC (2013) "Estimating the cost of capital in Q6 for Heathrow, Gatwick and Stansted: A report prepared for the Civil Aviation Authority (CAA)" at p.25

¹⁶ The source for this is the Gatwick Airport Bond Investor presentation February 2011.

¹⁷ PwC (2013) "Estimating the cost of capital in Q6 for Heathrow, Gatwick and Stansted: A report prepared for the Civil Aviation Authority (CAA)" at p.25

¹⁸ CAA (2013) "Economic regulation at Gatwick from April 2014: initial proposals", at p.172

¹⁹ PwC (2013) "Estimating the cost of capital in Q6 for Heathrow, Gatwick and Stansted: A report prepared for the Civil Aviation Authority (CAA)" at p.38

same large scale issuance blocks that can be issued by HAL.²⁰ As noted above, Gatwick is a large company and it is not clear that such premiums are needed to ensure its financeability.

In particular, it is noted that Heathrow has issued corporate bonds of up to £900 million in size (August 2008) while Gatwick's corporate bonds have been £300 million. However, Gatwick's Q6 financing involved the issuance of four long-term bonds each with a face value of £300 million. Further, a note by RBS reported that the £600 million issued in February 2011 was heavily oversubscribed with more than £2 billion of orders.²¹ This suggests that these issues could have been larger.

As noted above, allowances on the cost of capital for small companies have been used by Ofwat in the case of water only companies (see for example the equity and debt premiums in PR04).²² Premiums were applied to these companies based upon four different bands based on the opening Regulatory Capital Value²³ (RCV) in the regulatory period. In the band for the largest water only companies for PR04, the RCV limits were £280 million to £700 million.²⁴ No premiums were applied for the water and sewerage companies, who possessed larger RCVs.

The CC case of Bristol Water in 2010 examined the small company premium issue in more detail. Ofwat had allowed a debt premium up to 0.4%, given that the smaller companies had only been able to issue through pooled vehicles and could not access low cost EIB debt or innovative financial instruments e.g. Artesian finance.²⁵ This implied that larger companies could access such finance. The CC accepted that the variability in capex and opex relative to the size of the RCV would be cause for a small premium, but did not agree with an additional allowance based purely on size. The opening RCV for Bristol Water was £261m, with capex of around £48m per annum. The CC stated that:

"We do not consider that there is robust UK empirical evidence of small firms being more risky and hence having a higher cost of capital... Moreover, even if there were such evidence, we consider that it would not necessarily be right to infer from this that WoCs were higher risk than WaSCs since WoCs would not necessarily share any (unknown) general characteristics of small firms that increase their cost of capital due to higher risk."²⁶

In terms of Gatwick, the RAB is around ten times higher than was the case with Bristol Water, with better coverage ratios on capex (15x) and opex (8x), and better than in Q5. It would therefore not seem appropriate that an additional premium in the issuance costs should be adopted for Gatwick. In fact, Oxera's paper on behalf of Gatwick sees an allowance for issuance costs of 15 basis points as being reasonable.²⁷

The CAA has also explicitly ruled out a small company premium within the cost of equity in 2004 with the NATS price control review. The reason for this was that NERL was significantly larger in terms of RCV than other UK regulated companies which had been given a small company premium. The opening RAB in April 2006 was £0.8bn.

In addition, it is useful to note the CC's analysis from its 2008 review of the price control for Stansted suggesting that even the 15 basis points allowance for issuance costs was too high. This was based on further evidence gathered after the decision for Gatwick and Heathrow in Q5 and included:

²⁰ See PwC (2013) "Estimating the cost of capital in Q6 for Heathrow, Gatwick and Stansted: A report prepared for the Civil Aviation Authority (CAA)" at pp.37-38

²¹ RBS (2011) "Case Study Gatwick off to a flying start", p.1

²² Ofwat (2004) "Future water and sewerage charges 2005-10: Final Determinations", at p.41

²³ Equivalent to the RAB

²⁴ Ofwat (2004) "Future water and sewerage charges 2005-10: Final Determinations", at p.226

²⁵ Ofwat (2010) "Future water and sewerage charges 2010-15: Final Determinations", at p.132

²⁶ CC Bristol Water (2009) N37

²⁷ Oxera (2013) "What is the cost of capital for Gatwick Airport beyond Q5? Methodology and estimation", at p.34

- A study on the cost of capital in the water industry which found that water companies pay fees of around seven to ten basis points.
- Information from BAA that the fees associated with their bonds averaged approximately five basis points.
- Analysis from an investment bank suggesting that a regulated company would incur fees of no more than ten basis points a year when maintaining a constant debt-to-RAB ratio.²⁸

Consideration of the sale of Gatwick

A further point to note is that the analysis of the appropriate cost of capital should be based on a notional company rather than the financing situation of the actual company being regulated. In its report, PwC noted that Gatwick had carried out most of its financing needs for Q6. PwC calculated that the weighted average yield to maturity on Gatwick's embedded debt was 3.2%.

