



Financing Infrastructure in Asia:

Mezzanine Capital

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AMCG Partners

Mobilizing global capital for Asia's most promising companies

The 5th Annual
infrastructure
INVESTMENT WORLD
ASIA



➤ **Independent Specialist Mezzanine Capital Fund Manager focused solely on Asia:**

Direct investment firm comprised of a team of former credit-oriented ex-bankers, private equity practitioners and businessmen. Currently manage the Asia Strategic Capital Fund, L.P., a pan-Asian direct investment fund.

➤ **Pioneered Mezzanine Capital in Asia:** Certain senior members founded and managed the first mezzanine fund for Asia, the US\$246 million Asian Infrastructure Mezzanine Capital Fund, sponsored by Prudential Financial and the Asian Development Bank.

➤ **Strategic Financial Partner for medium sized companies and PE funds:**

Help fund major capex programs/projects, mergers, acquisitions, restructurings and recaps and buyouts with non-controlling capital.

➤ **Active investor in today's markets:** Actively investing mezzanine capital throughout Asia

➤ **Targeting Infrastructure and Infrastructure-related investments** Infrastructure development and investment companies, and infrastructure-related business

Strategic Partners:



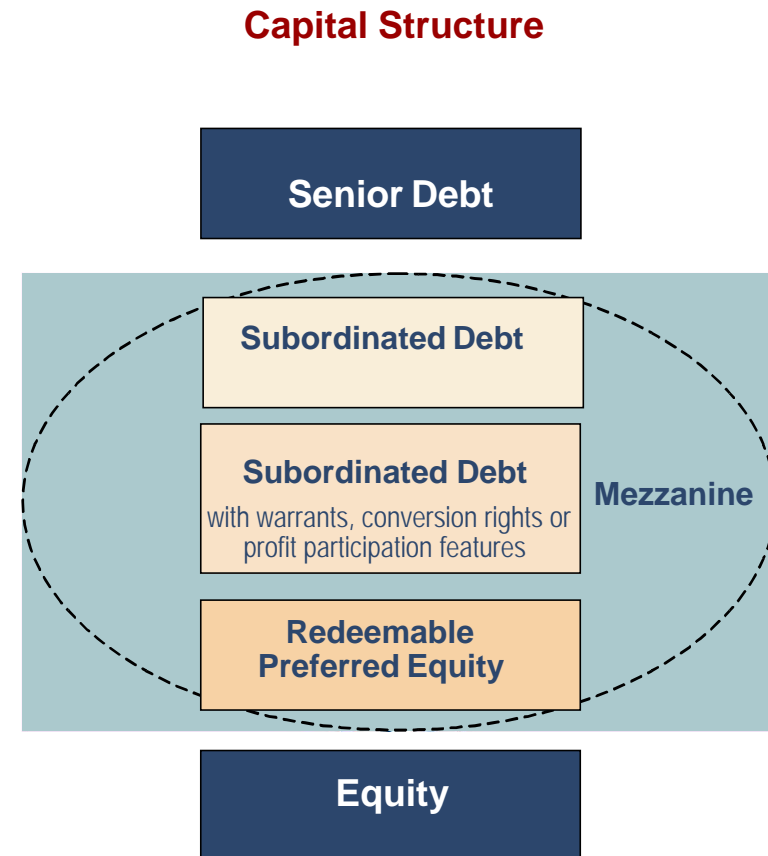


- 1. What are the key features of “Mezzanine Capital” ?**
- 2. What role can mezzanine capital play in financing Infrastructure Projects and Developers ?**
- 3. Is there a rationale for mezzanine capital investing by Institutional Investors ?**



“Mezzanine 101”:

- Capital layer between senior debt and equity in capital structure of a project or a company
- Long term source of largely subordinated risk capital with debt repayment characteristics
- Senior lenders and banks generally treat mezzanine as part of equity
- Flexible amortization and interest payments
- Cost between that of senior debt and equity
- If well structured, mezzanine can lower average cost of capital and improve the returns of existing shareholders of a project or company
- As provider of risk capital, the mezzanine lender/investor shares in a company's financial success but without major dilution of existing equity





