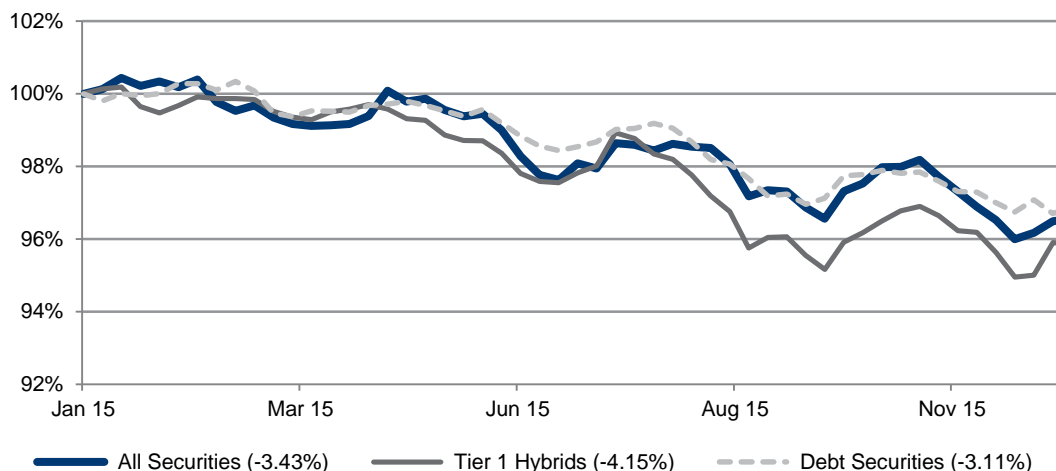


# *Can bonds beat shares? Opportunities for 2016*

January 2016

## 2015 – a quick recap of performance

- Prices declined across the board in 2015 as the S&P/ASX 200 index fell -2.1%
- The big four banks were mixed but on average declined -4.9%
- Morgans All Securities Index shed -3.4%
- Morgans Tier 1 Hybrid Index fell -4.2% short dated securities outperformed significantly
- Morgans Debt Securities Index declined -3.1%
- These Index capital value declines are before adding back income of circa 6.00%
- Treasury Bond index delivered modest positive performance of 2.30% over the year



## Upcoming Call/Maturity dates in 2016

### ANZPA (15 December 2016 Conversion date)

- The market expects ANZ to offer holders a new Tier 1 hybrid security or \$100 redemption value

### AYUHA (14 April 2016 Maturity date)

- The issuer raised \$250m in late 2015 to refinance this security - holders will receive \$100 face value

### ORGHA (20 December 2016 Call date)

- While under financial pressure, redemption and payment of \$100 to holders is anticipated

### PCAPA (6 April 2016 Step-up date)

- The market expects CBA to offer holders a new Tier 1 hybrid security or \$200 face value

### PPCG (20 June 2016 Maturity date)

- With access to attractively price wholesale debt, expect redemption at \$100

### WCTPA (30 June 2016 Step-up date)

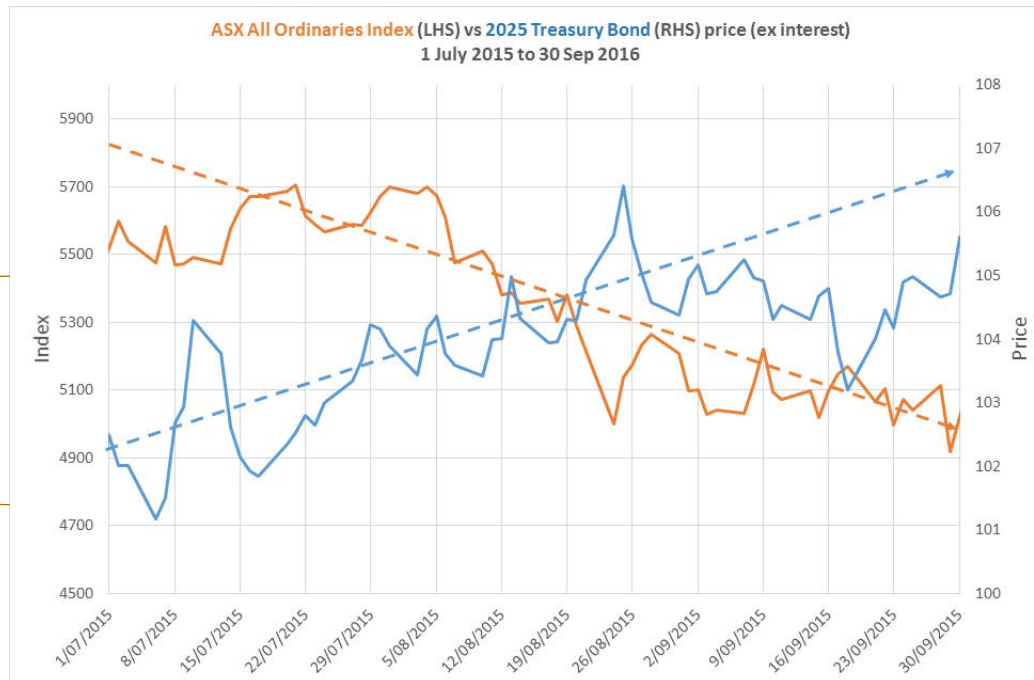
- The market expects WBC to offer holders a new Tier 1 hybrid security or \$100 face value

