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Peet Bonds (PPCHA)

Fixed Income

Issue overview

Issuer	Peet
Issue ASX code	PPCHA
Face value	$100
Estimated offer size	$75m
Minimum application	$5,000
Fixed rate (indicative)	7.50%
Franking	0%
Interest payments	Half Yearly
First interest payment	16 Dec 2016
Maturity	7 Jun 2021

Timeline

Lodgement of prospectus	2 May 2016
Bookbuild	9 May 2016
Offer opens	10 May 2016
Offer closes:	
Shareholder / Reinvestment	27 May 2016
Broker firm	6 Jun 2016
Issue date	7 Jun 2016
ASX listing (deferred settlement)	8 Jun 2016

This report is to be read in conjunction with the PPCHA prospectus.

A yield uplift from fixed rate senior debt

The new $75m Peet Bonds (PPCHA) provides investors the opportunity to invest in fixed rate senior debt of Australia's largest pure play residential land development business. The security has been launched as a replacement offer for the $50m Peet Convertible Notes (PPCG), ahead of its 16 June 2016 maturity date, where PPCG investors have the option of participating in the Reinvestment Offer.

We see a number of positives associated with the PPCHA issue including:

- **7.50% fixed rate:** Attractiveness increased following the RBA cutting the official cash rate by 0.25% to 1.75% on 3 May 2016.
- **No complex covenants:** Peet's gearing ratio is not to exceed 50% (pro forma 31%), while the Secured Gearing Ratio is not to exceed 40% (Negative Pledge).
- **Shrinking universe of ASX listed debt:** Since early 2014, investment grade corporate issuers have not undertaken replacement issues for maturing ASX listed debt securities. Alternative refinancing options have presented from a recovery in wholesale debt markets and improving access to bank debt.

Figure 1: Refinancing of Maturing ASX Listed Debt Securities

ASX Code	Security	Maturity / Call Date	Issue Size	ASX Listed Replacement Issue
BENHA	Bendigo & Adelaide Bank Retail Bonds	17 Mar 2014	$91m	No
TAHHA	Tabcorp Bonds	1 May 2014	$284m	No
LEPHC	ALE Notes 2	20 Aug 2014	$165m	No
HBSHA	Heritage Notes	27 Oct 2014	$50m	No
PRYHA	Primary Bonds	28 Sep 2015	$152m	No
CBAHA	CommBank Retail Bonds	24 Dec 2015	$570m	No
AYUHA	Australian Unity Notes	14 Apr 2016	$120m	AYUHB
PPCG	Peet Convertible Notes	16 Jun 2016	$50m	PPCHA
			$1,482m	

SOURCE: COMPANY DATA, BELL POTTER

A key investment risk with Peet is the impact to earnings from changes in the housing cycle. At the bottom of the last housing cycle in 2011/2012, Peet renegotiated covenants on its bank debt to achieve a waiver on its interest cover covenant in return for a reduction in its gearing covenant. A weak housing market near the PPCHA maturity in June 2020 may impact the ability of Peet to refinance debt.

Liquidity risk is another key consideration when investing in PPCHA. While the PPCHA offer provides the opportunity to obtain a material holding in the broker firm bookbuild, limited liquidity could result in it taking a number of weeks to trade a material holding.

Key features

- **7.50% fixed rate:** Indicative fixed rate, subject to bookbuild.
- **Senior unsecured debt:** PPCHA offered under the simple corporate bond regime
- **Mandatory payment of half yearly interest & face value at maturity in year 5:** Investors should note there is no guarantee that Peet's cash flows and capital resources will be sufficient to pay face value and interest as and when payable under the terms.

Peet Bonds

PPCG Reinvestment	Dates
PPCG Ex Entitlement	26 Apr 2016
PPCG Record Date	27 Apr 2016
Reinvestment offer closes	27 May 2016
Reinvestment issue date	7 Jun 2016
ASX listing (deferred settlement)	8 Jun 2016
Final interest payment	16 Jun 2016

Reinvestment Offer for Peet Convertible Notes (PPCG)

The $75m PPCHA offer provides a reinvestment opportunity for PPCG investors.

PPCG holders essentially have three options:

- **Option 1: Participate in Reinvestment Offer:** For PPCG holders that lodge their Personalised Reinvestment form by 27 May 2016, subscription for the PPCHA offer will be funded by selling to Peet their PPCG securities.
- **Option 2: Sell PPCG on market:** PPCG last traded at $103.00.
- **Option 3: Do nothing:** Peet must redeem all outstanding PPCG for $100 cash at the 16 June 2016 maturity date, plus the final half yearly coupon.

