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Suncorp Group Limited Subordinated Notes (SUNPD)

Fixed Interest

Issue overview

Issuer	Suncorp
Issue ASX code	SUNPD
Face value	$100
Estimated offer size	$500m
Bookbuild margin range	2.85-3.10%
Franking	0%
Interest payments	Quarterly
First interest payment	22 Aug 2013
Minimum application	$5,000
Optional redemption	22 Nov 2018
Maturity	22 Nov 2023

Timeline

Lodgement of prospectus	10 Apr 2013
Bookbuild margin	17 Apr 2013
Announcement of margin	18 Apr 2013
Offer opens	18 Apr 2013
Offer closes:	
Securityholder & reinvestment	10 May 2013
Broker firm	20 May 2013
Issue date	22 May 2013
ASX listing (deferred settlement)	23 May 2013

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

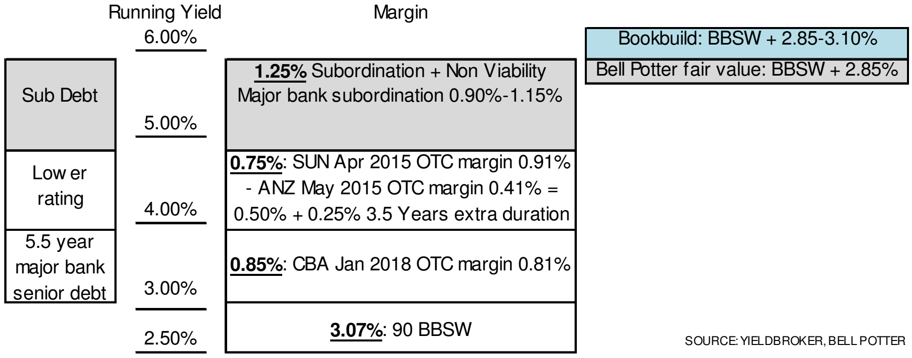
This report is to be read in conjunction with the SUNPD prospectus.

Replacing Convertible Prefs with Subordinated Debt

Suncorp has launched a new $500m Subordinated Note (SUNPD) issue, to replace $735m Suncorp CPS (SBKPB) ahead of its 14 June 2013 Mandatory Conversion date.

A new requirement for Tier 2 subordinated debt securities under the Basel III rules from 1 January 2013 is conversion under a Non-Viability trigger event. If APRA views that Suncorp would be non-viable in the absence of conversion Tier 1 (SUNPC) or Tier 2 (SUNPD) instruments or a public sector injection of capital, SUNPD would only be converted if full conversion of the $560m SUNPC issue was first required.

Figure 1: Fair margin on SUNPD



SOURCE: YIELDBROKER, BELL POTTER

Overall we assess a fair margin of 2.85%, which is at the bottom end of the 2.85-3.10% bookbuild range, providing a margin of ~0.85% above major bank ASX listed subordinated debt securities. As the $500m target issue size could be covered by the $735m reinvestment offer, Suncorp is not guaranteeing 100% allocation of reinvestment applications. This is to ensure an adequate allocation for new money.

Figure 2: Trading margins on debt and equity securities

	Ranking	Security	Trading Margin over BBSW	Maturity	First Call
Higher Ranking	Secured debt	SUN covered bond	77bp	Nov 2017	
	Unsubordinated unsecured debt	SUN senior debt	91bp	Apr 2015	
	Subordinated unsecured debt	ANZHA, NABHB	200bp	Jun 2022	Jun 2017
		Colonial (CNGHA)	250bp	Mar 2037	Mar 2017
		SUNPD (Tier 2)	**285bp**	**Nov 2023**	**Nov 2018**
		BOQ (OTC)	325bp	May 2021	May 2016
	Preference securities	SUNPC (Tier 1)	360bp	Mar 2020	Mar 2018
Lower Ranking	Equity	Ordinary Suncorp shares	500bp	Perpetual	

SOURCE: YIELDBROKER, BELL POTTER

Key features

- **Initial floating coupon of 5.92% p.a.:** Based on 90BBSW of 3.07% + bookbuild margin being set at 2.85%. Interest payments are not deferrable so long as the solvency condition is met. First quarterly interest payment date 22 August 2013.
- **Redemption highly likely at November 2018 first optional redemption date:** Although SUNPD has a Nov 2023 maturity (10.5 years), we view it as highly likely that SUN will redeem at the first optional redemption date in November 2018.
- **Potential for conversion under a Non-Viability Trigger Event**

