Debt Market Update

Q4 2018

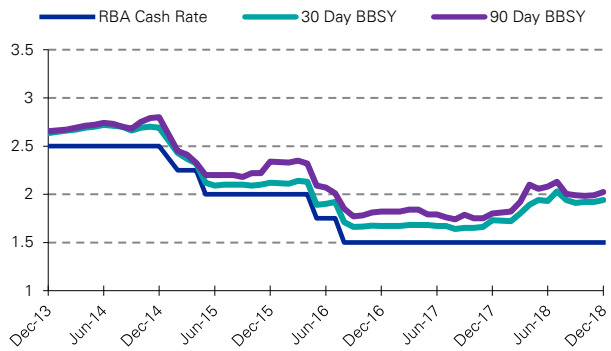
Key themes

- **Market conditions –** global market volatility heightens as investors grow cautious
- **Australian bank debt market** – refinancings comprise majority of volume as Q4 marks largest quarterly loan volume since Q1 2015
- **Australian domestic bond market** – busiest quarter of 2018 with continued investor support at extended tenors
- **Funding corporate activity** – depressed M&A lending continued in Q4 2018 and no sponsor backed deals reported as closed, capping off a disappointing year
- **USPP** – reduced volumes from Australia and NZ but strong international activity drives total USPP issuance

MARKET CONDITIONS

The fourth quarter of 2018 witnessed heighted global market volatility in the midst of geopolitical developments, including the US-China trade war and the Brexit process, as market participants grow cautious on the future outlook of debt markets. In response to rising borrowing costs for companies across the US and Europe, investors have closely monitored the communications of the RBA for guidance on any future adjustment of the target cash rate.

Figure 1: RBA Cash Rate vs 1 Month & 3 Month BBSY



Source: RBA and Bloomberg (data extracted January 2019) and KPMG Analysis

The spread between BBSY and the RBA cash rate can portray current credit risk sentiment of the banks and the supply and demand of funding available to borrowers.

Since August 2016, the RBA have remained patient holding the target cash rate at record low levels of 1.5%. Whilst the RBA has remained steadfast in its approach, the spread between the cash rate and BBSY has steadily risen. Where BBSY has historically traded on average at 15-27bps (30-90 days) above the cash rate over a 3 year period prior to 2018, this has increased to 40-51bps (30-90 days) in 2018.

Table 1: RBA Cash Rate vs 30 Day & 90 Day BBSY Spread

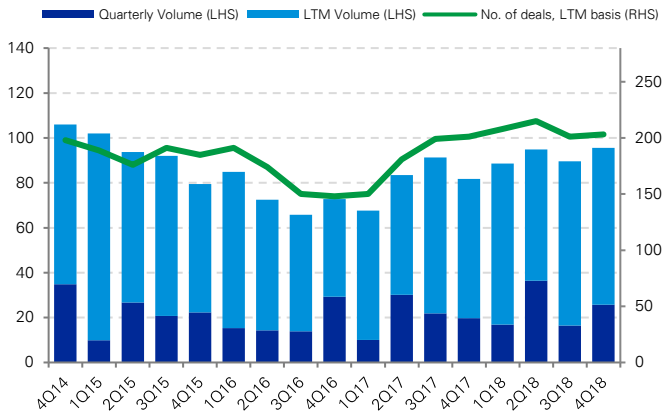
Rate	3 Year Average (Pre - 2018)	2017 Average	2018 Average
30 Day BBSY	15bps	17bps	40bps
90 Day BBSY	27bps	29bps	51bps

Source: RBA and Bloomberg (data extracted January 2019) and KPMG Analysis

AUSTRALIAN DOMESTIC BANK DEBT MARKET

The fourth calendar quarter of 2018 resulted in a 16.8% increase in Australian syndicated loan volume from the previous comparable period (on a 12 month rolling basis) to US$95.5bn, marking the largest recorded volume since Q1 2015. This was driven by an increase in the average transaction size in Q4 2018 with the number of deals remaining fairly consistent.

