

ANZ BANKING GROUP LTD

FACT SHEET

FEBRUARY 2024

I A M
INCOME ASSET
MANAGEMENT

ANZ Banking Group Ltd

Issuer Outline

Australia and New Zealand Banking Group Limited provides banking services. The Bank offers accounts checking, savings deposits, money market, mortgage, and term loans services, as well as card facilities and Internet banking services. Australia and New Zealand Banking Group serves customers in New Zealand and Australia.

Sector:	Financial
Sub-Sector:	Banks
Country:	AU
Ownership:	Public

IAM Credit View

ANZ proactively bid for new mortgage loans as it incentivised the market with cashbacks while growing its reach by broadening broker distribution channels, achieving an increase of ~40bps to 13.4% of market share. The rise in loan volumes was a positive carry to net interest income (+11% YoY) albeit thinning margins, which added to ANZ's overall cash profits of \$7.4bn (+14% YoY). Beyond organic growth, the lender will be acquiring Suncorp bank's mortgage lending portfolio subjected to final approvals by ACCC expected in early 2024. Post consolidation, ANZ is likely to displace NAB as the third-largest mortgage lender with the newly acquired ~2.3% in market share from Suncorp (ending total market share approximates to ~15.7%). Coincidentally, its close contender (NAB) has reiterated its disciplined focus in expanding the business banking book (prioritised over mortgage lending) which should help mitigate some active competition faced by ANZ. Notwithstanding NAB's acquisition of Citi's personal banking business which includes a mortgage book, adding ~1.4% of market share to NAB (ending total market share tallies to ~15.1%).

At the sector level, divestment from non-core operations has been a common theme across domestic banks. In 2022, ANZ had successfully completed the last of its divestments from non-core operations which marked its full exit from wealth management, life insurance and advisor businesses.

Issuer Credit Rating & Outlook

Agency	Rating	Outlook
S&P	AA-	STABLE
Moody's	Aa3	STABLE
Fitch	A+	STABLE

Key Financials (AUD m)

LTM (31 March)	2024
Net interest income	14,680
Non-interest income	2,839
NPAT	6,974
Gross loans	565,812
Total assets	960,079
Customer deposits	675,075
Short- and long-term debt	43,468
Non-performing loans (NPLs) to total loans (%)	N/A
CET 1 ratio (%)	15.20

For more information call 1300 784 132 or email adviserservices@incomeam.com

This timeline is considerably ahead of its peers who remain in the thick of transition projects that positions ANZ as a safer bank comparatively given the absence of transitional costs and operational risks associated with complex divestments. Elevated expenses continue to bite the likes of Westpac (-1% YoY but recorded the highest cost-to-income ratio of ~50% amongst peers) and NAB (+9.1% YoY). Similarly, ANZ saw costs rising by 6% as a result of inflationary pressures (higher wages), acquisition related spendings, and ongoing investment spend for ANZ Plus. ANZ also stands out from its peers considering all 4 underlying business divisions remained resilient, stable, and profitable - attesting for the effectiveness of ANZ's corporate governance, driving its disciplined commercial strategy and prudent risk management that will continue to serve the bank well in navigating the ever-changing sector and macro headwinds.

Relative value trade opportunities

ANZ Wholesale Subordinated Notes 6.736% 2038 features the highest fixed-rate issue yield by ANZ to date. Notably, its credit spread is trading tight at ~190bps considering an approximate 9 years to call (vs. comparable issue CBA 6.51% 2038 ,trading at +255bps), and only 10bps wider than ANZ Wholesale Subordinated Notes 8 FRN (2.35% margin over 3-month BBSW) despite having a further call date by ~5 years (2033 vs 2028). Additionally, fixed rate credit return volatility has historically been more volatile than floating rate credit returns due to higher duration risk. The slight differential in credit spreads between the 2 issues further presents ANZ Wholesale Subordinated Notes 6.736% 2038 as a good relative value trade.

Comparing the series of convertible notes issued by ANZ that feature a moderate longer time to call (>4 years to first call), the ANZ Capital Notes 6 priced most attractively at issue, offering 3.0% margin over 3-month BBSW. The newest issue ANZ Capital Notes 8 priced tighter at 2.75% over 3-month BBSW. Despite the modestly higher interim coupons, notes from series 6 is well received by the market, pricing at ~103c / 6.6% yield to maturity while series 8 is priced at par with higher yield to maturity by ~40bps at 7.0%. In this regard, the ANZ Capital Notes 8 offers better upfront value to gain exposure in an issuer that boosts promising commercial outlook alongside an improved balance sheet position further supported by its resilient and profitable business units.

