Client: John Laing Coverage
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John Laing's bread and butter has been in the UK social infrastructure and transport sectors, but it is now looking abroad much more intensively. Gary Lucas, director for international business development, talks to Catherine McGuirk.

Adjusted development

John Laing's reputation as a blue chip in British infrastructure was built on its experience building housing, hospitals and transportation, but since it sold its construction business ten years ago it has evolved into a concessions company with a substantial overseas portfolio and assets in a much broader number of sectors.

Laing currently has interests in 74 projects, 54 of which are direct investments. A further 19 are held in the John Laing Infrastructure Fund, which Laing established in 2010. Laing sold the assets as a package to the fund, which was created to give the sponsor access to a new source of equity funding and recycle some of its existing commitments. The listed fund's initial public offering attracted commitments that exceeded its £270 million ($434 million) target. Laing holds a 23% stake in the fund, but the float attracted interest from retail investors, due to the shares' inflation-indexed return and 6% yield target, as well as commitments from the more obvious infrastructure investors.

All of the assets spun out to the fund were availability-based and out of the construction and ramp-up phases and have proven revenue streams.

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"Project development post-financial close is very important to the company," says Gary Lucas, director of international business development for Laing. "We like to maintain an interest in projects for the long term, through construction, and make sure the asset is working well. We also prefer to maintain a management interest in the projects from construction onwards through shareholding."

Many of the assets on the Laing balance sheet are nearing the point at which they could be spun off to the John Laing Infrastructure Fund and though Lucas would not speculate on the fund's thinking, the two entities fit well together.

Laing has been expanding its operations by region for some time, particularly with its roads deals in Europe and its hospital projects in western Canada. However, the combination of the downturn in the UK PFI pipeline and the expected forthcoming governmental reviews of how projects are procured means that Laing needs to increase its foreign presence and diversify into new sectors.

The home front

"We're responding to the slowdown in the traditional domestic market," says Lucas. "The National Infrastructure Plan, the uncertainty over what changes the government will make, it doesn't help us to plan."

Though the UK has been Laing's concessions bedrock for over a decade, the PFI programme is waning and, combined with the effects of the financial crisis, this has resulted in downwards pressure on shareholders' returns. Laing says its approach has never been to promise hefty returns; rather to maintain stable investments and steady growth, so the impact of the combined crises went to the core of the company.

"We are looking at ways to balance the domestic changes," says Lucas. "We're expanding globally in a steady, controlled way and also exploring new types of asset classes in the UK – renewables, the waste sector, LABV [local asset-backed vehicles]. But we're not losing sight of the existing sectors, we're still bidding on hospitals."

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Its UK asset base varies from the Second Severn Crossing between England and Wales – one of its flagship assets – to its most recent success in bidding, in a consortium with Skanska, on the £74 million Croydon and Lewisham street-lighting project. It has also been named preferred bidder on housing regeneration projects in Lambeth and Oldham, and on Kenilworth railway station in Warwickshire.

Laing's core business still lies in social infrastructure and transport, but the likes of its £50 million equity commitment (for a 37.5% stake) in the £640 million Greater Manchester Waste deal demonstrate Laing's capacity for larger scale equity investment in newer asset classes. "There are synergies there with the renewables sector," says Lucas. "We're familiar with waste management and can adapt our environmental experience. We haven't made an investment in a renewable project yet, we're looking at how we can enter the market as a developer as well as an investor."

Despite the reduced dealflow and pending changes to project procurement in the UK, some new initiatives are already proving appealing to concessionaires and investors alike. "The question will be how the private sector should engage," notes Lucas. "The LABVs could have a big part to play."

The local asset-backed vehicle concept allows UK local authorities and councils to offer their assets, mostly land and buildings, for use by private sector developers. The authority and the sponsor then split any profit 50/50 after an agreed nominal sum for the use of asset. Laing has already been successful in two bids for LABV urban regeneration projects, in Croydon and Tunbridge Wells.

However, Lucas's wariness about the UK's future procurement policies has echoes across the UK infrastructure market as sponsors, lenders and even the grantors are waiting for central government to outlines how it plans to change project development and tendering processes.

