EDISON

UIL

Initiation of coverage

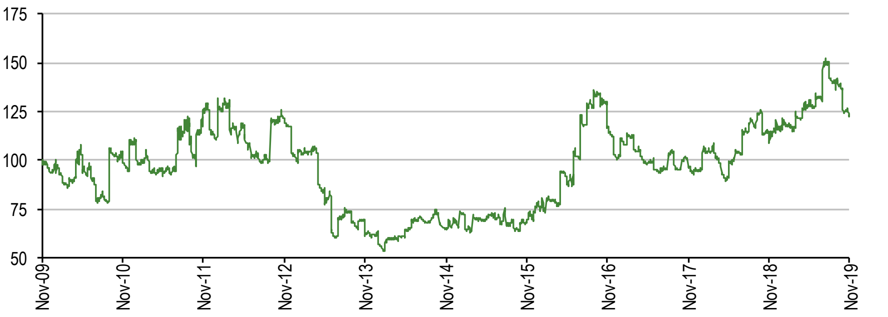
Seeking undervalued assets across the globe

Investment companies
Global value

10 December 2019

UIL Limited (UIL) is managed by ICM, where the lead managers aim to generate strong total returns by investing in undervalued companies across the globe. Charles Jillings, responsible for day-to-day management, stresses that ICM is a long-term, deep-value, high-conviction investor, seeking exposure to companies with high growth potential. UIL has generated strong absolute and relative NAV and share price total returns for investors; it measures investment performance against the FTSE All-Share index. The company has reduced its gearing significantly (although it remains high in the context of peers) and the board is now focused on achieving a lower discount to net asset value (NAV), targeting 20%.

Long-term NAV outperformance versus the FTSE All-Share index



Source: UIL, Refinitiv, Edison Investment Research

The market opportunity

The macro environment is uncertain. Global growth is slowing, partly due to the friction between the US and its trading partners, whereas global forward P/E multiples are, in aggregate, 14% above their 10-year average. With this as a backdrop, investors may benefit from a greater focus on businesses with meaningful growth potential that are trading at a discount to their intrinsic values.

Why consider investing in UIL?

- Concentrated, high-conviction portfolio, run by specialist investment team.
- Diversified fund with sector biases to financial services, technology and resources, and a geographic bias to Australia.
- NAV and share price total returns above 20% pa over the last five years.
- Regular quarterly dividends (current yield of 3.0%).
- Despite a recent narrowing and strong performance, UIL's shares still trade at a wide discount to NAV.
- UIL's gearing, while still relatively high, has reduced significantly.

Narrower discount in recent months

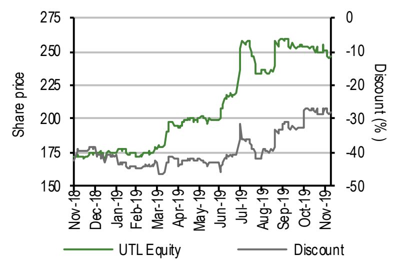
UIL's discount has narrowed meaningfully in recent months, partly supported by ongoing share repurchases. Its current 27.7% share price discount to cum-income NAV compares with the 32.2% to 40.0% range of average discounts over the last one, three, five and 10 years. The company follows a levered investment strategy; at end-October 2019, net gearing was 68.0%.

Price	**246.0p**
Market cap	**£212m**
AUM	**£492m**
NAV*	335.8p
Discount to NAV	26.7%
NAV**	340.0p
Discount to NAV	27.7%

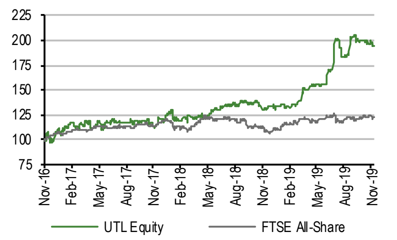
*Excluding income. **Including income. As at 3 December 2019.

Yield	3.0%
Ordinary shares in issue	86.2m
Code	UTL
Primary exchange	LSE
AIC sector	Flexible Investment
Benchmark	FTSE All-Share

Share price/discount performance



Three-year performance vs index



Gearing (including ZDPs)

Net*	68.0%

*As at 31 October 2019.

Analysts

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Edison profile page

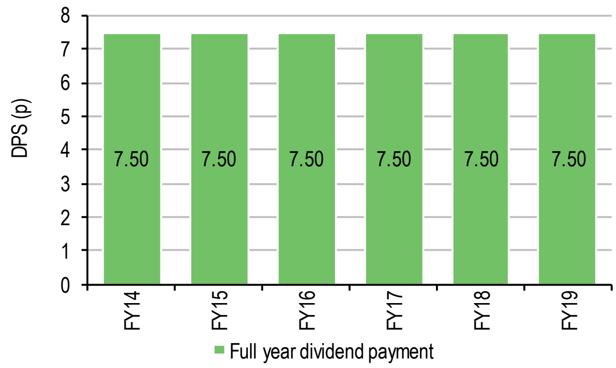
UIL is a research client of Edison Investment Research Limited

