BondAdviser

Research Report

Report Created on 8 May 2019

Issuer Name

The Trust Company (RE Services) Limited

Security Name

MCP Master Income Trust

Security Recommendation

Subscribe

Security Risk

Upper Medium

Issuer Outlook

Improving	Stable	Deteriorating

(Selected: Stable)

Key Characteristics

Product Type	Listed Investment Trust	**Asset Class**	Fixed Income
Issue Size*	$[1,128,000,000.00]	**Sub-Asset Class**	Credit
Net Asset Value	$2.00	**Investment Manager**	Metrics Credit Partners Pty Ltd
Current price	$[2.03]	**Responsible Entity**	The Trust Company (RE) Services Ltd
Fixed/Floating	Floating	**Custodian**	Perpetual Corporate Trust
Payment Frequency	Monthly	**Administrator/ Unit Registrar**	Mainstream Fund Services Pty Ltd
Target Return**	RBA Cash Rate plus 3.25%	**Offer Opens**	7 May 2019
Current Distribution***	[5.50]%	**Offer Closes**	27 May 2019
ASX Listed	Yes (ASX Code: MXT)	**Offer Price**	$2.00 (NAV)
Convertible	No	**Allotment Date**	3 June 2019
GICS Sector	Diversified Financials	**Normal Trading**	4 June 2019

* Issue size subject to final size of entitlement offer and placement. ** Distributions target a yield of 3.25% over the RBA Cash Rate but this can be subject to change. *** Based on annualised distribution rate of next distribution.

Summary

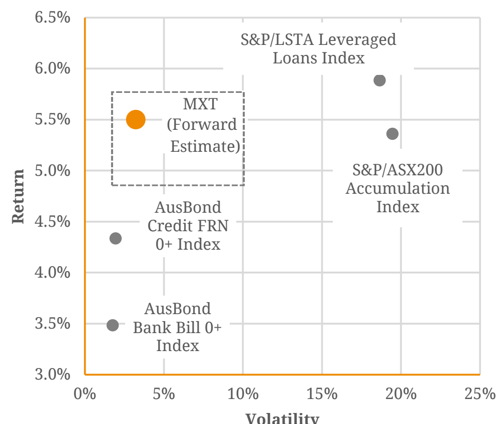
The MCP Master Income Trust (ASX: MXT) is a listed investment trust designed to provide investors with access or exposure to the Australian corporate loan market. This sub asset-class is a major pillar of the Australian corporate debt market but has historically been restricted to major global banks and institutional investors. For this reason, MXT offers a unique investment opportunity and exposure to a market typically not accessible to retail investors.

The investment objective of the trust is to provide stable income with a target return of the RBA cash rate plus 3.25% p.a. ([currently 5.50%]) after fees payable monthly. The Trust has invested in the MCP Wholesale Investments Trust, which, in turn, invests in wholesale funds that invest across the credit risk spectrum and are managed by Metrics Credit Partners Pty Ltd (Metrics). The Trust Company (RE Services) Limited serves as the Responsible Entity (RE). The Trust commenced trading on the 9th of October 2017 on the ASX at a Net Asset Value (NAV) of $2.00 (equal to the issue price of $2.00 per unit).

On 16 April 2019, the RE announced a non-renounceable Entitlement Offer to the guided value of $400 million. The entitlement offer ratio is 1 new unit for every 1.8 existing units and holders who take up their full entitlement may also apply for new units under the Oversubscription Facility. Any units not taken up under the Entitlement Offer will be offered to new investors under the Shortfall Offer (placement).

The offer opens and closes on 7th and 27th of May 2019 respectively. The additional units are expected to be issued on 4 June 2019 at NAV ($2.00) and assuming the full amount is raised, will increase total funds raised to ~$[1.1 billion].

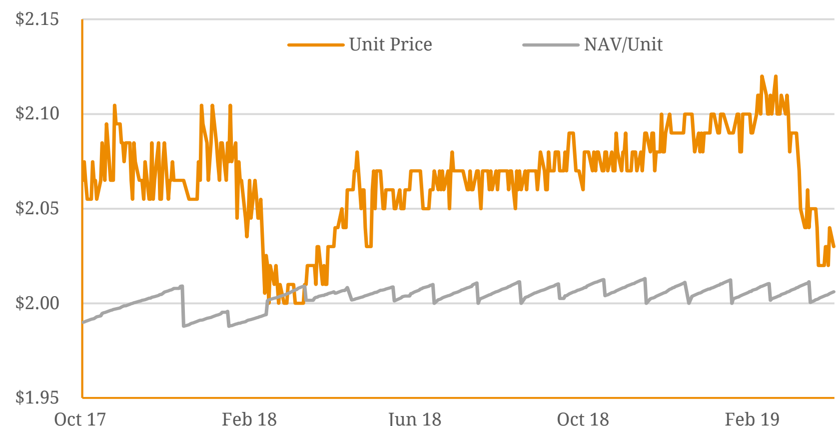
Figure 1: 10Y Risk Return[1]



[1] Forward return estimates for MXT, given inception was in 2017.

Source: BondAdviser Estimates, Bloomberg

Figure 2: Unit Price and NAV/Unit Performance



Source: BondAdviser, Bloomberg

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Security Recommendation - Subscribe *as at 8 May 2019*

A listed investment trust (LIT) structure derives unit holder returns from two sources: distributions and capital movements in the underlying portfolio as well as unit price movements which drive the prevailing premium/discount to NAV. The latter is a function of market and manager sentiment but also liquidity and structural features of the Trust. The Manager has established multiple mechanisms to assist in the stability of NAV and trading price. Price movements away from NAV are in our opinion speculative and not a function of fundamentals or financial risk management. The former is subject to risks and the investment manager's successful implementation of its portfolio strategy and risk framework.

Following its successful launch in October 2017, MXT has been met with strong demand in the secondary market. Consequently, units have consistently traded at a premium to NAV highlighting the quality of the underlying funds (sentiment driven). Operationally, MXT has exposure to over 100 loans, we would expect this to increase, given the additional capital of the Entitlement Offer. The NAV has remained stable at $2.00 (on an ex-distribution basis) highlighting the strength of Metrics' portfolio strategy and risk framework.

Overall, MXT has delivered on its targets and is performing in-line with our pre-market 'Subscribe' recommendation. MXT continues to provide diversified exposure to corporate loans with returns that are not correlated to equity markets. Our ongoing recommendation on MXT is a blend of both subjective and objective analysis of the underlying portfolio. We reiterate that this product offers investors a stable source of income with the margin being offered over the RBA Cash Rate considered fair and commensurate with its risk and the performance of MXT has confirmed our assumptions to date.

For this reason, we recommend investors **Subscribe** to the Metrics MXT Entitlement Offer and/or Shortfall Offer.

