BELL POTTER

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Resimac Group (RMC)

Upside from market share gains and low valuation

Recommendation	
Buy (Buy)	
Price	
$1.19	
Target (12 months)	
$2.15 (previously $3.30)	

GICS Sector
Diversified Financials

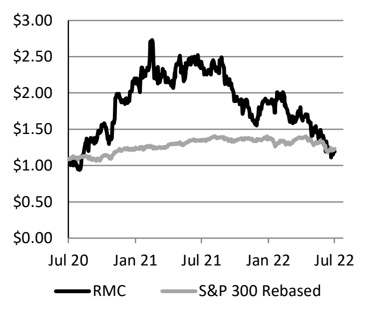
Expected Return	
Capital growth	**80.7%**
Dividend yield	**5.9%**
Total expected return	**86.6%**

Company Data & Ratios	
Enterprise value	**NR**
Market cap	**$492m**
Issued capital	**407m**
Free float	**37.5%**
Avg. daily val. (52wk)	**$493k**
12 month price range	**$1.11-2.52**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.40	1.75	2.37
Absolute (%)	-15.0	-32.0	-49.8
Rel market (%)	-7.7	-20.6	-40.9

Absolute Price



SOURCE: IRESS

Transfer of coverage – Buy for valuation re-rating

We resume coverage of RMC with a Buy rating following a change of analyst. RMC is a non-bank lender focussing on standard and specialised mortgages with a capital lite growth model, able to fund and distribute mortgages. It is relatively small, but profitable and paying dividends. Its market share has increased from 0.6% in 2019 to 0.7% today, but this small increase has resulted in a 44% increase in balance sheet assets and a 179% increase in profitability. Over a four-year period to FY 21, net interest income (NII) reached $242.7m, a CAGR of 33% and NPAT reached $104.0m, a CAGR of 58%.

But at this moment the company faces some risks. The Australian property market has shown strong price appreciation, and interest rates are rising rapidly. This is likely to lead to lower property values and increasing cost of servicing mortgage debt, which should lead to higher defaults. Set against this risk, average LVRs are low (sub 65%), LMI (insurance) is in place for prime loans (>80% LVR at outset), unemployment remains very low at just 4% with structural labour shortages, and while the economy will slow, we believe a deep recession is unlikely.

Investment View: target price $2.15/ share

Despite the strong revenue and profitability growth that the company has, and continues to generate, it's shares have been de-rated from a high of $2.73 (Feb 2021) to just $1.19, representing just 4.7 times 2022 prospective earnings. In this note we consider what sort of conditions could justify such a low valuation and estimate that to justify the current share price, the company would have to write off around 3% of mortgage assets, or c.$560m. To put this in context when Covid-19 struck and 10% of the book was put on hardship payment moratoriums, it took a collective provision of just $16m (from which minimal write-offs have materialised). To get a valuation close to the current share price implies a scenario that we regard as both extreme and unlikely. Our target price is $2.15 per share, set using a NPV of future profitability as a proxy for a DCF valuation. The next news event is the 2022 full year results in August.

Earnings Forecast

Year end June 30	2021a	2022e	2023e	2024e
NPAT (reported) (A$m)	107.8	103.4	96.2	80.6
NPAT (Adj) (A$m)	107.8	103.4	96.2	80.6
EPS (Adj) (cps)	26.4	25.3	23.5	19.6
EPS growth (%)	91.9%	-4.3%	-7.1%	-16.5%
PER (x)	4.5	4.7	5.1	6.1
Price/book (x)	1.5	1.2	1.1	0.9
Price/NTA (x)	1.7	1.3	1.1	1.0
Dividend (¢ps)	6.4	7.0	8.0	7.0
Yield (%)	10.8%	11.8%	13.4%	11.8%
Franking (%)	100.0%	100.0%	100.0%	100.0%
ROE (%)	38.3%	28.7%	22.4%	16.7%
ROA (%)	0.8%	0.6%	0.5%	0.4%
NIM (%)	2.07%	1.85%	1.69%	1.70%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Contents

Overview

Description

From the company website:

The Group is a residential mortgage and asset finance lending business, distributing Prime and Specialist products across multiple channels. The Group operates in Australia and New Zealand, originating a high quality loan portfolio, loan servicing capability, and global funding program. The Group's core capabilities include:

- **Product manufacturing:** The Group applies its detailed knowledge of the Australian and New Zealand markets to offer products to address demand, with attractive risk and return profiles
- **Distribution:** Distributing loans in Australia and New Zealand through relationships with accredited brokers, wholesale partners and a direct-to-consumer channel;
- **Treasury and funding expertise:** Strong long-term relationships with global funding partners, the Group is an experienced issuer in the global and domestic term securitisation markets; and
- **Risk management:** Operating a holistic enterprise risk management and governance framework utilising the three lines of defence model.

Source https://resimac.com.au/about-us/about-resimac

The company's main product is residential mortgages, offered both in the prime space as well as specialist mortgages to the self-employed, contractors and those with previous credit impairment. It has recently seen considerable growth in specialist mortgages. It has recently added asset finance, offering car loans and SME finance. This asset finance business remains small, and we make passing reference to it in this note.

Its mortgages are distributed through a network of 12,000 broker partners as well directly on-line via the homeloans.com.au and iMortgages website.

The group is a non bank lender and does not take deposits. This in turn means it is not regulated by APRA and does not have the heavy capital requirements of a bank. (it is able to offer offset mortgage accounts as these are not treated as deposits).

Funding of its lending is conducted through a short term warehouse facility and subsequent long term RMBS issues. RMC is one of the largest issuers or RMBS in Australia, having issued $41bn across 63 issues at the time of writing. Its position in this market means its spreads have narrowed – reducing its funding cost, although we are yet to see what effect rising rates will have on its funding costs.

As a result of low capital requirements and funding agreements in place it has been able to grow rapidly, generate profits and distribute these profits as dividends. In the last 6 months it has been conducting a share buyback, largely reflecting what management saw as an undervalued share price at $1.85 at the start of 2022.

Investment Thesis

We see the investment case as:

Resimac sits at an attractive size, being neither so small it is unprofitable, nor so large that that it struggling to gain market share. It has grown its market share from 0.6% in 2019 to 0.7% today, this small increase has resulted in a 44% increase in balance sheet assets and a 179% increase in profitability.

The track record is further illustrated by the growth in settlements from $2.0bn in H1 2019 to $3.5bn in H1 2022, a growth of 75% (CAGR of 20.5%). Over a four year period to FY 21, Net interest income reached $242.7m - a CAGR of 33% and NPAT reached $104.0m in FY21, a CAGR of 58%.

But there are risks. The Australian property market has shown strong price appreciation, and interest rates are now starting to rise. This is likely to lead to lower property values and increasing cost of servicing mortgage debt, which should lead to higher defaults. Set against this unemployment remains very low at just 4% and there are structural labour shortages.

Covid-19 sent the shares down 60% in 2020 which proved to be an over-reaction

While this does raise the prospect of an increase in defaults and bad debts, we estimate that to justify the current share price, our analysis suggests the company would have to write-off around 3% of mortgage assets, or $560m (see Figure 17 in the valuation section). To put this in context when Covid-19 struck and 10% of the book were on hardship payment moratoriums, it took a collective provision of just $16m (from which minimal write-offs have materialised).

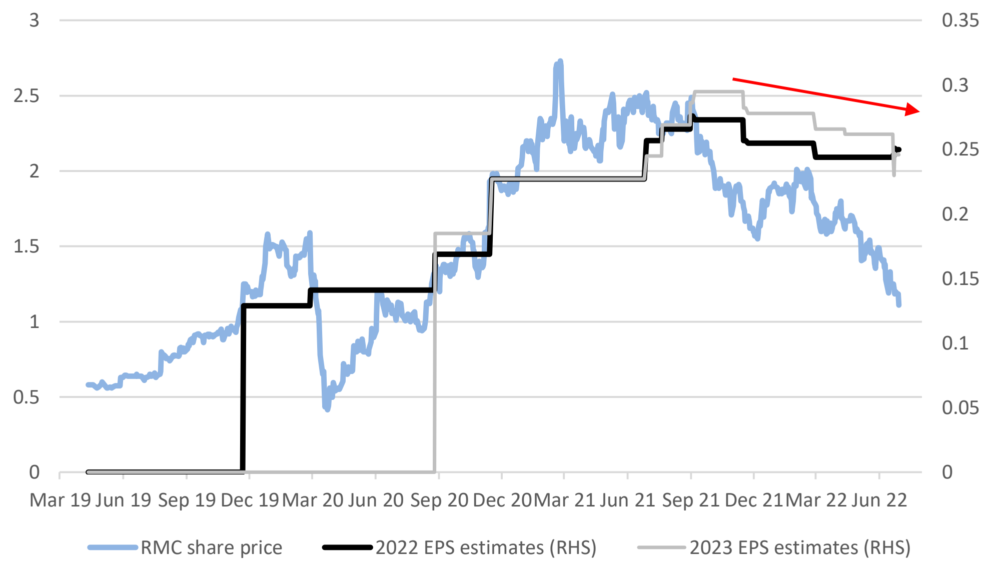
We note that there is a lack of liquidity in the shares, with an average daily trade of just $0.5m. We note that Somers, an investment company owns 62% of the shares, which effectively reduces the liquidity in the shares.

Why have the shares been so weak?

The share price is 56% below its 2020 peak, but EPS estimates are 17% below peak

The following chart in Figure 1 shows the movement in the RMC share price over the last two years compared to the movement in earnings expectations for 2022 and 2023. Note that RMC is covered by four other brokers, however the point is clear, earnings estimates have fallen 9% to 25.0c for 2022 and 17% to 26.2c for 2023 from peak (period between September and December) last year. By contrast the shares at $1.19 are 56% below their peak (Feb 21).

Figure 1 - Resimac Share price and earnings estimate history



SOURCE: BLOOMBERG

Housing market and economic background

One key reason for the falling share price is the uncertainty caused by rising interest rates and its effect upon the housing market.

