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Macquarie Group (MQG)

Calm down Doctor, now is not the time for fear

Recommendation

Buy (unchanged)

Price

\$144.75

Target (12 months)

\$158.00 (unchanged)

GICS Sector

Banks

Expected Return

Capital growth	9.2%
Dividend yield	4.4%
Total expected return	13.6%

Company Data & Ratios

Enterprise value	n/m
Market cap	\$51,297m
Issued capital	354m
Free float	100%
Avg. daily val. (52wk)	\$126.9m
12 month price range	\$114.35 - \$152.35

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	145.00	134.42	127.97
Absolute (%)	-1.70	6.04	11.39
Rel market (%)	3.16	4.94	1.26

Absolute Price



SOURCE: IRESS

Scope to beat FY20 guidance

MQG indicated satisfactory 3Q20 trading conditions across the Group earlier this month given a strong performance in its annuity-style components while the markets-facing components unsurprisingly came off a very strong prior period. MQG will release its FY20 result on Friday 8 May and current guidance is for statutory NPAT to be “slightly down on FY19” – this has been unchanged in the past nine months. Be that as it may, it is still our view that MQG will (true to its under-promise and over-deliver form) slightly beat its full year guidance – thus our forecast statutory NPAT of \$2,989m vs. \$2,982m in FY19. While FY20 EPS would be broadly flat at \$8.79, our estimates indicate EPS growth would be closer to 10% if FY19 EPS were to be normalised to exclude higher asset realisations.

Other positive guidance swing factors include base and performance fee upside from further AUM and EUM ramp-up, ongoing BFS volume growth ahead of system, sustained client hedging activity in the current volatile environment and favourable currency movements. In terms of the latter, the AUD weakened by ~1% or 0.8¢ between 31 March 2019 and 31 December 2019. Since then, the AUD has further weakened by ~6% or 4.1¢ and we note that an incremental 1¢ weaker AUD to the USD will lift MQG’s statutory NPAT by ~1.3%.

\$158.00 price target and Buy rating unchanged

There’s plenty of red today and we are not just talking about blood cells. In any case, we see a good buying opportunity in MQG following today’s market rout. As the top pick in our coverage universe, we view the Group as a LONG TERM “Cash and Growth” story. MQG’s investment proposition is also underpinned by a strong balance sheet, risk management capabilities, ability to deploy resources across the Group to generate returns in excess of those of its peers, ongoing cost discipline, proven adaptability to changing market conditions and access to value-adding global growth options. Our forecasts, \$158.00 price target and Buy rating are unchanged.

Earnings Forecast

Year end 31 March	2019	2020e	2021e	2022e
NPAT (statutory) (A\$m)	2,982	2,989	3,139	3,312
NPAT (for diluted EPS) (A\$m)	3,033	3,095	3,245	3,418
EPS (reported) (A¢)	883	879	925	978
EPS (reported) growth (%)	17%	-1%	5%	6%
PER (x)	16.4	16.5	15.7	14.8
P/Book (x)	2.8	2.4	2.3	2.2
P/NTA (x)	3.1	2.8	2.7	2.5
Dividend (A¢)	575	601	637	673
Yield (%)	4.0%	4.2%	4.4%	4.6%
ROE (%)	17.9%	16.3%	16.1%	16.2%
Compensation ratio (%)	39%	42%	38%	38%
Franking (%)	45.0%	40.0%	40.0%	40.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Calm down Doctor, now is not the time for fear



Scope to beat FY20 guidance

MQG indicated satisfactory 3Q20 trading conditions across the Group earlier this month. This is based on a strong performance in its annuity-style components [Macquarie Asset Management (MAM) and Banking and Financial Services (BFS) – combined 3Q20 net profit contribution up on 3Q19 and YTD FY20 net profit contribution up on a pcp basis mainly due to higher MAM base and performance fees and good BFS volume growth ahead of system] while the markets-facing components unsurprisingly came off a very strong prior period [Commodities and Global Markets (CGM) and Macquarie Capital (MC) – combined 3Q20 net profit contribution significantly down on 3Q19 and likewise YTD FY20 on a pcp basis due to significantly lower investment-related income in MC (that previously benefited from asset realisations) offsetting stronger CGM activity].

