

6 Sep 2019

BNK BANKING CORP. LTD (BBC)

Strategy coming together

BNK Banking Corporation Ltd (BBC) has delivered FY19 statutory NPAT of \$3.6m, up from a statutory FY18 net loss after tax of \$0.4m. FY19 saw the acquisition of Finsure Group (completed in September 2018) and as a such the statutory result includes a number of costs involved in the completion of the transaction.

BBC advises that underlying pro-forma NPAT (excluding non-recurring items and adjusted for a full 12-month Finsure contribution) would have been \$5.2m, down from \$6.8m in FY18.

We look forward to FY20 which should provide investors with the first 'clean' result, with a full year contribution from Finsure and the absence of any transaction related costs.

Strong loan book growth

A key strategy behind the acquisition of Finsure was the ability for the merged entity to fund a significantly increased volume of loans on balance sheet. A highlight of this result has been strong growth in this area, particularly during 2H19. Over the course of FY19 on balance sheet settlements of \$75m were achieved, with \$52m delivered in 2H19. FY20 has started strongly in this regard, with June settlements of \$19m.

Medium term targets for material profit growth

BBC notes that its priority for FY20 and beyond is to consolidate the Group's operating model and further drive synergies, whilst focussing on balance sheet loan growth.

BBC has outlined a range of three-year targets (refer Appendix), including growth in on balance sheet loans by FY22 from \$214m (at FY19) to between \$588m and \$723m. FY22 NPAT (including trail book NPV) of between \$11.4m and \$14.3m is being targeted, implying a three-year cumulative average growth rate (CAGR) of 30%-40%.

We have reduced our FY20 NPAT forecast (excluding NPV impact) by 18% from \$5.0m to \$4.1m, reflecting increased investment by the business.

Speculative Buy, Price Target \$1.16

In our previous note (12 April 2019 "Base in place, now for delivery") we concluded that with the Finsure merger complete, BBC had the base in place to provide management with the opportunity to drive earnings growth. We saw the key elements behind this as being continued growth at Finsure (early signs are solid), increased on balance sheet lending (a strong start has been made here) and the success, or otherwise, of BNK's digital banking offering (we look forward to greater clarity in this regard over the course of FY20).

Our Speculative Buy recommendation is maintained, with our price target reduced to \$1.16 / share, from \$1.26 / share previously, on the back of our reduced FY20 estimates.

Share Price:	\$0.70
12mth price target:	\$1.16

Brief Business Description:

BNK combines the mortgage broking business of Finsure, with a largely online banking operation, BNK Bank.

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 (Managing Director)

Top Shareholders:

John Kolenda	17.8%
Calvin Ng	10.4%
Resimac	5.4%

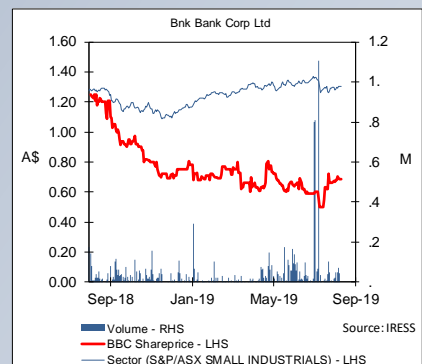
Company Address:

Lvl 14, 191 St Georges Tce
Perth, WA 6000

Issued Capital:	82m
- fully diluted	85m
Market Cap:	\$58m
- fully diluted	\$59m

	FY18a	FY19a	FY20e
Op. Revenue	5.1	24.2	33.9
NPAT (A\$m)	-0.4	3.6	4.1
NPAT (A\$m)*	-0.4	-0.6	4.1
EPS (cash)	-1.8	-0.8	4.9
P/E (basic)			14.2x
DPS (cps)	0.0	0.0	0.0

Source: Hartleys Research. *Cash NPAT



Author:

Oliver Stevens
Industrial Analyst
Ph: +61 8 9268 2879
e: oliver.stevens@hartleys.com.au

Hartleys has completed a capital raising in the past 12 months for BNK Banking Corporation Limited ("BBC") for which it has earned gross fees of \$235,175. Hartleys has also provided corporate advice within the past 12 months to BBC for which it has earned gross fees of \$20,000.

