ATLAS INFRASTRUCTURE

INFRASTRUCTURE ASSETS – PROTECTION IN A WORLD OF HIGHER INFLATION AND BOND RATES

With inflation expectations and bond yields rising, investors are rightly revisiting the relationship between infrastructure valuations, inflation and interest rates.

In the discussion below we draw three key conclusions

1. Infrastructure, as a real asset, provides investors with long term structural inflation protection
2. In the short term, there are meaningful differences in how quickly and efficiently different infrastructure assets can pass through changes to inflation and bond rates
3. The ATLAS portfolio is deliberately tilted towards assets with stronger inflation and interest-rate pass-through.

Introduction

The infrastructure sector is viewed as a long-duration, real asset class with strong protection from inflation, offset by higher sensitivity to bond rates. However, the reality is far more nuanced. The impact of inflation and interest rates varies significantly across sectors, depending on factors including inflation pass-through mechanisms, regulatory frameworks, leverage and refinancing requirements.

For example, regulated utilities in the UK and Europe often benefit from explicit inflation linkage and regulatory mechanisms that allow the recovery of higher financing costs. Meanwhile, assets such as renewables, communications infrastructure and some US utilities tend to have greater sensitivity to changes in discount rates and capital market conditions.

Table 1 – Inflation protection in Infrastructure sectors

Sector	Prices indexed to inflation	Cost inflation pass through	Returns indexed to inflation	Inflation protection for investors
UK & Italy Electric	Y	Y	Y	Strong
UK Water	Y	Y	Y	Strong
Airport	Y	Y	Mixed	Strong
Toll Road	Y	N	Indirect	Strong
Renewables	Mixed	N	Indirect	Moderate - Strong
Railways	Mixed	N	N	Moderate
Other EU Electric	N	Y	Indirect	Moderate
NA Electric & Gas	N	Y	Indirect	Moderate
Pipelines	N	Y	Indirect	Moderate - Low
Communications	Mixed	N	N	Moderate - Low

Table 2 – Bond yield protection in Infrastructure sectors

Sector	Interest cost pass through	Allowed returns linked to bond yields	Bond yield protection for investors
UK & Italy Electric	Y	Y	Strong
UK Water	Y	Y	Strong
Airport	Y	Y	Strong
Other EU Electric	Y	Y	Strong
NA Electric & Gas	Y	Indirect	Moderate
Pipelines	Mixed	Y	Moderate
Railways	N	Indirect	Moderate
Renewables	N	N	Low
Communications	N	N	Low
Toll Road	N	N	Low

Source table 1 & 2: ATLAS Analysis

At ATLAS, we believe not all infrastructure assets are created equal and we therefore use sector expertise and research resource to investigate and model the inflation and bond are exposure for each infrastructure asset we invest in.

Inflation and Bond protection in practice

Infrastructure assets can be protected from rising yields in three ways: inflation-linked revenues that increase cash flows, regulatory mechanisms that allow recovery of higher debt costs, and periodic resets of the allowed cost of capital that help maintain investor returns over time. The table below shows examples from the current ATLAS portfolio including the details of how the protection flows through to cashflow returns for investors.

