

Fund Research

Metrics Master Income Trust (ASX: MXT)



Overview

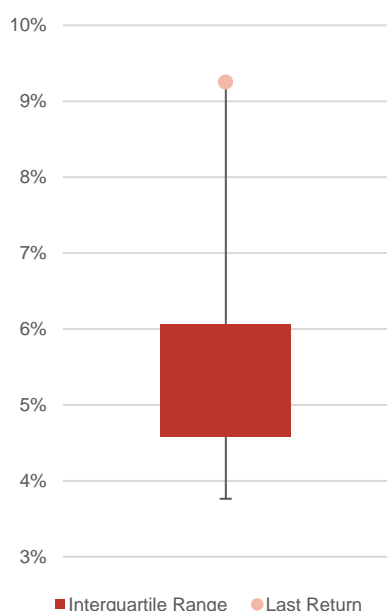
The Metrics Master Income Trust (the “Trust”; “MXT”; or the “Fund”) is a listed investment trust designed to provide retail investors with ready access to the Australian corporate loan market. As at 31 June 2023 the market capitalisation of the Fund was \$1.69 billion.

Private credit is an important part of the Australian corporate debt market that has previously been limited to major banks and institutional investors. For this reason, MXT offers retail investors a unique exposure to a debt sub-asset class that is not easily directly accessible to them.

The Trust’s investment objective is to provide stable capital value and an attractive income stream with a target return of the **RBA cash rate plus 3.25% p.a.** (currently 7.35% p.a.) **after fees**, payable monthly.

MXT invests in the Metrics Credit Partners Pty Ltd (MCP, Metrics) Wholesale Investment Trust (WIT), which, in turn, invests in Metrics wholesale institutional investor funds that participate across the credit risk spectrum and are managed by Metrics.

Figure 1. Monthly Net Returns Box Plot



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

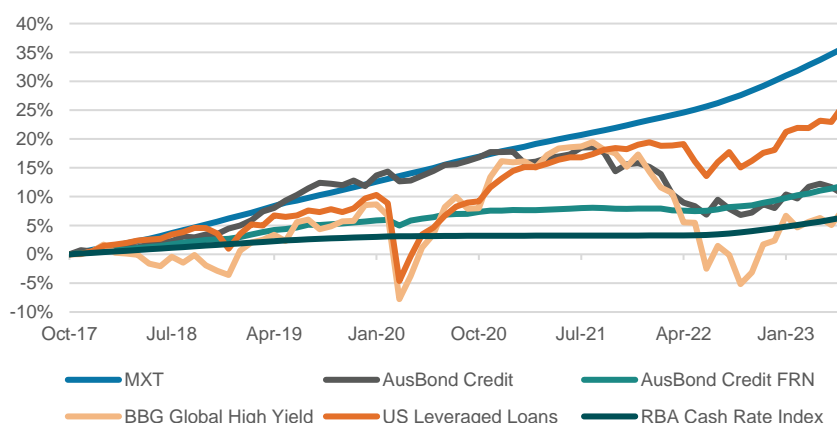
Figure 2. Monthly Net Returns* (%)

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD |
|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| 2023 | 0.71 | 0.64 | 0.73 | 0.69 | 0.74 | 0.74 | | | | | | | 4.25 |
| 2022 | 0.36 | 0.32 | 0.37 | 0.35 | 0.42 | 0.44 | 0.47 | 0.54 | 0.52 | 0.63 | 0.63 | 0.68 | 5.74 |
| 2021 | 0.33 | 0.33 | 0.43 | 0.31 | 0.36 | 0.32 | 0.31 | 0.34 | 0.34 | 0.34 | 0.37 | 0.38 | 4.14 |
| 2020 | 0.45 | 0.41 | 0.43 | 0.43 | 0.39 | 0.40 | 0.50 | 0.44 | 0.38 | 0.38 | 0.40 | 0.40 | 5.03 |
| 2019 | 0.48 | 0.47 | 0.54 | 0.54 | 0.52 | 0.33 | 0.43 | 0.43 | 0.38 | 0.42 | 0.42 | 0.43 | 5.41 |
| 2018 | 0.38 | 0.32 | 0.43 | 0.38 | 0.38 | 0.45 | 0.50 | 0.49 | 0.45 | 0.49 | 0.47 | 0.52 | 5.27 |
| 2017 | | | | | | | | | | 0.46 | 0.35 | 0.41 | 1.23 |

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 14 for unit price variance.

Product Assessment

Highly Recommended

In light of the recent withdrawal of conventional lenders, Metrics now has a broader and higher quality range of opportunities to reinvest funds as current investments mature.

In spite of broad market weakness, MXT's proven NAV stability contributes to the Fund's resilience during market downturns.

The Metrics Master Income Trust (ASX: MXT) enables investors to access three Metrics wholesale unlisted funds, thereby delivering a diversified investment opportunity in commercial loans. The largest portion, approximately 60%, of the portfolio is invested in the Metrics Credit Partners Diversified Australian Senior Loan Fund (DASLF), while around 20% each is allocated to the MCP Secured Private Debt Fund II (SPDF II) and the MCP Real Estate Debt Fund (REDF).

