

Analyst

TS Lim 612 8224 2810

Authorisation

Chris Savage 612 8224 2835

Macquarie Group (MQG)

Youth of eternal summers

Recommendation
Buy (unchanged)

Price
\$113.24
Target (12 months)
\$135.00 (unchanged)

GICS Sector
Banks
Expected Return

Capital growth **19.2%**

Dividend yield **3.3%**

Total expected return **22.5%**
Company Data & Ratios

Enterprise value **n/m**

Market cap **\$40,699m**

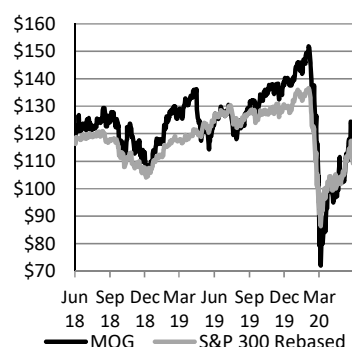
Issued capital **359m**

Free float **100%**

Avg. daily val. (52wk) **\$152.3m**

12 month price range **\$70.45 -**
\$152.35
Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	106.39	120.90	121.00
Absolute (%)	6.44	-6.34	-6.41
Rel market (%)	0.87	-6.45	5.96

Absolute Price


SOURCE: IRESS

Transcending realms

MQG's competitive advantage lies in managing risk and taking transformational or "rebirth" opportunities every few years to maximise and sustain shareholder value creation. In this note, we unpack in a series of charts some top line characteristics across the annuity-style and markets-facing activities. A recent development is the part reclassification (~28%) of Commodities and Global Markets (CGM) as an annuity-style activity. This does not come as a huge surprise given the consistent nature of some of its top line components that also generate higher returns on ordinary equity. While annuity-style net profit contribution to the Group is now ~63%, net operating income contribution is estimated at ~59% and with both measures indicating higher operational and capital efficiencies.

The transformation strategy is ongoing but the relevant charts suggest ~60% will be optimal for annuity-style activities (Macquarie Asset Management, Banking and Financial Services and perhaps up to a third of CGM). We believe this 60:40 mix will also facilitate adaptability to changing operating conditions and reallocation of capital and other resources to opportunities with higher incremental returns. The relevance of this mix is underpinned by: (1) strong correlation between base/performance fees and AUM/EUM growth, noting \$25bn equity is yet to be deployed into infrastructure and other assets; (2) net interest and associated fee income upside reflecting lending and deposit growth ahead of system; (3) post-pandemic M&A and capital markets activities benefiting Macquarie Capital; and (4) an expected boost in trading and risk sales income given greater risk mitigation requirements following COVID-19.

\$135.00 price target and Buy rating unchanged

Our profit forecasts, \$135.00 price target and Buy rating are unchanged. MQG remains: (1) a longer term "Cash and Growth" story; (2) the only game in town when it comes to inevitable post-pandemic economic recovery; and (3) the number one pick in our coverage universe.

Earnings Forecast

Year end 31 March	2020	2021e	2022e	2023e
NPAT (statutory) (A\$m)	2,731	2,420	2,797	3,069
NPAT (for diluted EPS) (A\$m)	2,833	2,518	2,895	3,167
EPS (reported) (A¢)	791	684	795	874
EPS (reported) growth (%)	-10%	-14%	16%	10%
PER (x)	14.3	16.6	14.3	12.9
P/Book (x)	1.9	1.8	1.7	1.6
P/NTA (x)	2.2	2.1	1.9	1.8
Dividend (A¢)	430	375	480	570
Yield (%)	3.8%	3.3%	4.2%	5.0%
ROE (%)	14.5%	11.4%	12.4%	12.9%
Compensation ratio (%)	41%	40%	40%	39%
Franking (%)	40.0%	40.0%	40.0%	40.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

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Transcending realms

MQG's competitive advantage lies in managing risk and taking transformational "rebirth" opportunities every few years to maximise and sustain shareholder value creation. In this note, we unpack in a series of charts some top line characteristics across its annuity-style and markets-facing activities. A recent development is the part reclassification (~28%) of Commodities and Global Markets (CGM) as an annuity-style activity. This does not come as a huge surprise given the consistent nature of some of its top line components that also generate higher returns on ordinary equity¹. While annuity-style net profit contribution to the Group is now ~63%, net operating income contribution is estimated at ~59% and with both measures indicating higher operational and capital efficiencies.

Figure 1 – MQG's share price premium justified by earnings consistency...

