

Utilico Emerging Markets Limited

Infrastructure and utilities in emerging markets

Utilico Emerging Markets (UEM) is a closed-end investment company with a focus on infrastructure, utilities and related companies in emerging markets. This specialisation differentiates it from its emerging market peers, while the dividend yield of 3.9% reflects investment in cash-generative businesses. UEM's NAV total return is above the peer group over, one, three, five and 10 years. Investors may wish to consider using UEM to gain exposure to companies that are integral to the long-term growth of emerging markets.

12 months ending	Total share price return (%)	Total NAV return (%)	MSCI EM TR (%)	MSCI EM Infrastructure Cap (%)	5-10 yr gov't yield +2% +RPIX* (%)
31/01/12	(4.3)	(1.1)	(4.9)	0.6	9.1
31/01/13	23.4	15.7	7.5	11.9	6.3
31/01/14	(3.5)	2.6	(13.0)	(11.5)	6.5
31/01/15	18.8	16.1	15.6	19.9	7.7
31/01/16	(10.5)	(9.3)	(15.9)	(15.3)	8.0

Note: Twelve-month rolling discrete £-adjusted total return performance. *Performance fee benchmark subject to an 8% minimum from April 2014.

Investment strategy: Focus on infrastructure/utilities

The manager adopts a bottom-up approach to stock selection, seeking long-term total returns. Investments are predominantly in listed companies and sectors that provide essential services or are monopolies including communications, transportation, infrastructure and utilities; businesses tend to be operational rather than greenfield. Favoured markets are those that are politically stable, have a growing middle class contributing to consumption growth and where there is a positive attitude towards foreign investment. Stocks are selected for their growth potential, strong cash flow generation, experienced management teams and dividends, which provide fundamental support in periods of weak stock market performance.

Market outlook: Relatively higher growth in EM

Since April 2015, emerging markets have exhibited marked weakness due to macroeconomic concerns, falling commodity prices and weaker currencies. Within this environment, infrastructure stocks have continued to outperform. The IMF January 2016 outlook highlights that growth in emerging markets is still expected to be well above the levels forecast for developed economies. Valuations for emerging markets remain relatively attractive with a forward P/E multiple of 11.1x for the MSCI Emerging Market index versus 15.8x for the MSCI World index.

Valuation: Wider discount, above average yield

Despite the relative outperformance of UEM versus the peer group, the share price discount to NAV has been on a widening trend since Q415 on the back of heightened macroeconomic concerns. The current c 12% discount is wider than the average of the last one, three, five and 10 years (range of 6.3% to 9.5%). UEM's above average yield ranks it third in the peer group.

Investment trusts

16 February 2016

Price 163.5p
Market cap £346.0m
AUM £412.0m

NAV* 181.35p
Discount to NAV 9.8%
NAV** 185.36p
Discount to NAV 11.8%

*Excluding income. **Including income. As at 15/2/16

Yield 3.9%

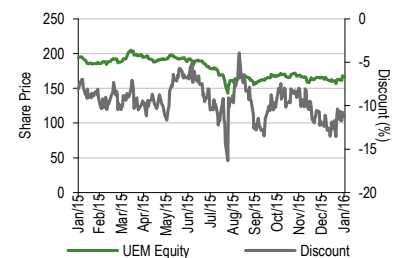
Ordinary shares in issue 211.6m

Code UEM

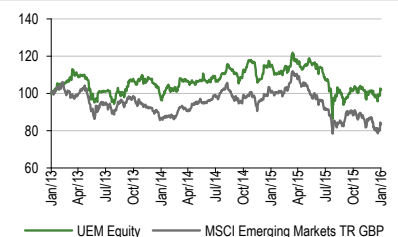
Primary exchange LSE

AIC sector Global Emerging Markets

Share price/discount performance



Three-year cumulative perf. graph



52-week high/low 205.0p 143.0p

NAV** high/low 222.9p 170.9p

**Including income.

Gearing

Gross* 1.9%

Net* 1.9%

*As at 31 December 2015.

Analysts

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[Edison profile page](#)

Exhibit 1: Trust at a glance

Investment objective and fund background

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

Recent developments

- 9 February 2016: Announcement of a 1.625p third interim dividend for FY16.
- 18 November 2015: Six-month report to September 2015. NAV total return -12.8%, MSCI EM index total return -18.7% (sterling adjusted). Announcement of a 1.625p second interim dividend for FY16.
- 16 November 2016: Appointment of John Rennocks as independent non-executive director.