MXT is a suitable choice for investors in search of an actively managed portfolio that produces consistent and appealing monthly income, and who are open to being exposed to a diversified collection of private loans, primarily focused on the real estate sector. The product exhibits low long-term correlation to traditional asset classes with a correlation since its IPO in June 2017 of 0.15 to the ASX200 Index and -0.18 to the AusBond Composite Index (BACM0). This allows for MXT to provide diversification benefits for investment portfolios, which tend to be weighed towards equities and fixed interest. That said, in June 2022 during a broad market selloff, rolling 40-day correlations of MXT with both the ASX200 and the BACM0 peaked at 0.65 and 0.56, respectively. This is still a relatively low correlation for a frequently traded, ASX-listed product that is subject to the general pressures of equity market drawdowns.

The Fund's NAV has been predictably stable, which we believe to be a key factor in MXT's buoyancy during share market downturns. However, investors do need to understand that unlike Metrics' unlisted funds, MXT is exposed to market volatility due to it being listed on the ASX. Such market exposure can result in the unit price trading at a discount to the NAV in periods of heightened volatility, as is evidenced by the spike in correlations during June 2022 discussed above. In such scenarios, investors who maintain faith in the underlying strength of MXT's investment portfolio may be provided the opportunity to enter at a reduced price. As a potential investor, there are pros and cons to weigh up as although the Fund may experience a higher level of unit price volatility, being listed does provide greater liquidity than an unlisted fund. After a ~14 month-period of the MXT unit price trading beneath the Fund's NAV, the price was above net asset value every day since 28 August 2023 to 5 October 2023. We view the resurgence in price to have been taken opportunistically as an opening for a profitable exit and the units now trade above par to NAV (2.9% premium as at 2 January 2024 close). The Fund has continued to outperform its net return target over the past year, 24 months, and since inception. On a rolling 24-month basis to 30 June 2023, MXT generated a net annualised return of 6.19% (assuming reinvestment of distributions), which was 134bps per annum above the target. Since inception (October 2017) the annualised net return was 5.55% or 113bps above the target.

Despite the portfolio being predominantly floating rate and indirectly unaffected by higher interest rates, the impacts of rising rates and the inflationary environment are both risks from the perspective of a borrower's creditworthiness. Given the stage in the credit cycle, we are especially cautious about the approximately 55% real estate exposure in the underlying portfolio, taking into account that around 20% of this is linked to real estate development. That said, it is positive that almost all of the real estate loans are the highest ranking in the capital structure (senior secured), and therefore the most protected as first losses are worn by subordinated/equity tranches in the borrower's capital structure. Moreover, it is worth highlighting that Metrics has a commendable history of initiating, arranging, and overseeing commercial real estate credit investments. It is also crucial to emphasise that the Manager does not provide loans to construction contractors.

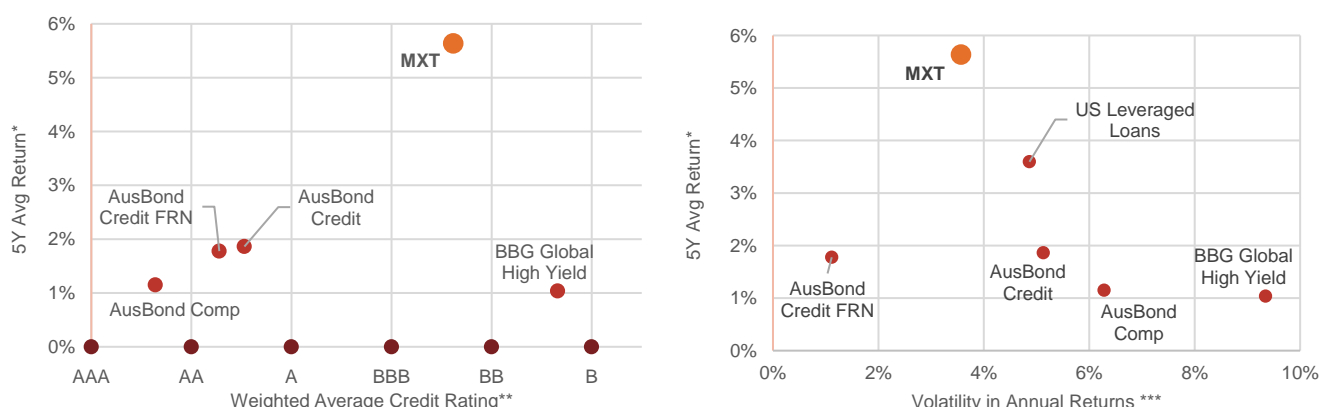
Banks are tightening lending policies as a reflection of the worsening economic backdrop. This is creating a far wider set of investment opportunities for Metrics as borrowers that were previously creditworthy enough to obtain bank financing are being forced to search elsewhere for capital. This has created a greater pipeline than would be expected at this part of the cycle and has shifted pricing power into the Manager's hands. This allows for maturing loans in the underlying portfolio to be replaced with exclusively the best opportunities on a risk-adjusted return basis.

