Utilico Emerging Markets

Infrastructure and utilities in growth markets

Investment companies

Utilico Emerging Markets (UEM) is a closed end investment company investing in utilities, infrastructure and related companies in emerging markets. Unusually among funds investing in this area, it offers a yield of over 3%, reflecting investment in cash-generative businesses. Following a period of weakness for emerging markets earlier this year, investors may wish to consider using UEM to gain exposure to companies that are integral to the development of these long-term growth markets.

12 months ending	Total share price return (%)	Total NAV return (%)	MSCI Emerging Markets TR GBP (%)	MSCI EM Infrastructure Capped (%)	5-10 Yr Gvt Yld +2% +RPIX (%)
30/09/10	33.7	33.2	22.3	21.6	9.0
30/09/11	(11.8)	(8.6)	(14.9)	(9.8)	9.7
30/09/12	21.3	18.1	13.2	17.3	7.4
30/09/13	12.4	14.3	1.0	1.2	6.7

Note: Twelve-month rolling discrete performance.

Investment strategy: Selecting within a growth area

The manager of the company has a positive view on equities in emerging markets (see page 6), but does not employ a strategic macro view in selecting stocks for the portfolio, instead focusing on fundamental analysis of individual companies and adopting a medium- to long-term view on holding s. In addition to the strong market positions often enjoyed by utilities and infrastructure companies, stocks in the portfolio generally have asset backing and strong cash flow. The manager invests in operational rather than greenfield assets, with unlisted assets accounting for less than 2.5% of the total. All this provides an element of risk mitigation and there is arguably evidence of this in the shape of superior returns and lower volatility compared with the MSCI Emerging Market index (page 9).

Outlook: Uncertainty near term, promising long term

The risks of investing in emerging markets have been to the fore this year, with slowing growth and taper-talk resulting in absolute and relative weakness, particularly since May. This has left valuation metrics in these markets at more attractive levels than in developed countries relative to historical levels. Beyond near-term volatility, there is a clear positive case for investment in emerging market infrastructure and utility companies, with growth in these sectors having the potential to outpace GDP growth, which in turn is still expected to exceed developed market growth significantly (see page 4).

Valuation: Wider discount

The current discount to NAV of 8.4% is modestly above the three-year average of 6.8%: a reflection of the weaker sentiment towards emerging markets seen this year. While the discount is similar to the average for emerging market peers, the below-index volatility of NAV returns and the above average dividend yield suggest the shares could comfortably sustain a much lower discount (the only other closed-end peer offering a similar level of yield trades at a premium).

3 October 2013

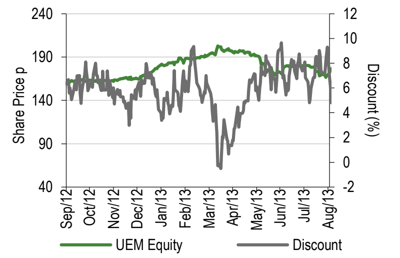
Price	**173p**
Market cap	**£368m**
AUM	**£429m**

NAV*	188.15p
Discount to NAV	8.1%
NAV**	190.99p
Discount to NAV	8.1%
Yield	3.4%

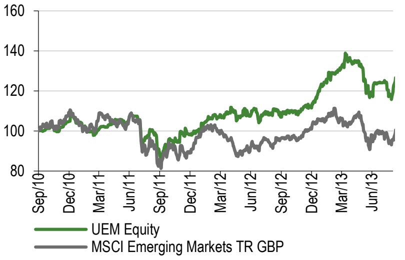
*Excluding income. **Including income.

Ordinary shares in issue	213.2m
Code	UEM
Primary exchange	LSE
AIC sector	Global Emerging Markets

Share price/discount performance*



Three-year cumulative perf. graph



52-week high/low	203p	159p
NAV* high/low	209.47p	170.4p

*Excluding income.

Gearing

Gross	4%
Net	4%

Analysts

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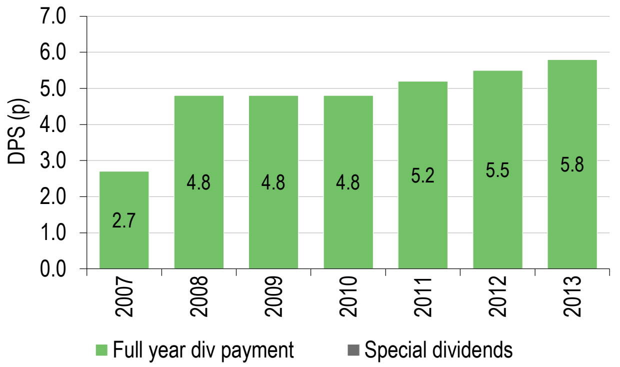
Utilico Emerging Markets is a research client of Edison Investment Research Limited

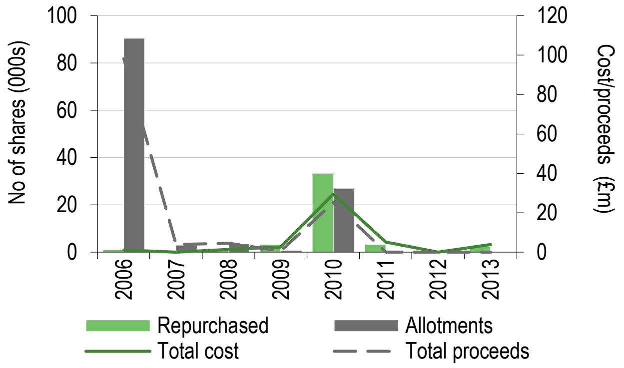
Exhibit 1: Company at a glance

Investment objective and fund background	Recent developments
Utilico Emerging Markets seeks long-term total return predominantly through investing in infrastructure, utility and related sectors, mainly in emerging markets. The manager follows a primarily bottom-up approach independent of index weightings. The company has an indefinite life subject to five yearly continuation votes. Performance fees are calculated by reference to the post-tax yield on FTSE Actuaries Govt. Securities UK Gilt 5-10 years plus inflation plus 2%, and company publications compare performance with the MSCI EM index.	23 July Q1 dividend declared: 1.525p. 23 July IMS for period to 30 June 2013: 3 month total return -5.0% cf MSCI EM index -7.8%.

