Building from the foundation

An update on the listed infrastructure investment company sector, following on from the article “2017 – A foundation year” in the *GLIO Journal* (issue 2).

By Ben **Newell**

2017 was an important year of development for the infrastructure companies, particularly in terms of acquisition activity. In 2018, the companies have focused on integrating these large acquisitions into their portfolios and consequently, acquisition activity has been more muted.

Social Infrastructure

2018 has been a more challenging year for the social infrastructure funds; share ratings have been under pressure with the bankruptcy of the UK’s Carillion highlighting counterparty and operational risk, although the impact on NAVs has been limited. Political risk has also weighed on share prices following the intensification of political rhetoric from the UK Labour Party surrounding nationalization.

Social Infrastructure – Carillion

Carillion provided facilities management services on a number of projects within the HICL, INPP and JLIF portfolios. In January, HICL announced that it was making a provision of £59.3m, or 2.2% of NAV, against the value of those projects impacted by the liquidation of Carillion. INPP and JLIF had lower exposures to Carillion than HICL, and accordingly the impact on NAV was much lower, £1.5m and £3m respectively. BBGI had no Carillion exposure. Importantly, all three companies who had exposure to Carillion have recently issued positive updates regarding the projects affected and made significant progress to transfer the facilities management service contracts to long-term replacement providers, on broadly similar terms.

Social Infrastructure – Political Headwinds

UK political headwinds have intensified since last September when John McDonnell, UK Shadow Chancellor of the Exchequer, told the Labour conference that he would bring existing PFI contracts back

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in-house. While the focus initially was on the financial impact, including the level of compensation payable, more recently McDonnell hinted that there may be none, saying that Parliament will determine whether or not compensation is provided and on what scale. In addition, a National Audit Office report published in January focused attention on the rationale, costs and benefits of the Private Finance Initiative and the use and impact of PFI.

When considering Labour's PFI proposals however, we believe it is also important to factor in the probability of an election of a Labour government; the implied probability of a Labour majority is currently 29%, while a 2022 General Election is now 42%. In our view, any move by the UK government to effectively renege on agreements entered into by previous governments would have significant consequences far beyond the infrastructure sector. Despite these headwinds however, the NAVs of these companies have been robust.

Social Infrastructure – Investment Activity

The investment activity in the first half of 2018 has been muted, compared to 2017. In April, HICL made a €21m investment to acquire an 85% interest in the Biology, Pharmacy and Chemistry Department of the Paris-Sud University PPP Project. The company disposed of its interest in the Highland Schools PPP2 project for £56.2m. This represented a premium of £9.7m over the Director's valuation of £46.5m as at September 30, 2017. InfraRed, the Investment Adviser to HICL, believed that the price achieved was in-excess of the value that could be achieved by retaining the investment within the portfolio.

In June, HICL recycled the proceeds of the earlier disposal and acquired an additional 7.2% interest in the A63 motorway concession in southwest France for €62m. The project is a 40-year toll-road concession to design, upgrade, finance, operate and maintain a 104km section of the existing A63.

In April, INPP made a £9m investment into digital fibre-based network assets, which is its first investment as part of its £45m commitment to the National Digital Infrastructure Fund. The investment has been made into Community Fibre, an ultra-fast full-fibre internet service to fund the rollout of full-fibre connectivity to a further 100,000 homes covering social and private housing estates across London.

In March 2017, INPP made a £274m investment to acquire a 4.4% interest in National Grid's Gas Distribution Network as part of a consortium which acquired a 61% interest. At the time, the consortium negotiated to acquire a further 14% interest, subject to put and call options between National Grid and the Consortium, and had pre-emption rights over the remaining 25%.

The latest investment arises as part of the consortium having entered into a second put and call option agreement providing for National Grid to dispose of its remaining 25% holding in Cadent and for the consortium to acquire 100% ownership of that business. INPP has committed a further £35-40m, and following the exercise of this option and the existing put and call option entered into at the time of the original acquisition, INPP will hold a 7.25% ownership interest.

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In April, BBGI made a small acquisition of a further 33.3% interest in the East Down Colleges PPP project in Northern Ireland for £2.1m.

Renewable Energy Infrastructure – Investment Activity

The UK listed renewables sector has performed strongly in 2018, and it has been particularly active in terms of investment activity.

In March, Bluefield Solar Income Fund acquired three sub-5-megawatt ground-mounted solar PV plants, located in Dorset for a total cash consideration of £19.9m. The plants are fully operational and qualify under the 1.2ROC regime.

In April, Foresight announced the acquisition of a 100% interest in a portfolio of five operational solar parks in the UK with an installed capacity of 53.3MW. The acquisition cost of the equity investment was £36.6m and the portfolio has long-term debt in place of £31.8m. The Foresight portfolio now comprises 27 solar assets with a net capacity of 374MW, including three Australian assets under construction. The fourth Australian asset delivered its initial electricity export to the grid on schedule in March 2018.

John Laing Environmental made its second investment into the field of anaerobic digestion and acquired the Icknield Farm plant located in Oxfordshire. The plant has a capacity of 5MW and predominantly produces biomethane exported to the National Grid. The plant has a 0.4MW CHP engine and is accredited under the Renewable Heat Incentive and Feed-in-Tariff. In June, JLEN also committed a further £8.5m to significantly expand the Vulcan Renewables anaerobic digestion plant.

NextEnergy Solar Fund acquired two operating solar plants located in Berkshire and Buckinghamshire with a total capacity of 7.2MW. In addition, both sites have integrated storage capabilities with a combined capacity of c1MW. These battery energy storage systems (BESS) comprise a lithium-ion battery pack integrated with switchgear and transformers capable of providing frequency response and grid balancing services. The acquisition price was £9.3m.

