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ANZ Capital Notes 4 (ANZPG)

Fixed Income

Issue overview

Issuer	ANZ
Issue ASX code	ANZPG
Face value	$100
Estimated offer size	$1,000m
Bookbuild margin	4.70-4.90%
Franking	100%
Dividend payments	Quarterly
First distribution payment	20 Dec 2016
Minimum application	$5,000
Optional Exchange	20 Mar 2024
Mandatory Conversion	20 Mar 2026

Timeline

Lodgement of prospectus	16 Aug 2016
Bookbuild margin	23 Aug 2016
Offer opens	24 Aug 2016
Offer closes	
ANZPA Reinvestment	19 Sep 2016
ANZ Securityholder	19 Sep 2016
Broker Firm	26 Sep 2016
Issue date	27 Sep 2016
ASX listing (deferred settlement)	28 Sep 2016

Increasing scarcity of supply

ANZ's new $1.0bn Capital Notes 4 (ANZPG) has been launched as a Basel III compliant replacement issue for the $1.97bn ANZ CPS2 (ANZPA) ahead of its 15 Dec 2016 mandatory conversion date. The Reinvestment Offer appears highly attractive, with the 4.70-4.90% bookbuild range providing a healthy 1.60% margin uplift on ANZPA's 3.1% issue margin. Following on from the successful 2016 listings of CBAPE ($106.90 peak), WBCPG ($103.90), and NABPD ($103.29), ANZPG has the potential to be another successful issue, when considering the following assessment criteria:

- **Reinvestment Offer could cover the entire transaction:** We note 58% ($627m of $1,081m) of ANZPB investors participated in the Feb 2014 ANZPE reinvestment offer (margin uplift 2.50% to 3.25%). The USD1.0bn raised from the ANZ Capital Securities offer in June 2016 also reduces the refinancing requirement for ANZPA.
- **Scarcity of new supply with increasing institutional demand:** The next major bank issue up for refinance is ANZPC (Sep 2017 call). Of the $4.65bn raised in total by CBAPE, WBCPG & NABPD, one institutional investor holds $885m (19%).
- **Historically high issue margin combined with longer duration**
- **Sufficient uplift relative to secondary market:** Assuming ANZPG is priced at a bookbuild margin of 4.70%, it provides a 0.20% margin uplift on ANZPF (Mar 2023 call) on a 4.50% trading margin at $97.70. It also offers a margin uplift of 0.90% relative to the avg trading margin of 3.80% on the index of 17 major bank prefs / capital notes, providing investors the potential to switch from lower margin issues.
- **Low deposit rates:** In a world of record low interest rates, high margin securities should become even more attractive to investors seeking income.

Figure 1: Trading margins on debt and equity securities

	Ranking (prior to exchange)	Security	Trading Margin over BBSW	Maturity / Mand Conv*	First Call
Higher Ranking	Senior debt	ANZ (OTC) senior	105bp	Apr 2021	
	Subordinated debt	ANZ (OTC) subordinated	230bp	May 2026	May 2021
	Preferred equity	ANZPF (Additional Tier 1)	450bp	Mar 2025*	Mar 2023#
		ANZPG (Additional Tier 1)	**470-490bp**	**Mar 2026***	**Mar 2024#**
Lower Ranking	Equity	Ordinary ANZ Shares	~600bp	Perpetual	

WHERE NOT CONVERTED OR WRITTEN-OFF ON ACCOUNT OF A CAPITAL TRIGGER EVENT OR A NON VIABILITY TRIGGER EVENT. FIRST CALL DATE IS DISCRETIONARY.

SOURCE: YIELDBROKER, BELL POTTER

* MANDATORY CONVERSION IS SUBJECT TO SATISFYING THE MANDATORY CONVERSION CONDITIONS

ANZPG IS PERPETUAL AND MAY NOT BE EXCHANGED.

Key features

- **Initial grossed up running yield of 6.45-6.65% (4.52-4.66% fully franked):** Floating rate based on 3 month bank bill of 1.75% + 4.70-4.90% bookbuild margin.
- **Option to exchange at year 7.5 with mandatory conversion at year 9.5:** ANZ has the option to redeem or convert ANZPG at the 20 Mar 2024 Call Date, subject to APRA approval and ANZ being solvent, and a Capital Trigger or a Non-Viability Trigger Event not having occurred. ANZPG may not be exchanged on the Mandatory Conversion Date, and you may continue to hold ANZPG indefinitely.
- **Ordinary dividend restrictions:** Applies on the non payment of ANZPG distributions. ANZPG distributions are discretionary and subject to the distribution payment conditions being satisfied. Unpaid distributions are non-cumulative.

