First State Investments

Infrastructure Investment



IAPF Breakfast Seminar

28 May 2015



FINANCIAL NEWS
AWARDS FOR EXCELLENCE IN INSTITUTIONAL ASSET MANAGEMENT EUROPE 2012
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Financial News 2012 Firm of the Year
Infrastructure Investment Management

- for professional clients -

First State Investments

Investment philosophy

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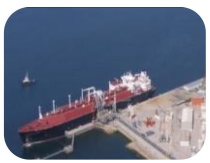
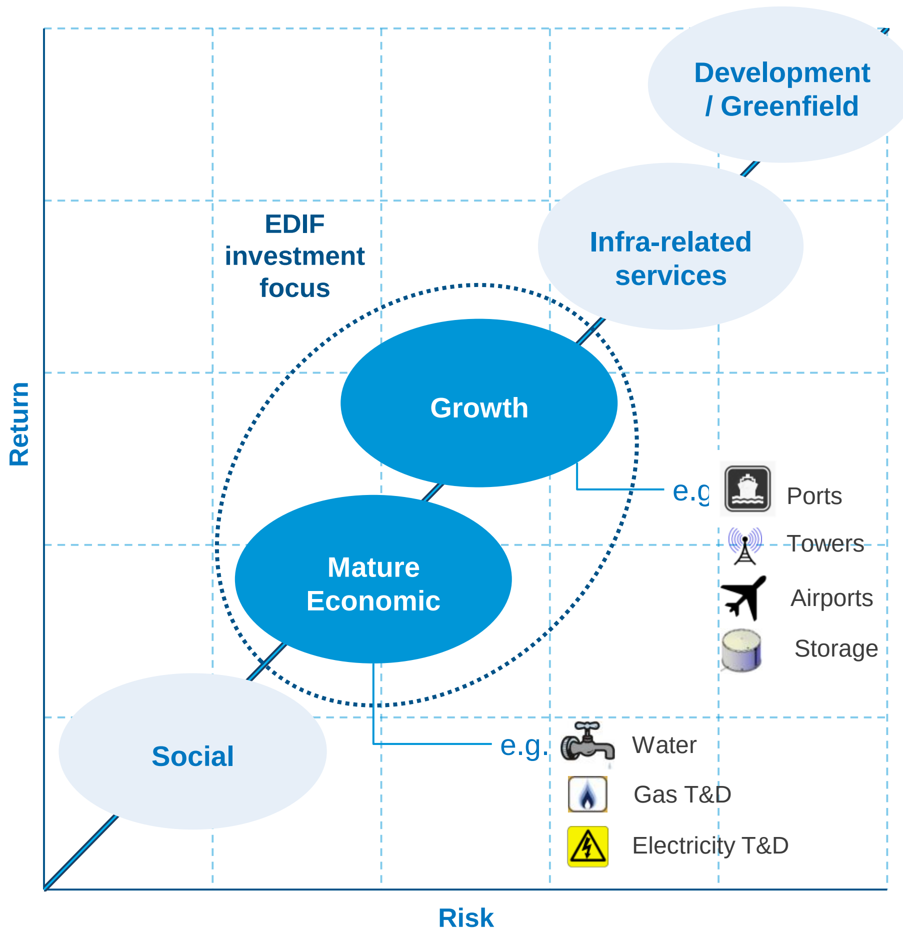



- Prudent philosophy to minimise operational and financing risks to generate long term value and enhance ongoing returns
- Active asset management with a focus on key value drivers
- Partnering with regional and/or strategic co-investors to access proprietary opportunities and/or skills under clear consortia arrangements
- Supporting management in realising growth opportunities
- Target lead or co-lead roles to ensure board representation and become involved in decision making:
  - Add value and manage risks
  - Act as catalyst for industry best practices
  - Ensure high standards of corporate governance including independent directorship representation
- Incorporation of ESG principles in all stages of the investment cycle
- Defined asset characteristics
  - Focused on transportation and utilities sectors
  - Investing in long-life assets providing fundamental services to the economy
  - Deliver inflation protected returns due to investor friendly regulatory regime, revenue linkage or a cost pass through arrangements to the final user
  - Strong dominant market position and high barriers to entry provide downside protection
  - Long term, predictable and stable cash flows allowing for a regular dividend stream to investors

