JN Asia Infrastructure Fund SP

Newsletter Quarter Ending 31st May 2020

Dear Investor,

This is the quarterly newsletter of JN Asia Infrastructure Fund ("the Fund" or "JNAIF") for the period ending 31st May 2020.

The first five months of 2020 saw one of the deepest corrections across all asset markets in a short period of time due to Global pandemic viz. COVID-19, followed by an equally swift recovery driven by aggressive monetary and fiscal stimulus. COVID-19 is a once in a lifetime black swan event that has had a significant impact across societies, economies and asset classes viz. equities, credit, currencies and commodity markets (in particular crude oil).

However, this event was also punctuated by one of the largest coordinated monetary and fiscal stimuli globally witnessed in history of modern economy. An unprecedented expansion of balance sheet by central bankers, the largest fiscal stimulus since World War-II, helped economies to soften the blow from pandemic. This was also helped by improving understanding of COVID-19, with hopes that some kind of treatment may be possible in 12-18 months. Many Asian countries seem to have effectively controlled the virus and their domestic economies are coming back to pre-COVID level at varying speeds. All this has led to one of the swiftest recoveries in various asset markets across the world.

Yet there are many questions that remain unanswered like eventual containment and eradication of COVID-19; its impact on global economies and socio-political structure. Complexities around those topics are immense and outcome unknown. We refrain from answering those and stick to the topics of investments, that we understand, in these uncertain times.

Given the uncertain global economic outlook, how does one build an equity portfolio from a bottom-up perspective?

As we all know, world is facing one of the biggest pandemics of our lifetime and clearly outlook for economies, employment, growth is uncertain and will probably remain the same for some time. Many market participants believe this is a combination of triple black swan events. First being the long drawn economic recovery post COVID-19 even after assuming better treatment and vaccine outcomes. Secondly, the shock from crude oil prices and its associated impact on industries and economies dependent on oil exports. Lastly, the geopolitical uncertainties surrounding the US-China cold war. In summary, currently there are many 'known unknowns' and many 'unknown unknowns" at play.

We believe, this time of high uncertainty is also the best time to increase exposure to core conviction themes. We have used this opportunity to tighten our portfolio and increase exposure in core holdings while reducing exposure in non-core names; further buying into quality names across the region which were available cheap. As the dust settles in May, we focus on portfolio from bottom up perspective even though macro risks remain very high. Our objective has always been to focus on the business fundamentals and rely more on what has changed for the long-term while being cognisant of the changes in the short-term.

As we mentioned in our earlier newsletters, we avoid taking any specific view on the markets given the complexity, changing market constituents and futility of the exercise. We are not bargain hunting or looking to time the upswing to buy high beta names. As we refrain from taking cyclicality or balance sheets risks. We do so to primarily avoid answering the question of whether the company will sink or survive at the bottom of the cycle. We are essentially buyers in quality names where

business fundamentals have not changed and their cash flow yields have improved due to price corrections.

Thus, while there are many unknowns at this stage today, there are a few things where we now have a greater confidence than what was a few months ago.

a) Similar to previous pandemics, this time also, market seems to have bottomed out when the number of infections peaked-out globally (refer to Chart A). For individual markets, recovery seems to be coinciding with gradual reopening of the economy from lock-down.

b) Despite being highly contagious, COVID-19 has shown a lower mortality particularly in younger populations. With 100+ Pharma companies working on treatments/ vaccines, some therapeutic solution likely, maybe in next 12-18 months.

