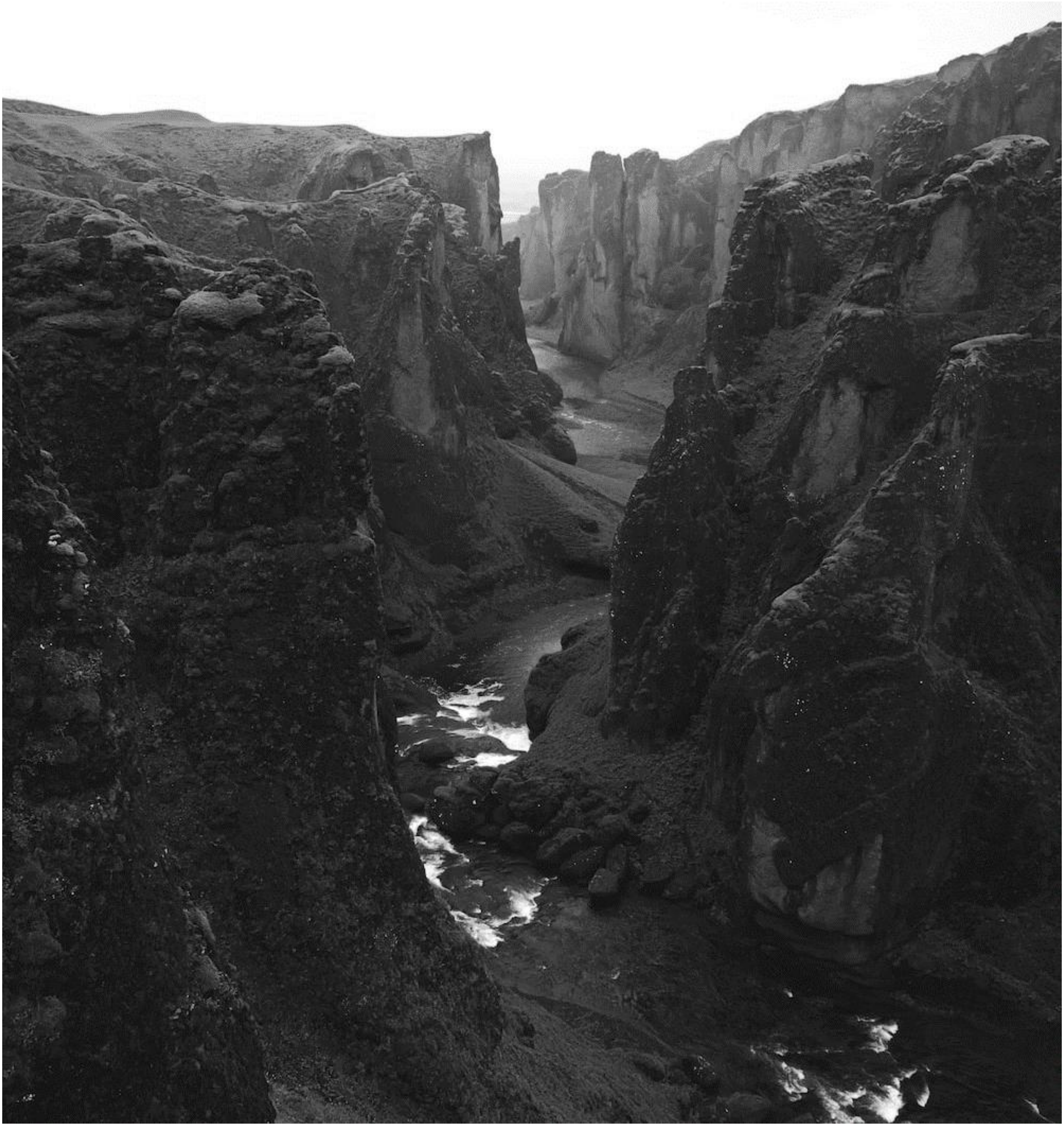
Fund Research

Metrics Income Opportunities Trust (ASX: MOT)



Overview

The Metrics Income Opportunities Trust (ASX: MOT) is a listed investment trust (LIT) that provides exposure to the full spectrum of Private Credit investments. MOT will be mostly invested in loans, notes and bonds, however may also provide investors with the potential for upside gains through exposure to private equity and equity-like investments.

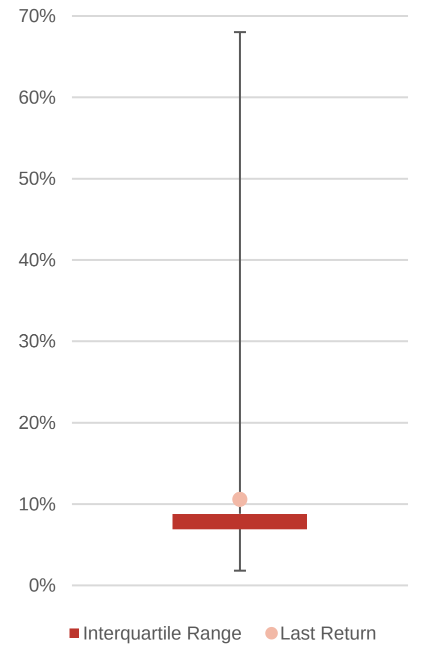
A wide range of assets, from senior secured loans to equity-like investments, comprise the asset class known as private credit. Historically, only institutional investors and large international banks have had access to this market, making it difficult for retail investors to participate.

