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THE NUMBERS
Quality of Earnings Analysis

Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

www.btnresearch.com

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Macquarie Infrastructure Corp. (MIC) Update

We will continue to cover MIC without an EQ rating, but are removing it from our Focus List as a Top Buy given the limited upside.

Summary

MIC announced a deal this week to sell its Atlantic Aviation unit to KKR for $4.475 billion with assumed debt. That came in above our high-end estimate at 16.2x pre-COVID EBITDA. The deal is expected to close on or before December 6, 2021. The total cash inflow will be $3.525 billion with $3.298 billion going to the shareholders as $37.35 per share in cash

That still leaves MIC Hawaii, the gas utility to sell which could add $5-$6 to the proceeds for shareholders. There is still an incentive for management to have a deal in place this year and close no later than June 2022. Compared to the current $38.50 stock price, there's still a potential 10%+ return over the 12-months.

We are moving the rating to neutral as much of the news is now out and the stock price responded favorably. The nature of the new structure may cause many investors to sell their positions before having shares exchanged from a C-Corp to an LLC structure causing the spread to narrow more slowly on this deal.

The New Structure

- Shareholders have already voted on the new structure and approved it. MIC will wait until just before the KKR deal closes to implement the new structure. Thus until December, MIC should remain a C-Corp.

- A new LLC will be established, and shareholders will exchange shares in MIC the C-Corp for the same number of shares in the new LLC. MIC Corp will then distribute the ownership of MIC Hawaii – the gas utility up to the LLC. MIC Corp will then only own

Atlantic Aviation and KKR will acquire the shares of MIC Corp from the LLC for $3.525 billion.

- Nearly all of the debt at the holding level of MIC Corp has been retired and the necessary cash is already in place to retire the small amount that did not tender in March.

- The transfer of MIC Hawaii to the LLC is expected to be a taxable event. It is also expected that shareholders in the LLC may have a tax payment if and when MIC Hawaii is sold and the deal completed. The main purpose of setting up the LLC is to make the much larger distribution of Atlantic Aviation's sale tax-free to shareholders and making the taxable impact only affect the smaller Hawaii unit.

What is Different?

- The cash flow being generated during 2021 is being produced only at Atlantic Aviation and at MIC Hawaii and the bulk of that is at Atlantic Aviation. Guidance from MIC was for $130-$160 million in Free Cash Flow from these entities in 2021. Originally, we speculated that 2021 cash flow could also be distributed to shareholders as deals were closed (or would result in higher net of cash prices for the operating companies.)

- With KKR buying MIC Corporate, KKR will essentially keep any of the cash that accumulates at Atlantic Aviation from the time of the purchase agreement until the transfer is complete. Thus, KKR is putting in $3.525 billion in cash and assuming about $1 billion in debt. If Atlantic has $40 million in cash on hand at closing or $100 million – that stays with KKR.

- However, because KKR is acquiring MIC Corp and MIC Corp is the source of cash via Atlantic Aviation to pay for all these transactions, legal bills and tax events – MIC shareholders will benefit by having KKR fund these costs.

- This makes the remaining distribution largely the $37.35 in cash from KKR plus the value of MIC Hawaii when it is sold and distributed.

What Is the Value of MIC Hawaii?

- MIC purchased Hawaiian Gas in 2005 (closed in 2006) for $238 million with $34 million extra for working capital and transaction costs. At the time, EBITDA was $26 million per year for a multiple of 9.5-10.5x EBITDA.

- MIC has expanded the gas company over the years and on a pre-COVID basis it has been generating about $60 million in EBITDA fairly consistently. From 2015-2019, EBITDA had a range of $59-$63 million. Much like Atlantic, we expect the Hawaiian Gas unit to be priced on pre-COVID figures.

- MIC Hawaii has also paid off more than half of its debt in April 2021. Total debt is now $93.5 million. When we last ran an estimate on the valuation, debt was $193.5 million. With many of the tax issues and transaction costs of distributing the gas unit up to the LLC now part of the KKR deal, the value of MIC Hawaii should be greater now:

Value of MIC HI at Multiple of:	**9.0**	**9.5**	**10.0**	**10.5**	**11.0**
Enterprise Value on $60mm EBITDA	$540.0	$570.0	$600.0	$630.0	$660.0
Less Debt	$93.5	$93.5	$93.5	$93.5	$93.5
Equity Value	$446.5	$476.5	$506.5	$536.5	$566.5
6.1% to Management Fee	$27.2	$29.1	$30.9	$32.7	$34.6
Value to shares	$419.3	$447.4	$475.6	$503.8	$531.9
Value per share (assume 89mm shares)	$4.71	$5.03	$5.34	$5.66	$5.98

- Under our prior update, we were valuing the MIC Hawaii at $3.44 per share. That assumed an additional $100 million in debt and a tax payment of $85 million. We believe the tax payment will come in much lower than that on the transfer and the additional debt has been repaid. It now looks like $5-$6 is a more reasonable forecast.

- Additional consideration – management can earn a $25 million bonus if they can have deals in place to sell both Atlantic Aviation and MIC Hawaii before the end of 2021 and have both deals close by June 2022. It is expected to require as long as a year to get the Public Utility Commission in Hawaii to sign off on the transfer, so the catalyst of announcing a deal for MIC Hawaii could happen during the summer of 2021. We are not certain if the $25 million bonus fee was set aside with the sale of IMTT already or if that would come out of the sale of MIC Hawaii. If the later, that would lower the proceeds to shareholders by 28-cents per share.

- The conclusion for MIC Hawaii is it could be worth about $5 per share +/- $1, which along with the $37.35 for Atlantic Aviation is $41.35-43.35. That is a 7.4%-12.6% return from today's price in less than a year. If a deal for MIC Hawaii is announced this summer, there could be one more pop in the stock toward these levels fairly soon. If it takes longer, the risk return may not be as compelling. That is why we are moving this to a neutral.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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