Forthcoming

AGM	September 2016
Preliminary results	June 2016
Year end	31 March
Dividend paid	Mar, Jun, Sep, Dec
Launch date	20 July 2005
Continuation vote	AGM 2016 and 5-yearly

Capital structure

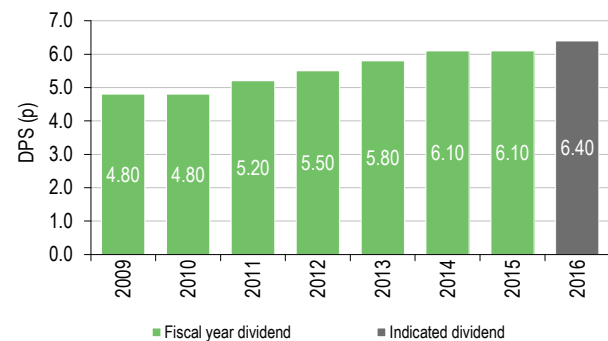
Ongoing charges	1.1%
Net gearing	1.9%
Annual mgmt fee	0.65%
Performance fee	15% of outperformance (cap: 1.85% of average net assets)
Trust life	Indefinite (continuation vote)
Loan facilities	£50m facility

Fund details

Group	ICM
Managers	Charles Jillings
Address	UK office: PO Box 208, Epsom, Surrey KT18 7YF
Phone	+44 (0)1372 271486
Website	www.uem.bm

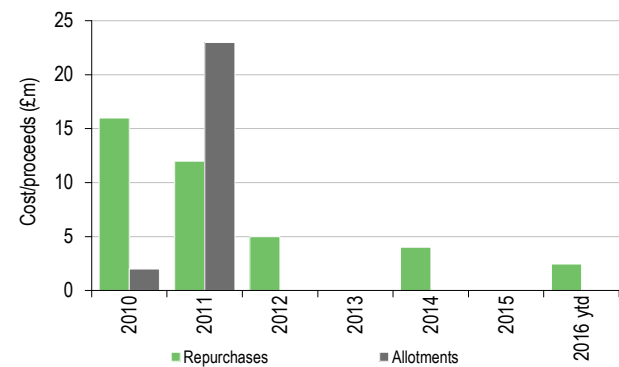
Dividend policy and history

The fund is managed for total return, but the board broadly seeks flat or rising dividends.

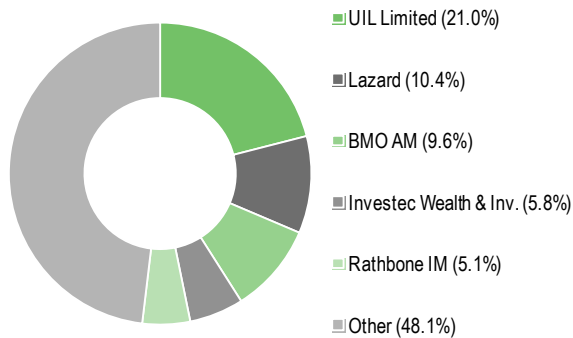


Share buyback policy and history

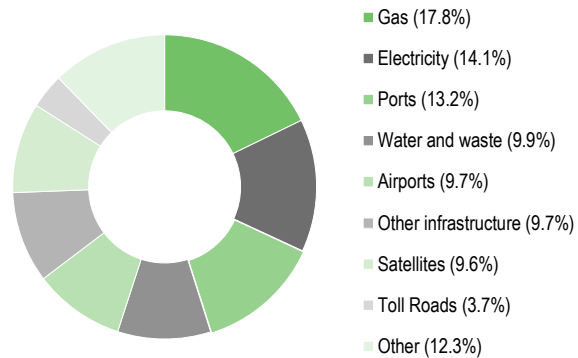
Subject to annual renewal, UEM has authority to repurchase up to 14.99% of the issued share capital and to allot shares up to 10% of the issued share capital.



