

INVESTMENT AND INVESTMENT FINANCE
THE SUPPLY AND DEMAND OF LONG-TERM FINANCE
Session V: Role of Long Term Investors and Sovereign Wealth Funds

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THE ROLE OF LONG TERM INSTITUTIONAL INVESTORS FOR GROWTH

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Cassa depositi e prestiti



Equity vs debt



- Large part of both theoretical and empirical literature highlighted the **importance of equity** in global economic systems
- The evidence shows that equity is crucial to guarantee a **robust and sustainable long-term economic growth**
- The **debt component** has played a key role, too
- However, as economic history has taught us, after strong recessions a **deleveraging phase** is needed to restore stability
- This last crisis will not represent an exception: both public and private agents will **reduce their high level of indebtedness**
- In the short and medium term, this deleveraging process would generate **pro-cyclical (recessive) effects** on economic growth

Investment needs



- At the same time, the **demand for public and private investment** is still increasing in both developing and developed countries
- As the world population continues to grow, emerging markets become industrialized, and developed markets need to replace aging infrastructure, **the need for investment will continue to grow**
- The European Commission¹ has estimated an **investment need of about € 2 trillion** for transportation, energy and information, communication, and technology (ICT) over the next decade
- In the emerging economies, there is a strong need to improve infrastructure in order to support their development in the long run. For instance, between 2012 and 2030 a global **investment in green infrastructure of about \$ 36–42 trillion** is needed to shift to a low carbon economy²
- Therefore, the **demand for long-term capital investment** is going to grow, while the supply of long-term capital may not keep up with the demand

¹European Commission (2012), *Europe 2020 Project Bond Initiative*

²B20 Task Force Recommendations on Green Growth, 2012

Financing needs



- The supply of both **public and private capital** is needed to meet the demand for global investment
- Both sectors however are under stress. Public finance, above all in advanced countries, is facing problems due to **high ratios of government deficit and debt over GDP** (government deficit/GDP is equal to 5.9% and 1.4% in advanced countries and emerging economies, respectively; public debt/GDP is equal to 110% and 34% in advanced countries and emerging economies, respectively)¹
- Banking sector is **tightening credit** to **cut the leverage** and to **reduce the exposure to risky assets**, although the monetary policies pursued by the major central banks helped to increase systemic liquidity and to keep interest rates low. Annual growth rate of loans to non-financial corporations in the Eurozone was equal to -1.8% at the end of 2012²
- The aging population in advanced economies, on the one side, and the investment boom and increased consumption in emerging markets, on the other side, will reduce the willingness to save at the world level, making the **global capital more costly** in the coming years³

¹IMF, *WEO Database*, October 2012

²ECB, *Monthly Bulletin*, January 2013

³McKinsey Global Institute, *Farewell to Cheap Capital? The implications of long-term shifts in global investment and saving*, December 2010

Financing tools



- Both **debt and equity tools** are needed to ensure the stability of the global financial system and support the economic growth at the world level
- **Long-Term Investments (LTIs)** in infrastructure projects, energy and renewables, R&D, etc., are particularly needed to increase productivity and reduce cyclicalities in the world economy in the long run
- Although the **implied volatility in the stock market** of US and Eurozone declined in the second half of 2012 (12% and 14%, respectively), the **spread charged on long-term loans to non-financial corporations** remained above the historical average (70 bps)¹
- The role of **stable and strongly capitalized financial institutions** like, development banks, pension funds, sovereign wealth funds, etc., which have a long-term investment horizon, is crucial nowadays

¹The spread is calculated as the difference between the interest rate on long-term loans to non-financial corporations and long-term deposits from non-financial corporations. The historical average is calculated since 2003. ECB, Monthly Bulletin, January 2013

