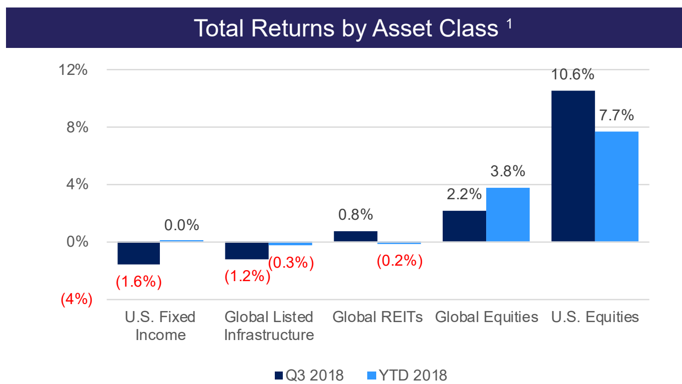
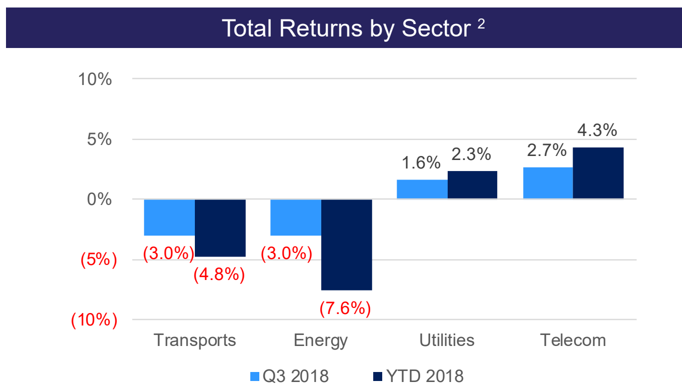
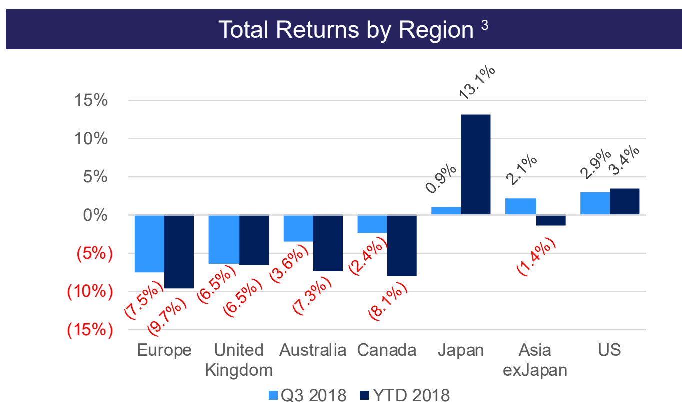
LISTED INFRASTRUCTURE INSIDER

CenterSquare
REAL ASSET INVESTMENT LEADERSHIP

October 2018







Infrastructure at the Turn

As we move along in the market cycle, disparate equity returns year-to-date have created a favorable set-up for infrastructure equities. The asset class is relatively flat in 2018, after a +18% run in 2017, while broader equity indices have returned mid to high single digits. As of the end of the third quarter, the space offers an attractive 3.9% dividend yield and high single digit underlying cash flow growth, while its yield spread and P/E are approaching the most discounted they have been in half a decade. For those with late-cycle nerves, we see listed infrastructure as just the right tonic: company cash flow tends to rise with inflation, due to CPI/RPI structured contracts, and the space has historically outperformed during periods approaching economic slowdowns, when investors gravitate to monopolistic businesses with inelastic demand. Going forward, we see several dynamics that should drive returns for listed infrastructure in the year ahead.

