

12 Apr 2019

BNK BANKING CORP. LTD (BBC)

Base in place, now for delivery

BNK Banking Corporation Ltd (BBC), became the new name of the former Goldfields Money (GMY), in late March. BBC has two key operating divisions, being Banking and Mortgage Aggregation.

The Banking division operates under two separate brands; Goldfields Money, which will remain in use in Western Australia's Goldfields region, and BNK Bank, a soon to be launched digital banking offering. The Mortgage Aggregation division comprises the recently acquired Finsure business.

BNK digital bank launching later in CY19

BBC's new digital banking brand "BNK Bank" will be launched later in CY19, targeting ongoing growth in BBC's depositor base.

A key strategy of BBC is to grow its on-balance sheet loan book (currently \$176m) through driving additional lending volumes, while maintaining a net interest margin (NIM) of at least 2%.

A growing deposit book is a key requirement for any bank lending business, through providing the required regulatory capital base, at a low cost, to enable increased on-balance sheet lending.

Finsure growth continues

Finsure continued to exhibit strong growth in what has been a very difficult macro environment, encompassing the uncertainty of the Royal Commission and its flow on effects to weak lending volumes, exacerbated by falling property prices.

Finsure has grown loan writer numbers by 10% since FY18, with aggregation settlements (over the six-month period) increasing by 11% to \$6.8bn.

1H19 results

In late February, BBC delivered its 1H19 results, representing the initial results for the business since the Finsure acquisition was finalised in September 2018. Given the transitional nature of this period, there are a variety of profit figures provided (see page 3). Overall, BBC delivered a small net profit on the back of the initial Finsure contribution, offsetting an operating loss from the Banking operations.

Speculative Buy, Price Target \$1.26

With the Finsure merger complete, BBC now has the base in place providing management the opportunity to drive earnings growth, which is reliant on successful delivery of the group strategy. Key elements of progress to monitor will be ongoing growth at Finsure, increased on-balance sheet lending and the success, or otherwise, of BNK's digital offering.

Our price target is reduced to \$1.26 / share (from \$1.37 previously) on the back of our reduced FY20 earnings estimates. Our Speculative Buy recommendation is maintained.

Share Price: \$0.73
12mth price target: \$1.26

Brief Business Description:

BNK combines a small retail banking operation with recently acquired mortgage broking business, Finsure.

Hartleys Brief Investment Conclusion:

Delivery of management's objectives provides the potential for material earnings upside.

Chairman & CEO:

Peter Wallace (Non-Exec. Chairman)
Simon Lyons (Exec. Director / CEO)

Top Shareholders:

John Kolenda	17.8%
Calvin Ng	10.2%
Resimac	5.4%

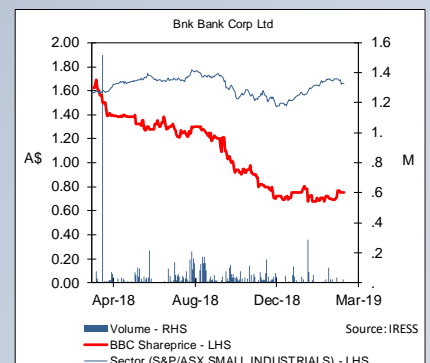
Company Address:

Lvl 14, 191 St Georges Tce
Perth, WA 6000

Issued Capital:	82m
- fully diluted	89m
Market Cap:	\$60m
- fully diluted	\$65m
Net Cash (1H19a):	\$23m

	FY18a	FY19e	FY20e
Op. Revenue	5.1	24.3	33.3
NPAT (A\$m)	-0.4	2.3	5.0
NPAT (A\$m)*	-0.4	0.7	5.0
EPS (c,basic)	-1.8	3.2	6.0
P/E (basic)		23.0x	12.2x
DPS (cps)	0.0	0.0	0.0

Source: Hartleys Research. *Cash NPAT



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Hartleys has completed a capital raising in the past 12 months for BNK Banking Corporation Limited ("BBC"), for which it has earned fees. Hartleys has provided corporate advice within the past 12 months to BBC, for which it has earned fees.

