Macquarie Global Listed Infrastructure[1]

Airports: preparing for take off

As we have written about previously, the rebound in travel following the post-COVID-19 reopening created interesting trends across the European aviation space, especially in 2022 and 2023, as traffic quickly returned to pre-pandemic levels in certain geographies. This created opportunities in stocks such as ENAV SpA, Aena SME SA, and Athens International Airport SA, but also created some uncertainty around how much further volumes could grow in 2024.

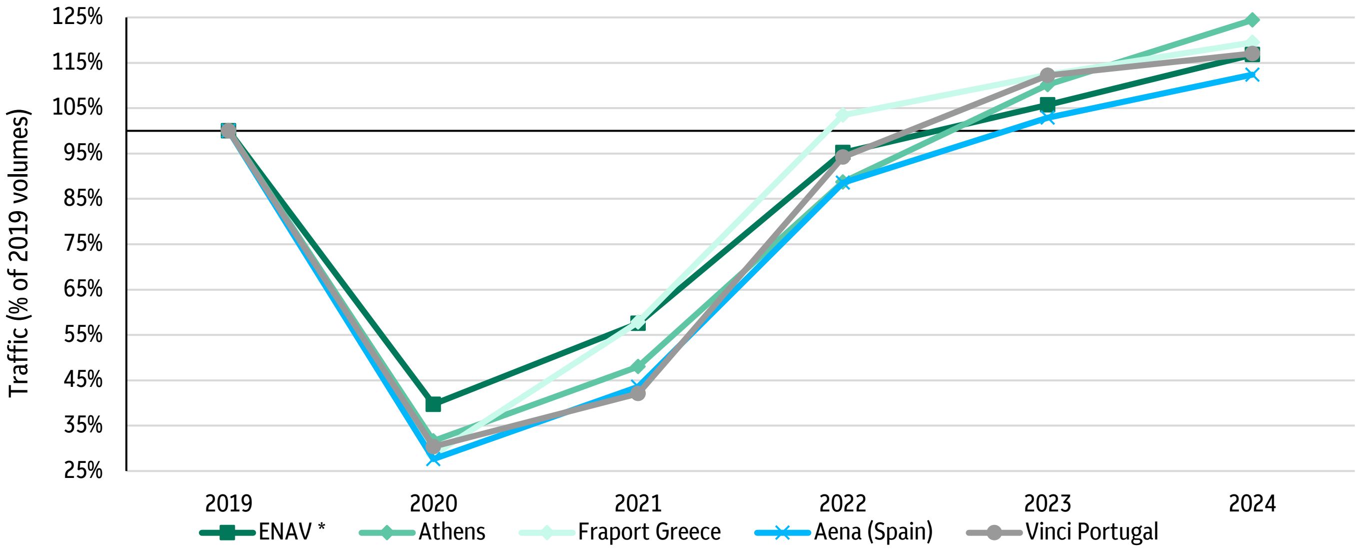
Despite this uncertainty, 2024 ended on a relatively strong note, with both pricing (for the airlines) and volumes holding up better than expected. As a result, we are experiencing a two-tier market in Europe: the leisure destinations, where traffic is now well ahead of 2019 levels, and the main hubs, such as Frankfurt and Paris, where traffic has either just about recovered or still lags 2019 levels. Looking ahead, each airport type faces potentially different outlooks, and these could have big implications on the share prices. The market remains focused on near-term traffic trends, which potentially overlooks traffic growth going forward as well as the regulatory risks.

Leisure destinations take off…

Demand for travelling to leisure destinations, such as the Mediterranean countries, has rebounded strongly from the COVID-19 lockdowns. Thanks to a diverse airline customer mix and significant exposure to low-cost airlines, seat capacity and volumes bounced back quickly. In looking across the major tourist destinations such as Spain, Greece, Portugal and Italy, passenger volume and air traffic are now well above 2019 levels of passengers. For example, for the full year 2024, Athens International Airport reported passenger numbers that were 124% of 2019 levels while Fraport's network of Greek regional airports reported traffic at 119% of 2019 levels. All four countries reported traffic volumes between 110–120% of 2019 levels, with island and seasonal destinations outperforming the main cities (bar Greece).

