

# MFG Core Infrastructure Fund

(Managed Fund) (Ticker: MCSI)

A low-cost diversified portfolio of 70-100 of the world's best infrastructure companies

Fund Update: 30 June 2021

ARSN: 646 028 131  
APIR: MGE9182AU

## Fund Features

- An actively constructed portfolio of 70 - 100 securities that meet our proprietary definition of infrastructure, rebalanced in a systematic manner
- Highly defensive, inflation-linked exposure
- Investors can buy or sell units on Chi-X like any other listed security or apply and redeem directly with the Responsible Entity

## Fund Facts

Portfolio Manager	David Costello		
Structure	Global Listed Infrastructure Fund, A\$ Hedged		
Objective	Achieve attractive risk-adjusted returns over the medium to long term through investment in a diversified exposure to infrastructure securities that meet the Investment Manager's definition of infrastructure.		
Inception Date	17 December 2009		
Management Fee <sup>1</sup>	0.50% per annum		
Buy/Sell Spread <sup>1,2</sup>	0.15%/0.15%		
Minimum Investment <sup>2</sup>	AUD\$10,000		
Fund Size/NAV Price	AUD \$343.9 million / \$1.5816 per unit <sup>3</sup>		
Distribution Frequency	Semi-annually		
Chi-X Ticker	MCSI		
iNAV tickers	Bloomberg	MCSI AU Equity	MCSIAUIV Index
	Thomson Reuters	MCSI.CHA	MCSIAUIV.P
	IRESS	MCSI.CXA	MCSI-AUINAV.NGIF

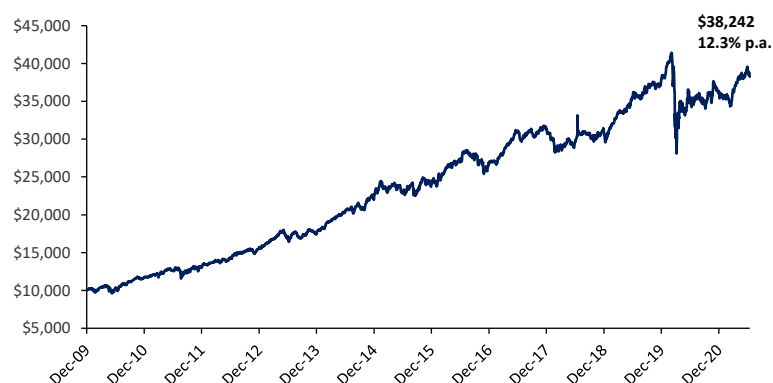
Visit [www.mfgcoreseries.com.au](http://www.mfgcoreseries.com.au) for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

<sup>1</sup>All fees are inclusive of the net effect of GST;

<sup>2</sup>Only applicable to investors who apply for units directly with the Fund;

<sup>3</sup>NAV per unit is cum distribution and includes a distribution of \$0.0288 per unit distribution payable on 21 July 2021.

## Performance Chart growth of AUD \$10,000\*



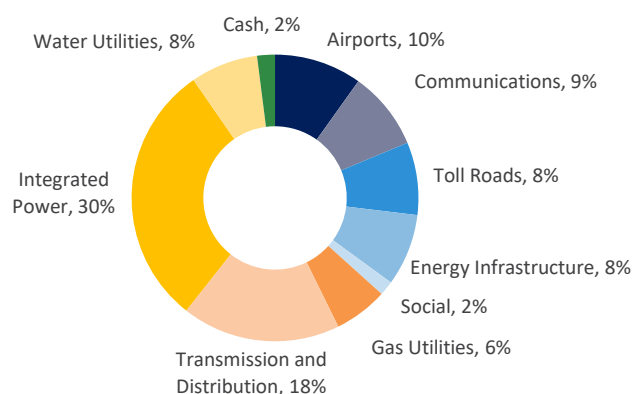
## Performance\*

	Fund (%)	Index (%)**	Excess (%)
1 Month	-0.1	-0.2	0.1
3 Months	3.0	1.8	1.2
1 Year	10.0	17.2	-7.2
3 Years (p.a.)	7.9	3.3	4.6
5 Years (p.a.)	6.3	4.8	1.5
10 Years (p.a.)	11.4	7.9	3.5
Since Inception (p.a.)	12.3	7.8	4.5

