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# Macquarie Group (MQG)

## X'mas in July

**Recommendation**
**Buy** (unchanged)

**Price**
**\$84.46**
**Target (12 months)**
**\$93.00** (previously \$90.00)

**Expected Return**

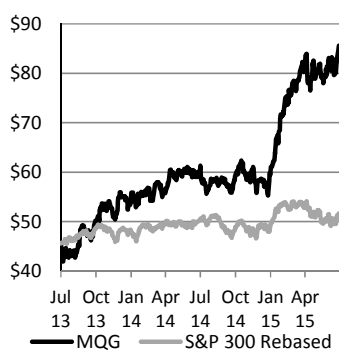
Capital growth	<b>10.1%</b>
Dividend yield	<b>4.4%</b>
Total expected return	<b>14.5%</b>

**Company Data & Ratios**

Enterprise value	<b>n/m</b>
Market cap	<b>\$28,169m</b>
Issued capital	<b>334m</b>
Free float	<b>100%</b>
Avg. daily val. (52wk)	<b>\$84.6m</b>
12 month price range	<b>\$54.65 - \$86.19</b>
GICS sector	<b>Banks</b>

**Price Performance**

	(1m)	(3m)	(12m)
Price (A\$)	79.60	82.24	59.72
Absolute (%)	6.11	2.70	41.43
Rel market (%)	4.52	8.22	39.83

**Absolute Price**


SOURCE: IRESS

**Profit guidance upgrade**

MQG held its AGM today and provided a positive 1Q16 trading update. Net contributions from the annuity-style and capital markets facing businesses were significantly up on a PCP basis and broadly in line with 4Q15. The annuity-style businesses (Macquarie Asset Management, Corporate and Asset Finance and Banking and Financial Services) benefited from strong underlying business growth, a weaker A\$, higher performance fees and some asset disposals (although there were no significant one-off items in 1Q16). The capital markets facing businesses (Macquarie Securities, Macquarie Capital and Commodities and Financial Markets) also benefited from a weaker A\$ as well as ongoing improvement in trading conditions across most of the business.

MQG has therefore upgraded its short term outlook. All else being equal and subject to the usual caveats, MQG now expects the combined net profit contribution in 2016 from operating groups to be up on 2015 (previously broadly in line) and the Group result in 2016 to be up on \$1,604m in 2015 (previously slightly up). The medium term outlook remains positive, underpinned by strong capital and debt funding positions, proven risk management, further cost initiatives and the ability to adapt the business mix to changing market conditions. The above also suggests a sustainable ROE that is comfortably headed towards 15-16% and one in our view that would be on par with the best of the major banks – in which case a \$100.00 share price based on >2 times book value would likely be achievable in the medium term.

**Price target upgraded to \$93.00, Buy rating maintained**

We have increased our earnings estimates by around 5% across the forecast horizon. This is largely due to 5-6% upgrades to net trading income, 13-14% higher performance fees in 2016 and 2017 and 8% higher performance fees in 2018. Given higher prospective earnings including improved performances within Macquarie Capital and Commodities and Financial Markets, the price target is upgraded to \$93.00 (previously \$90.00). MQG's Buy rating is maintained.

**Earnings Forecast**

Year end 31 March	2015	2016e	2017e	2018e
NPAT (reported) (A\$m)	1,604	1,780	1,962	2,135
NPAT (for diluted EPS) (A\$m)	1,609	1,785	1,967	2,140
EPS (reported) (Acps)	502	550	600	646
EPS growth (%)	31%	9%	9%	8%
PER (x)	16.8	15.4	14.1	13.1
P/Book (x)	2.0	1.8	1.7	1.6
P/NTA (x)	2.1	2.0	1.8	1.7
Dividend (Acps)	330	360	396	434
Yield (%)	3.9%	4.3%	4.7%	5.1%
ROE (%)	14.0%	13.3%	13.7%	14.0%
Compensation ratio (%)	41%	42%	42%	41%
Franking (%)	40.0%	40.0%	40.0%	40.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# X'mas in July

## Profit guidance upgrade

MQG held its AGM today and provided a positive 1Q16 trading update. Net contributions from the annuity-style and capital markets facing businesses were significantly up on a PCP basis and broadly in line with 4Q15. The annuity-style businesses (Macquarie Asset Management, Corporate and Asset Finance and Banking and Financial Services) benefited from strong underlying business growth, a weaker A\$, higher performance fees and some asset disposals (although there were no significant one-off items in 1Q16). The capital markets facing businesses (Macquarie Securities, Macquarie Capital and Commodities and Financial Markets) also benefited from a weaker A\$ as well as ongoing improvement in trading conditions across most of the business.

