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Silk Road Finance Corporation

Infrastructure: Key to Long Term Economic Prosperity in Asia

April 2016

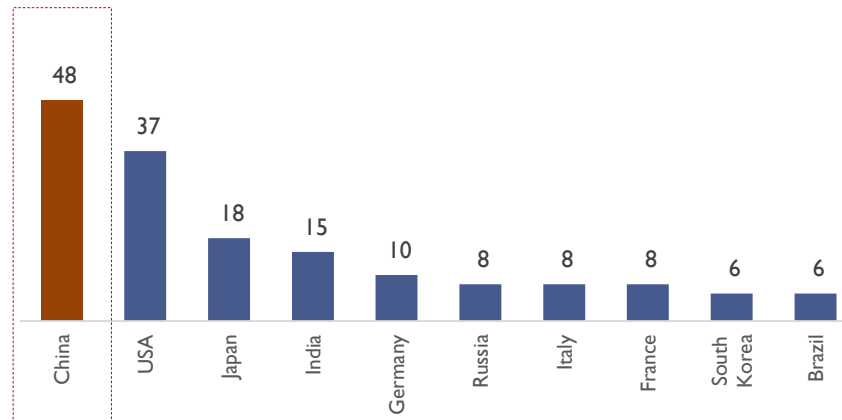


China incomparable growth in infrastructure development

In the past decades, China has been the world most proactive country in infrastructure investment. It supported China to achieve a prolonged double-digit GDP growth, the world fastest urbanization growth and significant improvement in people standard of living

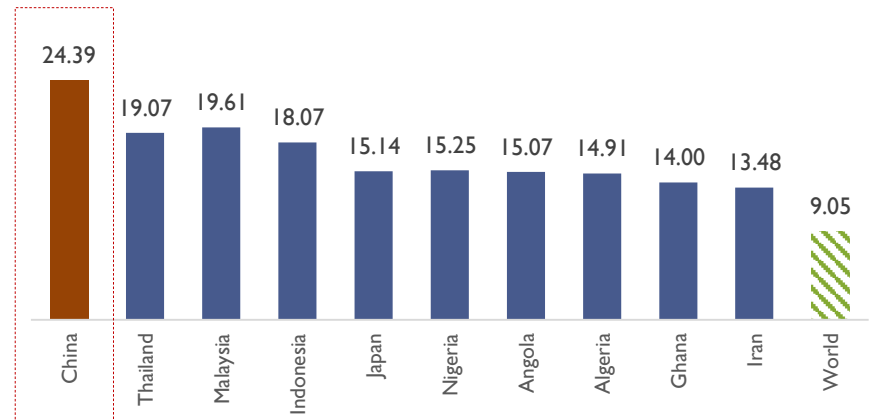
Top 10 physical structures and infrastructure spending countries¹

(US\$ trillion)



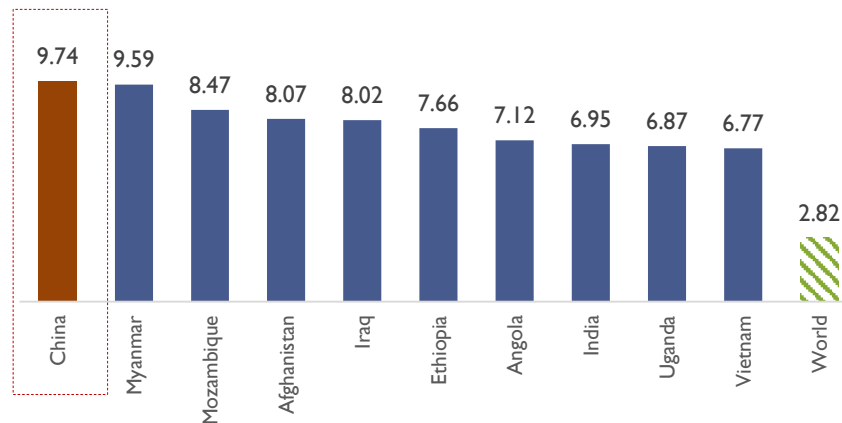
Top 10 urbanization rate growth during 1994-2014 countries²

(%)



