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Spotlight on listed infrastructure

The attractions to pension schemes

January 2020

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- Infrastructure typically gives investors access to regular, reliable and secure cashflows that grow over time and thus provide some protection from inflation generated from real, physical assets.
- Values of infrastructure assets are typically affected less by the economic cycle than the broader equity markets, which may deliver a less volatile return profile.
- Listed infrastructure allows investors to achieve some of the attractive beneficial features of infrastructure, but with liquidity that is not normally associated with the asset class.

Infrastructure and its continuing development

Infrastructure forms the backbone of any economy, providing essential services to individual communities and the country at large. For some time, the sectors and businesses that are considered to be infrastructure have been expanding and evolving, beyond what are regarded to be traditional areas.

The provision of such things as utility networks and public transport has been joined by new sectors including fibre optic cabling and renewable energy. Infrastructure can also be social in nature, for instance through the provision of student housing and hospitals and other essential features of our societies that are currently emerging.

Opportunities to invest in infrastructure through listed companies have been widespread for a long time and those opportunities are continuing to grow.

This growth is largely due to the need for huge amounts capital investment in new and existing infrastructure, in order to deliver the economic growth needed over coming decades. This can be through both new ventures or in existing experienced infrastructure companies, well-placed to take those opportunities forward.

The attractions of listed infrastructure

Listed infrastructure companies, and the assets that underly them, typically have a number of features that pension schemes find attractive:

Defensiveness during economic downturns – By their nature, the essential services that infrastructure typically provide are less-likely to be affected by fluctuations in the business cycle than are other industries. This defensiveness can bring welcome diversification to portfolios consisting of more economically-sensitive assets.

Reliable inflation-linked cashflows – Cashflows from infrastructure assets typically grow over time, often specifically linked to inflation or economic growth. They can also generally be relied upon, either contractually or through the essentiality of the service they provide. These can be a useful tool when considered against liabilities that themselves increase with inflation.

Security from real assets – The physical nature of most infrastructure assets offers some security to investors.

Liquidity – Listed infrastructure is likely to be far more liquid than individual infrastructure assets or holdings in private infrastructure companies or funds. This allows investors to increase or decrease their holdings of the infrastructure asset class as needs arise.

Using infrastructure to achieve growing cashflows

Pension funds ultimately aim to deliver cashflows to their members, which are likely to grow gradually over time as more and more members reach retirement. Members of Defined Contribution (DC) schemes will also welcome the potential to have those cashflows grow each year, to counter the effects of anticipated inflation. Infrastructure is well suited to meeting these requirements and we follow an approach that aims to deliver steady dividend growth over time.

Businesses that own or control critical physical infrastructure or long-life concessions are well-placed to deliver those cashflows. In addition, the reliable cashflows features of perpetual royalties mirror those of mainstream infrastructure, so we include them in our listed infrastructure strategy.

Diversification within a listed infrastructure strategy is also important

In the same way as diversifying broad pension scheme assets helps to reduce overall risk, diversifying a listed infrastructure portfolio presents similar benefits of being able to capture different qualities from different spheres.

We recognise that it is possible to look beyond what many may consider to be traditional infrastructure, to other areas carrying the features commonly associated with the asset class.

We believe it is best to consider **three distinct infrastructure categories**: economic, social and evolving.

Economic – traditional cornerstones of infrastructure, such as utilities energy pipelines and transport. These are typically defensive in nature and offering conservative but stable dividend growth over time.

Social – assets such as educational, health and government facilities provide similarly defensive features to economic infrastructure but through distinctly different asset bases.

Evolving – new and emerging avenues of infrastructure include such diverse areas as communications and transactions structures and networks, as well as royalty companies with their long-term, reliable and, usually, secured cashflows. These reflect an increasingly digital world and aim to capture some of the ongoing structural growth in infrastructure needs globally. These new avenues provide additional and more dynamic dimensions to an asset class that has stability at its core.

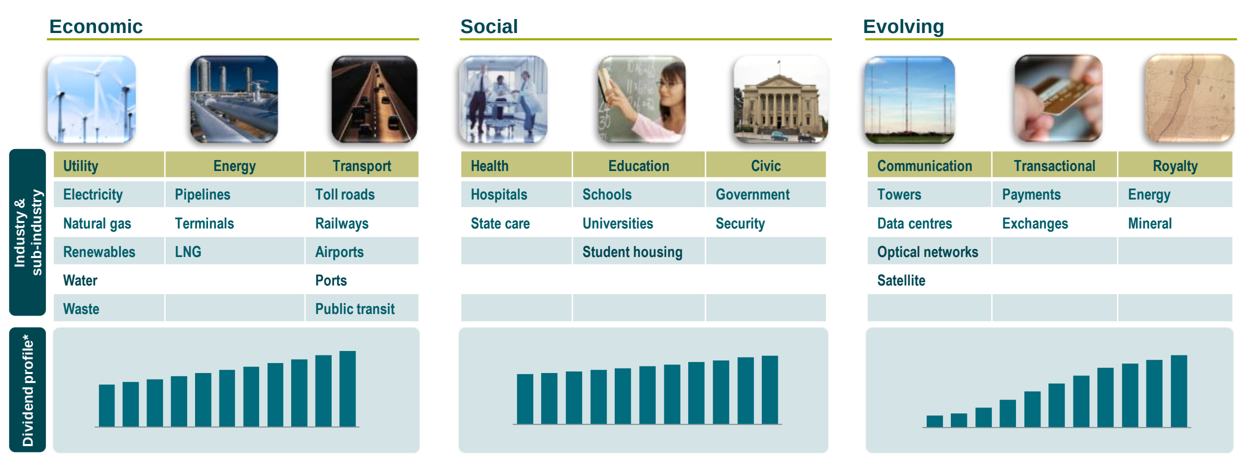
Embracing responsible investing

We believe that companies should demonstrate that they are acting in a responsible manner, with due regard for the environment and society. This is in addition to achieving a strong dividend track record and capital return culture.

From the outset, we have been performing rigorous analysis into each candidate company's standing on environmental, social and governance (ESG) factors as an essential part of our investment process. This can help provide us with confidence regarding the sustainability of the businesses which we might invest in.

Our detailed analysis can help us better understand how well a company goes about its business, and also identify any shortcomings it may have. It also enables us to engage with the company to encourage improvements in its processes and objectives, with the goal of helping it to achieve best practice.

Figure 1. Diversification across infrastructure classes



Source: M&G, 2019 *Expected annual dividend increase, for illustrative purposes only. Internal guidelines only, subject to change

Companies leading the way with optimal ESG standards are more likely to be rewarded with tailwinds in pursuit of their business plans. Headwinds, such as more costly financing or tighter regulations and expensive levies or taxes, are more likely to be reserved for an industry's ESG laggards, exemplified by businesses such as coal-fired power and nuclear power stations, which we exclude.

Addressing the needs of Defined Contribution schemes

A listed infrastructure strategy provides investors with the ability to access what are often thought of as illiquid, often privately-held assets via readily-tradeable investments. The nature of the underlying assets means the strategy can also offer a long-term investment that seeks equity market returns, sustained by exposure to real assets.

M&G's approach to the asset class specifically seeks to deliver a growing stream of distributions and offer diversification to investor's portfolios. This may be well suited to a defined contribution (DC) investor or any pension scheme for whom achieving a reliable, building income is an essential requirement.