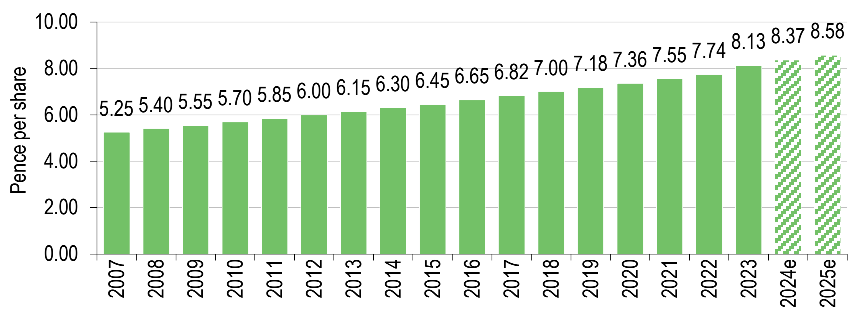
International Public Partnerships

Attractive, lower-risk returns

International Public Partnerships' (INPP's) portfolio continues to deliver consistent and predictable returns for investors, while providing environmental and social benefits for the individuals and communities that are served by its assets. INPP shares offer an attractive yield and the DPS is now in its 17th successive year of growth, with visibility for at least another 20 years. Continuing efforts to narrow the discount to NAV have gained traction, with both realisations and the share repurchase programme stepped up. However, discounts are sector-wide and a greater appreciation of the quality of INPP's cash flows, a decline in interest rates and the prospects for accretive reinvestment may prove more potent factors in a re-rating.

INPP delivers steady and progressive dividends



Source: INPP. Note: 2004 and 2005 are the company's DPS targets.

A prospective net return of more than 9%

Dividend growth in FY23 (5%) and FY24e (3%) reflects the positive impact of strong cash flow linkage to inflation and sets a higher base for future uplifts. Dividends are fully covered by portfolio cash flows and, with no benefit from reinvestment, these are expected to underpin DPS growth for at least the next 20 years. After dividends paid, H124 NAV per share was c 2% lower than at end-FY23, reflecting a c 30bp increase in the portfolio discount rate to 8.7% (vs 8.4% at end-FY23), driven by a higher assumed risk premium. The portfolio remains low risk and the lower NAV is compensated by faster growth as the discount rate unwinds. The expected future return from investing at the current discount to NAV is more than 9% pa.

Low-risk portfolio

INPP has a strong track record of generating consistent financial returns, commensurate with its low-risk investment strategy and we expect this to continue. The portfolio is well diversified and focused on assets that provide essential public infrastructure services. Contracted revenues are typically 'availability-based' or regulated, significantly government backed, uncorrelated with the economic cycle and have minimal interest rate risk. INPP has been listed since 2006 and the investment adviser is Amber Infrastructure, a specialist manager with a well-resourced in-house asset management and origination team. Its ability to actively and responsibly source, manage and enhance INPP's investments is one of the company's core strengths.

Investment companies
Infrastructure

24 September 2024

Price		**127p**
Market cap		**£2,410m**
Total assets*		**£2,852m**
NAV per share*		149.5p
Discount to NAV		15.3%
*As at 30 June 2024.		
FY24e DPS		8.37p
Yield		6.6%
Ordinary shares in issue**		1,896m
**Excludes 10.8k shares held in treasury.		
Code/ISIN		INPP/GB00B188SR5
Primary exchange		LSE
AIC sector		Infrastructure
Financial year-end		31 December
52-week high/low	139.2p	115.4p
NAV high/low	155.2p	149.5p

Gearing

Company borrowing*	N/A
Asset leverage*	68%

*As at 30 June 2024.

Fund objective

International Public Partnerships is an infrastructure investment company, which listed in 2006. It invests in a diversified portfolio of global public infrastructure assets and businesses, with a focus on availability-based or regulated revenues. It aims to provide investors with a consistent and predictable return from assets that meet societal and environmental needs, both now and in the future.

Bull points

- Operates in a structurally supported sector.
- Financial returns are consistent and predictable, and with good inflation linkage.
- Established, specialist, well-resourced manager with a global presence.

Bear points

- Higher capital costs are a headwind to new portfolio investment.
- Sector has re-rated with higher interest rates.
- Differing discount rates across the sector are difficult for investors to assess.