Typically 2 components:

Debt Component



Equity Component

(downside risk exposure)

- Long-term loans with a 5–12 year final maturity that are generally subordinated
- Usually a fixed interest rate
- Base coupons generally at higher rates than senior debt
- Possibility of rolled up interest (partial)
- Other terms and conditions typically include (a) security (usually second liens on assets/pledge of shares) and (b) covenant protection, some of which resemble bank covenants

(participation in the upside)

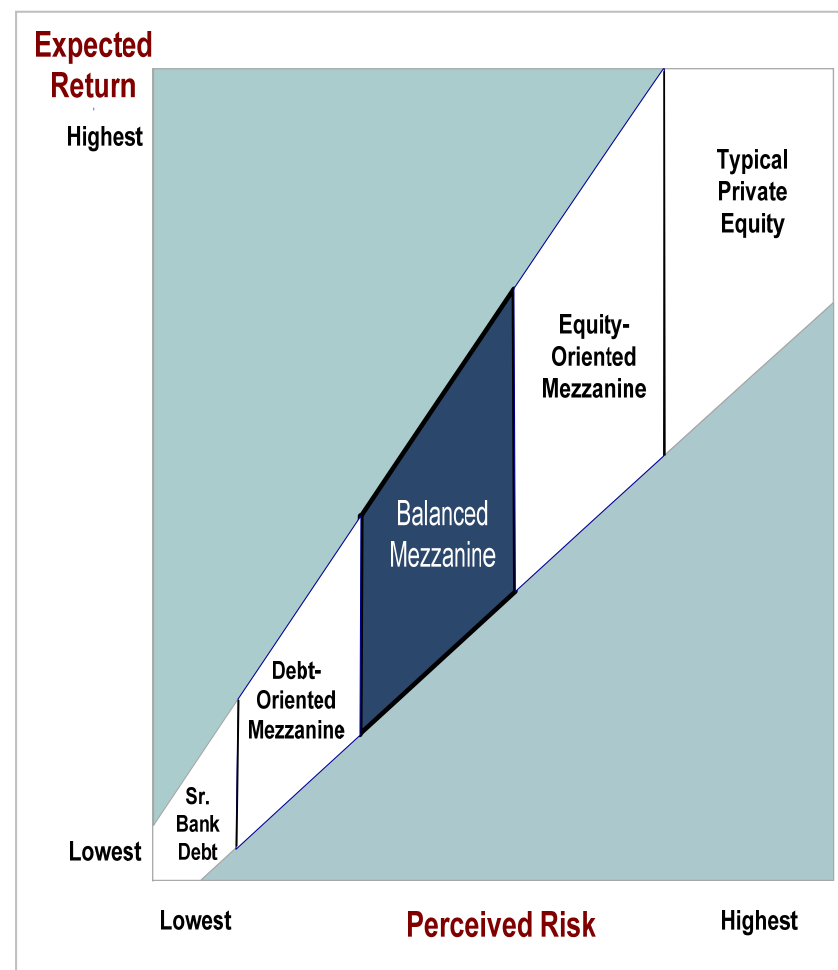
- Upside participation via equity kickers in the form of warrants, profit participation, conversion features or additional interest linked to key operational variables
- Exit through sale in IPO in local or international markets or to a strategic investor (via the exercise of drag and tag rights)
- Alternative exit structured via redemption features, prepayment premiums and/or put options

Types of Mezzanine Capital:
Debt-Oriented vs. "Balanced" vs. Equity-Oriented



Many types with different terms and conditions:

	Debt-Oriented Mezzanine	Balanced Mezzanine	Equity-Oriented Mezzanine
Risk	▲	▲▲	▲▲▲+
Cost	Lowest (but might not be available)	Generally mid-way between senior debt and equity	High
Dilution	None	Moderate	High
Typical Structure	Subordinated debt	Subordinated debt with equity kicker	Convertible preferred equity, or redeemable preferred equity
Expected Exit	Amortization	Combination of amortization (on debt) and trade sale or IPO (on equity)	Trade sale or IPO; or potentially contractual redemption if unconverted.
Availability (at holdco level)	Usually only for large rated issuers of high yield bonds	Yes (from mezzanine specialists)	Yes (from PE firms & some mezzanine specialists)



Mezzanine Capital Value Propositions for Infrastructure Sponsors:
Acquisitions – Renewable Energy Infrastructure Company Case Study



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Enhance equity IRR via additional leverage at a lower cost of capital than ordinary equity:

	Case 1 Senior & Equity	Case 2 Senior/Mezzanine/Equity
Financing	<i>Amount</i>	<i>Amount</i>
Senior Debt	231.3	219.9
Mezzanine	-	57.7
Equity	129.2	82.9
Total	360.5	360.5
Structure	<i>Percent</i>	<i>Percent</i>
Senior Debt	64%	61%
Mezzanine	0%	16%
Equity	36%	23%
Total	100%	100%
Multiple of EBITDA *		
Senior Debt/EBITDA	3.6	3.4
Mezzanine/EBITDA	0.0	1.2
Equity/EBITDA	2.6	1.7
Total / EBITDA	6.2	6.2
IRR		
Senior – swapped	7.0%	6.75%
Mezzanine	N/A	19.0%
Equity	26.8%	30.1%

Reduce cash equity required

Alternatively, enable a higher bid price at a preserved IRR
26.8% = \$ 383.2

* Trailing 12-month EBITDA

Enhance equity returns

Improve terms of senior debt



Variations on a fundamental theme

tradeoff between debt and equity components, and respective objectives of the investor/issuer

Debt with warrants	Convertible loan	Participating loans	Debt w/ Step-up or deferred interest	Convertible preferred equity
<p>Typically subordinated debt with detached equity warrants</p> <p>Principal is repaid after senior debt is largely or fully repaid</p> <p>Cash coupon</p> <p>Equity warrants can have zero or very low exercise price, and represent least dilutive minority stake in issuer</p> <p>May also have “full” strike price (but inherently more dilutive)</p>	<p>Typically subordinated</p> <p>Principal repaid at maturity, unless conversion occurs (in which case, debt swaps into equity at pre-agreed formula)</p> <p>Inherently more dilutive than debt w/ warrants</p> <p>Most applicable on eve of IPO, or a seed capital PE investor seeking max downside protect</p>	<p>Alternative form of mezzanine</p> <p>Base interest rate plus a performance-linked spread</p> <p>Interest rate linked to net profit, EBITDA, or sometimes sales – easy to “game”</p> <p>No equity</p> <p>Cumbersome to structure in practice</p>	<p>Subordinated debt with large amount of interest deferred (PIK often at final maturity)</p> <p>No equity participation, but potential for high IRR nonetheless</p> <p>Principal repayment is typically back-ended</p> <p>Does not work well for longer term finance (cumulative effect of deferred interest becomes punitive)</p>	<p>Similar to Convertible debt, except that default on a payment does not accelerate other debt, and cannot force an issuer into bankruptcy</p> <p>Essentially a form of “senior equity”</p> <p>Widely used in startup financings – basically it is equity</p>
Direct		Indirect		
Subordinated Debt with Equity Participation			Subordinated Debt	Senior Equity

