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The Role of Infrastructure in a Portfolio

September 2022

ECONOMIC OUTLOOK
CHALLENGES AHEAD

- Investors are facing a challenging environment over the next few years:
  - High inflation
  - Increasing interest rates
  - Reduced growth prospects
  - Heightened risk of recession
  - Likely ongoing volatility in markets

- What role can infrastructure play in a portfolio?
  - In past recessions and challenging market environments, investors have looked to infrastructure for its defensive characteristics

- However, there is no ‘one size fits all’ class of infrastructure:
  - The current environment could impact different categories of infrastructure in different ways
  - In our view, traditional “core” infrastructure is likely to be more resilient in a low growth inflationary environment, than more speculative “core plus” infrastructure assets

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Infrastructure can help navigate challenging environments

As it tends to provide:

STEADY RETURNS THROUGH MARKET CYCLES WITH LOWER VOLATILITY

- Essential services assets
- Monopolistic characteristics

STABLE LONG-TERM YIELDS

- Secure and predictable revenues
- Inflation linkage

DIVERSIFICATION

- Low correlations with other asset classes reduce overall portfolio risk

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Impact of inflation on infrastructure cashflows

Varying impacts for different infrastructure asset types

Impact Overview

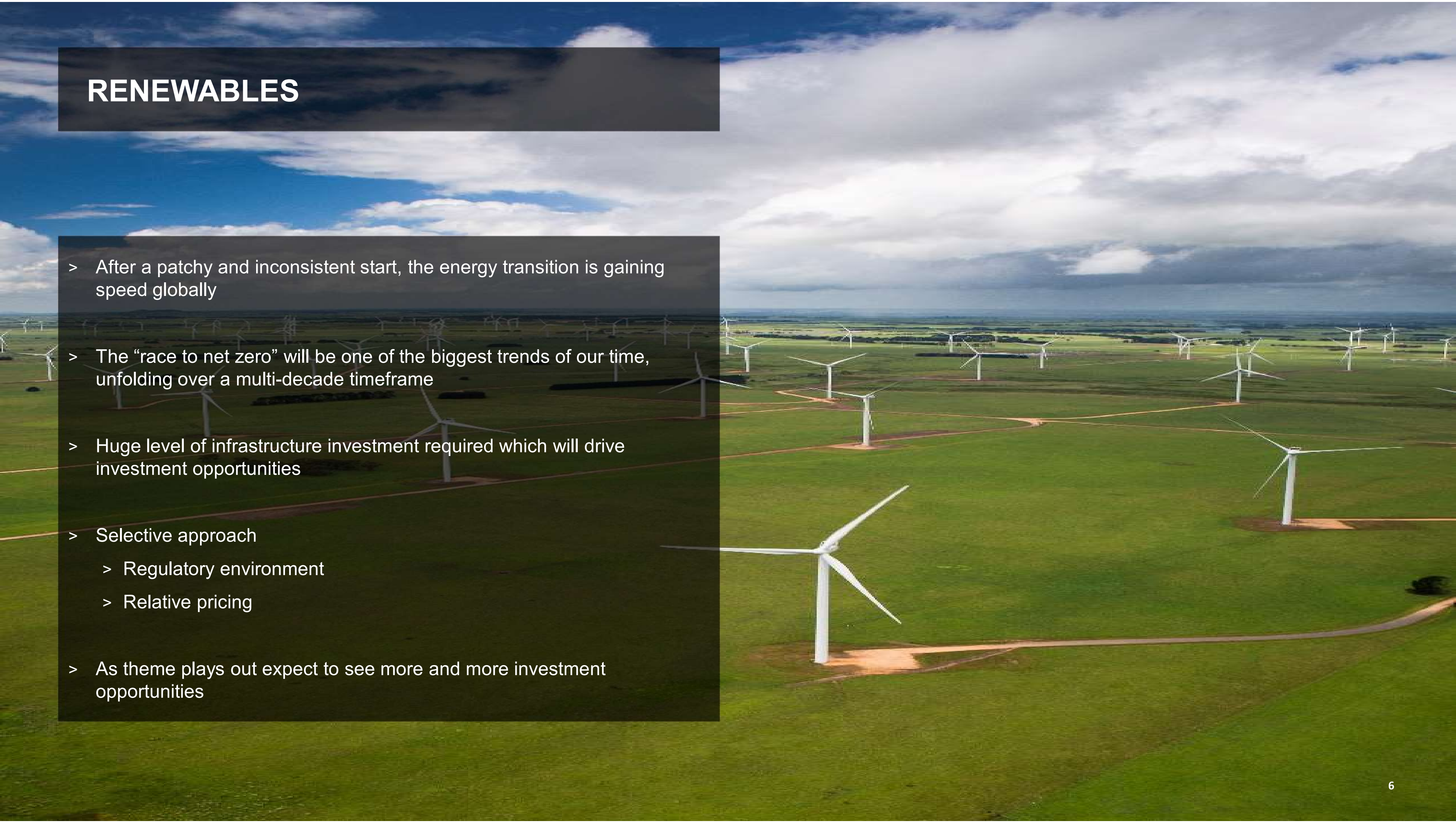
- Performance of infrastructure assets can be impacted – either positively or negatively – by a range of economic factors including inflation, interest rates, level of economic activity, etc
- Net impact on infrastructure cashflows depends on how these positive and negative impacts balance out
- Impacts can vary widely depending on the type of infrastructure asset
- The table summarises our view on the potential impacts for three sub-classes of infrastructure

