Fund Research

Metrics Income Opportunities Trust (ASX: MOT)

BondAdviser

Overview

The Metrics Income Opportunities Trust (ASX: MOT) is a listed investment trust (LIT) that enables investors to easily gain exposure to the Australian private credit market, via an actively managed portfolio of primarily floating rate private credit investments.

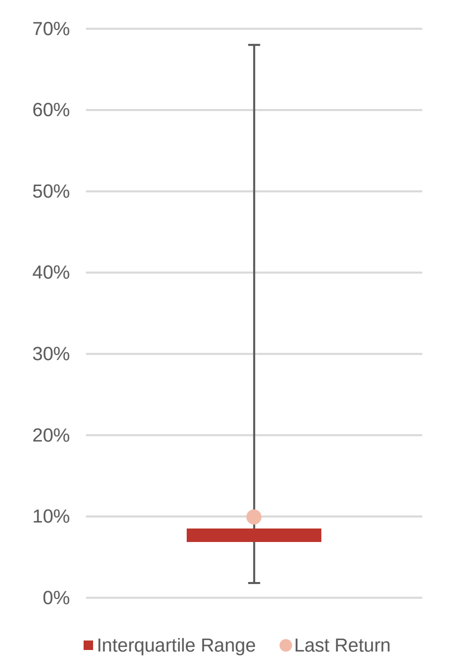
Private credit is a broad asset class that includes investments across the entire capital spectrum, from senior secured loans through to equity-like investments. Accessing this market has not been easy for retail investors as historically it has been limited to institutional investors and major global banks.

The underlying investment portfolio is managed by Metrics Credit Partners Pty Ltd (MCP, Metrics), an experienced alternative asset manager with specialist expertise and a strong track record in the private credit space. The Trust has invested in the Metrics Wholesale Income Opportunities Trust (WIOT), which, in turn, invests in wholesale funds that participate across the credit risk spectrum and are managed by Metrics.

The investment objective of the Trust is to provide attractive risk-adjusted returns with a **target return of 8 – 10% p.a. net of fees**, over a three-year period, with cash distributions payable monthly at a target of 7% p.a.

As at 30 June 2023, the market capitalisation of MOT was $532 million, with net asset value (NAV) at $566 million.

Figure 1. Monthly Net Returns Box Plot



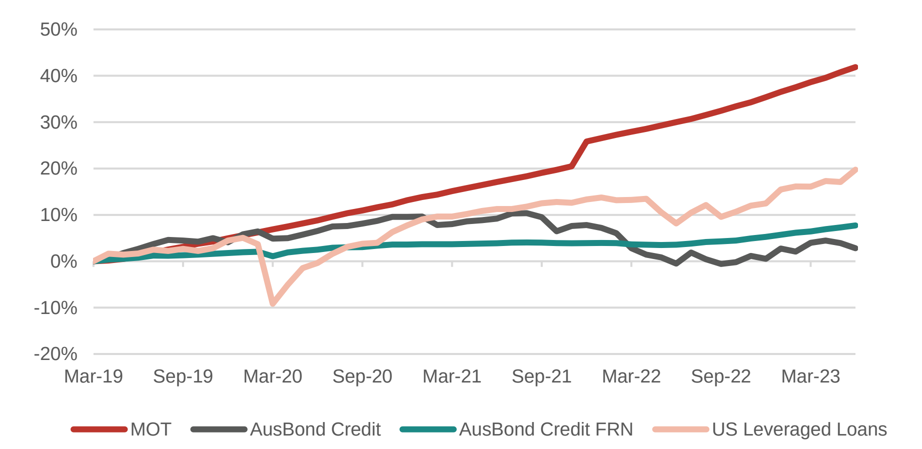
Source: BondAdviser, Metrics. Annualised monthly returns, after fees since inception. As at 30 June 2023.

