Magellan infrastructure Quarterly Update

April 2024

Jack Mann:

Hello and welcome to the Magellan Infrastructure quarterly update. My name is Jack Mann and I'm part of the Magellan distribution team. Today I've got with me two of the portfolio managers on the infrastructure strategy, Ofer Karliner and Ben McVicar. Welcome gents.

Ofer Karliner:

Hi Jack.

Ben McVicar:

Hi.

Jack Mann:

You can't go to a barbecue or pick up a newspaper without reading or hearing about the cost of living. Many Australians hear that beep every single day when they're driving around in their car. How do you think governments or toll roads in particular are going to navigate this pressure and how might that impact Transurban?

Ofer Karliner:

We haven't seen any direct political pressure on the toll roads we look at to not increase tolls, it simply hasn't happened, and they have not been able to put through toll increases they're allowed to. We have seen it manifest in other ways though, most obviously in New South Wales, and you talked about Transurban. The government here is doing a toll review and they're trying to make the tolls more equitable, so different tolls we build at different times, the different cost structures, and so the tolls reflect the cost of building that road. They're looking to try and make them more equal across the state effectively, across the city.

Importantly though, they've said that they recognize the contracts and they recognize the value of those contracts and they're not going to violate those contracts. So ultimately, Transurban is going to be no worse off as a result of this. But Transurban is working with the government to try and help make a fairer tolling system for everyone here, and that's probably going to be beneficial for shareholders in the long term or at least not worse for them. There are some other things, we've seen other jurisdictions, France for example. And Ben, you want to touch on what French government's doing?

Ben McVicar:

Yeah, sure, happy to jump in. So, when we think about France, what we've seen is a little bit different to this, the direct impact on toll. What we're seeing is the French government has decided to effectively follow populist policy and try to apply effectively a special tax that applies to the concession space, but it is targeted very much at the motorway companies. And what's kind of interesting from our perspective is that you will see this from time to time, governments will step in and try to take advantage of infrastructure and the very defensive nature of these assets. And when we think about investment in the space, we are very much focused on finding assets in jurisdictions and we're really confident in the rule of law. That's really important for us; we want to be really confident that the courts are going to protect our property rights ultimately.

And so, when we think about what's happening in France, what is kind of interesting in this instance is that the French government has constructed this new tax. So, it applies to concession assets in France, i.e. motorways plus a few airports. That is kind of different because the concession contract rules out just taxi motorways, so they've been a little acute effectively with the language around that. So, I think you'll see a challenge, because ultimately, it might apply to airports as well, but this thing is vast majority borne as tax by the motorway companies. So, I think we'll see a challenge on that. But ultimately, from our perspective, whether this happens or not, we're probably more about the precedent, because ultimately the economics, it's probably more a [inaudible 00:03:21] flash wing for these companies than an existential issue.

Jack Mann:

Let's shift to airports. So, in your previous videos, you've talked a little bit about Chinese travelers and the resurgence there. Can you give us a bit of an update and maybe compare it to the rest of the world?

Ofer Karliner:

Yeah, sure. So, China's probably been a bit slower in its recovery compared to the other developed markets in the world. To put that in context, Europe and North America in December last year were about 2% above 2019 levels. Asia-Pacific, which includes China, was down about 8.9%. That's largely driven by Chinese outbound, Chinese domestic was up around 8%. So again, they're late to reopen, the boss seen a bit more economic weakness in China, so that's kind of fed into a slower recovery than we would've expected. Mostly the rest of the recovery is playing out as we have expected. So if you look at the way Europe has recovered, while it's 2% above across the entire continent, there's been big disparities between the types of airports and you would've heard me talk about or other team members talk about, we expect leisure travel to come back first over business travel, short haul over long haul, a low-cost carrier over legacy carrier that really played out in January.

I won't use February because that's affected by the extra day. Aena, which covers Spanish airports, was up around 12% on 2019 levels, ANA which is the Portuguese airport operator that's owned by Vinci is up 15%, and both heavily focused on leisure and low-cost carrier travel. Fraport owns Frankfurt Airport, that's Hub Airport, mostly long-haul travel there, large contingent of legacy carrier, Lufthansa that was down 13% on 2019 levels. Their forward capacity is looking down 13% for the summer season as well. It's again, big disparity. That's kind of what we expected. I think we were looking for in the Chinese travel recovery is the spend rates per passenger, that's actually been weaker than we expected as a whole from the Chinese passengers. Historically, airports talked about three and a half to five times the average spend per international passenger for the Chinese passengers coming through the airports and now saying it's about three.

So, a bit more subdued, again, probably reflecting the economics of China being a bit softer than it has been pre-COVID. Despite that, we've seen big upticks in spend rates per passenger across a number of airports, most notably Paris Airport or Charles de Gaulle, which owned by ADP, the spend rates there, retail revenue there, 60% above pre-COVID levels. And part of that is the opening of a huge retail space in one of the Terminal One, one of their terminals. One of the reasons we owned it prior to COVID was this huge retail uplift we expected. It's now one of the best performing retail terminals in the world in terms of spend rates per passenger where it had almost no retail prior. Likewise, ANA is about 20% ahead, and that's benefiting from new K-passengers now being ex-EU so they can buy duty free. Again, spend per passenger is actually doing quite well in a lot of the airports we look at, despite the lack of Chinese passengers coming back.

