Analysts

Damien Williamson 613 9235 1958

Barry Ziegler 613 9235 1848

Authorisation

TS Lim 612 8224 2810

Macquarie Bank Capital Notes (MBLPA)

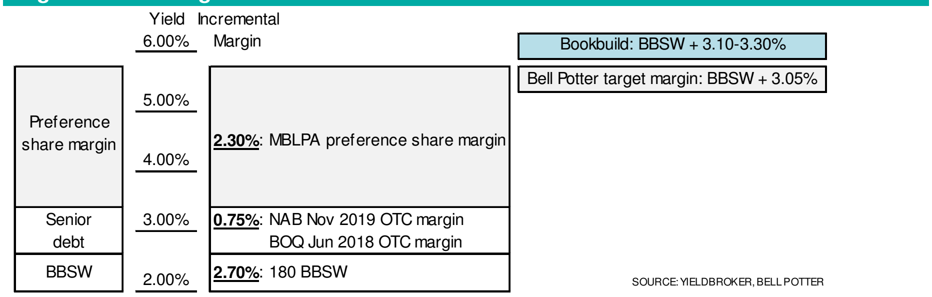
Fixed Income

Take advantage while there still is quality new supply

The new $400m Macquarie Bank Capital Notes (MBLPA) offers investors another well priced new Additional Tier 1 hybrid security from a quality issuer. The partially franked dividend may suit investors seeking a greater cash dividend income. Assuming the margin is set a 3.10%, bottom end of the 3.10-3.30% bookbuild range, income based on current 180BBSW of 2.70% is 5.80% gross. Reducing franking from 100% to 40% boosts cash income from 4.06% to 4.95%. As international income represented 68% of Macquarie's FY14 total income, ongoing dividends should remain partially franked.

As the largest non major bank issue since the $600m MQGPA in May 2013, MBLPA could well be the last bank hybrid issue in 2014. The only top 200 ASX listed banks not to launch Additional Tier 1 securities in 2014 are BOQ and NAB (2013 raised $3.2bn: $1.5bn NABPA, $1.7bn NABPB). While there has been a flurry of new issuance over recent weeks with $3.2bn raised from CBAPD ($2.6bn), CGFPA ($340m) and BENPE ($250m), this essentially offsets the $3bn of pending redemptions over Sep/Oct 2014.

Figure 1: Fair margin on MBLPA



SOURCE: YIELDBROKER, BELL POTTER

Overall we assess a MBLPA fair margin of 3.05%, equating to a 2.30% margin premium on NAB Nov 2019 wholesale senior debt (0.75% trading margin). This also equates to a 0.40% premium above our assessed 2.65% fair margin on CBAPD (Dec 2022 call). The combination of historically high issue margins, prospect of improvement in credit spreads and reduced new issuance pipeline provides the potential for MBLPA to trade at a modest premium.

Figure 2: Trading margins on debt and equity securities

	Ranking	Security	Trading Margin over BBSW	Maturity / Mand Conv	First Call
Higher Ranking	Senior debt	NAB (OTC) senior	75bp	Nov 2019	
↑	Subordinated debt	AMPHA	190bp	Dec 2023	Dec 2018
	Preference securities	MQGPA	320bp	Jun 2021	Jun 2018
↓		**MBLPA (Additional Tier 1)**	**310-330bp**	**Mar 2023**	**Mar 2020**
Lower Ranking	Equity	Ordinary MQG shares	~400bp	Perpetual	

SOURCE: YIELDBROKER, BELL POTTER

Key features

- **Initial grossed up running yield of 5.80% (4.95% cash yield franked at 40%):** Floating rate based on 180BBSW of 2.70% + bookbuild margin of 3.10%.
- **First option to redeem or convert at Mar 2020. Mandatory exchange Mar 2023.** Subject to APRA approval, Macquarie has the option to redeem or convert at the Optional Exchange Dates on 24 Mar 2020, 24 Sep 2020 and 24 Mar 2021.
- **Ordinary dividend restrictions:** Applies on the non payment of MBLPA dividends
- **Automatic conversion under the Capital Trigger / Non-Viability Trigger Events**

Issue overview

Issuer	Macquarie Bank
Issue ASX code	MBLPA
Face value	$100
Estimated offer size	$400m
Bookbuild margin	3.10-3.30%
Franking	40%
Dividend payments	Half yearly
First dividend payment	24 Mar 2015
Minimum application	$5,000
First optional exchange	24 Mar 2020
Mandatory exchange	24 Mar 2023