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ANZPA Reinvestment	Dates
ANZPA Ex Entitlement	5 Aug 2016
ANZPA Record Date	8 Aug 2016
Reinvestment offer opens	24 Aug 2016
ANZPA ex dividend	30 Aug 2016
ANZPA dividend paid	15 Sep 2016
Reinvestment offer closes	19 Sep 2016
ANZPA pro rata div paid	27 Sep 2016
ANZPA buy-back	27 Sep 2016
Issue date	27 Sep 2016
ASX listing (deferred settlement)	28 Sep 2016

ANZPA Redemption	Dates
ANZPA Ex Entitlement	5 Aug 2016
ANZPA Record Date	8 Aug 2016
Reinvestment offer opens	24 Aug 2016
ANZPA ex dividend	30 Aug 2016
ANZPA dividend paid	15 Sep 2016
Reinvestment offer closes	27 Sep 2016
ANZPA cease trading	28 Nov 2016
ANZPA ex dividend	29 Nov 2016
ANZPA redemption	15 Dec 2016
ANZPA dividend paid	15 Dec 2016

Reinvestment Offer for ANZPA holders

As the ANZPG offer is essentially a replacement issue for the ANZ Convertible Preference Shares 2 (ANZPA), ANZ is offering the opportunity to reinvest ANZPA securities held at the 8 August 2016 record date into new ANZPG securities (ex entitlement date 5 August 2016). ANZ will also give priority to allocations under the Reinvestment Offer over applications received under the Securityholder Offer.

ANZPA holders essentially have three options:

- **Option 1: Participate in Reinvestment Offer:** For ANZPA holders that lodge their Personalised Reinvestment form by 19 September 2016, ANZ will buy-back participating securities at $100 on the 27 September 2016 Reinvestment Date. ANZ will then reinvest proceeds into ANZPG. Investors will receive the scheduled quarterly dividend of $0.9042 fully franked on 15 Sep (ex div 30 Aug), plus a pro-rata dividend payment on 27 Sep of ~$0.11 fully franked for the 12 day period.
- **Option 2: Sell ANZPA on market:** ANZPA is expected to cease trading on 28 November 2016.
- **Option 3: Do nothing and receive $100 Cash Redemption:** In addition to receiving $100 cash redemption per ANZPA security on 15 December 2016, holders will receive two quarterly dividends of $0.9042 fully franked on 15 September and ~$0.85 fully franked (91 days) on 15 December.

Overall the Reinvestment Offer appears highly attractive, given the uplift in issue margin from 3.10% on ANZPA to 4.70-4.90% on ANZPG.

Offers for Broker Firm and Securityholders

- **Broker Firm Offer:** This is available to Syndicate Brokers of the ANZPG issue (Bell Potter is not a syndicate broker), subject to scaling back from the Reinvestment Offer demand. Broker firm bids will participate in the Bookbuild to be held on 23 August 2016.
- **Securityholder Offer:** Available to investors in ANZ, Subordinated Notes (ANZHA), Convertible Preference Shares (ANZPA, ANZPC), and Capital Notes (ANZPD, ANZPE, ANZPF). Applications for investors holding these securities at the 8 August 2016 record date requires a HIN or SRN. The closing date for the Securityholder Offer is 19 September 2016.

There is no Customer Offer or General Offer.

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Trading margins on bank hybrids on the road to recovery

Figure 2 tracks the average trading margins split across 4 sectors:

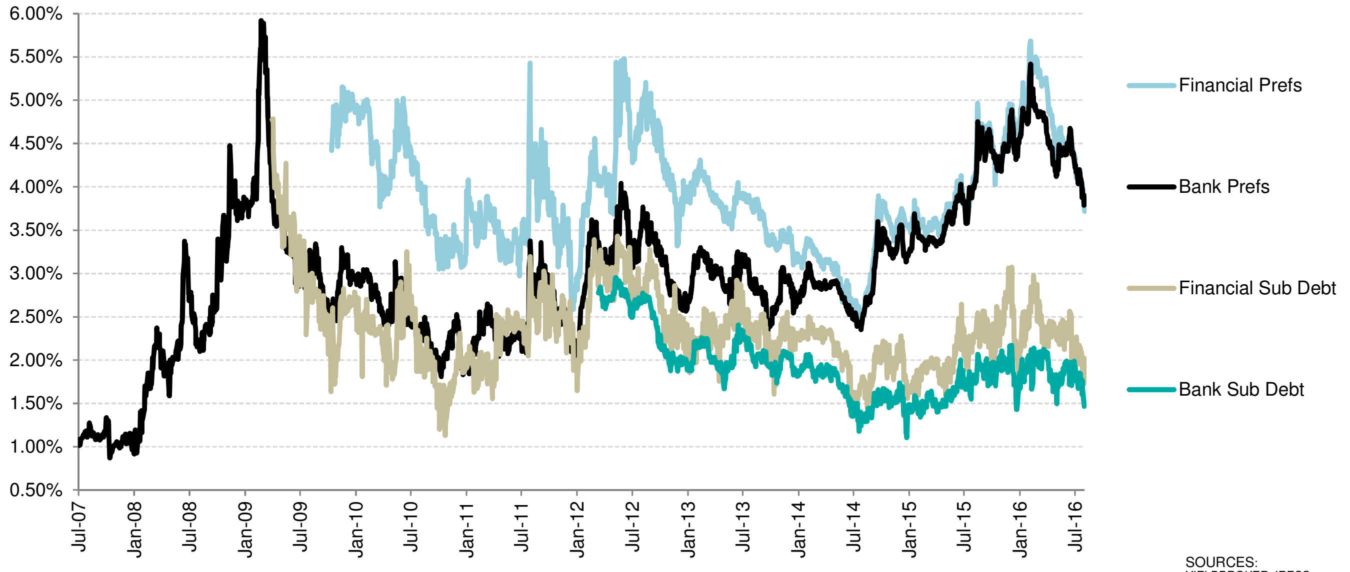
* Financial Prefs (AMPPA, BENPD, BENPE, BENPF, BOQPD, CGFPA, IAGPC, IANG, MBLPA, MQGPA, MQGPB, SUNPC, SUNPE)

