



USSABC Economic Brief: Saudi Arabian Civil Aviation Poised for Strong Growth

The Saudi Arabian civil aviation sector has garnered significant investments over time and is expected to continue as the number of flights and passengers steadily increases. This buoyant demand has spurred the need to prioritize airport infrastructure capabilities along with maintaining world-class services offerings compared to regional peers. The civil aviation sector's influence on the economy continues to grow as most recent data indicates that the sector contributes approximately 4.6 percent to the Kingdom's GDP. Furthermore, civil aviation's output accounts for approximately SAR128 billion (\$34 billion) in gross value added to GDP. With regards to employment opportunities, the civil aviation sector supports 530,000 jobs, of which 100,000 are direct, 90,000 are in the supply chain, 37,000 in employee spending, and 300,000 jobs in tourism.

Saudi Arabia boasts 27 airports consisting of 10 international and 17 domestic hubs. National airlines include Saudia (national carrier), Flynas, SaudiGulf, Nesma Airlines, and flyadeal. Moreover, an additional 105 foreign airlines fly in and out of the Kingdom's international airports. According to the General Authority of Civil Aviation (GACA), the most popular direct flight links are:

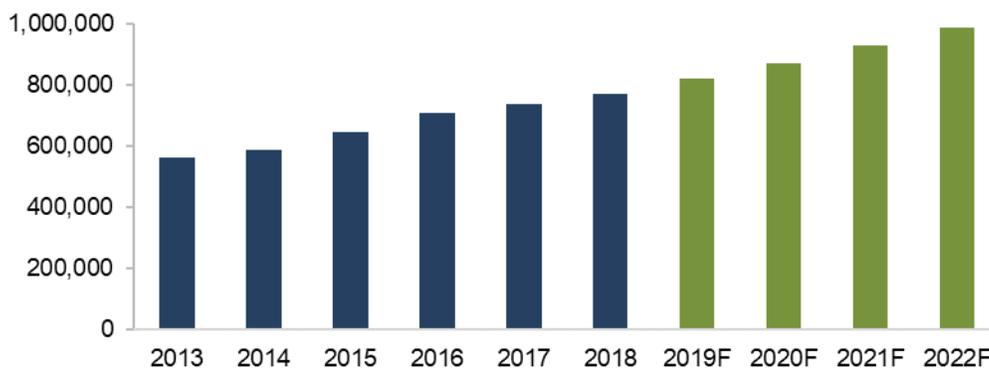
-  1. Egypt
-  2. UAE
-  3. India
-  4. Turkey
-  5. Pakistan
-  6. Bahrain
-  7. Jordan
-  8. Kuwait
-  9. Lebanon



Source: GACA

The number of total flights (arrivals and departures) has steadily increased between 2013-2018 growing from 565,631 to 771,828. We expect the total number of flights to increase by a compounded annual growth rate (CAGR) of 6.5 percent to 989,716 by 2022 as ongoing expansions of the Holy Mosque in Makkah will accommodate the growing number of religious pilgrims. Moreover, the development of the \$500 billion Neom project along with the Red Sea tourism project is anticipated to boost leisure tourism.