Note: the aforementioned trade opportunities reflect a point-in-time perspective and require reassessment as market movements are linked to the credit cycle and/or idiosyncrasies.

Strengths of ANZ

- **Strong capitalisation:** ANZ is well-capitalised, with a Common Equity Tier 1 (CET1) ratio of 13.3% at 30 September 2023. The Australian Prudential Regulation Authority (APRA) requires authorised deposit-taking institutions (ADIs) to hold a minimum ratio of Tier 1 capital to risk-weighted assets of 11.75%, with at least 10.25% in the form of CET1 capital (based on minimum prudential requirement of 4.5% plus D-SIBs capital buffer of at least 5.75%).

- **Healthy liquidity profile:** ANZ has an average liquidity coverage ratio (LCR) of 130% as at 30 September 2023, well-above regulatory minimums (100%), and on par with domestic peers. This implies that ANZ is well-positioned to meet net cash outflows over a 30-day period during a severe liquidity stress scenario. In addition, a third of its asset mix comprised of highly liquid assets, in excess of wholesale debt obligations (22% of its overall funding profile). The proportion of deposits that make up funding has picked up over the years to 56% as of FY23, which improves stability of funding and interest expense (compared to term funding).
- **Sound macro environment and regulatory oversight:** Australian financials, benefit from operating in an economy characterised as having a very high degree of economic resilience with low susceptibility to event risk. The Australian economy rebounded strongly after COVID-19 related disruptions, and while the impacts of the pandemic are largely behind us, it remains that institutional and governance frameworks compare well with overseas jurisdictions, providing an additional level of security, against future uncertainty. D-SIBs like ANZ are subjected to more intense supervisory oversight and stricter capital requirements to ensure greater capacity to absorb losses and to increase resiliency to failure.
- **Systematic importance to the Australian and New Zealand economies and financial systems:** In the unlikely event of a failure, it is expected that the both governments is more than likely to provide support for a workout solution as ANZ is highly interconnected with ANZ's financial sector as the lender to ~13.4% of Australia's total mortgage book and a third of the New Zealand mortgage market.

Weaknesses of ANZ

- **Near term debt repayment task:** ANZ has imminent debt maturities of \$28bn to address in FY24 including \$8bn that is payable to the RBA Term Funding Facility (TFF). TFF was introduced to provide ultra-low cost funding (three-year fixed rate of 0.25%) to support the economy during the Covid-19 pandemic. Given this source of funding is rolling off, ANZ will need to tap into the cash and/or debt markets for new funding to repay these maturities. This will likely incur higher funding costs considerably in light of elevated cash rates, dragging the profitability of ANZ due to higher interest spend. In the case that ANZ is unable to source appropriate funding, it may resort to reducing business activities (eg. lending) and/or operate with smaller liquidity buffers at the cost of heightening the risk of yet another regulatory breach.
- **Growing costs of writing new loans and refinancing:** Despite achieving a growth in market share (+40bps), overall NIM by ANZ was the lowest compared to peer average (170bps vs 185bps) as margins continue to be squeezed by growing competition. This was exacerbated by cashback offers targeted at refinancing borrowers that implied a higher cost of doing business. The balance between improving profitability and growing market share will be the focal point for the outlook on ANZ's margins after its relative underperformance in NIM. Institutional banking continues to be ANZ's strongest business unit and provides a safe backing for growing the bank's mortgage book. However, the bank's overall margins could be eroded by an unprofitable mortgage portfolio considering the sizeable investments spendings on process improvements.

Risks related to the ANZ

- **Ongoing cost pressures faced by retail customers and corporates:** Credit impairment charge has reportedly doubled in FY23 to \$245m while collective provision balance increased slightly by 3bps to \$4.03bn that represented ~57bps of total gross loans. Collective provision balance, or expected credit loss, is a forward-looking estimation of credit deterioration and does not require an actual loss event to have occurred for a credit loss provision to be recognised. The stressed scenario for expected losses assumed a ~3% increase in unemployment rates to 6.9% and a 14% fall in house prices. Corporate lending attributed approximately half of the estimated credit losses in this scenario despite being only 28% of total loan volumes, reflecting the sector's greater vulnerability to these macro drivers.
- **Weakness of the Australian Dollar:** ANZ is sensitive to forex movements given its extensive business operations in foreign countries as well as a sizeable holding of foreign investments. Offshore operations hold liquid assets denominated in local currency to meet required regulations as imposed by each jurisdiction's regulator. Foreign revenue will likely be lower once converted back to the Australian dollar as the currency appreciates, and reversely returns a higher net income in Australian dollar terms if the Australian dollar depreciates against other foreign currencies.
- **Rating downgrades:** Ratings on both issuers and issues can be influenced by factors that do not necessarily reflect the financial strength or credit quality of a specific issuer, such as the Australian sovereign rating, the rating agencies' view on the economic prospects of the country or relative strengths of the regulatory framework. For example, in 2020 both S&P and Moody's placed the ratings on a number of Australian financial institutions on negative outlook due to concerns about the economic outlook for Australia. This will adversely impact ANZ's ease of accessing cheaper funding, competitive position and financial stability.

