numis

Investment Companies

06 January 2023

Finding value amongst the discounts

Discounts of Investment Companies (ICs) widened in 2022 as the war in Ukraine and deteriorating macroeconomic conditions hit sentiment. Furthermore, rising interest rates led to a sell-off in "growth" stocks and investors questioning valuations of alternative assets based on discounting long-term cash flows. On average, the sector was on a discount of c.13% at the end of 2022, a level that has not been seen on a consistent basis since the global financial crisis, and briefly during the initial Covid induced volatility. We explain some of the drivers of the discount trends for Equity and Alternative Asset ICs and seek to identify value opportunities where either shares or underlying assets look cheap.

- **Discount opportunities**: We highlight discount opportunities across the ICs universe. We caution that discounts are only one part of the equation and that underlying net asset value performance is usually the biggest driver of returns. However, we believe it is worth highlighting opportunities where there is potential for discount narrowing to be a tailwind. We are focusing on value, but still seek to maintain a quality filter when highlighting these opportunities.
- **Equity ICs**: We identify value opportunities across a range of geographies and sectors. Unsurprisingly the widest discounts are in higher beta sectors such as Technology and Smaller Companies ICs where investors remain wary about the outlook. Amongst Global ICs, we believe RIT Capital stands out as particularly cheap after it suffered an unwarranted sell-off on press commentary yesterday. There may be attractive value in the unloved UK markets, including Temple Bar and Edinburgh IT, as well as UK Smaller Companies ICs, such as Aberforth, BlackRock and Henderson Sm Cos. In addition, we highlight recovery opportunities in China and Vietnam as well as Life Sciences and Tech. Some ICs with a double-discount, such as AVI Global or TR Property, may be attractive options for investors seeking a diversified approach.
- **Alternatives**: Valuations of alternative assets are more subjective and therefore identifying value can be more difficult than for Equity ICs with daily NAVs. As a result, value is often

reflected as much in the underlying assets and valuation methodology as in headline discounts. We believe the discounts in Listed Private Equity are more than factoring in potential asset value declines, particularly for HgCapital Trust and Oakley Capital, and that a lot of bad news is priced into Chrysalis. We highlight infrastructure funds with undervalued cashflows, differentiated portfolios and attractive risk adjusted total return potential, namely International Public Partnerships, Bluefield Solar, Greencoat UK Wind, Aquila European, VH Global Sustainable, Pantheon Infrastructure and Cordiant Digital. The property sector faces headwinds, but we see value in funds such as LXi REIT and Schroder Real Estate. In addition, we note Specialist ICs, in energy and music royalties as well as Syncona and Georgia Capital where assets or shares look undervalued.

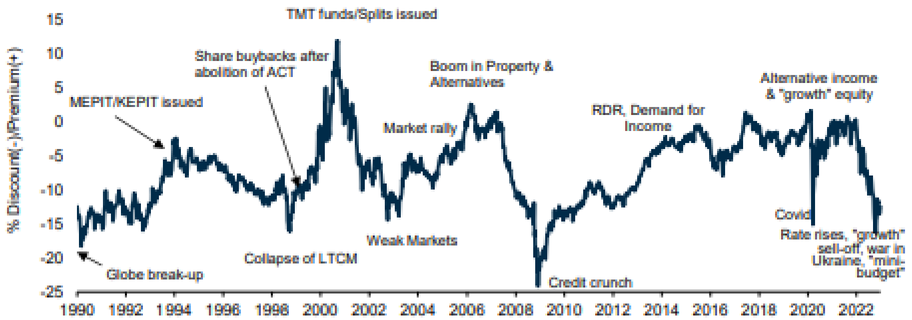
- **Corporate Action**: We also highlight exit opportunities and continuation votes that can be a catalyst for crystallising value through corporate action, as well as several funds in wind-ups that could offer IRR plays.

Discount Trends

Discounts widen close to Covid levels

Discounts in the Investment Companies (ICs) sectors were narrow in the context of recent history in late 2021 driven by strong appetite for growth equities and Alternative Income strategies. Discounts have widened in 2022 as the war in Ukraine and deteriorating macroeconomic conditions hit sentiment, and rising interest rates led to a sell-off in "growth" stocks and led investors to question valuations on assets valued based on discounting long-term cash flows. On average, discounts are now close to levels seen at time of Covid induced volatility and levels not seen on a consistent basis since the global financial crisis.

Figure 1: Long-term discount history – Investment Companies universe



Source: Numis

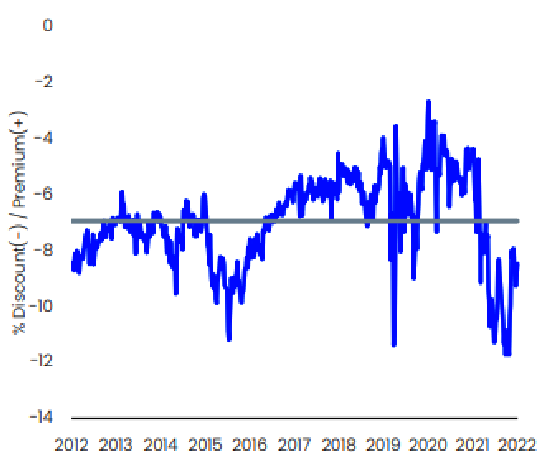
Equity ICs – Broad based discount widening

Equity ICs market cap weighted average discount of 8.5%

Growth-bias hit performance and rating on many ICs

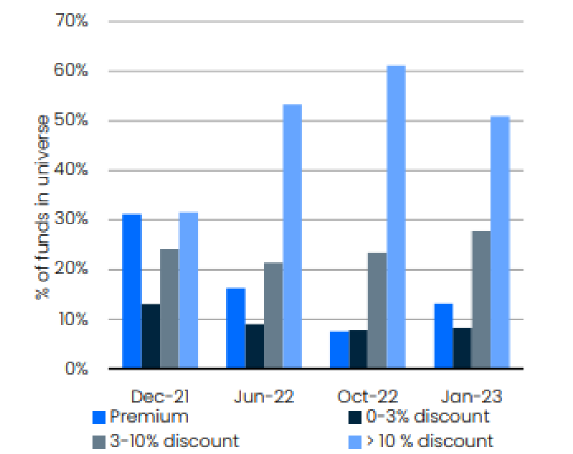
The market cap weighted average discount for Equity ICs reached historically tight levels after covid vaccine rally. Ending 2020 at a 2.7% discount, with many “growth” focused trusts trading on premiums. Since then, the trend has been widening of discounts which moved from 4.4% at the start of the year to 8.5% at the end of December 2022.

Figure 2: Equity ICs – Discounts vs 10 Year Avg



Source: Numis, Morningstar & Refinitiv

Figure 3: ICs universe by discount band over time



Source: Numis, Morningstar & Refinitiv. Note: Combined equity and alternative universe.

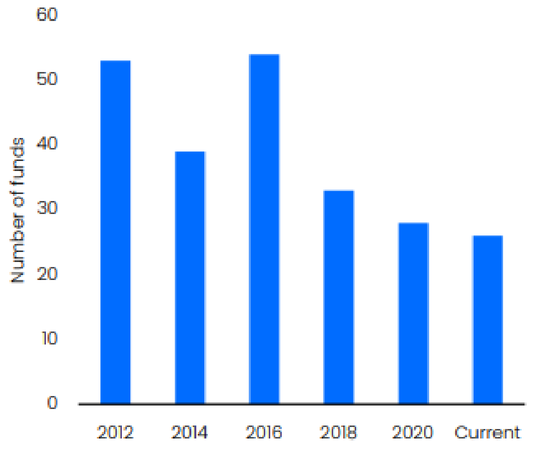
Mini-budget led to volatility

September’s “mini-budget” saw significant volatility with discounts troughing at c.12%, which was as wide as has been seen post-GFC. We have since seen some narrowing, but the current 8.5% remains wider than the 10-year average of 7.0%, indicating there is some value on offer.

Number of ICs on a premium/narrow discount has reduced

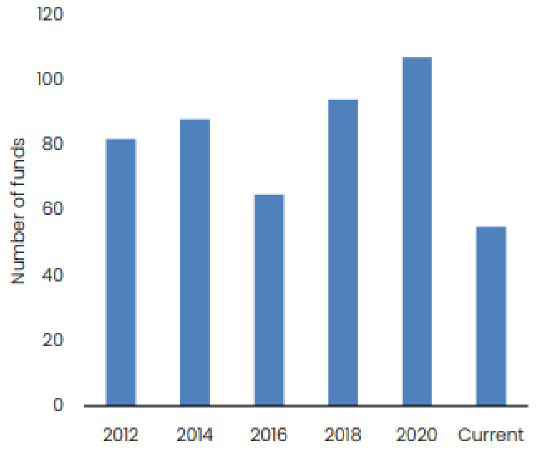
As a result, the number of ICs trading on a premium/narrow discount is around the lowest it has been for years. This has been particularly driven by a derating of growth-focused ICs. The derating of Scottish Mortgage had a meaningful impact on overall averages, given its market cap of c.£20bn at the start of 2022.

