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Weekly Market Insight

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Chart of the Week: Ted Lasso!

Please see below for Ted Lasso's dream team

Weekly Insights

- New ASX Listed Issue: Australian Unity (ASX Code: AYUPA) Mutual Capital Instrument (MCI)
- Building the 6% Yield Dream Team
- NCIG FY21 Results
- Weekly "Most" Traded

Week in Review

- Australia reported a record trade balance of AUD15bn on the back of strong exports in coal, natural gas, and gold making up for a fall in iron ore. The level is the highest ever to be recorded, beating analyst estimates of AUD10bn.
- The RBA kept the cash rate unchanged at 0.1% as expected and stuck to its projection of a rate hike no earlier than 2024.
- IAM Capital Markets acted as sole arranger for Capital Alliance Investment Group (CAIG), raising AUD21m via a 4 year, fixed rate, secured note paying a semi-annual coupon of 10% p.a. The deal was well received, with many clients electing to roll into the new CAIG transaction on the back of the recently announced redemption of the MoneyMe secured holdco note.

New ASX Listed Issue: Australian Unity (ASX Code: AYUPA) Mutual Capital Instrument (MCI)

Australian Unity (AU) is a financial services provider that fits into the ageing demographic story by offering a whole of range 'Wellness' approach for its members. Traced back to the 1840s, it has a platform of three businesses, which, whilst thematically linked, also offer a nice level of diversification and hedging benefits.

Profitability has been consistently good throughout several economic cycles. The five-year average NPAT is around AUD45m. In terms of the balance sheet (pro forma for acquisitions after FY21), there is around AUD500m in retained earnings and reserves, which has organically been reinvested into the business.

This constitutes around 2x the amount of mutual capital instrument (MCI) outstanding (on a pro forma basis). Members balances sit around AUD250m, which ranks ahead of the AYUPA MCIs. The new MCI transaction (AUD160m in total) will be used for pursing other acquisition opportunities across AU as well as to repay debt facilities that were utilised across several social infrastructure transactions.

Thus, in aggregate, there will be around AUD280m in MCI outstanding. AU has both APRA-regulated and non-regulated entities, which are wholly owned by a Non-Operating Holding Company (NOHC) – the issuer of the MCIs. Any surplus capital at the APRA-regulated entities is up-streamed back to the NOHC. However, profit is only up-streamed after each entity has been appropriately provisioned under APRA guidelines.

We believe the AYUPA MCIs offer good relative value and sit well wide of both listed and unlisted comparable issues. While the perpetual shares are unrated, a Yield to Call (%) of 4.75% (low end of the range) looks very good against BBB- rated AUD ASX Listed Hybrids. For those investors comfortable with high-yield financial risk outside the regional banks, the AYUPA MCI is also worth considering.

Credit Fundamentals

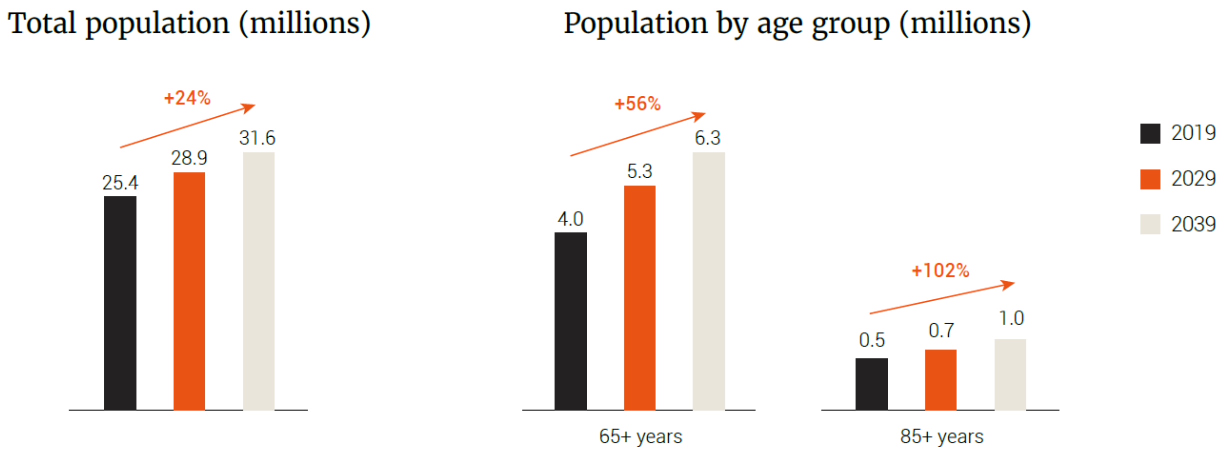
Australian Unity (AU) is a mutual with over 180 years of history that can be traced back to 1840. Through strategic mergers and diversifications into new activities, AU has grown to an organisation of approximately 7,000 employees across Australia, serving over 400,000 members. Since its origins, AU has remained committed to its core purpose of providing health, wealth, and care products and services that deliver community and social value.

