Data, decarbonization and the travel recovery

Three themes driving infrastructure are setting up a potentially strong vintage year, coinciding with stimulus programs focusing attention on the asset class.

by **Ben Morton**

KEY TAKEAWAYS

Digitalization of economies driving data infrastructure buildout

Companies and governments are ramping up investments in wireless networks to meet surging data usage, while 5G-enhanced technologies are poised to transform every corner of the economy over the next decade, supporting demand for cell towers and data centers.

Renewables paving the future for energy usage

Carbon-reduction policies, coupled with tax incentives and declining cost structures, are hastening the move away from fossil fuels to clean energy sources, providing what we believe is a game-changing growth opportunity for some U.S. utility companies and pure-play solar and wind producers.

Vaccines and economic recovery to get the world moving again

Economically sensitive subsectors such as freight rails and marine ports appear well positioned for improving activity levels in 2021, while passenger transport businesses that were heavily impacted by virus-driven travel restrictions stand to gain from an eventual return to "normal."

Introduction

2021 is shaping up to be a potentially attractive vintage year for global infrastructure

EXHIBIT 1

10-year performance characteristics

Annualized return	Global infrastructure	8.1%
	Global equities	9.9%
Standard deviation	Global infrastructure	11.5%
	Global equities	14.0%
Infrastructure up/down capture vs. global equities	Upside capture	62.3%
	Downside capture	51.3%

At December 31, 2020. Source: FTSE, MSCI and FactSet.
Data quoted represents past performance, which is no guarantee of future results. Data does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee investors will experience the type of performance reflected above. An investor cannot invest directly in an index, and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations, as volatility and other characteristics may differ from a particular investment. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend may begin. See page 12 for index associations, definitions and additional disclosures.

Momentum is growing for infrastructure-based stimulus

After decades of underinvestment in infrastructure in developed markets, the urgent need for a sustained economic recovery is putting infrastructure front of mind around the world. Many governments are including infrastructure-based stimulus programs as part of their fiscal relief efforts, taking advantage of historically low borrowing costs to drive growth and make critical investments in renewable energy. For example:

- The European Commission's €750 billion (US$865 billion[1]) Next Generation EU recovery fund, approved last July, included a large green infrastructure component.
- The U.K. announced plans in November to increase infrastructure spending to the highest sustained levels in more than 40 years, budgeting £100 billion (US$130 billion) for 2021 and £600 billion (US$800 billion) over the next four years.
- Japan's ¥74 trillion (US$710 billion) economic stimulus package revealed in December included nearly $400 billion in green and digital infrastructure.
- Australia substantially increased its infrastructure budget for 2020–21 and is planning a record A$110 billion (US$80 billion) in land transport improvements over the next decade.
- The U.S. relief bill passed in December included funding for transportation industries and broadband development and was broadly positive for renewables—extending tax credits, funding research, procuring renewable-sourced electricity, and investing in electric vehicle charging stations.

We believe this is likely just the beginning. In the U.S., the incoming Biden administration has made green infrastructure a centerpiece of its Build Back Better plan, and calls are growing for a substantial infrastructure stimulus package in 2021.

How a U.S. infrastructure bill may benefit listed infrastructure companies

Support for 5G investment could accelerate demand for denser tower networks. New incentives for renewable energy could benefit utilities shifting from carbon-based fuels to solar and wind. Public spending on roads and rails—though not directly benefiting owners and operators of infrastructure assets—would stimulate economic activity, potentially resulting in higher infrastructure utilization.

Attractive historical characteristics and current relative value

With the added attention on infrastructure, we are seeing increasing investor interest in listed infrastructure strategies, which offer historical characteristics that are in high demand today:

- Predictable revenues tied to regulated businesses, government concessions or long-term commercial contracts
- Returns similar to equities but with lower volatility and about half the downside capture over the 10 years ending December 31, 2020 (Exhibit 1)

(1) Currency conversions calculated as of the announcement date.

