AUSTRALIAN
RESEARCH
INDEPENDENT INVESTMENT RESEARCH

BNK Banking Corporation Limited (ASX: BBC)

BBC Posts Strong Growth In Uncertain Times

September 2020

INDEPENDENT
INVESTMENT RESEARCH

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Contents

BNK Banking Corporation Limited (ASX: BBC)

Initiating Coverage

Company Information	
Share price ($) as at 4 September 2020	0.65
Price Target ($ per share)	1.12
Issued capital:	
Ordinary shares (M)	95.3
Options (M)	0.0
Performance rights (M)	1.5
Fully diluted (M)	96.8
Market capitalisation ($M)	61.9
12-month Share Price Low/High ($)	0.39/0.70

Board and Management

John Sutton: Chairman

Don Koch: Deputy Chairman & Interim CEO

John Kolenda: Executive Director & CEO Aggregation

Brett Morgan: CEO Banking & Wholesale (appointed 7 August 2020, to commence in October)

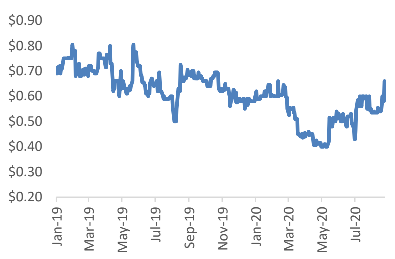
Jon Denovan: Non-Executive Director

Peter Hall: Non-Executive Director

Largest Shareholders	%
John Kolenda	14.0
Sf Legacy Investments Limited	9.7
Kar Ng	7.1
Resimac Limited	3.9
Bermuda National Limited	3.2
Top 20 Shareholders	**56.8**

Source: IRESS

Share Price



BBC POSTS STRONG GROWTH IN UNCERTAIN TIMES

BNK Banking Corp (ASX: BBC) is a diversified financial services company with operations across banking and mortgage broker aggregation. BNK has been one of the fastest growing mortgage aggregators in Australia and combined with the banking segment offers a range of lending and deposit solutions across a large distribution network.

KEY POINTS

Strong Loan Growth in FY20: The company has reported strong growth in FY20, with the Finsure acquisition providing a significant boost to the company since the merger in September 2018. The total loan book grew 18% to $48.1 billion in FY20 with total settlements of $16.1 billion for the total loan book in FY20, an increase of 21.5% on FY19.

Growth in banking loan settlements declined significantly in the 4Q'FY20 as the company reduced loan origination activities as a result of impacts from the coronavirus pandemic. Even with this decline, bank settlements increased 72.9% in FY20. Management have stated that liquidity and lending levels are expected to return to normal in 1H'FY21. Aggregation settlements continued to grow in the 4Q'FY20, with settlements up 21% from the 3Q'FY20 and a 23.2% increase in settlements for the Aggregation segment for the year.

Strong Deposit Growth & Improved Funding Mix: The banking segment is focused on improving the deposit funding mix. Historically, transaction accounts have been only a small percentage of deposits with the higher cost term deposits making up the bulk of deposits. The company has placed a focus on increasing the level of transaction accounts to reduce the costs associated with the deposit base. At 30 June 2020,the company had seen a 20.4% growth in deposits to $346 million with a 120% increase in transaction accounts over the year, with transaction accounts making up 35% of deposits at June-end, the highest it has been in the banks history. The company will be seeking to continue this trend of growing the deposit base and improving the funding mix.

Improved Profitability: Growth in higher margin products, including improved deposit funding mix and growth in on balance sheet lending combined with a decline in the growth in operating expenses resulted in an improved NPAT margin in FY20 of 13.9% compared to 11.9% in FY19. We expect profitability to continue to improve in FY21.

Well Capitalised: The company is well capitalised with $90 million cash and liquid holdings and a capital adequacy ratio of 21.4% at 30 June 2020. This provides the bank the ability to continue to grow its loan book. APRA has provided preliminary approval of the issue of a $10 million Tier 2 subordinated note, which we expect to be issued in 1H'FY21.

Finsure Acquisition Improves Banking Concentration Risk: One of the key strategic benefits of the Finsure merger has been diversification of the banks geographic concentration. BNK bank has historically serviced Western Australia (WA) and therefore has had significant concentration risk to this state. The distribution network acquired through the Finsure merger has assisted with diversifying the banks client base nationally, with 54% of the banks client base now outside WA. This compares to 33% in FY19.

Brett Morgan Appointed as CEO: On 7 August, the company announced the appointment of Brett Morgan as CEO of the Banking and Wholesale operating segments, after the resignation of the previous CEO in May. Mr. Morgan has substantial experience in the financial services industry, including senior banking roles at ING and key management positions at a number of digital and financial services businesses, including CEO of LaternPay and Flexischools, making Mr. Morgan a good fit to pursue the digital transformation of the banking segment. Mr. Morgan will commence his position in October. John Kolenda will continue as CEO of the Aggregation business (Finsure).

Price Target: We have assigned BNK a value of **$1.12** per share. The valuation is based on a PE multiple of 10x the FY21 forecast EPS plus the current value of the net trailing commission receivable per share. This represents an upside of 72.3% on the share price of $0.65 at 4 September 2020. FY21 is expected to pose some challenges to housing lenders due to restrictions imposed as a result of the coronavirus pandemic. Two key factors for housing market growth, unemployment and immigration, have been and will likely continue to be severely hampered by the pandemic. BBC continued to perform well despite the difficult lending conditions in the 2H'FY20. While we expect the company to continue to grow it's loan book in FY21, we are of the view that settlement growth will be tempered due to the macroeconomic environment.

Profit& Loss ($M)	FY18A	FY19A	FY20A	FY21F
Net interest income	3.47	3.45	4.81	6.64
Net commission income/expense	-0.26	17.40	19.13	20.57
Other income	1.89	9.39	14.44	11.97
Total net revenue	**5.10**	**30.24**	**38.38**	**39.17**
Impairment reversal/expense on loans and advances	-0.005	-0.02	-0.63	-1.08
Operating expenses	-4.57	-23.66	-27.86	-29.18
Transaction expenses	-0.938	-0.86	0	0
Impairment of bailment cash	0	0	-2.923	0
Profit/Loss before income tax	**-0.42**	**5.70**	**6.97**	**8.91**
Income tax expense/benefit	0.011	-2.095	-1.64	-2.67
Profit/Loss attributable to equity holders	**-0.41**	**3.60**	**5.32**	**6.24**
Average number of shares on issue				
Basic	23.13	70.32	86.73	95.48
Diluted	23.13	71.56	88.27	97.01
EPS				
Basic (cents per share)	-1.8	5.14	6.14	6.53
Diluted (cents per share)	-1.8	5.05	6.03	6.43

