Historical Case Study : Infigen Energy

26 February 2016

INFIGEN ENERGY ("INFIGEN")
HISTORICAL CASE STUDY AS PUBLISHED ON 26 FEBRUARY 2016

- Key portfolio addition for the period and the largest position of the fund
- Formerly Babcock & Brown Wind (BBW)
- Business struggled for years due largely to a challenged US subsidiary, which in late 2015 was sold
- Debt level is very large
  - No analyst coverage
  - Trading below replacement cost
  - Revenues now growing strongly, up 27% in 1H 2016
  - Cash flow capacity very strong
  - In our view, significant upside potential
  - Thesis details overleaf…

Infigen Energy overview	
Ticker	IFN
Price[1]	A$0.46
Mkt cap[1]	A$351m
P/E (FY17F)[2]	N/a
RoE (FY17F)[2]	N/a
Yield (FY17F)[2]	N/a
AWQ position size at cost[3]	13.2%

1. Last close as at 23 February 2016
2. Based on available Bloomberg consensus forecasts
3. As at 31 January 2016

INFIGEN STARTED LISTED LIFE JUST OVER 10 YEARS AGO…

Infigen listed on the ASX on 28th October 2005

- ♦ World's only listed pure play wind farm owner at IPO
- ♦ Initial asset portfolio 672 Megawatts (MW) installed capacity
- ♦ Framework pipeline of ~750MW available for acquisition from Babcock & Brown (BNB.AU)
- ♦ At the date of research initiation, valuation for FY2006F EV/EBITDA was 24.0x and FY2007F was 14.4x[1]
- ♦ Starting leverage was low at ~30% debt / enterprise value
- ♦ Spain, at IPO, was forecast to be the single largest adjusted revenue contributor[2]
- ♦ Over time the US assets came to be the largest part of the portfolio

The company was then known as Babcock & Brown Wind Partners (BBW.AU)

1. UBS initiation report dated 19 December 2005, valuation post management fees of 1.4% and not including Framework assets (equally not including the consideration for the framework assets)
2. Adj. revenue includes the contribution from equity accounted US assets as revenue

...INFIGEN – A LONG TIME IN THE WILDERNESS

infigen

- The credit crisis, underperforming assets and a complex U.S. tax equity structure contributed to a significant decline in market value
- In mid 2009, equity analysts valued Infigen's US assets at US$0.9 - 1.2 billion
- The US assets were sold in late 2015 for ~US$272m
  - A key positive despite the reduced proceeds
- Debt remains very high, at ~2x market capitalization ("market cap")

Infigen security price since IPO

Source: Bloomberg

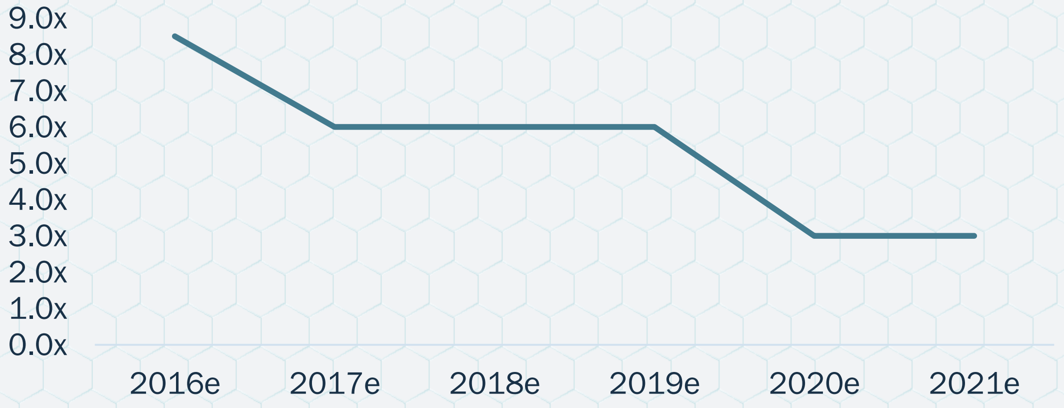
WHEN EARNINGS GROW STRONGLY, DEBT IS A SLINGSHOT ON EQUITY RETURN

- A firm's Enterprise Value (EV) is the sum of its market cap and net debt
- In the context of constant EV, if net debt falls fast, all else equal, market cap (and thus share price) must rise rapidly
  - If EV is actually rising, then the equity upside leverage is even stronger
- A challenge Infigen faces is that its Global Facility has a rapidly declining net debt to EBITDA covenant
  - Our analysis indicates the risk of covenant trip is de minimis

