Transport report: Bristol refashioned

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With a highly liquid bank debt market, many transport and utility borrowers have started looking beyond traditional bond financing for what are now very competitively priced project loans – a trend underlined by the recent £515 million ($930 million) bank financing for Bristol International Airport (BIA) in the UK.

Arranged and underwritten by Calyon and Société Génerale, the transaction – currently in syndication – provided BIA with committed funding for both existing business and forecast expansion plans, on conditions that compared favourably with all alternative funding options.

"Capital markets still have an important role to play", notes Michel Anastassiades, Global Head of Project Finance at Calyon, "but the current liquidity amongst banks means that the clear advantages of the banking market, such as flexibility and responsiveness to change, are no longer outweighed by keen pricing in the bond markets".

The airport's continuing rapid expansion and the associated need for ongoing additional funding, also contributed to the decision to go for a bank-funded solution.

BIA growth

BIA has grown over the years from a small local flying club, founded in 1930, into a major international airport handling over 5 million passengers and 50,000 commercial aircraft movements per annum. It is currently one of the fastest growing regional airports in the UK, with passenger volumes more than doubling over the past 3 years since its 2001 acquisition by Macquarie Airports of Australia and Grupo Ferrovial of Spain from previous owners Bristol City Council and First Group Plc. The shareholders also have ambitious plans for the future, with a target of exceeding 7 million passengers per annum by 2010.

BIA's impressive performance over recent years needs to be set against the UK regional airport sector as a whole, which has consistently achieved above average growth for more than 10 years. A recent survey published by the Civil Aviation Authority indicates that UK regional airports increased their overall market share over the period 1990-2004 from 34% to 40%. Over the past 4 years the CAA indicated that the regional airports enjoyed average growth of 7.9% p.a. whilst the London airports enjoyed growth of only 2.6%.

A number of key factors have contributed to the development of the sector. Firstly, the liberalisation of regulated European air services, which started in 1993, created and fuelled the market for low cost carriers. The development of these no-frills airlines has stimulated new demand from travellers who prefer to fly from their local airports, rather than spending valuable time getting to Heathrow or Gatwick. At the same time, there has been an increase in propensity to fly, as customers discover that they can travel to both popular and "unconventional" destinations from more convenient regional airports, saving valuable time both in getting to the airport and passing through.

Climbing passenger numbers has created a virtuous circle, with airlines launching a wider variety of routes and in turn further boosting passenger throughput and the associated commercial revenues.
BIA has exploited these sector trends and has out-performed its peers due to its focused commercial strategy, as well as a number of advantages of a more fundamental nature.

Competitive advantages

As the principal regional airport serving South West England, with the largest scheduled and charter network in the region, BIA has a clear competitive advantage. However, it is the strength and depth of BIA's large and relatively affluent catchment area that originally attracted the attention of Macquarie and Ferrovial and which continues to represent a key driver in the business plans of numerous airlines operating out of Bristol.

The airport benefits from a population of over 5 million people living within 90 minutes travel time. For most of these people, the only realistic alternative airports are Heathrow, Gatwick or Stansted, implying an extension to the journey time of at least a further 2 hours, without taking into account the extra time generally needed to pass through the larger airports. The average GDP in the South West regional economy is higher than any other UK region outside London and the South East, and the city of Bristol, with a population of 450,000, is the UK's 8th largest but 3rd richest city (in terms of GDP per capita).

BIA management argue there is plenty more to come in terms of growth potential. They point to the fact that there is still significant "leakage" of passengers based in the South West region to the major London airports, with the Government recently estimating that nearly 70% of local passengers by-pass Bristol at present. The improved range of destinations and frequency of services out of Bristol should help to reduce this trend, and accordingly increase BIA's regular passenger numbers.

Also, as BIA has recently broken through the crucial 5 million passenger threshold, it has begun to gain true critical mass. "The 5 million mark is key, as airlines, retailers and passengers will all start to regard BIA as a genuine contender as a major international airport, and hence the growth should become self-perpetuating," says Christoforos Stratos, Calyon's Global Head of Infrastructure Project Finance.

BIA's strategic strengths and its growth performance have not only benefited its passengers and shareholders. As a gateway to South West England, the UK government sees the airport as being strategic for the development of the economy of the region. In its White Paper of July 2002, the Department for Transport recognised explicitly that in the South West it is only BIA that has sufficient catchment to support a wide range of short haul scheduled services and short haul international charter services. In the same document, the government forecast that BIA would handle between 10 million and 12 million passengers per annum in the long-term, thus implying a further doubling of throughput.

Although BIA has benefited from the strength of the background fundamentals, it has taken the skill and commitment of the airport's management and shareholders to deliver the impressive growth recorded over the past 4 years.

