Finexia Childcare Income Fund
INVESTMENT RATING REPORT
March 2024

Foresight Analytics

INVESTMENT RATING: **VERY STRONG**

PRODUCT COMPLEXITY: **COMPLEX**

Fund Details
Investment Manager: Creative Capital Group Pty. Ltd.
Investment Structure: Australian Unit Trust
Wholesale/Retail: Retail & Wholesale
Category: Australian Credit
Investment Style: Active Childcare Centre Credit
Inception: 4 October 2022
Management Fee: Nil
Performance Fee: Nil
Distribution Fee (external brokers): Nil
Responsible Entity: Finexia Securities Limited
Investment Objective: To provide a stable monthly income of 5.65% p.a. above the RBA Cash Rate (currently 10.0%).

Performance – 31 December 2023

Period	Return	Annualised Return
1 month	0.91%	10.64%
3 months	2.70%	10.80%
6 months	5.40%	10.80%
12 months	11.00%	11.00%

Source: Creative Capital Group

Review Summary

The Finexia Childcare Income Fund ('the Fund') was launched in October 2022 and is managed by Creative Capital Group Pty. Ltd. A wholly owned subsidiary of Finexia Finance Group Ltd (ASX: FNX) ('the Manager' or 'the Group'). The Fund provides funding to select experienced childcare operators primarily for the purpose of funding recently opened or reopened childcare centres during the ramp-up period. Once a childcare centre reaches approximately 80% of full capacity, banks are then prepared to provide debt funding. This capacity threshold is typically achieved at around the 1-year anniversary following the re- / opening of a childcare centre. As such, the Fund's loans are transitional lends and almost invariably issued for a 12-month term.

The Fund may also provide lending to an established childcare lending and invariably to an existing borrower if that borrower chooses to refinance (ramp-up lend) with the Manager. As the loan book matures, established lends may increase as a percentage of the total portfolio, and consequently lowering the overall risk-return profile of the Fund.

The Fund's lends are secured principally by the leasehold titles of the childcare operators instead of the freehold titles of childcare property owners. Where an operator owns the freehold, a mortgage over the freehold interest is taken. The LVR on any given loan is almost invariably set at 65% and an amount that is inclusive of interest paid in advance for the full term of the loan. Once a borrower achieves a cashflow positive position, the loan is serviced on an interest-only basis, with principal paid back at the maturity date (and through refinancing by a 3rd-party lender).

Due to the Manager's investment process and careful curation of eligible borrowers, Foresight views these lends as highly attractive with particularly low repayment risk given the high operating yields well-placed and managed childcare centres have consistently generated (EBIT yields of circa 25% to 30%).

Additionally, in paying out the target return to investors and which is fixed at a specified rate above the RBA Cash Rate, the Manager effectively implements a quasi-first-loss equity note structure akin to that which exists in securitised notes. Should there be a shortfall in the borrower's repayments, the Manager is at risk, rather than investors.

Foresight views the Fund favourably in 2 key respects. First and foremost are the quality of the loans and the Manager's investment processes that contribute to this quality. In short, the current 10.64% annualised monthly return (31 December 2023) presents a compelling risk-return proposition for investors.

Second, the Fund provides a niche form of non-bank lending in a segment that is characterised by strong tailwinds and attractive structural characteristics for a non-bank lender. It is also a segment where the targeted borrowers have business models that have little exposure to the economic cycle. As such, this segment is materially different to the larger Australian private debt landscape. In short, we believe the Fund may serve as a strong source of portfolio diversification within a broader private debt portfolio.

Investment Rating and Foresight Complexity Indicator

A **VERY STRONG** rating indicates a very strong level of confidence that the Fund can deliver a risk-adjusted return in line with its investment objectives at this stage of the growth of online lending in Australia. The investment manager's support for this strategy is experienced and well-resourced.

Designation as a **COMPLEX** product indicates that the investment has a degree of illiquidity, as per all private debt investments. That said, we not the short duration of the loan portfolio and the Manager providing a treasury function.

Fund Details

Dominant Strategy	Investment in a portfolio of loans issued to childcare leasehold operators, secured by leasehold titles for the purposes of either trade-up transitional finance or refinancing for established childcare centres
Fund Type	Registered Australian Unit Trust ARSN: 658 543 625
Investment Manager	Creative Capital Group Pty. Ltd.
Trustee/RE	Finexia Securities Limited Pty. Ltd.
Custodian	Perpetual Corporate Trust Limited
KEY FEATURES	
Fund Inception	4 October 2022
Domicile	Australia
Legal Form	Registered Australian Unit Trust ARSN: 658 543 625
Geographic Mandate	Australia
Open/Closed	Open
Management Costs	Nil
Performance Fee	Nil
Distribution Fee	Nil
Benchmark	N/A
Distributions	Monthly, reinvestment available
Funds Under Management	As of December 2023 – $20.7M in the Fund and $45M in the childcare lending strategy as a whole.
Minimum Subscription	$5,000
Minimum Balance	$1,000
Entry Fee	Nil
Fund Term	Open-ended
Reporting	Investors receive monthly performance reports and annual audited financial statements
Redemptions	The Manager will approve redemption requests at its discretion. The Fund will endeavour to maintain sufficient liquidity to meet such requests. Refer to Liquidity Management, Investment Strategy section for specific details.
PRIMARY CONTACT	
Name and Title	Karl Brandt
Email Address	karl@fnx.com.au
Telephone Number	+61 499 775 757
Website	www.finexia.com.au

Investment Profile

BACKGROUND

The Finexia Childcare Income Fund ('Childcare Income Fund' or 'Fund') is a specialist lender to established Australian Childcare operators. Its lending activities are designed to address the gap in the bank market for providing funding for childcare and early learning centre operators to acquire, open and trade-up centres across Australia. The Childcare Income Fund was established in 2021 and launched in October 2022 by the ASX-listed financial services company Finexia Financial Group Limited ('Finexia'). The Fund is managed by the wholly-owned subsidiary, Creative Capital Group Pty. Ltd., a specialist private credit manager acquired by Finexia in 2020, and which is responsible for the management, loan origination, credit assessment and underwriting activities for the Fund.

While Finexia also provides broking services, the Group's strategic focus is firmly on growing its private credit business through the management of Creative Capital. In addition to the Fund, Finexia also established the Stay Company Income Fund in 2021. Both funds are designed to provide investors with attractive risk-return propositions in very niche private debt segments, with the Childcare Income Fund also presenting a very significant growth runway.

While the Fund was launched in October 2022, Creative Capital Group has been involved in childcare centre lending for approximately 7 years now. Prior to the launch of the Fund, it was funding such lending activities through a contributory mortgage scheme. While the Manager continues to provide this contributory mortgage scheme option, it is the pooled mortgage scheme, i.e. the Fund, that is now the primary source of funding for the Manager in the private debt sub-segment.

In October 2023, Finexia completed the first tranche ($25M) of a $50M securitised note issuance. The $25M raised has been deployed to the Finexia Childcare Income Trust ('the Trust'). The Trust is based on the same investment strategy as the Fund. The strategic rationale for the securitised note issuance was to diversify funding channels and expedite raising funds to deploy to the childcare lending vertical.

We also note that in January 2024, Finexia announced that it had formed a strategic alliance with Sequoia Financial Group Pty. Ltd. The alliance is intended to facilitate joint marketing efforts that leverage both companies' strengths to more effectively serve the financial planning and accountancy marketplaces.