Figure 2: Australian syndicated loan volume (US$bn)



Source: Loan Connector (data extracted January 2019) and KPMG Analysis

Notable syndicated transactions for the quarter included:

- QBE Insurance Group secured a US$2.4bn three-year multi-tranche revolving credit facility for general corporate purposes in December 2018.
- Seek Ltd closed a US$1.025bn-equivalent multi-tranche refinancing, which comes only 18 months after completing its previous borrowing of A$917m (June 2017), indicating a willingness for the online recruitment firm to tap back into the favourable market conditions for borrowers.
- Treasury Wine Estates, the Australian listed entity, increased its US$300m refinancing to US$350m due to increased market appetite. The dual-tranche facility comprises a US$120m 5 year term and a US$230m 7 year term, with opening interest margins of 130bp and 165bp over LIBOR, respectively.
- Qantas Airways, increased it's A$300m 10-year asset-backed loan to A$450m due to an oversubscription (7x). Similar to the previously reported A$300m facility in our Q3 report, the pricing of the increased facility is between 145-175bps tied to a loan-to-value ratio of 65%-80%. The borrowing marks the second loan for Qantas under the financing program it set up in October 2017.
- SGSP (Australia) Assets, owner operator of energy infrastructure assets (rated A- by S&P), closed an $A650m 5.5-year revolving credit facility in November 2018. The funds will replace the A$600m four-year tranche of the A$1.2bn facility signed in December 2015, which also carries a A$600m five-year portion.

Source: Loan Connector (data extracted January 2019), KPMG Analysis

There was no reported sponsored related M&A activity completed in Q4 2018 capping off a disappointing 2018, highlighted by a 53.2% reduction from the US$12.7bn (rolling 12 months) reported in 2017. Of the US$5.9bn of M&A-related financing in 2018, only 9% comprised of sponsor based financing, a dramatic decline to the 71% of sponsored lending recorded in 2017.

Whilst a poor result from an executed transaction standpoint, the result can largely be attributed to a number of deals failing to reach fruition. This was headlined by Harbour Energy's failed takeover pursuit of Santos Ltd that would have set records for leveraged buyout and related debt financing in APAC with its US$7.75bn senior debt financing.

Table 2: Notable syndicated loan transactions

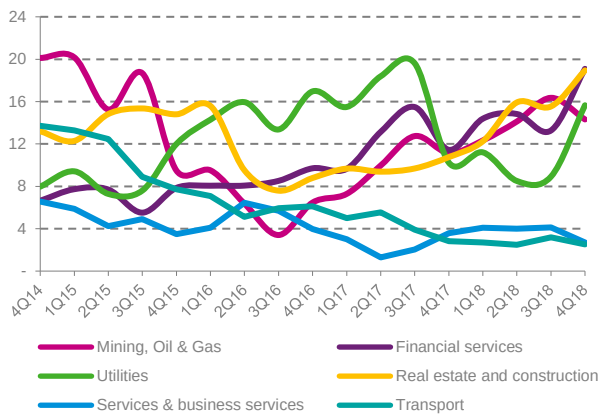
Borrower	Date	Tranche amount (m)	Tenor (years)	Margin (bps)
QBE Insurance Group Ltd	Dec-18	US$750	3	n/a
		US$50		
		US$100		
		US$1,500		
Seek Ltd	Dec-18	A$300	3	140
		A$250	4	155
		US$275	5	165
		US$100	4	155
		US$100	5	165
SGSP (Australia) Assets Pty Ltd	Nov-18	A$650	5.5	n/a
Treasury Wine Estates Ltd	Nov-18	US$120	5	130
		US$230	7	165

Source: Loan Connector (data extracted January 2019), KPMG Analysis

As was the case across ASPAC throughout the year, in the face of declining M&A-related activity, refinancing's continued to form the majority of deal flow, with 66% attributed to Australia's total issuance for 2018.

Looking at sector performance in Q4 2018 (on a LTM basis compared to Q4 2017), strong increases in volume across Utilities (53%), Financial Services (67%) and Real Estate & Construction (76%), combined to drive total volume up by 42%. Limited deal volume across Services & Business Services saw both sectors experience a decline from the prior quarter.

Figure 3: Australian syndicated loan volume, LTM by sector (US$bn)



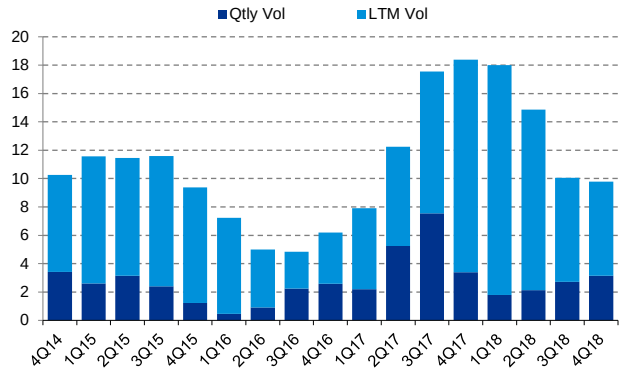
Source: Loan Connector (data extracted January 2019) and KPMG Analysis

AUSTRALIAN DOMESTIC BOND MARKET

The fourth quarter of 2018 was the busiest quarter of 2018, with total corporate volumes reaching A$3.14bn, marking an increase of 48% and 15% on Q2 and Q3 volumes respectively.

