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Macquarie Group Capital Notes 2 (MQGPB)



Issue overview

Issuer	Macquarie
Issue ASX code	MQGPB
Face value	\$100
Estimated offer size	\$400m
Bookbuild margin range	5.15-5.35%
Initial franking	40%
Interest payments	Half Yearly
First dividend payment	17 Mar 2016
Minimum application	\$5,000
First optional exchange	17 Mar 2021
Mandatory exchange	18 Mar 2024

Timeline

Lodgement of prospectus	23 Nov 2015
Bookbuild margin	27 Nov 2015
Announcement of margin	27 Nov 2015
Offer opens	1 Dec 2015
Offer closes:	
Securityholder & general	15 Dec 2015
Broker firm	17 Dec 2015
Issue date	18 Dec 2015
ASX listing (deferred settlement)	21 Dec 2015

Additional Disclosure: Bell Potter Securities Limited is acting as Co-manager to the MQGPB issue and will receive fees for this service.

This report is to be read in conjunction with the MQGPB prospectus.

Setting a new benchmark

The new \$400m Macquarie Group Capital Notes 2 (MQGPB) provides investors an opportunity to invest in a Basel III compliant Additional Tier 1 capital convertible, subordinated and unsecured securities of a top 10 ASX listed company. MQGPB's security structure is similar to the Macquarie Group Capital Notes (MQGPA) which contain a Non-Viability Trigger Event, but no Capital Trigger. While MQGPB is perpetual, the security structure provides for Optional Exchange at the first year 5 call date (Mar 2021), and Mandatory Exchange at year 8 (Mar 2024) provided the Mandatory Exchange Conditions on the Macquarie Group share price are satisfied.

Record high 5.15-5.35% bookbuild margin

Investor sentiment in the ASX listed hybrid market has been tested with the last 8 bank / financial hybrids failing to list at a premium. A key factor has been the impact of the capital call of ~\$40bn over 2015, spanning IPOs, hybrid issues and bank rights issues. This capital call has contributed to adverse movements in prevailing ASX listed hybrid margins from new issue launch to listing. Against this backdrop, pricing on the MQGPB issue provides investors:

- **Record high 5.15-5.35% bookbuild margin:** Exceeds the 5.10% issue margin set on BOQPD and AMPPA.
- **Fairly priced relative to the secondary market:** A 5.15% issue margin is consistent with current pricing in MBLPA (5.18% trading margin at \$94.20) and MQGPA (5.04% trading margin at \$100.50). It also offers an adequate spread of 0.36% above the current 4.79% average trading margin on the index of 11 financial prefs issued by BEN, BOQ, CGF, MQG, IAG, and SUN. Over recent years it has been common to see some weakness in hybrid securities over the offer period as investors seek funding to participate in new issues.
- **Partial franking boosts cash income:** Reducing franking from 100% to 40% boosts cash income per security from \$5.25 to \$6.40 (assuming issue margin set at 5.15% above the current 6 month bank bill of 2.35%). As international income represented 71% of 1H16 total income for Macquarie Group (MQG), ongoing dividends should remain partially franked. MQGPB distributions are at MQG's absolute discretion and may not be paid.

Figure 1: Trading margins on debt and equity securities

Ranking	Security	Trading Margin over BBSW	Maturity / Mand Conv	First Call	
Higher Ranking	Senior debt	Macquarie Bank (OTC)	118bp	Mar 2020	
		Suncorp (OTC)	125bp	Oct 2020	
	Subordinated debt	SUNPD	295bp	Nov 2023	Nov 2018 [#]
	Preference securities	MQGPA (Additional Tier 1)	504bp	Jun 2021 [*]	Jun 2018 [#]
		MBLPA (Additional Tier 1)	518bp	Mar 2023 [*]	Mar 2020 [#]
		MBLPB (Additional Tier 1)	515-535bp	Mar 2024[*]	Mar 2021[#]
Lower Ranking	Equity	Ordinary MQG Shares	~400bp	Perpetual	

[#] WHERE NOT CONVERTED OR WRITTEN-OFF ON ACCOUNT OF A NON-VIABILITY TRIGGER EVENT. SOURCE: YIELDBROKER, BELL POTTER
^{*} MANDATORY CONVERSION IS SUBJECT TO SATISFYING THE MANDATORY CONVERSION CONDITIONS