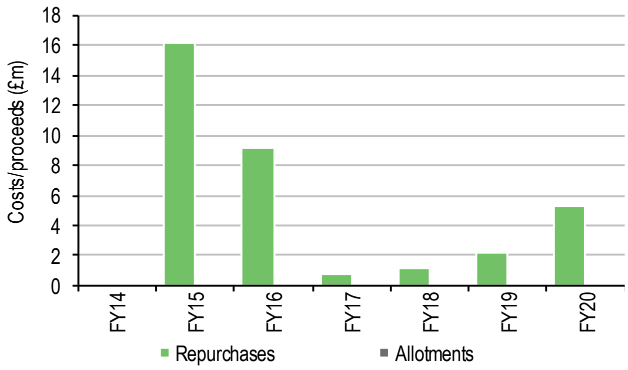
Exhibit 1: Company at a glance

Investment objective and fund background	Recent developments
UIL's objective is to maximise shareholder returns by identifying and investing in investments worldwide where the underlying value is not reflected in the market price. The company's investment performance is benchmarked against the FTSE All-Share index.	■ 15 November 2019: announcement of first interim dividend of 1.875p/share. ■ 6 November 2019: announcement of listing on the Bermuda Stock Exchange. ■ 9 October 2019: result of special meeting – the listing of UIL's ordinary shares will be transferred from the Premium Segment to the Specialist Fund Segment of the Main Market of the London Stock Exchange. ■ 2 October 2019: announcement of the appointment of Stuart Bridges as independent, non-executive director. ■ 13 September 2019: annual results to 30 June 2019. NAV TR +29.7% vs benchmark TR +0.6%. Share price TR +18.8%.

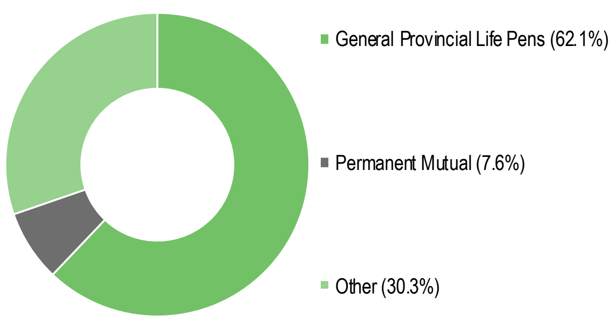
Forthcoming		Capital structure		Fund details	
AGM	November 2020	Ongoing charges	2.1%	Group	ICM Group
Interim results	February 2020	Net gearing	68.0%	Manager	Charles Jillings
Year end	30 June	Annual mgmt fee	See page 10	UK contact address	PO Box 208, Epsom, Surrey, KT18 7YF
Dividend paid	Quarterly	Performance fee	See page 10		
Launch date	14 August 2003*	Company life	Indefinite	Phone	+44 (0)1372 271486
Continuation vote	None	Loan facilities	See page 10	Website	www.uil.limited

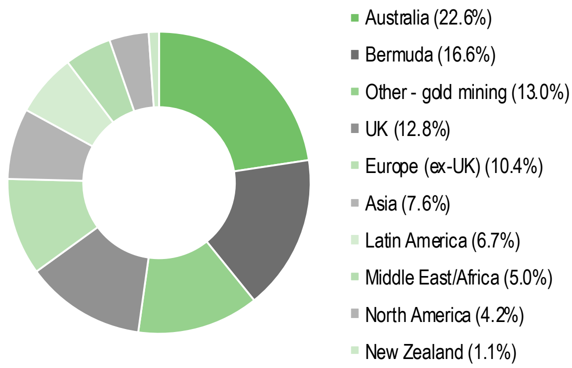
Dividend policy and history (financial years)	Share buyback policy and history (financial years)
Quarterly dividends are paid in December, March, June and September.	Renewed annually, UIL has the authority to repurchase up to 14.99% and allot up to 5% of shares in issue.





Shareholder base (at 30 June 2019)	Portfolio exposure by geography (at 31 October 2019)





Top 10 holdings (at 31 October 2019)

			Portfolio weight %	
Company	**Country****	**Sector**	**31 October 2019**	**31 October 2018*****
Somers	Bermuda	Financial services investment holding company	24.0	24.2
Utilico Emerging Markets Trust	UK	Emerging markets investment trust	16.7	16.0
Zeta Resources	Australia	Resources investment company	12.8	13.5
Resolute Mining	Australia	Gold mining	11.9	11.0
Optal	UK	Electronic payment services platform	7.5	6.6
Ascendant Group	Bermuda	Electric utility	4.9	N/A
One Communications	Bermuda	Telecommunications	4.5	N/A
Allectus Capital	Bermuda	Fintech investment company	4.0	2.0
Afterpay Touch Group	Australia	Electronic payment services platform	2.5	8.3
Vix Tech	Singapore	Automated fare collection systems	2.0	3.5
Top 10 (% of holdings)			**90.8**	**89.4**

Source: UIL, Edison Investment Research, Morningstar. Note: *Utilico Investment Trust – UIL's predecessor. **Of listing or domicile. ***N/A where not in end-October 2018 top 10.

Market outlook: Opportunities for value specialists

Exhibit 2 (LHS) shows the performance of indices (in sterling terms) over the last 10 years. The world market has outperformed both UK and emerging markets over this period, as global indices are dominated by the US, which has performed relatively strongly in recent years, helped by its accommodative monetary policy and robust corporate earnings growth. Investors in overseas equities have also benefited from sterling weakness following the Brexit vote in June 2016.