Conceptual example of equity leverage to falling net debt

	Year 0	Year 1	Year 2	Year 3	Year 4
EV (A$)	100	100	100	100	100
Net debt (A$)	80	65	50	35	20
Market cap (A$)	20	35	50	65	80
Shares (#)	20	20	20	20	20
Value per share ($)	1.00	1.75	2.50	3.25	4.00

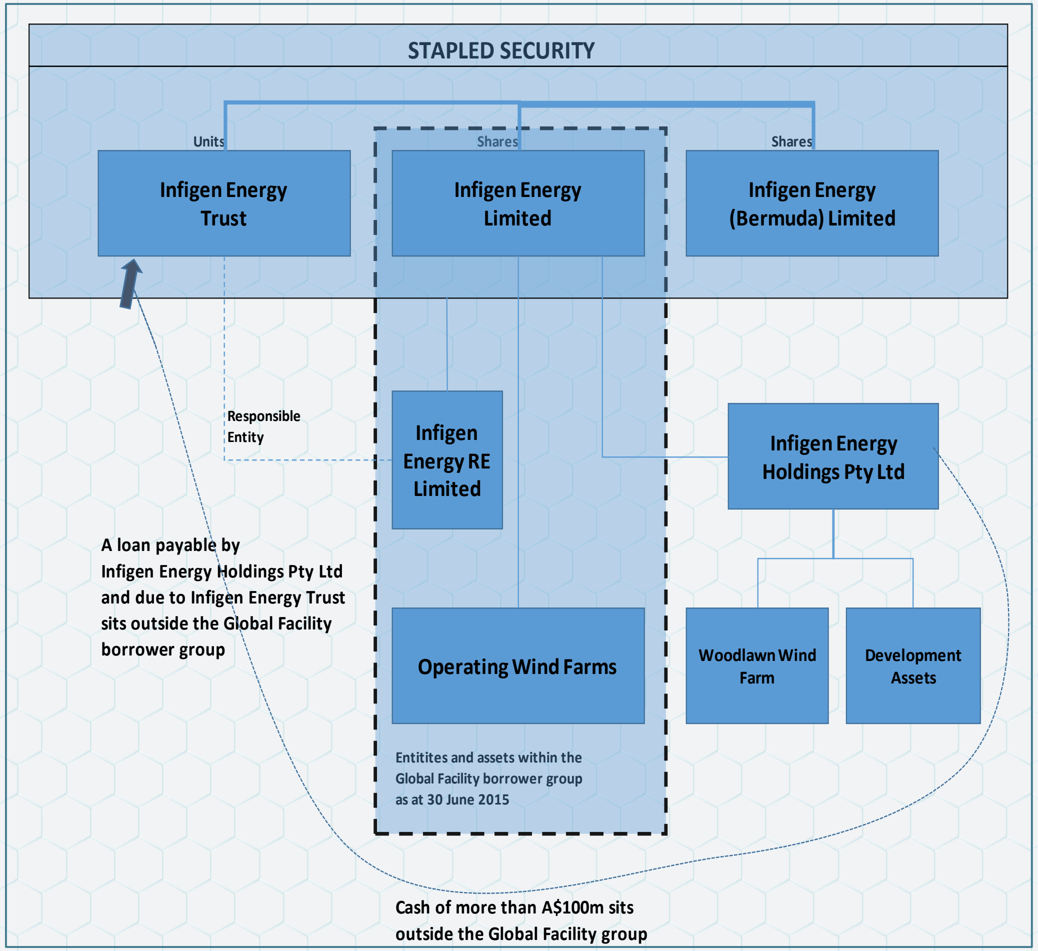
Infigen forced covenant step down (net debt/EBITDA)



Source: Infigen Energy and AWQ

QUIRKS OF INFIGEN'S CREDIT PACKAGE VASTLY REDUCE THE RISK OF COVENANT TRIP AND EQUITY VALUE COMPRESSION

- Infigen's Global Facility borrower group entities are subject to rapid covenant step down and full cash sweep
- Infigen has over A$100m sitting outside the Global Facility group in Excluded entities
- Contributions from Excluded entities to the Global Facility group count as EBITDA (and cause net debt to fall) under the covenant terms
- Thus Infigen has an ability to mitigate prior to covenant testing date and/or self cure post covenant testing date
- Covenant trip risk becomes de minimis



