# Gryphon Capital Income Trust (ASX: GCI)

ARSN 623 308 850

## Investment Update as at 31 July 2020

## Investment Objective

**Gryphon Capital Income Trust (GCI) set itself 3 strategic objectives at IPO:**

1. *Sustainable monthly cash income*
2. *High risk-adjusted return*
3. *Capital Preservation*

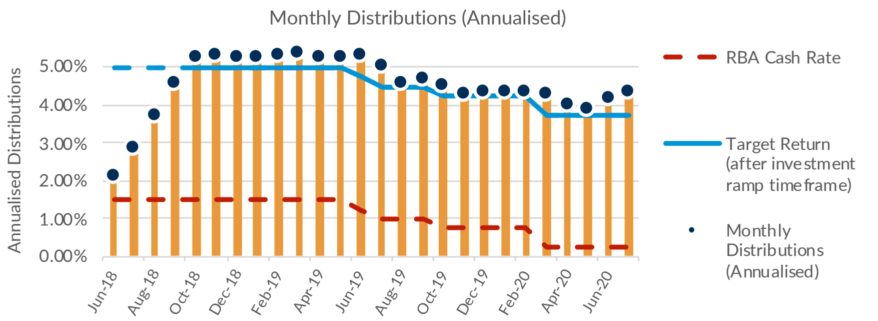
GCI continues to generate attractive and sustainable monthly income with highest risk adjusted returns through investments in a defensive asset class with a track record of low capital price volatility and capital preservation.

## Investment Highlights

| | |
|---|---|
| **Income**[1] | Sustainable monthly cash income. Current 12-month distribution yield at 4.35% (net). |
| **Large, institutional fixed income market** | Australian ABS market >A$110 billion is double the size of the corporate bond market |
| **Security, capital preservation** | Defensive asset class with a track record of low capital price volatility<br>No investor has ever lost a $ of principal investing in Australian Prime RMBS |
| **Portfolio diversification** | Allows retail and SMSF investors to access a fixed income asset class that generally has only been available to institutional investors |
| **Investment Manager** | Exposure to a specialist investment manager with a proven track record of investment outperformance |

## Distribution

GCI announced a 0.72 cents per unit distribution for the month of July, generating a distribution yield for the 12 months to July 2020 of 4.35% (net)[1].




## Fund Performance as at 31 July 2020

| | 1 Mth | 3 Mth | 6 Mth | 1 Yr | Incep (Ann)[2] |
|---|---|---|---|---|---|
| Net Return (%) | 0.36 | 1.08 | 1.33 | 3.72 | 4.49 |
| RBA Cash Rate (%) | 0.02 | 0.06 | 0.18 | 0.60 | 1.07 |
| Net Excess Return (%) | 0.34 | 1.01 | 1.15 | 3.10 | 3.38 |
| Distribution[1] (%) | 0.36 | 1.03 | 2.06 | 4.35 | 4.52 |
| Distribution (¢/unit) | 0.72 | 2.04 | 4.08 | 8.53 | 8.86 |

[1] Actual distribution as % of NTA, assuming distribution reinvestment.

[2] Inception date — 21 May 2018

**Note:** Past performance is not a reliable indicator of future performance.

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## ABOUT THE MANAGER

Gryphon Capital Investments Pty Ltd ("Gryphon") is a specialist fixed income manager with significant experience in the Australian and International fixed income markets. Gryphon manages individual segregated accounts on behalf of institutional investors and GCI on behalf of wholesale and retail investors seeking opportunities in fixed income credit markets including RMBS and ABS. Gryphon currently manages funds in excess of $2.1 billion.