"One of the major debates in UK PFI circles is whether there will still be a safeguard for hospital deals," says to a lender familiar with the market. "The decision is with the Department of Health and the impact will be on banks willingness to increase their risk exposure in lending without the existing safeguards."

Though existing projects are, in theory, contractually protected from retroactive modification, investors are uneasy. "The social housing projects, the Building Schools for

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the Future programme, there have already been project casualties, and now the Intercity Express programme [for which Laing is the preferred bidder] is under review," says the lender.

"We're responding to the slowdown in the traditional domestic market. The National Infrastructure Plan, the uncertainty over what changes the government will make, it doesn't help us to plan"

Foreign affairs

Though much of Laing's global activity complements its domestic operations, it follows different investment approaches depending on currency risk, equity exposure considerations and the other sponsors it works with. "Equity size is dependent on jurisdiction. We have investment criteria for different regions," says Lucas, citing the domestic market as a base case. "In the UK it can be anywhere from a 25% stake up to 100%, depending on partnerships and any procurement requirements about contractor equity."

With a few notable exceptions, Laing's approach has also been fairly consistent in terms of project size across its portfolio but, again, these strategies are open to adjustment as the company evolves. "Our preferred investment range is £20 million to £25 million, depending on the project; but we're willing to invest more in certain projects."

"Outside of the UK, we like to work with local partners on an equal or minority basis," says Lucas. "The norm for us is 25% to 50% for projects in other regions. The exception is India, where the risk profile is different and we'd look for a stake at the lower end of that range."

Laing closed its first Indian deal in 2010, taking a 26% stake in the £200 million NH3 toll road deal, in a consortium with a local contractor and developer, Hindustan Construction. The 26% was a calculated investment as Indian procurement rules give companies with stakes larger than 25% in existing projects a bidding advantage on future procurements.

Since that deal closed, India has announced its mega highways programme, which includes major projects each expected to cost around $2 billion, as opposed to the $200 million to $300 million sized deals that Laing prefers. "The procurement rules meant that we would have had to put up around $75 million in equity, which would have been too much exposure to one project in that market, so we aren't pursuing any of those deals," says Lucas.

As far as debt provision, Laing ties its financings to the local market. "We became active in Australia last year. There is less liquidity there for long-term debt, it tends to be

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debt for infrastructure projects, with maturities of around seven to eight years." Laing's debut to the Australian PPP market was on the successful bid for the New Royal Adelaide Hospital, on which it was part of a Macquarie-led consortium. Laing is also part of a bid submitted to the Australian Defence Force for its forthcoming Single LEAP II accommodation project, for which a preferred bidder is expected in the second quarter of 2011.

Its North American portfolio is more mature. Though the company had scaled back on its US presence during the financial crisis, it has a 45% stake in one existing PPP, the Denver Eagle rail project, which reached financial close in 2010 and was financed with private activity bonds.

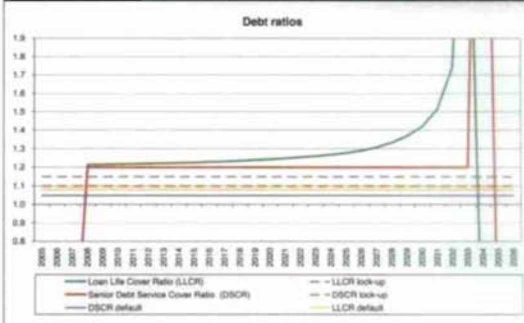
However, it has a robust operation in the British Columbia healthcare PPP market. "In Canada, there has been an established use of bond financing, with a brief spell where European banks stepped in when the capital markets were constricted, but bonds are most competitive long-term at the moment for that region."

Laing's preferences for leverage are also driven by local conditions. "In the UK, Europe and Canada, gearing was at around 10% to 15% before the global financial crisis, and it's now beginning to settle and come back to just above what it was in the mid 2000s. In India, we're looking typically at 25% to 30% equity."