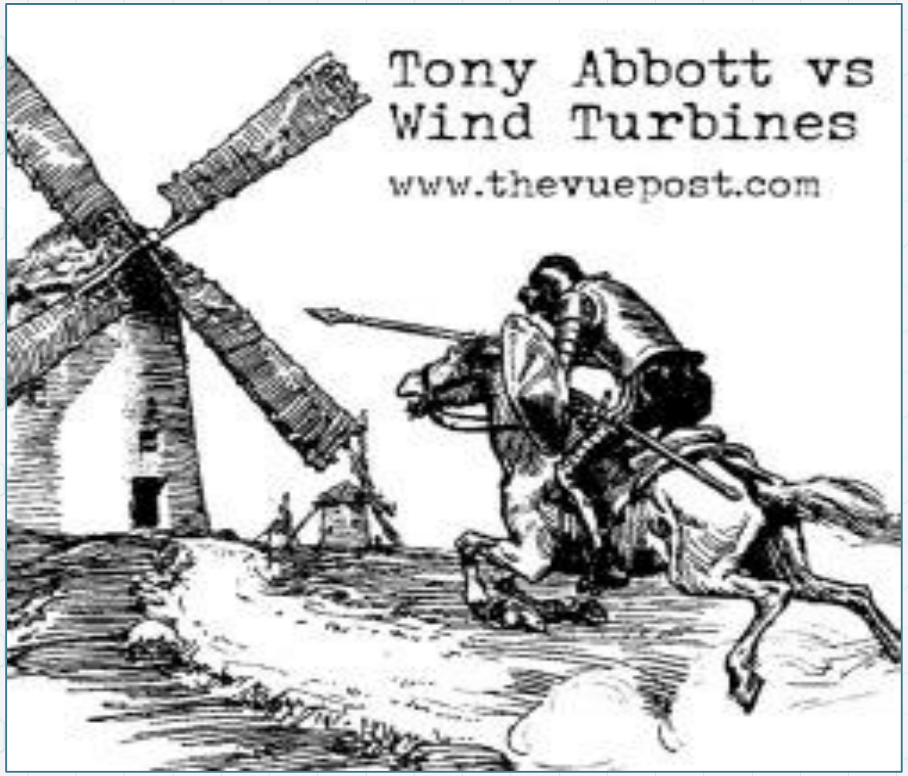
Source: Infigen Energy and AWQ

IN 2014 A HOSTILE POLICY ENVIRONMENT RESULTED IN THE PRICE OF GREEN CREDITS (LARGE GENERATOR CERTIFICATES) FALLING RAPIDLY…

Australia's then Prime Minister Tony Abbott during 2014 and 2015:

- Banned the federal renewable energy bank, the CEFC[1], from financing new wind projects
- Banned the CEFC investing in small scale solar
- Cut Australia's renewable energy target
- Entered the scientific debate on climate change by calling global warming "*crap*"
- Called wind turbines "*ugly*" (implicitly preferring the aesthetic appeal of open cut coal mines which are among the largest sources of Australia's carbon emissions)

