NEW CAPITAL ACCESS

The long-awaited growth of interest in fixed income from Australia's self-managed superannuation fund (SMSF) sector is starting to spin off a number of initiatives designed to facilitate market access, transparency and choice. With a proven track record of providing access to rated bonds and, more recently, originating unrated bond issues, **FIIG Securities** (FIIG) is one of the highest-profile specialists in the sector. It says what has been seen so far is barely a drop in the ocean.

BY LAURENCE DAVISON

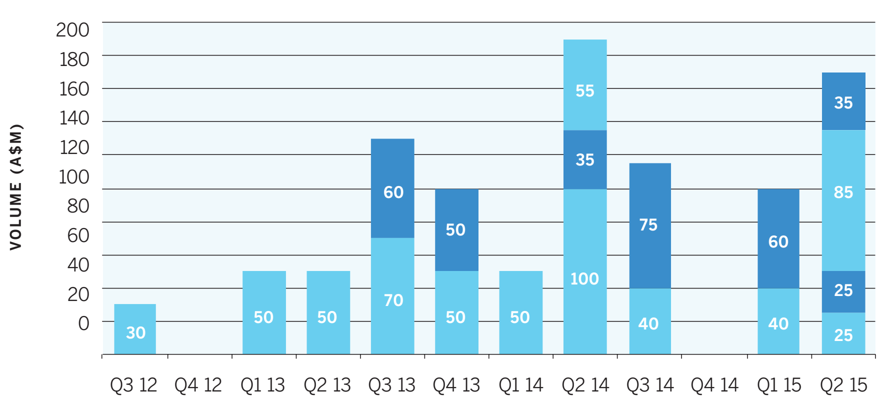
Building on its foundation of serving professional and institutional investors, FIIG says it is making bold strides in creating easier access to the corporate bond market for a broad range of investors and issuers. According to the company's own data, FIIG now has A$11 billion (US$8.1 billion) in assets under advice and turns over upwards of A$1 billion in bonds each month.

When FIIG originated its first-ever bond transaction – a A$30 million (US$22.2 million), six-year deal for Silver Chef priced in September 2012 – *KangaNews* noted that the deal was the first public, senior unrated bond bookbuild to be conducted in the Australian domestic market without a bank lead manager and that it was sold under wholesale documentation to professional and sophisticated investors. But there was little suggestion at the time of a new trend emerging.

Fast forward to August 2015, and FIIG has arranged no fewer than 19 bonds for total volume of just less than A$1 billion (see chart on this page). Issuers are rated and unrated, come from the corporate, financial, infrastructure and property sectors, include listed and privately held companies, and mix fixed and floating rates. The majority of these deals, though not all, have been for unrated, mid-cap borrowers which are new to debt capital markets. Most have previously sourced all their debt in the bank market – which FIIG says is a clear contrast to overseas markets, where bond funding is more broadly available.

Two complementary developments have opened the taps to a growing pipeline of this type of issuance, key FIIG executives say. The first is a growing need for debt diversification by the mid-cap corporate space, as well as the bank market seeking to optimise exposures under Basel III. Augmenting the debt structure of a corporate borrower with a bond enables relationship banks to retain cross-sell income and funding capacity.

BOND DEALS ORIGINATED BY FIIG



SOURCE: KANGANEWS AUGUST 18 2015

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JOHN RICCIOTTI FIIG

FINANCIAL-SECTOR SPECIALISTS

The sophistication and product engagement of a subset of FIIG Securities (FIIG)'s investor base is creating bespoke opportunities for financial-services firms with niche business.

MoneyTech Finance (MoneyTech) and CML Group (CML) issued A$25 million (US$18.5 million) apiece in FIIG arranged deals, for seven- and six-year tenor respectively, in the second quarter of this year.

John Ricciotti, head of debt capital markets at FIIG, says the transactions emerged from the fact that the financial sector is experiencing disruptive activity in areas like invoice discounting and receivables financing. CML and MoneyTech both operate in this space, and have done so for 5-10 years. As their businesses have grown they have run up against limitations growing bank funding in their sector, Ricciotti adds.

