

Utilico Emerging Markets

Attractive investment opportunities in abundance

Utilico Emerging Markets (UEM) is a closed-end investment company aiming to generate long-term total returns from a portfolio of emerging market equities, primarily in the infrastructure, utility and related sectors. Since launch, UEM has been managed by Charles Jillings supported by the specialist investment team at ICM. He is bullish on the outlook for emerging market equities, evidenced by UEM's increased level of gearing; the manager suggests that there are plenty of attractively valued companies available to invest in. UEM has a progressive dividend policy; annual dividends have been increased or maintained every year since the fund was launched in July 2005; its current dividend yield is 3.1%.

12 months ending	Share price (%)	NAV (%)	MSCI Emerging Markets (%)	MSCI EM Infrastructure Capped (%)	Performance fee benchmark (%)
30/06/13	11.3	14.6	6.8	7.2	6.1
30/06/14	9.4	6.5	1.7	1.9	7.0
30/06/15	6.8	5.1	3.5	0.4	8.0
30/06/16	5.1	8.2	3.9	9.9	8.0
30/06/17	18.0	16.5	27.8	11.2	8.0

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling. Performance fee benchmark subject to an 8% minimum from April 2014. MSCI indices are shown for illustrative purposes.

Investment strategy: Infrastructure/utility investment

Jillings selects primarily emerging market infrastructure and utility stocks on a bottom-up basis, following thorough fundamental research, from ICM's proprietary database of c 900 investible companies. He invests for the long term, avoiding short-term stock market 'noise'. The majority of UEM's portfolio is invested in asset-backed, cash-generative businesses and c 75% is in companies that currently pay a dividend, which provides a level of resilience in periods of weaker stock markets. UEM's portfolio is now less concentrated as the manager has found incremental attractive investment opportunities, while reducing exposure in several of the top 10 positions.

Market outlook: Lower valuation and higher growth

Emerging market equities continue to trade on lower valuation multiples than world equities. This may be due to their historical higher share price volatility; however, over the long term, emerging market equities have performed better than some developed markets, such as the UK. The outlook for economic growth is also relatively favourable for emerging markets. For investors seeking to invest in infrastructure and utilities to gain lower-volatility exposure to emerging market growth, a fund with a strong long-term performance track record may appeal.

Valuation: Trading broadly in line with history

UEM's current 10.5% share price discount to cum-income NAV is broadly in line with the averages of the last one, three, and five years (range of 8.3% to 10.5%). There is a discount control mechanism in place, whereby the manager is inclined, but not obliged, to repurchase shares when the discount exceeds 10%. UEM's board has a progressive dividend policy; the trust's current dividend yield is 3.1%.

Investment trusts

6 July 2017

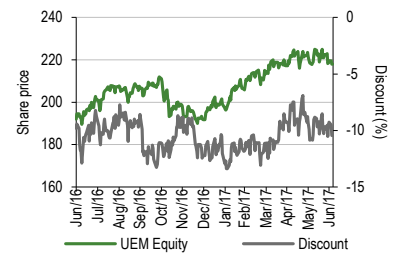
Price 218.0p
Market cap £464m
AUM £534m

NAV* 238.8p
Discount to NAV 8.7%
NAV** 243.5p
Discount to NAV 10.5%

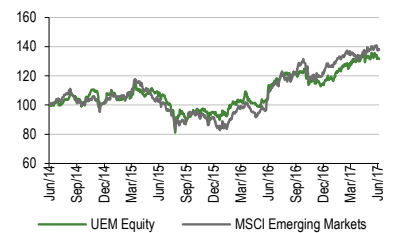
*Excluding income. **Including income. As at 4 July 2017.

Yield 3.1%
Ordinary shares in issue 211.4m
Code UEM
Primary exchange LSE
AIC sector Global Emerging Markets

Share price/discount performance



Three-year performance vs index



52-week high/low 225.0p 189.5p
NAV* high/low 246.8p 213.6p

*Including income.

Gearing

Gross* 9.2%
Net* 8.9%

*As at 31 May 2017.