Figure 4: Equity ICs with discounts wider than 15%



Historic as at 31 December. Current as at 3 January Source: Numis, Morningstar & Refinitiv

Figure 5: Equity ICs on sub-5% discounts or premium

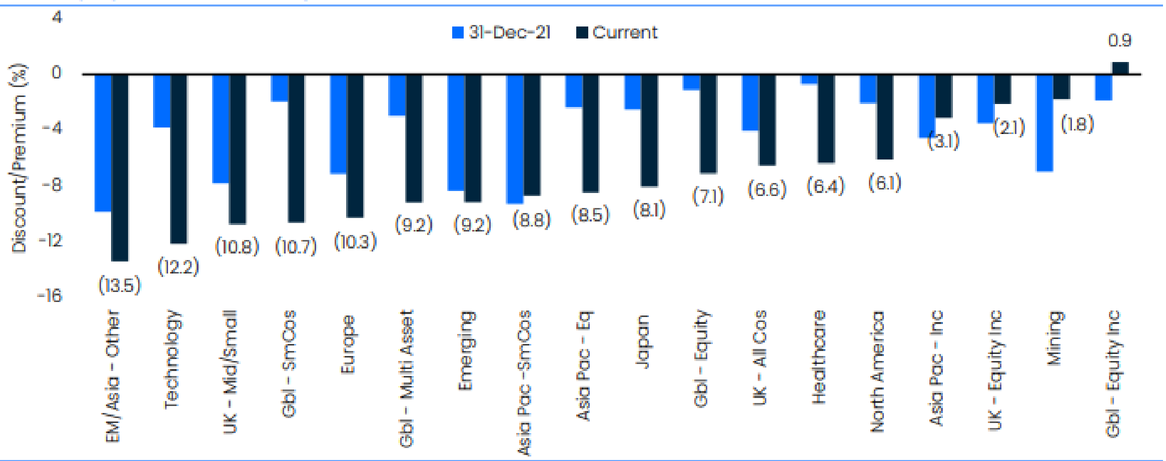


Historic as at 31 December. Current as at 3 January Source: Numis, Morningstar & Refinitiv

Sentiment to Equity Income and Mining has Improved

Most sectors have experienced widening discounts with the notable exceptions being Equity Income ICs across a range of geographies, reflecting improved performance as they naturally have more value-orientated strategies. In addition, strong performance from mining focused ICs, given the higher energy and commodity price environment, has seen discounts narrow.

Figure 6: Equity ICs – Discounts by sector

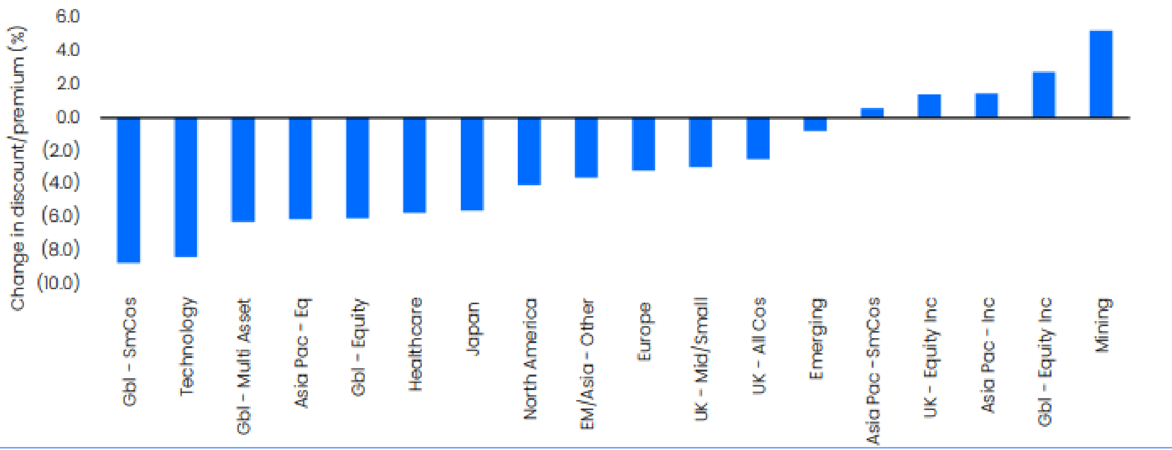


Discounts as at 3 January Source: Morningstar, Refinitiv & Numis

Tech, small caps and UK out of favour

Funds with exposure to technology, growth stocks and small caps were out of favour with investors, typically suffering from a combination of weak NAV performance and discount widening. Technology ICs understandably saw amongst the most significant widening of discounts over 2022, whilst the growth bias of Global Smaller Companies ICs also saw discounts widen meaningfully, as both Smithson and Edinburgh Worldwide moved from premiums to discounts. The negative outlook for the UK economy, means that UK mid and small cap ICs are trading on relatively wide discounts.

Figure 7: Equity ICs – Change in discount by sector



Discounts as at 3 January Source: Morningstar, Refinitiv & Numis

Global Multi-Asset affected by RIT Capital's rating

The Global Multi-Asset sector includes a number of defensively orientated trusts and therefore it is perhaps surprising to see the discount widen, but this largely reflects that RIT Capital Partners, which saw a share price fall of 21.5% last year, and has a market cap of c.£3.4bn.

Macro currently a key driver of ratings

Discounts vary by region depending on sentiment, the nature of shareholder registers, discount controls, and performance. Discounts have historically tended to be widest in sectors where the shareholder register is dominated by institutions (eg, Emerging Markets or Asia) as these investors tend to sell if the discount tightens, which means that retail flows have less impact on ratings. However, the macroeconomic backdrop is currently a big driver of discount levels with retail and institutional investors wary of the outlook for technology and growth stocks meaning they are currently amongst the widest discounts.

Retail demand evaporated in times of stress

In recent years, strong demand from retail investors has fuelled a narrowing of discounts, particularly for strongly performing growth strategies. This consistent demand led to questions about whether discounts would stay structurally narrower. Unfortunately, we saw this retail buying evaporate and reverse at times of stress, such as during covid and around the mini-budget. However, we still believe that over the long term retail demand is likely to support narrower discounts than we have seen in the past, especially when combined with more widespread and active discount controls, as well as an increased appetite to merge or wind-up sub-scale funds.

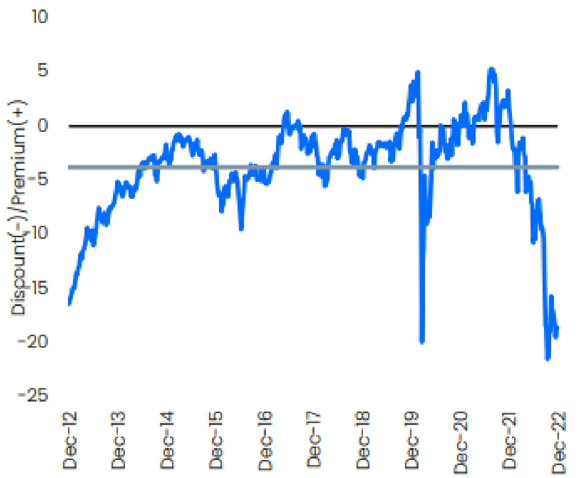
Alternatives – Derating in the face of rising rates

Stark derating in Alternatives

Reassessing alternative income in a higher rate environment

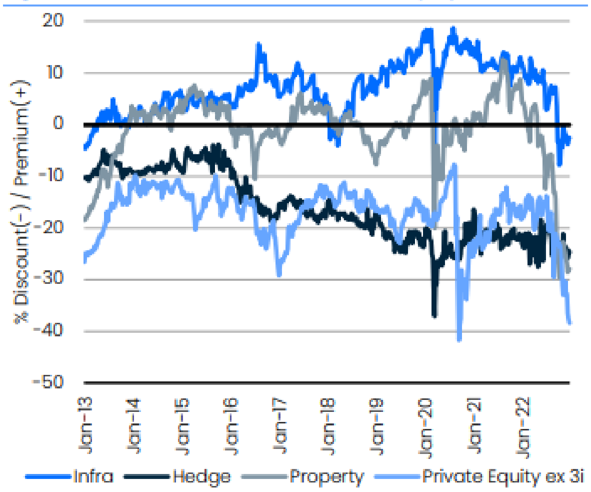
The derating of Alternative ICs is even more stark, although this partly reflects that NAVs often have a significant lag. Property, and in particular those subsectors with narrower net initial yields, were impacted by concerns of the impact of rising interest rates on valuations and debt costs, as well as yield opportunities elsewhere such as within fixed income.

Figure 8: Alternative ICs – Discounts vs 10 Year Avg



Source: Numis, Morningstar & Refinitiv

Figure 9: Alternative ICs – Discount history by sector

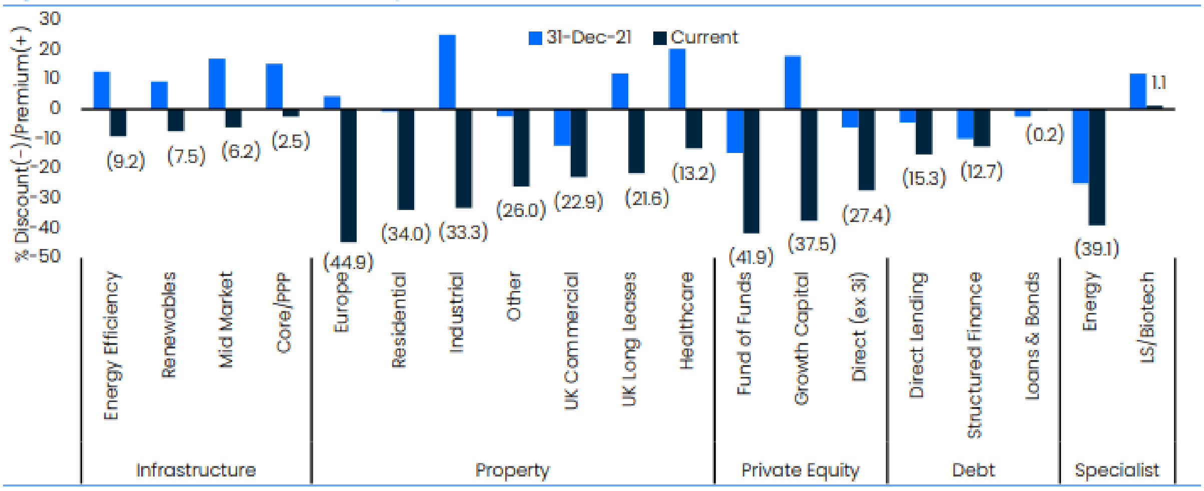


Source: Numis, Morningstar & Refinitiv

Growth Capital funds amongst the weakest performers

Growth Capital funds (Schiehallion, Chrysalis, Molten Ventures, Seraphim Space) were amongst the weakest performers in share price terms as they moved from significant premiums to wide discounts. The only sub sector within the Alternatives space seeing a tighter rating was Loans & Bonds, which includes several funds with exposure to floating rate assets.

