



Fraport's Recent Investment: A Questionable Platform for U.S. Growth

AIRMALL USA – An Extensive Review



Analyst: Ian Mikusko ■ (212) 332-9330 ■ imikusko@unitehere.org

Fraport AG is a German-based airport owner and operator with its primary operation at Frankfurt Airport. In August 2014, Fraport acquired airport concessions developer AIRMALL USA, which currently stands as Fraport's only investment in the North American market. Immediately following the acquisition, Fraport announced its intention to use AIRMALL as a platform for developing its U.S. business and to increase its U.S. brand exposure. This report examines whether AIRMALL is a suitable vehicle for growth in the U.S. market.

AIRMALL is a concessions developer that is contracted to develop and manage food and retail programs at four U.S. airports. Unlike most companies in Fraport's portfolio, AIRMALL does not manage entire airports. Rather, it manages airports' food and retail concessions programs. Another difference is that AIRMALL operates in an airport industry that remains publicly owned. While many European airports have privatized, every airport in the continental United States is governed by state or local governments.

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AIRMALL is a relatively small company, holding concessions leases at just four airports. Fraport has stated its intention to grow AIRMALL, thereby increasing Fraport's own presence and visibility in the market. AIRMALL's ability to win new business and to maintain its existing accounts is a critical factor in considering the wisdom of Fraport's AIRMALL investment.

A close review of AIRMALL's business portfolio, its recent track record and its troubled relationship with labor, reveals a company with questionable utility as a platform for growth.

- **Failure to grow since 2008:** AIRMALL has not won any new leases since 2008, a period which encompasses five unsuccessful attempts at growth. Most recently, AIRMALL was rejected by the City of Philadelphia in December 2014 in its attempt to win the concessions lease at Philadelphia International Airport.
- **Expiring leases:** AIRMALL could lose three of its four total existing leases within the next four years, including its largest account, Baltimore-Washington International Airport (BWI), where in December 2014 the state government issued a Request for Information (RFI) inviting AIRMALL's competitors to send information to the state about how they would each improve BWI's concessions program.
- **Declining enplanements:** Two of the four AIRMALL-managed airports have experienced a steep drop in enplanements over the last five years.
- **Problematic labor relations:** AIRMALL's inability to form a productive working relationship with labor in a political environment has affected its reputation within the industry.

Based on the above considerations, this report posits that AIRMALL faces significant challenges that threaten its potential as the vehicle for Fraport’s growth in the U.S. market.

Failure to capture new business

Despite competing for numerous new contracts, AIRMALL has failed to grow and expand its market share. The last contract captured by AIRMALL was at Cleveland Hopkins International Airport (CLE) over six years ago. AIRMALL has responded to five Requests for Proposals (RFP) since then, losing all five. Most recently AIRMALL was one of two companies that bid at Philadelphia International Airport (PHL). In December 2014, the City of Philadelphia approved a contract with AIRMALL’s sole competitor for the business, Marketplace Development.

RFP	RFP Release Date	Awarded To	AIRMALL Status
LOS ANGELES INTERNATIONAL <i>International Terminal, Terminal 2 & Theme Building</i>	May 2011	Westfield Concessions Management	REJECTED
LOS ANGELES INTERNATIONAL <i>Terminals 1, 3 & 6</i>	June 2011	Westfield Concessions Management	REJECTED
SAN JUAN LUÍS MUÑOZ MARÍN INTERNATIONAL <i>RFQ for private airport operator. AIRMALL bid as part of a consortium for this RFQ.</i>	July 2011	Aerostar Airport Holdings	REJECTED
WASHINGTON REAGAN NATIONAL & DULLES INTERNATIONAL (Round 2)	April 2012	Marketplace Development	REJECTED
PHILADELPHIA INTERNATIONAL AIRPORT	January 2014	Marketplace Development	REJECTED

In the U.S. market there are two primary models for airport concessions. AIRMALL only competes in one such model, the “concession developer model.” As such, AIRMALL’s opportunities are limited by the number of “concessions developer” procurements pursued by airports. AIRMALL and its fellow developers have failed to change the standard concessions model to the developer model. In such an environment, each opportunity for growth for a development company is of heightened importance. It is worth noting that one of the most important upcoming business opportunities for developers—the Washington DC airports where the current lease expires at the end of 2017—saw an unsuccessful AIRMALL proposal just three years ago.