Analysts

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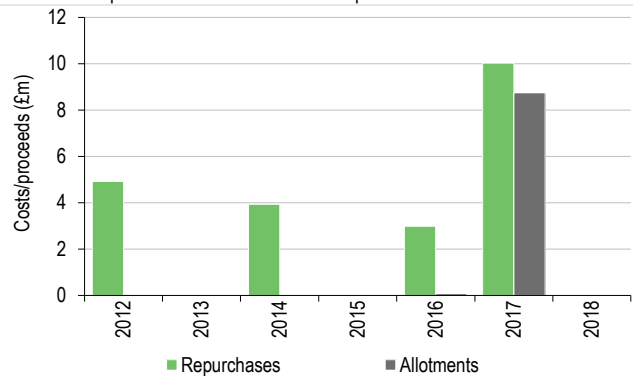
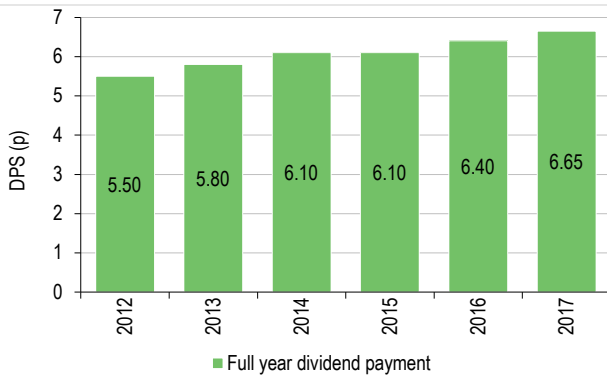
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Exhibit 1: Company at a glance

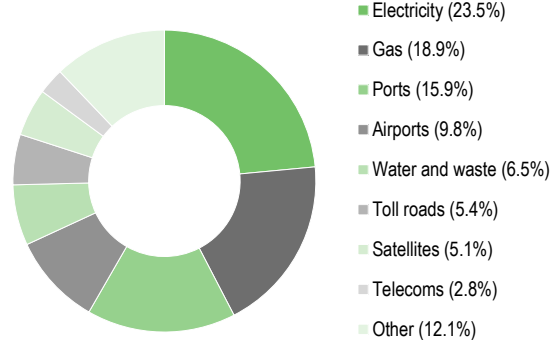
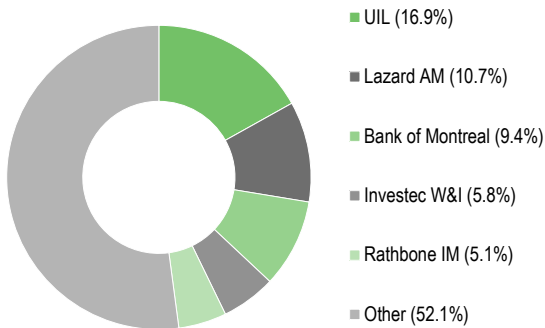
Investment objective	Recent developments
Utilico Emerging Markets' investment objective is to provide long-term total return by investing predominantly in infrastructure, utility and related sectors mainly in emerging markets.	<ul style="list-style-type: none"> 19 June 2017: Annual results to 31 March 2017. NAV total return of 26.2% versus MSCI Emerging Markets Index TR of 34.5%. 16 May 2017: Announcement of fourth quarterly interim dividend of 1.70p. 2 February 2017: Announcement of third quarterly interim dividend of 1.70p.

Forthcoming		Capital structure		Fund details	
AGM	September 2017	Ongoing charges	1.1% (at 31 March 2017)	Group	ICM
Interim results	November 2017	Net gearing	8.9%	Manager	Charles Jillings
Year end	31 March	Annual mgmt fee	0.65%	Address	UK office: PO Box 208, Epsom, Surrey KT18 7YF
Dividend paid	September, December, March, June	Performance fee	15% of outperformance (cap: 1.85% of average net assets)	Phone	+44 (0)1372 271486
Launch date	20 July 2005	Company life	Indefinite (subject to vote)	Website	www.uem.bm
Continuation vote	Five yearly, next 2021 AGM	Loan facilities	£50m		

Dividend policy and history (financial years)	Share buyback policy and history (financial years)
The fund is managed for total return, but the board broadly seeks flat or rising dividends.	Subject to annual renewal, UEM has authority to repurchase up to 14.99% and allot shares up to 10% of the issued share capital.