SUMMARY MODEL

BNK Banking Corp. Ltd					Recommendation: Speculative Buy					
Company Information					Profit & Loss (\$m)					
Date	6 Sep 2019	Lvl 14, 191 St Georges Tce			6/17A	6/18A	6/19A	6/20F		
Share Price	\$0.70	Perth, WA 6000			Revenue	4.2	5.1	24.2	33.9	
52 Week High-Low	\$0.50 - \$1.305	Ph: (08) 9021 6444			Expenses	-5.0	-5.4	-23.5	-27.0	
Dil. Market Cap (\$m)	\$59	www.goldfieldsmoney.com.au			Loan Provisions	-0.3	0.0	0.0	-0.1	
Ordinary Shares	82.4				Depn & Amort.	-0.3	-0.2	-1.0	-1.0	
Fully Diluted Shares	84.6				PBT	-1.3	-0.4	-0.3	5.8	
					Tax	0.3	0.0	-0.3	-1.7	
Price Target	\$1.16				NPAT (Excl. NPV Impact)	-1.0	-0.4	-0.6	4.1	
Upside / Downside	66%									
Price Target					Non-cash Adjustments					
12 Month Price Target	\$1.16				NPV of Trail Book (pre-tax)			6.0	0.0	
					NPV of Trail Book (post-tax)			4.2	0.0	
P/E (FY6/19A) at price target - Reported EPS	22.6x				Reported NPAT	-1.0	-0.4	3.6	4.1	
P/E (FY20) at price target - Reported EPS	23.6x				Reported EPS (basic, wghtd)	-5.1	-1.8	5.1	4.9	
					Cash EPS (basic, wghtd)	-5.1	-1.8	-0.8	4.9	
P/E (FY6/19A) at price target - Cash EPS	-140.2x				DPS (cps)	0.0	0.0	0.0	0.0	
P/E (FY20) at price target - Cash EPS	23.6x									
Multiples (\$/price at \$0.70)					Balance Sheet (\$m)					
P/E (basic, weighted)	13.6x	6/17A	6/18A	6/19A	6/20F	Cash	16	15	19	4
Cash P/E (diluted, weighted)	-84.5x					Deposits with ADI's	27	25	32	32
						FRNs with ADI's	11	7	46	46
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	Loans & Advances	157	171	214	331
Price / Book	0.8x	0.7x	0.6x	0.5x		NPV of Trail Comms - Receivable	0	0	269	348
						Shares in CUSCAL	0	0	0	0
						Property, Plant, Equipment	1	1	1	1
						Goodwill	0	0	19	19
						Other Intangibles	0	2	28	28
						Deferred Tax Assets	1	1	0	0
						Other	2	1	1	1
						Total Assets	215	221	646	811
						Deposits	194	195	287	381
						NPV of Trail Comms - Payable	0	0	230	297
						Creditors & other payables	1	1	3	0
						Current Tax Liabilities	0	0	0	0
						Provisions	0	0	1	1
						Interest Bearing Liabilities	0	0	0	5
						Deferred Tax Liabilities	0	0	12	12
						Other	0	0	0	0
						Total Liabilities	195	197	546	697
						Net Assets	20	25	100	114
						Cashflow Statement (\$m)				
						6/17A	6/18A	6/19A	6/20F	
						Net Operating Cash Flow	-1.7	2.1	-1.8	4.7
						Net Investing Cash Flow	-44.2	-8.0	-93.3	-119.1
						Net Financing Cash Flow	59.7	4.2	99.9	98.7
						Movement in Cash	13.8	-1.7	4.9	-15.7
						Key Metrics - Finsure				
						6/17A	6/18A	6/19A	6/20F	
						Loan writers	1,213	1,435	1,674	1,808
						Growth	31%	18%	17%	8%
						Loan writers - average	1,069	1,324	1,555	1,741
						Settlements per avg. loan writer (\$m)	9.7	9.1	8.1	8.3
						Growth		-7%	-11%	2%
						Aggregation Settlements (\$m)	10,400	12,018	12,613	14,408
						Growth		16%	5%	14%
						Aggregation - Loan book (\$m)	25,000	31,791	38,091	44,881
Analyst: Oliver Stevens Phone: +61 8 9268 2879					Last Earnings Estimate Change: 6 September 2019					
Sources: IRESS, Company Information, Hartleys Research										

