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CommBank PERLS XI Capital Notes (CBAPH)

Fixed Income

Issue overview

Issuer	CBA
Issue ASX code	CBAPH
Face value	$100
Estimated offer size	$750m
Bookbuild margin	3.70-3.90%
Franking	100%
Distribution payments	Quarterly
First distribution payment	15 Mar 2019
Minimum application	$5,000
Call Date	26 Apr 2024
Mandatory Exchange	26 Apr 2026

Timeline

Lodgement of prospectus	1 Nov 2018
Bookbuild margin	8 Nov 2018
Announcement of margin	9 Nov 2018
Offer opens	9 Nov 2018
Offer closes	7 Dec 2018
Issue date	17 Dec 2018
ASX listing (deferred settlement)	18 Dec 2018

Investments in CBA PERLS XI Capital Notes are an investment in CBA and may be affected by the ongoing performance, financial position and solvency of CBA. They are not deposit liabilities or protected accounts of CBA under the Bank Act 1959 (Cth) and are not guaranteed or insured by any Australian government, government agency or compensation scheme.

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

Staying on board

CBA's new $750m PERLS XI Capital Notes (CBAPH) has been launched as a Basel III compliant replacement issue for the $2.0bn CBA PERLS VI (CBAPC) security ahead of its 15 Dec 2018 optional call date. CBAPH breaks the 6 months issuance drought since MQGPC was launched in May, and an 8 month major bank issue drought since CBAPG was launched in March.

In order to minimise the refinancing risk of large issues, CBA has split the $2.0bn refinancing of CBAPC into both the $1,365m CBAPG issue and CBAPH. As CBAPG was entirely a new money issue, CBAPH appears to be predominately a Reinvestment offer, with only a small component likely for new money and Securityholders. Over recent years, we have typically seen participation rates in Securityholder offers of 45-60%, equating to potential Reinvestment offer demand of $900-$1,200m.

Assuming CBAPH is priced at the bottom end of the 3.70-3.90% bookbuild margin range, this currently equates to the same trading margin as CBAPG (6.5 years to the optional call date), and only fractionally below the 3.80% issue margin on CBAPC issue. Since listing in Nov 2012, CBAPC investors have had a relatively smooth ride, with a month end closing price below $100 for only 3 of the 72 months. This positive experience and lack of reinvestment alternatives could push Reinvestment demand to the upper end of the 45-60% historical reinvestment participation rate.

With a slightly shorter optional call date in April 2024 (5.5 years), factors that may support the issue include:

- **$3.1bn of pending redemptions before Christmas:** Following $3.8bn of net redemptions in the ASX listed debt and hybrid market in 2017, 2018 is on track to be a second consecutive year of net redemptions.
- **Scarcity of new supply:** After 10 years of growing their regulatory capital, banks are now increasingly considering capital management initiatives.

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	CBA (OTC) senior	90bp	Aug 2023	
	Subordinated debt	WBC (OTC) subordinated	170bp	Jun 2028	Jun 2023
	Preferred equity	**CBAPH (Additional Tier 1)**	**370-390bp**	**Apr 2026***	**Apr 2024#**
Lower Ranking	Equity	Ordinary CBA 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.

* MANDATORY EXCHANGE IS SUBJECT TO SATISFYING THE MANDATORY EXCHANGE CONDITIONS CBAPH IS PERPETUAL AND MAY NOT BE EXCHANGED.

SOURCE: YIELDBROKER, BELL POTTER

Key features

- **Initial grossed up running yield of 5.60-5.80% (3.92-4.06% fully franked):** Floating rate based on 3 month bank bill of 1.90% + 3.70-3.90% bookbuild margin.
- **Option to redeem at year 5.5 with mandatory conversion at year 7.5:** CBA has the option to redeem CBAPH at the Apr 2024 Call Date, subject to APRA approval and CBA being solvent, and a Capital Trigger or a Non-Viability Trigger Event not having occurred. CBAPH may not be exchanged on the scheduled Mandatory Exchange Date, and you may continue to hold CBAPH indefinitely.
- **Ordinary distribution restrictions:** Applies on the non payment of CBAPH distributions. CBAPH distributions are discretionary and subject to the distribution payment conditions being satisfied. Unpaid distributions are non-cumulative.

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CBAPC Reinvestment	Dates
CBAPC Ex Entitlement	24 Oct 2018
CBAPC Record Date	25 Oct 2018
Reinvestment offer opens	9 Nov 2018
Reinvestment offer closes	5 Dec 2018
CBAPC Ex Dividend	6 Dec 2018
CBAPC Dividend Paid	17 Dec 2018
Reinvestment Issue Date	17 Dec 2018
ASX listing (deferred settlement)	18 Dec 2018

CBAPC Redemption	Dates
CBAPC ceases trading	5 Dec 2018
CBAPC Ex Dividend	6 Dec 2018
CBAPC Dividend Paid	17 Dec 2018
CBAPC Redemption	17 Dec 2018

Reinvestment Offer for CBAPC

As the CBAPH offer is essentially a replacement issue for $2.0bn CBA PERLS VI Securities (CBAPC), CBA is offering the opportunity to reinvest CBAPC securities held at the 25 October 2018 record date into new CBAPH securities.