Balance Sheet ($M)	FY18A	FY19A	FY20A	FY21F
Assets				
Cash & cash equivalents	14.53	19.38	18.12	24.29
Trade and other receivables	0.71	285.49	412.62	410.31
Due from other financial institutions	24.51	32.34	33.34	37.00
Loans and advances	170.51	214.32	283.56	358.53
Other financial assets	7.46	46.19	38.23	31.77
Property, plant and equipment	0.79	1.20	3.81	3.03
Goodwill and other tangible assets	1.95	47.22	49.61	42.72
Deferred tax assets	0.67	0.00	0.00	0.00
Total Assets	221.12	646.14	839.29	907.65
Liabilities				
Deposits	195.22	287.13	345.79	404.57
Trade and other payables	1.04	245.23	365.64	365.64
Current tax liability	0.0	0	0	0
Provisions	0.28	1.29	1.31	1.35
Deferred tax liabilities	0	12.06	13.69	13.69
Total Liabilities	196.55	545.71	726.42	785.24
Net Assets	**24.57**	**100.44**	**112.87**	**122.41**

Cashflow	FY18A	FY19A	FY20A	FY21F
Operating cashflow	-4.52	-0.30	-0.88	0.07
Investing cashflow	-1.62	-2.88	-3.15	-3.61
Financing cashflow	4.44	8.02	5.69	9.70
Movement in cash	**-1.69**	**4.84**	**1.66**	**6.16**

Ratios	FY18A	FY19A	FY20A	FY21F
Revenue Growth	20.5%	493.0%	26.9%	2.1%
NPAT Growth	-59.3%	787.9%	47.7%	17.2%
EPS Growth (basic)	na	185.6%	19.5%	6.4%
NPAT Margin	-8.0%	11.9%	13.9%	15.9%
Return on Equity	-1.8%	5.8%	5.0%	5.3%
Return on Assets	-0.2%	0.8%	0.7%	0.7%

Multiples (Share price at $0.65)	FY18A	FY19A	FY20A	FY21F
P/E	-36.1	12.6	10.6	9.9
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Key Metric Assumptions	FY19A	FY20A	FY21F
Banking & Wholesale Segment			
Bank settlements ($m)	74.6	129.0	129.0
Wholesale settlements ($m)	578.4	447.0	447.3
Total settlements ($m)	653.0	576.0	576.3
Deposit growth	47.1%	20.4%	17.0%
Call deposit percentage	19.3%	35.3%	41.9%
Net Interest Margin (NIM)	1.95%	1.67%	2.0%
Aggregation Segment			
Loan writers	1,674	1,740	1,840
Growth	*na*	*3.9%*	*5.7%*
Average settlement per loan writer ($m)	1.98	2.30	2.2
Growth	*na*	*16.3%*	*-6.3%*
Loan settlements	12.6	15.5	15.6
Growth	*na*	*23.2%*	*0.1%*
Loan Book	38.09	45.4	51.6

SWOT ANALYSIS

STRENGTHS

- BNK Bank is APRA regulated and its deposits are government guaranteed up to $250,000 and can therefore compete for deposits with the traditional banks.
- The company has a diversified revenue stream with revenue from non-interest and non-commissions continuing to grow.
- The banking segment has seen strong growth in its deposit base. This growth has allowed for increased on balance sheet funding. On balance sheet loans currently deliver over 4x the margin delivered by off balance sheet (wholesale) loans.
- The company has improved its profitability through growth in improved margin products and a reduction in the growth of operating expenses. This has resulted in an improved NPAT margin in FY20 of 13.9%.
- The Aggregation business continues to be able to attract new loan writers to the platform. Loan writer growth is an important contributor to growth in the Aggregation loan book, SaaS and fee based income streams. The company launched the Infynity CRM in FY20, a market leading platform that will assist with broker recruitment and retention as well as provide additional revenue streams.
- The merger with Finsure has provided the strategic benefit of diversifying the geographic concentration and distribution network for the banking segment. In FY20, the banks loan exposure to WA was reduced to 46% of the loan portfolio from 67% in FY19. Geographic diversification will be an important element for on balance sheet lending growth.
- The newly appointed CEO for banking and wholesale is well placed to see the business through the continued digital transformation.

WEAKNESSES

- Low interest rates will continue to impact the NIM over the short-and-medium term. The RBA has stated that it does not expect interest rates to increase for two to three years given the current state of the economy.
- The company does not pay any dividends at this stage and therefore does not provide a regular income stream to shareholders, unlike many of its peers. We note that the company stated that it had approved a dividend policy in its FY20 results. The policy has not been disclosed but this suggests that the company intends to pay a dividend.

OPPORTUNITIES

- The ability of the banking arm to continue to increase the funding mix to increase the percentage of transactional accounts combined with deposit growth will allow for further growth in the higher margin on balance sheet funding.
- The proportion of loans originated by mortgage brokers is expected to continue to increase given brokers are in the best position to adhere to operating in the best interest of customers rules that were a result of the Royal Commission. This is expected to underpin long-term growth of the Aggregation business.
- The company has executed non-binding term sheets with an international bank and a domestic bank for securitisation warehouses with the company seeking to have a warehouse and securitisation program launched in 2Q'FY21. This will diversify funding as well as open up new revenue streams.

THREATS

- ADI's are heavily regulated and are therefore impacted by any changes to the regulatory regime. In particular, additional capital adequacy requirements or stricter lending rules may adversely impact the company.
- Given the current economic environment as a result of the Covid-19 pandemic, credit risk for the banking segment is elevated above what would be considered normal levels. While the company has reported low levels of impacts from increased bad loans, we note that a prolonged economic downturn and increased unemployment could result in increased bad loans.
- While the company has a diversified revenue stream the business is heavily exposed to residential mortgages. As such, a downturn in this market may result in reduced loan demand which would adversely impact the financial performance of the company.
- With over 50 aggregators in the market there is significant competition to capture mortgage brokers and increase numbers as an increased broker network equates to improved volumes and profitability. Finsure has been successful at growing the broker network since its inception, however the business will need to ensure they retain and attract brokers in a market where aggregators are constantly trying to recruit brokers to their platform.

COMPANY OVERVIEW

COMPANY HISTORY

BNK Banking Corporation Limited (ASX: BBC), previously known as Goldfields Money Limited (ASX: GMY), began as a regional credit union before being classified as a bank after changes to regulations. GMY was established in Western Australia and has grown its footprint nationally.

In September 2018, GMY merged with Finsure through a Share Sale and Purchase Agreement, whereby GMY acquired 100% of the shares in Finsure via the issue of GMY shares. 40.75 million GMY shares were issued to Finsure shareholders for the merger. Finsure is a national mortgage aggregation network and wholesale mortgage business with a growing mortgage broker network.

GMY has transformed into a digital bank, providing an alternative to traditional banks. The bank has transitioned to an online bank with the last remaining branch closed in June 2020. GMY aims to distribute first-class products through the distribution network. The digital bank is now complimented by the Bank@Post network across Australia.

The digital banking platform is built on mobile first, world class core banking system and proprietary mortgage distribution software. Finsure launched its new cloud based broker CRM platform "Infynity" in October 2019 and successfully transitioned Finsure's large broker force to the new platform over FY20. Infynity is industry leading mortgage software with open API connectivity enabling Finsure's marketplace to integrate with more products and services. The implementation will increase productivity and allow Finsure to refocus on broker recruitment in FY21. The technology platforms connect GMY directly to Australian consumers through the mobile and web platforms as well as indirectly through the loan writers in the Finsure network.

