

MCP Master Income Trust (MXT)

Date: 5 February 2018



Investment Rating Report

Investment Rating: **SUPERIOR**

Product Complexity: **BLUE - Relatively Simple Product**

Fund Details

Investment Manager: Metrics Credit Partners Pty Ltd

Investment Structure: Listed Australian Unit Trust

Wholesale/Retail: ASX listed – Wholesale & Retail

Category: Australian Credit

Investment Style: Diversified Australian private corporate credit

Inception: 9 October 2017

Management Fee: 0.60% p.a.

Performance Fee: May be payable by sub funds, waived if target return not achieved

Responsible Manager/Entity: The Trust Company (RE Services) Ltd

Investment Objective

The objective of the Trust is to generate monthly cash income (minimum target rate is RBA Cash plus 3.25% p.a. net of fees), low risk of capital loss and portfolio diversification by actively managing a well-diversified portfolio of Australian corporate loans.

Review Summary

The MCP Master Income Trust (MXT) is an ASX listed investment trust investing in the Australian direct corporate loan market, a sector which is dominated by bank investment.

The characteristics of a well-diversified corporate loan portfolio are very low capital volatility, regular income flow (monthly) and a significant return margin compared with cash and short term cash securities.

The active management team at Metrics Credit Partners is strong and very experienced in this sector and has completed over \$3.75 billion in corporate loan transactions since fund inception in 2013.

MXT offers monthly income, targeted at RBA Cash Rate plus 3.25% p.a., together with a low risk of capital loss through investment in a well-diversified and actively managed portfolio of corporate loans. As the investments of MXT are untraded, the liquidity of the Trust may be affected by the performance of the underlying loans. In addition, ASX listed MXT may at any time trade above or below the net asset value of the underlying securities.

This is an attractive investment on a risk-return basis offering well managed, well diversified investment in a sub-asset class that would otherwise be difficult to access for non-bank investors.

Investment Rating & Product Complexity Indicator

A SUPERIOR rating indicates the highest level of confidence that the Trust can deliver a risk adjusted return in line with its investment objectives. The investment manager support for this strategy is very experienced and well-resourced with a solid track record.

Designation as a Relatively Simple Product indicates that the investment manager will seek to outperform their chosen market sector, in this case the Australian corporate loan market. The investment, equity funded corporate loans, currently has no core leverage.

The strategies used to outperform, while requiring a depth of market experience and due diligence, are completely compatible with normal market practice. This includes the potential conversion of debt to equity in a restructuring, where the strategy is designed to limit capital loss/preserve investor capital.

Performance & Return

(%)	Oct	Nov	Dec	YTD
2017	0.46	0.35	0.41	1.23

Number of individual investments	69
Investment Grade (%)	74%
Interest duration (days)	24
Credit duration (years)	2.1

Source: MCP 31 December 2017

Fund Details

Fund name	MCP Master Income Trust (MXT)
Dominant strategy	Income generation through diversified investment in Australian corporate credit
Investment structure	Listed Australian Unit Trust
Responsible Entity	The Trust Company (RE Services) Ltd; ACN 003 278 831, AFSL 235150
Investment Manager	Metrics Credit Partners Pty Ltd; ACN 150 646 996, AFSL 416146
Custodian	Perpetual Corporate Trust Ltd; ACN 000 341 533, AFSL 236643
Administrator & Unit Registrar	Mainstream Fund Services Pty Ltd; ACN 118 902 891, AFSL 303253
KEY FEATURES	DESCRIPTION
Inception	MXT was listed on the ASX 9 October 2017
Legal form	Listed Investment Trust
Geographic mandate	Australia
Market Cap	A\$ 537m as at end December 2017
Net Asset Value	A\$ 517m as at end December 2017
NAV Pricing	Daily
Asset Class	Fixed Interest
Asset Sector	Direct Australian corporate debt
Investment Management fee	Declining rate dependent on Market Cap – expected to be circa 0.24% p.a.
Performance fee	May be payable by sub-wholesale funds, waived if target return of the Trust not achieved
Offer establishment costs	Approximately 0.22% pa
Responsible Entity Fee	0.03%
Distributions	Monthly
PRIMARY CONTACT	
e-mail address	invest@metricscredit.com.au
Telephone number	1300 010 311
Address	2 Ridge Street, North Sydney
Website	www.metricscredit.com.au

Investment Profile

HISTORY/BACKGROUND

Sydney-based Metrics Credit Partners (MCP), the investment manager of the MCP Master Income Trust, was formed in 2011 as a specialist corporate lending manager. The four managing partners; Justin Hynes, Andrew Lockhart, Graham McNamara and Andrew Tremain, control 65% of MCP, via Metrics Credit Holdings Pty Ltd, with the remaining 35% equity owned by NAB.