Shareholder base (as at 16 June 2017)	Portfolio exposure by sector (look through as at 31 May 2017)
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Top 10 holdings (as at 31 May 2017)			Portfolio weight %	
Company	Country	Sector	31 May 2017	31 May 2016*

Company	Country	Sector	31 May 2017	31 May 2016*
International Container Terminal Services	Philippines	Ports operator	5.3	3.8
Ocean Wilsons Holdings	Brazil	Ports operator and shipping services	4.3	4.4
Alupar Investimento	Brazil	Electricity generation & transmission	3.8	N/A
Malaysia Airports Holdings	Malaysia	Airport operator	3.7	7.6
Transgaz	Romania	Gas transmission	3.5	2.4
Transelectrica	Romania	Electricity transmission	3.3	3.4
Conpet	Romania	Oil pipeline operator	3.2	N/A
Rumo Logistica Operadora Multimodal	Brazil	Rail-based logistics operator	2.8	N/A
Eastern Water Resources Dev & Mgmt	Thailand	Water treatment and supply	2.8	5.1
APT Satellite Holdings	Hong Kong	Satellite operator	2.7	4.5
Top 10			32.7	44.3

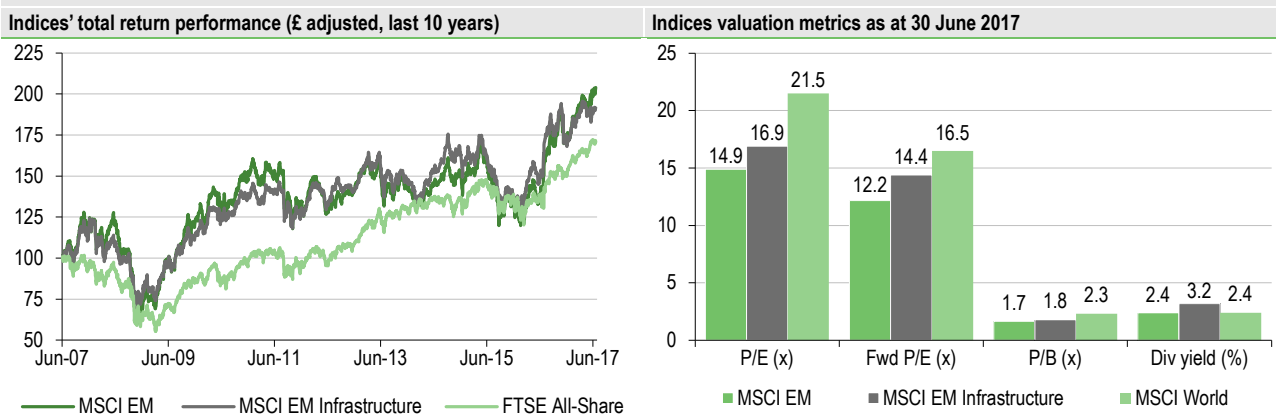
Source: Utilico Emerging Markets, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in May 2016 top 10.

Market outlook: Emerging markets still on a discount

Exhibit 2 (left-hand side) shows the performance of emerging market and UK shares over the last 10 years. The value of overseas equities to UK-based investors has been boosted over the last 12 months by the weakness of sterling. Despite above-average growth, emerging markets continue to trade at a discount to world equities, possibly due to their historical higher share price and economic growth volatility.

In its April 2017 World Economic Outlook, the International Monetary Fund maintained its forecasts for emerging market and developing economies growth of 4.5% and 4.8% in 2017 and 2018, respectively, versus 2.0% growth for advanced economies in both 2017 and 2018. Factors contributing to stronger emerging market growth include higher infrastructure spending, a rapid rise in the middle classes, relatively low levels of household debt and rising standards of education. While emerging market infrastructure stocks are trading at higher valuations on an earnings basis than emerging market stocks overall, they are trading on a similar price-to-book ratio and offer a higher dividend yield. Both asset classes are cheaper on earnings and price-to-book multiples versus world equities (Exhibit 2, right-hand side). For investors wishing to gain exposure to emerging markets equities, a fund offering an attractive yield from a portfolio of relatively stable businesses, which also has a positive long-term performance record, may be of interest.