### WOWHC (24 November 2016 Call date)

- Given the loss of 'equity credit' post the Call date redemption is expected; potentially a new issue

# What about Government Bonds?

- ASX Listed AGBs give direct bond exposure via CHESS
- 2015 delivered relatively flat performance at 2.30% over the year
- However this doesn't mean there isn't a case for holding bonds
- Bonds offer significant diversification in periods of severe equity market uncertainty

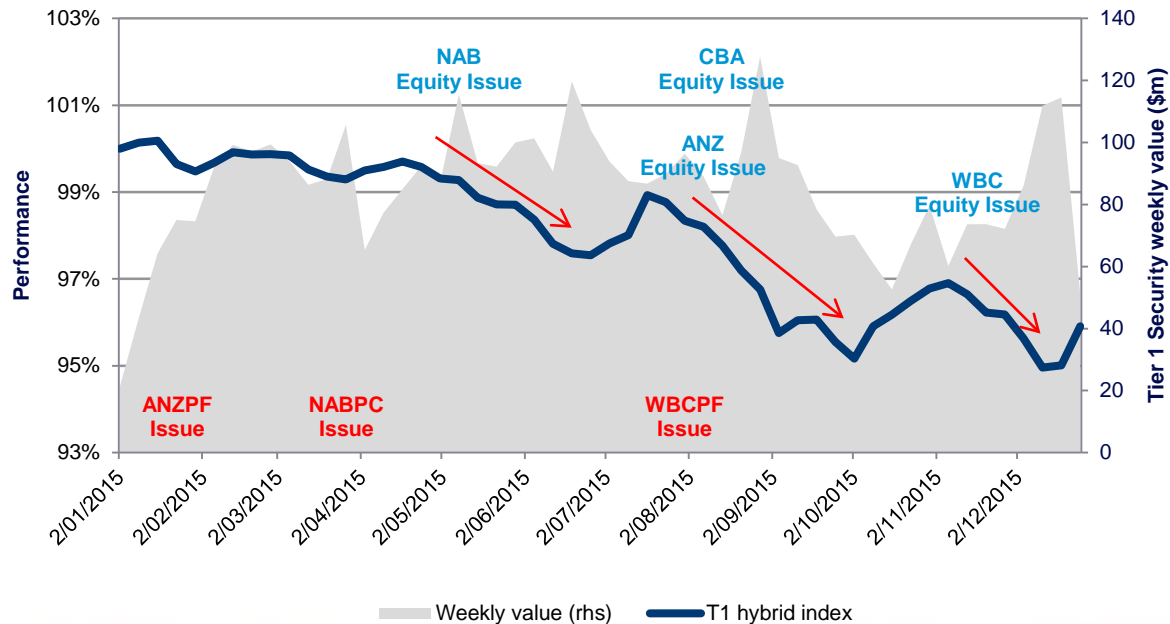


Equity prices fell

Bond prices rose i.e. yields fell

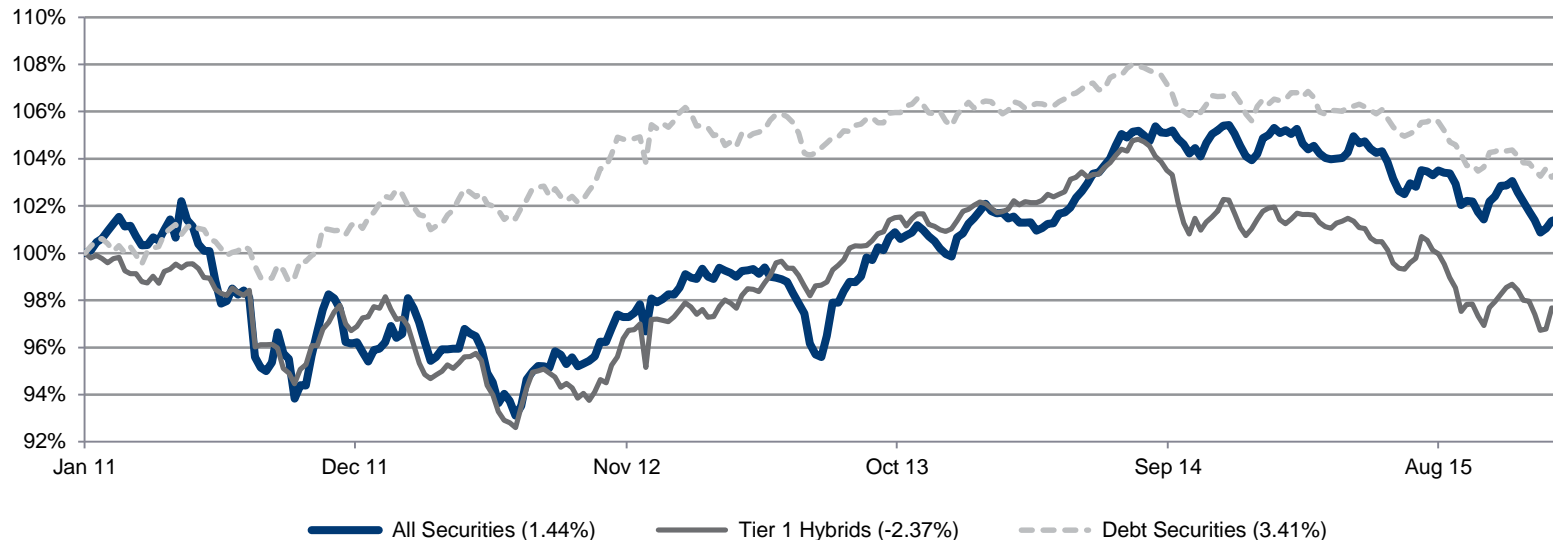
# It was bank equity raisings that impacted prices in 2015

- While there may be some “announcement effect” from new issues seen in Tier 1 hybrid securities, prices generally stabilise quickly
- However the substantial equity raisings undertaken by the major banks was the big driver of Tier 1 hybrid weakness in 2015
- The banks raised \$17.3b of equity in 2015 compared to just \$4.7b of hybrid issuance
- Tier 1 hybrid price weakness coincides with the announcement of bank capital raisings and increased trading volumes ensue as investors sell to fund them



## Tier 1 hybrid underperformance expected to reverse

- Security prices (illustrated below) have traded within 6 - 8% of Par value over the past five years
- Debt securities have performed the best due to their senior ranking and higher cash margins
- As these securities near call dates - prices move back toward Par
- In 2014 Morgans viewed Tier 1 hybrids as expensive but now see them as undervalued
- Tier 1 appeal is bolstered by the significant increases in core capital levels of the issuers
