

Haugesund Airport, Norway

Commercial, Operational and Financial Review:

Concession Ownership / Management of Haugesund Airport



9th June, 2015

STRICTLY PRIVATE & CONFIDENTIAL

Definitions

Grantor – the person or entity who actually grants the lease and becomes, in effect the Landlord for the agreement

Concessionaire – the person or entity who takes control / ownership of the airport

Concession Agreement – the legal document between the concessionaire and the grantor governing the conditions of the concession

Parties – refers to whomever the signatories to the Concession Agreement will be

HAU – refers in all cases in this document to Haugesund Airport

Air Navigation Service Providers – refers collectively to any company or entity that provides air traffic control or flight control services

ATC – refers to Air Traffic Control services

Executive Summary

This report is a review of the proposition that a third party concessionaire would enter into a long term lease or concession type agreement for the management of Haugesund Airport, Norway. There are 3 main sections to the report:

Section 1 – The Concession

This section provides an analysis of an airport concession in general terms and some of the basic risk factors associated with that type of arrangement. Some of the key aspects of an airport operation are also discussed in the context of a possible concession type arrangement.

Conclusions: concessions come with some advantages, however, we do not automatically believe that they are the right option in general for regional airports in Europe, like Haugesund. Further consideration should be given to taking full and outright ownership of the airport or to possibly having a more flexible term for the concession that can be extended to allow for long term investment and development in the airport by the proposed concessionaire.

Section 2 – Sweden

The examples and experiences that have taken place in the Swedish market are highly relevant to the planned deregulation of the Norwegian airport market. We assume that the Norwegian authorities have studied this market and the various models carefully. Even if in Norway, the deregulation of Avinor will happen only in a very limited way to begin with, it is still crucial that the right decisions are taken in this early period. Some good examples of how and what to do can be gleaned from the Swedish market.

Conclusions: any proposed concessionaire for Haugesund Airport should learn from and consider applying aspects of the Swedish deregulation model (State funding or financial contributions towards maintenance or investments for example).

Section 3 – Industry Trends

This section of the reports looks at the various emerging trends in the aviation industry that

could impact on route development at Haugesund Airport. In particular looking at Middle East carrier development, existing carriers at Haugesund Airport and low cost development at competing airports.

Conclusions: there are some very interesting and radical developments happening in the European and global markets, but our assessment is that Haugesund Airport remains in a strong position and can actually stand to benefit from some of these developments. Continued engagement with the route development process and marketing the destinations available at Haugesund Airport will be crucial for any proposed concessionaire.

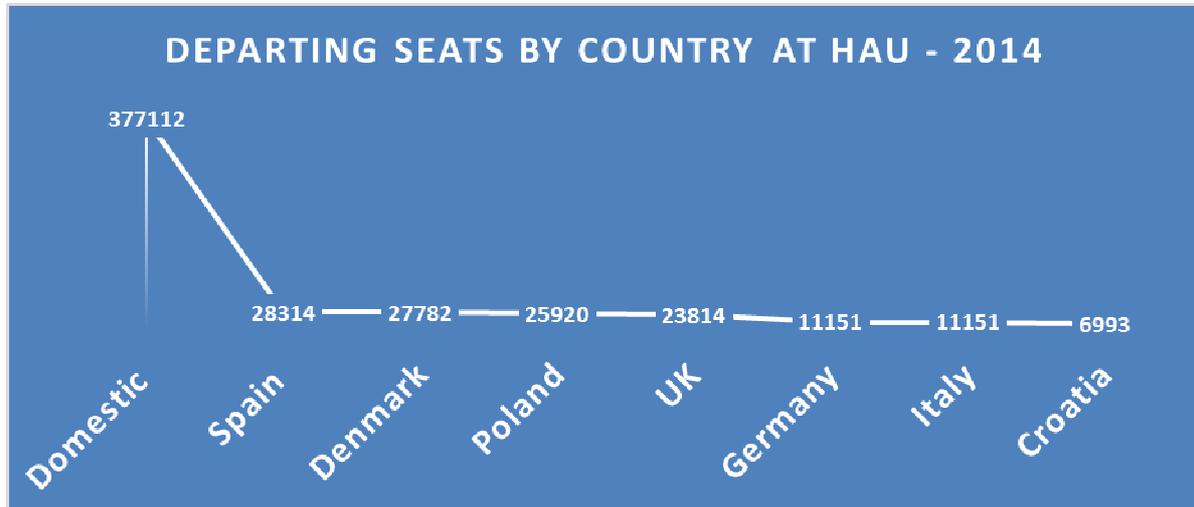
Introduction and Background

Haugesund Airport is a regional airport on the west coast of Norway. It lies approximately 140km south of Bergen and just some 80km north of Stavanger; both cities with large international airports. In 2014, Haugesund Airport processed almost 700,000 passengers, which was a small 2% decrease on the previous year. 5 airlines make up the majority of the traffic at Haugesund, displayed in terms of their departing seat capacity below:



The profile of carriers is therefore very strong, the presence of two of Europe’s leading ultra low cost airlines, although only making up some 20% of total capacity, is a strong indication that this market responds well to low cost development. The countries and destinations

served from Haugesund are also rather diverse. Based on 2014 data, 10 destinations were served in 7 different countries.



The Norwegian government has indicated in its transport strategy, that Haugesund Airport should be removed from the Avinor network. This, we assume, will become part of a wider deregulation of the airport and Avinor monopoly in Norway. A similar process has happened in Sweden in the last 10 to 15 years and Finland is also embarking on a similar airport deregulation strategy. This points to the fact that the governments in these countries are questioning the sustainability of the airport ‘network’ model.



We have been asked to assess the possibility of a third party concessionaire taking control of Haugesund Airport, with the purpose of running and developing it over a period of time. The market for regional airports in Europe at the moment is highly challenging, there are a

number of factors, as demonstrated in the image above, that make development of regional airports particularly challenging in the current climate. This is particularly so from a route development perspective. However, Haugesund Airport is uniquely positioned in that it has a strong carrier and traffic profile already and there are, we believe, good reasons to suggest that modest levels of traffic growth will be possible in the near to mid-term.

Section 1 – The Concession

The principle of airport concessions is not in any way a new one, it's a relatively common practice all over the world and in Europe there are also various examples of where this approach works quite well. It is however usually a practice associated with larger airports, Budapest, St. Petersburg (Pulkovo), Zagreb are examples of airports operated under concession type agreements. To the best of our knowledge, Haugesund Airport (HAU), would be the first regional category airport to be offered as a full concession. The Greek government appear to be about to announce plans to offer their regional airports for concession to the operator Fraport. It is not entirely clear how this concession will work in practice, however if it should proceed, it could be an interesting model for other regional airports and monopoly operators like Avinor.

In any event, the size of the airport is not the critical aspect of a proposed concession. Many of the parameters and risks remain the same irrespective of scale. The starting point for this report is to assess some of the key questions and concerns that should be addressed when considering taking on an airport concession agreement.

1.1 Who is the grantor of the Concession?

In the case of HAU, the grantor is most likely going to be:

- Avinor
- Civil Aviation Authority
- Ministry of Transport and Communications

The grantor of an airport concession can be a crucial part of the process, due primarily to possible changes in regulations or costs for service provision. To put this in context, new legislation and / or regulations are not uncommon in the aviation industry and these developments can often have a direct impact on the operation of an airport – and usually directly impacting cost structures. For example, enhanced security measures may mean that new scanning equipment needs to be installed. These developments are often not foreseen but are usually binding and can have a considerable impact on the financial performance of a regional airport. If for example the grantor of the concession is Avinor, can they reasonably be assumed to be acting in an objective and impartial manner when it comes to decisions that may impact HAU when they will be the owners and operators of two competing airports at Stavanger and Bergen? We would point to Avinor's recent heavy handed approach to overflight charges at both of the private airports of Sandefjord and Moss,

whereby without warning Avinor announced that both airports would suddenly have to pay 50m NOK per annum for overflight costs. There probably isn't any doubt that the airports should be paying something for that service, but it proves the point that the grantor of a concession at HAU, may not automatically be the right entity to them preside over decisions that could have a material impact on the financial performance of the airport.

Whoever the grantor of the concession may be, it must be clear that HAU should be treated in precisely the same manner as any other airport in Norway when it comes to legislative / regulatory changes. We don't know at this point, if there is even the possibility to influence who the grantor might be, but the long term implications of having a grantor that can act in an objective and impartial manner towards an independently operated airport, could be crucial.

