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Westpac Banking Corporation (WBC)

In the midst of a rebellious house

Recommendation
Hold (unchanged)
Price
$23.78
Target (12 months)
$26.00 (previously $27.10)

GICS Sector

Banks

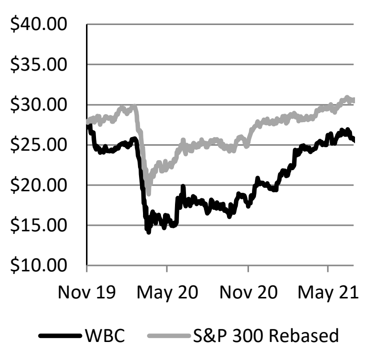
Expected Return	
Capital growth	**9.3%**
Dividend yield	**5.0%**
Total expected return	**14.3%**

Company Data & Ratios	
Enterprise value	**n/m**
Market cap	**$87,239m**
Issued capital	**3,669m**
Free float	**100%**
Avg. daily val. (52wk)	**$188.8m**
12 month price range	**$17.18 - $27.12**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	25.31	24.79	18.56
Absolute (%)	-6.05	-4.07	28.13
Rel market (%)	-7.49	-3.57	5.64

Absolute Price



SOURCE: IRESS

FY21: $5.35bn cash earnings, 60¢ final dividend

WBC's FY21 result numbers are: 1) statutory earnings $4.63bn (BP $4.80bn); 2) statutory EPS 127¢ (BP 131¢); 3) cash earnings $5.35bn (BP $5.52bn); 4) cash EPS 146¢ (BP 151¢); 5) cash earnings ex-notable items $6.82bn (BP $6.98bn); 6) cash EPS ex-notable items 186¢ (BP 191¢); 7) fully franked final dividend 60¢ (BP 49¢); 8) cash ROE 7.6% (BP 7.8% before management buyback); 9) Group NIM 2.04% (BP 2.06%); 10) credit impairment charge -$0.59bn/-8bp GLA (BP -$0.12bn/-2bp); 11) CIR 63% (BP 63%); and 12) Level 2 CET1 ratio 12.3% (BP 11.9%).

Notable items of $1.32bn reduced the Level 2 CET1 ratio by 15bp – a small price to pay for cleaning up historical one-off items. Excluding these items, cash earnings in FY21 are higher at $6.82bn (+33% pcp, -18% hoh). On a full year basis, the rise was due to the addition of notable items and impairment charges (likewise on a hoh basis). Unfortunately, this was also tempered by lower net interest income of $16.71bn (-2% pcp, -3% hoh), mixed other income ($4.32bn, up by 22% pcp but mainly due to one off items as the hoh figure was down by 14%) and very high operating expenses of $13.28bn (+5% pcp, +22% hoh but mainly due to one off items once again), and helped only by a credit impairment benefit ($0.59bn or a large pcp change).

Price target now $26.00, maintain Hold rating

There is a downward revision of around 3% in cash earnings for the foreseeable future. While net interest income broadly remains the same, we have lowered other banking income by the same amount and further increased operating expenses by around 5% until such time where we can see real progress. There is also a change in the credit impairment charge, being lower at around 9bp in FY24e (vs. 13bp previously). Finally, we have also increased the discount rate to 10% and dividend yield to 4.25%. The price target is thus lowered by 4% to $26.00 (previously $27.10). Given a 12-month TSR of less than 15%, we maintain a Hold rating for WBC.

Earnings Forecast

Year end 30 September	2021	2022e	2023e	2024e
Statutory earnings (A$m)	4,634	5,278	6,980	7,199
Cash earnings (A$m)	5,352	6,614	7,016	7,235
EPS (cash) (A¢)	146	184	199	205
EPS (cash) growth (%)	102%	26%	8%	3%
PER (x)	16.2	12.9	11.9	11.6
P/Book (x)	1.2	1.2	1.2	1.1
P/NTA (x)	1.4	1.4	1.4	1.3
Dividend (A¢)	118	128	138	142
Yield (%)	5.0%	5.4%	5.8%	6.0%
ROE (%)	7.6%	9.2%	9.6%	9.6%
NIM (%)	2.04%	1.94%	1.92%	1.92%
Franking (%)	100.0%	100.0%	100.0%	100.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

In the midst of a rebellious house

FY21: $5.35bn cash earnings, 60¢ final dividend

WBC's FY21 result numbers are:

1. Statutory earnings $4.63bn (BP $4.80bn);
2. Statutory EPS 127¢ (BP 131¢);
3. Cash earnings $5.35bn (BP $5.52bn);
4. Cash EPS 146¢ (BP 151¢);
5. Cash earnings ex-notable items $6.82bn (BP $6.98bn);
6. Cash EPS ex-notable items 186¢ (BP 191¢);
7. Fully franked final dividend 60¢ (BP 49¢);
8. Cash ROE 7.6% (BP 7.8% before management buyback);
9. Group NIM 2.04% (BP 2.06%);
10. Credit impairment charge -$0.59bn/-8bp GLA (BP -$0.12bn/-2bp);
11. CIR 63% (BP 63%); and
12. Level 2 CET1 ratio 12.3% (BP 11.9%).

WBC previously announced statutory and cash earnings will be reduced by $1.32bn after tax due to notable items. These included $0.97bn write-down of assets (goodwill, capitalised software and others) in Westpac Institutional Bank, $0.17bn additional provisions (customer refunds, payments, associated costs and litigation provisions), $0.26bn previously announced separation and transaction costs (to do with the sale of Westpac Life Insurance Services Limited) and $24m other costs related to the divestment of the Group's Specialist Business. The charges are also offset by gains of sale of Westpac General Insurance ($55m) and reversal of previous net write-downs on the non-sale of Westpac Pacific ($54m).

The net result is a reduction in the Group's CET1 ratio by 15bp – a small price to pay for cleaning up historical one-off items. Excluding these items, cash earnings in FY21 are higher at $6.82bn (+33% pcp, -18% hoh). On a full year basis, the rise was due to the addition of notable items and impairment charges (likewise on a hoh basis). Unfortunately, this was also tempered by lower net interest income of $16.71bn (-2% pcp, -3% hoh), mixed other income ($4.32bn, up by 22% pcp but mainly due to one off items as the hoh figure was down by 14%) and very high operating expenses of $13.28bn (+5% pcp, +22% hoh but mainly due to one off items once again), and helped only by a credit impairment benefit ($0.59bn or a large pcp change).

