

Issuer Name

**Commonwealth
Bank of Australia**

Security Name

**CBA Subordinated
FRN 2.05% 2033 10NC5**

Security Recommendation

Hold

Security Risk

Lower Medium

Issuer Outlook

Improving

Stable

Deteriorating

Key Characteristics

Currency	AUD	Last Price	A\$102.84
Outstanding Amount	A\$700,000,000.00	Accrued	A\$0.30
Par Value	A\$100.00	Capital Price	A\$102.54
Fixed/Floating	Floating	Running Yield	6.18%
Payment Frequency	Quarterly	Yield to Maturity	5.32%
Current Distribution	6.34%	Trading Margin	1.29%
Issue Margin / Coupon	2.05%	Optional Call Date	25 October 2028
Franking Credits Incl.	No	Legal Final Maturity	25 October 2033
ASX Listed	No (ISIN: AU3FN0082251)	Next Ex-Date	18 April 2025
Convertible	No	Next Payment Date	28 April 2025
GICS Sector	Banks	Next Cash Distribution	A\$1.56

Summary

On 25 October 2023, Commonwealth Bank of Australia (ASX: CBA) issued subordinated 10NC5 notes raising \$700mn. These securities were sold to wholesale investors only (no prospectus being issued) and are not listed on the Australian Securities Exchange. They are subordinated, unsecured medium-term notes (MTNs) and interest payments are non-discretionary and floating rate. The purpose of issuing the notes was for general corporate purposes and will qualify as Tier 2 regulatory capital for the Group.

The interest margin was set at 2.05% p.a. above the 90-Day BBSW and will be paid in arrears on a quarterly basis until conversion, redemption or maturity. CBA has the right (but not the obligation) to redeem (subject to APRA approval) the notes on the optional redemption date (25 October 2028) and each payment date thereafter until maturity on 25 October 2033.

This security contains terms known as a Non-Viability Trigger Event. Upon the occurrence of this event the security will be automatically converted into ordinary shares or written off. The holder will receive the lesser of the conversion number and maximum conversion number (see documentation for more detail). If a situation arises where conversion is not possible for any reason, holder's rights will be terminated, and the notes will lose all value.

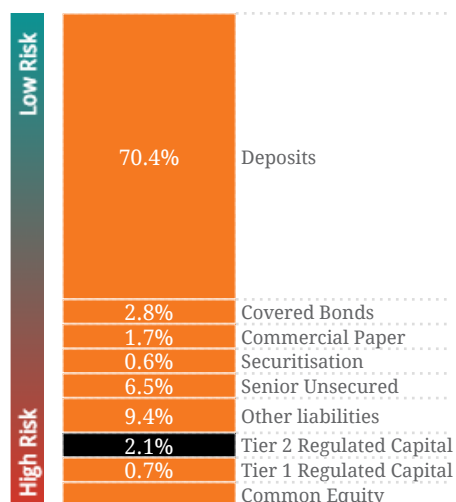
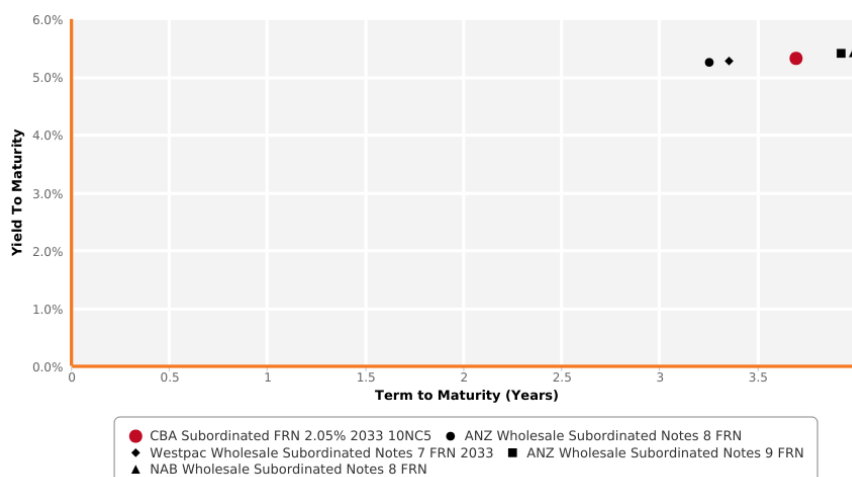
Figure 1: Capital Structure¹

Figure 2: Relative Value



Security Recommendation - Hold as at 17 February 2025

CBA delivered a strong 1H25 result, with cash NPAT up 2.3% y/y to \$5.13bn. Capitalisation and asset quality metrics remain robust, with the trend in non-performing exposure and arrears suggesting we have passed the trough in credit quality. The bank remains well positioned to navigate current conditions given its robust capital, funding, and liquidity positions, as well as its loan loss provision coverage, which continue to exceed pre pandemic levels.

