Aviation

The Kingdom of Saudi Arabia's Aviation Market

Journey Towards Liberalisation

ICF's industry experts have compiled the following brief but comprehensive overview of the Kingdom's complex aviation market. This ICF overview focuses on four mission-critical topics of liberalisation:

- Recent developments in the Kingdom's aviation marketplace
- Aviation growth challenges in Saudi Arabia
- Government and GACA response initiatives
- Opportunities for investors

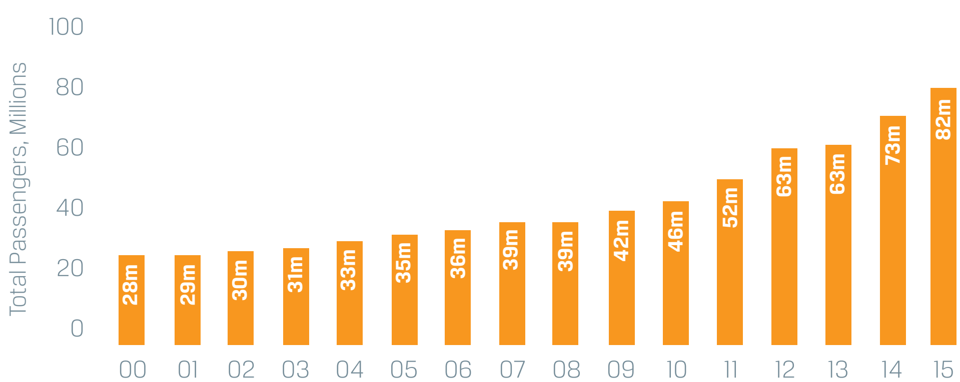
Saudi Arabian aviation has come a long way in a short time. However, the move to a fully liberalised aviation marketplace is not over. The pace of reform needs to continue if the General Authority of Civil Authority (GACA) wishes to achieve its aims of making its airports more globally competitive, improving the level of passenger service, and encouraging the private sector to invest while ensuring a high level of safety and security.

Recent Developments in the Kingdom's Aviation Marketplace

The Kingdom's airports handled more than 82 million passengers in 2015. Since 2000, air traffic has grown substantially, especially with an increase of international and domestic flights. During the past 15 years, air traffic has grown 7.3% per year and 12.3% in the past 5 years alone.

SAUDI ARABIA COUNTRYWIDE AIR TRAFFIC GROWTH

Total Passengers, 2000-2015



Source: ICF

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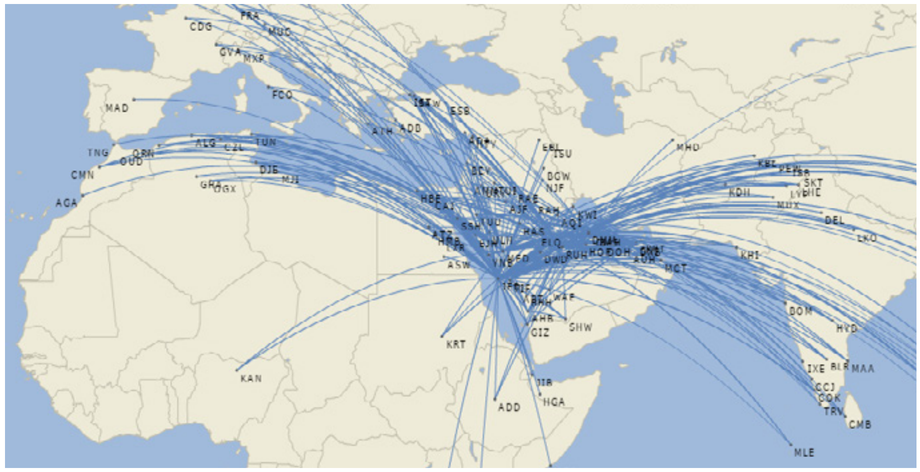
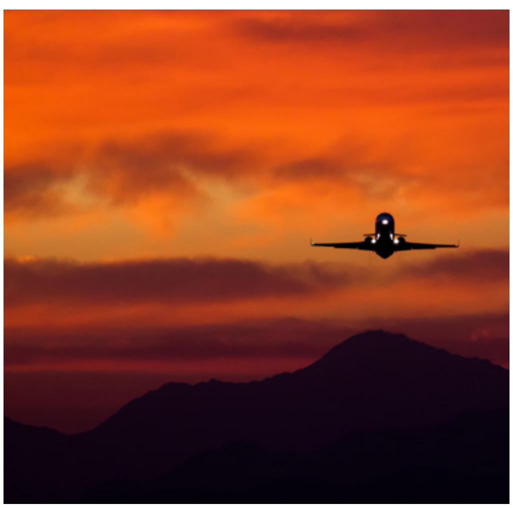


Source: ICF

Saudi Arabia's aviation landscape has continued to evolve and liberalise in the past few years. The achievements listed below represent the results of GACA's vision for air transport to liberalise and expand in an open competitive market. Underlying these results is the strategic market intelligence applied by ICF in its support for GACA.