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Growing dividends, fully covered by cash flow

Operationally and financially, the portfolio continued to perform well in H124. DPS of 4.18p was in line with the full year target of 8.37p (+3%) and was 1.1x covered by net operational portfolio cash flow of £105.8m. From 2025, INPP will commence quarterly dividend payments (currently bi-annually) in order to provide investors with a more regular income stream.

Portfolio distributions were slightly below the forecast level (98.5% compared with 100% in the past two years), primarily due to 'outage' at one of the 11 offshore transmission owners (OFTOs) in which INPP is invested. It is currently operating at 50% capacity as a result of an offshore cable fault. The fault appears to be beyond INPP's reasonable control and therefore INPP should be protected from revenue penalties, while the cable remains under the manufacturers' warranty. It is likely to take a few months to return to full service, but INPP expects to recoup the near-term revenue shortfall, with no material financial impact on the company.

Dividend cover of 1.1x excludes receipts from asset realisations. The second tranche of the late 2023 OFTO realisation (£107.8m) was received during the period, taking total cash receipts from investment to £213.6m or 2.5x dividends.

Exhibit 1: Cash flow summary and DPS cover

£m unless stated otherwise	H124	H123
Opening cash	128.6	92.8
Cash from investments	213.6	108.6
Corporate costs (for OCR)*	(17.8)	(17.7)
Net cash financing cost	(1.7)	(3.5)
Net operating cash flows before capital activity	**194.1**	**87.4**
New investment	(85.3)	(108.1)
Investment transaction costs	(1.1)	(2.1)
Working capital advanced	(0.4)	0.0
Net change in borrowing	(65.0)	77.7
Dividends paid (net of scrip)	(77.6)	(74.0)
Buybacks	(13.4)	0.0
Closing cash	**79.9**	**73.7**
Cash dividend cover	2.5x	1.2x
Cash dividend cover excluding cash from realisation activity	1.1x	N/A

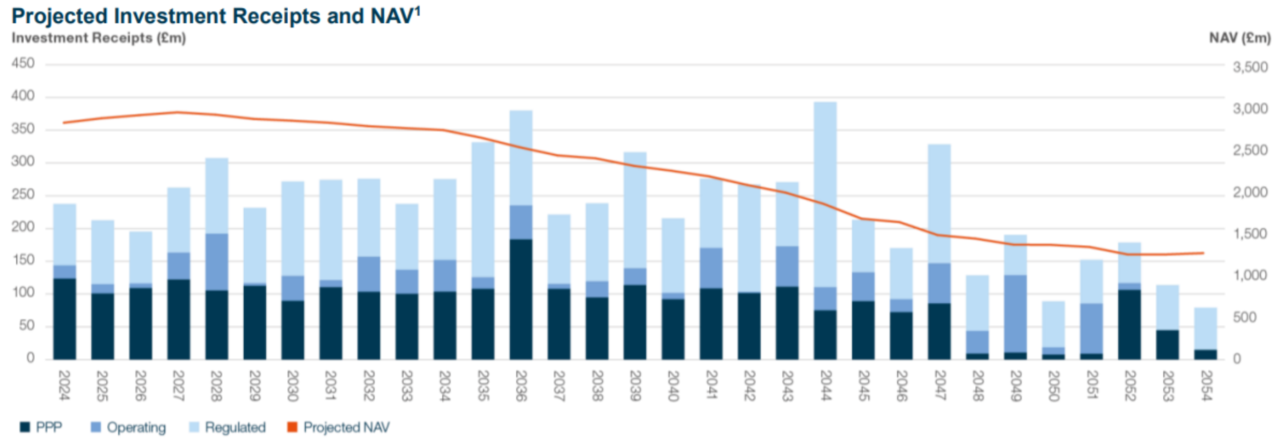
Source: INPP. Note: *Ongoing charges ratio.

Expected long-term cash flows

INPP expects cash flows from the existing portfolio to sustain progressive dividends for at least the next 20 years. This allows for the eventual run-off of those investments in projects that have time-limited, concession-based contracts, most of which have little or no material residual value at expiry (for example, when a school is handed back to the education authority). For such investments, cash flow distributions initially contribute 'income', in the form of dividends and interest, but, over time, will increasingly constitute a return of the capital invested. Without reinvestment, INPP's NAV would also be expected to decline, which is why it is important to look at NAV total return. Aggregate NAV total return since inception in 2006 to end-H124 is 7.3% pa.

