



# The Australian Banking Sector

A I A N a t i o n a l C o n f e r e n c e

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# Agenda

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IML Background

Banks – last 30 years

Banks – outlook

Investor approach to Banks

Conclusion

## About IML

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- Boutique manager established in 1998, 19 year track record on flagship Funds
- Over \$8b FUM – healthy mix of Retail and Institutional Clients
- Well resourced investment team with experienced leadership
- Disciplined 'true to label' Value & Quality style
- Consistent performance and outcomes over the past 19 years

## Retail Investor Needs

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- Capital preservation
- Reasonable capital growth
- Income focused

## Investment Philosophy: focus on value and quality

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We seek to buy and own:

Companies with a competitive advantage,

with recurring earnings,

run by capable management,

that can grow,

.....at a reasonable price.

## QV Equities Limited

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- Focused on Ex-20 stocks – seeking to provide investors diversification
- Focus on quality industrials - long-term capital growth & income
- Managed by Investors Mutual
- Experienced Board with independent majority
- Listed 22 August 2014

# Banks – last 30 years

A foundation to grow from

## Post 1987 – not a bad foundation to grow from:

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- Low household gearing levels:
  - March '87, Household debt/disposable income 55%
- Consumer Credit: able to grow off a low base
- Median house price to income ~ 2 x



## Post 1987: Economic Environment

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- Financial Deregulation
- Interest rates 12-18%
- Positive GDP growth

## Post 1987: Golden run of bank deregulation

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- The removal of interest rate controls
- Removal of lending controls
- Lower mortgage capital requirements

## Mortgage Brokers

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- Industry established early 1990s
- Aussie ('92), Rams ('95) – first movers
- Small proportion of overall residential mortgage issuance



## The Big 4 Banks

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- CBA float 1991 @ \$5.40
- WBC float 1970 @ sub \$2
- NAB float 1962 @ sub \$1
- ANZ float 1969 @ sub \$1

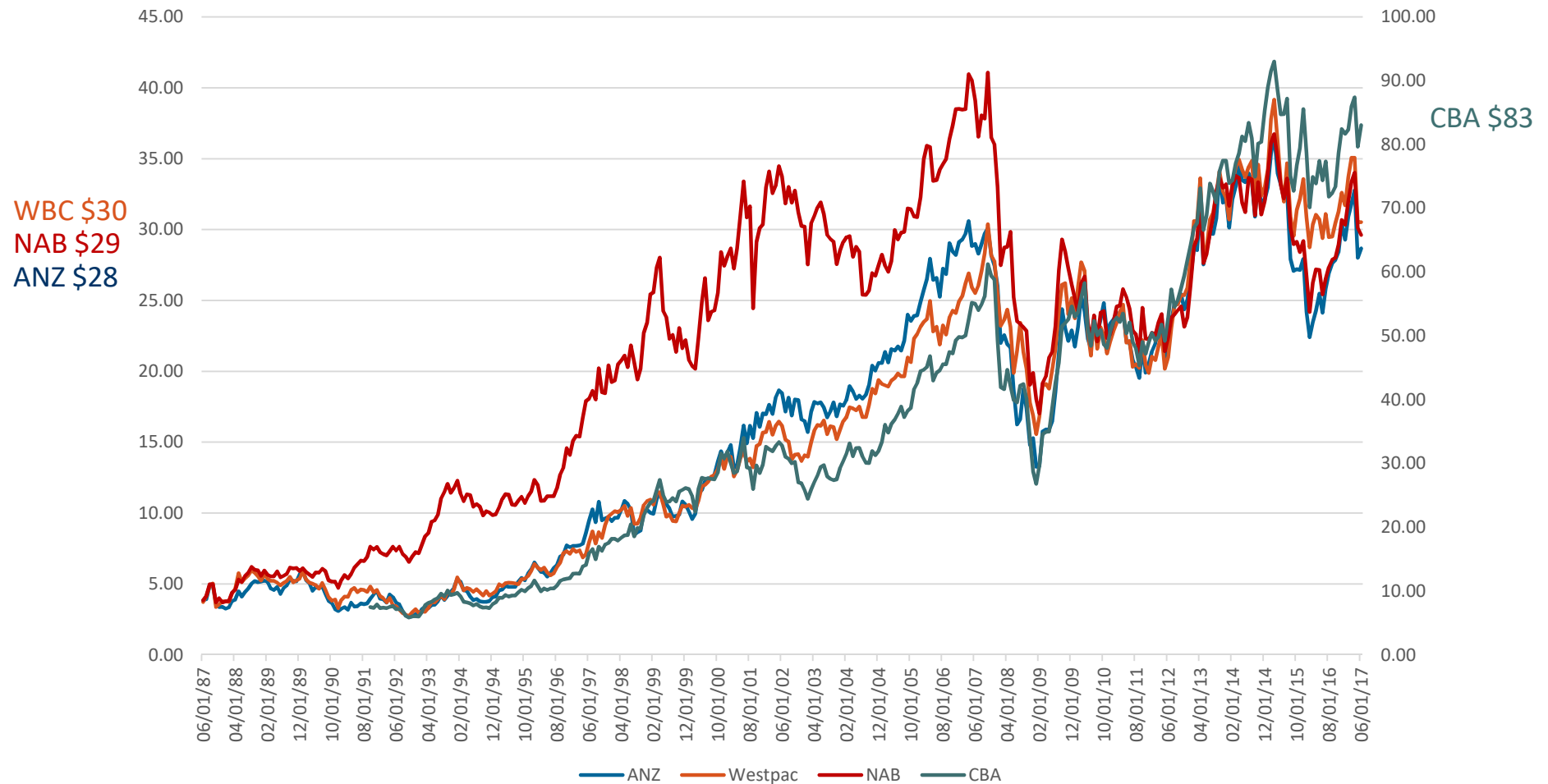
## Post 1987 – 2017 – extraordinary period of history for banks