## SNAPSHOT

| | |
|---|---|
| **ASX Code** | GCI |
| **IPO Date** | 25 May 2018 |
| **Asset** | Fixed Income, floating rate |
| **Market Cap** | $387.5m |
| **ASX Price** | $1.88 |
| **NTA/Unit** | $411.0m/$1.99 |
| **Investment Management Fee**[3] | 0.72% |
| **Performance Fee** | None |
| **Distributions** | Monthly |
| **Unit Pricing** | Daily |

[3] Includes GST, net of reduced input tax credits

## CHARACTERISTICS

| | |
|---|---|
| **Distributions (12m)**[4] | 4.35% |
| **RBA Cash Rate** | 0.25% pa. |
| **Interest Rate Duration** | 0.04 years |
| **Credit Spread Duration** | 2.00 years |
| **Number of Bond Holdings** | 91 |
| **Number of Underlying Mortgage Loans** | 114,870 |

[4] Actual distribution for the 12 months to 31 July, as a % of NTA, assuming distribution reinvestment.

## RESEARCH

BondAdviser

Independent Investment Research

Zenith Investment Partners — Recommended

Lonsec

## WEBSITE

**www.gcapinvest.com/gcit/overview**

## Market and GCI Investment Activity

July saw four new primary RMBS transactions totalling $3.4 billion; three Prime RMBS transactions and one $1 billion Non-Conforming RMBS. Additionally, there was a single $300 million Auto ABS transaction. From a portfolio positioning perspective, Gryphon has been increasing its portfolio weighting to Prime RMBS transactions with no loans experiencing COVID hardship and continued doing so in July by participating in one of the Prime RMBS transactions.

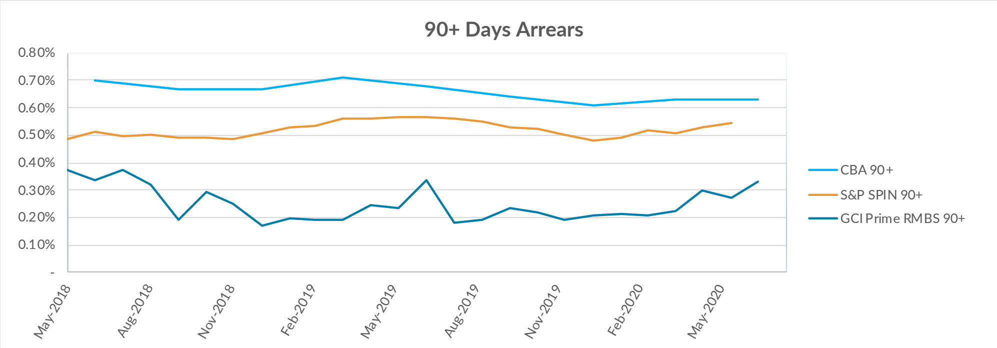
A not unexpected development in the market has been the breadth of investor support for these new issues despite the backdrop of "second wave" and lockdowns in Victoria. The global search for yield in the bond markets overlayed with the strong relative value offered by Australian RMBS has attracted new international investors with deep pockets. This strong international investor demand allowed a Non-Conforming transaction with mid-teen COVID impacted borrowers to upsize the transaction from $500 Million to $1 billion.

This investor demand is driven by unprecedented global monetary and fiscal stimulus programs with the consensus not "betting against the Fed".

Despite many newspaper headlines forecasting doom around the performance of COVID hardship borrowers, Gryphon continues to be cautious but constructive about future performance particularly when we analyse in a granular manner the protections available to RMBS bondholders.

## Borrower arrears not increasing ... yet

Recent major bank results confirm a trend we see in the GCI portfolio, that since March the proportion of borrowers not paying their home loan repayments (90+ days in arrears) has not increased significantly (see charts below).




That the number of borrowers in serious arrears (often referred to as non-performing loans) hasn't increased since March is not surprising as one would expect that any borrower who has experienced an income shock since the onset of COVID would have requested "COVID hardship" from their lender. Approximately 1 in 10 home loan borrowers from the major banks have requested "COVID Hardship". These borrowers are not required to make their mortgage payments for between 3–6 months although interest is still capitalised to their loan balance. In addition to the unprecedented monetary and fiscal stimulus programs, the banking regulator "APRA" has also provided support to the banking system by effectively "stopping the clock" on borrowers who have sought COVID loan repayment deferral arrangements — these borrowers are not being classified as being in arrears even though they are not making loan repayments. The performance of these "COVID hardship" borrowers is a focus for all lenders, banks and non-banks alike.

