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Crown Subordinated Notes (CWNHA)



Issue overview

Issuer	Crown
Issue ASX code	CWNHA
Face value	\$100
Estimated offer size	\$400m
Bookbuild margin	5.00%
Franking	0%
Interest payments	Quarterly
First interest payment	14 Dec 2012
Minimum application	\$5,000
Call date	14 Sep 2018
Step-up date	14 Sep 2038
Step-up margin	1.00%
Maturity	14 Sep 2072

Timeline

Lodgement of prospectus	13 Aug 2012
Bookbuild margin	17 Aug 2012
Announcement of margin	20 Aug 2012
Offer opens	21 Aug 2012
Offer closes:	
Shareholder & General	5 Sep 2012
Broker Firm	13 Sep 2012
Issue date	14 Sep 2012
ASX listing (deferred settlement)	17 Sep 2012

Additional Disclosure: Bell Potter Securities Limited is acting as Co-manager to the Crown Subordinated Notes issue and will receive fees for this service.

A six star 8.6% yield from a record high 5% issue margin

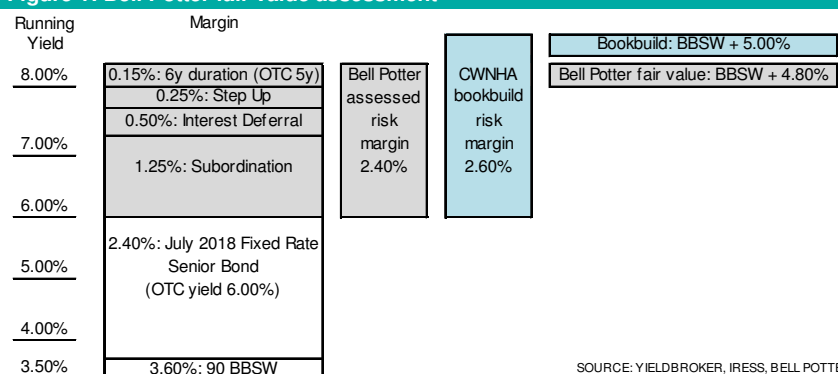
The new \$400m issue of unsecured, subordinated, cumulative notes by Crown (CWNHA) follows on from the announcements in early August of its intention to build 2 new "six star" luxury hotels. The 500 room Crown Towers Perth will commence in early 2013, cost \$568m and take 3 years to complete. While Crown and Lend Lease have signed an Exclusive Dealing Arrangement where both parties will work together to develop plans to build a luxury hotel resort at the Barangaroo South Project in Sydney.

CWNHA's subordinated debt security structure has achieved 50% equity credit from both S&P and Moody's until the Sep 2018 call date, providing support to Crown's financial metrics during this period of development. The issue margin of 5.00% is a record high for a floating rate hybrid, however, this in part reflects the issue terms required to satisfy both ratings agencies. We note the first call date is at year 6 versus the standard of year 5, maturity date is year 60 versus a minimum of year 25, while CWNHA has the provision for both optional & mandatory deferral of interest payments.

While the EBITDA track record for Crown Melbourne and Burswood has been strong, Crown's ability to execute on its development plans and to generate returns sufficient for the capital spend (debt burden) remain key risks. Overall we expect Crown's financial strength and issuer reputation should ensure redemption at the year 6 call date. We also take comfort from CPH's intention to invest \$100m in CWNHA.

Our CWNHA fair value margin assessment of 4.80% provides ~2.4% premium to the July 2017 Crown senior debt security trading in the wholesale over-the-counter market.

Figure 1: Bell Potter fair value assessment



SOURCE: YIELDBROKER, IRESS, BELL POTTER

Key features

- **8.60% initial floating yield:** Based on current 90BBSW of 3.60% + 5.00% margin.
- **Deferral Events:** Provision for interest deferral on a cumulative and compounding basis for both optional (subject to dividend stopper), and mandatory events if the Leverage Ratio is >5.0x (for two consecutive testing dates) or Interest Cover Ratio is <2.5x (for a testing date). Crown has stated it intends to undertake one or more measures to support these financial ratios and restore its credit profile if it is at risk.
- **Redemption most likely at year 6:** Although CWNHA has a 60 year maturity, we expect the loss of equity credit at the year 6 call date should be sufficient to ensure redemption. CWNHA with zero equity credit becomes an expensive debt facility.
- **Change of control trigger increases margin by 5.00%:** Applies if CWNHA is not redeemed under a change of control event. Excludes CPH and related entities.
- **Risks:** Refer page 7.