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

* Financial Subordinated Debt (AMPHA, CNGHA, SUNPD)

* Bank Subordinated Debt (ANZHA, NABHB, WBCHA, WBCHB).

Figure 2: Trading margins on ASX listed debt and hybrid sectors

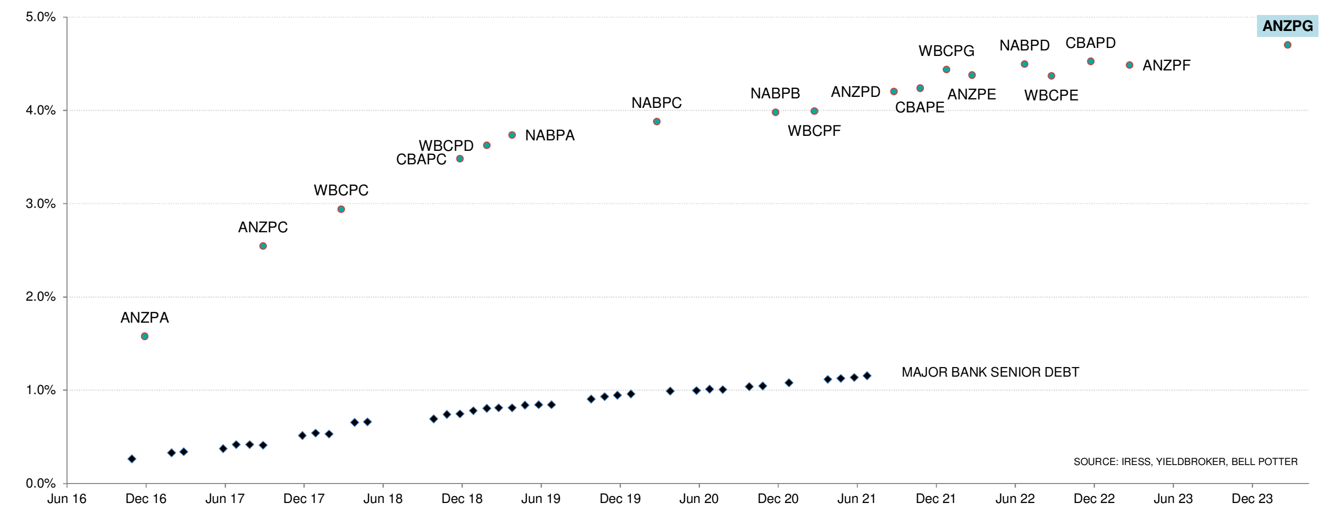


SOURCES: YIELDBROKER, IRESS, BELL POTTER

Highest margin currently available of all major bank hybrids

While the 4.70-4.90% bookbuild margin range in part reflects the longer duration of 7.5 years to the call date, the desire for higher income provides the potential for greater investor support for higher margin securities.

Figure 3: Trading margin on ASX listed major bank prefs & capital notes versus wholesale senior debt (15 Aug 2016)



SOURCE: IRESS, YIELDBROKER, BELL POTTER

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ANZPG margin at a record high spread to prevailing market

One key metric to consider when investing in a new hybrid issue is the attractiveness of the pricing compared with prevailing market pricing reflected by the average trading margin of the 17 major bank prefs and capital notes - which currently stands at 3.80%.

Figure 4: New issue spreads versus prevailing hybrid margins

Security	Launched	Issue Margin	Trading Margin Bank Index	Issue Margin Spread vs Trading Margin
ANZPG	16 Aug 2016	4.70%	3.80%	0.90%
WBCPG	17 May 2016	4.90%	4.20%	0.70%
NABPD	31 May 2016	4.95%	4.40%	0.55%
NABPB	12 Nov 2013	3.25%	2.78%	0.47%
CBAPC	3 Sep 2012	3.80%	3.34%	0.46%
ANZPD	3 Jul 2013	3.40%	3.19%	0.21%
CBAPD	18 Aug 2014	2.80%	2.62%	0.18%

SOURCE: COMPANY DATA, IRESS, BELL POTTER

Assuming ANZPG's issue margin is set at the bottom end of the bookbuild range at 4.70%, this represents a record high spread of 0.90% to the prevailing market. While the bookbuild margin range in part reflects ANZPG's longer duration of 7.5 years to the Mar 2024 call date, it still provides an uplift on the closest listed comparable - ANZPF (Mar 2023 call) on a 4.50% trading margin at $97.70.

