Capital Projects & Infrastructure

Infrastructure

Generating long term value from infrastructure investments

Infrastructure: back on the rails?

The global recession has impacted the development of the Infrastructure market. However, whilst M&A activity has fallen, the recession has given infrastructure investors an opportunity to assess the resilience of their investments

Whilst the financial crisis and global recession has taken its casualties, there is evidence that appears to reinforce the supposed 'core tenets' of infrastructure investing. On the whole, assets have remained less volatile than the wider economy leading to far fewer enforced refinancings than in the Private Equity market.

- Long term low risk assets – albeit with some notable exceptions, the performance of most infrastructure assets has remained robust. Regulated utilities have continued to perform in line with five yearly plans and have justified their infrastructure status. The performance of transportation assets has been more variable, with some hit heavily through their commodity specialisms and geographical positioning. However, after suffering an early slump in volumes, most appear now to have stabilised with trading improvements now being seen.

- Finance-ability of assets – despite a significant dislocation of the banking sector, it has still been possible for leveraged infrastructure deals to be driven through – largely through the formation of banking clubs - Angel Trains, Gatwick and Gas Natural are three such examples. However the cost of and availability of debt has lowered gearing levels and put pressure on equity returns. Liquidity in debt markets is improving slowly across the infrastructure marketplace, with banks beginning to take syndication risks. However the refinancing of portfolio assets appears likely to become one of the major issues for funds over the next two years.

- Although asset availability has started to increase as vendors have adapted to new market conditions, processes are taking longer with vendors and prospective purchasers alike cautious about committing. We foresee an improving pipeline of assets becoming available, through corporates looking to recycle capital and governments looking to reduce fiscal deficits.

In this revision of *Infrastructure 'Generating long term value from infrastructure investments'*, we look at the key themes across the infrastructure investment lifecycle, exploring recent trends in infrastructure fund-raising and investment, together with looking at key current issues from funds' and investors' perspectives.

As we move into 2010, in addition to an improved debt market, we envisage a focus on the core aspects of infrastructure investing:

- Fundraising & set-up – with a number of fund managers now preparing to launch fundraising for second funds and PE backed funds looking to raise their first infrastructure funds, fundamental questions around fund tenure, performance reward and annual/ overall yield targets will need to be addressed. With institutional investors in the driving seat, we believe there are likely to be some innovative structures linking reward to long-term performance as a result. We also expect that funds with a proven track record of successful Infrastructure investment may be favoured by institutions. Corporate Governance will inevitably be a more prominent issue for funds this time round.

- Asset management – there is likely to be continued pressure on infrastructure investors to demonstrate the value they add. It will be not enough to let assets run themselves, particularly with much tougher stances being taken by regulators penalising poor asset performance. As a result we foresee larger asset management teams within funds and greater focus on investment performance and operational improvement.

- The demands of new regulation – particularly with infrastructure falling within the scope of the European Directive on Alternative Investments, and with pension funds coming under greater pressure to understand the performance and value of their investments.

Key issues throughout a fund's lifecycle

Fund lifecycle

01 Strategic decisions

02 Fund set-up & launch

03 Deal origination

Key questions & issues

01 Strategic decisions

- Listed vs. unlisted?
- Open-ended or closed?
- Fund size?
- Asset target size, sector and geography?
- Target investors?

02 Fund set-up & launch

- Which jurisdiction?
- Creating an efficient financial and tax structure
- Establishing reporting principles & procedures
- Incentivising fund & investment managers

03 Deal origination

- Understanding target sectors & jurisdictions
- Finding the right asset at the right price
- Maintaining deal confidentiality
- Effective negotiation with vendors & management

Deal execution

04

- Accurately assessing valuation early
- Identifying key drivers and issues
- Evaluating upsides
- Incentivising management teams
- Overcoming barriers to cash extraction

Maximising post deal returns

05

- Effectively managing performance
- Accelerating value creation
- Management engagement and alignment
- Effectively monitoring capital projects

Fund lifecycle management

06

- Effective corporate governance
- Reporting valuations with integrity
- Optimising refinancing opportunities
- Identifying & minimising ongoing regulatory and administrative requirements

Exit strategy?

07

- Planning for optimal exits: early identification of exit issues
- Identification of likely asset purchasers
- Careful management of exit processes to maximise value

01 Strategic decisions

02 Fund set-up & launch

03 Deal origination

04 Deal execution

05 Maximising post deal returns

06 Fund lifecycle management

07 Exit strategy?

Strategic decisions

Getting the strategy right at the outset is key to both the success of the Fund launch as well as its ongoing performance. Over the following pages we explore recent key themes which will impact funds' strategic decisions.

To date, the impact of the credit crunch on the infrastructure market has been markedly split between the listed infrastructure players who have had to re-assess their models in the face of sustained pressure from shareholders and the financial press, and the unlisted funds who have largely continued activity as before, albeit within more restrictive market conditions.

Listed funds

The loss of shareholder confidence within the financial services sector has severely impacted stapled security and share prices of funds and fund managers respectively, predominately in the Australian market.

Major players have revisited their approach to investments, seeking to strengthen balance sheets through asset sales. Strengthening listed funds' corporate governance has been a key challenge for funds, with Macquarie and Challenger both publishing fund management agreements for the first time, and strengthening the independence of listed funds' boards.

We consider that in the medium term, it is unlikely that listed funds will be able to finance new infrastructure acquisitions through capital market fundraising.

Unlisted funds

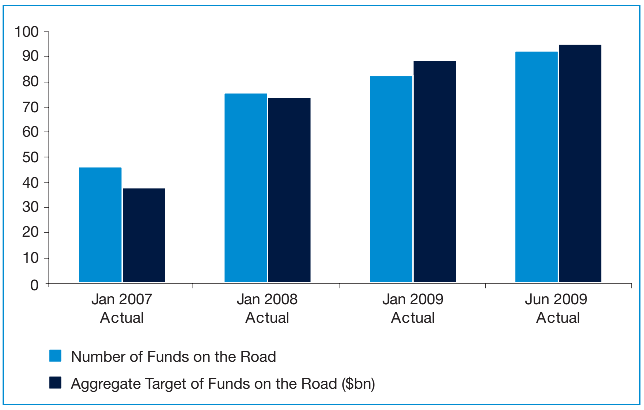
In the light of the above, and the credit crunch-related difficulties experienced by the global banks sponsoring most unlisted infrastructure funds, one might expect to have seen a similar picture in this market. However, the real picture is some way different from this.