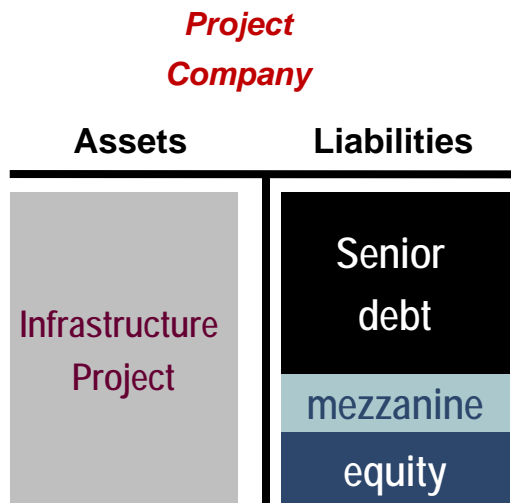


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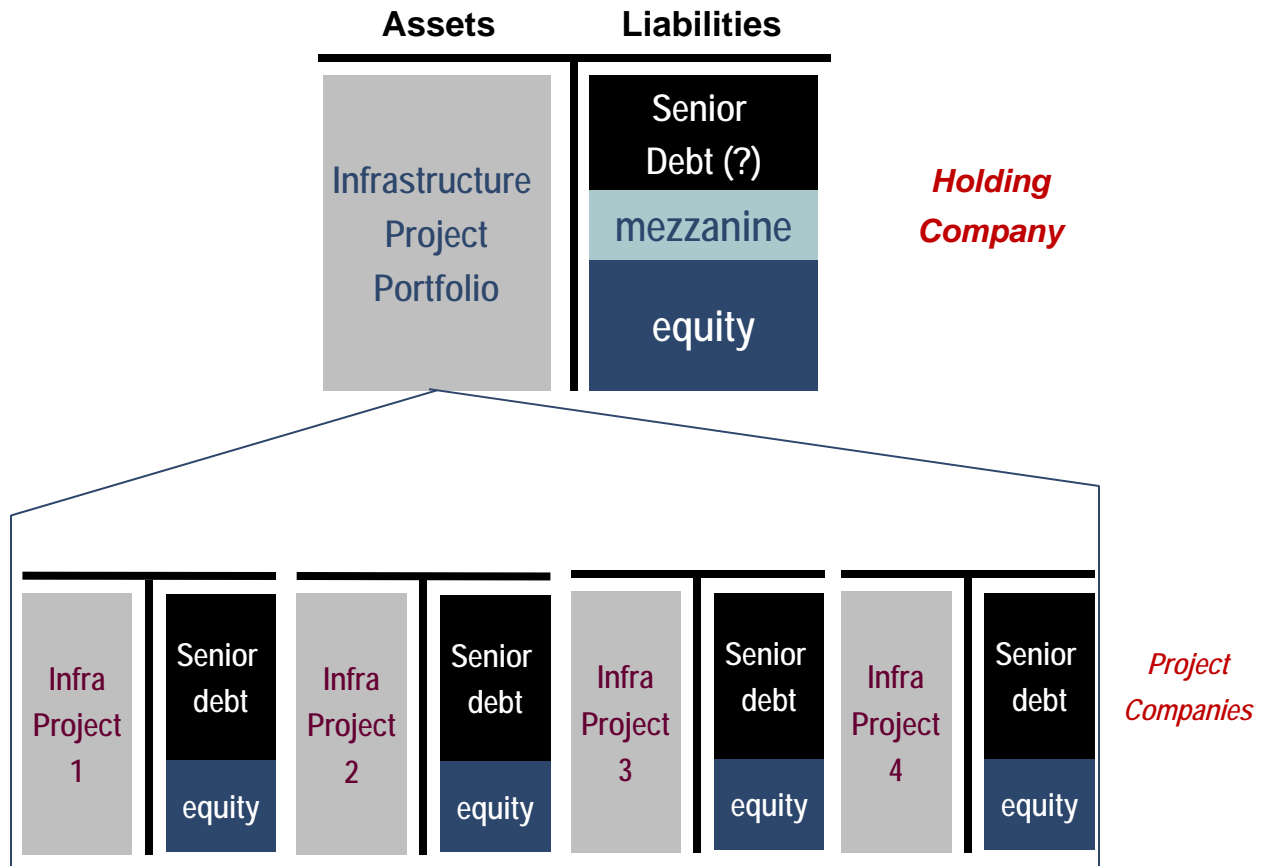


Project Mezzanine or Corporate Mezzanine ?