Given the strong performance across the board, MQG has upgraded its short term outlook (Figure 1). All else being equal and subject to the usual caveats, MQG now expects the combined net profit contribution in 2016 from operating groups to be up on 2015 (previously broadly in line) and the Group result in 2016 to be up on \$1,604m in 2015 (previously slightly up). The medium term outlook remains positive, underpinned by strong capital and debt funding positions, proven risk management, further cost initiatives and the ability to adapt the business mix to changing market conditions.

**Figure 1 – Outlook conservative in our view in light of annuity-style business momentum**

### Short term outlook

- Summarised below are the outlook statements for each Operating Group
- FY16 results will vary with market conditions, particularly the capital markets facing businesses

Operating Group	Net profit contribution				Update to FY16 outlook
	FY08–FY15 historical range	FY08–FY15 average	FY15	FY16 outlook as announced at FY15 result	
Macquarie Asset Management	\$A0.3b – \$A1.4b	\$A0.8b	\$A1.4b	Broadly in line with FY15	Up on FY15
Corporate and Asset Finance	\$A0.1b – \$A1.1b <sup>1</sup>	\$A0.5b	\$A1.1b	Broadly in line with FY15	No change
Banking and Financial Services	\$A0.1b – \$A0.3b <sup>2,3</sup>	\$A0.2b <sup>3</sup>	\$A0.3b	Up on FY15	No change
Macquarie Securities Group	\$A(0.2)b – \$A1.2b	\$A0.3b	\$A0.1b	Up on FY15	No change
Macquarie Capital	\$A(0.1)b – \$A1.2b	\$A0.3b	\$A0.4b	Up on FY15	No change
Commodities and Financial Markets	\$A0.5b – \$A0.8b	\$A0.7b	\$A0.8b	Broadly in line with FY15	No change
Corporate	<ul style="list-style-type: none"> <li>Compensation ratio to be consistent with historical levels</li> <li>Based on present mix of income, currently expect FY16 tax rate to be broadly in line with 2H15 and down on FY15</li> </ul>				No change

<sup>1</sup> Range excludes FY09 provisions for loan losses of \$A135m related to Real Estate Structured Finance loans as this is a restructured business

<sup>2</sup> Range excludes FY09 loss on sale of Italian mortgages of \$A246m as this is a discontinued business

<sup>3</sup> During FY14, Group Treasury revised internal funding transfer pricing arrangements relating to BFS's deposit and lending activities. FY13 comparatives only have been restated to reflect the current methodology.

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SOURCE: COMPANY DATA

**Table 1 – Annuity-style net profit contributions should remain in the high 60's**

Net profit contribution (\$m)	2014		2015		Growth	2016e	2016 guidance as announced 23 July 2015
<b>Annuity-style businesses</b>							
Macquarie Asset Management	1,051	32%	1,450	35%	38%	1,470	Up on FY15 (previously broadly in line with FY15)
Corporate & Asset Finance	826	26%	1,112	27%	35%	1,057	Broadly in line with FY15 (no change)
Banking & Financial Services	260	8%	285	7%	10%	288	Up on FY15 (no change)
Sub-total	2,137	66%	2,847	68%	33%	2,815	
<b>Capital markets facing businesses</b>							
Macquarie Capital	269	8%	425	10%	58%	464	Up on FY15 (no change)
Macquarie Securities	107	3%	64	2%	-40%	106	Up on FY15 (no change)
Commodities and Financial Markets	726	22%	835	20%	15%	878	Broadly in line with FY15 (no change)
Sub-total	1,102	34%	1,324	32%	20%	1,448	
<b>Total net profit contribution</b>	<b>3,239</b>	<b>100%</b>	<b>4,171</b>	<b>100%</b>	<b>29%</b>	<b>4,263</b>	Up on FY15 (previously broadly in line with FY15)
<b>Reported net profit (Group)</b>	<b>1,265</b>		<b>1,604</b>		<b>27%</b>	<b>1,780</b>	Up on FY15 (previously slightly up on FY15)
Compensation ratio	45%		41%			42%	Consistent with historical levels (no change)
Effective tax rate	39%		36%			33%	FY16 broadly in line with 2H15, down on FY15 (no change)

