

Summary of financial interviews

20 April 2011

1 Executive Summary

The Rolling Stock fleet renewal project team interviewed selected financiers and financial division heads of Rolling Stock Manufacturers (“RSM”) between 5 – 7 April 2011 at the Gallagher Estate in Midrand. The objective of the interviews was to assist the project team in assessing the broad market appetite for the project as well as testing certain project assumptions. The key messages from this engagement were:

- All participants welcomed the transparent and open market engagement process and looked forward to continuing interaction
- It was confirmed by foreign financiers that South Africa was a desirable location for sovereign-backed deals
- Most development banks saw value for money advantages in bringing multilateral providers into financial deals
- It was confirmed that the majority of financiers were prepared to finance the project wholly or almost wholly in South African Rand
- Most financiers were content to entertain structured deals that included a maintenance/ performance risk transfer to the manufacturer (subject to being able to manage such risk)
- Some but not all financing would be tied to certain manufacturing countries of origin
- All financiers valued the quality of the manufacturer (track-record, product quality etc..) although many trusted the PRASA procurement process to select these; some financiers went out of the way to comment on the quality of the industrial participants in the market engagement
- It was further believed that Basel 3 Requirements may bring pressure and tenor restraint on individual bank exposures going forward
- All financiers believed that a close alignment of the manufacturing awards and the financial tranches would be appropriate. There was no support for a single 18 year financial deal for all the rolling stock
- Some financiers drew attention to the need for upfront payments to support set up costs for the manufacturer given the level of local industrialisation required
- All debt financiers identified tenor lengths ranging from 12-20 years depending on financial instrument
- There were no outstanding concerns over a 65% local content subject to a reasonable build up of local trained resources and industrial capability
- All financiers saw the Public Finance Management Act and a budget allocation as the minimum commitment from National Treasury to support investment and some form of sovereign guarantees as necessary
- The tension between use of Export Credit Facilities and high levels of local content was noted

- **Some but not all financiers were prepared to provide equity investment in structured finance deals**
- **Most financial institutions saw that the project would benefit from high quality project management and the additional discipline and scrutiny that private finance bring to such a project**
- **Financiers suggested to shelter (fence-off) NT contributions over time by creating a separate SPC within PRASA**
- **The tension between a complex financing and the speed of initial delivery was noted**
- **Some participants suggested that OEM's are in a better position to get the best deal out of the ECA's than a normal financier**

2 Introduction

Dear Reader

The purpose of this document is to have a recording of the key points raised during the interviews with the financiers. This is a document for internal purposes only to be shared among the PRASA, DoT, the dti and the Transaction Advisors.

A separate document will be available for sharing on the PRASA Website containing a summarized version on a no names basis. Also a folder is available with all the material received from the financiers. These documents will also be available on the GIBB document management system.

Q&A Panel

Piet Sebola (Chair)	PRASA
Kogan Pillay	National Treasury
DeBuys Scott	KPMG
Daniel Loschacoff	KPMG
Theo Maeder	DoT
Rufus Boyd	Interfleet
Christiaan Beyers	The dti
Oliver Szocs (minute taker)	KPMG

Interview Questions

1	Please provide us with some examples of where you have financed rolling stock and/or transport infrastructure projects.	A	Piet Sebola
2	Please provide us with the envisaged potential benefits of external/private finance involvement, including efficiencies.	B	Daniel Loschacoff
3	What would be the necessary terms and structure of the upfront financial commitment from the National Treasury/Government of South Africa before tendering for such a project?	A	Kogan Pillay
4	Do you have any general concerns regarding third party financing of this particular project?	B	De Buys Scott
5	What appetite do financiers have to assume longer term performance/maintenance risk on the rolling stock, and conditions relating thereto?	A	Rufus Boyd
6	What is the maximum envisaged tenure for financing the rolling stock?	A	De Buys Scott
7	What guarantees or security would your require?	A	Kogan

			Pillay
8	What would be the optimal phasing/batching of financing contracts (assuming it would be impossible/inefficient to have a fixed financing upfront arrangement for the entire programme)?	A	De Buys Scott
9	What are the necessary capabilities you would seek of the successful consortium/rolling stock manufacturer before providing finance?	B	Rufus Boyd
10	How do you envisage the substance of relationships between consortium members, i.e. financiers/rolling stock suppliers/ECAs.	B	Daniel Loschacoff
11	Any other issues such as SA sovereign (currency) risk, risks related to (partial) local production, PRASA as the counterparty, etc.	A	Kogan Pillay

Financiers and RSMs funding divisions interviewed:

ABSA
Bombardier
Citibank
Continuum
Credit Agricole
DBSA
DEG/KfW
French Development Agency
Investec Bank
Landesbank
Mitsui
Natixis
Nedbank
Rand Merchant Bank
Siemens
Sojitz Corporation
Standard Bank
Vidistep / CNR / China Railway Construction Corporation
Vunani Capital/Commerz Bank

3 Initial consolidated responses

Please provide us with some examples of where you have financed rolling stock and/or transport infrastructure projects.