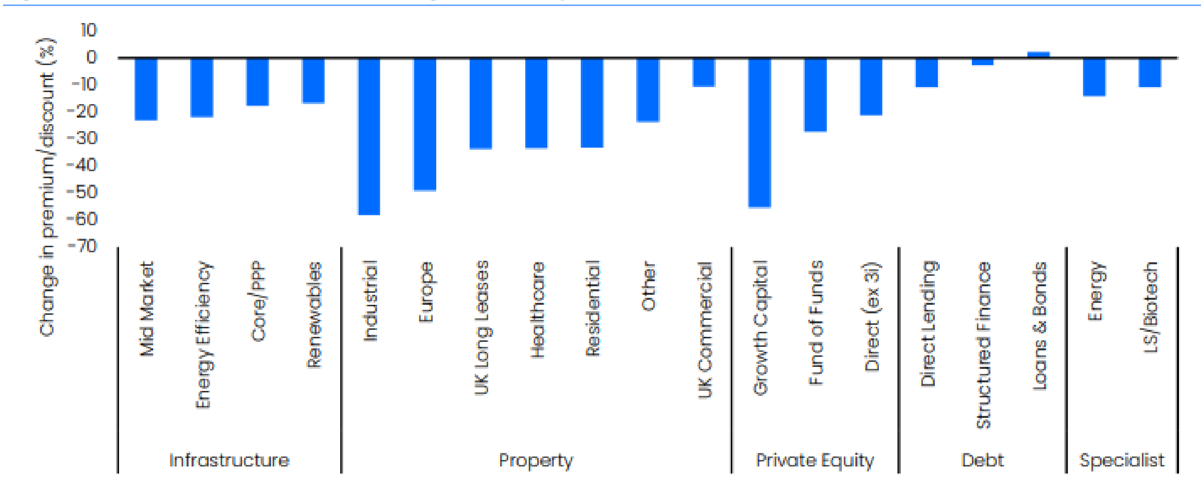
Figure 10: Alternative ICs – Discounts by sector



Discounts as at 3 January Source: Morningstar, Refinitiv & Numis

The rise in interest rates and volatility around the September mini-budget led Infrastructure ICs to move to discounts, which for many funds was the first time since launch.

Figure 11: Alternative ICs – Discounts changes in 2022 by sector



Source: Morningstar, Refinitiv & Numis

Rising discount rates mitigated by other drivers

Infrastructure sub-sectors have seen a relatively uniform change in rating. This shift in sentiment in part reflects the rise in global bond yields and interest rates, with its expected impact on discount rates, a major input of infrastructure portfolio valuations. Many funds have begun to increase discount rates although, we note the impact on NAV has been largely mitigated by other positive valuation drivers.

High inflation linkage remains a key attraction

There is clearly an ongoing repricing of all real assets and competition for investors' capital has increased, with multi-asset investors now viewing fixed income and bonds as viable return generating options. That said, we believe that Infrastructure ICs continue to offer attractive risk-adjusted return characteristics. In particular, portfolios which have a high level of inflation and/or contractual downside protection should continue to deliver stable performance. We also point to active management which could provide scope for the asset class to deliver more attractive returns than other alternatives.

Buying opportunity for scarce and essential assets

We see many of the current discounts as an opportune entry point to own scarce and essential assets, which deliver high quality cash flows. In addition, we see scope for discounts to close once market expectations for interest rates settle.

Real estate discount moves varied

Discount moves were varied more across real estate sub-sectors as specialist sectors such as Industrial, Long leases and healthcare moved from premiums to discounts. Diversified commercial ICs were already trading on discounts at the start of the year, in anticipation of capital value declines which happened in H2 2022 and are likely to continue in H1 2023.

Discount Opportunities

We seek to highlight discount opportunities across the Investment Companies universe. We caution that discounts are only one part of the equation and that underlying net asset value performance is usually the biggest driver of returns. However, we believe it is worth highlighting opportunities where there is potential for discount narrowing to be a tailwind. We are focusing on discount, but still seek to maintain a quality filter when highlighting these opportunities.

Equity ICs

A better environment for active management

In recent, years style factors have been the major driver of performance. We believe the environment where interest rates are more persistently higher should be a better environment for active management. We believe there is potential for both growth and value managers to make money and that greater rewards will come from stock selection, rather than styles.

FTSE All Share had a solid year

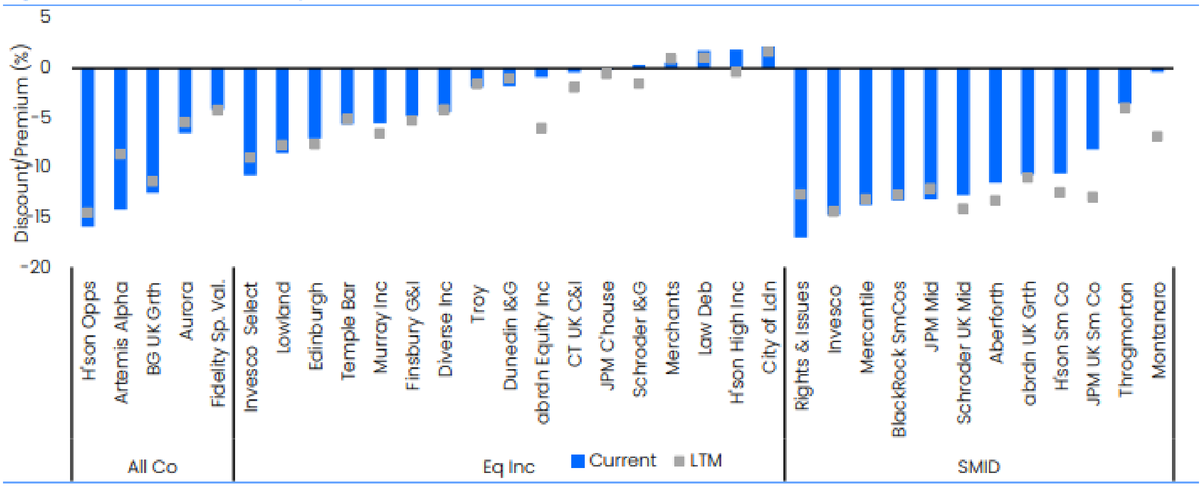
UK – Value in an unloved market

Relative to major global indices, the UK performed well in 2022, with the FTSE All Share up 0.3%. This was driven predominantly by the fact that many of the large caps in the index are international businesses and "value" stocks, including energy, financials and mining companies which comprise a significant portion of the index. The strength of the US Dollar versus the pound also improved returns for Sterling investors. Amidst this backdrop, the UK Equity Income sector proved to be resilient and was one of the best performing sectors in 2022.

UK market attractively valued

Despite a year of resilient performance, the UK has lagged global markets significantly in recent years and trades on a relatively cheap valuation. We believe this makes it a potentially attractive market. Most investors have been allocating more globally in recent years, but we believe there may be value in UK exposure, particularly given the risk that a period of Sterling strength could negatively impact overseas exposure. The pick-up in M&A is a potential route to crystallising some of this value.

Figure 12: UK ICs – Discount by fund



Discounts as at 4 January Source: Morningstar, Refinitiv & Numis

Temple Bar and Edinburgh IT offer some value

Several funds in the sector trade around NAV but there is some value compared to peers in Temple Bar (6% discount), which follows a value approach, as well as Edinburgh IT (7%), which seeks to build an "all weather" portfolio of growth, value and recovery stocks.

Out favoured value play

Fidelity Special Values (6%) has seen its discount narrow somewhat in recent weeks, however we rate the manager highly. Alex Wright's track record is exceptional, with NAV total returns of 203% (12.6%

pa) versus 97% (7.5% pa) for the FTSE All Share, driven through a contrarian approach in which the manager looks for unloved stocks where the downside is limited and there is a catalyst for change.

