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# *Queenstown Lakes District Council*

Issue of Shares in Queenstown Airport Corporation  
Limited to Auckland International Airport Limited

Detailed Report on Fairness Opinion

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15 March 2011





Queenstown Lakes District Council  
Private Bag 50072  
QUEENSTOWN 9348

15 March 2011

Dear Councillors

**Fairness Opinion in Relation to the Issue of Shares in Queenstown Airport Corporation Limited (“QAC”) to Auckland International Airport Limited (“AIAL”)**

In accordance with our engagement letter, we have prepared a fairness opinion in relation to the potential issue of QAC shares to AIAL.

Please do not hesitate to contact us if you have any questions or require any further information.

Yours sincerely  
**PricewaterhouseCoopers**

A handwritten signature in black ink that reads 'Bruce Wattie'.

Bruce Wattie  
Partner

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## Glossary of Terms

AAH	Auckland Airport Holdings (No. 2) Limited
AIAL	Auckland International Airport Limited
CAGR	Compound annual growth rate
CIAL	Christchurch International Airport Limited
DCF	Discounted cash flow
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
EBITDAF	Earnings before interest, tax, depreciation, amortisation and fair value adjustments
IMs	Input methodologies
NPAT	Net profit before tax
Pax	Passengers
PPE	Property, plant and equipment
QAC or the Company	Queenstown Airport Corporation Limited
QLDC	Queenstown Lakes District Council
RAB	Regulatory asset base
RESA	Runway ends safety areas
The Act	The Airport Authorities Act 1966
The Regulations	The Airport Authorities (Airport Companies Information Disclosure) Regulations 1999
WACC	Weighted average cost of capital
Yoy	Year on year

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# 1 Introduction

## Background

Queenstown Airport Corporation Limited (“QAC” or “the Company”) was, until recently, a wholly owned subsidiary of the Queenstown Lakes District Council (“QLDC” or “the Council”) and is a Council Controlled Trading Organisation under Part 5 of the Local Government Act.

In July 2010, QAC entered into a Subscription Agreement with Auckland International Airport Limited (“AIAL”) in relation to a share transaction (“the Transaction”). The Transaction is structured into two tranches. The First Tranche was completed in July 2010 and involved QAC issuing approximately 4.0 million new shares to AIAL for a total consideration of a little over \$27 million. The share issue provided AIAL with ownership of 24.99% of QAC’s issued capital and as a consequence, the Council’s shareholding fell from 100% to 75.01%.

The Second Tranche is structured as an option that QAC can exercise before 30 June 2011 (“the Option”). If the Option is exercised, further shares in QAC will be issued to AIAL, subject to AIAL’s shareholding in QAC not exceeding 35% of the total issued capital. The Option is conditional on QLDC approval and QLDC and AIAL entering into a shareholders’ agreement.

The price for the 4.0 million new shares issued in July 2010 was \$6.91 per share. If the Option is exercised, the price to be paid by AIAL for the additional shares will be \$7.47 per share, plus a lump sum amount of \$2.2 million.

Before exercising the Option, QAC is to seek approval from its majority shareholder, QLDC, which will decide whether community consultation is required.

Court proceedings have been instigated by certain parties opposed to the arrangements between AIAL and QAC. The Council is the first defendant in these proceedings. To avoid the cost of an interim hearing, Council has provided an undertaking that it will not make a decision on the Second Tranche approval until the legal action is clarified. However, it is permitted to do all the things necessary to prepare itself to make a final decision, including consulting with the community.

## Purpose of this Report

The primary purpose of this report is to provide our opinion on whether the potential issue of the Second Tranche Shares in QAC to AIAL is fair to the Council.

The report has been prepared within the context of the legal undertaking referred to above that before the Council could consider the potential issue of further shares by QAC to AIAL, it would consult with the community about that proposal. Consequently, a secondary purpose of this report is to provide information to the Queenstown Lakes community about the overall transaction contemplated in the Subscription Agreement.

## The Concept of Fairness

Our assessment of the fairness of the issue of the Second Tranche Shares in QAC has involved consideration of two questions:

- Is the consideration that AIAL will pay for the Second Tranche Shares fair?

For the purposes of this report the consideration is considered to be fair if it is equal to or more than fair market value, where fair market value is defined as:

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*“the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm’s length.”*

This definition of “fair market value” is reasonably standard. It does not require further definition, other than to say that:

- It rules out assessing the value that a special purpose purchaser might be prepared to pay for the asset. A special purpose purchaser is characterised as having a special interest in an asset and by a willingness to pay a premium for the asset over and above the price that other buyers are prepared to pay.
- The value will not be influenced by the identity of the buyer and seller.
- The value will encompass synergies and other buyer benefits to the extent that they are common to more than one buyer.
- The value will be influenced by the highest and best alternative use for the asset.
- Is the consideration sufficient to compensate the Council for the elements of control of QAC it will forego, or it will likely forego, if it approves the Second Tranche?

## **Information**

We have had access to information provided by the Company and from public sources. We have relied on the information provided to us and have not undertaken anything in the nature of an audit. The major sources of information used to prepare this report are listed in Appendix B.

## **Declarations, Qualifications, Disclaimer and Restrictions**

This report should be read in conjunction with the statements and declarations set out in Appendix A regarding our independence, qualifications, disclaimer, restrictions on the use of this report, reliance on information and indemnity.

Our valuation constitutes an “independent business valuation” in the manner prescribed by the New Zealand Institute of Chartered Accountants (NZICA) Advisory Engagement Standard No. 2 (AES-2). Accordingly our engagement has been completed in accordance with the Professional Standards of the NZICA.

## **Currency and Financial Years**

All monetary amounts in this report are expressed in New Zealand dollars and are exclusive of Goods and Services Tax (“GST”), unless stated otherwise.

Generally, references to “year” should be taken as referring to years ending on 30 June. For example, references to the “2010 year” refer to the year ended 30 June 2010.

Certain numbers included in tables throughout this report have been rounded and therefore the tables might not add exactly.

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## Report Structure

The report is structured into the following Sections:

No	Description
2	Our conclusions on the fairness of the Second Tranche to the Council
3	An overview of the Company and its activities
4	A description of clauses in the Company's constitution that are important to our analysis
5	A description of the Option the Subscription Agreement and the Strategic Alliance
6	An outline of the regulatory framework for airport companies and comment on why this is important for valuing the Company
7	A description of the approaches used to value the Company's business units
8	The results of our valuation of 100% of the share capital of the Company. This value is before applying a minority discount relevant when considering the value for the Second Tranche
9	Analysis of the options available to the Council in terms of approving or not approving the Option being exercised and our conclusions.

## Completion of Field Work

We completed the detailed analysis and field work for this report in early February 2011.



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## 2 The Transaction and Opinion on the Fairness of the Purchase Price

### The Transaction

In July 2010 QAC and AIAL entered into a Subscription Agreement. Under this Agreement:

- QAC issued 4,013,485 shares to AIAL, giving AIAL ownership of 24.99% of QAC's share capital.
- QAC has an option to issue further shares, the Second Tranche Shares, to AIAL, to increase its shareholding up to 35% of QAC's share capital. The Subscription Agreement refers to the Second Tranche Shares being sufficient to increase AIAL's shareholding to between 30% and 35% of QAC's issued share capital.
- QAC must receive approval from QLDC before it can exercise the Option and issue the Second Tranche Shares.

If the Second Tranche Shares are issued:

- AIAL will pay between \$10.8 million (if its shareholding increases to 30%) and \$20.7 million (if its shareholding increases to 35%).
- QLDC's ownership of QAC's share capital will fall to between 65% and 70% from its current level of 75.01%.
- QLDC will likely receive a cash payment. QAC has signalled that it will require some of the cash AIAL will pay for the shares but a significant amount of the cash can be distributed to shareholders.

With its current shareholding of 75.01% of the issued capital, QLDC exercises significant control over the Company. It controls changes to the constitution, can pass ordinary resolutions without shareholder meetings and pass special resolutions.

If the Council's shareholding falls below 75%, to 70% or 65%, its level of control will be diminished but it will still control the composition of the Company's board of directors and control the passing of ordinary resolutions at meetings of shareholders.

At 24.99%, AIAL has a significant non-controlling interest but it has no rights under the Constitution to appoint a director to the board. Also, it has insufficient votes to pass ordinary resolutions or prevent the Council from passing special resolutions.

If AIAL's shareholding increases to 30% – 35%, it will be able to exercise a degree of negative control but will not, under the current constitution, have sufficient votes to appoint a director to the board. However, one of the conditions in the Subscription Agreement is QLDC and AIAL must enter into a shareholders' agreement before the Second Tranche Shares are issued. AIAL has signalled in the Subscription Agreement that it will want the shareholders' agreement to provide it with a right to be represented on the board of directors in proportion to its shareholding and be included in material discussions relating to governance of the Company, among other things.

### Our Terms of Reference

Our terms of reference required us to consider the fairness to the Council if the Option is exercised and the Second Tranche Shares are issued. This primarily involved considering whether the price

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that AIAL will pay for the Second Tranche Shares will be sufficient to compensate QLDC for the rights it will give up if it approves QAC exercising the Option.

## **Fairness Opinion**

Our assessment of the fairness of the issue of the Second Tranche Shares under the Option has involved consideration of two questions:

- *Is the consideration that AIAL will pay for the Second Tranche Shares “fair”?*
- *Is the consideration sufficient to compensate the Council for the elements of control it will forego, or will likely forego, if it approves the Second Tranche?*

## **Value of the Second Tranche Shares**

We have prepared a valuation of the Second Tranche Shares that QAC will issue to AIAL and compared this to the consideration AIAL will pay for the shares in accordance with the pricing formula set out in the Subscription Agreement.

Our assessment is that the pricing formula for the Second Tranche Shares will result in AIAL paying an amount in excess of what can be considered to be the fair market value for the Second Tranche Shares. It is likely that the price that AIAL will pay for 5%-10% of the Company’s share capital under the Second Tranche would only be paid by a strategic purchaser or achieved through the sale of 100% of the Company’s shares.

## **Value of Control**

The value of a 65% or 70% interest in the Company will be less on a per share basis than the value of a 75.01% interest. The decrease in value is a consequence of the reduction in the level of control that will result from crossing the “75% threshold”.

Our assessment is that the reduction in the value of the Council’s shareholding as a consequence of moving below 75% threshold will more than offset any value benefit that the Second Tranche will deliver to QLDC through the full price being paid by AIAL for the Second Tranche Shares. Consequently, in theoretical value terms, the per share value of the Council’s shareholding after the Second Tranche will be lower than the per share value before the Second Tranche.

This result is almost inevitable because of the size of the Council’s shareholding compared to AIAL’s shareholding. AIAL would have to pay a very large premium for the Second Tranche Shares to compensate the Council for the loss in value in moving below 75%.

## **Conclusion**

The following factors are important to our assessment of the fairness of the Second Tranche to the Council:

- If the Second Tranche Shares are issued, QLDC will lose its near full control of the Company, but it will still have a high degree of control. It will still control the majority of the board of directors and the passing of ordinary resolutions.
- AIAL is currently a minority shareholder with minimal rights. The issue of the Second Tranche Shares will, subject to the outcome of negotiations over the shareholders’ agreement, enhance AIAL’s ability to exercise influence over the Company.
- QLDC will be faced with a large minority shareholder. AIAL, as an airport company itself will bring skills that will be beneficial for QAC. However, its objectives may not always be

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aligned with those of the Council. Given the size of its shareholding, any dispute between the shareholders could be time consuming and resource intensive to resolve.

- If the Option is exercised, it is likely that the Council will receive a substantial cash payment. While the value impacts of the Second Tranche (i.e. change in the value of the Council's shares in the Company) are important to the assessment of fairness, the Council will only realise the value change if it sells some or all of its shares. This is probably unlikely in the foreseeable future. A cash distribution on the other hand, is of real, immediate tangible value to the Council.
- AIAL's shareholding is held through a subsidiary company. QLDC currently has no means of directly controlling the ownership of that subsidiary, although the pre-emptive rights provisions in the Company's constitution can be triggered in the event that there is a change in control of AAH.
- The Company could utilise some of the cash raised from exercising the Option to fund development of part of its land bank.
- The Strategic Alliance Agreement between QAC and AIAL remains in place regardless of whether or not the Option is exercised.
- AIAL will pay a very "full" price for the Second Tranche shares. Our assessment is that the price is above the fair market value for those Shares. It is unlikely that QAC and the Council could achieve a similar price for 5% to 10% of the Company's share capital other than perhaps from another strategic purchaser or sale of the entire company. However, the premium incorporated into the price will not provide full financial compensation to the Council for the reduction in the value of its entire shareholding as a consequence of its ownership of the Company reducing from 75.01% to 70% or 65%.

The Council might give the Company approval to exercise the Option if:

- It places a high "value" on the cash that it is likely to receive from the issue of the Second Tranche Shares. As AIAL is paying a very full price for the shares, the cash available to the Council will be higher than it might otherwise be; and /or
- It considers that:
  - Providing the Company with cash to develop its undeveloped land will add value to the Company and reduce its risk profile through decreasing its dependence on passenger volume related revenue; and
  - It is unlikely that the Council will be in a position to contribute equity to finance development if the Option is not exercised.

Another reason for approving the Option might be to further embed AIAL into the Company so as to optimise the benefits it can bring to QAC. However, the Strategic Alliance Agreement remains in force whether the Option is exercised or not. Also, we cannot speculate on whether AIAL's commitment will be enhanced or not by an increase in its shareholding.

On the other hand, if:

- The Council does not necessarily need the cash it is likely to receive from the issue of the Second Tranche Shares,
- The Council considers that the Company should consider other options for financing the development of its land bank, and

- 
- The Strategic Alliance Agreement as it stands will work effectively for both AIAL and QAC

then the case for approving the exercise of the Option is not compelling. The considerable premium incorporated into the price that AIAL will pay will be insufficient to compensate the Council for the loss of value it will suffer if its shareholding is reduced below 75%. So, in the absence of a need for cash and a strong strategic reason for allowing its shareholding and its extensive control of the Company to be reduced, the rationale for giving the Company approval to exercise the Option is not clear.

## 3 Background to Queenstown Airport

### Ownership

QAC is a New Zealand incorporated company. The current shareholding structure of QAC is set out in the following table:

**Table 1 QAC Current Shareholding Structure**

	Shares Held	%
Queenstown Lakes District Council	12,046,880	75.01%
Auckland Airport Holdings (No.2) Limited	4,013,485	24.99%
Total Shares on Issue	16,060,365	100.00%

Source: *New Zealand Companies Office*

Auckland Airport Holdings (No.2) Limited (“AAH”)<sup>1</sup> is wholly owned by Auckland International Airport Limited, which is listed on the NZX. The 4,013,485 shares were issued to AIAL, through AAH, on 8 July 2010.

### History

QAC was established in 1935 and started providing services for domestic flights in the 1950’s. Some significant milestones in QAC’s recent history include:

- In the winter of 1995 Air New Zealand launched a trans-Tasman service. The limited length of the runway at that time restricted the size of planes that could land. Return flights had to fly via Christchurch to pick up fuel.
- The runway was lengthened in 1995 and 1998. This allowed direct flights from Brisbane, Sydney and Melbourne.
- QAC redeveloped its aprons and terminal in 2006/07 at a total cost of \$31 million. Potential passenger throughput increased from 250 per hour to 600 per hour as a result.

### Activities

The Company operates the Queenstown airport. It provides a runway, related airfield assets, the terminal building and related assets (e.g. car parks). It generates revenue from charging airlines and international passenger fees for provision of the airfield and the parts of the terminal directly related to handling passengers’ arrival and departure activities.

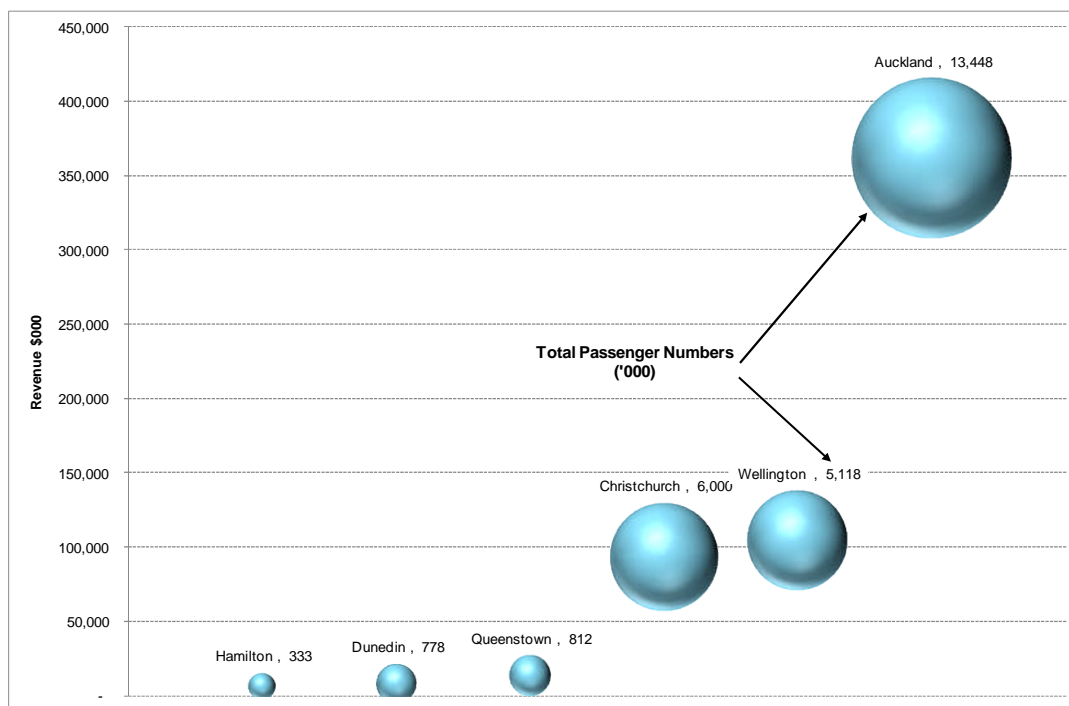
It also generates significant revenue from leasing or renting space in the terminal for retail operations, rental car companies etc. and land to airport users (for example air-tourism operators).

As owner of the airfield and terminal the Company is responsible for managing capacity to meet demand. Like most growing airports, a significant amount of cash generated from operating the airport is reinvested to expand capacity.

<sup>1</sup> Although AAH is the legal owner of the shares in QAC, we refer in this report to the shares being owned by AIAL.

The Company has experienced strong growth in passenger numbers in recent years, with growth in its international (trans-Tasman) business being particularly important. Although it is growing, the Company is still relatively small. This is demonstrated in the following figure, which compares QAC to other New Zealand airports in terms of revenue and passenger numbers (the airports are ordered along the X axis by revenue). The information on revenue and passenger numbers has been extracted from the airports' 2010 annual reports.

**Figure 1 Revenue and Passenger Numbers**



Source: Annual Reports

## Current Position

Key financial and operating metrics for 2006-2010 extracted from the Company's annual reports are presented in Table 2:

**Table 2 Key Metrics**

in 000s	2006	2007	2008	2009	2010	CAGR
Aeronautical revenue	4,872	5,309	5,877	5,854	7,108	9.9%
Non-aeronautical revenue	2,630	3,986	4,743	5,398	6,219	24.0%
<b>Total revenue</b>	<b>7,503</b>	<b>9,296</b>	<b>10,620</b>	<b>11,252</b>	<b>13,328</b>	<b>15.4%</b>
<b>EBITDAF</b>	<b>4,993</b>	<b>6,484</b>	<b>7,056</b>	<b>7,023</b>	<b>8,805</b>	<b>15.2%</b>
<i>EBITDAF margin %</i>	66.5%	69.7%	66.4%	62.4%	66.1%	
<b>Capital expenditure</b>	<b>17,126</b>	<b>14,470</b>	<b>4,053</b>	<b>4,086</b>	<b>11,322</b>	
Domestic passengers	584	599	638	609	704	4.8%
<i>Yoy % change</i>		2.6%	6.5%	-4.5%	15.6%	
International passengers	44	54	62	75	108	25.2%
<i>Yoy % change</i>		22.7%	14.8%	21.0%	44.0%	
Landings	4,083	4,086	4,189	4,149	4,377	1.8%
<i>Yoy % change</i>		0.1%	2.5%	-1.0%	5.5%	

Source: QAC Annual Reports

In 2010 QAC generated aeronautical revenue of \$7.1 million, \$6.0 million of which was from landing dues and \$1.1 million from departure taxes. This represented a 46% increase over 2006. 2010 non-aeronautical revenue was \$6.2 million, up from \$2.6 million in 2006, an increase of 137%. Overall, revenue increased 78% to \$13.3 million in 2010 from \$7.5 million in 2006.

The increase in revenue over the period reflects strong growth in the number of passengers and landings. International passengers increased from 44,000 in 2006 to 108,000 in 2010, an increase of 145%; domestic passengers rose to 704,000 from 584,000, up 21%. Landings increased by 7% to 4,377 in 2010, up from 4,083 in 2006.

Operating expenses rose to \$4.5 million in 2010 from \$2.5 million in 2006, reflecting growth in headcount and an increase in terminal operating expenditure subsequent to its redevelopment.

EBITDAF rose from \$5.0 million in 2006 to \$8.8 million in 2010, an increase of 76.3% (CAGR 15.2%). EBITDAF margins remained relatively stable over the period, falling slightly from 66.5% in 2006 to 66.1% in 2010.