Investors have an opportunity to participate in next-generation infrastructure themes at discounted relative values

- Inelastic demand (in typical, non-pandemic conditions) due to the essential nature of their services
- Attractive income profile at a time of historically low fixed income yields
- Inflation-linked revenues to defend against the rising risk of unexpected inflation

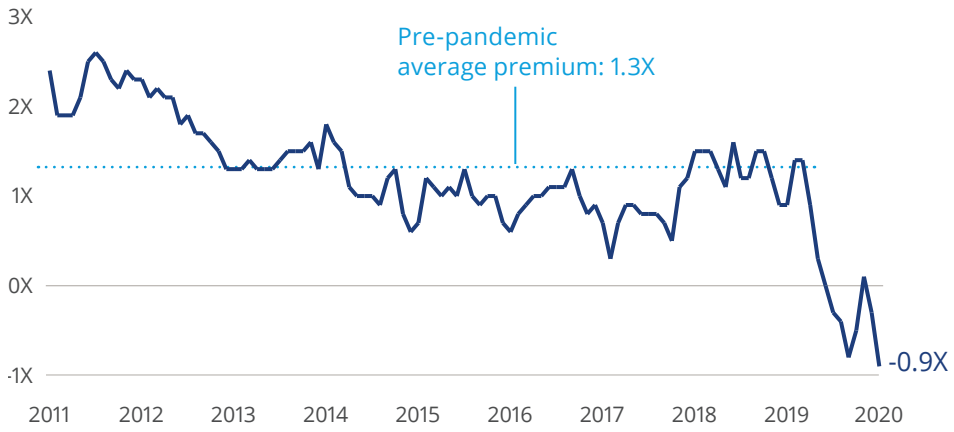
Historically, these characteristics have helped listed infrastructure achieve a 1–2X cash flow multiple premium over equities. But after a year in which infrastructure widely underperformed global equities—disproportionately impacted by travel restrictions and country lockdowns—that premium has vanished amid questions about the timing of a recovery and the potential lasting effects of the pandemic (Exhibit 2).

In our view, this represents an opportunity to enhance portfolio diversification potential with listed infrastructure at historically attractive relative values. Although some sectors could face long-term challenges, we believe most of the infrastructure universe is positioned to benefit from secular and cyclical tailwinds—including the digital transformation of economies, the global mission to slow climate change by transitioning to renewable energy, and the potential recovery in passenger travel due to the arrival of vaccines and an improving global economy.

EXHIBIT 2

Infrastructure's historical premium has vanished, representing potential value

EV/EBITDA spread (infrastructure minus equities)



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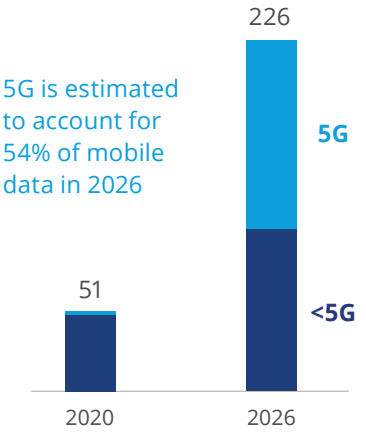
Digitalization of economies driving data infrastructure buildout

EXHIBIT 3

Growing data intensity will require massive investment in wireless networks

Global mobile data traffic, exabytes per month



At November 2020. Source: Ericsson Mobility Report. There is no guarantee that any market forecast or investment objective set forth in this presentation will be realized. See page 12 for additional disclosures.

Rising data intensity is spurring a wave of network investment

Data centers and cell tower companies are benefiting from strong secular growth trends, as virtually every industry is moving to build out digital platforms and utilize 5G wireless technology. We believe the persistence of work-from-home and learn-from-home policies will likely accelerate growth in network deployment.

By 2026, global mobile data usage is estimated to quadruple, with over half of all traffic likely to be carried by 5G networks (Exhibit 3). Deploying 5G networks will require not only increased investments in traditional "macro" cell towers, but also small-cell nodes, interspersed to provide capacity in areas of higher population density. These nodes can be placed on macro towers or existing structures, such as traffic lights, streetlamps and rooftops, connected to local data centers via underground fiber. Once in place, these networks will have the potential to open new commercial applications that are already taking shape.