FY19 RESULT SUMMARY

Fig. 1: FY19 result summary

BNK	Statutory	NPV impact	Adjusted
Interest revenue from banking activities	8.8		8.8
Interest expense from banking activities	-5.3		-5.3
Net Interest Income	3.5	0.0	3.5
Finsure - Comm. Income	187	-69	119
Finsure - Comm. Expense	-170	63	-107
Finsure - Net Comm. Income	17.4	-6.0	11.4
Other income	9.4	0.0	9.4
TOTAL NET REVENUE	30.2	-6.0	24.2
Operating Expenses	-23.7		-23.7
Transaction Expenses	-0.9		-0.9
PBT	5.7	-6.0	-0.3
Tax	-2.1	1.8	-0.3
Statutory NPAT	1	3.6	-0.6
Finsure Contribution	2	5.5	1.3
Banking Contribution	3	-1.8	-1.8
	3.6	-4.2	-0.6
Proforma Underlying NPAT			5.2

Source: BBC, Hartleys

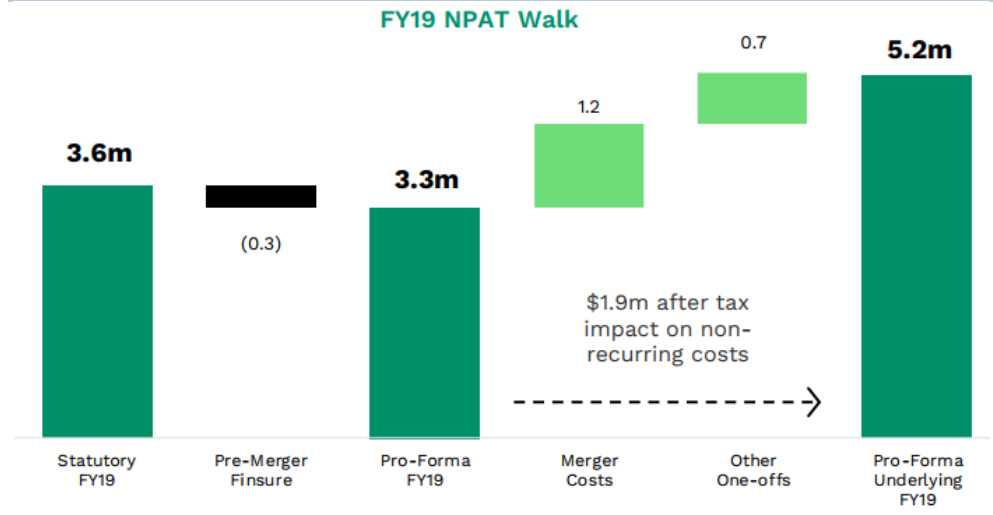
FY19 provides the first full year accounts for the combined entity since the merger with Finsure was finalised in September 2018.

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 FY19 the change in trail book NPV contributed positive \$6.0m pre-tax and \$4.2m post-tax to BBC's statutory result. 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 \$3.6m and negative \$0.6m on an adjusted basis.
- Finsure (*note 2*) contributed statutory NPAT of \$5.5m (\$1.3m adjusted), implying that BBC's banking business (*note 3*) made a statutory loss of \$1.8m.
- BBC advises that on a pro-forma underlying basis (i.e. assuming Finsure made a full 12-month contribution and excluding transaction costs) NPAT was \$5.2m (Figure 2). This compares to FY18 pro-forma underlying NPAT of \$6.8m.

