Gold status: the case for investing in airports globally

Introduction

While global financial markets continue to fluctuate wildly in response to the US-China trade war, and with some of the world’s largest economies mired in inward-looking debates about protectionism, one gold-laced trend flies in the face of such resurgent nationalism: air passenger traffic. Indeed, as we can see in Figure 1, air traffic is on the rise, indicating that mobility reigns supreme, even amidst expressions of anti-foreigner sentiment.

Figure 1: Air transport, passengers carried globally

Source: The World Bank

Helped in part by the democratization of air travel—via the proliferation of low-cost airlines around the globe—and buoyed by compelling demographic dynamics such as the millennial preference for travel, as well as outbound growth from emerging Asia, airports serve as a bright spot for long-term investing around the globe. Looking beyond the growth of tourism, airports—primary, secondary, tertiary, and even quaternary—naturally correlate with the investing theme of logistics supporting e-commerce, particularly given the increasing demand for same-day delivery.
As we shall see, even as “recession chatter” shakes boardrooms from Tokyo to Toronto, investment teams would do well to prepare to allocate capital to airports around the world, in the precise moment of a potential economic downturn, and dislocation in the public markets.

**At the macro level: the opportunity**

In light of the steadily rising swell of air passenger traffic, several countries dominate the landscape. The United States holds first place with the highest volume (889,022,000 passengers carried), followed by China (with 611,439,000 passengers). In **Europe**, Germany and Spain figure prominently (at 109,796,000 and 80,672,000, respectively), and the UK’s numbers (165,388,000) may soon be eclipsed by those of **India** (164,035,000), a swiftly rising market.

In both developed and emerging markets, several themes emerge that underpin growing demand. Across the world, the millennial preference for travel boosts revenue for leisure and hospitality, with the majority of global millennials preferring international to domestic travel. In the US, **millennials have a greater propensity to travel** than the Gen Z or baby boomer generations, while in China, millennials’ expenditure on travel has increased dramatically year over year. As the millennial generation is characterized by spending more on “experiences” (read: services) rather than material goods (such as physical homes), the growth is likely set to continue, even if there is a squeeze to income, which may result from an eventual crisis.

And from emerging Asia, the upward trajectory of Chinese outbound tourism is a well-trodden investment theme. India’s exponentially rising air traffic is attracting interest from strategic investors and companies. And in terms of destinations, as we can see in Figure 2, Europe is by far the most favored destination for international tourists around the world.

**Figure 2: International tourist arrivals**
A private matter

The trend toward privatization of airports has been well underway for the last few decades, with the liberalization of the sector across the globe. Currently, 43% of global air passenger traffic is powered by private capital. Regionally speaking, Europe takes the lead in terms of privatization, with 75% of air traffic held privately, with some of the world’s largest pension funds strategically invested in the space. Latin America and the Caribbean swiftly follow Europe, with 66% of airports privatized (and more on the way). Airports in the Asia-Pacific region are 47% privatized, and North America remains at a paltry 1%.

A notable dynamic is the economically positive relationship between privatization and performance, measured in terms of technical efficiency, cost efficiency, and the ratio of cash flow to revenue. As is often the case with privatization, an increase in private capital can yield greater competition and efficiency across the board. Private investments into airports follow the path of traditional infrastructure investing with either greenfield (that is, new project) or brownfield (existing project / upgrade) opportunities. Investors will typically pursue one of two types of return profile. Private equity investors may pursue a “J-curve” investing strategy, with initial capital deployed upfront, leading to higher IRRs and value appreciation down the line. This preference is often best matched with greenfield projects. Alternatively, investors are keen to have a potentially lower but steady rate of return—with an investment behaving similar to fixed income or utilities, brownfield projects are often alluring, as in many cases, the upfront development risk is removed.

