Transport Report: The $1 billion question

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Thailand's airport privatization ambitions are broader than those anywhere else in the region. It was in the mid-1990s that the Thai authorities first floated the idea of a partial privatization of the country's air transport infrastructure. Since then, those preliminary ideas have evolved into a decision to transform the Airports Authority of Thailand (AAT) into a holding company, 30% of which will be owned by private investors. Merrill Lynch is one of the advisers to the partial sale of AAT.

The authority will, in turn, own 100% of Bangkok International Airport and, when it is eventually finished, 85% of New Bangkok International Airport. AAT will also hold a 25% interest in those provincial airports which are currently state-run. According to Ian Thomas, senior consultant at the Center for Asia Pacific Aviation (Capa), based in Sydney, proceeds from the AAT sale will be used to part-finance the new Bangkok Airport, which is slated for completion in 2004. The government hopes to earn between Bt30 billion and Bt40 billion ($1 billion) from the airport privatization plans outlined so far.

In addition to the AAT sale, Thailand's Ministry of Transport and Communication has gone one step further and commissioned a report by PricewaterhouseCoopers (PWC) into the feasibility of a wholesale privatization of the 26 remaining state-owned provincial airports. Although the exact details are sketchy, analysts believe this may mean much more than 25%, and possibly 100%, of some of the provincial airports will be sold to private interests.

In scale, the scheme is reminiscent of the grand privatization programmes in both the UK and Australia. In terms of strategy, Thomas says the Thai authorities are adopting a model akin to the British Airports Authority privatization, at least with regard to the sale of AAT assets. ?The Thai government wants to sell the AAT to one single strategic investor, although AAT may eventually decide to have the airports operated by several different management groups,? says Thomas.

The scope of these ambitions concerns some independent observers. ?There's a wide disparity between the maturity of Thailand's air transport industry and those of Britain and Australia. It may well be too early to take this lock, stock and barrel approach to privatization,? says an air transport consultant closely watching the Thai airport sell-off.

Investors' concerns rest on two principal issues: the cost of modernizing the provincial airports, and the perceived volatility of travel demand in the Thai market.

Given Thailand's limited cash reserves, observers believe that the Thai authorities will want the cost of airport modernization to be borne in part or whole by the new owners of the airports. Thailand's airports will require extensive modernization in order to cope with the projected year-on-year increase in air travel over the next decade.

Thailand's economic growth will be one important factor in overall air travel growth. While the economy was stagnant and even negative during the past two years, most economists believe the country's GDP growth will accelerate above the 3% forecast for 2000 and average about 5% during the 2000 to 2009 period.

However, the consultant adds: ?Although no-one would dispute that private airports are run more efficiently than nationalized airports, the huge capital expenditure commitments that will be needed might well be best met by the Thai government itself rather than corporate credits.?

The Australian experience of airport privatization is instructive. Parvathy Iyer at Standard & Poor's, which recently produced a credit report on Sydney Airport, suggests previously nationalized airports are likely to suffer from ?higher gearing and weaker financial profiles following a sale?.

Admittedly, the Australian context is quite different from Thailand's ? Thailand's sovereign credit rating is many notches below Australia's sovereign rating, and potential creditors might think better of the risks if foreign companies with sturdy balance sheets are involved in the Thai airport arena.

But the actual process of buying into an airport is likely to weaken the balance sheet of the foreign investor as the company raises debt to fund the acquisition. It remains probable that funding costs for the new airport management are likely to be above funding costs that the Thai government could attain. ?The Thai authorities are probably best advised to stick to the privatization plans for AAT alone, since that will mean joint private and public sector ownership of the provincial airports,? adds the consultant.

?If the provincial airports are sold off piecemeal, to different investor groups, the spread in funding costs is likely to be exacerbated as creditors factor greater market risk into their pricing considerations,? says a project finance banker previously involved in the Australian airports sell-off.

The extent to which airports try to compete with each other to draw away air traffic (the essence of the market risk) has been amply demonstrated in Australia in recent months as airports fall over each other to lure Australia's start-ups into establishing their centre of operations at their hub. Melbourne Airport is known to be spending $8 million on a new terminal partly to convince Virgin to locate there. Thai airports, which generate much smaller cash flows than their Australian or British counterparts, are far more likely to suffer losses in similar competitive circumstances.