AU is split across three platforms, which, whilst thematically linked, also offer a nice level of diversification and hedging benefits:

1. Independent and Assisted Living (40% of EBITDA in FY21): Residential communities (including aged care), Home care services, Disability services, Indigenous services, and Health services
2. Retail (45% of EBITDA in FY21): Health insurance and Banking
3. Wealth and Capital Markets (15% of EBITDA in FY21): Advice, Investments, Property (including social infrastructure), Life and Super, and Trustee services

Australia's population is expected to both grow and age over the next twenty years. AU's strategic agenda is to meet Australia's future wellbeing needs for members across valued health, wealth, and care products.

Chart 1. Australia's growing and ageing population



Source: ABS 2020

AU issued AUD120m of MCIs in December 2020, becoming the first issuer of an MCI. In July 2021, AU acquired the aged care and retirement living owner-operator Greengate Partnership for AUD95m. Greengate delivered scale in the home care services platform through 253 independent living units and 225 residential aged care beds. This was funded by existing internal funds and the inaugural MCIs.

The new MCI transaction will be used for pursing other acquisition opportunities across AU as well as to repay debt facilities that were utilised across several social infrastructure transactions. Thus, in aggregate, there will be around AUD280m in MCI outstanding.

AU has been on a journey over the last ten years. The average cost of debt for AU has fallen from over 8% ten years ago to around the mid-3%. Furthermore, the debt maturity profile has improved with minimal debt outstanding in FY22 and the first large maturities not due until FY23.

AU has both APRA-regulated and non-regulated entities, which are wholly owned by a Non-Operating Holding Company (NOHC) – the issuer of the MCIs. Any surplus capital at the APRA-regulated entities is up-streamed back to the NOHC. However, profit is only up-streamed after each entity has been appropriately provisioned under APRA guidelines.

Financial Results

FY21 results were somewhat impacted by COVID-19. In FY21, NPAT was around AUD33m (up from AUD9m in FY20). This compares to a five-year average NPAT of around AUD45m. FY21 results included an extra AUD17m after tax deferred liability charges. Consistent across all health insurers, this charge related to elective claims surgery, which increased total provisions from AUD38m to AUD55m.

Positively, the banking division of AU was actually better off, with provisions falling following the reduction in expected credit losses (ECLs). This was largely due to Australian Government measures to protect households (including JobKeeper/JobSeeker), as well as house prices remaining firm. AU was thus able to pay a dividend of AUD14m (or around 41% of FY21 NPAT).

In terms of the balance sheet (pro forma for acquisitions after FY21), there is around AUD500m in retained earnings and reserves, which has organically been reinvested into the business. This constitutes around 2x the amount of MCI outstanding (on a pro forma basis). Members balances sit at around AUD250m, which ranks ahead of the AYUPA MCIs.

Chart 2. Financial Snapshot Across Three Business Platforms (of EBITDA in FY20)

	Independent & Assisted Living	**Retail**	**Wealth & Capital Markets**	**Corporate Functions**	**Australian Unity Group**
Principal activities	▪ Home & disability services ▪ Aboriginal services ▪ Health services ▪ Residential communities, including aged care	▪ Health insurance ▪ Banking	▪ Advice ▪ Investments ▪ Property (including social infrastructure) ▪ Life & Super ▪ Trustee services	▪ Shared services ▪ Fraternal activities ▪ Management of properties and other strategic investments ▪ Group liquidity	
Employees	5,713	325	316	500	**6,854**
Total assets	$764.1m	$1,539.6m	$328.1m	$434.9m	**$3,066.7m**
Total liabilities	$426.7m	$1,292.6m	$137.3m	$486.8	**$2,343.4m**
Net assets	$337.4m	$247.0m	$190.8m	$(51.9)m	**$723.3m**
Revenue	$496.4m	$709.5m	$170.5m	$(15.8)m	**$1,360.5m**
Adjusted EBITDA	$66.1m	$61.2m	$32.8m	$(75.7)m	**$84.5m**
Contribution to Adjusted EBITDA of operating business	**41%**	**38%**	**21%**	**-**	**-**

