ROUNDTABLE

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Listed is your best bet for core exposure

Four industry participants tell Bruno Alves how last year's volatility tested the asset class in all the right ways, highlight their advantage over generalists and explain why strategy drift is not an issue

Being a predominantly unlisted-focused infrastructure publication, we always look forward to our annual listed roundtable to catch up on how the other side of the market is doing. It's fair to say, though, that we were particularly curious going into our 2019 edition.

After all, unlisted infrastructure experienced its best fundraising in 2018, with over $80 billion. At the same time, volatility rocked global equity markets throughout most of the year. So how did the nascent asset class fare amidst all of this? Pretty well, it turns out, even if it didn't hit the record heights experienced by its unlisted peers.

"The structural tailwind of investors allocating to listed infrastructure is here to stay, even if 2018 was a relatively muted year in terms of fundraising, compared to unlisted. It was not a record year by any means," says AMP Capital global head of infrastructure Giuseppe Corona.

"But we've maintained our funds under management, so that stability, even in a challenging year, shows you there is a structural tailwind. The pullback in the listed infrastructure market was very mild compared to general equities globally, which went down 14 percent at the end of last year. It's a real highlight of the defensive characteristics of the listed infrastructure sector," says James Crutcher, senior research analyst at CBRE Clarion Securities.

"I'm going to say, 'Thanks equity markets'," jokes Atlas Infrastructure partner David Bentley. "The last quarter of 2018 was probably the first time since 2011 that we had any material pullback in equities. So, we've had a nice contemporary test and the asset class has got through that test very well."

Alex Araujo, manager of the M&G Global Listed Infrastructure Fund, agrees.

$2trn

Market cap of listed infra universe

"It was a good year for the asset class to prove itself. We've seen more strategies coming to market. A few of us, ourselves included, have launched new funds and they've grown very quickly, especially in the pullback context James just highlighted."

Core strength

That's good news for our group of specialists because as you might imagine, the name of the game for them is to make listed infrastructure as mainstream as possible.

"There is clearly a growing allocation to listed infrastructure," says Araujo.

"In fact, within our organisation, we have both a private infrastructure group and debt infrastructure capability, and we are increasingly seeing clients look to us for a solution across all three categories. It's not an us-versus-them type of story – these are quite complementary allocations."

Bentley also sees allocations increasing. "We're seeing some funds implement quite sizeable specific allocations to listed infrastructure. We know of one [pension] fund that has a separate carve-out from

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Giuseppe Corona

Head of global listed infrastructure, AMP Capital

Corona has been the head of AMP Capital's global listed infrastructure team since 2016, based in the London office. Prior to joining AMP Capital in 2012, he spent two years at Exane-BNP Paribas as a senior equity analyst covering multi-utilities and infrastructure companies. Previously, he spent a year in Switzerland, managing a long/short market neutral portfolio at Swan, a small investment boutique, and nine years at Bear Stearns Asset Management in the US where he was appointed managing director in 2006.

Alex Araujo

Manager, M&G Global Listed Infrastructure Fund

Araujo has been the manager of the M&G Global Listed Infrastructure Fund since it launched in October 2017. He initially joined M&G's income team in July 2015 and became co-deputy manager of the M&G Global Dividend Fund in April 2016. He has 25 years of experience in financial markets, having previously worked at UBS and BMO Financial Group. He graduated from the University of Toronto with an MA in economics and is a CFA charterholder.

David Bentley

Partner, Atlas Infrastructure

Bentley is a founding partner of Atlas Infrastructure, a London- and Sydney-based outfit. This follows his role as a portfolio manager with RARE Infrastructure from 2013-16. He was previously an infrastructure investment manager at Future Fund, the Australian government sovereign wealth fund, where he oversaw its investments in listed infrastructure, as well as managing several of the fund's unlisted infrastructure assets and pooled funds. Bentley also worked as a transaction services manager for PwC on deals involving Thames Water, Alinta and National Grid following a seven-year stint as a manager at EY.

James Crutcher

Senior research analyst, CBRE Clarion Securities

Crutcher is a senior research analyst and, as a member of CBRE Clarion Securities' global infrastructure research team, responsible for evaluating the listed infrastructure companies in the European region and the transportation sector globally. He joined CBRE Clarion Securities' predecessor firm in 2006. Prior to that, he worked in various research and analyst positions at ING Real Estate Investment Management and IPD. Crutcher has more than 18 years of financial industry experience.

