KPMG

Debt Market Update

Q4 2017

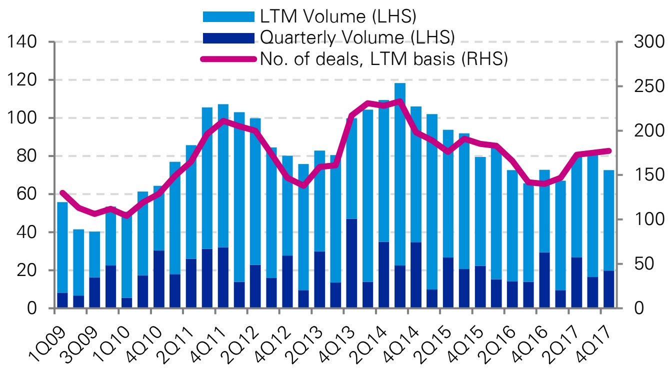
Key themes

- **Australian bank debt market** – quality issuers offering well-structured deals continue to take advantage of the strong liquidity in the syndicated loan market
- **Australian domestic bond market** – with bonds pricing below bank debt levels for 5-year tenors, bank debt issuers are increasingly accessing debt capital markets
- **USPP –** issuance continues to be dominated by large scale infrastructure privatisations – VIC project adds to the volume along with NSW projects
- **Positive outlook** for 2018 with more domestic privatisation projects in the pipeline

AUSTRALIAN DOMESTIC BANK DEBT MARKET

The volume in the syndicated loan market closed at US$72.5 billion for the calendar year 2017 – in line with the US$72.8 billion raised during 2016. Q4 2017 lending decreased by 32.5 percent to US$19.8 billion compared to US$29.3 billion in Q4 2016. Domestic banks continued to face intense competition from the offshore banks in Q4, with a number of Asian lenders more than doubling their share of syndicated and club loans in Australia since 2015 (*Source: Market Monitor, LoanConnector*). As a result, the market saw a number of oversubscribed transactions and a tightening of pricing throughout the year.

Figure 1: Australian syndicated loan volume (US$ billion)



Source: Loan Connector (data extracted February 2018) and KPMG Analysis

A significant amount of Q4 2017 lending volume was for project financing, especially in the renewable energy and infrastructure sectors. Some of the notable project financing transactions included:

- Cooper Energy raised a A$250 million 7-year loan, fully underwritten by ANZ and Natixis, to develop its Sole gas field in Victoria. The project has long term offtake agreements with a number of energy providers to supply circa 75 percent of its gas. The loan was priced with a margin of 400bps over BBSY during the 2-year construction phase, reducing to 300bps over BBSY when the project becomes operational. The transaction covenant's included a liquidity reserve, on-completion DSCR ratio and a cash flow utilisation negative pledge.
- French renewables developer, Neoen, secured A$182 million in project financing to develop a 150MW solar farm, located near Coleambally in NSW. The project has also received A$30 million in debt financing from the Clean Energy Finance Corporation. The loan is priced in the low 200bps over 6-month BBSW with a gearing of 68 precent.
- The Chinese wind turbine maker Xinjiang Goldwind Science & Technology Co Ltd (Goldwind) raised a A$680m 5-year project facility. The loan was provided to develop the 530MW Stockyard Hill Wind Farm, which will be Australia's largest wind farm. Lenders were heavily scaled back after the loan attracted close to A$1.9 billion in commitments. Pricing is expected to be in line with other similar transactions – 185-200bps for the construction phase and 165bps for the operational phase. KPMG advised Goldwind with respect to the project.
- Renewable energy developer RES Australia reached financial close in Oct-17 on the 68MW Emerald Solar Park in QLD. A 5-year A$118.5 million project loan was provided by NAB and WBC to support the construction. The project is backed by a long-term offtake agreement with Telstra Corporation.
- Latrobe Valley Power (Finance), the borrower for Alinta Energy, secured a 5-year acquisition loan totalling A$715 million to purchase Loy Yang B power plant from Engie

SA and Mitsui & Co. The loan has a margin of 235bps over BBSY with a 40 precent commitment fee of margin.