Source: AU Investor Presentation

Relative Value

The AYUPA MCI relative value can be assessed against several AUD ASX Listed Hybrids and OTC Capital Notes issued from domestic major and regional banks. The AYUPA MCIs sit well wide of both listed and unlisted comparable issues.

While the perpetual shares are unrated, a Yield to Call (%) of 4.75% (low end of the range) looks very good against BBB- rated AUD ASX Listed Hybrids. For those investors comfortable with high-yield financial risk outside the regional banks, the AYUPA MCI is also worth considering.

Building the 6% Yield Dream Team

Note: the following piece was originally published by Livewire and can be read here.

6% yield – that's the magic number many investors said they need to achieve their desired lifestyle. What stood out to me was that many investors were heavily reliant on equities to do that heavy lifting. However, fixed income's modest risk profile allows for an efficient return per unit of risk.

The team at Income Asset Management have taken on the challenge of putting together a hypothetical portfolio of fixed income assets that could deliver on income requirements and offer some diversification. We're calling it 'The 6% Yield Dream Team' or as Ted Lasso puts it "I do love a locker room. It smells like potential".

In this article for Livewire's 2021 Income Series, I'll explain why diversification is essential to make fixed income work in a portfolio and talk through the ten inclusions in our hypothetical portfolio.

Diversification is the Key

Whether it be in an equity portfolio, property, or fixed income, ensuring risk is spread across a range of individual investments within an asset class helps prevent large negative capital impacts from unforeseen events.

Fixed Income assets, including bonds, inflation-linked bonds, and floating rate notes, allow investors to diversify in four ways:

1. **Credit or issuer risk:** The risk the borrower will default
2. **Interest rate exposure or duration risk:** The term or length of the credit exposure
3. **Liquidity:** How easy is it to get your capital back
4. **Currency:** The currency in which the credit is issued

Fixed income investments also allow investors to manage cashflows (asset/liability match) through interest payments (coupons). Staggering maturity profiles of fixed income investments can help smooth out lumpier capital redemptions. There are few asset classes that can mitigate drawdown risk while providing income/return potential and liquidity.

To achieve a prudent level of diversification, it is important investors have access to a wide range of fixed income securities.

Choice, or a diverse view of fixed income markets, is important to assess the value of securities against a broader backdrop of investment opportunities.

IAM Capital Markets are market agnostic. We asses fixed income securities trading in all currencies, through listed exchanges and investment grade and high yield markets globally.

This approach ensures investors can adequately assess relative value, diversify portfolios, and access opportunities through different markets.

Drafting a diversified portfolio targeting a 'high yield' return of 6% per annum

Let's get to our high-yield portfolio and run through the different bonds we have selected.

The portfolio includes ten equally-weighted investments spanning ASX-listed, AUD, and USD issues trading in over-the-counter (OTC) markets. The portfolio includes investment grade, sub-investment grade, and issues that have not been rated by an agency.

IAM Capital Markets provide internal credit opinions from our Credit Strategy team and independent research reports from our research partner BondAdviser for all issues included in the portfolio.

When putting together the portfolio, these were the steps we followed:

- **Range of credit ratings:** we chose *attackers* (lower-rated) and *defenders* (higher-rated) to ensure that the portfolio can score and defend regularly.
- **Range of industries:** we chose a *midfield* that consists of various industries, from airports, banks, mining, telecommunications, and other financial services. Diversification of industries helps to eliminate idiosyncratic risk from a portfolio and lowers a portfolio's variance. If a midfield is doing their job, the engine room is working.

