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Infratil Limited: Comparison of Actual and Simulated Management Agreement Fees

Management services are supplied to Infratil by the Manager (H.R.L. Morrison & Co) under a management agreement (the 'Agreement') dated February 1994 and subsequently amended in 1995, 2001, 2002 and 2005.

In 2017, the Infratil Board commissioned Fidato Advisory Ltd. to review the fees payable to the Manager under the Agreement and to assess whether, in its entirety the Agreement is in the best interest of Infratil shareholders. The review concluded that based on a comparison of the fee terms of the Agreement and the terms expected for comparable funds, the fee terms under the Agreement were fair to Infratil shareholders.

In late 2019, the Board commissioned Fidato to undertake an updated review of the fee terms of the Agreement involving a two-stage process.

In the first stage, Fidato reviewed the remuneration structures of management agreements for funds which were identified as being most comparable to Infratil, and compared them to the terms of the Agreement, the findings of which are summarised as follows:

Management fees

The level of base management fees payable in relation to New Zealand and Australian assets falls within the range of comparable funds' base management fees.

The base management fees payable in relation to assets outside New Zealand and Australia are higher than the base management fees of the comparable funds, though it should be noted that assets outside New Zealand and Australia form a small part (less than 5%) of Infratil's total value.

Incentive fees:

The incentive fee structure under the Agreement is similar to the incentive fee structures of the comparable funds which provide for the manager to be paid a share of performance in excess of a hurdle rate. In addition, the 20% share of excess performance in the Agreement is in line with levels seen for actively managed comparable funds. However, the hurdle rate in the Agreement of 12.0% is substantially higher than the hurdle rates in the comparable funds which range from "10 Year Government Bond Rate + 4%" to a fixed 8% per annum.

In addition:

- The incentive fee in the Agreement applies only to non-New Zealand assets whereas the incentive fees in the comparable funds apply to all assets;
- Like most of the comparable funds, the incentive fee structure in the Agreement does not provide for the manager to participate in return below the hurdle rate (i.e. making the hurdle rate essentially a preferred return);

- Some of the comparable funds featured some sort of 'high water mark' clause to qualify future performance fee payments and this is not a feature of the Agreement. However, under the Agreement, payment of the second and third tranches of an annual incentive fee1 requires the base valuations agreed in the first year to be maintained; and
- The terms of all the comparable funds provide for deferred payment of earned performance fees across more than one fiscal period. Under the Agreement any annual incentive fee is structured in this manner (with payment occurring over three years, subject to the relevant value being maintained), however this feature does not apply to any initial incentive fees or any realisation incentive fees that become payable under the Agreement.

In the second stage, Fidato undertook simulation modelling to compare total incentive fees under a hypothetical contemporary incentive fee structure with the total incentive fees that were actually paid or accrued by Infratil since inception in accordance with the Agreement. We note that, because annual independent valuations were not required or undertaken for the entire Infratil portfolio (particularly its New Zealand investments), the rate of return generated by Infratil's portfolio of assets in each year was inferred from the total returns earned by holders of the company's debt and equity in each year, as determined based on publicly available information.

The results of the modelling indicated that the simulated incentive fees which would have been paid (or accrued) under a contemporary fee structure are, in present value terms, materially larger than the incentive fees actually paid (or accrued) under the Agreement. On that assessment, the current remuneration structure under the Agreement has, in totality, been demonstrably beneficial to Infratil shareholders over the 26 years.

Fidato Advisory Ltd. provides governance advice, and assurance and procurement services to wholesale and institutional investors. Founded in 2010 by Dr. Edward Schuck, the firm has worked with an extensive list of clients which includes charitable and consumer trusts, Maori funds, family trusts, listed companies and Crown agencies. A key aspect of Fidato's services is the firm's independence; it is not a provider of investment products and focuses solely on the provision of consulting services. Typical assignments include:

- Review of external investment advisor
- Review of statement of investment policy and objectives
- Advice on the governance of portfolio management (i.e. structures, delegated authorities and procedures)
- Support for tenders (i.e. management of RFP, advice on commercial terms)
- Investment product reviews

[1] Pursuant to the Agreement, there are the following categories under which performance fees are assessed each year: 1). Initial Incentive Fees, this is the first assessment and occurs in the third financial year following the acquisition of the investment; 2) Thereafter, annual incentive fee assessments until 3). A realisation incentive fee is assessed in the year in which the relevant investment is disposed of.