Infrastructure Investing

An opportunity for plans of all sizes

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KINDLE Capital Management Inc.

HRM PENSION PLAN

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What is Infrastructure?

- Assets characterized by:
  - Relatively stable rates of return
  - Potential for long hold periods
  - Physical "brick and mortar" features
  - High and sustainable barriers to entry (monopolistic assets)
  - Inelastic demand attributes
  - Correlation with economic drivers (GDP, population, employment)
  - Annuity-like with real return characteristics
  - Returns driven primarily by the asset

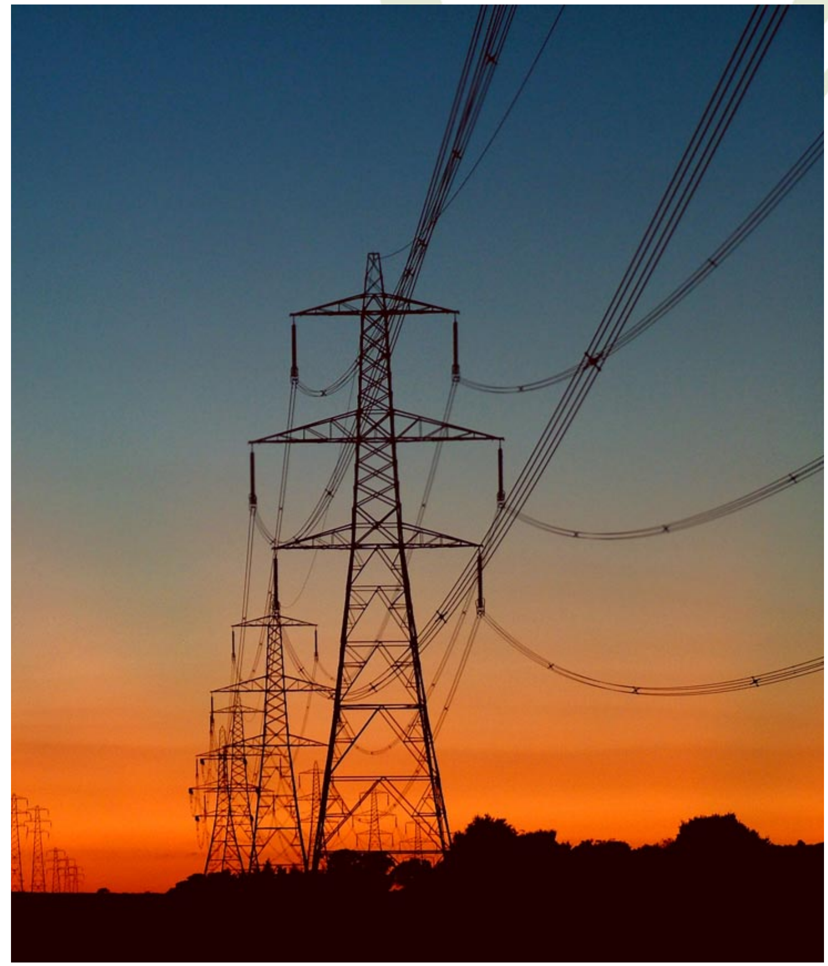
Infrastructure Asset Classes

1. Regulated Assets
2. Transportation Assets
3. Contracted Competitive Assets
4. Social Infrastructure Assets

Infrastructure Asset Classes

1. Regulated Assets

- Natural monopolies with high barriers to entry
- Stable demand
- Revenues based on rate of return
- *Examples: Electricity Transmission & Distribution ("T&D"), Gas T&D, Water Distribution, Collection and Treatment*



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Infrastructure Asset Classes

2. Transportation Assets

- Revenues based on use or availability
- Risks include regulatory pricing, demand, maintenance capital expenditures
- Revenues originate from users or government
- *Examples: Toll Roads, Bridges and Tunnels, Airports, Ports*

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Infrastructure Asset Classes

