Companies&Markets

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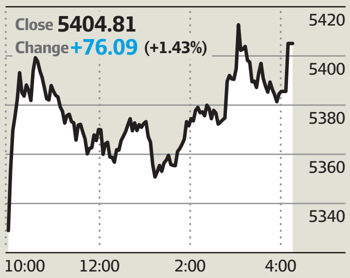
Payments Tap-and-go boom comes at a cost **p17**

Maley Bankers hope to dodge bad debt tsunami **p28**

Market snapshot

S&P/ASX 200 Index (points)



S&P/ASX 200 stocks Friday

Best	Close ($)	Change (%)
Silver Lake Res	2.15	+8.86
Gold Road Res	1.655	+7.12
GrainCorp	3.93	+7.08
Saracen Min	5.05	+6.99
Resolute Min	1.085	+6.90

Worst		
Xero fpo	75.32	-5.58
United Malt Grp	4.10	-4.43
ARB	15.37	-4.00
Boral	2.51	-2.33
DEXUS	8.73	-2.24

Indices	Close (points)	Change
ASX 200	5404.8	+76.1
Nikkei	20037.47	+122.69
Hang Seng (pm)	23797.47	-32.27
Shanghai A	3006.78	-2.02

Currency		Change
TWI	57.2	+0.3
$A/US¢	64.47	+0.12
$A/¥	69.08	+0.31
$A/€	0.5930	steady
$A/£	0.5297	steady

Rates	Close (%)	Change
Cash rate	0.25	steady
180-day bills	0.135	steady
10-yr bonds	0.919	-0.004

Commodities	Close ($US)	Change
Gold (spot)	1741.00	steady
Iron ore	93.65	+1.48
Oil WTI	29.43	+1.87

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Banks warned: Don't pull the plug too early

James Frost

The small business ombudsman has urged banks to support businesses well beyond the hibernation stage of the COVID-19 crisis, as lenders prepare to "check in" at the end of June with borrowers who requested a repayment holiday.

Banks have been clear that borrowers who have reached their borrowing limits should not be extended more credit, while Commonwealth Bank said last week it wanted customers to cut holidays short where possible.

But Australian Small Business and Family Enterprise Ombudsman Kate Carnell said it was important for banks not to jump the gun on relaxed lending conditions, because many businesses might not fully recover from the crisis until late 2021.

"The banks need to be reasonable. Don't pull the plug too early," she said.

"Banks have the capacity to call a loan in if you can't repay. I would hope that in the current environment that would be their last resort, because it's going to take between 12 and 18 months for some of them to get back on track."

Banks have deferred 703,000 loans worth more than $210 billion to date. Around 274,000 of those loans, worth more than $56.5 billion, are made up of business loans, personal loans and credit cards. The remainder is residential mortgages.

Banks have gone to considerable lengths to educate borrowers the loans being made available through the SME Coronavirus Guarantee and other measures are not "free money". Interest is typically capitalised on paused loans.

Ms Carnell said banks needed to be flexible when the payment holidays ended because few businesses that needed help would be in a position to make larger monthly payments.

"There are costs to deferring your business loan," she said. "It's important the banks give borrowers the ability to increase payments or extend the terms of the loan. They should have a choice."

As demand for new loans is eclipsed by the number of customers seeking help, banks have needed to hire new staff and redeploy existing employees where needed.

Australian Banking Association CEO Anna Bligh said banks had hired 1500 new employees and redeployed 2200 staff.

"Banks are here to support customers throughout the crisis and help the economy on the other side as we recover from the devastating effects of this pandemic," Ms Bligh said.

NAB has ramped up the number of staff on the front line by more than 500, taking the total number of additional staff dealing with customer inquiries since the crisis began to more than 1000.

Its latest intake of specialists includes 400 external hires and the redeployment of 100 existing staff, who will begin reaching out to customers who have taken up payment holidays.

NAB chief customer experience officer Rachel Slade said the bank had paused repayments on the home loans of 80,000 customers but wanted those able to make repayments to start doing so. "We don't want our customers to be in debt any longer than they need," she said. "We want our customers to choose what's best for them."

The team managing NAB's outbound calls would spell out the current position of the customer's home loan, the impact on the payment holiday on their balance and inquire about their ability to begin repayments.