SUMMARY MODEL

BNK Banking Corp. Ltd					Recommendation: Speculative Buy					
Company Information					Profit & Loss (\$m)					
Date	12 Apr 2019	Lvl 14, 191 St Georges Tce			6/17A	6/18A	6/19F	6/20F		
Share Price	\$0.73	Perth, WA 6000			Revenue	4.2	5.1	24.3	33.3	
52 Week High-Low	\$0.65 - \$1.75	Ph: (08) 9021 6444			Expenses	-5.0	-5.4	-22.4	-25.0	
Dil. Market Cap (\$m)	\$65	www.goldfieldsmoney.com.au			Loan Provisions	-0.3	0.0	-0.1	-0.1	
Ordinary Shares	82.4				Depn & Amort.	-0.3	-0.2	-0.9	-1.0	
Fully Diluted Shares	88.9				PBT	-1.3	-0.4	0.9	7.2	
Price Target	\$1.26				Tax	0.3	0.0	-0.3	-2.2	
Upside / Downside	72%				NPAT (Excl. NPV Impact)	-1.0	-0.4	0.7	5.0	
Price Target					Non-cash Adjustments					
12 Month Price Target					NPV of Trail Book (pre-tax)			2.3	0.0	
P/E (FY19) at price target - Reported EPS	39.7x				NPV of Trail Book (post-tax)			1.6	0.0	
P/E (FY20) at price target - Reported EPS	21.0x				Reported NPAT	-1.0	-0.4	2.3	5.0	
P/E (FY19) at price target - Cash EPS	137.6x				Reported EPS (basic, wghtd)	-5.1	-1.8	3.2	6.0	
P/E (FY20) at price target - Cash EPS	21.0x				Cash EPS (basic, wghtd)	-5.1	-1.8	0.9	6.0	
Multiples (\$/price at \$0.73)					Balance Sheet (\$m)					
P/E (basic, weighted)		6/17A	6/18A	6/19F	6/20F	Cash	16	15	21	16
Cash P/E (diluted, weighted)				23.0x	12.2x	Deposits with ADI's	27	25	25	25
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	FRNs with ADI's	11	7	7	7
Price / Book	0.8x	0.8x	0.6x	0.5x		Loans & Advances	157	171	201	251
Ratios						NPV of Trail Comms - Receivable	0	0	267	337
Return on Equity	-5.0%	-1.7%	2.1%	4.1%		Shares in CUSCAL	0	0	0	0
Return on Assets	-0.4%	0.4%	0.6%	1.3%		Property, Plant, Equipment	1	1	1	1
Share Data						Goodwill	0	0	42	42
Ord Issued shares (m)	22.5	25.9	84.0	84.0		Other Intangibles - Computer software	0	2	2	2
growth	25%	15%	224%	0%		Deferred Tax Assets	1	1	1	1
Weighted ave shares (m)	19.6	23.1	71.3	84.0		Other	2	1	1	1
growth	22%	18%	208%	18%		Total Assets	215	221	567	683
Diluted shares wghtd (m)	24.1	29.6	71.3	84.0		Deposits	194	195	235	275
growth	17%	22%	141%	18%		NPV of Trail Comms - Payable	0	0	224	283
Unpaid Capital						Creditors & other payables	1	1	0	0
Expiry	Number (m)	Avg Price	\$m unpaid			Current Tax Liabilities	0	0	1	2
30-Nov-21	1.94	\$0.00	\$0.00			Provisions	0	0	0	0
11-May-19	4.50	\$1.50	\$6.75			Interest Bearing Liabilities	0	0	0	0
TOTAL	6.44		\$6.75			Deferred Tax Liabilities	0	0	0	0
Directors & Senior Mgt						Other	0	0	0	0
Substantial Shareholders						Total Liabilities	195	197	460	561
Peter Wallace (Non-Exec. Chairman)	John Kolenda		17.8%			Net Assets	20	25	107	122
Simon Lyons (Exec. Director / CEO)	Calvin Ng		10.2%			Cashflow Statement (\$m)				
John Kolenda (Exec. Director)	Resimac		5.4%			6/17A	6/18A	6/19F	6/20F	
Derek La Ferla (NED)						Net Operating Cash Flow	-1.7	2.1	4.1	7.2
Peter Hall (NED)						Net Investing Cash Flow	-44.2	-8.0	-45.4	-51.7
Jussi Nunes (CFO)						Net Financing Cash Flow	59.7	4.2	47.5	39.8
						Movement in Cash	13.8	-1.7	6.2	-4.7
						Key Metrics - Finsure				
						6/17A	6/18A	6/19F	6/20F	
						Loan writers	1,213	1,435	1,665	1,781
						growth	31%	18%	16%	7%
						Loan writers - average	1,069	1,324	1,550	1,723
						Settlements per avg. loan writer (\$m)	9.7	9.1	8.5	8.3
						growth	-7%	-6%	-3%	
						Aggregation Settlements (\$m)	10,400	12,000	13,204	14,238
						growth		15%	10%	8%
						Aggregation - Loan book (\$m)	25,000	31,800	38,644	45,153
Analyst: Oliver Stevens					Last Earnings Estimate Change:					
Phone: +61 8 9268 2879					12 April 2019					
Sources: IRESS, Company Information, Hartleys Research										

