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Sector report Infrastructure

Water opens floodgates for infrastructure investment

As investors, we are undoubtedly experiencing a unique point in time with global structural concerns, limited growth, geopolitical risks and expected low investment returns over the coming years in both fixed income and equity asset classes.

We struggle to find investments that are supported by strong long-term growth drivers, which are not at extremely stretched valuation levels.

Helped by a global sense that infrastructure spending needs to pick up sharply alongside a drive towards better regulation and enforcement of water quality standards, we think water is set to do well in the years ahead.

Higher spending

There is increasing public and political agreement that degrading infrastructure is no longer acceptable and politicians around the world are pushing a populist agenda in favour of higher infrastructure spending – regardless of whether they lean to the right or the left.

Infrastructure spending and fiscal stimulus look to be the next phase of trying to support a sluggish global economy. Indeed, it was interesting to see that in the last US presidential election both candidates strongly favoured increasing infrastructure spending, although most water infrastructure spending is in fact generated by cities and states and not at a Federal level.

Water spending is already benefitting from this changing political atmosphere and seems likely to continue to do so for years to come.

Do the right thing

Having dialled back water infrastructure investment since the financial crisis, governments and water utilities have begun playing catch-up over the past few years. Meanwhile, the conversation has changed between those that propose the water capital budget and those that approve it.

Two truths about politicians are universal: they want to be re-elected (or appointed) and they do not want to be on the front page of the paper for the wrong reasons.

To over-generalise: in the past, the key goal of a politician (as far as utilities are concerned) was to keep water prices low to keep their constituents happy. But now, particularly in the US and China, the public reaction to recent examples of very serious water problems and the widespread contamination of surface and ground water, has elevated the importance of doing what is right over what is cheaper.

Notably this is happening when the earnings of water companies have already outpaced the market.

Strong growth

Over the past decade, our water portfolio's earnings per share have grown about 4% per year faster than the MSCI All Country World Index. We believe that 2017 will be another strong year of mid-teens EPS growth, driven by improving end markets and many company-specific drivers.

The strong earnings performance of water stocks in recent years has been achieved despite the low-growth macro environment. This is because that low growth led to significant restructuring, operational excellence initiatives, portfolio reshaping, improved balance sheets, product innovation and client focus, which are the hallmarks of strong businesses.

Matt Sheldon
Senior portfolio manager, KBI Global Investors

A rapidly growing global middle class is driving demand for clean water

On the whole, the water companies in which KBI Global invests are much less cyclical, with more durable sustainable competitive advantages.

Key drivers

When we started investing in water in 2000, the premise relied on long-term tailwinds, known as the 'five indisputables', to support long-term outperformance: constrained supply of clean water; rising demand; stricter regulation; more capital spent on infrastructure; and greater need for water technologies.

As we review these key drivers, we are struck by how much more relevant they are today. The supply/demand gap continues to widen.

Existing infrastructure is ageing and requires greater upkeep each year.

High-growth regions are becoming a larger share of the total – we started the strategy between the ninth and 10th five-year plan in China, before it was material. Today, China is the largest market.

The rapidly growing global middle class is increasingly demanding clean water, which is driving regulation and growth in infrastructure.

Finally, companies have been more successful at commercialising and bringing down the costs of technologies in order to address key water problems, from contamination and resiliency to availability. LW