CBAPC holders essentially have three options:

- **Option 1: Participate in Reinvestment Offer:** For CBAPC holders that lodge their Personalised Reinvestment Application form by 5 December 2018, their securities will be reinvested into CBAPH. The final quarterly distribution of $0.9989 fully franked ($1.4270 grossed up) which is payable on 17 December 2018 (ex div 6 December, record date 7 December).
- **Option 2: Sell CBAPC on market:** CBAPC ceases trading 5 December 2018.
- **Option 3: Do nothing and receive $100 Cash Redemption:** In addition to receiving $100 cash redemption per CBAPC security on 17 December 2018, holders will also receive the final quarterly distribution of $0.9989 fully franked ($1.4270 grossed up) payable on 17 December 2018 (ex div 6 December, record date 7 December).

Overall, CBAPC investors need to consider whether the likely 3.70% issue margin on CBAPH is sufficient to participate in the reinvestment offer. This is only fractionally below the 3.80% issue margin on CBAPC, where CBAPC has been one of the least volatile preference shares / capital notes over the past 6 years. This is highlighted by CBAPC having a month end closing price below $100 face value for only 3 of the 72 months while listed. Another key consideration is the reinvestment options available, particularly given the diminishing supply of new issuance to reinvest into.

Offers for Broker Firm and Securityholders

- **Broker Firm Offer:** This is available to clients of Bell Potter, which is a Syndicate Broker to the CBAPH issue. Broker firm bids will participate in the Bookbuild to be held on 8 November 2018.
- **Securityholder Offer:** Available to investors in CBA, PERLS VI (CBAPC), PERLS VII (CBAPD), PERLS VIII (CBAPE), PERLS IX (CBAPF) and PERLS X (CBAPG). Applications for investors holding these securities at the 25 October 2018 record date requires a HIN or SRN. The closing date for the Securityholder Offer is 5 December 2018.

There is no Customer Offer or General Offer.

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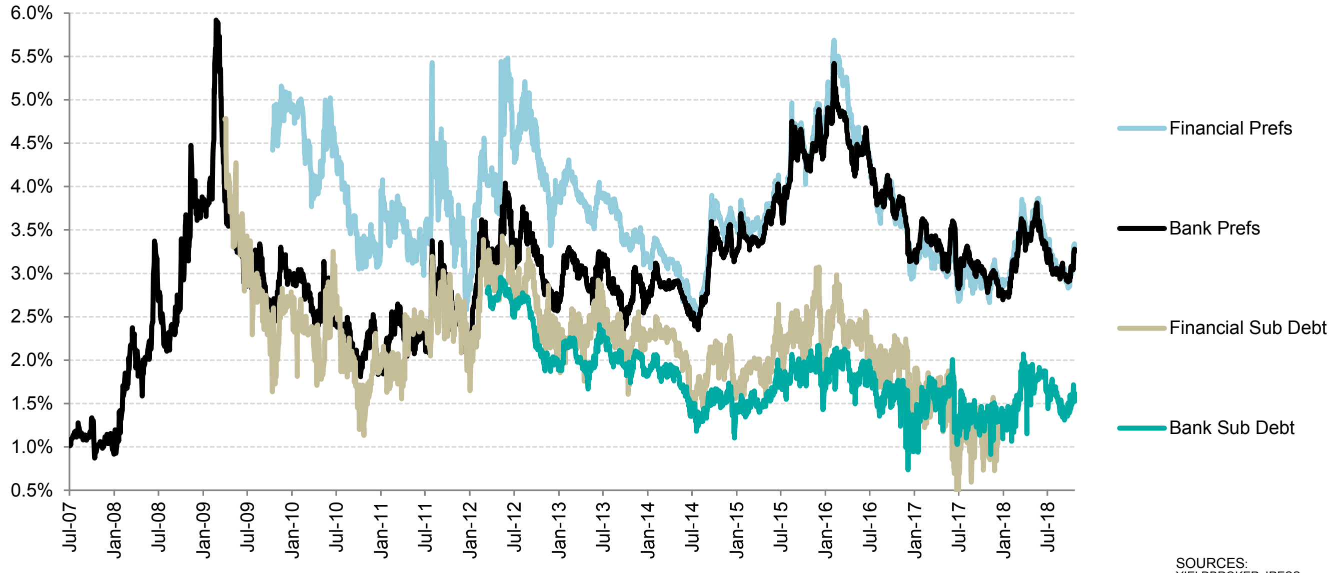
Hybrid market recovery since May driven by issuance drought

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

* Financial Prefs (AMPPA, BENPE, BENPF, BENPG. BOQPE, CGFPA, CGFPB, IAGPD, IANG, MBLPA, MQGPB, MQGPC, SUNPE, SUNPF, SUNPG)
* Bank Prefs (ANZPD, ANZPE, ANZPF, ANZPG, ANZPH, CBAPD, CBAPE, CBAPF, NABPA, NABPB, NABPC, NABPD, WBCPD, WBCPE, WBCPF, WBCPG, WBCPH)
* Bank Subordinated Debt (NABPE)