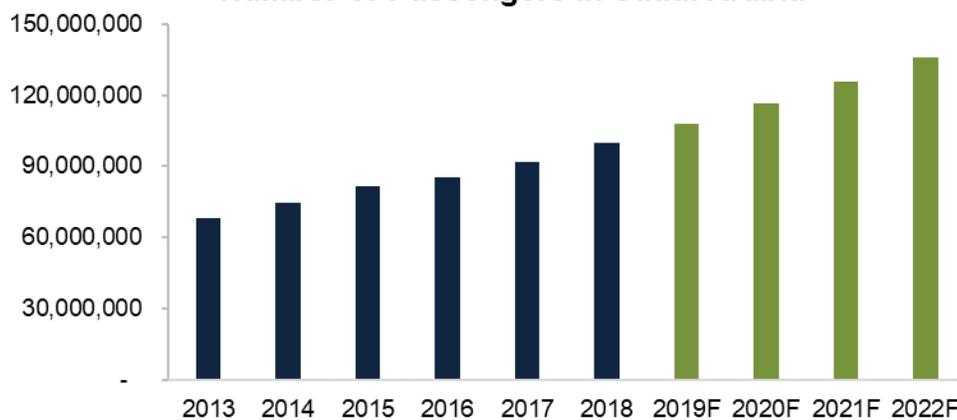
Number of Flights in Saudi Arabia



Source: GACA, GaStat, USSABC Estimates

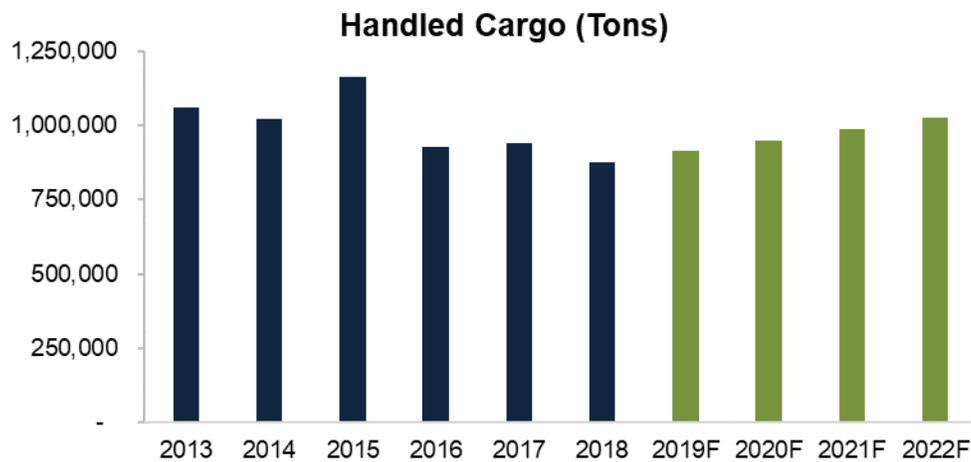
In tandem with total flights, the number of passengers has also witnessed impressive growth. Between 2013-2018 the total number of passengers (arrivals and departures) climbed from 68.1 million to 99.9 million. The increase of local airlines in the past few years has given customers more options to select from, resulting in affordable competitive pricing. In addition to religious and leisure tourism, the rising demand from regional neighbors for Saudi Arabia's healthcare tourism is also a strong catalyst for future growth. Hence, we forecast total passengers to grow at CAGR of 8 percent to reach 135.6 million passengers by 2022.

Number of Passengers in Saudi Arabia



Source: GACA, GaStat, USSABC Estimates

Cargo shipments by air have fluctuated between 2013-2018 going from 1.06 million tons to 877 thousand tons. However, significant investments are currently ongoing that will improve the scalability air freight deliveries over the medium to long-term. There are several factors that support future growth of cargo shipping. Two sectors that depend on airfreight and are poised for continued investments are consumer electronics and pharmaceuticals. In the case of pharmaceuticals, use of air freight is required for the transport of temperature controlled and time sensitive cargo. Given the expanding demand in healthcare sector, pharmaceuticals will play a vital supportive role in keeping this area a focal point into the future. Furthermore, GACA has set ambitious goals it expects to achieve by 2030. Some of these goals include increasing cargo handling capacity to 6 million tons, the construction of five new cargo terminals, the development of an additional 4 million square meters (sqm) of cargo and logistics facilities from the current 200 thousand sqm, and adding 20 cargo airlines operating in Saudi Arabia. Given these future projects, we anticipate cargo handling to grow by 4 percent CAGR through 2022 to reach 1.03 million tons.