- **Initial grossed up running yield of 7.50% (6.40% cash yield franked at 40%):** Floating rate based on 6 month bank bill of 2.35% + bookbuild margin of 5.15%.
- **Issuer option to exchange at year 5, mandatory exchange year 8:** MQG has the option to redeem or convert at the 17 Mar 2021, 17 Sep 2021 and 17 Mar 2022 Optional Exchange Dates, subject to APRA approval and MQG being solvent, and a Non-Viability Trigger Event not having occurred.
- **Ordinary dividend restrictions:** Applies on the non payment of MQGPB dividends

Macquarie Group Capital Notes 2

Macquarie Group Overview

With a history dating back to 1969, the Macquarie Group (MQG) provides banking, financial, advisory, investment and funds management services. At 30 Sep 2015, MQG employed over 13,500 staff and had total assets of \$209bn. MQG is currently the tenth largest ASX listed company by market capitalisation, with 1H16 net profit (half year ending Sep 2015) up 58% to \$1,070m.

MQG was formed as a result of a corporate restructure, comprising a Bank Group and a Non-Bank Group. The Bank Group has five operating groups:

- **Corporate & Asset Finance:** Corporate debt and asset financing across aircraft, motor vehicles, technology, healthcare, manufacturing, industrial, energy, rail and mining equipment. 1H16 net profit before corporate overhead up 31% to \$826m, with its asset finance and corporate lending portfolio increasing 17% to \$32.3bn.
- **Banking & Financial Services:** Provides personal and business banking, and wealth management products and services to 1.1m Australian clients. 1H16 net profit before corporate overhead up 21% to \$170m, driven by a 39% increase in the mortgage portfolio to \$27.6bn, and growth in funds under administration.
- **Macquarie Asset Management:** Global asset manager offering a diverse range of products. 1H16 net profit before corporate overhead up 45% to \$1,139m. The result was driven by increased annuity base fee income, a significant increase in performance fees to \$609m, favourable foreign exchange and market movement impacts, and a 19% increase in assets under management to \$502bn. Part of this divisional profit is attributable to the Non-Bank Group for Macquarie Infrastructure and Real Estate Division.
- **Commodities & Financial Markets:** Provides trading, risk management, sales, structuring, financing and market analysis and strategy services. 1H16 net profit before corporate overhead up 13% to \$282m, boosted by increased income from commodities related activities, and increased client activity in futures markets. A small component of this divisional profit is attributable to the Non-Bank Group for certain assets of the Credit Trading business and other less financially significant activities of this division.
- **Macquarie Securities:** Global institutional securities house. 1H16 net profit before corporate overhead increased from \$17m to \$240m, boosted by increased market volumes and strong Australian equities capital markets activities. A material component of the divisional profit is attributable to the Non-Bank Group for certain activities of the Cash division and the Derivatives and Trading division of Macquarie Securities.

In addition, to parts of the Macquarie Funds, Commodities & Financial Markets and Macquarie Securities divisions outlined above, the Non-Bank Group also consists of:

- **Macquarie Capital:** Offers a range of advisory and capital raising services. 1H16 net profit before corporate overhead up 13% to \$170m, ranking number 1 in Australia for announced and completed IPOs and mergers and acquisitions transactions in 2015 with 208 transactions worth \$116bn.

Macquarie Group Capital Notes 2

Macquarie Group Overview (continued)

MQGPB represents a Capital Note of Macquarie Group. This security is fully paid, subordinated, non-cumulative, unsecured and potentially perpetual if conditions for Mandatory Exchange are not met. Issue terms provide for conversion at the Mandatory Exchange date in March 2024 (subject to certain Exchange Conditions being satisfied), while a Non Viability Trigger Event will result in automatic conversion or MQGPB being written-off..

