Financial review and Risk report

Financial review

The Company delivered strong NAV growth and continues to grow its dividend per share.

Key financial measures (year to 31 March)	**2023**	2022
Total return[1]	**£394m**	£404m
NAV	**£3,101m**	£2,704m
NAV per share	**336.2p**	303.3p
Total income	**£158m**	£133m
Total income and non-income cash	**£202m**	£143m
Portfolio asset value	**£3,641m**	£2,873m
Cash balances	**£5m**	£17m
Total liquidity[2]	**£404m**	£786m

1 IFRS Total comprehensive income for the year.
2 Includes cash balances of £5 million (2022: £17 million) and £399 million (2022: £769 million) undrawn balances available under the Company's total revolving credit facility of £900 million.

"We continued to deliver on our objectives, with strong NAV growth and an increased dividend."

James Dawes
CFO, Infrastructure

Financial review continued

The Company delivered another year of outperformance, with the portfolio generating strong capital growth and income materially higher than the prior year. The dividend was well covered by net income this year. The target dividend for FY24 of 11.90 pence per share is an increase of 6.7% over FY23.

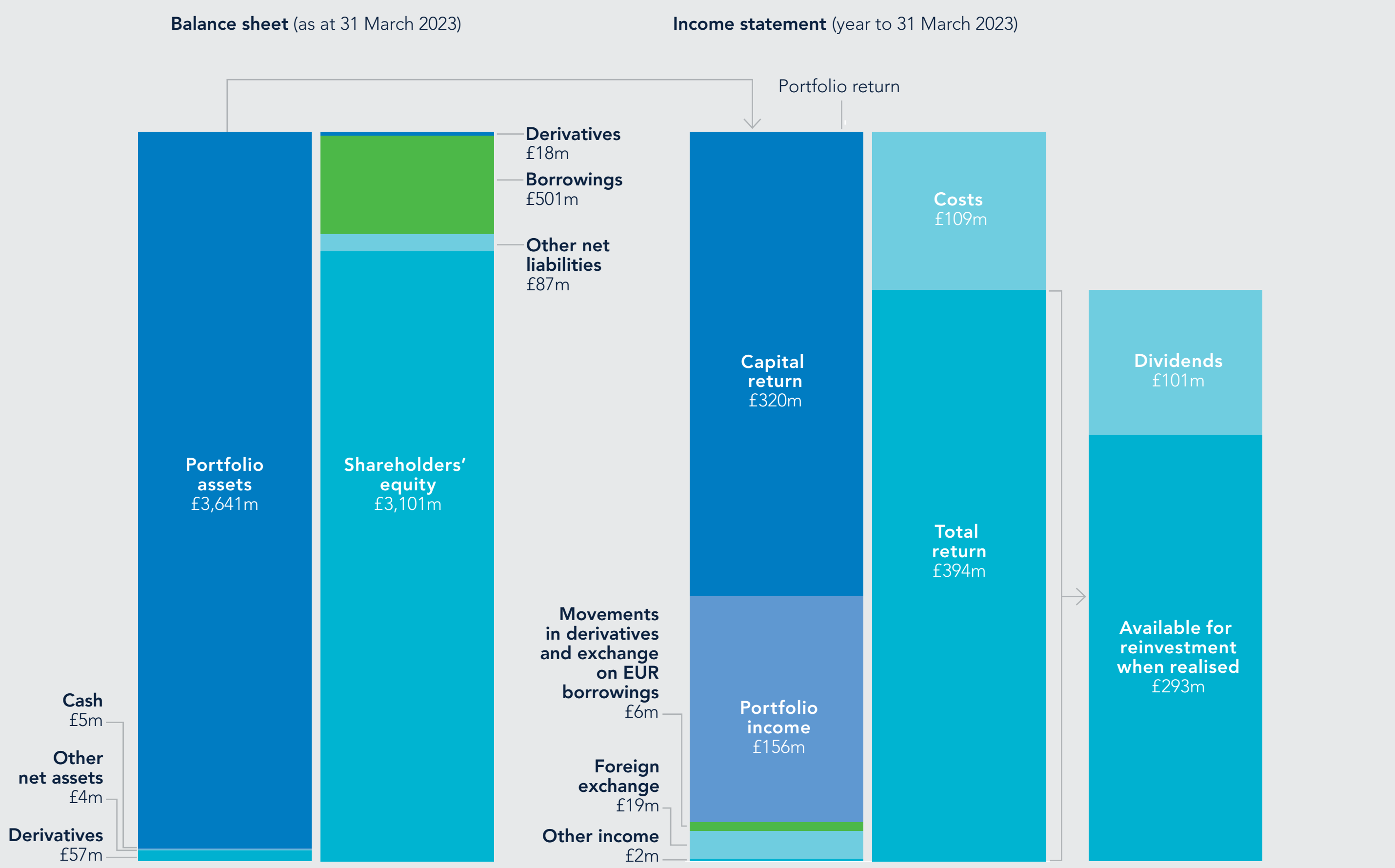
Total net investment in the year was £452 million, including the closing of the investments in GCX, TCR and Future Biogas, the syndication of a portion of the investments in ESVAGT and TCR and further investments in DNS:NET and Infinis. The Company maintained low levels of uninvested cash throughout the year and actively managed its liquidity position through its £900 million RCF facility and a £100 million capital raise in February 2023.