Suncorp Group Limited Subordinated Notes

SBKPB Reinvestment	Dates
SBKPB Ex Entitlement	28 Mar 2013
SBKPB Record Date	5 Apr 2013
Reinvestment offer closes	10 May 2013
SBKPB Resold to Suncorp	14 May 2013
Reinvestment Issue Date	22 May 2013
SBKPB div pay (69 days)	22 May 2013
ASX listing (deferred settlement)	23 May 2013

SBKPB Redemption	Dates
Ex entitlement	28 Mar 2013
Record date	5 Apr 2013
Reinvestment offer closes	10 May 2013
SBKPB cease trading	30 May 2013
SBKPB redemption	14 Jun 2013
SBKPB dividend paid	14 Jun 2013

Reinvestment Offer for Suncorp CPS2 (SBKPB) holders

As the $500m SUNPD offer is essentially a replacement issue for $735m SBKPB issue, Suncorp is offering the opportunity to reinvest SBKPB securities held at the 5 April 2013 record date into new SUNPD securities. As the target offer size is below the SBKPB issue size, Suncorp is not providing a guarantee of a 100% allocation to reinvestment funds. The reinvestment offer will, however, receive a priority allocation to ensure a high allocation.

SBKPB holders essentially have three options:

- **Option 1: Participate in Reinvestment Offer:** For SBKPB holders that lodge their Personalised Reinvestment for by 10 May 2013, Suncorp will conduct a resale process on 14 May 2013, where it is envisaged a high percentage of securities will be successfully reinvested into SUNPD. Reinvested securities will receive a dividend payment up to 22 May 2013 equating to $0.8272 fully franked (i.e. 90 BBSW at 14 March 2013 of 3.0508% + 3.20% margin = 6.2508% x 69 days / 365 days x $100 face value = $1.1817 gross x 0.7 = $0.8272 fully franked). SBKPB securities that are not successfully reinvested will be released from holding lock as soon as practicable after the 22 May 2013 issue date where investors can sell on market up to 30 May 2013. SBKPB investors that do nothing will receive $100 cash redemption plus $1.1029 fully franked for June 2013 quarterly dividend on the remaining securities on 14 June 2013.
- **Option 2: Sell SBKPB on market:** SBKPB ceases trading on 30 May 2013.
- **Option 3: Do nothing and receive $100 Cash Redemption:** In addition to receiving $100 cash redemption per SBKPB security on 14 June 2013, holders will receive the $1.1029 fully franked dividend for the 92 days of the June 2013 quarter.

Overall the Reinvestment Offer is worthy of consideration. The 2.85% issue margin on SUNPD compares favourably with the 3.20% gross issue margin on SBKPB, particularly given the move to a higher ranking security where the margin reflects the full cash amount of interest payments.

Refer Section 6 (page 62) of the prospectus for more information on the Reinvestment Offer.

Broker Firm Offer and Securityholder Offer

- **Broker Firm Offer:** This is available to clients of Bell Potter, which is a Syndicate Broker to the SUNPD issue. Broker firm bids will participate in the Bookbuild to be held on 17 April 2013.
- **Securityholder Offer:** Available to investors in Suncorp ordinary shares (SUN), Floating Rate Capital Securities (SBKHB), Reset Preference Shares (SBKPA), Convertible Preference Shares (SBKPB) and Convertible Preference Shares 2 (SUNPC). Applications for investors holding these securities at the 10 May 2013 Closing Date requires a HIN or SRN.

Suncorp Group Limited Subordinated Notes

Suncorp overview

Established by the Queensland Government in 1916, Suncorp represents the former State Government Insurance Office with operations spanning life and general insurance, Compulsory Third Party, superannuation and a building society. Suncorp merged with Queensland's largest locally based bank Metway in 1996 and became Australia's largest general insurer post the acquisition of Promina in 2007.