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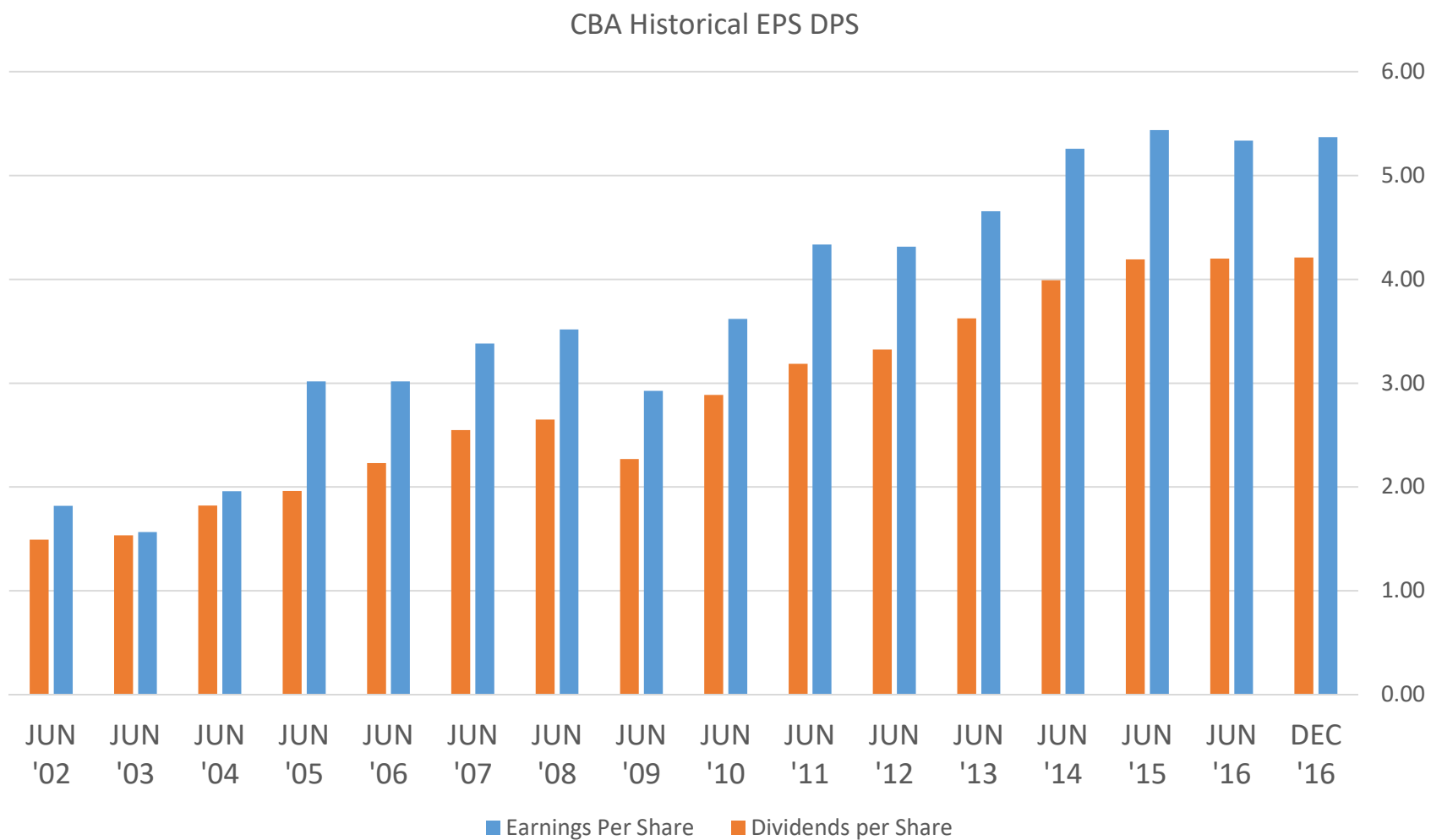
1987 – 2017 investors big winners:

- Big returns from the Big 4
- Dividends + Capital Growth
- Financials now 38% of the ASX 300

