Fixed Income Research

Villa World Bonds

- Villa World (ASX: VLW) is seeking to issue 0.5 million unsubordinated, unsecured senior bonds at an issue price of $100.00 to raise $50.0m.
- The Villa World Bonds must be redeemed for cash on the maturity date of 21 April 2022 and pay non-discretionary, cumulative cash coupons.
- Holders will receive floating rate, quarterly cash coupons based on a rate of 4.75% above the 90d BBSW per annum.
- Villa World Bonds will provide investors with portfolio diversification as a senior corporate bond with floating rate coupons.

Villa World

Villa World (ASX: VLW) acquires, develops and markets residential land and house and land estates. Villa World is an east coast residential developer with development and construction operations across New South Wales, Queensland and Victoria; and is an ASX 300 company. Villa World offers well-located land only product; as well as affordable to mid-priced 'house and land' packages under a no-variations, turnkey model. Importantly, it has no exposure to the high rise apartment sector.

Villa World's portfolio provides it with both geographic and product diversification, allowing Villa World to capitalise on different opportunities across its key market segments. Villa World’s portfolio currently comprises of projects that are at various stages of development including planning, construction and completed stock. Villa World’s projects are generally short to medium term, with completion occurring within 3-5 years.

Security snapshot

Villa World is seeking to issue 0.5 million Bonds (VLWHA) at an issue price of $100.00 per security to raise $50 million. The Villa World Bonds are unsubordinated, unsecured debt obligations of Villa World with a maturity date of 21 April 2022. Investors will receive quarterly unfranked, floating rate coupons based on a rate of 4.75% above the 90d BBSW per annum. The security cannot be extended past the maturity date and pays cumulative, non-discretionary coupons.

Figure 1: Key terms

<table>
<thead>
<tr>
<th>Key terms</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer</td>
<td>Villa World Limited</td>
</tr>
<tr>
<td>ASX code</td>
<td>VLWHA</td>
</tr>
<tr>
<td>Type of security</td>
<td>Unsubordinated, unsecured bond</td>
</tr>
<tr>
<td>Offer Size</td>
<td>$50 million</td>
</tr>
<tr>
<td>Face Value</td>
<td>$100.00</td>
</tr>
<tr>
<td>Minimum application amount</td>
<td>$5,000</td>
</tr>
<tr>
<td>Coupon rate</td>
<td>4.75% above the 90d BBSW</td>
</tr>
<tr>
<td>Term</td>
<td>Five years</td>
</tr>
<tr>
<td>Yield to maturity</td>
<td>7.30% based on an implied swap of 2.55%</td>
</tr>
</tbody>
</table>

Figure 2: Key dates

<table>
<thead>
<tr>
<th>Key dates</th>
<th>Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offer opens</td>
<td>30 March 2017</td>
</tr>
<tr>
<td>Morgans closing date</td>
<td>17 April 2017</td>
</tr>
<tr>
<td>Issue date</td>
<td>21 April 2017</td>
</tr>
<tr>
<td>Commencement of trading</td>
<td>27 April 2017</td>
</tr>
<tr>
<td>Coupon payment dates</td>
<td>21 July, 21 October, 21 January and 21 April in each year with the first payment due 21 July 2017</td>
</tr>
<tr>
<td>Maturity date</td>
<td>21 April 2022</td>
</tr>
</tbody>
</table>

Morgans Financial Limited is a Joint Manager to the issue of Villa World Bonds

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SOURCES: MORGANS, COMPANY REPORTS

IMPORTANT DISCLOSURES REGARDING COMPANIES THAT ARE THE SUBJECT OF THIS REPORT AND AN EXPLANATION OF RECOMMENDATIONS CAN BE FOUND AT THE END OF THIS DOCUMENT. MORGANS FINANCIAL LIMITED (ABN 49 010 669 726) AFSL 235410 - A PARTICIPANT OF ASX GROUP
Villa World Bonds

Key security features

- **Floating, Quarterly Interest Payments** – Coupons are floating rate, cumulative and payable quarterly in arrears. They are based on a coupon rate of 4.75% above the 90d BBSW.
- **Maturity Date** – Villa World Bonds are debt securities and have a maturity date of 22 April 2022.
- **Non-payment** of interest or repayment of capital is an event of default.

Rational for issuance

The proceeds of the Offer will be used to diversify Villa World’s debt funding and support its growth objectives.

Term

Villa World Bonds have a term of five years and a maturity date of 21 April 2022. The Bonds must be redeemed on this date; to not do so is an event of default.

