White Paper

Airport Infrastructure Lite – What Are the Next Investment Opportunities After TCR?

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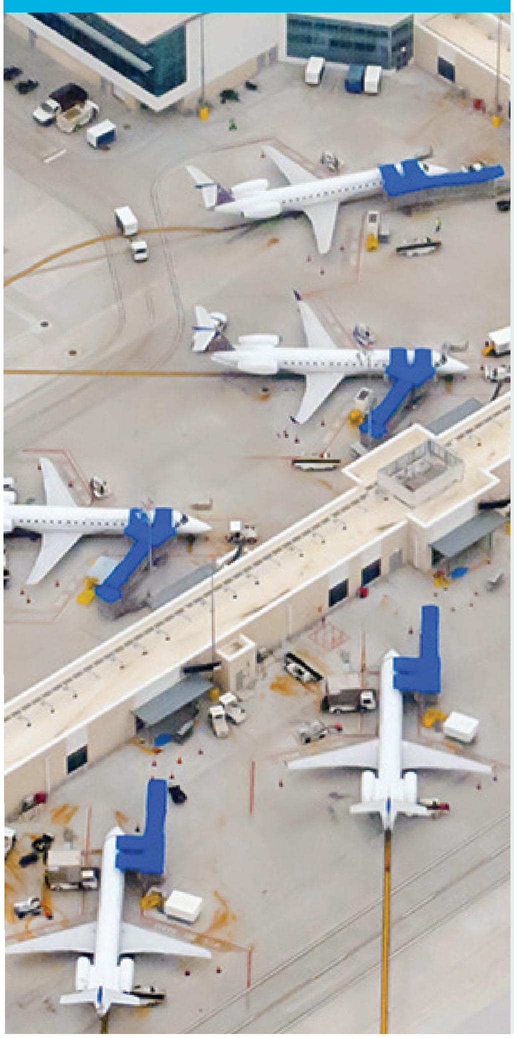

Abstract

With growing competition and a limited pipeline of airport transactions, airport investors are increasingly turning to ancillary airport businesses as a means to accessing the aviation asset class.

The 2016 sale of TCR, a ground service equipment leasing provider, attracted significant interest from both private equity and infrastructure investment firms. Ultimately, the company was acquired by 3i and Deutsche Alternative Asset Management—both investors associated with more traditional infrastructure investments. The type of investor TCR attracted indicated that it was considered to have the potential to offer infrastructure-like return characteristics.

As the market leader in its sector, the TCR opportunity could be considered a "one-off." However, the success of this transaction indicates that other similar transactions may follow. In this white paper, ICF explores the infrastructure characteristics of the TCR case and considers other businesses associated with airports that could attract infrastructure investors.

Airports – A Saturated Asset Class?

For the last two decades, airports have gained prominence and acceptance as infrastructure assets though they do not initially appear to meet all the characteristics of a "classic" infrastructure investment. Airports are protected by high barriers to entry, robust cash flows, and sound regulatory safeguards, but they are also at risk from airline collapses, modal competition, and price erosion. Despite these risks, their success as a class of infrastructure asset is apparent from the line of investors that forms around any new airport transaction opportunity and the high multiples of EBITDA (and multiples of RAB) that are paid.

The shortage of airport investment opportunities and fierce competition for airport assets has caused many investors to consider related types of assets. Current thinking indicates that such businesses may slip under the radar of more orthodox funds and for that reason constitute relative bargains in a sellers' market.

This thinking explains why TCR attracted such intense investor interest.

What Defines "Infrastructure Lite" Business Investments?

While TCR demonstrated many infrastructure investment characteristics (e.g., barriers to entry and a strong market leading position), these characteristics were set against intense competition and low margins in the ground handling sector. This type of business is better defined as "infrastructure lite."

The TCR Case Study

TCR is a Belgian-based entity that specializes in leasing ground support equipment (GSE) to ground handlers—the unglamorous tugs, tractors, and ground power units that keep an airport's ground operation functioning. When considering whether or not TCR could be considered infrastructure, we found that the company presented a balance of attributes that both met and did not meet traditional infrastructure characteristics.

Is TCR Infrastructure?

Yes: TCR grows with worldwide aviation demand and is itself closely linked to GDP. Additionally, to maintain and operate GSE, TCR enjoys airside access to airports. Because that access is scarce—limited by security, regulation, or governance at most airports—it creates a barrier to entry for others. TCR also holds a strong market leadership position where "pooling" of GSE is demanded by airports because of environmental and traffic considerations. TCR actually pioneered the concept of fleet pooling at Heathrow in 2004. By collectively owning and renting back an airport's GSE, pooling effectively creates a single GSE operator at the airport.

No: TCR's association with the ground handling business appears at the outset to be unhelpful as a sector where cutthroat price competition and low margins are endemic. GSE asset lives are typically short and the acquisition cost of individual GSE assets is low (not usual features of infrastructure businesses).

