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Westpac Subordinated Notes (WBCHA)

Fixed Interest

Issue overview

Issuer	WBC
Issue ASX code	WBCHA
Face value	$100
Estimated offer size	$500m
Bookbuild margin range	2.75-2.95%
Franking	0%
Interest payments	Quarterly
Minimum application	$5,000
First optional redemption	23 Aug 2017
Maturity	23 Aug 2022

Timeline

Lodgement of prospectus	16 Jul 2012
Bookbuild margin	20 Jul 2012
Announcement of margin	23 Jul 2012
Offer opens	23 Jul 2012
Offer closes:	
Securityholder	16 Aug 2012
Broker Firm	22 Aug 2012
Issue date	23 Aug 2012
ASX listing (deferred settlement)	24 Aug 2012

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

And now there are three

Following on from the successful Subordinated Note issues from ANZ (ANZHA) and NAB (NABHB), Westpac is seeking to raise $500m through the launch of its first ASX listed Tier 2 Capital security Westpac Subordinated Notes (WBCHA).

WBCHA is a vanilla subordinated debt security which will also provide attraction for participation from institutional investors seeking high yield. With terms providing for mandatory payment of interest and redemption at maturity, WBCHA's debt like features provides for greater investor protection than existing preference shares listed on the ASX. The margin also reflects the full cash amount of interest payments, unlike preference shares where the margin reflects the gross up amount of franking credits.

As the nature of the WBCHA security structure is virtually identical to both ANZHA and NABHB which were issued at a margin of 2.75%, we expect the WBCHA bookbuild margin will be set at the bottom end of the 2.75-2.95% range. This is particularly the case given the ANZHA and NABHB trading margins have firmed to 2.65% with both securities now trading above $101. As Westpac Feb 2017 senior debt margin is trading at a margin of 1.60% in the wholesale OTC (over-the-counter) market, the 1.15% of additional margin is attractive for a security that is one step lower on ranking.

Figure 1: Trading margins on debt and equity securities

	Ranking	Security	Trading Margin over BBSW	Maturity	First Call
Higher Ranking	Secured debt	WBC covered bond (issue margin 165bp)	105bp	Feb 2017	
	Unsubordinated unsecured debt	WBC unsecured bonds	160bp	Feb 2017	
	Subordinated unsecured debt	ANZHA (issue margin 275bp)	265bp	Jun 2022	Jun 2017
		NABHB (issue margin 275bp)	265bp	Jun 2022	Jun 2017
		WBCHA	**275bp**	**Aug 2022**	**Aug 2017**
	Preference securities	WBCPC (issue margin 325bp)	370bp	Mar 2020	Mar 2018
Lower Ranking	Equity	Ordinary WBC shares	>600bp	Perpetual	

SOURCE: YIELDBROKER, BELL POTTER

Key features

- **Initial floating yield of 6.31% p.a.:** Based on current 90 BBSW of 3.56% and bookbuild margin being set at 2.75%. This provides investors the opportunity to lock in historically high issue margins. The yield is above residential mortgage rates (6.19%) and term deposit rates (up to 5.2%) available to Westpac customers.
- **Quarterly unfranked interest**: First interest payment date is 23 Nov 2012. Interest payments are not deferrable so long as the solvency condition is met.
- **Redemption highly likely at year 5:** Although WBCHA has a 10 year maturity, we view it as highly likely that WBC will redeem at the first redemption date in August 2017. We note under the new APRA standards that comply with the implementation of Basel III, we expect WBCHA will included as Tier 2 capital until the year 5 call date.

Westpac Subordinated Notes (WBCHA)

More yield than a term deposit, more protection than a pref

Following the success of the recently issued Subordinated Notes offered by the ANZ (ANZHA) and NAB (NABHB), Westpac is offering a vanilla style of subordinated debt security to diversify funding sources and provide valuable Tier 2 regulatory capital.

Through the WBCHA issue, Westpac offers retail investors the opportunity to participate in an investment that is a simpler, defensive instrument that has generally been only available to the wholesale market.

Debt securities are an attractive investment alternative as they provide a regular, quarterly payments, a know time period and a return of capital. Debt securities also provide a defensive, low volatility investment during times of global uncertainty.

WBCHA also has the benefit of providing investors protection of the more debt like features such as cash redemption, mandatory payment of interest and more senior ranking over all other ASX listed Westpac securities, in the unlikely event of a wind up.

The structure of WBCHA, however, is different to preference share such as the recently listed WBCPC (Westpac Convertible Preference Shares) which has more equity like features. These features include satisfying the share price requirements of the Mandatory Conversion Conditions, conversion risk into ordinary shares at maturity, and automatic conversion if the Common Equity Capital Ratio falls below 5.125%. In addition, payment of preference dividends are at the issuer's discretion on a non-cumulative basis, subject to dividend restrictions on ordinary shares.

