

# Precinct Properties

## Convertible Notes Update

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The uncertain economic outlook and potential downside to commercial property valuations has meant greater scrutiny of balance sheets and increased risk of new equity issues, so we have provided an update on the Precinct Property (PCT) convertible notes (PCTHA). Near-term valuations for prime office and government leased property are expected to remain reasonably steady given the low vacancy, long leases and limited new supply coming on, and we remain a NEUTRAL rating for PCT. However, a deep recession will filter through to vacancy, rental pressure and valuations, even for the best located property. We view the PCT balance sheet as strong with a low chance of an equity issue. The PCTHA does not prevent PCT issuing new equity capital, however, if this was by way of a rights issue, the PCTHA strike price will be adjusted to reflect the dilution.

### **A recap on PCTHA convertible notes**

A convertible note is a type of hybrid security which has both fixed income and equity characteristics. Similar to a corporate bond, the notes pay a fixed rate of interest in the form of a coupon (quarterly at an annual rate of 4.80% on face value of \$1.00 or 4.36% on the current price of \$1.10). However, unlike a corporate bond, the notes convert into ordinary shares in PCT at the end of their term (at the lower of \$1.40 or a 2% discount to the PCT share price). As shown in Figures 1 and 2, the conversion mechanism provides noteholders with upside if PCT's share price trades above \$1.43 and downside protection if PCT share price falls below this level via the issuing of additional shares. Based on the 24 April PCTHA close price of NZ\$1.58, we calculate an IRR of 7.6% assuming the PCT share price is unchanged at conversion. This compares favourably with PCT ordinary shares with an IRR of 6.0% (the forecast dividends) over the same period and under the same price assumptions. Either a PCTHA price of NZ\$1.11 or a PCT share price of NZ \$1.55 at conversion would reduce our PCTHA calculated IRR to c.6%.

### **PCTHA no impediment to raising capital**

The uncertainty created by COVID-19 and eventual impact on property values has raised the risk of capital raisings to improve balance sheet positions. PCT's last reported gearing was 25.4% with a target of <37.5%. PCT's bank covenant gearing is 50%, as such it would take a 49% decline in asset values for this covenant to be breached. The PCTHA notes are no impediment to PCT raising equity capital, however, if this raise is a rights issue the PCTHA strike price will adjusted to reflect the dilution.

### **Conversion will impact PCT EPS by 2–3%**

The proceeds from the convertible note was to pay down debt associated with Commercial Bay and Bowen Campus developments and provide headroom for future developments, such as 1 Queen St and later Wynyard Quarter stages. While PCT can elect to settle the note as cash we believe this is unlikely given 1) these developments have been committed, and 2) PCT's low gearing is partly due to the PCTHA not being classified as debt. In Figure 4 we assess the dilution from conversion of PCTHA to common equity at different PCT share prices. Dilution from conversion is partially offset by lower interest costs given the relatively high cost notes. Our current earnings forecasts include dilution from conversion of PCTHA into PCT shares at a conversion price above NZ\$1.40.

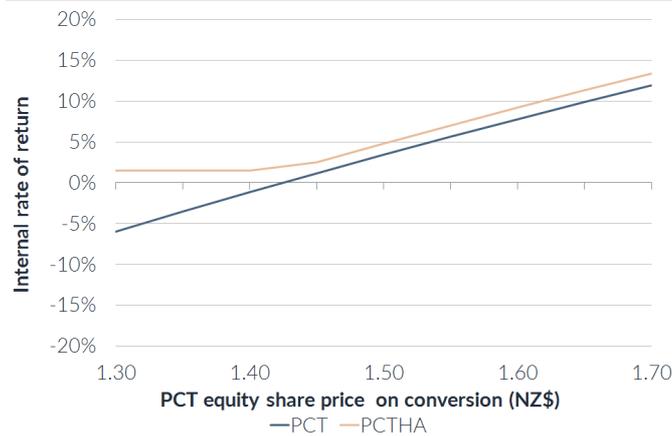
## Key charts and tables

**Figure 1. Conversion mechanism**

Share price	Conversion Price	Principal	Number of shares issued	Value of shares	Current shares on issue	Additional + Current	Equity Dilution
\$1.30	\$1.27	\$150,000,000	117,739,403	\$153,061,224	1,313,764,049	1,431,503,452	8.96%
\$1.40	\$1.37	\$150,000,000	109,329,446	\$153,061,224	1,313,764,049	1,423,093,495	8.32%
\$1.50	\$1.40	\$150,000,000	107,142,857	\$160,714,286	1,313,764,049	1,420,906,906	8.16%
\$1.60	\$1.40	\$150,000,000	107,142,857	\$171,428,571	1,313,764,049	1,420,906,906	8.16%
\$1.70	\$1.40	\$150,000,000	107,142,857	\$182,142,857	1,313,764,049	1,420,906,906	8.16%

Source: Forsyth Barr analysis

**Figure 2. IRR comparison**



Source: Forsyth Barr analysis

**Figure 3. Price performance**



Source: Forsyth Barr analysis

As shown in Figure 4 below, conversion of PCTHA will provide PCT with an earnings benefit due to lower interest costs. This does not lead to an increase in EPS for PCT equity holders due to the conversions dilutionary effect on equity.

**Figure 4. EPS dilution from conversion**

Share price	Number of shares issued	Total shares post-conversion	Interest savings	Tax Shield	Net Earnings benefit	Earnings dilution
\$1.30	117,739,403	1,431,503,452	\$7,200,000	\$2,016,000	\$5,184,000	-3.23%
\$1.40	109,329,446	1,423,093,495	\$7,200,000	\$2,016,000	\$5,184,000	-2.66%
\$1.50	107,142,857	1,420,906,906	\$7,200,000	\$2,016,000	\$5,184,000	-2.51%
\$1.60	107,142,857	1,420,906,906	\$7,200,000	\$2,016,000	\$5,184,000	-2.51%
\$1.70	107,142,857	1,420,906,906	\$7,200,000	\$2,016,000	\$5,184,000	-2.51%

Source: Forsyth Barr analysis

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