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

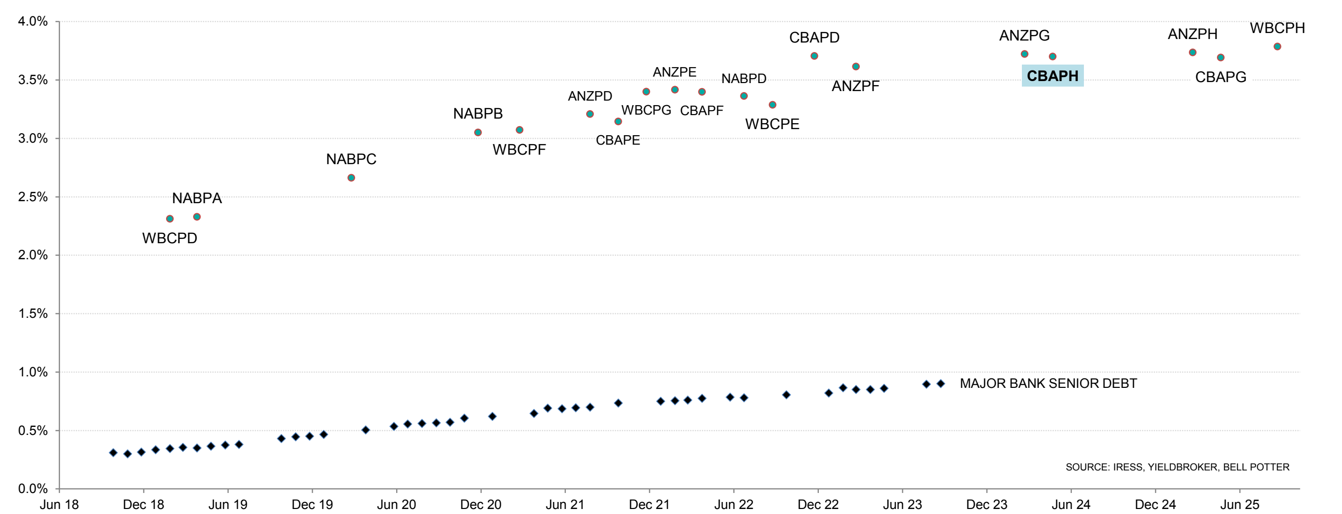


SOURCES: YIELDBROKER, IRESS, BELL POTTER

CBAPH margin reflects current pricing of longer dated hybrids

The 3.70-3.90% bookbuild margin on CBAPH (Apr 2024 optional call) reflects duration of 5.5 years (offers are perpetual and call dates conditional), reflecting secondary market pricing for longer dated CBA hybrids such as CBAPG (Apr 2025 optional call) on a 3.69% trading margin at $99.10. These secondary market trading margins do not factor in any reduction from the incorporation of brokerage costs. By contrast, there is no brokerage charge on subscribing for new issues. Investors also have the ability to bid for their desired holding at face value, versus chasing ASX listed stock where there may be limited liquidity.

Figure 3: Trading margin on ASX listed major bank prefs & capital notes versus wholesale senior debt (31 Oct 2018)



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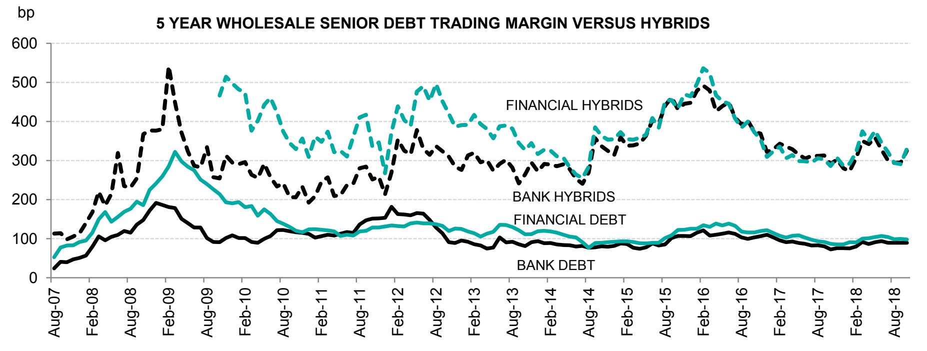
Wholesale funding costs stabilised

The recovery in the hybrid market has seen the spread between the average trading margin on major bank prefs / capital notes and major bank 5 year wholesale senior debt firm from 3.7% to a recent low of 2.0% since early 2016. The weakness in bank share prices and share market volatility has seen this spread modestly increase to 2.35% at 31 October 2018. This compares with an average spread of 2.1% since Jan 2010.