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

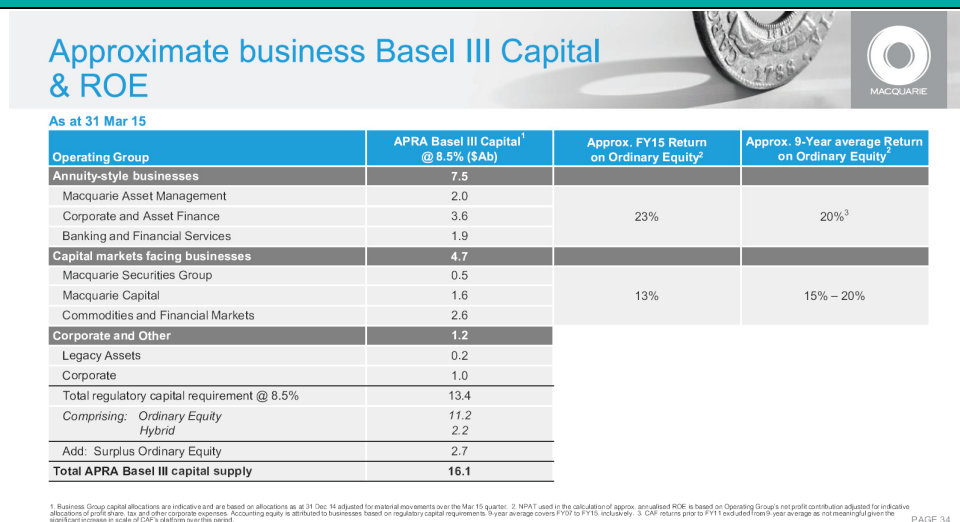
## Heading towards 15-16% sustainable ROE

Summary 1Q16 business segment observations are as follows:

- Macquarie Asset Management** – AUM of \$477bn was unchanged on a PCP basis with positive net flows in Macquarie Investment Management offset by adverse translation effect and net divestments from Macquarie Infrastructure and Real Assets (offsetting six acquisitions and three follow-on investments in five countries). 1Q16 performance fees were \$208m, largely from Macquarie Infrastructure Company and Macquarie Atlas Roads.
- Corporate and Asset Finance** – The asset portfolio increased by 1.7% over the quarter to \$29bn with additions coming from corporate and real estate lending.
- Banking and Financial Services** – On a QOQ basis, retail deposits were up 2% to \$38bn, Australian mortgages were up 10% to \$27bn and business lending was up 10% to \$5.7bn. FUA from the Wrap platform was unchanged at \$47bn. The enforceable undertaking was completed and compensation to date from MQG- and client-initiated reviews totalled \$11m.
- Macquarie Securities** – Benefited from higher volumes and market volatility especially in Asia, and higher ECM volumes in Australia and New Zealand.
- Macquarie Capital** – Benefited from higher global M&A volumes and ECM activity (119 deals valued at \$82bn, significantly higher on a PCP and QOQ bases largely due to timing).
- Commodities and Financial Markets** – Ongoing volatility in energy markets and agriculture contributed to higher transaction volumes while metals and FX/interest rate activities were stable.

Strong earnings momentum experienced in 3Q15 and 4Q15 has been maintained with what we consider to be better fee, commission and trading income again more than offsetting higher expansion-related operating expenses. The higher ROE annuity-style businesses should continue to generate close to 70% of total net profit contribution (i.e. before Corporate allocations). The overall improved performance suggests a sustainable ROE that is comfortably headed towards 15-16% (assuming a 20% sustainable ROE for annuity-style businesses and 17.5% sustainable ROE for capital markets facing businesses, Figure 2) and one in our view that would be on par with the best of the major banks.

