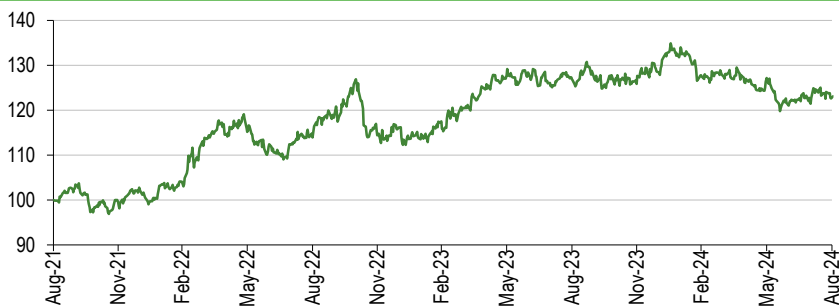


# Utilico Emerging Markets Trust

Market not reflecting very strong fundamentals

Utilico Emerging Markets Trust (UEM) is managed by Charles Jillings, at specialist value-based investor ICM. He reports that, operationally, the trust's investee companies are performing extraordinarily well, although this is not being reflected in the market. The manager suggests that investors have multiple distractions including concerns about a US recession, the US presidential election and wars in Ukraine and the Middle East. UEM's investments in infrastructure and utility assets ensure the fund has a consistently low beta. The use of gearing has resumed following the arrangement of a new £50m debt facility, reflecting Jillings' bullish outlook. UEM has solidly outperformed the MSCI Emerging Markets (EM) Index over the last three years. Since inception in 2005, the trust's NAV total return has compounded at 9.2% per year.

## NAV outperformance versus the MSCI EM Index over the last three years



Source: LSEG Data & Analytics, Edison Investment Research

## Why consider UEM?

Despite above-average growth prospects and attractive absolute and relative valuations, emerging markets seem to have been overlooked. This may well change once interest rates in developed markets come down as investors seek the potentially higher returns from equities versus those available in cash or fixed-income investments. UEM should also benefit when investors return to a focus on company fundamentals, which have been the long-term driver of market returns, rather than on macroeconomic developments.

Jillings and his team have identified four megatrends that are driving emerging market growth and all of UEM's holdings can be classified under one of the following: energy transition, digital infrastructure (infra), global trade and social infra. The manager and his team are benchmark agnostic, investing for the long term and avoiding short-term stock market 'noise'.

Since the end of the global COVID-19 pandemic, investment trust discounts have been wider than average, and UEM has not been immune to this trend. However, its current discount, which is wider than the one-, three-, five- and 10-year averages, seems something of an anomaly. While the trust invests in emerging markets, it owns high-quality, lower-risk, cash-generative assets and Jillings is very bullish on the prospects for UEM's portfolio companies. The trust has a robust performance record, a covered and growing dividend and an attractive dividend yield.

Investment trusts  
EM infrastructure and utilities

18 September 2024

**Price** 219.0p  
**Market cap** £412m  
**Total assets** £501m

NAV\* 266.2p  
Discount to NAV 17.7%

\*Including income. At 16 September 2024.

Yield 3.9%  
Ordinary shares in issue 188.1m  
Code/ISIN UEM/GB00BD45S967  
Primary exchange LSE  
AIC sector Global Emerging Markets  
Financial year end 31 March  
52-week high/low 235.0p 205.0p  
NAV\* high/low 281.6p 249.1p

\*Including income

Net cash (at 31 August 2024) 1.0%

## Fund objective

Utilico Emerging Markets Trust's investment objective is to provide long-term total returns by investing predominantly in infrastructure, utility and related equities, mainly in emerging markets.

## Bull points

- Specialist fund investing in high-quality emerging market companies.
- Progressive dividend policy and attractive yield.
- Higher economic growth and lower valuations in emerging versus developed markets.

## Bear points

- Discount is persistently wider than board's desired level of less than 10%.
- The MSCI Emerging Markets Infrastructure and Utility indices have underperformed the MSCI Emerging Markets Index over the long term.
- Emerging market indices can be more volatile than those in developed markets.

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## UEM: A unique EM fund with a strong long-term record

UEM is the only UK fund that is focused on infrastructure and utility assets, most of which are asset backed and more than 95% are operational. Jillings has a high degree of confidence in the positive prospects of the trust's portfolio companies. He and his team undertake detailed fundamental research to fully understand UEM's current and potential holdings, employing a long-term investment approach. Due to the nature of the assets held, UEM is a low-beta fund and more than 80% of the portfolio pays dividends, which supports the trust's progressive dividend policy.