Relative to other major New Zealand airports, the Company has recorded the strongest growth in both revenues and EBITDAF: QAC's revenue CAGR 2006-2010 was 15.4% compared to the next highest, Wellington, at 12.2% and an average (excluding QAC) of 6.1%. QAC's EBITDAF CAGR 2006-2010 was 15.2% relative to the next highest, also Wellington, at 9.7%.

The table below summarises the key revenue and EBITDAF growth metrics for QAC and its peers. In terms of EBITDAF margin, QAC (2010: 66.1%) ranks second only to Auckland (2010 76.0%). Auckland's position as the largest airport, New Zealand's primary international gateway and its diversified revenue base will partly explain its high EBITDAF margin.

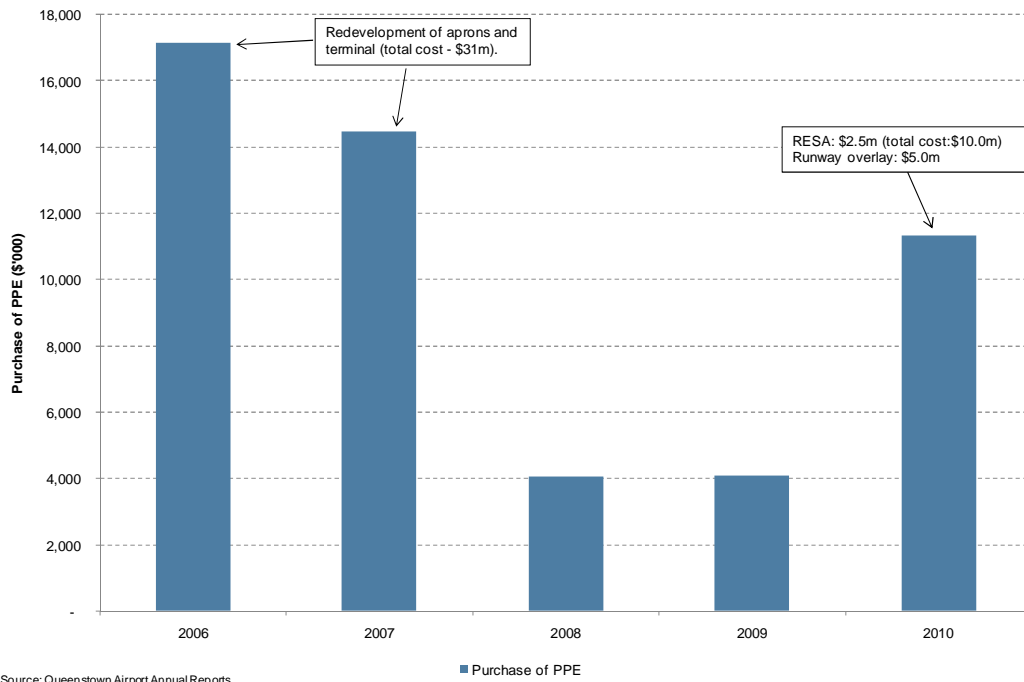
**Table 3 Revenue and EBITDAF Growth**

Airport NZD in 000s	Revenue 2006	Revenue 2010	CAGR 2006-10	EBITDAF 2006	EBITDAF 2010	EBITDAF % 2006	EBITDAF % 2010	EBITDAF CAGR 2006-10
Auckland	304,609	361,435	4.4%	238,956	274,633	78.4%	76.0%	3.5%
Hamilton	5,866	6,588	2.9%	2,969	1,649	50.6%	25.0%	-13.7%
Wellington	66,050	104,646	12.2%	47,052	68,228	71.2%	65.2%	9.7%
Christchurch	74,715	93,579	5.8%	42,914	60,773	57.4%	64.9%	9.1%
Dunedin	6,624	8,103	5.2%	3,894	3,774	58.8%	46.6%	-0.8%
<b>Queenstown</b>	<b>7,503</b>	<b>13,328</b>	<b>15.4%</b>	<b>4,993</b>	<b>8,805</b>	<b>66.5%</b>	<b>66.1%</b>	<b>15.2%</b>
<i>Average (excl QAC)</i>	<i>91,573</i>	<i>114,870</i>	<i>6.1%</i>	<i>67,157</i>	<i>81,811</i>	<i>63.3%</i>	<i>55.5%</i>	<i>1.6%</i>

Source: Annual Reports

QAC has expanded capacity in line with passenger volumes and landings. The following figure shows capital expenditure for 2006-2010. Significant items include redeveloping the runway aprons in 2006/7 and the completion of the new terminal facilities for a total of \$31m. Work also began on the RESA in 2010 (\$2.5m) and on the runway overlay (\$5.0 million).

**Figure 2 Capital Expenditure**



QAC is forecasting total capital expenditure of approximately \$25 million during 2011 to 2015. The principal components of this capital expenditure programme include:

- The construction of an additional three jet hardstands.
- The construction of a 'heavy taxiway'.
- Expenditure on the arrivals and departure lounges within the terminal.



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## 4 The Company's Constitution

There are four clauses in the Company's constitution that are particularly important to our review of the Transaction.

### Issue of Shares

Clause 2.1 governs the issue of shares by the Company's Board of Directors. In summary, under clause 2.1, the Board can:

- Issue shares "of any class at any time, to any person and in such numbers as the Board thinks fit" (clause 2.1.1).
- Issue shares that "rank as to voting or distribution rights or both, equally with or prior to existing shares without any requirement that the shares be first offered to existing Shareholders" (clause 2.1.2).

Under clause 2.2.1, the Board must decide the consideration for which the shares will be issued and the terms on which they will be issued.

### Special Resolutions

Under clause 12.2, the following matters can be approved by shareholders but only by a Special Resolution. A Special Resolution means a resolution approved by a majority of 75% of the votes of those shareholders entitled to vote and voting.

- Alteration to or revocation of the existing constitution or adoption of a new constitution.
- A major transaction, defined as:
  - An acquisition of assets with a value of more than half of the value of the Company's assets before the acquisition.
  - A disposal of assets with a value of more than half of the Company's assets before the disposal.
  - Acquiring rights or interests or incurring obligations or liabilities which are more than half the value of the Company's assets before the transaction.
- An amalgamation with one or more other companies.
- Liquidation of the Company.

### Written Resolutions

Under clause 13.3, a resolution in writing signed by not less than 75% of the Shareholders entitled to vote on that resolution is as valid as if it had been passed at a meeting of those shareholders.

## Appointment and Removal of Directors

Under clauses 15.3 and 15.4 Directors of the Company may be appointed or removed by:

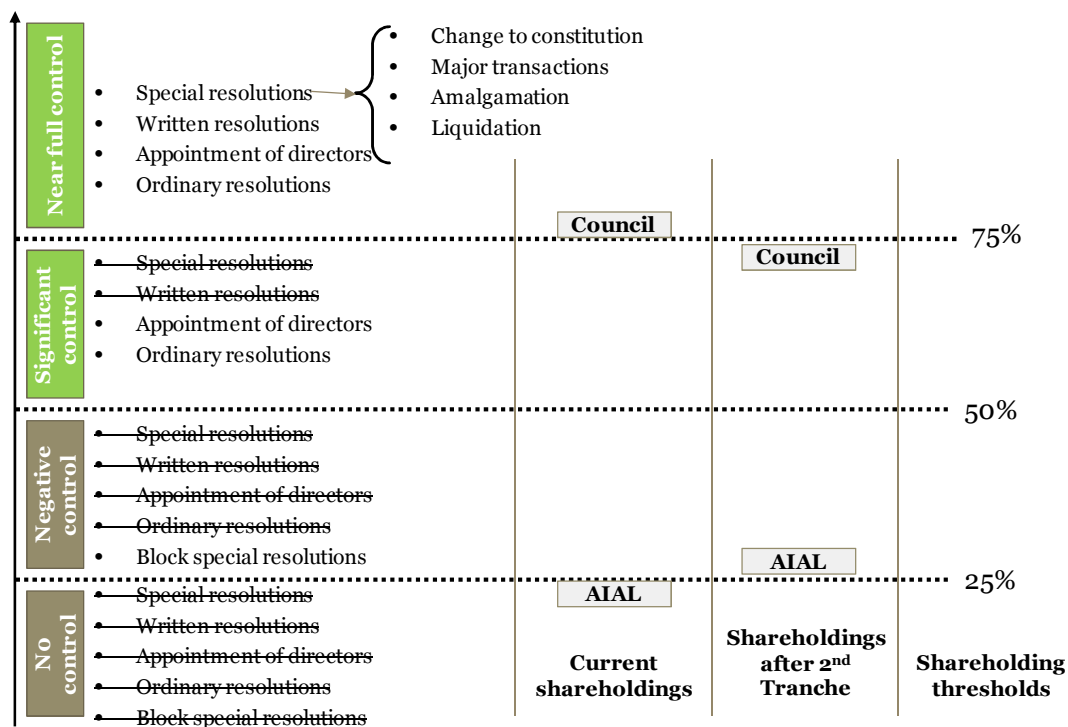
- A notice in writing signed by a majority (50%) of the Ordinary Shares.
- An ordinary resolution at a meeting of shareholders. An ordinary resolution can be approved by a simple majority (50%) of the votes entitled to vote and voting on the resolution.

### Comment

Clause 2.1, the issue of shares, was used by the Directors to issue shares to AIAL in the First Tranche.

The remainder of the clauses referred to above are relevant to our consideration of the Second Tranche because of the rights they confer on the Council given that it currently owns more than 75% of the Company's ordinary shares. At present, the Council has control of the constitution (clause 12.2), can pass resolutions without reference to AIAL (clause 13.3) and controls the composition of the Board (clauses 15.3 and 15.4). The shareholding thresholds are demonstrated in the following figure:

**Figure 3 Shareholding Thresholds**



If the Second Tranche occurs, the Council will still have considerable influence over the Company, It can still control the composition of the Board and ordinary resolutions at meetings of shareholders. However, it will not control the constitution or be able to pass special resolutions without the support of AIAL or be able to pass ordinary resolutions in writing without a shareholders' meeting.

## 5 The Transaction

### Introduction

The Transaction is comprised of two tranches. The first involved the issue of shares to AIAL in July 2010. The second, which is the subject of this report, involves the potential issue of additional shares to AIAL at the Company's option. The two tranches and associated matters are described in this Section.

### The First Tranche

The First Tranche involved the issue of the following shares to AAH:

**Table 4 The First Tranche**

Number of shares issued	4,013,485
Total consideration	\$27,733,181.35
Consideration per share	\$6.91
Form of consideration	Cash
Type of shares issued	Ordinary shares

*Source: Subscription Agreement*

The shares issued have the same rights, privileges, conditions and limitations and rank equally with the shares in existence at the date of the issue (which were all held by the Council).

The Company, AAH and AIAL entered into a subscription agreement to record the arrangements between them in relation to the issue of shares under the First Tranche. This agreement covers a wide range of matters, including:

- The price of the shares to be paid by AIAL under the First Tranche and other associated terms.
- The Second Tranche: the agreement establishes the option for the Company to issue a Second Tranche of shares to AIAL and the associated terms and conditions.
- Warranties: the Company provided certain warranties to AIAL.
- The granting by AIAL of a first right of refusal over any of its shares in the Company to the Company in the event that AIAL proposes to sell the shares. This is designed to ensure that AIAL does not sell its shares to a third party before offering them to existing shareholders (which it is bound to do in certain circumstances under the Constitution<sup>2</sup>) or the Company (which it is not required to do under the Constitution).
- Requiring the parties to sign the Strategic Alliance Agreement (discussed later in this Section).

The Subscription Agreement notes that the price for all First Tranche shares is at a “modest” discount to the value of the business agreed by the Parties for the purpose of setting the price to reflect that:

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<sup>2</sup> Clause 4 of the QAC Constitution

- The First Tranche Shares represent a minority stake in the Company.
- The Second Tranche will only occur with the approval of the Council.

## The Second Tranche

### Shares to be Issued

The Subscription Agreement provides the Company with an option to issue further ordinary shares to AIAL (“the Option”). This option may be exercised any time up to 30 June 2011 or “any other such date” as the parties may agree.

The number of shares to be issued needs to be sufficient to increase AIAL’s shareholding to between 30% and 35% of the Company’s issued share capital or “such other number as may be agreed between the parties”. Using the 30% to 35% range will result in the following shareholdings:

**Table 5 Second Tranche Shares**

	AIAL at 30% Shares		AIAL at 35% Shares	
Queenstown Lakes District Council	12,046,880	70%	12,046,880	65%
AIAL (AAH)	5,162,949	30%	6,486,782	35%
Total shares on issue	17,209,829	100%	18,533,662	100%
New shares issued to AIAL (AAH)	1,149,464		2,473,297	

*Source: Subscription Agreement*

### Terms

If QAC intends to exercise the Option, it must give AIAL 10 days notice and specify the date on which the shares will be issued to AIAL and AIAL must pay the consideration for the shares (the intention is for these two transactions to occur on the same day). This Second Tranche Completion Date can be up to 30 business days after the end of the Option period (i.e. it could occur in early to mid August 2011).

The issue of the Second Tranche shares by the Company and payment of the Consideration by AIAL are conditional on:

- The Council approving the issue of the Second Tranche Shares to AIAL on or before 30 June 2011. This condition gives the Council an effective right of veto over the Second Tranche, which is an important consideration given that the Second Tranche will reduce the Council’s shareholding below 75%.
- The Council entering into a shareholders’ agreement (although not stated, the agreement is presumed to be with AIAL).

These two conditions have different timing implications. Council approval must be provided on or before 30 June 2011, which is the Option expiry date. Development of the shareholders’ agreement does not have to be completed until the Second Tranche Completion date, which as noted above can be up to 30 business days after the Option is exercised.

The Subscription Agreement lists a number of matters that it is “intended that the Shareholders’ Agreement shall include”. These include AIAL having representation on the Company’s Board,

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protections for “minority shareholders”, inclusion of AIAL in material decisions on governance of the Company and “commercially appropriate dividend flows”.

Nothing in the Subscription Agreement compels the Council to approve the Second Tranche. It has a genuine choice to approve or not approve QAC exercising the Option.

The Pre-Completion Obligations in the Subscription Agreement impose requirements on the Company to ensure its business is operated in a manner to protect the integrity and value of its assets, limit the extent of any new obligations and any change to major contracts prior to completion or expiry of the Second Tranche.

These Pre-Completion Obligations are not onerous but they are obligations that a minority shareholder would not normally have a right to impose or enforce. They are included primarily because the price for the Second Tranche Shares has been set significantly in advance of when settlement for the shares will occur, if the Option is exercised.

AIAL also has access to the Company’s premises and records and other information “reasonably required concerning the business and affairs of Queenstown Airport to familiarise Auckland Airport with Queenstown Airport”.

These obligations and rights generally “expire” on completion or expiry of the Second Tranche Option (currently 30 June 2011).

### **Pricing**

The consideration for the Second Tranche shares is to be determined by the following formula:

$$STS \times (SP+P) + (FTS \times P)$$

Where:

STS = the number of Second Tranche Shares issued

SP = share price at which the first Tranche shares were issued (\$6.91)

P = premium per share (\$0.56)

FTS = First Tranche shares (4,013,485)

Under this formula the consideration to be paid for the Second Tranche shares will be comprised of two components:

- A price for the Second Tranche shares that incorporates a premium (\$0.56 per share) over the price paid for the First Tranche shares (\$6.91 per share). The sum of these two amounts produces a total price per share of \$7.47.
- An amount equal to the premium (\$0.56 per share) applied to the number of First Tranche shares issued (approximately \$2.2 million).

The parties agreed a price of \$7.47 per share for 100% of the issued shares as a starting point for agreeing the prices for the two tranches. The First Tranche shares were issued at \$0.56 per share less than \$7.47 to recognise the minority position being acquired. The Second Tranche will be issued at \$7.47 per share plus a fixed amount of \$2,247,552 representing the total discount on the First Tranche Shares.

This structure means that if the second Tranche option is exercised, the Company recoups the discount on the First Tranche shares and, in effect, all shares are issued to AIAL at the full value price of \$7.47. This is illustrated by the following example calculation of the consideration to be paid if the Second Tranche is exercised at 30% and 35%:

**Table 6 Second Tranche Consideration**

		AIAL at 30%	AIAL at 35%
Second Tranche Shares to be issued	<i>a</i>	1,149,464	2,473,297
First component of issue price <sup>3</sup>	<i>b</i>	\$7.47	\$7.47
First component of the Consideration	<i>c=a*b</i>	\$8,586,493	\$18,475,525
First Tranche Shares Issued	<i>d</i>	4,013,485	4,013,485
Premium per share	<i>e</i>	\$0.56	\$0.56
Second component of the Consideration	<i>f=d*e</i>	\$2,247,552	\$2,247,552
Total Second Tranche Consideration	<i>g=c+f</i>	\$10,834,044	\$20,723,077
Effective price per Second Tranche Share	<i>h=g÷a</i>	\$9.43	\$8.38
AAH Total Shareholding	<i>i=a+d</i>	5,162,949	6,486,782
Total consideration paid:			
First Tranche	<i>j</i>	\$27,733,181	\$27,733,181
Second Tranche	<i>g</i>	\$10,834,044	\$20,723,077
Total	<i>k=j+g</i>	\$38,567,226	\$48,456,258
Total consideration per share (AAH total shareholding)	<i>l=k÷i</i>	\$7.47	\$7.47

Source: Subscription Agreement

The Subscription Agreement provides for the possibility of the Share Price (\$6.91) being adjusted for the purpose of calculating the Second Tranche. The factors giving rise to an adjustment are a decrease in the value of the Company or if the Company makes a dividend payment or otherwise alters its capital structure. In practice, these adjustments, if they were to occur, will result in a reduction in the consideration for the Second Tranche shares. There is no allowance for the share price to increase in the event of the value of the Company increasing.

### Alternative Option

The Subscription Agreement provides the Parties with the option to increase AIAL's shareholding up to 35%, other than in accordance with the Option. That is, other than by the way of QAC issuing new shares to AIAL for cash.

If the Council approves the Option, then an alternative structure, which would fit under the alternative option clause, could be for AIAL to acquire shares from the Council directly, as opposed to QAC issuing shares to AIAL. This would enable QLDC to receive a cash payment from the Transaction directly and reduce or remove the need for QAC to pay a dividend (and so preserve QAC's imputation credits).

<sup>3</sup> \$6.91 plus \$0.56

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The benefit of the alternative structure clause is that it will allow the three parties, QLDC, QAC and AIAL, to agree on the most efficient means, from a business and financial perspective, of achieving the increase in AIAL's shareholding.

## **Strategic Alliance Agreement**

The Strategic Alliance Agreement was entered into at the time of the issue of the First Tranche Shares and was included as a Schedule to the Subscription Agreement. The Strategic Alliance Agreement records the intention of the parties to leverage the scale and connectivity that results from their relationship to grow travel, trade and tourism activities at all airports "wholly or partially owned or controlled by both parties". The objective is to deliver superior economic growth to their communities and earnings growth to the parties.

The Strategic Alliance Agreement sets out the basis on which the parties will collaborate and work together to achieve their growth objectives. In practical terms, probably the most significant element entails the parties working together to grow passenger volumes through attracting and retaining new airlines and services. This is founded on the parties' view that airports do not have to be passive providers of airfield and terminal services to which airlines choose to direct their services. There are opportunities to proactively market route opportunities to airlines to attract them to the airports. Having a network of airports located in prime destinations enhances the "offering" to airlines.

The Strategic Alliance Agreement also sets out the basis upon which AIAL's industry expertise in the operation of all aspects of an airport business will be made available to QAC.

To give effect to the parties' aspirations, the Strategic Alliance Agreement includes:

- Specific targets for increased activity and enhanced financial performance by the Company ("Stretch Outcomes").
- A general requirement for both parties to apply their general business acumen and specialist knowledge and skills to achieve the purpose of the Strategic Alliance Agreement and the specific targets, keep each other informed and generally act in good faith.
- Specific contributions to be provided by each party. These contributions are reasonably lengthy, but, in summary, they require AIAL to share knowledge and initiatives and apply its skills and expertise to assist QAC in specific areas to grow its activity levels and financial performance. QAC's obligations can be broadly put into three categories:
  - Work collaboratively with AIAL to achieve the outcomes desired from the Strategic Alliance Agreement
  - Share and provide information
  - Support AIAL in its position as a minority shareholder and in its relationship with QLDC.

The term of the Strategic Alliance Agreement is for five years from the First Tranche Completion Date (which was 8 July 2010). It is then automatically renewed for consecutive two year periods unless either party gives notice of its intention not to renew. Importantly, the duration of the Strategic Alliance Agreement is not contingent or conditional on the Second Tranche occurring.

There are terms to deal with a situation where the Stretch Outcomes are not achieved. These are in the form of a dispute resolution process and do not contain any financial penalty.

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## 6 Regulatory Environment

Airport companies are subject to regulatory considerations. For the purpose of this report we are primarily concerned with economic regulation, and its impact on how the Company prices its services and on the value attributable to its assets and business.

Airports have certain assets that have natural monopoly characteristics. Duplication of, and direct competition between these natural monopoly assets is unlikely (and would be inefficient). Consequently, there is a risk that airports could set prices for services provided by their natural monopoly assets at levels above those that would prevail in a workably competitive market.