Figure 2 – Annuity-style ROE up from 20% in 2014 to 23%



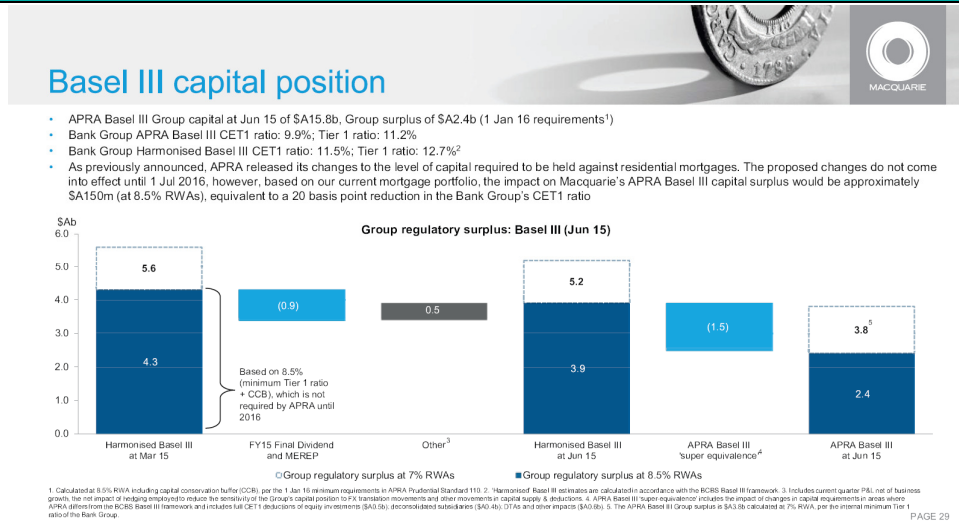
MQG's successful transformation/de-risking to date combined with its continued ascendancy up the capital efficiency ladder should then lead to further share price re-rating – likely trading in excess of two times book value and \$100.00 per share in the medium term.

### Capital meter pegged

Macquarie Bank's APRA Basel III CET1 capital ratio increased by 20bp over the quarter to 9.9%. APRA's recent announcement to increase the average mortgage risk weight to 25% will not have a material impact on this – mainly \$150m (at 8.5% RWA) and only knocking off 20bp from the 9.9% CET1 capital ratio. We note this will only come into effect on 1 July 2016 and the bank should have more than sufficient time to generate organic capital to offset the reduction. In any case, Macquarie Bank's CET1 capital ratio after this deduction of 9.7% still places it substantially ahead of its major bank peers.

Group surplus capital assuming 8.5% RWA is estimated by MQG at \$2.4bn – on a 10% RWA, we estimate surplus capital still in excess of \$1bn (suggesting plenty of gas still left in the tank).

**Figure 3 – CET1 capital ratio approaching 10%**



SOURCE: COMPANY DATA

### Price target upgraded to \$93.00, Buy rating maintained

We have increased our earnings estimates by around 5% across the forecast horizon (Table 2, next page). This is largely due to 5-6% upgrades to net trading income, 13-14% higher performance fees in 2016 and 2017 and 8% higher performance fees in 2018. Given higher prospective earnings including improved performances within Macquarie Capital and Commodities and Financial Markets, the price target is upgraded to \$93.00 (Tables 3 and 4 on the next page, previously \$90.00). MQG's Buy rating is maintained.

