FIIG | Factsheet

# Liberty Financial Pty Ltd

10 April 2024

**Sector:** Financials
**Sub-sector:** Banks
**Country:** Australia
**Ownership:** Public

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## Issuer Outline

Liberty Financial Group Pty Ltd (Liberty, Company, Group) pioneered specialty finance in 1997 as one of the first non-bank financial institutions (NBFI) in Australia. Liberty Financial Pty Ltd, the issuer of the notes, is the key operating entity for the Group. Liberty has total assets of approximately AUD15.7bn (as at 1H24) across its various products (home loans, car loans, personal and business loans).

The Company is listed on the ASX and had a market capitalisation of AUD1.19bn as of 9 April 2024.

Liberty has been able to develop a unique combination of capabilities to generate competitive advantage and durable financial performance, making the Group a successful niche lender, operating through three segments:

- Residential Finance (mortgages) in Australia and New Zealand.
- Secured Finance: providing motor vehicle, commercial and self-managed superannuation fund lending in Australia.
- Financial Services: include personal loans, insurance products, investment products and real estate services in New Zealand.

Please note, this factsheet refers to Liberty Financial, the non-bank lending entity. There are also RMBS investments issued by Liberty Funding which carry the Liberty name. These RMBS investments are from a related, but legally separate, entity.

## Key Financials (AUDm)

| LTM (30 Jun) | 2023 |
|---|---|
| Net interest income | 403.9 |
| Credit loss provisions | (61.9) |
| Underlying NPATA | 181.1 |
| Gross loans | 13,531.6 |
| NIM (%) | 2.8 |
| Loan loss reserves (%) | 0.6 |
| Credit losses (%) | 1.5 |

*Source: FIIG Securities, S&P Capital*

## Summary Bond Details

| ISIN | Issue Amount | Ranking | Coupon | Coupon Frequency | First Call[1] | Maturity Date |
|---|---|---|---|---|---|---|
| AU3FN0059200 | AUD 200m | Senior Unsecured | 3M BBSW + 2.45% | Quarterly | N/A | 17 Mar 2025 |
| AU3FN0060505 | AUD 200m | Senior Unsecured | 3M BBSW + 2.55% | Quarterly | N/A | 25 May 2026 |
| AU3FN0067914 | AUD 250m | Senior Unsecured | 3M BBSW + 3.10% | Quarterly | N/A | 5 Apr 2027 |
| AU3FN0076188 | AUD 175m | Senior Unsecured | 3M BBSW + 3.80% | Quarterly | N/A | 16 Mar 2028 |
| AU3FN0085338 | AUD 250m | Senior Unsecured | 3M BBSW + 3.75% | Quarterly | N/A | 8 Mar 2029 |

