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Airports versus toll roads: a novel reversal

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While the Covid-19 pandemic continues to affect airports and air passengers, the impact is being felt to a lesser extent on roads

Following previous macro shocks – the gulf wars, 9/11, SARs and cyclical major economic downturns – global air traffic has bounced back rapidly in a sharp V-shaped recovery, while toll road volumes followed more of an L-shape. The Covid-19 global pandemic, however, has resulted in unprecedented and prolonged drops in air passenger volumes. The second quarter of 2020 saw almost no travellers due to lockdowns. Since then the resurgence of infection rates, intermittent border restrictions and quarantines have materially impeded expected recovery. International air traffic may only recover beyond 2024, while European toll road volumes could recover over 2021-22[1]. As such we prefer toll roads to airports.

The ongoing pandemic has led to lack of confidence among passengers, airlines reducing fleets and consolidating routes due to lower load factors, very limited business travel and weaker purchasing power at the passenger level. Year-to-date European passenger volumes are down 70%-80% year-on-year compared to 2019, while the industry is forecasting a 70% drop in passenger numbers for the full year. Compare this to the International Air Transport Association's (IATA) December 2019 forecast of 3.8% growth for 2020[2].

Conversely, toll roads benefit from freight movements in line with economic activity and travellers' ability to self-isolate in transit with no quarantines on arrival. During the height of lockdown in Q2, toll roads enjoyed a base level of activity from heavy goods vehicles, possibly also carrying goods typically transported on passenger aircraft that no longer flew. France's March toll road data showed light vehicle traffic down 10% versus heavy goods only down 3%

[1] Heathrow Airport, Vinci SA, Aeroport de Paris data, October 2020
[2] https://www.iata.org/en/iata-repository/publications/economic-reports/airline-industry-economic-performance---december-2019---report/

compared to 2019 levels. Volumes overall fell 50% in Q2[3], but the drop in heavy vehicles was less severe as a base level of economy was maintained.

So far in 2020 overall toll road volumes across France and Italy have only fallen approximately 20% year-on-year. Data from construction company Vinci SA illustrates the trends well: light vehicles are down 23% year-on-year, heavy vehicles only 9%. Q3 saw overall volumes even exceeding 2019 levels during July and August, before slowing again in September as infection rates rose. For Q3, heavy vehicles only showed a decline of 2%, light vehicles were down 5%. Volumes into Q4 2020 and Q1 2021 are expected to vary between a 5% and 15% decline year-on-year[4]. Fresh lockdowns are a clear negative on traffic volumes, but we have at least seen how a recovery path might look.

Airports, however, need other airports to be open. Reciprocal removal of restrictions, testing regimes, shorter quarantines and travel corridors will be positive moves in lieu of any widely accepted vaccine. But passenger confidence needs to resume: an IATA survey of travellers showed that 83% would not fly if they had to quarantine on arrival, but 88% would be tested to facilitate travel[5].

In the short term, volume drops will result in severely weakened financials for airports. The sector has so far focussed on preserving liquidity for at least the next two years – albeit through leaning on creditors – issuing new debt and seeking waivers from covenants breaches through to 2021. Shareholders have provided support in the form of shareholder loans, waived dividends and, notably only in very few cases, provided equity injections. Other measures include severe curtailment of operating and capital expenditure.

The news around a vaccine is extremely positive, albeit from the perspective of sentiment rather than fundamentals in the short term. Earnings will only recover in line with volumes, while operating expenses and debt service needs – ie cash burn – remain. The news will help support any further capital raising exercises that may be necessary next year. However, a full-scale deployment of a vaccine to boost global traffic levels may only still be feasible by year-end 2021, in line with Heathrow's expectations earlier this month. Travel corridors, testing and shorter quarantine times, however, may prove to be better short-term drivers of traffic levels, with domestic and regional travel recovering faster than global.

As 2020 began, within a defensively constructed portfolio we were overweight regulated airports (which benefit from limited volume risk and are able to recover lost revenues in future tariffs set by regulators) that appeared to us to be overcompensating for the fundamental risks such as Heathrow and Aeroporti di Roma. As the pandemic set in and issuers rushed to the capital markets in April to shore up balance sheets, we participated in new issues from state-owned Schiphol and Aeroport de Paris. However, as credit markets recovered and the impact on air travel outlined above became clear we have trimmed our exposure to airports and replaced it with more resilient exposure in French and Italian toll roads, taking that sub-sector from underweight to overweight.

[3] Vinci SA, APRR, SANEF data, October 2020
[4] Vinci SA, APRR, SANEF data, October 2020
[5] https://www.iata.org/en/pressroom/pr/2020-10-21-04/

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