At the geopolitical level: investing in emerging vs. developed markets

As we can see in the regional data above, with 75% of airports held in private hands, Europe is a well-saturated (and profit-proven) market in terms of greenfield opportunities. However, with aging assets and growing demand, brownfield projects—including upgrades to existing structures, as well as streamlining services—are likely to grow. This stands in contrast to the emerging Asian story; with the public sector owning over ½ of assets, there is a long runway for private capital to play a significant role in both greenfield and brownfield projects. And in Latin America, recent and forthcoming auctions of airport concessions from Brazil to Colombia also present budding opportunities for private capital (for example, Brazil’s recent airport privatizations were snapped up by Swiss and Spanish strategic investors).

As global and institutional investors look to their geographical asset allocation, and weigh risks and opportunities for investing in emerging vs developing markets, it is important to differentiate between absolute risk vs perceived risk. Some institutional investors, particularly, although not exclusively, those domiciled in developed markets, may harbor a certain predisposition for investing close to home. That is, they may have a home bias. The anticipated complexity of doing business in emerging markets can act as a deterrent - in other words, a perceived risk and hence act as a deterrent—particularly when it comes to deploying capital into physical infrastructure over a 5-10 year (or even longer) horizon.

However, in our current age of populism, with movements of the far right and the far left polarising politics and rocking financial markets in western Europe and North America, there exists a mounting degree of uncertainty with regard to the relationship between private capital and the state, and as such, the future of specific privatization plans. Absolute risks exist for any infrastructure investor, in any part of the world. For airports, this can include safety, demand, prolonged fuel or airline strikes, a change in government, partners, or overlapping regulations. However, the continuing ripples of populism in advanced economies may prompt investors to firmly check their home bias, as the perceived risk of doing business in emerging markets can also spring forth from familiar and seemingly terra firma. In the meantime, the most opportunistic buyers will scout opportunities. Even with the eventual downturn—and the current souring outlook on global trade—a dislocation in the short to medium term in the public markets presents an ideal moment to deploy private capital for long-term value creation.
At the sector level: services

Private investment in airports is not limited to the material or physical assets. Commensurate with the globally-calibrated growth in e-commerce, supporting cargo (and efficiencies in cargo and logistics) presents an emerging opportunity in the realm of airport investing. Additionally, providing ground support and ground equipment might also be an ancillary service in which to invest, as building capacity and innovation in the space boosts customer satisfaction, and also potentially ROI for existing airport investments. Leading industry bodies are also fostering innovation hubs in which to explore applications of AI and IoT to spur improvements in airports around the globe.

For companies, as well as savvy investors, the outlook for retail in airports is also exceptionally bright. It is astonishing to note that “non-aviation services” can comprise over 50% of the total revenue of an airport. Indeed, total worldwide sales of duty free broke a barrier in 2018, surpassing $75bn in global revenue. (By way of comparison, this amounts to about \( \frac{3}{4} \) of the global revenue of the world’s largest airline alliance). Regionally speaking, even with the trade war in full swing, and associated consumption downgrades, retail sales within duty free in the Asia-Pacific region are up 14.2\% year over year. And in a world in which some commentators sound the “death of retail,” one global consumer company posted a 27\% increase in growth for its travel retail sales.

Conclusion

In sum, the prospects for growth in air passenger traffic around the world present one bright spot of mobility, generating palatable opportunities for the deployment of private capital, in the face of the darkening outlook for trade and global financial markets. Even with an eventual recession, the demographics underpinning some of this growth, including millennials’ propensity for international travel and the preference for outbound tourism from Asia’s emerging middle class, are unlikely to vanish. For private equity investors, in a world of crowded space—with LPs becoming GPs—opting for the J-curve in greenfield airport investments with a longer lockup period may provide a multitude of targets. And with interest rates falling into negative territory in the bond markets, fixed income investors may look to indirectly invest in brownfield airport projects, potentially within a fund structure.

And for any investor or company deploying capital to either greenfield or brownfield, emerging or developed markets, understanding the assets well before acquisition—and having a value creation plan—are critical to achieving investment success. Moreover, the ability to communicate the ways in which their investments are directly and indirectly contributing to economic growth becomes supremely important. With the hyper focus on job creation in countries from France to India, clearly codifying the many ways in which an airport can contribute to GDP growth becomes an indispensable part of asset operations on the ground. As such, it provides a form of resilience against the passing fancies of shifting governments and their voting publics around the world.
Additional information

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