

Working paper on the cost of capital: the implications of the RP3 draft performance plan for Heathrow Airport Limited (HAL)

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CHAPTER 1: Introduction

- 1.1 We have published our consultation on the draft performance plan for Reference Period 3 (RP3)¹, which includes performance targets and incentives for NATS (En Route) Plc – referred to as NERL – and will form the basis of the price controls for NERL's monopoly air traffic service activities. We will issue our final proposals in relation to these matters later in 2019. This is consistent with our Transport Act 2000 duties to regulate NERL as the UK en route air navigation service provider and our wider duties under the European Union (EU) Single European Sky (SES) performance scheme.
- 1.2 As part of our draft proposals, we have estimated the required cost of capital for NERL based on a weighted average cost of capital (WACC), drawing on a broad range of evidence. Our estimate of NERL's WACC takes account of both market wide parameters (that have general application) and parameters specific to NERL and its circumstances.
- 1.3 While focused primarily on NERL, this approach builds on the initial work on the cost of capital for Heathrow Airport Limited (HAL) that we published in December 2017, which was supported by a PwC report (completed in November 2017²) that provided initial estimates of the WACC for HAL.
- 1.4 Given the links between these workstreams this working paper sets out the implications for HAL of our work on RP3. In this context we have asked PwC to update its report on HAL's business as usual or 'as is' cost of capital, which excludes the important considerations associated with capacity expansion (as these are dominated by HAL specific factors rather than market wide parameters). We have published the latest report from PwC³ alongside this working paper.
- 1.5 In formulating our draft RP3 performance plan we took into account advice from PwC, whose latest report uses estimates for the market wide elements of our cost of capital calculations that are broadly consistent with our draft performance plan. In updating its earlier November 2017 report, PwC has also responded to a range of issues raised by stakeholders and updated its analysis where it considered it appropriate to do so. Where PwC considers company specific

¹ CAA, Draft UK Reference Period 3 Performance Plan proposals, CAP 1758, February 2019

² PwC, Estimating the cost of capital for H7, November 2017

³ PwC, Estimating the cost of capital for H7 – Response to stakeholder views, February 2019