Timeline

Lodgement of prospectus	15 Sep 2014
Bookbuild margin	19 Sep 2014
Announcement of margin	23 Sep 2014
Offer opens	23 Sep 2014
Offer closes:	
Securityholder & general	3 Oct 2014
Broker firm	7 Oct 2014
Issue date	8 Oct 2014
ASX listing (deferred settlement)	9 Oct 2014

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

Macquarie Bank Capital Notes

Macquarie Bank Overview

MBLPA represents a Capital Note of Macquarie Bank Limited (MBL). This security is fully paid, subordinated, non-cumulative, unsecured and potentially perpetual if conditions for Exchange are not met. Issue terms provide for conversion at the Mandatory Exchange date in March 2023, while Trigger Events may result in automatic conversion.

With a history dating back to 1969, MBL is an Authorised Deposit Taking Institution (ADI) regulated by APRA providing banking, financial, advisory, investment and funds management services to institutional, corporate and retail clients and counterparties around the world. In November 2007, Macquarie Group (MQG) was formed as a result of a corporate restructure, comprising a Bank Group and a Non-Bank Group. MQG is currently the 13th largest ASX listed company with a market cap of $18.6bn. In the year to March 2014, MBL contributed $752m to MQG's net profit of $1,265m. MBL consists of five operating groups:

- **Corporate & Asset Finance:** Corporate debt and asset financing across aircraft, motor vehicles, technology, healthcare, manufacturing, industrial, energy, rail and mining equipment. FY14 net profit before corporate overhead up 19% to $826m, with its asset finance and corporate lending portfolio increasing 14% to $25.5bn, while its real estate lending portfolio increased 12% to $9.0bn.
- **Banking & Financial Services:** Provides personal banking, wealth management and business banking products and services to retail clients, advisers, brokers and business clients. FY14 net profit before corporate overhead up 7% to $260m, driven by mortgage portfolio growth, 20% organic growth in funds under administration, and profit on sale of its 19.9% interest in OzForex via its IPO.
- **Macquarie Funds:** Global asset manager offering a diverse range of products. FY14 net profit before corporate overhead up 39% to $1,051m, driven by increased annuity base fee income and a 24% increase in assets under management to $425bn. $579m of this profit is attributable to the Non-Bank Group for Macquarie Infrastructure and Real Estate Division.
- **Fixed Income, Currencies & Commodities (FICC):** Provides trading, risk management, sales, structuring, financing and market analysis and strategy services. FY14 net profit before corporate overhead up 29% to $726m, boosted by a 58% increase in income from commodities related activities. $83m of this profit is attributable to the Non-Bank Group for certain assets of the Credit Trading business and other less financially significant activities of FICC.
- **Macquarie Securities:** Global institutional securities house. FY14 net profit before corporate overhead $107m vs FY13 loss of $50m, boosted by increased market volumes and equities capital markets activities. $89m of this profit is attributable to the Non-Bank Group for certain activities of the Cash division and the Derivatives function of Macquarie Securities.

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

- **Macquarie Capital:** Offers a range of advisory and capital raising services. FY14 net profit before corporate overhead up 84% to $269m, ranking number 1 in Australia for announced and completed mergers and acquisitions transactions in 2013 with 450 transactions worth $89bn.

Macquarie Bank Capital Notes

Macquarie Bank Financials

At March 2014, MBL had total assets of $139.9bn, which included $57.7bn of loan assets. The loan book is predominately weighted towards mortgages (42.8%), corporate and commercial lending (27.5%) and lease and retail financing (18.9%).

Figure 3: Macquarie Bank Loan Assets

Macquarie Bank Loan Assets	FY14	% loans	FY13	% loans	Growth
Year Ending 31 March	$bn		$bn		FY14 vs FY13
Mortgages	24.7	42.8%	20.8	41.8%	19.0%
Corporate & commercial	15.9	27.5%	13.2	26.5%	20.6%
Lease and retail financing	10.9	18.9%	9.6	19.3%	14.1%
Other	6.2	10.8%	6.2	12.5%	0.6%
Total Loans	**57.7**		**49.7**		**16.2%**

SOURCE: COMPANY DATA, BELL POTTER

MBL asset quality remained sound in FY14 with the impairment charge of $350m equating to 0.25% of the $139.9bn asset base.