Returns

Total return

The Company generated a total return for the year of £394 million, representing a 14.7% return on time-weighted opening NAV and equity issued net of the prior year final dividend (2022: £404 million, 17.2%). This performance is significantly ahead of the target return of 8% to 10% per annum to be achieved over the medium term.

Composition of balance sheet and income statement (year to 31 March 2023)



Financial review continued

This outperformance was driven by strong performance across the portfolio, particularly from TCR, Tampnet, Valorem, Attero and Ionisos, partially offset by underperformance from DNS:NET. Changes in the valuation of the Company's portfolio assets are described in the Movements in portfolio value section of the Portfolio review. The investment cases of our portfolio companies reflected in the valuations at 31 March 2023 are fully funded, with the exception of the DNS:NET fibre roll out. Our companies continue to generate discretionary growth opportunities that are accretive to our investment cases.

Total income and non-income cash of £202 million in the year was significantly higher than last year, due to income from new investments in GCX, ESVAGT, TCR and SRL (2022: £143 million).

Non-income cash receipts reflect distributions from underlying portfolio companies, which would usually be income to the Company, but which are distributed as a repayment of investment for a variety of reasons. Whilst non-income cash does not form part of the total return shown in Table 3, it is included when considering dividend coverage.

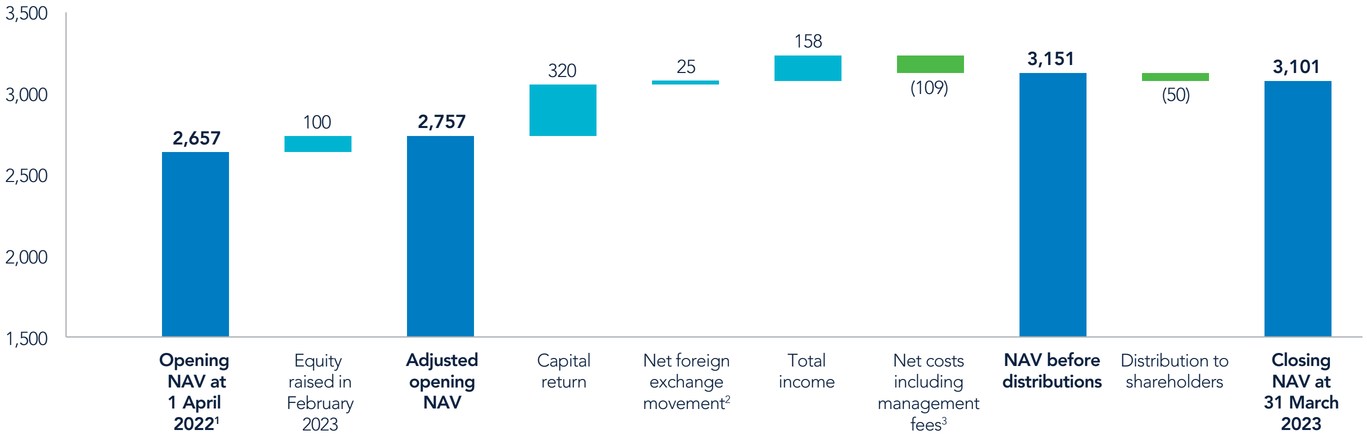
An analysis of the elements of the total return for the year is shown in Table 3.

