WHITEHELM CAPITAL

Airports: Buy, Hold or Sell?

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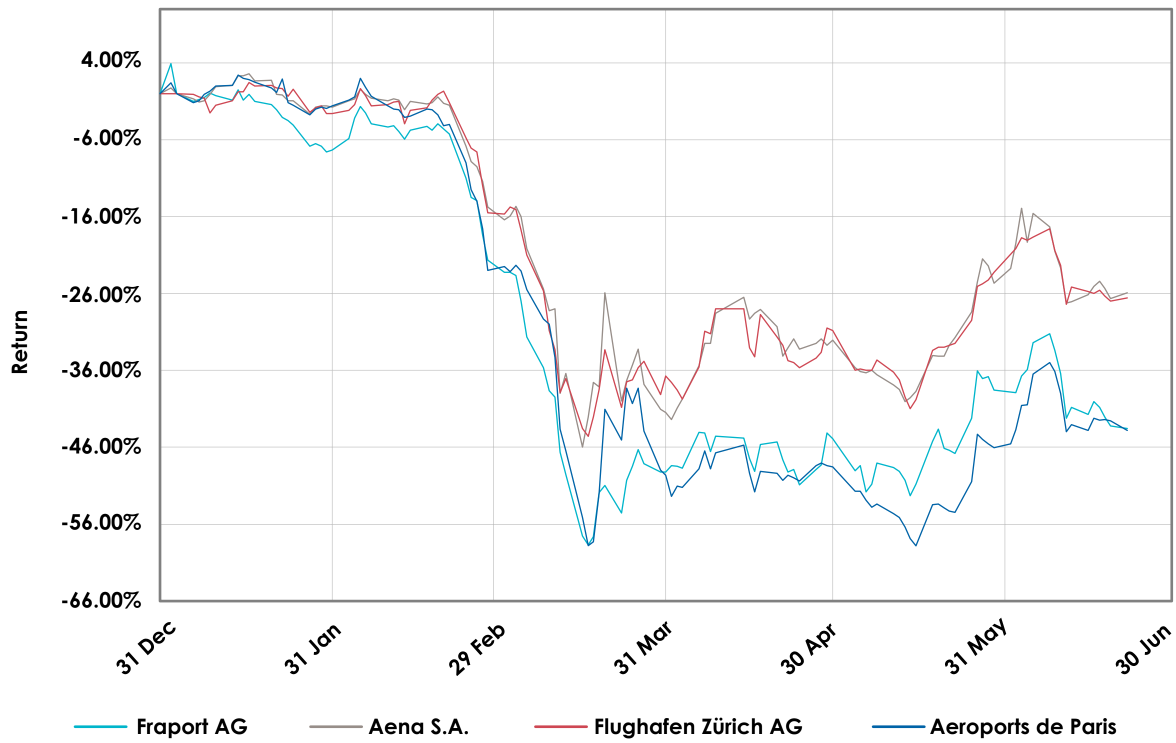
With lockdowns across the globe slowly lifting and signs that global economies are emerging from hibernation, is now the time to invest in airports? Valuations certainly are cheap relative to history with global airport stocks down over 40% over the last 4 months. The question becomes how long it will take before air traffic goes back to normal and which airports have a strong enough balance sheet and sufficient liquidity to survive. Consumer behaviour also has a part to play. When will the public feel safe enough to fly? Retail investors have piled into the sector in recent months with a buy the dip mentality, but many institutional investors are long-term investors in the sector.

We discuss the appeal of this sector with Whitehelm's Portfolio Manager Ursula Tonkin who has held her nerve and airport stocks during this pandemic.

1) Ursula, what percentage of the Whitehelm listed core infrastructure fund is held in airports?

Whitehelm hold three airport stocks: Zurich Airport, Paris Airport and Aena, an operator of Spanish airports with a total weight of 7% of the portfolio. These are preferred over other options such as Sydney or Auckland airports, both of whom are significantly more levered with less cash flow cover of interest payments on debt. Overall, the portfolio was conservatively positioned at the start of the year with two thirds of the portfolio in fully regulated utilities and only 25% in transportation infrastructure including airports, railways and tollroads.



Source: S&P CapitalIQ, Past performance is not a reliable indicator of future performance.

2) You hold these airports in your portfolio despite the travel industry grinding to a halt over the last few months. Can you explain why you chose to hold on to these stocks?

