

## Westpac Capital Notes 4 - WBCPG

WESTPAC has just announced the launch of a new income offer:

Westpac Capital Notes. The first round of access is through a broker firm allocation, prior to shareholder and general offer and listing in July.

The Notes will pay a quarterly coupon of 4.9%-5.2% (margin determined by the book build) over the 90 day bank bill swap rate (BBSW), which was 1.99% as of 17<sup>th</sup> May. The initial indicative rate will be 6.89%-7.19%pa with the rate to be set on the date of issue. The Notes are expected to redeem on the 20<sup>th</sup> December 2021\*\* and will be tradable on the ASX under code WBCPG.

Westpac Capital Notes 4 Offer Details	
<b>Issuer</b>	Westpac
<b>Security Name</b>	Westpac Capital Notes (WBCPG)
<b>First Call Date</b>	20 <sup>th</sup> December 2021
<b>Scheduled Conversion Date</b>	20 <sup>th</sup> December 2023 (unless redeemed earlier)
<b>Margin</b>	90 day BBSW + 4.9%-5.2% (rate to be determined by the book build)
<b>Size</b>	\$750 Million +
<b>Minimum Parcel</b>	\$5,000 (Wealth Focus minimum is \$10,000)

Source: Westpac Capital Notes 4 prospectus

\*\* It is expected that the issue will be repaid at the first opportunity in December 2021 with a scheduled conversion in 2023 (subject to mandatory conditions not being breached).

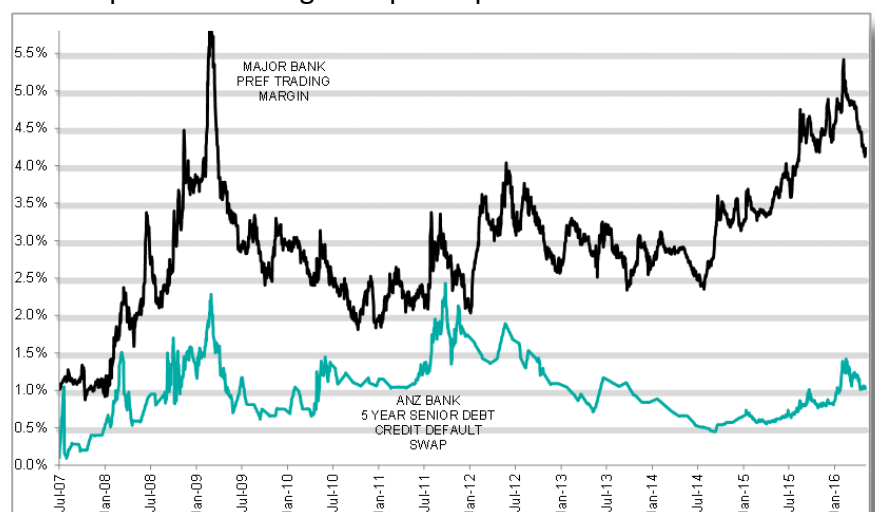
## Hybrids

We have covered the features of fixed income hybrids on numerous occasions over the previous 2 years. Investors who are looking for a basic understanding of hybrids and differentiating products should watch our online video [An Introduction to Fixed Income](#).

## Our analysis

The secondary market for the newer style bank hybrids from the Big 4 banks is well established and continues to grow with Westpac announcing Westpac Capital Notes 4 as a replacement for their existing \$750 Million issue, WCTPA.

The last 2 years has seen margins widen on new issues back to levels that were last seen during the GFC. This is in part due to the increased volume in the market as a result of the Australian Prudential Regulation Authority's directive that Financial Institutions increase their capital backing to



