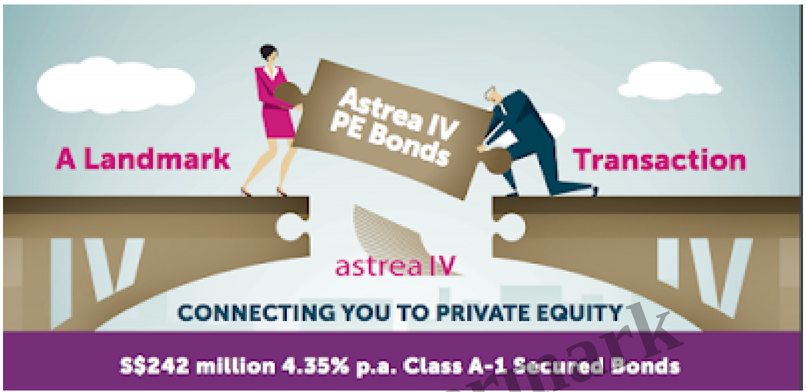
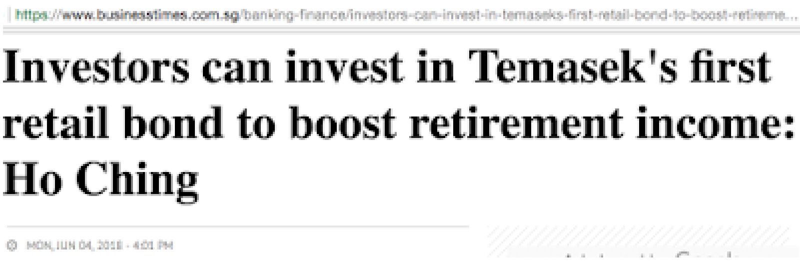
IPO Analysis: Is Astrea IV Private Equity Class A-1 bond worth a BUY?

Description

Astrea IV Class A-1 bonds are the talk of the town right now, and I've received so many DMs about this so I'm finally sitting down to evaluate and write this.



Details:
– The bond is launched by Astrea IV Pte. Ltd, which is an indirect subsidiary of Temasek
– 4.35% interest rate offered
– IPO applications **close at 12 noon on 12 June 2018**
– You can apply through ATM or online banking via DBS, POSB, OCBC or UOB
– Minimum subscription amount: S$2,000
– You CANNOT use your CPF or SRS funds to apply for this bond.
– Bond starts trading on SGX-ST on 18 June 2018


https://www.businesstimes.com.sg/banking-finance/investors-can-invest-in-temaseks-first-retail-bond-to-boost-retireme...

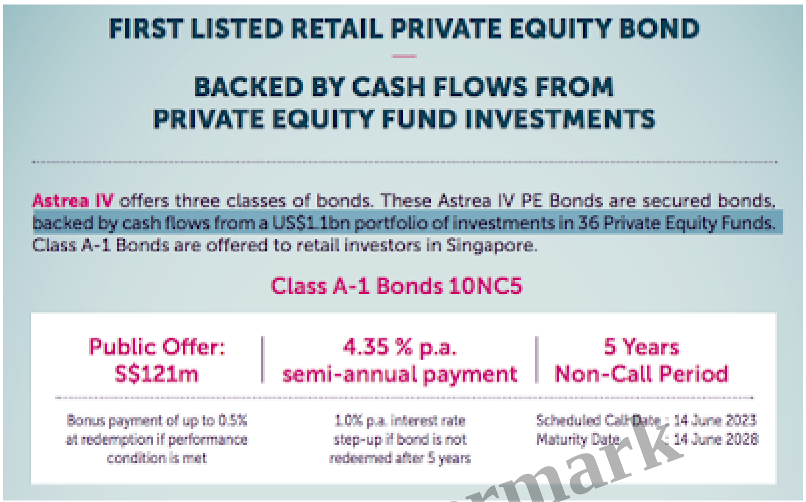
Investors can invest in Temasek's first retail bond to boost retirement income: Ho Ching

MON, JUN 04, 2018 - 4:01 PM

What are you *really* buying into?

