Fund Research

Metrics Income Opportunities Trust (ASX: MOT)

BondAdviser

Overview

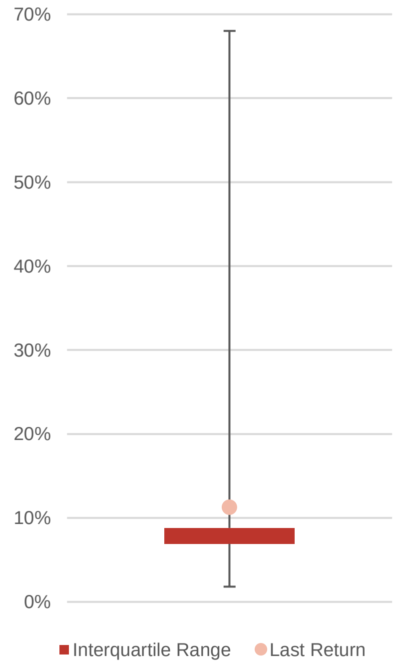
The Metrics Income Opportunities Trust (ASX: MOT) offers retail investors access to the Australian private credit market through an actively managed portfolio primarily comprising the full spectrum of private credit investments. MOT will be mostly invested in loans, notes and bonds, however, may also provide investors with the potential for upside gains through exposure to private equity and equity-like investments. The diverse range of assets which this listed investment trust (LIT) provides exposure to has historically only been accessible only to institutional investors and large international banks, previously posing a challenge for retail investors to participate.

The underlying investment portfolio is overseen by Metrics Credit Partners Pty Ltd (MCP, Metrics), a seasoned alternative asset manager with specialist knowledge and a proven track record in the private credit industry. The Trust invests in the Metrics Wholesale Income Opportunities Trust (WIOT), which, in turn, invests in wholesale funds managed by Metrics, covering various points along the credit risk spectrum.

The primary investment objective of the Trust is to deliver attractive risk-adjusted returns through the economic cycle, **targeting a return of 8–10% p.a. net of fees**. Monthly cash distributions are payable, with a goal of achieving a 7% p.a. return.

As at 31 December 2023, MOT's market capitalisation stood at $573 million, with a net asset value (NAV) of $569 million.

Figure 1. Monthly Net Returns Box Plot



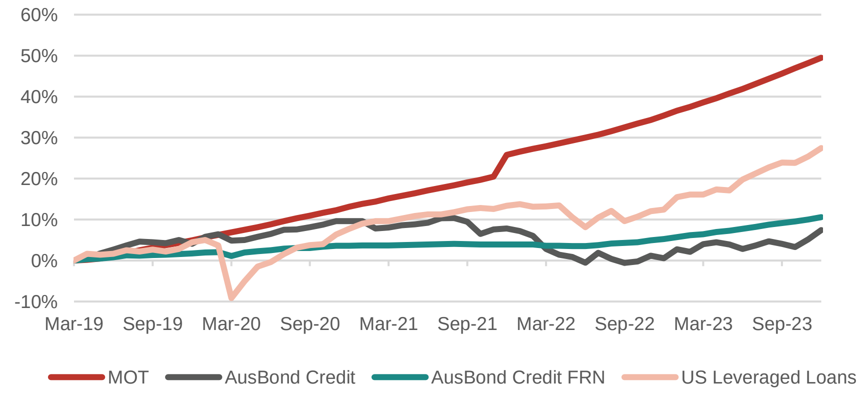
Source: BondAdviser, Metrics. Annualised monthly returns, after fees since inception. As at 31 December 2023.

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	0.95	0.81	0.90	**9.97**
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 31 December 2023. * Return is monthly net total return based on NTA plus dividends.*

Figure 3. Relative Cumulative Performance



Source: BondAdviser, Metrics, Bloomberg. As at 31 December 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

The inclusion of MOT in a portfolio provides advantages from a risk-adjusted return basis. This is reinforced by Metrics' proficiency in private credit, robust governance, and well-established procedures.

As per the target portfolio allocation, MOT invests its capital via Metrics Wholesale Income Opportunities Trust (WIOT) across four privately managed wholesale funds managed 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 a diversified portfolio to investors, encompassing a broad spectrum of corporate loans, notes, bonds, coupled with opportunities for potential equity-like returns via investments such as preference shares, options, equity, or warrants.

Due to the Fund's limited correlation with traditional asset classes, the inclusion of MOT in a portfolio provides advantages from a risk-adjusted return basis. This is reinforced by Metrics' proficiency in private credit, robust governance, and well-established procedures. As at 31 December 2023, on a rolling 12-month, 24-month and since inception basis, MOT has produced net returns of 10.44%, 8.63%, and 8.83% p.a. respectively, outperforming the lower band of its returns target (8-10% p.a. net of fees).

