

Evidence Paper in advance of the Public Accounts Committee Scrutiny Session – 23.9.19

Cardiff Airport's Performance and Development

SECTION 1: Governance and Performance

In 2013, the Welsh Government purchased Cardiff Airport for £52m as a strategic addition to Wales' transport infrastructure. The airport is Wales' gateway to the world and is a vital piece of our transport infrastructure. Continuing to develop such an important asset is a key priority. The strength of our domestic and overseas relationships and improving transport connectivity will help determine our ability to forge new markets and maintain and grow our position as an attractive and competitive place to visit and study, invest and do business, especially as we exit the EU.

The Welsh Government, on behalf of the Welsh Ministers, operates Cardiff International Airport Limited (CIAL) as an arms length public corporation, with distinct separation achieved through WGC Holdco Limited. WGC Holdco Limited was incorporated as a private company limited by shares on 21 March 2013.

WGC Holdco Limited acquired CIAL on 27 March 2013. The objective of the acquisition was to secure Cardiff Airport's future, enable the commercial management team to reinvigorate activity levels, and ensure its continued contribution as an asset to the economy and people of Wales. WGC Holdco Limited owns 100 per cent of the ordinary share capital. As such, whilst CIAL is a wholly owned subsidiary of the Welsh Government, it operates in an independent and commercial manner, makes investment decisions on a commercial basis, and is liable for its own actions and any issues arising from the running of its business.

Welsh Government financial investment to date

Immediately after completion of the purchase, the Welsh Government provided a £3.3m cash injection to CIAL to provide working capital for the company, which was subsequently converted into share capital.

In 2016, the Welsh Government provided grant funding of £169k to support the airport's safety and security. In 2018, the Welsh Government invested a further £6m into the airport by way of releasing share equity. We also agreed to fully fund replacement e-Passport Gates at a cost of £610k. However, at the time of submitting this paper, the total funding for the gates has not yet been fully claimed. The airport remains responsible for financing the associated maintenance and support agreements for the e-Passport Gates.

Since its purchase, the Welsh Government has agreed to a total commercial loan facility of £38.2m which will be repaid with interest over the next 20-25 years.

Prior to any investment (i.e. the initial purchase or commercial loan facilities), detailed State Aid and Financial Due Diligence analysis was undertaken to ensure commercial viability and sound evidence-based investment decisions were made. This analysis has been undertaken by external specialists and the existing loan facility is administered by the Development Bank for Wales (DBfW).

Governance arrangements

We have a strong executive team in place (particularly for a small, regional airport) which has made some significant achievements. Stringent governance arrangements are also in place for managing the airport and monitoring its performance. The Board of CIAL reports to Holdco on a quarterly basis, which monitors the airport on behalf of Welsh Ministers. The CIAL Board is made up of 3 Executive Directors and 4 Non-Executive Directors, plus the Chair of the Board. The Holdco Board is currently made up of 3 Directors, two senior civil servants and an independent non-executive director.

A range of KPIs are reported on, along with critical success factors and the business plan is approved and adjusted annually. On time performance and customer satisfaction are also monitored, and we are pleased that the airport has introduced a Customer Experience Team which looks at customer insight, complaints and trends – all of which are reported back to the relevant airport operations teams for regular adjustment. The KPI's that CIAL reports to HoldCo on include financial position, passenger numbers and destinations.

Achievements since acquisition

Over 1.588 million passengers used Cardiff Airport in 2018/19. Passenger numbers have grown by around 60% since the Welsh Government purchased the airport in 2013 when annual passenger numbers were in the region of 1 million. Passenger numbers have increased by 7% compared to 2017/2018, which was the busiest year since 2009. This is on top of an increase in passenger numbers of 10% in the financial year 2017/18 and 11% in 2016/17.

According to the Public Policy Institute for Wales (PPIW) Report (titled *Maximising the Economic Benefits of the Welsh Government's Investment in Cardiff and St. Athan Airports*) published in January 2016, the economic impact of Cardiff Airport generates in the region of £102m GVA per annum and is a key contributor to the local economy, supporting 1,900 jobs (directly employing the equivalent of 347.4 full time jobs). Over 30% of passengers are visitors to the country.

In 2018, the airport posted its first positive earnings before interest, taxes, depreciation, and amortization (EBITDA) in eight years, a significant milestone for its long term sustainability (particularly as EBITDA is used as an indicator of the overall profitability of a business).