Figure 2. Monthly Net Returns* (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2023	0.86	0.72	0.80	0.69	0.85	0.79							**4.71**
2022	0.58	0.57	0.52	0.50	0.56	0.55	0.55	0.65	0.69	0.71	0.67	0.80	**7.35**
2021	0.60	0.48	0.67	0.56	0.57	0.56	0.53	0.53	0.61	0.55	0.65	4.42	**10.72**
2020	0.61	0.60	0.59	0.60	0.60	0.62	0.73	0.67	0.55	0.63	0.56	0.78	**7.54**
2019				0.15	0.36	0.58	0.74	0.68	0.56	0.65	0.47	0.66	**4.86**

Source: BondAdviser, Metrics. As at 30 June 2023.
** Return is monthly net total return based on NTA plus dividends.*

Figure 3. Relative Cumulative Performance



Source: BondAdviser, Metrics, Bloomberg. As at 30 June 2023.
Calculated from cumulative net monthly returns of the Underlying Fund. Returns on NAV, not traded unit price, see Figure 12 for unit price variance.

Product Assessment

Recommended | Improving

MOT provides diversification benefits and potential for attractive risk-adjusted returns due to its low correlation with traditional asset classes, supported by Metrics' expertise and strong governance.

MOT has allocated its investments across four privately managed wholesale funds overseen by Metrics: MCP Secured Private Debt Fund (SPDF), MCP Secured Private Debt Fund II (SPDF II), MCP Real Estate Debt Fund (REDF), and MCP Credit Trust (MCP CT). Consequently, these foundational funds provide MOT investors with a diversified portfolio encompassing corporate loans, notes, and bonds, along with the potential for capitalising on equity-like prospects like preference shares and warrants.

Moreover, due to the Fund's low correlation with traditional asset classes, MOT also provides diversification benefits to investor portfolios. Furthermore, it introduces the possibility of attractive risk-adjusted returns, backed by Metrics' well-documented expertise in private credit, strong governance, and established procedures.

MOT continues to outperform its returns target and has done so as at 30 June 2023 on a rolling 12-month, 24-month and since inception basis with net returns of 9.14%, 10.07% and 8.61% per annum, respectively.

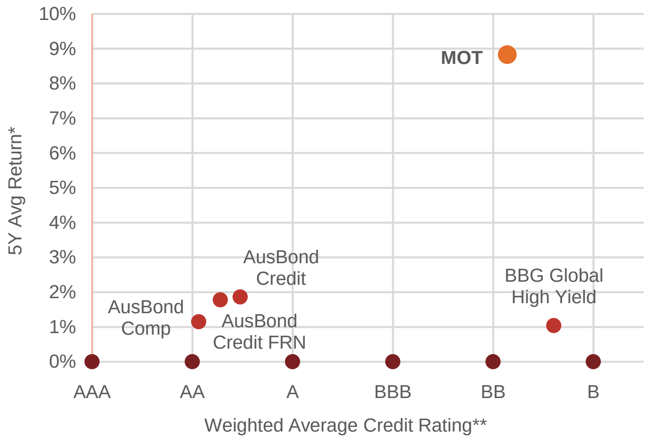
Despite the underlying portfolio's risk level increasing in terms of weaker seniority, diversification, and credit rating metrics, these deteriorations are from relatively strong bases and the portfolio still performs well in our GFC-like modelled scenario.

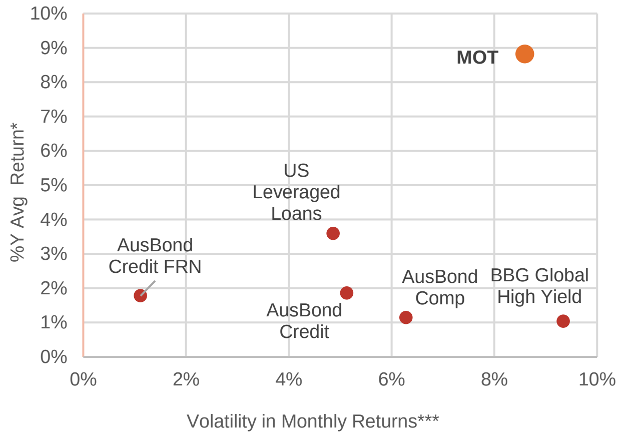
The risk profile of the underlying portfolio has continued to deteriorate over the Jun-23 quarter as a function of increased non-senior ranking exposures, lower average credit ratings, a reduction in counterparty diversification and a rising portion of the portfolio rolling off in the near term. This is an opportunistic strategy, and the target is for 8-10% through the cycle. Given the RBA cash rate has risen 4.25% over the past 18 months and the majority of the portfolio is floating rate, in the short term we view it likely that MOT will surpass its target return. The Fund's metrics related to credit rating, seniority, and concentration reveal a less conservative approach, suggesting a portfolio with incrementally higher risk compared to previous periods. Despite the more attainable target return, the Fund continues to focus on achieving the best risk-adjusted returns.