Metrics Credit Partners Pty Ltd (MCP, Metrics) manages the underlying investment portfolio. Metrics is a seasoned alternative asset manager with specialised knowledge and a proven track record in the private credit market. The Trust invests in the Metrics Wholesale Income Opportunities Trust (WIOT), which then makes investments in Metrics wholesale funds that participate across the credit risk spectrum.

The Trust's investment goal is to provide attractive risk-adjusted returns through the economic cycle, **with a target return of 8–10% p.a. net of fees**. Cash distributions are payable every month, with a target return of 7% p.a.

As at 30 September 2023, the market capitalisation of MOT was $554 million, with net asset value (NAV) at $569 million.

Figure 1. Monthly Net Returns Box Plot



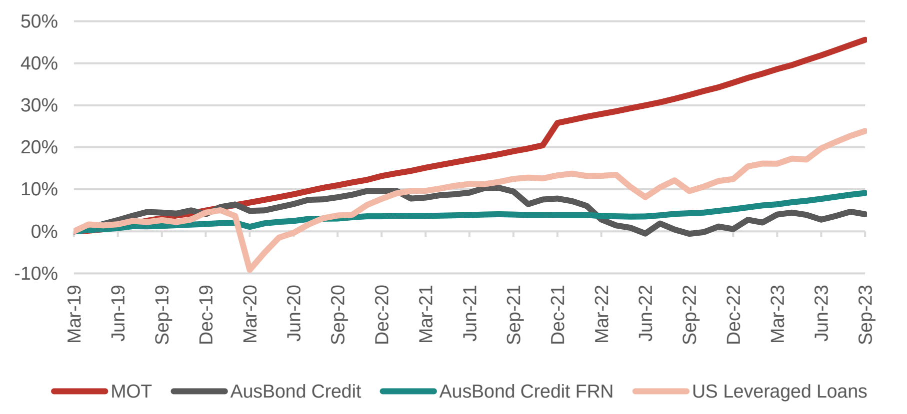
Source: BondAdviser, Metrics. Annualised monthly returns, after fees since inception. As at 30 September 2023.

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	0.87	0.89	0.84				7.31
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 September 2023. * Return is monthly net total return based on NTA plus dividends.*

Figure 3. Relative Cumulative Performance



Source: BondAdviser, Metrics, Bloomberg. As at 30 September 2023.
Calculated from cumulative net monthly returns of the Underlying Fund. Returns on NAV, not traded unit price, see Figure 15 for unit price variance.

Product Assessment

Recommended | Improving

MOT continues to outperform the lower band of its net returns target of 8-10 and has done so on a rolling 12-month, 24-month, and since inception basis.

MOT has diversified its investments as per the target portfolio allocation into 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). These funds offer MOT investors a diverse portfolio consisting of corporate loans, notes, bonds, as well as opportunities for equity-like returns such as from investments in preference shares, warrants, options or equity.

Additionally, MOT provides diversification benefits for investor portfolios as a function of the Fund's low correlation with traditional asset classes along with the potential for attractive risk-adjusted returns. This is supported by Metrics' expertise in private credit, strong governance and processes. MOT continues to outperform the lower band of its returns target of 8-10% net of fees and has done so as at 30 September 2023 on a rolling 12-month, 24-month, and since inception basis. With net returns of 9.92%, 10.58%, and 8.84% per annum, respectively.

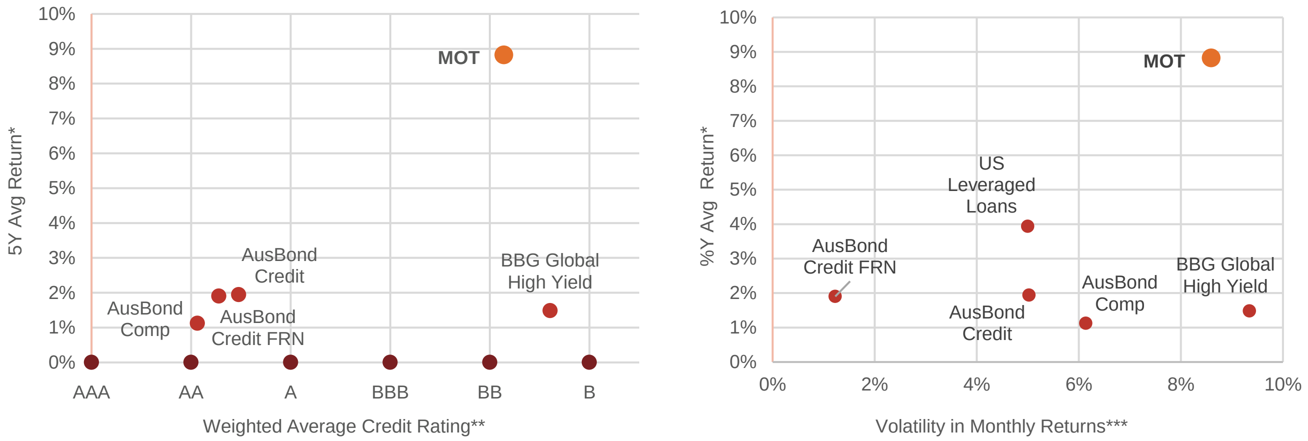
The foremost concern is the underlying portfolio's 82.2% allocation to real estate. A positive aspect, partially alleviating this concern, is that 65.3% of this real estate exposure is senior secured, and 75.5% of the total real estate exposures mature in less than 12 months.

