BELL POTTER

25 September 2012

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Authorisation

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Fixed Interest

Issue overview

Issuer	Suncorp
Issue ASX code	SUNPC
Face value	$100
Estimated offer size	$350m
Bookbuild margin range	4.65-4.85%
Franking	100%
Dividend payments	Quarterly
First dividend payment	17 Dec 2012
Minimum application	$5,000
Optional exchange	17 Dec 2017
Mandatory conversion	17 Dec 2019

Timeline

Lodgement of prospectus	25 Sep 2012
Bookbuild margin	2 Oct 2012
Announcement of margin	3 Oct 2012
Offer opens	3 Oct 2012
Offer closes:	
Securityholder & general	30 Oct 2012
Broker firm	5 Nov 2012
Issue date	6 Nov 2012
ASX listing (deferred settlement)	7 Nov 2012

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

Suncorp Group Limited Convertible Preference Shares2 (SUNPC)

Issuing CPS while the sun shines

Suncorp has launched a new $350m convertible preference share issue (SUNPC), seeking to raise Tier 1 regulatory capital as well as funding the replacement of its $575m Tier 2 Subordinated Callable Notes redeemable on 23 October 2012. While all preference shares such as SUNPC are perpetual in nature, SUNPC may be converted into ordinary shares at the mandatory conversion date in Dec 2019 (subject to meeting Mandatory Conversion Conditions, page 4) and at Suncorp's option in Dec 2017.

The issuer of SUNPC is Suncorp Group, which is a diversified financial services group containing an insurance arm and a banking arm, not the Authorised Deposit Taking Institution (ADI) Bank division. As such, APRA has determined the Common Equity Trigger Event, for a breach of Core Tier 1 capital below 5.125%, does not apply.

SUNPC is still subject to the Non-Viability Trigger Event, where conversion is required into Suncorp shares if APRA views that Suncorp would be non-viable in the absence of SUNPC conversion or a public sector injection of capital. Insurance company IAG on its IAGPC security also has a Non-Viability Trigger Event but no Common Equity Trigger.

Given the issue margin on IAGPC was 4.00% with half yearly dividends, SUNPC which offers the time value of money advantage of paying quarterly dividends offers value with a margin range of 4.65-4.85%, particularly from a top 20 ASX listed issuer with a diversified earnings base.

We assess a fair value margin on SUNPC of 4.50%. This represents a 0.90% premium to our 3.60% CBAPC fair value margin. When compared with CBAPC, the SUNPC structure has the advantage of no Common Equity Trigger Event, and one year shorter duration to mandatory conversion (year 7) and optional exchange (year 5).

Figure 1: Trading margins on debt and equity securities

	Ranking	Security	Trading Margin BBSW+	Maturity	First Call
Higher Ranking	Secured debt	SUN covered bond (issue margin 105bp)	68bp	Dec 2015	Dec 2014
	Unsubordinated unsecured debt	SUN senior debt	142bp	Apr 2015	
	Subordinated unsecured debt	Colonial (CNGHA)	325bp	Mar 2037	Mar 2017
		Bank of Qld (OTC)	387bp	May 2021	May 2016
	Preference securities	**SUNPC**	**465-485bp**	**Dec 2019**	**Dec 2017**
Lower Ranking	Equity	Ordinary SUN shares	>500bp	Perpetual	

SOURCE: YIELDBROKER, BELL POTTER

Key features

- **Initial gross running yield of at least 8.04% (5.63% fully franked):** Floating rate based on 90BBSW of 3.39% + bookbuild margin of at least 4.65%.
- **Issuer option to exchange at year 5, mandatory conversion year 7:** Suncorp has option to exchange in December 2017, subject to APRA approval.
- **Ordinary dividend restrictions:** Applies on the non payment of SUNPC dividends
- **Automatic conversion under the Non-Viability Trigger Event**