Risks related to the Instruments (Tier 2) and Additional Tier 1 (AT1)

- **Optional call dependent on regulatory approval:** Tier 2 notes include an early call feature where the face value of the notes may be repaid early in cash from a given date stated in the terms and conditions of the instrument. The optional redemption requires regulatory approval, which may not be provided. In general, regulators are unlikely to provide approval for a Tier 2 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

- **Conversion or write-down following a Non-Viability Trigger Event:** A Non-Viability Trigger Event occurs when APRA determines conversion to ordinary shares (or write-off) of some or all of an issuer's contingent capital securities (Tier 2 and AT1) is necessary to prevent that financial institution becoming non-viable. Whether a non-viability trigger event will occur is solely at the discretion of APRA. APRA does not define what constitutes a non-viability event and there are currently no precedents under Basel III to determine non-viability. If such an event occurs, the issuer may be required to convert some or all of its Tier 2 notes into ordinary shares. In a more severe scenario, the issuer may be required to write-off the value of these notes. We note that it is expected that the conversion/write-off would be expected to be applied first to AT1 hybrids and only then to the Tier 2 if the AT1 conversion/write-off was not sufficient to restore the issuer to a viable position.
- **Capped equity conversion:** Conversion of Tier 2 notes following a non-viability trigger event is subject to a maximum number of shares being issued. As such, if the notes are converted into ordinary shares, the value of ordinary shares an investor receives may be significantly less than the face value of their notes.
- **Subordination:** Tier 2 and AT1 notes are deeply subordinated, and rank ahead only of ordinary shares. AT1 was used recently when international banks (such as Credit Suisse and Silicon Valley Bank) collapsed rather than providing capital support earlier in the crisis.

ANZ BANKING GROUP LTD

FACT SHEET

FEBRUARY 2024

I A M
INCOME ASSET
MANAGEMENT

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call ¹	Maturity Date	Issue Rating (S&P/Moody's/Fitch)
AU3FN0070330	AUD300m	Subordinated Unsecured Tier 2	3mBBSW + 2.70%	Quarterly	12 August 2027	12 August 2032	BBB+ / Baa1 / A-
AU3FN0077939	AUD875m	Subordinated Unsecured Tier 2	3mBBSW + 2.35%	Quarterly	16 May 2028	16 May 2033	BBB+ / Baa1 / A-
AU3CB0296671	AUD1000m	Subordinated Unsecured Tier 2	6.736% ²	Semi-annual	10 February 2033	10 February 2038	BBB+ / Baa1 / A-
AU3FN0084026	AUD1435m	Subordinated Unsecured Tier 2	3mBBSW + 1.95%	Quarterly	16 January 2029	16 January 2034	BBB+ / Baa1 / A-
AU3CB0292472	AUD900m	Subordinated Unsecured Tier 2	6.405% ³	Semi-annual	20 Sept 2029	20 Sept 2034	BBB+ / Baa1 / A-
AU0000267783	AUD1.5bn	Jr Subordinated Additional Tier 1	3mBBSW + 2.75%	Quarterly	20 March 2030	Perpetual	- / - / -
AU0000261414	AUD1.3bn	Jr Subordinated Additional Tier 1	3mBBSW + 2.70%	Quarterly	20 March 2029	Perpetual	- / - / -
AU0000261422	AUD1.5bn	Jr Subordinated Additional Tier 1	3mBBSW + 3.00%	Quarterly	20 March 2028	Perpetual	- / - / -

¹ Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call.

² Resets on 10 February 2033 at a rate equal to the 3 month BBSW + 2.80%.

³ Resets on 20 September 2029 at a rate equal to the 3 month BBSW + 2.60%.