The risk profile of the underlying portfolio has largely improved over the September 2023 quarter as a function of increased diversification. However, it must be noted that the levels of non-senior ranking exposures, lower average credit quality, and a rising portion of portfolio rolling off in the near term are continuations of negative trends. This opportunistic strategy aims for an 8-10% p.a. return through the cycle. With the RBA cash rate rising by 4.25% in the past 24 months and a predominantly floating-rate portfolio, it is probable that MOT will exceed its target return in the short term. Fund metrics related to credit rating, seniority, and duration indicate a less conservative approach, implying a portfolio with ostensibly incrementally higher risk than in previous periods. Despite the target return being more achievable, the Manager remains committed to securing the best risk-adjusted returns.

While the Fund inherently has a degree of risk, specific aspects of the risk exposure demand careful consideration. The foremost concern is the underlying portfolio's 82.2% allocation to real estate based on committed loans and excluding cash but including real estate equity. A positive aspect, partially alleviating this concern, is that 65.3% of this real estate exposure is senior secured, and 75.5% of the total real estate exposures mature in less than 12 months. Another risk factor is the ability of the Fund's portfolio companies to manage higher interest payments, especially considering a 4.25% increase in base rates amid an economic downturn. However, it is both relevant and crucial to emphasise that Metrics has never experienced a default, resulting in no impact on the Fund's ability to meet target returns. This underscores Metrics' stringent screening and post-drawdown loan management processes, which aim to instill confidence with regards to investor expectations of full repayment of their commitment.

MOT currently fulfills all requirements except one for it to be upgraded to a Highly Recommended. The only outstanding criterion is the inability of BondAdviser to conduct five years' worth of research on the Fund, given that MOT was launched around four and a half years ago. Since there is less than a year until this criterion is satisfied, and with no anticipation of MOT falling short on any other criteria, our **Recommended** product assessment remains in place 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 September 2023.*

Construction and Investment Process

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

Portfolio Risk Management

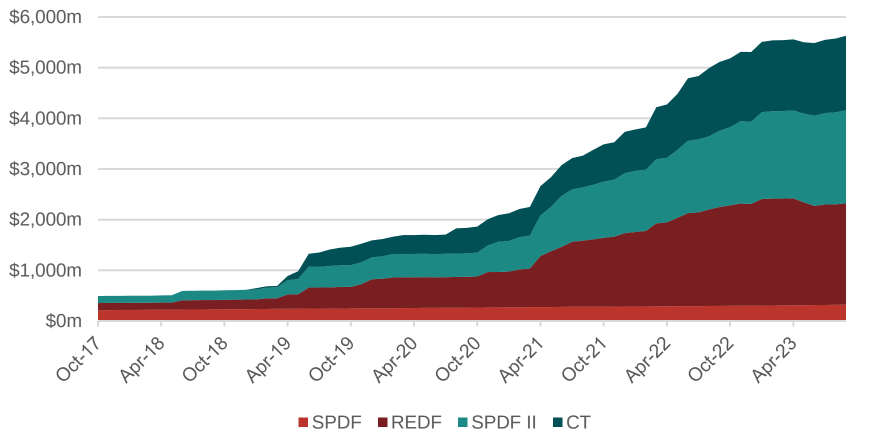
Unique borrower exposure was 161 as at 30 September 2023, remaining at the same high level as the previous quarter, while the number of individual investments increased from 255 to 264 over the same period. While the rise in number of investments is a credit positive, the portion of the MOT portfolio that is set to mature within the next 12 months continued to increase quarter-on-quarter. This places increasing pressure on the investment team to source new investments with 52.6% of investments due to mature before 30 September 2024. That said, the Fund is strategically positioned this way as shorter tenors improve credit risk while higher portfolio churn results in higher fees and a better return for investors.

For the last 18 months, MOT's FUM has remained unchanged around $560 million due to the fund being closed-ended. However, even if FUM for MOT holds steady or does not increase materially, the Fund is able to grow diversification via its three of its four underlying funds that it allocates to via the WIOT. This is because SPDF is closed-ended while the other three may still accept new applications. From the end of 2021 to September 2023, FUM for the REDF, SPDF II, and CT have risen by 38%, 55%, and 81% respectively. A continuation of such trend would be positive for future diversification.