Refer Section 4.2 (page 26) of the Peet Bonds Part A prospectus for more information on the Reinvestment Offer.

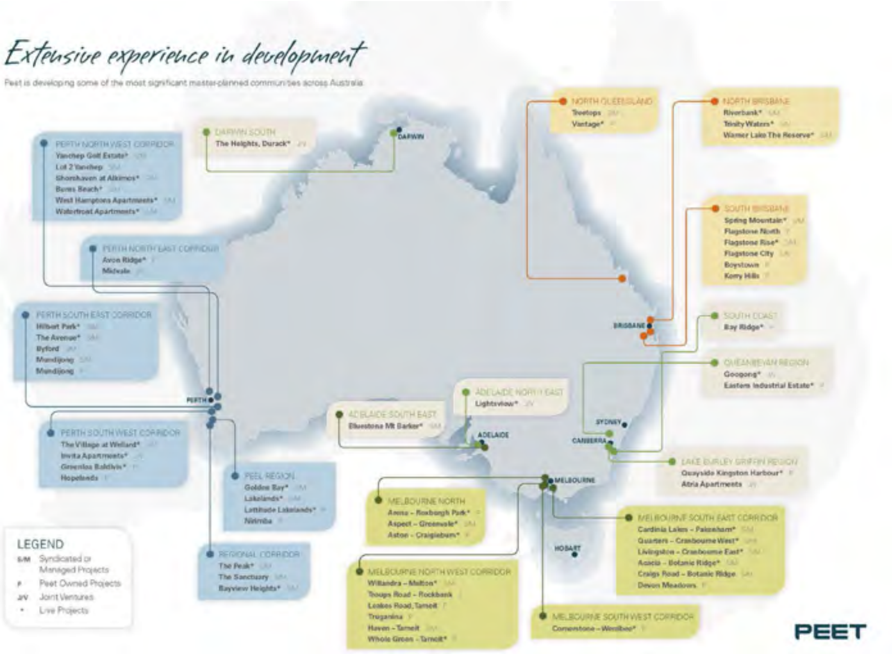
Peet overview

Listing on the ASX in 2004, Peet is Australia's largest pure play residential land development business with a market cap of $456m. Peet has an integrated business model of acquiring, managing, developing, marketing and selling residential land estates, with a land bank of 48,000 residential lots spanning around Australia.

Peet operates in three main segments:

- **Funds Management:** Manages and markets residential developments on behalf of land syndicates and under project management and co-investment arrangements.
- **Development:** Acquires parcels of land for residential development purposes.
- **Joint Venture:** Formed typically with Governments and private land owners where the joint venture party generally contributes land and Peet is responsible for funding and receives fees for managing and developing projects.

Figure 2: Peet residential developments



SOURCE: COMPANY

Peet Bonds

Improving financial metrics with housing recovery

The turnaround in the financial performance of Peet tracks the recovery in Lot Sales which stood at only 870 in 1H12. Between 1H14 and 1H16, lot sales in each half have been between 1,600-1,700.