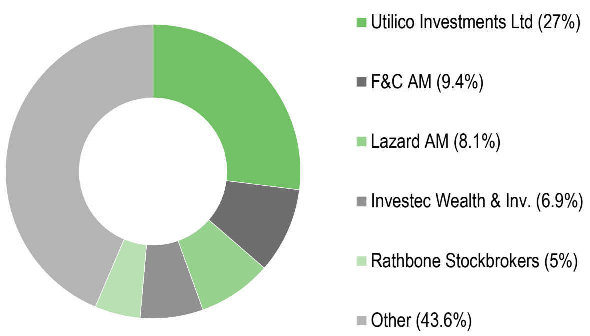
Forthcoming		Capital structure and fees		Fund details	
AGM	September 2014	Total expense ratio	3.2% (0.8% ex perf. fee)	Group	ICM
Interim results	November 2013	Net gearing	4%	Manager	Charles Jillings and Duncan Saville
Year end	31 March	Annual mgmt fee	0.5% of NAV	Address	UK office: P O Box 208, Epsom, Surrey KT18 7YF.
Dividends paid	Mar, Jun, Sep, Dec	Performance fee	Yes (see page 10)		
Launch date	20 July 2005	Company life	Indefinite (cont. vote)	Phone	+44 (0)1372 271486
Continuation vote	AGM 2016 and 5-yearly	Loans, facilities	£50m facility, £21.8m drawn	Website	utilicoemergingmarkets.com

Dividend policy and history	Share buyback policy and history
The fund is managed for total return, but holdings generate cash flows and dividends that provide a useful yield. The board broadly seeks flat or rising dividends.	UEM is authorised both to repurchase up to 14.99% of its ordinary shares and to allot shares up to approximately 10% of the issued share capital.

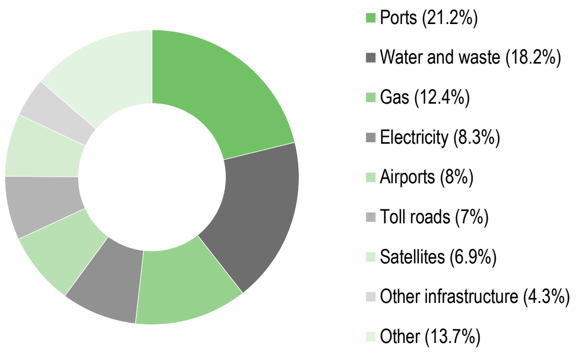




Shareholder base (as at 20 June 2013)



Sector exposures of portfolio (as at 31 August 2013)



Top 10 holdings (as at 31 August 2013)

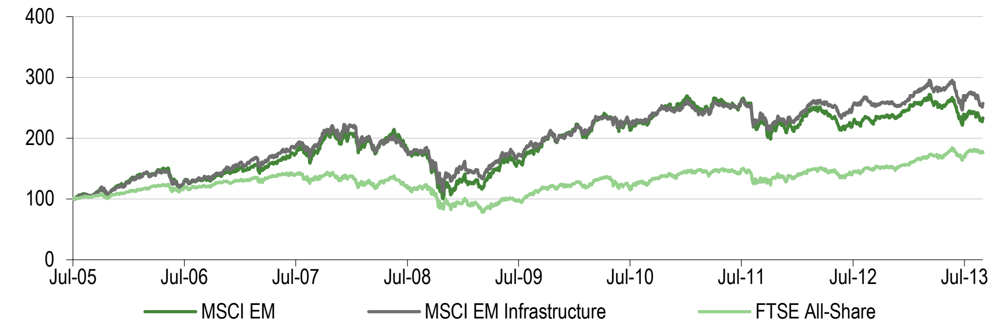
			Portfolio weight %	
Company	Country	Industry	31 August 2013	31 August 2012
Intl Container Terminal Svcs	Philippines	Transportation & Logistics	8.6	8.1
Eastern Water Resources Devt.	Thailand	Utilities	8.3	9.3
Malaysia Airport	Malaysia	Transportation & Logistics	8	6.4
Ocean Wilsons	Brazil	Transportation & Logistics	5.4	6.4
China Gas	China	Utilities	4.8	2.6
MyEG Services	Malaysia	IT Infrastructure	4.3	N/A
Asia Satellite Telecoms.	China	Satellites	4.1	3.7
Gasco	Chile	Utilities	3.6	N/A
Companhia de Saneamento de Minas Gerais	Brazil	Utilities	2.5	5.6
Companhia de Concessoes Rodoviaras	Brazil	Transportation & Logistics	2.5	3.2
Top 10			**52.1**	**51.5**

Source: Utilico Emerging Markets, Edison Investment Research

Market outlook: Favourable subsector within EM

To provide a context for the performance of the markets Utilico Emerging Markets addresses, we compare the performance of an emerging markets infrastructure/utilities index with global emerging market and UK market indices[1] in Exhibit 2. Both emerging market indices outperformed the UK market leading up to and following the financial crisis, but from mid-2010 both have flattened and then underperformed from mid-2012, particularly this year, as emerging market economic growth and market sentiment weakened. Over the whole period shown (from July 2005 when UEM was launched) the EM infrastructure/utilities index outperformed the global emerging markets index.

