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Fidante Daily Digest

News bulletin on alternative investment companies

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IMPACT SCORE

Our impact score reflects our own assessment of how the news would affect the company’s stock. It focuses on the potential future impact on discount/premium and performance dynamics that are likely to arise as a result of the news. It is not indicative of the company’s overall health and performance and is not directional (positive/negative). A high impact score can mean either adverse or positive impact, hence readers must make their own judgment with regards to this.

1 2 3 4 5

3 NESF* - NextEnergy Solar – Interims to 30 September 2018

Invests in a diversified portfolio of solar PV assets, largely in the UK

- The NAV as at 30 September 2018 was 105.1pps, up 2.17% since the last NAV on 30 June 2018, up 3.14% over the six-month reporting period, and up 5.12% year-to-date (total return). For 2018/19, the company is targeting a total dividend of 6.65pps (2017/18: 6.42pps), and the first quarterly dividend of 1.665pps was paid in September 2018. The cash dividend cover before the scrip was 1.2x (31 March 2018: 1.0x).
- The gross asset value was £975m at the end of the period (31 March 2018: £875m), and the net asset value was £610m (31 March 2018: £605m). The static NAV per share over the period was mainly driven by: a) the payment of dividends, the reinvestment of scrip dividend and operating costs; b) upward revisions in the forecasts for power prices adopted by the company, which were 1.0% higher than the assumptions as at 31 March 2018; and c) the value uplift generated by the acquisitions of assets with IRRs higher than the discount rate used in valuations. In the face of continuing strong demand for solar PV assets during the period, the company maintained its discount rate for unlevered operating solar PV assets at 6.75%. For those operating solar assets with fully-amortising long-term project level debt, the range of risk premia applied was unchanged from the previous period (0.7% - 1.0%). For solar assets outside the UK, an additional country risk premium has been applied. The levered discount rate applied to the Solis portfolio was 9.0% (unchanged). The resulting weighted average discount rate for the company's overall portfolio was 7.3% (unchanged). During the period, the consultants revised their forecasts for UK wholesale power prices upwards and project a lower real growth rate. The factors that contributed to these revisions included stronger commodity prices in the near-term relative to recent years, driven by the expectation of cold winters, a decline in gas storage and oil supply in the UK, and the increasing demand from gas generation. In the long-term, wholesale prices are expected to increase in line with gas and carbon prices, counterbalanced by the growth in low-cost renewable generation. The company's current long-term power price forecast implies an average growth rate of c. 0.2% in real terms over a 20-year period and an average price of c. £53/MWh in today's terms.
- As at 30 September 2018, the company's portfolio comprised 87 operating assets amounting to 691MW of installed capacity, with invested capital of £894m (31 March 2018: 63 assets, 569MW installed capacity and £734m invested capital). In May 2018, the company announced the acquisition of two operating solar plants of 7.2MW with integrated battery energy storage systems of 1MW capacity. In June 2018, NESF acquired ten operating solar plants with total installed capacity of 46.6MW, with associated ROC and FiT subsidies. In July 2018, the company announced the acquisition of a further ten operating solar plants in the UK with installed capacity of 66.8MW. The company's plans to start construction of subsidy-free projects (project rights have been secured to build more than 172MW of subsidy-free capacity) are on track for an announcement in the second half of the financial year. The investment manager is in negotiation for another 606MW of pipeline assets, of which 470MW represent subsidy-free assets and 136MW are with subsidies (though with the investment manager's disciplined approach bidding on these assets in the current competitive market, it does not expect to acquire all these assets).
- Total electricity generation was 480GWh during the period. The first half of the financial year was characterised by a notable overperformance of the company's portfolio, driven by high levels of solar irradiation, which were 8.4% above expectations. High temperatures reduced the technical efficiency of the solar PV systems, so that the actual net generation was 7.9% above budget (including unexpected and expected grid outages of various solar plants). The resulting negative asset management alpha of -0.5% (2017: +1.5%) was an expected result of the high irradiation and temperature conditions. The investment manager continued to focus on the portfolio's core technical and operating performance and the reduction in operating expenditure, and selectively entered into new power purchase agreements and hedges to take advantage of rising short-term power prices. The company's annualised ongoing charges ratio was 1.1% (2017: 1.1%) for the period, in line with the budget for the full year ending 31 March 2019.
- At period end, the total financial debt outstanding was £365.3m (31 March 2018: £270.4m) on a pro-forma look-through basis, including project level debt. Of this, £324.0m was long-term fully amortising debt and £40.0m was drawn under the company's short-term credit facility. This represented a gearing level of 37% (31 March 2018: 31%), below the stated maximum debt-to-GAV level of 50%. The company intends to deploy the proceeds from the first £100m

