

PRICEWATERHOUSECOOPERS 

FIVE-YEAR PERFORMANCE REVIEW

SUMMARY REPORT

GREATER TORONTO AIRPORTS AUTHORITY

October 2006



PRIVATE AND CONFIDENTIAL



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1 INTRODUCTION

1.1 Mandate

Under the terms of the Ground Lease with Transport Canada (the “Ground Lease”), the Greater Toronto Airports Authority’s (the “GTAA”) is required to commission an independent review of its management and the operational and financial performance of the Toronto Pearson International Airport (the “Airport”). The review must be in accordance with Section 9.02 of the Ground Lease and conducted every five-year period from the time of transfer from federal management. This performance review covers the period from July 1, 2001 to June 30, 2006.

1.2 Scope of Work and Limitations

The specific scope of the review conducted by PricewaterhouseCoopers LLP is set out in the Terms of Reference prepared by the GTAA and is in accordance with Section 9.02 of the Ground Lease. The specific Terms of Reference stipulate that the review include statements by or opinions from the reviewer describing or dealing with:

- a) The terms of reference of the review;
- b) Statements stating the extent to which the GTAA has been and is operating:
 - A safe and efficient service to the public; and
 - An efficiently run undertaking in accordance with the GTAA’s business plans and approved objects.
- c) Statements stating the extent to which financial and management controls, information systems and management practices have been and are maintained, including the steps taken to ensure that:
 - The assets of the GTAA have been safeguarded and controlled;
 - The financial, human and physical resources of the GTAA have been managed economically and efficiently; and
 - The operations of the GTAA have been carried out effectively.
- d) Any further information that is reasonably required by any nominator of members to the GTAA’s Board of Directors or by a majority of the Board;
- e) Any concerns or qualifications that the firm conducting the review has with respect to the foregoing; and
- f) Any other relevant information about the GTAA.

1.3 Approach and Methodology

In agreement with the GTAA, we have addressed the objectives of the review by relying upon available materials and published reports. Some of the documents reviewed were audited and/or produced by third parties. We also conducted interviews with various executives, employees and selected stakeholders (i.e. airlines and concessionaires) to corroborate some of our initial findings and conclusions.

However, the scope of work was not designed to conduct a detailed operations review of the GTAA nor does it include the initiation of any exhaustive, new independent research given the 90-day time horizon and the terms specified in the Ground Lease. In addition, our work does not constitute an audit that is conducted in accordance with generally accepted auditing standards, nor does it examine internal controls or attest or review services in accordance with standards established by the Canadian Institute of Chartered Accountants. We therefore cannot express an audit opinion based on the procedures performed.

In our review, we made numerous direct enquiries to management concerning financial, operating, contractual and other issues. We considered management responses, which took the form of detailed explanations, schedules, and other relevant documentation. GTAA management fully cooperated in providing additional materials and information in response to our requests. We applied analytical procedures such as comparing current and prior information. We discussed the information received with appropriate officials and representatives at the GTAA.

The GTAA facilitated interviews with external parties such as Transport Canada, Air Canada, Nuance Group, HDS Retail, other air carriers and GTAA executives and management representatives. We were not restricted or limited by the GTAA in conducting these interviews.

2 OPERATING CONTEXT AND KEY ACCOMPLISHMENTS

2.1 Operating Context

The GTAA operates Canada's largest and busiest airport. As Canada's largest airport, the GTAA is faced with different challenges and opportunities that do not concern other airports in Canada. The ability of the GTAA to weather industry wide challenges, during the review period was determined both by the size of the Airport as well as management's approach to these challenges.

The aviation industry as a whole was subject to significant volatility over the five-year review period. A number of events took place during this period which directly impacted the operations of the GTAA including the:

- Terrorist events of September 11, 2001 ("9/11");
- Bankruptcy of Canada 3000 in 2001;
- Reorganization of Air Canada under the Companies' Creditors Arrangement Act in 2003;
- Severe Acute Respiratory Syndrome ("SARS") Epidemic in 2003;
- Northeast Blackout of 2003; and
- Jetsgo Corporation filing for credit protection in 2004.

