This edition of Transport Perspectives focuses on two highly topical issues in the transport sector.

In the first article, Steffen Wagner and Tobias Wölfel analyze M&A trends in transport infrastructure.

In the second article, Daniel Lawrence explores the significant investment opportunity from rail development in the Middle East, and the associated challenges.

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M&A trends in transport infrastructure

Dr. Steffen Wagner and Tobias Wölfel

Mergers and Acquisitions (M&A) in the transport and logistics sector are highly dependent on overall economic growth and business confidence. As a result, total transactions values remain subdued due to the euro debt crisis and the subsequent worsening of global GDP growth numbers.

General overview
Graph 1 shows a sharp decline in deal values from H1 2011 to H2 2011 while the number of deals increased over this period, highlighting an increase in distressed transactions at the peak of the euro crisis. However since the second half of 2011, there has been a steady increase in total transactions values. In H1 2013, total transaction values grew by 3% compared to H2 2012 and by 11% compared to H1 2012. Transaction volumes have not been similarly affected by the current economic climate. In the first half of 2013 however, transaction volumes sharply declined while transaction values continued to rise, indicating a significant increase in average deal sizes. Which regions and subsectors are responsible for this trend?

While the EMA region still accounts for the largest share of global M&A activities in the transport sector, emerging markets in ASPAC and Latin America are gaining importance. In H1 2013, transactions in ASPAC accounted for almost 50% of total global deal value.

Transport infrastructure transactions gaining importance
When looking at M&A activity by subsector, the significant increase in transactions values in transport infrastructure deals is striking, as shown in Graph 2. This includes primarily airports, ports, and road operations.
Transaction values of infrastructure targets more than tripled in H1 2013 to US $16bn. As shown in Graph 3, this accounts for almost 70% of total transaction value in the transport and logistics sector, far above the average 20% in previous years. At the same time, transaction values of freight forwarders, logistics service providers and land transport companies (included in ‘Other transport & logistics’) – which usually hold the largest share of the total sector value – declined significantly by over 75%.

However, transaction volumes in infrastructure declined by almost 20% in H1 2013, showing an evident number of large cap transactions in this subsector. The largest of these transactions are shown in Table 1.

Other significant transactions occurring in 2012 included:

- Qatar Investment Authority acquisition of stocks in Heathrow Airport holding company FGP Topco for US $1.4bn.
- VINCI acquisition of Portuguese state terminal operator ANA for US $4bn.
- Aéroports de Paris (ADP) acquisition of shares of a total of US $874m in Turkish operator TAV.
- Private equity investor Global Infrastructure Partners (GIP) acquisition of Edinburgh airport in the UK for US $1.3bn.

![Graph 3: Infrastructure transaction values as share of total transport & logistics transaction values](image)


### Table 1: Largest infrastructure transport transactions completed in H1 2013

<table>
<thead>
<tr>
<th>Date</th>
<th>Target Name</th>
<th>Description</th>
<th>Acquiror name</th>
<th>% of shares acquired</th>
<th>Value of transaction (USDmn)</th>
<th>EV to EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>05/2013</td>
<td>Port Botany (Australia)</td>
<td>Port operator</td>
<td>Investor group</td>
<td>100</td>
<td>4,527</td>
<td>-</td>
</tr>
<tr>
<td>02/2013</td>
<td>Stansted Airport Ltd (UK)</td>
<td>Airport operator</td>
<td>Manchester Airport Group</td>
<td>100</td>
<td>2,380</td>
<td>14.2</td>
</tr>
<tr>
<td>04/2013</td>
<td>Australian Infrastructure Assets</td>
<td>Airport and road operations</td>
<td>Australian state-owned Future Fund Management Agency</td>
<td>100</td>
<td>2,081</td>
<td>-</td>
</tr>
<tr>
<td>05/2013</td>
<td>Terminal Investment Limited SA (Netherlands)</td>
<td>Terminal operator</td>
<td>Global Infrastructure Partners</td>
<td>35</td>
<td>1,929</td>
<td>-</td>
</tr>
<tr>
<td>06/2013</td>
<td>Aeroports de Paris SA (France)</td>
<td>Airport operator</td>
<td>Investor group of Credit Agricole SA, and Vinci SA</td>
<td>10</td>
<td>965</td>
<td>10.7</td>
</tr>
<tr>
<td>05/2013</td>
<td>Port Kembla Port Corp (Australia)</td>
<td>Port operator</td>
<td>Investor group</td>
<td>100</td>
<td>798</td>
<td>-</td>
</tr>
<tr>
<td>02/2013</td>
<td>Aeropuerto Internacional Luís (Puerto Rico)</td>
<td>Airport operator</td>
<td>Aerostar Airport Holdings LLC</td>
<td>100</td>
<td>628</td>
<td>-</td>
</tr>
<tr>
<td>06/2013</td>
<td>Terminal Link SA (France)</td>
<td>Terminal operator</td>
<td>China Merchants Holdings</td>
<td>49</td>
<td>539</td>
<td>-</td>
</tr>
<tr>
<td>01/2013</td>
<td>Vaninskiy Morskoy Torgovyi Port (VMPT, Russia)</td>
<td>Port operator</td>
<td>Mechel-Trans</td>
<td>73</td>
<td>503</td>
<td>-</td>
</tr>
</tbody>
</table>

