

Premier Energy & Water Trust

A BREXIT beneficiary

Assisted by a marked depreciation of sterling, to which it is unhedged, Premier Energy and Water Trust's (PEW's) NAV has soared by 26.1% since the UK's EU referendum. PEW has little exposure to "UK plc", a geared structure and many holdings that the manager believes are materially undervalued. The share price has not kept pace with recent NAV growth, allowing a discount to emerge, which we think provides an opportunity for long term investors. In addition, PEW's attractive 4.9% yield (based on its forecast dividend of 8p) could rise from here as PEW has reached its full year revenue targets just half way through its year.

Geared global utilities exposure

PEW invests in equity and equity-related securities of companies operating in the utilities and infrastructure sectors, with the twin objectives of achieving high income and long-term capital growth from its portfolio. Since the change of management and stock selection in June 2012, the portfolio has greater emphasis on emerging markets; smaller companies and special situations; and lower weightings to traditional, developed market, utility companies.

Year ended	Ords share price total ret. (%)	Ords share NAV total ret. (%)	FTSE All-World Utilities TR (%)	FTSE All-World TR (%)	FTSE All-Share TR (%)
31/07/12	(24.7)	(20.3)	0.0	1.3	0.5
31/07/13	57.4	56.8	13.7	25.4	24.3
31/07/14	38.2	21.6	2.9	4.7	5.6
31/07/15	0.3	(5.9)	6.8	12.0	5.2
31/07/16	3.8	8.0	29.4	17.8	3.7

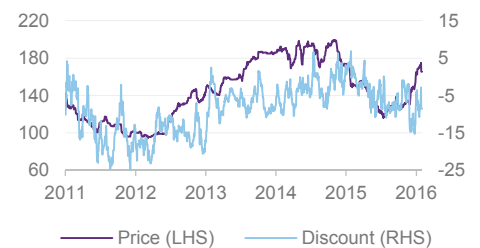
Source: Morningstar, Marten & Co. Note: PEW does not have a benchmark. For comparison purposes, we have used the FTSE All-World Utilities Index throughout this report. PEW's financial year end is 31 December.

AIC sector	Split capital
Ticker	PEW LN/PEZ LN
Base currency	GBP
Price (ords)	163.2p
NAV (ords)	173.14p
Premium/(discount)	(5.7%)
Yield (ords)	4.9%

Note: Yield is calculated assuming a minimum 8p per ordinary share (see pages 6 and 7).

Share price & discount (ords)

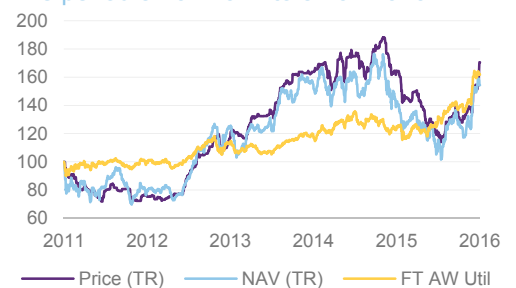
Time period 31/07/2011 to 26/08/2016



Source: Morningstar, Marten & Co

Performance over 5 yrs (ords)

Time period 31/07/2011 to 31/07/2016



Source: Morningstar, Marten & Co

Domicile	United Kingdom
Inception date	4 November 2003
Manager	J. Smith, C. Long
Market cap (ords)	29.5m
Ord. shrs outstanding	18.1m
Daily vol. (1-year avg.)	23,936 shares
Net gearing	75.3%

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UK just 10.5% of PEW's portfolio

Post-Brexit update

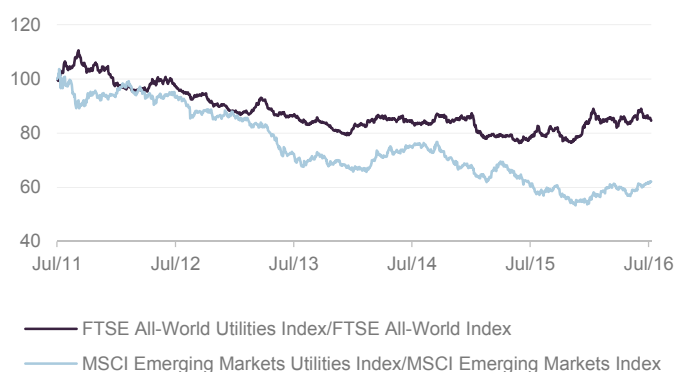
The collapse of sterling, post the announcement of the result of the UK referendum, has benefited the net asset value of funds such as PEW, which are denominated in sterling but have significant assets overseas. However, for PEW, there are a number of key considerations:

