Facing Facts:

The Survival of Airport Shopping and Dining

Issued by: The Airport Restaurant and Retail Association (ARRA), June 2020.

Airport Restaurant & Retail Association

Fact #1
Air Traffic Will Not Recover This Year

Enplanement projections on which any short-term relief plan for airport concessions is based, should be cautious and conservative given the current sharp level of traffic decline and complete uncertainty surrounding the duration of the COVID-19 pandemic. Since the declaration of the public health emergency four months ago, airline passenger traffic fell more than 95% from 2019 (pre-pandemic) levels. During May, there was a slight recovery. According to Airlines for America (A4A), the trade association of U.S. airlines, for the week ending May 24:

- Air travel (onboard passengers) fell 89%.
- Flights are down system-wide 74%.
- Domestic flights are down 68%.
- International flights are down 95%, and 2020 are expected to be half of flights in 2019
- Airlines have idled over 3,000 planes -- 50% of their fleets

As noted by American Airlines CEO Doug Parker, "We are all going to be in it for the long haul, but that doesn't mean we will all be flying around the same number of airplanes. We are all building our airlines in a way that doesn't anticipate having 2019 revenues in 2021."

While some airports have started to see small upticks in traffic, they have been sporadic and inconsequential relative to airlines, airports, and airport business partners. By every indication, recovery will be slow, an outlook shared by airlines and industry analysts alike. Traffic projections to the contrary should be justifiably viewed with skepticism, if not disregarded as wholly and unreasonably optimistic. Passenger volumes took 3 years to recover from 9/11 and 7+ years following the 2007-08 global financial crisis. In this environment, where the survival of thousands of concessions businesses is at stake, it is imprudent to use a "best case" scenario as the basis for structuring rent relief proposals.

Illustrative Media Articles

(Routes Online, April, 2020) "United Airlines believes passenger demand will likely remain suppressed into 2021 and cautions a return to pre-COVID-19 pandemic levels of flying is unrealistic for the foreseeable future".

(Reuters, May 2020) "After announcing that it would no longer fly its 18-wide-body 777s, Delta told its 14,500 pilots that it expects to have 7,000 more than it needs in the fall."

(Fortune, May 2020) "Delta Air Lines CEO Ed Bastian told employees Wednesday that it could take two to three years for the airline's business to recover from the impact of the coronavirus pandemic. Our load factors are in the 15-20% range. Our overall number of passengers is about 5% of what it should be. There is not too much lower we can go. Bastian said it will be three years before the airline gets back to a sustainable level. We are not going to be building back what we had necessarily. We will be building back a new Delta. I'm not sure you are going to see travel at scale the way we have come to know it in our industry."

(Fitch Ratings, April 2020) "The global economic impact of the pandemic will likely lead to reduced levels of traffic for longer than previously expected. Our current base case reflects traffic only slowly recovering toward 2019 levels by the end of 2021, with a full rebound to 2019 levels only occurring by 2022 or 2023."

(Business Insider, April 2020) "In a research note dated April 1, Stifel analyst Joseph DeNardi wrote that even in a best-case scenario, travel demand would only return "to the pre-outbreak trend by mid-2021," noting that current trends suggest that a more "bearish scenario is playing out."

(Reuters, May 15, 2020) "The airline industry is not likely to recover to pre-coronavirus levels for at least the next six to 12 months, Southwest Airlines Co (LUV.N) Chief Executive Officer Gary Kelly said on Thursday."

(New York Times, May 10, 2020) "The Airline Business Is Terrible. It Will Probably Get Even Worse. It would be naïve to believe we or anyone for that matter can accurately predict the course of this crisis or the recovery, J. Scott Kirby, United's president and incoming chief executive, told investors this month. When we say plan for the worst and hope for the best, however, we really mean it."

Fact #2

Airport Restaurant and Retail Operators Can't Pay Minimum Annual Guarantee (MAG) During Recovery and Survive

There can be no recovery without abatement of fixed rent or Minimum Annual Guarantee (MAG) through December 2020 at a minimum, and discounted percentage rent until traffic returns to at least 80% of 2019 baseline.