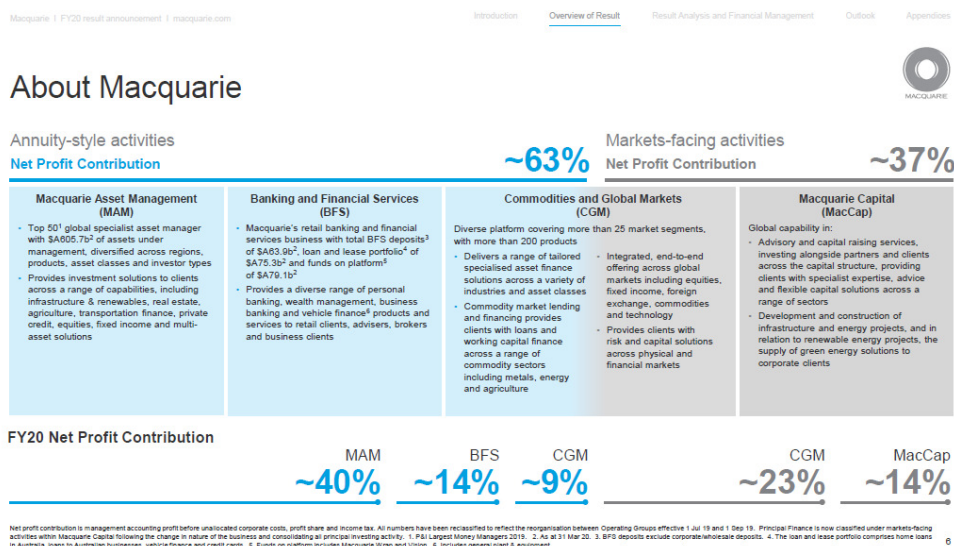
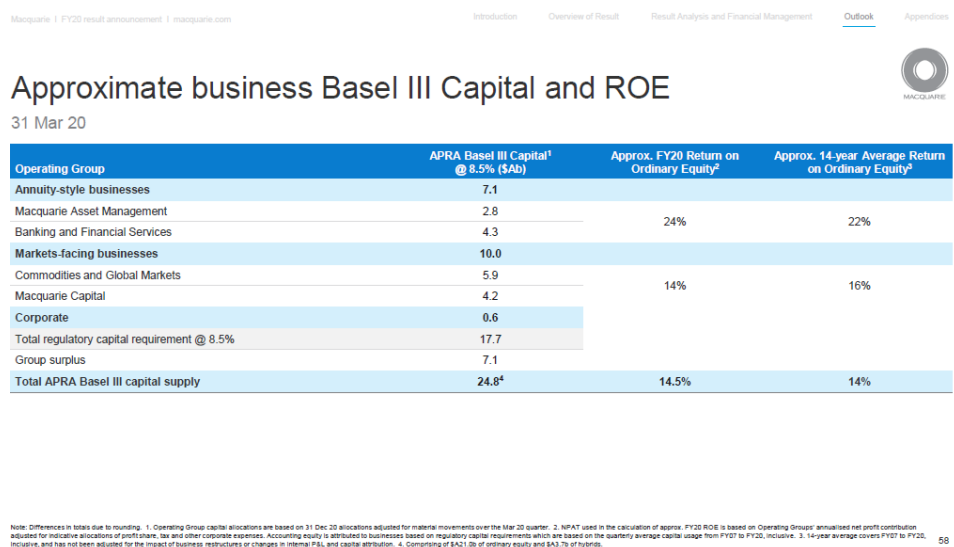


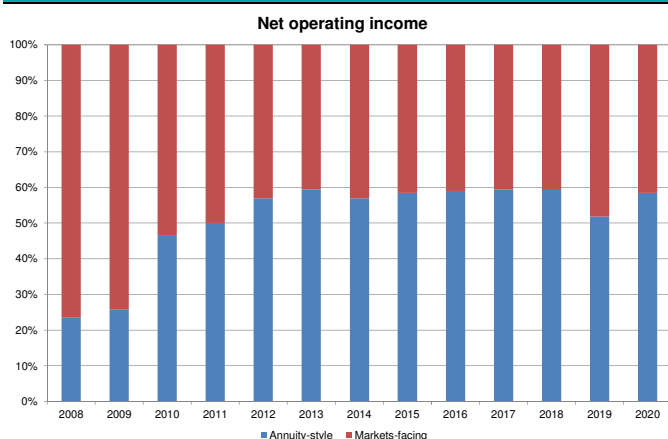
Figure 2 – ...and quality



¹NPAT based on Operating Group's annualised net profit contribution adjusted for profit share, tax and other corporate expenses.

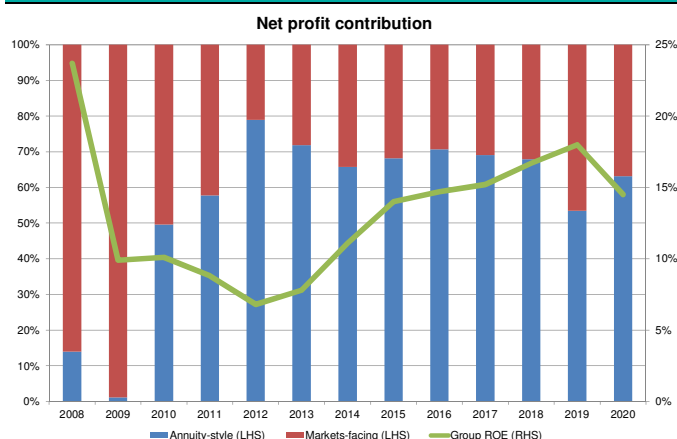
MQG's transformation strategy is ongoing but the following charts suggest ~60% will be optimal for annuity-style activities [Macquarie Asset Management (MAM), Banking and Financial Services (BFS) and perhaps up to a third of CGM] and conversely ~40% for markets-facing activities [Macquarie Capital (MacCap) and perhaps up to two-thirds of CGM]. We believe this 60:40 mix will also facilitate adaptability to changing operating conditions and reallocation of capital and other resources to higher return opportunities.

Figure 3 – Annuity-style net operating income ~59% of total...



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

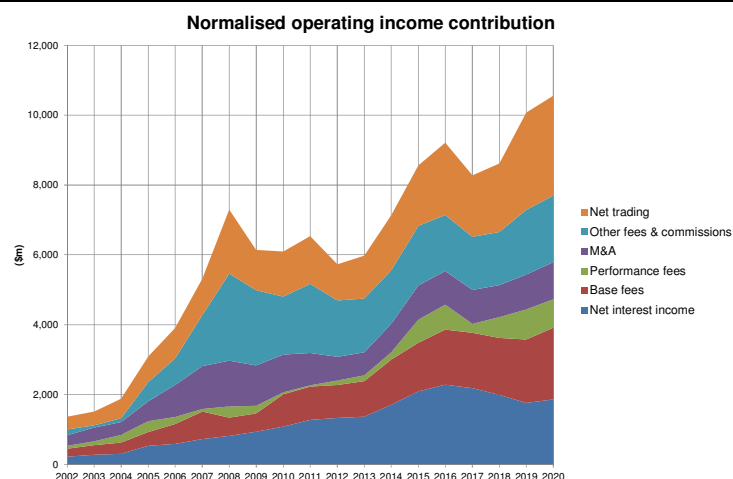
Figure 4 – ...and ~63% of net profit contribution