Although the legislation and regulations governing airports do not specifically define airports' natural monopoly assets, the elements of economic regulation in place are focussed on "identified airport activities". These are defined as:

- a) Airfield activities, including the provision of any one or more of the following:
  - i. Airfields, runways, taxiways and parking aprons for aircraft
  - ii. Facilities and services for air traffic and parking apron control
  - iii. Airfield and associated lighting
  - iv. Services to maintain and repair airfields, runways, taxiways and parking aprons for aircraft
  - v. Rescue, fire, safety and environmental hazard control services
  - vi. Airfield supervisory and security services:

Assets (including land) held to provide airfield activities in the future are also captured by this definition.

- b) Aircraft and freight activities. This includes activities such as the provision of hangars, refuelling facilities, freight storage etc.
- c) Specified passenger terminal activities. This includes the provision, within a security area of any one or more of the following:
  - i. Passenger seating areas, thoroughfares and air bridges
  - ii. Flight information and public address systems
  - iii. Customs, immigration and quarantine facilities and services
  - iv. Duty-free collection
  - v. Facilities for security and Police services:

The definition also includes activities to enable passenger check-in and baggage handling but explicitly excludes the provision of space for retail activities.

The Company undertakes airfield activities and specified terminal activities but not aircraft and freight activities.



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Under the Airport Authorities Act 1966 (“the Act”), the Company, and all airport companies, must annually disclose certain information as specified in the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 (“the Regulations”). The Act and the Regulations distinguish between specified airport companies (with revenue in excess of \$10 million) and other airport companies. Specified airport companies have to make a greater level of disclosure than non-specified airport companies. The Company is a specified airport company for the purpose of the information disclosure regime.

The disclosures that the Company has to make include financial statements for its identified airport activities. These statements and accompanying notes are a subset of the Company’s full financial statements.

While airport companies are subject to a disclosure regime, they are not (yet) subject to price control. Section 4A(1) of the Act states that:

*Subject to section 4B, every airport company may.... set such charges as it from time to time thinks fit for the use of the airport operated or managed by it, or the services or facilities associated therewith.*

Section 4B requires airport companies to consult with “substantial customers” before setting charges.

The Commerce Commission has recently been undertaking a process to define Input Methodologies (“IMs”) for disclosures to be made by Auckland, Wellington and Christchurch international airport companies pursuant to the Commerce Act (Specified Airport Services Information Disclosure) Determination 2010 (“the ID”). These three airport companies are regulated by the Commerce Commission under Subpart 11 of Part 4 of the Commerce Act 1986. Other airport companies are not subject to these regulations.

While the Company is not subject to the ID, we consider that the concepts that underpin the reasons for and the direction taken within the ID have an important bearing on the approach to valuing the Company’s identified airport activities.

The Commission’s Input Methodologies (Airport Services) Reasons Paper December 2010 contains a lengthy discussion on the basis and rationale for regulation of Auckland, Wellington and Christchurch airports. Of particular relevance to the valuation of QAC is the statement that:

*For most businesses, the value of an asset depends on its expected profitability, which—in a workably competitive market—is constrained by competition. In regulated markets, however, there is little or no competition and little or no likelihood of a substantial increase in competition. Airlines can be expected to have some degree of countervailing market power but the potential profitability of an Airport would nonetheless provide an inappropriate reference point for assessing returns, since it could be based on (and thus lead to) future monopoly pricing.*

*Regulatory asset values must instead be based on alternative approaches to valuation. Rather than reflecting the profits that an Airport expects to earn, the valuation of assets will help determine an appropriate baseline against which profitability can be assessed...**In other words, in a regulatory context, the usual link between asset values and profitability (and therefore prices as well) is reversed.***<sup>4</sup>

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<sup>4</sup> Commerce Commission, *Input Methodologies (Airport Services) Reasons Paper*, December 2010, P61.

The fundamental principle underpinning this statement is that prices for services being delivered from monopoly assets that produce returns for the owners of those assets above a “normal” cost of capital are not economically efficient. To promote efficient outcomes, prices should be no more (or no less) than is needed to provide a rate of return on and a return of “efficiently” invested capital. From a regulatory perspective the “value” of efficiently invested capital will drive prices, not the other way around.

This implies that invested capital must be derived independent of prices and therefore revenue and cash flow. The IM provides guidance on how the relevant airfield and terminal assets, being the primary components of invested capital, should be valued. These values are related to revenue (and therefore prices) as follows:

Regulatory Asset Base (being relevant airfield and terminal assets valued consistent with the IMs)

$$\begin{aligned}
 & \text{Times} \\
 & \text{Cost of Capital} \\
 & \text{Plus} \\
 & \text{Depreciation + Operating Expenditure + Tax} \\
 & \text{Minus} \\
 & \text{Revaluations + Other income} \\
 & \text{Equals} \\
 & \text{Revenue}
 \end{aligned}$$

By definition, if the cash flows that the company generates over time using this formula are discounted to a present value using the cost of capital, this should produce a value equivalent to the Regulatory Asset Base (“RAB”).

The valuation approach specified in the IMs can be summarised as:

**Table 7 Asset Valuation IMs**

Asset	Valuation Approach
Initial value of non-land assets	Values as on the last day of the disclosure year 2009, and as disclosed in the 2009 disclosure financial statements
Roll forward of initial value of non-land assets	CPI-indexation
Initial RAB values of land assets	Values on the last day of the disclosure year 2009, using the market value alternative use (“MVAU”) approach
Roll forward of initial RAB values of land assets	Can revalue airport land in the RAB using the MVAU valuation approach in any disclosure year

Conceptually, the implications of this regulatory framework for valuing an airport is that the “commercial value” of identified airport activities should be no more than the values derived from application of the IMs approach in Table 7. A value above this amount would imply that the owner expects to be able to charge prices above those implied by the regulatory approach.

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An important caveat to this statement is that no airports are currently subject to price control. As indicated earlier, the Act does not constrain airports in setting their prices. Similarly, the ID does not of itself regulate prices.

This is a particularly important issue. However, while airports can currently set prices:

- They are subject to the consultation requirements in the Act and the counter-veiling power of airlines, their customers.
- The Commission has clearly stated its position on pricing and what constitutes monopoly rent seeking behaviour. The approach that the Commission has used in the IMs and ID is consistent with the approach being used to determine Transpower's annual revenue, for example.

In our view, it would be imprudent to assume that an airport could consistently price services at a level that delivers rates of return on capital invested in specified airport activities assets valued in accordance with the ID in excess of the regulatory WACC. This implies that the fair market value for specified airport activities assets should approximate their RAB value, rather than a multiple (in excess of 1 times) of the RAB value.

We consider that this logic should apply to the Company's specified airport activities assets notwithstanding that it is not subject to the ID and not subject to any form of direct price control. While the Company is considerably smaller than Auckland, Wellington and Christchurch this doesn't mean that it should escape regulatory attention if it can be shown to be pricing on a basis that delivers monopoly rents to its owners.

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## 7 Valuation Approach

We have prepared a valuation of the Company to assist us determine whether the consideration that AIAL will pay for the Second Tranche Shares is fair. Confirming the valuation approach is the first step in the valuation process.

### **Business Units**

The value of shares in the Company is a function of the value of its business and assets (“enterprise value”) and the value of debt at the valuation date. The value of equity is estimated as the enterprise value less the value of debt.

The enterprise value of any business is the sum of the value of the individual parts of the business. We have identified three parts or business units that need to be valued separately to derive a value for the Company:

- The identified airport activities (refer to Section 6).
- Land held for development.
- Commercial activities.

### **Identified Airport Activities**

We have discussed in Section 6 the approach to valuing the identified airport activities. The steps to implement this approach are presented in Section 8.

### **Land Held for Future Development**

The Company has a significant amount of land outside the “boundary” of the land required for identified airport activities. Some of this land is subject to leases and generates income for the Company and some is vacant.

The Company has a theoretical option to sell land not needed for identified airport activities. However, in reality this is unlikely to be exercised for a range of reasons, including:

- Some of the land is integral to the delivery of comprehensive services to passengers and other users.
- The Company is able to generate income from utilising the land to provide services to airport users or leasing the land to third parties.
- An important issue for any airport is protection of its boundaries to ensure that it can conduct its business without conflicting uses encroaching on its operational flexibility.

With this in mind, we have sought to segregate land currently being used to generate commercial revenue from land being held for future development.

The value of the land held for future development has been assessed by reference to the value included in the asset valuation prepared for the Company as at 30 June 2010 and incorporated into its audited financial statements and disclosure accounts. This is a highest and best alternative use value.

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## Commercial Activities

The commercial activities primarily comprise renting or leasing space or buildings, car park operations and concessions. Appendix F contains a summary of the typical valuation approaches that are used to value commercial, trading businesses.

Commercial revenue, other than car park revenue is primarily in the form of rentals or lease payments. Some rentals for retail operations operating within the terminal are related to the lessee's (or concessionaire's) turnover.

The nature of the commercial business is such that it has characteristics similar to a commercial and retail property investment business, with the success of the business driven by passenger throughput.

We have used the discounted cash flow (DCF) methodology as the primary valuation approach for the commercial business. In selecting this approach we have taken into account that the Company's forecasts indicate that its earnings will grow over the medium term but there will be some cash flow volatility as a consequence of planned capacity expansion to accommodate volume growth. Commercial revenue and cash flow will follow a similar trend to the identified airport activities as it has a relationship with volume and capacity.

DCF allows the cash flow variability to be incorporated into the valuation. Capitalisation of earnings could be used, although it is not as transparent as, and less robust than DCF in dealing with cash flow variability.

## Cross Checks

We have cross checked the commercial business and total QAC valuation by comparing the earnings multiples implied by the values for the commercial business and the total business to market based evidence of comparable multiples.

## Summary of Valuation Approaches

The valuation approaches are summarised in the following table:

**Table 8 Valuation Approaches**

<b>Business Unit</b>	<b>Primary Valuation Approach</b>
Identified airport activities	Regulatory asset value
Land held for redevelopment	Highest and best alternative use
Commercial business	Discounted cash flow

## 8 Valuation of 100% of Queenstown Airport

### Introduction

In this Section we present our valuation of 100% of the share capital of the Company. The value for 100% of the share capital does not take into account the discount that might apply to the Second Tranche Shares given that they represent a small minority interest in the Company. The discount is discussed in the next section.

The enterprise valuations of the business units are presented first in this Section. These are then combined to produce the total business valuation. The Section includes the cross-checks used to test the reasonableness of the valuations produced by application of the primary valuation methodologies. Our conclusion on the value for 100% of the Company's share capital is presented at the end of the Section.

The values in this Section are in most cases presented as ranges. This is consistent with common practice and reflects that valuation is not an exact science and that there have been a number of judgements made in arriving at the valuation results.

The values do not take into account the impact on the Company if the Second Tranche Shares are issued. The immediate impact will be an increase in the Company's cash (i.e. a decrease in its net debt) with a consequential increase in the value of equity. Also, there has been no explicit adjustment to the forecasts underpinning the valuation to recognise the benefits that are expected to result from the strategic alliance with AIAL. This will impact on the commercial business.

### Valuation Date

The Option must be exercised on or before 30 June 2011. Our valuation has been carried out, effectively, as at 30 June 2011. In calculating the discount rate for the DCF valuation we have used risk free rates effective as at 26 January 2011.

### Identified Airport Activities

The identified airport activities have been valued in accordance with the principles outlined in Section 6. Applying these principles has involved the following steps:

**Table 9 Valuation Steps for Identified Airport Activities**

Step	Source for Data
The valuation of the identified airport activities as at 30 June 2009 is used as the starting point	2009 regulatory disclosure accounts
Adding "allowable" revaluations, being:	
• CPI for non-land assets	Calculated using CPI data from Statistics NZ
• MVAU movements for land assets	2010 regulatory disclosure accounts
Adding actual capital expenditure for 2010 and forecast capital expenditure for 2011	2010 regulatory disclosure accounts and QAC forecast pricing model
Deducting actual depreciation for 2010 and forecast depreciation for 2011.	2010 regulatory disclosure accounts and QAC forecast pricing model

The calculation of the values in accordance with this approach is presented in the following table:

**Table 10 Identified Airport Activities Value**

	<b>\$M</b>
Net book value at 30 June 2009	50.71
Depreciation	(2.38)
Additions	10.62
Revaluations	0.69
Value at 30 June 2010	59.64
Depreciation	(2.14)
Additions	7.65
Revaluations	0.87
Value at 30 June 2011	66.02

The revaluation has been calculated as 2% of the opening net book value in 2010 and 2011. This results in a lower revaluation in 2010 than actually recorded by the Company in its 2010 financial statements.

We have tested the value presented in Table 10 by reference to the cash flows the Company is forecasting to generate in 2012 and after a pricing review which will take effect from the 2013 financial year. The present value of these cash flows is marginally higher than the value in Table 10. The difference is in part due to the difference between the revaluation included in Table 10 and the revaluation or the identified airport assets included by the Company in its 2010 financial statements.

One matter to note is the treatment of the revaluations. One of the central principles underpinning the approach to pricing services in markets with minimal competition implicit in the Commission's approach to regulation is that service providers cannot create value by simply revaluing assets and raising prices to maintain returns on the higher (revalued) asset base. Revaluations should be treated as income in the year recorded and so contribute to the asset owner's required rate of return.

The implications of this for the value of the identified airport activities is that the revaluations of \$0.7 million in 2010 and \$0.9 million in 2011 should be factored into pricing calculations to justify the projected revalued asset base of \$66 million at 30 June 2011. If the revaluations are not incorporated into the price calculations then their inclusion in the valuation is difficult to support.

## **Future Development Land**

The Company is currently holding approximately 43.6 hectares of land held for future development. The Company had all its land assets valued at 30 June 2010. As noted in Section 7, this valuation unpinned the revaluation of assets included in the Company's 2010 audited financial statements and its 2010 audited disclosure accounts.

The approach to valuing land in the 2010 asset valuation was on a market value – highest and best use basis. This is a market-based approach that uses transactions for comparable parcels of land, taking into account specific zoning, size and physical characteristics of the land being valued.

The value of the land held for future development was \$30 million at 30 June 2010. We have considered movements in land value indices since 30 June 2010 and concluded that a value of \$30 million remains appropriate.

We acknowledge that there is a potential range of values for this land. We have tested the sensitivity of the total Company valuation to changes in the land value estimate. This is discussed later in this Section.

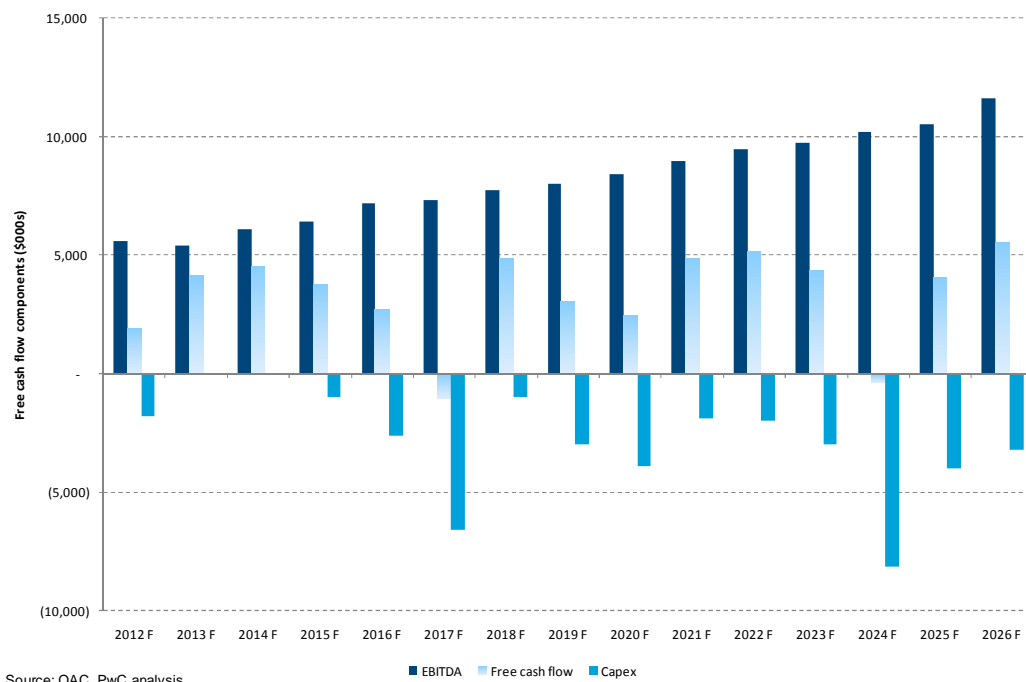
## Commercial Activities

We have estimated the value of the Company’s commercial activities using discounted cash flow as the primary valuation approach. This has been cross checked by reviewing the earnings multiples implied by the DCF calculation.

### Cash Flow Forecasts

The cash flow forecasts used in the base case DCF calculation are summarised below. These are commented on in more detail in Appendix E.

**Figure 4 Commercial Business Unit Free Cash Flows**



### Discount Rate

The present value of the forecast net operating cash flows has been calculated using our assessment of an appropriate weighted average cost of capital as the discount rate. The WACC is an amalgamation of the rates of return required by providers of both debt and equity capital, weighted by their respective contributions to the total capital structure.

A more detailed discussion on the WACC calculation is included in Appendix J.



We have estimated the WACC using the following inputs:

**Table 11 WACC Inputs**

WACC Input	Source	Input
Risk Free Rate	One year government bond yields expected in each of the years of the forecast period.	3.9% – 5.9%
Post Tax Market Risk Premium	PwC research on the New Zealand equities market	7.5%
Asset Beta ( $\beta$ )	Review of asset betas of comparable companies.	0.6 – 0.8
Gearing Ratio	Review of comparable companies.	30%
Cost of Debt	Margin over Risk-Free Rate	2.0%
Average Investor Tax Rate	PWC research, based on analysis of the typical tax profile of domestic and overseas investors.	28%

Source: PwC analysis

We have utilised a modified formulation of the classical capital asset pricing model (CAPM) to take account of New Zealand's dividend imputation regime and the fact that some investors (such as institutions) are taxed on capital gains.

The asset beta is the primary measure of relative risk in the WACC calculation. We have derived the beta by reference to the available evidence of betas for airports and for property and retail companies. The latter two industry sectors have been included in our analysis to reflect part of the underlying nature of the commercial business.

The inputs set out in Table 11 produce a WACC range of 7.8% to 9.2% for an asset beta of 0.6 and 9.3% to 10.7% for an asset beta of 0.8<sup>5</sup>.

### Valuation Calculation

The valuation of the commercial activities is summarised in the following table. The low and high values reflect the WACC range.

**Table 12 Commercial Business Value Calculation**

	Low \$m	High \$m
Present value of cash flows during the forecast period	25.5	27.8
Terminal value	16.7	24.6
Total enterprise value	42.2	52.3

### Cross Check

The following table summarises the EBITF and EBITDAF multiples derived from the DCF value and the earnings of the commercial activities for the 2010, 2011 and 2012 financial years.

<sup>5</sup> Further discussion on the discount rate is contained in Appendix J.

**Table 13 Commercial Business Value Cross Checks**

	<b>2010 Actual</b>	<b>2011 Forecast</b>	<b>2012 Forecast</b>
EBITF	4.44	4.23	4.91
Implied EBITF multiple	9.5x – 11.8x	10.0x – 12.4x	8.6x – 10.7x
EBITDAF	4.57	4.85	5.57
Implied EBITDAF multiple	9.2x – 11.5x	8.7x – 10.8x	7.6x – 9.4x

The ranges for the multiples are a function of the value range in Table 12.

We have considered the multiple ranges in the context of multiples for New Zealand companies listed on the NZX and to the multiples for listed airport companies (see Figure 5 and Figure 6 later in this Section). In our view the multiples derived from the high end of the value range are aggressive. The multiples should reflect the possibility of ongoing growth in passenger numbers passing through the airport but we do not consider that the growth potential can justify the upper end of the multiple range.

### **Total Company Base Case Value**

Combining the business unit values produces the following base case total value for 100% of the Company's equity:

**Table 14 Value Summary**

	<b>Low \$m</b>	<b>High \$m</b>
Identified airport activities	64.5	66.0
Land held for future development	30.0	30.0
Commercial activities	42.2	52.3
Enterprise value	136.7	148.3
Net debt	(9.0)	(9.0)
Equity value	127.7	139.3
Value per share	\$7.95	\$8.67

Net debt has been estimated based on the latest outlook for the Company's balance sheet as at 30 June 2011.

### **Sensitivities**

We have tested the sensitivity of the valuation to the following changes in key assumptions:

- A change in forecast passenger growth. This is focussed on lower passenger growth.
- A change in the value of the undeveloped land of plus/minus 5%. The undeveloped land value could be volatile and is subject to a degree of uncertainty.

Our assessment of these sensitivities is that they do not have a material impact on the valuation conclusion.

### Cross Check

We have compared the EBITDAF multiples implicit in the base case valuation to multiples of listed companies. Two groups of listed companies have been used:

- Listed airport companies. A description of the companies is included in Appendix G and the multiples are presented in Appendix H. The listed airport companies are located in a wide range of countries.
- Sixty four companies listed on the NZX. These have been used to provide an indication of the range of share trading multiples in a New Zealand context. This is an important point of reference given that that almost all of the airport companies in our sample in Appendix G are offshore companies.

