WESTPAC BANKING CORP
FACT SHEET
JANUARY 2024

Westpac Banking Corp

Issuer Outline

Westpac Banking Corporation 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. Westpac Banking serves customers worldwide.

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

IAM Credit View

FY23 was marked as the year of outperformances for Westpac Banking Corporation (WBC) financially and operationally over the last 5 years. This was built on the back of growing deposits, mortgages and institutional banking which collectively contributed to a 26% increase in net profit of $7.2 billion. In spite of the declining margins on WBC's mortgage book (alike to other lenders), WBC achieved growth in loan volumes (+$23 billion in home loans and +$12 billion in business loans) hence the overall improved profitability. In terms of fundamentals, its balance sheet position continued to strengthen with CET1 capital ratio increasing to 12.4% representing $4 billion of excess capital. This supported the bank's decision for $1.5 billion of shares buyback and a higher final dividend of 72 cents that served the shareholders well. On the operational front, WBC is undergoing a series of transformation including the divestments of non-core assets, simplification of legacy technological platform, and organisational restructure that separated consumer and banking divisions. More importantly, the bank has spent close to $6 billion on risk and regulatory change and paid penalties of $1.4 billion from AUSTRAC matters since 2019.

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	18,318
Non-interest income	3,684
NPAT	7,195
Gross loans	777,687
Total assets	1,029,774
Customer deposits	688,168
Short- and long-term debt	234,619
Non-performing loans (NPLs) to total loans (%)	0.17
CET 1 ratio (%)	14.59

The required remediation effort has saw WBC incurring the same investment spend as CBA (the largest market player and twice the size of WBC in terms of market cap) as each bank spent ~$2 billion on (1) risk and regulatory, and (2) growth and productivity initiatives. Unsurprisingly, bulk of the investment spend by WBC was directed at risk and regulatory (62%) while CBA only spent 32% for the same category and the remaining on growth initiatives. WBC forecasts the proportion of investment spend on regulatory projects to reduce from 2025 and redirect to more profitable purposes. All in all, the outlook for WBC is generally positive as all hands are on deck to resolve the jarring drag on profitability as evident by the ongoing prioritisation and investment spend on simplification and consolidation. In FY23, WBC has demonstrated sound management in weathering through the challenging macroeconomic environment while fending its profitability and market share against tougher competition - all while tackling the costly regulatory remediation and operational uplift.

Relative value trade opportunities

The Westpac 7.199% 2038 issue is deemed as the most attractive Tier 2 paper issued by WBC given its compelling gross yield compared to similar issues. It has been trading healthily above par since issuance, reflecting an excess demand for the high yielding note by the performing issuer who is on a positive trajectory. Although the Westpac 5.00% 2048 paper is trading at a deep discount paying a running yield of 7.1% (while the Westpac 7.199% 2038 has a lower running yield of 6.8%), the relative value does not stack up sufficiently considering higher duration risk (~4 years longer) and presumably lower trading liquidity (investors deterred from lower coupons/interim cashflows).

In 2023, WBC had one issuance of AT1 notes namely the Westpac Capital Notes 10 that priced at 310bps margin over BBSW3M with first call in September 2031. It's predecessor Westpac Capital Notes 9 is higher yielding at 340bps margin over BBSW3M that came to market the year before. Its first call is projected to be in September 2028 which is ~3 years sooner than series 10 despite being only one year apart in issuance, not to mention the higher margins for similar credit risk. In this regard, the Westpac Capital Notes 9 is more attractive when weighing the relativities.

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 WBC

- **Strong capitalisation:** WBC is well-capitalised, with a Common Equity Tier 1 (CET1) ratio of 12.4% at 30 September 2023. WBC targets the range of 11.0% to 11.5% for CET1 capital ratio to build in extra buffer to protect its financial position in anticipation of any adverse events from the economic and operating environment. 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. Of note, WBC is more likely to be stringent on capital management after breaches of liquidity standards were found by APRA in 2020. The incident saw WBC applying a 10% add-on to the net cash outflow component of its LCR calculation (removed in Sep-22) and a capital requirement add-on of $1 billion to reflect heightened operational risk profile (remains in place).