The Fund's opportunistic strategy continues to target the best risk-adjusted returns. This has resulted in meaningfully riskier underlying exposures in the portfolio than less than a year ago.

The risk profile of the underlying portfolio has increased in the Dec-23 quarter as a function of decreased credit quality and seniority that outweighed the small increase in diversification. In comparison to the September quarter, MOT's exposure to non-rated assets has risen to 20.78% from 15.15% three months earlier. This is a function of a greater weighting to equity-like securities in the portfolio. The portfolio's allocation to sub-Investment Grade rose 2.7 percentage points to 75.88% on the quarter while the allocation to senior secured assets fell from 54.9% as at 30 September 2023 to 52.4%. These credit negative alterations to seniority and credit quality overshadowed the slight diversification uplift via an increase in single investment tranche exposures from 264 to 267 as at 31-Dec-23.

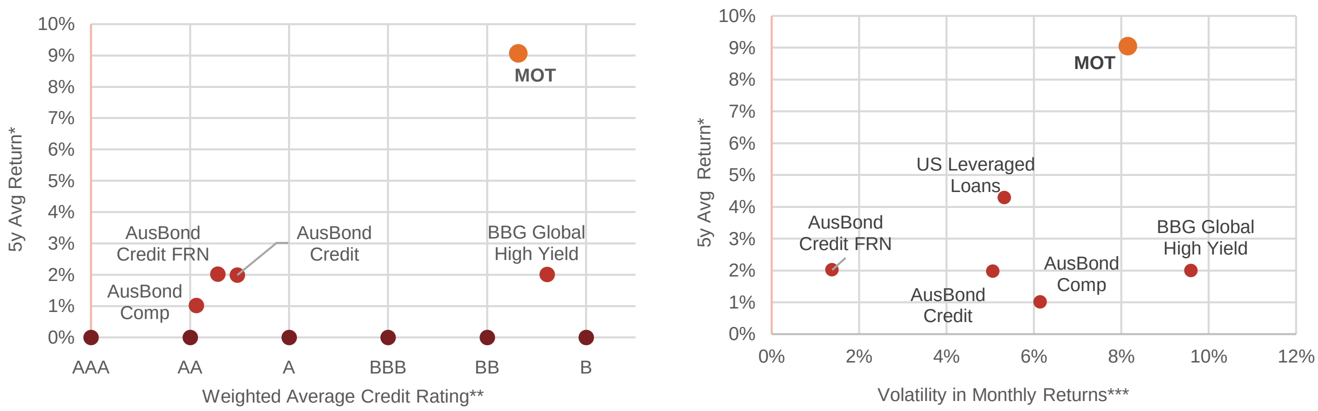
The portion of the underlying portfolio maturing in the near term continues to increase. Loans with under a year until maturity has risen from 40.7% as at Dec-22 to 57.5% as at Dec-23. This increased portfolio rolloff in the near term is a negative trend because it places more pressure on management to secure new suitable investment opportunities to ensure cash does not build up and act as an anchor on returns. That said, the Fund is strategically positioned this way as shorter tenors limit credit risk while higher portfolio churn results in higher fees and potentially better returns for investors.

MOT's opportunistic approach is designed to achieve an 8-10% p.a. return over the economic cycle. Given the 4.25% increase in the RBA cash rate over the last 24 months and the portfolio mostly consisting of floating-rate assets, it is likely that MOT should continue to surpass its return goal at least over the short term. The Fund's metrics, including credit rating, seniority, and investment duration, suggest a less conservative stance, as the portfolio has higher incremental risk compared to previous periods. Despite the more attainable target return, the Fund remains dedicated to achieving the highest possible risk-adjusted returns and allocates to the best opportunities available. It just so happens that these are currently on the riskier end of the spectrum.

Although we acknowledge the heightened risk profile of the underlying portfolio, it is essential and relevant to note that Metrics has never had any instances of losses impacting investor returns. This is a triumph for a lender that has been prevalent in markets for over 10 years providing capital to hundreds of direct counterparties. This strong track record, combined with the results of our forward-looking *Quantitative Analysis*, provides us with confidence in the underlying portfolio.

