First State Investments

Global Listed Infrastructure

Monthly Review and Outlook

February 2017

Market review

Positive earnings results, stabilising bond yields and robust US economic data supported global listed infrastructure in February.

The best performing infrastructure sector was Satellites (+11%)[1]. Earnings results from French operator Eutelsat (+18%, not owned) showed that cost-cutting measures had expanded margins, which eased concerns about the sustainability of the company's dividend. Towers (+9%) rose as investors identified value in the sector. Confident management commentary anticipating higher activity levels in 2017 added a further tailwind.

The only sector to finish the month lower was Pipelines (-1%), which paused after strong gains over the past 12 months.

The best performing region was Latin America (+9%), as improving investor sentiment towards Emerging Markets continued to drive demand for the region's toll roads, ports and airports. Lacklustre economic data weighed on infrastructure stocks in Japan (+1%).

Fund performance and activity

The Fund rose 2.8% in February, 22 basis points behind the FTSE Global Core Infrastructure 50/50 Index.[2]

Toll road holdings rallied, reflecting the appeal of the sector's high barriers to entry, strong free cash flow and inflation linked pricing. The best performing stock in the Fund was Brazil toll road CCR (+17%), which announced a R$4.1 billion (US$1.3 billion) equity raising to take advantage of upcoming auctions of high quality airport and toll road concessions. Australia's Transurban (+8%) announced solid 1H results. Steady traffic growth and toll increases in Sydney and Melbourne delivered a rise in toll revenue of 11%, and supported a 13% increase in distributions per share.

US-based tower companies American Tower (+11%), SBA Communications (+10%) and Crown Castle (+6%) all rose, helped by solid operational performance. Earnings numbers from both American Tower and SBA were in line with consensus. American Tower noted that structural themes in smartphone penetration and data consumption continue to work in the company's favour, resulting in expected higher network investment in 2017.

The Fund's electric and multi-utility holdings were supported by favourable earnings results and renewed investor appetite for stable, income producing assets. Spanish-listed Iberdrola (+8%) announced a 12% increase in full year earnings, led by strong performance from its US power networks. Solid 2016 financial performance by NiSource (+8%) was underpinned by the execution of its long-term utility infrastructure modernisation programs.

The worst performing stock in the Fund was US pipeline operator Kinder Morgan (-5%). The market was disappointed that the company failed to provide further details on how it would deleverage the balance sheet. We expect a positive outcome on the sale of a 50% share in the Trans Mountain Expansion Project in coming months. Canadian peer Enbridge Inc (+2%) gained following the completion of its Spectra Energy acquisition. The transaction makes it the largest constituent of the FTSE infrastructure benchmark, by index weight.

The other main detractors from Fund performance in a largely positive month were Japanese holdings. Kamigumi (-4%) fell as higher costs and weak performance from its international logistics business overshadowed volume growth at its domestic port operations. East Japan Railway (-1%) announced solid earnings numbers for the first nine months of the financial year, but underperformed as investor focus switched towards higher beta assets.

No stocks were divested, and no new stocks were added to the Fund during February.

Market outlook and fund positioning

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.

The Fund has maintained its largest overweight exposure to the toll roads sector. We are attracted to the undemanding valuation multiples and well-supported dividend yields of between 4% and 6% offered by the sector. We also believe the market is under-estimating the strength of pricing power and the potential recovery in volumes available to European toll road operators such as Atlantia and Abertis.

Mobile towers represent our second largest overweight exposure. We expect ongoing pressure on mobile phone carriers to improve network quality will continue to underpin healthy earnings growth for the sector.

[1] Sector classifications are defined by First State Investments and may differ from the benchmark index GICS classifications.
[2] Source: First State Investments as at 28 February 2017. Performance is based on First State Global Listed Infrastructure in SGD. Single pricing basis with net income reinvested.
All stock and sector performance data expressed in local currency terms. Source: Bloomberg.

The extent of the Fund's underweight to electric and multi-utilities has been trimmed. Relative underperformance in recent months has moved utility stocks higher within our investment process, leading us to add to existing high conviction utility holdings including PG&E, National Grid and NextEra Energy. This defensive adjustment against the current backdrop of buoyant markets is consistent with our contrarian approach; and with our philosophy of capital preservation being critical to achieving long-term capital growth.