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STRATEGIES FOR SUCCESSFUL INVESTING

MARKET WISDOM

Infrastructure: stable in volatile times

RARE FINDS

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By 2030, the global middle class population is expected to surge to 1.15 billion people, prompting the need for US$50 trillion worth of infrastructure investment over the next 15 years, according to the Organization for Economic Co-operation and Development, or OECD[1]. This is one of many reasons why interest in infrastructure investing is growing with both retail and institutional investors.

WHAT IS INFRASTRUCTURE?

Infrastructure refers to the "bricks and mortar" assets and networks that provide essential services to communities around the world. It includes utilities such as gas, electricity and water networks and transport infrastructure such as ports, airports, rail and roads.

Infrastructure companies own infrastructure that are often monopolies governed by regulation or exclusive contracts with governments. Their revenues are generally predictable, determined by their asset base and often linked to inflation. This means that these companies get paid to make their assets available to a market with built-in consumer demand because they provide essential services to communities and economies.

Infrastructure assets are expensive to build and require significant capital. However, these assets have very long lives, and therefore the initial capital cost can often be paid off over a period of decades. As a result, capital providers (including investors such as our firm, RARE Infrastructure) earn a return on their invested capital. In respect of utility assets, this is calculated by the infrastructure asset base multiplied by the allowed returns as determined by the regulator (i.e., Return on Capital). Over time, investors should also receive their capital back as these infrastructure assets are depreciated over their useful lives (i.e., Return of Capital).

SIMILAR TO A MORTGAGE

This concept is similar to a mortgage on a house. The bank (the capital provider) receives interest and principal payments over a defined period until the original capital is fully repaid. An infrastructure asset, such as an

Infrastructure's key investment characteristics

- Attractive, risk-adjusted returns in a diversified portfolio
- Defensive characteristics as revenues are derived from making assets available for the delivery of essential services
- Low correlation and volatility compared with traditional asset classes
- Stable long-term yields, with the potential for capital growth
- Reliable inflation-linked returns

electricity network, can be thought of as a "perpetual asset," even though it comprises many individual assets that will need replacing or upgrading over time.

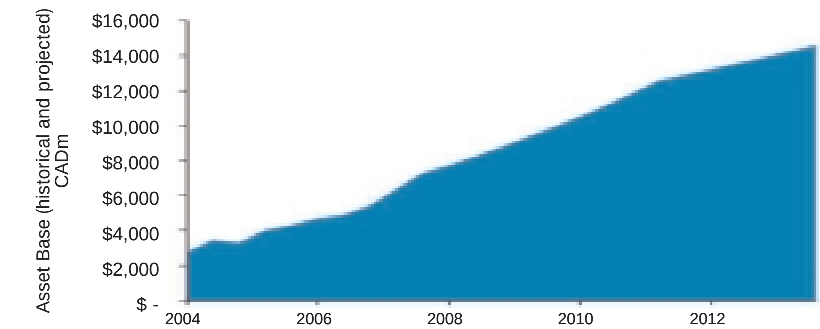
The graphic below shows a simplified breakdown of the components of regulatory revenue often used as a model for the remuneration of utility companies. The system of regulation (similar in concept around the world) means that investing in infrastructure assets provides not only a return on the capital invested, but also a return of the capital invested over the life of the infrastructure assets.

INFRASTRUCTURE IS NATION BUILDING

Good infrastructure efficiently provides key services, and improves economies' competitiveness and productivity. The development, ongoing maintenance and replacement of these long-term assets necessitates large capital spending programs, which ultimately creates jobs.

Infrastructure is critical for a community's long-term economic prosperity. Good infrastructure helps attract investment. For example, companies that build new factories trigger the necessity of good port, road and rail infrastructure and steady power and gas supplies—all positive for a community's long-term health. Infrastructure investment promotes jobs, taxes and ongoing economic development. As a result, many emerging markets consider infrastructure investment key to allowing their countries to emerge and many developed countries refer to their infrastructure investment plans as "nation building."

