IMAP Webinar Series

Property and Infrastructure: Do they offer defence in uncertain times?

Infrastructure Update

Justin Lannen – Maple-Brown Abbott
Mark Murray – Mercer
Moderated by
Toby Potter – IMAP

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Upcoming webinars

Friday 20th October – Allocating to Property and Infrastructure
Matthew Swieconek, Findex
William Morgan, Atrium Investment Management

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How to ask a Question

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Infrastructure Update

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Global Listed Infrastructure

October 2023

Infrastructure – does it offer defence in uncertain times?

Presentation for IMAP

What is listed infrastructure?

The physical structures, networks and companies that provide services essential to our daily lives and the growth of our economies. We define infrastructure assets by their physical characteristics and commercial frameworks.

Essential services

- Daily volume, high usage
- Large customer base
- Supporting social and economic activity
- Low/no risk of substitution

Strategic positions

- Often monopolies
- Strong demand catchment
- Long life, high value physical assets
- High barriers to entry
- Little or no competition

Stable cashflows

- Long-term contracts
- Captive market
- Pricing power, inelastic demand
- Low operating costs
- Prices/revenues often regulated
- Operating track record and history

Predictable growth

- Essential to GDP, stability and growth
- Inflation-linked contracts
- Permitted or regulated returns on new investment
- Increase competitiveness & productivity

Why invest in infrastructure?

A defensive asset class offering attractive risk-adjusted returns

Lower volatility

Demand for infrastructure is generally inelastic, and therefore revenues are resilient across market cycles. As a result, infrastructure assets generate a stable return profile and provide lower volatility than global equities and other riskier assets.

Income stability

Often defined by strong strategic positions, infrastructure investments can provide stable income with resilience to long-term inflation in some cases*.

Inflation protection characteristics*

Many core infrastructure assets have their earnings or revenues linked to contracts or concessions with built-in inflation escalators or have returns set by a regulated asset base with limited or no link to volumes or cyclical demand.

Portfolio diversification

An infrastructure allocation can enhance both income and the risk-return prospects of a portfolio due to its:

1) Lower volatility
2) Lower inter-asset class correlations
3) Stable and sustainable yields

Decarbonisation & digitalisation

Decarbonisation and digitalisation necessitate significant infrastructure investment, improving the growth outlook for certain sectors facilitating these trends, such as electric utilities and communications infrastructure.

* The level of inflation linkage of an infrastructure asset depends on numerous factors, including but not limited to contract/concession conditions, regulatory frameworks, ability to maintain margins, and capital structure. Based on their characteristics, toll roads, US oil pipelines and regulated assets in real return frameworks (e.g. UK, Italy, Brazil, Australia) exhibit high inflation protection characteristics. On the other hand, regulated assets with long rate cycles (e.g. HK) or those which operate in nominal return frameworks (e.g. US, HK, Japan) offer less inflation protection.

The definition of infrastructure matters if you want the attributes

Core infrastructure should offer a strong combination of inflation protection and low cash flow volatility. Infrastructure indices include a few sectors that lack these characteristics. For example, these sectors are not pure infrastructure in our view:

Stevedoring Companies
DP World, Hutch Ports, China Merchants

- ✗ Overly competitive
- ✗ Cyclical, unstable earnings

"Above rail" railways
CSX, Norfolk Southern, Union Pacific

- ✗ Excessive economic exposure
- ✗ Shorter-term contracting
- ✗ Exposed to "above rail" rolling stock assets

Integrated Utilities
Enel

- ✗ Largely unregulated (>20%)
- ✗ Exposure to merchant prices
- ✗ Competitive markets

