

Opportunity: 3 big disconnects in infrastructure

Research & Insights

January 2024

Ausbil Investment
Management Limited
ABN 26 076 316 473
AFSL 229722
Level 27
225 George Street
Sydney NSW 2000
GPO Box 2525
Sydney NSW 2001
Phone 61 2 9259 0200

We see 3 big disconnects in the global listed infrastructure market that we believe offer compelling opportunities for new and existing investors to enter the sector. Ausbil's Global Listed Infrastructure team talks through these disconnects in the growth of electricity grids, the upgrade of 4G networks to 5G, and the opportunity in regulated water utilities.

10-minute read

Key points

- We are seeing some significant and potentially valuable disconnects in the price and intrinsic value of infrastructure assets. We believe infrastructure valuations do not reflect the cashflows generated from infrastructure assets, and that they are cheap in the current market.
- We believe there is currently a significant opportunity for investors to benefit as global listed infrastructure is potentially rerated on improved earnings.
- Sectors of particular interest include regulated water utilities, electrical utilities and mobile phone towers. We believe that some key infrastructure assets from these sectors may offer upside potential last seen in the pandemic storm brought on by COVID-19.
- With valuations depressed but revenues rising on inflation - and driven by the compelling growth economics of the energy transition, 5G, electrification, Artificial Intelligence (AI), and demand for essential services like water - we believe that these are compelling reasons to have exposure to global essential infrastructure.

Q: In a nutshell, what are these three disconnects you are seeing in infrastructure?

A: We have been seeing significant buying opportunities over the last 6-months as a result of the major monetary policy normalisation that has been taking place across all asset markets in 2022 and 2023. We are at a point of inflection, in our estimation, where the outlook for earnings growth has turned more positive in infrastructure assets as we have reached a stabilisation phase in interest rates. Our outlook for return on equity invested in infrastructure is rising with the stronger cash flows from the impact of inflation, and the more normalised rate environment which we have entered.

Many investors do not understand that infrastructure cashflows benefit from upward movements in inflation through either pre-agreed increases in tolls and receipts (like toll roads), or agreed inflation in the overall asset base against which some infrastructure assets are able to earn a percentage return (like regulated water utilities).

In terms of value relative to price, sectors of particular interest with respect to their earnings outlook include regulated water utilities, electrical utilities and mobile phone towers. Figure 1 shows how far these sectors and the market in general have moved from long-term averages, representing a significant opportunity for investors.



Tim Humphreys
Head of Global Listed
Infrastructure

Phone: +61 2 9259 0281
Email: tim.humphreys@ausbil.com.au



Jonathan Reyes
Co-Head of Global Listed
Infrastructure

Phone: +61 2 9259 0286
Email: jon.reyes@ausbil.com.au



Natasha Thomas
Portfolio Manager -
Energy and Communications

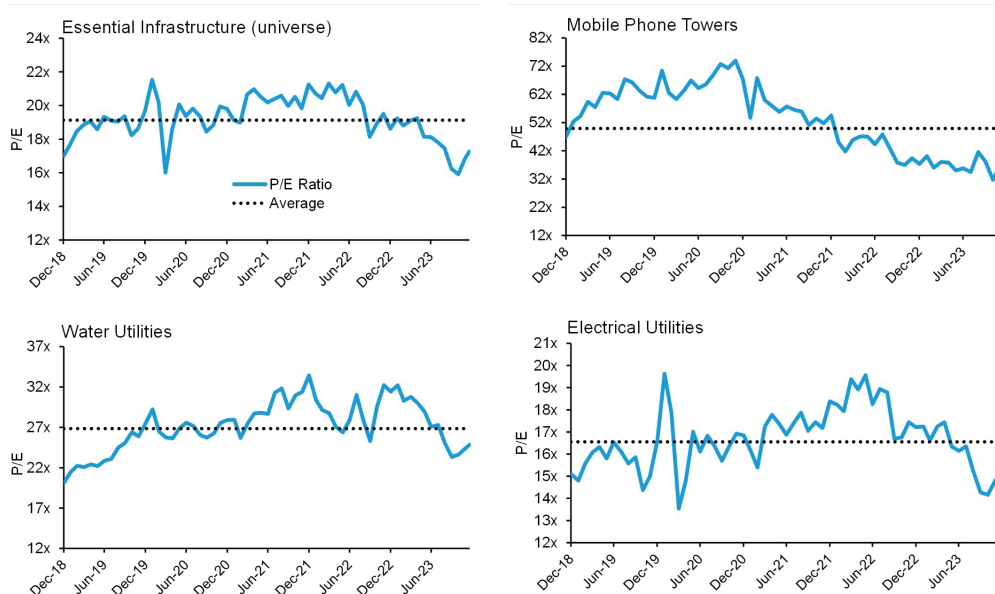
Phone: +61 2 9259 0283
Email: natasha.thomas@ausbil.com.au



Paul Johnston
Portfolio Manager - Utilities

Phone: +61 2 9259 0284
Email: paul.johnston@ausbil.com.au

Figure 1: A valuation disconnect across a number of key sectors



Source: Ausbil, Bloomberg. Uses a harmonic mean for the average.

About Ausbil Investment Management

Ausbil is a leading Australian based investment manager. Established in April 1997, Ausbil's core business is the management of Australian and global equities for major superannuation funds, institutional investors, master trust and retail clients. Ausbil is owned by its employees and New York Life Investment Management a wholly-owned subsidiary of New York Life Insurance Company. As at 31 December 2023, Ausbil manage over \$16.6 billion in funds under management.