Shareholder base (at 9 February 2016)



Portfolio exposure by sector (at 31 December 2015)



Top 10 holdings (at 31 December 2015)

Company	Country of listing	Sector	Portfolio weight %	
			31 December 2015	31 December 2014*
MyEG Services	Malaysia	Other infrastructure	9.4	7.1
Malaysia Airport	Malaysia	Airports	6.4	7.1
China Gas	Hong Kong	Gas	5.9	6.1
Eastern Water Resources Dev. & Mgmt.	Thailand	Water & waste	5.4	5.3
APT Satellite	Hong Kong	Satellites	4.9	4.7
International Container Terminal Services	Philippines	Ports	4.7	7.2
Ocean Wilsons	UK	Ports	4.4	5.5
Gasco	Chile	Gas distribution	3.1	3.3
Transelectrica	Romania	Electricity	2.7	N/A
China Resources Gas Group	Hong Kong	Gas distribution	2.6	N/A
Top 10			49.5	53.7

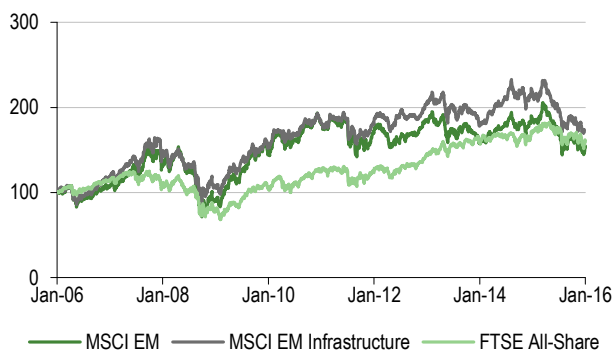
Source: Utilico Emerging Markets, Edison Investment Research, Morningstar, Thomson. Note: *N/A where not in December 2014 top 10.

Market outlook: Higher growth in emerging markets

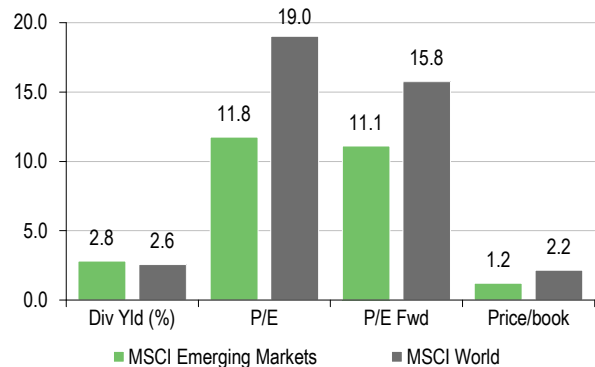
Although UEM is not managed against a benchmark, Exhibit 2 (left-hand side) shows that from January 2006 until April 2015 emerging markets outperformed developed markets, represented by the FTSE All-Share index. Emerging markets have weakened since Q215 as a result of lower growth assumptions, a collapse in the oil price and concerns about rising levels of debt. In this environment, emerging market infrastructure stocks have continued to perform better than the broader emerging market index.

Exhibit 2: Emerging markets vs advanced and world markets – performance and valuation metrics

MSCI Emerging Markets, MSCI EM Infrastructure and FTSE All-Share indices' £-adjusted total return performance rebased to 31 January 2006



MSCI Emerging Markets and MSCI World indices' valuation metrics at 19 January 2016



Source: Thomson Datastream, Edison Investment Research

Looking ahead, there are considerable uncertainties in the macroeconomic outlook and in January, the IMF lowered its growth forecasts for 2016 in emerging market and developing economies by 0.2% to 4.3%. However, this is still well above the 2.1% growth expected in the same period for advanced economies.

As shown in Exhibit 2 (right-hand side), valuations in emerging markets versus the rest of the world remain attractive in terms of P/E and price/book multiples, as well as offering higher dividend yields. For investors wishing to take a longer-term view on the higher growth generated in emerging versus developed markets, a fund such as UEM with its focus on at or above GDP growth companies in the cash-generative infrastructure and utility sectors may be appealing.

Fund profile: Emerging markets infrastructure/utilities

UEM was launched in July 2005; it is a Bermuda-registered investment company and listed on the premium segment of the London Stock Exchange. It seeks to provide long-term total returns to investors by investing primarily in infrastructure, utility and related sectors, mainly in emerging markets. UEM uses a modest level of gearing, with the aim of enhancing shareholder returns and may use derivatives to provide a level of protection against market corrections. The fund is run on a bottom-up basis; without regard to index weightings, but the MSCI Emerging Markets index is used for comparison. The benchmark for the performance fee is the FTSE UK Gilt five- to 10-year index post-tax yield, plus RPIX inflation, plus 2%, subject to an 8% minimum. The performance fee is capped at 1.85% of average NAV. UEM's investment manager is ICM Limited, a Bermuda-based manager with over £1.5bn of direct assets under management. Since inception, UEM has been managed by Charles Jillings and to 30 September 2015, achieved an average annual compound total return of 10.7%.