## Extraordinary period of growth for banks



## Strong dividends & earnings

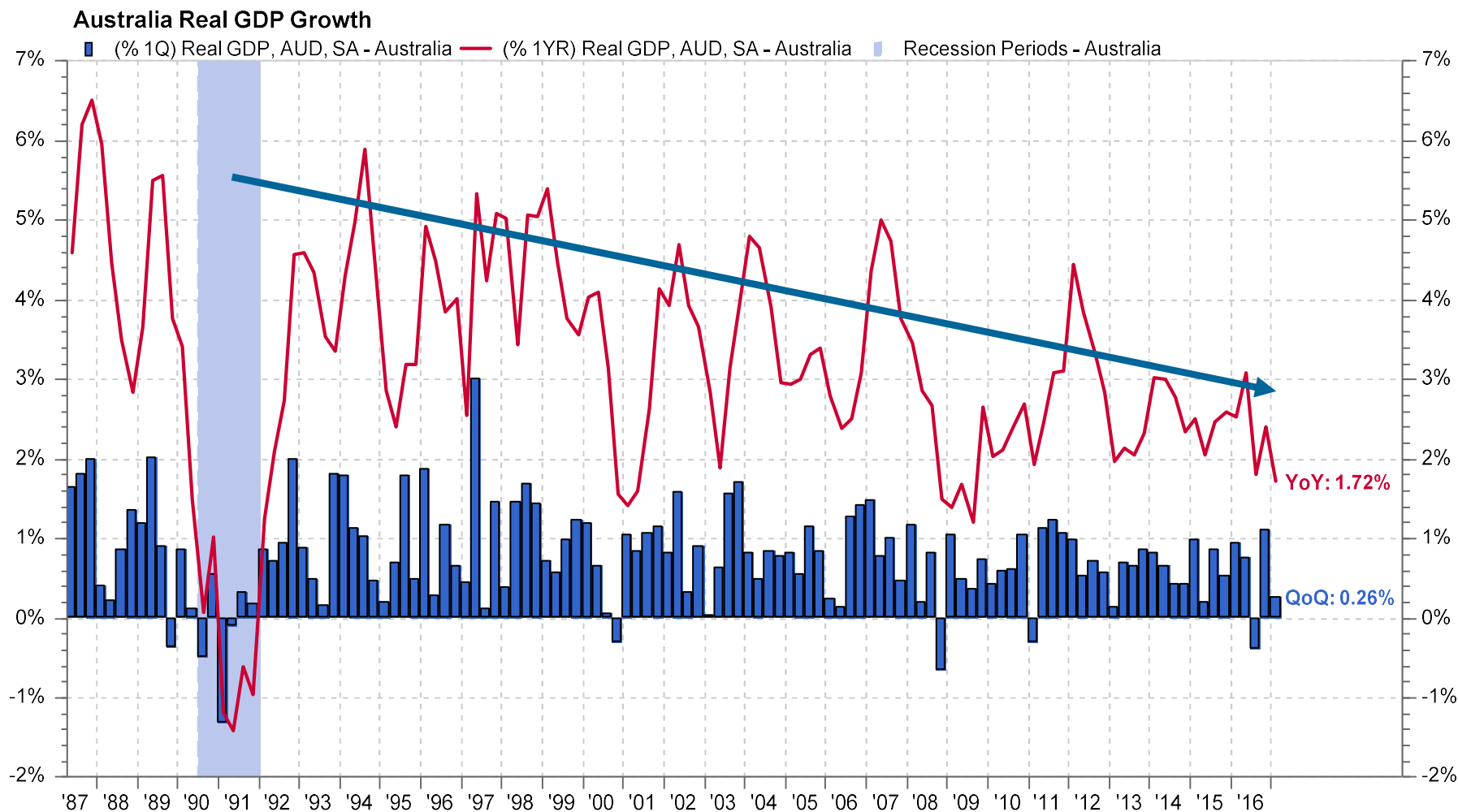


# Australian Banks – Outlook

Past industry drivers are today's risks

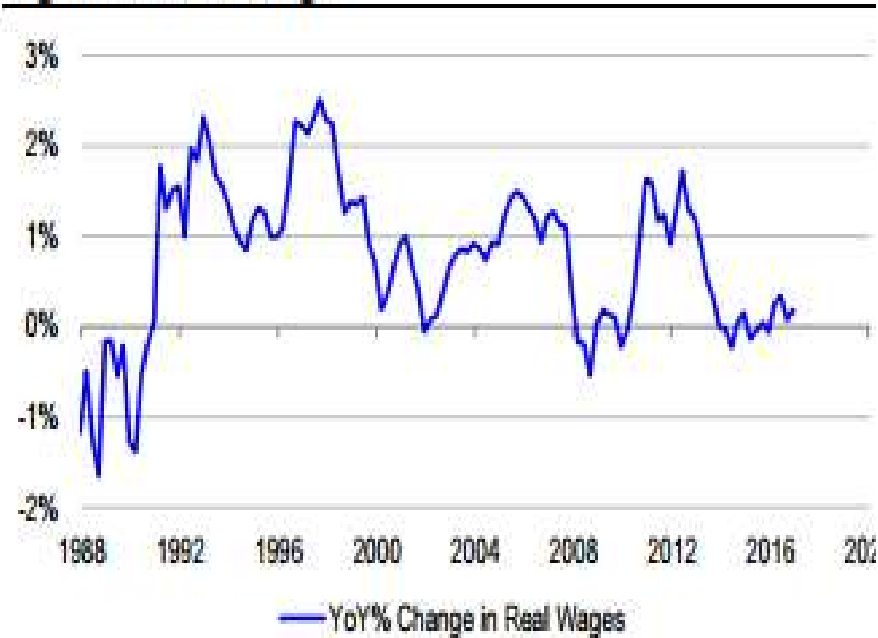


## Australian GDP growth trending lower

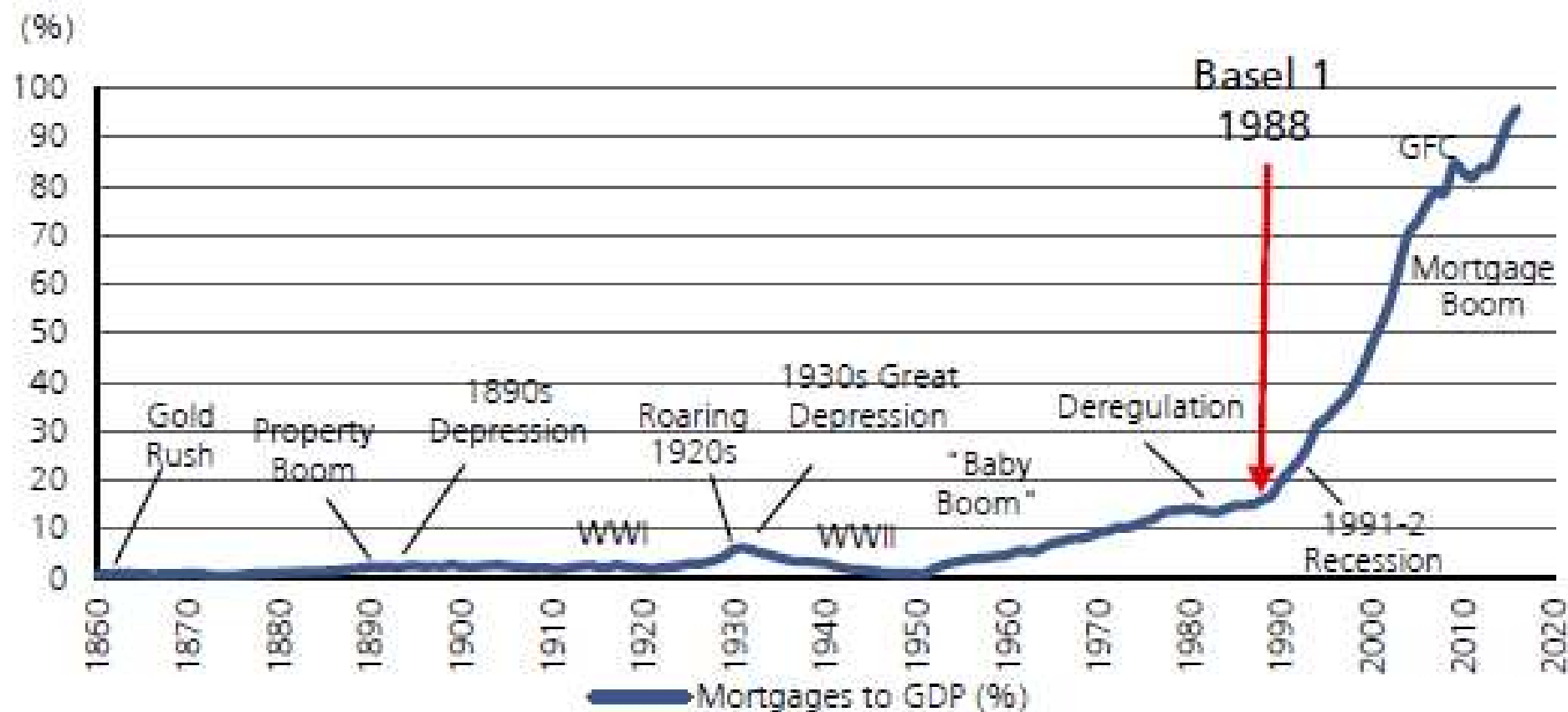


## Wage growth subdued

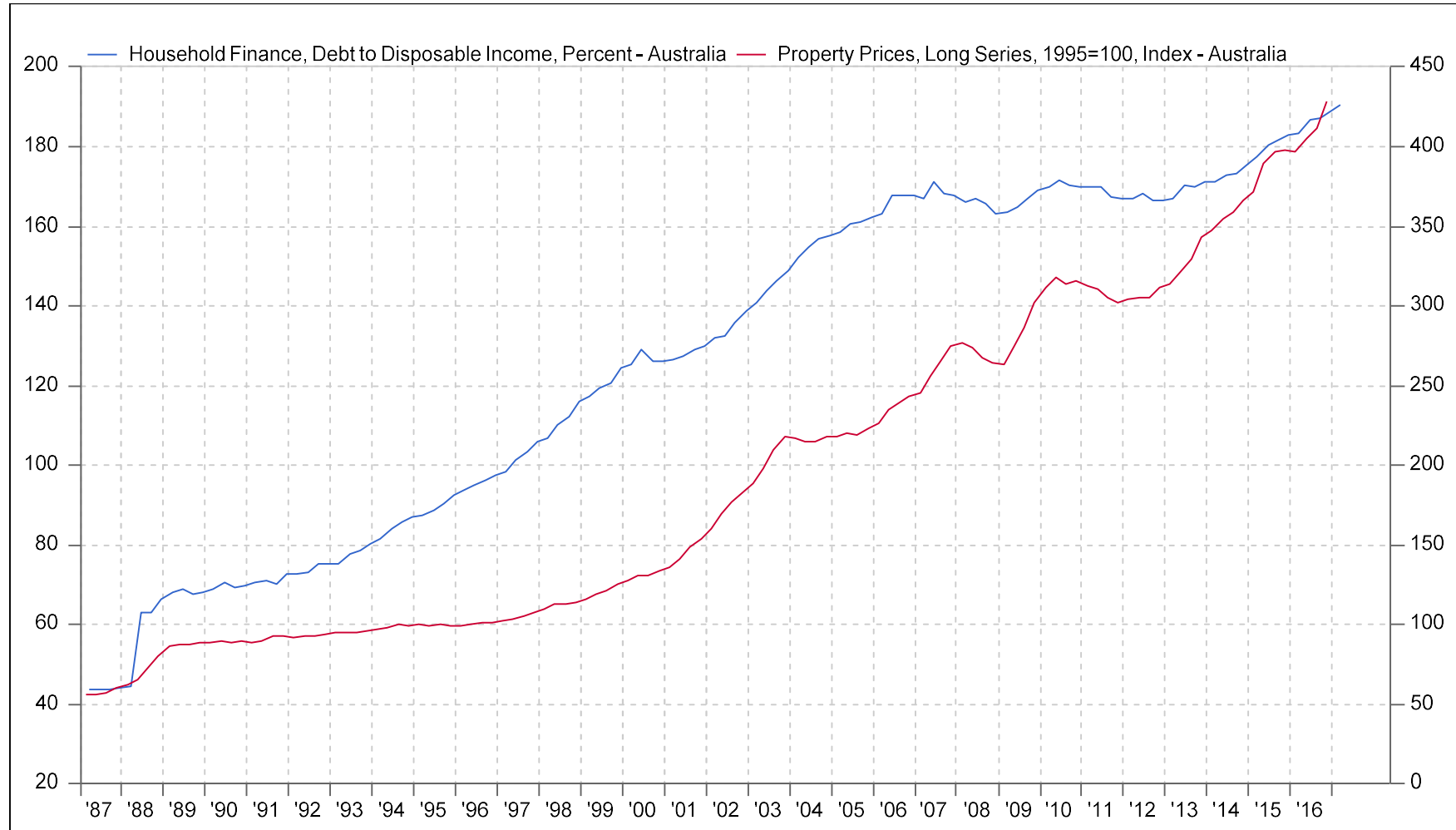