During late 2022 Metrics and the underlying funds that MOT invests into were highly active, which saw investment diversification peak. Following this highly active period a combination of repayments and lower new investment activity saw the numbers of these individual investments come down slightly throughout 2023.

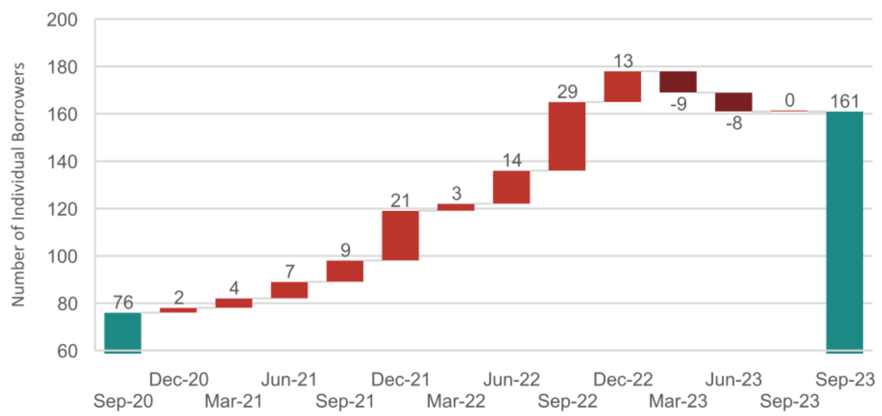
The past year for MOT has been one of deteriorating creditworthiness in the underlying portfolio as the Manager continues to allocate to both more subordinate and sub-investment grade loans. In our view there are three main factors that drive risk in a credit portfolio; (1) concentration, (2) seniority, and (3) credit risk. Figure 5 illustrates the drastic improvements in counterparty diversification from Sep-20 to Dec-22, however, there has been a reversion in this positive trend in 2023. An increase in diversity is a way to negate the weakening aspects of the portfolio in terms of seniority and credit risk.

Figure 5. WIOT Funds Under Management



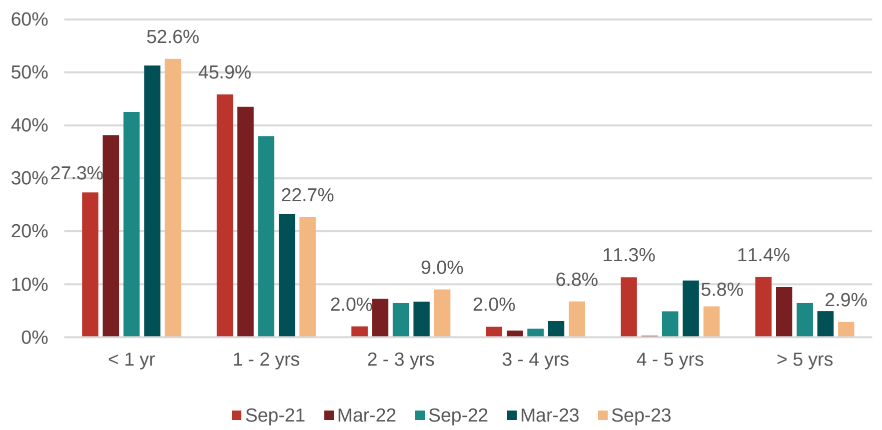
Source: BondAdviser, Metrics. As at 30 September 2023.

Figure 6. Unique Borrower Exposure Over Time



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

Figure 7. Portfolio Maturity Over Time

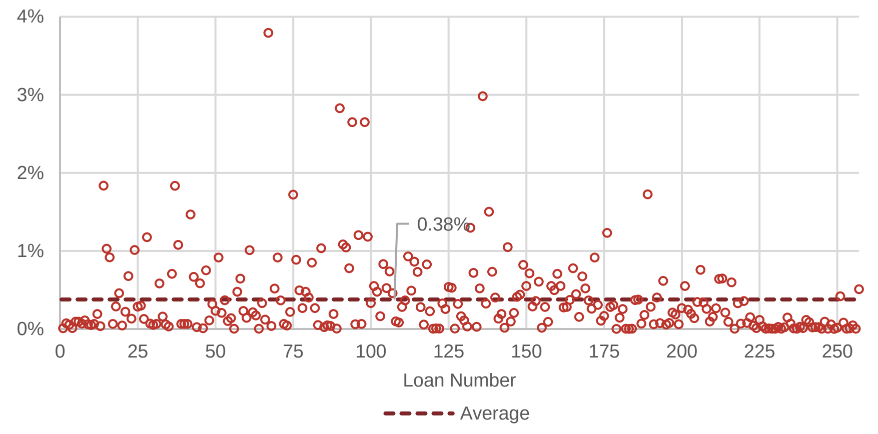


Source: BondAdviser, Metrics. As at 30 September 2023. Based on Metrics' underlying portfolio (WIOT) not MOT.

Throughout the third quarter of 2023, MOT's portfolio credit quality has largely held steady at around 73% sub-investment grade excluding cash. Although this is in line with the June 2023 quarter, there has been an uptick in sub-IG holdings over time, rising gradually from 63% 18 months ago.