Utilities

In utilities year to date, politics has been a significant factor in returns. In Europe, changing political winds, with their potential to impact utility regulation, have buffeted the group in a year of rapidly rising interest rates. Since Q1 alone, the governments of both Spain and Italy have changed hands, while the outlook for the U.K. has waxed and waned depending on the state of Brexit negotiations. With the votes counted, Spanish utilities have looked better positioned, given an outlook for regulated returns that is now much better than originally thought. In Italy, the unlikely alliance between center-right and anti-establishment parties has led to heightened uncertainty, with yields increasing over concerns that populist policies would increase deficit spending, and lead to conflict with the EU. Meanwhile, in the U.K., successful Brexit negotiations (ongoing as of this writing) should be favorable for the group, as some of Labour's anti-

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industry policies would be much less likely under a stronger conservative government. In the U.S., resolution to a year-long wildfire related liability issue in California is likely to provide clarity around future earnings prospects and remove an overhang that has severely depressed certain utility equities. Broadly speaking, we are cognizant of value opportunities that have arisen in the group, and with political headwinds abating in Europe and the U.S., we see a better path for valuations ahead.

Transports

In global transports, 2018 has proven to be a year where stock-picking matters, particularly in underwriting the sanctity of government contracts and in handicapping prospects for upcoming awards. A useful tale of two cities is that of Genoa, Italy, and Sydney, Australia, where two of the largest companies in the investment universe run operations that have fared very differently. In mid August, Atlantia SpA's A10 Genoa bridge collapsed, tragically killing over forty people and spurring calls by the Italian government to revoke a major concession of the owner-operator. While the company had highlighted the need for increased maintenance spending on the bridge as recently as last year, the risks are now undeniable: the concession in question represents 40% of company cash flow. Fresh analysis of potential reconstruction costs, fines, and continuation of government contracts are the key to an Atlantia investment, and we have re-examined our historical underweight after the shares' significant fall. Atlantia's Genoan plight is the mirror opposite of conditions in Sydney, Australia, where large-cap Transurban Group recently won ownership of the $25bln WestConnex project. Following over a year of speculation with a required equity offering of over $5bn, the project to expand and lay key roads around Sydney is particularly strategic given Transurban's existing asset base. After analysis and favorable positioning into the award process itself, we were able to participate in the company's deal at a significant discount to fair value. With the equity overhang removed and the potential for synergies ahead, we expect shares to outperform peers in the future, and future concessions to drive growth for the sector as a whole.

Energy

Year to date in energy, two sharp shifts in federal rules about pipeline tariffs have created a favorable set-up for the equities, whose underlying businesses are benefiting from oil prices and liquids volumes at new highs. In mid-March, the FERC (Federal Energy Regulatory Commission), issued a ruling that roiled the sector, mandating that MLPs (Master Limited Partnerships) would need to reduce their tolls to account for their treatment of income taxes. The ruling (which would potentially change the way pipelines have operated for years), was important for stock-picking: some companies would potentially see cash flows decline by 30%, while others would emerge unharmed. In mid-July, the FERC did a bit of an about-face, and issued a final notice that greatly amended its earlier rule-making. All-in, these clarifications eliminated most of the potential downside, and the entire sector rallied. The ability to successfully navigate these disparate directives, and position accordingly, was a significant contributor to our alpha over the first half of 2018. Today, we believe the removal of energy's regulatory overhang should enable the market to follow the money: of all the sectors in our

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coverage, energy has perhaps the most robust fundamentals, with the greatest upward bias to cash flow forecasts. With global crude and liquids prices up 50% over the last year, and liquids volumes in the U.S. growing at a double-digit clip, we are overweight this sector.

Telecom

We see two thematic developments impacting the telecom space materially as we move into 2019. First, as the groundwork for how the U.S. telecom carriers will deploy their 5G network architecture continues to be laid, recent focus has been placed on the utilization of the C-band frequency (3.7GHz-4.2GHz) as an incremental solution to address the need for greater spectrum capacity. Utilizing this bandwidth, when feasible, to service network demand would assist in allowing new technologies (i.e. driverless cars, autonomous drones, etc.) to take flight, reducing latency and broadening coverage. Going forward, entities with C-band spectrum assets could benefit from the monetization of bandwidth in select regions of the U.S. We feel this on-going process merits close monitoring given the potential value that could be unearthed to make room for 5G deployment in the U.S. Second, the First Responders Network, commonly referred to as FirstNet, recently initiated its buildout via AT&T site visits across the U.S. The capital expenditures that will take place over the next 3-5 years is substantial. From a simplistic point of view, four carriers are now becoming four and a half in terms of aggregate spending. The deployment should provide incremental revenue for owners of cellular towers as new equipment starts getting installed across America. This should prove a significant tailwind to the relevant equities in our coverage.