Gryphon receives loan level data on every RMBS investment, with COVID impacted borrowers flagged enabling us to perform granular stress testing on the higher risk borrowers. From the peak, approximately 6% of the COVID impacted borrowers have cured, with borrowers recommencing their loan repayments. While Gryphon is modelling an assumed increase in arrears once these borrowers' deferral arrangements cease in Q1 2021 and beyond, our focus is on whether these higher expected arrears ultimately roll into defaults and losses and if so, how much these expected losses eat into the large bondholders' protections.

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## PARTIES

**Responsible Entity**

One Managed Investment Funds Limited
ACN 117 400 987 AFSL 297042

**Manager**

Gryphon Capital Investments Pty Ltd
ACN 167 850 535 AFSL 454552

## AVAILABLE PLATFORMS INCLUDE:

| | |
|---|---|
| Asgard | BT Panorama |
| BT Super Wrap | BT Wrap |
| First Wrap | HUB24 |
| Macquarie Wrap | Mason Stevens |
| MLC | Navigator |
| Netwealth | North |

## FURTHER INFORMATION AND ENQUIRIES

**Gryphon Capital Income Trust**
www.gcapinvest.com/gcit/overview

**General**
Email info@gcapinvest.com

**Boardroom (Unit Registry)**
Phone 1300 737 760
Email enquiries@boardroomlimited.com.au

## Laser focus on COVID hardship borrowers ...

There are several common traits among all lenders who are managing COVID impacted borrowers including, among others:

- Risk scoring of every impacted borrower with a priority made to the "higher risk" borrowers
- Risk scoring methodologies vary between lenders but some common attributes include dynamic loan to value (LVR), employment sector, previous arrears and payments in advance or offset balances
- Where possible, lenders want borrowers in serious arrears to remain in their home and will incentivise them to start making payments — some lenders including major banks are offering borrowers the option to convert their mortgage payments to interest-only (historically low interest rates) for a short period (i.e. 1 year)

Gryphon receives loan level data each month with a COVID flag for borrowers who are on hardship or arrangement. In the GCI investment portfolio, about 6.2% of mortgage borrowers have been granted COVID hardship compared to over 10% for the major banks. While this may demonstrate the quality of portfolio holdings, Gryphon conducts granular analysis into the likely loss for any of these borrowers who may default.

## Granular modelling to forecast potential loss and bondholder protections against any loss ...

For the COVID hardship borrowers in the GCI portfolio, the average loan balance is approx. $570K with a weighted average indexed LVR of 65% meaning on average the borrower has greater than $300K equity in their home — this equity in the home is the first (of four) protections against loss for bondholders. Gryphon uses averages to simplify the explanation of bondholder protections but in practice our stress testing uses individual loan level data to more accurately forecast loss (not averages). Gryphon isolates high risk loans using this loan level data, stratifying borrowers by attributes including, LVR, arrears, if the loan has Lenders Mortgage Insurance, large loan, self-employed, interest only, dwelling type (i.e. house or unit), geographic region (i.e. non-metro, inner-city) among others. Rather than work in averages and top down, this granular bottom up stress testing enables us to accurately forecast the most high-risk loans where future losses may arise.

As an example of the "higher risk loans" bucket for Prime loans experiencing "COVID hardship", less than 1% is exposed to LVR > 80% with no lender mortgage insurance. Fortunately, there are additional protections against loss if any of these loans roll into default including excess spread in the transactions and bond subordination.

## RBA research "Determinants of Mortgage Defaults", July 2020

The most recent research released by the RBA in July 2020[1] provides an interesting insight into the potential performance for the borrowers impacted by COVID. The RBA research concludes that for a home loan borrower in Australia to default it requires both an inability to repay the loan, and (importantly) the home loan to also be in negative equity. Gryphon has adopted these conclusions as another stress test to all of our exposures. The GCI portfolio has a very small number of loans in negative equity (158 loans or approximately 0.1% of the portfolio) and only 19 of which have been impacted by COVID. None are in arrears and of the COVID impacted loans two-thirds have the benefit of mortgage insurance. Again, the ability to monitor house prices and therefore measure current LVRs confidently, requires access to individual loan level data with full post codes to correctly apply regional house price indices.