Direct Infrastructure investment

- Focus on mature economic infrastructure, growth infrastructure and selective infrastructure related services investments which typically offer greater potential to generate superior risk-adjusted returns
- Favours investment in economic infrastructure
- Focus on investing in existing businesses (brownfield)
- Value drivers:
  - High barriers to entry – monopoly assets providing essential services
  - Pricing power – inflation hedged income and timely pass-through of uncontrollable costs
  - Predictable cash flows – underpinned by transparent regulation or contracts
  - Sustainable growth – organic growth which is less dependent on the economic cycle
  - Management quality – sound strategy, good execution, positive alignment
  - Financial strength – balance sheet flexibility and capital discipline
  - Board representation – gaining Board representation
  - ESG culture – responsible approach to the environment, respect for stakeholders

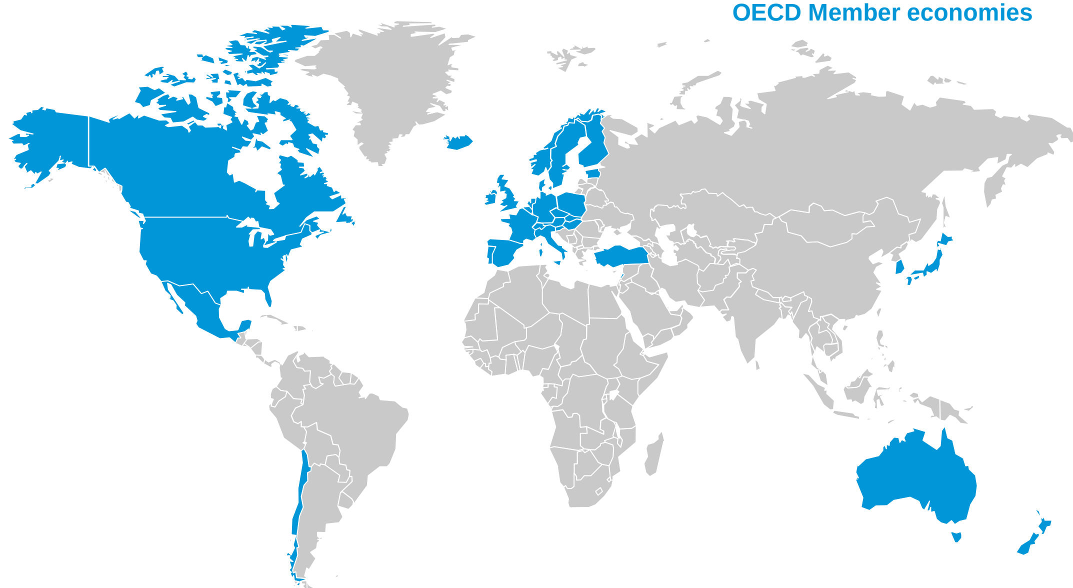


Global investment in a core context

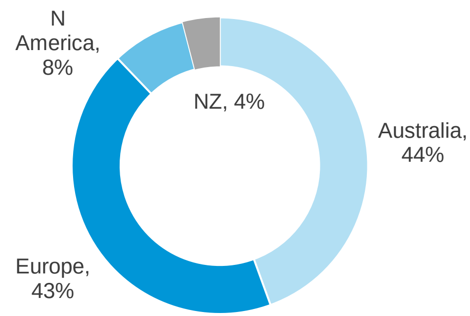
- In a core infrastructure context, this is generally understood to mean advanced economies / OECD members. Evidenced by:
  - **Index concentration**: IPD Global Index is 44% Australia, 43% Europe.
  - **Deal activity**: Historically, 93% of deals in Europe, North America and Oceania
- Low emerging market representation reflects greenfield-oriented opportunity set and higher perceived risk
- Level of opportunities (e.g. privatisations) also shapes relative prominence of regions in investor portfolios
  - North America has been under-represented
- Geographical shifts in activity highlight the value of having flexibility in a fund.