- In the April 28, 2020, white paper, *Financial Impact of COVID-19 on Airport Concessions*, ARRA Executive Director Rob Wigington characterized the impact of not having passengers and corresponding sales for operators as devastating. This is a fact.

- 15%-20% of 2020 budgeted sales are dedicated to pay rent (Minimum Annual Guarantees, Percentage Rent, Storage Rent, Common Area Maintenance and other fees) and another 10-12% for debt service. With no sales or little sales, these expenses grow magnificently as a percentage of sales. Moreover, it's important to shift the mindset from percentages to actual dollars. If an operator can manage all the other expenses in its P & L well (including cost of goods and products, employee wages, taxes and building expenses) they would still lose millions. The survival equation becomes one that has nothing to do with being profitable, but only how much cash a business has on hand, and how many months it can survive based on the payments drawn down on that sum.

Representative P&L's of Large ($10M) and Small ($2M) Food and Retail Operations at 30%* Sales Levels

F&B: $10M	Budget	30% Recovery	Difference
Sales	$10,000	$3,000	($7,000)
COGS	$2,530	$854	($1,676)
Total Labor	$3,103	$1,391	($1,711)
Total Rent & Occupancy	$1,780	$1,441	($339)
Royalties	$350	$105	($245)
Operating costs	$653	$370	($283)
Total Costs	$8,416	$4,162	($4,254)
EBITDA	$1,584	($1,162)	($2,746)
Annual Financing	$1,126	$1,126	$0
Pre-Tax Cash Flow	$458	($2,288)	($2,746)

F&B: $2M	Budget	30% Recovery	Difference
Sales	$2,000	$600	($1,400)
COGS	$520	$185	($335)
Total Labor	$656	$301	($355)
Total Rent & Occupancy	$340	$276	($64)
Royalties	$70	$21	($49)
Operating costs	$161	$104	($57)
Total Costs	$1,747	$888	($859)
EBITDA	$253	($288)	($541)
Annual Financing	$225	$225	$0
Pre-Tax Cash Flow	$28	($513)	($541)

Retail: $10M	Budget	30% Recovery	Difference
Sales	$10,000	$3,000	($7,000)
COGS	$3,920	$1,198	($2,722)
Total Labor	$2,249	$1,113	($1,136)
Total Rent & Occupancy	$1,850	$1,493	($357)
Royalties	$0	$0	$0
Operating costs	$596	$316	($280)
Total Costs	$8,615	$4,120	($4,495)
EBITDA	$1,385	($1,120)	($2,505)
Annual Financing	$901	$901	$0
Pre-Tax Cash Flow	$484	($2,021)	($2,505)

Retail: $2M	Budget	30% Recovery	Difference
Sales	$2,000	$600	($1,400)
COGS	$788	$241	($547)
Total Labor	$516	$224	($292)
Total Rent & Occupancy	$340	$276	($64)
Royalties	$0	$0	$0
Operating costs	$149	$97	($52)
Total Costs	$1,793	$838	($955)
EBITDA	$207	($238)	($445)
Annual Financing	$180	$180	$0
Pre-Tax Cash Flow	$27	($418)	($445)

* Currently at 11.5% of Normal Sales Levels 80+ days since airline traffic dropped below 85% of 2019 levels

- Operators cannot afford to pay full rent until at least 80% of the traffic returns. Until then, rent will need to be financially feasible and phased in. It seems disingenuous and illogical for anyone to demand rent when they know an operator is losing money and working hard to remain solvent. This is like *"getting blood from a stone"* as an operator paying this rent would only serve to shorten the time until they are forced out of business.

Monthly sales fluctuate based on historical traffic patterns

Assumptions
Originally Expected Sales: $10M
Percentage Rent: 15.0%
2020 MAG: $1211

Actual 202	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Est. % of Normal	*100%*	*100%*	*40%*	*5%*	*7%*	*12%*	*20%*	*20%*	*25%*	*25%*	*30%*	*30%*
Sales	$750	$667	$323	$41	$59	$112	$191	$187	$200	$212	$241	$253
% Rent	$113	$100	$48	$6	$9	$17	$29	$28	$30	$32	$36	$38
MAG	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*
Rent Paid	*$113*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*	*$101*
Effective %	*15.0%*	*15.1%*	*31.2%*	*248.3%*	*170.0%*	*90.5%*	*52.9%*	*53.9%*	*50.5%*	*47.7%*	*41.9%*	*39.8%*

