



REAL ASSET SECTORS

Airport cash flows soar above the clouds



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In many European and Asian countries airports are operated by public companies under long-term concessions. Airports have two distinct businesses and three general regulatory models that drive the overall attractiveness of the concession. The core transportation business is driven by landing fees and ramp handling fees charged to airlines. Airports also have a commercial business driven by lease revenues from retailers located in the airport. The regulatory models reflect an allowed rate of return applying either to the transportation business (dual till), both businesses combined (single till) or a hybrid model.

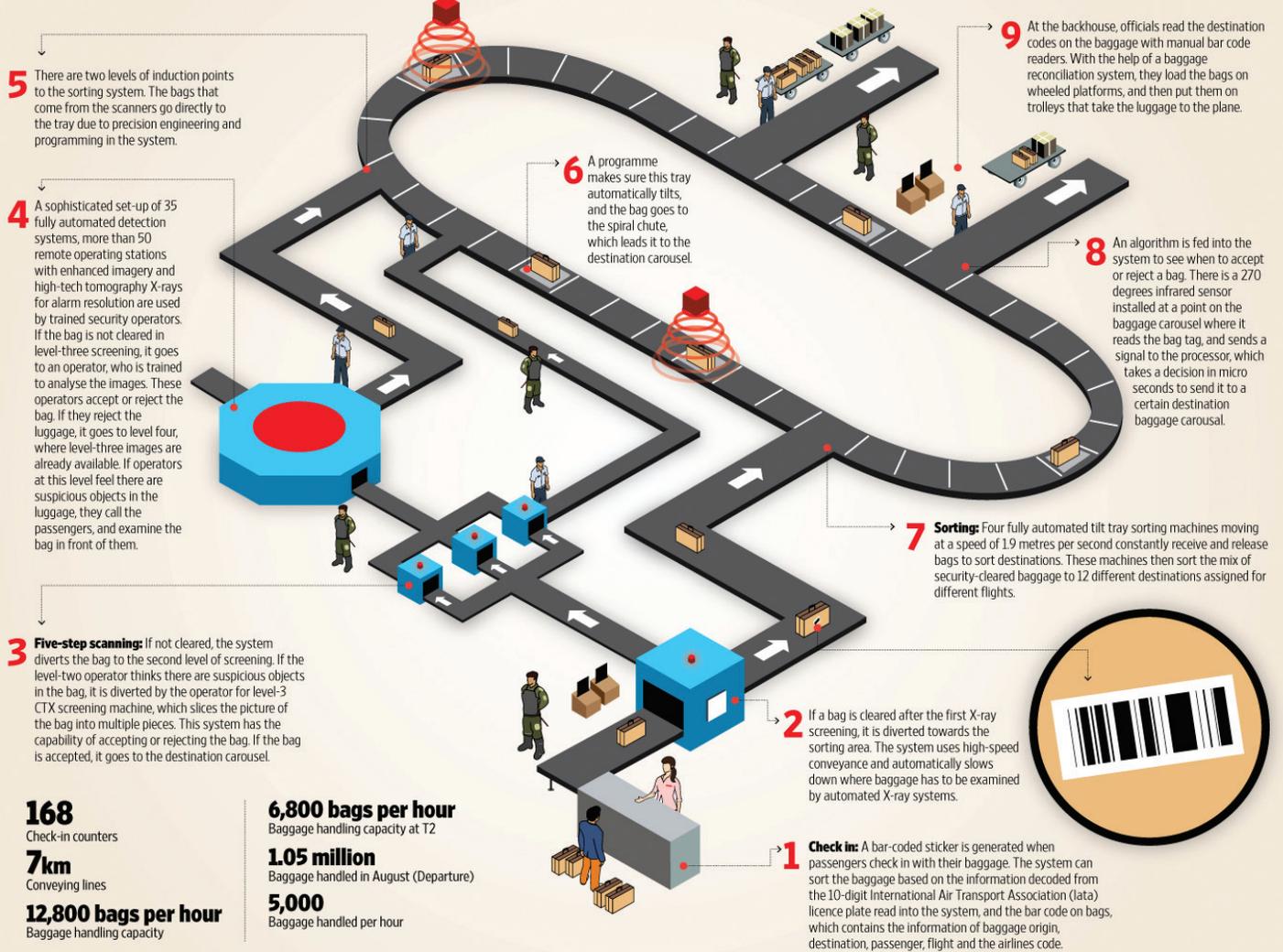
The core transportation business is driven by the scale of the airport and the quality of the airline tenants. A large international airport in a larger city centre will see higher passenger traffic and greater fee revenues. However, most countries have a dominant domestic airline and the economic health of that airline will also impact the level of fee revenue the airport can generate. The ideal airport will see high passenger traffic from business and leisure travellers who are visiting the city or connecting through the airport. The ideal airport will also have a diversified tenant roster of airlines with a dominant domestic carrier that is well-capitalized with an efficient fleet of airplanes and strong labour relations.



