Infrastructure Group London

Emmanuel Deblanc
BNP Paribas: Project Finance - Infrastructure

- Infrastructure sits in the Project Finance business of BNP Paribas
- BNP Paribas is a leader in Project Finance (as shown in the league table of Mandated Lead Arrangers for 2007)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Bank</th>
<th>Value (USD million)</th>
<th># deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>BNP Paribas</td>
<td>14 580</td>
<td>94</td>
</tr>
<tr>
<td>2</td>
<td>Royal bank of Scotland</td>
<td>11 760</td>
<td>68</td>
</tr>
<tr>
<td>3</td>
<td>Dexia</td>
<td>9 231</td>
<td>61</td>
</tr>
<tr>
<td>4</td>
<td>Calyon</td>
<td>8 346</td>
<td>55</td>
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<tr>
<td>5</td>
<td>Mizuho Financial Group</td>
<td>7 281</td>
<td>51</td>
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<tr>
<td>6</td>
<td>Bank of Scotland</td>
<td>6 552</td>
<td>31</td>
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<tr>
<td>7</td>
<td>Société Générale</td>
<td>6 193</td>
<td>42</td>
</tr>
<tr>
<td>8</td>
<td>Sumitomo Mitsui Banking Corp</td>
<td>4 873</td>
<td>49</td>
</tr>
<tr>
<td>9</td>
<td>State Bank of India</td>
<td>4 870</td>
<td>16</td>
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<tr>
<td>10</td>
<td>Mitsubishi UFJ Financial Group</td>
<td>4 772</td>
<td>33</td>
</tr>
</tbody>
</table>

Source: Thomson Financial Global Project Finance Full Year 2007

The London team is involved in two main streams of activities:

- **Traditional Project Finance (Public Private Partnerships or “PPPs”):**
  - Advising and or Financing Greenfield Projects in Europe (outside France, Italy and Spain) and Central Europe
  - Over the last two years we have been mandated by leading contractors, utilities and infrastructure funds
  - The Projects vary in complexity and size and we tend to focus on large transactions (above EUR 500 mio) with key clients of the bank

- **Acquisitions of Infrastructure Assets**
  - Infrastructure assets (ports, airports, rail, roads, environment) are a new asset class with dedicated financing provided by “Project Finance” Banks
  - General M&A activity and buoyant Infrastructure Funds seeking investments were the key drivers for record level of infrastructure financing
  - Although akin to LBOs the nature of the asset (essentially mono/oligopolies or regulated utilities) enable project type financing and tailor made structuring (long-term, mini-perm, bullet…) which differ significantly from the traditional LBO financing (3 tranches at relatively low Debt / EBITDA multiple) in terms of debt quantum and pricing. In addition most infrastructure funds have a take and hold strategy (unlike the traditional private equity funds)
**Fundamentals and trends of the infrastructure market**

### Demand and supply meet
- Many European countries face significant economic challenges and realise that they cannot finance their infrastructure investments alone.
- At the same time Australian and Canadian investors who, already familiar with infrastructure investments in their relatively mature domestic markets, are looking for opportunities elsewhere.

### Investors’ profile
- Pension funds need yield-generating assets with durations that match their liabilities.
- The shift toward fair-value accounting will increase the visibility of volatile investment returns.
- It is likely that pension funds will shift out of public markets (where the mark-to-market volatility is implicit) into private markets.
- Strong evidence of growing appetite for ultra-long duration (perpetuity for BAA bonds).

### Types of Market Players
- Different models for running infrastructure asset management businesses are emerging. Except for the first movers (Macquarie) competitor strategies and competencies are mostly unclear.
- Some firms are clearly targeting a significant global infrastructure business; others seem to be opportunistically launching infrastructure investment funds while the sector is hot.
- The distinction between competitors, partners and clients is often blurred.

### Market Size
- New funds are launched regularly – many with a target size in excess of EUR1 billion.
  - GS has raised USD 6 billion.
  - BNPP contemplates EUR 1 billion.
- Based upon the business values of each of the infrastructure main sub-sectors our estimated market size is EUR 6.5 trillion.
- Liquidity constraint from the banks versus untapped capacity of infrastructure equity funds could lead to “over-equitised” deals.
## Infrastructure Debt Model

