Sionna Investment Managers®

# SOUNDBITE

Monday February 13th, 2012

The energy infrastructure sector enjoyed a banner year in 2011 and significantly outperformed the broader market.

These “boring” infrastructure businesses, which include utilities, pipelines, and energy storage and processing, posted total returns of 20 to 40 per cent for the year. Compare those results with the S&P/TSX Composite total return: -8.7%. Also worth noting: Of the top 10 best-performing stocks in the S&P/TSX Composite last year, three were energy infrastructure companies.

While these businesses have produced solid operating results during this period, you have to question whether the outsized returns reflect the market’s insatiable appetite for yield. Energy infrastructure “names” (i.e., companies) traditionally pay healthy dividends. And we’re increasingly seeing investors, particularly retail investors, ignore other traditional valuation metrics entirely in the chase for dividend-paying investments. In some respects, it seems the market is valuing all yields equally, regardless of the payout ratios or debt levels behind them.

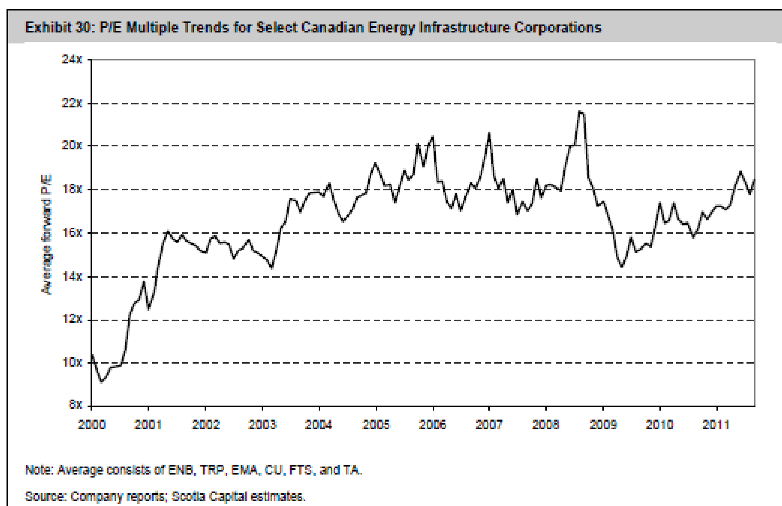

Exhibit 30: P/E Multiple Trends for Select Canadian Energy Infrastructure Corporations

Note: Average consists of ENB, TRP, EMA, CU, FTS, and TA.

Source: Company reports; Scotia Capital estimates.

In the energy infrastructure sector, valuations are becoming stretched and many stocks are trading at the high end of their historical range. A decade ago, these stocks were trading at P/E ratios of 10X-12X; now they have now risen to P/E ratios of 18X-20X. The chart (Exhibit 30) illustrates the average historical P/E ratio for a select group of energy

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infrastructure stocks. These stocks are trading at levels higher than long-term averages, and *materially* higher than the market's current P/E ratio of 14X-15X.

In an economy facing strong headwinds against growth, and susceptible to financial shocks, these high-yielding stocks arguably present an appealing alternative to the broader equity market. While they're not cheap on a relative or absolute basis, they have traded at even higher levels before, and are likely to continue to be relatively safe havens in volatile periods.

Sionna has long been attracted to such defensive businesses, with their stable asset bases and consistent earnings. However, we continue to believe that an array of valuation metrics – not purely yield – should be considered when assessing them. The relentless and often indiscriminant yield rally in recent years has pushed many of the energy infrastructure names to premium valuations. That is why Sionna has been trimming our exposure across our portfolios, and we are underweight in this "boring" segment of the market.

**Kim Shannon Discusses the Strengths of Sionna's Relative Value Strategy on BNN**

Sionna President and CIO Kim Shannon discusses the relative value investment strategy in a "Canadian Value Focus" segment on BNN's *Business Day* (Feb. 6th): Part 1 and Part 2.

The Sionna Team

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