- **Range of maturities:** we chose a mixture of short- and long-term bonds. Short-term bonds have less interest rate sensitivity and so act like *goalkeepers* for capital preservation. Long-term bonds have more interest rate sensitivity, and thus can be more volatile from a capital perspective. *We call these the super substitutes!*
- **Currency:** just like having a *good manager* and *coach*, you need multiple currencies, including AUD and USD respectively. Both react differently given their volatility relative to the market (or Beta). For instance, the AUD is more sensitive to the terms of trade (TOT) and commodity prices than the USD respectively. However, each currency is just as important to the overall team and desired portfolio outcome.

Chart 3. The Dream Team Portfolio

Issuer	Currency	Market	Issue Size (Mil)	Payment Rank	Coupon Type	Coupon Formula	Rating	Call Date	Maturity Date	Yield
LATITUDE GROUP HLD	AUD	ASX Listed	150	Tier 1 (Hybrid)	FLOATING	BBSW3M+4.750%	NR	27-Oct-26		5.700%
NATIONAL AUSTRALIA BANK	AUD	IG - AU	500	Tier 1 (Hybrid)	FIXED	4.950%	BBB-	12-Dec-29		4.350%
SYDNEY AIRPORT FINANCE	AUD	IG - AU	300	Senior Secured	INFLATION LINKED	3.120%	BBB+		20-Nov-30	3.500%*
LIBERTY FINANCIAL PTY	AUD	IG - AU	200	Senior Unsecured	FLOATING	BBSW3M+3.750%	BBB-		25-May-26	3.130%
PACIFIC NATIONAL FINANCE	AUD	IG - AU	100	Senior Unsecured	FLOATING	BBSW3M+2.600%	BBB-		12-May-27	3.300%
NBN CO LTD	AUD	IG - AU	400	Senior Unsecured	FIXED	2.200%	AA	16-Sep-30	16-Dec-30	2.670%
EMECO PTY LTD	AUD	High Yield - AU	250	Secured	FIXED	6.250%	B+	10-Jul-23	10-Jul-26	5.750%
CAPITAL ALLIANCE AU PTY LTD	AUD	High Yield - AU	25	Secured	FIXED	10.000%	NR		10-Aug-25	10.000%
JERVOIS MINING USA	USD	High Yield - US	100	Secured	FIXED	12.500%	NR	20-Jul-24	20-Jul-26	10.550%
COBURN RESOURCES PTY LTD	USD	High Yield - US	60	Secured	FIXED	12.000%	NR	20-Dec-23	20-Mar-26	10.735%
* Real yield of 1% + inflation assumption of 2.5%										**6.023%**

Source: IAM Capital Markets

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Latitude Group HLD: 5.7% (Unrated)

A solid fintech provider that is better placed than other businesses to deal with implementation of stricter regulation given its long track record. The structure of Latitude notes is very strong. Distributions are deferrable (but cumulative), there is a dividend/buyback stopper, a change of control 5% step-up, and if Latitude notes are not called (at first call), the margin increases to 12.75-13%. Not many domestic subordinated financials offer a coupon of BBSW3M+4.75%.

Capital Alliance AU Pty Ltd: 10.00% (Unrated)

This is a high-yield senior secured property credit that has three operational hotels and two assets under construction. The covenant package includes a gearing LVR, asset LVR, minimum total tangible asset (TTA) clause, and an interest service reserve account (ISRA). A coupon of 10% for a substantial asset-lend looks appealing versus other high-yield names.

Jervois Mining USA: 10.55% (Unrated)

This high-yield credit is uniquely placed in the battery metal thematic (nickel and cobalt). Recent underwritten equity raising has significantly de-risked the credit by raising additional liquidity that can be used over the construction period. First production is due in late 2022. A coupon of 12.5% looks appealing versus the broader USD high-yield universe and other metals and mining names.

Coburn Resources Pty Ltd: 10.735% (Unrated)

A high-yield credit uniquely placed to the mineral sands thematic. Mineral sands can be used in a range of everyday household products. All major construction contracts have been awarded and 100% of offtakes have been secured. First production is due in late 2022. A coupon of 12% looks appealing versus the broader USD high-yield universe and other metals and mining names.

Other names in the portfolio which have an external rating include:

National Australia Bank: 4.35%

A solid major bank Tier 1 (Hybrid) security offering a 4.95% coupon.

Sydney Airport Finance: 3.5%

The number one airport across the country. Protects investors against rising inflation with a coupon of CPI+3.12%.

Liberty Financial Pty Ltd: 3.13%

A solid financial services provider with a coupon of BBSW3M+3.75%.