Past and Projected Asset Base for Emera (Nova Scotia electricity provider)



Source: RARE Infrastructure

WHY IS INFRASTRUCTURE AN ATTRACTIVE INVESTMENT?

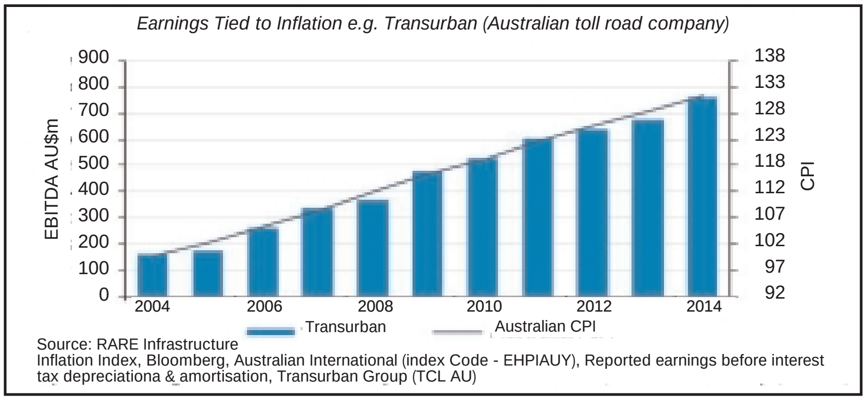
Listed infrastructure is comprised of publicly-traded securities of companies—such as **Emera Inc.**; see chart above—that own infrastructure assets. These assets produce relatively stable income income (dividends) and growth in capital as their assets grow in value.

At RARE Infrastructure, our key goals are to build and manage portfolios of investments that exhibit attractive risk/return characteristics, liquidity and superior medium- to long-term returns. Our view is that over the medium- to -long-term, infrastructure should provide a low double-digit return with a lower volatility than global equities. While you can't have a return without having some risk, we have an absolute return focus.

Our approach is to select companies, such as a U.S. utility or an Australian toll road or a European airport, that offers the best return for the lowest risk. Determining risk is critical to our investment decisions and enables us to take a long-term investment view. One of the benefits of this active approach is that it allows us to move between the more defensive utilities and the more GDP-leveraged toll roads, ports and rail

Simplified Components of Regulated Revenue

Capital Providers (Investors) ←	Return on Capital (like interest) ←	Asset Base x Allowed Return
	Return on Capital (like principal) ←	Depreciation
Operating Company Employees & Suppliers ←	Operating Costs ←	Based on discussions between company and Regulator



companies, depending on where an economy is positioned in the economic cycle.

LOWER VOLATILITY

When economies experience periods of weakness, the revenues of listed infrastructure stocks, unlike many industrial companies, tend to be resilient because the services their assets provide are still essential; consumers continue to use water, electricity and gas for heating, cooling and lighting, drive their cars on toll roads and use other essential infrastructure. This stable earnings profile results in a low volatility in earnings, which means a low volatility in returns and a stable dividend profile that should provide a solid income for investors.

ATTRACTIVE INCOME YIELDS

Listed infrastructure generally comprises mature-stage assets, which provide steady inflation-linked income distributions due to the stable and predictable earnings of the underlying assets.

As an example, **Consolidated Edison Inc.** (NYSE-ED), a company that provides gas and electricity distribution and retail, to areas in the northeastern U.S., primarily New York City, has seen its dividends per share grow in value since 1990.

INFLATION HEDGE

A natural hedge against inflation exists for many infrastructure assets such as gas, electricity, water and toll roads through tariff movements or toll increases that are explicitly linked to inflation. (See the chart above for Australian toll road firm **Transurban**.)

As governments worldwide find it increasingly difficult to pay for essential infrastructure, the private sector is stepping in to build, own and operate these facilities. This evolution continues to provide new opportunities for investors in the listed infrastructure space—a compelling addition to any portfolio. ▼

1 Croce, R. D. (2011), "Pension Funds Investment in Infrastructure: Policy Actions," OECD Working Papers on Finance, Insurance and Private Pensions, No. 13, OECD Publishing.