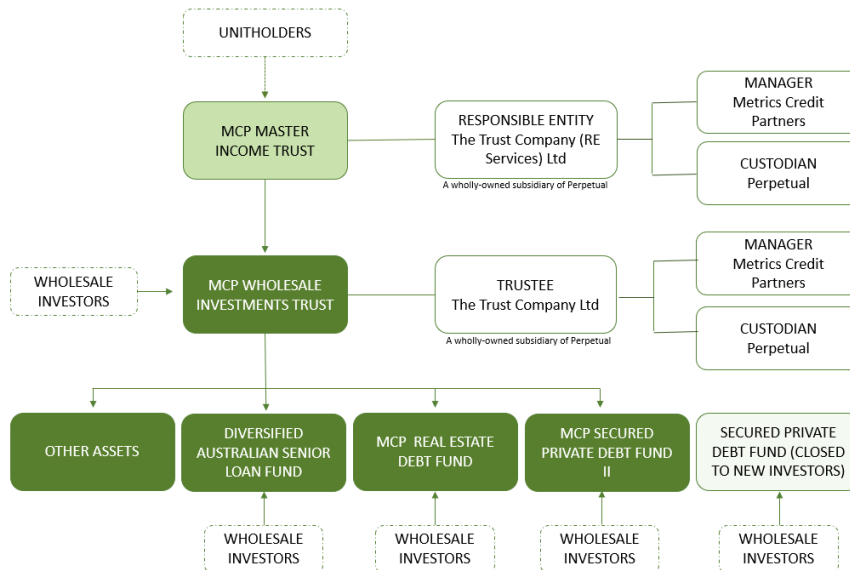
Prior to forming MCP, the partners collectively had extensive experience within banking environments in loan origination, corporate finance, credit analysis, credit portfolio management, leveraged and acquisition finance, syndicated loan transactions, distressed assets and distribution.

MCP launched its first wholesale fund, the Diversified Australian Senior Loan Fund in June 2013. This was followed by the MCP Secured Private Debt Fund in November 2015 (this fund has now closed to new investors). The MCP Real Estate Debt Fund and the MCP Secured Private Debt Fund II are relatively recent funds, having been launched in July 2017. The strategy for these funds is consistent with MCP's earlier funds.

MCP's wholesale funds have completed over A\$3.75 billion in loan transactions since inception. As at September 2017, investors in the wholesale funds comprised superannuation funds (35%), fund of funds (33%) and a mix of insurance companies, high net worth individuals and family offices.

Trust Structure

The ASX listed entity, the MCP Master Income Trust, was formed specifically for the purposes of raising capital through an IPO and providing increased liquidity to investors. The MCP Master Income Trust is a registered managed investment scheme which 100% invests into the MCP Wholesale Investments Trust, which in turn invests in several underlying MCP managed wholesale corporate loan funds.



As a guideline, the MCP Wholesale Investment Trust is expected to invest approximately 60% into the Diversified Australian Senior Loan Fund, and 20% respectively into the MCP Real Estate Debt Fund and the MCP Secured Private Debt Fund II. Details of the respective funds can be found in the Portfolio Construction section of this report.

OBJECTIVE

The objectives of the Trust are to generate monthly cash income (minimum target rate is RBA Cash plus 3.25% p.a. net of fees), maintain a low risk of capital loss and achieve portfolio diversification by actively managing portfolios and participating in Australia's bank-dominated corporate loan market. The Manager seeks to implement active strategies designed to balance

delivery of the target return, while seeking to preserve investor capital, from an actively managed loan portfolio, with a low risk of capital loss. The manager seeks to achieve this objective by investing in a well-diversified portfolio of Australian corporate loans. In Australia investment in this asset sector is dominated by banks. The Manager seeks to implement active strategies to achieve these objectives.

FUNDS UNDER MANAGEMENT

The market capitalisation of the MCP Master Income Trust (MXT) was \$537 million, with a Net Asset Value of \$517 million as at end December 2017. The fund manager, MCP, currently manages approximately \$2.7 billion, all of which is equity funded, across five wholesale funds.

