Morrison & Co Infrastructure Market Perspectives

Infratil Investor Day 2014

Last year we shared some observations and predictions regarding infrastructure investment markets

Demand for Infrastructure

- **Large and growing requirement** for new and expanded infrastructure
  - US$4t pa demand for infrastructure development
  - Driven by **multiple long term megatrends**

Supply of Capital

- **Wave of capital targeting the asset class**, primarily focused on mature assets:
  - Yield-hungry investors seeking "bond proxies" in a low interest rate environment
  - Sovereign wealth and pension funds seeking equity market diversification and stable, inflation-linked returns

A **supply-demand imbalance** that creates opportunities for contrarian investors:
– A **lot of capital** chasing a limited supply of **mature infrastructure** assets
– A **lack of capital** willing to take on **greenfield or expansion** projects

Recap: Multiple megatrends driving demand for new infrastructure

Drivers of demand for new infrastructure

Rise of **emerging markets middle-class**, urbanisation

Globalisation and growing trade volumes

Aging populations

Increasing **water scarcity**

Changing patterns of **energy demand & supply**

New **social infrastructure** for changing demographics

Historic underinvestment in the developed world

Climate change and emissions constraints

Three examples of megatrends influencing the IFT portfolio

Drivers of demand for new infrastructure

Rise of **emerging markets middle-class**, urbanisation

Changing patterns of **energy demand & supply**

Globalisation and growing trade volumes

2

New social infrastructure for changing demographics

1

Aging populations

Historic underinvestment in the developed world

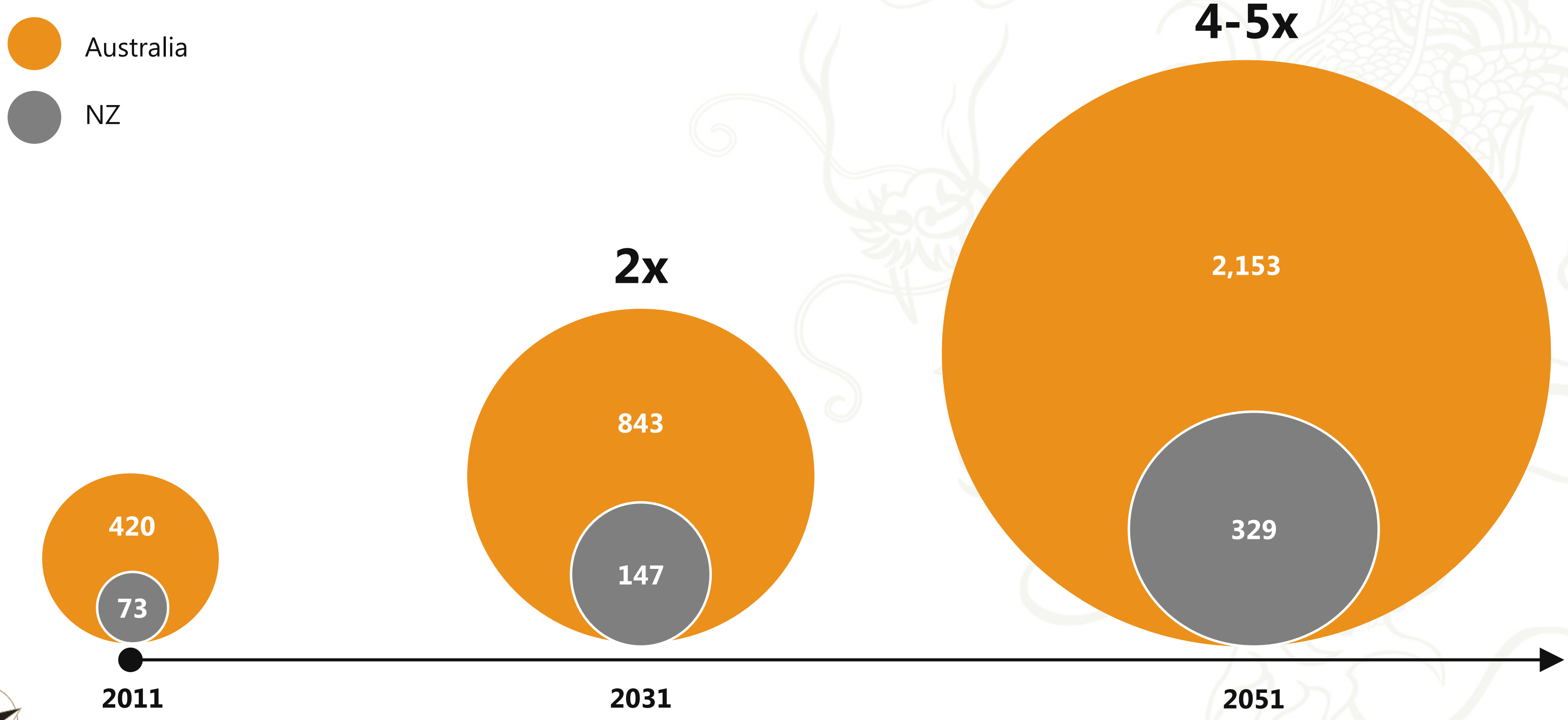
Increasing **water scarcity**

3

Climate change and emissions constraints

Aging Populations: An explosion in slow motion

NZ and Australian population projection 85yrs+ (000s)

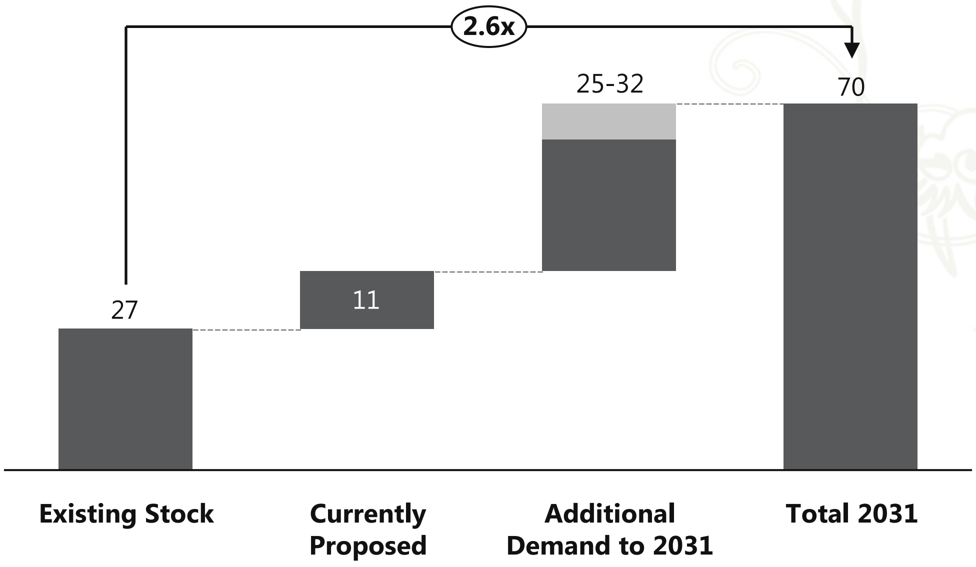


Source: Statistics New Zealand, Australian Bureau of Statistics. Not to scale.

Investing in the Aging Population megatrend

Demand for Retirement Villages will more than double by 2031

NZ Retirement Village Sector
Number of Apartments & Independent Living Units (000s)



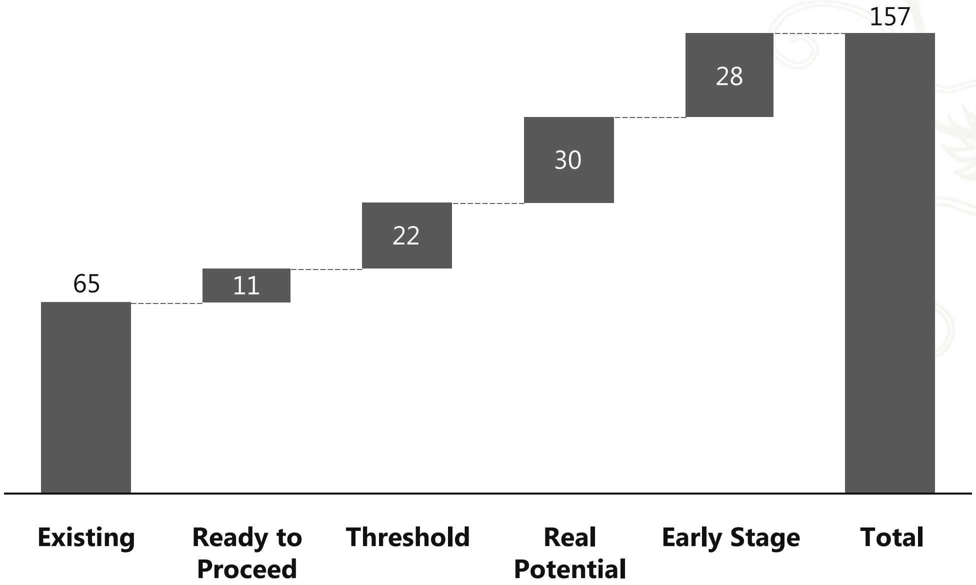
New build rate will need to grow to 2000+ pa (a new MET every 2 years)