Through March and April our airports team spent a lot of time analysing the liquidity of the airport stocks and modelled the cash flows and debt covenants under a conservative recovery scenario. As a result, we were comfortable with the financial viability of three airport stocks and felt that the share price declines more than reflected the outlook. We haven't added to the exposure however, as the prospects for a recovery in traffic is more uncertain than previous negative shocks such as the SARS epidemic in 2003. This is because (1) travel restrictions in some form may continue for some time even if the spread of the virus seems contained; (2) the deteriorating global economic outlook would likely slow the recovery in traffic and consumer spending, even if travel restrictions are eased; and (3) the crisis is also weakening the credit profile of airlines, which have been drastically cutting capacity. Our base case is that passenger numbers are severely depressed for 6 months, with a gradual recovery over the following 18 months, reaching 2019 levels in mid-2022, and zero growth for the rest of 2022.[1]

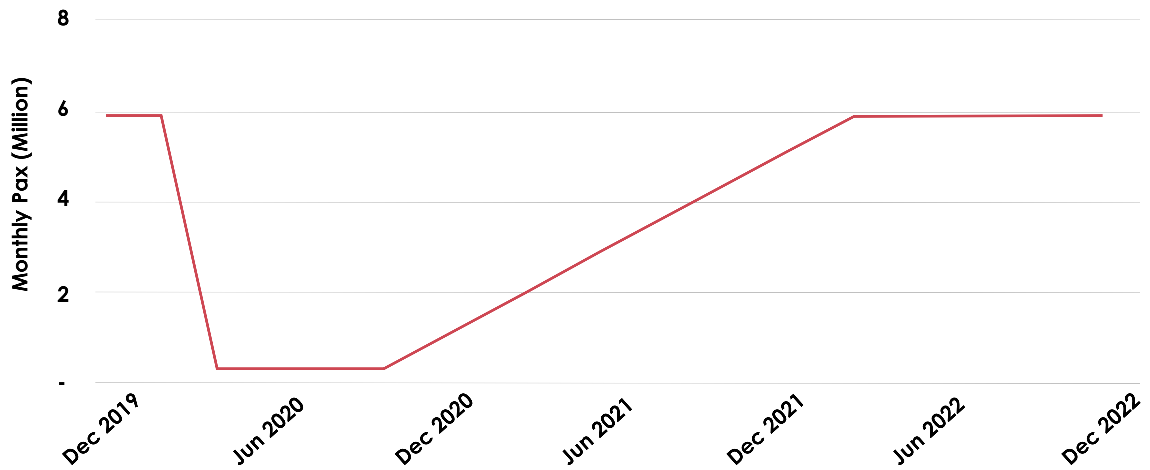
3) Have you made any changes to your holdings in the sector?

Yes, the result of our analysis was that we were comfortable with some exposure to the airports sector, including our holdings in Zurich Airport and AENA holdings, but we sold out of Frankfurt Airport and purchased Paris Airport. The share prices of both Frankfurt and Paris airports had been similarly impacted, around -45% from mid-February to the March lows, but Paris Airport has a much more secure liquidity position, so for the same valuation, we swapped to the higher quality asset.

Frankfurt Airport balance sheet is covenant light, which is good, but the company already had an above average debt load and the main concern is the large capex program, which they have only limited ability to delay without incurring large penalties. With the existing leverage, should the company not be able to access credit markets, this would require a very dilutive equity raising. In contrast, Paris Airport has lower overall leverage and a significant cash position.

1. Any projections are based on assumptions which we believe are reasonable but are subject to change and should not be relied upon.

Frankfurt Airport Passenger Number Forecast:



Source: Whitehelm, Any projections are based on assumptions which we believe are reasonable, but are subject to change and should not be relied upon.

4) What about the ongoing costs airports are incurring while passenger traffic is subdued?

The airports do have operating costs that can't be avoided, so they will be burning cash through this period. For example, Aena had 2019 operating costs of c.€210 million per month, on revenues of ~€370 million per month (a 43% operating margin) but has started a cost-savings plan based on renegotiating service contracts (security, cleaning, maintenance, etc), and the halting of new non-essential contracts, all leading to a target operating expenditure reduction of circa €43 million per month.

5) What is your view on the sector going forward?

We believe Aena, ADP Group (Paris Airport) and Zurich Airport have responded appropriately to this crisis, aggressively cutting costs, deferring capital expenditure and suspending 2020 dividends to preserve liquidity. Further, we believe these three operators have sufficient committed liquidity to continue to operate, while maintaining adequate headroom to financial covenants, under the Base Case which assumes a sharp reduction in passengers over the period of April to August, with a modest recovery for the second half of 2020. While the extent of this outbreak and ensuing impact on economic activity is difficult to estimate, under a protracted outbreak and slower economic recovery, they should continue to be able to access the debt capital markets. Aena and ADP in particular benefit from their categorisation as Government-related issuers. We believe that the sector is a hold and dividends will resume as passenger traffic improves over time.