As a result, the asset-class preferences of some of the most sophisticated investors on FIIG's radar were a boon for these companies. "We distribute RMBS [residential mortgage-backed securities] paper to our investors, which has given us access to a number of clients who understand asset-based structures, don't mind being in a cash-flow waterfall and like having exposure to these asset pools," Ricciotti reveals.

Ricciotti says the MoneyTech and CML bonds mirror some RMBS structures, such as covenants around receivables and a reserves regime. "What we like about these issues is that while we can do them at smaller volume – A$20-30 million, for instance – as the borrower's business grows the bond programmes can be tapped very easily."

Best of all, entering the bond market also grows the issuers' investor-relations footprint. "This is a real opportunity for issuers, as we are showing them that the number of investors in their bonds can double in a 12-month period. So the issuers gain access to 600-700 investors who are aware of the companies and can be accessed again. Public companies in this sector might only have 2,000-3,000 shareholders, so they are really creating their own new investor bases."

Natural buyers

Grant McCorquodale, head of personal and intermediary clients at FIIG in Sydney, explains: "The bond asset class is – or should be – the primary one for retirees. Retirement has evolved significantly in Australia since the cessation of defined benefit pensions, with the main change being the transfer of risk to the retiree. Australian baby boomers now entering retirement are crying out for capital-secure assets with reliable income streams which will last for the duration of their lives."

FIIG's business model has been to marshal this natural investor base into a sustained, scalable bid for wholesale-documented fixed-income assets. McCorquodale reveals that more than 80 per cent of the firm's clients are SMSF investors looking for capital-preservation initiatives.

"The psyche of SMSF investors is that they want to be closer to their investments," he adds. "SMSFs can invest directly in the equity market, and now they can do the same for bonds – thereby ensuring their portfolios are better positioned for retirement."

This does not just mean high-yield product, though. FIIG offers more than 350 bonds on its platform and transacts significant volume in mainstream, investment-grade product. For instance, John Cummins, head of institutional markets at FIIG in Sydney, says the volume of US dollar bonds bought via the firm's platform increased to US$780 million in the year to June 2015 from just US$140 million in the preceding 12 months.

Cummins comments: "It's a huge, and growing, sector – albeit many of these funds are effectively controlled by accountants and asset consultants. Adding the not-for-profit sector means an enormous quantity of Australian cash which is focused on capital-safe investments in cash, fixed income and direct property."

This demand has enabled the introduction to Australia of an asset class which has wider appeal, too. "The steadily increasing participation of the institutional sector cannot be ignored," Cummins adds. "On a recent trip to Asia we signed up several new investors, including a global asset manager with an Asian debt high-yield fund with an Australian allocation."

Investor sophistication

A key to FIIG's success as a lead manager has been its ability to deal with an investor base which qualifies as sophisticated – and thus does not require issuers to go through the resource-intensive process of bringing retail deals to market – but is not adequately served by the institutional environment.

Cummins suggests that FIIG's model is simply making the same access afforded the top-25 Australian institutional bond investors available to all sophisticated SMSF investors – in both secondary- and primary-market stages. "It's a great irony that a Belgian dentist can buy a bond issued by Telstra

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GRANT MCCORQUODALE FIIG

CREDIT MATTERS MORE THAN LISTING

Dicker Data and SCT Logistics are very different companies in terms of their sectors, corporate structures and asset bases. The fact that both were able to complete bond deals shows that unrated investors are credit focused above all, FIIG Securities (FIIG) says.

Dicker Data sold A$40 million (US$29.6 million) of five-year bonds in March this year. SCT Logistics issued A$30 million of floating-rate, four-year notes and A$55 million of fixed-rate, six-year bonds in June.

Dicker Data is exchange listed and is the second-largest player in Australia's IT hardware and software distribution sector. SCT Logistics is privately held, and is a significant player in the country's haulage market – with a particularly strong presence in transnational haulage.