- PEW is structurally short sterling. Like all of its currency exposures, PEW's exposure to sterling is geared and it is also unhedged. This has allowed PEW's NAV to rise some 26.1% (to 2 September 2016) since the referendum result and PEW can also be expected to benefit from any further sterling depreciation.
- Its strong focus on emerging markets means that it has relatively little exposure to domestic UK companies (9.9% of the portfolio at the end of July) with SSE, Pennon Group and National Grid making up the entirety of this exposure.
- Utilities are, to a large extent, focused on their own domestic markets and tend to engage in relatively little cross-border trading. As such, the forthcoming EU exit negotiations, and the recent exchange rate shifts, are likely to have limited impact on the underlying businesses. What's more, as regulated entities, the revenues and profits of the UK portion of these companies' activities are cushioned from any post-Brexit slowdown in the UK's economy.

The macro utilities environment

As illustrated in Figure 2, both global utilities and emerging market utilities are now trading at discounts to their wider equity markets, and a marked gap has opened up between the two. An example is provided in Figure 3 below.

Figure 1: Global and emerging utilities index perf.



Source: Bloomberg, Marten & Co.

Figure 2: Premium/(discount) of F12m P/E to parent index



Source: Bloomberg, Marten & Co.

Figure 3: Utility valuation discounts versus broader markets

Global utilities	F12m P/E ratio	Emerging Market utilities	F12m P/E ratio
FTSE All World	16.656	MSCI Emerging Markets	13.44x
FTSE All World Utilities	15.43x	MSCI Emerging Markets Utilities	9.85x
Utilities valuation discount (%)	7.4%	Utilities valuation discount (%)	26.7%

Source: Bloomberg, Marten & Co.

As discussed below, PEW's managers are addressing this emerging markets discount with a 49% weighting as at the end of July 2016.

Managers' view

The prospect of interest-rate rises has receded for now and the outlook for Brazil and China has improved

PEW's managers say that, after a difficult few years for the utility sector (2015 was particularly challenging), 2016 has seen an improvement in the sector's fortunes as the prospect of interest-rate rises has receded and the outlook for large emerging markets, such as China and Brazil, is also improving.

China (17.6% as at 31 July 2016)

PEW's managers say that companies reporting in H1 have seen continued strong earnings growth and China is now prioritising renewable energy and environmental investment, which offers a tailwind to companies focused on these areas. For example, the waste incinerator, China Everbright (3.2% of PEW's portfolio as at 31 July 2016) saw its earnings increase 33% year-on-year for H1. This follows on from an increase of 22% during 2015 (source: Bloomberg). Wind farm company, Huaneng Renewables (2.6% of PEW's portfolio as at 31 July 2016) saw its earnings increase 59% in H1. This follows an increase of 72% during 2015 (source: Bloomberg).

Latin America (10.3% as at 31 July 2016)

Political change and higher rainfall boost PEW's Brazilian holdings

In Brazil, the removal of President Dilma Rousseff from office, and the conclusion of impeachment proceedings against her, has seen its market experience a turnaround. The country has also benefitted from the return to normal rainfall, after a severe drought which is good news for PEW's Brazilian hydroelectric companies (the Bovespa Electric Energy Index increased by 55%, in local currency terms, to the end of July 2016). One example is Cia Paranaense de Energia which, on the back of strong performance, has become one of PEW's top ten holdings (see Figure 5). Despite these gains, PEW's managers believe that there is further strong upside potential for its holdings.

UK (9.9% as at 31 July 2016)

In the UK, PEW's managers continue to focus on regulated companies (SSE, Pennon and National Grid). They believe that, in the short term, lower interest rates will reduce funding costs (although over time these will be passed through to tariffs).

US (20.7% as at 31 July 2016)

The portfolio is still underweight the US, where the managers think stocks look fully valued but they continue to find opportunities in yield cos, and fixed interest positions, where they see value and report that key investments are performing well. For example:

- Terraform Global 9.75% bond (4.7% of PEW's portfolio as at 31 July 2016 and PEW's largest bond position) is up 26% YTD. The managers say that PEW has also benefitted from its high coupon as well as the FX gain.
- First Trust MLP Energy Income Fund (5.5% of PEW's portfolio as at 31 July 2016) has benefitted, as the oil price has recovered, increasing some 20% year to date. PEW's managers added to the position at depressed levels in January. They say that, despite the price appreciation, it is still yielding close to 9%.