Under our Alternative Investment Fund Research Methodology, MOT currently fulfills all requirements to attain a Highly Recommended product assessment except BondAdviser having conducted 5+ years of research on the Fund given it was incepted 4.75 years ago. With no anticipation of MOT falling short on any other criteria, we reiterate our **Recommended** product assessment and our **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 31 December 2023.*

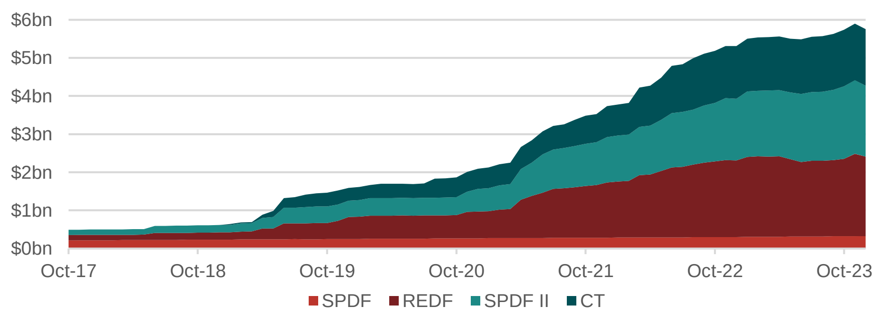
Construction and Investment Process

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

Portfolio Risk Management

MOT is closed-ended and therefore has relatively stable FUM unless if new units are issued, as was the case in February 2024 when a Unit Purchase Plan was announced, eventually raising $44.5 million at a price of $2.13 per new unit. This increase in FUM is dwarfed by the increase in monies for the underlying open-ended funds which MOT may invest into via the WIOT. The funds under management for the strategy's underlying investments summed to $5.8 billion as at 31-Dec-23, up from $2.09 billion three years ago. It is via growth in the WIOT that even if FUM remains stable or doesn't increase significantly for MOT, the Fund can still achieve diversification growth through its allocation to the four underlying funds. Over the past three years to December 2023, the FUM for REDF, SPDF II, and CT has grown at CAGRs of 44.1%, 46.0%, and 41.2%, respectively. We note that the WIOT is not currently allocated to SPDF II.

Figure 5. WIOT Funds Under Management



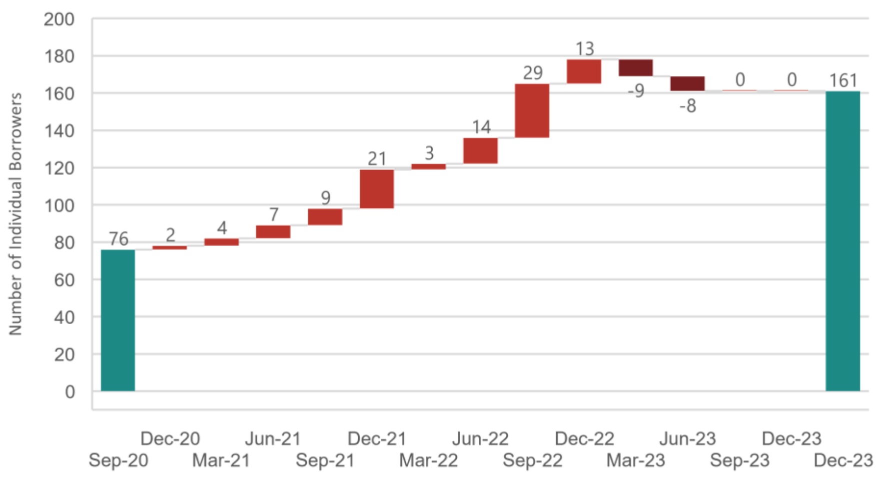
Source: BondAdviser, Metrics. As at 31 December 2023. Based on Metrics' underlying portfolio (WIOT) not MOT.

The unique borrower exposure has remained constant at 161 for the six months to 31 December 2023. Despite the stagnation, we still view this high level of counterparty diversification as a positive and note the portfolio is in a period of consolidation following mammoth growth prior to this. In the December quarter, we have also seen a continuation in the trend of increasing the number of individual tranches held in the underlying portfolio. This rose from 264 as at Sep-23 to 267 as at Dec-23.

During late 2022, Metrics and the underlying funds that MOT invests in were highly active, leading to a peak in investment diversification. Following this active period, a combination of repayments and lower new investment activity resulted in a slight decrease in the number of individual investments over 2023.

Despite the FUM for the WIOT growing in the past 18 months by 20.1%, this period was characterised by higher risk taking in the underlying portfolio as the Manager continues to allocate to both more subordinated positions and a greater portion of sub-investment grade loans. In our opinion, three main factors drive risk in a credit portfolio: (1) concentration, (2) seniority, and (3) credit risk. Figure 6 illustrates the significant improvements in counterparty diversification from Sep-20 to Dec-22; however, there was a slight reversal of this positive trend in 2023. Increasing diversity is a way to counteract the weakening aspects of the portfolio in terms of seniority and credit risk.

