Wealth FOCUS

Peet Bonds – Series 1, Tranche 1

Peet has just announced the launch of a new income offer: Peet Bonds. The first round of access is through a broker firm allocation, prior to shareholder offer and listing in December.

The Notes will pay a half yearly coupon at 7.5%pa and are due to mature 7th June 2021. The bond will be tradable on the ASX.

Peet Bonds Offer Details	
Issuer	Peet Limited
Security Name	Peet Bonds – Series 1, Trache 1 (PPCHA)
Maturity Date	7th June 2021 (unless redeemed earlier)
Interest Rate	7.5% (rate to be determined by bookbuild)
Size	$75 Million
Minimum Parcel	$5,000 (Wealth Focus minimum is $20,000)

Source: Peet Bonds prospectus

This issue will be used primarily to repurchase $50 Million Peet Convertible Notes due to mature in June.

Peet

For those not familiar with the Peet, they are one of Australia's largest residential land development businesses and have a history that spans over 120 years. The primary drivers of the business are development (land banking/development) and Funds Management (project management) of developments.

Historically, the company has focused on land banking in WA but has managed to transform itself over the last few years, diversifying into other states and into the very profitable "Funds Management" business. Investors would do well to spend time understanding the business as it has a significant impact on how you would assess the risk of this investment. Income primarily comes from two sources. In layman's terms;

1. Development – We view this as exposure to infrastructure, where they are in effect acquiring land, laying the infrastructure and selling on to developers to build residential properties.
2. Funds Management – Arguably a project management role, managing the development and markets residential developments on behalf of land syndicates and co-investment arrangements. This is beneficial as it allows them to farm out the expertise they have historically used for Developing their own land without having to employ significant capital.

This has also provided them with opportunity for some vertical integration to move into Joint Ventures typically with Governments and private land owners where the other party generally contributes the land and Peet funds the development, profiting on two fronts, receiving fees for managing and developing projects and the capital gain in the uplift in the developed land value.

Key features

This issue is a vanilla bond;

- 5 year term
- 7.5% fixed rate
- Financial covenants of 40% maximum senior secured debt and 50% overall debt

Risk	Existing Debt Obligations and Equity		Amount Drawn (31/12/15)	
Lower risk	Secured Debt	Bank loans	$185.5 Mill	
	Senior Unsecured Debt	**Peet Bonds**	**$75 Mill**	**This issue**
		Peet Convertible Notes	$50 Mill	
		Fixed rate loan	$0.2 Mill	
	Subordinated Debt	None	None	
	Hybrid Securities / Preferred Equity	None	None	
Higher risk	Ordinary Equity	Equity, Reserves, Retained Earnings	$488 Mill	

What we like

- Simple structure and easy to understand. Assuming solvency, the Bonds ***have to be*** paid back in 5 years
- Simple business model
- The Funds Management business is highly profitable with margins of 60-70%
- Peet's gearing ratios are relatively low at just over 30%
- There are relatively few comparables in the listed market, making this attractive for investors looking to diversify
- Relative to cash rates, a high income level of 7.5%pa
- A fixed rate of return which is likely to become more attractive as interest rates fall
- Distributions are unfranked (*Read our article on when unfranked is better than franked*)
- A small offering of $75 Million with $50 Million prioritised to existing Convertible Notes holders means that demand is likely to be high.

What we don't like

- Exposure to residential property
- A small offering of $75 Million means it is likely to be relatively illiquid

Our view

This is a clean and easy to understand vanilla bond from Peet. The key risk is general business risk of investing in a residential land property developer.

It is no secret that Australia property prices are among the highest in the world and although a correction would not impact on Peet to the same extent as pure residential property developers, it would still significantly impact on their shorter term profitability.

Overall, our view is that the limited size of issue, this week's rate cut and the lack of high yielding non-bank alternatives means that this will likely list at a premium.

We have long expressed our concerns for residential property and investors should note the high yield of 7.5% pa reflects the higher risk. However, we feel Peet's unusual business model means the market is likely demanding a higher premium than would otherwise be demanded.

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