Rapid growth in data usage in the late-4G environment and the urgent demands of the approaching 5G era will require massive investments to expand communications infrastructure capacity over the next decade. We believe this stands to directly benefit the cell tower industry, where public U.S. companies hold dominant market positions. In addition, we believe the spike in both wireless and wired data traffic has the potential to drive sustained demand for data centers.

5G use cases

The Internet of Things (IoT)

Embedded 5G hardware will enable any computerized item to interact with other objects over the internet, creating a global wireless network of interconnected "things."

Augmented reality and remote robotics

Augmented and virtual reality is expected to be a $73 billion market by 2024(2), powering applications as diverse as surgical tools, immersive entertainment, educational simulations and virtual tourism.

Autonomous vehicles

A single driverless car could generate as much data in a day as about 20,000 5G smartphones.(1) High data speeds, reliable connections and low lag times will be critical to allowing vehicles to communicate with each other and with city infrastructure sensors.

Smart manufacturing

Entire factories could become 5G enabled through a single roof antenna, letting manufacturers monitor every aspect of the production process in real time, correcting costly inefficiencies early in the fabrication stage and shortening the production cycle.

Smart cities

Connected infrastructure could become the backbone of entire smart cities, able to deliver targeted, hyper-efficient municipal services, from public transportation to snow removal, based on granular real-time information.

Agriculture monitoring

Real-time monitoring of crop, soil and livestock conditions and precision forecasting of weather patterns could help farmers optimize crop yields, identify early signs of livestock disease and manage acreage while controlling farm labor costs.

(1) At December 2020. Source: Statista, Intel, Cohen & Steers. Smartphone equivalence assumes 6GB of typical monthly data usage, compared with 4TB of data generated every 90 minutes of autonomous vehicle operation, representing typical daily use. (2) At November 2020. Source: Statista.

Independent tower model presents opportunities outside the U.S.

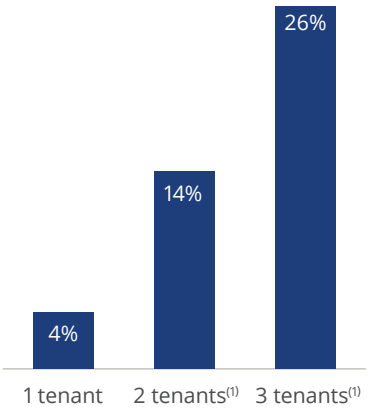
The U.S. is unique in that the majority of cell towers are owned by independent tower operators, which benefit from the ability to lease out space on those towers to multiple tenants (co-location). An independent tower company that can accommodate multiple tenants on a single tower can typically generate higher margins on those assets than what is seen among wireless carriers that still own and are the sole user of their towers. Exhibit 4 provides a hypothetical illustration of the potential margin improvement with increased tenancy.

Europe and many other parts of the world still operate largely with carrier-owned towers, which tends to be a far less efficient model. As a result, more mobile network operators are evaluating the ownership structure of their tower assets, increasingly resulting in asset sales, spin-offs, and IPOs. This move to independence, and new potential business combinations, can increase the number of tenants per tower and allow for cost savings through the decommissioning of redundant assets. This process is still in its infancy, offering potential value creation through more transitions and consolidation (Exhibit 5).

