



Australian  
National  
University

# ANU Student Managed Fund

Investment Recommendation

## Westpac Banking Corporation

**ASX code: WBC**

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### Notes:

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## Glossary

**AAE** – Active Australian Equities

**ANU** – The Australian National University

**APRA** – Australian Prudential Regulation Authority

**ASX** – Australian Securities Exchange

**AUSTRAC** – Australian Transaction Reports and Analysis Centre

**CAPM** – Capital Asset Pricing Model

**CBA** – Commonwealth Bank of Australia

**CET1** – Common Equity Tier 1

**CTI** – Cost-to-income ratio

**DCF** – Discounted cash flow

**ETP** – Exchange traded product

**FCFE** – Free cash flow to equity

**FSRC** – Financial Services Royal Commission

**FY** – Financial year

**GICS** – Global Industry Classification Standard

**IAC** – Investment Advisory Committee

**IOZ** – iShares Core S&P/ASX 200 ETF

**IPART** – Independent Pricing and Regulatory Tribunal

**LVR** – Loan-to-value ratio

**MoS** – Margin of safety

**NAB** – National Australia Bank

**NII** – Net Interest Income

**NIM** – Net Interest Margin

**NPAT** – Net profit after tax

**RAMS** – Raters and Mortgage Solutions (Westpac subsidiary)

**RBA** – Reserve Bank of Australia

**ROE** – Return on equity

**RWA** – Risk-weighted assets

**SME** – Small to medium sized enterprise

**SMF** – ANU Student Managed Fund

**WACC** – Weighted average cost of capital

**WBC** – Westpac Banking Corporation

## Portfolio Recommendation

The AAE Team recommends that the Student Managed Fund (SMF) sell its entire active position in Westpac Banking Corporation (WBC) within the Active Australian Equities portfolio, with the proceeds to be invested in the iShares Core S&P/ASX 200 ETF (IOZ). WBC is an Australian-based financial services and banking company operating across Consumer, Business, Institutional, and New Zealand banking segments, serving individuals, SMEs, corporates, and government customers. The fund purchased WBC in May 2019 at \$27.14 per share, and the position has generated total returns of 8.6% p.a over the holding period.

WBC has been a successful holding for the SMF, but at the current share price the prospective return no longer adequately compensates for the risks ahead.

Westpac's cost-to-income ratio of ~54% is the highest of the big four banks, and its UNITE program, a \$3.5 billion technology overhaul to close this gap, is the central assumption underpinning its current valuation. The program is already delayed, over budget, and delivery uncertainty has been compounded by the simultaneous departure of both the Group CIO and CTO in early 2026. At the same time, Westpac's NIM is under structural pressure, as aggressive mortgage discounting, heavy reliance on broker-originated loans, and a deposit base skewed toward higher-cost accounts compress profitability from both sides. WBC is also pursuing aggressive volume growth in home and business lending at precisely the point in the cycle when borrower stress is emerging and impairments are rising. Together, these issues present material risks and the valuation leaves little room for error.

## Investment Thesis

### Original Investment Thesis

The SMF's original investment thesis identified the following drivers of long-term value:

- high asset and loan book quality
- high sustainable dividend yield supported by strong ROE, amplified by WBC's fully franked dividends
- exposure to Australia's oligopolistic banking sector with strong pricing power
- strong management, franchise strength and SRI practices
- post-FSRC restructuring as a tailwind, with tighter lending standards and mortgage broking reform to steer customers toward the major banks



**AUSTRALIA**

**ASX code: WBC**

**Price (12/05/2026)** \$36.61

|                                         |                   |
|-----------------------------------------|-------------------|
| <b>Valuation (exc. FC)</b>              | \$23.18           |
| <b>Margin of safety (MoS) (exc. FC)</b> | -36.69%           |
| <b>Valuation (inc. FC)</b>              | \$34.04           |
| <b>Margin of safety (MoS) (inc. FC)</b> | -7.03%            |
| <b>Ordinary cash dividend yield</b>     | 4.14%             |
| <b>Dividend yield (inc FC)</b>          | 5.91%             |
| <b>GICS</b>                             | Financials        |
| <b>52-week range</b>                    | \$30.27 - \$43.32 |
| <b>Recommendation</b>                   | <b>Sell</b>       |
| <b>Key assumptions</b>                  |                   |
| <b>Cost of Equity</b>                   | 8.39%             |

### Five-year price history



## Why The Position Should be Sold

WBC's investment thesis has largely materialised across the identified strategic areas since the Fund's initial purchase. Loan book quality has been a clear outperformer, with credit impairment charges averaging just 0.10% of loans over FY2021-2025, materially below the original model's forecast of 0.33%. WBC has maintained fully franked dividends throughout the holding period, with the gross yield on cost recovering to approximately 7.8% including franking credits in FY2025, reflecting the significant income return the position has generated for the SMF. The oligopolistic structure of Australian banking has remained intact, with the big four collectively holding approximately 70% of total domestic lending assets. Governance and franchise strength were significantly tested by the \$1.3 billion AUSTRAC penalty in FY2020, but WBC has since executed a meaningful turnaround under new leadership, with regulatory overlays lifted and risk management practices substantially improved. However, pricing power has dissipated more than the original thesis anticipated, with NIM compressing from 2.08% at purchase to 1.95% in FY2025 as deposit and mortgage competition have created structural pressure on margins.