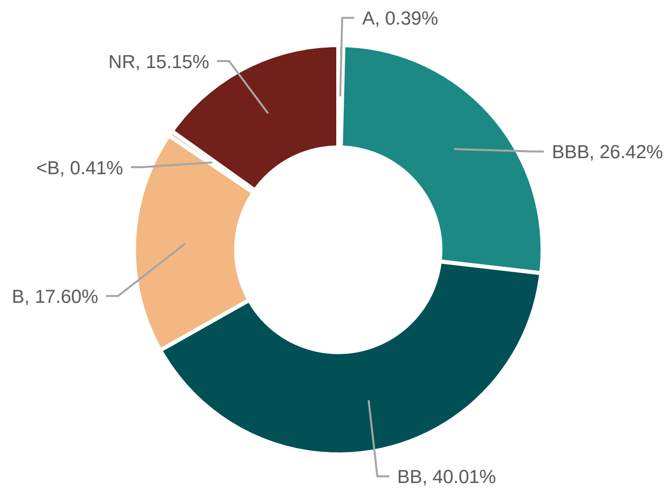
The portfolio's seniority composition has also shifted lower down the capital structure, with a decrease in the percentage allocated to senior secured debt and a corresponding rise in allocations to equities and subordinated debt. This deterioration in the seniority mix of the portfolio is quite material, as at a year ago, 73.7% of the portfolio was senior secured versus 54.9% as at September 2023.

Figure 8. Portfolio Individual Loan Mix*



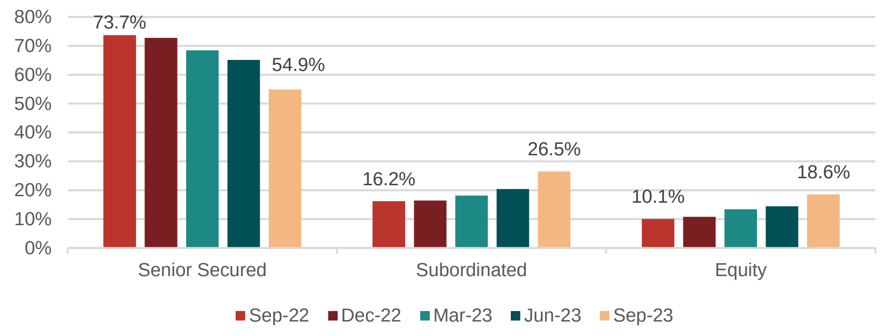
*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

Figure 9. Portfolio Credit Rating Mix*



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

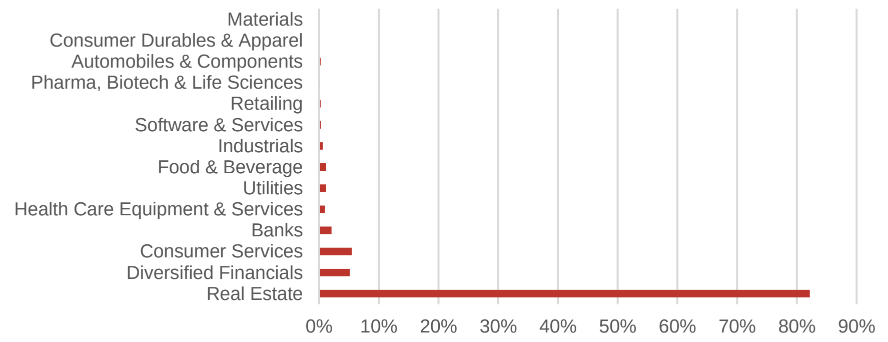
Figure 10. Portfolio Seniority Mix*



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

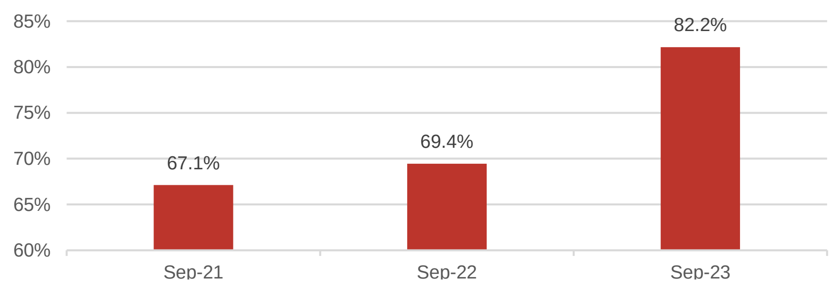
The portfolio is highly concentrated in the real estate sector, resulting in increased vulnerability in the event of industry-wide stresses. This has been an increasing trend, growing from a 67% weighting two years ago to 82% at September 2023. The advantages of portfolio diversification diminish significantly when there is a heavy concentration in an industry. Inherently, this large allocation into real estate is credit negative from the perspective of assets in the same industry being highly correlated. Positively, we note that 65.3% of this real estate exposure is senior secured,