Diversity and growth

Laing's ability to find ways to recycle its equity commitments have allowed it to bounce back quickly from the constrained funding environment of the credit crunch. Its preference for availability-based deals has made this process straightforward, and given it a strong secondary market following – both retail and institutional. Building up a substantial book in the busiest overseas markets, though, will require writing some large equity cheques, or a willingness to take a back seat to other large sponsors. ■

Average debt profile of a John Laing-sponsored project



Source: John Laing

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ProjectFinance
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US Energy: Fracking up

The surge in US shale gas production presents huge opportunities for power and midstream gas project financings. But production and environmental costs are not fully understood. By Edward Russell.

Regulars

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Babcock to unload recycling business

Babcock International is to emerge from rubbish by selling the waste management business it inherited in its £2.4 billion merger with VT Group last year. A review of Babcock's enlarged defence services group will entail the sale of a £700 million contract to build and maintain a private finance initiative recycling plant in Wakefield, West Yorkshire. The costs of the takeover and accounting red ink sent Babcock's 2010 profits into reverse. At an underlying operating level, the group reported £270 million of profits, but pre-tax profits were down by 10 per cent to £115 million. The dividend is up 10 per cent to 19.4p and the shares rose 35p to close at an historic high of 686½p. *(Robert Lea)*

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Babcock confident despite cuts

By Amy Wilson

BABCOCK, the engineering services company, is confident of winning more work from government departments, particularly in defence, despite substantial budget cuts due over the next few years.

The company, which bought rival VT Group for £1.5bn last year, reported a 50pc rise in revenue to £2.89bn in the year to the end of March, as a result of the takeover. Profits also climbed 57pc to £228.2m.

Including an £88m impairment charge on the goodwill attached to VT and the cost of shedding staff at VT's corporate headquarters, pre-tax profit slipped 11pc to £115.4m.

"It's a fiction that there's no business out there," said Peter Rogers, Babcock's chief executive, speaking of the public sector.

"In engineering there's a scarcity of resources. You need people with a background – they can't be hauled in off the street. We've focused on the parts of businesses which you can't stop doing or your assets won't work."

57pc

The rise in profits at Babcock. The company bought rival VT Group for £1.5bn last year

He cited the example of a Ministry of Defence contract to supply parts for the modification and repair of warships, for which Babcock has been selected as the sole bidder.

It could be worth £300m over the next 10 years. Babcock already carries out the modification work, and by taking on the procurement of parts as well, the Government cuts out all the civil servants who were used to liaise between Babcock and the MoD on the supply chain.

Babcock's own business, excluding the VT acquisition, grew by 5pc during the year. The company maintains Britain's nuclear fleet and runs dockyards for the Royal Navy.

Babcock also hopes to win more defence training contracts due for tender this year. The Government cancelled a planned £14bn private-finance initiative (PFI) to build a new defence training academy in South Wales as part of last year's strategic defence review, and will now outsource training in smaller batches.

Babcock company had net debt of £729m at the end of the financial year, up from £302.3m the previous year, as a result of the VT deal. Babcock has so far paid down about £160m of the debt it took on as part of the deal since it completed last summer.

Babcock's shares gained 28½p to 680p yesterday.

The company also said it would pay a final dividend of 14.2p on August 9, taking the total payout for the year to 19.4p, a 10pc increase.

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Skanska and Laing close on Croydon and Lewisham streetlight PFI

Skanska and Laing have closed financing on the Croydon and Lewisham street lighting PFI. The 50:50 joint-venture between Skanska and John Laing was appointed preferred bidder for the 25-year contract in February, and closed the £74 million ($121.2 million) debt financing for the project on 20 April.

The design-build-finance-maintain contract has an initial build period of five years, covering the installation of 38,000 new streetlights, 8,000 signs and bollards, and the refurbishment of 4,000 existing streetlights. The Department of Transport has awarded the sponsor £151.7 million in PFI credits, which will be disbursed as new lighting columns are installed.

The construction costs are about £74 million, and NIBC and Lloyds arranged a 24-year debt package to meet these costs. The debt package, which is split equally between the two banks, also includes a five-year equity bridge, which will be replaced with subordinated debt split between the two sponsors. The project is geared at around 90%, putting the project's equity and subdebt at just over £7 million. Pricing is thought to be in a similar region to the Surrey street lighting PFI closed by Skanska-Laing last year, which featured starting margins of 250bp over Libor.

Pinsent Masons and PwC are advised the grantors, and Addleshaw Goddard and Investec the sponsors.