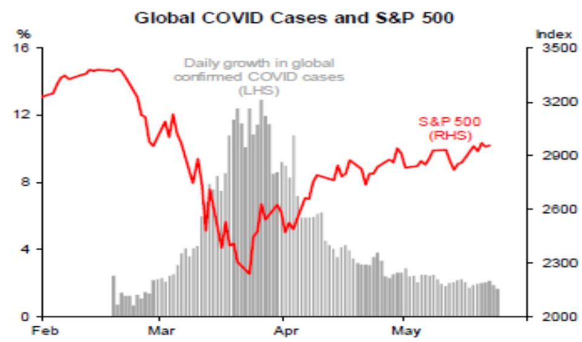
c) While there is a fear of second wave as economies gradually reopen, so far track record from China, Australia, Vietnam and Western Europe has been encouraging though in Korea, it has been a bit mixed.

d) Globally, Central Bankers will keep the liquidity tap flowing to keep financial markets stable viz. Global M2 growth running at 18-20% vs. nominal GDP growth (2020E) of close to zero. Thus, unlike 2009-19 period, velocity of money has picked up this time as developed economies have embarked on their largest fiscal stimulus seen since 1945; post WW-II.

e) Commodity prices led by crude oil seem to be stabilising aided by both supply reduction and prospect of demand revival. The **stealth** stimulus in China is reflected in stronger growth in fixed asset investments as well demand for hard commodities, capital goods etc.

While it remains difficult to predict a L-shape or U-shape recovery, we have reasonable confidence in ingenuity of humans to recover for this episode. We believe, in sustainability of quality businesses selected from our bottom-up approach to continue performing on a relative and absolute basis.

Chart 1: Peak in growth of daily COVID-19 cases coincided with the bottom for the broader US equity market



Source: Macquarie report

How do you see Infrastructure asset class behave in a post-pandemic world? What will be your investment approach?

The advantage of investing in Infrastructure is it allows us to take a long-term view given that the nature of assets, services and concession life typically ranges of 15-20 years and in some cases, over many decades.

Community and **Mobility** are associated with human behaviour since time immemorial and two key aspects that we focus on for infrastructure investment. These aspects are unlikely to change due to pandemics only the time to recovery might vary. Thus, if we take a view of the world beyond COVID-19, we believe the four areas mentioned below will continue to see robust demand irrespective of the nature of human society in post-pandemic world. These are:

Technology, Health care, Infrastructure and Environment. While the first two are quite obvious, we believe the need for Infrastructure investment particularly in developed world will rise as part of government driven fiscal stimulus and in emerging world, to improve and/or sustain their economic growth. In a similar fashion, need and understanding of sustainable environment will rise in post-

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pandemic world and the necessary investment in clean energy as well as circular economy.

In this background, we believe our infrastructure portfolio covers each aspect of these four secular themes without exposing to obsolescence risks and other cyclical risk factors. In the **technology segment**, our focus is on digital infrastructure viz. telecom towers, fibres, data centres, where the underlying product risk or risk of technology obsolescence is minimum. These businesses typically have 5-10-year contracts that are on take or pay basis, with some underlying price inflation and cost pass through clauses. We believe as the demand for 5G rollout accelerates, demand for fibre connected large telecom towers as well as micro-cells will increase. Demand for data centre is a function of increased spending on cloud infrastructure and outsourcing of data storage demand. Increasingly a large number of telcos are also outsourcing their tower investment and data storage to independent operators while focusing on their core network management and marketing activities.

In **Healthcare segment**, we focus on hard assets, which have long term earnings visibility, predictability and moat characteristics. In this segment, the biggest tailwind is ageing demographics in developed world and in many emerging economies as well. Thus, the need for retirement homes, diagnostic centres and tertiary level hospitals will see increasing demand with a certain level of pricing power. Beyond the current pandemic, demand for these services will stay robust and, in some cases, pent up demand viz. elective surgery, will rebound strongly.

As seen in the table, within **infrastructure,** our focus is largely on secular themes like *'rising aspiration of middle class'*, *'densification of urban centres'* and *'supply chain relocation'*.

We believe none of these processes are likely to stop in the post-pandemic world even though they may get delayed. The aspiring middle class in Asia will continue to travel driven by - business, leisure and education. Their experiential consumption (both discretionary and essential) in the form of travel, education and other leisure activities will continue. Thus, Air travel and hence need for **Airport infrastructure** will stay

Five Investment themes within Asian Infrastructure

Ageing demography

- Asia will double the share of elderly (65+ years) from 8% to 16% by 2040; settling at above 25%, more than 3x increase.
- By 2042, elderly population in Asia will be more than the entire population of EU and North America combined.
- Japan's elderly population currently at 28%.
- South Korea, Thailand, China, Australia and New Zealand are all aging fast.