"Already in the past week we've had hundreds of customers proactively contact us to reverse their home loan deferrals and resume making

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Revolution's Bob Sahota says he's hoping for more knock-out trades, as foreign investors retreat to their home markets. PHOTO: PETER BRAIG

Crisis is even better than GFC for this credit investor

Monday fundie Bob Sahota is sitting on $70m of 'dry powder'.

Jemima Whyte

During the GFC, credit investor Bob Sahota thought he had done the best deal of his career. Opportunities like it simply don't come around twice in a lifetime, he thought.

But he got it wrong. The COVID-19-crisis has delivered him something better – and there may well be more.

Sahota, the former head of fixed income at Challenger, founded Revolution Asset Management 2½ years ago and now manages nearly $400 million. He says the departure of offshore funds from the local market is giving him a rare opportunity to cheaply buy high-grade investments.

"I thought 2008 gave me the best deals of my career," the muscle-car collector says, noting his fund is sitting on about $70 million of "dry powder" in funds ready to be invested.

"The best opportunities so far are the offshore guys who tell us we find better value elsewhere in our own market and divest out of core [Australian] holdings."

The deal that eclipsed his previous personal best (a 2008 takeout of Goodman Group debt) was the fund's purchase in March of $11 million worth of triple-A, residential mortgage-backed

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NEXTDC's Melbourne centre is no longer the problem child

Yolanda Redrup

NEXTDC's second Melbourne data centre has transformed from the ugly duckling of its sites into a beautiful swan in a matter of months, according to analysts and investors who are bullish about the immediate and long-term prospects of the business.

Since March the business has contracted an additional 12 megawatts worth of deals to its Melbourne facilities, compared with less than 4MW in the previous four years.

On top of the 12MW of contracts, the company's customers have expansion options to add another 33MW.

This brings potential demand from existing customers to 60MW, leaving little room for further sales in its M1 and M2 sites and supporting the

Due diligence

construction of a third Melbourne location.

"Melbourne has swiftly emerged as NEXTDC's most dynamic market," Canaccord Genuity senior analyst Conor O'Prey says.

"Six months ago we were worried that M2 was a fast-depreciating asset, situated in a new availability zone and with little hyperscaler activity evident. The first-half 2020 results revealed only modest sales at M2, but a little over four months later, if all options are exercised, M2 looks to be sold out and the focus now turns to acquiring a site for M3.

"The firm and optional capacity sales will take some time to take up residence in M2, leaving time to procure a site for M3 followed by construction of the asset. Assuming no more capacity sales, and assuming NXT exits the 2020 financial year billing on 46MW of capacity, [this] implies a near 20MW gap between current and future billings, offering line of sight over an additional 30 per cent of facility occupancy."

NEXTDC builds hybrid data centres, which cater to both the retail and wholesale customers. Retail data centre deployments tend to be smaller contracts, which rely on the data centre providing additional services like connectivity to cloud providers and on-site staff. Wholesale contracts are those where businesses with large footprints, like banks, rent the space and power but provide their own services.

Hyperscale contracts, or "hyperscalers", are a form of wholesale contract. At the moment there are three main hyperscalers – Amazon Web Services, the Google Cloud Platform and Microsoft's Azure.

Speaking to *The Australian Financial Review*, Citi analyst Siraj Ahmed agrees with O'Prey's assessment, saying M2 has taken time to get going but is now firing on all cylinders.

"It was slow. But typically once one hyperscaler comes to the region, others follow and we're seeing that now," he says. "There was one in March, now another [in May] and there will be others. Sydney had been the key market, but now it looks like some players are coming to Melbourne."

NEXTDC has been one of the most resilient stocks throughout the COVID-19 downturn, trading comfortably up for the year to date.

In January the data centre business traded between $6.50 and $7.50. Even during the worst of the market sell-off, it never dipped below this. It has been trading at record highs this month, now fetching about $9.35.

In April, NEXTDC announced a $672 million capital raising to fund the initial phases of S3, along with other growth initiatives. Analysts and investors had been anticipating a raising but the size shocked a few.

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Crisis even better than GFC for this investor

securities (RMBS) from a large non-bank originator in Australia.

The fund was able to buy the debt at a 10 per cent discount to par value, delivering a current yield of 6.5 per cent, on a weighted average loan-to-value ratio of 69 per cent across the 1200 remaining mortgages for the next 30 months.