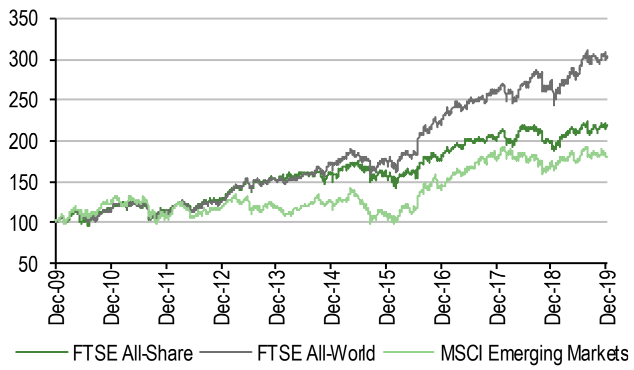
After a particularly benign period in 2017, share price volatility has picked up in recent quarters as investors focus on the prospects for economic growth and interest rate expectations. Current growth headwinds are exacerbated by the ongoing dispute between the US and its trading partners, notably China, which is affecting supply chains and business sentiment. Here in the UK, continued Brexit uncertainty is having a negative impact on spending intentions at both the corporate and consumer levels. In its October 2019 World Economic Outlook, the International Monetary Fund forecasts higher GDP growth prospects for emerging markets and developing economies (3.9% in 2019 followed by 4.6% in 2020, led by China and India) compared with developed economies (1.7% in both 2019 and 2020 – above-average growth estimates for the US, with below-average outlooks for Europe and Japan).

Looking at valuations in Exhibit 2 (RHS), markets look somewhat extended in terms of forward P/E multiples, with the world market trading at a 14% premium to its 10-year average. Emerging markets look relatively attractively valued, particularly on an absolute basis, whereas the UK has suffered significant outflows from international and domestic investors, which is reflected in both its absolute and relative multiples. During 2019, the US market has performed relatively well, but leadership has been narrow, led by select technology and consumer stocks that now look particularly expensive. In the UK, there has been a bifurcation between those companies with overseas earnings – which have been favoured by investors – and smaller-cap companies with domestic operations, which are looking particularly unloved.

In an environment of slowing economic growth and above-average valuations, investors may be well served by focusing on niche growth opportunities that are trading on reasonable multiples.

Exhibit 2: Market performance and valuation

Performance of indices (last 10 years, £)



Datastream indices forward P/E multiples (as at 9 December 2019)

(x)	Last	High	Low	10-year average	Last as % of average
UK	12.8	15.7	8.5	12.6	102
Developed markets	16.3	16.9	9.9	14.1	115
Emerging markets	12.2	13.6	9.2	11.5	106
World	15.5	16.3	9.8	13.6	114

Source: Refinitiv, Edison Investment Research

Fund profile: Seeking undervalued securities

UIL's predecessor, Special Utilities Investment Trust (SUIT), was launched in August 1993 as a split-capital fund investing in utilities. In August 2003, its income shares were redeemed at par and the capital shareholders were given the option for a cash exit or to roll their existing capital shares into a new fund, Utilico Investment Trust (UIT – c 70% elected to roll over). Given a number of challenges and regulatory headwinds in the European utility sector, UIT's mandate was changed to invest in undervalued companies across a range of industries, rather than focusing on the infrastructure, utility and related sectors.

UIL is the successor vehicle to UIT and began trading on 20 June 2007 as a Bermuda-registered company. It is now listed on the Specialist Fund Segment of the London Stock Exchange (see following section). On 5 November 2019, UIL announced a secondary listing on the Bermuda Stock Exchange. UIL is managed by ICM Investment Management and ICM (collectively referred to as ICM). It aims to identify and invest in compelling long-term investments across the globe, where the forecast underlying value is not reflected in their current share price.

The company may invest in shares, bonds, convertibles and other types of securities, including non-investment grade bonds and unlisted securities (up to 25% of gross assets at the time of investment). Derivative instruments are permitted for investment purposes and efficient portfolio management. There are no restrictions on UIL's sector and geographic exposure, but at the time of investment, no single investment will exceed 30% of gross assets. The company employs a levered strategy through zero dividend preference (ZDP) shares and a limited amount of bank debt (see Capital structure and fees section on pages 10 and 11). At end-October 2019, net gearing (ZDP shares plus borrowings) was 68.0%.

UIL's performance is benchmarked against the FTSE All-Share index. Data from UIL show that since inception to end-FY19 (30 June), its NAV total return compounded at a rate of 13.4% pa, which compares very favourably with the 8.1% pa total return of the FTSE All-Share index.

Change of London Stock Exchange listing

Following shareholder approval at a special general meeting on 9 October 2019, UIL transferred its listing from the Premium Segment of the Official list to the Specialist Fund Segment of the London Stock Exchange with effect from 7 November 2019. Independent shareholders almost unanimously supported the transfer with only 0.19% voting against the proposal. The meeting followed an announcement in July 2019 that the number of UIL's shares in public hands was close to the 25% minimum threshold. This is a result of the company continuing to buy back shares, along with share purchases by the board members and ICM's managers. As at 30 June 2019, ICM manager Duncan Saville had a 70.5% interest in UIL's issued share capital, which included the holdings of General Provincial Life Pension Fund (62.1%) and Permanent Mutual (7.6%). The Specialist Fund Segment does not have any free-float requirements. UIL's ZDP shares continue to be listed on the Standard Segment of the Main Market of the London Stock Exchange. The Specialist Fund Segment is designed to appeal to specialist funds and sophisticated investors; shares listed here may have limited liquidity and have greater share price volatility than shares listed on the Main Market. Data from the London Stock Exchange show that in August 2019, 42 closed-end investment funds were listed in this segment, with an average market cap of c £300m.