Source: CBRE; MCO analysis. Note: 25-32k range for additional demand to 2031 reflects potential additional impact of lower mortality rates.

Social Infrastructure: Catch-up required

Infrastructure Deficit + Changing Demographics = Greater use of Public Private Partnerships

Australian PPP Pipeline (A$bn)



"The size of the infrastructure challenge is unprecedented – the lack of spending on infrastructure over the past 20 years has reared its head when the restrictions are at the highest"

- ***Mike Baird (NSW Treasurer)***

Mar 2014

Source: Infrastructure Australia, Department of Infrastructure (National Infrastructure Construction Schedule, as at 31/03/2014)

Securing advantaged access to the Australian PPP Pipeline

A joint venture with one of Australia's leading contractors

IFT's entry into Australian PPPs

- **Initial acquisition of interests in two Australian PPPs**
  - SEQ Schools: Portfolio of 7 schools (in operation)
  - New Royal Adelaide Hospital: Part way through construction
- **JV with Leighton Contractors**
  - Cornerstone investment right in future Australian PPPs
  - Agreed target list covering A$30b+ of upcoming projects
- **Exclusive focus on availability-based PPPs**
  - Government counterparties
  - Revenue linked to facility availability, rather than utilisation/tolls

SE Queensland Schools

New Royal Adelaide Hospital

Source: Infrastructure Australia, Department of Infrastructure (National Infrastructure Construction Schedule)

Recap: Energy demand vs emissions constraints

When megatrends collide…

Air quality in Beijing has mostly stayed above "very unhealthy" and "hazardous" levels for about two weeks. On Tuesday, it hit 517 on an index maintained by the U.S. Embassy in Beijing, which described the pollution as "Beyond Index"

-Reuters Jan 2013

How is the global political response to climate change playing out?

International policy-makers are starting to respond

China

- Premier declares "war on pollution"
- First carbon market in Shenzhen
- 2 more carbon markets launched
- 8 carbon market pilots by year end
- Cap on coal consumption 6% below BAU growth
- 2013 installed renewables:
  –11.3 GW of solar PV
  –16 GW wind (~50% of world total)

USA

- Obama releases US climate plan:
  - Emission limits for generators
  - Renewable energy support
  - Energy efficiency support
- Climate change declared a “key diplomatic priority”
- RGGI* expanded to 9 states
- California ETS in operation
- New York funds $1bn Green Bank

European Union

- Backloading to raise carbon prices
- New EU 2030 targets
  - 40%+ emission reduction
  - 27% renewable energy
  - 40%+ renewable electricity
- UK introduces CfD scheme
- France introduces carbon levy to cut fossil fuel use 30% by 2030

* The Regional Greenhouse Gas Initiative is a cap & trade scheme designed to cap and reduce CO_2 emissions from the power sector in Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, Rhode Island and Vermont

Meanwhile in Australia…

Climate change policy remains heavily politicised, RET review is underway

Coalition Government Policy Framework

1. **Repeal of the carbon tax**
   - Currently being blocked by the Australian Senate

2. **Implementation of the "Direct Action" policy**
   - Centred around the flagship $3bn Emissions Reduction Fund

3. **Review of the Renewable Energy Target**
   - Terms of reference include consideration of "sovereign risk"
   - Recommendations due mid 2014

Recap: Two distinct macro drivers of infra capital flows

QE and the search for yield

- Ultra low interest rates led some investors to treat infra as a higher yield **“bond proxy”**
- Prices of **core low risk assets** such as US regulated utilities were **bid up during QE**
- **“Growth infra” assets** such as airports were **less impacted,** with performance remaining linked to economic outlook and business fundamentals