Pacific National Finance: 3.3%

A solid haulage company with an increasing revenue base from intermodal (non-coal related activities). This is the best investment-grade bond on a risk-return basis.

NBN Co Ltd: 2.67%

An essential piece of infrastructure for the Australian economy that has strong bipartisan support from both major political parties.

Emeco Pty Ltd: 5.75%

This solid high-yield mining services provider is benefiting from high commodity prices. Potential for upgrade from B+.

NCIG FY21 Results

IAM Capital Markets View

Operationally, NCIG has been diversifying counterparties outside of China when the China coal ban took place. Many other countries are looking for coal exports, so it's been relatively easy for Australia to shift the coal exports around.

However, China is now willing to pay up for Australia's share of coal exports – given they have problems internally with getting appropriate power sources. Again, higher thermal coal prices helps NCIG's counterparties and their credit strength.

NCIG's revenue is derived from toll charges payable by shippers under long-term ship-or-pay agreements. Toll charges (in USD and AUD) are set under a full cost recovery model, which provides NCIG with stable and resilient cashflows. During FY21, shareholders paid around AUD2.8m in extra toll charges to top up NCIG's debt service reserve account (DSRA) which was a credit positive development.

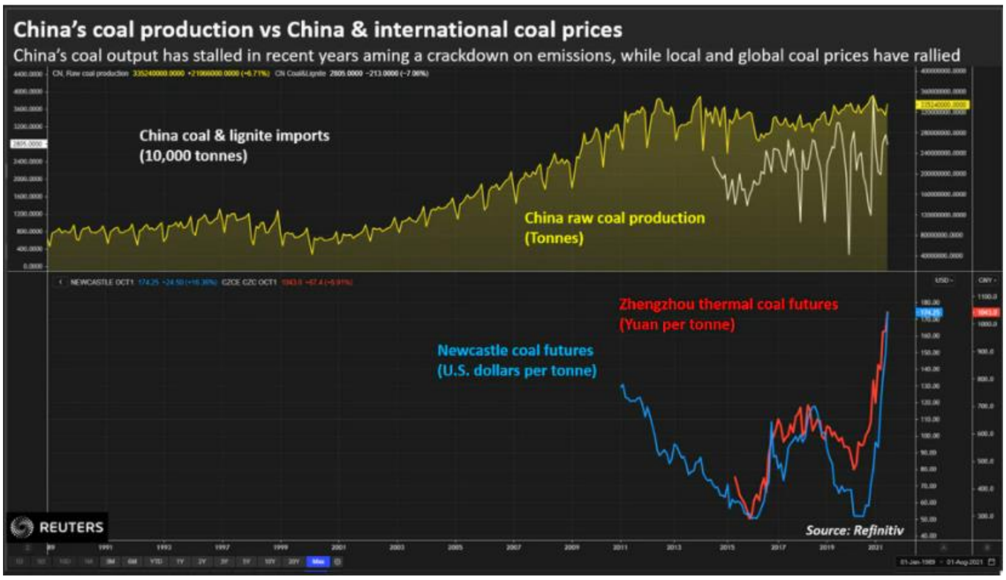
We believe the NCIG 27's and NCIG 31's are very cheap to the AUD BBB investment grade curve. Currently, the NCIG 31's are trading almost 1% wider than the recently issued PNHAU 3.8. Furthermore, the NCIG 27's and NCIG 31's trade around 1% and 2% wider than the Santos and Woodside curves, respectively. Given the positive coal price environment, there is still an opportunity for investors to pick up alpha in a credit which remains significantly mispriced.

FY21 Results

NCIG has remained focused on delivering on its commitments in FY21, notwithstanding the challenges faced throughout the year. In November 2020, a sudden and unforeseen storm cell passed through Newcastle, resulting in damage to one of NCIG's two shiploaders.