Source: GACA, GaStat, USSABC Estimates

Investment in the civil aviation sector's infrastructure is where the majority of government and private sector investments will be allocated. Infrastructure projects in civil aviation have been the first to successfully implement the public private partnership (PPP) model within the transport sector. Consequently, GACA set objectives of its privatization plan with a specific approach it envisages:

- **Implementing an airport privatization program through:**
 - Long-term PPP concessions
 - Corporatization
 - Management Contracts

- **Individual airports/terminals or bundles**

- **Service delivery corporatization:**
 - Air Navigation Service (ANS)
 - Saudi Aviation Information Technology (SAVIT)
 - Aviation Rescue and Fire Fighting (ARFF)

- **Economic development:**
 - Free Trade Zones/ Airport City hubs

The development of Prince Mohammed bin Abdulaziz International Airport in Madinah is considered to be the first PPP project of its kind. The SAR4.5 billion (\$1.2 billion) project was developed under the terms of a 25-year Build-Transfer-Operate (BTO) concession to build a terminal and carry out airfield enhancements to double the capacity to 8 million passengers per year.

New projects on the horizon include developing the masterplan for King Fahd International Airport in Dammam on behalf of the Dammam Airports Company. The long-term plan will extend to 2047 and covers the expansion of all airport facilities to serve growing passenger demands as well as the study of the airport's cargo area connection with the country's main rail freight line. Another significant project is the expansion of King Abdulaziz International Airport in Jeddah, the largest current project in the sector. The first phase of the project, valued at SAR27 billion (\$7.2 billion), involves expanding the airport's capacity from 17 million to 30 million passengers annually. The area covers 670,000 sqm and will have two new terminals for domestic and international passengers.

GACA awarded a SAR3.9 billion (\$1.46 billion) contract to upgrade two terminals at King Khalid Airport in Riyadh. The scope of the work includes redesigning, upgrading, and expanding terminals three and four.

It also calls for the demolition and reconstruction of aprons, terminal lounges and operation buildings. This project is one of several GACA has earmarked for King Khalid International Airport as it expects to invest a total of SAR16.9 billion (\$4.5 billion). Another project in the pipeline is the development of the King Abdullah airport in Jazan at a cost of SAR2.5 billion (\$667 million). The airport will accommodate 3.6 million passengers per year, according to GACA. The development of another new airport in Al-Qunfudah is also anticipated and will serve 500,000 passengers annually. It will include three halls, a runway, a road network, a control tower, and parking garage and retail space.

A key contributor in the privatization of the civil aviation sector is the Public Investment Fund (PIF). GACA aims to transfer a number of airports to the PIF prior to privatizing with the expectation that the airports will be more attractive to private investors. GACA will be able to concentrate on its core activities as a regulatory body rather than an airport operator. The initiative will involve transforming the airports into operating companies or corporate entities which will provide prospective investors with a clearer view of a potential investment offered by the PIF. By converting to an operating company, the financial performance of airports will be more transparent to private investors in line with international standards.

The large scale of financing needed to fulfill the development goals of Saudi airports has proliferated over the last few years. Prior dependence on public sector injections through capital investments put a strain on the government's ability to maintain and develop its airports. Furthermore, the nature of these projects necessitated long-term financing which created asset to liability mismatches for local banks, who favor short-term financing. Furthermore, contractors faced working capital challenges as significant expenditures in manpower and machinery necessitated specific project financing. Local banks have done well to accommodate the need for working capital financing in recent years given the scale of mega-projects that have been awarded within the last 10 years.

In recent years GACA shifted its sights to debt markets, in part, to satisfy its financing needs. GACA's first sukuk issuance in 2012 aimed at facilitating needed financing for the King Abdulaziz International Airport. That very first sukuk issuance raised SAR15 billion (\$4 billion) with a profit rate of 2.5 percent and was oversubscribed by three and a half times. The significance of the issuance was that prior sukuk were priced against U.S. Treasury bonds, which added a premium for the perceived additional risk. The GACA sukuk, in absence of a risk free local benchmark, established a local pricing point for future sukuk. The following year, after the success of its first issue, GACA went to the sukuk market once more as it floated SAR15.2 billion (\$4.1 billion) but with a higher profit rate of 3.21 percent.

The Saudi Arabian civil aviation sector is in the midst of rapid growth and future plans indicate heavy investments will support increasing demand across all phases. With the growing reliance on the private sector as an active participant and the diversification of available alternative financing, the civil aviation sector is also primed for new foreign direct investment opportunities. The ambitious plans set forth by GACA with regards to increasing, passenger, flights, cargo handling, and airport development highlights these numerous opportunities.

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