Key plays
- Retirement homes
- Healthcare
  - Diagnostics
  - Hospitals

Environment awareness

- Increased focus of governments, corporate and individuals to improve social and environmental awareness.
- Increased share of renewable and gas in the energy mix.
- Reduce and recycle waste and creating a circular economy

Key plays
- Waste management
  - Landfill, Recycling
  - Industrial and civil
  - Medical waste
- Renewable power
- Gas pipeline and distribution

Aspiring middle class

- 60% of world's millennials reside in Asia (1/3 in China or India). They spent $325bn on international travel in 2019.
- Asia accounts for 40% of business travel. Regional and domestic travel is growing via air (LCCs), rail and road.
- Travel and tourism could grow 4-7% for the long term.
- Travel gateways remain key consumptions hubs (DFS).
- Demand for international education is increasing.

Key plays
- Airports
- Toll roads
- Student accommodation
- International education
- Healthcare – Medical tourism

Digitalisation of Asia

- Asia leads in digital innovation across finance, manufacturing, consumer, transportation, energy, logistics, etc. Digitisation is growing at 50% p.a.
- Data usage could grow 20% CAGR. Asia contributes 50% of data users. This requires additional digital infrastructure: towers, cables, data centres.
- APAC is the fastest growing e-commerce region, expected to grow at 7-9%. Currently at ~$2tn, representing 65% of the global market.

Key plays
- Data center owners
- Telecom Towers
- Logistics and warehousing

Interconnected Asia

- Increasing digitalisation, improving regional connectivity, intertwined supply chain is further interconnecting Asia.
- OBOR, RCEP, will further integrate Asia-Pac economies.
- Movement of people, ideas, technology, goods and services will keep improving.

Key plays
- Airports
- Toll roads
- Ports
- 3PL Logistics
- Worker accommodation
- Public transport

relevant for many years to come. We don't take a view when international leisure travel will restart and probably it may take another year to normalise. At the same time, we wouldn't be surprised if there is strong rebound from pent-up demand once fear of virus subsides. We have seen the same in 2003 post SARS even though it was limited largely to Asia. Of late, some large online travel aggregators have seen cancellations stop. More importantly, most of the airport operators have very long-term concessions and strong balance sheets to see through next 1-2 years of difficulty.

In similar vein, we believe migration of students from Asian geographies to Western and Australian universities for higher education is a secular process, and likely to continue. This is a long-term trend, which didn't get impacted in past despite many political or economic crisis or due to technological disruptions. On-site education in universities will continue to drive demand for **student accommodation**, something we continue to stay positive on as an asset class.

The other Infrastructure assets like **Ports, logistics, warehouses** will see a differentiated demand outlook. The companies with regional presence are likely to benefit from supply chain relocation out of China in the medium term in the form of project logistics, higher throughput of container boxes. Similarly rising e-commerce penetration will see demand for high quality warehouses in tier-1 cities in particular.

We believe urbanisation is secular theme in emerging Asia, we have seen this over the past hundred years in Western World and in Developed Asia. China has seen the world's biggest experiment with urbanisation in the past quarter century, and this trend should continue in other Asian countries like India, Philippine, Indonesia etc. Even in developed countries like Australia, Japan or Korea, we have seen cities like Sydney, Melbourne, Tokyo or Seoul getting bigger in size and population. This also means densification of urban living implying requirement of more public infrastructure. We stay constructive on **public transport infrastructure** (buses, metros etc.) in the post-pandemic world. We believe there is no substitute to that even when we assume higher share of people working from home. We continue to like bus and metro operators particularly where the revenue is guaranteed, not taking a volume or pricing risk.

We believe the **toll roads** remain a key medium for personalised travel for the rising middle class in all the geographies. Irrespective of technology adoption i.e. hybrid vehicle or electric vehicle, the toll roads are likely to remain key medium for personalised travel for many decades to come. In fact, post pandemic, unsurprisingly road infrastructure has seen fastest revival of traffic as it helps to maintain social distance.

