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ECONOMIC SURPLUS

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Eckhard Drews, Director Controlling DFS

Vitan Todorov, Director Finance and Chief Accountant BULATSA

AGENDA

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In its monitoring reports PRB regularly uses the Economic Surplus indicator which is often understood as profit – a term that is defined unequivocally in the international accounting standards.

This has raised questions such as:

- **Are Economic Surplus and profit really synonymous?**
- **What financial interpretations derive from both values?**
- **How do their calculations differ?**
- **Is Economic Surplus correctly interpreted by audience?**

Economic Surplus – PRB approach – Paper SSC/15/55/21

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What is economic surplus:

- Part of PRB Annual Monitoring Report
- '… something analogous to the economic profit … rather than accounting profit'
- can be positive or negative

1. The main ATSP net gain/loss on ANS activities in one single year
   a. Cost sharing,
   b. Traffic risk sharing mechanism and
   c. Financial incentive mechanism for capacity and environment targets
   d. Carry-over effect: Inflation adjustment
   e. Uncontrollable cost (cost exempt)
2. The estimated surplus embedded in the cost of capital
3. WACC (Weighted Average Cost of Capital) is pre-tax

Economic Surplus – PRB approach – Paper SSC/15/55/21

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‘Conclusion’

“… It will provide early indications of those service providers that are reporting economic losses for their shareholders, or taking successful proactive actions to maintain or improve their expected level of economic surplus ...

Similar new analytical concepts have been introduced in the past (e.g. ATCO productivity, support costs, etc). The PRB expects the economic surplus to attain a similar level of acceptance and understanding over time”, i.e.:

- **ANSPs are supposed to plan for some Economic Surplus to exist and cost of equity is not a surplus by default, it is part of the cost base**
- **Attention is to be paid what is generated above the plan**
- **WACC is pre-tax and thus pre-dividend, therefore cannot be used to measure ‘money left’ for the ANSP!**
- **Sources of surplus are important, e.g. traffic above plan**

No link between Economic Surplus – and other KPAs

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- Service units (traffic) above plan generate additional above planned revenue
- Additional service units (+2 to +10%) are effectively charged at ~30%
- Additional service units (> +10%) are effectively charged at ~0%
- Additional traffic might have impact on Capacity performance
- Such source of “surplus” is out of ANSP control

Publications regarding Economic Surplus
Example 1

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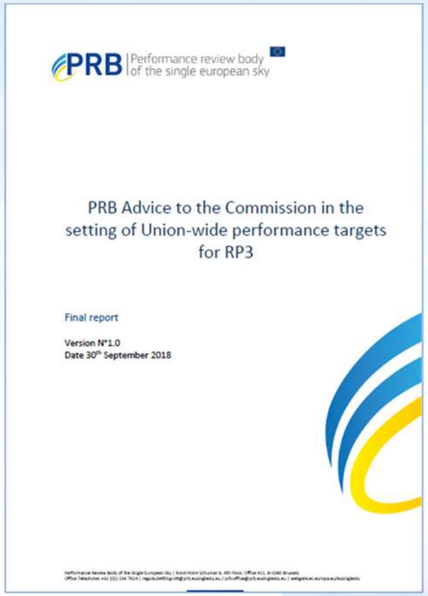
- **Overall for cost for the provision of the service** have largely remained flat during RP2. This means that ANSPs were able to handle the (slightly) increased traffic of the past years at the similar cost. However, this statement needs to be put into context: At the same time, ANSPs had substantially increased revenues, because through the current charging scheme, the charges don't only depend on the number of flights they handle, but also on the weight of the aircraft. As airlines are using larger aircraft and are increasing the load factor, revenue for ANSPs has increased. As the PRB has pointed out in the Target Ranges Report, many ANSPs have accumulated surpluses which they should be using to improve the quality of service.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PRB Advice to the Commission in the setting of Union-wide performance targets for RP3

Final report

Version N°1.0
Date 30th September 2018

a) CAP01: Ambition Level

166 The PRB proposed target ranges of 0.24-0.50 minutes of delay per flight for the target value for RP3, minimising the overall costs borne by airspace users and passengers. The considerable under-investment in the industry during RP2 has increased the impact of high traffic growth. At the same time, many ANSPs have continued to increase their economic surplus.

Publications regarding Economic Surplus
Example 2

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- Some air navigation service providers accumulated substantial surpluses during the reference period, which they do not have to return to airspace users. In view of the COVID-19 crisis, the PRB expects that those who accumulated surpluses will use the money to manage the liquidity gap in 2020 and 2021 and to reduce their cost during the crisis;

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PRB Monitoring Report 2019 and RP2 Overview

The 2019 monitoring consists of five reports:

- **PRB Monitoring Report 2019**
- Annex I – Union-wide detailed analysis for experts
- Annex II – Member States' detailed analysis for experts
- Annex III – Safety Report
- Annex IV – CAPEX Report

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Performance Review Body of the Single European Sky | Rond-Point Schuman 6, 6th Floor, Offices 611-613, B-1040 Brussels
Office Telephone: +32 (0)2 234 7824 | regula.dettling-ott@prb.eusinglesky.eu / prb-office@prb.eusinglesky.eu | webgate.ec.europa.eu/eusinglesky

Three approaches for a better representation of ANSPs' results

1. Costs may exceed revenues in the ANSP performance plans
2. The terminology 'surplus' should not be used by PRB presenting ANSPs' results
3. No mix of actual and planned figures for the calculation of Cost of Capital

First approach for a better representation of ANSPs' results

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Costs may exceed revenues

in the ANSP performance plans!