Recent fund raising has been higher than ever, with the latest figures showing more funds 'on the road' than at any time in the sector's history, despite contractions in financial markets.

PPP/PFI focussed funds

Both listed and unlisted PFI/PPP focussed funds remain attractive to investors with the quasi government covenant and significantly index linked nature of the underlying cash flows, proving attractive in difficult times.

Growth of infrastructure funds on the road

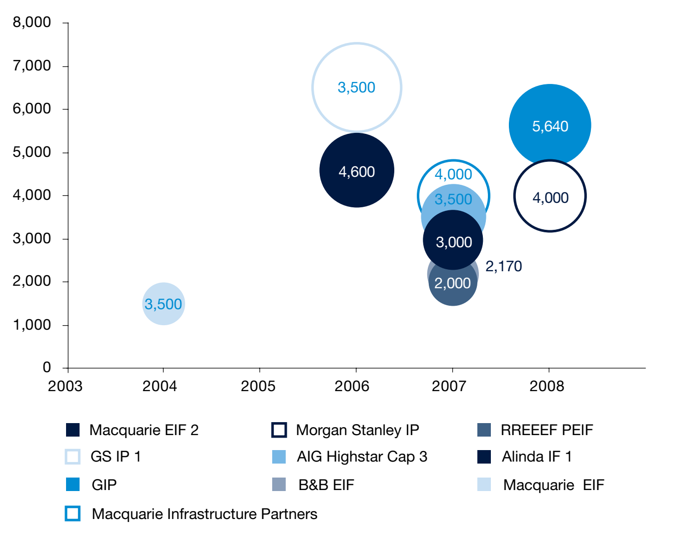


Source: Preqin 2009 Infrastructure Review

Strategic decisions

Of the ten largest infrastructure funds of all time, eight have been raised since May 2007. Most of these are still currently sitting on considerable uninvested commitments.

Ten largest unlisted infrastructure funds raised of all time



Source: Prequin June 2009 Infrastructure Review

Key strategic questions

Whilst infrastructure remains a viable long-term proposition, fund-raising is undoubtedly going to prove more difficult over the short term, with pension and insurance funds reassessing their asset-class allocations in the light of revised equity and fund valuations.

However, much of the evidence suggests that pension funds may increase allocations to infrastructure investment, following the difficulties faced by equity and other markets in recent times.

With this as the backdrop, a key component of fund-raising success will be in establishing a framework in which investors have confidence in funds' asset selection, management and remuneration structures.

Key strategic considerations are likely to include:

- Choice of limited partners
- Whether the fund is open or closed-ended, and the investment period if closed-ended
- Target return rates
- Minimum investor contributions
- Fund manager compensation

Fund management compensation

Following recent high profile events, we believe investor scrutiny will be considerably higher over the near future, with fund manager compensation of particular importance.

Whilst aligning investors' interests with fund manager's compensation is generally considered best practice, there are practical difficulties in achieving this, particularly for long-term closed-ended and unlisted open-ended funds, where investors are looking for stable, long-term returns, whilst fund managers and deal teams require resources and incentivisation in order to put investment plans into place.

Many funds' compensation structures have historically been formed around non-infrastructure fund models – with cash fees and carried interest elements. Going forward, we believe funds with compensation schemes which are transparent and aligned to long-term success will create most credibility in investors' minds.

Strategic decisions

Strategic decisions
01

02 Fund set-up & launch

Deal origination
03

Deal execution
04

Maximising post deal returns
05

Fund lifecycle management
06

Exit strategy?
07

Fund set-up & launch

In setting up a fund, it is critical to establish a structure which is robust and tax efficient whilst meeting the strategic aims of its trusted partners and general partner alike.

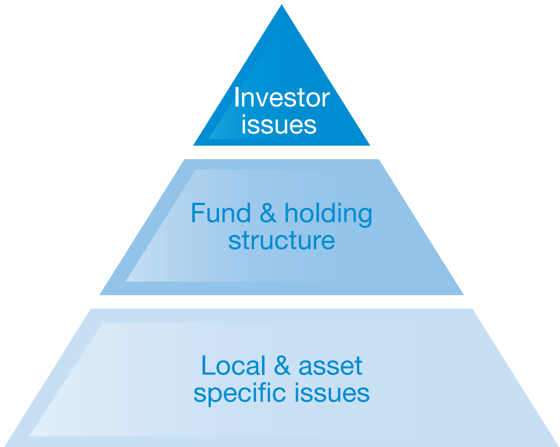
The three principle tiers in fund structuring are:

(i) the investors and general partner

(ii) the fund and asset holding vehicles

(iii) the underlying investments

Getting it right across all three tiers is critical for investors both in terms of ensuring a successful fund launch and delivering the requisite IRR. However, complex structures minimising risk need to be balanced with the views of investors and global regulators who generally seek transparency in terms of structuring and robust operating procedures.



Talking point

Infrastructure continues to be an attractive asset class for pension funds, who seek to match the long-term yield profile of infrastructure investments against their own, long-term, liabilities. This continues to be the case in the current market, with a "flight to quality" by pension fund investors in a period of fluctuating equity prices.

Getting the structure right at the outset is key to generating investor confidence, and driving the success of a fund's launch and ongoing deal success.

Our approach and experience

PwC brings a truly integrated infrastructure offering, incorporating specialists across the firm.

In addition our team of management incentivisation specialists is a core part of our fund structuring team which means we can provide a fully integrated solution through a single relationship team based in London.

Over the last three years, we have advised on the structuring of over 20 infrastructure funds.

PwC also recently worked on the December 2008 launch of a major fully seeded closed fund of PFI/PPP assets. Roles covered Vendor Due Diligence, Vendor Assistance, including building the fund model, Valuation and Tax and Accounting structuring advice.

Strategic decisions
01

Fund set-up & launch
02

Deal origination
03

Deal execution
04

Maximising post deal returns
05

Fund lifecycle management
06

Exit strategy?
07

Deal origination

Finding the right asset

Putting strategy into practice through making acquisitions is one of the most difficult aspects of fund investment. Making investments in the right targets at the right price, ensuring the right balance of sectors and geographies within a portfolio, and minimising fees on aborted deals are all challenges faced by funds.