3. Contracted Competitive Assets

- Underlying assets may be competitive and subject to fluctuating market prices
- Returns stabilized through long-term contracted rates and volumes
- Counterparty and performance risk
- *Examples: Electricity Generation, Midstream Gas*

Infrastructure Asset Classes

4. Social Infrastructure Assets

- Physical assets associated with provision of social good
- Stable cash flows contracted through government
- Revenues based on availability or performance standards
- *Examples: Schools, Hospitals, Prisons, Courts, Nursing Homes, Waste Disposal*

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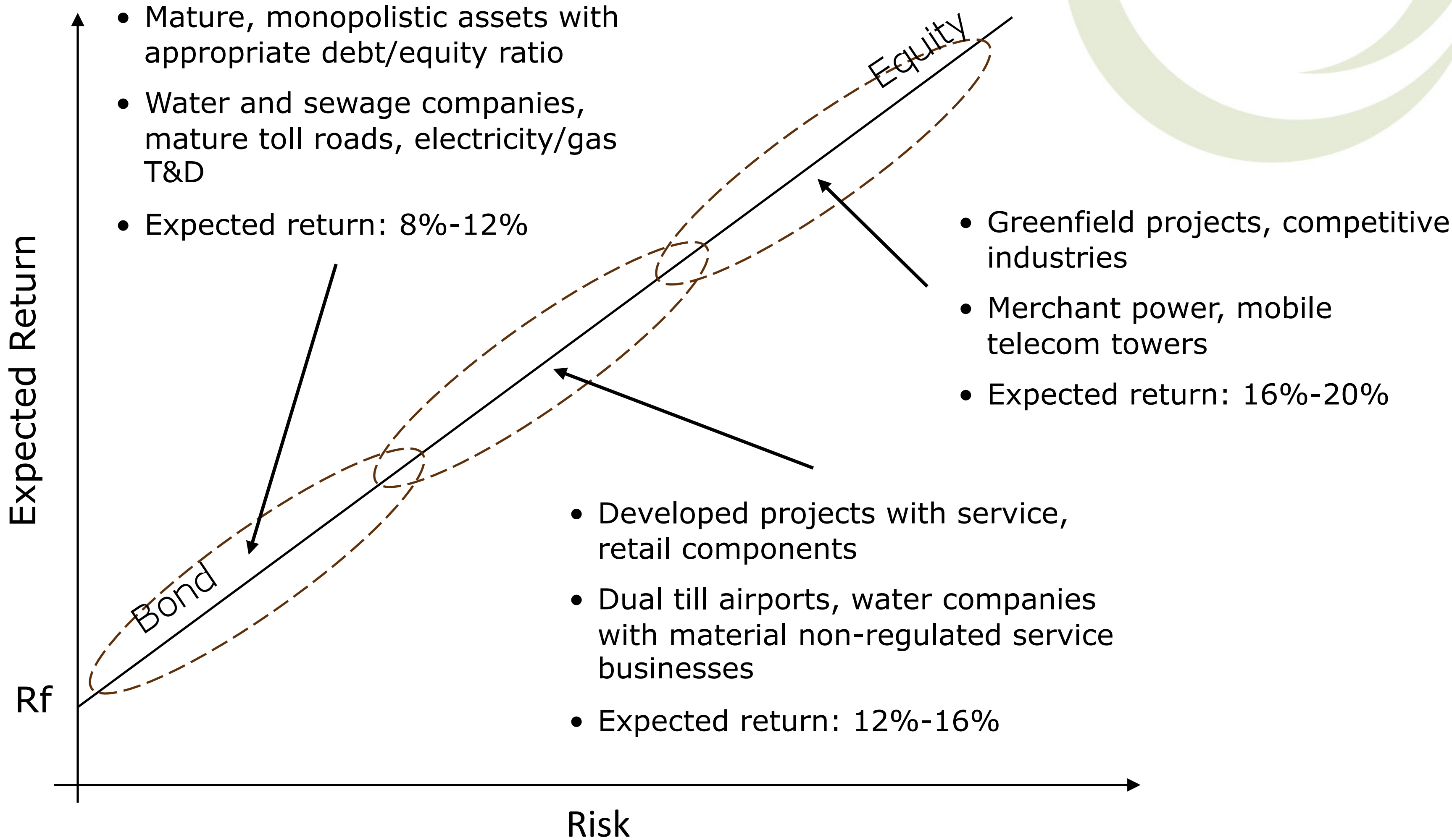
Infrastructure Revenue Models

