

Lonsec Income Investments

CommBank PERLS VII Capital Notes (CBAPD)

Risk rating categories

	LOW	MOD	HIGH	SPEC
FINANCIAL		●		
STRUCTURAL			●	
MATURITY			●	
LIQUIDITY	●			
INDUSTRY		●		
VOLATILITY			●	
RISK PROFILE			●	

Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
				●	●

Key details 17-12-2019

ISSUER	COMMONWEALTH BANK OF AUSTRALIA
SECURITY NAME	CBA PERLS VII (CBAPD)
SECURITY SIZE	\$3.0BN
INTEREST TYPE	FLOATING / Q
FRANKING	100.00%
CURRENT PRICE	\$100.20
FACE VALUE	\$100.00
ISSUE MARGIN	2.80%
LAST DECLARED RATE	2.59%
ADJ. CURRENT TRADING MARGIN	2.74%
CASH RUNNING YIELD	2.58%
GROSSED-UP RUNNING YIELD	3.69%
GROSSED-UP YTC	3.63%
OPTIONAL CALL DATE	15-DEC-22
MANDATORY REDEMPTION DATE	15-DEC-24
NEXT EST EX-DIV DATE	05-MAR-20

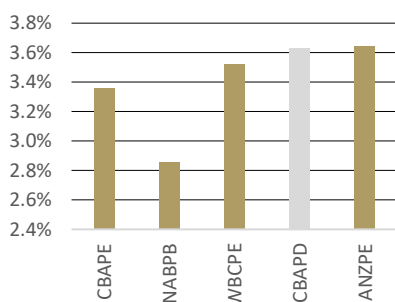
1 Based on 90 Day BBSW of 0.90%

Capital Ranking / Security Type

SECURED SENIOR DEBT	
UNSUBORDINATED & UNSECURED DEBT	
SUBORDINATED UNSECURED DEBT	
PREFERENCE SECURITIES	●
ORDINARY EQUITY	

Note: Securities listed in order of rank.

Grossed-up YTC for listed peers



Approved – Moderate to High Risk Rating

CommBank PERLS VII Capital Notes (CBAPD) pay quarterly, fully-franked distributions based on an issue margin of 2.80% over the 90-day Bank Bill Swap Rate and discounted for franking. CBA has the option to redeem or resell the issue on 15 December 2022 for \$100 cash, otherwise the issue is expected to exchange into \$101 worth of ordinary shares on 15 December 2024.

Financial Risk – Low to Moderate

Overall, Lonsec is comfortable with CBA’s financial position and outlook. We expect CBA to be able to meet its distribution payments and repay CBAPD holders their face value on maturity. We assign a ‘Low to Moderate’ financial risk rating.

CBA is a high-quality issuer with a strong capital position, investment grade credit rating and a proven track record of earnings, dividend and book value growth. Earnings and capital levels are sensitive to general economic and financial market conditions, as well as regulatory change. The macro-environment in Australia is currently being supported by low interest rates, which are translating into moderate credit growth and low impairments. Slower loan growth, increased funding costs, rising impairments and adverse impacts from the Royal Commission are what Lonsec regards as the key risks to earnings growth and capital stability.

Structural Risk – High

CBAPD are low ranking preference shares issued by CBA, which are classified as Basel III compliant Additional Tier 1 equity capital. They are not deposit liabilities and are therefore not protected by the government guarantee. CBAPD rank for payment of distributions and return of capital in a winding-up of CBA ahead of ordinary shares and equally with other Additional Tier 1 securities but are subordinated to the claims of senior ranking creditors and deposit holders.

Distributions are expected to be fully franked and paid quarterly at the discretion of CBA. Non-payment of a distribution will not be an event of default and distributions are non-cumulative, however, a dividend stopper applies, meaning that if distributions are not paid on CBAPD, CBA cannot pay a dividend on ordinary shares, or undertake a share buyback, until a distribution is paid in full on a subsequent distribution payment date.

CBAPD has a capital and non-viability trigger which are designed to protect CBA’s solvency during times of financial stress. The trigger clauses require for mandatory conversion into ordinary equity (without regard for the conversion conditions) should CBA’s Common Equity Tier 1 ratio fall to or below 5.125%, or APRA rule that conversion is necessary because without it CBA would become ‘non-viable’. Because of the maximum conversion number, CBAPD investors would receive less than \$101/share on conversion if CBA’s share price is less than ~\$16 at the time of forced conversion. If a capital trigger or non-viability trigger event occurs and conversion of CBAPD is not effective for any reason, the Notes will be terminated and holders will incur a principal loss. Lonsec regards this as an unlikely scenario within the term to maturity.

Maturity Risk – High

CBA has the option to redeem (subject to APRA approval) or resell CBAPD for \$100 cash on 15 December 2022, or at any time following the occurrence of a tax or regulatory event. If the issue has not been exchanged beforehand, CBA must exchange CBAPD into \$101 worth of ordinary shares on 15 December 2024, provided that the mandatory exchange conditions are satisfied. If the conversion conditions are not satisfied on 15 December 2024 (which would require CBA ordinary shares to be trading below ~\$44), CBAPD will not convert until the next scheduled distribution payment date when the conversion conditions are satisfied, and as a result this issue should technically be considered as perpetual. Lonsec believes this is unlikely to occur and expects CBAPD to be redeemed for face value on 15 December 2022. Holders cannot request redemption; however, investors seeking liquidity can sell on-market.

Liquidity Risk – Low

CBAPD is the largest listed income security on the ASX, with an issue size of \$3bn. This has supported average weekly turnover of ~\$10m.

Industry Risk – Moderate

Lonsec has assigned a Moderate industry risk rating in-part due to the industry’s leveraged exposure to underlying macroeconomic and financial market conditions, risks of adverse impact from the Royal Commission and a relatively high degree of regulation. Whilst Australian banks remain exposed to the risk of higher impairments if the economy were to slow significantly, the higher capital requirements being imposed by the regulators enhance the industry’s ability to withstand economic shocks.

Volatility Risk – High

CBAPD has traded in a range of \$85.29-98.49 since listing. Volatility maybe high over the remaining term, attributable to the Notes low ranking capital status, relatively low issue margin and capital / non-viability trigger conversion mechanisms, which may result in CBAPD being somewhat positively correlated to CBA’s ordinary share price. CBAPD may trade below par at some stage over the remaining life of the security, and may therefore not be suitable for short term investors. In forming our investment recommendation, we have assumed the Notes are held to maturity.

We strongly recommend that potential investors read the product disclosure statement or investment statement. Lonsec Research Pty Ltd • ABN 11 151 658 561 • AFSL 421 445 • This information must be read in conjunction with the Warning, Disclaimer, and Disclosure at the end of this document

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ISSUE DATE: 17-12-2019

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Analyst

Jack Dunn

Approved by

Chad Troja

Lonsec listed income risk rating spread

	NUMBER	%
LOW RISK	0	0%
LOW-MODERATE RISK	3	7%
MODERATE RISK	0	0%
MODERATE-HIGH RISK	22	51%
HIGH RISK	18	42%
SPECULATIVE RISK	0	0%
TOTAL	43	100%

Lonsec listed income recommendation spread

	NUMBER	%
APPROVED	42	98%
NOT APPROVED	1	2%
TOTAL	43	100%

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