The fund manager: Charles Jillings

The manager's view: Plenty of opportunities

In the context of recent market volatility and weakness, Charles Jillings comments that emerging markets are still growing; there is a continued move towards urbanisation and expanding middle classes. However, he stresses while this creates a positive long-term backdrop, he is investing in individual businesses rather than in a country's GDP. Jillings sees valuations in emerging markets being as attractive as 10 years ago and states that he is "not short of investment opportunities". Over time, the relative attractiveness of individual countries change and for example, the portfolio now has less exposure to Brazil given the challenging environment from both political and economic perspectives. However, over the next six months it is possible that exposure will be increased given how far both the currency and equities have fallen.

The portfolio includes several investments in Romania, where the manager has been investing for the last 10 years. Investor concerns about the country centre on corruption, corporate governance and business structures. Jillings notes that following influence from the IMF and EU accession, the Romanian government is starting to tackle corruption, and is looking at privatisations and better corporate governance. Stocks in the country are seen as fundamentally inexpensive and the manager believes that over time stock markets eventually catch up with the value of the underlying assets.

China is viewed as continuing to offer investment opportunities. UEM meets management teams in the country to investigate what is happening at the operational level. By way of example, Shanghai Airport is seeing strong passenger growth, helped by a growing middle class. It is becoming more of a hub in the region and should benefit when the Shanghai Disney Resort opens in June 2016. There are substantial regional differences in China, so the management team is careful to focus on the drivers for individual assets within the country.

With regards to regulation, the manager believes that every industry has government intervention to varying degrees. If regulation is seen as an impediment, he will walk away from an investment. There needs to be an understanding of why the regulation is in place and what the likely outcome is. For example, China is focusing on cleaning up its environment, which will be beneficial for the gas sector, (where UEM has two investments in its top 10 holdings). Due to the collapse in the oil price, there has been a near-term shift in demand from gas to oil. However, over the next five years the Chinese government will be encouraging the use of gas as it is a cleaner fuel. It is a volume-driven business; over time margins are sustainable, subject to short-term effects from the timing of changes in input and output prices.

Asset allocation

Investment process: Focus on long-term fundamentals

The manager pursues a bottom-up stock selection process seeking to identify companies whose underlying value is not reflected in the current share price. He is supported by a team of analysts who monitor a universe of c 900 companies. Models are constructed for potential investments and target prices determined. For each company held, post an earnings release, models and earnings forecasts are revised and a report is written highlighting details of the results, any changes in view, a valuation and a buy or sell recommendation. Holdings in the portfolio are long term and the manager avoids short-term 'noise' in the stock markets. Investments are primarily in listed companies and sectors having the characteristics of essential services or monopolies for example, infrastructure and utilities. Most investee businesses are operational rather than greenfield and generate strong cash flows supporting above-average dividend yields. The manager stresses the

importance of site visits to gain a real insight into how well assets are positioned and operated. A top-down overlay controls sector and geographic exposures in the portfolio and there are internal investment limits.¹ At the end of September 2015, unlisted securities were just 2.8% of the portfolio's gross assets. Favoured markets for investment are those that are politically stable, generating economic growth and where foreign investment is encouraged.

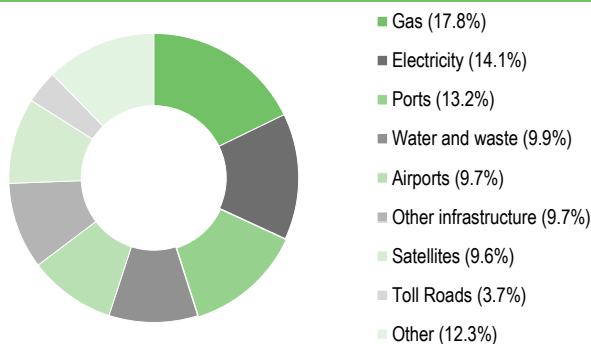
UEM has an active and constructive shareholder approach and generally considers it appropriate to support investee companies with their capital requirements. The significant distribution of retained earnings by Asia Satellite Telecommunications in 2015 was welcomed by UEM, as it had been discussing this issue with the company for a number of years.