1.2 What will the Structure of the Concession Be?

There are a number of different options to consider when it comes to the structure of an airport concession. It is likely that the optimal model is a hybrid approach whereby certain aspects of different models can be incorporated into one. Aviation in general, and airport management in particular, relies a number of highly regulated functions and services that require special attention under the terms of a possible concession arrangement. Some key questions that need to be addressed in the context of an airport concession are as follows:

1.2.1 General Risks & Challenges

In the construction of the concession agreement, there are some specific risks that could create challenges during the term of the concession. Some of these risks can be, and in our opinion, should be, mitigated against within the contract agreement. An example of one easily identifiable risk factor and how it can be mitigated against, is presented in the following:

Risk: Failure to obtain relevant operational or environmental permits



Reason: Government agencies act unreasonably in relation to issuance of permits

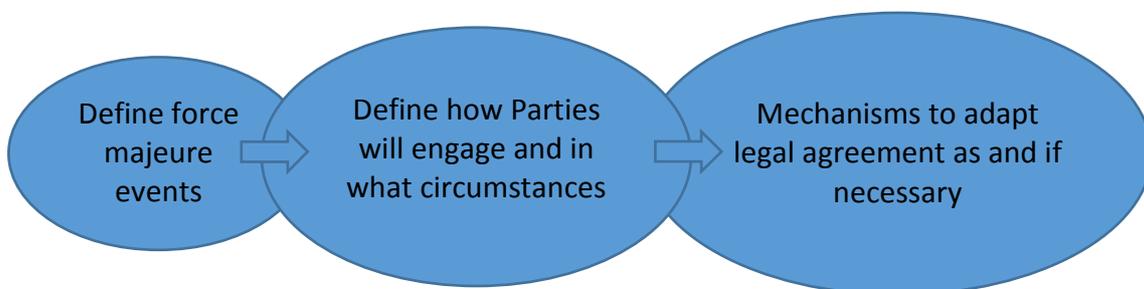


Responsibility: Damages suffered attributable to Government

The general principle here is to clarify in the agreement the various risk factors that could have a major impact on the ability of the concessionaire to effectively manage and develop HAU. One

obvious challenge to risk management, is the volatility of the aviation market makes it impossible to precisely define every future scenario and how that may impact the development or management of an airport. For this reason, another approach could be to focus on the somewhat elusive term of *Force Majeure*. The aviation industry is probably more susceptible than most to events of force majeure however it is a particularly challenging factor to define in any commercial negotiation. It is our view that there should be some recognition, in the concession agreement, of the fact that unpredictable and unforeseen events could occur during the life of the concession that would have a significant impact on the running or operation of HAU. Is it reasonable to consider that the concessionaire should take full responsibility for damages incurred as a results of these incidences or that the concessionaire should be forced to insure itself against all such events?

Equally, it is unlikely that the grantor will agree to being held responsible for force majeure events. This raises certain legal questions that cannot be fully addressed in this report. However, we would strongly advise due to the unique nature of the aviation industry, that any legal agreement at least includes some references to force majeure events and possible solutions. The image below gives a brief overview of one possible measure that could be incorporated into an agreement. This model would rely on the Parties mutually agreeing in advance what the parameters for force majeure could be:



1.2.2 Airport Management

This section will look at some of the main functions that need to be considered in relation to the actual running and management of the airport. In terms of a concession type agreement, our general view is that as much of the airport function as possible should be controlled and managed by the concessionaire. A successful long term strategy for HAU will be based upon the concessionaire being able to control, to the maximum extent possible, costs and revenue streams. This, of course, needs to be balanced against the concessionaire taking control of potentially costly and highly complex services.

1.2.2.1 Air Traffic Control (Case Study Sweden)

Air traffic control (ATC) is one of the most important issues to consider in the context of running a regional airport. The reason is that it is a very expensive service to provide: it requires highly trained man power to operate it; relies on technically advanced equipment; is a highly regulated service that requires high levels of maintenance to adhere to international standards. These costs are particularly important when one considers a 50 year or more concession agreement. The practical arrangement between the concessionaire and the grantor in relation to air tower services should be considered as a central part of the negotiation process.

The first important consideration is the monopoly market for tower services that currently exists in Norway. This means, that in the current regulatory environment the concessionaire will be forced to purchase tower services from Avinor as the only approved provider of those services in Norway. It is relevant at this point, to consider the situation in Sweden, where the air traffic control market has been deregulated and there is a private tower service company providing tower services at a cost that in some cases, is some 40% lower than the state owned provider Luftfartsverket (LFV).

Aviation Capacity Resources (ACR) AB are a Swedish registered company that provide tower services at 12 regional airports in Sweden. They are in fact the only company in Europe that has the Single European Sky Certification, which is the regulatory requirement for Air Navigation Service Providers in Europe. They are an incredibly efficient organization with only 105 employees. Of these 105, 92 are employed in tower service provision. To put that in context, most state run organisations have a ratio that is more like 1:1, in terms of tower operators to other employees. This is one of the ways in which ACR can provide such cost efficient services. Their reputation and safety standards are also flawless to date, indeed IC Aviation works with many of ACR's clients in the Swedish market and they are incredibly satisfied with the cost savings and the level of service provided by ACR.

Although ACR was established in 2004, it was not until 2011 that they were able to provide tower services in Sweden. There was a period of sustained lobbying and testing that ACR needed to do in order to convince the Swedish government to deregulate the market. This is important information for the HAU case because it could still take some time for the Norwegian government to fully deregulate the market for their services. The information that we have, is that Oslo-Rygge and Sandefjord-Torp airports will soon publish tenders for the provision of private or third party tower services. This is clearly a step in the right direction, however, the implications and timelines for the deregulation of the rest of the market is, as yet, unclear.

The key point in relation to HAU, is that any concession agreement with the grantor, must provide for a clause that allows third party ATC providers to operate at HAU. The second issue to consider is which Party keeps control or ownership of the ATC equipment the concessionaire or the grantor (Avinor). In the case of the airports in Sweden that were divested from the State operating company, in most cases, these airports took control and ownership of the equipment themselves as part of the negotiation procedure. We would suggest that this is best alternative for the proposed HAU concession also. Having full ownership and control of the equipment does create long term financial obligations in terms of maintenance costs. However, the added value is that the concessionaire, assuming a deregulated ATC market, can introduce a third party supplier. It is important to note that ACR only provides man power. They do not provide ATC equipment. This further justifies the necessity to have the ATC equipment in the control of the concessionaire.

1.2.2.2 Fire & Rescue, Security

We categorise fire, rescue and security services together because they share some similarities in terms of the employee and equipment structures. For a start, both are another man power intensive aspect of running a regional airport. This is not to mention the cost of providing and maintaining all of the actual fire-fighting and security related equipment. The key point to consider here is that no matter how complex and costly these services are to provide and maintain, the inclusion of the fire and security service equipment and personnel within the concession agreement is vitally important. This is because in state or monopoly managed airports, there is often significant excess employment capacity in particular within the fire and security service departments. These services are without exception absolutely an essential part of a successful and safe airport operation. However, there can be long periods of the day when their services are not necessarily needed but they are still required to be 'on site' and are therefore being paid to be available, but not necessarily being used to their fullest capacities. Some of IC Aviation's regional airport clients have developed novel solutions for flexible working practices that allow firemen and security personnel, to join in with other tasks, such as for e.g. loading and unloading aircraft. This necessitates suitable practices to be put in place so that, in particular, the fire fighters can access the service vehicles and equipment within certain time limits so that they can respond to potential emergencies.

We know that this type of flexible working is possible to implement from both a regulatory and practical perspective, however, it is possible that there would be resistance to such new working practices being introduced from incumbent employees. For this reason, it is vitally important that

the management of equipment and manpower is held in the concessionaire's control so that maximum efficiencies can be delivered across all aspects of the airport workforce. Ensuring that these types of synergies exist, can have a huge impact on the financial performance of a regional airport.

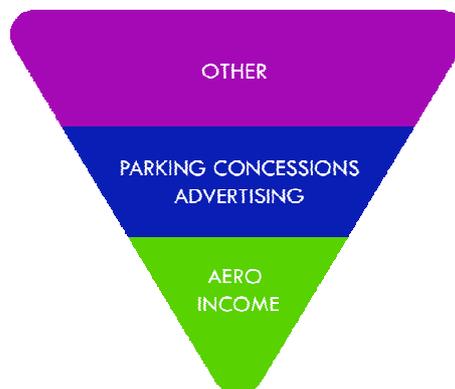
1.2.2.3 Commercial Activities

HAU, and Norway in general, has the added advantage of selling Duty Free products at its airports in respect of intra-European routes. This gives Norwegian airports a distinct competitive advantage over its EU counterparts, in particular in relation to regional airports. In the case of HAU, the current revenue structure of the airport would suggest that at least 70% of the total commercial revenues of the airport are derived from Duty Free sales. Or looking at the total airport revenue (including aeronautical revenue) 41% and possibly even more could be derived from Duty Free sales alone. There is no doubt therefore that this revenue stream should be developed as much as possible by the concessionaire. It is also worth mentioning the recent discussions by the Arbeiderpartiet in Norway about the abolition of Duty Free sales. This is something which should be strongly campaigned against and it appears that Avinor and the incumbent Ministry for Transport do not see this as a viable proposal. It would be one thing if a regional airport in Norway did not have Duty Free revenue, but still remained part of the Avinor group, because cross subsidization would continue to cover deficits. However, the situation for an independent regional airport in Norway with no Duty Free sales and very few ways in which to replace that level of revenue, would be devastating.