Table 3: Summary total return (year to 31 March, £m)

	2023	2022
Capital return (excluding exchange)	**320**	375
Foreign exchange movement in portfolio	**19**	9
Capital return (including exchange)	**339**	384
Movement in fair value of derivatives and exchange on EUR borrowings	**6**	(2)
Net capital return	**345**	382
Total income	**158**	133
Costs[1]	**(109)**	(111)
Total return	**394**	404

1 Includes non-portfolio related exchange gain of £2 million (2022: loss of £3 million).

Chart 6: Reconciliation of the movement in NAV (year to 31 March 2023, £m)



1 Opening NAV of £2,704 million net of final dividend of £47 million for the prior year.
2 Foreign exchange movements are described in Chart 8.
3 Includes non-portfolio related exchange gain of £2 million.

Financial review continued

Capital return

The capital return is the largest element of the total return. The portfolio generated a value gain of £320 million in the year to 31 March 2023 (2022: £375 million), as shown in Chart 6. There was a positive contribution across the majority of the portfolio and the largest contributors were TCR (£86 million), Infinis (£52 million) and Tampnet (£52 million). The only negative contribution was from DNS:NET (£54 million). These value movements are described in the Portfolio review section.

Income

The portfolio generated income of £156 million in the year (2022: £127 million). Of this amount, £1 million was through dividends (2022: £24 million) and £155 million through interest on shareholder loans (2022: £103 million). An additional £2 million of interest was accrued on the vendor loan notes issued in lieu of WIG proceeds (2022: £6 million) together with a further £0.5 million of interest receivable on deposits (2022: £0.1 million).

Total income and non-income cash is shown in Table 4.

Table 4: Total income and non-income cash
(year to 31 March, £m)

	2023	2022
Total income	158	133
Non-income cash	44	10
Total	**202**	143

A strong income contribution from the new investments in GCX and SRL and higher non-income cash receipts, particularly from Attero, offset the reduction in income from the divestment of the European Projects portfolio. A breakdown of portfolio income is provided in Chart 9 on page 62, together with an explanation of the change from prior year.

Interest income from the portfolio was significantly higher than prior year due to the new investments in GCX, SRL, TCR and ESVAGT. Dividend income was lower than prior year due to a high level of dividend income from Tampnet in the prior year as liquidity preserved during the pandemic was released.

Foreign exchange impact

The portfolio is diversified by currency as shown in Chart 7. We aim to deliver steady NAV growth for shareholders, and the foreign exchange hedging programme helps us to do this by reducing our exposure to fluctuations in the foreign exchange markets.

Portfolio foreign exchange movements, after accounting for the hedging programme, increased the net capital return by £25 million (2022: increased by £7 million).

Chart 7: Portfolio value by currency
(at 31 March 2023)

EUR	52%
GBP	18%
DKK	13%
USD	9%
NOK	8%

As shown in Chart 8, the reported foreign exchange gain on investments of £19 million (2022: £9 million) included a gain of £13 million from the Company's exposure to the US dollar, largely through Tampnet, which was not hedged in the first half of the year. This was accompanied by a £6 million gain on the hedging programme (2022: loss of £2 million). The positive hedge benefit resulted from favourable interest rate differentials on the euro hedging programme.

