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Australian Unity Bonds (AYUHB)

Fixed Income

Issue overview

Issuer	Aust Unity
Issue ASX code	AYUHB
Face value	$100
Estimated offer size	$200m
Minimum application	$5,000
Bookbuild margin range	2.80-2.90%
Franking	0%
Interest payments	Quarterly
First interest payment	14 Apr 2016
Maturity	15 Dec 2020

Timeline

Lodgement of prospectus	9 Nov 2015
Bookbuild margin	16 Nov 2015
Offer opens	17 Nov 2015
Offer closes:	
Member & reinvestment	4 Dec 2015
Broker firm	11 Dec 2015
Issue date	15 Dec 2015
ASX listing (deferred settlement)	16 Dec 2015

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

A long overdue vanilla bond from a quality issuer

The new $200m Australian Unity Bonds (AYUHB) offer provides an opportunity to invest in senior debt of a quality financial issuer. Structured as an unsubordinated and unsecured debt obligation (i.e. vanilla senior debt), AYUHB's interest payments are not deferrable and are mandatory. As AYUHB does not classify as regulatory capital, there is no requirement for the security to contain a Non Viability Trigger Event.

The AYUHB offer seeks to refinance the $120m Australian Unity Notes (AYUHA) ahead of its April 2016 maturity, where AYUHA investors have the option of participating in the Reinvestment Offer. In addition, funding is required for the $114m Home Care Services NSW acquisition (expected completion early 2016), where Australian Unity has obtained $100m of funding from NAB for a 12 month debt facility.

Going retail, avoiding wholesale

It is pleasing to see a quality financial issuer such as Australian Unity refinance a maturing ASX listed debt security by a replacement issue. Since early 2014, investment grade corporate issuers have not undertaken replacement issues for maturing ASX listed debt securities. Alternative refinancing options have presented from a recovery in the wholesale debt markets and improving access to bank debt.

Figure 1: Refinancing of Maturing ASX Listed Debt Securities

ASX Code	Security	Maturity / Call Date	Issue Size	ASX Listed Replacement Issue
BENHA	Bendigo & Adelaide Bank Retail Bonds	17 Mar 2014	$91m	No
TAHHA	Tabcorp Bonds	1 May 2014	$284m	No
LEPHC	ALE Notes 2	20 Aug 2014	$165m	No
HBSHA	Heritage Notes	27 Oct 2014	$50m	No
PRYHA	Primary Bonds	28 Sep 2015	$152m	No
CBAHA	CommBank Retail Bonds	24 Dec 2015	$570m	Unlikely
AYUHA	Australian Unity Notes	14 Apr 2016	$120m	AYUHB
			$1,432m	

SOURCE: COMPANY DATA, BELL POTTER

Attractive 2.80-2.90% bookbuild margin

Assuming this issue is priced on a margin of 2.80% (bottom end of the bookbuild range) above current 3 month bank bill of 2.20% equates to an initial running yield of 5.00%. In a world of diminishing yield, combined with a limited supply of quality senior debt investment options in the ASX listed debt market, this bookbuild margin appears very attractive, particularly when considering:

- **Wholesale pricing:** Issue margin provides an uplift of 1.60% on BEN Aug 2020 senior debt in the wholesale market (current trading margin 1.20%); and
- **AYUHA was issued as subordinated debt:** AYUHA's 3.55% issue margin reflected its ranking behind $179m of debt facilities at its March 2011 launch. In the wholesale market, the margin spread between BEN subordinated debt (Jan 2019 call, 2.60% trading margin) and BEN Aug 2020 senior debt is currently at 1.40%.

Key features

- **Initial running yield of 5.00-5.10%:** Floating rate based on 3 month bank bill of 2.20% plus bookbuild margin of 2.80-2.90%.
- **Senior unsecured debt:** AYUHB offered under the "simple corporate bond regime"
- **No Non Viability Trigger Event:** The last ASX listed debt security offered from a financial issuer without a Non Viability Trigger Event was WBCHA in July 2012.
- **Mandatory payment of quarterly interest and face value at maturity at year 5**

Australian Unity Bonds

AYUHA Reinvestment	Dates
AYUHA Ex Entitlement	2 Nov 2015
AYUHA Record Date	5 Nov 2015
Reinvestment offer closes	4 Dec 2015
Reinvestment (issue) date	15 Dec 2015
Accrued interest payment	15 Dec 2015
Further Amount payment	15 Dec 2015
ASX listing (deferred settlement)	16 Dec 2015

Reinvestment Offer for Australian Unity Notes (AYUHA)

The $200m AYUHB offer provides an early reinvestment opportunity for AYUHA investors.