2.2 Key Accomplishments

Our review highlighted the following key accomplishments:

Capital Program

After assuming responsibility to operate, manage and develop the Airport in 1997, the GTAA, in line with the corporate purposes set in the organization's original mission statement, initiated a \$4.8 billion 10-year Airport Development Program ("ADP"). The goal of this program, which represents the largest capital program in the history of Canadian airports, has been to improve and redevelop the airside, groundside and terminal facilities to meet the GTAA's current and future traffic demand. During the review period, the ADP focused on developing the Airport's air terminal buildings and the ancillary facilities.

Other major capital projects completed during the review period include the Terminal 3 redevelopment program, the commissioning of a Co-generation Plant and the introduction of an Automated People Mover.

As of June 30, 2006, the capital program delivered a new state-of-the-art terminal building and other service and operational enhancements to the Airport, with approximately 93% of the ADP program complete.

Financing

In 2002, the GTAA initiated a Medium-Term Notes program, as part of the GTAA's Capital Markets Platform, to finance its capital plans. As of June 30, 2006, the GTAA's total borrowings were \$7.1 billion. Approximately \$4.8 billion was raised over the review period. The proceeds from debt issuance activities were used to fund capital expenditure, to maintain adequate reserves and to finance operations at the Airport. The majority of the proceeds were used to fund the ADP.

Overall, the review of the GTAA's financial strategy, financial planning process and financial results for the period from July 1, 2001, to June 30, 2006 highlight that the GTAA:

- Demonstrated sound financial planning through its debt program;
- Complied with all the requirements of the Master Trust Indenture including cash flow / debt service coverage requirements ;
- Made considerable efforts to increase non-aeronautical revenues at the Airport;
- Maintained a rating in the range of A; and
- Was able to increase fees and charges sufficiently to raise financing for development and fund net cash flow requirements for operations.

This review also highlighted that the fees and charges at the GTAA are perceived to be the highest of all the airports in North America. This is largely due to the extensive capital program undertaken by the GTAA which resulted in a substantial increase in fees charged to airlines and other tenants at the Airport.

ISO 14001 Certification

ISO 14001 is an international standard for environmental management systems published by the International Organization for Standardization and was adopted by the Canadian Standards Association. The ISO 14001 standard is one of a suite of international environmental standards that provides businesses with a model for which to implement Environmental Management System.

In 1999, the GTAA was the first North American airport authority to become certified under ISO 14001. The GTAA has maintained continual certification of the ISO 14001 throughout the review period, by remaining committed to continuous environmental improvement, prevention of pollution and compliance with legislation. In 2005, the GTAA was recertified to the new standard, one year earlier than required.

Economic Contribution

The GTAA operates the largest and busiest airport in Canada. The Airport is a major North American gateway to the Europe. It is Canada's primary aviation hub with the largest source of Canadian-US (transborder) in the continent. As a result, the GTAA plays a significant role in the economic development of the Greater Toronto Area (the "GTA") and south central Ontario.

In addition to an Economic Impact Study, scheduled for release at the end of 2006, the GTAA is also in the process of conducting an Economic Development Study to evaluate how the Airport and the local community can work together to maximize the Airport's economic contribution in the region.

The Airport has had a very strong record of job creation. Due to airport operations, jobs have been created in many sectors of the economy, including the airline, aircraft maintenance, general aviation, hospitality and accommodation and ground transportation. Through all of these industries, the Airport has generated more than 130,000 jobs in 2005.

Emergency Response Procedures

The GTAA's Emergency Response Plan was tested on several occasions during the review period due to a number of incidents including the terrorist events of 9/11, SARS, and when Air France flight 358 over shot the runway in 2005.

Just hours after the attacks on the World Trade Centre Towers in New York City, air traffic in North America was shut down as virtually all aircraft were grounded. The shut down of air traffic created several challenges for the GTAA and its staff that were neither predictable nor planned including:

- Accommodating aircraft that were re-routed to the Airport and passengers that were stranded as a result of the Airport's closure; and
- Screening passengers to the re-opening of Airport operations several days later.

The GTAA also took the opportunity to review and improve its emergency response plan following the attacks including its internal emergency and fire procedures. It also enhanced its emergency procedures and execution tactics.