Now, don't get misled by [the above headline published in The Business Times last week]() – this is NOT a Temasek bond. Rather, it is a bond issued by one of their subsidiaries.

This is a really new and unique asset class because they're neither government-backed nor corporate bonds. Instead, they're private equity bonds. This is the 4th private equity bond that is being issued by Astrea, and the first one that is being opened up to retail investors.



These Astrea IV Class A-1 bonds *("Astrea bonds")* will then be used to invest across 36 private equity funds, which are invested into 596 underlying companies. Traditionally, I would dig up details about the investment assets, but since there's 36 funds and almost 600 companies, that's an almost impossible task because much information isn't available about these private companies, and neither does anyone have that much time anyway to scour through all.

Astrea IV Portfolio

No.	Funds	Vintage	Geography	Strategy	Commit-ment (USD)	NAV (USD)	% of NAV	Undrawn capital commit-ments (USD)	Total exposure (USD)	% of total expo-sure
1	AB - B (Feeder) L.P.	2012	Europe	Buyout	26.0	28.9	2.6	3.6	32.5	2.6
2	Apollo Overseas Partners (Delaware 892) VI, L.P.	2006	U.S.	Buyout	100.0	22.4	2.0	4.2	26.6	2.1
3	Apollo Overseas Partners VIII, L.P.	2013	U.S.	Buyout	30.0	26.5	2.4	8.3	34.8	2.7
4	Bain Capital Fund XI, L.P.	2014	U.S.	Buyout	30.0	27.6	2.5	8.0	35.6	2.8
5	Blackstone Capital Partners V L.P. and BCP V-S L.P.	2006	U.S.	Buyout	133.6	15.3	1.4	6.7	22.0	1.7
6	Blackstone Capital Partners VI, L.P.	2011	U.S.	Buyout	100.0	101.2	9.2	14.4	115.6	9.1
7	Carlyle Partners VI, L.P.	2013	U.S.	Buyout	30.0	29.7	2.7	3.5	33.2	2.6
8	Clayton, Dubilier & Rice Fund IX, L.P.	2013	U.S.	Buyout	30.0	21.8	2.0	7.2	29.0	2.3
9	Crestview Partners (TE), L.P.	2005	U.S.	Buyout	40.0	5.5	0.5	0.4	5.9	0.5
10	Crestview Partners II, L.P.	2008	U.S.	Buyout	50.0	42.2	3.8	9.3	51.5	4.1
11	CVC Capital Partners VI (B) L.P.	2014	Europe	Buyout	24.6	21.2	1.9	3.2	24.4	1.9
12	DBAG Fund VI (Guernsey) L.P.	2013	Europe	Buyout	24.6	20.7	1.9	3.3	24.0	1.9
13	EQT Mid Market (No.1) Feeder Limited Partnership	2013	Europe	Buyout	36.9	34.6	3.2	5.1	39.7	3.1
14	Hahn & Company I L.P.	2011	Asia	Buyout	37.0	39.2	3.6	1.1	40.3	3.2
15	Industri Kapital 2007 Limited Partnership IV	2007	Europe	Buyout	92.2	1.7	0.2	3.2	4.9	0.4
16	IK VII No 2 Limited Partnership	2012	Europe	Buyout	72.6	65.2	5.9	3.5	68.7	5.4
17	KKR Asian Fund II TE Blocker L.P.	2013	Asia	Buyout	25.0	27.8	2.5	3.6	31.4	2.5
18	KKR 2006 Fund L.P.	2006	U.S.	Buyout	25.2	4.3	0.4	0.4	4.7	0.4
19	KKR North America Fund XI L.P.	2012	U.S.	Buyout	30.0	41.1	3.7	3.2	44.3	3.5
20	Littlejohn Fund V, L.P.	2014	U.S.	Buyout	20.0	17.1	1.6	5.8	22.9	1.8
21	MatlinPatterson Global Opportunities Partners III L.P.	2007	U.S.	Buyout	100.0	49.1	4.5	2.4	51.5	4.1
22	Onex Partners IV LP	2014	U.S.	Buyout	20.0	14.5	1.3	5.0	19.5	1.5
23	PAG Asia I LP	2011	Asia	Buyout	79.0	75.5	6.9	7.8	83.3	6.6
24	Permira V L.P.1	2014	Europe	Buyout	33.2	37.1	3.4	5.4	42.5	3.4
25	Silver Lake Partners III, L.P.	2007	U.S.	Buyout	35.0	16.1	1.5	3.7	19.8	1.6
26	Silver Lake Partners IV, L.P.	2013	U.S.	Buyout	65.0	71.3	6.5	10.2	81.5	6.4
27	Tailwind Capital Partners (Cayman), L.P.	2007	U.S.	Buyout	25.0	10.2	0.9	2.6	12.8	1.0
28	TPG Partners IV, L.P.	2003	U.S.	Buyout	30.0	2.7	0.3	0.1	2.8	0.2
29	TPG Partners V, L.P.	2006	U.S.	Buyout	175.0	41.6	3.8	11.4	53.0	4.2
30	TPG Partners VI, L.P.	2008	U.S.	Buyout	35.0	17.0	1.5	1.8	18.8	1.5
31	Vista Equity Partners Fund V-A, L.P.	2014	U.S.	Buyout	15.0	17.0	1.5	3.1	20.1	1.6
32	FountainVest China Growth Fund, L.P.	2008	Asia	Growth equity	31.0	29.8	2.7	4.5	34.3	2.7
33	Raine Partners I LP	2010	U.S.	Growth equity	10.0	13.4	1.3	0.4	13.8	1.1
34	Trustbridge Partners II, L.P.	2007	Asia	Growth equity	27.0	26.5	2.4	1.3	27.8	2.2
35	Warburg Pincus Private Equity XI-B, L.P.	2012	U.S.	Growth equity	75.0	65.3	5.9	2.2	67.5	5.3
36	Offshore Mezzanine Partners II, L.P.	2012	U.S.	Private debt	40.0	17.3	1.6	8.2	25.5	2.0
Total - Astrea IV Portfolio		**2011**			**1,752.9**	**1,098.4**	**100.0**	**168.1**	**1,266.5**	**100.0**

