Airport transactions: Taking off around the globe.

Bernard Chow and Colin Smith

Executive summary

Airport transactions are on the rise, presenting a host of new opportunities for investors around the world. But to secure the best deals, investors must understand how the landscape is changing—in terms of who the biggest players are and what they're after. They also need to consider where the best opportunities might arise in the future as well as what pitfalls they might encounter—and how to avoid them.

In this article, we draw on our analysis of airport transaction trends and airport markets across the globe to offer insight into these questions. And we propose some guiding principles for navigating in the complex and changing airport investment arena.

Investors interested in infrastructure used to see airports primarily as a means of travelling from one deal to the next. Now many of them are looking at airports as deals in themselves—thanks to a recent glut of airport transactions. (See Figure 1.) The glut has followed a volatile period in which the global recession created a decline in the number of airport deals as well as deal value. As the impact of the economic downturn intensified, EV/EBITDA (enterprise value to earnings before interest, tax, depreciation and amortisation) multiples dropped from 18× in 2007–08 to 16× in 2009–10. Between 2007 and 2010, the number of deals stagnated owing to a lack of financing, reduced confidence in air traffic travel demand and gaps in valuation expectations. Consequently, we saw lower multiples. Many airport transactions were delayed, as investors elected to hold off until air passenger traffic demand showed clear signs of recovery.

But during 2011–12, average multiples rebounded to above precrisis levels, thanks to signs of economic recovery and transactions in emerging markets

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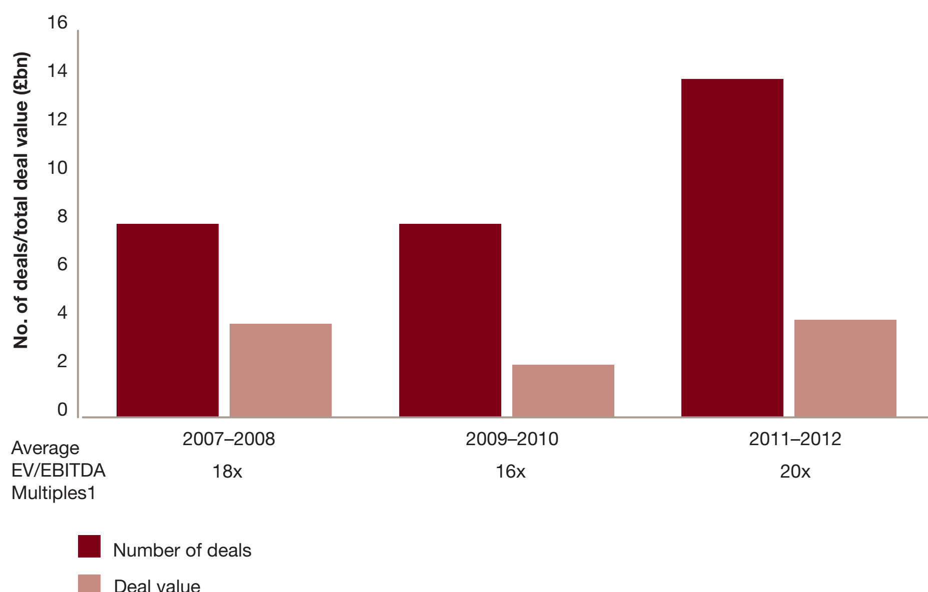
Figure 1: Global airport deals and deal value



Based on a selection of publicly disclosed airport transaction multiples. Includes 15 deals between 2008 to 2012 across a range of geographies
Source: Infranews, PwC analysis

such as Brazil. With multiples improving, deal value is recovering somewhat, and the number of deals has doubled from the 2009–2010 period. We think there are enough opportunities in the pipeline now to fuel investment activity for the next two years at least. That's good news for the diverse players hunting for deals in the airport sector.

Who's playing in the space?