A closer look at AIRMALL's current leases

AIRMALL holds a concessions lease at a total of four airports: Baltimore-Washington International Airport, Cleveland Hopkins International Airport, Pittsburgh International Airport and two out of four terminals at Boston Logan International Airport. AIRMALL's portfolio, if small, could appear to be a good starting place: Boston Logan and Baltimore-Washington International are booming airports, the 18th and 22nd largest airports in the United States, respectively. But a closer look at these airports reveals uncertainty or challenges at all four AIRMALL leases.

Baltimore-Washington International Airport (BWI)

BWI, which is owned by the State of Maryland, is AIRMALL's largest contract in terms of concessions sales. 40% of the total sales generated at AIRMALL-managed operations come from BWI. Fraport materials describing its AIRMALL purchase presented 2022 as the expiration-date for AIRMALL's BWI lease. While the 2022 expiration date is accurate, these materials contained a significant omission: the opt-out clause in the contract.

Under the terms of the BWI-AIRMALL lease, the State of Maryland can opt out of the AIRMALL contract without cause beginning in April 1, 2017. The 2017 opt-out has been debated by state officials, but decision-makers have not yet decided if they will exercise the option. A recent development indicates that Maryland is exploring that possibility. In December 2014, the Maryland Aviation Authority issued a Request for Information (RFI) to the airport concessions industry. The RFI solicited "suggestions, ideas and concepts which would result in increasing competition and revenues to the State." Six of AIRMALL's competitors submitted a response.

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If the state decides to opt out of the contract at this early date (4/1/17), it would cost AIRMALL an estimated \$35 million in revenue compared to what it would make if permitted to operate for the full term of the lease (under the assumption that AIRMALL's revenue from BWI increases at the same rate as its estimated revenue from 2011 to 2013).ⁱ

AIRMALL has been the focus of a contentious labor dispute at BWI for almost two years, which has involved protests, picket lines, and strike actions at the airport. Though AIRMALL does not employ the hourly concession workers, the company has been the focus of criticism

ⁱ The estimate was derived from ARN Factbook data on total concession sales and total rent collected from 2011 through 2013. AIRMALL's estimated revenue from BWI is calculated as 30% of the total rent that it receives per the terms of its lease. The projection for the amount of revenue that AIRMALL would lose if the opt-out is exercised is based on estimated revenue from April 1, 2017 through March 31, 2022 if AIRMALL's rate of estimated revenue growth from 2011 to 2013 (4.15% annually) continues through the term of the lease.

for its management of the program. Reports have revealed low-wages and lack of benefits for BWI's concession workers as well as racial disparity in job classification among surveyed BWI workers, with African-American workers much more likely than white workers to work in jobs such as dishwasher and cook instead of server and bartender.

The labor dispute has generated significant political attention. The recently-departed Governor of Maryland, Martin O'Malley, publicly criticized AIRMALL for the working conditions in its program and expressed interest in removing AIRMALL from the airport. The Maryland General Assembly has also considered legislation that would terminate AIRMALL's lease in 2017 if wages at the airport do not improve. The legislation did not pass in 2014 but similar legislation is likely to resurface in future legislative sessions.

The outcome of AIRMALL's role at BWI is not yet determined, but given the negative publicity the company has received and the importance of this account to AIRMALL's portfolio, the risk of the state exercising its opt-out 5 years prior to the 2022 expiration is an important consideration.

Boston Logan International Airport (BOS)

BOS is owned by the State of Massachusetts. AIRMALL manages two of the airport's four terminals at BOS, which is its second largest account in terms of sales. AIRMALL's concessions management lease expires in 2017. Industry interest in capturing the concessions business in BOS in 2017 is expected to be high.