John Ricciotti, head of debt capital markets at FIIG, says a key to the success of the two deals – as is the case for many transactions originated by the company – is the fact that investors were able to look at the issuers' core business when deciding whether to buy.

"My view is always that 'the credit sells through'," Ricciotti comments. "Dicker Data is certainly a mid-cap company but it is also the second-largest player in the IT distribution services sector. This means it has significant scale, strong cash flow and long-term distribution arrangements with strong counterparties across the hardware and software distribution business."

The same story applied with SCT Logistics, despite the differences between the two businesses. "Market share – it has 40 per cent share of east-west haulage and 20 per cent of north-south – was key, as was track record and hard assets," Ricciotti adds.

Neither was being an unlisted company an issue for SCT Logistics – though its business profile made it the type of unlisted entity which works best in the bond market. Ricciotti explains: "For a company like SCT Logistics, the issue of being unlisted is less significant. It's a third-generation company with the level of governance one expects from this, and it is also able to provide the reporting investors expect to see attached to the bond issue it completed. The bond includes undertakings around disclosure, which are akin to those applied to listed companies."

Market engagement and transparency are the keys, says John Cummins, FIIG's head of institutional markets. "SCT Logistics was probably the best supported deal I have seen all year, even though it was the largest and there was another one going on at the same time. The reason for the support it attracted was that the management presentation was as professional as I have ever seen, including in the investment-grade market."

Corporation in parcels down to A$1,000 – and do so from an Australian bank intermediary – but an Australian dentist can't. It's not a criticism, but it's a catch-up this market needs," Cummins says.

Many of the investors FIIG serves have highly developed risk understanding – including a willingness to engage with amortising and asset-backed structures which have opened the unrated bond market to a new group of financial sector issuers (see box on p51). FIIG also stresses that its approach to investor education is supported by extensive research coverage across all fixed-income sectors.

It does not attempt to sell every deal to every investor. "There is always a process of matching up investors with transactions," explains FIIG's Melbourne-based head of debt capital markets, John Ricciotti. "There are large deals which work well across our investor base and smaller ones which are of interest to a narrower investor group. But our research reports always break out the details of deal structures, and I would argue that even the more sophisticated ones are not as complicated as bank hybrid transactions."

Meanwhile, Cummins adds: "A truly diversified SMSF would not have a portfolio of high-yield bonds alone. This is where the definition of 'diversity' is quite different in the bond world from the equity world. In equities, diversification is all about being in different corporate sectors – because all the structures are largely the same. In bonds, to be truly diversified in the sense a fund manager would mean you need some fixed and some floating rate, some currency diversity, some inflation-linked, possibly an annuity – and then overlay that with different corporate sectors."

Issuers emerge

On the issuer side, Ricciotti says some common themes emerge despite the growing diversity of borrowers engaging with the Australian unrated bond market.

"Looking through the 19 transactions we have arranged to date, the key theme is issuers diversifying their funding in order to achieve greater flexibility in their businesses," Ricciotti says. "The driver can be capital for expansion or to create funding flexibility – for

"Once you have originated 19 deals, it is no longer a fluke. This market is going to keep growing. The really big point is that there is both a growing pool of borrowers and a massive pool of sub-institutional money in Australia."

JOHN CUMMINS FIIG

INFRASTRUCTURE SHAKE UP

The deals FIIG Securities (FIIG) arranged for Adani Abbot Point Terminal (Adani) and Plenary Group (Plenary) highlight the fact that infrastructure debt opportunities are slowly emerging from the bank market. Adani's deal also features a wider range of consequences.

Adani's deal was FIIG's largest to date, reaching A$100 million (US$74 million) in volume for six-year paper priced in May 2014. Plenary issued a A$35 million, seven-year bond a month later.

The structure put in place for Plenary was effectively borrowing against its equity interest in a number of established public-private partnerships (PPPs), says John Ricciotti, FIIG's head of debt capital markets.