<table>
<thead>
<tr>
<th>Description</th>
<th>Typical Leverage (Debt/Equity)</th>
<th>Amount of Equity</th>
<th>Typical Cost of Equity</th>
<th>Amount of Debt</th>
<th>Typical Pre-Tax Cost of Debt</th>
<th>Post-tax WACC³</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Equity Model (Strategic Investors)</td>
<td>Moderate leverage</td>
<td>50/50%</td>
<td>£500m</td>
<td>10-12%</td>
<td>£500m</td>
<td>5.00%</td>
</tr>
<tr>
<td>Infrastructure Funds</td>
<td>Increased leverage</td>
<td>75/25%</td>
<td>£250m</td>
<td>10-15%</td>
<td>£750m</td>
<td>5.70%</td>
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<tr>
<td>• Moderate leverage</td>
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<tr>
<td>• Single A credit</td>
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<tr>
<td>• Focus on stability and long-term growth</td>
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<tr>
<td>• Increased leverage</td>
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<tr>
<td>• Weak BBB credit</td>
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<tr>
<td>• Equity provided by long-term investors with a focus on stable growth and visibility</td>
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<tr>
<td>• Tendency to partner with strategies to extract synergies and drive efficiency</td>
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<tr>
<td>Traditional Private Equity Model</td>
<td>Maximum leverage</td>
<td>85/15%</td>
<td>£150m</td>
<td>20-25%</td>
<td>£850m</td>
<td>7.20%</td>
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<tr>
<td>• Borderline investment grade reflecting regulatory constraints not to fall below investment grade</td>
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<td></td>
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<td></td>
<td></td>
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<tr>
<td>• Minimum equity amount</td>
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<tr>
<td>• Focus on high equity returns</td>
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<tr>
<td>• Exit</td>
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<tr>
<td>• Long term (ten year plus) horizon</td>
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<tr>
<td>• Focus on dividend yield</td>
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<tr>
<td>• Underlying value creation: Optimizing ‘simple’ assets within a well-defined regulatory framework</td>
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<tr>
<td>• Financing: bullet structure, border line investment grade for senior, BB for junior</td>
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<tr>
<td>• Target returns: 10-15%</td>
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<tr>
<td>• Exit</td>
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<tr>
<td>• Five year horizon</td>
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<tr>
<td>• Focus on exit strategy</td>
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<tr>
<td>• Underlying value creation: Focus on turn-around strategies, cost reductions, synergies etc.</td>
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<tr>
<td>• Financing: Amortizing bank debt, high yield bonds and mezzanine</td>
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<td></td>
</tr>
<tr>
<td>• Target returns: 20%-25%</td>
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</table>

¹Assuming a hypothetical transaction size of £1,000m
²Based on 20-year Eswap rate of 4.698%. Assuming a tax rate of 30%. Assumes 30 bps spread for public equity (A rating). 100bps for infrastructure financing (BBB) and 250 bps for private equity.
³WACC = Weighted Average Cost of Capital.
What Has Changed

- Infrastructure sector in 2007
  - > $90bn worth of deals, ~260 transactions worth ~$350m
  - H1: characterised by abundant liquidity and enabling financial sponsors to maximise leverage and structures
  - H2: worsening credit and liquidity conditions coupled with a general aversion heightened threats for infrastructure transactions. Surprisingly H2 volumes exceeded H1. This potentially illustrates the required time to bring transactions to close and also the resilience of the sector

- Flight to quality and simplicity
  - Hybrid transactions may no longer be well received by the markets
  - Preference for regulated utilities or projects with Government backing
  - Overall, a reminder of the key characteristics of the sector: essentiality, LT cashflow generation, regulatory oversight, high barriers to entry, hard-built/non-movable

- “Back to basics”: longer commitment from sponsors, stricter covenant package
The above chart is a simplified illustration of the risk-return expectations in the sector: there is a wide diversity within each sub-class. For instance, in the toll road sector, a greenfield toll road presents a very different risk-return proposition from a large toll road network (e.g. Autostrade).
Syndicated Loans: current trends

- Flattening of the market structure:
  - to some extent, we are moving from a distribution model to a big final take & hold players to minimise uncertainty
  - this is driven by both issuers and lenders
- Lending criteria tightened
- Re-pricing of liquidity risk (penalising long tenors in particular)
- Lack of confidence in timing of securitisation take outs
- Practically, it translates into smaller, shorter, fewer, richer and more defensive deals
- The trend is more pronounced for mezzanine tranches where risk distribution is (even more) challenging. At this point, this is a take and hold market for a number of institutions
- Overall: a parsimonious capital usage
- RAROC is significantly improving
Update on Capital Markets (& infrastructure)

Investors
- Real cash accounts
  - Fear of Marking to Market when the knife may have further to fall
  - Limited/no appetite for wrapped paper
  - Needs will be there in a few weeks/months, i.e. no rush
  - However, infrastructure will probably be the first market to recover - investors migrating away from cyclical sectors

Negative Basis Traders
- A number of banks have ceased to take any incremental exposure to monolines and the cost of CDS on monolines makes the economics rather challenging
- The trade seems to have been proven right to date, but…
  - While the widening of the CDS written by a bank on a monoline for say 10-15% has matched and/or exceeded the spread widening on the wrapped paper itself,
  - There is very often a residual mismatch of maturities between the CDS and the wrapped bond: the CDS is typically for a blend of maturities.
Consequences of the Credit Crunch

- Credit supply has considerably dried up
  - A few key market players are on the side-line
  - The remaining players are getting more demanding
- While demand remains sustained
  - In the “real economy”, capex needs to be funded and facilities need to be re-financed
  - A few large issuers have postponed their access to market since August-07 and the pressure is mounting
- This could lead to:
  - A sustained higher credit spread environment
  - A further attraction for infrastructure equity / debt as a defensive and more resilient alternative investment in the current environment
  - A lower correlation to GDP than traditional equity plus an inflation hedge (relevant given the fears of a stagflation scenario settling in)
  - Real estate is not the safe haven it may have seemed
  - Commodities may be perceived as needing to correct in the short term (IMF believes the market needs to adjust by 15/20%)
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