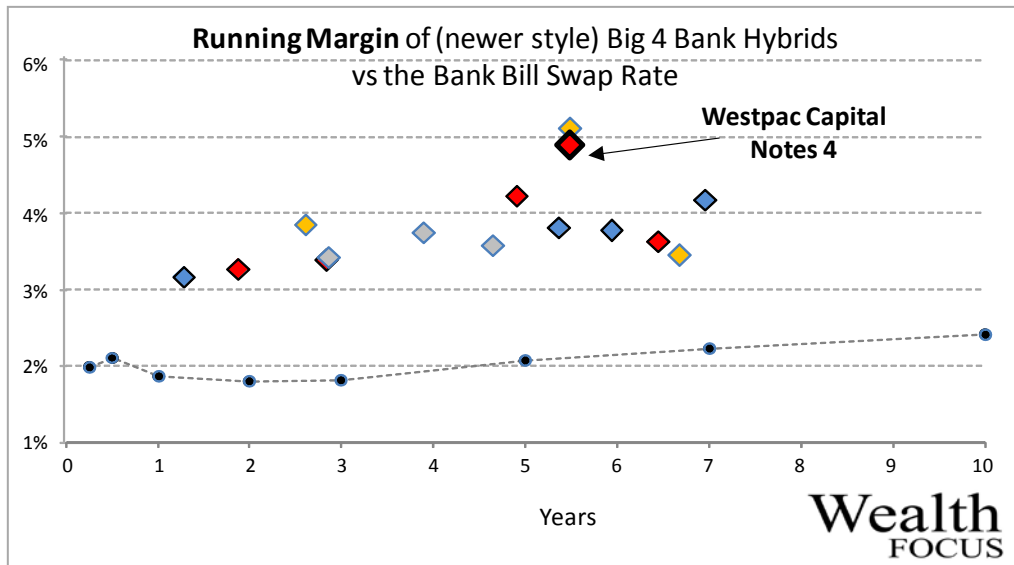
[www.fundsfocus.com.au](http://www.fundsfocus.com.au). This information has been prepared for distribution over the internet on a general advice basis and without taking into account the investment objectives, financial situation and particular needs of any particular person. Wealth Focus Pty Ltd makes no recommendations as to the merits of any investment opportunity referred to in this website. All indications of performance returns are historical and cannot be relied upon as an indicator for future performance. Please read our [Financial Services Guide](#) and [Disclaimer](#) for full details of our services and level of advice provided. 18/05/16

improve the financial stability of the sector.

The increase in issuance has benefited Investors as they now have more choice across of securities with differing maturities. The closest comparable issue to WBCPG is CBA's recent issue, [Perls 8](#) (CBAPE), which is maturing in 2023.

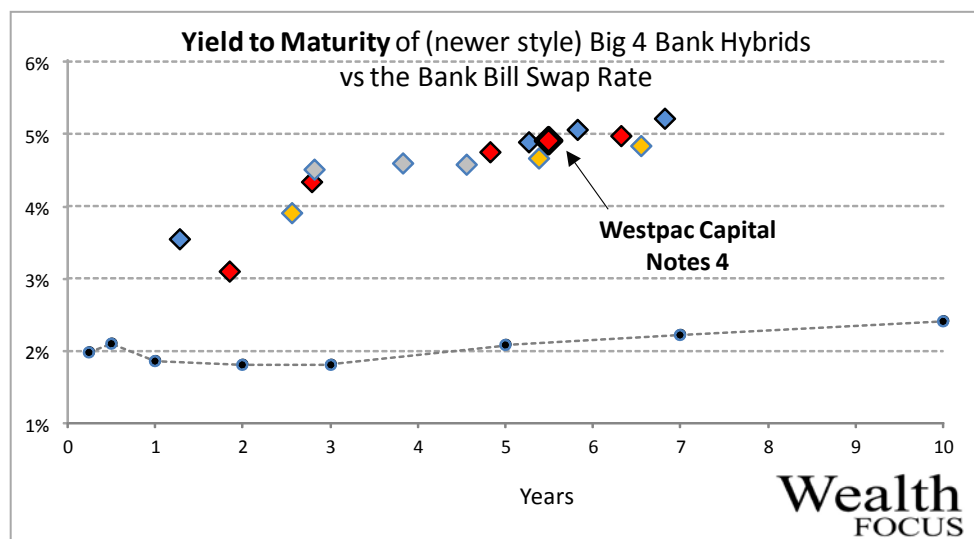
If Westpac is able to raise at a margin of 4.9% over the BBSW, currently 1.99%pa, WBCPG will be offering a considerably higher margin than their peers (with exception of the CBAPE issue).

We expect these relatively high issue margins to become more attractive if interest rates continue to drop.



### Do not overlook Yield to Maturity in the secondary market

Although a high Running Yield (distributions divided by purchase price) can be attractive as it provides you with a higher level of instantaneous income, it often distorts the real return an Investor achieves which is adjusted for the value at redemption. As hybrids are redeemed at face value, it is the Yield to Maturity measure which is an accurate measure for total return.