Positive / Negative Risk Factors

What factors would change the Recommendation UP

- Corporate loans are often secured by assets and rank ahead of other capital investors in an event of default.
- Underlying REDF and SPDF II funds now have 1.5+ years of trading history and have consistently delivered excess returns over their respective hurdle rates. DASLF has nearly a 6-year track record of providing reliable returns above benchmark.
- Loans remain the primary funding source for Australian companies resulting in a diverse investment universe across different industries and across the credit risk spectrum.
- Specialist expertise is required to operate in this market which is encompassed in Metrics' seasoned investment team.
- Metrics has a competitive advantage over banks who must comply with stringent capital regulation. For this reason, Metrics can be more flexible in its investment approach. Further regulatory pressure for banks would result in new investment opportunities for MXT. We acknowledge APRA has taken a recent interest into shadow banks, but this focus has been in the residential mortgage segment rather than the corporate loan market.
- A rising interest rate environment would result in higher future loan yields and improve underlying fund performance.
- Losses in the Australian corporate loan market has historically been very low.

What factors would change the Recommendation DOWN

- The corporate loan market is an interbank market which may be viewed as being less transparent than the corporate bond market (private side loan vs public side bond instruments).
- The underlying funds have a track record in relatively benign economic conditions and are yet to be tested in a continued period of economic distress.
- Given the unit price of the LIT is determined in a public market (ASX), the value of the product will be more sensitive to news flow and other announcements relative to Metrics' wholesale offerings.
- Reputational Risk: Loss of key relationships with clients which may compromise future business.
- Credit Migration Risk: Credit quality deterioration (or in a worst-case scenario, loan defaults) in the loan portfolio could result in asset write-downs.
- Lower interest rate environment due to additional rate cuts by the RBA would dampen future loan yields.
- Competition for corporate loans increasing. The penetration of international banks could crowd out smaller participants and result in loan margin compression.

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Issuer Outlook - Stable *as at 8 May 2019*

Performance

Similar to other debt instruments, loan performance is dependent on income and capital valuation. The capital value of loan assets will typically remain anchored around par value (see Valuation section) and because they are not actively traded,performance is predominantly driven by fees and income derived from origination and participating in underlying corporate loans.

In most cases, corporate loans are priced at an interest rate spread above a floating rate reference rate (BBSY in Australia). The spread will be contingent on many factors such as size, term, credit risk (and associated covenant package), purpose, the demand/supply dynamics of the market (i.e. business credit availability, alternative funding sources) and can be linked to conditions outlined in the agreement with the lender (i.e. credit deterioration, prepayment triggers). With the interest rate representing the ongoing cost of the loan, the lender can also receive various other fees which will result in incremental return including up-front fees, establishment fees and commitment fees. While effectively trying to achieve the same purpose for the issuer, the risks and sources of return are different to the traditional bond market.

MXT is designed to distribute funds across Metrics' Diversified Australian Senior Loan Fund (DASLF) and two funds which were established simultaneously with MXT. The DASLF represents Metrics' inital investment offering (60% weighting in MXT) and has consistently provided strong risk-adjusted returns. The complimentary private debt funds comprise the higher-yielding Real Estate Debt Fund (REDF, 20%) and the Secured Private Debt Fund II (SPDF2, 20%).

Overall, MXT currently consists of >100 individual investments, which is above Metrics' initial target of 75-100 loan assets. This target has subsequently been increased to >100 individual investments, which is not surprising given the greater capital available. MXT performed well over 2018, with net returns of 5.40%, furthermore strong price appreciation of MXT has generally provided solid mark-to-market capital returns to investors. The Trust has traded at ~3% premium to NAV since inception, however both the price and premium have fallen in anticipation of entitlement offers. Although this consistent premium represents a deviation from NAV (which should theoretically unwind over the medium-term), it demonstrates the strong underlying demand for MXT and is a testament to the quality of the underlying assets and Metrics' performance.

Risk Framework

Unlike bonds, capital price appreciation for loan assets is rare which emphasises the skew in credit investing (i.e. limited upside). It also makes risk management (or price downside) more important. While each loan asset has its own unique risk profile; scale and diversification is required to isolate and control credit risk at a portfolio level. At a loan level, extensive due diligence at all stages of the loan cycle is required and seasoned expertise in loan structuring (i.e. covenants, seniority, collateral) ensures loan level risk is managed. Similar to the Major Banks (the dominant players in the market), Metrics employs a rigorous risk framework to ensure portfolio quality is maintained and scheduled income is received in accordance with contracted obligations with borrowers.

While risk is monitored by the investment team on daily basis, structural risk mitigants at both an individual asset level and aggregate portfolio level underpin Metrics' investment philosophy. Asset selection involves a stringent set of criteria in which potential candidates are reviewed at multiple levels and ultimately decided upon by the investment committee. If eligible for the fund, loan agreements will often be secured by assets and will be subject to a custom covenant package tailored to the individual borrower. Risk limits are then set during the portfolio construction phase to ensure sectoral and counterparty diversification is achieved ensuring the portfolio's credit exposure generates a superior risk-adjusted return. The majority of the loan book will be secured under senior ranking arrangements, ensuring recovery rates remain high if faced with nonperforming assets. Historically, in excess of 90% of Gross Asset Value (GAV) has been positioned under senior ranking arrangements in the core DALSF. Additional risk limits have been set at an individual fund level in relation to leverage as well as counterparty and sector exposure.

Management

One of the key elements to this offering is access to an investment manager who operates very differently to traditional investment managers in actively traded assets. The Metrics Investment Team has a long and successful history of providing and managing corporate debt (i.e. loans, bonds and associated products) for corporate borrowers. While many investment managers have access to corporate bonds, the vast majority of corporate debt in Australia is provided in the loan market and more specifically by local and offshore banks. In Australia, the market has almost exclusively been dominated by the major banks (in the past) whereas internationally this is not the case.

High barriers to entry in the domestic loan market are one the key impediments to external investment. A significant and sophisticated asset base is required to even start. It also requires specialist operations, legal and negotiating teams who have sufficient experience to get invited to the table by an arranging party (i.e. corporate adviser, bank etc). The final element is having sufficient knowledge of the market as well as contract and insolvency law to ensure they can recover invested capital prior to default. This is the primary advantage over corporate bonds, that is, the structural terms provided are generally in favour of the lender (investor in this case) rather than the borrower.

While we acknowledge this will not always be the case, Metrics has the advantage of building favourable terms and conditions into loan assets which illustrates management's clear expertise and focus on risk mitigation.