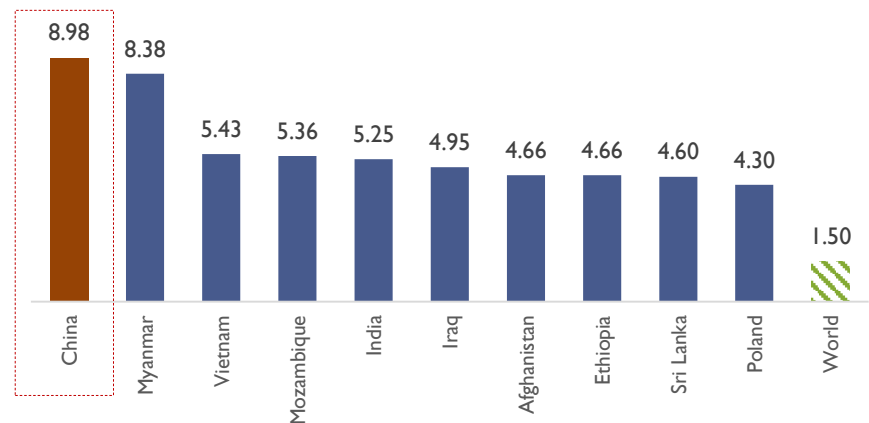
Top 10 average GDP growth during 1994-2014 countries²

(%)



Top 10 GDP per capital growth during 1994-2014 countries²

(%)



Source: Arcadis Consultancy Report, World Bank

Note:

1. Based on all the money a country spends publicly or privately on physical development, from infrastructure investment, construction, investments in plant and machinery and improvements in 'natural assets' such as land reclamation

2. Including countries with over 20 million population



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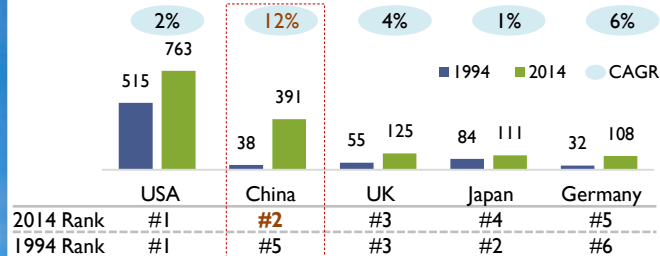
China impressive development in all key infrastructure categories

China has become one of the largest players among all key infrastructure categories

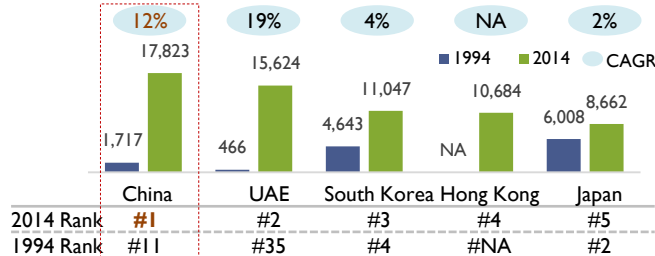


Air Transport

Passenger carried per year (million)

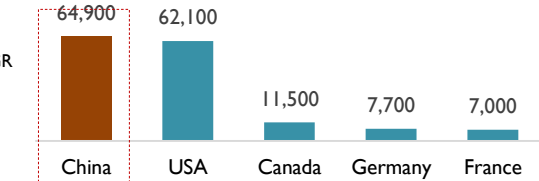


Freight (million ton times km)



Highway

Length of highway networks (miles)