Overall, the spread to the prevailing margin appears to sufficiently compensate investors for a modest adverse market movement before listing.

Figure 5: Listing performance of Basel III Compliant Additional Tier 1 Hybrid Issues: 2011-2016

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
ANZPG	16 Aug 2016	4.70%	3.80%	0.90%	28 Sep 2016			
NABPD	31 May 2016	4.95%	4.40%	0.55%	8 Jul 2016	$100.50	4.32%	-0.08%
WBCPG	17 May 2016	4.90%	4.20%	0.70%	1 Jul 2016	$100.90	4.49%	0.29%
CBAPE	16 Feb 2016	5.20%	5.40%	-0.20%	31 Mar 2016	$100.00	4.80%	-0.60%
MQGPB	23 Nov 2015	5.15%	4.57%	0.58%	21 Dec 2015	$100.51	4.77%	0.20%
AMPPA	26 Oct 2015	5.10%	4.27%	0.83%	1 Dec 2015	$100.10	4.70%	0.43%
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%
			Median:	0.21%				

SOURCE: COMPANY DATA, IRESS, BELL POTTER

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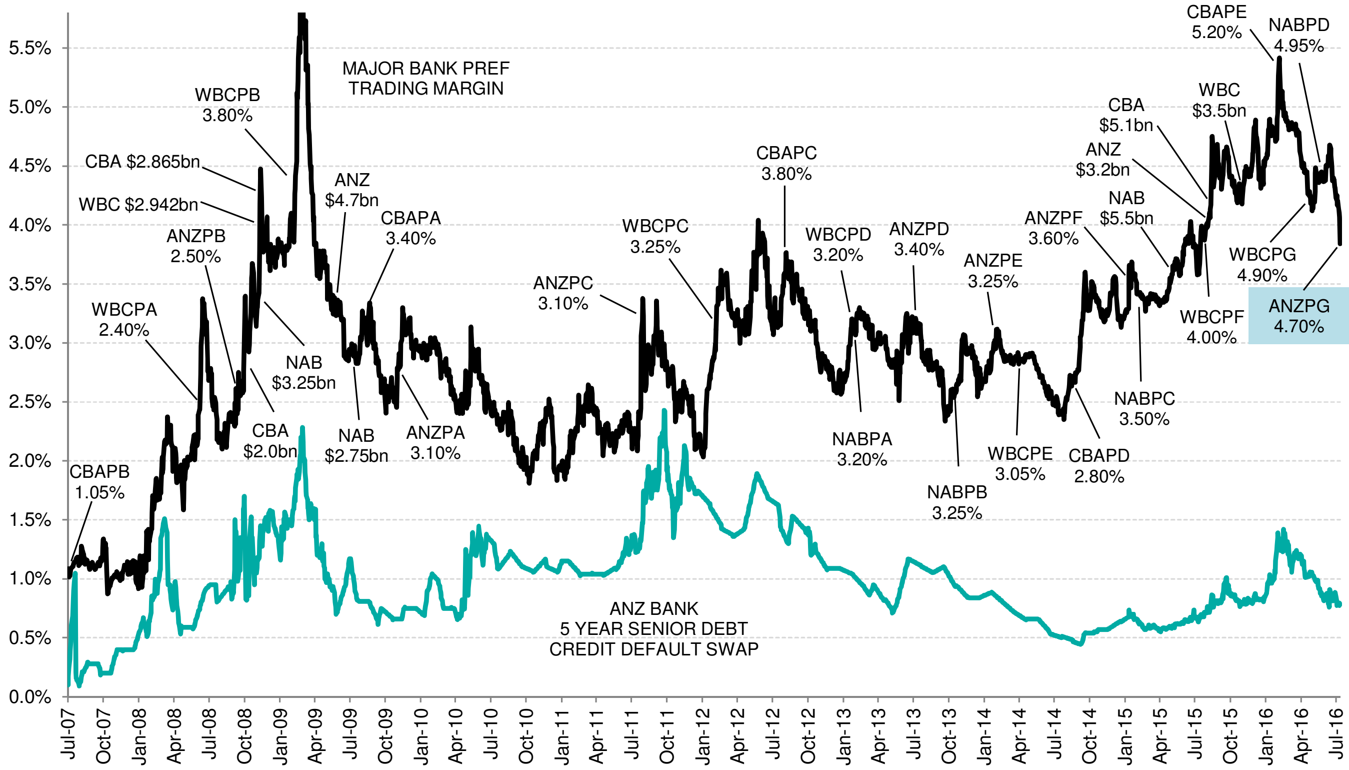
Lower capital raisings and interest rates supporting hybrids

Investor sentiment towards the ASX listed hybrid market has shown improvement over recent months, where the average trading margin on the 17 major bank prefs and capital notes has firmed from 5.40% in Feb 2016 to 3.80%. This is approximately the same level as July 2015, before ANZ, CBA and WBC raised a combined $11.8bn of ordinary equity.

