

Global Listed Infrastructure | Travel Diary

WALKING ON SUNSHINE

Andrew Greenup – Deputy Head of Global Listed Infrastructure | April 2019

Florida is home to world leading infrastructure companies. The US state offers investors exposure to strong demographics, pro-business politics and sensible regulation. Sunshine State is more than just a reference to the weather.

The state's utilities are leading the charge towards renewable energy while gas pipelines are delivering a low-cost transition fuel, both working to keep customer bills low and minimise political and regulatory risk.

Historic under-investment in transport infrastructure may provide an opportunity in the future. The state has introduced Public-Private Partnerships (PPPs) for road and airport projects, but the investment need remains significant.

The global listed infrastructure asset class is strongly represented in Florida (FL). The state is home to the United States' (US) largest utility and renewable energy owner NextEra Energy; freight railway giant CSX Corporation (CSX); and the world's fourth largest wireless tower firm SBA Communications. I have recently returned from a week in FL talking to management teams, visiting corporate head offices and conducting several asset tours including to the largest natural gas fired power plant in the US. The following note provides a brief overview of listed infrastructure within the state of FL including key exposures for our strategy.

With population growth above the national average, FL is now the third most populous state in the US, with just over 21 million people. FL's economy is robust with a Gross State Product of over US\$1 trillion, making it the 4th largest economy in the US.¹ If it was a separate country, FL would be the 16th largest economy in the world – not far behind Australia (GDP of US\$1.4 trillion) and larger than either the Netherlands (US\$0.9 trillion) or Switzerland (US\$0.7 trillion)². FL frequently rates highly among US states for being business friendly, ranking 7th in Forbes' "Best States for Business", 10th in CNBC's "Top States for Business" and 4th for "Business Tax Climate" from The Tax Foundation.

Utilities – the future is solar

FL's electric utilities are vertically integrated generation, transmission and distribution businesses that earn a regulated return. While per capita consumption of electricity in FL is close to the national average, this reflects the lack of significant industrial load. Residential electricity consumption is well above the national average owing to the heavy use of air conditioning. Residential electricity prices in FL are below the national average with the state ranking 27th across the US. Electricity generation in the state is dominated by natural gas which accounts for 70% of output³. The state has been closing coal, oil and nuclear power plants and replacing them with solar and gas-fired power plants.

Penetration of piped natural gas for residential dwellings in FL is low at around 10%, reflecting a lack of demand for gas heating given the warm climate⁴.

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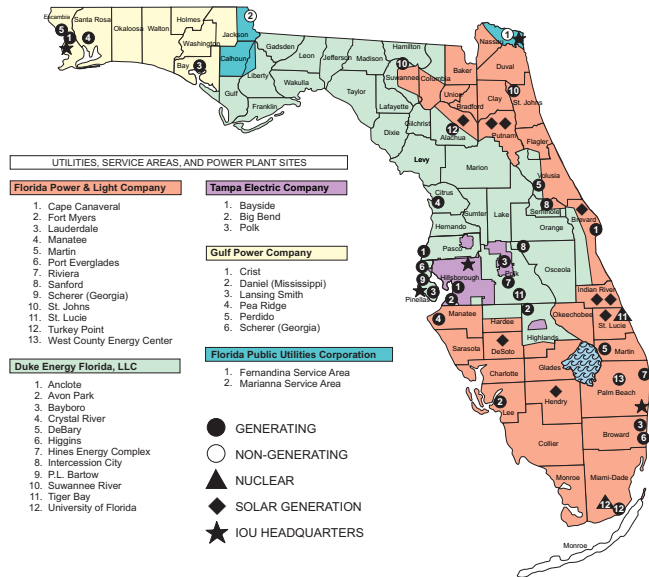
¹ Source: Current-price GDP in USD, as at Q3 2018, Bureau of Economic Analysis.

² Source: Current-price GDP in USD, as at October 2018, International Monetary Fund staff estimates.

³ Source: US Energy Information Administration.

⁴ Source: Emera Inc.

Map of Florida's electric utilities



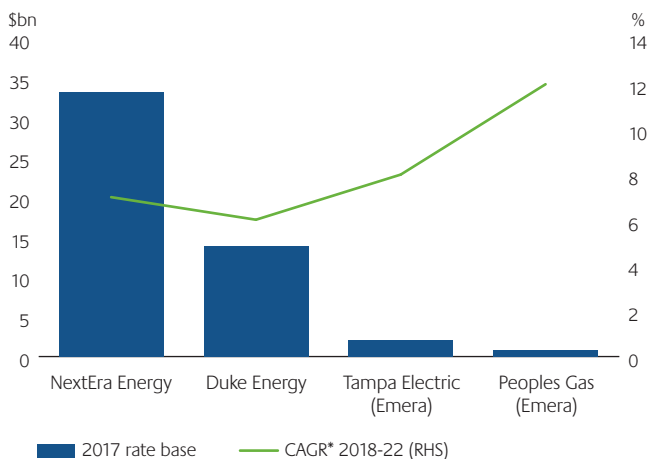
Source: Florida Public Service Commission.