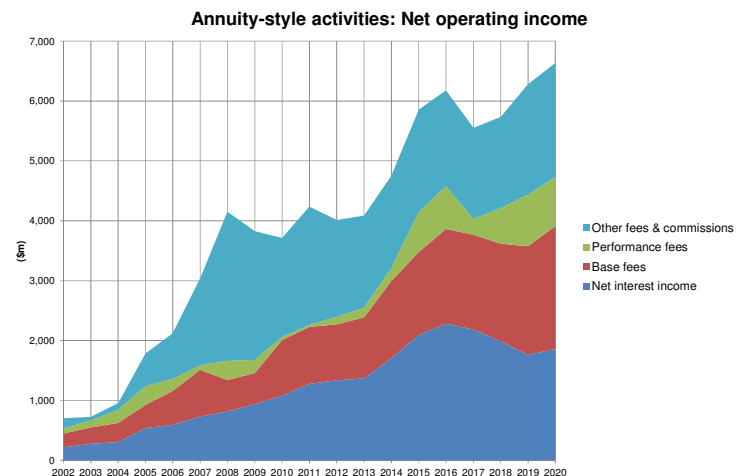
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The starting point is MQG's operating income base that excludes pre-GFC legacy items heavily reliant on significant balance sheet leverage (e.g. listed real estate investments, global mortgage securitisation and other asset/equity investments). These normalised patterns (Figures 5-7) illustrate MQG's gradual shift towards earnings consistency (i.e. within annuity-style activities, recurring in nature) and this is despite lower NIE that is consistent with a low interest rate environment.

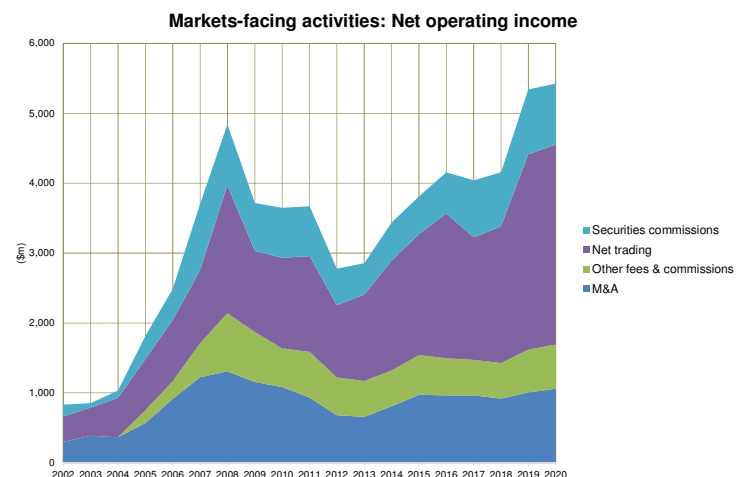
Figure 5 – Normalised operating income (i.e. excluding pre-GFC legacy activities)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 6 – Annuity-style operating income

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 7 – Markets-facing operating income

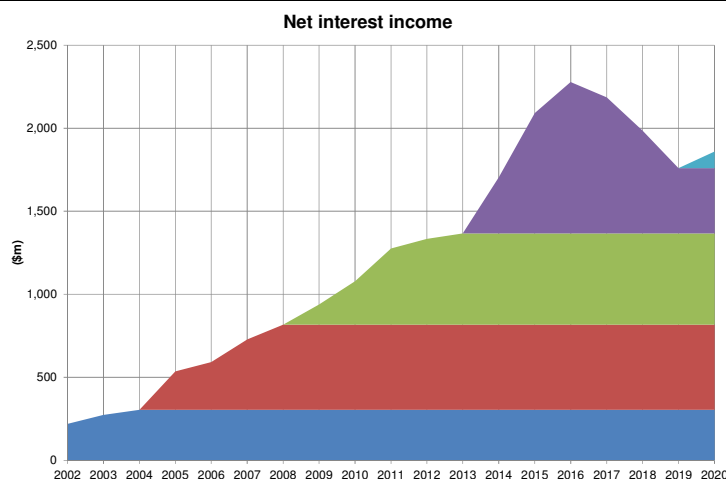
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Our recent observations are as follows:

1. Annuity-style net interest income tends to rebase after every 4-6 years but the flatter increments (since FY16, consistent with a lower rate environment) should start to lift as loans and deposits grow ahead of system (Figure 8, next page).
2. Annuity-style base fees tend to rebase after every 4-5 years but the transition period has narrowed down to 2-3 years given rising AUM and EUM (Figure 9, next page);
3. Performance fees exhibit some annuity-style characteristics now, having built up over time given EUM growth, as the fee pipeline matures and as performance fees stabilise at 50bp of EUM – these have taken almost six years to stabilise and the next rebasing should be shorter given greater and faster deployment of EUM, perhaps narrowing to 2-3 years (Figure 10, next page);
4. See also Figures 11-16 for strong AUM and fee correlation (pages 6-7);
5. Annuity-style other fees and commissions largely come from BFS and typically face higher competition domestically – although we expect the stabilisation period to narrow and to comfortably exceed \$1.5-2.0bn as fee income associated with higher core footings begin to increase (Figure 17, page 8);
6. Markets-facing M&A fees continue to exhibit annuity-style characteristics and appears to be trending towards a ~\$1.0bn minimum since FY13 (Figure 18, page 8); and