Revenue Model	Description	Examples
Regulated Rate of Return	• Pricing set by regulator • Pre-determined rate of return for assumed risk	• Gas, water and electricity distribution • Electricity and most gas transmission • Some airports
Availability Based	• Operator enters concession agreement (lease) • Term of 25-75+ years • Revenues are NOT subject to volume risk (use) • Pre-agreed pricing	• Toll roads, bridges and tunnels • Social infrastructure
Patronage Based	• Operator enters concession agreement (lease) • Term of 25-75+ years • Revenues are subject to volume risk (use) • Pricing capped but linked to inflation	• Toll roads, bridges and tunnels • Some airports • Seaports
Competitive	• Revenues subject to open market forces • Subject to volume risk • May sign bi-lateral agreements to reduce risk	• Merchant power generation • Midstream and natural gas storage • Seaports

Risk Return Profile



Infrastructure Returns

Infrastructure Asset	Risk	Expected Return	Expected Cash Yield Component
Utilities			
Water / Waste Water	Low	10-12%	8-10%
Gas Distribution	Low	11-13%	10-11%
Transportation and Logistics			
Toll Roads/Bridges/Tunnels - Brownfield	Low-Med	8-12%	4-8%
Airports	Medium	15-18%	5-10%
Seaports	Medium	15-18%	5-10%
Rail	Med-High	14-18%	8-12%
Toll Roads/Bridges/Tunnels - Greenfield	High	12-20%	3-5%
Power and Energy			
Electricity Transmission & Distribution	Low	11-13%	10-11%
Pipelines Oil & Gas	Medium	12-18%	7-10%
Oil & Gas Storage	Med-High	12-18%	7-10%
Power Generation	High	12-20%	4-12%
Telecommunications			
TV Towers	Med-High	14-18%	7-8%
Cell Phone Towers	High	14-20%	8-10%

Source: Kindle Capital

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The Infrastructure Market

- Market for infrastructure investments is facing two forces:
  - Increasing demand for infrastructure projects from investors
  - Increasing supply of infrastructure projects by governments and private sellers.
- Consequently, the quantity and price of infrastructure deals has increased (decrease in historical returns)
- Increased opportunities in the infrastructure space have been driven by:
  - Pressure on governments to trim debts and budget deficits,
  - Governments attempts to create jobs in the recent recession,
  - Existing infrastructure reaching the end of their useful lives
  - Desire of governments to transfer risks (e.g., design, construction, operations) to investors in the private sector

The Canadian Infrastructure Market

- The majority of Canadian infrastructure is nearing the end of its useful life and has suffered from massive underinvestment over the past 30 years
- Governments at all levels lack the financial resources to finance the required spending
- Current estimates of the infrastructure deficit across Canada range from $50 billion to $125 billion, which **greatly** exceeds Canada's new long term $33 billion infrastructure plan
- This presents a tremendous opportunity for private sector investment