With a market cap of $15bn, SUN is a top 20 ASX listed company, with operations spanning three key business segments across Australia and New Zealand:

- General Insurance: 1H13 net profit up from $162m to $564m. Driven by lower natural disasters and 9.6% Gross Written Premium (GWP) growth with premium increases recovering additional reinsurance costs. Underlying general insurance margin increased from 11.1% to 13.4%, above 12% target.
- Suncorp Bank:
  - ⇒ Core Bank: 1H13 net profit down 7.7% to $144m. Impacted by a decline in net interest margins from 1.92% to 1.83% and higher expenses with the cost to income ratio increasing from 51.7% to 52.7%. Impairment charge was also higher up from $9m in 1H12 (4bp of loans) to $32m in 1H13 (14bp of loans).
  - ⇒ Non-Core Bank: 1H13 net loss $140m (1H12 net loss $54m). The portfolio of run-off loans across development finance, property investment, lease finance and corporate sectors reduced from $4.5bn to $3.4bn, with non-performing loans falling by $205m to $1.6bn. Despite this, impairment charge increased from $122m in 1H12 to $162m in 1H13 due to decline in property values on specific exposures and accounting adjustments on longer duration land development assets.
- Suncorp Life 1H13 fell from $133m to $51m. Impacted by higher lapses (related to insurance affordability), higher claims and a lower investment return.

Capital Adequacy: Suncorp Bank's Common Equity Tier 1 Ratio (Basel III) was 7.39% at December 2012, above the APRA target for 1 January 2016 of 7.00%. The abatement of natural disasters has contributed to the Insurance Minimum Capital Requirements improving from 1.61x at June 2012 to 2.01x at December 2012.

Figure 3: Suncorp brands

SOURCE: COMPANY

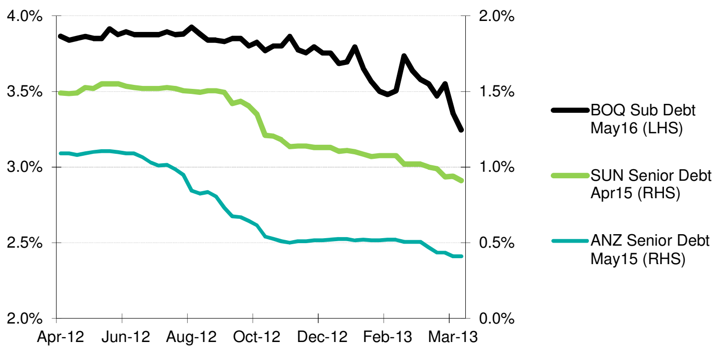
Suncorp Group Limited Subordinated Notes

2.85-3.10% bookbuild margin remains historically high

The trading margin on debt securities has shown continual improvement since Suncorp launches its SUNPC (CPS2) issue in September 2012, with the trading margin on Suncorp April 2015 senior debt firming from 1.50% to 0.91% (middle line).

We have also seen the trading margin on Bank of Queensland subordinated debt with a May 2016 call date firm from 3.85% to 3.25% (top line). The trading margins on the ASX listed subordinated note issues such as ANZHA, NABHB and WBCHA have also firmed from 2.75% to ~2.00% over this period. Overall the bottom end of the SUNPD bookbuild range of 2.85% offers a fair premium of 0.85% over the major bank subordinated debt issues.

Figure 4: Trading margins on wholesale debt securities



SOURCE: YIELDBROKER, BELL POTTER

Loss of Tier 2 capital status an incentive to redeem at year 5

SUNPD will be included as Tier 2 capital until the first optional redemption date on 22 November 2018. If the security has less than 5 years to maturity, the amount of the security included as Tier 2 is reduced by 20% at the beginning of each year. This provides a financial incentive to redeem at the optional redemption date.

Figure 5: Features of Suncorp fixed interest securities

	Term Deposits	Subordinated Notes	Convertible Preference Shares
ASX Code	Not quoted on the ASX	SUNPD	SUNPC
Legal Form	Deposit	Unsecured subordinated debt	Preference share
Protection under the Aust Govt Financial Scheme	Yes, up to $250,000	No	No
Term	1 months to 5 years	10.5 Years with a Non-Call period of 5.5 years	Perpetual, subject to Mandatory Conversion Conditions into ordinary
Issuer early redemption	No	Yes, 22 Nov 2018, subject to APRA approval	Yes, 17 Dec 2017, subject to APRA approval
Interest rate/dividend rate	Fixed	Floating: 90BBSW+285bp	Floating: 90BBSW+465bp (grossed up for franking)
Interest/dividend payment	Cumulative, unfranked	Cumulative, unfranked	Non-cumulative, franked (subject to gross up)
Payment deferral	No	No, unless SUN is not Solvent immediately after making the payment	Yes, dividends are subject to director discretion and APRA tests including a distributable profits test
Interest/dividend payment	End of term, annually, half yearly, quarterly or monthly.	Quarterly	Quarterly
Transferable	No	Yes - ASX listed	Yes - ASX listed
Investor right to request early redemption	Yes, subject to conditions and penalties	No	No
Conversion into Ordinary Shares	No	Only under Non-Viability Trigger Event	Yes, subject to Mandatory Conversion Conditions & Non-Viability Trigger Event
Ranking	Senior to SUNPD, preference shares and ordinary equity	Senior to preference shares and ordinary equity	Senior to ordinary equity