A notable feature of Metrics' track record is the complete absence of any defaults resulting in no impact on investor returns. Considering the vast and numerous range of counterparties Metrics extends loans to, we view this outcome as a product of rigorous screening protocols designed to instill trust before the precise distribution of funds.

In general, our confidence in Metrics' ability to maintain robust systems and procedures for originating and structuring loans, while also diligently overseeing performance to minimise credit risk at both the individual loan and portfolio levels remains steadfast. At the portfolio level, risk is reduced by the diversification benefits of 300 unique counterparties while at the individual loan level, 91% of the portfolio on a commitment basis is senior secured. These factor both work to reduce the potential loss to the portfolio in the instance whereby a counterparty defaults.

We continue to view MXT favourably from a risk-return standpoint and reiterate our rarely attained product assessment of **Highly Recommended**.

Figure 4. Estimated Risk-Adjusted Return Comparison



* All returns for indices calculated using annualised monthly returns for the past five years. Average return for MXT calculated since inception in October 2017.

** Credit Ratings based on BondAdviser estimates. *** Calculated based on annualised monthly returns data for past five years for indices and since inception for MXT. Source: BondAdviser Estimates, Metrics, Bloomberg. As at 30 June 2023.

Construction and Investment Process

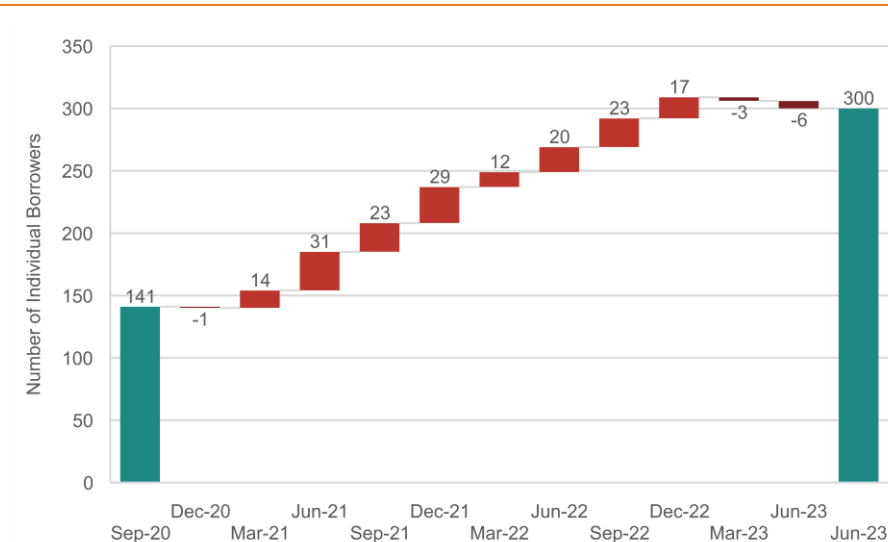
There have been **no material changes** to MXT's construction and investment process.

Portfolio Risk Management

At its most fundamental level, a private credit portfolio's risk level is determined by the expected losses which are driven by defaults and recovery rates given defaults. We view there as being three primary drivers of this risk that can be managed by a credit portfolio manager: concentration, credit quality, and seniority. There are other factors that impact the portfolio from a risk perspective, but these three aspects are elemental to private credit funds such as this.

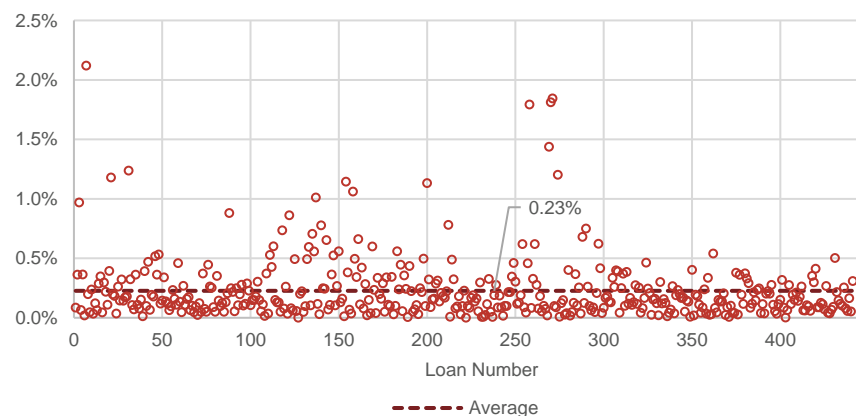
Diversification is important from a counterparty and individual loan exposure basis, but also when considering industry exposure and tenor buckets. The more diverse a portfolio, the less the Fund would be impacted by a single counterparty defaulting. Two years ago, the portfolio had 296 investments across 185 individual borrowing counterparties. This has since grown to 441 loans and 300 borrowers while the average exposure has fallen from 0.34% to 0.23%, illustrating the general long-term diversification improvements. While positive on a long-term basis, there has been a slight reduction in diversification over the past six months with the portfolio having nine less counterparties than as at 31 December 2022.