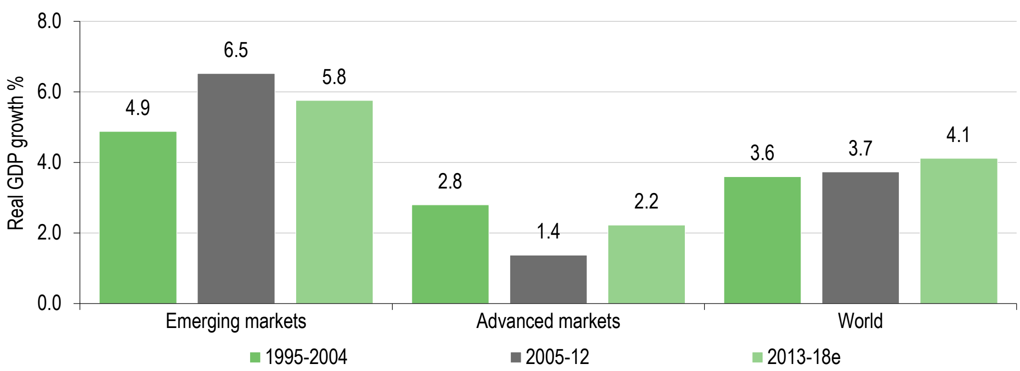
Exhibit 2: MSCI Emerging Markets, MSCI EM Utilities and FTSE All-Share indices compared



Source: Thomson Datastream. Note: All TR in £ terms.

Turning to the economic outlook, we show IMF data for average GDP growth rates over two historical periods and forecasts for 2013-18. Emerging economies globally have outperformed advanced markets and are expected to continue to do so despite near-term reductions in growth estimates. When looking at these numbers, it is worth recalling that 2012 GDP per capita in emerging markets was c $7,000 compared with c $40,000 in advanced economies.

Exhibit 3: GDP growth – emerging markets versus advanced and world markets



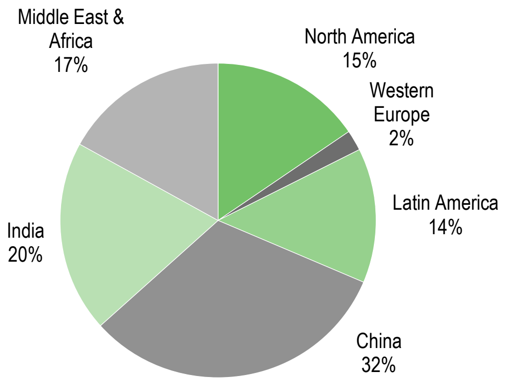
Source: IMF April 2013 WEO adjusted for July 2013 downgrade, Edison Investment Research

We consider next the prospects for UEM's speciality: utilities and infrastructure. Global data in this area are less readily available, but the general proposition that utilities and infrastructure sectors should see growth at or above GDP growth in emerging markets is credible, as they are likely to be instrumental in these countries moving up the development curve. Within a study of top global

[1] UEM's specific exposures mean there is not an obvious index to use as a comparator, but the capped MSCI emerging market infrastructure index shown includes both infrastructure and utility components with capping limiting the telecoms weighting to one third. The broader indices are the MSCI Emerging Markets and FTSE All-Share indices. All indices are in total return and sterling-adjusted form.

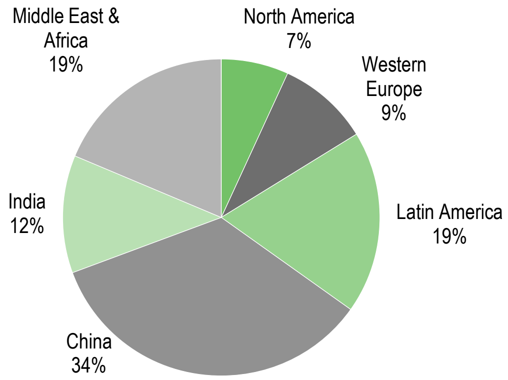
cities,[2] the McKinsey Global Institute estimated that 440 emerging market cities would account for nearly half of global growth 2010-2025. Within this, the emerging market share of growth in two key infrastructure/utility indicators, container port capacity and municipal water demand, is projected to be 85% and 80% respectively. While this does not give estimated growth rates by territory, it underlines the likely heavy weighting of infrastructure and utilities growth towards emerging markets. The sectoral analysis of the UEM portfolio shows that ports and water and waste sectors together account for 39% of assets (as at end-August – see Exhibit 9).