Against this backdrop, the stock has appreciated ~37% over the holding period while providing the Fund with significant fully franked dividend income. Realisation of the original investment thesis, sector-wide re-ratings and structural demand from compulsory superannuation inflows into major bank equities have been key drivers of this appreciation. The position has delivered strong returns for the SMF. However, we believe the risks associated with holding WBC outweigh the prospects for further return, and that is why we recommend the SMF sell Westpac.

The team's investment case for a sell is driven by:

- Execution risks associated with the UNITE initiative
- NIM compression in a mature, competitive market.
- Emerging credit risk headwinds

## Model Evolution

The AAE team's DCF model produces a target share price of \$34.04 including FC, implying a MoS of – 7.03%. To provide a clearer context on the development of WBC's fundamentals and our updated view, the table below compares key forecast drivers in the current model iteration against the last revaluation (S2 2025).

| Metric                                   | Current Model (Updated) | Prior Model (21/7/25) |
|------------------------------------------|-------------------------|-----------------------|
| Average Interest Earning Assets (FY2026) | \$1,077,561             | \$986,122             |
| NIM (FY26-FY2035)                        | 1.91%-1.84%             | 1.90%-1.86%           |
| Cost-to-income ratio (FY2026-2035)       | 55.3%-47%               | 52.15%-45%            |
| Impairments % Loans (FY2025-2031)        | 0.11-0.16               | 0.08-0.14             |
| Target Price Incl FC                     | \$34.04                 | \$39.75               |

Average interest earning asset growth has been revised upward to reflect Westpac's volume-led strategy and elevated 1H26 momentum, particularly the 23% surge in institutional lending. While positive in isolation, this reinforces our views on future impairments as growth is concentrating in more exposed segments where credit risk is rising. Impairment charges are forecast to step up from the low of 5–8bps in FY22–1H26 to 16bps by FY30, slightly above 15 basis point normalised levels, reflecting the unwinding of pandemic-era credit conditions and building stress in the institutional book. NIM has been revised downward, tapering from 1.94% in FY25 to 1.84% in the terminal year, reflecting a more persistent structural decline driven by sector wide pressures and WBC's specific loan book composition. Our model still assumes a meaningful reduction in the cost base over the forecast period from the UNITE initiative. However, cost-to-income has been revised upward as our view on UNITE execution has deteriorated and now declines from ~54% to ~47% by FY35. The combined effect is a reduction in NPAT across the

forecast period. These revisions produce a target price of \$34.04 vs \$39.75, bringing the margin of safety to a level at which we no longer view the risk-reward as favourable.

## Investment Case

### Execution Risks Associated with the UNITE Initiative

#### The Strategic Importance of Unite

A key risk to WBC is the execution of its UNITE program, which underpins the market's thesis for holding the stock. UNITE is a \$3.5 billion technology overhaul aimed at simplifying legacy systems and consolidating approximately 180 platforms into 60, addressing the structural inefficiency that has accumulated through decades of acquisitions, including St George, BankSA and BT, which were never fully integrated into a unified technology environment. Westpac's cost-to-income ratio of ~54% remains materially above peers and has been the highest of all big four banks during the holding period. This structural cost disadvantage has been a persistent drag on ROE, with Westpac's five-year average ROE of ~9.0% trailing NAB, CBA and ANZ which averaged ~11.4% over the same period. Management has itself positioned UNITE as the primary vehicle for closing this gap, targeting roughly \$750 million in annual savings by 2030. UNITE is currently the largest standalone transformation program amongst peers, accounting for approximately 40 per cent of WBC's total investment spend through FY27 and FY28. By comparison, ANZ's \$1.5 billion annual investment envelope is dispersed across transformation, growth and regulatory work, while NAB and CBA have no similar programs. Successful delivery is a key determinant of WBC's intrinsic value and further upside. Our scenario analysis reflects this significance, illustrated by a more severe execution failure of UNITE producing a margin of safety including FC of -26.2% with a target price of \$29.01 against a base case valuation of \$34.04.