Figure 5. Unique Borrower Exposure Over Time



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

Figure 6. Individual Loan Exposure*

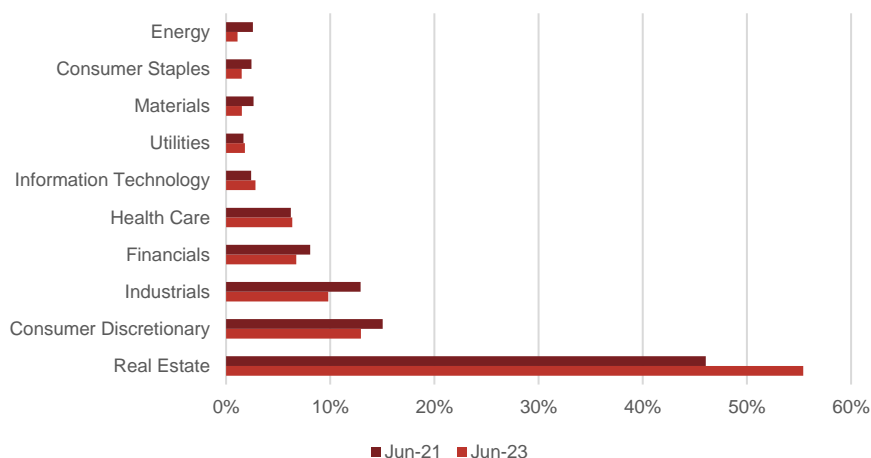


Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.

In terms of industry diversification, this is a weak point of the underlying portfolio as it has a 55.4% weighting to real estate, and its second largest exposure is 12.9% to consumer discretionary. We view both sectors as subject to economic headwinds in the near term and stress that investors gain comfort with Metrics' diligence and processes prior to investing in a Fund with greater than two-thirds of its FUM lent to borrowers operating in challenged sectors. Not only this but since 30 June 2021, the weighting to real estate has gradually increased to be now 9.4 percentage points higher than two years ago. We view this trend as credit negative and would prefer to see the Fund's

weighting to real estate substantially reduced as asset cross-correlations are a vital aspect of credit portfolios.

Figure 7. Portfolio Exposure by S&P Sector*

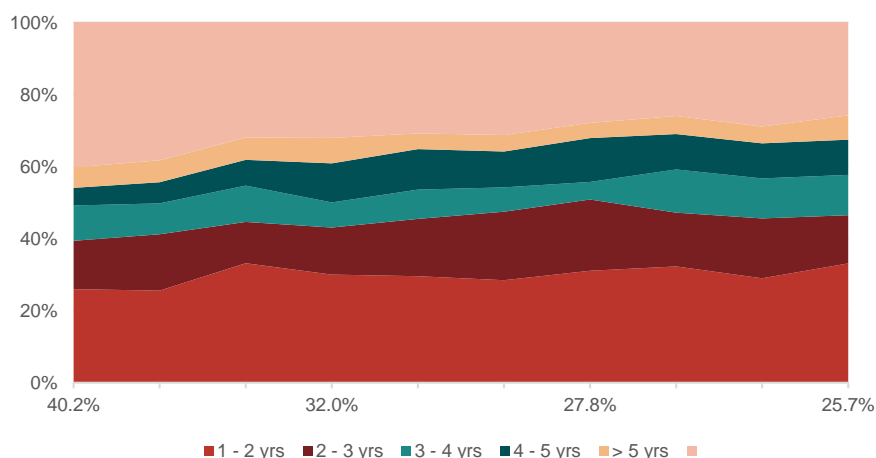


Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.

Over the six months from 31 December 2022 to 30 June 2023, the portfolio composition by tenor to maturity has risen from 31.9% maturing in less than a year to 40.2%. The increased roll-off creates additional pressure for the investment team's capacity to write fresh loans in a bid to avoid accumulating excess cash that could impede returns. The high rates backdrop makes the risk of cash drag particularly prominent, intensifying the urgency for efficient redeployment. That said, while having idle cash is undesirable, hastily investing in riskier credits at this stage of the economic cycle would be even more detrimental.

In Metrics's defence, the manager has consistently demonstrated its ability to efficiently recycle capital over several years, without adversely affecting the portfolio's credit quality or returns. Despite the larger-than-usual refinancing challenge ahead, we anticipate that Metrics will continue its successful track record in this regard, as there are ample corporate lending opportunities available at present.