Exhibit 2: Market performance and valuation



Source: Thomson Datastream, MSCI, Edison Investment Research

Fund profile: Investment in infrastructure and utilities

UEM was launched in July 2005. It is a Bermuda-registered investment company listed on the premium segment of the Official List of the Financial Conduct Authority and its shares are traded on the Main Market of the London Stock Exchange. UEM aims to generate long-term total returns from a diversified portfolio primarily invested in emerging market infrastructure, utility and related sectors.

Since launch, the fund has been managed by Charles Jillings, who is a director at ICM – a Bermuda-based investment company, which has more than £16bn in assets that are managed either directly or indirectly for institutional and retail investors. ICM specialises in the infrastructure and utility, financial services, mining and resources, technology and fixed income sectors. The manager selects stocks on a bottom-up basis; he is unconstrained by index weightings, although MSCI Emerging Market Index allocations are used as a reference. ICM is eligible for a performance fee for outperformance versus the UK gilt five- to 10-year index post-tax yield, plus RPIX inflation, plus 2%, subject to an 8% minimum, which is capped at 1.85% of average NAV.

There are internal risk management guidelines in place, including gross asset limits (at the time of investment) of 60% in the top 10 holdings, 10% in a single stock, 30% in an individual country, 25%

in a sector, and 5% in unlisted securities (currently 3.5%). Investments outside of the core infrastructure, utility and related sectors are capped at 20%. The limit on gearing (total borrowings versus gross assets) is 25% at the time of drawdown; at end-May 2017, net gearing was 8.9%.

The fund manager: Charles Jillings

The manager's view: Optimistic on the outlook for EM equities

Since launch to end-May 2017, UEM's NAV total returns have compounded at 12.0% pa. This is lower than the 15.0% annual total returns that the manager seeks from investee companies as a result of UEM's running costs, exchange rates and emerging market share price volatility. However, Jillings is optimistic on the outlook for emerging market equities. As a result, he has increased UEM's gearing meaningfully over the last several months from £11.0m at end-October 2016 to c £50.0m (the full amount of the current debt facility). The manager believes that the next 10 years will provide as many attractive opportunities in emerging market equities as occurred in the last 10 years. He focuses on markets where the political environment is generally stable; economic growth is favourable, helped by growing middle classes that demand better infrastructure, utilities and related services (the sectors in which the majority of UEM's portfolio is invested); and where there is a positive attitude to foreign direct investment. Jillings stresses the importance of investing in companies with strong management teams that have an appreciation of financial considerations as well their underlying businesses.

The manager says that he avoided investing in Argentina for many years due to capital controls and rampant inflation under the Kirchner administration. The government was interfering in business, such as disallowing tariff increases for energy transmission companies, which in an inflationary environment made them unprofitable. President Mauricio Macri has been in office since 2015; the manager opines that he has rapidly implemented widespread and radical changes. In 2016, a 200% tariff hike was implemented for utility companies, with further substantial increases to be phased in from April 2017 to April 2018. UEM now has a holding in Transportadora de Gas del Sur (TGS), the largest gas distribution company with a c 60% market share. The manager says the company has now had a \$2bn utility asset base recognised with an 8.99% allowed rate of return; he expects a dividend to be paid in 2018.

Asset allocation

Investment process: Thorough fundamental research

The manager is able to draw on the deep experience of ICM's investment team to construct a portfolio that is diversified by geography and sector, primarily in the emerging market infrastructure, utility and related sectors. He invests for the long term, avoiding 'market noise', aiming to generate both capital growth and income. The focus is on listed companies, the majority of which are currently profitable and paying dividends; the typically strong cash flow generation nature of investee companies provides some insulation during periods of economic weakness or currency fluctuations. UEM's portfolio consists of c 60 to 90 high-conviction ideas selected from a bespoke investible universe of c 900 companies. Potential investments are subject to in-depth fundamental research, which includes the construction of detailed models and setting valuation targets. Site visits and meetings with company managements and foreign government officials are a key part of the investment process. The manager adopts a strict valuation discipline; buying companies that are trading at a discount to their perceived value, that he believes can generate 15% annual returns for shareholders. Investments in FY17 totalled £161.2m (£96.1m in FY16), partially funded by higher bank debt, and realisations were £142.2m (£130.5m in FY16), which is higher than the historical average due to an intentional diversification away from the largest portfolio holdings.

