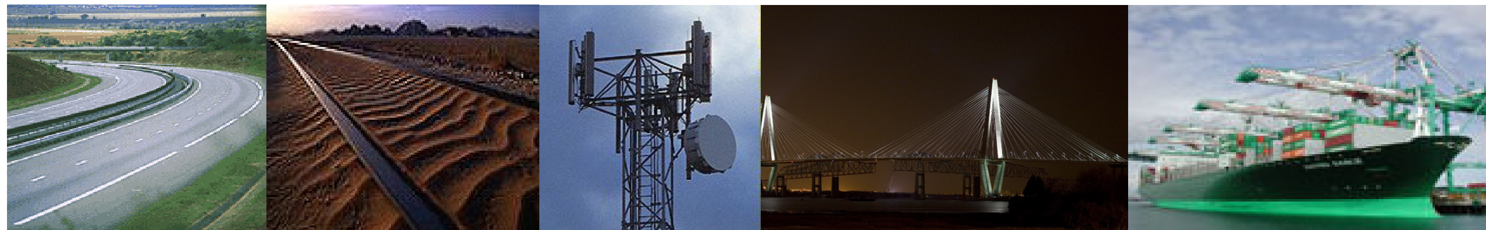
Exane Seminar
London 2008

Infrastructure Group London



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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)**

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

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)

Corporate & Investment Banking

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

Corporate & Investment Banking

Infrastructure Debt Model

<table>
<tr><th></th><th>Description</th><th>Typical Leverage (Debt/Equity)</th><th>Amount of Equity[1]</th><th>Typical Cost of Equity</th><th>Amount of Debt</th><th>Typical Pre-Tax Cost of Debt[2]</th><th>Post-tax WACC[3]</th></tr>
<tr><td rowspan="1">Public Equity Model (Strategic Investors)</td><td>• Moderate leverage
• Single A credit
• Focus on stability and long-term growth</td><td>50/50%</td><td>£500m</td><td>10-12%</td><td>£500m</td><td>5.00%</td><td>6.7-7.7%</td></tr>
<tr><td rowspan="2">Infrastructure Funds</td><td rowspan="2">• Increased leverage
• Weak BBB credit
• Equity provided by long-term investors with a focus on stable growth and visibility
• Tendency to partner with strategics to extract synergies and drive efficiency</td><td>75/25%</td><td>£250m</td><td>10-15%</td><td>£750m</td><td>5.70%</td><td>5.5-6.7%</td></tr>
<tr><td colspan="6">▪ Exit
  ▪ Long term (ten year plus) horizon
  ▪ Focus on dividend yield
▪ Underlying value creation: Optimizing ‘simple’ assets within a well-defined regulatory framework
▪ Financing: bullet structure, border line investment grade for senior, BB for junior
▪ Target returns: 10-15%</td></tr>
<tr><td rowspan="2">Traditional Private Equity Model</td><td rowspan="2">• Maximum leverage
• Borderline investment grade reflecting regulatory constraints not to fall below investment grade
• Minimum equity amount
• Focus on high equity returns</td><td>85/15%</td><td>£150m</td><td>20-25%</td><td>£850m</td><td>7.20%</td><td>7.3-8.0%</td></tr>
<tr><td colspan="6">▪ Exit
  ▪ Five year horizon
  ▪ Focus on exit strategy
▪ Underlying value creation: Focus on turn-around strategies, cost reductions, synergies etc.
▪ Financing: Amortizing bank debt, high yield bonds and mezzanine
▪ Target returns: 20%-25%</td></tr>
</table>

[1]Assuming a hypothetical transaction size of £1,000m

[2]Based on 20-year £swap 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.

[3]WACC = 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

Infrastructure: a diversified asset class

- **The above chart is a simplified illustration of the riskreturn 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).**

Corporate & Investment Banking

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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