Although the Fund inherently carries a level of risk, certain elements of the risk exposure within the Fund require attention. The primary concern is that the underlying portfolio has an 81% weighting to real estate based on committed loans excluding cash. On a positive note and partially mitigating this concern, is that a significant majority (80%) of this real estate exposure is senior secured, and 63% of the total real estate exposures mature in less than 12 months. Another aspect causing concern is the overall capability of the Fund's portfolio companies to handle increased interest payments, given that amidst an economic contraction, base rates are 4.25% higher. It's important to highlight that Metrics has never experienced a default, resulting in no impact on investor returns. This underscores Metrics' rigorous screening procedures, aimed at fostering confidence in full repayment before committing funds.

MOT currently meets all criteria bar one to be upgraded to Highly Recommended, being that BondAdviser has not yet been able to conduct research on the Fund for five years. This is a function of MOT have been incepted just over four years ago. As there is less than a year until this criteria is met and there is no expectation for MOT to fall behind on any other of the criteria, our **Recommended** product assessment stands with an **Improving** outlook.

Figure 4. Estimated Risk-Adjusted Return Comparison





** All returns for indices calculated using annualised monthly returns for the past five years. Average return for MOT calculated since inception in April 2019.*
*** Credit Ratings based on BondAdviser estimates. *** Calculated based on annualised monthly returns data for past five years for indices and since inception for MOT. Source: BondAdviser, Metrics, Bloomberg. As at 30 June 2023.*

Construction and Investment Process

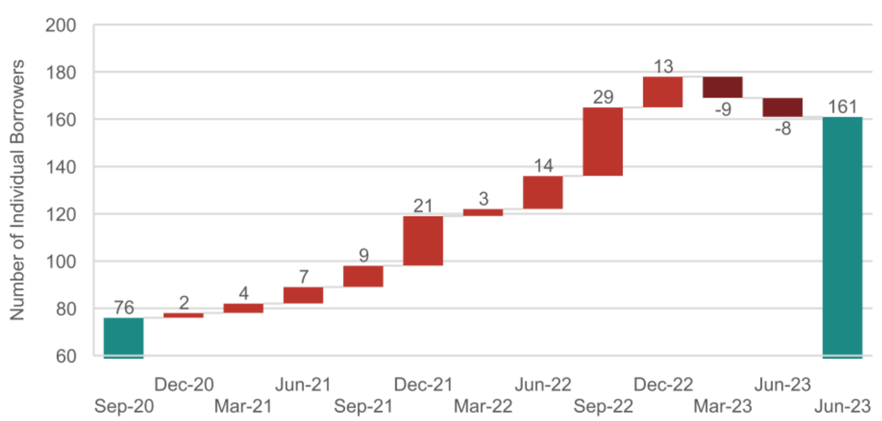
There have been **no material changes** to MOT's construction and investment process.

Portfolio Risk Management

A handful of datapoints have seen slight deterioration over the Jun-23 quarter from a combination of shortcomings. Importantly, the capital protection of a credit portfolio serves as the most significant function. Due to this, diversification is incredibly important to this portfolio as the more diverse a portfolio is, the less impact a default will have on returns. The recent downtrend in diversification over the past half-year and high weighting on maturing loans creates a signal for alert.

