First State Investments

Global Listed Infrastructure

Monthly Review and Outlook

May 2016

Key highlights:

- The Global listed infrastructure rose 1.7% in May, 3bps behind its benchmark index
- Pipelines, airports and water utilities gained the most. The satellite sector was impacted by a profit warning from Eutelsat
- Oceania was the best performing region while Europe and Asia lagged

Market review

Global listed infrastructure was supported by well-received earnings numbers, improving market sentiment and investor demand for income generative assets against a backdrop of low or negative bond yields. In SGD terms (total return), the FTSE Global Core Infrastructure 50-50 index rose 1.7%, while global equities increased by 3.1%.

The best performing sector was **Pipelines**. First quarter earnings results from the sector featured healthy volumes, steady margins and a more disciplined approach to capital expenditure. Rising oil prices provided an additional tailwind. **Airports** rallied as Mexican operators surged on robust earnings results and very positive momentum in passenger volumes.

The worst performing sector was **Satellites**. French operator Eutelsat announced a material profit warning, triggered by pricing weakness and slowing growth in key markets. SES, the largest listed satellite operator, fell in sympathy and then came under additional pressure after announcing an equity raising. We have been concerned for some time that capacity build-out and technological advances were eroding pricing power and represented structural headwinds for the sector over the medium term. As a result the Fund exited the sector in July 2015, another example of fundamental research and sell-discipline leading to capital preservation for our clients. **Ports** also lagged as slowing growth in global trade and a cooling Chinese economy weighed on Asian operators.

The best performing region was **Oceania**. Lower Australian interest rates and continued strong volumes supported Australian and New Zealand toll road and airport stocks. **Europe ex-UK** was the worst performing region on underperformance from the Satellites sector, and on weakness from conventional power generation utilities, whose businesses face a structural challenge from the rise in renewable energy.

Fund review

In SGD terms, the Fund returned 1.7% in May, in line with the benchmark index.

Its best performing holding was Mexican airport operator **GAP**, which announced a 10% increase in passenger volumes for April compared to the previous year, underpinned by the opening of new routes, growth in domestic air travel, and the popularity of tourist destinations serviced by its airports.

US gas utility **UGI Corp** announced pleasing second quarter results. Although warm weather impacted US volumes, this was largely offset by cost reductions and better than expected synergies from acquisitions in its European division. A return to normalized weather conditions next year would provide a significant tailwind to 2017 earnings.

Volume growth buoyed **Eurotunnel**. The company recorded its sixth consecutive month of record traffic levels in April, highlighting the sustained demand for the essential service it offers. The unique nature of the Channel Tunnel gives the company high barriers to entry, while advantages in speed, frequency and reliability over ferries - its main competitors - provide strong pricing power.

Hong Kong-listed electric utility **Power Assets Holdings** gained as investors shrugged off the absence of a special dividend announcement at the company's AGM. UK power and water utilities **National Grid**, **United Utilities** and **SSE** rose on demand for defensive assets.

US electric and gas utility **PG&E** rallied after announcing an 8% dividend increase – its first since 2010 and evidence that its turnaround story remains on track. Gains from **Alliant Energy** and **Xcel Energy** were partly offset by **Iberdrola** and **Exelon** which declined on concerns that warmer weather and soft power markets may impact earnings from their power generation segments.

Canadian energy pipeline operator **TransCanada** was buoyed as its takeover of smaller US peer **Columbia Pipeline Holdings (flat)** drew closer. US peers **Spectra Energy** and **Kinder Morgan** also climbed as the recovery in oil prices provided a supportive backdrop. However **Magellan Midstream Partners** lagged as investors took the view that its stable, conservative business may underperform more commodity-sensitive peers if oil prices were to rise further.

The worst performing stock in the portfolio was Brazilian toll road operator **CCR** which lagged after rallying substantially since the start of the year. The shares fell despite robust first quarter earnings results that included a 25% increase in EPS, as higher toll tariffs and new projects outweighed the impact of a 2% fall in traffic volumes.

Brazilian water utility **SABESP** also declined, having delivered considerable gains to investors in recent months.

Port operators China Merchants Ports and COSCO Pacific, whose globally diversified port assets include significant Chinese exposure, fell as lower trade volumes between Europe and China in 2015 continued into 2016 and impacted first quarter earnings. More positively, the relatively robust US economy remains supportive of volumes on trans-Pacific routes. Japanese peer Kamigumi gained on solid 2017 guidance as disciplined cost control neutralised the impact of softer volumes. The company's undemanding valuation multiples and large net cash position also aided performance.

Fund holdings remained consistent throughout the month.

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 investment process currently favours toll roads, freight rail and ports. These sectors contain mispriced, high quality companies in secure market positions, trading at appealing valuations. Conversely, we maintain a cautious stance towards satellites, whose businesses face structural headwinds. We have also adopted a selective approach towards multi-utilities and airports, which in some cases have reached valuation levels that are difficult to justify on fundamentals.

Global listed infrastructure has delivered favourable returns over recent years as equity risk premiums have recovered and investors have sought alternative sources of income in a low cash/bond yielding environment. In spite of this, valuations overall remain reasonable and in line with long term averages. Fundamentals support a yield of 3%-4% and earnings growth of 5%-6%, outcomes backed by tangible assets providing essential services in contracted or regulated business models.