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## Capital Allocation

Dear Mike

We are writing, first and foremost, to congratulate you and Infrared on an outstanding result: the sale of the A63 at a 21% premium to NAV. Well done!

The board and shareholders must now turn their attention to capital allocation. We felt it appropriate to write to you publicly, as we think our concerns are of fundamental interest to all shareholders and because it sounds, from your announcement, that plans to redeploy capital are quite advanced.

In the RNS you state that:

*The Board sees significant opportunity to invest the proceeds into currently available investment opportunities, where these enhance HICL's strategic priorities and the expected returns exceed the hurdle set by share buybacks.*

I am afraid we are extremely sceptical that such investments can be found *without materially altering the risk profile of the fund*. At the time of writing the share price of HICL is 115.6p which represents a discount of 26% to the last published NAV and a 27% discount to the pro-forma NAV, taking into account the uplift from this disposal. The weighted average discount rate on the existing portfolio stands at 8.4%.

Any shares repurchased by the company today generate an immediate return of 37%. Such repurchases are accretive to NAV per share, earnings per share and dividend cover. In addition, pursued with vigour, they would reduce the discount to NAV at which the shares trade.

We assume that your hurdle for new investments is the “share price implied net return”, which you refer to in your most recent interim results. We think that this hurdle is insufficient as it assumes an infinite time horizon. We are a patient, long term investor, but as Rowan Atkinson once observed “eternity... I hardly need tell you, is a heck of a long time”.

To illustrate this point, we generously assume that a new investment must breakeven, as compared with share repurchases, within 7 years. The required rate of return for a new investment to achieve this is 13.4%<sup>1</sup>. Even then, we find it extremely unlikely that such investment opportunities exist since

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<sup>1</sup> Calculated as the immediate uplift of 37% from repurchasing your shares followed by compounding over a 7 year period at the portfolio discount rate of 8.4%.

– at a similar level of risk – they would need to offer prospective returns 60% higher than the existing portfolio. That is before considering the additional risk of making new investments into unknown assets compared with buying your own portfolio at a discount.

Furthermore, we think it highly likely that the company's NAV is understated. The company has now, as your announcement highlights, made £1bn of disposals at an 11% premium to the stated NAV. Two immediate conclusions flow from this observation. First, the true return from buying back shares is likely to be higher than the 37% figure quoted above. Second, and more importantly, this highlights the challenge of making attractive new investments. For any new investment to be more attractive than repurchasing your own shares, such purchases must be made at a discount to fair value greater than the discount at which your shares trade. We share your belief that Edward and his team are skilled managers, but even he would struggle to simultaneously sell assets for £1.21 and buy assets, of similar quality, for less than 73p. The market is simply not that inefficient.

We are not alone in our views; you will doubtless have read research commentary published this morning which shares our scepticism.

An unfortunate consequence of the proposed merger with TRIG is that your shareholders have concerns over the board's approach to capital allocation and to maximising shareholder value. This is reflected in the significantly higher discount to NAV at which HICL's shares trade relative to its peers. Given everything that we have laid out above, we think there is a considerable risk that your statement today will compound this issue<sup>2</sup>. We urge you to set out more clearly your framework for making new investments and to place much greater emphasis on buybacks over new investments until the discount has narrowed very materially.

We would very much welcome the opportunity to discuss this matter with you and the manager. We would also welcome discussing this with other shareholders *especially those who might hold different views to our own*.

Yours sincerely



Chris Clothier

Co-CIO, CG Asset Management

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<sup>2</sup> Indeed, at the time of writing the share price reaction is less than the pro-forma increase in the NAV per share.