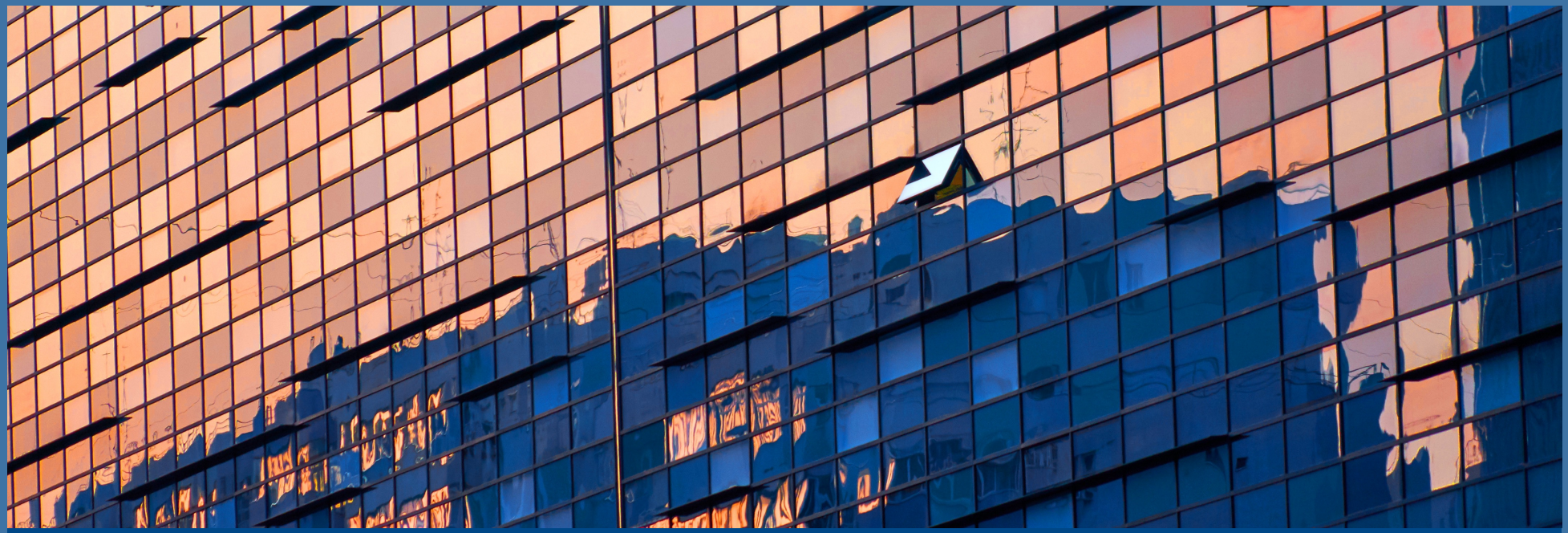


Quarterly valuation update for the energy and infrastructure sector

Q1 2021

mazars

Quarterly valuation update
Introduction

Welcome to the inaugural edition of our quarterly valuation update for the energy and infrastructure sector. This update focuses on some of the main publicly available valuation trends in the sector, covering both debt and equity metrics.

Infrastructure is an increasingly mature asset class, with an increasing number of listed and unlisted funds set up specifically to invest in and manage real assets across the infrastructure and energy sectors. For the purpose of this update, we have constructed two global indices that focus on listed funds, as follows:

- An index of infrastructure funds, currently including 11 funds with activities across 15 countries
- An index of renewable energy funds, currently including 15 funds with activities across 12 countries

While other infrastructure and energy company indices exist in the public domain, they tend to have a broader scope; such is the case for construction companies, transport operators, concessionaires and utilities that gauge sentiment across the sector.