### Four megatrends driving emerging market growth

Here is a reminder of the four megatrends that Jillings and his team have identified as the drivers of emerging market growth, along with an example of a portfolio company in each category.

**Social infra** (28.5% of the portfolio at end August 2024) – urbanisation and the rise of the middle class are driving demand for better social infrastructure. **Manila Water** owns one of the largest water concessions in the Philippines as well as smaller operations domestically and in other countries including Indonesia, Saudi Arabia, Thailand and Vietnam. Along with volume growth due to increases in per capita water usage, expanding service coverage and urbanisation trends, the regulatory environment in the Philippines has improved; the government acknowledged the need for increased industry capex allowing Manila Water to generate a higher return on equity. A change in its controlling shareholder has shifted the company's focus to operational efficiency and enhancing shareholder returns. Manila Water remains inexpensive, trading at 6.6x EV/EBITDA with a 6.5% dividend yield.

**Energy transition** (27.6%) – decarbonisation and investment in energy is supporting strong economic growth. **India Grid Trust** is a tax-efficient infrastructure investment trust, distributing 90% of its net cash flows to investors, which include private equity backers such as KKR & Co. The company develops and operates power transmission lines; it also has a newer solar renewables business. India Grid Trust is a well-positioned, efficient operator, running completed projects, under long-term contracts, so generates strong cash flow. The company is valued at 10.7x EV/EBITDA and offers a dividend yield above 10%.

**Digital infra** (23.6%) – rapid digital adoption is accelerating the demand for digital infrastructure. **Sonatel** is the largest telecoms company in Senegal and also operates in Mali, Sierra Leone, Guinea Conakry and Guinea Bissau. The company is controlled by Orange and most of its local currency revenues are pegged to the euro. Sonatel is well positioned and growing strongly in mobile data, fibre broadband and mobile money services. The company is listed in a frontier market, which has underperformed emerging markets, leading to a very attractive valuation of 2.9x EV/EBITDA and a 7.9% dividend yield.

**Global trade** (20.3%) – trade is being fuelled by structural growth drivers, geopolitical dynamics and shifting supply chains. **Santos Brasil Participações** operates three port container terminals in Brazil and provides integrated logistics for cargo transportation. The company is the third largest Brazilian port operator and is in the favourable position of having spare capacity at its main terminal asset in Santos port, while its two larger direct competitors are capacity constrained. The majority (60%) of Santos's volumes are from the MSC shipping line and price negotiations with the company occur every two years. In 2023, Santos was able to negotiate a 60%+ price increase with MSC and, while the 2025 price rise is likely to be smaller, it should provide a modest margin uplift. The company is trading on an 8.5x EV/EBITDA multiple, generates sustainable cash flow and has a 95% dividend payout ratio. It has a 6.5% dividend yield and a special dividend from excess capital is expected to be paid by the end of 2024.

## Observations on the investment backdrop

Jillings comments that across the globe, inflationary pressures are easing albeit interest rates remain elevated, and the consensus view is that most central banks will continue to lower interest rates. He notes that despite the growth headwind of a higher cost of capital for both governments and corporates, employment has been relatively resilient across all economies.

The manager suggests that despite this backdrop GDP growth has generally been ahead of consensus, which is being driven by a broader economy and underlying structural drivers. During the global pandemic, there was an acceleration in the roll-out of the digital economy, including in the financial system, which has resulted in increased formalisation of people in the workforce (witnessed in India and Mexico) and has therefore helped to drive economic activity. According to Jillings, despite the ongoing noise, global trade remains robust, as geopolitical tensions have led to shifts in the manufacturing base, benefiting countries such as Mexico and Vietnam.

Although US GDP has recently exceeded expectations, the manager believes the Federal Reserve will start to lower interest rates, because if they remain elevated, they will eventually stifle economic growth. Jillings is looking for two 25bp interest rate cuts before the end of the year. Regardless of the size of the cut, it should lead to a weaker US dollar and stronger emerging market currencies.

## Portfolio breakdown

At the end of August 2024, UEM's top 10 positions made up 37.2% of the portfolio, which was a higher concentration versus 35.3% a year earlier. All four of the growth megatrends are represented in the trust's largest holdings.