On a market share basis, at least these were considered sound given almost no change in APRA's housing credit, card, household deposit and business deposit measures. The same can be said of measures used by RBA and Reserve Bank of New Zealand. Regardless, profitability continues to increase on a notional basis (such as cash EPS, ROE and the dividend payout ratio).

Figure 1 – Notable items and simplification impacts

Notable items and simplification impacts.

Notable items

($m after tax)	FY20	FY21	2H21
AUSTRAC proceedings	(1,442)	-	-
Remediation and litigation	(440)	(448)	**(172)**
Write-down of goodwill & other assets	(614)	(1,164)	**(965)**
Asset sales / revaluation	(123)	11	**(182)**
Total cash earnings impact	(2,619)	(1,601)	**(1,319)**

- Lower remediation provisions in Business and Consumer, higher in New Zealand and Advice
- Provisions for outstanding regulatory investigations

- Write-down of WIB goodwill, capitalised software and other assets

- Separation/transaction costs for divestments
- Partly offset by gain on sale of General Insurance and Pacific write-back

Contribution of businesses sold

P&L contribution ($m)[1]	1H21	2H21
Net interest income	9	**5**
Non-interest income	64	**128**
Expenses	(9)	**(6)**
Core earnings	**64**	**127**

Sales completed
- New Zealand Wealth Advisory
- General Insurance
- Lenders Mortgage Insurance
- Vendor Finance

1 Contribution of businesses exited in respective period. For detail on the contribution of business under sale agreement and presented as Held for Sale refer to Westpac's 2021 Full Year Financial Results Announcement Section 5 Note 9.

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Westpac GROUP

SOURCE: COMPANY DATA

P&L variances are shown below.

Figure 2 – P&L variances

Westpac Group Y/e September 30 ($m)	FY21	BP	Variance	Comments
Net interest income	16,714	16,722	0%	Broadly in line with our expectations
Other income	4,324	4,570	-5%	Lower insurance and lower platform contributions plus bank transaction fees
Net operating income	**21,038**	**21,292**	**-1%**	Broadly in line with our expectations
Operating expenses	-13,283	-13,410	1%	Broadly in line with our expectations
Impairment charges	590	115	-81%	Better individual provision outcome
Operating profit before income tax	**8,345**	**7,997**	**4%**	Due mainly to lower impairment charges
Income tax expense	-2,988	-2,476	-17%	Intangible/asset write-down costs
Net profit to non-controlling interests	-5	-4	n/m	In line with our expectations
Cash earnings	**5,352**	**5,518**	**-3%**	Negative variance largely due to higher effective tax rate
Cash earnings ex-notable items	**6,817**	**6,983**	**-2%**	Negative variance largely due to higher effective tax rate
DPS (¢)	118	107	10%	Better dividend outlook
EPS (cash basis) (¢)	**146**	**151**	**-3%**	Negative variance largely due to higher effective tax rate
EPS ex-notable items (cash basis) (¢)	**186**	**191**	**-2%**	Negative variance largely due to higher effective tax rate
Payout ratio (target 70-75%)	81%	71%	10%	Higher payout given higher 2H21 dividend
Underlying payout ratio	**63%**	**56%**	**7%**	Higher payout given higher 2H21 dividend
NIM	2.04%	2.06%	-0.02%	Broadly in line with our expectations
ROE	7.56%	7.80%	-0.24%	Negative variance largely due to higher effective tax rate
Effective tax rate	36%	31%	-5%	Intangible/asset write-down costs
Cost ratio	63%	63%	0%	In line with our expectations

SOURCE: COMPANY DATA

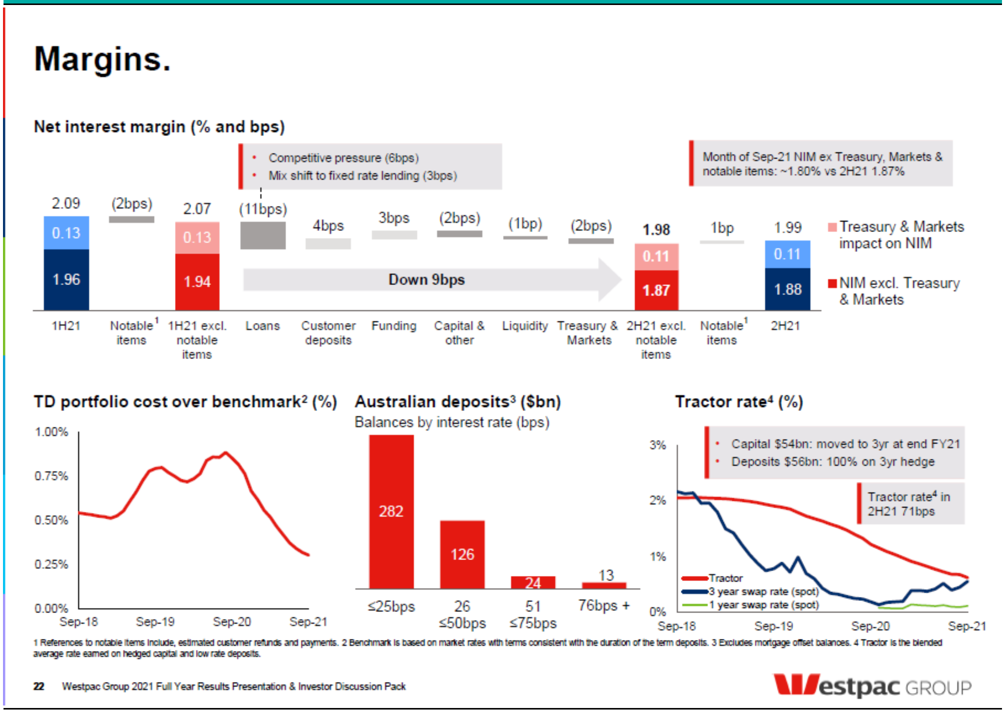
Net interest income $16.71bn

Net interest income of $16.71bn was down by 2% pcp with a 4bp reduction in NIM (2.04%) but at least there was very little change in business volumes. Excluding notable items, this was down by $0.64bn (-4%) with NIM down by an even higher fall of 8% to 2.02% (mainly mortgage competition leading to lower spreads on new and refinanced lending, plus the general fall in interest rates as a whole). On a hoh basis, the fall was even greater at -10bp to 1.99%.