Rising inflation has led the RBA to raise interest rates from 0.1% throughout 2021, to 0.35% in May, 0.85% in June, and to 1.35% in July and there is a general expectation that interest rates will continue to rise.

Investors should take comfort from low unemployment which is key driver of default

This is usually bad news for the housing market for two main reasons. Firstly, it increases the total cost of using a mortgage to buy a house, which in turn is likely to put downwards pressure on house prices. Secondly borrowers may face trouble meeting the rising interest costs on their mortgage, which may in turn lead to default with the bank repossessing the property and making a loss selling it for less than the mortgage plus accrued interest.

There are a number of reasons why this should not be a problem in the short term.

1 **Unemployment is currently low** at around 4% and there is a shortage of labour. If unemployment rises, there will be more problems in servicing loans. The shortage of labour means that workers may be able to demand pay rises to partially offset the effect of higher interest rates.

2 **Property values have not fallen dramatically**, and the demand for housing remains strong (although this remains a risk). LVRs across RMC's asset portfolio are low. The average dynamic LVR across the RMC portfolio is 60% for prime mortgages and 66% for non-conforming. Within this average there is a spread with some recently issued mortgages at or above 95%. RMC will not be immune from default, but we are starting from a base of very low annual charges for bad and doubtful debts of just 0.03% of the mortgage book per year. To justify the current share price, we estimate the company would need to write off around 3.00% of the mortgage portfolio.

3 **LMI Insurance should protect the portfolio.** Mortgages above an LVR of 80% have LMI insurance in place at issue, which should protect RMC from some losses.

4 **Interest rates are still low in historic terms and would still be at 3%**. The RBA rate at 1.35% is very low by historic standards. The question remains how fast and how high until interest rates peak. While the RBA will increase interest rates further, we believe the aim is to combat inflation, not to put the country into a deep recession. With interest rates having been so low, we believe the economy would slow down, but would probably cope if interest rates rose to 3 per cent, a level that is still low by historic standards. However, pushing rates to 6 per cent (as some commentators are suggesting), would likely push the economy into a deep recession.

The extent to which the RBA will raise will also be influenced by the degree to which other developed countries raise rates. To lag the USA or EU, could see the A$ weaken against major currencies, which would be inflationary for imported goods.

Liquidity and buybacks

Liquidity in the stock is relatively low, with average daily volume of just under $0.5m/day. At the end of 2021, RMC began a buyback, with authority to buy 10% or 40.8m shares, although given the liquidity and the existence of a large holder this was probably not an achievable target. After 6 months, the company has bought back 2.4m shares or 0.6% of issued capital. We understand managements desire to buy back what they see as an undervalued share. The company has spent $3.8m on the buyback. The average price paid is $1.53 with a minimum of $1.15 and a maximum of $1.85.

62% shareholder

The company has a large shareholder in Somers Limited, a Bermuda based listed investment company (ticker SOM.BH) which owns 62% of Resimac Group. Somers is managed by ICM Limited, a Bermuda based fund manager. Duncan Saville, the Chairman of ICM group is one of the non-exec directors of Resimac Group board.

This holding is historic, as Somers held 79% of RMC, prior to the merger with Homeloans in 2016 (the merger was 72.5% Resimac, 27.5% Homeloans meaning Somers retained a c.60% majority holding). Although RMC is effectively a subsidiary of Somers, RMC is accounted as an investment at fair value through P&L, effectively market value.

RMC is a major holding for Somers, representing 56.9% of funds under management at September 2021 (RMC shares were $2.05). having risen from 51.7% of FUM at September 2020 (RMC $1.45). We note that the movement in Somer's FUM has closely mirrored the movement in RMC's share price since Mar 2020.

(see https://www.somers.limited/portfolio/assets-under-management/ for more details)

With RMC being around half of NAV and with the shares having fallen by 34.3% over the last quarter from $1.75 to $1.15, we expect this will have had a roughly 17% negative effect on Somers' NAV.

Somers though appear to be long term holders of RMC, having been involved for a long time and have been through a similar share price decline in Q1 2020, when RMC's share price fell by 60% after it faced potential losses from Covid-19. We have no reason to expect that Somers is under any short term pressure to reduce their holding in RMC, and especially not at the current share price.

The following quote is taken from the Somers annual report, in which they acknowledge the concentration risk in its three biggest stocks, but anticipate that concentration risk will reduce by other means:

*"Resimac at $376.3 million (2020: $258.9 million), Waverton at $117.2 million (2020: $71.9 million) and PCF at $37.5 million (2020: $32.0 million) together represent 80.4% of total investments. It is **anticipated that this concentration will continue to reduce as new capital flows, an increased but limited level of leverage, and net positive cash flows from existing investments allow for new investment opportunities**"*

(Source: Somers 2021 Annual Report.)

A potential chicken and egg conundrum

Despite being a long term holder, the Somers holding is unhelpful for the investment case for two reasons:

- A large long-term holder reduces the potentially liquidity in the stock, making it less attractive to large/institutional holders, and
- Potential investors wanting to take a position in RMC might simply defer a decision until there is a liquidity event (most likely being a sell down by Somers at a higher price).

In other words, RMC shares would benefit from liquidity to drive a higher share price, but equally this needs a higher share price to create the liquidity.

We don't know what Somers' intentions are, but as they are long term holders and used to volatility, it would seem unlikely that Somers is about to reduce its holding in RMC.

Development of assets, NIM and bad debts

Improving operational performance

We track the development of some of the key operational metrics produced by the company to highlight the improvement in revenue and profitability.

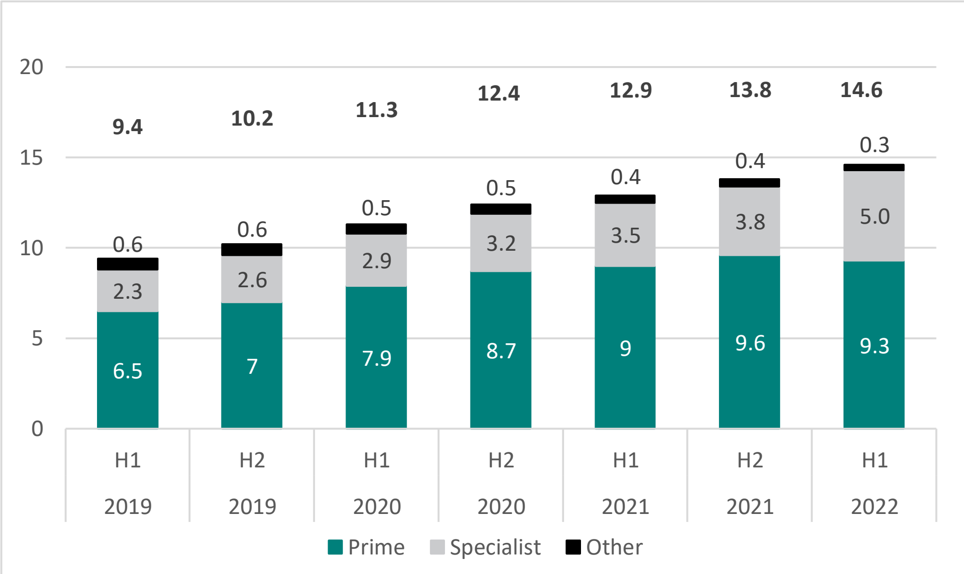
Loan book size

Figure 2 below shows the development of the RMC loan book. At H1 2022, this was $14.6bn, 13% or $0.8bn higher than one year earlier ($13.8bn at FY 2021). Over the period shown, the loan book has grown from $9.4bn (at H1 2019), a CAGR of 15.8%.

At H1 2022, $9.3bn of the loan book was prime (64%), $5.0bn was specialist (34%) and $0.3bn was asset finance (2%).

The 7% fall in the amount of prime loans in H1 22 was attributed to the price competition in the mortgage market and the shift to fixed rate loans.

Figure 2 - Development of the loan book ($bn, half yearly)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

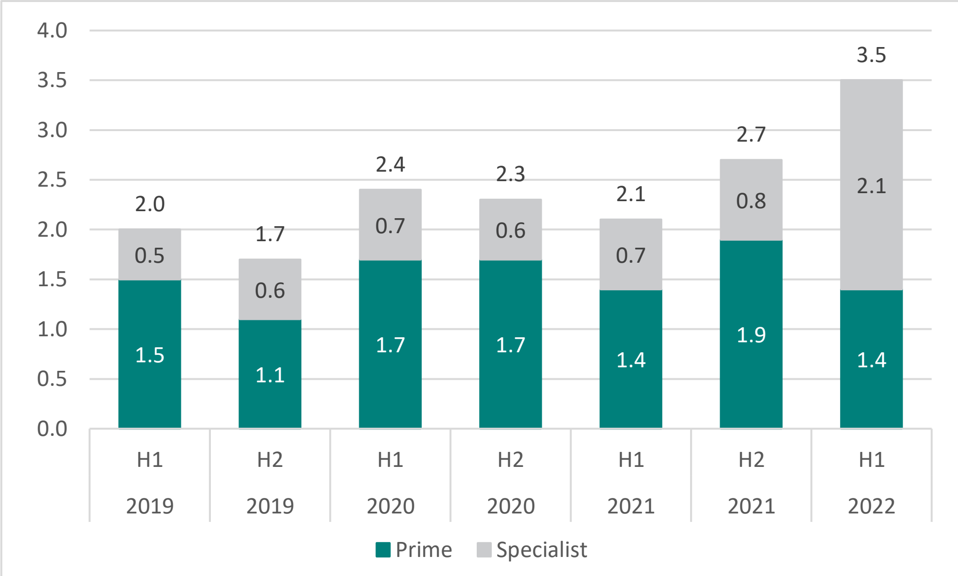
We note that around 20-27% of the book runs off every year (being the difference between the growth in the loan book and the amount of new settlements in each period), which we assume is a combination of refinancing away, repayments, or lost to bad debt provisions and write-offs. This corresponds to the average life of the book being about 4-5 years. This also illustrates the importance of a volume of settlements coming through every year to replace those that exit.