Current portfolio positioning

Over the last 12 months, the allocations to UEM's largest portfolio holdings have decreased; the manager has expanded the stock list as a result of finding further attractive investment opportunities (during FY17, the number of portfolio holdings increased from 86 to 92). UEM regularly announces its top 20 holdings, which comprised 57.4% of the portfolio at end-May 2017 compared to 63.3% at end-May 2016. The manager also states that in recent years, the percentage of the portfolio in the top 10 holdings has declined from above 50% to the current level of c 35%.

Exhibit 3: Portfolio geographic and industrial exposure (% unless stated)

Geography	Portfolio end-May 2017	Portfolio end-May 2016	Change (pp)	Industry	Portfolio end-May 2017	Portfolio end-May 2016	Change (pp)
Brazil	19.1	11.4	7.7	Electricity	23.5	16.5	7.0
China incl. Hong Kong	17.0	26.5	(9.5)	Gas	18.9	18.6	0.3
Romania	11.4	8.8	2.6	Ports	15.9	14.2	1.7
Philippines	6.9	5.7	1.2	Airports	9.8	12.8	(3.0)
Middle East/Africa	6.5	7.0	(0.5)	Water and waste	6.5	9.4	(2.9)
Other Latin America	6.4	4.7	1.7	Other	6.3	6.5	(0.2)
Malaysia	6.2	12.2	(6.0)	Toll roads	5.4	3.7	1.7
India	6.0	4.8	1.2	Satellites	5.1	9.0	(3.9)
Argentina	5.5	0.0	5.5	Telecoms	2.8	2.3	0.5
Other Europe	4.5	3.7	0.8	Other infrastructure	2.4	4.1	(1.7)
Thailand	4.1	6.6	(2.5)	Infrastructure inv. funds	1.9	2.0	(0.1)
Chile	3.5	5.6	(2.1)	Renewables	1.5	0.9	0.6
Other Asia	2.9	3.0	(0.1)				
	100.0	100.0			100.0	100.0	

Source: Utilico Emerging Markets, Edison Investment Research

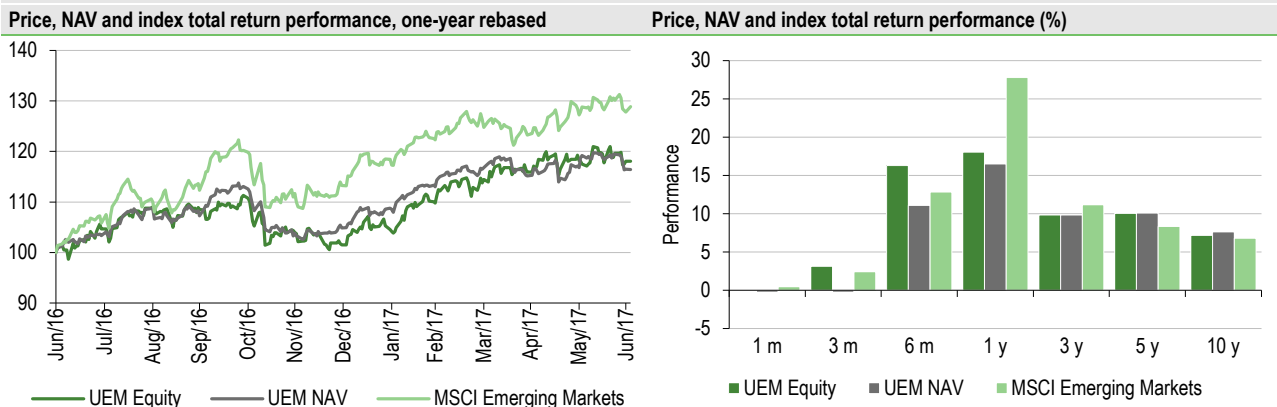
Exhibit 3 shows UEM's exposure by geography and sector. While stock selection is made on a bottom-up basis, it is interesting to note the major changes over the last 12 months. On a geographic basis, the largest increases in exposure are in Latin America: Brazil (+7.7pp) and Argentina (+5.5pp); while the largest decreases are in Asia: China/Hong Kong (-9.5pp, due to valuation considerations) and Malaysia (-6.0pp). The manager notes that UEM's FY17 dividend was more than fully covered, partly due to the shift in geographic exposure, as Latin American companies in aggregate pay higher dividends than Asian companies. On a sector basis, over the last 12 months, the largest increase in exposure is electricity (+7.0pp), offset by lower exposure in satellites (-3.9pp) and airports (-3.0pp).

