Cross dressing

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Last year's impressive $550 million IPO on the Australian Stock Exchange (ASX) was just the latest evidence of Babcock & Brown's (B&B) metamorphosis from boutique lease arranger into principal investment businesses.

According to Giles Frost, co-head of UK infrastructure, "The changes in the ways the finance leasing market worked and, in particular, the reduced ability to create advantageous cross-border deals promoted the pace of change. As work diminished in one area, it grew in others. We are now a significant global developer of and investor in assets."

The success of the IPO, from which Babcock & Brown received close to $6 billion in orders, coupled with overlapping business interests has brought with it a number of back-handed comparisons with Macquarie. And it is fair to say that both groups have similar growth strategies.

Back to its US roots

Nowhere is this more evident than in the US toll road market. Babcock & Brown is currently bidding on the Indiana toll road concession, which it hopes will be its break-through deal. The only problem is that Macquarie Infrastructure Group (MIG) and Cintra, the concession-holders to the massive $1.83 billion Chicago Skyway project and the main toll road competition in the US, stand in its way.

Although the State of Indiana is tight-lipped about the project, the principal bidders are: Cintra with Macquarie, FCC and Sacyr's Itinere have submitted independent bids, while Abertis has joined forces with local Washington Group International. Other bidders include Autoroutes du Sud de La France, Italy's Autostrade, as well as Hong Kong-based Cheung Kong Infrastructure.

The state is even keeping a lid on the size of the project but market sources state that it could come in anywhere between $2.5 and $3 billion.

The state and its adviser, Goldman Sachs, issued a request for proposals on September 28. Binding offers for the minimum 50-year concession for the toll road are due in early 2006. First opened in 1956, the 157-mile road, which uses a barrier toll collection system, runs between the border with Illinois, just south of Chicago, and the border with Ohio. It connects the Ohio turnpike with the Chicago Skyway. It is expected that the toll road will be upgraded to electronic toll collection.

Given MIG and Cintra's head start in the US toll road market, Babcock & Brown will have its work cut. To date, MIG has invested in three major private toll roads including Chicago Skyway and the greenfield project South Bay Expressway (SR125) in San Diego. In September, MIG also closed its $533 million investment in Dulles Greenway toll road in Virginia, through the concession limited partnership, TRIP II.

With US players still content to underwrite and place debt, rather than taking lead sponsor roles, Babcock & Brown should be able to make its mark on what still remains a wide-open market for toll roads. In early 2006, Babcock & Brown is looking to set up a permanent strategic base to take advantage of this.

UK PFI solid

Despite its success with social infrastructure projects in the UK, Babcock & Brown has decided not to pursue similar deals in the US. Formed in 1997, the UK PFI/PPP team has since closed some 15 projects with a total value of £425 million ($1 billion).

"Our PFI business originated in the 1990s and came out of some of our Australian real estate business. It was realised early on that UK PFI had similarities with some Australian real estate structures we had developed," says Frost.

The latest deal to close is a £200 million project for Northamptonshire schools. The project, which covers capital new build as well as refurbishment, is their largest single PFI scheme to date. The maintain-and-operate concession has a 25-year term.

In September 2004, Babcock & Brown, together with Galliford Try and Amey, secured the mandate. The consortium beat off competition from Jarvis, while a third consortium comprising Gleeson and PFI provider Canmore pulled out of the race early on.

Not all deals have run as smoothly. Babcock & Brown's £40 million ($76 million) Tower Hamlets project, which was underwritten by Sumitomo Mitsui Banking Corporation, and syndicated in a club deal earlier this year, ran into serious difficulties prior to closure.

Babcock & Brown had chosen Ballast as its lead contractor on both this deal and the Northamptonshire schools scheme before it went bust. Eventually, the scheme was re-based, without the help of public money, and closed with Balfour Beatty (construction) and GSL (facilities management).

Despite the difficult gestation period for some PPPs, Frost still believes there are enough opportunities in the market for players like Babcock & Brown. "Project finance offers pretty attractive value for money to governments. Apart from anything else you get a capital asset now and you commit to a forward revenue stream, which you don't need to find until the year in question when you need to pay it. At a macro level this is a universal attraction.

"We are in the middle of building a significant business. We're not just looking at PFIs, but how we take what was a PFI bidding and delivery business and turn it into a longer-term public sector partnering business."

A liking for LIFTs

Part of the plan is to further develop NHS LIFT projects. These projects offer Babcock & Brown the opportunity of entering into long-term relationships with governmental organisations, on a geographical franchise basis, to be the exclusive provider of healthcare infrastructure, such as new buildings. The schemes run for a 20- to 25-year term, and provide the sponsor will a steady deal flow over that period. The first tranche of schemes, which covers some 42 sites across the UK, is estimated to be around the £1 billion ($1.8 million) mark. Babcock & Brown is currently involved in four projects across 12 areas.