OBJECTIVE

The Fund aims to provide highly consistent monthly income returns with minimal risk (i.e. a constant NAV of $1.00 per unit) from the provision of secured loans to established childcare operators as key money to set up new or recently renovated centres and trade up to full operation and occupancy. Existing multi-site operators are targeted as potential borrowers. Freehold childcare operators and owners will be considered should they meet the investment manager's investment criteria.

The Fund is targeting a return of 5.65% per annum (net of fees) above the RBA Cash Rate. Investors can choose to have income distributed monthly in arrears in the form of cash or reinvested as additional units. We note that childcare centre leasehold loans have historically exhibited strong credit performance with low to no arrears and nil losses through the economic cycle. Given the trade-up nature of the lends, interest for the full term of the loan is necessarily pre-paid in advance (and which forms a component of the LVR) with the principal and capitalised interest repaid at maturity and by way of a refinancing exit strategy.

It is important to note how the Manager has structured the payment of returns to investors. The Manager applies a cashflow priority waterfall to the distribution of total interest income, with investors being the first recipient of those monies and at a level consistent with the target return. The residual of the total interest income is then allotted to the Manager and utilised for fees, costs, etc.

Should there be a Loss Given Default (LGD), the Manager will incur this loss to the greatest degree possible, thereby providing an additional layer of protection for its investors. By 'greatest degree possible', the buffer will effectively be a function of the net interest margin (NIM) the Manager earns on the loan portfolio. This structure is akin to a first-loss equity note structure that exists in securitised notes.

INVESTMENT UNIVERSE

The Fund will offer secured loans exclusively to experienced operators of childcare businesses, specifically leasehold childcare centres. Security for these loans will consist of a registered first mortgage over the leasehold childcare centres or a first registered mortgage of the real property where applicable. Funding is aimed at experienced operators with multiple childcare centres in strategic locations across Australia. The loans are designed to allow such operators to open and then trade up to a point where the occupancy and cash flows are stable and sufficient for it to reach an appropriate valuation. At this point, the loan would generally be refinanced by a traditional bank financier.

As a general rule of thumb, a leasehold childcare becomes eligible for refinancing by a traditional bank financier once it has achieved an 80% occupancy rate. For the purpose of this report, a centre is deemed to be "Established" when it as has demonstrated, for 3 consecutive months, both; occupancy and EBIT (annualised) at or above that stated within the valuation. "Formative" is deemed to be any centre that does not yet meet the above criteria. The Fund has and is likely to finance an increasing percentage of established childcare centre operator loans for existing trade-up borrowers that choose to refinance with the Manager. The key implication here is that such a development will lower the risk-return profile over the overall portfolio, with Established loans typically being priced at circa 100 basis points (bps) lower than Formative loans to reflect the lower risk of the former. The Manager expects that by 2025, around 65% of the total loan book will represent refinanced loans to established childcare centres operating at, or near to, full capacity.

FUNDS UNDER MANAGEMENT

In relation to the Fund, the FUM is currently $20.7M and made up of 14 loans in total. Additionally, the Finexia Childcare Centre Trust has additional FUM of $24M and is based on exactly the same strategy as the Fund. As such, the Manager has a total FUM of $45M in relation to its childcare lending strategy.

The 2 investment vehicles interact with each other in terms of loans and FUM. With the recent completion of the $25M notes issuance in October 2023, the loans utilised to populate the Trust's portfolio were removed from the Fund's portfolio. The proceeds to the Fund were used to re-capitalise the Fund for additional Loans and to repay certain unitholders in the Fund. This loan reallocation, repayment and consequent reduction in the FUM of the Fund is evident in Exhibit 1 below. If there is a material redemption request put to the Trust, Finexia can choose not to fund it through its own balance sheet, and instead fund it through the Fund. (i.e., a portion of the Trust's loan book would transfer to the Fund).

On the topic of material redemption risk, or the 'quality' of existing FUM, we note there is a significant amount of insider capital, which we believe has a low likelihood of withdrawal (consider it for all intents and purposes permanent capital from a redemption risk perspective). We would also suggest that there is a solid stability and diversity of investor capital, with Fund capital largely being sourced from high net worth (HNW) investors. The Trust capital, being institutional capital, can also be regarded as highly stable. There is a liquidity reserve of 6 months interest on A & B Notes. It is a revolving line for 3 years with a non-call period of 2 years. There is currently unutilised availability within the Trust (~$1.2m) accounting for the differenced in Gross Loan Assets to FUM between the Trust ($25m Notes & $24m FUM and Fund $20.7m FUM noting $45m in Gross assets as at 30/12/2023)

Finally, in relation to the FUM growth outlook, we note that the Manager's prospective childcare centre pipeline is significant and lends are only limited by the investor capital available. However, given Foresight's positive view on the Fund, we would expect FUM to grow consistently over time. The Manager has stated that it expects the loan book to be in the vicinity of $91M by 30 June 2024 and $196M by 30 June 2025.

Exhibit 1: FUM Timeline (to 31 Dec 2023)

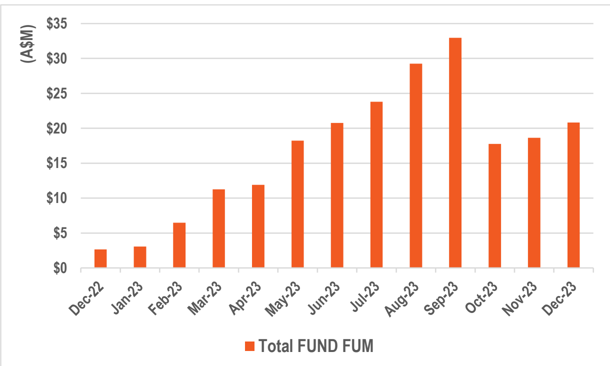
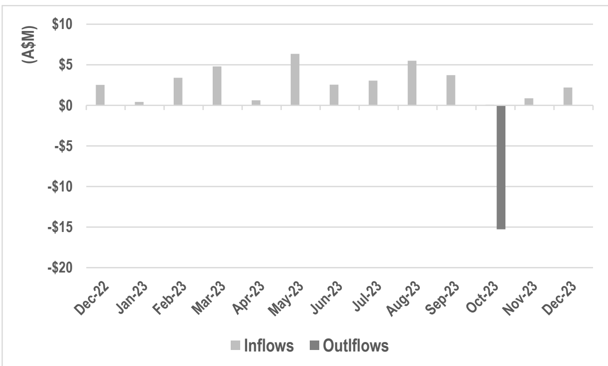


Exhibit 2: Monthly Net Flows (to 31 Dec 2023)



Source: Creative Capital Group

The Australian Childcare Sector – An Overview of the Transitional Lending Market

Childcare today is integral to the social and economic fabric of Australian society. It has evolved from its origins as a child-minding service for working parents to become a central pillar of Australia's Social Infrastructure, providing an important extension of the primary education system and, at the same time, contributing to economic growth by enabling increased workforce participation.

The childcare centre lending market is differentiated based on 3 different operating models that exist in the Australian market:

1) A leasehold title in which the childcare operator provides childcare services only (Leasehold Going Concern, no property ownership)

2) A freehold title in which the operator both owns the property and provides childcare services (Freehold Going Concern)

3) A freehold title in which the property owner outsources the provision of childcare services to a third-party (Lessor's Passive)

The Manager's focus is lending to the first two models noted above. Freehold Passive and leasehold/Freehold Going Concern (Operator) are 2 distinct asset classes and have quite different characteristics in relation to loan servicing, repayment risk and collateral. A brief summary of the key differences that exist between the 3 sub-segments is presented below.