Today's airport investor profile looks very different from yesterday's. In the past, infrastructure funds and construction companies were the big players in this space. Now, major players also include previously conservative pension funds that are investing directly in airports and boldly setting aside money for emerging markets. Sovereign wealth funds, logistics groups, private equity houses and consortia made up of financial institutions and operational experts have also moved into the game. The infrastructure firm Global Investment Partners (GIP) is an apt example. Founded by Credit Suisse, General Electric Company and an independent senior management team, GIP acquired Gatwick airport in 2009 and Edinburgh airport in April 2012.

Even as new faces are showing up, familiar faces are disappearing—or at least fading into the background. Take Hochtief AG, the German construction company, for example. Hochtief had moved into the airport management space but has since sought to divest its airport concessions business primarily as a means to unlock value and defend against Grupo ACS's hostile takeover in 2010.

What's driving these changes? For the most part, it's the global financial crisis that, in turn, has subjected investors to brutal refinancing pressures. Airport investors who borrowed money from banks five or six years ago were assessing multiples of 18×. Then those multiples dropped to 15×, leaving investors with insufficient asset backing to pay their loans. These trends have prompted investors to put more cash into airports. That isn't easy for speculative investors for whom cash is expensive. Often, it's construction companies that fall into this category. This scenario has played out in a big way in Spain. Following a wave of airport investing by Spanish construction companies, the Spanish economy collapsed, crippling the construction business. Companies had to sell their assets because of financing requirements.

Today's airport investors not only look different from yesterday's; they also keep different criteria in mind when they're eyeing potential deals. (See Figure 2.) Private equity firms are usually most interested in small airports—those with one terminal and fewer than 5 million passengers per year—that have the potential to grow quickly. And they're looking at a relatively short investment horizon of five to seven years. By contrast, pension funds typically seek stable assets in a position to ensure longer-term returns (10-plus years). They're more interested in airports that serve more than 5 million passengers per year and that have multiple terminals. Construction companies, not surprisingly, are interested in airports that need significant development.

More investors may also be considering airports' revenue mix when making investment decisions. While the lion's share of most airports' revenue comes from carriers, revenue from retail and real estate has become a notable source of growth. Some European airports are deriving anywhere from 33% to as much as 50% of their revenue from real estate and retail. UBS points out that Zurich Airport, whose retail and real estate revenue amounted to 50.3% in 2011, has even more retail space landside as its urban location tempts nonpassenger shoppers. Indeed, Goldman Sachs cites retail revenue as a major factor in recommending European airports.