However, the cost of debt estimate used in PwC's analysis is a combination of the embedded and current cost of debt – reflecting the fact that a notional company would have some debt that was incurred before the regulatory period and would carry out further financing in the period. This means PwC's notional cost of debt is likely to be lower than Gatwick's actual cost of debt as the airport will not be able to take advantage of the lower current cost of debt. While this would not normally be an issue, PwC moots that the timing of this financing may have been driven by the timing of the Gatwick airport disposal by BAA (which was arguably driven by a review of BAA by the CC).²⁹

We agree with the CAA's proposal that it would not be appropriate to include GAL's actual cost of debt in the WACC rather than the cost of debt of a notional company. The CAA rightly notes that if the actual cost of debt was included this would largely remove the incentive for the airport operator to finance efficiently and could generate costs for users. As noted by the CAA, the change of ownership occurred during the CC's market investigation and was in advance of any requirement from the CC. In fact the timing may have been driven by wider Ferrovial financing issues. We also agree with the CAA's conclusion that Gatwick's management had control of the current financing arrangements.³⁰

Conclusion

Allowances for the perceived higher demand risks faced by Gatwick and its 'small' size have led the CAA to propose a WACC of 5.65% for Gatwick. However, as shown in our analysis, it is not clear that Gatwick is significantly more risky than Heathrow and therefore requires a higher cost of capital. It is also the case that Gatwick is not a 'small' company in terms of its RAB and furthermore the CC's unfavourable analysis of the case for additional allowances based on size suggests that the CAA risks being over-generous to Gatwick. Thus the combination of a high cost of equity, a low level of notional gearing and additions to the overall cost of debt to cover Gatwick's assumed higher issuance costs lead to an overall cost of capital in the initial proposals that is overly generous and that, over the long term, will lead to unnecessarily high costs for consumers. On the basis of this note and CEPA's additional analysis³¹ following the CAA's initial proposals, we are therefore suggesting a revised range for Gatwick of 4.76% to 4.88% for the pre-tax WACC, with a midpoint of 4.82%.

²⁸ Competition Commission (2008) "Stansted Airport Ltd price control review, Appendix L: Cost of Capital", at pp.L10-L11

²⁹ PwC (2013) "Estimating the cost of capital in Q6 for Heathrow, Gatwick and Stansted: A report prepared for the Civil Aviation Authority (CAA)" at pp.38-39

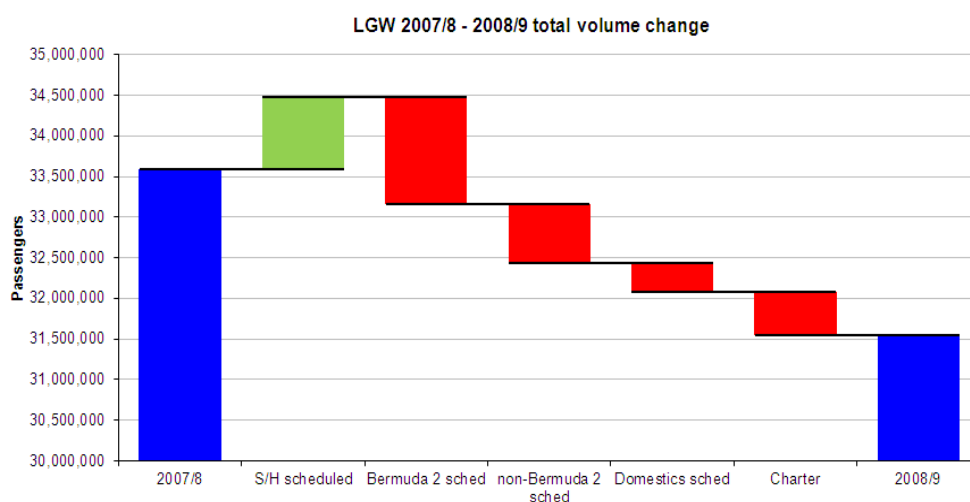
³⁰ CAA (2013) "Economic regulation at Gatwick from April 2014: initial proposals", at p.170

³¹ See CEPA's papers on the equity beta, appropriate point estimate and cost of debt indexation for further detail.