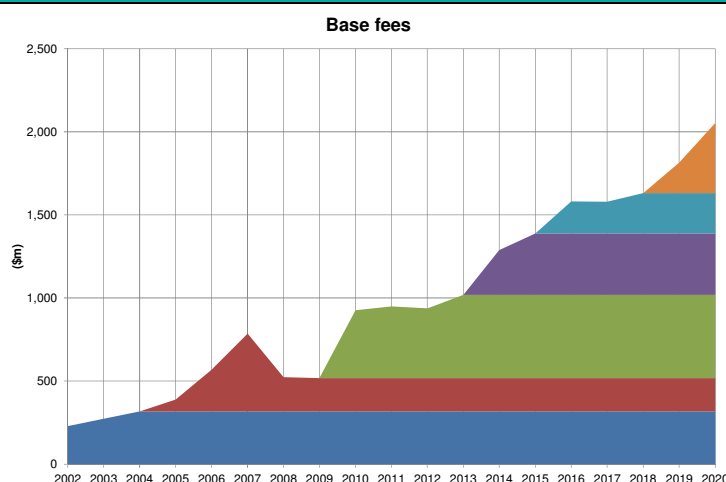
7. Markets-facing trading and risk sales income also exhibit some annuity-style characteristics with an implied sustainable base of \$2.0-2.5bn, not surprising given greater risk mitigation requirements in volatile markets (Figure 19, page 8).

Figure 8 – Annuity-style: Net interest income impacted in a low rate environment



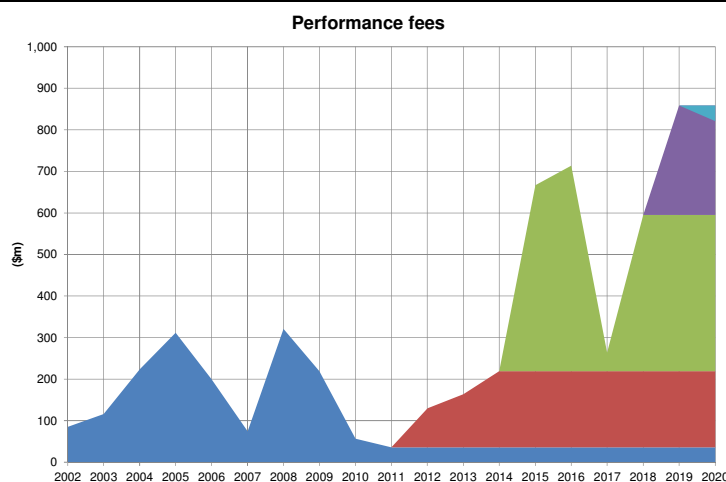
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 9 – Annuity-style: Base fees linked to AUM growth



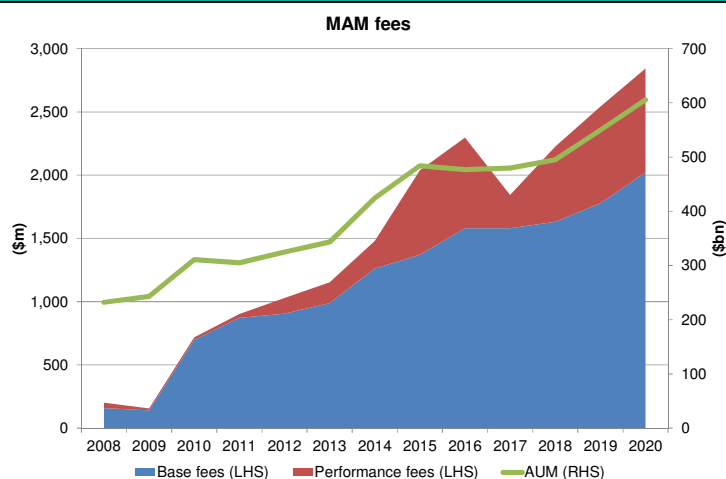
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 10 – Annuity-style: Performance fees rebased to >\$800m



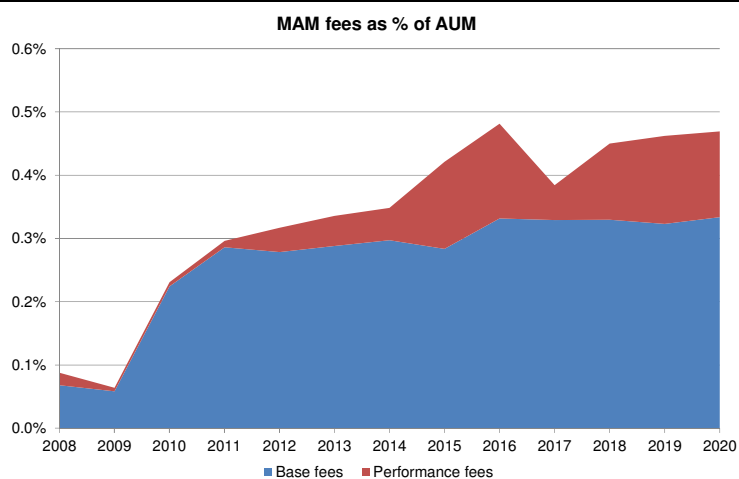
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 11 – MAM fees 1



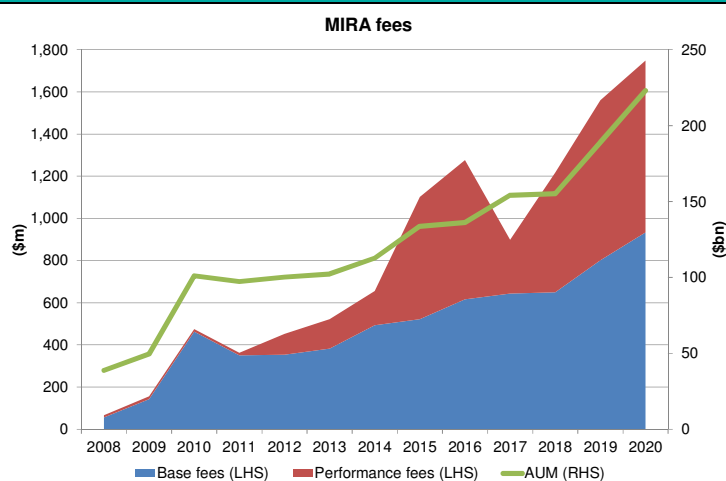
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 12 – MAM fees 2