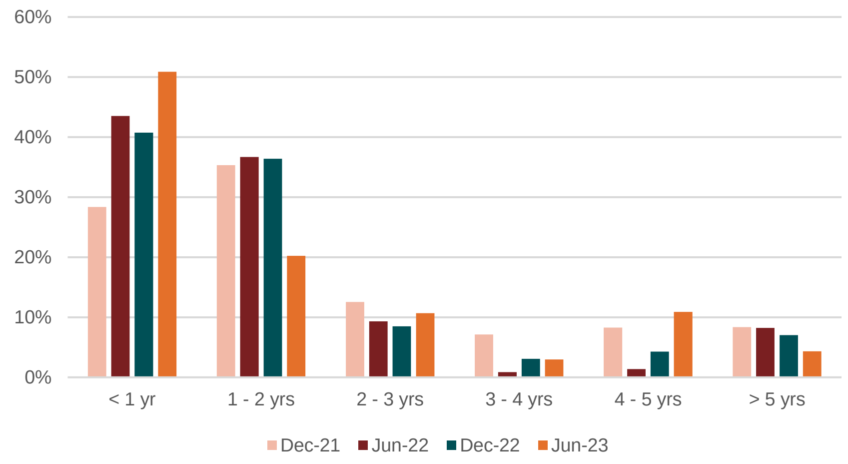
Unique borrower exposure continues to remain high despite the fall from Mar-23 levels of 169 to 161 while the number of individual investments has fallen from 259 to 255 within the same period. Furthermore, 50.9% of the MOT portfolio is set to mature within the next 12 months. There is continuing pressure on the investment team to source new investments as the roll-off has moved a negligible 0.4 percentage points less compared to a quarter ago.

Figure 5. Unique Borrower Exposure Over Time



Source: BondAdviser, Metrics. As at 30 June 2023. Based on Metrics' underlying portfolio (WIOT) not MDIF.

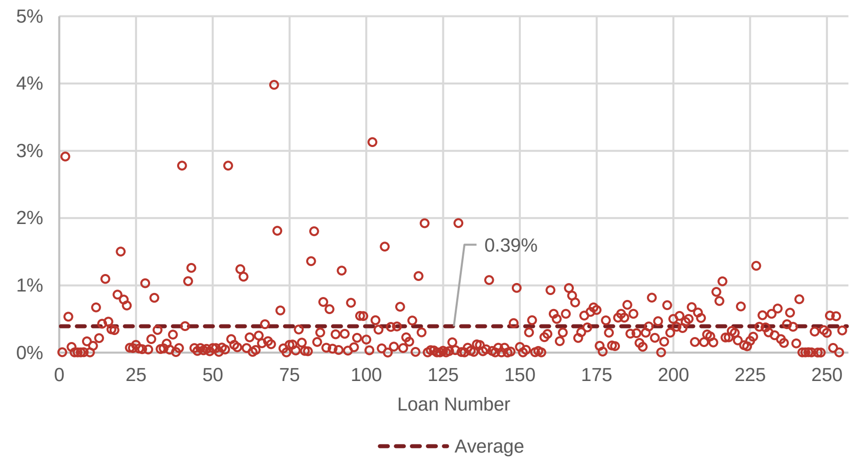
Figure 6. Portfolio Maturity Over Time



Source: BondAdviser, Metrics. As at 30 June 2023. Based on Metrics' underlying portfolio (WIOT) not MDIF.

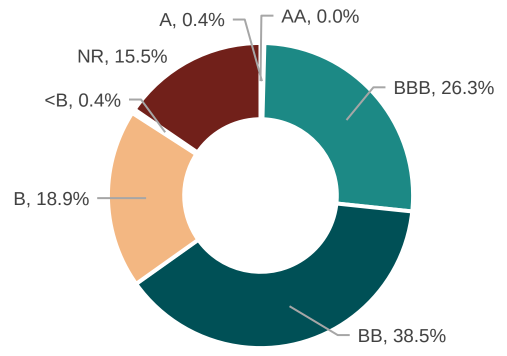
Portfolio credit quality has continued to worsen throughout the period with the portfolio increasing weights sub-investment grade securities. The fund has seen further increases in weight to the "B" rating securities which has increased from 14.60% to 18.94% from a year prior to current. The Fund is also steering towards equity and equity-like securities that are held by the credit trust with the weighting of "NR" securities increasing from 9.10% to 15.46% within the year prior to now. Additionally, the deviation from senior secured to subordinated and equity is continuing with a 12.6% decrease over the past four periods. The exposure to senior secured has moved from 77.7% to 65.1% from 30-Jun-22 to 30-Jun-23. This shift has seen a 5.9ppt increase to subordinated positions, and a 6.6ppt increase to equity weighting.