The mixture of growing lower spread mortgages and more liquid assets also contributed to the NIM decline. While AIEA was flat over the year (and this is a good outcome especially in FY21), average loans continue to dive at 2% lower (together with 15% higher liquid assets thereby increasing market liquidity but lowering NIM as a whole).

Australian mortgage growth was largely in owner occupied lending (+9%) while investor lending was down by 5% (no surprises). Fixed rate lending is now 38% of the book, up from 28% previously. Likewise, customer deposits grew 4%. This fully funded loan growth and is consistent with higher liquidity in the market space (government stimulus payments, decline in retail spending, etc.).

Figure 3 – Full year NIM down to 2.04% excluding notable items



SOURCE: COMPANY DATA

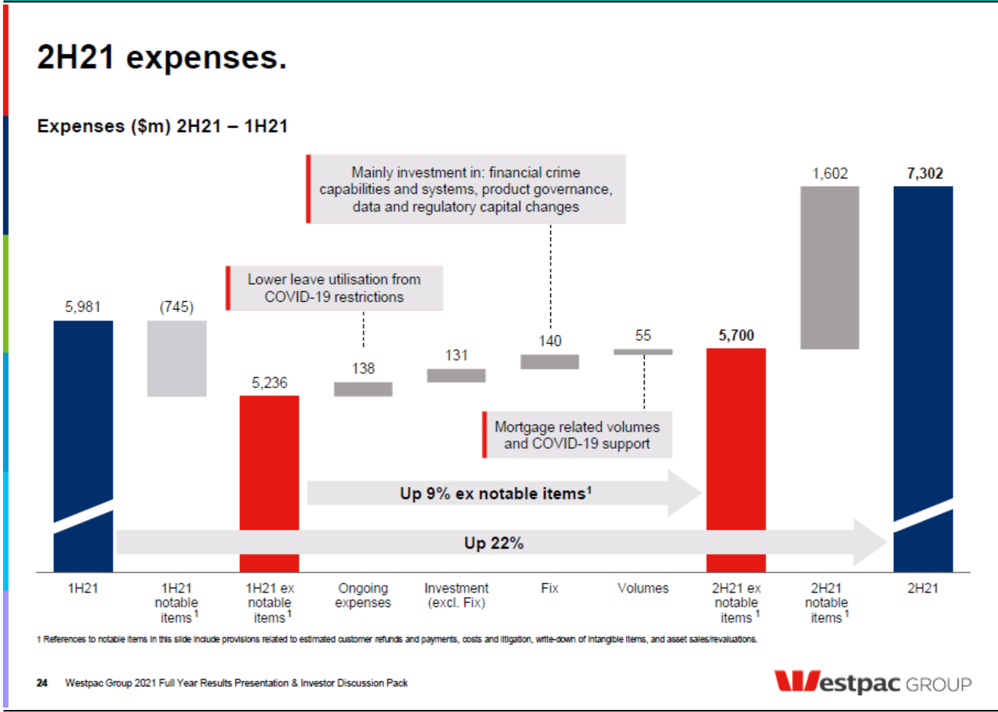
Other banking income $4.32bn

This was $4.32bn in FY21, higher than the previous year by 22%. Excluding notable items, other banking income was flat (notable items included $537m from Coinbase Inc. and basically a gain in sale of $160m from the general insurance business). This comprised higher insurance income (favourable life policyholder liability revaluation, lower general insurance claims and higher LMI from an increase in mortgage growth) just net of lower trading income (lower volatility plus closure of the energy trading business in the previous year), lower correspondent banking relationships, removal of 80 fees in Consumer and lower wealth income particularly in customers shifting now to lower margin products.

Operating expenses $13.28bn

Operating expenses were $13.82bn being only 1% lower than our estimate and broadly in line with expectations, with the small increase due mainly to staff costs (FTE up by 9% or 3,294 focusing on FIX strategy, CORE initiatives and strengthening risk and financial crime teams). This was the only item other than net interest income that was close to reality. Notable items on the other hand were $2.54bn and included the AUSTRAC penalty and write-downs of intangibles.

Figure 4 – Lots of one-off items still



SOURCE: COMPANY DATA

Credit impairment benefit $0.59bn

As with the other major banks, there is really no issue with credit quality considering the fact that there was still a small amount of benefit in 2H21. Mortgage 90+day delinquencies continue to head down towards 107bp (likewise other consumer loans to 176bp) while gross impaired assets are also down (Watchlist and Substandard 1.36% of TCE and down from 1.60% in 1H21; impaired assets flat at 0.19% of TCE).

Provision coverage also remains in good shape despite being down by around $0.50bn since March 2021 to $5.00bn. To recap, this is mainly due to changes in collective provisions – as the bank starts to wind down from improved asset quality. In other words, there are still fewer stressed exposures including a fall in Watchlist and Substandard loans plus lower overall Australian and New Zealand delinquencies that more than offset individual provisions from a single source (e.g. Forum Finance fraud is an example).

