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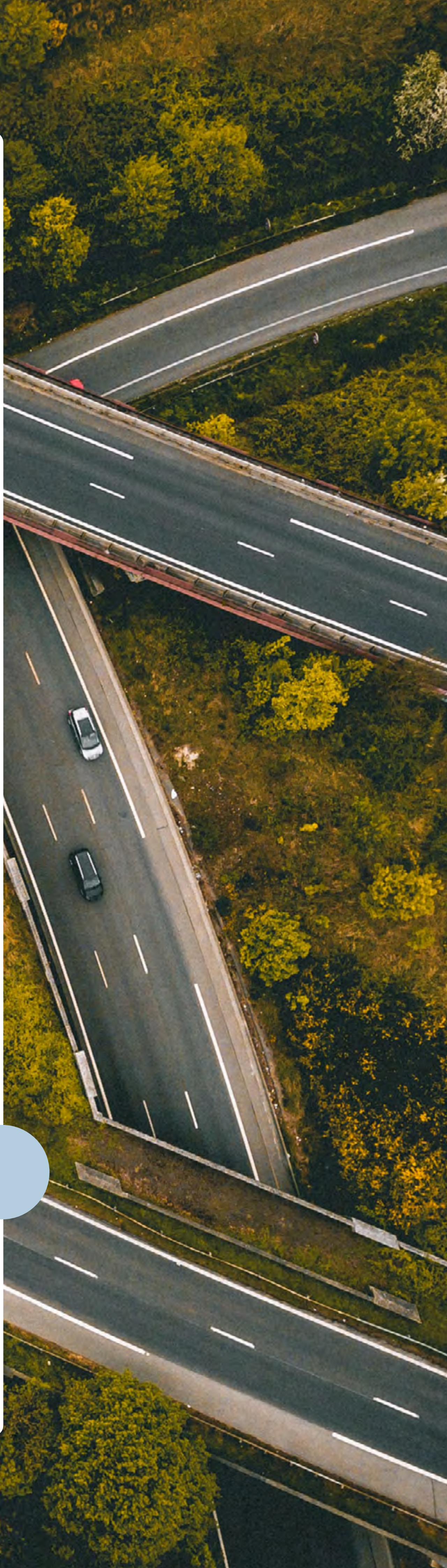
Riding the Infrastructure Wave: Potential Growth Beyond the Inflationary Boom



MARCH 2024

Marketing communication

Riding the Infrastructure Wave: Potential Growth Beyond the Inflationary Boom.

After a rough few years due to the pandemic, the infrastructure sector is looking up since the inflationary boom. Here's why areas such as clean energy, power grids, toll roads and telecoms towers - things that everyone relies on every day - may be worth exploring for potential growth in the future.

1. Inflation boost

Typically seen as a financial constraint, inflation can potentially work in favour of certain companies, particularly those in the infrastructure sector, by increasing revenues and cash flows. Infrastructure contracts and regulatory frameworks allow these companies to adjust their revenues in line with inflation rates, ensuring stable cash flows. This mechanism applies to various industries, such as toll roads and water utilities, where price adjustments help maintain financial stability and support future investment.

In addition, the gradual accumulation of tolls or fees over time strengthens the financial position of infrastructure companies, enabling them to undertake projects, pay dividends and maintain their real value. It is important to note that although the full impact of inflation on revenues may take time to materialise, the delayed realisation can ultimately benefits these companies. For example, adjustments to toll rates based on the previous year's inflation can result in a time lag before revenue growth becomes apparent, highlighting the long-term benefits of inflation for infrastructure companies.

2. Sector-specific potential opportunities

From cleaner energy to faster internet, infrastructure is key to helping our society meet its digital and environmental challenges. Not to mention, investing in 5G, renewable energy and AI could mean long-term growth.