Suncorp Convertible Preference Shares 2

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 $12.0bn, SUN is a top 20 ASX listed company, with operations spanning three key business segments across Australia and New Zealand:

- General Insurance: FY12 net profit up 25.8% to $493m. Strong premium growth due to increased natural hazards and reinsurance costs. This offset $278m of natural hazard claims above allowance, primarily due to $234m of claims relating to the Melbourne hail storm, and negative income mismatch of $197m.
- Suncorp Bank:
  - ⇒ Core Bank: FY12 net profit up 11.6% to $289m. Boosted by 9.6% residential lending growth, net interest margin stable at 1.91% and a 19.6% reduction in impairment charge to $41m (9bp of loans).
  - ⇒ Non-Core Bank: FY12 net loss $263m (FY11 net loss $175m). The portfolio of run-off loans across development finance, property investment, lease finance and corporate sectors reduced from $7.3bn to $3.5bn, with non-performing loans falling from $2.4bn to $1.8bn. Despite this, impairment charge increased from $122m in 1H12 to $242m in 2H12 on account of $73m of provisions against three retail assets and $55m of accounting adjustments on longer duration land development assets.
- Suncorp Life FY12 net profit up 68.5% to $251m. Driven by strong results in major business areas.

Capital Adequacy: Suncorp Bank's Common Equity Tier 1 Ratio (Basel III) was 7.29% at June 2012, above the APRA target for 1 Jan 2016 of 7.00%. The series of natural disasters across recent years has contributed to the Insurance Minimum Capital Requirements falling from 2.03x at December 2010 to 1.61x at June 2012.

Figure 2: Suncorp brands

SOURCE: COMPANY

Suncorp Convertible Preference Shares 2

Historically high margins limit downside risk

The 4.65-4.85% SUNPC margin range represents a record high for an ASX listed debt / hybrid security issued by a top 20 ASX listed company. It also provides a healthy premium to the 3.80% margin on the recent CBAPC issue and the 4.00% margin on the IAGPC issue, highlighting the historically high margins on offer.

Figure 3: Issue margins on comparative preference shares

Date of Listing	Issuer	Hybrid Code	Description	Margin over BBSW
13-Jun-08	SUN	SBKPB	Convertible Preference Shares	3.20%
29-Jul-08	WBC	WBCPA	Stapled Preferred Securities	2.40%
1-Oct-08	ANZ	ANZPB	Convertible Preference Shares	2.50%
30-Mar-09	WBC	WBCPB	Stapled Preferred Securities II	3.80%
13-Oct-09	CBA	CBAPA	PERLS V	3.40%
18-Dec-09	ANZ	ANZPA	Convertible Preference Shares 2	3.10%
29-Sep-11	ANZ	ANZPC	Convertible Preference Shares 3	3.10%
26-Mar-12	WBC	WBCPC	Convertible Preference Shares	3.25%
2-May-12	IAG	IAGPC	Convertible Preference Shares	4.00%
18-Oct-12	CBA	CBAPC	PERLS VI	3.80%
1-Nov-12	BEN	BENPD	Convertible Preference Shares	5.00-5.50%
7-Nov-12	SUN	SUNPC	Convertible Preference Shares 2	4.65-4.85%

SOURCE: COMPANY DATA, BELL POTTER

SUNPC compares favourably with other convertible preference shares on a trading margin basis (i.e. gross yield to maturity less BBSW). It offers a premium to IAGPC, with SUNPC providing the time value of money advantage of quarterly dividends (IAGPC half yearly), combined with a more diversified business which includes a bank, and a larger market cap ($12bn vs $9bn).

The Common Equity Trigger Event for a breach of Core Tier 1 capital below 5.125% is a feature of recent Basel III Additional Tier 1 Capital issues, including ANZPC, WBCPC, BENPD and CBAPC. APRA does not require this feature on SUNPC as the issuer is Suncorp Group, which is a diversified financial services group containing an insurance arm and a banking arm, not the ADI Bank division.