The positive fourth quarter results finished the year on a high note, as year-to-date issuances totalled A$9.79bn. Despite the significant 47% decrease to 2017's record breaking year-to-date issuances of A$18.8bn, 2018 total issuances remained firm in comparison to the figures reported in 2016, 2015 and 2014.

Figure 4: A$ corporate bond market (A$bn)



Source: Bloomberg (data extracted January 2019) and KPMG Analysis
Note: Criteria has changed, new criteria excludes Financials and Government

In continuing with the trend demonstrated throughout 2018, Q4 saw the domestic bond market record a number of issuers secure longer dated funding (up to 25 years), and receiving strong investor appetite at long-dated tenors (regularly greater than 10 years).

Transactions during the quarter constituted domestic and international issuers. Some of the notable transactions for the quarter included:

- University of Sydney demonstrated the continued desire for long dated, high-rated Australian credits with a 25-year transaction for A$200m in November 2018. The deal affirmed the ability of the Australian University sector to tap into extended tenors of a high credit quality and follows suit to Macquarie University's deal in Q3 across a 10 and 25 year tranche.
- Chorus, a New Zealand telecommunications infrastructure provider, inked a return to domestic issuance by completing a 10 year, NZ$500m (180bps/mid swap) in November 2018. The transaction includes a rate reset after five years, helping to stimulate retail demand.
- Heathrow Airport announced its debut in the Australian dollar market in October 2018 with a $175m issuance across a 10 year tranche. The majority of the book comprised domestic contingent with a small subset of Asian investors.

Source: KangaNews (data extracted January 2019) and KPMG Analysis

Notable corporate bond transactions and relevant terms are presented in Table 3.

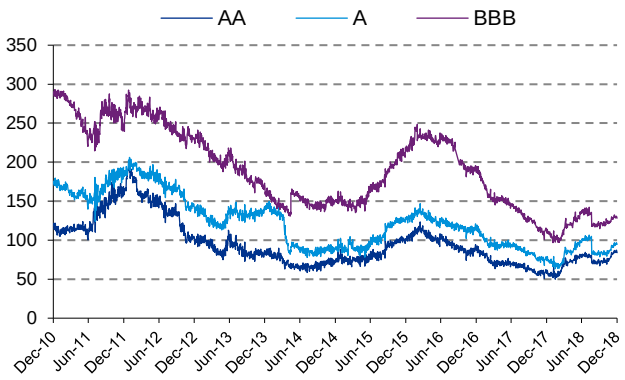
Table 3: Notable corporate bond transactions

Borrower / Rating	Date	Amount ($m)	Tenor (Years)	Margin (bps)
University of Sydney - Aa1	Nov-18	A$200	25	n/a
Transurban - BBB+ / Baa1 / A-	Nov-18	C$650 C$200	10 4	202 n/a
Chorus – BBB/Baa2	Nov-18	NZ$500	10	180
Heathrow Funding - A- / A-	Oct-18	A$175	10	140

Source: KangaNews (data extracted January 2019) and KPMG Analysis

Margins experienced a slight increase throughout the quarter to finish the year, with the average margin on A and BBB rated corporate issuances for 5 year tenors rising to 95bps and 128bps respectively at year end. Despite the marginal increase in pricing, credit conditions and liquidity levels remained favourable for borrowers.

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



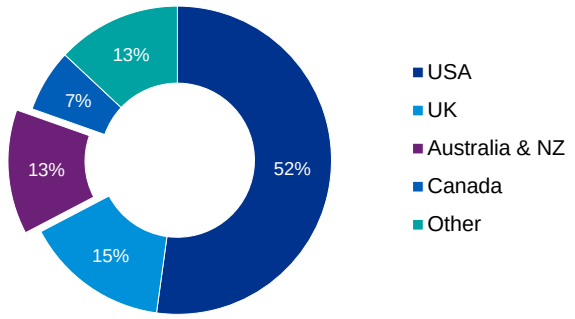
Source: Bloomberg (data extracted January 2019), KPMG Analysis

US PRIVATE PLACEMENT MARKET

Australian and New Zealand (Aus & NZ) issuers in the USPP market recorded a decline in Q4 2018, demonstrating a 43% decrease from Q3 levels, with only US$1.7bn of issuance for Q4 2018. However, the YTD performance remains stable for Aus & NZ issuers with 2.7% growth compared to prior year levels.