Key investment decisions will focus on target sector, territory, brownfield vs. secondary, appetite for construction risk, targeted yield, currency and the maturity of regulatory environments.

Barriers to acquiring assets will include language, lack of local knowledge and strength of local feeling towards foreign investors, the nature of the acquisition process and the strength of likely competitors.

Pre-emption clauses may also preclude acquisitions: in the PFI/PPP market in particular, pre-emption clauses in the shareholder agreements will typically give existing shareholders the ability to acquire any disposal stake at market value.

Finally, even when targets in the right sectors and at the right time are available for the right price, working with vendors and management teams to effect a transaction will always be unpredictable. Commercial confidentiality and ongoing incentive arrangements will regularly feature in pre-deal discussions.

Talking point

Since the inception of infrastructure as an asset-class, funds have debated whether to pursue a complementary asset approach, or whether to build up a portfolio of diverse asset types. The attraction of the former is that it will enable funds to build specialisms and generate synergies – particularly in generating revenues and building purchasing power, potentially significantly enhancing assets' post-deal returns.

Building up a diverse portfolio enables funds to balance investor risks but typically makes asset optimisation more difficult.

Our approach and experience

Our approach to advising clients on originating and managing deal processes is simple: to use locally based sector specialists who can work with vendors and management teams alike to effect the best results for our clients.

Our global network with offices in 153 countries gives PwC the ability to operate as both a local and global partner, sharing knowledge, skills and resources.

Accessing our global reach enables our clients to identify, research and arrange introductions to infrastructure investment opportunities across Europe and beyond. We have significant experience of introducing opportunities to funds and managing local deal processes.

In the PFI/PPP market we have advised on originating single asset and portfolio acquisitions across the sector. Clients include Infrastructure Investors, Henderson, Dutch Infrastructure Fund and Allianz. We also acted as lead financial and structuring advisers to Serco and GSL on the disposal of their PPP portfolio interests to Infrastructure Investors and SMIF respectively.

Strategic decisions
01

Fund set-up & launch
02

Deal origination
03

Deal execution
04

Maximising post deal returns
05

Fund lifecycle management
06

Exit strategy?
07

Deal execution

Deal volumes

Deal volumes have undoubtedly decreased in 2009. According to Infrastructure Journal, the full year deal count in 2009 was 764, compared to 1048 closed transactions in 2008 and 822 closed transactions in 2007.

Despite falling deal volumes, significant assets continue to be purchased by infrastructure funds, with recent deals including: Global Infrastructure Partner's acquisition of London Gatwick Airport, Morgan Stanley's acquisitions of Gas Natural and Chicago's Metered Parking Concession and Citi Infrastructure Investors acquisition of Itinere.

Post-credit crunch surveys have shown that fund managers and advisers remain confident as to their ability to undertake deals within the infrastructure market. We see two primary reasons for this:

- Firstly, with significant amounts of unallocated capital, funds will be able to make pure equity investments in assets, with a view to refinancing when debt markets stabilise. With vendors' expectations falling, this should enable funds to avoid highly competitive auction processes, and buy assets for their true underlying value
- Secondly, the consistent and relatively sheltered profile of many infrastructure assets will mean that when debt markets return, infrastructure is likely to be one of the more attractive sectors to debt providers over the long term

Talking point

"For funds to take full advantage of equity-only deals, they will need to be appropriately structured at the outset, minimising cash flow leakage / blockage arising from inefficient financial and tax structures."

Deal execution

Key acquisition issues faced by infrastructure investors

Deal execution

Deal execution
Key infrastructure deal requirements

Financial analysis

Understanding target assets properly is critical to a successful infrastructure deal. Issues will vary from determining the true underlying performance of a target asset to separating infrastructure from non-infrastructure elements.

Evaluation of upsides with risk

To date, many funds have generated deal success through optimising costs of capital and debt. Within the current environment, understanding the time risk within assets and identifying areas of unrealised upside will drive funds' ability to win auctions without overpaying assets.

Regulatory & commercial analysis

One key focal point in understanding infrastructure assets' post-deal performance is the regulatory environment in which they operate.

Regulators are becoming ever more sensitive to consumer pressure across key sectors (water, airports & rail in particular). In these uncertain times, fully understanding targets' regulatory environments becomes even more important.

Early assessment of valuation

In the current environment it is imperative that investors have a robust early view on asset valuations, so that appropriate decisions can be made on entering sale processes and incurring deal costs.

Deal structuring

With infrastructure valuations inherently based on generation and extraction of cash from operating assets (whether operating or through refinancing), it is imperative that valuation assumptions are mirrored in the practicalities of asset investment.

Key issues regularly seen include limited reserves or "dividend traps" within an operating group impairing an acquirer's ability to extract generated cash. Identifying solutions pre-deal is key.

Accurate modelling

No valuation can be effective without a model which accurately represents regulatory structures, tax positions and intra-group cash flows, together with the frequently diverse return requirements of ultimate shareholders.

Modelling needs to be an integrated exercise, having specialists across all necessary fields involved in the modelling process.

Talking point

Credit-crunch driven liquidity constraints have had a significant impact on the appetite of infrastructure lenders. Pre-credit crunch, large banks were willing to enter into sole-underwriter positions at a fixed price on many large infrastructure deals. Now these same banks want one or more co-underwriters and require market flex (a right for lenders to increase interest rates) on pricing and sometimes other terms. Credit committees want much higher comfort that they will be able to sell down debt through the syndication markets, to avoid holding significant debt on their balance sheets. Some borrowers are responding by asking

Key infrastructure deal requirements

Asset-level tax

Asset level tax assumptions have always formed a critical part of robust valuation models.

This requirement, however, is particularly acute in current market conditions, where levels of acquisition finance are lower than previously seen: the ensuing proportionate increase in equity investment will increase the likelihood of taxable profits within operating businesses and hence will make effective pre-acquisition structuring and tax planning a pre-requisite for most deals.