EXHIBIT 4

Independent tower operators may enhance margins by hosting more tenants

Hypothetical illustration of ROI impact for a U.S. tower operator

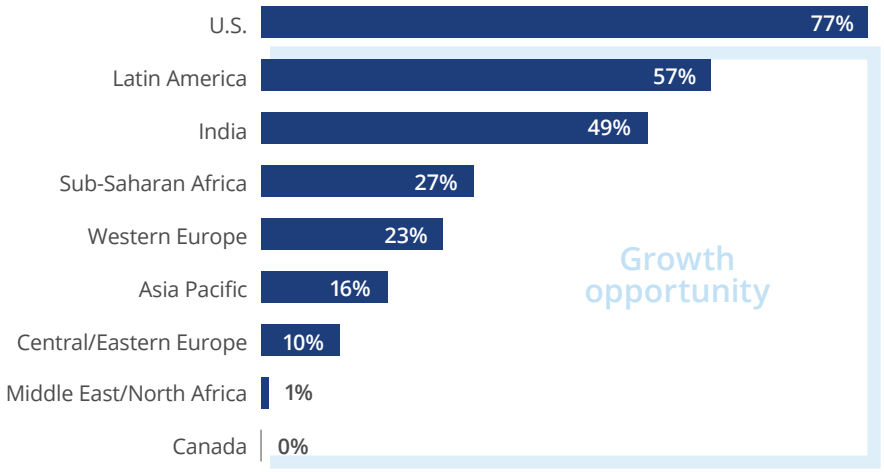


At December 31, 2020. Source: Cohen & Steers.

EXHIBIT 5

Higher margins for independent tower businesses could drive adoption, particularly outside the U.S.

% of tower assets owned by independent operators



At November 30, 2020. Source: Cohen & Steers, company data.

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(1) Assumptions: construction cost of $280,000; revenues of $25K, $55K and $90K, respectively (co-located tenants typically pay higher rents than anchor tenants on build-to-suit towers in the U.S.); and modestly higher operating expenses with each new tenant. Return on investment (ROI) is gross margin (revenues minus operating expenses) divided by construction cost. See page 12 for additional disclosures.

Renewable generation paving the future for energy usage

Decarbonization trends are accelerating the transition to renewables

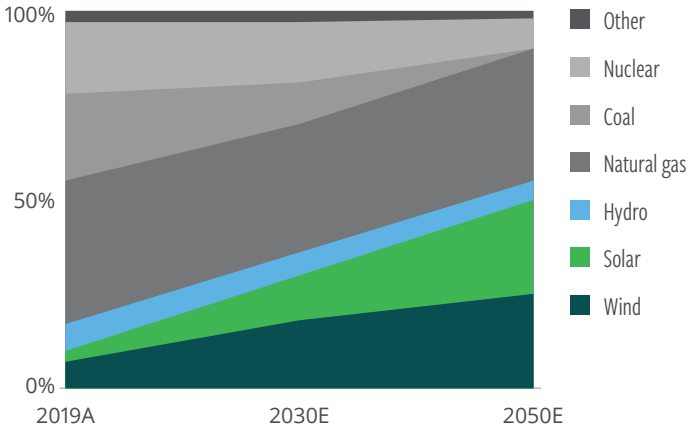
Political and regulatory support for renewable energy is strong, and substantial improvement in the production cost curve for solar and wind has allowed renewables to become cost competitive with traditional sources of generation. Compared with other markets such as Europe (about 20% penetration in 2020), the U.S. is still in the early innings of transitioning from carbon-based fuel sources to clean energy (10% penetration), while some emerging economies have yet to begin the transition in earnest.

Given competitive economics and a low carbon footprint, the energy transition is generally supported by a broad group of stakeholders, including politicians, regulators, customers and shareholders. Most U.S. utilities are actively building out renewable energy assets, doubling their contribution since 2016 to more than 10% of all U.S. energy generation in 2019. In the next 30 years, wind and solar are expected to account for half of the U.S. power mix as coal and nuclear plants are retired (Exhibit 6). Part of this is due to better economics, as scale and technology advancements have allowed utilities to build new wind and solar generation quickly and efficiently. Today, unsubsidized costs for clean energy are in line with—or in some cases, below—traditional coal, gas and nuclear generation (Exhibit 7). In effect, it is now often cheaper to save the environment than to pollute it.