Late last year, a consortium comprising Babcock & Brown, Balfour Beatty and GSL providing the facilities management, closed the £90 million Wolverhampton LIFT scheme. The deal was underwritten by lead arranger NIB Capital together with Sumitomo Mitsui Banking Corporation (SMBC). The 90% senior debt is being paid back in the usual manner for LIFT transactions: an amortising term facility, a bullet facility and a bid cost loan. The tenor on the scheme is 25 years.

Given the success of PPP in the UK and Australia, Babcock & Brown is scouring the Continent as well as Ireland for opportunities. However, Frost is conscious of the size investment needed in building a team to go after new markets.

Even so, Babcock & Brown seems intent in bulking up its global PPP/PFI business despite the financial cost. In September, 27 employees left ABN Amro Infrastructure Capital in Australia for Babcock & Brown for a total wage packet of some A$50 million. Four senior PPP/PFI arrangers from ABN Amro London also made the jump.

Other current UK PFI projects include waste management schemes. Babcock has just teamed up with waste management company, Shanks Group PLC, to bid for the Greater Manchester Waste Disposal Authority (GMWDA). The deal is estimated to be between £250 and £300 million. Other bidders include waste and water utility Pennon Group PLC and construction group John Laing, SITA and WRG.

In response to the relatively recent EU Landfill Directive – which aims "to prevent or reduce as far as possible negative effects on the environment, in particular the pollution of surface water, groundwater, soil and air, and on the global environment, including the greenhouse effect, as well as any resulting risk to human health, from the landfilling of waste, during the whole life-cycle of the landfill" – a host of similar-sized projects is expected to come to market.

High on wind

One sector in which Babcock & Brown has outpaced the competition, both as advisor and sponsor, is renewables. Over the past 15 years, Babcock & Brown has an enviable record: some 2,000MW in wind energy, valued at over $2 billion.

In late October, wind spin-off, Babcock & Brown Wind Partners (BBWP) completed an IPO on the ASX. It is expected that some $250 million will now be slated for a variety of investment opportunities, including: acquiring membership interests in four US wind farms with an estimated capacity of 216MW; acquiring Spanish wind farms with a capacity of up to 450MW over the next three years; as well as a number of other opportunities.

According to Antonino Lo Bianco, partner at Babcock & Brown, Milan, "BBWP is the only listed wind company worldwide which invests and operates only in construction or in operations in countries where there is a proven revenue stream supported by legislation.

"With our know-how we can take on more risk. When a project reaches construction and operation, and all risks have been appropriately dealt with, then the project is proposed to BBWP. If BBWP accepts the proposal, then the project is transferred."

The company's latest deal is a Eu110 million Sardinian wind farm. On December 6, Babcock & Brown, together with Saras SpA, completed the construction and financing for the largest single wind farm in both in Italy and Europe. However, the project did not run smoothly; the 84MW Ulassi wind farm had to overcome a number of political issues.

Whilst the farm underwent construction, the billionaire managing director of ISP Tiscali, Renato Soru, was elected President of Sardinia. Given his renowned antipathy to the over predominance of wind farms, the regional legislature enacted a law whereby all wind farms where construction had not been started would require environmental authorization.

Although construction on Ulassi had already commenced, the regional administration issued a letter to the sponsors the day before financial close stating that the project might contravene this new law. In light of this, the sponsors decided to halt the project until the authorisation had been granted. SocGen, Mediocredito Centrale, BNL and Centrobanca committed to underwrite the financing.

The deal follows hot on the heels of Babcock & Brown's two smaller US wind farm financings under its construction finance programme. The two farms are Wind Park Bear Creek, a 24MW project located in Luzerne County, Pennsylvania, and the Jersey Atlantic Wind Farm, a 7.5 MW project located at the Atlantic Counties Utility Authority (ACUA). Both are located on the US East Coast and were brought to the brink of construction by outside developers. It is expected that the construction debt will ultimately be replaced using B&B's all-equity model. The lead arrangers were Bayerische Landesbank, HSH-Nordbank and UFJ Bank.

The time last year, GWP purchased six wind farms from Gamesa Energia S. A. for Eu200 million. The acquisition was financed through project and corporate debt, as well as an equity rights issue of $75 million.

Despite the current high levels of Babcock & Brown's wind activity, the firm is still cautious about the market.

"Prices are already at the very high end of the spectrum. If people aren't careful, some will have their fingers burnt and lose money. There's nothing wrong with wind projects per se; it's just that a combination of risk, low returns and aggressive expectations could get some players in to trouble," adds Lo Bianco.

However, if one or two high-profile deals do crater, then the knock-on effect for all industry players will be considerable. Yet, it seems no one is listening. Germany, for example, continues to be highly aggressive in terms of pricing.

Nevertheless, with deal levels showing no sign of abating and France and Italy expected to deliver a cluster of projects in 2006, Babcock & Brown will continue to pound the wind acquisition trail.