HOW THE **BAGGAGE HANDLING** SYSTEM WORKS

Since starting commercial operations in 2010, the international terminal at Delhi airport has handled more than 89 million bags with only a 0.3% chance of a bag being lost in the system. What is the science behind these efficiency levels? Mint takes a look at how the baggage handling system (BHS), or the so-called mangle of steel at the Indra Gandhi International Airport Terminal 3, functions.

Compiled by Nikita Mehta; graphic by Yatish Asthana/Mint



168
Check-in counters
7km
Conveying lines
12,800 bags per hour
Baggage handling capacity

6,800 bags per hour
Baggage handling capacity at T2
1.05 million
Baggage handled in August (Departure)
5,000
Baggage handled per hour

Source: Delhi International Airport (P) Ltd

The commercial business is driven by lease revenues generated primarily from retail tenants located within the airport. Airports tend to structure these leases with a base rent per square foot augmented with participation in the retailer's sales. Many of the

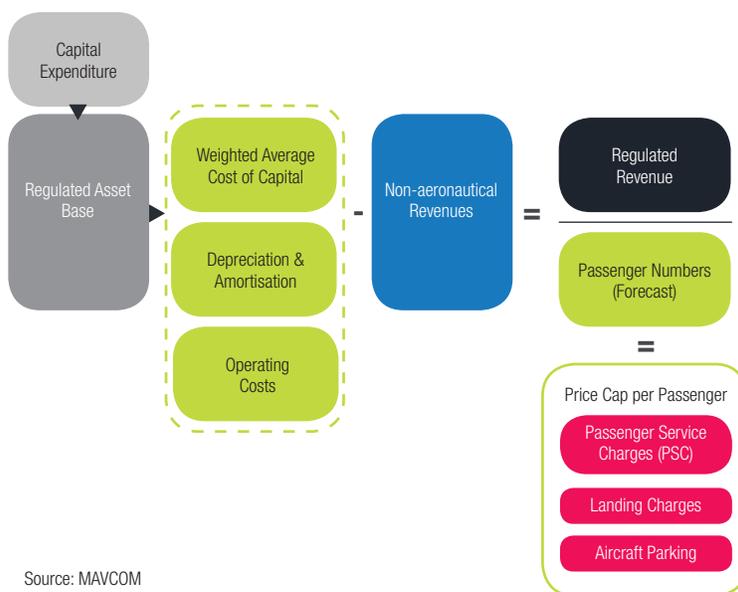
retailers tend to focus on high margin items (alcohol, tobacco, perfume, cosmetics, luxury clothing and accessories), making the sales participation of airports very lucrative.

Airport concessions are generally awarded for 50 years or more. However, the economics of the concession are usually adjusted every 5 years. Airports are normally regulated under a model that permits them to earn an “allowed rate of return” on their Regulated Asset Base (“RAB”). The RAB is calculated based on the assets the firm owns that directly contribute to the regulated operations of the business. The allowed rate of return is driven by bond yields, equity risk premiums and the posture of the regulator. The ideal airport will grow its RAB by investing cash flow to drive revenue growth (additional runways, retail locations and gates) and cost savings (automated baggage handling, newer equipment, digitization). The ideal airport would also enjoy a favourable regulatory environment allowing the airport to earn higher allowed rates of return.



There are three different models the regulator can apply to an airport. Single Till models mean that the transportation and commercial businesses are both captured in the allowed rate of return. This model does not provide much incentive for the airport operator to invest in the asset since the allowed rate of return caps the ability of the airport operator to recoup a return on their investment. Dual Till models mean that the transportation business is subject to the allowed rate of return while the commercial business is unregulated. This model provides great incentive to the airport operator to invest in both businesses since it can earn a strong return on these investments. Many regulators apply a hybrid model where a specific portion of the commercial business’ returns are used to subsidize the transportation business. The ideal airport would operate under a Dual Till regulatory regime with a favourable regulator that provides the airport with incentives to invest in both the transportation and commercial businesses.

Regulated Asset Base Model



Source: MAVCOM

Aena S.A. (“Aena”) is the holding company that operates the majority of Spain’s airports, the London-Luton airport (51% ownership) and airports in Mexico (12), Jamaica (2) and Colombia (2). The company has a portfolio of 46 airports and two heliports, which cumulatively handled 280M passengers in 2018, making it the largest airport operator globally. The Spanish airports are operated in perpetuity, with the heliports operated under concession. The airports have different characteristics, from hub to touristic to regional aviation assets and this leads to a varied mix of airline presence and demand seasonality across the portfolio.

In 2018 Aena enjoyed 5.7% passenger traffic growth which fueled 7.3% revenue growth and 7.0% dividend growth. The business generated a 61.5% EBITDA margin in 2018 but the commercial business EBITDA margin was 83.0%, demonstrating the attractiveness of the Dual Till regulatory model in Spain. Aena has consistently earned a return in excess of its allowed rate of return, reflecting strong passenger traffic and rising passenger spend at their airports. Continued capital investment should drive RAB growth and offset any slowing in traffic growth driven by Brexit.



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