Headline Achievements

- 5* airline, Qatar Airways launched new flights to Doha on 1 May 2018. The service flies customers on board a Boeing 787 Dreamliner to Hamad International Airport where they can connect to 160 destinations worldwide.
- A number of improvements and new facilities were unveiled including additional seating in departures, two new Costa outlets, a larger WH Smith store with Well Pharmacy products, the car parks have been extended and reconfigured, a new car hire centre, a Meet & Greet parking service and a revamped 51° Executive Lounge and Business Lounge.
- New-generation e-Passport Gates have been introduced at border control.
- A new baggage belt system has been introduced, which has improved the security search process and two air bridges have been upgraded to enhance the customer's journey through the airport.
- From 1 April 2019, the airport took over running the Bro Tathan airfield (formerly St Athan airfield), in effect being one airport with two runways – this offers significant benefits in terms of efficiency and operational delivery.
- The airport brought forward its commitment to paying the 'Real living wage' from April 1st 2019; a year earlier than planned.
- In 2019, the first gender pay gap reported that Cardiff Airport's 'Mean Gender Pay Gap' of 2% is significantly less than the Aviation Sector average which stands at 34% and differs greatly to the UK average of 17%; Wales' average of 12% and the Industry (Transportation and Storage) average 3%.
- In 2019, the operation of the airport achieved a 15% decrease in carbon emissions and a 7% reduction in electricity consumption.
- KLM celebrated 30 years of flying customers between Wales and its hub at Amsterdam Schiphol airport
- Vueling celebrated its 800,000 passenger milestone.
- The airport unveiled its draft Masterplan for the next 20 years, which sets out ambitious plans for expansion between now and 2040.

Airline operators

Earlier this year, Flybe announced its jet base operations, with associated staff and aircraft, would be withdrawn from Cardiff Airport from October as part of a companywide restructure. This followed the sale of the company to Connect (a Stobart and Virgin consortium) after experiencing financial difficulties. Approximately 100 personnel who are employed locally will be affected. Whilst this is disappointing news, at the end of May, Flybe announced its winter schedule for 2019-20 with increased flights on existing routes including Dublin, Edinburgh and Paris.

This is a positive reflection of Flybe's commitment to Wales. It offers choice and provides good connectivity within the UK and with Ireland and France as well as creating new opportunities for customers to access hub airports in Ireland and France for onward travel.

2019 saw new routes to Dubrovnik (Croatia), Naples (Italy) and Enfidha (Tunisia) launched by TUI which adds 100,000 seats from Cardiff.

Ryanair introduced new routes to Barcelona, Malta and Malaga complementing its existing flights to Faro.

Thomas Cook introduced a larger A321 aircraft to its summer operation, adding 29,000 extra seats across 11 routes. Plus, some routes started operating in April as opposed to May due to popular demand including Enfidha, Dalaman, Larnaca, Palma and Tenerife.

Rebuilding confidence

The introduction of Flybe's base at Cardiff Airport in 2015 was aimed at rebuilding confidence at the airport and achieving steady growth and increased passenger numbers. Flybe provided the solid foundations that the airport needed at the time with core routes being introduced out of Wales / the UK. Flybe has been the vital catalyst for other airlines establishing new services from Cardiff. Whilst the jet operations are due to be withdrawn later this year, the airline's presence at the airport remains a success.

The airport has achieved very good passenger growth to date, and remains on target for achieving 5% growth this year (2019). Vitally, the airport is not dependent on one operator.

The new long haul route to Doha, which was launched in May 2018, is also testament to the confidence airlines and passengers alike are demonstrating in Cardiff Airport.

Disparity between passenger growth and profit

There is a level of disparity between the reported overall profits of the business and positive passenger growth. Small, regional UK airports such as Cardiff are subject to the same rigorous safety and security standards than their larger, more profitable counterparts. This results in a much greater percentage of the airports running costs being attributable to mandatory regulatory burdens than for larger airports which are able to offset these costs against larger passenger numbers and larger profits. Aviation policy is reserved, and the UK Government's stance makes the operating environment for Cardiff Airport arguably more challenging than it might be in other countries. UK aviation policy is primarily focussed on larger, generally privately owned, airports which serve significant conurbations (such as Heathrow and Gatwick); it does not specifically encourage or support regional publically owned airports. As a result of the UK Government's interpretation of European aviation regulations, the UK's aviation regulatory body, the Civil Aviation Authority (CAA) imposes some of the most stringent aviation standards across the world. Whilst we have arguably some of the safest skies in the world, this achievement comes at a financial cost which is felt most notably by smaller, regional airports. The UK's approach to State Aid restricts the opportunity to support CIAL to meet these costs. In other EU member states policies permit support for safety and security measures. The UK approach does not.

