STIFEL

Ecofin Global Utilities & Infrastructure Trust

EGL.LN – LSE; EGL.L

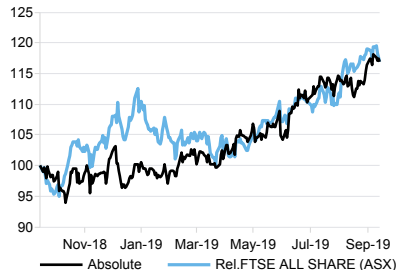
September 13, 2019 Investment Funds

POSITIVE

INITIATION OF COVERAGE

Price (12 September 2019)		149p
Changes	**Previous**	**Current**
Rating	-	POSITIVE

Share price performance (indexed)



Key data

Bloomberg/Reuters codes:	EGL LN / EGL.L
Market cap (£m)	137
FTSE ALL SHARE	4,035
12mths perf (%)	15.5
12mth high-low (p)	152 - 120

Key financials

Price (p)	149
NAV est at 12/09/19 (p)	170
Discount to 12/09/19 NAV est (p)	12
2019 FY dividend estimate (p)	6.4
Dividend yield (%)	4.3
Last quarterly dividend (p) and ex-div date	1.6; 01/08/19

Price as of close on 12 September 2019

All sources unless otherwise stated: Company data, FactSet, Stifel estimates

International infrastructure, 12% discount, 4.3% yield

Summary

This trust offers something different to both the PFI and debt infrastructure funds with its focus on listed equity investments in the infrastructure and utilities sectors on a global basis. It is well diversified geographically with only 11% of assets in the UK. Therefore, it is much less exposed to the UK political and nationalisation nervousness than some of the PFI funds. It also offers an attractive dividend yield of 4.3% and appears to be mispriced on a 12% discount.

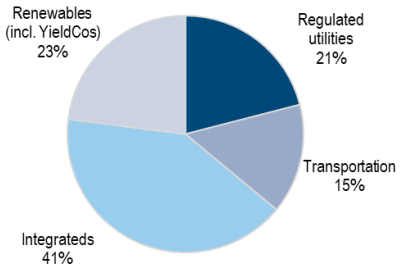
Key Points

Figure 1: Top 10 holdings at 31/08/19

10 largest holdings at 31/08/19	% of portfolio	Country
NextEra Energy	6.2	US
Iberdrola	5.0	Spain
Enel	4.7	Italy
EDP	3.9	Portugal
Engie	3.8	France
Exelon	3.7	US
RWE	3.7	Germany
NextEra Energy Partners	3.7	US
Covanta	3.5	US
National Grid	3.3	UK
Total	**41.5**	

Source: Company data

Figure 2: Sector allocation (% portfolio) at 31/08/19



Source: Company data

Offers something different: The portfolio has c.40 equity investments from a global universe of c.300 companies. The focus is on US and European companies, which have the ability to generate strong income and capital growth. The manager takes an active approach in terms of turnover and use of leverage, which is typically c.10% of NAV.

Dividends: The trust pays quarterly dividends and is on course to pay a 6.4p total full year dividend, with a yield of 4.3%. The revenue earnings are supplemented by some payment from capital; however, dividend cover should increase materially from 0.75x last year to c.0.85x to 0.9x in the year ahead, reflecting portfolio dividend growth and a reduction in fees and expenses.

Key Positives: 1) Very experienced management team in this specialist sector, 2) sector potentially has low volatility and low beta characteristics, 3) 4.3% dividend yield, and 4) low UK exposure means relatively low nationalisation risk, compared with UK PFI funds. **Key Negatives:** 1) Leverage facility is via a prime brokerage account, rather than a term loan – the positive is this is low-cost leverage, however, if the prime brokerage facility became unavailable, replacement leverage may be more expensive, 2) dividend paid is 0.75x covered by revenue EPS - however, cover should increase given reduced expenses and dividend growth expectations on underlying investments, and 3) the low UK weighting (11% of portfolio) means there can be some NAV volatility due to currency.