[1] Macquarie Global Listed Infrastructure is an equity team within Macquarie Asset Management's (MAM) Equities & Multi-Asset business.

Leisure destinations (pax mn)

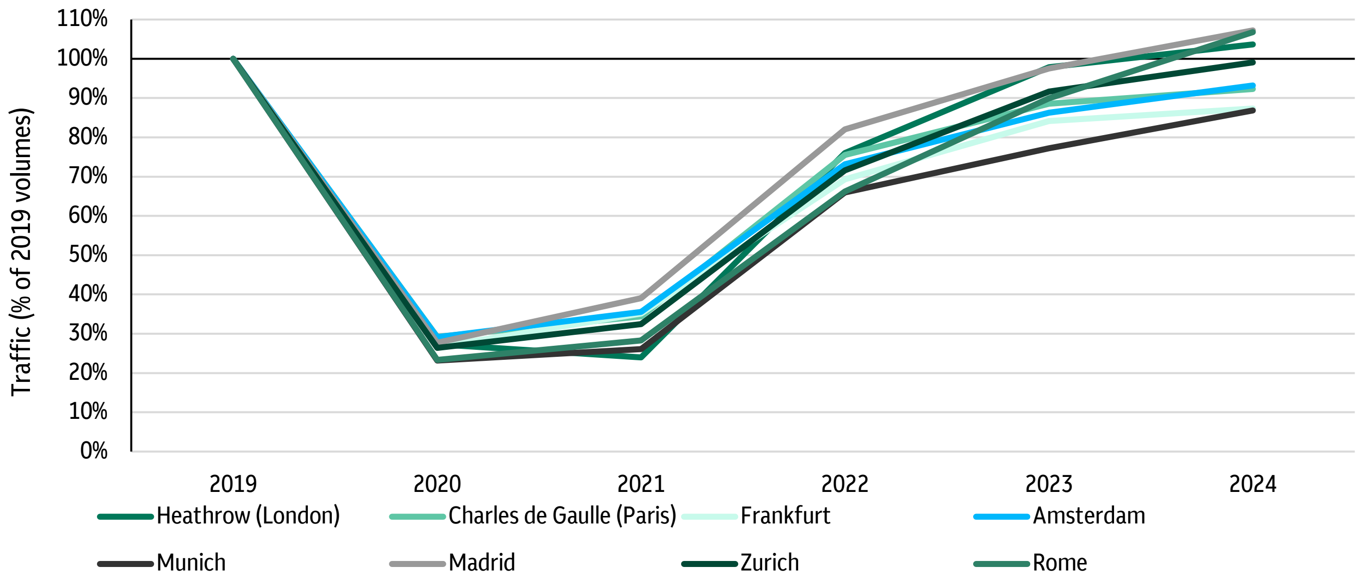


Source: Company disclosures. Eurocontrol (ENAV)

...while hubs experience delays

Despite the strong demand for leisure travel, the key airport hubs in Europe have lagged these destinations. Hub airports are often more reliant on a flag carrier, so the outlook is skewed to the performance of one airline. The best-performing hub (Madrid, which is the hub for Iberian Airlines, part of the International Airlines Group (IAG)) reported traffic that was 107% of 2019 levels. While this is a strong recovery, it lagged most of the Spanish network. Meanwhile Frankfurt and Munich, which are hubs of Lufthansa, reported 2024 traffic that was 87% of 2019 levels. Macroeconomic weakness in Germany has been a key driver of the slow recovery in passenger volumes. This has led airlines such as Lufthansa to more slowly return capacity than peers in other markets. Lufthansa's capacity growth has also been hampered by the Pratt & Whitney geared turbine fan GTF engine issues and strikes in 1H24. Additionally, other airlines, such as easyJet, have left the domestic German market completely, allocating capacity to other routes with stronger demand. As for the rest of the hub airports, traffic as a percentage of 2019 levels falls somewhere in between Madrid and Frankfurt/Munich.

