FINANCIAL REVIEW

HD **Port of Newcastle sale a tale of hot market**

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The NSW government's **sale** of a 98-year lease on the Port of Newcastle for $1.75 **billion** is a telling reminder that the infrastructure asset market is so hot that even risky, commodity-linked assets can achieve record prices. Port of Newcastle was sold by Treasurer Andrew Constance to a consortium comprising Hastings Funds Management and **China** Merchants Group, a state-owned enterprise that already owns 22 ports in **China**. The winning bidder paid 27 times earnings.

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The craving for Australian infrastructure assets is partly bound up with the shifting sands in global interest rate markets and the strategic positioning by specialist asset managers and owners.

Low global interest rates have direct and indirect ways of fuelling the high prices paid for assets such as Port of Newcastle.

First, low interest rates are forcing pension and sovereign wealth funds to reconsider their asset allocation decisions. Money is being shifted out of fixed interest funds into long-lived infrastructure assets, which have many of the characteristics of **bonds**.

Marginal changes in asset allocation can have a powerful impact on money flows across asset classes when the funds under management are in excess of $100 **billion**, which is the case for several Canadian pension funds.

Second, the low interest rate environment allows buyers to inject greater leverage into the transaction. They can borrow more money than would normally be possible and this allows a successful buyer such as Hastings and **China** Merchants to tolerate a lower internal rate of return.

However, this cyclical sweet spot for infrastructure sellers will inevitably change as interest rates rise. Australia, which has a record low official cash rate of 2.5 per cent, will probably see rates rise closer to the nominal GDP growth rate of 4 per cent.

Rates are also going to rise in the United States when it ends its quantitative easing. A return to more normal monetary conditions in the US will make it harder to justify debt-fuelled bids with internal rates of return in single digits.

Specialist strategic buyers from around the world have been queuing up to take advantage of the once-in-a-lifetime opportunity presented by state government asset sales.

Last week, Abertis Infrastructure from Spain failed in its bid for Queensland Motorways Ltd, which was sold by the government-controlled Queensland Investment Corp for $7 **billion** to a consortium led by Transurban .

However, the QML deal was the classic GDP-type infrastructure asset which provides the buyer with direct exposure to economic growth in south-east Queensland.

The **China** Merchants **purchase** of Port of Newcastle in partnership with Hastings is a far more risky proposition than the QML deal.

The buyers are exposed to the fortunes of the Australian **coal** export market. On the one hand that insulates the buyers from the Australian economy but at the same time it exposes the port owners to the vagaries of the commodity price cycle.

While Newcastle is the world's largest **coal** port, the **coal** is sourced from the higher cost Hunter Valley region which produces thermal **coal** of a lower grade to that found in the Bowen Basin in Queensland.

The NSW government was advised on the Port of Newcastle **sale** by Richard Wagner from Morgan Stanley . He is likely to be in demand from other governments selling port assets.

Queensland has several ports that can be sold. However, the largest of them all is the Port of Melbourne which could crack the $7 **billion sale** price for QML. Investment bankers are turning their attention to other assets likely to be sold over the next three years including the $40 **billion** worth of utilities in NSW, utilities in other states, ports in WA and a desalination plant in South Australia. Constance's next challenge is to formulate a plan for selling the electricity poles and wires in NSW. That will have to wait until after the next election in March 2015.

Those who accuse the big banks of suffocating the entrepreneurial talent in their funds management businesses should take a closer look at the performance of Emilio Gonzalez , chief executive of BT Investment Management.

Gonzalez has transformed the BTIM business from a domestically focused **company** with 65 per cent of its revenues from Australian equities funds into a global business with sales in Australia, the United Kingdom, Asia and the United States.

Four years ago BTIM only managed money in Australia. Three years ago it added the UK to the list, with the **purchase** of J O Hambro.

It then expanded last year into Asia and this year expanded into the US.

This is a success story that has delivered in spades for shareholders. Since the global financial crisis BTIM's shares have risen from about $3 to $6.70. The stock hit a record high of $7.35 in March.

The beauty of the funds management business model is that it is capital light, it can be exported around the world (provided the **company** offers global products), its costs are relatively stable and it can buy teams of committed funds managers who want to share in the upside.

BTIM's costs rose by $6.9 **million** over the past two years. Over the same period, revenue rose from $91 **million** to $255 **million**.

Gonzalez is a big supporter of the Asian funds passport, which has the potential to open up new markets in Korea, Taiwan and Singapore.

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CO hasfml : Hastings Funds Management Limited | wstpac : Westpac Banking Corporation Limited

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