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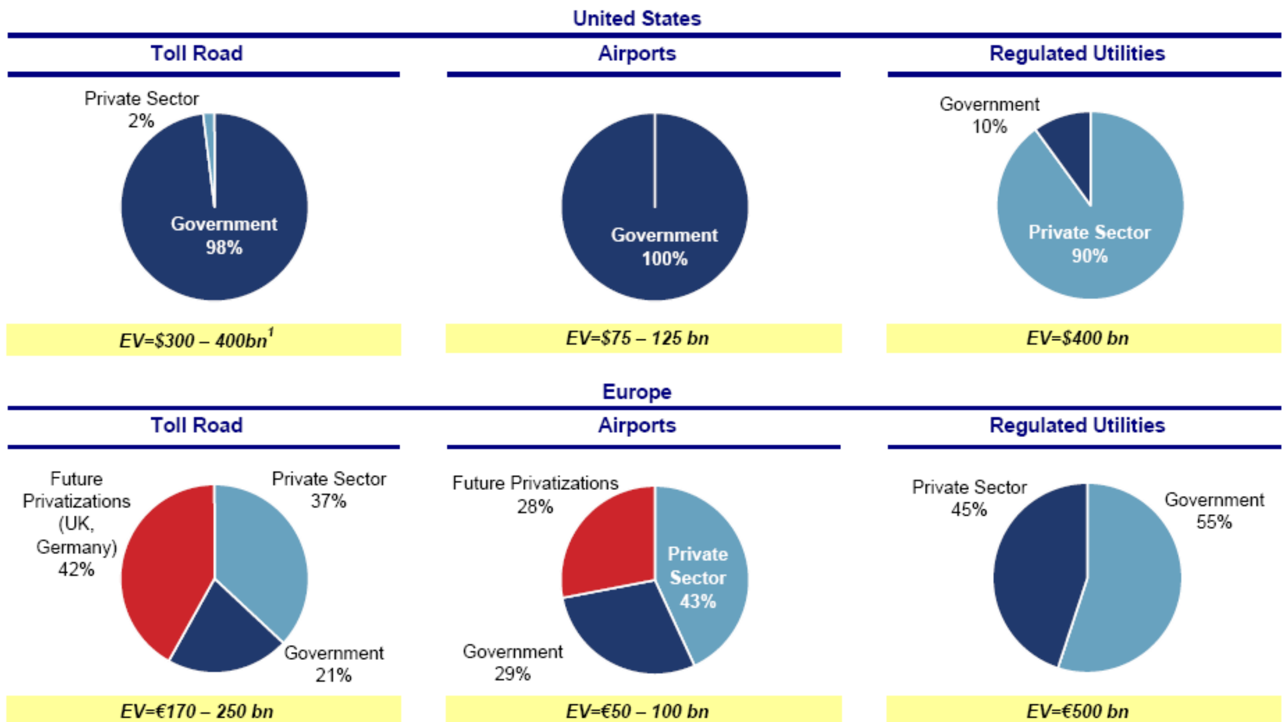
The Infrastructure Market

- Overall, the size of the potential private infrastructure market is enormous



Source: Goldman Sachs

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Why Invest in Infrastructure?

Cash Flow Stability	• Reliable and predictable cash flow streams due to regulated and contracted revenues
Monopolistic Characteristics	• Captive market and high barriers to entry produce more predictable future cash flows
Attractive Risk-Return Profile	• Lower volatility of returns and market risk compared to other asset classes
Duration Match	• Long-term investments are a good fit for institutions with long-term liabilities and limited liquidity requirements
Portfolio Construction	• Low correlation to other asset classes, including global equities and government bonds
Inflation Hedge	• Real return nature of infrastructure investments may provide a hedge against long-term inflation