ANZPC, CBAPC & WBCPC were all issued with a term one year longer than SUNPC - i.e. 8 years to mandatory conversion with an option for early redemption at year 6. SUNPC has 7 years to mandatory conversion with optional exchange at year 5.

Figure 4: Convertible preference share ranking: gross yield to maturity margin over BBSW

Issue	ASX Code	Gross Margin Over BBSW	Price 24-Sep-12	Face Value	Mkt Cap $m	Call / Conv Date	Conv Method	Gross Run Yld	Gross Yld to Mat	Gross YTM to Swap	Conv Disc
BEN CPS	BENPD	500bp	$100.00	$100	$125	Dec-17	Mand Conv	8.36%	8.36%	5.00%	2.5%
SUN CPS	SBKPB	320bp	$99.25	$100	$729	Jun-13	Mand Conv	6.69%	8.29%	4.90%	1.0%
SUN CPS2	**SUNPC**	**465bp**	**$100.00**	**$100**	**$350**	**Dec-17**	**Mand Conv**	**8.04%**	**8.04%**	**4.65%**	**1.0%**
IAG CPS	IAGPC	400bp	$100.25	$100	$378	May-17	Mand Conv	7.80%	7.91%	4.55%	1.0%
CBA PERLS V	CBAPA	340bp	$201.37	$200	$2,014	Oct-14	Mand Conv	6.79%	7.19%	3.80%	1.0%
CBA PERLS VI	CBAPC	380bp	$100.00	$100	$1,500	Dec-18	Mand Conv	7.19%	7.19%	3.80%	1.0%
WBC CPS	WBCPC	380bp	$98.47	$100	$1,171	Mar-18	Mand Conv	6.71%	6.97%	3.61%	1.0%
ANZ CPS2	ANZPA	310bp	$99.26	$100	$1,954	Dec-16	Mand Conv	6.57%	6.91%	3.52%	1.0%
ANZ CPS3	ANZPC	310bp	$98.88	$100	$1,325	Sep-17	Mand Conv	6.76%	6.87%	3.51%	1.0%
ANZ CPS1	ANZPB	250bp	$99.00	$100	$1,070	Jun-14	Mand Conv	5.98%	6.78%	3.39%	2.5%
WBC SPS	WBCPA	240bp	$99.15	$100	$1,027	Sep-13	Mand Conv	5.84%	6.73%	3.34%	1.0%
WBC SPS II	WBCPB	250bp	$101.45	$100	$921	Sep-14	Mand Conv	7.09%	6.50%	3.11%	1.0%

Projected running yield and yield to maturity assume BBSW holds at the current level: 90 BBSW 3.39% 180 BBSW 3.36%

Suncorp Convertible Preference Shares 2

Mandatory Conversion Conditions

In order for bank Convertible Preference Shares (CPS) to qualify as Additional Tier 1 capital, APRA has imposed a maximum conversion number in order to limit the dilution of ordinary shares upon conversion.

This maximum conversion number represents the face value of the preference share divided by 50% of the volume weighted average price (VWAP) of the issuer on the 20 business days preceding the issue date (Issue Date VWAP). For example, if SUN's 20 day VWAP was $9.29 before the issue date, the maximum exchange number would be 21.529 Suncorp shares per SUNPC security (i.e. $100 / (50% x $9.29).

To protect SUNPC holders from receiving less than face value at mandatory exchange, there are Mandatory Conversion Conditions which investors need to be aware of:

- First: VWAP of ordinary shares on the 25th business day before a possible Mandatory Conversion Date (12 November 2019) must be above 55% of the Issue Date VWAP. Using the Suncorp's price of $9.29 x 55% = $5.11
- Second: VWAP of ordinary shares during the 20th business days immediately preceding a possible Mandatory Exchange Date (19 November 2019) must be greater than 50.51% of the SUNPC Issue Date VWAP $9.29 x 50.51% = $4.69.
- Third: No Delisting Event (i.e. Suncorp shares delisted or suspended from ASX trading) applies to ordinary shares in respect of a Mandatory Conversion Date, which may prevent converted shares being sold on the ASX.

