

Australian Banks

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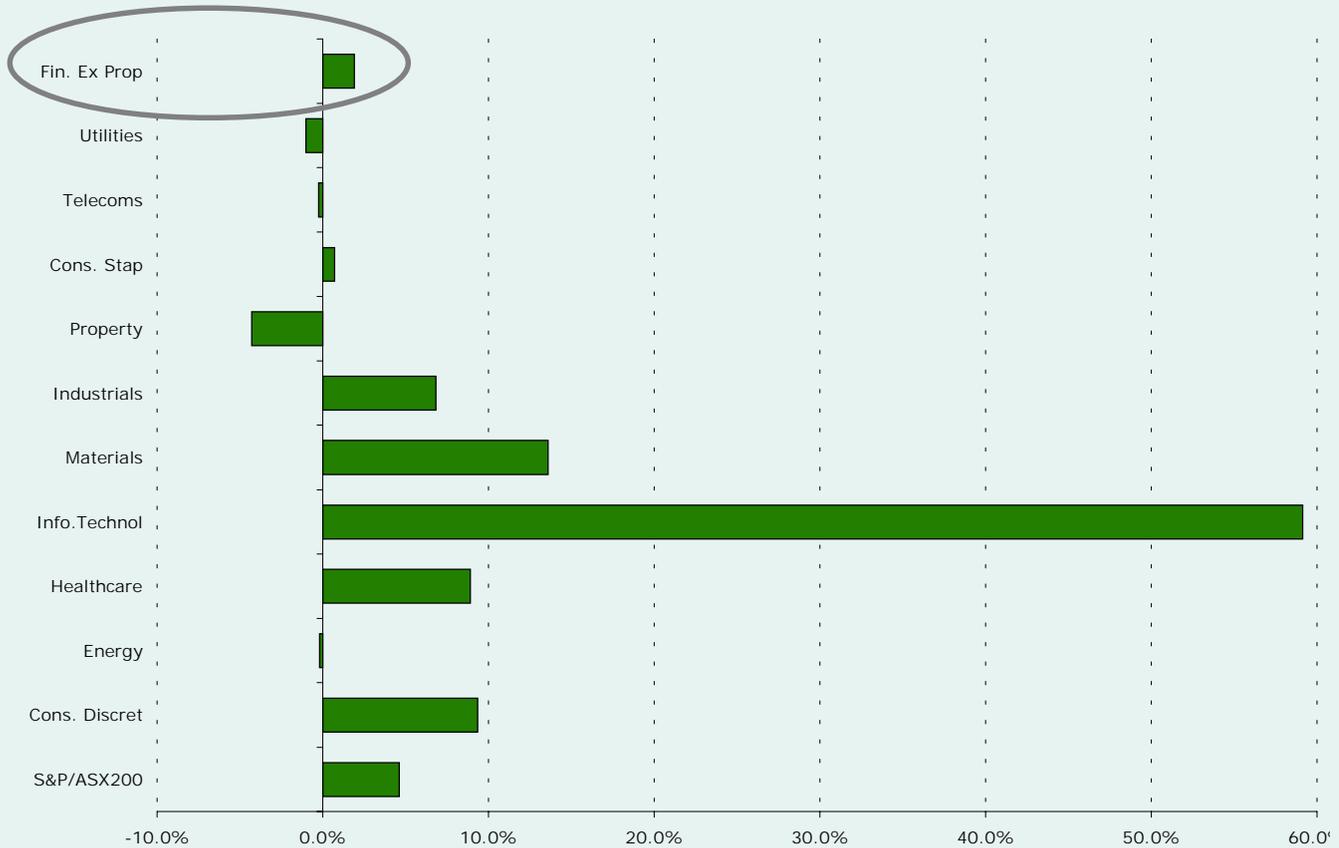
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Who is Mark Skocic?

- 9 years Equities Analyst at stockbrokers ABN AMRO, Merrill Lynch, HSBC
- 5 years as Risk Manager for stockbroker McIntosh Securities
- 7 years in Chartered Accounting with KPMG
- Chartered Accountant, MBA, ASIA
- Key message - good companies may go out of favour, but not out of business

Banks look out of favour



Source: ABN AMRO

Are Aussie banks out of favour?