52% of all capital raised in 2013 was by global funds

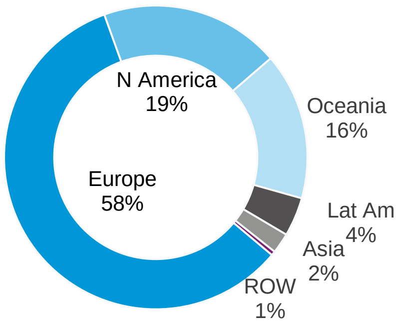
OECD Member economies



IPD Global Infra Index – geographical allocation
as at June 2014



Institutional infrastructure activity
2002-2014



Source: First State Investments and Zephyr

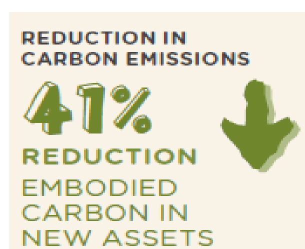
Case studies

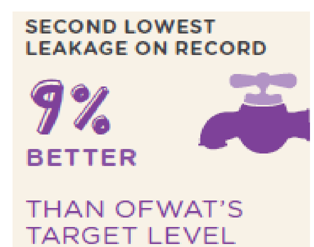
Case study: ESG at Anglian Water Group (AWG)

Love Every Drop Campaign sets industry standards

Launched in 2010 as an initiative going beyond what is expected by the regulator – putting AWG as the industry leader about its long-term commitment to promote the resilience of the water sector

- Out of 1,350km of pipelines renewed or provided, 60% has been done without digging trenches or laying new pipes (using no dig technique)
- AWG has avoided pouring 260,000 tonnes of concrete (equivalent to 93,000 m3) from carbon reduction & off-site manufacture
- The total carbon reduction from capex & operations amounts to 371,000 tonnes, equivalent to 300 million bottles of red wine
- >99% of the waste produced by AWG capital delivery partners is either recovered, reused or recycled





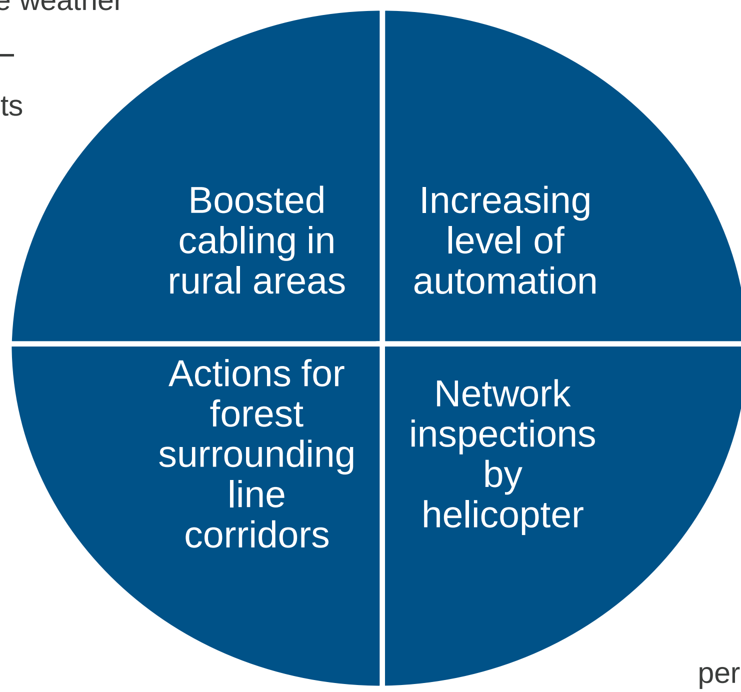
Case study: Asset management

Acceleration of capex for improved reliability

Caruna has accelerated its capex programme to increase the resilience of the network. This has been enabled through the introduction of ENW operational team to share experiences and discuss lessons learnt

Redeveloped procurement model and increased annual capex spending by €55m p.a. to achieve weather proofing targets within the next 5 years – 8 years ahead of regulatory requirements

Capex programme with a particular focus on investments in weather-proofing, network automation and smart control to improve reliability performance



Approved network-wide forest clearing programme to improve protection of overground lines against falling trees

Developed a more structured approach to network inspection. Improved data quality permits more targeted / efficient capex spending

Case Study: Innovation leadership at ENW

improved performance through innovation

ENW is a frontier company in innovation and develops cutting-edge technologies leading to improved performance

"Innovation is approached differently by each of the network companies, with ENW innovation is more innate, with change coming from within the organisation. It is evident that there is strong leadership, and a consistent approach towards innovation, with customer value at the centre.

