MARTEN & CO

Update | Investment Companies

24 February 2015

Premier Energy & Water Trust

Value in emerging markets

As evidenced by its recent final results, Premier Energy and Water (PEW) has seen the NAV of its ordinary share, supported by gearing from its ZDP, outperform all of the FTSE benchmarks commonly used to compare its performance (FTSE All-World Utilities, FTSE World and FTSE All-Share). Global utilities had a strong run during 2014. However, emerging markets, to which PEW's portfolio is heavily exposed, continue to look cheap both against global utility valuations and global equity valuations. Income generation from the portfolio also remains strong.

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

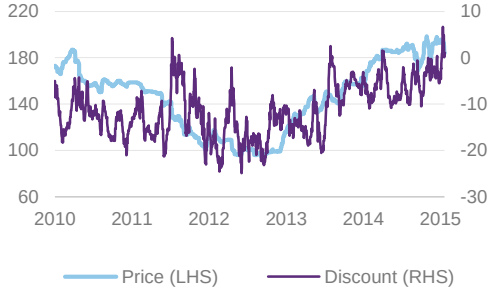
Year Ended	Share Price Total Return (%)	NAV Total Return (%)	FTSE All-World Utilities TR. (%)	FTSE All-World (%)	FTSE All-Share (%)
31/01/11	(0.7)	11.0	8.5	20.1	18.1
31/01/12	(26.6)	(28.8)	(5.1)	(1.7)	(0.3)
31/01/13	12.9	6.2	5.0	15.1	16.3
31/01/14	48.1	41.1	4.1	9.2	10.1
31/01/15	30.2	30.5	25.2	17.6	7.1

Source: Morningstar, Marten & Co. Note: PEW does not have a benchmark but, for comparison purposes, we have used the FTSE All-World Utilities throughout this report.

Sector	Split Capital
Tickers (ords/ZDPs)	PEW / PEWZ
Base Currency	GBP
Price (ords)	184.50
NAV (ords)	182.54
Prem./(Disc.) (ords)	1.1%
Yield (ords)	5.6%

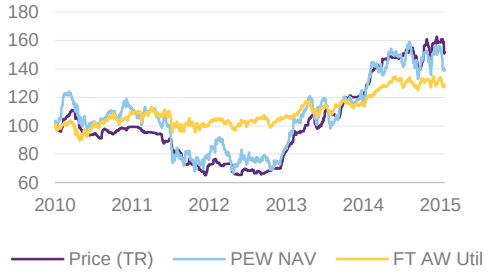
Share price and discount

Time period: 31/01/2010 to 18/02/2015



Performance over 5 years

Time period: 31/01/2010 to 18/02/2015



Domicile	United Kingdom
Inception Date	November 2003
Managers	J. Smith, C. Long
Market Cap (ords)	32.1m
Ord. shrs outstanding	17.4m
Avg Daily Trading Vol.	29,156
Net Gearing	125.3%

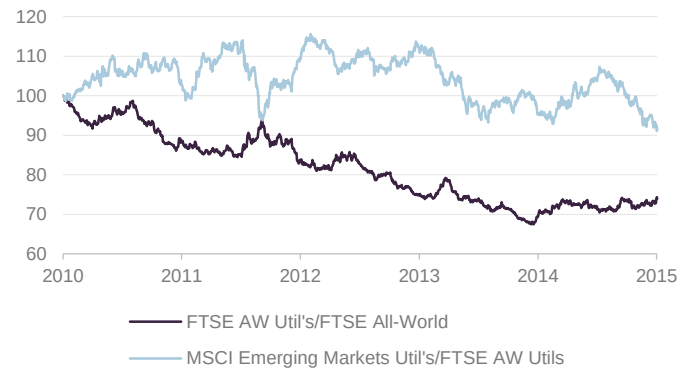
Value in emerging market utilities

As illustrated in Figure 1, 2014 was a good year for global utilities, which outperformed global markets in general, thereby ending a four year trend of broad underperformance. However, within this performance has been mixed; the strong performance of the US market has predominantly driven the gains.