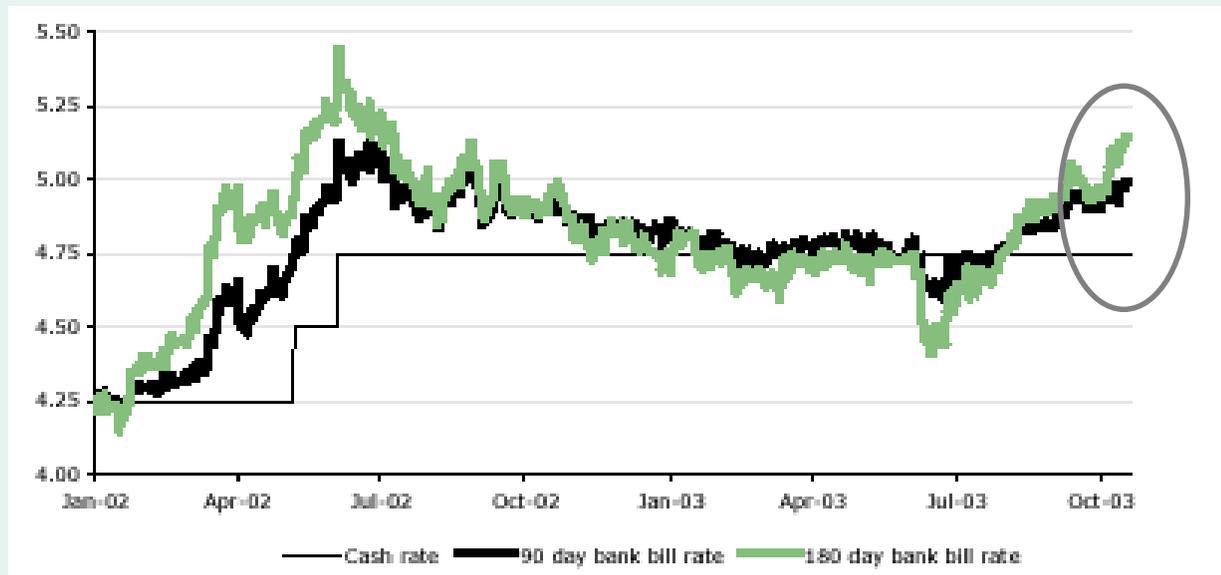
- Sector rotation to growth/cyclical stocks is betting on US led recovery ...
- ... and Aussie banks are seen as default funding source for high beta shift.
- With bank profits not at risk, banks are now popping up on our value radars.
- History tells us that fundamentals survive when themes die.

No macro reasons for lending to fall yet

- **In brief** - we should not be surprised with the consumers demand for credit.
- Low unemployment, low interest rates and high consumer confidence all support robust borrowing in Australia ...
- ... however, with the RBA more confident about global growth, the signal that interest rates will rise is now clearer than ever.

Real rates already higher than official rates anyway

- So, will rising interest rates kill the 'great Australian dream' of home ownership?
- Or, will higher rates accelerate demand for fixed-rate loans and minimise loan churn?