Main drivers of M&A in transport infrastructure

What are the main drivers behind this trend of increasing M&A activity in the transport infrastructure segment? First of all, public budget restraints across debt ridden countries have forced national governments to privatise national infrastructure and look for private operators and investors in order to secure the sustainable operation of strategic transport infrastructure and hub networks. On the other hand, private investors like pension funds are constantly looking for investment opportunities with steady cash flows and growth perspectives. Transport infrastructure targets including ports and airports can offer these opportunities. Graph 4 shows that global trade is growing faster than global GDP, while container throughput is even outgrowing trade. While the multiplier is expected to be lower in the future as compared to the past 15 years, the trend is nevertheless expected to continue.

Furthermore, infrastructure operators are less affected by overcapacities than freight forwarders or carriers and also less dependent on contracts like logistics service providers. While margin pressure for transport and logistics companies remains high due to the sector’s fragmentation and cost pressures such as rising fuel costs, the regional position of transport infrastructure on strategic transport network hubs ensures operators a significantly smaller degree of competition. Hence, operating profit margins are substantially higher than logistics and freight forwarding peer groups (Graph 5) and cash flows steady, making infrastructure operators an ideal target for pension and state funds and investors keen on steady returns.

At the same time, strategic investors are also looking for inorganic growth opportunities, especially in emerging markets where growth forecasts are significantly above the mature markets in Western Europe and North America. Although numbers of transactions in infrastructure have been rising due to privatizations and divestments of non core activities of building and construction conglomerates, availability of relevant targets for investors have been low, especially when compared to the vast number of transactions in the other transport and logistics subsectors. Therefore, transaction multiples for infrastructure targets constantly rose over the past four years – from EV/EBITDA of 6.3 in 2009 to over 10.0 in 2012/2013, in line with trading multiples of the respective peer group.

Outlook

The share of infrastructure within total transport transaction values is expected to remain high in the near future. A major driver will likely remain privatizations of national infrastructure in order to cope with rising government debt ratios and secure sustainable traffic growth. In Japan, the government has announced its intention to sell rights of airport management and operation of 29 government owned airports.

Furthermore, a number of large transactions have been announced in 2013 but not yet completed. Among

these, Canadian state-owned Public Sector Pension Investment Board agreed to acquire Hochtief Airport GmbH (HTA), for an estimated US $1.439bn. In Turkey, Dogus Holding agreed to acquire the operating rights of Galata port from state-owned TC Basbakanlik Ozellestirme Idaresi Baskanligi, for US $702m. In Spain, state-owned AENA airports authority aims to raise around US $7.9bn in a partial privatization before the end of the year, while Abertis Infraestructuras, which holds stakes in 29 airports across Europe, the USA and Latin America, is working on a divestment strategy for its airport division and recently agreed to sell Belfast International airport and Stockholm’s Skavsta airport to ADC & HAS Airports Worldwide according to Reuters News.