The fund manager: Charles Jillings

The manager's view: Avoiding short-term market noise

ICM's investment teams are led by Duncan Saville and Charles Jillings. Jillings is responsible for day-to-day management. His view on the macro backdrop is that the noise around ongoing topics is clearly having an impact on the global economy and asset markets; and that it is difficult to be confident in the outcomes. The manager is concerned about the relationship between the US and China; his view for some time has been that the issue is not just about trade, and the frictions are much deeper, which could cause significant economic headwinds in the future. Regarding Europe, Jillings says the EU's relationship with the UK is a concern. The UK is the sixth-largest economy in the world, so lower growth here will also affect European growth, which is already subdued. He is more positive on the outlook for emerging markets, as most of these countries' authorities are pursuing policies to promote economic growth, such as in China, India and Brazil. The manager points to Brazil, where interest rates are at record lows, pension reform has been voted through and the government is encouraging foreign ownership of Brazilian companies. Jillings says that China and India are also 'energising their economies'.

Although global growth is slowing, the manager says that for the type of investments UIL seeks, he is still finding compelling opportunities. ICM's managers are total return, bottom-up investors rather than focusing on global stock markets and the macro environment. Jillings explains that ICM's process is common across all platforms. All of the investment teams are looking for deep value in their respective spaces, either mispriced growth or mispriced asset-backed companies. He says the majority of investments require a degree of active engagement, so as a result UIL is in the relatively 'active management' camp. In terms of earnings support, the manager argues that interest rates are low or declining further, which is a benign or positive environment for many businesses; however, he observes higher levels of debt at the personal, corporate and government levels, which he suggests will become unsustainable at some point, and put pressure on earnings.

Jillings says he 'can see a lot of disruption coming', believing that regardless of a company's business, all firms will experience technological disruption, either directly or indirectly. The manager believes the financial services sector is already disrupted and highlights UIL's position in Afterpay Touch Group, which 'has turned a piece of the payments market on its head'. It allows retailers to offer customers the ability to buy now and pay later in instalments, without affecting their credit scores (as long as payments are made on time); this is proving very popular with the millennial generation. Afterpay receives a small percentage (around 4%) of the retailer's sales, and fees from the customer for non-payments (if a payment is missed, no more credit is available). In the UK, the company trades as Clearpay and has recently signed a contract with Marks & Spencer, allowing its online customers to spend between £30 and £800, repaying in four instalments.

Asset allocation

Investment process: Focused on undervalued assets

UIL is managed by ICM, a specialist investment manager with c £15bn of assets under management (both directly and indirectly). The investment teams are led by Duncan Saville and Charles Jillings, both of whom are chartered accountants with backgrounds in corporate finance and asset management. Other senior members of the investment team are Jacqueline Broers, Jonathan Groocock and Mark Lebbell (covering the utilities and infrastructure sectors); Gavin Blessing (fixed income); Dugald Morrison (resources); Jason Cheong (technology); and Alasdair Younie (financial services).

The fund's objective is to invest in undervalued assets across the globe. Reasons for a business to be under priced may include: technological change, an underperforming management team or shareholder apathy.

Around 65% of the portfolio is invested via ICM-managed funds, or 'platforms', principally Somers (financial services), Utilico Emerging Markets Trust (emerging markets utilities and infrastructure), Zeta Resources (natural resources) and Allectus Capital (technology, with a particular focus on fintech) (see Current positioning for a fuller explanation of each platform).

Jillings highlights what he believes to be the benefits of this approach:

- **Focused strategy** – each platform has a narrow mandate.
- **Dedicated research analysts** – focused on understanding current portfolio businesses and identifying new investments that fit each platform's remit.
- **Financial support** – ability to draw on UIL's financial resources.
- **Deep knowledge** – ability to optimise investment opportunities and undertake corporate finance-led transactions.

The remaining c 35% of the fund is in direct holdings including Afterpay Touch Group and Optal (holdings in the Allectus Capital platform before distributing to shareholders in 2016), and Resolute Mining. At end-FY19, around one-third of the fund was invested in operating companies and the total number of companies in the portfolio (including the platforms) was 42.

UIL's portfolio is constructed after incorporating the manager's three medium-term views on the macro backdrop into account: global financial markets are over-indebted; technological change provides the opportunity for strong investment returns; and emerging markets offer higher GDP growth opportunities than developed markets.

Jillings believes in the importance of supporting investee companies with their capital requirements while maintaining an active and constructive shareholder approach, including reviews of their capital structure and business efficiencies. UIL may often be among an investee company's largest shareholders and maintains regular contact with them. There is no limit as to how much of a company UIL may own and it may sometimes take legal or management control of a firm. When industries are going through change, the company wants to be a substantive shareholder to enable it to have a voice.

The manager says sometimes when he invests in companies, they are not the opportunities that sparkle; however, they can provide visibility on other companies that are ultimately much stronger investments. These may evolve into platform investments, such as resources-focused investment holding and development company Zeta Resources, which was launched in June 2013.

Current portfolio positioning

UIL has a concentrated portfolio. At end-October 2019, its top 10 holdings made up 90.8% of the fund, marginally higher than 89.4% a year earlier; eight positions were common to both periods (Exhibit 1). However, it should be noted that each platform investment holds a number of underlying positions, thereby significantly reducing portfolio risk.

Looking at the company's geographic exposure (Exhibit 3), Australia is the largest segment in the portfolio, although the weighting declined by 6.9pp over the 12 months to 31 October. Other notable changes are a fall in UK exposure (-7.3pp), with higher weightings in continental Europe (+5.2pp) and Bermuda (+4.8pp).