Figure 7: Real wages



## Australian Mortgage Debt to GDP- 1860-2016

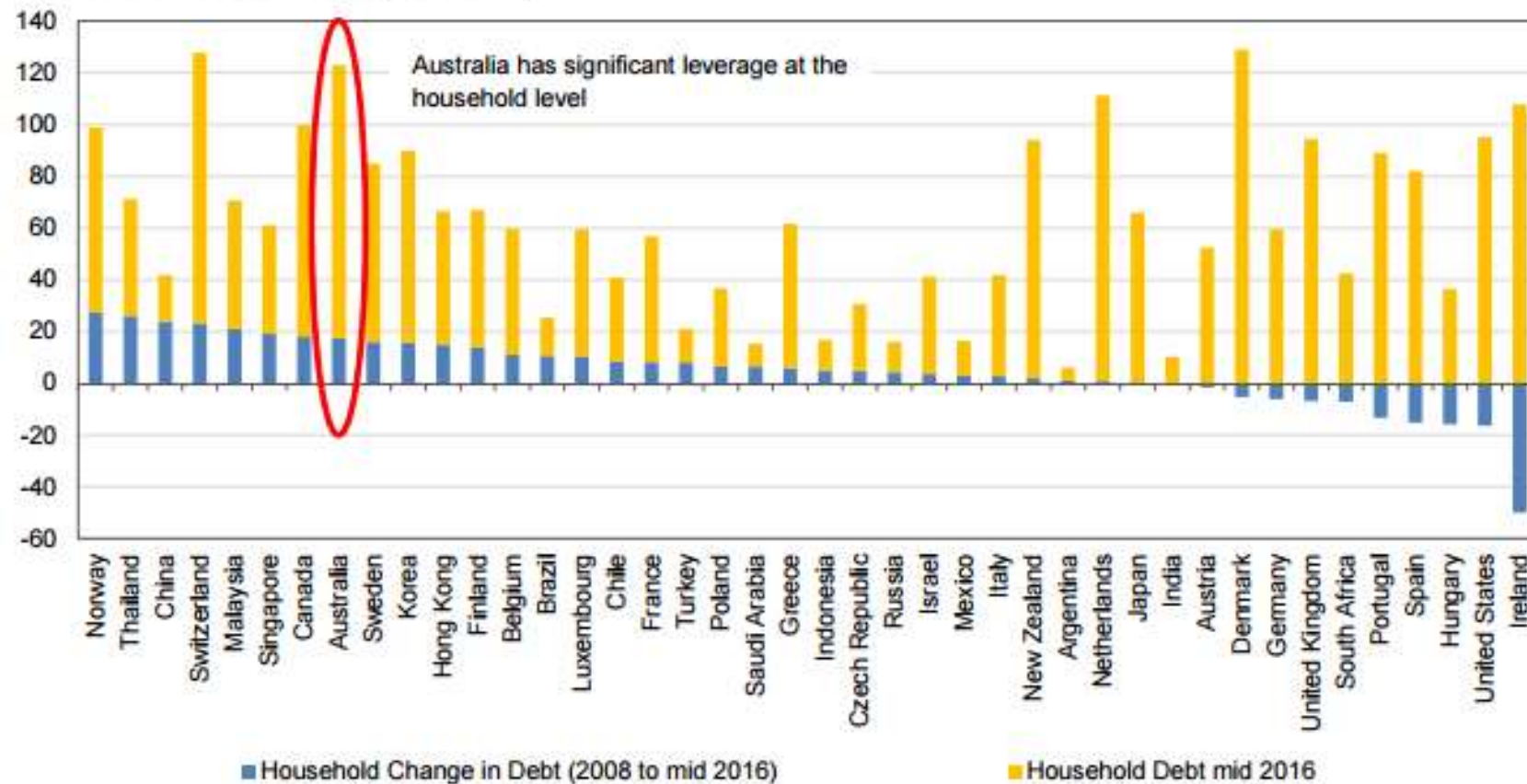


## Australian Housing: Household debt increases as property prices climb

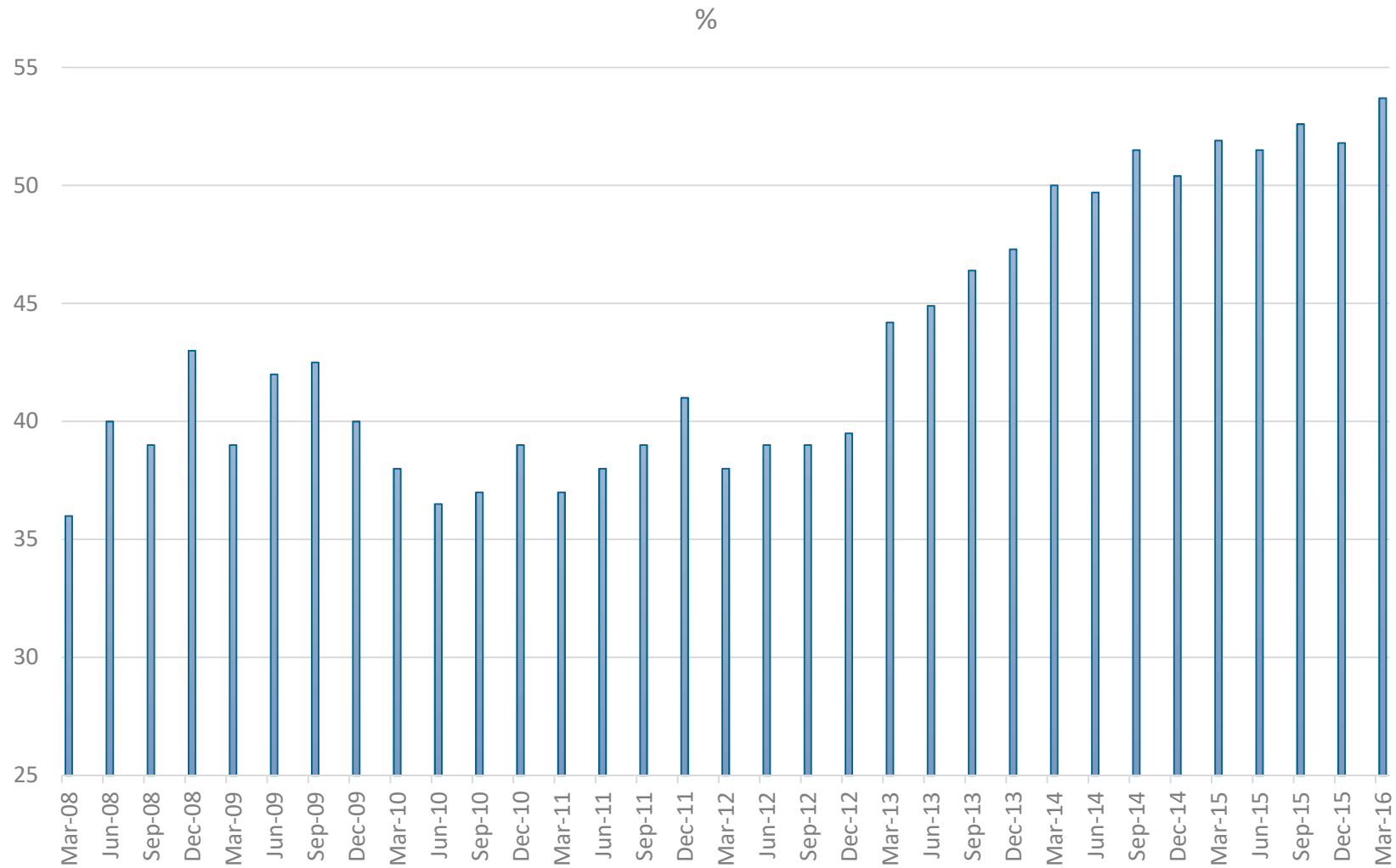


## Australia's Household debt high relative to peers

Household Sector Debt (% of GDP)