Has grown at a rate of 204% per 10-year period



Port

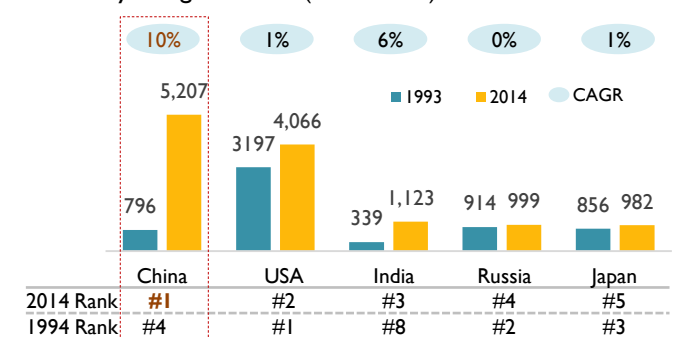
Ranking of Container Ports of the World('000 Twenty-foot Equivalent Units)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
1	Singapore 23,192	Singapore 24,792	Singapore 27,936	Singapore 29,918	Singapore 25,867	Shanghai 29,069	Shanghai 31,739	Shanghai 32,529	Shanghai 33,617	Shanghai 35,285	Shanghai 36,537
2	Hong Kong 22,602	Hong Kong 23,539	Shanghai 26,152	Shanghai 28,006	Shanghai 25,002	Singapore 28,431	Singapore 29,938	Singapore 31,649	Singapore 32,579	Singapore 33,869	Singapore 30,922
3	Shanghai 18,084	Shanghai 21,719	Hong Kong 23,998	Hong Kong 24,494	Hong Kong 21,040	Hong Kong 23,699	Hong Kong 24,384	Hong Kong 23,117	Shenzhen 23,278	Shenzhen 24,037	Shenzhen 24,205
4	Shenzhen 16,197	Shenzhen 18,470	Shenzhen 21,099	Shenzhen 21,417	Shenzhen 18,250	Shenzhen 22,510	Shenzhen 22,571	Shenzhen 22,941	Hong Kong 22,352	Hong Kong 22,226	Ningbo-Zhoushan 20,627
5	Busan 11,843	Busan 12,039	Busan 13,261	Busan 13,453	Busan 11,980	Busan 14,194	Busan 16,185	Busan 17,046	Busan 17,686	Ningbo-Zhoushan 19,450	Hong Kong 20,073



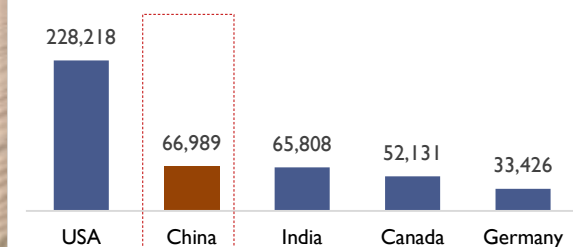
Power

Electricity net generation (billion kwh)

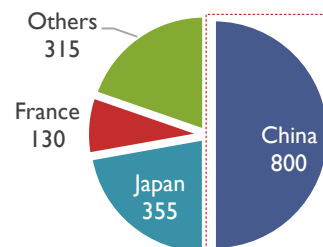


Railway

Rail lines length (total route-km)

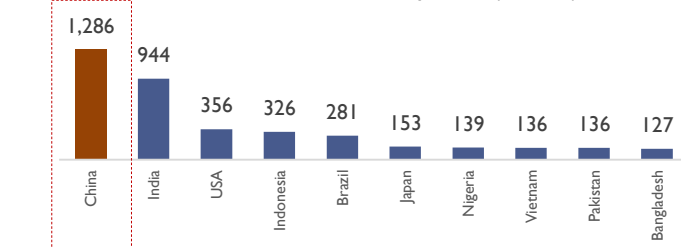


World high-speed trains passengers/year (million)



Telecommunication

2014 total number of mobile subscriptions (million)



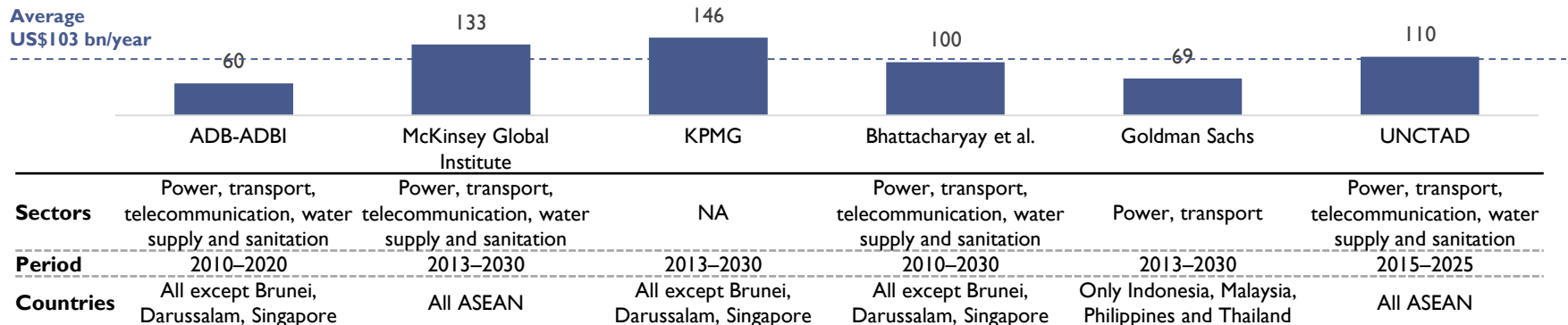
Source: World Bank, Sohu Business, Government of Hong Kong, Ericsson Mobility Report