Figure 2: Top 10 ASX listed companies by market capitalisation

Rank	Company	Market Cap 20 Nov 2015	Underlying Net Profit	12 month period ending
1	Commonwealth Bank	\$135bn	\$9,137m	30 June 2015 (FY15)
2	Westpac	\$103bn	\$7,820m	30 Sep 2015 (FY15)
3	ANZ Bank	\$80bn	\$7,216m	30 Sep 2015 (FY15)
4	National Australia Bank	\$78bn	\$6,718m	30 Sep 2015 (FY15)
5	Telstra	\$66bn	\$4,303m	30 June 2015 (FY15)
6	BHP	\$66bn	\$7,669m	30 June 2015 (FY15)
7	CSL	\$46bn	\$1,674m	30 June 2015 (FY15)
8	Wesfarmers	\$43bn	\$2,440m	30 June 2015 (FY15)
9	Woolworths	\$30bn	\$2,453m	30 June 2015 (FY15)
10	Macquarie	\$28bn	\$1,996m	30 Sep 2015 (2H15+1H16)

NOTE: BHP & CSL FY15 USD NET PROFIT TRANSLATED AT AVERAGE AUD/USD EXCHANGE RATE FOR FY15 OF 0.8367

SOURCE: COMPANY DATA, BELL POTTER

At the release of its 1H16 results on 30 Oct 2015, MQG stated it “intends to redeem the Preferred Membership Interests \$US400m hybrid in Dec 15 and expects to replace these in due course”. The Macquarie Preferred Membership Interests were issued on 2 December 2010, paying fixed rate coupons of 8.375% p.a. and are redeemable at MQG’s option at any half yearly distribution date from 2 December 2015.

We see the potential for MQGPB to be upscaled from \$400m to \$550-\$600m in order to cover the redemption of the Macquarie Preferred Membership Interests.

Overall, Macquarie Group remains well capitalised. At its 1H16 result, MQG stated it had a Group capital surplus of \$3.1bn above APRA’s requirement for 1 January 2016.

Figure 3: Macquarie Bank APRA Basel III Capital Adequacy

At 30 September 2015	\$m	% RWA
Common Equity Tier 1	9,068	9.87%
Additional Tier 1	1,112	1.21%
Total Tier 1	10,180	11.08%
Tier 2	2,316	2.52%
Total Capital	12,496	13.60%
Risk Weighted Assets (RWA)	91,912	

SOURCE: MACQUARIE BANK SEP 2015 PILLAR 3 DISCLOSURE DOCUMENT

Macquarie Group Capital Notes 2

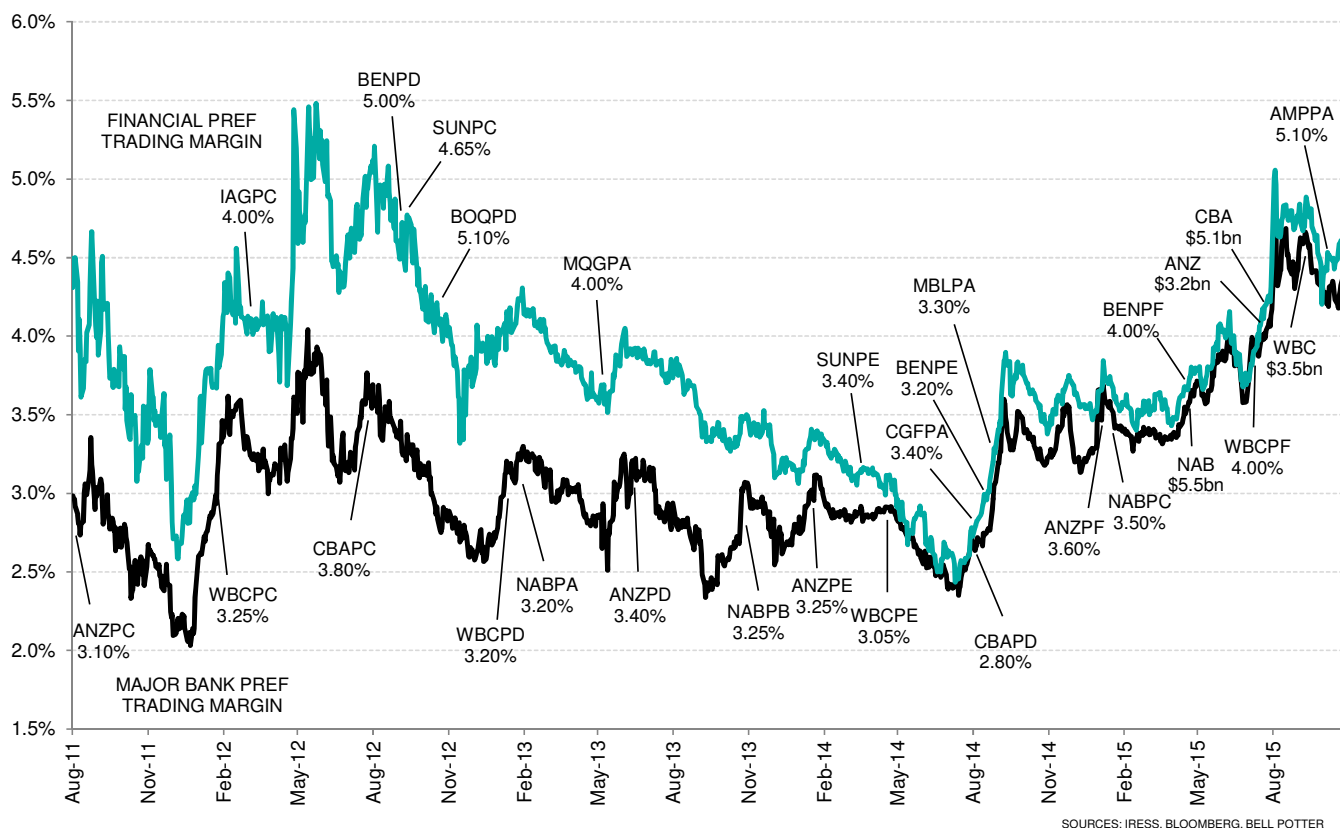
Figure 4 tracks the average trading margins split across the following sectors:

* Financial Prefs (BENPD, BENPE, BENPF, BOQPD, CGFPA, IAGPC, IANG, MBLPA, MQGPA, SUNPC, SUNPE)

* Bank Prefs (ANZPA, ANZPC, ANZPD, ANZPE, ANZPF, CBAPC, CBAPD, NABPA, NABPB, NABPC, WBCPC, WBCPD, WBCPE, WBCPF)

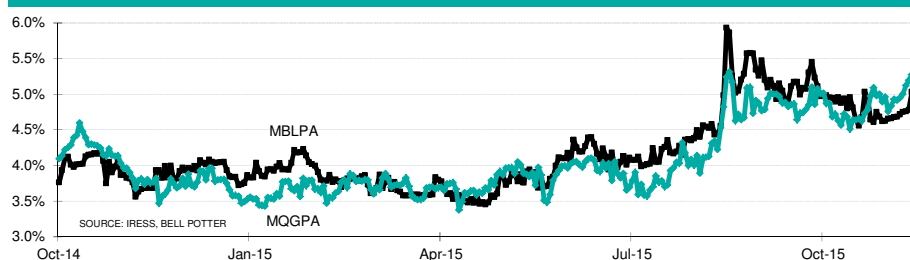
This chart highlights the weakness in hybrids, which appears to be largely attributable to the volume of bank rights issues and new hybrid issues since mid 2014.

Figure 4: Average trading margins on ASX listed bank and financial prefs



The MQGPB bookbuild margin of 5.15-5.35% appears consistent with recent trading in MQGPA (Jun 2018 first call) and MBLPA (Mar 2020 first call). Since 3 August 2015, the average trading margin on MQGPA has been 4.75% versus 4.92% on MBLPA. In a low interest rate, MQGPB on a gross running yield of 7.50% (6.40% cash 40% franked) is likely to appear on the radar of investors chasing yield.

Figure 5: Trading Margins MBLPA and MQGPA



Macquarie Group Capital Notes 2

Pricing reflects current market trading

Investor sentiment towards the ASX listed hybrid sector has been tested with the last 8 bank / financial Additional Tier 1 hybrids failing to list at a premium. A key factor has been a deterioration in the prevailing hybrid margins during 6 of these new issues, where the average sector trading margin has deteriorated between 44-83bp from the day of the issue launch to the day of the ASX listing.

The bottom end of the MQGPB bookbuild range of 5.15% provides an adequate spread of 0.36% above the current 4.79% average trading margin on the index of 11 financial prefs issued by BEN, BOQ, CGF, MQG, IAG, and SUN.