*[1] Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call.*

# Liberty Financial Pty Ltd

## Strengths

- Established and defendable business: Liberty was one of the first companies in Australia to design and offer loans to the underserviced non-prime mortgage market, where borrowers do not have an established credit history or have non-standard financial arrangements (so called non-conforming loans). Liberty benefits from a well-established position as primary underwriter of residential, auto, and commercial loans, with a high degree of industry knowledge and proficiency within its chosen markets. The Company has made a strategic decision to reduce its concentration to lower margin residential lending and enhance portfolio diversification, which will likely be a net positive for the business due to the highly competitive nature of the Australian residential mortgage lending space. Secured lending (motor finance and commercial finance) and financial services (and loans to SMSF and personal loans) contributed about 38.7% and 9.4% of loans originated in 1H24 respectively.
- Implementation of macro prudential limits on banks will benefit Liberty's loan growth: As the Australian Prudential Regulation Authority (APRA) tightens lending standards for banks, borrowers that no longer fall within the bank's risk framework will look for alternative lenders, including NBFIs such as Liberty. As of 31 December 2023, Liberty reported a total loan portfolio of AUD14.0bn (from AUD11.2bn in 2019); while it has experienced a slowdown in origination of its residential loan products, this slowdown was compensated by solid origination in the Company's secured asset lending.
- Sound asset quality: Liberty's asset quality metrics remain solid, despite a recent uptick due to the higher interest rate environment. The declined in level of loans in arrears in recent years is more likely a function of the growth in loans, rather than a step-change improvement in underlying performance. Nevertheless, current levels remain well-below historical averages. As of 31 December 2023, 30+day arrears were 3.1% (compared to 3.0% in 2H23and 2.2% in 1H23), and 90+day arrears were 1.5% (the same as in 2H23 and 1.0% in 1H23). Liberty's lending is somewhat lower risk compared to other nonbank peers, given that its asset portfolio remains mostly within the residential mortgage space (56.4% of its loan portfolio, although this has declined from around 69% at year-end 2021 by active choice from Liberty). Furthermore, Liberty's loan portfolio is well-diversified by geography, broadly mirroring the population distribution of Australia.
- Very strong capitalisation: Liberty, as a non-bank financial institution (NBFI), is not prudentially regulated, and as such, is not legally obligated to maintain a prescribed level of risk-adjusted capitalisation as regulated financial institutions are. Nevertheless, for Liberty capitalisation – measured by the level of capital held by the finance company – is a relative and absolute strength. Credit rating agency S&P Global Ratings' (S&P) assesses it as such in their credit rating methodology. Given the step-up in coupon rates across all senior unsecured debt if the credit rating falls below investment grade, Liberty is highly incentivised to maintain a strong level of capitalisation and is very likely to continue to do so. S&P requires Liberty to maintain a Risk Adjusted Capital Ratio (RAC) of more than 15% to avoid a ratings downgrade. As of 30 June 2023, Liberty has a RAC of 15.7%, and S&P forecasts Liberty's RAC ratio will remain around 16% over the next two years.
- Well-managed liquidity profile: Funding for Liberty occurs primarily through warehouse and securitisation. Reliance on unsecured term debt (short and long-term) remains modest, and as such, so does the refinancing (liquidity) risk. Liberty maintains a staggered maturity across its MTNs with maturities between FY25-FY29. Unutilised warehouse funding stands at around 50.7% (AUD3.8bn utilised on AUD7.5bn limit; Liberty's policy is to have no less than 40-50% available within its warehouses). According to S&P, Liberty's warehouse funding is provided by seven, highly rated bank counterparties with well-spaced maturities (largely unchanged in recent years).
- Notes benefit from a negative pledge: So long as the notes remain outstanding the Issuer will not create or permit to be outstanding any Security Interest (other than a Permitted Security Interest).

## Risks

- Strong growth may mask asset-quality underperformance: Liberty has been one of the primary beneficiaries of various restrictions placed on bank lending in recent years, with compound annual growth of approximately 20.0% over the last five years. As mortgages generally season over the medium-term (three to five years), strong growth can mask potential asset quality issues. In periods of strong growth, the influx of new loans overwhelms the small proportion of older loans going bad, making it hard for the true level of arrears to come to the fore (as growth in the denominator, total loans, outpaces growth in the numerator, impaired loans).