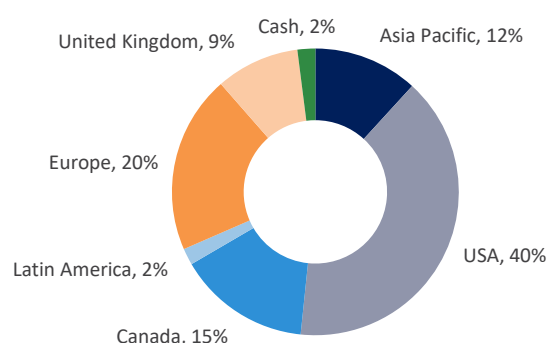
## Top 10 Positions

Company	Sector <sup>#</sup>	%
TC Energy Corporation	Energy Infrastructure	3.0
Fortis Inc	Transmission and Distribution	3.0
Transurban Group	Toll Roads	3.0
Enbridge Inc	Energy Infrastructure	3.0
National Grid PLC	Transmission and Distribution	3.0
Vinci SA	Toll Roads	3.0
Cellnex Telecom SA	Communications	2.9
Aena SME SA	Airports	2.4
Sydney Airports	Airports	2.4
Snam SpA	Gas Utilities	2.2
TOTAL:		27.9

## Sector Exposure<sup>#</sup>



## Geographical Exposure<sup>#</sup>



\* The Fund was established on 17 December 2009 as an unregistered managed investment scheme. On 19 November 2020, the Fund's name was changed to MFG Core Infrastructure Fund and on 30 November 2020 the Fund was registered with ASIC as a registered managed investment scheme and became available to retail investors.

\*\* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Returns denoted in AUD.

\*\* S&P Global Infrastructure Net Total Return Index (A\$ Hedged) spliced with UBS Developed Infrastructure and Utilities Net Total Return Index (A\$ Hedged). Note: as the UBS Developed Infrastructure and Utilities Net Total Return Index (A\$ hedged) ceased to be published from 31 May 2015, it was replaced by Magellan on 1 January 2015 with the S&P Global Infrastructure Net Total Return Index (A\$ Hedged).

# Sectors are internally defined. Geographical exposure is by domicile of listing. Exposures may not sum to 100% due to rounding.

## Fund Commentary

The portfolio recorded a positive return in the June quarter when utilities was the only sector of 11 in the MSCI World Index to decline in US dollars. The stocks that contributed the most were the investments in Cellnex Telecom of Spain, National Grid of the UK and Enbridge of Canada. Cellnex, a wireless telecommunications infrastructure and services company with more than 50,000 sites across Europe, gained as the market overhang associated with the company's recent capital raising dissipated. National Grid, an electricity and gas utility with operations in the UK and US, rose after its operating profit for fiscal 2021 beat consensus by 2 percentage points. Enbridge rose on the back of strong first-quarter results, which revealed that the company's critical Mainline asset is once again operating in a fully utilised and apportioned manner, after disruptions associated with the health crisis weighed on volumes during 2020. Trading in the company's stock was also supported by a favourable judgment, issued by the Minnesota Court of Appeals, reaffirming the regulator's approval of the company's Line 3 replacement project. The decision reassured investors that the project would meet its previously guided fourth-quarter 2021 in-service date.

The stocks that detracted the most were the investments in Sydney Airport, Eversource Energy of the US and APA Group of Australia. Sydney Airport slid after Melbourne then Sydney were placed in 'lockdown' after the virus escaped quarantine. Eversource Energy fell after the Connecticut Public Utility Regulatory Authority slammed the utility that through subsidiaries offers electricity, natural gas and water services for its preparation for and response to Tropical Storm Isaias that hit in 2020. In a politically charged decision, the authority found that Eversource did not satisfy relevant performance standards, ordered an indefinite reduction of 90 basis points to subsidiary Connecticut Light & Power's authorised return on equity, ordered the opening of a regulatory docket to consider issuing civil penalties against the subsidiary and foreshadowed the disallowance of certain costs that the authority asserts were imprudently incurred were Eversource to seek recovery. Eversource has indicated it will appeal these findings. APA declined amid talk that the assets of Australia's largest natural gas infrastructure business would be worth less in the transition to cleaner energy.

