FIIG | Factsheet

Bendigo and Adelaide Bank Ltd

7 April 2020

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Issuer Outline

Bendigo and Adelaide Bank Ltd (Bendigo) is a regional bank that specialises in retail banking with a focus on regional and rural communities. Bendigo is one of Australia's largest regional banks, with loans under management of more than AUD60.0bn.

Bendigo offers a range of banking and wealth management services across all states and territories in Australia, with a particularly strong retail deposit franchise and community focus. Its largest operations are in Victoria and South Australia. It also owns Rural Bank and Delphi Bank.

Security
AUD275m BBSW+2.45% Nov 2028

ISIN
AU3FN0046066

Currency
AUD

Type
Subordinated Tier 2

Key Financials (AUDm)

LTM (30 Jun)	2019
Net interest income	1,286
NI margin (%)	1.96
NPAT	377
Gross loans	62,110
Customer deposits	52,301
Gross impairments (%)	1.21
Credit losses (%)	0.08
CET 1 ratio (%)	8.92

Source: FIIG Securities, Company reports

Key Terms

Coupon Type	Floating	Minimum Amount	AUD10,000
Rate	3M BBSW+2.45%	Denomination	AUD10,000
Frequency	Quarterly		
Domicile	Australia	AU Withholding Tax Exempt	Yes
Amount Issued/Outstanding	AUD275m/AUD275m	Tier 2 Security	Yes

Key Dates

Issue Date	30 November 2018	Maturity Date	30 November 2028
Call Dates	30 November 2023 @ 100.00 and each subsequent interest payment date up the Maturity Date[1]		

[1] Subject to APRA approval

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Tier 2 Structure	
Interest Deferral/Cancellation	Yes, interest is deferrable and cumulative if, prior to the payment of interest, the issuer is not solvent or would not be solvent after payment
Cash Coupon	Yes
Non-Viability Trigger	Yes. A Non-Viability Trigger Event occurs when APRA has provided a written determination to the Issuer that: (a) the conversion or write-off of certain regulatory capital instruments of the Issuer is necessary because without the conversion or write-off, APRA considers that the Issuer would become non-viable; or (b) without a public sector injection of capital into, or equivalent capital support

Strengths

- Strong funding structure: Bendigo has a high level of customer (household and business) deposits which account for more than 75% of total funding needs, toward the top-end of industry averages. The bank's reliance on short-term wholesale funding is generally limited to around 10% of its funding needs, at the lower-end of regional and major bank peers.
- Good franchise strength of Community Bank model: Bendigo has developed a sustainable and defendable niche through the evolution of its Community Bank model, which underpins a supportive customer base and a high level of customer deposit funding. The Community Bank model sees the bank partnering in local communities, regional and rural, to ensure a local banking presence is maintained. The model is underpinned by a cost and revenue-sharing structure. The bank derives close to a third of its residential mortgages and customer deposits through this model.
- Focus on lower-risk retail lending: Bendigo's core business is residential mortgages, which account for around 70% of total loans, of which 63% is owner-occupier. The average loan-to-valuation ratio is around 60%. The focus on residential mortgage lending, against a backdrop of very low interest rates and relatively benign economic conditions, is likely to explain the bank's low level of credit losses (bad debt expenses) of generally around 10 basis points.
- Sound regulatory oversight: Australian financial institutions, including Bendigo, benefit from operating in an open economy characterised as having a very high degree of economic resilience. Institutional and governance frameworks compare well with overseas jurisdictions. Australian financial institutions are overseen by a highly regarded regulator in APRA. APRA oversees banking, insurance and superannuation, with the aim of maintaining the integrity, safety and soundness of financial institutions.
- Relative credit strength versus other forms of capital: Financial institutions including Bendigo have various instruments in their capital structure that count toward capital. These instruments have varying degree of risks, reflecting, among other factors, the point at which they will absorb losses

  First (and riskiest) is common equity. Next are Additional Tier 1 (AT1) hybrids which would likely be the first instruments that would be written off if requested by APRA. Tier 2 capital (such as the notes) would likely only be written off if all AT1 capital has been converted into common equity or written off. While both AT1 and Tier 2 hybrids have optional coupon payments, issuers generally have full discretion over the coupon payment for an AT1 instrument; the majority do not accumulate if a coupon payment is missed. For Tier 2 instruments, including this issuance, coupons can be deferred but the interest will accumulate. As at 30 June 2019, Bendigo had ~AUD900m in regulatory recognised AT1 capital, equivalent to 18% of total capital or around 2-times Bendigo's annual earnings.