In general, the trend for regional airports in Europe, needs to be a bigger focus on non-aeronautical revenue. Relying on landing and other fees from airlines is not a sound basis for long term sustainability. All airlines in Europe, whether they are low cost airlines or full service, are constantly seeking to reduce costs, and airport fees will be one aspect of a regional airport's business that will continue to face downward pressure for the foreseeable future. The first triangle below shows the basic structure of the old revenue model for regional airports in Europe. The second, shows the new model:



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For this reason, it is essential that other commercial activities are also explored and developed by any concessionaire at HAU. Another revenue stream that can be developed reasonably easily is for example revenue generated by advertising. The current revenue structure at HAU would suggest that only a very small percentage of the total revenue comes from advertising, or in real terms some NOK1m per annum. This is certainly an area of revenue generation that we believe could be enhanced significantly. This also supports the idea that all commercial activity should be included within the concession agreement, with full flexibility given to the concessionaire as to how they may wish to further develop the Duty Free, advertising or other ancillary sources of revenue. It should be noted at this point, that although Duty Free and advertising revenue will always be an important part of HAU’s revenue streams, as concessionaires / managers of the airport facility, there are also many other novel ways in which to drive additional commercial revenues. Some examples of modest revenue generating ideas that don’t require any significant investment are: use the airport as a venue for conferences, children’s parties and study trips. Organise technical visits from other

airports to HAU, become a role model for how to successfully run a regional airport. There are many other opportunities too, these can be discussed in more detail at a later stage if or when the concession commences.

1.2.2.4 Traffic Development

Traffic development is vital to the very existence and long term survival of HAU airport. It is also obvious that any potential concessionaire should be given full control and responsibility for all traffic and route development responsibilities. There are more detailed assessments about route development opportunities for HAU in the following sections of this report. For the purposes of this section, it is only important to highlight that being able to fully control and manage the route and traffic development part of HAU for the full term of the proposed concession is an obvious, but important, issue to consider. Any potential concessionaire, should strongly consider any risk factors that might impact their ability to successfully develop traffic at HAU – for example developments that could happen at competing airports that would impact the development of at HAU. This is even more important to consider in the eventuality that the grantor of the concession may be the same entity that is managing and developing competing airports within HAU’s own catchment. As described earlier in this report, this situation has the potential to create certain conflicts of interest that may damage HAU’s ability to freely and successfully develop traffic at HAU. There will be more on this point in the following sections of this report.

1.2.4 Customs and Immigration

Some short words about customs and immigration are useful to present at this point. The key question to consider here is whether this will remain as a Government function, which we assume is the only option available. However, it should be clarified in writing with the responsible authorities under what terms the service will continue to be provided. The obvious answer is that the criteria for providing the service should not change at any stage during the concession, just because the airport is no longer a governmental or Avinor owned airport.

1.2.5 Fuel Supply

Again some very short words about fuel provision at HAU. Fuel provision is a revenue generating opportunity for airport operators. Will the management of this function be under the control of the concessionaire? In our view, this should be the case. The concessionaire should be given the

flexibility to change supplier or otherwise implement changes that might benefit the airport's revenue streams.

1.2.6 Permits

The issue of permits for airports covers two, distinct but somewhat related areas. First is the operational permit, usually granted by the Civil Aviation Authority of the country in question and this permit grants to the management / owners of the airport the legal right to run and maintain the airport. The second important permit to consider is the environmental permit.

1.2.6.1 Operational Permit

There are clear guidelines set out in Norwegian legislation about the requirements for and the process of applying for Technical / Operating Approval of an airport in Norway¹. The application procedure and permit issuance is governed by the Norwegian Civil Aviation Authority (CAA). The process for approval follows similar basic principles in most European countries, and indeed some aspects of the approval requirements are also regulated by international law.

In order to obtain an operative license, there are a number of requirements in relation to running and operating the airport that need to be demonstrated to the satisfaction of the CAA. Each of these requirements has specific further guidelines as to exactly what needs to be demonstrated and how. For the purposes of this report, this is simply a short summary of some of the main requirements that must be satisfied:

- a) Demonstrating sufficient safety management systems are in place
- b) Appropriate design of ground services
- c) Appropriate security procedures and equipment
- d) Air navigation services and equipment must be to the required standard

It is also possible to make an application for a renewal or a modification of an existing approval to the Norwegian CAA – which could be an option to consider for the proposed concessionaire at HAU. An application for a renewal in the name of the new concessionaire would give the peace of mind that the approval is secure. And an obvious benefit to having the permit in the name of the

¹ This is the source for instructions and rules when applying for airport operating permits in Norway:
<https://lovdata.no/dokument/LTI/forskrift/2014-12-19-1913>

concessionaire, considering that they will be the *de facto* owner of the airport for the period of the concession, is that there is less of a likelihood that it can be withdrawn or removed unexpectedly.

In relation to a modified or extended operating permit, it is important to note that under the relevant Norwegian legislation, it may be mandatory to apply for a modified permit if there are any changes proposed at the airport, including to airport equipment or the airport's surroundings, which involves changes in the conditions which formed the basis for the original approval. Crucially, in the case of HAU, these changes can also include changes in ownership; a concession type agreement may imply that there are new owners or at least a change to the ownership structure as far as the CAA are concerned. However, it could also be argued, in the case of the proposed HAU concession, there is no direct change of ownership per se, and it is likely that some of the key personnel that operate and manage the airport currently, will remain in situ post concession, which can be one important criteria for assessing operating permits.

On balance, our advice would be that applying for a new or modified operative permit would be a time consuming, costly and unnecessary process. There is obviously an existing operative permit at HAU that is most likely fit for purpose. Our research could not locate the actual permit so we can only speak in a qualified manner about the permit, but the airport must be subject to a permit of some sort or it would not be operating. It would be our suggestion that the license that is presently issued to and held by Avinor, should be simply transferred to the concessionaire. The process in Sweden, where to date 9 airports have been sold from the State airport operator, Swedavia, was simply that the operating licenses were transferred to the new owners.

The Swedish example therefore raises the prospect of leaving the HAU operating permit in the hands of the existing holder, in this case, Avinor. The one that this raises is concern about the ability of the concessionaire to ensure that the license will remain valid and be kept up to date. There is also the issue of whether the holder would also need to be the employer of certain key personnel (for example the airport CEO) at the airport, which has obvious disadvantages for the proposed concessionaire.

Before any final decision is taken on the issue of the operative permit, it will be imperative for any proposed concessionaire to engage with the Norwegian CAA, to ensure that all of the permutations and possibilities for the operating licence can be fully clarified.

1.2.7 Environmental Permit

This aspect of running an airport that is also essential and the precise status of the existing environmental permit, its conditions, duration, etc. need to be clarified before any concession agreement is signed. The main challenge with environmental permits, is that they can become invalidated or obsolete by a change in circumstance at the airport or by international or national laws changing that require new environmental measures to be introduced.

We can give one example of a small regional airport in Sweden that was required by Swedish law to apply for a totally new environmental permit because they had a new helicopter flight arriving and departing at the airport. Not only is the process a highly complicated one, it is also immensely costly. For this small Swedish airport, which in passenger number terms is much smaller than HAU, it is estimated that the cost to apply for a new permit will be some €300,000. The introduction of new legislation or regulations is a total variable and there is little that an airport's management can do to prepare for such an eventuality.

Environmental permits are also, of course, usually limited in time to some 15 or 20 years, assuming no extraneous factors, as mentioned above, arise in this time period. It may be one suggestion that the existing holder of the environmental permit for HAU, presumably Avinor, should be charged with ensuring that it remains in place and valid, as part of the concession agreement. At the very least, any new proposed concessionaire needs to be fully aware of the precise conditions of the existing permit and if there are any easily recognizable changes that may arise in selection to the permit within the near future.

Two other important questions should also be considered and clarified with the grantor that relate to general environmental issues:

1. Will the concessionaire be liable for past environmental damages? It is possible that environmental damage could occur due to negligence, acts or omissions that occurred before the concessionaire takes control of the airport. Who should be liable for the cost of these damages?
2. Will the concessionaire be fully liable for future environmental damages, even if totally unforeseen or as a result of force majeure?

1.3 Termination of the Concession

Some consideration should be given by the proposed concessionaire as to how to terminate the concession if the need should arise. This is a point that will require further legal analysis before the conclusion of any proposed agreement, however, the first key question that arises under this topic is, what is a reasonable length of time for an airport concession to exist? Airports by their very nature are a long term investment, to that end, anything less than 50 years is probably not worth considering for a concessionaire who may for example be required to invest considerable sums of money in developing the airport. There is also the possibility of running a concession that does not have a specific end date, a practice common in the United States in relation to some of their public utility companies. There are pros and cons to this approach because in theory, the concession can be cancelled at any time or unexpectedly which is not an ideal situation. However, if the agreement is created properly, it could have a minimum term of some 50 years for example with the expectation to continue for an indefinite time period after that. The positive arguments for this approach are that it gives the concessionaire peace of mind that any investments in developing the airport have the possibility to be recouped because the concession should, in theory, last forever. If you consider the situation after 40 years of a 50 year lease, and some financial investments are required, if the concessionaire knows that the lease will end in 10 years' time, there may be less incentive to spend the required money.