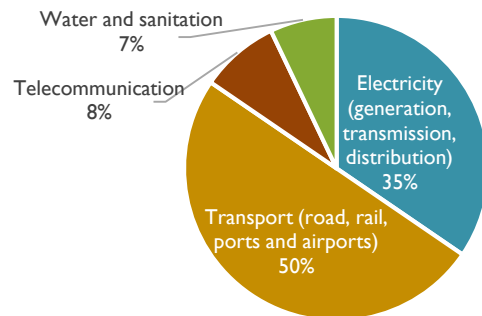
Robust demand in infrastructure investment in Asia

Annual infrastructure investment needs in ASEAN

Estimated annual investment needs (US\$ bn)



Estimated of infrastructure investment by sectors



Next 5 years infrastructure investment in Transportation (US\$ bn)

	Highway	Railway	Ports	Others	Total Investment
China	1,005	727	71	112	1,914
Southeast Asia	203	68	36	13	320
South Asia	211	118	10	18	357
Central Asia	29	11	2	2	43
West Asia and North Africa	264	101	21	17	403

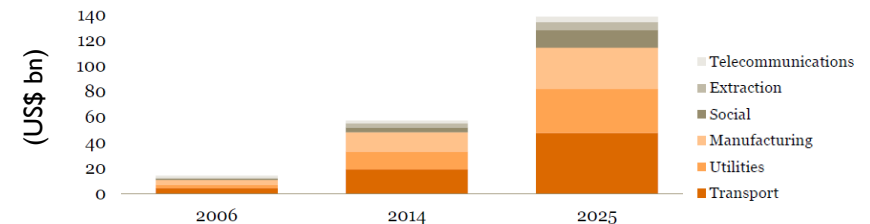
Source: ASEAN Investment Report 2015, Asian Development Bank Institute

Note:

1. Indonesian government expected to contribute US\$121bn to achieve the target and has received US\$50 bn leading from Chinese banks for 2 infrastructure projects in 2015. Therefore, there's a funding gap of US\$379 bn which relies on other sources

Case Study: Indonesia to ramp up infrastructure

- Under Indonesia's national medium-term development plan for 2015-2019, infrastructure investment has been **targeted as requiring up to US\$550 bn**
- The **addressable funding gap amounted to US\$379 bn¹** expected to be filled by SOE companies, private investors and Chinese capital



Sectors	Gov' Target	Investment (US\$ m)
Power	42GW of new capacity	US\$83 m
Ports	5 port hubs and 19 feeder ports across the archipelago	US\$81 m
Roads	3,650km of new roads targeted (1,000km tolled)	US\$78 m
Oil and gas	600,000b/d refining capacity	US\$43 m
Water	100% access to clean water and sanitation by 2019	US\$42 m
Rail	3,258km new tracks (1,099 urban and 2,159 intercity)	US\$24 m
Airports	Reduce airport capacity utilization from >100% to 95%	US\$14 m



Strong support from International Financial Organizations

Numerous financial organizations focusing on financing infrastructure projects have been established in recent years

Financial organization	Establishment date	Sources of fund and size	Members	Objectives
UAE-China Joint Investment Cooperation Fund	14 December 2015	US\$10 bn; equally contributed by members	China, Abu Dhabi	Seek investments in areas including conventional and renewable energy, infrastructure, technology and advanced manufacturing
Maritime Silk Road Fund	19 May 2015	RMB10 bn	Fuzhou City Government, China Development Bank (Fujian Branch), China-Africa Development Fund	Facilitate the construction of a transport network and cooperation with ASEAN, establish marine aquaculture farms and develop industrial parks in southeast Asian countries, etc
Silk Road Fund	4 November 2014	China committed US\$40 bn	Open for Asian investors	Leverage on Chinese capital to support Belt and Road initiative directly
Asian Infrastructure Investment Bank	24 October 2014	Authorized capital of US\$100 bn; equity allocation and capital contribution weighted by countries' GDP	Asia: China, India, South Korea, etc. Europe: the United Kingdom, France, Germany, Italy, etc. More than 40 countries indicated interest to be founding country	Fully utilize the infrastructure construction capability and development potential in Asia-Pacific region and fulfill the demand in infrastructure investment and financing
BRICS New Development Bank	15 July 2014	Initial capital of US\$100 bn; evenly contributed by five member	China, Brazil, Russia, India, South Africa	Support BRICS and other developing countries in infrastructure construction and sustainable development
China-ASEAN Investment Cooperation Fund	25 January 2010	Phase I capital of US\$1 bn and aiming to raise US\$10 bn over the next 8 years; EXIM Bank of China is the anchor sponsor	EXIM Bank of China, China Investment Corp., Bank of China, China Communications Construction Co.	Target investment opportunities in infrastructure, energy and natural resources in the ASEAN countries
Shanghai Cooperation Organization Development Bank	25 October 2010	NA	China, Russian Federation, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan	Provide support to the members' energy, transport and modern information technology demonstration projects