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JAMES CRUTCHER
CBRE Clarion Securities

its infrastructure allocation to listed infrastructure, within a $10 billion portfolio."

Corona believes there is good reason for that, particularly given how the market is tightening for certain sectors on the unlisted side. "It's very difficult to get a large allocation to core infrastructure on the direct side now. So, if you want exposure to core infrastructure, listed allows you to get that at an attractive valuation."

"If you're trying to buy core assets these days at a 7 percent or 8 percent return and you then take a private equity-style management fee – or even 1 percent or 1.5 percent – off that, you're toast. So, it makes sense to do core infrastructure in the listed market. What private equity does best is taking medium-performing assets and turning them into good ones – that's why they earn those fees. Buying a utility and sitting on its board … that's not what you should be paying private equity-style fees for," argues Bentley.

"That game is over," adds Corona.

There's also a geographic element to it, as our participants point out. If you want access to core infrastructure in the US, for example, you'll be hard-pressed to do it outside midstream or renewables. Utilities or GDP-exposed assets, like railways or airports, are much harder to get on the unlisted market.

And strategy drift – or boundary-stretching esoteric assets – are not a feature of the listed infrastructure market at the moment.

"Availability of assets is not an issue," Corona says. "Our investment universe comprises between 150 and 180 companies with a market capitalisation north of $2 trillion. So, there are plenty of [core] opportunities."

Crutcher puts the asset class into perspective: "People might look at listed infrastructure as niche, but the market capitalisation of listed infrastructure is bigger than the market capitalisation of listed real estate."

That niche perception, though, has to do with the relatively small number of specialist managers investing in a space which is largely dominated by generalists. That's a good thing, according to all our participants.

"The terrific thing of being a specialist in a space where 95 percent of the ownership is non-specialist is that it gives you a huge opportunity for alpha. Generalists are just rotating in and out of stuff. A lot of this stuff isn't trading on fundamentals on a day-to-day basis," Bentley points out.

"That's a very good point," says Araujo. "You've almost got an arbitrage between what's typically a very short-term community in these kinds of companies – what I often call the hedge funds up and down Fifth Avenue pair-trading utility stocks – versus true long-term investors who are actually putting the fundamental value of the business at the forefront of their decision-making."

Crutcher drives home the point by highlighting the obvious: that listed infrastructure teams are, well, comprised of infrastructure professionals.

"Take something like regulatory risk, which is so important for infrastructure performance. It's pretty specialist and even big generalist funds don't necessarily have the resources to devote to analysing that risk and opportunity. That's exactly why we have an edge," he says.

Adds Corona: "That's also the reason why we don't have to extend to core-plus or value-add infrastructure – there are still good returns to be extracted in core listed infrastructure because we are competing against generalists allocating capital using different valuation methodologies, trading strategies, etc. We can generate high single-digit returns for our investors just staying true to our label and core strategy."

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>
> **GIUSEPPE CORONA**
> **AMP Capital**

Bottom-up, with a twist

So how does our group of specialists go about selecting stocks that give their clients the kind of core exposure they've been touting? Almost unanimously using a bottom-up approach, without neglecting the big themes – like the energy transition or digital infrastructure – that are shaping the asset class.

Araujo gives an idea of how that approach can work. "We're distinctly bottom-up and we also take advantage of the benefits of long-term investing. Very often the option-value, as I like to call it, from some of these secular tailwinds doesn't get priced in the market. For example, the societal and political impetus behind accelerating the energy transition finds its way to the returns that are embedded in these types of businesses. And that's something I often think the market doesn't pay attention to on account of being very short-term focused – they're just looking at beating the next quarterly earnings."

Much the same could be said about the digital infrastructure space where, as Bentley puts it, "you almost can't model [the sector] because the growth is too crazy".

Crutcher is perhaps happier than most of our other participants to play those secular trends. "I wouldn't say we're a thematic fund, but there's a top-down element to our process as well as the detailed bottom up. So, we try to identify secular trends – things like midstream companies investing in critical natural gas in the US, or the communications sector's trend towards data transmission and storage. We're happy to play some tilts on that."

What do our participants try and stay away from, then?

"From a sectoral perspective, we haven't had to go up the risk curve. We have also stayed out of emerging markets at this point," answers Bentley. "It's not the assets, because they are pretty good – emerging markets just tend to trade very heavily on what's going on in the market, which means you can own a great asset that ends up being mispriced for a very long time."