- Western Roads Upgrade Project, Sunshine Coast Gateway Pty Ltd, Lincoln Gap Wind Farm and Moree Solar Farm were some of the other deals that contributed to the project financing volume for the quarter.

(Source: IJGlobal and Market Monitor LoanConnector)

M&A related financing was limited in the quarter due to subdued activity in the general corporate space. For the calendar year 2017, M&A activities accounted for US$12.4 billion through 23 deals, 47.1 percent down from 2016's record-setting US$23.3 billion raisings. Some of the notable transactions for Q4 2017 in this segment include acquisition loans for Pro-Pack Packaging's (A$70 million) and Home Investment Consortium Co Pty Ltd.'s (A$300 million).

A number of large refinancing transactions also contributed to the loan volume in Q4, including AMP Group's 2-year extension of its existing A$750 million revolving credit.

Table 1: Notable syndicated loan transactions

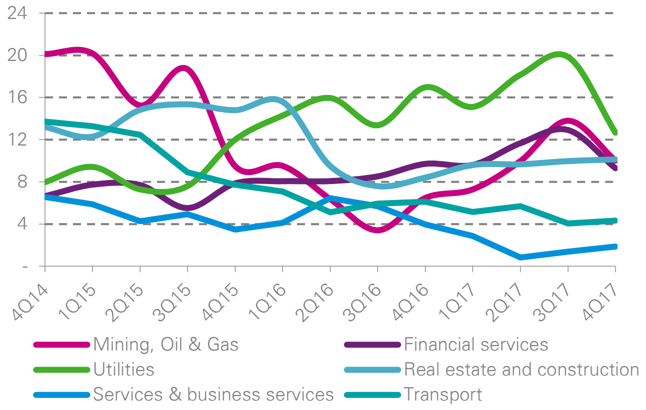
Borrower	Date	Tranche amount (A$m)	Tenor (years)	Margin (bps)
Axicom Finance Pty Ltd	Dec-17	635	5	155
		200	7	175
		100	10	195
Oaks Hotels & Resorts Ltd	Dec-17	150	5	164
Moree Solar Farm Pty Ltd	Dec-17	70	5	145
AMP Group Finance Services Ltd	Dec-17	300	3	80
		300	5	100
		300	6	110
Yarra Park City Pty Ltd	Dec-17	350	4	305
Cooper Energy (Sole) Pty Ltd	Dec-17	250	7	400
Stockyard Hill Wind Farm Pty Ltd	Dec-17	680	5	185-200
Latrobe Valley Power	Dec-17	715	5	235
Frasers Property	Dec-17	500	5	150
Spotless Group	Nov-17	489	2	155

Source: Loan Connector (data extracted February 2018), KPMG Analysis

We are increasingly seeing signs of banks being more sector selective and cautious in their credit decision making. Nonetheless, the bank market continues to see high levels of liquidity. The number of renewable energy deals reaching financial close has increased progressively over the last few years and we expect a strong pipeline still in place for investors and project developers to work together.

In regard to sector performance in Q4 2017, the real estate and construction sectors' loan volume continues to be supported by new projects and refinances. As noted earlier, significant funding has been raised in the renewable energy space in Q4, however on an annual basis 2017 volume in the overall utilities sector was down as compared to 2016.

Figure 2: Australian syndicated loan volume, LTM by sector (US$ billion)



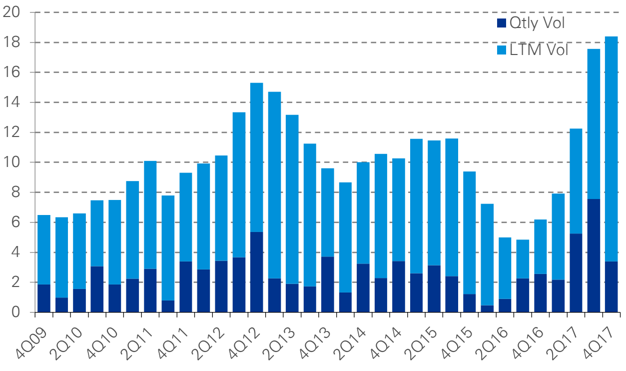
Source: Loan Connector (data extracted February 2018) and KPMG Analysis