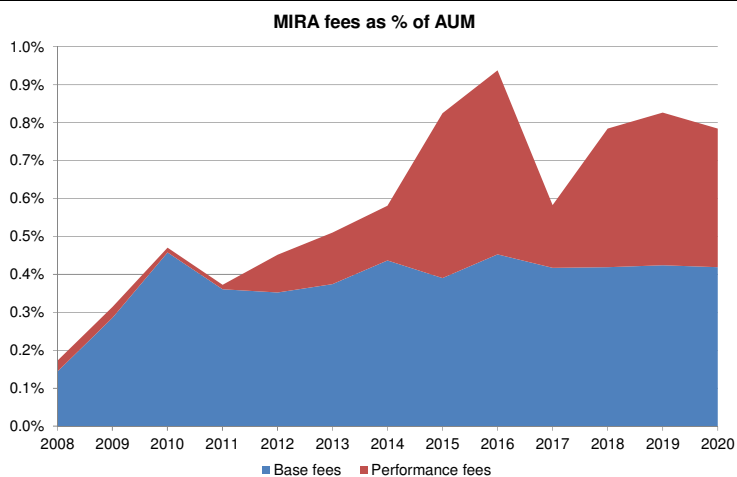
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 13 – MIRA fees 1



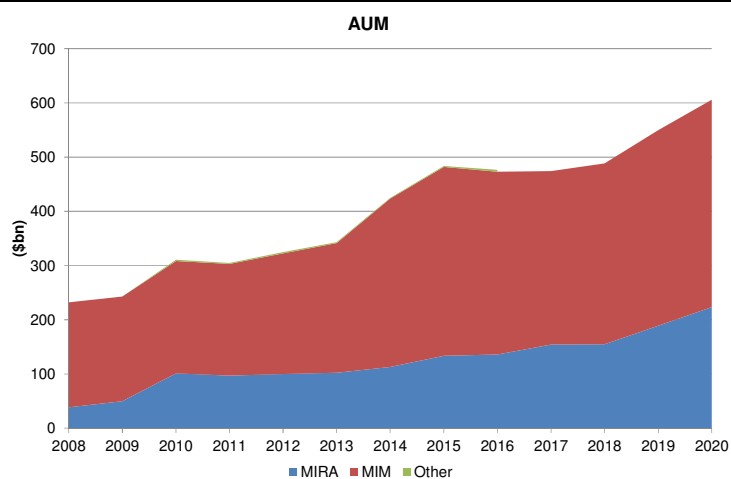
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 14 – MIRA fees 2



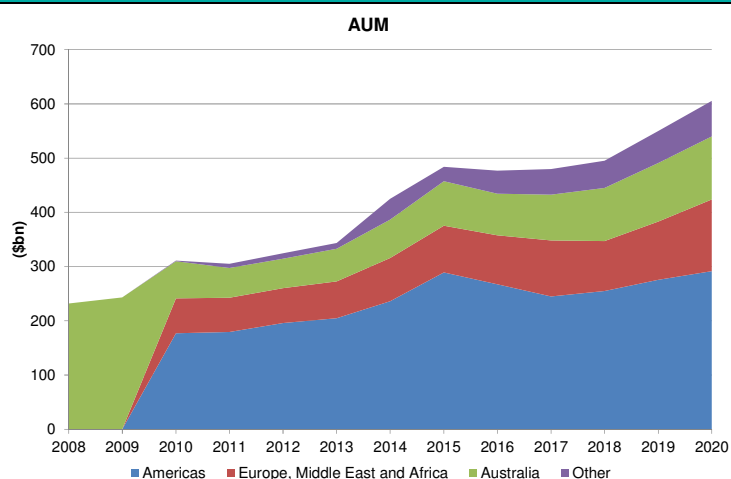
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 15 – AUM 1