Table 2 – Estimate changes

Macquarie Group Y/e March 31 (\$m)	2016e			2017e			2018e			2019e		
	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change
Net interest income	2,268	2,233	2%	2,400	2,364	2%	2,518	2,480	2%	2,658	2,617	2%
Net trading income	1,702	1,657	3%	1,677	1,591	5%	1,698	1,600	6%	1,712	1,609	6%
Fee & commission income												
- Base fees	1,519	1,519	0%	1,575	1,575	0%	1,642	1,642	0%	1,710	1,710	0%
- Performance fees	624	549	14%	485	431	13%	378	349	8%	314	314	0%
- M&A, advisory & u/w fees	863	863	0%	932	932	0%	1,007	1,007	0%	1,088	1,088	0%
- Brokerage & commissions	830	830	0%	849	849	0%	868	868	0%	888	888	0%
- Other fee and commission income	555	551	1%	580	575	1%	602	597	1%	626	620	1%
- Income from life business, etc.	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
- Other revenue	1,742	1,731	1%	1,895	1,871	1%	1,973	1,948	1%	2,056	2,029	1%
<b>Total operating income</b>	<b>10,103</b>	<b>9,933</b>	<b>2%</b>	<b>10,394</b>	<b>10,188</b>	<b>2%</b>	<b>10,688</b>	<b>10,491</b>	<b>2%</b>	<b>11,052</b>	<b>10,875</b>	<b>2%</b>
Operating expenses	-6,921	-6,890	0%	-7,032	-7,001	0%	-7,153	-7,127	0%	-7,292	-7,275	0%
Impairment expenses	-487	-481	-1%	-395	-386	-2%	-309	-302	-2%	-285	-279	-2%
<b>Operating profit before tax</b>	<b>2,695</b>	<b>2,562</b>	<b>5%</b>	<b>2,966</b>	<b>2,801</b>	<b>6%</b>	<b>3,226</b>	<b>3,061</b>	<b>5%</b>	<b>3,476</b>	<b>3,321</b>	<b>5%</b>
Corporate tax expense	-898	-854	-5%	-989	-934	-6%	-1,075	-1,020	-5%	-1,159	-1,107	-4%
Minority interests	-16	-16	n/m	-16	-16	n/m	-16	-16	n/m	-16	-16	n/m
<b>NPAT (reported)</b>	<b>1,780</b>	<b>1,692</b>	<b>5%</b>	<b>1,962</b>	<b>1,851</b>	<b>6%</b>	<b>2,135</b>	<b>2,025</b>	<b>5%</b>	<b>2,301</b>	<b>2,198</b>	<b>5%</b>
EPS (reported) (cps)	550	522	5%	600	567	6%	646	616	5%	688	664	4%
Net DPS (cps)	360	354	2%	396	392	1%	434	432	0%	470	472	0%
Return on equity	13.3%	12.8%	0.6%	13.7%	13.2%	0.6%	14.0%	13.6%	0.4%	14.1%	14.0%	0.1%
MQG compensation ratio	42.2%	42.7%	-0.5%	41.6%	42.2%	-0.5%	41.1%	41.6%	-0.5%	40.4%	40.8%	-0.4%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 3 – MQG SOP valuation

Sum-of-Parts (As Is)	2017e NPAT	Pros. PE (times)	Value (\$m)	Per share
Macquarie Securities	87	8.0	699	\$2.10
Macquarie Capital	344	9.0	3,098	\$9.29
Macquarie Asset Management	948	13.5	12,796	\$38.37
Commodities and Financial Markets	613	9.0	5,514	\$16.53
Corporate & Asset Finance	807	12.5	10,093	\$30.26
Banking & Financial Services	223	12.5	2,793	\$8.37
Real Estate Banking	0	0.0	0	\$0.00
Corporate & Other	-1,061	6.5	-6,899	-\$20.68
<b>Total</b>	<b>1,962</b>	<b>14.3</b>	<b>28,094</b>	<b>\$84.23</b>

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 4 – MQG composite valuation

Composite Valuation	Value (\$m)	Per share	Weighting	Composite value per share
DCF	28,227	\$84.63	33%	\$28.21
Dividend yield play (short term)	-	-	-	-
ROE (sustainable)	32,976	\$98.87	33%	\$32.96
Sum-of-Parts	28,094	\$84.23	33%	\$28.08
Average				\$89.25
Surplus capital (@ 10.0% RWA less \$150m for higher mortgage RWA)				\$3.75
<b>Total</b>				<b>\$92.99</b>

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

# MQG profile

## Company description

Macquarie Group (MQG) is a global provider of retail and wholesale banking, financial, advisory, investment and funds management services. Founded in 1969, MQG operates across 58 overseas locations supported by 14,085 FTE (of which 54% are international staff). The Group has established alliances with 32 companies in 14 countries specialising in infrastructure investment, wealth management and FX services. 70% of income is sourced overseas.

## Investment strategy

MQG is currently sitting on sufficient capital/liquidity buffers and funding lines to sustain its unique business model but faces severe revenue headwinds in its core securities and advisory businesses. We see good leverage to North American, Europe and Asia in the long run.

## SWOT analysis

### Strengths

1. Australia's independent global investment bank with diverse management and entrepreneurial capabilities; and
2. Leveraged to the fast growing wealth management segment including earnings diversity by segment and geography (increasing Asian footprint plus leverage to improving US economy).

### Weaknesses

1. Ongoing loss in market share in the core securities and advisory businesses;
2. Succession planning and staff retention;
3. Lacks balance sheet for DCM and lending initiatives; and
4. Misunderstood by investors given past legacy issues involving investments and excessive compensation ratios.