For more information call 1300 784 132 or email adviserservices@incomeam.com

ANZ BANKING GROUP LTD

FACT SHEET

FEBRUARY 2024

I A M
INCOME ASSET
MANAGEMENT

Tier 2 Structure

Interest Deferral/Cancellation	Interest is deferrable and cumulative if, prior to the payment of interest, the issuer is not solvent or would not be solvent after payment.
Non-Viability Trigger	Yes, standard Basel III compliant non-viability trigger. If APRA determines the issuer is at risk of becoming non-viable, the terms of the notes indicate that the primary method of loss absorption will be via conversion of the subordinated notes into equity, in-part or in full.

Perpetual Tier 1 (AT1) Structure

Interest Deferral/Cancellation	Interest is deferrable and non-cumulative. Interest payment is optional and, if unpaid, the issuer has no obligation to pay any deferred amounts later. A cancellation of interest does not constitute a default under the Notes for any purpose.
Common Equity Tier 1 Trigger	If a bank determines, or APRA notifies a bank in writing, that the bank's Common Equity Tier 1 ratio is less than or equal to 5.125%, the bank may be required to write-off some or all the face value of the notes or convert some or all of the notes into ordinary shares.
Non-Viability Trigger	If APRA determines that an issuer requires capital support to prevent it from becoming non-viable (a 'non-viability event'), the bank may be required to write-off some or all the face value of the notes or convert some or all of the notes into ordinary shares.
Maturity	The notes do not have a maturity date. This means that the issuer does not have an obligation to repay the principal, although if it elects to do so, it will require APRA approval.

For more information call 1300 784 132 or email adviserservices@incomeam.com

ANZ BANKING GROUP LTD

FACT SHEET

FEBRUARY 2024

IAM
INCOME ASSET
MANAGEMENT

Disclosure

© 2024 IAM Group | Income Asset Management Group Limited ACN 010 653 862 (ASX: IAM) and wholly owned subsidiaries, IAM Capital Markets Ltd ACN 111 273 048 AFSL 283119, IAM Cash Markets Pty Ltd ACN 164 806 357 as corporate authorised representative (no. 001295506) of AFSL 283119, Trustees Australia Limited ACN 010 579 058 AFSL 260038 and IAM Funds Pty Ltd ACN 643 600 088 as corporate authorised representative (no. 001296921) of AFSL 260038, together the IAM Group.

Disclaimer: The information in this document is for general information purposes only and does not purport to contain all matters relevant to any particular or financial instrument. It is not intended to be a recommendation, offer or invitation to purchase, sell or otherwise deal in securities or other investments. Before making any decisions in respect to a financial product, you should read the relevant Financial Services Guide and Product Disclosure Statement and seek independent and specific advice from an appropriately qualified professional. Income Asset Management Group and its subsidiaries shall not be liable for any errors, omissions, defects, or misrepresentations in the information or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the information contained here.

IAM Group offers general financial product advice only. As a result, any information or advice, has been provided without taking account of your objectives, financial situation and needs. Because of this, you should, before acting on any advice from IAM consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If the information or any advice, relates to the acquisition, or possible acquisition, of a particular financial product, you should obtain and consider the product disclosure statement or documents relating to the product before making any decision about whether to acquire the product. Neither IAM Group, nor any of its directors, authorised representatives, employees, or agents, makes any representation or warranty as to the reliability, accuracy, or completeness, of any information or advice. Nor do they accept any liability or responsibility arising in any way (including negligence) for errors in, or omissions from, any information or advice. IAM Group, its staff and related parties earn fees and revenue from dealing in the securities as principal or otherwise and may have an interest in any securities mentioned. Any reference to credit ratings of companies, entities or financial products must only be relied upon by a 'wholesale client' as that term is defined in section 761G of the Corporations Act 2001 (Cth). IAM Group does not provide tax advice and is not a registered tax agent or tax (financial) advisor, nor are any of the IAM Group staff or authorised representatives. IAM Group does not make a market in the securities or products that may be mentioned.

An investment in notes or corporate bonds should not be compared to a bank deposit. Notes and corporate bonds have a greater risk of loss of some or all of an investor's capital when compared to bank deposits. Past performance of any product is not a reliable indication of future performance. Any forecasts are predictive in character and based on specified assumptions generally available at the time and no reliance should be placed on the accuracy of any forecast information. The actual results may differ substantially from the forecasts and are subject to change without further notice. IAM may quote to you an estimated yield when you purchase a bond. This yield may be calculated by IAM on either A) a yield to maturity date basis; or B) a yield to early redemption date basis. Some bond issuances include multiple early redemption dates and prices, therefore the realised yield earned by you on the bond may differ from the yield estimated or quoted by IAM at the time of your purchase.

For more information call 1300 784 132 or email adviserservices@incomeam.com