Figure 7. Portfolio Individual Loan Mix*



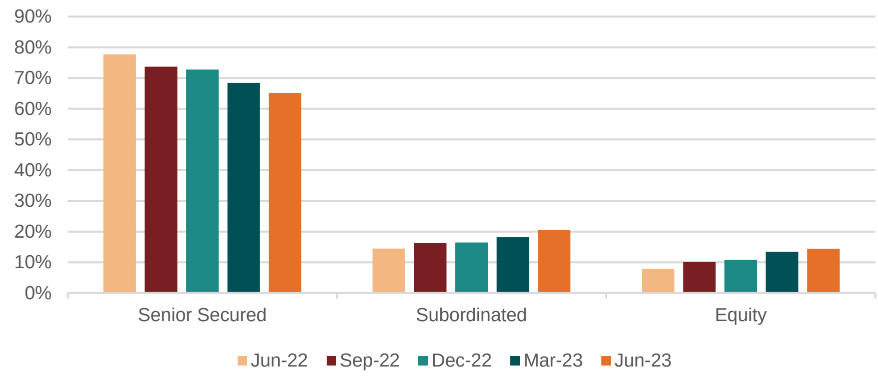
*Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIOT) not MDIF.*

Figure 8. Portfolio Credit Rating Mix*



*Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIOT) not MDIF.*

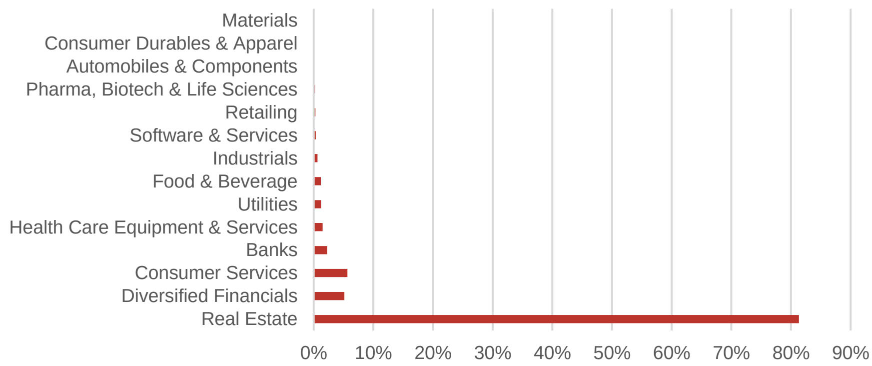
Figure 9. Portfolio Seniority Mix*



*Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIOT) not MDIF.*

The portfolio is also heavily weighted towards real estate investment. This creates a scenario where the portfolio faces heightened risks with the case of higher interest rates apparent. With this in mind, it is also important to note that approximately 70% of real estate loans are senior ranked which relieves any negative signals that this raises.

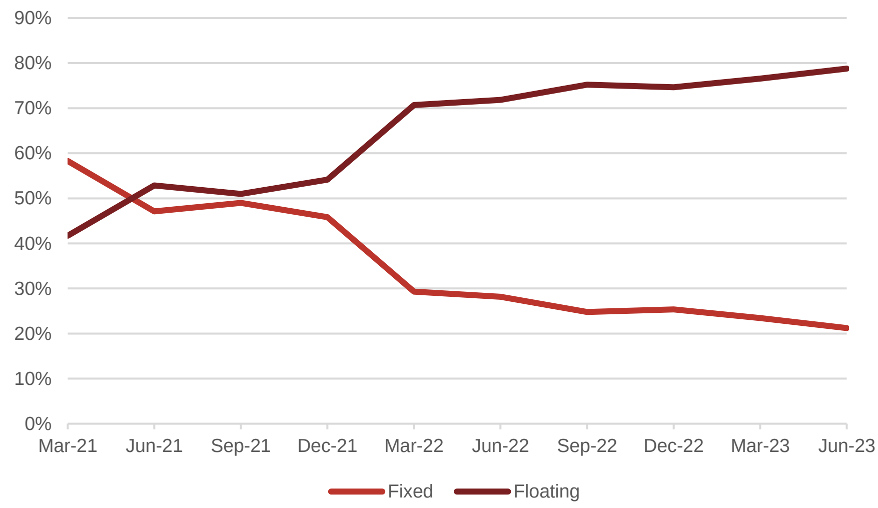
Figure 10. Portfolio Mix by S&P Industry Group*



*Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIOT) not MDIF.*

Although credit quality continues to worsen, it should be noted that this could be a factor in newly found opportunities through recent stiffening from banks which has resulted in opportunities for Metrics to reconsider their capital structure. It is rational for banks to shift away from higher credit risk investments in order to reduce the potential for any losses. This has created a scenario in which a greater number of investment deals are apparent and has created a broader pipeline in which creates reassurance from the potential concentration risks. It is a point to note as the shift in seniority and credit ratings in the portfolio poses a heightened risk in the event of default.

Figure 11. Portfolio Mix by Rate Type*

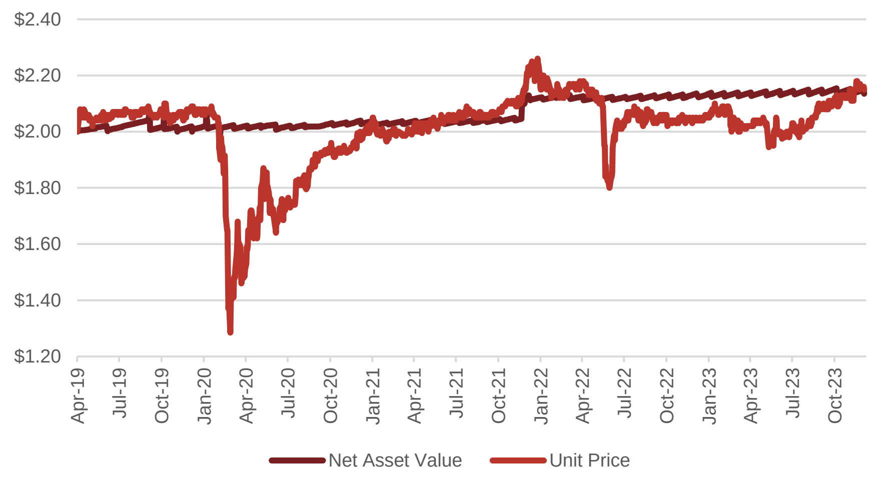


*Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIOT) not MDIF.*

Fund Governance

There have been **no material changes** to MOT's fund governance.

Figure 12. Net Asset Value Against Unit Price



Source: BondAdviser, Metrics, Bloomberg. As at 2 January 2024.

The structure of the Trust has not changed and is outlined in prior reports (see page 4 of MOT Update Report – 21 April 2021).

Struggles within the markets caused June 2022 to display a discount of 15.2% between the unit price and NAV of MOT. Although such a discount is not surprising due to market conditions, the discount is still illogical due to frequent updates from Metrics. Metrics conducts weekly portfolio stress testing and has independent monthly portfolio valuation and impairment testing completed by an accounting firm. This provides us with a positive context towards the stated NAV. MOT has consistently traded above NAV since 7 December 2023 and most recently was at a 0.7% premium (as at 29 December close). Notably Metrics incepted the Metrics Direct Income Fund, an unlisted fund which invests in the same underlying portfolio as the Metrics Master Income Trust (ASX: MXT). The minor difference between the two is the MDIF has the ability to purchase MXT shares, which helps support the unit price. The size of MOT (NAV of $569 million at 30-Sep-23) is much less in comparison to MXT and MDIF (NAVs of $1.77 billion and $1.23 billion respectively).

