



White Paper

Saudi Arabia's Changing Aviation Landscape

By Abbas Mirza, ICF

The Kingdom of Saudi Arabia has been the subject of important economic and social change – a process thrown into focus by Vision 2030, the Kingdom's blueprint for future prosperity led by Crown Prince Mohammad bin Salman bin Abdulaziz Al-Saud.

Saudi Vision 2030 has clearly articulated the need to restructure the government's strategy and to diversify the Kingdom's economy to reduce its reliance on oil revenues such that it can sustain, expand, and create a more productive economy. In line with this, the country is considering a number of steps to:

- Transform Saudi Arabia's strategic location into a global hub connecting three continents: Asia, Europe, and Africa.
- Utilize resources more efficiently.
- Expand into new economic sectors to become an economic powerhouse.
- Privatize government services.



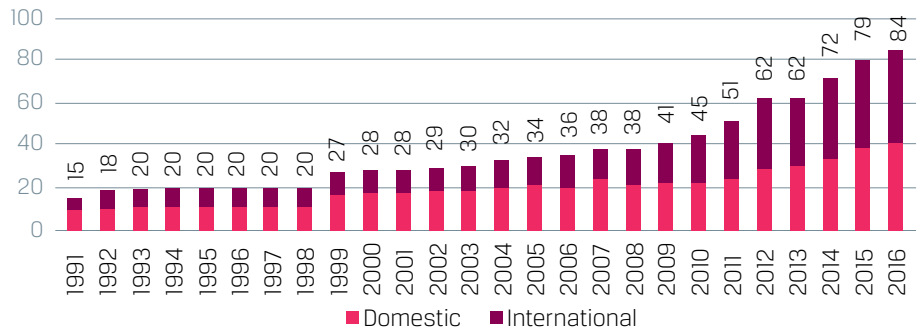
The aviation industry is seen as playing a key role in this strategy.

The Kingdom of Saudi Arabia has long recognized the aviation sector as a means to drive economic growth and talent development, while elevating the Kingdom's position on the regional and global stage. However, only recently, and partly driven by Saudi Vision 2030, has the pace of liberalization and regulatory reform truly gained momentum. One key initiative behind this growth has been increased private sector participation (PSP) activity through the privatization of the Kingdom's airports.

Overview of the Saudi Aviation Market

Over the last two decades, the aviation market in Saudi Arabia has grown substantially. Following a noticeable growth acceleration over the past five years, the Kingdom's airports in 2016 handled more than 84 million passengers.

EXHIBIT 1. TOTAL PASSENGER TRAFFIC AT SAUDI ARABIA'S AIRPORTS (MILLIONS)



Source: ACI, GACA, ICF analysis

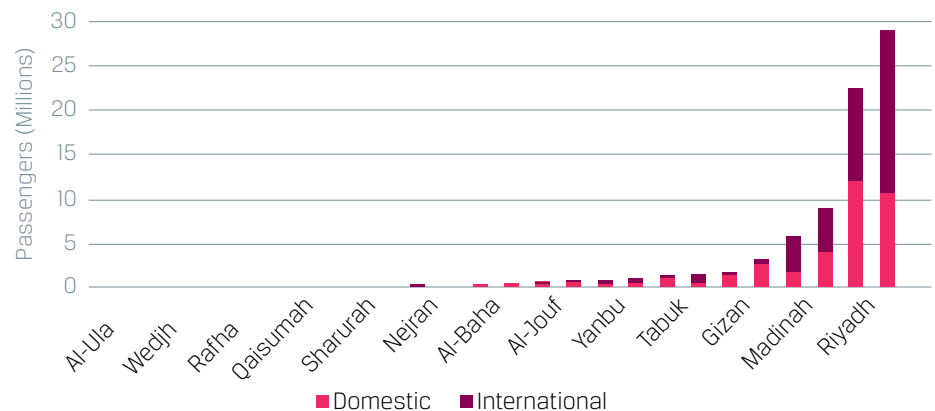
CAGR	1991-1995	1995-2000	2000-2005	2005-2010	2010-2016
International	9.6%	3.0%	5.4%	11.2%	11.7%
Domestic	4.6%	9.8%	4.1%	1.1%	10.4%
Total	6.7%	7.0%	4.6%	5.4%	11.1%

Saudi Arabia's population is heavily concentrated in a few large cities, and the concentration of traffic among airports shows a similar pattern. The top four airports, namely Jeddah, Riyadh, Dammam, and Madinah, presently account for more than 80% of the passenger traffic.

As the total air traffic expands further, however, we would expect a progressive sharing of growth with the regions as a wider range of services become viable. Saudi Arabia regards this increase in regional access as an important element in its overall goal for better intra-country connectivity and mobility.



EXHIBIT 2. DISTRIBUTION OF TRAFFIC BETWEEN AIRPORTS IN SAUDI ARABIA



Source: ACI 2015

Factors Contributing to Recent Growth

Several favorable factors have contributed to the dynamic growth of the Saudi market:

- Economic growth:** The country's real GDP has doubled from the height of the previous oil boom in 1980 to 2016.
- Migration:** The growing economy has attracted significant net migration and the population of the country has doubled since 1990 and is currently over 32 million people.
- Domestic Fare Cap:** General Authority of Civil Aviation of Saudi Arabia (GACA) took positive steps toward reforming the domestic fare cap in 2015 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.
- New Airlines:** Several new GCC based carriers, namely flyadeal, Nesma Airlines, and Saudi Gulf Airlines, have commenced operations in Saudi Arabia since 2016.
- Open Skies:** The liberalization trend is expected to continue towards an eventual open skies regime, which de facto exists with a few countries already.

