

Macquarie



MACQUARIE INFRASTRUCTURE GROUP
RESPONSE TO GOLDMAN SACHS JB WERE
EQUITY PORTFOLIO STRATEGY ARTICLE

15 FEBRUARY 2006

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Goldman Sachs JB Were recently published an equity portfolio strategy article which raised concerns regarding infrastructure, property and utilities funds. While many of the issues raised in the article are general in nature, Macquarie Infrastructure Group (MIG) is referenced a number of times. The following paper provides MIG's view on some of the more material issues raised in the paper.

Management and Performance Fees

MIG management companies are entitled to base and performance fees in return for providing management services. The fee structure shows a clear alignment of interests with investors:

- Base fees are primarily related to market capitalisation which is a function of security price. If the security price rises, the investors and responsible entity will benefit and the inverse would also apply; and
- Performance fees are payable in the events where the return on an investment in MIG achievable by the investor exceeds the comparative return achievable from investing in the broader Australian industrials sector. The performance fee payable is a percentage of the excess performance achieved by the investor.

We believe that this approach is superior in creating alignment of interests with investors than any structure based on accounting measures which may not relate to the investors returns achieved based on market pricing. In addition, MIG has developed and constructed a number of toll roads over its history which have generated considerable shareholder value, despite the absence of revenue and cash flow during the construction period. MIG investors who have reinvested dividends and participated in capital raisings would have received a compound annual return of 17.5% p.a. over 9 years, after payment of all management fees.

MIG Approach to Acquisition and Investment

MIG seeks to identify and secure new investments which are value accretive to the portfolio. Value is created where the return achievable on the investment exceeds the risk adjusted cost of capital. Since listing in 1996, MIG has made a number of additional and significant investments which have generated considerable shareholder value. The most notable of these investments are the 407 ETR and M6 Toll.

In the past 15 months, MIG has secured 4 new investment opportunities for investors. In all instances these investments offered:

- a higher expected internal rate of return than the existing portfolio;
- a higher equity risk premium than the existing portfolio; and
- a higher equity return than required by MIG's risk adjusted investment criteria.

Sustainability of the MIG Model

MIG has invested in a number of long term, high quality toll road concessions around the world. The portfolio is not mature and growth in cash flows is expected to be driven by increasing traffic, increasing tolls and control of operating costs. Over time, the growth in cash flows are expected to provide the opportunity for increasing the debt employed in these investment and accelerating investors returns. The use of debt is both prudent and efficient.



In relation to debt employed:

- MIG uses limited-recourse financing at the investment level which is capable of being repaid exclusively by expected cash flows of the project;
- MIG maintains a high degree of interest rate hedging to protect investors returns against rising interest rates;
- Debt typically has a materially lower return requirement than equity, resulting in increased expected equity returns; and
- Increased debt used at the project level reduces equity capital invested in the projects and this strategy should result in lower base fees payable to MIG management companies and higher returns to investors.

MIG conducts a regular review of all expected future returns on investments and a detailed 5 year cash flow forecast of MIG. Distributions paid to investors and guidance provided by Directors are based on expected cash flows to be generated by MIG from both operating surplus and proceeds from refinancing.