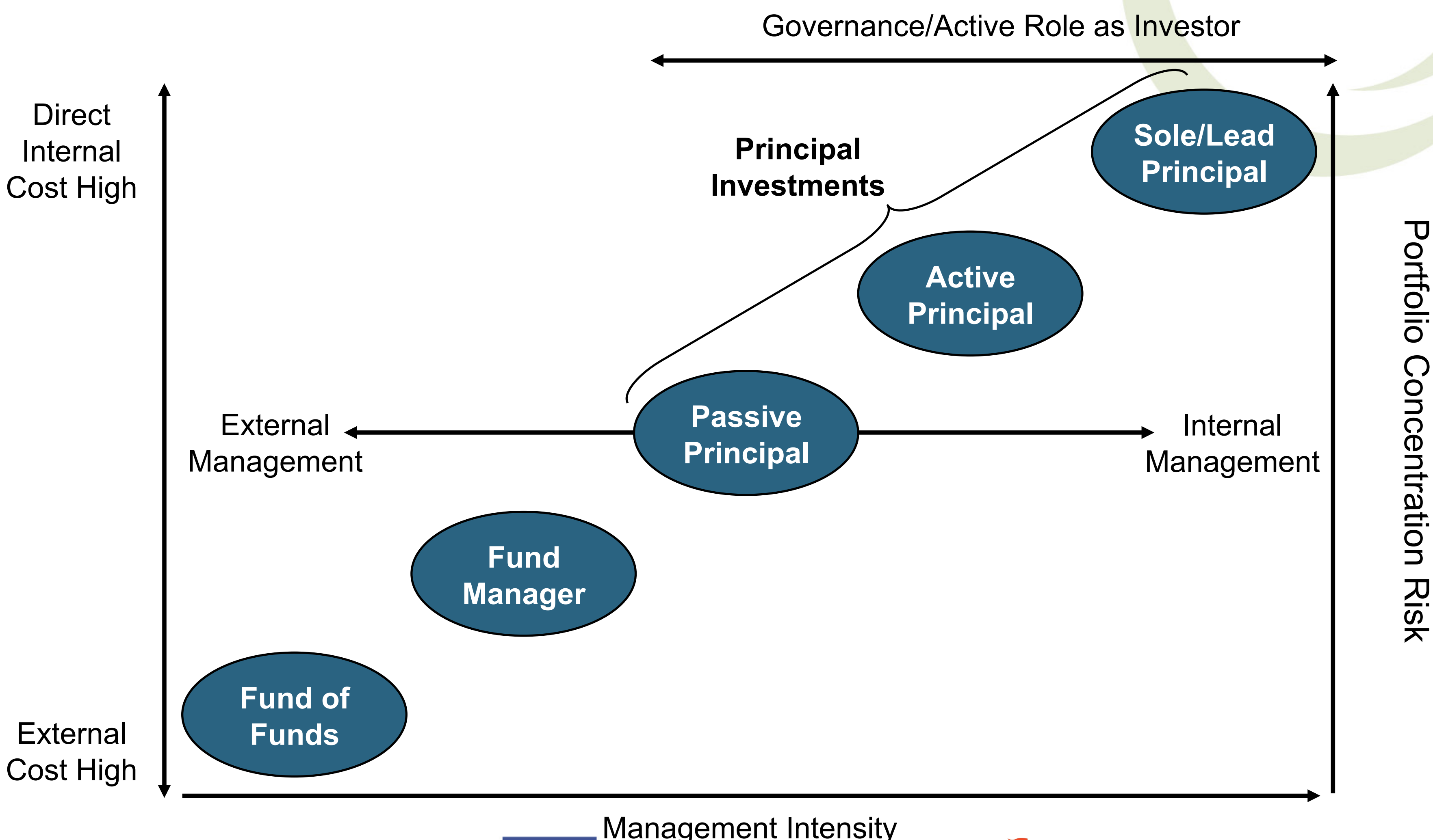
The Risks of Infrastructure Investing

- Certain assets often described as infrastructure have volatile return characteristics and operate in competitive environments
  - Fibre optic cable, satellites
- Every infrastructure investment has unique risks that may adversely impact returns
  - Commodity price risk: uncertainty of future commodity prices due to fluctuations in market prices (natural gas)
  - Pricing risk: uncertainty in future electricity prices due to market fluctuations (electricity generation)
  - Early-stage development/demand risk: uncertainty with timing of operational launch and future use (toll roads under construction)
  - Technology risk: uncertainty of future technological developments (communications infrastructure)
  - Financing risk: risk of not being able to refinance debt at attractive rates; risk of default