Final dividend 60¢

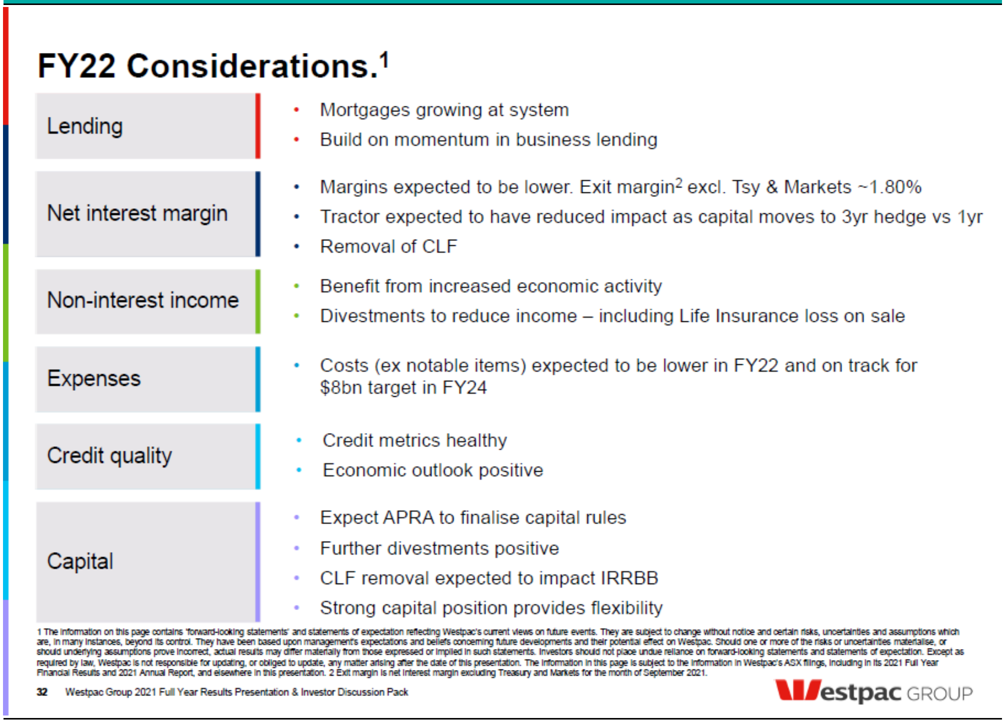
The fully franked final dividend was 60¢, up from 58¢ in 1H21 despite the notable items as discussed earlier. As a result, payout was 121% in 2H12 (60% in 1H21) and will be paid on 21 December 2021. This may sound high but it was to do with steadying the rate throughout the year. The Board has determined to satisfy the DRP by arranging for the share purchase by a third party and the market price will be set over 10 trading days commencing 11 November 2021 but with no discount. The rising dividend follows improvements in overall capital.

Level 2 CET1 ratio 12.3%

Level 2 CET1 ratio was 12.3% at the end of FY21 despite the notable item hit (being 15bp as goodwill and capitalised software have no impact on regulatory capital). This is still more than the 10.5% minimum (from 8.0%) including the capital conservation buffer and the countercyclical capital buffer. Level 2 CET1 ratio was built up as follows: cash earnings ex notable items +72bp; notable items -15bp (reduction in cash earnings and higher deduction for DTA slightly offset by lower deductions for goodwill and capitalised software); 1H21 dividend -49bp; RWA movement -16bp (mortgage risk weight floor of 25%); capital deductions -19bp (e.g. capital invested in entities not consolidated for regulatory purposes and higher deduction for capitalised expenditure); FX translation -1bp; and divestments +26bp (being sales of Coinbase Inc. and WBC's general insurance and LMI businesses).

WBC has also announced an off-market buyback of up to $3.5bn (BP forecast at least $3.0bn). This follows improvements in operating performance including progress on strategic priorities and completion of a number of divestments. All else being equal, this should technically reduce Level 2 CET1 ratio by around 80bp.

Figure 5 – Looking ahead



SOURCE: COMPANY DATA

Price target now $26.00, maintain Hold rating

There is a downward revision of around 3% in cash earnings for the foreseeable future. While net interest income broadly remains the same, we have lowered other banking income by the same amount and further increased operating expenses by around 5% until such time where we can see real progress. There is also a change in the credit impairment charge, being lower at around 9bp in FY24e (vs. 13bp previously). Finally, we have also increased the discount rate to 10% and dividend yield to 4.25%. The price target is thus lowered by 4% to $26.00 (previously $27.10). Given a 12-month TSR of less than 15%, we maintain a Hold rating for WBC.

Table 1 – Estimate changes

Westpac Group	FY21			FY22e			FY23e			FY24e		
Y/e September 30 ($m)	Actual	Forecast	Variance	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change
Profit & Loss												
Net interest income	16,714	16,722	0%	16,721	16,774	0%	16,854	16,802	0%	17,154	16,872	2%
Other income	4,324	4,570	-5%	4,801	4,941	-3%	4,919	5,064	-3%	5,001	5,151	-3%
Net operating income	**21,038**	**21,292**	**-1%**	**21,522**	**21,715**	**-1%**	**21,773**	**21,866**	**0%**	**22,155**	**22,023**	**1%**
Operating expenses	-13,283	-13,410	1%	-11,751	-11,339	-4%	-11,250	-10,671	-5%	-11,119	-10,512	-5%
Impairment charges	590	115	-81%	-326	-821	152%	-502	-893	78%	-704	-958	36%
Operating profit before income tax	**8,345**	**7,997**	**4%**	**9,445**	**9,555**	**-1%**	**10,020**	**10,302**	**-3%**	**10,332**	**10,553**	**-2%**
Income tax expense	-2,988	-2,476	-17%	-2,825	-2,832	0%	-2,997	-3,056	2%	-3,091	-3,131	1%
Net profit to non-controlling interests	-5	-4	n/m	-6	-4	n/m	-6	-4	n/m	-6	-4	n/m
Cash earnings	**5,352**	**5,518**	**-3%**	**6,614**	**6,719**	**-2%**	**7,016**	**7,243**	**-3%**	**7,235**	**7,418**	**-2%**
Cash earnings ex-notable items	**6,817**	**6,983**	**-2%**	**6,913**	**7,019**	**-2%**	**7,231**	**7,458**	**-3%**	**7,379**	**7,563**	**-2%**
DPS (cps)	**118**	**107**	**10%**	**128**	**130**	**-2%**	**138**	**140**	**-1%**	**142**	**144**	**-1%**
EPS (cash basis) (cps)	146	151	-3%	184	183	1%	199	196	2%	205	200	3%
Cash payout ratio (target 70-75%)	81%	71%	10%	70%	71%	-2%	69%	71%	-2%	69%	72%	-3%
- Ex-notable items	63%	56%	7%	67%	68%	-2%	67%	69%	-2%	68%	71%	-3%
ROE	7.6%	7.8%	-0.2%	9.2%	9.1%	0.1%	9.6%	9.5%	0.1%	9.6%	9.4%	0.2%
NIM	2.04%	2.06%	-0.02%	1.94%	1.99%	-0.06%	1.92%	1.97%	-0.05%	1.92%	1.94%	-0.02%
Cost ratio	63%	63%	0%	55%	52%	-2%	52%	49%	-3%	50%	48%	-2%
Impairment expense as % of GLA	-0.08%	-0.02%	0.07%	0.04%	0.11%	0.07%	0.07%	0.12%	0.06%	0.09%	0.13%	0.04%
Effective tax rate	36%	31%	-5%	30%	30%	0%	30%	30%	0%	30%	30%	0%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 2 – Composite valuation