Q: Just quickly, how do you look at earnings growth in listed infrastructure where the underlying assets have such long future cash flow profiles?

A: Listed infrastructure companies issue earnings that represent the overall economics of the business, sometimes underpinned by the cashflows of a single infrastructure asset, or by a spread of infrastructure assets. While we use terms like earnings and earnings growth, in infrastructure we typically look at these over the long term, contrary to a typical equity analyst approach that looks at earnings growth in the near term, and valuations as a multiple of these earnings.

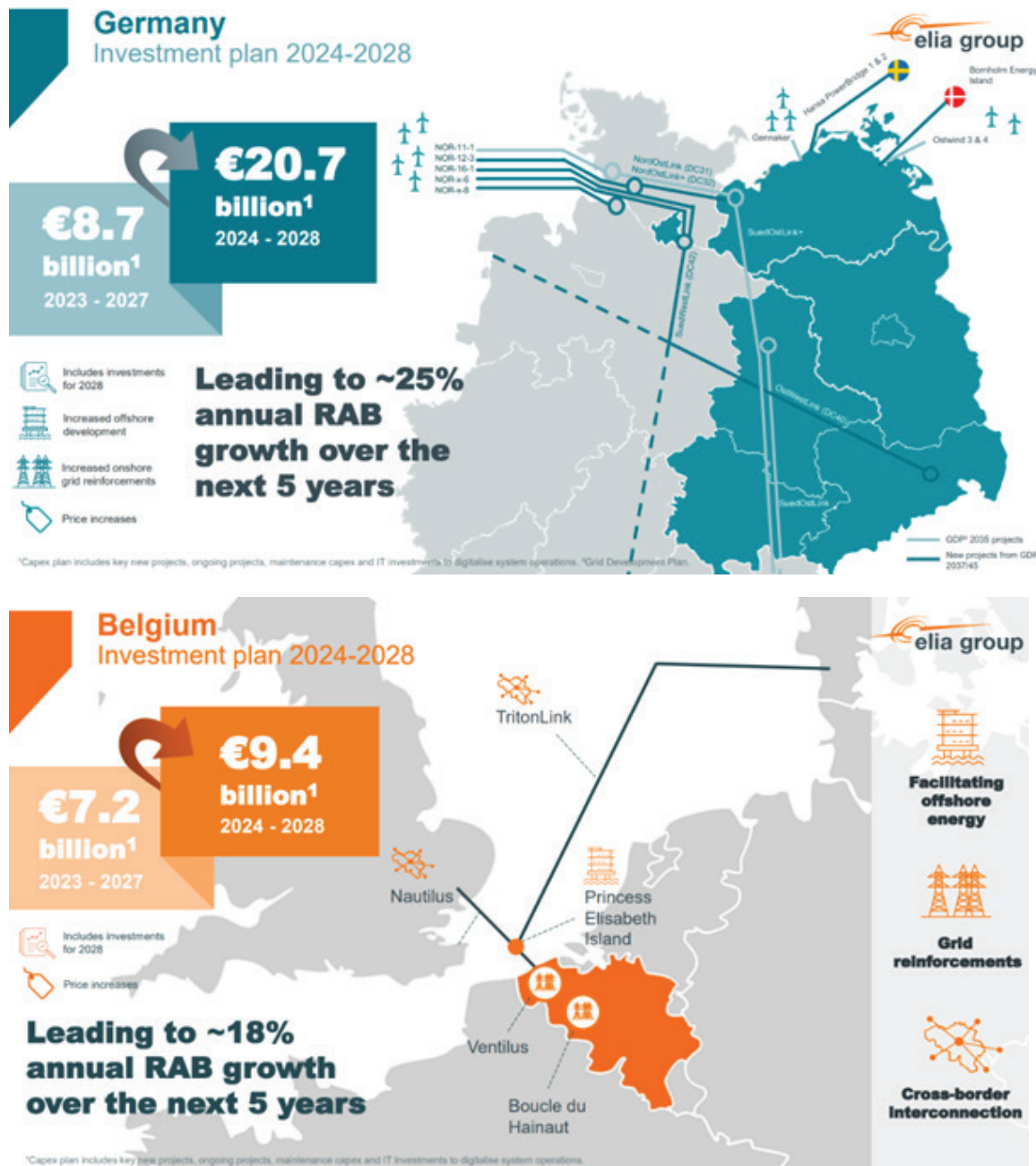
In infrastructure, we value assets on lifecycle cashflows, and their owning entities benefit from these and generate reported earnings. Typically, because infrastructure assets are real and have long depreciation and amortisation schedules, we look at earnings growth before these items as EBITDA, earnings before interest, tax, depreciation and amortisation.

Q: Going back to the sectors where you see a disjoint between their earnings outlook and their current prices, can you give us an example, like from electric utilities and grids?