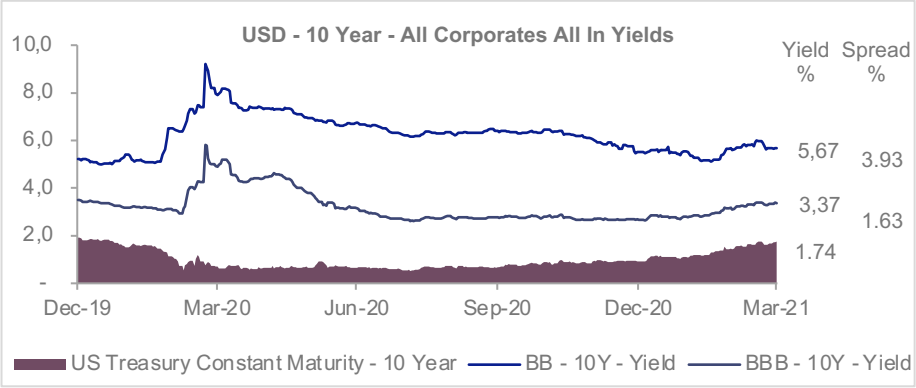
By focusing on pure asset owners, the Mazars indices aim to be more closely aligned with market sentiment on the valuation of these assets, which is reflected in this update and includes a number public statements from funds on how they currently approaching their own valuations.

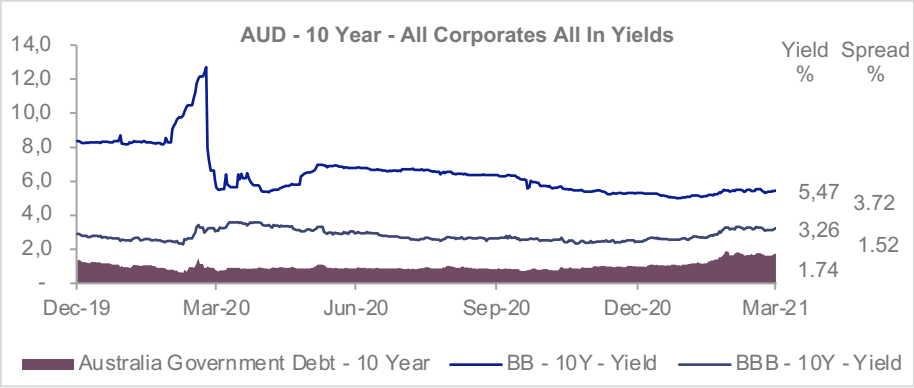
We hope therefore that this update provides a focused and nuanced view on valuation metrics in this domain, helping to advance the knowledge base across the sector.

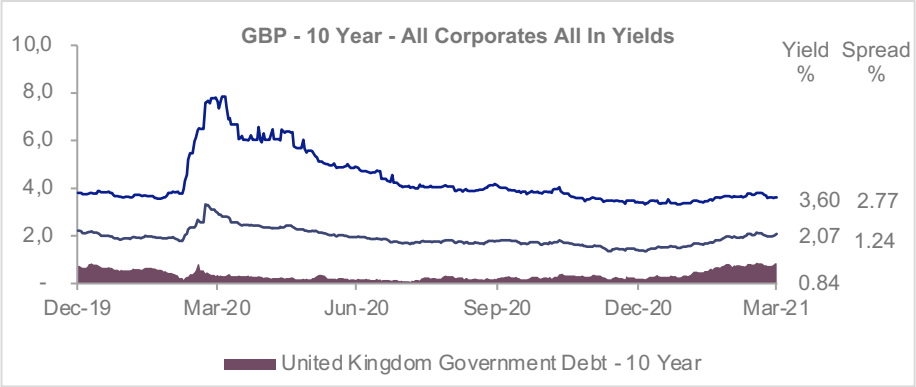
Quarterly valuation update
Debt valuation trends

