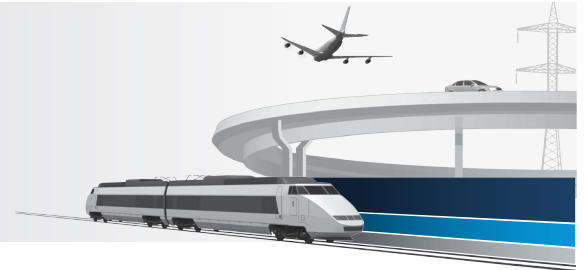


# Planes, trains and automobiles

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May 2016

2016 has started strongly for European toll roads and airports, providing upside earnings risks.

A broad range of infrastructure assets are joining the European listed infrastructure sector via IPOs, corporate restructurings and government privatisations.

An asset tour of Groupe Eurotunnel's Folkestone terminal further reinforced our view of the strong pricing power, high barriers to entry and structural growth this unique, privileged asset offers.

I have just spent two weeks in Europe on planes, trains and automobiles visiting infrastructure companies, assets, analysts and investors in London, Paris, Madrid and Edinburgh. I also attended a Latam investment conference while in London.

## Toll Roads: 'The Fast and the Furious'

Europe is home to most of the world's leading toll road operators. On this trip I met with Abertis, Vinci, Ferrovial, CCR and OHL.

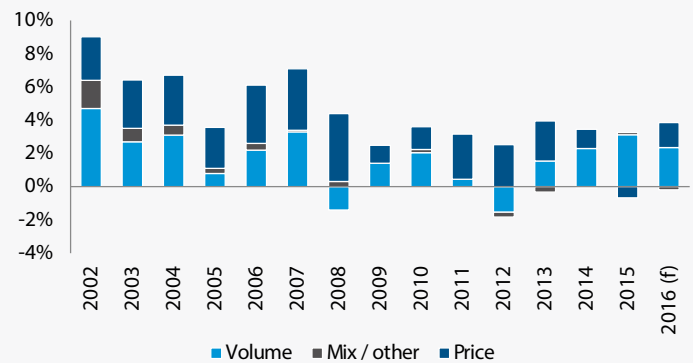
Toll road traffic appears to have started 2016 strongly. Spain and, to a lesser degree, France are performing ahead of my expectations. This upside is based on higher numbers of light vehicles, which are benefitting from solid consumer confidence, lower oil prices, a warm European winter and more domestic holidays (as tourists avoid North Africa and Turkey). Brazil's tollroads are still reporting declining traffic but even in a troubled economic environment, early-year volumes are not as bad as I had expected.

The good news for listed tollroad companies is that pension funds and unlisted infrastructure funds are bidding up the value of infrastructure assets globally, under the guise of lower required returns. The bad news is that these funds are making it harder for listed 'pure play' toll road companies like Abertis and Atlantia to acquire mature assets at reasonable prices. This has given the combined construction and concession toll road operators (Ferrovial, Vinci, OHL and Pinfra) the advantage of being able to source less competitive greenfield or brownfield expansions.

Several toll roads are aggressively expanding into the higher growth airport industry. Vinci, Atlantia and CCR have recently

acquired or won new airport concessions, which now account for between 5% and 15% of profits. I do not believe this process has finished, and expect these new players to bid up the price of new airport assets coming to market.

## Vinci's ASF revenue growth



Source: Autoroutes du Sud de la France, First State Investments

## Portfolio implications

Our strategy has an overweight position in toll roads. We believe the market overestimates the risks facing the sector's stable cash flows and underestimates the growth optionality of the assets. Risks to medium term earnings appear to be modestly on the upside. We expect these low risk businesses to again be fast and furious performers in 2016.

## Visiting Abertis' head office in Madrid



Source: First State Investments

### Eurotunnel: Superman

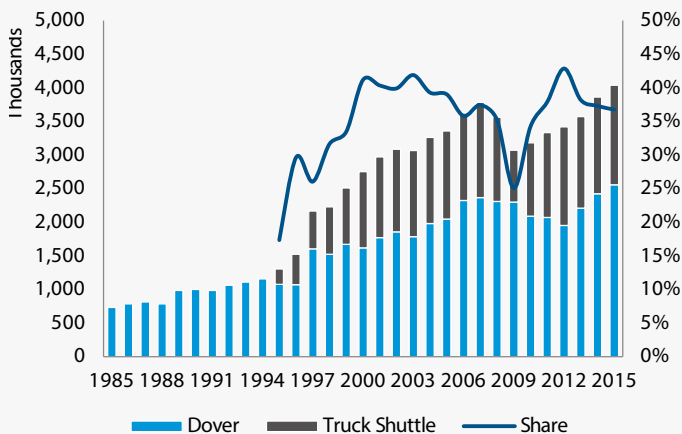
Is it a tollroad? Is it a railway? No, it is Groupe Eurotunnel. Eurotunnel is a unique infrastructure asset, part toll road and part railway. The company has a concession which lasts until 2086 to operate three 50km tunnels (two single track railway tunnels and one service tunnel) under the English Channel between Folkestone and Calais.