AYUHA holders essentially have three options:

- **Option 1: Participate in Reinvestment Offer:** For AYUHA holders that lodge their Personalised Reinvestment form by 15 December 2015, subscription for the AYUHB offer will be funded by selling to Australian Unity their AYUHA securities. Reinvested securities will receive $0.9682 interest for the 62 day period between the 14 October 2015 payment date and the 15 December 2015 Issue Date (i.e. 3 Month BBSW 2.15% + 3.55% issue margin = 5.70% x 62 days / 365 days x $100 face value = $0.9682). Australian Unity will also pay a "Further Amount" of interest as an incentive to participate in the Reinvestment Offer. This is to compensate AYUHA investors for the reduction in margin for the 121 days between the 15 December 2015 Issue Date and the 14 April 2016 AYUHA Maturity Date. Assuming a margin of 2.80% is set on AYUHB, the Further Payment would be $0.2486 (i.e. 3.55% AYUHA margin - 2.80% AYUHB margin = 0.75% x 121 days / 365 days $100 face value = $0.2486). These payments combined equal $1.2168.
- **Option 2: Sell AYUHA on market:** Applying a fair margin of 1.80%, we assess a fair value on AYUHA of $101.17. We note AYUHA closed at $101.17 on 6 November 2015.
- **Option 3: Do nothing:** Australian Unity must redeem all outstanding AYUHA for $100 cash at the 14 April 2016 maturity date, plus the final quarterly interest coupon.

Refer Section 4.2 (page 27) of the Australian Unity Bonds Part A prospectus for more information on the Reinvestment Offer.

Australian Unity Bonds

Australian Unity overview

Australian Unity is a national healthcare, financial services and retirement living organisation. With origins that date back as far as 1840, the Australian Unity brand was formed following the merger of ANA (Australian Natives' Association) and Manchester Unity (Victoria) in 1993.

It is structured as a public, unlisted, mutual company with ~300,000 members (eligible customers and staff). The mutual structure of the organisation results does not distribute profits in the form of dividend to shareholders. Instead profits are reinvested into the growth of wellbeing services and products for its members. It also has approximately 2,500 employees providing services to 850,000 customers across its four major operating divisions:

⇒ Healthcare (56.8% of FY15 EBITDA): Australia's sixth largest private health insurance fund with over 225,000 policyholders.

⇒ Retirement Living (24.2% of FY15 EBITDA): Operates 19 retirement villages and five aged care facilities in Victoria and NSW, offering 2,074 home units and 609 aged care beds.

⇒ Financial Services & Investments (15.0% of FY15 EBITDA): Provides funds management, real estate and mortgages, banking (Big Sky), investment bonds, funeral bonds, and education savings plans (Lifeplan). This division has $7.3bn of funds under management (FUM).

⇒ Personal Financial Services (4.0% of FY15 EBITDA): Provides professional fee -for-services advice through a network of 183 financial advisers, spanning financial planning, finance broking, general insurance and trust and estate administration services.

Figure 2: Segment operating performance

Segment Analysis	FY13 $m	FY14 $m	FY15 $m	% Group (excl corp)
Revenue				
Healthcare	735.2	789.1	828.3	75.4%
Retirement Living	73.1	89.2	106.8	9.7%
Investments	111.7	103.2	107.2	9.8%
Personal Financial Services	33.7	39.8	56.9	5.2%
Corporate / Eliminations	-15.1	-16.6	-18.0	
Total Segment Revenue	**938.5**	**1,004.8**	**1,081.2**	
EBITDA (adjusted)				
Healthcare	47.8	43.6	56.2	56.8%
Retirement Living	12.6	21.3	23.9	24.2%
Investments	15.3	13.8	14.8	15.0%
Personal Financial Services	2.1	2.3	3.9	4.0%
Corporate / Eliminations	-29.4	-26.1	-34.4	
Total Segment EBITDA	**48.5**	**54.8**	**64.6**	
EBITDA Margins				
Healthcare	6.5%	5.5%	6.8%	
Retirement Living	17.3%	23.9%	22.4%	
Investments	13.7%	13.3%	13.8%	
Personal Financial Services	6.2%	5.9%	6.9%	

SOURCE: COMPANY DATA, BELL POTTER

Australian Unity Bonds

Covenant Gearing Ratio to remain below 50%

One key covenant applying to AYUHB is that Australian Unity must ensure that on each half year balance date, the Covenant Gearing Ratio must be under 50%. Assuming $100m of additional net borrowings has been undertaken to fund the Home Care Services NSW acquisition, Australian Unity estimates its pro forma 30 June 2015 Gearing Covenant Ratio stands at 39.9%.

Figure 3: Australian Unity Gearing

Borrowing Facilities	Maturity	30 June 2015 $m	Pro Forma $m
Health Insurance Subordinated Capital	July 2018 call / July 2023 maturity	30.0	30.0
Retirement Village Investment Notes	November 2015 to December 2023	63.2	63.2
Retirement Living Development Finance	June 2016 to August 2017	25.3	25.3
Specific Interest Bearing Liabilities		118.5	118.5
Australian Unity Notes / Bonds	April 2016 / December 2020	120.0	200.0
Other External Loans	Rolling three month	5.1	5.1
Guarantees	December 2015 to January 2023	6.8	6.8
Acquisition Funding	November 2016	0.0	20.0
Other Interest Bearing Laiblities		131.9	231.9
Gearing Ratio Debt (implied)		250.4	350.4
Equity (implied)		535.0	535.0
Covenant Gearing (D/D+E)		**32%**	**40%**

PRO FORMA ASSUMES AN ADDITIONAL $100M OF ACQUISITION FUNDING

SOURCE: COMPANY, BELL POTTER ESTIMATES

Interest cover adequate at 3.08x

Australian Unity's interest cover has steadily improved over recent years to stand at 3.08x at 30 June 2015. There is the potential for interest cover to slightly deteriorate following the increase in indebtedness with the Home Care Services NSW acquisition.