Emerging market utilities, currently trading on a forward P/E of 11.4x look attractive relative to global utility valuations at 16.3x.

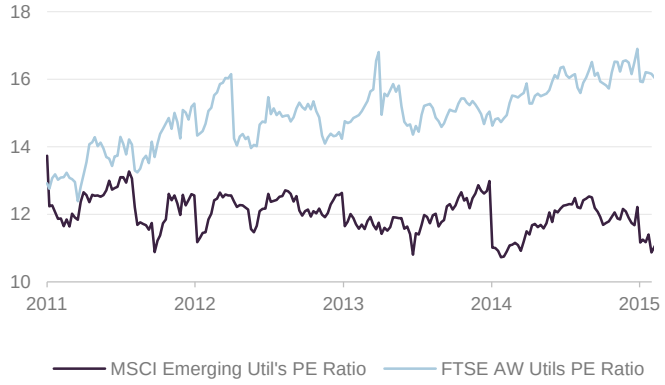
In fact, as is also illustrated in Figure 1, emerging market utilities have significantly underperformed global utilities during the last six months, reversing gains made during the previous six months and continuing a general trend of underperformance during the last three years. These moves are reflected in emerging vs global utility market valuations (see Figure 2), with global utilities trading towards the top end of the four year trading range in historic P/E terms, whilst emerging market utilities have becoming increasingly cheap. However, looking at forward P/E's for 2015, The FTSE All-World Index is trading at 16.3x, whilst the FTSE All-World Utilities Index is modestly cheaper (15.8x) and the MSCI Emerging Markets Utilities Index is appreciably cheaper still at 11.4x (Source: Bloomberg).

Figure 1: Global and Emerging Utilities Index perf.



Source: Bloomberg, Marten & Co.

Figure 2: Global & Emerging Utilities F12m PE Ratios



Source: Bloomberg, Marten & Co.

PEW: Income from utility exposure

Base yield on ordinary share of 5.6%, 7.3% if additional dividends are included.

Premier Energy & Water Trust plc is a UK investment trust, listed on the main market of the LSE, that invests globally in the equity and equity related securities of companies operating in the utility and infrastructure sectors. Its exposure includes both developed and emerging markets (split 42%/58% as at the end of January 2015). PEW aims to pay a high level of income on its ordinary shares (currently a yield of 5.6% on its ordinary shares, 7.3% if additional dividends are included – see page 7 for further details) and provide long term capital growth. PEW is aided, in this regard, by the significant gearing provided to the ordinary shares by its zero dividend preference shares (1.25x – further details regarding PEW's split capital structure can be found in our initiation note of 18 June 2014 - see page 9 of this note).

The portfolio has been managed by Premier Fund Managers since PEW's launch in 2003. Premier Funds is an independent asset manager with £3.2bn of assets under management as at 31 December 2014. The investment managers are James Smith and Claire Long (please see our initiation note of 18 June 2014 for more details on

their biographies) and there has been a marked improvement in performance since the change of strategy in June 2012, when James joined the Premier team. The portfolio is managed using a bottom up investment process based on fundamental research (details of this are also provided in our June 2014 note).

The investment process used to manage PEW's portfolio is benchmark agnostic.

It should be noted that PEW is not managed with respect to any particular benchmark. However, for the purpose of performance evaluation, the board specifically look at the FTSE All-World Utilities Index, FTSE All-World Index and FTSE All-Share Index.

Ordinary share life extension approved in August 2014; ZDPs expire end December 2015

August 2014 saw shareholders approve a set of proposals that amended PEW's structure for the purposes of allowing it to continue beyond its previously scheduled wind up date of December 2015. Details of the restructuring and its impact on the different share classes are discussed in length in our note of 7 August 2014. Looking forward, PEW's ZDPs expire on 31 December 2015. The ZDPs represent a significant proportion of PEW's gross assets (£45.1m out of a total of £80.3m as at 31 January 2015) and we believe that existing shareholders would welcome replacement gearing so that PEW can continue with a structure that is similar to its current form. As such, we expect an announcement in the current year.