Enhanced disclosure from the investment manager illustrates the expected future development of portfolio receipts and NAV. This includes no impact from accretive reinvestment, which is highly likely given the vast global requirement for infrastructure investment.

Exhibit 2: Projected investment receipts and NAV



Source: INPP. Note: This chart is for illustrative purposes only and is not intended to provide any future profit or NAV forecast. Cash flows shown are projections based on the current individual asset financial models and may vary in future. Only agreed investment commitments as at 30 June 2024, and expected cash flows up to 2054, are included. Full details of the assumptions can be found in the H124 Financial Report on INPP's website.

Increased discount rate reduced NAV

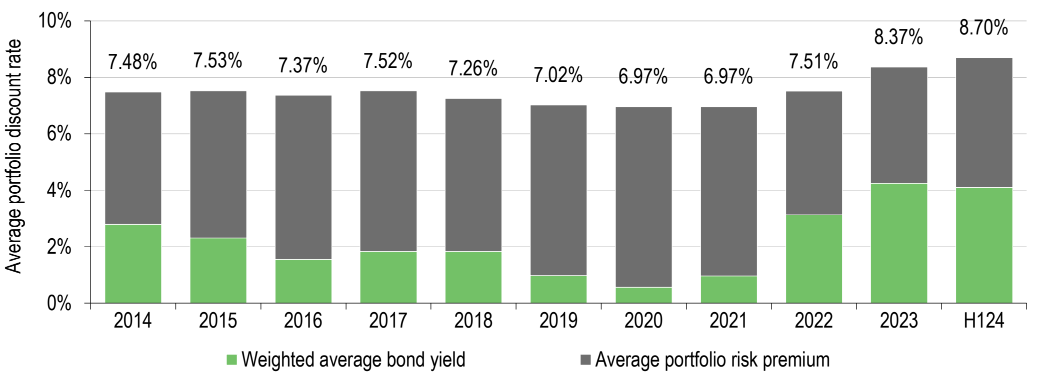
H124 NAV per share of 149.5p was 2.0% lower than at end-FY23, adjusted for dividends paid.

The decline primarily reflects the 30bp widening of the portfolio weighted average discount rate to 8.70% compared with end-FY23.The discount rate increase was, in turn, driven by INPP's decision to lift risk premia, increasing the weighted average portfolio risk premium to 4.60% (vs 4.12% at end-2023), more than offsetting the impact of lower bond yields. INPP says that it has adjusted the investment risk premia to ensure that portfolio valuations continue to reflect recent market-based evidence of pricing for infrastructure investments, notwithstanding the limited transaction activity for assets similar to INPP's.

The long-term macroeconomic assumptions (for inflation, interest rates and the like) applied to valuation have been relatively stable and consistently applied over time, with short-term flexing. This was the case in H124 when near-term inflation assumptions were slightly reduced.

At 8.70%, the discount rate is at a 10-year high, despite the maturing of INPP's portfolio, the quality and reliability of portfolio cash flows, and continuing strong investor demand for infrastructure assets. In H124, the increased discount rate has reduced the current 'fair value' of expected future cash flows, but, assuming no change to the cash flows themselves, it will be offset over time by a faster growth in NAV as the discount rate unwinds.

Exhibit 3: INPP's discount rate history



Source: INPP

Across the sector there is a great deal of variation in the discount rates applied, primarily reflecting differences in investment risk, the quality of cash flows and the ability to manage these. While direct comparisons between companies are inappropriate, it is equally difficult to say with any certainty what the right discount rate should be. INPP provides detailed sensitivity data to assist investors in this respect, but, in our view, the best test of whether any particular discount rate is appropriate is whether or not investment return expectations are met. On this measure INPP has a strong track record.

Disciplined approach to capital allocation

INPP continues to take a very disciplined approach to capital allocation, which is underpinned by its revised return targets and is key to the company's efforts to reduce the discount to NAV. Although the discount to NAV at which INPP's shares trade is not out of line with infrastructure peers or the broader investment company sector, the board remains focused on 'self-help' measures that it hopes will mitigate these broader pressures and enhance the company's value.