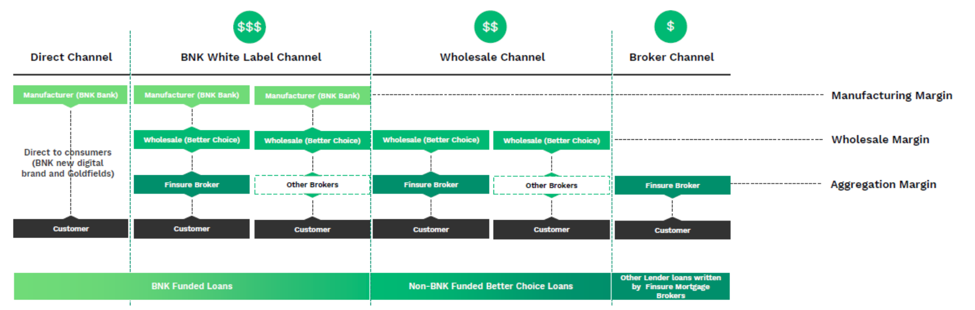
GMY changed its name in March 2019 to BNK Banking Corporation Limited and the Goldfields Money brand will be fully replaced with the new digital banking brand "BNK Bank" in 1H'FY21.

BUSINESS MODEL

BBC provides lending and deposit solutions through its banking and mortgage broker aggregation network. Post the merger with Finsure, the company has an expanded distribution network. Finsure is the third largest mortgage aggregator in Australia with a network of 1,740 loan writers and a loan book of $45.4 billion at 30 June 2020. Finsure's business is concentrated to NSW and Victoria with over 80% of the loan writers located in these two states. This is a positive for the banking segment given the banking operations have historically been concentrated in WA.

BBC leverages a combination of mortgage models to optimise volume and margins. The company utilises data collected from the expanded network for product manufacturing.

BNK Distribution Model



Source: BBC

FY20 HEADLINE RESULTS

The company released its FY20 results on 28 August 2020. FY20 represented the first full trading year of the merged business with Finsure, with FY19 having three quarters of trading as a combined entity.

The company experienced strong loan book growth with the total loan book growing 18% to $48.1 billion. The majority of the loan book is attributed to the Aggregation segment (Finsure) which grew to a record $45.5 billion, a 19.5% increase on the pcp.

Growth in the loan book drove revenue and NPAT growth, with a reduction in the growth in operating expenses and a focus on higher margin products contributing to an improved NPAT margin. Net commission income is the greatest contributor to revenue, accounting for 49.8% of revenue in FY20.

The bank was well capitalised at 30 June 2020, with $90 million in cash and liquid holdings and a capital adequacy ratio of 21.4%. This provides the company the ability to continue to grow its on balance sheet loan book.

As with all banks, customers were offered mortgage payment deferral given the unprecedented circumstances that have arisen due to the coronavirus pandemic. At 19 August, 4.5% of the on balance sheet loan portfolio were impacted, this is down from 5.6% in May. Management remains confident that the value of the portfolio exposed to repayment deferrals will continue to decline, however, will continue to work with its customers who require additional assistance. The loan loss provisions have been increased from 0.12% in FY19 to 0.26% in FY20 to account for the additional risk.

FY20 Headline Statutory Results

	FY19	FY20	Movement
Profit & Loss ($m)			
Net Revenue	30.24	38.38	+26.9%
NPAT	3.60	5.32	+47.7%
EPS	5.14	6.14	+19.5%
DPS	0.0	0.0	0.0%
Balance Sheet ($m)			
On balance sheet loans & advances	214.3	283.6	+32.3%
Cash & equivalents	97.9	89.7	-8.4%
Net NPV of future trailing commission	38.9	44.2	+13.6%
Deposits	287.1	345.8	+20.4%
Loan loss provision	0.12%	0.26%	+0.14%
Loan Book ($b)			
Wholesale loan book	2.3	2.3	-1.7%
Aggregation loan book	38.1	45.5	+19.5%
Total loan book	40.6	48.1	+18.3%

CAPITAL STRUCTURE

At 4 September 2020, the company had 95.3 million ordinary fully paid shares on issue and 1.5 million performance rights outstanding.

During FY20 the company raised $7 million through the issue of 11.7 million fully paid ordinary shares. Pre-approval has been received by APRA for the issue of a $10 million Tier 2 subordinated note.

Share Capital Issued as at 4 September 2020	
Fully paid ordinary shares	95,302,066
Performance Rights	1,526,666
Total	**96,828,732**

OPERATING SEGMENTS

BBC has three reporting segments: (1) Aggregation; (2) Wholesale Mortgage Management; and (3) Banking.

AGGREGATION

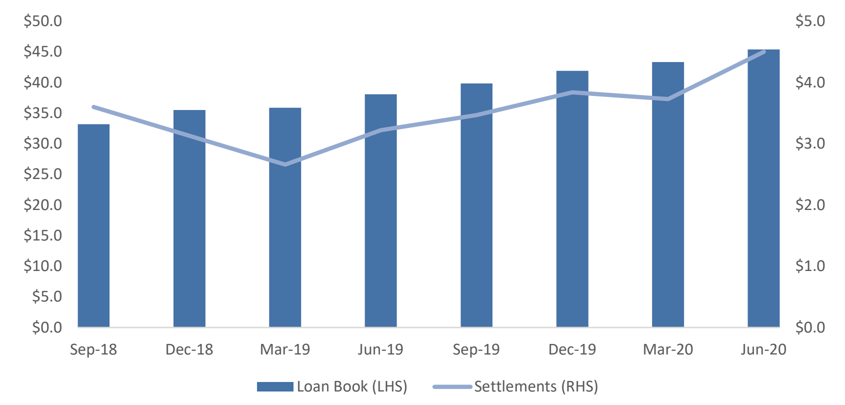
The Aggregation operating segment represents the Finsure business. Finsure was established in 2011 and merged with Goldfields Money Limited (now BNK Banking Corp) in September 2018.

The Finsure business generates revenue from commissions from loans made by brokers (upfront and trailing) and from the additional services provided to mortgage brokers, such as software, compliance and website services. Finsure will continue to develop "add-on" products to improve the revenue per broker.

Loan Book

The loan book for the Aggregation segment has been steadily increasing quarter on quarter in FY19 and FY20. The loan book grew 19.5% in FY20 to $45.5 billion with total settlements of $15.5 billion in FY20, an increase of 23.2% on FY19. New housing loan commitments excluding refinancing in Australia fell 10.6% in the June quarter on a seasonally adjusted basis (see Australian Housing Lending Sector Section below). The Aggregation segment bucked this trend with settlements up 20.6% in the June 2020 quarter.