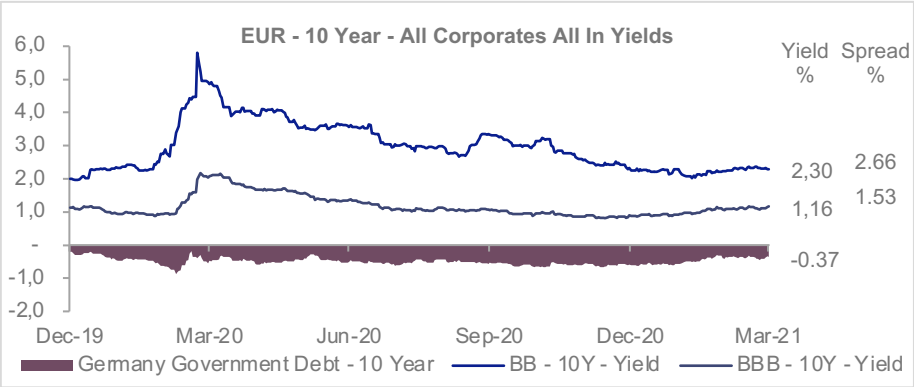
There are emerging signs of underlying pressures in public debt markets that could impact valuations in the sector

- Government bond yields are relevant to valuations because they are often used to inform the risk free rate and influence the cost of debt.
- The graphs below indicate a significant rise in Q1 2021, following a period of very low yields in all markets underpinned by central bank interventions as a response to initial Covid-19 market volatility.
- This has fed into BBB bond pricing: less so to BB grade bonds, but overall pricing remains in line with pre-Covid-19 levels.





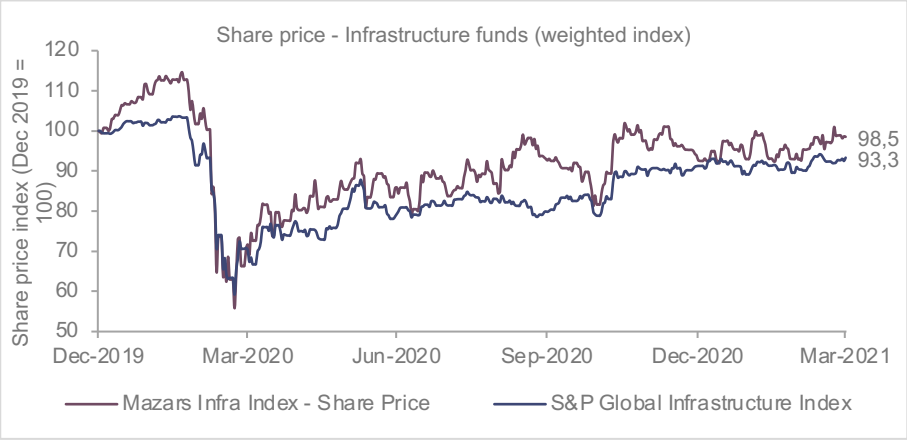




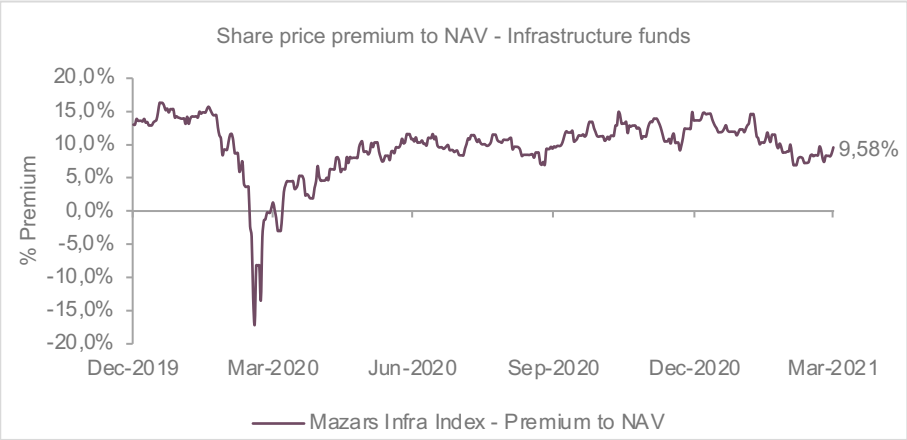
Source: Capital IQ, Mazars analysis

Quarterly valuation update
Equity valuation trends – infrastructure funds

Recent pricing trends relating to infrastructure funds are suggestive of higher asset valuations. This is backed by public statements.