FEES

The fees payable on this investment are effectively wholesale management fees, with a sliding scale that has benefitted from the success of the IPO in raising over \$500m. The management costs are comprised of:

- Responsible Entity fee
- Investment Management expenses, and
- Recoverable expenses (essentially the cost of the IPO)

Responsible Entity fee	Estimated at 0.03% p.a.
Investment Management expenses	Estimated at 0.24% p.a.
Recoverable expenses	While this includes initial offer costs, it has not been charged as an upfront cost to the Trust. The expense will be recovered from the fund over the life of the Investment Management Agreement. Estimated cost to unitholders is 0.33% p.a.

The fees above are estimated for the current market cap of over \$500m. The fee range for amounts less than \$500m up to \$500m is 0.60%.

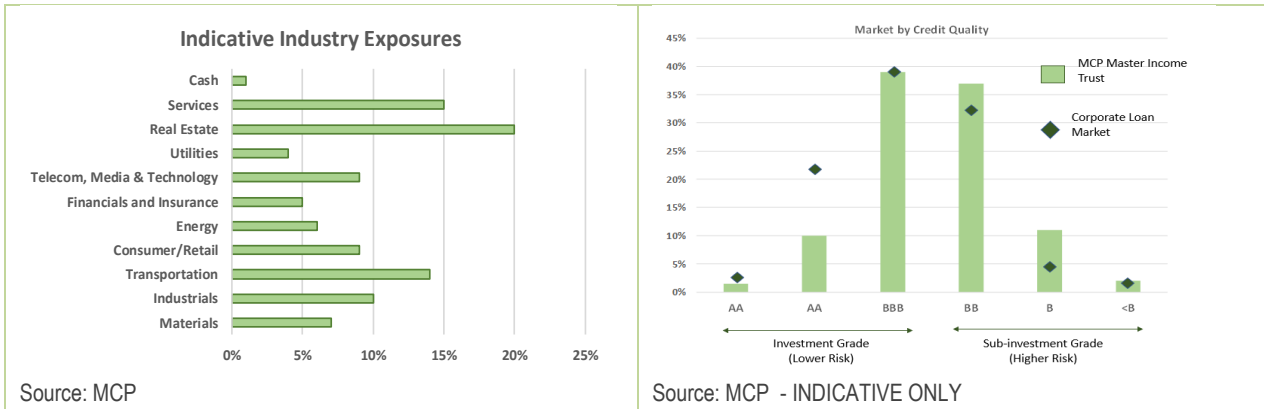
Investment Management Fee Note

The MCP Master Income Trust does not itself charge ongoing investment management fees. However, as it sub-invests in the Wholesale Master Income Trust, which in turn invests in other wholesale funds, management fees are incurred for the underlying investments. The main sub-trusts are:

	Management Fee	Performance Fee	Indicative exposure
Diversified Australian Senior Loan Fund (sliding scale)	<ul style="list-style-type: none"> – < A\$100m 0.30% – A\$100–200m 0.25% – A\$200-500m 0.20% – > A\$500m 0.175% 	nil	60%
MCP Real Estate Debt Fund	0.20%	15% capped at total IMF of 0.75%	20%
MCP Secured Private Debt Fund II	0.20%	15% capped at total IMF of 0.75%	20%

INVESTMENT UNIVERSE

The MCP Master Income Trust invests in a portfolio of direct credit; that is untraded corporate loans which broadly reflect activity in Australia's corporate loan market, diversified by borrower, industry and credit quality. Borrowers will be Australian domiciled (>80%), while the loans may be secured, unsecured, senior or sub-ordinated, investment grade or sub-investment grade.



Although typically the investments will be direct loans to Australian companies, the investment mandate of the sub-trusts give the Trust the ability to use other financial instruments in certain situations. These are listed in the table below. In a workout the Trust may hold options, equity and warrants, which carry a greater risk of loss than debt securities should the borrower become insolvent.

Other Allowable Investments

The mandates of the funds in which MXT invests also allow the Trust to acquire the following physical and derivative instruments:

Instrument	How the instrument might be used/acquired
Cash and commercial paper	– part of portfolio cash management
Revolving Line of Credit	– while the loans to counterparties are not leveraged, MCP has access to a line of credit to assist with cash flow management.
Bonds, convertible notes & hybrids	– to assist with portfolio diversification
Options, equity and warrants	– risk management – where required in a workout scenario
Credit default swaps	– sold where the underlying asset is held by an investment grade counterparty, or – bought as part of risk management strategies
Credit linked notes	– to assist with portfolio diversification
Foreign exchange & interest rate swaps or options	– risk management

While the derivatives above are allowed in the sub-trust mandates, since inception MCP has not entered into any derivative transaction and is not expected to enter into such transactions based on current portfolio settings.