Hub airports (pax mn)

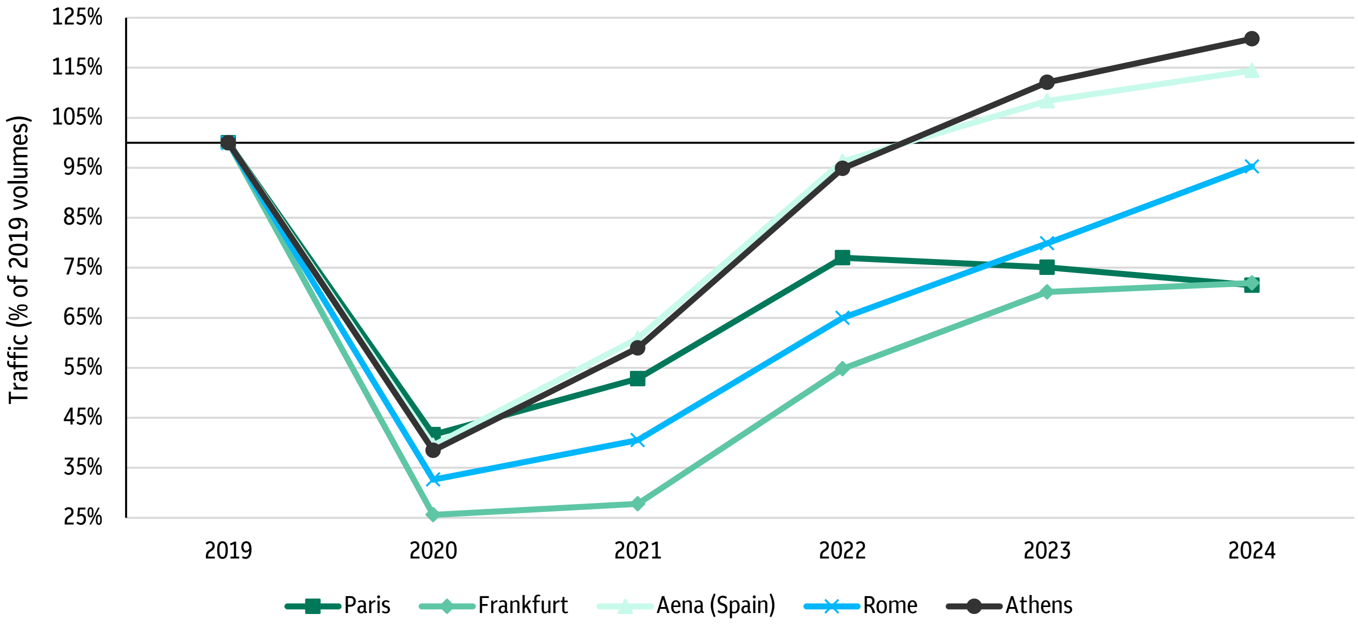


Source: Company disclosures

Domestic demand has been a drag on hub airports...

Intuitively, if the leisure destinations are thriving, it would make sense that the hubs are thriving as well. The passengers flying to the sunny locations need to come from somewhere, and given the hubs typically have a large catchment area, these airports should benefit from the return of leisure travel. Drilling further into the data reveals the divergence. At most of the hub airports, EU and intercontinental travel are close to 2019 levels (if not ahead). Even at the laggard of the group, Frankfurt, intercontinental traffic is 93% of 2019, while total traffic is at 87% of 2019 levels. The key driver of the shortfall then isn't international travellers but rather domestic. At both Frankfurt and Paris, 2024 domestic passenger numbers remained depressed, at 72% of 2019 levels. Although this is a small percentage of the total passengers (16% at Paris and 9% at Frankfurt), it is enough of a decline to weigh on the numbers. Meanwhile in Spain, domestic passenger numbers in 2024 were 114% of 2019 levels while at Athens, domestic passengers were 121% of 2019 levels.

