
# Utility Equity

## A comprehensive, high-conviction total return approach to utility investing

### Strategy Overview

| | |
|---|---|
| **Firm AUM:** | $203.7B |
| **Strategy AUM:** | $3.2B |
| **Inception Date:** | July 31, 1994 |
| **Number of Holdings:** | Typically 40-60 |
| **Benchmark:** | S&P Composite 1500® Utilities Index |
| **Available Vehicles:** | ▪ Institutional Separate Account |
| | ▪ US Mutual Fund |

### Team Members

**Portfolio Managers**

*Average Experience: 25 years*

Bobby Edemeka

Teresa Ho Kim, CFA

Shaun Hong, CFA

**Dedicated Analysts: 4**

*Average Experience: 20 years*

### Highlights

- Diversified and dynamic utility portfolio seeks to provide both capital appreciation and current income
- Utilizes a comprehensive approach, investing globally in traditional utilities (electric, gas, and/or water), renewable electricity generation, midstream energy and telecommunications infrastructure
- Seeks to identify companies that possess: fleet transformation and grid modernization investment opportunities driven by decarbonization trends; improving fundamentals underappreciated by the market; and attractive valuations relative to intrinsic value
- In-depth specialization and extensive experience in analyzing the operational, financial, and regulatory factors within the utility and infrastructure universe
- Jennison is a pioneer in utility investing, with a long-term track record (starting 7/31/94)

| Performance | 3Q20 | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception of SP1500U |
|---|---|---|---|---|---|---|
| **Utility Equity Composite (Gross)** | 5.7% | 0.0% | 9.2% | 11.7% | 12.0% | 11.4% |
| **Utility Equity Composite (Net)*** | 5.5 | -0.5 | 8.7 | 11.3 | 11.7 | 10.9 |
| **S&P Composite 1500® Utilities Index** | 5.1 | -7.1 | 6.7 | 10.2 | 10.7 | 9.1 |

***Past performance does not guarantee future results.*** **For periods prior to 4/1/18, net of fee performance is presented net of Jennison's actual advisory fees and transaction costs. For periods beginning 4/1/18, net of fee performance reflects the deduction of a model fee. It is net of transaction costs and is calculated based on the highest tier of the fee schedule in effect for the respective period (0.50%), which may not reflect the actual historical fees applied to accounts in the Composite. Inception of Utility Equity Composite: 7/31/94. Inception of S&P Composite 1500® Utilities Index (SP1500U): 12/31/94. S15U: S&P Composite 1500® Utilities Index. Periods greater than one year are annualized. See disclosures for important information.*



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## Sector Allocation

| Sector Allocation | Representative Portfolio |
|---|---|
| Utilities | 81.1% |
| Real Estate | 6.8 |
| Communication Services | 5.5 |
| Energy | 5.2 |
| Cash | 1.3 |

*Source: Jennison. See disclosures for important information.*

## Country Allocation

| Country Allocation | Representative Portfolio |
|---|---|
| United States | 77.8% |
| Spain | 6.3 |
| Germany | 5.5 |
| Denmark | 3.6 |
| Italy | 3.3 |
| Canada | 2.6 |
| Cash | 1.3 |

*Source: Jennison. See disclosures for important information.*

## Largest Holdings

| Largest Holdings | Representative Portfolio |
|---|---|
| NextEra Energy | 8.7% |
| RWE | 5.6 |
| Cellnex Telecom | 5.5 |
| Dominion Energy | 4.7 |
| Ameren | 4.6 |
| CMS Energy | 4.5 |
| Orsted | 4.1 |
| Entergy | 3.7 |
| American Electric Power | 3.7 |
| NextEra Energy Partners | 3.3 |
| | 48.5% |

*Source: Jennison. See disclosures for important information.*

## Largest Absolute Impact (3Q20)

| Top Five | Average Weight | Total Return | Contribution to Return | Bottom Five | Average Weight | Total Return | Contribution to Return |
|---|---|---|---|---|---|---|---|
| NextEra Energy | 8.6% | 16% | 1.27% | FirstEnergy | 4.0% | -25% | -0.89% |
| Orsted | 4.1 | 20 | 0.71 | American Tower | 1.9 | -6 | -0.11 |
| Ameren | 4.5 | 13 | 0.56 | Dominion Energy | 4.7 | -2 | -0.10 |
| NextEra Energy Partners | 3.2 | 18 | 0.53 | Evergy | 0.3 | -10 | -0.10 |
| RWE | 5.6 | 7 | 0.39 | Cheniere Energy | 2.2 | -4 | -0.09 |

***Past performance does not guarantee future results.*** *Source: FactSet. The holdings identified do not represent all of the securities purchased, sold or recommended by Jennison during the time period shown. A complete list of holdings and how each contributed to the portfolio's return is available upon request. See disclosures for important information.*

## Overview

Within the S&P Composite 1500® Utilities Index, all segments advanced except for gas utilities. Investor preference for the "clean and green" theme help drive independent power producers & energy traders, along with water utilities to double-digit gains. Both electric and multi-utilities advanced. Notable Index contributors included NextEra Energy, Duke Energy, and Xcel Energy. FirstEnergy, Dominion Energy, and Evergy were among the notable Index detractors over the third quarter.