Infrastructure investments do not work in a vacuum. Whilst PPP/PFI and infrastructure investment has often been able to assume a benign tax environment, the tax environment in key jurisdictions is constantly evolving. Examples range from changes to the Industrial Buildings Allowances in the UK, the potential extension of foreign investor taxation rules on certain US infrastructure property (FIRPTA), the potential difficulty of investor taxes in respect of Indian investment projects and recent changes to the treatment of debt in many European countries.

The value of practical asset-level tax advice cannot be underestimated: it requires local tax expertise in relation to the jurisdiction, knowledge of the physical assets, and perhaps most importantly a clear understanding of the contractual arrangements by which the asset level cash flows are generated.

Our approach and experience

PwC's approach to assisting clients with deal execution is based on three core principles:

- Thorough understanding of our infrastructure clients' objectives and requirements
- Deep expertise in sectors and disciplines
- Specialist infrastructure practitioners in all key territories

Taking these core principles, we have assembled a team with significant experience of all key sectors, disciplines and geographies (see page 31 for a selection of our infrastructure deal experience). This team is supplemented by experts from the Firm's wider network, where appropriate.

Our approach to due diligence is specifically geared to the infrastructure market: primarily focused on (i) understanding and identifying risks and practical issues in the cash flow assumptions within our clients' investment models, whilst (ii) developing strategies to enable our clients to maximise post-deal value and cash extraction from their portfolio investments.

banks to "club" together ahead of financial close to remove the risk of changes in terms that may otherwise arise from the market flex process.

This appears likely to remain reality for some time as there are no signs of a return to pre-crunch "underwrite and syndicate (without market flex)" deals. Either "club and hold" or "underwrite and syndicate (with market flex)" deals will remain the norm. In practice, this will have the effect of extending deal processes, as forming banking clubs and flexible syndicates will take more time and resources than single-bank underwritten deals. ”

Deal execution

Sector specific issues – Core infrastructure

Energy & utilities

Key sectors: Water, Electricity, Gas

These sectors feature high levels of regulatory risk, particularly across the impact of pricing reviews, with 2009 reviews revealing a tough stance taken by regulators. Most assets will have significant capital expenditure and maintenance costs and will require a high level of post-deal monitoring.

Transportation infrastructure

Key sectors: Ports, Airports, Roads, Rail

Asset performance is demand driven, often reliant on passenger or commodity trends. Much focus will be on the timing and size of volume recoveries across this sector. The high level of capital investment required in this sector should be considered by any investor - lifecycle costs can also be significant. Parts of these sectors are also subject to strict regulation and government tariffs.

Waste & renewables

Key sectors: Waste & energy from waste, wind & hydro power generation.

These assets are differentiated from other infrastructure investments, as most have significant development requirements, and future plans are often dependent on as-yet unrealised technological developments. Forming appropriate views on technology viability and re-powering assumptions is likely to be key to long-term investment success in this sector.

Whilst some fund sponsors have chosen to set up specialist investment bodies for these assets, others have taken the approach of balancing development opportunities with operating assets.

Geographical focus

Understanding local economic, regulatory and taxation environments is important in any deal process. However it is of critical importance in current times with market dislocation leading to differing approaches across Europe.

With trading environments changing rapidly, ensuring teams contain local sector specialists is paramount.

Our approach and experience

PwC brings an unparalleled combination of global industry expertise and infrastructure deal experience to our clients. We have specialist pan-European Energy & Utilities, Waste & Renewables and Transport teams, together with a transaction modelling team which specialises in developing and reviewing financial models to assess operational cashflows and transaction financing.

Talking point

"Clearly, for all acquisitions, understanding the sector is paramount to deal success. However, with the current economic uncertainties, understanding the susceptibility of a particular asset to changing market conditions could make the difference between deal success and sub-optimal post-deal returns. One particular challenge is understanding the regulatory environment of a specific asset. This will determine investors' abilities to recover through tariffs/prices the impact of increasing finance costs or commodity fluctuations."

Sector specific issues – Public-private partnerships

The primary PFI/PPP market is currently adapting to the impact of the 'credit crunch', in particular the impact of:

- Reduced liquidity;
- Increased cost of debt; and
- Lack of capital markets and monoline insurance.

Whilst infrastructure remains an active market and transactions are still progressing, this financial turmoil has translated into deals generally being financed with more conservative funding structures (cover ratios, margins and fees) primarily through the commercial debt markets. Deals are being closed on a bank club basis with little evidence of a general syndication market.

There is some evidence that unwrapped bonds and private placements may become a more mainstream funding option (there have been only a handful of such transactions to date). Historically PFI/PPP transactions were rated low investment grade at BBB or BBB- (S&P). Given there is limited market for this type of paper it is uncertain the extent to which both commercial (e.g. level of security and risk transfer) and financial structures (e.g. gearing) will need to change.

The secondary market has continued to be active with material acquisitions/disposals and new funds established. However some of the financial issues described above are impacting on the performance of closed projects, for example the downgrading of monoline insurers can trigger increased debt margins.

Talking point

“One key element of executing successful deals in the PPP space is in appropriately identifying potential for value enhancement within PPP projects, together with understanding the principle threats to achieving base case returns. With achieving material value enhancements more challenging in the current climate (with limited opportunities to financially engineer assets), investors will need to acutely consider the likelihood and impact of downside scenarios.”

Our approach and experience

PwC's PFI specific valuation services provide an informed, expert judgement backed by deep industry knowledge. Requirements for a valuation can range from weighing up investment opportunities to agreeing valuations with tax authorities and passing takeover or transfer pricing guidance. With valuations being controversial and subjective, independent opinions will have to stand up to external scrutiny. In the PFI/PPP sector, PwC provide valuation opinions on the only two PFI funds listed on the LSE:

- HSBC Infrastructure Company; and
- Babcock and Brown Public Partnerships

We have also provided private opinions on valuations on a number of engagements both to help investors understand the potential value of their investments and as part of an acquisition or disposal.

PwC's Structuring team can help clients to identify the principal concerns that will determine the right structure for a transaction and assists in marshalling the complex range of factors including tax, legal, accounting and regulatory issues that will need to be considered together. They advise on a comprehensive range of transactions types including: IPOs, PFI/PPP bids, return of cash / value to shareholders, mergers and demergers, refinancing, securitisation and group reorganisations.