Figure 3: Peet financial performance 1H12-1H16

	1H12	2H12	1H13	2H13	1H14	2H14	1H15	2H15	1H16
Revenue	$m	$m	$m	$m	$m	$m	$m	$m	$m
Funds Management	15.5	17.1	15.1	15.2	17.2	19.0	21.2	17.4	21.6
Development	36.0	57.2	55.9	72.6	29.2	75.0	94.8	91.2	67.4
Joint Venture	9.7	10.4	9.1	30.3	45.4	50.2	47.7	53.2	29.6
Equity Accounted Investments	0.0	0.0	-0.6	2.4	15.3	5.3	1.4	5.0	6.6
Other	2.6	-1.6	11.8	29.0	12.3	27.8	19.1	9.8	11.5
Total Revenue	**63.8**	**83.1**	**91.3**	**149.5**	**119.4**	**177.3**	**184.2**	**176.6**	**136.7**
EBITDA									
Funds Management	9.5	13.4	9.1	9.7	15.5	14.2	14.2	14.2	14.6
Development	5.1	15.8	9.2	19.6	4.8	20.2	19.6	26.1	17.8
Joint Venture	1.3	1.3	1.2	8.3	13.1	14.3	10.2	11.2	11.1
Equity Accounted Investments	0.0	0.0	-1.0	2.6	15.4	4.1	2.5	5.0	6.9
Other	2.6	-2.4	-3.0	-2.7	-20.9	-7.0	-0.6	-10.0	-10.1
Total EBITDA	**18.5**	**28.1**	**15.5**	**37.5**	**27.9**	**45.8**	**45.9**	**46.5**	**40.3**
Depreciation & Amortisation	-1.1	-1.6	-1.3	-1.5	-1.5	-1.3	-1.6	-1.3	-1.7
EBIT	**17.4**	**26.5**	**14.2**	**36.0**	**26.4**	**44.5**	**44.3**	**45.2**	**38.6**
Net Interest	-7.6	-9.3	-13.6	-12.7	-9.6	-18.0	-14.3	-15.5	-12.8
Tax	-1.1	-5.8	-0.2	-7.0	-1.5	-8.9	-9.1	-8.7	-7.3
Outside Equity Interest	0.0	0.2	0.6	1.0	-0.8	-0.5	-3.8	0.3	0.0
Net Profit	**8.7**	**11.6**	**1.0**	**17.3**	**14.5**	**17.1**	**17.1**	**21.4**	**18.5**
Operating Cash Flow	1.6	-10.2	12.2	57.5	-19.6	56.8	65.4	47.9	14.2
EPS (operating) (cents)	2.7	3.6	0.4	5.0	3.4	3.9	3.8	4.5	3.8
Dividend (cents)	0.0	0.0	0.0	0.0	0.0	3.5	1.5	3.0	1.75
Lot Sales	870	906	963	1,345	1,735	1,790	1,610	1,619	1,659
Lot Settlements	872	1,180	970	1,121	1,507	1,984	1,456	1,810	1,275

SOURCE: COMPANY DATA, BELL POTTER

This has translated through to an improvement in Interest Cover, which has increased from 1.6x in FY12 to 4.4x in 1H16, while gearing has reduced from 40% to 31%. Peet expects gearing to be back within its 20-30% target range by June 2016. Peet's gearing ratio is not to exceed 50% (pro forma 31%), while the Secured Gearing Ratio is not to exceed 40% (Negative Pledge).

Figure 4: Peet financial performance 1H12-1H16

	FY12	FY13	FY14	FY15	1H16
	$m	$m	$m	$m	$m
Revenue	**146.9**	**240.8**	**296.7**	**360.8**	**136.7**
EBITDA	**46.6**	**53.0**	**73.7**	**92.4**	**40.3**
EBIT	**43.9**	**50.2**	**70.9**	**89.5**	**38.6**
Net Interest	-16.9	-26.3	-27.6	-29.8	-12.8
Tax	-6.9	-7.2	-10.4	-17.8	-7.3
Outside Equity Interest	0.2	1.6	-1.3	-3.5	0.0
Net Profit	**20.3**	**18.3**	**31.6**	**38.5**	**18.5**
Operating Cash Flow	-8.6	69.7	37.2	113.3	14.2
EPS (operating) (cents)	2.7	3.6	0.4	5.0	3.8
Dividend (cents)	0.0	0.0	0.0	0.0	1.75
Cash	22.6	36.4	38.8	57.7	49.3
Debt	316.1	321.0	295.5	234.9	235.1
Net Assets	265.3	380.3	420.0	483.9	488.0
Gearing (covenant)	**40%**	**34%**	**30%**	**24%**	**31%**
Interest Cover (reported)	**1.6x**	**1.7x**	**2.8x**	**4.0x**	**4.4x**
Lot Sales	1,776	2,308	3,525	3,229	1,659
Lot Settlements	2,052	2,091	3,491	3,266	1,275

SOURCE: COMPANY DATA, BELL POTTER

Peet Bonds

Shrinking universe of high yield fixed rate debt

In a world where the official cash rate is 1.75% and 5 year swap is 2.25%, fixed rate senior debt yielding 7.50% is likely to spark investor interest, particularly in a market that lacks high yield investment options.

On a risk / reward basis, 7.50% fixed on vanilla Peet senior debt issued under the simple corporate bond regime compares favourably with the 10-11% offered by the private equity owners offered on subordinated debt of issuers such as Myer, Healthscope and MYOB. All of these issuers had significant financial covenants to comply with, that required ongoing improvement in financial performance to satisfy interest cover and leverage ratios. These subordinated debt issues were all redeemed in subsequent IPOs.

