The only way is up

BBGI's share price should benefit as interest rates fall…

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Analysts:

David Brenchley
david.b@keplerpartners.com

It looks like the period of 5%-plus interest rates we've been in is finally ending, with the UK's Bank of England cutting in August and the US Federal Reserve widely expected to follow suit in September. Add that to the cuts we've already seen from the European Central Bank and the Bank of Canada and the direction for rates from here is down.

The International Monetary Fund said in May that UK interest rates should fall to 3.5% by the end of 2025, while interest rate traders are currently predicting cuts by the Fed at its next seven meetings until June 2025, according to CME FedWatch.

In terms of the investment company universe, perhaps no sector will benefit more than infrastructure. Yet, the recovery in the share prices of infrastructure investment trusts is more than an interest rate story.

There's also likely to be some support by more closely involving the private sector in government drives to repair and improve ageing infrastructure that has been neglected for decades in most Western economies.

Reasons to be positive

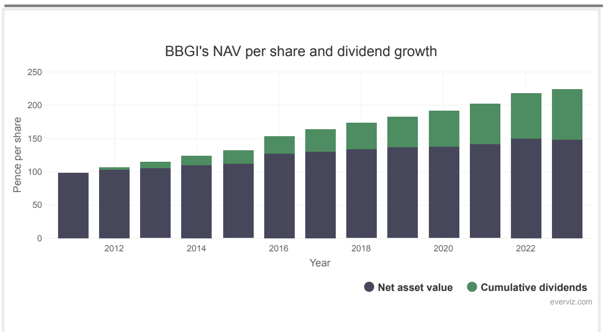
As bond yields had risen alongside interest rates, capital was reallocated from a swathe of income-focused alternative investment company sectors, including infrastructure, into lower-risk gilts.

Things have been looking up more recently, though. Take **BBGI Global Infrastructure (BBGI)** as an example. The share price total return over the past three years has been -2.4%, according to the Association of Investment Companies (AIC), yet the NAV total return over those three years has been 7.9% and the dividend is up 17% since 2020.

This shows that BBGI has delivered strong financial and operational performance, even in the high interest rate environment in the past few years, underpinning the resilience of BBGI's business model. Perhaps this is why BBGI stands on one of the lowest discounts in the AIC's Infrastructure sector, at 7.8%.

The likelihood is that this share price discount to NAV is an anomaly that will continue to be corrected as interest rates trend downwards. Indeed, as rate expectations have become more favourable, the discount has narrowed from as wide as 18% in February.

Fig.1: BBGI Is Delivering Growth



Source:BBGI Global Infrastructure

An additional positive comes through the UK's new Labour government having made no secret of its desire to remedy the decades of underinvestment we've had in our infrastructure. The chancellor

Rachel Reeves has put infrastructure at the forefront of her party's plan to reinvigorate economic growth. To do this, she has reiterated the need to involve private capital alongside government spending.

The UK doesn't stand alone in prioritising higher spending on infrastructure. Both the US and European Union passed bills in 2021 that promise hundreds of billions of dollars and euros respectively worth of investment in infrastructure projects from railways and roads to power grids and green technology.

Taking a low-risk approach

Going back to our BBGI example, this is a company that provides investors with a globally diversified portfolio of infrastructure assets. Its portfolio spans the UK, Canada, the US, Australia and Continental Europe.

All its holdings are based in AA/AAA-rated investment-grade economies and are predominantly rented out to credit-worthy government or government-backed counterparties.

In addition, BBGI owns availability-style social infrastructure assets, which means that revenues are paid to the company so long as the assets it owns are available for use. This provides BBGI with predictable cashflows (rather than demand-style assets, where revenues depend on how often they are used so are less predictable).

Alongside this, BBGI has inflation-linked contracts, giving it a high inflation correlation. This all adds up to leave BBGI at the lower-risk end of the infrastructure space.

BBGI's income story stacks up, too. As a reminder, as well as providing attractive total returns linked to inflation, BBGI also targets a steady and progressive dividend payment. It has consistently delivered this, either meeting or exceeding its dividend targets every year since IPO in 2011. This has culminated in BBGI being recognized by the AIC as a next generation dividend hero.

Fig.2: BBGI Dividend V UK CPI

Source: BBGI Global Infrastructure

The dividend target for 2024 is 8.4p, an increase of 6% on 2023's payout. This puts the forward yield at 6.2%, which is well above the yield on the 10-year gilt at about 3.9%.

In addition, BBGI's forward yield based on its 2025 dividend target of 8.57p is 6.35%, well above the 3.5% level the IMF thinks UK interest rates should be by the end of next year.

The dividend is well covered, at about 1.4 times, and there's no structural gearing at the trust level. This leaves BBGI's balance sheet in a solid place. A good example of this was its 2022 acquisition of stakes in Germany's A7 motorway and the John Hart Generating Station in Canada. BBGI paid a total consideration of over £60 million for these assets, but the residual cash flows generated by its underlying portfolio enabled it to fully repay its borrowings by the end of 2023.

The predictable cash flows from BBGI's existing portfolio provide substantial headroom to sustain progressive annual dividends for the next 15 years, even without additional investments.

BBGI is a rarity in the investment company sector in that it's managed in-house. The first thing to point out here is that board members, management and employees are all aligned with shareholders by having significant skin in the game.

Every member of both the management board and the supervisory board are shareholders, while 87% of BBGI's employees own shares or have vesting shareholding entitlements. This means that the entire team is focused on making the portfolio better, not bigger; the team is motivated by the same metrics that are important to shareholders: growing the NAV per share and the dividend.

The management team does this by taking an active asset management approach and focuses on high-quality assets with secured long-term cash flows with high inflation correlation.

The disciplined capital allocation policy is aimed at the long-term strategic rationale of optimising overall portfolio composition and enhancing shareholder value and involves benchmarking each potential investment against other alternative capital allocation options.

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