Mind your exits?

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Even before the events of September 11 in the US, the market for Middle Eastern airport financing was one of the least developed of all businesses in the region. Indeed, phone calls to bankers traditionally active in the region generated some fairly nonplussed responses, suggesting that few banks have really begun to focus on airports in the Middle East despite having been involved in emerging market airport financings elsewhere.

And since the airplane attacks in the US, few bankers are optimistic of the sector getting going for some time. ?The current global problem will make any airport financings in the region very difficult in the near to medium terms,? says one infrastructure financier in London. ?But it is very much a question of waiting to see what the US response is and how that is received internationally.?

False start?

The timing of the US attacks coincided closely however with the first real progress made in the region for private sector participation in the airport business. A consortium led by BAA, the UK airports operator, was selected as the preferred bidder for two airports in Oman ? defeating six other groups in the bidding process. Oman is privatizing two airports, Seeb International, which handles 2.7 million passengers a year, and Salalah on the north-west coast of the Indian Ocean, which sees some 150,000 of passengers a year.

The BAA-led consortium will take a 75% stake, with the remaining 25% held by the state. The operating concession runs for 25 years and involves the development and management of the airports. Other members of the consortium include the Bahwan group and ABB Equity Ventures. The consortium has won preferred bidder status, but had not yet completed contractual negotiations. The contract will run from next January.

But following the US plane attacks, sources familiar with the situation suggest that the BAA consortium is now actively trying to renegotiate elements of the agreement to reflect the global airline crisis. ?Whatever revenue projections firms had, they must now have come down dramatically following September 11,? says Andrew Blease, vice-president, senior analyst, at Moody's in London.

Revenues revisited

The economic environment for airports has changed markedly since the bids went in and the uncertainty attached with it will only make airport deals harder to finance. ?Banks are viewing airport deals with concern following the attacks in the US earlier this month,? says Doug Strong, head of infrastructure & mining finance, at ANZ Investment Bank in London. ?Revenue projections made before September 11 need to be revisited.?

Given the limited amount of time for analysis since the attacks in the US and the still unfolding international developments flowing from them, there is no real consensus yet as to what effect these events will have on Middle Eastern air traffic over the medium term.

Some analysts are relatively positive that the effects will not be long lasting. ?We expect European traffic to keep up its strength and other non-US air traffic to recover over the next year following the attacks in the US,? says Jan Willem Plantagie, associate director, infrastructure finance ratings, at Standard & Poor's in Frankfurt. ?Clearly all depends on further political or military events which could have a severe impact future traffic levels?.

In a research report published on September 13 focusing principally on European airports, S&P points to the quick recovery in airline passenger numbers after the Gulf War in 1999-91 and cites broader historical performances following the recession in the 1990s. However, the agency does note that it is not possible to predict the long-term effects for non-US passengers.

Moody's is more negative about the time it will take for passenger numbers to pick up from pre-September 11 levels. ? We generally expect Middle Eastern aircraft passenger numbers to be severely reduced, in an order of magnitude of the reduction seen in at least as much as US passenger numbers,? says Blease at Moody's. Moreover, Moody's is less certain that any return to normal volumes will be seen for some time. ?I expect that the Middle East will take much longer to recover than Europe for example,? says Blease at Moody's. ?There are some positive precedents such as the recovery after the Gulf War but it is hard to judge whether this recovery will be similar.?

Airport fundamentals

But why, given the high levels of private market participation in other sectors in the region such as power and oil and gas, has been there so little progress in the airport sector? The consensus suggests that there simply has not been the demand so far. ?From a political point of view, these states are generally independently wealthy,? says a London-based banker. ?And the reason why there has not been much in the way or private sector involvement in the region is basically because these states haven't needed it. They have chosen to finance these constructions themselves. The traffic throughput is not that great in comparison with western Europe, for example, and the capital requirements for these airports have therefore been manageable for these governments.?

However, as Oman's airport tender and a number of other projects suggest governments are beginning to accept that there is a need for private sector involvement. ?To date, airport infrastructure in the region has been financed by the states themselves who have not needed off-balance sheet financing,? says Blease at Moody's. ?However, that may change in the future especially for airports requiring large capital expenditure for expansions. We may also see more airport privatizations particularly as the sale of these assets around the world has attracted high multiples of Ebitda when sold.?