1H19 RESULT SUMMARY

Fig. 1: 1H19 result summary

BNK	Statutory	NPV impact	Adjusted
Interest revenue from banking activities	4.2		4.2
Interest expense from banking activities	-2.6		-2.6
Net Interest Income	1.6	0.0	1.6
Finsure - Comm. Income	77.8	-27.0	50.8
Finsure - Comm. Expense	-71.2	25.4	-45.8
Finsure - Net Comm. Income	6.5	-1.6	5.0
Other income	3.3	0.0	3.3
TOTAL NET REVENUE	11.5	-1.6	9.9
Operating Expenses	-9.6	0.0	-9.6
Transaction Expenses	-0.9	0.0	-0.9
PBT	1.0	-1.6	-0.6
Tax	-0.3	0.5	0.1
Statutory NPAT	1	0.7	-0.4
Finsure Contribution	2	2.1	1.0
GMV Contribution	3	-1.5	-1.5
		0.7	-0.4
Proforma Underlying NPAT	4		1.6

Source: BBC, Hartleys

1H19 provided the first set of accounts for the combined entity since the merger with Finsure was finalised in September 2018.

In Figure 1 we show BBC's statutory numbers to which we have made adjustments related to the NPV impact of changes in the Finsure trail book. In 1H19 the change in trail book NPV contributed positive \$1.6m pre-tax and \$1.1m post-tax to BBC's statutory result. As discussed in the Valuation section (refer page 7) we normalise for changes to the trail book NPV, due to their non-cash nature.

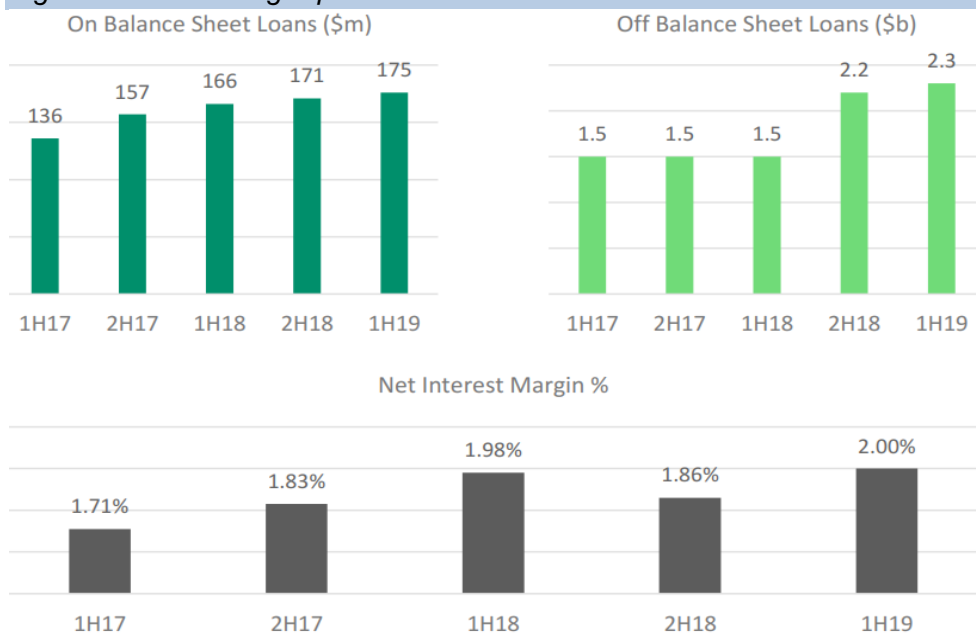
We highlight some of the key numbers from Figure 1:

- Statutory NPAT (*note 1*) was \$0.7m and negative \$0.4m on an adjusted basis.
- Finsure contributed (*note 2*) statutory NPAT of \$2.1m (\$1.0m adjusted), implying that BBC's residual / organic banking business (*note 3*) made a statutory loss of \$1.5m (1H18 NPAT \$0.1m).
- BBC advises that on a pro-forma underlying basis (i.e. assuming Finsure made a full six-month contribution and excluding transaction costs) NPAT was \$1.6m (*note 4*). This compares to FY18 pro-forma underlying NPAT of \$6.8m.

Excluding the NPV impact we estimate that 1H19 pro-forma underlying NPAT was \$0.5m, while the equivalent FY18 definition of NPAT was \$3.0m.

BANKING

Fig. 2: Banking Operational Metrics



Source: BBC

- Net growth in on-balance sheet loans was only \$5m during 1H19 as settlements of \$22m were slightly below 1H18 (\$24m).

It is very early days, though we note that a key part of the rationale for the Finsure merger was the ability for BBC to write more (higher margin) loans on-balance sheet.

BBC reported a Capital Adequacy Ratio of 18.7% at 1H19 and noted that this provides capacity for further growth. Management has also noted that they are working toward establishing a non-operating holding company (NOHC) structure which will free up additional lending capacity.

- Net Interest Margin (NIM) improved to 2.0%, with BBC noting that its target is to maintain NIM at or above 2%.
- As shown in Figure 1, Net Interest Margin generated by BBC was only \$1.6m, clearly this is still very small in the scheme of things, but remains a key focus area for future growth.
- The off-balance sheet loan book comprising white-label lending grew to \$2.3bn at period end.

FINSURE

Fig. 3: Finsure Operational Metrics



Source: BBC

- Finsure’s operational metrics continue to improve. Notably loan writer numbers increased by 10% since FY18.
- Management reports that aggregation settlements of \$6.8bn were up 11% on 1H18. This is a strong result in what is a very tough external market.
- During its 3.5 months of ownership by BBC, Finsure contributed NPAT of \$2.1m (~\$1m, when excluding NPV impact).

Regulatory Update

Since the release of the Hayne Royal Commission final report there has been significant movement in regard to the mortgage broking regulatory environment. Both political parties support the introduction of a “best interests obligation” for brokers. In regard to broker remuneration, current policies are as follows:

- **Liberal.** Trail commissions to remain, with a review of their operation in three years time. The coalition has not at this stage outlined any changes to upfront commission structures and / or rates.
- **Labor.** Abolition of trail commissions on new loans from 1 July 2020. In regard to upfront fees, Labor has proposed a capped commission fixed rate of 1.1% payable by the lender.

FORECASTS

Fig. 4: Forecasts

BBC	FY18	FY19	FY20
Net Interest Margin	3.2	3.5	4.3
Aggregation Net Revenue		13.1	18.0
Fees & Other Revenue	1.9	7.6	11.0
Total revenue	5.1	24.3	33.3
Expenses	-5.4	-22.4	-25.0
Loan impairments	0.0	-0.1	-0.1
EBITDA (Adjusted)	-0.3	1.8	8.2
D&A	-0.2	-0.9	-1.0
PBT	-0.4	0.9	7.2
Tax	0.0	-0.3	-2.2
NPAT (Adjusted)	-0.4	0.7	5.0
Trail Comm. NPV Chg (pre-tax)		2.3	
Trail Comm. NPV Chg (post-tax)		1.6	
Reported EBITDA	-0.3	4.1	8.2
Reported NPAT	-0.4	2.3	5.0
Reported EPS (basic)	-1.8c	3.2c	6.0c
Cash EPS (basic)	-1.8c	0.9c	6.0c
Loan writers (period end)	1,435	1,665	1,781
Settlements - Aggregation	\$12.0b	\$13.2b	\$14.2b
Settlements - on-balance sheet	\$46m	\$65m	\$90m

Source: BBC, Hartleys

At the time of our initiation report (16 February 2018), we noted that our forecasts entailed a high degree of risk given the wide range of potential earnings outcomes that we considered possible.

