Partners Group
REALIZING POTENTIAL IN PRIVATE MARKETS

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Q2 2023 Review

Partners Group Listed Investments SICAV – Listed Infrastructure

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2023 Q2 review

Key market drivers

After the turbulence caused in March by banking concerns and failures in both Europe and the US, global equity markets staged a strong recovery during Q2, led primarily by the technology sector. While the data showed that inflation had moderated slightly during March, and the job market continued to show resilience, the Fed hiked rates again in May, with more hikes expected before the end of the year. During the quarter, there was investor excitement around future prospects for AI-technologies, with shares in the software and semiconductor sectors gaining significantly in May. The excitement around the technology sector can be measured by the tech-heavy NASDAQ posting its best H1 return in 40 years. Uncertainties around a US government default also caused some volatility, but its eventual resolution led to strong rally in equity markets towards the end of the quarter.

During Q2, the Partners Group Listed Investments SICAV - Listed Infrastructure Fund rose by over 2%, outperforming its benchmark comfortably by over 250 bps. The strong outperformance was driven by healthy Q1 earnings growth as a few companies were able to drive earnings higher despite rising cost pressures. Our focus within the portfolio remains on companies that can deliver earnings growth in a rising inflation and a feeble economic growth scenario. Unsurprisingly, data centers was the best performing sub-sector within the portfolio, supported by good performances by railways and waste operators. However, social infrastructure and renewables were notable decliners during the quarter, with a more subdued performance.

Key portfolio drivers

Within transport, railways, toll roads and airports all delivered healthy performance during Q2, particularly the railways. Within railways, Rumo and CSX were particularly strong performers, as both were among the top 5 performers in the portfolio during the quarter. Rumo, the Brazilian railroad operator, reported strong Q1 results, especially on higher tariffs, which grew 28% year-on-year. We remain confident that Rumo's strong competitive position will allow the company to increase prices while continuing to grow volumes. CSX, the US railway operator, performed well despite a decline in industry volumes in June, as it led the productivity gains among US rails. Intermodal traffic saw continued weakness, whereas bulk commodities held up well. The company also announced that in a collaboration with CPKC and G&W, they would each acquire or operate portions of Meridian & Bigbee Railroad to establish a new freight corridor for shippers that connects Mexico, Texas and the US Southeast. Finally, the European airports also delivered healthy Q1 results with strong recovery in passenger numbers, but there was some pullback towards the end of the quarter for ADP as a result of the riots in France. Overall, transport infrastructure performed very well during the quarter, and supported the portfolio returns.

Communication infrastructure had a bifurcated performance, with Equinix – the sole data center operator in the portfolio – delivering a robust performance, while the towers in the US and in Europe, both reporting rather muted or slightly negative performance. Equinix was among the best performing companies in the portfolio during the quarter, as generative AI applications are expected to generate growing demand for data center capacity, on top of the secular growth in both co-location and interconnection. In addition, Equinix also reported strong Q1 results, with mid-term guidance for earnings growth remaining in the high single digit range over the next few years. Within towers, Crown Castle was a notable underperformer, as it reported slightly weaker revenue growth than expected. All other tower cos reported either in-line or above expectations results.

Within utilities, the waste operators and pipeline operators both performed well, while regulated water utilities was a notable decliner in Q2. Regulated transmission and distribution utilities were slightly positive, with CTEEP, the Brazilian regulated transmission operator, reporting the strongest performance in the portfolio in Q2. CTEEP grew revenue and EBITDA by 25% and 39% year on year in Q1, with continuing strong momentum for its capex for both greenfield projects and grid reinforcement. However, the Chinese gas utilities were weak performers in Q2 as gas demand has not recovered as well as it was expected when China started re-opening its economy. Both the Chinese gas utilities in our portfolio delivered rather underwhelming Q1 results, which led to their poor performance in the quarter. Among waste operators, Republic Services reported very strong Q1 results, particularly due to pricing growth in its waste collection business. While volumes have grown at low single digits, pricing on the other hand delivered high single digit growth, driving overall revenues higher by nearly 10% during the quarter. Pipelines also contributed positively to portfolio growth driven mainly by the performance of Williams. The company, after fairly disappointing share price performance YTD, reported an improvement to its financials and achieved a net leverage ratio below 4x ahead of schedule. This will likely see it focus more on growth and shareholder distributions, which prompted a strong rebound in the share price.