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Market Outlook

From a borrower's perspective, loans are advantageous due to their cost and flexibility relative to other forms of debt such as bonds. This is partially the reason why loans are the dominant debt funding source for Australian companies. This leaves Metrics with a vast opportunity set within the Australian corporate loan market and an enviable position to capitalise on opportunities and offer investors credit exposure historically non-existent outside the walls of a bank.

Fundamentally, we see minimal stress across the corporate credit spectrum with systemic risk largely muted in fairly benign economic conditions. There are some pockets of financial distress and increased risk appetite to participate in mergers and acquisitions (increased leverage) but this is typically well understood by lenders (including Metrics).

For corporates, organic growth opportunities remain limited in line with a slowly deteriorating economic climate, and as a result, corporate strategy remains anchored to acquisitive growth, restructuring and cost initiatives. This has resulted in typically healthy balance sheets with low leverage and high liquidity but history suggests this can reverse quickly if smart acquisitive strategies evolve into speculative corporate activity, especially as the credit cycle has reached a late stage. However, balance sheet deterioration and rising default rates are a required precedent and are not a near-term scenario in our opinion.

Systemic market-wide shocks (tail risks) are a primary risk to our outlook for corporate credit but due to structural features (i.e. covenants, capital structure) and significant lender protection inherent in loan funding, we remain comfortable with the credit risk of the loan market and MXT.

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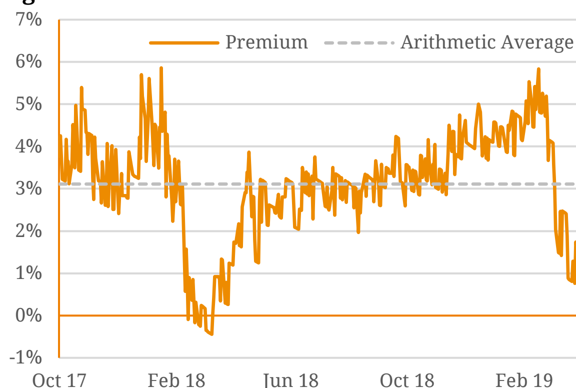
Master Income Trust Performance Update

Since listing in October 2017, MXT has exhibited solid performance. On a relative basis, MXT has outperformed all other domestic fixed income asset classes to date (see Figure 4) with a cumulative gross return of 9.82%. Due to strong demand in the secondary market, the units have traded consistently above NAV (average premium of 3.1%) (see Figure 3) and only moderated twice (March 2018 and currently) on anticipation of entitlement offers, which are issued at NAV.

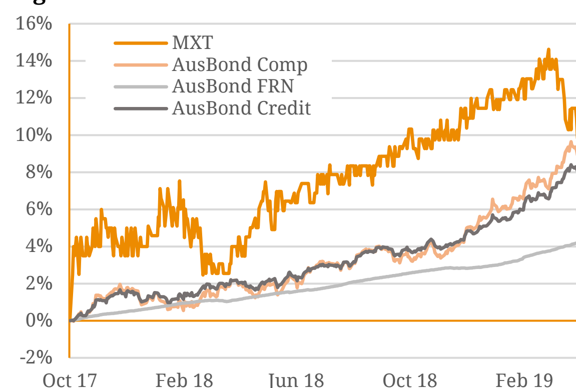
As stated in the pre-market documentation, the first distribution was made for the first three months of trading on 12 January 2018 before shifting to monthly distributions. The March 2019 monthly distribution was made at 1.13c per unit, which denotes an annualised distribution rate of 5.48% since listing, which exceeds the target net return of RBA Cash Rate + 3.25% throughout the economic cycle (pro-forma 4.75% p.a.).

Figure 3. MXT Premium to NAV



Source: BondAdviser, Bloomberg, Metrics

Figure 4. Relative Cumulative Performance



Source: BondAdviser, Bloomberg, Metrics

Table 1. Total Price Return Composition

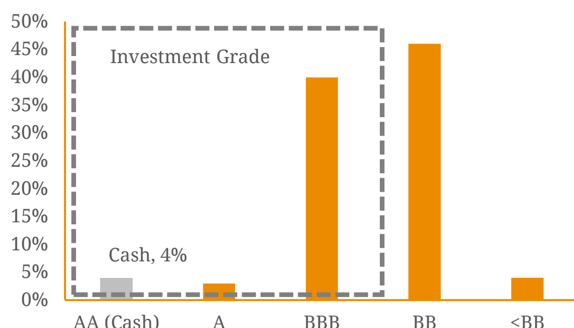
Component	Mar-19	Feb-19	Jan-19	Dec-18	Nov-18	Oct-18
Market Price	$ 2.05	$ 2.11	$ 2.10	$ 2.10	$ 2.09	$ 2.08
NAV	$ 2.00	$ 2.00	$ 2.00	$ 2.00	$ 2.00	$ 2.00
Distribution	1.13c	0.96c	1.08c	0.89c	1.20c	0.90c
Premium/Discount	2.50%	5.50%	5.00%	5.00%	4.50%	4.00%

Source: BondAdviser, Metrics

Operationally, Metrics expects to deploy capital raised from the Entitlement Offer in a timely manner. We naturally expect Metrics in the future to raise fresh capital for further expansion of its investment strategy in the corporate loan market. We prospectively remain cautious to the possible downsides of accelerated AUM growth, given the complexity of the market, long lead times of origination and reinvestment requirements of maturing loans. This could potentially lead to weaker origination standards, which facilitate the deployment of capital.

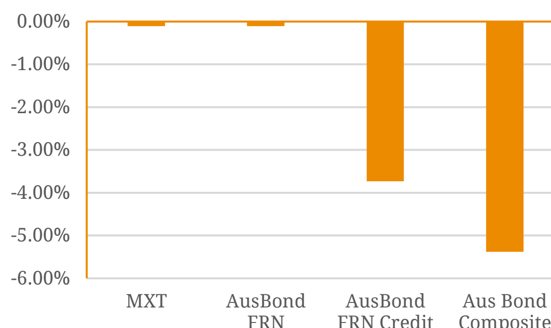
In terms of risk, 60% of assets are investment-grade (see Figure 5 – inclusive of 4% cash) while credit duration remains short relative to other asset classes at 2.5 years (aligned with Metrics' robust risk management framework). Additionally, monthly distributions ensure that interest rate sensitivity remains (see Figure 6) negligible which is a major advantage of MXT in the current economic climate.