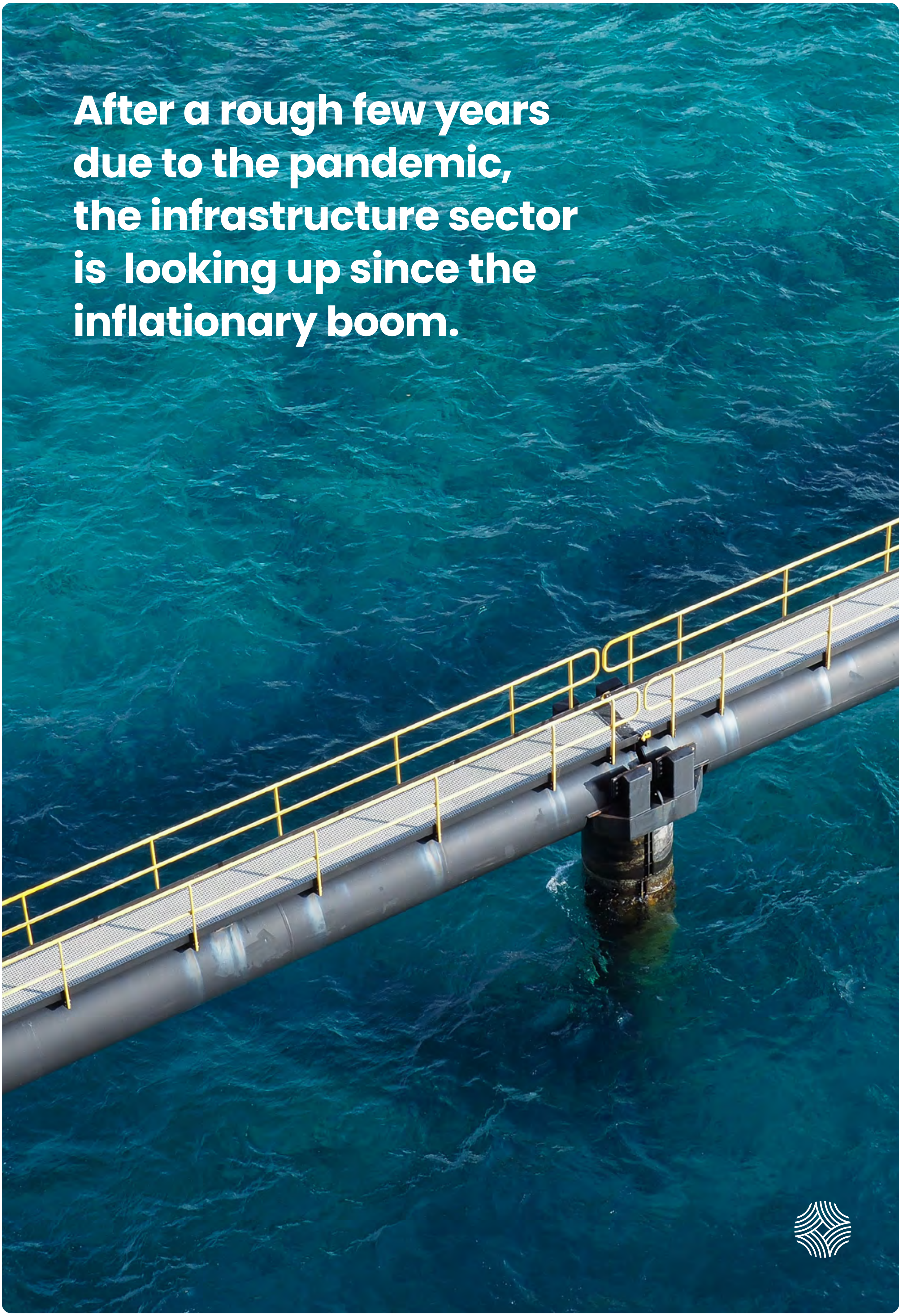
Within the broader infrastructure market, specific sectors offer unique growth drivers and opportunities. For example, the telecoms sector, particularly mobile tower companies, remains positioned for growth, fuelled by the exponential increase in mobile data consumption and the ongoing 5G investment cycle. Transport infrastructure, despite recent challenges, is poised for recovery as travel patterns normalise post-pandemic, creating opportunities in areas such as airports and toll roads. In addition, energy infrastructure companies play a critical role in the global shift to cleaner energy sources, with a focus on natural gas and initiatives to support the energy transition.

3. Unlocking value

Key market insights show that infrastructure valuations currently do not fully capture the potential cash flows they generate. Over the past 12 months, essential infrastructure has underperformed global equities by around 20%[1]. A move of this magnitude has only recently been matched by the experience during the pandemic lockdowns of 2020 and 2021, which hit infrastructure such as toll roads and airports particularly hard.

The current disconnect could be an opportunity for investors as these assets are expected to be re-rated on the back of improved earnings. The market does not currently adequately reflect the profitability boost expected from inflationary revenue increases, nor does it fully appreciate the longer-term benefits from issues such as energy transition and technological advances such as the transition from 4G to 5G mobile technology.