MQG will release its FY20 result on Friday 8 May and current guidance is for statutory NPAT to be “slightly down on FY19”. Guidance has been unchanged in the past nine months and is subject to market conditions, FX movements, potential regulatory changes and tax uncertainties, transaction completion and period end reviews, and geographic composition of income.

Table 1 – Guidance and reality

Result	Date	Initial guidance	AGM update	Interim update	Operational briefing update	Initial expected result (\$m)	Actual result (\$m)	Outcome	Estimated outcome variance	Result day share price movement	Prior trading close	Trading close
FY07	15-May-07	Improved result on FY06	-	Up on FY06	-	>916	1,463	Beat	46%	3.0%	\$88.01	\$90.67
FY08	20-May-08	Improved result on FY07	-	Up on FY07	Up by ~23% on FY07	>1,463	1,803	Beat	23%	-7.3%	\$65.00	\$60.23
FY09	01-May-09	Challenging to repeat FY08 performance	Increasingly challenging market conditions	Exceptionally challenging market conditions	Exceptionally challenging market conditions	<1,803	871	Miss	-46%	1.6%	\$32.92	\$33.46
FY10	30-Apr-10	Challenging market conditions	Broadly in line with FY09	Broadly in line with FY09	Up on FY09	871	1,050	Beat	21%	4.0%	\$47.55	\$49.46
FY11	29-Apr-11	Improved result on FY10	Broadly in line with FY10	Broadly in line with FY10	Broadly in line with FY10	>1,050	956	Miss	-13%	0.8%	\$34.32	\$34.58
FY12	27-Apr-12	Improved result on FY11	Improved result on FY11	Down on or broadly in line with FY11 depending on market conditions	~25% lower than FY11	>956	730	Miss	-25%	2.9%	\$27.96	\$28.78
FY13	03-May-13	Improved result on FY12	Improved result on FY12	Improved result on FY12	Up by ~10% on FY12	>730	851	Beat	10%	10.9%	\$38.23	\$42.39
FY14	02-May-14	Improved result on FY13	Improved result on FY13	Improved result on FY13	Improved result on FY13	>851	1,265	Beat	41%	0.9%	\$58.20	\$58.70
FY15	08-May-15	Broadly in line with FY14	Broadly in line with FY14	Slightly up on FY14	Upper end of 10-20% range on FY14	1,265	1,604	Beat	27%	3.5%	\$76.50	\$79.18
FY16	06-May-16	Slightly up on FY15	Up on FY15	Up on FY15	Up on FY15	1,700	2,063	Beat	21%	-0.3%	\$65.30	\$65.10
FY17	05-May-17	Broadly in line with FY16	Broadly in line with FY16	Broadly in line with FY16	Broadly in line with FY16	2,063	2,217	Beat	7%	3.2%	\$91.92	\$94.89
FY18	04-May-18	Broadly in line with FY17	Broadly in line with FY17	Slightly up on FY17	Up by ~10% on FY17	2,217	2,557	Beat	15%	0.2%	\$107.75	\$108.01
FY19	03-May-19	Broadly in line with FY18	Broadly in line with FY18	Up by ~10% on FY18	Up by ~15% on FY18	2,557	2,982	Beat	17%	-5.4%	\$136.20	\$128.81
FY20	May 2020	Slightly down on FY19	Slightly down on FY19	Slightly down on FY19	Slightly down on FY19	<2,982	-	-	-	-	-	-
Total average									11%			
Total average since GFC									12%			
Average beat									23%			
Average beat since GFC									20%			
Average miss									-28%			

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

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Other positive guidance swing factors include base and performance fee upside from further AUM and EUM ramp-up, ongoing BFS volume growth ahead of system, sustained client hedging activity in the current volatile environment and favourable currency movements. In terms of the latter, the AUD weakened by ~1% or 0.8¢ between 31 March 2019 and 31 December 2019. Since then, the AUD has further weakened by ~6% or 4.1¢ and we note that an incremental 1¢ weaker AUD to the USD will lift MQG's statutory NPAT by ~1.3%.