Note on Australian Bonds vs Australian Direct Credit (floating rate)

MXT is differentiated from other Australian fixed interest funds through its investment in direct corporate lending rather than traded bonds and cash securities. The corporate bond market is not well developed in Australia, due to the size of the market, cost of issuance for corporates and uncertainty in the amount that can be raised through a bond issue.

The size of the untraded corporate loan market in Australian is estimated to be approximately \$1.1 trillion. As at September 2016, 78% (approximately \$872 billion) of the Australian corporate loan market was provided by way of corporate loans (Source: ABS). Lending is concentrated amongst the four major Australian banks, which together provide approximately 75% of all Australian corporate loans (Source: APRA Monthly Banking Statistics, March 2017).

There are, however, significant constraints on banks due to capital adequacy requirements. MXT, being 100% equity funded, is well placed to compete against banks for deal flow, and is more agile in the selection of the borrowers it will lend to.

For investors, the two sub-asset classes have the following respective advantages:

Corporate Bonds	Direct Corporate Credit
<ul style="list-style-type: none"> ▪ Liquidity⁽¹⁾ ▪ Price Transparency⁽²⁾ ▪ Potential capital gains 	<ul style="list-style-type: none"> ▪ Diversification – better spread of industry sectors ▪ Lower price volatility – direct credit is normally priced relatively close to par ▪ Capital recovery in the event of default can be significantly enhanced through: <ul style="list-style-type: none"> – Specific debt covenants – Seniority – Collateral, and – Experience of the lender in workout and recovery situations ▪ Potentially higher margins over floating rate due to illiquidity, complexity of loan offer and reduced accessibility of debt providers

- (1) **Liquidity** – The structure of MXT, a listed trust, gives investors significantly enhanced liquidity for the investment in direct corporate credit.
- (2) **Price transparency** – MXT publishes Net Asset Value (NAV) on a daily basis. The process for calculation of NAV is detailed in the “Investment Process” section of this report.

Investment Objective

To provide **monthly cash income** with a low risk of capital loss and portfolio diversification by actively managing diversified loan portfolios and participating in Australia’s bank dominated corporate loan market. The Manager seeks to implement active strategies designed to balance delivery of the target return, while seeking to preserve investor capital.

Investment Strategy

The Trust’s investment strategy is to create a diversified exposure to Australian corporate loans generally reflecting activity in the corporate loan market and with the resultant diversity by borrower, industry and credit quality. Through active portfolio risk management, MCP will seek to preserve investor capital.

The strategic objectives in forming the wholesale fund-of-fund, MCP Wholesale Investments Trust, and listing MXT include:

- Increase scale of portfolio(s) to provide meaningful market/investor liquidity
- Use scale to offer retail investors a wholesale fee structure
- Reduction of borrower risk. In the medium term the target number of borrowers is 75 – 100, with no more than 5% of trust assets going to a single borrower. The Trust does not intend to invest in the banking sector.
- Lower the capital and income volatility
- Enhanced liquidity enabling portfolio adjustment
- Leverage off the increase in access to deal flow and industry reputation by increasing market size in this sector.

Investment Process

The process undergone by the investment team can be classified into the following areas:

- Portfolio construction
- Asset origination

- Due diligence
- Investment decisions
- Ongoing asset management

The Investment Committee, comprising the four Managing Partners, meets daily to oversee all aspects of the process. It is responsible for investment decisions, portfolio and industry monitoring and ensuring compliance with mandates.