The state's electric and gas utility market is dominated by four listed infrastructure companies. These are NextEra Energy (via Florida Power & Light, Gulf Power and Florida City Gas), Duke Energy, Emera Inc (via Tampa Electric and Peoples Gas) and Chesapeake Utilities (via Florida Public Utilities Corporation). In addition, there are 35 small municipal-owned utilities and 18 rural cooperatives.

We view the pro-business environment in FL for utilities as positive. The state's utility regulator has traditionally been constructive in looking for win-win solutions for customers *and* shareholders. The state's electricity prices have remained static for over a decade (FL's average 1,000-kWh residential bill was \$99 in 2018 vs \$109 in 2006), while allowing strong investment, timely recovery of costs and a good allowed Return on Equity (ROE) ranging from 10%-12%⁵.

The state's regulator has recently allowed utilities to spend several billion dollars building utility scale solar, now that the technology has become cost competitive. In January 2019, NextEra Energy announced an ambitious "30-by-30" plan to install 30 million solar panels (~10,000 megawatts) by 2030. Going forward, we expect FL's utilities to grow their asset bases by between 7% and 12% per annum over the next five years from (1) large scale build out of solar plants, (2) modernisation of older power plants and (3) grid maintenance and modernisation.

FL utilities' respective rate bases and forecast growth rates



Source: First State Investments estimates. *Compound Annual Growth Rate.

⁵ Source: NextEra Energy.

In our view FL offers one of the most attractive risk adjusted return opportunities within the utility sector globally and is a material stock price driver for portfolio positions of NextEra Energy and Emera Inc.

Touring Emera Inc's Bayside Power Station in Tampa



Source: First State Investments.

Energy infrastructure – gas fuels the sunshine state

FL does not produce material amounts of oil or natural gas. As a result the vast majority of its energy transportation and storage infrastructure is dedicated to the importation of natural gas and refined oil products, for consumption within the state. FL's natural gas needs are supplied predominantly by three transmission pipelines, all owned by listed infrastructure firms. In 2017, 87% of the natural gas delivered to FL was used to generate electricity⁶.

Florida Gas Transmission, the original pipeline, brings natural gas into FL from Texas. It is a 5,300-mile pipeline with 3.6 billion cubic feet per day capacity, owned equally by Kinder Morgan and Energy Transfer. Its customers are the state's utilities. In 2002, the 745-mile Gulfstream Natural Gas System was opened with a capacity of 1.3 billion cubic feet per day. This pipeline brings in gas from Louisiana and is equally owned by Williams Companies and Enbridge Inc. In 2017, the \$3.2 billion Sabal Trail Interstate Pipeline opened. This time, FL's two largest utilities, NextEra Energy and Duke Energy, decided to become equity owners in the pipeline (in conjunction with Enbridge Inc) as well as being the main customers.

FL does not have any oil production or refineries, hence the state has no interstate oil pipelines. Petroleum is imported into the state via marine terminals at its major ports. One intrastate pipeline transports refined oil products from Tampa to Orlando.

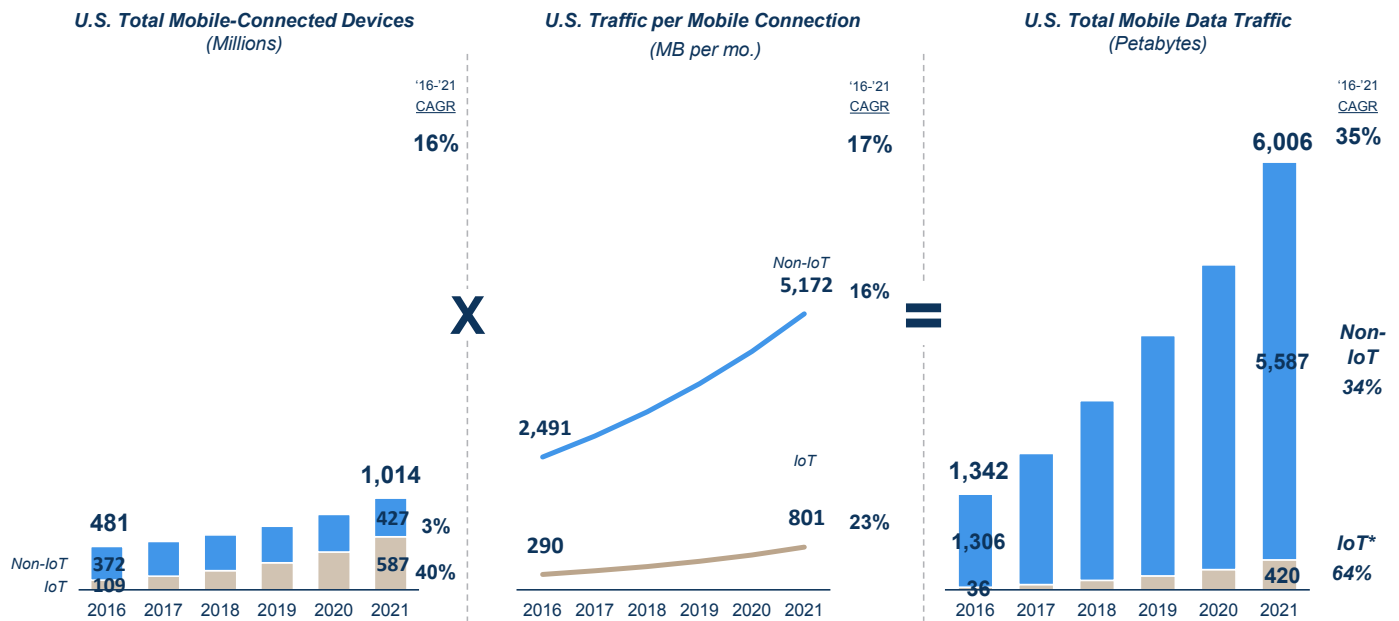
We value FL's energy infrastructure highly given its strong end demand, low risk counterparties and business-friendly culture. We believe these assets have expansion opportunities over the next decade. The portfolio has positions in Kinder Morgan and Williams Companies who are both owners of FL's energy infrastructure.