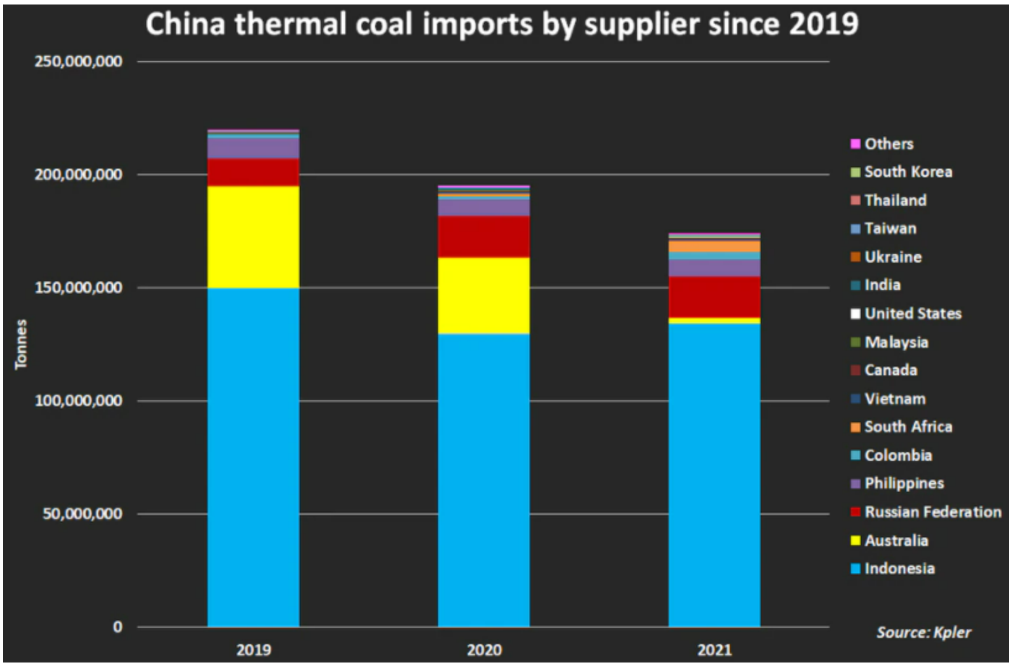
Following the shiploader incident, nominal capacity was reduced from 66mt pa to 47.6mt pa operating with a single shiploader over two berths. As a result, total terminal throughput was below FY20's result, at 45.1mt for FY21. This represented a decreased of 9.4mt on FY20 (54.5mt).

Chart 4. China Coal Production and International Coal Prices (USD/tonne)



Source: Refinitiv

Chart 5. China Thermal Coal Imports by Country (tonnes)



Source: Kpler

NCIG was pleased to advise stakeholders of the return to service of shiploader 2 in July 2021. The cost of reinstatement is fully recoverable under insurance, subject to market standard deductibles and exclusions. NCIG's revenue was not impacted by the shiploader 2 damage due to the strong ship or pay agreements in place with all their customers.

NCIG has a USD2.2bn debt book and approximately 65% of their revenue is derived from USD. Because NCIG's financial statements are shown in AUD, they are therefore impacted by movements in the AUD/USD. All else equal, a higher AUD/USD is better for NCIG on conversion of USD borrowings to AUD.

Financials

- Profit before tax of AUD332m (FY20: AUD119m loss)
  - Insurance proceeds of AUD33m were in respect of the damaged shiploader 2
  - Repairs and maintenance of AUD66m were significantly higher than FY20 due to the repair cost of shiploader 2, which is recoverable under insurance (subject to market standard deductibles)
  - FX gains on foreign current of AUD286m in FY21 (FY20: AUD72m loss) due to the impact of an increase in the AUD/USD exchange rate on conversion of USD borrowings to AUD since FY20
  - Fair value gains on interest rate swaps of AUD53m in FY21 (FY20: AUD54m loss) due to a favourable movement in the MTM value of swaps caused by an upward shift in the forward interest rate curve since FY20
- Current borrowings decreased by AUD41m and non-current borrowings decreased by AUD360m, mainly due to:
  - The repayment of a maturing USPP Note USD25m in November 2020, which was funded by drawing down on a facility established in 2019 for this purpose
  - NCIG's principal repayments during FY21 of USD76m
  - An increase in the AUD/USD exchange rate
- Current and non-current derivative financial instruments decreased by AUD13.3m and AUD39.6m respectively due to a favourable movement in the MTM liability value of swaps, which was caused by an upward shift in the forward interest rate curve and the maturity of some out-of-the-money swaps that were previously recognised as a liability
- Interest paid to third parties decreased by AUD35m — mainly due to the repayment of USD25m USPP Notes (utilising undrawn committed bank facilities), the scheduled amortisation of USD76m bank facilities, and the prepayment of USD571m bank facilities in June 2021.