WBCHA also has the benefit of the time value of money with quarterly interest payments, combined with the fact the WBCHA margin reflects the full cash amount of the unfranked interest payments. Whereas the WBCPC margin reflect the grossed up value of franking credits on half yearly payments.

Figure 2: Features of Westpac fixed interest securities

	Term Deposits	Subordinated Notes	Convertible Preference Shares
ASX Code	Not quoted on the ASX	WBCHA	WBCPC
Legal Form	Deposit	Unsecured subordianted debt	Preference share
Protection under the Aust Govt Financial Scheme	Yes, up to $250,000	No	No
Term	1 month to 5 years	10 Years with a Non-Call period of 5 years	Perpetual, subject to Mandatory Conversion Conditions into ordinary shares
Issuer early redemption	Yes, subject to conditions and penalties	Yes, 23 August 2017, subject to APRA approval	Yes, 31 March 2018, subject to APRA approval
Interest rate/dividend rate	Fixed	Floating: 90BBSW+275bp	Floating 180BBSW+325bp (grossed up for franking)
Interest/dividend payment	Cumulative, unfranked	Cumulative, unfranked	Non-cumulative, franked (subject to gross up)
Payment deferral	No	No, unless WBC is not Solvent immediadiately after making the payment	Yes, dividends are subject to director discretion and APRA tests including a distributable profits test
Interest/dividend dates	End of term or annually	Quarterly	Half yearly
Transferable	No	Yes- ASX listed	Yes- ASX listed
Investors right to request early redemption	Yes, subject to conditions and penalties	No	No
Conversion into Ordinary Shares	No	No	Yes, subject to Mandatory Conversion Conditions and capital trigger event
Ranking	Senior to WBCHA, preference shares and ordinary equity	Senior to preference shares and ordinary equity	Senior to ordinary equity

SOURCE: COMPANY DATA, BELL POTTER

Westpac Subordinated Notes (WBCHA)

Loss of Tier 2 capital status an incentive to redeem at year 5

APRA has advised Westpac that WBCHA is expected to be eligible for inclusion as Tier 2 capital under its transitional provisions of its current prudential standards for the implementation of the Basel III reforms.

These transitional provisions apply to Tier 2 Instruments that do not include incentives to redeem (such as a step-up) issued after 17 December 2009 and before 1 January 2013. Securities which comply with these requirements may be included in the relevant category of regulatory capital (i.e. Tier 2) until their first available call date (August 2017). By contrast, the ASX listed Tier 2 note issues undertaken by AMP (AQNHA) and Heritage Building Society (HBSHA) in 2009 had the provision for a 50% step-up in margin if these securities are not redeemed at the 5 year call date.

In order for Westpac to redeem WBCHA at year 5, it must obtain APRA's prior written consent. Factors that are considered in obtaining this consent include:

- WBCHA is replaced concurrently or beforehand with Tier 2 Capital of at least the same quality; or
- APRA is satisfied that Westpac's capital position will be well above its minimum capital requirements after Westpac redemption.

Benefits of WBCHA

- Historically high issue fixed margin of at least 275bp above 90 BBSW, for an expected term of 5 years.
- Interest is paid quarterly in arrears fully in cash.
- Interest payments mandatory, subject to Solvency test that Westpac is able to pay its debts as they fall due and its Assets exceeds liabilities. Payments are not subject to the discretion of the Directors and are not deferrable.
- This is the first ASX listed WBC debt issue and therefore allows for diversification into another major bank issue.
- Issue likely to be rated by Standard & Poor's, thereby increasing institutional participation.
- Potential for capital gain if credit spreads contract over the life of the issue.
- Issuer strength of Westpac. With a lending portfolio weighted 97% to Australia and New Zealand, and 26% market share of the Australian mortgage market have contributed to its impairment charge being low relative to its peers.

Westpac Subordinated Notes (WBCHA)

Investment risks

Key investment risks include:

- WBCHA is not a Government protected deposit liability of Westpac.
- WBCHA rank behind all WBC bank deposits and senior debt obligations.
- New issues may offer more attractive issue terms and margins, placing downward pressure on the security price.
- As Westpac relies on credit and capital markets to provide a source a of liquidity and funding for lending activities, there is the risk that access to these markets may be severely restricted in the event of a major systemic shock to the Australian, New Zealand or other financial systems. These shocks may result from economic, financial or political issues.
- A dislocation of credit markets may also result in an increase in credit spreads, placing downward pressure on the security price.
- A material deterioration in global capital markets and the Australian economy could result in an adverse change in Westpac's operating and financial performance. This in turn could potentially lead to weakening of its capital adequacy and Westpac's ability to redeem the securities.
- Adverse regulatory changes / Government policy.
- Operational risks and trading risks of Westpac.
- Increasing competition in financial services.
- Holders have no redemption rights before the maturity date in August 2022.
- The market price of WBCHA will fluctuate as a security listed on the ASX for various reasons including liquidity, interest rate changes, credit margins, the financial performance of Westpac and general economic conditions. The price of the Westpac Notes can fluctuate above or below par.

Fixed Income

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