The role of equity

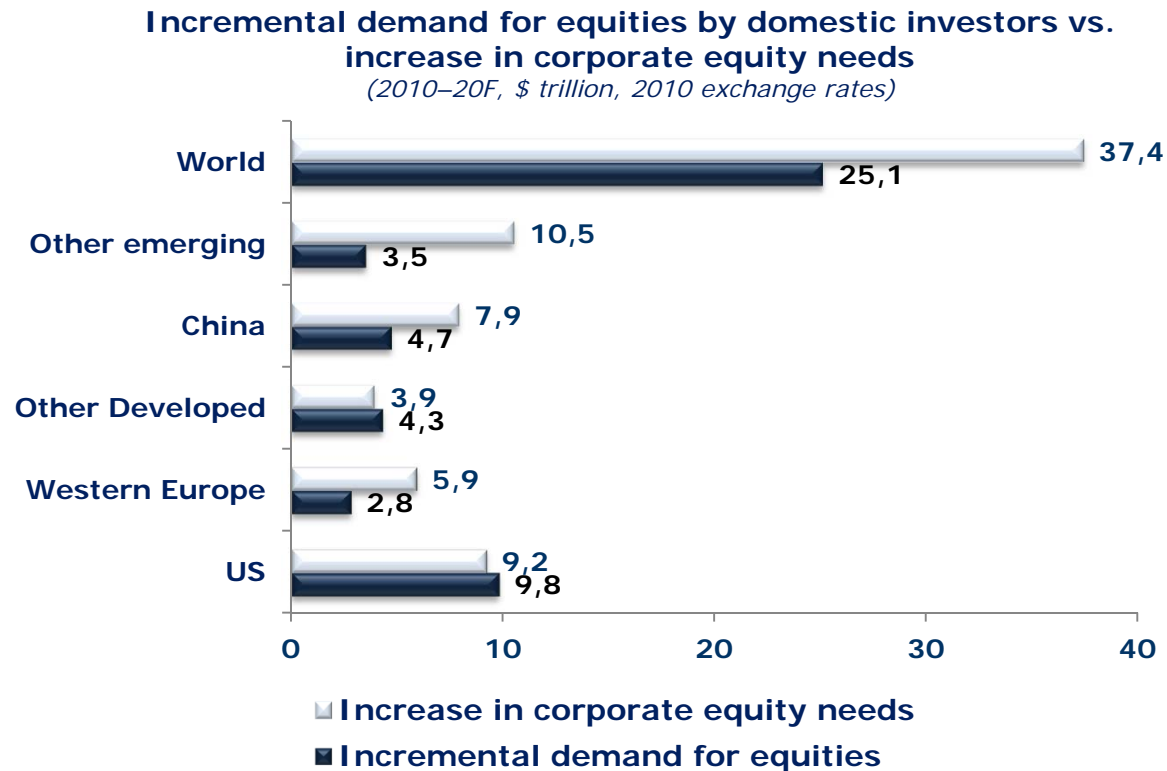


- There is a need for:
 - ✓ solidity, for **buffers of capital** that can absorb potential losses during shocks without seeking speculative returns
 - ✓ **forward-looking capital investing** through the cycles even for the ultimate benefit of future generations
 - ✓ more **strategic and long-term investments**
- Now more than ever, **the contribution of equity** to the stabilization and recovery of the entire economy is relevant
- In this new era, **government/public institutions'** equity investment is critical and it would be everything but compelling for private equity investors contribution and restored confidence

Equity needs



- According to McKinsey estimation¹, total **investor demand for equities** would grow by more than **\$ 25 trillion** over the next decade
- However, investor demand for equities may not satisfy **corporate needs**, that in the same period will increase by **\$37.4 trillion**



The role of "Institutional" equity investors



- The main drivers for Government's agencies investment in equity can be outlined as follows:



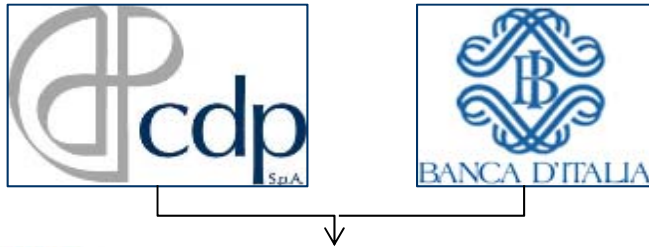
- **Acting as a catalyst for attracting private sector financial resources in strategic investment fields**
- **Creating investment partnerships with foreign SWFs, behaving as the most authoritative national counterpart vis-à-vis foreign investors**
- **Restoring investors' confidence as well as economic and financial stability, in order to ensure sustainable economic growth**
- **Generate fair returns on investments, thus leaving aside grants and subsidies investments' rationale**

A different objective function



- **Government investment vehicle** and/or Development Banks can be critical in providing equity capital
- With respect to other equity investors, their objectives might go beyond pure return on investment acting as new “**market conform instruments**” of **industrial policy** with a direct or indirect public mandate
- They could represent a vehicle through which a new and different industrial policy can be designed. An industrial policy based not only on public subsidies, grants and fiscal incentives, but also providing **equity and strategic view support to the industrial sector**
- In particular, their objective function is characterized by:
 - ✓ the **support of companies in strategic sectors**
 - ✓ a **duration normally longer** than the market operators are willing to take
 - ✓ **non speculative IRR**
- Strategic private equity funds alongside with their sponsors, the development banks, will become key allies of policymakers in their effort to create general conditions needed to stimulate competitiveness and long term growth