Source: ABN AMRO

Banks can cope with sector concerns

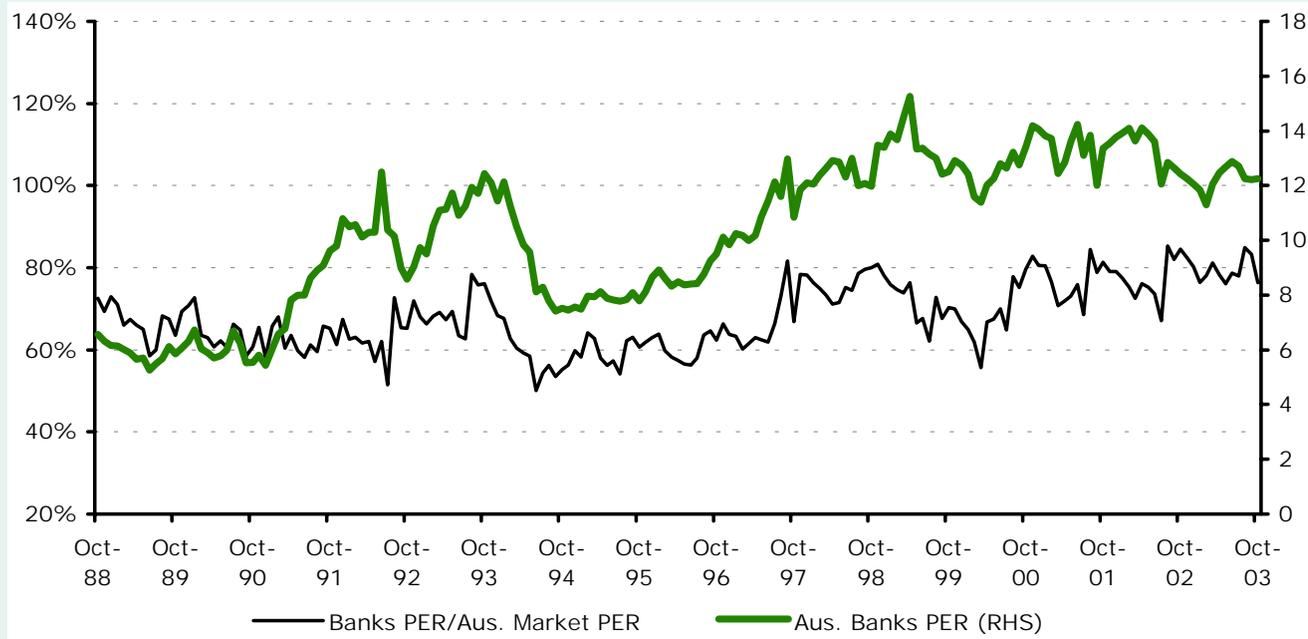
- If home lending bubble is about to burst, APRA stress testing says big banks are fine.
- Margin squeeze from mortgage brokers is offset by incremental new business.
- Eventual recovery in business lending could advantage major banks.
- Equity market recovery to boost earnings in wealth management divisions.

Bank fundamentals and valuations attractive

- Lending growth remains robust (~15%) with no real signs of slowdown ... yet!
- Earnings stability can not be overlooked.
- Valuation relative to broader market
 - FY04 bank PER of 12.7 vs ASX200 of 15.4
 - FY04 dividend yield of 5.4% vs ASX200 of 4.3%
 - ROE of 17% vs ASX200 of 16.4%
 - FY04 EPS growth of 15.7% vs ASX200 of 13.4%

Banks are still cheaper than market

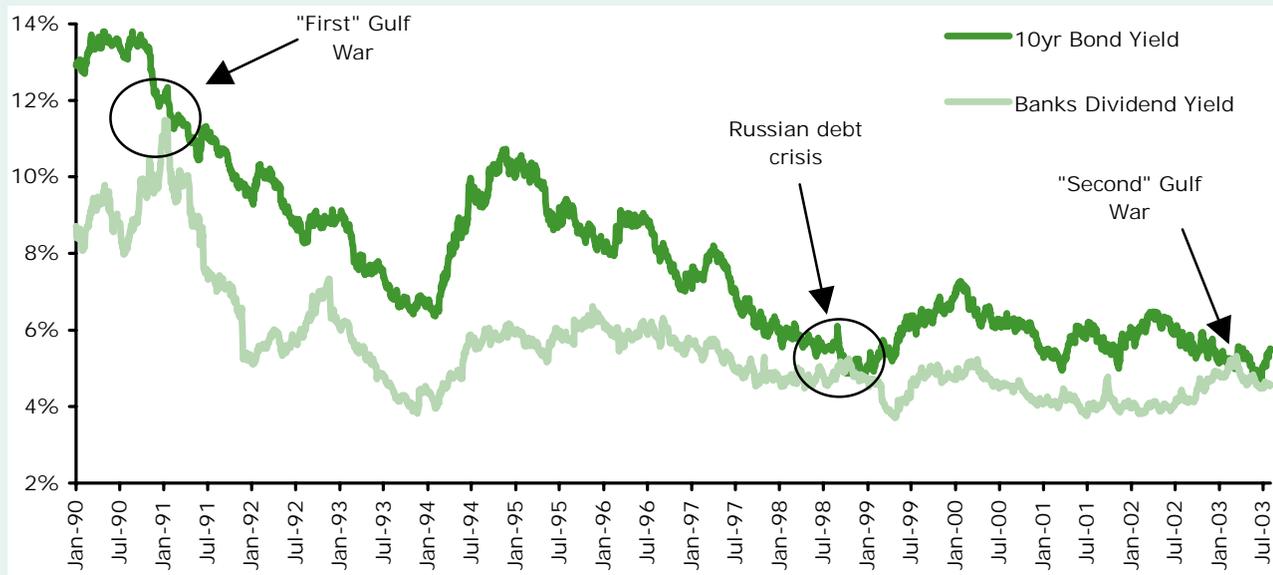
Bank P/E vs market P/E (FY04 estimates)