Current portfolio positioning

The portfolio currently has c 90 names; the top 10 positions represent 49.5%, which is down from 53.7% a year ago. There are eight names that are common to both periods; this reflects the manager's long-term investment stance. The two new names in the top 10 holdings are Transelectrica (a wholly-regulated Romanian electricity company) and China Resources Gas Group (a gas distributor).

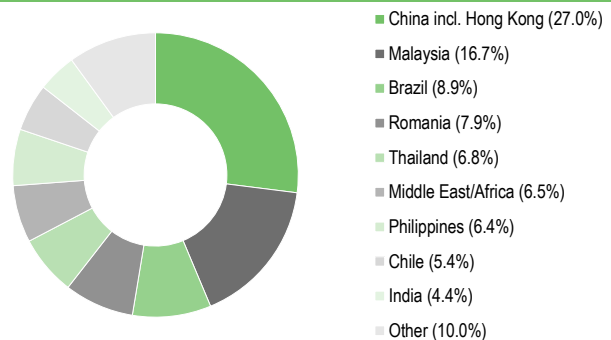
Looking at the sector exposures; the areas that have seen the largest increase over the last 12 months are electricity (+4.2%) and gas (+2.8%), while the largest decreases have been in ports (-4.1%) and toll roads (-3.9%). Among the larger country exposures, the main changes over the last 12 months were reductions for China/Hong Kong and Brazil and an increase for Romania, reflecting decisions made on individual companies, market moves and currency fluctuations.

Exhibit 3: Sector exposure at 31 December 2015



Source: Utilico Emerging Markets, Edison Investment Research

Exhibit 4: Geographic exposure at 31 December 2015



Source: Utilico Emerging Markets, Edison Investment Research

Performance: Outperformance versus the indices

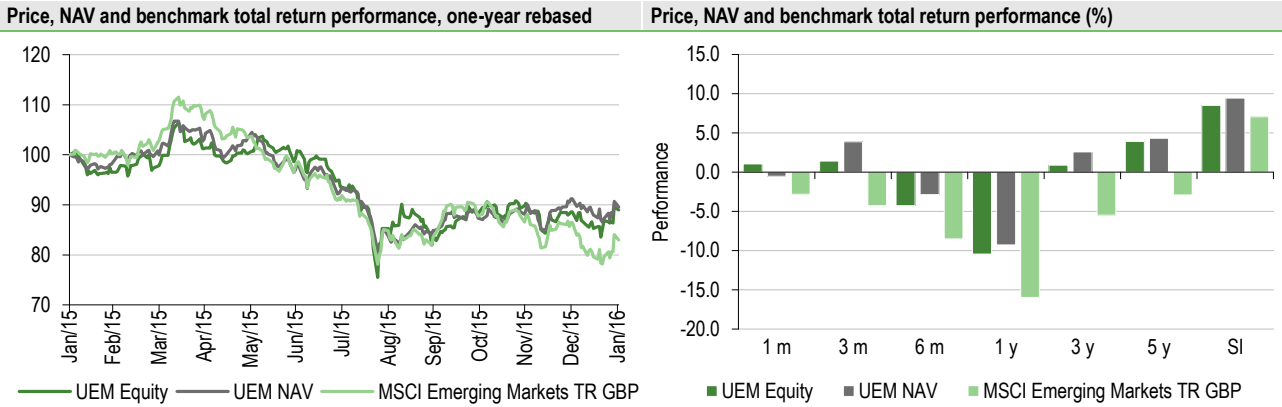
As shown in Exhibit 6, UEM has outperformed the MSCI Emerging Market index over all time periods shown in terms of both price and NAV total return. It has outperformed the MSCI Emerging Market Infrastructure index in terms of NAV total return over all periods, with the exception of the very short term. UEM has outperformed its absolute benchmark since inception, but marked weakness in emerging markets has meant that it has lagged over shorter periods. Exhibit 7 shows a near-term relative outperformance versus the MSCI Emerging Market index during a period of heightened stock market volatility.

Underlying the positive relative performance year to date, there has been a divergence between different holdings. MyEG Services, for example, has performed well and some profits have been taken on the position. International Container Terminal Services has seen its share price decline by

¹ With respect to gross assets at the time of investment: single investment 10%; single country 30%; unquoted investments 5%; gearing 25%; top 10 investments 60% and single sector 25%.

c 20% on concerns about slowing GDP. The manager considers that the shares are oversold and present a buying opportunity, given the longer-term growth opportunities for the company, a disciplined management team and a refinanced balance sheet.