Revenues and costs might not be equal (example)

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Real terms	ANSP figures	PRB calculation	Delta	
Revenues Performance Plan	100	100	0	
Costs Performance Plan	150	100	50	=> costs are the basis for the calculation of charges
Surplus Performance Plan	**-50**	**0**	**-50**	
Revenues actual	100	100	0	
Costs actual	140	90	50	
Surplus actual	**-40**	**10**	**-50**	=> Surplus in PRB calculation, loss in statutory accounts

The PRB-calculation assumes, that the financial result for the ANSP in the Performance Plan is 0 (Zero) → Revenues and costs are equal (incl. Return on Equity)

But: For the Performance Plan the Unit Rate might e.g. be reduced by the State leading to a planned negative result for ANSPs.

Second approach for a better representation of ANSPs' results

The terminology 'surplus' should not be used by PRB presenting ANSPs' results!

Second approach for a better representation of ANSPs' result

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The terminology 'surplus' and its calculation leads to misinterpretations and to confusion with the results in the statutory accounts (e.g. EBT = Earnings Before Taxes)

DFS 2017:

Mio. €	En-route	Terminal	∑
Economic Surplus	120.2	-2.5	117.7
Statutory accounts	39.7	-61.2	-21.5
Delta	-80.5	-58.7	

⇒ **There is a gap of approx. 140 Mio. € between the Economic Surplus calculated by PRB and the statutory accounts!**

Economic Surplus vs. annual statutory accounts (example)

The following example shows a huge deviation to the financial results:

⇒ **How is this possible?**

Transition annual statutory accounts to Economic Surplus (example)

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P&L - annual statutory accounts Mio. €	**Statutory accounts**
Revenues	**70.0**
Staff costs	50.0
Operational Costs	30.0
Depreciation	10.0
Financial Expense	10.0
Profit / Loss annual statutory accounts	**-30.0**

Transition Mio. €	**Total (enroute and terminal)**
Annual statutory accounts (P&L)	-30.0
Deviation revenue reduction targeted by the State	50.0
Uncontrollable costs	10.0
Bonus/Malus	5.0
Economic Surplus (nominal)	**35.0**
Inflation index actual	*110.9*
Difference between nominal and real	**-3.4**
Economic Surplus real terms (PRB approach)	**31.6**

Huge difference between **statutory accounts** (-30.0 Mio. €) and **Economic Surplus** (+31.6 Mio. €) lead to miss-interpretations

Third approach for a better representation of ANSPs' results

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No mix of actual and planned figures for the calculation of Cost of Capital!

Calculation of Return on Equity (RoE) should be based on actual figures

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DFS 2017; in T€	Performance Plan	Actual	Economic Surplus
Asset Base	436,722	682,599	682,599
Return on Equity	7.45%	5.23%	7.45%
Result	32,536	35,728	50,854

No mix of actual (such as asset base) and planned (percentage of Return on Equity) figures for the calculation of Cost of Capital

Calculation of PRB shows a totally different RoE compared to the real accounts.

The ‘virtual RoE’ shown in the official Monitoring Report (see below) might lead to misunderstanding and wrong conclusions:

ATSP estimated surplus ('000 €2009) based on actual data from Reporting Tables	2015A	2016A	2017A
Total asset base	1 397 725	1 457 775	1 471 128
Estimated proportion of financing through equity (in %)	34.1%	39.6%	46.4%
Estimated proportion of financing through equity (in value)	476 728	577 082	682 599
Estimated proportion of financing through debt (in %)	65.9%	60.4%	53.6%
Estimated proportion of financing through debt (in value)	920 997	880 693	788 529
Cost of capital pre-tax (in value)	62 663	67 784	63 633
Average interest on debt (in %)	2.9%	2.8%	1.6%
Interest on debt (in value)	27 147	24 791	12 779
Determined RoE pre-tax rate (in %)	7.5%	7.5%	7.5%
Estimated surplus embedded in the cost of capital for en-route (in value)	35 516	42 993	50 854
Net ATSP gain(+)/loss(-) on en-route activity	57 195	70 714	69 361
Overall estimated surplus (+/-) for the en-route activity	**92 712**	**113 706**	[illegible]
Revenue/costs for the en-route activity	**819 320**	**774 473**	**738 418**
Estimated surplus (+/-) in percent of en-route revenues	**11.3%**	**14.7%**	**16.3%**
Estimated ex-post RoE pre-tax rate (in %)	**19.4%**	**19.7%**	**17.6%**

Conclusion – Economic Surplus method …

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- is very technical and only at expert level fully comprehensible,
- is still a misunderstood concept which differs strongly from the legal books,
- is transferred in publications into the better known term 'profit' thus indicating that ANSPs have had an enormous of surplus,
- should be indicative to show what was generated in excess to the Performance Plan and ensure consistency with the annual reports,
- is no requirement resulting from regulation but an indicator invented by PRB,
- There is a need to improve the message with the target to avoid confusion as financial experts need to translate and interpret the data to decision makers.