A: Investing in the 'poles and wires' of electricity transmission grids is one of the most exciting infrastructure investment opportunities, and we believe that there is a potential for significant growth in these assets. Take Elia Group for example. Elia, the owner of the Belgium transmission grid and 50 Hertz (part of the German transmission grid), recently upgraded its growth capex forecast to €30bn over 2023-2027 (from €16bn). Elia Group's current market capitalisation is near €7.5bn with an enterprise value of around €14bn, illustrating the scale of this investment opportunity for the company. The key driver of the substantial increase in growth CAPEX is the massive global energy transition that is underway, and the need to connect and integrate a far greater amount of renewable energy as countries seek to decarbonise their economies, and from the additional load growth resulting from Data Centres and AI.

From a sector perspective, prior to the emergence of the key themes of the energy transition and demand growth from electrification/data centres, asset base growth in electrical utilities was typically 0-2%pa in Europe before inflation, with the key driver being asset replacement due to ageing infrastructure. For the period 2023-28, Elia is forecasting strong growth in its regulated asset bases, with around 25%pa growth in Germany and 18%pa growth in Belgium, as illustrated in Figure 2, which also provide electricity to Sweden and Denmark.

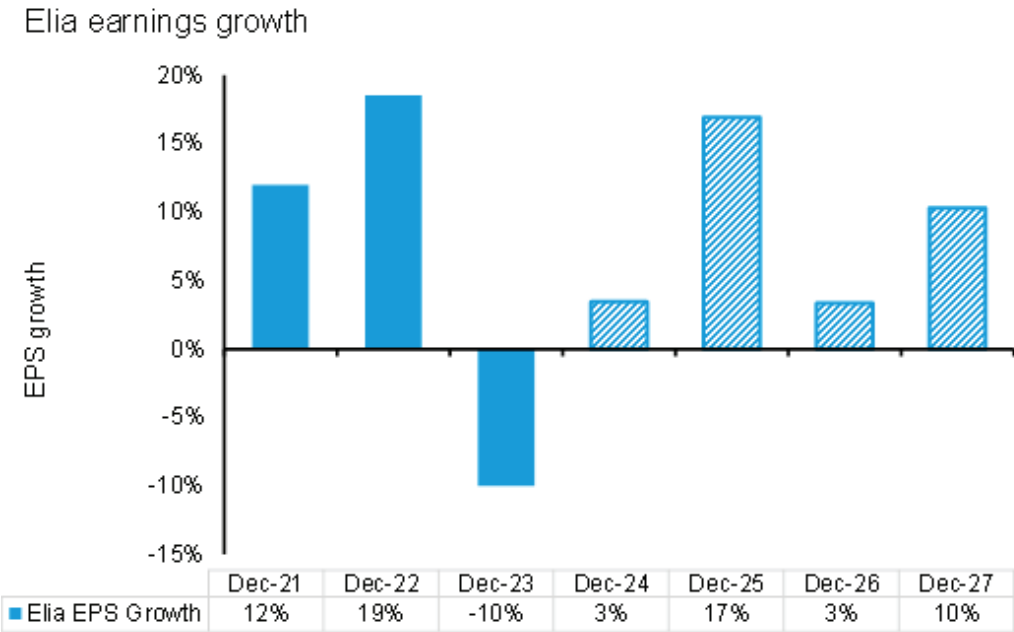
Figure 2: Elia's huge electrical grids in Germany and Belgium



Source: Elia as at December 2023, for Germany to Belgium.

From the perspective of Elia’s profit growth potential, Elia is projecting a compound average growth rate (CAGR) of 20% in net profit from 2024 to 2028, and double-digit earnings per share CAGR over the same period, all reflecting the need for additional equity to assist in funding the significant CAPEX expenditure program they have in place. Figure 3 shows projected earnings growth that is expected to come from this significant expansion in operation and capacity.

Figure 3: Elia earnings growth projections



Source: Ausbil, Elia as at December 2023.

Q: What about the impact of 5G on mobile phone tower companies?

A: 5G is the 5th generation of global wireless technology used for mobile and internet services. To state the obvious, the ‘G’ in 5G stands for generation. 5G is the next stage in the evolution of communication technology that follows the previous ‘Gs’ from 1 to 4. Over time, the ‘Gs’ have progressed across faster data speeds, lower latency, increased capacity, and improved connectivity for a wide range of devices, as illustrated in Figure 4. For more on the emergence of 5G, read our thought pieces: [Spotlight on communication towers: Why are they so exciting?](#); and [Communication tower infrastructure: explaining the ‘Gs’ that are changing communications](#).

Figure 4: Meet the ‘OGs’ of communication towers

Understanding the 'Gs' of Communications

Supports the following capabilities

Approx commercial launch year	Technology	Download Speeds (bit/s)	Voice	SMS/MMS	Mobile Internet	Video calls	Mobile broadband Internet	HD TV	Cloud computing	Internet of things (IoT)
5G	2020	Digital	target up to 10Gbps	✓	✓	✓	✓	✓	✓	✓
4G	2009	Digital	up to 100Mbps	✓	✓	✓	✓	✓	✓	
3G	2001	Digital	>1.44kbps	✓	✓	✓				
2G	1991	Digital	>14.4kbps	✓	✓					
1G	1980s	Analogue	NA	✓						

