

BAA Budapest Conference Call
Monday 19th December 2005
15:00 UK Time
Chaired By Mike Clasper

Mike Clasper

Good morning everybody for those in America, and anybody coming in from the UK, good afternoon. I just want to take you through basically the core points around the acquisition that's been announced. And, of course, most of you know it was going on for quite awhile. We're now at least able to talk about the details of the acquisition. So I'll basically take you through that rationale and talk lines and then let's hopefully have a healthy question and answer session.

First of all I'll say a little bit about Hungary before I get into its implications for us. Hungary as you know is a new member of the EU. From an aviation point of view, it's a tremendous growth opportunity, not just because of the similar facts as occurred in Ireland and in Portugal where the economy gets lots of gains from joining the EU, but obviously it's going to generate foreign direct investment. Because of membership in the EU it's already happening. It's also got a very, very healthy tourist business already developed in the last couple years or so, based on being in the EU, but very, very importantly compared even to Portugal and Ireland, its strategic position geographically right in the middle of the new EU and, the way the EU is going to develop, means that businesses are making quite a lot of choice of thinking of it as a cargo logistics, you know, business centre. So there's no doubt that aviation in Hungary makes a lot of sense as a sort of growing industry and that can be seen in the growth momentum of the airport before we've acquired it.

Now let's start turning to, in the context of ourselves, I think we see it as a truly transformational breakthrough type of deal for our international business. It's not just because of the scale of the investment or the scale of the opportunity that it's created, not

just the size, but the fit. There is a huge opportunity there to develop the retail business, something that we know about and we know how to do, it's majorly underdeveloped. There's no doubt there is going to be a lot of growth, but the facilities haven't been built out for that growth yet, so we can design them in the right way. However, the one thing that we won't have which we have in the UK all the time is space constraint. The landmass of Budapest is the same as Heathrow and it's doing 7.8 million passengers at the moment, not 67 million passengers. And most of that landmass is underdeveloped, or not developed at all. So, we get the chance to develop almost in a green field the sort of business parks, the hotels, the property development, the retail, and so on and so on that we would have liked to have done at Heathrow knowing what we know today. But, of course, the first terminal at Heathrow was built in 1952.

So that in a sense is why it's a perfect fit for us in terms of us being able to use our talents to develop it. It's also got the advantage that, because of the wide spaces in the airfield, we can fine-tune the capital to the traffic. We don't have to put the facilities down in the big lumps that we've had to do at Heathrow in terminal five or the big one-off investment that goes with Stansted generation 2 the second runway at Stansted. So if the traffic grows very quickly we can add a bit more of a facility cost-effectively, if it grows a little slower we don't have to add it, or we can add a little bit less of a facility and still make it capital-efficient. So that works very, very well for us.

Now, why we're doing international at all of course is because we're doing it to get a better return than we get in our tightly regulated London markets. And Budapest, in the way the government has set up the framework around this acquisition, is an extremely benign regulated environment. In effect, anything that we do that drives efficiency in the operation or drives the commercial revenues, any aspect of commercial revenues, any upside that we get from that we keep. There's no five-year review return on capital, adjust the prices down and we lose the gain, we keep it permanently for the life of the contract. And, you know, given what I've just said about the way we can use our skills to develop the opportunity in retail, car parking, property, hotels, cargo, logistics and so on,

it's quite a mouth-watering idea that we can then have those returns for our shareholders instead of having it simply subsidize the airlines.

Now, when I turn to the returns we basically assessed the project and its valuation on the cash flows over the life of the contract. We then applied an 8% weighted average cost of capital to that, which then got us a range of valuations and we bid right in the middle of that range. We didn't add a strategic premium. I want to explain a little bit about that 8% weighted average cost of capital because some of you'll be working out what are the details of how you calculated it. Well basically we took the debt, the expected interest rate on the debt, we assumed a 50-50 gearing, we then used that against the 8% weighted average cost of capital which implies a 12% return for our shareholders. Were the financial structure to be any better than that, in terms of the gearing of the asset as you look at it, or the risk-free rate as you look at it, obviously that would imply higher returns than the 12%.