Crown Subordinated Notes

Crown overview

Crown is one of Australia's largest entertainment groups with businesses and investments in the integrated resorts and entertainment sectors in Australia and Macau. Crown a top 50 S&P/ASX company with a market cap of \$6.2bn, with Consolidated Press Holdings (CPH) owning 43% of its issued capital at 9 Sep 2011.

Crown's wholly owned operations:

- Crown Melbourne (FY12 EBITDA \$510.6m): The Crown Entertainment Complex comprises a casino with a licence extending to 2033 and licences to operate 2,500 electronic gaming machines (EGMs) and 500 table games. In addition, it has three hotels - Crown Towers, Crown Metropol and Crown Promenade - which combined have ~1,600 guest rooms, function rooms including the 1,500 seat Palladium ballroom, restaurants, retail and entertainment facilities.
- Burswood (FY12 EBITDA \$226.3m): Perth's premier integrated resort comprising a casino with a licence extending to 2060 and licences to operate 2,000 EGMs and 220 table games. In addition it has two hotels, a convention centre, a 20,000 seat indoor entertainment centre (Burswood Dome), 22 restaurants and bars, a nightclub and a 2,300 seat theatre. We note EGMs are not permitted in hotels and clubs in WA, and as part of the \$568m Crown Towers Perth development, the WA Government has agreed not to oppose an application for 500 additional EGMs and 130 additional tables.
- Aspinall's Club (FY12 EBITDA \$20.6m): Located in Mayfair, London, it is one of only five licensed high-end casinos in the West End entertainment district.

Crown's investments:

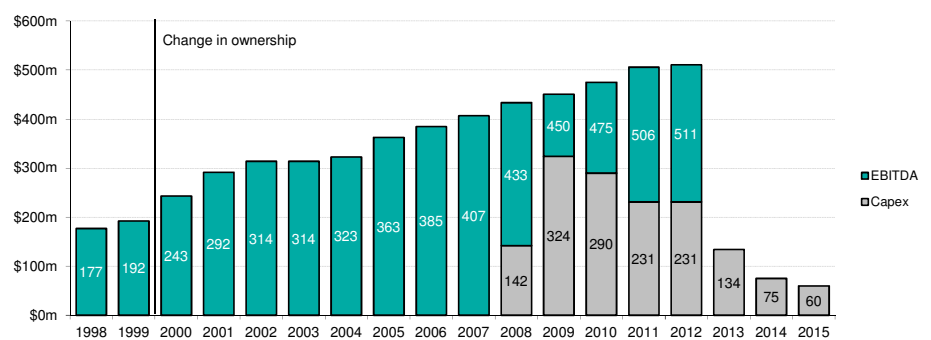
- Melco Crown (33.6%): A developer and owner of casinos and entertainment resort facilities and is one of only six companies granted regulatory gaming concessions in Macau. It owns City Of Dreams: an integrated casino entertainment resort with ~450 table games and 1,350 EGMs; Altira Macau: a luxury casino and hotel with ~180 table games; Mocha Clubs: 2,100 EGMs, and a 60% interest in Studio City Project. In July 2012, Melco Crown announced it had entered into a memorandum of agreement with parties in the Philippines to form a consortium to develop and operate a casino and hotel complex in the Philippines.
- Betfair (50%): Online betting exchange.
- Aspers Holdings (50%): Regional UK casino business.
- Cannery Casino Resorts (24.5%): Operates casinos and resorts in Pittsburgh and Las Vegas.
- Echo Entertainment (10%): Operates four casino complexes in Sydney (The Star), Brisbane (Treasury), Gold Coast (Jupiters) and Townsville (Jupiters). In total these properties operate 4,494 EGMs, 415 table games and 1,408 hotel rooms. Crown is currently seeking regulatory approval in NSW and Queensland to allow it to increase its ownership in Echo up to 25%.

