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StockCo Holdings Pty Ltd

8 February 2019

This security is available for Retail and Wholesale Clients

Security
AUD47m 8.75% Oct 2022

ISIN
AU3CB0240117

Currency
AUD

Type
Unsecured

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Issuer Outline

StockCo is an Australian niche provider of a specialty agricultural finance product tailored to fund the "finishing" phase of livestock's growth. Finishing finance is provided by funding the purchase price of livestock for a defined period of time with a specific end market in mind. The period of funding can vary from 2 to 12 months, and the current weighted average term of StockCo's finance book is around 6 months. StockCo provides livestock finance facilities for pasture and feedlot based cattle and sheep producers.

Since beginning operations in 2014, StockCo has financed over AUD450m of livestock. The wider StockCo business is now the largest specialist livestock financier in both Australia and New Zealand, and continues to rapidly expand its market leading position in the Australian livestock industry. This position has been recently further strengthened by Elders' purchase of 30% of StockCo Holdings 2 Pty Limited, StockCo's direct parent.

Key Financials (AUDm)

LTM (30 Jun)	2018
Net Finance Margin	12.8
Credit Losses	0.4
EBIT	20.3
NPAT	4.4
Receivables (Net)	178.3
Borrowings	174.2
EBIT Interest Cover	2.1x

Source: FIIG Securities, Company reports

Key Terms			
Coupon Type	Fixed	Amount Issued/Outstanding	AUD47m/AUD47m
Rate	8.75%[1]	Minimum Amount	AUD10,000
Frequency	Monthly	Denomination	AUD1,000
Domicile	Australia	AU Withholding Tax Exempt	Yes
Key Dates			
Issue Date	6 October 2016	Maturity Date	6 October 2022
Call Dates	6 October 2019 @103.00*	6 October 2020 @101.50*	6 October 2021 and thereafter @100.00

[1] Coupon steps up to 9.50% from October 2021

**Callable on each monthly coupon date with at least 30 days' notice (not more than 60 days)*

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Strengths

- Naturally de-leveraging assets: Livestock naturally accretes in value as it progresses through the finishing phase and grows to its target settlement weight. This is an important point to note and differentiates this collateral from many other forms of asset financing where the assets naturally depreciate in value, such as car loans or business equipment.

  As livestock matures, StockCo's security position improves with the effective loan to value ratio (LVR) decreasing over time.

- Collateral value largely immune to changes in beef prices: A fall in price can affect the value of stock and therefore the value of the security supporting the Notes. The Eastern Young Cattle Indicator (EYCI) is the most commonly used benchmark for beef prices in Australia. Cattle prices have retraced somewhat since reaching record highs in October 2016, however remain elevated over a longer timeframe.

- Relatively low-risk lending: Finishing financing is considered a low-risk form of stock financing for several reasons:
  - it is short-term, generally six-twelve months, which reduces the risk of an adverse event occurring;
  - it is secured by an appreciating asset; and
  - the finishing process does not commence until after the higher risk breeding and adolescence stages are completed, and relates to young, healthy livestock, that are typically rapidly increasing in value and where the risk of mortality is low

- Quality of security: The primary security for StockCo is the livestock assets, which are a relatively high liquid form of collateral. Security over the assets is registered in all instances on the Personal Property Securities Register (PPSR), giving StockCo, if necessary, the right to enter a property and take possession of livestock.

  StockCo's standard loan documentation also includes guarantees from individuals or entities related to the borrower that own significant additional assets. Additionally, the right to mortgage additional assets is built into StockCo's Master Livestock Agreement which underpins all lending. This provides StockCo with mortgage security over the assets of the borrower in the event of default.

- Strong distribution network: StockCo has a broad distribution network through a variety of channel partners. The Shareholders Agreement with Elders contains non-compete clauses together with the equity investment, which will further align incentives and promote growth. StockCo's management believe that this is a highly cost effective way to achieve broad market coverage without increasing its fixed-cost base; StockCo does not need to cover under-utilised overheads. In addition, this network is supported by established local knowledge of prospective clients and their farming practices.

- Experienced management team: Marcus Kight, Group Managing Director and 70% shareholder established the business and over a 20 year period he has been responsible for the development of the Company from AUD3.5m in assets to over AUD200m.

  CEO Richard Brimblecombe has over 20 years' experience in senior management roles in financial services, commodity trading and processing, rural services and distribution.

  CFO Jeremy Cranswick has over 15 years' experience with prior roles as leader of the Crowe Horwath Hawke's Bay Audit Department, at KPMG's Financial Services Audit Department as well as Lloyds of London insurance syndicates.

  Head of Credit, Michael Foote has significant Agribusiness experience through roles in the meat processing industry and a technical product development company. He has an honours degree in Bio Technology and Bio-process Engineering from Massey University.