- As securities approach call/conversion dates - prices will move back up toward Par



# Morgans Security Summaries are now available on asx.com.au

- Morgans provides a single page summary of all major ASX listed bonds and hybrids
- It covers:
  - Issuer details
  - Key credit considerations
  - Financial commentary
  - Company financial profile
  - Historical price performance



## Tatts Bonds

Bond 3-Bbsw+ 3.10% 5-07-2019

TTSHA,ASX

<b>Security Issue Size</b> A\$195m	<b>Avg. Daily Turnover</b> \$0.05m	<b>Last price</b> Fair value Fair margin	<b>A\$103.50</b> <b>A\$102.59</b> <b>239 bp</b>	<b>HOLD</b>
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### Pricing

Clean price:	\$103.36
Cash yield:	5.08%
Gross yield:	5.08%
Yield to call:	4.42%
Implied sw apt:	2.32%
Trading margin:	2.10%

### Issue Details

Issuer:	TTS
Face Value:	\$100.00
Issue Date:	29 Jun 12
Call Date:	5 Jul 19
Term to Call:	3.5 years
Maturity Date:	5 Jul 19

### Distribution Details

Dist. Rate:	3.10% + 90d
Payable:	Quarterly
Franking:	0%
Current coupon:	5.25%
Next distribution:	5 Apr 16
Ex distribution:	22 Mar 16
Accrued:	\$0.14
Cash payment:	\$1.31
Gross payment:	\$1.31
Deferrable:	No
Cumulative:	Yes
Div. Stopper:	Yes

### Financial Covenants

Interest Cover:	ND
Leverage ratio:	No

### Issuer Details

Tatts Group Limited (TTS) is a portfolio of networked gambling businesses providing leisure and entertainment products and services in the lotteries, wagering, gaming and technical services in Australia and has an investment in gaming venues in United Kingdom. TTS comprises six operating segments namely Tatts Lotteries, TattsBet, Tatts Pokies, Maxgaming, Bytecraft and Tatarus.