Chart 8: Impact of foreign exchange ('FX') movements on portfolio value
(year to 31 March 2023, £m)

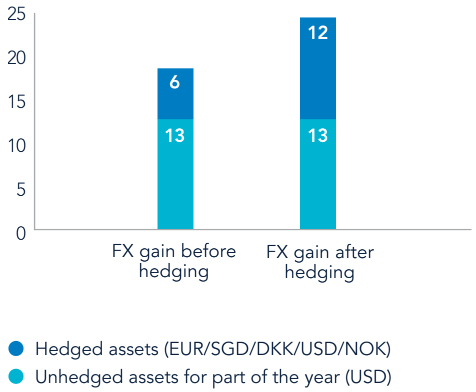


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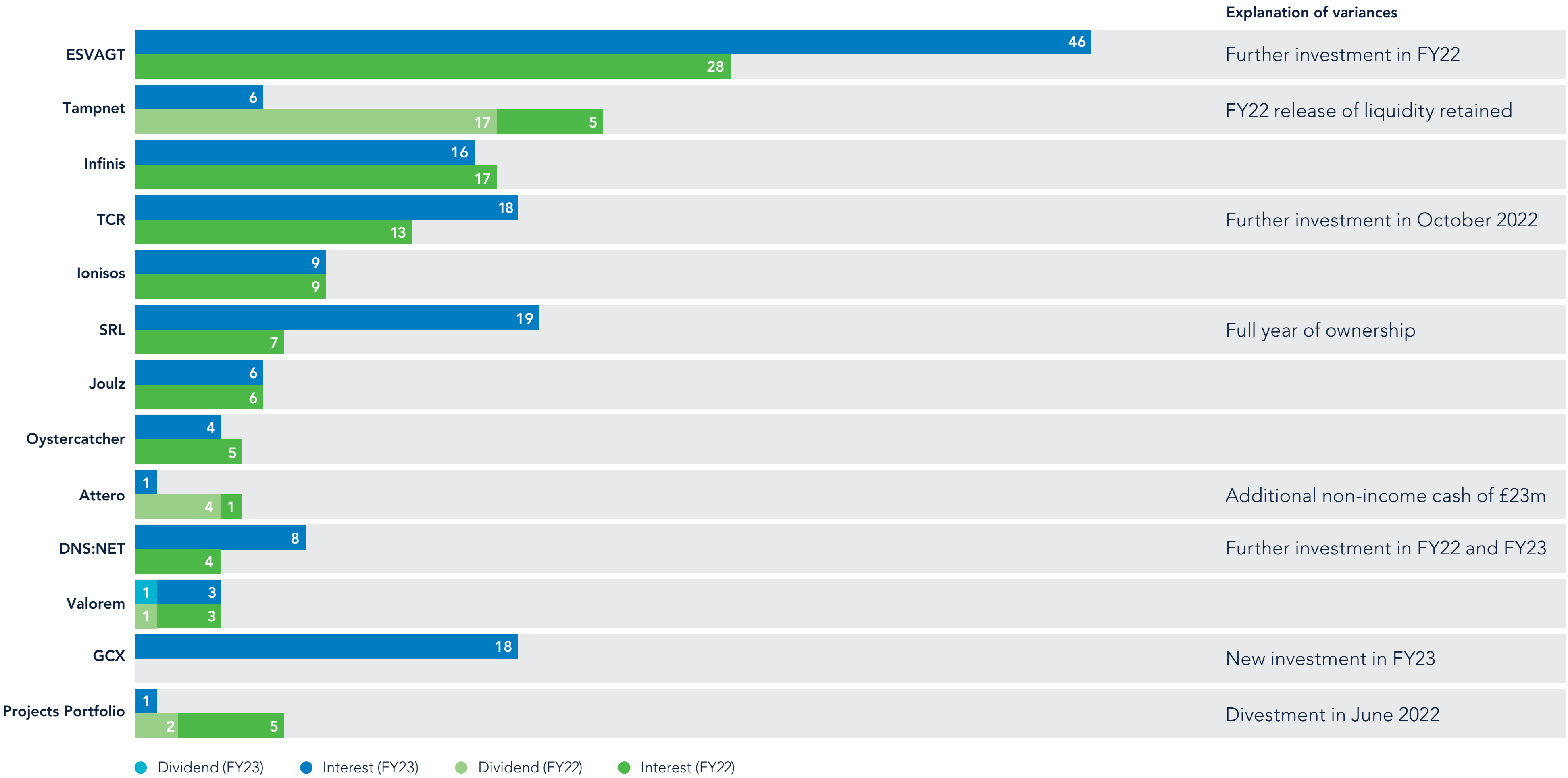
Chart 9: Breakdown of portfolio income (year to 31 March, £m)