AUSTRALIAN DOMESTIC BOND MARKET

Following a record volume of A$7.6 billion in the previous quarter, Q4 2017 was relatively quiet with total issuance of A$3.4 billion, circa 55 percent lower than Q3 2017. However, the calendar year 2017 has been a stand-out year with total volume of A$18.4 billion (including Kangaroo bonds) raised in the domestic corporate bond market, significantly higher than previous years. Despite low yields and spreads, investors have continued to show support for corporate issuers in the domestic bond market.

Recent transactions have seen very highly rated issuers (AA- and above) seeking longer dated funding and receiving investor appetite at long dated tenors (University of Melbourne: 25-year and Deutsche Bahn: 15-year, refer Table 2 for deal size and pricing details). Combined with the continued theme of 'A' band and 'BBB+' issuers receiving support for 10 year transactions, including Vodafone as detailed below, it is evident that the Australian domestic bond market is starting to provide a viable alternative for issuers seeking longer tenors than the usual three to seven years. These longer tenor issuances have been possible partly due to the presence of Asian investors complementing the domestic investor base. According to KangaNews, both the University of Melbourne and Deutsche Bahn deals were heavily supported by Asian investors, in particular life insurance companies, with a structural need for ultra-long tenors and those attracted to the strong credit ratings of the issuers (*University of Melbourne: AA+ and Deutsche Bahn: AA-*).

Figure 3: A$ corporate bond market (A$ billion)



Source: Bloomberg (data extracted February 2018) and KPMG Analysis
Note: Criteria has changed, new criteria excludes Financials and Government

Table 2: Notable corporate bond transactions

Borrower / Rating	Date	Amount (A$m)	Tenor (Years)	Margin (bps)*
University of Melbourne / AA+	Dec-17	100	25	126
Vodafone Group PLC / BBB+	Dec-17	750	5	105
		400	10	165
ESTA Utilities / A-	Dec-17	100	6	104
Multinet Gas / BBB+	Dec-17	265	7	125
University of Wollongong / AA	Dec-17	175	10	92
Endeavour Energy / Baa1	Nov-17	350	7	123
Ausgrid Finance / Baa1	Oct-17	1,200	7	122
United Energy Distribution / BBB+	Oct-17	170	7	125
Deutsche Bahn / AA-	Oct-17	150	15	98

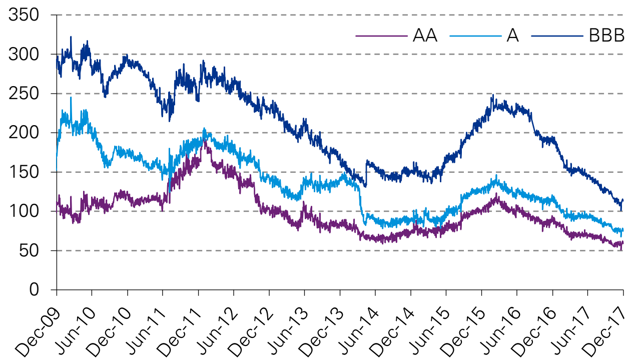
Source: KangaNews, Bloomberg (data extracted February 2018) and KPMG Analysis
** Indicative spread over A$ swap rate*

This quarter saw several offshore issuers making their return to the domestic bond market and further raisings from Australia's strong growth sector of higher education (*source KangaNews*):

- Vodafone Group Plc raised A$1.15 billion in Dec-17, 11 years after its debut transaction. This transaction saw Asian investors forming an integral part of Australian dollar corporate deals. According to KangaNews, Vodafone did not roadshow or hold any investor calls prior to the transaction. Books reached A$1.4 billion ahead of pricing. The transaction was announced and launched within 24 hours.
- Deutsche Bahn made a quick return within 4 weeks of its inaugural issuance in Sep-17, for a 15-year transaction, issuing A$150 million at an attractive pricing of 98bps over BBSW. This is the longest issued tenor for a corporate Kangaroo post GFC.
- University of Melbourne returned after 3 years to issue its second deal in the market – A$100 million for 25 years at 126bps over swap. For a modest deal size as this, the potential investor base was vast. It is the longest tenor achieved by an Australian University, second to University of Wollongong's inflation-linked 30-year transaction in 2008.
- University of Wollongong issued A$175 million to support its infrastructure development plans.