In relative terms, the portfolio outperformed the benchmark index over the quarter. Outperformance relative to the benchmark was principally attributable to the Fund's overweight exposure to regulated utilities in developed markets, which comprise more than 60% of the portfolio and less than 20% of the benchmark. Regulated utilities performed strongly during the quarter, supported by softening nominal yields on ten year US Treasury bonds. Nominal yields on the key risk-free rate proxy declined by around 30 basis points during the quarter, despite comments from the US Federal Reserve that it is likely to begin tightening monetary policy sooner than previously signalled. This pronouncement by the Fed prompted market participants to revise their expectations of future inflation lower, driving real yields on ten-year US Treasury bonds even more deeply negative. Relative performance also benefited from the greater global diversification of our regulated utility holdings in comparison to the benchmark; regulated utilities domiciled outside of the United States, which performed strongly during the quarter, comprise more than 25% of our portfolio, relative to just under 2% of the benchmark.

## Portfolio Positioning

Investments in the MFG Core Infrastructure Fund are selected by reference to a rigorous fundamental research process that implements our strict, proprietary definition of infrastructure. To qualify for inclusion in the Fund, prospective portfolio companies must meet three criteria:

1. They must be appropriately characterised as infrastructure. Our definition of an infrastructure company requires that the company must be engaged in the provision of essential services and generate reliable cash flows. Our insistence upon reliable cash flow generation distinguishes our approach from that of other infrastructure managers and leads us to exclude companies whose earnings have material exposure to competition, movements in commodity prices, or sovereign risk.
2. Their balance sheets must be sufficiently robust to withstand exogenous shocks. The focal point of this analysis is a requirement that all companies meet sector-specific minimum interest coverage ratios, struck to reflect the variability of cash flows.
3. The probability of environmental, social, and governance (ESG) risk factors impairing expected future cash flows must be low. If we assess that there is a material probability that ESG risks will lead to a significant impairment of expected cash flows within our investment horizon, the company will be excluded from our investible universe.

To assess these criteria, we undertake extensive due diligence – meeting with management, interrogating financial statements, and consulting with industry experts – to develop a deep understanding of prospective portfolio companies and the business environment within which they operate.

The application of these criteria gives rise to a portfolio of companies that exhibit strong infrastructure characteristics, with reliable cash flows underpinned by transparent regulation or long-term contracts with creditworthy counterparties.

Portfolio construction follows a systematic approach designed to provide investors with efficient access to a broadly diversified portfolio of high-quality infrastructure securities. Portfolio weights are struck by reference to the relative free-floating market capitalization of stocks in the Fund, subject to a series of risk controls that deliver targeted diversification at the security level, across infrastructure sub-sectors, and by geographic region.

The application of our systematic portfolio construction methodology yields a portfolio with a prominent skew towards regulated utilities and a notable geographic exposure to the US. We judge that the fundamental prospects of the companies in the portfolio are extremely favorable.

The regulated electric utilities in the portfolio (categorized as 'integrated power' and 'transmission and distribution' in the chart) typically operate within regulatory frameworks that protect their earnings against movements in fuel and purchased power costs. In most instances, regulatory mechanisms also moderate the sensitivity of earnings to changes in customers' consumption of electricity. Reflecting

these supportive regulatory settings, almost all the electric utilities in the portfolio reported 2020 financial results that were in line with or ahead of guidance issued prior to the pandemic, despite severe reductions in the volume of commercial and industrial demand precipitated by lockdowns.

The regulated electric utilities in the portfolio present investors with a unique opportunity to have an impact on their communities by accelerating the transition to net-zero emissions while continuing to generate attractive risk-adjusted investment returns. The International Energy Agency (IEA) estimates that global renewable generating capacity will need to triple over the period to 2030 and increase nine-fold over the period to 2050 if the world is to achieve net zero by mid-century.<sup>1</sup> The IEA further projects that investments in electricity grids will triple to 2030, remaining at elevated levels until 2050.<sup>2</sup> In the US, where more than 60% of our regulated electricity utility investments are domiciled, Princeton University estimates that the transition to net zero will require investments in new wind and solar capacity totaling US\$3.4 trillion to US\$6.2 trillion and in new transmission capacity totaling US\$2.5 trillion to US\$3.7 trillion.<sup>3</sup> The augmentation of distribution networks to support the electrification of transportation is likely to require yet further significant investment. Under the regulatory construct, these investments boost the earnings potential of our electric utilities, presenting investors with an opportunity to compound attractive risk-adjusted investment returns for a generation.

The water utilities in the portfolio are among the most defensive assets in the Fund. Stable underlying demand confers the earnings of these companies a high degree of predictability. The replacement of ageing pipes and water treatment plants coupled with efforts to enhance the resilience of networks against the impacts of climate change supports expectations of predictable growth in earnings well into the future.