Composite Valuation	Value ($m)	Per share	Weighting	Composite value per share
DCF	89,990	$24.53	25%	$6.13
Dividend yield (sustainable)	110,489	$30.12	25%	$7.53
ROE (sustainable)	84,190	$22.95	25%	$5.74
Sum-of-Parts	84,169	$22.94	25%	$5.74
Surplus capital *	2,838	$0.77		$0.77
Total				**$25.91**

* Less estimated NZ new capital requirement

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 3 – SOP valuation

Sum-of-Parts (As Is)	FY22e NPAT	Pros. PE (times)	Value ($m)	Per share
Consumer Bank	3,376	13.0	43,885	$11.96
Business Bank	1,314	13.0	17,076	$4.65
Westpac Institutional Bank	508	12.5	6,344	$1.73
Specialist Businesses	480	10.0	4,805	$1.31
Westpac New Zealand	708	13.0	9,210	$2.51
Group	228	12.5	2,850	$0.78
Total	**6,614**	**12.7**	**84,169**	**$22.94**

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 4 – Segment analysis

Group KPIs	1H16	2H16	1H17	2H17	1H18	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Growth in NIE	10%	5%	1%	4%	13%	6%	-4%	1%	3%	-2%	-2%	-2%
Growth in other income	-4%	-9%	3%	-5%	-18%	-12%	-32%	-19%	-2%	-6%	39%	7%
Growth in operating expenses	4%	3%	2%	2%	4%	9%	7%	0%	22%	31%	-3%	12%
Growth in PBT before BDD	8%	-1%	1%	1%	5%	-4%	-23%	-6%	-17%	-33%	15%	-22%
Growth in loans	6%	6%	4%	3%	5%	4%	2%	1%	1%	-3%	-4%	2%
Growth in deposits	6%	9%	7%	3%	5%	14%	9%	-1%	4%	6%	2%	5%
NIM	2.14%	2.12%	2.07%	2.10%	2.28%	2.15%	2.12%	2.13%	2.13%	2.03%	2.09%	1.99%
Cost ratio	42%	42%	42%	43%	42%	46%	50%	47%	60%	64%	55%	71%
Cost / average assets	1.08%	1.08%	1.07%	1.09%	1.09%	1.14%	1.14%	1.11%	1.31%	1.39%	1.33%	1.60%
Tier 1 capital ratio	12.1%	11.2%	11.7%	12.7%	12.8%	12.8%	12.8%	12.8%	12.9%	13.2%	14.5%	14.6%
Impairment expense / loans	0.21%	0.14%	0.15%	0.10%	0.13%	0.10%	0.09%	0.13%	0.62%	0.27%	-0.11%	-0.06%
Total provisions / RWA	1.03%	0.89%	0.88%	0.78%	0.71%	0.66%	0.95%	0.91%	1.30%	1.40%	1.28%	1.14%
ROE	14.2%	13.8%	14.0%	13.6%	14.0%	12.1%	10.4%	11.1%	2.9%	4.7%	10.1%	5.0%

Consumer Bank	1H16	2H16	1H17	2H17	1H18	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Market share												
- Home loans	12.6%	12.7%	12.9%	13.0%	13.0%	12.9%	12.9%	13.2%	12.8%	12.7%	12.7%	13.1%
- Other loans	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.4%	0.4%	0.3%	0.3%	0.3%
- Deposits	9.3%	9.4%	9.5%	9.6%	9.7%	9.9%	9.7%	9.7%	9.3%	9.1%	9.1%	9.3%
NIM	2.37%	2.34%	2.27%	2.36%	2.40%	2.14%	2.20%	2.24%	2.33%	2.41%	2.39%	2.29%
Other income / footings	0.08%	0.08%	0.08%	0.07%	0.06%	0.16%	0.09%	0.02%	0.05%	0.04%	0.04%	0.04%
Operating expense / footings	0.32%	0.31%	0.30%	0.30%	0.31%	0.34%	0.31%	0.32%	0.34%	0.35%	0.37%	0.36%
Cost ratio	41%	40%	40%	40%	40%	43%	42%	44%	45%	47%	51%	53%
Impairment expense / loans	0.08%	0.06%	0.08%	0.08%	0.07%	0.06%	0.07%	0.08%	0.10%	0.15%	-0.02%	-0.01%
Effective tax rate	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%

Business Bank	1H16	2H16	1H17	2H17	1H18	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Market share												
- Home loans	2.2%	2.2%	2.0%	2.0%	1.9%	2.5%	2.3%	2.1%	2.0%	1.9%	1.8%	1.8%
- Other loans	3.7%	3.7%	3.6%	3.5%	3.5%	3.6%	3.5%	3.0%	2.9%	2.8%	2.7%	2.7%
- Deposits	5.7%	5.8%	5.1%	5.2%	5.3%	6.9%	6.6%	6.7%	6.3%	6.3%	6.3%	6.2%
NIM	2.72%	2.72%	2.70%	2.74%	3.19%	3.17%	3.06%	3.30%	3.05%	2.93%	3.17%	3.07%
Other income / footings	0.21%	0.21%	0.22%	0.23%	0.12%	0.42%	0.24%	-0.05%	0.11%	0.08%	0.09%	0.09%
Operating expense / footings	0.35%	0.34%	0.36%	0.36%	0.36%	0.53%	0.45%	0.24%	0.37%	0.42%	0.40%	0.46%
Cost ratio	36%	36%	36%	36%	36%	40%	43%	39%	44%	54%	50%	60%
Impairment expense / loans	0.14%	0.13%	0.14%	0.10%	0.10%	0.10%	0.04%	0.07%	0.48%	0.47%	-0.09%	-0.26%
Effective tax rate	30%	30%	30%	30%	30%	30%	30%	30%	31%	30%	30%	31%