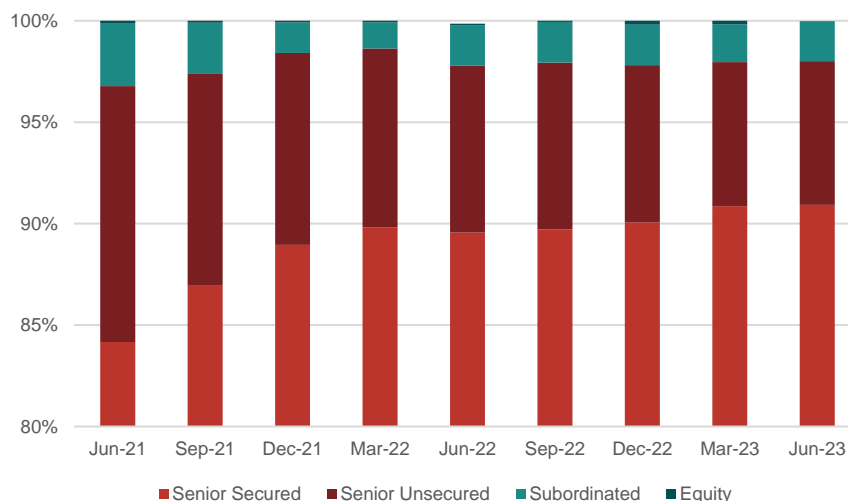
Figure 8. Portfolio Loan Tenor Mix*



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

When looking at seniority, the long-term trend has been a positive one, with the portion of senior secured loans in the book growing from 84.2% at Jun-21 to 90.9% at Jun-23. The increased portion of first lien loans in the Fund provides investors with a higher expected recovery in an event of default, providing better capital protection. This increased allocation to more senior tranches in combination with the aforementioned counterparty diversification is a substantial risk reduction to where the portfolio was two years' prior.

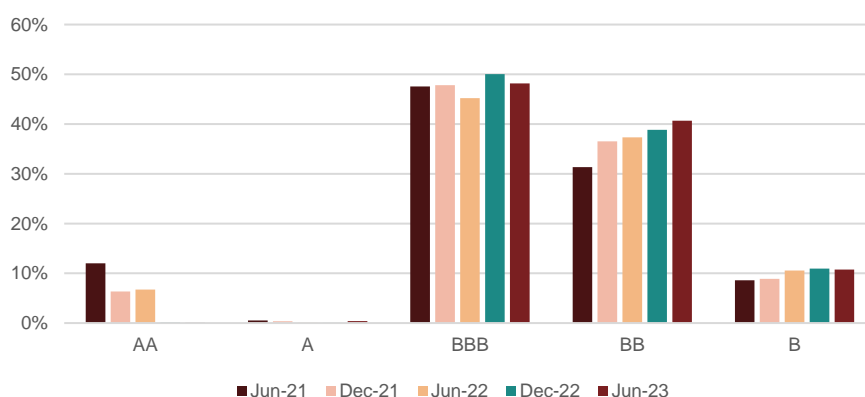
Figure 9. Portfolio Seniority Mix*



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

Again looking to June 2021 as a baseline, the portfolio had a 12.0% holding of cash (rated AA) at the time which has now been fully deployed with cash holdings of 0.1% at Jun-23. This 12% of the portfolio has almost entirely been allocated to BB-rated loans (+9.3%) with a slight uptick in B-rated loans (+2.2%) over the two-year period. This gradual tilt further into BB has interestingly tipped the weighted average credit rating of the portfolio from investment grade to sub-investment grade. We do not have an issue with this for a number of reasons. Firstly, this is a private credit fund, and the majority of investment grade borrowers would not engage private credit funds. Such a borrower would typically access bank loans or public credit markets as rates are more competitive than in private credit, resulting in a lower available pool of investment grade opportunities for Metrics to deploy into. Secondly, we have comfort in the Manager's processes and systems both at the origination stage and managing the counterparty during the life of the loan. Although this is a weakening in the portfolio's creditworthiness, it was to be expected as FUM grew, the number of investment grade opportunities that the WIT could deploy into would fall. If anything, we are pleasantly surprised by the Fund's ability to maintain a ~48% allocation to BBB loans as the size of the fund has increased from \$1.7 billion drawn at Jun-21 to \$3.9 billion drawn at Jun-23.

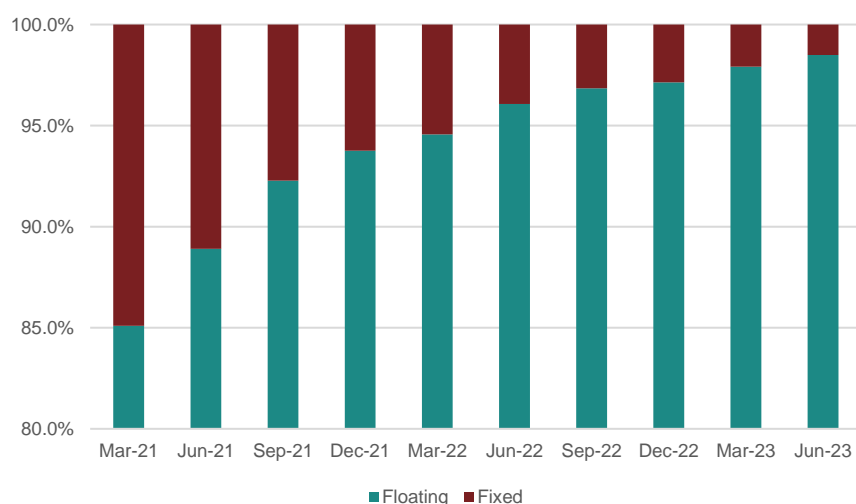
Figure 10. Portfolio Credit Rating Mix*



Source: BondAdviser, Metrics. As at 30 June 2023. * Including cash. Based on Metrics' underlying portfolio (WIT) not MXT.