Replacing the previous fixed-level return target of 7%, INPP has adopted a more dynamic approach that explicitly considers the relative merits of share buybacks in addition to any pertinent economic or strategic considerations. As noted above, the net return that is currently available to the company on share repurchases is more than 9%.

In this context, INPP has:

- Disposed of c £235m of assets in the past 18 months, all in line with or above the prevailing carrying values, providing tangible evidence to support NAV and accretive capital recycling opportunities. Further disposals are planned to fund the increased repurchase programme (see below).
- Accelerated the growth in dividends (as noted above).
- Fully repaid drawings on the company's floating rate debt facility and subsequently reduced the facility size from £350m to £250m, with a saving on commitment fees.
- Undertaken an accretive share repurchase programme. Introduced in early 2024, this has increased in size from £30m to £60m and will now run until Q125. During H124, INPP acquired 10.8m shares with an aggregate value of c £13m at an average price of 126p. A further c 6m shares, with a value of c £8m have been repurchased since.

The most significant disposal to date has been the realisation of the senior debt positions in four OFTOs, along with an increase in leverage at one of these. INPP says this brings leverage in line with similar investments and that it remains at a prudent level. The senior debt was realised at an undisclosed modest premium to the H123 valuation and the overall transaction realised proceeds of £200m, of which around half was received in H223 and the balance in H124. The sale was accretive to overall portfolio return (as measured by weighted average discount rate) and increased the average portfolio duration. Also in H223, INPP sold its stake in Airband, a leading fibre network operator serving rural and hard-to-reach areas across the West of England, for £12m.

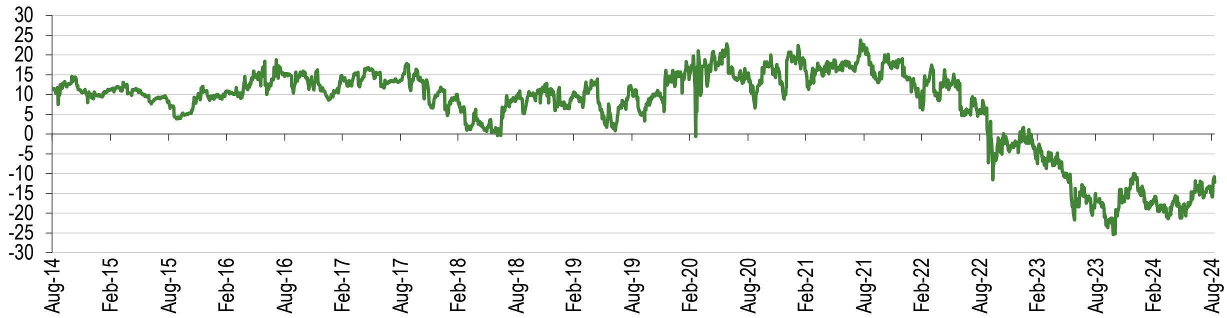
Since the end of H124, a 50% stake in four UK community healthcare facilities (the 'Three Shires Portfolio') has been sold to Equitix (an existing shareholder) for £14m.

In addition to debt repayment, share repurchases and increased dividends, INPP invested £83.5m in H124. Most significant was the c £77m investment in the Moray East OFTO (discussed in detail in our initiation note). The remaining investments included the funding of two long-standing commitments, to Flinders University Health and Medical Research Building and Gold Coast Light Rail Stage 3 projects (expected to be funded between 2024 and 2025). INPP also funded £4.0m of the additional £13m investment commitment it made to toob, a UK fibre-to-premise network operator, with the rest to be fully deployed by 2025. INPP has also agreed to provide BeNEX with an additional £15m of expansion capital. BeNEX, an investor in rolling stock and train operating companies, will acquire additional regional rail operations in Germany.

Discount to NAV has begun to narrow

A combination of the board's pro-active discount management and the anticipation of a decline in interest rates has seen the discount to NAV at which INPP's shares trade begin to narrow, having been as wide as 23% in October 2023. It, nonetheless, remains at c 13%, compared with the c 15% premium at which the shares traded prior to interest rates climbing sharply upwards, and further discount narrowing remains a key focus for the company. Given the scale of need for infrastructure investment, for which private capital will be key, we expect attractive investment returns and long-term growth opportunities to be re-established over time.