3-Way Market Segmentation by Loan Servicing & Collateral Characteristics

Attribute	Freehold Going Concern	Leasehold Going Concern	Lessor's/Passive Interest
Assessed against	Net operating profit. Yields have generally tracked 10-15%. Net profit margins ~ 28%-35%.	Net operating profit. Yields have generally tracked 20-25%. Net profit margins ~ 20%-25%.	Rental yield. Demand from investors for a considerable period saw yields reach historically low levels. Current yields range between 5-6.5%.
Security	First mortgage over freehold property. First GSA over owning or operating party and personal guarantees.	First mortgage over the leasehold property interest. First GSA over the owning entity and personal guarantees.	First mortgage over freehold property. First GSA over owning entity and personal guarantees.
Default risk	Lower default risk due to the high income buffer.	Lower default risk due to the high income buffer.	Higher default risk due to the low returns from rental income only.

The vast majority of freehold properties are owned by parties with no connection to the childcare operator. The most common owner of the freehold interest would be a property fund such as Charter Hall or the SMSF of an HNW.

Where the operator is the owner of the property and operates the business from the same location, it is treated as a freehold going concern and would generally be valued on this basis and would include a freehold mortgage.

The selling of the freehold property is of no consequence to the leasehold childcare centre operator; it just means they have a different landlord. The lease remains with the same parameters and term. The only factor to address from the Manager's point of view when a landlord sells the property is that the incoming freehold owner accepts and maintains Right of Entry (ROE).

Whether freehold or leasehold, they both have value and trade independently in the market. They can both be mortgaged and sold separately.

COLLATERAL OVERVIEW

Freehold and leasehold are 2 distinct asset classes, and the nature of the collateral is similarly distinct. Taking a first mortgage over a freehold interest in a property provides the lender with an asset to rely on as collateral. Taking a first mortgage over a leasehold interest in a childcare centre provides the lender with a cashflow and a business value to rely on as collateral. However, there are advantages to taking a first mortgage leasehold interest:

- High Yield Income – Leasehold childcare properties generate sizable net income. Income used to service the mortgage has a significant buffer before serviceability is compromised, which substantially reduces the risk of default. The income yield range for a freehold is 3%-6% compared to the leasehold range of 19%-30%. Refer to Exhibits 3 and 4 below.
- Faster Repayment – Higher income generation means faster repayment. We note that the weighted average loan expiry (WALE) of the Fund's portfolio is currently a short 5.5 months. This limits exposures to sector wide risks that may impact the childcare sector over time.
- Control – Whilst repayment of debt on a freehold asset remains reliant on the performance of a given tenant, there is no control on the business performance. In contrast under a leasehold lend the lender defines a range of performance KPIs and, should these not be met, has the ability to appoint a back-up manager and/or sell the leasehold to a new operator.
- Liquid Secondary Market – Any mortgage in default relies on the underlying market for the asset. There is a strong and liquid secondary market for leasehold childcare properties. We note that according to the Manager, market multiples (typically being multiple of EBIT) have remained relatively consistent over recent years as have yields (Exhibit 3).
- Appropriate Loan-to-Value Ratio (LVR) – The Fund prudently manages its loan exposure to asset values, with LVRs generally being less than 65%. This LVR level is inclusive of prepaid interest for the full term of the loan. We also note that as any given childcare centre progressively trades up, the implicit value of the leasehold business increases due to an EBIT multiple expansion, all things equal. That is, the implicit LVR also decreases.
- Lower Initial Cost – Acquiring a leasehold interest in a property is often less expensive than purchasing the property outright. This means that the borrower may require a smaller mortgage and carry lower risks for the lender.
- Flexibility – Leasehold interests often come with greater flexibility than owning the property outright. For example, the tenant may be able to negotiate a more appropriate lease term, which would give them greater flexibility with the property or allow them to expand their business in the future. This flexibility is generally a benefit to the lender, as it reduces the likelihood of default.

- Leasehold Improvements – Tenants have usually made significant improvements to the leased property that increase its value. If the tenant defaults on the mortgage, the lender is able to take over the leasehold interest and benefit from these improvements.
- Lower Default Risk – The low yield on freehold assets leaves very little room for error, including where interest rate increases impact both the net income from the asset and the capital value of a given asset.

We also note that personal guarantees are an important deterrent against operators 'walking away' from unprofitable businesses. Bankruptcy extinguishes a party's ability to hold a Childcare Provider License. In that context, where possible, guarantees are provided by individuals in whose name the licence has been granted, or in the case of corporate guarantees, the individual controller of the company is also a guarantor.

Exhibit 3: Historic EBIT Yields – Leasehold

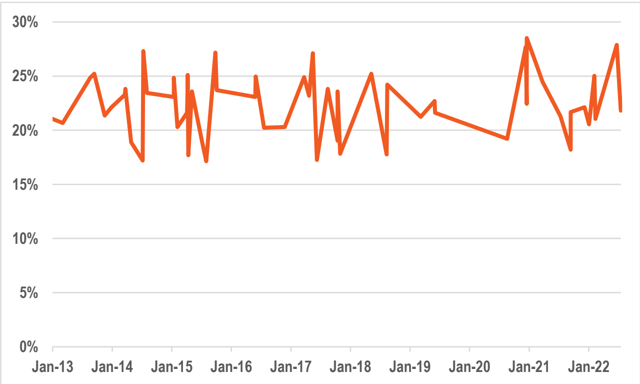
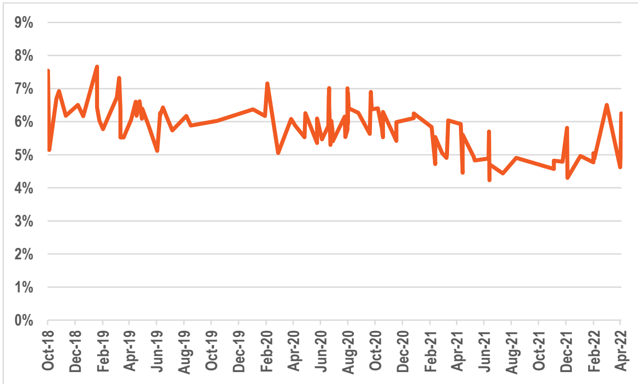


Exhibit 4: Historic EBIT Yields – Freehold



Source: Creative Capital Group

AUSTRALIAN CHILDCARE SECTOR – NAVIGATING NEW CHALLENGES

Early Learning Management, the backup service provider for the Fund and a sector expert, published an industry insight in November 2023 entitled 'Australian Childcare Adaptation: Navigating New Challenges' (https://elm.net.au/adapting-australian-childcare-challenges/). The article uses Goodstart Early Learning, the largest provider of childcare services in the Australian sector, as a case in point for some of the current risks and challenges confronting leasehold operators in the segment. While Goodstart is used as an example, we note that the issues aren't limited to Goodstart, with other large operators (G8 Education, Affinity Education, etc.) also posting less than stellar financial results. This downturn reflects the complex interplay of various factors that have impacted the sector as a whole. These challenges are summarised below, a verbatim copy-and-paste of the Early Learning Management article.