Westpac Institutional Bank	1H16	2H16	1H17	2H17	1H18	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Market share												
- Loans	3.0%	2.9%	2.7%	2.7%	2.7%	2.7%	2.6%	2.5%	2.6%	2.2%	2.1%	2.2%
- Other IEA	-	-	-	-	-	-	-	-	-	-	-	-
- IBL	4.5%	4.6%	4.9%	4.5%	4.8%	5.0%	4.5%	4.6%	4.9%	4.3%	3.7%	3.8%
NIM	1.72%	1.76%	1.56%	1.62%	1.60%	1.74%	1.67%	1.50%	1.46%	1.23%	1.27%	1.24%
Other income / footings	0.39%	0.36%	0.52%	0.43%	0.37%	0.39%	0.35%	0.26%	0.25%	0.34%	0.35%	0.29%
Operating expense / footings	0.32%	0.34%	0.37%	0.39%	0.33%	0.37%	0.33%	0.29%	0.28%	0.38%	0.41%	1.04%
Cost ratio	42%	45%	42%	48%	47%	49%	46%	51%	53%	62%	67%	192%
Impairment expense / loans	0.14%	0.00%	0.08%	-0.01%	-0.01%	-0.01%	0.02%	0.02%	0.26%	0.14%	0.01%	0.18%
Effective tax rate	31%	30%	28%	29%	28%	33%	28%	27%	41%	43%	32%	15%

Westpac New Zealand	1H16	2H16	1H17	2H17	1H18	2H18	1H19	2H19	1H20	2H20	1H21	2H21
Growth												
- Loans	8.3%	9.5%	6.7%	2.8%	3.4%	4.1%	3.7%	4.7%	6.0%	4.4%	3.6%	4.8%
- Deposits	6.7%	10.9%	3.4%	1.5%	8.5%	6.0%	4.2%	4.2%	7.5%	10.1%	7.3%	6.9%
NIM	2.18%	2.13%	1.96%	2.09%	2.24%	2.25%	2.23%	2.09%	2.06%	1.89%	2.06%	1.94%
Other income / footings	0.18%	0.20%	0.18%	0.18%	0.14%	0.13%	0.16%	0.13%	0.11%	0.10%	0.10%	0.09%
Operating expense / footings	0.34%	0.35%	0.35%	0.33%	0.31%	0.31%	0.31%	0.33%	0.33%	0.31%	0.31%	0.34%
Cost ratio	42%	43%	44%	41%	40%	39%	38%	44%	47%	46%	43%	49%
Impairment expense / loans	0.01%	0.06%	-0.04%	-0.05%	0.04%	-0.01%	0.02%	-0.03%	0.22%	0.11%	-0.10%	0.02%
Effective tax rate	28%	28%	28%	29%	28%	28%	26%	28%	28%	28%	28%	29%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Westpac Banking Corporation

Company description

WBC is Australia's oldest bank with a focus in Australia and New Zealand. Following the transformational merger with SGB in December 2008, the bank is now the leading financial services player in the country (with 10m customers, ~1,000 branches and ~2,700 ATMs) and the largest provider of wealth platforms.

Investment strategy

Our current rating reflects WBC's relatively lower credit risk profile and ROE and value upside from productivity and efficiency gains within Westpac Retail & Business Banking in the medium term in rationalising the branch network with St George. The other key value drivers are scale in banking and wealth management and traditional exposure to the important NSW market.

Valuation

The price target is closely aligned with the bank's composite valuation, weighted as follows:

Table 5 – Composite valuation

Composite Valuation	Value ($m)	Per share	Weighting	Composite value per share
DCF	89,990	$24.53	25%	$6.13
Dividend yield (sustainable)	110,489	$30.12	25%	$7.53
ROE (sustainable)	84,190	$22.95	25%	$5.74
Sum-of-Parts	84,169	$22.94	25%	$5.74
Surplus capital *	2,838	$0.77		$0.77
Total				**$25.91**

* Less estimated NZ new capital requirement

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 6 – SOP valuation

Sum-of-Parts (As Is)	FY22e NPAT	Pros. PE (times)	Value ($m)	Per share
Consumer Bank	3,376	13.0	43,885	$11.96
Business Bank	1,314	13.0	17,076	$4.65
Westpac Institutional Bank	508	12.5	6,344	$1.73
Specialist Businesses	480	10.0	4,805	$1.31
Westpac New Zealand	708	13.0	9,210	$2.51
Group	228	12.5	2,850	$0.78
Total	**6,614**	**12.7**	**84,169**	**$22.94**

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SWOT analysis

Strengths

1. Conservative Board/Management with relevant banking experience;
2. Strong execution capabilities;
3. Scale in domestic wealth management and global markets; and
4. Domestic retail and SME banking franchise, including service and sales.

Weaknesses

1. Multiple brands – lack of synergies; and
2. Overweight NZ (but the risks are partially mitigated by exposure to relatively lower risk retail assets).

Opportunities

1. Radical restructuring of the combined WBC/SGB network especially in NSW; and
2. East coast leverage.

Threats

1. Macroeconomic factors, e.g. higher unemployment rate and slowing credit growth;
2. Changes in regulatory environment; and
3. Increased competition specifically from the other majors on the domestic front in retail and wholesale banking and wealth management.