01 Strategic decisions

02 Fund set-up & launch

03 Deal origination

04 Deal execution

05 Maximising post deal returns

06 Fund lifecycle management

07 Exit strategy?

‘Downstream’ management & reporting

Over the next few years, the ‘downstream’ elements of infrastructure investing are likely to preoccupy fund managers and investors. Funds which are pro-active in managing their investors’ requirements are likely to generate more confidence in the marketplace.

We consider the four key areas in downstream infrastructure management to be (i) management alignment & engagement, (ii) visibility of performance, (iii) risk mitigation, and (iv) value creation.

Key factors defining how infrastructure funds establish their asset management approach will include:

- The degree of ownership/control over investments
- Regulatory obligations to demonstrate active management of investments
- Reporting requirements to limited partners or shareholders
- Access to asset management resources of parent companies or fund sponsors

Talking point

With the state of the current market, it is imperative that funds develop a robust asset management strategy, with pre-deal planning and post-deal implementation, so that transaction value is first recovered and then exceeded, whilst effective monitoring is maintained at all times.

Our approach and experience

Some of our experience is detailed below:

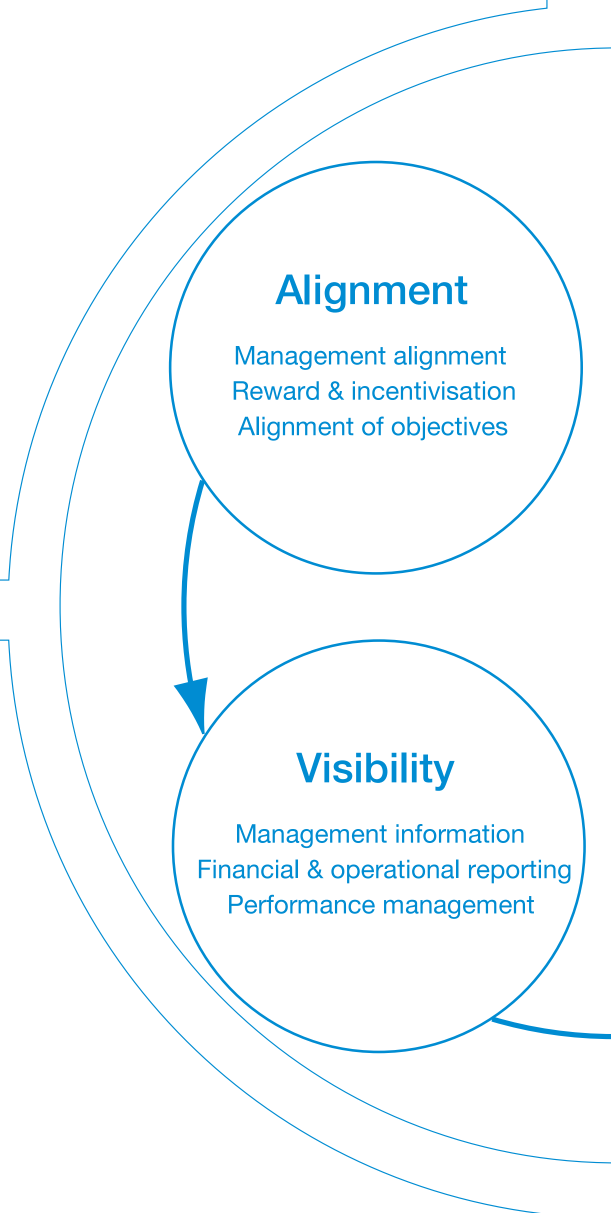
- Telecommunications provider/Telecommunications asset – PwC advised on a plan to take control of and realign the strategy of a recently acquired infrastructure asset, developing a detailed integration process, highlighting key issues, risks and opportunities
- Infrastructure fund/Telecommunications asset – PwC advised on organisational strategy & ran a planning process to ensure that initiatives were supported by clear objectives, plans and ownership
- Infrastructure fund/port assets – PwC supported the business in optimising the finance function, giving increased financial and operational insight to the business and asset managers, improving finance efficiency and organisation, shortening month-end close timescales and re-engineering cash collection
- Rail Operator – PwC worked with the client to formulate asset strategies within budgetary constraints to achieve optimal cost profiles while balancing operational and capital expenditure, operational risk and long-term sustainability of the railway for a period of 20+ years
- Utility Company – A PwC review identified ways of optimising capital efficiency and provided assurance on programme delivery. The review included a critique of delivery mechanisms, project delivery structure, and approaches to project management for their £1.6bn capital programme

Maximising post-deal returns

01 Alignment

Investor challenges

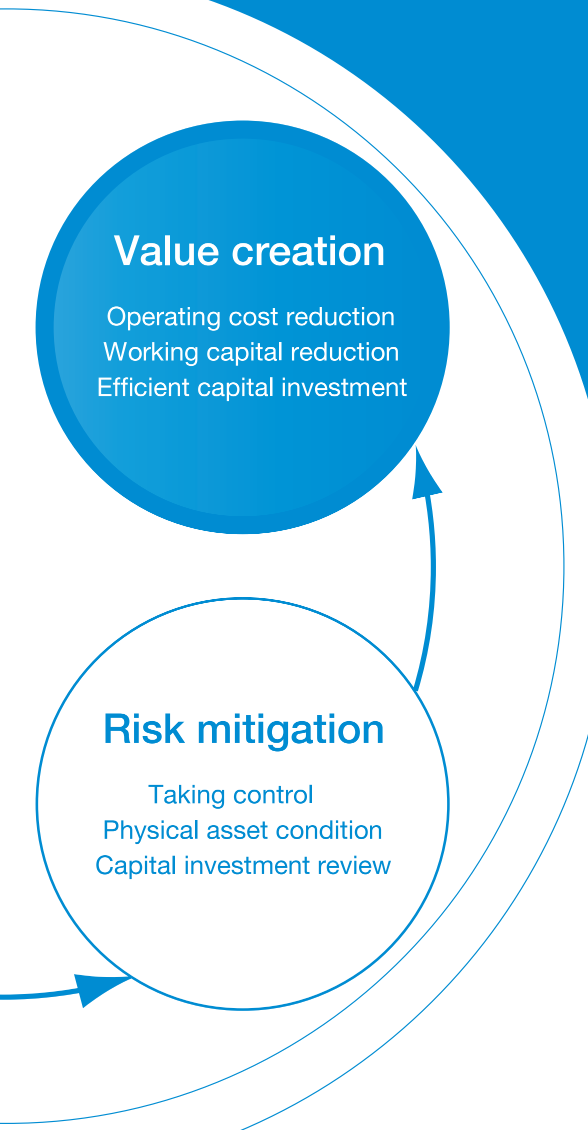
- Alignment of fund managers and business leaders on the business strategy, objectives and budgets
- Defining reward & incentivisation measures that drive performance whilst rewarding good asset stewardship
- Clear & agreed authorities, roles and responsibilities
- Clear and timely communications whilst management and new owners establish longer term plans
- Effective governance and decision making for consortia investments
- Transitioning rapidly to a new ownership, management and organisation structure
- Identifying and developing talent in the organisation



