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How Infrastructure Companies Could Rebuild the World

March 6, 2018

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Wilson Magee, director of global real estate and infrastructure securities, Franklin Real Asset Advisors, gives his take on planned infrastructure projects in emerging markets. He also builds a case for listed infrastructure companies providing the capital and expertise needed to fix America’s aging infrastructure.

The need for infrastructure development is truly a global phenomenon. Many emerging countries need to develop new infrastructure to meet the needs of their growing populations, economies and cities. And, many developed countries, including the United States, need to repair, upgrade or completely replace aging infrastructure.

Emerging markets have been demanding an increasing share of global resources, and we anticipate that trend to persist. Both of the two largest developing economies, China and India, have ambitious infrastructure plans.

China already has infrastructure-related policies in place that we view as very supportive. Chinese Premier Xi Jinping’s “One Belt One Road” initiative would potentially build and enhance transportation infrastructure to mimic the old Silk Road trade route.

In India, the Ministry of Road Transport and Highways reportedly has plans to increase its highway network by 20,000 kilometers over the next couple of years.[1] That planned increase is roughly four times the distance from New York to San Francisco. When completed, India’s national highway network will total about 50,000 kilometers.[2]

In Mexico, we are excited about the long-term growth prospects for the nation’s airport system. Based on our analysis of government data, the average annual air passenger trips per year in Mexico is 0.4 per person, while in the United States it’s about 2.4.[3] That shows us the enormous growth potential as Mexico sees increased passenger traffic on its airlines and into its airports.

The Private Sector’s Role in US Infrastructure Development

In the US Congress, there seems to be bipartisan support for improving the dire state of the nation’s aging infrastructure. It was a main talking point during the 2016 US presidential election. That same year, the American Society of Civil Engineers gave US infrastructure a “D+” overall grade.

In February of this year, US President Donald Trump unveiled a US$1.5 trillion plan to rebuild America’s roads, bridges, airports and water-treatment facilities. The plan calls for federal spending of US$200 billion over the next 10 years and for state and local governments and the private sector to fund the remaining US$1.3 trillion.

However, there has been some disagreement on who should pick up the tab for the bulk of the proposed infrastructure improvements. Many Democrats say Trump’s plan puts too much pressure on state and local government budgets and are calling for US$1 trillion in federal spending. Yet Republican deficit hawks are balking at an increase in federal spending after the recent passage of the tax reform plan and 2019 fiscal year budget.

Given these budget constraints at the local, state and federal levels, we think the private sector will likely play a crucial role in Trump's infrastructure plan. In our view, listed infrastructure companies, such as airport, toll road and water-treatment operators, are likely to provide both their capital and their operational expertise.

That said, we don't expect to see an infrastructure bill moving swiftly through the US Congress in the near term. Immigration reform seems to be the current focus in the House and Senate.

Whether a US infrastructure bill passes or not, infrastructure spending is ongoing. For example, we've seen US power utilities continue to invest in growth initiatives that favor the transition to cleaner forms of energy, such as natural gas and renewables. In our view, the increasing use of renewables will help support further investments in power transmission grids, both in the United States and throughout the world.

Investing for the Future

We think financing infrastructure projects across the globe will likely require increasing levels of private funding. We see listed infrastructure companies as providing that funding and the services for economies to operate, prosper and grow.

In particular, we are excited about the growth prospects for global toll road operators, US liquefied natural gas (LNG) export facilities and water utilities.

In the transportation sector, an Australia-based leader in tolling technology that also operates in the United States appears likely to benefit from a US infrastructure bill. Another example is a French-based concessions and construction company that operates toll roads and airports globally. The company's toll roads in France are currently benefiting from positive and accelerating gross domestic product growth trends in the country.

In the energy sector, we think companies that build and operate gas pipelines and LNG export facilities in the United States are likely to benefit from the streamlining of federal permits. One example we see is a US-based energy company that develops and operates the first LNG export facility in the United States and continues to expand its capacity.

In the utilities sector, we think an American public utility company that operates in the United States and Canada is well-positioned to improve US water systems. In our view, the lead water crisis in Flint, Michigan, underscores the need to invest in US municipal water systems to keep them operating safely.

Overall, we think the outlook for listed infrastructure companies is strong, based on our analysis of revenue and dividend growth rates. We find the growth rates for these companies to be fairly predictable. They typically operate under long-term contracts, regulated return models or have monopolistic assets.

What Are the Risks?

All investments involve risks, including possible loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested. Investments in infrastructure-related securities involve special risks, such as high interest costs, high leverage and increased susceptibility to adverse economic or regulatory developments affecting the sector. Special risks are associated with foreign investing, including currency rate fluctuations, economic instability and political developments.

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1. Source: Economic Times of India, “India will have 50,000 km highways network in 2 years: Government,” September 27, 2017.

2. Ibid.

3. Sources: Mexico Communications and Transport Ministry; US Department of Transportation, Bureau of Transportation Statistics.