preference share issue, which occurred post period end, to repay existing debt facilities, resulting in a capital structure with lower financial debt outstanding and significantly reduced annual cash costs to the company. A further £100m preference share issue is expected to be employed primarily to further repay existing debt facilities – outstanding debt is then expected to be reduced to £200.8m, with a gearing ratio of 20%.
- In the upcoming period, the company intends to focus on: a) increasing the technical and operating performance; b) optimising revenues and reducing operating costs across the existing portfolio of assets; c) continuing to identify UK opportunities in the secondary market with ROC accreditations, despite the narrowing pipeline due to increased competition for such assets; and d) progressing the preparation of the construction of subsidy-free assets.

Fidante comment

- This was another period of steady progress for the company, illustrated by the NAV performance and the regular payment of fully-covered dividends, in line with the stated targets. The managers' plans to adapt to developments in the solar PV market, via investments in assets with energy storage capabilities and in subsidy-free plants in the UK, are continuing as planned. And most recently, the company has introduced an innovative financing structure, via the issuance of preference shares, which should result in benefits for the company's shareholders relative to other forms of financing, in terms of, for example, the dividend cover and the delivered IRR. Furthermore, the managers have identified a sizeable pipeline of further acquisitions opportunities for the disciplined deployment of the current resources available to the company.

DID YOU KNOW?

Author: Aliy Akbarov

Survey time

It has been a great month if you have an interest in asset management trends and like reading lengthy third-party reports. Over the last 30 days, we saw the Thinking Ahead Institute (not-for-profit but set up by Willis Towers Watson) publish its rating of top 500 asset managers by AUM, PwC publish a report on the 'revolution' in asset management and E&Y's alternative funds survey, to mention just a few. Each of those is a great read in its own right and perhaps warrants its own analysis, but it is the first survey on that list which we will be focusing on today.

I think the best way for me to proceed is to list some of the key findings below and add some of my thoughts in the text that follows. Overall, the survey shows that:

- The aggregate AUM for the 500 asset managers that were surveyed was $93.8tn as at the end of 2017, up 15.6% compared to 2016 and fast-approaching the $100tn mark.
- The size of the average asset manager, expressed by the median AUM, was almost $44bn, which represents a low double-digit increase.
- The top 20 asset managers by AUM have tightened their grip on their share of the total pool, which has reached 43.3% in 2017. Interestingly, this group enjoyed a bigger growth rate compared with the rest of the sample at 18.3%. BlackRock, Vanguard and State Street complete the top three for the fourth-year running.
- Geographically, the UK's AUM growth lagged its peers at 9.6% growth against 15.9% for the rest of the world on average. European assets under management enjoyed particularly strong growth at 15.8% whilst the US was right behind at 15.1%. Japan, the Asian powerhouse, grew its AUM by 12.6%. Within the top 20, US managers ceded one spot to Europe, changing the overall distribution to 12 US managers and 8 European managers within the top 20.
- In terms of growth, China has increased its assets by a blistering 22%, which is similar to India. Denmark came in as the European champion, growing its AUM by 14.3% and 12.1% in local currency and USD, respectively. South Africa comes at the very bottom as the political uncertainty seemed to have weighed on the AUM in the country which reduced by 5% and 11.5% in local currency and USD, respectively.