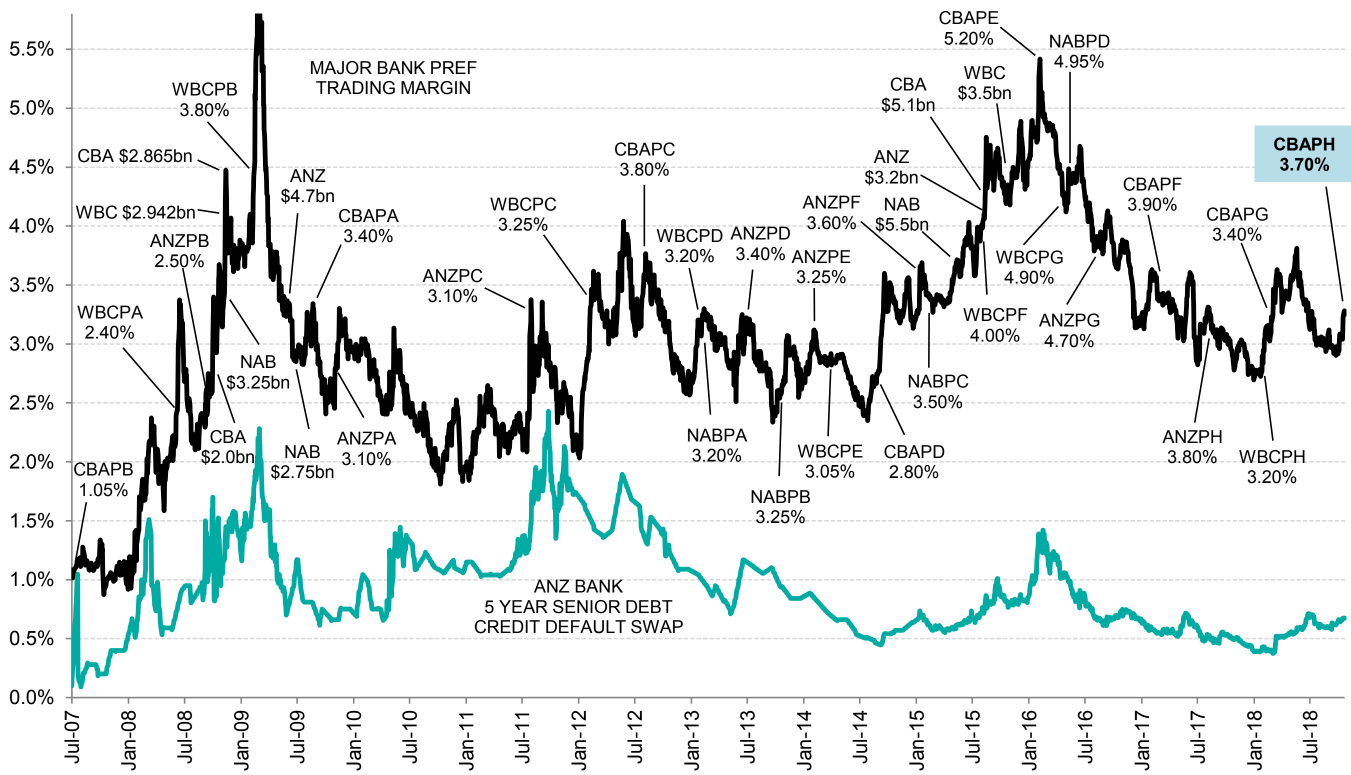
Figure 4: Average trading margins versus wholesale senior debt



SOURCE: YIELDBROKER, BELL POTTER

Assuming CBAPH is priced at the bottom end of the bookbuild range at a margin of 3.70%, this will offer a margin uplift of 0.30% when compared with the CBAPG issue launched in March 2018. The rally in the hybrid market since early 2016 has seen new issue margins on CBA hybrids trend lower from a peak of 5.20% on CBAPE in Feb 2016, to 3.90% on CBAPF in Feb 2017 to now 3.40% on CBAPG in Mar 2018.

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



SOURCES: IRESS, BLOOMBERG, BELL POTTER

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Well priced at a 0.45% spread to the prevailing market average for a 5.5 year security

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 18 major bank prefs and capital notes. Attractive pricing to ensure a listing premium has been a key factor behind the last 14 bank / financial hybrids launched since AMPPA in Oct 2015 listing at a premium. This has been crucial for restoring investor confidence, and support for new hybrid issues.

Assuming CBAPH's issue margin is set at the bottom end of the bookbuild range at 3.70%, this represents a spread of 0.45% to the prevailing market of 3.25% on the 18 major bank convertible prefs / capital notes which have an average duration of 3.5 years. The 0.45% spread indicates CBAPH is well priced for the extra 2 years duration with to CBAPH's optional call date in 5.5 years (Apr 2024), providing a reasonable buffer for an adverse market move between CBAPH launching and listing.

This 0.45% spread is in-line with the median new issue spread of 0.45% on the 41 major bank / financial hybrid issues since 2011. We also note the 14 positive new listings launched between Oct 2015 (AMPPA) and Nov 2017 (BOQPE) had a median spread to the prevailing market of 0.79%. This winning sequence was broken with both WBCPH and CBAPG failing to list at a premium, where the 0.45% and 0.35% issue spreads provided an insufficient buffer longer dated securities (7-7.5 yrs to optional call). Hybrid market weakness also followed from the March 2018 announcement of the Shorten franking policy in March 2018 seeking to stop the cash refund on excess franking credits from July 2019 if the ALP wins the Federal Election.