Figure 5. MXT Rating Distribution



Source: BondAdviser, Metrics as at 31 March 2019

Figure 6. ~Change in MV for +1% Interest Rate Move



Source: BondAdviser, Bloomberg, Metrics

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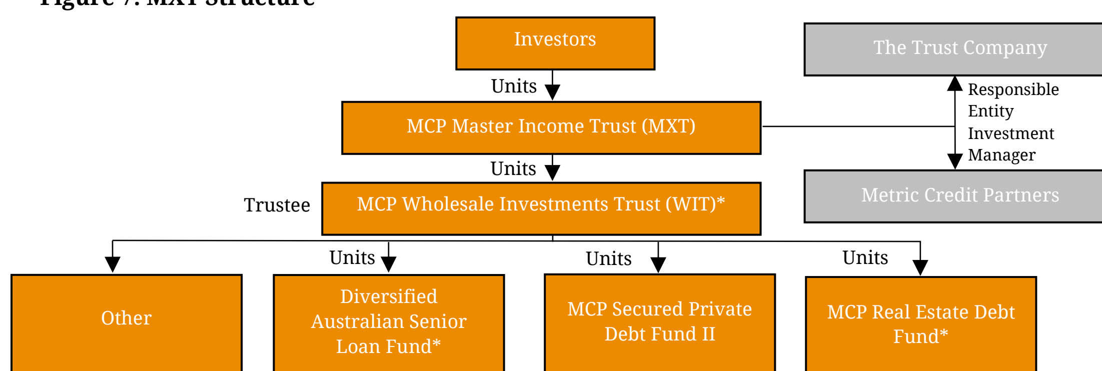
Asset Allocation and Legal Structure

The legal structure of MXT is reasonably complex from a high level but protects the unitholder by engaging a separate independent Responsible Entity to act in the best interest of holders. MXT is a passive trust which will fully invest any funds raised into the MCP Wholesale Investments Trust (WIT) which in itself has an independent trustee. The WIT controls the allocation into the underlying funds and assets (see Figure 7).

The MCP Master Income Trust (Metrics MXT) aims to generate a minimum return of the RBA Cash Rate plus 3.25% net of all costs and fees (currently 4.75%) by investing in Metrics' wholesale funds. This includes Metrics' Diversified Australian Senior Loan Fund (DASLF), Secured Private Debt Fund II (SPDF2) and Real Estate Debt Fund (REDF). Actual allocation is expected to be 60-70% for DASLF, 20-30% for SPDF II and 10-20% for REDF with no less than 60% of MXT proceeds going into the DASLF. Importantly, the portfolio is diversified across borrowers, industries, credit quality and loan products. This DASLF delivers the majority of the MXT's investment grade exposure while the SPDF II and REDF provide the bulk of the high- yielding exposures. WIT retains the flexibility to alter the allocation mix to best deliver on the Investment Objective but any changes to allocation of underlying wholesale funds would require Responsible Entity approval. Unitholders will receive advice of any material changes via Metrics' website and the ASX. The current allocation is DASLF 60%, REDF 20% and SPDF II 20%.

Figure 7. MXT Structure



Source: Company Reports, *Metrics is the manager of each of the DASLF, SPDFII, REDF and WIT

Investment Strategy

MXT's investment strategy is focused on the success of the investment strategies of the underlying funds.

- The underlying investment universe will target ~100 primarily floating rate corporate loan investments promoting diversification and protecting investors against a rising interest rate environment.
- The portfolio will be diversified across industries and the credit quality risk spectrum with limited exposure to the government sector and no exposure to the Australian banking sector.
- Each individual asset is expected to be no greater than 5% of total funds under management at origination.
- On a consolidated basis, the investment universe is expected to comprise ~85% of Australian domiciled borrowers.

DASLF represents Metrics' core investment fund focusing on large syndicated scale corporate loan assets across a diverse range of industries. The fund comprises ~94 investments and has an external credit rating of BBB+ (Positive Outlook) by Standard & Poor's (S&P). The DASLF is the longest serving Metrics fund and hence, has the most extensive trailing performance history (4.97% p.a. net of fees since June 2013 inception).

SPDF II invests in Australia's mid-market corporate loan market with a portfolio (~16 investments) of sub-investment grade loans targeting an annual return equal to 4.00% over the 90-Day Bank Bill Swap Rate (BBSW). Since inception (October 2017), the fund has returned 8.85% net of fees.

REDF invest in a portfolio (~18 investments) of Australian Commercial Real Estate (CRE) debt assets targeting an annual return of 5.00% over the 90-Day BBSW. Since inception (also October 2017), REDF has returned 8.23% net of fees. On this basis and given the indicative weightings, we believe the underlying funds should continue to comfortably meet the MXT target yield (4.75%).

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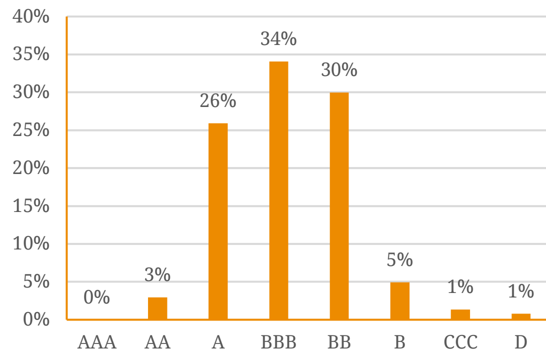
Risk/Return Analysis

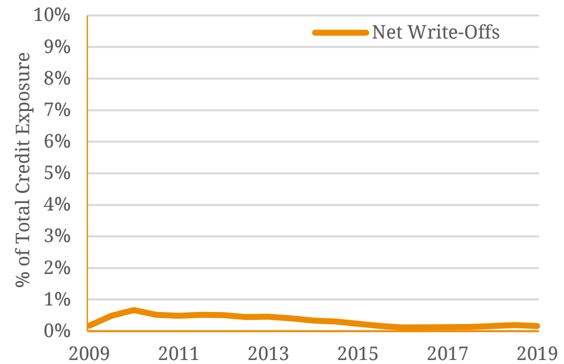
There is no broad market index for the Australia corporate loan market which makes it difficult to analyse the sub-asset class on a risk/return basis. The most useful gauge of market characteristics is the four major Australian banks who dominant corporate lending with a market share of ~75%. Public corporate loan return data from the banks is limited but historical risk metrics can be derived from regulatory disclosures. While credit quality across the major banks' aggregate corporate loan book is diverse and ~30-35% non-investment grade on average, loss rates have been muted throughout the economic cycle which differentiates corporate loans from other corporate debt instruments.