Pricing has continued to tighten in the domestic corporate bond market (as shown in Figure 4 below), with the margin difference on 'A' and 'BBB' band rated corporate issuances having compressed significantly since the peak gap last observed in Mar-16 (circa 60bps and 105bps, respectively).

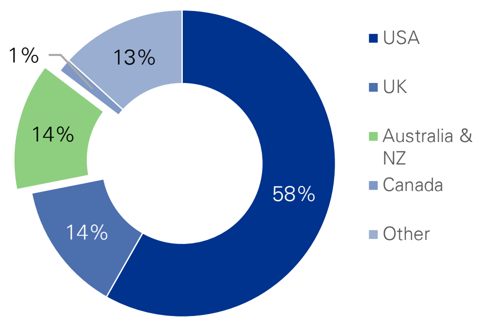
Figure 4: Australian corporate bond 5yr spread to A$ swap (bps)



Source: Bloomberg (data extracted February 2018), KPMG Analysis

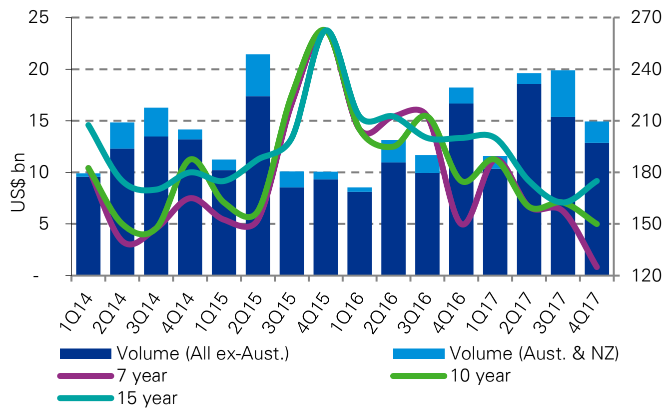
US PRIVATE PLACEMENT MARKET

Figure 5: USPP 2017 YTD volume precent by country



Source: Private Placement Monitor (December 2017), KPMG analysis

Figure 6: USPPs volumes and NAIC-2 pricing (bps (RHS) and US$ billion equivalent (LHS))



Source: Private Placement Monitor

The US Private Placement (USPP) market had a subdued fourth quarter pricing US$2.1 billion – a drop of 45 percent from the US$4.5 billion written in Q3 2017. Despite this drop, it was an increase of 34.3 percent compared to the prior corresponding period, rounding up the year with a written volume of US$8.9 billionn.

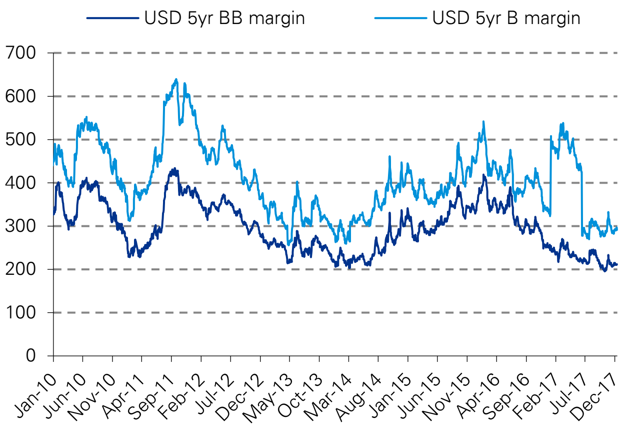
Continuing the trend observed in Q3 2017, the supply in Q4 2017 was dominated by Australian infrastructure privatisations. Endeavour Energy, a recently privatised energy provider (viewed as a NAIC-2), raised its debut offering of US$795 million equivalent and was strongly supported by investors who continued to seek high quality infrastructure assets in Australia. The transaction comprised multiple tranches issued in US$ and A$, across 10, 12 and 15-year maturities, with pricing of 115-135bps over US Treasuries for US$ tranches and 130-1665bps over A$ swap for A$ tranches, respectively.

