Turkish infra hits the fast lane

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Turkey's infrastructure is, in common with that of most emerging markets, in serious need of an upgrade. With real GDP growth averaging almost 7 per cent since 2003, the country is more prosperous than ever - with growth expected to continue at a rate of between 4 and 5 per cent over the next five years - so it's never been in a better position to carry out the work it so badly needs.

At the same time that Turkey's economy has started to take off, its business-friendly government has also woken up to the need to involve the private sector in the country's infrastructure upgrade.

Privatisation priorities

The sectors that look most likely to be affected by this shift in policy are the energy generation and distribution industries, and Turkey's transport infrastructure.

According to the Turkish government's *2008 Annual Programme*, the privatisation of electricity generation and distribution assets is a priority in order to "contribute to the formation of a competitive market".

To that end, state-owned power plants have been structured into portfolio groups, and "studies towards incorporation and transfer of them to the Privatisation Administration are underway".

Privatisation of electricity distribution was also made a priority for 2008.

The agency goes on to say it is working towards a diversification of its energy mix - with the revision in 2007 of its renewable energy legislation to promote that sector, and a draft law on the building and operation of nuclear power plants, transmitted to parliament.

With regard to the country's transport infrastructure, the report laments the state of Turkish railways and highways. It notes that its highways per km^2 is less than half that of the EU-25 average, while motorway per km^2 is less than 1/7 of the EU's average. To that end, a major motorway privatisation programme is planned for later this year.

These are just part of a line-up of infrastructure assets soon to come to market in a growing emerging market economy on the edge of Europe.

Political uncertainty

Over the past couple of years, Turkey has been moving seemingly inexorably towards the EU - and though full membership is far from guaranteed, the country has nonetheless steadily been transforming itself into a serious candidate.

The past few months, however, have seen a lot of that progress thrown into doubt with the ruling party facing a legal challenge over its very existence.

The ideological struggle taking place in the courts between hardline secularists and those who support the moderate Islamist AK Party's right to rule is making outside investors nervous - and, for now, making the country a lot less of an attractive proposition.

The *Economist Intelligence Unit* (EIU) says it expects the court to rule against the AKP - leading to the formation by its members of a new party, which will remain in government.

At least until a verdict is reached, however, the AKP is still in power and the pro-business reforms it has enacted are still valid.

Opportunities in energy

The country's electricity distribution monopoly has been divided into 20 regional parcels - of which three are currently in the process of being privatised.

Baskent Electricity Distribution and Sakarya Electricity Distribution have just closed the bidding for interested parties, while the tender for the Aras and Meram Electricity Distribution company is open until 15 July 2008.

The bidders for Baskent and Sakarya are as follows:

Baskent Elektrik Dagitim

- Hema Endustri
- Akcez Consortium
- Haci Omer Sabanci Holding - Österreichische Elektrizitatswirtschafts-Aktiengesellschaft (Verbund) - Enerjisa Enerji Üretim Consortium
- Dogan Sirketler Grubu Holding - Saray Hali-Kantur-Akdas Insaat ve Ticaret Consortium
- Park Holding

Sakarya Elektrik Dagitim

- Alsim Alarko Sanayi Tesisleri ve Ticaret .
- Akcez Consortium
- Haci Ömer Sabanci Holding - Österreichische Elektrizitatswirtschafts-Aktiengesellschaft (Verbund)-Enerjisa Enerji Üretim Consortium
- UDDA Consortium
- Park Holding

Arzu Cavdar, head of project finance at ING Turkey, says that utilities are some of the most desirable companies in Turkey at this time.

Nine power plants were also sold in Ankara in March this year. The deal consisted of a rights transfer for 30 years of the state-owned company Ankara Dogal Elektrik Üretim, and was won by Zorlu Group for US$510 million. The power plants were as follows:

- seven hydro power projects
- one geothermal power project
- one diesel fuel power project

Gas distribution is also being privatised - Istanbul's distributor, Izgaz, will be tendered on 17 July while the Igdas gas distribution privatization - for the industrial zone around Istanbul - has also been announced.

Again Ankara got there first, though, with its gas distributor - Baskent Dogalgaz Dagitim - being snapped up in March this year by a consortium of Global Yatirim and Energaz for US$1.61 billion.

Perhaps most exciting in this sector, however, will be Turkey's first nuclear power plants. Two of them are being planned - at Akkuyu and Sinop - with the tender for Akkuyu currently open with a September 24 deadline [Projects Database].

Opportunities in transport

On the transport side, the biggest news is yet to come this year with the announcement of the tenders to operate the country's motorway network.

One has already been launched - the Gebze-Orhangazi-Izmir toll motorway - but the big bonanza will be announced later in the year.

Eight motorways will be up for privatisation - along with two bridges over the Bosphorous in Istanbul - in contracts likely to be worth a total of around €5 billion.