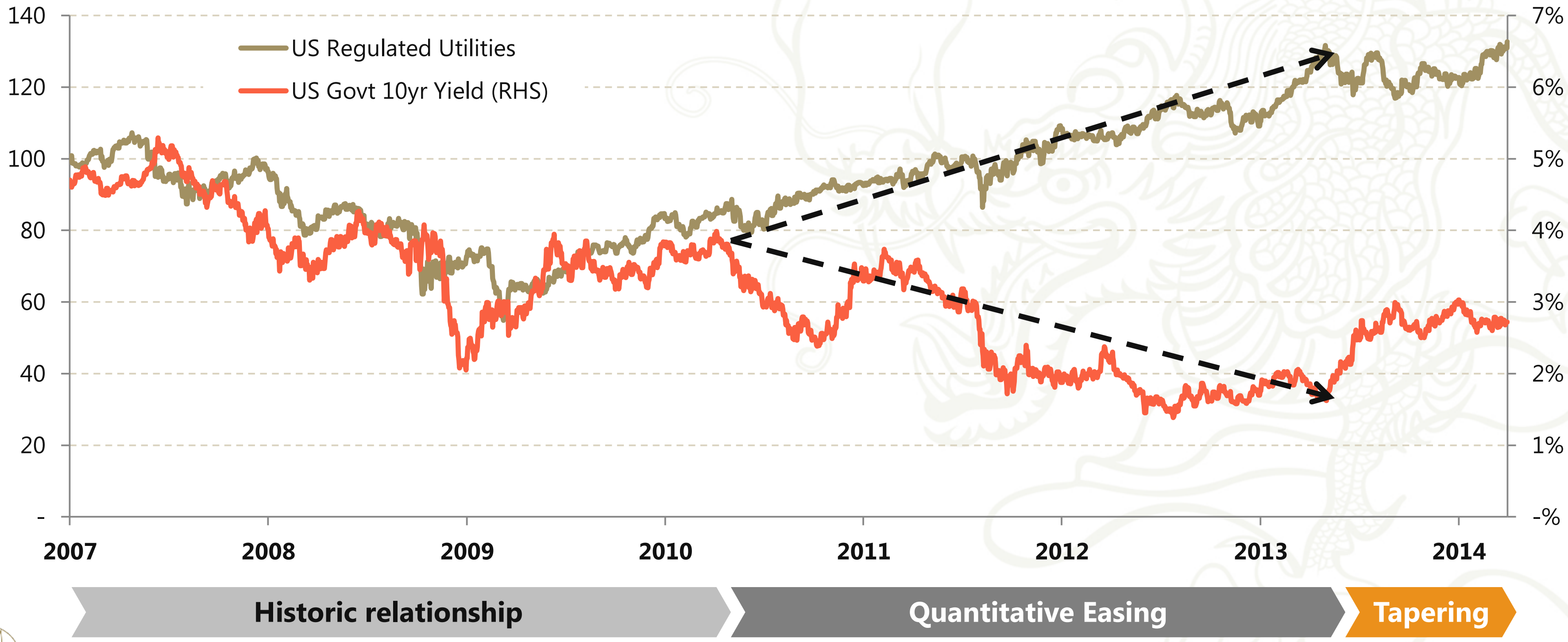
Weight of infrastructure capital

- **SWF’s and pension funds continue to grow in size**, and are **increasing allocations to infra**
- This has created a **‘weight of capital’ targeting unlisted infrastructure**
- Greatest impact on **large scale, core infrastructure assets**

How have these capital flows developed over the last 12 months?