- All interviewees could state significant and relevant experience
- A number of institutions had examples working with Transnet and Gautrain in South Africa. Many also had relevant experience in other African countries. There is a tendency of French companies to work more in the francophone countries and English speaking countries mainly in Nigeria, South Africa and Kenya. There is a language barrier especially considering the transfer of knowledge issue when foreign engineers have to communicate to the South African worker pool.
- Some banks mentioned South African experience with similar large programmes in other sectors (power, toll roads, etc.)
- ECA financing can be provided by most of the banks. Some seem to have more experience and better global relationships than others. Some had innovative packages which can be cheaper than others. This is due to discounts on insurance premium and local currency funding. All agreed that ECA should be a part of the package due to its low cost.

What would be the necessary terms and structure of the upfront financial commitment from the National Treasury/Government of South Africa before tendering for such a project?

- National Treasury guarantees / support will be required, but not always in the form of State guarantees
- Almost all require proper business plan as well and not just reliance on State guarantees
- Most require a budget allocation commitment of more than 3 years
- Termination clauses (“step-in” rights) should be in the contracts
- Various levels of support for different aspects of transaction
- Clear framework to be in place. Clarity on payment structure.
- Depending on the project structure more equity may have to be in the project (up to 30% equity required)
- Development Financial Institutions (DFIs) can take the portion of debt which does not have government guarantee
- Government support in general seems to be important in delivering value for money. It is important that project receives this support all the way.
- Project management and implementation risk need to be mitigated. In the past South African projects experienced delays and significant overruns

due to poor project management. Creation and monitoring of timelines is important, clear definition of roles and most importantly clear objectives.

- Certain international Government institutions may have additional benefits, but they generally require a minimum involvement of their industry.
- Long Distance service and Metrorail may have different commercial targets. Long distance rail may have better returns and can therefore be financed with less Government guarantees sooner.
- One respondent identified PRASA property and buses can be used in the funding structure (on balance sheet).
- Ensure the group of financiers are aligned strategically (i.e. has interest in development goals, interest in sector and generally share the sense of importance of this project)
- One respondent suggested to outsource profitable existing lines (Moloto and Soweto lines) to private investors and let them (partly) finance the rolling stock and assume (some) demand risk

What appetite do financiers have to assume longer term performance/maintenance risk on the rolling stock, and conditions relating thereto?

- Most financiers are prepared to partake in some form of maintenance / operational risk with the RSMs
- All financiers will look for substantial track record, product quality, etc. in the RSM
- Due diligence will focus on the long term view on the RSM companies as well as their international experience
- Manufacturers with financing arm saw no issue in accepting the risk of the performance of their sister companies
- Banks with track record in rail are best equipped to monitor contractual obligations and to ensure manufacturers are under control
- Penalty systems would be built into the contract to ensure risk is mitigated
- RSM may also be able to provide guarantees, which will decrease the funding cost and gearing ratio
- In-house finance departments of RSM are best suited to take on the risk and will make it cheaper

What is the maximum envisaged tenure for financing the rolling stock?

- Long term periods quite possible, in excess of 20 years but optimum funding structure to be flexible in period with refinancing options
- Evolution of the financing structures will be ongoing including possible re-engagement with funders
- Local Banks saw no liquidity problem in local market

- All institutions saw Basel 3 (matching of assets and liability periods for Banks) as likely having a general impact on liquidity, tenor and cost of finance
- Given the social impact of the project there are lower cost of finances available from some institutions
- ECAs are generally limited to 10-12 year finance with repayment start after construction (i.e. after 3 years). There is also a grace period after construction of maximum 6 month. Therefore the maximum for ECAs is 15 years.
- Some fixed interest rate options may be available for the programme
- Financing for manufacturer can use different options focused on private sector.

What would be the optimal phasing/batching of financing contracts (assuming it would be impossible/inefficient to have a fixed financing upfront arrangement for the entire programme)?