Exhibit 3: Portfolio geographic exposure (% unless stated)

	Portfolio end-October 2019	Portfolio end-October 2018	Change (pp)
Australia	22.6	29.5	(6.9)
Bermuda	16.6	11.8	4.8
Other - gold mining	13.0	13.6	(0.6)
UK	12.8	20.1	(7.3)
Europe (ex-UK)	10.4	5.2	5.2
Asia	7.6	6.3	1.3
Latin America	6.7	6.6	0.1
Middle East/Africa	5.0	1.5	3.5
North America	4.2	4.5	(0.3)
New Zealand	1.1	0.9	0.2
	100.0	**100.0**	

Source: UIL, Edison Investment Research

In terms of UIL's sector exposure (Exhibit 4), financial services makes up nearly a quarter of the fund. The largest changes over 12 months to end-October are a fall in the technology weighting (-6.0pp) and increases in infrastructure investments (+4.8pp) and telecoms (+3.0pp).

Exhibit 4: Portfolio sector exposure (% unless stated)

	Portfolio end-October 2019	Portfolio end-October 2018	Change (pp)
Financial services	24.3	24.5	(0.2)
Technology	19.0	25.0	(6.0)
Gold mining	13.0	13.6	(0.6)
Resources	11.1	10.2	0.9
Telecoms	6.6	3.6	3.0
Infrastructure investments	5.9	1.1	4.8
Electricity	4.1	5.3	(1.2)
Oil & gas	2.6	3.9	(1.3)
Ports	2.3	2.1	0.2
Road & rail	2.0	1.7	0.3
Water	1.7	1.0	0.7
Renewables	1.6	1.0	0.6
Airports	0.6	1.6	(1.0)
Other	5.2	5.4	(0.2)
	100.0	**100.0**	

Source: UIL, Edison Investment Research

Jillings highlights some of UIL's holdings, noting that its investment company (platform) positions are trading at a discount to the value of their underlying investments, effectively affording UIL investors a 'double discount', as the fund itself is trading at a greater than 25% discount to NAV. As an example, Utilico Emerging Markets Trust's shares are currently trading at a c 10% discount to its cum-income NAV.

- **Somers** (SOM) is a Bermuda-listed financial services investment company. Its largest holding (c 34%) is Resimac Group (RMC). The manager explains that in Australia, outside of the four major and smaller banks, there are a number of mortgage originators, one of which is Resimac. The non-bank mortgage lenders have fewer regulatory challenges than the banks and the company has robust fundamentals, helped by low interest rates and a long history of securitisation. Other Somers holdings include Bermuda Commercial Bank (c 21%), and UK-based Waverton Investment Management (c 19%) and PCF Group (PCF, c 13%).
- **Utilico Emerging Markets Trust** (UEM) is a UK-listed investment trust focusing on infrastructure, utility and related assets in emerging markets. Since launch in July 2005, the fund has generated an annual NAV total return of 11.0%. UEM has an addressable universe of c 900 companies. Portfolio holdings tend to be no larger than 5%, which mitigates risk, given the focus on emerging rather than developed markets. The manager says ICM is a well-known investor in UEM's sectors and explains that urbanisation and growth of the emerging market middle class is driving demand for airports and other infrastructure assets. Jillings argues that although the infrastructure and utility sectors have had positive demand drivers for the last decade, he expects this to continue for at least the next 20 years.
- **Zeta Resources** (ZER) is an Australia-listed, closed-ended Bermuda investment company, with direct and indirect exposure to resource projects and mining companies. The portfolio includes significant exposure to nickel and copper, with demand for both elements coming from the automotive industry due to the development of electric vehicles. Jillings explains there has been underinvestment in nickel and copper production, so he believes the opportunities, driven by higher demand, should be very significant for the company. The largest position in the fund is Panoramic Resources (c 38%) – in early-November 2019, it received a takeover bid from Independence Group to acquire the shares in Panoramic that it does not already own; the manager believes the bid is opportunistic.
- **Allectus Capital** is an unlisted investment company jointly owned by ICM and UIL. It has a value-focused technology portfolio (c $50m) of listed and unlisted companies, largely in the Asia Pacific region and the UK. It focuses on early-stage, potentially disruptive businesses, primarily in the fintech sector.

- **Optal** is a direct unlisted position, originally held in Allectus Capital's portfolio. It is a developer of global payment systems, primarily targeting the travel industry, and has a long-term strategic partnership with MasterCard. The manager says that Optal is growing significantly and pays a dividend.
- **Afterpay Touch Group** (APT) is an Australian technology-driven payments company with more than six million active users and nearly 40k merchants building a multi-country global footprint (see The manager's view on page 5). It was originally an investment within Allectus Capital's portfolio. The company was formed from the July 2017 merger of Afterpay (May 2016 IPO at A$1 per share) and Touchcorp (March 2015 IPO at A$1.40 per share). Afterpay Touch Group is now trading around A$30 per share.