Jack Mann:

Yeah, so it seems like the consumer's still super strong, right?

Ofer Karliner:

Correct. Yeah.

Jack Mann:

I suppose the big talking point has been the consumer in the U.S. and if we're thinking about the U.S., later this year, we've obviously got the election coming up. I've been speaking to Arvid about his kind of outcomes or how he sees that maybe playing out. What do you think the outcome might be for energy transition and will there be any impacts?

Ben McVicar:

Yeah, it's an interesting question. So, when you think about the United States and the election coming up, the conclusion in terms of impact that we see today is minimal. We don't think there's going to be a big investment impact. I'm talking about the underlying businesses. There's, put aside for a second, the impact on fixed income markets, rates, and everything you might see as a more sort of near-term market effect. But if you think about the business impact, number one is yes, it looks like Trump is probably the market favorite at this point, but noting it's still very, very early days in this process and what can still happen. So, when we think about what could happen, probably one of the key things that we focus on was the Biden policy and the Inflation Reduction Act. The IRA, why we care about that one specifically is it has a lot of tax incentives related back to renewable buildouts.

So, things like tax incentives for wind farms, for solar power stations. And so, what that kind of means is one, is think about the politics and one, would Trump go after this. To us, it seems less likely because we actually look at the beneficiary states that typically have been probably more skewed to Republican in nature. So, there's going to be a political calculus involved in this, but let's go ahead and assume that he does decide to remove some of these tax incentives. What you could see as a result is that some of the more marginal developments simply just don't go ahead anymore because it doesn't make economic sense. What is kind of important in this discussion though, is when you think about renewables in productive regions in the U.S., you're no longer aligned on subsidy to make this work. And so, what happens now is the economics drive the development of these projects alone.

And so, from our perspective, you might see a bit of a headwind to growth, but the reality is you're still going to see a lot of projects going on. And in fact, there's a lot of developments happening under the first Trump administration. And in addition to which, renewables are just a piece of the overall growth possibility for these electric utilities, you still have a lot of growth that's going to come out of just maintaining and developing and refurbishing their grid assets, their poles and wires. So, you're going to see a lot of opportunity there alone. So yes, we think there might be, if you saw all of that happen and you saw that policy impacts, you might see a bit of an impact, but we think it's going to be more of a headwind than a significant issue now. I think we've all been doing this long enough to know, never say never. There're always things you don't expect, but that's the way we're seeing the world today.

Jack Mann:

So, you guys have, you've always said infrastructure is reliably boring. Can we flip it on its head a bit, little bit, and can you give me maybe something in the portfolio that you're excited about?

Ben McVicar:

Reliably boring to everybody else, we get pretty excited about it. So, when we think about infrastructure assets and what we've got in the portfolio today, we have talked in the past about probably three of our larger positions, and I just touched on a couple of them before. One is Aina Spanish airport operator, one of the largest airports, the largest airport holding into the portfolio. It's a nice airport, as you just heard. The traffic recovery has been really quick driven by the fact its low-cost carrier dominated, the fact that it's short haul travel and more personal travel gear to see that recovery play out really quickly in that asset. Vinci, which is a big toll road operator, but they're diversified infrastructure operator. The largest assets are probably French motorways who are subject to some of those taxes we were just talking about. But the underlying core assets, these motorways, they are highly cash flow generative.

They mature toll roads, they spin out cash at this stage, and their tolls are linked to inflation over time. So, it's a really nice asset. Ferrovial which is again a European domiciled business, but it's actually more North American in nature. Its key assets are staking the 407 ETR motorway in Toronto. This is very long concession life, very limited pricing restrictions on that asset. So, it's really attractive in terms of the opportunity. And they've also got a really nice portfolio of U.S. motorways as well, which is outside of Transurban is a bit of a rarity. So, we've talked about those in the past, but that's probably ones we are still excited about those. But some of the other opportunities as well, which we haven't touched on as much is probably more in the utility side in North America. It's kind of interesting because utility companies have been the relative laggard in our universe over the last few years.

And what's kind of interesting in that space is it's really starting to throw up some valuation opportunities because of that relative lag in price. The underlying companies are doing what we expect. And so, when we think about an example of that, a company Dominion Energy, they're a large integrated utility in the U.S. What's kind of interesting from my perspective is that they've just been through a transition as they've moved to a more, call it a vanilla regulated utility. And in that process, as they've cleaned up their position, they've probably done that carrying too much debt for their current credit rating. And in that process, they've also had a regulatory determination go against them. And so, it's had a lot of pressure and they've had to work overtime to effectively get that cleaned up to do an asset sale process to bring down that debt level and restore the credit metrics to where they should be.

But what's kind of interesting when we look at that is this is a company who, a lot of these issues are more rear vision mirror stuff now as opposed to fore looking, but the valuation continues to look really interesting. And so we are, that's an example, we're seeing a number of opportunities like that in that U.S. Utility sleeve of the portfolio as well.

Jack Mann:

Great. It's great to see you excited. Thanks for joining me today guys and thank you very much for listening today. Please feel free to share this with any of your clients.

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