Portfolio construction	Portfolio construction considers the relevant target portfolio settings, and MCP's view on the broader economy, relative industry value and preferred risk setting. Potential new loans are assessed for the impact on the portfolio. Considerations include the type of investment, the target fund returns, the desired mix of tenor to maturity, aggregated exposure by industry group, credit quality and portfolio liquidity.
Asset origination	MCP maintains a transaction/investment pipeline, monitoring opportunities as well as the fund's maturity profiles. The time from identification of a potential transaction to successful conclusion can be anything from 3mths to 18mths. Once identified, a marketing strategy is devised for a target investment, well ahead of the borrower coming to market. As the potential for acquiring a loan asset becomes nearer, more detailed analysis is conducted. The secondary market is also constantly monitored for asset purchase opportunities. The three main sources of pipeline assets are via direct origination, the syndicated loan market and the secondary loan market.
Due diligence	<p>MCP estimates that approximately 1 in 20 of the loan opportunities that it identifies proceed to full due diligence. Investment papers are prepared for consideration of new investments. These papers are rigorous and detailed. The key focus is the identification of risks and an analysis of how such risks are to be mitigated.</p> <p>External reviews and due diligence from acceptable independent consultants are also required by MCP, at the borrower's cost. These cover risk areas such as tax & accounting, financial, technical, commercial and legal issues relevant to the transaction.</p> <p>Restricted industries: MCP will not invest in where a business may impact reputational risk, including companies that are connected with pornography, tobacco, violation of labour laws, tax avoidance schemes, or weapons manufacture and distribution.</p>
Investment decisions	<p>Using the detailed due diligence/credit analysis investment papers, consideration is given to:</p> <ul style="list-style-type: none"> ▪ portfolio limits – credit, maturity, senior debt minimums etc ▪ portfolio liquidity ▪ industry limits including restricted industries ▪ foreign currency limits ▪ individual and aggregated exposure limits
Ongoing asset management	<p>Loan assets and industries are continuously monitored to ensure the ongoing robustness of portfolio assets.</p> <p>The MCP team's extensive history in loan portfolio management allows them work with borrowers to seek the best investor outcomes to mitigate the likelihood of default and to recover capital in the event of default.</p>

Asset Pricing

MCP and its external valuation consultant, an international accounting firm, closely monitor the Australia credit market in calculating the Net Asset Value (NAV) of the Trust on a daily/monthly basis.

The primary valuation risk lies in either negative credit migration, ie an increased likelihood of default through either changes in the borrower's ability to service the loan or in industry/sector macro-economic factors and sector credit margin changes.

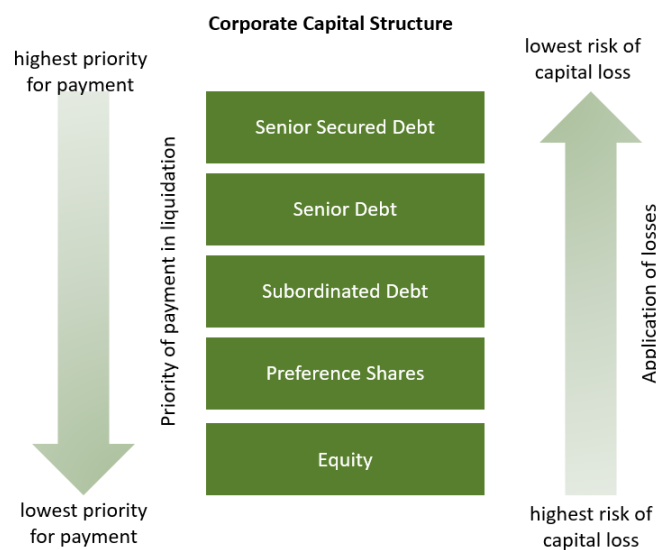
Potential reductions in loan valuation can be reduced substantially on loans which are structured effectively using loan covenants, tenor and seniority. Note that in Australia there is a high level of lender protection due to the regulatory and legal framework.

Taking the valuation factors for MXT's loan portfolio of corporate loans together; buy-to-hold, good use of covenants and seniority, the regulatory framework and the risk targeted due diligence by MCP, the indication is that there will be a high level of capital stability, with the Trust assets being priced at close to par.

Note on Corporate Capital Structure

It is important to compare the risk of capital loss from a corporate debt portfolio with the potential loss from investing in an equity portfolio. In Australia, corporate loans are normally ranked as senior secured, senior unsecured or subordinate/mezzanine debt. In the event of a corporate default scenario, all debt must be paid before there is any return to equity holders.