Costs

Management and performance fees

During the year to 31 March 2023, the Company incurred management fees of £47 million (2022: £43 million), including transaction fees of £3 million (2022: £10 million). The fees, payable to 3i plc, consist of a tiered management fee, and a one-off transaction fee of 1.2% payable in respect of new investments. The management fee tiers range from 1.4%, reducing to 1.2% for any proportion of gross investment value above £2.25 billion.

An annual performance fee is also payable by the Company, amounting to 20% of returns above a hurdle of 8% of the total return. This performance fee is payable in three equal annual instalments, with the second and third instalments only payable if certain future performance conditions are met. This hurdle was exceeded for the year ended 31 March 2023, resulting in a performance fee payable to 3i plc in respect of the year ended 31 March 2023 of £45 million (2022: £54 million).

The first instalment, of £15 million, will be paid in May 2023 along with the second instalment of £18 million relating to the previous year's performance fee and the third instalment of £2 million relating to the FY21 performance fee.

For a more detailed explanation of how management and performance fees are calculated, please refer to Note 18 of the accounts.

Fees payable

Fees payable on investment activities include costs for transactions that did not reach, or have yet to reach, completion and the reversal of costs for transactions that have successfully reached completion and were subsequently borne by the portfolio company. For the year to 31 March 2023, fees payable totalled less than £1 million (2022: £3 million).

Other operating and finance costs

Operating expenses, comprising Directors' fees, service provider costs and other professional fees, totalled £3 million in the year (2022: £3 million).

Finance costs of £16 million (2022: £5 million) in the year comprised arrangement and commitment fees for the Company's £900 million RCF and interest on drawings. Finance costs were higher than in FY22 due to an increase in interest rates and a greater average drawn balance.

Ongoing charges ratio

The ongoing charges ratio measures annual operating costs, as disclosed in Table 5 below, against the average NAV over the reporting period.

The Company's ongoing charges ratio is calculated in accordance with the Association of Investment Companies ('AIC') recommended methodology and was 1.64% for the year to 31 March 2023 (2022: 1.41%). The ongoing charges ratio is higher in periods where new investment levels are high and new equity is raised or capital is returned to shareholders. Realisation of assets reduces the ongoing charges ratio. The cost items that contributed to the ongoing charges ratio are shown below.

Table 5: Ongoing charges (year to 31 March, £m)

	2023	2022
Investment Manager's fee	**44.6**	32.6
Auditor's fee	**0.8**	0.6
Directors' fees and expenses	**0.5**	0.5
Other ongoing costs	**1.9**	2.4
Total ongoing charges	**47.7**	36.1
Ongoing charges ratio	**1.64%**	1.41%

The AIC methodology does not include transaction fees, performance fees or finance costs. However, the AIC recommends that the impact of performance fees on the ongoing charges ratio is noted, where performance fees are payable. The ratio including the performance fee was 3.19% (2022: 3.52%). The total return of 14.7% for the year is after deducting this performance fee and ongoing charges.