Figure 6: Listing performance of Basel III Compliant Additional Tier 1 Hybrid Issues: 2011-2018

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
CBAPH	1 Nov 18	3.70%	3.25%	0.45%	18 Dec 2018			
MQGPC	7 May 2018	4.00%	3.50%	0.50%	8 Jun 2018	$100.65	3.76%	0.26%
CBAPG	7 Mar 2018	3.40%	3.05%	0.35%	9 Apr 2018	$97.00	3.46%	0.41%
WBCPH	5 Feb 2018	3.20%	2.75%	0.45%	14 Mar 2018	$99.00	3.47%	0.72%
BOQPE	22 Nov 2017	3.75%	2.90%	0.85%	29 Dec 2017	$101.50	2.86%	-0.04%
SUNPG	23 Oct 2017	3.65%	2.90%	0.75%	27 Nov 2017	$101.50	2.97%	0.07%
BENPG	16 Oct 2017	3.75%	2.90%	0.85%	14 Dec 2017	$101.64	3.00%	0.10%
ANZPH	16 Aug 2017	3.80%	3.30%	0.50%	29 Sep 2017	$101.10	3.12%	-0.18%
SUNPF	27 Mar 2017	4.10%	3.10%	1.00%	8 May 2017	$101.26	3.05%	-0.05%
CGFPB	28 Feb 2017	4.40%	3.25%	1.15%	10 Apr 2017	$101.20	3.17%	-0.08%
CBAPF	20 Feb 2017	3.90%	3.45%	0.45%	3 Apr 2017	$102.00	3.37%	-0.08%
IAGPD	21 Nov 2016	4.70%	3.60%	1.10%	23 Dec 2016	$103.00	3.18%	-0.42%
ANZPG	16 Aug 2016	4.70%	3.80%	0.90%	28 Sep 2016	$100.63	4.02%	0.22%
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:	0.45%				

SOURCE: COMPANY DATA, IRESS, BELL POTTER

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Lower capital raisings and redemptions supporting hybrids

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

- **Hybrid redemptions set to exceed issuance for a second consecutive year:** Following net redemptions in the ASX listed debt and hybrid market of $3.8bn in 2017 ($5.4bn issuance vs $9.2bn of redemptions), 2018 remains on track to be a second consecutive year of net redemptions with $7.5bn of pending redemptions.
- **Modest IPO volumes and no bank equity raisings since 2015:** weakness in hybrids in 2015 coincided with $17.3bn of major bank equity raisings that year.

Figure 7: Issuance 2010-2018

Issuance ($bn)	2010	2011	2012	2013	2014	2015	2016	2017	2018YTD	Cumulative
Hybrid Issuance	0.92	3.42	13.16	8.66	7.46	5.60	7.03	5.42	4.11	55.78
Hybrid Redemptions	1.10	1.68	3.09	2.42	5.90	1.07	5.68	9.24	4.35	34.52
Net Hybrid Issuance	-0.17	1.75	10.07	6.24	1.56	4.53	1.35	-3.82	-0.24	21.26
IPOs	7.98	1.56	1.27	9.69	18.65	7.00	8.32	5.74	6.95	67.17
Major Bank Raisings	0.00	0.00	0.00	0.00	0.00	17.30	0.00	0.00	0.00	17.30
Net Hybrid & Equity Issuance	**7.81**	**3.31**	**11.34**	**15.93**	**20.21**	**28.83**	**9.67**	**1.92**	**6.71**	**105.73**
Bank Pref Avg Trading Margin (31Dec)	1.92%	2.14%	2.76%	2.72%	3.13%	4.48%	3.22%	2.80%	3.25%	
Bank Pref Avg Duration (years) (31Dec)	3.6	3.0	3.2	3.9	5.1	4.4	4.1	3.8	3.5	
Bank 5YrSnr Trading Margin (31Dec)	1.13%	1.54%	0.96%	0.94%	0.82%	1.07%	1.10%	0.76%	0.90%	
CBA CET1 (30 June)	6.6%	7.3%	7.5%	8.2%	9.3%	9.1%	9.6%	10.1%	10.1%	

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

New hybrid issuance to increasingly aligns with refinancings

After 10 years of growing their regulatory capital levels, banks are now increasingly considering capital management initiatives, led by ANZ commencing a $1.5bn on-market buy-back. In this environment, banks hybrid issuance appears increasingly aligned with refinancing maturing securities. In looking at the pipeline of $1.1bn of maturing ASX listed debt securities before Christmas, we expect the trend to continue where banks / financial issuers will refinance via the wholesale debt market.

Figure 8: Pipeline of pending redemptions of ASX listed debt and hybrids

ASX Code	Security	Call Date	Issue Size	ASX Listed Replacement Issue
SUNPD	Suncorp Subordinated Notes	22 Nov 2018	$770m	No
AMPHA	AMP Subordinated Notes 2	18 Dec 2018	$325m	Unlikely
ASX Listed Debt Redemptions Pending			$1,095m	
WHFPB	Whitefield Convertible Reset Pref	30 Nov 2018	$40m	Reset / Holder Exchange offered
CBAPC	CBA PERLS VI	15 Dec 2018	$2,000m	CBAPH
ASX Listed Hybrid Redemptions Pending			$2,040m	
			$3,135m	

SOURCES: COMPANY DATA, BELL POTTER

CommBank PERLS XI Capital Notes

CBAPH reinvestment likely to raise $900m-$1.2bn

If the participation trend in recent reinvestment offers continues at a range of 45-60%, then we expect between $900m to $1.2bn of the $2.0bn CBAPC issue will be reinvested into CBAPH. Given the strength of the hybrid market and lack of new issuance, there is the potential for reinvestment participation to be at the upper end of this range, which will further squeeze the supply available for new money investment.

