BBGI Global Infrastructure

BBGI has clear differentiating features within the infrastructure peer group...

Kepler ALTERNATIVE INCOME RATING

Update
08 November 2022

Overview

BBGI Global Infrastructure (BBGI) is a responsible investor with a strong ESG approach which invests in and actively manages a global portfolio of low-risk essential social infrastructure assets for the long term, diversified across highly rated investment-grade countries. Its £1.1bn portfolio is over 99% operational and as at September 2022 consists of 56 different investments, c. 87% of which are majority owned by BBGI.

BBGI invests in availability-based infrastructure assets and those that are backed by secure government revenues with high-quality inflation linkage. Availability-based assets attract contractual revenues as long as they are available for use by stakeholders, and do not vary by changes in GDP or by how much they are used (see **Portfolio section**). This ensured that BBGI had no material financial impacts from the COVID pandemic lockdowns, unlike some of its peers.

Despite a challenging macroeconomic backdrop, BBGI is clear that its resilient and defensive strategy and differentiated low-risk portfolio should continue to provide long-term, predictable, inflation-linked and sustainable shareholder returns. To the end of the last reporting period (30/06/2022), BBGI had delivered an annualised return since IPO of 9.3% on an NAV total return basis.

BBGI has paid a steady stream of growing dividends since it was launched in 2011, having delivered a compound average increase in annual dividend of 3.1% between 2012 and 2021. Dividends are paid semi-annually, and the shares currently yield 4.7%.

BBGI is internally managed, with the managers and staff being directly employed, so the team are 100% focussed on BBGI and fully aligned with shareholders, plus the OCF is the lowest in the peer group. As has been the case in the past, as BBGI grows, the OCF is likely to reduce further.

Analysts:

William Heathcoat Amory
+44 (0)203 384 8795

Analyst's View

In our view, BBGI occupies a clear niche within the listed infrastructure peer group. BBGI targets government-backed revenues for all of its projects, and invests in those that are availability-based with a strong approach to ESG and high-quality inflation linkage (see **Portfolio section**). As a result, BBGI was entirely unaffected by the COVID pandemic lockdowns that were imposed, allowing it to outperform its peers in NAV total return terms over the last five years.

Geographic diversity is another differentiator to peers, which typically have a strong bias towards the UK compared to BBGI's current 33% UK exposure. By diversifying across different economies and political systems, overall returns should be smoother. As we discuss in the **Portfolio section**, with 100% availability-based assets, BBGI's portfolio arguably has the cleanest exposure to inflation without the price elasticity considerations of demand-based assets. BBGI's availability-based cash flows have entirely mechanical links to inflation. As such, whilst the theoretical sensitivities of peers to inflation are perhaps slightly higher than BBGI's are, the practical reality is less clear-cut.

BBGI has generally attracted a higher premium than peers, which we believe is a function of the fact that the portfolio is 100% availability-based and ongoing charges have come down over time. The supply of new shares in BBGI has been lower than the supply of shares for peers, which could also be the reason for its premium rating relative to peers. BBGI currently trades at a 7.2% premium to its historical NAV, well below its five-year average premium of 19.6%.

BULL
Clear investment proposition, targeting 100% availability-based assets with strong ESG credentials
Geographic diversity helps smooth returns
Internally managed, meaning BBGI's scale leads to a clear cost advantage and fully aligned team

BEAR
Premium to NAV may give way if attraction of shares to investors falls
Geographic diversity means FX movements will affect cash flows (for good or bad), despite hedging activity which should protect the portfolio (an adverse 10% movement of all currencies against GBP would only impact NAV by 3%)
All things being equal, rising interest rates around the world may lead to discount rates rising, thus lowering the NAV

