

Nairobi Stock Exchange and Africa
Stock Exchanges Conference
Infrastructure Finance – Africa's
Experience
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But first, a word on Infrastructure Finance and Equity Markets

Infrastructure Finance and Equity Markets

Equity markets **are** used to finance infrastructure:

- UK and other utility privatisations
- Eurotunnel

But even in developed markets it can be a risky investment for shareholders:

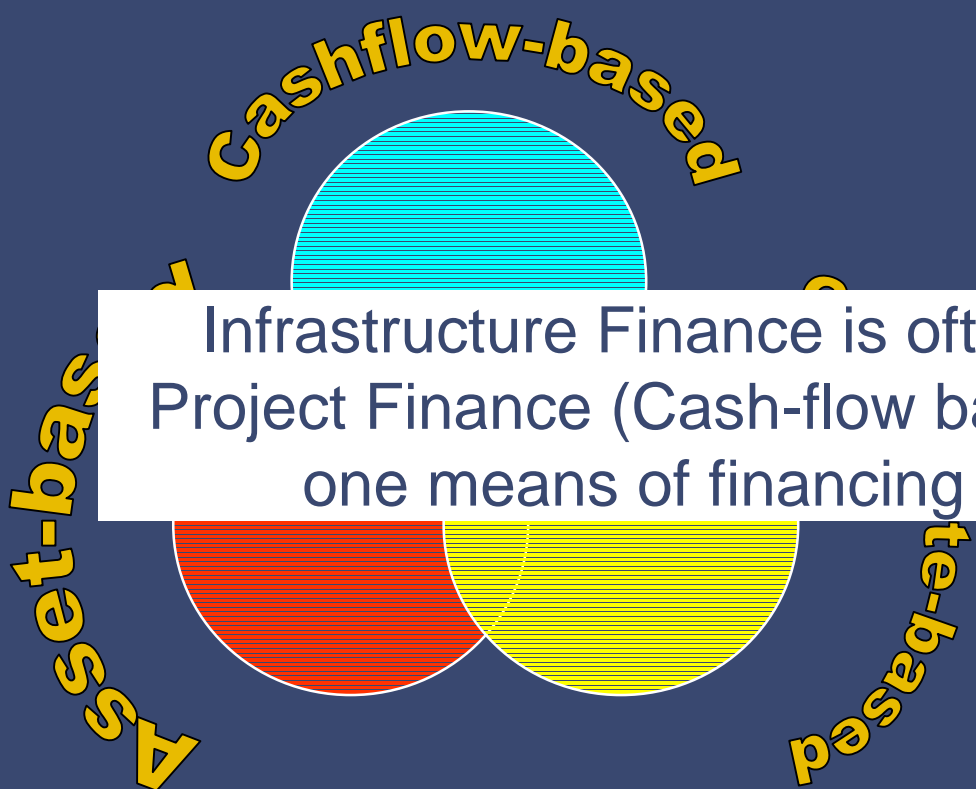
- Railtrack
- Eurotunnel

Given the state of most of our infrastructure in Sub-Saharan Africa, infrastructure investment will not be a “public equity” play for some time to come. But that does not mean that Capital Markets are not important

What is Infrastructure Finance?

There is no such thing as Infrastructure Finance. But there are a number of ways of financing infrastructure

Different approaches, but interlinked



Infrastructure Finance is often confused with Project Finance (Cash-flow based), which is just one means of financing infrastructure