Annex 1: British Airways analysis

The analysis in this annex has been carried out by British Airways (BA). BA have used airline TMS data³² to assess the effects of the end of the Bermuda II agreement and other one off effects. In Figure A1.1, the reasons for the traffic decline in the worst year, 2008/9, are separated out. The growth in shorthaul of 0.9 million passengers has been more than offset by the Bermuda II (scheduled) decline of 1.3 million passengers.

Figure A1.1: Gatwick total volume change, 2007/8 to 2008/9



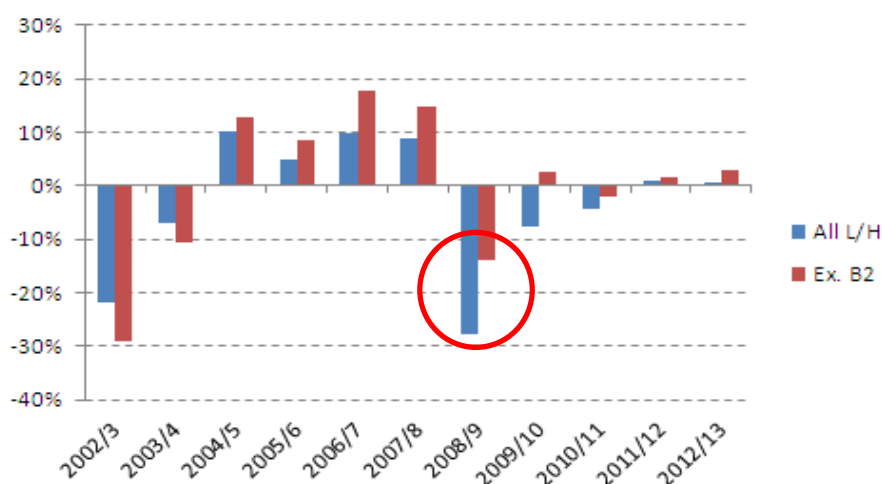
Source: British Airways

Figure A1.2 examines the traffic reduction on routes affected by Bermuda II separately from other longhaul routes. This shows that the abolition of Bermuda II explains the longhaul difference between Heathrow and Gatwick in 2008/09, with Bermuda II accounting for half of the decline in longhaul volume at Gatwick that year. This liberalisation was also the dominant reason for the much smaller longhaul traffic reductions in 2009/10 and 2010/11. By March 2013 all US airlines had withdrawn from LGW³³.

³² TMS data uses the best available source of data (IATA, AEA or CAA) and also excludes staff passengers. It is the data used by BA for its own commercial planning. Note that the CEPA analysis used the CAA's data and hence there may be some differences between the two.

³³ The source for this is British Airways and Gatwick Airport Bond Investor presentation February 2011.

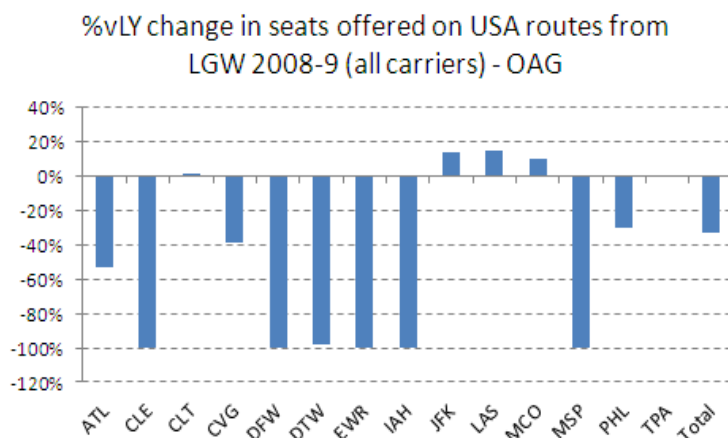
Figure A1.2: Impact of the end of Bermuda II on Gatwick volumes



Source: British Airways

Figure A1.3 demonstrates that the fall in traffic volumes on these routes resulted from a reduction in airline capacity, consistent with the movement of routes to Heathrow, rather than a fall in demand per se. This would support the hypothesis that the volume decline of Gatwick’s Bermuda II routes would not be due to falling market demand or volatility, but due to reduced seat availability.

