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VIDEO TRANSCRIPT OF TFI-NEWS INTERVIEW WITH JOHN MCCARTHY, MANAGING DIRECTOR & GLOBAL HEAD OF RREEF INFRASTRUCTURE

INTRO: TFI News met with John McCarthy, Managing Director and Global Head of RREEF Infrastructure Funds to discuss the current state of the market for infrastructure investors.

I start off asking John to outline the parameters of the fund and investment criteria.

MCCARTHY: Total funds under management or assets under management are about, in US dollar terms, about US \$16 billion. That's split between listed and unlisted. The listed is the smaller component, the unlisted the larger component. The question is probably more focused on the unlisted side, so that is approximately US \$10.5 billion and that is split between Comingled Funds and managed separate accounts, that the manage directly on behalf of pension funds.

The separate accounts are restricted in their activity and focus to the Australian market and the commingled funds operate in Europe and are restricted in their focus to the European context, foreign investment perspective.

TFI: Looking back at 2011, what has been your experience as a fund manager, in terms of the quality of deals that come to market?

MCCARTHY: Well the deal flow through 2010, '11 and continuing on into 2012 in the foreseeable future, is very different and the way in which the deal flow was characterized before the financial crisis, the credit crisis with significant liquidity from banks, you saw more auction processes characterizing how assets were being acquired in the market.

Since then, you have seen a shift to more negotiated transactions, between vendors and specific financial sponsors.

If I look at our own funds, the last six investments have all been made through separate -- not separate accounts but negotiated transactions.

Our current pipeline has probably the next three transactions exactly on the same basis and so it's been more the process or the model around which acquisitions are being made, rather than some fundamental shift in the type of assets that are being sold.

Our business is principally focused on Greenfield assets acquired from utility or operating, or owners of those assets which are not government in the main. Government processes generally require some probity and therefore require some level of auction and therefore they are generally more uncertain in their outcome, more timely, more expensive and subject to factors beyond our control.

So, in terms of deploying capital more efficiently, we have found that the corporate sector is a more logical place for us to play, at this point in time.

TFI: How do you deal with regulation, seeing that the Spanish cut the renewables subsidies and the U.K. with subsidies cut for solar. How do you take into account this factor for investments?

MCCARTHY: Well it depends on the country. It depends on the form of regulation. You have regulation around water, gas, electricity, renewable energy and different forms of regulation and different risks associated with regulation, depending on where you are.

We have approached that, as far as renewables is concerned, to understand the risk profile or the cost of subsidy involved by type of renewable energy and take the view that where that subsidy is greatest, the risk of changes also the greatest.

We have spent probably six years, five years, in looking at each of the regulatory environments, in each of the countries, in each of the technologies and it took five years before we got comfortable to make an investment.

And we made our first investment in 2010. That was in Spain but it was only made after the regulation was reviewed and the new law brought in and promulgated and it supported our view that the risk of photovoltaics was where change was most likely and it was and that wind and solar thermal, the change was not significant in terms of impacting returns, it puts more of a cap on the type of return, the upside in the arrangement.

As a result of that law change with the significant fiscal deficit position that Spain was in and still is in, there was clearly the opportunity, at that point, to have far, more wide-ranging changes to the regulation, which would've had more significant impacts on the marketplace, generally.

I think, Spain now has taken a relatively intelligent approach to it and recognizes the risk to the flight of capital, that significant change may occur. So they recognize the need to be able to attract capital and support the capital, let's say, for the longer-term GDP that they're looking to generate.

So there is a -- a sort of, a degree of rational thought process around regulatory regimes and possibly more rational thought in the more western geographies, than other geographies, so we restrict our activity to those areas where we expect that to play out and we restrict our investment strategy to tried and tested regimes, as far as regulation is concerned and then we limit the investment strategy to only take a proportion of the capital exposure to that, so it's managed in that way.

TFI: Looking at the U.K. market, you have an investment in Peel Ports...What's your view on the growth story for ports in the U.K. and other countries now?

MCCARTHY: I mean, ports are fascinating, it's probably in the area where some of the most significant losses have been incurred and where they have occurred it is been to ports that have really limited diversification in the product that they service.

And in that, I mean, container traffic, 100 percent container ports, which is where the greatest growth has been over the last 15 years but where the greatest decline in volumes was felt as a result of the economic recession which saw volumes fall by 20 to 25 percent, globally.

So, there's a lot of lessons and what's occurred and in investing in ports, you need to be in a largely monopoly position. You should be the owner and operator of the port. You should not be seeking to invest in a business which is competing with the terminal operator in the same port area, where volumes then, can only be attracted by cutting price.

So, there is some clear sort of benchmarks, if you like, that sort of characterize which ports actually qualify for an infrastructure, core infrastructure play and those that probably are better off in private equity type territory.

Growth in the ports, I mean, Peel ports, which is our second-largest ports operations in the U.K. and one of the larger investments of our first fund, is one of the best performing assets in the fund and it is that because of the diversification in its revenue base.

We have no one client of the port which is more than eight percent of the total revenue. We have over 70 percent of the revenues under some form of long-term contract. We're the landlord of the port area and so growth in the business has been consistent, year on year, since 2006 and this year we'll outperform what we had assumed, when we made the investment in 2006.

So it's an example of a good investment that is consistent with the investment 'hot-spots', that investors bought into.

Ports are a fascinating asset because they have many component parts and they allow for CAPEX and they allow for growth.