The focus on **sustainable development** with **clean environment** is likely to rise in the post-pandemic world. Increasingly a greater number of companies will take a holistic 'stakeholder' approach rather than addressing shareholders' interest only. Our portfolio addresses this issue in three ways: a) *Gas utilities* - increasing penetration of gas in energy mix thus substituting coal or liquid hydrocarbon is fastest and cheapest way of reducing carbon intensity. Affordability, availability and easy to use will continue to drive usage of natural gas in Asia for many years to come. b) *Renewable power viz. Geothermal* is an interesting sustainable source of power generation and New Zealand power generators offer that unique opportunity. We remain cautious on the ability of certain renewable assets to make superior return on a sustainable basis. This is largely due to regulatory interference and large buckets of capital chasing this segment. At the same time, we continue to like transmission infrastructure which is becoming increasingly important to address complexity of renewable power as it becomes a larger share of

generation mix. Typically, these investments in transmission network get regulated return with a minimum volume or pricing risk. c) *Circular economy* - With or without China's sword policy, increasingly a greater number of nations are focussing on recycling waste - municipality waste, hazardous waste and medical waste, thus improving environment and creating a circular economy.

Lastly, water and electricity utilities will continue to see stable demand. However, in case of regulated assets, the regulator will continue to lower allowable return in line with lower benchmark interest rates, which will act as long-term headwinds.

What is your near term and medium-term return outlook on Infrastructure assets?

COVID-19 is a black swan event, but unlike previous black swan events this event was not triggered by economic issues (like growth slowdown, over-leveraged balance sheet). It is a pandemic which now has a disproportionate impact on the overall society, broader economy and the infrastructure sector. Nonetheless without balance sheet recession, it is reasonable to expect an uneven economic recovery with easing of global lockdown.

Even though **Equity Risk premium** have come down in past two months since peaking out in late March, they are still at very high level particularly in Emerging markets and in sectors which depend on **human 'mobility'** and **'community'** behaviour.

We classify the impact of CONVID-19 on infrastructure sector as short-term impact, which could continue till third quarter of 2020 assuming there is no second wave of COVID-19 and, long-term impact, which could last beyond 2020.

In the short term, we expect.

A. Corporate credit spreads to stay wide as banks and investors demand higher risk premium. This can lead to higher funding cost and cash flow mismatch. We believe quality infra companies will be able to showcase their balance sheet strength and should not face issue on debt refinancing or spike in cost of debt or drop in credit ratings. None of our portfolio companies have faced any major issue either in refinancing their debt or any rating downgrades, so far.

B. The digital Infrastructure asset like telecom towers, fibres or data centres, haven't seen any major impact on demand. Rather, benefitted from higher data consumption due to work from home. On the flip side, infra assets which depend on 'mobility' and community' behaviour of human being - Airports, ports, toll roads, public transports, hospitals, retirement houses, student accommodation, will continue to face a higher impact because of social distancing. *Returns from such assets in next six months could stay subdued.*

C. Certain infra companies could also see cut in dividends for a couple of quarters.

D. There would also be risks for infra assets linked to potential supply chain breakdowns, consumption slowdown, impact on real estate at transport gateway hubs.

In the medium term, we expect:

A. There is scope that tourism linked discretionary travel might take longer to recover depending on the remediation of CONVID-19. However, business travel and public transport related travel sould recover faster post containment of CONVID-19. Expect reasonable recovery of traffic across airports and toll road companies.