Source: ABN AMRO

Highest dividend yield since early 1990s

History of 10 year bond yield and bank dividend yields



Source: Datastream, ABN AMRO

- Extreme pricing anomalies in banks are normally corrected as yields approach 6%.
- ~6% dividend yields last seen in early 1990s when cash rates (~7%) and bad debts were higher.

Why not stick with banks, they will outlive us

- Not many companies earn money 24-hrs a day, 7-days a week.
- But even when lending slows, borrowers still have debt obligations to service.
 - Banks are well positioned in to cater for financial need of all age groups
 - Personal finance eg, credit cards, car loans
 - Mortgages - owner occupied and investment
 - Wealth Accumulation - savings, super
 - Post retirement - annuities

Conclusion - don't forget fundamentals

- A sentiment switch is outweighing bank fundamentals, but for how long?
- Australian banks are funding part of the move into the cyclical/growth plays.
- We know bank fundamentals are intact, with most major banks cheap relative to the broader market.
- Recent results and AGMs confirm strength of the underlying businesses.
- Banks on our valuation radar include NAB, ANZ and Suncorp.

The companies and our ranking

The majors

1. National Australia Bank (Buy)
2. Australia & New Zealand Banking Group (Buy)
3. Westpac (Hold)
4. Commonwealth Bank of Australia (Reduce)

The regional banks

1. Suncorp (Add)
2. Adelaide Bank (Add)
3. St. George Bank (Hold)
4. Bank of Queensland (Hold)
5. Bendigo Bank (Hold)

The investment bank

1. Macquarie Bank (Add)

NAB (Buy, price target A\$35.00)

- **Result due 11 Nov:** ABN forecast cash NPAT of A\$4,128m (+8% on pcp).
- **Strategic upside:** John Stewart appointment is strong signal that UK growth will be taken seriously and, for now, organically.
- **Performance risk:** How much is NAB prepared to pay for AMP? Strategic fit appears high, but at current levels EPS dilutive. At this stage we do not think NAB is willing to walk away.
- **Valuation:** one of the cheapest banks in the sector.

ANZ (Buy, price target A\$20.50)

- **Result on 24 Oct:** Reported NPAT of A\$2,348m (+8.3% on pcp).
- **Strategic upside:** ANZ acquired NBNZ (from Lloyds TSB), a high returning business and is targeting A\$110m in pre-tax synergies over three years.
- **Performance risk:** Exposure to NZ economy (currency, etc), integration synergies not realised.
- **Attractive valuation:** Cheapest bank in the sector. At an FY04 cash PER of 11.4x, ANZ's valuation gap to the rest of the sector is now at its widest point for some time.

WBC (Hold, price target A\$17.10)

- **Solid Result:** Cash NPAT of A\$2,271m up 10% on pcp. FY04 profit growth of 9% expected.
- **Strategic upside:** A focus on managing existing business without distractions deserves some recognition. Turnaround in BT offers upside.
- **Performance risk:** WBC offers similar prospects to sector peers over the medium term, high reliance on investment banking and New Zealand.
- **Valuation concern:** Business is very sound, but relative to peer group WBC's valuation is at a premium - PER of 13x vs ANZ/NAB at 11x.

CBA (Reduce, price target A\$28.00)

- **Earnings outlook:** AGM re-affirmed strong trading.
- **Strategic upside:** The which new bank transformation program provides significant upside should it be successful.
- **Performance risk:** The maturity of CBA is real as top-line growth options are lacking. Profit growth is hinged to its 'Which new bank?' transformation program - A\$900m pa cost and revenue benefits from 2006.
- **Valuation concerns:** We can not justify premium PER - especially given CBA is a cost-cutting story now.