Figure 2: Airport deals pipeline

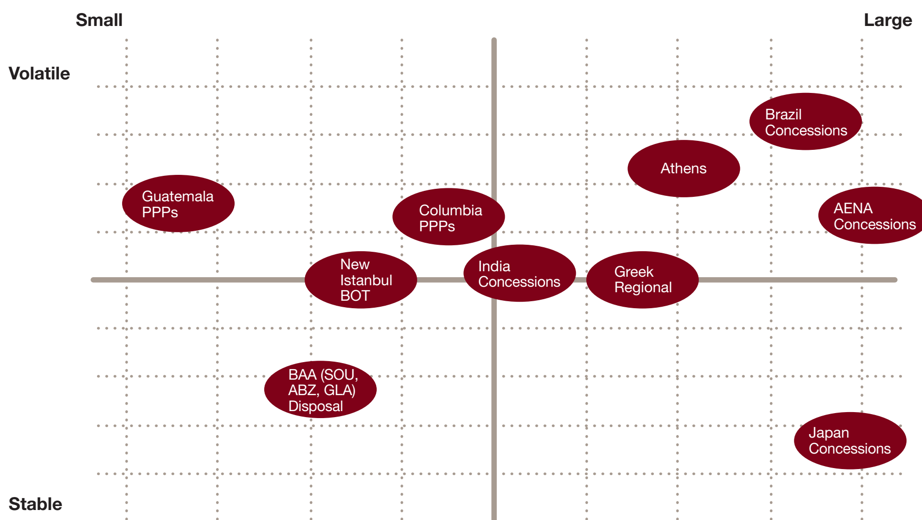
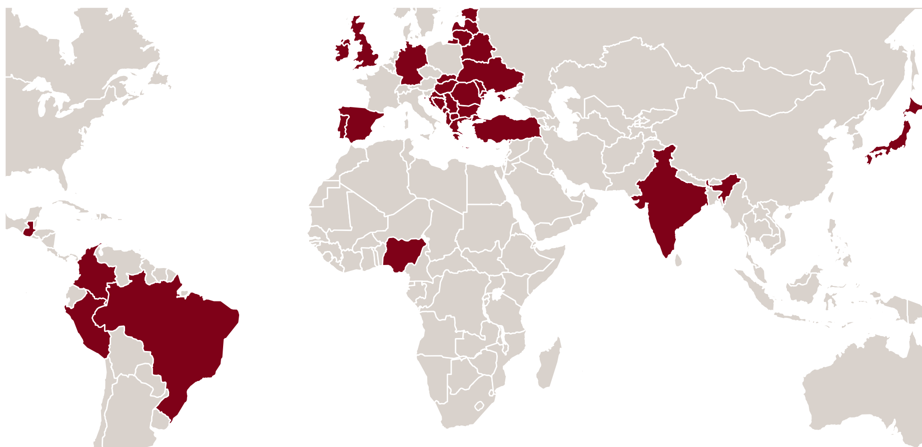


Figure 3: Areas for short- to medium-term transaction activity



What are the opportunities—and where will they arise?

A number of forces have come together to produce perfect conditions for airport investment. These forces include pressures on governments and major corporations to reduce their debt burdens, regulators forcing sales to increase competition and improve passenger service levels, a recovery in passenger air traffic demand, and a sustained interest in good-quality infrastructure assets among both equity and debt providers.

For today's diverse investors, all this is redefining the fundamentals of the market—creating a whole new set of opportunities. (See Figure 3.) On the supply side, the types of airports coming to market, as well as the ways they come to market, have changed. For instance, some markets (Japan, Portugal, Spain) are seeing extensive privatisation of airports, as governments seek to sell off assets to manage monstrous levels of debt.

In other markets, such as Brazil, Vietnam, Indonesia and Central America, governments are replacing private-sector airports with public-sector airports. These airport markets have no trouble finding money for investment; what they need is expertise. So they're launching concessionary programs aimed at gaining commercial and operational efficiencies. In many emerging markets, airport development is also a key component in governments' plans for developing the national economy.

As investors (including private holders) sell their assets, there's more stock on the market. But the opportunities look different, depending on how the assets come to market and where the activity is taking place. For instance, some opportunities are all about refinancing: An investor can snap up an airport because the investor has enough cash to cover the debt and equity. In many emerging markets, the opportunities are all about new builds and redevelopment of existing airports.

So what can we expect to see? Though government sales of airports have come slowly to market, we anticipate a pick-up in such activity, with Portugal, France, Greece, Spain and Ireland all expected to launch privatisation processes for European airports.

And with airport operators being typically capital-constrained, we expect to see partnerships in which operators align their operating credentials with infrastructure investors' firepower to improve airport commercial and operational infrastructure and thus aero and commercial yields. We may see this particularly in the sale of large, government-owned airport groups such as Aeropuertos Españoles y Navegación Aérea (AENA) of Spain.

For large, stable airports, we think there will continue to be no shortage of long-term capital available. Indeed, the big hub airports like Zurich, Vienna, France's Charles de Gaulle and Frankfurt are relatively stable in terms of traffic, because more airlines want to use them than they have room for. Even if some aren't at full capacity throughout the day, they will be at peak times morning and evening. And if an airline goes bankrupt, there will be another airline ready to take up the slack. Meanwhile, infrastructure funds and private equity houses will remain interested in fast-growing, well-run airports, driving merger and acquisition (M&A) activity into the foreseeable future.