Our valuation assumptions for this security are based on it being redeemed in full on the first call date (25 October 2028). If this security is not called on this date (extension risk), the price of the security would likely fall. We view this a remote scenario at present but a risk investors should be aware of.

At a trading margin of 1.29% (17/02/25), the notes trade broadly in line with the Big Four Tier 2 credit curve. We maintain a **Hold** recommendation.

Positive / Negative Risk Factors

What factors would change the Recommendation **UP**

- **Favourable Industry Dynamics.** The major domestic banks continue to benefit from favourable industry dynamics that support high market share. Supported by the four pillars policy, which maintains the separation of the four largest banks, the Major Banks (ANZ, CBA, NAB, WBC) dominate domestic banking. This includes residential mortgages and corporate lending. Despite non-major bank lending gaining traction in recent years, the dominance of the four Major Banks looks set to continue.
- **Strong Capital Position.** CBA, like its Major Bank peers, maintains a strong capital position. APRA's focus for the banks remains on common equity capital, with the expectation that the Major Banks are compliant with its updated benchmark of "unquestionably strong" minimum CET1 ratio of 10.25% of risk-weighted assets (RWAs). CBA has maintained a significant loss absorption cushion through earnings, capital, and loss provisioning, which are the primary defences against credit impairments.
- **Transparent Regulatory Oversight.** APRA continues to implement disciplined controls over domestic banking operations. Often stricter than global regulator peers, APRA has also displayed a willingness to work with the industry during times of stress to ease any headwinds where possible. Furthermore, APRA continues to work with the industry to support improved transparency, which has come in many forms over the years.
- **A Supportive AAA-rated Federal Government.** A Supportive AAA-rated Federal Government. As witnessed during the GFC, and most recently the COVID-19 crisis, domestic banking benefits from a supportive government. An example includes the provision of the Term Funding Facility for the industry to support lending to businesses during the pandemic. It is possible Australia may lose its AAA-rating in the medium-term, but this is not expected to impact levels of government support. To be clear, in the event of bank failure, we do not expect government support to hybrid investors.

What factors would change the Recommendation **DOWN**

- **Regulatory Risk.** Banks are highly regulated, and changes to regulation could impact profitability and/or require changes to the business model. Regulation could also require changes to the capital model, which may be impacted by more punitive pricing of extension risk for loss absorbing capital.
- **Operational Risk.** There are risks of financial losses, fines and regulatory sanctions because of failures and/or inadequate processes, systems and controls. This includes cyber risk, which is a growing threat. Regulatory requirements to hold capital for operational risk provides a loss absorption buffer against the financial impact from such events as well as sharpening Management and Board focus on operational risk management.
- **Funding and Liquidity Risk.** The inability to raise funding and meet financial obligations would significantly impact a bank's reputation, its cost of funding and ultimately its ability to continue to do business. This risk is mitigated by minimum regulatory requirements and oversight provided by the prudential regulator.
- **Uncertain Macroeconomic and Geopolitical Environment.** Australia, like other western economies, has been subject to strong inflationary forces, high interest rates, and housing unaffordability which poses risks to the economy and consequently asset quality. Supplementary risks stem from geopolitical tensions and macroeconomic uncertainty.
- **Non-Viability Trigger.** The primary risk to this security is where APRA determines that a Non-Viability Trigger Event has been breached. If breached, investors are at risk of substantial capital losses, with all of the Notes written-off in a worst-case scenario. We view this a remote scenario at present but a risk investors should be aware of. As Tier 2 capital this security sits above AT1 securities in CBA's capital structure so despite still being junior it is not as deeply subordinated.

