

# Redefining infrastructure – can generation companies really deliver what investors are looking for?

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SEPTEMBER 2011

## Insights



Understanding what investors are looking for when they invest in infrastructure is critical to determining what types of companies infrastructure securities funds should invest in.

A closer look at generation companies reveals that they may not be suitable for investors seeking the defensive attributes expected of the asset class.

### A 'pure play' definition of infrastructure

We believe many investors considering a global infrastructure securities fund are seeking attractive risk-adjusted returns, through exposure to companies with stable and predictable real cash flows and with lower sensitivity to the overall economy relative to the broader market.

Based on this thesis we developed our 'pure play' definition of infrastructure in relation to the analysis of global listed infrastructure securities. The approach focuses on companies that own and operate infrastructure assets. These companies typically have high barriers to entry, predictable and guaranteed long-term royalty streams, high operating margins and stable cash flows, in some cases protected from inflation.

They typically fall within four major sectors:

- > Energy Infrastructure – including electricity transmission and distribution, as well as oil and gas transportation, distribution and storage
- > Transportation – including toll roads, airports and ports
- > Communications Infrastructure – limited to satellites and wireless communication towers; and
- > Water – including water treatment, distribution and wastewater treatment.

We exclude from our 'pure play' definition power generation companies, rail companies and infrastructure service providers such as construction companies, cement manufacturers and energy service providers. Whilst these form part of the infrastructure value chain, we believe they do not typically possess the defensive characteristics required to be considered 'pure play' infrastructure.

### Why exclude power generation companies?

When compared to traditional definitions of infrastructure, our exclusion of power generation companies is the most significant. We exclude it from our definition for four main reasons.

Firstly, **cash flows of generation companies can be much more correlated to commodity prices** and GDP than other infrastructure assets, which means that they're less able to offer the stability of returns that investors are looking for. They can also operate without the inflation hedge typically expected from infrastructure assets.

Secondly, due to the size and number of power generation companies, **they tend to dominate when they are included in an infrastructure index** – as evidenced by some indices which comprise up to 80% generation. Whilst generation companies can at times offer attractive investment opportunities and we are able to invest in them as part of our off-benchmark allocation, a significant portfolio weighting to the sector can add substantially to volatility and distort the risk-return characteristics that we believe investors are seeking from infrastructure.

Thirdly, generation is a heavily regulated industry and what cash flow stability you get is only by virtue of the regulation rather than because they're natural monopolies. We also believe highly regulated generation companies have a **higher risk of negative changes to regulation**.

Such changes can result in a significant de-rating of a security, for reasons quite unrelated to the underlying fundamental drivers of the company. We've seen evidence of this recently in Europe and other parts of the world as governments seek to increase their revenues in order to address fiscal deficits or try to introduce measures to ease utility bills for consumers.

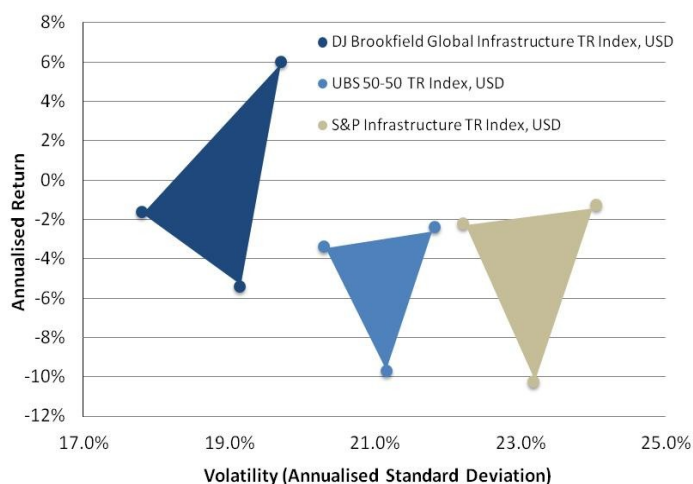
And finally there is always the spectre of **political risk**. This can come in many and quite often unforeseeable forms, that make forecasting it nearly impossible. The German reaction to the Fukushima disaster, closing all of their nuclear power plants, and the imposition of taxes for nuclear and hydro-electric generation in Europe are recent examples where political actions have negatively impacted the sector.

## Outcomes of the pure play approach

Our 'pure play' approach is reflected in the Dow Jones Brookfield Global Infrastructure index (the benchmark used by our Fund<sup>^</sup>), which we helped Dow Jones to create.

The chart below compares the historic risk and return characteristics of this index to two other global infrastructure indices, whose broader definitions of infrastructure include power generation as a significant component. We can see that the pure play approach has exhibited lower risk, with a generally higher return, than the comparable indices on a rolling three year return basis since 2006.

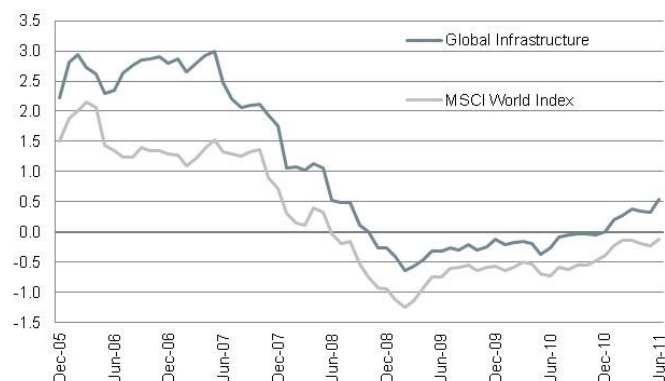
### Combining low volatility with high returns across a cycle



Source: Bloomberg/AMP Capital. Rolling three year results for the periods ended June 2009 through June 2011 (USD total return).

Companies which meet our pure play criteria have so far delivered on the promise of stable, consistent cashflows throughout the market cycle, with annual earnings growth of between 4% and 10% over the past 10 years\* and average dividend growth of 5.8% per year over the past 5 years\*\*. This has contributed to consistently better risk-adjusted returns than the broader equity market, as represented by the three-year rolling Sharpe ratio depicted in the chart below.

## Three year rolling Sharpe ratio



Source: AMP Capital research, FactSet, Bloomberg, Dow Jones Brookfield Global Infrastructure Index as at 30 June 2011

## What is your fund made of?

In summary, when compared both to other global infrastructure indices and the broader equity markets, our 'pure play' approach to infrastructure has delivered a solid track record of attractive total returns together with lower volatility – precisely the defensive characteristics that we believe investors are seeking from infrastructure investment.

For investors choosing a global infrastructure securities fund, we believe that understanding what goes into the fund is critical in assessing whether it matches the risk-return profile they are seeking. In uncertain times such as these, it is more important than ever to know what your global infrastructure securities fund is actually made of.

<sup>^</sup>References to the Fund or to our Fund refer to the AMP Capital Global Infrastructure Securities Fund (Hedged and Unhedged)

\*As of 30 June 2011. Global infrastructure EBITDA growth is derived using the constituents of the Dow Jones Brookfield Global Infrastructure Index on 31 December 2010 and is calculated from 30 December 2000 through 30 June 2011. Note: Median EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation). Source: AMP Capital research and estimates; FactSet, Dow Jones Brookfield Global Infrastructure Index, Merrill Lynch Global Quantitative Strategy, MSCI, IBES, Worldscope

\*\*As of 31 March 2011. Source: AMP Capital research, FactSet, Bloomberg, Dow Jones Brookfield Global Infrastructure Index