Domestic traffic (pax mn)



Source: Company disclosures

There are likely three drivers of the weakness in the domestic recovery

1. Geographic	2. Macroeconomic backdrop	3. Airline exposure
Spain and Greece have a significant part of the population living on islands. These residents cannot realistically use another form of transportation to travel within the country, so when they want to travel to the mainland, they almost always need to fly. Government policy also often supports this, with Spain offering discounts of up to 75% on flights from the islands to other Spanish destinations. As the economies have recovered from COVID-19, it is no surprise that domestic travel has followed.	German and French gross domestic product (GDP) growth has lagged the rest of Europe coming out of the pandemic. This likely has been a drag on domestic travel, especially relative to Spain and Greece (which have been among the strongest performers in GDP growth since COVID-19). As a result, airlines have taken capacity out of the domestic market and moved the planes to other routes.	With their point-to-point network, the low-cost carriers (for example, Ryanair and easyJet) are quick to react to changes in demand. They can easily move planes to the most popular routes. The legacy airlines (such as Lufthansa, Air France and British Airways) have a different approach, as their networks rely partially on connectivity via the hub airports. They cannot move capacity around as quickly, as moving a plane from the hub could impact the broader network of connections.

…but this weakness also creates opportunities

Despite the weakness in the domestic markets, we do not think this represents a structural headwind for passenger growth at the hub airports like Paris and Frankfurt. It could even create an interesting opportunity. Smaller planes usually fly domestic routes, so fewer domestic flights should open more slots for larger planes (either on intra-EU or intercontinental flights). This could allow the airport to handle more passengers with minimal incremental costs. Additionally, international travellers tend to spend more money in the airport than domestic ones. This brings a benefit to the non-regulated part of the airport, which is an important lever for value creation.

Additionally, the underperformance of domestic traffic creates an opportunity for traffic growth beyond the normal GDP cycle. A simple return to 2019 traffic levels could happen if the economic situation stabilises. Fewer strikes (both at airlines and airports) and more aircraft coming back into service (since the GTF engine issues) could help as well. Meanwhile, with capacity and passenger numbers in Spain well ahead of the pre-pandemic levels, there is less scope for normalization, and future passenger growth will likely require continued GDP growth.

Positioning

For those following the positioning of the Macquarie Global Listed Infrastructure portfolio, you would have seen that over the past 18 months the portfolio was positioned the most defensively it had been for some time. Specifically, that meant larger holdings in regulated utilities and lower exposure to user demand assets (transportation infrastructure such as airports).

While the defensive positions remain, we have taken the opportunity to increase the portfolio’s exposure to airports.

We recently added to several different stocks, including French airport operator Aéroports de Paris SA (ADP) and German airport operator Fraport AG.

Where we saw the risks

The prior positioning was primarily driven by two factors:

1. **Valuation**: The team saw the airport sector as quite overvalued. The market had extrapolated the post- COVID-19 recovery, pent-up demand release and was pricing the stocks as if growth was going to continue at quick levels forever.
2. **Near-term demand**: In addition, the team was nervous about the pace of air travel as concerns increased for an economic slowdown, which may impact near-term demand.

Over 2H24, airports lagged meaningfully as the market started to recognize these issues, and we saw some slowdown in air travel, particularly in Europe.

New opportunities

ADP – Charles De Gaulle

French airports continue to experience a slower relative recovery to other leisure destination airports. The most interesting aspect of ADP is its holding in an Indian airport company, an investment made years ago. The value of the holding is potentially significant relative to the market capitalisation of the company. ADP is bringing onboard a new CEO, which will provide the opportunity to consider what to do with the stake. If it were to occur, we believe it would be very positive for the stock price.

