

# ECOFIN WATER & POWER OPPORTUNITIES plc

## 31 December 2011

### Company Objectives

The Company's investment objectives are to achieve a high, secure dividend yield and to realise long-term growth for the benefit of Shareholders, while taking care to preserve shareholders' capital. The Company's assets are primarily invested in the equity and equity-related securities of utility, utility-related and energy companies worldwide.

### As at 31 December, 2011

Net Assets:	£412,449,036
of ZDP shares	£70,025,327
of Ordinary shares <sup>1</sup>	£342,423,710
Ordinary share price:	115.25p
Ordinary share NAV <sup>2</sup> :	163.16p
Premium/(Discount):	(29.36%)
Dividend yield <sup>3</sup> :	5.6%

<sup>1</sup> First issued on 29 June, 2005 at 100p per share and an initial NAV per share of 104.91p

<sup>2</sup> Not fully diluted

<sup>3</sup> The current annualised yield of 5.6% reflects quarterly dividend payments totalling 6.50p for calendar 2011.

### Key Company Details & Fund Characteristics

Launch date:	28 February 2002
Dealing currency:	Sterling
Sector:	Global utilities and energy
Benchmark:	n/a
Traded:	London Stock Exchange
Financial year end:	31 March
Results announced:	November (half yearly), July (final)
AGM:	September
Ordinary share dividends:	paid May, August, November & February

### Performance

EW&PO <sup>1</sup>	1 Month %	3 Months %	1 Year %	3 Years %	Since Inception <sup>2</sup> %
Net Assets	0.6	2.9	-3.0	-1.9	163.0
NAV per Ordinary Share	0.6	3.2	-4.9	-1.7	n/a
Ordinary Share Price	3.8	0.2	-14.2	-5.9	n/a
<b>Markets (£)</b>					
MSCI World	0.9	7.4	-7.2	20.7	12.5
MSCI World Utility	0.5	0.9	-6.4	-14.8	28.9
MSCI World Energy	0.3	16.2	-1.4	24.0	87.7
WilderHill New Energy Global Innovation	-5.9	-4.8	-39.9	-33.0	-2.7

<sup>1</sup> Adjusted for a £50 million capital increase in June 2005, a £108.2 million capital increase in January 2007, tender offers in July 2007 and April 2009, and the launch of £60 million nominal value of Zero Dividend Preference shares (ZDP shares) in July 2009

<sup>2</sup> Company launched on 28 February, 2002. Ordinary shares first issued on 29 June, 2005

### EW&PO Performance since Inception

	Return %	Annualised %
Net Assets	163.0	10.3
Net Assets including dividends	231.2	12.9
Net Assets including dividends reinvested	278.9	14.5



## ECOFIN WATER & POWER OPPORTUNITIES plc

### Portfolio Distribution\*

#### BY MARKET CAPITALISATION (% of Portfolio)

More than £10,000 million	28.5
£5,000 to £10,000 million	5.1
£1,000 to £5,000 million	21.3
£200 to £1,000 million	4.9
Less than £200 million	13.5
Unquoted	15.6
Bonds	11.1
	<b>100.0</b>

#### BY GEOGRAPHY (% of Portfolio)

North America	39.1
United Kingdom	11.8
Continental Europe	19.1
Emerging Markets	15.3
Other Developed Markets	3.6
US Bonds	8.7
Other Bonds	2.4
	<b>100.0</b>

#### BY SECTOR / TYPE (% of Portfolio)

Non-regulated Utilities	21.1
Regulated Utilities	11.7
Energy	14.0
Bonds	11.1
Unquoted	15.6
Infrastructure	12.0
Alternative Energy	5.9
Ecofin Funds	7.6
Other	1.1

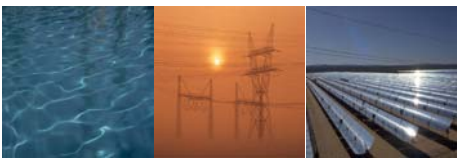
**100.0**

#### 10 LARGEST INVESTMENTS\*

Company	Country	Activity	% of Portfolio
Texas International Energy Partners Inc**	US	Gas	10.0
Ecofin China Power & Infrastructure Fund	China	Infrastructure	5.1
Williams Companies	US	Gas	3.2
Origo Partners	China	Infrastructure	3.0
OGE Energy	US	Power	2.3
ITC Holdings Corp	US	Power	2.2
FirstEnergy	US	Power	1.9
Water Property Investments**	US	Water	1.9
Pennon Group	UK	Utilities	1.8
BG Group	UK	Gas	1.8
		<b>Total</b>	<b>33.2</b>