Quantitative Analysis

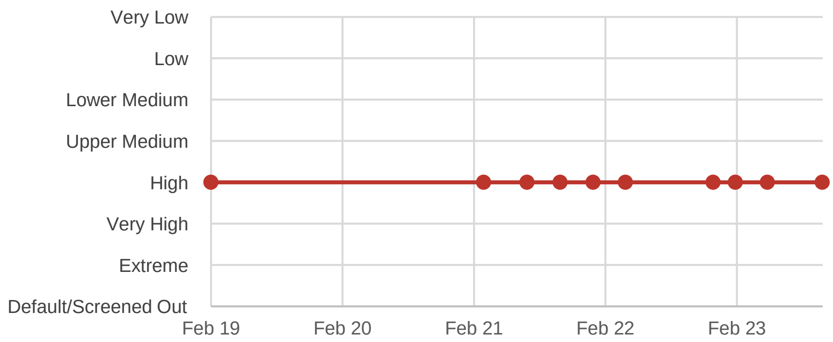
The underlying portfolio is much changed on two years prior and there have been risk aspects highlighted by our modelling that have improved while other risks are more pronounced than previously. This is atypical of a growing private credit fund as usually as FUM grows, so too does the number of loans. This added diversity mitigates against the impact of default due to lesser exposure. Versus 30 June 2021, the underlying fund is now comprised of more than double the number of individual loans (255 versus 126). From a seniority perspective, the portfolio weights to senior secured, subordinated and equity positions are relatively similar to Jun-21 levels. That said, the composition of the portfolio from a credit quality perspective has deteriorated. Including cash, the Fund was 45.9% weighted to investment grade two years ago, versus 26.7% at Jun-23. As investments with worse credit ratings are more likely to default compared to the latter, the portfolio positioning towards lower credit grade investments has shown negative affects to the simulated scenarios for MOT. The 10.7% allocation to cash at Jun-21 plays a large role in anchoring both the expected returns and the losses absorbed in our modelling at the time.

A large portion of credit risk revolves around portfolio concentration. Although there has been a slight reduction over the past six months from 178 individual counterparties at Dec-22 to 161, portfolio diversity in MOT remains high. Should this trend continue, the impacts in our modelled scenarios would become more dire.

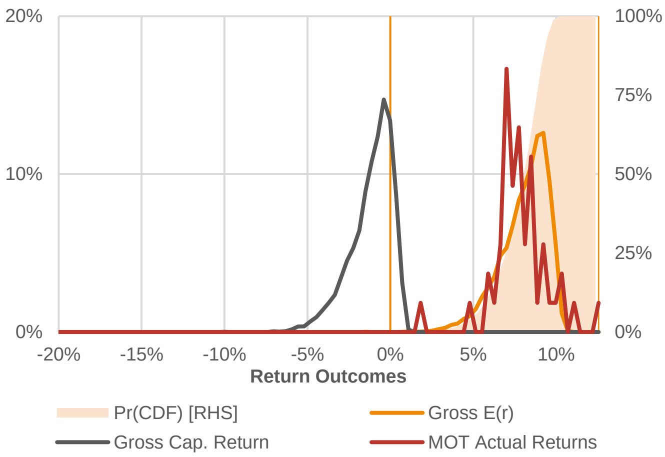
Following rising swap rates and an incremental increase in risk-taking across the portfolio, the median expected returns in our neutral simulation have improved to 8.19% versus the previous experience of 7.56% (as at 31 March 2023). Following the higher risk in the underlying portfolio, outcomes in the GFC-like scenario have slightly worsened despite the benefits from higher swap rates. The 99% VaR has fallen quarter on quarter from -5.09% to -5.27% on an expected gross return basis. While there has been some weakness here, the safety net from having a highly diversified and largely senior secured portfolio is clear. A return of -5.27% or worse only 1% of the time in a GFC-like scenario is a strong result for an opportunistic credit fund. In the distressed scenario, the projected outcomes exhibit a growing negative skew, accompanied by an elevation in the standard deviation of expected returns. These changes stem from the worsening attributes of the portfolio, with the most significant impact arising from a shift towards lower credit ratings, along with a heightened exposure to subordinated and equity-like investments.

