MOELIS AUSTRALIA

BUSINESS UPDATE

OCTOBER 2017

Understanding the Rate Pendulum

In our June newsletter, we discussed record low global interest rates and the strong flow of capital into Australia (given its relatively attractive yields) as investors search for higher returns. Since then, the US Federal Reserve has indicated that a December rate hike is likely and has forecast three hikes in 2018 and two in 2019. The expectation is that we have also reached the bottom of the interest rate cycle in Australia and the next move is up.

What are the implications of higher rates?

The Australian real estate market has experienced exceptional capital growth as interest rates have declined. The big four banks balance sheets are highly exposed to residential housing loans with a large portion of these being interest-only.

As rates rise, associated increases in loan repayments will put borrowers under pressure, particularly given earnings growth has not kept up with house price growth. The concern for banks is that as rates rise so do defaults thereby increasing the likelihood of distressed sales and downward pressure on the housing market.

What have policy makers done in response to this situation?

On 31 March 2017, APRA announced measures to reinforce sound residential mortgage lending practices. The policies guided lenders to cap interest-only loans at 30% of new mortgage lending. This led to a series of (bank imposed) rate hikes on such loans. The RBA also acted, announcing "top-down" stress-testing for Australian banks.

CONTENTS

BUSINESS UPDATE

"There are abundant opportunities across the financing landscape"

How has the market reacted to the increased scrutiny of lenders?

Banks have reduced lending on all fronts which has created opportunities for non-bank lenders. Corporate bond issuances and alternative financing are funding methods that have grown significantly as a result. This year will see an estimated $42 billion in corporate bonds being issued which is a record and represents year on year growth of 21% since 2015. In the alternative finance space, Australia was the second largest (China was number one) alternative finance market in Asia Pacific with $775 million of new issuances in 2016 which represented growth of 53% on 2015.

"Great opportunity for institutions that can properly evaluate the merit of borrowers and structure appropriate products"

Where do the opportunities lie?

There are abundant opportunities across the financing landscape as banks have over reacted to the regulations imposed and are overlooking good risk adjusted returns across borrowers. On a global scale, the Australian financing landscape is still under banked and is of high quality. For example, the average credit rating for Australia's one-year corporate bond index is A+, a full two levels above the US, Europe and Asia and ~60% of Australia's credit index is rated A, compared with less than 40% for the US and Europe.

Conclusion

Corporate Australia's strong interest coverage position and appetite to fund value accretive projects is a great opportunity for institutions that can properly evaluate the credit of borrowers and structure appropriate products.

Where Moelis is Investing

Moelis Australia Secured Loan Fund

Moelis Australia has established a Secured Loan Fund to provide investors with a diversified exposure to a portfolio of short duration loans secured by a first lien mortgage on Australian real property. This fund is the first in a series of funds with this investment mandate.

The Fund enables investors to benefit from market conditions affecting commercial banks and Moelis' expertise in credit assessment and asset management. The portfolio will be managed according to strict risk-limits including a maximum loan-to-value ratio (<65%), obligation for all mortgages to be first lien and specifications over the quality of the collateral.

The Fund targets a net return to investors of 8% per annum and will reach final close around 31 October 2017.

Moelis Australia Redcape Hotel Group

In July 2017, a Moelis Fund acquired the Redcape Hotel Group for $676m representing an asset level capitalisation rate of 9.6%. Redcape is the second largest gaming hotel operator in NSW and consists of 25 hotels, 22 of which are located in NSW and 3 in Queensland.

Moelis raised equity of $394m from a combination of existing Moelis managed funds, high net worth individuals, family offices and Moelis Australia staff. The Moelis Australia Redcape Hotel Group is forecast to deliver an initial cash yield of 8.75% per annum (paid quarterly) with anticipated earnings growth of 3-5% per annum. The forecasted 5 year pre-tax IRR is 12.7% per annum.

It is expected that Moelis Australia will IPO Redcape Hotel Group within the next 12-18 months

Moelis Australia Aged Care Fund

A Moelis Australia Fund has entered into an agreement to acquire a controlling interest in aged care operator and developer Infinite Care. Infinite is a leading operator of aged care services, and currently operates a portfolio of 5 recently refurbished aged care facilities (~400 licensed beds) and has a development pipeline of ~1,500 bed licenses across 13 to be developed facilities in areas of high demand.

"Targeting a total return to investors of 20%+ p.a. over a 4 year term"

The Fund is targeting a total return to investors of 20%+ p.a. over a 4 year term and provides investors with exposure to:

- Favourable industry dynamics driven by Australia's rapidly ageing population and undersupply of aged care facilities;
- An existing profitable operating platform and established head office function;
- Highly experienced and financially aligned management team with a strong track record; and
- A large ~1,500 bed development pipeline across 13 facilities in areas of aged care undersupply.

Fully developed, Infinite's 1,500 bed pipeline of new aged care facilities should have a total value in excess of $450 million.

Investor demand for Infinite Fund was very strong, resulting in Moelis Australia up-sizing the Fund's capital raising from $50m to $70m. The increased capital will allow Infinite Care to accelerate the development of new aged care facilities which is expected to have a positive impact on the Fund's total return. Moelis Australia will retain a 10% ($7m) co-investment in the Fund.

The transaction highlight's Moelis Australia's strategy of investing in opportunities with sound industry macro fundamentals, underlying real estate exposure, quality management teams and significant potential for growth.

Success Stories

Credit Opportunity Fund I

In July 2016, Moelis established a Credit Opportunities Fund which made a $20m senior secured debt investment in an Australian logistics business.

The Fund's investment is performing very well, with the Fund having already returned over half of the equity invested, and is on track to exceed its target IRR of 15% p.a. The Fund demonstrates Moelis' expertise in analysing complex distressed credit situations and its ability to provide investors with highly attractive risk adjusted returns.

Moelis Australia Childcare Fund

In December 2016, a Moelis Australia Childcare Fund provided a $19m convertible loan to childcare operator Paisley Park Early Learning to fund the development of a portfolio of new childcare centres and the acquisition of a portfolio of operating childcare centres. Paisley Park is now operating 19 centres, having recently completed developments at Box Hill and Chadstone in Melbourne. Construction is progressing at a further three centres located in

BUSINESS UPDATE

"Downside protection with the ability to participate in equity upside"

Malvern and Bundoora in Melbourne and Randwick in Sydney.

The Childcare Fund is targeting to deliver a 20%+ p.a. IRR to investors, including a cash yield of 9% p.a. The Fund's convertible loan structure provides investors first ranking security and downside protection with the ability to participate in equity upside in a company with a highly experienced management team and exposure to favourable industry dynamics.

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THE MOELIS STANDARD

The Moelis Standard inspires the highest level of quality, partnership and integrity in every interaction with our clients and each other.

- We measure our performance by the long-term success of our clients
- We foster a culture of partnership, passion, optimism and hard work
- We stay ahead of the changing environment to provide the most relevant advice and innovative solutions
- We share ideas and experience across our organisation to achieve the best results for our clients
- We will not compromise our vision or values
- We deliver more