MARKET INSIGHT

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Redmayne Bentley

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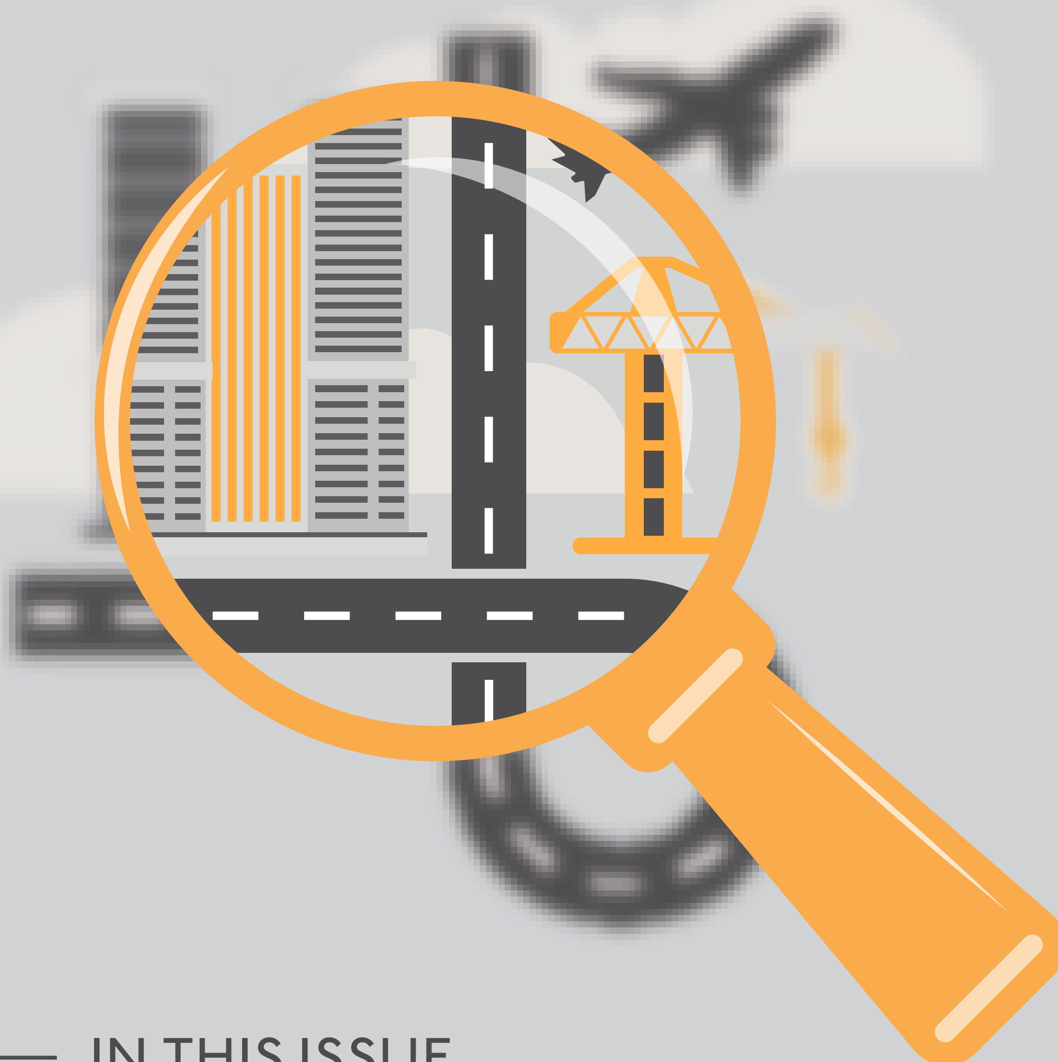
An Alternative Focus



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2025 is a very special year for Redmayne Bentley as we will celebrate our 150th anniversary in December. As we look ahead to this significant milestone, we want to thank our clients, readers and listeners for your support.

By mid-February there have already been multiple events of interest, ranging from President Trump's trade tariffs to a new Chinese Artificial Intelligence (AI) tool which caused a sharp decline in the share prices of some big tech names, before rallying back. In addition, the Bank of England cut interest rates to 4.50% while issuing a gloomier outlook for UK economic growth than Chancellor Rachel Reeves would have been hoping for. Government borrowing costs, which had caused some concerns for markets at the turn of the year, have moved lower providing some respite for bond investors.

For this edition of *Market Insight*, the focus is placed on alternatives, a catch-all term for assets which fall outside of the commonly accessible stocks, bonds and cash investments. For some time alternatives have been the domain of institutional investors who possess both the scale of capital, and time horizon, necessary to participate. The low-interest rate environment of the latter stages of the 2010s allowed the asset class offering to private investors to increase with multiple launches of listed infrastructure funds, with it quickly becoming an attractive source of income in a low-yield environment.