All lending relies primarily on cashflows for repayment

Most lending involves taking security over physical assets

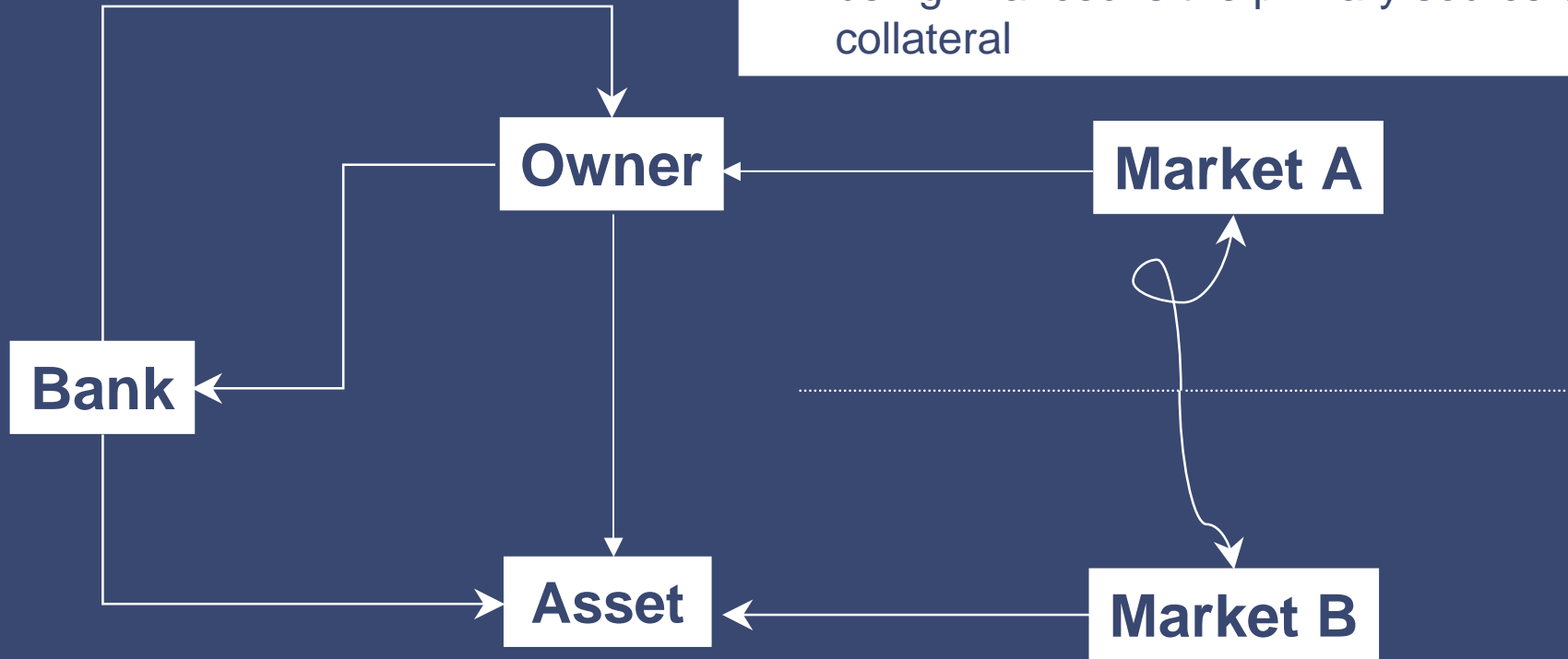
Lending always remains the borrower's obligation

What is Infrastructure Finance?

Asset-based Lending Principle

Asset-based lending:

- remains corporate obligation
- depends primarily on cashflow
- termed asset-based because the asset being financed is the primary source of collateral