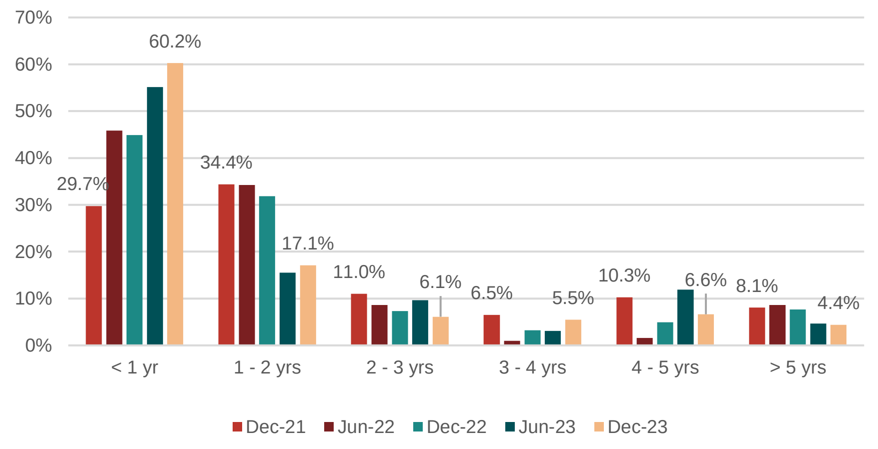
Figure 6. Unique Borrower Exposure Over Time



Source: BondAdviser, Metrics. As at 31 December 2023. Based on Metrics' underlying portfolio (WIOT) not MOT.

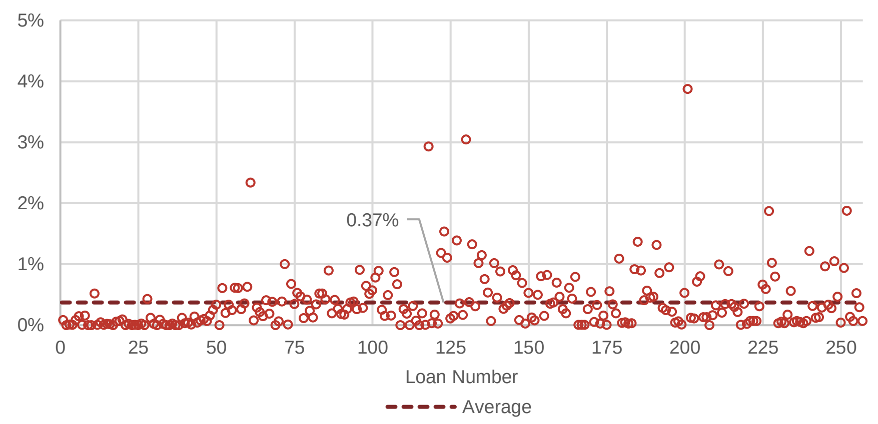
Notably however, there has been a materially large rise in the number of individual investments with less than a year until expected maturity. When compared to 12 months prior, there has been a 16.8 percentage point rise in the portion of the MOT portfolio that is set mature within the next year. This places increasing pressure on the investment team to source new investments with 60.2% of the portfolio (on a drawn basis, excluding cash) due to mature before 31 December 2024. Although, as previously mentioned, Management is not overly concerned by this trend as higher portfolio churn results in higher fees and potentially a better return for investors.

Figure 7. Portfolio Maturity Over Time*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

Figure 8. Portfolio Individual Loan Mix*

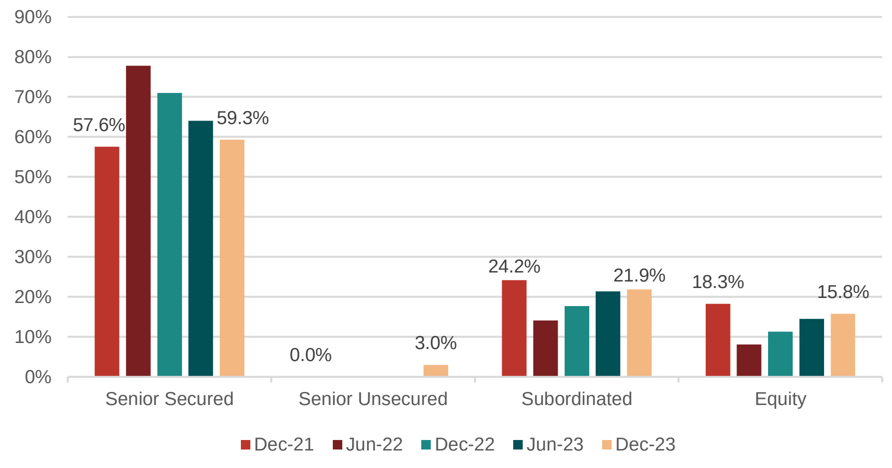


*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

In the 12 months to 31 December 2023, the underlying portfolio's seniority mix has changed quite materially. This has been driven by a gradual increase in the weighting towards equity-like securities, coinciding with a steady reduction in the Fund's allocation to senior secured investments. At Dec-22 71.0% of the portfolio was allocated to senior secured investments versus 59.3% a year later.