Figure 9: Participation in reinvestment offer replacement issues

Issue	Target	Bookbuild Completion	Reinvestment Offer	Securityholder Offer	Final Size	Securityholder Full Allocation Cap	Allocation Above Cap	Cornerstone (BNP Paribas Noms)
MQGPC	$600m	$650m	MQGPA $445.7m (74.3%) Scaling 75%, Allocation $334.3m	$15.7m	$1,000m	$5,000	13%	
CBAPG	$750m	$1,250m	No	$115m	$1,365m	Full Allocation		$103m
WBCPH	$750m	$1,450m	WBCPC $623m (52.4%)	$240m	$1,690m	Full Allocation		
BOQPE	$300m	$325m	BOQPD $159m (52.9%)	$25m	$350m	Full Allocation		
SUNPG	$250m	$300m	SUNPC undisclosed	$0m	$375m	No Offer		
BENPG	$300m	$260m	BENPD $124m (46.1%)					
ANZPH	$1,000m	$552m	ANZPC $682m (50.9%)	$248m	$931m	Full Allocation		
SUNPF	$250m	$300m	No	$75m	$375m	$300,000	28.5%	
CGFPB	$350m	$430m	No	$30m	$460m	$300,000	89.7%	
CBAPF	$750m	$1,450m	CNGHA undisclosed	$190m	$1,640m	$15,000	0%	$230m
IAGPD	$300m	$350m	IAGPC $224m (59.5%)	$0m	$404m	No Offer		
ANZPG	$1,000	$1,300m	ANZPA $900m (45.7%)	$322m	$1,622m	Full Allocation		
NABPD	$750m	$1,350m	No	$149m	$1,499m	Full Allocation		$300m
WBCPG	$750m	$1,450m	WCTPA undisclosed	$252m	$1,702m	$25,000	87.5%	$300m
CBAPE	$1,250m	$910m	PCAPA $260m (22.3%)	$540m	$1,450m	$15,000	95.0%	$285m

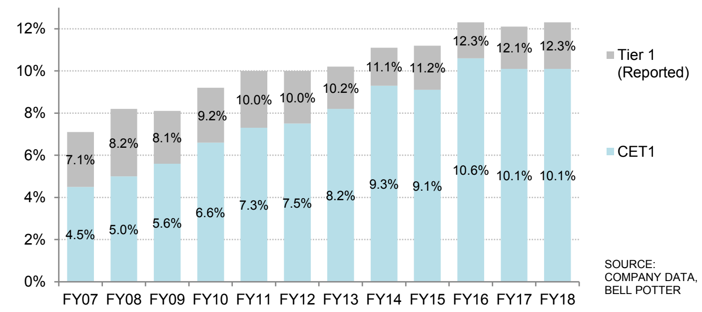
NOTE: ANZPH DID NOT CONDUCT A NEW MONEY BOOKBUILD. SOURCES: COMPANY DATA, IRESS, BELL POTTER

Sound issuer financials

The fundamental strength of the Australian major banks has finally been reflected in the trading margins of their prefs / capital notes. For FY18, CBA reported a 4.8% decline cash net profit to $9.2bn. CBA's Common Equity Tier 1 capital ratio was 10.1% at Jun 2018 to 10.4% at Dec 2017, while the FY18 group impairment charge of $1,079m (15bp of loans) remains near cycle lows.

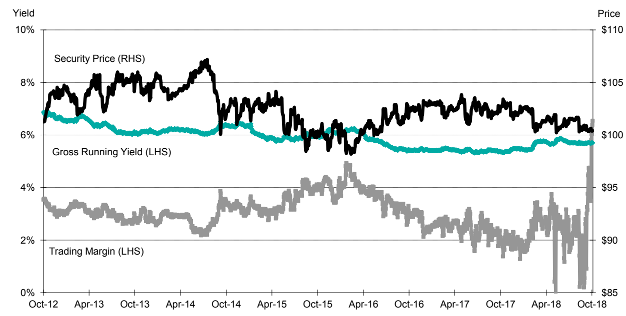
Investors in CBAPC have benefited from the stability of CBA over the past 6 years with this security rarely trading below $100 since listing.

Figure 10: CBA CET1 and Total Tier 1



SOURCE: COMPANY DATA, BELL POTTER

Figure 11: CBAPC security price and trading margin



SOURCE: IRESS, BELL POTTER

CommBank PERLS XI Capital Notes

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.

The Mandatory Exchange Date is 26 April 2026, or, if the Mandatory Exchange Conditions are not satisfied on that date, the first Distribution Payment Date after that date on which the Mandatory Exchange Conditions are satisfied.

On the Mandatory Exchange Date (subject to Maximum Exchange Number and Mandatory Exchange Conditions), investors will receive for each CBAPH a variable number of ordinary shares with a value equal to $101.01. This is based on the initial face value and the VWAP of ordinary shares during the period of 20 business days before the Mandatory Exchange Date with the benefit of a 1% conversion discount. The value of ordinary shares received could be less than this amount if the face value has previously been reduced (following a Capital Trigger Event or Non-Viability).