2021 MAG $1,030 at 85% of Last Year Actual Paid

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Est. % of Normal	*80%*	*80%*	*80%*	*80%*	*80%*	*80%*	*80%*	*80%*	*80%*	*80%*	*80%*	*80%*
Sales	$618	$549	$666	$670	$699	$766	$787	$772	$659	$697	$662	$696
% Rent	$93	$82	$100	$100	$105	$115	$118	$116	$99	$105	$99	$104
MAG	*$106*	*$106*	*$106*	*$106*	*$106*	*$106*	*$106*	*$106*	*$106*	*$106*	*$106*	*$106*
Rent Paid	*$106*	*$106*	*$106*	*$106*	*$106*	*$115*	*$118*	*$116*	*$106*	*$106*	*$106*	*$106*
Effective %	*17.2%*	*19.3%*	*16.0%*	*15.9%*	*15.2%*	*15.0%*	*15.0%*	*15.0%*	*16.1%*	*15.2%*	*16.1%*	*15.3%*

Fact #3
Deferral Is Not Relief

Deferring MAG is not a viable solution. Simply stated, lost sales in April, May, June, and later are gone forever and will never be available to support the rent being deferred. If rent is deferred until late 2020, 2021, or even a later date, rent will actually double during the period operators are expected to repay deferrals. But, sales will not double and, once again, MAG will force businesses into a negative cash position.

- Monthly cash flow during a normal period is inadequate to pay deferred rent. As shown in the representative P&Ls above, in the budgeted normal month, EBITDA – the only cash available to pay deferred rent – is less than rent, indicating there is not enough cash flow to repay deferrals, even during normal times.

- For demonstration purposes, a business that did $10M in aggregate sales, would be paying $3.5M in rent on $7.5M in sales. This would topple any operator's Profit and Loss statement. There would be no dollars in that equation to pay for raw goods, products or employees. This would only serve to put the operators out of business quickly. If a deferral is intended to "buy time" to allow an airport time to find a permanent solution, that would be logical. However, if truly contemplated to be paid in the future, it is not feasible under any scenario, or sustainable by restaurant and retail operators.