Issuer Outlook - Stable as at 17 February 2025

Profitability

CBA delivered a strong 1H25 result, with cash NPAT up 2.3% y/y to \$5.13bn (ahead of analyst expectations). Underlying margins remained stable whilst a disciplined approach to volume growth drove higher levels of operating income (up 3.3% y/y). Improvements in profitability were offset by a 6.0% y/y increase in operating expenses, reflecting ongoing inflationary pressures and increased investment in technology. Positively, 1H24 loan impairment expenses were 22.9% lower versus the prior corresponding period.

1H25 pre-provision profit (which exclude credit impairment charges and tax) was up 1% on the prior year at \$7.73bn and remains above the recent 4-year average of \$7bn. This was supported by a 9bps y/y improvement in net interest margin to 2.08%, partly unwinding compression experienced in FY24 and following stabilisation in 2H24. While competitive pressure remains on both deposits and loan products, this was offset by higher earnings on capital and replicating portfolio hedges. Average interest earning assets also increased 3% y/y when excluding the impact of liquid assets. That said, there was a 120bps y/y deterioration in the cost to income ratio to 45.2% (albeit remaining low versus peers) reflecting cost inflation and technology spend.

Capitalisation and Liquidity

CBA's balance sheet remains robust and well supported by sound capitalisation and liquidity levels. The bank's Common Equity Tier 1 Capital (CET1) ratio came in at 12.2%, down 10bps compared to the prior half, but 195bps stronger than its regulatory minimum (10.25%). This also compares favourably to pre-pandemic levels of 11.70%. At the FY24 result CBA indicated its intention to operate at a post dividend CET1 ratio of greater than 11.0%, except in times of unexpected capital volatility, which we view as positive.

An interim fully franked final dividend of \$2.25 per share was declared. This equates to a dividend payout ratio of 73% of cash NPAT, which is down from 79% recorded in FY24 and within management's 70-80% target range.

As at 31 December 2024, only \$300mn of the \$1.0bn on-market share buy-back was completed. We note this has been previously extended at the FY24 results for 12 months to 13 August 2025. While this appears material, completion of the buyback would only reduce the pro forma CET1 ratio by ~15bps, leaving it at a still strong level. Additionally, we view an on-market buyback as preferable to handing back surplus capital to equity holders (in lieu of dividends) as it is flexible and can be implemented progressively.

CBA's Tier 2 capital of 6.6% as at 31 December 2024 (unchanged over the period) comfortably surpasses APRA's requirements for additional loss-absorbing capital effective from 1 January 2024 (5.00%), and is slightly above the 6.50% requirement by 1 January 2026.

CBA's funding and liquidity position continues to be a point of focus for management, with key metrics remaining well above the regulatory minimums of 100%. Both the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) deteriorated y/y over the period on a quarterly average basis, down 6pp to 116% and 57p to 127%. That said, these levels remain well clear of the bank's 100% regulatory minimum.

Customer deposit funding increased remained stable at a healthy 77%. This source of funding is expected to remain competitive given expectations that cash rates have arguably peaked. However, CBA have ample levers here to compete in our view; given their deposit offerings are currently at the low end of the market – however, this would weigh on NIM.

Asset Quality

Whilst CBA's asset quality remains sound, there remains some pockets of weakness and sectors that require ongoing attention. Troublesome and non-performing exposures (as a proportion of tangible common equity) increased 19bps y/y to 0.95%, though moderated 3bps from 30 June 2024 suggesting the credit cycle may of peak.

Home loans 90-days plus in arrears rose 5bps to 0.66% and is now in line with the historical average from August 2008 to June 2023. Positively, however, this has somewhat stabilised, rising just 1bp over the period.

Home loan repayment buffers remain healthy. The percentage of home loan customers in Australia ahead on repayments increased by 2ppt to 80% over the period. Relative to the FY24 results, Australian mortgages in possession ticked down to 0.01%, mortgages in negative equity remained stable at 0.8% and the dynamic mortgage portfolio loan-to-value ratio (LVR) fell 1ppts to 42%.

Amongst the credit card and personal portfolios, 90-days plus in arrears improved over the period declining 6bps to 0.68% and 18bps to 1.32% respectively in 1H25. However, we acknowledge the latter remains elevated relative to the historic average of 1.25%.

The group's provision coverage (as a proportion of credit risk weighted assets) fell by 4bps to 1.62% compared to FY24, though remains well above pre-pandemic levels (2H19: 1.08%) and is in line with peers.

