# Tortoise Sustainable Listed Infrastructure UCITS Fund (TSLIF)

## Q4 2020 QUARTERLY COMMENTARY

### Performance

Over the quarter, the fund's NAV increased by 12.3% compared with the S&P Global Infrastructure Index which gained 10.1% (total returns in Euros). The U.S. dollar declined by approximately 4.1% against the Euro over the 3 months (-8.0% over 6 months and -8.2% over 1 year), dampening returns.

For the year, the fund's NAV increased by 4.1%, significantly outperforming its reference index, the S&P Global Infrastructure Index, which declined by 14.2%. Other comparators include the MSCI World Utilities Index (-3.8%) and the MSCI ACWI which increased by 6.7% in 2020 (all total returns in Euros). In an incredibly difficult environment, essential assets businesses performed relatively well, reputationally and financially. Utilities found demand for their services either unaffected or only moderately negatively impacted by lockdowns, except where commercial and industrial services account for a high proportion of revenues, and capital investment plans remained intact. As major owners and developers of clean energy sources at a time when the global conscience is fully focussed on climate action, the renewables-focused utilities presented an appealing combination of defensive characteristics and, increasingly, higher expectations for growth.

As of 31 December 2020

| *(All total returns in EUR)* | 3 months % | 6 months % | 1 year | Since inception* % |
|---|---|---|---|---|
| TSLIF NAV | 12.3 | 11.5 | 4.1 | 15.3 |
| S&P Global Infrastructure Index | 10.1 | 6.9 | -14.2 | -6.8 |

*6 August, 2019

NAV performance includes the effects of all costs for the Founder share class. Index returns are gross returns.

### Market overview

The fourth quarter witnessed significant intra-month volatility in equity markets as confidence vacillated. Renewables-focussed integrated utilities and pure renewables names continued to perform, as they did all year, while transportation infrastructure shares moved in tandem with optimism for economic recovery in 2021.

By November, there was an exuberant rally in equity markets upon the announcement of promising coronavirus vaccines providing this optimism for a resumption of some normality and growth, and there were exceptionally strong moves in the portfolio amongst both transportation infrastructure and renewables-oriented utilities. The U.S. elections later that month delivered a change in administration which will likely intensify federal policy efforts to tackle climate change (particularly in light of the later achievement of a Democratic majority across both houses of Congress).

By then we were already seeing fairly large moves in commodities prices too. WTI increased by 25% in November, natural gas prices were lower until the arrival of more wintry temperatures caused 5-15% upticks during the month's last week. European carbon prices continued to rise and closed at a new all-time high (over €30/MT) by the end of the year. Power prices were rising in response.

The European Union outlined further plans to boost renewables investment (particularly with respect to offshore wind capacity) and the UK announced a £12bn green investment plan, which includes interest in green hydrogen, an upgraded offshore wind target and a ban on the sale of traditional combustion engine cars by 2030 (5 years earlier than the last plan). The anticipation of a Biden administration was also generating hopes that his $2tn climate change investment program would further boost renewables growth prospects and accelerate the sector's transformation.

Growth- and renewables-focussed utilities also received a lot of attention with several hosting capital markets days. Enel became the first large European utility to commit to 10-year growth targets, providing visibility on double-digit total returns for shareholders to 2030, driven by renewables and clean infrastructure growth. Similarly, Iberdrola's capital markets day delivered incremental visibility to 2025 and an effective doubling of renewables capacity additions.

By December, the interest rate backdrop was generally less favourable for pure regulated utilities in the U.S. and UK given the modest steepening in yield curves in both markets. The benchmark 10-year U.S. Treasury yield, which dropped to under 0.6% by March 2020 and held in a tight range until the end of Q3 (0.65%) moved higher to close the year at [0.93%].

## Performance attribution

Over the 3 months, 6 and 12 months to 31 December, 2020, TSLIF's NAV total return meaningfully outperformed the sector reference index and the MSCI World Utilities Index. This reflected good stock selection across regions in 2020, a relatively high weighting (compared to any indices) in Europe where renewables-focussed names performed consistently well, and a meaningful contribution over the last 6 months from the relatively small emerging markets exposure.

We described last quarter (Q3 2020 commentary) how U.S. waste-to-energy company Covanta had drifted lower with general weakness in more cyclical and commodity-exposed names; investors were also digesting a dividend cut and the slow growth prospects until UK plants come online. We maintained our belief that Covanta is a structural beneficiary of the shift away from waste disposal to landfills, that the underlying value of the company had not changed, and that upcoming results would demonstrate the resilience of the core business.

