Partners Group
REALIZING POTENTIAL IN PRIVATE MARKETS

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Q3 2022 Review

Partners Group Listed Investments SICAV – Listed Infrastructure

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2022 Q3 review

Key market drivers

The third quarter began strongly for equity markets, with healthy performance in July, despite the IMF projecting weaker global economic growth in 2022 and beyond. However, this rally was short-lived, as September turned to be a weak month overall for equity markets driven by persistently high inflation, as well as rising recession risks both in North America as well as in Europe. The high inflation prompted the Fed to implement a third-straight 0.75% rate hike in September, while in Europe, the backdrop was similar with central banks also combatting inflation, as the continent deals with the ongoing energy crisis and looming risks of a recession. During the quarter, European energy prices reached record levels, and the EUR slid to its lower level against the USD in nearly two decades. The Fed has clearly indicated that bringing inflation down will be their top priority, dashing hopes of a 'pivot' in strategy, at least until there is evidence that inflation has stabilized and may perhaps be declining.

During another volatile quarter, the Partners Group Listed Investments SICAV – Listed Infrastructure Fund also declined in value, falling by 5.8%, mainly due to its weak performance in September. With the exception of railroads and waste operators, all other sub-sectors performed negatively, particularly the airports held in our portfolio. Regionally, the Brazilian equities were clear outperformers, but all other regions performed negatively, with European equities continuing to underperform the North American equities.

Key portfolio drivers

Within transport, railroads and toll roads held up better, while airports were weaker. Rumo, Canadian National and Atlantia were all among the best performers in the portfolio during the quarter, with Rumo in particular delivering strong volumes outlook for 2022 and 2023. The company is expected to meet its ambitious 2022 guidance and is well positioned for strong growth in 2023. On the other hand, Aena was among the weakest transport infrastructure companies with some concerns around its retail business, though the leisure focused traffic at its airports continues to recover strongly. We continue to hold our investment thesis that leisure traffic will recover faster, while some business traffic may have been impaired permanently, or at least be slower to recover.

Communication infrastructure had a very weak quarter, though very little can be attributed to underlying or specific company factors. Cellnex has been among the worst performing stocks in the portfolio, but it was driven by a lack of news on the M&A (and because of its pan-European presence), rather than any concerns about the company. Cellnex has approximatively EUR 8 billion of available liquidity, and they had a deadline to deploy it by August, but that was clearly missed. Management continues to be prudent, preferring not to do deals at elevated multiples, which is why they decided to walk away from the Deutsche Telekom's towers portfolio. At the same time, their contract structure is such that two thirds of their contracts are CPI-linked, while the remaining have fixed escalators. We appreciate management's disciplined approach, and to reject deals where multiples remain elevated, though the market would clearly like Cellnex to announce an M&A transaction soon. The US towers in our portfolio – Crown Castle ("CCI") and American Tower ("AMT") – also had poor returns, and after several years, their P/AFFO multiples, which measure a REIT's ability to pay dividends to shareholders in the long term, have traded to below 20x. There has been no slowdown in 5G deployment, while the near-term churn as well as FX exposure for AMT is well-known. Equinix, the only data center in our portfolio, has some headwinds due to rising construction costs, but demand for data and reduction in time lag are both secular growth tailwinds, that we will believe will likely outlast any near-term economic weakness. The company has also traded down to below 20x P/AFFO multiple, with high single digit annual growth outlook over the mid-to-long term.

Within utilities, the regulated transmission and distribution utilities came under pressure and was the worst performing sub-sector. This was mostly driven by the weak performance of Chinese gas utilities, which have clearly been impacted by China's 'zero-COVID' policy. National Grid ("NG") and Terna were other weak performers, but the factors are mostly country risk (UK and Italy, respectively). It is important to note that for NG, approximatively 40% of its business is USD-based, which stands to gain from the current turmoil for the GBP, while Italian utilities have experienced significant sovereign risk in the past, and have still consistently delivered stable returns. We do not see any deterioration to the fundamentals in either case. Energy pipelines, water and waste operators performed better, but the overall sector performance was affected by regulated transmission & distribution. Sabesp, the Brazilian water operator, was the best performing company in the portfolio (further benefitting from BRL appreciation) during this period because of renewed expectations about its privatization.

Finally, social infrastructure was slightly negative during this period, providing stability in an otherwise volatile quarter. Both companies that we hold in our portfolio have up to 40 years of visibility on cash flows, and they are based on availability rather than demand variation.

Portfolio positioning and outlook

Though regulated utilities are the second largest allocation in the portfolio currently, over the past year, we have been increasing exposure to towers and railroads by reducing exposure selectively to pipelines and airports. Other sectors where we have also increased exposure are waste managers and data centers. During the pandemic, we found that certain companies offered compelling valuations for us to consider increasing them. In the past quarter, we made limited changes, with an increase in Infrastrutture Wireless Italiane ("Inwit"), Terna and TC Energy, while we divested our position in Atlantia (following the take-private offer).

Communications infrastructure will remain one of our key sector focuses perhaps 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 Mobile Network Operators ("MNO") 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 (approximatively 30 years in some cases), and with very healthy EBITDA margins (approximatively 50%). They also have inflation escalators, with very low maintenance capex as percentage 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 been increasing our position in communication infrastructure throughout 2021, which had supported the strong performance of the fund last year. Despite the poor performance YTD, we find that underlying fundamentals and leasing activity all remain robust.

Regulated utilities had a poor performance in Q3, but we continue to see good opportunities within this sub-sector. Much of this poor performance was driven by sovereign risk (China, UK, Italy), but we do not anticipate that this has led to any deterioration of business operations. None of these utilities have modified their medium-term investment plans or seen 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 24 months. Finally, while performance of transport infrastructure has recovered to some extent, we find that toll road traffic recovered meaningfully during this summer, but airport passenger numbers remain rather weak. 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 and people may perceive cars as a safer mode of transport. 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, two thirds 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. We continue to believe a balance between defensiveness and growth will be a better outcome for our fund presently. The underlying portfolio companies, except airports due to the COVID-19 situation, continue to perform well from a fundamental point of view. Furthermore, a scenario of rising nominal rates is not a negative per se for the Fund as more than two thirds of the portfolio companies' underlying revenues are directly or indirectly linked to inflation.

ESG

We believe it is worthwhile highlighting that the Fund follows an ESG approach like all Partners 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 'AAA' – the highest possible rating – by the MSCI ESG platform.

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