Figure 6: Listing performance of Basel III Compliant Additional Tier 1 Hybrid Issues: 2011-2015

Security	Launched	Issue Margin	Trading Margin Index Bank / Financial	Issue Margin Spread vs Trading Margin	Listing Date	Opening Price	Trading Margin Index Bank / Financial	Trading Margin Index Change Since Launch
MQGPB	23-Nov-15	5.15%	4.79%	0.36%	21 Dec 2015			
AMPPA	26-Oct-15	5.10%	4.44%	0.66%	1 Dec 2015			
WBCPF	27 Jul 2015	4.00%	3.94%	0.06%	9 Sep 2015	\$99.00	4.51%	0.57%
BENPF	27 Apr 2015	4.00%	3.47%	0.53%	16 Jun 2015	\$99.10	3.91%	0.44%
NABPC	17 Feb 2015	3.50%	3.43%	0.07%	23 Mar 2015	\$100.00	3.40%	-0.03%
ANZPF	27 Jan 2015	3.60%	3.63%	-0.03%	6 Mar 2015	\$99.99	3.33%	-0.30%
MBLPA	16 Sep 2014	3.30%	3.20%	0.10%	9 Oct 2014	\$98.00	3.62%	0.42%
BENPE	3 Sep 2014	3.20%	2.92%	0.28%	13 Oct 2014	\$98.00	3.76%	0.84%
CGFPA	27 Aug 2014	3.40%	2.82%	0.58%	10 Oct 2014	\$99.00	3.69%	0.87%
CBAPD	18 Aug 2014	2.80%	2.62%	0.18%	2 Oct 2014	\$97.00	3.45%	0.83%
WBCPE	7 May 2014	3.05%	2.90%	0.15%	24 Jun 2014	\$101.48	2.61%	-0.29%
SUNPE	31 Mar 2014	3.40%	3.11%	0.29%	9 May 2014	\$101.19	3.11%	0.00%
ANZPE	11 Feb 2014	3.25%	3.12%	0.13%	1 Apr 2014	\$100.75	2.89%	-0.23%
NABPB	12 Nov 2013	3.25%	2.78%	0.47%	18 Dec 2013	\$100.25	2.88%	0.10%
ANZPD	3 Jul 2013	3.40%	3.19%	0.21%	8 Aug 2013	\$100.00	2.88%	-0.31%
MQGPA	14 May 2013	4.00%	3.65%	0.35%	20 Jun 2013	\$100.70	3.91%	0.26%
NABPA	13 Feb 2013	3.20%	3.20%	0.00%	21 Mar 2013	\$99.75	3.15%	-0.05%
WBCPD	30 Jan 2013	3.20%	3.12%	0.08%	12 Mar 2013	\$99.94	3.15%	0.03%
BOQPD	7 Nov 2012	5.10%	4.17%	0.93%	27 Dec 2012	\$101.00	4.07%	-0.10%
SUNPC	25 Sep 2012	4.65%	4.61%	0.04%	7 Nov 2012	\$101.48	4.17%	-0.44%
BENPD	24 Sep 2012	5.00%	4.49%	0.51%	1 Nov 2012	\$101.00	4.26%	-0.23%
CBAPC	3 Sep 2012	3.80%	3.34%	0.46%	18 Oct 2012	\$101.61	3.10%	-0.24%
IAGPC	19 Mar 2012	4.00%	4.11%	-0.11%	2 May 2012	\$99.60	4.01%	-0.10%
WBCPC	16 Feb 2012	3.25%	3.19%	0.06%	26 Mar 2012	\$99.75	3.24%	0.05%
ANZPC	23 Aug 2011	3.10%	2.98%	0.12%	29 Sep 2011	\$100.00	2.80%	-0.18%

SOURCE: COMPANY DATA, IRESS, BELL POTTER

In response to APRA's requirements for the Australian major banks to operate with regulatory capital levels in the top quartile of global banks, the heavy lifting has been done with bank rights issues raising a combined \$17.3bn (NAB \$5.5bn May 2015, ANZ \$3.2bn Aug 2015, CBA \$5.1bn Aug 2015, WBC \$3.5bn Oct 2015). While trading in the major bank hybrids has yet to reflect the stronger credit profiles, in Oct 2015, one ratings agency outlined the potential for a credit rating upgrade on hybrid and subordinated debt instruments from these banks.

