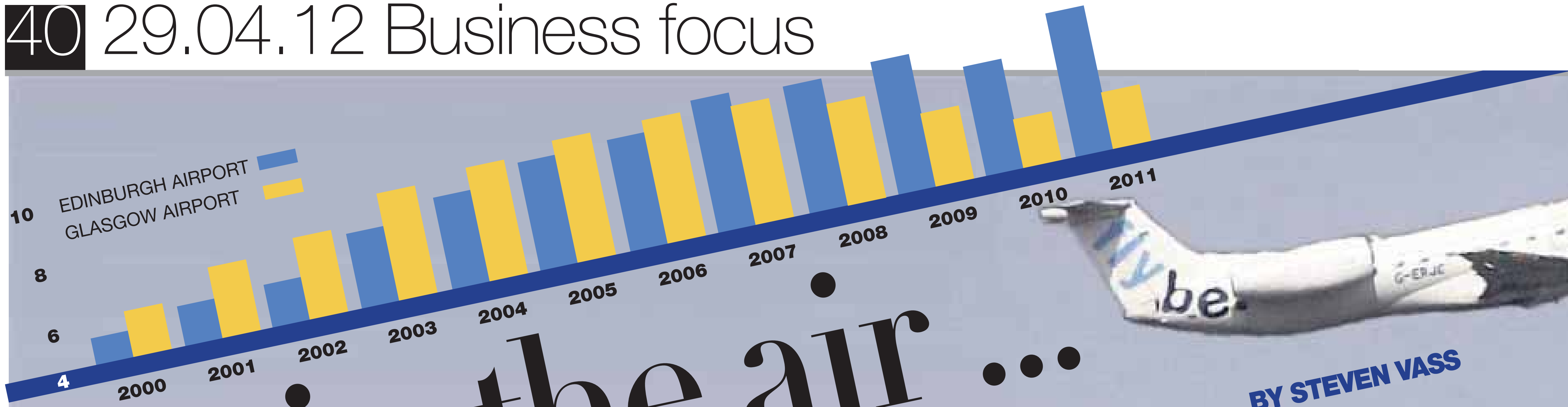

Up in the air ...

IS THE SALE OF EDINBURGH AIRPORT GOOD OR BAD NEWS FOR SCOTTISH TRAVELLERS?

BY STEVEN VASS

AS airport delays go, this one will take some beating. Two thousand, one hundred and twenty-five days after the Office of Fair Trading (OFT) announced it would investigate the British airport market, Edinburgh Airport finally changed hands last week.

The investment giant Global Infrastructure Partners (GIP) paid £807 million, considerably more than expected, to buy Edinburgh from BAA. After nearly six long years of uncertainty, in which BAA has fought a losing battle for control of its assets, the fate of Scotland's biggest airport has finally been decided. For the first time since Glasgow and Edinburgh airports were brought under the control of the then state-owned British Airport Authority in the 1970s, they now have different owners. With Glasgow still owned by BAA, when GIP takes official control of Edinburgh on June 1, business watchers will be braced for what threatens to be a fascinating battle from the two ends of the M8.

Depending on your point of view, the UK has a notorious or glorious reputation for taking a free market approach to foreign companies buying infrastructure. Where the Germans and the French jealously guard their national assets, the British authorities have done nothing to stop nuclear power stations, water utilities and steelmakers being bought by foreign operations.

BAA is the nearest thing to an exception, however. When Goldman Sachs and the Spanish construction giant, Ferrovial, were battling to take over the airport operator near the peak of the easy money days in 2006, the OFT warned that it might launch an investigation into the sector.

The Ferrovial chairman, Rafael del Pino, swallowed the poison pill regardless, sealing the deal with a knockout bid of £10.3 billion in early June 2006. As well as the two main Scottish airports, it meant that Heathrow, Stansted, Gatwick, Southampton and Aberdeen were all now in Spanish hands. The OFT duly announced its investigation later the same month, raising the curtain on a horror show that is still far from over.

By the time of del Pino's death two years later, BAA was up to its eyes in a Competition Commission (CC) enquiry and Ferrovial's debts were getting close to unmanageable as the value of the airports plunged with the credit crunch. The CC published a provisional report in August 2008 saying that it was minded to recommend the sale of two London airports and either Edinburgh or Glasgow. This gave Ferrovial the excuse or motive to announce a few weeks later that it would put Gatwick up for sale.

In autumn 2009, it went to GIP, a New York-based multi-billion-pound infrastructure fund jointly set up by General Electric and Credit Suisse, for £1.5bn. Having launched in 2006, GIP's international portfolio already included UK assets London City Airport and the waste group, Biffa. It is a 10-year fund looking to offload everything by the end of the period.

This supposed sacrifice by BAA did nothing to assuage the CC. It stuck to its provisional findings, prompting a legal battle that is still raging. The fate of the Scottish airports looked likely to drag on, but then BAA announced last October that it would put one up for sale and focus on saving Stansted.

The question was which one would go. Edinburgh was smaller but had grown steadily over the years, latterly picking up valuable Ryanair business at the expense of Prestwick and making the most of its dominance in the Scottish freight and mail markets. It was also seen as the airport with the most potential, given its proximity to Holyrood, the financial services industry and Scotland's leading tourist attractions. It finally took the lead in 2007, the year of the failed terrorist attack against Glasgow.

