FROM MAYDAY TO HEYDAY:
Have airports recovered from COVID-19?

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Air traffic volumes have been rebounding strongly from their mid-2020 lows and could reach pre-pandemic levels by end-2023. However, airports have not yet fully shed the effects of the virus and risks to the economic outlook could mean the pandemic's side effects linger.

Life was almost unrecognisable at the onset of the COVID-19 pandemic in early 2020. Stay-at-home orders and working from home policies were implemented, social distancing enforced and almost all forms of travel discouraged. Three years on from the declaration of the pandemic, many aspects of life have shed the effects of the virus. However, the recovery from the pandemic has not been homogeneous, by jurisdiction nor by sector.

Broadly speaking, the aviation sector was decimated in 2020 by the wake of the COVID-19 pandemic. Per Figure 1, global passenger volumes fell by 60% in 2020 compared to a year earlier. According to McKinsey, US$230 billion was lost across the aviation sector in 2020, with airlines accountable for US$168 billion and airports US$32 billion.[1]

Air traffic volumes have been recovering, especially since the start of 2022, supported by the easing of travel restrictions, border re-openings, pent-up demand and excess savings. Airfares have been elevated on the back of higher fuel costs – in Europe, airfares were on average 25% higher in 2022 than they were in 2019.[2] However, higher airfares have not stalled the resumption of air travel, particularly leisure travel.

Corporate travel has been much slower to recover. With demonstrated success at going virtual, business airfares on the rise, pressure to reduce corporate expenses and the evolving nature of the workforce, the value of business travel is being reassessed. However, there undoubtedly remains a need for it. Results from a study conducted by MIT's Human Dynamics Lab shows that the most valuable communication is done in-person. Typically, 35% of the variation in a given team's performance is explained by the number of times team members spoke face-to-face.[3]

Airport revenues are inextricably linked to air traffic volumes.

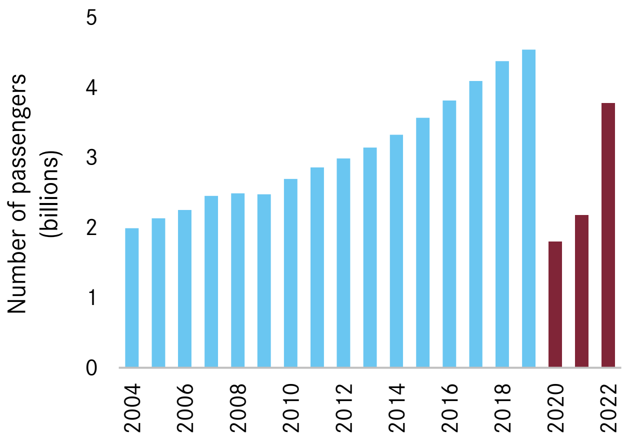
Airport activities can be split into two distinct lines, aeronautical and non-aeronautical businesses. Aeronautical services involve the management of the runways of the airport and revenue is charged on a per passenger and per aircraft bases.

Non-aeronautical revenue consists of income from the use of the land bank at the airport as revenue from car parking, retail and duty free, business park rental and rental car income. On average, aeronautical revenues make up just over half of total revenue for airports.[4]

The volume of air traffic is the primary determinant of aeronautical revenues, so when air traffic declines, these revenues decrease proportionally. Non-aeronautical revenues are also linked to passenger traffic and output. Meanwhile, airports' operating expenditures are typically quite inflexible and capital costs are largely fixed and are incurred regardless of air traffic volumes.

The COVID-19 pandemic presented a significant challenge for airports' revenues and their financial viability. Airport revenues in 2021 were 48% below the pre-COVID-19 forecast for 2021.[5] Furthermore, due to the capital-intensive nature of airports and largely fixed capital costs, the airport sector increased debt levels significantly. The industry's average debt-to-EBITDA ratio rose from 5:1 to 13:1 in 2021.[6]

