

There is no shortage of opportunities in the universe of infrastructure plays, says First State's Peter Meany

# Solid process provides steady inflows



As investors' interest in infrastructure companies continues to grow, thanks in no small part to the relative stability it provides during times of market turbulence and the fact that it can be used as a hedge against inflation, the First State Global Listed Infrastructure Fund, managed by Peter Meany, has attracted steady inflows. Much of the fund's success has been due to its solid investment process, which has helped the fund to consistently outperform its sector peers since its launch in 2007.

Overall, the story of the sector is driven by structural drivers, including urbanisation in the emerging markets, the globalisation of trade and the security of energy supplies. These are all themes that are played out in the portfolio, with the manager trying to find bottlenecks in the growth of a sector or service that will necessitate an investment in relevant infrastructure assets. At the moment there is no shortage of opportunities and Mr Meany's outlook for the infrastructure sector remains positive.

He says: "Current market conditions are ideal for our infrastructure fund. We are in an environment of lower economic growth, higher inflation and relatively high volatility, which suits our style of investing."

Inflation remains a key factor, with the political unrest in North Africa and the Middle East fuelling a further spike in the cost of living, driven largely by higher fuel prices. Against this economic backdrop, infrastructure is seen by many investors as an attractive area, given the ability of many companies in the sector to deliver inflation-proof earnings.

Mr Meany says: "Many infrastructure companies are able to pass on rising costs to customers due to their monopolistic position in the market and the highly regulated environment in which they operate."

"There is, of course, another side to the equation and we have to consider what has been driving that inflation and whether there are any direct or indirect risks to the portfolio. If most of the inflation has typically come through from higher food and energy prices, there are sectors within our universe that can be negatively affected. For example, in the integrated utilities sphere there are pressures with sourcing coal and gas for power generation. We have to consider whether that particular cost can be passed through to the customer without competitive or regulatory risks."

In general, though, most infrastructure assets benefit from having cast iron agreements in place with local governments and regulators, which allows them to introduce inflation-linked tariffs or, alternatively, to operate in an environment with little – if any – competition. It gives many infrastructure companies ultimate pricing power, a key benefit in an inflationary environment as far as investors are concerned.

"The areas which we currently favour include toll roads and airports," Mr Meany adds. "Toll roads, for example, are typically not under any cost pressures, such as food or import costs, and operate on margins of about 70%-80%."

The outlook for airports, as well as some other areas of the European infrastructure market, is supported by privatisation of public assets, as governments move to cut spending and reduce their budget deficits in the aftermath of the sovereign debt crisis. New opportunities include airports in Madrid and Barcelona, as well as four French regional airports, Irish electric utilities and the Port of Dover.

"With airports, in particular, there is the opportunity once they have been privatised to run them more efficiently and improve the margins. This would include looking to expand the retailing within the airport, as well as to further develop the property. Privatisation is often a politically driven process and assets are sometimes sold below what they are fundamentally worth as governments are keen for their initial public offerings to be seen as successful," the manager adds.

Furthermore, Mr Meany anticipates that a general improvement in the health of companies – he expects the first quarter earnings season to be "robust" – should fuel more merger and acquisition activity. Certainly the fund has benefitted from the recent increase in market transactions, with the takeover of Forth Ports in Edinburgh in the final quarter of 2010 providing investors in the fund with a 23 per cent windfall.

"We have also seen further interest in Spanish motorway company Abertis from CVC Private Equity, with the firm looking to restructure and sell down assets, using the proceeds to return profits to shareholders," Mr Meany says. The company is one of the fund's top ten holdings, accounting for 3.8 per cent of the portfolio.

More broadly, the manager believes the long term stories supporting the sector are twofold, with the need for investment and improvement of existing infrastructure in the developed world being matched by the expansion of new infrastructure projects in the emerging markets. And while the fund currently has its highest weightings to

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Europe and North America, with about 37 and 28 per cent respectively, the Asia Pacific region also features prominently, although Mr Meany describes it as being a "call rather than a core option for us".

"We generally favour investments in lower risk, cash flow generating assets," he adds. "We tend to prefer assets operating in markets with stable regulatory, political and legal systems and look for investments in Asia that are run alongside governments or an established commercial player."

He states that one of his team's analysts, who is based in Hong Kong, has identified a number of opportunities within Chinese toll roads, utilities and ports, although for Mr Meany it is vital that these come at the right price. Currently he does not believe they offer enough compensation for the additional risk they entail.

This aversion to unnecessary risk is central to the way Mr Meany runs the fund, which aims at delivering steady rather than spectacular performance. As he explains: "We have always positioned the fund as a combination of steady income and capital growth. We are aiming to achieve a solid annual return of 10-12 per cent and, if you look over the past three years, that is exactly what we have delivered. We are now on track for another year with returns in that range."

"We have never pitched it as a shoot-the-lights-out fund that will be up 20 per cent one year, but down 20 per cent the next. We want to give our investors something different from that."

This common sense approach is aided by the strong team Mr Meany has in place, which comprises seven investment professionals working on the fund. They conduct more than 300 meetings a year with company management, as well as regulators, governments and industry bodies, which enables the team at First State to undertake the principally bottom-up stock selection process.

"We can also tap into other areas of expertise at First State," Mr Meany says. "There are 50 people specialising in infrastructure, both listed and unlisted, which is a great resource. In addition, we can also debate stock calls with other equity teams and draw on the work of our macro committee which looks at the broader economic picture."

All in all, the combination of First State's conservative investment approach and thorough bottom-up research has brought into being a fund which many investors see as a well run and consistent performer. For while the listed infrastructure sector as a whole has, undeniably, performed strongly over recent years – returning 9.6 per cent against global equities' 1.2 per cent over the 10 years to January 2011 – choosing the right fund to suit the individual investor's needs has remained vital.

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