\* Excludes EIH Cyprus, a liquidating cash vehicle, which was 4.06% of the portfolio

\*\* Unquoted



# ECOFIN WATER & POWER OPPORTUNIES plc

## Capital Structure

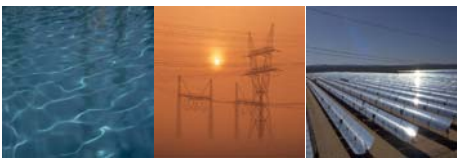
	As Reported (£)	As Adjusted (£)
Total Assets (less Cash at Bank)	537,029,000	512,513,000
Cash at Bank	2,409,000	26,926,000
<b>Total Assets</b>	<b>539,439,000</b>	<b>539,439,000</b>
Bank Debt	47,964,000	47,964,000
Convertible Unsecured Loan Stock	79,026,000	79,026,000
Zero Dividend Preference Shares	70,025,000	70,025,000
Net Assets attributable to Ordinary Shares	342,424,000	342,424,000
	<b>£539,439,000</b>	<b>£539,439,000</b>
Gearing (Net Debt / Ordinary Shareholders' Funds)	56.8%	49.7%
Gearing (Net Debt less Convertible Unsecured Loan Stock / Ordinary Shareholders' Funds plus Convertible Unsecured Loan Stock)	27.4%	21.6%

The Total Assets of the Company include an equity investment of £24.6 million in EIH Cyprus Group which is a joint venture between the Company and other funds managed by the Investment Manager, Ecofin Limited. 99.7% of the assets of EIH Cyprus are in cash which represents the proceeds of the sale of one of the Company's investments, Solel Solar Systems Limited. The figures in the 'As Adjusted' column of the table above have been adjusted to include the Company's share of this cash in the Cash at Bank figure.

Net Debt is Bank Debt, the Convertible Unsecured Loan Stock and the Zero Dividend Preference Shares, less Cash at Bank. The assets of the company include approximately £92.4m in bonds, and options representing approximately £1.1m on a delta adjusted basis. Adjusting the Total Assets less Cash at Bank ('As Adjusted') for these two components, the total equity exposure of the Company was 122.4% of Ordinary Shareholders' net assets.

### Gearing

- The Directors believe that the use of gearing is justified given the nature of most of the companies in which the Company invests; that is, companies which provide essential services, operate in regulated markets, have relatively low levels of business risk and pay dividends.
- Gearing amplifies the performance of the Company's net assets. As a consequence, the NAV of an Ordinary Share is more volatile than would be the case if the Company were not geared. The maximum level of gearing is set by the Board and its current policy is that gearing should not exceed 60% for any sustained period.



## MARKET COMMENTARY

Markets were challenging in December, suffering swings in sentiment that have characterised the environment for many months. The crises at hand were largely unchanged and Europe garnered much of the attention. Economic growth expectations for 2012 were all but eliminated for much of Continental Europe and for many other regions were scaled back. By mid-month the mechanics of a “fiscal compact” negotiated at the 9th December EU summit were announced and this provided some short term relief to markets. More meaningfully, in order to provide liquidity and to ease severe financing strains for banks, the ECB announced 3-year unlimited loans providing support for banks and, through them, their sovereign debt markets. A modest Christmas rally ensued, helped by better US economic figures. Congress also passed a 2-month extension of the temporary payroll tax cut first introduced in January 2011 to stimulate growth.

The US utilities sector, which rose 4.1% in December and 15.4% for the calendar year, was the best performing of all sub-sectors in the S&P in 2011. All of the outperformance occurred in the second half of the year as the debt crises became more acute, causing interest rates to tumble. Investors became more defensive and sought alternate areas with high dividend yields – a favourable backdrop for utilities. However, during December UK and European utilities underperformed their broader market indices, and for the calendar year UK utilities rose 3.6% while European utilities fell 26.8%.

In the energy markets, oil prices tracked Euro-zone and financial market sentiment in December until Iran threatened to shut the Strait of Hormuz and the OPEC meeting unexpectedly agreed to raise the official output ceiling to 30mbpd (from 24.8mbpd), changing the production quota for the first time in 3 years to reflect the real production rate from the group. By month-end, oil prices were standing at \$107/bbl (Brent) and \$100/bbl (WTI), approximately where they started. For calendar 2011, Brent and WTI were 12.8% and 4.7% higher, respectively, while natural gas prices closed the year at \$2.99/mbtu, down 32% due to growing production and the subsequent above average builds in inventories.