Looking at the secondary market, Westpac looks to have priced Capital Notes 4 in line with other hybrids with the additional attraction of a higher running yield.

### ***Non-viability Clause, Capital Trigger Event and Inability Event***

*Investors who are familiar with the new style hybrids we have seen over the last couple of years will be very aware of these clauses.*

*It is useful to understand that these clauses are as a result of APRA requiring further reassurance that in another GFC event, if required, hybrids would convert to ordinary equity, thereby reducing the bank's debt costs and protecting deposit holders.*

*Now that banks have to hold a higher level of capital and a better quality loan book, it seems unlikely that any of these conditions would be breached, however, investors would do well to consider the increased disclosure and warnings within each prospectus over the last couple of years.*

*For those unfamiliar with the conditions, new hybrids now contain non-viability and capital trigger clauses that should the bank's Tier 1 Capital Ratio fall below 5.125%, or APRA views the bank as non-viable without an injection of capital, the hybrids would automatically convert to ordinary shares.*

*We have also seen a gradual introduction of an Inability Event Clause added which states that in the event that the issuer is unable to issue further ordinary shares, ie the company has ceased trading, a Capital Trigger Event or Non-Viability Event, hybrid note holders lose their investment.*

*This is extremely unlikely however investors would do well to remember the increase in yield offered carries additional risk.*

### **Our View on Westpac Capital Notes 4**

We maintain our concerns over the non-viability clauses within the new style of hybrids but investors looking to switch equity allocation into an asset class with reduced capital risk would do well to consider these newer style hybrids. *We do not consider hybrids a suitable alternative for fixed income/cash as it behaves differently during periods of financial market distress.*

Since our review of CBA Perls 8 in February, hybrid spreads have contracted and Westpac Capital Notes 4 looks well priced. The Notes look to be priced in line with other Big 4 peers but offer a higher running yield than most of the other comparables.

This is unusual for Westpac as they have historically priced their new issues at a tighter margin than the secondary market. This would suggest to us that they would like to upsize this IPO with our guess being closer to \$1.5 Billion.

That aside, Investors should be aware that the primary role of Capital Notes 4 is to refinance \$750 Million of existing WCTPA and priority is often given to investors looking to roll their existing investments which makes demand for this Issue difficult to gauge.

On a side note, NAB had announced their intention to launch another hybrid in their recent results. It would not surprise us to see an additional 0.1%-0.2%pa margin reflecting the perceived difference in business risk between the two banks.

*Contact us if you would like an allocation to Westpac Capital Notes 4 or have an existing investment in Westpac SPS Trust (WCTPA) you would like to roll into the new issue.*

[www.fundsfocus.com.au](http://www.fundsfocus.com.au). This information has been prepared for distribution over the internet on a general advice basis and without taking into account the investment objectives, financial situation and particular needs of any particular person. Wealth Focus Pty Ltd makes no recommendations as to the merits of any investment opportunity referred to in this website. All indications of performance returns are historical and cannot be relied upon as an indicator of future performance. Please read our [Financial Services Guide](#) and [Disclaimer](#) for full details of our services and level of advice provided. 18/05/16

## Key features

- **Indicative floating yield of 6.89-7.19%pa** - based on current 90 BBSW of 1.99% and book build margin range of 4.9-5.2%.
- **Option to redeem at year 5 with scheduled conversion at year 7** - Westpac has the option to convert in December 2021 or on any subsequent dividend payment date.
- **Ordinary dividend restrictions** - applies on the non-payment of WBCPG dividends
- **Automatic conversion under the Capital Trigger Event and Non-Viability**
- **Redemption highly likely in 5.5 years** - although WBCPG has a 7.5 year maturity, its likely Westpac will redeem/convert at the first call date in December 2021. Major incentives for redemption/conversion include the potential for reputational damage and risk of credit rating downgrade, leading to an increased cost of funding on future debt issues.

*Note: Westpac Capital Notes 4 will be listed on the ASX and as such the price of the Note's will be subject to market movements. Investors selling on market may receive a price lower (or higher) than the issue price.*

***Investors looking for an allocation can contact us on 1300 559 869***

***We encourage you to view our online presentation [An Introduction to Fixed Income](#)***