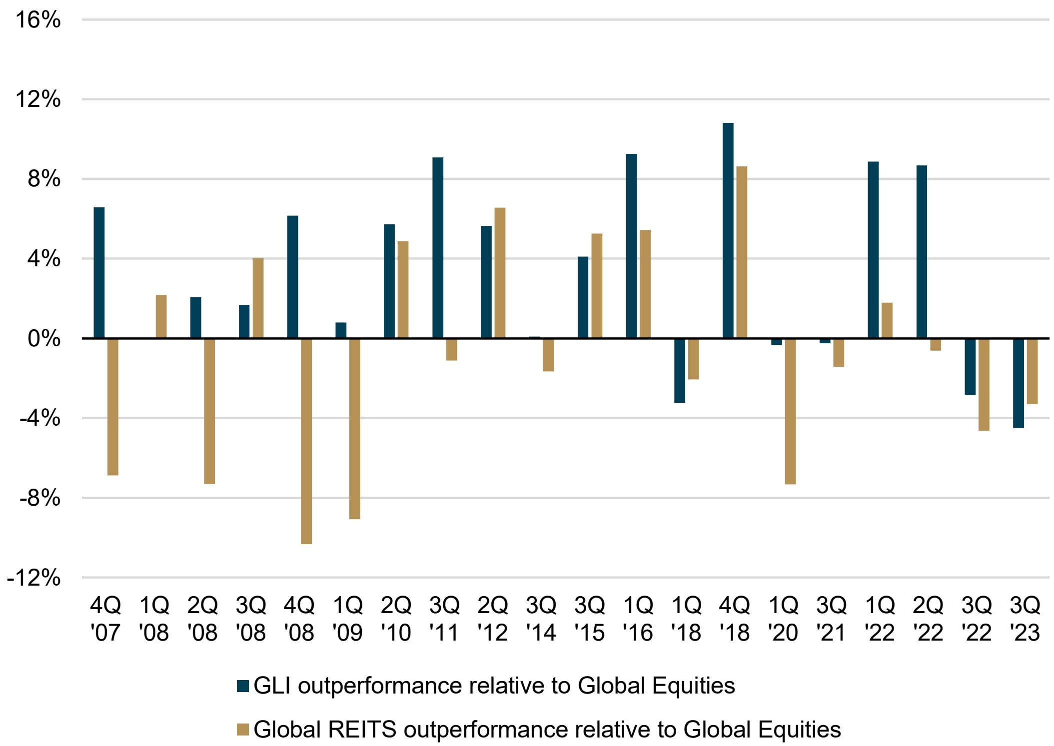
Satellites
SES, Eutelsat, Intelsat

Industry disruption has led to:

- ✗ Lower barriers to entry
- ✗ Increased competition
- ✗ Earnings risk and volatility

Infrastructure is typically more defensive

During quarters of negative global equity returns (USD)



Average return

Global Equities	(8.7%)
Global Infrastructure	(5.3%)
Global REITS	(9.6%)

Quarters of outperformance

Global Infrastructure Outperformed	15/20 (75%)
Global REITS Outperformed	8/20 (40%)

Source: Bloomberg. Returns in USD. Calculations based on quarterly data from index inception at **31 December 2005 to 30 September 2023**. Returns of the FTSE Global Core Infrastructure 50/50 Index have been compared to the MSCI World Index and FTSE EPRA/NAREIT Global Total Return Index. **Past performance is not a reliable indicator of future performance.**

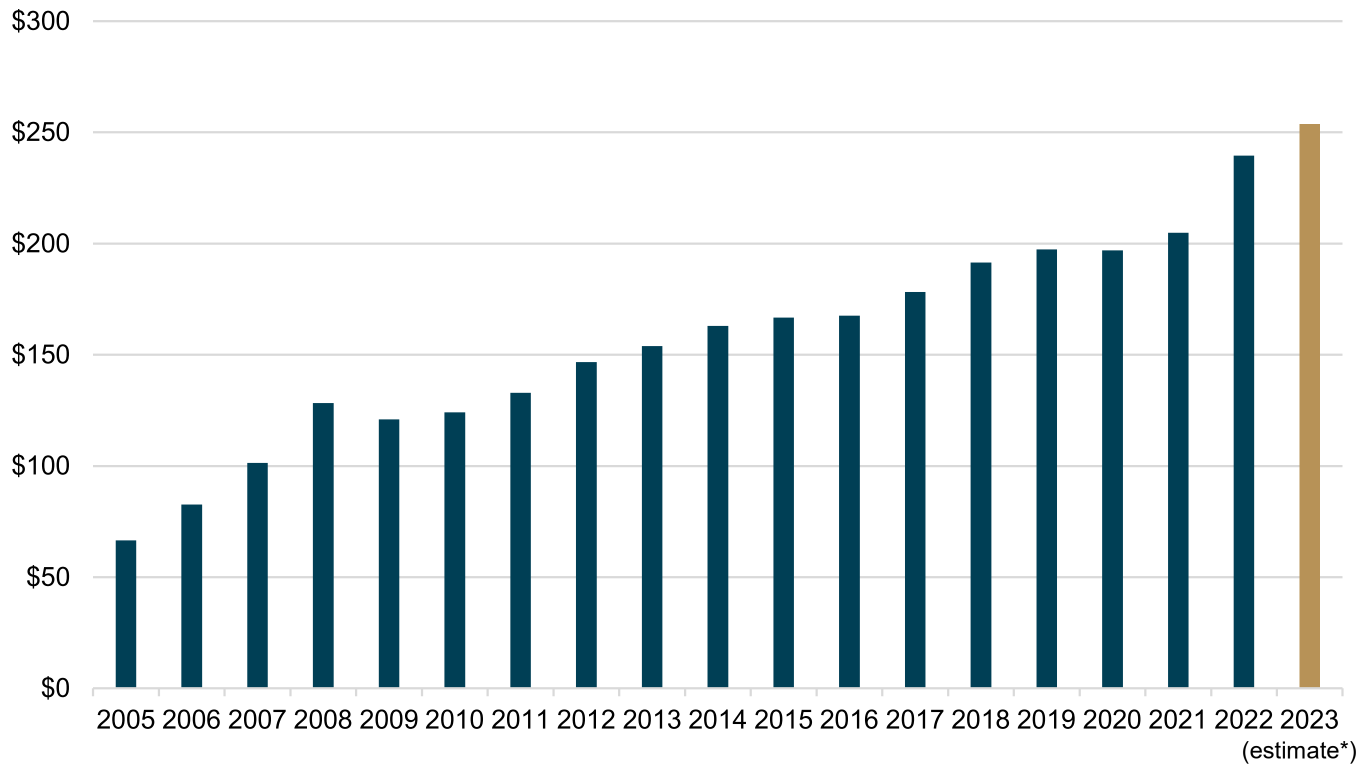
Current infrastructure investment themes
The world is short of the infrastructure required to advance the quality of life