- Pattern Energy Convertible Bond (4.2% of PEW's portfolio as at 31 July 2016) is now trading at 25% above the value the managers first purchased it at in February 2016.

India (7.4% as at 31 July 2016)

PEW's primary allocation to India is OPG Power Ventures (coal fired electricity generation in India and 7.2% of PEW's as at 31 July 2016). This company's share price performance was disappointing during the first seven months of 2016 (by its low in July the share price had fallen 34.6%) but has recovered strongly following its results announcement on 1 August (it is now down 12.5% YTD). PEW's managers believe that the investment case remains intact and the holding was topped up at lower price levels. PEW's managers felt that previous market concerns (growth ambitions and how these could be financed as well as later than usual results release) were significantly overdone. They highlight that:

- OPG's generation is up 70% year-on-year
- PBT for the year ended 31 March 2016 was up 32%
- OPG's net debt is on a flat to falling trend
- OPG is to commence dividend payments from the current financial year
- The company is diversifying into solar power
- The Indian rupee has recently strengthened against sterling
- OPG's new Gujarat facility is operational for current year to 31 March 2017
- Bloomberg consensus P/E to 31 March 2017 is 8.75x.

Asset allocation

Figure 4 shows that India and the UK have fallen whilst Latin America and North America have seen the largest increases. The managers say that much of the movements reflects changes in the values of the underlying portfolio as OPG fell and the Brazilian hydroelectric companies benefited from the ending of the drought.

Figure 4: Geographical allocations



Source: Premier Energy & Water, Marten & Co. Note: OPG Power Ventures is registered in the Isle of Man, all of its operations are in India and it is treated as an Indian exposure for the purposes of this analysis.

Figure 5: Top 10 holdings as at 31 July 2016

Holding	Sector	Geography	Allocation 31 July 2016 (%) ^{*1}	Allocation 31 Jan 2016 (%) ^{*1}	Percentage point change
OPG Power Ventures	Electricity	India	7.2	11.1	(3.9)
TerraForm Global	Renewable energy	Global	6.1	5.4	0.7
Beijing Enterprises Holdings	Gas	China	5.8	3.3	2.5
SSE	Electricity	UK	5.7	6.2	(0.5)
First Trust MLP and Energy Income	Multi-utilities	North America	5.5	4.1	1.4
China Power International Dvlpmnt.	Electricity	China	5.4	5.8	(0.4)
Pattern Energy Conv. Bond 4%, 2020	Renewable energy		4.2	0.0	4.2
Engie ^{*2}	Multi-utilities	Global	4.0	4.2	(0.2)
Cia Paranaense de Energia	Electricity	Latin America	4.0	1.9	2.1
Pennon Group	Water and waste	United Kingdom	3.2	3.4	(0.2)
Total of top 10			51.3	48.8	

Source: Premier Energy & Water Trust, Marten & Co. ^{*1} portfolio excluding cash, ^{*2} formerly GDF Suez.

Performance

During H1 2016, the FTSE All-World Utilities Index returned 26.3% in sterling total return terms, whilst during the whole of 2015, it lost 2.5%. PEW's NAV underperformed the FTSE All-World Utilities Index at the beginning of the year, arguably reflecting the trust's underweight exposure to large developed market utilities, which benefitted from a perception of them as a safe haven, and its geared capital structure. However, as illustrated in Figures 6 and 7, this has reversed in recent months, with PEW providing particularly strong outperformance since the end of June. Now its gearing is working in

its favour as sterling declines and OPG recovers. PEW's share-price performance failed to keep pace with that of its NAV performance. This has led to a widening of the discount in recent months.

Figure 6: PEW NAV/FTSE All-World Utilities Index* – rebased to 100 since 31 July 2011



Source: Morningstar, Marten & Co. *Note: PEW does not have a formal benchmark. For comparison purposes, we have used the FTSE All-World Utilities Index.