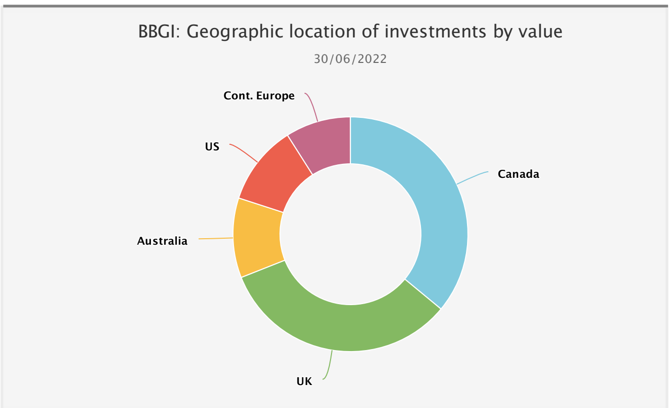
Portfolio

BBGI Global Infrastructure (BBGI) has a £1.1bn portfolio of low-risk essential social infrastructure assets, diversified around the world across highly rated investment-grade countries. Infrastructure assets are typically considered resilient to economic cycles, and are defensive. Originally BBGI was spun out of Bilfinger, a German civil engineering and construction firm, but there has been an internal management team investing and managing the portfolio since the IPO in 2011. Bilfinger has not had any involvement or shareholding in the investment company since 2013. The internal management gives BBGI a cost advantage over peers, as we discuss in the **Charges section**.

In total the portfolio consists of 56 different investments (as at the end of September 2022), c. 87% of which are majority owned by BBGI. BBGI invests only in availability-based assets and those that are backed by government revenues with high-quality inflation linkage. Availability-based assets attract contractual revenues as long as they are available for use by stakeholders, and they do not vary by changes in GDP or by how much they are used. Examples include hospitals and schools, but also roads (as distinct from toll roads, which are demand-based). Risks that such assets are not available, and therefore contractual payments reduce or cease, are largely minimised through contractual facilities management, operation and maintenance where any reductions would typically be passed down to subcontractors and/or insurance arrangements. These investments typically have a fixed lifespan (the weighted average life of BBGI's investments is 20.8 years, as at 30 June 2022) and represent a series of highly predictable cash flows into the future with a zero terminal value. As we discuss in the **Dividend section**, BBGI pays a high prospective semi-annual dividend (yielding 4.7% as at 02/11/2022). Over time, it is BBGI's task to make accretive availability-based investments, which are in line with its strict criteria and aligned to its ESG principles, to try to maintain and continue to extend these cash flows into the future.

A variety of different countries around the world have embraced private finance to provide infrastructure in these areas, and so the team have been able to develop a portfolio that has exposure to several major AAA/AA-rated economies, which we show below. BBGI's differentiated low-risk portfolio helps ensure that it provides long-term, predictable and sustainable shareholder returns. By having exposure to different economies and political systems, overall returns should be smoother than if all investments were made in the same country and same sector. We note that geographic diversity is a differentiator to the London-listed infrastructure fund universe, which typically has a strong bias towards the UK, with c. 75% of assets located in the UK compared to BBGI's current 33%. Of course, this does open BBGI up to currency movements. The team aim to mitigate this risk through the use of hedges, which should mean that a 10% move in all currencies against GBP would translate into a more modest +/-3% impact on cash flows.

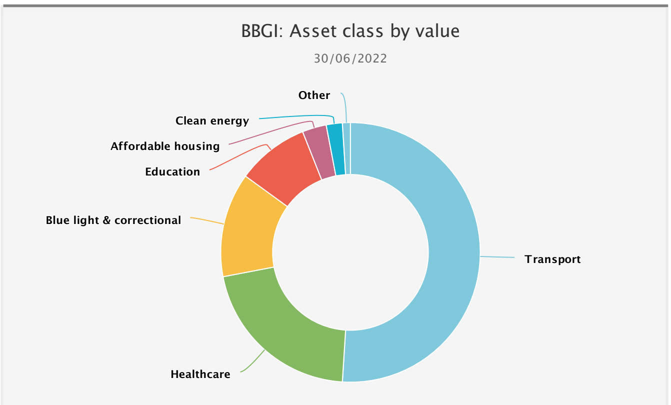
Fig.1: Asset Diversity (Geographic)



Source: BBGI

The majority of BBGI's portfolio is invested in transport, which is dominated by North American assets, although there are transport assets in five different jurisdictions. Education is dominated by UK investments, whilst the other asset segments tend to be more evenly spread geographically. The team note that they have no acute-care facilities in the UK, which they observe tend to be more under pressure financially, leading to an element of friction with the relevant authorities. We understand from the BBGI team that they see it as their role to ensure that clients have a high level of customer satisfaction, which is why the team have a high level of asset availability of 99.9%.