Managers' view

The Managers acknowledge that 2014 was a strong year for utilities and they expect that, with the prospect of interest rates rises, particularly in more developed economies, 2015 is likely to be a tougher market environment not just for equities in general but particularly for utilities as it will likely reduce their relative attractiveness on yield grounds. However, despite this, they retain an optimistic outlook for PEW's portfolio. At the macro level, PEW's portfolio is tilted towards emerging markets utilities, which remain cheap relative to global equities and look compelling vs developed market utility valuations – particularly those in the US, to which the fund has relatively low exposure. Weakness in Latin American currencies (7.9% of gross assets as at 31 January 2015), particularly during the last two months, has been a headwind to the portfolio but Brazil is starting to look attractive and the manager expects to add at the margin. PEW's portfolio has recently benefited from the recent pull back in the pound and reflecting structural weaknesses in the UK economy, the managers expect this trend to continue. They also see opportunities at the company level to drive portfolio performance. For example, the Indian Rupee has strengthened, which is broadly beneficial to PEW's largest holding OPG Power Ventures.

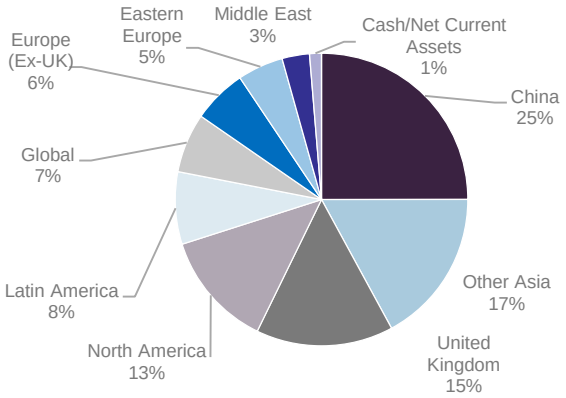
A key concern, for many investors, is the impact on the demand supply balance for utilities from an ongoing low oil price. However, whilst they think a low oil price will be generally supportive of economic growth and global equity markets, the manager's view is that PEW's portfolio should be relatively immune from changes in the oil price. It invests in utilities, rather than up-stream oil and gas companies, and whilst many utilities have some upstream operations, for example Centrica and SSE have some upstream assets, in the UK these are primarily gas assets, owned as a mechanism to hedge their downstream supply profitability. Of the two Centrica, has greater exposure to upstream assets, which was a contributory factor in the managers' decision to sell out of the holding in late 2013 at a level well above the current price. For UK producers, the gas price has now largely disconnected from the oil price and,

looking at PEW's portfolio, approximately half is invested in 'pure play' utilities (natural monopoly businesses operating wire and pipe networks or renewable energy businesses operating on long term regulated prices). By their very nature such businesses should not be unduly exposed to commodity spot prices. The balance of PEW's portfolio is invested in integrated utilities (combining both regulated and unregulated revenues) or purely competitive businesses (mainly electricity generation and supply). Little electricity is generated globally using oil (natural gas and coal dominate). The global coal market is also seeing soft pricing (weak demand and over supply) which, for generating utilities is generally a positive, whilst US and UK gas have also seen a declining price reflecting increasing supply. Overall, with the global economic outlook improving, the managers expect the supply demand balance to be favourable for utilities.

With regard to recent talk of a labour government implementing tariff freezes, the manager's observe that OFGEM/OFWAT reviews for regulated utilities are now finished and the terms are now fixed until 2020 and beyond. As such any tariff freezes are unlikely to impact the regulated utilities anytime soon and, in the managers view, such a move would likely benefit the larger energy suppliers anyway, as it would lock in the decent dual fuel margins they're already earning at the expense of the smaller operators who are more competitively priced in the attempt to win market share.