Derating has created potential M&A targets

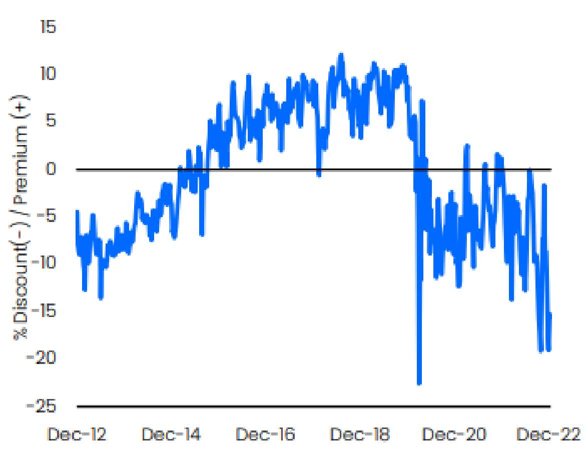
Looking further down the market spectrum, 2022 painted an entirely different picture for UK small/mid-caps. The FTSE 250 (-17%) and the NSCI ex ICs index (- 18%) saw heavy losses, whilst the "growth" bias of many UK small and mid-cap ICs led them to underperform their benchmarks. Aberforth Smaller Companies, which has a distinct value bias, was the exception, but the shares still offer some value on a c.12% discount. At the "growthier" end of the market, despite a difficult period we continue rate the management team of Henderson Smaller Companies (11%) highly and note that Neil Hermon has had experience managing in previous cycles. The "Growth At a Reasonable Price" approach has served the fund well over the longer-term. BlackRock Smaller Companies (13%) offers relative value, particularly versus its stablemate BlackRock Throgmorton (4%). We think that the sector is well placed for a recovery and would highlight the strength of the balance sheets of many of the underlying companies compared to previous cycles, whilst attractive valuations create an opportune breeding ground for M&A.

Increased disclosure should be well received

Global – RIT Capital a stand out opportunity

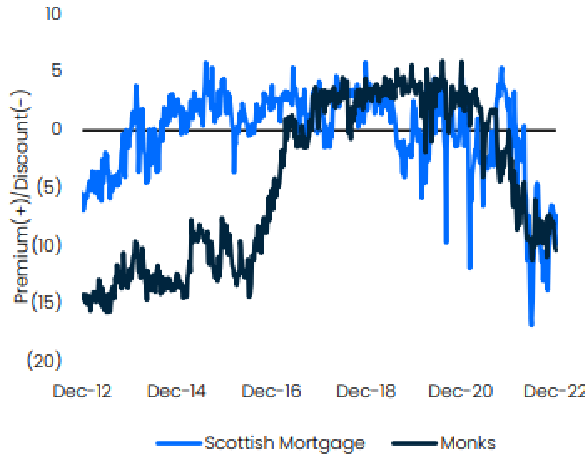
We believe that RIT Capital is an attractive option for defensively minded investors. It has a record of limiting downside in market declines, whilst participating in the market upside. The shares were weak in early December, as concerns were raised about lags in the portfolio valuation and their potential impact on NAV. We believe investors have been somewhat reassured after the manager increased disclosure on the nature of the portfolio, including confirming that over 90% of its private assets were valued at September valuations in the November NAV. In addition, the manager gave greater detail of the drivers of returns and its outlook which we believe should be well received by investors. The shares recovered from their mid-December lows, but were down nearly 10% yesterday due to a Questor article in the Telegraph. We believe this is a significant overreaction and that the current c.17% discount is an extremely attractive entry point for both investors with a defensive mindset and those looking for an attractive total return opportunity.

Figure 13: Discounts – RIT Capital Partners



Source: Numis, Morningstar & Refinitiv

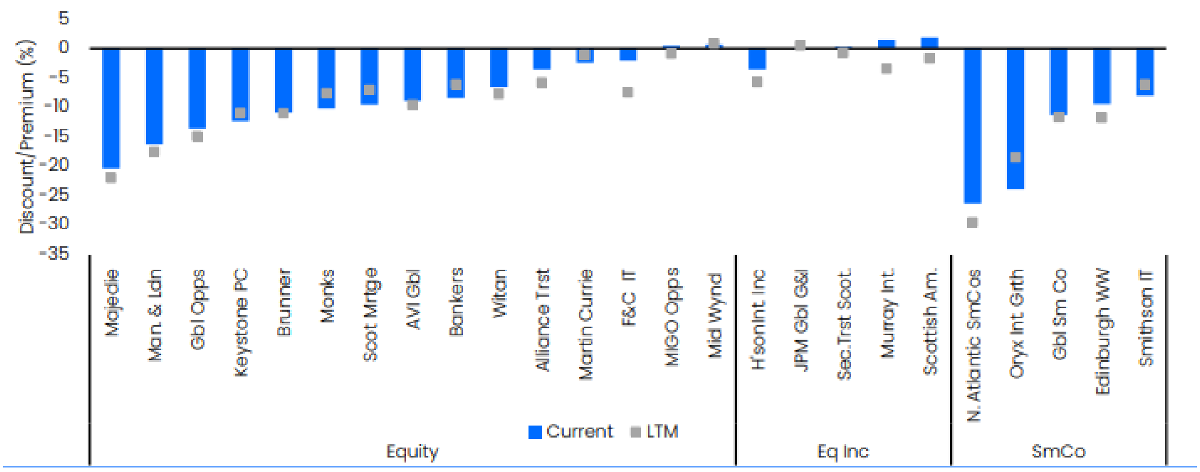
Figure 14: Discounts – Monks and Scottish Mortgage



Source: Numis, Morningstar & Refinitiv

The outlook for "growth" stocks remains unclear and there are as many views as investors. For those looking for "cheap" exposure to growth stocks we believe that Monks is an attractive way to gain exposure to a diversified portfolio of growth stocks, currently on a c.11% discount, close to its widest in the last year. Scottish Mortgage is also close to a c.10% discount, although it has been wider in recent times. We would caution that the underlying asset performance will be a more meaning driver of returns in the long-term.

Figure 15: Global ICs – Discount by fund



Source: Morningstar, Refinitiv & Numis

Innovation should help to drive revenue growth

Technology – Better value but keeping a close eye on revenues/earnings

2022 was a difficult year for the technology sector. The hopes of a "Santa rally" were dashed with the Nasdaq down c.8% in December, in Sterling terms, as investors continue to weigh up the impact of higher rates on tech stocks. Smaller companies, particularly non-profitable ones without near term earnings prospects, were the target of the market sell-off, however in recent weeks we have seen larger cap companies such as Tesla, Amazon and Salesforce struggling. In January 2023, Tesla sold off on the back of missing order estimates, whilst Salesforce and Amazon became the latest companies to announce plans to reduce its workforce. Clearly the technology sector is not immune to worsening macro conditions and there is likely to be spend scrutiny in the medium term, but they are well placed to continue to grow their revenues faster than other sectors due to continued innovation and the ability of software to deliver efficiencies. In addition, we believe that a lot of the risks facing the sector have been priced in and we would highlight Allianz Technology and Polar Capital Technology as highly appealing options on c.10% discounts.

Small cap biotech a recovery opportunity

Life Sciences – Potential for returns regardless of macro backdrop

Another sector that has endured a tumultuous time of late is Biotechnology. Biotech Growth has struggled, given its bias towards small caps which have underperformed larger peers and exposure to China. Small caps are now trading at historically low valuations and present a compelling recovery opportunity. We believe the sector benefits from positive tailwinds including favourable regulation, positive demographic changes, strong innovation and M&A. As a result, of these trends we believe the sector has the potential to deliver returns regardless of the general economic conditions. Biotech Growth currently trades on a c.9% discount and benefits from an experienced, well- resourced management team and we think that the current discount offers value. We also believe International Biotechnology is an attractive way to access the market, although it offers less value trading on a c.2% discount.

Top down thematic view combined with bottom-up analysis

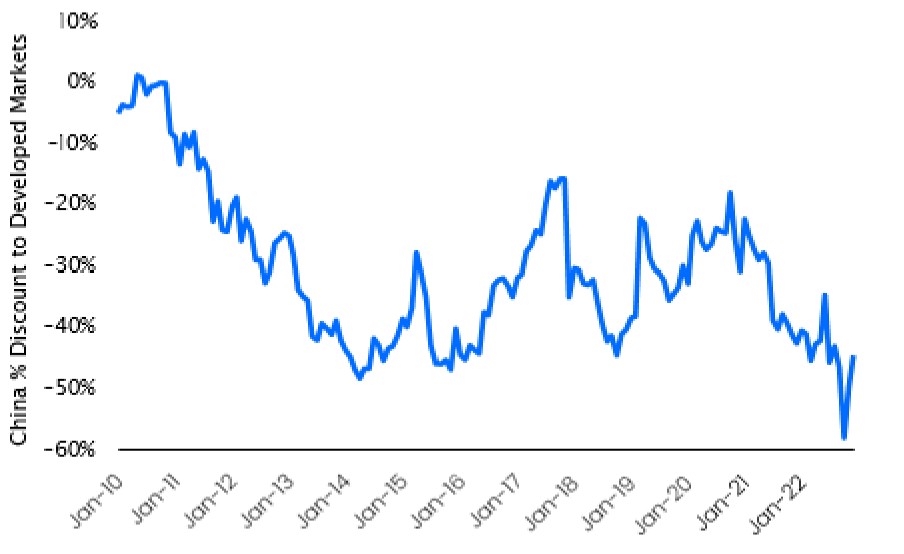
Bellevue Healthcare offers an annual redemption opportunity at close to NAV, for up to 100% of share capital. The shares have derated following the last redemption in November 2022 and are now trading on a c.8% discount which offers good value. The fund has a strong track record since launch in December 2016, despite a period of recent underperformance, generating NAV total returns of 133.9% (18.2% pa) compared with 101.3% (14.7% pa) for the MSCI World Healthcare Index. The managers combine a top down thematic/macro view with bottom-up fundamental analysis resulting in a concentrated portfolio seeking to take advantage of a rapidly evolving sector.

