For better Financial Foresight

Ekinci Economics Consulting

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What will infrastructure privatization bring winning bidder?

Context

Third attempt to privatize roads and bridges on October 31st will be effective for the government budget and winning bidder. In order to refrain from same failure the government experienced in electricity privatization the Privatization Administration has obliged a collateral payment of US$ 50 million before the auction. The remaining share of collateral payment, US$150 million, will be paid only by the winner party to the government after the auction. The infrastructure in Turkey was not developed until 2000; basic infrastructure quality rose from 3.4 points out of 5 in 2005 to 4.4 in 2012 according to global competitiveness report of the World Economic Forum. The number of new registered cars on the roads augments every year, i.e. to 603 thousands in 2011 from 353 thousands in 2008, because of growing young population (half of the population under 29 years of age) and income level (US$ 20,000 per capita expected in 2007)in the country.

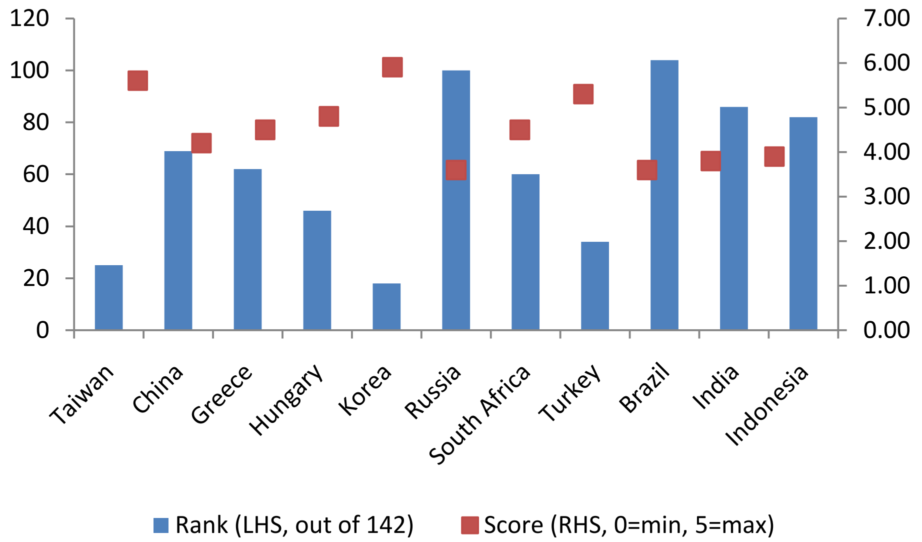
The government aims both cost savings and provide higher standard of service quality through this privatization. The roads need to be restructured and meet international standards on the EU accession agreements prerequisites as Turkey is a membership candidate since 2004. United Nations gave also motive by recently adding Ankara-Istanbul highway to Asian Highway Network.

According to World Economic Forum's 2012 Global Competitiveness Report Turkey is among the best within emerging markets in terms of quality of infrastructure(see chart 1 below) . Private company which will take over seven toll roads and two bridges in one package from the government is not required to make a higher than US$ 100 million maintenance expense per year. New investment requirements for these companies will be on service units along these roads.

The business is profitable; it would create vertical integration with many sectors for the winning party. The tender has been postponed twice only because of the difficulties of financing projects in the global financial turmoil environment. Now that the global economic conjecture returned relatively to normal, the bidder companies do not have difficulties to finance their infrastructure projects. For example Dogus Holding which has applied to the tender with a consortia of four (Autostrade- Dogus

Holding-Makyol-Akfen) will be financed by Deutsche Bank, Unicredit and Goldman Sachs for the privatization of road tolls. Construction companies, if they win the tender, they will live the advantage to use their own resources for maintenance and repair of the roads. Big conglomerates, which are also interested in the auction, have sufficient vertical integration to handle the business.