Initiate with Positive recommendation: We think this trust is doing a good job providing investors with exposure primarily to non-UK infrastructure and utility investments. The track record is good, with a one-year NAV total return (to 31/08/19) of +21.9% and two-years +25% (vs S&P Global Infra Index +13.4%). We don't think the market has fully realised this trust has a clean, simple structure following its birth post the *Ecofin Water & Power* reconstruction in 2016. The 12% discount and 4.3% dividend yield are attractive, in our view. With the trust only having 11% of assets in the UK, it is less vulnerable to nationalisation worries and political sensitivity than the PFI Infrastructure sector. We initiate with a Positive recommendation. *Continued overleaf...*

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Completed: 13 September 2019 02:32EDT
Disseminated: 13 September 2019 02:32EDT

Ecofin Global Utilities & Infrastructure

Offers something different

This trust offers an alternative to both the PFI Infrastructure funds and also the debt infrastructure funds with its sole focus on listed equity investments in the infrastructure and utilities sectors on a global basis. It is well diversified geographically, with only 11% of assets in the UK. Therefore, it is much less exposed to the UK political and nationalisation nervousness than some of the PFI funds. It also offers an attractive dividend yield of 4.3% and appears to be mispriced on a 12% discount.

Portfolio

The portfolio has around 40 equity investments, and we set out the full list in Figure 6. The trust has a relatively broad remit and is able to invest in:

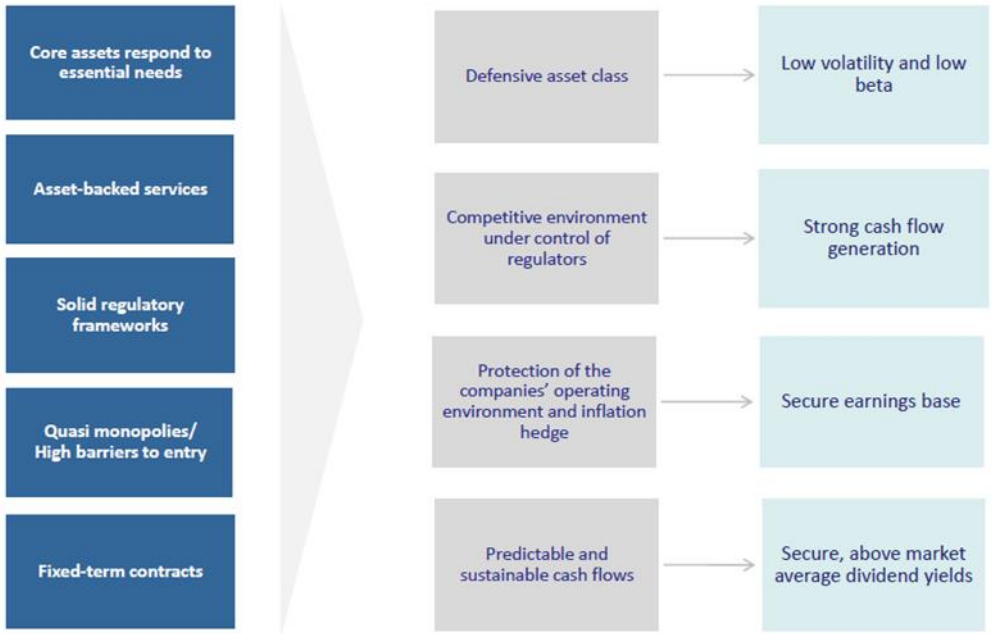
1) **Transport** – including roads, railways, ports and airports;

2) **Utilities** – including generation and distribution of gas, electricity and liquid fuels together with renewable energy;

3) **Water & environment** – water supply and wastewater together with environmental services.

The sector exposures are shown in Figures 12 & 15. There are a number of characteristics, which are set out in Figure 3, that make economic infrastructure and utilities an attractive asset class for investors. Included among these characteristics are the assets being relatively defensive and exhibiting low volatility and low beta.

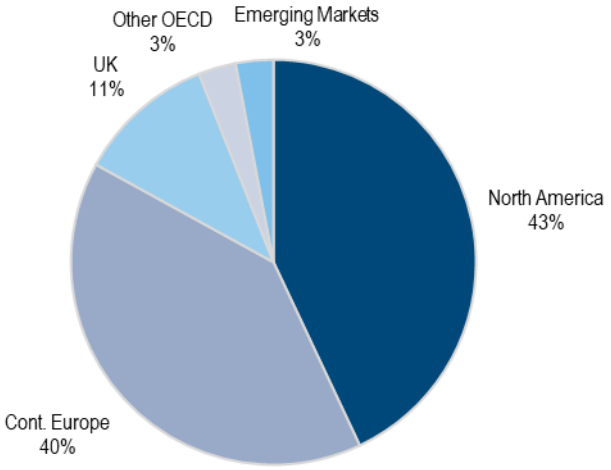
Figure 3: Common characteristics of economic infrastructure and utilities