1. Mezzanine invests at the project level

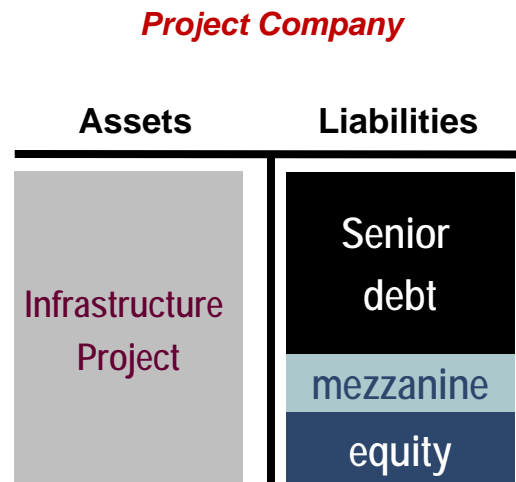


2. Mezzanine invests in the investment holding company





1. Mezzanine into the project



Benefits for the Project Sponsor

- Less equity required (to the extent that mezzanine substitutes for equity)
- No need to share equity upside of overall corporate holding company
- Ability to ring-fence individual assets, without need to grant security interests to other parts of portfolio

Issues / Challenges

- Scarcity of “project-only” mezzanine providers
- How to capture “equity upside” on a single infrastructure project, esp. a finite life BOT?
- Completion risk implications for the subordinated lender
- Lack of diversification (single project risk)