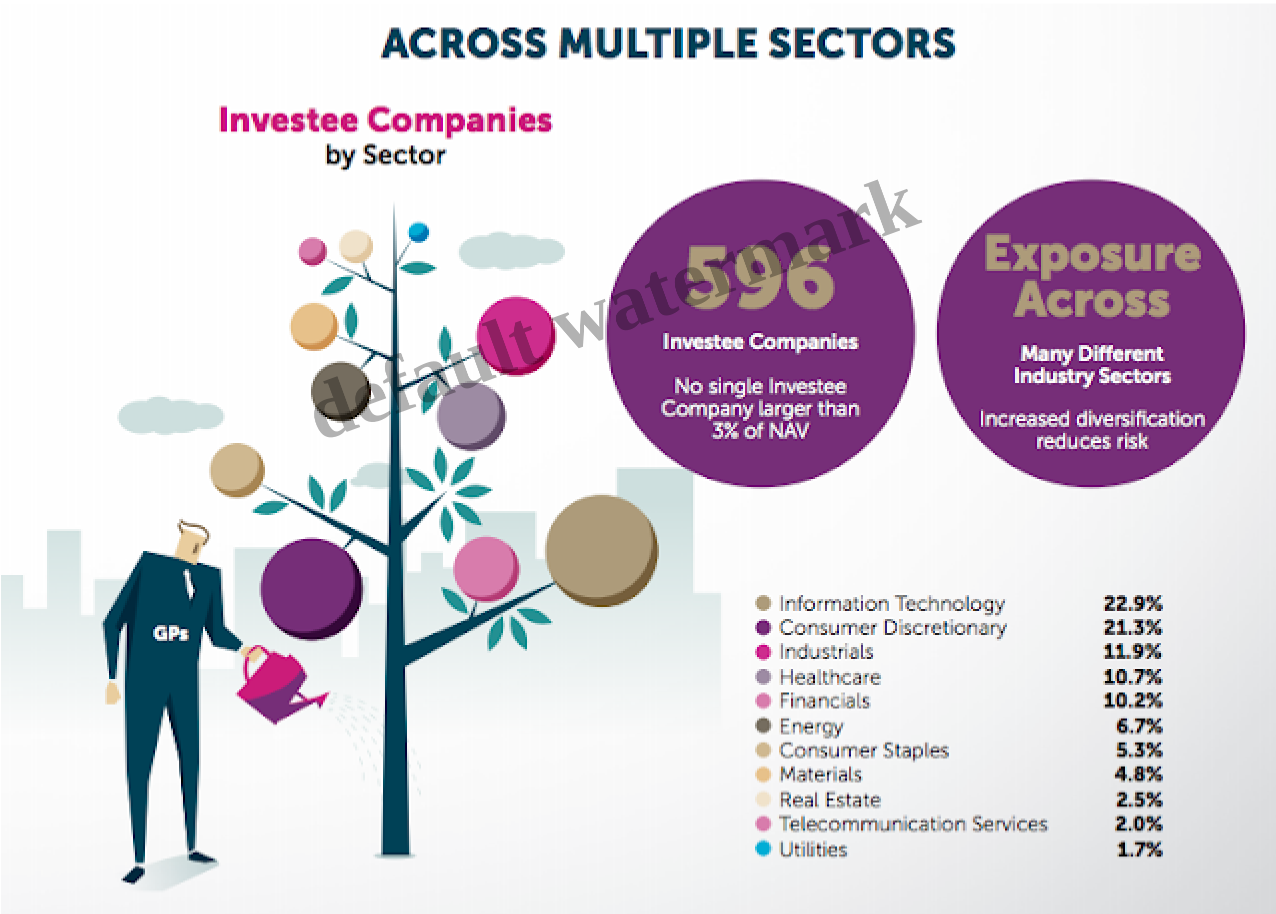
Source: Transaction documents, Fitch Ratings. As of 31 March 2018