Fig.2: Asset Diversity (Type)



Source: BBGI

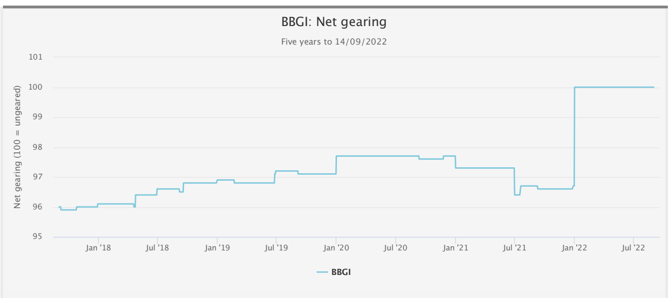
Infrastructure investments tend to have an element of correlation with inflation, with cash flows contractually linked to inflation. Being availability-based, the BBGI team observe that this link is direct, in that there is no elasticity-of-demand considerations to factor in. They contrast their exposure to contracted inflationary increases with the situation of a toll road operator. Toll road operators may have the right to increase tolls in line with inflation, but may decide to mitigate some of the increase in toll rates so as to avoid a reduction in usage. In contrast, BBGI's availability-based cash flows have entirely contractual links to inflation. Whilst the theoretical sensitivities of peers to inflation are perhaps slightly higher than BBGI's are, the practical reality is less clear-cut. As such, if inflation persists, then investors should continue to see increases in BBGI's cash flows. That said, there may be some slight lags: we understand that for UK infrastructure assets, for example, the relevant inflation statistic from which cash flows are determined is published in the spring each year. In terms of valuations, investments are currently valued based on an expectation that in 2023 inflation will decline from its current elevated levels and revert to levels under 3% thereafter. Yet if inflation remains persistent, then the prospects of a higher NAV are there (see **Performance section** for BBGI's key NAV sensitivities).

Gearing

Over time, BBGI is not expected to have structural gearing or long-term borrowings at the corporate level. However, as is common across the sector, BBGI periodically uses short-term flexible gearing (a £230m revolving credit facility with a £70m accordion tranche, maturing in 2026) to acquire assets. BBGI then aims to repay these borrowings through subsequent share issuance, with that having last occurred in July 2021. This process avoids the problem of cash drag, and ensures the investment company can be as fully invested as possible over time. BBGI has permission to be geared to a maximum of 33% of portfolio value (or gross assets), which is equivalent to gearing of c. 50% of NAV. That said, according to Morningstar statistics, over much of the last five years BBGI has not been geared and has instead consistently had a small net cash position over this time. Given the credit facility does not mature until 2026, recent market volatility means that BBGI does not necessarily need to tap equity markets in the near term as it acquires suitable investments.

Within the portfolio, it is worth noting that BBGI's assets are held through special purpose vehicles, which make

Fig.3: Gearing



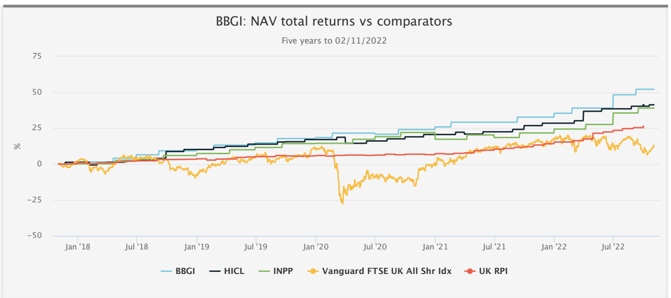
Source: Morningstar

substantial use of gearing due to the strong credit quality of the revenue streams. These borrowings are fixed rate and amortising, meaning that by the end of the life of each asset, all debt will have been repaid.

Performance

BBGI markets itself as having a low-risk, diversified portfolio of assets spread across highly rated investment-grade countries with stable, well-developed operating environments. BBGI aims to deliver long-term, predictable and inflation-linked shareholder returns, and targets a progressive annual dividend payment supported by the active management of the portfolio. The BBGI team target government-backed revenues with strong inflation linkage for all of their projects, and invest only in those that are availability-based (see **Portfolio section**). As a result, BBGI was entirely unaffected by the lockdowns imposed at the time of the COVID pandemic while other peers in the listed infrastructure sector were affected through their investments in demand-based assets such as toll roads, which saw falls in revenues that negatively affected the cash flows from those assets. It was this solid performance during a period that one might see as being the ultimate test for an investment company that has enabled BBGI to outperform its peers in NAV total return terms over the last five years, as illustrated in the graph below. That said, as economic conditions return to normal, it may be that peers potentially experience something of a short-term bounce-back from affected assets, resulting in a period of higher relative NAV growth.