Interest Payments

The Interest Payments on Villa World Bonds are floating rate, cumulative and payable quarterly in arrears. Interest payments are based on a rate of 4.75% above the 90d BBSW. Interest Payments will not have any franking credits attached to them and non-payment is an event of default.

Interest Payments are payable quarterly in arrears on 21 July, 21 October, 21 January and 21 April of each year with the first Interest payable on 21 July 2017.

If an amount payable to a Holder in respect of a Villa World Bond is not paid under the Terms when due, interest accrues on the unpaid amount (both before and after any demand or judgment) at a rate equal to the last applicable Interest Rate plus 2% from (and including) the date that the amount becomes due to (but excluding) the date on which payment is made to the Holder.

Ranking

The Villa World Bonds of all Series (assuming future issues) rank equally with each other (including, without any preference by reason of Issue Date or the date of registration of any Holder on the Register) and at least equally with all other unsubordinated and unsecured obligations of the Issuer (other than any obligations preferred by mandatory provisions of applicable law). The obligations of the Issuer in respect of the Villa World Bonds will rank behind any secured obligations of the Issuer.

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Type of instrument</th>
<th>Existing debt obligations and equity</th>
<th>1H17 Proforma</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest</td>
<td>Secured Debt</td>
<td>Bank Loans</td>
<td>$124.9m</td>
</tr>
<tr>
<td></td>
<td>Subordinated, unsecured debt</td>
<td>Villa World Bonds</td>
<td>$50.0m</td>
</tr>
<tr>
<td></td>
<td>Subordinated, unsecured debt and hybrid instruments</td>
<td>None</td>
<td>$0.0m</td>
</tr>
<tr>
<td>Lowest</td>
<td>Ordinary Equity</td>
<td>Contributed equity, reserves, retain profits</td>
<td>$269.2m</td>
</tr>
</tbody>
</table>

Guarantor Group

The Bonds benefit from a Guarantee given by the Guarantors. Villa World is required to ensure that, so long as any Bond remains outstanding, each member of the Group which provides a guarantee of the indebtedness of any other member of the Group, under the terms of any of the Group's external bank debt facilities, is a Guarantor.
If a Guarantor ceases to provide a guarantee under the terms of any of the Group's external bank debt facilities, such Guarantor will be entitled to be released as a Guarantor without the consent of the Holders.

Villa World will not, and will ensure that no Guarantor will, create or permit to subsist any Security Interest (other than a Permitted Security Interest) upon the whole or any part of its (or a Guarantor's) present or future assets or revenues to secure any Relevant Indebtedness or any guarantee relating to any Relevant Indebtedness.

**Negative Pledge and Reported Gearing Ratio**

So long as any of the Villa World Bonds remain outstanding, the Issuer will not, and will ensure that no Guarantor will, create or permit to subsist any Security Interest (other than a Permitted Security Interest) upon the whole or any part of its (or a Guarantor's) present or future assets or revenues to secure:

(a) any Relevant Indebtedness; or

(b) any guarantee, indemnity or other like obligation relating to any Relevant Indebtedness,

without at the same time according to the Villa World Bonds either the same security or an equal ranking security as is granted to or is outstanding in respect of such Relevant Indebtedness, guarantee, indemnity or other like obligation or such other security as shall be approved by a Special Resolution of Holders.

So long as any Villa World Bonds remain outstanding, the Issuer will not incur, and will ensure that no Guarantor incurs, any Financial Indebtedness on or after the Issue Date if the incurrence of such Financial Indebtedness would result in the Reported Gearing Ratio being greater than 50%. The secured Reported Gearing Ratio is not permitted to be greater than 40%.

Villa World will be subject to the Gearing Ratio and the Secured Gearing Ratio limits, which are used in the Negative Pledge and the limitation on debt incurrence covenants. These are company ratios and differ from the Prescribed Ratios outlined in the Corporations Act.

**Reported Gearing Ratio**

\[
\text{Gearing Ratio} = \frac{\text{Gearing Ratio Debt}}{\text{Gearing Ratio Assets}}
\]

**Reported Secured Gearing Ratio**

\[
\text{Secured Gearing Ratio} = \frac{\text{Secured Gearing Ratio Debt}}{\text{Secured Gearing Ratio Assets}}
\]

As at 31 December 2016 the Reported Gearing Ratio and the Secured Gearing Ratio were both 23%. On a pro-forma basis the Reported Gearing Ratio is 18% while the Secured Gearing ratio is 7%.
Redemption and Buy Back

Each Villa World Bond must be Redeemed by the Issuer on the Maturity Date at its Face Value (together with the Interest payable on the Maturity Date) unless:

a) the Villa World Bond has been previously Redeemed; or

b) the Villa World Bond has been purchased by the Issuer or any member of the Group under a Buy Back (in the open market or otherwise and at any price) and cancelled. Villa World Bonds purchased may be held, resold, dealt with or cancelled at the sole discretion of the Issuer.