- Following a sharp fall at the onset of the Covid-19 pandemic, the graph to the left shows a recovery in the weighted average share prices for infrastructure.
- Prices have, however, been relatively static since November 2020 and remain below pre-Covid-19 levels. In part, this accounts for net asset values also remaining below pre-pandemic levels.
  - The initial sharp pricing falls may partly be due to general market sentiment, with widespread sell-offs.
  - However, in the infrastructure sector, there was also real pandemic impact for some funds, especially those holding assets with demand risk, such as toll roads and airports.



Source: Capital IQ, Reports from Funds, Mazars analysis

- The second graph shows how the weighted average premium to NAV has generally increased back to historic levels since the onset of Covid-19 . But the decline seen in Q1 2021 (given share prices are holding steady) is a sign of increased asset valuations in the sector.
- This is backed up by comments in the public domain from infrastructure funds suggesting lower discount rates for assets, especially those with lower risk. For instance, HICL recently indicated that sustained demand from institutional investors for the defensive attributes that are typical of core infrastructure has led to the higher asset prices observed from Oct 2020 to Feb 2021.
- Potentially, funds are also starting to look again at cashflow forecasts for assets with demand risk, having cited valuation forecasts significantly during the course of 2020.

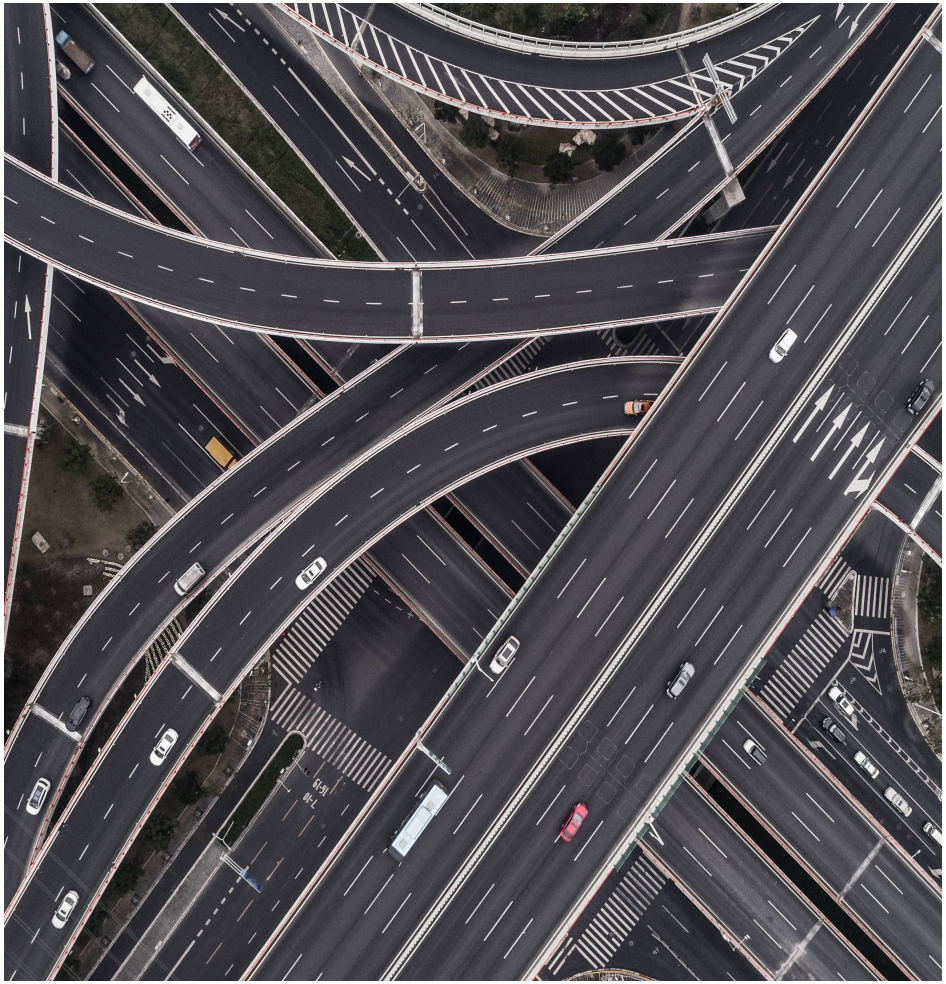
Quarterly valuation update
Infrastructure assets during Covid – contrasting fortunes

