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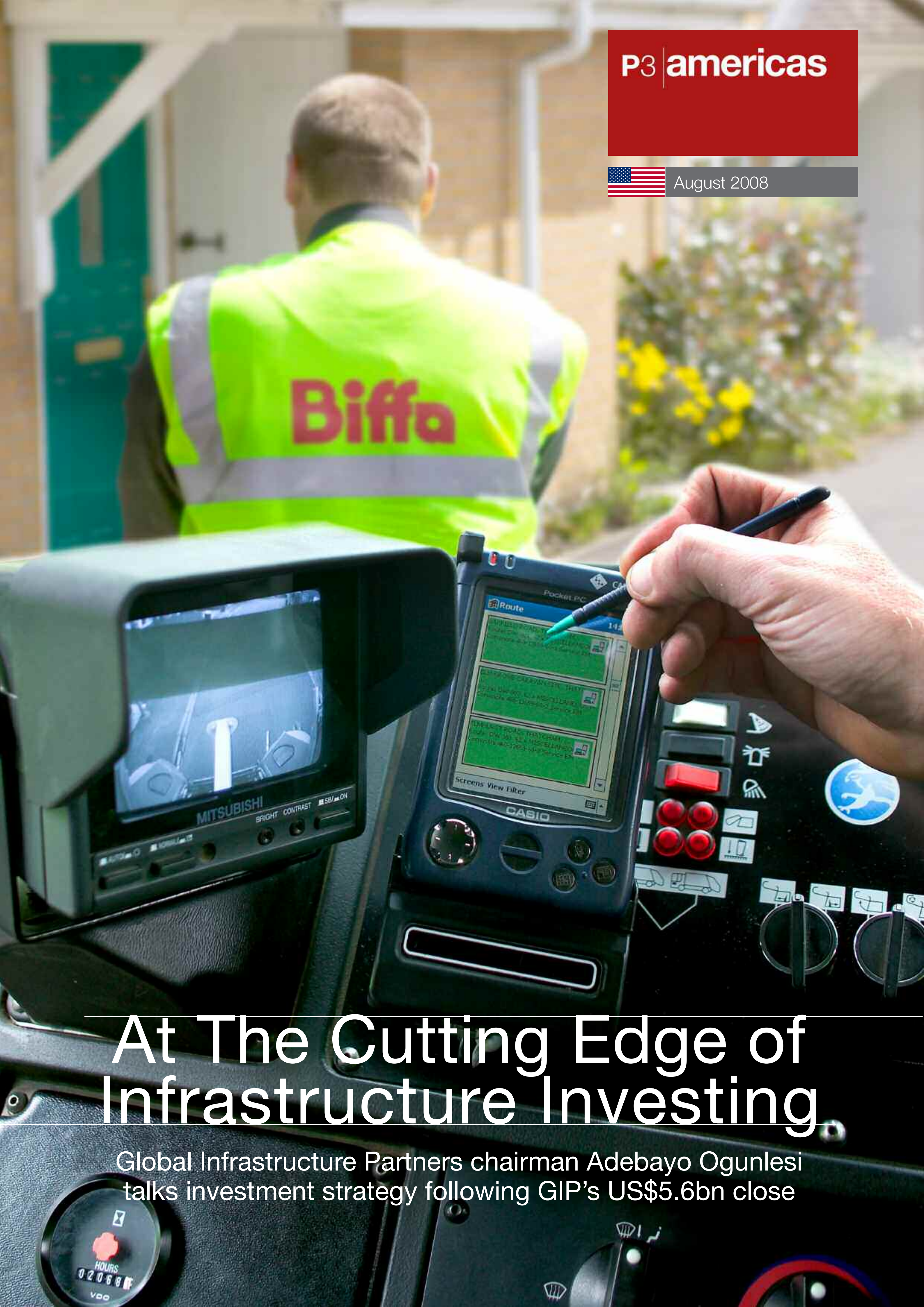