To date our earnings forecasts for BBC have proven to be optimistic. We reduce our forecasts for both FY19 and FY20.

Key changes include:

- We have reduced our estimate of on-balance sheet settlements to \$65m in FY19 (from \$100m) and \$90m in FY20 (from \$170m). In this regard, we now prefer to await evidence of increased on-balance sheet lending and clarity around BBC's lending capacity.
- We increase our expense estimates based on initial expense contribution from Finsure and the likelihood of increased investment as BBC launches its BNK brand.
- Overall our FY20 NPAT forecasts (excluding NPV impact) reduce from \$7.8m to \$5.0m. EPS reduces from 8.1cps to 6.0cps.

VALUATION & PRICE TARGET

VALUATION

We maintain our valuation methodology:

- We adopt the NPV of the existing trail book as shown on the 1H19 balance sheet (equivalent to \$0.42 / share).
- Using a PER methodology we capitalise our FY20 earnings expectations. We apply a PER multiple of 14.0x to our earnings forecasts.

We have increased the multiple that we apply, from 12.0x previously, to take into account the higher potential level of growth in future years (in part due to the lower FY20 base resulting from our reduced forecasts).

We also note that this multiple is materially higher than the 10.0x PE multiple (applied to FY19 forecasts) that we use in valuing mortgage broking peer Australian Finance Group (AFG).

As per Figure 5, we set our price target for BBC at \$1.26 / share, reduced from \$1.37 / share previously.

Fig. 5: Price Target & Implied Multiples

BBC		Price Target	
NPV of trail book		\$0.42	
FY20 EPS (cps)		6.0	
FY20 PER		14.0x	
Capitalised Earnings		\$0.84	
BBC Price Target		\$1.26	
Implied Multiples at Price Target		FY19	FY20
EV/EBITDA		44.1x	9.9x
PER		137.6x	21.0x
PER (adjusted for trail book)		91.8x	14.0x

Source: Hartleys

RISKS

There are a number of risks which may impact upon BBC, from a variety of perspectives, such as regulatory, integration and market risks. Below we highlight some of the key risks we see:

- **Achieving Scale in Banking.** BBC has been a sub-scale banking operation throughout its listed life. The merger with Finsure provides the opportunity for management to drive additional scale and earnings from the BBC Banking platform. This however is not a given, there remains risk that the Banking operations do not attain a meaningful scale.
- **Achieving growth in on-balance sheet lending capacity.** A key BBC strategy is to grow on-balance sheet lending. The ability to achieve this is in part dependent on BBC being able to grow its regulatory capital base. The business is seeking to do this through growth in its depositor base in addition to establishing a NOHC structure to enable the release of additional capital.
- **Finsure growth.** From an operational perspective Finsure has grown strongly since its establishment. The ability to continue this growth to a large extent rests on the ability of the business to continue to attract good quality loan writers. As Finsure continues to build scale this operational growth will need to be complemented with earnings growth.
- **Integration.** While operationally BBC and Finsure will likely be kept quite separate, there will be risks related to bringing the businesses and their respective management teams together. BBC will continue to be lead by its existing management team, based in Western Australia, while the key earnings generator of the business (Finsure) will be managed by its existing management team, based primarily in Sydney.
- **Regulatory.** The mortgage broking industry continues to be subject to regulatory uncertainty, though this has abated somewhat over the last month as both major political parties have provided initial insight into their policies related to the industry. We believe it is reasonable to expect that regulatory risk (perceived and real) will be an ongoing and ever-present companion to the mortgage broking industry, which may impact upon investor sentiment from time to time.
- **Market.** The overall health of the domestic economy and its impact on consumer demand for home loan-type credit is an important macro driver. In recent times, housing credit growth has been very weak.
- **Maintenance of credit quality.** Post-merger, as BBC seeks to accelerate its lending growth there is increased potential for lower quality loans to be approved. BBC will need to ensure it has the necessary credit approval capability to cope with the expected large increase in on-balance sheet loan applications.
- **ATM Contracts.** BBC notes that an inability for its Cashpoint ATM contract to continue may have an adverse effect on BBC, particularly during the current financial year.
- **Illiquidity.** While the material increase in shares on issue post the Finsure merger should assist in improving the liquidity of BBC shares, it is likely that liquidity will remain low.

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.
Buy	

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