Sensitivities

Table 7 – Sensitivities

Y/e September 30	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Sensitivities									
Group NIM +10bp									
- NPAT upside (cash basis)	9.1%	8.8%	8.7%	8.5%	8.3%	8.2%	8.2%	8.1%	8.1%
- Price target upside	$2.40	$2.31	$2.28	$2.23	$2.19	$2.16	$2.15	$2.14	$2.13
Group Loans +1%									
- NPAT upside (cash basis)	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%
- Price target upside	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20	$0.20
Consumer Bank loans +1%									
- NPAT upside (cash basis)	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
- Price target upside	$0.13	$0.13	$0.12	$0.12	$0.12	$0.12	$0.12	$0.12	$0.12
Business Bank loans +1%									
- NPAT upside (cash basis)	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
- Price target upside	$0.05	$0.06	$0.06	$0.06	$0.06	$0.06	$0.06	$0.06	$0.06
NZ loans +1%									
- NPAT upside (cash basis)	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
- Price target upside	$0.03	$0.03	$0.03	$0.03	$0.03	$0.03	$0.03	$0.03	$0.03
Other income +1%									
- NPAT upside (cash basis)	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
- Price target upside	$0.13	$0.13	$0.13	$0.12	$0.12	$0.12	$0.12	$0.12	$0.12
BDD +1%									
- NPAT upside (cash basis)	0.0%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%
- Price target upside	-$0.01	-$0.01	-$0.02	-$0.02	-$0.02	-$0.02	-$0.02	-$0.02	-$0.02
Costs +1%									
- NPAT upside (cash basis)	-1.2%	-1.1%	-1.1%	-1.0%	-1.0%	-1.0%	-0.9%	-0.9%	-0.9%
- Price target upside	-$0.33	-$0.30	-$0.28	-$0.27	-$0.26	-$0.25	-$0.25	-$0.25	-$0.25

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Westpac Banking Corporation
as at 1 November 2021

Recommendation	Hold
Price	$23.78
Target (12 months)	$26.00

Table 8 – Financial summary

Westpac Bank		**Share Price (A$)**	**23.78**
As at	1-Nov-21	**Market Cap (A$M)**	**87,239**

PROFIT AND LOSS

Y/E September 30 ($m)	**2020**	**2021**	**2022e**	**2023e**	**2024e**
Net interest income	17,086	16,714	16,721	16,854	17,154
Other banking income	3,540	4,324	4,801	4,919	5,001
Total banking income	**20,626**	**21,038**	**21,522**	**21,773**	**22,155**
Funds management income	0	0	0	0	0
Insurance income	0	0	0	0	0
Net operating income	**20,626**	**21,038**	**21,522**	**21,773**	**22,155**
Operating expenses	-12,700	-13,283	-11,751	-11,250	-11,119
Impairment charges	-3,178	590	-326	-502	-704
Operating profit before income tax	**4,748**	**8,345**	**9,445**	**10,020**	**10,332**
Income tax expense	-2,138	-2,988	-2,825	-2,997	-3,091
Net profit to non-controlling interests	-2	-5	-6	-6	-6
Preference dividends	0	0	0	0	0
Cash earnings	**2,608**	**5,352**	**6,614**	**7,016**	**7,235**
Adjustments	-318	-718	-1,336	-36	-36
Statutory earnings	**2,290**	**4,634**	**5,278**	**6,980**	**7,199**

CASHFLOW

Y/E September 30 ($m)	**2020**	**2021**	**2022e**	**2023e**	**2024e**
NPAT (cash basis)	2,608	5,352	6,614	7,016	7,235
Increase in divisional loans	18,040	-18,012	-17,557	-16,125	-16,520
Increase in other assets	-10,991	32,860	-5,450	-5,670	-5,900
Capital expenditure	-2,755	1,057	-86	-89	-92
Investing cashflow	**4,294**	**15,905**	**-23,093**	**-21,885**	**-22,511**
Increase in deposits & borrowings	30,857	24,800	19,010	18,180	18,755
Increase in other liabilities	-28,104	-4,887	4,524	1,408	1,487
Ordinary equity raised	2,751	0	0	0	0
Other	-2,336	54	-7,054	-4,719	-4,966
Financing cashflow	**3,168**	**19,967**	**16,480**	**14,868**	**15,276**
Net change in cash	10,070	41,224	0	0	0
Cash at end of period	**30,129**	**71,353**	**71,353**	**71,353**	**71,353**

BALANCE SHEET

Y/E September 30 ($m)	**2020**	**2021**	**2022e**	**2023e**	**2024e**
Cash and liquid assets	30,129	71,353	71,353	71,353	71,353
Divisional gross loans	689,120	705,999	724,097	740,800	757,938
Provisions	-6,132	-4,999	-5,540	-6,118	-6,735
Other gross loans	9,541	8,374	8,374	8,374	8,374
Other IEA	166,355	134,907	140,357	146,028	151,927
Intangibles	11,497	10,109	10,109	10,109	10,109
PP&E	3,910	2,853	2,939	3,028	3,120
Insurance assets	0	0	0	0	0
Other assets	7,526	7,281	7,281	7,281	7,281
Total assets	**911,946**	**935,877**	**958,970**	**980,855**	**1,003,366**
Divisional deposits	539,800	564,600	583,610	601,789	620,544
Other borrowings	291,834	290,937	295,461	296,869	298,357
Other liabilities	12,238	8,248	8,248	8,248	8,248
Total liabilities	**843,872**	**863,785**	**887,319**	**906,907**	**927,149**
Ordinary share capital	39,946	40,995	37,495	37,495	37,495
Other equity instruments	0	0	0	0	0
Reserves	1,544	2,227	2,227	2,227	2,227
Retained profits	26,533	28,813	31,872	34,169	36,438
Minority interests	51	57	57	57	57
Total shareholders' equity	**68,074**	**72,092**	**71,651**	**73,948**	**76,217**
Total sh. equity & liabs.	**911,946**	**935,877**	**958,970**	**980,855**	**1,003,366**
WANOS - statutory (m)	**3,590**	**3,653**	**3,595**	**3,521**	**3,521**
WANOS - cash (m)	**3,595**	**3,657**	**3,598**	**3,524**	**3,524**

PROFITABILITY RATIOS

Y/e September 30	**2020**	**2021**	**2022e**	**2023e**	**2024e**
Return on assets	0.3%	0.6%	0.7%	0.7%	0.7%
Return on equity	**3.8%**	**7.6%**	**9.2%**	**9.6%**	**9.6%**
Leverage ratio	6.4%	6.9%	6.7%	6.6%	6.7%
Net interest margin	**2.08%**	**2.04%**	**1.94%**	**1.92%**	**1.92%**
Cost / income ratio	62%	63%	55%	52%	50%
Cost / average assets	1.35%	1.46%	1.24%	1.16%	1.12%
Growth in operating income	0%	2%	2%	1%	2%
Growth in operating expenses	27%	5%	-12%	-4%	-1%
Jaws	**-27%**	**-3%**	**14%**	**5%**	**3%**