Capital performance of such funds has suffered at the hands of higher interest rates leaving investors facing multi-year low share prices and a combination of high yields and wide share price discounts to Net Asset Values (NAV). There has been some activity in the sector, with BBGI Global Infrastructure receiving an all-cash offer at a small premium to estimated NAV from a Canadian pension fund. Other infrastructure companies were buoyed by the news, but renewables-focused strategies, with large wind farm portfolios, failed to participate in the rally on the back of reported valuation declines.

Our stock focus article comments on a UK-listed alternative asset manager, Intermediate Capital Group (ICG), which is a constituent of the FTSE 100 and manager of some US$107bn of assets. The last 12 months have been positive for the company, with large asset raises across the key strategies and strong share price performance. With a diverse range of strategies and customers, the company's platform and track record should provide a strong position from which to capture the forecasted increased demand for alternative strategies which range from private debt to equity. The key risk remains in the delivery of attractive performance within ICG strategies to capture future assets, further increased by the use of the company's own balance sheet to provide initial funding and scaling capital to the ICG investment strategies.

In a low-yield environment, liquid alternative strategies became more commonplace in private investor portfolios, and it will be interesting to see how the demand for such strategies evolves. Some will average down, taking advantage of wider discounts and higher yields, while others could very well cut their losses and return to looking at bond markets as a source of yield.

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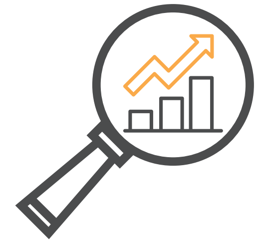
STOCK FOCUS



INTERMEDIATE CAPITAL GROUP

RUTH HARRIS | INVESTMENT RESEARCH ANALYST

Private markets are a rapidly growing area of the asset management industry. Asset owners are increasing their allocations due to the expectation of higher returns and low correlations with traditional public market assets. The trade-off for these benefits has typically been lower liquidity and a lack of transparency, though these long-dated assets have been well suited for investors with long-dated liabilities, typically defined benefit pension funds and other large institutional investors. However, higher returns and a surge in semi-liquid products have also increased demand from retail clients. Global investment firm BlackRock expects the alternatives industry to grow to US$20tn by 2030, from the current US$13tn of Assets Under Management (AUM). With both institutional and retail investors pushing cashflow into private markets, we may see a strong long-term pipeline of AUM for high-quality alternatives managers. Intermediate Capital Group (ICG) is one such manager which appears well-positioned to benefit from the growth of private markets.

Founded in 1989, ICG is a UK-listed globally-diversified private market and asset management business originally set up to offer flexible investment solutions in emerging asset classes. It joined the FTSE 100 in 2020 and, as of the end of 2024, has US$107bn total AUM over 16 strategies covering structured and private equity (44% of AUM), private debt (28%), credit (17%), and real assets (11%). ICG is regionally diversified, with clients across Europe, the Americas, Asia Pacific, and the UK, the majority of which are pension funds and insurance companies.

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ICG scaled rapidly through 2024 in response to a surge in client demand. Over the calendar year, it raised an additional US$22bn of funds, more than twice the amount raised in 2023. AUM increased 27.5% year-on-year, with fee-earning AUM up 8.1% to US$71bn. While part of the AUM is fee-exempt, the majority not yet earning fees is 'dry powder', which is capital committed by clients that has not yet been deployed. In coming years, as this is invested, it will start generating fees for ICG, creating a strong tailwind for future earnings. Over the last five years, ICG has grown AUM and fee-earning AUM at compound annual growth rates of 19.3% and 14.7% respectively.

The company has three strands of income driving returns to shareholders. Management fees are the core component of revenues and are charged as a percentage of invested assets. The base management fee is a relatively resilient and predictable stream of income which is generally not impacted by fund valuations. On top of this, the company receives an additional fee for performance in excess of a minimum hurdle rate of return. Performance fees represent 10-15% of total fee income and are harder to forecast due to the unpredictability of returns. Finally, ICG generates a return from its investment portfolio where it invests in its strategies alongside its clients.

Relative to peers, ICG has a large investment portfolio on the balance sheet demonstrating its 'skin in the game' commitment as a fund manager for clients. Using its investment portfolio, the company can deploy capital to seed and scale investments to support the launch of new strategies. In addition, investing in its more established flagship strategies allow ICG to directly benefit from its own fund management returns.