Fig.4: NAV Total Returns (Five Years)

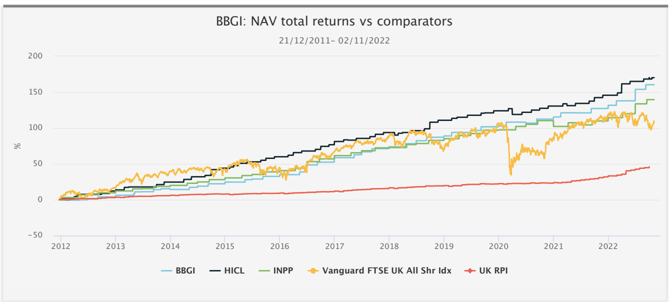


Source: Morningstar

Past performance is not a reliable indicator of future results.

To the end of the last reporting period (30/06/2022), BBGI has delivered NAV total returns since IPO of 9.3% per annum. As the graph below shows, this represents outperformance of International Public Partnerships (INPP) and the FTSE All Share, and puts BBGI's returns well ahead of UK inflation. On the other hand, HICL Infrastructure (HICL) has outperformed BBGI on an NAV total return basis over the same period.

Fig.5: NAV Total Returns Since IPO



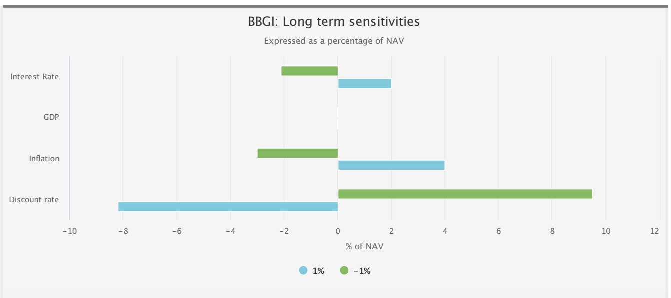
Source: Morningstar

Past performance is not a reliable indicator of future results.

Within the infrastructure universe, the portfolio's weighted average discount rate gives an idea of the expected annual returns (before fees) from the portfolio. BBGI had a weighted average discount rate of 6.55% as at 30/06/2022, which compared to HICL's 6.6% discount rate and INPP's 6.97% rate as at the same date. In our view, BBGI's lower discount rate reflects the higher proportion of lower-risk, availability-based assets that BBGI owns. The future NAV returns that shareholders will experience will depend on the BBGI team's ability to deliver added value, as well as being dependent on long-term macroeconomic assumptions and exchange rates (although BBGI aims to mitigate FX exposure by hedging a proportion of cash flows, meaning that a change in all FX rates relative to GBP of 10% will only translate into a 3% cash flow impact). We show the sensitivity of the NAV to some of these assumptions in the chart below.

Of particular note given the rapid rise in long-term government bond yields, we note that the discount rate has the largest impact on the NAV, and HICL has recently announced a 50 bps rise in its discount rate. Whilst there is definitely some read-across from this development for BBGI, at the same time it is worth noting that BBGI has a much lower exposure to the UK, which has seen bond yields rise higher than those of other G7 countries. Potentially offsetting a rise in discount rates, deposit rates and inflation are also rising, and we note the positive correlation of BBGI with inflation and the lack of any impact from changes to GDP growth rates. As we discuss in the

Fig.6: NAV Sensitivity

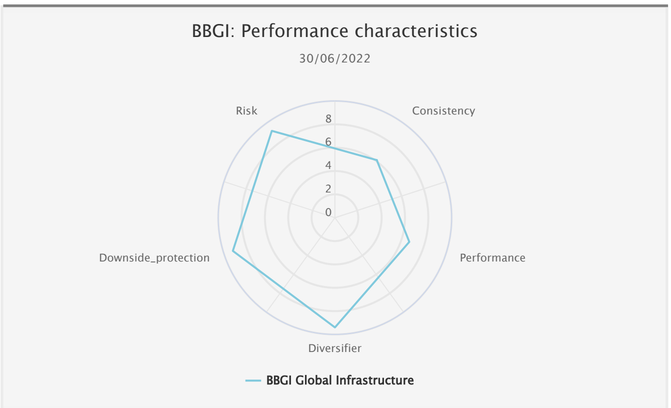


Source: BBGI

<u>**Portfolio section**</u>, with 100% availability-based assets, BBGI's portfolio arguably has the cleanest exposure to inflation without the price elasticity considerations of demand-based assets. BBGI benefits from a rise in interest rates because its portfolio companies tend to hold large amounts of cash on their balance sheets, meaning they clearly earn higher returns as interest rates rise. In March 2023 we expect BBGI to provide an updated NAV for 31 December 2022.