The total loan loss rate as a proportion of gross loans and acceptances (GLAA) was 7bps in 1H25 down from 9bps in 1H24 and remains historically low. CBA's average loan loss rate from FY10 to FY19 was ~20bps, suggesting the loan portfolio is still performing strongly despite challenging macroeconomic conditions.

Outlook

We assign CBA a **Stable** credit outlook.

Despite guidance not being provided, management commentary suggests an improvement in the bank's operating

environment. Cost of living pressures remain a headwind for asset quality; however, relief has stemmed from moderating inflation, improvements in real incomes, tax cuts and rebates. The bank highlighted a narrowing in the spender and savings gap between younger and older Australians, and tax cuts have largely been saved, flowing through to deposit and offset accounts.

On a sequential half basis, assets 90+ days in arrears remain flat, whilst total credit provisions have moderated – suggesting growing confidence in asset quality and the lending backdrop. Provisioning remains strong compared to pre-pandemic levels and is \$2.63bn greater than management's central expected credit loss scenario. Additionally, management believes provisioning remains sufficient to cover potential weakness in collateral values (i.e., house prices). In our view, a housing supply/demand imbalance has been a key factor driving residential property prices. This imbalance is not likely to abate materially in the near to medium term and remains supportive of asset quality.

Currently, the bank holds over \$3.0bn of excess capital and management has made little progress on their proposed share buyback – likely reflecting an elevated share price and ongoing macroeconomic uncertainty. Management remains focussed on allocating capital prudently, and in line with their existing capital expenditure frameworks. CEO, Matt Comyn, noted that the relative opportunity costs of higher capital levels have never been lower. The bank expects to generate strong risk adjusted returns via ongoing investment in their technology platforms and AI capabilities.

Underlying levels of inflation remain above the RBA's 2-3% band but has declined considerably. This has caused ongoing speculation regarding the timing of anticipated rate cuts. Given current strength in unemployment levels, we believe a deep rate cutting cycle is unlikely, and thus, isn't a key risk for profitability. We do expect however, that deposit competition will be the largest headwind to NIM outcomes – this view was echoed by recent commentary from management.

Given ongoing macroeconomic uncertainty, banks must remain focused on operating expenses. Australian banks have a strong track record of using technology to improve efficiency, but tight cost control must be balanced with sustained investment. Past underinvestment has led to compliance breaches and operational risks. With rising spending in these areas, a broad focus on risk—not just credit risk—is essential.

Figure 3: Credit Curve (Comparable Securities)