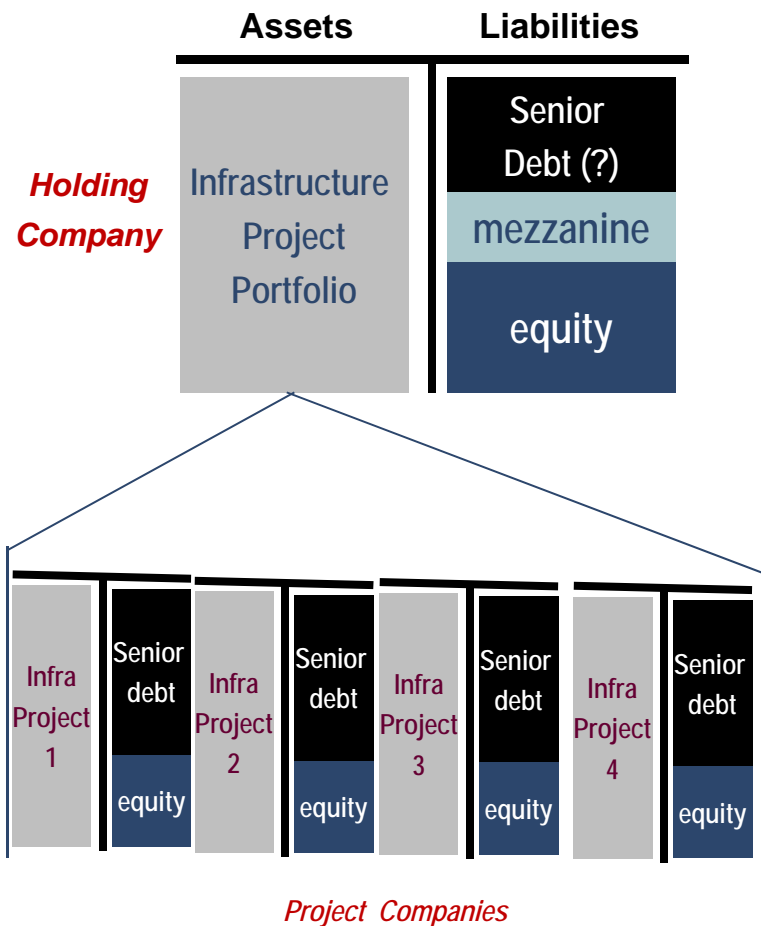
Implications

- Most mezzanine capital is “corporate level” mezzanine

Uses of Mezzanine to Finance Infrastructure:
Project-Level vs. Corporate Level



2. Mezzanine Capital into the investment holding company



Benefits for the Sponsor

- Potential to fund required equity contributions (or subordinated shareholder loan) to projects
 - e.g., statutory limits in China that cap infrastructure financings at 65% debt/capitalization
- Flexibility to deploy proceeds in multiple projects in group
- May play indispensable role in a credit tightening environment when lenders close doors on private sector sponsors (e.g., recently in China) or certain industries & geographies

Issues / Challenges

- Structural subordination to project senior lenders
- Cross border financing requires careful structuring, and has concomitant issues
- Timing of cash flows from onshore to offshore to service mezzanine debt & how to enforce against assets onshore?
- Complex multi-asset portfolio has higher DD requirements

Implications

- Equity kicker needs to be at the holdco level
- Holdco senior likely to be “the mezzanine” (i.e., senior = mezz)
- Mezzanine investor requires adequate return for risks borne

Overall Benefits of Mezzanine Capital to Infrastructure Development & Investment Companies



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1. Mezzanine Capital is a less dilutive form of risk capital

- Allows original shareholders to retain ownership as a result of its higher priority in the capital structure
- Facilitates partnership with strong sponsors and access to a broader and better quality deal flow
- Incentives aligned through tailor-made structures and performance-based pricing

2. Mezzanine Capital is a highly flexible financial instrument that allows for the design of tailor made structures to meet particular needs of companies

- Debt and equity components can be adapted depending on the type of investment opportunity:
 - Lower interest payment and higher equity component in growth plays
 - Higher coupon and lower equity component in stable cash flow and/or value plays
- Flexibility in terms of the type of instrument (sub-debt or preferred stock), security, amortization schedule and payment of interest (cash or PIK)
- Equity kickers in the form of warrants, profit participation features, or additional interest linked to key performance variables (volume, output, etc.)
- Exit via scheduled amortization, prepayment (normally at a premium) or sale to a strategic investor or IPO

3. Mezzanine Capital is generally less costly than other forms of long-term risk capital

- Reduced risk attributes of mezzanine allows it to offer a lower absolute cost of financing compared to private equity
- Potential deductibility of interest can significantly reduce the after-tax cost of debt component
- Equity kicker component linked to performance measures



1. Mezzanine Capital finance of infrastructure growth companies in era of credit tightening
 - Tightening of senior and high yield debt availability
 - Tightening of equity capital availability

2. Infrastructure companies seeking “equity-equivalent” capital at the project (or onshore) level, and willing to accept lower dilution “debt-like” obligation at holding company (offshore) level.
 - Mezzanine Capital at holdco can serve as equity at opco/project level

3. Infrastructure companies that have unexpectedly postponed an IPO, due to adverse market conditions.
 - Mezzanine Capital as replacement for lost IPO proceeds

4. Mezzanine Capital finance of infrastructure company buyout opportunities
 - Opportunities to co-finance management buyouts by qualified management teams



5. Infrastructure companies seeking longer-term financing to better match the longer-term nature of their assets, and replace short-term bank debt with longer-term capital.
 - Substitution of short-term debt with long-term subordinated debt

6. Medium-sized listed infrastructure companies seeking alternative to a secondary offering, due to unfavorable valuations.
 - PIPE structured in mezzanine format for lower dilution impact

7. Restructuring of shareholder ownership among shareholders
 - Companies (or a major shareholder) seeking to finance the repurchase shares from one or more existing shareholders, to optimize shareholder mix



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- **Positive Selection Bias**

With certain types of Mezzanine Capital, the need for periodic interest and principal - servicing capability creates a selection bias towards more stable and resilient industries and companies.

- **Downside Protections**

Mezzanine Capital generally benefits from downside protections based on superior ranking relative to equity, and contractual and other rights that are associated with a debt instrument, including covenants, default rights, and other features.