Bits explained

8bits = 1 byte

8kbps = 1 kilobit per second

Kilobit per second

Megabit per second

Megabit per second

Gigabit per second

kbps, kbit/s, kb/s

Mbps, Mbit/s, Mb/s

Mbps, Mbit/s, Mb/s

Gbps, Gbit/s, Gb/s

Source: Ausbit

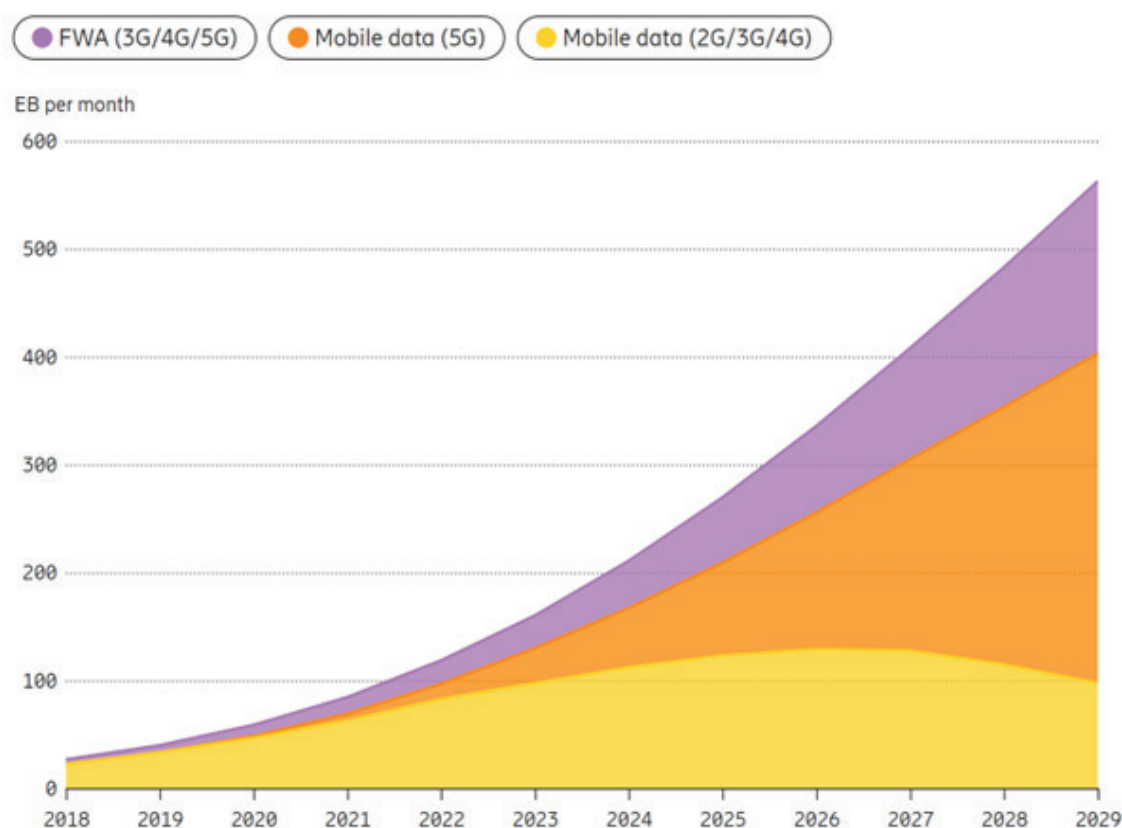
Source: Ausbil

In simplified terms, like earlier generations of communications technology, 5G adopts radio wave technology rather than transmitting through physical conduits, so it is invisible and not something you can touch or feel. Mobile networks typically operate within frequencies from around several hundred megahertz up to 40 gigahertz. Other uses for this part of the radio wave spectrum include TV broadcasting, GPS, Wi-Fi, Bluetooth and cordless phones.

5G builds on advancements in radio wave spectrum usage, and the freeing up of spectrum as services such as analogue TV broadcasting are switched off in a sort of virtuous circle of spectrum recycling. However, there is a visible aspect to 5G, the tangible tower and small cell network that powers the transmission of information that makes the whole system work; this is the area of interest and opportunity for essential infrastructure investing.

5G uses higher frequencies than 4G. As a result, 5G waves are able to carry more data, but the trade-off is that they are not able to travel as far (a few hundred meters on present technology), compared to 4G frequencies which can carry data several kilometres. This means that a 5G network requires up to 10 times more towers, base stations and small cells to provide 'blanket' wireless coverage for users to achieve the same reach as 4G. This need to densify networks to support growing demand for data benefits the mobile phone tower operators, as shown in Figure 5.

Figure 5: Global mobile network data traffic

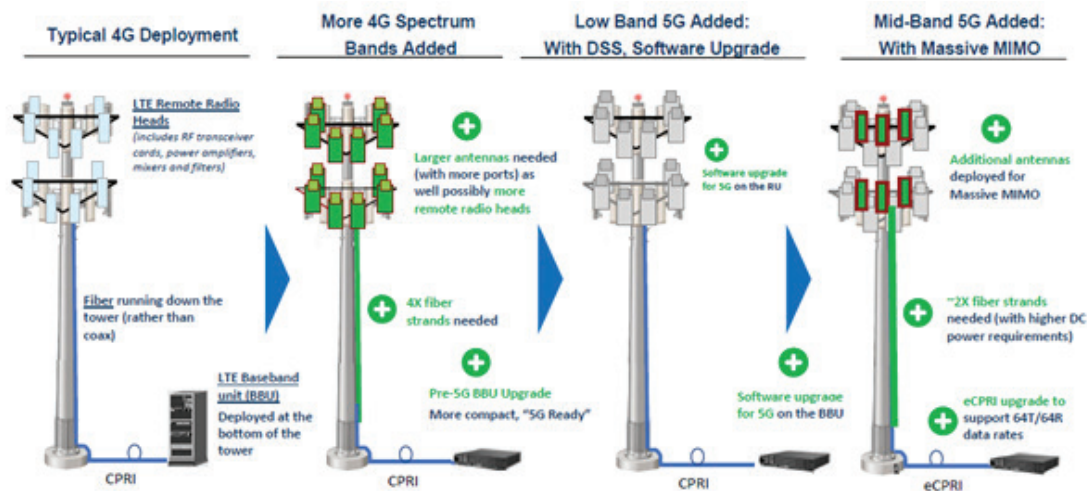


Source: Ericsson.