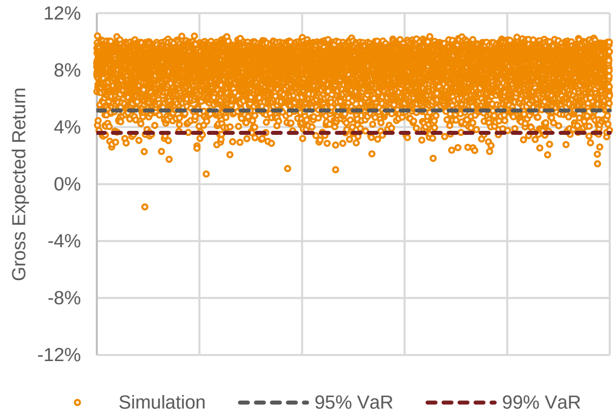
Although the portfolio's quality has retraced quarter-on-quarter, our modelling has substantially improved over the past two years due primarily to diversification benefits. In June 2021, the portfolio consisted of 89 individual borrowers to 161 as at Jun-23. We maintain a risk score of "High" or "BB" which is in line with the portfolio's weighted average credit rating. Should the portfolio increase diversification, especially from a sectoral exposure perspective, the Risk Score could be notched upwards.

Figure 13. Risk Score



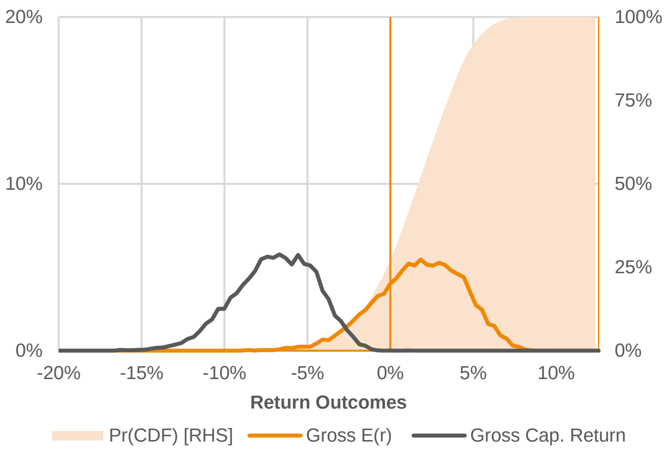
Scenario 1. Baseline Asset Assessment

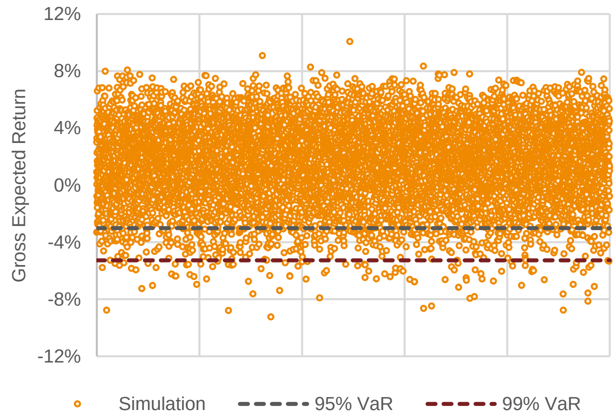




Source: BondAdviser Estimates as of 30 June 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated. For a more detailed explanation of the methodology, please contact BondAdviser.

Scenario 2. Stressed Asset Assessment





Source: BondAdviser Estimates as of 30 June 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated.

Reporting History

MOT Update Report – 23 October 2023

MOT Update Report – 7 July 2023

MOT Update Report – 22 December 2022

MOT Update Report – 22 October 2022

MOT Update Report – 26 May 2022

MOT Update Report – 27 April 2022

MOT Update Report – 5 November 2021

MOT Update Report – 21 August 2021

MOT Update Report – 29 April 2021

MOT IPO Report - 28 February 2019

Alternative Investment Fund Research Methodology

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Report created on 3 January 2024.