The 5 best and worst contributors to the NAV during the quarter were:

| Company | % of NAV at 31 Dec. | NAV contribution % |
|---|---|---|
| **Top 5:** | | |
| Covanta | 2.5 | 1.52 |
| EDF | 3.0 | 1.51 |
| SSE | 3.1 | 1.14 |
| EDP-Energias de Portugal | 4.1 | 1.06 |
| Drax | 2.4 | 1.02 |
| **Bottom 5:** | | |
| Dominion Energy | 1.7 | -0.25 |
| Pennon | 1.4 | -0.16 |
| Iren | 3.0 | -0.07 |
| Williams | 1.5 | -0.01 |
| APA Group | 1.6 | -0.01 |

Covanta's shares did indeed come roaring back to life after the company announced on 30 October, along with quarterly earnings, the CEO's departure, and a full strategic review. We topped up the fund's holding (we had been waiting for this development) and the shares rose by approximately 63% (in local currency) over the quarter. The majority of Covanta's plants (waste incinerators) are in the U.S., and some of these may be offloaded to free up capital for higher return assets in Europe, particularly in the UK. All options are on the table and the new CEO (previously a board member) has a compensation package (base salary of $1 plus 1mn options) which is fully aligned with the performance of the share price over the next 3 years.

EDF moved into the limelight toward the end of the month and was a strong performer as a restructuring of the state-owned company's structure seems imminent, along with reform of the French remuneration formula for nuclear facilities to incentivise investment in a new generation fleet. According to the press, the re-shaping of the company could lead to full nationalisation of the nuclear (and potentially hydro) assets and an IPO listing of EDF Green which would include EDF's global renewables assets, its electricity networks and the company's downstream client portfolio. We see the key upside in unlocking the underlying value of EDF's high quality renewables and infrastructure assets which is heavily diluted in the company's current structure.

EDP's shares performed well over the quarter (+23%). The company – the top contributor to the NAV's growth during the year as a whole – reported solid results, further gains on asset disposals and upgraded guidance. We anticipate a significant increase in renewables growth guidance at the company's strategic update this year with its balance sheet now in good shape to exploit opportunities.

At the height of the pandemic, we materially increased our position in Drax whose share price had suffered a substantial setback due to the steep decline in power prices as lockdowns were enforced across Europe. We were confident that fundamentals would recover (they did; by the end of September the share price had increased by about 70%) and continue to like the fundamentals, particularly its gearing to higher carbon prices in Europe. The price of carbon dipped briefly to €16/ton in March but was €27/ton again by the end of September and is currently hovering at new all-time highs around €30/ton given increasingly ambitious EU emissions policies and notwithstanding the economic slump.

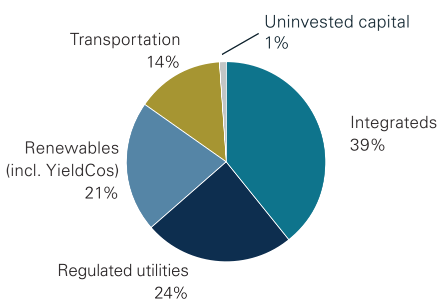
Just outside of the Top 5 contributors, it is worth noting the strong performance of the portfolio's holdings in emerging markets (China Longyuan and China Suntien, together 2.8% of the portfolio) and Canadian renewables companies TransAlta Renewables and Brookfield Renewable (5.3% including Brookfield Renewable Partner BEP-U and Brookfield Renewable Corp BEPC). The Hong Kong-listed shares of China Longyuan Power, the largest wind developer and operator in China, rose 54% in Q4 2020 and the strength has accelerated into January. The company announced on 31 December plans for a listing on the China A share market (in addition to Hong Kong). A dual listing should imply incremental upside through a gradual alignment of valuation between H shares and A shares. China Suntien, also held in the portfolio, already has a dual listing; its A shares trade at a price/book value which is 4 times that of the company's Hong Kong listed shares, suggesting significant fundamental upside for the H-shares (which are part of the portfolio).

The Canadian renewables companies in the portfolio performed especially well over the last few months. Their share price momentum was further sustained by the outcome of the U.S. elections and Canada's pledge in December of more aggressive carbon pricing. In addition, both names continue to benefit from strong ESG-related fund flows. TransAlta Renewables announced the acquisition of wind projects late in December and the shares are enjoying a valuation catch-up to peers.