Figure 4: Macquarie Segment Net Profit, Assets and Impairment Charge

	FY14 Net Profit ($m)			**FY14 Segment Assets ($m)**		
Division	**Bank**	**Non Bank**	**Group**	**Bank**	**Non Bank**	**Group**
Macquarie Funds	472	579	1,051	6,365	2,217	8,582
Corporate and Asset Finance	816	10	826	26,370	173	26,543
Banking and Financial Services	261	-1	260	29,611	1	29,612
Macquarie Securities	18	89	107	20,830	5,185	26,015
Fixed Income, Currencies & Commodities	643	83	726	43,646	1,165	44,811
Macquarie Capital	0	280	280	0	2,885	2,885
Corporate	-1,458	-527	-1,985	13,089	2,367	15,456
Total	**752**	**513**	**1,265**	**139,911**	**13,993**	**153,904**

	FY14 Impairment ($m)			**Impairment / Segment Assets %**		
Division	**Bank**	**Non Bank**	**Group**	**Bank**	**Non Bank**	**Group**
Macquarie Funds	0	4	4			
Corporate and Asset Finance	-85	0	-85	0.32%		0.32%
Banking and Financial Services	-49	2	-47	0.17%		0.16%
Macquarie Securities	-5	0	-5	0.02%		0.02%
Fixed Income, Currencies & Commodities	-206	158	-48	0.47%	-13.56%	0.11%
Macquarie Capital	0	-208	-208		7.21%	7.21%
Corporate	-5	-113	-118	0.04%	4.77%	0.76%
Total	**-350**	**-157**	**-507**	**0.25%**	**1.12%**	**0.33%**

SOURCE: COMPANY DATA, BELL POTTER

At 31 March 2014, Macquarie's CET1 ratio was sound at 9.62%, equating to a $2.95bn surplus over 5.125% threshold for the Capital Trigger Event.

Figure 5: APRA Basel III Common Equity Tier 1 Capital at 31 March 2014

APRA Basel III Capital Adequacy			**7.00% CET1**	**5.125% CET1**
At March 2014	**$m**	**% RWA**	**Surplus $m**	**Surplus $m**
Common Equity Tier 1 (CET1)	6,318	9.62%	1,719	2,951
Tier 1	6,961	10.60%		
Risk Weighted Assets (RWA)	65,698			

SOURCE: COMPANY DATA, BELL POTTER

Macquarie Bank Capital Notes

Historically high margins limit downside risk

Given the improvement in the ASX listed debt and hybrid market and wholesale markets, the 3.10-3.30% MBLPA margin range remains elevated compared with pre GFC levels.

Figure 6: New Issue margins on comparative financial preference shares and capital notes

Listing Date	Issuer	ASX Code	Description	Margin over BBSW	Listing Date	Issuer	ASX Code	Description	Margin over BBSW
7-Apr-06	CBA	PCAPA	PERLS III	1.05%	7-Nov-12	SUN	SUNPC	Convertible Preference Shares 2	4.65%
22-Jun-06	WBC	WCTPA	Trust Preferred Securities	1.00%	27-Dec-12	BOQ	BOQPD	Convertible Preference Shares	5.10%
11-Jul-07	CBA	CBAPB	PERLS IV	1.05%	12-Mar-13	WBC	WBCPD	Capital Notes	3.20%
13-Jun-08	SUN	SBKPB	Convertible Preference Shares	3.20%	21-Mar-13	NAB	NABPA	Convertible Preference Shares	3.20%
29-Jul-08	WBC	WBCPA	Stapled Preferred Securities	2.40%	11-Jun-13	MQG	MQGPA	Capital Notes	4.00%
1-Oct-08	ANZ	ANZPB	Convertible Preference Shares	2.50%	8-Aug-13	ANZ	ANZPD	Capital Notes	3.40%
30-Mar-09	WBC	WBCPB	Stapled Preferred Securities II	3.80%	18-Dec-13	NAB	NABPB	Convertible Preference Shares II	3.25%
13-Oct-09	CBA	CBAPA	PERLS V	3.40%	1-Apr-14	ANZ	ANZPE	Capital Notes 2	3.25%
18-Dec-09	ANZ	ANZPA	Convertible Preference Shares 2	3.10%	9-May-14	SUN	SUNPE	Convertible Preference Shares 3	3.40%
29-Sep-11	ANZ	ANZPC	Convertible Preference Shares 3	3.10%	24-Jun-14	WBC	WBCPE	Capital Notes 2	3.05%
26-Mar-12	WBC	WBCPC	Convertible Preference Shares	3.25%	2-Oct-14	CBA	CBAPD	PERLS VII Capital Notes	2.80%
2-May-12	IAG	IAGPC	Convertible Preference Shares	4.00%	8-Oct-14	CGF	CGFPA	Capital Notes	3.40%
18-Oct-12	CBA	CBAPC	PERLS VI	3.80%	9-Oct-14	MQG	MBLPA	Capital Notes	3.10-3.30%
1-Nov-12	BEN	BENPD	Convertible Preference Shares	5.00%	13-Oct-14	BEN	BENPE	Convertible Preference Shares 2	3.20%