Over the last 12 months, the airport has invested heavily in improving the passenger experience. Departure lounge upgrades, increased retail and food / beverage outlets, new car hire area, and a 'meet and greet' area are key areas of improvement. In

addition, it has significantly improved its safety and security measures imposed by statutory regulations; however more upgrades will be required in the coming years due to further forthcoming changes in screening equipment.

It has also chosen to invest and improve in other areas such as supporting people with reduced mobility (PRM) around the airport, the provision of adult changing facilities and the introduction of multi-faith prayer rooms. These improvements, while not statutorily required by the airport, support Welsh Government policy areas such as the Wellbeing and Future Generations Act (Wales), the Equality Act and the Welsh Language Act. The airport's commitment to improving the customer experience is demonstrated by the continued increase in passengers using the airport.

We recognise that different route destinations attract different types of customer – different types of passengers have different spend patterns – for example, how much they are likely to spend within the departure lounge area. Therefore, any change to the routes being offered at Cardiff Airport directly impacts sales at the airport, and therefore the profitability of the overall business.

The airport Board, with Holdco's support, is purposely reinvesting a greater proportion of funds available to it due to the significant level of underinvestment by its previous owner. Whilst very good progress has been made to date, there is still a long way to go on the airport's journey to improved success.

Financial performance

As a wholly owned subsidiary of the Welsh Government, unlike many other regional airports (such as Bristol), because of the way that the Welsh Government's block grant and borrowing powers work CIAL is restricted from seeking its own private investment/funding and remains entirely reliant on the Welsh Government for loan/equity funding. The financial performance of the airport is a commercial matter for them, however as sole shareholder, the Welsh Government is pleased to see the first positive EBITDA report in 8 years.

It is clear that further investment will be required to fulfil both our and the airport's long term ambitions of growth and expansion, but we recognise that there is a limit to how this can be achieved solely via the public purse. We remain open to exploring long term future investment and ownership models.

Administration costs have continued to increase for a number of reasons – many of which are directly due to the airport's expansion and improvement plans, but also these are attributable to the regulatory burden that smaller regional airports struggle to absorb. Cardiff Airport has also 'insourced' many staff which were historically contracted out. From around 40 employees, the airport is now responsible for over 300 employees. Fairer working conditions have been introduced and zero hours contracts reduced – all of these have a direct impact on overhead costs. While increased passenger numbers are very much welcomed, these too come with additional costs – with more staff being required to serve the additional customers. We remain optimistic that as the airport exceeds 2m passengers per annum (currently 1.588m passengers per annum), the financial performance of the airport will in turn improve.

SECTION 2: Development

Masterplan

We welcome the introduction of the airport's draft Masterplan which sets out its high level ambitions to 2040. The airport is working with the Vale of Glamorgan Council to have the Masterplan adopted as Supplementary Planning Guidance (SPG), and with its other stakeholders to develop the nearby area and maximise future business opportunities for airport related activity. We look forward to supporting the airport to achieve its ambitions.

Route Development and Air Passenger Duty

The development of further aviation links to the rest of the UK, Europe and beyond is vital to the long term prosperity of Wales. To this end, the airport has successfully introduced new air links, such as the new long haul route to Doha launched in May last year, which provides important prospects for the Welsh economy. In addition to the Qatar route, Cardiff Airport has seen significant growth as a result of other partner airlines such as Flybe, KLM, Ryanair, TUI and Thomas Cook.

Identifying further new routes for Wales remains a priority. However, the UK Government's opinion that Cardiff Airport's catchment is joint with that of Bristol Airport is an increasing frustration for both the Welsh Government and Cardiff Airport. In 2017, we published compelling, peer-reviewed evidence which clearly demonstrates Cardiff and Bristol Airports have only a fraction of potential overlapping catchments for domestic and short haul services, which would have no detrimental effect on Bristol Airport. The UK Government refuses to accept our evidence but to date has not provided any supporting evidence to backup its position.

At the beginning of 2018, we developed a number of robust business cases to support a suite of new domestic Public Service Obligation (PSO) air services from Cardiff. We remain committed to arguing our case and continue to pursue this with the UK Government – particularly as talks on Britain's exit from the European Union progress. Wales's largest trading partner is the rest of the UK, with around 80% of our trade going to domestic markets.