ASSET QUALITY

Y/e September 30	**2020**	**2021**	**2022e**	**2023e**	**2024e**
Impairment expense / GLA	**0.45%**	**-0.08%**	**0.04%**	**0.07%**	**0.09%**
Impairment expense / RWA	0.73%	-0.14%	0.07%	0.10%	0.14%
Total provisions ($m)	**6,132**	**4,999**	**5,540**	**6,118**	**6,735**
Total provisions / GLA	**0.88%**	**0.70%**	**0.76%**	**0.82%**	**0.88%**
IAP / GIA	22%	39%	25%	25%	25%
IBL / IEA	97%	101%	101%	101%	101%
Total provisions / RWA	1.40%	1.14%	1.18%	1.25%	**1.32%**

VALUATION DATA

Y/e September 30	**2020**	**2021**	**2022e**	**2023e**	**2024e**
Cash earnings ($m)	2,608	5,352	6,614	7,016	7,235
EPS (statutory basis) (¢)	64	127	147	198	204
- Growth	-68%	99%	16%	35%	3%
EPS (cash basis) (¢)	73	146	184	199	205
- Growth	-63%	102%	26%	8%	3%
P / E ratio (times)	32.8	16.2	12.9	11.9	11.6
P / Book ratio (times)	1.3	1.2	1.2	1.2	1.1
P / NTA ratio (times)	1.5	1.4	1.4	1.4	1.3
Net DPS (¢)	31	118	128	138	142
Yield	1.3%	5.0%	5.4%	5.8%	6.0%
Franking	100%	100%	100%	100%	100%
Payout (cash basis)	43%	81%	70%	69%	69%

CAPITAL ADEQUACY

Y/e September 30	**2020**	**2021**	**2022e**	**2023e**	**2024e**
Risk weighted assets ($m)	437,905	436,650	468,016	488,976	510,752
Average risk weight	50%	51%	53%	54%	55%
Tier 1 ratio	**13.2%**	**14.6%**	**13.5%**	**13.2%**	**13.1%**
CET1 capital ratio	**11.1%**	**12.3%**	**11.59%**	**11.4%**	**11.4%**
Total capital ratio	16.4%	18.9%	17.4%	16.9%	16.7%
Equity ratio	7.5%	7.7%	7.5%	7.5%	7.6%

DIVISIONAL

Y/E September 30 ($m)	**2020**	**2021**	**2022e**	**2023e**	**2024e**
Consumer & Business Banks					
Net interest income	12,710	12,470	12,538	12,625	12,872
Other income	1,133	1,037	1,084	1,149	1,177
Net operating income	**13,843**	**13,507**	**13,623**	**13,774**	**14,049**
Operating expenses	-6,474	-7,152	-6,737	-6,459	-6,415
Impairment charges	-2,386	609	-187	-339	-519
Operating profit before income tax	**4,983**	**6,964**	**6,699**	**6,976**	**7,115**
Income tax expense	-1,503	-2,094	-2,010	-2,093	-2,134
Cash earnings	**3,480**	**4,870**	**4,689**	**4,883**	**4,980**
Home loans	440,900	455,700	464,814	474,110	483,592
Other loans	93,700	89,300	91,086	92,908	94,766
Deposits	371,200	394,300	406,129	418,313	430,862
Westpac Institutional Bank					
Net interest income	1,111	919	1,043	1,060	1,078
Other income	1,182	1,102	1,054	1,079	1,105
Net operating income	**2,293**	**2,021**	**2,098**	**2,139**	**2,182**
Operating expenses	-1,316	-2,574	-1,322	-1,278	-1,308
Impairment charges	-404	-162	-51	-52	-52
Operating profit before income tax	**573**	**-715**	**725**	**810**	**822**
Income tax expense	-241	45	-218	-243	-247
Cash earnings	**332**	**-670**	**508**	**567**	**575**
Loans	66,600	67,600	68,952	70,331	71,738
IBL	102,900	97,800	100,734	103,756	106,869
Westpac New Zealand					
Net interest income	1,832	1,987	1,890	1,960	2,033
Other income	319	323	321	334	346
Net operating income	**2,151**	**2,310**	**2,211**	**2,294**	**2,380**
Operating expenses	-998	-1,062	-1,153	-1,198	-1,244
Impairment charges	-302	79	-58	-80	-104
Operating profit before income tax	**851**	**1,327**	**1,000**	**1,016**	**1,033**
Income tax expense	-239	-377	-292	-296	-301
Net profit to non-controlling interests	0	0	0	0	0
Investment experience	0	0	0	0	0
Cash earnings	**612**	**950**	**708**	**720**	**731**
Loans	81,788	88,400	93,705	97,333	101,106
Deposits	65,700	72,500	76,747	79,721	82,813
Notable items					
Net interest income	-143	56	0	0	0
Net fee income	-133	0	0	0	0
Net wealth mgt, insurance & other income	-130	145	0	0	0
Net operating income	**-406**	**201**	**0**	**0**	**0**
Operating expenses	-2,539	-1,816	-427	-306	-206
Operating profit before tax	**-2,945**	**-1,615**	**-427**	**-306**	**-206**
Income tax expense	326	150	128	92	62
Cash earnings	**-2,619**	**-1,465**	**-300**	**-214**	**-144**
Group cash earnings ex-notable items	**5,227**	**6,817**	**6,913**	**7,231**	**7,379**
EPS ex-notable items (cash basis)	**145**	**186**	**192**	**205**	**209**
- Growth	**-36%**	**28%**	**3%**	**7%**	**2%**
Return on equity ex-notable items	**7.7%**	**9.6%**	**9.6%**	**9.9%**	**9.8%**
Payout ratio ex-notable items	**21%**	**63%**	**67%**	**67%**	**68%**
Net operating income ex-notable items	**21,032**	**20,837**	**21,522**	**21,773**	**22,155**
Operating expenses ex-notable	**10,161**	**11,467**	**11,324**	**10,944**	**10,913**
CIR ex-notable items	**48%**	**55%**	**53%**	**50%**	**49%**

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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