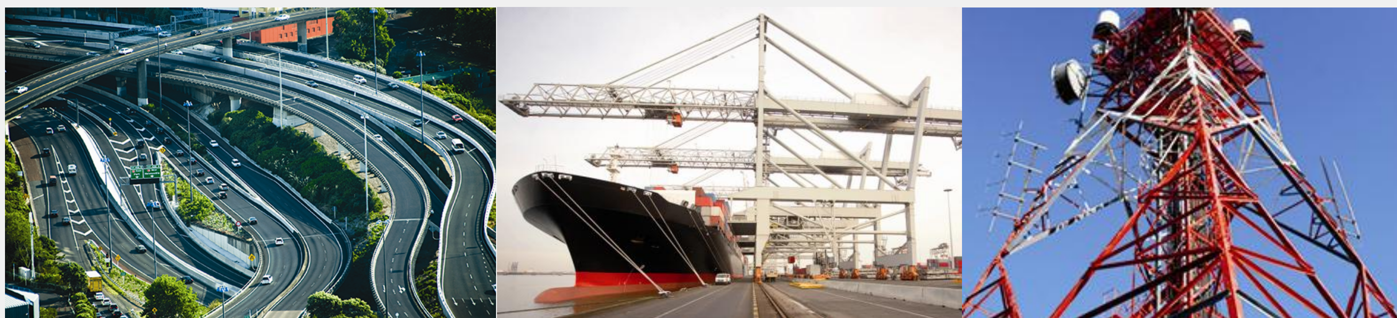
First State Investments

Global Listed Infrastructure

Monthly Review and Outlook

As at November 2014



Welcome to the latest monthly update on First State Global Infrastructure, providing a review of the Fund and latest outlook for the sector.

Key highlights:

- Global listed infrastructure continued a positive run, increased by 2.5% in November.
- Communications infrastructure outperformed, while energy pipelines lagged due to falling oil prices.
- Japan and the UK were the best-performing regions.
- Fund positioning remains tilted towards 'growth' oriented sectors such as toll roads, ports and railways.
- Underweight exposure has been maintained towards 'income' sectors such as regulated utilities and energy pipelines that are most affected by rising bond yields.

Market review

Global listed infrastructure rose throughout November against a backdrop of dramatic macroeconomic developments. OPEC decided at the end of the month not to lower its output ceiling, causing oil prices to plunge to new multi-year lows. Visible cash flows and generally good third quarter results from a broad range of infrastructure companies provided a stable base for asset class performance. In SGD term (total return), the UBS Global Infrastructure & Utilities 50-50 Index returned 2.5% over the month, compared to a 3.5% gain by the MSCI World Index.

Communications infrastructure – **Mobile towers** and **Satellites** – performed best. Planning restrictions on tower sites and satellite positions represent substantial barriers to entry for these sectors, while increased demand for capacity by smart phone users continues to underpin robust revenue growth. American Tower announced that it would add to its faster-growing overseas towers portfolio by purchasing Brazilian and Nigerian tower portfolios for a total of US$2.25 billion. SBA Communications reported better than expected 3Q revenues and guidance that it expects to carry out further acquisitions. Crown Castle also rose, despite 3Q results which guided towards a relatively muted growth outlook due to tenant non-renewals following mobile phone carrier consolidation. The company's dividend payout ratio was increased to 75%, giving this highly cash generative company a well-backed 4% dividend yield.

UK satellite operator Inmarsat climbed on 3Q results which included EBITDA 6% ahead of consensus thanks to tightly controlled operating costs; and positive guidance on the progress of its upcoming Global Xpress service. Peers SES and Eutelsat also rose on demand for highly visible, contracted cash flows and sustainable dividend yields.

Passenger rail and **Ports** also gained. Japanese passenger rail stocks including West Japan Railway and Central Japan Railway reported robust October passenger numbers, continuing the trend of steady passenger growth. The port sector performed strongly on 3Q good results. Dubai-based DP World rallied after announcing a 9% volume increase in 3Q. German port Hamburger Hafen reported a 14% increase in its 3Q profits, largely driven by better than expected volumes in its intermodal business segment and a lower tax rate. The

decision by the People's Bank of China to cut interest rates for the first time in two years in an effort to stimulate levels of economic activity provided a tailwind to Chinese port operators such as China Merchants Holdings International and COSCO Pacific.

The worst-performing sector, **Energy pipelines**, came under pressure as oil prices continued their slide throughout the month. A broad range of US and Canadian energy pipeline companies including Pembina Pipeline Corporation, Cheniere, ONEOK and Williams Cos experienced sharp falls in their share prices on concerns that structurally lower oil prices could limit the economic viability of higher cost US shale oil projects. This in turn could curtail demand for the scheduled energy infrastructure build-out, putting US energy pipeline companies' earnings growth assumptions at risk.

Freight rail underperformed as US operators with Crude by Rail business segments such as Canadian Pacific, Kansas City Southern and Canadian National were impacted by the prospect of lower volumes. Freight rail operators haul a range of other bulk cargo types and intermodal containers, giving them a level of diversification that is likely to reduce the potential impact of lower oil prices.

Japan was the best performing region. As well as strong performance from the passenger rail sector, economically sensitive infrastructure stocks including Japan Airport Terminal and port/logistics operators Sumitomo Warehouse and Mitsubishi Logistics were supported by the recently announced expansion of the Bank of Japan (BoJ)'s asset purchase program.