At The Cutting Edge of Infrastructure Investing

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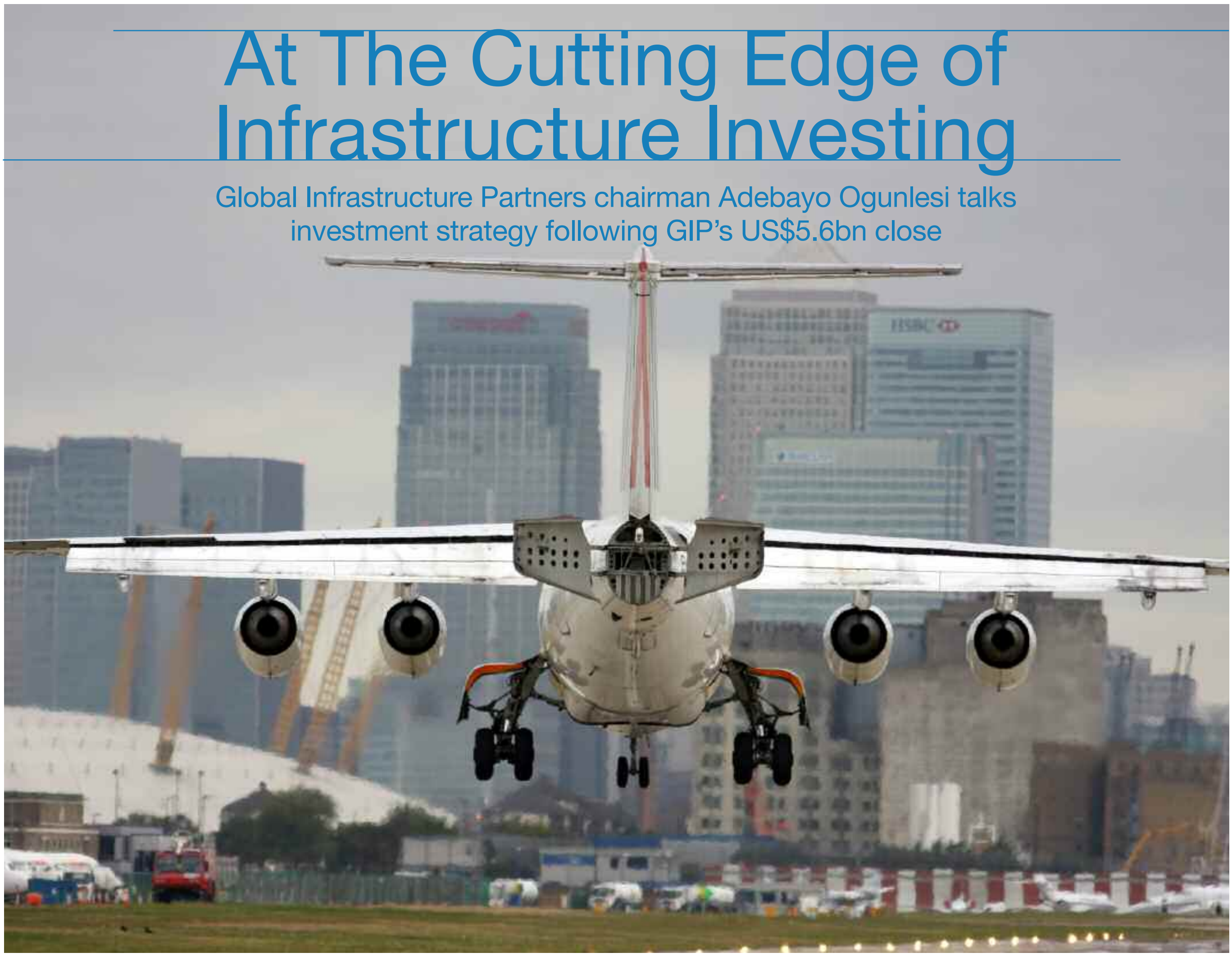


Global Infrastructure Partners (GIP) is following an investment strategy focusing strongly on how best to operate infrastructure assets. It has the fortune of being able to call on the vast experience of one of its founding partners, GE, which has long since been at the cutting edge of best practice in a multitude of industries. Continuing to utilize this experience and make operating improvements at the assets it invests in should stand GIP in good stead as the global economy heads for harder times.

P3Americas managing director Richard Kenton and executive editor Peter Allison met GIP chairman and managing partner Adebayo Ogunlesi at the fund's New York office recently to discuss its investment strategy in more detail.

If one thing separates Global Infrastructure Partners (GIP) from other infrastructure funds, it is its ability to tap into one of world's largest industrial multinationals and lay claim to some of the best operating minds in the business. GIP, whose founding investors are General Electric (GE) and Credit Suisse, closed its first global infrastructure fund in May this year.