1. Clean Energy Finance Corporation
2. From the novel "Don Quixote"; *Miguel* de Cervantes, 1605



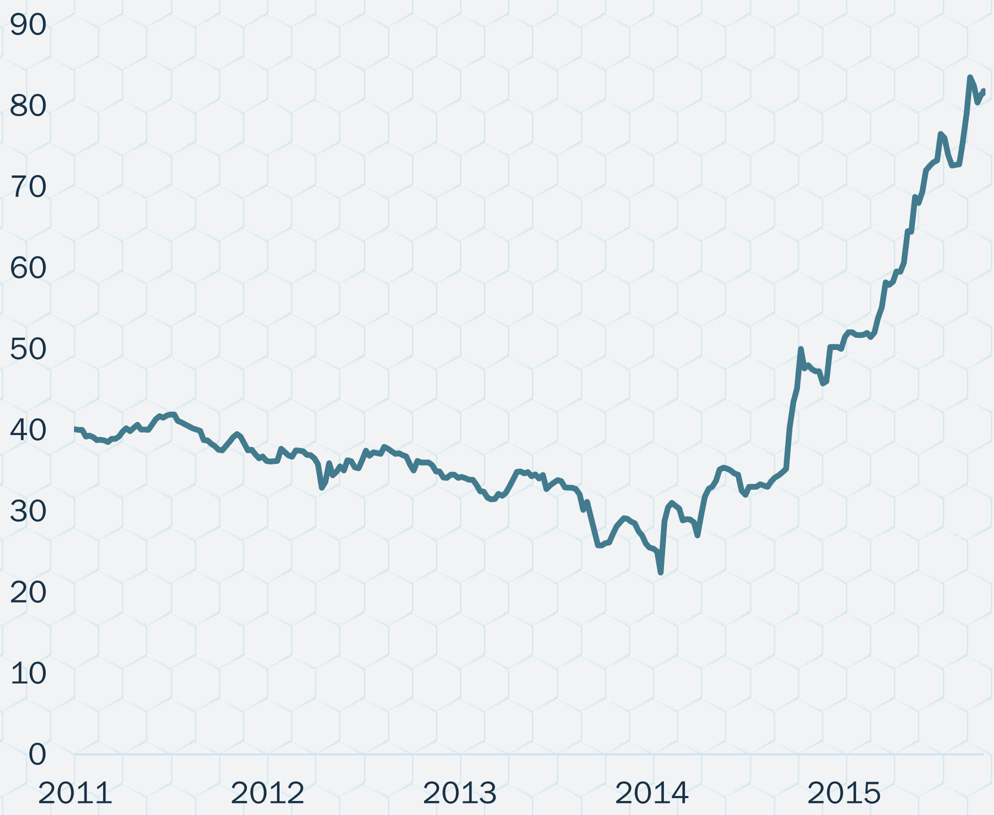
"Just then they came in sight of thirty or forty windmills that rise from that plain. And no sooner did Don Quixote see them that he said to his squire, "Fortune is guiding our affairs better than we ourselves could have wished. Do you see over yonder, friend Sancho, thirty or forty hulking giants? I intend to do battle with them and slay them"[2]

...YET WITH POLICY CERTAINTY RESTORED, MARKET FORCES ARE DRIVING UP LGC PRICES STRONGLY

- Policy uncertainty drove LGC prices below A$30/MWh in 2014
- This resulted in delays in obtaining financing for new renewable projects, which can easily take 2+ years to develop and build
- Post reaffirmation of the RET[1] LGC prices are again subject to market forces
- LGCs are a MAJOR source of revenue for Infigen, with the LGC price often being higher than the wholesale power price
- We envisage an acute shortage of LGCs for at least several years
- Should result in strong earnings which in turn will drive deleveraging...and thus strong growth in the security price

1. Renewable Energy Target, for Large scale generation of 33,000 GWh by 2020

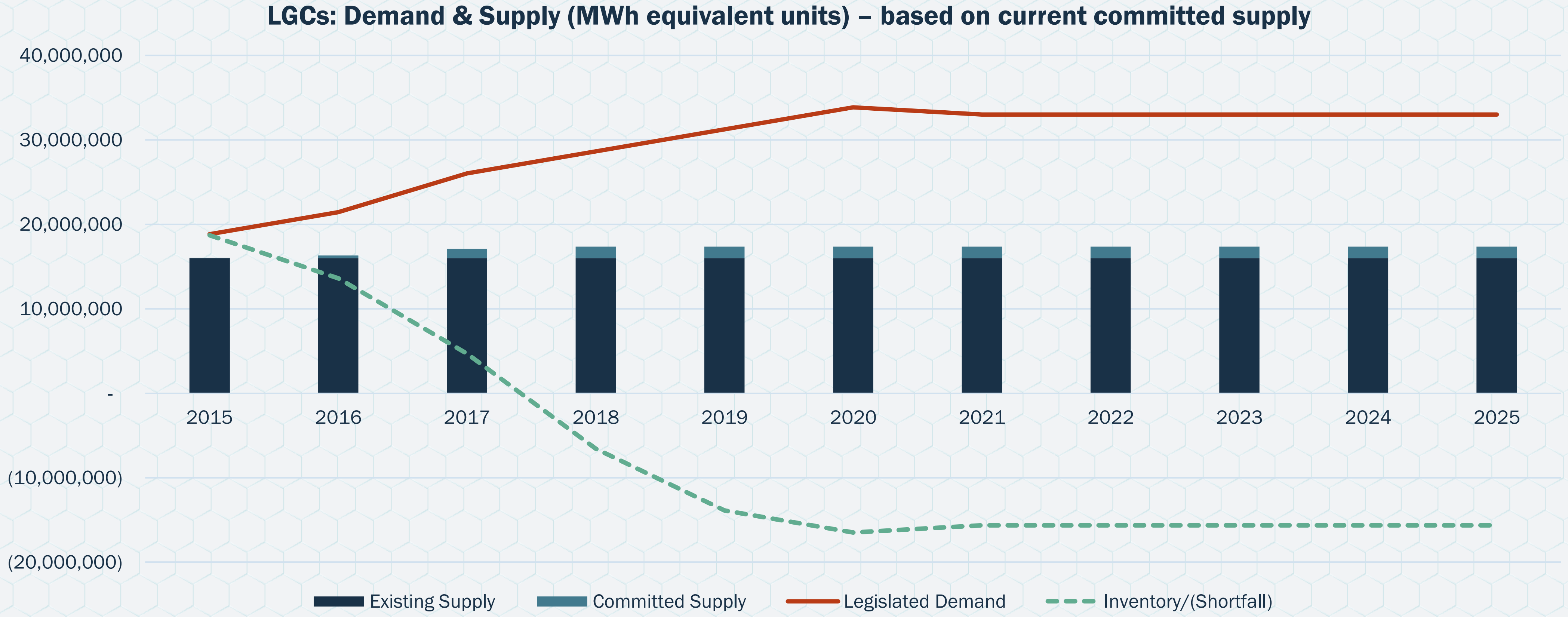
LGC price (A$ per MWh)