Settlements/ new business

Figure 3 below shows the development of new settlements, rising to $3.5bn in H1 2022, an increase of 67% year-on-year (compared H1 2021). Over the three-year period shown, settlements increased by 75% from $2.0bn, a CAGR of 20.5%.

As shown in Figure 2, we note the shift to specialist settlements in H1 2022.

Figure 3 – New Settlements ($bn, half yearly)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Net interest income (NII)

The chart in Figure 4 shows the development of net interest income increasing from $55.1m in H1 2019 to $133.4m in H2 2022. The amount of net interest income increased rapidly to $122.1m in H1 2021 as NIM widened on a growing book. Since then, the rate of net interest income has been more pedestrian, as the NIM has contracted slightly on an expanding loan book.

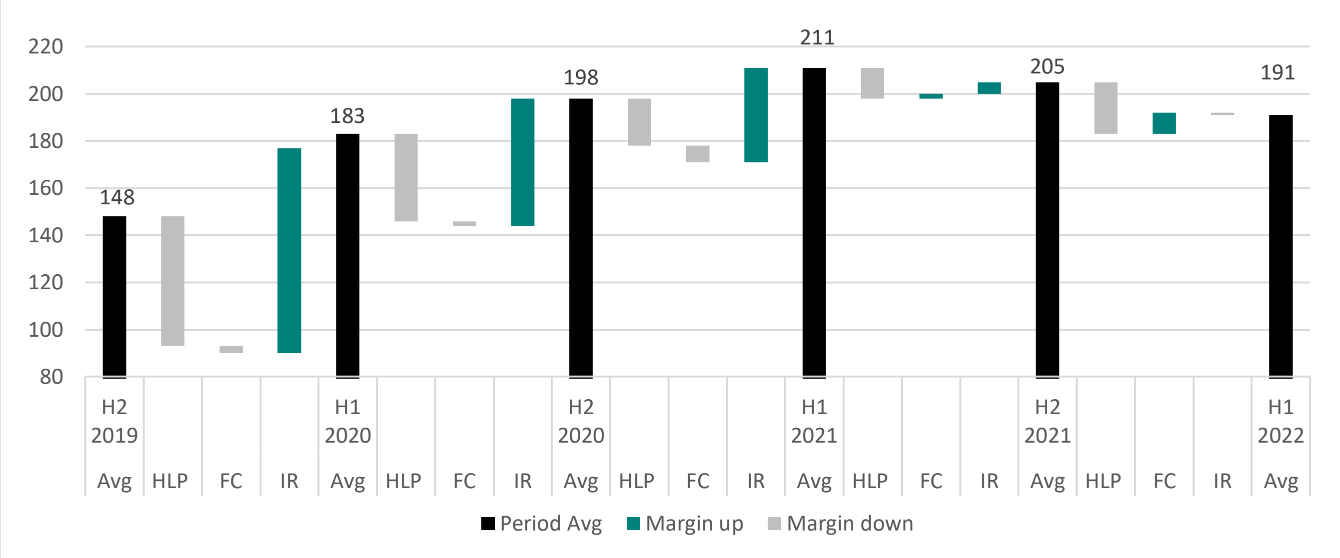
Figure 4 - Development of net interest income ($m)

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Net interest margin (NIM)

In the chart in Figure 5, we show the development of RMC's net interest margin, from 148bp in H2 2019, rising to a peak of 211bps in H1 2021, and then declining back to 191bps in H1 2022. This movement over the period shown is the result of a downward movement of 185bps in interest rate costs paid on RMBS (beneficial) and a 147bps reduction in margin from lower home loan pricing.

Figure 5 - Net interest margin, and movements H2 2019 to H1 2022 (bps)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES - AVG = AVERAGE RATE, HLP= HOME LOAN PRICING, FC = FUNDING COST, IR = INTEREST RATE MOVES IN BBSW/BKBM

The key movements have been:

- **Home loan pricing**, the interest received on the assets, which in turn depends both upon the rate of new business coming on board and the effect of older loans being repaid or refinanced. This has moved down in every period shown by a total amount of 147bps. This reflects both lower cash rates and competition in the mortgage market.
- **Funding cost**, being the change in the cost of warehousing and RMBS, movements and reflects both new funding from new RMBS, as well as the retirement/repayment of existing RMBS. These changes have generally been small moving a few basis points in each period and down by just 1 bp over the entire period shown.
- **Interest rates**, being the movement in the BBSW and BKBM rates reflecting the rates paid on the liabilities. As interest rate moved down in 2020 and H1 2021, this reduced the interest cost paid on the outstanding RMBS. This stabilised after H1 2021.

In the first two years shown (between H2 2019 and H1 2021) the net interest margin rose as the interest rates received on the home loans, rose more quickly than interest paid on the RMBS and warehouse.

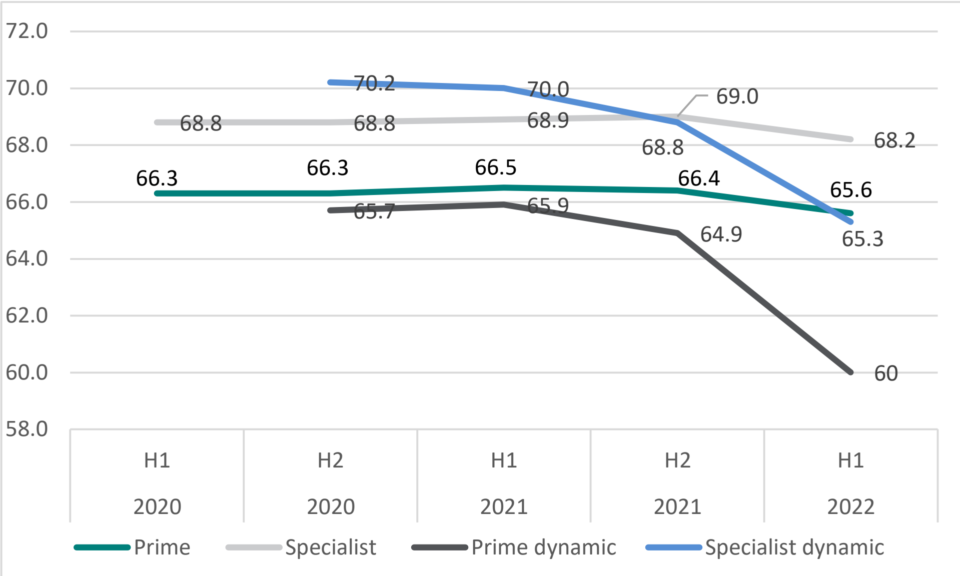
In the last year shown (between H1 2021 and H1 2022) the net interest margin fell from 211bps to 191bps. Over this period margins were impacted by the run-off of the higher yield back book and competitive pricing for new home loans, combined with a small increase in funding costs on the liabilities (warehouse and RMBS).

In our forecasts we assume that NIM declines back to around 170bps, driven by competition in the market. We regard this as a conservative assumption. We think it unlikely that it will fall back to 2019 levels (of 148bps), as the company is much larger and has improved its ability to fund at attractive rates.

Loan to Value ratio (LVR)

The chart in Figure 6 shows the development of LVR on the loan to value ratio on both the prime and specialist mortgage book.

Figure 6 - Development of LVR, static and dynamic/revalued (%)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The LVR is set at the outset based upon the value of the loan compared to the value of the property (adjusted for subsequent repayments).

The prime LVR ratio has been in the ratio 65.6-66.5% in the period shown, however adjusting for rising property values the prime dynamic ratio has fallen to 60% at H1 2022. Likewise, the specialist LVR has been in the range 68.2-69.0% but allowing for recent property values this fell to 65.3% at H1 2022.

We believe that this is a comfortable level of LVR. We understand that just 4% of the loan book has an LVR above 90%, and just under 10% has an LVR above 80%. (based upon slide 12 from the H1 2022 company results presentation)

We believe this provides RMC with a significant buffer against credit losses.

Provision for doubtful debts/charge for doubtful debts

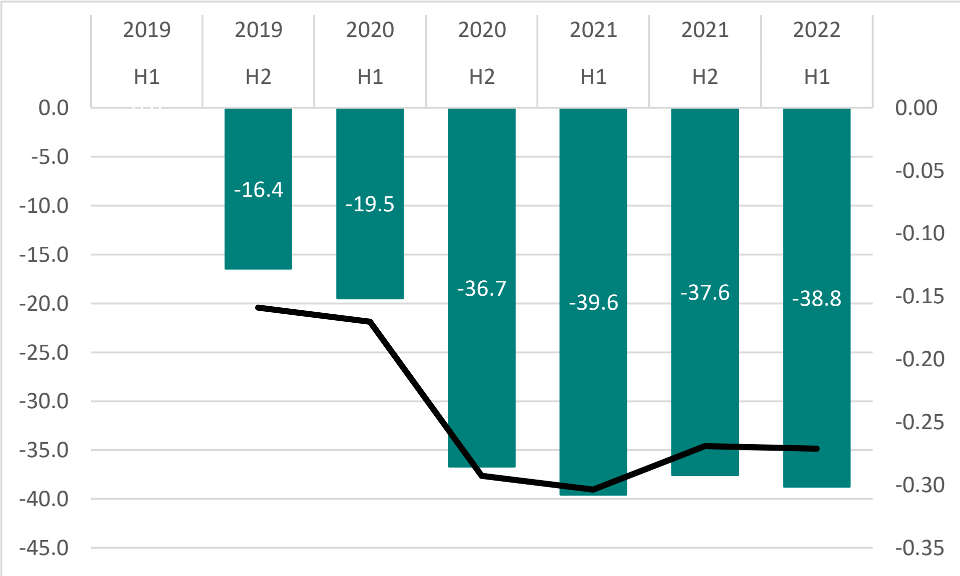
The chart in Figure 7 shows RMC's provisions for bad debts, and those provisions as a percentage of the loan portfolio (using end period AUM)

Provisions are currently $38.7m, equivalent to 26bp of the loan portfolio, of which $33.6m or 23bps relates to collective general provisions against the portfolio and $5.1m or 3bps relates to specific properties.