In August 2005, Air France flight 358 over shot the runway. Since the findings of the Air France incident have not yet been released, GTAA management was unable to formally comment on the effectiveness of the GTAA's response to this incident.

3 GENERAL FINDINGS AND CONCLUSION

Our general findings and conclusion with respect to GTAA management's performance and the Airport's operational and financial performance over the review period are provided below. The findings and conclusion are based on the methodology and approach and scope of work outlined in Section 1.

3.1 Safe and Secure Service to the Public

The GTAA's management practices at the Airport were aligned with the objective of ensuring a safe and secure service to the public during the review period. The GTAA has worked to ensure that all necessary procedures are in place and emergency teams are kept in a state of readiness. While the Airport policy is to make everyone responsible for safety, the GTAA's safety and security program hinges on qualified and equipped staff, continuous training, detailed emergency procedures and regular exercises. GTAA's safety management system includes identifying significant aspects of safety management, setting targets, monitoring progress, investigating incidents and introducing corrective procedures. The purpose of the system is to ensure that anybody who has a direct responsibility towards safety is tracking and reporting events through a single line of accountability. The GTAA has also demonstrated its commitment to establishing a safe workplace for its employees and implementing numerous initiatives aimed at reducing or preventing accidents at the Airport from occurring.

Throughout the period of review, the GTAA has maintained GTAA's certification under the requirements of the *Aeronautics Act* and associated regulations, thereby meeting the standards set by the international aviation community and federal regulators. Both Transport Canada and the International Civil Aviation Organization conduct regular safety audits of the Airport's safety management system and in 2005, both organizations acknowledged the excellent security programs in place at the Airport.

3.2 Effective Planning and Implementation

The GTAA conducted appropriate planning procedures and operates in accordance with its stipulated plans and objectives. The GTAA has implemented a structured approach to preparing its planning documents, managing operations against those plans and evaluating and reviewing actual performance against plans. Our review and discussions with the management team found that broad goals are translated into specific objectives to which management is held accountable. The Board is also regularly and appropriately involved in setting the goals and plans of the GTAA and monitoring performance.

The current approach to implementation allows the GTAA to effectively monitor initiatives in order to understand its performance in achieving its stipulated objectives. Management reporting and controls act as a means of relaying performance information to managers and the Board in order to monitor the GTAA's progress with respect to its established plans and forecasts. The GTAA's Planning Department

reports on a monthly basis to the Board on time and costs expended in relation to budgets and forecasts established. This continuous reporting framework acts as a means of keeping the Board up to date and further assists in monitoring the GTAA's performance.

3.3 Management Control Practices and Systems in Place

Financial and management controls, information systems and related practices at the Airport were maintained by the GTAA in a prudent and reasonable manner. While information and control systems are implemented by management, they are monitored by the Board of Director's Audit Committee and are further evaluated through both internal and external audit functions. The external audit reports presented to the GTAA outlined no differences in opinion with management over the financial statements and did not identify any significant issues of concern during the review period. Internal audits of the GTAA between 2001 and 2004 concluded that the GTAA also had adequate processes and controls in place to mitigate its exposure to certain risks. Over the review period, the Board adopted a self-assessment process, intended to assess the effectiveness of its four committees, the Board Chairperson and the chairpersons of each of its committees. This assessment was also reinforced by efforts to review and revise the charters of each of its four committees to align stipulated responsibilities with suggested best practices for governance.

3.4 Assets Safeguarded and Controlled

In our opinion, the actions of the GTAA to protect and control its assets were reasonable. As noted above, the Finance Department maintains an internal control system, and regularly uses internal and external audits to verify and test the controls in place at the Airport. The GTAA has also complied with requirements under its safety and security standards and has a comprehensive risk management and insurance program in place to further protect its assets and facilities.