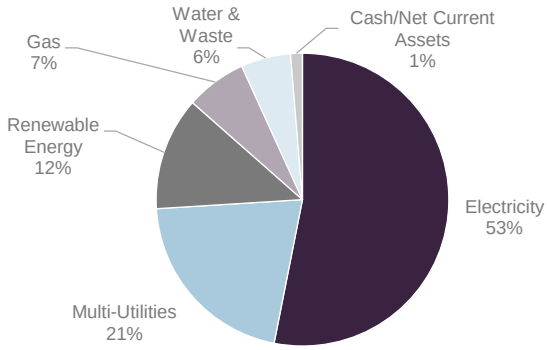
Asset allocation

Figure 3: Geographic allocation as at 31/01/2015



Source: Premier Energy & Water

Figure 4: Sectoral allocation as at 31/01/2015



Source: Premier Energy & Water

Figure 5: Top Ten Holdings as at 31 January 2015

Holding	Sector	Geography	Allocation 31/01/2015 (%)	Allocation 31/07/2014 (%)	Percentage point change
OPG Power Ventures	Electricity	Asia (Ex-China)	8.8	9.5	(0.7)
China Power International	Electricity	China	5.8	3.9	1.9
Renewable Energy Generation	Renewable Energy	UK	5.6	6.3	(0.7)
Huaneng Power International	Electricity	China	4.7	3.8	0.9
Fortune Oil	Gas	China	3.4	3.6	(0.2)
Ecofin Water & Power Conv. Bonds	Multi-Utilities	Global	3.3	3.6	(0.3)
GDF Suez	Multi-Utilities	Global	3.2	3.2	(0.0)
China Everbright International	Water & Waste	China	3.1	2.7	0.4
Enersis	Electricity	Latin America	3.0	3.1	(0.1)
SSE Plc	Electricity	UK	3.0	3.2	(0.2)

Source: Premier Energy & Water Trust, Morningstar, Marten & Co.

As illustrated in Figure 3, the portfolio is tilted towards emerging rather than developed markets. The portfolio's sector and geographic allocations look broadly comparable to their allocations six months ago, which reflects the longer term investment horizon favoured by the manager.

In terms of its top ten holdings, the managers continue to remain positive on OPG Power. It has two new power stations that are expected to come online in Q1 2015, which will treble its generation capacity. Once these plants are in production and generating revenue, OPG has committed to commencing paying dividends.

With regards to Renewable Energy Generation, the managers consider that the company is providing a strong operational performance that is not yet reflected in the current market price. In the manager's view, valuing the existing wind farms on its balance sheet at £2m per MW is equivalent to the current market cap of the company and that, as such, the development business, oil regeneration business and development pipeline are effectively free. Reflecting this, they are happy to continue to hold the stock and observe that, with its renewables exposure, it may be attractive to a private equity buyer.

Fortune Oil, the fifth largest position in the portfolio as at 31 January 2015, received an offer from its largest shareholders during December. In the view of PEW's manager, whilst the offer has seen Fortune post a strong share price gain and PEW make a significant gain on its original investment, the offer significantly undervalues the stock, which the manager believes continues to trade at a substantial discount to fair value. Payment is expected in March and the managers intend to recycle the proceeds into the portfolio.

For China Power International and Huaneng Power International, the managers consider that both stocks continue to be attractive and should benefit from a falling coal price. They're happy to continue to hold. With regards to the Ecofin convertibles, the manager observes that, at the current NAV, these are now in the money and as such should benefit from any accretion in the NAV, while having little risk to capital.

The managers have added positions in the Romanian Utilities, Transelectrica and Transgaz. Both are value plays offering an attractive yield (c 6% and 10% respectively) and offer decent growth prospects (10-15% per annum in the managers view). Furthermore, whilst there is inevitably some political risk, the managers consider that Romanian regulation is not punitive with utilities permitted to earn fair returns on equity. The managers have also been adding to the Italian utility companies Acea and Hera. They expect both will act as consolidators and will benefit from moves to consolidate the myriad of local government utility operators.