Performance attribution in H1 2016

US utility holdings, fixed - income holdings and Latin American holdings have been notable contributors to performance. PEW's Indian and Chinese holdings have detracted

In terms of performance attribution, the strongest contributions to performance during the first half of 2016 came from PEW's US utilities holdings (+7.1%) which have been posting decent single digit earnings growth, its Latin American holdings (+5.0%) and fixed income holdings. PEW's Indian and Chinese holdings were the largest detractors (-3.4% and -1.0% respectively), whilst its currency hedging also cost 1.0%. UK utilities also performed well, contributing 1.0% to portfolio return, which in part reflects their status as safe-haven assets, but also likely reflects the fact that the prospect of interest-rate rises appear to have receded for now.

Figure 7: Total return performance to 31 July 2016 (Performance figures in excess of 1 year are annualised)

	1 month (%)	3 months (%)	6 months (%)	1 Year (%)	3 years (%)	5 Years (%)	Since 1 June 2012 (%)**
NAV	5.1	20.5	33.6	8.0	7.3	9.1	19.1
Share price	19.1	30.0	41.2	3.8	12.9	11.3	22.7
FTSE AW Utilities*	1.7	16.9	22.4	29.4	12.5	10.1	13.2
FTSE All-World*	5.1	14.7	20.5	17.8	11.4	11.9	15.8
FTSE All-Share	3.9	7.6	11.8	3.7	4.8	7.5	10.9

Source: Premier Energy & Water Trust, Morningstar, Marten & Co. * Note: All figures are in sterling equivalent terms. **Note: James Smith joined Premier in May 2012, taking over as lead manager of the trust with effect from 1 June 2012.

Revenue earnings and dividend

Following the partial repayment of its then outgoing ZDP at the end of December 2015, PEW's gross assets contracted by £25.7m (from £76.2m to £50.5m). As PEW's ordinary shareholders earn income across the entirety of PEW's gross assets (i.e. including those attributable to its ZDP shareholders) it was a reasonable assumption

that this reduction would, inter alia, lead to a reduction in the total dividend for the ordinary shares. PEW's directors reviewed the portfolio and in February 2016 announced a minimum dividend target of 8p per share for the year ended 31 December 2016 (actual dividend for 2015 was 10.4p excluding special dividends).

As at 26 August 2016, PEW has accrued income of 7.3p per share. Given that PEW has already paid a first quarterly dividend of 1.9p, the board's 8p target looks readily achievable and income is in fact higher than original expectations. The manager advises that there are three key reasons for the superior revenue generation:

- PEW has benefitted from exposure to a number of high yielding assets (the Terraform bond, Pattern Energy Convertible Bond)
- Significant dividend increases from a number of holdings. For example, China Power International (5.4% of PEW's portfolio as at 31 July 2016) increased its dividend by 38% year-on-year.
- PEW has also benefitted from a weaker sterling-US dollar exchange rate during 2016 than in the prior year. The average rate was 1.53 US dollars per pound during 2015. The average year to date is lower at 1.41 and it seems probable that the average for H2 will be lower still.

Fund profile

Geared exposure to global utilities with a strong emerging market bias and income focus

PEW is a UK investment trust, listed on the main market of the London Stock Exchange. It invests globally in the equity and equity-related securities of companies operating in the utility and infrastructure sectors. It maintains a relatively concentrated portfolio (48 stocks as at the end of July 2016, with the top five accounting for 30.3% of gross assets), which includes exposure to both developed and emerging markets (split 51%/49% as at the end of July 2016). PEW aims to pay a high level of income on its ordinary shares (currently a yield of 4.9% on its ordinary shares) and provide long-term capital growth. It is aided, in this regard, by the significant gearing provided to the ordinary shares by its zero dividend preference shares (net gearing of 75.3% of the ordinary shares NAV).

Additional information is available at the fund manager's website, www.premierfunds.co.uk

Previous research publications

Readers interested in further information about PEW may wish to read our initiation note *3 years later, in a new league!*, published on 16 July 2015 and our update note, *It's a £24m rollover!*, published on 4 February 2016. You can read the notes by clicking on them in Figure 8 or by visiting our website.

Figure 8: Marten & Co. previously published research on PEW

Title	Note type	Date
A step change in performance	Initiation	18 June 2014
Solid interims and plans for the future	Update	7 August 2014
Value in emerging markets	Update	2 February 2015
3 years later, in a new league!	Annual overview	16 July 2015
It's a £24m rollover!	Update	4 February 2016

Source: Marten & Co.

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