This raises yet another question as to whether a concession is actually the right model for this proposed transfer of management at HAU at all. Another model to consider is simply that a third party takes full control and ownership of the airport. In **Section 2** of this report, there is a detailed description of the process in Sweden, whereby the State sold airports to regional municipalities. The Swedish model is certainly worth considering in the case of Norway in general and HAU specifically.

Coming back to the issue of concession termination and assuming this is the preferred model, we would conclude by simply raising some questions about under what conditions the Parties should be able to terminate the concession before its scheduled end date. The most obvious and likely reason for an early termination will be some sort of dispute about the terms of the concession. We assume that any concession agreement will include references to dispute resolution mechanisms, however, we would strongly urge these clauses to be very clear about the precise methods for dispute resolution, appointed jurisdictions as well as detailing, to the best extent possible, what the consequences will be for both Parties in event of a dispute that leads to the termination of the lease.

For example, does the concessionaire simply hand the airport back, or what other further and / or lasting implications could there be for the concessionaire? It will be important to ensure for example, that no recurring financial obligations can ensue after the termination of the concession.

1.4 Payment Terms

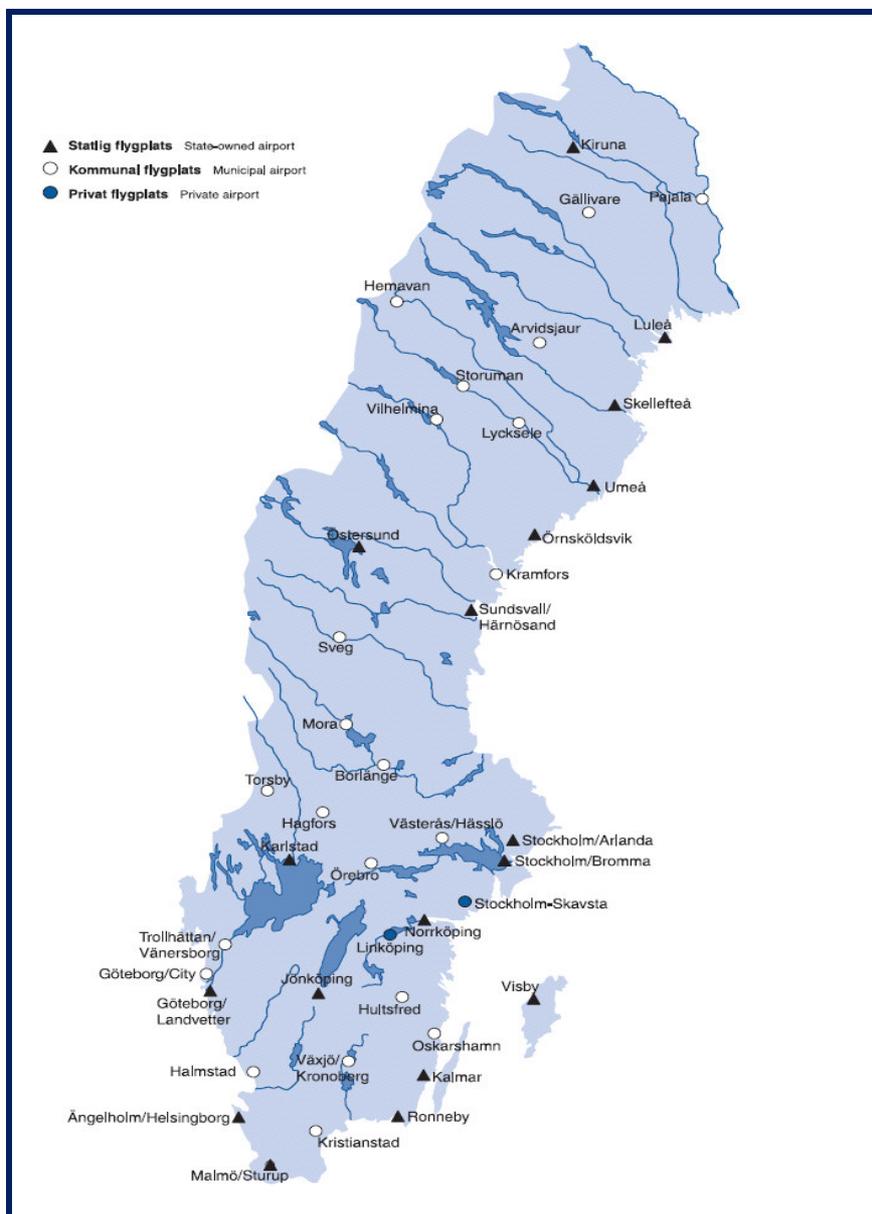
For the purposes of this report, we can't get into too much detail about the precise commercial aspects of a proposed concession when it comes to considering the possible costs or rents for the concession. However, as we have pointed out, aviation is a particularly volatile and unpredictable industry. And for that reason, over the life of a 50 year concession many things are likely to change from the concessionaire's perspective. Accordingly, the proposed concession agreement should probably allow any agreed rental prices to be adjusted over time, even though it is impossible to determine accurately at the outset what those adjustments should be or what might cause them to occur. There are some standard legal clauses that cover concession agreements and which are suitable for an airport concession also. There are three categories of price adjustment mechanisms specifically worth considering:

1. Standard indexation points over the life of the agreement
2. Mechanisms for periodic revisions of the concession agreement and of the indexation rules
3. Rules for price adjustment in the face of unforeseen events

These various mechanisms necessarily lead to more questions that need to be considered as part of the contract negotiations. For example: how should indexation rules be designed? How frequently should prices be changed or indexation applied? What procedures should be followed to revise indexation rules, if the Parties agree to this mechanism? How often should these rules be revised and how will decisions be made about rule changes? Should independent arbitrators be appointed to oversee any such discussions and mechanism changes?

Section 2 - Airport Deregulation Process – Sweden

In 2007, under the then coalition government led by the centre-right party, The Moderates, a political decision was made to deregulate the Luftfartsverket (LFV). Up to this time, LFV was the monopoly provider of airport services and the biggest owner / operator of Sweden’s larger airports and up to 2005, it was also the regulatory authority for the aviation industry in Sweden. The LFV airports are denoted in black in the following map. The white circles are primarily small regional airports that were (and continue to be) owned by local municipalities and / or regions. At that time, there were only two entirely privately owned airports at Stockholm-Skavsta and Linköping. Gothenburg City Airport (Säve) was equally owned by LFV, Gothenburg Municipality and Volvo.



The specific decision about the process of how to deregulate the LFV monopoly, was only taken after a government appointed adviser carried out an extensive review of the Swedish airport and LFV system. The initial findings of the investigation were as follows:

2.1 Corporatisation of LFV

It was determined that the existing LFV group should be corporatized and in fact should be split into two entities, one commercial, state owned administrative authority to manage the technical aspects of the air transport market such as Air Traffic Control (and a state owned limited company to manage, develop and run the airports. This latter company became known as Swedavia. It was also suggested that this company should be partly privatised to introduce more experience and efficiencies. Despite this recommendation, Swedavia was never privatised and all shares are owned by the Swedish state. It should also be noted that in 2005, the regulatory aspect of LFV, known as Luftfartsstyrelsen (today Transportstyrelsen), was separated from LFV.

2.2 Airport Classification

The investigation also concluded that there should be a classification of Sweden's airports. The classification would be based upon the airport's contribution to meeting transport policy objectives, mainly in the form of improved accessibility for citizens and businesses in the local regions. Three categories were created:

a. Nationally Strategic Airports

For these airports, it was proposed that the state should guarantee any financial deficits for the operation of the airport. This should continue to be done through cross-subsidization of the state owned airport network operator.

These airports were defined as: Arlanda***, Bromma***, Landvetter***, Malmö***, Kiruna***, Luleå***, Umeå***, Visby***, Östersund***, Arvidsjaur*

b. Regionally Strategic Airports

For these airports, it was proposed that compensation from the state could be up to 75% of the deficit for the operation of the airport. These airports were defined as Regionally Strategic:

- Göteborgs City*, Gällivare*, Hagfors*, Halmstad*, Hemavan*, Kramfors*, Kristianstad*, Lycksele*, Mora*, Oskarshamn*, Pajala*, Sveg*, Torsby*, Trollhättan*, Vilhelmina*, Växjö*, Örebro*, Kalmar*
- Skavsta**, Linköping**
- Ronneby*** Jönköping***, Karlstad***, Örnsköldsvik*** Sundsvall ***, Skellefteå ***, Ängelholm***

c. Other Airports

It was proposed that this category of airport should receive no state support whatsoever. 4 airports were classified as 'other': Borlänge*, Storuman* and Västerås*, Norrköping*.