In our proprietary spider chart below, we show how BBGI has performed in NAV terms versus an expanded peer group of all infrastructure, renewable energy and commercial property trusts over the past five years in some key categories. Each category is scored out of ten based on rolling 12-month returns over the last five years, and scores are normalised to the peer group. This data reflects the performance characteristics investors would have experienced over the last five years. We note that BBGI scores strongly for risk, downside protection and diversification characteristics.

Fig.7: KTI Spider Chart



Source: Morningstar/Kepler Partners LLP

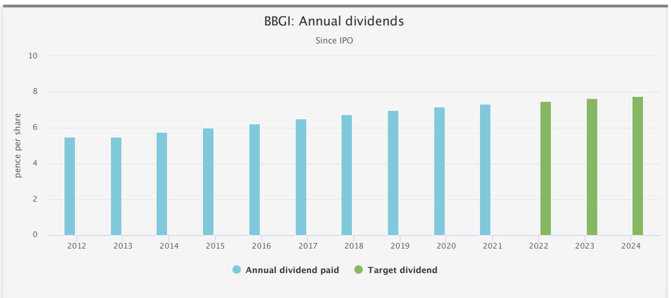
Past performance is not a reliable indicator of future results.

Dividend

BBGI has paid a steady stream of growing dividends since it was launched in 2011, so far having delivered a compound average increase in annual dividend of 3.1% between 2012 and 2021. Dividends are paid semi-annually. The target dividend of 7.48p for the current financial year (ending December 2022) represents a dividend yield at the current price of 4.7%. This compares to BBGI's closest comparable peers HICL and INPP, which both offer yields of 5.0% and 5.1% respectively (Source: JPMorgan Cazenove).

Reflecting the high degree of visibility on the company's cash flows, not to mention the fact that the portfolio is 100% availability-based, the BBGI board provides guidance on its target dividends into the future. Currently, the board has a target level of dividend for the current as well as subsequent two financial years, giving a high degree of visibility for shareholders. We note that the currently targeted dividends represent c. 2% increases. As we discuss in the **Portfolio section**, BBGI's revenues have high-quality inflation linkage, which over time should provide a tailwind to revenues and therefore dividend cover or dividend growth. In the current financial year, the interims show that the dividend is covered c. 2x. There is an element of seasonality in BBGI's cash flows, with more cash now being received in the first half of the year (absent one-offs). The BBGI team say that an element of this increase is attributable to inflation and active asset management initiatives, but they are expecting that over the full year dividend cover will be in the order of 1.4x to 1.5x. In the last financial year, BBGI's dividend was 1.31x covered by cash, with the board expecting it to be covered 1.2x to 1.3x over the long term.

Fig.8: Dividend



Source: BBGI

Management

BBGI is an internally managed investment company, with the managers and staff being directly employed. BBGI was established in 2011, with the co-CEOs and seed assets having originally been part of Bilfinger, a German civil engineering and construction company. The management team comprises c. 25 individuals. BBGI is headquartered in Luxembourg, with management teams in North America, the UK, Germany, the Netherlands and Ireland.

The original leadership team in place at the time of the IPO remain, with Duncan Ball and Frank Schramm having been co-CEOs of BBGI since inception. They were joined by CFO Michael Denny in early 2012, shortly after the IPO. Duncan, Frank and Michael represent the management board of BBGI, and a supervisory board comprising five independent members is also in place.