The manager again highlights the attractive investment opportunities available in Romania. A year ago, 2016 Romanian GDP growth was estimated at 4.1% but subsequently was reported as 4.8%. The outlook is for acceleration in annual economic growth, with 5.7% recorded in Q117 and the Romanian finance ministry forecasting 5.2% for 2017. In the December 2016 legislative election, the Social Democratic Party won with a promise to tackle the fiscal deficit. All state-owned enterprises are required to pay out 90% of earnings and surplus distributable reserves. Three of UEM's top 10 holdings are Romanian: Conpet, Transelectrica and Transgaz. They have yields ranging from c 8% to c 13% and the manager highlights their low single-digit EV/EBITDA valuation multiples, despite significant share price appreciation over the past year. All three companies have significantly increased their dividend payout ratios, but their balance sheets remain strong.

Performance: High absolute one-year total returns

Sterling weakness in H216 boosted the returns for UK-based investors in overseas equities. UEM's share price and NAV total returns of 18.0% and 16.5% over one year, respectively, lagged the MSCI Emerging Market Index total return of 27.8%, as would be expected given its higher quality, lower volatility focus. However, over the longer term, UEM has outperformed this index. Since inception to end-FY17, UEM's total return of 280.8% is meaningfully ahead of the 194.8% total return of the MSCI Emerging Markets Index.

Exhibit 4: Investment trust performance to 30 June 2017



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

UEM's relative returns are shown in Exhibit 5. It has outperformed the MSCI Emerging Markets Index over five and 10 years, while lagging over shorter periods. However, it has outperformed the MSCI Emerging Market Infrastructure Index over almost all periods shown. UEM's NAV total return has outperformed its performance fee benchmark over one, three and five years, while lagging over 10 years.

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	(0.6)	0.7	3.1	(7.6)	(3.6)	8.1	3.6
NAV relative to MSCI Emerging Markets	(0.7)	(2.6)	(1.6)	(8.8)	(3.6)	8.4	8.2
Price relative to MSCI EM Infrastructure	(0.2)	5.3	8.9	6.1	8.0	20.4	9.8
NAV relative to MSCI EM Infrastructure	(0.3)	1.8	4.0	4.7	8.0	20.6	14.7
Price relative to FTSE All-Share	2.4	1.7	10.2	(0.1)	6.9	(2.4)	18.6
NAV relative to FTSE All-Share	2.3	(1.6)	5.3	(1.4)	7.0	(2.2)	23.9
Price relative to performance fee benchmark*	(0.8)	1.2	11.9	9.3	5.1	12.8	(6.3)
NAV relative to performance fee benchmark*	(0.9)	(2.2)	6.9	7.9	5.1	13.1	(2.1)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-June 2017. Geometric calculation. *Benchmark for performance fee is UK Gilt five- to 10-year post-tax yield, plus RPIX, plus 2%, subject to an 8% minimum from 1 April 2014.

Exhibit 6: NAV total return performance relative to MSCI EM index over five years



Source: Thomson Datastream, Edison Investment Research

Discount: Broadly in line with historical averages

UEM's current 10.5% share price discount to cum-income NAV is broadly in line with the averages of the last one, three, five and 10 years of 10.5%, 9.6%, 8.3% and 8.6%, respectively. The range of discounts over the last 12 months is 6.9% to 13.4%. There is an inclination, but not a commitment to repurchase shares when the discount exceeds 10%. There have been no share repurchases so far in FY18. In FY17, 4.8m shares (2.3% of issued capital) were repurchased at a cost of £10.0m.

Exhibit 7: Share price discount to NAV (including income) over three years (%)


Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

UEM currently has 211.4m ordinary shares in issue. In September 2015, there was a one-for-five bonus issue of subscription shares; the remaining exercise dates are the last business dates in August 2017 and February 2018 at an exercise price of 183.0p. During FY17, 4.8m subscription shares were exercised, raising £8.7m. Exercise of all the remaining 37.8m subscription shares would result in c 3.8% dilution to the current NAV.