SUN (Add, price target A\$13.50)

- **Earnings outlook:** AGM reiterated strong momentum into 1H04, earnings risk is low.
- **Strategic upside:** New CEO has outlined strategies (eg, use of mortgage brokers) to win back market share in core banking with early signs positive. SUN continues to extract higher-than-anticipated cost savings from its GIO acquisition.
- **Performance risk:** SUN's exposure to the rural sector and property lending in Queensland pose questions as to the quality of loan book.
- **Valuation:** Cheap bank with leverage to insurance and bank sectors.

ADB (Add, price target A\$9.50)

- **Earnings outlook:** Last weeks AGM confirmed 42% yoy increase in 1Q loan approvals. Earnings growth guidance of 10% confirmed.
- **Strategic appeal:** ADB has expanded successfully beyond its home market (through mortgage managers), thus a major beneficiary of the boom in home lending.
- **Performance risk:** Being highly dependent on home lending means being highly vulnerable to a 'hard landing'.
- **Valuation:** Expensive against major banks, but regional banks are an execution story.

MBL (Add, price target A\$37.50)

Not all Australian banks are defensive and domestic

- **Result due 13 Nov:** ABN AMRO forecast cash NPAT of A\$405m (+16% on pcp).
- **Strategic appeal:** Only listed investment bank (leverage to equity market rebound), focus on top-line growth (within risk parameters).
- **Performance risks:** How sustainable is this unique business model and what capacity is there to continue sourcing innovative deals?
- **Valuation:** It is hard to value growth stocks because one can never predict future earnings and cash flows. However, our DDM is A\$37.46.

SGB (Hold, price target A\$21.50)

- **Result due 5 Nov:** ABN forecast cash NPAT of A\$713m (+14% on pcp).
- **Strategic appeal:** SGB has two advantages over its larger rivals: its smaller size means it can grow at a faster rate, and it still has the opportunity to stabilise its market share of mortgage lending. FY04 and FY05 guidance of +10% was maintained.
- **Performance risks:** The principal challenge facing SGB is weathering the likely slowdown in housing lending over FY04 and FY05.
- **Valuation concern:** After an exceptional rally in recent months, we see further upside as limited. We prefer an entry price at A\$19.50 or below.

BEN (Hold, price target A\$8.00)

- **Earnings outlook:** AGM reiterated strong trading.
- **Strategic differentiator:** The only bank opening branches on scale with a unique community banking model, and its success is evident in growth in its revenue base. BEN also has no reliance on third-party loan originators.
- **Performance risks:** Community banking model has not been tested in slowing housing market.
- **Valuation concern:** The most expensive bank at 19.5x FY04.

BOQ (Hold, price target A\$8.40)

- **Strong result:** 56% increase in NPAT to A\$44.7m, with UFJ leasing business to boost FY04 profits.
- **Another unique model:** Growth has been driven by above-average asset growth, led in part by its unique owner-manager branch model of 'face-to-face' banking.
- **Economies of scale being realised:** High cost recovery has meant that more revenue growth has fallen to the bottom line.
- **Capex set to increase:** A risk to shareholder creation is BOQ's major IT systems overhaul which could increase the cost burden via higher amortisation charges.

Bank earnings

30 October 2003							
COMPANY	Share Price** \$	Reported Profit				Est. Frkg	Current Action
		pre abnormals & prefs.	PE	DPS	DY		
		2004	2004	2004	2004	2004	
BANKS							
National Aust. Bank	30.85	4,735	10.9	176.0	5.7	100	ADD
Commonwealth Bank	27.70	2,407	15.0	161.0	5.8	100	REDUCE
Westpac Bank	16.28	2,314	13.1	85.0	5.2	100	HOLD
ANZ Bank	17.88	2,632	12.6	96.0	5.4	100	BUY
St. George Bank	21.04	746	15.6	108.0	5.1	100	HOLD
Macquarie Bank	34.92	433	18.7	112.2	3.2	100	ADD
Suncorp Metway	12.93	516	13.8	60.0	4.6	100	ADD
Bendigo Bank	8.85	71	16.0	40.0	4.5	100	HOLD
Adelaide Bank	8.25	62	14.1	41.0	5.0	100	ADD
Bank of Queensland	9.94	62	15.6	42.0	4.2	100	HOLD

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