Source: Company data

Internationally diversified

Figure 4: Geographic allocation (% of portfolio) at 31/08/19



Source: Company data

Europe and the USA are the key focus

The portfolio is primarily focused on U.S. companies, which represent 43% of the portfolio. The next largest segment is European businesses, which comprise 40%. The managers say that the key countries are France, Italy and Spain which each represent between 8% to 10% of the portfolio. Germany and Portugal both represent a further c.6% each and there is also a small investment in Switzerland. The UK only accounts for 11%, with the remainder being other OECD countries at 3% and emerging markets at 3%. A maximum limit of 60% of the portfolio can be invested in the USA, and no other country can be more than 40% of NAV. The limit for exposure to emerging markets is 10% and the manager says they reduced exposure a year ago, given trade war issues. Investments are normally in equities, with an upper limit of 10% for fixed-income investments. The manager says there are currently only two investments classed as 'quasi-equity', and these are in the USA.

Potential investment universe of 300 companies

The manager says the trust has exposure to a relatively large universe of approximately 300 companies – around half of those are in North America, about 100 are in Europe, including the UK, and another roughly 50 companies are in Asia, and the emerging markets. The manager has chosen to invest in around 40 of these companies, which equates to less than 15% of the potential universe. The trust can hedge currencies, but does not generally do this. At times, there can be some 'natural hedge' when the manager borrows in currencies that match the underlying assets. However, with leverage typically only around 10% of NAV, this has a limited impact. Therefore, there can be some volatility in the NAV at times of significant currency moves, as we have seen in the past year.

In the Appendix at the back of this note, we set out the monthly evolution of the portfolio in terms of geographic and sectoral exposure, over the past year.

Portfolio of investments

Largest 10 investments are 45% of NAV…a relatively high conviction approach

In terms of concentration, the largest 10 investments will typically account for 35% to 45% of the portfolio. The largest ten investments are disclosed monthly - at 31/08/19, 41.5% of the portfolio was accounted for by the largest 10 investments, and this is equivalent to 44.6% when expressed as a percentage of NAV, with this taking into account the impact of the trust's 7.5% leverage (Figure 5). The manager also publishes the vast majority of the names in the portfolio on a 6 monthly reporting basis and we set this out in Figure 6. They say that since this date there have been fairly few changes in the company names in the portfolio and a further detailed list of investments will be published with the finals to 30/09/19.

Largest 10 portfolio investments at 31/08/19

Figure 5: 10 largest investments at 31/08/19 (% of portfolio)

Holding	% of portfolio	Country
NextEra Energy	6.2	US
Iberdrola	5.0	Spain
Enel	4.7	Italy
EDP	3.9	Portugal
Engie	3.8	France
Exelon	3.7	US
RWE	3.7	Germany
NextEra Energy Partners	3.7	US
Covanta	3.5	US
National Grid	3.3	UK
Total	**41.5**	

Source: Company data

Detailed list of significant portfolio holdings at 31/03/19 (interim results)

Figure 6: Portfolio holdings at 31/03/19

Company	Country	Fair value £'000	% of investments
NextEra Energy	United States	9,661	6.3
Enel	Italy	7,172	4.6
Exelon	United States	7,095	4.6
Iberdrola	Spain	6,870	4.4
EDF	France	5,813	3.8
Covanta	United States	5,694	3.7
Terraform Power	United States	5,543	3.6
RWE	Germany	5,354	3.5
NextEra Energy Partners	United States	5,218	3.4
National Grid	UK	5,038	3.3
Top ten investments		**63,458**	**41.2**
Algonquin Power & Utilities	Canada	4,934	3.2
Public Service Enterprise Group	United States	4,707	3.0
EDP-Energias De Portugal	Portugal	4,513	2.9
Williams Companies	United States	4,504	2.9
SSE	UK	4,385	2.8
Ferrovial	Spain	4,306	2.8
American Electric Power	United States	4,157	2.7
DTE Energy	United States	3,711	2.4
Pennon Group	UK	3,670	2.4
Suez	France	3,588	2.3
Top twenty investments		**105,932**	**68.6**
Flughafen Zurich	Switzerland	3,508	2.3
E.ON	Germany	3,454	2.2
Evergy	United States	3,228	2.1
Engie	France	2,991	1.9
Uniper	Germany	2,987	1.9
Snam	Italy	2,917	1.9
Sempra Energy	United States	2,808	1.8
APA Group	Australia	2,666	1.7
Drax	UK	2,596	1.7
ENAV	Italy	2,558	1.7
Top thirty investments		**135,645**	**87.8**
Other investments: Ten companies		18,886	12.2
Total number of investments: 40		**154,531**	**100**

Source: Company data

Key attributes of investments

Companies investing in their businesses to enable future dividend growth

The manager is looking for essential assets and services that have an onus on modernising and improving their offering in order to cater to the growth in renewable and clean energy. This is reflected in the portfolio, and some of the trust's best performing investments over FY18 were clean energy suppliers, with capex focused on "grid modernisation, reliability and inter-connection", such as *NextEra Energy*, *Exelon*, *Covanta* and *NextEra Energy Partners*. The manager hopes that by investing in companies that are committed to improving their business – such as *Public Service Enterprise Group,* which will invest over $15bn in upgrades over the coming years – this will come full circle and enable dividend growth in the future.

