KEYNOTE INTERVIEW

Transport shifts through the gears

The sheer breadth of opportunities that the transport sector offers makes it an attractive segment for infrastructure investment strategies, says DWS's Harold d'Hauteville

The transport sector's potential, especially in Europe, relates to its sizeable and remarkably diverse universe of investment opportunities. The stock of existing assets is deep, and the mega-trends of decarbonisation and digitalisation are driving capital towards sustainable and more efficient transport modes, as well as fleet electrification. Even the forms of transport where sustainability appears more challenging, like aviation, are showing positive performance and showcase the sector's potential resiliency.

Similarly, the continent's robust regulatory environment supports investments in the decarbonisation of transport, and the EU's recent commitment to greater strategic independence should support regional trade flows. This could point towards positive investment returns for the long term. Harold d'Hauteville, head of European infrastructure equity at DWS, expands on why investment in Europe's transport sector is proving particularly attractive.

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Q Why invest in the European transport sector?

Europe presents a wide array of transport investment opportunities, potentially more diverse than could be seen in other markets. For example, in the US, core infrastructure assets like roads and airports are largely publicly managed and harder to access. Europe offers investors access to the full spectrum of assets, including roads, airports, ports, rail, train stations, leasing, logistics, shipping and public transportation.

Interestingly, investors also tend to have significant exposure to digital and energy assets, partly due to substantial prior investment in these sectors. Transport, with fewer transactions happening post-pandemic, might now be an attractive space and help with portfolio diversification.

Ancillary businesses adjacent to transport are also evolving, including equipment leasing and electric vehicle charging, mirroring the asset class growth we see for the transport sector more generally. Examples here include ground operations support at airports, toll road service stations, rolling stock and specialist equipment leasing as well as adjacent developments within ports, such as biomass terminals, intermodal connections and harbour towage businesses.

In our view, part of the transport sector's appeal lies in the comprehensive scope of opportunities available, which cater to various investment strategies, from core to value-add. And thanks to the diverse range of business models available, investors can find different ways of benefiting or protecting themselves from the key macroeconomic factors underpinning these businesses.

Q How are the mega-trends of decarbonisation and digitalisation impacting the transport sector?

Decarbonisation and digitalisation are both major trends influencing transport. When we think about the energy transition, specifically, it has different effects depending on the transport mode in question. The decarbonisation mega-trend, for example, is certainly driving a modal shift from road to rail.

Sustainability is also boosting investment in public transport, where the electrification of fleets requires substantial financial support. This is a good example of transport investment serving as a positive tailwind for decarbonisation.

Where it might initially seem likely to have the most damaging impact concerns air travel, but traffic numbers continue to show significant growth. While the widespread use of sustainable aviation fuels (SAFs) may be some way off and electric aircrafts further still, the sustainability movement has prompted further investment in airport efficiency. As such, decarbonisation can be both a threat and a growth driver for the transport sector, especially for aviation.

Looking at digitalisation, this trend is necessitating investment and fostering innovation across the sector. Perhaps, one casualty of digitalisation in the post-covid era is a reduction in business travel. We're seeing slightly lower numbers of travellers to some more business-focused airports, due to the rise in online meetings, whilst holiday travel is thriving. However, the impact of digitalisation is still largely positive, leading to more efficient operations.

Q How is aviation demand faring after the challenges of the pandemic?

The aviation sector suffered significantly during the pandemic, highlighting its higher vulnerability compared to freight transport, for instance. However, air traffic has rebounded strongly, exceeding 2019 levels by 2023/24, though recovery varies by airport type and region.

Admittedly, travel patterns have changed and not all airports have recovered in the same way. Business travel has reduced somewhat. But continued growth across aviation is largely being fuelled by holiday travel facilitated by low-cost carriers – especially in Europe. Direct flights have also increased competition for major airport hubs.

In the aftermath of the pandemic, there's been a renewed focus on the environmental impact of air travel. Even so, addressing aviation emission levels is challenging. Electric aeroplanes remain some way off and fleet rejuvenation takes time. SAFs also face weak demand due to high costs and ongoing technological development. Additional support mechanisms may be needed for the wider adoption of this fuel source, especially given that it looks to be the only feasible medium-term option for aircraft decarbonisation.