BIA has a particularly strong management team with significant airport and aviation expertise. It also benefits from the experience and commitment of its shareholders, both of which are seasoned infrastructure investors with a long-term commitment to the airport sector.
In addition to BIA, Ferrovial has airport investments in Sydney, Belfast City and Antofagasta in Chile, whereas Macquarie has substantial shareholdings in Rome, Sydney, Birmingham and Brussels airports.

Building a new customer base

Prior to 1997, BIA's ability to increase passenger numbers was constrained by its inability to contemplate significant investment in airport facilities thanks to its public sector ownership. However, following privatisation in 1997, BIA implemented plans for a new £28 million "state-of-the-art" passenger terminal.

When the Terminal was opened in March 2000 it had capacity for around 4.5 million passengers per annum. Developments since, together with those planned over this winter, will take capacity to around 6 million passengers. Planned incremental terminal extensions will increase capacity to 9 million passengers over the next few years. "The significant spare capacity in both runway and terminal facilities serves to minimise construction-related risks, as well as reducing the likelihood of disruptions to airline schedules", comments Stratos.

In 2001, BIA was chosen by Go (subsequently acquired by easyJet) as its second operating base after London Stansted, following a detailed evaluation of over 160 airports around Europe.
The choice was clear, based on the strength of BIA's fundamentals (modern facilities, affluent catchment area with

limited competition etc). Subsequently, easyJet has chosen to expand its operations at Bristol to 8 aircraft, which now account for approximately 50% of passenger volumes.

In addition to easyJet, BIA has succeeded in attracting a number of other high quality airlines and has built up a well-diversified scheduled and charter airline portfolio comprising more than 30 airlines serving over 100 destinations in the UK, Europe, North America and Africa. Scheduled airlines include both full service and low cost carriers, resulting in a relatively even split in the airport's aeronautical revenues between low-cost, full service and charter segments. A clear mark of BIA's coming of age was recorded in May 2005, when the airport launched its first daily long-haul transatlantic service to New York (EWR) on Continental Airlines.

The experience of the BIA management has been key in terms of building and maintaining strong relationships with the airlines and encouraging the opening of new successful routes, including the New York service. The lack of regulatory control over BIA's airport charging regime has allowed the management to devise innovative pricing structures that encourage the most efficient use of airport resources. The management take a proactive interest in the performance of individual routes and also undertake regular and highly detailed market research, using the conclusions both to target new route opportunities and to help airlines to improve load factors and profitability on existing routes.

An analysis of BIA's financial performance reveals a relatively balanced split of revenues between aeronautical and "commercial" sources (including retail, catering and car parking). "Despite the abolition of intra-European Duty Free in 1999 we have consistently seen airports delivering growth from their retail and catering segments – this is an area with significant potential and upside", says Stratos.

On the cost side, BIA has made significant strides over the past few years and is now very efficient in comparison to its peers, with unit costs per passenger among the lowest of the UK's airports.

A key aspect of BIA's competitiveness is the management's strategy of operating the airport as, in essence, a pure "infrastructure provider", having out-sourced most of the ancillary activities that are especially labour-intensive (e.g. baggage handling) or specialised (e.g. car park operations) to outside companies. However, BIA management has also had conspicuous success in improving staff productivity and thus avoiding significant staffing increases as passenger numbers have grown.

Refinancing

The highly impressive performance of BIA over recent years (and correspondingly bullish forecasts) set the scene for a competitive refinancing. In their approach to the transaction, arrangers Calyon and SG sought to permit a re-leveraging of the business to levels more appropriate to its current performance, whilst at the same time retaining as much flexibility as possible for the shareholders and management, particularly with respect to the funding of capital expenditure for expansions.

The facilities, all of which have an 8-year tenor, are divided into a £340 million "mini perm", which has been used to refinance existing debt and pay a special distribution to the shareholders, a £165 million capex facility linked to both essential maintenance and future expansions of the airport, and a further £10 million revolving working capital facility. The "mini perm" structure was seen as ideal, given the lack of regulation of BIA's activities and the fact that it owns the airport land and assets on a freehold basis and has an indefinite right to operate.

The decision to tap the bank market was taken by the shareholders after careful consideration of both bank and bond options. "In recent times we have seen investors in the capital markets, particularly in the US private placement market, becoming increasingly sophisticated in their risk analysis techniques" notes Calyon's Anastassiades, "however, capital markets issues for dynamic borrowers will always suffer from the relative lack of flexibility inherent in such transactions. In this case, the combination of flexibility and terms offered by a bank-funded mini perm proved the perfect solution".