

July 2024

## Police and Nurses Capital Note

By IAM Capital Markets

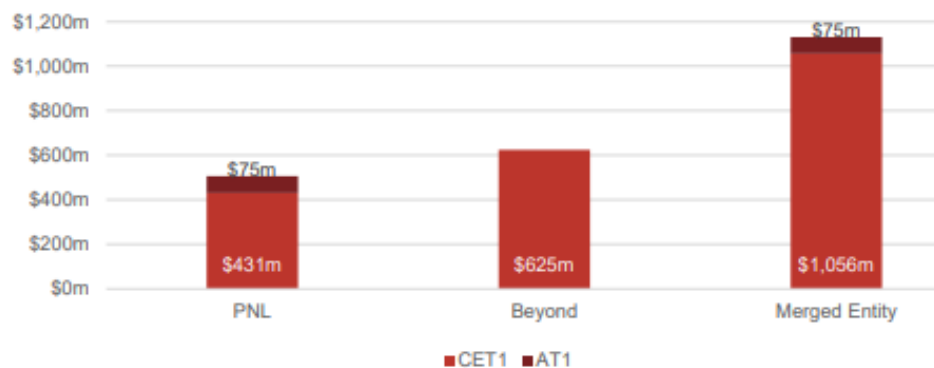
On June 5th, it was announced that Police and Nurses (PNL) and Beyond Bank have agreed to sign a Memorandum of Understanding (MoU) for a possible merger between the two mutual banks. If approved, the combined group would be one of the largest mutual banks in Australia, with an estimated 487k customers, with approximately 17bln in assets. We believe there is material capital price upside in the P&N BBSW+5.75% Additional Tier 1's (AT1) notes if the merger goes ahead.

While there is execution risk associated with any merger, the reasoning and strategic rationale make sense. Both banks have the same core banking system which makes integration much easier, and they each have prior experience with merger transactions. In a banking environment that is extremely competitive, scale is key – so a larger entity should be better placed to keep up with a constantly changing sector.

Another reason the merger makes sense is from a geographic standpoint. PNL is headquartered in Perth with a strong presence in WA, Northern NSW and Southeast Queensland. Beyond Bank on the other hand is headquartered in Adelaide with a strong position in SA, ACT, NEW, VIC and WA. Having improved diversification across Australia would undoubtedly help the bank going forward. BondAdviser covers P&N and views the potential merger as credit positive for the following reasons:

“As seen in the chart below, Beyond Bank does not have any AT1 capital notes on issue, so on a pro forma basis as at 31 March 2024 there would be significantly more (+625 million) loss absorbing capital i.e. CET1 capital would sit below these AT1 notes. The pro forma CET1 ratio for the combined group of 14.5% would be materially higher than PNL's current ratio of 12%.”

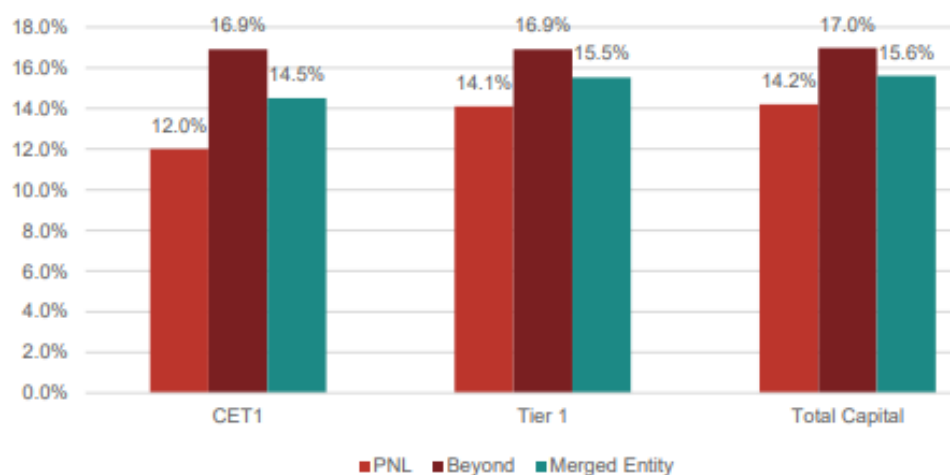
**Figure 14. Tier 1 Capital – Merged Entity based on sum**



Source: BondAdviser, APRA as at 31 March 2024.

“Secondly, the increased earnings on the combined group provide significantly greater coverage for distributions on these notes based on the FY23 NPAT of the respective banks. This does not factor in integration costs or potential cost synergies.”

**Figure 15. Regulatory Capital Ratios – Merged Entity based on sum**



Source: BondAdviser, APRA as at 31 March 2024.

Investors should also note there is no change of control, and therefore AT1 noteholders will capture the capital upside if the merger goes ahead. Both banks have a BBB+ rating by S&P, which means the end issuer rating is likely to be BBB+ (or higher) given improved business and financial metrics. This will mean there will be more income available for the combined group - distributions on P&N AT1s will be more than able to be met 10.4x vs 3.7x cash distribution coverage. While there is execution risk, we believe that the potential upside and short term to call make this worthy of consideration for investors.

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