02 Visibility

Investor challenges

- Putting in place the right performance measures according to the business priorities (i.e. cash generation, profitability, tax efficiency)
- Ensuring management information is robust and timely – particularly immediately after the deal
- Ensuring management information meets fund and asset managers' needs
- Comparability across assets/investments
- Investor reporting and compliance with financing arrangements
- Robust budgeting and forecasting: building in challenging but realistic and achievable improvements
- Improving transaction processing to speed up information flow



04 Value Creation

Investor challenges

- Reinvigorating organisations with limited experience of change and a lack of commercial focus
- Working capital reduction and improved cash generation
- Taking advantage of the scale of the fund portfolio (e.g. purchasing, shared services. asset combinations)
- Targeted “buy & build” acquisitions
- Optimising spend on renewal or maintenance of the physical assets – whole-life cost modelling and scenario planning
- Accelerating priority capital projects
- Avoiding cost & time overruns – value leakage, regulatory risk and market perception
- Efficient procurement
- Supply chain re-design and tax efficiency
- Preparing for end-of-lease / handover conditions

03 Risk mitigation

Investor challenges

- Identifying and taking control of significant risks and business critical issues immediately post-completion
- Implementing a robust interim set of controls
- Understanding the underlying physical condition of the assets
- Refocusing capital projects in progress on to the new business objectives
- Proactively engaging with the regulator to understand and address their needs
- Managing the influence of pressure groups and external bodies on the regulatory environment
- Refinancing ahead of schedule

Strategic decisions
01

Fund set-up & launch
02

Deal origination
03

Deal execution
04

Maximising post deal returns
05

Fund lifecycle management
06

Exit strategy?
07

Fund lifecycle management
(i) Ongoing reporting

Effective corporate governance and reporting considerations

Maintaining investor confidence during difficult economic periods is challenging, particularly for funds whose priority to date has been in fundraising and asset accumulation. We explore below some of the key challenges faced by funds, and consider the most effective approach to those challenges.

- Investor reporting – How funds best communicate the impact of current credit market conditions on fund performance and compliance with financing agreements. In the current market, investors will demand more transparent reporting
- Focus on governance frameworks – particularly in relation to internal risk monitoring/compliance and independence of fund managers from the funds. Consistent and well-understood governance policies are key in this respect
- Cash flow forecasts – Demonstrating how portfolio cash flow forecasts (and asset valuations) have adapted to changes in funds' capital costs, also considering the impact of credit uncertainties on the risk profile of portfolio companies
- Information management – Management of information is crucial as key stakeholders are likely to change and existing stakeholders may require more transparency around results

We consider that the biggest area of investor focus is likely to be on corporate governance and investor reporting, particularly with the proposed European Directive on the regulation of Alternative Investment Fund Managers now in the forefront of politicians' minds. With many funds at a relatively early stage in their life cycle, best practice is yet to be solidified in Infrastructure Reporting.

Again, we believe that those funds which develop coherent and consistent management reporting frameworks will be more likely to benefit from the highest levels of investor confidence, and hence be best positioned for future fund raising.

Talking point

Transparent disclosure and regular reporting to infrastructure investors is becoming increasingly important in the current environment. Whilst the performance of infrastructure assets should be somewhat shielded from economic trends due to cashflow stability, any deterioration in the assets' open market values and ongoing performance would require clear communication and explanation to investors to clarify any concerns and retain future fund commitments.

Displaying best practice corporate governance, particularly regarding (i) robust due diligence over investment projects and (ii) timely and effective reporting, has received heightened focus lately, particularly following recent high profile fraud cases in the hedge fund environment. Now, more than ever, funds need to take the opportunity to protect their status in the fund investment world and distinguish themselves through a combination of performance and robust governance.

Fund lifecycle management
(ii) Valuations

Reporting valuations with integrity

Monitoring the ongoing performance of portfolio assets and appropriately reporting portfolio asset valuations back to investors is a key priority for most funds.

We are observing increasing investor, regulatory and accounting pressure for funds to periodically prepare reliable valuations of their assets.

This pressure is particularly acute in the current economic climate where not even infrastructure businesses are insulated from the knock-on effects of the economic slowdown and the pressures in the credit markets. Recent historical trading may no longer be an appropriate benchmark for an ongoing valuation, whilst a shortage of comparable deals will inevitably make establishing an earnings multiple more difficult.

When markets are in turmoil it is of vital importance to maintain investor confidence. Robust and realistic valuations with sufficient disclosures that reflect knowledge of the industry will assist in that process.

Remuneration for managing partners has also recently come under pressure due to lower returns from underperforming assets. When measuring performance based on the value of the investments, periodic independent valuations may be required to justify compensation.

Our approach and experience

Cash flows for infrastructure assets can typically be forecast reliably over a 20-30 year period. We therefore recommend using a discounted cash flow analysis as the primary valuation method, cross-checked against available market multiples.

In relation to cash flow projections, it is important to perform thorough and diligent analysis and discuss extensively, whether and how, the implications of the financial crisis are fully reflected in financial projections.

When determining the discount rate, the typically highly leveraged nature of infrastructure investments puts emphasis on a robust analysis of the expected cost of debt and target gearing ratios for the assets to be valued.

Our infrastructure valuation specialists regularly provide independent valuations and valuation advice for investor communication, financial reporting or management incentive schemes. Our valuation clients include Citi Infrastructure, AMP Capital, RREEF, Arcus and Eiser Infrastructure.

Talking point

“With the complex and often highly regulated nature of infrastructure assets, a deep understanding of the industry and regulatory environments will be required in order to reach an appropriate and reliable valuation.