Chart 1: Ranking of overall infrastructure quality in selected counties



The tender process

Roads in Turkey today are constructed, maintained and operated by the state; the General Directorates of Highways (GDH). Revenues of GDH come from the state budget; approximately 2 per cent of the budget goes for roads in Turkey. The privatization of motorways and bridges was on the government agenda since 15 October 2010. The tender commenced in 2011 and was cancelled twice because of the difficulties the bidders find in financing their projects. The scope of the privatization includes 2,036km of motorways and two bridges, their connection roads, motorway service areas, maintenance-operation and toll collection units. The motorways consists of 7 toll roads connecting Edirne-Istanbul-Ankara; Pozanti-Tarsus-Mersin; Tarsus-Adana-Gaziantep; Toprakkale-Iskenderun; Gaziantep-Sanliurfa; Izmir-Cesme; Izmir-Aydin and Izmir-Ankara freeway. The two bridges that are going to be privatized are in Istanbul; Bosphorous and Fatih Sultan Mehmet (FSM) bridges.

Motorways and bridges are already existing infrastructure while there will be new service investment units to be built on the roads by the winner party. There are 46 number of parking areas and 74 service areas (some being empty) along these roads and the winner party will make new investments in these parking and service areas. Service investments will include fuel sales, cafeteria, restaurant, canteen and hotel facilities.

These roads and bridges will all be privatized in one package and the transfer of operating rights will be given to the winner bidder for 25 years period. The companies which will compete in the tender are Vinci Concessions Holding, Zorlu Holding-OHL Concessions Joint Venture, Nurol Holding-MV Holding-AlsimAlarko-Kalyon- Fernas Joint Venture, Dogus Holding-Autostrade-Makyol-Akfen Joint Venture and Koc Holding- UEM Group Berhad- Gozde Group Joint Venture. Last four include big Turkish conglomerates some of which are also active in the construction business and some are existent construction companies. Vinci Concessions is a French company, being the only company in the tender without a partnership.

Government goals on privatization

Traffic average is constantly increasing in Turkey. There is a 5.7 per cent annual average increase in vehicle/km on highways and 12.2 per cent on motorways, between 2002 and 2011 (see Chart 2). This rise in vehicle/km ratio is nearly zero per cent in the EU. In Turkey, there is a high potential for an increase in the number of vehicles per capita; as compared to the developed countries (see Chart 3). It is still well below EU levels however considering increasing young population (50 per cent of the whole population) and increasing per capita income (from US$ 4,000 in 2002 to US$ 14,700 in 2012; officially estimated to be US$ 25,000 by 2023).Vehicle usages in seven motorways and two bridges that are subject to privatization reached 350 million for the whole year in 2011. Road infrastructure and service quality have to meet this increasing demand. Therefore, first goal of the government in privatizing major infrastructure is better management of toll motorway network.

Chart 2:

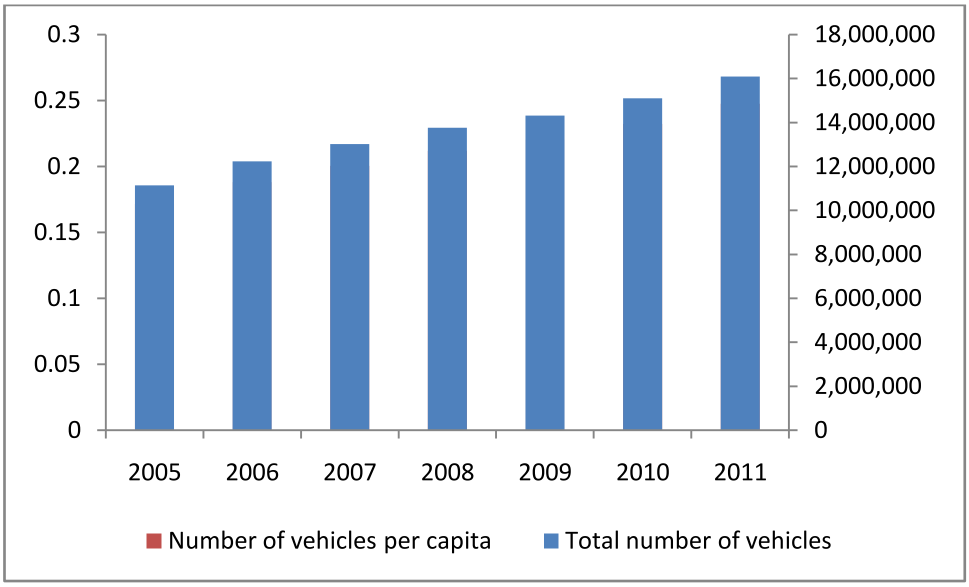
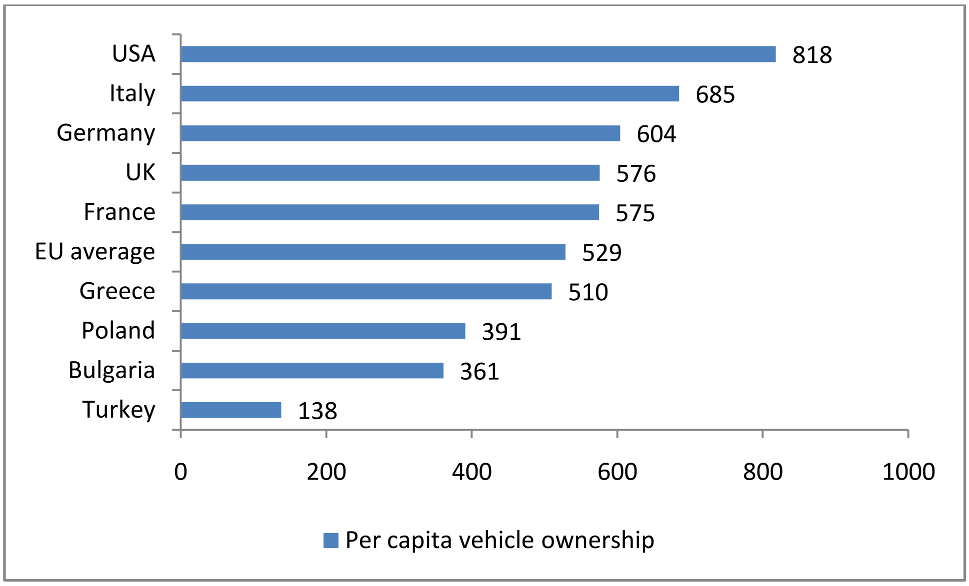


Chart 3:



Second motive of the government is to eliminate the construction cost burden of these roads. The government has spared US$ 3.5 bn. from its budget for the maintenance, repair and service cost of roads in Turkey last year. The total expense on seven motorways which are subject to privatization was around US$ 1bn. in total between 2007 -2011. If the new owner is a conglomerate it would benefit from vertical integration and provide maintenance, repair and service units at a lower cost thanks to its subunits i.e. construction company.

Third goal of the government is to increase the quality of infrastructure for international recognition, which is necessary for the AKP that cares about Turkish EU candidacy. High quality of infrastructure is one of the conditions in the EU accession treaty. A programme amounting to 13 million euro has been provided to Turkey for increasing the quality of infrastructure, to be managed by the European Committee for Standardisation [link: http://quality-turkey.kalder.org/exc/index.htm]. An EU budget support of 5.6 billion euro has been provided under the IPA 2007 programme by the EU to support the quality infrastructure in Turkey.

