

BARINGS VIEWPOINTS

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AN ALTERNATIVE APPROACH BAI'S UNIQUE STRATEGY FOR REAL ASSET & PRIVATE EQUITY INVESTING

Competition on the rise

Allocations to real assets, private equity and infrastructure form an integral part of many portfolio allocation strategies as investors look for compelling capital returns, as well as predictable current yield.

Today, record levels of capital are being committed, with combined dry powder across private equity and infrastructure totalling \$875 billion over the first seven months of 2017, up 18% from the end of last year.¹ While this has provided managers with ample firepower to deploy toward deals, the rising competition has meant that yields have compressed for core infrastructure and the prospect of capital upside or price appreciation has diminished. For the buyout universe, the competition-driven increase in purchase price multiples and leverage is likely to make the J-curve deeper and capital returns more back-ended. As a result, investors are confronted by a more challenging environment in their search for opportunities offering mid-teen IRRs with current yield.

Real assets, real differentiation

By focusing on real assets and asset-based investments in an area that sits between more traditional definitions of infrastructure and private equity, we aim to combine the attractive current cash flow of infrastructure with the long-term capital uplift offered by private equity. In doing so, the BAI Direct Investments platform targets a differentiated shape and quality of return for investors.

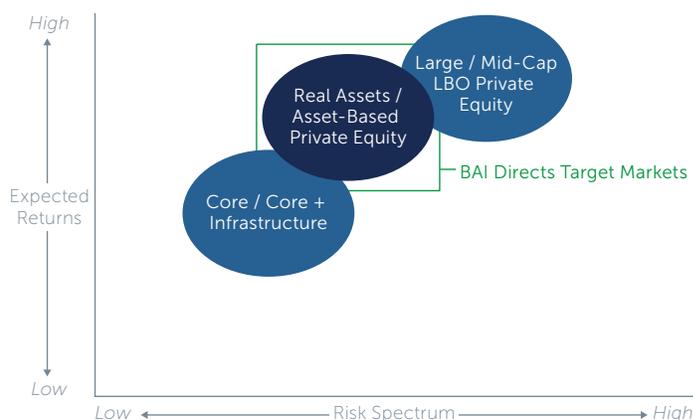
The shape of the return profile exhibits the risk-adjusted qualities associated with predictable current cash flow and rises in line with the potential for capital gains from private equity investing and enterprise development. Enterprise development is where scaling real assets and bringing in operational capabilities can transform the value paradigm for an asset that trades on a book value basis into a going concern that can be sold for a multiple of earnings.

A focus on current cash flow is a key part of the investment thesis. In addition to de-risking returns, healthy current cash flows can offer the reinvestment optionality for enterprise value creation. By using comparatively modest levels of debt, the current yield expected to be received should be more stable over time. Through this approach, BAI aims to build a strategy that can capture attractive current yield and upside returns for our investors, with a targeted distribution rate of 5–7% and gross IRR of 12–15%.²

Highlights

- In today's environment where dry powder and purchase multiples are rising, finding attractive risk-adjusted returns in traditional private equity and infrastructure is increasingly challenging for many sophisticated allocators
- BAI's investment focus on real assets and asset-based PE aims to provide an attractive shape and quality of return by combining current cash flow with long-term potential capital upside
- Through intelligent and proprietary sourcing of quality assets, active management and enterprise development, BAI aims to deliver compelling risk-adjusted returns for the longer term to investors

FIGURE 1: UNIQUE MARKET POSITIONING



SOURCE: BARINGS. AS OF SEPTEMBER 2017.

BAI Directs platform focuses on less competitive markets

The starting point for achieving a distinctive risk-return profile is disciplined asset selection. BAI sources assets from three broad categories of real assets and asset-based businesses: capital assets, infrastructure, and intangibles. Within these areas, we target investments that are integral to the real economy and supported by longer-term thematic, industry and asset trends

1. Source: Preqin. As of August 31, 2017.

2. There is no guarantee that the targeted rate of return and/or distribution rate will be achieved.

FIGURE 2: BROAD INVESTMENT CHARACTERISTICS

	Infra	PE	BAI DIRECTS APPROACH Real Assets/Asset Based Private Equity
Investment Horizon	Long-Term	Medium Term	Long-Term
Return Drivers	Asset Cash Flow & Capital Gains	Capital Gains	Asset Cash Flow & Capital Gains
Current Cash Flow	Yes	No	Yes
Active Management	Moderate	High	High
Upside Potential	Moderate	High	High
Downside Risk	Low	Significant	Moderate
Leverage	Syndicated	Significant/Often Syndicated	Moderate

SOURCE: BARINGS. AS OF SEPTEMBER 2017. FOR ILLUSTRATIVE PURPOSES ONLY

in sectors such as transportation, media and entertainment, pharmaceuticals, financial services and infrastructure.

By operating in between traditional PE and infrastructure, we believe BAI is often able to capitalize on its sourcing abilities to avoid competitive bidding processes and overpaying. In contrast to traditional PE and infrastructure, the markets targeted are generally underinvested, allowing BAI to source undiscovered deals and to look at the widest possible opportunity set. Our operational expertise allows us to target real assets and to find better value opportunities than would be possible for passive strategies or managers without an operational focus that only target company investments.

Finally, by investing in real assets that are valued on a book value basis—which have arguably seen lower price inflation than enterprise valuations—we believe BAI is positioned to find more attractive value opportunities.

Value creation

For the specialist and often undermanaged assets and areas of the market targeted, BAI is uniquely positioned to maximize value through active management, sector specialization and industry knowledge. BAI targets operationally-intensive investments with higher barriers to entry and has a preference for controlling stakes in order to execute business plans, in line with our underlying investment theses.

Conclusion

BAI seeks to build a strategy of actively managed real assets and asset-based businesses that uses lower leverage and provides attractive current yield and valuation upside potential.

The BAI Directs platform aims to provide attractive risk-reward ratios and diversification to other core real asset investments or traditional private equity, targeting a specific value proposition. We believe the differentiated approach is able to deliver a distinctive shape and quality of return that is difficult to capture in more traditional areas of core infrastructure and private equity, particularly in today’s competitive market. Given the targeted investment characteristics of the BAI Directs platform, the strategy would typically fit into a traditional allocation for private equity and infrastructure or a current yield or inflation portfolio.

Strategies for maximizing asset value include expanding product and service offerings, broadening the geographical footprint, building scale at an operating company and capitalizing on attractive reinvestment opportunities. In addition to these expansion-type strategies, we seek to extend the life of the assets we manage and to implement efficiency-enhancing and quality control measures in order to extract their full value.

By way of example, ground transportation, a fragmented sector, offers many such opportunities. In the sector, BAI predicted a shift that would boost demand for intermodal containers and trucking equipment and initiated a presence there. We then built up a critical mass of transportation assets and identified a highly experienced management team to operate the business and execute the strategy.

Today, the team is creating value not solely through best-in-class management, but by aiming to maximize returns from its asset base and taking advantage of market inefficiencies. In particular, the team has been innovative in deploying older intermodal assets to respond to supply constraints during seasonal peaks in online shopping. As a result of this overall strategy, BAI’s portfolio company Milestone is one of today’s market leaders in supplying, leasing and asset management activities of transportation equipment in the U.S.

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