This is a simple example of the relative risk of each asset sector:



Portfolio Construction

The MCP Master Income Trust invests, via the MCP Wholesale Investments Trust, in three underlying wholesale trusts in varying proportions at the discretion of the Manager. The three funds, key characteristics and expected investment in each are:

Fund	Key Objectives	Expected Investment
MCP Diversified Australian Senior Loan Fund	<ul style="list-style-type: none"> - target average credit BBB-/BB+ - >90% senior ranking loans - >80% Australia domiciled - Minimum target return 90day BBSW plus margin of 2.75% 	60-70%
MCP Real Estate Debt Fund	<ul style="list-style-type: none"> - >50% senior ranking loans - Minimum target return 90day BBSW plus 5% - Diversified wrt sector and geography 	10-20%
MCP Secured Private Debt Fund II	<ul style="list-style-type: none"> - 100% Australian domicile - Minimum target return 90day BBSW plus 4% - predominantly sub-investment grade assets 	20-30%

The three underlying portfolios each offer a diverse investment mix, with the differentiated credit, tenor and sector exposures giving the Investment Committee good flexibility in portfolio construction.

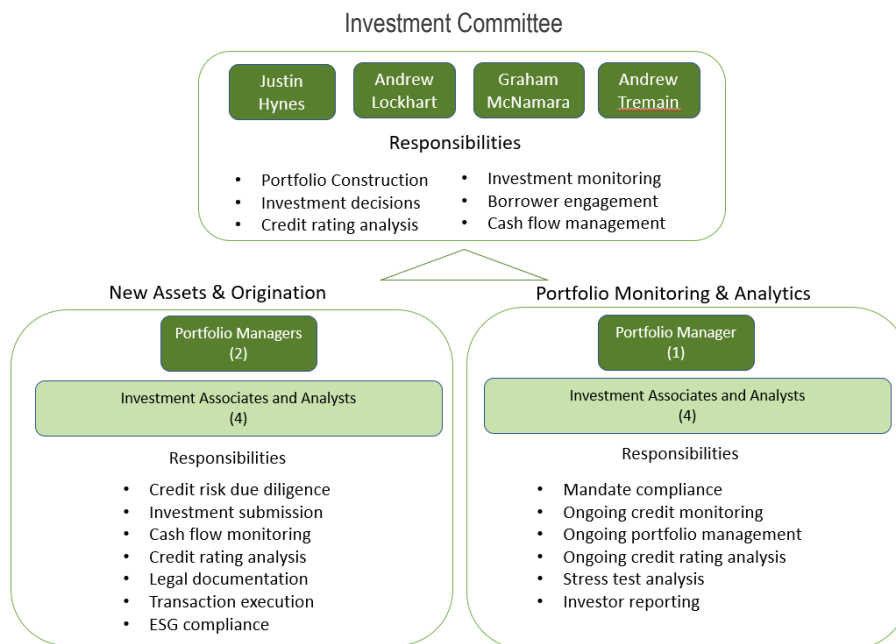
MXT Portfolio Risk Parameters

	Target Range	Limit
Total Investment Grade	50 – 75%	80%
Sub-Investment Grade	25 – 50%	50%
Minimum Senior Ranking	90 – 95%	>80%
Australian Domicile		>80%

Investment Team

The depth of experience of the investment team, particularly the Managing Partners, is a key differentiator for this investment. Direct corporate credit is a private and confidential market and the skills needed to succeed differ from the skills needed for the management of a publicly traded bond portfolio. Depth of experience is essential to good risk management and directly affects the ability to achieve a well-diversified portfolio with a low risk of capital loss.

Investment Team Structure



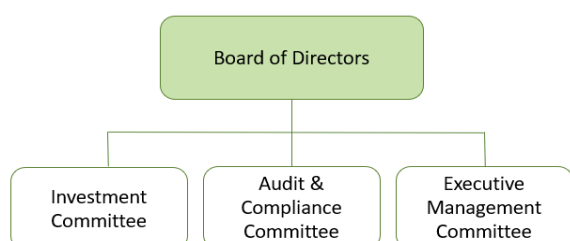
MCP is continuing to hire as their FUM increases.