Figure A1.3: Decline in LGW B2 volume 2008/09

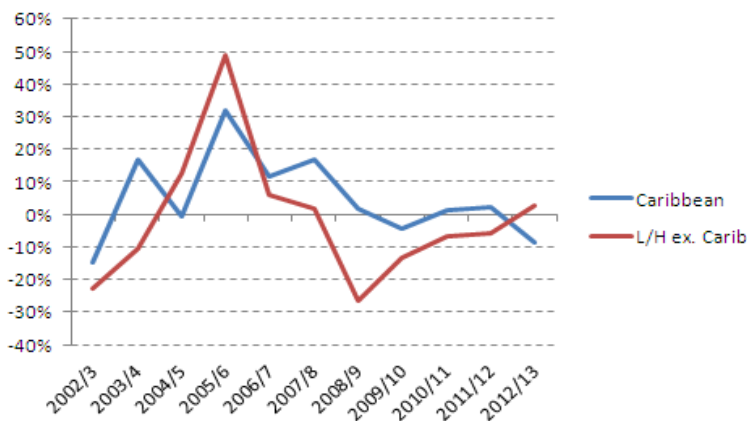


Source: British Airways

In contrast to the Bermuda II routes, Caribbean routes fared better, despite the recession and a structural change in Air Passenger Duty (APD) that disadvantaged the region. In fact it is surprising to see such resilience for longhaul leisure destinations, confounding the expectation that leisure routes are more vulnerable in a downturn, with Caribbean volumes up 2% vLY³⁴ compared to other longhaul at -27% vLY due to weathering the combined effects of APD and financial crisis better than other longhaul markets. This lends weight to the argument that systematic volatility is exaggerated.

³⁴ That is, the change in passenger numbers compared to the previous year.

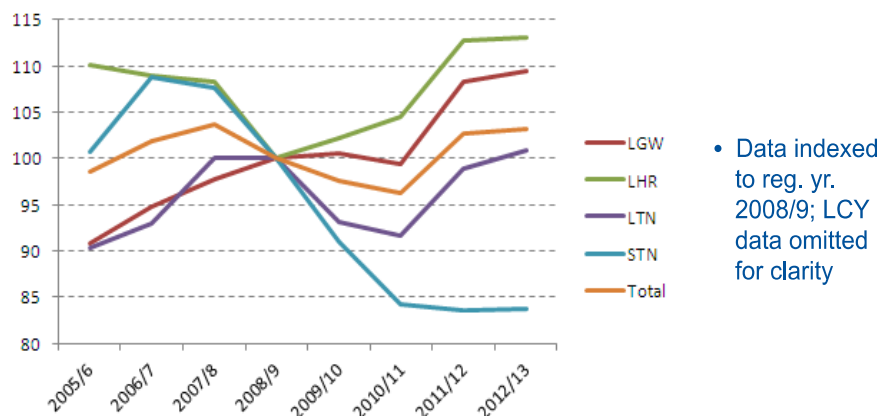
Figure A1.4: Caribbean market less affected by 2008/09 events than other longhaul



Source: British Airways

Gatwick’s particular strength is in shorthaul, where demand has been stronger and less volatile than at all the other London airports apart from LCY (which is considerably smaller). Since 2005/06, Gatwick has gained 18 points compared to a London average of 5 points. Figure A1.5 shows Gatwick’s performance on shorthaul routes compared to other London airports. Note that London City has been omitted for clarity.