Management increased its collective provisions to 27bps in H1 2020, as the Covid-19 virus struck and there was concern about the ability of customers to service debt during the lockdowns and closures of businesses. The specific Covid-19 overlay amount was $16.4m and this has proved to be conservative with government support reducing the financial impact of Covid-19, leading to very few bad debts. It has not been necessary to use or increase the general provision. The provision was maintained at 27bps at H1 2021 and reduced to 23bps in at FY 2022.

Australia still faces issues associated with Covid-19, inflation and rising interest rates, but as we noted earlier unemployment remains low at around 4% and we are yet to see a material increase in bad and doubtful debts. Management seem comfortable that in the current environment that the business is comfortably provided and hopes to be able to release some of this provision in future.

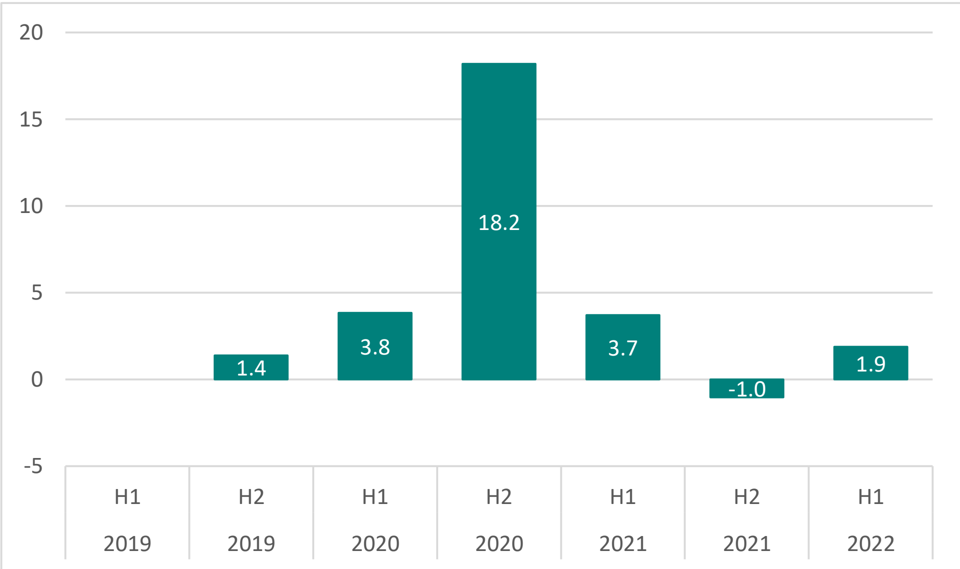
Figure 7 - Development of provision for bad debts ($m, LHS) as a % of loan portfolio (%, RHS)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The charge for bad and doubtful debts is illustrated in Figure 8. This highlights the charge taken in H2 2020, increasing the provision shown above in Figure 7. Excluding this, the charges taken in other periods have been relatively small.

Figure 8 – Charge for bad and doubtful debts ($m)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

In Table 1 below we show the development of the loans past due for the last four years, as provided by the company. Looking at the percentages in the bottom part of the table we note the low level of arrears over 180 days.

The only area where there was a significant increase was in loans 30 days to 60 days past due (shaded below). These figures are released annually and should be updated with the full year results in August.

Table 1 - Loans past due, ($000s amounts and percentages)

	2018	2019	2020	2021
0 days and <30 days	8,538,202	10,242,482	12,438,670	13,458,212
30 days and less than 60 days	32,052	39,805	35,313	395,691
60 days and less than 90 days	13,753	11,995	10,038	36,677
90 days and less than 180 days	15,430	14,151	14,487	23,188
180 days and less than 270 days	6,662	6,538	4,746	6,278
270 days and less than 365 days	2,970	3,983	2,145	2,753
365 and over	10,436	18,066	12,995	11,641
TOTAL	8,619,505	10,337,020	12,518,394	13,934,440
Percentages				
0 days and <30 days	99.06%	99.09%	99.36%	96.58%
30 days and less than 60 days	0.37%	0.39%	0.28%	2.84%
60 days and less than 90 days	0.16%	0.12%	0.08%	0.26%
90 days and less than 180 days	0.18%	0.14%	0.12%	0.17%
180 days and less than 270 days	0.08%	0.06%	0.04%	0.05%
270 days and less than 365 days	0.03%	0.04%	0.02%	0.02%
365 and over	0.12%	0.17%	0.10%	0.08%
TOTAL	100.00%	100.00%	100.00%	100.00%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Distribution and underwriting

Distribution

The company offers a range of prime and specialist mortgages catering for employed and self-employed as well as borrowers with a range of LVR borrowing and credit histories.

The company distributes mortgages through three channels

- Digital/Direct via the homeloans.com.au and iMortgage brand. This channel accounts for around 15% of Resimac's distribution. Nationally, this channel accounts for about $160bn of mortgages pa.
- 3rd Party brokers account for around 85% of RMC's distribution. Nationally, this channel accounts for about $200bn of mortgages pa. across Australia.
- Wholesale – a legacy channel distributing white label mortgages. The group has ceased distribution, although at the end of 2021, still had a portfolio of $2.4bn of AUM. These are not on balance sheet. Across Australia, this channel accounts for about $4bn of mortgages pa.

Market share

Resimac is less than 1% of the market but is growing

Table 2 is taken from APRA data for approved deposit taking institutions, which therefore exclude RMC and similar lenders that are not deposit takers. We have added RMC to the table to show roughly where it would stand if included.

Table 2 - Mortgage lending in Australia

	Amounts 30/06/2019	Amounts 30/06/2020	Amounts 30/06/2021	Amounts 30/04/2022	Total change 2019-2022	Market share 30/06/2019	Market share 30/04/2022	Increase in market share
CBA	434,683	453,349	483,617	514,578	18.4%	25.5%	26.0%	0.4%
WBC	413,073	408,576	417,957	428,358	3.7%	24.3%	21.6%	-2.7%
NAB	261,990	263,455	267,746	287,532	9.7%	15.4%	14.5%	-0.9%
ANZ	248,026	250,413	262,797	260,630	5.1%	14.6%	13.1%	-1.4%
MQG	37,413	50,013	67,564	89,033	138.0%	2.2%	4.5%	2.3%
BOQ	27,585	28,242	30,677	59,582	116.0%	1.6%	3.0%	1.4%
BEN	41,145	45,021	51,684	56,480	37.3%	2.4%	2.8%	0.4%
ING	48,811	51,534	52,163	55,659	14.0%	2.9%	2.8%	-0.1%
Suncorp-Metway Limited	43,314	42,887	42,651	45,515	5.1%	2.5%	2.3%	-0.2%
HSBC	19,041	21,790	23,220	27,428	44.0%	1.1%	1.4%	0.3%
AMP Bank Limited	17,378	18,467	18,777	20,722	19.2%	1.0%	1.0%	0.0%
Credit Union Australia Ltd	12,806	12,982	12,992	14,556	13.7%	0.8%	0.7%	0.0%
Resimac	10,211	12,444	13,857	13,900	44.3%	0.6%	0.7%	0.1%
Newcastle Permanent Building Society Limited	8,368	8,176	8,457	8,747	4.5%	0.5%	0.4%	-0.1%
Others	88,664	96,400	103,820	113,710	28.2%	5.2%	5.7%	0.5%
Total	**1,702,298**	**1,751,305**	**1,844,123**	**1,982,528**	**16.5%**	**100.0%**	**100.0%**	**0.0%**

SOURCE: APRA * FIGURE AT 30 DECEMBER 2020

The total (APRA) mortgage market in Australia was $1,982.5bn at 30 April 2022. RMC had $13.9bn of mortgage assets in Australia at 31 December 2021, giving it a market share of around 0.7%.

A small change in market share has materially changed profitability

Note that in the three years between 2019 and 2022, RMC's market share increased from 0.6% to 0.7%, or just 0.1%. This small change in share represented a significant 44% growth in balance sheet assets, while in the same period profit before tax increased by 179% from $27.0m to $75.6m

In other words, RMC may be able to continue to show significant growth by just making modest market share gains, provided it maintains its position as a competitive lender.

Underwriting

RMC undertakes the usual steps that one would expect in mortgage underwriting, we highlight the following features:

- The Australian Lending Team comprises 37 staff (35 hold a lending delegation) across Sydney, Perth, and Melbourne.
- Automated credit scoring techniques are not used for decisioning purposes, as all loans are decisioned by experienced underwriters based on the merits of the loan, capacity to service, security and the individual applicant's story. For example, the maximum mortgage is usually limited to $2.5m, however underwriters have scope to approve larger mortgages if the circumstances allow.
- Loans carry a maximum LVR of 95% for Standard rates and 98% for the Quickstart product, based upon an independent valuation report, or an electronic valuation report.
- Lending is offered on suitable residential property of a minimum standard. Valuation data from the ValEx valuation management system supplied by RP Data (Corelogic) is used to assess acceptable security of properties. Resimac uses The Market Trends Report with enhancements when determining property price movements and future growth predictions.
- Credit checks carried out by Equifax, with Fraud and AML checks carried out by Fraudcheck and Vericheck AML systems.
- Minimum Serviceability ratio of 1.0x on stress tested interest rate (income net of living expenses/finance expenses).
- Lender Mortgage Insurance is generally required on LVRs over 80%.

Funding – Warehousing and RMBS

RMC has two main forms of funding, a short-term warehouse facility provided by a range of banks and a medium term RMBS note program. Loans are typically issued with funding provided from the warehouses and when a suitable size has been reached (or at least annually), the company will issue RMBS notes. At that point accumulated loans are transferred from the warehouse into this structure. Note that RMC doesn't have a license to accept deposits and therefore does not use deposits to fund itself.

The warehouse facilities

The warehouse facilities are provided by a range of major bank in Australia and New Zealand, with differing facilities provided across prime loans, non-conforming loans or asset finance. The warehouse facilities typically have a one-year term, meaning RMC can be expected to launch at least one RMBS facility in each class each year to empty the warehouse. We understand that the warehouse facility spreads are wider (more expensive) than those that can be achieved from the RMBS note program, giving RMC an incentive to transfer.