Financial review continued

Balance sheet

The NAV at 31 March 2023 was £3,101 million (2022: £2,704 million). The principal components of the NAV are the portfolio assets, cash holdings, the fair value of derivative financial instruments, borrowings under the RCF and other net assets and liabilities. A summary balance sheet is shown in Table 6.

At 31 March 2023, the Company's net assets after the deduction of the proposed final dividend were £3,050 million (2022: £2,657 million).

Cash and other assets

Cash balances at 31 March 2023 totalled £5 million (2022: £17 million).

Cash on deposit was managed actively by the Investment Manager and there are regular reviews of counterparties and their limits. Cash is principally held in AAA-rated money market funds.

Other net assets and liabilities predominantly comprise a performance fee accrual of £83 million (2022: £64 million), including amounts relating to prior year fees.

Table 6: Summary balance sheet (at 31 March, £m)

	2023	2022
Portfolio assets	**3,641**	2,873
Cash balances	**5**	17
Derivative financial instruments	**39**	8
Borrowings	**(501)**	(231)
Other net (liabilities)/assets	**(83)**	37
NAV	**3,101**	2,704

The movement from March 2022 is due to an increase in the performance fee payable of £45 million, following the outperformance in the period. £26 million of prior year performance fees were paid during the period. The vendor loan note of £98 million, included as an asset within other net assets at March 2022, was redeemed in July 2022.

Borrowings

The Company increased the commitments under its RCF in July 2022 from £700 million to £900 million in order to maintain a good level and maturity of liquidity for further investment whilst minimising returns dilution from holding excessive cash balances. This is a three-year facility, with a maturity date of November 2025. A further one-year extension option is available under the facility agreement. At 31 March 2023, the total amount drawn was £501 million.

An additional credit facility of £300 million available at the beginning of this financial year, with a maturity of less than one year, was cancelled in July 2022 at the same time as the commitments under the RCF were increased.

Capital raise

In February 2023, the Company successfully completed a capital raise, with net proceeds of £100 million, by way of a placing of ordinary shares in the capital of the Company at 330 pence per share. The placing price represented a discount of approximately 3.4% to the share price immediately prior to the announcement of the placing. A total of 30,915,990 new ordinary shares were admitted to trading on the London Stock Exchange main market for listed securities on 14 February 2023. The Company now has a total of 922,350,000 shares in issue, an increase of 3.5%. Soft pre-emption was followed where possible in allocating the shares.

NAV per share

The total NAV per share at 31 March 2023 was 336.2 pence (2022: 303.3 pence). This reduces to 330.6 pence (2022: 298.1 pence) after the payment of the final dividend of 5.575 pence (2022: 5.225 pence). There are no dilutive securities in issue.

Dividend and dividend cover

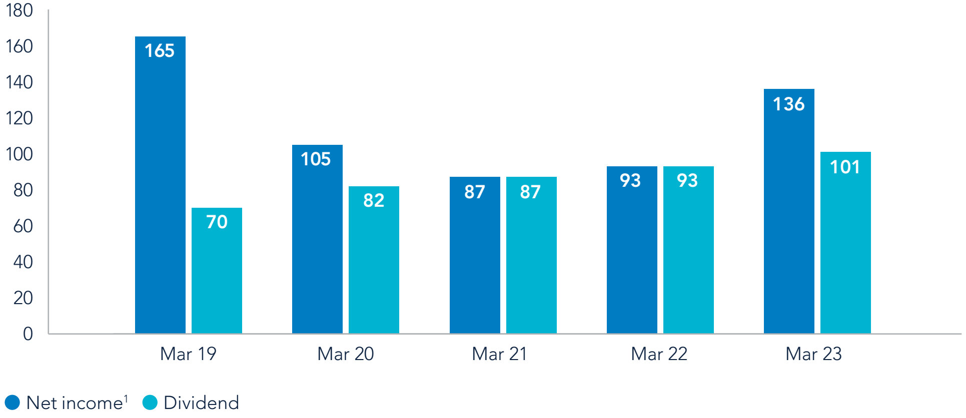
The Board has proposed a dividend for the year of 11.15 pence per share, or £101 million in aggregate (2022: 10.45 pence; £93 million). This is in line with the Company's target announced in May last year.