"The portfolio continued its strong performance with no material adverse effect on valuation resulting from Covid-19."

BBGI Global Infrastructure S.A.

"Motorway traffic: down 27.1% in Italy, 30.6% in Spain, 24.1% in France, 26.1% in Chile, 8.5% in Brazil and 11.8% in Mexico. Airport traffic: down 76.8% at Aeroporti di Roma and 68.4% at Aéroports de la Côte d'Azur"

Atlantia Spa

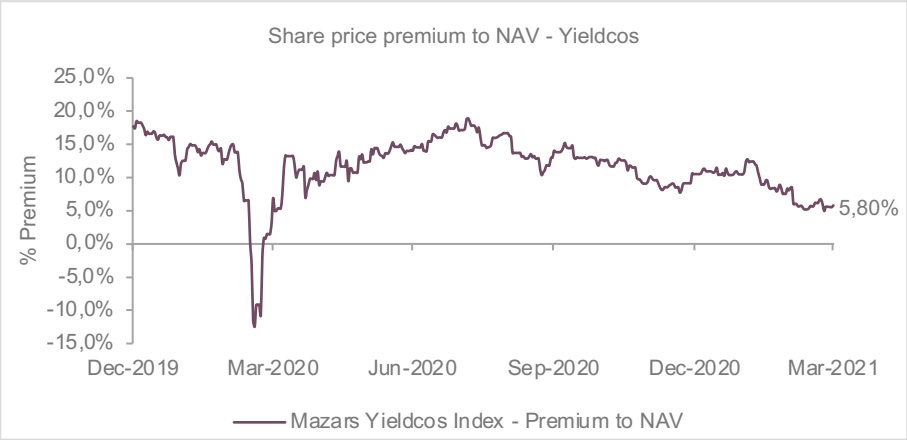


Quarterly valuation update
Equity valuation trends – renewable energy funds

Renewable energy funds have also been writing up valuations of assets. But current share prices suggest investors don't currently see much room for further upside.

Source: Capital IQ, Mazars analysis

- The graph on Mazars Yieldcos Index indicates that the weighted average share prices had already recovered to pre-pandemic levels by May 2020 and then increased steadily over the year to December. Prices have since reduced marginally, but remain higher than they were before the onset of Covid-19.
- The S&P Global Clean Energy Index, which includes companies in global clean energy related businesses from both developed and emerging markets, indicates an explosion of activity in the sector, but is perhaps a less reliable guide to how asset pricing has moved in this period.



Source: Capital IQ, Reports from Funds, Mazars analysis

- Since July 2020, the weighted average premium to NAV has fallen fairly sharply from a peak of nearly 20% to just over 5% by March 2021.
- This is partly explained by rising share prices, with improving market sentiment in the sector reflected in the top graph. But the bigger reason remains rising asset valuations, linked to:
  - Higher power prices – as illustrated by comments shown on the next page
  - More bullish valuation assumptions, such as those around asset life and inflation
  - Lower discount rates, with recent reductions signalled amongst others by Foresight Solar Fund Limited and Octopus Renewables Infrastructure Trust

Quarterly valuation update
Does 2021 signal a power price recovery?