Figure 5: Comparative high yield fixed rate ASX listed securities

Issuer	Code	Fixed Rate	Swap	Margin	Launch	Listing	Call / Maturity	Redeemed	Size	Ranking	Financial Covenants
Myer	MYFG	10.1938%	6.2438%	**3.95%**	28 Jul 06	14 Aug 06	15 May 13	Oct 09 (IPO)	$255m	Subordinated debt	Interest Cover to improve from 1.7x to 2.5x Senior Leverage ratio to reduce from 5.6x to 2.5x Debt Service Cover ratio above 1.05x Capex restrictions
Macquarie	MQCPA	11.095%	7.595%	**3.50%**	28 May 08	8 Jul 08	30 Jun 13	Jun 13	$600m	Preferred equity	No financial covenants
Heritage	HBSHA	10.00%	5.565%	**4.435%**	14 Sep 09	26 Oct 09	27 Oct 14	Oct 14	$50m	Subordinated debt	No financial covenants
Healthscope	HLNG	11.25%	5.50%	**5.75%**	15 Nov 10	20 Dec 10	17 Jun 16	Jul 14 (IPO)	$200m	Subordinated debt	Interest Cover to improve from 1.45x to 2.35x Senior Leverage ratio to reduce from 5.15x to 2.7x Debt Service Cover ratio above 1.1x Capex restrictions
Peet	**PPCG**	**9.50%**	**5.50%**	**4.00%**	**25 May 11**	**20 Jun 11**	**16 Jun 16**		**$50m**	**Senior debt**	**Gearing below 52.5%** **Interest Coverage above 2.25x**
Heritage	HBSHB	7.25%	3.75%	**3.50%**	17 May 12	20 Jun 12	20 Jun 17		$227.5m	Senior debt	No financial covenants
Whitefield	WHFPB	10.00% (7% fully franked)	3.60%	**6.40%**	4 Jul 12	16 Aug 12	30 Nov 18		$30m	Preferred equity	Gearing >35% option for holder conversion, Gearing >25% option for issuer conversion
MYOB	MYBG	10.00%	n/a	**6.70%**	26 Nov 12	21 Dec 12	20 Dec 17	Apr 15 (IPO)	$155m	Subordinated debt	Interest Cover to improve from 1.7x to 2.5x Senior Leverage ratio to reduce from 5.6x to 2.5x Cashflow cover ratio above 1.10x Capex restrictions
Healthscope	HLNGA	10.25%	3.40%	**6.85%**	4 Mar 13	28 Mar 13	25 Mar 18	Jul 14 (IPO)	$305m	Subordinated debt	Interest Cover to improve from 1.45x to 2.35x Senior Leverage ratio to reduce from 5.15x to 2.7x Debt Service Cover ratio above 1.1x Capex restrictions
Peet	**PPCHA**	**7.50%**	**2.25%**	**5.25%**	**3 May 16**	**20 Jun 16**	**7 Jun 21**		**$75m**	**Senior debt**	**Gearing <50%, Secured Gearing<40%**