Despite the low volume levels experienced by Aus & NZ issuers in Q4, the US (52%), UK (107%) and Canada (582%) all recorded strong increases in comparison to Q3 2018, driving the total volume to US$20.4bn in Q4. The strong aggregated finish to 2018 ensured total USPP volume continued to demonstrate year-on-year increase, marking a combined 5.5% improvement on 2017 levels.

Figure 6: USPP 2018 volume percent by country



Source: Private Placement Monitor (December 2018), KPMG analysis

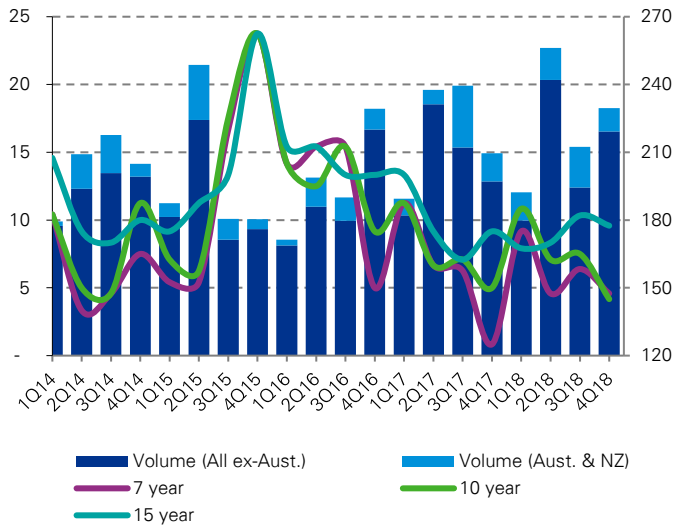
Despite the low activity quarter there were some notable transactions completed by Aus & NZ issuers, driven primarily off the back of continued strong contributions from the Services, Financials, Utilities' and Energy sectors.

Origin Energy Ltd (NAIC-2) tapped the USPP market securing US$250m, across 10-year bullets at 210bps. Origin Energy is an energy retailer in Australia across electricity, gas and LPG. The transaction marked Origin's latest activity since tapping the USPP market in December 2013 for a total of US$150m.

AquaSure (NAIC-2), operator of the Victorian desalination plant producing desalinated water in Australia, secured US$325m with a 15-year final, 10-year average life, placement at 115bps.

Fonterra Cooperative Group Ltd (NAIC-1), the leading multinational dairy company out of NZ, re-entered the USPP market, securing a total of US$200m across a 10-year bullet at 125bps.

Figure 7: USPPs volumes and NAIC-2 pricing (bps (RHS) and US$bn equivalent (LHS))



Source: Private Placement Monitor (data extracted December 2018), KPMG analysis

OUTLOOK

In the face of heighted global market volatility through the ongoing mounting geopolitical developments, including the US-China trade war and Brexit, market participants are becoming increasingly concerned about the outlook for the world economy. Borrowing costs for companies in the US and Europe have begun to increase, coupled with sharp declines across major equity markets, the credit environment is beginning to become less favourable and appears to be dampening market sentiment.

Central bank policy is at the forefront of market scrutiny as investors closely monitor decisions influencing the cash rate. The RBA have continued to hold the target cash rate at record low levels of 1.5%, despite a steadily widening spread becoming evident with market based pricing levels. The RBA's hand may be forced to adjust rates in the aim to support weakening macroeconomic indicators.

The domestic bank market remains competitive, with strong appetite for quality credits from alternative lenders and offshore banks providing ongoing competition to the Big 4 banks.

Following the release of the Royal Commission findings, and in the face of potentially softening economy and property market, we expect Australian banks will continue to be circumspect in their lending.

Our Global Debt Advisory offices

KPMG's global Debt Advisory team of over **120** professionals helps our clients achieve optimal financing outcomes across the entire spectrum of debt products.

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Recent capabilities added to Brisbane

Craig Jones has recently joined the Brisbane office as a Director, joining with 18 years of banking experience (predominantly at ANZ), with a prime focus on execution in the local Queensland market and providing assistance on transactions that match his capabilities nationally.

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