We have included this section below from the perspective of balance. However, and importantly, the Manager is very aware of these challenges, and the resultant risks are a key focus in its investment processes with the purpose of eschewing such risks. As such, we have also noted how the Manager deals with these risks. The Manager only approves approximately 20% of prospective lends, and that prospective pipeline is already highly selective. However, we would contend that industry risks and impacts of challenges are higher for established lends than trade-up lends. This is simply because established lends are for a materially longer duration.

From an investor perspective, it's clear that a non-bank lender in the segment requires a high degree of sector expertise and experience, which translates to a scarcity premium and higher returns to investors.

Sector-Wide Challenges and Responses

Goodstart Early Learning: The company reported a significant loss of $85.3M for FY2023, marking a considerable increase from the previous year's $65.7M loss.

Manager Response: Goodstart is a not-for-profit organisation and as a Not-For-Profit they do not have an imperative for profit and therefore would not fall into the general target market for Finexia. It is also important to note that Goodstart are not representative of the sector as a whole, even as the largest single operator in the sector, as it holds a legacy portfolio of centres that are aging, in need of update, refurbishment and CAPEX combined with impacts of significant increases in leasing cost via market & CPI with long term legacy leases.

Goodstart are renowned in the industry for throwing staff at any problems that arise, as confirmed by their Revenue/Employee ratio of 83.87 compared to industry average of 105.01 (IBISWorld Goodstart Early Learning Ltd 30 June 2022). They are head office heavy and bureaucratic. This is also confirmed in the recent ACCC report noting: "Not-for-profit providers appear to face lower land costs than for-profit providers, but these savings are invested into labour for centre based day care services."

The target market for Finexia is the For-Profit sector who are well placed to better manage costs, occupancy & staffing than Not-For-Profit operators.

G8 Education's Strategic Decisions: A notable example of the sector's challenges is G8 Education's decision to offload 31 underperforming centres, which cost $26 million to transfer these facilities to a smaller operator. This strategic move by G8 Education, a significant player in the industry, underscores the difficulties faced in maintaining profitability and operational efficiency across a large network of centres. The decision to streamline their operations by offloading less profitable centres is a response to the intense competitive environment and the need to optimise resources.

Manager Response: Note some of the centres G8 offloaded are in an attempt to rationalise centres in areas where they do not have operational efficiency by optimising centre networks and maximising economies of scale. i.e. in locations where centres are standalone or are some distance from others meaning additional management staff requirements and when combined with a significant head office being a listed Company.

Regulatory Pressures: Childcare providers are increasingly navigating a complex regulatory landscape. The Australian Competition and Consumer Commission (ACCC) has closely scrutinised the sector, focusing on the expenses and profit margins of large providers. This scrutiny has led to calls for more stringent regulations, which could include fee caps and tighter operational guidelines. Such regulatory changes could significantly impact the financial models of childcare providers.

Manager Response: As occurs in Markets in general when there is a legislative or regulatory change that impacts Private enterprise the Private sector finds a way to work around these things. In this case, the measure of profitability of Operator Groups. Middle market operators have begun splitting groups between different approved providers to lower the centres operating under one approved provider to fall under thresholds for capture as large groups. Regarding fee caps, to date operators see little chance or impact and in some cases suggest to bring it on with the bigger risk being staff retention and availability.

Impact of Work-From-Home Trends: The shift towards remote working, accelerated by the COVID-19 pandemic, has led to changes in attendance patterns at childcare centres. Many providers have reported a drop in attendance, particularly on Mondays and Fridays, as parents adjust their childcare needs to meet flexible work schedules. This shift has implications for revenue and operational planning for childcare centres.

Manager Response: Monday and Fridays have always been the hard days to fill even before any COVID WFH issues arose. Operators have adapted by using technology to sell these days often doubling income on days that there are absences as parents still need to pay for absences yet the centre can actually replace and resell that place for the day with Childcare Operators using CCMS Childcare Management Systems (CCCMS) technology such as xplor, OWNA & KidSoft etc. Where centres can and are impacted by WFH trends the industry is consolidating centres in these CBD locations. If centres in these locations are sought to be funded an understanding of the client's strategy is of utmost importance.

Responses to Staffing Challenges: The sector is also grappling with staffing challenges, including shortages and the need for higher wages to attract and retain qualified staff. Goodstart Early Learning's call for a government-backed wage subsidy reflects the industry's need for support in addressing these workforce issues. Ensuring a well-compensated, stable workforce is crucial for maintaining the quality of childcare services.

Manager Response: The number one issue for Childcare Operator is staff acquisition and retention as it is with all businesses across Australia. Operators have sought to address this with; RTO Training and education programs, traineeships and initiatives including working engagement with RTOs. The availability and quality of educators and staff has a significant impact on the quality, reputation and profitability of a service. Stable staff tenure and continuity also contributes to service viability.

Labour shortages are affecting the supply of services to all children across Australia but that these shortages are more acute for suppliers serving regional and remote areas which is where additional rigor and diligence around staff availability is imperative.

Adapting to Market Dynamics: In response to these challenges, childcare providers are exploring various strategies to adapt and remain viable. These include optimising centre networks, investing in technology and infrastructure, and exploring new service models to cater to changing family needs. Providers are also focusing on enhancing operational efficiency and exploring innovative approaches to manage costs.

Manager Response: The private sector as noted in responses to the above do manage changing market dynamics far greater than Not-For-Profit or Government services with actions to manage operational efficiencies, economies of scale, cost and utilisation of technology to improve utilisation. The key challenges are primarily related to: Staff; Finding appropriate sites; Approvals and builds; Competition; Rents

Finexia are conscious of these issues with significant focus placed on understanding the risks around these and what mitigating actions clients are taking around same.

Investment Philosophy

The Manager's investment philosophy is integrally related to the tailwinds in the sector, the quality of the lending sub-segment the Fund targets, and the lack of meaningful competition that could impact the growth prospects of the Fund. We unpack the dynamics in the market that form meaningful components of the Manager's overall investment philosophy below:

- **Addressing a Funding Gap** – Given the growth of the sector, the fragmentation of market participants, and the Basel III risk-weighted capital allocation requirements, Australian banks have failed to keep up with the demand for loans. Their rigid approach to their underwriting policies has created a large gap for near-bank-standard lending opportunities. The Fund services the gap by issuing fully secured loans to established, experienced childcare operators.
- **Lack of Meaningful Competition** – Foresight does not believe there is any material risk of other established non-bank lenders entering this niche segment. Banks do not usually issue ramp-up loans, but if there is a risk of potential competition (generally if an operator has an existing lending relationship with a bank), the Manager may opt not to pursue such a loan beyond the initial due diligence stages. We see a potential opportunity for the Manager to obtain warehouse funding from existing participants in the SME warehouse market (i.e., a beneficiary).
- **Macro Tailwinds** – The investment thesis for supporting childcare centre business operators remains strong given the clear tailwinds in the sector being generated by an ongoing supply-v-demand imbalance, substantial government support via family subsidies, and rising living cost pressures forcing parents back into the workforce. The childcare sector is large and fragmented, with over 8,000 centres (approximately 75% in major cities), but there is a degree of consolidation occurring as large groups either build new centres or acquire and renovate existing centres. In short, there is no shortage of prospective lending opportunities for the Manager. We note that according to the IBISWorld – Childcare Services in Australia Industry Report (April 2023), there is a notable trend of approximately 400 new childcare centres being constructed annually. The forecast indicates a substantial growth trajectory, with an estimated 2,000 new centres expected to be developed from 2023 to 2028. Notably, each childcare centre presents an average loan size of $1.8M, presenting a significant annual lending opportunity totalling $720M.
- **Strong Collateral Protections** – The collateral protections over a leasehold lend were covered in some detail earlier in the report. But in short, repayment risk is greatly mitigated by high profit margins, a strong secondary market for leasehold operations, prudent LVRs and personal guarantees.
- **Secondary Market Liquidity** – The competition for childcare investments by both private and institutional investors intensified following successive announcements from the Federal Government and then Labor Opposition, each committing to long-term financial support for the childcare sector beyond the duration of the pandemic. and often they can trade anywhere from 2 to 2.5 times projected income on day one without a child in it. And even when they traded up, they trade anywhere from 5 to 7 times income, depending on the market, the area, lease parameters and so forth.