While the 5G networks are owned and operated by mobile phone companies, the equipment that is critical to operate these networks, such as antennas and base stations, resides on tower structures and at the base of the towers, as illustrated in Figure 6. The mobile phone tower companies lease space on the towers, land parcels, and small cells that house this equipment to the network operators under a long-term lease agreement, so the addition of equipment results in increased revenues at little or no cost to the tower operator.

Figure 6: The rapid densification of networks to accommodate 5G with more and more equipment

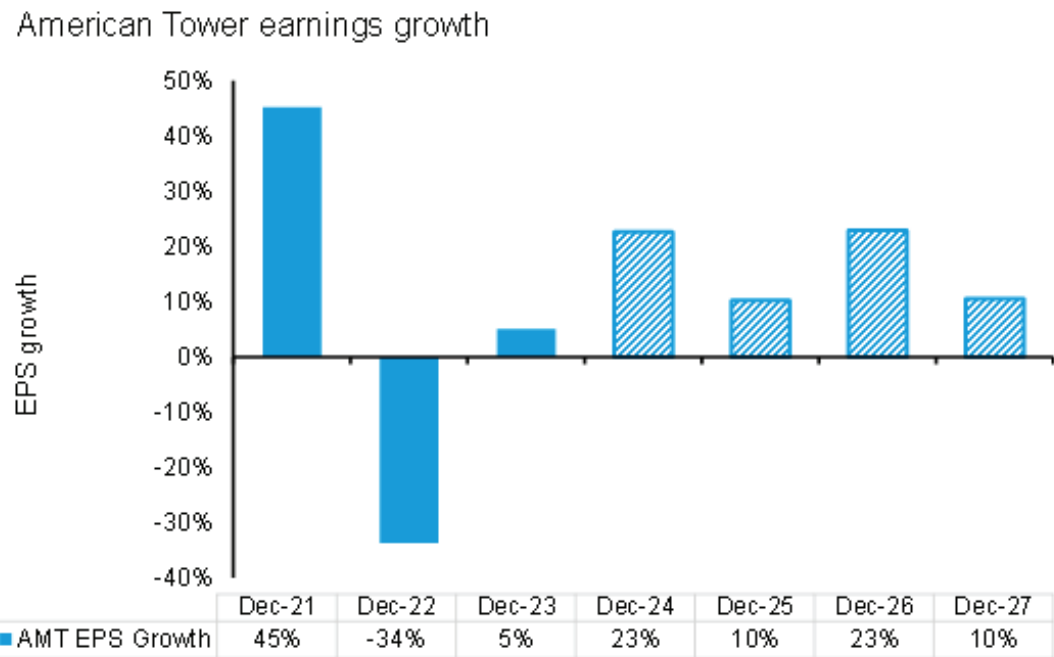
Equipment configuration is growing, with more antennas, fibre and software upgrades



Source: American Tower, December 2023.

Across the communications infrastructure sector we are seeing attractive investment opportunities, one being US mobile phone tower company, American Tower. We are well into the early stages of the carrier’s 5G deployments in the US. American Tower’s leasing structure supports around 5% compound annual growth in its US tower business through to 2026. In its international business, American Tower is poised to benefit from the completion of 4G networks by carriers, even before the transition to 5G in those markets begins. In addition, American Tower has a small data centre business which is at the forefront of investment to support growing demand from AI. Figure 7 illustrates the earnings outlook for American Tower.