Investing in people might sound like a cliché but in a world where infrastructure funds are no longer assured high returns once an asset has been highly geared, the value in investing surely comes from successful asset operation.

GIP's senior executives have a mix of industrial and investment banking experience. However, for Adebayo Ogunlesi, the chairman and managing partner of GIP and the former head of Credit Suisse's global investment banking practice, while good banking skills are important it is the multi-business knowledge and technical capabilities that really matter.

"We don't think the key to being successful in infrastructure is financial engineering", says Ogunlesi. "The real key to being successful has to do with how you manage assets".

Dream Team

Ogunlesi works alongside seven other senior executives including Bill Woodburn, the former president and CEO of GE Infrastructure, the GE business division that includes the firm's water and process technologies unit. It is no coincidence therefore that water is a key target investment area for GIP alongside waste, energy and transportation. And it is no coincidence either that GE has significant domain knowledge in two of the other three areas. In energy, the firm is the largest manufacturer of turbines for power plants, a manufacturer of wind energy systems as well as being active in the oil and gas sector. In transportation, GE is the largest global lessor of aircraft through its GE Commercial Aviation Services (GECAS) business, and an aircraft engine manufacturer through GE Aviation. It also manufactures locomotives for freight and passenger rail applications. GE's water business covers equipment manufacturing including desalination and water treatment in addition to building and operating facilities.

"When you think of three of the four areas in which we want to focus, the ability to tap into GE's technical expertise, operating capabilities and knowledge is something we think is quite unique", says Ogunlesi.

It is easy to reel off the list of capabilities of one the world's largest multinationals but the proof of the pudding is in the eating.

London City Airport

If evidence of GIP's credentials as an operator were needed then the obvious place to look is the UK's London City Airport (LCY), which it acquired jointly with AIG Financial Products (AIG-FP) in late 2006. Since GIP and AIG-FP have been working with the LCY management, the airport has invested over £30m (US$60m) in building four new aircraft parking stands and reconfiguring the departure lounge.

The GIP and AIG-FP team have also focused on turnaround time at the airport, and setting targets for reducing the amount of time aircraft spend at the gates. Cutting turnaround time means the need to spend additional capex on new gates is avoided. "Get the planes out faster and you need fewer gates to service the same number of aircraft," explains Ogunlesi.

The new owners have also paid considerable attention to throughput time for security lines at LCY. Although a relatively small measure, it is things like this which make a difference in improving the overall quality of service.

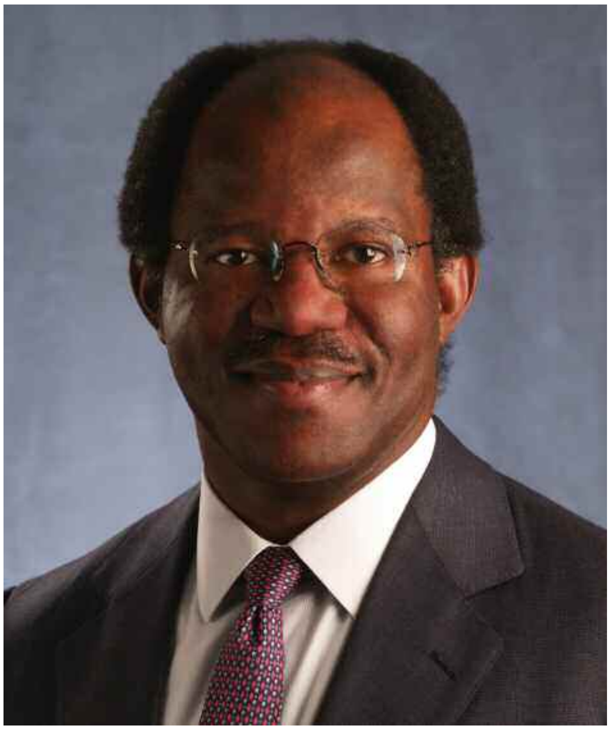
Best Practice

Ogunlesi's verdict is that applying industrial best practices to an infrastructure asset like LCY provides a higher quality service to customers and ultimately translates into improved financial results. "When you think about airports you think about things like touch-time, cycle time and process flow," he says. "All of these are concepts that we are now applying which is second nature to someone who has run industrial and manufacturing plants." Again, it is no coincidence that LCY chief operating officer Scott Stanley, who joined the airport in November last year from GIP with responsibility for its day-to-day operations, has worked for General Motors, GE, Honeywell and United Technologies in operations and supply chain management roles.