The EBITDAF multiples for the airports and the New Zealand listed companies are calculated from prices set by trades in small parcels of shares that do not confer any element of control on the purchaser. They do not include any explicit premium that might be appropriate for valuing a 100% interest in QAC. We have adjusted the multiples for a control premium.

As with any benchmarking exercise, finding a sufficiently deep sample of directly comparable companies is challenging. Caution must be exercised when drawing conclusions from international companies as they will be subject to different regulatory regimes and will have trading and business mix differences etc. Also, all of the airport companies are significantly larger than QAC.

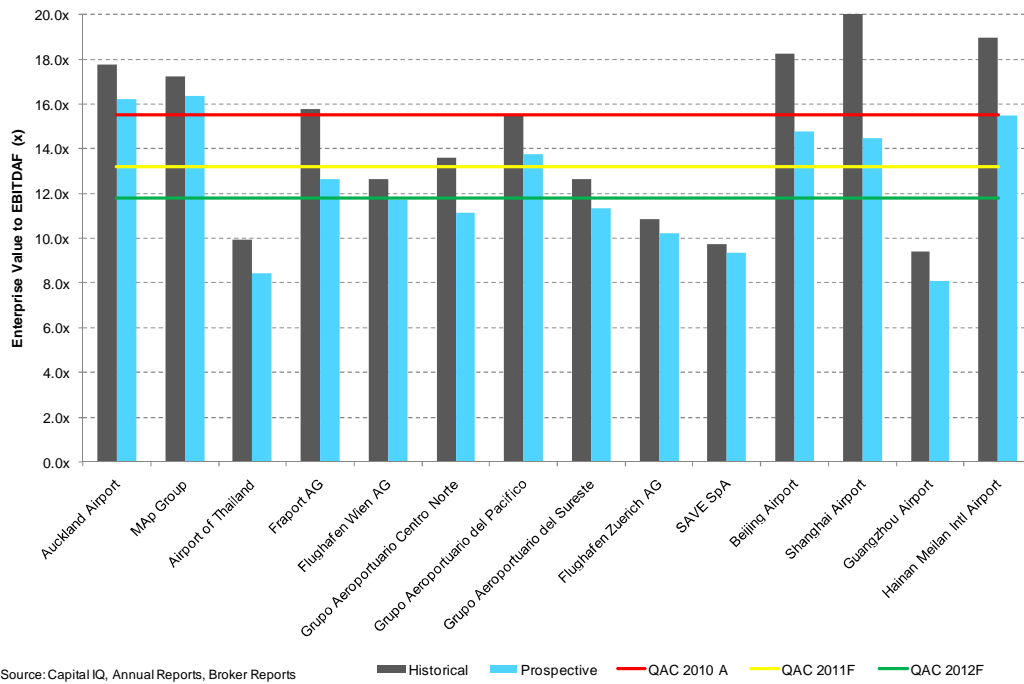
The multiples implicit in the base case value for the Company are summarised in the following table:

**Table 15 QAC Earnings Multiples**

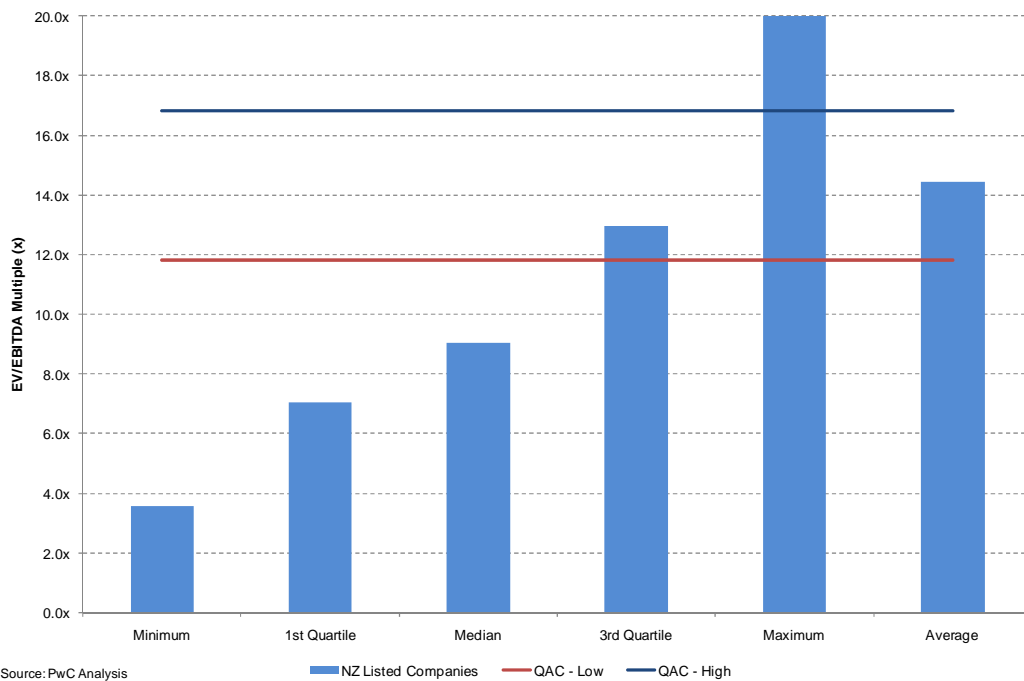
<b>Multiples</b>	<b>2010 A</b>	<b>2011F</b>	<b>2012F</b>
<b>Low</b>			
EV/EBITDAF	15.5x	13.2x	11.8x
EV/EBITF	21.7x	17.9x	15.9x
Equity/NPAT	39.3x	28.5x	22.2x
Equity/Net Assets	1.4x	1.1x	1.0x
<b>High</b>			
EV/EBITDAF	16.8x	14.3x	12.8x
EV/EBITF	23.5x	19.5x	17.2x
Equity/NPAT	42.8x	31.1x	24.2x
Equity/Net Assets	1.6x	1.2x	1.1x

The QAC EBITDAF multiples (low value) are compared to the listed airport companies in Figure 5. The QAC EBITDAF multiple range is compared to the EBITDA multiples observed for New Zealand listed companies in Figure 6.

**Figure 5 Airport Company EBITDAF Multiples**



**Figure 6 NZ Market EBITDA Multiples**



The conclusions that can be drawn from this analysis are limited but it does suggest that the Company's valuation multiples are at the top end of the range.

AIAL might be considered to be the most comparable company to QAC. However, it is important to recognise that the operations of AIAL quite different to those of QAC. One obvious difference is size: Auckland Airport's asset base is 24 times larger than QAC's. Also, Auckland has a different

mix of revenue, with more revenue not related to passenger volume than QAC. Its revenues are more diversified than QAC's.

In Appendix I we identify some of the differences between Auckland Airport and QAC and comment on how these differences can be interpreted when comparing the earnings multiples of QAC to those of Auckland Airport.

The following table contains a comparison of QAC and AIAL multiples. Also included in the table are multiples for Christchurch Airport. This is based on a valuation and earnings forecasts included in CIAL's 2010 Statement on Intent.

**Table 16 QAC, AIAL and CIAL Comparison**

<u>Airport</u>	<u>EV/EBITDAF</u>	<u>EV/EBITDAF</u>	
	<u>Historical</u>	<u>Prospective</u>	
Auckland Airport	17.7x	16.2x	
Christchurch Airport	17.1x	16.5x	
Queenstown Airport	15.5x - 16.8x	13.2x - 14.3x	
	<u>EV/EBITF</u>	<u>EV/EBITF</u>	
	<u>Historical</u>	<u>Prospective</u>	
Auckland Airport	22.3x	19.9x	
Christchurch Airport	25.6x	n/a	
Queenstown Airport	21.7x - 23.5x	17.9x - 19.5x	
	<u>Equity/NPAT</u>	<u>Equity/NPAT</u>	<u>Equity/</u>
	<u>Historical</u>	<u>Prospective</u>	<u>Net Assets</u>
	<u>Historical</u>	<u>Prospective</u>	<u>Historical</u>
Auckland Airport	32.8x	27.5x	1.8x
Christchurch Airport	41.0x	43.3x	1.5x
Queenstown Airport	39.3x - 42.8x	28.5x - 31.1x	1.4x - 1.6x

Source: Capital IQ, Annual Reports, CIAL 2010 Statement of Corporate Intent

The comparison provides comfort that the value range for QAC is comparable to that for AIAL and CIAL. However, the relative size of QAC and other issues (refer to Appendix I), strongly suggest that it should have earnings multiples lower than AIAL and CIAL.

## Summary

The Company's business has been divided into three business units for the purpose of the valuation. The three business units have different characteristics and risk profiles and require different valuation techniques. Combining the values for the three business units produces a base case value calculation for 100% of the shares in the Company of:

**Table 17 Base Case Valuation Calculation Summary**

	<u>Low</u>	<u>High</u>
Value for 100% of the shares	\$127.7 million	\$139.3 million
Value per share	\$7.95	\$8.67

In concluding on the value for 100% of the shares in the Company we have taken into account the following:

- We have interpreted the earnings multiples comparison presented in this section, particularly in relation to the commercial business unit, as indicating that the fair market value for the shares is at the bottom end of the base case valuation calculation range.

- Regulatory considerations are an important factor in assessing the fair market value range. While the earnings multiples comparison suggests that the top end of the value range is challenging, there is a component of the total value that is under-pinned by the value of the identified airfield activities.
- The Company has recorded strong growth historically. There is a reasonable prospect that the passenger volume growth will continue for the foreseeable future. This should drive earnings growth.
- Operational constraints, which limit the size of planes that can use the runway, and the nature of Queenstown as an end-destination, mean that the Company will not achieve the scale of Auckland, Wellington or Christchurch airports. However, this will not constrain growth for the foreseeable future.
- Queenstown is primarily a tourist destination and the Company's prospects are inextricably linked to the fortunes of the tourism industry. Passenger volumes in recent years have been resilient notwithstanding a downturn in international tourism.
- Like all airport companies, QAC is constantly balancing capacity with demand. The Company will generate significant annual operating cash flows but this will be absorbed periodically by capital expenditure needed to meet demand growth.
- The Company has high fixed costs and low variable costs. Short term changes in volumes (up or down) can have a significant impact on profitability.
- The Company is small compared to New Zealand's three principal international airports.

Taking all relevant factors into account, we conclude that a fair market value for 100% of the shares in QAC is:

**Table 18 Fair Market Value Range**

	Low	High
Fair market value of 100% of the shares	\$120 million	\$128 million
Value per share	\$7.47	\$7.97

The fair market value per share range is higher than the value used to set the price for the First and Second Tranches. The increase is in part due to the profit expected to be generated by the Company in the 2011 financial year, which is being invested in the identified airport assets.

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## 9 Options Available to the Council and Fairness Opinion

The issue of the Second Tranche Shares by the Company and the payment for those shares by AIAL is conditional on the Council:

- Approving the issue of the Second Tranche Shares
- Entering into a shareholders agreement with AIAL.

Both of these conditions must be met before the Second Tranche Shares can be issued. However, the Council is under no obligation to approve the share issue and enter into an agreement with AIAL. It does have a genuine choice to approve or not.

There are consequences to both approving or not approving the Second Tranche. These are discussed below.

### Approving the Option

The consequences of the Council giving QAC approval to exercise of the Option will be or could be:

- The Council's shareholding will fall below the 75% threshold. It will no longer have control of the constitution, be able to pass special resolutions and pass ordinary resolutions without a meeting of shareholders. It will still have in excess of 50% of the ordinary shares and so will be able to pass ordinary resolutions and control the composition of the Board. However, moving below 75% will diminish the control the Council can exercise over the Company.
- The Council will have a commercially focussed fellow shareholder that will have a degree of negative control i.e. the ability to block any special resolutions or actions that require a 75% majority. This is the converse of the reduction in the level of control that can be exercised by the Council.
- AIAL, as a significant minority, will look to have some protections put in place and some rights assigned to it to reduce the risk that it will be trapped with an illiquid stake in the Company with no influence over strategy and distribution policy. Approving the option will mean entering into a shareholder's agreement with AIAL. AIAL has signalled what it requires from the shareholders' agreement. These include:
  - Board representation.
  - A commitment from the Council to work towards the growth target included in the Strategic Alliance Agreement.
  - "Appropriate" minority shareholder protections.
  - Inclusion with the Council in making material governance decisions.
  - A commercially appropriate dividend policy
  - In the event of a material default by one party the right for the party to acquire the defaulting party's shares at fair value.

These requirements for the shareholders' agreement will result in the Council ceding some of its rights, as a majority shareholder, to AIAL.

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- The Company will receive cash of between \$11 million and \$21 million. The Company has said that it does not require this cash to fund its business-as-usual operating and capital expenditure for the foreseeable future. However, it expects to use some of the cash to finance the development of land in its land bank. We have been advised that cash not required by the Company will be available for the shareholders. This could result in a reasonably substantial amount of cash being available to the Council.

The parties will need to agree on the level of cash that should or needs to be retained by the Company. They will also need to agree on the most efficient way of structuring the transfer of shares and the flow of cash.

## **Not Approving the Option**

The consequences of the Council not giving QAC approval to exercise the Option will be or could be:

- The Council retaining significant control over the Company. The Council's shareholding will not fall below 75% and so it will retain control of the constitution, the ability to pass special resolutions and to pass ordinary resolutions without a meeting of shareholders. The Council will continue to have almost full control of the Company.
- The Council will not be obliged to enter into a shareholders' agreement and will not be obliged to provide AIAL with any of the protections and rights it is looking for.
- AIAL will own a large, non-controlling stake in the Company. It will not have sufficient votes to achieve board representation and will have no ability to prevent the Council from unilaterally making changes to the Company's strategic direction, business operations and dividend policy.
- The Council will have no control over the ultimate ownership of AAH, the AIAL subsidiary that owns its QAC shares. It will continue to rely on the existing protections in the Company's constitution regarding pre-emptive rights and change in control of AAH.
- The Strategic Alliance Agreement will remain in place. AIAL and QAC will both be obliged to fulfil their obligations under the Strategic Alliance Agreement. The benefits that AIAL is expected to bring to QAC are not, in theory, dependent on QAC exercising the Option. We cannot speculate on AIAL's level of commitment to the Strategic Alliance Agreement if the Option is not exercised.
- The Council will forego the opportunity to receive a considerable cash payment that would likely occur if the Option is exercised.
- The Company's gearing level is at a low level now as a consequence of the cash received from the First Tranche. It would be possible for the Company to increase its borrowing and pay-out a substantial one-off dividend even if the Option is not exercised. However, the Company has indicated that its planned capital expenditure together with a modest dividend programme will utilise its existing borrowing capacity. So a one-off dividend now will mean an injection of equity capital will be required later to facilitate the capital expenditure programme.
- It is possible that QAC will not have cash available to develop its land bank for some time. This will delay its ability to diversify its revenue streams and reduce its dependency on passenger volume related revenue.



## Summary

Not approving the Second Tranche means the status quo will prevail but the Council will most likely forego receiving a reasonably significant amount of cash. Approving the Second Tranche means the Council will most likely receive cash but cede a degree of influence and certain rights to AIAL. Within this context the decision to approve or not approve the Second Tranche can be summarised as:

*Is the consideration that AIAL will pay for the Second Tranche “fair” and is it sufficient to compensate the Council for the influence and rights it will forego, or will likely forego, if it approves the Second Tranche?*

### Consideration being paid by AIAL

We have concluded that a value in the range \$7.47 to \$7.97 per share would represent fair market value for 100% of the shares in the Company. This value range does not incorporate any discount for a minority interest in the Company that does not provide the holder with an element of control or influence.

If the Second Tranche is approved, the Consideration that AIAL will pay will be in the range of \$10.8 million to \$20.7 million. Although this incorporates an amount that represents the discount to the parties’ fair value that was deducted from the First Tranche Consideration, it will only be received by the Company if the Second Tranche occurs.

The following table includes the consideration for the Second Tranche Shares (expressed as a price per share), the fair value price range (before any discount to reflect the minority characteristics of the Second Tranche Shares) and the difference between these two amounts.

**Table 19 Second Tranche Price and Fair Market Value for 100% of the Shares**

	AIAL at 30%		AIAL at 35%	
Second Tranche consideration per share	\$9.43		\$8.38	
Fair market value range per share	\$7.47	\$7.97	\$7.47	\$7.97
Difference per share	\$1.96	\$1.46	\$0.91	\$0.41

The difference per share indicates that the price per Second Tranche Share is above the fair market value per share based on the valuation for 100% of the shares in the Company.

The fair market value in the table does not include a discount to the value of the shares to be purchased by AIAL to reflect they are a minority parcel. Whether a discount is warranted and the level of the discount will depend on the impact the proposed shareholders’ agreement has on the rights and obligations of both parties.

It is unlikely that a shareholders’ agreement will remove all of the negative aspects of the Second Tranche Shares being a minority parcel and AIAL being a minority shareholder, albeit a large minority, in a company with only one other large shareholder. The minority shareholder is exposed to the majority shareholder making decisions that may not be consistent with the minority shareholder’s expectations for the direction of the Company, for example decisions on dividend policy that could impact on the ability of the Company to reinvest to enhance capacity.

In these circumstances a discount to the value of the Second Tranche Shares will be appropriate. If the discount is 20%<sup>6</sup>, the table changes to:

**Table 20 Second Tranche Price and Discounted Fair Market Value**

	AIAL at 30%		AIAL at 35%	
Second Tranche consideration per share	\$9.43		\$8.38	
Fair market value range per share	\$5.98	\$6.38	\$5.98	\$6.38
Difference per share	\$3.45	\$3.05	\$2.40	\$2.00

The difference per share equates to a total dollar amount of \$3.5 million to \$6 million. That is, if AIAL was to pay a price per share for the shares to be issued under the Second Tranche that reflects the minority characteristics of the parcel of shares, the proceeds to be received by the Company would be between \$3.5 million and \$6 million dollars less than the amount AIAL will actually pay under the Second Tranche. This difference represents an implicit value transfer to QLDC.

Our assessment is that the pricing formula for the Second Tranche Shares will result in AIAL paying an amount in excess of what can be considered to be the fair market value for the Second Tranche Shares. It is likely that the price that AIAL will pay for 5%-10% of the Company's share capital under the Second Tranche would only be paid by a strategic purchaser or achieved through the sale of 100% of the Company's shares.

### Value of Control

The value of a 65% or 70% interest in the Company will be less on a per share basis than the value of a 75.1% interest. The decrease in value is a consequence of the reduction in the level of control that will result from crossing the "75% threshold".

The following table is an example of the affect of the discount to the value of the Council's shareholding that will result from moving below the 75% control threshold. The example assumes:

- The value of the Council's current shareholding is discounted by 5% to reflect that it doesn't own 100% of the share capital.
- The value will be discounted by a further 5% when its shareholding reduces below 75%.
- The Second Tranche consideration received from AIAL is retained by the Company.

**Table 21 Value Implications for the Council's Shareholding**

	Low Value		High Value	
	70%	65%	70%	65%
Council shareholding after the second Tranche	70%	65%	70%	65%
Pre second Tranche discount (less than 100%, greater than 75%)	5%	5%	5%	5%
Value of QLDC's shares before the Second Tranche	\$M 85,511	85,511	91,212	91,212
Post Second Tranche further discount for less than 75%	5%	5%	5%	5%
Value of QLDC's shares after the Second Tranche	\$M 82,654	82,552	87,708	87,245
Value reduction	(2,857)	(2,960)	(3,504)	(3,967)

Our assessment is that the reduction in the value of the Council's shareholding as a consequence of moving below the 75% threshold will more than offset any value benefit that the Second Tranche will deliver to QLDC through the full price being paid by AIAL for the Second Tranche shares.

<sup>6</sup> The price paid by AIAL for the 1<sup>st</sup> Tranche Shares was \$6.91 per share. This incorporated a discount of approximately 7.5% on the value of 100% of the shares assessed by QAC and AIAL at that time of \$7.47 per share. This discount is relatively low (and the price per share relatively high) for non-controlling, albeit large shareholding and may, arguably, have included a "strategic premium" to gain a cornerstone stake.

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Consequently, in theoretical value terms, the per share value of the Council's shareholding after the Second Tranche will be lower than the per share value before the Second Tranche.

This result is almost inevitable because of the size of the Council's shareholding compared to the number of shares in the Second Tranche. AIAL would have to pay a very large premium for the Second Tranche to compensate the Council for the loss in value in moving below 75%.

## **Fairness Opinion**

The following factors are important to our assessment of the fairness of the Second Tranche to the Council:

- If the Second Tranche Shares are issued, QLDC will lose its near full control of the Company, but it will still have a high degree of control. It will still control the majority of the board of directors and the passing of ordinary resolutions.
- AIAL is currently a minority shareholder with minimal rights. The issue of the second Tranche shares will, subject to the outcome of negotiations over the shareholders' agreement, enhance AIAL's ability to exercise influence over the Company.
- QLDC will be faced with a large minority shareholder. AIAL, as an airport company itself will bring skills that will be beneficial for QAC. However, its objectives may not always be aligned with those of the Council. Given the size of its shareholding, any dispute between the shareholders could be time consuming and resource intensive to resolve.
- If the Option is exercised, it is likely that the Council will receive a substantial cash payment. While the value effects (i.e. change in the value of its shares in the Company) of the Second Tranche are important to the assessment of fairness, the Council will only realise the value change if it sells some or all of its shares. This is probably unlikely in the foreseeable future. A cash distribution on the other hand, is of real, immediate tangible value to the Council.
- AIAL's shareholding is held through a subsidiary company. QLDC currently has no means of directly controlling the ownership of that subsidiary, although the pre-emptive rights provisions in the Company's constitution can be triggered in the event that there is a change in control of AAH.
- The Company could utilise some of the cash raised from exercising the Option to fund development of part of its land bank.
- The Strategic Alliance Agreement remains in place regardless of whether or not the Option is exercised.
- AIAL will pay a very "full" price for the Second Tranche Shares. Our assessment is that the price is above the fair market value for the Second Tranche Shares. However, the premium incorporated into the price will not provide full financial compensation to the Council for the reduction in the value of its entire shareholding as a consequence of its ownership of the Company reducing from 75.01% to 70% or 65%.