Eurotunnel has two main profit streams. Firstly it earns income by transporting truck and passenger vehicles via train through its tunnels at 140km/h; each crossing takes 35 minutes. Eurotunnel has ~40% truck and ~50% passenger vehicle market shares in the cross-Channel market. The company operates in an oligopoly market structure, competing against two cross-Channel ferry operators. Pricing is unregulated and Eurotunnel has a long history of being able to implement 'inflation plus' price increases. The company offers a superior service to ferries in terms of speed, frequency and reliability. This enables it to charge a premium to its ferry competitors and still grow market share.

Eurotunnel's second main profit stream is the fixed charge that it levies on the 10 million people who cross the channel by passenger train (Eurostar). This charge is €19 per passenger and escalates at an average of British and French inflation rates less 1%. Eurostar (and Eurotunnel's infrastructure) has a 77% market share of the London-Paris route and an 81% share of the London-Brussels route versus airlines.

In addition to these low risk profit centres, Eurotunnel requires minimal capital expenditure levels to support this growth, as the tunnel is currently operating at capacity utilisation of just 50%. Low risk EBITDA growth combined with minimal capex provides strong free cash flow generation which swiftly de-leverages Eurotunnel's balance sheet, allowing strong dividend growth. Over the next five years, we forecast Eurotunnel to grow its EBITDA, free cash flow and DPS at CAGRs of 4%, 6% and 11% respectively.

#### UK-France truck traffic\*



Source: Port of Dover, Groupe Eurotunnel, First State Investments  
 \*1997 and 2009 market shares were adversely impacted by truck fires

### Portfolio implications

The company has underperformed recently on the back of Brexit fears and related weakness in sterling (~50% of Eurotunnel's revenue but just ~30% of its costs are denominated in GBP). We view this situation as creating a mispricing opportunity for a quality company with a very long-term concession. We think Eurotunnel is a 'superman-like' asset.

#### Eurotunnel asset tour in Folkestone



Source: First State Investments

## Airports: Flying High

On this trip I met with Aeroports de Paris (ADP), BBA Aviation, Ferrovial (operator of and largest shareholder in Heathrow Airport) and Vinci (the world's fifth largest airport operator). Over the past year, traffic and reported earnings from airports around the globe have surprised on the upside despite ordinary economic growth. The only area of weakness has been private jet travel in the US, where volumes have been flattish over the past few months.

Since the successful IPO in 2015 of the world's largest airport operator AENA, airport privatisation momentum has accelerated. Late last year, Santiago airport was re-auctioned with a new terminal due to be built by an ADP / Vinci consortium. Japan sold Osaka's airports to a consortium led by Orix and Vinci. France is in the middle of selling its third and fourth largest airports in Nice and Lyon respectively. Nice in particular is attracting a large field of bidders. Despite the chaos of Brazil's government it appears that the country is still on track to sell four airports this year, including the ten million passenger Salvador Airport (for which I expect CCR to be a strong bidder). In the longer term, ADP is considering investments in Iranian and Vietnamese airports.

I view airport privatisations as win / win / win scenarios for governments, customers and the acquiring companies. Governments benefit by reducing public debt levels with the initial sale proceeds and through the removal of future capital expenditure requirements. Customers get better facilities, expanded retail offerings, more services and better airline connectivity. The acquiring company also wins, as it reduces costs, expands revenues and develops the under-utilised asset base of a previously government owned entity.

## Portfolio implications

Airports are flying high as they continue to offer strong structural earnings growth. Air travel is growing at a multiple of GDP growth, while a positive passenger mix effect, underpinned by high spending Chinese consumers and rising wealth in developing markets, is providing a further boost. These factors are driving strong upwards earning revisions across the sector in spite of weak global economic growth. However, we see some downside risks (luxury goods spending by Chinese tourists in Europe fell 35% in March) to these bullish growth trajectories. Hence our strategy is currently underweight the airport sector as we struggle to find quality airports that are materially mispriced.

## Conclusion

This is the most optimistic and confident I have seen the management teams of European infrastructure companies despite suboptimal political situations across many European countries. Earnings are surprising on the upside and balance sheets are underlevered, creating opportunities to increase dividends and grow shareholder value.

## Biggest surprises

- The range of infrastructure assets joining the global listed infrastructure sector, from telecom companies (Telefonica and Deutsche Telekom) IPO'ing mobile tower assets to Petrobras divesting midstream assets, Brazilian transmission line auctions and a significant number of airports.
- Following a solid 2015, European airports and toll roads look like being earnings upgrades stories again in 2016.
- Continued strength in the Spanish economy despite political stalemate.
- How badly UK politicians are managing the "Stay in the EU" campaign.



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