What are the investment pitfalls?

Despite the allure of new opportunities, investors will need to take to care to avoid several pitfalls. For one thing, airports are not a single asset class, despite sharing characteristics such as runways, passenger terminals and luggage carousels. The performance of airports varies from one another according to factors like location, captive market, mix of airline customers and management team. All of these can in turn affect an airport's investment potential.

Investors who ignore this fundamental truth are at serious risk of overvaluing airports. Witness the recent rebuilding of airport balance sheets for those that were overleveraged in the heady days of 2006–08. The lesson? Investors need to evaluate each airport on its own merits as well as make strict due diligence a core part of the deal-making process.

The overvaluation risk can also be avoided by aligning a particular airport to an investment strategy. Stobart Group did this by recognizing the potential in using Southend Airport as its southern logistics hub and attracting easyJet flights away from Stansted. Middle Eastern investors Qatar Investment Authority (QIA) and Abu Dhabi Investment Authority (ADIA) saw value in the long-term regulated stability of Heathrow and Gatwick, respectively. And GIP no doubt is starting to realise the "Gatwick magic dust" opportunities at Edinburgh, an airport that has demonstrated resilience during the recession and that has strong growth opportunities operating as a hub airport in the North.

But there are other risks in addition to that of overvaluing airports. To illustrate, for the many investors focused on the BRIC countries—Brazil, Russia, India and China—the danger is that economic growth in any of these markets may stall. If that happens, investment opportunities in emerging markets will be slow coming to market. What's more, airport markets in developing countries don't yet have well-established passenger travel trends. Take Vietnam, where it's unclear whether Hanoi or Ho Chi Minh City will become the country's primary destination hub and thus the best opportunity for investment. This situation injects more uncertainty into the picture for investors than they face in developed markets, where travel trends are more established.

What's more, in some markets, deals on offer can be less than stellar. For example, when the Spanish government offered concessions for the Madrid and Barcelona airports, the terms were so draconian that no one bid. The risk here for investors is that they may spend a lot of time and money on inquiries, legal fees and other expenses associated with the bidding process, only to discover that the deal in question won't be going anywhere.

The deepening of the relationships between airports and their airline customers presents another kind of risk for investors. Even though an airport's revenues may increasingly come from non-aviation sources (such as retail, parking and real estate), many large airports are tied to their large airline customers. In the past, infrastructure investors weren't as involved in airport operations and could afford to adopt a hands-off approach, expecting airlines to accept the fees that were set. But airlines now face daunting operational, competitive and cost challenges and have overhauled their business models to meet those challenges. Investors therefore need to understand the difficulties confronting airlines, the changes that air carriers are making to improve their competitive position, and the impact of all this on the relationship between airports and airlines.

Finally, for investors considering committing to a consortium, it's important to understand which credentials the partners should bring to the table and ensure that the right expertise is represented in the final

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configuration. That all depends on the target airport and its defining characteristics—such as whether major construction will be required and whether a potential upside can be captured through expertise in commercial development. In addition, the right relationship and business culture is important when vendors decide on the preferred bidder, especially when existing shareholders such as local authorities may have specific requirements in mind. Different partners can bring different forms of value to the table, and outside advisers can bring critical insight in areas including financial, business planning, legal, operational, capital expenditures (capex) and tax and accounting. (See Figure 4.)

Next steps

The airport sector will continue to see significant deal activity in the next three years, with a great number of opportunities for investors to consider in coming months. While competition is fierce and valuations are likely to increase further, investors should exercise due care in evaluating each opportunity, to avoid several potential pitfalls. Having early conversations with advisors who bring in-depth sector knowledge and experience can help.

> A number of forces have come together to produce perfect conditions for airport investment.

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Figure 4: Building a strong consortium

Consortium requirements will depend on the target airport and key characterics—e.g. Will major construction be required, can potential upside be captured through expertise in commercial development