The Outer Suburban Arterial Roads (OSARs) PPP project (NAIC-2), based in Victoria raised its first USPP offering of US$308 million equivalent. This PPP is part of the Victorian Government's A$1.8 billionn Western Roads Upgrade Project, Victoria's largest investment in road infrastructure to date. The total debt financing secured for the project is A$700 million, the remainder of which, was raised in the local bank market.

Other notable transactions in the quarter included Sonic Healthcare (NAIC-2) and Dexus Property Group (NAIC-1 issuer), raising US$500 million and US$185 million, respectively.

US HIGH YIELD BOND MARKET

Figure 7: US high yield bond spreads (bps)



Source: Bloomberg (data extracted February 2018) and KPMG Analysis

The US high yield corporate bond market spreads remained relatively flat and well below the historic averages at the beginning of the quarter, as the geopolitical tension between North Korea and the US gradually eased.

However, a number of unrelated events in Nov-17 quickly changed market sentiment, pushing the spreads upwards (circa 20-25 bps across BB-rated issuers and 50-55bps across B-rated issuers) and causing numerous retail investors to pull out of the market.

Contributing factors to the interim volatility in the market included growing concerns over the proposed US tax reform measures, failed / struggling merger activity in the US telecom industry[1] and weak third quarter earnings of certain large corporates. The swing in the high yield market was broadly similar to the drops observed in the S&P 500 Index.

OUTLOOK

2017 was an eventful year with several domestic large-scale infrastructure deals lifting the volumes across all markets. The trend is expected to continue in 2018 with more bankable PPP projects in the pipeline. These include privatisation of the NSW State's 51 percent stake in the WestConnex Motorway Project and the multi-billion Cross River Rail PPP in QLD. A tender of up to A$1 billion to replace the rolling stock in NSW regional train network has already been announced. The Victorian State government is considering another project for road upgrades after closing A$1.8 billionn Western Roads Upgrade Project. Further, the A$2.6 billion refinancing of Royal Adelaide Hospital PPP is already underway with original maturity of May-18.

The total size of these transactions are expected to be large enough to match similar infrastructure loan volumes seen in 2017.

With such a robust pipeline and positive outlook for 2018, the domestic banks can expect more competition from the offshore banks, as they increasingly look to take market share, including via flexibility around terms and pricing.

The Australian bond market continues to be a viable funding option and a stand-out market for corporate issuers, especially from a pricing perspective. In addition, the significant order book volumes and the continued lengthening of transaction tenors will provide corporate issuers with greater confidence in the market as a viable alternative for capital diversification.

[1] *On 4 November 2017, the merger between the third and fourth largest US wireless carriers, Sprint and T-mobile was called off. A combined company would have had in excess of 130 million subscribers, behind Verizon Communications Inc. and AT&T Inc. Further, during the same period the Trump's administration opposed the merger of AT&T with Time Warner, which if successful, would have resulted in significantly higher distribution fees for other peers in the industry,*

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KPMG CONTACTS

David Heathcote
Partner
Sydney
+61 2 9335 7193
dheathcote@kpmg.com.au

Scott Mesley
Partner
Melbourne
+61 3 9288 6748
smesley@kpmg.com.au

Greg Eldridge
Director
Melbourne
+61 3 9288 5759
geldridge@kpmg.com.au

Conrad Hall
Director
Brisbane
+61 7 3434 9105
conradhall@kpmg.com.au

Matt McKenna
Director
Sydney
+61 2 9295 3878
mmckenna1@kpmg.com.au

Ian O'Brien
Director
Perth
+61 8 9413 7926
lobrien2@kpmg.com.au

KPMG.com.au