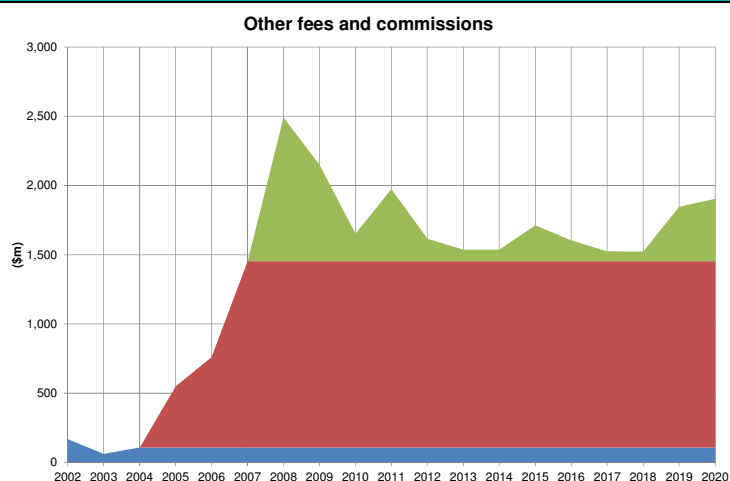


SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

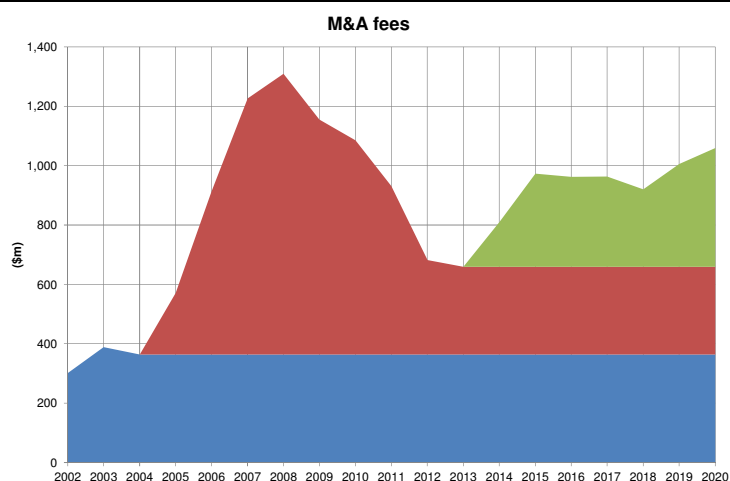
Figure 16 – AUM 2



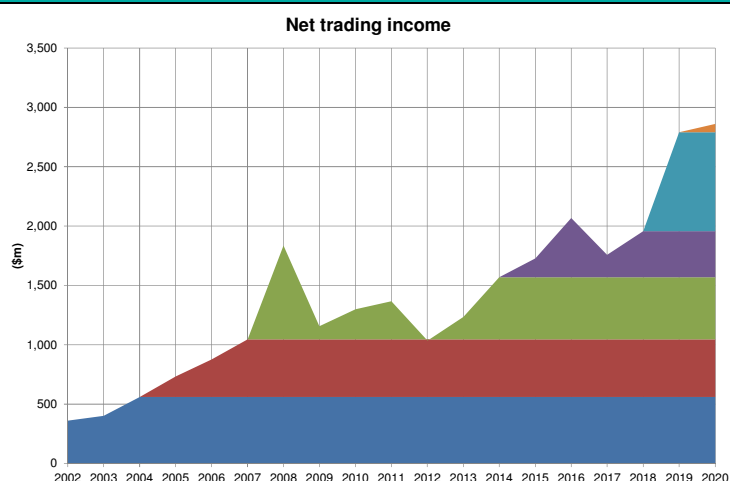
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 17 – Annuity-style: Other fees and commissions likely rebasing to \$1.5-2.0bn

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 18 – Markets-facing: M&A fees rebased to ~\$1.0bn minimum

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 19 – Markets-facing: Net trading income rebased to above \$2.5bn

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

\$135.00 price target and Buy rating unchanged

Our profit forecasts, \$135.00 price target and Buy rating are unchanged.

Table 1 – Composite valuation

Composite Valuation	Value (\$m)	Per share	Weighting	Composite value per share
DCF	40,749	\$113.38	25%	\$28.34
Dividend yield play (short term)	49,290	\$137.14	25%	\$34.29
ROE (sustainable)	48,651	\$135.37	25%	\$33.84
Sum-of-Parts	49,179	\$136.83	25%	\$34.21
Average				\$130.68
Surplus capital (@ 10.5% RWA) @ 25%				\$3.58
Total				\$134.27

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 2 – SOP valuation

Sum-of-Parts (As Is)	FY22e NPAT	Pros. PE (times)	Value (\$m)	Per share
Macquarie Securities	-	-	-	-
Macquarie Capital	464	8.5	3,947	\$10.98
Macquarie Asset Management	1,553	11.5	17,859	\$49.69
Commodities and Global Markets	1,430	22.0	31,461	\$87.54
Corporate & Asset Finance	-	-	-	-
Banking & Financial Services	745	9.5	7,073	\$19.68
Real Estate Banking	-	-	-	-
Corporate & Other	-1,395	8.0	-11,161	-\$31.06
Total	2,797	17.6	49,179	\$136.83

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 3 – SOP comps

Comps: PE (FY21-22e)													
Macquarie Capital													
Global	BK.US	CSGN.SW	GS.US	MS.US	SCHW.US	UBSG.SW						Mean	Median
	9.0	6.4	8.3	8.8	19.2	8.3						10.0	8.6
Macquarie Asset Management													
Domestic	IFL	JHG	PDL	PPT	PTM							Mean	Median
	10.7	9.9	11.8	12.9	17.3							12.5	11.8
Global	AB.US	AMG.US	ARCC.US	BAM/A.CN	BLK.US	BX.US	EV.US	JHG.US	LM.US	OAK.US	TROW.US	Mean	Median
	8.6	5.5	8.8	13.8	16.2	16.2	10.7	9.6	11.3		14.6	11.5	11.0
Commodities and Global Markets													
Global	CME.US											Mean	Median
	22.0											22.0	22.0
Corporate & Asset Finance													
Global	CBSH.US	CIT.US	GATX.US	SBNY.US	TRTN.US	8331.JP						Mean	Median
	17.2	5.8	13.5	8.3	7.5	6.4						9.8	7.9
Banking & Financial Services													
Domestic	ANZ	CBA	NAB	WBC	BEN	BOQ	ABA	MYS				Mean	Median
	9.7	14.5	10.5	9.9	11.3	10.8	11.1	10.7				11.1	10.8
Global	BAC.US	TFC.US	C.US	JPM.US	MTB.US	PNC.US	FITB.US	USB.US	WFC.US			Mean	Median
	9.1	9.1	6.4	10.0	9.1	11.4	7.9	9.7	7.5			8.9	9.1
	TD.CN	RY.CN	CM.CN	BMO.CN	BNS.CN	NA.CN						Mean	Median
	9.7	9.5	8.1	8.0	7.9	8.6						8.6	8.4