Figure 6: Average trading margin - major bank prefs and capital notes versus 5 year senior debt credit default swaps



SOURCES: IRESS, BLOOMBERG, BELL POTTER

A recovery in sentiment can be attributed to a couple of key factors:

- **Positive trading of new listings launched in since Nov 2015:** reflecting attractive new issue pricing of AMPPA, AYUHB, MQGPB, CBAPE, WBCPG and NABPD
- **Lower IPO volumes and no bank equity raisings in 2016:** weakness in hybrids coincided with large bank equity raisings
- **Search for yield:** continued attraction of securities with high issue margins
- **Minimal net hybrid issuance in 2016:** NABPD is the only new issue undertaken in 2016 that is not refinancing a maturing security. We expect the $700m WOWHC (Nov 2016 call) will be replaced by a new ASX listed security.

Figure 7: New issuance 2010-2016

Issuance ($bn)	2010	2011	2012	2013	2014	2015	2016YTD	Cumulative
Hybrid Issuance	0.92	3.42	13.16	8.66	7.46	5.60	4.75	43.98
Hybrid Redemption	1.10	1.68	3.09	2.42	5.88	0.90	2.10	17.17
Net Hybrid Issuance	-0.17	1.75	10.07	6.24	1.58	4.70	2.65	26.80
IPOs	7.98	1.56	1.27	9.69	18.65	8.30	3.63	51.08
Major Bank Raisings	0.00	0.00	0.00	0.00	0.00	17.30	0.00	17.30
Net Hybrid & Equity Issuance	**7.81**	**3.31**	**11.34**	**15.93**	**20.23**	**30.29**	**6.28**	**95.18**

SOURCE: ASX, AFR, BLOOMBERG, COMPANY DATA, BELL POTTER

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Potential drought of major bank refinancing issues

Post the completion of the ANZPG offer, the next major bank Additional Tier 1 hybrid security likely to be refinanced by an ASX listed issue is the $1.34bn ANZPC ahead of its 1 Sep 2017 call date. Early 2018 has the likely refinancing issue for the $1.19bn WBCPC security, totalling only $2.53bn of major bank refinancing issues by early 2018.

By contrast, the major banks have pending redemptions of $5.4bn of subordinated debt securities between Mar 2017 - Aug 2017, where it appears likely the banks will continue the trend of issuing into the wholesale debt market.

Figure 8: Upcoming maturities - ASX listed major bank debt and hybrid securities

Security	Call / Maturity	Value ($m)	Replacement Issue Considerations
CNGHA	31 Mar 2017	1,000.0	Redemption expected at call date. Replacement issue currently appears unlikely.
NABHB	18 Jun 2017	1,172.5	Redemption expected at call date. Banks frequently issuing Tier 2 subordinated debt in wholesale market.
ANZHA	20 Jun 2017	1,508.6	Redemption expected at call date. Banks frequently issuing Tier 2 subordinated debt in wholesale market.
WBCHA	23 Aug 2017	1,676.2	Redemption expected at call date. Banks frequently issuing Tier 2 subordinated debt in wholesale market.
ANZPC	1 Sep 2017	1,340.0	Basel III compliant Additional Tier 1 replacement issue expected.
WBCPC	31 Mar 2018	1,189.4	Basel III compliant Additional Tier 1 replacement issue expected.
Total		**7,886.7**	

SOURCE: COMPANY DATA, BELL POTTER

High participation expected from ANZPA reinvestment offer

The turn in market sentiment and attractive pricing of the ANZPG issue should translate to a high level of participation in the ANZPA reinvestment offer. The last refinancing transaction ANZ undertook in February 2014 resulted in 58.0% ($626.9m) of ANZPB investors reinvesting into ANZPE, accepting the uplift in issue margin from 2.50% to 3.25%.

Figure 9: Participation in reinvestment offer replacement issues

Security	Issue Margin	Maturity/ Call Date	Issue Size $m	Reinvestment $m	**Reinvestment Participation**	Replacement Issue	Issue Margin	Listing Date	Issue Size $m
AQNHA	4.75%	15 May 14	202.2	30.1	**14.9%**	AMPHA	2.65%	19 Dec 13	325
ANZPB	2.50%	16 Jun 14	1,081.2	626.9	**58.0%**	ANZPE	3.25%	1 Apr 14	1610
WBCPB	3.80%	30 Sep 14	908.3	528.9	**58.2%**	WBCPE	3.05%	24 Jun 14	1311
CBAPA	3.40%	31 Oct 14	2,000.0	1328.1	**66.4%**	CBAPD	2.80%	2 Oct 14	3000
AYUHA	3.55%	14 Apr 16	120.0	62.6	**52.2%**	AYUHB	2.80%	16 Dec 15	250
PCAPA	1.05%	6 Apr 16	1,166.5	260.0	**22.3%**	CBAPE	5.20%	31 Mar 16	1450
Average					**45.3%**				

SOURCE: COMPANY DATA, IRESS, BELL POTTER

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Investor preference for high margin / high income securities

The desire for higher income provides the potential for greater investor support of ANZPG relative to other lower margin bank hybrids of a similar duration. Historically, CBAPC (PERLS VI) launched in September 2012 has been one of the better supported securities in the ASX listed hybrid market, highlighted by it trading on a monthly high above $100 every month since listing in November 2012.