In June, NextEnergy acquired a portfolio of ten operating solar plants totalling 46.6MW for an investment value >

Table 1: Overview of the UK Infrastructure Companies Annualized Total Returns, as at June 29, 2018

Company	Country	Sector	MC $Mn	FF MC $Mn	FF Wght	Yield	Beta	YTD	1 Yr	3 Yrs	5 Yrs	7.5 Yrs	10 Yrs
HICL Infrastructure	UK	Diversified	3,416	3,416	24.1%	5.4%	0.41	-6.1%	-5.2%	2.8%	6.9%	8.4%	6.7%
INPP	UK	Diversified	2,661	2,342	16.5%	4.8%	0.44	-6.3%	-5.3%	6.7%	7.1%	7.8%	8.0%
Greencoat	UK	Renewable Energy	1,869	1,607	11.3%	5.2%	0.16	4.8%	9.1%	10.0%	9.3%		
3i Infrastructure	UK	Diversified	2,392	1,579	11.1%	4.0%	0.55	8.8%	20.8%	14.3%	15.5%	13.6%	11.6%
JLIF	UK	Diversified	1,549	1,301	9.2%	6.0%	0.39	-0.8%	-6.6%	4.7%	5.8%	6.8%	
TRIG	UK	Renewable Energy	1,498	1,138	8.0%	5.8%	0.31	4.5%	6.1%	8.0%	7.8%		
BBGI	UK	Diversified	943	670	4.7%	4.8%	0.39	-1.9%	-2.0%	8.0%	8.4%		
Nextenergy	UK	Renewable Energy	824	593	4.2%	5.9%	0.28	-1.6%	0.9%	6.8%			
Bluefield Solar	UK	Renewable Energy	591	591	4.2%	5.5%	0.21	5.8%	11.4%	10.2%	9.7%		
Foresight Solar	UK	Renewable Energy	645	548	3.9%	6.1%	0.23	3.5%	2.4%	7.0%			
JL Environment	UK	Renewable Energy	538	398	2.8%	6.1%	0.41	-2.4%	2.0%	5.6%			
Grand Total			16,927	14,184	100.0%	5.2%	0.38						

Source: GLIO & Reuters

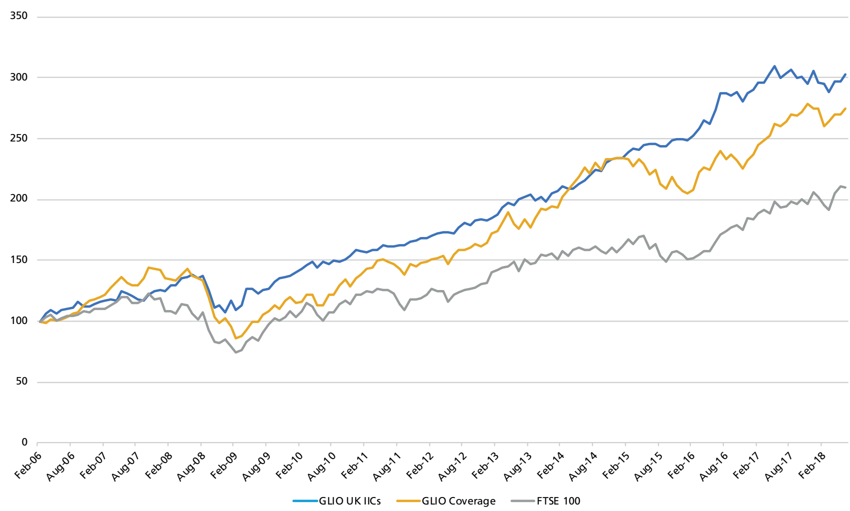
of £52.9m, and the portfolio now comprises 75 assets with a total capacity of 622.7MW and an investment value of £792.4m.

Greencoat UK Wind acquired Brockaghboy windfarm from ERG Power Generation SpA for a total consideration of approximately £163m. Brockaghboy is located approximately 30 miles east of Londonderry in Northern Ireland and has a capacity of 47.5MW. It is accredited to receive 0.9 ROCs per MWh from August 2017 and was fully commissioned in February 2018. The forecast net load factor is 40.5%. In May, Greencoat exercised its option to increase its shareholding in the Clyde windfarms to 28.2% for a consideration of £114.2m.

In January, the Renewables Infrastructure Group announced that it had acquired the 41.2MW Clahane operational windfarm and its 13.8MW extension which is currently under construction. The consideration was €72m. In June the company acquired two windfarms in France with a combined operating capacity of 31.8MW and are expected to become operational in Q4 2018. The total consideration was €28m.

In June, TRIG acquired Solwaybank onshore windfarm, which is currently under construction and expected to become operational in Q1 2020. Solwaybank is one of the few UK windfarms to benefit from the Contracts for Difference, which fixes the power price during the first 15 years of operations. Solwaybank has an allocated strike price of £82.50 per MWh in 2012 prices (equivalent to £91.14 in current prices).

UK Infrastructure Investment Companies versus GLIO Coverage & FTSE 100 February 2006 to June 2018



Core infrastructure characteristics

These companies provide investors with low cost access to portfolios of key infrastructure assets. The portfolios are well diversified and have low asset concentration. The dividend yields (4.0-6.1%) are highly attractive, and these are underpinned by long-term, stable and predictable cash flows, along with strong underlying operational performance. These companies provide explicit inflation protection and in addition, we believe they have capital preservation characteristics which could have significant value in a more challenging environment.

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