EXHIBIT 6

Wind and solar are expected to make up half of U.S. power generation by 2050

Estimated U.S. power mix

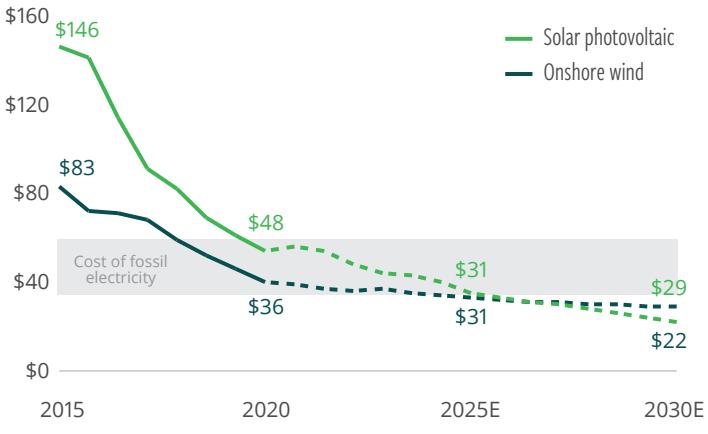


At July 2020. Source: U.S. Energy Information Administration, Wells Fargo Securities, Cohen & Steers.

EXHIBIT 7

Wind and solar are now cheaper than some carbon-based energy

Levelized cost of energy, $/MWh



At December 2020. Source: BloombergNEF.

Based on U.S. data but illustrative of global trends. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin. There is no guarantee that any market forecast or investment objective set forth in this report will be realized. The mention of specific sectors is not a recommendation or solicitation to buy, sell or hold any particular security and should not be relied upon as investment advice. See page 12 for additional disclosures.

Most U.S. utilities are transitioning away from carbon-based fuel sources

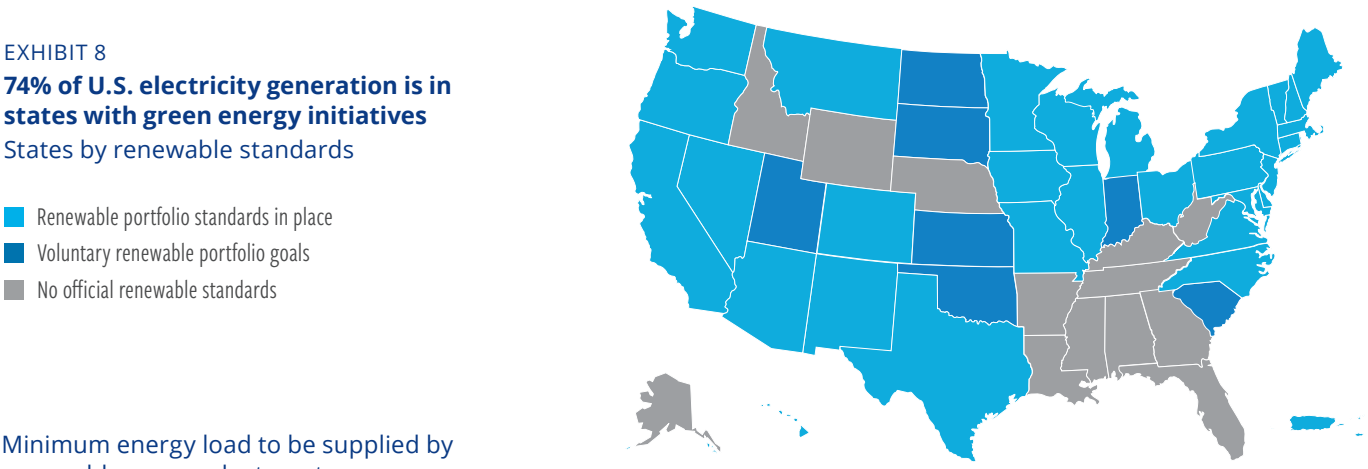
Federal and state governments have encouraged the shift to renewable energy through tax credits, which were extended by Congress in December and are likely to be expanded under the Biden administration. Many states have also adopted aggressive carbon-reduction targets. Today, 30 states, D.C. and some U.S. territories have renewable portfolio standards that require utilities to supply a minimum percentage of their retail load from clean energy sources (Exhibit 8). Including the seven other states with voluntary renewable portfolio goals, 74% of U.S. retail electricity sales are in states with green energy initiatives.

