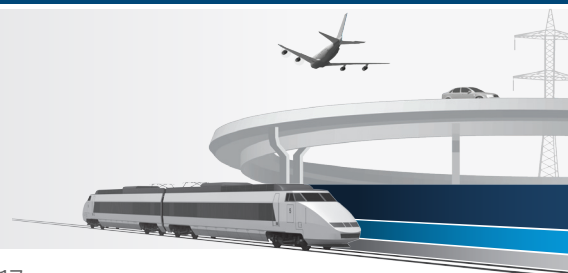


A Day In The Life



Andrew Greenup, Deputy Head of Global Listed Infrastructure | February 2017

Leaving a hot Australian summer I flew into a cold European winter to spend a week researching infrastructure. Following is a brief summary meant to provide an insight into a day in the life of a global listed infrastructure investor.

Monday: Paris

Monday morning started with a quick breakfast meeting with Eurotunnel, then off to La Défense to visit several utilities followed by afternoon meetings with Groupe ADP (Aéroports de Paris) and gas utility Rubis. Key points of interest were:

Despite low corporate confidence, the French economy is improving. This is supporting reasonable (2-3%) traffic growth on the country's toll roads and airports. Construction activity levels and the number of cranes at work are the highest I have observed in Paris at any time over the past eight years.

The return of inflation is boosting 2017 and 2018 revenues for most French infrastructure due to price escalation clauses in concessions and contracts.

Paris head office of Groupe ADP



Source: CFSGAM.

Eurotunnel continues to offer a compelling customer proposition for truck, passenger vehicles and people with superior service in terms of time, reliability and frequency relative to its ferry and airline competition. This, combined with a long life concession until 2086, only 60% utilisation (minimising capex needed to grow) and CPI plus pricing power makes this company a compelling infrastructure investment in our view.

French electric, gas, water & waste utilities remain under significant downward earning pressure owing to declining volumes and falling prices. This, combined with over leveraged Balance Sheets is contributing to value destructive asset disposal programs.

Groupe ADP, Rubis and Suez Environment are executing growth options by exporting their infrastructure expertise to developing markets. In doing so they are creating significant value for their shareholders. For example, Groupe ADP is exploring opportunities to upgrade and expand airports in Chile, Vietnam, Cuba and Iran.

Tuesday: Rome

Arriving at the hotel around midnight, a quick run was needed to energise me before driving to various parts of Rome to meet management of Atlantia, RaiWay, ENEL and Enav. Key points of interest were:

Consolidation of Italy's mobile tower industry remain inevitable in my view, due to the compelling industrial logic of substantial synergies. Within the next three to five years my best guess is that Cellnex Telecom and RaiWay will acquire Inwit and EI Towers.

Italy's recently privatised government infrastructure companies, mobile tower owner RaiWay and air navigation service provider Enav offer significant potential upside. Both companies are positioned to deliver relatively low risk earnings growth by reducing inefficient government cost bases and driving operational efficiencies.

Many Italian infrastructure companies (including Inwit, RaiWay and Enav) have significantly under-levered Balance Sheets which provide upside value creation potential for equity holders.

Rome looked even more run down than I remembered from my last visit two years ago. Economic stagnation continues to adversely impact the social fabric of Italian society.

Another night flight, this time from Rome to Madrid but not before a quick tour of Rome's Fiumicino airport (owned by Italian infrastructure giant Atlantia). While this airport has improved greatly since Atlantia acquired it in 2013, it remains very underwhelming with significant room for improvement.

Rome head office of Atlantia



Source: CFSGAM.

Wednesday: Madrid

After breakfast with a stockbroker, today was spent at an investor conference in Madrid with back-to-back company management meetings. Spain is home to many global infrastructure conquistadors including toll road giant Abertis, infrastructure pioneer Ferrovial and global renewable energy leader Iberdrola. Key points of interest were:

A robust Spanish economy is driving strong traffic growth at the country's airports and toll roads, benefiting AENA and Abertis. I would note that domestic construction and new infrastructure building within Spain still remains dormant given the aggressive overbuild that took place in the early and mid-2000s.

After suffering deflation in 2016, inflation has accelerated in early 2017 which will flow through to concession revenues in 2018.

This is the most optimistic I have seen Spanish infrastructure corporates. This optimism, combined with repaired Balance Sheets, is leading to greater appetite to deploy capital (almost exclusively outside Spain) both organically and via acquisitions. I expect 2017 to be a busy year for Spain's infrastructure companies; in particular Iberdrola and Abertis. Higher corporate confidence also tends to lead to higher dividend payouts.

Iberian companies Iberdrola and EDP Renewables are the second and fourth largest wind farm operators in the US market respectively. As you would expect, both companies were adamant that Trump was not going to impact the growth of the US renewables industry. Half the industry is now driven by utilities buying renewables energy to meet 29 state-based Renewable Portfolio Standards, while the other half is driven by corporates like Google, Amazon, Bloomberg, Nike and Home Depot. EDP Renewables has signed one Power Purchase Agreement since Trump's election and Iberdrola is about to sign one.