- * **already municipality owned at time of investigation**
- ** **privately owned at time of investigation**
- *** **part of the LfV group at time of investigation**

NOTE: There were other Swedish airports at the time of the deregulation process, however, no scheduled flights existed to these airports so they do not get mentioned. Examples of these airports are Skövde, Lidköping and Gävle.

2.1.1 Privatising Certain Airports

Another proposal by the investigating team was that either or both Landvetter and Malmö airports could be fully or partially privatised. This proposal did not manifest in reality post the publication of the investigators' report.

2.1.2 Airport Closures

In relation to the 4 airports in the 'Other' category, the government investigators were indifferent as to whether these airports should try to find funding from elsewhere or alternatively simply close down. Therefore, airport closures were considered by the government, but by no means forced - and as it happened, none of these airports have, to date, been closed down.

2.3 What Happened in Practice?

It was obvious that the government of the day was very positive towards the process of deregulation and in some way or another, breaking up the LfV monopoly. The airport investigation itself was a

clear indication that the government supported some fundamental changes. The process was driven by ideological reasons as well as financial concerns about the sustainability of the LFV model and at the time other state owned monopolies such as the Vin & Spritcentralen (monopoly importer of alcoholic beverages) was also being deregulated. The other key feature of this process is the fact that the LFV were also very much behind it and proactive in working with the government to achieve the objectives.

In reality, some of the most interesting features (related to for example privatising Swedavia and some airports) of the investigation did not actually happen. From an airport ownership and management perspective, this is how the process ultimately unfolded:

1. LFV 'sold' 9 of its airports to local / regional municipalities where the airports were located
2. The deficit funding system, proposed by the investigation team, did not work out entirely as proposed

More on these Points 1 and 2 below

3. The airport in Ängelholm was re-sold by the regional authorities to the private construction PEAB the very same day as of the sale from LFV to municipality.
4. The airports that were already under Municipal ownership at the time of the investigation remained that way
5. No airports were closed down, although some airports, for example, Storuman remain 'open' without the existence of any scheduled passenger flights

2.4 Sale Process from LFV to Municipalities

In terms of the airports that were sold to the local municipalities, this was a lengthy process and the transactions did not proceed each in the same manner or each with the same sort of model. The process took place over a period of around 7 years. Even before the investigators' report was published in late 2007, 3 LFV airports had already been sold to local municipalities. These were: Norrköping, Kalmar and Halmstad. The timelines for the remaining airport sales were as follows:

- Karlstad (2010)
- Jönköping (2010)
- Skellefteå (2010)

- Ängelholm (2011)  PEAB
- Örnköldsvik (2011)
- Sundsvall (2013)

It is also important to note that not all of the municipalities were in favour of the process of taking control and ownership of the airports. This goes some way to explaining why the process took such a long time. The negotiations were also all very different and there were different conditions granted for each of the airports. As LFV's Chief of Negotiations, Olle Sundin, explained:

'During our negotiations, the municipalities have proven to be a tough counterparty that pushed us properly, while discussions proceeded in a very good spirit.'

To give some examples, it is possible to identify some common themes that were present throughout the various negotiations and sale agreements. However, this cannot be seen as an exhaustive list and not all of these factors occurred in each case:

1. Many of the airports were sold for a nominal fee of just SEK1
2. In some cases, LFV agreed to pay lump sum or recurring subventions to cover future investment in infrastructure for example. The amount varied depending on the airport, but where it was allocated by LFV, there were reasonable grounds to demonstrate that the airport would need to invest certain sums of money in essential infrastructure improvements or maintenance works
3. The tower service equipment was in some cases transferred entirely to the new owners. Some airports took ownership of only some of the equipment with other parts of it still being owned and controlled by LFV
4. Other equipment such as fire trucks, handling equipment, etc. was also transferred to the new owners in their entirety

2.5 Government Contributions to Airports in Sweden

In addition to the subventions that some of the municipalities received as part of the sale process from LFV, there are also government contributions allocated to Sweden's independent airports. However, the proposals made in the government investigation about covering the deficits of the Nationally and Regionally Strategic Airports by up to 100% and 75% respectively, did not happen in this way.

In relation to the Nationally Strategic Airports, the Swedish state is effectively subsidising any potential losses. Within the Swedavia network loss making airports are cross-subsidised by profitable ones. In relation to the Regionally Strategic Airports, the Swedish state does subsidize these airports to a certain extent but with a different system than envisaged by the initial proposals. What happened in practice, is that a set amount of money per year is dedicated as a contribution towards the running costs of these airports that is then divided between the various airports.

In 2012, a 10 year plan was introduced whereby the government would offer a total budget for airport contributions that would be divided up between all of the non-governmental airports that have scheduled traffic and are not in the vicinity of Stockholm. For example, Stockholm- Skavsta, Örebro, Norrköping and Västerås receive no contributions. Crucially however for some airports the contribution funding is not given directly to the airports but to the regional councils (Regionförbund) where those airports are based. It is up to the regions themselves then to decide whether the airports should get the money, or if it should be distributed elsewhere within other transport modes in the region. The airports that ‘receive’ money via the regional channels are in the following table:

Airport	Annual Contribution ('000 SEK)
Borlänge	1,971
Halmstad*	2,523
Karlstad*	3,604
Jönköping*	2,335
Kalmar*	3,474
Kramfors	5,498
Kristianstad	2,731
Mora	2,348
Oskarshamn**	1,760
Skellefteå*	4,156
Tollhättan	2,210
Växjö	2,202
Ängelholm*	402
Örnsköldsvik*	4,768
Total	40,000

*** airports that were sold by LFV to local municipalities**

**** closed down in 2014 but the regional council still receive the funding**

NOTE: After the decision about the divisions of the funding, Sundsvall Airport was sold to the municipalities of Sundsvall and Timrå. The actual amount of 40MSEK will now be split into new sums as another airport should receive its share of the money.

There is a second category of airports in Sweden that could be best described as remote airports that also receive state contributions. These airports and the amounts they receive are as follows:

Airport	Annual Contribution ('000 SEK)
Arvidsjaur	9,477
Gällivare	11,082
Hagfors	3,098
Hemavan	10,167
Lycksele	8,519
Pajala	4,100
Sveg	4,315
Torsby	2,959
Vilhelmina	9,119
Total	63,000

2.6 Ownership Models of Independent Airports

These are some examples of the ownership structures of the LFV airports that were sold. In most cases, the ownership is 100% by the municipality, but the below examples show some slight variances to the ownership structure.

Anelholm

- 100% private – was sold to the local municipality by LFV and the same day was sold to the private company PEAB (this transaction is subject to legal proceedings currently)

Jonkoping

- Airport is 100% municipality owned
- The airport real estate company is however controlled by a separate municipal company

Vaxjo (never an LFV airport, but ownership model is interesting)

- Airport infrastructure owned by the region and 2 local municipalities
- Airport tower services are owned by a separate company (we assume with a view to selling ATC services or training in order to generate additional revenue)

2.7 Legal Issues Surrounding Swedish State Contributions

In Sweden today, there are effectively 2 main forms of State subsidies being paid out to independent

airports, or in particular, the airports that were sold by the LFV group. These consist of: LFV subventions agreed at the time of the sale process and State contributions towards operating the airport.

In relation to the State subventions, these amounts may fall within the remit of the new State aid guidelines, which strictly limit the amount and the circumstances in which regional airports can receive this sort of operating aid. It is not clear what approach the Swedish government will take in respect of these airport contributions as a result of the new guidelines.

In relation to the LFV subsidies that were given to certain airports when they were sold by LFV, these came at a time when the State aid rules for airports were different. What we know is that there were no incidences of these transactions being notified to the European Commission by the Swedish government. We can assume therefore that on the evidence before them, the LFV and / or the Swedish State felt that there was no State aid in question and therefore no notification to the Commission was necessary. In our view, even with the new State aid rules, this type of transfer funding or subvention funding is unlikely to be considered as State aid. There is one key test that can be carried out when a transaction of this sort occurs and there is the potential for State aid to be present. This test is referred to in various terms, but can best be described as the Market Economy Investor Principle (MEIP). This test assesses whether or not privately owned companies in the same situation would enter the same sort of agreement. In Sweden, the nominal cost of the airports (in many cases just SEK1) and the existence of subvention support, on the face of it, may look like State aid. However, as with Avinor, many of the LFV airports were loss making so selling them effectively for free and offering certain financial support was probably a realistic market negotiation and agreement.