- Automatic Restoration Systems (ARS), the UK's first automated system able to restore low voltage faults remotely
  - ENW worked with Kelvatek, a technology manufacturer to develop devices called the modular Rezap and the Bidoyng smart fuse
  - These enable to switch loads on the low voltage network and restore customer supply automatically
- Opening of a dedicated Training academy
  - State of the art training academy to recruit and train young engineers and apprentices with the best technical skills
  - Investment funded by the workforce renewal allowance
- What is next in RIIO-ED1?
  - ENW's innovation programme is expected to deliver over £130m of benefits over the next 10 years
  - ENW expects to roll-out smart grids and smart metering for customers

Transactions opportunities

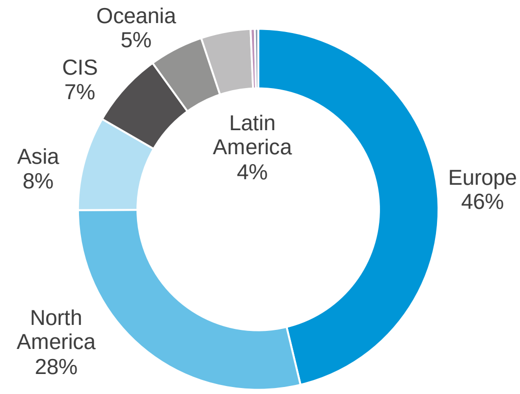
Europe: an active market

Unmatched depth & diversity

- **Cornerstone region for developed-market investors** – 24 of the 34 OECD members located in Europe, which rates highly on institutional criteria such as property rights and transparency.
- **Market depth** – Europe not only largest institutional infrastructure market, but is also the largest market for overall corporate infrastructure M&A, accounting for half of global deals.*
- **Multiple jurisdictions increase diversification potential**. With >30 national governments, investors are better able to diversify political and regulatory risk, and are less exposed to actions of any one government (e.g. privatisation delays)

Corporate infrastructure activity by region*

2002-2014

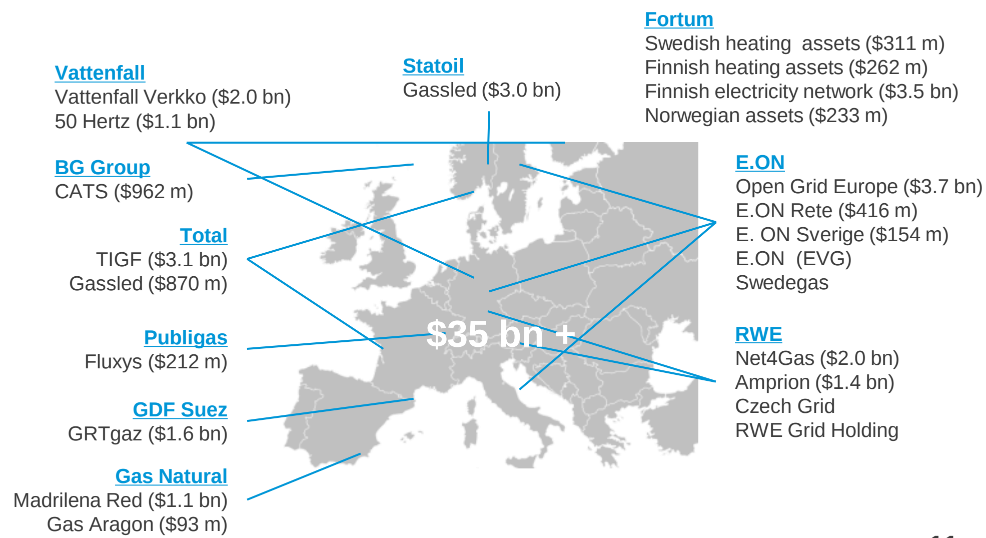


Good mix of cyclical, structural drivers

- Large European utilities **divesting assets**, due to:
  - Financial pressures: repairing debt-laden balance sheets
  - Strategic reasons: exiting lower-margin 'non-core' activities
  - Regulation: unbundling of vertically-integrated utilities
- New EU-wide **renewables target** of 27 per cent of energy from renewables by 2030 announced in 2014. Less prescriptive, but more market-based than previous version.
- **Privatisations** will continue to present opportunities, particularly in southern Europe.
- **Contractors** recycling capital from mature assets into greenfields