The reduction in value is theoretical and if the Council intends to hold its shares in QAC indefinitely the reduction is unlikely to be realised. However, falling below 75% would prevent the Council selling the QAC business without approval of AIAL in the future, among other things.

The Council might give the Company approval to exercise the Option if:

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- It places a high “value” on the cash that it is likely to receive from the issue of the Second Tranche shares. As AIAL is paying a very full price for the shares, the cash available to the Council will be higher than it might otherwise be; and /or
  - It considers that:
    - Providing the Company with cash to develop its undeveloped land will add value to the Company and reduce its risk profile through decreasing its dependence on passenger volume related revenue; and
    - It is unlikely that the Council will be in a position to contribute equity to finance development if the Option is not exercised.

Another reason for approving the Option might be to further embed AIAL into the Company to optimise the benefits it can bring to QAC. However, the Strategic Alliance Agreement remains in force whether the Option is exercised or not. Also, we cannot speculate on whether AIAL’s commitment will be enhanced or not by an increase in its shareholding.

On the other hand, if:

- The Council does not necessarily need the cash from the Second Tranche
- The Council considers that the Company should consider other options for financing the development of its land bank
- The Strategic Alliance Agreement as it stands will work effectively for both AIAL and QAC

then the case for approving the exercise of the Option is not compelling. The considerable premium incorporated into the price that AIAL will pay will be insufficient to compensate the Council for the loss of value it will suffer if its shareholding is reduced below 75%. So, in the absence of a need for cash and a strong strategic reason for allowing its shareholding and its extensive control of the Company to be reduced, the rationale for giving the Company approval to exercise the Option is not clear.

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## Appendix A: Important Notice

### Declarations

We have prepared this Report at the request of Queenstown Lakes District Council. The terms of our engagement as agreed with QLDC require us to provide an independent assessment of the fairness to QLDC of the Purchase Price for the Second Tranche Shares in Queenstown Airport Corporation Limited that may be issued to Auckland Airport Holdings (No. 2) Limited, a wholly owned subsidiary of Auckland International Airport Limited.

This Report should not be used for any other purpose. This Report is not an investment recommendation.

We consent to this Report being placed on QLDC's website.

### Qualifications

This Report has been prepared by the Corporate Finance division of PricewaterhouseCoopers, which provides advice on mergers, acquisitions and divestments, valuations, independent expert's reports and appraisals, financial investigations and strategic corporate advice.

### Independence

We consider ourselves to be independent of QLDC, QAC and AIAL. We confirm that:

- We have not had any part in formulation of the proposed transaction.
- Our fee for preparation of this report is based on the time required for its completion, and it is not contingent on the success or implementation of the proposed transaction.

We do not currently provide services to QLDC or QAC. We have in the past provided limited, one-off advisory taxation or internal audit advice to AIAL and QLDC. We have also audited the financial statements of the Auckland International Airport Marae Trust.

Our independence asserted in relation to this Report has not been impaired by other work undertaken for AIAL or QLDC and their related entities.

### Disclaimer and Restrictions on Scope of Our Work

The statements and opinions expressed in this Report are based on information available as at the date of the Report.

In preparing this Report, we have not independently verified the accuracy of information provided to us, and have not conducted any form of audit of QAC.

In forming our opinion, we have relied on forecasts and assumptions prepared by QAC and Airbiz (a consultant to QAC) about future events which by their nature are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

The statements and opinions expressed in this Report have been made in good faith and on the basis that all relevant information for the purposes of preparing this Report has been provided by QAC and/or its Directors and advisors, and that all such information is true and accurate in all

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material aspects and not misleading by reason of omission or otherwise. Accordingly, neither PricewaterhouseCoopers nor its partners, employees or agents accept any responsibility or liability for any such information being inaccurate, incomplete, unreliable or not soundly based or for any errors in the analysis, statements and opinions provided in this Report resulting directly or indirectly from any such circumstances or from any assumptions upon which this Report is based proving unjustified.

Our opinion has been arrived at based on economic, market and other conditions prevailing at the date of this Report. Such conditions may change significantly over relatively short periods of time.

We reserve the right, but will be under no obligation, to review or amend our Report if any additional information, which was in existence on the date of this Report, was not brought to our attention or subsequently comes to light.

### **Limitation of Liability**

We will accept liability to pay damages for losses arising as a direct result of breach of contract or negligence on our part in respect of services provided in connection with, or arising out of this engagement but, to the extent permitted by law, any liability of PricewaterhouseCoopers, its partners and staff (whether in contract, tort, negligence or otherwise) shall in no circumstances exceed five times the fees paid in the aggregate in respect of all such services.

### **Indemnity**

QLDC has agreed that, to the extent permitted by law, it will indemnify PricewaterhouseCoopers and its partners, employees and consultants in respect of any liability suffered or incurred as a result of or in connection with the preparation of the Report. This indemnity will not apply in respect of any negligence, wilful misconduct or breach of law by us. QLDC has also agreed to indemnify PricewaterhouseCoopers and its partners and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where PricewaterhouseCoopers or its employees and officers are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, we shall reimburse such costs.

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## Appendix B: Sources of Information

We have had access to the following major sources of information for the purposes of our valuation:

- Worksheet excerpts from QAC's forecast pricing model
- QAC's terminal lease schedule and plan
- An excel worksheet schedule detailing the size and value of land held for future development
- QAC's annual reports and statutory accounts for the years ending 30 June 2006 to 2010
- QAC statement of financial performance for the 6 months ended 31 December 2010
- QAC's Budget & Annual Operating plan for 2010 & 2011
- Discussions with QAC management & consultants
- QAC's Airport Authorities Act Disclosure Financial Statements for 2009 and 2010
- A valuation of QAC's asset as at 30 June 2010 prepared by Seagar & Partners

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## Appendix C: Industry Overview

### Introduction

In this section we provide an overview of the airport industry in New Zealand and comment on factors that impact the sector. The discussion includes a high level review of the recent financial performance of a selection<sup>7</sup> of New Zealand airports.

The information presented in this section provides context for our assessment of the financial prospects for QAC.

### Airport Operations and Economics

The business activities of an airport can be divided into:

- Aeronautical activities. This is the provision of aeronautical facilities (runways, taxiways, terminals etc) for use by airlines. The aeronautical activities of an airport can have sole supply characteristics.
- Non – aeronautical activities. This covers a broad range of services and includes renting or leasing space in the terminal for retail and other commercial operations, provision of car parking and leasing of land or land and buildings to airport users and other third parties.

### Aeronautical Revenue

Sources of aeronautical revenue typically include:

- Landing charges paid by airlines. These are often based on the Maximum Certified Takeoff Weight (“MCTOW”) of the aircraft.
- Aircraft parking charges.
- Charges levied on airlines for provision of related terminal services. These are often charged on a per passenger basis.
- Charges levied on departing passengers. These are more often than not charged to international passengers in the form of a “departure tax”.

In 2010 QAC generated a little over \$7.1 million of revenue from aeronautical activities.

### Non-aeronautical Revenue

Airports generate non-aeronautical revenue from a range of sources. These include:

- Letting terminal space to retailers, other commercial operators and government agencies. The rental income from retail tenants is sometimes linked to their turnover.
- Renting of land or land and buildings to third parties. Tenants might be involved in airport related activities (freight forwarding, air tourism etc) or they may be involved in non-airport activities (but that don’t conflict with the operation of the airport).

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<sup>7</sup> Airports analysed: Auckland, Hamilton, Wellington, Christchurch, Dunedin and Queenstown.



- Car parking. Car parking revenue is a material component of non-aeronautical revenue for some airports.

In 2010 QAC generated approximately \$6.2 million from non-aeronautical activities.

### Cost Structure

An airport's business is built around the provision of infrastructure to service aircraft and passengers. As a consequence, a large component of an airport's costs is related to providing, maintaining and operating assets and will not change in direct proportion to short term fluctuations in volumes – the costs are more fixed than variable.

QAC's costs for 2010 are summarised in the following table. Employee costs and the asset related costs (depreciation, amortisation and loss on revaluation) will not vary with short term volume changes. "Other expenses" similarly has a large fixed component.

**Table 22 QAC Cost Structure**

	\$M	% of Total
Employee costs	1.4	18.1%
Depreciation, amortisation and loss on revaluation	3.3	41.9%
Other expenses	3.1	40.0%
Total expenses (excluding finance costs)	7.8	100.0%

*Source: QAC Annual Reports*

### Capital Requirements

Airports are capital intensive businesses and require significant investment (and reinvestment) in land, civil works and buildings. In 2010 these assets represented 98% of the total assets owned by QAC.

Airports that experience relatively high rates of volume growth have to actively manage the balance between capital expenditure and demand. Over-investment in capacity is not easily removed and can lead to poor returns on capital. Equally, augmenting capital assets takes time.

### Profit Drivers

Growth in passenger numbers is an important driver of airport earnings:

- Growth in passenger numbers is usually accompanied by an increase in aircraft landings subject to available capacity (or larger planes with a heavier MCTOW). Growing numbers of passengers will result in growing aeronautical revenue.
- Commercial revenue opportunities will increase with passenger numbers. Whether this results in revenue and earnings growth will depend on whether the airport can profitably exploit the opportunities created by passenger growth.

Land development can also be an important source of revenue and capital growth. The Company has a land bank that it is intending to develop for both airport related and other commercial activities.

## Snapshot of New Zealand Airports

Figure 7 presents domestic and international passenger numbers for the 2010 financial year for a selection of New Zealand airports.

**Figure 7 Domestic and International Passengers**

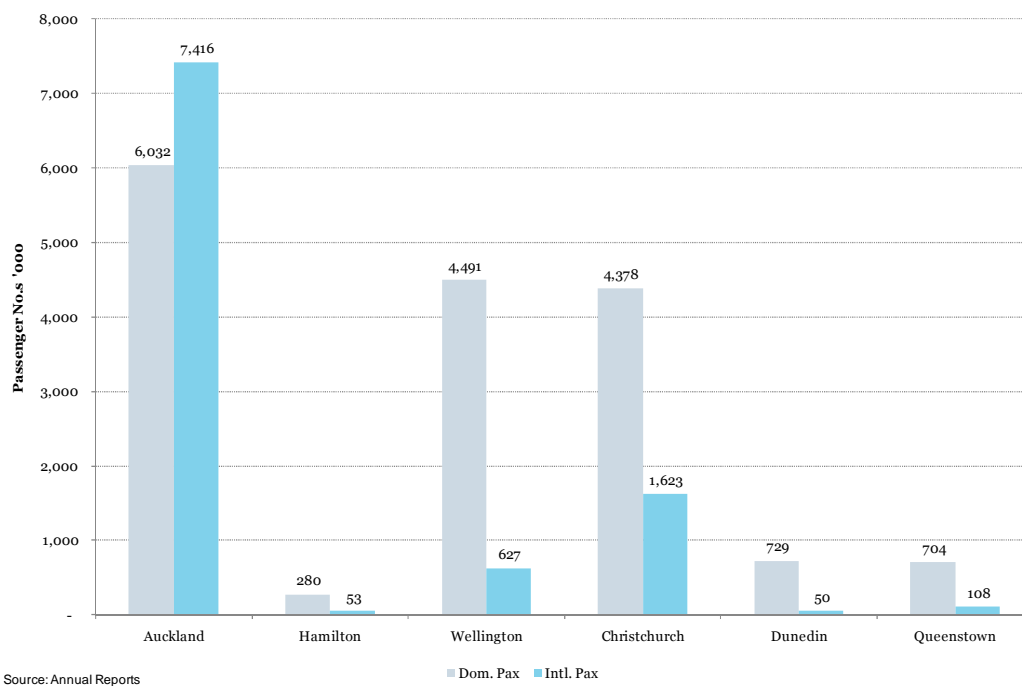


Figure 7 highlights the characteristics of the New Zealand airport sector:

- Auckland Airport is the largest airport in New Zealand by a considerable margin. It is the country's primary international "gateway" for tourists and travelling residents. In 2010 Auckland Airport handled approximately 50% of total passenger movements and 75% of international passenger movements for the airports analysed.
- Christchurch Airport is the 2<sup>nd</sup> largest airport by passenger numbers and handled approximately 22% of total passenger movements in 2010. Christchurch has historically been the main gateway into the South Island for tourists.
- Wellington is primarily a domestic airport. It is a transit point for some flights between the North and South Islands.
- Hamilton, Dunedin and Queenstown Airports are much smaller than Auckland, Wellington and Christchurch. Collectively they handled 7% of total passengers in 2010.
- QAC is very much a tourist airport and relies on people travelling to Queenstown and the surrounding region for leisure.
- QAC's international passenger movements have increased as a percentage of total passenger movements from 7% in 2006 to 13% in 2010. This is in contrast to most of the other airports, which have experienced declining or relatively constant international passenger movements as a percentage of total passenger movements in recent years.

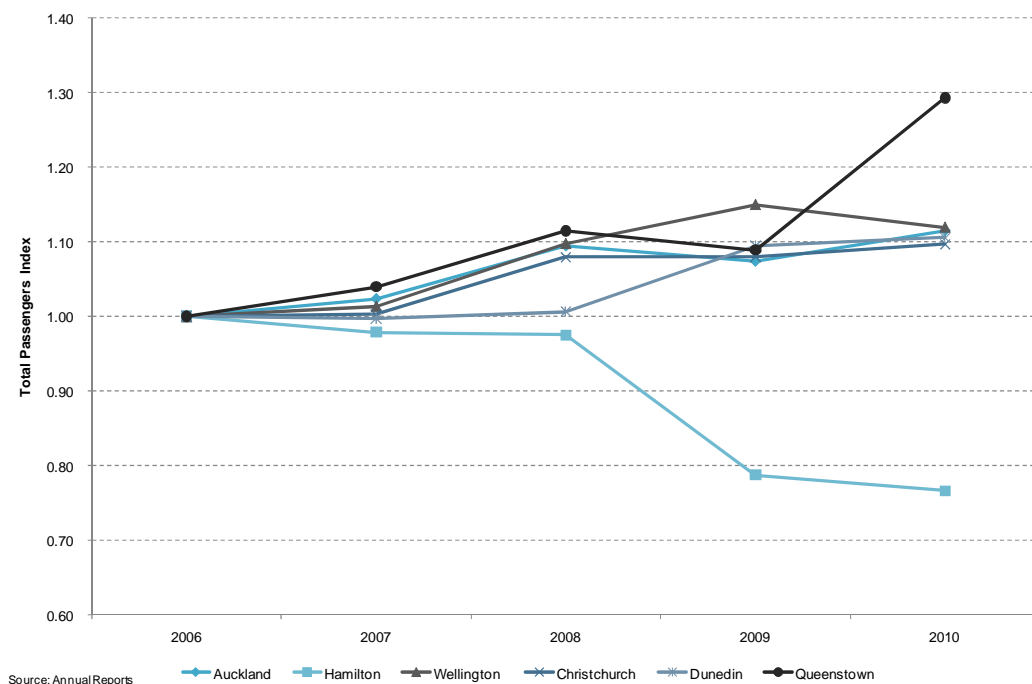
## Recent Financial Performance of New Zealand Airports

Figure 8 presents indices of total passenger movements from 2006 to 2010 for the New Zealand airports analysed. Figure 9 presents indices of EBITDAF.

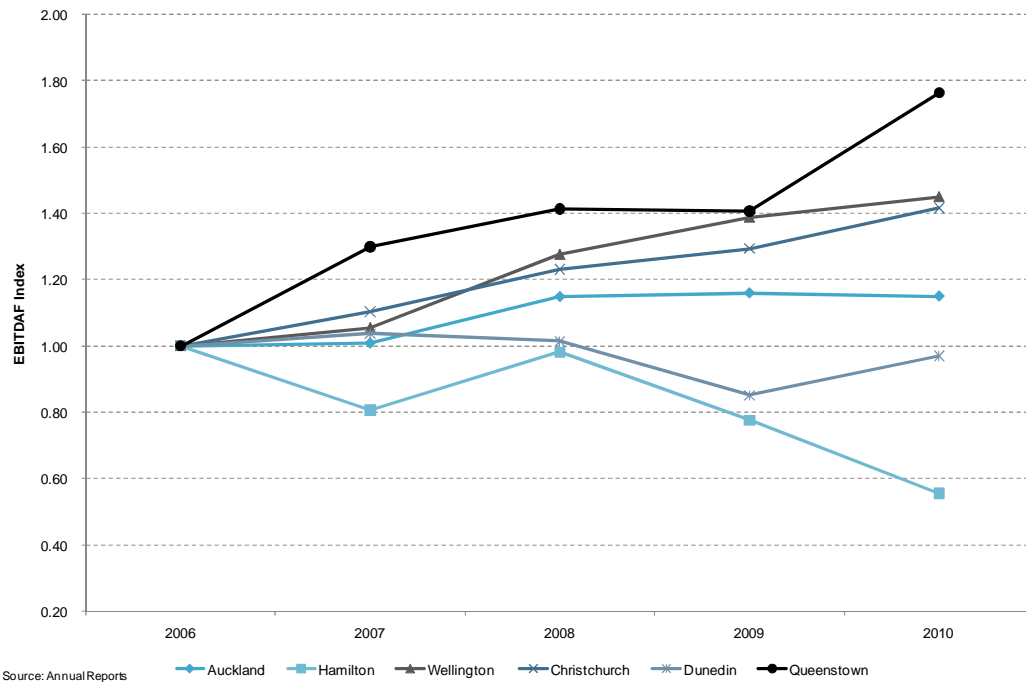
We make the following comments with respect to Figure 8 and Figure 9:

- Passenger movements have increased at all airports over the period, with the exception of Hamilton Airport.
- EBITDAF has followed the trend in passenger movements at all airports except Dunedin. The sharp decrease in EBITDAF at Dunedin Airport in 2009 was due at least in part to increased maintenance expenditure on the apron pavements.
- QAC has outperformed all of the other airports in terms of passenger movement and EBITDAF growth over the period. The disproportionate increase in EBITDAF (up 76%) relative to passenger movements (up 29%) is in part due to the increase in international passenger movements as a percentage of total passenger movements.

**Figure 8 Passenger Movements Indices**



**Figure 9 EBITDAF Indices**



## Outlook

The outlook for the global airport industry is quite positive. Boeing is forecasting that world airline traffic will grow by 5.3% per annum<sup>8</sup> between 2009 and 2029. Airbus is forecasting growth of 4.8% per annum<sup>9</sup> over the same period.

Airline traffic growth within the Asia Pacific region is forecast to be higher than global growth. Boeing is forecasting that half of the world's new airline traffic over the next 20 years will be to, from or within the Asia Pacific region.

Boeing and Airbus have forecast annual growth in airline traffic within the Asia Pacific region of 6.8% and 5.8% respectively over the period 2009 to 2029. Two notable drivers of this forecast growth are:

- The significant economic growth expected from countries within the region, particularly China and India. The forecast economic growth will cause incomes within the region to rise and therefore make air travel affordable for more people.
- The increase in competition within the airline industry caused by the introduction of low cost carriers.

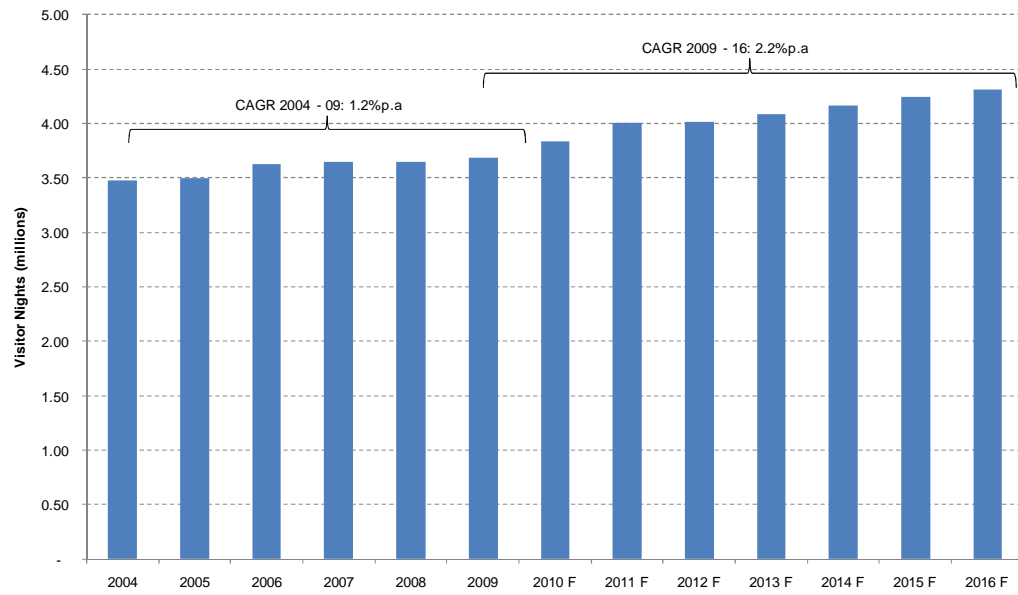
These macro trends present a benign market environment for QAC, although as QAC is a tourist airport, its future economic prospects will be heavily influenced by how Queenstown continues to develop as a tourist destination.