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 CBA's 20 day VWAP was $69.23 before the issue date, the maximum exchange number would be 2.89 CBA shares per CBAPH security (i.e. $100 / (50% x $69.23)).

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

- First: VWAP of ordinary shares on the 25th business day before a possible Scheduled Conversion Date (19 Mar 2026) must be above 56% of the Issue Date VWAP. Using the above example with the CBA share price on 31 Oct 2018 of $69.23 x 56% = $38.77.
- Second: VWAP of ordinary shares during the 20 business days immediately preceding a potential Mandatory Exchange Date (26 Mar 2026 - 24 Apr 2026) must be greater than 50.51% of the CBAPH Issue Date VWAP (i.e. $34.97 using the above example for Issue Date VWAP).
- Third: Continuous trading (i.e. No Delisting Event) prior to a possible Mandatory Exchange Date - to provide protection should investors wish to sell the ordinary shares they receive upon conversion. A Delisting Event occurs when CBA is delisted or suspended, or there is an Inability Event.

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

Figure 12: Mandatory Exchange Conditions

	CBAPH	ANZPD	ANZPE	ANZPF	ANZPG	ANZPH	CBAPD	CBAPE	CBAPF	CBAPG	NABPA	NABPB	NABPC	NABPD	WBCPD	WBCPE	WBCPF	WBCPG	WBCPH
Issue Date	17-Dec-18	7-Aug-13	31-Mar-14	5-Mar-15	27-Sep-16	28-Sep-17	1-Oct-14	30-Mar-16	31-Mar-17	6-Apr-18	20-Mar-13	17-Dec-13	23-Mar-15	7-Jul-16	8-Mar-13	15-Jun-14	8-Sep-15	30-Jun-16	13-Mar-18
Mandatory Conversion Date	26-Apr-26	1-Sep-23	24-Mar-24	24-Mar-25	20-Mar-26	20-Mar-27	15-Dec-24	15-Oct-23	31-Mar-24	15-Apr-27	22-Mar-21	19-Dec-22	23-Mar-22	8-Jul-24	8-Mar-21	23-Sep-24	22-Mar-23	20-Dec-23	22-Sep-27
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%	1.0%
Issue Date VWAP	$69.23	$29.16	$32.30	$35.18	$26.80	$29.70	$78.62	$75.50	$84.08	$74.57	$30.64	$33.86	$38.03	$25.27	$29.89	$34.37	$31.23	$29.48	$30.37
50% Dilution Cap	$34.62	$14.58	$16.15	$17.59	$13.40	$14.85	$39.31	$37.75	$42.04	$37.28	$15.32	$16.93	$19.02	$12.64	$14.95	$17.23	$15.62	$14.74	$15.19
Max Conv No (Face Value/Dilution Cap)	2.89	6.86	6.19	5.69	7.46	6.73	2.54	2.65	2.38	2.68	6.53	5.91	5.26	7.91	6.69	5.81	6.40	6.78	6.59
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%	56.00%	56.12%	56.12%	56.12%	56.12%	56.12%
Conv Test 1 Security Price	$38.77	$16.33	$18.09	$19.70	$15.01	$16.63	$44.02	$42.28	$47.09	$41.76	$17.16	$18.96	$21.30	$14.15	$16.77	$19.29	$17.53	$16.54	$17.04
Conv Test 2 - % Issue Date VWAP	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%	50.51%	50.51%	50.51%	50.51%
Conv Test 2 Security Price	$34.97	$14.73	$16.31	$17.77	$13.54	$15.00	$39.71	$38.14	$42.47	$37.66	$15.48	$17.10	$19.21	$12.76	$15.10	$17.36	$15.77	$14.89	$15.34
Conv Test 3 - Continuous Trading	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	n/a	n/a	n/a	n/a	n/a
Parent Share Price - 31 Oct 2018	$69.23	$25.93	$25.93	$25.93	$25.93	$25.93	$69.23	$69.23	$69.23	$69.23	$25.21	$25.21	$25.21	$25.21	$26.85	$26.85	$26.85	$26.85	$26.85
Prem/Disc to Dilution Cap	100.0%	77.8%	60.6%	47.4%	93.5%	74.6%	76.1%	83.4%	64.7%	85.7%	64.6%	48.9%	32.6%	99.5%	79.7%	55.9%	72.0%	82.2%	76.8%
Prem/Disc to Conversion Test 1	78.6%	58.8%	43.4%	31.6%	72.8%	55.9%	57.3%	63.7%	47.0%	65.8%	46.9%	33.0%	18.4%	78.1%	60.1%	39.2%	53.2%	62.3%	57.5%

SOURCE: COMPANY DATA, BELL POTTER

CommBank PERLS XI Capital Notes

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 2020. 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 CBAPH must be converted into ordinary equity if the financial position of CBA requires an immediate injection of capital. These prudential standards also require Australian banks to hold a minimum Common Equity Tier 1 (CET1) 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.

The release of APRA's Information Paper 'Strengthening banking system resilience - establishing unquestionably strong capital ratios' on 19 July 2017 outlined a target CET1 ratio inclusive of buffers for the major Australian banks of 10.5% by 1 Jan 2020.

