

Business review Infrastructure

“Our first year as a distinct business line has seen the successful launch of 3i Infrastructure Limited, and our reach extended in continental Europe, Asia and the US. Together, these initiatives made for a good year and provide a strong base from which to build future asset growth in this rapidly-expanding market.”



Business model

Building on 3i's experience of making infrastructure investments for over 20 years, the Group established a distinct Infrastructure business line during the year. Infrastructure assets and returns had previously been reported as a part of the Growth Capital business line.

The objective was to facilitate the expansion of 3i's business in this rapidly-growing market internationally and also to prepare for the launch of a listed investment vehicle, 3i Infrastructure Limited, which is advised exclusively by 3i and in which 3i Group plc has a 46.4% stake.

The business model for the Infrastructure business line is to achieve a blended return through a combination of returns earned on assets (invested either directly by 3i or indirectly through 3i Infrastructure Limited) and advisory and performance fees earned from advising external funds such as 3i Infrastructure Limited.

An annual advisory fee paid by 3i Infrastructure Limited to 3i is based on the fair value of 3i Infrastructure Limited's investments at 1.5% for investments when initially acquired, reducing to 1.25% for investments held for longer than five years. A performance fee of 20% is earned by 3i on the total return above an 8% performance hurdle at the end of a financial period.

Strategy

A dedicated international team of 14 investment professionals has a geographical focus on Europe, Asia and the US through four hubs: London; Frankfurt; Mumbai; and New York. These investors target three main sub sectors: social infrastructure

(eg PFI projects, hospitals, education, and government accommodation); utilities (eg water, gas, electricity distribution); and transportation (eg roads, airports, ports, rail and ferry operations).

An example in the utilities sector was the £251 million AWG investment. Anglian Water, AWG's principal business, is the fourth largest Ofwat regulated water and waste-water company, with 4.2 million water and 5.4 million waste-water customers.

Marketplace

Infrastructure businesses tend to be asset-intensive businesses providing essential public services over the long term, often on a regulated basis or with a significant component of revenue and costs that are subject to long-term contracts.

There is a substantial market opportunity for new and replacement infrastructure in developing and more mature economies. Increasing recognition by governments of the value that the private sector can bring to infrastructure has also grown demand.

The combination of these factors has resulted in a significantly growing asset class.

3i Infrastructure Limited

3i Infrastructure Limited listed on 13 March 2007 with a market capitalisation of £700 million. 3i's infrastructure investments in Europe and the US are now made mainly through the 3i Infrastructure listed company.

3i's initial investment in 3i Infrastructure Limited was provided by transferring four seed assets with a value of £234 million and investing £91 million in cash. Three assets, Alpha Schools, Octagon Holdings and Infrastructure Investors (I²), were transferred in full (£94 million). Osprey (AWG) was transferred in part (£140 million) with the balance (£111 million) remaining on the 3i balance sheet, as 3i Infrastructure Limited is not permitted to hold more than 20% of its portfolio cost in any individual asset.

The board of 3i Infrastructure Limited, which is chaired by Peter Sedgwick, a former member of the management committee of the European Investment Bank, comprises four independent non-executive directors. A fifth non-executive director is Paul Waller, a member of 3i's Management Committee.

At 31 March 2007, 3i's 46.4% shareholding, including associated warrants, in 3i Infrastructure Limited was valued at £334 million.

3i Infrastructure Limited is expected to publish its first interim results in November 2007.

Gross portfolio return

The Infrastructure business line generated a gross portfolio return of 16% on opening portfolio value in the year to 31 March 2007. Of the return, £12 million relates to the transfer of assets to 3i Infrastructure Limited and income yield on the portfolio. A further £8.6 million unrealised profit was generated from the increase in 3i Infrastructure Limited's share price and associated warrants since flotation.

Investment and realisations

During the year, the Infrastructure team made new investments of £251 million in Osprey (AWG) and £6 million in T2C. In addition, further drawdowns of £32 million were made by I² and Alma Mater to fund the purchase of new assets in those funds.

The only disposals made were transfers of assets to 3i Infrastructure Limited and proceeds from a partial realisation in the Alma Mater fund.

Portfolio

In addition to the £334 million value of 3i's holding in 3i Infrastructure Limited at 31 March 2007, the Group continues to hold direct investment in four assets not transferred to 3i Infrastructure Limited with a value of £135 million, the largest of these being the retained holding in Osprey (AWG) with a value of £111 million.

Michael Queen Managing Partner



For further information on Infrastructure please visit www.3i-infrastructure.com