Also of note is interest rate risk (duration). While a portfolio of loans is typically immune to given the predominantly floating rate nature, the investor needs to be cognisant that in a rising rate environment, the borrowers have to meet higher interest payments and are therefore at higher risk of default as serviceability falls. This means that although there is not a direct price impact from interest rate rises, there could be one on the basis of weakening counterparty creditworthiness.

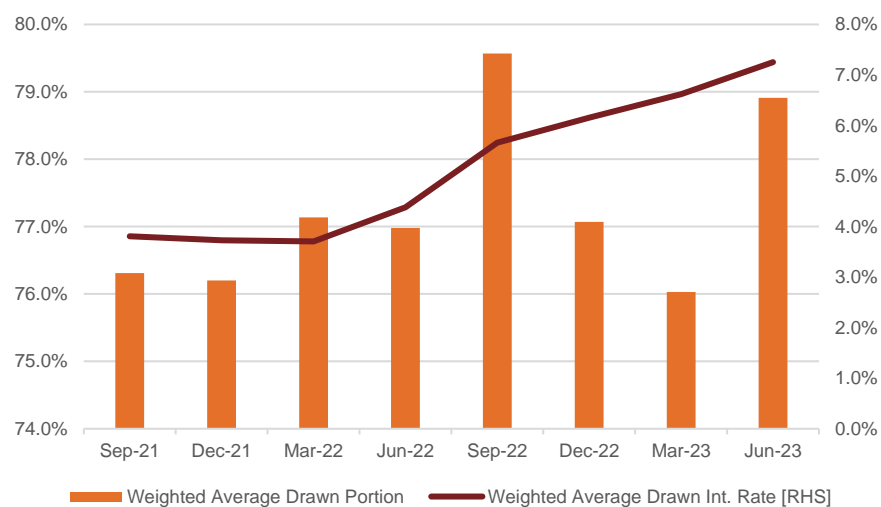
Figure 11. Portfolio Loan Interest Payment Mix*



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

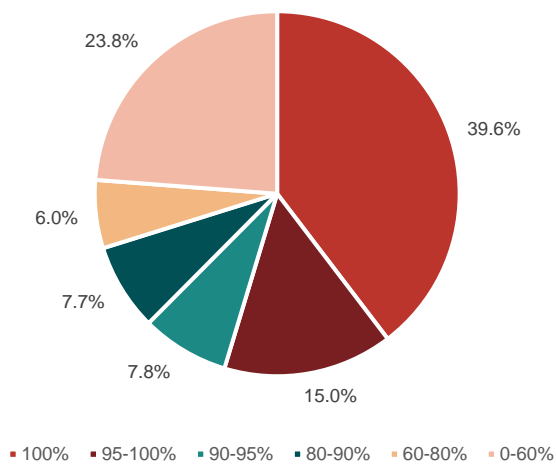
Typically when economic conditions worsen, businesses need more money to stay afloat, reinforcing Warren Buffett's saying that to a company, cash is like oxygen. Interestingly, the softening economic conditions are yet to have a material impact on Metrics' portfolio businesses as is evidenced by the substantial buffer of 21.1% in undrawn funds on a committed basis. Only 39.6% of loans on a committed basis are fully drawn as at 30 June 2023. It is worth noting that a significant portion of the undrawn loans are project/construction facilities. The average drawn rate for construction loans is 58.1% and these facilities comprise 26.3% of the underlying portfolio.

Figure 12. Portfolio Weighted Average Drawn Portion and Interest Rate*



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

Figure 13. Portfolio Weighted Average Drawn Portion and Interest Rate*

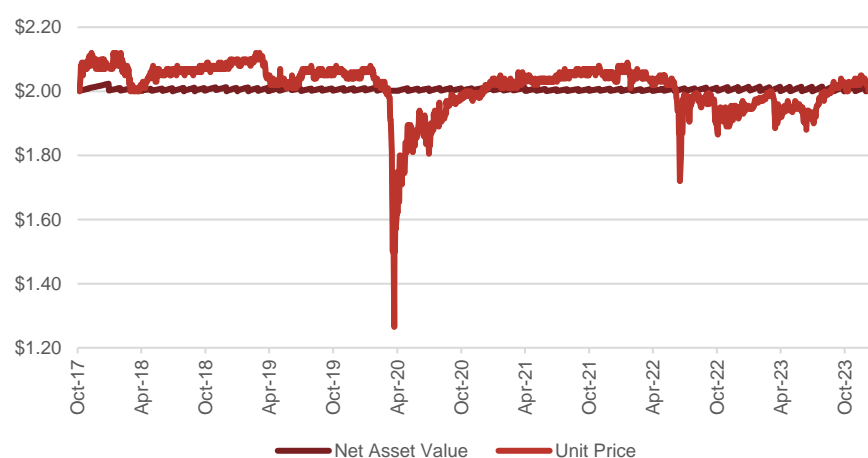


Source: BondAdviser, Metrics. As at 30 June 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIT) not MXT.