Green shoots in early 2023

China – Reopening trade has further to go

China's equity market has experienced a difficult couple of years suffering from the fallout from government policy in relation to Covid-19, a clampdown on technology companies, and issues with overleveraged property developers. However there appears to be signs of a recovery. The zero-Covid policy has been hastily reversed, and in early 2023 regulators approved a $1.5bn fundraising for Ant Group's consumer unit. Authorities have also approved the most significant batch of new blockbuster game releases in months. This has helped the MSCI China Index to rise 33% in Sterling terms since the end of October. Momentum appears to be building, although there may be some short-term volatility given the impact of a significant wave of Covid infections. Despite the recent recovery, Chinese equities trade at a c.45% discount to Developed markets versus an average of c.30% since 2010 which we believe remains interesting. abrdn China stands out as a value play on a c.14% discount whilst we believe Fidelity China Special Situations (10% discount) is an attractive option for investors comfortable with the risk profile (the fund is 25% geared and has a small/mid cap bias).

Figure 16: China - Valuation discount to Developed Markets



Source: Datastream. P/E ratio of MSCI China vs MSCI World index.

Trip to Ho Chi Minh City reinforced our positive view

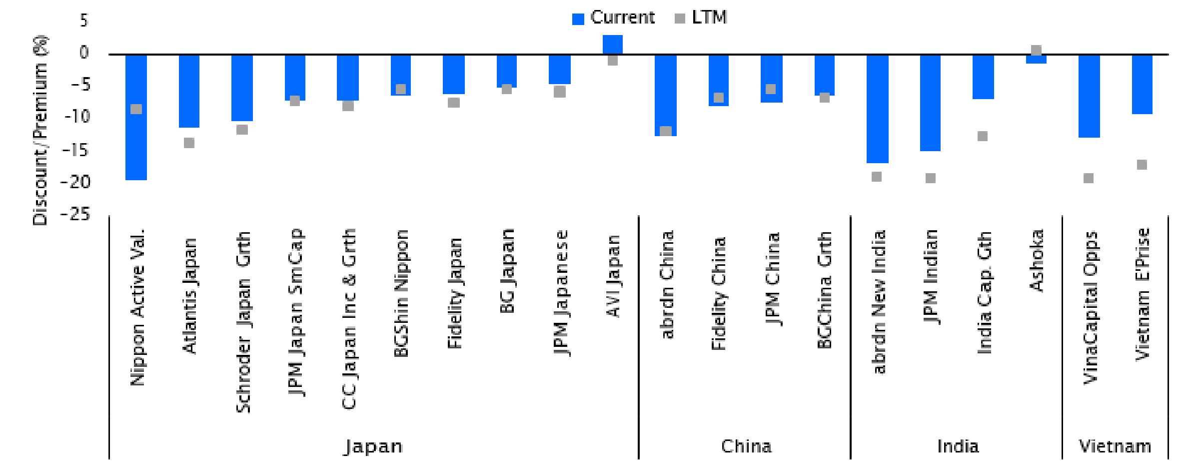
Vietnam – Long-term growth at better value after market sell-off

We have long been convinced that investors should have exposure to Vietnam, as the country's economy is uniquely positioned generating healthy economic growth (6.5% expected in 2022) supported by positive demographics with a population of 97m and an emerging middle class, as well as strong foreign direct investment and being a manufacturing export hub that is benefitting from the diversification of supply chains away from China. Our trip to Ho Chi Minh City for the VinaCapital conference in October reinforced our view.

Policy action should help ease fears

After two very strong years, Vietnam sold off in 2022 partly driven by significant volatility in real estate stocks due to difficulties in developers accessing credit. Ultimately, we do not view this as a terminal issue, indeed the government is drafting amendments to the decree to extend corporate bond maturities. We continue to believe Vietnam offers an attractive long-term fundamental growth story, with the potential MSCI Emerging Markets index inclusion as a positive technical tailwind which will help drive a rerating from the current decade low valuations. As a result, we have both VinaCapital Vietnam Opportunity (14% discount) and Vietnam Enterprise (11% discount) on our recommended list.

Figure 17: Asia-Pacific (single country) ICs – Discount by fund



Discounts as at 4 January Source: Morningstar, Refinitiv & Numis

Underlying portfolio trading at a 33% weighted average discount

Double discounts

We believe it may be an opportune time to invest in AVI Global based on the double discount. The shares trade on a c.9% discount to NAV, but we believe there is significant value in the underlying portfolio of funds and holding companies, which trade on a weighted average discount of 33% at 30 November. This has narrowed somewhat from 37% at October which was around the widest it has been since the aftermath of the global financial crisis. The fund offers discounted exposure to cheap investment companies such as Pershing Square and Third Point, as well as basket of Listed private equity fund. In addition, the portfolio includes European holding companies, such as EXOR and Aker, and alternative asset managers, KKR and Brookfield AM.

Double discount

TR Property also offers the potential to benefit from a "double discount" given many of its underlying listed property holdings trade on wide discounts to their NAVs. The fund trades on a c.10% discount which we believe is an undemanding entry point for fund providing investors a one-stop shop for exposure to listed property stocks and a manager with a strong track record.

Historically wide underlying discount

MIGO Opportunities does not offer a double discount, trading around NAV, but the underlying portfolio discount recently reached a historic wide level, at 29%. The fund benefits from an experienced manager in Nick Greenwood, who seeks funds that have fallen out of favour and trade on wide discounts, with the potential to narrow through a change in sentiment and/or corporate action.

Alternative ICs

Subjective valuations in Alts

Valuations of alternative assets are typically more subjective and therefore identifying value can be more difficult than for Equity ICs with daily NAVs. As a result, value is often reflected as much in the underlying assets and valuation methodology as in the headline discount.

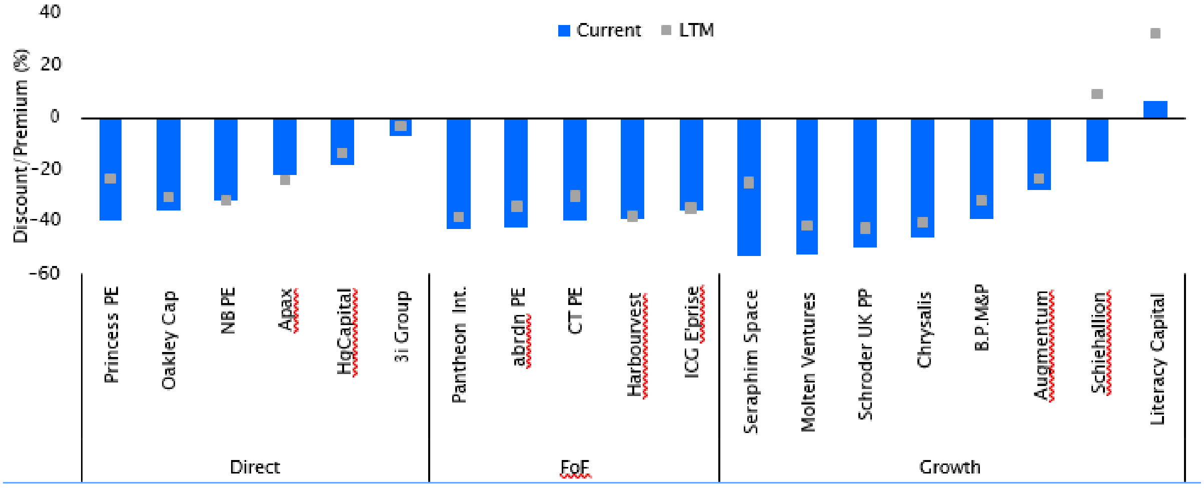
We will outline in future notes our favoured ICs by asset class, but believe we provide various opportunities which we believe offer value either on an asset basis or given the discount to NAV. We focus on companies with quality managers and underlying assets.

Listed PE should command a higher allocation in our view

Private Equity – Discounts imply overly pessimistic outlook

We believe Listed Private Equity (LPE) funds offer investors an attractive risk/return opportunity that should command a higher allocation in many investors' portfolios. Companies are staying private for longer but many investors struggle to access this opportunity. Regulators are seeking to increase investment to private and illiquid assets through work with DC pension schemes and LTAFs. We believe Listed PE funds provide a tried and tested route to access private assets through a selection of high-quality managers with a record of outperforming equity markets. In addition, there is currently an attractive valuation opportunity with wide discounts factoring in significant potential NAV declines, whereas we believe portfolios have been, and will continue to be, more resilient than investors expect.

Figure 18: Private Equity ICs – Discount by fund



Discounts as at 4 January Source: Morningstar, Refinitiv & Numis

Mission critical software

HgCapital Trust remains one of our highest conviction recommendations in the Investment Companies sector. We believe the nature of the companies in the Hg portfolio is significantly different from the blue-sky technology that many investors are most concerned about. Hg focuses on dull tech that seeks to automate business processes and increase efficiency, which should be in high demand in environment where labour costs are rising, whilst the business crucial nature of the software provided leads to high levels of recurring revenues and pricing power. As a result, we believe the 18% discount offers value, and is supported by continued exits at material uplifts to carrying value.

Conservatively valued portfolio

For those wary about valuations, we believe Oakley Capital Investments is an attractive option. Oakley has an average entry multiple of just 9.6x as its opportunities are generally sourced through its network of entrepreneurs, with 89% being primary deals and 80% being uncontested, and its willingness to undertake complex deals, such as spin-outs. The portfolio valued at just 13.7x EV/EBITDA, whilst growing strongly delivering average EBITDA growth of 18% H1 2022. Oakley Capital has a strong track record through a well-defined strategy focusing on mid-market European buyouts in the Consumer, Technology and Education sectors, demonstrated by OCI's NAV total returns of 23% pa over the last five years. We continue to see the 36% discount as excessive and unwarranted.