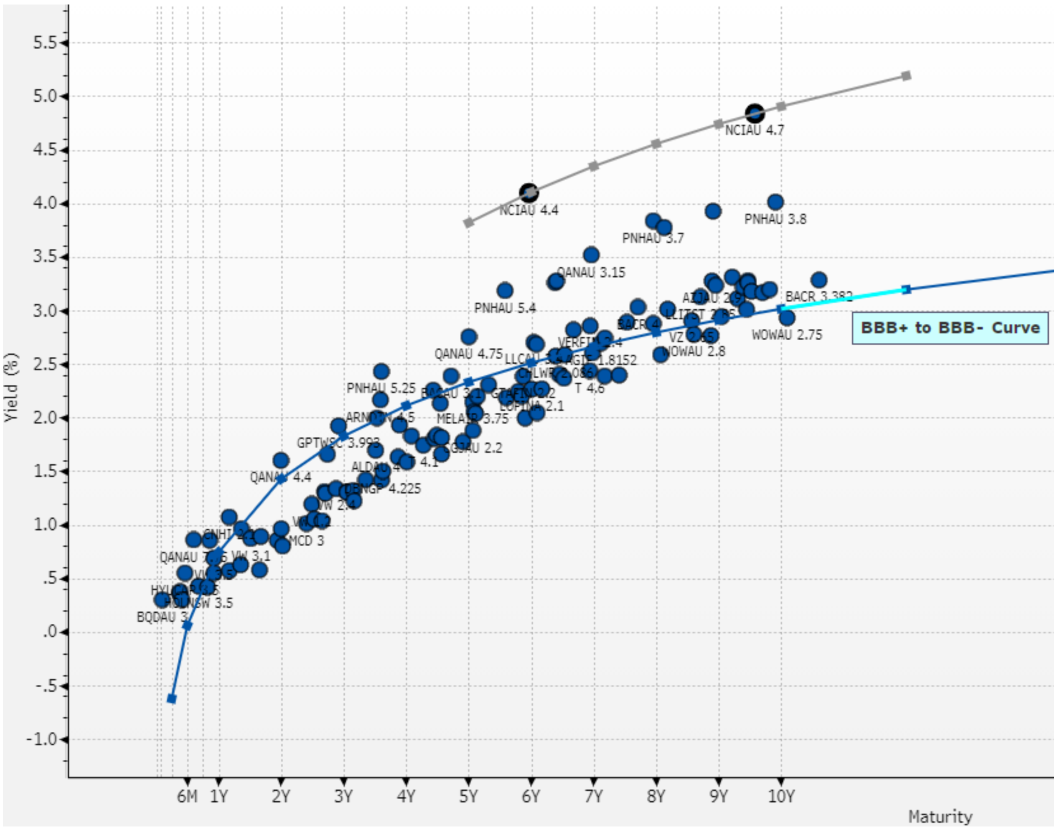
Chart 6. NCIG Holdings Financial Metrics

Financials AUDm	**FY20**	**FY21**	**%Change**
Revenue	**456.20**	**414.70**	**-9.1%**
EBITDA	**378.50**	**332.20**	**-12.2%**
Interest Expense	- 264.10	- 231.90	-12.2%
Profit after Tax	**- 99.30**	**216.60**	**318.1%**
FFO	**132.60**	**119.90**	**-9.6%**
WC & Other Charges	- 17.50	16.60	
CFO	**115.10**	**136.50**	**18.6%**
Capex	- 0.80	- 0.70	
FCF	**114.30**	**135.80**	**18.8%**
Dividends	-	-	
Cash	67.50	81.90	
Assets	**2,783.00**	**2,575.70**	
ST Debt	157.10	116.60	
LT Debt	3,787.50	3,426.50	
Total Debt	**3,944.60**	**3,543.10**	
Net Debt	**3,877.10**	**3,461.20**	
Equity	- 1,414.90	- 1,198.30	
Total Capital	**2,529.70**	**2,344.80**	
Ratio's			
Revenue Growth	**8.2%**	**-9.1%**	
EBITDA Margin	**83.0%**	**80.1%**	
EBITDA/Interest Expense	**1.4x**	**1.4x**	
FFO/Total Debt	**3.4%**	**3.4%**	
Total Debt/EBITDA	**10.4x**	**10.7x**	
Net Debt/EBITDA	**10.2x**	**10.4x**	
Total Debt/Total Capital	**155.9%**	**151.1%**	