Figure 7: Earnings growth projections for American Tower

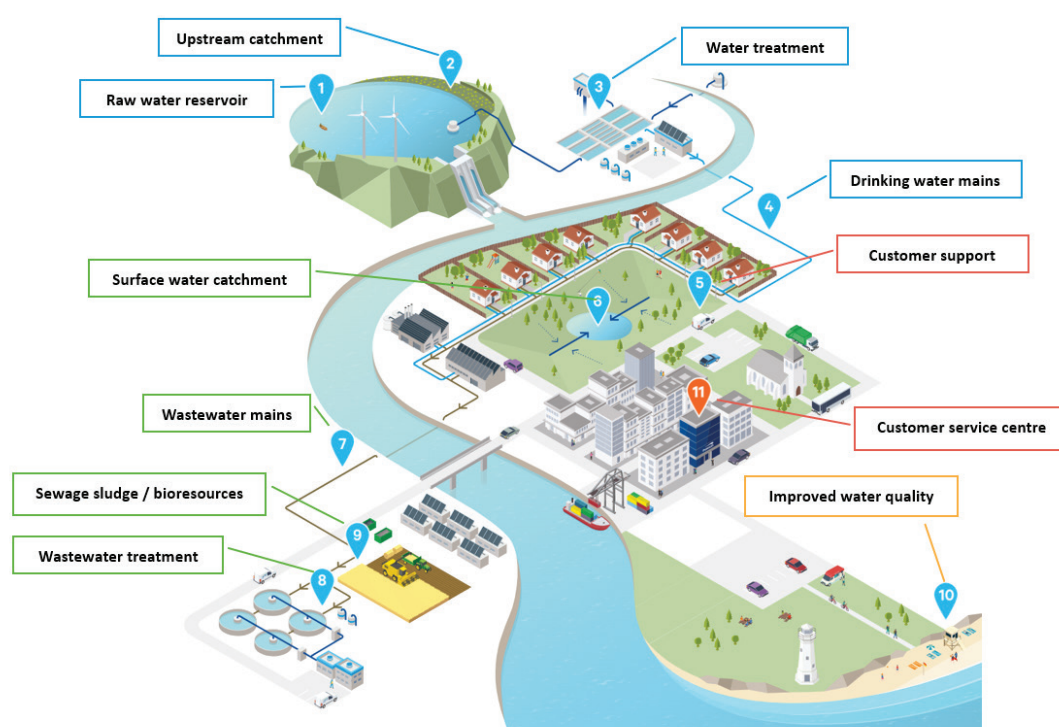


Source: Ausbil, American Tower as at December 2023.

Q: You said there was a disconnect in regulated water utilities as well? How do you see the earnings coming from the water sector relative to their current pricing?

A: Water infrastructure is considered essential infrastructure and is typically monopolistic in nature given that most water infrastructure is unique and utilities in this area typically operate as the only provider of water and waste/sewage services in any given jurisdiction. Figure 8, from the listed water utility, Pennon Group PLC (Pennon) in the United Kingdom, illustrates the various components of water infrastructure, from the gathering, treatment, and delivery of potable water to the gathering, treatment, recycling and disposal of wastewater and sewage.

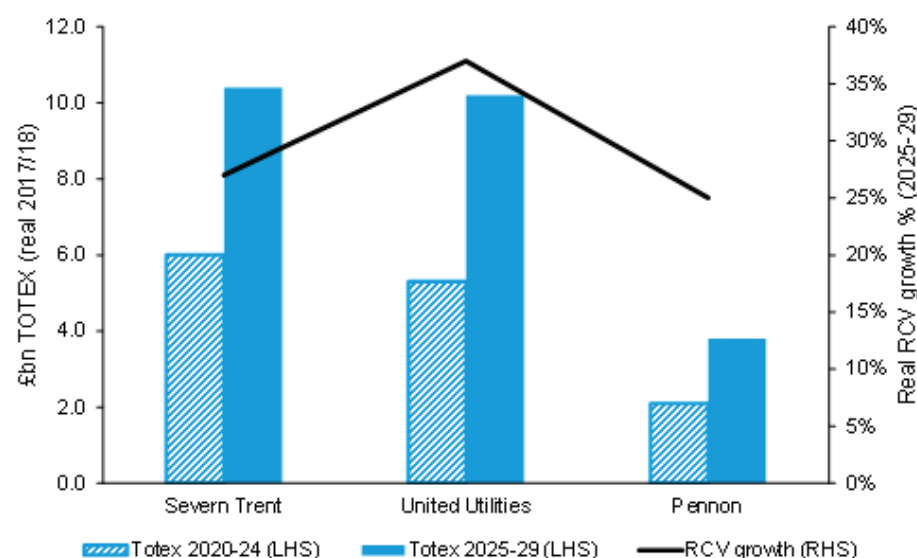
Figure 8: Pennon's water assets: Understanding how water infrastructure works



Source: Pennon, Ausbil simplified, as at December 2023. Ausbil currently holds a position in the listed equity of Pennon, but we may not always hold a position. This diagram helps to illustrate the different ways water infrastructure may generate returns.

We believe water companies offer attractive elements of yield and growth. Yield comes through the allowable return regulators support given prevailing returns on debt and equity for infrastructure assets. As the utility's assets grow (as represented by the Regulated Capital Value or RCV), the yield for an allowable return naturally increases. Asset values grow through additional allowable capital investment a utility makes in improving and expanding their services and network to meet the water demands and environmental objectives of their region. In the UK, the regulation is in 'real' terms meaning equity investor returns enjoy inflation protection characteristics. The RCV is inflated by actual inflation annually.

Figure 9: Investing in their business and earnings growth through TOTEX

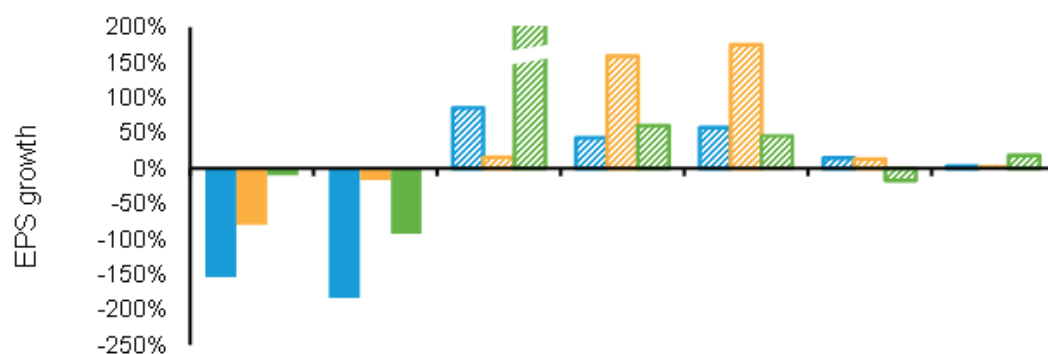


Source: Ausbil, Pennon, Severn Trent, United Utilities.