Assumes Annual MAG of $1,211K paid in 12 equal installments of $101K

MAG Repayment is 6 equal installments for each month deferred

Months MAG Deferred: 3

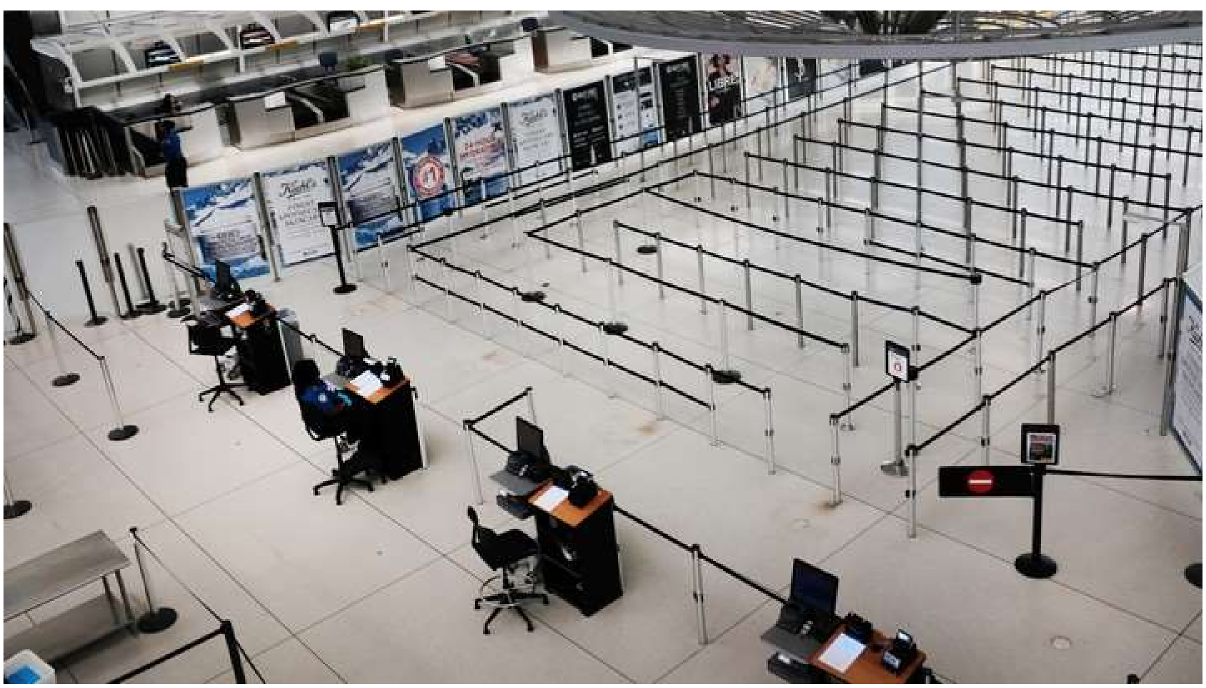
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Sales	$750	$667	$323	$41	$59	$112	$191	$187	$200	$212	$241	$253
% Rent @ 15%	$113	$100	$48	$6	$9	$17	$29	$28	$30	$32	$36	$38
MAG	$101	$101	$101	0	0	0	$101	$101	$101	$101	$101	$101
April MAG Repayment							$17	$17	$17	$17	$17	$17
May MAG Repayment							$17	$17	$17	$17	$17	$17
June MAG Repayment							$17	$17	$17	$17	$17	$17
Total MAG	$101	$101	$101	$0	$0	$0	$151	$151	$151	$151	$151	$151
Rent Paid	$113	$101	$101	$6	$9	$17	$151	$151	$151	$151	$151	$151
Effective %	15.0%	15.1%	31.2%	15.0%	15.0%	15.0%	79.3%	80.8%	75.8%	71.6%	62.8%	59.8%

Fact #4

The COVID-19 Financial Crisis is Devastating All Operators – Large and Small

Martin Moodie, Founder of the Moodie Davitt Report, was recently asked about the payment of MAGs in global concession contracts during the pandemic. He noted that there are airports who erroneously believe that operators, particularly ones operating globally, "have the money to pay MAG." Moodie went on to say that the rent and MAG challenge exists in every market worldwide. The perception is that a large company can withstand poor performance in one market by making up for it in others. However, in this case of global impact, the scale of the larger companies works against them as every market in which they operate has been affected. Each market around the world is suffering much the same way, and the problem becomes multiplied by the size and scale of the companies.

- Losses in passengers and corresponding sales worldwide have put large companies in danger of insolvency as every business they operate is at risk.
- In early March each of the public companies in the airport concessions industry raised cash to remain solvent. That cash is being used for survival. With no sales, these businesses are losing money each day. Just like all companies in this business, large and small, they are operating at a barebones level until business returns.
- These businesses now face the challenge of repaying debt in a market that won't recover for years.



Fact #5
Interconnectivity of Primes, ACDBEs, and Subtenants = Financial Impact on All

Large and small operators are bound together through joint ventures and subleases. It is a misconceived notion, as some have suggested, that in order to support small businesses and ACDBEs (Airport Concessions Disadvantaged Business Enterprises), financial relief need only support them to the exclusion of larger prime companies. In fact, the concessions industry is extremely interconnected.