And so there are CAPEX plans, there are structural shifts occurring in the marketplace around the delivery mechanisms of goods. There is a move to bigger ships, deeper waterways, there's been significant investment required in the U.K. The major container terminals in the Southeast deliver goods into the most congested part of the country and it's possible that actually different ports can come into play, to compete with the ports in the Southeast, simply because they can deliver boxes more cheaply to end user.

So there's a lot in the mix and the outlook is very positive.

TFI: Looking at valuations now of assets...Have you seen sellers expectations, meeting with buyers bids, is there sort of a reality gap on pricing, for example, looking at Hochtief airports and the process there and that's been dragged out and collapsed?

MCCARTHY: Yeah but there are many, it's not just price expectations that may lead to the collapse of certain processes. Airports was a very complicated process, a very complicated ownership structure, a diverse range of assets across Europe and outside of Europe, so there are probably many reasons why that has sort of running to certain headwinds.

We have done three investments this year. We did two investments last year. There are certainly vendors out there, whose price expectations have met our value expectations, so I don't think the gap is that significant in and of itself but there are many other factors that hang around, that influence the outcome and some of those are just simply dealing with banks, dealing with distressed situations, dealing with regulation, change in regulation, dealing with shareholder agreements and the nuances that exist therein, if you were an incoming party that needs consents and so forth.

So, I think the market, you have seen that the investors generally have sort of stepped back to the point that they're looking much more deeply into many of these aspects that make up the risk profile and the return profile of an asset. So it's all of that combined in a market that is much more aware of the need to deliver against the return objectives that it sold to investors, that are leading to it.

But in certain instances, clearly, there is a price expectation and the gap, it's not being met but one would expect that 'there'll be a meeting of the minds', a more logical meeting of the minds around that question as we move forward because the environment we are in, is not going away quickly.

TFI: Leading to that, looking at the Eurozone now and how it's going to play out, the next couple of years, the next five years...

MCCARTHY: um hmm! How is it going to play out?

TFI: Are people still expecting returns to investments that were in the high teens, promised at the time of fund raisings, to actually materialize over the coming 5 to 10 years? Have they now realigned their expectations with the reality?

MCCARTHY: Everybody may have a different reality and I can't speak on behalf of where the expectations are, the issues are, within other people's portfolios.

We went out -- when we raised the first time, we were pretty conservative, relative to the market, so we didn't offer high -- we didn't offer 15 percent plus returns. We offered 10 to 12.

We predicated our offering on the delivery of an income yield, as well. So we had an income return and it total return that we were targeting. So, with hindsight being the great thing that it is actually, it proved to be quite a sensible approach to the asset class.

So, we're fully expecting to deliver on the returns that we sold the fund.

There will be -- there are situations of some distress out there. There will be situations where by dint of leverage, assets are not going to be able to be refinanced, additional equities is going to have to be put in or they're going to have to change hands and so I don't think a lot of the funds are going to be able to deliver on the expectations that they were sold against in 2004, '05 and '06.

But within that, if you look through most of the funds and most of assets, the core businesses within them, have actually performed as expected, maybe the growth hasn't been there or maybe the leverage is been too high but most of assets have still been good assets. There've just been over-valued or over-leveraged or the operational risk hasn't been properly understood and managed and that's impacted returns.

But I think, returns today are better than there were in 2006, '07, '08, you are able to get 100, 200 basis points better return in this market and you're doing it at a lower leverage so the risk adjusted return, is actually better as well.

So, it's going to be mixed, across the board.

TFI: Looking at the state of the credit markets now, obviously the key issue -- the key theme will continue through to next year as well, what's your view now in terms of experiences with the credit markets, access to finance and what's your thoughts and concerns going forward now, to 2012?

MCCARTHY: Concerns, probably that you're in the market where the cost of finance is going to be significantly high, the conditions around which it's provided are significantly stricter, the depth of the market is a lot smaller than banks that are trading, so they are the issues that we face.

Within that, a lot of the deals that we're doing or looking at doing, either have finance in place, so you're really dealing with a restructuring of the existing finance or you're getting a new finance and at the more conservative end of the marketplace, like the core end of the marketplace, there is finance that is available for that. At the high-risk end, it becomes more difficult but then it can be made up with equity, so that the leverage factor is significantly lower.

But there is a structural issue and the European marketplace, specifically and banks need to de-lever massively and corporates and governments need to de-lever massively.

And so there are alternatives that are becoming available and we are pursuing those alternatives, as some others are, in terms of being an institutional provider of the debt.

Solutions to infrastructure is clearly needed and is happening and I think will gather significant pace over the course of the next 2 to 3 years but debt is available and it's just there on

different terms and in smaller quantities and it's not a block to doing transactions, you just have to factor it into the whole picture.

TFI: Summing up now. Looking towards next year, some activity in the marketplace, do you think we will still continue to see a lot of secondary market deals, rather than government sales? Do you think that you will see governments finally bring to market now, privatizations?

MCCARTHY: I think privatizations -- you're going to see more privatizations in the next sort of 3 to 5 years but they're still difficult processes, the politics that motivate decision-making, both to the positive, and the negative, in terms of the outcomes.

You have seen in Spain that the sale of the Madrid airport and Barcelona has been slowed down because of the political considerations around and change of governments. So for us there is going to be opportunities there but that's balanced against probably more lucrative suite of opportunities that are available from secondary sales and add-ons to existing portfolio assets.

And so I think, what we see is, a broader suite of investment opportunity that assist in rationalizing some of the competitive processes in marketplace, allowing for more logical decision-making, more rational decision-making and ultimately public better returns from the decisions which are made.

TFI: John, thank you much. Thank you.

MCCARTHY: Thank you.