Fig. 2: FY19 pro-forma underlying NPAT



Source: BBC

LOAN BOOK

Across each of its loan books BBC delivered solid settlements and resultant loan book growth during the period (Figure 3).

Fig. 3: Loan Book and Settlements

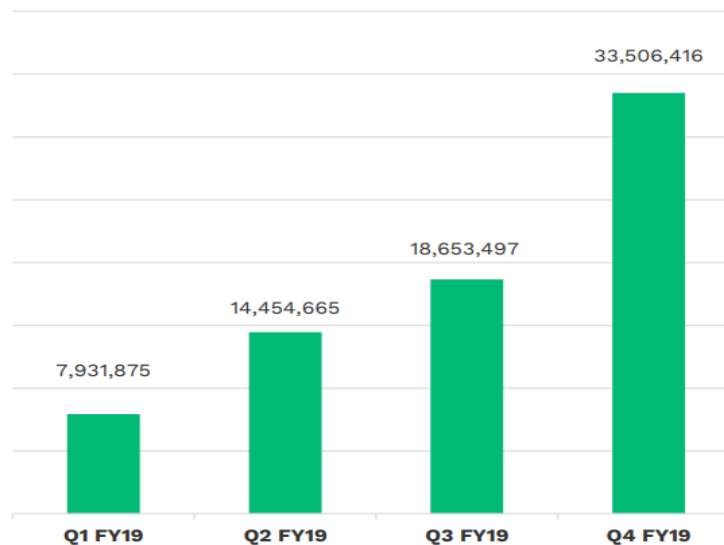
	FY18	FY19	\$ Var	% Var
Loan Book				
BNK (Bank)	170,510,550	214,323,347	43,812,797	25.7%
Better Choice (Wholesale)	2,237,904,616	2,340,892,771	102,988,155	4.6%
Finsure (Aggregation)	31,790,660,072	38,091,056,183	6,300,396,111	19.8%
Total	34,199,075,238	40,646,272,301	6,447,197,063	18.9%
Settlements				
BNK (Bank)	46,254,208	74,546,453	28,292,245	61.2%
Better Choice (Wholesale)	385,945,824	578,443,291	192,497,467	49.9%
Finsure (Aggregation)	12,018,008,066	12,613,335,047	595,326,982	5.0%
Total	12,450,208,098	13,266,324,792	816,116,694	6.6%

Source: BBC

Of particular note, on balance sheet loan settlements accelerated materially in 2H19 as the broader distribution capabilities of the expanded group started to contribute.

Settlements in 2H19 of \$52m were well up on the \$22m achieved in 1H19 (Figure 4). BBC reports that this momentum has continued with settlements of \$19m achieved in July.

Fig. 4: On balance sheet settlements



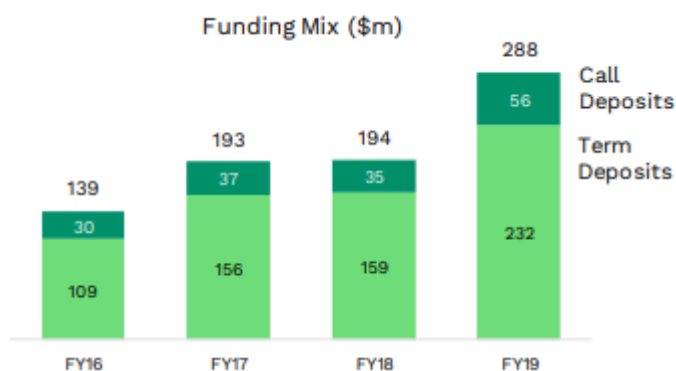
Source: BBC

FUNDING

BBC's on balance sheet loan book grew strongly in FY19, up 26% (\$44m) to \$214m. To aid in funding this loan growth BBC was also successful in growing its deposit book strongly. Deposits were up 47% (\$92m) to \$288m (Figure 5).