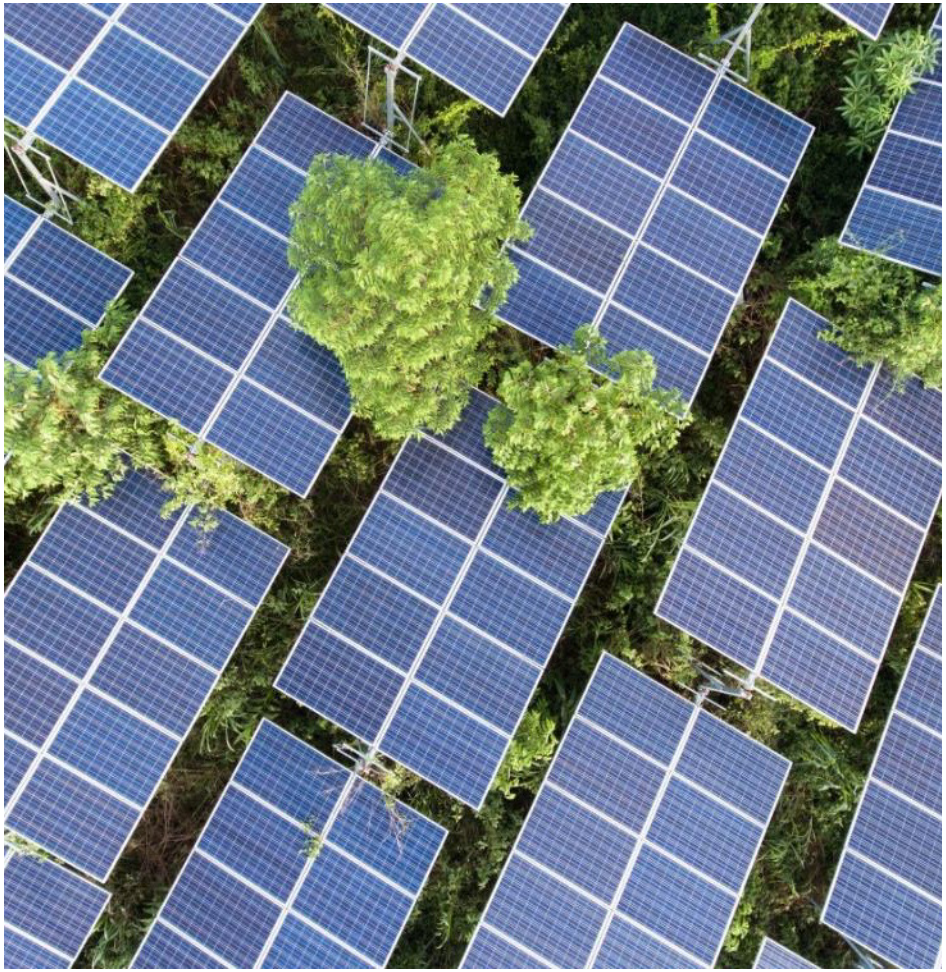
"Despite a recovery in power prices over the second half of 2020, the y-o-y comparison shows a decrease of 10.9% for UK day ahead market base load power price.

Demand is expected to recover faster than envisaged in previous forecasts, resulting in a small increase in near-term prices."

Bluefield Solar Income Fund

"The impact of COVID-19 on the Company has been limited despite shutdown measures reducing US electricity demand by 3.8% during 2020. With the COVID-19 recovery underway in the US, the EIA forecasts electricity demand will increase by 2.1% in 2021."

US Solar Fund Plc



Quarterly valuation update
Conclusions

Three key themes from Q1 2021:

- Higher Government bond yields, but cost of debt remains low.
- Infrastructure funds are signalling reduced discount rates to value assets in lowest risk sectors. Assets with demand risk will see valuations sensitive to passenger or user forecasts, linked heavily to the speed and size of economic recovery post-Covid-19.
- Renewable energy funds have been signalling higher asset valuations for some time, notwithstanding lower power price forecasts. But recent share price reductions, combined with reduced premia to NAV, may be suggesting the market no longer sees significant valuation upside - the potential for short-term recovery in power prices doesn’t change that.

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