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Review

26th March 2020

Hornet Infrastructure – Water Fund (EUR)

General market review

In March, share prices fell extremely sharply due to measures to combat the COVID-19 virus. The MSCI World Index (EUR) fell by -14.2% in the reporting period and -19.1% YTD 2020, after the World Health Organization WHO classified the virus as a pandemic. As a consequence, global trade of goods and travelling has been severely restricted. The US Federal Reserve (FED) surprisingly cut its key interest rate by 100bps to 0.25% on March 15 and has increased purchases of government bonds and mortgage bonds as well as corporate debt (new) within its unlimited QE program over the month. The ECB is also taking extraordinary measures and has launched an emergency program worth EUR 750bn for public and private credit. The BOE announced a GBP 600bn infrastructure investment program by 2025 to stimulate the economy. The leading currencies EUR / USD as well as the GBP and JPY are experiencing increased volatility together with currencies in the emerging markets.

Investment Portfolio

The NAV of the Hornet Infrastructure - Water Fund (EUR) was again relatively stable in March with -6.9% to EUR 1,068.42 or -6.8% since the beginning of 2020. We highlight the M&A transaction at Pennon Group Plc. The UK water utility received a takeover bid of GBP 4.2bn (GBP 3.7bn net cash) from the private equity firm KKR in March for the waste management business, which accounts for approx. 30% of EBITDA, but the purchase price means over 75% of the total market capitalization. This shows not only the relative attractiveness in the water and environmental services sector in Europe and the UK, but also in the regulated water sector worldwide. The demand for stable real assets is likely to continue to rise as the risk of inflation increases. At the same time, medium-term refinancing rates are still falling, e.g. for Suez. With profits of the hedging strategy, we used the market sell-off to build up positions in the emerging markets, particularly in Brazil with discounts of 40-50%. The entire infrastructure portfolio (NAV) currently shows a discount of 14% to our calculated fair value.

Market review Infrastructure

In the infrastructure sector, the transport and energy sectors were again negatively affected. The latter in the wake of the extraordinary supply expansion of the OPEC countries, which has caused the WTI oil price to implode by -66.5% since the beginning of the year to USD 20.5 per barrel. On the other hand, the transport sector was badly affected, primarily due to the reduced demand. Airport and road operators in some cases fell by over -50%. The USD 2'000bn stimulus package approved by the US government partially calmed the markets towards the end of the month. The entire infrastructure sector lost -16.4% in the reporting month and -28.8% YTD 2020. Electricity and water utilities show more stability, since they have a relatively inelastic demand situation. Electricity suppliers in the US are currently experiencing a 7-11% year-on-year drop in sales due to reduced industrial activity.

Stabilizing water infrastructure with social impact

The current situation is not only drastic for many service and industrial companies, but also has a temporary impact for regulated water suppliers, although water consumption worldwide may not account for more than 2-4% of disposable income - but this constantly. In urban centers, private water consumption reaches approximately 2/3 of the total water volume distributed. Nevertheless, we notice an increased beta in the sector, which is mainly due to the high volatility in the interest rate area. In the United States, the 10-year US Treasury rose from 0.6% to just 1.2% in March, to come back to +0.6% after the fiscal and monetary stimulus. In Brazil, the 10-year interest rate rose from 2% to over 5.2% and back to below 4% in March. In consultation with the local regulators, major water utility companies in Brazil have announced that they will postpone low-income payments for private connections in the current situation, which means not only a loss of around 4-5% in sales and working capital, but also social solidarity and impact.

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