The 36 PE funds.

If you're unfamiliar with private equity, what they basically do is to invest in distressed or promising companies, go in with their expertise and restructure or turn the business around (usually making operational or financial improvements), with the final aim (usually) being to **sell it off for a profit**. As a result, the returns on such investments (*when successful*) can be tremendous – think 2 to 3 digit percentage figures at least.

So in this case, when you buy these Astrea bonds, you're pooling your cash which will then be used to invest into these funds and underlying companies. The profits will then be used to pay the interest on your bond (4.35%) and finally return you your capital after 5 years.

Given the sheer number of funds and underlying companies, coupled with the fact that the exposure to a single partner / company / sector is quite low (even Blackstone Capital Partners, which is the largest, is merely 10.6% of NAV), the risk here is quite minimal even if one or some fold.



(There's a step-up interest portion in these Astrea IV bonds if they're not reclaimed after 5 years i.e. on 14 June 2023, but I'm not going to go into that because I've no intention to hold it for any longer than that, due largely to opportunity cost. There may be a bonus payment of up to 0.5% at redemption if performance condition is met.

For those of you who are keen on a longer-time holding period, there will be a 1% per year interest step-up rate if the bond is not yet redeemed after 2023.)

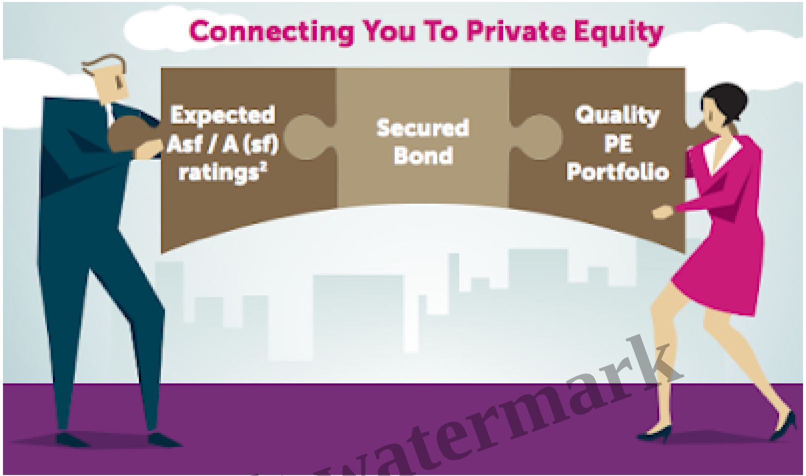
Who's behind the bond?