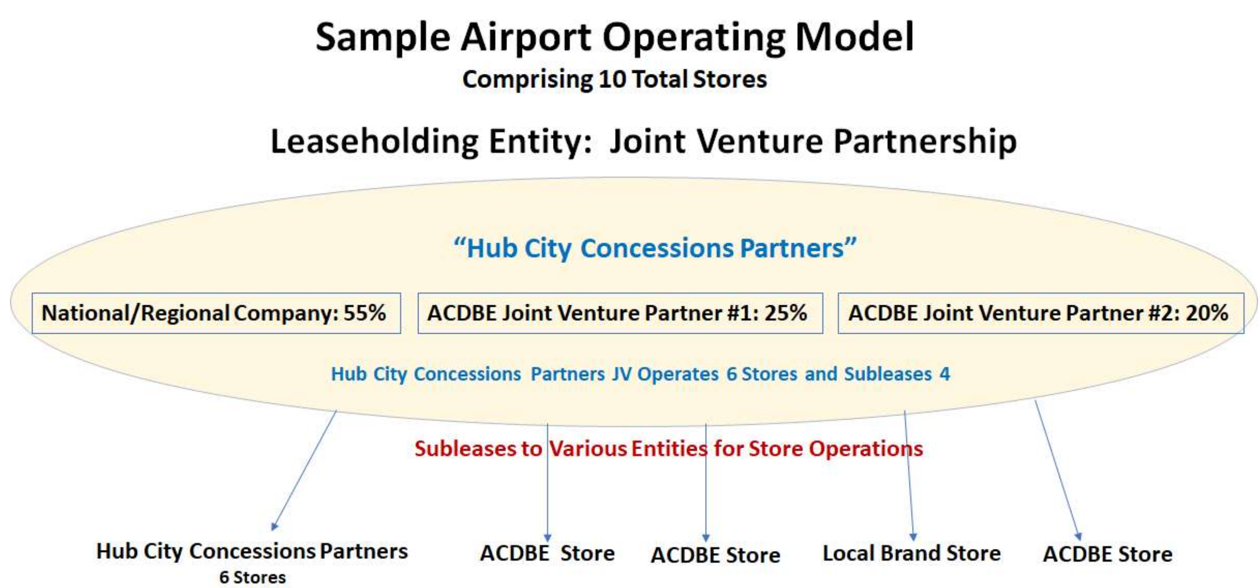
- *The overwhelming majority of ACDBEs are in joint venture arrangements with prime operators.*

- Those that are not in joint ventures primarily operate as sublessees under the umbrella of prime or "Master Concession" contracts.

- The benefits derived from these structures for the local operator or ACDBE include reduced risk, capital financing, shared real estate for support space and distribution, among many others.

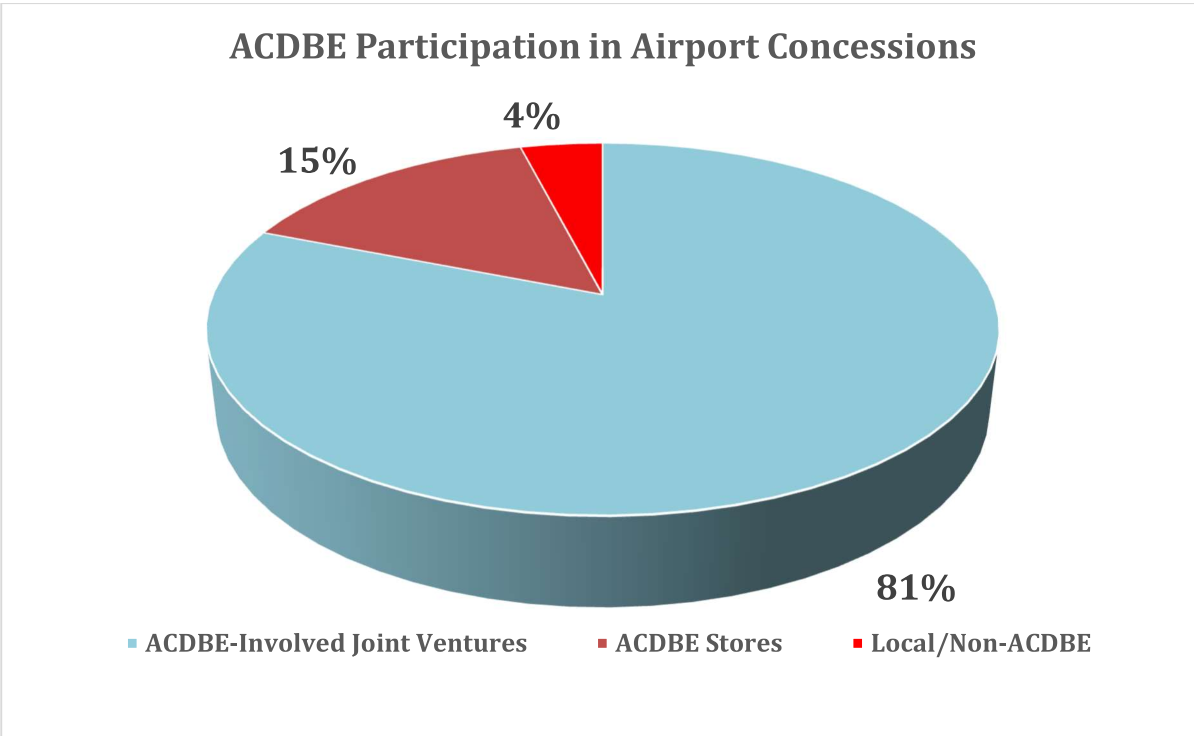
- Primes in turn depend upon their local partners for capital contributions, administrative and financial oversight, authenticity of local/regional themes, and on-site management.