The **motorways** are as follows:

- Pozanti-Tarsus-Mersin
- Edirne-Istanbul-Ankara
- Tarsus-Adana-Gaziantep
- Toprakkale-Iskenderun
- Izmir-Çesme
- Izmir-Aydin
- Gaziantep-Sanliurfa
- Izmir ve Ankara Çevre

The **bridges** are:

- Bogaziçi
- Fatih Sultan Mehmet

A tunnel under the Bosphorous is also in the works, with a preferred bidder already announced for phase 2 [Projects Database] of a 3-phase project. The first phase - the construction of the tunnel - is still at the shortlist phase and is expected to be finalised in one year's time. The project as a whole is worth around US$1.1 billion.

Turkey's port privatisations have been a long-running saga. According to the state planning authority, the ports industry is too fragmented - meaning economies of scale associated with large ports are not being realised.

Over the last decade, a number of ports in Turkey have gone into private hands. The following ports were privatised by transfer of operation rights for periods of up to 30 years:

- 1997 - Tekirdag, Hopa, Giresun, Ordu, Sinop and Rize
- 1998 - Antalya
- 2000 - Alanya and Marmaris
- 2003 - Cesme, Kusadasi, Trabzon and Dikili

The Privatisation Higher Council on 30 December 2004 decided that the TCDD (Turkish rail company) ports should be included in the privatisation portfolio.

These TCDD ports are:

- Izmir [Projects Database]
- Mersin [Projects Database]
- Iskenderun

- Derince
- Bandirma
- Samsun

The flagship project - privatisation of the Izmir port - is currently making its way through the courts after the contract to operate it was won by a Hutchinson-led group. The privatisation has been challenged by the trade union.

Marina Petroleka, infrastructure analyst at *Business Monitor International*, says the court case shows up the "persistent tensions between the judiciary and the government. You can see the underlying tensions there, and it might scare some investors away."

Jonathan Simpson of Paul Hastings says he believes the contract will have to be re-tendered. That fate has already befallen the Iskenderun port, where the PSA-Akfen winning consortium had its contract cancelled. That port is now due to be re-tendered.

More encouraging was the Mersin port privatisation, which reached financial close a year ago giving hope that such deals are not impossible in Turkey. PSA-Akfen was again the winner.

The Bandirma port privatisation is also moving forward with local industrial conglomerate Celebi currently finalising the financing of its US$175.5 million deal. Samsun port's privatisation is not yet at such an advanced stage.

The foreign investment climate

Among the government's reforms is a serious push to make Turkey a more attractive destination for foreign investment.

Arzu Cavdar says: "The government is making changes to make it easier for foreign direct investors.

"The amount of foreign direct investment has grown in the last five years to US$22 billion in 2007, and we expect that to keep on growing.

"The majority of that is through private equity investments - a lot of which is from the Middle East - and the government is quite comfortable having private equity in the country."

Evidence of that can be found in October last year when US private equity house KKR made a splash with its buyout of ferry and lorry transport operator U.N Ro-Ro, which cost it €910 million (then US$1.28 billion).

It was a landmark transaction as the first financial sponsor-led buyout in Turkey with a value in excess of US$1 billion. The debt financing for the acquisition was arranged by Turkish banks Garanti Bankasi and Turkiye Is Bankasi.

Martin Leenhouds is an Istanbul-based fund manager with Probel, an investment advisor to the Great Circle Fund, an emerging markets fund sponsored by the US government-backed Overseas Private Investment Corporation (OPIC).

He says that "the volume of private equity transactions will increase over the coming years", but that while "there might be some very interesting companies for private equity - due to corporate governance and best practice issues, they might not be suitable for private equity [takeover]."

Infrastructure funds have also been showing interest in Turkey.

At the end of May, Babcock & Brown was rumoured to be testing the water for a US$1 billion fund to invest in the country. For B&B's own reasons that plan is now likely to be on the back burner, but it is an indication that major global players are starting to sit up and take interest.

Marina Petroleka of *BMI* suspects that we are likely to see interest from major investment banks like Goldman Sachs or Morgan Stanley in the Turkish infrastructure market.

James Riddell, infrastructure funds partner at Deloitte, says: "The majority of the big Europe-focused infra funds are looking at Turkey. A large number of high quality assets are being privatised."

However, he adds: "Some funds aren't up to the curve as to investing in Turkey - there are still issues around getting cash out, and other cash issues."

Conclusion

While much depends on the current legal and political struggles going on in Turkey, the future looks bright for project financiers and investors in the infrastructure sector.

Even a change of government will not change the truth that the country's infrastructure needs a lot of investment - and pressure from the EU and IMF will ensure that the private sector is still seen as a vital partner to the country in its drive to improve its infrastructure.

Brownfield investments in the energy sector - particularly the utilities which private equity and infra funds love so much - are being sold off this year, giving the sector a healthy uptick.

The Izmir port court case will send a message to the project finance industry - positive or negative - when a decision is reached there. However, even if the court comes down on the side of the unions, past experience shows that foreign investors can make headway in Turkey's port sector.

The best prospect, however, appears to be the US$5 billion worth of motorway privatisations, to be announced later this year.