The outlook for Queenstown as a tourist destination appears positive as illustrated in Figure 10 which presents historical and forecast visitor nights<sup>10</sup> in Queenstown over the period 2004 to 2016.

<sup>8</sup> Current Market Outlook 2010 – 2029, Boeing, 2010.

<sup>9</sup> Airbus Global Market Forecast 2010 – 2029, Airbus, 2010.

**Figure 10 Queenstown Historical and Forecast Visitor Nights**



Source: The Tourism Strategy Group (a division of the Ministry of Economic Development) ■ Visitor Nights

Visitor nights in Queenstown have increased in recent years from 3.5 million in 2004 to 3.7 million in 2009. This growth is expected to continue with visitor nights forecast to grow at a CAGR of 2.2% over the period 2009 to 2016. The corresponding growth rate for New Zealand as a whole is 1.2% per annum.

<sup>10</sup> The number of nights a visitor stays in a destination (in all forms of accommodation).

## Appendix D: Historical Financial Results

In this section we present QAC's historical operating and financial results and comment on some of the relevant features of its recent operating and financial performance and financial position.

Financial information in this section has been extracted from the Company's audited financial statements.

### Background to Historical Results

The recent growth in passenger numbers and the Company's earnings has outpaced that of its New Zealand peers since 2006. An increase in the number of international flights serving strong tourist demand has been an important contributor to the growth. Continuing out-performance will rely on maintaining strong growth in international traffic in particular.

QAC's domestic passenger numbers have risen from 584,000 in 2006 to 704,000 in 2010 (CAGR 4.8%). International passenger numbers grew from 44,000 to 108,000 over the same period (CAGR 25.2%). Figure 11 presents international and domestic passenger numbers over 2006 to 2010.

**Figure 11 International and Domestic Passengers**



The growth in passenger numbers is consistent with the airport serving an increasing number of flights over the period 2006-2010, both from existing and new airlines.

Queenstown benefits from being a popular destination in both summer and winter seasons. Increasing trans-Tasman seat availability has proved very popular with winter sports tourists from Australia, whereas the pan-Asian market is targeted for international visitors in the summer season. The table below shows the growth in passengers and landings over 2006 to 2010.

**Table 23 International and domestic passengers and landings**

<u>in 000s</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
International Pax	44	54	62	75	108
Domestic Pax	584	599	638	609	704
International Landings	n/a	n/a	0.269	0.325	0.452
Domestic Landings	n/a	n/a	3.920	3.824	3.925

Source: QAC Annual Reports and Company Website

There have been notable changes in the airlines serving the airport over the period. Jet Star commenced domestic services in 2009 and has recently expanded its trans-Tasman services. Pacific Blue introduced a trans-Tasman service in 2009 but ceased domestic services in October 2010.

The growth in international passengers has influenced QAC's revenue mix. In general, international passenger growth tends to produce higher aeronautical and non-aeronautical revenues. Aeronautical revenues from domestic landings consist of a *per pax* charge for embarking and disembarking passengers and a per tonne landing charge per aircraft. In addition to higher charges per passenger, international flights incur an international facility charge per aircraft.

To indicate how aeronautical charges at QAC compare to other New Zealand airports we have referred to estimates of international and domestic turn-around costs<sup>11</sup>. The estimates of domestic turn-around costs were contained in a report<sup>12</sup> for AIAL and published on its web site. The estimates of international turn-around costs were provided to us by Airbiz and QAC. This information is presented in the following tables.

**Table 24 Domestic turn around costs**

<u>Airport</u>	<u>Dom.</u>
Auckland	2,249
Hamilton	2,897
Wellington	3,476
Christchurch	2,290
Dunedin	2,139
Queenstown	2,962
<b>Avg (excl QAC)</b>	<b>2,610</b>

Source: Airbiz

<sup>11</sup> Total turn around costs comprise landing charges, aircraft parking charges, any passenger related charges and terminal navigation charges.

<sup>12</sup> Domestic turn around costs: *Review of Reports on Airport Charges, Airbiz, November 2010.*

**Table 25 International turn around costs**

Airport	Direct Airport Charges	Third Party Charges	Total Cost
Cairns	6,733	1,146	7,879
Sydney	6,986	663	7,648
Brisbane	6,832	686	7,518
Nadi	7,126	119	7,244
Adelaide	5,948	1,189	7,137
Wellington	5,086	1,528	6,614
Auckland	4,448	1,532	5,980
Christchurch	4,212	1,532	5,744
Melbourne	4,441	617	5,058
Perth	2,379	938	3,317
Queenstown	6,824	1,763	8,587
<b>Avg (excl QAC)</b>	<b>5,419</b>	<b>995</b>	<b>6,414</b>

Source: Airbiz and QAC

The analysis suggests that QAC has domestic and international turn-around costs above the average for its peers.

Given the higher growth rates in international passengers and aircraft relative to domestic, and the differences in revenues generated, QAC has experienced a shift in its revenue composition and in its revenues per passenger. The table below shows the composition of QAC's revenues and how they have evolved over time. Figure 12 shows the progression of aeronautical and non-aeronautical revenues per passenger over 2006 to 2010.

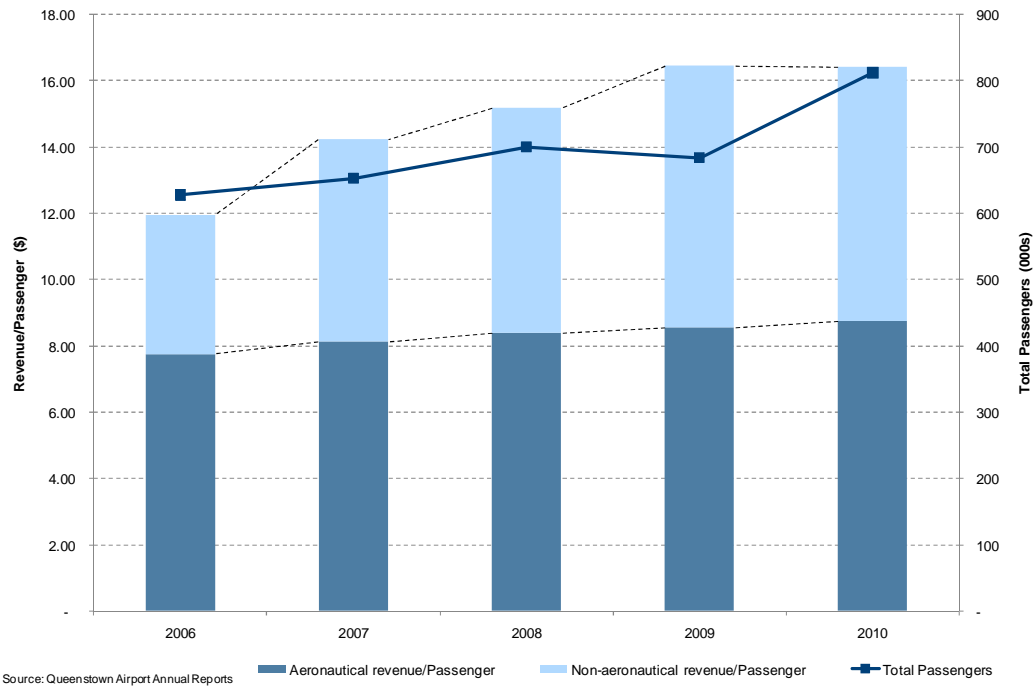
**Table 26 Composition of total revenue**

Year ended 30 June NZD in 000s	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Actual
Landing dues	4,451	4,787	5,258	5,088	6,003
Departure tax	422	522	620	766	1,105
<b>Aeronautical Revenue</b>	<b>4,872</b>	<b>5,309</b>	<b>5,877</b>	<b>5,854</b>	<b>7,108</b>
Car park revenue	554	774	1,012	1,211	1,254
Operating lease rental revenue	1,731	2,677	3,079	3,371	3,969
Other revenue	345	536	652	815	997
<b>Non-aeronautical Revenue</b>	<b>2,630</b>	<b>3,986</b>	<b>4,743</b>	<b>5,398</b>	<b>6,219</b>
<b>Total Revenue</b>	<b>7,503</b>	<b>9,296</b>	<b>10,620</b>	<b>11,252</b>	<b>13,328</b>
<b>As a % of total revenue</b>					
Landing dues	59%	51%	50%	45%	45%
Departure tax	6%	6%	6%	7%	8%
<b>Aeronautical Revenue</b>	<b>65%</b>	<b>57%</b>	<b>55%</b>	<b>52%</b>	<b>53%</b>
Car park revenue	7%	8%	10%	11%	9%
Operating lease rental revenue	23%	29%	29%	30%	30%
Other revenue	5%	6%	6%	7%	7%
<b>Non-aeronautical Revenue</b>	<b>35%</b>	<b>43%</b>	<b>45%</b>	<b>48%</b>	<b>47%</b>
<b>Total Revenue</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: QAC Annual Reports



**Figure 12 Aeronautical and non-aeronautical revenue per passenger**



Commensurate with the increase in passenger numbers and flights, QAC has undertaken a number of significant capacity and infrastructure improvements:

- 2006/7: Completed development of new aprons and terminal resulting in an additional 6,000 m<sup>2</sup> of terminal space.
- 2006/7: Car parks doubled to 700.
- 2006/7: Fire fighting equipment upgraded.
- 2006: Runway Extension Safety Area (RESA) planning begins to comply with Civil Aviation Authority requirements. The RESA project is to be completed by 2011.
- 2008: Began investigating reconfiguring terminal entrances to increase the exposure of international passengers to retail and food and beverage outlets.
- 2010: Runway overlay capital expenditure of \$5m was incurred; this is usually required approximately every 10 years.
- 2010: Plans developed to expand the international arrivals hall, build three additional jet stands and construct a “heavy taxiway”.

In addition to capital spending requirements, operational expenses have increased with passenger numbers. A significant driver of operating expenditure has been increasing spend on the terminal post redevelopment in 2006. Employee benefits expenses have also increased each year in line with headcount. Overall, total operating expenses have increased from \$2.5 million in 2006 to \$4.5 million in 2010 (CAGR: 16%).

## Financial Performance

The Company's financial performance for the years ended 30 June 2006 to 2010 is summarised in Table 27.

**Table 27 Historical Financial Performance**

Year ended 30 June NZD in 000s	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Actual
Landing dues	4,451	4,787	5,258	5,088	6,003
Departure tax	422	522	620	766	1,105
<b>Aeronautical Revenue</b>	<b>4,872</b>	<b>5,309</b>	<b>5,877</b>	<b>5,854</b>	<b>7,108</b>
Car park revenue	554	774	1,012	1,211	1,254
Operating lease rental revenue	1,731	2,677	3,079	3,371	3,969
Other revenue	345	536	652	815	997
<b>Non-aeronautical Revenue</b>	<b>2,630</b>	<b>3,986</b>	<b>4,743</b>	<b>5,398</b>	<b>6,219</b>
<b>Total Revenue</b>	<b>7,503</b>	<b>9,296</b>	<b>10,620</b>	<b>11,252</b>	<b>13,328</b>
Operating expenses	1,419	2,033	2,413	2,672	2,838
Employee benefits expense	510	593	1,013	1,167	1,290
Other expenses	581	186	139	390	395
<b>Total Operating Expenses</b>	<b>2,510</b>	<b>2,812</b>	<b>3,565</b>	<b>4,229</b>	<b>4,523</b>
<b>EBITDAF</b>	<b>4,993</b>	<b>6,484</b>	<b>7,056</b>	<b>7,023</b>	<b>8,805</b>
Fair value gain/(loss) on derivatives	-	(144)	113	51	(578)
Revaluation gain/(loss) on PPE	-	-	-	-	(751)
Gain/(loss) on sale of PPE	0	1,869	-	-	63
<b>EBITDA</b>	<b>4,993</b>	<b>8,208</b>	<b>7,169</b>	<b>7,073</b>	<b>7,539</b>
Depreciation and amortisation	1,081	2,549	2,871	2,405	2,505
<b>EBIT</b>	<b>3,912</b>	<b>5,659</b>	<b>4,298</b>	<b>4,669</b>	<b>5,033</b>
Net interest expense	1,079	2,240	2,562	2,316	1,702
<b>NPBT</b>	<b>2,833</b>	<b>3,419</b>	<b>1,736</b>	<b>2,352</b>	<b>3,332</b>
Tax expense	935	578	579	706	7,086
<b>NPAT</b>	<b>1,898</b>	<b>2,841</b>	<b>1,157</b>	<b>1,647</b>	<b>(3,755)</b>
EBITDAF margin %	66.5%	69.7%	66.4%	62.4%	66.1%
Aeronautical revenue % of total revenue	64.9%	57.1%	55.3%	52.0%	53.3%
Non-aeronautical revenue % of total revenue	35.1%	42.9%	44.7%	48.0%	46.7%
Landings	4,083	4,086	4,189	4,149	4,377
International passengers	44,000	54,000	62,000	75,000	108,000
Domestic passengers	584,000	599,000	638,000	609,000	704,000
Total passengers	628,000	653,000	700,000	684,000	812,000
EBITDAF/Passenger (\$)	7.95	9.93	10.08	10.27	10.84

Source: Queenstown Airport Annual Reports

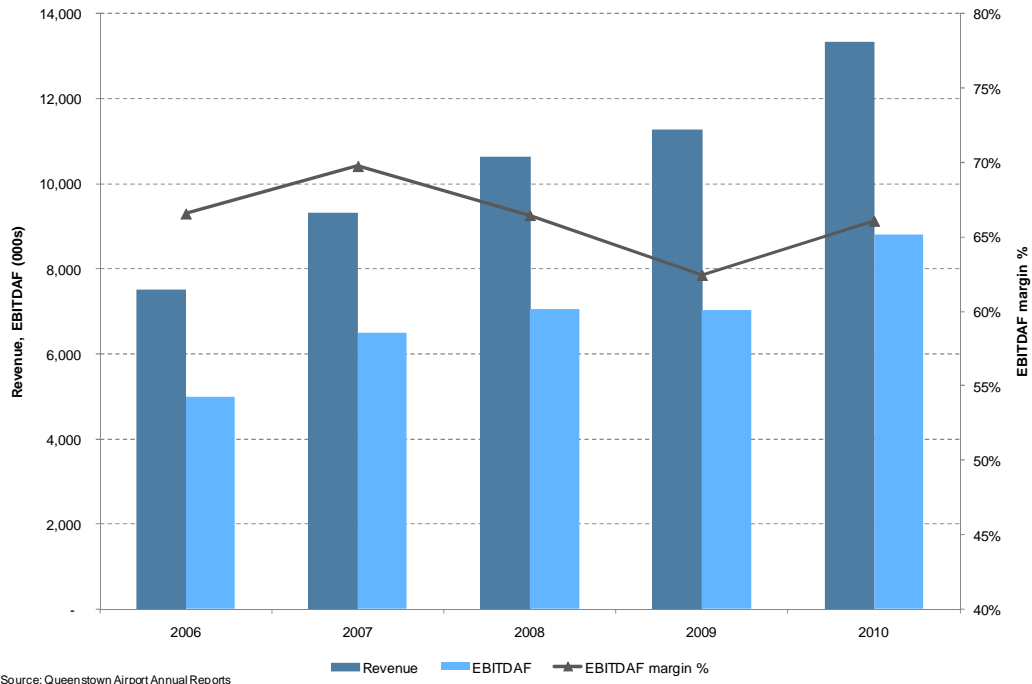
**Note:** In 2010 QAC earned other comprehensive income of \$75 million (net of tax) from the revaluation of properties.

This has been excluded from the Income Statement as it does not form part of the Net Profit or Loss for the Company.

Total revenue has increased 78% from \$7.5m in 2006 to \$13.3m in 2010 (CAGR 15.4%). Operating expenses have increased 80% over the same period from \$2.5m in 2006 to \$4.5m in 2010 (CAGR 15.9%). The reasonable consistency between the rate of growth in operating expenses relative to revenues means the EBITDAF margin has been relatively stable over the period.

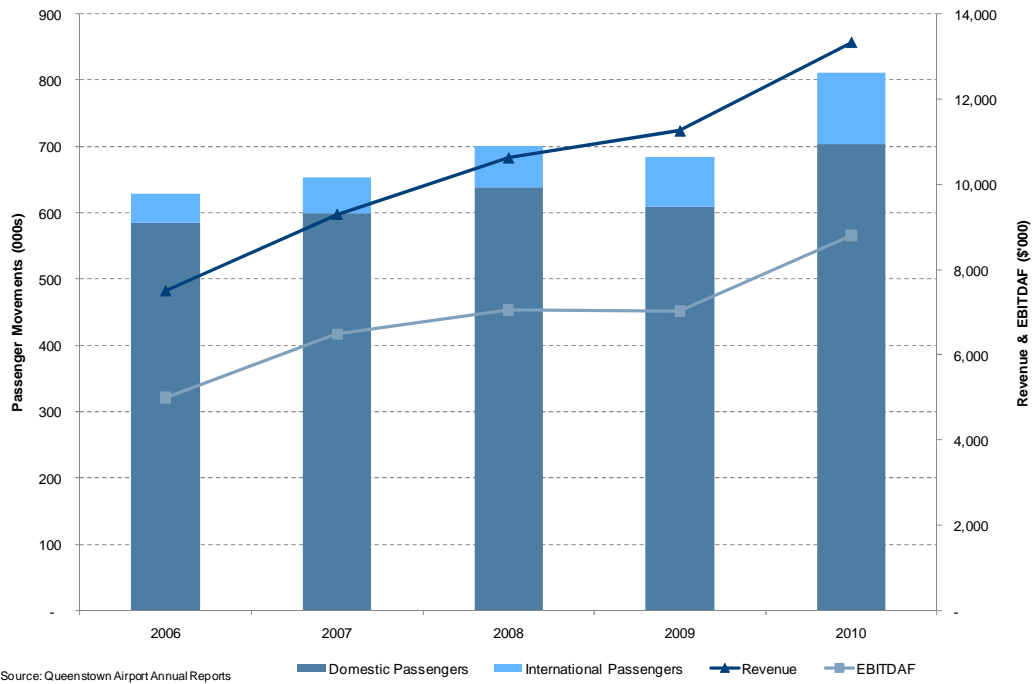
The following figure plots revenue, EBITDAF and margins over 2006 to 2010.

**Figure 13 Revenue, EBITDAF and EBITDAF margin % 2006 to 2010**



As previously noted, the principal driver of revenue and EBITDAF growth since 2006 has been rising passenger numbers, both domestic and international. The following figure plots revenue, EBITDAF and passenger movements over the last five years.

**Figure 14 Revenue, EBITDAF and passenger movements**



## Financial Position

The Company's statement of financial position as at 30 June 2006 to 2010 is summarised in Table 28.

**Table 28 Historical Financial Position**

As at 30 June NZD in 000s	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Actual
Cash	7	42	7	6	166
Trade and other receivables	1,245	904	824	661	1,032
Other current assets	166	323	130	40	371
<b>Total Current Assets</b>	<b>1,418</b>	<b>1,268</b>	<b>962</b>	<b>708</b>	<b>1,569</b>
Property, plant and equipment	34,892	45,195	46,441	47,532	132,260
Intangible assets	-	-	270	556	956
Deferred tax assets	564	666	729	681	-
<b>Total Non-current Assets</b>	<b>35,456</b>	<b>45,861</b>	<b>47,440</b>	<b>48,769</b>	<b>133,216</b>
<b>Total Assets</b>	<b>36,875</b>	<b>47,130</b>	<b>48,402</b>	<b>49,477</b>	<b>134,785</b>
Bank overdraft	52	-	209	164	-
Trade and other payables	2,595	1,188	1,207	921	1,552
Other current liabilities	94	266	203	513	1,464
Interest bearing debt	-	-	-	-	35,750
<b>Total Current Liabilities</b>	<b>2,740</b>	<b>1,454</b>	<b>1,620</b>	<b>1,598</b>	<b>38,766</b>
Interest bearing debt	22,400	31,100	31,050	30,500	-
Deferred tax liabilities	-	-	-	-	7,325
<b>Total Non-current Liabilities</b>	<b>22,400</b>	<b>31,100</b>	<b>31,050</b>	<b>30,500</b>	<b>7,325</b>
<b>Total Liabilities</b>	<b>25,140</b>	<b>32,554</b>	<b>32,670</b>	<b>32,098</b>	<b>46,091</b>
Share capital	10,331	10,331	10,331	10,331	10,412
Retained earnings	1,404	4,244	5,401	7,048	3,293
Revaluation reserve	-	-	-	-	74,988
<b>Total Equity</b>	<b>11,735</b>	<b>14,575</b>	<b>15,732</b>	<b>17,379</b>	<b>88,694</b>
<b>Total Liabilities and Equity</b>	<b>36,875</b>	<b>47,130</b>	<b>48,402</b>	<b>49,477</b>	<b>134,785</b>
Net debt	22,445	31,058	31,252	30,657	35,584
Net debt/Total assets	61%	66%	65%	62%	26%
Net debt/Equity	191%	213%	199%	176%	40%
Net debt/EBITDAF	4.50	4.79	4.43	4.37	4.04

Source: Queenstown Airport Annual Reports

We make the following comments with respect to QAC's financial position:

- The Company's overall level of indebtedness has increased due to capital expenditure on capacity expansion. However, its improved financial performance means that its ability to service this debt has also increased. Net debt/EBITDAF has decreased from 4.50x to 4.04x.
- QAC re-valued its land, buildings and infrastructure assets<sup>13</sup> to "fair value"<sup>14</sup> at 30 June 2010. With the exception of land, the basis of valuation for all assets was Optimised

<sup>13</sup> Roads, car park, runway and aprons.