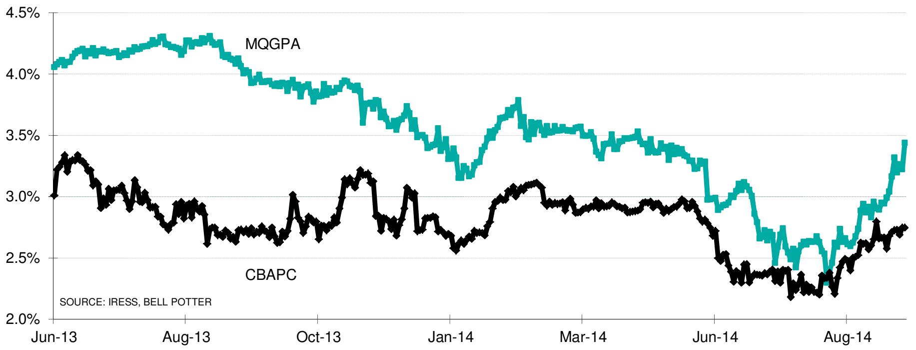
SOURCE: COMPANY DATA, BELL POTTER

Closing margin gap between financial and major bank prefs

In mid 2008, the margin differential between a Macquarie and a major bank pref was 1.10%. WBCPA (Sep 2013 mandatory conversion) was priced at a margin of 2.40% above 90BBSW, while MQCPA (June 2013 mandatory conversion) was priced at a margin of 3.50% above 5 year swap. In early 2013 this narrowed to 0.80%. WBCPD (Mar 2019 call) was priced at a margin of 3.20% above 90BBSW, versus MQGPA (Jun 2018 call) at 4.00% above 180BBSW. This has closed to potentially 0.30% with CBAPD (Dec 2022 call) priced at 2.80% above 90BBSW, while bottom end of the MBLPA (Mar 2020 call) bookbuild margin is 3.10% above 180BBSW. On an adjusted basis, this 0.30% is effectively ~0.55% allowing for the 2.75 years shorter duration on MBLPA.

If we compare the trading margin differential between MQGPA (Jun 2018 call) and CBAPC (Dec 2018 call) since MQGPA listed in June 2013, MQGPA's trading margin has on average been 0.75% higher than CBAPC (3.54% vs 2.79%). Over 2014 this has narrowed to 0.47% (3.18% vs 2.71%), narrowing as much as 0.29% (2.74% vs 2.45%) in trading since 1 July 2014.

Figure 7: Trading margin on CBAPC and MQGPA



Macquarie Bank Capital Notes

Bookbuild margin range attractive relative to financial prefs

The recovery in credit markets is highlighted by the chart in Figure 8 which tracks the average trading margins since January 2013 splits across 5 sectors:

* Financial Prefs (BENPD, BOQPD, IAGPC, IANG, MQGPA, SUNPC, SUNPE)
* Industrial Subordinated Debt (AGKHA, AQHHA, CTXHA, CWNHA, ORGHA, TAHHB)
* Bank Prefs (ANZPA, ANZPC, ANZPD, ANZPE, CBAPC, NABPA, NABPB, WBCPC, WBCPD, WBCPE)
* Financial Subordinated Debt (AMPHA, AYUHA, CNGHA, SUNPD)
* Bank Subordinated Debt (ANZHA, NABHB, WBCHA, WBCHB).