- Many organisations would take their cue from the manufacturers minimum order requirements
- Volumes per annum varied between 250 and 500 for 5 to 10 years to a monetary investment of R 5 billion per annum
- Volume to be significant for the start, approximately 2500 to 3000, around 5 years of full production to justify local content requirements. Clear trade off between complex finance structure and procurement against speed of delivery
- Finance batches of 3-4 years seem appropriate. Manufacturing for local content is expected to need a minimum of 5 years
- There are many large capital expenditure programmes in place in South Africa and therefore batching and planning helps managing liquidity of the market (such as currently already being coordinated within the NT)
- 10-15% of capex will have to be raised in the first 18-24 month
- Capital markets can be accessed easier for batches and those have sufficient Rand based currency to cover the costs over the long term
- Some financiers echoed the view of RSM that the 65% local content requirement remains a major issue, requires careful definition in measurement and realistic timeframe.
- RSMs claim that with in-house finance capability they will be able to offer a highly competitive package given that all elements required are in-house, established ECA relationships, maintenance risk best positioned with RSM
- All international finance coupled with ECAs and likely to obligatory link to RSM in country of origin
- It is generally accepted that multi-layered financiers will be involved e.g. (1) DFIs longer term, slightly less security stringent, (1) RSM with ECA, maximum 10 to 12 years, ECA also possible for local finance, (3) possible

project finance around maintenance with availability incentives, (4) local banks who impressed with their appetite and preparation) quite flexible with longer tenures than global and more appetite to be flexible to ensure participation.

Please provide us with the envisaged potential benefits of external/private finance involvement, including efficiencies.

- **Involvement of private finance can have significant benefits e.g. due diligence oversight, monitoring and financial performance incentives**
- **Higher level of private investment would allow Government to spread out payment obligations.**
- **Private sector can bring additional experience**
- **For private investment the yields of the project have to be known. Private sector requires higher yields.**
- **Some participants stated that private finance would only bring additional costs and that the performance incentives could also be dealt with in the OEM and maintenance service contracts.**

What are the necessary capabilities you would seek of the successful consortium/rolling stock manufacturer before providing finance?

- **Track record and balance sheet of RSMs are very important. This includes localization experience as well as overall strategic alignment and corporate culture.**
- **Innovation is another positive characteristic for RSMs (i.e. “first loss” support (equity of 10 - 15%)**
- **Financing institutions have relationships with most major RSM either in their country of origin or their international branches. Companies, which are less known may be accepted, however due diligence has to be performed.**
- **Chinese Rolling Stock manufacturers are less known in the international space and hence only a few banks have existing relationships and the experience working with Chinese companies.**
- **BEE component was seen as a critical value add by some institutions**
- **A comment was made that RSMs and financing institutions will likely interact in the next year before RfP is issued**
- **Limit the number of consortium members to reduce risks**

How do you envisage the substance of relationships between consortium members, i.e. financiers/rolling stock suppliers/ECAs.

- **Certain OEM's with a finance arm noted that they would be able to finance this without further (direct) support of the commercial banks,**
- **Commercial banks envisage a deal structuring role. In some cases they recommend to be involved earlier to advice on the structure.**
- **Commercial banks will also aim to be debt providers.**

- **Most banks can assist with ECA financing.**
- **DFIs will work with any banks and should not be considered as competition, but rather complimentary.**
- **Varied views on process of procurement with some in favour of sequential or parallel processes for technical and financing procurement and others being in favour for an integrated process.**
- **Equity finance is limited by internal bank regulations. Most banks are willing to discuss or go out and provide internal sources of equity.**
- **Certain banks mentioned the possibility to create an SPV to follow operating lease approach.**

Do you have any general concerns regarding third party financing of this particular project?

- **General concern is the track record of Government run programmes and their project management that lead to overruns and delays. Feedback is to ensure risks mitigation strategies are in place, timelines are realistic and roles & objectives are clearly defined.**
- **Continuous strong political will is key for the programme success**
- **Government willingness to support the project in form of guarantees and other commitments**
- **Changes in capital markets over the long term are a concern**
- **Transparency is a concern, but to date financing institutions are happy with the communication**
- **Approval times and Signing of Agreements**
- **Monitoring of localization objectives to ensure success**

Other comments?

Financing institutions brought experts from ECA financing, rail & infrastructure experts, public sector experts, project finance experts corporate finance, PPP experts, Regional experts, financial advisory, debt capital markets, asset based financing, Roscos, investment banking and PRASA account managers.