Depreciated Replacement Cost (“ODRC”). Land was valued using the direct comparison/market value method.

- As the First Tranche of the transaction with AIAL occurred after balance date, the cash raised (\$27.7 million) is not reflected in QAC’s statement of financial position as at 30 June 2010.
- The recent change in tax legislation relating to depreciation on commercial buildings resulted in a substantial increase in the income tax expense for 2010 (an increase of over \$6 million). This reduced the Company’s equity and resulted in it breaching one of its banking covenants. As a consequence, all interest bearing bank debt had to be classified as “current” in the 2010 financial statements. The equity raised through the issue of shares to AIAL means the company is again in compliance with its banking facilities.

## Cash Flow

The Company’s statement of cash flows for the years ended 30 June 2006 to 2010 is summarised in Table 29. A graphical presentation of this information is presented in Figure 15.

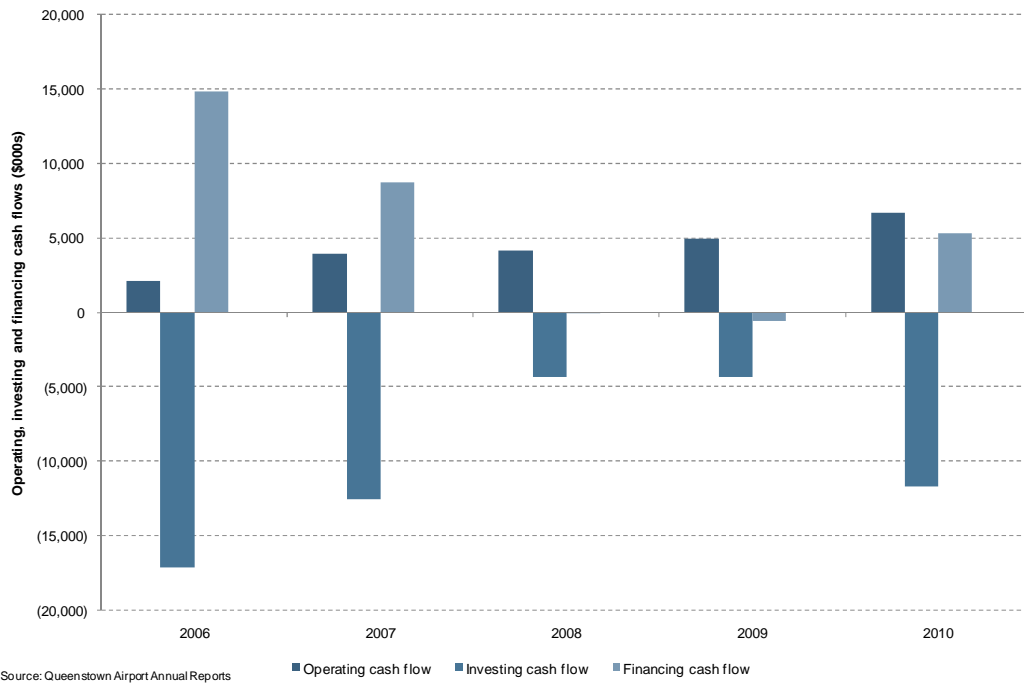
**Table 29 Historical Statement of Cash Flows**

Year ended 30 June NZD in 000s	2006 Actual	2007 Actual	2008 Actual	2009 Actual	2010 Actual
<b>Operating cash flow</b>	<b>2,098</b>	<b>3,952</b>	<b>4,129</b>	<b>4,973</b>	<b>6,662</b>
Proceeds from sale of PPE	0	1,905	-	-	64
Purchase of PPE	(17,126)	(14,470)	(4,053)	(4,086)	(11,322)
Purchase of intangible assets	-	-	(270)	(292)	(411)
<b>Investing cash inflow/(outflow)</b>	<b>(17,125)</b>	<b>(12,566)</b>	<b>(4,323)</b>	<b>(4,378)</b>	<b>(11,670)</b>
Proceeds/(repayments) from borrowings	14,400	8,700	(50)	(550)	5,250
Proceeds from issue of shares	406	-	-	-	81
<b>Financing cash inflow/(outflow)</b>	<b>14,806</b>	<b>8,700</b>	<b>(50)</b>	<b>(550)</b>	<b>5,331</b>
<b>Net increase/(decrease) in cash held</b>	<b>(221)</b>	<b>86</b>	<b>(244)</b>	<b>45</b>	<b>323</b>
Cash at beginning of period	177	(45)	42	(202)	(157)
<b>Cash at end of period (net of overdraft)</b>	<b>(45)</b>	<b>42</b>	<b>(202)</b>	<b>(157)</b>	<b>166</b>

Source: Queenstown Airport Annual Reports

<sup>14</sup> “Fair value” in this context, as set out in New Zealand International Accounting Standards, is defined as: “the amount for which an asset could be exchanged between knowledgeable and willing parties in an arms length transaction”.

**Figure 15 Operating, investing and financing cash flows**



QAC has invested just over \$50 million in its asset base over the five years to 30 June 2010. Approximately 44% of this has been funded by operating cash flow with the balance coming from additional borrowings.

## Appendix E: Forecasts

Financial projections prepared by QAC and presented in its 15 year financial model have been used as an input to the valuation presented in this report.

### Operating Revenues and Costs

The Company is forecasting continued strong growth in passenger numbers and landings in the long term and on the provision of sufficient infrastructure to meet demand. The forecasts assume total passengers will nearly double by 2020, rising from 812,000 in 2010 to 1,556,000.

International passengers are forecast to continue to grow at a faster rate than domestic passengers, increasing from 13% of total passenger numbers in 2010 to 27% by 2020. Matching the proportionate rise in international passenger numbers, international landings are forecast to increase to 21% of all landings by 2020, from 10% in 2010.

**Table 30 QAC Passenger and Landings Forecasts 2010-2020**

	2010 A	2015 F	2020 F
<b>Passengers (000s)</b>			
International	108	306	417
Domestic	704	923	1,139
<b>Total</b>	<b>812</b>	<b>1,229</b>	<b>1,556</b>
<b>Landings</b>			
International	452	1,185	1,615
Domestic	3,925	4,998	6,169
<b>Total</b>	<b>4,377</b>	<b>6,183</b>	<b>7,784</b>

Source: QAC, PwC Analysis

Airfield revenues are forecast to rise from \$2.7 million in 2010 to \$6.2 million in 2020 (CAGR of 8.9%). Operating expenses allocated to Airfield activities are forecast to rise at a much lower CAGR rate of 1.7% to 2020. Consequently, EBITDAF for Airfield activities is expected to rise nearly 400% by 2020 to \$4.0 million from \$0.8 million in 2010, at a CAGR of 17.2%. This growth demonstrates the operating leverage inherent in the business model.

**Table 31 QAC Airline Revenues and EBITDAF Forecasts 2010-2020**

NZD in 000s	2010 A	2015 F	2020 F
<b>Airfield</b>			
Landing charges	2,467	4,808	6,020
Other revenue	186	178	197
<b>Total Revenue</b>	<b>2,653</b>	<b>4,986</b>	<b>6,216</b>
<b>EBITDAF</b>	<b>827</b>	<b>3,022</b>	<b>4,048</b>
<i>EBITDAF margin %</i>	31.2%	60.6%	65.1%

Source: QAC, PwC Analysis

Terminal revenues (passenger charges, international passenger departure taxes and aeronautical leases) are forecast to rise in line with passenger numbers. Total terminal revenue is forecast to increase 140% over the period from \$5.2 million in 2010 to \$12.5 million in 2020.

In contrast to the Airfield activities, total expenses are assumed to rise to service the increased passenger activity at a CAGR of 10.3% a year. EBITDAF is forecast to rise by 126% over the period to \$7.7 million from \$3.4 million in 2010.

**Table 32 QAC Terminal Revenues and EBITDAF Forecasts 2010-2020**

<b>NZD in 000s</b>	<b>2010 A</b>	<b>2015 F</b>	<b>2020 F</b>
<b>Terminal</b>			
Passenger charges	4,106	6,049	7,943
Passenger departure tax	1,105	2,748	3,744
Aeronautical leases	-	762	842
<b>Total Revenue</b>	<b>5,211</b>	<b>9,559</b>	<b>12,529</b>
<b>EBITDAF</b>	<b>3,407</b>	<b>6,439</b>	<b>7,703</b>
<i>EBITDAF margin %</i>	<i>65.4%</i>	<i>67.4%</i>	<i>61.5%</i>

Source: QAC, PwC Analysis

Within Commercial activities, leases and licences are forecast to continue to be the most significant revenue generators, accounting for 33.3% of commercial revenues by 2020 (2010: 45.0%). The strongest growth in the segment is forecast to come from rental cars (CAGR 14%).

Overall, Commercial revenues are forecast to rise by 81% by 2020 to \$9.9 million from \$5.5 million in 2010. Nearly all of this growth is related to volume (growth in the number of passengers passing through the terminal); price changes are not a significant feature of the forecasts. As much of the commercial activity is run on a concessionary basis, associated operating expenses remain low, with EBITDAF margins forecast to remain above 85% from 2011 onwards.

**Table 33 QAC Commercial Revenues and EBITDAF Forecasts 2010-2020**

<b>NZD in 000s</b>	<b>2010 A</b>	<b>2015 F</b>	<b>2020 F</b>
<b>Commercial</b>			
Leases and Licences	2,460	2,590	3,292
Concessions	821	1,376	1,961
Non Terminal Revenue	586	664	766
Car Parks Revenue	1,244	1,889	2,603
Rental Cars	317	825	1,179
Other Income	35	72	80
<b>Total Revenue</b>	<b>5,464</b>	<b>7,415</b>	<b>9,881</b>
<b>EBITDAF</b>	<b>4,572</b>	<b>6,398</b>	<b>8,402</b>
<i>EBITDAF margin %</i>	<i>83.7%</i>	<i>86.3%</i>	<i>85.0%</i>

Source: QAC, PwC Analysis

Taking all three categories together, total revenues are forecast to increase to \$28.6 million in 2020 from \$13.3 million in 2010 at a CAGR of 7.9%. Combined operating expenses are forecast to increase to \$8.5 million from \$4.5 million at a CAGR of 6.5%. As a result, EBITDAF rises by 129% to \$20.2m, and margins improve over the period to 70.4% in 2020 from 66.1% in 2010.

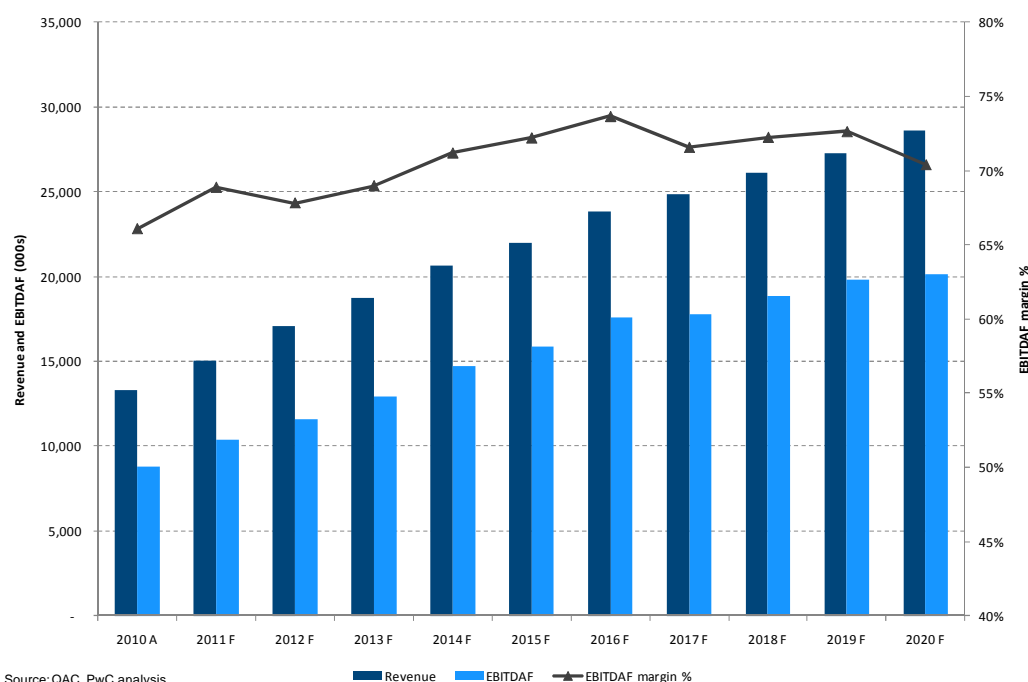


**Table 34 QAC Revenues and EBITDAF Forecasts 2010-2020**

<b>NZD in 000s</b>	<b>2010 A</b>	<b>2015 F</b>	<b>2020 F</b>
Landing charges	2,467	4,808	6,020
Other revenue	186	178	197
<b>Total Airfield</b>	<b>2,653</b>	<b>4,986</b>	<b>6,216</b>
Passenger charges	4,106	6,049	7,943
Passenger departure tax	1,105	2,748	3,744
Aeronautical leases	-	762	842
<b>Total Terminal</b>	<b>5,211</b>	<b>9,559</b>	<b>12,529</b>
Leases and licences	2,460	2,590	3,292
Concessions	821	1,376	1,961
Non terminal revenue	586	664	766
Car parks revenue	1,244	1,889	2,603
Rental cars	317	825	1,179
Other income	35	72	80
<b>Total Commercial</b>	<b>5,464</b>	<b>7,415</b>	<b>9,881</b>
<b>Total Revenue</b>	<b>13,328</b>	<b>21,960</b>	<b>28,627</b>
<b>Total Expenses</b>	<b>4,523</b>	<b>6,101</b>	<b>8,474</b>
<b>EBITDAF</b>	<b>8,805</b>	<b>15,860</b>	<b>20,153</b>
<i>EBITDAF margin %</i>	<i>66.1%</i>	<i>72.2%</i>	<i>70.4%</i>

Source: QAC, PwC Analysis

**Figure 16 QAC Revenues and EBITDAF Forecasts 2010-2020**



## Capital Expenditure

QAC's ability to maintain its service levels given the likelihood of continued passenger growth is dependent on how it continues to increase capacity. The Company faces some capacity constraints, which fall into four broad categories:

- Maximum aircraft size due to length of runway and alpine topology.
- Maximum number of flights per hour due to no second runway and/or taxi routes.

- 
- Terminal capacity constraints (number of jet stands; baggage make up & reclaim facilities, etc.).
  - Consent to extend landing/take-off window (currently 6 a.m. to 10 p.m.) and the installation of runway lighting required to extend into hours of darkness.

QAC has recently made a number of announcements about action it is taking to address its capacity constraints:

- Taxiways – a ‘heavy taxiway’ will be constructed and sealed over the next two to three years;
- Terminal capacity – work has commenced extending the Western side of the terminal to make way for an expanded baggage and makeup area. Three jet hardstands will be built over the next three years; and
- Take off and landing times - the Company’s Directors voted in December 2010 to accept the independent Commissioner’s recommendation to the Queenstown Lakes District Council to not allow flights between 10pm and midnight, after extensive consultation with stakeholders.

Aeronautical and terminal capital expenditure plans are driven by passenger number forecasts. Non-aeronautical terminal capital expenditure assumptions for offices and retail are based on terminal planning ratios, and as such are indirectly linked to passenger numbers, via the calculations for aeronautical terminal square metres.

Plans for commercial capital expenditure (for rental car offices etc) are based on commercial revenue forecasts, through maintaining a capital to revenue ratio, and as such are also consistent with revenue growth assumptions in the forecasts.

Figure 17 presents commercial revenue and commercial revenue per dollar of commercial capital expenditure over 2010 to 2020.

**Figure 17 Commercial revenue and commercial revenue/commercial capital**

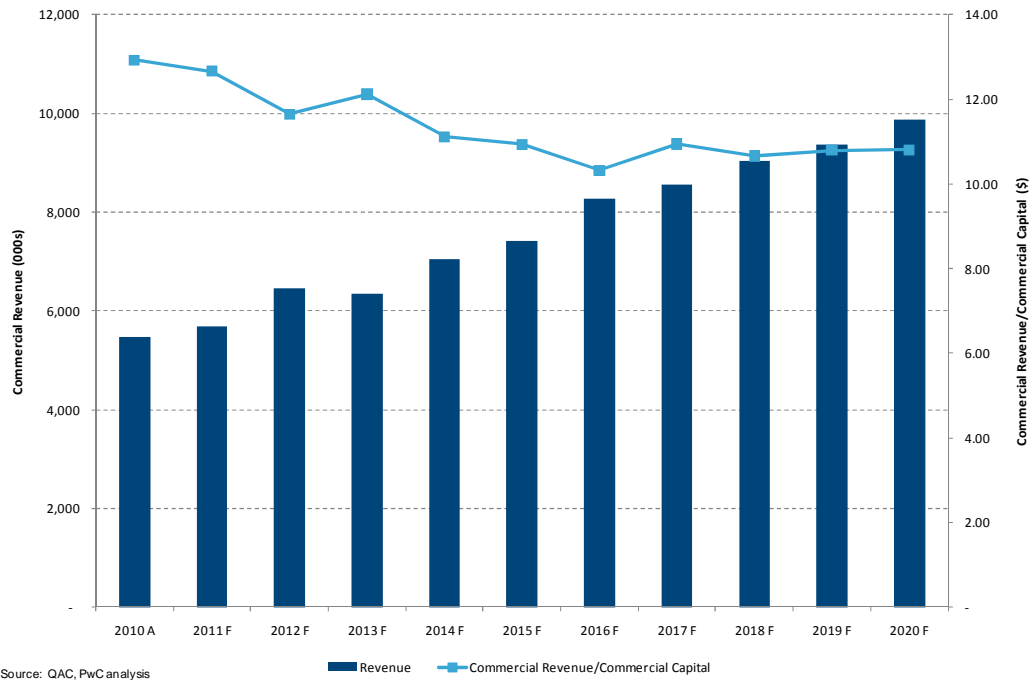


Table 35 below summarises QAC’s capital expenditure requirements, split by project related capital expenditure by line of business and other maintenance capital expenditure. As can be seen, the major capital expenditure events are relatively evenly distributed in 2011-2013; other significant requirements are expected to fall in 2017, 2019 and 2020.

**Table 35 QAC Expansion and Maintenance Capital Expenditure Forecasts 2011-2020**

NZD in 000s	2011 F	2012 F	2013 F	2014 F	2015 F	2016 F	2017 F	2018 F	2019 F	2020 F
Airfield	7,350	-	5,000	-	-	-	-	-	3,691	-
Terminal	-	5,959	-	-	-	-	5,103	-	-	7,161
Commercial	2,000	-	-	-	-	-	5,404	-	2,114	3,155
Other	300	2,741	387	313	1,343	3,254	2,074	1,605	1,466	1,917
<b>Total</b>	<b>9,650</b>	<b>8,699</b>	<b>5,388</b>	<b>313</b>	<b>1,343</b>	<b>3,254</b>	<b>12,581</b>	<b>1,605</b>	<b>7,271</b>	<b>12,233</b>

Source: QAC, PwC Analysis

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## Appendix F: Valuation Methodologies

There are four principal methodologies commonly used for valuing a business of a trading enterprise:

- Discounted cash flow analysis (DCF).
- Capitalisation of earnings.
- Industry rules of thumb.
- Notional realisation of assets.

Each of these methodologies has application in different circumstances. A key factor in determining the appropriate methodology is the actual practice commonly adopted by buyers and sellers of the type of business being valued.

It is a fundamental principle that the value of an asset or business is represented by its expected future cash flows, discounted to a present value at a rate which reflects the risk inherent in those cash flows. This approach, referred to as the DCF methodology, is particularly suited to situations where a business is in a growth phase or requires significant additional investment to achieve its projected earnings.

The capitalisation of earnings methodology requires an assessment of the maintainable earnings of the business and the selection of an appropriate capitalisation rate, or earnings multiple. This methodology is most appropriate where there is a long history of relatively stable returns and capital expenditure requirements are neither large nor irregular. In practice, it is often difficult to obtain accurate forecasts of future cash flows and therefore the capitalisation of earnings methodology is often used as a surrogate for the DCF methodology.

Three commonly used approaches to the capitalisation of earnings methodology are the capitalisation of:

- Earnings before interest, taxation, depreciation and amortisation (EBITDA) by an appropriate EBITDA earnings multiple to obtain an enterprise value (which comprises the value of an enterprise's debt and equity).
- Earnings before interest and taxation (EBIT) by an appropriate EBIT earnings multiple to obtain an enterprise value.
- Tax paid profits at an appropriate price earnings (PE) multiple to obtain the value of the enterprise's equity.

In some industries businesses are valued using well established "rules of thumb". Generally these rules of thumb are used as a cross check for a primary valuation methodology such as capitalisation of earnings or DCF.