Portfolio activity

Active approach

The manager aims to take an active 'hands-on' approach to managing the portfolio, and they say that turnover has been around 35% of NAV over the past year. This has actually come down from the previous year to 30/09/18, when it was close to 100% of NAV. The higher turnover in that year reflected some market volatility and valuation opportunities around the U.S. tax reform process. The manager will actively trim and add to positions according to valuations and market conditions.

Dividend & revenue account

Quarterly dividends paid

The trust pays dividends on a quarterly basis, and in the last financial year to 30/09/18, the dividend totalled 6.4p. In the current year to 30/09/19, three quarterly dividends of 1.6p have been paid, which is at the same quarterly rate as in the prior year, and we assume a total FY 2019 dividend of 6.4p. The FY 2018 revenue EPS was 4.8p, which meant that the dividend was 0.75x covered by net revenues, with the shortfall covered by drawing on the capital account (i.e. NAV). Whilst this is not ideal, we do note that many investment trusts are now supplementing their dividends from revenue earnings with some payment from capital.

Dividend cover should increase….

We also think that dividend cover should increase materially going forward, potentially being fully covered in a year or two. For example, in the past six months, expenses have been reduced, with the trust no longer paying research related costs. Also, the annual management fee has been reduced from 1.25% of NAV to 1.0% of NAV. The manager also expects to see dividend growth from the underlying portfolio companies of around 6% to 8% p.a. If we assume the trust's dividend increases by a smaller percentage than this 6% to 8% p.a., this will allow cover to increase over time. It seems reasonable to assume a cover level of around 0.85x to 0.90x in the year ahead. The Trust was set-up in September 2016 following the reconstruction of a previous trust (*Ecofin Water & Power Opportunities*), and in the relatively short period since launch, it has not accumulated revenue reserves. However, it does have distributable reserves – i.e., a 'special reserve' that can be used to fund dividends, which are not fully covered by revenue earnings. In the year to 30/09/18, this transfer totalled £1.5m, with £120.6m retained in the 'special reserve'. This reserve can also be used to fund the cost of share buybacks.

Management team

Tortoise acquired Ecofin

In December 2018, the manager of the trust, Ecofin Ltd, was acquired by Tortoise Investments, a privately-owned U.S. investment management firm. It is a specialist investor in energy infrastructure and manages some US$20bn of client funds. The team responsible for this listed trust are based in London.

Very experienced management team

The portfolio manager is Jean-Hugues de Lamaze, who has 29 years of experience in equities and utilities/infrastructure investments. This includes 12 years as a fund manager and 17 years as a sell-side research analyst. He has worked at Tortoise/Ecofin since 2008. Mr. de Lamaze is assisted by a team of five analysts, covering their respective regions. The portfolio manager sits on, and is assisted by, an investment advisory committee composed of three other individuals.

Performance

Figure 7: Ecofin Global Utilities & Infra Performance since admission (26/09/16) to 31/08/19

(all total returns in £)	1 M %	3 M %	6 M %	1 Y %	2 Y %	Since admission (26/09/16) %
Net Asset Value	**+4.1**	**+12.5**	**+19.9**	**+21.9**	**+25.2**	**+39.3**
Share Price	**+2.8**	**+13.5**	**+18.9**	**+22.9**	**+23.2**	**+53.3**
FTSE All-Share Index	*-3.7*	*+1.8*	*+4.1*	*+0.2*	*+5.1*	*+17.8*
FTSEASX Utilities	*+1.7*	*+5.3*	*-1.3*	*+1.2*	*-10.3*	*-14.4*
MSCI World Index	*-1.6*	*+9.0*	*+13.4*	*+7.4*	*+21.6*	*+41.7*
MSCI World Utilities Index	*+3.7*	*+11.0*	*+18.0*	*+24.8*	*+24.4*	*+39.8*
S&P Global Infrastructure Index	*+0.8*	*+7.8*	*+15.8*	*+18.4*	*+13.4*	*+30.3*