Its 3.80% issue margin was first surpassed by the 4.00% issue margin on WBCPF launched in July 2015. When comparing CBAPC with WBCPD whose issue margin is 0.60% less at 3.20%, the average trading margin on CBAPC has been 0.27% lower since WBCPD listed on 12 March 2013. There is only 81 days difference in duration between the call dates: 17 December 2018 on CBAPC and 8 March 2019 for WBCPD.

Figure 10: Average Trading Margin: CBAPC versus WBCPD

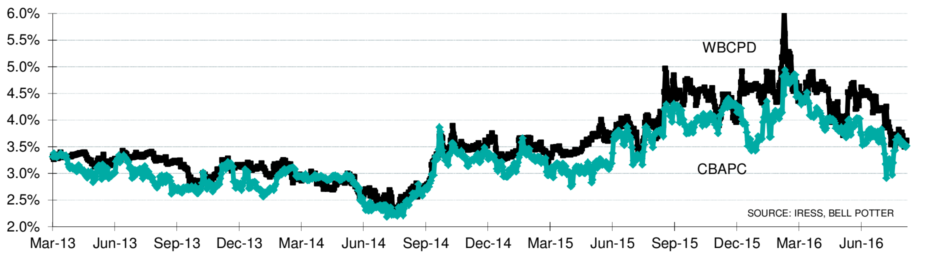
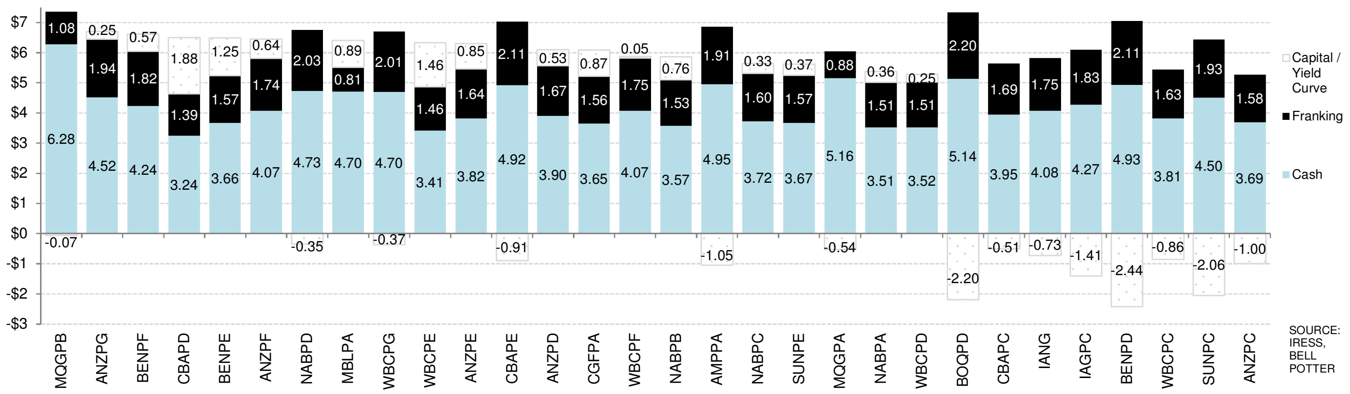


Figure 11 provides a ranking of securities based on the highest gross Yield to First Call (maturity). The blue box represents forecast cash income per security (annualised) over the next 12 months while black represents forecast franking. The white box represents the gap between income levels and Yield to First Call (maturity), where this component of return is associated with the impact of the capital price premium / discount allowing for bank bill movements priced in by the yield curve. In a low interest rate world, there appears to be continued investor support for high margin securities over lower margin securities.

Assuming pricing is set at a margin of 4.70% above the current 3 month bank bill rate of 1.75%, ANZPG is expected to provide investors with annual cash income of $4.515 per security, plus franking of $1.935 ($6.45 grossed up). On a gross Yield to First Call (maturity) basis, ANZPG currently ranks second to MQGPB, while on a cash income basis, it ranks 10th (4th excluding financial prefs).

Figure 11: Forecast cash and franking payments per bank and financial hybrid security (annualised) at 15 Aug 2016



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Mandatory Conversion Conditions

In order for bank Convertible Preference Shares (CPS) and Capital Notes to qualify as Additional Tier 1 capital, APRA has imposed a maximum conversion 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 ANZ's 20 day VWAP was $26.61 before the issue date, the maximum exchange number would be 7.52 ANZ shares per ANZPG security (i.e. $100 / (50% x $26.61)).

To protect ANZPG holders from receiving less than face value at Mandatory Conversion, there are a number of Conversion Conditions to be aware of:

- First: VWAP of ordinary shares on the 25th business day before a possible Mandatory Conversion Date must be above 56.00% of the Issue Date VWAP. Using the ANZ price on 15 August 2016 of $26.61 x 56.00% = $14.90.
- Second: VWAP of ordinary shares during the 20 business days immediately preceding a potential Mandatory Conversion Date must be greater than 50.51% of the ANZPG Issue Date VWAP (i.e. $13.44).