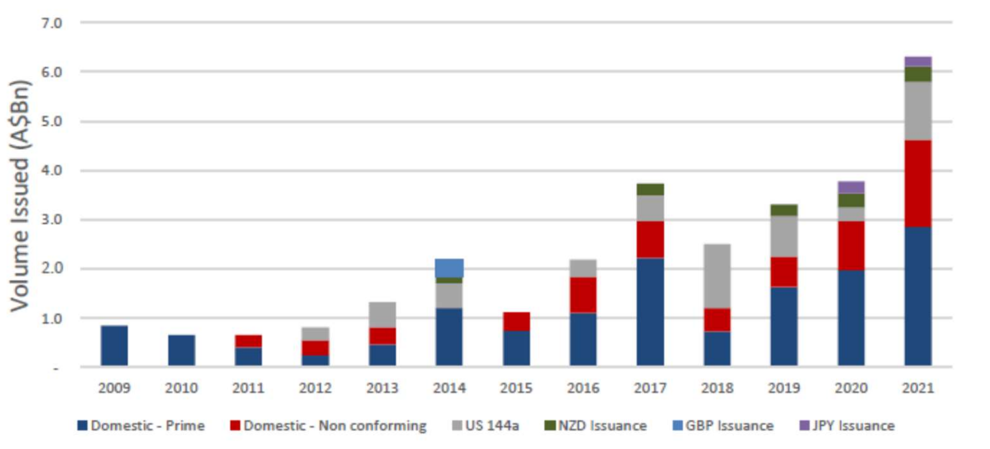
RMBS

Resimac is one of the largest issuers of RMBS in Australia, and issues at tight spreads

The company has been active in the RMBS market having issued around $41bn of notes across 63 issues since 2009. Annual calendar issuance to 2021 is shown in Figure 9. In 2021 Resimac issued three prime Australian issues totalling $3.5bn (spread across domestic prime and US144a). This made it the second largest issuer in Australia, having issued slightly less than Macquarie in 2021, but significantly more than other main issuers such as Bendigo and Adelaide, Columbus Capital and FirstMac.

These notes have varied in size but recent issues of Australian prime RMBS have been in the $0.5-1.0bn range with up to three issues per calendar year, while non-conforming has typically been $1.0-1.5bn range with fewer issues per year. NZ issuance has typically been $0.2-0.4bn annually since 2019.

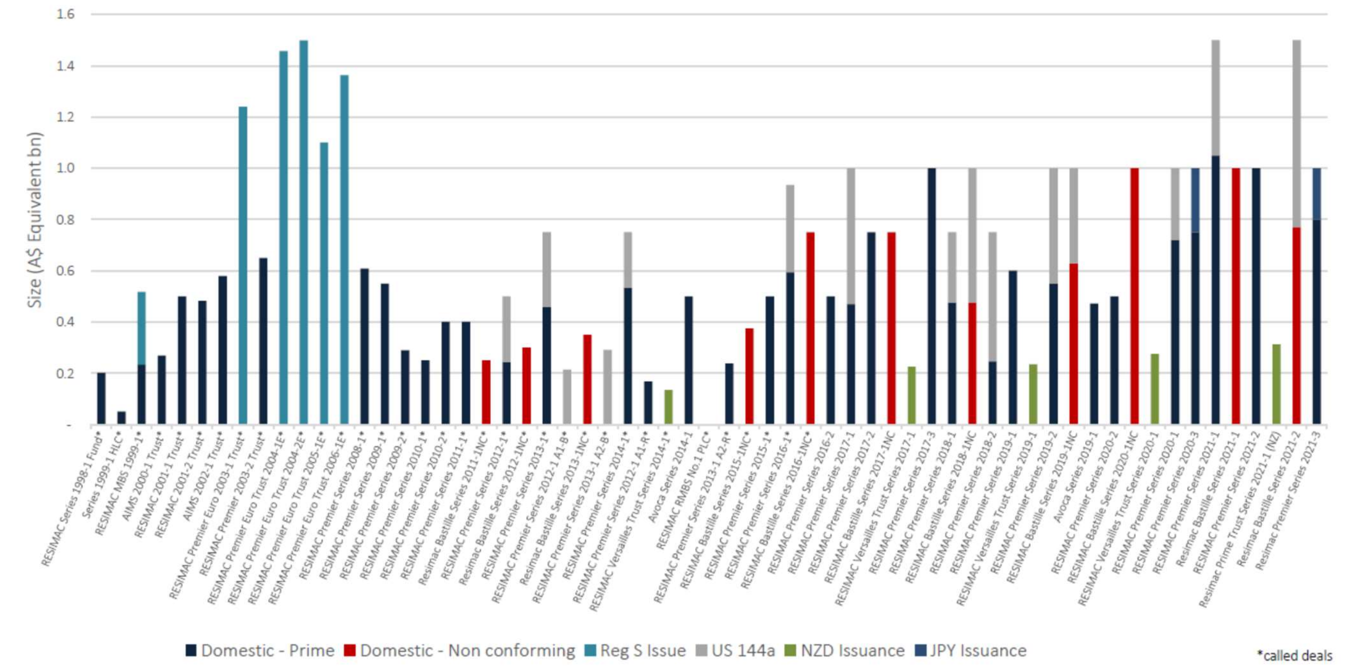
Figure 9 – RMC annual issuance of RMBS (by calendar year)



SOURCE: COMPANY DATA

After a record $6bn of issuance in calendar 2021, we understand that RMC has issued $2bn in 2022: $1bn through the Resimac Premier Series 2022-1 announced in March and $1bn Bastille trust Series 2022-1NC announced in May. We would expect further issuance through the remainder of 2022.

Figure 10 - RMC historic RMBS issuance to 1998 to 2021 (calendar year)



SOURCE: COMPANY DATA

In the chart in Figure 10 above, issuance is grouped by type of loan (conforming/non-conforming), country of origin (Australia or NZ) and by market & currency issued into Australia, NZ, US 144a/Reg-S or Japan. This results in the following types of issuance:

- Premier (Prime) - AUD/JPY/USD 144a programme
- Bastille (Non-Conforming) - AUD/JPY/USD 144a programme
- Avoca (acquired collateral e.g. RHG) - AUD
- Versailles (New Zealand) – NZD
- RESIMAC Prime Trust (Prime) - NZD

Typical RMBS structures and funding costs

We provide a brief description of the RMBS structure, as part of the equity story for equity investors, and to help understand the funding costs that we have used in our assumptions. We are not providing an investment opinion on the underlying RMBS structures and interested investors should seek specialist advice.

These note issues are typically structured into tranches between various classes (such as A1, A2, AB, B, C, D, E, F and class G notes as shown in the example in Table 3 below). These classes may offer varying currencies, degrees of credit rating, security of interest payments, credit enhancements and timing of maturity proceeds, with increasing spread/coupons to compensate for risk. In general the highest class A notes have a fairly rapid repayment profile (less than one year), while the more junior notes having a much slower repayment, in the example below these haver a weighted average life of 4.4 years.

In Table 3 below, we show the features of the Resimac Prime Trust 2022-1 series, a typical Australian prime issue. The class A2 notes represented 81% of the issue and offered a spread of 95bps over 1M BBSW rates. By contrast the lower ranking notes represented a small component of the issue but offered 200-500bps over BBSW. We calculate that the weighted average spread of the notes shown was 100.4bps, although this will increase over time as the higher rated tranches are repaid, leaving only the lower rated classes.

Resimac reduced its spreads by 20bps over 3yrs

The spreads offered on the prime notes have narrowed over time with some of the older vintages having higher spreads. For example, we calculated that Resimac Premier Series 2019-2 had a weighted average spread of 119bps (over BBSW and US$ Libor rates), so it appears that over the three years RMC has achieved a roughly 20bps improvement in spread costs.

These issues might have different structures offering notes in a range of currencies including US$, GBP, NZ$ and YEN, and offering spreads over USD Libor, GBP LIBOR, NZ BKBM, SOFR as well as fixed rates.

Table 3 - Resimac 2022-1 RMBS spread structure (Australian Prime mortgages- All AUD$)

Tranche/Class	Rating (S&P/Fitch)	Spread vs BBSW 1M (bps)	Size (A$m)	Expected life (years)
A1	AAA(sf)/AAAsf	55	90	0.5
A2	AAA(sf)/AAAsf	95	810	2.9
AB	AAA(sf)/NR	150	50	4.4
B	AA(sf)/NR	175	17	4.4
C	A(sf)/NR	225	21	4.4
D	BBB(sf)/NR	280	6	4.4
E	BB(sf)/NR	450	3	4.4
F	B(sf)/NR	ND	1.5	4.4
G	NR/NR	ND	1.5	4.4

SOURCE: COMPANY DATA, BLOOMBERG

Other issues typically offer higher spreads, such as the New Zealand (Versailles) notes and non-conforming (Bastille) notes. The A2 tranches may yield an additional 40-60bps compared to the prime issues.

Spreads are wider on the non-conforming issues

In Table 4 below, we show the spreads on the May 2022, $1bn Bastille trust 2022-1NC note covering non-conforming loans. The spreads on this issue were higher than the prime issue. The A3 A$ tranches had a 45bps higher spread at 140bps spread compared to 95bps spread on the A2 notes of the prime 2022-1 issue. The AB issue has a 40bps higher spread at 190bps, compared to 150bps on the prime issue. The weighted average spread on this issue was 146bps.

Table 4 - Resimac 2022-1NC RMBS spread structure (Australian Prime mortgages AUD$ except A2)

Tranche/Class	Rating (S&P/Fitch)	Spread vs BBSW 1M (bps)	Size (A$m)	Expected life (years)
A1	AAA(sf)/AAAsf	80	105.0	0.6
A2 – USD	AAA(sf)/AAAsf	SOFR + 120	215.0	1.9
A3	AAA(sf)/AAAsf	140	354.0	3.0
A3-SB	AAA(sf)/AAAsf	140	35.0	3.0
AB	AAA(sf)/AAAsf	190	93.0	4.1
B	AA(sf)/NR	240	66.1	4.1
C	A(sf)/NR	260	17.0	4.1
D	BBB(sf)/NR	300	10.7	4.1
E	BB(sf)/NR	500	6.6	3.5
F	B(sf)/NR	700	3.6	0.7
G	NR/NR	ND	3.0	4.1

SOURCE: COMPANY DATA, BLOOMBERG

The $35m A3-SB tranche was a social bond, with the proceeds used to fund first time buyers with high LVR.