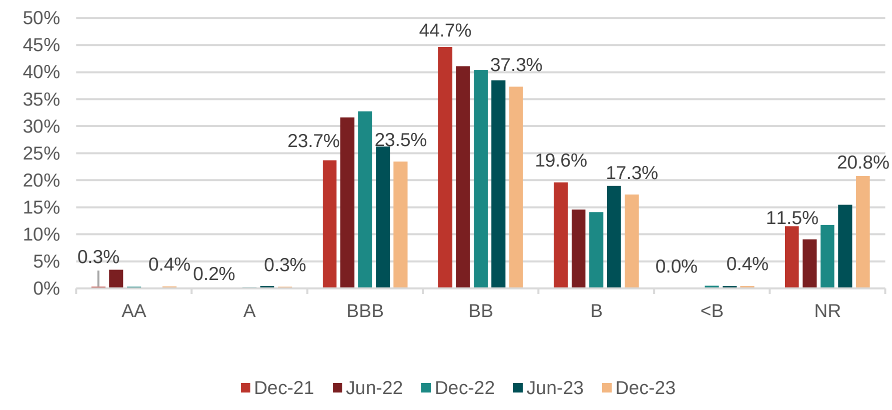
This also unsurprisingly coincides with a reduction in the amount of investment grade investments held within the portfolio, falling from around 26.8% as at 30 September 2023 to 24.1% as at 31 December 2023. The weighted average credit rating has been on a deteriorating trajectory for several quarters now.

Figure 9. Portfolio Seniority Mix*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

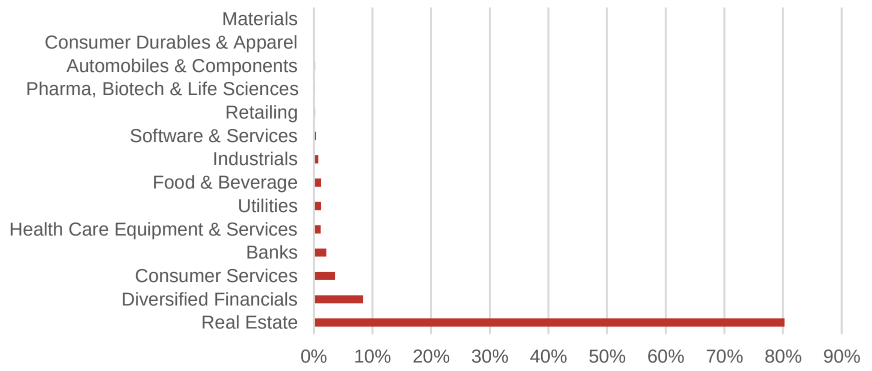
Figure 10. Portfolio Credit Rating Mix*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

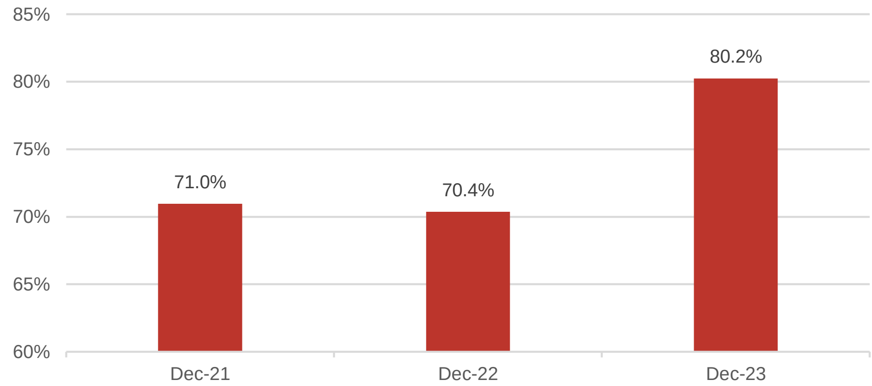
The portfolio's significant overweighting to the real estate sector remains a drawback from a credit perspective given that there is typically high correlation between assets in the same industry. Sector-wide stress for real estate could drastically impact portfolio performance given the ~80% exposure to the sector on a drawn basis. Notably however, in the December quarter we saw a slight reduction in the allocation to real estate (inclusive of real estate equity) from 81.3% as at Sep-23. Despite this positive movement, 80.2% is still a large allocation to a single industry and largely undoes the previously mentioned diversification benefits.