**Exhibit 1: Top 10 holdings (at 31 August 2024)**

Company	Country	Sector	Mega trend	Portfolio weight %	
				31 Aug 2024	31 Aug 2023
International Container Terminal Services	Philippines	Ports operator	Global trade	5.4	4.6
FPT Corporation	Vietnam	Data services	Digital infra	5.2	3.3
Alupar Investimento	Brazil	Electricity transmission & generation	Energy transition	4.4	4.3
Orizon Valorização de Resíduos	Brazil	Waste treatment	Social infra	4.2	3.6
Santos Brasil Participações	Brazil	Port operator	Global trade	3.6	N/A
InPost	Poland	Logistics operator	Digital infra	3.2	N/A
India Grid Trust	India	Electricity transmission	Energy transition	3.0	2.9
Manilla Water Company	Philippines	Water	Social infra	2.9	N/A
VinaCapital Vietnam Opportunity Fund	Vietnam	Investment fund	Social infra	2.7	N/A
Companhia de Saneamento Básico do Estado de São Paulo (Sabesp)	Brazil	Water & waste treatment	Social infra	2.6	N/A
<b>Top 10 (% of portfolio)</b>				<b>37.2</b>	<b>35.3</b>

Source: UEM, Edison Investment Research. Note: N/A is not in August 2023 top 30.

**Exhibit 2: Portfolio geographic and industry exposure (% unless stated)**

Geography	Portfolio end August 2024	Portfolio end August 2023	Change (pp)	Industry	Portfolio end August 2024	Portfolio end August 2023	Change (pp)
Brazil	25.7	23.3	2.4	Ports & logistics	20.5	18.9	1.6
China incl. Hong Kong	11.7	13.5	(1.8)	Electricity	16.5	19.8	(3.3)
Vietnam	11.0	8.1	2.9	Data serv & digital infra	12.8	12.5	0.3
Other Europe	11.0	17.4	(6.4)	Water & waste	11.5	6.7	4.8
The Philippines	8.4	4.6	3.8	Renewables	8.7	12.5	(3.8)
Middle East/Africa	7.4	5.8	1.6	Airports	6.5	5.5	1.0
India	6.4	10.4	(4.0)	Telecoms	5.8	5.4	0.4
Other Asia	6.4	6.4	0.0	Gas	4.6	7.0	(2.4)
Other Latin America	4.8	10.5	(5.7)	Road & rail	4.3	4.2	0.1
Poland	3.9	N/S	N/A	Other	8.8	7.5	1.3
Chile	3.3	N/S	N/A				
	<b>100.0</b>	<b>100.0</b>			<b>100.0</b>	<b>100.0</b>	

Source: UEM, Edison Investment Research. Note: N/S is not stated separately.

Exhibit 2 shows UEM's portfolio breakdowns by geography and sector at the end of August 2024, which are a result of bottom-up stock selection. A detailed year-on-year comparison by geography is not possible due to a change in the way that the data are presented. However, compared with the MSCI Emerging Markets Index, UEM has a notable higher weighting in Brazil (c 26% vs c 5%) and a meaningful lower allocation to China (c 12% vs c 24%). In the 12 months to 31 August 2024, the largest changes in UEM's sector exposure were a higher weighting in waste & water (+4.8pp) and a lower allocation to renewable assets (-3.8pp).

## Performance: Strong relative three-year record

As shown in Exhibit 3, there are 11 funds in the AIC Global Emerging Markets sector. It is only possible to make a broad comparison of the peers as they follow such diverse mandates. UEM's NAV total returns are above average over the last three and 10 years, ranking third out of 10 and fifth out of nine funds respectively. The trust's performance does not take the dilutive effect of UEM's historical subscription shares before February 2018 into account.

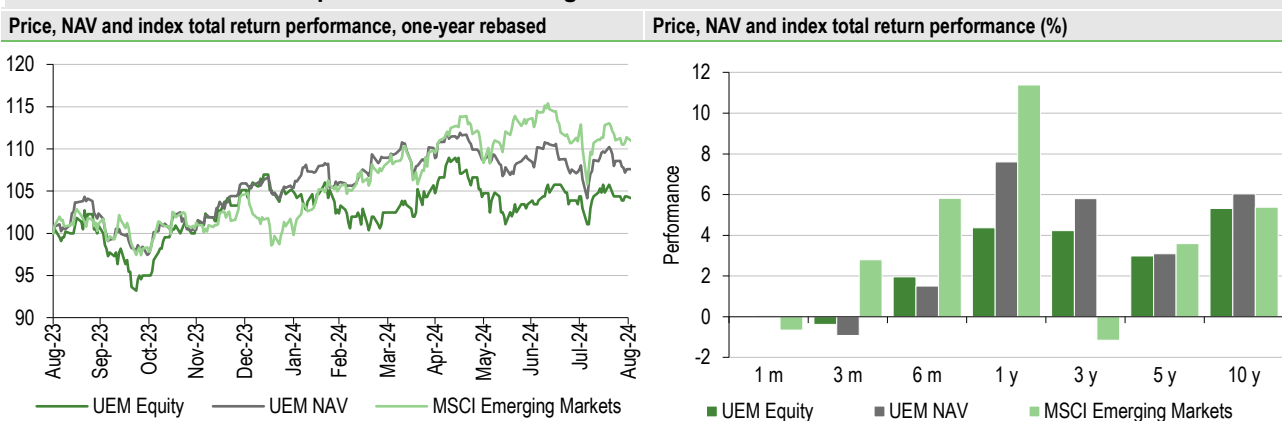
**Exhibit 3: AIC Global Emerging Markets sector at 17 September 2024\***

% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Utilico Emerging Markets	411.9	3.9	19.2	17.8	78.7	(18.0)	1.5	No	100	3.9
Ashoka WhiteOak Emerging Markets	35.3	8.7				(3.4)	1.9	Yes	100	0.0
Barings Emerging EMEA Opps	65.8	16.5	(16.1)	(13.0)	36.5	(21.0)	1.6	No	100	3.0
BlackRock Frontiers	272.6	6.7	33.6	48.3	91.9	(11.0)	1.4	Yes	100	4.4
Fidelity Emerging Markets	487.4	13.4	(14.5)	(2.9)	41.4	(13.8)	0.8	No	100	2.3
Gulf Investment Fund	69.7	1.7	51.8	96.8	138.5	(3.6)	1.9	No	100	4.0
JPMorgan Emer E, ME & Africa Sec	41.3	32.8	(94.3)	(92.9)	(85.9)	110.0	3.2	No	102	0.5
JPMorgan Emerging Markets	1,170.3	5.6	(13.1)	18.8	107.8	(12.0)	0.9	No	103	1.6
JPMorgan Global Emerg Mkts Inc	372.2	8.9	5.1	32.4	82.8	(13.6)	0.9	No	109	4.2
Mobius Investment Trust	156.4	5.7	1.0	68.8		(9.7)	1.4	No	100	0.9
Templeton Emerging Mkts Inv Trust	1,693.6	7.1	(2.6)	18.1	69.5	(13.7)	1.0	No	100	3.2
<b>Simple average</b>	<b>434.2</b>	<b>10.1</b>	<b>(3.0)</b>	<b>19.2</b>	<b>62.4</b>	<b>(0.9)</b>	<b>1.5</b>		<b>101</b>	<b>2.5</b>
<b>UEM rank (out of 11 funds)</b>	<b>4</b>	<b>10</b>	<b>3</b>	<b>7</b>	<b>5</b>	<b>10</b>	<b>5</b>		<b>4</b>	<b>4</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance data at 17 September 2024 based on ex-par NAV. TR, total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Excluding JPMorgan Emerging Europe, Middle East & Africa Securities, which formerly invested in Russian securities and distorts the averages, UEM's discount is wider than the average 12.0% discount and its ongoing charge is in line with the mean. The trust is moving from an ungeared position now a new debt facility has been arranged. UEM has an attractive dividend yield, which is 1.4pp above the sector mean.

**Exhibit 4: Investment trust performance to 31 August 2024**



Source: LSEG Data & Analytics, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

While UEM has given back some of its relative performance in recent months, Jillings reports that the trust's underlying investments are continuing to perform strongly. Hence, UEM is well positioned from a valuation perspective. The trust has faced currency headwinds, especially in Brazil, which is the largest country exposure (c 26%), where the Brazilian real has declined by around 15% year to date against sterling. Negative currency moves have offset positive share price moves following strong earnings reports, such as for Santos Brasil Participações, whose Q224 revenues grew 38.6% and adjusted EBITDA was 56.8% higher year-on-year.

