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Results analysis: Sequoia Economic Infrastructure Income

SEQI's high dividends continue to be well-covered by cash...

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- **Sequoia Economic Infrastructure Income (SEQI) delivered positive NAV per share growth over the six months to the end of September, with its steady high dividends boosting the NAV total return to 5.1%. NAV per share rose 1.3% to 95.03p, while the trust paid dividends, on target, worth 3.4375p. Over the period the share price discount to NAV widened from 13.5% to 15.6%, and so the share price total return was 3.2%.**

- **Two quarterly dividends of 1.71875p were cash covered by a factor of 1.06x. The board expects the dividends to remain cash covered in the second half.**

- **SEQI's portfolio remains highly diversified, with 54.8% in defensive sectors and 58.5% n senior secured loans. There is low construction risk of just 8.1%.**

- **During the period, the managers made progress on resolving the three non-performing loans. Exposure to these fell to 5.5% at the period end and has since fallen further to just 3.7% as one of the three positions has been sold.**

- **The managers increased exposure to fixed-rate loans over the half-year to 62% of the portfolio in order to capitalize on the high level of interest rates and mitigate the impact of expected rate cuts.**

- **The board has continued to implement one of the largest buybacks in the listed fund sector, commenced back in July 2022, spending £39.5m to repurchase 49.3 million shares over the period. These contributed 0.47p to NAV per share. The board states it will continue these buybacks to support share price and reduce discount levels, factoring in the underlying liquidity of the portfolio, dividend cover and portfolio diversification needs amongst other considerations.**

- **During the period, the triennial continuation vote was passed with 96.43% of votes cast in favour of continuation.**

- **Board chair James Stewart said: "I am delighted to announce another robust half year performance. As the economic challenges experienced in the previous financial year have begun to ease in the last six months, the Company has demonstrated its adaptability, resilience, and ability to generate significant cash. This performance supports our ongoing balanced approach to capital deployment, underpinned by the Investment Adviser's extremely selective approach as it considers the strong pipeline of future opportunities, benefitting from ongoing strong market demand for infrastructure debt finance."**

Kepler View

Sequoia Economic Infrastructure Income (SEQI) has once again delivered a high yield with a solid NAV, and burnished its credentials as an interesting option for fixed income exposure. Annualised NAV returns of 10.2% exceed the targeted 7-8% over the long run. They were equivalent to the returns of the high yield bond market, but were almost entirely due to income rather than movements in the prices of the debt portfolio, which netted off essentially flat. The short average portfolio loan life of 3.5% and 42% exposure to floating rate loans make the portfolio valuation relatively insensitive to interest rate movements, with a modified duration of close to 2% (i.e. a 1% upward movement in applicable interest rates across the portfolio brings a 2% downward movement in portfolio value, and vice versa). SEQI invests predominantly in private debt, and focuses on economic infrastructure related names. This brings defensiveness and exposure to some of the key structural growth themes in the world economy.

One notable development in the results was the good progress made on the three non-performing loans. One of these, as we note above, has now been resolved, and good progress was made on recovering the loan made to Bulb Energy. As a result, only 3.7% of the portfolio is classed as non-performing. Progress was also made on reducing the portion of the portfolio subject to enhanced monitoring from 10% to 7%. Loss rates have been exceptionally low since launch, with an annualised rate of 0.51% compared to 1.6% for similarly-rated non-financial corporate bonds. This reflects the stock selection of the managers, as well as the work they are able to do if borrowers do run into trouble to restructure and recover funds lent.

The team has tilted the portfolio further towards fixed-rate investments over the half-year, these rising to 62% from 58%. This reflects their view that fixed rates are attractive over a three to four year investment horizon, with the outlook being for rates to fall over this period. The flexibility to move between fixed and floating rate debt is one of the levers the managers have to pull in pursuit of alpha. We would note though that it will have increased slightly the duration of the fund and therefore the volatility of the value of the loan book. The team also use interest rate swaps to alter the duration and limit the exposure of the income book to a faster-than-expected collapse in short-term rates.

The managers are bullish on the investment pipeline, noting that they have identified c. £500m of potential investments with an average yield of 10.1%, above the gross target range of 9-10%. They note that they have identified investments in Italy and Portugal which may for the first time feature in the portfolio.

At the current discounted price, SEQI offers a highly attractive 8.6% covered yield, achieved without the use of structural fund gearing. The 15.6% discount to NAV also provides attractive potential upside which is not normally available elsewhere in the credit market. The board has committed considerable capital to buybacks in pursuit of narrowing the discount and these have added 0.47p to NAV per share during the period in question. The trust has significant cash on the balance sheet to use for buybacks or further investments. The trust has a net cash position of £69m providing plenty of flexibility, and the board has stated that it may use the revolving credit facility more frequently to meet investment and buyback requirements.

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