- Success of the ACDBE/small business is inextricably tied to success of the prime, and primes operating in U.S. airports have for decades fully incorporated ACDBEs in their business models and operations. One does not survive without the other.



Fact #6

The “Meeting of the Minds” Underlying Concessions Contracts is Gone



Airports and concessionaires agree to the terms of lease and concession agreements with the understanding that there will be sufficient enplaning passengers to generate sales and profits, commit capital, support ACDBE partners, and pay fair rent to the airport. Naturally, there are market risks that airports and concessionaires must bear, such as the cyclical nature of the economy, fluctuations in air travel, and airline competition. However, the COVID-19 global pandemic and subsequent business crash is not a foreseeable risk that any party agreed to take. COVID-19 is far more than a typical market fluctuation; it is an unforeseeable catastrophic event that has crippled the global travel sector. The result is that the basis of the fundamental agreement between airport and concessionaire –enplanements in exchange for rent – has been materially and adversely affected.

For an airport to take a position that “a contract is a contract” and continue to expect concessionaires to pay minimum fixed rent when there are few, if any, enplaning passengers, ignores the basic expectation of both parties when signing a lease and concession contract – that there would be passengers at sufficient levels to sustain an airport concessions business. Concessionaires never agreed to be an airport’s insurance policy. Eliminating fixed and/or minimum rents until such time as there is sufficient traffic to support functional airport concessions businesses honors the “meeting of the minds” of both parties at the time of contracting. This is good faith. This is fundamentally fair.

Fact #7
CARES Act Grants Replace Lost Revenue

In guidance and an accompanying FAQ issued on April 4, the FAA states that CARES Act grants to airports can "be used for any purpose that airports can lawfully use funds." Moreover, in both the guidance and public statements by FAA officials the FAA speaks affirmatively of an airport's ability to provide rent abatement. Indeed, during a May 13 interview (ARRA/AMAC COVID-19: Survival and Revival teleconference, May 13, 2020),the FAA's Associate Administrator of Airports observed the "clear intent of Congress" that CARES Act grants are intended to pay operating and capital expenses in order to *free airport cash to support the solvency of airport tenants.*

The FAA suggests several factors airports should consider in providing rent abatement, all of which apply because of the COVID-19 public health emergency. In short, there is more than sufficient justification to apportion a share of CARES Act grants to abating MAGs and renegotiating rent and fees:

Factor	COVID-19 Impact
The underlying basis for rent has temporarily declined or materially altered due to COVID-19	The basis for rent in a commercial environment is the sales-producing ability of a retail or restaurant location. At this time, sales have fallen to less than 10% of sales during the comparable period last year. Airport stores and restaurants have no economic value at this time due to the material alteration of the underlying basis for rent.
Rent abatement reflects the decline in fair market value	With minimal passenger traffic and no meaningful sales, none of our stores and restaurants is generating positive cash flow from operations – much less covering overhead and capital costs (i.e., depreciation, interest, and principal repayment) – severely reducing or eliminating current fair market value. In short, rent abatement truly reflects current fair market value approaching zero.
Changes in volume of traffic	In addition to the catastrophic decline in passenger volumes already experienced, airlines continue to announce dramatic schedule cuts through mid-summer and to the end of the year that practically assure substantially diminished passenger traffic for the foreseeable future.
Desirability of having solvent tenants	The continued solvency of all concessionaires is in question. Ongoing cash-flow losses cannot be sustained in the face of continued low passenger volumes through much of the remainder of 2020. Without long-term rent abatement, it is possible that much of the concessions industry will not survive.