Figure 8. Major Bank Corporate Loan Book Credit Profile



Source: Major Banks' APS 330 as at 1H19

Figure 9. Major Bank Historical Loss Rates

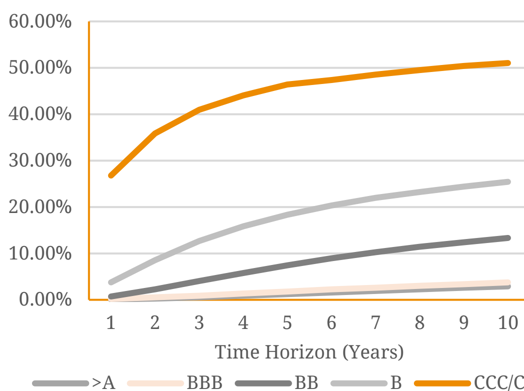


Source: Major Banks' APS 330

Given loans are generally held to maturity by the lender, they are not typically marked-to-market for profit purposes as would otherwise occur with other fixed income instruments. For this reason, credit migration risk (i.e. deterioration in the credit quality of an asset) will typically not impact loan profitability in the absence of default. While loan margins are usually fixed and the lender may not be adequately compensated for the increase in credit risk, this is typically mitigated by the margin being linked to credit quality by way of public credit rating, financial covenants and other structural features.

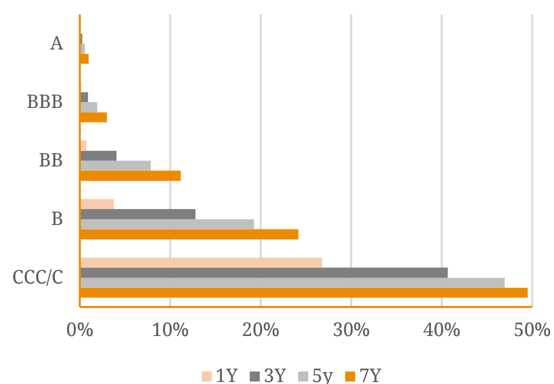
For bank lending, negative credit migration will increase the probability of default and hence, the bank will be required to hold more capital against that asset (decreasing its return on capital) but this is irrelevant for equity-funded non-bank lenders such as Metrics. As a result, the primary downside risk to a corporate loan portfolio is the risk of default (i.e. non-payment of interest and/or principal at maturity). Although counterparty and sector default risk can be diluted across a portfolio of many assets, systemic risk (market risk) will always persist. Mitigation will depend on the effectiveness of individual loan structures (i.e. covenant package, tenor, seniority) to ensure recovery rates remain high in the event of default. Unsurprisingly there is strong positive relationship between credit quality, term and the probability of default (see Figure 11). For this reason, credit risk migration is closely monitored by lenders and is a key input into loan valuation.

Figure 10. Global Corporate Average Cumulative Default Rates (1981 – 2017)



Source: S&P

Figure 11. Global Corporate Average Transition Rates to Default by Time Period (1981 – 2017)



Source: S&P

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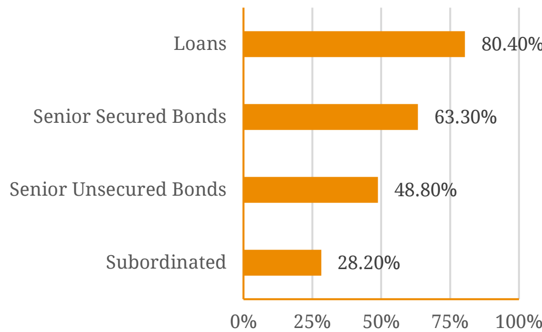
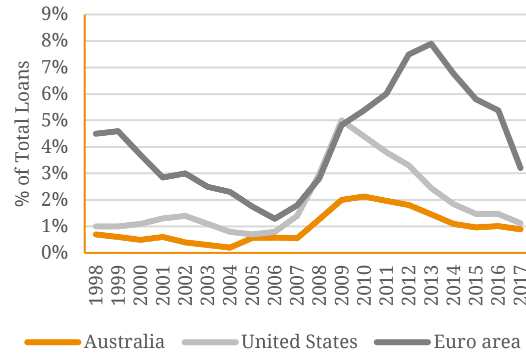
There is also a positive relationship between seniority (in context of the capital structure) and recovery rates. According to Moody's Investor Services, corporate loans have demonstrated a global recovery rate of ~80% behind senior secured bonds (~60%), senior unsecured bonds (~50%) and subordinated bonds (~30%). There is a lack of publicly available data to deduce empirical recovery rates for Australian corporate loans but given the domestic regulatory and legal framework (significant lender protection) and the historical loss rates of the major banks, it is reasonable to assume Australian corporate loan recovery to be closer to 95%.

Figure 12. Global Corporate Debt Recovery Rates (1987-2016)



Source: Moody's

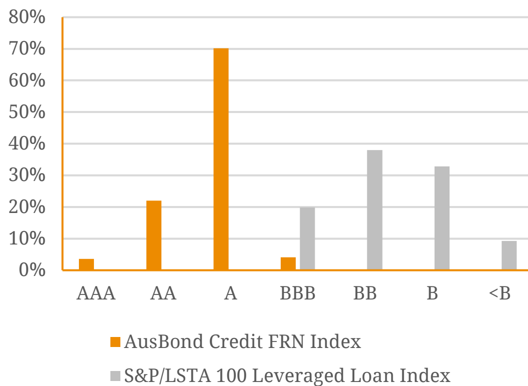
Figure 13. Global Bank Non-Performing Loans



Source: World Bank

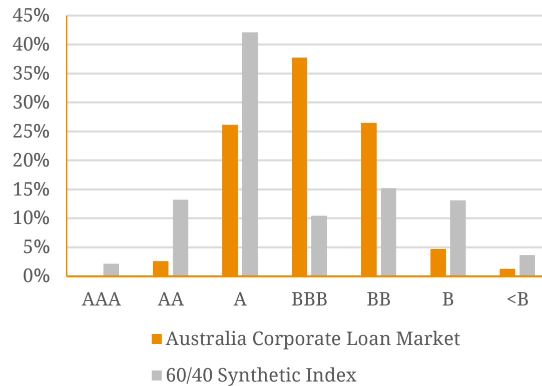
As Australian corporate loans exhibit unique characterises it is difficult to objectively assess expected return. The two comparable indices used in our analysis are the S&P/LSTA 100 Leveraged Loan Index and the AusBond Credit Floating Rate Note Index (0+ Years). The former is designed to reflect the performance of the 100 largest facilities in the US leveraged loan market (high risk corporate loans) while the latter tracks the performance of Australian floating rate notes (primarily banks and other financial institutions). While neither of these indices represent the domestic corporate loan market, our analysis suggests that a 60/40 blend is a reasonable proxy based on individual rating distributions on underlying assets.

Figure 14. Individual Index Rating Distributions



Source: S&P, Bloomberg

Figure 15. 60/40 Rating Distribution vs Market



Source: BondAdviser Estimates

While this proxy of credit rating distribution may be close there are too many independent variables to have confidence in its historical returns. For this reason, the most appropriate indicator of performance (albeit limited) is the trailing history of Metrics' Diversified Australian Senior Loan Fund which represents the majority allocation under the MXT. The DASLF has returned a strong risk-adjusted performance but we concede this has been achieved in fairly benign economic conditions.