Performance

As illustrated in Figure 6, there has been a marked uplift in the performance of PEW's ordinary share NAV since the strategy change was implemented, in Mid-2012, when James Smith joined the management team. The strategy was particularly successful during 2013 with PEW's total assets beating the FTSE All-World Utilities Index by 15.2 percentage points. The gearing amplified the return so that PEW's NAV beat this index by 49.2 percentage points. Looking at Figure 6, it can be seen that PEW's NAV broadly followed that of the FTSE All-world Utilities Index during the first half of 2014, albeit with some volatility, but underperformed during the second half. As illustrated in Figure 7, during 2014, PEW's total asset actually underperformed the FTSE All-World utilities Index (17.7% vs 20.5%). However, given the positive impact of the gearing

during the period, PEW's NAV Total return nonetheless beat the index (26.6% during the year).

Figure 6: PEW NAV/FTSE AW Utilities Index – rebased to 100 since 31/01/2010

Source: Morningstar, Marten & Co.

Figure 7: Total Asset TR vs NAV TR

Year Ended 31 Dec.	Total Asset Return (%)	NAV Total Return (%)	NAV TR less Total Asset TR	Share price Total return (%)	FTSE AW Utilities TR (%)	FTSE All World TR (%)	FTSE All – Share TR (%)
2010	3.9	4.8	0.9	(10.0)	3.8	16.7	14.5
2011	(11.3)	(32.8)	(21.5)	(30.7)	(3.6)	(6.6)	(3.5)
2012	2.9	(4.0)	(6.9)	3.7	(1.6)	11.9	12.3
2013	24.5	58.5	34.0	71.8	9.3	20.8	20.8
2014	14.7	26.6	11.9	31.6	20.5	11.3	1.2

Source: Premier Energy & Water Trust, Morningstar, Marten & Co.

Figure 8: total return performance to 31/01/2015

	1 month (%)	3 months (%)	6 months (%)	1 Year (%)	3 years (%)	5 Years (%)	Since 30/06/2012 (%)
NAV TR	3.1	4.3	6.8	30.5	25.0	9.1	28.4
Share price TR	0.3	11.5	6.7	30.2	29.6	9.7	40.6
FTSE AW Util's	4.1	5.9	14.9	25.2	11.0	7.1	11.6
FTSE All-World	2.3	4.8	10.2	17.6	13.9	11.8	16.0
FTSE All-Share	2.6	3.9	2.5	7.1	11.1	10.1	12.7

Source: Premier Energy & Water Trust, Morningstar, Marten & Co. Note: Performance figures in excess of 1 year are annualised numbers.

As illustrated in Figure 7, 2014 was a good year for global utilities – the FTSE All-World Utilities Index posted a return of 20.5% beating the FTSE All-World (11.3%) and FTSE All-Share (1.2%) by significant margins. Much of this performance came during the fourth quarter of the 2014. The managers believe that the move is due largely to US based investors pulling money out of emerging markets in favour of low risk higher yielding assets in their domestic market. PEW has been underweight the US on valuation grounds and so this move was a headwind to the trust's relative performance.

Another negative was the portfolio's overweight exposure to Latin America, which has suffered due to currency weakness, particularly that of the Brazilian Real (the election results have created considerable uncertainty whilst the ongoing drought has impacted hydro-electric generation). However, the managers consider that these

issues will resolve themselves and, with current weakness, may represent a buying opportunity.

The managers report that individual stock selection was strong with the investments in Chinese coal fired power stations and investment in Indian thermal electricity production performing well.

Dividend

Additional dividend (currently 0.75p per quarter) expected to continue until the final payment for Q4 2015 in March 2016.

PEW pays quarterly dividends. These have traditionally been structured as three smaller payments for the first three interim dividends (paid in June, September and December) with a larger fourth interim in March.

In addition, beginning with the second interim dividend for the 2013 year, PEW has paid an additional dividend of 0.75p per share per quarter. This is because the board decided, in August 2013, that it would be prudent to run down the company's, then significant, revenue reserves prior to the then scheduled wind up at the end of 2015. However, to avoid the potential tax implications of paying a lump sum, the board opted to smooth the distribution, hence the additional quarterly payments. Reflecting this policy, and the revenue reserve per share at the end of 2014 (as illustrated in Figure 9), we expect these additional dividends to be maintained throughout 2015 with the final additional dividend payment to be made with the fourth interim payment in respect of 2015 (expected to be paid March 2016).