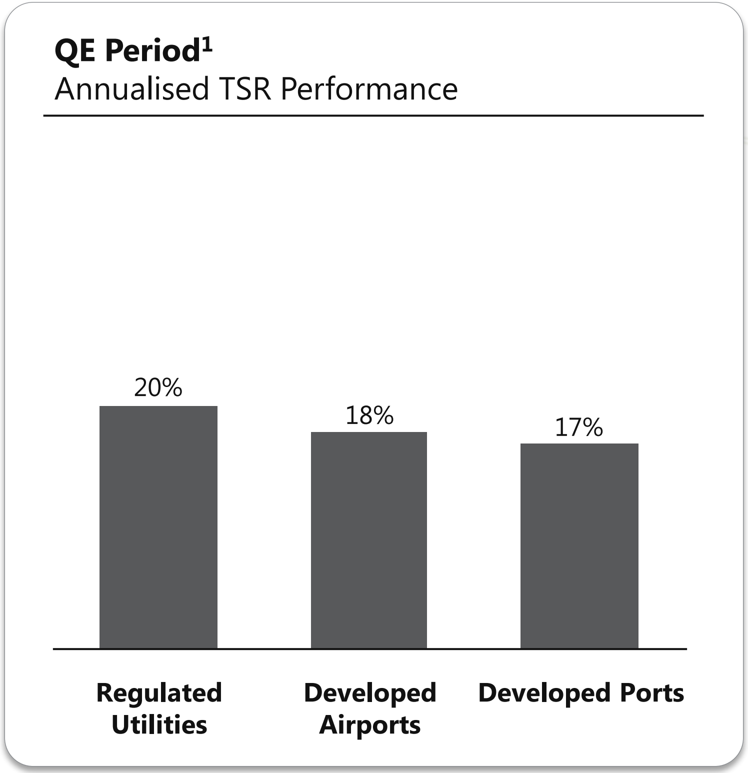
The "bond proxy" play in regulated utilities came off as tapering expectations took hold

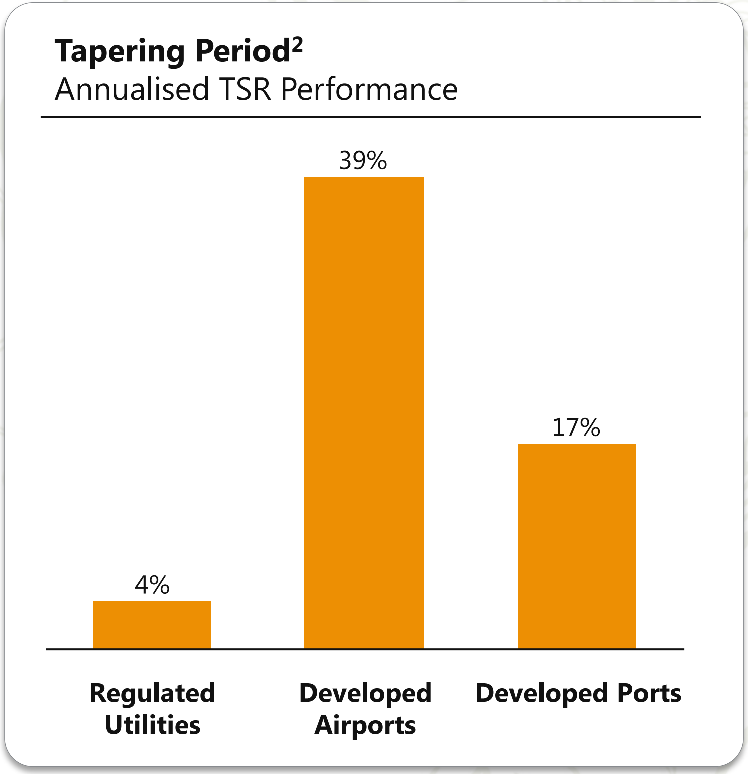
US Regulated Utilities vs US Govt 10 Yr yield: 2007 – 2014



Source: Bloomberg; Morrison & Co analysis

However "growth infrastructure" assets have continued to perform well





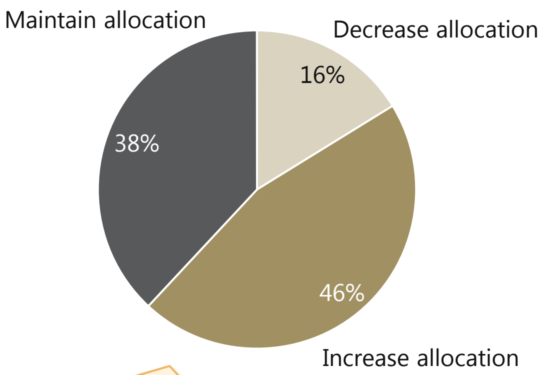
Source: Bloomberg; Morrison & Co analysis

Notes: 1. Annualised returns in QE Period (from October 2008 to April 2013), 2. Annualised returns in Tapering Period (from April 2013 to March 2014)