The Utility Equity Composite (hereinafter, the "Composite") advanced, but underperformed the S&P Composite 1500® Utilities Index (the Index) over the third quarter.

Positions within the representative account's (hereinafter, the "Portfolio) electric utilities and multi-utilities drove absolute performance, while renewable electricity and integrated telecommunication services were meaningful tailwinds. In terms of absolute performance, midstream infrastructure was the only segment that negatively affected the Portfolio during the quarter.

Relative to the Index, out-of-index holdings in renewable electricity and successful stock selection within multi-utilities positively contributed to relative performance. Allocations to integrated telecommunication services also contributed to gains. Allocations to water utilities helped but poor stock selection within the segment more than offset any positive effect. Conversely, overweight allocations to out-of-index positions within midstream infrastructure was among the main detractor of relative results. Overweight positioning within specialized REITs also hampered gains. Both poor stock selection and underweight allocations within electric utilities was a headwind to relative results over the quarter.

The S&P 500® Utility Index is composed of traditional regulated utility companies, whereas the Portfolio's holdings generally encompass traditional regulated utility companies as well as energy infrastructure, telecom services, and telecom infrastructure companies. The Portfolio may also selectively invest in non-utility companies.

## Key Contributors

- **NextEra Energy** (NEE) announced it was raising its 2021 earnings guidance and extending its 8% growth outlook to 2023. Management pointed to the ongoing strength of its renewables development and execution across all business, which has led to its increased conviction in its outlook. The Company also approved a 4:1 stock split – which was approaching $300 share – more investable to a broader investment pool – typically a move to attract retail investors. From Jennison's view, NEE continues to be the best-in-class clean energy/ESG story.
- Denmark-based **Orsted**, one of the leading global developers of renewables and is a global leader in offshore wind development. Jennison believes demand for new offshore wind generation is about to enter an accelerated growth phase, with Orsted well-positioned to capture market share in this fast-growing segment of global electricity generation.
- **Ameren** is a fully regulated, public utility, providing electric generation, transmission and distribution, as well as natural gas services in both Illinois and Missouri. Ameren posted 2Q20 earnings, continuing its trend of EPS beats, while reaffirming FY20 guidance. Jennison continues to favor this core holding and believes Ameren is a quality utility that should benefit from attractive rate base investment opportunities with above average earnings and distribution growth. Additionally, Ameren recently filed their Integrated Resource Plan (IRP) with the state of Missouri. The 20-year plan – a first for the Company - included an additional $3.3 billion in spending on renewables, on top of its existing $1.2 billion already earmarked. The plan also set forth the retirement of its coal facilities 10 years earlier than expected. The Company is targeting a 50% reduction in carbon emissions by 2030, 85% by 2040, and net zero emissions by 2050. In Jennison's view, Ameren is making clear progress down the path towards becoming a cleaner energy play.

## Key Detractors

- **FirstEnergy (FE)** along with its subsidiaries is an electric distribution and transmission company serving over six million electric customers across six states while also running one of the largest transmission systems in the US with over 25,000 miles of lines. On July 21st media outlets reported a lobbying scandal related to actions surrounding the passage of House Bill 6 (HB6) – a nuclear subsidy bill in 2019 to assist struggling nuclear power plants in Ohio. The bill was instrumental in enabling FirstEnergy's former subsidiary (FES) to emerge from bankruptcy and separate itself, leaving the FE as a clean and fully regulated utility. The news sent shares down ~17%. The following day, as more details surrounding the investigation surfaced, shares fell an additional ~30%. Over the course of two days, more than $9.5B in the stock's market cap had been wiped out. We believe the stock's violent reaction was overdone and was likely a result of forced-selling by hedge funds and other long-only investors exiting their positions, in our view. FirstEnergy's Ohio business makes up only a quarter of its total earnings per share (EPS), which roughly equates to around 10% of total EPS. We continue to maintain our current position and believe the valuation discount is unwarranted, even when factoring in any potential fines/punishment or impact to earnings.