If a Tax Event occurs, the Issuer may Redeem all (but not some) of the Villa World Bonds of a Series in whole before their Maturity Date at the aggregate Redemption Amount.

Change of Control

If a Change of Control Event occurs:

a) the Trustee may, if directed by a Holder Resolution, require the Issuer to Redeem all (but not some) of the Villa World Bonds of a Series; or

b) the Issuer may Redeem all (but not some) of the Villa World Bonds of a Series, on the Change of Control Redemption Date at the aggregate Redemption Amount.

As soon as reasonably practicable after the occurrence of a Change of Control Event, the Issuer must give notice of the Change of Control Event to the Trustee with a copy to the Registrar, the Holders and the Stock Exchange.

Events of Default

Each of the following is an Event of Default in relation to Villa World Bonds of a Series:

a) Non-payment - the Issuer fails to pay within ten Business Days after the due date any amount payable by it under any Villa World Bond of the Series;

b) Breach of other obligations - the Issuer fails to comply with any of its other material obligations under the Terms or the Trust Deed and such failure remains unremedied for a period of 30 Business Days after the Issuer has received written notice from the Trustee in respect of the failure;

c) Cross-acceleration - any Financial Indebtedness greater than A$5,000,000 (or its equivalent in any other currencies) of any member of the Villa World Group becomes due and payable before its stated maturity due to the occurrence of a default event (however described) under that Financial Indebtedness. For the purposes of this Event of Default, Group does not include joint venture entities included in the consolidated financial statements of the Group pursuant to Current Account Practice;

d) Insolvency - an Insolvency Event occurs in respect of the Issuer;

e) Guarantee - the Guarantee is not (or is claimed by a Guarantor not to be) in full force and effect;

f) Vitiation - all or any rights or obligations of the Issuer, the Holders or the Trustee under the Trust Deed or the Terms are terminated or are or become void, illegal, invalid, unenforceable or of limited force and effect (other than because of equitable principles or laws affecting creditors’ rights generally or the replacement of the Trustee pursuant to the terms of the Trust Deed); and

g) Unlawfulness - it is, at any time unlawful for the Issuer to perform any of its payment obligations under the Villa World Bonds.
So long as an Event of Default is subsisting, the Issuer will not declare or pay a dividend, make any capital return or make any distribution on any issued share in the Issuer, or pay any interest or other amounts in respect of any debt security issued by the Issuer which ranks behind the Villa World Bonds in priority for payment of interest or other similar amounts.

**Prescribed Financial Ratios**

The Corporations Act requires Villa World to disclose certain Key Financial Ratios, calculated in accordance with regulation 6D.2.06 of the Corporations Regulations, that are relevant to Villa World. These are a gearing ratio, a working capital ratio and an interest cover ratio; known collectively as Prescribed Ratios.

The basis of the calculation of these ratios is different to the calculations used by Villa World when calculating its Reported ratios.

**Gearing Ratio**

The Prescribed Gearing Ratio indicates the ratio of the liabilities of the Group on a consolidated basis to its equity determined in accordance with Current Accounting Practice. The higher the Prescribed Gearing Ratio, the higher the level of debt being carried by an issuer as a proportion of its capital base.

\[
\text{Gearing Ratio} = \frac{\text{Total Liabilities}}{\text{Total Equity}}
\]

The Gearing Ratio as at 31 December 2016 was 75% (87% pro-forma).

**Working Capital ratio**

The Prescribed Working Capital Ratio indicates whether an issuer has sufficient short term assets to meet its short term liabilities. Generally, a higher Prescribed Working Capital Ratio indicates a greater ability to meet liabilities over the short term, including unexpected liabilities.

\[
\text{Working Capital Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}
\]

The Working Capital Ratio as at 31 December 2016 was 3.1x (4.2x pro-forma).

**Interest Cover Ratio**

The Prescribed Interest Cover Ratio provides an indication of an issuer’s ability to meet its interest payments from earnings. Generally, a low Prescribed Interest Cover Ratio may indicate an issuer could face difficulties in servicing its debt if earnings decrease or interest rates increase.

A decrease in the Prescribed Interest Cover Ratio may also indicate that the ability of an issuer of bonds such as the Bonds to make interest payments under the bonds has diminished (because of a decrease in its interest coverage position).

\[
\text{Interest Cover Ratio} = \frac{\text{EBITDA}}{\text{Net Interest Expense}}
\]

The Interest Cover Ratio as at 31 December 2016 was 8.4x (8.4x pro-forma).