Nonetheless, historical data from the major banks' corporate loan books gives us confidence in the resilience of Australian corporate loans through the economic cycle which is ultimately a testament to the expertise required to operate in this segment of the corporate debt market. As a result, we believe the MXT will be able to achieve the return similar to the DASLF (5.04% p.a. since inception). This is also comparable to the blended proxy (5.34% average annual return over 10 years) but at a much lower volatility (8.30% standard deviation in annual returns for the proxy over the same period). Considering the MXT's target yield of the RBA Cash Rate plus 3.25% p.a. (net of all costs and fees) and the RBA's estimate of the long-term cash rate of 3.50% (implying a range of 4.75 – 6.75%), we believe this observable performance is a reasonable estimate of expected return. Due to the valuation techniques used for loans, it is challenging to objectively estimate expected volatility but based on available data we approximate a long-term annual standard deviation of 2.00-6.00%.

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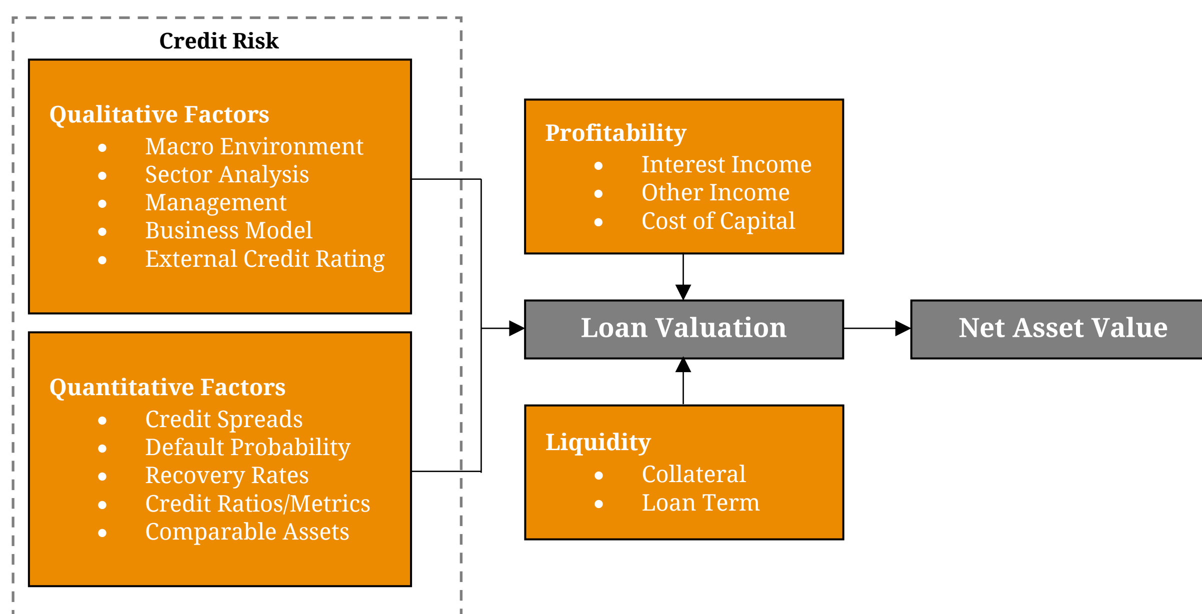
Valuation Considerations

In an active market (i.e. equity and bonds), the value of an asset for the purposes of calculating NAV is its traded price (fair value hierarchy Level 1). However, where an asset is less actively traded or a traded price does not exist, the value of an asset for the purposes of calculating NAV is determined in accordance with applicable accounting standards (fair value hierarchy Levels 2 or 3). Due to the relative illiquidity and private nature of the interbank Australian corporate loan market, credit risk is a key input the asset valuation. Credit risk is assessed in terms of probability that a borrower may default, estimated level of utilisation of a loan at default and the anticipated loss given a default has occurred. As such, loans are typically categorised as fair value hierarchy Level 2 assets and include a subjective element in the valuation process. As there is limited transactional data, Metrics utilises multiple channels to compile as much valuation sources as possible to deduce capital value.

While assets will typically always be priced around par value, potential valuation write-downs will be dependent on underlying probability of default as well as recovery rates at the point of default. Credit spreads are also a useful market-based indicator of default (credit) risk which can be used on a relative basis against peers to identify fair asset value. These quantitative measures will typically warrant a case-by-case approach with company, sector and macroeconomic factors all coming into play. For each of the underlying funds, if loan assets are held below par losses will be charged directly against the profit or loss statement which will ultimately impact the NAV of MXT. However, unlike bonds, a default on a corporate loan by no means results in capital loss which is supported by Metrics' extensive experience in workout and corporate recovery situations. In fact, loan structures are manufactured to ensure experienced lenders such as Metrics can participate and act long before an event of default materialises. We acknowledge Metrics can hold equity interests in work-out scenarios but we believe this is flexibility is necessary to ensure the investment manager can expertly recover distressed debts.

Figure 16. The Loan Valuation Process



Source: BondAdviser

The NAV per Unit of the Trust is published daily on the website of the Manager and lodged with the ASX (under prudent listing and disclosure rules). Nonetheless, the price of MXT is subject to market forces and may deviate from the NAV.

Perpetual Trust Services through its wholly-owned subsidiary The Trust Company (RE Services) Limited is the Responsible Entity of MXT. In addition to the Fund's own Asset Valuation policies and procedures, the Trustee has appointed a major international accounting firm to conduct an Independent Credit Portfolio and Market Price Review providing an independent overlay to asset valuation on a monthly basis.

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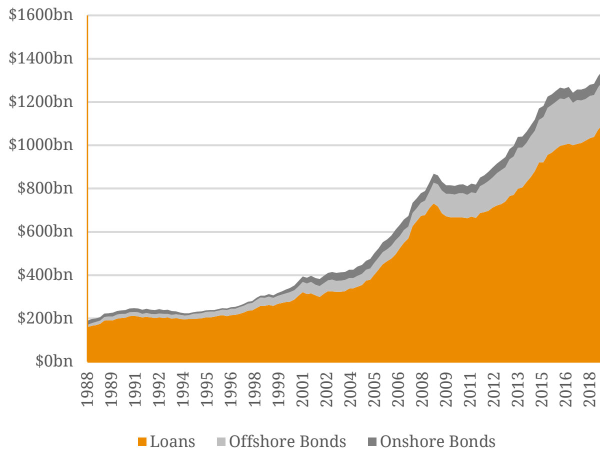
Industry Background: Australian Corporate Loans