Contractual payment obligations, even if deeply subordinated or deferred, can provide the Mezzanine Capital investor a stronger negotiation position in the event of a default, and in any subsequent restructuring or recovery effort.

- **Reduced Exit Risk**

Where a Mezzanine Capital investment has amortization prior to final maturity, this reduces the reliance on a liquidity event or major debt refinancing of the borrower for a return of capital.

- **Stable Valuations**

Most types of Mezzanine Capital are comprised principally of debt instruments, which do not normally fluctuate in value compared to equity instruments.

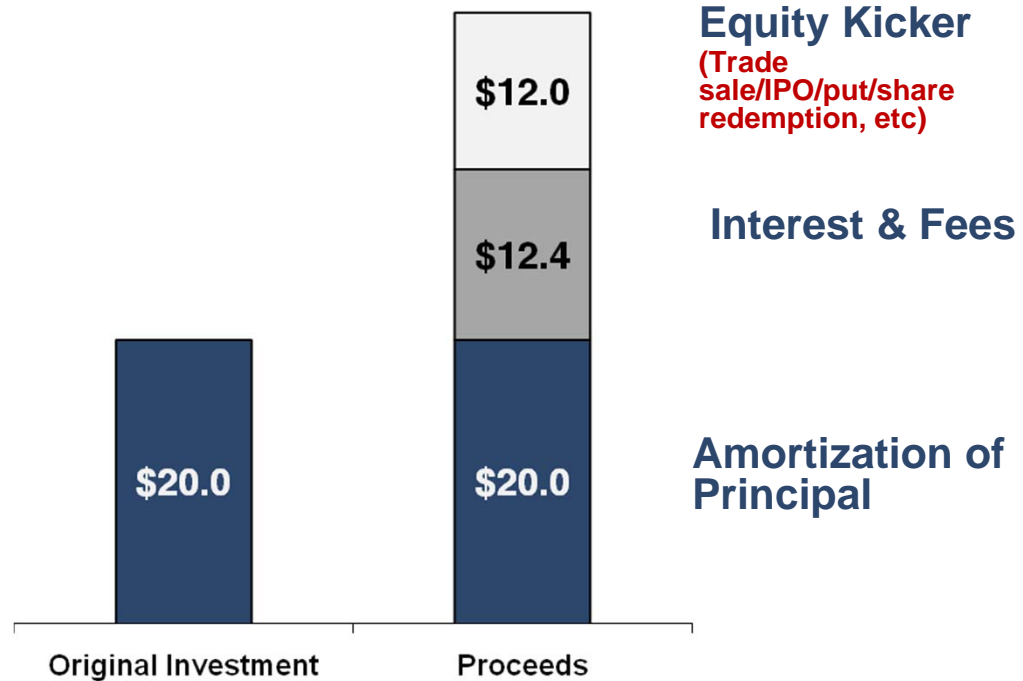
- **Less Correlation with Traditional Asset Classes**

Mezzanine Capital fund performances generally do not correlate with traditional asset classes, which enhances portfolio diversification. Mezzanine Capital has also proven to be less susceptible to economic cycles.



Exit from Mezzanine Capital Investments can be primarily via the cash flows of the Company