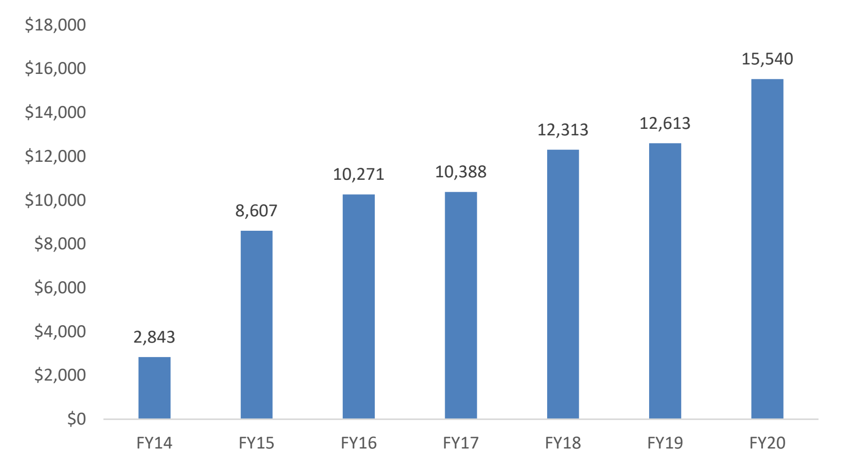
Finsure Loan Book ($ billions)



Source: BBC, IIR

Finsure's loan book has experienced strong growth since 2014 with loan settlement CAGR of 27.5%. Loan settlements continued to increase despite the challenges experienced in FY19 which saw a number of its peers experience a decline in settlements.

Historical Loan Settlements ($ millions)



Source: BBC, IIR

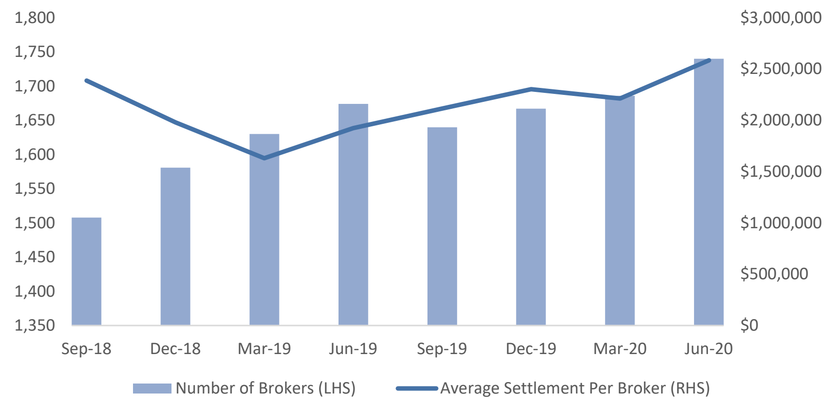
Loan Writers/Brokers

A key part of the aggregation business is the number of mortgage brokers in the network. It is a volume game to some degree. Finsure has been steadily increasing the number of brokers which has contributed to loan growth. An increase in the size of the loans written has also contributed to growth. This is highlighted by the growth in the average settlement value per broker in the below chart.

At 30 June 2020, Finsure had 1,740 brokers, the highest number of brokers in its history. Over FY19 and FY20, the Aggregation broker network has added 33 brokers on average per quarter, with a decline in brokers only experienced in one quarter of the two year period.

The mortgage broker aggregation market is competitive with over 50 aggregators according to the Mortgage & Finance Association Australia (MFAA). Finsure seeks to offer brokers the best platform available to retain and attract brokers.

Finsure Broker Network



Source: BBC, IIR

WHOLESALE

The Wholesale reporting segment operates under the Better Choice Home Loans Brand and is funded by a range of third party wholesale funding providers. Better Choice Home Loans funds and services mortgages using independent mortgage brokers for the origination of the loan as opposed to a direct interaction with the customer. Goldfields Money (now BNK) was recently added as a funder to the wholesale business. The Better Choice Home Loans business was acquired with the Finsure merger.

The Wholesale segment earns fees for services, largely in the form of upfront and trail commissions as well as administration fees for mortgage management.

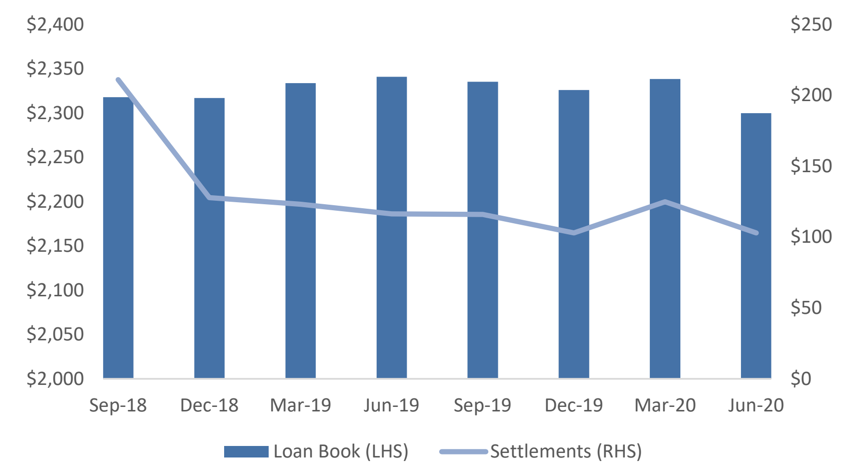
Better Choice Homes Loans is currently serviced by 5,500 mortgage brokers. The broker distribution network was further enhanced during the 4Q'FY20 with the Better Choice Home Loan products launched with PLAN Australia brokers. PLAN Australia is a mortgage aggregator with 1,600 mortgage brokers.

The Wholesale loan book generates a lower margin than the on balance sheet funding however provides an important distribution arm for the business. The FY20 revenue contribution from the Wholesale segment was ~17% of the company's net revenue.

Covid-19 saw the closure of the company's processing centre in Manila. This function has been integrated into the Australian operations. The company has indicated to IIR that the operations will likely remain in Australia even after international borders are reopened.

The wholesale segment has been in a bit of a holding pattern over FY19 and FY20 as can be seen by the loan book in the below chart. Settlements have been on a declining trend on a quarterly basis. The decline in 4Q'FY20, has been a result of general market weakness as a result of Covid-19, tightening of lending requirements and increased processing times by lenders combined with the major banks taking market share through aggressive pricing strategies and cash back offers for new business.