Source: Bloomberg

AS A RESULT OF POLICY UNCERTAINTY, PLANNING FOR NEW CAPACITY STALLED…

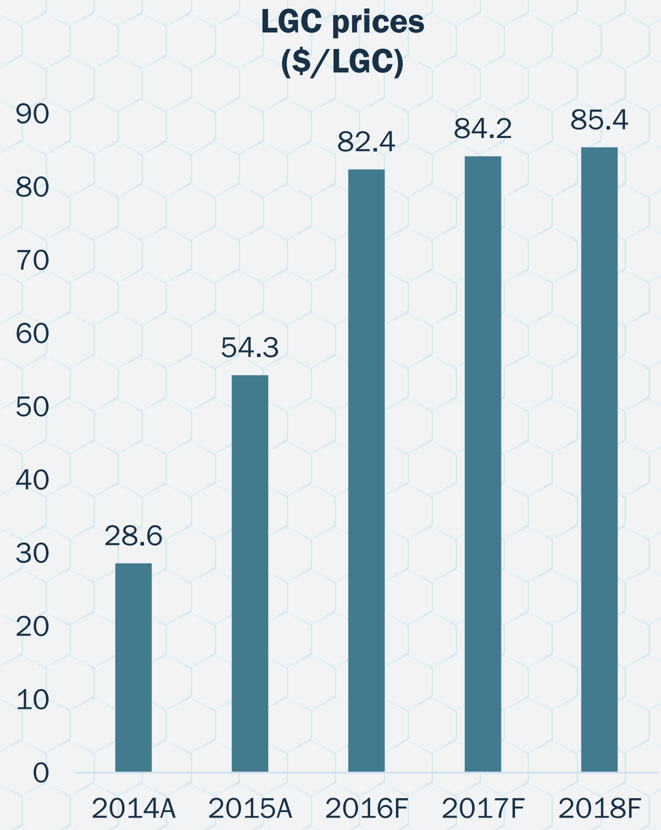
Cumulative capacity of 5 to 6 Gigawatts is needed to meet the supply shortfall