Sahota says he's hoping for more knock-out trades, revealing he's negotiating on some other deals with offshore managers, although he doesn't want to go into more detail.

Revolution is one of a handful of funds that have recently been set up to invest in credit markets, an area traditionally dominated by major banks and one of the few asset classes, Sahota says, that can deliver income in a yield-starved environment.

Revolution is targeting returns of 4 per cent to 5 per cent above the cash rate, and in the past year has delivered 5.77 per cent above the cash rate, before fees, in its first-round fund.

The average credit rating is BB, and the credit duration is 2.4 years. Revolution's new second fund has returned 0.84 per cent above the cash rate, before fees, in the last three months.

The manager focuses on lending to fund leveraged buyouts and acquisitions as well as real estate. It also invests in securitisations of home loans, personal and business loans, and aircraft leases.

In the first fund, asset-backed securities and leveraged buyout loans make up most of the loans, with commercial property accounting for 7 per cent.

"We've only done one [property] deal since we started 2½ years ago," Sahota says.

"What we find is through these sorts of dislocations there could be some very good opportunities in refinancing coming out of the banks, which typically price very tightly."

So far, the fund has seen one deal it liked, but it missed out on "by a very small margin" on pricing. Sahota says that property loans, which he expects will be priced at 400 basis points to 500 basis points over swap if banks step back, could be "quite an interesting opportunity in the next 12 to 18 months".

Partly completed residential property deals, he says, have been an easy place to make double-digit returns, but "we're really going to understand if you are going to get the money back".

They have no interest in being distressed debt managers, says Sahota, who is working from his Sydney CBD office. As for the broader economy? Sahota says the fund is running aggressively negative assumptions, including 12 per cent unemployment and a 30 per cent decline in house prices.

"We're fixed income guys. We see things half empty, we're always going to be more conservative," he says. " We don't have upside in getting better than getting our money back."

He expects the next 12 months will be "quite tough" for a whole range of businesses, not just partly completed residential projects.

> **We're fixed income guys, we see things half empty, we're always going to be more conservative.**
> Bob Sahota

"There's going to be a number of industries and businesses that will sadly not make it through. Some of them were fairly marginal businesses prior to COVID and then there's the ones that have born the brunt – retail, tourism, to some extent mining services, property deals."

While Sahota expects some businesses won't make it through in coming months, he disagrees with the idea that it will be credit and hedge funds, rather than banks, that call in administrators first. The fund always tries to buy what he calls "sleep at night credits", but if they go wrong, a forced sale is the last option.

He says the fund is involved in one business where revenue has disappeared overnight, but it has 18 months of "oxygen" on the balance sheet.

"We're going to work with them to get through, rather than pressing the nuclear button and sell the business – it's in no one's best interest to sell in this environment, once through the pandemic things are going to get better."

As a manager who has a large part of his portfolio in asset-backed securities, Sahota, like much of the market, says he welcomes the support by the Australian Office of Financial Management.

As for leveraged buy-outs?

"There's no way it can go at the pace of 2019," he says. "But while the primary market might be subdued, we have ample opportunities to buy secondary."

Sahota was pleased to see some action in the leveraged buyout market when Madison Dearborn Partners kicked off a $725 million raising for its acquisition of APM, the country's largest provider of disability employment services. It wants to raise the funds in tranches worth $500 million and $225 million and told banks and credit funds it was willing to pay about 550 basis points and 950 basis points above the swap rate for each.

The raising – and public terms – threw up another long-simmering, but rarely public aired, matter in the sector: arranging fees, and whether they should always go to the fund's investors.

"For us it's clear. This is part of the core economics of the deal, both an upfront arranging fee and running margin," he says. "You can really shift the mix between the upfront and the margin. If you've got an interest in taking some of the fees … it really does bring about a misalignment between your and your clients.

"This sort of stuff happened pre-2007 and I was surprised it reared its ugly head again. Some are wise to it, and others think it is part of the industry."

Outside investing, Sahota is pursuing his passion for Australian muscle cars, especially Ford Falcon GTs and GTHOs of the 1970s.

"It's the only thing that keeps me sane at the moment," he says. "It is very nostalgic, very analogue in a very digital world, and with manual gearboxes which most people can't even use any more. It takes you away. And it's actually been a fantastic investment."