Sub-Class	Asset Example	Impacts		Net Effect
		Positive	Negative	
Growth linked	• Airports • Ports • Toll roads	• Patronage increases with growth • Service charges can increase by inflation (or another factor)	• Operating costs increase with growth and inflation • Potential increased cost of debt, but mitigated through hedging arrangements	Generally positive
Regulated	• Electricity transmission & distribution • Water	• Throughput increases with growth • Service charges inflation linked	• Operating costs increase with growth and inflation • Potential increased cost of debt, but mitigated through hedging arrangements	Neutral to moderately positive
Public Private Partnerships (PPP)	• Availability based revenue • Schools • Hospitals	• Passthroughs on consumables • Partial or full hedge on inflation	• Residual risk on inflation if incomplete hedge • Potential increased cost of debt, though very limited due to long-term hedging arrangements (often for full term of concession)	Neutral to slightly negative

It looks like infrastructure but…

Is it investable infrastructure?

Type of Infrastructure	Examples	Risk Profile	Type of Cashflow Security	Investable?
Availability based concession (includes Public Private Partnerships)	• Public schools • Hospitals	Lowest	Up to 100% of cashflows secured under long term availability contract with creditworthy counterparty	Yes
Regulated assets	• Electricity transmission and distribution networks	Moderate	Regulatory framework gives level of certainty over prices for a set period	Yes
Natural monopoly growth assets	• Airports • Sea ports • Established toll roads	Higher	Cashflows directly related to patronage levels which is influenced by economic activity	Yes
Greenfield patronage dependent assets	• Greenfield toll roads	Very High	Cashflows directly related to patronage levels which are hard to forecast	No
Competition exposed assets	• Merchant power plants	Very High	Cashflows not underwritten by long term contracts and highly exposed to competitive pressure	No



RENEWABLES

- After a patchy and inconsistent start, the energy transition is gaining speed globally
- The “race to net zero” will be one of the biggest trends of our time, unfolding over a multi-decade timeframe
- Huge level of infrastructure investment required which will drive investment opportunities
- Selective approach
  - Regulatory environment
  - Relative pricing
- As theme plays out expect to see more and more investment opportunities

CONCLUSION

- The global environment continues to be challenging:
  - Inflation to remain elevated for next few years
  - Interest rates increasing, though not expected to hit historical heights
  - Lower growth and increased risk of recession
- A strong medium-term pipeline of infrastructure opportunities is expected as governments around the world roll out infrastructure developments as a key part of their post-COVID economic recovery plans
- While not immune to economic conditions, compared to many other asset classes we expect infrastructure should be relatively resilient, as it can tend to offer investors:
  - Steady returns due to essential services nature of assets which will underpin demand
  - Secure revenues and inflation linkage which will be attractive in the current environment
  - Diversification due to its low correlation to other asset classes
- Continued strong investor support for the sector

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