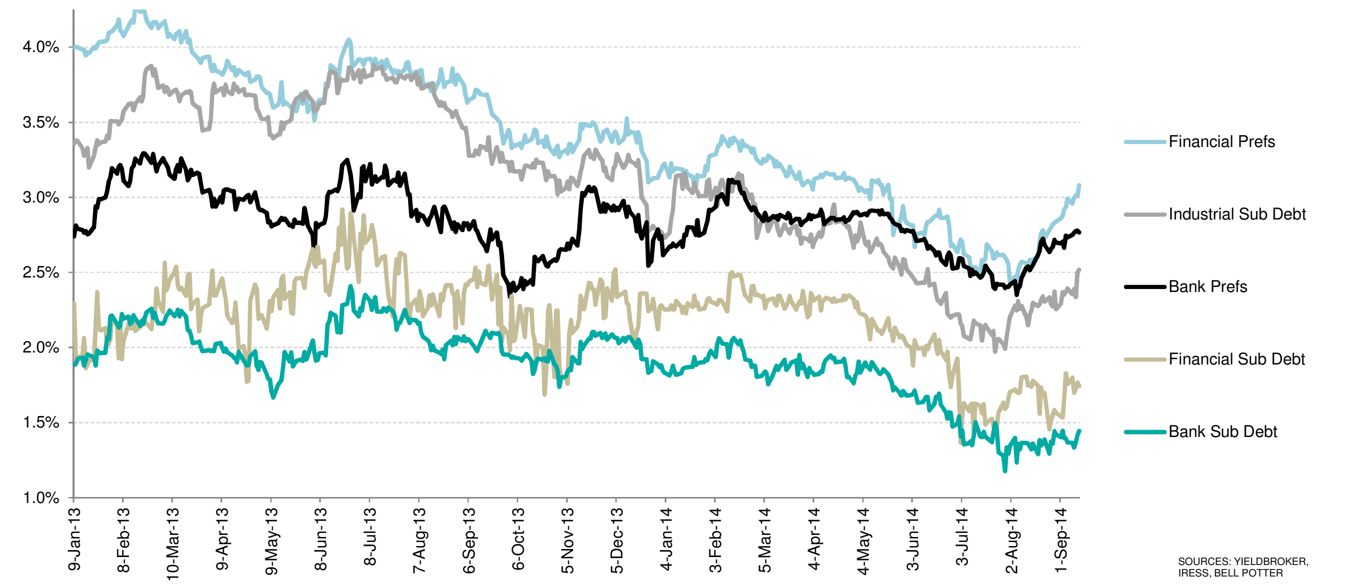
Up until early 2014, the two sectors with lower trading margins to major bank prefs were major bank subordinated debt and financial subordinated debt. As at 2 September 2014, the major bank prefs are at the upper end of these five sectors, on a trading margin fractionally below the lower rated financial prefs.

It is also worth noting the average of the average trading margin on the seven financial prefs from BEN, BOQ, IAG, MQG and SUN was continuously below 3.00% between 20 May 2014 and 8 September 2014, hitting a low of 2.43% on 1 August 2014. This highlighting the attractiveness of the 3.10-3.30% bookbuild margin range on MBLPA, particularly once the market digests the four current issues.

The lack of new supply up until mid August 2014 saw trading margins firming lower. The launch of CBAPD, CGFPA, BENPE and MBLPA has seen greater value emerge in the major bank prefs and the financial prefs. These sectors have dominated new issuance since early 2013.

Lack of supply of new debt securities combined with redemptions has been a key factor behind the greater margin compression of the other three debt sectors.

Figure 8: Trading margins on ASX listed debt and hybrid sectors



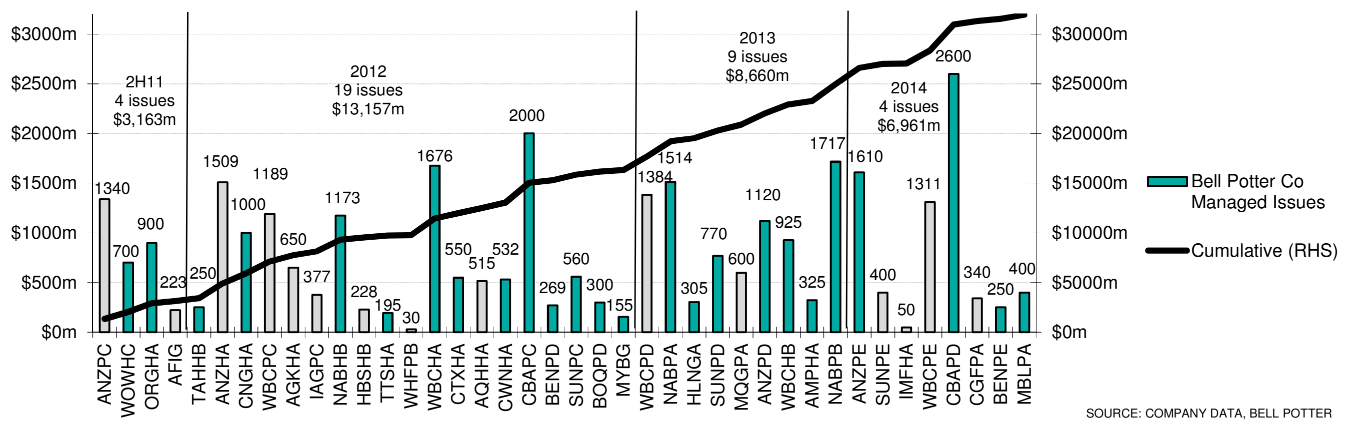
SOURCES: YIELDBROKER, IRESS, BELL POTTER