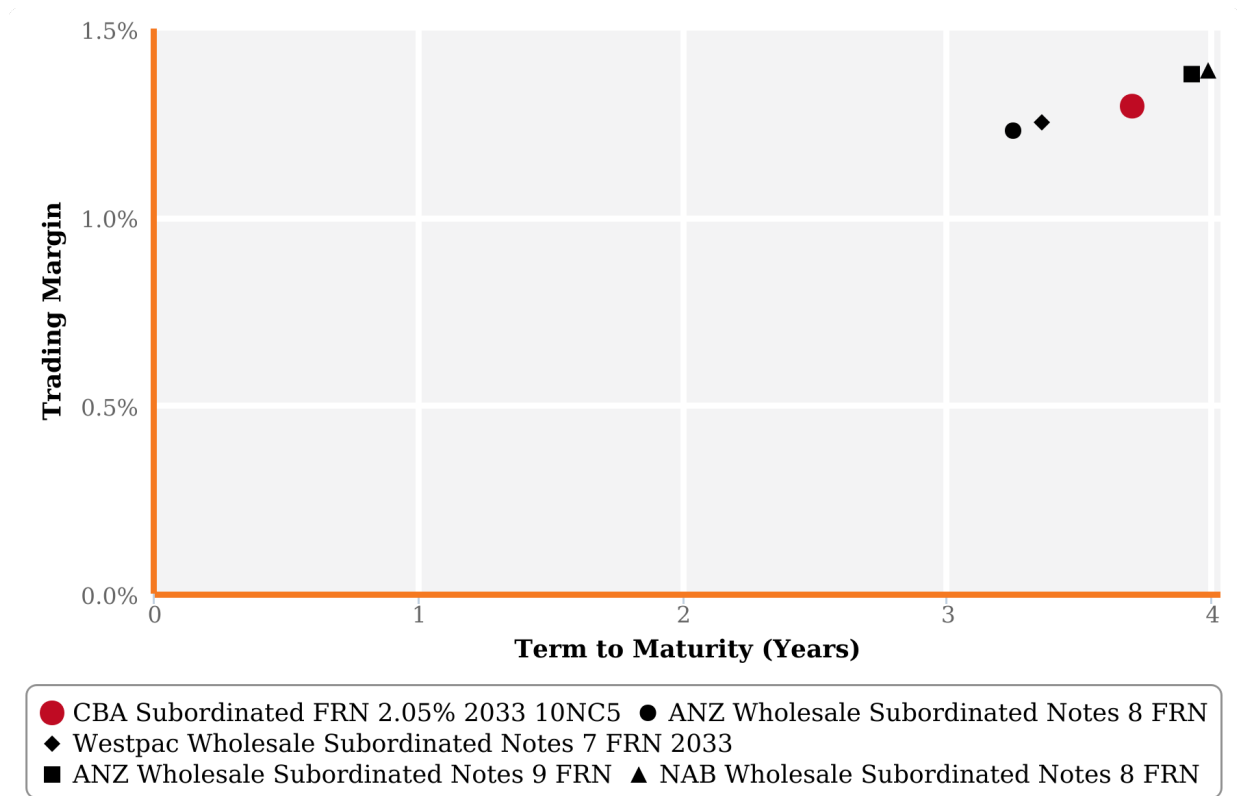
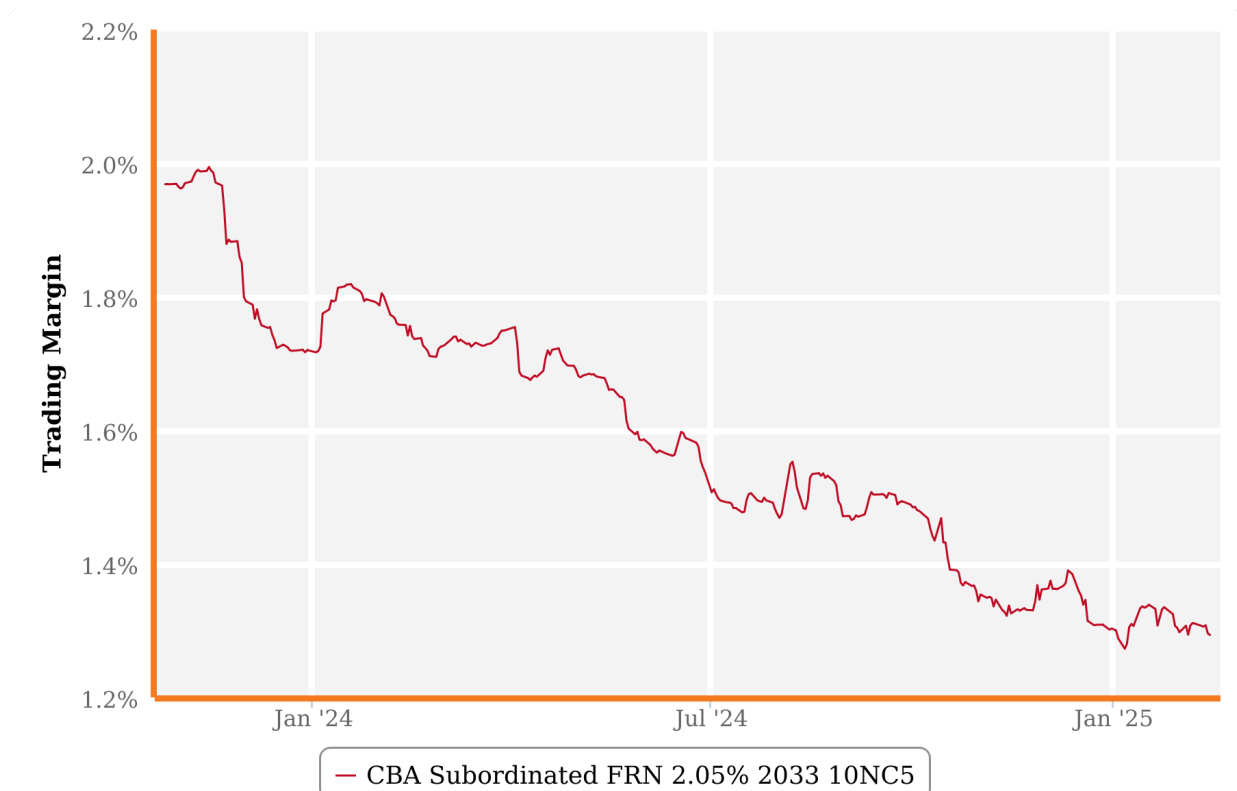


Figure 4: Historical Trading Margins of Comparable Securities



¹ The balance sheet structure diagram represents a measure of liabilities and capital in order of seniority of the overall cash balance sheet.