Figure 7: New issuance 2010-2015

Issuance (\$bn)	2010	2011	2012	2013	2014	2015	Cumulative
Hybrid Issuance	0.92	3.42	13.16	8.66	7.46	5.01	38.64
Hybrid Redemption	1.10	1.68	3.09	2.42	5.88	0.43	14.59
Net Hybrid Issuance	-0.17	1.75	10.07	6.24	1.58	4.58	24.04
IPOs	7.98	1.56	1.27	9.69	18.65	17.56	56.71
Major Bank Raisings	0.00	0.00	0.00	0.00	0.00	17.30	17.30
Net Hybrid & Equity Issuance	7.81	3.31	11.34	15.93	20.23	39.44	98.05

SOURCE: ASX, AFR, COMPANY DATA, BELL POTTER

Macquarie Group Capital Notes 2

Mandatory Exchange Conditions

In order for bank Convertible Preference Shares (CPS) and Capital Notes to qualify as Additional Tier 1 capital, APRA has imposed a maximum exchange number in order to limit the dilution of ordinary shares upon conversion.

This Maximum Exchange Number represents the face value of the preference share divided by 50% of the volume weighted average price (VWAP) of the issuer on the 20 business days preceding the issue date (Issue Date VWAP). For example, if MQG's 20 day VWAP was \$83.00 before the issue date, the maximum exchange number would be 2.41 MQG shares per MQGPB security (i.e. $\$100 / (50\% \times \$83.00)$).

To protect MQGPB holders from receiving less than face value at mandatory exchange, there are Mandatory Exchange Conditions investors need to be aware of:

- First: VWAP of ordinary shares on the 25th business day before a possible Mandatory Exchange Date (i.e. 12 Feb 2024) must be above 56% of the Issue Date VWAP. Using the MQG share price of $\$83.00 \times 56\% = \46.48 .
- Second: VWAP of ordinary shares during the period of 20 business days immediately preceding a possible Mandatory Exchange Date (19 Feb 2024 - 15 Mar 2024) must exceed 50.51% of the Issue Date VWAP (i.e. $\$83.00 \times 50.51\% = \41.92).
- Third: No Delisting Event (i.e. MQG shares delisted or suspended from ASX trading) applies to ordinary shares in respect of a Mandatory Exchange Date, which may prevent exchanged shares being sold on the ASX.
- Fourth: MQG is not Delisted at the Mandatory Exchange Date and no Inability Events subsists to prevent exchange of MQGPB.

If the Mandatory Exchange Conditions are not satisfied, mandatory exchange will not occur. In the event mandatory exchange does not occur, the security will remain on issue and continue to pay dividends at the same margin. Mandatory Exchange Conditions will be tested on each subsequent half yearly dividend date. The payment of MQGPB dividends is subject to satisfaction of the Solvency Conditions.

Figure 8: Mandatory Exchange Conditions

	MBLPB	AMPPA	BENPD	BENPE	BENPF	BOQPD	CGFPA	IAGPC	MBLPA	MQGPA	SUNPC	SUNPE
Date of Hybrid Issue	18-Dec-15	30-Nov-15	1-Nov-12	10-Oct-14	16-Jun-15	24-Dec-12	9-Oct-14	1-May-12	8-Oct-14	8-Jul-08	20-Mar-13	8-May-14
Mandatory Conversion Date	18-Mar-24	22-Dec-23	13-Dec-19	30-Nov-22	15-Jun-23	15-Apr-20	25-May-22	1-May-19	24-Mar-23	7-Jun-18	22-Mar-21	17-Jun-22
Conversion Discount	1.0%	1.0%	2.5%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Issue Date VWAP	\$83.00	\$5.95	\$7.98	\$12.08	\$12.09	\$7.11	\$7.23	\$3.46	\$57.93	\$42.42	\$9.49	\$12.92
50% Dilution Cap	\$41.50	\$2.98	\$3.99	\$6.04	\$6.05	\$3.55	\$3.61	\$1.73	\$28.97	\$21.21	\$4.75	\$6.46
Max Conv No (Face Value/Dilution Cap)	2.41	33.61	25.06	16.56	16.54	28.15	27.67	57.80	3.45	4.71	21.07	15.48
Conv Test 1 - % Issue Date VWAP	56.00%	56.00%	57.50%	55.00%	55.00%	56.12%	55.00%	57.50%	56.00%	55.56%	56.00%	55.00%
Conv Test 1 Security Price	\$46.48	\$3.33	\$4.59	\$6.64	\$6.65	\$3.99	\$3.98	\$1.99	\$32.44	\$23.57	\$5.31	\$7.11
Conv Test 2 - % Issue Date VWAP	50.51%	50.51%	51.28%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%
Conv Test 2 Security Price	\$41.92	\$3.01	\$4.09	\$6.10	\$6.11	\$3.59	\$3.65	\$1.75	\$29.26	\$21.43	\$4.79	\$6.53
Conv Test 3 - Continuous Trading	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Parent Share Price - 20 Nov 2015	\$83.00	\$5.89	\$10.70	\$10.70	\$10.70	\$13.55	\$7.90	\$5.54	\$83.24	\$83.24	\$13.30	\$13.30
Prem/Disc to Dilution Cap	100.0%	100.0%	168.2%	77.2%	77.0%	281.4%	118.6%	220.2%	100.1%	292.5%	180.3%	105.9%
Prem/Disc to Conversion Test 1	78.6%	78.6%	133.2%	61.0%	60.9%	239.8%	98.7%	178.5%	78.6%	253.2%	150.3%	87.2%