In a year when Heathrow's traffic was down and BAA endured the embarrassment of the Terminal Five opening, it comes as no surprise that LCY – in terms of passenger volume – was up almost 30%.

Global Strategic Investment

It is this close attention to running an asset that has helped determine GIP's investment strategy. Ogunlesi says he is relatively agnostic about how the fund is allocated across energy, transportation, water or waste. "We look for good investment opportunities which fall into any of those sectors," he states. However, within those sectors, GIP has adopted a different approach when compared to some of the other infrastructure funds. In



Adebayo Ogunlesi
Chairman, GIP

transportation, for example, it focuses on airports, ports and freight rail. It does not invest in toll roads. The reason for this explains Ogunlesi is that it is questionable whether GIP can achieve its target returns by investing in toll roads, and moreover, there is limited opportunity for making operating improvements. "We don't think there is a tremendous amount of scope to apply industrial practices to a toll road," he states, "and therefore we don't invest in them."

GIP's approach to investing on a geographical basis is similar to its sectoral investment approach. Once again, Ogunlesi says he is agnostic – in the non-committal sense of the word.

The fund has offices in New York, Stamford (Connecticut), London and Hong Kong and is set to open one in Delhi. However, Ogunlesi says GIP will look at investing in any country – within limits – in both developed and emerging markets. "We deliberately set the fund up to look at things on a global basis," he says. Where to deploy capital for him is a function of the climate and environment for infrastructure investing and whether GIP can find good companies and assets that give it scope to improve operations. To date, the fund has successfully invested in countries as diverse as the US, UK, Argentina and India (see box).

GIP's preference for investing primarily in operating companies and assets is likely to mean that it invests more in developed markets than in emerging ones such as China, India or Brazil where opportunities tend to be greenfield rather than brownfield, although Ogunlesi says the fund will continue to look at options in these markets.

CLOSING A US$5BN+ INFRA FUND

Closing a sizeable infrastructure fund in what is clearly a difficult financial environment is no mean feat. However, GIP pulled it off in May when it announced close of its first global infrastructure fund with total commitments of US$5.64bn.

The two founding investors, Credit Suisse and GE, each committed US$500m to the fund and were able to get almost 100 institutions from 26 countries to join them. Investors in GIP include unions, public and private pension funds, sovereign wealth funds, corporates, insurance companies, foundations, universities, asset managers and a number of high net worth individuals. This last category accounts for approximately 7% of the fund.

The highly successful fundraising shows a number of things according to Ogunlesi not least that infrastructure is starting to become accepted as a distinct asset class

A total 40% of the fund's commitments came from US institutions – the largest single country. "When you consider that the Canadians, Australians and Europeans understood infrastructure long before US institutions did, it is something of a surprise," says Ogunlesi. "We also think it is quite encouraging."

In addition to LCY and Biffa, GIP's acquisitions to date include global port investor International Port Holdings (IPH) and East India Petroleum Ltd. (EIPL). Investments made through IPH include Great Yarmouth Port in the UK, a container terminal – also at Great Yarmouth in a joint venture with PSA International, and Argentinean container terminal, logistics and warehousing business International Trade Logistics (ITL).

In June, the fund acquired the 830MW natural gas-fired Channelview cogeneration facility in Houston, Texas for a consideration of US$500m in conjunction with Fortistar. The plant, which has been operational since 2002, sells steam and a portion of its electric output under long-term contracts with Equistar Chemicals, one of the world's largest polymers, petrochemicals and fuels companies.

The UK is King

In terms of geographical exposure, the UK is currently the largest single market for GIP. Between LCY, waste management company Biffa which it acquired earlier this year in conjunction with Montagu Private Equity, and Great Yarmouth Port acquired in 2007, the fund has in excess of £1bn (US$2bn) invested in the UK.

For GIP, the opportunity presented by Biffa is helping the management run the company better by providing higher quality service to its customers. Biffa provides waste collection, treatment, recycling and disposal services to around 75,000 UK customers in the industrial, commercial and municipal sectors. It is also one of the top three landfill operators in the UK.

In line with its strategy of following industrial best practice, GIP brought in the experienced Andre Horbach as CEO last month – formerly with a wind energy company and 19 years at GE. Horbach succeeded Bill Woodburn, who recruited him and had been acting CEO of Biffa since April.