If the Mandatory Conversion Conditions are not satisfied, conversion on the Mandatory Conversion Date will not occur. Under this scenario, the security will remain on issue and continue to pay distributions at the same margin. The Conversion Conditions will be tested on each subsequent future quarterly distribution date. The payment of ANZPG distributions is subject to satisfaction of the Distribution Payment Conditions.

Figure 12: Mandatory Conversion Conditions

	ANZPG	ANZPA	ANZPC	ANZPD	ANZPE	ANZPF	CBAPC	CBAPD	CBAPE	NABPA	NABPB	NABPC	NABPD	WBCPC	WBCPD	WBCPE	WBCPF	WBCPG
Date of Hybrid Issue	27-Sep-16	18-Dec-09	29-Sep-11	7-Aug-13	31-Mar-14	5-Mar-15	17-Oct-12	1-Oct-14	30-Mar-16	20-Mar-13	17-Dec-13	23-Mar-15	7-Jun-16	23-Mar-12	8-Mar-13	15-Jun-14	8-Sep-15	30-Jun-16
Mandatory Conversion Date	20-Mar-26	15-Dec-16	1-Sep-17	1-Sep-23	24-Mar-22	24-Mar-15	15-Dec-20	15-Dec-24	15-Oct-21	22-Mar-21	19-Dec-22	23-Mar-22	8-Jul-24	30-Mar-20	8-Mar-21	23-Sep-24	22-Mar-23	20-Dec-23
Conversion Discount	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Issue Date VWAP	$26.61	$21.80	$19.53	$29.16	$32.30	$35.18	$56.08	$78.62	$75.50	$30.64	$33.86	$38.03	$25.27	$20.83	$29.89	$34.37	$31.23	$29.48
50% Dilution Cap	$13.31	$10.90	$9.77	$14.58	$16.15	$17.59	$28.04	$39.31	$37.75	$15.32	$16.93	$19.02	$12.64	$10.42	$14.95	$17.23	$15.62	$14.74
Max Conv No (Face Value/Dilution C	7.52	9.17	10.24	6.86	6.19	5.69	3.57	2.54	2.65	6.53	5.91	5.26	7.91	9.60	6.69	5.81	6.40	6.78
Conv Test 1 - % Issue Date VWAP	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	55.56%	56.12%	56.12%	56.12%	56.12%
Conv Test 1 Security Price	$14.90	$12.21	$10.94	$16.33	$18.09	$19.70	$31.41	$44.02	$42.28	$17.16	$18.96	$21.30	$14.15	$11.57	$16.77	$19.29	$17.53	$16.54
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%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%
Conv Test 2 Security Price	$13.44	$11.01	$10.01	$14.73	$16.31	$17.77	$28.33	$39.71	$38.14	$15.48	$17.10	$19.21	$12.76	$10.52	$15.10	$17.36	$15.77	$14.89
Conv Test 3 - Continuous Trading	Yes	Yes	Yes	Yes	Yes	Yes	n/a	Yes	Yes	Yes	Yes	Yes	Yes	n/a	n/a	n/a	n/a	n/a
Parent Share Price - 15 Aug 2016	$26.61	$26.61	$26.61	$26.61	$26.61	$26.61	$76.30	$76.30	$76.30	$27.20	$27.20	$27.20	$27.20	$29.76	$29.76	$29.76	$29.76	$29.76
Prem/Disc to Dilution Cap	100.0%	144.1%	172.5%	82.5%	64.8%	51.3%	172.1%	94.1%	102.1%	77.5%	60.7%	43.0%	115.3%	185.7%	99.1%	72.8%	90.6%	101.9%
Prem/Disc to Conversion Test 1	78.6%	118.0%	143.3%	63.0%	47.1%	35.1%	142.9%	73.3%	80.5%	58.5%	43.4%	27.7%	92.2%	157.1%	77.4%	54.3%	69.8%	79.9%

SOURCE: COMPANY DATA, BELL POTTER

ANZ Capital Notes 4

Early Conversion Events: Capital Trigger and Non-Viability

The fallout from the Global Financial Crisis has seen the Basel Committee on Banking Supervision establish new capital reforms to be phased in between 1 January 2013 and 1 January 2019. The key objective of these new reforms is to ensure banks are adequately capitalised in the event of future crises. On 28 September 2012, APRA published its final Basel III prudential standards which include 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 a Non-Viability Trigger Event, where securities such as ANZPG must be converted into ordinary equity if the financial position of ANZ requires an immediate injection of capital. These prudential standards also require Australian banks to hold a minimum Common Equity Tier 1 Capital Ratio of 4.5% on 1 Jan 2013. This increased to 8.0% on 1 Jan 2016 after inclusion of the 2.5% Capital Conservation Buffer and a further 1.0% D-SIB (Domestically Systemically Important Banks) Capital Buffer.