US regulated electric utilities	– Clean energy and decarbonisation trends – Supportive policy and tax incentives – Resilient earnings in weaker macro-economic environments
UK water infrastructure	– Monopoly water networks - regulation, earnings certainty, inflation pass-through and ESG thematic
Transport mobility	– Airports, toll roads, Channel Tunnel concessions. Traffic and pricing growth
Renewable energy developers	– Government policy support and large capital expenditure opportunities as the world decarbonises
Digitalisation	– Ongoing growth in digital network infrastructure
Asset recycling	– Asset sales by listed infra companies, utilising private markets valuation gap – Significant discounts remain between listed & private peers

Note: Examples are illustrative only. Not a recommendation to buy or sell any security

Significant ongoing capital expenditure to drive growth

Total capex for Focus List (US$bn)



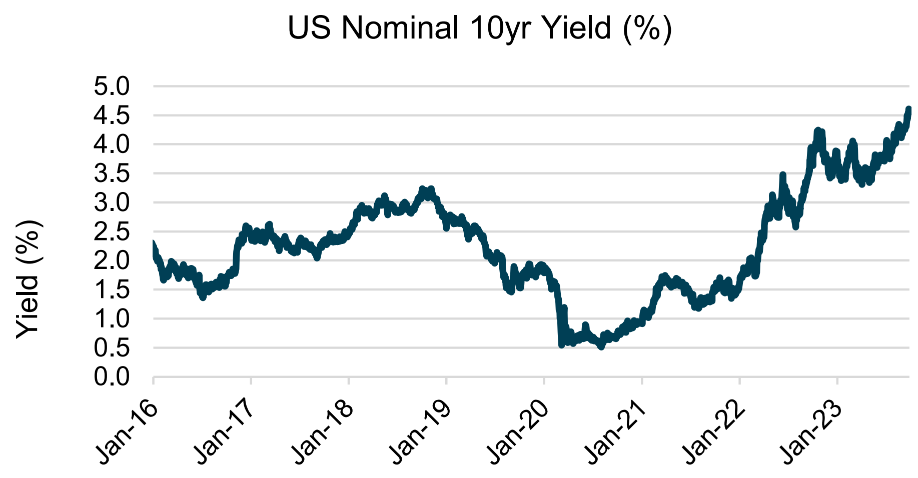
Source: Bloomberg; MBA calculations. As at **31 December 2022**.
*excludes M&A activity.

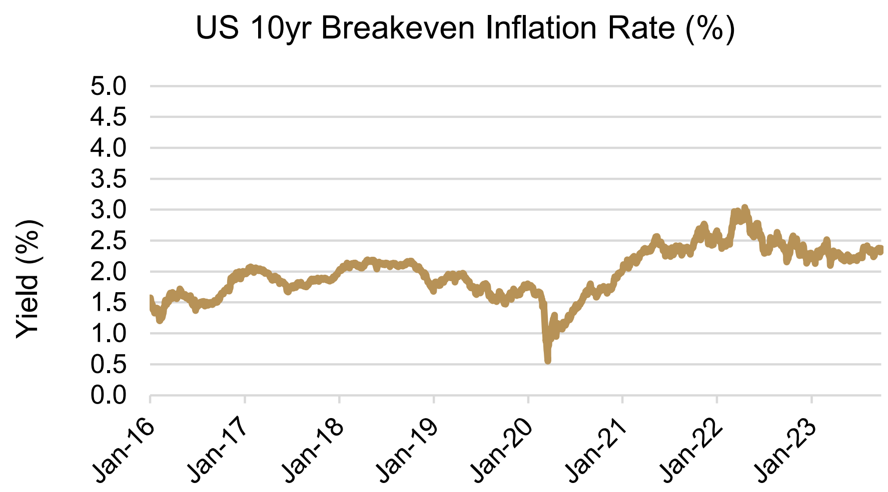
Plenty of organic growth opportunities for listed infrastructure