SOURCE: COMPANY DATA, BELL POTTER

Suncorp Group Limited Subordinated Notes

Early Conversion Event: Non Viability Trigger Event

The fallout from the Global Financial Crisis has seen the Basel Committee on Banking Supervision establish new capital reforms to be phased in between 1 January 2013 and 1 January 2019. The key objective of these new reforms is to ensure banks are adequately capitalised in the event of future crises. APRA has responded to these Basel III capital reforms by publishing a discussion paper in March 2012 on adopting an accelerated timetable for implementation. Under Basel III, APRA requires Australian banks to hold a minimum Common Equity Tier 1 Capital Ratio of 4.5% on 1 January 2013, increasing by the 2.5% capital conservation buffer to 7.0% on 1 January 2016.

Post 1 January 2013, APRA's Basel III requirements for the issue of Tier 2 securities include a Non-Viability Trigger Event.

A new requirement for Tier 2 subordinated debt securities under the Basel III rules from 1 January 2013 is conversion under a Non-Viability trigger event. If APRA views that Suncorp would be non-viable in the absence of conversion Tier 1 (SUNPC) or Tier 2 (SUNPD) instruments or a public sector injection of capital, SUNPD would only be converted if full conversion of the $560m SUNPC issue was first required.

We note there are currently no precedents for a Non-Viability Trigger Event. Suncorp believes the types of situations in which APRA may become concerned about non-viability include significant capital losses, prolonged difficulties in raising funding or maintaining sufficient liquidity.

The Non Viability Trigger Event provides the potential for SUNPD holder to receive less than face if the conversion price is 80% below the Issue Date VWAP. Using the current Suncorp share price of $11.53, there is the potential for losses if SUNPD is converted at below $2.31 (i.e. $11.53 x 0.2 = $2.306). In practice this event will only occur in the unlikely scenario that Suncorp suffers severe impairment losses and does not raise ordinary equity to absorb those losses.

Investment risk:

ASIC "Be wary of the risks" warning: Money Smart website

The ASIC publication should be used as guidance which may be relevant to your consideration of SUNPD – namely, information for retail investors who are considering investing in hybrid securities.

Copies of the ASIC Guidance can be obtained from ASIC's website at:

www.moneysmart.gov.au/investing/complex-investments/hybrid-securities-and-notes

Basically, hybrid securities (including subordinated notes and convertible preference shares) may be from well-known companies but they are very different from 'normal' corporate bonds.

Some hybrid securities make investors take on 'equity-like' risks. Some also have terms and conditions that allow the issuer to exit the deal or suspend interest payments when they choose. Some are very long-term investments (for example, more than 20 years).

Hybrid securities may be unsuitable for you if you need steady returns or capital security typically from a bank term deposit style of investment.

Suncorp Group Limited Subordinated Notes

Investment risks

Key Business Risks of Suncorp include:

- A material deterioration in global capital markets and the Australian economy.
- Adverse changes in Suncorp's financial performance which combined with a major series of natural disasters and poor investment performance could place pressure on the levels of Suncorp's regulatory capital levels.
- Increasing reinsurance costs.
- Adverse regulatory changes.
- Operational risks and trading errors.
- Increasing competition.
- Credit rating downgrades.
- Losses associated with counterparty exposures.
- Poor performance of acquired businesses.

Key Security Risks include:

- SUNPD is not a bank deposit protected by the Government guarantee scheme.
- As subordinated debt, SUNPD ranks behind all Suncorp deposits and senior debt obligations.
- 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 security price.
- SUNPD may lose priority ranking ahead of Ordinary Shares and Preference Shares in the event of a wind up if converted due to a Non-Viability Trigger event.
- Inability Event: If Suncorp is not able to issue ordinary shares from Conversion under a Non-Viability Trigger Event, SUNPD holder's rights (including to the payment of interest and face value) will be immediately and irrevocably written off and terminated. This will result in SUNPD losing its value and investors will not receive any compensation. Scenarios under which this may occur include Suncorp being prevented from issuing ordinary shares by circumstances outside of its control, including an applicable law or order of any court, or action of any Government authority from issuing shares.

Refer Section 5 (page 48) of the prospectus for further information on risks.

Fixed Income

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