Figure 11. Portfolio Mix by S&P Industry Group*



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

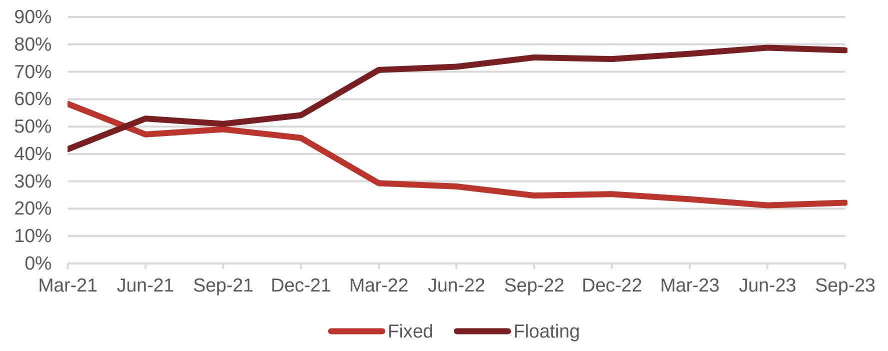
Figure 12. Real Estate Exposure



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

In the September 2023 quarter the interest rate type of the underlying portfolio remained relatively consistent, maintaining almost an 80:20 allocation of floating:fixed rate securities.

Figure 13. Portfolio Mix by Rate Type*

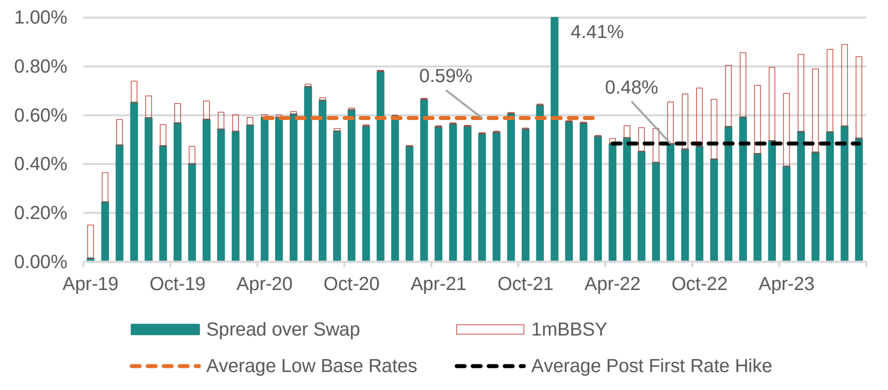


*Source: BondAdviser, Metrics. As at 30 September 2023. *Excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

For the two years between April 2020 and April 2022, the RBA cash rate was near zero at either 0.25% or 0.10%. Over this time, MOT returned 9.41% per annum net of fees. At 31 March 2020, the portfolio was less diversified with 73 individual borrower exposures and four relatively large holdings that each constituted greater than 5% of FUM. Additionally, 16% of the portfolio was equity and 34% was subordinated. This is very different to the current portfolio of 161 unique borrowers, 65% senior secured and the five largest exposures are all between 2.5% and 4.0%. The average monthly return (excluding the 4.42% in December 2021 due to remarking equity-like positions) over this two-year period above the 1m BBSY rate was 59bps. Since the beginning of the cash rate hiking cycle, monthly net returns have only exceeded the swap rate by an average of 48bps. On an annualised basis, this is a 1.33% drop in returns generated above the risk-free rate.

There are two primary reasons for this, the first being that around 20% of the underlying portfolio is fixed rate in nature and therefore would not have benefitted from the rising rates. The second reason is the increase in exposure to private equity and equity-like investments which now comprise 15% of MOT. MOT is a multi-strategy fund that looks to invest in equity positions in growth companies and Real Estate investments that provide capital growth opportunities. These are unlike credit instruments in that they do not provide regular returns and will therefore be a drag on immediate returns, however may provide potential upside for investors over time.

Figure 14. Breakdown of MOT Monthly Net Returns

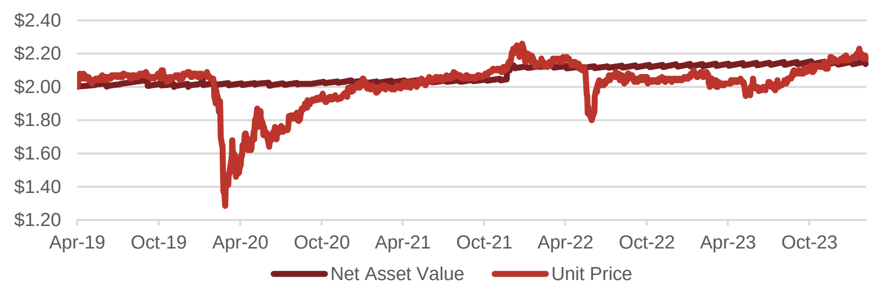


Source: BondAdviser, Bloomberg Metrics. As at 30 September 2023.

Fund Governance

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

Figure 15. Net Asset Value Against Unit Price



Source: BondAdviser, Metrics, Bloomberg. As at 1 March 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).