1 - Sources: Ausbil, Bloomberg, January 2024

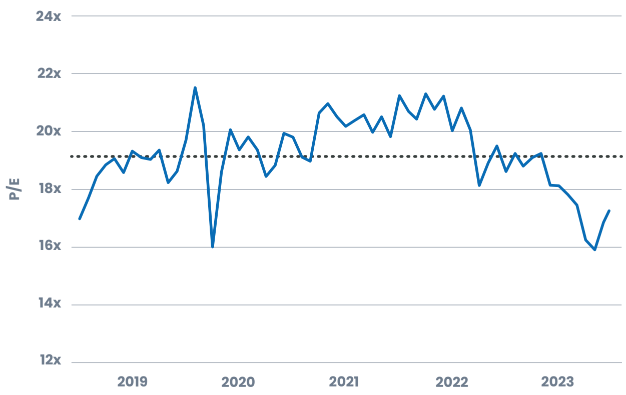

After a rough few years due to the pandemic, the infrastructure sector is looking up since the inflationary boom.

Valuation discrepancies in infrastructure

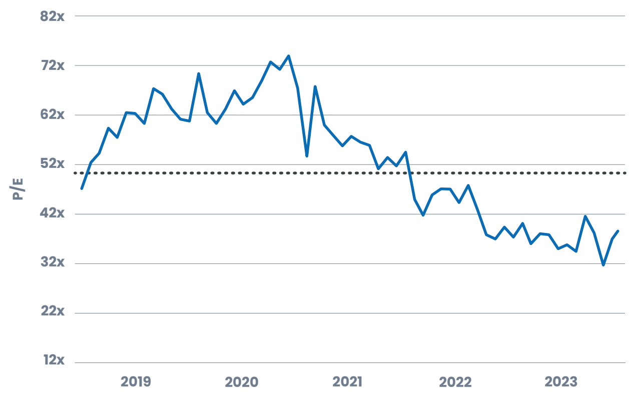
PE ratio ••• Period average

Here are four infrastructure sectors that are trading below their average price-to-earnings ratio since December 2018, despite exhibiting different trends over the period.

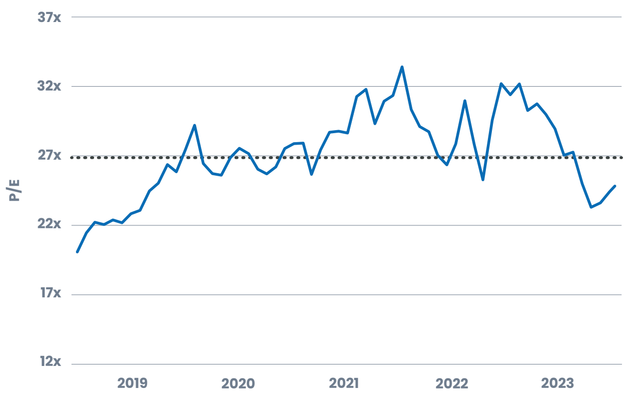
Essential infrastructure (universe)



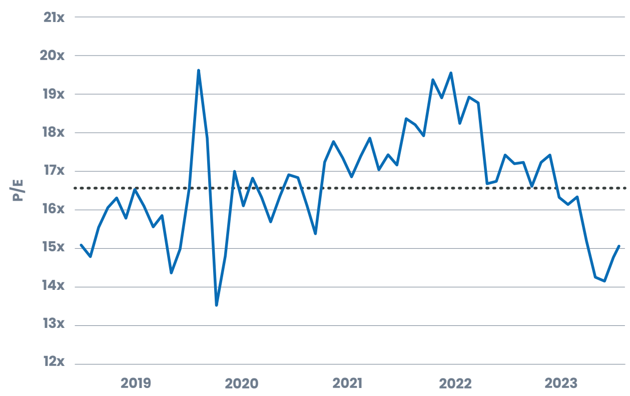
Mobile phone towers



Water utilities



Electrical utilities



PE ratio: Price to Earnings is the ratio of share price of a stock to its earnings per share. It is one of the most popular valuation metric of stocks

Past performance of a given financial instrument or index or an investment service or strategy, or simulations of past performance, or forecasts of future performance do not predict future returns.

Sources: Ausbil, Bloomberg, January 2024

4. Navigating risks

The main risks to infrastructure investment are linked to the broader economy. If inflation rises and central banks continue to raise interest rates, this could make infrastructure investments less attractive. A rise in real bond yields could have a similar effect. While we think interest rates and bond yields could level off soon, we're keeping an eye on various scenarios to be prepared.