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Table 2 – MQG SOP valuation					Table 3 – MQG composite valuation				
Sum-of-Parts (As Is)	FY22e NPAT	Pros. PE (times)	Value (\$m)	Per share	Composite Valuation	Value (\$m)	Per share	Weighting	Composite value per share
Macquarie Securities	-	-	-	-	DCF	51,208	\$144.50	30%	\$43.35
Macquarie Capital	1,246	9.0	11,212	\$31.64	Dividend yield play (short term)	54,841	\$154.75	20%	\$30.95
Macquarie Asset Management	1,665	13.8	22,978	\$64.84	ROE (sustainable)	57,236	\$161.51	20%	\$32.30
Commodities and Global Markets	1,359	20.0	27,181	\$76.70	Sum-of-Parts	55,542	\$156.73	30%	\$47.02
Corporate & Asset Finance	-	-	-	-	Average				\$153.62
Banking & Financial Services	796	12.5	9,956	\$28.09	Surplus capital (@ 10.5% RWA) @ 25%				\$3.77
Real Estate Banking	-	-	-	-					
Corporate & Other	-1,754	9.0	-15,785	-\$44.54					
Total	3,312	16.8	55,542	\$156.73	Total				\$157.39

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Macquarie Group

Company description

Macquarie Group (MQG) is a diversified financial group providing clients with asset management and finance, banking, advisory and risk and capital solutions across debt, equity and commodities. Founded in 1969, MQG operates across multiple locations in over 27 countries supported by 15,704 FTE (58% overseas). The Group has established alliances with 32 companies in 14 countries specialising in infrastructure investment, wealth management and trading services. Around 69% of operating income is sourced overseas with nearly half of this coming out of the Americas region.

Investment strategy

We consider MQG primarily as a global wealth and risk manager with deep infrastructure capabilities. The company as a lower risk, higher return investment proposition should consequently be trading at higher PE and PB multiples than the major banks. It is currently sitting on sufficient capital/liquidity buffers and funding lines to sustain its unique business model and we see good long term leverage to the North American and European markets.

SWOT analysis

Strengths

1. "Cash and Growth" story;
2. Australia's independent global wealth and asset manager with diverse management and entrepreneurial capabilities;
3. Proven risk management framework and culture; and
4. Leveraged to the fast growing wealth management segment including earnings diversity by segment and geography (increasing leverage to the improving US economy).

Weaknesses

1. Small footprint in mortgage lending (although being addressed); and
2. Lacks balance sheet for significant DCM and lending initiatives (but this is more of a risk management issue).

Opportunities

1. Green Investment Bank incremental earnings;
2. US banking de-regulation;
3. Well placed to capitalise on upturn in global wealth services, etc.; and
4. Further infrastructure growth opportunities in North America and Europe.

Threats

1. Brexit uncertainty and implications for EMEA operations;
2. Increased scrutiny from Hayne inquiry into Australian banks;
3. Regulatory risk and compliance costs; and
4. Soft (staffing) issues (e.g. susceptible to poaching, etc.).

