MACQUARIE BANK LTD
FACT SHEET
FEBRUARY 2024

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Macquarie Bank Ltd

Issuer Outline

Macquarie Bank Limited operates as a bank. The Company offers advisory and capital markets, trading and hedging, funds management, asset finance, financing, and research and retail financial services. Macquarie Bank serves customers worldwide.

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

IAM Credit View

Macquarie Bank Limited (MBL) is well positioned to deliver top line returns while providing downside credit protection for investors. Despite the macro headwinds of tighter financial conditions and weaker economic activity, MBL continues to post strong profits as its business mix evolves through the cycle - most recently the axe to grow its lending arm which saw the bank taking ~5% of the residential market share (+2% vs 2022), becoming the fifth largest mortgage lender in Australia (after the big 4 banks). MBL also boosts robust capital adequacy and strong liquidity position as affirmed by rating agencies' upgrades on its long-term issuer rating to A1/A+/A in June 2023. By extension, its parent Macquarie Group (ASX: MQG) was upgraded by a notch to A2 rating, citing very strong profitability in FY23 and continued conviction for its internationally diversified income stream to weather through all economic conditions. As of FY23e, MBL was the only division in MQG to post positive YoY growth in net profit contribution driven by improved net interest and trading income (+49%) and fee and commission income (+23%). That said, revenue over the last 2 years was noticeably concentrated in commodities which tend to be more volatile for earnings.

Issuer Credit Rating & Outlook

Agency	Rating	Outlook
S&P	A+	STABLE
Moody's	A1	STABLE
Fitch	A	STABLE

Key Financials (AUD m)

LTM (31 March)	2023
Net interest income	2,640
Non-interest income	10,265
NPAT	3,905
Gross loans	142,384
Total assets	330,823
Customer deposits	134,648
Short- and long-term debt	99,096
Non-performing loans (NPLs) to total loans (%)	0.11
CET 1 ratio (%)	15.60

This is likely to be mitigated by MBL's conservative approach to capital, funding and liquidity that positions the bank well to respond to macroeconomic challenges and dynamically pivot to income-generating opportunities.

Relative value trade opportunities

The current marks on MBL's US$ 6.125% AT1 (first call 8/03/2027) presents an attractive opportunity to enter the position cheaply. The credit spread differential compared to ANZ US$ 6.75% (first call 21/09/2026) is ~200bps whereby MBL perp note is trading at ~500bps over ASW on terms vs ANZ at ~300bps over ASW. The credit profile of MBL remains strong and arguably on par with the big 4 major banks as it has proven to be a consistent performer over the medium to long term and well-positioned to withstand market volatility due to diversified income streams and backing by MQG.

MBL US$ 6.798% 10Y tier 2 bullet issued in Jan-23 currently trades at ~270bps ASW which is ~40bps wider than the NAB US$ 6.429% tier 2 bullet that was issued in the same month. Comparatively, the MBL note offers better relative value considering the spread and coupon pick up for similar duration risk and credit risk.

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 MBL

- **Strong capitalisation:** MBL is well-capitalised, with a Common Equity Tier 1 (CET1) ratio of 15.6% on 31 March 2023. Under Basel III rules, 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 8.5% (including the 2.5% capital conservation buffer), with at least 7.0% in the form of CET1 capital.

- **Healthy debt maturity profile supported by strong liquidity:** The weighted average term maturity of term funding maturing beyond one year on 31 March 2023 is 3.6 years for the bank, meaning the risk of significant refinancing in a period of potential market dislocation is greatly mitigated. MBL also had an average liquidity coverage ratio (LCR) of 214% as at year end 31 March 2023 (+30% from 2022), well-above regulatory minimums (100%), as well as domestic peers (134% average of the big 4 banks). The group's liquidity policy also requires sufficient cash and liquid assets to meet expected outflow under a 12-month stress scenario and meet minimum regulatory requirements. For context, 28% of MBL's funded assets was held in cash and liquid assets which is almost thrice of MBL's short-term funding task, including TFF repayment of A$9.5bn.

- **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.

- **Diversified operations:** MBL's operations are relatively diverse compared with domestic peers. Operating revenues are well-diversified across individual product lines, with no particular product lines of significant concentration. This compares with domestic banks who have a significant concentration to residential property, for example. By extension and given the global reach of both MQG and MBL, the bank's geographic diversity is also a relative strength, with more than a third of its credit exposures outside of Australia and spread primarily throughout Europe, the Americas, and Asia.

