

OUTCOMES
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PERFORMANCE }

HERMES INFRASTRUCTURE

LGC INVESTMENT SUMMIT

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For professional investors only


HERMES
INVESTMENT MANAGEMENT

Hermes Infrastructure

AUM c£4.1bn¹

Across a shared platform

£2.8bn NAV²

15 investments

Team

Over 130 years' experience

An overview

- ▶ Specialist infrastructure manager with a diversified portfolio of predominantly UK assets
- ▶ Ultimately majority owned by BT Pension Scheme, one of the UK's largest occupational pension schemes
- ▶ Hermes Infrastructure offers a tailored approach to infrastructure investment
- ▶ Range of ownership stakes, from 100%, to joint control, to significant minority
- ▶ Hermes Infrastructure's ultimate beneficiaries includes over 1.6m pension scheme members, of which around 450,000 are pensioners
- ▶ Promoters of a responsible approach to infrastructure investing

¹ As at 31 December 2016 with the addition of a £140m co-investment account as at 31 March 2017. AUM includes NAV plus unfunded commitments

² Includes £2.3bn NAV as at 31 December and additional c£500m investment completed on 31 March 2017

Our infrastructure definition

*The **basic** facilities, **services**, and **installations needed for the functioning of a community or society**, such as transportation and communications systems, water and power lines, and public institutions including schools, hospitals and prisons'*

Who's responsible?

- ▶ Government is responsible for providing infrastructure services
- ▶ Government may discharge its responsibility or outsource to the private sector
- ▶ Infrastructure services can be paid for from general tax revenues, under 'user pay' arrangements, or a combination

Infrastructure investment characteristics

Economic characteristics

- ▶ High barriers to entry
- ▶ Potential for economies of scale
- ▶ Low operating costs with high target operating margins
- ▶ Inelastic demand for services
- ▶ Long life real assets

Investment characteristics

- ▶ Attractive long-term returns
 - Monopolistic
 - Stable, predictable cash flows
 - Low correlation to traditional asset classes
 - Lower sensitivity to economic cycles
- ▶ Potential for liability matching
 - Long duration and limited reinvestment risk
 - Inflation linkage
 - High and stable yields

An attractive asset class with favourable characteristics for pension funds with longer-term liability matching needs such as LGPS