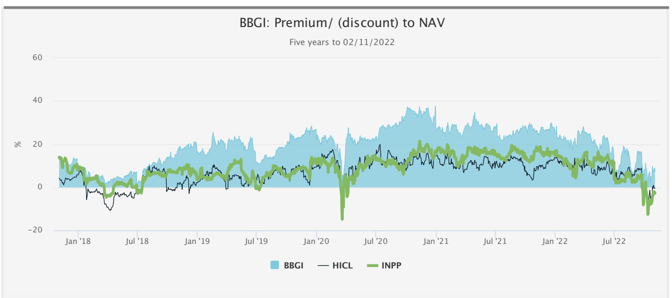
As we highlight in the **Charges section**, having an internally managed team responsible for BBGI's assets is a differentiator. The team are 100% focussed on BBGI and fully aligned with shareholders as a result, with the team not being paid or incentivised to grow the NAV for growth's sake. The investment company's OCF is the lowest in the peer group, and given its structure this ensures that the OCF will reduce if BBGI grows in size, with fixed costs reducing as a proportion of a larger asset base.

Discount

Over the last five years, the premium at which BBGI's shares have traded relative to NAV has averaged 19.6%. Recent market ructions and rises in interest rates have seen premiums evaporate across the market, and BBGI trades on a premium to its historical NAV of 7.2% as at 02/11/2022. As the graph below illustrates, BBGI has almost always attracted a higher premium than peers, which it retains to this day. We believe this is a function of the lower ongoing charges over time, conservative valuations and the fact that the portfolio is 100% availability-based (meaning that revenues are less variable, for good or for bad, although that was a definite positive during the COVID-induced lockdowns, and similarly should be during any potential recessionary backdrop).

Whilst BBGI has had the highest premium in the sector, it is also true that BBGI has not grown as fast as HICL or INPP. For example, the last placing of shares was conducted in July 2021, raising £75m, whilst peers have issued significantly more shares. As BBGI is internally managed the team are 100% aligned with shareholders, and argue that they will not pursue growth for the sake of growth as shareholder value is the top priority, with portfolio growth second. That said, with an internally managed team the ongoing charges figure will reduce as the asset base increases, so shareholders would benefit from accretive growth. In not growing as fast as HICL or INPP, another reason may be the market for availability-based assets is smaller. For whatever reason, the supply of new shares in BBGI has been lower than the supply of shares for peers, which could also be the reason for the premium rating relative to peers. A rapid rise in interest rates and inflation around the world makes it hard to determine what the next published NAV will be. Over the long term, BBGI's income characteristics will likely remain undiminished, and so investors may see this as a potentially attractive entry point.

Fig.9: Discount To NAV



Source: Morningstar

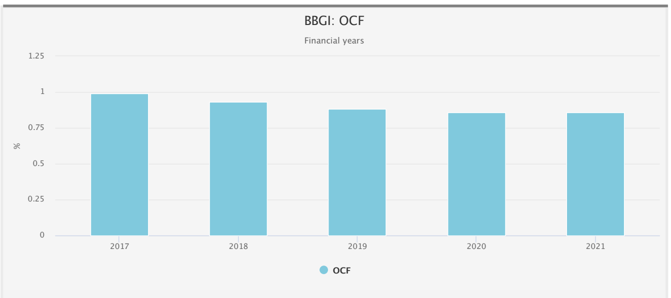
Should BBGI trade at a sustained discount to NAV, the board has the ability to make share repurchases. The next continuation vote will be held in 2023, and every second year thereafter.

Charges

BBGI is internally managed, which is likely the reason why it has the lowest OCF amongst its peers. BBGI quotes an annualised OCF of 0.86% (as at 30 June 2022). As a percentage of average NAV, fees directly linked to investment performance recorded in 2021 were 0.1%, whereas for 2020 they were 0.08%. Combined, the aggregate of ongoing charges plus investment performance fees was 0.96% in 2021, versus 0.94% in 2020. This compares to HICL and INPP, which have current OCFs of 1.1% and 1.2% respectively. BBGI's KID Reduction in Yield figure is 1.32% (as at 31/12/2021). We note that calculation methodologies can vary between different investment trusts and sectors.

Having a management team who are directly employed brings advantages (see **Management section**), one of which is that as the asset base rises, this can lead to a significantly lower proportionate cost. Over time, the OCF has reduced quite materially. For example, in 2017 the OCF was quoted as being 0.99%, with the most recently announced annual figure representing a 13% fall over five years, as we illustrate in the chart below.