Capital Trigger Event

A Capital Trigger Event occurs when either CBA determines, or when APRA notifies CBA that it believes CBA's Common Equity Tier 1 Capital Ratio is equal to or less than 5.125%. Under this Trigger, CBA must immediately convert enough CBAPC, CBAPD, CBAPE, CBAPF, CBAPG and CBAPH securities on an approximate pro rata basis to boost the Common Equity Tier 1 (CET1) Capital Ratio above 5.125%.

CBA's Basel III Common Equity Tier 1 Capital Ratio at 30 Jun 2018 stood at 10.1%, providing a buffer of over $23bn above the 5.125% threshold. If we include CBA's cash net profit from continuing operations for the 12 months to June 2018 of $9.2bn, a breach of the Common Equity Trigger requirement currently appears very low, particularly as CBA has options such as cutting ordinary dividends and undertaking equity raisings.

Non-Viability Trigger Event

In addition, CBAPH will be converted if APRA determines that CBA 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.

CommBank PERLS XI Capital Notes

Potential for Loss under Trigger Event if CBA below $13.85

Exchange resulting from a Capital Trigger Event or a Non-Viability Trigger Event will be done at the VWAP of CBA shares traded on the 5 Business Days immediately preceding the Conversion Date. While this is not subject to the Mandatory Exchange 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 CBA's 20 day Issue Date VWAP was $69.23, the maximum conversion number would be 7.22 CBA shares per CBAPH security (i.e. $100 / (20% x $69.23)). As such, CBAPH investors may be exposed to receiving less than face value if CBAPH is converted at less than $13.85. 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, CBAPH holders will hold ordinary shares and rank equally with other holders of ordinary shares (i.e. lose priority ranking).

Inability Event

One additional risk is an Inability Event where CBAPH will be written off if CBA 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 CBA being prevented from issuing ordinary shares due to laws relating to the insolvency, winding-up or other external administration of CBA, Australian foreign investment laws, the Corporations Act or other applicable laws, an order of a court, an action of any Government authority or operational delays.

Under an Inability Event, CBAPH holder's rights (including to distributions and face value) are immediately and irrevocably terminated, resulting in CBAPH losing its value and investors will not receive any compensation.

CommBank PERLS XI Capital Notes

Investment risks

Key Security Risks include:

- CBAPH is not a bank deposit protected by the Government guarantee scheme
- CBAPH is subordinated and unsecured, and ranks behind deposits, senior debt and subordinated debt in CBA.
- CBAPH distributions are non-cumulative and discretionary.
- CBAPH distribution payments are subject to the following Payment Conditions:
  - ⇒ CBA, in its absolute discretion, making the Distribution;
  - ⇒ Payment not resulting in a breach of CBA's capital requirements as they are applied to CBA (on a Level 1 basis) or the CBA Group (on a Level 2 basis) under APRA's current Prudential Standards at the time of payment;
  - ⇒ Payment not resulting in CBA 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.
- In elected at the 2019 Federal Election, the ALP intends to introduce a policy to prevent certain individuals and superannuation funds being entitled to receive a cash refund on any excess franking credits from 1 July 2019. If introduced, CBA will not be required to gross up CBAPH distributions and no redemption right is expected to be triggered. This policy may impact the cost and efficiency of CBA raising Tier 1 and Additional Tier 1 Capital in the future.
- Adverse change in CBA'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.
- CBAPH will lose its value and investors will not receive any compensation if CBA 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 CBA 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 CBAPH at the 26 Apr 2026 Mandatory Exchange Date requires CBA's share price at the time of Mandatory Exchange to be above certain thresholds. If these thresholds are not met in Apr 2026 or at future quarterly distribution payment dates, CBAPH may remain on issue indefinitely.
- CBAPH holders may receive $101.01 of ordinary shares for each CBAPH security held on the Mandatory Exchange Date, based on the 20 day VWAP. This VWAP may be higher than the market value of CBA shares converted.

CommBank PERLS XI Capital Notes

Investment risks (continued)

Key Business Risks of CBA include:

- A material deterioration in global capital markets and the Australian economy.
- Adverse regulatory changes.
- Adverse regulatory impact as a result of the Royal Commission into the banking, superannuation, and financial services industries. The Royal Commission is scheduled to table its final report due by 1 Feb 2019.
- Adverse outcome of allegations filed by the Australian Transaction Reports and Analysis Centre (AUSTRAC) in the Federal Court regarding breaches of Australia's anti money laundering and terrorism financing laws.
- Operational risks and trading errors.
- Increasing competition.
- Credit rating downgrades.
- Losses associated with counterparty exposures.
- Poor performance of acquired businesses.

Refer page 55 (Section 5) of the prospectus dated 1 November 2018 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 CBAPH – 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

CBA has developed an interactive module on bank hybrid securities basics which may assist you to better understand bank hybrid securities, their features and risks. It explains the different ways you may invest in a bank, including by depositing money or investing in securities issued by a bank.

The module is available from www.commbank.com.au or from:

commbank.com.au/about-us/shareholders/securities/bank-hybrid-securities-basics.html

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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**