The A2 tranche was US$215m, priced at 120bps over SOFR, while the other tranches were priced in AUD.

Forecasts and assumptions

Key assumptions

Table 5 summarises the key assumptions made in our model. We identify two key assumptions being the net interest margin, and charge for bad and doubtful debts (both shaded in the table) as ones that materially change the profit forecast and valuation. As such we show different scenarios for these assumptions in our valuation and investigate levels that would justify the current share price.

Table 5 - Key modelling assumptions

Year end June 30	2020a	2021a	2022e	2023e	2024e	2025e
BBSW rate 1M (end)	0.10%	0.03%	1.80%	2.30%	2.50%	2.50%
BBSW rate 1M (yr avg)	0.73%	0.06%	0.30%	2.00%	2.25%	2.50%
Interest rate on assets						
Residential & personal	3.63%	3.33%	3.27%	4.90%	5.15%	5.40%
Spread vs BBSW	2.90%	3.27%	3.15%	2.90%	2.90%	2.90%
Interest rate on liabilities						
RMBS rate on liabilities	2.09%	1.55%	1.52%	3.25%	3.50%	3.75%
spread vs BBSW	1.36%	1.49%	1.40%	1.25%	1.25%	1.25%
Net interest margin	1.90%	2.07%	1.85%	1.69%	1.70%	1.71%
Loan growth (net)	21.1%	11.3%	12.0%	7.0%	7.0%	7.0%
Bad & Doubtful Debt (BDD) Charge ($m)	22.01	2.68	4.41	5.29	37.59	6.01
BDD as a % Gross Loans Assets (GLA)	0.17%	0.02%	0.03%	0.03%	0.20%	0.03%
Cost growth						
IT	100.35%	62.60%	12.0%	10.0%	8.0%	8.0%
Personal	-4.71%	4.47%	7.0%	6.0%	6.0%	6.0%
Other costs	-13.89%	4.66%	5.0%	4.0%	4.0%	4.0%
Overall cost growth	0.61%	13.55%	11.02%	6.44%	6.17%	6.20%
Cost/income ratio	37.8%	31.4%	34.6%	37.5%	37.2%	36.9%

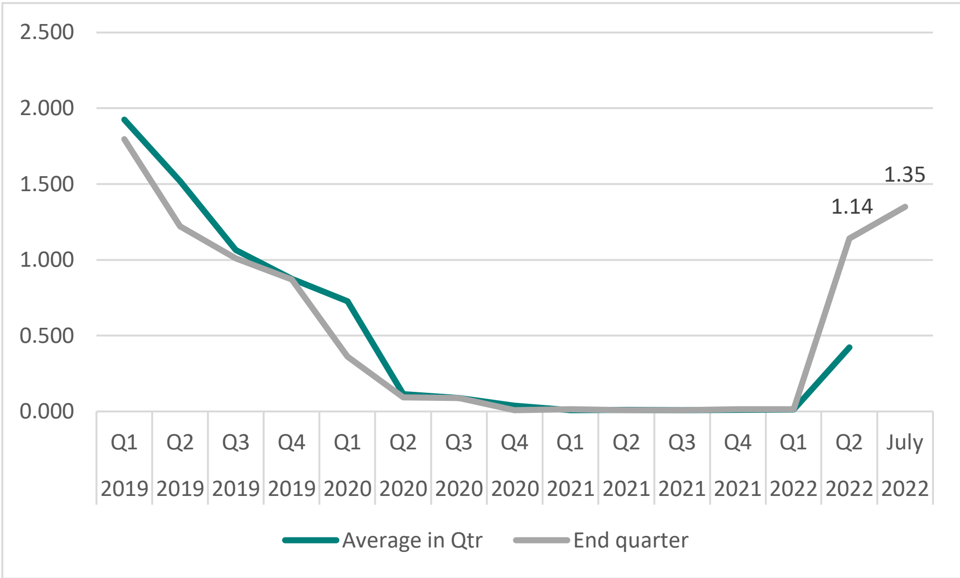
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

BBSW rates

The chart in Figure 11 below, shows the development of 1M BBSW rates, which are relevant to both the funding cost and the rate charged on the mortgage assets. At time of writing (July 2022), 1M BBSW rates were 1.34%, and in-line with the RBA Cash Rate of 1.35%. We implicitly assume that 1M BBSW rates closely track the RBA Cash Rate. We assume this rate will rise to 2.3% by end 2023 and 2.5% at end 2024.

As most of the assets and liabilities are both priced off spreads above 1M BBSW or the RBA Cash Rate, our model is not that sensitive to the actual rate, although there are real world effects on house prices, interest costs for consumers and ultimately bad debt charges. As a secondary point, there are timing differences between rates being set and the rate paid by customers, which will impact the precise level of our forecasts, but not the general direction.

Figure 11 - BBSW 1M rates at end of quarter and average over quarter (%)



SOURCE: BLOOMBERG AND BELL POTTER SECURITIES ESTIMATES

Funding Spreads

We have assumed that funding spreads settle at about 125bps over 1m BBSW, and this ties in with our analysis of prime and non-conforming issues having a average spread of between 100bps to 150bps. We expect the average spread to come down as older vintages with higher spreads mature and are replaced with newer vintages with lower spreads.

Residential mortgages spreads

This is a key assumption and we feel we have set this conservatively. We assume the spreads on residential mortgages reduce in coming years, as we expect borrowers, and their brokers will be keen to seek out better rates in the face of rising interest rates. Competition in the market will force mortgage providers to lower rates in order to encourage re-mortgaging and avoid excessive losses of market share.

We note that the company earned 2.90% over BBSW in 2020, 3.27% in 2021 and we expect 3.15% in 2022, falling to 2.9% in future years. We believe this is a relatively cautious assumption.

The company may seek to maintain spreads by switching to a higher proportion of non-conforming mortgages, however as we enter a more difficult period this carries its own set of risks.

Net interest margin

The net interest is derived from the model, however we note the figures are close to the difference between mortgage spread and the funding spread.

We expect the NIM to decline from 207bps in 2021 to 169bps in 2023, as a combination of declining spreads on mortgages set against relatively stable funding costs. We do not expect NIM to fall back to the 148bps level that was being earned in 2019.

Bad and doubtful debt charges

This is a key assumption in our model. We showed the charges taken by the company in Figures 7 and 8, and the loans past due experience in Table 1. We are not modelling provisions in our model and instead assume that this cost reflects losses that are written off straight away.

We have set the 2024 assumption at a pessimistic level, implying a higher level of losses, and we expect the actual outcome to be considerably lower than this. The level of this charge at 20bps in 2024, is a similar level to the general provision taken by the company in response to Covid-19 (16bps). This was by itself a large provision and has not subsequently been utilised. We vary this charge in scenarios (Figure 14 and 15 below) to determine how our valuation would vary by changing this assumption.

Despite making this pessimistic assumption, our DCF valuation is still considerably higher than the current share price.

Net loan growth

We assume the loan book grows at 12% in 2022 falling to 7.0% in 2023 onwards, which is slower than it grew in 2020 and 2021.

Cost growth

In 2022 we assume cost growth of 12% for IT projects, 7% for personal and 5.0% for all other costs, giving a blended cost growth of 11.0% (as H1 2022 costs are actuals meaning a minimum level of cost growth is already baked in).

We assume that as the market slows in 2023 and 2024, the company will restrain cost growth, to 10% in 2023 for IT, falling to 8% in 2024 and beyond. We assume personal and other costs will grow at 6% and 4% respectively. This gives a blended cost growth of 6.4-6.2% for 2023-25. This is close to the personal cost growth which is just over half of total costs. The cost/income ratio in Table 5 above, is an output of the model.

Forecasts

Based on our assumptions above, our forecasts for the P&L are shown in the table in Figure 12.

Figure 12 – Forecasts

INCOME STATEMENT											
Y/e June 30 ($m)	**2019a**	**2020a**	**1H21a**	**2H21a**	**2021a**	**1H22a**	**2H22e**	**2022e**	**2023e**	**2024e**	**2025e**
Net Interest Margin (NIM)	117.9	188.6	122.1	120.7	242.7	124.3	122.5	246.8	245.0	263.1	282.6
Net commission and fee revenue	-12.5	-24.7	-12.9	-12.4	-25.3	-14.7	-13.4	-28.1	-30.4	-32.9	-35.5
Other revenue	4.5	0.7	1.7	6.3	8.0	6.6	1.2	7.8	7.9	7.9	8.0
Total revenue	**128.7**	**164.5**	**110.9**	**114.5**	**225.4**	**116.2**	**110.2**	**226.5**	**222.5**	**238.2**	**255.1**
Operating expenses (inc D&A)	61.9	62.2	34.5	36.2	70.7	38.8	39.6	78.5	83.5	88.7	94.2
Impairment expenses	3.0	22.0	3.7	-1.0	2.7	1.9	2.5	4.4	5.3	37.6	6.0
Earnings Before Tax (EBT)	**63.9**	**80.3**	**72.7**	**79.3**	**152.1**	**75.6**	**68.0**	**143.6**	**133.7**	**111.9**	**155.0**
Tax	16.8	24.3	22.0	22.2	44.3	21.2	19.1	40.2	37.4	31.3	43.4
Adjusted profit (NPAT)	**47.1**	**56.0**	**50.7**	**57.1**	**107.8**	**54.4**	**49.0**	**103.4**	**96.2**	**80.6**	**111.6**
One-off items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported net profit (NPAT)	**47.1**	**56.0**	**50.7**	**57.1**	**107.8**	**54.4**	**49.0**	**103.4**	**96.2**	**80.6**	**111.6**

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Valuation

Profit as a proxy for cash

We generally use cash flow to value companies, but for banks and other lenders, this is difficult because capital cashflows are mixed with operational cashflows. It is not easily possible to differentiate capital cashflows (related to operational borrowing and lending) from operating or shareholder cashflows (such as interest payments, expenses and shareholder dividends). As such, a successful growing bank/lender would probably be overall cashflow negative as it lends to borrowers, while a declining bank should be cashflow positive.