Financial review continued

Table 7: Dividend cover (year to 31 March, £m)

	2023	2022
Total income, other income and non-income cash	**202**	143
Operating costs, including management fees	**(66)**	(50)
Dividends paid and proposed	**(101)**	(93)
Dividend surplus for the year	**35**	–
Dividend reserves brought forward from prior year	**794**	868
Realised gain/(loss) over cost on disposed assets	**30**	(20)
Performance fees	**(45)**	(54)
Dividend reserves carried forward	**814**	794

Chart 10: Dividend cover (five years to 31 March 2023, £m)



1 Net income is Total income, other income and non-income cash less operating costs.

When considering the coverage of the proposed dividend, the Board assesses the income earned from the portfolio, interest received on cash balances and any additional non-income cash distributions from portfolio assets which do not follow from a disposal of the underlying assets, as well as the level of ongoing operational costs incurred in the year. The Board also takes into account any surpluses retained from previous years, and net capital profits generated through asset realisations, which it considers available as dividend reserves for distribution.

Table 7 shows the calculation of dividend coverage and dividend reserves. The dividend was fully covered for the year with a surplus of £35 million (2022: no surplus).

The retained amount available for distribution, following the payment of the final dividend, the realised profit over cost relating to the sale of the European Projects portfolio and the performance fee will be £814 million (2022: £794 million). This is a substantial surplus, which is available to support the Company's progressive dividend policy, particularly should dividends not be fully covered by income in a future year.

A shortfall could arise, for example, due to holding substantial uninvested cash or through lower distributions being received from portfolio companies in order to preserve liquidity.

Chart 10 shows that the Company has consistently covered the dividend over the last five years.

Sensitivities

The sensitivity of the portfolio to key inputs to our valuations is shown in Chart 11 and described in more detail in Note 7 to the accounts. The portfolio valuations are positively correlated to inflation. The longer-term inflation assumptions beyond two years remain consistent with central bank targets, eg. UK CPI at 2%.

The sensitivities shown in Chart 11 on page 66 are indicative and are considered in isolation, holding all other assumptions constant. Timing and quantum of price increases will vary across the portfolio and the sensitivity may differ from that modelled. Changing the inflation rate assumption may necessitate consequential changes to other assumptions used in the valuation of each asset.

Financial review continued

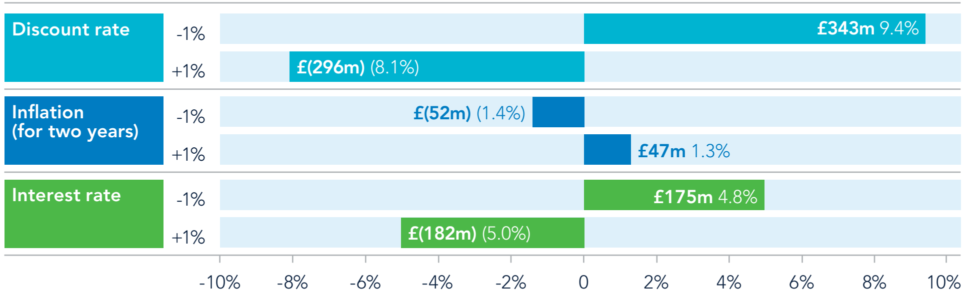
Alternative Performance Measures ('APMs')

We assess our performance using a variety of measures that are not specifically defined under IFRS and are therefore termed APMs. The APMs that we use may not be directly comparable with those used by other companies. These APMs provide additional information of how the Company has performed over the year and are all financial measures of historical performance.

