Deep dive in
High Income Infrastructure Loans Strategy

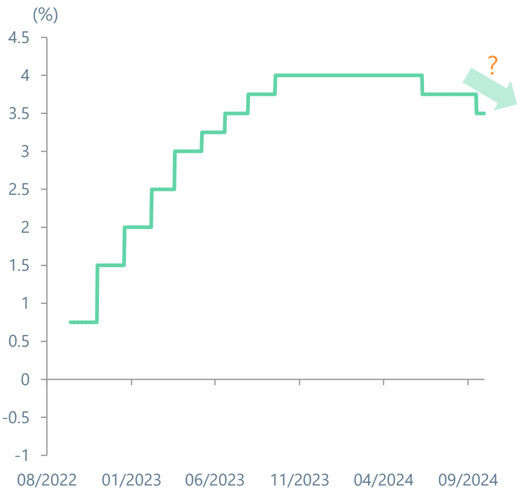
October 2024

Overcoming market challenges
with infrastructure debt, a stable yield asset class

Rate-cut cycle?
It will offer opportunities

Following an initial monetary easing in June 2024, the European Central Bank (ECB) persisted with its rate-cutting cycle in September 2024. Should this trend of rate cut persist, it is anticipated to stimulate lending activities. Indeed, lower cost of debt, and by extension lower cost of capital, will create new opportunities for sponsors such as new project, acquisitions, and refinancing, all of which will necessitate substantial financing.

European Central Bank Policy rate[1]



Recession ?
The asset class demonstrates its resilience

Fears of a prolonged recession in the eurozone have not materialized in 2024. However, geopolitical uncertainty has meant that economic activity has remained weak, and a recession cannot be ruled out in the short to medium term. In that context, infrastructure assets, providing essential services and backed by long term contracts, remain a resilient solution to navigate through a potential recession as it was the case during the Covid-19 pandemic.

[1] Source: SCOR Investment Partner, Bloomberg

Inflation ?
Contractual or natural hedge against it

Inflation uncertainty has increased significantly since the start of 2021 and remains a source of concern for investors. Infrastructure projects cash flows are either contractually indexed to inflation, or inelastic due to the monopolistic situation and the essential service provided. In both cases, it enables cost increases to be passed on to the end-user. Additionally, projects benefit from a substantial EBITDA margin, which makes it easy to absorb any mismatches between the indexation of the various revenue and cost components.

Sustainability ?
Unique position for sustainable investments

Sustainable investments are becoming a major challenge for investors who have increasingly ambitious objectives. Infrastructure is in a unique position to take advantage of long-term investment themes such as energy transition and digitalization of the economy thanks to its straightforward purpose (i.e. operating one or several identified assets).

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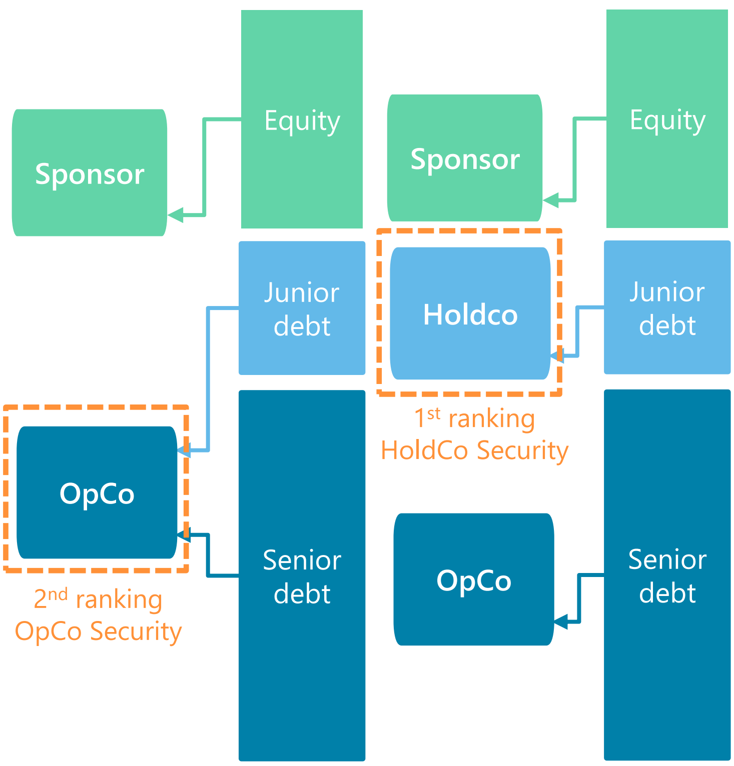
Advantages of secured high-income infrastructure debt, highlighting the uniqueness of this segment

vs EQUITY / MEZZANINE DEBT

Priority in capital waterfall

High Income debt holders have either first claim (unitranche debt) or second claim (junior debt at OpCo level or senior debt at HoldCo level) on assets and cash flows generated by a project through their security package. In any case, they rank senior to equity and/or mezzanine debt holders and have priority in the capital waterfall. Given the defensive nature of the asset class, strong recovery rates are observed, especially when providing unitranche debt (no debt subordination).