Table 4 – Financial summary

Macquarie Group						Share Price (A\$)	144.75				
As at	26-Feb-20					Market Cap (A\$M)	51,297				
PROFIT AND LOSS											
Y/e March 31 (\$m)	2018	2019	2020e	2021e	2022e	Y/e March 31	2018	2019	2020e	2021e	2022e
Net interest income	1,986	1,760	1,670	1,919	2,069	NPAT (reported) (\$m)	2,557	2,982	2,989	3,139	3,312
Net trading income	1,957	2,791	2,834	2,852	2,818	EPS (reported) (cps)	758	883	879	925	978
Fee & commission income						- Growth	15%	17%	-1%	5%	6%
- Base fees	1,568	1,778	1,898	1,993	2,093	EPS (reported, diluted) (cps)	743	864	860	902	950
- Performance fees	595	765	926	729	765	- Growth	15%	16%	0%	5%	5%
- M&A, advisory & u/w fees	845	1,023	887	914	941	P / E ratio (times)	19.1	16.4	16.5	15.7	14.8
- Brokerage & commissions	686	1,222	1,235	1,272	1,311	P / Book ratio (times)	2.8	2.8	2.4	2.3	2.2
- Other fee and commission income	597	492	445	463	481	P / NTA ratio (times)	3.0	3.1	2.8	2.7	2.5
- Income from life business, etc.	0	0	0	0	0	Net DPS (cps)	525	575	601	637	673
- Other revenue	2,871	3,422	3,282	3,596	3,701	Yield	3.6%	4.0%	4.2%	4.4%	4.6%
Total operating income	11,105	13,253	13,178	13,738	14,180	Franking	45%	45%	40%	40%	40%
Operating expenses	-7,456	-8,887	-9,034	-9,328	-9,530	Payout (statutory basis, target 60-80%)	69%	65%	68%	69%	69%
Impairment expenses	-185	-499	-266	-332	-346	CAPITAL ADEQUACY					
Operating profit before tax	3,464	3,867	3,878	4,079	4,303	Y/e March 31	2018	2019	2020e	2021e	2022e
Corporate tax expense	-883	-879	-875	-926	-977	Risk weighted assets (\$m)	91,730	77,517	91,051	98,117	104,952
Minority interests	-24	-6	-14	-14	-14	Average risk weight	60%	48%	50%	50%	50%
NPAT (reported)	2,557	2,982	2,989	3,139	3,312	Tier 1 ratio	12.8%	13.5%	13.6%	13.6%	13.6%
Adjustment	53	51	106	106	106	CET1 capital ratio (Bank)	11.0%	11.4%	11.7%	11.8%	12.0%
NPAT (basic/diluted EPS 2012+)	2,610	3,033	3,095	3,245	3,418	Equity ratio	9.5%	9.0%	9.3%	9.1%	9.0%
CASHFLOW											
Y/e March 31 (\$m)	2018	2019	2020e	2021e	2022e	DIVISIONAL					
NPAT (reported basis)	2,557	2,982	2,989	3,139	3,312	Y/e March 31 (\$m)	2018	2019	2020e	2021e	2022e
Increase in loans	-18,411	14,574	-8,519	-7,965	-6,998	Macquarie Securities					
Increase in other assets	21,452	-31,542	-11,597	-6,051	-6,545	Net trading income					
Capital expenditure	-417	6,725	-852	-168	-173	Brokerage & commissions					
Investing cashflow	2,624	-10,243	-20,968	-14,185	-13,716	Other revenue					
Increase in deposits & borrowings	8,156	9,722	9,512	9,036	8,139	Total operating income					
Increase in other liabilities	-618	1,951	10,142	4,203	4,585	Operating expenses					
Ordinary equity raised	0	0	1,670	0	0	Net profit contribution b/4 OEI					
Other	-1,631	-3,836	-2,700	-2,194	-2,321	Cost ratio					
Financing cashflow	5,907	7,837	18,625	11,046	10,403	Macquarie Capital					
Net change in cash	11,088	576	645	0	0	M&A, advisory & u/w fees	845	1,023	887	914	941
Cash at end of period	38,559	39,135	39,780	39,780	39,780	Other revenue	477	1,994	1,753	1,918	2,009
BALANCE SHEET											
Y/e March 31 (\$m)	2018	2019	2020e	2021e	2022e	Total operating income	1,322	3,017	2,640	2,832	2,950
Cash and liquid assets	38,559	39,135	39,780	39,780	39,780	Operating expenses	-545	-1,073	-1,258	-1,122	-1,155
Divisional gross loans	86,183	71,757	80,368	88,405	95,477	Impairment expenses	-56	-183	-145	-177	-184
Provisions	-470	-618	-710	-781	-856	Net profit contribution b/4 OEI	721	1,761	1,238	1,534	1,612
Other IEA	56,977	68,422	74,160	80,212	86,757	Cost ratio	41%	36%	48%	40%	39%
Intangibles	993	2,031	2,666	2,666	2,666	Macquarie Asset Management					