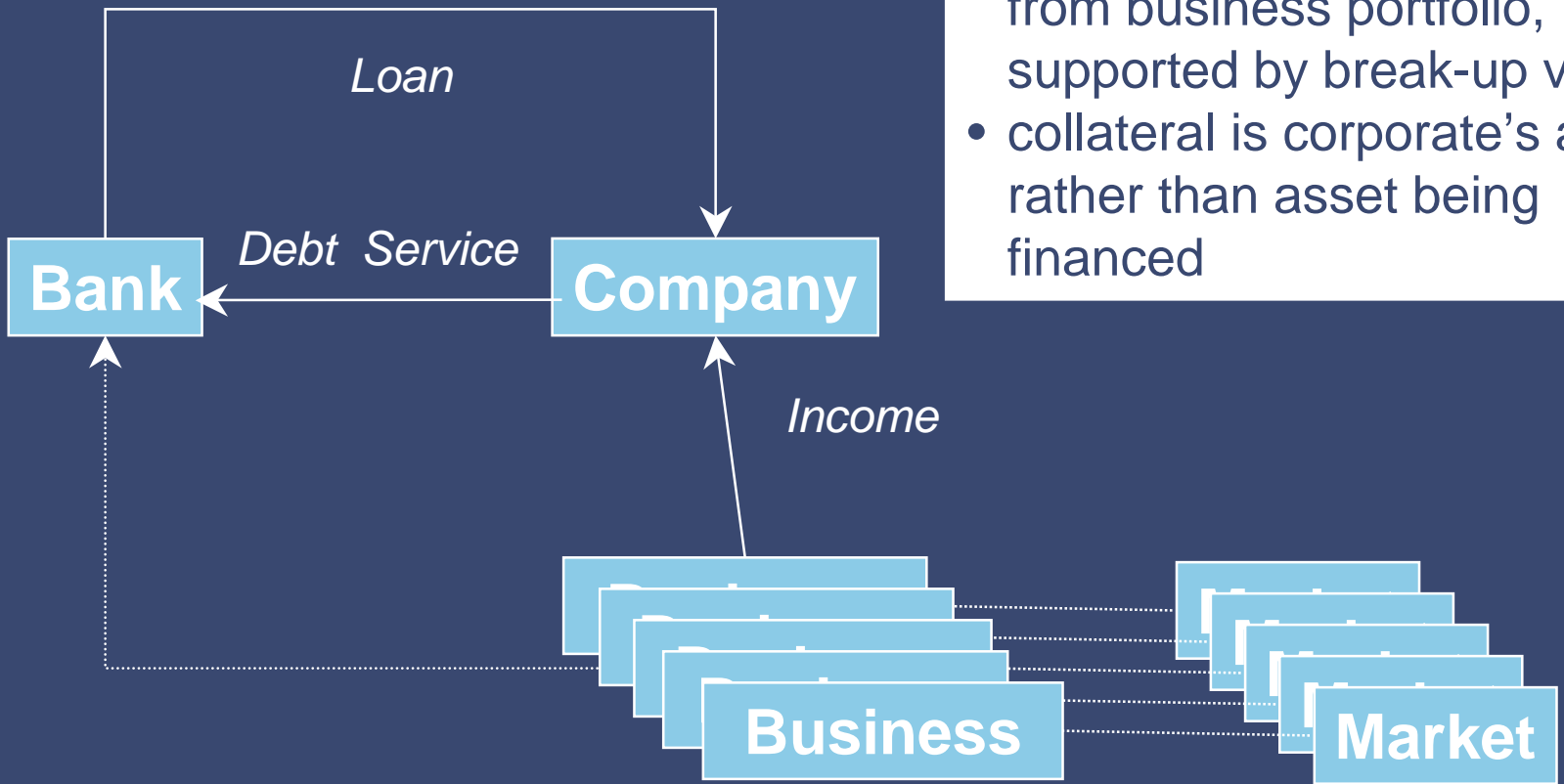


What is Infrastructure Finance?

Corporate-based Lending Principle

Corporate-based lending:

- depends primarily on cashflow from business portfolio, supported by break-up value
- collateral is corporate's assets, rather than asset being financed



Asset-based and Corporate-based Lending have similarities

- Both rely primarily on cashflow
- Both run the risk that a decline in cashflows can be matched by a decline in asset values
- But both can potentially 'leverage' collateral to the extent that:
 - For asset based financing, the value of the asset is independent of business performance (eg. Aircraft lease)
 - For balance sheet based financing, the asset values are independent of the business' current performance (eg. change in management can improve value)
- Both also apply prudent lending limits, based on:
 - a multiple of income
 - a proportion of asset value (eg. 60% - 75% of asset value)

