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# Staying the course

**UKW may have a new co-manager in 2024 but the trust's attractive qualities remain the same...**

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**Greencoat UK Wind (UKW)** announced last month that Laurence Fumagalli will be stepping down from his role as co-head of the UKW management team at the beginning of March 2024. Laurence played a significant role at the trust, having helped launch it as the first listed renewable infrastructure fund in 2013, alongside co-manager Stephen Lilley.

Although he will stepping down from his role at UKW, Laurence will remain a part of the senior management team at Schroders Greencoat, notably chairing the fund manager's valuation committee.

Stephen will also remain in his role and will be joined by a new co-manager, Matt Ridley, who is currently Head of Private Markets at Schroders Greencoat and has close to two decades of experience investing in renewable energy infrastructure.

Managerial changes may unnerve some investors, particularly given the volatile few years we've had. However, even though UKW may have a new co-manager in 2024, the investment process and ultimate objective remain the same – namely delivering strong total returns for shareholders via real NAV growth and a dividend that rises in line with RPI inflation.

That the trust is capable of delivering on that objective was illustrated at the end of October. UKW announced a £100m buy back scheme and increased its dividend for the 2024 financial year to 10p per share. The dividend increase represents a 14.2% uplift to 2023, far exceeding the rate of inflation in the UK of 5.2%.

The higher dividend and new buyback programme were a more tangible illustration of some of the points the managers made earlier this year when the trust released its half-year results. These included a simple breakdown of the trust's dividend coverage, based on various changes to the power price.

We have covered those figures in more detail previously, but the key takeaway was that, even if we assume there is a substantial decline in the power price and higher levels of inflation, UKW would still be able to pay a growing, fully covered dividend.

The trust managers have also been more conservative in terms of valuations, increasing UKW's discount rate to 1% above the level it was at when it held its IPO a decade ago. Today this stands at 11%, which implies a prospective forward return of 10% when management fees are factored out. However, that is on a NAV basis and, given UKW trades at a 12.4% today, the implied return is higher for potential investors.

Given that the implied returns on a NAV basis already offer a roughly 6% equity risk premium, you would think that there is reason for the discount to tighten. That has happened to an extent over the past two months, with the trust discount's tightening from over 20%.

However, the lingering discount likely reflects the fact that investors have focused on the trust's yield, as opposed to its total return. The forward yield on the trust now stands at approximately 6.9%. This still offers a healthy premium over gilts but clearly it is not the same as the return implied by the discount rate.

To understand that discrepancy, it's worth looking at the reinvestment that UKW has undertaken. From IPO in 2013 through to the end of September this year, UKW paid £887m in dividends but also reinvested £877m of excess cash flow.

This has enabled the trust to grow its NAV in real terms substantially since listing, which in turn has fed into its ability to increase dividend payouts. Rate hikes have meant the managers' ability to enhance

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returns through leverage have been made more difficult. However, higher discount rates have also offset this to a large extent, meaning borrowing is still additive to returns for the trust.

Despite these positives, UKW has continued to linger on a wide discount in 2023 – an unusual phenomenon for a trust that traded at an average premium every month from IPO until the end of last year.

But the trust has not been alone in this. As one UK equity fund manager noted recently, 2023 has been something of a strange year, with the fundamentals for trusts like UKW suggesting they were attractively valued, but few investors that were willing to buy.

That appears to be changing. As noted, the trust's discount has tightened substantially in the past two months, perhaps inspired by the buyback programme and increased dividend. Broader coverage of how distorted valuations have become may have played a role as well.

Heading into 2024, the prospect of the rate hike cycle hitting its peak also looks like another potential catalyst for the UKW discount to tighten, with the high yield that UKW currently offers starting to look more appealing relative to bonds than it does today. Assuming that's the case, it may provide a happy start for the new co-manager.

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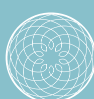

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