Pantheon and HarbourVest both solid choices

Among the diversified funds of PE funds, we favour stocks with well-resourced management teams, and mature portfolios that are generating strong net cash flows. In this regard, we believe that Pantheon International (43% discount) and HarbourVest Global PE (42% discount) stand out. Both funds invest via a combination of Primary, Secondary and Direct/Co-investment, and are differentiated from the peer group by having exposure to Venture Capital/Growth investments (37% for HVPE and 25% for Pantheon). Pantheon in particular has made a conscious decision to increase its allocation to coinvestments, as well as single-asset secondaries, increasing concentration to individual assets that the manager believes can deliver greater growth potential whilst maintaining its diversified approach. ICG Enterprise also offers value on a 37% discount with a focus on defensive growth companies that can deliver in a variety of conditions.

Capital Markets Day provided a reassuring insight

Chrysalis Investments has endured a torrid time over 2022, reflecting the changing environment and volatility in listed markets. That said, we cannot help but feel that the fund is coming through the worst of it. We believe the portfolio has exposure to a number of exciting growth sectors including Insuretech, Fintech and Cybersecurity. We believe the focus on companies with strong uniteconomics leaves the portfolio relatively well placed as the market shifts from growth to profitability. At 30 September, 35% of the portfolio was profitable, 32% funded through to profitability based on company budgets, and a further 14% have a cash runway of c.two years. The remaining 19% were either expected to either be funded by Chrysalis or other investors, or will be sold. Chrysalis' Capital Markets Day gave investors a reassuringly detailed insight into the businesses, as well as the valuation methodology. The sale of the positions in THG and Revolution Beauty draws a line under weak performers that had attracted a disproportionate amount of attention, and importantly, there has been clarity on the performance fee structure going forward. In our view there is an excessive amount of bad news factored into the current share price, and brave buyers at the current discount of c.48% will be rewarded over the medium-to-long term, albeit volatility is to be expected.

Infrastructure – Value in high quality cash flows

Of the thirty listed infrastructure funds we analyse, we highlight the following discounts as offering an attractive entry point to a range of high quality asset bases. We believe each fund has scope to deliver attractive returns in the current environment both in absolute terms, and relative to the relevant peer group.

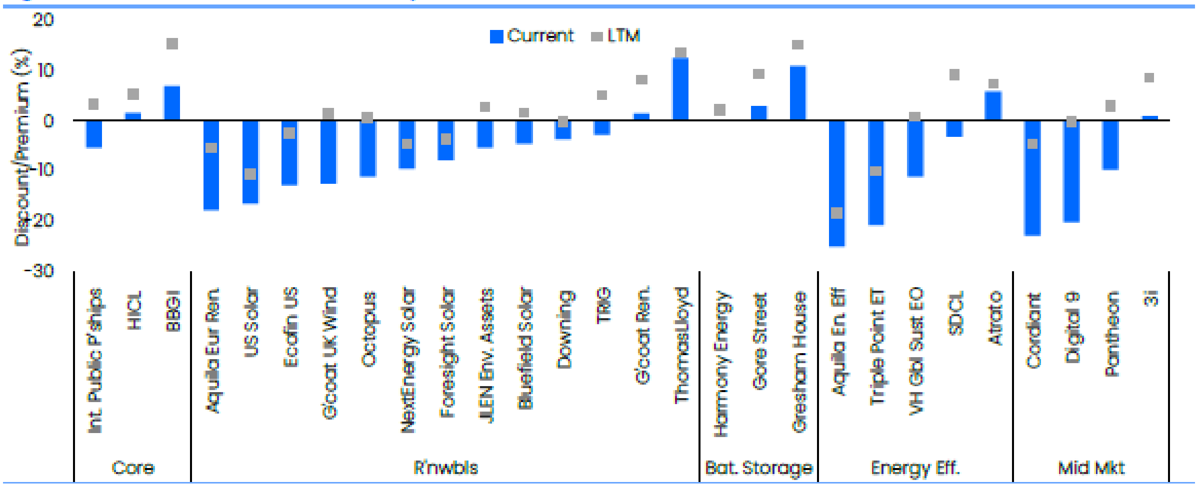
INPP our core recommendation

Core infrastructure: International Public Partnerships (INPP) is our core recommendation and we believe it currently offers value trading on a 4% discount and 5.1% yield (fully covered), which compares to an average premium of 4% over the last 12 months, and a 6% premium for BBGI and 2% premium for HICL Infrastructure. In addition, for the vast majority of time since launch the fund has traded on a premium. We believe the rating does not reflect the quality of cashflow which is generated from the portfolio, which includes a high level of contractual inflation protection (70%). Since its IPO in 2006, INPP has delivered NAV total returns of 7.9% pa, in excess of its 7.0% target, with a healthy underpin from income and a track record of growing dividends by c2.5% pa.

Strong origination capabilities a key differentiator

We believe the fund has benefited from the manager's strong origination capabilities, generally through multi-year processes, which has given it exposure to a differentiated set of assets. This includes sectors that we believe are attractive in the current environment, such as offshore transmission cables (OFTOs) and the Thames Tideway "super-sewer", which combined represented c 34% of the portfolio at 30 June. These assets have favourable characteristics, including downside protection in OFTOs, and no weather or power price risk. In addition, they represent a good example of innovative procurement methods (particularly Tideway) showing the managers ability to work effectively to deliver on government agenda. Moreover, these investments provide a notably positive impact on the environment, bolstering INPP's already strong ESG credentials.

Figure 19: Infrastructure ICs – Discount by fund



Discounts as at 4 January Source: Morningstar, Refinitiv & Numis

Unjustified discount for Aquila European Renewables

Renewables: Discounts are widespread across the renewable funds as rising discount rates and regulatory interference has weakened investor sentiment, although share price returns in 2022 remain strong given the backdrop of high power prices. Notably, Aquila European Renewables (AERI) is trading on a 18% discount (5.6% yield), the widest of the sector. We do not believe this is justified. The portfolio is arguably more conservatively valued than a number of its peers, gearing is low, equity is now fully deployed and construction assets have been largely de-risked in H2 2022. All else equal, we would expect this to have a positive impact on NAV in the coming quarters. We calculate NAV total returns since IPO (to 30 Sept NAV) of 7.14% which is at the top end of the target rage (6.0-7.5%).

Consistent track record since listing

Bluefield Solar Income Fund (BSIF): While the shares do not trade on the widest discount, at c.5%, we point to the attractive yield, 6.2%, which is ahead of the sector average. We also remind investors of the consistently strong returns that have been delivered from the high quality portfolio. Since IPO, we calculate that BSIF has delivered NAV total returns of 10.6%, one of the highest in the renewable sector (UKW is highest at 10.8%), a high proportion of which has come from income. A key driver of this has been management's strong origination which has sourced assets at attractive prices, with a high proportion of projects having been acquired through the construction phase. Moreover, management showed strong capital discipline between 2017-2020 when pricing in the market for its target assets was aggressive. We also credit the performance to balance sheet optimisation which has helped to drive an effective power price hedging strategy allowing the fund to capture power price highs and mitigate lows. Management has continued to build a proprietary pipeline of opportunities, which we believe bodes well for future returns in a competitive market.

UKW discount appears too wide

Greencoat UK Wind (UKW): Trading on a discount of 13% to our NAV estimate (yielding 5.1%) appears too wide to us. Management has already adjusted its discount rate to the highest level of the peer group at 8.2% which implied 470bps premium over the relevant 10 year gilt. Moreover, we remind investors that UKW's business model to focus solely on wind assets (although increasingly offshore) as well as targeting a higher proportion of merchant power exposure, has to date resulted in the strongest NAV total return since IPO of the peer group of 10.8% pa.

High target returns from lowly geared and differentiated portfolio

Energy transition: We continue to highlight VH Global Energy Opportunities (GSEO) which offers one of the highest target returns (10%, including a 5% yield) in the listed infrastructure peer group. Moreover, this is expected to be delivered from a lowly geared and differentiated portfolio of global, energy transition assets. Indeed, to date only one of its projects has a very modest level of debt equivalent to c.3.4% of GAV (at 30 June). Since its IPO in February 2021, the manager has shown strong execution skills, converting the pipeline it presented to investors which to date has delivered returns ahead of target with scope for further upside. In its interim results, dividend cover was healthy at 1.1x (excluding refinancing gains on its US asset). Once commitments are operational this is expected to rise to c.2.0x., giving comfort in the target dividend of 5.0p (5.0% yield). We view GSEO as unique amongst the infrastructure peer group, not only by virtue of its global energy transition focus but the investment strategy to commit to build programmes which are expected to have a notable impact in each jurisdiction and solve for a structural supply/demand gap in each market.
The relatively high level of construction which stood at 41% at 30 Sep August bodes well for future NAV progression. Construction programmes are typically short-term and management seek to de-risk each commitment by signing EPC contracts which provide protections to cost over-runs and other potential return detractors. We believe the c.13% discount is an attractive entry point.

Digital Infrastructure sells-off

Digital: Digital infrastructure is a relatively new segment in the listed infrastructure fund universe following the IPO of two funds in 2021: Digital 9 Infrastructure (DGI9) and Cordiant Digital Infrastructure (CORD). The shares enjoyed strong performance post IPO, but 2022 was a disappointing year for shareholders with both DGI9 and CORD falling below their IPO price in H2 2022, leaving them trading on discounts of 20 and 24% respectively. In part, we believe this reflected the perceived concentration of investments in central and eastern Europe for CORD, an area of geopolitical sensitivity. We also believe the relatively limited disclosure by CORD has been a barrier to attracting new investors. The change in sentiment towards DGI9 reflects the uncovered dividend and perceived implications for portfolio performance following the change in lead fund managers.