PEW's investment objective includes paying a high dividend (current twelve month trailing yield is 7.3% vs FTSE All-Share yield of 4.2%) and, whilst there is not a formal requirement to grow the dividend, this has been the trend throughout PEW's life (see Figure 9 below). The total base dividend for 2014 represents a current yield of 5.6%. In terms of revenue generation during the next twelve months, the manager's view is that the underlying fundamentals are encouraging. Sterling has been weakening recently, which will boost the value of overseas dividends once converted back into GBP. There are also some significant positions that are currently not paying a yield. The manager expects that some non-payers, such as OPG Power Ventures, will commence dividend payment or that alternatively these positions can be recycle into dividend paying stocks (e.g. proceeds from the sale of Fortune Oil). The managers also report that they're seeing strong dividend growth from the underling companies – typically between 3%-5% per annum. However, the currency can still be a big swing factor.

Figure 9: Revenue generation and dividend payment analysis

Year Ended 31 Dec.	Revenue return per share (p)	Total base dividend (p)	Special/ additional dividends	Total divs. inc. special/ add. divs. (p)	Y/E Rev. reserve per ord. shr (p)	Base dividend yield, on year end ord price (%)	Total dividend yield, on year end ord price (%)
2009	10.19	7.70	1.70	9.40	11.4	4.1	5.0
2010	9.33	8.10	-	8.10	8.6	5.2	5.2
2011	10.90	8.90	-	8.90	12.0	8.5	8.5
2012	11.10	9.30	-	9.30	14.0	9.4	9.4
2013	11.25	10.00	2.25	12.25	14.1	6.4	7.8
2014	*10.11	10.40	3.00	13.40	10.8	5.4	7.0

Source: Premier Energy & Water Trust, Bloomberg, Marten & Co. *Revenue return for the 2014 year was impacted by one off expenses incurred to extend PEW's life beyond the end of 2015. In the absence of these expenses, revenue return would have been 12.55p per share.

For 2014, PEW generated a revenue return of 10.11p per ordinary share, which is a fall of 10.1% when compared with the 11.25p revenue return per share generated for the 2013 year. However, the board report that this is due entirely to the £417k of costs

(2.44p per ordinary share) that were incurred to extend PEW's life during 2014. In the absence of these costs, PEW would have generated a revenue return per ordinary share of 12.55p, which would have been equivalent to an 11.6% increase in revenue income. As illustrated in Figure 9, the trend has been one of an increasing revenue return during the last five years (excluding the transaction costs of the life extension). The compound annual growth rate in the PEW's revenue reserve per share has been 4.4% during the last five years.

As illustrated in Figure 9, PEW has increased its total base dividend by 4% for the 2014 year. The compound annual growth rate in the base dividend has been 6.2%.

Discount

The trend of discount narrowing has continued during the last twelve months to the extent that PEW is now trading at a modest premium and has recently been able to issue some stock. As illustrated in the discount chart on page 1, the trend since the change of strategy in mid-2012 has been one of a gentle narrowing of the discount to NAV of the ordinary shares. During this time, PEW's ords have moved from trading at a c 23% discount to trading at a modest premium (c 3% today). This movement arguably reflects 1) the significant improvement in PEW's performance since the strategy change as well as the compelling yield that the ordinary shares offer. As discussed above, we expect that PEW will cease to pay its additional dividends (0.75p per quarter) with the final dividend payment for the 2015 year (in March 2016). However, we observe that the underlying yield from the base dividend remains attractive (currently 5.6%) and is well covered by earnings. It also quite feasible that PEW's share may see further strong demand once clarity is provided regarding the roll-over of the ZDPs at the end of this year.

Fees, capital structure, board

Please see our initiation note of June 2014 and update note of August 2014 for further details.

A step change in performance – 18/06/2014

Solid interims and plans for the future – 07/08/2014

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