Exhibit 4: Municipal water – share of 150% estimated growth 2010-2025e



Source: McKinsey Global Institute Cityscope 2.0

Exhibit 5: Containers – share of 40% estimated growth 2010-2025e

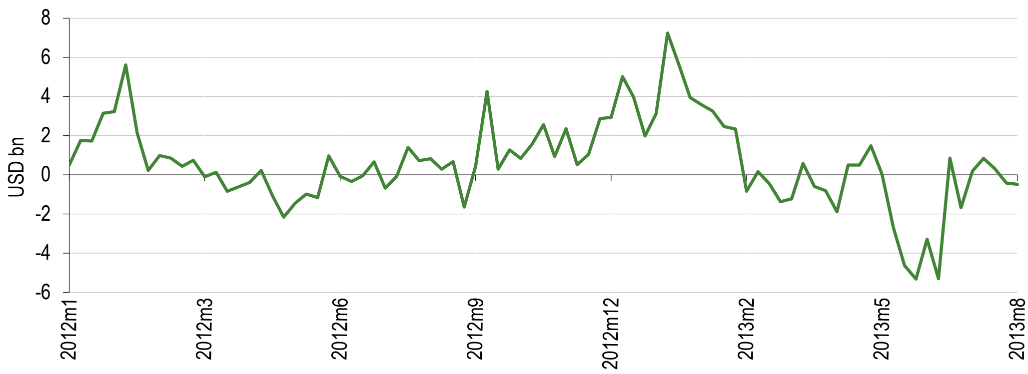


Source: McKinsey Global Institute Cityscope 2.0

Therefore, in broad terms, the outlook for the sectors in which UEM is invested appears favourable and the stock market performance of infrastructure and utility stocks, as captured by the MSCI EM Infrastructure index, has modestly outperformed the overall emerging market index.

In the near term, emerging equity market levels appear to have been influenced by net inflows and outflows. Exhibit 6 shows EPFR data for a sample of emerging market equity fund flows from the beginning of 2012. This shows a period of inflows towards the end of 2012 and early-2013 replaced by significant outflows following the Fed's remarks in May about the tapering of quantitative easing. Flows more recently have moved to neutral territory and it remains to be seen how the delay in the tapering of QE and its eventual realisation will affect markets.

Exhibit 6: EPFR indicator of net flows into emerging market equity funds



Source: EPFR Global

For investors prepared to look through such near-term volatility, recent market weakness may provide an opportunity. We look next at where markets stand in terms of valuation. This comparison, using Datastream indices (Exhibit 7), generally shows emerging markets overall and emerging market utilities (we are lacking a straightforward infrastructure proxy) standing close to or

[2] Urban World: Cities and the rise of the consuming class, McKinsey Global Institute, June 2012.

below (price/book) three- and 10-year averages. They also appear relatively attractively valued when compared with US or UK markets.

Exhibit 7: Comparing historical equity valuation measures (over 10 years except P/Es)

Price to prospective earnings	Last	High	Low	3-year ave.	Last % of average
EM Gas/Water/Multi-Utilities	11.9	13.0	8.0	10.9	109%
Emerging Markets	10.4	11.6	9.1	10.3	101%
US	14.8	14.9	11.4	13.1	114%
UK	12.8	12.8	8.8	10.7	120%
World	13.3	13.4	10.1	11.8	112%
Price to book				**10-year ave.**	
EM Gas/Water/Multi-Utilities	1.5	2.3	1.1	1.6	97%
Emerging Markets	1.6	2.7	1.1	1.8	91%
US	2.7	3.1	1.3	2.4	112%
UK	1.7	2.7	1.2	2.0	88%
World	1.9	2.5	1.1	1.9	102%
Return on equity (%)					
EM Gas/Water/Multi-Utilities	11.8	14.7	9.3	12.4	95%
Emerging Markets	13.1	18.6	11.2	15.5	84%
US	13.4	17.8	3.9	13.5	99%
UK	8.2	20.6	2.9	12.3	67%
World	10.8	16.7	4.7	12.4	87%
Dividend yield (%)					
EM Gas/Water/Multi-Utilities	3.6	5.0	2.3	3.4	106%
Emerging Markets	2.9	5.0	1.7	2.6	111%
US	2.0	3.5	1.5	1.9	104%
UK	3.2	6.6	2.7	3.4	96%
World	2.5	4.6	1.9	2.5	102%

Source: Thomson Datastream as at 19 September 2013.

Our conclusion is that relatively strong economic growth in emerging markets, the potential for faster growth in the utilities/infrastructure sectors, and reasonable valuations on a comparative basis provide an encouraging background for investing in the market segments targeted by UEM. Normal emerging market risks apply, with the sharp correction seen this year illustrating the possible impact of swings in sentiment and fund flows. Utilities and infrastructure companies can also be politically sensitive and investors such as UEM have to keep a close eye on developments in regulatory models.

In the following sections, we look more closely at the fund profile and the manager's investment approach.

Fund profile: Investing in structurally important assets

Launched in July 2005, UEM is a Bermuda-registered investment company listed on the London Stock Exchange. The company invests primarily in quoted emerging market infrastructure and utilities companies. Typically, these businesses are structurally important within their local economy, enjoying the benefits of strong market positions, which provide the portfolio with an element of risk mitigation. The manager adopts a stock picking approach based on fundamental analysis, with limited attention paid to indices or strategic overview. The time horizon is medium to long term, but valuation considerations drive some activity, resulting in portfolio turnover averaging around 26% over recent years. Performance fees are earned when fund performance beats an absolute hurdle rate, while the company accounts show performance in the context of the MSCI Emerging Markets index. Gearing (4% end-August) is used for working capital rather than structural purposes and derivatives are employed to hedge general market risk to some degree (see page 7).