Cordiant shares look attractively priced

At current levels we believe that CORD shares look attractively priced. It is not one we would buy solely for income (current DPS target is 4.0p representing a yield of 4.8%). However, we believe the manager has a number of options to drive value from the existing portfolio. To this end, the interim results analyst meeting provided helpful insight into two of the operating companies and the opportunity set before them. It also confirmed that dividend cover is healthy. Although the board confirmed that buy-backs were not likely, which may disappoint some investors, we believe a combination of meaningful communication improvement and potential for crystalising value from part of the portfolio should it wish to prove valuations could bolster the share price.

NAV upside as acquisitions move from cost to fair value

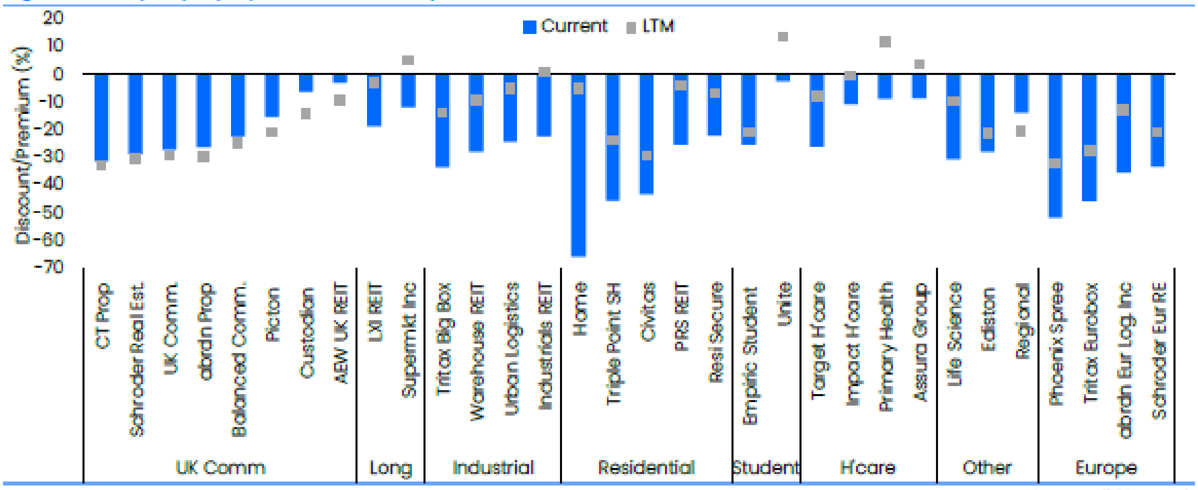
Diversified mid-market: We also highlight Pantheon Infrastructure (PINT) which currently trades on a discount of c.10%. It is not our preferred play for income (4.2% yield, based on 2023 target) and there is more limited track record for the portfolio given the November 2021 IPO, but we take some comfort that management has demonstrated timely execution of its pipeline and there should be NAV upside as acquisitions move from cost to fair value. There was modest evidence of this in Q3. At 30 September, c.38% of the invested portfolio (8 assets) was held at cost.

Repricing in property markets likely to continue

Property – A lot of bad news priced in

The steep increase in gilt yields and borrowing costs during 2022 has triggered an inevitable repricing within commercial property investment markets which will likely continue through H1 2023. However, we believe the prospects for further near-term NAV weakness have been more than baked-in to current share prices of property Inv Cos, with an average discount of 28% across the sector at year-end.

Figure 20: Property Equity ICs – Discount by fund



Source: Morningstar, Refinitiv & Numis

Dynamic management team with proven track record

We highlight value in LXi REIT (c.17% discount), which owns a diversified portfolio of key operating assets that are let on long-term leases with a high proportion of rents (c.64%) subject to CPI or RPI linkage. The fund's dynamic management team have a proven track record having delivered 10.1% NAV TR since launch through accretive forward fundings, profitable recycling of capital as well as actively extracting value from the existing portfolio.

Successful refinancings a potential catalyst

Having historically traded at a premium prior to September's mini budget, we believe the current discount represents a very attractive entry point. With an aggregate £734m of borrowings due to expire over the course of 2023 and 2024, debt refinancings will be a near term priority for management. We believe the announcement of successful refinancing that provides clarity on finance costs could be a catalyst for a re-rating.

Value in Schroder Real Estate

We believe the diversified commercial peer group also continues to offer value and highlight Schroder Real Estate (27% discount) in particular. The NAV will not be immune from further weakness in the near-term, but the portfolio is 49% weighted to industrial assets which continue to witness favourable occupational markets. Furthermore, the fund's 2019 debt refinancing, which was costly at the time, is now proving beneficial as SREI has among the cheapest debt in the peer group, with limited near-term refinancing risk. This should protect earnings and potentially provides scope for further dividend growth, which combined with delivery of accretive management initiatives, could act as a catalyst for an improvement in the rating.

Scope for a recovery in underlying listed assets

Specialists – Niche value opportunities

We believe Syncona is a compelling opportunity. The headline discount is just 6%, but we believe there is value in the underlying listed assets, which have generally performed poorly since IPO, and that unquoted holdings are conservatively valued. In particular, Autolus (2% of NAV) recently released impressive data in its Phase 2 FELIX study of obe-cel for the treatment of relapsed and refractory adult acute lymphoblastic leukaemia. However, its share price remains suppressed given this required it to raise additional capital. We believe there is scope for a recovery in portfolio holdings and that the management team has a strong in its life sciences portfolio.

Well managed legacy conventional assets driving performance

Riverstone Energy continues to trade at a c.48% discount to NAV despite very strong performance in 2022 (the fund was amongst the top performing Investment Companies) driven predominantly by its legacy conventional assets which were beneficiaries of surging oil and gas prices during H1 and helped by the share buyback programme. The legacy conventional assets, which made it through the tough years of Covid-19 are generally well managed, with lean operations, and have deleveraged, allowing them to generate significant free cash flow. 2023 is unlikely to be quite as strong, however we believe Onyx Energy may distribute material dividends back to RSE which could lead to the options of investing in further decarbonisation opportunities, which have derated given their growth equity bias, as well as bolstering firepower for the already significant share buyback programme. Furthermore, the potential merger between Hammerhead and DCRD provides more options for both harvesting cash flows and potentially realising the investment as part of RSE's transition process.

Positive sector dynamics in music royalties

We believe there are a number of positive dynamics for the music royalty funds that provide a positive backdrop for revenues, given the continued growth of streaming, price rises from streaming platforms and the CRB ruling increasing songwriters share of income. That said, we can understand investors wariness about the fund given the rise in interest rates and concerns about whether there has been a "land grab" for assets with insufficient focus on pricing. The NAV is highly sensitive to discount rates (Hipgnosis 0.5% increase to the discount rate would decrease NAV by 7.9%, Round Hill 1% increase in discount rate would lead to 17.8% decrease in NAV) but we note that current discount rates were already above other market participants. The funds are now trading at wide discounts, c.40% for Hipgnosis Songs and 34% for Round Hill Music, which we believe is a much more attractive starting point for investors providing a cushion against some of the potential concerns. It will be interesting to see if these funds attract the attention of non-mainstream ICs buyers, given the discounts and the amount of capital that is being deployed in the asset class. We note that Hipgnosis has a continuation vote due in 2023 which may act as a catalyst for corporate action and a narrowing of the discount.

Strong-track record but discount appears entrenched

We believe that Pershing Square offers value on a 33% discount given the manager's strong track record. The discount is somewhat entrenched and we do not see immediate catalysts for it to narrow, although we note that the Board/manager have highlighted the possibility of moving the listed to the US as a holding company. This would take a long time and be highly complex, but Bill Ackman has indicated he is not afraid of complexity.

Overlooked and heavily undervalued

Georgia Capital: The Georgian economy grew 10.0% in 11M22 in real terms, and is expected to grow 9.0% in 2023 according to the IMF. Georgia Capital provides exposure to a portfolio of exciting companies in growth sectors spanning Banks, Healthcare, Education, Renewable Energy and Insurance amongst others. Bank of Georgia was in the top five best performers in the FTSE All Share last year (excluding takeovers) delivering a 69.0% share price total return, and has since announced it expects to receive $137m as part of a legacy claim settlement, equivalent to 33% of Numis' 2022 estimated profits before tax, or c.10% of its market cap. We believe this has the potential to put it on the radar of a wider range of fund managers, and may prove to be the catalyst necessary to drive a rerating in Georgia Capital's >60% discount to NAV.

Strong income and capital growth

Debt – Value in floating rate assets

We believe there are several funds that offer a potentially attractive return profile, particularly in a higher interest rate environment, such as TwentyFour Income and TwentyFour Select Monthly Income, although both are trading on premiums and issuing new shares, therefore not explicitly "value" plays, but we believe the underlying assets are attractively valued with scope to strong income and capital growth.

Proven strong credit underwriters

There is some value in BioPharma Credit, which is trading on a c.6% discount. We believe the managers have proved themselves as strong credit underwriters during a difficult period in the biotech sector. The fund yields 7.3% based on ordinary dividends, or c.12% including a recent special dividend. The fund changed its discount control mechanism in November, which has removed the immediate catalyst to narrow the discount, but it has remained active in buying back which we believe limits downside to the discount.