Exhibit 5: Investment trust performance to 31 January 2016



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 6: Share price and NAV total return performance, versus benchmarks (percentage points)

	One month	Three months	Six months	One year	Three years	Five years	Since launch
Price relative to MSCI Emerging Markets	4.0	5.9	4.6	6.5	21.5	40.3	15.2
NAV relative to MSCI Emerging Markets	2.4	8.5	6.2	7.9	27.8	43.1	26.2
Price relative to MSCI EM Infrastructure	0.8	2.0	4.2	5.7	14.2	19.8	(1.1)
NAV relative to MSCI EM Infrastructure	(0.8)	4.5	5.7	7.1	20.2	22.1	8.4
Price relative to FTSE AllSh	4.3	5.4	3.2	(6.1)	(8.7)	(7.1)	28.0
NAV relative to FTSE AllSh	2.6	8.0	4.7	(4.9)	(4.0)	(5.3)	40.2
Price relative to Benchmark	0.4	(0.5)	(7.9)	(17.1)	(17.2)	(15.7)	6.2
NAV relative to Benchmark	(1.2)	1.9	(6.5)	(16.0)	(12.8)	(14.1)	16.3

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-January 2016. Geometric calculation. Benchmark is Uk Gilt five- to 10-year post-tax yield plus RPIX 2%, subject to an 8% minimum from 1 April 2014.

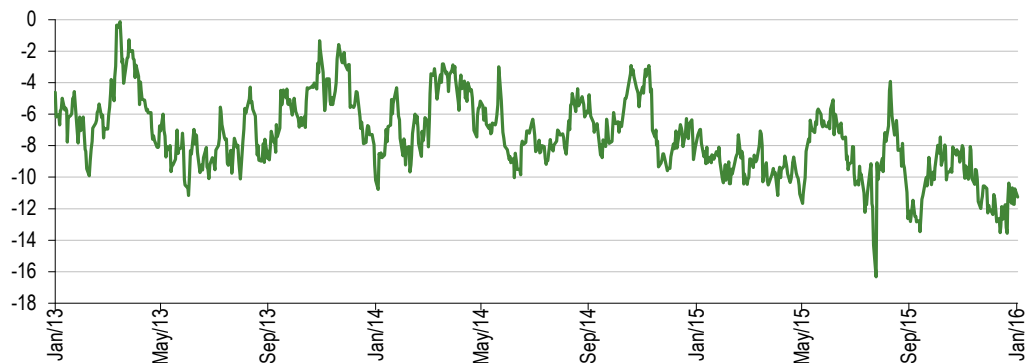
Exhibit 7: NAV performance relative to MSCI EM index over five years



Source: Thomson Datastream, Edison Investment Research

Discount: Wider with emerging market concerns

The board and manager closely monitor the share price discount to NAV. There is an inclination, but not a commitment, to repurchase shares when the discount moves above 10%. As shown in Exhibit 8, the discount has widened, as investor sentiment towards emerging markets has become more cautious. The sharp increase in the discount in August 2015 corresponds to the sell-off in the Chinese stock market. The current discount of 11.3% is wider than the averages of the last one, three, five and 10 years (range of 6.3% to 9.5%). Due to the widening discount, UEM has been repurchasing shares; year-to-date 1.4m shares have been repurchased at a cost of £2.3m.

Exhibit 8: Share price premium / discount to NAV (including income) over three years (%)


Source: Thomson Datastream, Edison Investment Research.

Capital structure and fees

UEM has 211.6m shares in issue. It has the authority to repurchase up to 14.99% and allot up to 10% of its issued share capital. At 30 September 2015, bank debt had decreased by 43% to £18.1m year-on-year. This was due to realisations and a special distribution from Asia Satellite Telecommunications. UEM has a £50m lending facility, which matures on 30 April 2016, and the board will seek to extend this for two years.

In September 2015, UEM announced a one-for-five bonus issue of subscription shares and following approval at a special general meeting, 42.6m subscription shares were issued. They are exercisable on the last business day of February and August in 2016 and 2017, and the final opportunity is 28 February 2018. The exercise price is 183.0p and if the shares are exercised, UEM's fixed costs will be spread over a wider base and liquidity in UEM shares is likely to increase.