Source: Company data

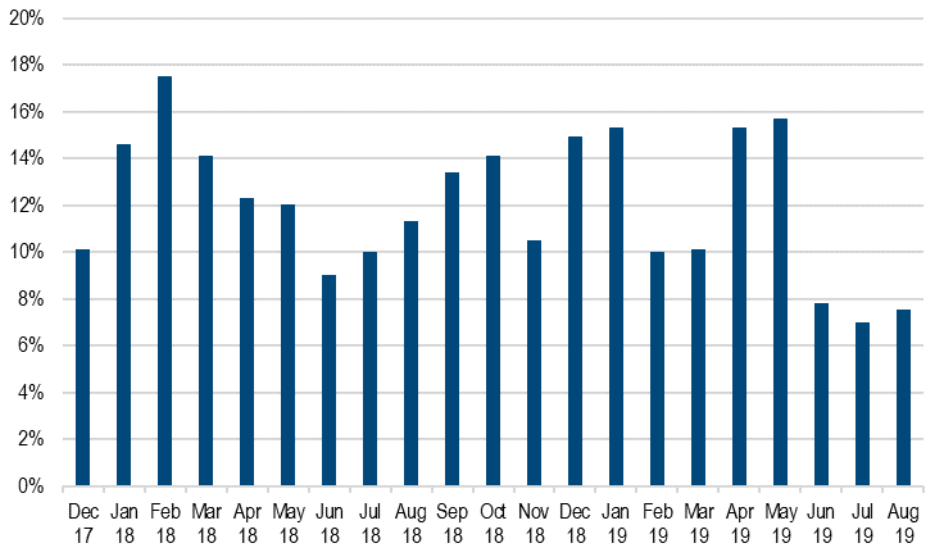
Strong period of returns

Since the trust's launch in September 2016, the returns have been strong in the period to 31 August 2019 (Figure 7). The NAV total return (TR) has risen by +39.3%. The trust does not have a formal benchmark, given the lack of a 'good-fit'. However, it does use two comparative indices – over the same period, the *S&P Global Infrastructure Index (£)* is up +30.3% and the *MSCI World Utilities Index (£)* has risen +39.8%. Whilst some infrastructure and utilities companies have performed relatively strongly over this three-year period, the manager's stock selection does also appear to have added value, given the performance ahead of the comparative indices. The trust's typical leverage of c.10% (of NAV) has also been helpful to returns during this period. The more recent one-year returns have also been good, with the NAV TR +21.9% in the year to 31/08/19, with this focus on long duration infrastructure business models relatively defensive at the latter stages of the economic cycle. The sector's relatively attractive yields also appear to be in demand at a time of falling global interest rates.

Structural issues

Leverage

Figure 8: Ecofin Global Utilities & Infra: monthly net leverage from December 2017 to August 2019 (% of NAV)



Source: Company data

Active use of leverage

The managers are proactive with their use of leverage in the trust. We think this is appropriate, given that it is a key structural tool for investment trust managers to use. With the trust being able to borrow money at LIBOR +0.5%, it has also resulted in some yield pick-up, which is helpful for the revenue account, given that portfolio investments typically have a yield of 4% to 5%.

Recent leverage around 10%

The maximum leverage that the trust is permitted to use is 25% of NAV, but it has typically been at levels well below the maximum since it was set-up three years ago (monthly leverage since the start of 2018 is depicted in Figure 8). Over the year to 30/09/18, the average leverage level was 11% of NAV. The weighted average cost of debt is LIBOR + 0.5%. The borrowings are through a prime brokerage

arrangement provided by Citigroup. The trust does not have a fixed-term loan facility in place, and the prime brokerage agreement may be terminated by either party by giving three business days written notice. It is important to note that this is a portfolio of relatively liquid large cap companies and in the unlikely event that the current leverage of c.£12m had to be repaid quickly, this should be fairly easy to achieve. The advantage is this arrangement provides a flexible, low-cost borrowing facility at a relatively modest rate over LIBOR. The disadvantage is that a prime brokerage agreement is less secure than a term loan. If the prime brokerage facility were to be renegotiated or terminated, the trust may not be able to finance its borrowing on as favourable terms. The borrowing costs are allocated 50% to revenue and 50% to capital.

Continuation vote

Overwhelming vote in favour…

At the most recent annual general meeting (AGM) on 5 March 2019, shareholders voted in favour of continuation, with 97.5% of those voting for and 2.5% against. Shareholders representing 29.9% of the shares in issue voted on this resolution. Following this vote, future continuation votes will be held every five years, with the next one due in March 2024.