As a result of the challenges around SAFs, the focus on improving aviation's carbon footprint has shifted to airport operations, including ground operation efficiency, electrification, renewable power purchase agreements (PPAs) and electric ground support equipment. These green improvements are a key part of the sustainability strategy of airports.

> *"The transformation of transport, particularly in terms of electrification, should present a continuous stream of opportunities for investors"*

Q What sort of influence is the regulatory climate having on the sector?

Different transport modes face varying impacts from decarbonisation initiatives and the regulatory environment that drives them. The shift to electric cars, promoted by mandatory targets, creates opportunities in EV charging infrastructure, albeit with associated risks. From our point of view, we've certainly looked at regulatory changes as an opportunity to support the decarbonisation of private car transportation.

European regulations represent a comprehensive approach towards energy transition, setting behavioural restrictions and efficiency targets, including targets for energy composition and emissions. That can help create a supportive investment framework. For instance, regulations promoting the use of biofuels in gasoline and biomethane in transport fuel are generating investment opportunities.

Regulatory changes, like reduced penalties for car manufacturers' electrification targets, can influence investment decisions in different ways, of course. But Europe has a relatively stable and coherent regulatory framework providing investors with some level of certainty. Even so, as always with regulations, you should remain prudent of potential change.

Q How can governments ensure public transport plays a significant role in the sustainability drive?

Looking at our investment portfolio, we see the twin demand drivers of mobility and sustainability converging around public transportation. For example, we run bus operations in Belgium, where the local transport authorities include bus fleet electrification target levels in their tenders. This is pushing sustainability across operators' fleets. The fee operators receive for managing the bus services reflects the costs of this electrification, with electric buses generally proving more expensive to purchase than conventional ones but are cheaper to run.

In the UK, regional authorities are pushing for increased mobility and broader public service coverage through franchising systems. In London, a franchising system is already common. Elsewhere, commercial models tended to be preferred, which can lead to efficient operations on key lines but may not deliver the best results in terms of geographical coverage and broad access to mobility. So, public authorities can shape sustainability in the public transport space more broadly, with fleet electrification being primarily supported by subsidies in the UK.

Q What sort of emerging trends do you see for the sector? And how optimistic are you about the future?

Looking ahead, in our opinion there should be sufficient optimism for transport investment due to the diversity of opportunities on offer. Decarbonisation remains a central trend, requiring substantial fleet electrification investment in public transport and providing opportunities in adjacent segments such as biofuels for existing fleets.

Rail may also present attractive prospects in both the freight and passenger segments, requiring improvements in efficiency and resilience. Likewise, the need for increased efficiency and resilience is leading to investment requirements in leasing and equipment pooling solutions to support increasingly complex supply chains on a global and regional level.

Assessing the global picture, while recent US tariffs may have created some uncertainty, their direct impact on European exports is relatively limited. Of course, some sectors such as the automotive industry are more exposed. The main impact on Europe is indirect, stemming from uncertainty, which reduces investment from European industrials and corporates, thus softening demand and impacting GDP.

On the one hand, transport, being more GDP-exposed, should feel this effect on ports and road traffic. On the other, the more aggressive stance taken by the US has spurred reactions in Europe, such as Germany's €500 billion infrastructure fund, which aims to support economic activity and will indirectly benefit transport.

Furthermore, events in the US shouldn't take away from the robust regulatory and policy support seen at both European and national levels. This is creating more favourable investment conditions. Globally, similar opportunities also exist, with trade flow evolution being a key consideration, and especially in sectors like ports. Europe's ambition for regional trade flows aims to reduce dependence on the US and Asia, which will have a significant impact on where capital is directed.

The transformation of transport, particularly in terms of electrification, may present a continuous stream of opportunities for investors. The decarbonisation and digitalisation movements are not likely to go away, and neither is the ever-evolving need for mobility. Even if the ideal exit window for some transport businesses may be pushed back, due to uncertainty arising from macroeconomic turmoil, the general direction of travel appears positive. ■

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