In the case of HAU, the context is somewhat different than that which happened in Sweden. The context for HAU is a possible concession type agreement. It is conceivable therefore under the terms of the proposed concession, that Avinor could be liable, for the duration of the concession, for all and any investments needed in runway maintenance or repair, or the replacement of technical equipment or fire and rescue equipment. In the event that Avinor don't agree to this, there is still ample justification for them to contribute financially in a lump sum payment or recurring payments for any major investments that may be needed at HAU. This obviously requires a detailed technical review to be carried out at HAU to identify any short, medium and long term investments that may

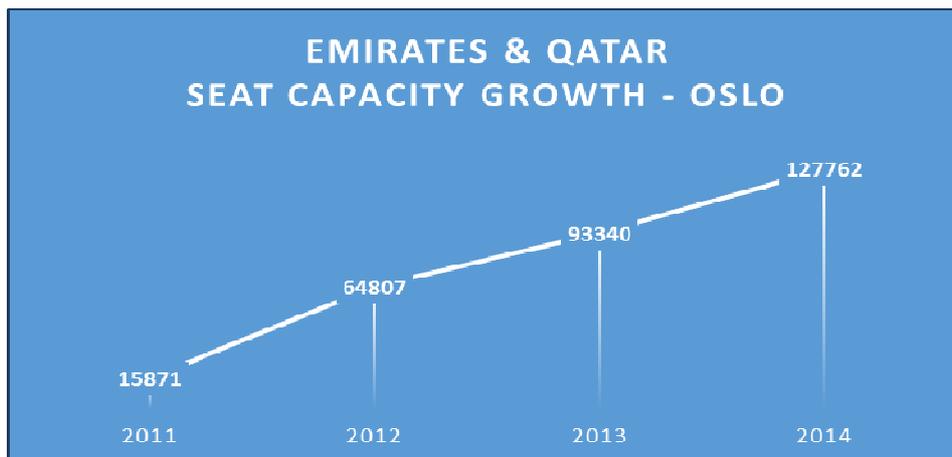
be required in key areas of the airport operation.

Section 3 – Global and European Aviation Industry Outlook

There are two distinct features in the global and European aviation market, which will have an impact on the development opportunities for HAU. The first is the booming Middle East carriers and in particular their expansion into the Scandinavian market. The second issue is the financial stability of Europe's and in particular, the Scandinavian, carriers.

3.1 Middle East Carriers

The below graph shows the rate of growth from both Emirates and Qatar airlines at Oslo airport, since they entered the market in 2011. It demonstrates a rapid expansion of capacity where they now offer some 2,500 departing seats per week from Oslo. Out of the big 3 Middle East (ME) carriers, Etihad is notably not present at all in the Scandinavian market. Etihad and the other Middle East (ME) carriers have also been developing aggressively in other European markets in recent years. As they do so, these carriers are fundamentally altering global travel patterns for European passengers. From a HAU perspective, one of the most significant developments is that in November 2014, SAS and Etihad announced a code share agreement. SAS make up approximately 40% of the departing capacity at HAU, so this clearly has the potential to impact on the airport's future development. Etihad carries approximately 15m passengers per annum but is also one of the fastest growing airlines in the world, with 23% passenger growth in 2014 alone. The airline operates a fleet of circa 120 aircraft of which more than 80 are large aircraft with the capacity to carry anything from 230 up to 500 people. Etihad has firm orders for almost another 300 brand new aircraft, of which a substantial percentage will be long haul planes. Along with airlines like Qatar and Emirates, Etihad has developed a highly successful strategy of flying people East and West around the globe using its base in Abu Dhabi as a central transit point. They typically offer competitive ticketing prices, convenient connection times and an unrivalled on-board experience.



Another interesting feature of Etihad’s business model is its willingness to engage in what they call ‘equity alliances’ with other airlines. These alliances go beyond the traditional airline code share arrangements and mean that Etihad purchases shares in other airlines. Here are some of the current equity alliances that Etihad has engaged in:

Airline	Etihad Ownership
Aer Lingus	4.1%
Air Serbia	49%
Air Seychelles	40%
Air Berlin	29.2%
Alitalia	49%
Darwin Airline	34%
Jet Airways	24%
Virgin Australia	24.2%

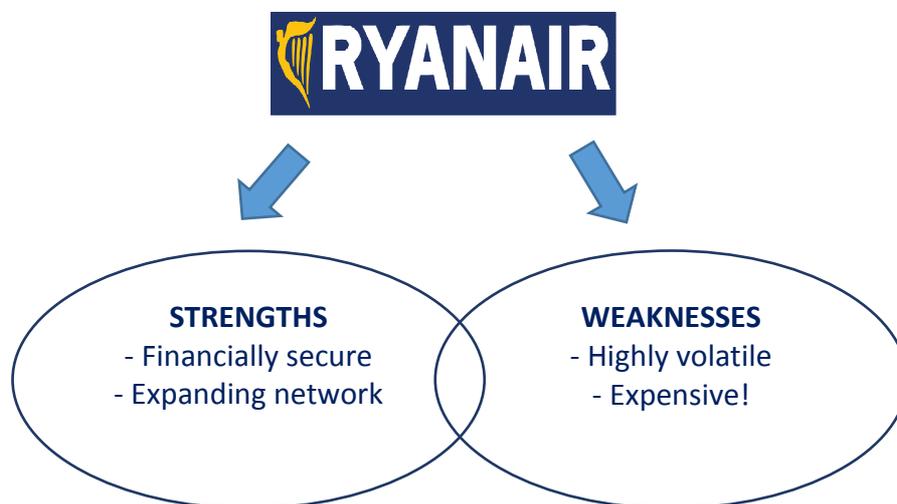
The key question for HAU, is how SAS’s initial code share arrangement with Etihad will expand and evolve in the longer term. At the moment, the arrangement is limited to the extent that it allows the two airlines to use each other’s codes on selected routes. However, if Etihad in partnership with SAS started flying directly from one of SAS’s Scandinavian hubs, to its base in Abu Dhabi where passengers can very conveniently fly onward to more than 80 global destinations then this could signal some development potential for HAU. Most probably this would mean that load factors and perhaps capacity on the Oslo route may increase, as this market would likely increase with Etihad code share flights assuming the transfers in Oslo and onwards to the Middle East were efficient. The prospect of SAS teaming up with Etihad to collect Scandinavian passengers from regional airports like HAU and deliver them to the rest of the world via the Middle East is exciting and we would estimate a rather real prospect in the coming years.

Whatever way it is interpreted, it is clear that Etihad’s interest in SAS signifies a turning point for the Middle East carriers in the Nordic market. Although Qatar (since 2007) and Emirates (since 2011) have been flying to Sweden, Denmark and Norway, it is arguably much more significant if Etihad engages with SAS in an equity alliance arrangement. This would give SAS an opportunity to access funding and provide much needed financial stability for a more aggressive growth strategy that it has until now, not been able to afford itself. And all indications are that any future SAS growth is pointed directly east, giving potential access to some very interesting markets from airports like HAU.

3.2 Financial Stability of Existing Carriers

In order to assess, as we will do in the following sections of this report, the prospects for route development at HAU, it is important to understand the position of the existing carriers that operate there. The diagrams show a summary of the main strengths and weaknesses of the scheduled carriers operating at HAU:







3.3 Route Development Review for HAU (1-2 years)

Route development for regional airports all over Europe is a challenge as airlines seek to reduce risks. However, HAU already has some of the best airlines in Europe, from a network development perspective, flying to the airport. Wizzair (W6), Ryanair (FR) and Norwegian (NO) all offer reasonable prospects for growth. And in the case of W6 and FR specifically, there is a good prospect that within the following couple of years, more opportunities will arise as these airlines continue to expand their base networks across other parts of Europe. For W6, it is also clear that Norway is becoming an increasingly important market for them. They only started flying to Norway in 2006 and in that time have rapidly increased capacity from around 1 departure per week to more than 3,000. W6 can therefore be an important partner for HAU in the future and we would strongly advise prospective concessionaires at HAU that the existing Gdansk route should be developed as much as possible. A continued strong performance on that route will encourage W6 to add more routes to the HAU network, just as they have been doing at Bergen and Stavanger.

The development with FR, although providing more international destinations than any of the other carriers at HAU, continues to be a little bit volatile. They still change schedules and cancel routes unexpectedly, which can be unsettling and confusing for potential passengers. FR also requires highly competitive cost arrangements for route development, which can put a strain on an airport's finances. It should also be noted that if and when airlines like FR come to realise that airport fees are no longer controlled by the monopoly provider Avinor, they might exert significant pressure to have those fees reduced, especially if they believe that the new owners / managers of the airport have

the flexibility to do so. Nevertheless, FR will more than likely continue to be an important partner for HAU for the foreseeable future. It would be our suggestion that for the next 1 – 2 years, the existing FR activity should be developed as much as possible, continuing marketing activities and campaigns to increase awareness of the flights should give the routes as much opportunity as possible to develop strongly and give FR less reasons to cancel or reduce capacity in the future.