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



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

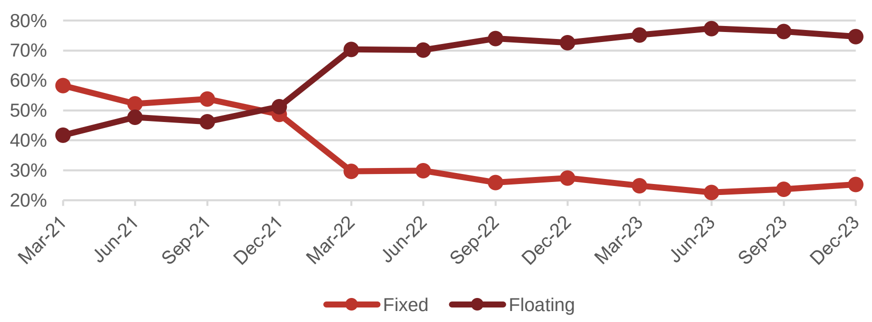
Figure 12. Real Estate Exposure*



*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

The portfolio remains largely floating rate, however has seen a slight uptick towards more fixed-rate exposure since the Jun-23 quarter. Now with the market pricing in cuts to the RBA Cash Rate, it would be logical to expect the portfolio's weighting to fixed rate payments to increase, so as to lock in higher yields before they fall. That said, this would be taking on interest rate risk (duration). Given the Fund is opportunistic in nature and has a fixed-rate target of 8-10% p.a., we have no issue with this strategy should it unfold.

Figure 13. Portfolio Mix by Rate Type*



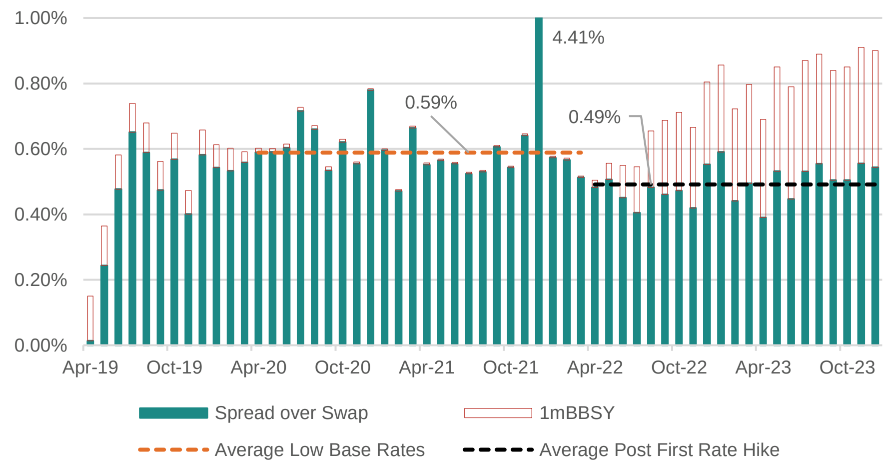
*Source: BondAdviser, Metrics. As at 31 December 2023. *Based on the drawn value of commitments and excluding cash. Based on Metrics' underlying portfolio (WIOT) not MOT.*

MOT is currently structured slightly differently to how it was during the low-rate environment from April 2020 to April 2022 where the RBA cash rate was either 0.25% or 0.10%. Over this time, MOT returned 9.41% per annum net of fees. Since then, the RBA cash rate has risen to 4.35% and during this rate hike cycle, MOT has returned 9.31% per annum net of fees.

There are two primary reasons for this, the first being that around 24% 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 16% 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.

The average monthly return above the 1m BBSY rate was 59bps over the low-rate period (excluding the 4.42% in December 2021 due to remarking equity-like positions). Since the beginning of the cash rate hiking cycle, monthly net returns have only exceeded the swap rate by an average of 49bps. On an annualised basis, this is a 124bps drop in returns generated above the risk-free rate.

Figure 14. Breakdown of MOT Monthly Net Returns

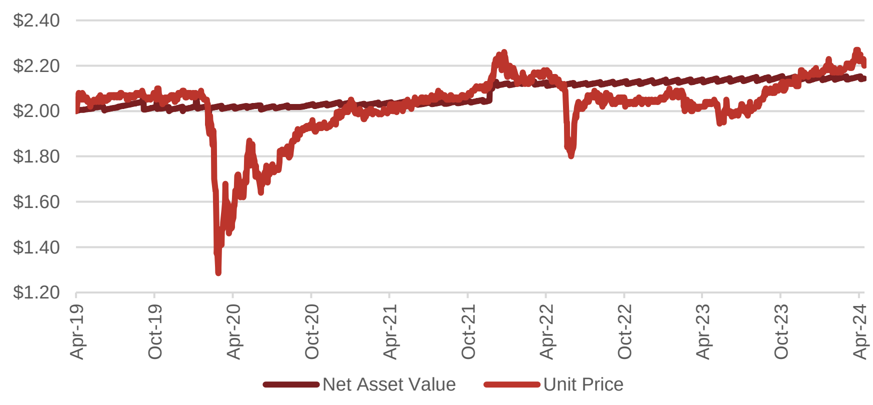


Source: BondAdviser, Bloomberg Metrics. As at 31 December 2023.

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 8 May 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).