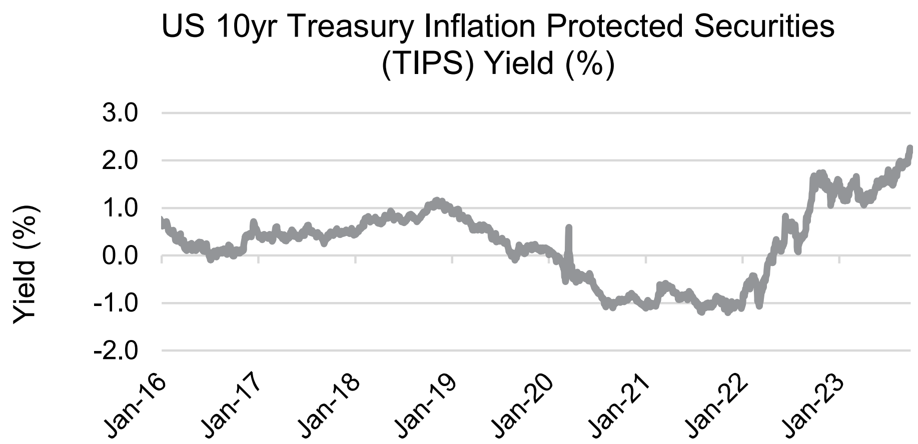
- Aggregate capex by Focus List companies forecast to be more than **US$250bn**
- Spending approximately **10%** of current market capitalisation
- We favour rate base investments, and organic expansions of existing networks

Long rates continue to rise

…whilst inflation expectations have moderated



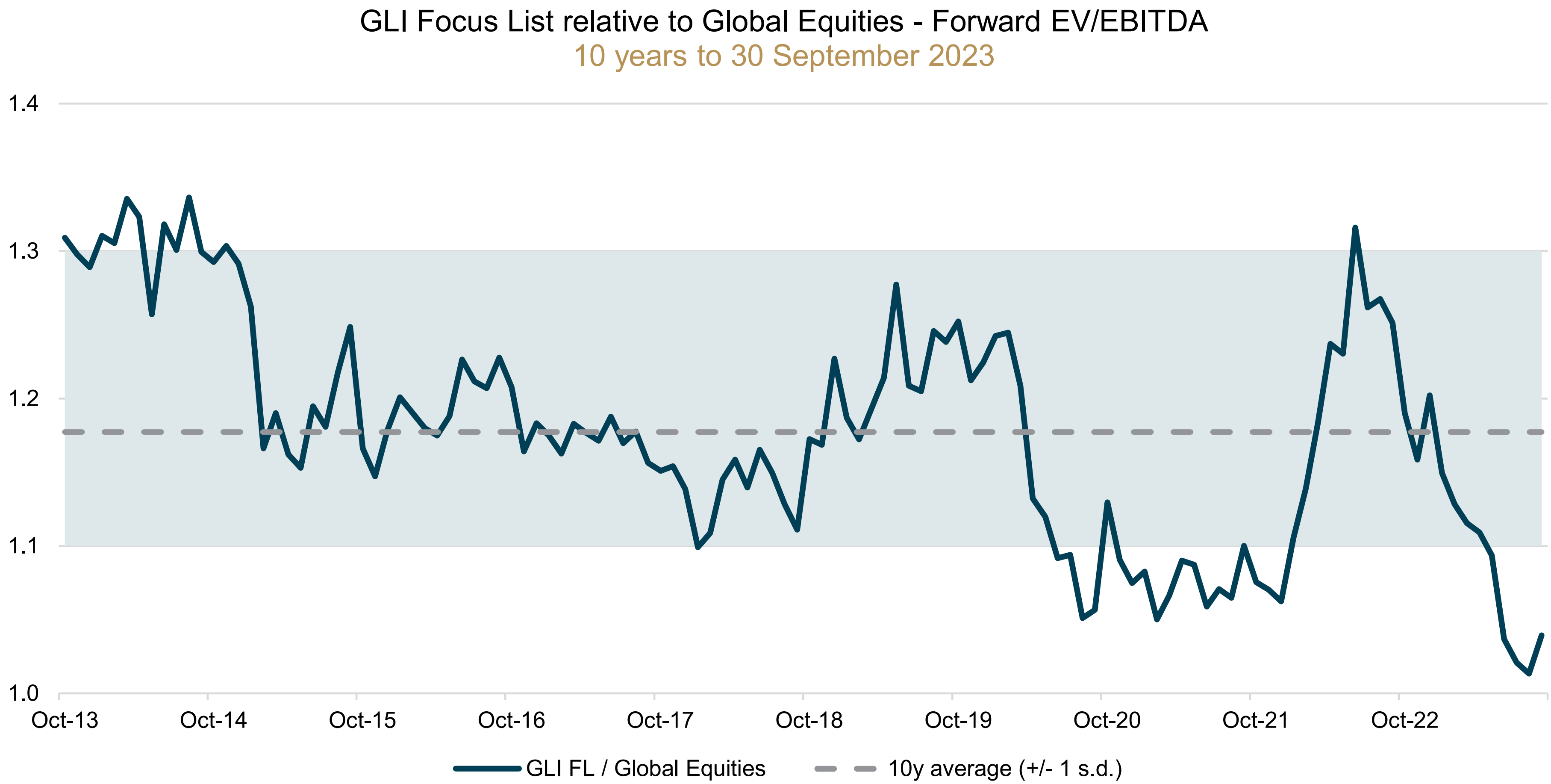




- **Inflation expectations have moderated, while real yields continue to rise**
- **Over the short-term, the share market is often confused** about the link between nominal yields and different infrastructure assets