Okay, so now that you know this is NOT a Temasek bond…then who exactly is behind it? That's Azalea Investment Management, which was set up in 2016 and is a wholly-owned subsidiary of Azalea

Asset Management, which is then owned by Temasek Holdings.

Although they're relatively new as an entity, Azalea's management team apparently has extensive experience and institutional knowledge in the private equity space. The senior management team comprises of PE veterans and is led by Ms. Margaret Lui-Chan, who has been with Temasek since 1985.

Temasek and its affiliates have also launched 3 Astrea investment vehicles prior to this. Check out this really informative Fitch report for more information.



Why is the yield so high?

That was the first question that came to my mind when I read about the bonds being launched. Compare this to the Singapore Savings Bonds which is pretty much 100% risk-free (since it is backed by the Singapore government) and yields 2.63% for this month's issuance. Now contrast this to a riskier corporate bond such as Aspial's bonds, which were launched for 5.25% previously.

Comparative corporate yields

Stacking up SG A-rated paper vs Azalea A-1 bonds (5-year scheduled call date, 4.35% interest pa)

ISSUER	RATING	COUPON	MATURITY	CURRENT YIELD (%)
CMT	A2	3.2115	Nov 23	**3.16**
CMT	A2	2.88	Nov 27	**3.57**
Areit	A3	3.14	March 25	**3.27**
Areit	A3	2.47	Aug 23	**3.10**
RCS	A3	3.2	March 25	**3.28**
Singtel	A1	2.895	March 23	**2.96**

Source: DBS Bank

If this is from (albeit indirectly) Temasek, the next financial juggernaut in Singapore, then why is the yield so high?! Wouldn't it make more sense to price it at about 3+% yield, since the brand name Temasek alone would warrant some sort of a premium and perceived safety net?

According to Ho Ching, she says the main aim of this bond is largely to help retail investors in Singapore supplement their retirement income.

Why is the yield so low?

You didn't read that wrong ? for investors who truly understand the huge kind of returns that are seen in private equity *(remember, 2 or even 3 percentage digits can be fairly common, if they spot the right gems / get lucky on the sale)*, why is the yield being offered to A1 bondholders here so low at just 4.35%?

Class	Principal Amount	Interest Rate	Scheduled Call Date	Interest Rate Step-up	Expected Ratings (Fitch/S&P)[1]	Maturity Date
A-1	S$242 million	4.35% p.a.	14 June 2023	1.00% p.a.	Asf / A (sf)	14 June 2028
A-2	US$210 million	5.50% p.a.	14 June 2023	1.00% p.a.	Asf / Not rated	14 June 2028
B	US$110 million	6.75% p.a.	Not Applicable	Not Applicable	BBBsf / Not rated	14 June 2028

This can be easily explained using high risk, high returns; low risk, low returns.

Firstly, the minimum investment amount to participate in Class A-1 bonds is just S$2,000, in contrast to Class A-2 and B (US$ 200k each).

The risks in Astrea IV Class A-1 bonds in terms of default are also significantly lower than the other bonds issued in this exercise, as Class A-1 bonds will be redeemed first in any event before A-2 or B. This means that even if Astrea faces liquidity or financial problems, A-1 bondholders will be paid first.

Since the risk undertaken by class A-2 and B bondholders are higher (they only get paid *after* A-1), they're compensated with a higher yield in order to incentivise them to buy these bonds. Unfortunately, you don't get to buy them as they're not open to the public and have already been fully subscribed anyway.

Are my returns guaranteed?

No. You MUST understand this point.