Fraport – Frankfurt Airport

The company's capital spending program is expected to come to an end in 2026. The team is projecting a material inflection to cash flow positive in the near term. In addition, the company has recently struck a multiyear agreement with its major airline partner, creating greater price stability for the longer term and the potential for improved financial outcomes.

Conclusion

Macquarie continues to believe equity markets are relatively short term in their focus and thus will often respond to information that is less material to the fundamental long-term value of a company. We seek to exploit the market's generally short-term focus, which may see mispricing of infrastructure stocks owning and operating long-life assets such as airports.

One such example is the rebound in travel following the post-COVID-19 reopening, which created opportunities in stocks such as ENAV SpA, Aena SME SA and Athens International Airport SA.

Today, we are experiencing a two-tier market in Europe: the leisure destinations, where traffic is now well ahead of 2019 levels, and the main hubs, such as Frankfurt and Paris, where traffic has either just about recovered or still lags 2019 levels. Such dispersion has, in our view, created opportunities for us to pivot the portfolio to where we see the strongest risk adjust opportunities, including companies such as ADP and Fraport.

Contact us

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Key risks

The potential for adverse events in the global infrastructure sector to impact the performance of the investments of the Strategy. Investments in securities issued by companies which are principally engaged in the infrastructure business will subject the Strategy to risks associated with direct investment in infrastructure assets. Factors such as the availability of finance, the cost of such finance in general as well as in comparison to prior periods, the level of supply of suitable infrastructure projects and government regulations relating to infrastructure may influence the value of these investments and hence the Strategy.

The risks of investing in the infrastructure sector include those listed here.

New project risk: Where an infrastructure issuer invests in new infrastructure projects, it is likely to retain some residual risk that the project will not be completed within budget, within the agreed time frame and to the agreed specification.

Strategic asset risk: Infrastructure assets may include strategic assets, that is, assets that have a national or regional profile, and may have monopolistic characteristics. The nature of these assets may generate additional risk given the national/regional profile and/or their irreplaceable nature and may constitute a higher risk target for terrorist acts or political actions.

Documentation risk: Infrastructure assets are often governed by a complex series of legal documents and contracts. As a result, the risk of a dispute over interpretation or enforceability of the documentation may be higher than for other issuers.

Operation risk: Should an infrastructure issuer fail to maintain and operate the assets efficiently, the ability to maintain payments of dividends or interest to shareholders may be impaired. Failure by the infrastructure issuer to carry adequate insurance or to operate the asset appropriately could lead to significant losses and damages.

International investments entail risks including fluctuation in currency values, differences in accounting principles, or economic or political instability. Investing in emerging markets can be riskier than investing in established foreign markets due to increased volatility, lower trading volume, and higher risk of market closures. In many emerging markets, there is substantially less publicly available information, and the available information may be incomplete or misleading. Legal claims are generally more difficult to pursue. The Strategy may invest in preferred stock and hybrid securities, which may have special risks. Preferred and hybrid securities may include provisions that permit the issuer, at its discretion, to defer distributions for a stated period without any adverse consequences to the issuer. Some preferred and hybrid securities are non-cumulative, meaning that the dividends do not accumulate and need not ever be paid. A portion of the Strategy's assets may include investments in non-cumulative preferred or hybrid securities, under which the issuer does not have an obligation to make up any arrears to its investors. Preferred and hybrid securities may be substantially less liquid than many other securities, such as common stocks or US government securities. Generally, preferred and hybrid security holders (such as the Strategy) have no voting rights with respect to the issuing company unless preferred dividends have been in arrears for a specified number of periods, at which time the security holders generally may select a number of directors to the issuer's board. Generally, once all the arrears have been paid, the security holders no longer have voting rights. In certain varying circumstances, an issuer of preferred or hybrid securities may redeem the securities prior to a specified date. For instance, for certain types of preferred or hybrid securities, a redemption may be triggered by a change in federal income tax or securities laws. A redemption by the issuer may negatively impact the return of the security held by the Strategy.

Important information

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