Finally, both the social infrastructure operators in our portfolio reported poor performance during Q2. While there was little company-specific news, both have a significant presence in the UK where, as yields started to increase, it led to poor performance of these otherwise defensive sectors.

Portfolio positioning and outlook

Regulated utilities and communication infrastructure both remain the largest allocations within our portfolio, though during 2022, we increased exposure to railroads and waste operators by reducing exposure selectively to pipelines and airports. In the past quarter, we have made no changes to our target allocations, as we continue to believe that the portfolio is well-positioned for what will likely be a challenging year.

Among sectors, communications infrastructure remains one of our key sector focuses over the next few years, given the strong tailwinds for the sector. We continue to see large investment needs for the sector that could drive earnings growth over the medium to long term. We see more scope of outsourcing towers by MNOs in Europe, and the 5G investments by the US-based MNOs are expected to accelerate further. These are companies that are expected to grow at mid-to-high single digits (higher in certain cases), with very long-term contracts (~30Y in some cases), and with very healthy EBITDA margins (>50%). They also have inflation escalators, with very low maintenance capex as % of revenue. We do not believe the sub-20x P/AFFO multiples will last for very long, and the market will react positively to earnings growth for the sector. Data centers are also expected to benefit from such long-term secular trends. We have increased our position in communication infrastructure over the past two years, and despite the poor performance in 2022, we find that underlying fundamentals and leasing activity all remain robust.

We continue to see good opportunities within regulated utilities. Most of the companies within the sector reported strong FY 2022 earnings, and we expect this trend to continue in 2023. During the pandemic, the regulated utilities did not modify their medium-term investment plans or faced unfavorable changes to their regulation, both of which are promising indicators for the sector's earnings growth potential. However, within the sector, we continue to emphasize on electric and water utilities, and have changed allocations accordingly. Furthermore, those utilities that are subject to stable regulation, have a strong balance sheet and meaningful capex on their regulated asset base, should also provide better performance even in a rising interest rate environment.

We remain positive on the US waste managers, and our exposure to the sector has grown accordingly over the past two years. Finally, while performance of transport infrastructure has recovered to some extent, we find that toll road traffic recovered meaningfully during last summer, but airport passenger numbers remain rather weak. This is evident from observing Vinci's reported numbers as toll road traffic in 2022 was above 2019 levels, while airport passengers remain below the 2019 levels for all airports in our portfolio, as well as in our wider coverage universe. We continue to take a cautious approach on the sector and believe traffic on toll-roads will recover faster than airports, as appetite for travel remains. Furthermore, toll-road valuations are attractive. We are cautious on airports over the medium-term, and especially on those that are exposed to international long-haul, business and transfer traffic. We also remain positive on the outlook for railroads.

In summary, we have slightly shifted our portfolio towards companies that we believe will do better in an inflationary environment. However, 2/3rd of the portfolio remains invested in less GDP-sensitive sectors such as regulated utilities, towers and social infrastructure operators, which will likely still provide growth even in an economic downturn scenario. The underlying portfolio companies continue to perform well from a fundamental point of view. Furthermore, a scenario of rising nominal rates is not a negative per se for Partners Group Listed Infrastructure as more than 70% of the portfolio companies' underlying revenues are directly or indirectly linked to inflation.

ESG

Group products. Partners Group has been an early mover in ESG, as a UNPRI signatory since 2001 and with a dedicated ESG team that has been in place for many years. We have in the past and continue to decline certain investments purely on ESG concerns and the exclusion of power generation and in particular "dirty" coal fired power plants and "tail risky" nuclear power plants makes our Fund even further ESG relevant. We would also like to highlight that our Fund is rated 'AA' by the MSCI ESG platform.

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