"The idea that you have to go to

emerging markets to get great growth is just wrong," Crutcher interjects. "Upgrading and improving infrastructure in the developed world is still a huge opportunity and is driving growth for our companies."

Araujo brings it back to the client. "It's all about what you are looking to deliver to your investors. For us, we tend to find very high-quality dividend discipline in North America and parts of Europe. There are also developed-market businesses with very interesting emerging-market elements to their growth profile. Sometimes, it's where they are getting much of their growth [from] and that's a more comfortable place for us to go."

Make friends and influence people

One secular trend which none of our participants can afford to ignore is the unstoppable rise of ESG.

According to our *LP Perspective Survey 2019*, compared with the other main alternative asset classes, LPs active in infrastructure are most likely to give major consideration to ESG when carrying out due diligence (41 percent versus a low of 27 percent for private debt).

Perhaps unsurprisingly, ESG is front and centre for all of the managers around the table. "We were fortunate to be able to develop a new product with a blank sheet of paper a few years ago and introduced ESG into our investment process right from the beginning. What we discovered very early on is that ESG needs to be asset class and sector specific – a standardised, outsourced approach just doesn't work," stresses Araujo.

He offers an example: "The utilities sector remains the world's top generator of greenhouse gases. We can't afford to have stranded assets because businesses have lost their social licence to operate. Nor can we afford stranded-asset risk. So, we do the work ourselves, which is a huge undertaking, but it gives us confidence we are applying ESG for the purposes of sustainability of assets and cashflow streams over the long term."

Of course, engaging with portfolio companies to make sure they stick to these principles is a key part of the job. But aren't listed outfits at a disadvantage compared to unlisted managers, who can intervene more directly? "The beauty of the listed market is that you can hold 1 percent or 20 percent [of a company] and have the same rights," says Araujo. "There are a lot of levers you

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Atlas Infrastructure

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ALEX ARAUJO
M&G Global Listed Infrastructure Fund

can pull as an equity owner. You can send open letters to the board, engage with other shareholders and, at the extreme, use regulatory or legal channels to gain more representation and influence outcomes."

"Listed infrastructure managers are a pretty small group and we are all pretty aligned. So, we have the ability to call each other and make a bit of a difference," adds Bentley. But he also highlights that, as sector specialists, listed infrastructure managers enjoy a fair amount of goodwill. "Even though sometimes we might be only 10 percent of a company's market cap, these companies love having us as shareholders: we're not hedge funds, we're long-term capital."

Also, as Corona rightly highlights, making sure your voice is heard when portfolio companies are allocating capital is a crucial part of the 'G'. "If you think about capital allocation, it's probably one of the most important decisions these companies have to make. If we can't make an impact on how a company allocates capital, we are not doing our jobs."

Living in a different world

Fundamentally, adherence to ESG principles is also a recognition that we are living in a different world. "We have to remember that many of the assets we invest in have a physical footprint and can impact local stakeholders," says Araujo. "This is especially true for new projects. Take pipeline development, for example – the industry used to be able to lay pipe wherever and whenever it wanted, but that's now become far more challenging."

But the biggest concern for the vast majority of our participants is whether people will be able to pay for some of the big transformations just around the corner.

"Customer affordability is a big issue," warns Corona. "In an environment where, because of demographics and globalisation, you have a working class getting poorer and poorer, affordability could be an issue. And since infrastructure is very capital intensive, it could be an easy target for populism."

Bentley thinks that is especially true of the demands created by the ongoing energy transition. "You have massive investment requirements to change the generation mix from fossil fuels to renewables, the fortification of networks, etc. Someone's going to have to pay for that. In theory, if you have a regulated cost of capital you can increase bills by X amount. But if you then cause a 5 percent appreciation in customer bills, that's not going to happen," Bentley says.

"On a note of optimism – " Crutcher starts, to much laughter around the table, "wholesale costs still make up the majority of customer bills. So, if you go through the energy transition and reduce wholesale costs, you can do a lot for the consumer, even if you're spending more on the grid."

Importantly, Crutcher believes this particular circle can be squared. "The challenge is for governments and regulators to solve the social contract between consumers, the companies and investors early rather than defer those tough trade-offs until later, as generally happens. But why shouldn't that challenge be solvable?"