Aviation Growth Challenges in Saudi Arabia

To fulfil this vision, GACA, under the stewardship of Saudi Arabia's Minister of Transport Sulaiman Bin Abdullah Al-Hamdan, addressed key structural issues that have constrained aviation growth in the past:

- **GACA's role:** GACA has had a wide range of sometimes conflicting roles. Not only was it the safety and price regulator for both airports and airlines, but it also acted as airport operator and navigation services provider. These responsibilities included setting airline domestic ticket price caps—a major intervention in the marketplace that has inhibited the development of a competitive environment for new airlines. The political difficulties of raising such caps has meant that prices have not been increased in more than 15 years, while inflation index has increased by at least 40% and airline cost index by more than 100%.
- **Airline financial problems on domestic routes:** Partly because of the domestic price caps, airlines historically have suffered financial losses on these routes. Such losses caused the bankruptcy of one of the first low-cost carriers, Sama. Flynas, Saudi Arabia's only other LCC, made losses every year since its formation in 2007 and will report its first-ever profit in 2015. For obvious reasons, the price cap has reduced appetite by future new airlines to serve the domestic market.
- **Airlines withholding capacity:** At the same time, given the cost pressures on many routes, airlines operating in the domestic marketplace have been reluctant to add seat capacity, despite substantial demand.

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- **Support of air links to small cities:** The regional market has been severely underserved in the past, with limited frequency and capacity because of poor facilities and the lack of incentive to operate these "thin," low-yielding routes.
- **Lack of investment:** For decades, capital investment in the Kingdom's regional airports has been largely ignored. Instead, the focus has been primarily on enhancing infrastructure for the Kingdom's "gateway airports" of King Khalid Airport International Airport (Riyadh), King Abdul Aziz International Airport (Jeddah), and King Fahd International Airport (Dammam).

Government and GACA Response Initiatives

The government and GACA have responded to these concerns through a wide ranging set of initiatives:

- GACA's role: In 2013, GACA announced that a holding company would be created with the remit of separating the services provided by the executive arm of the company from the control and policy-making sections. The holding company also is mandated with the privatisation of the Kingdom's airports.
- Domestic fare cap: GACA took tentative steps toward reforming the fare cap in 2014 when it allowed domestic carriers to lift ticket prices within 10 days of departure. More recently, consensus rests on less regulatory intervention and the phasing out of price controls so airlines have far more flexibility and freedom in how they set prices based on market drivers.
- Focused support for air links to small cities: In January 2016, GACA announced an initiative which will see the launch of the Watani hub program. Hail Airport has been chosen as the Kingdom's first hub to serve all airports in the Kingdom's north. The second phase of the Watani project will see the creation of a second hub to serve airports in the Kingdom's southern regions.
- Lack of investment: In addition, GACA has started upgrading some of its regional airports for a better passenger experience. Capital expansion plans for 10 regional airports are under way at Al-Ahsa, Al-Wajh, Sharurah, Wadi alDawasir, Qaisumah, Rafha, Turaif, Arar, Qassim, and Al-Jouf. One important consequence of these measures is that passengers using regional airports will be able to travel internationally, directly bypassing the international airports such as Riyadh and Jeddah. This bypassing in turn will help foster regional development.

Opportunities for Investors

Private-sector participation in all the Kingdom's airports by 2020 will see further injections of capital and international expertise to drive efficiency and profitability.

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A vigorous privatisation process leading to private sector participation in all of the Kingdom's airports has commenced with both Prince Mohammed Bin Abdulaziz Airport in Madinah (2011) and Terminal 5 at King Khaled International Airport in Riyadh (2016). These airports have been concessioned to the private sector. King Abdulaziz International Airport at Jeddah and King Fahd International Airport at Dammam are slated for privatisation in late 2017. The remaining airports are expected to privatise between 2018-2020.

In a direct move to attract more foreign investors and expertise, GACA recently announced that no obligation exists to have a local Saudi partner. For some airports, local ownership will be capped at 25%.

Medinah Airport was the first successful major airport privatisation. Under a 25-year build-operate-transfer scheme, the TIBAH Consortium, a joint venture comprising local companies Al-Rajhi Holding and Saudi Oge as well as Turkey's TAV Airports, was successful in winning the competitive tender in 2011.

Other examples of the government's efforts to transition airport assets to the private sector include:

- Concessioning 10 VIP lounges to a private operator (a joint venture between al Musbah and Plaza Premium) in 2011.
- Private-sector involvement in the operations and management of KAIA's new fuel farm which awarded to a local Saudi operator (Al Bakri Holdings) in 2014.
- The award of a second ground-handling pan airport licence to Swissport in 2015.
- Listing of both the Saudi Airlines Catering Company and the Saudi Ground Services Company on the Saudi Stock Exchange in 2012 and 2015, respectively.

ICF has contributed to many of the successful initiatives highlighted above. Specifically, ICF has advised on multiple assignments within Saudi Arabia including issues relating to liberalising aviation, introducing airline competition, and encouraging private-sector investment in airports. This support in making the Saudi aviation landscape a progressive and vibrant marketplace demonstrates ICF's commitment to international aviation growth development.

About ICF

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