One way utilities are transitioning to clean energy is by replacing fossil fuel plants with new renewable operations in a "steel for fuel" industry initiative, swapping out traditional coal and gas generation for fuel-free wind and solar. The benefits can be substantial, often leading to lower energy bills for consumers and allowing utility companies to shift capital to clean, return-generating assets. We believe future policy and regulatory support at the federal and state levels could solidify the growth outlook for these utilities as they build and then earn a return on renewable assets. By contrast, we believe this shift will create long-term challenges for midstream energy businesses, although fossil fuels—and natural gas, in particular—will likely be an important part of the transition in the near to medium term.

EXHIBIT 8

74% of U.S. electricity generation is in states with green energy initiatives

States by renewable standards



Minimum energy load to be supplied by renewable sources by target year

Arizona	15%	2025	Kansas	20%	2020	New Jersey	50%	2030	Rhode Island	38.5%	2036
California	100%	2045	Maine	100%	2050	New Mexico	100%	2045	S. Carolina	2%	2021
Colorado	30%	2020	Maryland	50%	2030	New York	100%	2040	S. Dakota	10%	2015
Connecticut	27%	2020	Massachusetts	35%	2030	N. Carolina	12%	2021	Texas[a]	10 GW	2025
D.C.	100%	2032	Michigan	15%	2021	N. Dakota	10%	2015	Utah	25%	2025
Delaware	25%	2026	Minnesota	26.5%	2025	Ohio	12.5%	2026	Vermont	75%	2032
Hawaii	100%	2045	Missouri	15%	2021	Oklahoma	15%	2015	Virginia	100%	2045
Illinois	25%	2025	Montana	15%	2015	Oregon	50%	2040	Washington	100%	2045
Indiana	10%	2025	Nevada	100%	2050	Pennsylvania	18%	2021	Wisconsin	10%	2015
Iowa[a]	105 MW	1983	New Hampshire	25.2%	2025	Puerto Rico	20%	2035			

At December 2020. Source: National Renewable Energy Laboratory (U.S. Department of Energy), Cohen & Steers.
(a) Some states mandate a minimum renewable energy generation capacity rather than a % of total capacity.
See page 12 for additional disclosures.

Power grid modernization supports earnings growth potential for utilities

Utilities have a critical role to play in fixing America's aging infrastructure. The current power grid has fueled over a century of energy consumption and economic growth, but it is now in need of significant repair and modernization. Power outages are disruptive and costly for customers and society, particularly with a subset of the population working from home. Furthermore, the modern electric grid must be able to accommodate the new supply of renewable resources.

In response to both changing customer preferences and new renewable supply, utilities across the country have started to implement grid modernization programs. We estimate these initiatives, in addition to renewable generation investments, are accelerating the earnings growth opportunity for U.S. electric utilities from 4% historically to around 6% per year over the next several years.

Grid modernization investments typically focus on three discrete areas:

Base grid maintenance and upgrades

- Replace poles, wires and substations
- Move wires underground
- Replace aging steel

Repairs and replacements are needed to ensure electrical infrastructure is in good condition to deliver power to customers safely and reliably. A large portion of distribution infrastructure is nearing its end of life and will become less reliable and more expensive to repair and maintain. Utilities are therefore replacing poles, wires and substations that are older and more prone to failure. This is particularly important in areas of the country that tend to experience severe weather events.

Cost efficiency and cybersecurity

- Install sensors, smart meters and voltage regulators
- Deploy software and hardware for cyber defense and automated data processing

Utilities are adding new technologies to the grid to increase efficiency and security while reducing costs for customers. These technologies include digital sensors, meters, automation, communications and control systems that help utilities deliver greater value from the underlying infrastructure and limit lost energy. For example, Advanced Metering Infrastructure (AMI) allows utilities to automate the assessment of customer power usage data for billing purposes without the need of a manual meter reading. An upfront investment in these "smart meters" reduces costs for both the utility and customers. AMI results in fewer truck rolls, reduced call center volume and reduced meter service and replacement costs. Separately, another aspect of this spending is cyber-related investments to protect the grid from outside threats.