If Mandatory Conversion Conditions are not satisfied, mandatory conversion will not occur. *SUN does, however, have the option of applying to APRA for cash redemption.* Two factors APRA will consider in allowing redemption are:

- Suncorp issues a replacement capital instrument of at least the same quality as SUNPC
- APRA is satisfied Suncorp's capital position is sound and does not have to issue a replacement capital instrument for SUNPC.

In the event mandatory conversion does not occur, the security will remain on issue and continue to pay dividends at the same margin. Mandatory Conversion Conditions will be tested on each subsequent quarterly dividend date.

Figure 5: Mandatory Conversion Conditions

	SUNPC	ANZPA	ANZPB	ANZPC	BENPD	CBAPA	CBAPC	IAGPC	MQCPA	SBKPB	WBCPA	WBCPB	WBCPC
Date of Hybrid Issue	6-Nov-12	18-Dec-09	1-Oct-08	29-Sep-11	1-Nov-12	13-Oct-09	17-Oct-12	1-May-12	8-Jul-08	13-Jun-08	29-Jul-08	30-Mar-09	23-Mar-12
Mandatory Conversion Date	17-Dec-19	15-Dec-16	16-Jun-14	1-Sep-19	13-Dec-19	15-Oct-14	15-Dec-20	1-May-19	30-Jun-13	14-Jun-13	26-Sep-13	30-Sep-14	30-Mar-20
Conversion Discount	1.0%	1.0%	2.5%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Issue Date VWAP	$9.29	$21.80	$17.35	$19.53	$7.75	$50.49	$55.08	$3.46	$48.79	$14.38	$20.09	$17.51	$20.83
50% Dilution Cap	$4.65	$10.90	$8.68	$9.77	$3.88	$25.25	$27.54	$1.73	$24.40	$7.19	$10.05	$8.76	$10.42
Max Conversion No (Face Value/Dilution Cap)	21.53	9.17	11.53	10.24	51.61	7.92	7.26	57.80	4.10	13.91	9.95	11.42	9.60
Conversion Test 1 - % Issue Date VWAP	55.00%	56.00%	56.00%	56.00%	57.50%	56.00%	56.00%	57.50%	55.56%	55.56%	55.56%	55.56%	55.56%
Conversion Test 1 Security Price	$5.11	$12.21	$9.72	$10.94	$4.46	$28.28	$30.84	$1.99	$27.11	$7.99	$11.16	$9.73	$11.57
Conversion Test 2 - % Issue Date VWAP	50.51%	50.51%	51.28%	51.28%	51.28%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%
Conversion Test 2 Security Price	$4.69	$11.01	$8.90	$10.01	$3.97	$25.50	$27.82	$1.75	$24.64	$7.26	$10.15	$8.84	$10.52
Conversion Test 3 - Continuous Trading	Yes	Yes	Yes	Yes	Yes	n/a	n/a	Yes	Yes	Yes	n/a	n/a	n/a
Parent Share Price - 24 September 2012	$9.29	$24.70	$24.70	$24.70	$7.75	$55.08	$55.08	$3.37	$29.00	$9.29	$24.58	$24.58	$24.58
Prem/Disc to Dilution Cap	100.0%	126.6%	184.7%	152.9%	100.0%	118.2%	100.0%	94.8%	18.9%	29.2%	144.7%	180.8%	136.0%
Prem/Disc to Exchange Test 1	81.8%	102.3%	154.2%	125.8%	73.9%	94.8%	78.6%	69.4%	7.0%	16.3%	120.2%	152.7%	112.4%

Suncorp Convertible Preference Shares 2

Early Exchange Events: Capital Trigger Events

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 Jan 2013 and 1 Jan 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 Jan 2013, increasing by the 2.5% capital conservation buffer to 7.0% on 1 Jan 2016.