Therefore, net profit – being shareholder cashflows relating to interest income, fees and commissions, net of costs, is probably the closest proxy to sustainable cashflow, and ties closely to the ability to pay dividends.

Net profit is not a perfect measure of cashflow and includes the depreciation and amortisation charges found in industrial companies. In addition, charging and releasing provisions for bad debts is not a cash flow and may be unrelated to the ultimate losses or recoveries sustained on these loans.

DCF/ NPV of profit

We value RMC using NPV/DCF valuation, with a WACC of 12.2% applied to profit after tax, as a proxy for cash flow.

A summary of our valuation is shown in Figure 13 below. We use our explicit forecasts for the next 4 years and then project forward using the long-term real growth rate of 1%.

We value the next 10 years Net profit after tax at $594m. We value the terminal value at $984m assuming no long-term growth, which discounted to present value terms, gives a present value of $279m. This gives a total NPV of $873m, or $2.13 per share and we round this up to $2.15 as a target price.

Figure 13 - DCF valuation

WACC Calculation / key assumptions	
Risk free rate	**5.0%**
Market risk premium	**5.5%**
ß = beta	**1.30**
Tax rate	**30.0%**
Cost of equity	
WACC / Discount rate	**12.2%**
Inflation	**1.0%**
Nominal growth rate	**0.0%**
Long-term real growth rate	**1.0%**

($m)	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e	Beyond
EBT	144	134	112	155							
Tax paid	-40	-37	-31	-43							
SIB capex	0	0	0	0							
Total Profit as proxy for Cashflow	**103**	**96**	**81**	**112**	**113**	**114**	**115**	**116**	**117**	**118**	**984**
	92	**77**	**57**	**71**	**64**	**57**	**52**	**46**	**42**	**38**	**279**

Total NPV	**873**
Shares on issue	409
Value per share (AUD 000's)	**2.13**

SOURCE: BELL POTTER SECURITIES ESTIMATES

Valuation Sensitivity

We show our valuation relative to some alternative assumptions in the following tables.

In Figure 14 we show the sensitivity of our valuation to changes to changes in the key assumptions of spread earned on the assets in 2023 through to 2025, against the bad debt charge in 2024. Our base case valuation is highlighted in red. Figure 15 shows the percentage change from our base case.

We discussed the interest rate spread above earned on assets and noted that the company earned 2.90% in 2020, 3.27% in 2021 and as a central case we expect 2.90% in 2022, however we believe this is a relatively cautious assumption.

We showed above that the company took a total bad debt charge of 17bps or $22m in 2020 (of which $16m was a general provision for Covid-19) and this was considered a high charge and the provision hasn't subsequently been utilised.

To get a valuation close to the current share price implies a scenario that we regard as both extreme and unlikely

Note that we are applying a simple methodology, applying this bad debt as a simple charge to the P&L (rather than as a provision), to estimate what degree of pessimism being discounted by the market. We are not going through the full process of modelling the loan book for increases past due loans, the loss of interest income, assuming a percentage of the book go through to repossession, and then sold at a reduced LVR, with recovery of losses through LMI. We believe that to get a 1% write-off would require significant stress in the economy and housing market, which we regard as both as an extreme and unlikely scenario.

We note from these tables that in order to get close to the current share price (circled in the table) we have to assume that spreads on assets would decline to 2.65-2.75% with the bad debt charge rising to 2-3% in 2024 or spreads would decline to our 2.90% forecast with bad debt charges rising to around 4% of the loan book.

We regard neither of these scenarios as at all likely and feel that the current share price is discounting far too much bad news.

Figure 14 - Valuation sensitivity to 2024 bad debt charges (rows) & interest margin in 2023 through 2025 (columns)

	2.65%	2.75%	2.90%	3.00%	3.15%
0.03%	1.59	1.82	2.17	2.41	2.75
0.20%	1.55	1.78	2.13	2.37	2.71
1.00%	1.36	1.60	1.95	2.18	2.53
2.00%	1.13	1.36	1.71	1.94	2.29
3.00%	0.90	1.13	1.48	1.71	2.06
4.00%	0.66	0.89	1.24	1.48	1.82

SOURCE: BELL POTTER SECURITIES

Figure 15 – As previous, % change from base

	2.65%	2.75%	2.90%	3.00%	3.15%
0.03%	- 0.25	-14%	2%	13%	29%
0.20%	-27%	-16%	0%	11%	27%
1.00%	-36%	-25%	-9%	2%	18%
2.00%	-47%	-36%	-20%	-9%	7%
3.00%	-58%	-47%	-31%	-20%	-4%
4.00%	-69%	-58%	-42%	-31%	-15%

SOURCE: BELL POTTER SECURITIES

In Figure 16 we show the sensitivity to our valuation to changing the discount rate and long-term nominal growth assumption. The base case is a 12.2% discount rate and a long-term growth rate of 0% and is highlighted in red. In Figure 17 we show our sensitivity as a percentage change from our base case assumptions.

Figure 16 - Valuation sensitivity to LT nominal growth (rows) and Discount rate (columns)

	10.2%	11.2%	12.2%	13.2%	14.2%
-1.0%	2.40	2.19	2.02	1.87	1.74
0.0%	2.58	2.34	2.13	1.96	1.82
1.0%	2.79	2.51	2.27	2.08	1.91
2.0%	3.06	2.71	2.44	2.21	2.02

SOURCE: BELL POTTER SECURITIES

Figure 17 - As previous, % change from base

	10.2%	11.2%	12.2%	13.2%	14.2%
-1.0%	12.6%	2.8%	-5.5%	-12.6%	-18.7%
0.0%	20.9%	9.5%	0.0%	-8.0%	-14.8%
1.0%	31.0%	17.5%	6.5%	-2.7%	-10.4%
2.0%	43.5%	27.2%	14.2%	3.6%	-5.2%

SOURCE: BELL POTTER SECURITIES

Note that we regard a 12.2% discount rate and a 0% long term growth (implying a lack of inflation) as conservative. In other companies we have valued recently we have used a discount rate closer to 10%. 1% seems low compared to current inflation expectations.

Relative valuations

In Figure 18 below, we compare the valuation of RMC against similar Australian banks and lenders. We use our own forecasts for RMC and the Bloomberg Best Estimate of consensus for the others. The multiples in the table have not been adjusted to normalise the different year ends.

We note that at 4.8 times 2022 earnings RMC is one of the lowest multiples across the quoted lenders.

Figure 18 - Australian banks and lenders – relative valuations

Australian Banks & Lenders	BP Rec	BP target price (AUD)	Year end	Close Price in Local	Shr Price Ccy	Market Cap (AUD Bn)	PE Forecast (X)	PE Next year (X)	P/BK forecast (X)	P/BK next year (X)	Dividend Yield Forecast (%)	Dividend Yield Next year (%)
Banks												
AUST AND NZ BANKING GROUP			Sep	22.80	AUD	63.90	10.85	10.27	1.01	0.98	6.35	6.67
NATIONAL AUSTRALIA BANK LTD			Sep	28.15	AUD	89.79	13.32	12.21	1.47	1.42	5.29	5.72
COMMONWEALTH BANK OF AUSTRAL			Jun	93.08	AUD	158.38	17.31	16.94	2.10	2.04	4.12	4.38
WESTPAC BANKING CORP			Sep	20.00	AUD	70.02	13.08	10.69	0.98	0.97	6.14	6.60
BENDIGO AND ADELAIDE BANK			Jun	9.37	AUD	5.29	11.09	11.26	0.78	0.76	5.66	6.01
BANK OF QUEENSLAND LTD			Aug	6.93	AUD	4.49	9.28	9.39	0.71	0.69	6.62	7.07
MACQUARIE GROUP LTD			Mar	170.65	AUD	65.95	15.90	15.16	2.15	2.01	3.75	3.83
Lenders												
RESIMAC GROUP LTD	Buy	2.15	Jun	1.21	AUD	0.49	4.78	5.15	1.24	1.08	5.79	6.61
MONEY3 CORP LTD			Jun	2.01	AUD	0.43	8.34	7.28	0.00	0.00	6.47	7.41
PROSPA GROUP LTD			Jun	0.78	AUD	0.13	17.73	16.96	1.91	1.82	0.00	0.00
JUDO CAPITAL HOLDINGS LTD			Jun	1.32	AUD	1.46	146.67	24.00	1.04	0.98	0.00	0.00
PEPPER MONEY LTD/AU			Dec	1.34	AUD	0.59	4.05	4.21	0.80	0.71	9.25	8.81
MONEYME LTD			Jun	0.65	AUD	0.15	-17.92	9.77	7.50	1.64	0.00	0.00
Weighted Average							15.00	13.73	54.73	0.46	4.68	4.95

SOURCE: BLOOMBERG & BELL POTTER SECURITIES ESTIMATES (CLOSING PRICES AT 7 JULY)

Resimac Group (RMC) Overview

Company description

The Group is a residential mortgage and asset finance lending business, distributing Prime and Specialist products across multiple channels. The Group operates in Australia and New Zealand, originating a high-quality loan portfolio, loan servicing capability, and global funding program. The Group's core capabilities include:

- **Product manufacturing**: The Group applies its detailed knowledge of the Australian and New Zealand markets to offer products to address demand, with attractive risk and return profiles
- **Distribution**: Distributing loans in Australia and New Zealand through relationships with accredited brokers, wholesale partners and a direct-to-consumer channel;
- **Treasury and funding expertise**: Strong long-term relationships with global funding partners, the Group is an experienced issuer in the global and domestic term securitisation markets; and
- **Risk management**: Operating a holistic enterprise risk management and governance framework utilising the three lines of defence model.