"We had investors who had allocated to a number of those PPPs, including bonds issued before the financial crisis, so they understood the underlying assets. Things like defence housing, railway stations, exhibition centres and law courts tend to have long concession periods, government counterparty risk and are seasoned assets with benign abatement histories," Ricciotti explains.

He adds that Plenary's business model is focused on designing, constructing and then managing assets, and it was this business model – with diversity achieved by a bond structured at the corporate level – which appealed to investors in its FIIG-arranged bond offer. "The opportunity for investors was to get a yield pickup by sitting on top of a diversified portfolio of projects with strong track records rather than a single one," Ricciotti explains.

He also says the FIIG investor base in general is very interested in the infrastructure sector, especially the potential ability to invest in long-dated securities – even at lower yield than a typical unrated bond would offer.

The ready availability of alternative funding options to many infrastructure-sector borrowers is the biggest challenge in drawing them to the bond market. However, Ricciotti says: "As banks seek to optimise capital under Basel III, FIIG is able to complement the capital structure by providing 10-15 year bond financing for infrastructure assets."

Adani was a case in point, albeit at a mid-tenor maturity. Ricciotti says Adani was first funded through the bank market on acquisition, then got rated and termed out part of its debt in the bond market. It then hit a liquidity hole in the institutional market, which FIIG was able to fill.

"We offer an additional liquidity pool to the fund manager market," Ricciotti comments. "We often act as a conduit for lines of bonds between the institutional market and our investors, and the Adani transaction shows that we can bring a sizeable bid."

Ricciotti reveals that FIIG has had discussions with issuers in the prime and "near-prime" rated market, about FIIG's ability to help fill A$100-200 million gaps in funding profiles. "If we can provide deal sizes of up to around A$100 million and the local institutional market can provide similar volume we see it as a really good opportunity for this type of issuer."

instance if the issuer is seeking to enhance the capacity of its relationship banks by reducing lending exposure and allocating cross-sell accordingly."

The bank market has been receptive to the addition of an unrated bond to the balance sheets of their middle-market clients, Ricciotti suggests. "All the majors and a number of regional banks have provided credit approval for the bonds. We see growing recognition by the banks that they can retain capacity to fund liquidity and transactional services, while capturing the bulk of the 'relationship wallet' through not having to introduce additional banks."

Most but not all of the issuers FIIG brings to market are unrated, Ricciotti says. Adani Abbott Point Terminal (Adani) and New Zealand-based insurer, CBL Insurance Group, both carry investment-grade ratings. The market is open even to unlisted issuers, provided they are willing to provide adequate disclosure (see box on facing page).

Neither are these issuers desperate for capital – it is simply the case that the domestic demand for their product makes the bond market the best option for debt diversification.

"It is always competitive when FIIG gets involved in a financing process, because inevitably we are being compared with banks and, often, debt capital markets funding as well," Ricciotti says. "However, FIIG is able to provide an additional tranche of long-term capital that is complementary to both bank debt and equity, providing greater stability to the capital structure."

The Adani transaction highlights the growing opportunity set for this type of capital in the infrastructure sector, and also a potential growth area in the rated space where longer tenor is desired (see box on this page).

Ricciotti adds: "I describe the general credit profile of our borrower base as 'near prime'. We are not in the business of assigning ratings, but what we look for are middle-market issuers – with proven earnings track records, strong credit metrics, a degree of scale and diversity."

FIIG believes the future is bright. "There is a major asset-allocation need for fixed income in the SMSF sector, especially when you compare with OECD averages. According to the latest data, Australians have about 10 per cent of their pension assets in bonds whereas the global average is more than 30 per cent. SMSFs have less than 5 per cent of their investment assets in bonds. However, the gates are now starting to open," McCorquodale argues.

Cummins adds: "Once you have originated 19 deals, it is no longer a fluke. This market is going to keep growing. The really big point is that there is both a growing pool of borrowers and a massive pool of sub-institutional money in Australia. This isn't so much a story about FIIG as about the market. We're in a good position to facilitate the growth of this market." •