Final goal is to make some additional revenue to the national budget -which is well behind the government target. Despite an official target of 1.5 per cent budget deficit over GDP ratio, the budget will give a deficit at around 2.3 per cent of the GDP this year. Recent tax hikes on gas, fuel and electricity prices will not be enough to meet official target this year. Although privatization revenue is not encountered in national budget, it would be a source of proceed for the government. The expectations for the privatization revenue alter between US$ 4.5 bn. and US$ 10bn. (the government estimate) of which US$ 4.5 bn. is expected from the sale of two bridges. We would base our computation on the lowest value at a tender value of US$ 4.5 bn. to give the highest possible return to the winning bidder despite there is enough application to the tender.

Other investments

These will be privatization of already existing bridges/roads, but there will also be new investments on service units. There are 74 number of parking areas in these roads and the winner party will make new investments in these parking areas. The service investments will include fuel sales, cafeteria, restaurant, canteen and hotel facilities. There are some service facilities in these roads which are already under operation but two thirds of the service area's contract termination date is 2013; some of them are already empty (service areas that are empty).

There is an OGS (automatic pass) system for toll collection in the bridges and motorways. Passengers do not pay cash but are required to have an OGS toll transponder to pay the toll. Transponders are issued by banks to their account holders. This system was adopted to avoid traffic congestion at toll plazas. There will be a new system HGS (fast pass system) will be run by the winning bidder will completely replace the old card pass system. This will provide an already revenue amount of US$ 220 million to the company that win the tender. There are 7 OGS toll booth in Bosphorous Bridge, bringing revenue of US$39 million from 47 million cars last year and 5 potential HGS toll booth. There are 10 OGS toll booth in FSM Bridge, bringing US$ 49 million from 50 cars that passed last year and 11 potential HGS toll booth (see Table 1 below).

Table 1:

Highway	**Number of OGS**	**Potential number of HGS**
Edirne-Istanbul	87	72
Istanbul-Ankara	115	125
Izmir-Cesme	19	32
Izmir-Aydin	20	37
Mersin-Pozanti-Tarsus	31	56
Adana-Iskenderun-Sanliurfa	49	77

Why the privatization makes sense to the bidders now?

Except from one company, the other parties in the tender are joint ventures, including some French, Italian, Argentine and Malaysian companies. The Privatization Administration in its pre-publicity document sets forth all revenue-expense profile of the business and declares that the business would yield an annual net income of at least US$ 370 million per year. All of the procedures of take over to the new company process will be completed by December 2012.

Share of ground transport for passenger and goods in total transport system in Turkey is 95 per cent, well above the EU's share of 80 per cent and USA's 90 per cent. The number of vehicles that uses these seven roads and two bridges that are going to be privatized recorded highest increase of the last five years (6.1 per cent year-on-year) in 2011. Having on average 15 million cars using toll ways each month; passenger car number that uses toll roads and bridges for the whole year reached 350 million in 2011. Based vehicle statistics we see that the rise in the usage of these roads multiplies each coming year.

In terms of local currency, there was an increase of 6 per cent rise in gross revenues last year from the ways that are going to be privatized. The gross revenue from these roads and bridges through 330 million vehicles in 2010 was TRY 842 million while this was TRY 893 million from 350 million vehicles in 2011. In 2011 monthly revenue was around TRY 71 million on average from the ways that are going to be privatized (see Table 2 below).

Table 2:

	No of vehicles (mn.)				
	2007	**2008**	**2009**	**2010**	**2011**
Edirne-Istanbul	50,7	51,5	52,8	57,0	63,2
Istanbul-Ankara	66,2	69,5	71,6	75,7	82,1
FSM Bridge	81,0	78,8	78,4	80,5	83,5
Bosphorus Bridge	66,3	67,2	65,7	67,6	68,5
Izmir-Cesme	7,3	7,8	8,9	8,9	9,9
Izmir-Aydin	11,2	12,1	11,7	12,0	12,7
Mersin-Tarsus-Pozanti	9,3	10,0	11,0	12,1	13,1
Adana-Iskenderun-Sanliurfa	11,0	12,9	14,2	15,7	16,8
TOTAL	**303,1**	**309,8**	**314,2**	**329,6**	**349,8**

While gross revenue from Bosphorus Bridge rose to US$ 68.8 million in 2011 from US$74.9 million in 2010; expenses rose only to US$1.7 million from US$ 1.6 million.