Value in CLOs

In addition, Fair Oaks Income offers value on a c.14% discount. The fund offers exposure to a mixture of CLO equity (86% of the portfolio) and CLO debt notes (14%) meaning it has a relatively high risk/return profile. A regular buyback should limit discount volatility.

Portfolio issues to work through in infrastructure debt

Infrastructure debt funds moved to c.20% discounts during the course of 2022. We believe they offer value when they trade on double-digit discounts, as there remain some issues to be worked through in their portfolios. GCP Infrastructure behaves more like an infrastructure/renewable equity fund given its sensitivity to power prices. It also has significant exposure to social housing, although it is seeking to reduce this. It is currently trading on a c.10% discount. Sequoia Economic Infrastructure is on a c.7% discount which we would not expect to narrow significantly until there is a resolution to its troubled investment in Bulb Energy. There are a number of debt funds in wind-up, which we cover below.

Wind-ups, Corporate Action and Special Situations

Corporate action can present investors with a variety of opportunities to help crystalise value. In particular, exit opportunities, tender offers, manager or mandate changes and in some cases a wind-up or M&A.

More scope for M&A in Alts

We believe there is much greater scope for M&A in the ICs sector now that a significant portion of the sector is invested in alternative assets which have more subjective valuations, are less liquid and may be attractive to non-traditional IC investors, such as pension funds.

Potential for corporate action in 2023

Several debt funds have been taken-out in recent years as valuation methodologies led to conservative NAVs and share prices were depressed. JLIF Infrastructure was subject to a £1.4bn takeover in 2018 when it briefly moved to a discount. We note that US Solar is in a sale process for its assets. We believe it is interesting that Hipgnosis Songs is on a c.40% discount, whilst Blackstone are deploying significant capital in the asset class with the manager outside of the listed funds. The issues and suspension of Home REIT may leave it open to corporate action.

Wind-ups

In some cases, winding-up may be the most appropriate option for a fund, particularly when a significant portion of the shareholder register has indicated they are seeking an exit.

Wind-ups can offer attractive IRRs

For some investors a wind-up can offer an attractive IRR play, particularly if an attractive entry point is created by selling from investors wary of holding a vehicle that will become increasingly small and potential delist. Several Debt funds have proposed realisation strategies over the last few months, including VSL Specialty Lending, NB Global Monthly Income, Starwood European Real Estate Finance, whilst ICG Longbow UK Property Debt remains in the process of returning capital. If investors can get comfortable with the underlying assets these can generate an attractive income and return of cash as they winddown.

Continuation votes

Most funds have some form of continuation vote, although these typically pass without incident. We have highlighted a number of funds trading on discounts that have continuation votes over the next year. We expect most to pass, but the vote can be a stimulus for corporate action.

Table 1: Upcoming continuation votes

Fund	Discount	Mkt Cap	Cont vote	Details
Chrysalis Investments	(46.2)	476.1	AGM Nov 2023	Every 3 yrs
Hipgnosis Songs	(41.8)	1,059.3	AGM 2023	Every 5 yrs
abrdn European Logistics Income	(36.8)	298.0	AGM 2023	Every 3 yrs
Target Healthcare REIT	(26.5)	519.1	AGM Nov 2023	Every 5 years. Ordinary resolution
Crystal Amber	(26.3)	81.2	AGM Nov 2023	Every 2 yrs
Oryx International Growth	(21.4)	153.3	AGM Aug 2023	Special resolution to wind-up every 2 yrs
Aquila European Renewables Income - £	(17.8)	330.7	AGM 2023	Every 4 yrs
Jupiter Green	(17.6)	42.5	AGM Sep 2023	Every 3 yrs thereafter
Henderson Opportunities	(16.1)	83.1	AGM Mar 2023	Every 3 yrs
Atlantis Japan Growth	(15.6)	73.8	AGM Aug 2023	Every 4 yrs
VinaCapital Vietnam Opportunity	(14.2)	746.3	AGM Dec 2023	Every 5yrs, special resolution to wind-up
City Natural Resources Growth & Income	(14.0)	129.8	AGM Nov 2023	Annual
European Opportunities	(13.6)	737.5	AGM Nov 2023	Every 3 yrs thereafter
Aberdeen Japan	(13.0)	71.6	AGM May 2023	Continuation vote if avg discount>10% in 90 days to FY end (31-Mar)
Brown Advisory US Smaller Companies	(12.3)	144.6	AGM Nov 2023	Every 3 yrs
Supermarket Income REIT	(12.1)	1,267.5	AGM 2023	Every 5 yrs thereafter
abrdn New Dawn	(11.5)	301.3	AGM Aug 2023*	*annually if discount >15% in 90 days to 30-Apr
Schroder BSC Social Impact	(11.4)	78.9	AGM 2023	Every 2yrs
Aberforth Smaller Cos	(10.6)	1,126.6	AGM Mar 2023	Every 3 yrs
India Capital Growth	(8.8)	124.5	AGM July 2023	Every 3yrs. Subject to performance conditions
JPMorgan China Growth & Income	(8.2)	294.5	AGM Jan 2023	Every 5 yrs
Gabelli Merger Plus	(7.8)	53.8	AGM Dec 2023	Every 5 yrs thereafter
Baillie Gifford Japan	(7.1)	717.2	AGM Nov 2023	Annual
JPMorgan Emerging Markets	(6.9)	1,284.2	AGM Nov 2023	Every 3 yrs
Geiger Counter	(6.1)	59.0	AGM Mar 2023	Annual
SDCL Energy Efficiency Income Trust	(5.5)	1,095.4	AGM 2023	Every 3 yrs
Fidelity European	(5.4)	1,324.3	AGM May 2023	Every 2 yrs
Bluefield Solar Income	(5.1)	831.6	AGM Nov 2023	Every 5 years. Continuation vote if 3Y returns do not exceed targets

Data as at 3 January Source: Morningstar & Numis

Weaker performers more susceptible to corporate action

Funds that are languishing on a discount and have also underperformed respective benchmarks may be more susceptible. European Opportunities (14% discount) has underperformed the MSCI Europe over one, three and five years, whilst it has consistently traded on a double-digit discount in recent years. This is in part driven by the high-profile fraud and collapse of Wirecard. abrdn Japan (11%) has also lagged its benchmark, TSE 1st section, over multiple time periods. A continuation vote will be triggered if the discount exceeds 10% over the three months to 31 March 2023, which may be a catalyst for more corporate action. It will be interesting to see if there is any pressure on Hipgnosis Songs at its continuation vote, expected at the AGM in late Q3, given the weak share price performance from the significant derating to a >40% discount. Exit opportunities can present attractive opportunities to obtain a full or partial exit at close to NAV. In addition, they can be a trigger for more substantial corporate action.

Table 2: Upcoming Exit Opportunities

Fund	Date	%Prem/ (Disc)	Net Assets £m	Details
Exit Opportunities				
CVC Income & Growth	Mar-23	(5.2)	127	Semi-annual tender facility for up to 25% (max 15% each tender). Prev. quarterly (50% annual limit)
Diverse Income	May-23	(2.5)	340	Annual redemption facility for up to 100% of share capital at NAV
Miton UK Microcap	May-23	(6.9)	65	Annual redemption facility for up to 100% of share capital at NAV
Weiss Korea Opportunity	May-23	(0.3)	125	Two yearly exit for up to 100% of share capital at NAV
BB Healthcare	Nov-23	(8.3)	931	Annual redemption facility for up to 100% of share capital at NAV
Value & Indexed Property	2024	(23.0)	128	Exit at NAV less costs
Miton Global Opps	Sep-24	0.2	84	Three yearly exit for up to 100% of share capital at NAV
Strategic Equity Capital	2025	(6.1)	150	Full exit opportunity
TwentyFour Income	Sep-25	2.1	677	Three yearly exit for up to 100% of share capital at 2% discount
BlackRock Frontiers	2026	(7.5)	272	Exit at NAV less costs in 2026
Performance Triggered Tenders				
Templeton Emerging Mkts	Mar-24	(12.0)	1,956	Tender at NAV if underperforms MSCI EM in 5y to 31 March 2024
Schroder Japan Growth	Jul-24	(11.9)	286	25% tender offer at NAV if underperforms Topix by 2% pa to 31 July 2024
JPMorgan Indian	Sep-25	(17.3)	765	25% tender offer at NAV if underperforms MSCI India in 5y to 31 March 2025
BlackRock Latin American	Dec-25	(7.2)	118	Tender offer for 25% share capital at 2% discount if underperforms MSCI EM Latam over 3Y to Dec 25 by >0.50%
Asia Dragon	Aug-26	(11.0)	568	25% tender offer at 2% discount if underperforms MSCI AC Asia ex Japan in 5y to 31 Aug 2026
Scottish Oriental Sm Cos	Aug-26	(11.1)	333	25% tender offer at 2% discount if underperforms MSCI AC Asia ex J SmCap in 5y to 31 Aug 2026
Fidelity Emerging Markets	Sep-26	(11.6)	627	25% tender offer if underperforms MSCI EM in 5y to 30 Sep 2026
abrdn New India	Sep-27	(17.7)	398	Tender offer for 25% share capital at 2% discount if underperforms over 5Y to March 27
Discount Triggered Tenders				
Third Point	Mar-24	(16.8)	559	Tender 25% of NAV at a 2% discount wider than 10% in the six months to 31 March 24; Another in 2027
Artemis Alpha	Sep-24	(8.6)	111	Three yearly tender offer for 25% of share capital at 3% discount

Data as at 3 January Source: Numis Securities Research