Keys to success in cross border infrastructure financing

1

Experienced, creditable and professional sponsor, contractor and operator

- Sponsor has to oversee and drive the entire project from project approval, construction permits application, EPC selection and appointment to project completion and acceptance and coordinate all the parties including creditors, contractors, operators and, likely customers / off-takers. An experienced and professional sponsor with strong management and execution capabilities is important to ensure seamless execution of construction
- The credibility and capability of the contractor is crucial in guaranteeing the technical specifications and quality of the construction
- The operators are important in maintaining the quality of the project's assets and operating the facility at maximum efficiency

2

Commercial viability of the project

- Commercial viability of a project is important to attract financing from the market
- Market defines good financial returns as revenue exceeds costs plus the commercially required return on capital and adjust for potential risks
- Market assesses returns by building a project financial model and checking project cash flows, returns, and financial robustness to justify the commercial attractiveness of a project

3

Robust Legal Framework

- A legal and regulatory framework that supports infrastructure investment is crucial to facilitate investments in complex and long-term infrastructure investment arrangements, reduce transaction costs, ensure appropriate regulatory controls, and provide legal and economic mechanisms to enable the resolution of contract disputes



Keys risks in cross border infrastructure financing

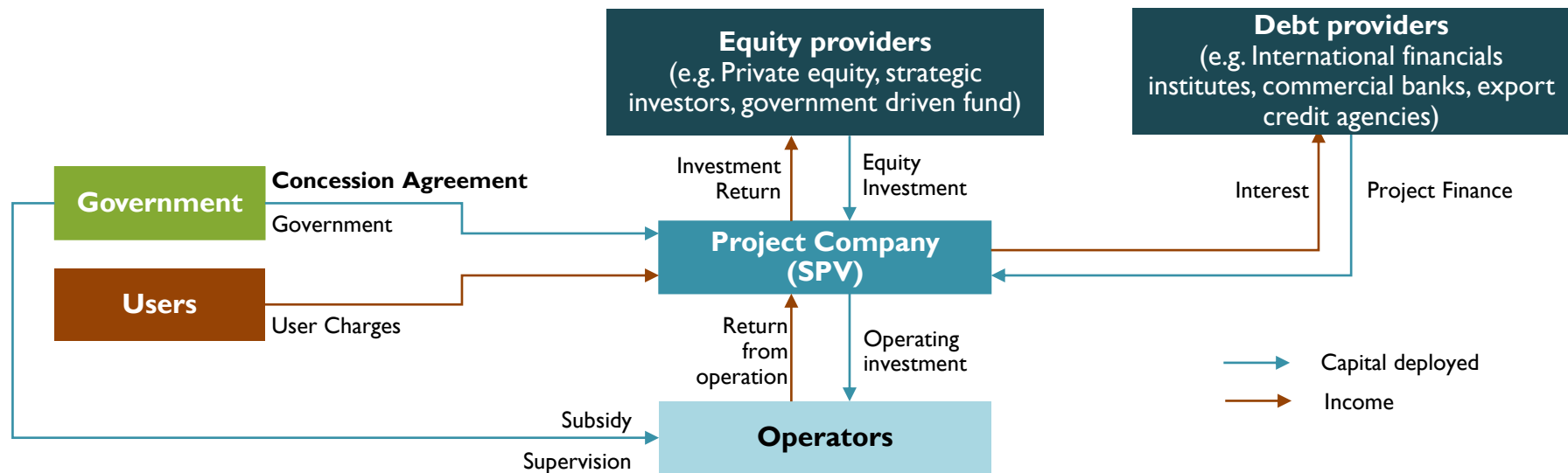
Potential risks	Potential risks	Considerations and mitigants
Political risk	<ul style="list-style-type: none">• Potential war or civil disturbance, expropriation, exchange controls or other types of currency transfer limitations and changes in the tax regime	<ul style="list-style-type: none">• Seek governmental assurances e.g. obtain comfort letters from the government indicating its support of the project• Include stabilization clauses in the investment agreement under which the government agrees not to take certain actions or to compensate investors for the costs of certain actions they take• Purchase political risk insurance which repays the finance providers if the project is damaged or destroyed by, or as a result of, political violence
Construction and start-up risks	<ul style="list-style-type: none">• Project delay and not able to be completed on time and/or within budget	<ul style="list-style-type: none">• Enter into a turnkey construction contract with the construction contractor which agrees to construct the project by a specific date and in accordance with the agreed specifications and assumes the liability for construction and performance defects and delays• Engage a creditable project operator