Source https://resimac.com.au/about-us/about-resimac

Investment thesis, Buy, Target Price $2.15/sh

We see the investment case as:

Resimac sits at an attractive size, being neither so small it is unprofitable, nor so large that that it struggling to gain market share. It has grown its market share from 0.6% in 2019 to 0.7% today, this small increase has resulted in a 44% increase in balance sheet assets and a 179% increase in profitability.

The track record is further illustrated by the growth in settlements from $2.0bn in H1 2019 to $3.5bn in H1 2022, a growth of 75% (CAGR of 20.5%). Over a four year period to FY 21, Net interest income reached $242.7m - a 4 year CAGR of 33% and NPAT reached $104.0m in FY21, a 4year CAGR of 58%.

But there are risks. The Australian property market has shown strong price appreciation, but interest rates are now starting to rise. This is likely to lead to lower property values and increasing cost of servicing mortgage debt, which should lead to higher defaults. Set against this unemployment remains very low at just 4% and there are structural labour shortages.

While this does raise the prospect of an increase in defaults and bad debts, we estimate that to justify the current share price, our analysis suggests the company would have to write-off around 3% of mortgage assets, or $560m. To put this in context when Covid-19 struck and 10% of the book were on hardship payment moratoriums, it took a provision of just $16m.

We note that there is a lack of liquidity in the shares, with an average daily trade of just $0.5m. We note that Somers, an investment company owns 62% of the shares, which effectively reduces the liquidity in the shares.

Valuation

We value Resimac using NPV/DCF valuation, with a WACC of 12.2% applied to profit after tax, as a proxy for cash flow.

We use our explicit forecasts for the next 4 years and then project forward using the long-term real growth rate of 1%.

We value the next 10 years Net profit after tax at $594m. We value the terminal value at $984m assuming no long term growth, which discounted to present value terms, gives a present value of $279m. This gives a total NPV of $873m, or $2.13 per share.

Risks

The following are taken directly from the 2021 company report and accounts:

Funding risk: The funding platform currently comprises a mix of warehouse facilities, term securitisations and corporate debt. The Group depends on these sources to fund mortgage originations;

Capital and liquidity requirements: The Group is required to maintain sufficient liquidity levels under Australian Financial Services Licence requirements;

A risk exists that the Group could be required to contribute additional 'first loss' equity capital to support the credit position of senior ranking note holders in the warehouse facilities and term securitisations which could impact the Group's profitability, ability to grow and/or could force it to raise additional capital.

Regulatory and licence compliance: The Group is subject to extensive regulation in each of the jurisdictions in which it conducts business. The Group holds eight Australian Credit Licences. Changes in laws or regulations in a market in which the Group operates could impact the business. The Group is licensed and/or registered to operate a number of its services across a range of jurisdictions. Changes to these licensing regimes, the revocation of existing licences, an inability to renew or receive necessary licences or a change in capital requirements could have a material adverse effect on the Group's business, operating and financial performance;

Macroeconomic environment: A material downturn or increase in unemployment, decreases in house prices, higher interest rates, general reduction in demand for credit and/or a reduction in borrowers' ability to service their debt (credit risk); and

Covid-19: The Group will continue to monitor the effects of Covid-19 on business performance and take action as required. Covid-19 enforced lockdowns and border closures continue to provide macroeconomic headwinds to the economy, with pockets of financial stress evident. The Group's diversified portfolio and conservative credit policies is assisting the Group to manage Covid-19 headwinds.

(Source: company 2021 report and accounts page 16)

We highlight the following risks:

Operational risk: RMC relies on staff and other third parties (including data and IT suppliers) to originate and service loans.

Distribution: RMC relies on third parties to distribute its loans. Its ability to distribute through the broker channel in particular, depends upon maintaining a competitively priced mortgage offering that pays a current rate of commission to the broker. As such RMC could be susceptible to competitors willing to undercut in pricing or overpay commission as a means to gain market share.

Resimac Group
as at 8 July 2022

Recommendation	Buy
Price	$1.19
Target (12 months)	$2.15

Table 6 - Financial summary

Resimac Group (RMC)	Price Target (A$)	2.15	Share Price (A$)	1.19
	Recommendation:	BUY	Market Cap (A$m)	484.9

INCOME STATEMENT

Y/e June 30 ($m)	2020a	2021a	2022e	2023e	2024e
Net Interest Margin (NIM)	188.6	242.7	246.8	245.0	263.1
Other revenue	0.7	8.0	7.8	7.9	7.9
Total revenue	**164.5**	**225.4**	**226.5**	**222.5**	**238.2**
Operating expenses (inc D&A)	62.2	70.7	78.5	83.5	88.7
Impairment expenses	22.0	2.7	4.4	5.3	37.6
Earnings Before Tax (EBT)	**80.3**	**152.1**	**143.6**	**133.7**	**111.9**
Tax	24.3	44.3	40.2	37.4	31.3
Underlying profit (NPAT)	**56.0**	**107.8**	**103.4**	**96.2**	**80.6**
One-off / abnormal items	0.0	0.0	0.0	0.0	0.0
Reported net profit (NPAT)	**56.0**	**107.8**	**103.4**	**96.2**	**80.6**
Amortisation expense	0.0	0.0	0.0	0.0	0.0
Underlying Cash NPAT	**56.0**	**107.8**	**103.4**	**96.2**	**80.6**

OPERATING CASHFLOW

Y/e June 30 ($m)	2020a	2021a	2022e	2023e	2024e
EBT	80	152	144	134	112
Tax paid	-24	-44	-40	-37	-31
Other	0	0	0	0	0
Operating cashflow	**56**	**108**	**103**	**96**	**81**
SIB capex	0	0	0	0	0
Maintainable cashflow	**56**	**108**	**103**	**96**	**81**
Dividends paid	-11	-17	-29	-33	-29
Free cashflow	**45**	**91**	**75**	**63**	**52**

BALANCE SHEET

Y/e June 30 ($m)	2020a	2021a	2022e	2023e	2024e
Cash and Liquids	366	620	964	964	964
Gross Loans	12,543	13,963	15,839	16,945	18,131
Provisions	-37	-38	-43	-46	-49
Other IEA	0	0	0	0	0
Intangibles	29	28	28	28	28
PP&E	2	2	0	0	0
Other assets	124	70	80	75	71
Total assets	**13,027**	**14,645**	**16,868**	**17,966**	**19,145**
Deposits	0	0	0	0	0
Other borrowings	12,686	14,171	16,377	17,414	18,541
Other liabilities	99	153	90	89	88
Total liabilities	**12,785**	**14,324**	**16,467**	**17,502**	**18,629**
Share capital	120	120	122	122	122
Retained earnings	129	219	294	357	409
Reserves	-8	-18	-15	-15	-15
Total shareholders' equity	**242**	**321**	**400**	**464**	**516**
W/A shares on issue (m)	**406.5**	**407.8**	**408.8**	**409.8**	**410.7**

VALUATION DATA

Y/e June 30 ($m)	2020a	2021a	2022e	2023e	2024e
Adj (underlying) NPAT ($m)	56.0	107.8	103.4	96.2	80.6
Underlying EPS (c)	13.8	26.4	25.3	23.5	19.6
Underlying EPS growth (%)	*17.4%*	*91.9%*	*-4.3%*	*-7.1%*	*-16.5%*
Underlying P/E ratio (x)	**8.6**	**4.5**	**4.7**	**5.1**	**6.1**
Price/book (x)	2.0	1.5	1.2	1.1	0.9
Price/NTA (x)	2.3	1.7	1.3	1.1	1.0
NTA/share ($)	0.52	0.72	0.91	1.06	1.19
Book value/share ($)	0.59	0.79	0.98	1.13	1.25
DPS (c)	3.0	6.4	7.0	8.0	7.0
Yield (%)	**5.0%**	**10.8%**	**11.8%**	**13.4%**	**11.8%**
Franking (%)	100%	100%	100%	100%	100%
Payout ratio adj cash basis (%)	22%	24%	28%	34%	36%
Payout ratio reported basis (%)	22%	24%	28%	34%	36%
Effective tax rate (%)	30%	29%	28%	28%	28%

PROFITABILITY RATIOS

Y/e June 30 ($m)	2020a	2021a	2022e	2023e	2024e
Return on assets (%)	0.5%	0.8%	0.6%	0.5%	0.4%
Return on equity (%)	**25.6%**	**38.3%**	**28.7%**	**22.3%**	**16.5%**
Leverage (x)	55.7	49.7	44.6	40.6	38.2
Net Interest Margin (NIM) %	**1.90%**	**2.07%**	**1.85%**	**1.69%**	**1.70%**
Cost/Income ratio (%)	37.8%	31.4%	34.6%	37.5%	37.2%
Cost/Avg assets (%)	0.51%	0.51%	0.49%	0.48%	0.47%
Growth in revenue (%)	27.9%	37.0%	0.5%	-1.8%	7.1%
Growth in expenses (%)	0.6%	13.5%	11.0%	6.4%	6.2%
Jaws (%)	27.2%	23.5%	-10.6%	-8.2%	0.9%

ASSET QUALITY

Y/e June 30 ($m)	2020a	2021a	2022e	2023e	2024e
impairment expense / GLA (%)	0.17%	0.02%	0.03%	0.03%	0.20%
impairment expense ($m)	22.0	2.7	4.4	5.3	37.6
Total provisions + GRCL ($m)	36.7	37.6	42.6	45.6	48.8
Total provisions + GRCL / GLA	0.29%	0.27%	0.27%	0.27%	0.27%
Deposits as % of GLA	0%	0%	0%	0%	0%

KEY ASSUMPTIONS

Y/e June 30	2020a	2021a	2022e	2023e	2024e
BBSW rate 1M (end)	0.10%	0.03%	1.14%	2.30%	2.50%
BBSW rate 1M (yr avg)	0.73%	0.06%	0.12%	2.00%	2.25%
Average loan rate	3.63%	3.33%	3.27%	4.90%	5.15%
Spread vs BBSW 1M	2.90%	3.27%	3.15%	2.90%	2.90%
RMBS rate on liabilities	2.09%	1.55%	1.52%	3.25%	3.50%
Spread vs BBSW 1M	1.36%	1.49%	1.40%	1.25%	1.25%

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.

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