Ogunlesi is confident that GIP will find other investment opportunities in the UK, including any that might arise from a possible break-up of BAA's portfolio. "Any of the airports that BAA may divest would certainly be something we'd want to look at," he confirms.

EMEA – Limited Potential?

Elsewhere in Europe, Ogunlesi anticipates GIP will make investments in the next year or so. He is cautious about the Middle East despite talk of an emerging infrastructure market. On the positive side, the need for operating and technical experience to run assets plays to GIP's strengths and gives it an advantage. "The issue in the Middle East is not capital," states Ogunlesi. "What they are looking for is operating capability".

However, the downside is that many of the opportunities are greenfield which does not fit with GIP's investment strategy. In water and wastewater, for example, an area which requires hundreds of billions of dollars of investment, the need is for new facilities. "We would love to own a desalination plant or water treatment plant in the Middle East," says Ogunlesi, "but many of the opportunities are greenfield."

Energy not Roads in the US

Where Ogunlesi does see opportunities, however, is in the US. GIP's focus there is the energy sector, which has a long history of private sector involvement.

The fund sees more opportunities in US private-to-private transactions than with public-to-privates. "The US energy sector has always been majority private," says Ogunlesi. "Utilities are mostly investor owned and most of the oil and gas infrastructure and power generation assets are in private hands."

The opposite is true of the transportation sector where the majority of roads, bridges, ports and airports are owned by state and municipal governments.

Ogunlesi recognizes the huge requirement for investment in the US transportation sector but raises the concern that private sector involvement in some aspects of infrastructure has not been as welcome as it could have been. Governor Ed Rendell and the state legislature are still to agree a way forward for the Pennsylvania Turnpike concession and Texas ran into political opposition last year for its P3 toll road program. In these cases, the sale or lease of a state asset is as much a political as it is a financial decision. That said, Ogunlesi thinks deal-flow will eventually come. "I'm not smart enough to know how soon that eventuality is, but my suspicion is that it may happen slower than most people expect."

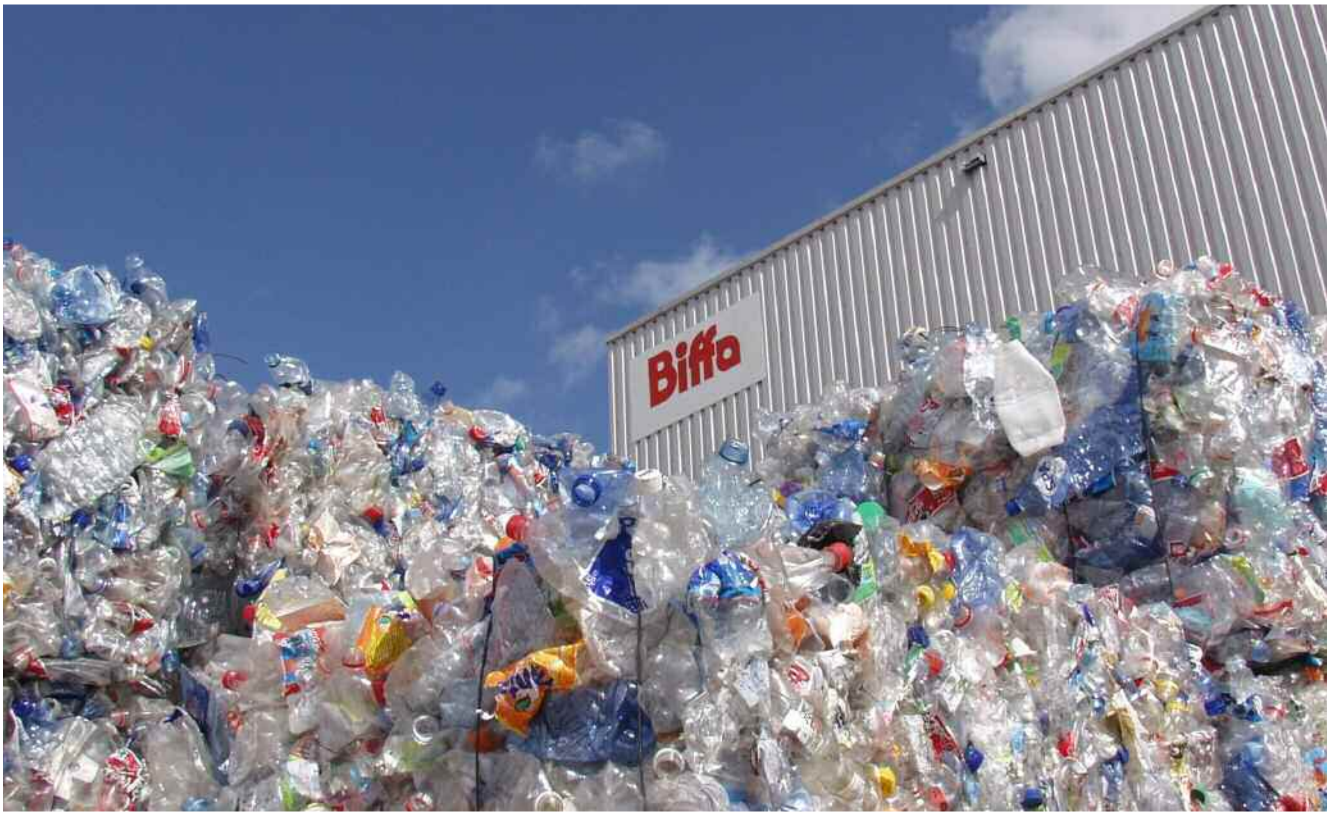
While toll road and bridge P3s have moved slowly, energy has been huge. "Energy-based funds have not been short of investment opportunities," states Ogunlesi. "In the last two years there have been between US$30bn and US$40bn of transactions, maybe even more." GIP is particularly attracted to the US electric sector, says Ogunlesi. In June, the fund announced that it was acquiring a cogeneration power plant in Houston, Texas. The 830MW plant has long-term contracts to supply steam and electric power to one of the world's largest chemical companies.