Exhibit 4: P/NAV discount since interest rates began to increase (%)

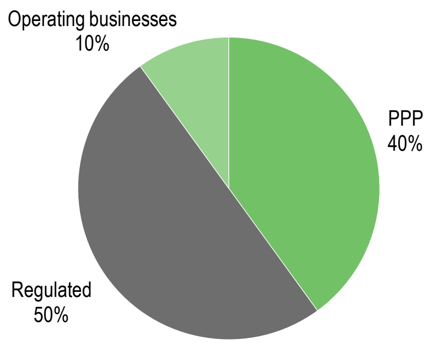


Source: LSEG Data & Analytics

Key portfolio developments

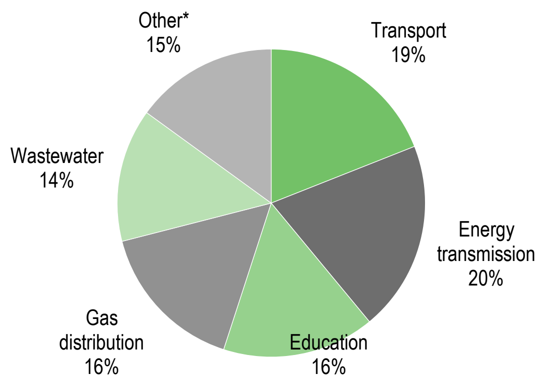
INPP's portfolio comprises over 140 assets, of which the largest number by far are the public-private partnership (PPP) assets, in aggregate accounting for 40% of the portfolio. The majority of projects or companies that INPP is invested in benefit from availability-based or regulated revenues and by fair value, PPP and regulated assets represented 90% of the total and operating businesses the balance.

Exhibit 5: Type of investment (by fair value)



Source: INPP. Note: As at 30 June 2024.

Exhibit 6: Investment by sector (by fair value)



Source: INPP. Note: As at 30 June 2024. *Other includes Family Housing for Service Personnel, health, judicial and digital.

PPP investments (40%)

The company's PPP assets mostly comprise individual concession-based investments, which span various sectors, such as education, healthcare, justice and other social infrastructure sectors across multiple jurisdictions. Revenues are nearly always based on the availability of the asset (rather than the extent that it is used), are long term and are contracted with government or government-backed entities. Most importantly, the PPP projects have maintained a high level of asset availability at 99.8%, with very marginal performance deductions (0.1%). The only notable demand-based revenue exposure within the PPP assets is in Diabolo Rail,[1] the rail link between Brussels Airport and Belgium's national rail network, which has seen passenger numbers recover to above pre-pandemic levels.

The sector has begun to see an increasing focus on 'handback', the process of transferring PPP assets and the associated services back to the public sector at contract expiry. For INPP, the first handback is in 2025 (Hereford and Worcester Courts), representing a very minor 0.1–0.2% of portfolio value, and will not be significant until the mid-2030s.

Amber Infrastructure's capabilities and its sector experience will be important in facilitating an efficient and seamless handback, avoiding remediation costs or reputational risk.

Regulated investments (50%)

The use of economic regulation within the infrastructure sector is most often applied to businesses or assets that are monopolistic in nature and is aimed at protecting the interests of consumers, while ensuring investors are provided with a fair return on their investment via a predictable and transparent regulatory framework. INPP's investments in Cadent (the UK's largest gas distribution network), OFTOs and Tideway (which is building a new 25km 'super sewer' under the River Thames) are each regulated by a statutory independent economic regulator, providing INPP with a relatively high degree of predictability regarding future returns on capital.

The transition to net zero carbon will change the role of Cadent's gas distribution network over time as consumers gradually shift their consumption to lower-carbon alternatives such as renewable electricity and hydrogen, alongside an expected decline in natural gas. Cadent has a critical role to play throughout the transition and beyond, continuing to safely and reliably provide gas and thereby facilitate the increased use of cleaner, albeit more intermittent, technologies; driving reductions in emissions while customers still need gas; and converting and developing the network to enable the distribution of cleaner fuels such as hydrogen to where it is needed when customers are ready. In the near term, INPP says that it continues to perform strongly and in line with expectations and has a stable outlook. The Office of Gas and Electricity Markets (Ofgem) does not expect any major regulatory changes in the next five-year price control period, which starts in 2026 (with Ofgem's final determination in late 2025).