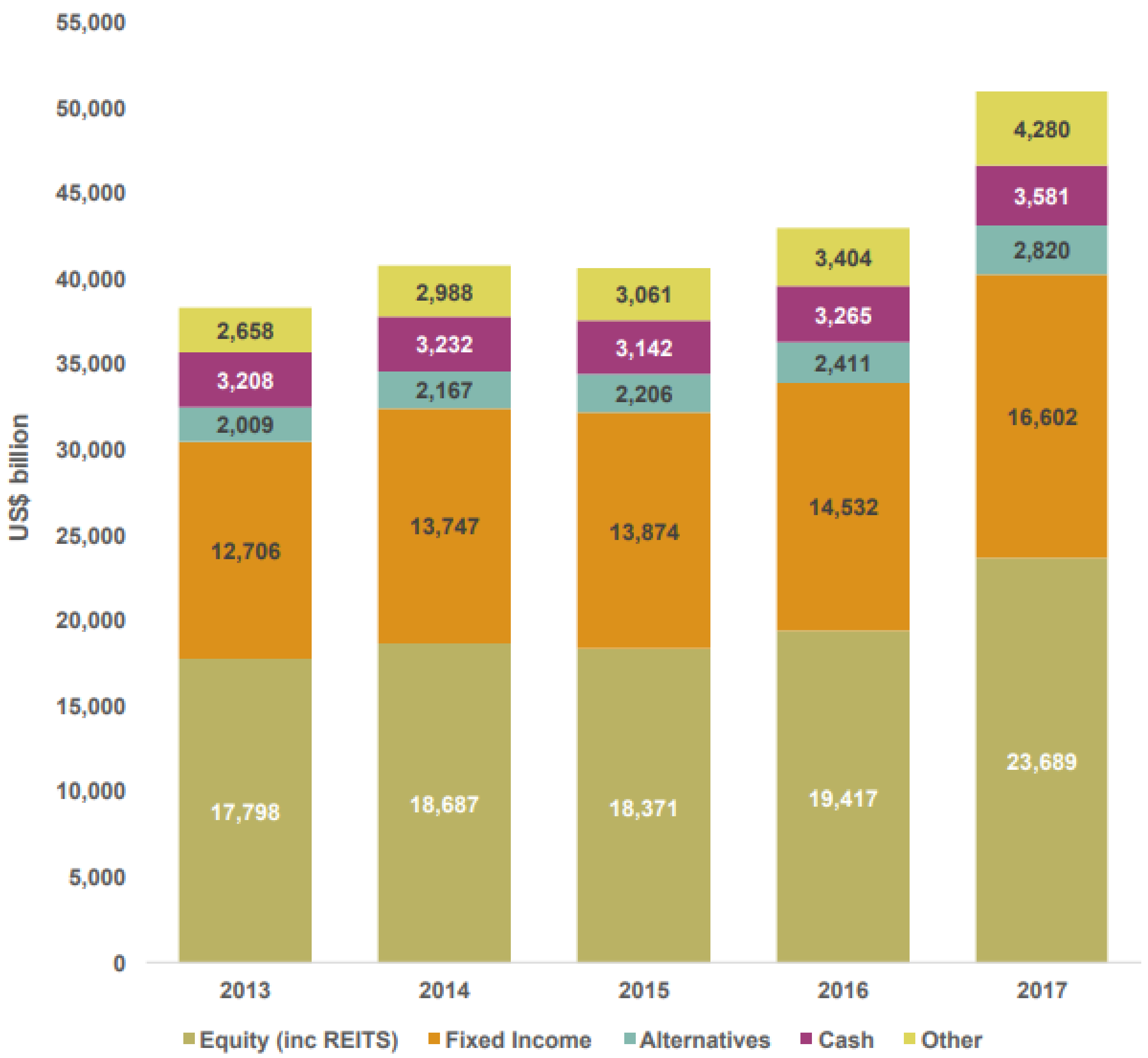
- Passive investments continue to outgrow active investments. Equity and fixed income still represent almost 80% of total assets but in the average portfolio, almost 16% of assets are alternatives.
- Much can be said about what the figures above reflect as trends in asset management. In the UK, which I dare say is the asset management capital of the world (the US is bigger but more assets are domestic), the Brexit uncertainty has weighed on asset managers which have seem little in terms of concrete guarantees that cross-border activities will go on unencumbered post-Brexit. This is also further evidence that there may be a huge backlog of assets ready to be released to invest in or through the UK as soon as a concrete outcome on Brexit is in sight. At a recent Real Estate forum which I attended, all participants seemed to be in agreement that with or without Brexit, the UK real estate market is ripe with opportunity.