Source: NCIG Holdings 2021 Financial Statements

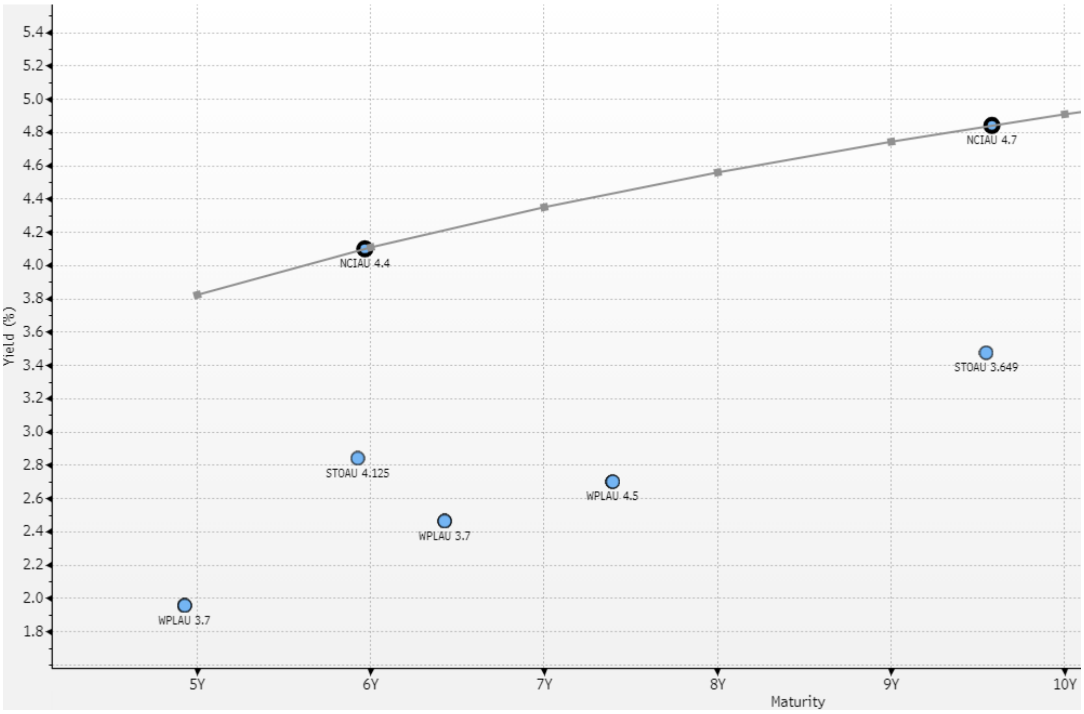
Relative Value

Chart 7. NCIAU Bond Curve vs AUD BBB Investment Grade Curve



Source: Bloomberg

Chart 8. NCIAU Bond Curve vs Santos/Woodside Curve



Source: Bloomberg

Weekly Most Traded

The table below outlines our most frequently traded issues over the past week.

CCY	Issuer	Structure	Rating (S&P, Fitch, Moody's)	Cpn Type	Cpn	Call/Maturity	Yield
AUD	Bendigo and Adelaide Bank	Sr Unsecured	BBB+, A-, A3	Floating	3m BBSW +0.520%	02-Dec-25	1.479%
AUD	Clearview Wealth	Subordinated	N/A, BB+, N/A	Floating	3m BBSW +6.000%	05-Nov-25	5.230%
AUD	Macquarie Bank	Sr Unsecured	A+, A, A2	Floating	3m BBSW +0.480%	09-Dec-25	1.450%
AUD	Liberty Financial	Sr Unsecured	BBB-, N/A, N/A	Floating	3m BBSW +2.550%	25-May-26	3.166%
USD	FMG Resources	Sr Unsecured	BB+, N/A, Ba1	Fixed	4.375%	01-Jan-31	3.573%
USD	NCIG Holdings	Unsecured	B+, N/A, WR	Fixed	12.500%	31-Mar-27	10.102%

*Priced to the IAM Capital Markets assumption of repayment.

CONTACT US

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