First State Investments
首域投資

Global Listed Infrastructure

Monthly Review and Outlook

December 2016

- First State Global Listed Infrastructure Fund invests in global listed infrastructure and infrastructure-related securities.
- Investing in shares in a single sector may expose the Fund to greater volatility than investing in multiple sectors. The value of the Fund may be impacted by risks associated with listed infrastructure including changes in environmental regulations. It is possible that the entire value of your investment could be lost.
- All or part of the Fund's fees and expenses may be paid out of capital resulting in an increase in distributable income and effectively a distribution out of capital. Similarly in certain circumstances dividends may be paid out of capital. This amounts to a partial return of an investor's original investment, or from any capital gains attributable to that original investment, and may result in an immediate decrease of the Net Asset Value per share.
- You should not base your investment decision solely on this document. You should not invest unless the intermediary who sells it to you has advised you that the Fund is suitable for you and explained how it is consistent with your investment objectives.

Key highlights:

- Global listed infrastructure increased in December on solid fundamentals and continued investor demand for real assets.
- European transport infrastructure gained, reflecting robust volume growth and relatively attractive valuations. Towers and Utilities recovered from the previous months underperformance from bond-sensitives.
- In USD terms, the First State Listed Infrastructure Fund (the 'Fund') returned +1.4% in December, 130 bps behind its benchmark index. For the 2016 calendar year the Fund returned +11.7%, slightly behind its benchmark by 9 bps.

Market review

Global listed infrastructure rallied in December against a brightening economic backdrop and on growing hopes of a business-focused White House administration in 2017. In USD terms, the FTSE Global Core Infrastructure 50/50 index ended the month +2.8% higher, while global equities rose 2.4%.

The best performing infrastructure sector was Towers, which rallied on renewed demand for their low risk cash flows, supported by barriers to entry, pricing power and structural growth in mobile data. Utilities also regained ground on continued investor appetite for stable, income generative assets - even in an environment of sharply rising bond yields. This demand was demonstrated by Cheung Kong Infrastructure's A$7.3 billion bid for Australian multi-utility Duet Group at a generous 1.5x RAB valuation multiple.

Water Utilities (flat) lagged as gains by developed market operators were balanced by the sharp fall in Chile's Aguas Andinas (-17%, not owned). The company was impacted by a proposed reduction in its minimum guaranteed returns, a reminder of the regulatory risks that infrastructure investors can face. Railroads and Pipelines paused for breath, following strong gains throughout most of 2016.

Europe was the best performing region. More economically sensitive infrastructure assets such as toll roads and airports were supported by robust volumes, upbeat business sentiment surveys, and the extension of the ECB's Quantitative Easing program. Asia ex-Japan lagged on concerns that a strengthening US dollar and rising interest rates could represent headwinds to economic growth in the region.

Fund review

In USD terms, the Fund gained 1.4% in December, 130 bps behind its benchmark index.

European transport infrastructure reported positive volume growth, consistent with signs of a more supportive economic backdrop. The best performing stock in the Fund was French airport operator Aeroports de Paris which rallied on better than expected November passenger growth of 6.2%. Spanish peer AENA reported an increase in November passengers of over 10%, as its trend of robust organic growth continued.

Atlantia, which operates long life concessions on Italy's network of high quality motorways, announced that it would commence a share buy-back of up to 5% of the company's issued capital. Spanish-listed toll road operator Abertis was supported by its undemanding valuation multiple compared to peers. Eurotunnel climbed on firm November truck shuttle volume growth of 6.8%.

US mobile towers Crown Castle, SBA Communications and American Tower gained as concerns about the impact of a potential merger between tower customers Sprint and T-Mobile subsided. The tower sector continues to be supported by the rapid growth in mobile data traffic, which is forecast by networking equipment maker Cisco to rise at an average annual rate of 53% between 2015 and 2020. Italian tower company Inwit rallied as the 19-20x EV/EBITDA multiple that ATC Europe paid for FPS Towers in France highlighted the relative value in European towers.

The Fund's utility holdings also increased as investors looked past December's widely expected 25 bps interest rate rise by the US

[1] The Fund's calendar year performance: -5.7% (2015); 12.3% (2014); 17.3% (2013); 10.4% (2012); 1.2% (2011).