The Tideway development is on track and on budget, with major construction works already completed. The project should be fully operational in 2025, providing significant environmental benefits by capturing 95% of the polluting overflows from London's existing sewage network. INPP does not expect the financial problems of Thames Water, which has a licence requirement to collect revenues from its customers and pass these to Tideway, to have any material impact on its investment. Tideway has statutory and regulatory protections, designed to mitigate any revenue disruption.

INPP has investments in 11 OFTOs, which connect the UK onshore electricity grid to offshore windfarms and are regulated by Ofgem.[2] The revenues generated are not linked to electricity

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1 The share of demand-based revenues in the Diabolo Rail revenue mix is variable over time but INPP estimates it to be c 75% for the remaining term of the concession up to 2047. The remaining revenues are a mix of availability-based payments and contributions that are linked to wider use of the Belgian rail network, subject to a contractual floor. The Diabolo Rail concession agreement provides investors with some demand risk protection and includes a revenue adjustment mechanism that allows the project to seek an increase in the passenger fares it charges where passenger numbers and returns fall below a certain threshold.

2 The Office of Gas and Electricity Markets.

production or price – instead the OFTO is paid a pre-agreed, availability-based revenue stream for a fixed period of time (typically 20–25 years). The regulatory arrangements beyond the existing licence periods are yet to be determined, although Ofgem has indicated its objective of maximising the combined operational lifetimes of both generation and transmission assets where it is economic and efficient to do so. In this respect, it expects incumbent OFTOs to be best positioned to operate transmission assets in an extension period.

Operating businesses (10%)

INPP's investments in operating businesses mainly include Angel Trains (one of the UK's largest rolling stock leasing companies) and BeNEX (an investor in both rolling stock and train operating companies that operate regional passenger rail franchises across Germany), along with a small investment in digital infrastructure companies. On behalf of the company, Amber Infrastructure holds a board position on each business, through which it engages in their governance with the aim of ensuring effective risk management and driving the overall financial, operational and ESG performance of its investments. Angel Trains is performing well, with the train operators (its customers) experiencing good levels of traffic. INPP does not expect any impact on the company should the new UK government proceed with its mooted renationalisation of UK railways.

The German government is currently considering extending its subsidy of regional train travel (Deutschlandticket), which was first introduced in 2023 and has successfully achieved its aim of increasing passenger use. While BeNEX has no direct benefit from this for the first two years from introduction (around 20% of its revenues are normally linked to passenger numbers), the growing popularity of train use is positive for its continued development as it expands its regional footprint.

Attractive implied returns

INPP provides an attractive FY25e yield of 6.6% and visibility of long-term dividend growth. The expected NAV total return is 8.7% pa, reflected in the discount rate. Taking into account the discount to NAV, investment at the current price implies a projected net return of more than 9%,[3] more than twice the 30-year UK government bond yields and well ahead of the 10-year average total return of the UK All-Share Index of 5.7% pa.

Over 10 years to 30 June 2024, INPP's cumulative NAV total return is well ahead of the broad UK equity market and the UK Consumer Price Index (CPI). More recently, and particularly in the past year, INPP has continued to generate a positive NAV total return but in relative terms performance has been more mixed.

Exhibit 7: Cumulative returns to 30 June 2024

Cumulative (%)	One year	Three years	Five years	10 years
INPP NAV total return	1.6	19.8	27.4	93.8
INPP share price total return	1.7	-13.2	6.2	50.1
UK All-Share Index	13.0	23.9	30.9	77.8
UK CPI	2.0	20.5	24.3	33.8

Source: LSEG Data & Analytics, Office of National Statistics, Edison Investment Research

The near-term performance can be seen more clearly in the discrete period data below. As may be expected, INPP's share price and NAV performance have a low correlation with the wider UK equity market over shorter time periods and, as discussed earlier in this note, it has de-rated even as the broader market has re-rated in anticipation, among other factors, of interest rate reductions.