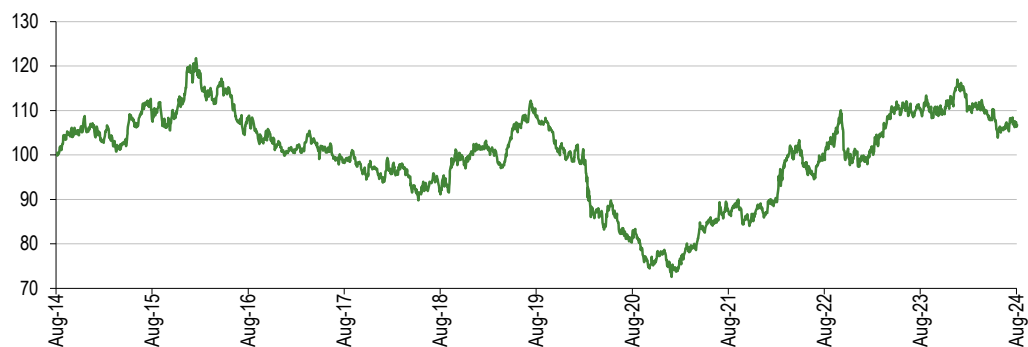
**Exhibit 5: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI Emerging Markets	0.7	(3.1)	(3.6)	(6.3)	17.2	(2.9)	(0.6)
NAV relative to MSCI Emerging Markets	0.7	(3.6)	(4.1)	(3.4)	22.6	(2.4)	6.3
Price relative to MSCI EM Utilities	1.5	(1.4)	(3.8)	(17.3)	(5.7)	(1.0)	21.9
NAV relative to MSCI EM Utilities	1.5	(2.0)	(4.3)	(14.7)	(1.4)	(0.5)	30.4
Price relative to CBOE UK All Cos	(0.8)	(2.8)	(9.2)	(11.0)	(10.1)	(16.4)	(7.5)
NAV relative to CBOE UK All Cos	(0.8)	(3.4)	(9.6)	(8.3)	(6.0)	(15.9)	(1.1)

Source: LSEG Data & Analytics, Edison Investment Research. Note: Data to end August 2024. Geometric calculation.

UEM's relative performance is shown in Exhibit 5. Its NAV and share price are meaningfully ahead of the MSCI Emerging Markets reference index over the last three years, while its NAV has outperformed over the last decade.

**Exhibit 6: NAV total return performance versus MSCI Emerging Markets Index over 10 years**



Source: LSEG Data & Analytics, Edison Investment Research

**Exhibit 7: Five-year discrete performance data**

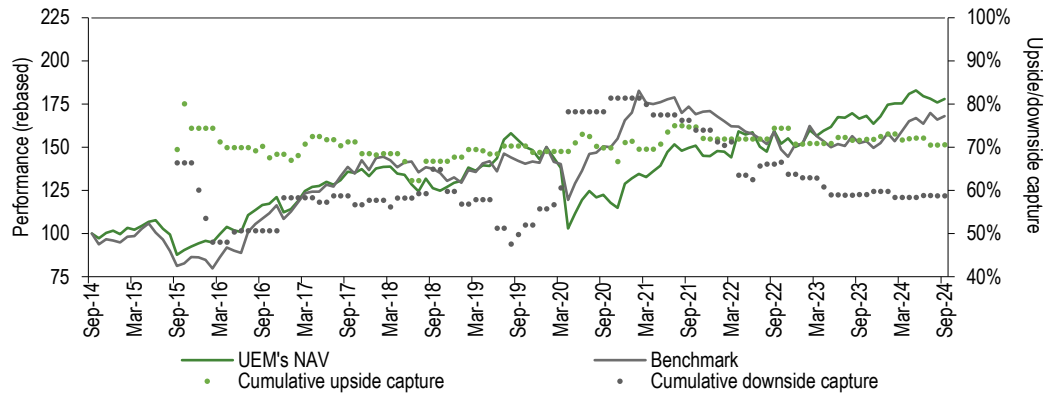
12 months ending	Share price (%)	NAV (%)	MSCI Emerging Markets (%)	MSCI EM Utilities (%)	CBOE UK All Companies (%)
31/08/20	(21.0)	(20.3)	4.5	(22.6)	(13.5)
31/08/21	29.5	23.4	18.2	25.9	27.1
31/08/22	3.8	5.8	(7.1)	23.3	1.8
31/08/23	4.6	4.0	(6.6)	(22.8)	5.5
31/08/24	4.4	7.6	11.4	26.1	17.3

Source: LSEG Data & Analytics. Note: All % on a total return basis in pounds sterling.

## UEM's upside/downside analysis

UEM offers a specialised yet defensive exposure to emerging markets. In Exhibit 8, we show the trust's upside/downside capture over the last decade. In months where emerging market stocks rose, on average, UEM captured 71% of the upside, whereas in months where emerging markets declined, the trust captured just 59% of the downside. In recent years, UEM's upside capture rate has remained relatively stable, while its downside capture has been more volatile, which chimes with higher stock market volatility over this period.

**Exhibit 8: UEM's upside/downside capture**



Source: LSEG Data & Analytics, Edison Investment Research. Note: Cumulative upside/downside capture calculated as the geometric average NAV total return (TR) of the fund during months with positive/negative reference index TRs, divided by the geometric average reference index TR during these months. A 100% upside/downside indicates that the fund's TR was in line with the reference index's during months with positive/negative returns. Data points for the initial 12 months have been omitted in the chart due to the limited number of observations used to calculate the cumulative upside/downside capture ratios.

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