Investment Strategy

The Fund offers secured loans exclusively to experienced operators of childcare businesses with multiple childcare centres in strategically positioned locations across Australia. Loans are specifically for leasehold childcare centres. Security for these loans will consist of a registered first mortgage over the leasehold childcare centres and personal guarantees.

The loans are designed to provide experienced and well-capitalised operators of childcare centres with a loan facility that allows them to open and then trade until the occupancy and cash flows are stable and sufficient for it to reach an appropriate valuation. At this point, the loan would generally be refinanced by a traditional bank financier. The product is designed to replicate and largely replace loans that were traditionally provided by major Australian Banks.

Loans may be used for acquisition, expansion, construction, refurbishment, playscape development, fit-out, equipment, supplies, technology, staff costs, professional development, working capital, marketing, licensing fees, insurance, and bank guarantees for leases.

The loan term on each centre is typically 12 months, which is the industry-accepted stabilisation period in ordinary circumstances. A childcare centre is generally considered to be stabilised when at least 85% of all places within a single centre are filled for a period of 3 months. As we discussed above, banks will typically offer refinancing once 80% capacity is reached.

The Fund's typical loan characteristics are listed below:

- Operators with more than 10 existing operating centres will be the target market. Their existing portfolio of assets will generate sufficient free cash to meet contingencies.
- The operators' personal and business financial positions will need to be appropriate.
- The LVR is typically 65% on an acceptable stabilised occupancy valuation figure. The LVR may be achieved by taking additional security over existing stabilised and operating childcare centres, giving a pooled LVR.
- Interest on the loan will typically be pre-paid for the initial 12-month loan period. Hence, no repayments will be required for the trade-up period.
- Loan terms are typically 12 and extendable with interest payable monthly in arrears.
- Security to the operational childcare business.
- The Fund has recourse to directors' and key sponsors' assets via personal guarantees.
- Formative childcare centre loans (still in the trading-up phase) are currently priced at no less than an 8.90% margin over the RBA Cash Rate, plus a 2% application fee.
- Established childcare centre loans (fully traded-up) are currently priced at no less than a 6.90% margin over the RBA Cash Rate, plus a 2% application fee.

Tade-Up vs. Established Childcare Centre Loans

As the existing loan book matures, it is reasonable to expect an increasing portion of the total portfolio to comprise established childcare centre loans as some borrowers will choose to refinance with the Manager. As noted, it is the Manager's expectation that by the end of 2025, approximately 65% of the loan book portfolio will represent established childcare centre loans.

Irrespective of the realised split, an increase in the established loan split will reduce the overall risk-return profile of the Fund and, hence, all things equal, returns to investors. However, the Manager may choose to avoid this development in one of 2 ways. Firstly, spin such established lends out into the Trust or, secondly, establish a new fund to house established childcare centre loans. Either initiative would retain the 'integrity' of the current risk-return profile of the Fund.

While it is not Foresight's role to predict the future, it is our expectation that it is more likely than not the Manager will pursue one or both of the initiatives, thereby retaining the current risk-return profile of the Fund.

Backup Service Provider

If a centre is not performing in line with agreed parameters, the Manager will review it and advise on 'fixes'. If the issues are still not sufficiently addressed, the leasehold operator can be removed. The Manager has a contractual agreement with Early Learning Management (ELM) to act as a backup service provider if required. The founders of ELM have been involved in the Australian childcare sector for a significant period of time. The business is essentially a management outsourcing company to childcare operators. In a worst-case scenario, the Manager has the ability to take possession of the leasehold title and sell it.

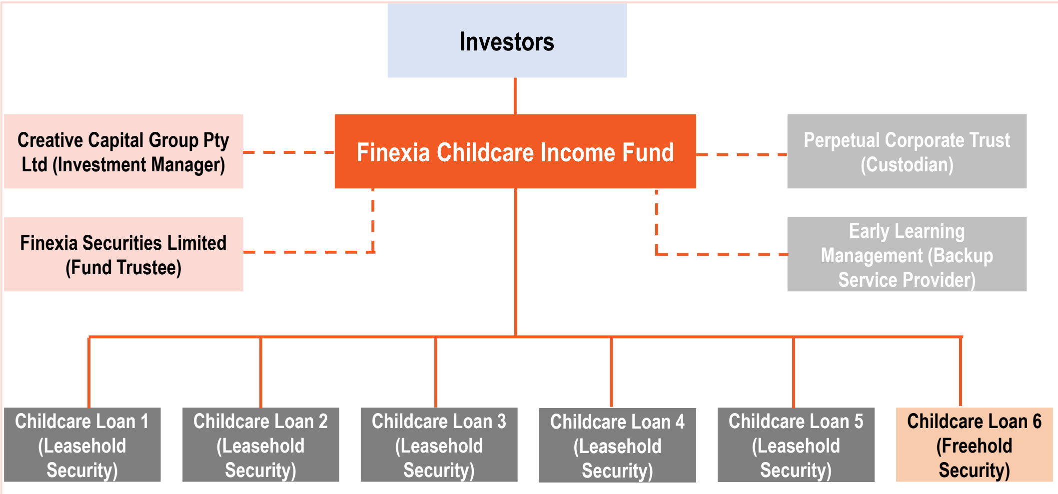
Liquidity Management

To date, the Fund has had 3 redemption requests and all 3 have been met and financed by the Manager. Under the liquidity facility, the Manager effectively provides a treasury function. Specifically, liquidity is assisted by Creative Capital Group as the Manager in which the Manager holds units in the Fund, and it will provide additional capital to fund redemption requests. The Manager's treasury function also extends to addressing any funding gaps between loan funding needs and loan repayments in exchange for units in the Fund.

As such, the Manager plays an important role in absorbing significant credit positions without causing disturbances or funding gaps, thus ensuring the seamless and efficient management of the Fund's portfolio and capital flows. It also means investors are not subject to cash drag risk, and it provides a further alignment of interest between the Manager and investors (they are co-investors in the Fund).

Fund Structure

The structure of the Fund is illustrated below.



Investment Process

Selection Criteria

The Manager pays particular attention to the reputation and experience of the operator and the broader financial strength of the operator group.

In relation to the childcare centre itself, the importance of demographic research and obtaining quality legal advice relating to contracts, leases and other agreements prior to the acquisition of a childcare property cannot be overstated. The key investment risks factored into the selection of a suitable childcare centre include the following:

- Location relative to demographic trends
- The development of competing centres in the catchment area and the potential reduction in government financial support
- Remaining lease term
- Age of the premises
- Owner's exposure to capital expenditure

Details of the selection criteria are below:

Initial Screening, Analysis & Due Diligence

1. **CHILDCARE SPECIFIC PARAMETERS**
   - Catchment Demographic and Demand assessment (typically at least 3 children for every 1 available childcare space (3:1 Ratio)).x
   - Fee structure compared with peers and competing centres
   - Wages / Salaries ratios and ability to control costs
   - Rent as a percentage of sales to be in line with market parameters and acceptable.
   - Benchmarking against peers.
   - Number of Approved / Licenced Childcare Places.