Selected energy utility divestments **

2010-2014



* Excludes institutional. private equity and MLP deals

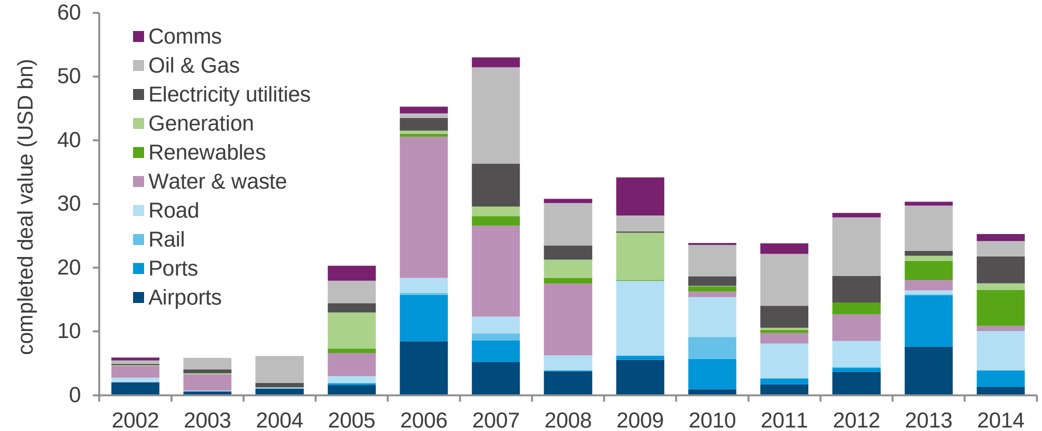
Source: First State Investments and Zephyr. **Sales to financial buyers only.

A sector-diversified approach

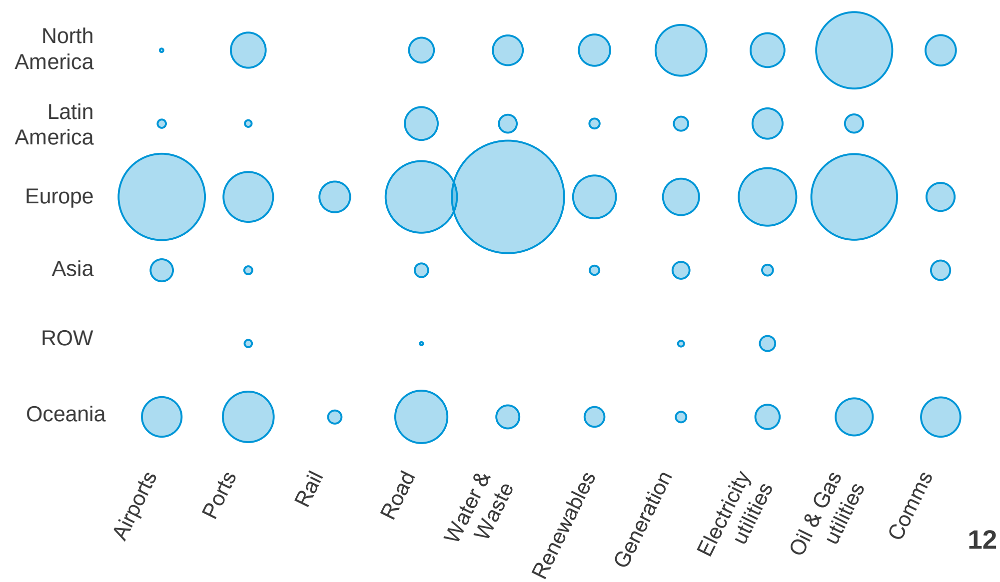
- Despite increased institutional interest in infrastructure (demand), brownfield deal volumes have remained relatively steady (supply).
- At a sector level, activity has tended to be sporadic and unpredictable
  - Highlights limited window of opportunity to acquire highly-prized assets (e.g. UK water)
  - Underscores difficulty in constructing a diversified portfolio from scratch
- Timely capital deployment while maintaining value has become more challenging for investors
- Seasoned funds or portfolios allow investors to instantly access tightly-held sectors (e.g. Australian airports)

52% **of activity since 2002 in just five 'hotspots'**

Institutional activity by target sector



Sector-regional activity matrix (2002-2014)



Source: First State Investments and Zephyr

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