### Opportunities

1. Strategic appeal – complements majors (e.g. ANZ) and offshore peers including private equity interests in non-traditional banking markets;
2. Well placed to capitalise on upturn in global advisory services, etc.; and
3. Further growth opportunities in Asia, North America and Europe.

### Threats

1. Increased competition from the majors;
2. Regulatory risk re: remuneration;
3. Storm contingent liabilities; and
4. Soft (staffing) issues (e.g. susceptible to poaching, etc.).

Table 5 – Financial summary

Macquarie Group						Share Price (A\$)					84.46
As at						Market Cap (A\$M)					28,169
23-Jul-15											
<b>PROFIT AND LOSS</b>											
<b>Y/e March 31 (\$m)</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	<b>Y/e March 31</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>
Net interest income	1,705	2,092	2,268	2,400	2,518	NPAT (reported) (\$m)	1,265	1,604	1,780	1,962	2,135
Net trading income	1,570	1,727	1,702	1,677	1,698	EPS (reported) (cps)	384	502	550	600	646
Fee & commission income						- Growth	53%	31%	9%	9%	8%
- Base fees	1,286	1,384	1,519	1,575	1,642	EPS (reported, diluted) (cps)	370	484	529	575	617
- Performance fees	217	667	624	485	378	- Growth	50%	31%	9%	9%	7%
- M&A, advisory & u/w fees	667	797	863	932	1,007	P / E ratio (times)	22.0	16.8	15.4	14.1	13.1
- Brokerage & commissions	874	823	830	849	868	P / Book ratio (times)	2.4	2.0	1.8	1.7	1.6
- Other fee and commission income	548	559	555	580	602	P / NTA ratio (times)	2.6	2.1	2.0	1.8	1.7
- Income from life business, etc.	0	0	0	0	0	Net DPS (cps)	260	330	360	396	434
- Other revenue	1,475	1,974	1,742	1,895	1,973	Yield	3.1%	3.9%	4.3%	4.7%	5.1%
<b>Total operating income</b>	<b>8,342</b>	<b>10,023</b>	<b>10,103</b>	<b>10,394</b>	<b>10,688</b>	Franking	40%	40%	40%	40%	40%
Operating expenses	-6,026	-6,771	-6,921	-7,032	-7,153	Payout (statutory basis)	68%	66%	65%	66%	67%
Impairment expenses	-210	-730	-487	-395	-309						
<b>Operating profit before tax</b>	<b>2,106</b>	<b>2,522</b>	<b>2,695</b>	<b>2,966</b>	<b>3,226</b>	<b>CAPITAL ADEQUACY</b>					
Corporate tax expense	-827	-899	-898	-989	-1,075	<b>Y/e March 31</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>
Minority interests	-14	-19	-16	-16	-16	Risk weighted assets (\$m)	65,698	86,459	95,473	102,317	109,367
<b>NPAT (reported)</b>	<b>1,265</b>	<b>1,604</b>	<b>1,780</b>	<b>1,962</b>	<b>2,135</b>	Average risk weight	49%	54%	54%	54%	54%
Adjustment	14	5	5	5	5	<b>Tier 1 ratio</b>	<b>10.6%</b>	<b>11.0%</b>	<b>11.0%</b>	<b>11.3%</b>	<b>11.6%</b>
<b>NPAT (basic/diluted EPS 2012+)</b>	<b>1,279</b>	<b>1,609</b>	<b>1,785</b>	<b>1,967</b>	<b>2,140</b>	<b>Core Tier 1 ratio</b>	<b>9.6%</b>	<b>9.7%</b>	<b>9.9%</b>	<b>10.3%</b>	<b>10.6%</b>
<b>CASHFLOW</b>											
<b>Y/e March 31 (\$m)</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	Equity ratio	7.7%	7.7%	7.5%	7.6%	7.7%
NPAT (cash basis)	1,265	1,604	1,780	1,962	2,135	<b>DIVISIONAL</b>					
						<b>Y/e March 31 (\$m)</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>
Increase in loans	-6,886	-10,484	-10,189	-5,703	-5,537	<b>Macquarie Securities</b>					