2. **MANAGEMENT CONSIDERATIONS & KEY ATTRIBUTES**
   - Confirmation of appropriate industry background and experience including holding relevant Approved Provider status from the relevant Statutory Body in an appropriate State of Australia.
   - Operator Management / Qualitative Measures
     - Be an approved Long Day child care centre receiving the Commonwealth Government's Child Care Subsidy (CCS)
     - Demonstrated ability to operate / manage multiple sites (business management experience / qualifications).

Investment, Monitoring & Exit

3. **ONGOING LOAN MONITORING**
   - On-going performance monitoring (main elements);
     - Monthly - Occupancy and key centre performance checks and regulatory/tax/other financier compliance.
     - Quarterly - Centre level and Group level management P&L and CFB.
     - Annual - full credit review encompassing all related entities.

4. **LOAN MATURITY & EXIT CONSIDERATIONS**
   - Target Loans to satisfy the credit policies of Major Banks and other NBFIs within the life of the loan term, or;
   - Structure of the loans and group financial position and credit profile of the borrower should allow for a refinance to take place on commercial terms.
   - Consideration to appeal of the asset in the secondary market to be given where exit strategy is from sale of the centre and also as the second way out.

PORTFOLIO CONSTRUCTION

Strict portfolio construction limits are based on postcode. Specifically, the Manager does not extend lends to any more than 1 childcare centre in any given postcode. At the Trust level, but not the Fund level, there are prescribed state-based limitations. There has been an indirect impact on the Fund in this regard, as it has partly dictated which existing lends were transferred to the Trust.

State-based diversification is not particularly important, partly because government regulation is set at a Federal level and in any given state, there will always be demographic growth areas. The Fund has grown its loan portfolio as it has diversified away from QLD (and it will continue to do so). In regards to 2 very large markets, NSW and VIC, the Manager has barely scratched the surface and has ample growth potential.

ONGOING PORTFOLIO MANAGEMENT

Ongoing The Finexia Childcare Income Fund maintains vigilant oversight of customer and counterparty performance to minimise any resulting arrears and subsequent defaults and forms an integral part of its credit risk controls. When feasible, external credit ratings and reports are acquired at a reasonable cost and factored into the decision-making process. The Fund adheres strictly to a policy of engaging only with creditworthy counterparties.

The Fund requires borrowers to provide key performance information on a monthly basis. Borrowers are also required to follow the rules listed below and provide a Monthly Compliance Certificate:

- No material change in business activity
- No material change in ownership of the business or any obligor
- No new business partner, shareholder, owner or related party
- All statutory payments are up to date (including Superannuation, GST, PAYG or other tax obligations)
- No rent arrears (as applicable)
- No breach of any finance facility advanced by anyone to any obligor
- No breach of any licence or service provider approval
- Insurance policies are in place, current, and have not had any breaches
- Creative Capital Group's interest remains noted on secured centres
- Confirm sound banking relationship in place with ongoing support expected

These requirements have 2 core purposes:

- They ensure that each centre within the portfolio is achieving its occupancy and trading milestones so the valuation isn't diminished.
- They confirm that the remaining borrower group centres are meeting performance hurdles and trading profitably.

ESG

From an ESG perspective it is the 'S' component that is pertinent to the Fund. A key tenet of the Finexia Childcare Income Fund is that it provides significant social benefit for the broader community by making childcare more accessible and boosting economic growth through increased participation of primary carers (mostly women) in the workforce.

Improving availability and access to early childhood education through the provision of childcare can have several positive social impacts, including educational equity; cognitive, social and emotional development for children; parental employment and gender equality; and community building and long-term economic benefits. We note that in many areas in Australia there is a distinct shortage of childcare facilities and places.

Investment Team

The Credit Committee at Finexia Childcare Income Fund serves as the authoritative body overseeing all proposed loans and other financial accommodations. Tasked with the responsibility of evaluating loan applications, the Committee examines submissions brought forth by the sales team. This review process ensures a thorough assessment, leading to a well-informed decision on the approval or rejection of each loan.

With a notification period of 24 hours for a Credit Committee meeting, the Committee efficiently approves the credit checks conducted by the sales team. The Committee comprises Neil Sheather, Patrick Bell, Jean Marc Li, and Scott Smith, who ensure sound and strategic decisions for the Fund's credit-related matters. We note the Manager is planning to add an additional independent investment committee member over the next 12 months. This appointment is expected to focus on an individual with significant experience and expertise in the Australian childcare sector.

The Manager has recently appointed a new board member, specifically Robert Spano, as a Non-Executive Director. Robert has over 40 years of experience in corporate finance and broader credit markets in Australia and offshore.

Name	Title	Board/Investment Committee/Team
Neil Sheather	Executive Chairman/Director	Board
Patrick Bell	CEO/Executive Director	Board
Robert Spano	Non-Executive Director	Board
Scott Smith	Independent Credit Committee Member	Credit Committee
Conrad Wilson	Lending Executive	Credit Team
Jason Hokin	Corporate Advisory	Credit Team
Addison Clarke	Private Credit Specialist	Credit Team

KARL BRANDT

Karl is the General Manager of Capital Markets at Finexia Financial Group. He guides a team dedicated to asset and funds management, debt, and equity capital markets. With a strong background in the 'Big 4' banks, including ANZ and Commonwealth Bank, demonstrated expertise in funds management and deal/credit structuring across various industries, including childcare, aged care, tourism, and international trading/Import Export business. Karl is also a founding Partner at Creative Capital Group, a specialist Private Credit business focusing on finding the right financial solutions for clients. Karl holds a Masters in Business Administration with Distinction from Griffith University, specialising in Accounting & Finance.

NEIL SHEATHER

Neil joined the Finexia Group in 2014. Neil has a career spanning over 25 years in senior roles such as directorships, responsible executive, licensee, and senior executive management positions. With a recent focus on overseeing the Group's Funds and Asset Management operations, Neil serves as the current Chair of the Group's Credit and Investment Committee. Since the inception of the Group, he has led the Australian operations, playing a pivotal role in reshaping the financial outcomes through strategic restructuring initiatives. Neil holds a Master of Business Administration degree from Newcastle University and several other postgraduate qualifications, including a Graduate Diploma in Applied Finance.

PATRICK BELL

Patrick joined the Finexia Group in October 2020. Patrick has over 20 years of experience in the financial services industry. Currently serving as the CEO and Director of Finexia Financial Group, Patrick's leadership is marked by his extensive experience in corporate finance, where he led Corporate Banking teams for a 'Big Four' bank for more than a decade. His proficiency extends across the commercial financing and private credit sector, where he has garnered expertise in managing detailed lending transactions. Patrick's strategic focus spans diverse industries, including property construction and development, childcare, and tourism. Patrick holds a Bachelor of Business and a Masters in Business Administration, complemented by a Diploma of Finance and Mortgage Broking.