In addition, if the economy accelerates but inflation remains low, investors may shift from defensive assets to those that perform better in a growing economy. This could affect the way people invest in infrastructure. We're also looking at how individual companies manage their debt and deal with rising costs due to inflation, especially in industries such as airports.

5. Looking ahead

Over the next twelve months, there are potential opportunities in key infrastructure investments. Our outlook for essential infrastructure next year is supported by three main factors.

First, the current underperformance of global equities offers significant potential for valuation gains. Second, the full impact of recent inflation has yet to be felt in revenues and cash flows, with ongoing inflation likely to drive future profitability. Finally, enduring growth drivers such as the energy transition, technological shifts such as the transition from 4G to 5G, and the influence of AI offer compelling opportunities for infrastructure investments.

Despite recent challenges, the infrastructure sector offers potential for investors. Companies in the sector may benefit from inflation-linked revenue adjustments, which promote financial stability. Certain industries, such as clean energy, telecommunications, and transport, offer growth prospects driven by rising demand and technological advances. With current valuations understating their potential, infrastructure assets could be an opportunity for investors seeking long-term growth and an inflation hedge.

3 infrastructure sectors to watch

Ride the Green Grid Wave

While the goal of reducing carbon emissions through renewable energy alone is laudable, achieving this goal by 2050 will require significant investment not only in renewable energy, but also in electricity grids. Energy infrastructure companies play a vital role in facilitating this transition.

Transition to 5G Networks

The transition to 5G networks marks a critical juncture in communications technology. The need for denser networks to support 5G offers investment opportunities, particularly for mobile tower companies that stand to benefit from the expansion of high-speed networks and rising data demand.

Potential in Water Utilities

With a growing need for investment in water and wastewater infrastructure, water companies present an appealing combination of steady returns and potential for growth. These returns are supported by regulatory allowances set based on prevailing returns for infrastructure assets.

Source: Ausbil, January 2024

Insights from our fund managers

Exploring Potential Opportunities in Electricity, Telecoms and Water

Tim Humphreys, Head of Global Listed Infrastructure at Ausbil, provides insights into the growth potential of some of the sector's key areas. He highlights opportunities in electricity transmission networks, telecommunications with the advent of 5G, and water infrastructure as investment needs increase.

Where do you see potential opportunities in infrastructure in the coming year?

Tim Humpreys: We believe that current infrastructure valuations do not adequately reflect the substantial cash flows generated by infrastructure assets. According to our scenario and estimates, sectors such as regulated water utilities, electric utilities and mobile phone towers offer upside potential comparable to that seen during the pandemic. In these areas, revenues are rising due to inflation and driven by the growth prospects of energy transition, 5G technology, electrification, artificial intelligence (AI) and increasing demand for essential services such as water.

Why do you see potential in the electricity grid sector?

T.H.: This sector offers potential due to the global energy transition. As countries seek to decarbonise their economies, there is a growing need to integrate renewable energy sources into the grid. This will require significant investment in electricity transmission infrastructure to connect and accommodate the increased renewable energy capacity. Companies operating in this sector are forecast to grow as they expand their regulated asset base to support the energy transition.

How do you see the prospects for the telecoms sector as 5G networks develop?

T.H.: The outlook for the telecoms sector looks promising as 5G networks continue to evolve. 5G is a major step forward in communications technology, offering faster data speeds, lower latency and increased capacity. As the rollout of 5G networks progresses, there will be increased demand for infrastructure, particularly cell towers and small cells, to support the densification of networks. This presents opportunities for companies that lease space for telecommunications equipment.

Can you comment on the investment potential in the water infrastructure sector?

T.H.: The critical role of water services and the need to upgrade infrastructure make the water infrastructure sector attractive. Water utilities, which typically operate as monopolies, provide essential services such as drinking water supply and wastewater treatment. As water infrastructure ages and environmental concerns escalate, there is an urgent need for long-term investment to improve resilience and address challenges such as water quality and leakage rates.

€144 B

AUM at end June 2023*

+600

Experienced and committed professionals

+ 25 years

Leading the way in sustainable investing

*As of 30/06/2023, Candriam changed the Assets Under Management (AUM) calculation methodology, and AUM now includes certain assets, such as non-discretionary AUM, external fund selection, overlay services, including ESG screening services, [advisory consulting] services, white labeling services, and model portfolio delivery services that do not qualify as Regulatory Assets Under Management, as defined in the SEC's Form ADV. AUM is reported in USD. AUM not denominated in USD is converted at the spot rate as of 30/06/2023.

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