As QE recedes, the wave of capital targeting unlisted infrastructure will continue

Pension & SWF investors are increasing infra allocations

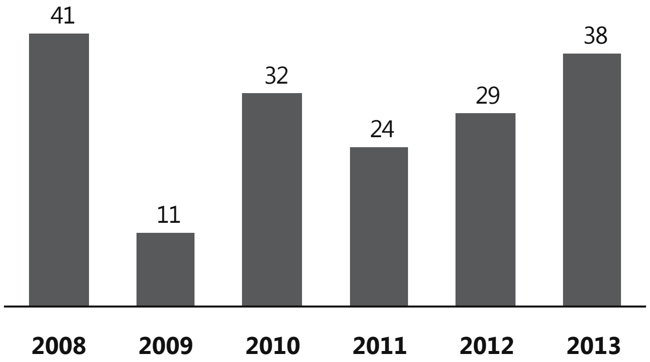
Investor intentions for infrastructure allocations in 2014
% Preqin survey respondents[1]



- 72% of active investors in infrastructure still have **less than 5% of total assets** allocated to infrastructure
- Amongst established infra investors in Australia & Canada, **typical allocations are 10-15%**

Pools of discretionary infra capital continue to be raised

Unlisted infrastructure capital raised
$bn

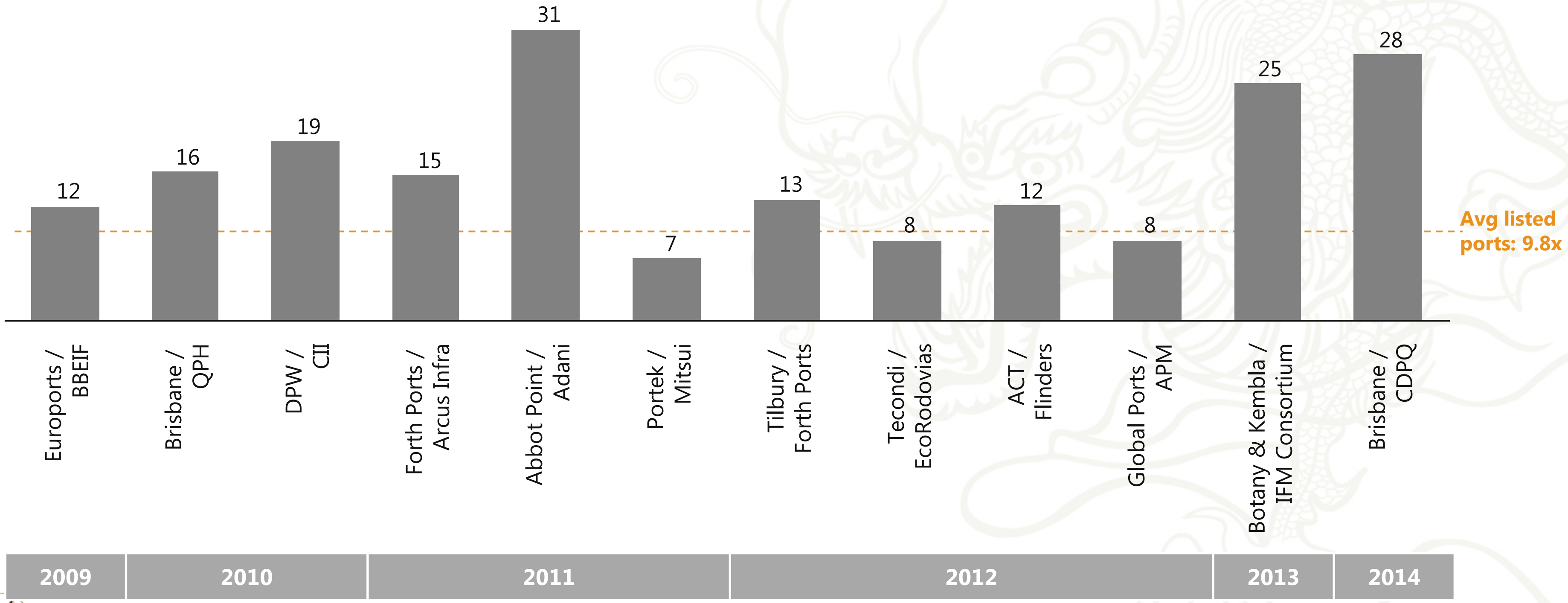


- **~$175bn raised** over the past 6 years
- Considerable **dry powder still waiting to be deployed** with limited investment periods