Structural risks	<ul style="list-style-type: none">• Obligations to third parties that take precedence over the payments to the lenders	<ul style="list-style-type: none">• Obtain structural enhancements and protections• Clear contract provisions and definitions, e.g., regarding force majeure• Understand the existence and strength of covenants, conditions, representations, and warranties and ensure the debt ranks at least pari-passu
Operating risks	<ul style="list-style-type: none">• Potential impact on servicing the debt as a result of revenue and costs volatility	<ul style="list-style-type: none">• Engage a competent project operator• Obtain insurance against property damage and may also obtain third party liability and business interruption insurance• Project company to agree to extensive reporting obligations and inspection
Repayment risk	<ul style="list-style-type: none">• Nonpayment by the project company as a result of generating insufficient revenues, obligations to third parties, avoiding making the necessary payments to the lenders, etc.	<ul style="list-style-type: none">• Set up a debt service reserve account which is funded with loan proceeds or project revenues and dedicated for loan services apply ratio tests e.g. debt service cover ratio and loan life cover ratio tests periodically with failure giving rise to an event of default or other sanction• Limit the project company's obligations to third parties
Currency risk	<ul style="list-style-type: none">• Potential currency mismatch between revenue stream and loan• Loss from fluctuating foreign exchange rates• Potential currency restriction in less developed countries	<ul style="list-style-type: none">• Seek insurance coverage for currency inconvertibility or for transfer risk• Enter into currency swaps or hedging agreements to manage currency risk• Set up offshore reserve account such that part of the loan proceeds is deposited outside the jurisdiction of the project that can be drawn upon if the project company does not make a payment on the loan for any reason e.g. currency restriction
Legal risk	<ul style="list-style-type: none">• Enforcement risk as a result of foreign jurisdiction's local law is not consistent with international norms, or its legal institutions are weak, corrupt or subject to undue political Influence	<ul style="list-style-type: none">• Make sure the governing law is sophisticated, stable and predictable e.g. New York or English law• Partnering with Multilateral Lenders (e.g. the World bank) or Export Credit Agencies



Public-Private Partnership framework

Public-Private Partnership (“PPP”) is a long-term contractual relationship between the public sector and the private sector for the purpose of having the private sector deliver a project or service traditionally provided by the public sector