BBC ended FY19 with a Capital Adequacy Ratio (CAR) of 20.4%, down from 22.0% in FY18.

Fig. 5: Deposit Mix



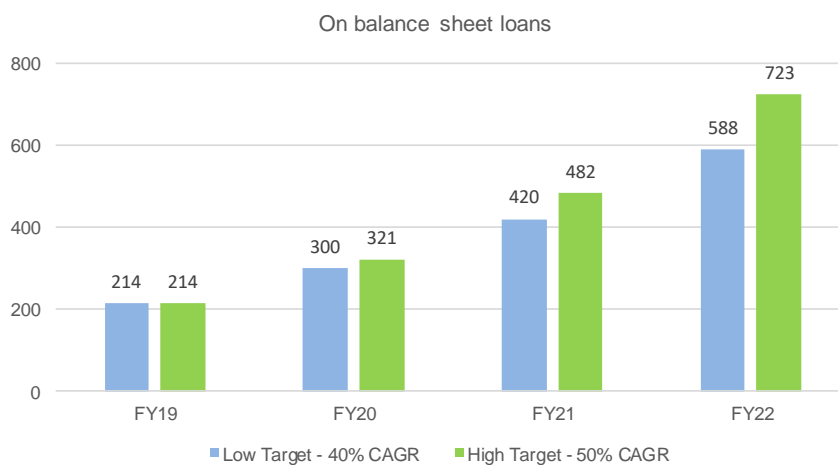
Source: BBC

ON BALANCE SHEET LENDING TARGETS

A key strategy of BBC, on the back of the increased distribution network provided by Finsure, is to increase the level of on balance sheet lending. BBC is targeting a three-year CAGR in its on-balance sheet loan book of 40%-50%, implying an FY22 loan book of between \$588m and \$723m (Figure 6).

To facilitate this loan book growth will require ongoing growth in BBC's deposit book, likely to be combined with additional sources of capital.

Fig. 6: On balance sheet loan book target



Source: BBC, Hartleys

FINSURE

The Finsure acquisition was completed in September 2018. In what was a difficult year for the mortgage broking industry on the back of the Royal Commission and the difficult lending environment Finsure's high level metrics were solid:

- Loan writer numbers grew 17% to 1,674.
- Settlements of \$12.6bn, were up 5% on FY18 (\$12.0b).
- Loan book grew 20% to \$38.1bn, from \$31.8bn.

A snapshot of Finsure's national spread of loan writers and loan book is shown in Figure 7.

Fig. 7: Finsure



Source: BBC

FORECASTS

Fig. 8: Forecasts

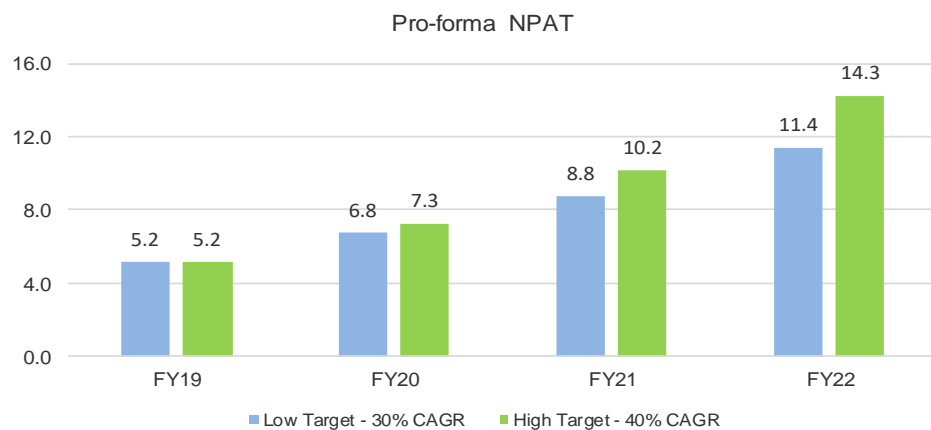
Forecast Changes	FY19a	FY20 Old	FY20 New	Chg.
Net Interest Margin	3.5	4.3	5.5	
Aggregation Net Revenue	11.4	18.0	16.6	
Fees & Other Revenue	9.4	11.0	11.9	
Total revenue	24.2	33.3	33.9	2%
Expenses	-23.5	-25.0	-27.0	-8%
Loan impairments	0.0	-0.1	-0.1	
EBITDA (Adjusted)	0.7	8.2	6.8	-17%
D&A	-1.0	-1.0	-1.0	
PBT	-0.3	7.2	5.8	-20%
Tax	-0.3	-2.2	-1.7	
NPAT (Adjusted)	-0.6	5.0	4.1	-18%
Cash EPS (basic)	-0.8c	6.0c	4.9c	-18%
Loan writers (period end)	1,674	1,831	1,808	
Settlements - Aggregation	\$12.6b	\$15.4b	\$14.4b	
Settlements - on-balance sheet	\$75m	\$70m	\$160m	
NIM	1.95%	1.90%	2.00%	