Source: Bloomberg. As at **30 September 2023.**

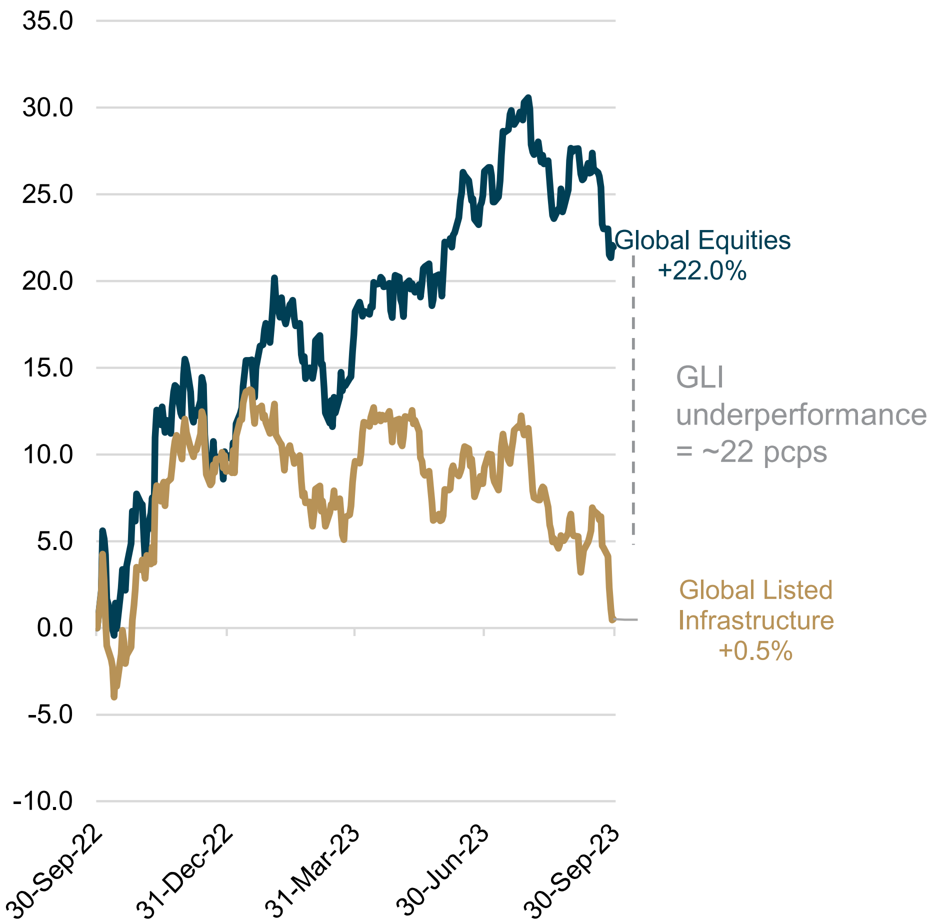
Valuations relative to global equities are at 10-year lows



Note: The data in the above chart uses the then current broker consensus estimates, and has been sourced from Bloomberg. It is substantially complete, although not surprisingly is missing a few data points due to either the stock not yet being listed or there being insufficient consensus estimates at any point in time. We have reviewed the data and are **30 September 2023.**

Listed infrastructure has lagged behind global equities over the last year

Total returns (%) – 12 months to 30 September 2023



Over the past 12 months, global listed infrastructure has underperformed global equities by ~22pcps, and the sector's forward EV/EBITDA de-rated by ~6%.

- We estimate that the technology sector contributed ~8%[1] to the performance of global equities (i.e. ~38% of the total return), and so even excluding the AI-driven tech boom, global equities still outperformed significantly
- Over the last 12 months, global listed infrastructure EBITDA has grown by 13%, far outpacing the 4% EBITDA growth of global equities

A combination of these factors has led to a significant decline in the valuation of global listed infrastructure relative to global equities.

Source: Bloomberg as at 30 September 2023

1 This is an estimate calculated as the product of the weight of the Information Technology sector in the MSCI World Index as at 31-Aug-23 (latest available) and the 12 month return of the MSCI World Information Technology Index. Estimates are based on assumptions and contingencies which are subject to change without notice. These are provided as a general guide only.

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The Focus List is a proprietary list of infrastructure stocks considered by the Maple-Brown Abbott investment team as providing the strongest combination of inflation protection and low volatility. The stocks on the Focus List may change at any time according to the investment team’s assessment of suitability for inclusion. Backtested performance for the Focus List is developed with the benefit of hindsight and has inherent limitations. Specifically, backtested results do not reflect actual trading or the effect of material economic and market factors on the decision-making process. Actual performance may differ significantly from backtested performance. As of 30 September 2023, there were 107 stocks on the Focus List with a combined market capitalisation of around US$2.0 trillion. The investment team believe the Focus List has a narrower definition of ‘infrastructure’ relative to many other infrastructure funds and indices. Infrastructure assets on the Focus List must provide an essential service (for example, by supporting social and economic activity, having a naturally large customer base and be at low risk of substitution) and hold a strategic position (for example, through high barriers to entry, facing little or no competition and owning long-term, high-value assets). These assets are ideally supported by strong underlying commercial frameworks which should allow them to generate long-term, stable cashflows. In contrast, businesses that face highly cyclical demand risk or competitive, market-based pricing are excluded from the Focus List.