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Risks

- Basel III compliant structural features: The subordinated bonds are Basel III complaint and as such do not include a step-up margin if not called and contain a point of non-viability clause. If APRA, the Australian Prudential Regulator, determines that Bendigo requires capital support to prevent it 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. The number of shares at time of conversion may be worth significantly less than the face value of the notes and a holder may suffer a loss as a consequence of conversion.

  If the notes required to be converted following a non-viability event are not converted for any reason within 5 business days of the non-viability trigger, then conversion will not occur and the notes will be written off.

- Optional call dependent on regulatory approval: The notes include an early call feature where the face value of the Tier 2 may be repaid early in cash in November 2023 and then each subsequent interest payment date. The optional redemption requires regulatory approval, which may not be provided.
- Heightened exposure to non-retail banking: Bendigo has a relatively high exposure to commercial lending compared with its regional banks peers, at close to 25% of total lending, of which more than 40% is agriculture related. Although this can support earnings and business diversity, it can also leave the bank susceptible to idiosyncratic loss-events. The performance of agriculture is susceptible to national weather patterns and commodity price movements which in-turn may impact the bank's overall earnings and asset quality performance. The bank's level of non-performing loans is toward the upper-end of peers, owing in-part to its exposure to agriculture, although credit losses are very low (reflective of the seasonality associated with agriculture lending).
- Small market share: Although Bendigo has a sound and defendable business model, its market share is quite small at around 2% of system assets. At the same time, the bank has a reasonably high reliance on third-party channels (brokers) to generate new loans, at around 40%, although its reliance is toward the lower-end of system averages. These factors can leave the bank and its business volumes susceptible to competitive and margin (profitability) pressures.
- 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. For example, in 2017 both S&P and Moody's reduced the ratings on a significant number of financial institutions in Australia due to concerns about the economic conditions in Australia, primarily the level of growth in private sector debt and residential property prices.

Other risks

- Call risk: Subject to any necessary prior written approval from APRA, Bendigo has the option to call the bonds early at the call dates listed above. Holders should not expect that APRA approval will be forthcoming. A decision to call the bonds ahead of the maturity date depends on a number of factors, including the relative cost of entering new debt financing, the company's liquidity position, and the availability and attractiveness of new funding opportunities at the call date.
- Duration risk: n/a
- Interest deferral/cancellation: Yes, as highlighted above.
- Non-viability trigger: Yes, as highlighted above.

Summary

Bendigo is a well-established regional bank with a sound and defendable franchise. The bank is well-funded and capitalised, with a high proportion of earnings with recurring characteristics (businesses and households repaying their loans). The Bendigo and Adelaide Bank Ltd AUD 3M BBSW+2.45% 30 November 2028 subordinated tier 2 bonds would suit investors looking for an adequate margin on an investment grade floating rate instrument from a well-known Australian bank.

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Financials

The financial summary below represents the consolidated operations of Bendigo. The figures below are presented as reported and unadjusted.

FYE June 30 (AUDm)	2015	2016	2017	2018	2019
Profit and Loss					
Net interest income	1,179	1,164	1,213	1,305	1,286
Non-interest income	302	311	310	283	306
Total revenue	**1,481**	**1,475**	**1,523**	**1,588**	**1,592**
Provision for loan losses (credit losses)	(68)	(44)	(72)	(71)	(50)
Non-interest expenses	885	904	891	938	965
Net profit after tax	**424**	**416**	**430**	**435**	**377**
Balance Sheet					
Liquid assets	6,459	7,129	6,326	5,582	6,299
Gross loans	55,809	57,542	60,998	61,857	62,175
Net loans	55,531	57,256	60,777	61,602	61,792
Intangibles (inc. goodwill)	1,581	1,635	1,664	1,650	1,686
Total assets	**66,029**	**68,573**	**71,416**	**71,440**	**72,570**
Deposits	53,505	57,055	58,772	59,530	60,567
Notes payable	4,926	3,823	4,480	3,545	3,464
Other debt	1,412	1,408	1,539	1,590	1,568
Total liabilities	**61,087**	**63,457**	**65,990**	**65,820**	**66,939**
Total equity	**4,942**	**5,115**	**5,426**	**5,620**	**5,632**
Credit metrics					
Non-performing loans	1.68%	1.57%	1.30%	1.30%	1.21%
Bad debt expense	0.13%	0.08%	0.12%	0.12%	0.08%
Net interest margin	1.89%	1.89%	1.86%	1.98%	1.96%
Common Equity Tier 1 Ratio	8.17%	8.09%	8.27%	8.62%	8.92%

Source: Bendigo, S&P Capital IQ

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