Our gas utility investments operate within regulatory constructs that protect their earnings against movements in volatile natural gas prices. In many instances, these businesses also benefit from weather normalization clauses and revenue decoupling mechanisms that moderate the sensitivity of earnings to changes in customer consumption. As a consequence of this favorable treatment, the gas utilities in the portfolio delivered robust financial results during 2020, notwithstanding the impact of covid-19 lockdowns on commercial and industrial demand.

The significant investment required to replace ageing cast iron, bare steel and vintage plastic pipe within gas distribution networks supports attractive earnings growth rates for our gas utilities. We expect the space heating loads that dominate demand for gas to prove resilient to electrification in the regions where we invest, reflecting the superior economics and technical properties of gas-fired heating relative to electric heat pumps.

The communications infrastructure assets in the portfolio generate highly defensive earnings streams. Leases over tower assets are typically struck with an initial term of five to ten years, provide for multiple renewal terms, and limit the

termination rights of tenants. Moreover, lease agreements ordinarily embed rent escalation clauses, with rents typically escalating at a rate of about 3% p.a. in the US and at prevailing inflation rates in international markets.

With mobile data consumption expected to grow at rates in excess of 25% p.a. in key international markets over the next five years,<sup>4</sup> the communication infrastructure companies in the portfolio are poised to benefit from strong tenancy growth as wireless carriers add cell sites to deliver adequate network coverage. Having regard to the operating leverage inherent in the tower companies' business models, this revenue growth is expected to yield outsized growth in earnings and cash flow.

The toll road investments in the Fund are among the most structurally advantaged infrastructure assets in the world. Congestion on alternative routes implies that these assets face limited competition and capture a disproportionate share of incremental growth in traffic. Moreover, concession agreements typically provide for tolls to escalate at CPI or fixed nominal rates above CPI, preserving the real value of cash flows in an inflationary environment. While lockdowns in response to the health crisis continue to intermittently disrupt volumes, the rapid recovery in volumes observed when restrictions eased in various markets during 2020 demonstrates the robust underlying demand for the efficient transportation that these essential assets provide. The rollout of vaccines carries the promise of a more sustained return to normal conditions.

The global health crisis continues to weigh heavily on the results of our airport investments. For the month of April (the most recently available data), the International Air Transportation Association (IATA) reported that global passenger demand remained about 65% below its 2019 level, with international demand operating at approximately 13% of its pre-pandemic level.<sup>5</sup> Encouraged by the efficacy of vaccines, IATA's most recent projections call for world aviation activity to exceed 2019 levels by 5% in 2023, while guidance from major airports suggests a recovery to 2019 passenger volumes between 2023 and 2027. We continue to diligently monitor the financial position of our airport investments and remain comfortable that they possess sufficient liquidity to operate until passenger volumes recover.

The energy infrastructure companies in the Fund generate earnings by storing and transporting crude oil, natural gas, and chemicals in their network of storage terminals and pipelines. The selective group of storage and pipeline assets that meet our strict definition of infrastructure derive the bulk of their earnings under long-term take-or-pay arrangements or from assets that are subject to economic regulation. Critically, these arrangements immunize earnings against the movements in commodity prices that erode the reliability of cash flows from most oil and gas pipelines. Moreover, while our energy infrastructure investments often bear some volume risk on their regulated assets, the advantaged producing regions and demand centres that these pipelines and storage assets serve have historically supported consistently high levels of utilization.

While the transition to a global economy that is less reliant on fossil fuels may challenge energy infrastructure companies in the long term, we expect their reliable earnings to be

<sup>1</sup> International Energy Agency, Net Zero by 2050: A Roadmap for the Global Energy Sector, May 2021.

<sup>2</sup> International Energy Agency, Net Zero by 2050: A Roadmap for the Global Energy Sector, May 2021.

<sup>3</sup> Princeton University, Net-Zero America: Potential Pathways, Infrastructure, and Impacts, December 2020.

<sup>4</sup> Ericsson Mobility Report, November 2020.

<sup>5</sup> International Air Transportation Association, Air Passenger Market Analysis, April 2021.

fundamentally undisturbed for at least the next 15 years. While most major automotive companies have signaled their intent to discontinue the sale of internal combustion engine passenger vehicles between 2030 and 2035, the existing fleet will support demand for crude oil well beyond this period. Indeed, Bloomberg New Energy Finance forecasts that there will still be more than 900 million fossil-fuel vehicles on the road in 2040, representing more than half of the global fleet.<sup>6</sup> We expect continued demand from power generation and space heating to lend similar resilience to natural gas transportation assets.

