London Bridge Capital

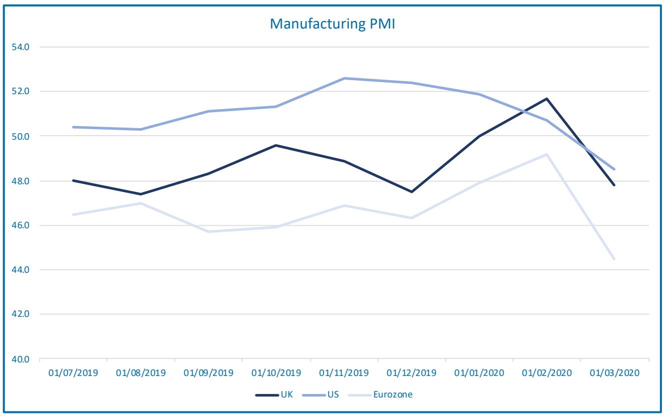
April 2020

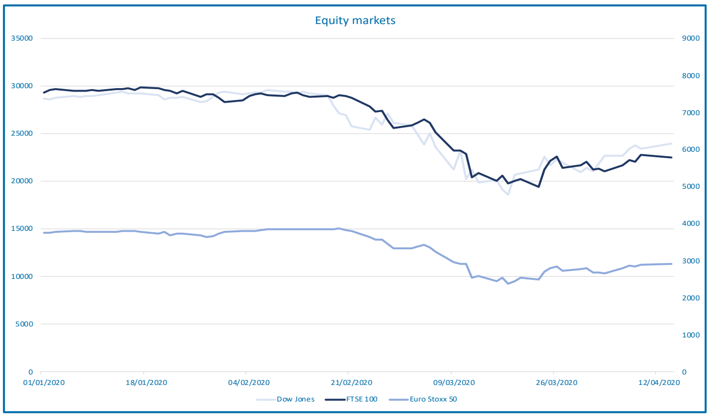
Classification - Public

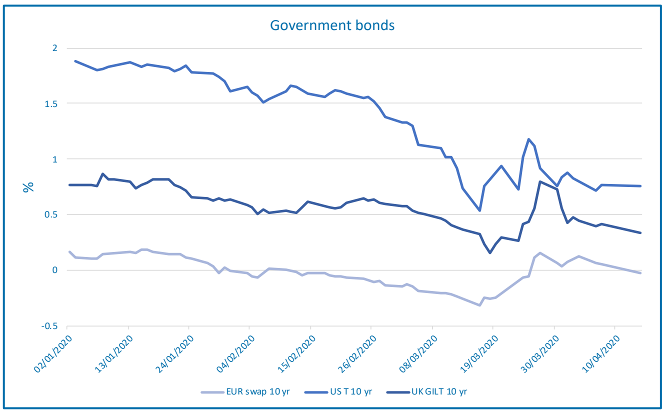
To (QE…) infinity and beyond returns!

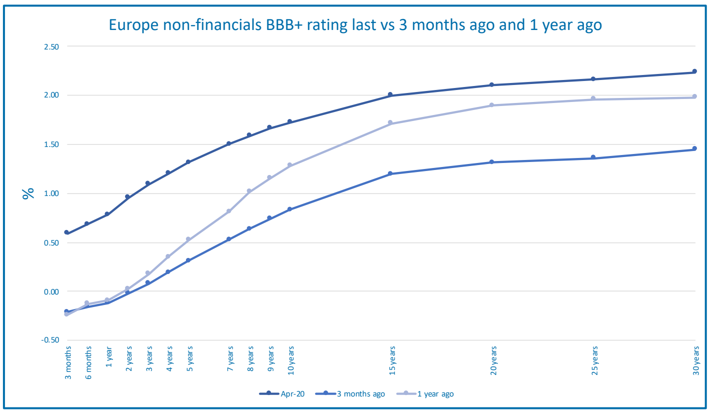
Executive Summary:

- We have seen huge volatility in the financial markets in Q1 2020, with a sharp economic downturn caused by the arrival of the COVID-19 virus in Europe and North America and consumer demand/supply chains evaporating across multiple industries. However, as a result of global government support, we subsequently saw the start of a potential recovery in both the equity and debt capital markets in the run up to Easter.
- Debt capital markets have seen record issuance across Europe (EUR 633.86bn to date), with corporates who have robust credit ratings accessing multiple markets to preserve liquidity as uncertainty remains on the impact of the real economy. Whilst, credit spreads initially widened significantly (on average 117bp) for corporates, we have seen a marked contraction over the last month. In addition, overall funding rates have been mitigated by lower "risk-free" rates.
- The timing of the economic recovery will have a significant impact on Governments' funding support programmes and their future debt issuance programmes.
- Energy & Infrastructure has remained resilient as an asset class overall compared with other cyclical, consumer-driven sectors. However, debt investors are reviewing individual sub-sectors which have been impacted within their portfolios.