The fund manager: Charles Jillings

The manager's view: Positive on EM, focused on stock picks

The manager has a broadly positive view of the prospects for emerging market stocks. He does not envisage emerging economies decoupling from developed markets in the foreseeable future given the close linkages that exist. In terms of the background in developed markets, the US determination to maintain growth is clearly positive, while the more recent data in the UK suggest this economy is turning. If Japan can follow through with its reflationary efforts and Europe is no worse than a neutral influence, the net backdrop in developed economies should be at least modestly positive. If this is then combined with China achieving GDP growth in excess of 7%, the environment for emerging market investors should be satisfactory or better.

In terms of selecting stocks for the portfolio, the manager does not believe he should be distracted by near-term views on macroeconomic trends given the way in which these fluctuate. Instead he focuses on stock selection within a broad view that utilities, infrastructure plays and similar companies are both geared to long-term growth in these markets and instrumental in achieving it. The manager believes such companies are capable of delivering above GDP growth.

The manager's rationale for holding two of the stocks in the portfolio where the investment has been increased over the last year gives a flavour of the investment approach and the kind of opportunity he seeks to identify. China Gas Holdings is an operator of gas distribution infrastructure in China with the potential to benefit from growing demand for this source of relatively clean energy. Efforts to address environmental problems mean that gasification in cities has a high priority indicating a favourable long-term backdrop for the business, which has already been recording very high growth in profitability (FY13 EBITDA growth 25.6%) and share price. Another gas infrastructure company is Gasco in Chile, which also has operations in Colombia and Argentina. The manager sees this as an under-researched stock that has the monopoly concession for distributing piped natural gas in Santiago, as well as strong market shares in LPG services in Chile and Columbia (27% and 23% respectively) with the potential to expand margin in a favourable regulatory environment.

Asset allocation

Investment process: Stock picking within EM universe

The manager addresses a universe of approximately 900 infrastructure, utility and similar stocks within the emerging markets countries as included in the MSCI Emerging Markets index. The formal limit for single country exposure is 50%, but in practice 25-30% would be the manager's comfort level. Individual stock exposure above 10% would prompt profit taking. The team runs a comprehensive database covering the stock universe, but does not rely on this for stock selection, instead picking stocks based on bottom-up analysis. Detailed models are maintained on almost all holdings, including explicit forecasts for three to five years and other metrics appropriate to the company concerned.

Stocks in the portfolio generally have asset backing and strong cash flow characteristics. The manager therefore focuses on operational businesses rather than greenfield investments, and only has limited exposure to unlisted investments, thereby ensuring greater transparency. While listed investments also tend to ensure greater liquidity, the manager does not give this priority when selecting investments, taking a patient approach to the realisation of the value identified. The time horizon is described as long-term, with the broad objective for investments being that they should have the capability to double over five years. The portfolio turnover implies an average holding period of about four years, with the manager indicating that this time horizon is reduced by turnover resulting from top-slicing when investments have performed well.

In terms of style, the manager seeks value, but is not simply looking for value or “unloved” stocks, but instead for attractively priced companies which have strong market positions that tend to characterise infrastructure and utilities sector businesses. Many of the portfolio holdings arise from ideas the team picks up on its extensive schedule of traveling in emerging markets, with most trips yielding one or two potential investments. The competition between investment ideas put forward by members of the team creates a natural sell discipline, with holdings being replaced where the manager believes a better opportunity has been identified.

The management company, ICM, has a team of 15 analysts and managers with the portfolio manager and four analysts focused on the UEM fund (see Exhibit 8). Mark Lebbell looks at communications including fixed line, mobile and satellites; Jonathan Groocock focuses on utilities and Jacqueline Broers’ area is transport. These analysts in turn have junior analysts reporting to them, and a fixed income expert and more generalist analysts are included in the overall team. Collectively, they have substantial experience in emerging markets and the utilities and infrastructure markets, enabling them to make informed assessments of the presentations made by management teams. Although not activist managers, they do seek to provide helpful feedback to portfolio companies much as a non-executive director might, encouraging a focus on shareholder returns and the bottom line, as well as revenue growth.

Exhibit 8: Utilico Emerging Markets portfolio management team

	Function/title	Age	Experience/qualification
Duncan Saville	Director of ICM	56	Chartered accountant and director of a number of companies.
Charles Jillings	Lead manager of portfolio and employee of UEM and ICM	57	Chartered accountant. Previously worked in corporate finance and director of several companies.
Jacqueline Broers	Analyst	33	Chartered accountant. At UEM since 2010; previous experience in corporate finance.
Jonathan Groocock	Analyst	35	CFA charterholder. At UEM since 2011.
Mark Lebbell	Analyst	41	Associate member of Inst. Of Electrical Engineering and Technology. At UEM since launch.
Ross Wilding	Analyst	34	MBA, CFA charterholder. Joined UEM 2012.

Source: Utilico Emerging Markets accounts for the year to end March 2013

Charles Jillings is currently employed both by ICM and the company, reflecting an arrangement that combines elements of self-management and contracted-out management. There is no double counting of costs as the relevant salary expense is deducted from fees. The advent of the Alternative Investment Fund Managers Directive will mean the company needs to decide whether it or ICM should be the designated manager. This formal rearrangement should not itself result in any change in the management of the company’s portfolio.