Wholesale Loan Book ($ millions)



Source: BBC, IIR

BANKING

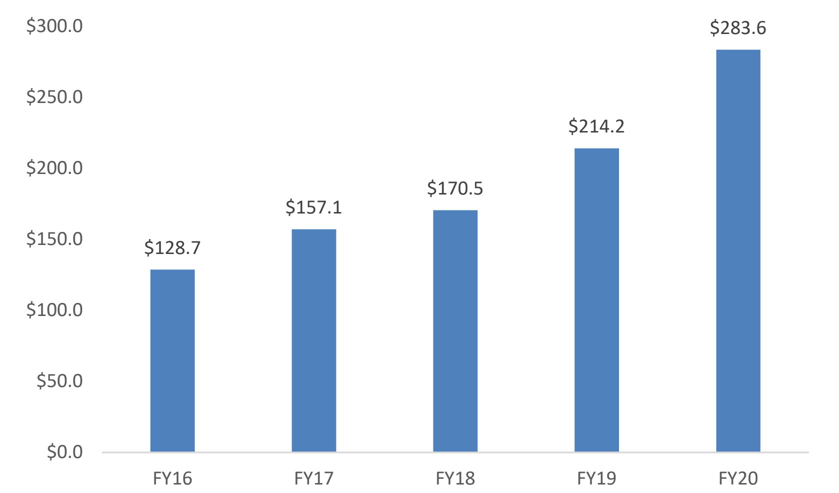
The banking segment operates under the Goldfields Money brand, operating as an APRA-regulated deposit taking institution (ADI). The bank was established in Western Australia (WA) 38 years ago. The bank provides deposit accounts, personal loans and mortgages. In conjunction with the recent name change of the company, the bank will be rebranded as BNK Bank in coming months.

The bank currently distributes products directly to customers as well as through third party intermediaries across Australia. Given the bank was established in WA, the bulk of its customers have historically been in WA. The bank is making a concerted effort to diversify geographically. The merger with Finsure is a key part of the diversification strategy with the majority of the Finsure business on the East Coast of Australia.

Loan Book

The banking segment experienced strong growth in FY20 with the loan book increasing 33% to $285 million at 30 June 2020. Most of the growth was achieved during 1H'FY20 with the loan book increasing 23.7% to $265.2 million at 31 December 2019. Growth slowed in the second half with the loan book increasing a further 7% to $285 million. The slower growth reflects the decision by the company to moderate loan originations in 4Q'FY20 in response to the uncertainty stemming from the Covid-19 pandemic. We view this to be a prudent response by the bank. The bank has stated that the loan origination pipeline has started to grow since June-end and will be buoyed by the launch of additional lending products.

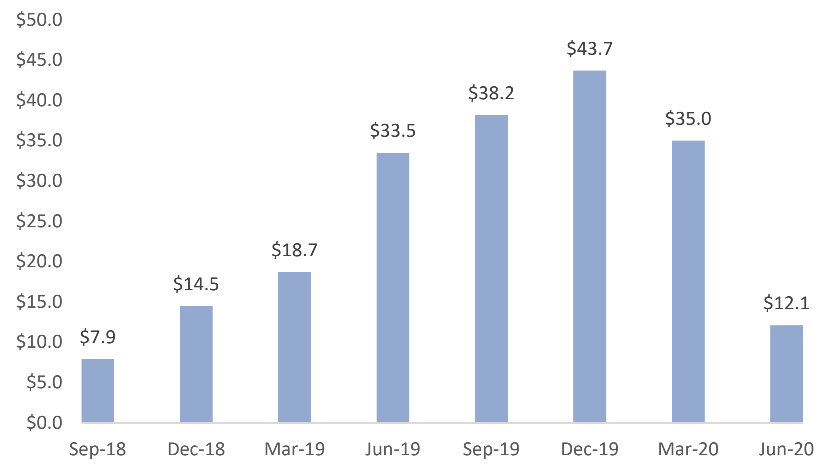
On Balance Sheet Loans Net of Provisions ($ millions)



Source: BBC, IIR

The below chart shows the bank settlements on a quarterly basis for FY19 and FY20. The quarterly settlements increases dramatically from $7.9 million in Q1'FY19 to $33.5 million in Q4'FY19. As discussed above the growth continued in the 1H'FY20 but has been impacted by measures taken by the bank on the back of the Covid-19 pandemic. Despite the weakness in the 2H'FY20, total bank settlements for the year were up 72.9% on FY19.

Bank Settlements ($ millions)



Source: BBC, IIR

The banking segment primarily services residential mortgages with residential loans accounting for 85.9%, 88.7% and 92.9% of loans and advances in FY18, FY19 and FY20, respectively.

Loan Type Percentage of Loan Book

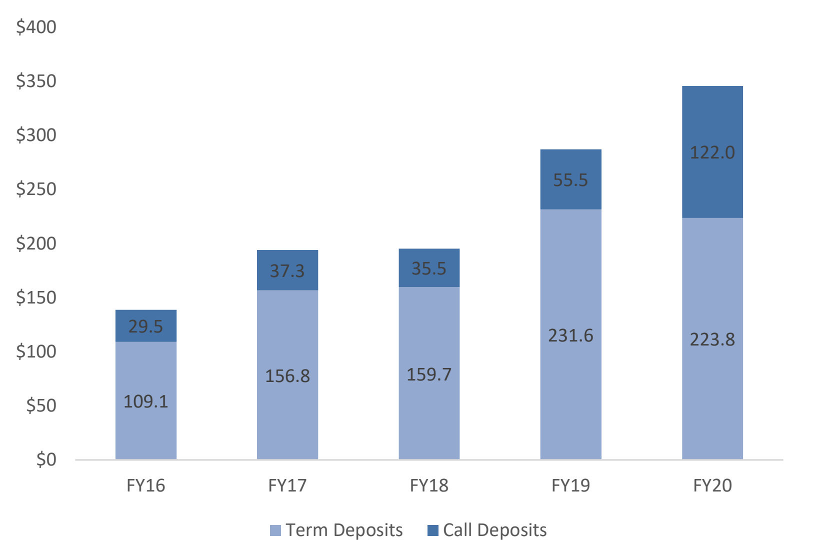
	FY18	FY19	FY20
Residential loan	85.9%	88.7%	92.9%
Term loans	12.5%	10.4%	6.6%
Personal loans	1.3%	0.6%	0.3%
Overdrafts	0.3%	0.2%	0.2%

Source: BBC, IIR

Deposits and Funding Mix

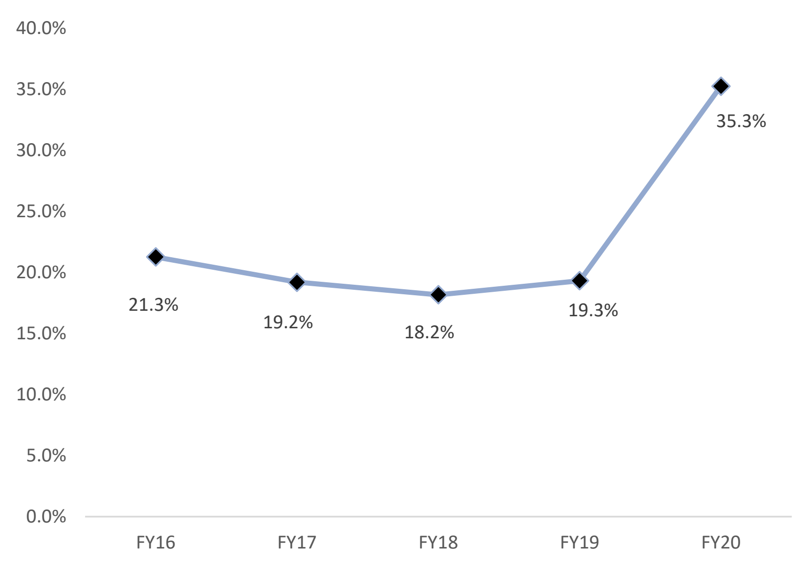
The deposit base for the banking segment has consistently increased over the past five financial years. In FY20, deposits increased 20.5% to $346 million. More pleasingly was the improved funding mix. Call deposits, which are lower cost liabilities, increased 120% to $122 million. The banking segment will continue to focus on improving the funding mix with an increased level of call deposits having a positive impact on profitability.