Fact #8
Airport Financials Are Sound – Opportunity Exists for MAG Relief

According to Moody's Investors Service, the airport bond rating agency, (Sector Comment, April 29, 2020) despite the impact of COVID-19 airport finances and bond ratings remain stable. The CARES Act grants "will generally provide funds for six to 12 months of operating expenses and debt service, though some small airports will receive amounts that achieve far greater lengths." Moody's further stated: "We do not currently expect any defaults per our definition if air travel substantially recovers in the next 24-36 months."

During this time when traffic and concession sales are off by over 90% due to the COVID-19 pandemic, ARRA recommends airports look for ways to work within their existing financial structures to address the threat of closure facing retail and restaurant tenants. Simply attempting to collect MAG from concession operators is a recipe for bankruptcy of concessions companies.

Airports have 'cash-on-hand' and multiple layers of reserve funds specifically established to cover periods of unanticipated events or emergencies and the resulting disruption on operations and revenues. Such reserve funds are a critical component of fiscally sound management. They are required by investors, underwriters, financial institutions, and bond rating agencies to ensure the airport will have enough resources to repay bond debt, maintain and operate the airport, and undertake capital projects funded by the bonds.

Most airports also have Airline Use and Lease Agreements that establish the rents and fees airlines pay to use the airfield, terminal, apron, and hangers. While these agreements can take many forms, under 'Residual' agreements, the waiver or reduction of rents and fees from concessionaires (and other non-aeronautical users) may shift costs to the airlines. Essentially, if the airport has a shortfall at the end of the fiscal year, the airlines must cover it.

Regardless of the form of airline agreement - compensatory, residual or hybrid - the temporary waiver of fixed rents (MAGS) can indeed be pursued to ensure concessionaire solvency. While an airport may have greater latitude to waive or adjust rents under some agreements, even under more restrictive residual agreements solutions can be found.

A few considerations are important:

- When looking at which revenue source 'makes or breaks' the airport budget, concession fees are unlikely to move the needle one way or the other. For U.S. airports, aeronautical revenue constitutes about half of total revenues. Of the remainder, terminal concessions produce less rent than automobile parking and rental cars, and therefore, have less impact on total airport revenue.