Macquarie Bank Capital Notes

$3bn of redemption money looking for a home

Prior to the launch of CBAPD only $3,371m had been raised in the 4 issues in 2014. Factoring in year-to-date redemptions of $1,166m reduced net raisings to $2,205m. Over Sep / Oct 2014, it is expected six ASX listed debt & hybrids will be redeemed, with a face value of $3,054m. The CBAPD, CGFPA, BENPE and MBLPA issues currently have the potential to raise $3,590m, only adding $536m of net new issuance.

Figure 9: New ASX listed debt and hybrid issues: August 2011 - September 2014



SOURCE: COMPANY DATA, BELL POTTER

Since Sep 2012, new issuance has been dominated by financial issuers, with 19 of the 22 issues. While 2014 has seen BEN, IAG, WBC and ANZ all issue Tier 2 subordinated debt securities in the wholesale market, every ASX listed financial issue this year has been an Additional Tier 1 hybrid. If bank new issuance is aligned with replacement of maturing securities, the next two hybrid issues could be for BENPB ($90m) ahead of its June 2015 step-up date and PCAPA ($1,167m) ahead of its April 2016 step-up date.

Figure 10: Pending redemptions of ASX listed debt and hybrid securities

Security	Call / Maturity	Amount ($m)	Replacement Issue Considerations
BENHA	17-Mar-14	90.5	No - Jan 2014 $300m Basel III compliant Tier 2 subordinated debt issue (wholesale)
TAHHA	1-May-14	284.5	No - Senior debt refinancing
AQNHA	15-May-14	172.1	AMPHA
ANZPB	16-Jun-14	454.3	ANZPE
LEPHC	20-Aug-14	165.0	No - Senior debt refinancing
AAZPB	12-Sep-14	275.0	Redemption $100 cash + $1.5155 interest (74 days) on 12 Sep 2014 following Change of Control event
2014 YTD Redemptions		**1,441.4**	
TPAPA	30-Sep-14	250.0	Redemption $100 cash + $3.05 fully franked on 30 Sep 2014 following sale of NZ Business
WBCPB	30-Sep-14	379.4	Remaining securities from WBCPE offer will be redeemed
BENPC	10-Oct-14	100.0	$250m BENPE offer
HBSHA	27-Oct-14	50.0	"Strong preference" to redeem at 27 Oct 2014 step-up date (subject to APRA approval). Multiple refinancing options.
CBAPA	31-Oct-14	2,000.0	$2.6bn CBAPD offer
Total 2014 (remaining)		**2,779.4**	
BENPB	15-Jun-15	90.0	Chance of Basel III compliant Tier 1 replacement issue - BENPE raising may be sufficient to fund redemption
PRYHA	28-Sep-15	152.3	Senior debt refinancing increasingly likely
CBAHA	24-Dec-15	570.0	Ease of raising wholesale senior debt vs ASX listed
Total 2015		**812.3**	
PCAPA	6-Apr-16	1,166.5	Basel III compliant Tier 1 replacement issue expected
AYUHA	14-Apr-16	120.0	Multiple refiancing options
PPCG	16-Jun-16	50.0	Potential ASX issue for funding diversification
WCTPA	30-Jun-16	762.7	Basel III compliant Tier 1 replacement issue expected
WOWHC	24-Nov-16	700.2	WOWHA (1999) replaced by WOWHB (2006). WOWHC (2011) launched shortly after WOWHB redemption
ANZPA	15-Dec-16	1,968.7	Basel III compliant Tier 1 replacement issue expected
ORGHA	22-Dec-16	900.0	Gearing likely to reduce following completion of APLNG
Total 2016		**5,668.2**	

SOURCE: COMPANY DATA, BELL POTTER

Macquarie Bank 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 conversion number in order to limit the dilution of ordinary shares upon conversion.

This maximum conversion 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 $57.95 before the issue date, the maximum conversion number would be 3.45 MQG shares per MBLPA security (i.e. $100 / (50% x $57.95)).