Fund Governance

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

Figure 14. 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 [MXT Update Report – 21 April 2021](#)).

The price to NAV discount for MXT reached a peak of 14.2% during the market turmoil in June 2022 but had decreased to under 1% by February 2023. However, in March 2023, amid renewed market turbulence triggered by the failure of three US banks (Silicon Valley Bank, Silvergate Bank, and Signature Bank) and the collapse of Credit Suisse, MXT's unit price to NAV discount widened to over 6%, despite daily updates confirming a stable NAV. MXT units have traded at a 2.9% premium to NAV as at 2 January 2024, which is a positive shift following the market shock.

MXT announced on 1 December 2023 that the Fund had completed a wholesale placement for 98.2 million units at a price of \$2.00 per new unit, raising a total of \$196.4 million. The placement was originally set to raise up to \$175 million and was announced on 29 November, with the units being placed in a trading halt until the fundraising was complete. Since this announcement, the Fund's Unit Price has consistently traded at or above the offer price of \$2.00 as at 2 January 2024.

Quantitative Analysis

As the impact of rising rates has passed through the portfolio, across both the baseline and stressed scenarios, we have again seen improvements versus the previous experience (as at 31 March 2023). Our modelling highlights the portfolio's remarkable ability to safeguard against losses in challenging situations, while also delivering strong returns relative to the level of risk. The significant predictability of returns is highlighted by the lack of drastic difference when contrasting the expected returns in a scenario akin to the Global Financial Crisis (GFC) versus a benign economic backdrop. The median capital return for the two scenarios are -0.96% and -0.11%, meanwhile the median capital return for MXT's underlying portfolio as at Jun 2021 in the same economic simulations were -2.34% and -0.32%, respectively. This is a manifestation of the continued high level of diversification and senior debt in the portfolio.

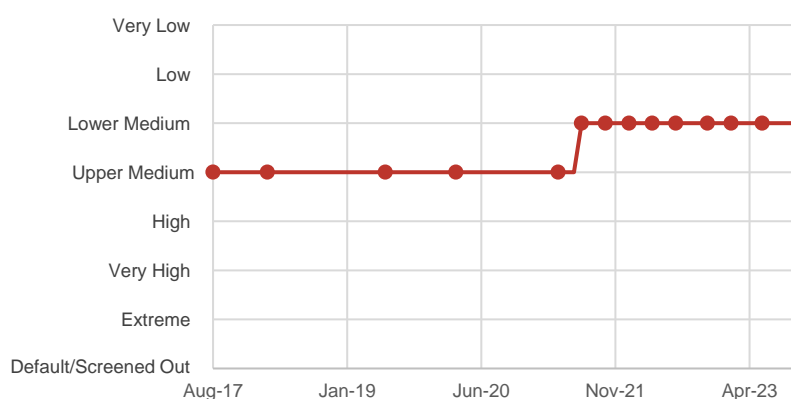
In credit portfolios, the most significant risk arises from an overconcentration of exposure to a single counterparty, with diversification playing a pivotal role in safeguarding capital. Seniority follows closely in importance for capital protection as lower-ranking capital takes losses first in an event of default (EOD). Over the last 12 months, MXT has actively undertaken measures to enhance these aspects. This involved expanding the number of individual borrowing counterparties in the portfolio from 249 to 300 and persistently increasing the proportion of senior secured exposures. These strategic adjustments have resulted in decreased losses in an EOD and, consequently, have bolstered overall performance in adverse conditions (highlighted in the models below).

That said, MXT has recently implemented slight alterations in its portfolio construction that have a negative impact on credit. As of June 30, 2023, the last 24 months have seen a notable rise in the quantity of sub-investment grade loans within MXT's holdings. It is important to note that while this represents a credit-negative development, the advantages of diversification and seniority have effectively outweighed the adverse impact.

