FIIG | Factsheet

Bank of Queensland Limited

31 October 2022

Sector: Financials
Sub-sector: Insurance & Banks
Country: Australia
Ownership: Public

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Issuer Outline

Bank of Queensland Ltd (BOQ) is one of Australia's leading regional banks, established in 1874. It is listed on the ASX with a market capitalisation of AUD4.8bn as at 31 October 2022. It has evolved from a Queensland focused, retail branch-based bank to a national diversified financial services business.

BOQ provides banking, financial services and insurance products, mainly to retail, SME and commercial clients. Although it lends throughout Australia, close to half of its business is concentrated in Queensland. BOQ is the ninth-largest retail and commercial bank in Australia.

Key Financials (AUDm)

LTM (31 August)	2022
Net Interest Income	1,529
Non-interest income	153
NPAT	426
Gross Loans & Advances (GLA)	81,250
Total Assets	99,930
Customer Deposits	60,489
Net interest margin (%)	1.74
Credit loss provisions (% of GLAs)	0.47
CET1 Ratio (%)	9.57

Source: FIIG Securities, Company Reports

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3FN0042339	AUD 200m	Sub. Unsec. T2	3M BBSW + 1.85%	Quarterly	01 May 2023	01 May 2028
AU3FN0064408	AUD 400m	Sub. Unsec. T2	3M BBSW + 1.75%	Quarterly	19 May 2027	19 May 2032

[1]Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call.

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Tier 2 Structure	
Interest Deferral/Cancellation	Interest is deferrable and cumulative if, prior to the payment of interest, the issuer is not solvent or would not be solvent after payment.
Non-Viability Trigger	Yes, standard Basel III compliant non-viability trigger. If APRA determines the issuer is at risk of becoming non-viable, the terms of the notes indicate that the primary method of loss absorption will be via conversion of the subordinated notes into equity, in-part or in full.

Strengths

- Focus on low-risk residential lending: BOQ's core business is low risk, with predominantly a retail focused operating model, utilising multi-brand strategy (Virgin Money, ME Bank) to diversify its geographic and demographic exposures. Its business is focussed primarily across residential mortgages and small and midsize enterprise (SME) lending. Residential mortgages account for more than 75% of total loans (see Figure 2), given the favourable backdrop for housing performance over the last decade (very accommodative interest rates and stable employment conditions). Asset quality metrics are solid with low credit losses at approximately 0.19% of total GLA's. The bank also maintains ample credit loss provisions, currently 85bps of customer loans. The recent addition of ME Bank delivers material scale, broadly doubles BOQ's retail bank size and provides further geographic diversification.

Figure 1: Loans diversification by Geography

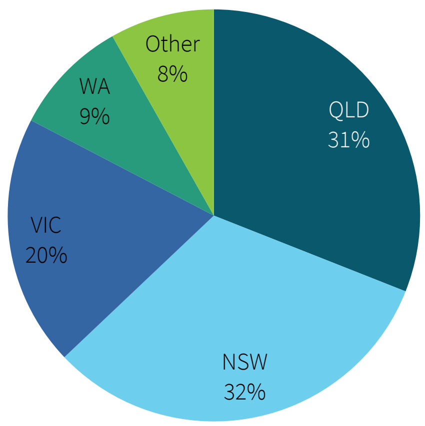
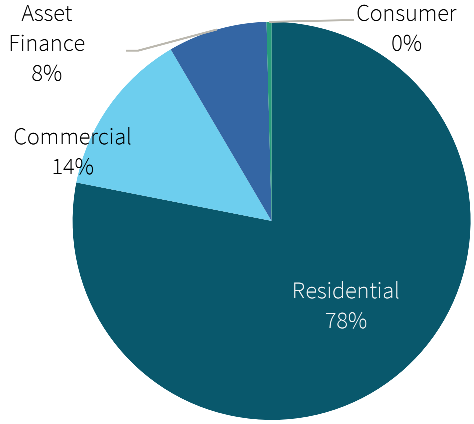


Figure 2: Loans diversification by Type



Source: Company

- Sound capital and funding structure: BOQ's core measure of capital, its Common Equity Tier 1 ratio, is sound at 9.6%, which is at the mid-point of immediate peers (albeit, toward the lower-end of country-wide averages). The Bank is also well-funded, with retail customer deposits providing approximately 67% of the bank's funding needs. While neither of these metrics is an outlier compared with sector averages, they are reflective of a mid-tier regional bank with a solid funding structure with limited reliance on confidence-sensitive forms of funding.