FSI: shareholders and capital

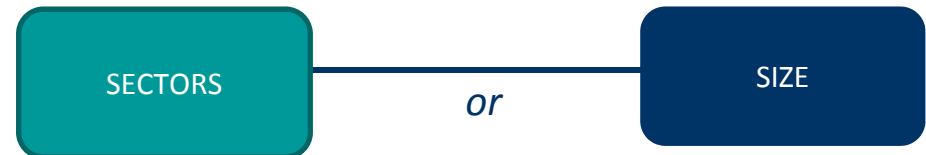
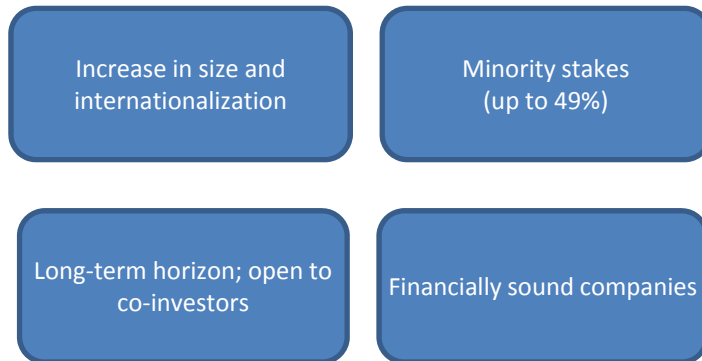


 Fondo Strategico Italiano

CDP committed capital: € 4 billion

Target capital commitment: € 7 billion

Investment perimeter (DM 8/5/2011)



- Defense
 - Security
 - Infrastructure and public services
 - Transportation
 - Telecommunication
 - Energy
 - Financial services and insurance
 - High tech and research
- Annual revenues of at least €300 million
 - At least 250 employees

FSI: Investment strategy



Mainly primary capital

- Mainly capital increase for Italian corporates growth

Increase in size and internationalization

- Focus on targets with transformational potential of organic and external growth

Mainly minority investments

- Mainly minority direct investments of up to 49% with governance rights
- Open to co-investors on a deal-by-deal basis or through joint ventures focusing on specific sectors

Meritocratic investment process

- Board of Directors and Investment Committee with independent members

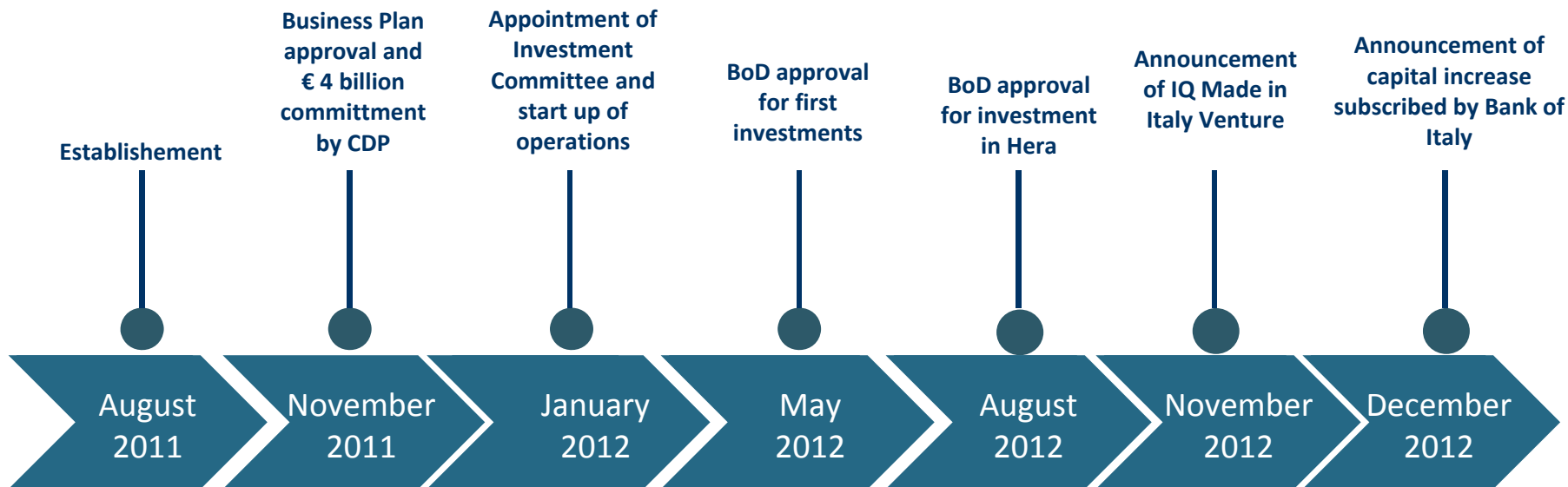
Long-term horizon

- Up to 10 years investment horizon. Joint stock company with no relevant corporate time limitations

Financially sound companies

- Targets cannot be in financial distress. No turnaround situations
- Prudent use of leverage

FSI: Key milestones



FSI: Contributions to the partnership



In November 2012 FSI and Qatar Holding signed an agreement to set up a joint venture named "IQ Made in Italy Venture"
The joint venture will invest in the "Made in Italy"



- Local knowledge
- Institutional profile and wide access to the market
- Pipeline of investment opportunities
- Long term investment horizon



- Global knowledge
- Expertise in the target sectors
- Long standing relationship with Italy: (i) 6 Italian professionals in the team; (ii) track record of investments in Italy (iii) pipeline
- Long term investment horizon