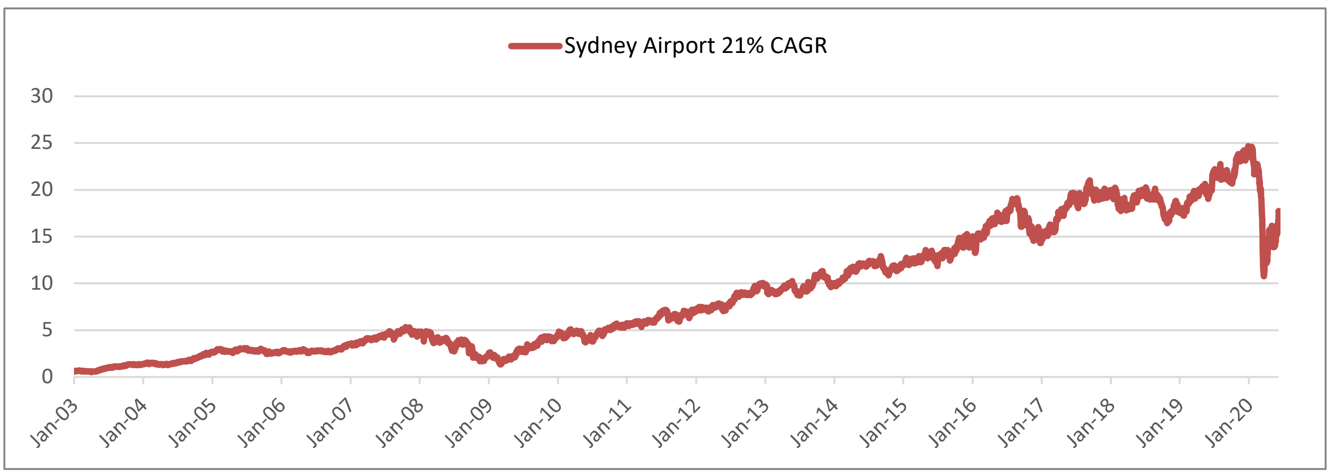
B. Interest rates may stay lower for longer. As risk premiums stabilise, lower risk free rates should lead to higher cash flow multiples for long dated assets like Infrastructure with predictable cash flows. On top of that

the on-going fiscal stimulus may lead to inflation in the medium term, lowering real cost of capital. This is a positive for long dated assets like Infrastructure.

C. Increased focus on environmental awareness will lead to better business for waste management, renewables, gas distribution companies. The current event will re-price companies and businesses that have positive impact on Environment.

Overall, we believe long term impact will be more positive for the Infrastructure sector in comparison to near term negative impact. We have seen similar sharp correction in listed Infra stocks earlier, however the long-term return profile has remained intact.

Chart 2: Sydney Airport Total USD return is 21% CAGR since 2003



Source: JNAIF, Bloomberg

Chart 3: Shanghai Airport total USD return 17% CAGR since 2003

Source: JNAIF, Bloomberg

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JNAIF portfolio snapshot at end of May 2020

Calendar Returns	2017*	2018	2019	2020^	Annualized#
Fund (Gross of Fees)	2.66%	-0.88%	19.88%	-17.78%	0.12%
Fund (Net of Fees)	2.27%	-2.03%	18.02%	-18.16%	-1.26%
MSCI Asia Pacific Ex-Japan Index	1.59%	-16.25%	15.85%	-13.83%	-6.12%
MSCI Asia Ex-Japan Infra Index	1.08%	-8.65%	5.39%	-12.56%	-6.06%

*** Since 8th Nov 2017, ^ Till 31st May 2020,**
 # Annualized since inception 8th Nov 2017

Country Allocation	Portfolio %
Australia	15.8%
China	15.5%
India	11.8%
New Zealand	11.5%
Singapore	9.8%
Hong Kong	8.7%
Indonesia	6.0%
Malaysia	5.1%
Philippines	5.0%
Taiwan	4.9%
Thailand	4.3%
Cash	1.6%
Emerging Markets exposure	**52.7%**
Developed Markets exposure	**45.7%**

Sector Allocation	Portfolio %
Highways & Railtracks	14.2%
Waste Management	13.8%
Air Freight & Logistics	13.3%
Health Care Facilities	12.9%
Industrial Real Estate	10.8%
Airport Services	9.2%
Telecom Services	6.0%
Gas Utilities	5.9%
Electric Utilities	4.2%
Others	8.1%
Cash	1.6%