The APMs are consistent with those disclosed in prior years but this year we have added two new APMs, Total liquidity and Portfolio debt to enterprise value. The Directors monitor total liquidity to assess the Company's ability to make further investments, the efficiency of the balance sheet, and short-term viability. Portfolio debt to enterprise value is monitored to assess the underlying gearing of portfolio companies, the consequential risk in the forecast cashflows of those companies and the ability of portfolio companies to fund capital expenditure from their own resources.

- Total return on opening NAV reflects the performance of the capital deployed by the Company during the year. This measure is not influenced by movements in share price or ordinary dividends to shareholders. This is a common APM used by investment companies
- The NAV per share is a measure of the underlying asset base attributable to each ordinary share of the Company and is a useful comparator to the share price. This is a common APM used by investment companies
- Total income and non-income cash is used to assess dividend coverage based on distributions received and accrued from the investment portfolio
- Investment value including commitments measures the total value of shareholders' capital deployed by the Company
- Total portfolio return percentage reflects the performance of the portfolio assets during the year
- Total liquidity is a measure of the Company's ability to make further investments and meet its short-term obligations
- Portfolio debt to enterprise value is a measure of underlying indebtedness of the portfolio companies

Chart 11: Portfolio sensitivities (year to 31 March 2023)



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The definition and reconciliation to IFRS of the APMs is shown below.

APM	Purpose	Calculation	Reconciliation to IFRS
Total return on opening NAV	A measure of the overall financial performance of the Company. For further information see the KPI section.	It is calculated as the total return of £394 million, as shown in the Statement of comprehensive income, as a percentage of the opening NAV of £2,704 million net of the final dividend for the previous year of £47 million, adjusted on a time-weighted basis for the receipt of the £100 million capital raise on 14 February 2023. An adjustment to increase the opening NAV by £13 million is required for this time weighting.	The calculation uses IFRS measures.
NAV per share	A measure of the NAV per share in the Company.	It is calculated as the NAV divided by the total number of shares in issue at the balance sheet date.	The calculation uses IFRS measures and is set out in Note 14 to the accounts.
Total income and non-income cash	A measure of the income and other cash receipts by the Company which support the payment of expenses and dividends.	It is calculated as the total income from the underlying portfolio and other assets plus non-income cash being the repayment of shareholder loans not resulting from the disposal of an underlying portfolio asset.	Total income uses the IFRS measures Investment income and Interest receivable. The non-income cash, being the proceeds from partial realisations of investments, are shown in the Cash flow statement. The realisation proceeds which result from a partial sale of an underlying portfolio asset are not included within non-income cash.
Investment value including commitments	A measure of the size of the investment portfolio including the value of further contracted future investments committed by the Company.	It is calculated as the portfolio asset value plus the amount of the contracted commitment. At 31 March 2023, the Company had no investment commitments.	The portfolio asset value is the 'Investments at fair value through profit or loss' reported under IFRS. The value of future commitments is set out in Note 16 to the accounts.
Total portfolio return percentage	A measure of the financial performance of the portfolio.	It is calculated as the total portfolio return in the year of £501 million, as shown in Table 1, as a percentage of the sum of the opening value of the portfolio and investments less amounts syndicated in the year (excluding capitalised interest) of £3,325 million.	The calculation uses capital return (including exchange), movement in fair value of derivatives, underlying portfolio income, opening portfolio value and investment in the year. The reconciliation of all these items to IFRS is shown in Table 1, including in the footnotes.
Total liquidity	A measure of the Company's ability to make further investments and meet its short-term obligations.	It is calculated as the cash balance of £5 million plus the undrawn balance available under the Company's revolving credit facility of £399 million.	The calculation uses the cash balance, which is an IFRS measure and undrawn balances available under the Company's revolving credit facility, which are described in Note 11 to the accounts.
Portfolio debt to enterprise value	A measure of underlying indebtedness of the portfolio companies.	It is calculated as total debt as a percentage of the enterprise value of the portfolio companies, and does not include indebtedness of the Company.	The calculation is a portfolio company measure and therefore cannot be reconciled to the Company's accounts under IFRS.