The figures also corroborate the story of investors switching to passive from active at increased velocity. This is particularly visible for pension plans, where there are requirements for enhanced transparency when it comes to fees for underlying investments. There is little need to elaborate on the historic and growing relationship between private and government pension plans and asset managers. The two are natural partners as one's activity complements the other's and this link has grown even stronger since the onset of the low rate environment, as pension plans can't rely on the primary purchase of government bonds for instance to fulfil their obligations.

In that vein, there are two major events worth highlighting which have changed the pensions and investments industry over the past decade. First, the auto-enrolment legislation was introduced in 2012 which dramatically increased the number of people saving money through a retirement plan across the UK. This no doubt was a welcome boon for the asset management industry as the volume of member assets increased dramatically whilst also remaining grouped in corporate pension plans which are easier to target than individuals. Next, the government introduced the famous 2015 Pension Freedoms which removed the requirement of annuitisation of pension benefits and significantly increased the flexibility individuals can enjoy upon retirement. The latter has also fundamentally altered the way we think of pensions as the greater choice of retirement options has opened up the gates to additional layers of complexity. But if we overlay these developments with the increased switch to passive investments through ETFs and index-tracking funds, there are some reasons for concern. For one, the concentration risk becomes so high that the fallout becomes unpredictable in the event of a market downturn. Worse, if such an event was to occur, it would be people's precious lifesavings which would be at risk. With most market pundits predicting a correction in the next few years, the trustees of pension funds would be wise to assess whether moving assets to passive investments will do much in terms of downside protection.

Of course, passive is a much easier sell today and this is the precise reason why the top three managers have such a tight grip on both current and future assets. Returns have been buoyed by years of monetary largesse whilst valuations have shot up above historical averages whilst many active strategies have languished. It is in those moments that it is most important to remember that the value of active management lies precisely in its downside management.

Asset participation by asset allocation



Source: FT, Bloomberg, Fidante Partners, 2018.

Credit/lending NAV performance

- TwentyFour Income (TFIF) NAV as at 16-Nov-18 (114.25pps) was down 0.43pps (0.37%) since the last NAV on 9-Nov-18, down 0.30% month-to-date and up 3.44% year-to-date.

Hedge fund NAV performance

- Alternative Liquidity Fund (ALF) NAV as at 31-Aug-18 ($0.3228 per share) was down $0.0163 per share (4.81%) in August and down 16.38% year-to-date.
- Sanditon (SIT) NAV as at 16-Nov-18 (96.75pps) was up 0.92pps (0.96%) since the last NAV on 9-Nov-18 and up 4.63% year-to-date.

Private equity NAV performance

- Ashmore Global (AGOL) GBP NAV as at 31-Oct-18 (597.77pps) was down 5.97pps (0.99%) in October and up 3.15% year-to-date.

Share buybacks and issuance

- Alcentra European Floating Rate Income (AEFS) bought back 35,000 shares at 99.20pps on 19-Nov-18.
- Capital Gearing Trust (CGT) issued 5,500 shares at 4070pps on 19-Nov-18.
- ICG Enterprise (ICGT) bought back 15,000 shares at 829.0pps on 16-Nov-18.
- NB Distressed Debt Extended (NBDX) bought back 40,000 Extended shares at $0.943 per share on 19-Nov-18.

- NB Global Floating Rate Income (NBLS*) bought back 950,000 GBP shares at 91.6117pps and 37,500 USD shares at $0.939 per share on 19-Nov-18.
- P2P Global Investments (P2P) bought back 33,000 shares at 780.0pps on 19-Nov-18.
- Residential Secure Income (RESI) bought back 150,000 shares at 92.84pps on 19-Nov-18.

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