Clearly, TCR is not a pure infrastructure asset, making it harder for investors to build a business case to justify paying infrastructure multiples. However, the company does offer a sufficient number of attractive infrastructure characteristics to be considered "infrastructure lite," explaining why it attracted competitive bids from multiple infrastructure investment players.

Identifying Airport Ancillary Business Infrastructure Lite Investments

Following the successful 2016 sale of TCR, investors will be considering what other types of business at an airport could be classified in the same way. We have used a four-step process to consider this question.

Step 1: Determine Airport-Related Activities

The first step is determining what other ancillary businesses operate at an airport. Not surprisingly, there is a vast range of undertakings, even just considering the immediate terminal and airfield context before taking into account MROs, hotels, cargo terminals, and other freestanding activities. Exhibit 1 provides some examples.

EXHIBIT 1. EXAMPLES OF AIRPORT-RELATED ACTIVITIES

Terminal

- Baggage handling systems
- Lifts, escalators, and walkways
- Jet bridges
- Terminal seating
- Common Use Terminal Equipment (CUTE)
- Flight Information Display Systems (FIDS)

Airfield

- Airfield lighting and signage
- Pre-conditioned air
- Fire and rescue
- Meteorological services
- Vegetation management
- Ground Service Equipment (GSE)

Step 2: Identify Target Companies

The second step is to identify the companies operating in each of the ancillary business areas. ICF has conducted this exercise, producing an extensive database (longer than it is possible to present in this paper). Interestingly, many of the businesses identified are already private equity owned, and given that the path for TCR was from private equity to infrastructure fund, private equity ownership could be regarded as a first step in "re-rating" businesses as infrastructure.

However, for various reasons, the list of realistic potential targets is much shorter. Many airport ancillary businesses can be excluded on the basis of lack of scale. Additionally, a significant sub-set of businesses operate across sectoral boundaries (e.g., a lift manufacturer may have great contracts at international airports, but aviation as a subset of its overall activity is immaterial) thus complicating its value as an aviation asset.

What type of airport ancillary business might make good infrastructure lite investments?

Investors should look for airport service businesses that go beyond a one-off sale to sales that benefit from an ongoing relationship and may involve maintenance, asset renewal, or even potentially operation of an activity at an airport.

Step 3: Assess Their Potential for Long-Term Airport Relationships

Possibly the most important step is to question whether ancillary businesses have "stickiness" with respect to the airports they serve. In other words, investors should be on the lookout for businesses that go beyond a one-off sale to arrangements constituting an ongoing relationship. This may involve maintenance, asset renewal, or even potentially operation of an activity at an airport.

For example, after an airfield lighting manufacturer makes the initial sale of a system to an airport, it has a privileged position for airfield lighting asset renewal. Not typically vulnerable to generic replacement of system parts, this arrangement could be associated with a long-term maintenance contract on the airfield lighting system. This supplier is well placed to achieve such continuity, but many airport ancillary businesses are not.

Step 4: Question Infrastructure Characteristics of the Business

From the winnowed-down list, the next question is: Does this business display infrastructure characteristics? In an investment and academic context, the definition of "infrastructure characteristics" appears extremely malleable but often boils down to the elements described in Exhibit 2.

EXHIBIT 2. INFRASTRUCTURE CHARACTERISTICS

In Exhibit 3, ICF has matched the infrastructure characteristics identified above to selected airport-related areas and confirmed that activities such as baggage handling and fuel farms meet many of the infrastructure characteristic boxes and, therefore, could strongly be identified as airport ancillary business infrastructure lite investments.

EXHIBIT 3. INFRASTRUCTURE CHARACTERISTICS OF AIRPORT-RELATED BUSINESSES

	Barriers to entry	Long duration assets	High upfront costs	Long-term, stable cash flows	Inflation related contract
Baggage Handling Systems	■	■	■	■	■
FIDS	■			■	■
CUTE	■	■		■	■
Jet Bridges	■	■			
Airfield Signage	■		■	■	
Fire and Rescue	■	■	■		
FBO	■	■	■		
Fuel Farms	■	■	■	■	■

This process provides a potentially promising shortlist of investment opportunities. The relevant entities that are currently in private equity hands may potentially be considered ripe for "re-rating" and infrastructure fund interest. For others, particularly those in private hands, the case needs to be made that access to infrastructure fund capital and networks provides opportunities for capital and geographical growth, as was the case with TCR.

ICF expects the airport ancillary business sector to provide many interesting opportunities for infrastructure funds in the coming months and years. We expect the "airport infrastructure lite" asset class to gain more prominence and acceptance, as airports did only a couple decades ago.

About ICF

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About the Author

Simon Morris has more than 25 years of experience in the aviation industry, and his expertise primarily lies in business planning of airport businesses. He leads ICF's Airport team in transaction projects worldwide, building on work in due diligence and comprehensive business and strategic planning for owners, investors, and private-sector interests. Previously, Mr. Morris worked at A.T. Kearney and LeighFisher.

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