3.5 Economical and Efficient Management of Resources

From our review, it appears that the GTAA has managed its resources in a manner that has enabled it to realize several substantial accomplishments over the review period, including:

- Delivery of the ADP program, representing the largest construction project in the history of Canadian airports, on time and on budget;
- Management of an extensive debt program with approximately \$7.1 billion outstanding as at June 30, 2006. The GTAA has been in compliance with its debt covenants and sustained a rating in the A range from Moody's, Standard & Poor's and Dominion Bond Rating Services;
- Realization of a sustained and steadily improving level of customer service since the opening of the new Terminal 1, despite a turbulent aviation environment during this period in which there were

several incidents (beyond the GTAA’s control) that negatively impacted operations at the Airport; and

- A significant economic contribution to the south central Ontario region.

We are of the opinion that the GTAA had the requisite policies, processes and management infrastructure in place during the review period to effectively address the challenges and opportunities set out under its planning context and presented by the continuously evolving aviation environment.

3.6 Efficient Operations of the GTAA

Over the review period, the GTAA has addressed its mandate to operate airports in the south central region of Ontario on a commercial basis, set fees for their use and develop and improve facilities. During the review period, the GTAA focused on increasing the throughput of passengers and cargo at the Airport by making capital investments and maintaining high levels of customer service, during a period of heightened security. We believe that the GTAA is operating the Airport in a manner that addresses current air transportation needs in the GTA and it effectively prepares for the future needs of the region through the ADP, the Terminal 3 redevelopment program, the Master Plan and other planning initiatives. Major accomplishments ranging from delivering important capital projects to implementing various service innovations have each contributed to improving the facilities, operations and services at the Airport. The GTAA also has operating practices in place to obtain ongoing input from passengers, air carriers, tenants and other relevant stakeholders as a means of continually improving its operations and customer service offering. In the context of the GTAA’s operating environment and the volatile and evolving aviation sector, we believe that the GTAA has operated an efficient service over the review period.

3.7 Other Matters

The Ground Lease requires us to indicate whether there are “other matters, concerns or qualifications or relevant information” that should be reported. Based on our review, we believe there are no other significant matters, concerns or qualifications or relevant information that need to be reported under the Terms of Reference which are not already in the public domain.

3.8 Challenges

The GTAA is now entering into its second decade of operations with a new terminal building, improved airside infrastructure and other service enhancements. While the last 10 years have focused on constructing a world-class airport, the focus will be shifting to utilizing the Airport to its full extent. The potential risks and challenges over the next decade include:

- Increasing non-aeronautical and non-aviation based revenue (to the extent it is practicable) to mitigate against traffic and airline bankruptcy risk;
- Addressing concerns it has regarding ground rent payments to Transport Canada;
- Continuing to operate effectively and efficiently in today’s volatile aviation market;
- Adapting to developments with respect to security requirements which are seemingly increasing with time while optimizing service levels;
- Managing further capital development, such as Pier F and G, to minimize service disruptions and minimize cost while ensuring that the overall return on investment is optimized;
- Optimizing throughput and expected growth from the new facilities while meeting costs and maintaining service levels;
- Continuing to monitor its debt program effectively and maintain debt ratings at investment grade levels;
- Taking advantage of technological developments in the aviation industry and ensuring the Airport is a position to change and adapt to them so that they do not negatively impact operations;
- Maintaining the Airport’s primary hub status in Canada in light of potential future developments in the North American aviation market which may include hubbing strategies of various airlines, the addition of new direct routes to other airports in Canada and increasing competitiveness of other airports resulting from lower fees and charges; and
- Successfully meeting the challenges facing the international airport sector which include:
 - increasing demand for better service, punctuality and competitive prices; and
 - managing lower profit margins, shorter ground times, tighter security restrictions and tougher competitors.

3.9 Conclusion

Our review concludes that the GTAA has met the standards as outlined in Section 9.02 of the Ground Lease during the period of July 1, 2001 through to June 30, 2006. More specifically, we conclude that:

- The GTAA has provided a safe and secure service to the public;
- The GTAA has developed the policies, process and systems necessary to manage its operations, and financial, human and physical resources in an efficient, effective and economical manner;
- The assets of the GTAA have been effectively safeguarded and controlled; and
- The GTAA is operating in accordance with its plans and approved objectives.

Pursuant to Subsection (e) of Section 9, it our opinion that there are no major concerns or qualifications to be disclosed in relation to the standards established in Section 9 of the Ground Lease.