In terms of SAS, Norwegian and Wideroe, we don't see immediate options for new destinations with those carriers. SAS, as explained, could offer an overall boost to their traffic numbers if the Etihad code share arrangement expands. Norwegian are constantly adding new bases to their network and they might have some new opportunities most likely in southern European leisure type destinations. Wideroe, it would appear to us, has very limited opportunities for new destination growth within its network. The Copenhagen route is clearly a hugely important route for the airport of HAU but also the surrounding area. Similarly to the strategy for FR and W6, the concessionaire at HAU should continue to develop this route as much as possible through marketing and general awareness generation.

To summarise, the stabilisation and maintenance of the existing network of routes from HAU should be the priority for route development at HAU over the coming 12 to 18 months. That is not say that new routes should not be investigated and pursued, but the profile of routes and carriers at HAU currently is rather impressive and diverse as it is. Ensuring and proving to other carriers that this profile can be maintained for a long period of time should be the priority.

3.4 Complimentary / Low Cost Airport Concept for Haugesund Airport

There is little doubt that HAU is operating in a highly competitive airport market. Stavanger with more almost 50 destinations and 4.7m passengers per annum and Bergen with close to 60 destinations and 6.2m passengers per annum are both directly within HAU's catchment area. This is not to mention the increasingly global competition that regional airports in Europe are now facing. Airlines are increasingly willing to simply move their operations to markets where they can make more money, whether that is within Europe or as Norwegian's Bjorn Kjos has indicated, moving aircraft to places like Africa, the Middle East, etc. Luckily for an airline, their main assets are moveable whereas the same cannot be said for airports who rely on geographically fixed infrastructure to generate revenue.

For this reason, HAU needs to develop its own niche that can allow it to maintain reasonable levels

of traffic volumes and also develop modestly in the coming years. The strategy of attracting Ryanair (FR), Europe's largest low cost carrier, was in hindsight an excellent strategy. Although FR present their own challenges for airport managers in terms of negotiations and potential route volatility, they still offer a critical competitive advantage over airports like Stavanger and Bergen because they can in the right circumstances bring a lot of passenger volume. Adding Wizzair (W6) to the HAU network increases HAU's profile as a low cost hub.

The main challenge that exists, and has been referred to earlier in this report, is ensuring that FR and W6 continue to maintain a presence at HAU. One risk factor that exist in relation to the low cost airport concept for HAU is FR's evolving business model. FR is moving in a direction that takes them away from the fundamental low cost principles that they started out with. In particular when considering where they will grow their network in the future, there has been a recent shift towards main airports in cities like Barcelona, Rome, Brussels, Copenhagen, Berlin, etc. The big question therefore is what role, if any, regional airports will play for FR in their next growth phase that will take place over the next few years?

Our opinion, from a HAU perspective, is that the main airports strategy that FR are engaging in, is much more likely to impact cities that have both a main and a low cost airport. So for example in the case of Brussels main airport, Ryanair directly reduced capacity at the low cost Brussels Charleroi airport when they started services in the main airport. For an airport like HAU, although the prospect of becoming a major FR hub is unlikely, there will probably always be a place for certain FR destinations to be flown to / from HAU. The obvious examples are the leisure type routes to Spain for example for which there seems to be confirmed strong demand, albeit only in summer. We also believe that the prospect of FR entering either Stavanger or Bergen airports is rather unlikely. These airports do not fit the profile of a major airport for the purposes of FR's current strategy. Other factors that support this theory is that the airport charges are what FR would deem to be high cost and there is very little ability for FR to negotiate any meaningful discounts at those airports. Finally, there does not appear to be any strategic reason for Ryanair to enter either Stavanger or Bergen. Many of the decisions taken to enter main airports at places like Brussels, Rome, Copenhagen, were a direct response to a competitive situation that FR needed to counter to protect its own business or in the pursuit of improving its market share.

In relation to W6, the situation is a little more uncertain when it comes to development at Bergen and Stavanger airports. W6 started flying to Bergen in 2009 with just one route to Gdansk. They now

operate from 5 destinations in Eastern Europe, with some 12 departures weekly on Airbus A320 aircraft (circa 180 seats per plane). In relation to Stavanger, they entered this market in 2011 with just one route but now operate 4 routes with around 11 weekly departures. At HAU, W6 only entered the market in 2012 with one route. However, it has steadily increased its capacity on the Gdansk service, which is clearly a very positive sign. W6, unlike for example FR, have a tendency to be more stable with their route development decisions. Once they decide on a route and an airport, they are less likely to reduce capacity, cancel routes or pull out of airports. For this reason, and based on their steadily increasing activity at Stavanger and Bergen airports, we must assume that they will maintain a similar or perhaps increased level of activity at HAU over time. Therefore we believe that W6 will continue to be a provider of low cost services at HAU for the foreseeable future.

The prospects of other low cost carriers entering either the Bergen or Stavanger markets we believe is rather unlikely. However, this raises another question about the low cost market in Europe in general which will be addressed in the following section.

3.5 Analysis of European Low Cost Market

HAU has rather cleverly positioned itself as the low cost airport for the entire West coast of Norway. For the reasons outlined above, we don't believe that either Stavanger or Bergen will become threats to HAU's position, more on this below. However, the question that does arise about low cost airlines in Europe is whether or not the traditional model will exist at all in the future. If we look at this from a Scandinavian perspective and the carriers in that market, Norwegian airlines cannot really be considered a low cost carrier. They may be lower cost than some of their nearest competitors, for example SAS, but many of aspects of the business model are not low cost at all – and indeed as they embark on their long haul strategy, their operating costs have been increasing. Apart from FR and W6, there are really no other true low airlines in the Scandinavian market.

The main reason we must ask the question about the future existence of the low cost airline, is that the only two ultra-low cost operators in the market (FR & W6) are slowly changing their business models to become more like full service airlines. Allocated seating, flexi / business type tickets, flying to main airports are just a few innovations that both FR and W6 have been engaging in. At the very least, what we are likely to see in Europe in the coming years is a multitude of hybrid type models. The traditional low cost airline that FR started in Europe is unlikely to exist in its purest form in the future. On balance, there are probably no real implications for HAU as a result of this trend. As noted above, the likelihood for HAU is that both FR and W6 will continue to operate at HAU and while W6

may continue a modest level of development at either or both Bergen and Stavanger, we don't see this having any detrimental impact on their existing route to HAU. We would however note again at this point that the development and marketing of the existing FR and W6 routes at HAU is a very important part of the airport's future development.

The other key attribute that should be acknowledged in relation to HAU, is that there is very active local engagement in relation to airport development. For example, the company Haugasund Travel (known now as Go To) has been doing a lot of work engaging with airlines and generally promoting the airport and the destinations. The travel segment of that company has no doubt contributed to improved load factors and yield on routes from HAU as a result of tours and holiday packages being sold. This is something that can clearly be expanded due to FR's new policy of allowing tour operator bookings and being part of global distribution systems such as Amadeus and Sabre.

3.6 Stavanger & Bergen Airports – Low Cost Growth

For the reasons presented above, we don't believe that either Stavanger or Bergen has the potential to attract any other low cost carriers than for example W6. EasyJet (although again it is questionable whether they are actually a low cost carrier) attempted to operate a London from Bergen, but they ceased operating that during 2014. Furthermore, the Nordic and Scandinavian market is not really part of EasyJet's strategy, apart from their base in Copenhagen, they only operate one route from Geneva to Stockholm and they don't operate (anymore) to Finland at all. Therefore, the prospect of further easyJet services to either Bergen or Stavanger is highly unlikely.

The other factor to consider is that the airport charges and availability of marketing support is tightly regulated by the Avinor fees, charges and rules at Stavanger and Bergen. This gives a lot less flexibility when approaching, in particular, low cost airlines. Having assessed Wizzair, Ryanair and EasyJet as 3 of the biggest 'low cost' airlines in Europe – it is clear that none of them have the potential in the near term to develop any significant level of activity at Bergen or Stavanger. And there are not that many other European low cost carriers left to consider. Even if we classify Norwegian as a low cost airline, they are already heavily present, in particular at Bergen with some 160 departures per week on B737 aircraft. Their presence at Stavanger is around 100 weekly departures. This compares with their presence at HAU of circa 90 weekly departures. There is of course scope for Norwegian to increase their presence at both Bergen and Stavanger – but even so this would not really change the current situation and would not automatically mean that those airports are suddenly becoming low cost hubs.

These factors add a lot of evidence to the fact that HAU can and will continue to maintain its position as the low cost hub for this part of Norway. Excluding Norwegian, again assuming they even are a low cost carrier, the penetration of low cost traffic at both Bergen and Stavanger is very small. And it must be concluded that if they have not managed to attract more low cost carriers in the last 10 to 15 years (when the low cost boom was at its height) we don't really see that they will start to do so now. The final point, is that it is also questionable whether or not Avinor or Bergen or Stavanger are actively targeting low cost carrier growth for their airports; anecdotal evidence would suggest that they are not, lending yet more weight to the argument that these airports will not become any sort of centre or hub for low cost activity.