With transaction multiples high, public budgets low and growth prospects steady, M&A in transport infrastructure is expected to remain a recurring theme on the sector’s agenda.

Graph 4: Historic multipliers of trade and sea freight growth over GDP (15 year CAGR)

Graph 5: Infrastructure vs. logistics and freight forwarders average EBITDA margins

Graph 6: Infrastructure companies average trading multiples

Source: Bloomberg, 2013.


Source: Bloomberg, 2013.

3. Reuters News, 07/22/2013; Reuters News, 06/13/2013; Reuters News 03/20/2013
Bridging the Gulf – opportunities and challenges for the GCC railway

Daniel Lawrence

Following the recent hiatus in UK rail franchising activities, many European rail operators have been turning their attention increasingly to developments overseas. One area eliciting particular interest is the Middle East. The region holds huge potential for rail operators, due to an extensive transport investment plan driven by the ambition and wealth of the Governments. The estimated budget for rail development in Saudi Arabia alone is believed to be US $90bn over 30 years. The region also has the benefit of being largely free from incumbent operators.

Giving particular impetus to rail development in the region is a planned railway running from Kuwait’s border with Iraq to the Omani coast, linking all six Gulf Cooperation Council (GCC) nations. Each member state is undertaking or planning rail projects which will either form part of this network or will feed into it.

While not the largest global rail project (China’s estimated investment in high speed rail is $300bn), this is arguably the most complex rail project being undertaken in the world. This complexity is due to challenges of connecting six independent countries, all of whom (with the exception of Saudi Arabia) did not have significant existing railway track before the project commenced.

Indicative of these challenges is the delay in progress in setting up the Gulf Rail Authority, which will oversee the project. The decision was announced in 2009, with the stated intention to set up the Authority the following year. However this has been delayed and the GCC is now hoping that the authority will be in place by the end of 2014.

This article identifies the potential the railway brings, and the key challenges that must be overcome before the GCC railway proves a realizable opportunity for foreign operators.

The current market
An overview of the current market is outlined in Table 2.

The potential for the railway
If implemented properly, the project will likely bring benefits of easier (and thus increased) trade within the region, and a shift of people and goods away from the roads and onto the rails. This should also have the effect of boosting safety. Rail is, worldwide, significantly safer than road travel. By putting more goods and passengers onto the railways, this will reduce the volume of traffic on the region’s notoriously congested highways. Given the geography of the gulf region, it will likely also offer significantly reduced journey times for cargo compared to sea transportation.

However, while the potential for freight is clear, the passenger case is less so. In the GCC region, people may be more hesitant to swap their cars for a train than, for example, in Europe. The Dubai Metro, while a hit with expatriates and tourists, is still significantly underused by Emiratis. The region’s governments will need to work to encourage modal shift alongside the investment in rail to ensure an appropriate return on investment is earned.

Challenges to overcome
There are five key issues which must be overcome:

Commercial issues
This is of most relevance to potential operators. It is also the issue that has been least addressed. Each member of the GCC is responsible for constructing their track, systems and stations. But what of the ‘above the rail’ operation? Who will operate the trains, who will procure the operators, and who will set fares and tariffs? The answers to these questions have taken a back seat as the GCC grapples with questions around immigration, security and standardization (see below). Taking passenger rail as an example, will the countries establish a similar model to Eurostar (or indeed Gulf Air) where the member states have an individual stake in the operation? Will they award franchises or access rights to private operators from any country? And will they permit multiple operators to compete on the same track? The role of the operator during the build phase also needs to be clarified. These questions can likely only be answered by the establishment of a Gulf Railway Authority.
### Table 2: Overview of the current market