SOURCE: BLOOMBERG

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 15,849 FTE (58% overseas). The Group has established alliances with over 30 companies in 14 countries specialising in infrastructure investment, wealth management and trading services. Around 67% 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\$)						113.24
As at						Market Cap (A\$M)						40,699
16-Jun-20												
PROFIT AND LOSS						VALUATION DATA						
Y/e March 31 (\$m)	2019	2020	2021e	2022e	2023e	Y/e March 31	2019	2020	2021e	2022e	2023e	
Net interest income	1,760	1,859	2,117	2,271	2,381	Profit attributable to ordinary equity holders of MQG (\$m)	2,982	2,731	2,420	2,797	3,069	
Net trading income	2,791	2,861	2,793	2,899	2,910	EPS (cps)	883	791	684	795	874	
Fee & commission income						- Growth	17%	-10%	-14%	16%	10%	
- Base fees	1,778	2,021	1,912	1,963	2,061	EPS (diluted) (cps)	868	765	661	759	831	
- Performance fees	765	821	709	728	764	- Growth	17%	-12%	-14%	15%	9%	
- M&A, advisory & u/w fees	1,023	951	835	818	842	P / E ratio (times)	12.8	14.3	16.6	14.3	12.9	
- Brokerage & commissions	1,222	1,271	1,309	1,348	1,389	P / Book ratio (times)	2.2	1.9	1.8	1.7	1.6	
- Other fee and commission income	492	457	474	492	512	P / NTA ratio (times)	2.5	2.2	2.1	1.9	1.8	
- Income from life business, etc.	0	0	0	0	0	Dividend per ordinary share (cps)	575	430	375	480	570	
- Other revenue	3,422	2,892	2,863	2,859	2,907	Yield	5.1%	3.8%	3.3%	4.2%	5.0%	
Net operating income	13,253	13,133	13,012	13,378	13,766	Franking	45%	40%	40%	40%	40%	
Total operating expenses	-8,887	-8,871	-9,166	-9,349	-9,511	Payout (target 60-80%)	65%	54%	55%	60%	65%	
Net credit & other impairment charges	-499	-808	-696	-394	-267							
Operating profit before income tax	3,867	3,454	3,149	3,636	3,988	CAPITAL ADEQUACY						
Income tax expense	-879	-728	-715	-825	-905	Y/e March 31	2019	2020	2021e	2022e	2023e	
Loss/(profit) attributable to non-controlling interests	-6	5	-14	-14	-14	Risk weighted assets (\$m)	77,517	95,618	101,943	108,077	113,873	
Profit attributable to ordinary equity holders of MQG	2,982	2,731	2,420	2,797	3,069	Average risk weight	49%	46%	46%	46%	46%	
Adjustment	67	102	98	98	98	Tier 1 ratio	13.5%	13.6%	13.9%	14.4%	14.7%	
Profit used in calculating diluted EPS (2012+)	3,049	2,833	2,518	2,895	3,167	CET1 capital ratio (Bank)	11.4%	12.2%	12.7%	13.1%	13.5%	
CASHFLOW						Equity ratio	9.3%	8.5%	8.6%	8.6%	8.7%	
Y/e March 31 (\$m)	2019	2020	2021e	2022e	2023e	DIVISIONAL						
NPAT (reported basis)	2,982	2,731	2,420	2,797	3,069	Y/e March 31 (\$m)	2019	2020	2021e	2022e	2023e	
Increase in loans	15,448	-12,312	-7,364	-6,532	-5,304	Macquarie Securities						
Increase in other assets	-26,991	-35,861	-5,959	-6,445	-6,971	Net trading income						
Capital expenditure	6,725	-343	-152	-157	-162	Brokerage & commissions						
Investing cashflow	-4,818	-48,516	-13,475	-13,135	-12,436	Other revenue						
Increase in deposits & borrowings	7,700	10,500	7,029	6,384	5,412	Total operating income						
Increase in other liabilities	-1,452	44,125	5,195	5,460	5,817	Operating expenses						
Ordinary equity raised	0	1,670	0	0	0	Net profit contribution b/4 OEI						
Other	-3,836	-2,218	-1,169	-1,506	-1,860	Cost ratio						
Financing cashflow	2,412	54,077	11,055	10,338	9,368	Macquarie Capital						
Net change in cash	576	8,292	0	0	0	M&A, advisory & u/w fees	1,023	951	835	818	842	
Cash at end of period	39,135	47,427	47,427	47,427	47,427	Other revenue	1,994	1,222	989	1,030	1,102	
BALANCE SHEET						Total operating income	3,017	2,173	1,824	1,847	1,944	
Y/e March 31 (\$m)	2019	2020	2021e	2022e	2023e	Operating expenses	-1,073	-1,168	-991	-1,014	-1,052	
Cash and liquid assets	39,135	47,427	47,427	47,427	47,427	Impairment expenses	-183	-267	-501	-233	-100	
Divisional gross loans	62,500	75,300	82,830	89,456	94,824	Net profit contribution b/4 OEI	1,761	738	332	601	792	
Provisions	-618	-1,106	-1,272	-1,366	-1,430	Cost ratio	36%	54%	54%	55%	54%	
Other IEA	68,422	73,026	78,985	85,430	92,401	Macquarie Asset Management						
Intangibles	2,031	3,268	3,268	3,268	3,268	Base fees	1,778	2,021	1,912	1,963	2,061	
PP&E	4,701	5,044	5,196	5,354	5,515	Performance fees	765	821	709	728	764	
Insurance assets	0	0	0	0	0	Other revenue	784	890	866	866	866	
Other assets	21,586	52,843	52,843	52,843	52,843	Total operating income	3,327	3,732	3,487	3,557	3,691	
Total assets	197,757	255,802	269,277	282,412	294,848	Operating expenses	-1,453	-1,554	-1,508	-1,548	-1,602	
Divisional deposits	53,400	63,900	70,929	77,313	82,724	Impairment expenses	0	0	0	0	0	
Other borrowings	103,986	148,667	153,862	159,322	165,139	Net profit contribution b/4 OEI	1,874	2,178	1,979	2,009	2,089	
Other liabilities	22,007	21,451	21,451	21,451	21,451	Cost ratio	44%	42%	43%	44%	43%	
Total liabilities	179,393	234,018	246,242	258,086	269,314	Commodities and Global Markets						
Ordinary share capital	6,174	7,844	7,844	7,844	7,844	Net trading income	2,940	2,939	2,939	2,939	2,950	
Other equity instruments	7	7	7	7	7	Other revenue	1,659	1,764	1,817	1,871	1,928	
Reserves	1,773	2,773	2,773	2,773	2,773	Total operating income	4,599	4,703	4,756	4,810	4,878	
Retained profits	9,807	10,439	11,690	12,981	14,189	Operating expenses	-2,689	-2,699	-2,832	-2,902	-2,975	
Minority interests	603	721	721	721	721	Impairment expenses	-165	-258	-59	-59	-59	
Total shareholders' equity	18,364	21,784	23,035	24,326	25,534	Net profit contribution b/4 OEI	1,745	1,746	1,865	1,850	1,844	
						Cost ratio	58%	57%	60%	60%	61%	
Corporate & Asset Finance												
Total sh. equity & liabs.	197,757	255,802	269,277	282,412	294,848	Net interest income						
WANOS - statutory (m)	324	333	340	340	340	Net operating lease income						
WANOS - diluted (m)	351	371	381	381	381	Other revenue						
PROFITABILITY RATIOS						Total operating income						
Y/e March 31	2019	2020	2021e	2022e	2023e	Operating expenses						
Return on assets	1.5%	1.1%	0.9%	1.0%	1.1%	Impairment expenses						
Return on equity	18.0%	14.5%	11.4%	12.4%	12.9%	Net profit contribution b/4 OEI						
Leverage ratio	5.3%	5.1%	5.3%	5.6%	5.7%	Cost ratio						
Cost / income ratio	67%	68%	70%	70%	69%	Banking & Financial Services						
Cost / average assets	4.41%	3.73%	3.48%	3.39%	3.30%	Net interest income	1,678	1,728	1,813	1,907	1,977	
Growth in operating income	19%	-1%	-1%	3%	3%	Base fees	0	0	0	0	0	
Growth in operating expenses	19%	0%	3%	2%	2%	Commission income	492	457	474	492	512	
Jaws	0%	-1%	-4%	1%	1%	Other revenue	0	0	0	0	0	
Effective tax rate	23%	21%	23%	23%	23%	Total operating income	2,170	2,185	2,287	2,400	2,489	
ASSET QUALITY						Operating expenses	-1,347	-1,267	-1,286	-1,335	-1,379	
Y/e March 31	2019	2020	2021e	2022e	2023e	Impairment expenses	-67	-148	-136	-102	-108	
impairment expense / GLA	0.80%	1.07%	0.84%	0.44%	0.28%	Net profit contribution b/4 OEI	756	770	864	963	1,002	
impairment expense / RWA	0.64%	0.85%	0.68%	0.36%	0.23%	Cost ratio	62%	58%	56%	56%	55%	
Total provisions (\$m)	618	1,106	1,272	1,366	1,430	Compensation ratio	39%	41%	40%	40%	39%	
Total provisions / RWA	0.80%	1.16%	1.25%	1.26%	1.26%	Net profit contribution b/4 OEI						
Indiv ass prov / gross imp assets	237%	239%	239%	239%	239%	Annuity-style businesses	2,630	2,948	2,843	2,972	3,091	
IBL / IEA	121%	144%	140%	136%	133%	Capital markets facing businesses	3,506	2,484	2,197	2,451	2,635	
Total provisions + GRCL / RWA	0.80%	1.16%	1.25%	1.26%	1.26%	Combined net profit contribution	6,136	5,432	5,040	5,423	5,727	

