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BRIEFING

INVESTING IN AIRPORTS: THE THREE STAGES OF SUCCESS

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- A DISCUSSION OF THE MAIN CONSIDERATIONS FOR INVESTORS IN AIRPORTS AND AVIATION.

"GLOBAL AVIATION CONTINUES TO GROW, VERY RAPIDLY IN SOME PARTS OF THE WORLD."

There are many compelling reasons to invest in airports. Global aviation continues to grow, very rapidly in some parts of the world. Effective stewardship of an airport can yield a significant dual revenue stream from aeronautical and non-aeronautical services. Airport ownership may offer the opportunity to create or develop an "aerotropolis" or mega-hub of retail and entertainment services. It may also enable investors to use technological innovation to provide superior, more personalized services to enhance the passenger experience, increase passenger traffic and thereby improve returns.

However, good outcomes do not happen by accident. The processes of buying and then effectively operating an airport are often full of traps for the unwary, not least in regulatory aspects. Fortunately, with good preparation and understanding of risks involved at each stage of a transaction, these traps need not deter a prudent investor.

In this briefing we consider three key stages an investor needs to consider.

The multi-million dollar question

The most important question you should ask is why you are looking to invest in an airport. These five considerations may guide you to your answer.

What type of investor are you?

Airports are attractive assets for different classes of investor, from existing airport operators (strategic investors) looking for stable returns from the long-term operation

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of the airport, to financial investors seeking steady, inflation-protected returns from operating the airport over a more medium-term period, such as pension funds, sovereign wealth funds, infrastructure funds and private equity houses.

Go it alone or invest jointly?

It is important to decide whether you will invest alone or jointly and whether you may want to syndicate or refinance your investment after completion. Will you be prepared to invest alongside a government with a controlling or residual interest? Consider to what extent your interests are aligned with any co-investors or other stakeholders.

When do you need to see a return?

Your preferred timescale for achieving a return on investment will influence many other key decisions to be made at this early stage. Some airports have significant revenue growth potential even in the short-term owing to the strength of underlying demand. We have seen passenger numbers increasing in some Asian and African airports at double the rate of many European airports. Others may require significant capital expenditure in the short-term in order to generate growth and drive returns.

What type of airport are you looking for?

Your reason for investing in an airport may determine the type of asset you prefer. An airport serving a capital or major city is likely to offer year-round passenger traffic, whereas regional or secondary airports may have less frequent or more seasonal traffic.

How prepared are you to overcome the regulatory hurdles?

Regulation can affect the value of your asset throughout the investment cycle. Planning restrictions (perhaps motivated by noise concerns raised by local residents) can restrict or prevent capacity expansion. Multiple ownership of airports that arguably compete with each other can raise competition concerns – even after the purchase has been completed, as shown by the enforced sales by BAA within a few years of Ferrovial’s acquisition.

Planning for success

No airport investment can be successful without careful planning to seek to avoid the most common pitfalls and mitigate the most significant risks. For us, the following three areas are the most critical.

The team

Investing in an airport is a highly complex project which requires a large team with diverse skill-set. It would be wise for the project team to comprise at least:

- A **project board** of suitably experienced individuals with overall responsibility for the purchase and the preparation of the business case and strategic plan;
- A **project team** of individuals with appropriate expertise to manage the purchase. Project roles and responsibilities should be clearly assigned to team members from the outset and regular communication among team members is essential.
- **External advisers**. The project team should include specialist advisers to assist with financial, legal (including regulatory/competition), tax, technical, environmental and insurance due diligence, and to prepare the complex suite of project documents in collaboration with the rest of the project team.