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>$740</td>
<td>$365</td>
<td>27m</td>
<td>Rail, bus and coach, small university metros</td>
<td>Renfe</td>
</tr>
<tr>
<td>UAE</td>
<td>$271</td>
<td>Not Available</td>
<td>5m</td>
<td>Metro, bus and coach, monorail</td>
<td>Serco</td>
</tr>
<tr>
<td>Qatar</td>
<td>$189</td>
<td>$114</td>
<td>2m</td>
<td>Bus and coach</td>
<td>None at present</td>
</tr>
<tr>
<td>Kuwait</td>
<td>$166</td>
<td>$104</td>
<td>3m</td>
<td>Bus and coach</td>
<td>None at present</td>
</tr>
<tr>
<td>Oman</td>
<td>$91</td>
<td>$47</td>
<td>3m</td>
<td>Bus and coach</td>
<td>None at present</td>
</tr>
<tr>
<td>Bahrain</td>
<td>$32</td>
<td>$20</td>
<td>1m</td>
<td>Bus and coach</td>
<td>None at present</td>
</tr>
<tr>
<td>Total GCC</td>
<td>$1,489</td>
<td>$650</td>
<td>41m</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK (Comparator)</td>
<td>$2,323</td>
<td>$479</td>
<td>63m</td>
<td></td>
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</tr>
</tbody>
</table>

**The economy**
A significant part of the delay to date is due to the global economic downturn. Falling global trade levels impacted infrastructure projects worldwide. Given that the pan-GCC railway is predominantly freight, it may also have suffered, with the GCC deciding not to procure major contracts at the low point of the economy. With the economy stabilizing, and confidence returning to the region, we may see an increased speed of progress.

**Immigration**
A major challenge facing the project from a passenger (and staff) perspective is the subject of immigration. Like the EU, citizens of the GCC countries are free to travel from country to country visa-free, and have the right to work in the other countries. However, many expatriate and migrant workers do not enjoy this right. This poses a significant issue for the railway. In the UAE for example, 80% of residents are not Emirati. For passenger trains to efficiently operate cross-border, there would need to be a way to ensure immigration controls are in place. The Eurostar between London and continental Europe faces similar challenges. This has been mitigated by passport checks taking place before boarding the train. However, the pan-GCC railway is more complex, involving six jurisdictions instead of (for border controls purposes) two. The right balance will need to be struck between ensuring smooth running of train services, and maintaining border controls.

**Security and customs**
Linked to the above issue is one of security and customs. At present, road traffic between some GCC countries is subject to strict controls, with extensive checks being carried out, particularly on cargo vehicles. In April 2012, for example, queues of trucks up to 17km long were reported at the border from the UAE to Saudi Arabia, as customs and border officials carried out necessary checks. A robust system must be in place in order to search freight trains without causing significant delay to the cargo, or to other trains using the network.

The GCC has announced it expects agreement on immigration, security and customs by the end of 2013.

**Standardization**
Each member state is charged with building its own railroad, which will eventually feed or become part of this network. Many projects are already in construction, with Saudi Arabia and the UAE leading the way. As a result, by the time the Gulf Railway is implemented, it...
may be that different countries already have various standards and operating models which it will be challenging to integrate. On the most important standards, the GCC member states have been consistent. For example, the rail networks in Saudi Arabia and the UAE are both being built using the standard (1,435mm) gauge. However, until the Gulf Railway Authority is in place to set standards, significant interaction is required between a wide range of public and private sector bodies to ensure consistency.

Implications for operators

For operators, the delay in progress is frustrating. Many operators are aware of the major potential opportunity in the GCC region but the delay in progress does not give them the ability to effectively plan.

For many operators, the priority is to keep building relationships in the region (with governments and potential joint venture partners). Two guiding principles for the region seem particularly relevant:

- Approval and decisions can take a long time to be made. However once the decision is made, things typically move quickly.
- Relationships are important to ensure operators are constantly up to date with the latest developments.

Until the Gulf Railway Authority is established, there will likely be little certainty for operators. In the meantime, individual countries (particularly Saudi Arabia and the UAE) seem to be making significant progress in developing their sections of the railway. This may provide more immediate opportunity for operators (for example, Deutsche Bahn have recently gained a minority stake in a new UAE freight operator), but runs the risk of causing significant integration issues when the projects are eventually linked up. There are also opportunities to operate bus and coach services in the region, which require far less investment.

Conclusion

This project is incredibly ambitious. However, the GCC region has famously delivered projects in ways and at speeds that others would deem impossible due to the ambition of the countries in the region. As with many things in the region, if the political will is there, ambitious projects can be delivered.