Table 3 - Inflation & Interest rate linkage in the ATLAS Portfolio

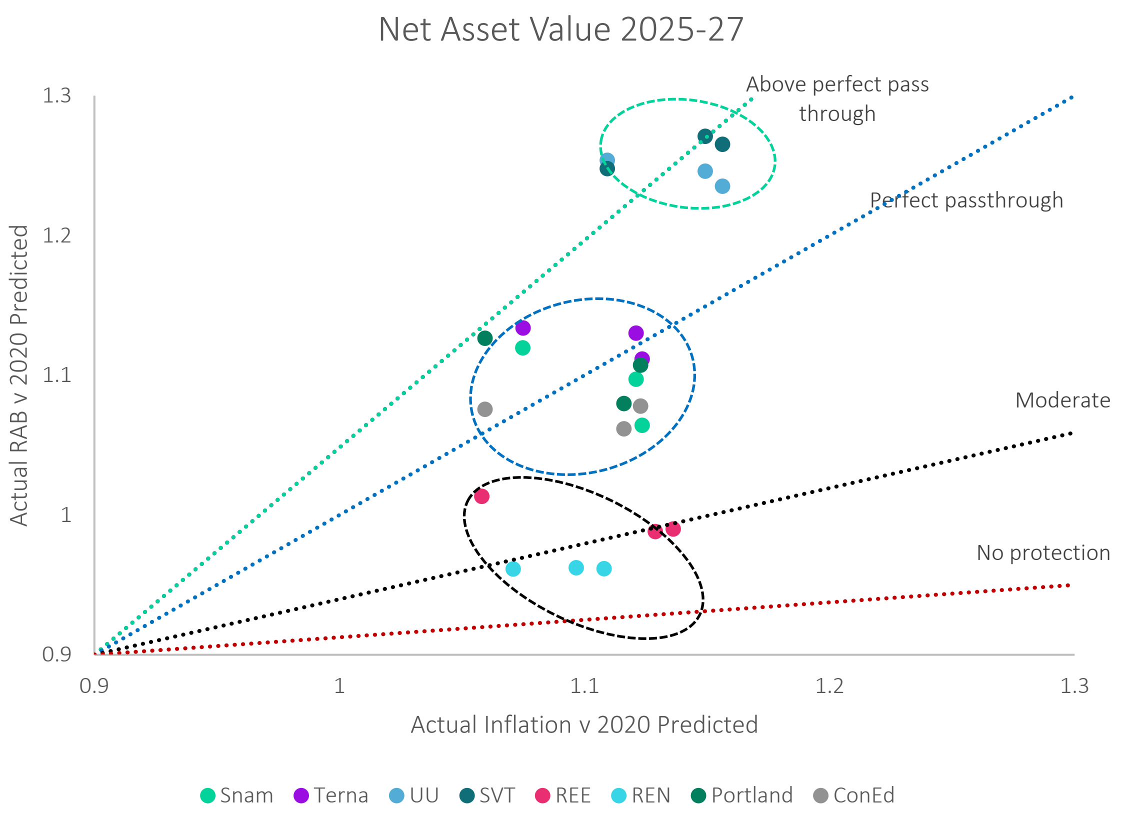
<table>
<tr><th>Calculation of total allowed revenue</th><th colspan="2">ATLAS Portfolio example</th></tr>
<tr><td>Allowed return on assets
(regulated asset base x allowed WACC)</td><td>Terna, National Grid, Severn Trent</td><td rowspan="2">Protection for investors.
Inflation pass-through in rates.
Interest passthrough in terms of allowed interest on debt.
Cost of capital adjustment using the prevailing cost.</td></tr>
<tr><td>Inflation
(last years allowed revenue x last years CPI</td><td>United Utilities, Severn Trent, Terna</td></tr>
<tr><td>Interest costs
(allowed debt level x allowed debt cost</td><td>National Grid, United Utilities, ADMIE</td><td rowspan="2">Opportunities for outperformance.
If the company can deliver services for a lower operating cost or lower capital cost, they get to keep the upside.
Some regimes provide incentive for better operational performance.</td></tr>
<tr><td>Operating Costs
(agreed between company and regulator over five years. If company spends less gets to keep 50% of savings)</td><td>Severn Trent, United Utilities, California Water Service</td></tr>
</table>

Case study – portfolio asset performance in the 2022 – 2023 inflation surge

In addition to the ex-ante forecast of inflation protection, using our asset level due diligence, we have also tested our forecasts using ex-post analysis of the 2022-2023 inflation surge and the impact on regulated asset values.

The chart below shows the change in outturn net asset value vs expected net asset value plotted against the change in outturn inflation vs expected inflation. It shows that, for the most part, the regulated utilities performed at or above the expected inflation protection given the regulatory structure.

Chart 1 – Comparison of NAV and Inflation Outcomes Relative to Expectations



Source: ATLAS Analysis

Refinancing risk

A secondary risk for equity investors from rising bond yields is often a squeeze on credit ratings and an increase in refinancing risk. ATLAS notes that infrastructure assets, especially those that are regulated, have had a strong track record in accessing debt markets, even when credit markets have been largely closed to corporate issuance (i.e. in 2008/9).

Within the ATLAS portfolio, there is a specific portfolio construction focus on mitigating balance sheet and refinancing risk. This means the portfolio has limited exposure to companies facing meaningful refinancing risk and avoids businesses with excessive leverage. Thus, the overall ATLAS exposure to a potential credit tightening scenario is significantly lower than the broader infrastructure universe and much lower than the broader corporate sector.

Outlook and portfolio positioning

Given the current macro environment and outlook, the ATLAS Investment Committee will continue to tilt the portfolio towards stronger inflation protection and towards assets that perform better in higher inflation and higher bond rate environments:

- Approximately 73% of holdings are regulated utilities, where frameworks typically allow recovery of debt costs and provide a degree of protection against rising yields. This means higher nominal cash flows can help offset the valuation impact of higher discount rates.
- Approximately 90% of the portfolio benefits from either direct or indirect inflation linkage, with 32% direct and 58% indirect exposure.
- The portfolio is stress tested against a 2008/9 style credit crunch to identify any refinancing risks.

Taken together, these characteristics mean that portfolio cash flows are generally more resilient to a higher inflation and higher interest rate environment than the broader infrastructure universe.

Conclusion

ATLAS believe the portfolio is well positioned for a higher-for-longer inflation and bond rate environment. While rising yields may create short-term valuation volatility, our focus on regulated utilities, inflation-linked revenues, strong balance sheets and prudent diversification provides meaningful protection as well as ensuring that investors will be fully compensated for inflation in their long-term asset values. In our view, high-quality infrastructure remains one of the most attractive ways to preserve purchasing power while maintaining exposure to essential long-duration assets.

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