Crown Subordinated Notes

Crown Melbourne

Since the change in ownership 12 years ago, Crown has delivered a steady growth in EBITDA. With the major capex program nearing completion, it appears reasonable to expect a boost in earnings from the refurbishments and areas impacted or closed during the capital works. An improvement in free cash flow could also assist in funding the luxury hotel developments in Perth and Sydney.

Figure 2: Crown Melbourne Normalised EBITDA (1998-2012) and Capex (2008-2015f)

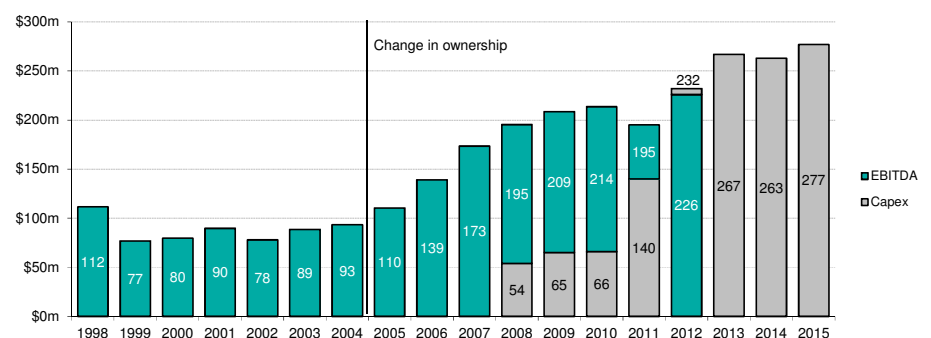


SOURCE: COMPANY DATA, BELL POTTER

Burswood

Crown management has more than doubled Burswood EBITDA since it was acquired 7 years ago. The capex Crown forecasts over the next 3 years on the \$568m Crown Towers Perth development could exceed annual EBITDA for Burswood.

Figure 3: Burswood Normalised EBITDA (1998-2012) and Capex (2008-2015f)



Equity credit for some, debt for others

In order to obtain Equity Credit, the security must have equity like features such as deferral of interest payments and the provision for the issuer to extend redemption to the maturity date. The structure of CWNHA satisfies the requirements of both S&P and Moody's to allow 50% classification as equity in calculation of its financial ratios until the Sep 2018 call date, therefore providing ratings support to Crown.

While the structure satisfies the ratings agencies equity requirements, others view this as debt. As such CWNHA will be classified as debt by the ATO, allowing tax deductions on interest payments. Crown will also report this security as debt on its balance sheet.