ROBERT SPANO

Robert Spano was appointed a non-executive director effective from 1 February 2024. Robert has over 40 years of experience in the corporate finance and credit markets in Australia and overseas. He has held numerous senior executive and directorships, including as CEO of Alleasing, the largest non-bank-owned leasing company in Australia and New Zealand at the time. More recently, Robert, as a major shareholder in Bigstone Finance, was instrumental in Metrics Credit Partners' acquisition of the business in 2021. He remains a shareholder and Director of Metric Credit Business Finance.

SCOTT SMITH

Scott Smith is a seasoned professional with a diverse career spanning finance, credit management, and commercial real estate. Armed with a Master's in Property Studies and a Bachelor's in Commerce, his journey began as a Commercial Sales and Leasing Consultant. He rapidly progressed through roles at institutions like Westpac Banking Corporation and a private finance company, culminating in his appointment as General Manager of Lending. During this tenure, he managed a substantial loan portfolio, oversaw lending processes, and engaged in credit committee decisions.

CONRAD WILSON

Conrad is a founding Partner at Creative Capital Group having joined the Finexia Group with the acquisition of Creative Capital Group in 2020. Conrad's specialisation lies in industry lending, encompassing areas such as property development and investment, childcare, aged care, accommodation, and management and lending rights. His proficiency extends to various financial instruments, including commercial and private lending, mezzanine funding, equity, and seed funding solutions. Having held senior lending roles for an extensive period, Conrad is well-equipped to assist both new entrants and existing operators across all aspects of funding. Specifically, Conrad has demonstrated proficiency in childcare transactions, covering freehold, leasehold, and going concern scenarios, as well as ventures in the medical sector.

JASON HOKIN

Jason joined the Finexia Group in 2021. He has over 15 years of experience in the finance industry, working across small boutique accounting firms, unlisted and listed investment trusts, and the Big Four Banks. His expertise spans Corporate Finance, Property Finance, and Working Capital Solutions. Jason's areas of expertise include Banking, Credit, Portfolio Management, and Financial Services.

ADDISON CLARKE

Addison joined the Finexia Group in 2021. His expertise is in Equities Trading, Financial Analysis, and Equity Research. His professional journey is marked by remaining at the forefront of dynamic financial markets, with a particular commitment to advancing the domain of private and commercial lending. He holds a Master of Finance and a Bachelor of Business from Bond University, along with the Kaplan Professional Tier 1 Generic qualification.

Compliance and Operations

The Compliance Committee comprises Neil Sheather, Scott Smith, and Warren Goward. The dedicated Compliance Officer is Neil Sheather.

NEIL SHEATHER

Neil Sheather is one of the founders of Finexia Securities Limited and was the original applicant for the Company's Australian Financial Service Licence. Neil played a critical role in formulating and implementing the current Compliance framework and Compliance Program. Neil remains a responsible manager and is the nominated 'key person' on the licence.

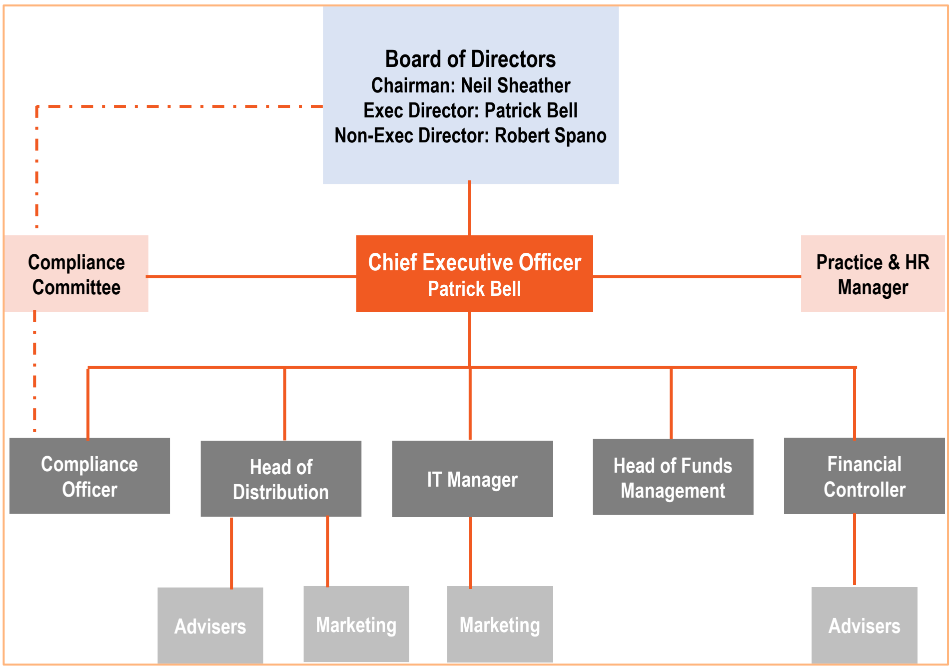
In the role of Compliance Officer, Neil oversees the whole of Finexia's Compliance program which encompasses:

- Maintaining the Compliance program, ensuring the relevant procedures and policies remain current and appropriate for the business. Key to this undertaking is ensuring that Finexia is aware of any regulatory changes or changes in industry standards.
- Monitoring and assessing compliance with Finexia's licence obligations.
- Developing a risk assessment framework and conducting risk assessments along with ongoing monitoring to identify any risks or gaps in the program.
- All reporting obligations to the various stakeholders including regulators and the Finexia board. This includes a comprehensive documentation program designed to ensure all records are maintained, contemporary and accurate.
- Ensuring all staff and authorised representatives maintain the appropriate ongoing education and training standards expected of an AFSL holder. This includes instilling a compliance-aware culture across the organisation.

Once a prospective lending platform has been approved by the IC, the Head of Compliance ensures the loan is consistent with the stated mandate of the Fund. So too will the Responsible Entity (RE) of the Fund. All movements of money to and from the Fund are managed and authorised by the Custodian of the Fund.

Creative Capital Group Pty. Ltd. is the Investment Manager. Finexia Securities Ltd. (ACN 608 667 778, AFSL # 485760) is the Trustee and Responsible Entity. Perpetual Corporate Trust Limited (ABN 99 000 341 533) is the Custodian.

Management Structure



Risk Management

The Trustee of the Fund is responsible for monitoring the terms of the Product Disclosure Statement and ensuring that all trades are appropriately recorded and accounted for.

The compliance of the Fund with its Constitution and Investment Mandate is overseen by Finexia's Head of Compliance, Neil Sheather.

Unit pricing is delegated to the Fund Administrator, following the valuation guidelines contained in the Fund Trust Deed. Note that the Fund is a registered managed investment scheme (ARSN: 658 543 625) under the Corporations Act 2001, and the Trust Deed is lodged with ASIC.

Performance (31 December 2023)

The performance of the Fund is detailed below. We note the following:

- To date, the Fund has generated returns slightly in excess of the stated target of the RBA Cash Rate + 5.65% p.a. We would expect the Fund to continue to achieve its stated returns target based on the operating profit margins of the selected borrower cohort combined with the Manager providing a quasi-first-loss equity note aspect.
- We note the zero arrears and LGD track record of the Fund to date. Though the Fund has only been operational for a short time, we have a high degree of conviction that this quality of performance will persist based on various pertinent factors discussed in this report.