Total Deposits and Funding Mix ($ millions)



Source: BBC, IIR

Percentage of Call Deposits



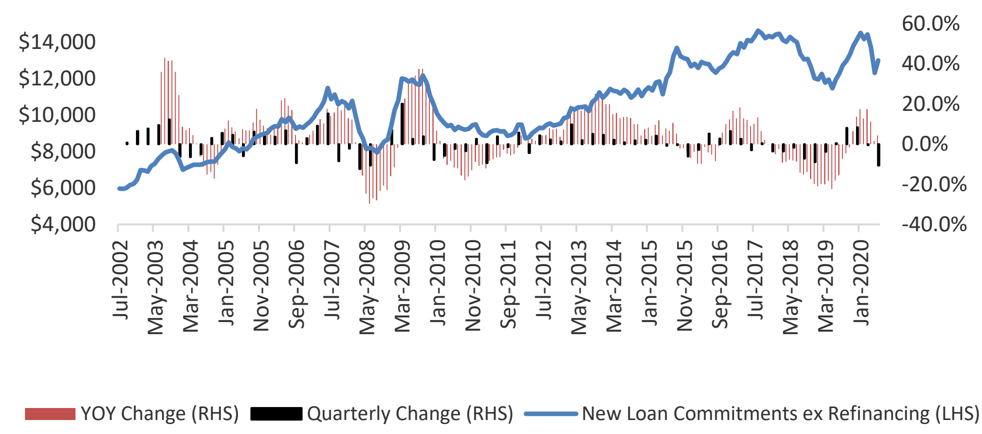
Source: BBC, IIR

AUSTRALIAN HOUSING LENDING MARKET

Given a large portion of the company's business is related to residential mortgages, we take a look at the housing lending market in Australia.

New housing loan commitments excluding refinancing (seasonally adjusted) has been increasing at a compound annual growth rate of 3.1% from July 2002 to June 2020. After hitting a high in May 2017, new housing loan commitments excluding refinancing has been weakening. There was a recovery towards the end of 2019 and into the beginning of 2020, however, new loan commitments declined significantly in the June 2020 quarter, falling 10.6% for the quarter, the biggest quarterly decline over the 18 year period. This is not unexpected given the impact the Covid-19 pandemic had on the economy during this period. We note that despite the quarterly decline, new loan commitments was up 4.5% over the 12 months to 30 June 2020.

New Loan Commitments Ex Refinancing, Seasonally Adjusted ($ millions)

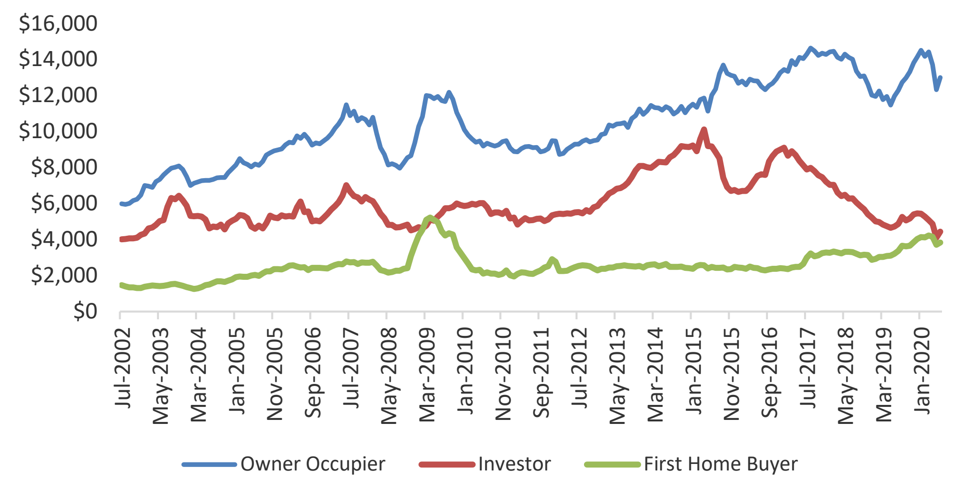


Source: ABS, IIR

Looking at the new loan commitments by lender category we can see that Owner Occupier loans continue to account for the highest number of new loan commitments while investor loans have been on the decline. Investor loans have been impacted by the changes to payment requirements for investor loans to principal and interest payments. Interest only payments were a key driver for Investor loans during the 2012 to 2015 period.

Government subsidies have contributed to an increase in the amount of loans provided to First Home Buyers over the last few years. We expect this trend to continue in 2020 as the government provides additional grants to first home buyers in the wake of the pandemic.

New Loan Commitments Ex Refinancing By Type, Seasonally Adjusted ($ millions)



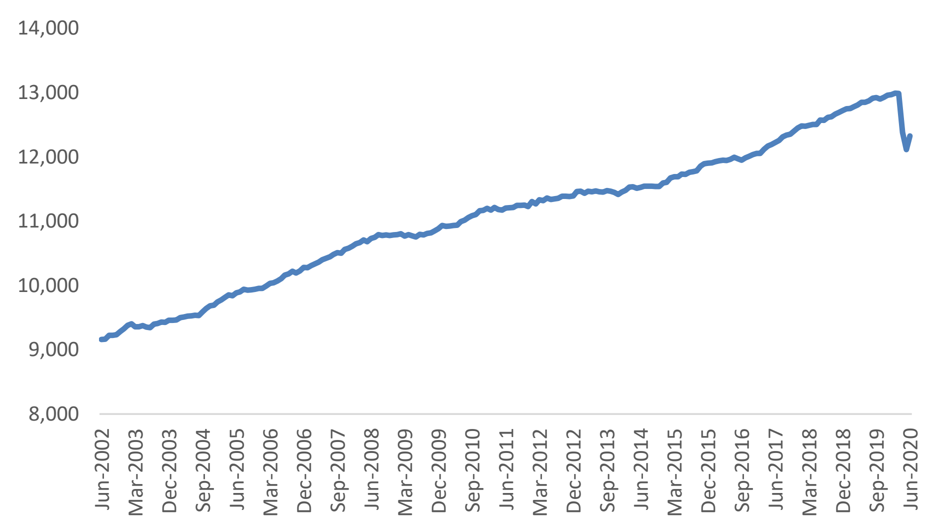
Source: ABS, IIR

Headwinds for the Housing Sector

There are a lot of uncertainties regarding the housing market for the remainder of 2020 and into 2021 as Stage 4 lockdowns in Victoria and the potential for other states to have to reintroduce tougher restrictions due to the ongoing Covid-19 pandemic. A key driver of housing demand is the level of employment. The number of people employed dropped dramatically over the June quarter as businesses were forced to close. The number of employed people fell 5.1% over the June quarter, the largest quarterly fall over the past few decades as shown in below chart. We note that these figures included those employees receiving the JobKeeper payout and therefore appear better than they actually are.