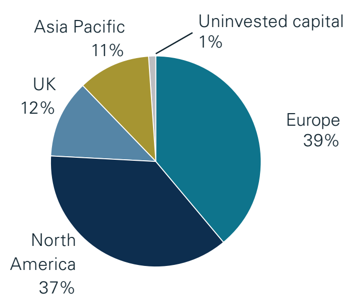
There was slight weakness in a few utilities (Dominion) and general weakness in transport (APA) and energy infrastructure (Williams) towards the end of the year with the resurgence of COVID-related restrictions around the world. These were more than offset by the ongoing strength across regions in the portfolio's renewables-oriented integrated utilities and pure renewables companies.

As of 31 December 2020

**By sector** (% of NAV)




**By geography** (% of NAV)




## Portfolio changes

New holdings introduced into the portfolio during Q4 included Hong Kong-listed China Longyuan Power, the largest generator of electricity from wind in China and Asia (discussed above), and its smaller peer China Suntien. Their shares are undervalued based on our growth expectations for the companies. Helpfully, China, by far the world's largest emitter – while also the world's largest installer of renewables, hydro and nuclear – surprised last year with a pledge to become carbon neutral by 2060, marking a decisive step up in its contribution toward the global energy transition. Veolia, the French multinational water and waste management utility, was also added; it is bidding for its main competitor Suez, having already secured Engie's c. 30% stake. We think the deal is attractive, with significant synergies for Veolia to extract and therefore substantial growth potential for the combined group. We also added to existing positions in Iberdrola, SSE, Drax, National Grid, Covanta (as discussed above), NextEra Energy Partners, Ferrovial and ENAV. We exited FirstEnergy and Sempra Energy.

As a result of this activity, the regional allocations changed slightly. Together, exposure to Europe and the UK remained at just over 50% at quarter-end, the same as three months earlier, the allocation to North America declined to 38% (from 42% at the beginning of the quarter), and the 'rest of the world' represented approximately 11% (up from 8%) of the portfolio.

## Yield

With the strength in markets and TSLIF's portfolio, the yield on the portfolio was lower by year-end at 3.7% (4.4% as at 30 September, 2020). Income received from investments was dented slightly during the year due to constraints on some portfolio holdings with more cyclical exposure (i.e., exposure to industrial contracts or air and road traffic levels) and political intervention in France, but some portfolio changes mitigated these effects.

We anticipate a strong rebound in dividend receipts this year – in the order of 10% year-over-year – given the resilience in demand for most of the portfolio's essential services, the call for renewable energy even while the pandemic weighs on global energy needs, momentum in cashflows for portfolio holdings and their balance sheet health. We anticipate that growth in income will resume and that the longer term average growth rate will be +5-7% per annum.

## Strategy

There is little dispute that investment in infrastructure must increase substantially in order to achieve commitments consistent with the Paris Agreement, SDGs, and national and corporate responsibility and climate policies. In Europe, which wants to reach carbon-neutrality by 2050, national energy plans require total investments of €825bn over the next decade alone according to Goldman Sachs. Myriad global initiatives are pulling in the same direction to drive greenhouse gas emissions lower, adopt cleaner and renewable energy sources, and promote more efficient use of those resources. Companies at the sharp end of innovation and strategies that will enable sustainability goals to be accomplished are growing and we expect their shares to be rewarding.

While there may be a pandemic-related pause in infrastructure investment recorded for 2020, the growth trajectory for global investment in clean power and efficiency measures appears secure; cleaner energies should, we believe, continue to capture a greater share of overall energy related investments – due to pure economics and political priorities. Utilities are the specialists, developers, owners and leaders in low carbon energy. It is interesting to note that oil majors BP, Royal Dutch Shell and Total also recently pledged to begin spending ambitiously to develop cleaner fuels, potentially eyeing utilities' existing renewables assets and backlogs as an effective way to make quick inroads.

The strategy continues to screen well in terms of carbon emissions, i.e., tonnes of $CO_2$ emitted per megawatt hour of electricity generation. Electricity generators in the strategy's portfolios generally have $CO_2$ emissions which are significantly below the average emissions of their relevant electricity grid and the companies sitting in the global utilities index. As at 31 December, the portfolio's electricity generators had $CO_2$ emissions which were 24% below the average emissions of the electricity grid in which the companies operate, largely because of a relatively small reliance on coal (11% of the mix), and 37% lower than those of companies in the global utilities index (as measured in $tCO_2$/$million invested). EGL's companies screen even better on a forward-looking basis.

We think that the fund's portfolio, and the sectors it is exposed to, can deliver solid, uncorrelated, sustainable growth in a variety of economic and market environments. The portfolio's companies are proving their resilience and continuing to develop pipelines of development opportunities, thereby providing visibility on cash flow growth over the foreseeable future. Furthermore, valuations in these sectors still largely reflect historical norms rather than the substantial growth we envisage given the course of policy and corporate capital allocation plans.