

CBA Perls VI

Commonwealth Bank has announced the launch of a new income offer: CBA Perls VI (CBAPC). The first round of access is through a broker firm allocation, prior to shareholder and general offer and listing in October.

The Shares will pay a quarterly coupon of 3.80%-4.00% over the 90 day bank bill swap rate (BBSW), 3.62% as of 31st August, with an initial indicative rate of 7.42%-7.62%pa. (The first quarterly price to be set on date of issue) and are expected to redeem 15th December 2018. The Shares will be tradable on the ASX.

CBA Perls VI Offer Details	
Issuer	Commonwealth Bank
Security Name	CBA Perls VI
Initial Call Date	15th December 2018
Mandatory Conversion Date	15th December 2020 (unless redeemed earlier)*
Margin	90 day BBSW + 3.80%-4.00%
Size	\$750m+
Minimum Parcel	\$5,000 (Wealth Focus minimum is \$10,000)

Source: CBA Perls VI prospectus

* conversion subject to conditions

This issue will be used to the extent necessary, to refinance PERLS IV and otherwise to fund CBA's business.

It is expected that the issue will be repaid at the first opportunity in December 2018 with a mandatory redemption in 2020*.

Key Features

- Indicative floating yield of 7.42%-7.62%pa** – based on current 90 BBSW of 3.62% and bookbuild margin range of 3.8%-4.0%. First payment due on 30th December 2012.
- Option to redeem at year 6 with mandatory conversion at year 8** – CBA has the option to convert in December 2018 or on any subsequent dividend payment date.
- Financial Strength** – CBA provides investors with exposure to one of the largest companies listed on the ASX and a market cap of over \$87bn.
- Automatic conversion under the Capital Trigger Event** – we encourage you to be familiar with this clause as it is the reason that this hybrid structure requires a higher margin for investors to consider investing
- Redemption highly likely in 6 years** - although CBAPC has an 8 year maturity, we think CBA will redeem/convert at the first call date in December 2018. Major incentives for redemption/conversion include the potential for reputational damage and risk of credit rating downgrade, leading to an increased cost of funding on future debt issues.

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What we like

1. **CBA hybrids considered at the lower end of the risk spectrum** – Post GFC, the market feels there is an implied guarantee over the banks, as such bank hybrids, and in particular, the big four are considered lower risk by many than some of the lower grade issues such as [APA](#), [Crown](#), [Origin Energy](#) and [Tabcorp](#).
2. **Shorter term** – The recent trend on issues is to extend the maturity date in excess of 25 years. e.g. [Origin Energy Notes](#) (ORGHA), [Woolworths Notes](#) (WOWHC) [Colonial Group Notes](#) (CNGHA), [APA Notes](#) (APKHA) and [Caltex Notes](#) (CTXHA). This is an attempt to fit ratings house' criteria to consider the issue as equity rather than debt. CBAPC's mandatory conversion in 8 years (subject to certain conditions being met) should provide some reassurance to investors.
3. **A higher level of income** – Relative to the other recent CPS issues (ANZPC and WBCPC), CBA Perls VI offers the highest level of income. Investors ambivalent to market movements and view the risk of Australian banks failing as negligible would do well to consider this issue for its higher level of income.

What we don't like

1. **The automatic conversion clause** – APRA standards on new issues means that the bank issues such as [ANZPC](#) (issued August 2011), [WBCPC](#) (issued March 2012) contain an automatic conversion clause to ordinary shares should their Tier 1 capital ratio fall below 5.1%. In the event of a bank failing and a run on deposits, investors holding these hybrids could find themselves converted to ordinary shares in CBA. As a result investors are being offered historically high yields. We should also note that the CBAPC conversion clause is generally more favourable than ANZPC & WBCPC which have a floor on the conversion price.

If you feel there is a risk of the Australian banks failing then this issue is not for you.

We note that CBA have highlighted they are looking for \$750 Million on this issue. Since the funds are for the repayment of around \$1.4 Billion of Perls IV (CBAPB), we strongly suspect that CBA are really looking for over \$1.5 Billion and wouldn't be surprised if this reached as much as \$2 Billion. Whilst we like to see a scale back on these issues as it indicates that there is more demand than supply which should help support the share price upon listing, an issue of this magnitude tends to provide liquidity in the secondary market which institutional investors like.

Comparison to ANZPC & WBCPC

The two most comparable issues on market are ANZPC & WBCPC issued at 3.10% & 3.25% over the 180 day BBSW.

Reflecting the higher risk associated with the automatic conversion clause, these are now trading at below face value and are offering a yield to maturity of around 3.8% over BBSW.

At first glance it would be easy to consider CBAPC as trading at fair margin, but investors should note that both ANZPC & WBCPC are semi annual payments, whereas CBAPC is a quarterly payment.

Quarterly payments are typically more attractive as this allows you to re-invest your return and obtain a higher gross roll up return and value this around \$1.20.

We also feel that the higher running yield (ie the higher income paid today excluding the benefit of a capital gain at maturity) is more attractive to investors.

Our view

Due to the automatic conversion clause within these types of issues, we generally have a preference for the older style bank hybrids over these issues within our client portfolios, but a margin of 3.8% over the BBSW is relatively attractive for this type of issue.

If you are of the view that the banks are never going to fail, you would do well to consider this issue as it allows you to access the highest hybrid margin offered by one of the big four banks.

We view it a relatively attractive issue and wouldn't be surprised to see this trading around \$101 on listing (based on ANZPC & WBCPC pricing as of the 31/08/12).

We also note that the re-investment offer for existing Perls IV holders as of the 3rd September and have listed an overview for Perls IV investors below:

Issue	Issue Margin over BBSW	Current yield		Issue Date	Price 31/08/12	Accrued dividend
		to maturity (over BBSW)				
ANZ CPS 3 (ANZPC)	3.10%	3.84%		28/09/2011	\$ 96.87	\$ 0.27
Westpac CPS (WBCPC)	3.25%	3.78%		23/03/2012	\$ 101.00	\$ 3.00
CBA Perls VI (CBAPC)	3.8%-4.0%*	3.8%-4.0%*		24/08/2012	\$100.00*	-

* Not yet listed on ASX - CBAPC margin is set over 90 day BBSW, ANZPC & WBCPC are set over the 180 day BBSW. Margin over BBSW to be set 10/09/12

Reinvestment Offer for Perls IV (CBAPB) holders

Existing Perls IV holders on the register as at 7th September 2012 have the opportunity to reinvest CBAPB securities into new CBAPC securities with a guaranteed allocation.

CBAPB holders essentially have two options to mature their investment:

- **Participate in Reinvestment Offer** - CBAPB holders can lodge a request for reinvestment for by 5 October 2012. Their securities will be redeemed at \$200 on 12th October and funds reinvested into CBAPC on the 17th October 2012 Issue Date with a final pro-rata distribution on 23rd October.
- **Do nothing and receive \$200 Cash at redemption** – Investors will received \$200 cash redemption per security on 31st October and \$1.3852 fully franked distribution on 23rd October and an additional distribution of \$0.2486 payable on 31st October 2012.

Our view is if you don't want to hold on to CBAPC post listing, sit tight until the end of October.

Note: CBA Perls VI will be listed on the ASX and as such the price will be subject to market movements. Investor's selling on market may receive a price lower (or higher) than the issue price.

Investors looking for an allocation can contact us on 1300 559 869

We encourage you to view our online presentation [An Introduction to Fixed Income](#)