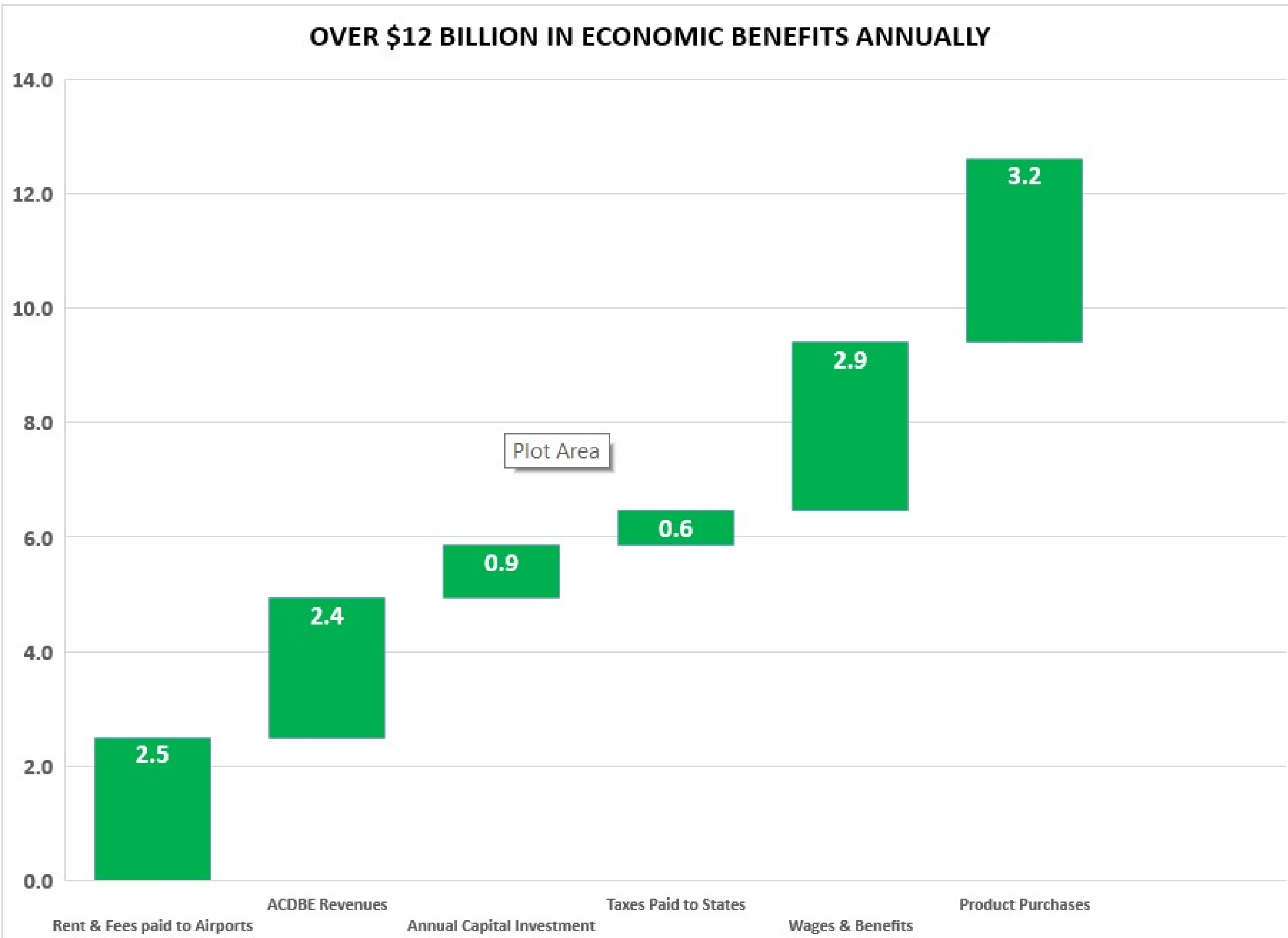
- Concessions are fully passenger oriented. In addition to their revenue value, they provide vital services to the traveling public and enhance the passenger experience. Without question, terminal concessions are critical to the full functioning of an airport and it is in all parties' best interest that they survive and are operational when passenger traffic starts to rebound.

- Just as airports are working with the airlines to make adjustments to their rents, fees, leased space and flight schedules, so too should they work with concessionaires to help them survive this crisis. Indeed, the FAA CARES Act guidance encourages airports to consult with <u>all</u> stakeholders. In doing so, the needs and interests of the entire airport community should be balanced.

- Each part of the airport system must be sustained, viable, and ready to launch as air travel resumes. Failure of any one of the key elements--whether airlines, concessions or other key partners--will severely threaten the airport's full recovery.

Fact #9
Airport Restaurant and Retailers are Critical to the Local Economy

Airport restauranteurs and retailers contribute significantly to local economies. The chart below highlights components of the industry's contribution.



Source: ARRA Members

Fact #10
What Can Airports Do Now?

There are several immediate steps that airports can take to assist concessions operators, enabling them to survive the historic drop in traffic and have a reasonable chance to resume service as traffic returns:

- Take a realistic view of traffic patterns and in formulating rent relief proposals, plan for the worst-case scenario - whether or not it turns out to be the case.
- Grant immediate relief from fixed rent (MAG) through 2020, and initiate variable percentage rent rates until 80% of pre-COVID or 2019 enplanements have returned and stabilized. Honor the intent of the $10 billion Federal relief package, which was enacted to offset lost revenue, and provide rent abatement to concessionaires.
- Engage all stakeholders in the discussions of rent relief.
- Consider using unrestricted reserve funds to meet other budget requirements .
- Defer capital investment in new concessions development projects.
- Suspend all storage rents, utilities, CAM, Marketing Fund and parking fees.
- Suspend all scheduled mid-term refurbishment.
- Suspend any pending RFPs/RFQs.
- Develop a measured and rational store reopening plan in collaboration with concession operators which considers the recalibration of MAG and percentage rents, to be updated and revised as the situation continues to unfold.