Ferrovial is having real success with its new managed lane toll roads in Dallas, Texas. This success is helping it win new projects in the Carolinas and Virginia. If Trump's infrastructure plan actually translates into action, Ferrovial is very well placed to participate and create value for all stakeholders.

Ferrovial's successful US express lanes



Source: Ferrovial, CFSGAM.

After a day of seven back-to-back meetings, tapas and red wine were the order of the evening.

Thursday: Madrid

Back to the conference for more infrastructure management meetings. Key points of interest were:

Iberia's electric and gas transmission utilities (Red Electrica, Enagas and REN) continue to see no or very limited capital expenditure growth in their core asset bases. By way of example, Enagas' eight Spanish LNG import terminals are only 20% utilised, hence no need for new assets. This means these companies are increasingly reliant on a higher risk strategy of acquiring assets overseas to achieve their modest EPS growth targets of around 2% pa.

The Spanish electricity generation and supply industry remains in overcapacity, with only modest demand growth. The government's determination to proceed with a new 3,000mw renewables auction later this year will only add to industry overcapacity and further hurt power prices. This has negative implications for Iberdrola, Gas Natural and Endesa.

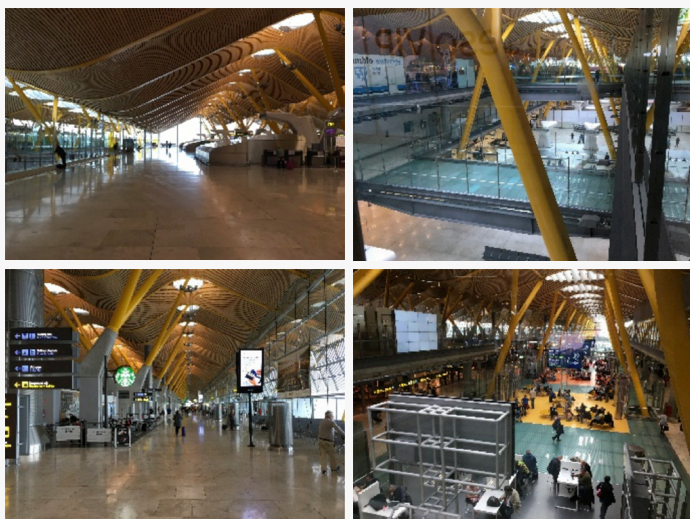
A large number of infrastructure concessions remain trapped in over-leveraged Spanish construction and concession companies including OHL, Sacyr, Acciona and FCC. Several of these companies have active infrastructure divestment programs which are likely to provide acquisition opportunities for the global listed infrastructure sector.

On the topic of corporate restructuring, while I was at the conference Spanish based European mobile tower company, Cellnex, announced it had acquired 3,000 towers from French conglomerate, Bouygues. Cellnex stock increased 6% after the announcement.

Even in Spain I couldn't escape Bill Gates' love affair with waste utilities. In addition to his ownership of 32% and 7% respectively of US waste giants Republic Services and Waste Management, he also owns 6% of Spain's leading waste utility, FCC.

From the conference it was only a short drive to Madrid's magnificent Barajas airport. The massive amount of excess capacity at this world-leading airport means its owner, AENA, can grow earnings without significant levels of capital expenditure, making it a highly cash generative company.

AENA's Madrid Barajas airport



Source: CFSGAM.

Friday: London

Last but not least, a quick day in London visiting infrastructure company management. Key points of interest were:

I was surprised by the growth National Grid is achieving in its US businesses; specifically replacement capex in gas distribution as well as electric transmission opportunities.

UK energy policy remains problematic and full of contradictions. This has been exacerbated by a more interventionist May government, Brexit focus and government led industry policy (which I am more used to hearing in France than the in UK). This reduces investment opportunities and increases political and legal risks for the likes of Centrica, SSE and National Grid. As an aside, I think the new acronym for the department of energy (BEIS, for Business, Energy & Industrial Strategy) is even worse than the old one (DECC, for Department of Energy and Climate Change).

The global satellite industry is experiencing significant turbulence due to increased industry capacity, reduced delivery costs, changing technologies, evolving pricing / business models and disruption to end user's business models. That said, we believe Inmarsat's core maritime satellite business has a uniqueness and monopoly essential service characteristics that leaves it better placed than other fixed satellite operators of Intelsat, SES, Eutelsat and Abertis' Hispasat.

Conclusion

I was positively surprised by the strength of the European economies I visited, the high degree of corporate confidence despite weak governments and upcoming elections as well as the (so far) rational deployment of capital by most companies in value accretive investment decisions.

The main negative surprises were the degree of downside that persists in European integrated utilities earnings, some over-exuberance in renewables investment (too much money chasing too few assets) and a British government relying less on competitive markets and more on government-led industrial solutions.

As always, European infrastructure firm's refusal to buy back their shares remains a disappointment. However when this changes, it will provide significant upside to infrastructure equity holders.

In my last European travel diary nine months ago I wrote that these companies were in an earnings upgrade cycle. Despite Brexit and a year of difficult elections, I believe earnings upgrades will continue in 2017 for the European infrastructure sector.



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