Performance: Long-term record of outperformance

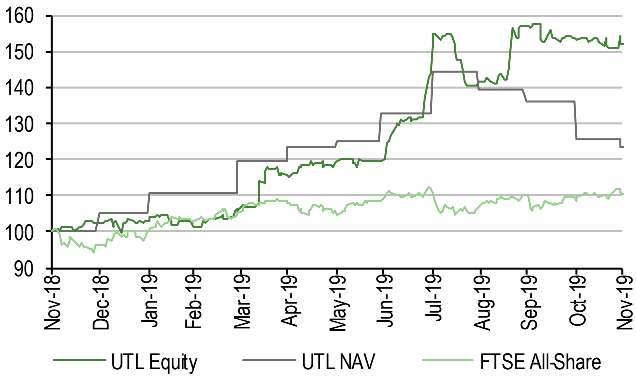
Exhibit 5: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	FTSE All-Share (%)	FTSE All-World (%)	MSCI Emerging Markets (%)
30/11/15	1.1	7.0	0.6	2.1	(13.3)
30/11/16	36.0	85.8	9.8	25.8	31.2
30/11/17	12.9	(6.3)	13.4	15.7	23.0
30/11/18	15.0	12.5	(1.5)	5.5	(3.2)
30/11/19	52.2	23.7	11.0	12.7	6.2

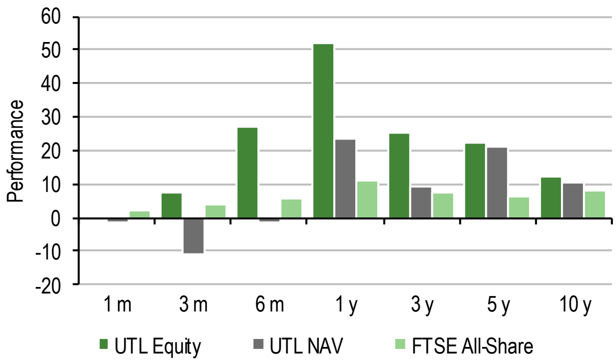
Source: UIL, Refinitiv. Note: All % on a total return basis in pounds sterling.

Exhibit 6: Investment company performance to 30 November 2019

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: UIL, Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

In FY19 (ending 30 June), UIL's NAV and share price total returns of 29.7% and 18.8% respectively were considerably ahead of the 0.6% total return of the FTSE All-Share index. Positive contributors to performance included Afterpay Touch (+168.1%), Bermuda First Investment Company (+77.5%), Optal (+60.9%) and One Communications (+51.1%), while NAV performance detractors included the fund's largest position Somers, which declined by 5.8%.

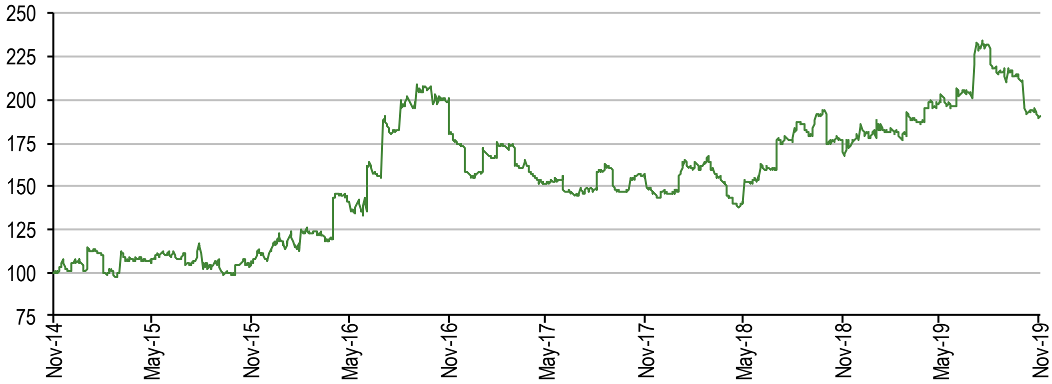
As shown in Exhibits 5 and 6, UIL has delivered a strong share price total return over the last 12 months (+52.2%) compared to a +23.7% NAV total return, which has led to a meaningful narrowing of the company's discount (Exhibit 9). Its absolute returns over the last five years are also very robust, helped by the fund's gearing (NAV and share price total returns of +21.0% pa and +22.1% pa respectively).

Exhibit 7: Share price and NAV total return performance, relative to indices (%)	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE All-Share	(3.0)	3.3	20.0	37.1	59.3	98.3	46.2
NAV relative to FTSE All-Share	(3.6)	(14.4)	(6.8)	11.4	5.1	89.1	22.5
Price relative to FTSE All-World	(3.2)	5.7	16.0	35.1	43.7	53.9	5.4
NAV relative to FTSE All-World	(3.8)	(12.4)	(9.9)	9.7	(5.2)	46.7	(11.6)
Price relative to MSCI Emerging Markets	(0.7)	7.3	22.9	43.2	56.1	88.8	76.7
NAV relative to MSCI Emerging Markets	(1.3)	(11.1)	(4.6)	16.4	3.0	80.1	48.1

Source: UIL, Refinitiv, Edison Investment Research. Note: Data to end-November 2019. Geometric calculation.

UIL's relative returns are shown in Exhibit 7. Its NAV has outperformed the FTSE All-Share index over most periods shown, particularly over the last one, five and 10 years. This is an imperfect measure given the company only has 12.8% exposure to the UK (although it is relevant for UK investors) so we have also included global and emerging markets indices as comparators. UIL's NAV has outpaced the performance of the FTSE All-World index over one and five years, and the MSCI Emerging Markets index over one, three, five and 10 years.