Problems of US Airport Investing

It might seem odd at first that an infrastructure fund which owns an airport is not featuring in the competitive process for the long-term lease of Chicago's Midway Airport.

However, taken in the context of GIP's view of the wider US transportation sector it comes as no surprise.

Again, Ogunlesi recognizes the need for investment in US airports and the lack of money in the public sector but says the problem is down to how the industry is structured. There is a huge demand for investment, but



US airports are different from European or Australian ones which have actively involved the private sector. In the US, the airlines often own the terminal buildings at an airport. "Unlike LCY where we bought the runway and the terminal, buying a US airport is different in terms of how the economics work," says Ogunlesi.

The Cause of Nightmares?

The biggest fear for any infrastructure investor right now is the global economic downturn and GIP is no exception.

Ogunlesi's overriding concern is stagflation – the toxic combination of inflation with slow or negative economic growth. He acknowledges that the fund's assets are not immune to what happens in the global economy but they are nevertheless well equipped to weather the coming storm. GIP's conservative approach to financing the assets it invests in means it should be well positioned to ride out tough economic times. LCY is financed with an almost equivalent sum of debt and equity; it was acquired for around £770m (US$1.54bn) with the investors contributing £370m (US$740m) of equity and borrowing £400m (US$800m). To fund the £1.7bn (US$3.4bn) Biffa acquisition, GIP, Montagu Private Equity and their partners invested £700m (US$1.4bn) and borrowed £1bn (US$2bn). "Those are the only two investments we have made that have any debt financing," says Ogunlesi, "everything else is all equity."

Given LCY's customer base, GIP is naturally sensitive to a downturn in the financial services industry or companies in this sector moving out of London to the Middle East or Asia. Ogunlesi's view, however, is that this is just part of the curve that any long-term investor must contend with. "We think LCY survives the downturn because of the value proposition it presents to airport users and passengers as well as airlines" he states. Ogunlesi is equally optimistic about the waste sector, which he says is less affected by recession and should continue to grow with population. "The story is the same for all of these assets," he says, "if you finance them conservatively, focus on improving operations and the quality of service to customers, and hold them, you go through the downturn and come back on the upturn."

Downturn or upturn, GIP is already featuring as a prominent infrastructure investor and is set to do so in the next few years. Its attention to industry best practice in managing assets as well as the nature of the fund – it is a 10-year fund – means that it will be an active investor. It is a different philosophy than adopted by other funds in the infrastructure space and the test of its success in delivering value will come when it starts to contemplate an exit from assets like LCY.

One suspects that investors in the fund will not be disappointed.

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