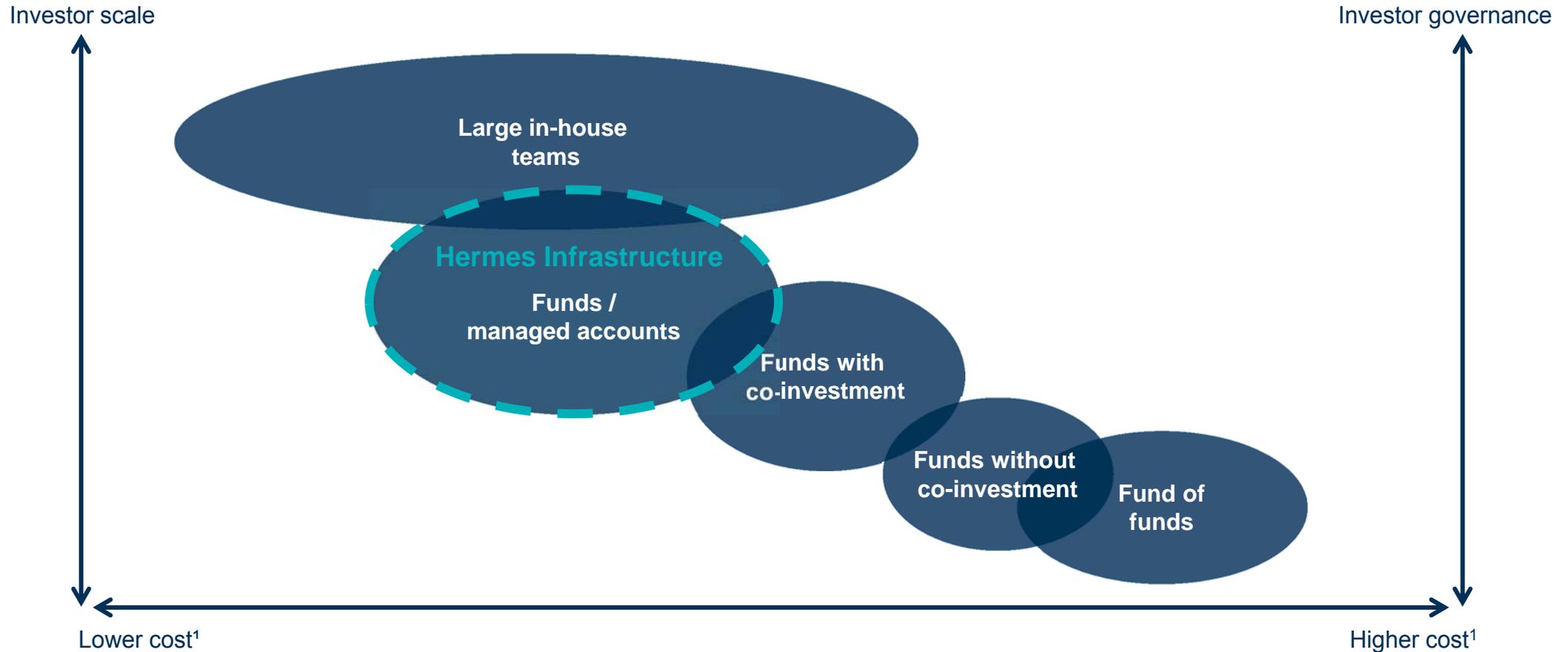
Hermes' approach to infrastructure investment

Our investment approach

- ▶ **Direct equity** investor primarily in operating assets
- ▶ Europe focus with **strong UK bias**
- ▶ **Core** and **Value Added investment strategies** selected at investor discretion
- ▶ Investments made on fundamental investment characteristics without sector bias but with sector, currency and geography portfolio construct overlays
- ▶ **Minority equity stakes (typically)** with focus on partnering with first class industry and financial co-investors with common values whilst exercising effective investment oversight and asset management
- ▶ **Prudently leveraged** or un-leveraged infrastructure businesses
- ▶ Seeking high **UK inflation linkage**
- ▶ Focus on **best in class governance** encouraging bright lines of executive responsibility and accountability, information transparency, appropriate management of conflicts of interest and supporting positive responsible investment outcomes

Accessing infrastructure investments

Hermes Infrastructure provides a unique hybrid solution combining pension fund ownership with a shared platform for managed clients including LGPS



¹ Total Expense Ratio (TER).

Hermes' approach to infrastructure investment

Client access approach

- ▶ Hermes Infrastructure's **shared platform** enables institutional investors with similar investment objectives, longer term outlook and common values to access infrastructure opportunities
- ▶ Platform has facilitated significant capital aggregation enabling participation by investors in **larger scale opportunities** or controlling positions in smaller opportunities
- ▶ Resulting **economies of scale** shared with participating investors and LGPS treated as a single client offering further scalability and value for money
- ▶ Hermes approach has resulted in **high quality deal flow**
- ▶ Recognised as a **UK 'partner of choice'** by highly active and sophisticated market participants

Better governance is essential

Few asset classes are as necessary, or significant, to the daily lives of individuals as infrastructure

- ▶ These businesses provide essential social services, including access to water, energy, health and social care, and vital transport services
- ▶ They can be integral to the continued functioning of the economy and society at large
- ▶ The UK Government is currently carrying out a consultation on strengthening the corporate governance regime for public and large private entities.