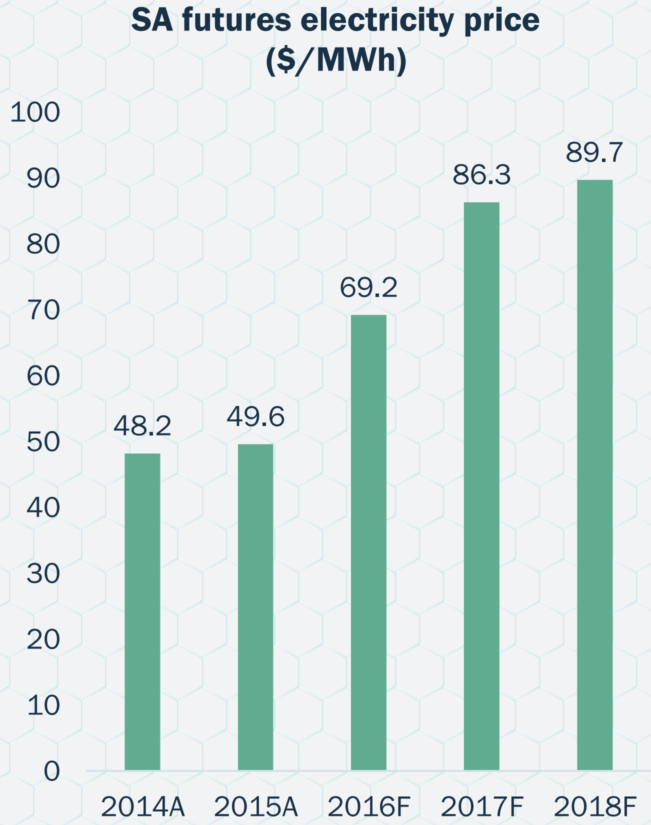


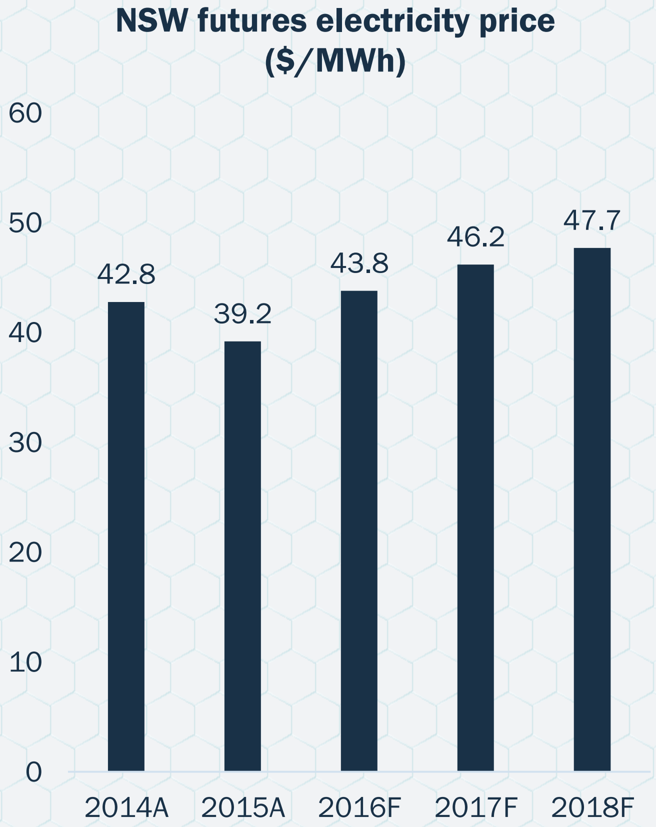
Source: Clean Energy Regulator, AEMO & Arowana analysis, which assumes 35% capacity factor on new supply

...WITH RESULTING PRICE INCREASES BENEFITING INFIGEN

Substantially improved outlook will benefit Infigen's merchant assets







Source: Infigen

THE CLEAR TREND LOCALLY AND INTERNATIONALLY IS FOR RET'S TO INCREASE OVER TIME

In 2015, Australia was one of the very few jurisdictions to reduce rather than increase their Renewable Energy Target. The overwhelming and inexorable trend is for RET scheme increases:

- **September 2015:** California increased their 2030 renewable energy target from 33% to 50%
- **May 2015:** QLD commit to a 50% renewable energy target by 2030
- **August 2015:** ACT commit to a 100% renewable energy target by 2025 – previous target was 90% by 2020
- **2014:** SA commit to a 50% target by 2025 up from 33% by 2020 set in 2009
- **2015: Australian Labour Party announced its renewable energy policy is for a 50% target by 2030**

Renewable energy will inexorably increase over time as a proportion of overall energy mix - driven by climate change and wide public support

IN THE MEDIUM TERM THIS IS BULLISH FOR LGC PRICES AND THUS BULLISH FOR INFIGEN

ULTIMATELY WE BUY A SECURITY FOR WHAT WE THINK IT WILL BECOME TOMORROW, NOT WHAT IT IS TODAY

Before Infigen was…	…and we think Infigen will transition to
♦ Highly leveraged, no distributions paid to equity as all cash is swept to repay debt	♦ Sustainable leverage ♦ Cash flow supports high distribution yield
♦ No equity coverage; all former brokers dropped coverage in the depths of Infigen's challenges ♦ "Ugly" wind farm owner and developer	♦ Infigen begins to receive equity research coverage again? ♦ Only pure play green energy exposure on ASX of scale ♦ Potential for Infigen to become a "market darling"
♦ RET/LGC scheme at risk under former government	♦ RET reaffirmed with earliest review 2020 (scheme life to 2030) ♦ ALP policy is for lift in RET target from 23% of electricity from renewables to 50% ♦ Value in Infigen's development book starts to be recognised by the market