Cash-flow based (Project) Finance

- Relies completely on cashflow
- Has no collateral support because:
 - assets are usually special-purpose and immobile
 - there is little chance that anyone else can do any better
- (Although lenders invariably insist on security regardless)
- It applies prudent lending limits, based on:
 - multiples of cashflow (clearly sensible)
 - proportions of asset value (not sensible)
- However, unlike either asset or corporate lending, it frequently relies on credit support/ enhancement eg through corporate, sovereign, multilateral or financial institution guarantees or cashflow support eg through take or pay type contracts

Corporate and Project lending compared

Corporate

- Low debt:equity ratios \ll 1:1 eg 25%
- Profits most important
- Annual to 3 year horizon
- Exposure:range of commercial risks
- Balance-sheet debt
- Assets continually refreshed

- Many activities in many places

- Can be quoted or privately held
- Few constraints on management action
- No ownership in customers/suppliers

Balance sheet or Equity driven

Project

- High debt:equity ratios \gg 1:1 eg 9:1
- Cashflows most important
- Lifetime perspective
- Restricted risk exposure
- Non-recourse debt
- Single asset not usually replaced / renewed
- Usually single activity in a single place
- Not usually quoted
- Tight constraints on the freedom of action
- Sponsor involvement in key subcontracts

Cash flow driven

Typical applicability of different forms of financing to the Infrastructure Sector

Asset based	Corporate	Cashflow based
Infrastructure Service Providers	Mobile telephony	Single, stand alone, specialist asset
Mobile assets eg aeroplanes, rolling stock, ships	Other ICT services (eg ISP, cable TV)	Power stations, roads, railway line, water treatment plants

Amongst the infrastructure sub-sectors, mobile telephony lends itself to corporate lending because the revenue prospects vs. capex needs are significantly more favourable than in other infrastructure industries

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Attracting sponsors (equity providers) to Africa's infrastructure is probably the biggest challenge we face. There are a number of reasons for this

- **Small populations**
- **Low per capita incomes**
- **Uneconomic tariffs/ low willingness to pay**
- **Poor cross border coordination**

Market constraints

Image

- **Perceived high political risk**
- **Perceived lack of commitment**
- **Poor track record - some high profile failures/ delays/ disputes**

- **Absent or untested regulatory frameworks and institutions**
- **Lack of regulatory experience/ capacity**
- **Conflicting/ overlapping regulatory structures**

Regulatory and institutional constraints

Financial constraints

- **Heavily degraded infrastructure**
- **Creditworthiness of customers**
- **Poor sovereign credit ratings**
- **Understanding of private sector risk appetite**

Absence of equity is, of course, a key constraint to debt financing, but there are other problems too

Asset based

Lack of definition and clarity in tax based legislation. Resulting in lack of fair incentives

Short tenors

Lack of developed secondary market for assets

Reluctance of lenders to finance used assets

Enforceability risks

Corporate

Corporate governance weaknesses eg non-execs

Weak compliance – especially unlisted

Weak Balance Sheets

Expertise/technical skills

Market size & associated Market risk

Cashflow based

Weak regulatory environment

Sovereign/ expropriation/Fx/ political risk

Lack of 'iron clad' take or pay contracts

Enforceability risks

Market risk

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Solutions to attracting greater private equity are well known and well documented

- Political commitment to difficult reforms – retrenchment, tariff increases, loss of patronage, loss of control
- Create larger markets – power pools, harmonisation of labour, tax, investment, sector, capital market laws
- Low per capita incomes such a big problem? Mobile phones, water vendors?
- Public sector/ concessionary funds alongside private equity
- Legal and regulatory reform and capacity building
- Reliance on regulation through contract
- Trade on and learn from successes

Solving the private equity problems will go a long way towards increasing the flow of debt to our markets, but more is required