Capital Trigger Event

A Capital Trigger Event occurs when either ANZ determines, or when APRA notifies ANZ that it believes ANZ's Common Equity Tier 1 Capital Ratio is equal to or less than 5.125%. Under this Trigger, ANZ must immediately convert enough ANZPC, ANZPD, ANZPE, ANZPF and ANZPG securities on an approximate pro rata basis to boost the Common Equity Tier 1 (CET1) Capital Ratio above 5.125%. ANZ's Basel III Common Equity Tier 1 Capital Ratio at 30 June 2016 (pro forma) stood at 9.0%, providing a buffer of $16bn. If we include ANZ's adjusted pro forma cash net profit for the 12 months to March 2016 of $7.0bn, a breach of the Common Equity Trigger requirement appears very low, particularly as ANZ has options such as cutting ordinary dividends and undertaking equity raisings.

Non-Viability Trigger Event

In addition, ANZPG will be converted if APRA determines that ANZ would be non-viable in the absence of an exchange or a public sector injection of capital. We note there are currently no precedents for a Non-Viability Trigger Event. Types of situations in which APRA may become concerned about non-viability include being insolvent, significant capital losses and financial stress, prolonged difficulties in raising funding in the public or private market, or maintaining sufficient liquidity.

Potential for Loss under Trigger Event if ANZ below $5.32

Exchange resulting from a Capital Trigger Event or a Non-Viability Trigger Event will be done at the VWAP of ANZ shares traded on the 5 Business Days immediately preceding the Conversion 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 divided by 20% of the issue date VWAP. If ANZ's 20 day Issue Date VWAP was $26.61, the maximum conversion number would be 18.79 ANZ shares per ANZPG security (i.e. $100 / (20% x $26.61)). As such, ANZPG investors may be exposed to receiving less than face value if ANZPG is converted at less than $5.32. In practice this will only occur in the unlikely scenario that the issuer suffers severe impairment losses and does not raise equity to absorb those losses.

As it is likely that conversion under one of these Trigger Events would occur prior to a company Wind Up, ANZPG holders will hold ordinary shares and rank equally with other holders of ordinary shares (i.e. lose priority ranking).

ANZ Capital Notes 4

Inability Event

One additional risk is an Inability Event where ANZPG will be written off if ANZ is not able to issue ordinary shares from Conversion within five Business Days of the Trigger Event Conversion Date (i.e. Capital Trigger Event or Non-Viability Trigger Event). Scenarios under which this may occur include ANZ 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, ANZPG holder's rights (including to distributions and face value) are immediately and irrevocably terminated, resulting in ANZPG losing its value and investors will not receive any compensation.

Investment risks

Key Security Risks include:

- ANZPG is not a bank deposit protected by the Government guarantee scheme
- ANZPG is subordinated and unsecured, and ranks behind deposits, senior debt and subordinated debt in ANZ.
- ANZPG distributions are non-cumulative and discretionary.
- ANZPG distribution payments are subject to the following Payment Conditions:
  - ⇒ ANZ, in its absolute discretion, making the Distribution;
  - ⇒ Payment not resulting in a breach of ANZ's capital requirements as they are applied to the ANZ Level 1 Group or the ANZ Level 2 Group or both under APRA's prudential standards;
  - ⇒ Payment not resulting in ANZ becoming insolvent; and
  - ⇒ APRA not otherwise objecting to the payment.
- 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.
- Adverse change in ANZ's financial performance which combined with a major bad debt event could lead to the Common Equity Tier 1 Capital Ratio falling below 5.125%, resulting in automatic conversion under the Capital Trigger Event. Automatic conversion may also be required under a Non-Viability Trigger Event.
- ANZPG will lose its value and investors will not receive any compensation if ANZ is not able to issue ordinary shares within 5 business days from Conversion under a Capital Trigger Event or Non-Viability Trigger. Scenarios under which this may occur include ANZ 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.
- Conversion of ANZPG at the 20 March 2026 Mandatory Conversion Date requires ANZ's share price at the time of Mandatory Conversion to be above certain thresholds. If these thresholds are not met in March 2026 or at future quarterly distribution payment dates, ANZPG may remain on issue indefinitely.
- ANZPG holders may receive $101.01 of ordinary shares for each ANZPG security held on the Mandatory Conversion Date, based on the 20 day VWAP. This VWAP may be higher than the market value of ANZ shares converted.

ANZ Capital Notes 4

Investment risks (continued)

Key Business Risks of ANZ include:

- A material deterioration in global capital markets and the Australian economy.
- Adverse regulatory changes.
- Operational risks and trading errors.
- Increasing competition.
- Credit rating downgrades.
- Losses associated with counterparty exposures.
- Poor performance of acquired businesses.

Refer page 61 (Section 6) of the prospectus dated 16 August 2016 for further information on risks.

Additional investment risk:

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

The ASIC publication should be used as guidance which may be relevant to your consideration of ANZPG – namely, information for retail investors who are considering investing in hybrid securities.

You can find this guidance by searching 'hybrid securities' at www.moneysmart.gov.au.

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).

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

Learning more about investing in bank hybrid securities

ANZ has developed an interactive module on bank hybrid securities basics which may assist you to better understand bank hybrid securities, their features and risks.

The module is available from shareholder.anz.com/education/hybrids

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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 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**