In April 2014, changes were made to the fee structure. The management fee was changed from 0.50% of gross assets to 0.65% of net assets. An 8% minimum hurdle was introduced to the performance fee benchmark and performance fees were capped at 1.85% of average net assets in each financial year. Had this new structure been in place since the fund's inception, UEM estimates that total fees paid to the manager would have been more than 10% lower. For FY15 the performance fee was £3.1m and ongoing charges were 1.1%.

Dividend policy

The board's objective is to maintain or increase the annual dividend, which has been achieved each year since the fund was launched in 2005. Dividends are paid quarterly and for FY16 the board has forecast a 6.4p total dividend representing an increase of 4.9% (1.525p for the first quarter followed by three payments of 1.625p). UEM is able to distribute from both capital and income returns, which allows a higher dividend to be paid than if paid solely from dividend income.

For the six months to 30 September 2015, revenue income increased by 60.5% year-on-year to £17.9m. This was mainly due to Asia Satellite Telecommunications distributing its retained earnings to shareholders; UEM received £7.7m as a result. Excluding this distribution, for the six month period, revenue income was more than 1.5x dividends paid by UEM. On a seasonal basis, there is more dividend income received in H1 versus H2.

Peer group comparison

The selected group shown in Exhibit 9 comprises the AIC Global Emerging Markets sector excluding those funds in realisation phase or with a market cap below £50m. UEM cannot be directly compared with the peer group, given its focus on areas such as infrastructure and utilities. However, its exposure to emerging markets means the comparison has some relevance. UEM's NAV total return is above the peer-group average by a significant margin over one, three, five and ten years. In terms of risk-adjusted returns, its Sharpe ratio is ahead of the peers over one and three years. UEM's share price discount to NAV is in line with the peer group and its ongoing charge is lower. The yield of 3.7% ranks third in the peer group, where five out of nine trusts pay a dividend.

Exhibit 9: Selected peer group at 31 January 2016

% unless stated	Market Cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	NAV TR 10 Year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Ongoing Charge	Perf. fee	Net Gearing	Dividend yield (%)
Utilico Emerging Markets	353.6	(9.3)	8.0	23.5	125.7	(1.2)	(0.1)	(8.7)	1.1	15.0	103.0	3.7
Advance Developing Markets	197.3	(13.2)	(16.8)	(18.2)	28.1	(1.6)	(0.9)	(10.6)	1.1	10.0	0.0	0.0
Advance Frontier Markets	83.0	(13.2)	0.1	0.1		(1.3)	(0.2)	(8.1)	1.6	12.0	96.0	0.0
BlackRock Frontiers	151.0	(6.3)	21.2	27.9		(1.4)	0.4	(1.7)	1.5	10.0	105.0	4.1
Fundsmith Emerging Equities	172.1	(11.8)				(1.9)	(2.1)	(0.2)	0.9		100.0	0.0
Genesis Emerging Markets Fund	580.3	(14.7)	(15.6)	(8.0)	78.3	(1.6)	(0.8)	(13.4)	1.6		100.0	0.0
JPMorgan Emerging Markets	667.5	(11.4)	(6.7)	0.9	77.4	(1.3)	(0.5)	(12.7)	1.2		100.0	1.2
JPMorgan Global Emerg Mkts Inc	226.6	(21.4)	(18.1)	2.2		(1.8)	(0.8)	(11.8)	1.2		111.0	6.4
Templeton Emerging Mkts	1,187.0	(27.2)	(30.3)	(28.3)	56.9	(2.3)	(1.1)	(12.4)	1.2		100.0	2.1
Average	402.1	(14.3)	(7.3)	0.0	73.3	(1.6)	(0.7)	(8.8)	1.3	11.8	90.6	1.9

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

The board comprises six non-executive directors, five of whom are deemed independent of the manager. Alexander Zagoreos is the chairman and was appointed in June 2005; the deputy chairman, Garth Milne (previously a director of UEM from 2005 to 2010), was appointed in November 2014. Gary Madeiros was appointed in June 2007 and Anthony Muh in October 2010. Susan Hansen (appointed September 2013) is deemed not to be independent due to her directorship of RESIMAC, which has the same majority shareholder as the investment manager. The newest member of the board is John Rennocks, who was appointed in November 2015, having recently retired as deputy chairman and senior independent director of Inmarsat.

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