The passenger cars in Edirne-Istanbul highway rose to 63.2 million in 2011 from 20 million in 2002, while revenue per vehicle rose to US$ 1.42 from US$1 during this period expenses only rose from US$ 7.3 million in 2002 to US$ 24.5 million in 2011. In Istanbul-Ankara highway revenue per vehicle rose from US$ 1.1 in 2002 to US$

2.02 in 2011 while the number of vehicles using this way rose from 32 million to 82.1 million. Only from the net revenue items the business looks very profitable.Nevertheless, the rise in motorway and bridge toll prices will not be freely determined by the winner bidder. A possible formula that is discussed is an annual hike in prices based on CPI plus risk premium while the risk premium would cover new investments that would be taken by the winner party. A limit i.e. 2 per cent would be determined for the risk premium. According to the new legislation, the winning party would be refrained from exchange rate risk. The private company that owns these roads is not allowed to set a toll price freely but will be allowed increase tolls each year based on both CPI and depreciation of the local currency.

Along with the privatization, the winning bidder will also own the rights of all fuel stations, service areas on the roads that are privatized. The company can open new service areas along the road with the permission of the GDH. There are service areas in these roads which already pay rent on contract base; the winning party will have the right on these contracts and will be allowed to build new service areas to empty service areas.

The requirements for upkeep of the roads

Investment requirements for the winning bidder will include additional lane investments, toll booth investments, connection road investments, additional maintenance units and control centre investment.

There is a minimum requirement for the company to meet maintenance, repair, operation and similar liabilities of investors. Last year, this minimum requirement the government had obliged the awarded party to make was US$ 1.5 bn.; this amount was expected for the construction of about 200km of additional toll roads. Since then, the government has finalized the construction of 95 km of the roads, cutting additional investment requirement for the winning bidder to US$ 350mn. So in total the total expense to the winning party will be around US$ 5 bn. along with the collateral payment. Moreover, the roads will have to be surfaced with asphalt every seven to eight years and this will cost around US$ 1.5bn. Therefore in total there will be an expense of US$ 6.5 bn. but considering US$ 330bn net revenue for 25 years this investment requirement would be nil.

Conclusion

The income from the tolls of existing bridges is constantly increasing; the winner party would have the advantage of it in the next 25 year. There are 577 number of toll booths in motorways and 33 number of toll booths in bridges. Total income from only two bridges last year was US$ 157 million last year.

The assets will provide attractive rates of returns to the winning company as there is an average 15 per cent vehicle/km annual increase in the country. Net revenue of US$ 330 million every year will make a return of US$ 8.3 billion to the new owner, well meeting the privatization expense.

The conglomerates especially Dogus, Zorlu and Alarko have controlling stakes in seven main business lines: financial services, automotive, construction, tourism, real estate, media and energy. These big conglomerates will use their own resources if they win the tender in infrastructure business. Also there are big construction companies in five consortia which applied to tender, i.e. Makyol, which are active in heavy construction and infrastructure (highways, airports, dams, tunnels, bridges etc.), commercial real estate, housing development as well as tourism investments. These big construction companies will live the benefit of service investments along the roads if they win the tender.

Finally, the government would be disposed of most of the budget cost that goes to infrastructure expenses. With lower burden on Treasury we keep our long term forecast for lower interest rates for the next year that would increase loan demand and trigger growth rate.

Ekinci Ekonomik Danışmanlık Bilgilendirme Yazısı

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Her ne kadar müdürleri, memurları, çalışanları veya danışmanları kendi adlarına menkul yatırımları yapsa da EEC, şirket olarak herhangi bir menkul kıymete yatırım yapmaz.