Source: BBC, Hartleys

- Our forecasts do not include any estimates related to changes in the NPV of the trail book.
- Overall our FY20 NPAT and EPS estimates reduce by 18%, largely reflecting an increase in operating expenses.

BBC has provided guidance for various FY22 targets, including NPAT. Based on FY19 underlying pro-forma NPAT of \$5.2m, BBC is targeting three-year CAGR of 30%-40%, equivalent to FY22 NPAT (inclusive of trail book NPV impact) of \$11.4m - \$14.3m (Figure 9).

Fig. 9: BBC FY22 NPAT target



Source: BBC, Hartleys

VALUATION & PRICE TARGET

VALUATION

We maintain our valuation methodology:

- We adopt the NPV of the existing trail book as shown on the FY19 balance sheet (equivalent to \$0.47 / share).
- Using a PER methodology we capitalise our FY20 earnings expectations. We apply a PER multiple of 14.0x to our earnings forecasts.

Our price target is \$1.16 / share, reduced from \$1.26 / share previously on the back of our reduced EPS estimate.

Fig. 10: Price Target

BBC	Price Target
NPV of trail book	\$0.47
FY20 EPS (cps)	4.9
FY20 PER	14.0x
Capitalised Earnings	\$0.69
BBC Price Target	\$1.16

Source: Hartleys

RISKS

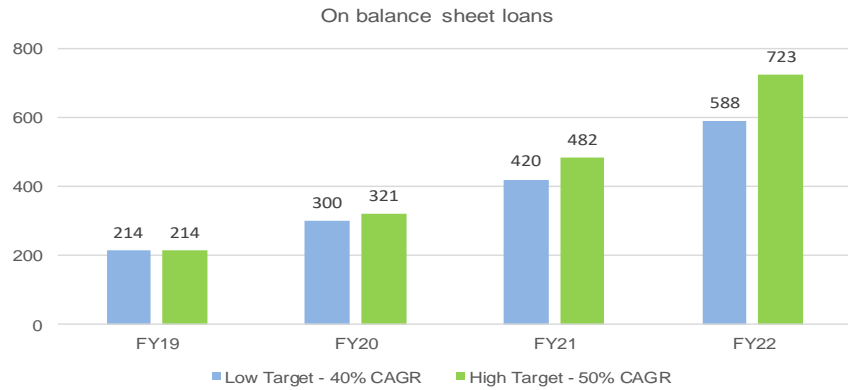
Below we highlight some of the key risks we see for BBC:

- **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. Based on BBC's targets additional sources of capital are likely to be required.
- **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.
- **Regulatory.** 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.
- **Maintenance of credit quality.** 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.
- **Illiquidity.** BBC is a thinly traded stock, with limited share market liquidity.