Increase in other assets	4,776	-13,629	-6,125	-6,625	-7,166	Net trading income	234	289	318	343	364
Capital expenditure	-668	-768	-214	-220	-227	Brokerage & commissions	547	542	553	564	575
<b>Investing cashflow</b>	<b>-2,778</b>	<b>-24,881</b>	<b>-16,528</b>	<b>-12,548</b>	<b>-12,930</b>	Other revenue	84	87	102	109	116
						<b>Total operating income</b>	<b>865</b>	<b>918</b>	<b>973</b>	<b>1,016</b>	<b>1,055</b>
Increase in deposits & borrowings	3,636	6,467	3,666	3,816	4,093	Operating expenses	-758	-854	-868	-885	-902
Increase in other liabilities	5,561	25,123	11,846	7,657	7,726	<b>Net profit contribution</b>	<b>107</b>	<b>64</b>	<b>106</b>	<b>131</b>	<b>153</b>
Equity raised	-795	835	390	396	403	Cost ratio	88%	93%	89%	87%	85%
Other	-511	100	-1,154	-1,282	-1,428	<b>Macquarie Capital</b>					
<b>Financing cashflow</b>	<b>7,991</b>	<b>32,525</b>	<b>14,748</b>	<b>10,587</b>	<b>10,795</b>	M&A, advisory & u/w fees	667	797	863	932	1,007
						Other revenue	180	286	310	328	342
Net change in cash	6,378	9,248	0	0	0	<b>Total operating income</b>	<b>847</b>	<b>1,083</b>	<b>1,174</b>	<b>1,261</b>	<b>1,349</b>
<b>Cash at end of period</b>	<b>19,457</b>	<b>28,705</b>	<b>28,705</b>	<b>28,705</b>	<b>28,705</b>	Operating expenses	-548	-629	-650	-683	-718
						Impairment expenses	-30	-29	-60	-61	-62
<b>BALANCE SHEET</b>											
<b>Y/e March 31 (\$m)</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	<b>Net profit contribution</b>	<b>269</b>	<b>425</b>	<b>464</b>	<b>516</b>	<b>569</b>
Cash and liquid assets	19,457	28,705	28,705	28,705	28,705	Cost ratio	65%	58%	55%	54%	53%
Divisional gross loans	50,799	61,666	71,920	77,673	83,258	<b>Macquarie Asset Management</b>					
Provisions	-667	-1,049	-1,114	-1,165	-1,212	Base fees	1,262	1,372	1,507	1,563	1,630
Other IEA	64,990	75,064	81,189	87,814	94,980	Performance fees	217	667	624	485	378
Intangibles	1,221	1,164	1,164	1,164	1,164	Other revenue	445	408	405	413	421
PP&E	6,311	7,079	7,293	7,513	7,740	<b>Total operating income</b>	<b>1,924</b>	<b>2,447</b>	<b>2,536</b>	<b>2,461</b>	<b>2,429</b>
Insurance assets	0	0	0	0	0	Operating expenses	-877	-997	-1,066	-1,039	-1,025
Other assets	11,793	15,347	15,347	15,347	15,347	Impairment expenses	4	0	0	0	0
<b>Total assets</b>	<b>153,904</b>	<b>187,976</b>	<b>204,504</b>	<b>217,052</b>	<b>229,982</b>	<b>Net profit contribution</b>	<b>1,051</b>	<b>1,450</b>	<b>1,470</b>	<b>1,422</b>	<b>1,405</b>
						Cost ratio	46%	41%	42%	42%	42%
Divisional deposits & IBL	42,552	49,019	52,685	56,501	60,594	<b>Commodities and Financial Markets</b>					
Other borrowings	95,326	121,126	132,972	140,629	148,356	Net trading income	1,580	1,693	1,700	1,650	1,650
Other liabilities	4,112	3,435	3,435	3,435	3,435	Other revenue	286	472	486	501	516
<b>Total liabilities</b>	<b>141,990</b>	<b>173,580</b>	<b>189,092</b>	<b>200,565</b>	<b>212,384</b>	<b>Total operating income</b>	<b>1,866</b>	<b>2,165</b>	<b>2,186</b>	<b>2,151</b>	<b>2,166</b>
						Operating expenses	-956	-996	-968	-1,001	-1,041