Looking forward, ICG is aiming to continue to grow both its flagship and scaling strategies to expand and diversify the business. It is working on first-time funds, including Real Estate Asia and Infrastructure Asia, as well as launching ICG Core Private Equity which will be its first wealth-focused strategy. Wealth is a fast-growing market for alternative investments, and ICG could leverage its scale and experience to become a key competitor in the space.

The recent strong performance has driven the share price up 30% over the last year to mid-January 2025. The company also offers a yield of 3.38%, paying a progressive dividend with the board intending to increase the dividend per share by at least mid-single digit percentage points on an annualised basis. Over the last five financial years, ICG grew the dividend at an annual rate of 9.72%. With an attractive dividend policy and track record of increasing distributions in excess of the target growth rate, ICG may be appropriate for investors looking for both an income and the potential for capital growth.

There are risks to ICG's model, principally its large investment portfolio which makes it highly exposed to changes in Net Asset Value (NAV) and the performance of its own investments. Likewise, the investment portfolio is illiquid and would be hard to translate to cash if the company required. Investors could also expect to see ICG's share price fall if the underlying investment performance is poor, as it would be harder to raise future funds from clients weakening the pipeline. However, as demand for private markets is forecast to grow from both institutional and retail clients, ICG may be well positioned to benefit from structural trends in the asset management industry in the years to come. ■

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INSIGHT

INFRASTRUCTURE INVESTMENT COMPANIES

ALASTAIR POWER | INVESTMENT RESEARCH MANAGER

Recent years haven't been kind to the Infrastructure Investment Companies sector. Share prices have suffered at the hands of higher interest rates, with negative capital returns exacerbated by share price premiums moving to discounts against Net Asset Values (NAV). Looking back to the late 2010s, companies within the sector offered investors yield, in a low-yield environment, leading to a swath of new public offerings and scaling opportunities for incumbents. Beyond the yield, they also offered access to physical assets with cashflows showing positive correlation to inflation and operating within a regulated framework. There was a lot to like within the sector given the lack of attractive returns on offer within the classical areas of the bond market such as UK government and high-grade corporate bonds.

Unfortunately, 2025 has started poorly, with higher government borrowing costs and other company-specific issues causing share prices to move lower, discounts to NAV widen, and dividend yields to creep into the 8-10% range.

Share prices trading at material discounts to the reported NAV per share is a hot topic. With equity-focused investment companies, the NAVs are released daily, making the metric a potentially more robust method when considering the value on offer. With listed infrastructure vehicles, however, the infrequent nature of valuations and complexity in their calculation has led to requests for companies to prove their valuations through selective asset sales. In recent months, HICL, International Public Partnership, and Greencoat UK Wind have all completed sales at or above the most recent valuations. One of the more recent NAV tests came in February with a Canadian pension fund making an all-cash offer for BBGI Global Infrastructure (BBGI) for a 3.4% premium to the estimated end of 2024 NAV.

“Income-focused investors now have a wider array of options for generating yield given the higher returns on offer in bond markets, and lower levels of perceived complexity.”

While the takeover bid for BBGI had a positive impact for the sector, with other core infrastructure funds of HICL and International Public Partnerships moving higher on the news, there’s potential for the event to be an isolated occurrence. BBGI’s portfolio has a healthy weighting to Canadian infrastructure assets such as roads, bridges and hospitals, which have a high crossover to the stated aims of the Canadian pension fund. A second consideration comes in the internally managed structure of BBGI, which removes the challenge of acquirers buying out external management contracts.

Within the renewables infrastructure sector, wind farm owners Greencoat UK Wind (UKW) and The Renewables Infrastructure Group (TRIG) released trading updates in recent weeks, providing colour to the drivers influencing recent share price declines. Both indicated downward revisions to energy yield estimates, causing NAVs to decline. On the positive side, dividend distribution amounts were increased with UKW advancing the dividend 3.5%, in-line with the Retail Price Index rate of inflation, and TRIG by 1.1%. In addition, asset sales are enabling the paying down of debt and repurchasing of shares, which on dividend yields of 8.73% and 9.31% respectively, is an attractive use of capital.

The Infrastructure Investment Companies sector extends beyond the names commented on above, with a myriad of options for investors in different sub-sectors from core to renewable infrastructure. Shareholder patience has been tested, with share price total returns meaningfully deviating from the NAV total returns. The question remains; where do we go from here? High current dividend yields and share buyback programs could reasonably be expected to underpin some attractive forward returns, but consideration remains as to where the marginal buyer of shares will come from.

Income-focused investors now have a wider array of options for generating yield given the higher returns on offer in bond markets, and lower levels of perceived complexity. Competition for capital within portfolios is high and there’s likely to be a divide between those happy to average down, repurchasing more shares at lower prices, or looking elsewhere. ■

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