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Infrastructure deals are proving attractive sources of return against a background of rising inflation

M&A suitors come a-calling

MARKET VIEW

Peter Meany

Merger and acquisition activity across the infrastructure sector has increased over the past six months due to attractive valuations, low interest rates, strong balance sheets and rising corporate confidence.

Demand for infrastructure is strong from pension funds and unlisted funds seeking assets and the scarce nature of infrastructure means some unlisted funds are acquiring listed companies at big premiums.

Infrastructure companies remain attractive sources of returns in an environment of rising inflation, as many of them have their revenues linked to inflation through regulation, contracts, or operate in less competitive markets with the pricing power to maintain margins.

In the past six months, several infrastructure firms have received takeover offers at significant premiums to their market prices.

The most recent was ConnectEast, which owns the concession to operate a 45km toll road in Melbourne, Australia. The consortium behind the A\$2.4bn (£1.5bn) bid included a number of big pension schemes from Europe, the US, Asia and New Zealand, highlighting the attractive return characteristics of this type of asset.

In July, the board of UK water utility, Northumbrian Water Group, recommended a £2.4bn takeover by Cheung Kong Infrastructure, which is controlled by Hong Kong's richest man Li Ka-shing. The agreed acquisition price was at a 38 per cent premium.

Northumbrian Water has regulatory approval to raise prices in some areas by 8 per cent in the coming year and agreed on price levels with regulators through 2015, giving it good visibility on future income.

The fund also benefited in May from a takeover battle

for US electric utility, Central Vermont Public Service. This company eventually agreed to a takeover offer from Gaz Metro Limited Partnership at a 45 per cent premium.

Over the past four years, our funds have benefited from holding companies that have become takeover targets and we currently hold many high-quality, undervalued names that would be potentially attractive to an M&A suitor.

With financial markets again significantly undervaluing listed infrastructure assets following the recent market sell-off, we expect to see escalating M&A activity from unlisted infrastructure funds, as well as take privates by existing shareholders and corporate transactions.

There is also a trend of governments becoming distressed sellers of infrastructure assets, with forthcoming privatisations giving us the opportunity to pick up high-quality assets at attractive valuations.

This should open the door to a change in mindset from service provider to for-profit. Such assets are typically hindered by a big employee base, limited cost focus, lack of capital investment and limited profit focus or incentives.

Privatisations in the coming months include airports in Madrid, Zagreb and São Paulo, as well as numerous utility, ports, toll roads and railways.

Overall, privatisations and corporate activity have the potential to provide listed infrastructure investors with additional return opportunities above those of the underlying assets.

European austerity measures are leading to heightened uncertainty but despite a difficult global economic environment, inflation protection and structural growth should continue to underpin earnings for global listed infrastructure.

Peter Meany is manager of the First State global listed infrastructure fund