We believe there is a growing need for much greater investment in water and wastewater infrastructure in the UK, presenting investors with an unprecedented growth opportunity for UK water companies. This much higher investment is required to protect water quality and enhance the resilience of the networks, address storm overflows, reduce leakage rates and protect the environment from climate change. The 3 listed UK water companies are projecting a step-up in total expenditure (TOTEX) on their networks from 2025-29 (compared to 2021-24) of between 73-92% in real terms. This significant increase in expenditure, if approved by the regulator OFWAT, we think will translate into real RCV growth of between 25-37% over the period, ultimately translating into higher earnings, cash flows and dividends for shareholders over time, as shown in Figure 9. We believe this increase in the overall regulated asset base is expected to translate into earnings growth for all three listed water companies, as illustrated in Figure 10.

Figure 10: Earnings growth projections for listed UK water companies

UK listed water utilities earnings growth



	Mar,22	Mar,23	Mar,24	Mar,25	Mar,26	Mar,27	Mar,28
Severn Trent	-154%	-183%	86%	43%	58%	15%	4%
Pennon	-80%	-17%	16%	159%	175%	13%	4%
United Utilities	-10%	-93%	721%	60%	46%	-17%	18%

Severn Trent Pennon United Utilities

Source: Ausbil, Pennon, Severn Trent, United Utilities as at December 2023.

Q: If you could sum up what excites you in infrastructure in 2024, what would you say?

We see the compelling value proposition for essential infrastructure over the next twelve months as being a combination of three things. Firstly, the short-term underperformance relative to global equities has led to a significant valuation upside opportunity. Secondly, the benefits of recent inflation are yet to feed through into revenues and cashflow, and with inflation set to remain above trend for the next few years, this benefit will take several years to be fully realised in higher profits. Finally, the long-term secular growth drivers such as the energy transition, repowering Europe, mobile phone technology transition from 4G to 5G, and the impacts of AI have never looked better. To us as infrastructure investors, this is both compelling and exciting, and we are positioned in essential infrastructure to benefit from this over the next twelve months.

Contact Us

Institutional



Mark Knight

Chief Executive Officer

Phone 0438 307 841

Email mark.knight@ausbil.com.au



Adrian Amores

Head of Global Institutional Distribution

Phone 0435 962 052

Email adrian.amores@ausbil.com.au



Fawaz Rashid

Senior Manager, Global Institutional Distribution

Phone 0401 830 483

Email fawaz.rashid@ausbil.com.au

Wholesale



Hik Chadirchi

Head of Wholesale Distribution

Phone 0424 160 728

Email hik.chadirchi@ausbil.com.au



Andrea McGarry

Business Development Manager, QLD & NT,
Wholesale Clients

Phone 0411 465 426

Email andrea.mcgarry@ausbil.com.au



Dimitri Giannaras

Business Development Manager, NSW & ACT,
Wholesale Clients

Phone 0431 576 815

Email dimitri.giannaras@ausbil.com.au



Marko Matosevic

Business Development Manager, VIC, TAS & WA,
Wholesale Clients

Phone 0431 340 553

Email marko.matosevic@ausbil.com.au



William Orr

Business Development Manager, NSW,
Wholesale Clients

Phone 0402 620 188

Email william.orr@ausbil.com.au



Michael Peros

Business Development Manager, VIC,
Wholesale Clients

Phone 0401 430 426

Email michael.peros@ausbil.com.au

DISCLAIMER

General

Research provided to a client may vary depending upon various factors such as a client's individual preferences as to the frequency and manner of receiving communications, a client's risk profile and investment focus and perspective (e.g., market wide, sector specific, long-term, short-term, etc.), the size and legal and regulatory constraints.

This information is for distribution only as may be permitted by law. It is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located, in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject Ausbil to any registration or licensing requirement within such jurisdiction.

This information is a general communication and is educational in nature; it is not an advertisement nor is it a solicitation or an offer to buy or sell any financial instruments or to participate in any particular trading strategy. Nothing in this document constitutes a representation that any investment strategy or recommendation is suitable or appropriate to an investor's individual circumstances or otherwise constitutes a personal recommendation. By providing this document, none of Ausbil or its representatives has any responsibility or authority to provide or have provided investment advice in a fiduciary capacity or otherwise. Investments involve risks, and investors should exercise prudence and their own judgment in making their investment decisions. None of Ausbil or its representatives is suggesting that the recipient or any other person take a specific course of action or any action at all. By receiving this document, the recipient acknowledges and agrees with the intended purpose described above and further disclaims any expectation or belief that the information constitutes investment advice to the recipient or otherwise purports to meet the investment objectives of the recipient. The financial instruments described in the document may not be eligible for sale in all jurisdictions or to certain categories of investors.

The value of any investment or income may go down as well as up, and investors may not get back the full (or any) amount invested. Past performance is not necessarily a guide to future performance. Neither Ausbil nor any of its directors, employees or agents accepts any liability for any loss (including investment loss) or damage arising out of the use of all or any of the Information.