Source: BondAdviser

Commonwealth Bank of Australia: Financial Summary

Commonwealth Bank of Australia: Financial Summary

Recommendation Summary

Hold

17 February 2025

Profit and loss (Continuing Operations)	2024	2023	2022	2021	Funding & Liquidity	2024	2023	2022	2021
Net Interest Income (\$m)	22,824.0	23,056.0	19,473.0	18,839.0	NSFR (%)	116.00	124.00	130.00	129.00
Other Bank Inc. (\$m)	3,986.0	4,474.0	5,462.0	5,265.0	LCR (%)	136.00	131.00	130.00	129.00
Other Income (\$m)	111.0	82.0	208.0	310.0					
Total Revenue (\$m)	26,921.0	27,530.0	25,143.0	24,414.0					
Total Expenses (\$m)	-12,337.0	-12,079.0	-11,816.0	-11,485.0					
Pre-Provision Profit (\$m)	14,584.0	15,451.0	13,327.0	12,929.0					
Provisioning Expense (\$m)	-802.0	-1,108.0	357.0	-554.0					
Taxation (\$m)	-4,301.0	-4,155.0	-4,011.0	-3,532.0					
Min. Int. and Prefs. (\$m)	0.0	0.0	0.0	0.0					
Statutory NPAT (\$m)	9,481.0	10,188.0	9,673.0	8,843.0					
Adjustments (\$m)	355.0	-16.0	-78.0	-190.0					
Cash NPAT (\$m)	9,836.0	10,164.0	9,595.0	8,653.0					

Capital Adequacy	2024	2023	2022	2021
CET1 (%)	12.30	12.20	11.50	13.10
Additional Tier 1 (%)	2.00	2.30	2.10	2.60
Tier 1 Capital (%)	14.30	14.50	13.60	15.70
Tier 2 Capital (%)	6.60	5.50	4.00	4.10
Total Capital (%)	20.90	20.00	17.60	19.80
International CET1 (%)	19.10	19.10	18.60	19.40
Dividend Payout (%)	79.10	74.30	67.60	70.60

Balance Sheet	2024	2023	2022	2021
Loans (\$m)	942,210.0	926,082.0	878,854.0	811,356.0
Cash&Liquids (\$m)	83,080.0	116,619.0	161,154.0	100,041.0
Intangibles (\$m)	7,600.0	7,393.0	6,899.0	6,942.0
Trading Assets (\$m)	79,033.0	67,627.0	25,315.0	36,970.0
Other (\$m)	142,153.0	135,124.0	143,038.0	136,653.0
Total Assets (\$m)	1,254,076.0	1,252,845.0	1,215,260.0	1,091,962.0
Deposits (\$m)	882,922.0	864,995.0	857,586.0	766,381.0
Debt Issues (\$m)	144,530.0	122,267.0	116,902.0	103,003.0
Other (\$m)	153,536.0	193,578.0	167,934.0	143,860.0
Total Liabilities (\$m)	1,180,988.0	1,180,840.0	1,142,422.0	1,013,244.0
Equity (\$m)	73,088.0	72,005.0	72,838.0	78,718.0

Asset Quality & Provisions	2024	2023	2022	2021
Provision Charge/GLA (%)	0.09	0.12	-0.04	0.07
Gross Impaireds/GLA(%)	0.41	0.36	0.33	0.42
90 Days+ Past Due/GLA (%)	0.41	0.33	0.35	0.46
Coll. Provisions/Credit RWA (%)	1.46	1.43	1.17	1.39
Total Provisions/Credit RWA (%)	1.66	1.64	1.36	1.63
Total Provisions/GLA (%)	0.65	0.64	0.60	0.76

Source: Company data, BondAdviser estimates.

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- **Buy** - Over the next 12 months, the analyst expects the security to outperform the current yield due to credit spread tightening or favourable movements in the underlying yield curve.
- **Hold** - Over the next 12 months, the analyst expects the security to provide stable returns broadly in line with the current yield but with little credit spread tightening.
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