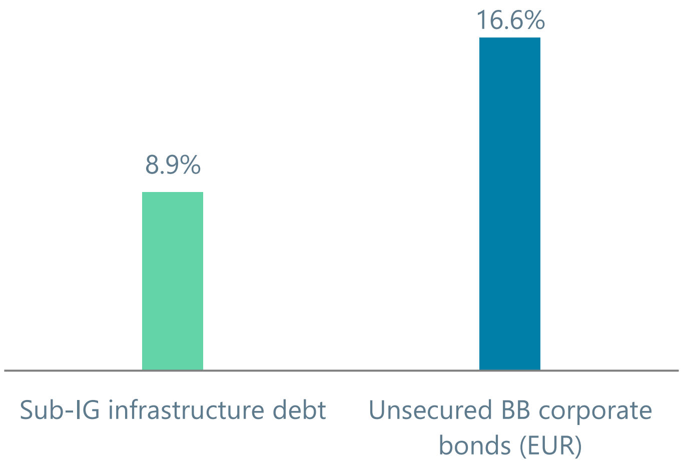
Typical junior infrastructure debt structures



Historical low default rate

Over the last decades, high income infrastructure debt has experienced default rates twice, as low as for corporate debt with equivalent risk profile (unsecured BB). The asset class remains resilient over time, backed by projects providing essential services and secured by long-term contracts.

10-year cumulative default rate (%)[1]



Recurrent returns and diversification

Stable cash flows with a conservative financial structure provide recurrent returns. Contrary to equity where dividends distribution follow a J-curve, in addition to mezzanine debt which is usually structured with payment-in-kind interests. This means that interests are capitalized instead of being distributed to the investors.

In addition, high-income debt provides diversification by complementing traditional allocation to infrastructure equity and to corporate debt.

[1] *Source: SCOR Investment Partners and Moody's report "Infrastructure & Project Finance: Infrastructure default and recovery rates, 1983-2019" (dated 2020)*

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Advantages of secured high-income debt highlighting the uniqueness of segment

vs SENIOR DEBT

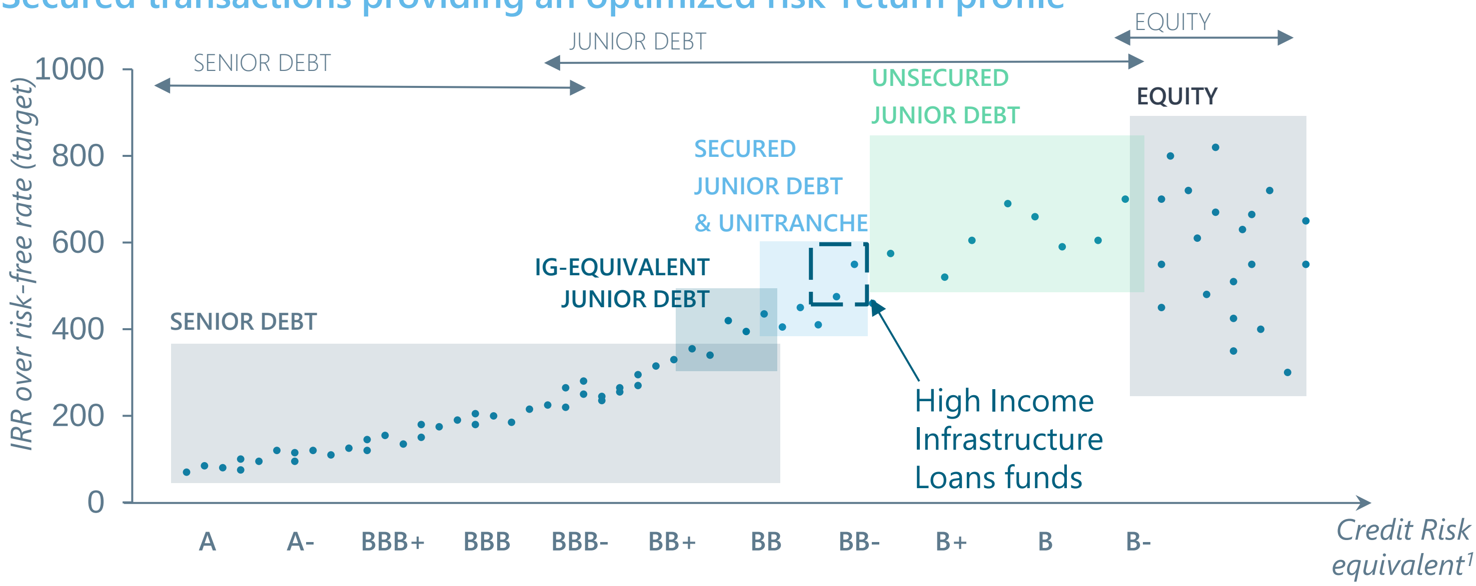
Shorter tenor

Due to the higher risk profile (compared to senior debt), high income debt is structured with a shorter tenor: the loan maturity usually stands between 5 and 10 years. This can provide a more suitable solution for an investor who does not have an Asset & Liability Management strategy over the long term and/or preferring a more “liquid” positioning in the infrastructure space. Another positive impact of this shorter tenor is the Solvency II treatment for insurers, as the capital charge ratio remains relatively similar to that of senior debt.

Attractive risk return profile

Given the strong barriers to entry (niche market, financial structure complexity), the high-income debt market provides a strong complexity premium even higher than senior debt compared to liquid corporate debt (around 300 bps as of 20.09.2024), according to our analysis.

Secured transactions providing an optimized risk-return profile



Past performance is not a reliable indicator of future performance and performance is not constant over time.

Source: SCOR Investment Partners, based on internal research, for illustrative purpose only | [1]S&P/Fitch rating scale

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