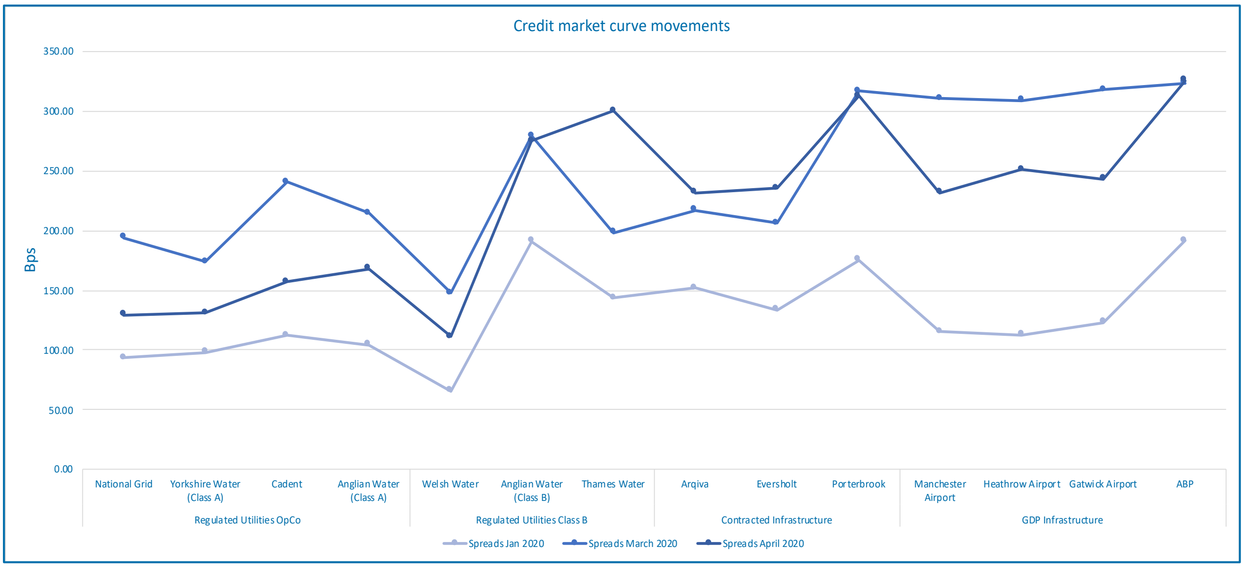


Source: Bloomberg

- The above graphs demonstrate the significant falls in the equity markets and widening credit spreads as COVID-19 spread from Asia to Europe and North America in March 2020, both capital markets have seen a marked improvement in the run up to the Easter break.
- This has been driven by investors' confidence in Governments' actions on their isolation strategies, significant quantitative easing ("QE"), furloughing programmes and a hope that we will soon reach peak COVID-19 mortality rates.
- However, we are only starting to see data from the impact on the real economy from the global pandemic and there remains uncertainty in the timing of the recovery, which has a significant impact on both Government funding support programmes and the financial recovery for corporates.
- As such, whilst government bond rates remain at fundamental lows, we have seen a widening of yields more recently reflecting in part a change in funding requirements in the coming months.

Energy & Infrastructure sector update:

- The graph below highlights the widening of credit spreads since the COVID- 19 virus began, reflecting exposure to the GDP impact of the isolation strategy and expected recovery timescales.
- Overall, we have seen a positive tightening (circa 25bp) of credit spreads in the sector since the debt capital markets re-opened in March 2020. As a result of prompt action by Central Banks, investor confidence has been returning to the credit markets for Energy & Infrastructure issuers with robust credit ratings.
- Significant issuance has taken place, predominantly in the US$ and EUR capital markets, with a focus on liquidity preservation as a priority over lower new issuance premiums.



Source: Bloomberg

- Corporates are focused on the well-being and safety of their employees and managing absence rates, the impact of the supply chains and customer receivables. Most Energy & Infrastructure companies will be resilient. However, we do believe a greater differentiation of infrastructure as an asset class will be seen by credit investors across the respective sub-sectors.

  ⇒ **Power generation:** Wholesale power prices have been impacted by a 20-30% reduction in demand, due to countries' home isolation strategies. Larger generators' revenues are partially mitigated by a rolling commodity hedging programmes. However, smaller players and renewable generators with market driven revenue components e.g. ROCs will be impacted.

  ⇒ **Energy transmission and distribution:** Limited impact by falling wholesale energy prices, but they are highlighting an operational curtailment and focusing on essential projects. Majority of revenue counterparty exposure will usually be to the larger utilities/energy suppliers, but exposure to the smaller independent energy supply companies could have an impact on receivables cashflow in the short term.

  ⇒ **Water utilities:** In the UK, the larger water and sewerage companies ("WASCs")/ European municipal utilities are more integrated and still retain exposure to domestic retail customers. As such, ongoing discussions with stakeholders (regulators/governments) on consumer payment holidays could also impact short term cashflow.

  ⇒ **Transport:** We believe this sub-sector is the most exposed to the impact of COVID-19 and it will be important to explain to investors the individual risk mitigants and recovery plans: regulated versus unregulated, counterparty exposures, GDP recovery scenarios and strategic positioning of asset. In our opinion, rating agencies, banks and debt investors are looking to be constructive.

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