## Gryphon granular stress testing provides confidence in GCI's portfolio's robustness

Using loan level data, on a monthly basis Gryphon is stress testing, isolating higher risk loans in negative equity, recalculating expected losses and bondholder protections; we continue to be very confident in the portfolio positioning being able to continue to deliver sustainable monthly income with a strong focus on capital preservation. All this work confirms the defensive nature of RMBS in the COVID-19 environment.

[1] The Determinants of Mortgage Default in Australia — Evidence for the Double-trigger Hypothesis, Economic Research Department, RBA, July 2020

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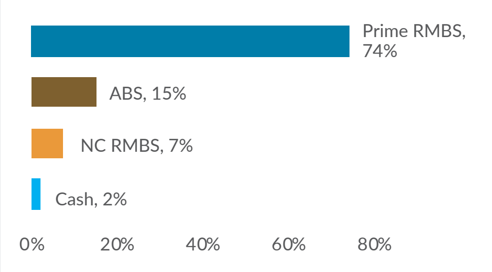
## Portfolio Construction[1]

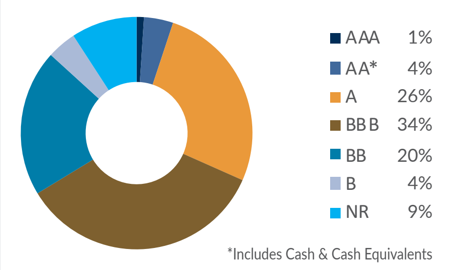
[1] As at 31 July 2020.

### Sector Allocations[2]




[2] Excludes Manager Loan.

### Rating Breakdown[2]




[2] Excludes Manager Loan.

### Portfolio Underlying Residential Mortgage Loan Statistics[3]

| | Total | Prime | Non-conforming[4] |
|---|---|---|---|
| No. of Underlying Loans | 114,870 | 107,410 | 7,460 |
| Weighted Average Underlying Loan Balance | $475,363 | $463,440 | $604,956 |
| Weighted Average LVR | 65% | 65% | 69% |
| Weighted Average Seasoning | 30 months | 30 months | 27 months |
| Weighted Average Interest Rate | 3.67% | 3.54% | 5.06% |
| Owner Occupied | 65% | 65% | 67% |
| Interest Only | 24% | 24% | 24% |
| 90+ Days in Arrears as % of Loans | 0.41% | 0.35% | 1.02% |
| % Loans > $1.5m Balance | 0.89% | 0.74% | 2.58% |

[3] Please note that although the values in this Investment Report are accurate portfolio statistics, the return and performance of actual credit instruments invested in are assessed individually.

[4] Non-conforming loans are residential mortgage loans that would not typically qualify for a loan from a traditional prime lender and are generally not eligible to be covered by LMI. Borrowers may not qualify due to past credit events, non-standard income (self employed) or large loan size.

### ABS Sector Allocation

| Sub sector | % | A | BBB | BB | B |
|---|---|---|---|---|---|
| ABS SME | 14.6% | 3.0% | 6.1% | 4.0% | 1.5% |

### SME Portfolio Underlying Mortgage Loan Statistics[5]

| | |
|---|---|
| No. of Underlying Loans | 4,245 |
| Weighted Average Underlying Loan Balance | $476,817 |
| Weighted Average LVR | 58.7% |
| % > 80% LVR | 0.20% |
| Weighted Average Borrowers' Equity | $335,952 |
| 90+ Days in Arrears as % of Loans | 0.19% |
| % > $1.5m Current Balance | 1.20% |

| Borrower Type | |
|---|---|
| SMSF | 74.4% |
| Company | 13.3% |
| Individual | 12.4% |

| Property Type | |
|---|---|
| Residential | 36.4% |
| Commercial | 62.6% |
| Mixed | 1.0% |

[5] Please note that although the values in this Investment Report are accurate portfolio statistics, the return and performance of actual credit instruments invested in are assessed individually.

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**ASX release date: 17 August 2020**

**Authorised for release by One Managed Investment Funds Limited, the responsible entity of Gryphon Capital Income Trust.**