Federal Reserve, and focused on the stable fundamentals of these long term businesses. US operators Eversource Energy, Alliant Energy, Xcel Energy, NextEra Energy, Dominion Resources and PG&E performed well. Spanish-listed peer Iberdrola, which owns Spanish, UK, US and Latin American utilities, rallied on improved sentiment towards European assets. UK utility National Grid agreed to sell a 61% stake in its gas distribution network to a consortium of institutional investors and sovereign wealth funds. The transaction, which attributes an overall Enterprise Value of £13.8 billion to the assets, will allow the company to focus on its higher growth business segments. The bulk of the sale proceeds will be returned to investors via a special dividend and share buybacks.

The Fund's Japanese holdings also drove positive performance. Continued yen weakness provided a tailwind for port operator Kamigumi. Gas utility Tokyo Gas rose as concerns eased about the potential impact of deregulation in Japan's retail gas market, due in April 2017. Passenger rail company East Japan Railway saw passenger numbers stabilize, following adverse weather conditions in September.

The worst performing stock in the Fund was Hong Kong-listed utility Power Assets Holdings, which bucked the trend of utilities gains on concerns that it may be involved in the bid by its parent company Cheung Kong Infrastructure for Duet Group. Chinese toll road operator Jiangsu Expressway and Chinese-listed port companies China Merchants Ports Holdings and Cosco Shipping Ports fell on concerns for the outlook of the US interest rates and global trade under a Trump administration.

The Fund's pipeline holdings delivered mixed returns in December, following a year of exceptional gains from the sector. US operator Kinder Morgan announced disappointing guidance that 2017 distributable cash flow would be flat on 2016, as expansion projects are offset by asset sales and potentially weaker results from commodity exposed businesses. Enbridge Inc (flat) and Spectra (flat) also lagged rising markets. Enterprise Products Partners performed better, reflecting its robust earnings growth profile based on exposure to US energy exports and growth in Natural Gas Liquids.

The Fund built a position in US regulated utility American Electric Power in December. The company has made positive strategic moves in recent years by transitioning away from competitive generation and focusing investment in regulated assets, especially transmission, whilst retaining a strong balance sheet. With almost three-quarters of capital expenditure to be spent on transmission and distribution over the next 3 years, supporting their earnings forecast of between 5% and 7%, the company trades at an unwarranted discount to its peer group.

A position was also initiated in US multi-utility NiSource. The company operates regulated gas utilities in seven states in the Midwest and an electric utility in Indiana. Low gas prices and growth in production in the nearby Marcellus shale gas region are stimulating customers to switch energy sources to natural gas. These conditions are supportive of regulated rate base growth across the business of between 6% and 8% per annum, which if achieved is likely to translate to earnings at the high end of their 4% to 6% annual EPS growth rate target.

Following strong gains in the last 12 months, Canadian pipeline operator TransCanada was sold on the view that the current valuation multiple does not adequately reflect the potential execution risk associated with the integration of Columbia Pipeline Group, acquired earlier in 2016; and on the lack of certainty associated with unsecured future pipeline projects. Holdings in Japan Airport Terminal were also divested after stock catalysts - the approval of additional landing slots and a weaker yen - played out and share price outperformance moved it lower in our investment process.

Outlook

The Fund invests in a range of global listed infrastructure assets including toll roads, airports, ports, railroads, utilities, pipelines and mobile towers. These sectors share common characteristics, like barriers to entry and pricing power, which can provide investors with inflation-protected income and strong capital growth over the medium-term.

Our outlook for global listed infrastructure is positive. Most listed infrastructure companies are in good financial shape, with prudent levels of debt and conservative dividend pay-out ratios. These metrics suggest that listed infrastructure will continue to offer reasonable risk-adjusted returns to investors. Mispricing and value opportunities can be found both between and within infrastructure sectors, presenting scope for active managers to add value.
The chart below highlights the significant variance in returns by sector over 2016, our positioning and stock selection in pipelines (overweight) and satellites (zero weight) being key contributors to >400 bps of alpha for the year.

From here, potential headwinds to the asset class could include higher bond yields, and political or regulatory interference. With this in mind, our Fund's positioning remains tilted towards growth infrastructure such as the toll road sector, which contains high quality companies generating healthy cash flows and trading at discounts to intrinsic value. We also favour mobile towers as we believe the market continues to underestimate mobile data growth, and to overestimate potential risks to free cash flows, for these strategically valuable and well-managed infrastructure companies. An underweight exposure has been maintained in interest rate sensitive utilities, especially those with lower earnings growth outlooks. We also see a number of tailwinds for the year ahead, including ongoing structural drivers (like demand for mobile data or renewable energy); and shifting asset allocation from low-yielding bonds and volatile equities towards real assets.