Project documents

Undoubtedly, the project documents, such as the sale and purchase agreement, shareholders' agreement and financing agreements, are an essential part of any successful investment. But, as with any large investment project, you should also prepare:

- a **project plan** comprising the steps necessary to complete the investment, the individuals responsible for each aspect of the investment, a schedule of meetings for the project board, the project team and the advisory team, a clear timeline for executing the investment and regular progress reports to the project board;
- a set of **approval procedures** for the investment;
- a **risk register** for the investment process, including the anticipated key risks and an assessment of their likelihood, impact on the project and financial model and proposed mitigants. The project board should monitor, re-assess and update these risks throughout the investment process;
- a **business case** setting out the strategic, economic, commercial, financial and management case for the investment and identifying risks likely to affect the ongoing commercial viability of the airport;
- A **strategic plan** outlining the five or ten year strategy to develop the airport and maximise its revenue streams opportunities. For example, Glasgow Prestwick Airport devised a "Strategic Vision" document that contemplated it becoming a UK Spaceport, a hub for EU emergency disaster relief programmes, a training centre for commercial pilots and engineers and a centre of excellence in aviation engineering; and
- an **exit strategy** outlining the proposed timing and methods to exit the investment, the investor's preferred exit route(s) and any actions to be taken to facilitate a clean and profitable exit.

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Coordination

Having a high-performing and experienced project team will not help you unless there is clear coordination between all team members. From day one, there must be clear reporting lines and well-defined responsibilities for all those involved. Deal timetables and strategies can be affected by numerous factors, such as the outcome of governmental, planning, regulatory or competition law processes, or employee consultations. Close coordination of all the moving parts and regular communication between team members is essential.

Running your airport

The deal has closed, the champagne corks have popped and you now own an airport. Whatever your answer to the multi-million dollar question was, and however much planning and preparation you have put into it, in many respects the hard work is only beginning. Here are three tips for lightening the load:

Establish and maintain good investment management and governance arrangements

Keep a close eye on the airport's ongoing commercial and financial performance and viability, and be prepared to make numerous (hopefully minor) adjustments to maximize your return.

Ensure that risks are properly identified, and actively managed by appropriately experienced team members applying rigorous procedures.

“AIRPORTS OPERATE IN AN INCREASINGLY COMPETITIVE ENVIRONMENT: GROWTH AT ONE AIRPORT MAY COME BY ATTRACTING AN AIRLINE AWAY FROM ANOTHER AIRPORT.”

Establish audit and risk committees to ensure ongoing scrutiny of the airport’s operations.

Capitalise on unexpected opportunities
Airports operate in an increasingly competitive environment: growth at one airport may come by attracting an airline away from another airport. Seize any opportunity to leverage your airport’s unique assets or its competitive position to improve the business.

Plan for “known unknowns”
The converse of the last tip is how you react to unexpected adversity. Some misfortunes you can (and may even be required to) plan for, for example, emergency procedures. Others – such as regulatory intervention – may be unexpected but you should plan for them nonetheless.

You might come under pressure to sell a stake to the Government. You might face concerns about a concentration of airport ownership. What will you do to diversify your air carrier base? What if your major carrier decides to go to a direct competitor? How will you reduce and manage your operational costs during the next economic downturn? Plan for these down-side risks now and, for each, consider the most appropriate levers at your disposal to redress the situation.

Conclusion
In a highly competitive market, the difference between securing and losing a prize asset – on the one hand – and operating it successfully or not – on the other – may be marginal and depend on a handful of critical decisions. It is prudent therefore not to give any hostages to fortune and to prepare meticulously in advance for each stage of the investment process: from planning to execution, management and operation and finally exit.

FOR MORE INFORMATION

If you have any questions about our airports or aviation practice, please contact your usual WFW contact or any of the partners listed below.

JEREMY ROBINSON
Partner
London
+44 20 3036 9800
jrobinson@wfw.com

PAUL DORIS
Partner
London
+44 20 7814 8199
pdoris@wfw.com

JAN MELLMANN
Partner
London
+44 20 7814 8060
jmellmann@wfw.com

REX ROSALES
Partner
London
+44 20 7863 8975
rrosales@wfw.com