In June 2022 market challenges led to the unit price trading at a 15.2% discount to the NAV of MOT. This flew in the face of the daily NAV updates provided by Metrics that reiterate – despite the volatile market conditions – the underlying holdings had not been marked down. To bolster this, Metrics also conduct weekly stress testing and monthly credit impairment reviews through an external accounting firm, supporting conviction for the stated NAV. Nevertheless, as market conditions have recovered so too has the discount, as at 8 May 2024 MOT is trading at a 2.6% premium to NAV, highlighting the trend of convergence present since June 2023.

Trading at a premium to the NAV is frequently viewed by managers as an opportunity to grow FUM, by issuing new units. Following MXT's footsteps a few months earlier, this was the case for MOT which on 23 February 2024, MOT announced an offer of new units via a Unit Purchase Plan (UPP) with a maximum number of ~80 million units to be issued at a price of $2.13 per security. A total of $44.5 million was raised. 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. We note this has not been the case post the recent Metrics Master Income Trust (ASX: MXT) capital raise and MOT has traded above NAV every day since 6 December 2023, including the 29 trading days since announcing this UPP.

Quantitative Analysis

Heightened allocation to riskier assets over the December 2023 quarter overall resulted in weaker modelled outcome in our GFC-like scenario while the benign experience was largely unchanged. During this quarter MOT has increased the number of individual investment tranches that comprise the portfolio from 264 to 267, while maintaining 161 unique counterparties. This contributes to a minor improvement in diversification which reduces the overall effects a singular default has on the performance of the entire portfolio. On the other hand, there has been a weakening in both the seniority and credit quality of the portfolio as MOT has scaled further into equity-like opportunities. Last quarter, 54.9% of the portfolio was senior secured which has declined to 52.4% as at 31 December 2023. Similarly, the percentage allocation to Investment Grade (IG) securities has declined from 26.8% to 24.1%.

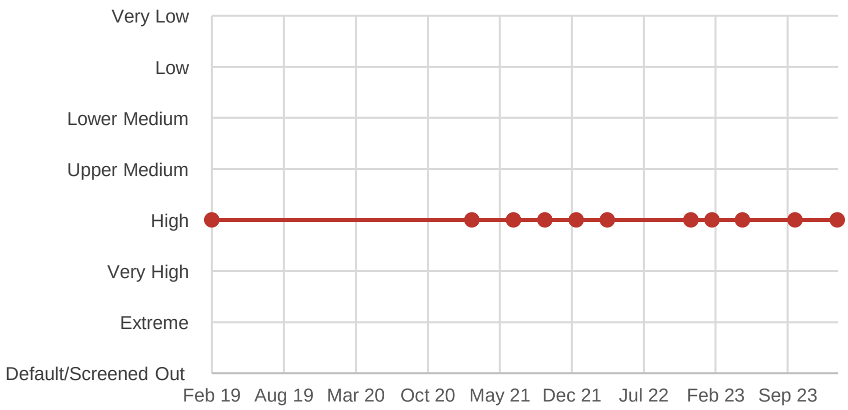
The holdings of the underlying portfolio tilting towards equity-like securities reduces the expected returns of the portfolio in our modelling given the higher likelihood of default and lack of coupon income. This is best reflected through our GFC-like scenario whereby the 99% VaR gross expected return has fallen from -4.37% as at 30 September 2023 to -6.27% as at 31 December 2023. The average expected gross return in a GFC-like environment is +1.23%, down 64bps from three months ago. Although there has been a reduction in how well insulated the portfolio is, there is still a great deal of capital protection from the majority of the portfolio being senior secured and in the BB to BBB bracket (61% of the portfolio).

Interestingly, in our baseline assessment the modelled experience of the portfolio has also become less certain since the last iteration. The distribution of expected returns is larger with fatter tails and the median gross return has slightly come down from 8.50% as at Sep-23 to 8.39% as at Dec-23. The key change is the lower VaR floors, falling from a 99% Var of 4.14% three months ago to 3.36%. This illustrates the reduction in income being produced by the recently added equity-like positions. As discussed earlier, this creates a greater reliance on irregular equity revaluations to generate returns rather than the regular monthly income. It is worth noting that given our modelling does not take into account equity revaluations, that actual outcomes may be better than our modelling suggests (equity positions are likely to produce better outcomes than 0.0% per annum).