Mind the gap

- ▶ Historically infrastructure was provided by national governments, but ownership has increasingly transferred to private investors. Between 2015 and 2021, roughly 50% of the UK's national infrastructure pipeline is expected to be financed by private investors
- ▶ It has also increased its focus on foreign ownership of critical infrastructure
- ▶ We believe this provides an ideal context to explore the idea of an enhanced corporate governance regime for essential service infrastructure
- ▶ We believe a clear best-practice reference point for the governance of privately-owned essential service businesses that helps to articulate and align the objectives of Government, private investors and the public, can only be beneficial

Governance of privately owned infrastructure

Key issues

- ▶ Lack of diversity
 - Boards populated largely by financial investors, are often large and made up of individuals with similar backgrounds, profiles, skills and experiences
- ▶ Blurred lines
 - Individuals may often be required to act in two capacities – as a company director and as a representative of their appointing shareholder
 - Approval processes can be merged in the name of efficiency, blurring distinctions between shareholders, non-executives and executives
 - As a result conflicts of interest may not be clearly identified, disclosed or mitigated
 - S172 duties can be unintentionally diluted – directors have duties, shareholders do not...
 - Potentially compromising accountability of executive teams

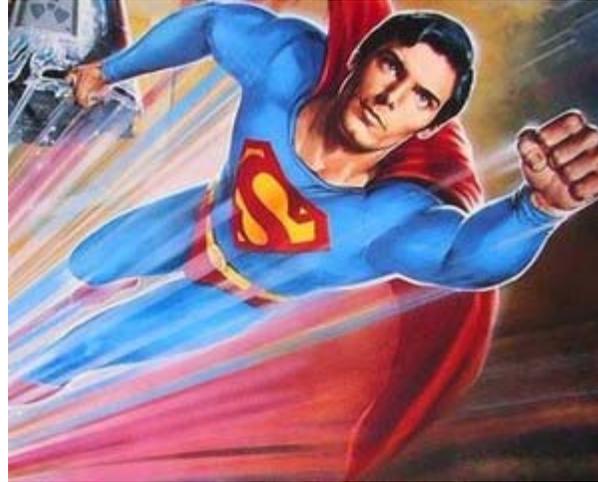
Governance of privately owned infrastructure

Key issues cont.

- ▶ Time constraints and board size
 - Can mean long term stakeholder and ESG considerations do not receive the strategic focus they deserve and may not be considered holistically
- ▶ Reporting and transparency
 - Lack of consistency in content/format
 - Low / lack of public transparency and trust
- ▶ Legitimacy
 - With key stakeholders including customers, Government and regulators
 - Potential to reduce the cost of capital and mitigate the need for additional regulatory interventions such as limits on foreign ownership

Governance of privately owned infrastructure

Possible result



Desired result



Summary

Few asset classes are as necessary, or significant, to the daily lives of individuals as infrastructure

- ▶ Infrastructure businesses provide essential social services, including access to water, energy, health and social care, and vital transport services
- ▶ They can be integral to the continued functioning of the economy and society at large
- ▶ Hermes Infrastructure offers a bespoke approach to infrastructure investing providing:
 - **Scale** – leverage Hermes Infrastructure’s established shared investment platform and ‘club’ with other institutional investors to deliver immediate economies of scale and efficiency improvements
 - **Tailored** – bespoke and adaptable investment programme
 - **Value for money** – benefits of greater scale shared with pool members by fee savings under pan-LGPS discount
 - **Greater access** – enhanced access to quality deal flow and co-investment opportunities leveraging shared platform
 - **Focus on enhanced governance and responsible investment**

Hermes Investment Management

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns - outcomes for our clients that go far beyond the financial - and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

Private markets

Infrastructure, Private Debt, Private Equity, Commercial and residential real estate

High active share equities

Asia, global emerging markets, Europe, US, global, and small and mid-cap

Credit

Absolute return, global high yield, multi strategy, real estate debt and direct lending

Multi asset

Multi asset inflation

Stewardship

Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | New York | Singapore

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