SOURCE: COMPANY DATA, BELL POTTER

Macquarie Group Capital Notes 2

Early Exchange Events: Capital Trigger Events

The fallout from the Global Financial Crisis has seen the Basel Committee on Banking Supervision establish new capital reforms to ensure banks are adequately capitalised in the event of future crises. One important component is for banks to increase their minimum Common Equity Tier 1 (CET1) Capital Ratio from 4.5% on 1 January 2013, to 7.0% by 1 January 2016 after the inclusion of the 2.5% Capital Conservation Buffer.

On 28 Sep 2012, APRA published its Basel III prudential standards, which included a number of changes to the eligibility criteria for capital instruments, including stricter criteria for instruments to qualify as Additional Tier 1 Capital. These requirements include a Capital trigger Event and/or a Non-Viability Trigger Event, where Basel III compliant Additional Tier 1 and Tier 2 Capital securities must be converted into ordinary equity if the financial position of the financial institution requires an immediate injection of capital. MQGPB does not contain a Capital Trigger Event as the issuer is Macquarie Group, which is a diversified financial services group, not an Authorised Deposit Taking Institution (ADI).

Non-Viability Trigger Event

MQGPB will be Exchanged if APRA determines that MQG would be non-viable in the absence of an exchange or write off or a public sector injection of capital. We note there are currently no precedents for a Non-Viability Trigger Event. MQG believes the types of situations in which APRA may become concerned about non-viability include a serious impairment of MQG's financial position and insolvency.

No Mandatory Conversion Conditions under Early Exchange

Exchange resulting from a Non-Viability Trigger Event will be done at the VWAP of MQG shares traded on the 5 Business Days immediately preceding the Exchange Date. While this is not subject to the Mandatory Conversion Conditions, it is still subject to the Maximum Conversion Number, which represents the face value of the preference share dividend by 20% of the issue date VWAP. If MQG's 20 issue date VWAP was \$83.00, the maximum exchange number would be 6.02 MQG shares per MQGPB security (i.e. $\$100 / (20\% \times \$83.00)$). As such, MQGPB investors may be exposed to receiving less than face value if MQGPB is exchanged at less than \$16.60. If MQGPB is not exchanged with 5 business days of a Non-Viability Event, the security will be Written-Off and investors will lose their entire investment (Inability Event).

ASIC "Be wary of the risks" warning: Money Smart website

ASIC's Money Smart website provides information for retail investors who are considering investing in "Complex Investments" such as hybrid securities:

www.moneysmart.gov.au/investing/complex-investments/hybrid-securities-and-notes

Basically, hybrid securities (including subordinated notes and convertible preference shares) may be from well-known companies but they are very different from 'normal' corporate bonds.

Some hybrid securities make investors take on 'equity-like' risks. Some also have terms and conditions that allow the issuer to exit the deal or suspend interest payments when they choose. Some are very long-term investments (for example, more than 20 years or perpetual).

Hybrid securities may be unsuitable for you if you need steady returns or capital security typically from a bank term deposit style of investment.