Renewable electrification

- Connect new wind and solar farms to the grid
- Install two-way power lines
- Add charging stations for electric vehicles

Renewable resources such as wind and solar farms are often built on greenfield sites that do not have readily available transmission. As a result, new interconnections are required to connect them to the grid. Older power lines must also be replaced with two-way transmission to allow distributed generation resources such as solar roof panels to feed electricity into the grid. Likewise, electrification of transportation resources (electric vehicle charging interconnections) will play an important role in future utility grid modernization plans.

These critical grid modernization investments are needed to address new renewable supply and changing customer demand. In addition to driving above-trend growth for utilities, these upfront investments have the potential to create long-term cost savings for customers and enjoy strong regulatory support.

Vaccines and economic recovery to get the world moving again

Freight rails stand to benefit from a potential continued rebound in activity

The recovery of the goods-based economy (including e-commerce) has led to a resurgence of freight rail volumes that has exceeded the broader economic recovery (Exhibit 9). This can also be seen in the shift in mix of freight being moved. Whereas shipments of energy commodities and related goods are still below 2019 levels, the movement of consumer goods has accelerated, benefiting from increasing online orders and a broader trend of inventory restocking. We expect the broader onshoring trend to provide the potential for a continued tailwind as we move through 2021.

Toll roads have recovered with the ebbs and flows of travel restrictions

Traffic on European toll roads recovered relatively strongly following the initial lockdown, as travelers favored shorter road trips that allowed them to maintain distance from others (Exhibit 10). Traffic has scaled back as virus cases have accelerated, although we believe these trends offer a good indication of the potential for a rapid recovery following distribution of vaccines.

EXHIBIT 9

Freight rail traffic is now tracking above 2019 levels

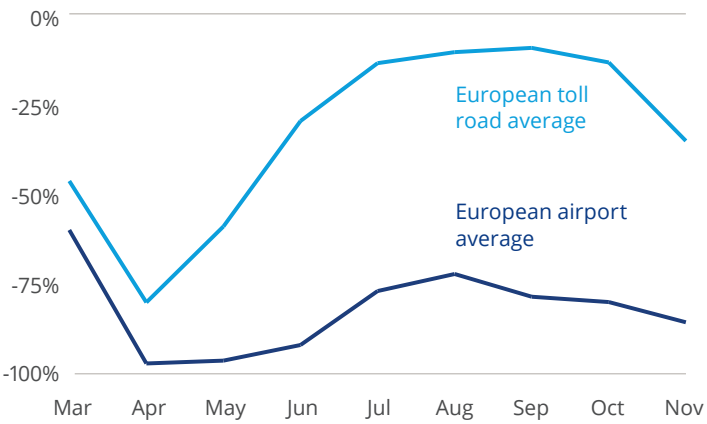
Year-over-year change in U.S. freight rail carloads

At December 31, 2020. Source: Association of American Railroads.

EXHIBIT 10

Toll road traffic has strongly recovered from trough levels

Year-over-year passenger growth (listed company assets only)



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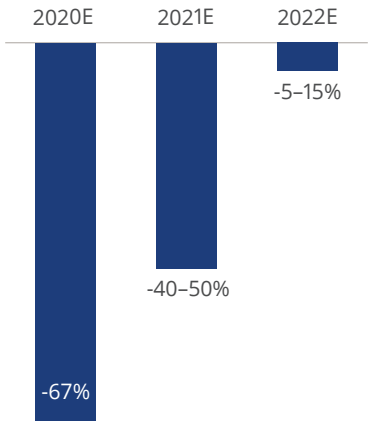
Vaccine distribution provides visibility to the mass passenger transport recovery

In contrast with freight rails and toll roads, we expect the potential recovery in air travel to be more gradual (Exhibit 11), with domestic passenger volumes recovering faster than international. Our base case is that air travel will surge after widespread vaccine distribution due to pent-up demand, but then taper off below historical levels, reflecting a reduced appetite for corporate travel in favor of more efficient virtual meetings.