Figure 4: Australian Unity Interest Cover

	FY13 $m	FY14 $m	FY15 $m
Adjusted EBIT	54.7	53.2	63.5
Net Interest	19.3	18.1	20.6
Interest Cover	**2.83x**	**2.93x**	**3.08x**
Net Profit	29.4	29.7	34.6
Members' Funds	479.9	508.3	542.9

SOURCE: COMPANY DATA, BELL POTTER

Australian Unity Bonds

Margin attractive relative to comparative debt securities

As AYUHB is a senior debt security, a healthy margin premium has been offered relative to current trading in senior debt securities issued by BEN, SUN and TTS.

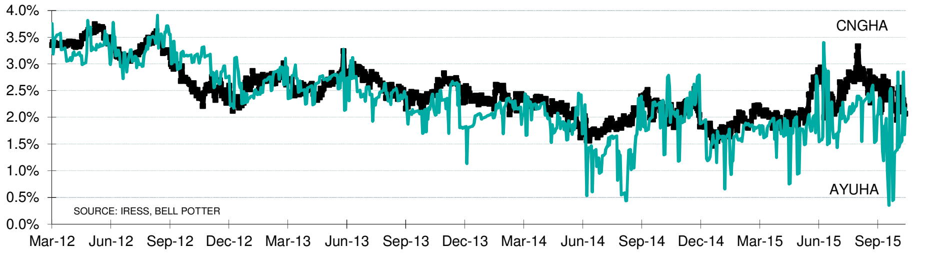
Figure 5: Trading Margins on comparative debt securities

	Ranking	Security	Trading Margin over BBSW	Maturity	First Call
Higher Ranking	Senior debt	BEN (Senior OTC)	120bp	Aug 2020	
		SUN (Senior OTC)	125bp	Oct 2020	
		TTSHA	180bp	Jul 2019	
		AYUHB	**280-290bp**	**Dec 2020**	
	Subordinated debt	AYUHA	220bp	Apr 2016	
		CNGHA	220bp	Mar 2037	Mar 2017
		AMPHA	245bp	Dec 2023	Dec 2018
		BEN (Subordinated OTC)	250bp	Jan 2024	Jan 2019
Lower Ranking		SUNPD	260bp	Nov 2023	Nov 2018

SOURCE: YIELDBROKER, BELL POTTER

Investors in the Australian Unity Notes (AYUHA) have had a positive experience, with this security rarely trading below face value. AYUHA has also closely tracked the Colonial Group Subordinated Notes (CNGHA). Since CNGHA listed on 29 March 2012, AYUHA's median trading margin has been 17bp lower than CNGHA.

Figure 6: Trading Margins AYUHA and CNGHA



SOURCE: IRESS, BELL POTTER

Pros and cons of investing in bonds: MoneySmart website

ASIC's Money Smart website provides information for retail investors about the pros and cons of investing in corporate bonds.

www.moneysmart.gov.au

Australian Unity Bonds

Investment risks

Default Risk is the key investment risk for AYUHB. This reflects the ability of Australian Unity to generate sufficient cash flows to satisfy debt obligations (i.e. scheduled interest payments), and to refinance indebtedness on commercially reasonable terms (i.e. redemption at maturity). Deterioration in Australian Unity's financial and operating performance increases the Default Risk. If Australian Unity is unable to generate sufficient cash flow to satisfy its debt obligations, the group may have to undertake alternative financing plans, such as refinancing or restructuring of existing debt, reducing or delaying capital investments or seeking to raise additional capital. As a mutual, Australian Unity is not able to raise equity via a share issue.

Other Investment Risks include:

- AYUHB are not deposits, or protected accounts of Australian Unity or any other member of the Australian Unity group for the purposes of the Banking Act.
- 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 market price of the Bonds. It is possible that the Bonds may trade at a market price below their Face Value. There is a risk that if you sell prior to the Maturity Date, you may receive a lower price than the Face Value.
- The market for AYUHB may be less liquid than the market for other securities. If holders wish to sell their Bonds, they may be unable to do so easily, or at an acceptable market price, or at all, if insufficient liquidity exists.
- AYUHB may be redeemed early where there is a Tax Event, Change of Control Event, or where less than 10% of the Series remain on issue. In the event of an early Redemption, you may not receive the returns you expected to receive on the Bonds (if held to maturity).

Key Business Risks of Australian Unity include:

- Excessive financial indebtedness.
- Poor performance of acquired businesses and investments.
- Operational risks.
- Increasing competition.
- Adverse regulatory changes.
- A material deterioration in global capital markets and the Australian economy.
- Funding and liquidity risk.
- Accounting mismatches and errors.
- Losses associated with counterparty exposures.

Refer Section 4 (page 33) of the Australian Unity Bonds Part B: Base Prospectus for further information on risks.

Fixed Income

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