The company employs derivatives to moderate the market exposure of the portfolio using liquid put options on the S&P 500 to do this. The put options are relatively long-dated, out of the money options, with the premium paid largely offset by writing a lesser number of shorter-dated call options. The FY13 accounts show a net cash outflow from purchase and sale of derivatives of £5m while taking the seven-year period from 2007, including the financial crisis, there was a net inflow of £16m. The year-end net exposure was £102m or 22% of year end investments of £456m; the maximum gross exposure during the year was £113m, not significantly above the year-end figure. Again looking at the history since 2007, the average net exposure has been lower at 9% of year end investments. Finally, the profit and loss impact has been modest on balance with a cumulative loss of £3.5m (2007-13) including a gain of £16.7m in 2008. The effect of transactions is to provide some protection in the event of a significant downturn at expense of some transaction and opportunity cost in a strong market.

The company does not engage in foreign exchange hedging and the main currency exposures are to the Brazilian real, Chinese renminbi and US dollar, reflecting portfolio exposures and the derivative position.

Overview

The number of holdings in the portfolio is above the average for the Global Emerging Market peer group (see page 11) at 80 versus 69, but the top 10 holdings account for 53% of the total versus 41%, suggesting a greater-than-average concentration on top picks within the portfolio. Fixed income, while not specified in the portfolio analysis, accounted for less than 5% of the portfolio and unquoted stocks were approximately 2.5% of the total, leaving quoted equities at around 95% of the total. Gearing was 4% at the end of August.

Current portfolio positioning

The sector analysis shown in Exhibit 9 highlights that Ports and Water & Waste are the largest exposures by some margin, although, taken together, the percentage accounted for by these areas has fallen by over eight percentage points from the same month last year. The other notable change over 12 months is the increased percentage in the Gas sector, with the holdings in China Gas and Gasco (see Exhibit 1 – top 10 holdings) being important contributors to this.

If we group the infrastructure and utilities exposures within the sectors, then infrastructure, led by Ports, Airports, Toll roads and Satellite, accounts for 52% of the portfolio, while utilities (primarily Water, Gas and Electricity) comprise 41% of the total.

Exhibit 9 Sector analysis as at end-August 2013 and 2012 (%)

Sector	Aug-13	Aug-12	Difference
Ports	21.7	24.1	-2.4
Water and waste	17.5	23.3	-5.8
Gas	12.5	6.3	6.2
Airports	8.2	7.3	0.9
Electricity	7.7	9.8	-2.1
Satellites	7.3	4.7	2.6
Toll roads	7.2	10.4	-3.2
Other	6.7	6.0	0.7
Other infrastructure	4.4	2.3	2.1
Infrastructure investment funds	3.0	3.4	-0.4
Renewables	1.6	0.9	0.7
Telecoms	1.3	1.0	0.3
Post Office	0.8	0.3	0.5
Infrastructure IT	0.1	0.2	-0.1
	100.0	**100.0**	**0.0**

Source: Utilico Emerging Markets

The geographical exposure in terms of the company base is shown in Exhibit 10. China and Hong Kong and Brazil have comfortably the largest representation, reflecting stock selection rather than a strategic view. Looking at the changes over 12 months, the main ones are an increase in China and Hong Kong (influenced by the increase in China Gas) and a 10 percentage point reduction in Brazil (reflecting in part currency and market weakness).

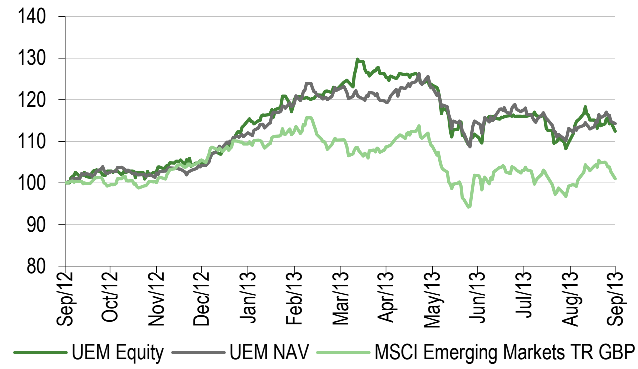
Exhibit 10: Geographical allocations as at end August 2013 and 2012 (%)	Aug-13	Aug-12	Difference
China & Hong Kong	30.1	23.5	6.6
Brazil	19.3	29.4	-10.1
Malaysia	14.5	10.8	3.7
Philippines	9.8	10.2	-0.4
Thailand	8.7	9.9	-1.2
Other Far East	5.5	6.4	-0.9
Other Latam	4.6	3.0	1.6
Eastern Europe	3.3	3.8	-0.5
Middle East & Africa	3.2	2.2	1.0
Other	1.0	0.8	0.2
Total	**100.0**	**100.0**	**0.0**

Source: Utilico Emerging Markets

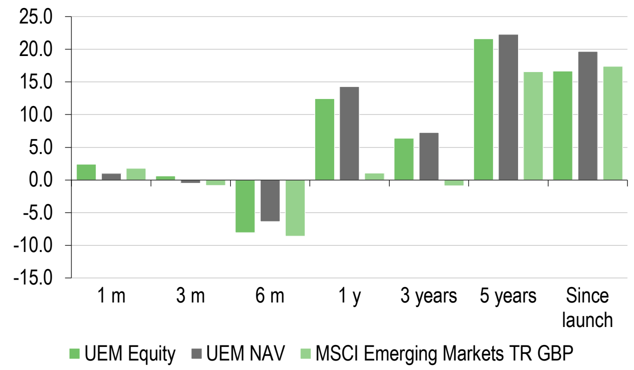
Performance: Ahead of EM indices

Exhibit 11: Investment trust performance

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)*



Source: Thomson Datastream, Edison Investment Research. Note: Launched 20 July 2005. * Three, five and since launch figures are annualised compound returns.