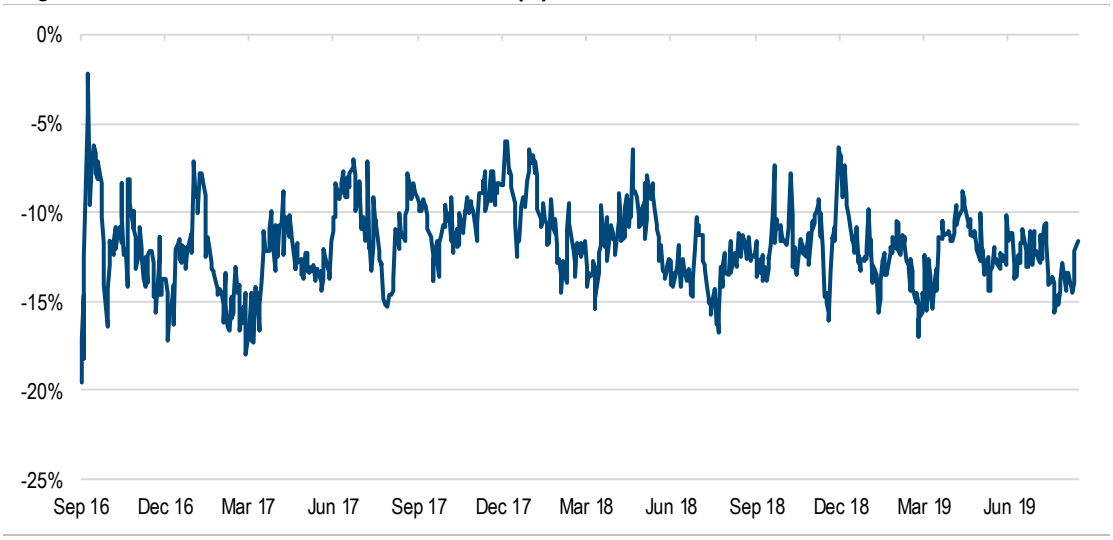
Management fee structure

Fee reduced earlier this year

Following the passing of the continuation vote on 05/03/19, the manager reaffirmed their proposal for the annual management fee to be reduced. Therefore, from March 2019, the management fee was reduced to 1% of the net assets of the trust, compared to 1.25% previously. The trust does not charge a performance fee. In addition, from the same date, the trust has ceased to pay a contribution to the investment manager's research costs (£90,000 to revenue account and £90,000 to capital account). In the year to 30/09/18, the ongoing charges ratio (OCR) was 1.99%, and following the reduction in the management fee it had fallen to 1.67% at 31/03/19 (based on the forecast OCR to the year to 30/09/19). The board says it will continue to focus on expenses, with the intention of continuing to reduce the OCR. A summary of the fee structure is given in the data section at the end of this note.

Valuation, Positives & Negatives & Recommendation

Figure 9: Ecofin Global Utilities & Infra: discount (%) from admission on 26/09/16 to 10/09/19



Source: Datastream

Discount

Factors influencing the discount

The 12% discount appears a bit of an anomaly, given: 1) the trust offers exposure to infrastructure and utilities listed equities, and this is a relatively in vogue area of the market, 2) the dividend yield is 4.3% and 3) the long-term performance record has been good. Investment Trust discounts are simply a function of the daily supply and demand dynamics in the market. We think issues that may have some bearing on this trust's discount include:

1) **Historic structure**: Prior to the reorganisation in September 2016, the predecessor trust had more than one class of capital, including zero dividend preference shares & Convertible Unsecured Loan Stock (CULS), significant leverage as well as investments in unquoted companies. We don't think the market has fully appreciated how different this trust is to its predecessor (*Ecofin Water & Power Opportunities*), given it now has a simple one share class capital structure, simple leverage structure and no unlisted investments.

2) **Marketing and size:** With the trust having a sub-£200m market cap, we realise it is too small to be included in the coverage lists of some institutions and large wealth management firms. However, we think for many of the medium- and smaller-sized wealth management firms, platform investors and retail investors, the trust does offer a viable vehicle from which to gain exposure to global infrastructure investments. We think relatively modest demand for the shares could result in some significant share price re-rating.

Discount controls – buybacks & continuation votes

In terms of discount controls, the board has the ability to repurchase 14.99% of shares in issue, although no shares have been repurchased in the past year. There is a continuation vote at five-year intervals, with the next one due in March 2024.