The Welsh Government recently attended World Routes in China, along with Cardiff Airport. (World Routes is a global event for airlines, airports and aviation stakeholders to discuss, develop and plan network strategy. It attracts the most senior decision makers from the world's leading aviation organisations.)

Visit Wales also engages with a number of these airlines such as Qatar Airways and KLM to promote Wales in a number of markets.

Welsh Ministers have long been engaged with the UK Government to pursue the devolution of Air Passenger Duty (APD) to Wales. Consumers and businesses need

choices for how they can connect with the rest of the UK, Europe and the world. APD effectively stifles this choice. We hope the devolution of APD will enable the introduction of further new routes, including more long haul destinations.

The Welsh Affairs Committee (WAC) recently concluded its inquiry into the devolution of APD to Wales. We warmly welcome the Committee's unanimous recommendation that APD should be fully devolved to Wales without further delay. Despite the cross-sector business sector support, cross-party political consensus and independent evidence that demonstrates the benefits of APD devolution, the UK Government's response to the Committee has confirmed it has no intention of devolving APD.

Independent expert analysis demonstrates clear economic benefits for Wales if APD is devolved and a subsequent decision is taken by Welsh Ministers to reduce rates of APD in Wales. As the UK leaves the EU, the devolution of APD is a means by which we can promote the economic attractiveness of Wales and growth in Wales, in unison with the Welsh Government's existing economic policies.

Devolving APD to Wales would mean the Welsh Government would have the ability to set tax rates which would apply across all of Wales. APD is a significant financial constraint to the development of new routes and air connectivity across Wales.

Devolving APD would be consistent with the UK Government's approach to devolving taxes which overlap with other devolved responsibilities. The Welsh Government considers APD to be a useful potential lever in delivering other devolved responsibilities relating to regional economic development and tourism.

In the event APD is devolved to Wales, the Welsh Government's decisions on future APD rates would take account of potential environmental impacts, including carbon emissions, in order to meet statutory requirements of the Well-being of Future Generations Act (Wales) (2015) and Environment (Wales) 2016 Act. This assessment would be done in the context of which powers were being devolved and the circumstances at the time of any decision by the UK Government on devolution. Any changes proposed would also be subject to full consultation with businesses and the people of Wales.

We will continue to encourage the airport to expand its route offer, despite these constraints, and would welcome further development of its long haul route offer.

Expanding the business

The airport is diversifying its business portfolio in order for it to continue to grow. Activities are already underway such as directly supplying fuel to its partner airlines, increasing its cargo and freight operations and taking over the operation of the nearby Bro Tathan airfield by providing remote radar services and joint Rescue and Fire Fighting Services (RFFS). Air traffic control will also be provided by CIAL from 1st April 2020.

Surface Access

We are working closely with the airport and other partner organisations to improve surface access links to the airport and wider enterprise zone, and we continue to support the T9 bus link from Cardiff city centre. Road access will soon be greatly improved as 5 mile lane improvements reach completion later this year, and the Vale of Glamorgan Council is currently funding a WelTAG Stage 2 study to look into the provision of a new road link from junction 34 of the M4 to the top of 5 Mile Lane (A4226) which is considered to be a regionally significant infrastructure project and would reduce congestion into Cardiff and the Vale of Glamorgan. It would deliver significantly improved travel times for people traveling to Cardiff and the Vale from Rhondda, Cynon, Taff, Bridgend and the West and could include sustainable travel options such as park and ride or rail link to key destinations. The airport is one of many businesses which would feel a positive impact from the delivery of this project.

The removal of the Severn Bridge tolls has increased the propensity to travel from England, which is anticipated to have a limited but positive impact on passenger numbers. This surface access improvement should further support passengers to fly from their local airport, thereby reducing congestion and pollution from road traffic – this is particularly pertinent for the long-haul traffic catchment which includes both South Wales and the west.

Brexit

The airport is noticing some limited impact as a result of the UK's planned departure from the EU. Longer term bookings have slowed down and airlines are reluctant to commit longer term. The falling value of the pound is continuing to impact exchange rates and the cost of fuel – both of which have a significant impact on the airport and its potential profitability.

While this is largely outside of the control of the Welsh Government and the airport, Brexit has stimulated the airport to look at how it can secure the best possible future for the business – diversification being the airport's main response while continuing to put customers at the heart of everything it does.