The trust's NAV total return relative performance has been ahead of MSCI Emerging Markets and MSCI Emerging Markets Infrastructure indices over one-, three- and five-year periods (see Exhibit 12); it has also been ahead of the emerging markets index since launch (see Exhibit 11 bar chart).

The last two rows in Exhibit 12 show the difference in performance versus the absolute hurdle rate used to calculate performance fee (the post-tax yield on the FTSE Actuaries Government Securities UK Gilt 5-10 years Index plus inflation (RPIX) and plus 2%). Unsurprisingly, given the weakness in emerging markets seen since May, this shows NAV underperformance over six months, but outperformance over one and five years, and NAV performance that has been close to the hurdle rate over three years.

Exhibit 12: Share price and NAV total return performance, difference versus benchmarks (percentage points)

	One month	Three months	Six months	One year	Three years	Five years
Price versus MSCI Emerging Markets TR GBP	0.7	1.4	0.6	11.4	23.0	21.4
NAV versus MSCI Emerging Markets TR GBP	(0.7)	0.3	2.2	13.3	26.1	24.3
Price versus MSCI EM Infrastructure Cap	1.0	4.2	0.1	11.2	13.3	15.1
NAV versus MSCI EM Infrastructure Cap	(0.4)	3.1	1.8	13.1	16.4	18.0
Price versus FTSE All-Share TR GBP	1.3	(5.0)	(11.9)	(6.5)	(13.0)	13.6
NAV versus FTSE All-Share TR GBP	(0.1)	(6.1)	(10.2)	(4.6)	(10.0)	16.6
Price versus 5-10 Yr Gvt Yld +2% +RPIX	1.9	(1.1)	(11.4)	5.8	(5.2)	33.4
NAV versus 5-10 Yr Gvt Yld +2% +RPIX	0.5	(2.2)	(9.7)	7.6	(2.2)	36.3

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-September 2013.

In Exhibit 13 below we set out UEM and MSCI Emerging Market indices' total returns and standard deviations over periods between one and five years. This demonstrates that over these periods, UEM has delivered both higher total returns and lower volatility, potentially indicating the benefits of the cash-generative, income-generating profile of portfolio holdings. As a further indicator of risk-adjusted performance, the peer group comparison (page 11) shows that NAV Sharpe ratios (an indicator of risk-adjusted returns) for one and three years were usefully above the group averages.

Exhibit 13: Comparing returns and standard deviations for UEM and MSCI EM index

	One year	Three years	Five years
Utilico Emerging Markets NAV total return	14.8%	7.8%	16.6%
Utilico Emerging Markets standard deviation	12.1%	12.4%	16.3%
MSCI EM total return	2.8%	-0.9%	9.6%
MSCI EM standard deviation	14.2%	15.8%	21.2%

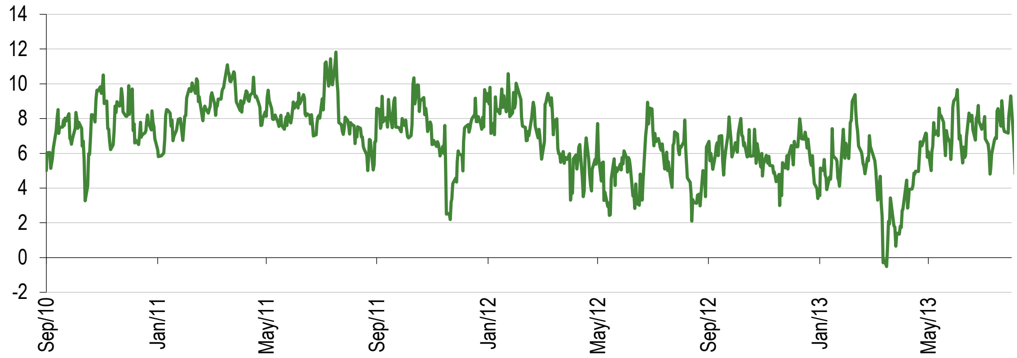
Source: Datastream, Edison Investment Research

Discount: Back close to average levels after tightening

The board has not set a specific target discount, but includes this among its key performance indicators for the trust and monitors significant dealings and movements in the share price. The company may buy back or issue shares to avoid substantial imbalances in the market for the shares. The board would also consider buybacks on a similar basis to other investment decisions and would be inclined to buy were the discount to move above 10%. The company repurchased shares to the value of £5m in 2011 and £29m in 2010. There were no shares repurchased in 2012.

The discount has averaged 6.8% over the last three years, but, as Exhibit 14 shows, this has ranged between a marginal premium and a discount of nearly 12%. We ascribe the sharp contraction visible in April this year to the purchase of 2.3m shares (consideration £4.5m) to satisfy half the performance fee due (see comments on fees in next section). The average discount is therefore probably a more reasonable reflection of market expectations for a normal level. Our peer group comparison (see Exhibit 15) shows that UEM has both an above-average yield and a close to average discount, suggesting scope for the habitual discount to narrow.

Exhibit 14: Discount over three years (NAV at par ex-income)



Source: Thomson Datastream, Edison Investment Research. Note: Positive values indicate a discount; negative, a premium.