Key Positives & Negatives

In our view, **Key Positives** include: 1) Very experienced management team in this specialist sector, 2) sector potentially has low volatility and low beta characteristics, 3) 12% discount and 4.3% dividend yield, and 4) low UK exposure means relatively low nationalisation risk, compared with UK PFI funds. **Key Negatives** include: 1) Leverage facility is via a prime brokerage account, rather than a term loan – the positive is this is low-cost leverage, however, if the prime brokerage facility became unavailable, replacement leverage may be more expensive, 2) dividend paid is 0.75x covered by revenue EPS - however, cover should increase given reduced expenses and dividend growth expectations on underlying investments, and 3) the low UK weighting (11% of portfolio) means there can be some NAV volatility due to currency.

Recommendation

Attractive discount and yield in a sector performing well

We think this trust is doing a good job providing investors with exposure primarily to non-UK infrastructure and utility investments. The track record is good, with a one year return (to 31/08/19) of +21.9% and two-year return of +25%. We don't think the market has fully realised how much cleaner and simpler the trust is since it was born out of the reconstruction of *Ecofin Water & Power* in 2016. The 12% discount and 4.3% dividend yield are attractive, in our view. With the trust only having 11% of assets in the UK, it is less vulnerable to nationalisation worries and political sensitivity than the PFI Infrastructure sector. We initiate with a Positive recommendation.

Key data & structural issues

Investment policy

The Company's investment objectives are to achieve a high, secure dividend yield on its investment portfolio and to realise long-term growth in the value of the portfolio for the benefit of shareholders while taking care to preserve capital.

Fund Manager

Jean-Hugues de Lamaze

Board of Directors

David Simpson (Chairman), Iain McLaren, Martin Nègre, Malcolm King

Fee structure

Management fee: 1.0% p.a. of net assets (reduced from 1.25% in March 2019)
Performance fee: There is no performance fee.

Ongoing Charge: 1.67% at 31/03/19 (based on forecast ongoing charges for the year to 30/09/19).

Ability to employ leverage

The maximum level of gearing utilised and the nature and term of any borrowings are the responsibility of the Directors. They have authorised the Investment Manager to maintain gearing of up to 25%. Gearing is the amount of the Company's borrowings less cash, divided by the Company's net assets attributable to shareholders. Gearing at 31/08/19 was 7.5% and comprised a prime brokerage account.

Life & Continuation

Unlimited life; continuation votes to be held at five-year intervals, with the next one at the 2024 AGM.

Discount Controls

There is no formal discount control mechanism targeting a specific discount to NAV. However, the Board will consider using share repurchases to assist in limiting any sustained discount and discount volatility.

Figure 10: Ecofin Global Utilities and Infrastructure 10 largest holdings (% of portfolio) at 31/08/19

Name	% of NAV
NextEra Energy	6.2
Iberdrola	5.0
Enel	4.7
EDP	3.9
Engie	3.8
Exelon	3.7
RWE	3.7
NextEra Energy Partners	3.7
Covanta	3.5
National Grid	3.3
Total	**41.5**

Figure 11: Ecofin Global Utilities and Infrastructure premium (%) from 26/09/16 to 10/19/19

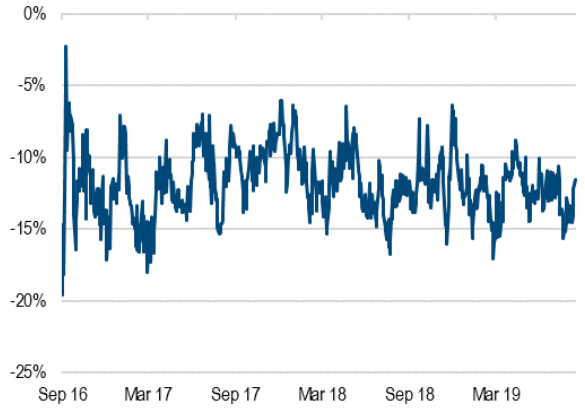
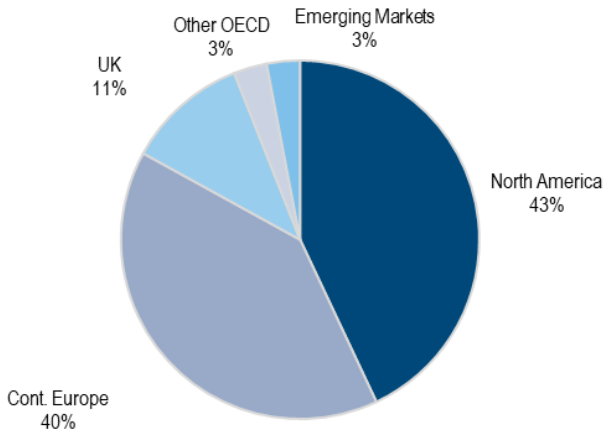