APRA's Basel III requirements for the issue of Tier 1 securities include a Non-Viability Trigger Event. Under this Trigger Event, securities such as SUNPC must be converted into ordinary equity if the financial position of Suncorp requires an immediate injection of capital.

Non-Viability Trigger Event

In addition, SUNPC will be Exchanged if APRA determines that Suncorp would be non-viable in the absence of an exchange or write off or a public sector injection of capital. We note there are currently no precedents for a Non-Viability Trigger Event. SUN 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.

No Mandatory Conversion Conditions under Early Exchange

Exchange resulting from a Capital Trigger Event or a Non-Viability Trigger Event will be done at the VWAP of Suncorp shares traded on the 5 Business Days immediately preceding the Exchange Date. While this is not subject to the Mandatory Conversion Conditions, it is still subject to the Maximum Conversion Number, which represents the face value of the preference share dividend by 20% of the issue date VWAP. If SUN's 20 issue date VWAP was $9.29, the maximum exchange number would be 53.8213 SUN shares per SUNPC security (i.e. $100 / (20% x $9.29)).

As such, SUNPC investors may be exposed to receiving less than face value if SUNPC is exchanged at less than $1.86. In practice this will only occur in the unlikely scenario that the issuer suffers severe losses and does not raise equity to absorb those losses.

Suncorp Convertible Preference Shares 2

Investment risks

Key Security Risks include:

- SUNPC is not a bank deposit protected by the Government guarantee scheme.
- As preferred equity, SUNPC ranks behind deposits, senior debt and subordinated debt in Suncorp.
- SUNPC dividends are at Suncorp's discretion and are non-cumulative.
- Dividend Payment Test: Suncorp must satisfy the requirement of the Dividend Payment Tests in order to pay SUNPC dividends. These include:
  - The dividend would not result in Suncorp's minimum capital requirements breaching APRA's capital adequacy guidelines.
  - The dividend would not likely result in Suncorp becoming insolvent.
- 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.
- SUNPC may lose priority ranking ahead of Ordinary Shares in the event of a wind up if converted due to a Non-Viability Trigger event.
- Conversion of SUNPC at the Dec 2019 Mandatory Conversion Date requires SUN's share price at the time of Mandatory Conversion to be above certain thresholds. If these thresholds are not met in Dec 2019 or at future quarterly dividend payment dates, SUNPC may remain on issue indefinitely.
- Inability Event: If Suncorp is not able to issue ordinary shares from Conversion under a Non-Viability Trigger Event, the rights attached to SUNPC in respect of dividends and return of capital on and from the sixth day after the Non-Viability Conversion Date will change. SUNPC holders will lose priority ranking over ordinary equity and the economic interest will be effectively limited to the dividends payable on the number of ordinary shares SUNPC holders would have receive on conversion. The capital value under of SUNPC under an Inability Event will most likely be significantly reduced as SUNPC will become an investment which may not be able to be sold on the ASX. In the event of a winding up, SUNPC holders claim relates to the surplus available to ordinary shareholders on the basis that SUNPC was converted into ordinary shares (i.e. proportionate claim to the enlarged ordinary equity base). 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.
- As Suncorp's Constitution does not presently contemplate the issue of preference shares on the terms contemplated where a Write Off is to apply which is required for SUNPC to be Basel III compliant, Suncorp is seeking Shareholder approval at its 2012 AGM to amend its constitution for inclusion of this term. If Shareholder Approval is not obtained, SUNPC would not be Basel III compliant and would only count as regulatory capital in accordance with APRA's standard transitional treatment.

Suncorp Convertible Preference Shares 2

Investment risks (continued)

Key Business Risks of SUN 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.

Refer Section 5 (page 54) of the prospectus for further information on risks.

Additional 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 SUNPC – 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.

Fixed Income

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