Form a regulatory perspective there is little to stop private sector participation in airport projects in the region. ?Airports that require substantial development and capital infusion often use a concession structure to privatize,? says Deepak Maheshwari, assistant director, global corporate finance at ANZ Investment Bank in London. ?Airports are strategic assets and governments often wish to retain the right to ownership and require commitment from the operating consortium to invest in the upgrade of the airport. A concession structure enables the government to get a long term commitment from the investor and also share the revenue upside. The rules and regulatory frameworks in most countries in the region now support a concession structure.?

Small beginnings

Indeed, there are numerous other airport related projects underway in the region. A number of schemes are being developed in Egypt. Egyptian airports provide a different set of characteristics to most other airports in the region as it was of the few states where most passengers moving through its airports are chiefly tourists.

The biggest potential prize for airport operators is the Terminal 3 project at Cairo airport, being offered by Cairo Airport Authority. The project involves the construction of a new terminal building as well as the development of existing buildings and land at the airport.

The project has been declared a priority by President Mubarak, although some bankers close to the project report that there is considerable dissent within the Egyptian government over private sector inclusion. ?It appears that the Egyptian government has lost the critical mass required for private sector participation,? says a banker familiar with the country. ? Effectively, there is a battle going on over whether to proceed with the private sector.?

The country also has three regional airports which are attracting bidding interest Luxor, Bargh el Arab and Sharm el-Shaikh.

A consortium led by ABB Equity Ventures has been awarded the 25 year build-operate-transfer contract to develop the new airport terminal at the Sharm el-Shaikh airport by Egyptian Airports Holding. The total investment cost is set at around $170 million and the project will have capacity to handle 3,000 passengers an hour. Revenue streams will come from both aeronautical charges and retail.

However, these three airports are seen more as a means to build relationships with the Egyptian authorities rather by airport operators who are eyeing the Cairo Airport expansion with interest. ?The bidding for the regional airports in Egypt is being seen as an opportunity for firms to position themselves for the Cairo airport project,? says one project financier.

Other projects in the region include the expansion of Dubai International Airport's terminal three which is being handled by Dubai Aviation Authority.

Saudi Arabia is also understood to be contemplating the expansion of Jeddah airport. A design for the expansion has been completed by a Dutch firm and the project may go ahead on a let or contract basis.

And in Morocco, there is a planned $123 million expansion of Mohammed V airport near Casablanca. The African Development Bank will make a $70 million loan to finance part of the project's foreign exchange costs. The project involves the construction of a second runway, new terminal buildings and a new ground control system.

Travel patterns

Yet, how attractive Middle Eastern airport projects are to financiers is uncertain. Partly it is too underdeveloped a market to get a clear indication but also the situation is clouded by the events in the US. At the moment, for obvious reasons, there is little enthusiasm for these types of assets. But assuming over time that normalcy returns to global air traffic patterns and volumes that should change. However, compared to other regions where private sector participation in airports is developing such as western Europe, the Middle East offers less attractions from a passenger revenue perspective.

There are two key variables when looking at potential airport revenues, firstly overall passenger volumes and secondly the average spend per passenger. On both of these points, the Middle East is not as attractive as some other parts of the world. The region in itself is not a major destination but more of a transit point for travel between the West and Asia. The questions for airport operators and their financiers are whether passenger growth on these routes is likely to continue to expand and whether the Middle East itself can begin to attract more final destination passengers. Already there are examples, such as Dubai which is growing as a winter-sun destination for Europeans, that the region can bring in more passengers itself.

?From a credit perspective, banks look to the airport's passenger demographic profile and the potential for growth in the share of non-aeronautical revenue to aeronautical revenue as seen in recent years in Western Europe and elsewhere,? says one project financier. ?If the demographic does not support such a change in ratio, the credit revenue risk, primarily lies in the airport's ability to market and grow passenger traffic.?

The second and related factor is the amount spent by each passenger passing through an airport. If more final destination travelers ? and principally tourists ? can be brought in then the situation will look more promising from an economic perspective. At the moment, however, the average spend per passenger is lower than in some other regions. Contributing to this is the significant proportion of travelers which are migrant workers who are unlikely to produce the non-aeronautical revenues these projects need. ?Spend capacity per person is lower in the Middle East as compared to Western Europe because of the difference in traffic and demographic profile of the airport users.? says Deepak Maheshwari at ANZ. ?This affects the revenue streams of airports and airport revenues in the Middle East are more likely to between 60:40 and 75:25 in favour of aeronautical charges whereas in the west non-aeronautical revenues account for more than 60% of overall airport revenues of most major airports.?

Over the past 10 years in Western Europe the spend per person going through an airport has grown faster than the actual volume of passengers and that is a trend which is starting to happen in the Middle East. If this rate can be sustained in the region then bankers are likely to start taking much more interest.