Ordinary share capital	5,085	5,930	6,320	6,716	7,119	Impairment expenses	-184	-334	-340	-231	-132
Other equity instruments	27	17	17	17	17	<b>Net profit contribution</b>	<b>726</b>	<b>835</b>	<b>878</b>	<b>919</b>	<b>993</b>
Reserves	669	1,656	1,656	1,656	1,656	Cost ratio	51%	46%	44%	47%	48%
Retained profits	5,637	6,306	6,933	6,712	8,319	<b>Corporate &amp; Asset Finance</b>					
Minority interests	496	487	487	487	487	Net interest income	663	737	852	920	969
<b>Total shareholders' equity</b>	<b>11,914</b>	<b>14,396</b>	<b>15,412</b>	<b>16,488</b>	<b>17,598</b>	Net operating lease income	520	561	671	788	835
						Other revenue	93	430	41	47	49
<b>Total sh. equity &amp; liabs.</b>	<b>153,904</b>	<b>187,976</b>	<b>204,504</b>	<b>217,052</b>	<b>229,982</b>	<b>Total operating income</b>	<b>1,276</b>	<b>1,728</b>	<b>1,565</b>	<b>1,755</b>	<b>1,853</b>
<b>WANOS - statutory (m)</b>	<b>306</b>	<b>298</b>	<b>304</b>	<b>309</b>	<b>314</b>	Operating expenses	-381	-482	-455	-482	-499
<b>WANOS - diluted (m)</b>	<b>346</b>	<b>332</b>	<b>337</b>	<b>342</b>	<b>347</b>	Impairment expenses	-69	-134	-52	-62	-65
						<b>Net profit contribution</b>	<b>826</b>	<b>1,112</b>	<b>1,057</b>	<b>1,211</b>	<b>1,289</b>
<b>PROFITABILITY RATIOS</b>											
<b>Y/e March 31</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	Cost ratio	30%	28%	29%	27%	27%
Return on assets	0.8%	0.9%	0.9%	0.9%	1.0%	<b>Banking &amp; Financial Services</b>					
<b>Return on equity</b>	<b>11.0%</b>	<b>14.0%</b>	<b>13.3%</b>	<b>13.7%</b>	<b>14.0%</b>	Net interest income	738	825	803	868	937
Leverage ratio	4.6%	5.1%	5.2%	5.4%	5.6%	Base fees	24	12	12	12	12
<b>Net interest margin</b>	<b>1.55%</b>	<b>1.70%</b>	<b>1.61%</b>	<b>1.54%</b>	<b>1.50%</b>	Commission income	605	538	516	532	548
Cost / income ratio	72%	68%	69%	68%	67%	Other revenue	0	0	0	0	0
Cost / average assets	3.91%	3.87%	3.51%	3.32%	3.19%	<b>Total operating income</b>	<b>1,367</b>	<b>1,375</b>	<b>1,332</b>	<b>1,412</b>	<b>1,497</b>
Growth in operating income	16%	20%	1%	3%	3%	Operating expenses	-1,060	-1,060	-1,009	-1,035	-1,063
Growth in operating expenses	14%	12%	2%	2%	2%	Impairment expenses	-47	-30	-35	-42	-49
<b>Jaws</b>	<b>2%</b>	<b>8%</b>	<b>-1%</b>	<b>1%</b>	<b>1%</b>	<b>Net profit contribution</b>	<b>260</b>	<b>285</b>	<b>288</b>	<b>335</b>	<b>386</b>
Effective tax rate	39%	36%	33%	33%	33%	Cost ratio	78%	77%	76%	73%	71%
<b>ASSET QUALITY</b>											
<b>Y/e March 31</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>	MQG compensation ratio	45%	41%	42%	42%	41%
impairment expense / GLA	0.41%	1.18%	0.68%	0.51%	0.37%						
impairment expense / RWA	0.32%	0.84%	0.51%	0.39%	0.28%						
<b>Total provisions (\$m)</b>	<b>667</b>	<b>1,049</b>	<b>1,114</b>	<b>1,165</b>	<b>1,212</b>						
Total provisions / RWA	1.02%	1.21%	1.17%	1.14%	1.11%						
Indiv ass prov / gross imp assets	42%	46%	46%	46%	46%						
IBL / IEA	120%	125%	122%	120%	118%						
<b>Total provisions + GRCL / RWA</b>	<b>1.02%</b>	<b>1.21%</b>	<b>1.17%</b>	<b>1.14%</b>	<b>1.11%</b>						

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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