### Key Credit Positives

– Strong lotteries business which generates reliable earnings for the group.  
– Pokies compensation received totalling \$450m (costs are yet to be awarded) which was used to reduce debt.

### Key Credit Negatives

– Operates in the highly competitive wagering market with increased competition expected to impact margins.  
– The Victorian Government appealed the ruling.

### Financial Commentary

Tatts Group's H115 result was solid and was driven by a strong performance in Lotteries where margins continue to increase. The performance in Gaming was also good and there was margin improvement in the Wagering business (although top-line performance was disappointing).

### Company Financials

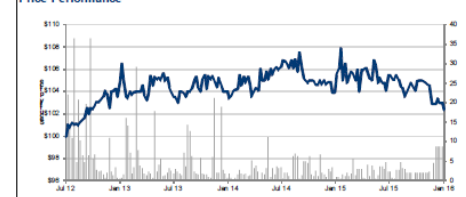
	Jun 11	Jun 12	Jun 13	Jun 14	Jun 15
Revenue (A\$m)	3,657.0	3,879.4	2,929.5	2,859.9	2,918.8
EBITDA (A\$m)	609.0	646.7	484.4	487.4	501.1
NPAT (A\$m)	275.4	316.1	227.4	226.6	255.8
Operating Cashflow (A\$m)	402.1	362.9	363.0	391.6	526.4
Gross Debt (A\$m)	1271.1	1307.2	1621.3	1361.0	986.5
Total Equity (A\$m)	2,664.1	2,663.6	2,760.4	2,896.0	2,971.1
Debt / EBITDA	2.09x	2.02x	3.35x	2.77x	1.93x
EBITDA / Int Exp	5.94x	6.69x	4.54x	5.42x	6.49x
Gearing (NDIIE)	39.6%	38.2%	45.9%	23.4%	6.9%

SOURCES: MORGANS, REEL, COMPANY DATA, FACTSET

### Security Details

TTSHA is a Senior Debt Security with a Maturity Date of 5 July 2019. On this date the Issuer must Redeem each security for \$100.00. There is no equity conversion, or extension risk associated with TTSHA and holders will receive unfranked coupons based on a rate of 3.10% above the 90d BBSW.

### Price Performance



SOURCES: MORGANS, REEL, COMPANY DATA

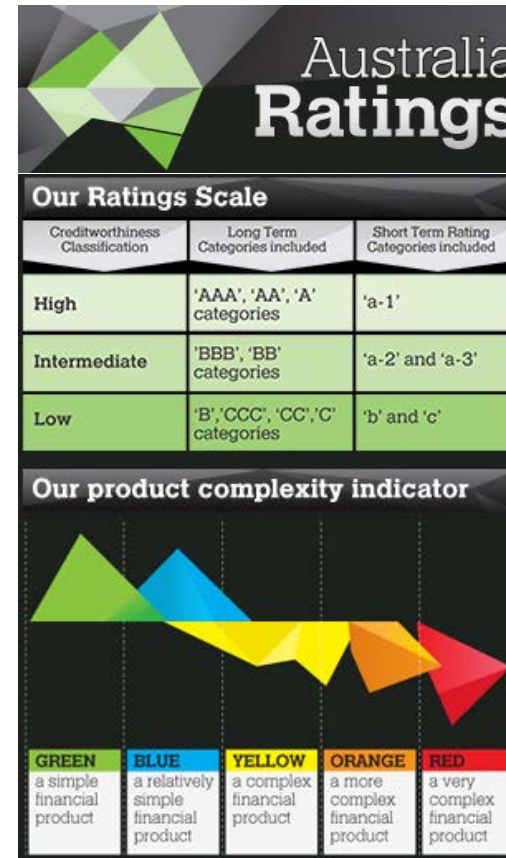
# Deciding on which Corporate Bonds to hold

## Diversification

- Don't just hold all high yielding debt
- Accept that lower yield securities offer the benefit of lower risk
- Different maturity profiles
- Different industries

## Credit and complexity

- Consider the credit quality of the issuer
- Look at the complexity of the security structure
- Australia Ratings provides issuer credit ratings and security complexity indicators





## Portfolio construction

- Take a long-term approach to the sector albeit consider that there will be opportunities to adjust positions over time
- Remain diversified across issuers, position in the capital structure and tenor
- Consider incorporating Government Bond exposure into portfolios – be mindful of duration risk
- Term deposits still offer a reasonable risk/return proposition in the current environment
- With current high issue margins – shorter (~ 5-6 years) Bank Tier 1 issues look attractive
  - Longer dated issues could remain under some pressure
- In the ASX listed space key picks include:  
ANZPA, CBAPC, CTXHA, GMPPA, IANG, MQGPA, NABPC and WBCHA

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