- Limited regulatory oversight as NBFI: Liberty is not regulated by APRA, the Australian prudential regulator who oversees banking, insurance, and superannuation with the aim of maintaining the integrity, safety, and soundness of financial institutions. The absence of strong regulatory oversight may imply that risk management frameworks may not be as rigorous as what would normally be required by regulated lenders. On the other hand, as a smaller issuer without a deposit base to rely on, Liberty can't afford to become complacent and must maintain a strong capital base to convince investors. It is worth noting Liberty's recent period of strong growth has been accompanied by consistently strong risk-adjusted capital ratios. The lack of regulation, and since it is not an authorised deposit taking institution (ADI), could potentially raise the risk that additional regulatory obligations will be imposed on both Liberty and the sector more broadly at some point in the future.
- Expansion into a lower-risk customer base could erode profitability: As Liberty continues to grow, it will continue to attract more "bank like" customers, which is deemed to be a natural progression for the lender. However, these borrowers typically offer a leaner margin. As funding costs rise, margin pressures are likely to affect Liberty's profitability (but the quality of the portfolio should improve). Additionally, its increasing focus on secured lending (motor finance and commercial finance) and financial services (and loans to SMSF and personal loans), which generally generate greater risk when compared to residential lending, may lead to worsening credit metrics such as nonperforming loans and bad debt expenses. On the other hand, these segments typically generate higher margins, which all else, being equal, will support earnings.
- Funding risk: As a non-bank lender, Liberty is highly reliant on wholesale funding as it is unable to take household deposits. During times of financial market stress, access to wholesale funding can prove challenging and expensive, making it susceptible to increased cost of funding which places pressure on margin benefits. Over the last few years, the Group has benefited from historically low interest rates and therefore, access to lower cost funding (which helped drive strong performance). Recently, Liberty faced some spread widening in wholesale markets which saw its cost of funds rise quite substantially (compared to ADIs, which rely in part on deposits and are able to pass on rate changes at a faster rate to existing borrowers compared to depositors, which creates a temporary tailwind). However, we note that as of 31 December 2022, Liberty had 50.7% in unused capacity across its warehouse facility.

# Liberty Financial Pty Ltd

### Financials

The financial summary below represents the consolidated operations of Liberty Financial Group Pty Ltd (AUDm, FYE 30 June).

| Income Statement | FY19 | FY20 | FY21 | FY22 | FY23 |
|---|---|---|---|---|---|
| Net interest income | (11.3) | 81.9 | 368.8 | 427.8 | 403.9 |
| Non-interest income | 0.0 | 0.0 | 211.2 | 205.0 | 225.5 |
| Total revenue | (11.3) | 81.9 | 580.0 | 632.9 | 629.4 |
| Provision for loan losses (credit losses) | (33.0) | (55.7) | (54.3) | (52.7) | (61.9) |
| Non-interest expenses | (21.6) | (11.1) | (334.7) | (384.1) | (423.0) |
| Net profit after tax | 56.3 | 71.7 | 185.4 | 219.3 | 181.1 |
| Balance Sheet | FY19 | FY20 | FY21 | FY22 | FY23 |
| Cash and investment securities | 679.9 | 396.9 | 499.2 | 546.9 | 1,219.9 |
| Gross loans | 11,254.1 | 11,712.1 | 12,280.8 | 12,904.7 | 13,531.6 |
| Total assets | 12,334.3 | 13,036.1 | 13,559.9 | 14,325.2 | 15,692.4 |
| Term debt | 9,865.8 | 9,158.4 | 9,589.2 | 8,871.2 | 9,803.7 |
| Warehouse facilities | 1,995.6 | 2,629.8 | 2,565.6 | 3,861.0 | 4,211.9 |
| Total liabilities | 12,095.7 | 12,012.5 | 12,529.8 | 13,209.1 | 14,522.1 |
| Total equity | 238.6 | 1,023.5 | 1,030.1 | 1,116.1 | 1,170.3 |
| Credit metrics | FY19 | FY20 | FY21 | FY22 | FY23 |
| Net interest margin | N/A | 2.65% | 3.08% | 3.08% | 2.76% |
| Bad debt expense (credit loss provisions) | 0.3% | 0.5% | 0.6% | 0.5% | 0.6% |
| Cost-to-income ratio | N/A | 24.7% | 22.8% | 22.7% | 26.6% |
| Nonperforming loans* | 1.0% | 2.0% | 2.0% | 1.2% | 1.5% |

*Source: S&P Capital, Company, FIIG Securities.*

**As measured by Stage 3 loans impaired and 90 days past due.*

# Liberty Financial Pty Ltd

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