January 2015

Investment market update

Despite weaker global markets and continued falls in Australia's key commodity export prices, the Australian share market returned 2% in December as lower interest rates and a surge in bank shares helped offset further falls in the mining sector. In this month's update we revisit our investment in APA Group in light of its recent capital raising activities to fund an acquisition of more pipeline infrastructure.

Performance of key markets

	% CHANGE				
	MONTH	FYTD	1 YEAR	3 YEARS P.A.	5 YEARS P.A.
Australian Shares (ASX 300)	2.0	2.4	5.3	14.7	6.5
US Shares (S&P 500) in US Dollars	-0.3	6.1	13.7	20.4	15.5
US Shares (S&P 500) in Australian Dollars	4.1	22.4	24.3	29.8	17.7
Asian Shares (MSCI Asia)	-1.7	1.1	4.8	8.1	3.4
Australian Dollar (AUD/USD)	-4.1	-13.3	-8.5	-7.2	-1.9
Australian Fixed Interest (UBSA Composite)	1.7	5.0	9.8	6.4	7.3
Cash (UBSA Bank Bill)	0.2	1.4	2.7	3.2	3.8
Balanced (MySuper) option*	**1.7**	**5.9**	**9.9**	**14.2**	**8.7**

Returns are for periods to 31 December 2014. Past performance is not an indication of future performance.

* *Returns relate to our Accumulation (not Pension) investment options and are published after fund taxes and investment expenses, other than account-based fees.*

See performance information for all options

'Santa rally' boosts markets into year-end, but January looks jittery

Persistently falling oil prices that dominated markets over the past six months continued in December. While negative sentiment was initially contained to energy companies and oil exporters, the threat of contagion from oil producers (particularly Russia) to the broader economy and financial system drove sharp falls in global share markets in the early weeks of December.

But by around mid-month, some emergency policy measures by Russian authorities (including a 6.5% rate hike) helped to stabilise the Rouble and bought some calm to markets generally. This acted as a catalyst for a 'Santa rally' into year-end that reversed much of the early losses and actually helped push the Australian market into positive returns for the month. 'Santa rally' is the colloquial name given to the seasonal strength that is often observed in the share market from mid-late December through to early January. This boost has proved to be short-lived. At the time of writing, renewed downward pressure on oil prices has again spilled over into broader markets and 2015 has opened with a softer tone.

Overall, the first six months of the financial year continued to deliver solid returns for members. Our Balanced option returned 5.9% over that period (after Fund taxes and investment fees but before account-based fees). Though the Australian share market returned just 2.4% over that period, the 13% fall in the Australian dollar helped boost the return on international shares.

APA Group wins bid for Queensland gas infrastructure

Last month's *Investment market update* focused on one of our 'fortress assets' - APA Group (APA), Australia's largest gas infrastructure company. After our report, APA acquired BG Group's pipeline infrastructure in Queensland for USD 5.2 billion in Australia's second largest deal of 2014.

Why the deal makes strategic sense for APA

APA has acquired a 540km pipeline spanning from the gas fields of the Surat Basin in South East Queensland to a liquefied natural gas (LNG) export facility at the Port of Gladstone. By securing ownership, APA will avail that pipeline to gas shippers BG and CNOOC for their gas transportation needs and in turn, those shippers will pay APA a set sum escalated by inflation for a minimum of twenty years. Importantly, the shippers will bear operating costs and pay APA for pipeline capacity regardless of whether that capacity is actually used or not. The acquisition is attractive to APA for a number of reasons, including:

a) **Connectivity**: APA could harvest potential synergies from integrating the pipeline into its established network;
b) **Core business:** APA specialises in operating pipelines that produce defensive, inflation-linked revenue streams backed by BG's and CNOOC's substantial balance sheet and sound credit worthiness (rated A and AA- by Standard & Poor's respectively); and
c) **New markets:** APA now has a significant presence in the gas fields supplying Australia's East Coast LNG export facilities and could use its infrastructure as a beachhead to support future gas developments in the region.

What about the price?

Some market commentators have questioned the USD5.2 billion price tag, bearing in mind that overpaying for assets can undo even the best laid out strategies. At UniSuper, we recognised that "there was a risk that APA management will overbid to win the asset" as outlined in the last *Investment market* update, but ultimately concluded that "we trust APA Management will exercise the same discipline recently displayed in relation to the Envestra deal". Given current market settings and our public knowledge of the deal, we estimate the investment return to be around 9% p.a. on the transaction. While this may not be high by historical standards, we feel that high single digit returns for moderate risk assets are attractive in the context of historically low prevailing interest rates. We also feel that the more pessimistic analysts are not fully grasping the upside potential given the synergies with APA's business.

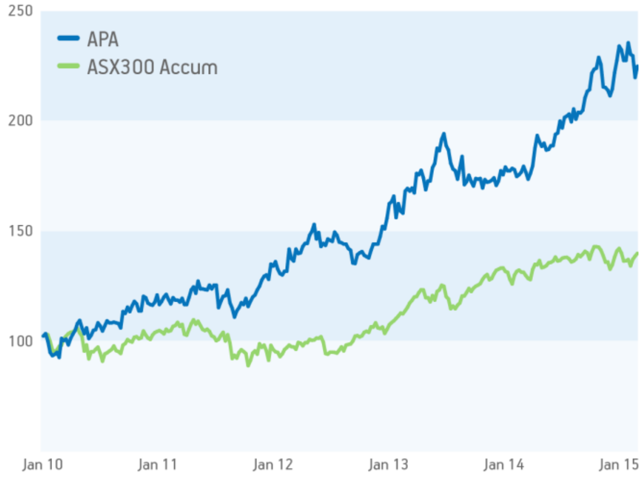
UniSuper's participation

As APA's largest shareholder, we played a key role in raising $1.84 billion* of equity, which will be used to finance the deal along with USD 4.1 billion of debt financing commitments. On top of taking up our ($154 million) pro-rata share of the discounted rights issue at a price of $6.60 per share, we also purchased just under $60 million that became available when some institutional investors chose to sell their rights at $7.65 per share. This has taken our current holding in APA to 10.8%.

Our heavy involvement in the capital raising underscores the advantages of being a large institution operating with a governance structure that allows for timely decision making.

Investment returns: APA v. ASX300

Index: 2010=100



Source: Bloomburg

An optimal way of investing in infrastructure

Over the past few years our preferred method of investing in infrastructure has been through listed market operators (rather than a consortium of financial investors in a fund). We are now the largest investor in Transurban, Sydney Airport and APA. The primary driver of our preference has been value; to our minds the listed market has offered higher quality assets at cheaper prices.

Similar to Transurban's purchase of QML (see the May 2014 *Investment market update*), the APA transaction demonstrates another advantage of investing in an operator rather than a fund. Due to the type of strategic synergies described above, an operator invariably brings a clear bidding advantage when it comes to competing for new assets. Of course there is also the added benefit of owning a liquid asset, although it would be fair to assume that we are in no hurry to sell.

**All values are denominated in AUD unless otherwise noted.*