Now, you know, given the traction of what I've just said of course it sounds too good to be true. And of course you have to make an assessment that there are some risks in this project, and that's where we've done our homework, right? Because the major risk is this benign regulatory environment changes in one way or another over time. The way that I look at it there's sort of three elements to that. The first element is this is what we normally do. We're normally dealing with politicians and governments. And therefore we understand how to manage those risks very well on a sort of day-to-day basis. The second thing is there's a huge need and desire by the Hungarian government to make this a success because we all know that for an economy there's far more job creation in economic growth in a great airport growing than there is any marginal gain by playing around with the economics of the airport. I mean, you know, there's an estimate that for each million of passengers that you have at international airport, you're creating thousands of jobs in the local and national economy. So why would they choose to disturb if we're managing it well, which is always the deal. If we're managing the airport well, why would they disturb something which not only would you know potentially hurt

the economy in Hungary, but it would also put off future foreign investment which is, of course, critical to their ambitions to be as strong an economy as the existing old EU.

The third thing though is we're not daft. We have ensured that we cover it by having in the contract itself a clause that says, if there is a government-driven material change in the economics in the first five years, then we get our money back plus 11% interest which ought to be enough of a protection from anything happening on the political side that would give us any concerns.

The other thing that you look at in an investment like this is obviously currency risk, but we're in an interesting situation here in that, not only are we and in some of the material that you've probably seen, expressing the landing charges in euros, that's not a translation from the local currency, that's because the airlines pay in euros. That means we're at an interesting position whereby any weakness in Hungarian currency means that our local costs will be lower but our revenues would be protected by the euro, which is a sort of unusually positive position to be in where you've got earnings in a foreign economy not backed by the dollar of the euro or the pound. So from a currency risk point of view this is abnormally low.

So at the end of the day, why are we doing it? We're doing it because it's a transformation of our international business to sit along side our UK business, the returns are very, very strong and we've been able to structure the deal in a way in which all of those returns come to us. Again, in the material that you've probably seen, 99% of the cash returns come to us even though we only own 75% of the equity of the asset. So we're very excited about it and we're looking forward to getting on with it, and we're looking forward to doubling the EBITDA dollar in the next five or six years.

If I can now hand over to the operator so that we can have questions.

Operator

We will now begin the question and answer session. Your first question comes from Robert Curtis of NTI News Agency.

Robert Curtis

This is Robert Curtis from the Hungarian News Agency, London, good afternoon Mr Clasper.

Mike Clasper

Good afternoon.

Robert Curtis

Mr Clasper, you mention political risk, can I ask you to comment a little bit further on the possible controversy that is being stirred by this transaction in Hungary, and how would you rate the chances of this transaction having to be reversed or modified in any way should there be a government change, and secondly, how would you comment on the Moody's move today that actually downgraded BAA in connection with this transaction.

Mike Clasper

On the first point probably most of the other callers on the line don't know this, but of course we do know that there has been quite a lot of dialogue in the upcoming election around this privatisation. I think I go back to what I said earlier. I think we will run the asset very well for Hungary. We think that will be appreciated by all parties and all government. We're used to dealing with changes in parties, they've occurred plenty of times in our time as running the UK operation, and I do think both parties have expressed the importance of direct foreign investment in the future of Hungary even just in the last few days. And I don't think anybody would want to give a signal that said these things weren't being respect. But it is in public domain that were that to happen as I said earlier in the call, we would get our money back plus 11% interest. So in the sense of the purpose of this call, which is what about the risks within, you know, our decision to proceed, then I think they are very well mitigated and covered.

In terms of the Moody situation, we expected this rating change, have been talking to the Ratings Agencies about it, our expectation is that we'll have a one-notch drop and we'll go on a stable outlook. It only marginally increases the cost of our debt, we have a lot of headroom, and it doesn't get in the way of doing all the things that we want to do in developing our core asset base here in the UK.

Okay, next question please?

Operator

There are no further questions at this time.

Mike Clasper

Okay, well thank you very much. Obviously if over the next coming days and in the new year, if people want to sort of get any more details as you absorb all the material we've pumped out, then Sarah Hunter of our Investor Relations Group will be happy to take your call.

Thanks for joining us today and Merry Christmas to you all.