However, the risk of default is pretty low, in my opinion, due to how this has been structured. In the event of a shortfall, Astrea IV also has a 10-year committed capital call facility with DBS which will step in to cover the payments ?

When can I get back my money?

You can sell the bonds anytime after 18 June 2018 on SGX, just like how you would with ordinary stocks. Otherwise, you can also choose to hold the bonds until its call date on 14 June 2023, or even longer if you want to be entitled to the step-up interest (provided the bonds aren't fully redeemed by then).

Is there a chance that I'll lose my money? Will Temasek save us if anything happens to Astrea?

The direct risks to bondholders which you should be aware of are:

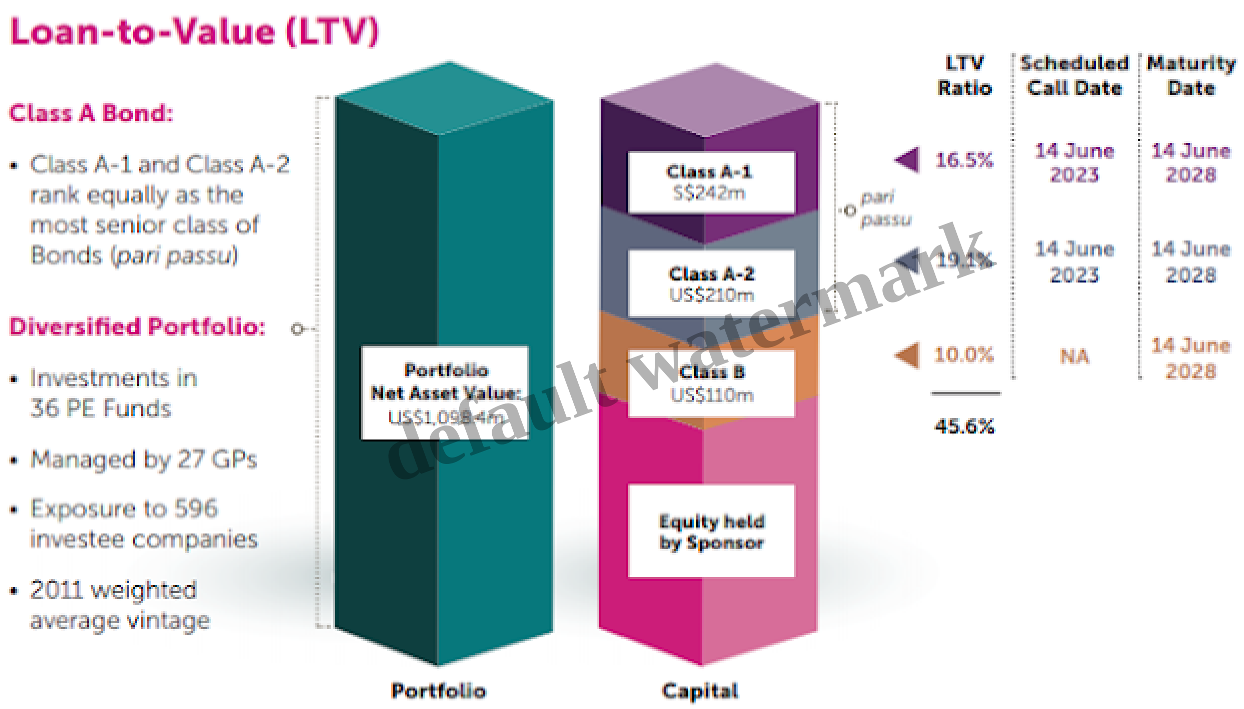
– the bond price might fall below its issued price on the bond market
– the Manager might not be able to fulfil its interest repayments
– the Manager might not be able to reclaim the bonds and pay back the original capital sum to bondholders

Now, it is important to note that **Temasek Holdings is not guaranteeing these bonds.** This is even explicitly mentioned in the prospectus, that is, if you bothered to read through (all 306 pages of) it. Therefore, if the bond manager fails to repay the bonds and/or interest, there is no guarantee that Temasek will step in to save bondholders.

Are they capable of repaying the bond interest and capital?