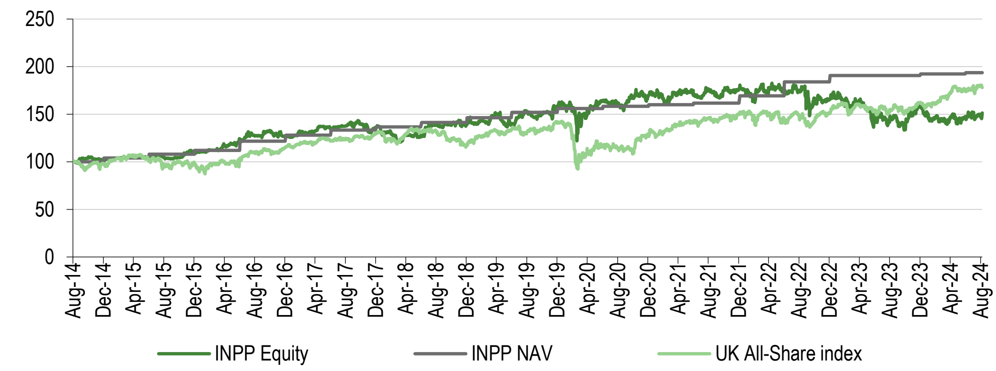
[3] 9.3% at the end-June 2024 share price of 127.6p.

Exhibit 8: Discrete performance

12 months ending	Total NAV return (%)	Total share price return (%)	UK All-Share Index (%)	CPI (%)
30/06/20	4.1	17.8	(13.0)	0.6
30/06/21	2.2	3.9	21.5	2.5
30/06/22	13.8	2.1	1.6	9.4
30/06/23	3.6	(16.5)	7.9	8.0
30/06/24	1.6	1.7	13.0	2.0

Source: LSEG Data & Analytics, Office of National Statistics, Edison Investment Research

Exhibit 9: Consistent NAV returns, well ahead of the broad UK equity market



Source: LSEG Data & Analytics, Edison Investment Research. Note: Total returns in sterling.

Peer group comparison

The AIC Infrastructure sector, of which INPP is a constituent, is a diverse group in terms of the types of assets companies focus on and the risk-return balance that they target, making any comparison of risk-adjusted returns difficult. Looking simply at P/NAV and dividend yield, INPP trades in line with the group average.

HICL Infrastructure and BBGI Global Infrastructure are perhaps the closest peers to INPP, investing in core infrastructure assets in developed markets. However, compared with INPP, the HICL portfolio has a greater exposure to pure demand risk, while BBGI is focused mostly only on PPP.

Compared with INPP, 3i Infrastructure has a more concentrated portfolio, with a much greater exposure to demand-based revenues, albeit in structurally supported growth sectors, which it actively manages for growth.

Pantheon Infrastructure provides a diverse portfolio of operational infrastructure assets, primarily sponsor-led co-investments and an arm’s length ability to influence the management of the underlying assets.

As their names suggest, Cordiant Digital is focused on a range of operational digital infrastructure assets, with a greater focus on growth and an increased risk appetite versus INPP.

GCP Infrastructure invests in UK assets with a focus on debt, including a significant weighting to senior debt.

Sequoia Economic Infrastructure is an international investor in infrastructure debt.

Exhibit 10: AIC Infrastructure peer group (%, unless stated)

Group/investment	Market cap (£m)	NAV TR one year	NAV TR three years	NAV TR five years	NAV TR 10 years	Discount	Ongoing charges	Performance fee	Trailing dividend yield
International Public Partnerships	2,465	1.6	19.8	27.4	93.8	(15.3)	**1.2**	**No**	**6.2**
3i Infrastructure	3,141	11.6	50.1	84.7	288.8	(5.9)	1.6	Yes	3.4
BBGI Global Infrastructure	935	5.1	25.0	40.7	132.6	(9.8)	0.9	No	5.7
Cordiant Digital Infrastructure	605	11.8	35.7			(35.2)	1.1	Yes	5.1
GCP Infrastructure Investment	678	4.2	27.9	33.7	94.8	(27.2)	1.2	No	8.9
HICL Infrastructure PLC	2,593	1.0	21.4	30.6	115.5	(18.6)	1.2	No	6.4
Pantheon Infrastructure	384	13.2				(26.2)	1.4	No	3.8
Sequoia Economic Infrastructure	1,278	11.1	12.1	26.6		(14.7)	1.0	No	8.6
Weighted average	**1,509.8**	**6.4**	**29.2**	**45.8**	**165.7**	**(9.3)**	**1.2**	**-**	**6.0**
Rank	**3**	**7**	**6**	**5**	**5**	**3**	**3**	**-**	**4**

Source: Morningstar. Note: As at 24 September 2024; TR, total return.

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