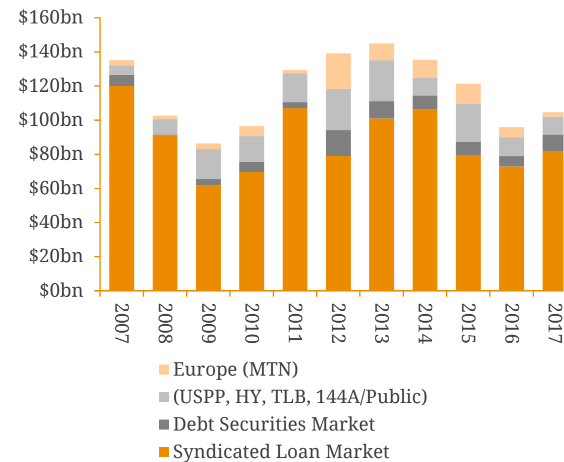
Although the corporate loan market receives relatively little attention in the financial media, it represents the largest component of the corporate debt capital market. As suspected, the market has been historically dominated by the major banks and barriers to entry are high due to the scale, expertise and capital required to ensure portfolio quality and diversification. Nonetheless, the Australian loan markets has remained the primary funding source for Australian corporations and represents ~65% of all Australian corporate debt. In contrast, the domestic corporate bond market represents just ~4% as many issuers prefer to issue debt securities in international bond markets for its cost-effectiveness and exposure to a broader range of investors or source debt capital via the domestic loan market. Overall, the corporate loan market presents an untapped income opportunity for Australian investors.

Figure 17. Australian Corporate Debt Market



Source: ABS

Figure 18. Corporate Debt Security Issuance

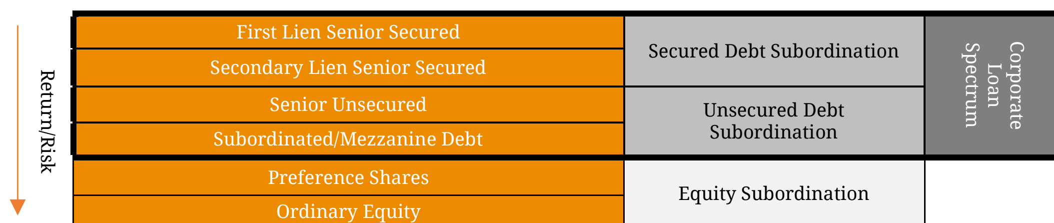


Source: Reuters

In its simplest form, a corporate loan is a debt funding arrangement between a company and a lender. The lender typically provides the company with a borrowing facility in which management can choose to draw-down from and repay as it deems fit. Similar to other loans, the company will pay interest on drawn debt and the facility will be subject to a maturity date where renegotiation will generally take place with the lender or the company will look to refinance from other funding sources. While the general concept is the same, Australian corporate loans typically fit into Bilateral Loan, Club-Style Loan and Syndicated Loan and are one of many funding sources available to companies in the capital market.

To fulfill funding requirements, businesses can either choose to raise debt or equity capital which is further segmented into options of varying tenors and structures. Dependent on the arrangement with the lender, loans can be secured against certain assets (i.e. collateral) or unsecured. These obligations can be further classified into different levels of subordination on both a secured and unsecured basis which in turn forms the company's capital structure. Contingent on the funding requirements of the company, loans can be structured customarily but due to regulatory constraints and internal risk management frameworks, lenders primarily loan funds under senior secured rankings arrangements.

Figure 19. Corporate Capital Structure Example



Source: BondAdviser

As a result, corporate loans almost always rank ahead of other investors in the capital structure making the sub-asset class to be one of more low-risk investments in the fixed income universe. However, the corporate loan market has lower liquidity relative to other fixed income instruments and valuation is less transparent. For this reason, seasoned expertise is required to operate in this specialist market which, among other things (i.e. capital requirements, regulation), has historically hindered external investment.

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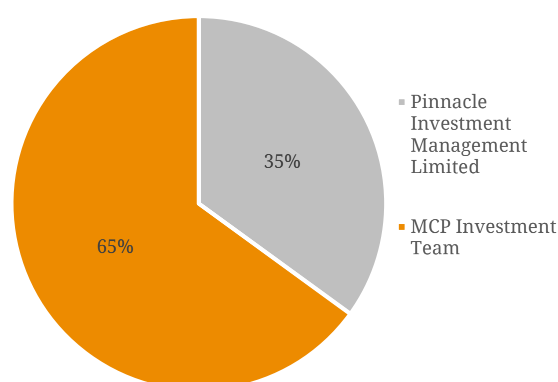
About Metrics Credit Partners

Metrics Credit Partners is an alternative asset manager with specialist skills in fixed income and private credit equity and capital markets, providing expertise to investors seeking opportunities in debt (credit and fixed income) markets with assets under management (AUM) of $4 billion as at May 2019 (see Figure 21). Metrics' Investment Team is comprised of senior and experienced market specialists with on average 30 years' experience investing in and managing corporate debt assets (loans, bonds and associated products). Metrics can support investors looking to access corporate debt including listed and unlisted corporates, infrastructure, leveraged & acquisition and property debt, across the full credit risk spectrum.

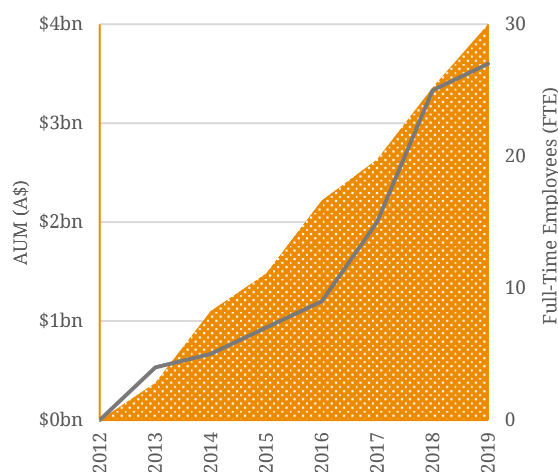
The team responsible for managing the investments of MXT is led by the Investment Committee which consists of four seasoned professionals who are highly experienced. The Investment Committee is responsible for portfolio construction, investment decisions, borrower engagement, investment monitoring and cash flow management. The four Partners on the Investment Committee collectively own 65% of Metrics, with the remaining 35% being own by Pinnacle Investment Management Limited, a subsidiary of Pinnacle Investment Management Group Limited (ASX: PNI). The summary biographies for each member of the Investment Committee are below.

Figure 20. Ownership Distribution



Source: BondAdviser, Company Reports

Figure 21. Assets Under Management Growth



Source: BondAdviser, Company Reports

Investment Committee

Justin Hynes – Justin has considerable loan origination, structuring and portfolio management experience, including workout and restructuring experience. Justin has extensive acquisition and corporate finance experience in both an advisory and principal capacity in Australia and South-East Asia. Justin has approximately 22 years' financial markets experience, and previously specialised in leveraged and acquisition finance as well as corporate finance. Justin holds a Bachelor of Commerce and Bachelor of Japanese Studies from the Australian National University.