The combination of a significant decrease in stock market values and a decrease in the number of infrastructure transactions promises to make the valuation process even more challenging.”

Fund lifecycle management
(iii) Refinancing

Refinancing challenges

Funds' ability to refinance infrastructure investments is of particular importance to those who have successfully made investments over the last five years with short-to-medium term acquisition finance.

With costs of debt increasing and facility availability diminishing, there are now relatively few opportunities for funds to benefit through increasing financial terms.

In order to avoid diminishing investor returns through more expensive financing structures, early planning will be vital.

However, whilst the traditional refinancing may be off the table at the moment, consideration should be given to other options to realise value from assets.

In order to sustain future activities and achieve business objectives, portfolio companies will need to consider their existing liquidity sources and assess alternative ways to satisfy liquidity needs. In the short term, this will provide greater visibility of future cash requirements and greater flexibility with stakeholders. In the longer term, it will position companies well when growth returns to the market.

In order to release cash from their asset base, companies need to look beyond working capital and consider ideas such as outsourcing tangible and non-tangible assets, tax payment timing and pension contributions.

Within the UK PFI/PPP market there has long been the principle of sharing refinancing gains with the public authority. Initially the proportions shared between the public and private sector were 30:70 (largely on a voluntary basis) and for a number of years standard contracts have been on a 50:50 basis, however in October 2008 the Government introduced an escalating sharing provision for new transactions with 70:30 sharing of any refinancing gains over £3m.

Our approach and experience

PwC's Structuring team can also provide advice on refinancing. Some of the key refinancings we have advised on include the following:

- BAA – Following its acquisition by a consortium led by Ferrovial, the BAA Group refinanced debt of c.£13billion in August 2008
- Newcastle Airport – Refinancing c.£200m of SPV debt
- Southern Water – Securitisation and refinancing

PwC has also advised on the majority of PFI portfolio refinancings and a number of PPP/PFI type refinancings including the Edinburgh Royal Infirmary, Glasgow Schools, Swindon & Marlborough Hospital and Thales Tornado Training Services where PwC devised the refinancing structure to provide the required return to shareholders.

Strategic decisions
01

Fund set-up & launch
02

Deal origination
03

Deal execution
04

Maximising post deal returns
05

Fund lifecycle management
06

Exit strategy?
07

Exit strategy

There are a number of factors which can lead to funds seeking new equity from investments, which include funds reaching the end of their lifecycle, making strategic decisions to bring in new investors or requiring new equity to pay down debt. Current market conditions may even necessitate forced sales of assets.

In all cases, careful consideration will need to be made to generate most value and manage the sale process most effectively.

A robust exit strategy will allow vendors to maximise returns on the sale of the asset, whilst minimising issues, time required and cost. A tightly controlled sale process will ensure the exit process is streamlined, ensuring minimal disruption to the fund's other operations.

Sale process

A high quality, robust vendor due diligence should highlight the attractions and potential upsides of an asset and at the same time should carefully present any significant issues.

Prospective buyers will often be interested in understanding:

- the reasonableness of assumptions on long-term growth projections
- the impact of the economic downturn on short and medium term forecasts
- other opportunities to drive profit and cashflows
- likely stand-alone operating costs or one-off separation costs

Our approach and experience

PwC can support the Vendor side providing a wide range of services to support the preparation of robust financial and other information required in completing a disposal transaction. Within PwC we have substantial experience in providing such services, both in the Core Infrastructure and PFI/PPP space:

Our recent infrastructure vendor due diligence experience includes the following:

- Gas Natural
- EdF Energy
- Southern Water
- Land Securities Trillium
- Euroports

In the UK we have also undertaken vendor due diligence for the most significant PFI/PPP infrastructure transactions in the market, including:

- the c.£925m sale of the Secondary Market Infrastructure Fund
- the establishment of the c.£1bn Trillium Partners Fund by Land Securities Trillium
- acquisition of the remaining stakes in Infrastructure Investors (I^2) from 3i and Societe Generale
- the current finance raising of a major PFI developer
- the recent disposal of 49.9% of a major closed infrastructure fund with a portfolio of PFI/PPP assets

Our approach

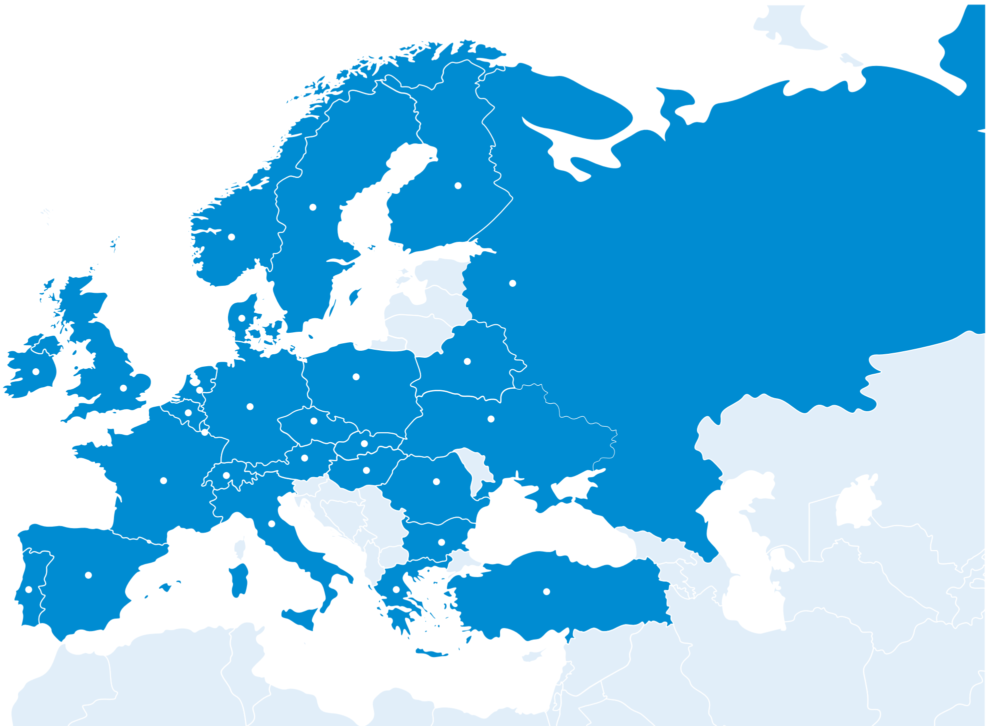
At PwC, we understand the key differences which mark infrastructure investors from the rest of the investment community, and the key issues which face investors and asset managers.

