

Westpac Banking Corporation (ASX: WBC): Westpac announces \$3.5 billion off-market share buy-back

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Reading Time: 5 Mins

By Team Ace Investors

Stock Code	ASX: WBC
Shares O/S	3.66 billion
Closing Price	AUD 21.050
Market Cap	77.13 billion
52 W H/L	27.120/19.230
One Year Stock Performance	5.88%
Avg. Volume(TTM)	7.67 million
EPS(TTM)	1.378
P/E	15.2
Annual Dividend Yield	5.60%
Franking	100%
Last Dividend Ex-Date	05-Nov-21
Last Dividend Pay Date	21-Dec-21
DPS (AUD)	0.6
ROE (%)	7.79%

(Source: ASX)

Company Overview

Westpac Banking Corporation (“WBC” or the “Company”) is Australia’s 2nd largest bank with a 22% market share in the Australian mortgage market. The Company operates through five divisions namely Consumer, Business, Westpac Institutional Bank (WIB), Westpac New Zealand, and Specialist Business. The consumer division is responsible for sales and service to consumer customers in Australia. WBC's Business division provides business banking and wealth facilities and products for customers across Australia. WIB delivers a broad range of financial products and services to commercial, corporate, institutional, and government customers. Westpac New Zealand is responsible for the sales and service of banking, wealth, and insurance products for consumer, business, and institutional customers in New

Zealand. Specialist Business encompasses insurance, superannuation, auto& vendor finance businesses, etc. WBC possesses a unique portfolio of brands providing a range of financial services across consumer, business, and institutional banking, and wealth administration supporting 14.1 million consumers and businesses in Australia and New Zealand. The company is well-positioned to deliver across its key markets with a focus on service-led strategy.

Five operating divisions



(Source: Company Reports)

Investment Rationale

Delivering on its strategy to simplify business portfolio

Westpac Banking Corporation has taken up several corrective measures to improve its operational efficiency as well as overcome a shortfall in risk management practices. The company has adopted a simple three-step strategy Fix, Simplify and Perform to address the outstanding prevailing issues, simplify business focus and generate sustainable long-term returns for shareholders respectively. In 2020, the company has formed a Specialist Businesses division to identify non-core businesses and optimize the business portfolio. In line with its strategic focus, the company has completed the sale of its four businesses and exited two investments in Zip Co. and Coinbase Inc. In addition, WBC has announced the sale of three more businesses and expects to complete these sales by the end of the CY2022. In 2020, WBC has restructured the business along with major customer offerings and introduced a 'Lines of Business' operating model, creating a better end-to-end responsibility for product lines to simplify processes. For example, in its mortgage line of business, WBC has made over 70 changes to simplify processes and speed up approval times for customers. Under the simplification program, the company also rationalized its offerings and retired more than 200 products throughout the year. The company also consolidated its international presence by closing offices in Mumbai and Jakarta. In Dec 2020, the company launched an end-to-end digital mortgage application process, making it easier and faster for customers to apply for a home loan and to track its progress along the way. In May 2021, WBC has announced a target cost base of \$8 billion by 2024.

This is an ambitious target, and the company is started to see its impact on its costs of simplification initiatives designed to meet this goal including the further exit of businesses, completion of activities to fix risk management shortcomings, business simplification, and digitization of processes. The company has set several milestones under its strategic objectives to simplify its portfolio and strengthen risk management practices.

- Continues to strengthen its risk management practices to deliver on its CORE program and Financial Crime remediation
- Accelerate customer payments & complete Advice remediation
- Complete multi-year technology plan
- Exit non-core businesses and close 5 international offices to simplify its portfolio
- Simplify System by completing the migration of BT Wrap customers and advisers to Panorama and CSH roll-out mortgages to regional brands and brokers
- Set a 3-year cost plan and maintain its balance sheet strength

PROGRESS ON PORTFOLIO SIMPLIFICATION	
Businesses/Investments sold	Completed
Zip Co. Ltd.	Oct 2020
Coinbase Inc.	May 2021
General Insurance	Jul 2021
Vendor Finance	Jul 2021
Westpac LMI	Aug 2021
Westpac NZ Wealth Advisory	Dec 2020
Announced sale	Completion expected
Motor Vehicle Finance	First half of 2022
Westpac NZ Life Insurance	First half of 2022
Westpac Life Insurance	Second half of 2022

(Source: Company Reports)

The CORE program is expected to establish an end-to-end risk management framework to improve customer outcomes

To become a simpler and stronger bank, WBC continues to rectify its shortcomings at its source and its Customer Outcomes and Risk Excellence (CORE) program is leading the change. The CORE program was first established in 2020 and expanded in 2021. The program is intended to address the issues identified by its assessments and by the regulators including the Australian Prudential Regulation Authority's (APRA) Risk Governance Review, completed in December 2020, which resulted in a court-enforceable undertaking agreed with APRA. Over the past 18 months, WBC has rebuilt its approach to financial crime including elevating the Financial Crime, Compliance & Conduct function, with the Group Executive reporting directly to the CEO, and increasing the number of financial crime specialists by around one-third since 2019. This transformation is part of a significant multi-year program of work aimed at improving Westpac's management of financial crime risk, including

addressing issues highlighted in the civil proceedings commenced by AUSTRAC against Westpac on 20 November 2019 concerning alleged contraventions of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006. These civil proceedings were settled in 2020. The CORE program is focused on achieving sustained improvement in risk management effectiveness, and real outcomes including:

- A strong culture where accountability is clear
- Effective end-to-end risk management resulting in better customer outcomes
- Three lines of defense model where everyone is clear on their accountabilities and understands their role in identifying and managing risk
- Better insights, underpinned by high-quality data —Stronger risk oversight and better execution

Westpac announces \$3.5 billion off-market share buy-back

Westpac has decided to return up to \$3.5 billion to shareholders through an off-market buy-back program. Given strong FY21 operating performance and progress on strategic priorities including the completion of several divestments of non-core assets identified, have contributed to a strong capital position with a common equity tier 1 ratio of 12.3%, comfortably above APRA's unquestionably strong benchmark of 10.5%. Following the recent fall in Westpac's share price, the rationale for the Buy-Back is even more compelling. Specifically, the lower share price may provide Westpac with the opportunity to buy back more shares than was originally contemplated. As a function of the current share price, the sale proceeds and franking credits that are distributed to Buy-Back participants are potentially reduced. In considering these changes, Westpac has decided to amend certain key terms of the Buy-Back, including the Buy-Back tender discount range and timetable. The Buy-Back tender discount range has been changed to 0% to 10% from 8% to 14%, to improve the potential return of the Buy-Back for Eligible Shareholders; and extended the closing date for the tender period has been extended to 7:00 pm (Sydney time) on Friday, 11 February 2022, to provide Eligible Shareholders with additional time to assess the revised Buy-Back terms.

For FY21, WBC has reported a 105% YoY growth in Cash Earnings to \$5352 million versus \$2744 million in FY20 due to a turnaround in credit impairment charges (a \$2,638 million cash earnings increase) and lower notable items (infrequent items that do not reflect ongoing business performance). Net interest income for the period increased \$162 million compared to 2020, reflecting a 3 basis point increase in net interest margin (to 2.06%) partly offset by a small decline in average interest-earning assets of \$2.3 billion (down less than 1%). The rise in net interest income was predominantly due to (i) a \$667 million change in unrealized gains on fair value economic hedges, from a charge of \$477 million in 2020 to a benefit of \$190 million in 2021; and (ii) lower wholesale funding and deposit costs; partly offset by lower spreads on mortgages and business lending from intense competition, and a shift in the mix of the portfolio to lower spread fixed-rate lending; and reduced returns on hedged capital and liquid assets from lower interest rates. The Group recognized a credit impairment benefit of \$590 million in 2021 compared to a charge of \$3,178 million in 2020 given

an improved economic outlook and improvement in asset quality. The Board has determined a final dividend of 60 cents per ordinary share. FY21 full-year ordinary dividend of \$1.18 is higher than the ordinary dividends declared in 2020 and represents a payout ratio of 79.25%. The full-year ordinary dividend is fully franked.

REPORTED NET PROFIT ATTRIBUTABLE TO OWNERS OF WESTPAC (\$m)			
	FULL YEAR SEPT 2021	FULL YEAR SEPT 2020	% MOV'T SEPT 21 - SEPT 20
Net interest income	16,858	16,696	1
Non interest income	4,364	3,487	25
Net operating income	21,222	20,183	5
Operating expenses	(13,311)	(12,739)	4
Net profit before impairment charges and income tax	7,911	7,444	6
Impairment (charges)/benefits	590	(3,178)	large
Profit before income tax	8,501	4,266	99
Income tax expense	(3,038)	(1,974)	54
Net profit for the period	5,463	2,292	138
Profit attributable to non-controlling interests (NCI)	(5)	(2)	150
Net profit attributable to owners of WBC	5,458	2,290	138
Total cash earnings adjustments (post tax)	(106)	318	large
Cash earnings	5,352	2,608	105
Add back notable items (after tax)	1,601	2,619	(39)
Cash earnings excluding notable items	6,953	5,227	33

(Source: Company Reports)

ACE's Recommendation:

Westpac Banking Corporation (ASX: WBC) is Australia's 2nd largest bank with a 22% market share in the Australian mortgage market. The company is well-positioned to deliver across key markets with a focus on service-led strategy. WBC has taken up several corrective measures to improve its risk management practices and simplify its business portfolio. In 2020, the company has formed a Specialist Businesses division to identify non-core businesses and optimize the business portfolio. In line with its strategic focus, the company has completed the sale of its four businesses and exited two investments in Zip Co. and Coinbase Inc. In addition, WBC has announced the sale of three more businesses and expects to complete these sales by the end of the CY2022. In 2020, WBC has restructured the business along with major customer offerings and introduced a 'Lines of Business' operating model, creating a better end-to-end responsibility for product lines to simplify processes. We believe that the disinvestment of non-core businesses along with a strong balance sheet will provide enough headroom to grow in the medium term. The stock has advanced +8.67% YTD to A\$21.050/share and offers an attractive opportunity. So, we would like to recommend a **BUY** rating on the stock.

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