PP&E	11,426	4,701	5,553	5,721	5,894	Base fees	1,568	1,778	1,898	1,993	2,093
Insurance assets	0	0	0	0	0	Performance fees	595	765	926	729	765
Other assets	-2,343	17,754	23,612	23,612	23,612	Other revenue	399	784	806	824	824
Total assets	191,325	203,182	225,430	239,615	253,331	Total operating income	2,562	3,327	3,630	3,546	3,682
Divisional deposits & IBL	65,095	74,817	84,329	93,365	101,504	Operating expenses	-1,003	-1,453	-1,472	-1,476	-1,528
Other borrowings	106,321	109,665	119,450	123,653	128,239	Impairment expenses	0	0	0	0	0
Other liabilities	1,729	336	694	694	694	Net profit contribution b/4 OEI	1,559	1,874	2,158	2,071	2,154
Total liabilities	173,145	184,818	204,472	217,712	230,436	Cost ratio	39%	44%	41%	42%	42%
Ordinary share capital	6,234	6,174	7,714	7,714	7,714	Commodities and Global Markets					
Other equity instruments	9	7	7	7	7	Net trading income	1,960	2,940	2,938	2,938	2,938
Reserves	1,297	1,773	1,927	1,927	1,927	Other revenue	1,035	1,659	1,695	1,746	1,799
Retained profits	8,817	9,807	10,615	11,560	12,552	Total operating income	2,995	4,599	4,633	4,684	4,737
Minority interests	1,823	603	695	695	695	Operating expenses	-1,997	-2,689	-2,700	-2,846	-2,918
Total shareholders' equity	18,180	18,364	20,958	21,903	22,895	Impairment expenses	-88	-165	-61	-61	-61
Total sh. equity & liabs.	191,325	203,182	225,430	239,615	253,331	Net profit contribution b/4 OEI	910	1,745	1,873	1,777	1,758
WANOS - statutory (m)	322	324	326	326	326	Cost ratio	67%	58%	58%	61%	62%
WANOS - diluted (m)	351	351	360	360	360	Corporate & Asset Finance					
PROFITABILITY RATIOS											
Y/e March 31	2018	2019	2020e	2021e	2022e	Net interest income	289				
Return on assets	1.3%	1.5%	1.3%	1.3%	1.3%	Net operating lease income	932				
Return on equity	16.8%	17.9%	16.3%	16.1%	16.2%	Other revenue	515				
Leverage ratio	6.2%	5.2%	5.5%	5.6%	5.7%	Total operating income	1,736				
Net interest margin	1.52%	1.27%	1.13%	1.19%	1.19%	Operating expenses	-626				
Cost / income ratio	67%	67%	69%	68%	67%	Impairment expenses	34				
Cost / average assets	3.91%	4.35%	4.06%	3.95%	3.81%	Net profit contribution b/4 OEI	1,144				
Growth in operating income	3%	19%	-1%	4%	3%	Cost ratio	36%				
Growth in operating expenses	3%	19%	2%	3%	2%	Banking & Financial Services					
Jaws	0%	0%	-2%	1%	1%	Net interest income	1,584	1,678	1,708	1,879	2,029
Effective tax rate	25%	23%	23%	23%	23%	Base fees	0	0	0	0	0
ASSET QUALITY											
Y/e March 31	2018	2019	2020e	2021e	2022e	Commission income	517	492	445	463	481
impairment expense / GLA	0.21%	0.70%	0.33%	0.38%	0.36%	Other revenue	0	0	0	0	0
impairment expense / RWA	0.20%	0.64%	0.29%	0.34%	0.33%	Total operating income	2,101	2,170	2,153	2,342	2,511
Total provisions (\$m)	470	618	710	781	856	Operating expenses	-1,289	-1,347	-1,288	-1,336	-1,379
Total provisions / RWA	0.51%	0.80%	0.78%	0.80%	0.82%	Impairment expenses	-75	-67	-86	-94	-102
Indiv ass prov / gross imp assets	28%	172%	216%	216%	216%	Net profit contribution b/4 OEI	737	756	780	912	1,030
IBL / IEA	120%	132%	132%	129%	127%	Cost ratio	61%	62%	60%	57%	55%
Total provisions + GRCL / RWA	0.51%	0.80%	0.78%	0.80%	0.82%	MQG compensation ratio	39%	39%	42%	38%	38%
Net profit contribution b/4 OEI											
Annuitant-style businesses	3,440	2,630	2,938	2,983	3,184	Net trading income	1,960	2,940	2,938	2,938	2,938
Capital markets facing businesses	1,631	3,506	3,110	3,311	3,370	Other revenue	1,035	1,659	1,695	1,746	1,799
Combined net profit contribution	5,071	6,136	6,048	6,294	6,554	Total operating income	2,995	4,599	4,633	4,684	4,737

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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