The **UK** rallied. Water company United Utilities rose ahead of the publication of the regulator Ofwat's final determinations on UK water sector pricing for the period 2015 – 2020. Publication is due on 12 December, and is expected to provide the sector with increased regulatory certainty. Renewed takeover bid rumours also focused investor interest in the company. Pennon, whose proposed 2015 – 2020 plans have qualified for fast-track treatment by Ofwat, announced in-line first half results. It also guided that it was on track to deliver a full year dividend increase 4% above inflation, despite a price freeze for customers during the 2014 – 15 financial year.

European infrastructure generated mixed returns. Although European utilities including Enel, Snam and Terna underperformed, a candid speech from European Central Bank (ECB) president Mario Draghi on the importance of increasing the inflation rate caused economically sensitive sectors to rally on hopes that the ECB may take action to stimulate growth. Toll roads including Atlantia and Abertis; airports Aeroports de Paris and Flughafen Zuerich; and Channel Tunnel operator Groupe Eurotunnel rose during the month.

Fund review

The Fund returned 2.9% in November.

Positive drivers of performance included large holdings in port operator China Merchants Holdings International and Italian toll road Atlantia; underweight positioning in integrated utilities; and limited exposure to the energy pipelines sector. Underweight exposure to the strongly performing satellite and mobile tower sectors detracted from relative performance.

Transactions

New positions were built in Chinese gas distribution utility ENN Energy and mobile tower operator SBA Communications. ENN is well positioned to benefit from increasing natural gas usage in China, driven by the government's determination to reduce the country's reliance on coal. We expect it to achieve double-digit per annum volume growth for the next 3-5 years. The company is run by an experienced management team with a long history of operating in Chinese city gas markets. A negative reaction by the market to its recent acquisition of North American assets presented an opportunity to gain exposure to high quality, high growth infrastructure assets at an appealing valuation.

Holdings in US electricity and gas utility NiSource and US east coast freight rail operator Norfolk Southern were sold. NiSource operates monopolistic utility businesses within favourable regulatory jurisdictions, and is run by a well-regarded management team. However, growing market recognition of its stable business model and ongoing growth potential during our holding period have caused it to trade at full valuation multiples. Norfolk Southern also reached our target valuation range, having risen strongly since the Fund's initial investment in October 2012 as a steadily improving US economy led to volume and margin growth.

Award of the month – G20 Global Infrastructure Hub

The recent G20 Leaders' Summit decided to establish a Global Infrastructure Hub in order to increase global investment in infrastructure. The Hub, which will be based in Sydney, Australia, is expected to unlock an additional US$2 trillion in global infrastructure capacity to 2030 by coordinating the infrastructure plans and activities of governments, the private sector, banks and other organisations.

Outlook

The Fund invests in a wide range of global listed infrastructure assets including toll roads, airports, ports, railroads, utilities, pipelines, energy storage, mobile towers and satellites. 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 underweight exposure to 'income' sectors such as regulated utilities and energy pipelines that are most interest rate sensitive. We have maintained a cautious approach to the Energy Pipeline sector, taking the view that excessive capital inflows have supported inflated valuations and led to higher risk business models, unwelcome exposure to commodity prices, and potentially unsustainable growth expectations. Recent falls in oil prices have triggered share price declines across the sector, reflecting a healthy increase in scepticism towards pipeline business models. However in our view, valuations within the sector remain above company fundamentals.

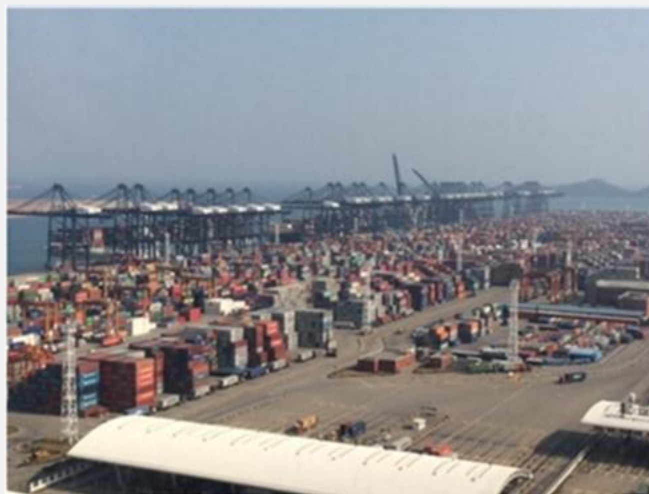
Fund positioning remains tilted towards 'growth' orientated sectors such as toll roads, ports and railways. These sectors benefit from increasing volumes and positive operating leverage in an improving economic environment.

Pictures of the month – port asset tour by analyst Jessica Johnson in East Shenzhen, China

Jess visited Yantian International Container Terminals in East Shenzhen this month. This infrastructure asset is 57% owned by listed port operator Hutchison Port Holdings. In 1993, Yantian was a fishing village. Today, its port handles over 10 million twenty-foot equivalent units (TEUs) every year.

It took under 20 years for Yantian to handle its first 100 million TEUs. Singapore took 26 years to reach that milestone; Hong Kong took 34 years. Current volume growth at the port is being driven by the US housing and spending recovery, resulting in more US-bound container ships.

Source: First State Investments.



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