- **Healthy debt maturity profile supported by strong liquidity:** The average time to maturity/next call of term funding beyond one year is 4.5 years for the bank, meaning the risk of significant refinancing in a period of potential market dislocation is greatly mitigated. WBC also had an average liquidity coverage ratio (LCR) of 138% as at 30 September 2023 (+3% from 2022), well-above regulatory minimums (100%), as well as domestic peers.

- **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.

- **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 WBC is highly interconnected with Australia's financial sector infrastructure, including as a major counterparty to other Australian institutions in derivatives markets.

Weaknesses of WBC

- **Near term debt repayment task of ~A$40bn:** WBC has imminent debt maturities of A$41bn to address in FY24, a third 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. Given this source of funding is rolling off, WBC 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 WBC due to higher interest spend. In the case that WBC 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.

- **Erosion of margins from high ongoing costs:** WBC incurred the highest cost-to-income ratio amongst the big 4 banks in FY23 at 49.4% (vs 46.2% average) citing inflationary pressures driving up resourcing costs and elevated spend on risk and regulatory initiatives. Despite its sound management that saw overall YoY profitability, cost base remains a significant drag. Loan revenues is likely to dip further as margins continue to be squeezed by heavier market competition. This deteriorates WBC's top line margins, weakening its financial position and profitability in the coming years unless WBC achieves a lower cost of running the business. Notwithstanding the growing challenge of customer retention and prospects as a result of a damaged reputation from the series of breaches and non-compliance matters as evident by AMP since 2019.

- **Concentrated revenue stream from banking activities:** WBC continues to divest from non-core operations to focus on banking business in ANZ. Playing to its strength, WBC's skew leaves its earnings more vulnerable to the pressures on lending markets, and households and businesses that are experiencing elevated cost burdens from higher interest rates and inflation. Over the recent years, WB has partially or fully sold off 10 non-core divisions including Private Portfolio Management and Life Insurance. Diversity in revenue streams has proven to be an effective hedge particularly in times of market volatility as Macquarie bank has shown.

Risks related to the WBC

- **Execution risk of ongoing initiatives for uplifting WBC's technological and operational platforms:** WBC currently uses antique systems (that partly resulted in the headlined risk management oversight and compliance breaches) while working on improving technological capabilities. The migration work will require significant integration efforts which poses higher susceptibility to a technology failure and non-compliance. Projects aimed at streamlining systems and process have been requiring significant resourcing and costs. Customer experience and outcomes may also deteriotate in this period of less stability alongside a possibility of unplanned delays or costs to the projects.

- **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 WBC's ease of accessing cheaper funding, competitive position and financial stability.

- **Weakness of the Australian Dollar:** WBC 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 Australian dollar as the currency appreciates, and reversely return 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 a 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 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.

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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)
AU3CB0304376	AUD1500m	Subordinated Unsecured Tier 2	7.199%[2]	Semi-annual	15 November 2033	15 November 2038	BBB+ / Baa1 / -
AU3CB0300358	AUD1100m	Subordinated Unsecured Tier 2	6.394%[3]	Semi-annual	23 June 2033	23 June 2038	BBB+ / Baa1 / -
AU3FN0079091	AUD1500m	Subordinated Unsecured Tier 2	3mBBSW + 2.30%	Quarterly	23 June 2028	23 June 2033	BBB+ / Baa1 / -
AU3FN0049672	AUD1000m	Subordinated Unsecured Tier 2	3mBBSW + 1.98%	Quarterly	27 August 2024	27 August 2029	BBB+ / Baa1 / A-
AU3CB0300366	AUD300m	Subordinated Unsecured Tier 2	6.491%[4]	Semi-annual	23 June 2028	23 June 2033	BBB+ / Baa1 / -
AU0000306557	AUD1.75bn	Jr Subordinated Additional Tier 1	3mBBSW + 3.10%	Quarterly	22 September 2031	Perpetual	BBB- / - / -
AU0000229452	AUD1.51bn	Jr Subordinated Additional Tier 1	3mBBSW + 3.40%	Quarterly	22 September 2028	Perpetual	BBB- / - / -

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

[2]Resets on 15 November 2033 at a rate equal to the 3-month BBSW + 2.40%.

[3]Resets on 23 June 2033 at a rate equal to the 3-month BBSW + 2.60%.

[4] Resets on23 June 2028 at a rate equal to the 3-month BBSW + 2.30%

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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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Disclosure

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