Crown Subordinated Notes

Figure 4: ASX listed subordinated debt securities with equity credit features

	Crown Subordinated Notes (CWNHA)	APA Group Subordinated Notes (AQHHA)	Caltex Subordinated Notes (CTXHA)	AGL Energy Subordinated Notes (AGKHA)	Colonial Group Subordinated Notes (CNGHA)	Tabcorp Subordinated Notes (TAHHB)	Origin Energy Notes (ORGHA)	Woolworths Notes II (WOWHC)
Issue size	\$400m	\$350m	\$525m	\$650m	\$1,000m	\$250m	\$900m	\$700m
ASX Listing	17 September 2012	19 September 2012	6 September 2012	5 April 2012	29 March 2012	23 March 2012	23 December 2011	25 November 2011
Margin: 90BBSW+	5.00%	4.50-4.70%	4.50%	3.80%	3.25%	4.00%	4.00%	3.25%
Maturity	60 years	60 years	25 years	27 years	25 years	25 years	60 years	25 years
First call date	Year 6	Year 5.5	Year 5	Year 7	Year 5	Year 5	Year 5	Year 5
Step-up date	Year 26	Year 25	Year 5	Year 7	n/a	Year 5	Year 25	Year 5
Step-up margin	1.00%	1.00%	0.25%	0.25%	0.00%	0.25%	1.00%	1.00%
Optional interest deferral	Yes, subject to dividend stopper	Yes, subject to dividend stopper	Yes, subject to dividend stopper	No	Yes, subject to dividend stopper	No	Yes, subject to dividend stopper	Yes, subject to dividend stopper
Mandatory interest deferral	Yes, if Crown's Leverage Ratio is above 5.0x, or Interest Cover Ratio is below 2.5x	No	No	Yes, if AGL's Leverage Ratio is above 4.0x, or Interest Cover Ratio is below 3.0x	No	Yes, if Tabcorp's Leverage Ratio is above 3.5x, or Interest Cover Ratio is below 3.0x	Yes, if Origin's Leverage Ratio is above 4.0x, or Interest Cover Ratio is below 3.5x	No
Interest deferral	Interest can be deferred on a cumulative and compounding basis	Interest can be deferred on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis	Interest can be deferred for up to 5 years on a cumulative and compounding basis
Assessed equity credit	50% first 6 years, then 0%	50% first 5.5 years, then 0%	50% first 5 years, then 0%	100% first 7 years, then 0%	50% first 5 years, then 0%	100% first 5 years, then 0%	100% first 5 years, then 0%	50% first 5 years, then 0%
Ranking	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above ordinary equity	Subordinated, ranks above prefs and ordinary shares held by Commonwealth Bank	Subordinated, ranks above ordinary equity	Subordinated, ranks equal with Euro Capital Securities and above ordinary equity	Subordinated, ranks above ordinary equity

SOURCE: COMPANY DATA, BELL POTTER

Crown Subordinated Notes

Mandatory Deferral of Interest

CWNHA provides for Mandatory Deferral of Interest if Crown's Leverage Ratio is above the Maximum Level (5.0x) in relation to two consecutive Testing Dates, or the Interest Cover Ratio is below the Minimum Level (2.5x) in relation to one Testing Date.

Assuming 100% debt funding for Crown Perth (\$568m) and Barangaroo (up to \$1bn) with EBITDA remaining constant, we estimate Crown still has adequate headroom under these covenants. Gross debt under this scenario would increase to \$3.26bn versus \$3.8bn of debt covenant debt capacity. We would also expect continued growth in EBITDA, particularly as the major capital spend at Crown Melbourne is nearing completion.

Essentially a breach would require an EBITDA decline of at least 58%. Crown has stated that if its financial profile materially deteriorates such that it risks having an Interest Cover Ratio below the Minimum Level or a Leverage Ratio above the Maximum Level, it intends to take a number of measures to restore its credit profile. These measures may include asset sales, equity issuance, discontinuation of certain businesses and suspension of ordinary dividends.

Figure 5: Pro Forma Leverage Ratio and Sensitivity

6 Months Ended (pro-forma)	30 June 2012
	\$m
Gross Debt	1,694.7
Less 50% of Crown Subordinated Notes on issue	-200.0
Relevant Gross Debt	1,494.7
Relevant Gross Debt (divided by two)	747.4
Normalised EBITDA	359.6
Leverage Ratio (Relevant Gross Debt / Normalised EBITDA)	2.1x
Sensitivity to reach 5.0x Leverage Ratio	
Increase in Relevant Gross Debt (constant EBITDA)	140.6%
Decline in Relevant EBITDA (constant Net Debt)	58.4%

SOURCE: COMPANY DATA, BELL POTTER

Figure 6: Pro Forma Interest Cover and Sensitivity

6 Months Ended (pro forma)	30 June 2012
	\$m
Normalised EBITDA	359.6
Interest Paid	63.4
Interest Received	-4.9
Net Interest Paid	58.5
Less 50% of Interest on Crown Subordinated Notes	-8.7
Relevant Net Interest Paid	49.8
Interest Cover Ratio (Normalised EBITDA / Relevant Net Interest Paid)	7.2x
Sensitivity to reach 2.5x Interest Cover	
Decline in Normalised EBITDA (constant Net Interest)	65.4%
Increase in Net Interest Paid (constant EBITDA)	188.8%