Fig.10: Ongoing Charges



Source: BBGI

In BBGI's case, the senior management team are remunerated through an annual bonus and an LTIP, both of which are set formulaically and depend on financial and strategic KPIs (including ESG KPIs, which represent 10% of the LTIP award). Remuneration matters are set by the remuneration committee of the independent supervisory board. The committee has made changes to the management team's remuneration structure in order to remain up to date with best governance practices, including the introduction of features such as bonus deferral and post-employment shareholding requirements. These are designed to ensure that executive and shareholder interests are closely aligned and focussed on long-term sustainable performance. The BBGI team argue that they will not pursue growth for the sake of growth.

ESG

BBGI sees itself as a responsible investor in global social infrastructure and we believe that ESG is fully integrated into its business model. BBGI aligns its active asset management approach with six focussed UN Sustainable Development Goals (SDGs)/ESG principles which are integrated into the investment company's investment and operating model. BBGI qualifies as an Article 8 Fund under SFDR and incentivises strong ESG performance by directly linking results to executive compensation. An Article 8 Fund promotes environmental or social characteristics and follows good governance practices.

In its **UN PRI assessment report** BBGI was rated as five out of five stars for Investment and Stewardship, and four out of five for Direct Infrastructure. BBGI was also a signatory to the Net Zero Asset Managers initiative in 2021. During the last financial year carbon emissions from the BBGI team's activities have been fully offset, and this is one of the key developments reported on in BBGI's comprehensive ESG report (**downloadable here**). In the next step towards reducing the carbon footprint of the investment company, the team have started to track and report Scope 1 and 2 emissions at portfolio companies. They have also committed to report this information from 2022 onwards and to share it with public sector clients in the hope that this will influence a reduction in GHG emissions from each asset.

Carbon reduction is clearly a key area of focus for the team, which was captured in a 'materiality assessment exercise' the team conducted during 2021. Overall, scenario analysis has highlighted that the BBGI portfolio is very resilient to climate hazards, both in today's environment and under future climate-warming scenarios. The team have identified the ten most material sustainability topics and strategic ESG areas of focus. These ten topics have shaped BBGI's ESG commitments and KPIs, which the team are now tracking to ensure incremental progress in the delivery of positive stakeholder outcomes. Carbon reduction represented three of the ten topics, with three areas of focus being identified within the 'social' factor of ESG and four within the 'governance' factor. BBGI will be reporting against all of these over time, providing ESG investors with plenty of information on how well their investment is progressing in ESG terms. As we discuss under **Charges**, 10% of the management board's LTIP compensation is linked to ESG performance, ensuring that the board is aligned with investors.

Disclaimer

This report has been issued by Kepler Partners LLP. **The analyst who has prepared this report is aware that Kepler Partners LLP has a relationship with the company covered in this report and/or a conflict of interest which may impair the objectivity of the research.**

Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise and you may get back less than you invested when you decide to sell your investments. It is strongly recommended that if you are a private investor independent financial advice should be taken before making any investment or financial decision.

Kepler Partners is not authorised to make recommendations to retail clients. This report has been issued by Kepler Partners LLP, is based on factual information only, is solely for information purposes only and any views contained in it must not be construed as investment or tax advice or a recommendation to buy, sell or take any action in relation to any investment.

The information provided on this website is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Kepler Partners LLP to any registration requirement within such jurisdiction or country. In particular, this website is exclusively for non-US Persons. Persons who access this information are required to inform themselves and to comply with any such restrictions.

The information contained in this website is not intended to constitute, and should not be construed as, investment advice. No representation or warranty, express or implied, is given by any person as to the accuracy or completeness of the information and no responsibility or liability is accepted for the accuracy or sufficiency of any of the information, for any errors, omissions or misstatements, negligent or otherwise. Any views and opinions, whilst given in good faith, are subject to change without notice.

This is not an official confirmation of terms and is not a recommendation, offer or solicitation to buy or sell or take any action in relation to any investment mentioned herein. Any prices or quotations contained herein are indicative only.

Kepler Partners LLP (including its partners, employees and representatives) or a connected person may have positions in or options on the securities detailed in this report, and may buy, sell or offer to purchase or sell such securities from time to time, but will at all times be subject to restrictions imposed by the firm's internal rules. A copy of the firm's Conflict of Interest policy is available on request.

PLEASE SEE ALSO OUR TERMS AND CONDITIONS

Kepler Partners LLP is authorised and regulated by the Financial Conduct Authority (FRN 480590), registered in England and Wales at 70 Conduit Street, London W1S 2GF with registered number OC334771.