Summary

After relatively placid returns in the first three quarters of 2018, we see a groundswell building for listed infrastructure fundamentals and cash flows. Global utilities are beginning to see regulatory and political clarity. Toll roads and railroads are seeing concessions come to market, midstream fundamentals are surging, and telecom continues to enjoy the secular tailwind of more data and more capital spend. The need to move energy, people, data, and goods continues to propel cash flows for an asset class that enjoys significant stability, inflation-indexed pricing, and which sports an attractive yield and total return. We are optimistic about the road ahead.

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[1] Source: Bloomberg, as of September 30, 2018. Asset class returns are calculated using established indices as proxies. A full list of these indices and their definitions is provided at the end of this document. Past performance is not indicative of future results.

[2] Source: Bloomberg, as of September 30, 2018, based on sector returns within the FTSE Developed Core Infrastructure 50/50 Index. A full list of indices and their definitions is provided at the end of this document. Past performance is not indicative of future results.

[3] Source: Bloomberg, as of September 30, 2018, based on regional returns within the FTSE Developed Core Infrastructure 50/50 Index. A full list of indices and their definitions is provided at the end of this document. Past performance is not indicative of future results.

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Definition of Indices

U.S. Equities: S&P 500
U.S. Fixed Income: FTSE US Broad Investment Grade (USBIG) Bond Index
Global Equities: MSCI ACWI Index
Listed Infrastructure : FTSE Developed Core Infrastructure 50/50 Index
Global REITs: FTSE EPRA NAREIT Developed Total Return Index

FTSE Developed Core Infrastructure 50/50 Index
The FTSE Global Core Infrastructure 50/50 Index and FTSE Developed Core Infrastructure 50/50 Index give participants an industry-defined interpretation of infrastructure and adjust the exposure to certain infrastructure sub-sectors. The constituent weights for these indices are adjusted as part of the semi-annual review according to three broad industry sectors – 50% Utilities, 30% Transportation including capping of 7.5% for railroads/railways and a 20% mix of other sectors including pipelines, satellites and telecommunication towers.

S&P 500
The S&P 500 is an index that is considered to be a gauge of the U.S. equities market. The index includes 500 leading companies spread across the major sectors of the U.S. economy. The index focuses on the larger cap segment of the U.S. market and represents approximately 75% of the market capitalization of U.S. securities. The index is the most notable of the many indices owned and maintained by Standard & Poor's, a division of McGraw-Hill Companies.

MSCI ACWI Index
MSCI ACWI Indexes offer a modern, seamless, and fully integrated approach to measuring the full equity opportunity set with no gaps or overlaps. MSCI ACWI represents the Modern Index Strategy and captures all sources of equity returns in 23 developed and 24 emerging markets.

FTSE EPRA NAREIT Developed Total Return Index
The FTSE EPRA Nareit Global Real Estate Index Series is designed to represent general trends in eligible real estate equities worldwide. Relevant activities are defined as the ownership, disposal and development of income-producing real estate. The FTSE EPRA Nareit Developed Index is designed to track the performance of listed real estate companies and REITS worldwide. By making the index constituents free-float adjusted, liquidity, size and revenue screened, the series is suitable for use as the basis for investment products, such as derivatives and Exchange Traded Funds (ETFs).

FTSE US Broad Investment Grade (USBIG) Bond Index
The FTSE US Broad Investment-Grade Bond Index (USBIG) measures the performance of US Dollar-denominated bonds issued in the US investment-grade bond market. Introduced in 1985, the index covers US Treasury, government sponsored, collateralized, and corporate debt providing a reliable representation of the US investment-grade bond market. Sub-indexes are available in any combination of asset class, maturity, and rating.

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