Communications infrastructure – data, data, data

FL is home to SBA Communications, the third largest owner of wireless towers in the US. We like the wireless tower business model given (1) strong structural growth in wireless data usage, requiring telecom operators to continually upgrade their networks to meet demand, (2) contracted revenue streams typically with 3% price escalators on average, (3) low risk counterparties, (4) compelling economics of tenant co-location and (5) high barriers to entry. These, combined with SBA Communications' exceptional management team, make this company one of the highest quality names in our investment process.

⁶ Source: US Energy Information Administration.

US mobile data traffic growth projections



Source: American Tower.

*Internet of things (IoT). The Internet of things is the extension of Internet connectivity into physical devices and everyday objects.

The wireless tower market finished 2018 strongly with customer activity remaining robust in early 2019. While consumer handset replacements have slowed, data usage per phone has increased 21% over the past 12 months, driven by an ever increasing offering of over-the-top content⁷.

Transport infrastructure – needs to be better

To the detriment of FL's taxpayers, the vast majority of the state's transportation infrastructure (roads, railways, airports, ports) is owned and operated by local or state government. In 2016 the American Society of Engineers gave FL's transport infrastructure the following unflattering marks: Airports B-, Roads C, Bridges B, Transit C and Ports B-.

The exception to government ownership is the freight railway sector. The vast majority of FL's rail traffic consists of inbound bulk commodities, intermodal and autos; outbound traffic is relatively modest. The listed infrastructure sector owns and operates almost all the freight railways in FL. CSX is the largest and most extensive railway in FL, accounting for around 50% of track miles. The second largest railway is the Florida East Coast Railway (FEC) which runs a 350 mile mainline from Jacksonville to Miami and services the ports of Miami, Palm Beach and Everglades. FEC is owned by Mexican listed infrastructure firm, Grupo Mexico Transportes. Further, Norfolk Southern and Genesee & Wyoming each own several small railways in the north of the state.

FL has 22 commercial airports and is the second largest aviation market in the US with over 170 million passengers pa. Just over 20% of these passengers are international. In 2018, global listed infrastructure firm Vinci acquired the 3 million passenger Orlando-Sanford International Airport, Orlando's second airport and the eighth largest in Florida⁸. Over the next few years we expect Vinci to attract new airlines, expand number of destinations, upgrade the retail offering, invest in better facilities and improve the cost base of this small airport in order to better compete against Orlando's large 47 million passenger main airport.

It is encouraging that the state has historically and is currently utilising PPPs to build new road projects. These include the \$0.7 billion Port Miami Tunnel, the \$1.2 billion I-595 Express and the still under-construction \$2.3 billion I-4 Ultimate project. To date, these projects have been funded mainly by construction companies and not global listed infrastructure firms. Going forward we expect several listed infrastructure firms to investigate participating in FL PPPs, including Ferrovial, Transurban and Atlantia/ACS.

Conclusion

Its business-friendly environment and constructive regulation makes FL an attractive place for global listed infrastructure firms to invest. Our strategy has significant exposure to this large, high growth state via holdings in NextEra Energy, Emera Inc, SBA Communications, Kinder Morgan, Williams Companies and Vinci.

Talking geopolitics with former US Secretary of Defence, Chuck Hagel



Source: First State Investments.

⁷ Ericsson Mobility Report November 2018.

⁸ Source: US Federal Aviation Administration.

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