# Mortgage Broker influence



## Increasing Regulation

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- Increasing capital requirements
- Expanding regulatory powers
- Bank Levy

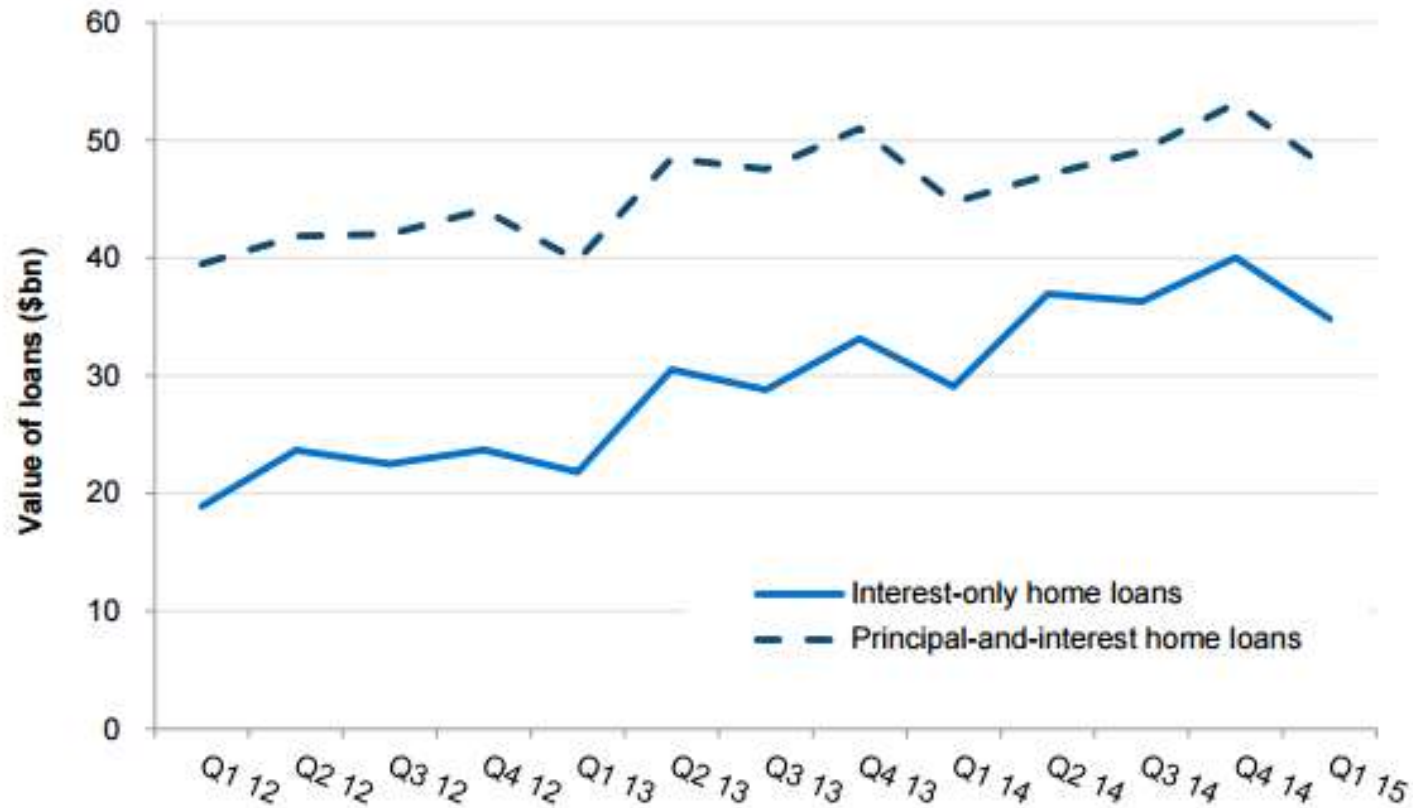
## Bank Bashing: Reactions to bank levy

			
<b>CBA</b> <b>Ian Narev</b>	<b>NAB</b> <b>Andrew Thorburn</b>	<b>Westpac</b> <b>Brian Hartzer</b>	<b>ANZ</b> <b>Shayne Elliott</b>
This is bad policy and we need to call that out. There was no consultation with the banking system about a tax that will impact on economic growth and the strength of our banks.	It is very unfortunate that the government has chosen to once again target our industry with a range of measures – including a significant additional tax – that will distract and constrain us when we need to focus on the future and growth.	It is disappointing that the Australian Government has implicitly favoured large foreign banks over Australian banks operating in their home market.	While the banking industry has made itself an easy political target, the industry is taking action to significantly improve its relationship with customers and the community.
			

Source: Deutsche Bank, Financial Review



## Interest only loans



Source: APRA, [Quarterly authorised deposit-taking institution property exposures: March 2015](#) (Excel file, 362kb), Tab 1c.

## Which bank is better quality and value?



	Clydesdale Bank	ANZ
Deposit funding	90%	63%
Leverage	15x overall 20x housing	16x overall 43x housing
Book quality/risk	75% retail, 25% SME	50% international, institutional
5 year growth	50% mortgages 25% SME	Shrink institutional Grow retail
Valuation % book	0.8x	1.7x

## Stock case study: Clydesdale Bank (CYB)

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- Opportunities to cut costs, return capital and gain market share
- 90% deposit funding, 75% of lending in retail and 25% in SME
- £690-700m reduction of costs in FY17
- CYB could release ~\$660m or \$0.75 cps excess capital

# Investor approach to banks

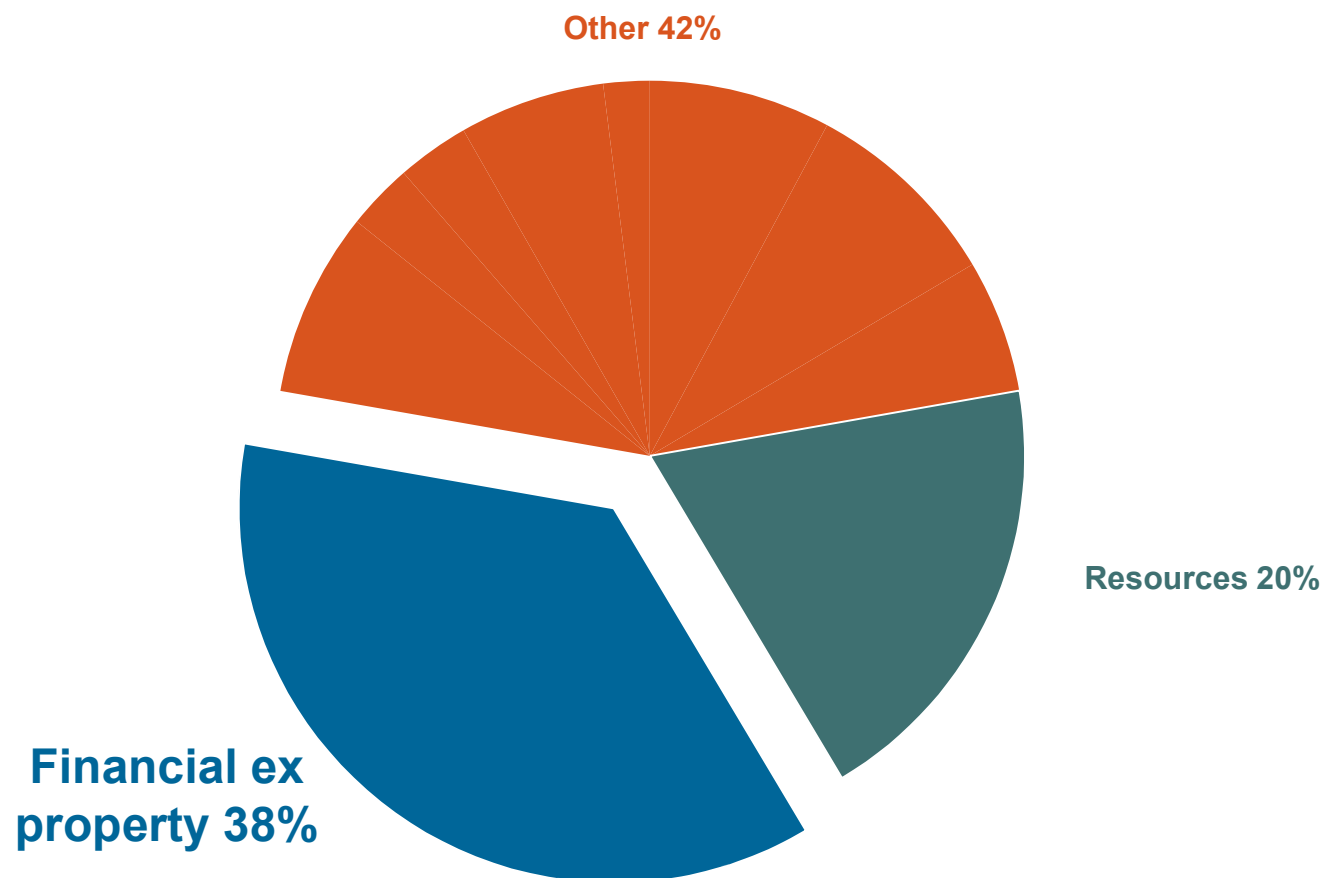
## Banks are widely held by retail investors:

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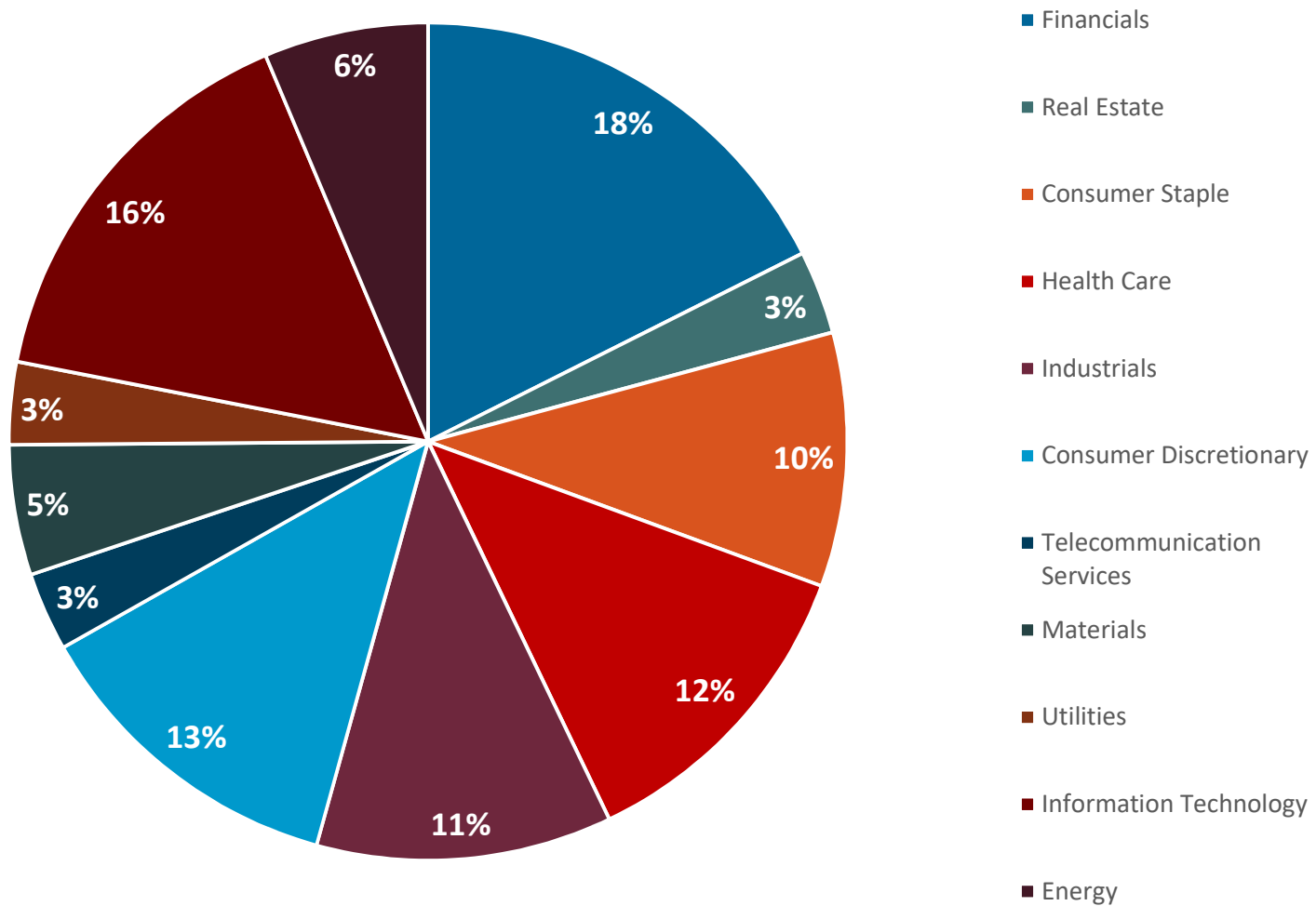
- Source of franked income – yield
- Past Returns
- Comfort & familiarity
- Lack of perceived alternatives

## ASX 300 – Heavily represented by financials

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## MSCI World: Diversity



## Investment Philosophy: focus on value and quality

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Companies with a competitive advantage,