Exhibit 8: NAV total return performance relative to benchmark over five years



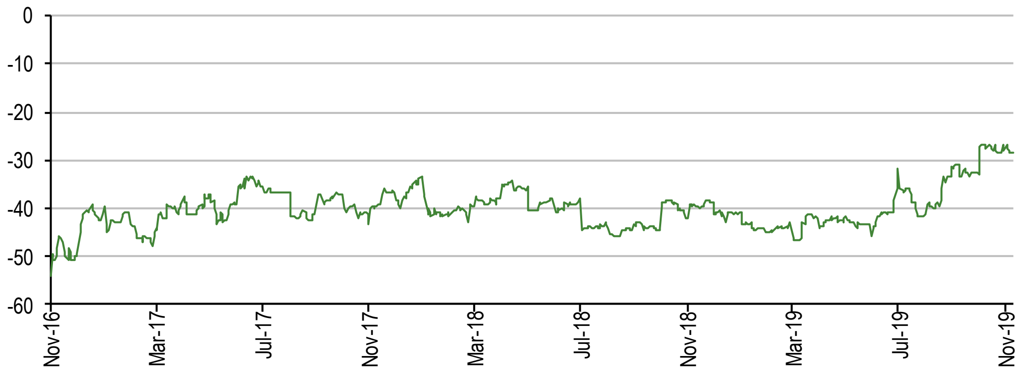
Source: UIL, Refinitiv, Edison Investment Research

Discount: Recent narrowing in the discount

Renewed annually, UIL has the authority to repurchase up to 14.99% and allot up to 5% of shares in issue. The company's discount has narrowed considerably in recent months and there is scope for this trend to continue given the company's strong investment performance, a lower level of gearing, and regular quarterly dividends. UIL's board is aiming for a 20% discount, which it believes is achievable over the medium term via continued share repurchases and a higher focus on marketing to existing and potential investors. In FY19, the company repurchased 1.2m shares (1.4% of the share base), at an average discount of 51.2%, and share buybacks have continued in FY20 (2.1m shares, equivalent to 2.4% of the share base).

Based on the 3 December weekly NAV, UIL's shares are currently trading at a 27.7% discount to cum-income NAV, which is towards the lower end of the 12-month range. This may reflect a recognition by investors of the board's serious intent to narrow the company's discount. The current discount is narrower than the 39.2%, 40.0%, 38.1% and 32.2% averages over the last one, three, five and 10 years respectively.

Exhibit 9: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

Capital structure and fees

UIL has 86.2m ordinary shares outstanding and follows a levered strategy using ZDP shares and bank debt. It has a £50m senior secured multicurrency revolving facility with Scotiabank Europe (£38.3m drawn). The loan matures in March 2020 and is expected to be extended to 2022.

In the FY14 annual report, the board stated its commitment to reducing the company's debt and gearing. This has occurred in each subsequent year – gearing was 64.6% at 30 June 2019 versus 87.3% a year earlier, and 160.4% at 30 June 2013. UIL's current level of gearing is well below the board's 100% target maximum – 68.0% as at end-October 2019, which is a level the manager is comfortable running.

Exhibit 10: ZDP shares (at 31 October 2019)

	2020	2022	2024	2026
Accrued capital entitlement (p)	144.43	122.55	109.69	107.67
Share price (p)	151.00	132.50	117.00	108.50
Premium/(discount) to NAV (%)	4.5	8.1	6.7	0.8
ZDP cover* (x)	5.21	2.99	2.41	2.04
Yield to redemption* (%)	2.6	3.5	3.4	4.9
ZDP redemption value (p)	154.90	146.99	138.35	151.50
Shares in issue (m)	39.0	50.0	30.0	25.0
Ticker	UTLE	UTLF	UTLG	UTLH

Source: UIL, Edison Investment Research. Note: *Based on final redemption values.

As shown in Exhibit 10, UIL has four tranches of ZDP shares spread over six years. They are rolled every two years to ensure the portfolio is not disrupted if they are redeemed for cash. Jillings says the company's ZDP share strategy will continue, as it provides a secure, long-term debt facility. From inception to end-FY19, UIL had issued £373.6m of ZDP shares and redeemed £326.1m; they are issued by UIL Finance, a wholly owned subsidiary of UIL.

In October 2018, the 2018 ZDP shares were redeemed at a cost of £51.2m, using realised investments, while 20.0m 2024 ZDP shares were cancelled (having been held on the balance sheet as standby for the 2018 ZDP share redemption). The board is considering proposals for the redemption of the 31 October 2020 ZDP shares.

UIL's overall financing costs have declined over the years from an average rate of 6.3% at end-June 2013 to 5.5% at end-June 2019. They should decline further as the board is expecting to refinance the 2020 ZDP shares at a lower rate than the retiring 2020 ZDPs.

ICM is paid an annual management fee of 0.5% pa of UIL's total assets less current liabilities (excluding borrowings and excluding the value of all holdings in companies managed or advised by ICM or its subsidiaries from which it receives a management fee), along with 45% of ICM's costs of providing company secretarial services. ICM is entitled to a 15% performance fee on NAV returns above the higher of 5.0% or the UK gilt five- to 10-year index post-tax yield plus RPIX inflation. The NAV must exceed the high water mark NAV from when the performance fee was last paid (adjusted for capital events and dividends) and is capped at 2.5% of financial year-end NAV (adjusted for capital events and dividends paid). It is also reduced to take into account any fees paid to ICM by companies where UIL is an investor.

In FY19, UIL's ongoing charges (excluding performance fees) were 2.1% (FY18: 2.2%), while including performance fees they were 5.1% (FY18: 4.4%). While these fees may appear relatively high compared with other investment companies as they are calculated on total assets but expressed as a percentage of average net assets (after the deduction of the ZDP shares), based on gross assets the fees are considerably lower.