Exhibit 5: Net Performance

Period	Return	Annualised
1 month	0.91%	10.64%
3 months	2.70%	10.80%
6 months	5.40%	10.80%
Since Inception (12 months)	11.00%	11.00%

Exhibit 6: Key Performance Statistics

Period	Returns (p.a.)
Arrears (+30 days)	0.0%
Loss-Given-Defaults	0.0%
WALE	5.5 months
LVR	63.7%

Source: Creative Capital Group

Exhibit 7: Monthly & Annualised Monthly Returns

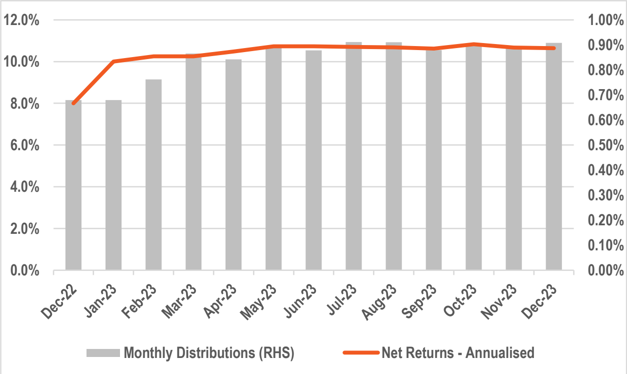
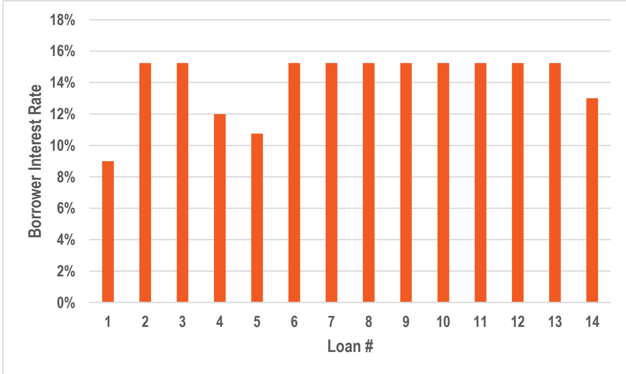


Exhibit 8: Current Portfolio by Borrower Interest Rate



Source: Creative Capital Group

PORTFOLIO CHARACTERISTICS

The Fund's portfolio is presented below in varying aspects. We note that established loans already comprise 54% of the total book, and this may continue to grow over the short-to-medium term. Understandably given the current relatively low FUM, there is a material degree of portfolio concentration, both by loan obligor and state. As FUM grows, the portfolio will become more diversified. The weighted average life (WALE) of the Fund is currently 5.5 months. By Australian private debt standards (excluding mid-market corporate debt), this is a relatively lengthy WALE, and it brings into play a higher risk of various sector-wide risks and challenges that may impact childcare centre operators, as previously discussed in the report.

Exhibit 9: Portfolio by Type – Formative vs. Established

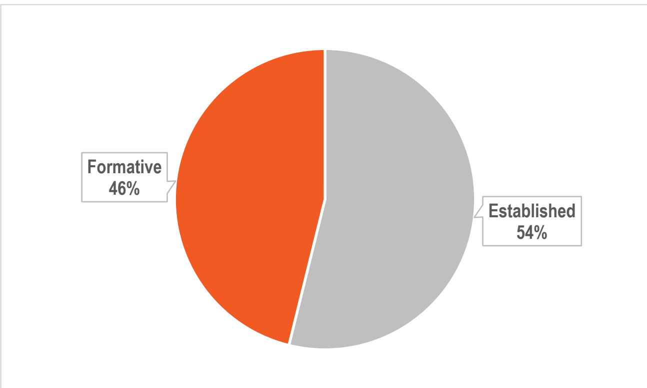
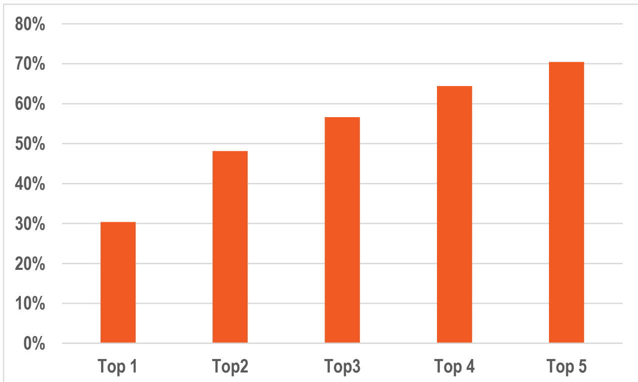


Exhibit 10: Portfolio by Loan Obligor Concentration



Source: Creative Capital Group

Exhibit 11: Portfolio by Geography Timeline

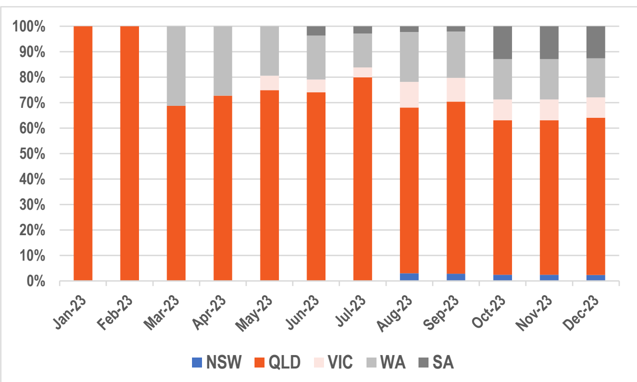


Exhibit 12: Portfolio Key Statistics

Fund Profile	End Dec 2023
Number of Loans	14
Formative/Established Split	48%/54%
Average/Median Loan Size	$1.48M/$1.06M
Weighted Average LVR	63.7%
Cash	0.0%
Arrears over 30 Days	0.0%
Weighted Average Loan Expiry	5.5. months

Source: Creative Capital Group

Transparency & Reporting

The Manager has provided Foresight Analytics and Ratings with the required information in a transparent fashion. Investors receive monthly performance reports and annual audited financial statements.

Third-Party and Service Advisors

Fund Administrator	AMAL Asset Management Limited (ABN 31 065 914 918)
AFSL Licensee	Finexia Securities Ltd. (ACN 608 667 778) AFSL # 485760
Trustee	Finexia Securities Ltd. (ACN 608 667 778)
Custodians	Perpetual Corporate Trust Limited (ABN 99 000 341 533)
Accounting, Fee and Distribution Calculation	Lucas & Co Chartered Accountants, KPMG, Titanium Digital Pty Limited
Taxation Advisor	KPMG
Auditor	Mazars (Audit) QLD Pty. Ltd.
Insurance Provider	Lloyds Of London
IT network Provider	BITS Technology Group, Microsoft 365 Suite and Telstra Network

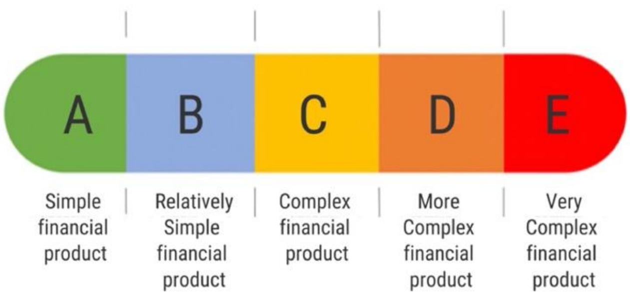
Investment Rating Scale

The Foresight 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 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 fund's 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 return of its benchmark.

Foresight Complexity Indicator

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



Investment Rating and Foresight Complexity Methodology

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

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Financial Services Guide

A copy of the Foresight Analytics' Financial Services Guide can be provided by calling 02 8883 1369.