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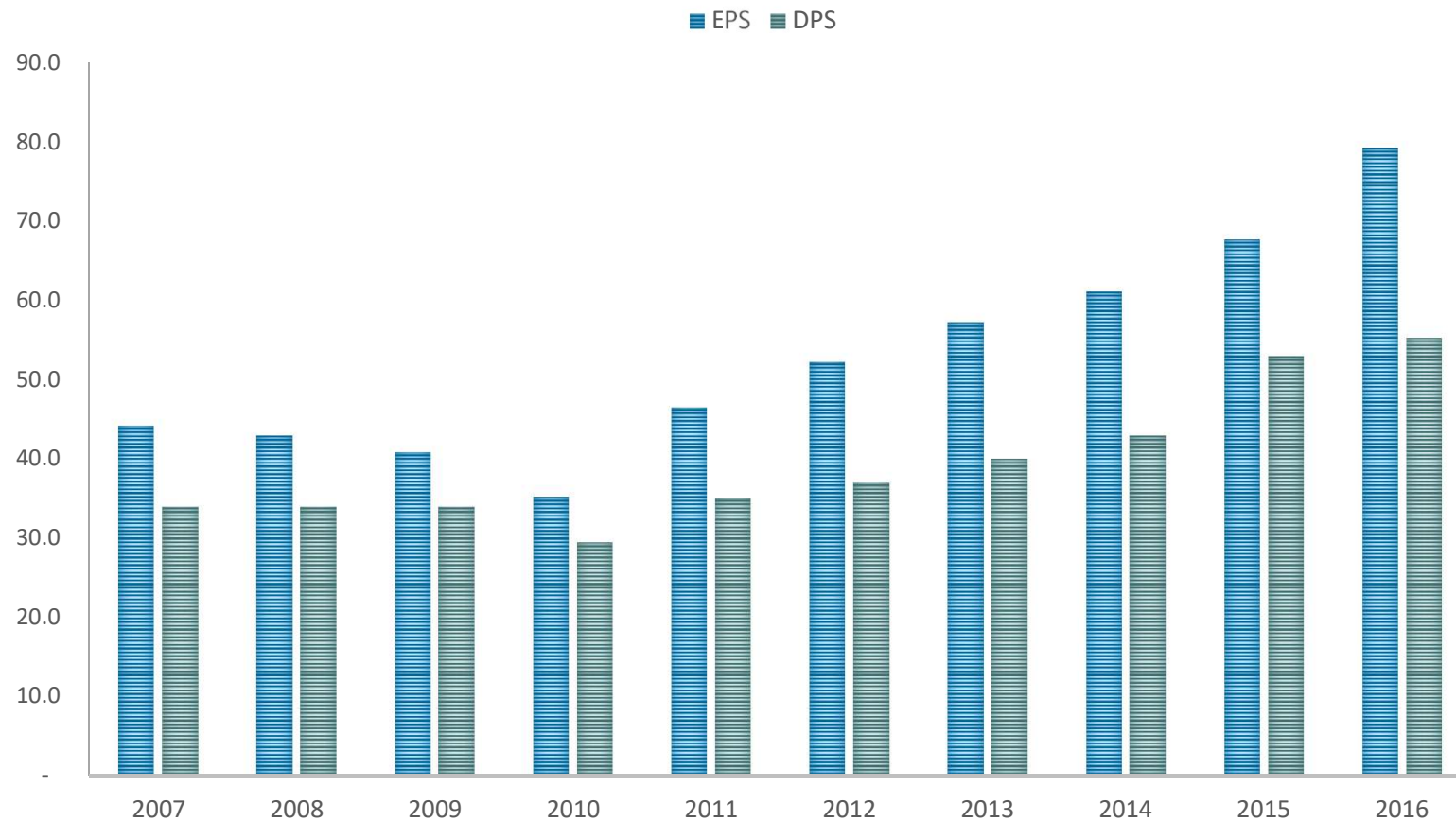
## Compounding of retained earnings

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Year	Business assets	Profit (R.O.E)	Dividend	Retained earnings
1	100.00	10.0	5.00	5.00
2	105.00	10.5	5.25	5.25
3	110.25	11.0	5.50	5.50
4	115.75	11.6	5.80	5.80
5	121.55	12.2	6.10	6.10
6	127.65	12.8	6.40	6.40
7	134.05			