EXHIBIT 11

We expect a longer path to an airport recovery

Estimated global passenger volumes vs. 2019 (global listed infrastructure companies under our coverage)



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Midstream energy: Selectively positioned in a transitioning industry

Infrastructure contains a selective subset of the midstream universe

Midstream energy companies contended with an unprecedented supply/demand shock in 2020, compounding structural challenges, that resulted in material underperformance. Importantly, we consider only 8–10 of the roughly 40 midstream companies as infrastructure. In general, this subset of companies is characterized by a) a focus on core regulated or contracted pipeline and storage businesses; b) lower direct and indirect exposure to energy commodity prices and production volumes; and c) better corporate governance, balance sheets and liquidity.

Transitioning to Midstream 3.0

Over the past five years, the midstream energy sector has firmly transitioned from a growth sector associated with "shale renaissance" spending requirements to the current period of cash flow harvesting. Since 2017, many midstream companies have materially reduced their reliance on capital markets (Midstream 2.0). We are now seeing steps that could further improve the industry in the coming years (Midstream 3.0). This includes an increased focus on capital allocation, as companies have reduced distributions and capital expenditures in an effort to generate excess free cash flow and reduce debt levels. A big driver of this in 2020 has been cost cuts, which we believe will continue to offset a challenging top-line environment for the industry.

These shifts now taking place are increasingly putting companies in a position to prioritize leverage reduction, reinvest in energy transition opportunities, buy back stock and, potentially at some point, sustainably increase distributions. Furthermore, we believe the market remains too fragmented and is likely to experience accelerating consolidation, similar to what is happening in the upstream exploration & production space.

Conclusion: The right time for infrastructure

We believe infrastructure is strongly positioned to benefit from the digital transformation of economies, the transition to clean energy and a vaccine-driven economic recovery

The unique nature of the 2020 downturn has created an attractive opportunity, in our view. Though listed infrastructure typically defends well in volatile markets, the direct impact of the pandemic on some sectors of infrastructure has left the asset class at a cash flow multiple at a discount to equities, compared with a typical 1–2X premium. That infrastructure should warrant no premium despite its history of predictable cash flows, strong returns and low volatility—particularly at a time of meaningful market uncertainty and continued low interest rates—strikes us as an irrational dislocation.

Though a small segment of the listed infrastructure market is likely to face longer-term structural challenges, most infrastructure sectors have either benefited from the accelerated adoption of e-commerce and renewables, or have a clear foundation for potential recovery—factors we believe have yet to be fully appreciated. Accordingly, we believe 2021 is likely to be an attractive year for adding to or initiating an allocation to global listed infrastructure.

Summarizing the case for global listed infrastructure

Supportive secular drivers

- Access to essential real assets that underpin societies and global economies
- Historical underinvestment has led to severe service quality deterioration—capital spending is critical and has increasing support globally

Differentiated performance profile

- Predictable cash flows may provide a reduced downside capture during periods of volatility
- History of equity-like returns with lower risk
- Potential for 3–4% dividend yield and 4–6% long-term cash flow growth

Attractive valuations

- Valuation multiple relative to equities at a decade low

Compelling investment themes

- The digital transformation of economies can be a secular driver of growth for cell towers and data centers
- Utilities and renewable developers could offer stronger growth and better value than the market appreciates, underpinned by growing support and competitive costs for clean energy investments
- Transportation infrastructure could offer leverage to an economic recovery

About the author

Benjamin Morton, Executive Vice President, is Head of Global Infrastructure and a senior portfolio manager for Cohen & Steers' infrastructure portfolios, including those focused on master limited partnerships. He has 21 years of infrastructure-related investment experience. Prior to joining Cohen & Steers in 2003, Mr. Morton worked at Salomon Smith Barney as a research associate for three years, covering the utility and pipelines sectors. He also worked at New York Mercantile Exchange as a research analyst. Mr. Morton holds a BA from the University of Rochester and an MES from Yale University. He is based in New York.

Index definitions / important disclosures

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