Source: [1]Preqin; *140 global institutional investors*

This wave of capital is supporting strong valuations in large private market infrastructure transactions

Selected Port Transaction Multiples (EV/EBITDA)

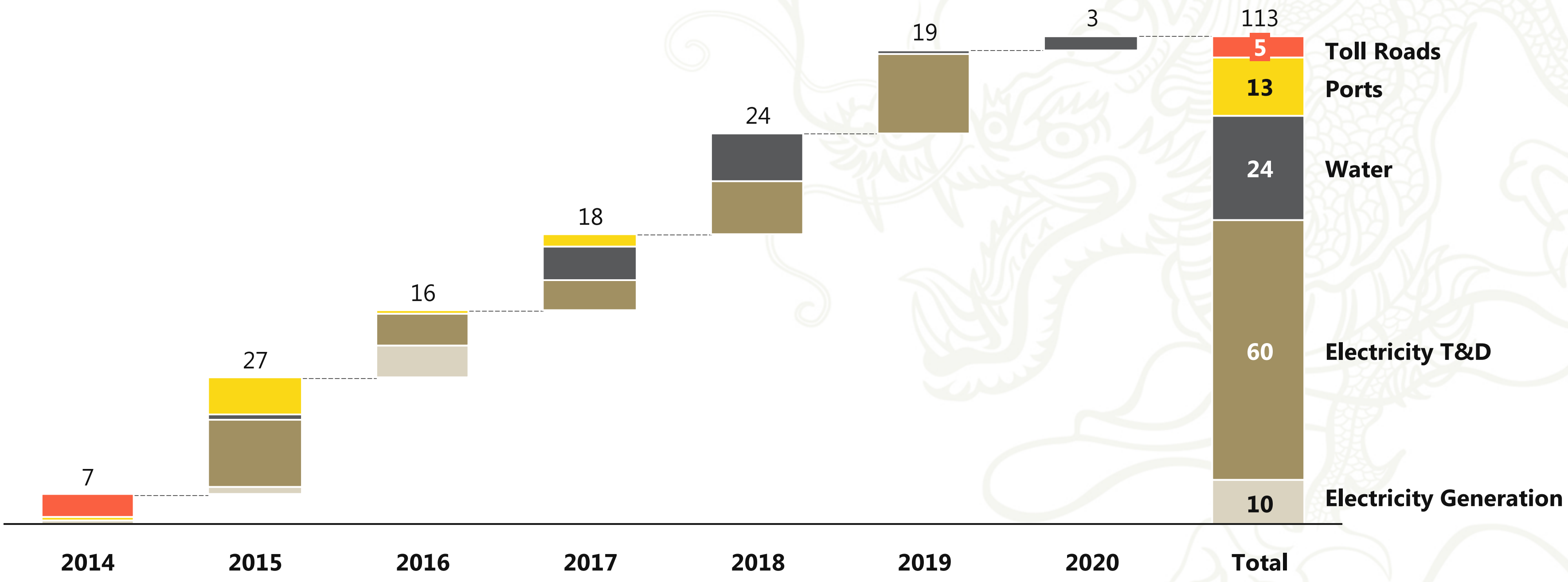


Source: Morrison & Co analysis

Governments are responding to this demand by recycling mature infrastructure assets

A$100b+ infrastructure privatisation pipeline in Australia

Pipeline of Potential Infrastructure Privatisations (A$bn, By Subsector)



Source: ANZ, MCO Analysis

In Summary:
What does it all mean for infrastructure investors?

Supply-demand balance for infra capital

- Massive **requirement for new infrastructure** spend
- Strong and growing **institutional demand for unlisted, mature infrastructure assets**
- Governments looking to **bridge this gap** by **recycling capital** through privatisation

Implications for infrastructure investors

- **Incumbent owners of 'growth infrastructure'** will benefit from:
  - **Earnings growth** from exposure to **macro demand drivers**
  - **Valuation growth** from increased **investor demand**
- In the current market:
  - **Listed infra** can offer better value than private auctions
  - **Greenfield investments** offer attractive returns
  - **Valuation gains available** for investors that can manage assets through periods of development and transition risk
- Will privatisations reset the infra supply-demand balance?

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