Key Experience – Managing Partners / Investment Committee

Andrew Lockhart	<ul style="list-style-type: none"> Key responsibility is MCP Finance and Stakeholder Relations activities Andrew has approximately 30 years' banking, funds management and financial markets experience Andrew's specialist areas have included management of large, diversified and complex loan portfolios, leverage and acquisition finance, corporate and institutional lending and corporate and workout recovery
Justin Hynes	<ul style="list-style-type: none"> Key responsibility is MCP's operational activities

	<ul style="list-style-type: none"> Justin has approximately 20 years' financial market experience Justin's specialist areas have included leverage and acquisition finance, corporate finance, loan origination, structuring and portfolio management, and corporate workout and restructuring
Graham McNamara	<ul style="list-style-type: none"> Key responsibility is MCP's Risk Management & Compliance function Graham has approximately 37 years' experience in banking, funds management and financial markets Graham's specialist areas include portfolio risk management, debt origination and distribution, agency management corporate workout and recovery and corporate banking. He has established the loan syndications and agency business at major Australian banks Graham served as a director of the Asia Pacific Loan Market Association and was the founding chairman of the Association's Australian branch
Andrew Tremain	<ul style="list-style-type: none"> Andrew has approximately 30 years' Australian, European and Asian banking experience Andrew's specialist areas include corporate, structured, leverage and acquisition finance, loan syndications, portfolio management, corporate workout and recovery and relationship management

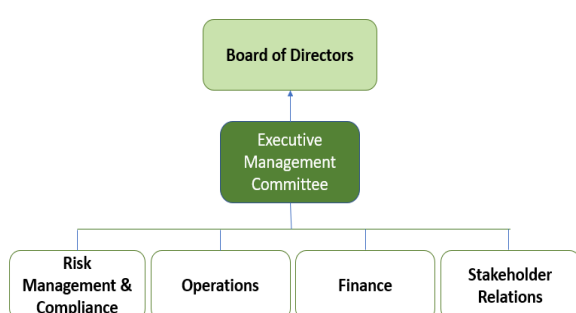
Business Management



The Board comprises three directors from MCH, one from NAB, and an independent Non-Executive Chairman.

The Board meets approximately six times a year'

NAB has no day to day operational or investment management role within MCP. The Investment Committee is entirely independent of NAB in its decision making and comprised exclusively of the Managing Partners.



MCP has distinct structures in place to separate the investment activities from operational aspects of the business, and all activities of MCP are subject to Board oversight.

The Executive Committee meets weekly, with each executive director delegated specific business line responsibilities.

The Executive is supported by external resources, organised along functional business lines.

Risk Management

- MCP: MCP has detailed policies and procedures addressing operational risk articulated in its Operational & Investment Policy Manual. These policies and procedures are reviewed and updated on an annual basis, and monitored and managed via the Executive Management Committee and the Audit and Compliance Committee.
- MCP Funds: Operational risks are identified, modified and mitigated via RE/trustees fund compliance plans as well as through various policies and procedures FundBPO and PCTL have in place.

Performance

1. MXT Performance

MXT was listed on 9 October 2017. As at December 2017 the Trust was 100% invested with a reasonable spread of asset sector and credit risk gained through investment in 69 loan facilities. MXT is committed to a number of new loan facilities closing early 2018.

The first distribution of 2.186c per unit represents an annual distribution rate of 4.75%. This distribution covered the period since inception. Going forward the Trust will distribute on a monthly basis.

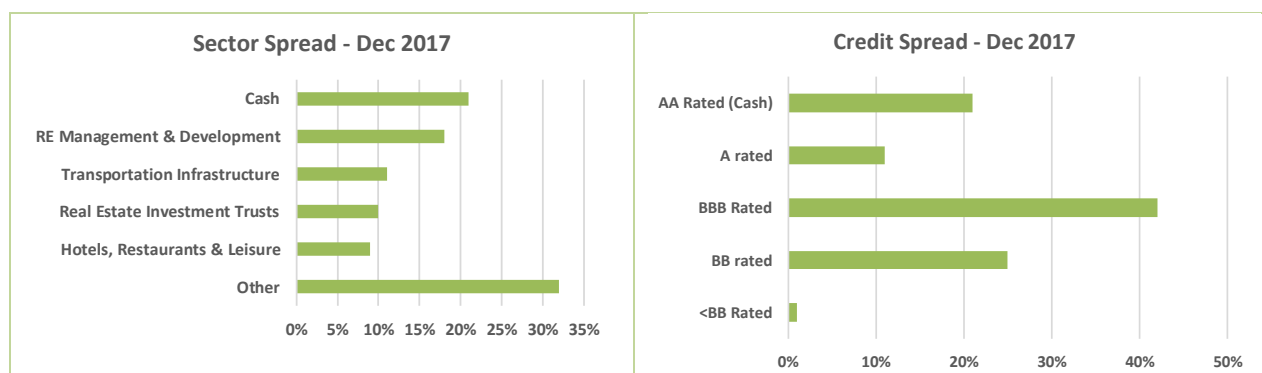
NET RETURNS (annualised)

(%)	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017										0.46	0.35	0.41	1.23

FUND SETTINGS (as at 31 December 2017)

Number of individual investments	69
Investment Grade (%)	74%
Interest duration (days)	24
Credit duration (years)	2.1

PORTFOLIO CHARACTERISTICS



2. MCP Diversified Australian Loan Fund

The MCP Diversified Australian Loan Fund will be the biggest contributor to the ongoing performance of MXT, with an expected 60% investment.