Notional realisation of assets assumes that the value of a business is equal to the realisable value of its individual assets. This is generally used either in relation to businesses holding readily marketable assets with little or no intangible value attaching to the business or where liquidation will yield a higher value than a going concern value.

## Appendix G: Comparable Companies

Company	Description
<b>Auckland Airport</b>	Auckland International Airport Limited provides airport facilities and supporting infrastructure in Auckland. The company serves approximately 22 international airlines. It offers airfield landing, passenger, terminal, and car parking services. It also operates duty free and specialty stores, foreign exchange, and food and beverage outlets, as well as engages in the rental of space in facilities, such as terminals and cargo buildings, and stand-alone investment properties. The company was founded in 1988 and is based in Auckland, New Zealand.
<b>MAp Group</b>	MAp Group owns and operates airports in Sydney, Copenhagen, Brussels, and Bristol. It also holds strategic investments in Japan Airport Terminal, Grupo Aeroportuario del Sureste de Mexico S.A de C.V, and Newcastle International Airport. The company was formerly known as Macquarie Airports and changed its name to MAp Group on October 23, 2009. MAp Group is based in Sydney, Australia.
<b>Airports of Thailand</b>	Airports of Thailand Public Company Limited, together with its subsidiaries, manages, operates and develops airports in Thailand. It operates six international airports, including Don Mueang, Chiang Mai, Hat Yai, Phuket, Chiang Rai, and Suvarnabhumi providing services for Thailand and international flights. It also leases spaces at the airports to conduct airport-related activities. In addition, the company offers hotel services and various services, such as landing, parking, passenger, and aircraft services. It was formerly known as Airports Authority of Thailand and changed its name to Airports of Thailand Public Company Limited in September 2002. The company was founded in 1979 and is headquartered in Bangkok, Thailand.
<b>Fraport AG</b>	Fraport AG operates the Frankfurt Airport in Germany. The company has four segments: Aviation, Ground Handling, Retail and Real Estate, and External Activities and Services. The Aviation segment provides in flight and terminal operations, airport security, and airport expansion activities. It also provides runways, taxiways, and VIP services. The Ground Handling segment provides aircraft handling, check in, passenger and crew transport, passenger bridges, cabin cleaning, sanitary, de-icing, and push back services, as well as services for passengers with restricted mobility. The company was founded in 1924 and is based in Frankfurt am Main, Germany.
<b>Flughafen Wien AG</b>	Flughafen Wien Aktiengesellschaft, together with its subsidiaries, constructs and operates civil airports and related facilities in Europe and the Middle East. The company manages Vienna International Airport and Voslau-Kottingbrunn Airport. The company has four segments: Airport, Handling, Retail and Properties, and Other. The Airport segment provides aviation and airport services, such as the operation and maintenance of the movement areas, the terminal, the VIP centre, and VIP lounges, as well as various equipments required for passenger and baggage handling. The Handling Segment supplies ground and cargo handling services, including the loading and unloading of aircraft; and the transportation of passengers, crews, and catering materials, as well as cabin cleaning and aircraft towing and de-icing. The company is headquartered in Schwechat, Austria.
<b>Grupo Aeroportuario Centro Norte</b>	Grupo Aeroportuario del Centro Norte, S.A.B. de C.V., through its subsidiaries, holds concessions to develop, operate, and maintain airports in the central and northern regions of Mexico. The company operates 13 airports in Monterrey, Acapulco, Mazatlan, Zihuatanejo, Chihuahua, Culiacan, Durango, San Luis Potosi, Tampico, Torreon, Zacatecas, Ciudad Juarez, and Reynosa. It offers various aeronautical services, including aircraft landing, parking, boarding, and unloading services; passenger walkway; airport security services;

Company	Description
	complementary services, such as ramp handling and baggage handling services, catering services, aircraft security, aircraft maintenance and repair, and fuelling; leasing of space to airlines; and permanent ground transportation services. In addition, the company engages in non-aeronautical activities, including commercial activities carried out at its airports, such as the operation of parking and advertising facilities; leasing of space to retail stores, car rental companies, food and beverage service providers, communications service providers, financial service providers, ground transportation service providers, and time-share developers. The company is based in Nuevo Leon, Mexico. Grupo Aeroportuario del Centro Norte, S.A.B. de C.V. operates as a subsidiary of Aeroinvest, S.A. de C.V.
<b>Grupo Aeroportuario del Pacifico</b>	Grupo Aeroportuario del Pacifico, S.A.B. de C.V. develops, operates, and maintains airports in the Pacific and central regions of Mexico. It operates 12 airport facilities in the cities of Guadalajara, Puerto Vallarta, Tijuana, Los Cabos, Silao, Hermosillo, Mexicali, Los Mochis, La Paz, Manzanillo, Morelia, and Aguascalientes. The company also leases space to restaurants, retailers, and service providers. It serves airlines; providers of baggage handling services; retail store operators, duty-free store operators, food and beverage providers, time share developers, financial services providers, car rental companies, telecommunications providers, VIP lounges, advertising and travel agencies, and tourist information and promotion service providers. The company is headquartered in Guadalajara, Mexico.
<b>Grupo Aeroportuario del Sureste</b>	Grupo Aeroportuario del Sureste, S.A.B. de C.V., through its subsidiaries, holds concessions to operate, maintain, and develop airports in the southeast region of Mexico. It operates nine airports located in Cancun, Cozumel, Huatulco, Merida, Minatitlan, Oaxaca, Tapachula, Veracruz, and Villahermosa. The company offers various aeronautical services, including passenger, landing, aircraft parking, usage of passenger walkways, and airport security services. Its non-aeronautical services comprise commercial activities, such as the leasing of space in airports to retailers, restaurants, airlines, and other commercial tenants, as well as advertising; and the provision of complementary services consisting of luggage check-in, sorting and handling, aircraft servicing at gates, aircraft cleaning and maintenance, cargo handling, airport security, aircraft catering, assistance with passenger boarding and deplaning, ground transport, and aircraft fuel supply services to air carriers. Grupo Aeroportuario del Sureste, S.A.B. de C.V. was founded in 1998 and is headquartered in Mexico City, Mexico.
<b>Flughafen Zuerich AG</b>	Flughafen Zürich AG owns and operates Zurich Airport in Switzerland. The company operates in two segments, Aviation and Non-Aviation. The Aviation segment engages in the construction, installation, operation, and maintenance of the airport operating infrastructure. Its services include the maintenance of runway system, apron zones, and passenger zones in the terminals; and the provision of freight operations, baggage sorting and handling system, aircraft energy supply system, passenger handling, and safety services. This segment also installs, operates, and maintains security infrastructure. The Non-Aviation segment engages in the development, marketing, and operation of the commercial infrastructure at Zurich Airport. This segment also operates retail outlets and car parks at the airport and rents commercial premises. The company is headquartered in Kloten, Switzerland.
<b>SAVE SpA</b>	SAVE SpA, together with its subsidiaries manages airports in Italy. The company manages and develops airport infrastructure, which include the movement of aircraft, passengers, and goods inside the airports, as well as the granting of space on airport premises for commercial activities. It provides airport management services for Venice Marco Polo Airport, Treviso Sant'Angelo Airport, Padua Airport, Venice Lido Airport, and Pantelleria Airport. In addition, it manages mobility infrastructures and related services that consist of upgrading,

Company	Description
	improving, and managing the real estate complexes of the medium-sized Italian railway stations; promoting and increasing passenger activity in the Port of Venice; and managing the Venice to Padua motorway section. Further, the company involves in various food and beverage operations comprising provision of catering services for the public; and the operation of convenience stores that sell magazines, newspapers, and essential articles, as well as department stores, which sell specialty products for the travelers at airports, railway stations, highways, shopping malls, and ports. As of December 31, 2009, it operated 159 stores. The company is based in Tessera, Italy.
<b>Beijing Airport</b>	Beijing Capital International Airport Company Limited engages in the ownership and operation of the international airport in Beijing; and the provision of related services in the People's Republic of China. The company offers aeronautical services, which consists of aircraft landings and take-offs, passenger service facilities, ground support services, and fire-fighting services for domestic and foreign airlines. Its non-aeronautical services include the franchise of the business of ground handling agent services; in-flight catering services; operating duty free and other retail shops in the terminals, as well as restaurants and other food and beverage businesses; and leasing advertising spaces inside and outside the terminals. The company also involves in leasing properties in the terminals; operating car parks; and providing ground handling facilities for ground handling agent companies. The company was founded in 1958 and is based in Beijing, the People's Republic of China. Beijing Capital International Airport Company Limited is a subsidiary of Capital Airports Holding Company.
<b>Shanghai Airport</b>	Shanghai International Airport Co., Ltd. provides ground handling services to domestic and foreign airlines and passengers. It also leases aviation business space, commercial space, and offices inside the airports. It also involved in advertising; and operating other logistics business related to airfreight. The company was formerly known as Shanghai Hongqiao International Airport Co., Ltd. and changed its name to Shanghai International Airport Co., Ltd. in June 2000. Shanghai International Airport Co., Ltd. is based in Shanghai.
<b>Guangzhou Airport</b>	Guangzhou Baiyun International Airport Co. Ltd. operates in Guangzhou City as a hub airport in the People's Republic of China. It provides ground handling and other extended services for airline companies, passengers, and cargo owners. The company was founded in 2000.
<b>Hainan Meilan Intl Airport</b>	Hainan Meilan International Airport Company Limited operates an airport and provides related services in the Peoples Republic of China. The company's aeronautical business consists of the provision of terminal facilities, ground handling services, passenger, and cargo handling services. Its non-aeronautical businesses include leasing commercial and retail spaces at the Hainan Meilan Airport; airport-related business franchising; leasing advertising space; operating car parking places; providing tourism services; and selling duty-free and consumable goods. The company was founded in 2000 and is headquartered in Haikou City, the People's Republic of China.

## Appendix H: Comparable Company Multiples

Company	Country	Mkt Cap NZDm	Net Debt NZDm	EV NZDm	Revenue NZDm <sup>1</sup>	EBITDAF NZDm <sup>1</sup>	EBITDAF Margin %	EV/EBITDAF Historical <sup>2</sup>	EV/EBITDAF Prospective <sup>2</sup>	M.Cap/NPAT Historical <sup>2</sup>	M.Cap/NPAT Prospective <sup>2</sup>	M.Cap/NA Historical <sup>2</sup>
Auckland Airport	New Zealand	2,821	1,078	3,898	361	275	76.0%	17.7x	16.2x	32.8x	27.5x	1.8x
MAp Group <sup>3</sup>	Australia	7,344	6,640	13,984	1,693	1,016	60.0%	17.2x	16.4x	18.3x	16.1x	1.1x
Airport of Thailand	Thailand	2,509	1,797	4,306	1,082	542	50.0%	9.9x	8.4x	62.9x	21.9x	1.0x
Fraport AG	Germany	7,846	4,651	12,498	3,601	989	27.5%	15.8x	12.6x	36.6x	33.4x	2.1x
Flughafen Wien AG	Austria	1,861	1,148	3,009	908	297	32.7%	12.7x	11.7x	17.8x	16.0x	1.6x
Grupo Aeroportuario Centro Norte	Mexico	1,082	67	1,149	206	106	51.2%	13.6x	11.2x	26.4x	26.9x	1.6x
Grupo Aeroportuario del Pacifico	Mexico	2,992	(132)	2,860	356	231	65.0%	15.5x	13.7x	28.6x	26.1x	1.3x
Grupo Aeroportuario del Sureste	Mexico	2,236	(67)	2,169	341	214	62.8%	12.7x	11.3x	32.2x	23.7x	1.9x
Flughafen Zuerich AG	Switzerland	3,247	1,641	4,889	1,148	563	49.0%	10.9x	10.2x	15.2x	21.8x	1.8x
SAVE SpA	Italy	728	106	834	608	107	17.6%	9.7x	9.4x	28.0x	24.5x	1.9x
Beijing Airport	China	3,115	3,846	6,961	989	477	48.3%	18.2x	14.7x	62.1x	42.4x	1.5x
Shanghai Airport	China	5,050	349	5,399	667	334	50.0%	20.2x	14.5x	42.9x	24.8x	2.3x
Guangzhou Airport	China	2,142	51	2,193	662	291	43.9%	9.4x	8.1x	23.6x	18.7x	2.0x
Hainan Meilan Intl Airport	China	815	(191)	623	68	41	60.3%	19.0x	15.5x	32.3x	26.3x	3.0x
<i>Average</i>								<i>14.5x</i>	<i>12.4x</i>	<i>32.8x</i>	<i>25.0x</i>	<i>1.8x</i>
<i>Median</i>								<i>14.5x</i>	<i>12.2x</i>	<i>30.4x</i>	<i>24.7x</i>	<i>1.8x</i>

Source: Broker Reports, Capital IQ

Note: All figures in NZD, converted at spot rates prevailing on 20 December 2010.

<sup>1</sup> Latest annual results.

<sup>2</sup> Adjusted for control premium of 25%.

<sup>3</sup> Financial information for MAp Group represents the proportionately consolidated revenue and EBITDAF of investee airports.



## Appendix I: QAC and AIAL Comparison

Factor	Metric	QAC	AIAL	Comment	QAC relative to AIAL
Size	Total assets (2010)	\$135m	\$3,262m	Auckland Airport has an asset base that was 24x larger than QAC's in 2010. Earnings multiples can have some positive correlation with the firm size.	↓
Size	Pax (2010)	812k	13,448k	AIAL handled 16.5x as many passengers as QAC handled in 2010.	↓
Historical Growth	% change EBITDAF last 5 years	76%	15%	High growth businesses tend to trade on higher earnings multiples than low growth businesses. QAC has grown faster than AIAL over the last five years (EBITDAF up 76% vs. 15% for AIAL).	↑
Growth Prospects	% change EBITDAF 2010 - 2013	47%	24%	QAC is also expected grow faster than AIAL in the future. EBITDAF for QAC is expected to increase by 47% from 2010 to 2013, EBITDAF for AIAL is forecast to increase by 24%.	↑
Profitability	Avg. EBITDAF margin % last 5 years	66%	77%	Profitability is also positively correlated with earnings multiples. AIAL appears to be more profitable than QAC as measured by the average EBITDAF margin for the two companies over the last 5 years. AIAL's outperformance can in part be attributed to the economies of scale AIAL enjoys from being a larger airport than QAC.	↓
Profitability	Avg. EBITDAF/pax last 5 years	\$9.81	\$20.37	Another measure of profitability is EBITDAF per passenger. AIAL also appears to be more profitable than QAC as measured by this metric.	↓
Diversification	Number of airlines flying into airport	4	22	Diversification reduces risk. The number of airlines that fly into an airport is one measure of diversification. AIAL has 22 airlines whereas QAC has 4 (we have not included smaller airlines like Aspiring Air etc in this analysis). However, both airports are very reliant on the financial prospects of Air New Zealand, the dominant domestic carrier.	↓
Diversification	Non-aero. revenue % of total revenue	47%	54%	Another measure of diversification is the ratio of non-aeronautical revenue to total revenue, reflecting the extent of reliance on passenger volume. In 2010 QAC generated 47% of revenue from non-aeronautical activities versus 54% for AIAL.	↓

Source: Annual Reports, QAC, Broker reports

## Appendix J: Cost of Capital

We have used an estimate of QAC’s Weighted Average Cost of Capital (“WACC”) to discount future cash flows for the purpose of the valuation. The WACC has been estimated using the following model:

$$\text{WACC} = D/V * R_d * (1 - T_c) + E/V * R_e$$

The individual components of the model are outlined in Table 36.

**Table 36: WACC Component Descriptions**

Component	Description
D/V and E/V	Relative proportions of debt and equity in the capital structure.
R <sub>d</sub>	The Company’s cost of debt
T <sub>c</sub>	The corporate tax rate
R <sub>e</sub>	The cost of equity = (R <sub>f</sub> *(1-T <sub>i</sub> )+D <sub>y</sub> *T <sub>d</sub> +B <sub>e</sub> *PTMRP
R <sub>f</sub>	The risk free rate of interest (government stock yields)
T <sub>i</sub>	Investor tax rate
D <sub>y</sub>	Dividend yield
T <sub>d</sub>	The effective tax rate on dividends
B <sub>e</sub>	Equity beta = B <sub>a</sub> *(1 + D/E). B <sub>a</sub> (asset beta) is a measure of the relative riskiness of returns.
PTMRP	Post tax market risk premium

### Risk Free Rate

New Zealand bond yields are, by convention, quoted on a semi-annual basis. Accordingly, quoted yields need to be converted to annual yields using the following formula.

$$\text{Annual yield} = ( 1 + \text{Semi-annual yield} / 2 )^2 - 1$$

The following risk free rates have been used in the valuation:

**Table 37 Risk free rates**

	1 year	2 year	3 year	4 year	5 year	10 year
Risk Free Rates	3.93%	4.40%	4.73%	5.01%	5.27%	5.86%

Source: Capital IQ

### Asset Betas

We have estimated separate asset betas for QAC’s aeronautical and commercial businesses. To estimate an asset beta for QAC’s aeronautical business we have considered:

- Asset betas for AIAL and MAp Group calculated using five years of monthly return data for these companies.

- The asset betas for Auckland, Wellington and Queenstown airport as disclosed in their financial statements for identified airport activities.
- The asset beta for airport service businesses as specified by the Commerce Commission in *Input Methodologies (Airport Services), Reasons Paper, December 2010*.

This analysis is presented in Table 38.

**Table 38 Aeronautical asset betas**

<b>Airport</b>	<b>Asset Beta</b>
<b>Market</b>	
Auckland Airport	0.58
MApp Group	0.65
<b>Disclosure Accounts</b>	
Auckland	0.50 - 0.70
Wellington	0.45 - 0.60
Queenstown	0.65
Commerce Commission	0.60
<i>Source: Annual Reports, CapitalIQ, Commerce Commission</i>	

We consider that an asset beta of 0.60 is appropriate for QAC's aeronautical business. This is in line with guidance provided by the Commerce Commission and is within the range of asset betas observed for the other airports.

Revenue for QAC's commercial business is in part determined by the turnover of lessees. The commercial business has some of the characteristics of a retail business and a property ownership business. To estimate an asset beta for QAC's commercial business we have considered asset betas observed for listed retail businesses and commercial property companies. This analysis is presented in Table 39.

**Table 39 Retail and commercial property asset betas**

<b>Retail Businesses</b>	<b>Asset Beta</b>
Briscoe Group	0.93
Hallenstein Glassons	0.84
Michael Hill	0.77
Pumpkin Patch	1.06
<b>Average</b>	<b>0.90</b>
<b>Property Companies</b>	<b>Asset Beta</b>
AMP NZ Office Trust	0.33
CDL Investments	0.57
ING Property Trust	0.30
Kiwi Income Property Trust	0.30
Goodman Property Trust	0.34
The National Property Trust	0.42
Property for Industry Limited	0.30
<b>Average</b>	<b>0.37</b>
<i>Source: PwC estimates</i>	

The asset betas observed for retail businesses are much higher than those for the property companies. In our view, the asset beta for the commercial business should not be less than the asset beta for the aeronautical business. The commercial assets have some but not all of the natural monopoly characteristics of the aeronautical assets. We consider that an asset beta in the range of 0.60 to 0.80 is appropriate for the commercial business.

## Gearing

Our estimate a reasonable level of gearing for QAC has taken into account:

- The gearing of a selection of New Zealand airports calculated using book values of net debt and equity. This information was extracted from annual reports for the year ended 30 June 2010 for Auckland, Hamilton, Christchurch and Dunedin airports. Information for Wellington Airport was extracted from its annual report for the year ended 31 March 2010.
- The gearing of the comparable companies outlined in Appendix C calculated using book values of net debt and market values of equity (market capitalisation) as at 17 December 2010.
- The gearing of QAC as at 30 June 2010 calculated using book values of net debt and equity.

This analysis is presented in Table 40 and Table 41 below.

**Table 40 Book Gearing for New Zealand Airports**

<u>Airport</u>	<u>D / (D+E) (book values)</u>
Auckland	36%
Hamilton	13%
Wellington	38%
Christchurch	22%
Dunedin	42%
Queenstown	29%
<b>Average</b>	<b>30%</b>

*Source: Annual Reports*

**Table 41 Gearing for International Airports**

<u>Airport</u>	<u>D / (D+E)</u>
Auckland Airport	28%
MAp Group	47%
Airport of Thailand	42%
Fraport AG	37%
Flughafen Wien AG	38%
Grupo Aeroportuario Centro Norte	6%
Grupo Aeroportuario del Pacifico	-5%
Grupo Aeroportuario del Sureste	-3%
Flughafen Zuerich AG	34%
SAVE SpA	13%
Beijing Airport	55%
Shanghai Airport	6%
Guangzhou Airport	2%
Hainan Meilan Intl Airport	-31%
<b>Average</b>	<b>19%</b>

Note: Calculated using book value of net debt and market value of equity.

*Source: Capital IQ, Annual Reports*

We consider that a reasonable level of gearing for QAC (D/D+E) is 30%.

Re-gearing the asset beta estimates for this level of gearing results in an equity beta of 0.86 for the aeronautical business and an equity beta of 0.86 to 1.14 for the commercial business.

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### **Market Risk Premium**

PwC has carried out research on the post-investor tax market risk premium (to allow for the impact of dividend imputation) for use in the New Zealand post-investor tax CAPM. Allowance has been made for the estimated proportion of investors liable for tax on capital gains. This research has indicated a premium of approximately 7.5%.