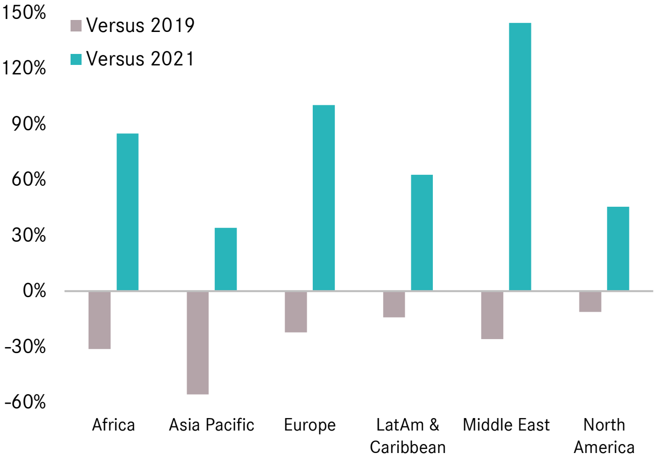
FIGURE 1: NUMBER OF SCHEDULED PASSENGERS BOARDED BY THE GLOBAL AIRLINE INDUSTRY



Source: Statista

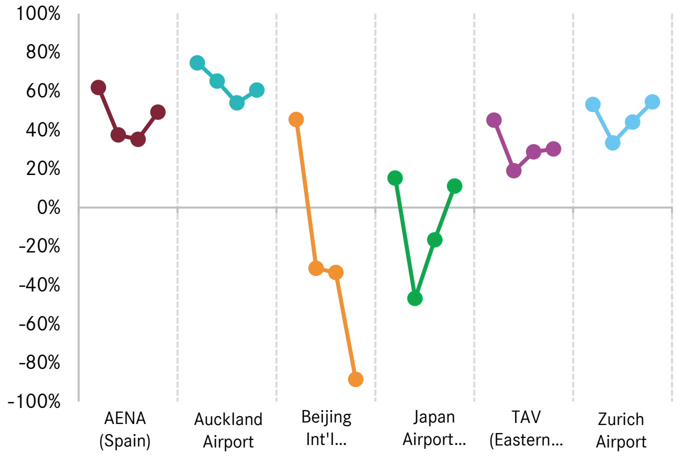
[1]McKinsey & Company, *Taking stock of the pandemic's impact on global aviation*, 31 March 2022.
[2]Eurostat, based on the Harmonised Index of Consumer Prices, Passenger Transport by Air.
[3]Harvard Business Review, *The New Science of Building Great Teams*, April 2012.
[4]Airports Council International, *Airport Economics Report, 2021 Edition*.
[5]Airports Council International, *The impact of COVID-19 on the airport business – and the path to recovery*, 24 February 2023.
[6]Infrastructure Global, *Airport debt ratios more than doubled during Covid*, 22 March 2023

FIGURE 2: RPKs IN 2022 VERSUS 2019 AND 2021



Source: International Air Transport Association

FIGURE 3: AIRPORTS' EBITDA MARGIN, 2019 - 2022



Source: Bloomberg

While global air traffic rebounded in 2022, revenue passenger kilometers (RPKs, the number of revenue-paying passengers multiplied by distance travelled) remain below pre-COVID-2019 levels by reasonable margins in all global jurisdictions, as presented in Figure 2.

Importantly, there is significant distinction in the recovery by airport, with strong determinants being an airport's location, government support throughout the pandemic, its reliance on corporate versus leisure travel and the volumes of cargo shipped through the airport. Figure 3 illustrates the heterogeneity in recoveries, via the EBITDA margin for a variety of global listed airport stocks. Of the airports presented, most have now experienced a material recovery in their EBITDA margins since the lows in 2020, but airports in jurisdictions that have had severe and long-lasting COVID-19 lockdowns have not recovered (Beijing) or been slower to recover (Auckland).

The recovery is expected to continue, but airports may not be out of the woods yet.

According to the Airports Council International, global passenger traffic is expected to reach 92% of 2019 levels in 2023, before exceeding pre-pandemic levels by 2024. Looking forward, there are a number of risks facing the global economy, including the ongoing conflict in Ukraine, instability in the global banking sector, slowing economic growth in many parts of the world and the potential for monetary policy missteps.

Aviation is inextricably linked to macroeconomic conditions – the impact of inflation and disposable income are critical in air transport demand. On the other hand, China's reopening and strong labour markets globally could support the sector's recovery.

An airport's location and passenger mix will ultimately be key factors in determining the sensitivity of passenger volumes to changes in economic conditions. Broadly speaking, we would expect large international 'hub' airports with a diverse passenger base to generally exhibit relatively inelastic demand (except for in global pandemics, evidently).

Airports remain an important component of infrastructure portfolios.

We remain convinced that airports will continue to be a compelling asset class. That said, airports are heterogenous, in terms of the type of airport, the market it serves and the types of aircrafts using them. The COVID-19 pandemic remains an important reminder of the requirement for sound investment guidelines in portfolio construction, ensuring diversity both in airport and non-airport exposures to ensure the asset class offers long-term value for investors.

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