Section 4 – Review of Operating Costs and Revenues

4.1 Staffing Costs (General)

One thing that appears unusual from our perspective, at least in the context of what would be a separate (possibly private) management company, is that currently there are separate staff departments for each function. Functions like fire, security, technical, parking should be much more integrated. Many regional airports are using what could be termed as a ‘Smart Airport Concept’, this was referred to in the earlier sections of this report. The idea is that airport staff should act in multi-functional ways, so that security staff can help out with other functions when they are not required to man the scanning equipment. Likewise with fire fighters, administrative personnel and so on.

We estimate that of the 27 staff currently employed across the Airport Services Department, there would be scope for modest headcount reductions. Even setting a target of reducing the headcount by 3 employees would deliver savings of approximately 2.6m to 3.4m NOK annually. It is our opinion that even with increasing passenger numbers in the coming years, the Airport Services Department’s should still function perfectly well with less numbers of staff than the existing 27. This also means that adequate training would need to be provided to existing staff so that they can carry out other tasks.

It follows therefore that we don’t believe that the administration staff increasing by up to 4 employees from the period 2015 to 2020 is either necessary or sensible to consider. It would also appear from the current calculations that the security function is outsourced. It may be that this is the most cost efficient way of carrying out this service, however, many airports around Europe carry out this function themselves using their own employees. This allows much greater flexibility when, for example, trying to implement smarter working practices. The handling function is also outsourced at HAU, this will be dealt with in more detail below.

4.2 Case Studies

4.2.1 Ängelholm Airport, Sweden

Ängelholm airport in the south west of Sweden, is a privately owned airport, 100% owned by the PEAB construction group. It was formerly part of the Swedavia / LFV group. The airport processed approximately 400,000 passengers in 2014, so it is smaller than HAU in terms of passenger volume.

Why it is interesting to compare with HAU is that it keeps some of the main functions of the airport functions in-sourced, most notably, the handling and security functions are both carried out directly by airport staff. Both of these functions are currently outsourced at HAU. Ängelholm only has a total of 90 employees whereas, HAU has a total of 190, including the currently out-sourced handling and security functions. It is also important to highlight that Ängelholm is also a profitable airport at a net level. HAU does have some 40% more passengers per annum than Ängelholm. However, 40% more passengers per annum should not justify more than a 100% increase in headcount. As noted above, any proposed concessionaire at HAU needs to consider that the overall headcount would need to be reduced and to offer the best chance of making money.

4.2.2 Moss Airport, Rygge

We received some input from Pål Tandberg, CEO of Rygge Airport. As previously mentioned in this report, Rygge Airport are locked in a bitter dispute with Avinor over the cost of ATC, approach and over-flight services. Mr. Tandberg is of the opinion that there are such serious structural issues with the way in which the ATC and other air navigation services are provided by Avinor, that it is almost impossible for any independent airport in Norway to survive financially. Mr. Tandberg has offered to speak to any potential concessionaire in person about these issues and I would suggest that any group or company that is considering taking the concession at HAU, should contact IC Aviation and we will facilitate a meeting with Mr. Tandberg in the soonest possible timeframe. We have already addressed the issue of ATC services and the complexity and costs associated with this, but the recent experiences of Rygge Airport (and Sandefjord-Torp) in their dealings with Avinor, gives some us some serious concerns for any potential concessionaire at HAU to operate independently from the Avinor Group.

4.3 Handling Function

There is no financial information in the material we have received about the handling function at HAU. This is currently carried out by third party providers Aviator and SASG. However, there are infrastructure charges (which may also go by another name) that Avinor levies upon handling agents. The most recent financial data available for Avinor, shows that the company made 9.2m NOK from handling revenues in 2013. This should most certainly be included as a future revenue stream for the HAU budget.

Avinor is clearly charging these fees at the moment, so any proposed concessionaire should assume that they can also charge these types of fees to handling companies. It is not possible to determine, from publicly available data, what level of fee Avinor imposes upon the handling companies, but if you consider that they made some 9.2m NOK in 2013, with passenger numbers of some 50m per annum across all of their airports, you can make certain assumptions as to how much per passenger the charge works out to be. However, it is unlikely that this charge is applied as a per passenger fee and is more likely charged to the handling companies per aircraft turnaround. More information should be sought from Avinor as to the level of charge currently applied to handling companies at HAU before any concession agreement is signed.

Furthermore, some consideration should be given to the possibility of in-sourcing the handling function. Many smaller regional airports around Europe provide handling services. A full cost benefit analysis would need to be carried out to consider the potential value of doing this. It should be noted however that at the very least, maintaining the handling staff as employees of the airport (or the concessionaire) gives further opportunities to implement smarter working practices.

4.4 Budget Planning (Worst Case)

The budget that we have revived, shows steady increases in passenger numbers, averaging 4% for domestic and 8% for charter and international over the next 5 years. Another budget should be produced that demonstrates the impact of falling passenger numbers on the overall operating revenue. It should not be assumed that each category of passenger will definitely increase. The increasing passenger numbers have an obvious positive impact on aeronautical revenue, increasing it by some 30% from 2015 to 2020 based on the numbers we have reviewed.

The international traffic is most likely to be the biggest risk factor when it comes to potential decreases. This is due to the potential volatility of Ryanair, the main provider of international services at HAU. Indeed, from 2014 to 2015 Ryanair will suspend (or perhaps cancel entirely) 4 international routes. This will lead to a decrease of up to 23% of the international traffic at HAU. In absolute terms, the actual passenger volume impact to the airport will be small, a loss of some 40,000 to 50,000 passengers (less than a 10% decrease based on existing traffic volumes). However, the impact on the airport's revenue is more

pronounced. In 2015 this could lead to a decrease of some 51,000 NOK in aeronautical revenues. And a loss of Duty Free revenues of some 6.6m NOK.

Any financial forecast must therefore examine the possibilities of decreasing international passengers over the course of the next 5 to 10 years and examine the precise impact that this will have on the airports overall revenue performance. It is only then, that other ancillary revenue forms or cost savings can be considered as a means to offset any potential decreases in aero-nautical and Duty Free revenues.

4.5 Financial Review - Summary

There are examples of airports of a similar and even smaller size than HAU in Europe that are profitable. The financial forecasts and budget that we have reviewed demonstrate that HAU could have a positive EBIT of some 12.1m NOK by 2020, but this is almost entirely based upon strong passenger growth in the international and charter sectors. Ryanair has demonstrated from 2014 to 2015 that it has the potential to reduce international traffic therefore we would advise that an alternative 'worst case' budget should be prepared to consider the impact of reducing international passenger numbers.

Secondly, the employee headcount at HAU would appear to be surplus to requirements and that will continue to have a significant impact on the overall cost structure of the airport. Staff costs take up almost half of the total costs at HAU and this target should be reduced as a means to improve the financial performance of the airport and as a measure to offset potential declining revenues.

Full Report - Conclusions & Summary

Running, operating or maintaining any airport is a costly and complicated process. Between 50% – 60% of Europe's airports are loss making – coupled with the fact that many European airlines are also loss making, presents considerable challenges for the industry. There are, of course, many examples of regional airports in Europe that are not loss making and are developing very successful and profitable business models.

How and in what way, the airport of Haugesund is controlled and developed in the future, as an independent entity from Avinor, will determine much of its future success. There has already been many positive initiatives from local entities in the Haugesund area in terms of helping to establish new routes to the airport – and that’s part of the reason for Haugesund Airport’s existing carrier and route profile. The airport has also developed a niche market, becoming a regional low cost hub for this part of Norway - we don’t believe this will be challenged by other airports in the catchment area. However, route development is only one part of the equation for an airport. Managing and developing commercial revenues is also a critical aspect of running, in particular, a regional airport. Norway and Haugesund Airport enjoy the privilege of Duty Free sales, giving a massive boost to commercial revenue streams. There are also other activities that a potential concessionaire could engage in at Haugesund Airport, with relatively small investment that could boost commercial revenues considerably.

The future, therefore, we believe is very bright for Haugesund Airport. There are many reasons to suggest that this airport will continue to develop into a mid-sized regional hub, with potential to grow to some 1m passengers over a period of 5 - 10 years. For that reason, we would advise any potential third party that may assume control of the airport, has a reasonably good chance of developing Haugesund into a thriving regional airport. The much bigger question left for us after the conclusion of our analysis, is whether a concession is the right type of structure to have for a third party to manage and successfully develop a regional airport like Haugesund. There are many questions that need to be further assessed and analysed in relation to this issue. The main concern from our perspective, is whether or not a concession will allow enough independence for the concessionaire to manage and control the destiny of the airport. For example, if key functions of the airport are in the control of a grantor, does this allow for interference in the concessionaire’s objectives or if the grantor has the ability to arbitrarily make decisions that directly impact the development of the airport, how can that risk be negated in a concession agreement? And is it therefore more straightforward to have a third party owning and controlling all aspects of the airport function?