Pittsburgh International Airport (PIT)

PIT is owned by Allegheny County. It is AIRMALL's third largest account, but is significantly smaller than BOS or BWI, generating just 17% of the total sales from AIRMALL-managed terminals. PIT is the airport where AIRMALL launched its model in 1992 (at the time under the ownership of BAA). Its lease does not expire until 2029.

Of all of AIRMALL's accounts, PIT is its most stable given its history at the airport and the date of its lease expiration.

It is important to note, however, that PIT's enplanements have been in decline, and correspondingly, concessions revenue has dropped. PIT's enplanements dropped by 22% from 2007 to 2013, and concessions sales dropped by \$3.6 million—from \$49.7 million to \$46.1 million—between 2011 and 2013. Unless enplanement trends are reversed it will be difficult for AIRMALL to maintain or increase its revenue from PIT.

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Cleveland Hopkins International Airport (CLE)

CLE is owned by the City of Cleveland. It is AIRMALL's smallest account by total concessions sales. CLE is in the same category as PIT as a struggling airport. CLE's enplanements dropped by 21% between 2007 and 2013. Earlier this year United dropped CLE as a hub, threatening a further decrease in enplanement levels.

Overall Picture

AIRMALL is at risk of losing three of its four airport contracts within the next five years. Together these three contracts accounted for over 83% of concession sales at AIRMALL-managed terminals in 2013, with PIT, AIRMALL's single long-term stable contract registering just

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16.9%. If enplanement trends continue—with passenger traffic increasing at BOS and BWI and decreasing at CLE and PIT—this percentage will get even smaller. AIRMALL's ability to retain its business at BOS and BWI, with possible 2017 terminations at both airports, could prove crucial for the success of Fraport's investment.

Airport	Lease Status	Percentage of concession sales (2013)
BALTIMORE-WASHINGTON INTERNATIONAL AIRPORT	2017 opt-out	40%
BOSTON LOGAN INTERNATIONAL AIRPORT	2017 expiration	28%
PITTSBURGH INTERNATIONAL AIRPORT	2029 expiration	17%
CLEVELAND HOPKINS INTERNATIONAL AIRPORT	2019 expiration	15%

Industry Reputation

AIRMALL's reputation within the airport industry is of critical importance given Fraport's intention to use AIRMALL to enhance its own brand in the U.S. market. As the two companies become further integrated, AIRMALL's actions and reputation will increasingly reflect upon Fraport.

The U.S. airport industry is a political environment. In such an environment a negative track record with regards to labor can have an adverse reputational impact. Accordingly, the labor

dispute at BWI and AIRMALL's general recalcitrance in forming a productive relationship with labor is a reputational concern.

The BWI conflict has received a great deal of press attention and political consideration within the City of Baltimore and the State of Maryland. The conflict has not been confined to those markets, however.

Significantly, during the selection process for the Philadelphia International Airport, a group of Maryland State officials sent letters to officials in Philadelphia recommending that AIRMALL not be selected as the Philadelphia Airport's concessions manager.

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AIRMALL also stands out for its overall inability to form a working relationship with labor. In the United States, airports are publicly owned and a good relationship with labor can be beneficial to a company's success. While nearly all of the prominent airport concessions companies in the U.S. have decided to work with labor as a fellow industry stakeholder, AIRMALL has taken a different course.

Summary

Fraport's entrance into the U.S. market was a bold move with both risk and opportunity. AIRMALL's foundation of four existing airport leases suggests an appealing platform for U.S. growth. A closer analysis, however, raises questions about whether that outward appeal will translate into long-term opportunity. There are a number of concerns about the company that raise questions over whether AIRMALL will serve as the vehicle for growth that Fraport hoped for. A summary of concerns about AIRMALL that its new owner should keep in mind:

- Potential lease termination at BOS and BWI in 2017, which together accounted for 68% of AIRMALL's business in 2013.
- AIRMALL's failure to win new business since 2008.
- The reputational impact of the ongoing labor dispute at BWI.