APPENDIX – GROWTH TARGETS

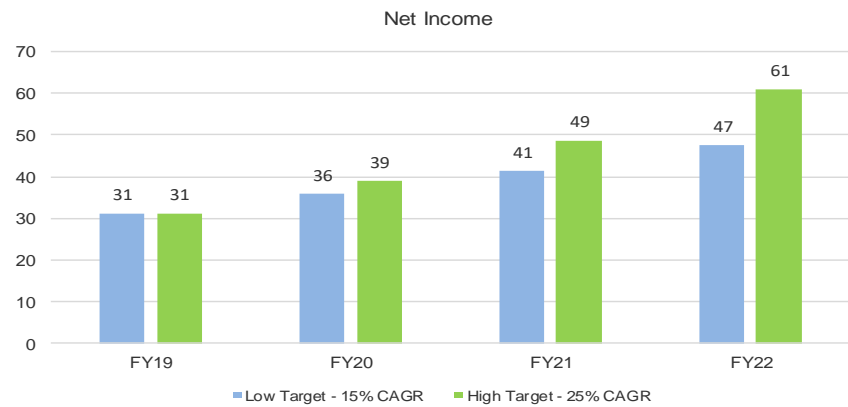
BBC has detailed a number of growth targets to be achieved by FY22. These are summarised below.