The latter airport had grown powerfully for 20 years by sending Strathclyde to the sun each summer. It scored a great coup when it was selected by Emirates Airlines as one of the UK airports for sending people east via Dubai in 2004, but took a battering from the demise of courier operators like XL and Fly Globespan in the second half of the decade. Between 2007 and 2010, annual passenger numbers fell 25%. And although it had received substantial investment from BAA, including the second terminal, it was perceived in the industry as a lower growth priority.

BAA's masterplans for the two airports predicted 10 million annual passengers in Glasgow and 12 million in Edinburgh by 2020. Hence most commentators assumed Glasgow would be sold, but either BAA believes it can turn Glasgow around or everyone underestimated Ferrovial's desire to reduce its debts.

After chief executive Colin Matthews announced he had made the "very difficult" decision to sell Edinburgh, the most likely buyers emerged as GIP and JP Morgan, and an end sale price of between £500m and £600m was expected.

JP Morgan, which does not own airports, reportedly came a distant second with £735m at the final bidding, although sources close to the process insist this substantially underestimates the true figure.

News of the deal was met favourably last week. GIP is considered to have done a good job of improving City and particularly Gatwick, investing in areas such as security to cut customer waiting times and picking up new long-haul airline business, which is more profitable than short-haul. In its most recent six-monthly period, Gatwick's earnings before interest, tax, depreciation and amortisation (EBITDA) was up by more than one-third to £164m on a 15% rise in revenues.

"I have been impressed with GIP's performance at Gatwick," says John Strickland, an aviation expert at JLS Consulting. "Everyone is constrained for capacity in the southeast, but they got Air Asia, Air Vietnam and are getting some extra capacity for China. Airlines don't easily move airports or open new services. They have to be courted and persuaded, especially in this kind of climate where airlines are more risk averse."

GIP has indicated it will have a similar approach in Edinburgh. There is certainly a long-haul opportunity, since it amounted to only 160,000, or 2%, of Edinburgh passenger journeys last year compared to 785,000, or 11%, at Glasgow. This will potentially be made easier by the new Boeing 787 Dreamliners, which make longer direct flights more feasible.

There is also work to be done in short-haul, particularly to resolve a festering row with Ryanair over airline fees. The Irish budget carrier cut five routes from its summer schedule earlier this year and last week announced it would cut a further eight from the winter schedule. Ryanair boss Michael O'Leary welcomed the GIP takeover last week by saying that BAA's "dead hand" had been removed from the tiller. Ryanair fights so ruthlessly that it does not make much money for airports, but it brings customers nonetheless.

Strickland believes there is an investment opportunity, too, on the rationale that more people will use a customer-friendly airport and will spend more money at the retail outlets if they are not held up in check-in and security.

Glasgow Airport can expect stiffer competition from the new owners of Edinburgh Airport as it seeks to make a return on its investment

"BAA did invest in the airport," he says. "But it had to manage investment across a portfolio of seven airports. And Ferrovial bought BAA at a pretty high price before the financial meltdown, so it probably had limitations on its investment ability as a result."

YET Strickland and others are equally clear that Edinburgh is not Gatwick. Where the London airport offered a dire customer experience in its late BAA days, most observers think Edinburgh is quite well run.

Louise Congdon of the York Aviation consultancy, who advised one of the other bidders, says: "I didn't sense there were major customer service issues which needed addressing in Edinburgh... Our view was that the airport was a safe bet, a good solid asset. There was potential for improvement in performance, but not by a massive amount. Our view was that the masterplan [with its 12 million passengers forecast for 2020] was there or thereabouts."

She adds that while GIP will look to achieve savings in duplicated costs with its other group airports, there may not be many such opportunities. In terms of route development, she says that airports cannot dictate to airlines that they must only use the runways in their portfolio and GIP will need to compete to win business at Edinburgh in the same way it has done at Gatwick.

At the same time, GIP has paid a high price for the airport. The £807m tag is nearly 17 times the £48.3m the airport made in EBITDA in 2011. This is way above the 10 times multiple it paid for Gatwick, and in line with the prices paid for airports in the mid-noughties. GIP would not comment last week on whether it had paid much more than originally planned.

If so, it will have a bearing on the airport's profit targets to ensure that it hits GIP's expected internal rate of return (IRR) on the investment. Congdon points out that this will depend on the way the deal has been structured – for example, if GIP has borrowed a lower proportion of the purchase price than the other bidders, it might be able to live with a lower IRR. It borrowed around £350m, meaning that about 43% of the investment came from the fund. It will also be able to compensate later by selling stakes to other investors, like it has done at Gatwick.

Nevertheless, Edinburgh could well be under serious pressure to increase profits at a time of high consumer debt and probably high fuel prices. So Glasgow and others like Newcastle can expect particularly fierce competition, albeit that several observers say there is enough growth potential to go around. Airlines can expect very tough fee negotiations. Consumers might see higher shop and restaurant prices and higher supplementary charges for things like car parking.

While BAA prepares for this whirlwind, at least it has the consolation of having received a great price. Its accountants will be talking about raising the value of the rest of the airports on its balance sheet, which might mean more investment at Glasgow.

Or, as one analyst suggested half-seriously last week, it might even look to sell it. So what happens next is anyone's guess. All we can say is that the days of stable predictability for Scotland's airports are probably gone for good.