- **Systematic importance to the Australian economy and financial system:** In the unlikely event of a failure, it is expected that the Australian government is more than likely to provide support for a workout solution as MBL is highly interconnected with Australia's financial sector infrastructure, including as a major counterparty to other Australian institutions in derivatives markets.

Weaknesses of MBL

- **Near term debt repayment task of ~A$20bn:** MBL has imminent debt maturities of ~A$20bn to address in FY24, half of which 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. MBL will need to source funding to repay these maturities, and typical funding avenues for the banks include raising new money in wholesale markets and formation of new deposits. Both of which are likely to incur considerably higher funding costs in light of elevated cash rates, impacting profitability adversely.

- **Vulnerability to group-level risks:** As a subsidiary, MBL is susceptible to all major decisions and actions taken by its parent, particularly if MQR significantly increases the group's risk appetite, undergoes financial distress and/or breaches regulatory or risk management thresholds. This is notwithstanding the spill over effects of internal risk incidents inflicted by other divisions namely Macquarie Asset Management and Macquarie Capital as all divisions share centralised group functions.

Risks related to the MBL

- **Large volatility led gains in CGM business:** Some of the markets in which MBL operates in are complex and volatile compared to the relatively vanilla retail and commercial banking activities of Australia's domestic banking market. The proportion of earnings with 'annuity-type' characteristic is also lower relative to domestic peers, with net interest income at less than 50% (by comparison, domestic banks generally generate more than two-thirds of its earnings from net interest income). MBL's Commodities and Global Markets (CGM) business operates in and depends on the operation of global markets. Sudden declines and significant volatility in the prices of assets may substantially curtail or eliminate the trading markets for certain assets,

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which make it very difficult to sell, hedge or value such assets, and in turn may negatively affect the bank's earnings, capital, and liquidity.

- **Diversity in earnings raises vulnerability around complexity and geopolitical risks:** Although diversity is a relative strength, the increased complexity can counterbalance some of the stability generally observed in more predictable income streams. Jurisdictions in which MBL does business may be negatively impacted by slow growth rates or recessionary conditions, market volatility and/or political unrest.

- **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 several Australian financial institutions, including MBL (S&P only), on negative outlook due to concerns about the economic outlook for Australia.

- **Weakness of the Australian Dollar:** MBL is the most sensitive to forex movements among Australian banks, given its more geographically diverse operations. The bank leaves investments in foreign operations exposed to foreign currency, which aligns the currency of capital supply with capital needs, resulting in net currency exposure. Therefore, net income will be lower in Australian dollar terms if the Australian dollar appreciates, and reversely a higher net income in Australia dollar terms if the Australian dollar depreciates against other foreign currencies.

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, the price of the notes will likely 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

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and only then to 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.

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date	Issue Rating (S&P/Moody's/Fitch)
AU3FN0054284	AUD750m	Subordinated Unsecured Tier 2	3mBBSW + 2.90%	Quarterly	28 May 2025	28 May 2030	BBB / Baa2 / -
AU3FN0061065	AUD750m	Subordinated Unsecured Tier 2	3mBBSW + 1.55%	Quarterly	17 June 2026	17 June 2031	BBB / Baa2 / BBB+
AU3CB0290039	AUD500m	Subordinated Unsecured Tier 2	6.082%[2]	Semi-annual	7 June 2027	7 June 2032	BBB / Baa2 / BBB+
USQ568A9SS79	USD1000m	Subordinated Unsecured Tier 2	6.798%	Semi-annual	18 January 2033	18 January 2033	BBB / Baa2 / BBB+
USQ568A9SP31	USD750m	Jr Subordinated Additional Tier 1	6.125%[3]	Semi-annual	8 March 2027	Perpetual	BB+ / Baa3 / -

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

[2]Resets on 7 June 2027 at a rate equal to the 3-month BBSW + 2.70%.

[3]Resets on 8 March 2027 and every subsequent five years at a rate equal to a five-year rate + 3.70%.

Tier 2 Structure

Interest Deferral/Cancellation	Interest is deferrable and cumulative if, before 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.

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