The manager increased the level of gearing in H217 (£46.8m versus £19.7m at H117) due to an abundance of attractive investment opportunities. At end-May 2017, bank debt of £49.4m was approaching UEM's £50.0m available facility; adding back cash, net gearing was 8.9%.

ICM is paid an annual management fee of 0.65% of net assets. In FY17, ongoing charges (excluding performance fees) were 1.1%, which was in line with the prior financial year. Including performance fees, FY17 ongoing charges were 2.9%, which was 1.8pp higher than the prior year. Subject to an 8% minimum hurdle, a 15% performance fee on returns in excess of the UK gilt five- to 10-year index post-tax yield plus RPIX inflation plus 2% is payable (the NAV must exceed the high watermark NAV when the performance fee was last paid). The performance fee is capped at 1.85% of net assets; 50% is paid in shares and 50% in cash.

Dividend policy and record

UEM pays quarterly dividends in September, December, March and June. While its primary objective is capital growth, the board has a progressive dividend policy; annual dividends have been increased or maintained every year since the fund's inception in 2005. The FY17 annual dividend of 6.65p per share was a 3.9% increase versus the prior year, which was in line with the five-year compound annual growth rate; it was 1.16x covered by revenue earnings.

Revenue income increased meaningfully in FY17 (excluding Asia Satellite Communications' special dividend in FY16), due to higher dividends from investee companies, larger portfolio exposure to higher-yielding investments, such as in Brazil and Romania, and sterling weakness. At end-FY17, retained revenue reserves were 6.23p per share, which was equivalent to 0.94x the FY17 annual dividend. UEM's current dividend yield is 3.1%; based on a growing level of dividend income, the manager is hopeful that the trust will be able to grow its annual dividend payout in FY18.

Peer group comparison

UEM is a member of the AIC Global Emerging Markets sector. Exhibit 8 shows the peers with a market cap in excess of £100m. UEM's specific focus on infrastructure and utility assets means that the funds cannot be compared directly; however, its diverse emerging market exposure means that there is some relevance to the comparison. Its NAV total returns are ahead of the peer group weighted average over five and 10 years, while lagging over one and three years; UEM's higher-quality focus may have contributed to weaker relative performance over one year. The fund has a below-average discount and the joint lowest ongoing charge, although a performance fee is payable. Following the recent increase in gearing, UEM has the highest level of gearing and it has the third highest dividend yield of the five peers that pay a dividend.

Exhibit 8: Selected peer group as at 03 July 2017*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Utilico Emerging Markets	466.9	16.5	32.5	61.7	108.6	(7.8)	1.1	Yes	109	3.0
Aberdeen Emerging Markets	295.9	26.6	37.0	47.8	51.3	(12.9)	1.1	Yes	100	0.0
BlackRock Frontiers	261.2	24.4	35.9	127.2		3.9	1.4	Yes	105	3.6
Fundsmith Emerging Equities Trust	284.4	9.3	14.3			1.3	1.9	No	100	0.0
Genesis Emerging Markets Fund	887.9	20.7	29.7	45.8	114.0	(12.7)	1.4	No	100	0.0
JPMorgan Emerging Markets	991.3	23.2	48.5	60.9	109.3	(10.9)	1.2	No	100	1.1
JPMorgan Global Emerging Markets	362.4	23.0	27.5	49.5		(3.6)	1.4	No	106	4.0
Templeton Emerging Markets	1,902.3	33.4	30.3	43.6	111.7	(12.4)	1.2	No	103	1.2
Weighted average		25.3	33.3	53.8	107.4	(9.7)	1.3		102	1.8
UEM rank in sector	4	7	4	2	4	4	8		1	3

Source: Morningstar, Edison Investment Research. Note: *Performance as at 30 June 2017. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

There are currently five non-executive directors on UEM's board, four of whom are independent of the manager. Chairman John Rennocks was appointed in November 2015 and assumed his current role in September 2016, following the retirement of Alexander Zagoreos. The deputy chairman is Garth Milne, who was appointed in November 2014. Garry Madeiros was appointed in June 2007 and Anthony Muh in October 2010. Susan Hansen was appointed in September 2013; she is also on the board of Homeloans, which is a company associated with ICM, so is considered to be non-independent. UEM's manager, Charles Jillings, stood down from the board in March 2012 to improve corporate governance and increase the board's independence.

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