In addition to unemployment, the closure of our borders means that immigration will be lower for the foreseeable future. It would appear only access to a vaccine would change this equation at this point. Given population growth is an important driver of housing demand, this will inevitably have an adverse impact on the housing market while the border closure remains in place.

Number of People Employed, Seasonally Adjusted ('000)



Source: ABS, IIR

Government stimulus and the ability to defer loan repayments has avoided catastrophe for the meantime but this will be wound back and there will come a time when households will have to operate without or with reduced government handouts. The impact of this is yet to be known and will be highly dependent on the ability of the economy to rebound once state borders open again and ultimately international borders.

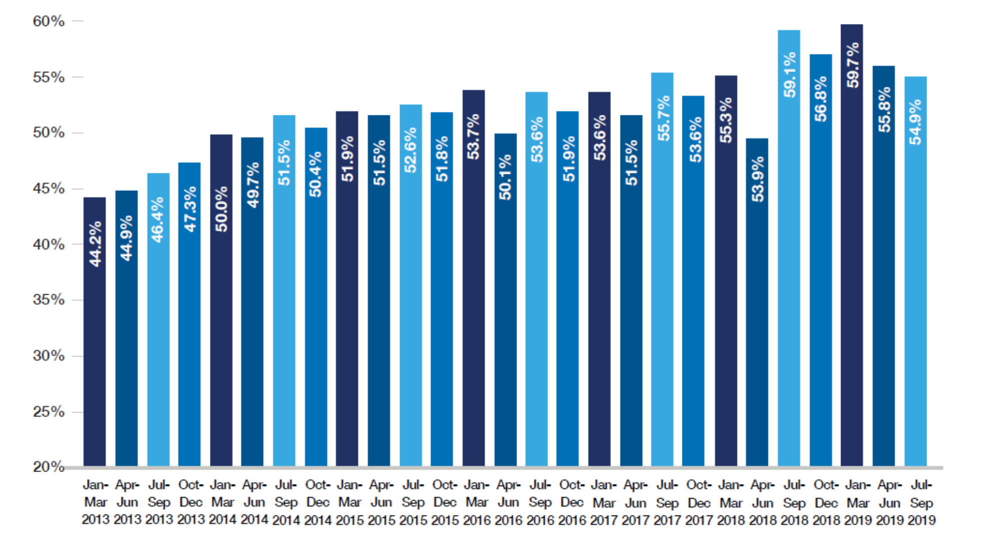
In support of the housing market during this difficult period will be low interest rates. The cash rate has dropped to an all time low of 0.25% and the RBA has stated that it does not see the interest rate increasing for at least two to three years.

ROLE OF MORTGAGE BROKERS IN THE HOUSING SECTOR

Deregulation of the banking sector in the 1980's has driven the growth of the mortgage broking sector. Mortgage brokers now play a significant role as the source of loan originations for residential mortgages.

Mortgage brokers and aggregators accounted for 55% of new residential home loans during the September 2019 quarter, according to the latest industry report by the MFAA. This is down from the highs of ~60% in the March 2019 quarter. The percentage of home loans written by brokers has been steadily increasing over the years. The percentage of home loans originated by mortgage brokers and aggregators was over 10% higher in the September quarter 2019 compared to the March quarter 2013.

Residential Home Loans Settled by Mortgage Brokers



Source: Mortgage Finance Australia Association (MFAA)

The recent Royal Commission into the Banking System saw the payment structure of mortgage brokers be put under the spotlight. The review recommended that the commission payment structure be removed and replaced with brokers receiving a fixed fee for their services. After significant lobbying from the mortgage broking industry the federal government decided not to impose this recommendation and the payment structure remains unchanged. This will be reviewed in 2022. A key outcome from the Royal Commission is that lenders must act in the best interest of the client. This outcome is expected to increase the use of mortgage brokers given they are best positioned to achieve this outcome.

PEER COMPARISON

We view BBC to have three key ASX-listed peers - Australian Finance Group (ASX: AFG), Resimac Group (ASX: RMC) and Mortgage Choice Limited (ASX: MOC). AFG and MOC's primary business is mortgage aggregation while RMC is a non-bank lender that originates its loans primarily through the mortgage broker network in Australia. A point of differentiation for BBC is the banking arm for the company is an APRA regulated ADI.

We note that there are over 50 mortgage aggregators operating in Australia according to the MFAA and a number of non-bank lenders. Therefore there is significant competition across the sector that is not reflected in the below peer group as we have solely focused on the key ASX-listed peers for the purposes of this comparison.

AFG is the largest operator in the peer group by some margin. AFG had 2,975 mortgage brokers and a loan book of $154.6 billion at 30 June 2020. BBC has the second largest loan book and mortgage broker network in the peer group. AFG's merger with Connective has not been opposed by the ACCC and is waiting for approval by the courts to proceed. Connective is one of the largest mortgage aggregator networks in Australia with over 3,000 loan writers. This will significantly increase the size and market share of AFG.

Looking at some key financial metrics from FY20, we note that BBC reported the highest revenue, NPAT and EPS growth in FY20. This highlights the strength of the company's performance in FY20. From a Return on Equity (ROE) perspective, BBC lags its peers.

Unlike the other three companies in the peer group BBC does not currently pay a dividend. One could expect the company to trade at a discount to its peers as a result of this, however, this is not the case. From a PE ratio perspective, the company is trading at a higher multiple than RMC and MOC. BBC trades at a lower multiple than AFG, which is to be expected given AFG is the largest player in the market and is therefore likely to trade at a premium to the peer group.

Peer Comparison	AFG	RMC	MOC	BBC
Key Business Metrics				
Loan writers at 30 June 2020	2,975	na	554	1,740
Loan writer growth FY20	0.0%	na	-1.4%	3.9%
Loan book ($ billion) at 30 June 2020	$154.6	$12.4	$54.0	$48.1
Settlements ($ billion) at 30 June 2020	$34.1	$4.7	$10.0	$18.1
Settlement Growth FY20	9.0%	30.6%	6.4%	21.5%
Financial Metrics FY20				
Revenue growth	6.1%	23.6%	-1.0%	26.9%
NPAT growth	15.3%	18.5%	-31.3%	47.7%
EPS growth	12.5%	16.9%	-31.8%	19.5%
Return on Equity (ROE)	26.9%	25.6%	10.7%	5.0%
DPS (cents per share)	10.1	3.0	6.5	0.0

Source: Company announcements, Iress, IIR

PRICE TARGET & INVESTMENT VIEW

We have assigned a value of **$1.12** per share for BNK. This represents an upside of 72.3% on the share price of $0.65 at 4 September 2020. The valuation is based on applying a PE multiple of 10x to the FY21 EPS plus the NPV of the net trailing commissions per share.

We have assigned a PE multiple of 10 as this reflects the average PE of the peer group over the past 12 months. This is below the average PE of 13x over the past three years to 28 August 2020. We view the reduced PE ratio as appropriate to reflect the increased risks associated with the housing market in FY21.