SOURCE: COMPANY DATA, IRESS, BELL POTTER

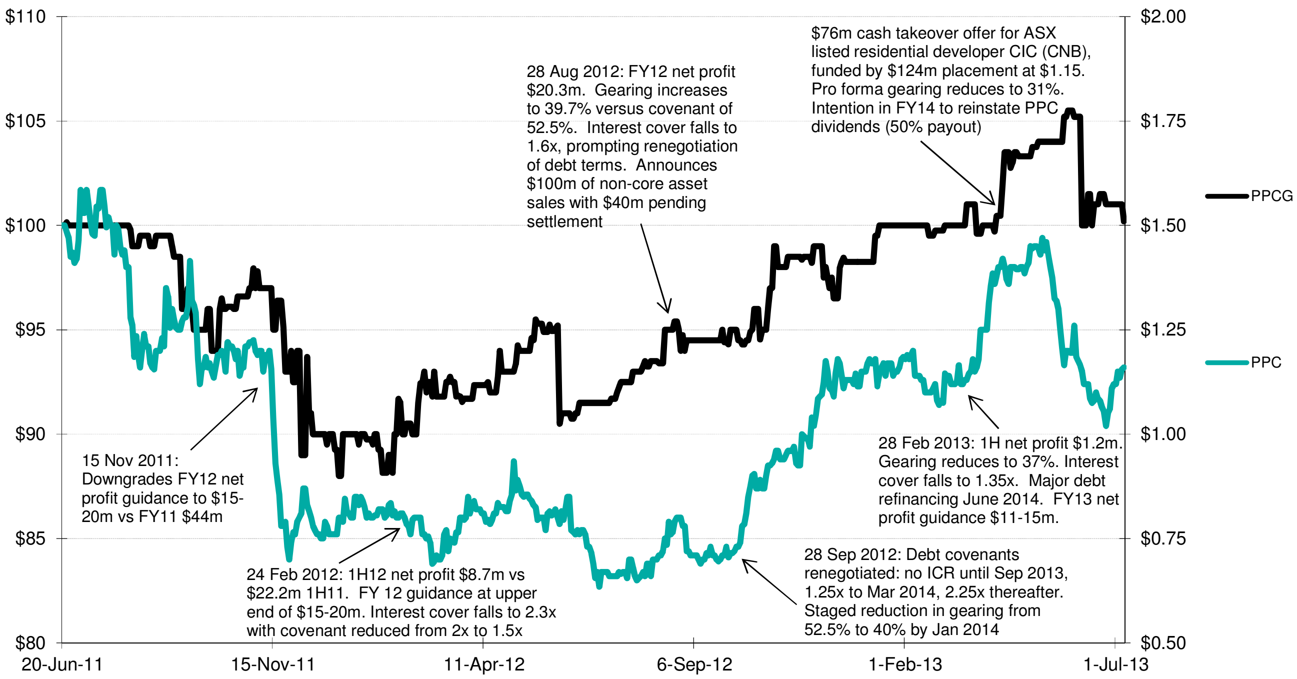
Peet Bonds

Investment risks

Default Risk is the key investment risk for PPCHA. This reflects the ability of Peet to generate sufficient cash flows to satisfy debt obligations (i.e. scheduled interest payments), and to refinance indebtedness on commercially reasonable terms (i.e. redemption at maturity). Deterioration in Peet's financial and operating performance increases the Default Risk. If Peet is unable to generate sufficient cash flow to satisfy its debt obligations, the group may have to undertake alternative financing plans, such as refinancing or restructuring of existing debt, reducing or delaying capital investments or seeking to raise additional capital.

The downturn in the financial performance of Peet across late 2011 and 2012 pushed the PPCG security price to an all time low of $88.00. Peet was also required to restructure its debt facilities to achieve a waiver on its interest cover covenant.

Figure 6: Performance of Peet and PPCG during downturn in 2011-2012



In an event of a wind-up, PPCHA is unsecured, while the $185.5m of bank loans at 31 December 2015 were secured.

Figure 7: Peet capital structure

Ranking	Instrument	Existing obligations	Amount drawn at 31 Dec 2015
Higher Ranking	Senior secured debt	Bank loans	$185.5m
	Senior unsecured debt	PPCG (Convertible Notes)	$50.0m
		PPCHA (Bonds)	**$75.0m**
		Fixed rate loan	$0.2m
	Subordinated Debt	None	
	Preference securities	None	
Lower Ranking	Equity	Ordinary equity	$488m

SOURCE: COMPANY DATA, BELL POTTER

Peet Bonds

Investment risks

Other Investment Risks include:

- Adverse movement in credit spreads as a result of a tightening in the availability and cost of credit.
- New issues may offer more attractive issue terms and margins, placing downward pressure on the market price of the Bonds. It is possible that the Bonds may trade at a market price below their Face Value. There is a risk that if you sell prior to the Maturity Date, you may receive a lower price than the Face Value.
- Fixed rate issue - potential for PPCG to trade at a discount if bond yields increase
- The market for PPCHA may be less liquid than the market for other securities. If holders wish to sell their Bonds, they may be unable to do so easily, or at an acceptable market price, or at all, if insufficient liquidity exists.
- PPCHA may be redeemed early where there is a Tax Event, Change of Control Event, or where less than 10% of the Series remain on issue. In the event of an early Redemption, you may not receive the returns you expected to receive on the Bonds (if held to maturity).

Key Business Risks of Peet include:

- Residential property market conditions
- Property values
- Rezoning and planning approval delays
- Interest rates and bank lending criteria
- Inflation and construction costs
- Availability of funding and refinancing risk
- Changes in Government policy
- Success of syndicates and joint ventures
- Increase in unemployment rate

Refer Section 4 (page 29) of the Peet Bonds Part B: Base Prospectus for further information on risks.

Pros and cons of investing in bonds: MoneySmart website

ASIC's Money Smart website provides information for retail investors about the pros and cons of investing in corporate bonds.

www.moneysmart.gov.au

Fixed Income

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