Fig. 11: On balance sheet loans



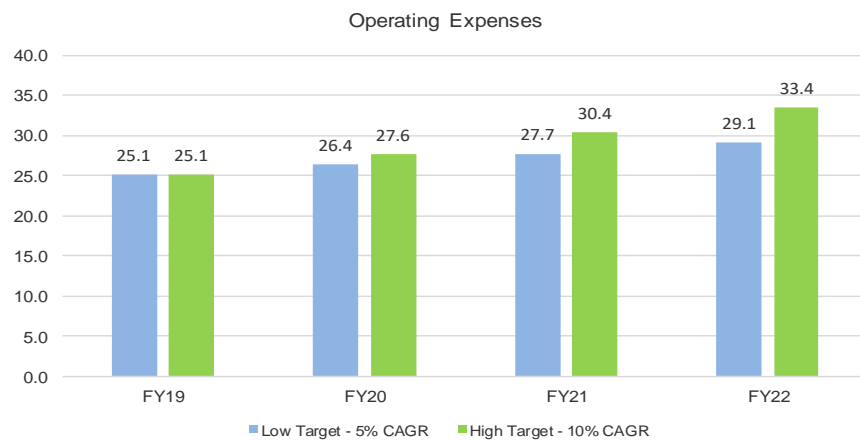
Source: BBC, Hartleys

Fig. 12: Net Income



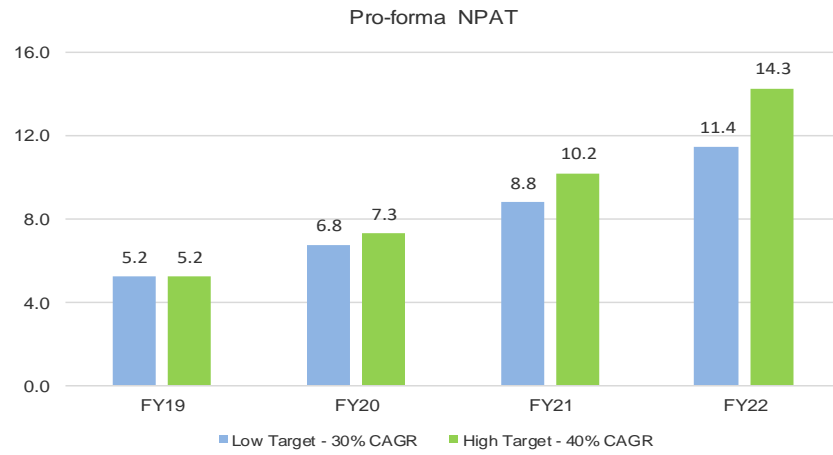
Source: BBC, Hartleys

Fig. 13: Operating Expenses



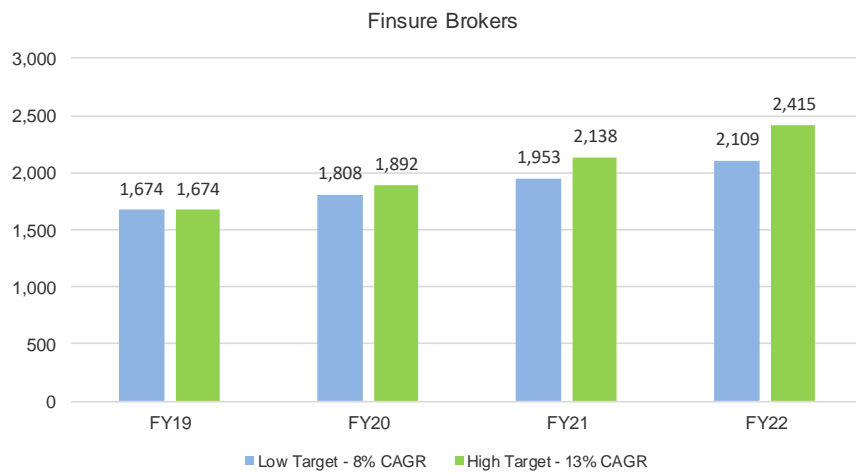
Source: BBC, Hartleys

Fig. 14: NPAT



Source: BBC, Hartleys

Fig. 15: Finsure Brokers



Source: BBC, Hartleys

HARTLEYS CORPORATE DIRECTORY

Research

Trent Barnett	Head of Research	+61 8 9268 3052
Mike Millikan	Resources Analyst	+61 8 9268 2805
John Macdonald	Resources Analyst	+61 8 9268 3020
Paul Howard	Resources Analyst	+61 8 9268 3045
Aiden Bradley	Research Analyst	+61 8 9268 2876
Oliver Stevens	Research Analyst	+61 8 9268 2879
Michael Scantlebury	Junior Analyst	+61 8 9268 2837
Janine Bell	Research Assistant	+61 8 9268 2831

Corporate Finance

Dale Bryan	Director & Head of Corp Fin.	+61 8 9268 2829
Richard Simpson	Director	+61 8 9268 2824
Ben Crossing	Director	+61 8 9268 3047
Ben Wale	Director	+61 8 9268 3055
Stephen Kite	Director	+61 8 9268 3050
Scott Weir	Director	+61 8 9268 2821
Scott Stephens	Associate Director	+61 8 9268 2819
Rhys Simpson	Associate Director	+61 8 9268 2851
Michael Brown	Executive	+61 8 9268 2822

Registered Office

Level 6, 141 St Georges Tce Postal Address:

Perth WA 6000	GPO Box 2777
Australia	Perth WA 6001
PH:+61 8 9268 2888	FX: +61 8 9268 2800
www.hartleys.com.au	info@hartleys.com.au

Note: personal email addresses of company employees are structured in the following manner: firstname.lastname@hartleys.com.au

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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Carrick Ryan	+61 8 9268 2864
Justin Stewart	+61 8 9268 3062
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Jayne Walsh	+61 8 9268 2828
Veronika Tkacova	+61 8 9268 2836

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Nicola Bond	+61 8 9268 2840
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Sven Burrell	+61 8 9268 2847
Simon Casey	+61 8 9268 2875
Tony Chien	+61 8 9268 2850
Tim Cottee	+61 8 9268 3064
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Andrew Gribble	+61 8 9268 2842
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Shane Lehmann	+61 8 9268 2897
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Jamie Moullin	+61 8 9268 2856
Chris Munro	+61 8 9268 2858
Michael Munro	+61 8 9268 2820
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Heath Ryan	+61 8 9268 3053
David Smyth	+61 8 9268 2839
Greg Soudure	+61 8 9268 2834
Sonya Soudure	+61 8 9268 2865
Dirk Vanderstruyf	+61 8 9268 2855
Samuel Williams	+61 8 9268 3041

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