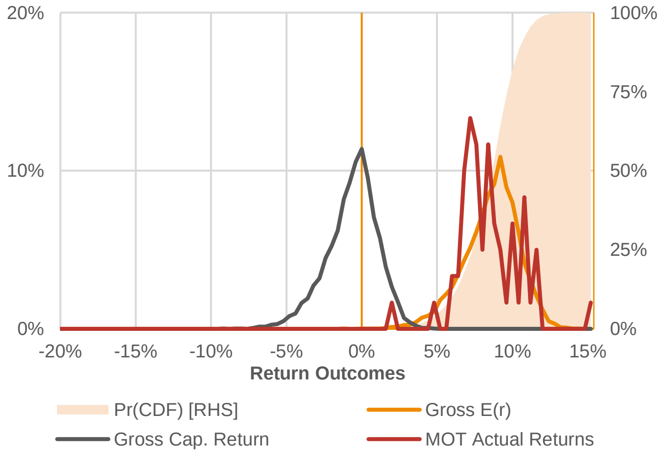
Looking further back in time, we can contrast the Dec-23 experience with that of 18 months prior (June-22), whereby the effects of these changes in credit quality, seniority, and diversification on the outcomes of the portfolio become more patent. As at 30 June 2022 the median return of the portfolio in our baseline assessment was 6.42% and the 99% VAR in our distressed assessment was -3.08%. This highlights how the decrease in credit quality and seniority has widened the gap between the upside in baseline scenarios and downside in GFC like scenarios (higher highs and lower lows).

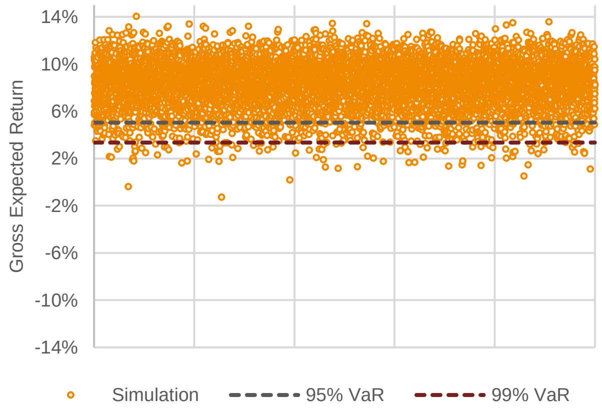
The portfolio this quarter is certainly riskier than it was as recently as three months ago, however, it still produces results in line with a portfolio of loans rated BB and provides far greater capital protection than a portfolio of B-rated securities. For this reason, we reiterate a risk score of "**High**" which is BB-equivalent. If there is a continuation in the deterioration of seniority and credit quality of the portfolio that isn't combated by increased diversification, a downgrade to a Risk Score of "Very High" could be warranted. Whereas, significantly increasing the sectoral diversification, improvements in underlying credit quality and seniority could drive an upwards notching to the Risk Score.

Figure 16. Risk Score



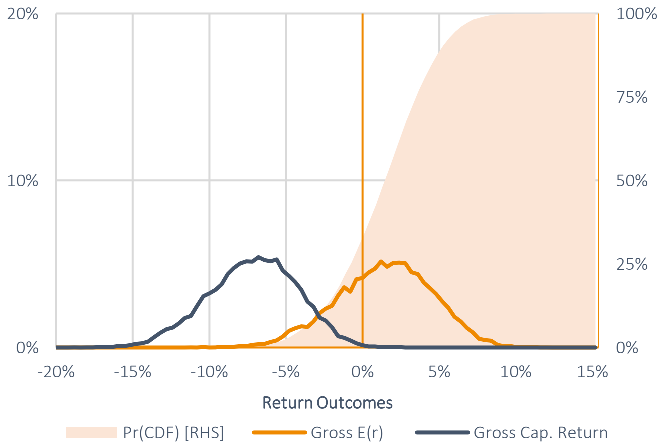
Scenario 1. Baseline Asset Assessment

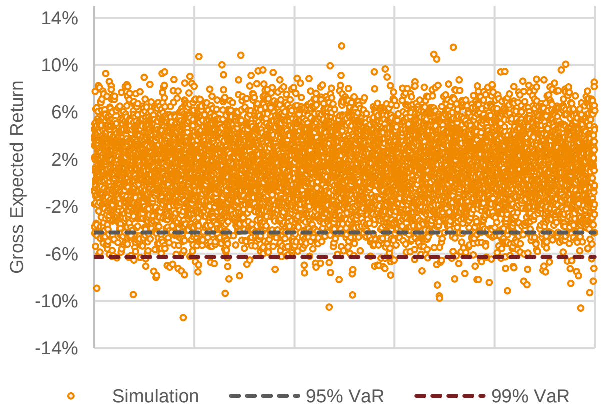




Source: BondAdviser Estimates as of 31 December 2023 portfolio. Excludes impact of management and origination fees. Gross capital returns excludes the value of coupons/income and is only modelling impairment or loss given default, based on historical credit data from Moody's. Impact of traded price is not simulated.
For a more detailed explanation of the methodology, please contact BondAdviser.

Scenario 2. Stressed Asset Assessment





Source: BondAdviser Estimates as of 31 December 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

Alternative Investment Fund Research Methodology

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