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Infrastructure Update

Mark Murray
Mercer

Mercer

welcome to brighter

Global Unlisted Infrastructure

October 2023

Mark Murray CFA, Portfolio Manager, Sydney

Global Unlisted Infrastructure

Assets essential for functioning communities

Energy / power	Communications	Water / Waste	Transport	Social infrastructure

Privately financed infrastructure

Public private partnerships (PPPS)

Attractive investment characteristics

- High barriers to entry
- Inelastic demand
- Predictable cash flows
- Low volatility
- Low correlation to other asset classes
- Partial inflation linkage
- Yield potential
- ESG aligned

Global Unlisted Infrastructure

Wide spectrum of return and risk profiles

c. 6% - 9%

Core

- c. 90% income / 10% appreciation
- Hold: c. 7+ years
- E.g. brownfield assets in social infrastructure and regulated utilities

c. 9% - 12%

Core+

- c. 60% income / 40% appreciation
- Hold: c. 6+ years
- E.g. monopolistic contracted assets with long-term contract profiles and high renewal rates

c. 12% - 15%

Value-Add

- c. 20% income / 80% appreciation
- Hold: c. 5 to 7 years
- E.g. less monopolistic contracted assets and patronage that have a material growth or expansion orientation

15%+

Opportunistic

- c. 10% income / 90% appreciation
- Hold: c. 4 to 6 years
- E.g. assets in development, and/or emerging markets, and/or are highly growth oriented/private equity-like

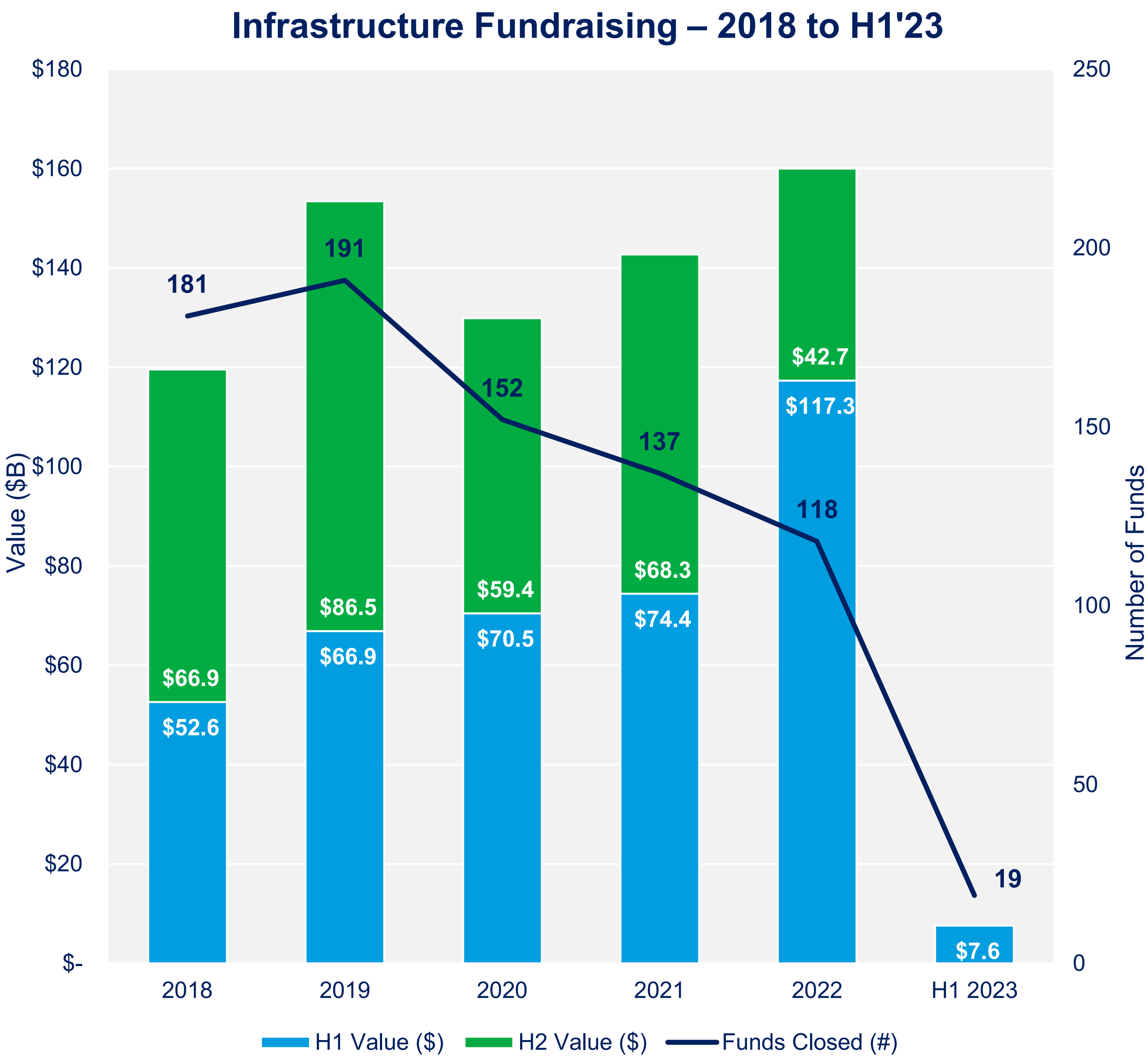
Infrastructure Debt c. 4-10%+

These assumptions are for illustration and educational purposes only. Actual returns may differ.