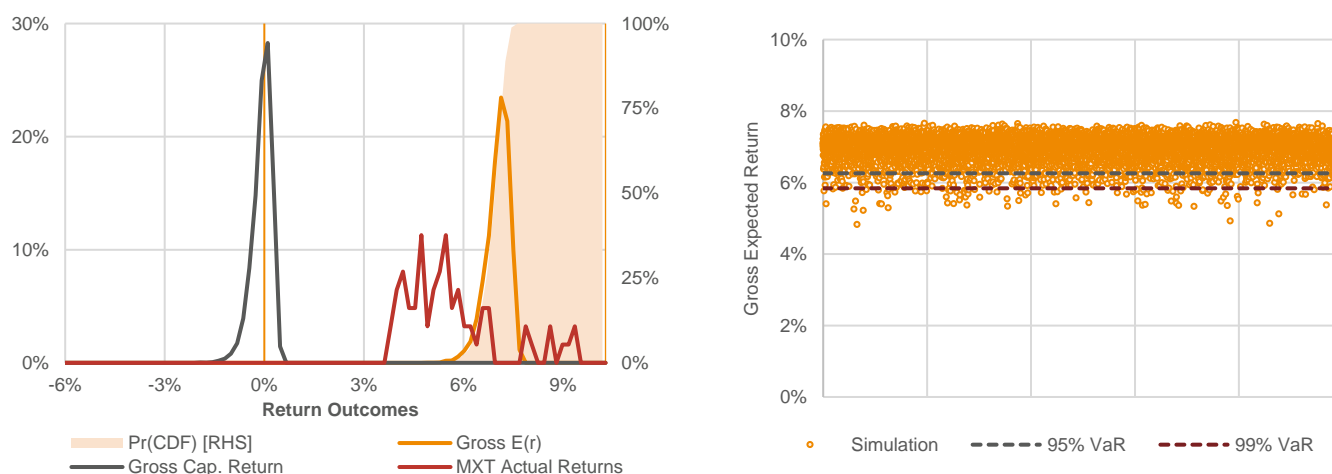
Additional to the strategic enhancements from increased diversification and seniority, MXT has also increased the proportion of floating rate loans. This has been favourable in the rising rate environment as expected income has increased in tandem with the higher base rates, driving higher simulated gross returns.

The improved portfolio risk metrics underscore the positive impact of Metrics' efforts and elucidate why our risk score remains consistently at **Lower Medium** or "A," a credit rating category a notch above the portfolio's weighted average credit profile. This affirmation is attributed to MXT's superior counterparty diversification, affirming its commitment to mitigating risk and enhancing overall portfolio resilience.

Figure 15. Risk Score

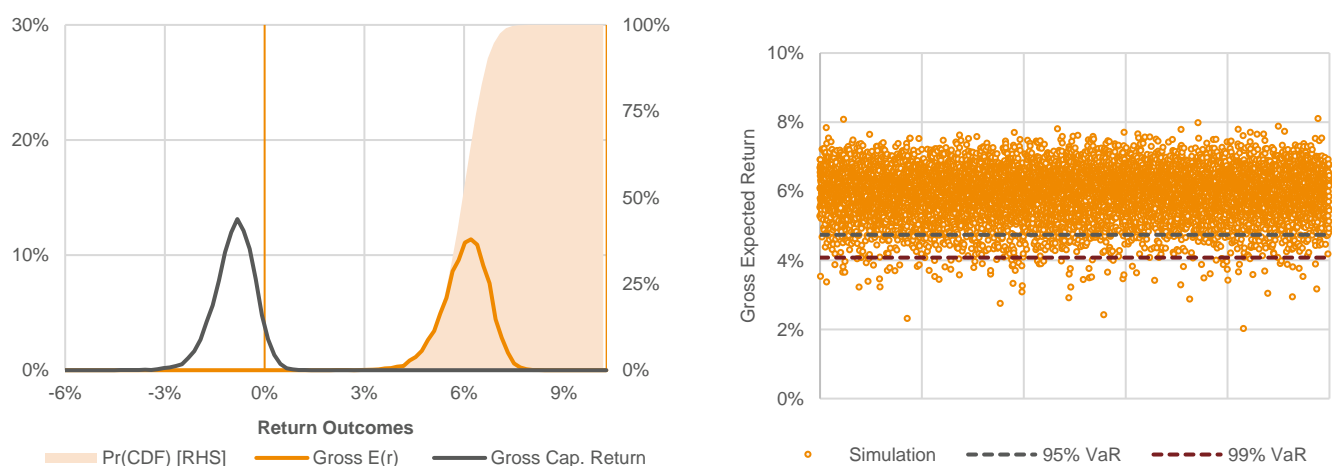


Scenario 1. Baseline Asset Assessment



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

[MXT Update Report – 23 October 2023](#)

[MXT Update Report – 7 July 2023](#)

[MXT Update Report – 7 December 2022](#)

[MXT Update Report – 17 October 2022](#)

[MXT Update Report – 26 May 2022](#)

[MXT Update Report – 27 April 2022](#)

[MXT Update Report – 5 November 2021](#)

[MXT Update Report – 21 August 2021](#)

[MXT Update Report – 21 April 2021](#)

[MXT Update Report – 27 February 2020](#)

[MXT Update Report – 8 May 2019](#)

[MXT Entitlement Offer Report – 26 February 2018](#)

[MXT IPO Report – 1 August 2017](#)

Alternative Investment Fund Research Methodology

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