Through working with funds from the inception of infrastructure as a standalone investment class, we have gained a wealth of knowledge and experience which enables us to understand the differing needs and requirements of infrastructure investors, and to work with our clients to optimise fund performance through effective structuring, deal-making and ongoing asset management.

Our core team contains more than 50 specialists operating from London, whose primary focus is working with infrastructure funds across the investment cycle: these range from fund set-up and structuring teams, through to asset management and post-deal optimisation specialists.

Our core infrastructure team is supplemented by the PwC Network, across Europe and beyond, with infrastructure specialists in all major European territories. In doing so, we can ensure that our clients receive a consistency of service, no matter where the target asset or fund location.

PwC European Infrastructure network



UK	Norway
Ireland	Sweden
France	Finland
Germany	Russia
Luxembourg	Czech Republic
Spain	Ukraine
Portugal	Slovakia
Switzerland	Hungary
Italy	Romania
Malta	Bulgaria
Austria	Turkey
Netherlands	Greece
Denmark	Cyprus

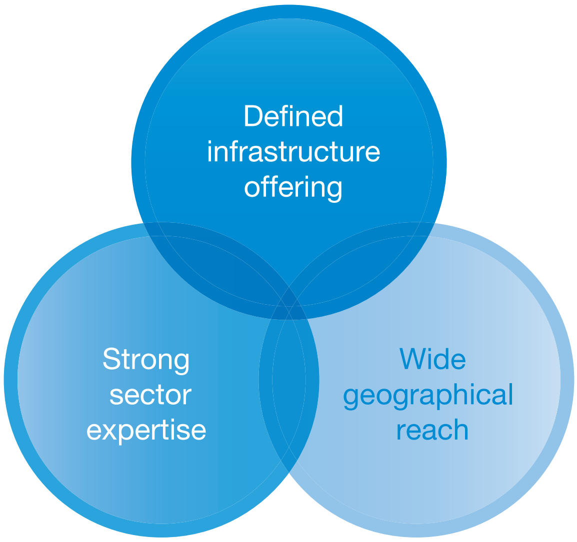
Our approach

Further, by bringing our network together, we are able to provide our clients with early sight of investment opportunities, as well as offering the ability to harness our sector and geographical specialists to give an insight into investment targets or territorial developments.

Inevitably there will be investment successes and failures within the infrastructure sector, which are likely to be exacerbated by current market conditions. We believe that a measured approach to asset management, incorporating careful planning of structuring and investment decisions and post-deal integration and optimisation, will give funds the best chances of exceeding their investment targets.

Our advice to our infrastructure clients is entirely based around helping them achieve long-term success in the marketplace. Whether we are advising on fund's launch and structuring, ongoing transactions or the optimisation of an acquired asset or portfolio, our approach will combine deep product specialism with the benefit of our extensive experience in the infrastructure sector.

The combination of a specific, differentiated approach together with strong sector expertise and wide geographical reach enable us to deliver the best product most efficiently.



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05
Maximising post deal returns

06
Fund lifecycle management

07
Exit strategy?

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Our experience

Roads

UK Highways Agency
Lusoscut Consortium
Eurolink Consortium and Vinci-Hegarty
Essex County Council
Birmingham Highways Management
Cardiff Transport Partnership
Isle of Wight Council
Highway City Management

Airports

Airport Weeze
Budapest Airport
Newcastle Airport
Leeds/Bradford International Airport
Exeter International Airport
Czech Airlines
London City Airport
Airport Plzen Line
Bratislava Airport
Kosice Airport
Newquay Airport
East Midlands and Bournemouth Airports
London Luton Airport
Bristol Airport
Skavsta Airport
Dusseldorf Airport
Cardiff International Airport
Belfast City Airport
London Gatwick Airport

Schools

Birmingham Schools
Glasgow Schools
Building Schools for the Future

Waste – Commercial

Biffa
Cory Waste
Fawley HTI plant
Cleanaway
ERM
SafetyKleen

Energy – Gas

Silverpoint
IEG
Centrica
Transco
East Midlands Pipelines
National Grid
Inexus
Gas Natural

Energy – Electricity

Teeside Power Station
United Utilities Electricity
Airtricity
Northern Star Generation
Westinghouse
Keyspan Inc
Enfield Power Station
Drax Group
Edison Mission
Powergen/E.ON
British Energy
TXU UK Operations
Innogy
Niagara Mohawk Inc
National Grid
Intergen

Accommodation

Addiewell Prison
Fazakerley Prison
MoD Main Building
Colchester Garrison
Allenby Connaught accommodation
Brent Housing

Water

Tbilisi Water
Thames Water
South Staffs Water
Southern Water
Thames Water
Northern Ireland Water Service
Mid Kent Water
Cambridge Water
South East Water
Wessex Water
MOD
Hoogheemraadschap Delftland
Municipality of Sofia
United Utilities

Telecoms

National Grid Wireless
Airwave
Eircom
National Grid PKP
Iceland Telecom
Deutsche Telekom
Eircom

Ports & Ferries

Sokhna Port
Thessaloniki Port
PD Ports
Manuport
Westerlund
Seehafen Rostock
Rauma & Botnia
WCT
Euroports
Condor Ferries
Wight Link
Port of Dover

Healthcare

Dartford and Gravesham hospital
Edinburgh Royal Infirmary
Bromley Hospital
Swindon & Marlborough Hospital
LIFT Schemes (various)

Motorway Services & Car Parks

NCP
Welcome Break

Transport

Docklands Light Railway
London Underground InfraCo
Intercity Express Procurement
Second Severn Crossing
M25
M6 Toll Road

Rail

Department of Transport
Scottish Borders
First Group
Scottish Borders Council
Tie Limited
Transport for London
Docklands Light Rail
London Underground
London & Continental Railways
Surrey County Council
Office of the Rail Regulator
Nottingham City Council
First/Keolis Rail
Porterbrook

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