GROSS RETURNS (annualised)

	1 month	3 month	6 month	1 year	3 year	Since Inception
Portfolio Return	5.19%	4.83%	4.86%	4.72%	4.78%	5.36%
90-day BBSW	1.87%	1.78%	1.76%	1.74%	2.00%	2.23%
RBA Cash Rate	1.56%	1.53%	1.53%	1.50%	1.78%	2.04%

Source: MCP

- This Fund has an issuer rating of BBB+ / A-2 from Standard & Poor's.
- >90% senior debt and >80% Australian assets

Transparency & Reporting

MCP provides both standardised and bespoke reporting to its clients, depending on their individual reporting requirements. MCP is committed to being transparent. Standardised reporting comprises:

- Unit price is published daily and distributed to investors
- Monthly performance reporting
- Quarterly performance reporting with commentary
- Transaction confirmations and monthly holding statements (for wholesale investors in underlying funds)
- Audited annual accounts and regulatory reporting (including income tax and distribution statements).

Compliance

The MCP Master Income Trust is subject to the governance and compliance structure designed, implemented and monitored by the RE/Trustee. Compliance plans are in place to ensure that:

- duties and obligations as RE/trustees are met,
- key control activities exist to ensure compliance, and
- monitoring activities exist which identify whether controls are operating effectively.

The Trust is subject to both internal and external audit. MCP is externally audited by KPMG, including an audit of MCP's adherence to its obligations under its AFS licence. MCP has an Audit and Compliance Committee which reports to MCP's Board. This Committee comprises MCP's independent Chairman, a NAB appointed compliance professional and MCP's Executive Director, Risk & Compliance.

Third Party & Service Advisors

Fund administrator	Mainstream Fund Services Pty Ltd
Legal advisor	King & Wood Mallesons / Minter Ellison
Custodian	Perpetual Corporate Trust Ltd
Auditor	KPMG
Insurance provider	London Australia Underwriting P/L (on behalf of Lloyds of London)
Independent valuation	International Accounting Firm
Distribution services	Pinnacle Partners
Firm Accounting	Pitcher Partners
IT network provider	Telstra, cloud based
Portfolio software	Proprietary systems (Excel), HiPortfolio (Mainstream)

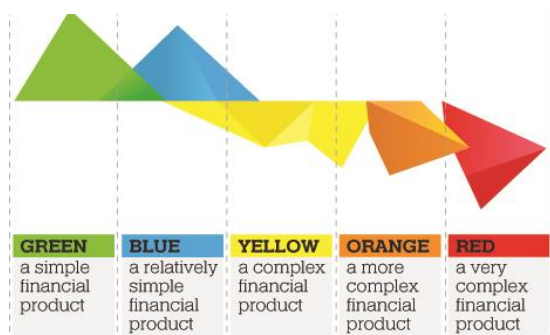
Investment Rating Scale

The Australia Ratings Analytics' investment rating is an opinion on how well we believe a fund will perform against a range of risks.

Rating	Definition
Superior	Indicates the highest level of confidence that the fund can deliver a risk adjusted return in line with the investment objectives of the fund.
Very Strong	Indicates a very strong conviction that the fund can deliver a risk adjusted return in line with the investment objective of the fund.
Strong	Indicates a strong conviction that the fund can deliver a risk adjusted return in line with the investment objective of the fund.
Competent	Indicates that the fund may deliver a return in line with the funds relevant benchmark.
Weak	Indicates a view that the fund is unlikely to deliver a return in line with the investment objective of the fund and/or meet the returns of its benchmark.

Product Complexity Indicator

A Product Complexity Indicator (PCI) highlights the complexity of an investment by its terms and conditions' structure and transparency that may affect the investor's return.



Credit Rating & Product Complexity Methodology

Australia Ratings Analytics' methodology for its investment rating and research can be downloaded from its website.

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