Dividend policy and record

UIL pays regular quarterly dividends in December, March, June and September and it has the flexibility to pay dividends from capital reserves. In FY19, UIL's revenue return of 7.63p per share was 14.4% higher year-on-year. The dividend was maintained for the sixth consecutive year, at 7.50p per share and was fully covered for the first time in six years. At end-FY19, the company had revenue reserves of 10.3p per share, which is equivalent to c 1.4x the annual dividend. The board anticipates the annual dividend will be maintained at 7.50p per share and is hopeful that reserves will build; based on its current share price, UIL offers a yield of 3.0%.

Peer group comparison

Exhibit 11 shows the 16 funds in the AIC Flexible Investment sector with market caps greater than £50m that have been trading for more than three years; they follow a variety of investment mandates. UIL's NAV total returns are above average over all periods shown, ranking first over one year (+16.2pp), first over three years (+13.5pp), first over five years (+108.6pp) and second over 10 years (+36.5pp). Although narrower than its historical averages, the fund has one of the widest discounts in the selected peer group, and one of the highest ongoing charges. UIL has the highest level of gearing and an above-average dividend yield (1.0pp above the mean).

Exhibit 11: Selected peer group as at 9 December 2019*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
UIL	212.0	24.3	34.0	155.8	171.6	(27.7)	2.1	Yes	168	3.0
Aberdeen Diversified Inc & Growth	342.0	7.2	16.3	8.0	64.2	(11.3)	0.9	No	109	5.0
BMO Managed Portfolio Growth	75.5	10.1	33.4	49.5	158.6	(0.3)	1.0	Yes	100	0.0
BMO Managed Portfolio Income	61.3	13.8	26.5	38.6	145.4	0.3	1.1	Yes	100	4.4
Caledonia Investments	1,694.3	8.5	31.0	52.2	143.3	(16.3)	0.9	No	100	1.9
Capital Gearing	462.8	6.8	17.4	35.4	87.0	2.4	0.7	No	100	0.5
Hansa Investment Company 'A'	219.6	(0.4)	18.9	26.0	79.9	(33.5)	1.3	No	100	1.2
Henderson Alternative Strat Trust	99.6	1.6	13.8	24.5	20.5	(21.3)	0.9	No	100	1.9
JZ Capital Partners	232.4	5.5	0.0	32.5	139.3	(63.0)	3.2	Yes	102	0.0
Miton Global Opportunities	76.0	2.7	24.4	54.2	122.4	(1.3)	1.4	Yes	100	0.0
New Star Investment Trust	81.3	5.2	20.6	48.7	76.6	(29.2)	0.9	Yes	100	1.2
Personal Assets	1,126.5	6.8	14.3	27.5	77.3	1.6	0.9	No	100	1.3
RIT Capital Partners	3,332.3	8.5	22.5	45.5	118.3	10.2	0.7	Yes	114	0.0
Ruffer Investment Company	395.0	4.6	3.1	12.9	53.5	(3.2)	1.1	No	100	0.8
Seneca Global Income & Growth	85.9	15.4	25.1	46.6	125.4	1.0	1.5	No	108	3.9
Tetragon Financial	858.6	9.6	27.2	96.4	578.2	(47.3)	1.7	Yes	100	5.9
Average (16 funds)	**584.7**	**8.1**	**20.5**	**47.2**	**135.1**	**(14.9)**	**1.3**		**106**	**2.0**
Fund rank in sector	**10**	**1**	**1**	**1**	**2**	**12**	**2**		**1**	**5**

Source: Morningstar, Edison Investment Research. Note: *Performance to 6 December 2019 based on ex-par NAV. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

Two of UIL's board members, Eric Stobart and Warren McLeland, stood down after the release of the company's annual report in September 2019. Stobart had served as a director since 2007 and McLeland since 2013. There are now five directors on UIL's board, four of whom are independent of the manager:

- **Peter Burrows** (chairman) joined the board in September 2011 and assumed his current role in November 2015. He has a background in stockbroking and in 1986 founded Burrows, his own independent specialist private client stockbroking business. Burrows has served as chairman and director of a number of listed and unlisted companies.
- **Alison Hill** was appointed as a director in November 2015. She is an executive director and CEO of Bermuda-based The Argus Group, which provides insurance, retirement and financial services. Hill is a trustee and on the committees of a number of non-corporate organisations in Bermuda. She is a fellow of the Chartered Institute of Management Accountants and a chartered global management accountant.
- **Christopher Samuel** joined the board in November 2015. He was CEO of Ignis Asset Management until mid-2014, when it was acquired by Standard Life Investments. Samuel is a chartered accountant and chairman of BlackRock Throgmorton Trust and JPMorgan Japanese Investment Trust, and a non-executive director of Alliance Trust and Sarasin & Partners.
- **David Shillson** was appointed as a director in November 2015. He has a background in corporate and commercial law across a variety of sectors and is a senior partner of New Zealand-based Kensington Swan. This law firm has acted for associates of UIL and ICM; therefore, Shillson is considered to be a non-independent director. He is a member of the New Zealand Law Society and the New Zealand Institute of Directors.
- **Stuart Bridges** is the newest member of the board; he was appointed in early October 2019. He is also chairman of the audit and risk and management engagement committees. Bridges is a non-executive director and chairman of the audit committee of Caledonia Investments and RateSetter (the trading name of Retail Money Market). He is a chartered accountant; his previous employment includes senior roles at Control Risks Group, Nex Group, Hiscox and Henderson Global Investors.

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