FIIG | Factsheet

Liberty Financial Pty Ltd

29 March 2022

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Issuer Outline

Liberty Financial Group Pty Ltd (Liberty, the Company, the Group) pioneered specialty finance in 1997, as one of the first non-bank financial institutions (NBFI) in Australia. Liberty Financial Pty Ltd, the issuer of the notes, is the key operating entity for the Group. Liberty has total assets of ~AUD12.2 billion across its various products - home loans, car loans, personal and business loans.

The company listed on the Australian Stock Exchange (ASX: LFG) in December 2020 and had a market capitalisation of AUD1.73bn as at 17 December 2021.

Liberty has been able to develop a unique combination of capabilities to generate competitive advantage and durable financial performance, making the Group a successful niche lender, operating through three segments;

- Residential Finance (mortgages) in Australia and New Zealand;
- Secured Finance – providing motor vehicle, commercial and self-managed superannuation fund lending in Australia;
- Financial Services which include personal loans, insurance products, investment products and real estate services in New Zealand.

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

Key Financials (AUDm)

LTM (30 June)	2021
Net Interest Income	339.8
Credit Loss Provisions	0.4
Net Profit After Tax	185.4
Gross Loans	12,239.4
Net Interest Margin (%)	2.74
Loan Loss Reserves (%)	0.6
Credit Losses (%)	0.0

Source: FIIG Securities, S&P Capital

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	Next Call[1]	Maturity Date
AU3FN0046819	AUD200m	Snr Unsecured	BBSW + 3.25%	Quarterly	N/A	7 Mar 2022
AU3FN0050118	AUD200m	Snr Unsecured	BBSW + 2.60%	Quarterly	N/A	6 Mar 2023
AU3FN0053153	AUD250m	Snr Unsecured	BBSW + 2.35%	Quarterly	N/A	26 Feb 2024
AU3FN0059200	AUD200m	Snr Unsecured	BBSW + 2.45%	Quarterly	N/A	17 Mar 2025
AU3FN0060505	AUD200m	Snr Unsecured	BBSW + 2.55%	Quarterly	N/A	25 May 2026
AU3FN0067914	AUD250m	Snr Unsecured	3mBBSW + 3.10%	Quarterly	N/A	5 April 2027

Liberty Financial Pty Ltd

Strengths

- Very strong capitalisation: Liberty, as a NBFI, is not prudentially regulated, and as such, is not obligated to maintain a prescribed level of risk-adjusted capitalisation as is the case for regulated financial institutions. Nevertheless, capitalisation for Liberty is a relative and absolute strength, as measured by the level of capital held by the finance company according to credit rating agency S&P Global Ratings' (S&P) credit rating methodology. Given the step-up (across all senior unsecured debt) if the credit rating falls below investment grade, Liberty is highly incentivised and therefore likely to maintain a strong level of capitalisation (based on S&P's credit rating methodology). S&P requires Liberty maintains a Risk Adjusted Capital Ratio (RAC) of more than 15% to avoid a ratings downgrade, Liberty has a RAC of 16.3% as at 30 June 2021 (FY21) and a CET1 ratio of 13.5%. S&P forecasts Liberty's RAC ratio will remain ~16% over the next two years. Liberty paid dividends of ~AUD181m in FY21. At the same time, the Company frequently issues new capital with AUD1,050m of unsecured debt issued and AUD4.5bn across six new securitisation trusts in FY21.
- Strong profit: Liberty reported a NPAT of AUD185.4m for FY21, driven primarily by lower funding costs as short-term wholesale rates declined noticeably during the calendar year, meaning the Group is tracking ahead of Liberty's IPO forecast of AUD166m for FY21. The Company has benefited from a stronger than expected economic rebound after COVID19 in Australia and New Zealand.
- Implementation of macro prudential limits on banks will benefit Liberty's loan growth: As the Australian Prudential Regulation Authority (APRA) tightens lending standards for banks, borrowers that no longer fall within the bank's risk framework will look for alternative lenders like, we believe Liberty that will benefit from this shift. S&P forecasts Liberty's loan book growth to increase ~22% in FY22.
- Sound asset quality: Liberty's asset quality metrics remain broadly unchanged year-on-year and at a low level, with credit losses (provisions) at 6bps and gross charge-offs (actual economic losses) at 1bp. Liberty's asset quality metrics are likely to ultimately benefit from the finance company's shift toward a higher proportion of prime borrowers (currently ~75%). Liberty's lending is somewhat lower risk compared to other nonbank peers, given that its asset portfolio remains predominantly within the residential mortgage space (~72% of total assets, with an increasing share of prime mortgages). Furthermore, Liberty's loan portfolio is well-diversified by geography, broadly mirroring the population distribution of Australia.