To protect MBLPA 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 Mandatory Exchange Date (17 Feb 2023) must be above 56% of the Issue Date VWAP. Using the MQG price on 12 Sep 2014 of $57.95 x 56% = $32.54.
- Second: VWAP of ordinary shares during the 20 business days immediately preceding a potential Mandatory Exchange Date (24 Feb 2023 - 23 Mar 2023) must be greater than 50.51% of the MBLPA Issue Date VWAP (i.e. $29.27).
- Third / Fourth: Continuous trading prior to a possible Mandatory Exchange Date - to provide protection should investors wish to sell the ordinary shares they receive upon conversion. A Suspension Event (third exchange condition) and a Delisting Event (fourth exchange condition) occurs when MQG 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 dividends at the same margin. The Exchange Conditions will be tested on each subsequent future half yearly dividend date.

Figure 11: Mandatory Exchange Conditions

	MQGPA	ANZPA	ANZPC	ANZPD	ANZPE	BENPD	BOQPD	CBAPC	IAGPC	MQGPA	NABPA	NABPB	SUNPC	SUNPE	WBCPC	WBCPD	WBCPE
Date of Hybrid Issue	8-Oct-14	18-Dec-09	29-Sep-11	7-Aug-13	31-Mar-14	1-Nov-12	24-Dec-12	17-Oct-12	1-May-12	8-Jul-08	20-Mar-13	17-Dec-13	20-Mar-13	8-May-14	23-Mar-12	8-Mar-13	15-Jun-14
Mandatory Conversion Date	24-Mar-23	15-Dec-16	1-Sep-17	1-Sep-23	24-Mar-22	13-Dec-19	15-Apr-20	15-Dec-20	1-May-19	7-Jun-18	22-Mar-21	19-Dec-22	22-Mar-21	17-Jun-22	30-Mar-20	8-Mar-21	23-Sep-24
Conversion Discount	1.0%	1.0%	1.0%	1.0%	1.0%	2.5%	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	$57.95	$21.80	$19.53	$29.16	$32.30	$7.98	$7.11	$56.08	$3.46	$42.42	$30.64	$33.86	$9.49	$12.92	$20.83	$29.89	$34.37
50% Dilution Cap	$28.98	$10.90	$9.77	$14.58	$16.15	$3.99	$3.55	$28.04	$1.73	$21.21	$15.32	$16.93	$4.75	$6.46	$10.42	$14.95	$17.23
Max Conv No (Face Value/Dilution Cap)	3.45	9.17	10.24	6.86	6.19	25.06	28.15	3.57	57.80	4.71	6.53	5.91	21.07	15.48	9.60	6.69	5.81
Conv Test 1 - % Issue Date VWAP	56.00%	56.00%	56.00%	56.00%	56.00%	57.50%	56.12%	56.00%	57.50%	55.56%	56.00%	56.00%	56.00%	55.00%	55.56%	56.12%	56.12%
Conv Test 1 Security Price	$32.45	$12.21	$10.94	$16.33	$18.09	$4.59	$3.99	$31.41	$1.99	$23.57	$17.16	$18.96	$5.31	$7.11	$11.57	$16.77	$19.33
Conv Test 2 - % Issue Date VWAP	50.51%	50.51%	51.28%	50.51%	51.28%	51.28%	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	$29.27	$11.01	$10.01	$14.73	$16.56	$4.09	$3.59	$28.33	$1.75	$21.43	$15.48	$17.10	$4.79	$6.53	$10.52	$15.10	$17.40
Conv Test 3 - Continuous Trading	Yes	Yes	Yes	Yes	Yes	Yes	Yes	n/a	Yes	Yes	Yes	Yes	Yes	Yes	n/a	n/a	n/a
Parent Share Price - 12 Sep 2014	$57.95	$32.83	$32.83	$32.83	$32.83	$12.60	$12.56	$80.23	$6.15	$57.95	$34.25	$34.25	$14.55	$14.55	$34.25	$34.25	$34.09
Prem/Disc to Dilution Cap	100.0%	201.2%	236.2%	125.2%	103.3%	215.8%	253.5%	186.1%	255.5%	173.2%	123.6%	102.3%	206.6%	125.2%	228.9%	129.2%	97.9%
Prem/Disc to Conversion Test 1	78.6%	168.9%	200.2%	101.0%	81.5%	174.6%	215.0%	155.5%	209.1%	145.9%	99.6%	80.6%	173.8%	104.8%	195.9%	104.2%	76.3%

SOURCE: COMPANY DATA, BELL POTTER

Macquarie Bank 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 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 MBLPA must be converted into ordinary equity if the financial position of MBL 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 increases to 7.0% on 1 Jan 2016 after inclusion of the 2.5% Capital Conservation Buffer.