Andrew Lockhart – Andrew has considerable loan origination, structuring and portfolio risk management experience and has been responsible for the origination and management of large, diversified and complex loan portfolios including considerable corporate restructuring experience. Andrew has approximately 32 years' banking, funds management and financial markets experience and previously specialised in leverage and acquisition finance as well as corporate and institutional lending. Andrew holds a Bachelor of Business and Master of Business Administration from the Queensland University of Technology.

Graham McNamara – Graham has considerable commercial banking experience covering portfolio risk management, debt origination and distribution, agency management and corporate banking. Graham has approximately 39 years' experience in banking, funds management and financial markets and has established the loan syndications and agency businesses at major Australian banks. Graham served as a director of the Asia Pacific Loan Market Association and was the founding chairman of the Association's Australian Branch. Graham is a Member of the Australian Institute of Company Directors.

Andrew Tremain – Andrew has considerable Australian, European and Asian banking experience covering corporate, structured, leverage and acquisition finance, portfolio management and relationship management. Andrew has approximately 32 years' experience and previously specialised in leveraged and acquisition finance as well as loan syndications. Andrew holds a Bachelor of Commerce from Macquarie University.

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Appendix 1. MXT Underlying Attribution

	F Jun-19	*F May-19*	*F Apr-19*	Mar-19	Feb-19	Jan-19	Dec-18	Nov-18	Oct-18	Sep-18	Aug-18	Jul-18	Jun-18	May-18	Apr-18	Mar-18	Feb-18	Jan-18	Dec-17	Nov-17	Oct-17
SPDFII (BA Estimate)																					
Weight	*20%*	*20%*	*20%*	20%	20%	20%	20%	20%	20%	20%	20%	20%	14%	14%	17%	25%	25%	25%	25%	25%	25%
w/ cash weight	*14%*	*14%*	*14%*																		
Net Monthly	*0.72%*	*0.71%*	*0.70%*	0.68%	0.59%	0.76%	0.81%	0.71%	0.67%	0.64%	0.63%	0.74%	0.53%	0.67%	1.07%	0.66%	0.61%	0.74%	0.71%	0.66%	0.92%
Annualised	*8.97%*	*8.84%*	*8.76%*	8.47%	7.31%	9.51%	10.16%	8.86%	8.34%	7.96%	7.83%	9.25%	6.55%	8.34%	13.62%	8.21%	7.57%	9.25%	8.86%	8.21%	11.62%
REDF (BA Estimate)																					
Weight	*20%*	*20%*	*20%*	20%	20%	20%	20%	20%	20%	20%	20%	20%	14%	14%	11%	15%	15%	15%	15%	15%	15%
w/ cash weight	*14%*	*14%*	*14%*																		
Net Monthly	*0.71%*	*0.70%*	*0.70%*	0.70%	0.61%	0.80%	0.71%	0.66%	0.78%	0.61%	0.67%	0.64%	0.69%	0.80%	0.73%	0.68%	0.43%	0.50%	0.56%	0.54%	0.76%
Annualised	*8.80%*	*8.67%*	*8.67%*	8.73%	7.57%	10.03%	8.86%	8.21%	9.77%	7.57%	8.34%	7.96%	8.60%	10.03%	9.12%	8.47%	5.28%	6.17%	6.93%	6.68%	9.51%
DASLF (BA Estimate)																					
Weight	*60%*	*60%*	*60%*	60%	60%	60%	60%	60%	60%	60%	60%	60%	41%	41%	41%	60%	60%	60%	60%	60%	60%
w/ cash weight	*42%*	*42%*	*42%*																		
Net Monthly	*0.45%*	*0.44%*	*0.43%*	0.48%	0.46%	0.49%	0.45%	0.41%	0.42%	0.41%	0.45%	0.43%	0.42%	0.42%	0.42%	0.38%	0.29%	0.33%	0.39%	0.30%	0.39%
Annualised	*5.48%*	*5.37%*	*5.32%*	5.91%	5.66%	6.04%	5.54%	5.03%	5.16%	5.03%	5.54%	5.28%	5.16%	5.16%	5.16%	4.66%	3.54%	4.03%	4.78%	3.66%	4.78%
Cash (BA Estimate)																					
Weight	*0%*	*0%*	*0%*	0%	0%	0%	0%	0%	0%	0%	0%	0%	31%	31%	31%	0%	0%	0%	0%	0%	0%
w/ cash weight	*30%*	*30%*	*30%*																		
Net Monthly	*0.13%*	*0.13%*	*0.13%*	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%	0.13%
Annualised	*1.51%*	*1.51%*	*1.51%*	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%	1.51%
MXT																					
BA Net Monthly				0.49%	0.45%	0.53%	0.50%	0.45%	0.46%	0.47%	0.50%	0.50%	0.35%	0.39%	0.38%	0.23%	0.18%	0.22%	0.22%	0.21%	0.31%
BA Annualised				6.06%	5.52%	6.51%	6.18%	5.54%	5.72%	5.75%	6.18%	6.23%	4.31%	4.74%	4.64%	2.80%	2.19%	2.71%	2.73%	2.54%	3.75%
Metrics Annualised				**6.68%**	**5.79%**	**5.91%**	**6.42%**	**5.79%**	**6.04%**	**5.54%**	**6.04%**	**6.17%**	**5.54%**	**4.66%**	**4.66%**	**5.28%**	**3.91%**	**4.66%**	**5.03%**	**4.28%**	**5.66%**
BA Estimated **Annualised** Return if:																					
No Cash Lag	*6.46%*	*6.34%*	*6.29%*																		
1m Cash Lag	*6.46%*	*6.34%*	*4.70%*																		
3m Cash Lag	*4.81%*	*4.73%*	*4.70%*																		
Distribution (cents per unit)																					
Reported				1.13	0.96	1.08	0.89	1.20	0.90	0.79	0.96	0.91	0.93	0.81	0.78	0.81	0.73	0.81	2.19	-	-
No Cash Lag	*1.05*	*1.04*	*1.02*																		
1m Cash Lag	*1.05*	*1.04*	*0.77*																		
3m Cash Lag	*0.79*	*0.77*	*0.77*																		

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- **Hold** - Over the next 12 months, the analyst expects the security to provide stable returns broadly in line with the current yield but with little credit spread tightening.
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- **Ceased Coverage** - The recommendation has ceased due to issuers failure to disclosure necessary information or coverage is subjectively removed in accordance with our Research Governance Statement.

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