Market challenges in June 2022 led to a 15.2% discount between the unit price and NAV of MOT. Although such discounts can be typical during volatile market conditions as assets are broadly sold down, the price inconsistency that arises for the Fund flies in the face of daily NAV updates from Metrics, confirming the underlying holdings are stable. Metrics also conducts weekly stress testing along with monthly independent portfolio valuations and impairment testing through an accounting firm, providing a positive context for the stated NAV. The discount has significantly narrowed since June 2022, to the point of MOT trading at a 2.0% premium on 29 February 2024. This was reflective of the trend of convergence that has been the case since June 2023.

Continually trading at a premium to NAV may be viewed by the Manager as an opportunity to grow FUM, which would allow for an even more diverse portfolio. This has previously been the case for MOT, which has undertaken two capital raisings since its inception. The first was announced on 26 August 2021 after the share price was consistently above NAV for 40 trading days. The proposal was initially to issue up to ~26 million new units at a price of $2.03 (NAV was $2.0384 and units last traded at $2.07). 26.04 million was the final amount allocated, raising ~$53 million. The units then continued to trade at a premium to NAV every day following the capital raise until shortly after the second raise, which was announced on 10 February 2022. This renounceable entitlement offer was for up to $150 million in new units at a price of $2.12 (NAV was $2.1179 and units last traded at $2.18 pre-announcement). In total, approximately $113 million of new units were issued at $2.12. MOT continued to trade above NAV until the market-wide volatility in June 2022.

On 7 December 2023, MOT traded at a NAV premium for the first time since the June 2022 disconnect and has continued to do so for the past 61 trading days up to 1 March 2024. On 23 February 2024, MOT announced an offer of new units via a Unit Purchase Plan with a maximum number of ~80 million units to be issued at a price of $2.13 per security. Although raising capital for MOT has not previously been a trigger to trade beneath its NAV, capital raises are typically associated with negative movements in unit prices. However, we note this has not been the case post the recent MXT capital raise.

It is also worth noting that other private credit listed investment trusts, namely the Metrics Master Income Trust (ASX: MXT) and the Qualitas Real Estate Income Fund (ASX: QRI) have recently completed capital raises following broad market strength. MXT raised ~$196 million along with a further ~$76 million via a Unit Purchase Plan which closed on 30 January 2024, and QRI raised ~$41 million.

Quantitative Analysis

The underlying portfolio of MOT has been altered quite significantly over the past 18 months. As a function of this, some risk aspects have been enhanced while others have become more pronounced. During this period since March 2022, MOT has increased both the number of unique borrowers from 122 to 161, and the number of loans comprising the portfolio from 193 to 264. Crucially, this contributes to enhancing diversification and, in the event of a default, mitigates the overall impact of such an occurrence on the entire portfolio's performance. However, in the same 18-month timeframe whereby the portfolio's risk improved from diversification benefits, the portfolio deteriorated in terms of both seniority and credit rating. As at 31 March 2022, 71.7% of the portfolio was senior secured, versus a fall to 54.9% at 30 September 2023. Similarly, the percentage allocation to Investment Grade (IG) securities has decreased from 37.0% to 22.7% during this period.

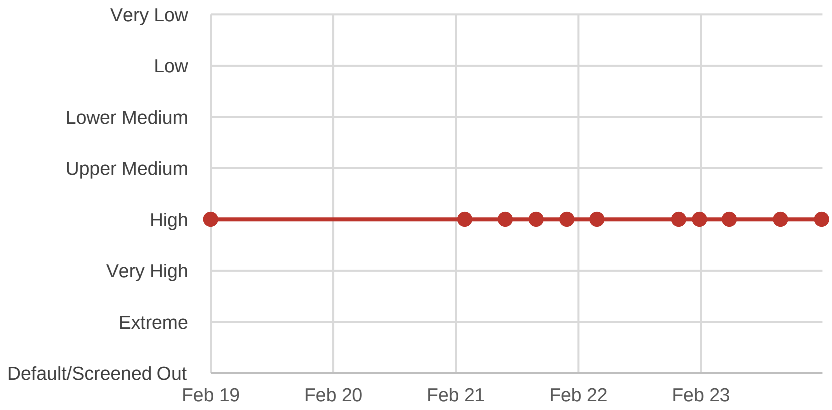
These long-term trends are also the case for quarter-on-quarter. For the past four quarters, each of the Fund's investment grade and senior positions have fallen versus the prior quarter. The improvements in portfolio diversity work to offset this in a distressed environment while the riskier holdings provide higher returns in a benign environment. This has led to a comparative improvement in the performance of the portfolio under our modelling both in our benign and GFC-like scenarios in comparison to our last iteration as at 30 June 2023.

This is reflected in a rise in median expected returns to 8.50% versus the previous experience of 8.19% (as at 30 June 2023). The improved returns have been achieved whilst simultaneously reducing the downside in the GFC like scenario, whereby the 99% VaR has increased quarter on quarter from -5.27% to -4.37% on an expected gross return basis. A return of -4.37% or worse in a distressed scenario only occurring 1% of the time is a strong result for an opportunistic credit fund. That said, it must be noted that in the distressed scenario, the projected outcomes continue to exhibit an increasingly negative skew. This is a direct result of worsening attributes of the portfolio, with the most potent impact arising from the reduction in seniority and deterioration in credit quality.