Therefore, a privatization programme which allows for substantial competition between airports is more likely than not to cause a lowering of perceived creditworthiness, evidenced again by the Australian experience. Standard & Poor's report on Sydney Airport's credit rating states explicitly its view of the relationship between privatization and credit strength. ?The negative outlook [for Sydney Airport] is based on strong privatization prospects before the end of 2001 and the potential for the rating to be negatively affected by the acquirer's funding arrangements,? says Iyer.

At the root of the difficulties of a wholesale privatization of Thailand's airports is the country's immature air market and underdeveloped economy and infrastructure. Analysts point out that Thailand's air market depends about 50% on business travel, producing an environment that is high-yield and price inelastic, but also low-volume, thin and, most important of all, volatile, compared with the Australian or UK markets.

The situation is made worse by Thailand's aviation policy, which continues to be restrictive. One of the central constraints lies in the fact that undesignated competitors to Thai Airways, such as Bangkok Airways, are prevented from flying the same domestic routes as the national flag carrier. At the moment, there is only one designated national carrier, Angel Airlines, which only very recently started operations.

Although the policy ensures a measure of stability, (Thai Airways is forced to fly certain routes, even at a loss) analysts believe this restriction stunts the natural growth of the market. ?A totally free domestic aviation industry is likely to be much more aggressive in chasing new passengers than Thai Airways is alone,? says a Hong Kong-based research analyst.

Capa's Thomas is hopeful that privatization of the airports sector will force the government into modifying its protectionist stance. ?I think the government is bound to realize that it will need to boost air traffic to make the airports sell-off work,? he says. However, there is no word yet of any tangible change in government policy.

Because of the way that the competition rules are set, it serves Bangkok Airways, a private carrier, not to upgrade the runways at the two airports it operates (on Samui Island and in Sukothai) which are tailored to the needs of its ATR fleet. Why? Because by lengthening the respective runways it would be possible for Thai's larger 737 jets to fly to the two Bangkok Airways hubs. Since the competition rules state that undesignated domestic operators cannot fly the same routes as the flag carrier, a decision to upgrade the airports would seemingly be business suicide for the regional operator.

In spite of the risks outlined above, it is important to note that Thailand's efforts to privatize the sector have stirred tremendous interest from potential investors across Europe, the US and Japan, and within Thailand itself. Federal Express, Lufthansa, Kreditanstalt für Wiederaufbau, Frankfurt Airport, Siemens, Kanemetsu, Marubeni and Sumitomo are just some of the companies hoping for a slice of the action. However, observers point out that this interest is principally concentrated on the existing and planned Bangkok international airports and the four largest provincial airports: Chiang Mai, Phuket, Hadyai and Chiang Rai.

Prasert Prasattong-Osoth, president and CEO of Bangkok Airways, says that his own airline is interested in buying into the four main provincial airports. Osoth even acknowledges that running the airports could be a safer bet than running an airline and in the Thai context, he, of course, should know. Yet, Thailand's other provincial airports are a different proposition entirely to the four largest. Most get only a fraction of the passenger traffic at Chiang Mai, the busiest outside of Bangkok, which had a passenger volume of two million in 1999.

In fact, both Osoth and the PricewaterhouseCoopers report have come out advising against the complete sell-off of the provincial airports. Osoth also recommends that the government should ?semi-privatize? (by which he means the government should retain at least a 30% stake) the provincial airports before full privatization. The PWC report goes even further, saying that privatization of the 26 provincial airports will not draw the necessary level of interest from operators to ensure that the government's sale price targets are met.

The Thai government might learn something from the more cautious approach of both India and Indonesia. In India, the government, despite being known for its pro-deregulation stance, ruled out corporatization and privatization of the five major airports including Delhi, Mumbai, Calcutta and Bangalore. Instead, the airports are expected to be modernized in partnership with the private sector, and that partnership will take the form of 30- to 59-year leases rather than outright sale.

Thomas thinks that the Thai government will at least stop short of a piecemeal privatization of the regional airports, whereby the spoils are divided between different investor groups. He points out that, at the moment, the AAT draws together all revenues from its subsidiary airports into consolidated accounts.

It is unclear whether the AAT is moving to break the consolidated accounts down, airport by airport. As this is a necessary precursor to a sale of individual airport assets, and a task that would take several months to complete, the conclusion must be that the idea of an airport-by-airport disposal process is no longer under consideration, particularly as the airports' sale is scheduled to launch soon.