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.

Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
TS Lim	Head of Research	612 8224 2810	tslim
Industrials			
Steven Anastasiou	Industrials	613 9235 1952	sanastasiou
James Filius	Industrials	613 9235 1612	jfilius
Sam Haddad	Industrials	612 8224 2819	shaddad
Alex McLean	Industrials	612 8224 2886	amclean
Hamish Murray	Industrials	613 9235 1813	hmurray
Chris Savage	Industrials	612 8224 2835	csavage
Jonathan Snape	Industrials	613 9235 1601	jsnape
Damien Williamson	Industrials	613 9235 1958	dwilliamson
Healthcare/Biotech			
John Hester	Healthcare	612 8224 2871	jhester
Tanushree Jain	Healthcare/Biotech	612 8224 2849	tnjain
Financials			
TS Lim	Banks/Regionals	612 8224 2810	tslim
Lafitani Sotiriou	Diversified Financials/Fintech	613 9235 1668	lsotiriou
Resources			
Peter Arden	Resources	613 9235 1833	parden
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9235 1856	showe
Associates			
Joseph House	Associate Analyst	613 9235 1624	jhouse

Bell Potter Securities Limited
ACN 25 006 390 7721
Level 29, 101 Collins Street
Melbourne, Victoria, 3000
Telephone +61 3 9256 8700
www.bellpotter.com.au

Bell Potter Securities (HK) Limited
Room 1701, 17/F
Prosperity Tower, 39 Queens Road
Central, Hong Kong, 0000
Telephone +852 3750 8400

Bell Potter Securities (US) LLC
Floor 39
444 Madison Avenue, New York
NY 10022, U.S.A
Telephone +1 917 819 1410

Bell Potter Securities (UK) Limited
16 Berkeley Street
London, England
W1J 8DZ, United Kingdom
Telephone +44 7734 2929

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T S Lim, authoring analyst, holds long positions in MQG, MQGPC, MQGPD and MBLPB.

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