How to Access Infrastructure Investing

Strategy	Description	Fees
Fund of Funds	• Commit capital to an organization that selects, invests in and monitors the performance of externally managed funds	• Management Fee (0.5% to 1.0%) • Carried Interest (5% to 10%) • Underlying Fund Fees (1-2% management fee, 10-20% carry)
Infrastructure Fund Manager	• Commit capital to external funds that are managed by a third party (General Partner) that sources, assesses, structures and actively manages investments in portfolio companies	• Management Fees (1.0%-2.0%) • Carried Interest (10%-20%)
Passive Principal	• Direct investments made on a passive/ syndicated basis • Due diligence conducted by lead investor	• Case-by-case basis • Closing fee and/or annual management fee to lead investor
Active Principal	• Sponsoring the investment, conducting due diligence, governance rights (board seats) • Investment is made at closing, shared among equal size partners	• Direct/internal costs
Sole/Lead Principal Investor	• Sponsoring the investment, conducting due diligence, governance rights (board seats) • Large institution takes the lead role and may/ may not syndicate to passive investors	• Direct/internal costs

Exposure Options



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Publicly Traded Infrastructure

Strategy	Description	Fees
Publicly Traded Infrastructure Funds investing in <u>private</u> assets	• Commit capital to externally listed funds that are managed by a third party (General Partner) that sources, assesses, structures and actively manages investments in portfolio companies • Assess to liquidity through public market listings	• Similar to private fund model
Publicly Traded Infrastructure Funds investing in <u>listed</u> assets	• Identifies publicly listed infrastructure related companies and creates a diversified portfolio • Similar to a mutual fund structure	• 1% to 3% based on the daily closing NAV of the portfolio • Potential up-front and exit fees
Publicly Traded Infrastructure Companies	• Direct, minority investments made in publicly traded infrastructure assets • Due diligence conducted internally	• Direct Internal Expenses

Syndication Market

Defined

- Co-investment direct access to global transactions
- Reliance on lead investor(s) for deal execution resources
- Passive investment with limited liquidity

Benefits to Minority Investors

- Strong alignment of interest amongst shareholders
- Opportunity to invest alongside leading infrastructure investors
- Sharing of resources (intellectual and capital)

CPPIB/OTPP Syndication Protocol

Term	Details
Obligations	• Commit Discretionary program: no obligation for lead investor (E.g., CPPIB) to offer syndication. • No fiduciary obligation among members of the investor group • Each investor shall form his own view as to the merits and size of commitment (subject to the minimum size and availability)
Minimum commitment	• Minimum commitment of $100 million per investor
Investment objectives	• Aligned in terms of investment horizon, philosophy, cost of capital and views on governance • Common view on infrastructure investments: focus on physical assets with long-term cash flows, a low risk profile, and inflation protection
Closing period	• Up to three months post-close
Pricing	• At lead investor's cost, plus (1) a roll-forward at the expected IRR and (2) share of acquisition costs • No ongoing management costs, no performance fee ("carry")
Governance	• Majority of directors nominated by investors; target 15% interest per board seat • Structure for both simple majority and super majority decision thresholds
Information rights	• Quarterly and annual accounts from management • Annual valuation performed by an independent firm

Case Study – 407ETR Syndication

- In late 2010, CPPIB completed two transactions resulting in the purchase of a 40% interest in 407 International Inc. ("407ETR"), a 108 km highway in Toronto, for ~$3.8 billion
- By March 2011, CPPIB successfully syndicated ~$1 billion of equity to a small group of institutional investors

- Kindle Capital arranged a consortium of like-minded Canadian institutional investors to purchase more than $100 million equity interest in the 407ETR Syndication
  - Consortium consisted of 8 Canadian pension plans and endowment funds ranging from $1 billion to $15 billion, including HRM Pension Plan

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Case Study – 407ETR Syndication

- 407ETR was an attractive investment opportunity for Canadian institutional investors
  - High quality asset with strong operational track record
  - Favourable concession agreement (length, price-setting mechanism)
  - Attractive risk-adjusted returns
  - Strong management team
  - Experienced investor group (lead investor and shareholder group)
  - Growth opportunities
- Shareholder governance rights in the syndication vehicle
  - Information rights
  - Board representation
  - Customary drag/tag provisions
  - Supermajority voting thresholds

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