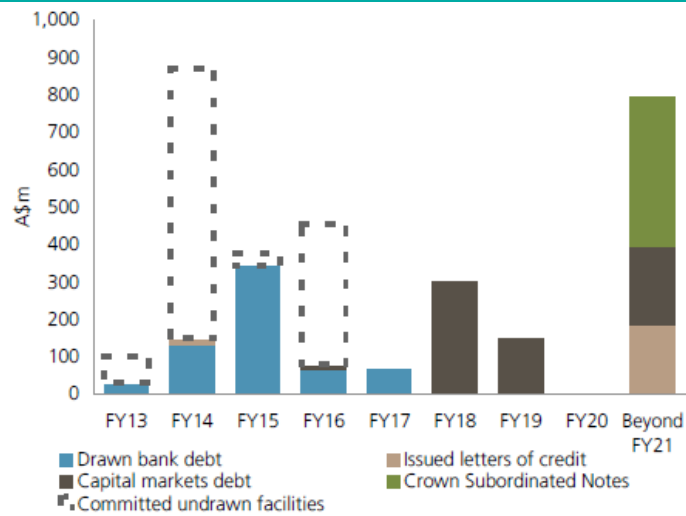
SOURCE: COMPANY DATA, BELL POTTER

Crown Subordinated Notes

Minimal near term debt refinancing

Crown has undertaken a number of significant refinancing tasks to maintain liquidity and extend maturities. At 30 June 2012, Crown had committed undrawn bank debt facilities of \$512.4m and a weighted average debt maturity of 4.5 years.

Figure 7: Debt maturity profile - pro forma at 30 June 2012



SOURCE: COMPANY DATA

Figure 8: CWNHA ranking - pro forma as at 30 June 2012

	Ranking	Existing Instruments	Amount
Higher Ranking	Debt	Bank debt, US private placements, European Medium Term Notes, Australian Medium Term Notes	\$1,695m
		Subordinated debt / hybrids CROHA	\$400m
Lower Ranking	Equity	Ordinary shares	\$3,375m

SOURCE: COMPANY DATA, BELL POTTER

Crown Subordinated Notes

Investment risks

Investment risks are essentially split between Crown Business and Security Risks.

Key Business Risks include:

- Regulatory risks: Including new licences to third parties, loss of licences, enforced reduction / restrictions / taxes applied to EGMs and table games.
- Volatility of VIP gaming: Due to restriction of bet limits, changing casino preferences, and variations in win rates.
- Adverse changes to economic conditions and consumer sentiment, leading to a reduction of customer patronage.
- Increased indebtedness of Crown following its investment in two major hotel developments. Crown's also needs to execute on its development plans and to generate returns sufficient for the capital spend. These risks may impact Crown's ability to refinance debt and maintain its investment grade credit rating.
- Overpaying for acquisitions and investments could weaken Crown's credit profile. Crown may also lack sufficient knowledge of the risks associated with entering a new geography.
- Fraud and IT failures. Counterfeit of casino chips could result in a material loss to Crown. A prolonged IT system failure could result in a significant loss of revenue to Crown.
- OneTel Litigation. Under the Demerger Deed, Crown is liable for 75% of any liability arising to the extent that CMH and its officers are unsuccessful in defending the proceedings issued in the Supreme Court of NEW relating to OneTel's decision not to proceed with a proposed \$132m rights issue in 2001. The potential amount of any such liability is difficult to determine.

Key Security Risks include:

- CWNHA are subordinated obligations of Crown, therefore, rank behind senior debt but ahead of shareholders in the event of a wind-up.
- Adverse movement in credit spreads as a result of a tightening in the availability and cost of credit.
- The interest rate margin is fixed for an initial period of up to 26 years. If credit margins widen beyond the initial range as a result of market forces or a deterioration of Crown's credit metrics, CWNHA may trade at a discount. New issues may also offer more attractive issue terms and margins, placing pressure downward pressure on the security price.
- Deferral of interest payments is likely to have an adverse effect on the market price of CWNHA. An adverse changes in Crown's operating performance could potentially trigger a Mandatory Deferral of Interest Payments and reduce the ability of Crown to redeem at the first call date. Interest payments may also be deferred at the sole discretion of Crown.
- CPH may not proceed with proposed \$100m cornerstone investment.

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