Prior to making any investment or financial decisions, any recipient of this document or the information should take steps to understand the risk and return of the investment and seek individualised advice from his or her personal financial, legal, tax and other professional advisors that takes into account all the particular facts and circumstances of his or her investment objectives.

Any prices stated in this document are for information purposes only and do not represent valuations for individual securities or other financial instruments. There is no representation that any transaction can or could have been effected at those prices, and any prices do not necessarily reflect Ausbil's internal books and records or theoretical model-based valuations and may be based on certain assumptions. Different assumptions by Ausbil or any other source may yield substantially different results.

No representation or warranty, either expressed or implied, is provided in relation to the accuracy, completeness or reliability of the information contained in any materials to which this document relates (the "Information"), except with respect to Information concerning Ausbil. The Information is not intended to be a complete statement or summary of the securities, markets or developments referred to in the document. Ausbil does not undertake to update or keep current the Information. Any opinions expressed in this document may change without notice and may differ or be contrary to opinions expressed by other business areas or groups, personnel or other representative of Ausbil. Any statements contained in this Report attributed to a third party represent Ausbil's interpretation of the data,

Information and/or opinions provided by that third party either publicly or through a subscription service, and such use and interpretation have not been reviewed by the third party. In no circumstances may this document or any of the Information (including any forecast, value, index or other calculated amount ("Values")) be used for any of the following purposes:

(i) valuation or accounting purposes;

(ii) to determine the amounts due or payable, the price or the value of any financial instrument or financial contract; or

(iii) to measure the performance of any financial instrument including, without limitation, for the purpose of tracking the return or performance of any Values or of defining the asset allocation of portfolio or of computing performance fees.

By receiving this document and the Information you will be deemed to represent and warrant to Ausbil that you will not use this document or any of the Information for any of the above purposes or otherwise rely upon this document or any of the Information. Except as otherwise specified herein, these materials are distributed by Ausbil, to persons who are eligible counterparties or professional clients and are only available to such persons. The Information does not apply to, and should not be relied upon by, retail clients.

The information contained in this document is given by Ausbil Investment Management Limited (ABN 2676316473) (AFSL 229722) (Ausbil) and has been prepared for informational and discussion purposes only and does not constitute an offer to sell or solicitation of an offer to purchase any security or financial product or service. Any such offer or solicitation shall be made only pursuant to an Australian Product Disclosure Statement or other offer document (collectively Offer Document) relating to an Ausbil financial product or service. A copy of the relevant Offer Document may be obtained by calling Ausbil on +612 9259 0200 or by visiting www.ausbil.com.au and the target market determination which is available at <https://www.ausbil.com.au/invest-with-us/design-and-distribution-obligations/fund-tmds> before acquiring or investing in the fund. This document is for general use only and does not take into account your personal investment objectives, financial situation and particular needs. Ausbil strongly recommends that you consider the appropriateness of the information and obtain independent financial, legal and taxation advice before deciding whether to invest in an Ausbil financial product or service. The information provided by Ausbil has been done so in good faith and has been derived from sources believed to be accurate at the time of completion. While every care has been taken in preparing this information, Ausbil make no representation or warranty as to the accuracy or completeness of the information provided in this video, except as required by law, or takes any responsibility for any loss or damage suffered as a result or any omission, inadequacy or inaccuracy. Changes in circumstances after the date of publication may impact on the accuracy of the information. Ausbil accepts no responsibility for investment decisions or any other actions taken by any person on the basis of the information included. Past performance is not a reliable indicator of future performance. Ausbil does not guarantee the performance of any strategy or fund or the securities of any other entity, the repayment of capital or any particular rate of return. The performance of any strategy or fund depends on the performance of its underlying investments which can fall as well as rise and can result in both capital gains and losses.

Australia The information contained in this Report has been prepared for general use only and does not take into account your personal investment objectives, financial situation or particular needs. Ausbil is the issuer of the Ausbil Australian Active Equity Fund (ARSN 089 996 127), Ausbil Australian Geared Equity Fund (ARSN 124 196 407), Ausbil Australian Emerging Leaders Fund (ARSN 089 995 442), Ausbil MicroCap Fund (ARSN 130 664 872), Ausbil Australian SmallCap Fund (ARSN 630 022 909), Ausbil Balanced Fund (ARSN 089 996 949), Ausbil Active Dividend Income Fund (ARSN 621 670 120), Ausbil Australian Concentrated Equity Fund (ARSN 622 627 696), Ausbil Active Sustainable Equity Fund (ARSN 623 141 784), Ausbil Global SmallCap Fund (ARSN 623 619 625), Candriam Sustainable Global Equity Fund (ARSN 111 733 898), Ausbil 130/30 Focus Fund (ARSN 124 196 621), Ausbil Long Short Focus Fund (ARSN 642 635 498), Ausbil Global Essential Infrastructure Fund (ARSN 628 816 151) and Ausbil Global Resources Fund (ARSN 623 619 590) (collectively known as 'the Funds'). The information provided is factual only and does not constitute financial product advice. It does not take account of your individual objectives, financial situation or needs. Before you make any decision about whether to invest in a financial product, you should obtain and consider the Product Disclosure Statement of the financial product and the target market determination which is available at <https://www.ausbil.com.au/invest-with-us/design-and-distribution-obligations/fund-tmds> before acquiring or investing in the fund.