Macquarie Group Capital Notes 2

Other investment risks

Key Security Risks include:

- MQGPB are not deposits, or protected accounts of Macquarie Bank or any other member of the Macquarie Group for the purposes of the Banking Act. MQGPB is not a bank deposit protected by the Government guarantee scheme.
- As preferred equity, MQGPB ranks behind deposits, senior debt and subordinated debt in MQG.
- MQGPB dividends are at MQG's absolute discretion and are non-cumulative. Distributions can only be paid if the Payment Conditions are met.
- Dividend Payment Conditions: MQG must satisfy the following requirement in order to pay MQGPB dividends. These include:
 - ⇒ MQGPB dividend payments must not result in a breach of MQG's capital adequacy requirements under APRA's prudential standards.
 - ⇒ The dividend would not likely result in MQG becoming insolvent.
 - ⇒ APRA does not object to the payment.
- MQGPB may convert into MQG shares. There is a risk that MQGPB may never convert and will remain on issue as it is a perpetual instrument.
- Adverse movement in credit spreads as a result of a tightening in the availability and cost of credit.
- New issues may offer more attractive issue terms and margins, placing downward pressure on the security price.
- MQGPB may lose priority ranking ahead of Ordinary Shares in the event of a wind up if converted due to a Non-Viability Trigger event.
- Conversion of MQGPB at the Mar 2024 Mandatory Exchange Date requires MQG's share price at the time of Mandatory Exchange to be above certain thresholds. If these thresholds are not met in Mar 2024 or at future half yearly dividend payment dates, MQGPB may remain on issue indefinitely.
- Inability Event: MQGPB will be written off if MQG is not able to issue ordinary shares from Conversion within five Business Days of the Non-Viability Trigger Event Conversion Date. Scenarios under which this may occur include MQG being prevented from issuing ordinary shares by circumstances outside of its control, including an applicable law or order of any court, or action of any Government authority from issuing shares. Under an Inability Event, MQGPB holder's rights (including to dividends and face value) are immediately and irrevocably terminated, resulting in MQGPB losing its value and investors will not receive any compensation.

Macquarie Group Capital Notes 2

Other investment risks

Key Business Risks of Macquarie include:

- Adverse financial performance of MQG may impact the ability to make scheduled MQGPB dividend payments and redeem or exchange at a future call or exchange date.
- Market conditions, including a deterioration in domestic and global funding markets. This can negatively impact market liquidity, increase credit spreads and reduce funding availability. In recent years global equity and debt markets have experienced difficult conditions, resulting in reduced liquidity, extreme volatility and declining asset prices, as well as greater counterparty credit risk, widening of credit spreads and lack of price transparency in credit and other markets.
- Liquidity risk in matching cashflows with financial commitments as they fall due.
- Legal, regulatory and compliance risk. Macquarie is supervised by a number of regulators which include APRA, RBA, ASIC, ASX and ACCC in Australia. Regulators may impose material penalties for breach of legal requirements.
- Poor performance of acquired businesses.
- Foreign exchange risk. A significant portion of MQG's operating income is derived and operating expenses incurred from offshore business activities, which are conducted in a broad range of currencies and with counterparties around the world.
- Market and asset price risk.
- Interest rate risk. A mismatch between the interest rate risk on assets and liabilities could have an adverse financial impact.
- Operational risks and trading errors.
- Increasing competition.
- Credit rating downgrades.

Refer page 58 of the prospectus for further information on risks.

Fixed Income

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Additional risks of hybrid securities

Hybrid securities are perpetual and do not constitute a deposit liability of the Issuer. They may be exchanged at the Issuer's discretion at the Optional Exchange Date (first call date) and then at the Mandatory Conversion Date if certain conditions have been satisfied. Hybrid securities pay discretionary dividends which are not cumulative if unpaid. Hybrid securities have complex terms of issue and each investment will differ in terms of terms of conditions, time frame and interest rates. They often involve heightened risk and may not be suitable for all investors.

There are additional risks associated with this kind of investment as compared to a term deposit with the same issuer. These risks include:

- A 'trigger event' occurring leading to a deferral of interest payments or the Issuer repaying the hybrid early or much later than expected;
- Credit spreads widening making the return from the investment less attractive in comparison to other products;
- Additional new issuance at a higher margin;
- Market price volatility;
- Liquidity risk for hybrids is generally greater than shares in the Issuer company;
- Subordinated ranking;
- Distributions are at the discretion of the issuer;
- These products may be perpetual and can only be redeemed or exchanged for either cash or equity at the Issuer's option;
- Early repayment is at the Issuer's discretion

You should acquaint yourself with the specific returns, features, benefits and risks unique to any hybrid security before investing in them. If you do not understand, or have any concerns about a particular product you should talk to your Adviser. ASIC has published guidance, which may be relevant to your consideration of an investment of this kind, called "Hybrid securities and notes", under the heading 'Complex investments' at www.moneysmart.gov.au/investing

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