Capital structure and fees

UEM has one class of share with 213.2m ordinary shares in issue. The company is authorised to buy back up to 14.99% of the issued share capital and issue new shares representing approximately 10% of the existing capital. At board discretion, the company can also operate a tender scheme, but this has yet to happen and is not expected to be offered if gross asset growth exceeds 10% or the performance exceeds the benchmark by over 15%. The maximum that could be tendered would be 12.5% of the shares in issue.

The company has an unlimited life subject to continuation votes, with the next due at the 2016 AGM and every five years thereafter.

The company may employ gearing, which must not exceed 25% of gross assets at time of drawdown. At the end of August, the company had debt of £21.8m drawn on a facility of £50m and gearing of 4%. The facility is seen as providing working capital rather than structural gearing for the company.

The management fee paid to ICM is 0.5% pa of the gross assets less current liabilities (excluding borrowings used for investment purposes). There is the potential for a performance fee each financial year of 15% of any outperformance of the post-tax yield on the FTSE Actuaries Government Securities UK Gilt 5-10 years Index plus inflation (RPIX) plus 2%. The performance fee is subject to a high water mark: at the end of March 2013 (the last period for which a performance fee was paid), the NAV was 205.49p. Half the performance fee is paid in cash and half in shares, which must be held for 12 months. The ongoing charge excluding performance fee was 0.8% for FY13 (FY12: 0.9%), and including performance fee 3.2% (FY12: 0.9%). Averaging ongoing fees, including performance fees for financial years 2006-13, gives a figure of 2.1%.

Dividend policy

The company's objective is long-term total returns and the manager invests in operational companies generating strong cash flows, many of which pay out a stated percentage of earnings, providing visibility of income. The portfolio yield is approximately 4% and has been around this level since launch. This supports UEM's ability to pay dividends itself and move to quarterly payments in the last financial year. The board looks to maintain or increase dividends.

The company is able to distribute both capital and income as dividends and last year the final quarterly payment was made out of capital, reflecting dividend reductions at portfolio companies undertaking investment programmes.

The yield on the company's shares of 3.5% is substantially above all but one of the peers that pay dividends.

Peer group comparison

As Exhibit 15 illustrates, there are 10 London-listed closed-end funds (excluding different share classes) investing in the global emerging markets category. Given the specific mandate UEM follows, focusing primarily on infrastructure and utilities stocks, the fund is not directly comparable with others in this sector. Nevertheless, given that emerging markets tend to move together in the near term and the likelihood that investors will be considering different ways of gaining exposure to these markets, the peer group has some relevance. Furthermore, we imagine that many investors would consider investing in a more generalist emerging market fund and a specialist such as UEM.

Exhibit 15: Global Emerging Market Investment Companies

Fund Name	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	Sharpe 1y (NAV)	Sharpe 3y (NAV)	Discount (ex-par)	Latest ongoing charge	Perf fee	Net gearing	NDY(%)
Advance Developing Markets	283	6.5	-0.1	26.0	0.6	0.1	-9.8	1.08	Yes	97	
Advance Frontier Markets	90	21.2	17.6	24.8	1.9	0.7	-8.3	1.54	Yes	92	
Africa Opportunity	31	36.9	47.0	67.4	2.1	1.0	-2.8	3.83	Yes	98	0.7
Ashmore Global Opp GBP	94	-7.8	-21.9	-24.4	-0.9	-0.8	-29.6	0.82	Yes	89	
Ashmore Global Opp USD	58	-7.0	-22.1	-10.6	-1.0	-0.7	-28.4	0.82	Yes	89	
BlackRock Frontiers	107	35.6			2.9		8.4	1.57	Yes	101	1.1
BlackRock Frontiers C	64						8.1		Yes	73	1.4
Genesis Emerging Markets	732	7.4	7.2	68.7	0.8	0.3	-5.2	1.69	No	99	
JPMorgan Emerging Markets	693	8.7	6.1	64.9	1.0	0.4	-9.9	1.2	Yes	95	0.8
JPMorgan Global Emerg Mkts Inc	294	14.8	29.6		1.4	0.8	3.2	1.27	Yes	106	4.0
Templeton Emerging Markets UK	1850	5.6	1.1	74.3	0.6	0.2	-8.0	1.31	No	100	1.1
Utilico Emerging Markets	**376**	**15.5**	**25.1**	**68.9**	**1.2**	**0.8**	**-7.2**	**0.85**	**Yes**	**105**	3.5
Wtd average		**8.5**	**6.3**	**57.2**	**0.8**	**0.3**	**-7.3**	**1.29**		**99**	1.1

Source: Morningstar. Notes: TR=total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash/cash equivalents as a percentage of shareholders' funds.

In terms of net asset value total return, UEM has been comfortably ahead of the weighted average over the periods shown, ranking fourth over one and five years and third over three years. Similarly, the Sharpe ratios for one and three (and five years – not shown) are noticeably above the average values. The ongoing charge before performance fee is below average. The charge, including performance fee, has been significantly higher in years where performance has been above the absolute hurdle (total charges in recent years, where performance fees were payable, were 3.2% FY13 and 2.5% FY11). We note in this context that the NAV return comparison is after the effect of fees and the majority of funds in the peer group by number also charge performance fees.

Finally, it is worth highlighting again the yield of c 3.5% offered by the trust, second only to the income-focused JP Morgan Global Emerging Markets Income trust.

The board

The board (four members, all non-executive and independent of the manager) are Alexander Zagoreos (Chairman), Garry Madeiros, Anthony Muh and Kevin O'Connor (Deputy Chairman). The average length of service for the directors is approximately six years. The chairman and deputy chairman have served since the inception of the company.

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