  The level of loans in arrears has declined in recent years, although this is more likely a function of the significant growth in loans, rather than a step change improvement in the underlying performance. Nevertheless, current levels remain well-below historical averages and in-light of a significant shift in its customer-set toward prime mortgages, arrears for Liberty are likely to be broadly consistent with those reported by larger commercial banks.
- Established and defendable business: Liberty was one of the first in Australia to design and offer loans to the underserviced non-prime mortgage market, where borrowers do not have established credit history (so-called nonconforming loans). Liberty benefits from a well-established position as primary underwriter of residential, auto, and commercial loans, with a high degree of industry knowledge and proficiency within its chosen markets. The Company has made a strategic decision to reduce its concentration to lower margin residential lending and enhance portfolio diversification, which will likely be a net positive for the business due to the highly competitive nature of the Australian residential mortgage lending space. Commercial and auto loans contributed to about 13% and 8% of loans originated in FY21, respectively.
- Well-managed liquidity profile: Funding for Liberty is primarily through warehouse and securitisation. Reliance on unsecured term debt (short and long-term) remains modest, and as such, so does the refinance (liquidity) risk. Liberty maintains a staggered maturity across its MTN's (with maturities between FY22-FY26). Unutilised warehouse funding stands at around 54% (~AUD3.1bn utilised on AUD5.7bn limit - Liberty's policy is to have no less than 50% available within its warehouses). According to S&P, Liberty's warehouse funding is provided by six, highly rated bank counterparties with well-spaced maturities (largely unchanged in recent years).
- Notes benefit from a negative pledge: So long as the notes remain outstanding the Issuer will not create or permit to be outstanding any Security Interest (other than a Permitted Security Interest).

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Risks

- Strong growth may mask asset-quality underperformance: Liberty has been one of the primary beneficiaries of various restrictions placed on bank lending in recent years, with compound annual growth of ~20% over the last five years, noting that many of these prudential restrictions were removed with the onset of COVID19. However with the re-introduction of lending restriction for banks, this may result in further growth for Liberty in FY22. As mortgages generally season over the medium-term (three to five years), strong growth can mask potential asset quality issues (as growth in the denominator outpaces growth in the numerator, which typically lags the former).
- Limited regulatory oversight as NBFI: Liberty is not regulated by APRA. The absence of strong regulatory oversight may see that risk management frameworks are unlikely to be as rigorous as what would normally be required by regulated lenders. It is worth noting Liberty's recent period of strong growth has been accompanied by consistently strong risk-adjusted capital ratios.
- Expansion into a lower-risk customer base could erode profitability: As Liberty continues to grow, it will continue to attract more "bank like" customers, which is deemed to be a natural progression for the lender however these borrowers offer a leaner margin. As funding costs rise, margin pressures are likely to affect Liberty's profitability (but the quality of the portfolio should improve).
- Funding risk: As a non-bank lender, Liberty is highly reliant on wholesale funding as it is unable to take household deposits. During times of financial market stress, access to wholesale funding can prove challenging and expensive. The group has benefited from historically low interest rates and access to lower cost funding over the last few years. Liberty's reliance on wholesale funding makes it susceptible to increased cost of funding placing pressure on margin benefits. However we note that as at 30 June 2021 Liberty had ~60% in unused capacity across its warehouse facility.
- Potential for regulatory change: Liberty is not regulated by APRA as it is not an Authorised Deposit taking Institution (ADI), and as such, there is risk that additional regulatory obligations will be imposed on both Liberty and the sector more broadly.

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Financials

The summary financial results below are based on Liberty's consolidated operations. Credit statistics are based on our calculations.

(AUDm)	FY17	FY18	FY19	FY20	FY21
Profit and loss					
Net interest income	160	161	193	267	340
Interest Income	362	495	629	647	622
Interest Expense	(202)	(334)	(436)	(380)	(282)
Other income	64	127	182	203	231
Other finance expenses	(64)	(97)	(142)	(153)	(177)
Net operating revenue	**160**	**191**	**233**	**319**	**394**
Operating expenses	(71)	(88)	(117)	(132)	(181)
Credit loss provisions	(13)	(19)	(22)	(33)	(0.4)
Net profit after tax	**60**	**63**	**89**	**135**	**185**
Balance sheet					
Cash and cash equivalents	256	351	680	397	499
Gross loans	6,992	9,323	11,280	11,659	12,239
Specific provisions	(22)	(28)	(23)	(21)	(21)
Collective provisions	(9)	(13)	(33)	(56)	(54)
Net loans	**6,961**	**9,282**	**11,223**	**11,582**	**12,164**
Total assets	**7,547**	**10,195**	**12,662**	**13,036**	**13,567**
Unsecured term debt	300	425	725	875	1,050
Securitised term debt	3,781	6,709	8,776	8,219	8,539
Warehouse facilities	2,827	2,125	1,996	2,630	2,566
Total liabilities	**7,067**	**9,572**	**11,851**	**12,012**	**12,528**
Contributed equity	70	170	320	719	719
Reserves	(3)	(5)	(3)	(140)	(114)
Retained profits	394	440	490	452	441
Non-controlling interests	19	17	3	(15)	(6)
Total equity	**480**	**622**	**811**	**1,016**	**1,039**
Credit statistics					
Net interest margin	2.64%	1.90%	1.79%	2.24%	2.74%
Net interest income to operating revenues	99.7%	84.3%	83.0%	84.1%	86.3%
Cost to income (non-interest expense to operating revenues)	44.5%	46.1%	50.3%	41.1%	46.0%
Credit losses (new loans loss provisions)	0.22%	0.24%	0.21%	0.28%	0.00%
Loan loss reserves	0.44%	0.44%	0.50%	0.66%	0.62%
Net charge-offs	0.18%	0.15%	0.07%	0.01%	0.01%

Source: Company reports, FIIG Securities, S&P Capital IQ

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