Saudi Arabia's Airport Privatizations

Experience worldwide has made clear that rapid air traffic expansion is only possible if the airport infrastructure can respond effectively to the new demands. Saudi Arabia has responded with a program of privatization that would have been unthinkable even a decade ago.



In 2017 alone:

- A consortium of Turkey's TAV Group and Saudi Arabia's Al Rajhi Holding Group were awarded the concession rights to develop and operate three international airports: Yanbu, Hail, and Al-Qassim. These 30-year concession awards build on TAV and Al Rajhi Holdings Group approvals for a 25-year concession in 2012 to develop and operate Prince Mohammad bin Abdulaziz Airport (PMIA) in Medina, alongside contractor Saudi Oger. The PMIA privatization process took over 14 months to complete, while the more recent airport privatizations were concluded within four months.
- GACA recently awarded Consolidated Contractors Company, Flughafen Munchen – the operator of Munich Airport – and Asyad Holding Group to develop a new international airport in the city of Taif, near Mecca. The new airport is expected to open towards the end of 2020.
- Singapore's Changi Airports International (CAI) won the rights to operate King Abdulaziz International Airport (KAIA) in Jeddah, which is the main gateway to Mecca, for a 20-year period. GACA will bear the \$7.2 billion cost of the ongoing expansion works to transform the customer experience and cater for future passenger growth.

Of note in recent transactions is that "traffic risk guarantees" are not included in the contractual arrangements as they were for PMIA. To an extent, GACA's decision not to include this contractual clause implies their confidence that the underlying fundamentals are in place for robust future traffic growth without market share cannibalization between airports.

Future Prospects for Saudi Arabian Markets

Looking ahead, GACA has set itself the ambitious target of privatizing all of its 27 airports by 2020 as a means to raise revenues, encourage best in class international operators, manage the passenger travel chain, and seek private sector investments to fund capital expansion plans.

Over time, from a governance perspective, each airport will be transformed into an operating company with its own board responsible for all operational and financial performance. Each airport company will be owned by the Public Investment Fund (PIF) which will be responsible for future privatizations. PIF will, over time, become the world's largest sovereign wealth fund and take over Saudi Civil Aviation Holding, which will act as an umbrella company for the airport operators. Privatizations may take the form of initial public offerings and equity stake sales.

Riyadh's King Khaled International Airport will be the first entity to undergo this transformation. It is intended that a minority stake sale (value yet to be determined) in the newly formed Riyadh Airport Company will take place towards the latter part of 2017 or the beginning of 2018.

Expansion of the holy sites of pilgrimage and connected infrastructure is expected to remove some of the existing bottlenecks, which is, in turn, expected to allow further growth of pilgrim traffic. In line with the Saudi Vision 2030 strategy of increasing religious traffic to meet its responsibilities to the Islamic world as a whole, two major programs have been set in hand:

- A \$27 billion expansion program began in 2011 at Mecca with the ultimate aim of more than doubling the capacity of the Grand Mosque to 2 million peak capacity.
- A \$7 billion program at the Prophet's Mosque in Medina to enable its current peak capacity of 1 million worshippers to increase by 60%.

Finally, optimism in the aviation sector is further demonstrated by the government's intention to not only enhance the current infrastructure but to build new airports over time. Initial approval has been granted for two new airports in the Riyadh region to serve northern and southern provinces, thus making regional cities more connected with the overall aim of better serving the Saudi citizen.

In addition, plans are being formulated by GACA to assess the feasibility of a new airport in the Mecca province, which would be business-based as opposed to the new Taif Airport whose primary objective is to serve the profitable religious traffic segment.

Conclusion

In conclusion, the Kingdom's political will is redrawing the aviation landscape at a pace never seen before. This is being shaped not only by Saudi Vision 2030 but also the pressing economic need to adjust to the challenging economic realities of low oil prices for the foreseeable future and less reliance on state funding.

Private sector participation in the Kingdom's airports are not only alleviating the downward pressure on capital expenditure budgets, but also introducing world-class airport operators to enhance the passenger experience.

From once being trapped in a relatively static and conservative government-driven paradigm, Saudi Arabia is in the process of rapid transformation. Indeed, by 2020, the Kingdom's aviation market system will be ahead, in some respects, of many countries in Europe and North America.

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About the Author

Abbas Mirza, Vice President with ICF's Aviation Group, is a former head of commercial at Heathrow Airport, BAA, and brings over 20 years of commercial and financial experience to his assignments. Mr. Mirza is a leading expert in financial modeling of airport revenues and costs for airports with a remit to maximizing asset values. In addition to his commercial and retail expertise, Mr. Mirza has significant experience in the airport transaction arena, working and preparing material for governments, civil aviation authorities, and private investors on airport privatizations.

For more information, contact:

Abbas Mirza

abbas.mirza@icf.com +44 20 3096 4927

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