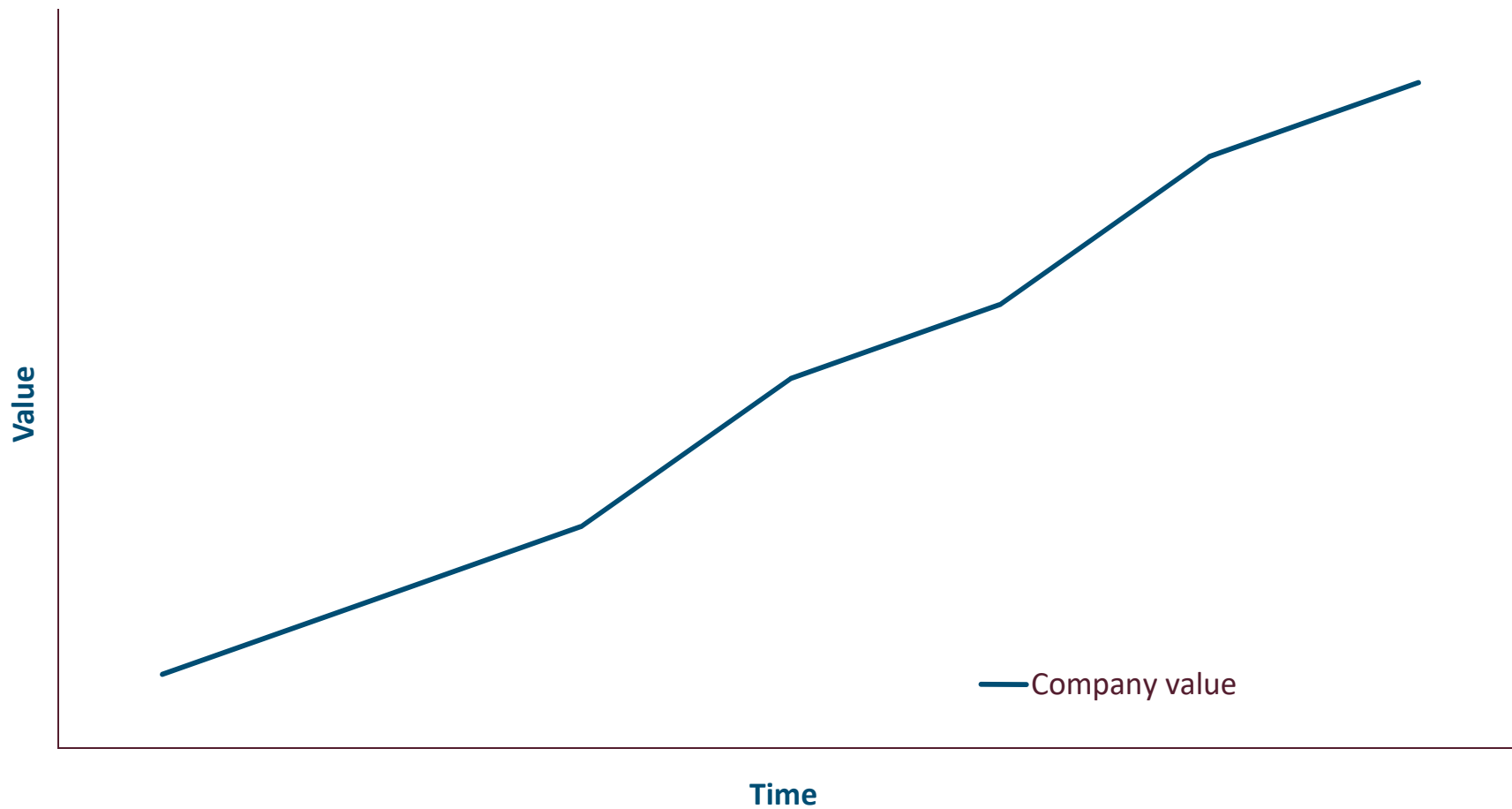
# Amcor

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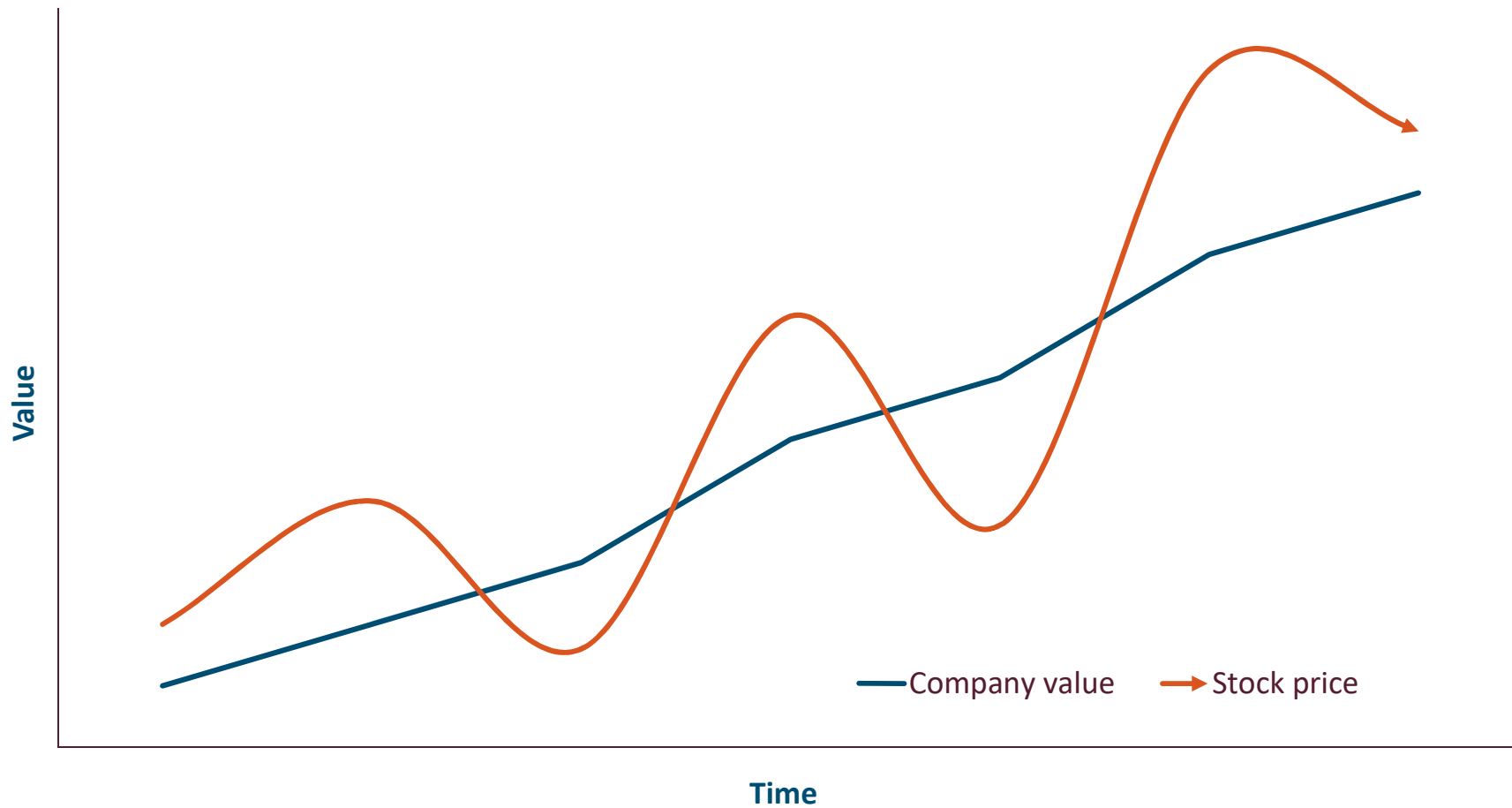
## Value over time

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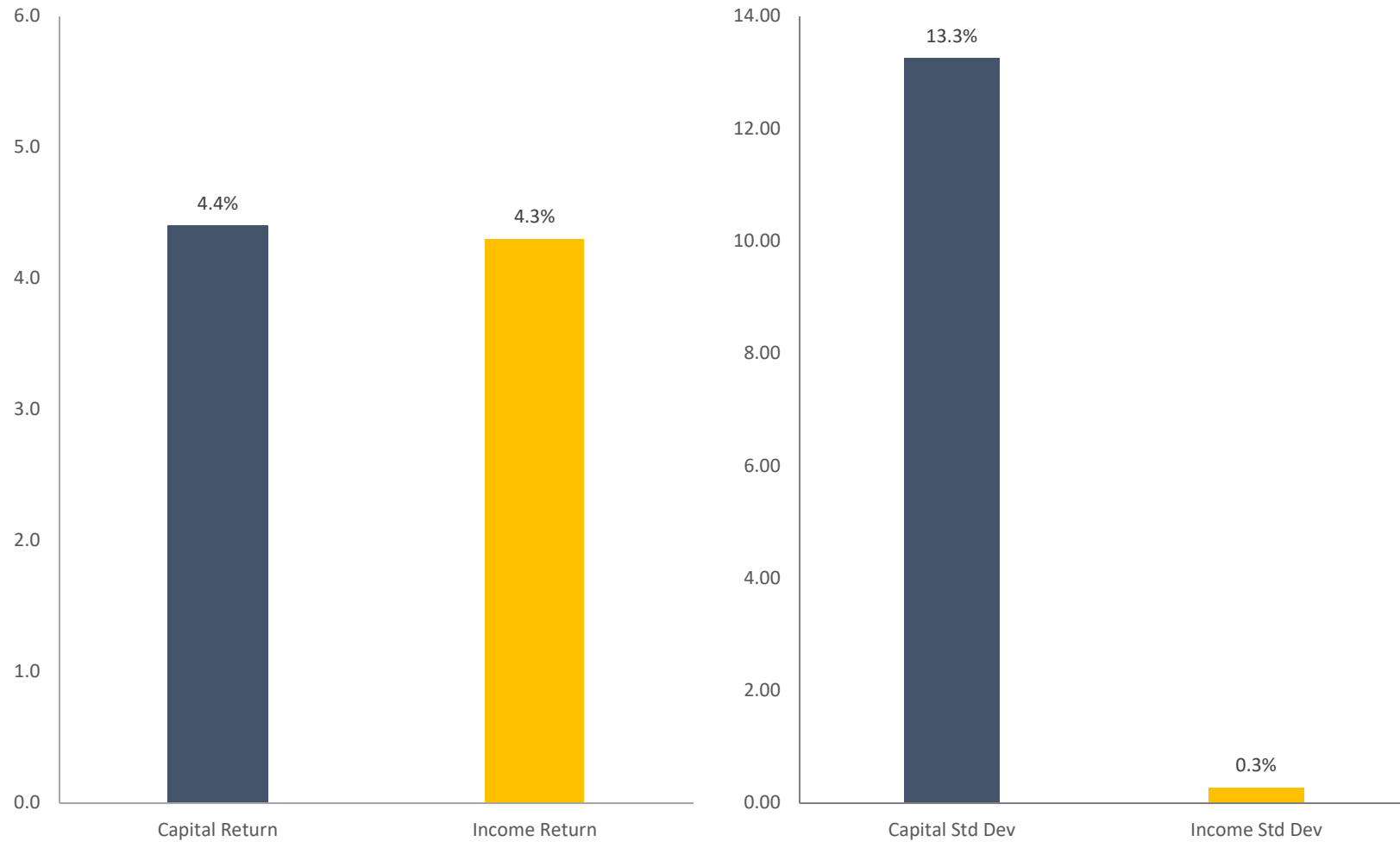


## Stock price over time

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## Income - the least volatile component of investment returns



*Over 20 years – capital and income return broken up*

*Source: IRESS, ASX300 data since 1996. As at 31 December 2016*

## Focus on quality dividend paying stocks

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Company	FY17 Yield
SCA Property Group	6.0%
Spark Infrastructure	6.7%
Hotel Property Investments	7.0%
Genesis Energy	7.7%
Pact	3.7%

## Quality mid and small caps

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- Pact Group
- Spark infrastructure
- Steadfast
- Sky City
- Sonic
- Ansell



## QV Equities key stocks –


KEY EQUITY INVESTMENTS	ASX Code
Spark Infrastructure	SKI
Sonic Healthcare	SHL
Clydesdale Bank	CYB
Ancor	AMC
Pact	PGH
Fletcher Building	FBU
Ansell	ANN
Steadfast	SDF
Bank of Queensland	BOQ
Tox Free	TOX



## Key take outs...

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- The landscape for banks has changed – the golden era has passed
- It's a question of how much banks do you own and which ones
- Attributes sought from banks can be found else where – quality industrials
  - Growing and sustainable franked income
  - Reasonable capital growth over time
- As always – stock selection is key



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