Figure A1.5: Shorthaul passenger index at Gatwick compared to London average

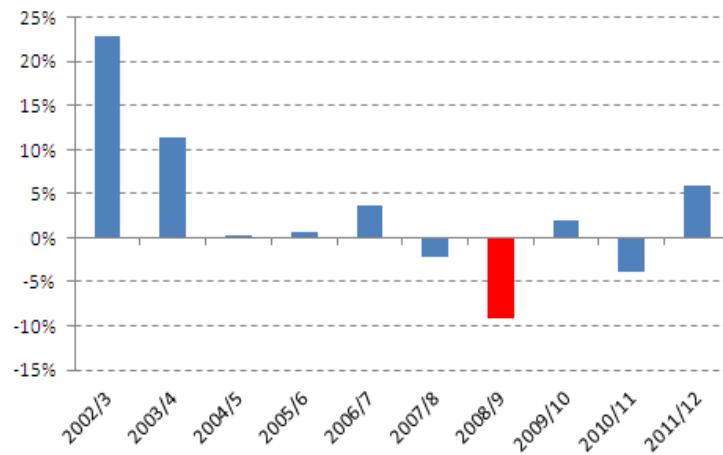


Source: British Airways

Gatwick has lost domestic flights, especially in 2008/9 when large airport price rises³⁵ were imposed in a recession, but because of the small proportion of domestic services, even a relatively large reduction has little impact overall. This can be seen in the next two figures, with Figure A1.6 showing that the greatest decline in domestic passengers on an annual basis at Gatwick was in 2008/09.

³⁵ Under the CAA Q5 decision, charges in 2008/09 increased by RPI+21% (source: CAA Q5 final determination).

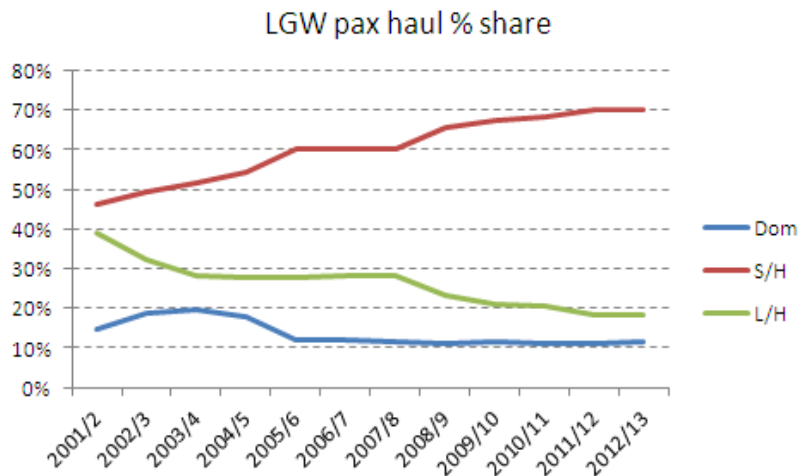
Figure A1.6: Change in passenger numbers at Gatwick



Source: British Airways

As can be seen in Figure A1.7, shorthaul has grown to account for 70% of Gatwick’s passenger numbers, more than offsetting the declining longhaul volume.

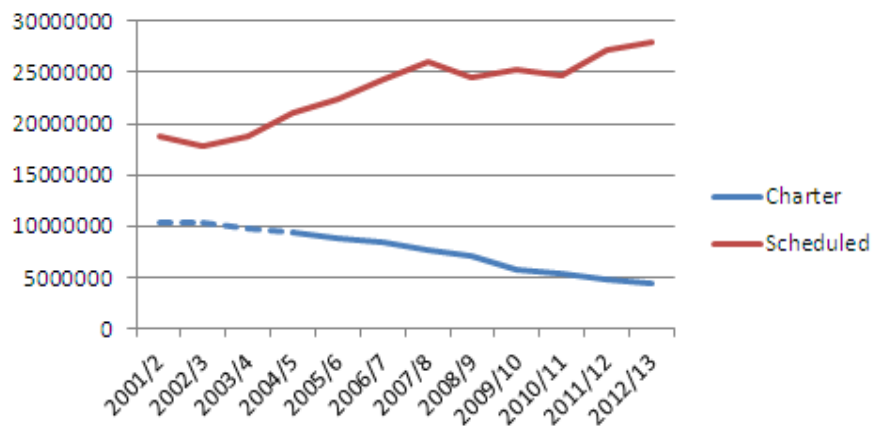
Figure A1.7: Passenger share at Gatwick



Source: British Airways

Another clear trend at Gatwick has been the long term decline in charter passengers. As the following figure shows, this is part of a structural shift from chartered to scheduled and therefore has not damaged the airport.

Figure A1.8: Charter and scheduled volumes



Source: British Airways

Finally, it should be noted that Easyjet made Gatwick their main operational base during Q5 and Norwegian has just started an operating base at the airport after several years of rapid growth.