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## Key Detractors (continued)

- **American Tower (AMT**) reported another solid quarter in 2Q20, but slightly lowered its 2020 revenue guidance due to a bad expense charge in India and lower pass-through revenues in the US. Despite higher churn rates, the Indian market is transitioning to a three-carrier market, which we slowly expect to fade. More than two-thirds of the Indian population still utilizes 2G technology with no access to wired infrastructure. We continue to believe AMT will benefit from its opportunities in India for many years to come. AMT is an independent owner, operator and developer of communications real estate and is engaged in the leasing of space on multi-tenant communications sites to wireless service providers, radio and television broadcast companies, wireless data and data providers, government agencies, along with municipalities, just to name a few.
- Shares of **Dominion Energy** traded off after the Company decided to reposition itself and divest its gas infrastructure business to Berkshire Hathaway. As a result of the sale, the Company had to lower its earnings guidance and cut its dividend, all of which sent shares significantly lower. While the stock traded off initially, and details of the sale were digested, the stock clawed back most of its losses and was subsequently higher after the quarter ended. Dominion is a Virginia-based multi-utility engaged in the provision of electricity and natural gas to homes, businesses, and wholesale customers.

## Outlook

During the third quarter, Utilities (S&P 500® Utility Index) continued to lag the broader market (S&P 500 Index), underperforming by ~279 bps. Year-to-date through September 30, 2020, the group is down 5.68% versus the S&P 500, which is up 5.57%. Worth pointing out however, is that the sector did top the S&P 500 (+2.3% vs. -4.5%) in the month of September as COVID, fiscal stimulus and political concerns seemed to outweigh an accommodative Federal Reserve. We believe this monthly outperformance was underpinned by a general flight to safety, and note that the group's betas have steadily trended down. The median 90-day rolling beta was down to 0.487 (as of 09/30/20) which is the lowest since February before COVID lockdowns occurred in March. Both year-to-date and one-year betas (through September 30, 2020) are at 1.19 and 1.18, respectively. We see Utilities, as a whole, looking increasingly attractive given the declining beta and the ongoing relative valuation discount to the broader market. The group shown resilience as most utilities affirmed their FY2020 earnings guidance, as companies are able to mitigate early readings of COVID-19's negative impact with cost efficiencies, operational responses, and collaborative efforts with regulators. Moreover, the runway of capital projects particularly in renewables deployment and grid modernization continues to be long and visible, in our view. At this time, we continue to favor those companies that possess: balance sheet strength (as credit concerns have come to the forefront again); flexible capital spending plans; companies that do not plan to issue block equity in the near-term; and those with some measures to handle the volumetric risk coming from power demand weakness in the industrial and commercial classes.

We believe the sector's fundamental growth will not be structurally impacted by COVID-19 and its related economic knock-on effects. Broadly speaking, Jennison's internal research indicates that utility fundamentals are healthy, and we project the sector to generate mid-high single digit earnings growth with commensurate dividend growth, owing to highly visible capital expenditure trajectories plus improving regulatory compacts. In particular, utilities are well positioned in the secular trend of the 'energy transition' to cleaner sources benefitting from rising demand for renewable energy supply and the subsequent grid infrastructure investment needed to modernize aging networks and absorb the intermittent nature of renewable generation.

From an overall positioning standpoint, we favor utilities with solid and sustainable dividend yields and above-average projected earnings and/or dividend growth operating in constructive regulatory environments that support timely and attractive returns on capital deployed. We continue to seek out companies that can mitigate customer bill impacts by focusing on operating efficiencies, versus the common strategy of serial rate increase requests. Regarding renewable energy, we feel any project setback due to supply chain disruptions is not a major driver of long-term shareholder return. In our view, 'energy transition' investment is supported by two broad and enduring themes: (1) pronounced reductions in the cost of renewable energy, driven by continued technological advancement, and (2) increasing public policy support driven by concerns over greenhouse gas emissions, energy security, and most recently, job creation.

Moving to our midstream infrastructure exposure, we have consolidated our holdings into midstream energy companies that we believe should be well-positioned to thrive over the next several years due to their exposure to prolific natural gas basins with more visible long-term demand, are more North American focused, and lower sensitivity to geopolitical oil risks. In our view, midstream companies with strong balance sheets, integrated asset systems with multiple touch-points across the entire energy value chain, as well as those stocks that have transparency and strong ESG metrics, will continue to fare better going forward. Lastly, regarding communications infrastructure, we continue to favor wireless towers and datacenter operators. We do not expect any material impact from COVID-19 on the tower companies as they have long-term contracts with wireless operators, which we view to be low counterparty risk. In Europe, we continue to see compelling growth potential through M&A within the independent tower sector, alongside the organic secular growth opportunity. In the datacenter space, the demand for data has increased during this time as "shelter in place" policies have been imposed. Fundamentally, both industries capitalize on exponential data demand growth around the world.

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***Beta*** *is used to measure the volatility of a manager relative to the chosen risk market index.*

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