- Structural elements of the Notes: The Notes benefit from a six month, fully funded interest reserve account. The Notes also benefit from tighter look-through covenants than the senior club debt. A breach of such covenants will trigger a cash lockup at StockCo Holdings (stopping the payment of any distributions to equity) to ensure cash flow coverage in the instance where a breach then lockup occurs at StockCo AgriCapital.

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All cash will be locked in StockCo Holdings if the Interest Coverage Ratio (ICR) at StockCo AgriCapital is under 1.75x (compared to the 1.5x threshold in the Senior Club covenants), or if the ICR at StockCo Holdings is under 2x. This lockup will also be activated if StockCo AgriCapital exceeds the 70%Total Indebtedness to total tangible assets (TTA) ratio, or if the look through gearing inclusive of both StockCo AgriCapital indebtedness and StockCo Holdings unsubordinated indebtedness is greater than 92% of TTA.

Risks

- StockCo is exposed to agricultural shocks caused by disease and drought: Like all agriculture lending, StockCo is exposed to externalities including weather, disease and commodity prices. There has been no major outbreak of cattle/sheep disease in Australia, with minor outbreaks of possible Foot and Mouth Disease confined to the 1800's. The risk of disease is mitigated through the following:
    - Australia's isolation and world class biosecurity regulations;
    - the NLIS system for identification and traceability of livestock introduced to track cattle during disease and food incidents;
    - Australia's vast land-mass and therefore ability to contain outbreaks to localised regions; and
    - StockCo's geographic diversity

  The risk posed by drought is mitigated to some extent by the tendency of farmers to reduce purchases of livestock when a drought is forecast given the increased difficulty or cost in securing sufficient feed and therefore return. However, a prolonged drought would likely cause lending volumes to also fall, therefore reducing StockCo's profitability.
- Competition and low barriers to entry: While there are low barriers to entry, effective and scalable livestock financing requires specialised systems, customised underwriting standards, unique security documents and active management with frequent client interaction. Historically, therefore potential competitors like trading banks sought minimal exposure to funding livestock due to the specialist knowledge required to appropriately manage direct livestock exposures. If banks do take direct exposure, they will typically only offer a much lower portion of the value compared to StockCo's 100% of the purchase price.
- Risk of bad debt and fraud: Financials such as StockCo are constantly at risk from bad debts and potential fraud. As at FY18, the Company has yet to write-off a loan and specific provisions amounted to AUD170k, with expectation of full recovery.

  The historical loss rate of the New Zealand business with over NZD1.1bnn of livestock funded over 20 years is 0.4% (although much of this was as a result of the global financial crisis). While weather and feeding conditions are generally more favourable in New Zealand relative to Australia, the performance of the New Zealand operations is informative as policies and procedures in Australia are largely derived from the New Zealand operations.
- Lending to high-risk or inappropriate producers: Further to typical credit assessment, StockCo also reduces the risk of default by screening and only lending to appropriate producers. StockCo will only lend to experienced livestock producers with a proven history of successful livestock production and with a demonstrated ability to successfully engage in the proposed trades.

  Initial analysis is based on gaining an understanding of farming operations and in the design of an appropriate financing structure. Farm inspections are undertaken by a StockCo representative or delegated agent (e.g. Elders) for all potential clients. The primary objective of the inspection is to assess the quality of the farmer, land and plant, existing stock and farming practices, and suitability for the proposed transaction.

  StockCo will also use its network of rural contacts to obtain discreet information regarding the reputation of a potential client from both a financial and operational standing.
- Imperfect security and enforcement: If security and legal documentation is insufficient or not perfected, StockCo is at risk from losses when enforcement is required.

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StockCo's security has been tested in litigation in NZ, which has operated with a PPSR regime since 2002, and on which the Australian PPSR regime was based. Another finance provider with a General Security Agreement (GSA) attempted to claim that some of StockCo's stock was covered by its GSA. The judge ruled that StockCo's stock were clearly identified as StockCo's.

- Limited rights in senior securitisation structure: This is offset by the covenants which are set above the senior funding levels breach of which will trigger a cash lockup at Holdings Pty Ltd level, interest reserve requirements and the right to stop origination forcing senior structure into unwind.
- Key man risk: Marcus Kight is the founder and a driving force behind the business. Key man risk is mitigated by the development of a capable management team including Australian CEO, Richard Brimblecombe, Group CFO, Jeremy Cranswick, and Head of Credit, Michael Foote. Richard Brimblecombe is heavily bound by non-compete clauses that endure for five years after cessation of employment and all three key executives have LTI programs designed to encourage and reward long term service.

Other risks

- Call risk: A decision to call the bonds ahead of the maturity date depends on a number of factors, including the relative cost of entering new debt financing, the company's liquidity position, and the availability and attractiveness of new funding opportunities at the call date.
- Duration risk: n/a
- Interest deferral/cancellation: n/a
- Non-viability trigger: n/a

Summary

StockCo's unsecured 8.75% fixed rate notes offer a high yield exposure and potential diversification to the agricultural sector.

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