Figure 12: Ecofin Global Utilities and Infrastructure sector allocation (% of portfolio) at 31/08/19

	%
Regulated Utilities	21
Transportation	15
Integrateds	41
Renewables (incl. YieldCos)	23
Total	100

Figure 13: Ecofin Global Utilities and Infrastructure geographic breakdown (% of portfolio) at 31/08/19



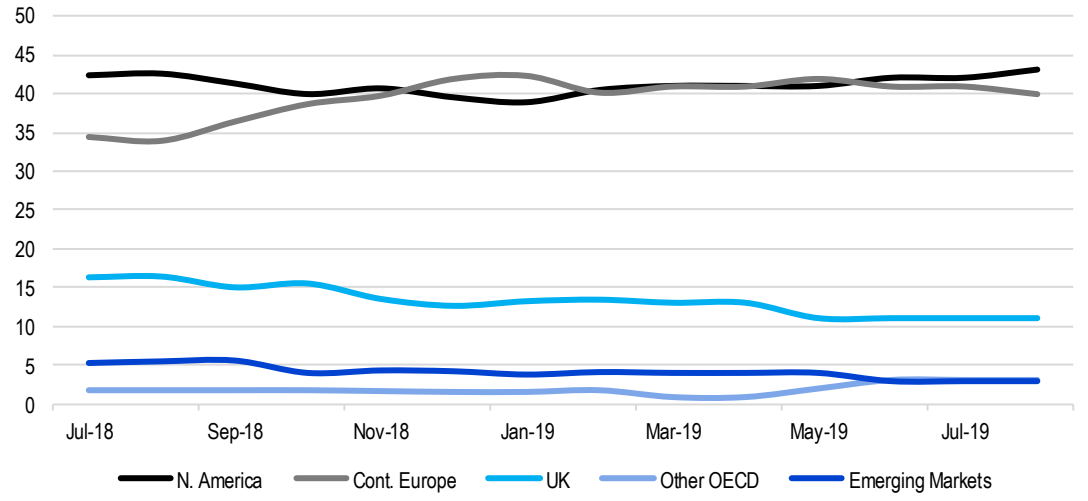
Source for figures: Company data, Datastream

Appendix

In Figures 14 and 15 we illustrate how the portfolio sectoral and geographic split has evolved over the past year. A comparison prior to this date is not possible as the trust changed its geographic and sector definitions prior to July 2018.

Geographic split between July 2018 and August 2019

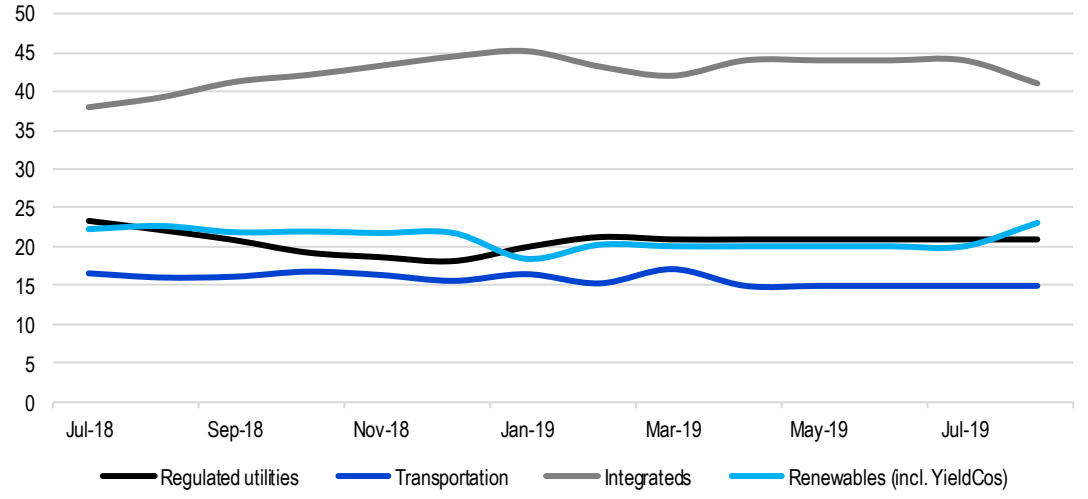
Figure 14: Geographic split from July 2018 to August 2019 (% of portfolio)



Source: Company data

Sector split between July 2018 and August 2019

Figure 15: Sector split between July 2018 and August 2019 (% of portfolio)



Source: Company data

Important Disclosures and Certifications

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