PPP framework illustration



PPP models

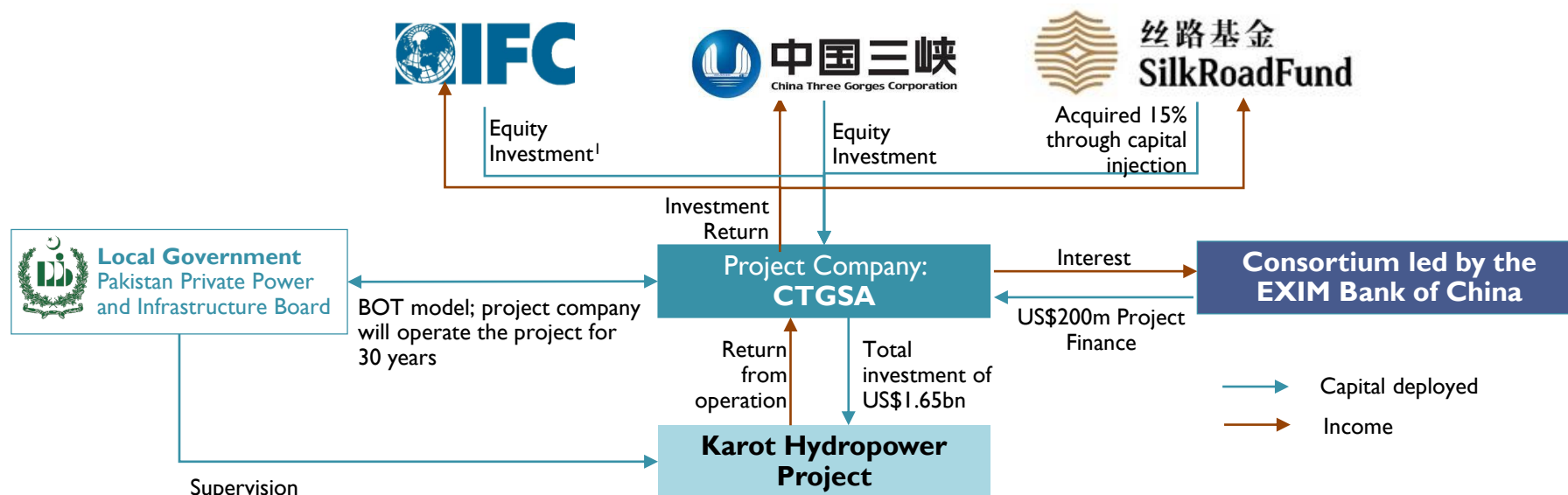
- **Rehabilitate, operate, and transfer (“ROT”)**: rehabilitates an existing facility, then operates and maintains the facility at its own risk for the contract period
- **Rehabilitate, lease or rent, and transfer (“RLT”)**: rehabilitates an existing facility at its own risk, leases or rents the facility from the government owner, then operates and maintains the facility for the contract period
- **Build, rehabilitate, operate, and transfer (“BROT”)**: builds an add-on to an existing facility or completes a partially built facility and rehabilitates existing assets, then operates and maintains the facility at its own risk for the contract period
- **Private finance initiative (“PFI”)**: handles the up-front costs of the facility then leased to the public which makes annual payments to the private company
- **Build, lease, and transfer (“BLT”)**: builds a new facility largely at its own risk, transfers ownership to the government, leases the facility from the government and operates it at its own risk up to the expiration of the lease
- **Build, operate, and transfer (“BOT”)**: builds a new facility at its own risk, operates the facility at its own risk, and then transfers the facility to the government at the end of the contract period
- **Build, own, operate, transfer (“BOOT”)**: builds a new facility at its own risk, then owns and operates the facility at its own risk, and then transfers the facility to the government at the end of the contract period
- **Design-build-finance-Operate (“DBFO”)**: finances and constructs the asset, which gives the private entity the incentive to complete on time and within budget. The public sector paid for the asset when it has been completed

PPP Case Study: Silk Road Fund debut investment in US\$1.65 bn Pakistan Karot Hydropower Project

Project overview

- In April 2015, Silk Road Fund (“SRF”) signed a MOU with China Three Gorges Corp and the Pakistan Private Power and Infrastructure Board to provide capital to support the construction of the Karot Hydropower Project on the Jhelum River, in the country’s northeast with a required investment value of US\$1.65 bn
- Karot Hydropower Station, the fifth largest hydropower station in Pakistan with an installed capacity of 720,000 kilowatts, and an annual power generation capacity of 3.2 bn kilowatt-hours, is a priority project within the broader China-Pakistan Economic Corridor initiative, proposed by Chinese Premier Li Keqiang in May 2013
- SRF acquired 15% stakes and become a major shareholder in the project company, China Three Gorges South Asia Investment Ltd (“CTGSA”) which is a subsidiary of the China Three Gorges Corp. SRF also joined in a consortium led by the Export-Import Bank of China together with China Development Bank and International Finance Corporation to provide US\$200 m loan to the project
- The project adopts build, operate, transfer (“BOT”) model and has started construction in January 2016
- The project expected to be completed in 2020 and will be operated by the Chinese for 30 years and then transferred to the government of Pakistan

Karot Hydropower Project structure



Source: News, SRF press release

Note:

1. International Finance Corporation has agreed to invest \$100 million in 720-megawatt Karot hydropower project on 18 September 2015



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