Asset based

- Lobbying/ seeking clarification of statutory provisions on taxation issues
- 'Roll overs' – balloon payments that automatically roll over into renewed terms
- Credit enhancements and escrow supports + deposits if necessary
- Foreign (neutral) jurisdiction for arbitration

Corporate

- Improve external, internal audit, compliance, board and reporting functions
- Strong / 'clean' credit history - accounts receivable, accounts payable
- Demonstrable value, margins and long term market niche (strong business plan)
- Strong, reputed and highly skilled management team

Cashflow based

- Iron tight contracts – with contractors, suppliers, off-takers
- Backed by guarantees- sovereign, Exim/multilateral/ commercial insurers/MIGA type guarantees and some corporate credit support
- Customer due diligence (long term contracts) supported by escrow accounts if required
- Sinking funds and high debt service ratios to cushion weak cash flows

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One only has to look around to see that these constraints can be overcome. The challenge is to learn from these examples

Asset based

AVIATION

Kenya Airways – Kenya

- Acquisition of 777-200ER
- Deal Size: US \$137m
- Approx \$18m deposit (Equity) on asset
- US Exim backed financing by BOEING
- Cost of Capital – LIBOR based

Corporate

TELECOMS

Safaricom Bond – Kenya

- Roll out of the GSM network
- Deal Size: KSh4 billion
- Period/tenure: 3 years
- Underwritten (75% of the bond issue) and syndicated by Citibank N.A
- Cost of capital: Treasury Bill Rate plus 1%

Cashflow

HEALTHCARE

Albert Luthuli Hospital – South Africa

- (first healthcare PPP)
- **Deal Size:** US\$ 75 million
- Lending period/tenure: 15 years
- Financing structure: Siemens guaranteed commercial bank finance supplemented with some South African government concessionary funding.

One only has to look around to see that these constraints can be overcome. The challenge is to learn from these examples

Asset based

Contributing factors to success

- Strong corporate performance
- Quoted
- KLM – Strategic partner
- Track record in market & business plan for growth

Corporate

Contributing factors to success

- Strong backing by local and international banks
- Weak equity market contributed to appetite for corporate bonds
- Strong subscriber base and share of the Kenyan mobile telephony market
- Backing by Vodafone Plc

Cashflow

Contributing factors to success

- Strong level of government commitment, i.e. contribution to the capital cost
- Participation of strong international consortium, led by Siemens
- First major PPP/PFI deal to close in South Africa
- Participation commitments from the banks

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In conclusion, equity markets do not have a significant role to play, just yet, in financing Africa's infrastructure, but

- The corporate Bond market does have a role to play
- Quoted corporates are better placed to access debt finance (all types)
- Capital markets can play a key role in driving improvements in corporate governance as well as management, which are key to attracting debt finance

Conclusion

Of course, world class financial advice can be very valuable too

Project Finance Global by value of closed deals for 2003

		Number	Value US\$m
1	PRICEWATERHOUSECOOPERS (3)	36	10,358
2	Macquarie (2)	27	8,523
3	Deutsche (6)	7	6,852
4	Banca Intesa (-)	4	5,711
5	Citigroup (1)	9	5,634
6	ABNAMRO (-)	10	4,461
7	Royal Bank of Scotland (-)	5	3,938
8	CSFB(-)	3	2,840
9	SMBC(-)	2	2,687
10	SG(5)	6	2,554

(2002 top ten figures in brackets)

Source: Project Finance International, January 2004



Especially when it is on your doorstep

PricewaterhouseCoopers in Africa

- Angola
- Botswana
- Burundi
- Cameroon
- Congo, Democratic republic
- Congo, Republic of
- Cote d'Ivoire
- Egypt
- Ethiopia*
- Gabon
- Ghana
- Guinea
- Kenya
- Libya
- Malawi
- Mauritius
- Morocco
- Mozambique
- Namibia
- Nigeria
- Senegal
- South Africa
- Sudan*
- Swaziland
- Tanzania
- Uganda
- Zambia
- Zimbabwe



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