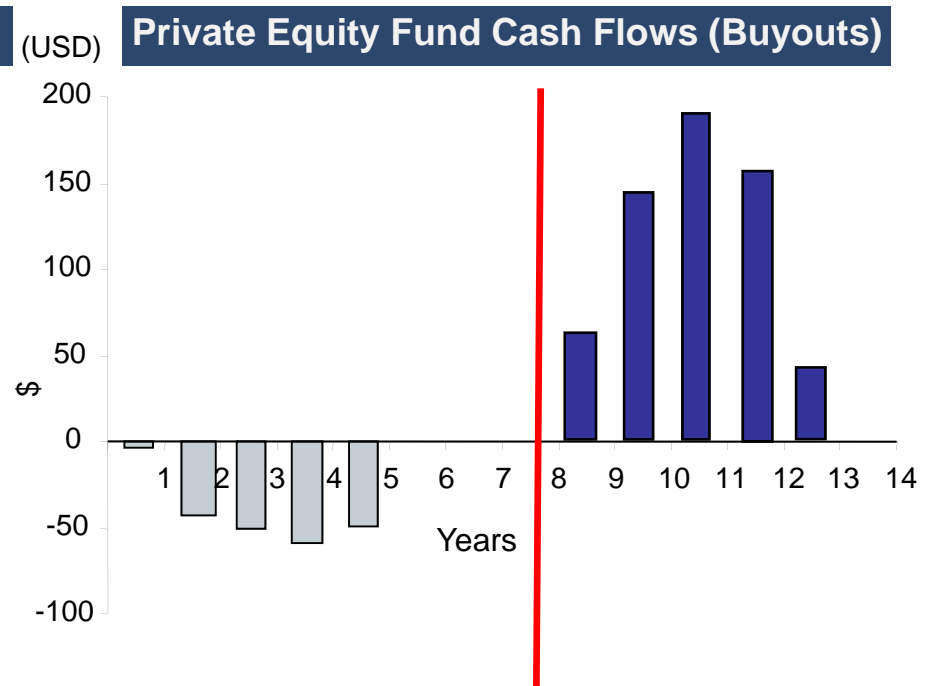
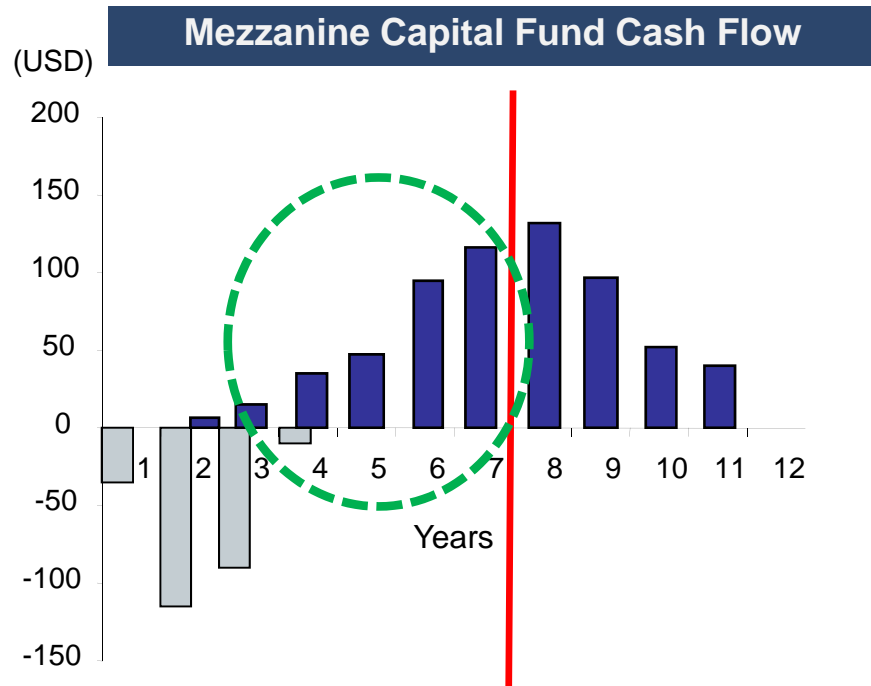
The return on a \$20 million, 6 year investment, with a coupon of 11% p.a., 1.5% fee, and a total IRR of 19% would have the following components:



Mezzanine Value Propositions for Investors:
Proposition 3 – Opportunity for Earlier Returns of Capital



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■ Capital Calls ■ Returns to Investors

Assumes no prepayment prior to maturity

Value Propositions for Mezzanine Investors:

Proposition 4 – Opportunity to Offset J-Curve Impact



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