## PERFORMANCE

The Company’s investment portfolio under-performed the broad equity market indices in December although it out-performed the MSCI World Utility and Energy indices. The North American books, equities and bonds, generated the most added-value for the Company. Emerging market equities (outside of China) and the Renewables positions also contributed meaningfully during the month. Continental European utilities and energy positions detracted from overall performance.

- In December, US utilities rose 4.1% and the Company’s large US exposure contributed very positively to overall returns with continuing added value from Williams Companies, OGE - on recognition of the value of its midstream business - and ITC Holdings, on its transaction to acquire the transmission assets of Entergy. General Electric and Calpine Corp, a pure play independent power producer, also performed well.
- In contrast, European utilities fell 6.2% during December and our Continental European book detracted from overall performance. Eurotunnel was severely de-rated in November and December as fears grew of a downgrade of France’s AAA credit rating. Although Eurotunnel has no major refinancing maturities coming up, it is relatively highly geared. We are confident that the company should benefit from ferry operator Seafrance’s financial troubles as well as added traffic surrounding the 2012 London Olympics.
- UK utilities outperformed their European counterparts during the month (they fell 1.7%) and the year due to a high proportion of regulated names, a robust underpinning by the performance of UK Gilts and a stable regulatory framework. The Company’s UK portfolio was approximately flat in December, slightly outperforming the local index.



## ECOFIN WATER & POWER OPPORTUNITIES plc Investment Commentary

- Asian markets were often directionless on thin volumes as the holiday season approached but the HSCEI rose 4.5% in December, led by financial shares. The Company's second largest holding, Ecofin China Power & Infrastructure Fund, was nearly flat (+0.05%) over the month given its lack of exposure to financials and weakness in Datang Renewable, one of the largest wind operators, and Tianneng Power, the largest eBike lead-acid battery maker, on fears of a "hard landing" for the Chinese economy. For the calendar year 2011, both the Shanghai Composite and the HSCEI fell 21.7% while the Ecofin China Fund declined 15.3%.
- In December, the Company's energy holdings detracted from overall performance due principally to profit taking in one of our large holdings, Novatek, and declining expectations for 2012 world GDP growth.
- The bond portfolio comprises principally US bonds and our exposure increased slightly in December due to price appreciation of holdings as well as additional purchases. The total return for the Company's bond portfolio was 2.6% in December, adding value to overall Company returns this month. The Bond book returned 11.5% for the calendar year, comparing very favorably with benchmark high yield indices, which returned 4.4% for 2011, and equity markets.

### OUTLOOK

In the **US**, persistently low interest rates remain supportive for yield instruments. While conscious that valuations are relatively high, we believe the mid-stream sector looks attractive given high dividend growth. Select companies will continue to benefit from the infrastructure build-out required to gather, process and transport oil, gas and natural gas liquids to market. We are now more positive on the US economy and will continue to be overweight this market.

In **Europe**, we remain cautious, especially with respect to integrated utilities and generators, despite low valuation levels. Strategy will focus on companies with superior earnings and cash flow growth profiles. International Power, for example, offers exposure to non-European growth and should be able to generate double-digit EBIT growth per annum over the next five years. Infrastructure and capital goods names like Siemens also look attractive given their exposure to long-term cycles in global markets as opposed to Europe alone.

In **China**, we suspect that money growth could stir outperformance and a fall in inflation to 4% or lower could trigger more aggressive easing. We continue to expect a "soft landing" for the economy.

In the **energy** markets, notwithstanding geopolitical tensions and sensitivity to supply disruptions in light crudes, we believe the downside risk to crude oil is dependent on world GDP growth, mostly in Asia.

Steadily declining US gas prices have finally caused a couple of significant US producers to curb existing output and to shrink their gas directed drilling. Although currently high storage levels during a warmer than normal winter will limit an immediate pick-up in prices, we expect reduced future supply and the displacement of coal by gas in power generation will together set the stage for a sustained recovery in US gas prices.

**Texas International Energy Partners Inc** ("TxIEP"), the Company's largest investment active in US shale gas and oil, has undergone a management reorganization. Having acquired an attractive and diversified platform of reserves, TxIEP is evolving speedily into a fully-fledged development company and has strengthened its leadership team by putting in place a seasoned Chief Executive. Frank D Bracken III is a long standing sector specialist with outstanding experience in both financial services and the industry. TxIEP's former CEO is becoming Chairman while the company is also deepening its operational and geological skills. Production continues in line from two sites, while the active drilling program continues in south Texas and eastern Montana, funded by cash flows and drawings on the recently expanded credit facility.