BNK Valuation	
NPV of trailing commissions per share	$0.47
FY21 EPS	6.53
PE Multiple	10x
Value per share	$0.65
BNK Price Target	**$1.12**

KEY INPUTS FOR OPERATING SEGMENTS

The key inputs for the operating segments are provided below. We expect FY21 to provide a difficult economic backdrop as a result of the coronavirus pandemic. Unemployment is expected to continue to increase in the 1Q'FY21 largely due to the stage 4 restrictions that were imposed on Victoria in August 2020 for an initial period of 6 weeks to curb a Covid-19 outbreak. The restrictions have resulted in a number of businesses having to close and a reduction in employees allowed on sites to reduce movement throughout the city. Increasing Covid-19 cases in NSW is also resulting in the State becoming jittery and if the outbreak cannot be controlled, increased restrictions may be reimposed to get control of the outbreak.

Forecasting the outcomes of the housing market in FY21 is difficult given the outcome will be driven by a number of variables. We expect the impact of border closures and increased unemployment from tighter restrictions to have a negative impact on the housing market in 1H'FY21, particularly in the 2Q'FY21 with the Federal Government announcing reductions in the JobKeeper and JobSeeker payments after the first phase of the program ends in September. We expect the domestic economy to open up in the 2H'FY21, however, the ability of businesses to reopen after the JobKeeper program ends in March 2021 is yet to be seen. We will also get a better picture of the damage to the housing market when the mortgage deferment period ends in March 2021.

The risks for BNK in FY21 are largely outside the control of the company with the housing market heavily dependent on the economic outcomes that result from government imposed restrictions. We view the risks associated with FY21 to be heightened compared to those experienced in the 4Q'FY20. With that said, the company is well placed to continue to grow its loan book and while the company may not grow its settlements at the same rate as FY20 due to the macroeconomic environment, we expect the company will be able to maintain the level of settlements achieved across the business in FY20 in the upcoming financial year.

Key Inputs		
	FY20A	**FY21F**
Banking & Wholesale		
Bank Settlements ($m)	129.0	129.0
Growth	*72.9%*	*0.0%*
Wholesale settlements ($m)	447.0	447.3
Growth	*-22.7%*	*0.1%*
Deposits	345.8	404.6
Growth	*20.4%*	*17.0%*
Aggregation		
Loan writers	1,740	1,840
Growth	3.9%	5.7%
Loan Settlements	15.5	15.6
Growth	23.2%	0.1%
Average Loan Settlements per broker	2.3	2.2
Growth	16.3%	-6.3%

RISKS

- **Regulatory Risk:** ADIs and mortgage providers are heavily regulated and as such any changes to regulations can impact the operations of a business in this sector. The Royal Commission in the Financial Services sector saw recommendations to remove the commission payment structure of mortgage brokers and move to an upfront fee payment. This recommendation was not implemented by the Federal Government however will be reviewed in 2022. Any changes to the payment structure would impact the Aggregation business.
- **Softening Housing Market Risk:** The company is primarily exposed to the residential mortgage market through the banking and aggregation segments. The housing market had been enduring a period of softening prior to the Covid-19 pandemic which has been exacerbated by the pandemic. The company has been able to continue to grow during this period, however a prolonged downturn in this market results in heightened risks for BBC's growth prospects.
- **Limited Liquidity:** The stock has historically had low levels of liquidity which provides risks for investors with both entering and exiting the stock in a timely manner.
- **Loan writer growth:** The growth of the Aggregation segment is highly dependent on the ability of the company to continue to grow the number of loan writers. The company has been successful at growing loan writers since its establishment, however, it is a very competitive market with mortgage aggregator always seeking to poach loan writers. BBC seeks to offer the best platform for loan writers to continue to attract and retain loan writers to their platform.

- **On Balance Sheet Growth:** The banking segment is focused on growing on balance sheet loans given they are more profitable than off balance sheet loans. In order to do this the company will be required to continue to grow its regulatory capital base.

BOARD AND MANAGEMENT

Jon Sutton - Chairman (Non-Executive): Mr. Sutton was appointed as a Director in October 2019. Mr. Sutton has more than 25 years' experience in the financial services industry. Mr. Sutton was the CEO and Managing Director of the Bank of Queensland (BOQ) and retired in 2018. Prior to joining BOQ, Mr. Sutton served as the CEO and Managing Director of Bankwest and was part of the acquisition team that purchased Bankwest. Mr. Sutton has held senior roles in CBA both in the banking and global markets divisions. Mr. Sutton is currently a Director of Sydney Football Club and an Advisory Board Member to SendFX.

Peer Hall - Director (Non-Executive): Mr. Hall is an experienced financial services professional. Mr. Hall's previous board and industry appointments include: Non-Executive Director of BLSSA Pty Ltd, Chair of the Corelogic RP Data sponsored Residential Valuation Industry Advisory Group, Ministerial Advisory Board Member for NSW Housing Minister and Chairman and Council Member of the Lenders Mortgage insurance sub-committee. Mr. Hall has also held senior executive position of Country Executive of Genworth Financial Australia & NZ and Managing Director of Genworth Financial Mortgage Insurance Australia & NZ.

Don Koch - Interim CEO & Director (Executive): Mr. Koch was the CEO of ING Bank in Australia from 2009 to 2012 before becoming the CEO of ING Bank Italy from 2012 to 2016. Mr. Koch most recently ran a program for ING Asia as a joint venture with a large local bank within China. Mr. Koch was the former CIO and part of the team that launched ING Direct in Australia.

Mr. Koch was appointed as Interim CEO following the resignation of Mr. Lyons. He will return to his position as a Non-Executive Director when Mr. Morgan commences in October.

Jon Denovan - Director (Non-Executive): Mr. Denovan joined the board in September 2019. Mr. Denovan is a Special Counsel with leading national law firm, Dentons, and is a leading industry authority on regulation and compliance for the mortgage industry. Mr. Denovan is regularly consulted by the Commonwealth Government and industry bodies on matters relevant to the National Consumer Credit Protection Act, National Credit Code, and best interests obligation, amongst others.

John Kolenda - CEO of Aggregation & Director (Executive): Mr. Kolenda is the Managing Director of Finsure Group and has extensive experience in the mortgage broking and aggregation sector. Mr. Kolenda was the General Manager Sales and Distribution at Aussie Home Loans for ten years from 1994 before founding X Inc, which was a successful mortgage originator before its merger with the mortgage broking operations of Ray White in 2007. Mr. Kolenda founded several businesses before launching Finsure Group in 2011. Mr. Kolenda co-founded and chairs Aura Group Pty Ltd, a boutique corporate advisor and investment house.

Brett Morgan - CEO of Banking and Wholesale: Mr. Morgan has substantial experience in the financial services industry, including senior banking roles at ING and key management positions at a number of digital and financial services businesses, including CEO of LaternPay and Flexischools, making Mr. Morgan a good fit to pursue the transformation of the banking segment through the digital transformation. Mr. Morgan will commence his position in October.

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