Capital Trigger Event

A Capital Trigger Event occurs when either MBL determines, or when APRA notifies MBL that it believes MBL's Common Equity Tier 1 Capital Ratio has is equal to or less than 5.125%. Under this Trigger, MBL must immediately Exchange enough MBLPA securities to boost the Common Equity Tier 1 (CET1) Capital Ratio above 5.125%. MBL's Basel III Common Equity Tier 1 Capital Ratio at 31 March 2014 stood at 9.62%, providing a buffer of $2,951m. If we include MBL's net profit for the 12 months to March 2014 of $752m, a breach of the Common Equity Trigger requirement appears low, particularly as Macquarie has options such as cutting ordinary dividends, divesting assets and raising equity.

Non-Viability Trigger Event

In addition, MBLPA will be Exchanged if APRA determines that MBL 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 MQG under $11.59

Conversion resulting from a Capital Trigger Event or 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 Exchange Conditions, it is still subject to the Maximum Exchange 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 $57.95, the maximum conversion number would be 8.63 MQG shares per MBLPA security (i.e. $100 / (20% x $57.95)). As such, MBLPA investors may exposed to receiving less than face value if MBLPA is converted at less than $11.59. 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, MBLPA holders will hold ordinary shares and rank equally with other holders of ordinary shares (i.e. lose priority ranking).

Macquarie Bank Capital Notes

Inability Event

One additional risk is an Inability Event where MBLPA will be written off if Macquarie is not able to issue ordinary MQG shares from Exchange 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 Macquarie 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, MBLPA holder’s rights (including to dividends and face value) are immediately and irrevocably terminated, resulting in MBLPA losing its value and investors will not receive any compensation.

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).

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 Bank Capital Notes

Other investment risks

Key Security Risks include:

- MBLPA is not a bank deposit protected by the Government guarantee scheme.
- As preferred equity, MBLPA ranks behind deposits, senior debt and subordinated debt in MBL.
- MBLPA dividends are at MBL's discretion and are non-cumulative.
- MBLPA dividend payments must not result in a breach of MBL's capital adequacy requirements under APRA's prudential standards, or payment must not result in MBL becoming insolvent.
- 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 MBL's and 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 Common Equity Trigger Event. Automatic conversion may also be required under the Non-Viability Trigger Event.
- MBLPA will lose its value and investors will not receive any compensation if Macquarie is not able to issue ordinary shares in MQG within 5 business days from Exchange under a Capital Trigger Event or Non-Viability Trigger. Scenarios under which this may occur include Macquarie 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 MBLPA at the March 2023 Mandatory Conversion Date requires MQG's share price at the time of Mandatory Conversion to be above certain thresholds. If these thresholds are not met in March 2023 or at future half yearly dividend payment dates, MBLPA may remain on issue indefinitely.

Macquarie Bank Capital Notes

Other investment risks

Key Business Risks of Macquarie include:

- Adverse financial performance of MQG may impact the ability of MBL to make scheduled MBLPA 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 my 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 54 of the prospectus for further information on risks.

Fixed Income

Bell Potter Securities Limited
ACN 25 006 390 772
Level 38, Aurora Place
88 Phillip Street, Sydney 2000
Telephone +61 2 9255 7200
www.bellpotter.com.au

Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
TS Lim	Head of Research	612 8224 2810	tslim
Industrials			
Sam Haddad	Industrials	612 8224 2819	shaddad
John O'Shea	Industrials	613 9235 1633	joshea
Chris Savage	Industrials	612 8224 2835	csavage
Jonathan Snape	Industrials	613 9235 1601	jsnape
Sam Byrnes	Industrials	612 8224 2886	sbyrnes
Bryson Calwell	Industrials Associate	612 8224 2879	bcalwell
John Hester	Healthcare	612 8224 2871	jhester
Tanushree Jain	Healthcare/Biotech	612 8224 2849	tnjain
Financials			
TS Lim	Banks/Regionals	612 8224 2810	tslim
Lafitani Sotiriou	Diversified	613 9235 1668	lsotiriou
Resources			
Peter Arden	Resources	613 9235 1833	parden
Stuart Howe	Resources	613 9235 1782	showe
Fred Truong	Resources	613 9235 1629	ftruong
Quantitative			
Tim Piper	Quantitative & System	612 8224 2825	tpiper