Global Unlisted Infrastructure

Fundraising trends

- 2023 unlisted infrastructure fundraising has been slow and many fundraising timelines have been extended.
- Economic volatility in 2022 and continued uncertainty around rate hikes in early 2023 resulted in decisions being paused in H1 2023.
- Infrastructure managers in the market are seeking to raise US$366.6bn across 391 different funds1.



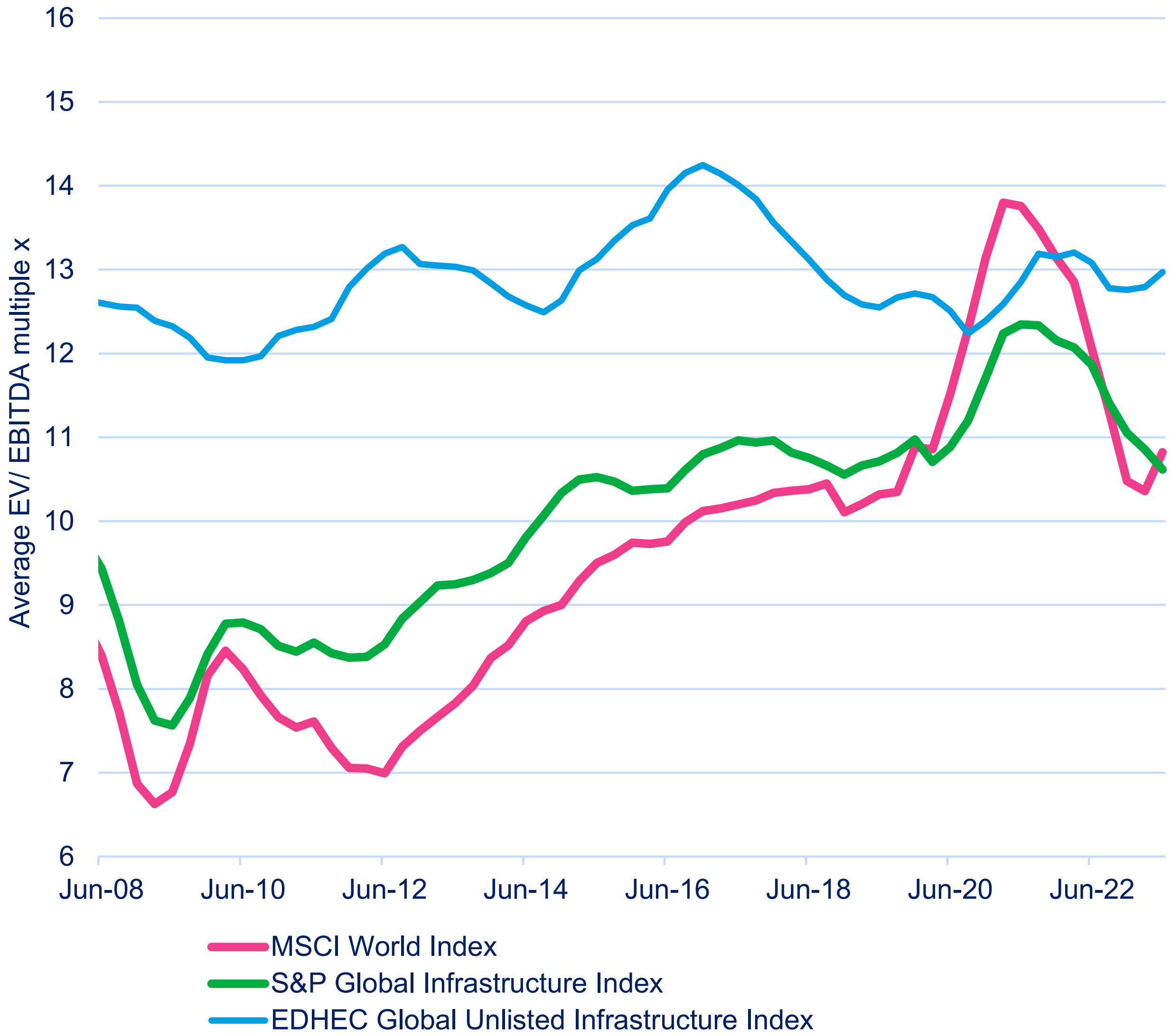
Source: Infrastructure Investor (Q2'23)
Notes: (1) As of 12th Jul. 2023 (Infrastructure Investor)

Global Unlisted Infrastructure

Infrastructure market pricing

- Infrastructure transaction pricing is commonly quoted in terms of Enterprise Value to Earnings Before Interest, Tax Depreciation and Amortisation
- Unlisted transactions commonly involve substantial minority or majority control shareholdings, which tend to trade at higher earnings multiples on average.