Below we illustrate the historic results of these ratios:

<table>
<thead>
<tr>
<th>Prescribed Key Financial Ratios as at</th>
<th>Jun 15</th>
<th>Jun 16</th>
<th>Dec 16</th>
<th>Pro forma - Dec 16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prescribed Gearing Ratio</td>
<td>96%</td>
<td>102%</td>
<td>75%</td>
<td>87%</td>
</tr>
<tr>
<td>Prescribed Interest Cover Ratio</td>
<td>4.2x</td>
<td>6.3x</td>
<td>8.4x</td>
<td>8.4x</td>
</tr>
<tr>
<td>Prescribed Working Capital Ratio</td>
<td>2.3x</td>
<td>2.7x</td>
<td>3.1x</td>
<td>4.2x</td>
</tr>
</tbody>
</table>

SOURCE: MORGANS RESEARCH COMPANY
In overseeing the capital management aspect of its business, Villa World focusses on other relevant financial ratios, which include the gearing ratio and the interest cover ratio that Villa World has historically reported in disclosures made to the ASX as part of its annual and half-yearly reporting.

**Reported Gearing Ratio**

This Reported Gearing Ratio, as so adjusted, allows Villa World to monitor its capital management requirements in line with the Villa World business model and its stated strategies and is calculated as follows.

\[
\text{Reported Gearing Ratio} = \frac{\text{Gearing Ratio Debt}}{\text{Gearing Ratio Assets}}
\]

Where:

- **Gearing Ratio Debt**: Interest bearing liabilities less cash and cash equivalents; and
- **Gearing Ratio Assets**: Assets less cash and cash equivalents.

This Reported Gearing Ratio as at 31 December 2016 was 23%.

**Reported Interest Cover Ratio**

The Reported Interest Cover Ratio is calculated as EBITDA of the Group over interest expense (taking account of any related hedging arrangements) of the Group. The key difference between the calculation of the Reported Interest Cover Ratio and the Prescribed Interest Cover Ratio (calculated earlier) is that the Prescribed Interest Cover Ratio is calculated on the basis of interest expense net of interest revenue. The Reported Interest Cover Ratio is calculated as:

\[
\text{Reported Interest Cover Ratio} = \frac{\text{EBITDA}}{\text{Interest Expense}}
\]

Where:

- **EBITDA**: Earnings before interest expense, taxes, depreciation and amortisation; and
- **Interest Expense**: Net interest expense taking account of any related hedging arrangements.

The Reported Interest Cover Ratio as at 31 December 2016 was 8.1x.

**Peer Financial Comparisons**

The below comparison highlights Villa World’s financial position relative to peers. Villa World is in a solid financial position with a lower gearing ratios and a stronger interest coverage ratios than both Peet (ASX: PPC) and Sunland Group (ASX: SDG).

<table>
<thead>
<tr>
<th>Prescribed Key Financial Ratios as at</th>
<th>Villa World</th>
<th>Peet Limited</th>
<th>Sunland Group</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Jun 15</td>
<td>Jun 16</td>
<td>Dec 16</td>
</tr>
<tr>
<td>Gearing Ratio</td>
<td>96%</td>
<td>102%</td>
<td>75%</td>
</tr>
<tr>
<td>Interest Cover Ratio</td>
<td>4.2x</td>
<td>6.3x</td>
<td>8.4x</td>
</tr>
<tr>
<td>Working Capital Ratio</td>
<td>2.29x</td>
<td>2.71x</td>
<td>3.14x</td>
</tr>
</tbody>
</table>

*Sunland has a large 2H earnings skew.

SOURCE: MORGANS RESEARCH, COMPANY, FACTSET CONSENSUS
Key risks – See Section 4 of the Base Prospectus for full details

There are risks associated with investing in the Villa World Bonds which include, but are not limited to the following:

- Villa World may experience financial difficulty, such that it cannot make interest or principal payments when they are due;
- Villa World may go out of business entirely, in which case investors may not be repaid, including any outstanding interest or principal at that time;
- Villa World has the right to create and issue any class of debt securities, including an additional Series of Bonds, without the approval of Holders. Any such future debt securities issuance by Villa World is subject to the relevant gearing ratio limits specified in the relevant Offer Specific Prospectus;
- Investors may not be able to sell the Bonds on the ASX or the relevant securities exchange on which the Bonds are listed to exit their investment before their maturity date, or may only be able to do so at a loss.
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Morgans is a Joint Lead Manager to the issue of Villa World Bonds and may receive fees in this regard.

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Stocks under coverage

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