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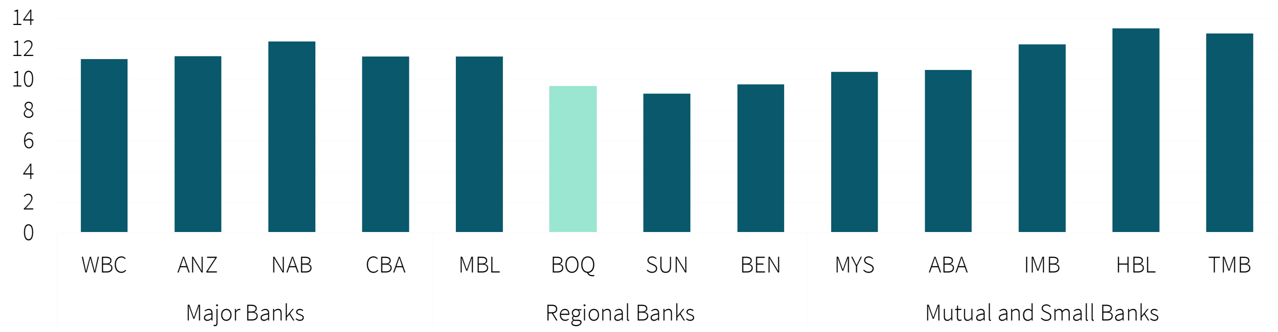
Figure 3: Bank Regulatory Tier 1 Capital Ratios (not exhaustive)



Source: Company

- ME Bank acquisition improves scale: The acquisition of ME Bank in mid-2021 should drive growth and improve BOQ's exposure to markets outside Queensland (which it was previously heavily weighted in). The acquisition places BOQ as the largest regional bank in Australia, overtaking Bendigo and Adelaide Bank (BEN). ME Bank should also provide BOQ access to origination pipelines in Melbourne, Australia's fastest growing city. We expect these factors, and increased economies of scale, will help BOQ remain competitive against BEN and other regional peers.
- Sound macro environment and regulatory oversight: Australian financial institutions benefit from operating in an economy characterised as having a very high degree of economic resilience with low susceptibility to event risk. While the Australian economy has recovered relatively strongly from the direct impacts of the pandemic, the current high inflation environment and associated interest rate increases by the Reserve Bank of Australia have the potential to put strain on the post-pandemic recovery, with increased pressure on consumers. The current low level of unemployment and significant savings accumulated over the past two years should provide a buffer. Nevertheless, BOQ maintains adequate level of credit provisioning to account for this uncertain outlook. Australian banks including BOQ are overseen by a highly regarded prudential regulator, APRA, who oversees banking, insurance and superannuation, with the aim of maintaining the integrity, safety and soundness of financial institutions.

Risks

- Small market share and concentrated business base: Given that the bank predominantly focuses on residential lending, BOQ's earnings are sound, with net interest income accounting for nearly 90% of operating revenues. Despite BOQ's sound and defendable business base, its market share is quite small at just over 2% of system assets. The bank also has a relatively higher cost-to-income ratio (of 55.7% as of 31 August 2022) compared to its peers. These factors can leave the bank and its business volumes susceptible to competitive and margin (profitability) pressures, which are unlikely to moderate in the near term. The performance of BOQ's niche segments, including BOQ Finance (asset finance), BOQ Specialist (banking services to medical, dental, veterinary and accounting professionals), and Virgin Money, have performed relatively well in recent periods, providing some margin offset. However, given mortgage lending accounts for 78% of its lending base, the bank is likely to remain susceptible to volume and margin pressures while system credit growth remains modest.
- Funding profile susceptible to competitive pressure: Customer deposits make-up the majority of BOQ's funding profile. The four major banks in Australia hold a dominant market position, and should they choose or are forced to compete more aggressively for customer deposits, it leaves smaller banks like BOQ, vulnerable.

Risks relevant to Subordinated Unsecured Tier 2 Instrument

- Deeply subordinated ranking: Tier 2 are unsecured and deeply subordinated instruments, ranking ahead only of ordinary shares and additional Tier 1 (AT1) hybrids. Tier 2 rank behind senior creditors, which includes depositors, senior unsecured and senior non-preferred creditors (mostly relevant for European banks, only), noting that Tier 2 instruments will rank ahead of AT1 hybrids.

- Optional call dependent on regulatory approval: Tier 2 and AT1 notes include an early call feature where the face value of the notes may be repaid early in cash from a given date stated in the terms and conditions of the instrument. The optional redemption requires regulatory approval, which may not be provided.

  In general, regulators are unlikely to provide approval for a Tier 2 or AT1 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

- Conversion or write-down following a Non-Viability Trigger Event: A Non-Viability Trigger Event occurs when APRA determines conversion to ordinary shares (or write-off) of some or all of an issuer's contingent capital securities (AT1 and Tier 2) is necessary to prevent that financial institution becoming non-viable. Whether a non-viability trigger event will occur is solely at the discretion of APRA. APRA does not define what constitutes a non-viability event and there are currently no precedents under Basel III to determine non-viability. If such an event occurs, the issuer may be required to convert some or all of its AT1 or Tier 2 notes into ordinary shares. In a more severe scenario, the issuer may be required to write-off the value of these notes. We note that it is expected that the conversion / write-off would be expected to be applied first to AT1 hybrids and only then to the Tier 2 if the AT1 conversion / write-off was not sufficient to restore the issuer to a viable position.

- Capped equity conversion: Conversion of Tier 2 and AT1 notes following a capital trigger event (for AT1 only) or a non-viability trigger event is subject to a maximum number of shares being issued. As such, if the notes are converted into ordinary shares, the value of ordinary shares an investor receives may be significantly less than the face value of their notes.

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