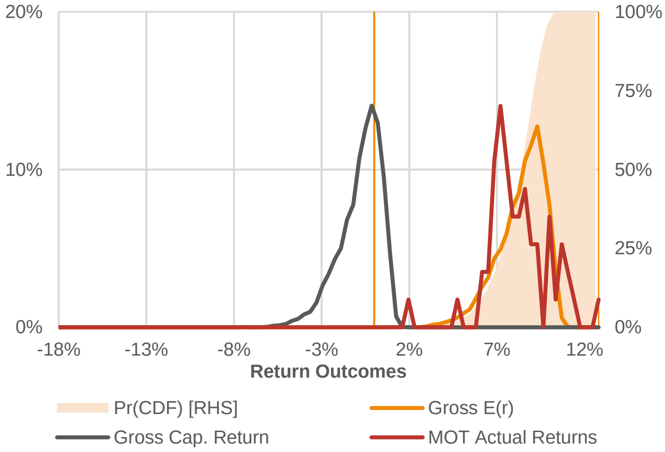
Interestingly, when compared to two 'control' 50 bond portfolios rated BB and BBB respectively, holding all price-related aspects the same as MOT's weighted average, MOT provides incredibly strong results on a downside protection basis. The baseline BB-rated portfolio provided a 99% VaR of -6.22% and the BBB-rated portfolio produced a 99% VaR of -3.48%. MOT's modelled returns in a stressed environment falls between the two, despite being far more diverse. MOT consistently outperforms the BB-rated portfolio in both stressed and benign environments however, the Fund is struggling to stay on par with the BBB-rated counterpart.

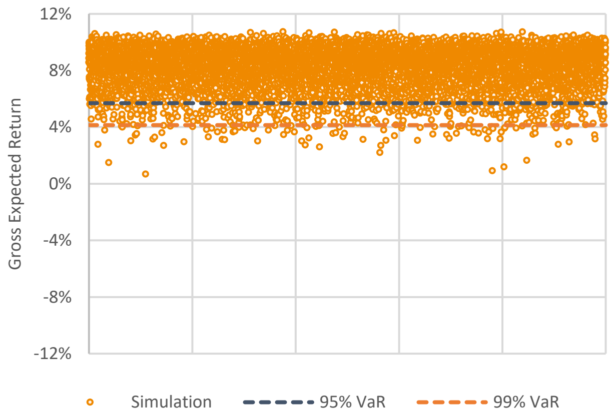
The portfolio's quality improved quarter on quarter, and our modelling has substantially improved in the two years prior to this primarily driven by diversification benefits. We reiterate a risk score of "**High**" or "BB", which is line with the weighted average credit rating of the underlying portfolio. Significantly increased sectoral diversification could drive an upwards notching to the Risk Score.

Figure 16. Risk Score



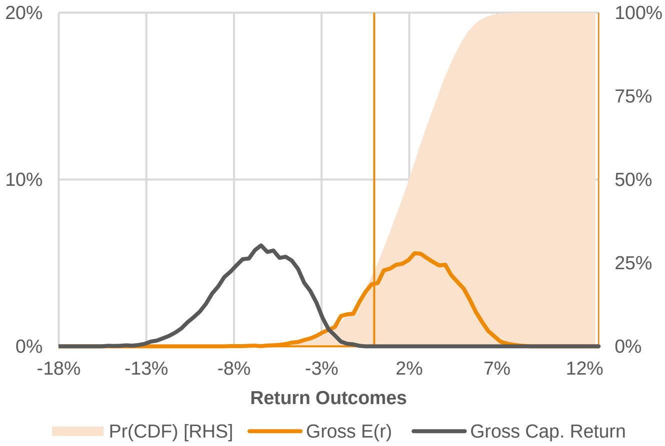
Scenario 1. Baseline Asset Assessment

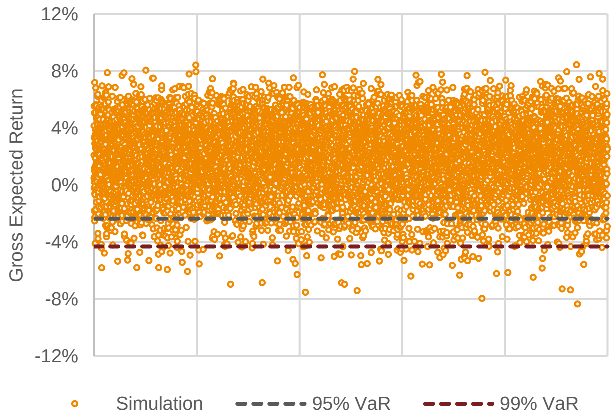




Source: BondAdviser Estimates as of 30 September 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price 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 September 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 – 3 January 2024]
[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 4 March 2024.