PRIVATE'S PROGRESS

The saga of the Saudi Arabian Airlines group privatisation could soon have a happy ending, as **Martin Rivers** *discovers.*

When Saudi Arabia's Supreme Economic Council approved the plan to privatise flag carrier Saudia in 2006, no-one was expecting an overnight transformation of the 61-year-old flag carrier.

It had already taken six years to bring the roadmap before government, with His Royal Highness Prince Sultan Bin Abdul Aziz having inaugurated the first privatisation studies in 2000.

The actual process of dividing Saudia into six private businesses – catering, cargo, ground handling, maintenance, training and the core airline unit – was destined to take many more years.

But, notwithstanding several missed deadlines, steady progress has been made by the carrier. Its cargo, catering and ground handling units have all been part-privatised; while the maintenance and training units are due to join their ranks by the second quarter of 2013.

Privatisation comes against a backdrop of rapid change in the kingdom's skies, with renewed investment in airport infrastructure, liberalisation of the domestic market and the establishment of an independent civil aviation authority all shaking up the aviation sector.

Indeed, handing Saudia over to the private sector is just one facet of the broader goal of boosting competition in the kingdom, explained Shakeel Adam, managing director of Aviado Partners Consulting and one of the early architects of the airline's overall restructuring approach.

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The ground handling business is close to an IPO launch.

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"The royal family has been systematically commercialising major activity in the country for years," he said. "The aim appears to be to turn large state enterprises into self-sufficient, efficient commercial organisations, in effect reducing the financial burden on the government.

"The advantage to privatising is that it can act as a catalyst for restructuring the business itself. Through the process of privatisation the state creates the opportunity not only to restructure the balance sheet, but also to actually reorganise and reshape the business.

"It's about strengthening the commercial viability of the business by using the transformation process to boost efficiency."

To this end Saudi Arabian Airlines Catering (SAAC) became the first unit to undergo privatisation in 2007, with 49% being sold to Strategic Catering Company (SCC), a consortium led by Abdulmohsen Alhokair Group.

The catering unit moved further into the private sector over the summer of 2012, when 24.6 million shares – representing 30% of the company – were released in an initial public offering (IPO).

About 12.3% of the stake came from Saudia itself, while 14.7% was contributed by SCC and a further 3% by minority shareholders. That left just a little over one-third of SAAC under public sector control.

Shawgi Mushtag, executive vice president of privatisation at Saudia and former vice president of the catering unit, said the flotation had been "very successful based on financial and operational results".

At the time of writing, shares in the business were up almost 15% since the offering, which was itself 221% oversubscribed.

Strategic unit

The second strategic unit to undergo privatisation was the airline's massive freight operation, Saudi Airlines Cargo, which was turned into a limited liability company during a 30% divestment to Tarabut Air Freight Services in 2008.

In a sign that specialisation has had a positive impact on the company, Saudi Airlines Cargo posted a 26% year-on-year increase in cargo tonnage during the first half of 2012. That came despite industry body IATA warning that the modest recovery in freight markets – evident since late 2011 – had "stagnated" over the first seven months of 2012, with global freight traffic declining 2.4%.

The cargo specialist now serves a global network of 225 destinations, including newly introduced routes to Frankfurt, Vienna, Ho Chi Min City and Dubai.

Peter Scholten, vice president of commercial operations at Saudi Airlines Cargo, said the ultimate aim of privatisation was "to improve the service levels of the cargo activities and to grow activity in the market".

Though he emphasised that there are currently no plans to hold an IPO for the cargo unit, Saudia's ground handling unit is itself on the cusp of a stock market launch.

Saudi Ground Services (SGS) was established in 2010 under the third wave of privatisation to date. It was created by the merger of forbearer Saudi Arabian Airline Ground Services with two other companies – National Handling Services and Attar Ground Handling.

Mushtag confirmed that SGS is close to launching an IPO "very soon", though he declined to provide details about the timeline or pricing, noting that the financial advisors have yet to start work on the process. Earlier media reports had claimed that HSBC was being enlisted to oversee the IPO.

Aviado's Adam explained that stock market flotation is not always the favoured course of action when privatising a large, multi-faceted company that

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SGS

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Saudi Cargo and the MRO business SAEI are exciting prospects for a private investors.

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commands a captive audience. Instead, a small pool of strategic investors with relevant expertise and close-knit interests will often be the preferred option.

"It really depends on the relationship between the different units," he said. "How will they be carved up? Which businesses are going to be fully separated, and are they really going to be arms-length from each other or not?"

Citing efforts elsewhere in the industry to privatise frequent flier programmes, Adam suggested that total autonomy among all airline units is not always advisable. "Once they separate and start becoming completely independent businesses running completely separately, they have different incentives, different performance metrics, and different reasons for existence," he cautioned.

However, when it comes to the strategy of part-privatising individual units in a staggered manner – as Saudia has done – he said there are clear benefits.

Not only can the company "test the market" and evaluate investors' appetites before releasing more shares, but it can also re-invest minor capital injections in order to improve the business and ultimately achieve a higher valuation for the majority holding.

With catering, cargo and ground handling already privatised, all eyes inevitably fall on the remaining three strategic units – maintenance, training and the passenger airline.

Maintenance division

The Jeddah-based maintenance division, which employs more than 5,000 staff, was rebranded Saudia Aerospace Engineering Industries (SAEI) ahead of a tender for 30% of the company's capital originally advertised in 2011. Mushtag declined to comment on how far the divestment has progressed, though he said privatisation of the unit should be completed by the second quarter of 2013.

An identical timeframe was given for the privatisation of the Prince Sultan Aviation Academy (PSAA), Saudia's training unit, while the jewel in the crown – the core airline unit – is still awaiting government approval.

Leaving the passenger airline until last is standard practice, Adam explained, as privatisation in essence involves "separating out all of the pieces so you've got less baggage to deal with at the end". A slimmed-down, operationally-focused airline would likely then undergo an IPO, he conjectured.

Questions remain over the form Saudia will take when privatisation comes full circle. Proposals had been drawn up to split the airline into smaller divisions – a full-service carrier, a VIP carrier, a charter unit and a religious carrier for Hajj and Umrah traffic – but no decision has been announced. For the time being, integration into the SkyTeam alliance will rightly take precedence.

What is clear, however, is that the kingdom's aviation sector is undergoing seismic changes, propelled by liberalisation of the duopolistic domestic market and massive infrastructure investments. Having lost ground to regional competitors, Saudia must embrace this new era by "changing the mind-set of the entire organisation", Mushtag concluded.

Though not a miracle cure for the challenges facing the airline, privatisation is undoubtedly a step – or, more accurately, a series of small steps – in the right direction.