Listed and Unlisted EV/EBITDA Multiples



Sources: Bloomberg and EDHEC

Global Unlisted Infrastructure

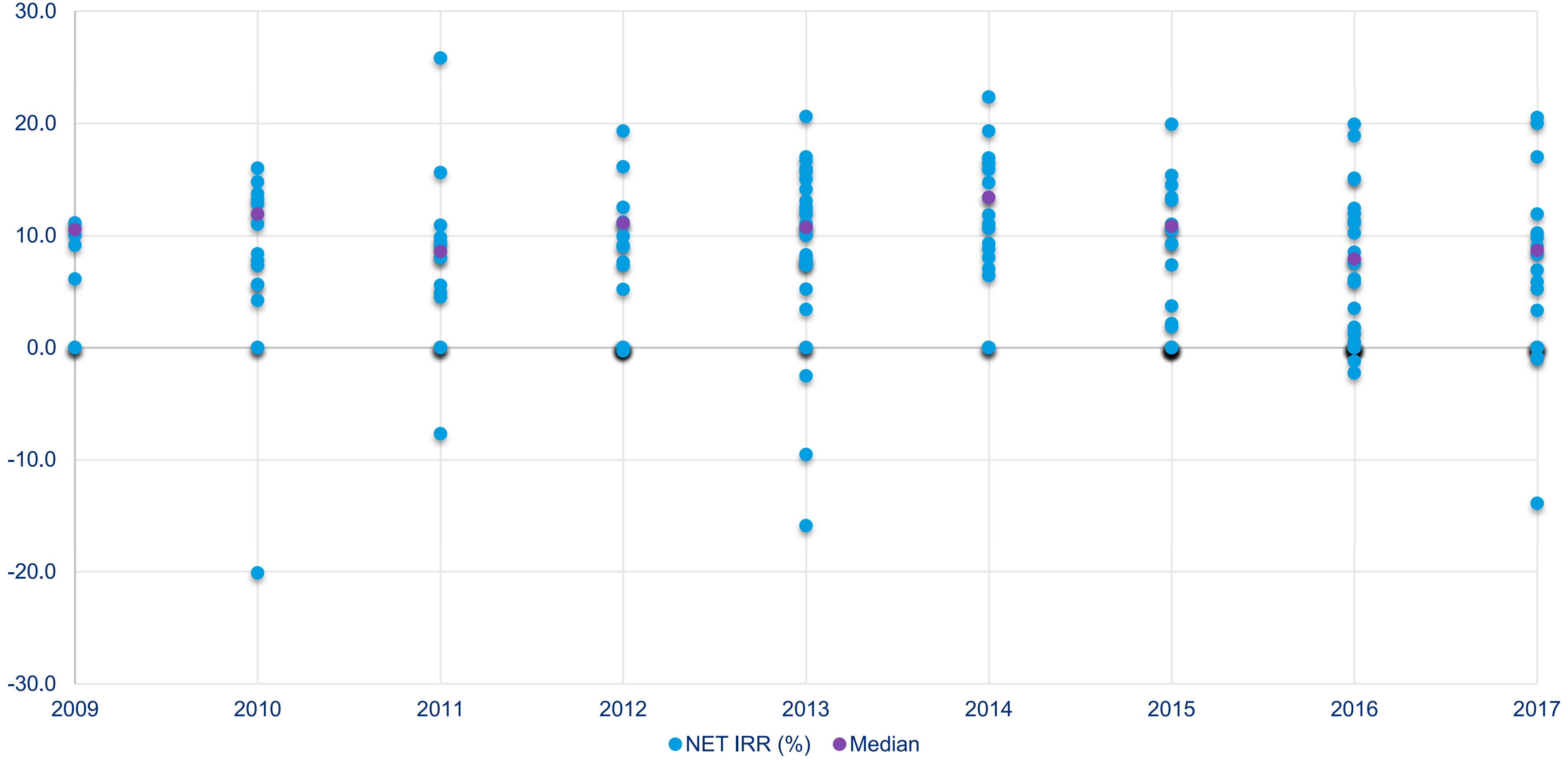
Environmental, Social and Governance (ESG) matters are key

- Performance in ESG terms is an integral component of successful investment outcomes. Infrastructure assets require a continuing social licence to operate. Poor ESG performance is often associated with poor investment performance.
- ESG related factors need to be fully integrated into due diligence and asset management processes; an asset's type does not make it ESG friendly.
- For example, a wind farm where construction has been delivered late and over budget, where on-site Health & Safety has been poor, and where the local community has not been consulted would not be viewed favourably in ESG terms.

Global Unlisted Infrastructure

Vintage and fund selection skills matter

Net infrastructure IRR globally by vintage year*



* For illustration and educational purposes only.
Past performance is no guarantee of future performance.
Sources: Preqin, Mercer

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QUESTIONS

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