As with all bonds, you should always evaluate the financial health of the investment manager before you decide whether to buy or stay out. *Remember, that's the main reason why I said I was staying away from Aspial and Hyflux bonds back then?*

Since Astrea's financials are not entirely public and we can only rely on the numbers presented in their prospectus covering a limited timeframe of August 2017 – March 2018, a few figures to highlight are:
– USD 48.6 million of profits generated
– USD 342.5 million was used for their investing activities



That doesn't really tell us much, especially when there's no year-on-year comparison to gauge how they've fared. Therefore, we can only look to their Loan-to-Value below, where you'll see that Class A-1 bonds have a LTV of 16.5%, which is relatively low, and thus the chances of default should also be quite low since only $181 million in the reserve account is needed to fully redeem Class A-1 bonds.

Sounds good, but what's the catch?!

I'm a huge skeptic, so this deal honestly sounded too good to be true to me. But after scouring through the prospectus and various bloggers / investment houses' take on this bond IPO, I struggle to find anything reallllly negative about it.

Initially, I thought, is this some conspiracy?! Why would Temasek issue a bond with such a high yield?! Can't they get institutional or corporate loans for this? I bet companies would be *scrambling* just to subscribe! Or just get the private banks to issue it to their high-net-worth customers?

Then I thought, or maybe they're in financial trouble, that's why they're raising this money from us mortals? But then I realised that the total sum of S$242 million raised really doesn't count for much, considering Astrea's access and connections to Temasek Holdings.

My cousin attended the talk on this bond yesterday and I got her to ask them this question on my behalf. The answer by their CEO, Ms. Margaret Lui-Chan was that their vision is to open to retail investors. Lol.

So I can only say, looks like Ho Ching might be right after all, and this bond truly is being created to help retail investors? You can be the judge.

Disclaimer: I am NOT sponsored, nor do I have any connections nor payment from Temasek or Astrea or anyone, for that matter, in exchange for this post.

TLDR Summary

This is probably the longest IPO analysis I've ever written for a single product, so if you got bored halfway, I don't blame you. Here's a quick breakdown of my view towards Astrea IV Class A-1 Bonds:

Pros
– This is one of the safest bonds I've seen in a long time, especially given the A-rating by two reputable rating agencies (Fitch and S&P), not to mention Ho Ching putting her own personal name behind this (I assume, since she didn't correct the BT article nor ask them to apologise / correct / take it down).
– Long track record since this is already the 4th Astrea bond being launched, with the first in 2006.
– There are some quality PE managers in the 36 funds listed above, including Blackstone and KKR. Private equity folks should recognise these names ?
– The Sponsor owns 55% equity interest, so they do have their skin in the game and are less likely to want to see this fail.
– Their marketing is rock solid and has definitely generated the hype needed for this to become over-subscribed. Talk about FOMO!
– The first few pages of their IPO prospectus is just lovely! Kudos to whoever designed it ?

Cons
– It is not easy to understand, and is the first of its kind for retail investors.
– It was slightly mis-marketed (in my opinion) since there was so much emphasis and hype on their connections to Temasek, leading many investors to think this is essentially a Temasek Holdings bond.

You can also watch this short (marketing) video explaining the bonds here:

So Budget Babe, are you subscribing?!

Considering the hype and 4.35% yield, I'll be subscribing to these bonds and leave it as part of my bond portfolio (together with my CPF). After all, I'm the biggest skeptic of most corporate bonds, but this is one in recent years that actually managed to get my attention.

With their connection to Temasek, I doubt that Astrea will default on the bond interest payments, and I don’t think their bond prices will fluctuate too much on the open market either.

But please don’t follow me – do your own homework! Here’s the full 306-pages of the bond IPO prospectus as well as the Fitch report for you to read before you make your next move. Nonetheless, I’m betting this is going to be oversubscribed, and can only hope that I get some allocation from my application!

December 2023 Update: My Astrea Class A-1 Bonds have been redeemed on its Scheduled Call Date! Hooray! Now on to redeploy the capital elsewhere ?

With love,
Dawn

Category

1. Investing