Having regard to the advantaged characteristics and favorable prospects of the companies in the portfolio, we remain confident that the Fund will continue to meet its objectives of delivering attractive risk-adjusted investment returns over the long term and protecting capital in adverse markets.

<sup>6</sup> BloombergNEF, Electric Vehicle Outlook 2021, June 2020.



## Stock story: CMS Energy



CMS Energy is a high-quality US regulated utility delivering consistent earnings growth with exposure to the net-zero structural shift.

CMS operates in the supportive US regulatory jurisdiction of Michigan, serving 1.9 million electric customers and 1.8 million natural gas customers. Michigan's above-average authorised returns and incremental allowances for renewables and efficiency position CMS as one of the most attractive regulated utilities in the US. Moreover, Michigan's forward-looking test-year rate-setting methodology reduces regulatory lag and dampens inflation risk, providing a high degree of confidence that the company will earn its authorised rate of return in full. Bipartisan support for a highly regulated utility sector in Michigan accentuates the constructive environment in which CMS operates.

CMS is in the early stages of its shift to renewables, a transition that is likely to support attractive growth in the company's rate base and earnings well into the future. In 2020, just 11% of the electricity delivered by CMS was sourced from renewables. Yet this figure is set to rise dramatically. CMS recently outlined one of the most aggressive decarbonisation goals in the industry, targeting an exit from coal-fired generation by 2025 and net-zero emissions by 2040. The capital required to achieve this goal will sustain high levels of investment for the next 20 years. Beyond this, Michigan's goal to be carbon neutral by 2050 and the resulting increase in electrification should sustain CMS's investment in the electricity grid at relatively high levels. CMS's rate base (the key measure of a utility's earnings potential) is projected to grow at a rate of about 7.5% p.a. over the next decade, supporting growth in earnings per share at a similar level.

We view favourably CMS's recent decision to divest its non-core home improvement lending company, EnerBank. The move reinforces the CMS 'Clean and Lean' strategy, leaving an almost entirely pure-play regulated utility. CMS's June 2021 'Integrated Resource Plan' also sees the company transferring assets from its unregulated business, CMS Enterprises, to its regulated business, sheltering these assets from the risks inherent in competitive wholesale energy markets and providing a further boost to the growth prospects of its core utility operations.

CMS has delivered consistent earnings growth of about 7% p.a. over the past decade and on average earned above its authorised return, reflecting support from regulatory incentives and adder mechanisms. Considering the constructive regulatory environment in Michigan and a strong capital investment plan supported by decarbonisation goals, CMS is well placed to maintain consistent, reliable earnings growth and cash flows over the next three decades.

## Stock story: Alliant Energy



Alliant Energy is a US utility that provides power to nearly one million electricity and 420,000 gas customers in Iowa and Wisconsin. The utility that earned revenue of US\$3.4 billion in 2020 (85% from electricity and the remainder mainly from gas) sees its future in renewables.

The company has plans to 'green' its services in the two Midwest states where it operates. The utility is building wind and solar energy capabilities to replace two coal-based facilities in Iowa and plans to retire two large coal-fired plants with solar-based assets in Wisconsin.

Alliant Energy is aiming to reduce carbon emissions by 50% by 2030 compared with 2005 levels. The company is expected to attain this goal as it had achieved a 42% reduction by 2020. Such success has prompted the utility to declare that by 2025, half its generating assets will be renewables.

Alliant Energy says it intends to eliminate all coal generation by 2040 but will likely achieve this feat earlier. Achieving this would help the company meet its aspirational goal of net-zero carbon emissions from the energy it generates by 2050.

The investment appeal of Alliant Energy is that in turning green it will expand its 'rate base', the capital investment on which it earns a regulator-approved return. Alliant Energy is expected to spend US\$5.9 billion from 2021 to 2024 and another US\$7 billion to US\$9 billion in the following five years on going green.

Alliant Energy's plan holds promise because the company operates in states where regulators support investment in renewable energy. The company expects to grow its rate base (on which it can earn regulator-approved returns) from about US\$11 billion in 2020 to about US\$14 billion in 2024.

Alliant Energy has delivered 5% to 7% underlying earnings-per-share growth over the past decade. The utility's green journey has the potential to deliver similar returns in coming years.