#### Execution Risk and Delivery Uncertainty

The scale and complexity of UNITE introduces meaningful execution risk. The program's completion date has already slipped from FY28 to FY29 following a decision to consolidate to a single deposit ledger, requiring around one-third of initiatives to be replanned. Investment spend has also escalated, with FY26 guidance of \$850-950 million up from \$660 million in FY25. As many of the costs are expensed rather than capitalised, this creates a direct headwind to earnings. The simultaneous departure of both the Group CIO and Group CTO within weeks of each other in early 2026 has also raised significant concerns around delivery uncertainty and continuity. Westpac's own track record warrants caution. The Strategic Investment Priorities program (2009-14) spent ~\$2bn nominally on budget but failed to consolidate the same problem UNITE is now being asked to solve. Given that benefits are weighted toward the back end of the program and that the most technically complex work lies ahead, the path to the targeted cost-out remains long, capital-intensive and exposed to delivery failure. Our model still assumes a meaningful reduction in the cost base over the forecast period from the UNITE initiative. However, our cost-to-income has been revised upward (i.e. less improvement than previously modelled) as our view on UNITE execution has deteriorated. For the SMF, this represents a material risk, where the fund would need to hold WBC through years of elevated investment spend and execution uncertainty before the payoff arrives, at a valuation that leaves little room for error.

### Rising Credit Risk

#### A Decade of Benign Credit Conditions

Rising credit risk, compounded by macroeconomic headwinds, poses a material and long-term threat to Westpac. Australian banks have operated in a benign credit environment for the better part of a decade. Following the Royal Commission-driven tightening of lending standards and the fiscal and monetary support deployed through Covid-19, impairment charges compressed dramatically. For Westpac specifically, charges averaged approximately 7 basis points across FY21 to FY25, well below the pre-pandemic normalised level of approximately 15 basis points cited by S&P Global Ratings. However, the conditions that supported this environment are unwinding. Inflation re-accelerated sharply through the second half of 2025, prompting the RBA to reverse its cutting cycle with back-to-back rate hikes bringing the cash rate back to 4.35%. The Middle East conflict has added a further inflationary shock through energy prices, compounding the pressure on household budgets and business cost structures across the

economy. Pandemic-era savings buffers that insulated households through the first-rate cycle are now substantially exhausted, and business insolvencies remain elevated across construction, retail and hospitality. A modest mean reversion toward pre-pandemic normalised levels alone would represent a material drag on long-term earnings that we believe is underappreciated at the current valuation.

### Early Warning Signs

Evidence of rising credit risk in the near term is already present. Although headline stability metrics remain intact, with a CET1 ratio of 12.3% and stressed exposures declining to 1.17%, impairment charges have more than doubled from 4 basis points in 2H25 to 10 basis points in 1H26, and collectively assessed provisions have risen to 129 basis points, their highest level since Covid-19. In the longer term, there is a risk that Australian banks are entering a structurally higher bad debt environment relative to what has prevailed since 2014. The conditions that suppressed credit losses over that period, namely record low interest rates, fiscal stimulus and pandemic-era savings buffers, were temporary and are now either exhausted or reversing. Australia's household debt-to-disposable income ratio of approximately 177% sits near record highs and is now being serviced at a cash rate of 4.35% and rising, compared to near-zero rates that prevailed for much of the low-impairment period. At this level of indebtedness, even modest rate increases materially compress disposable income, and the pandemic-era savings buffers that absorbed the first hiking cycle are now substantially exhausted. Compounding this, 30% of mortgage holders report they expect to struggle with repayments over the next three months, and credit card spending hit a record \$40.5 billion in January 2026 with 51% of balances accumulating interest. On the business side, ASIC data shows 14,722 companies entered external administration in FY25, an approximate 100% increase over two years, with construction accounting for the largest share of failures in every period. As the RBA has flagged, if that trend shifts further toward businesses carrying bank debt, the flow through to impairments could be meaningful.

Royal Commission reforms and tighter capital requirements have structurally improved the quality of bank loan books, and we are not forecasting a return to the loss rates of the early 1990s or the GFC. However, our forecasted bad debt charge of approximately 16 basis points reflects a normalisation toward pre-pandemic levels which we believe represents the appropriate base case. This step-up has a material impact on the valuation and the impact of further increases are detailed in our scenario analysis.

### Westpac's Loan Book Composition

Westpac's loan book composition amplifies this sector-wide credit risk. Construction, one of Westpac's most material business lending exposures, carries the highest stressed sector exposure at ~4.7%. This risk is compounded by the Middle East conflict which is inflating energy input costs and when combined with persistent labour shortages, has reduced dwelling approvals to approximately 198,000 per annum, well below pre-Covid levels of 214,000 (Martin, 2025). Westpac's addition of a specific portfolio overlay for energy-intensive sectors in 1H26, with collective overlays more than doubling from A\$130 million to A\$282 million, is an implicit acknowledgement that this risk is not yet fully reflected in headline metrics. Compounding this, total business lending grew 15% in 1H26, driven by a 23% surge in institutional lending into energy, infrastructure, critical minerals and property finance, the same sectors explicitly overlaid for credit risk. To put this into context, Westpac's peers grew the business lending book by ~10% on average over the same period. The composition of Westpac's A\$527 billion mortgage book is also skewing toward higher-risk segments, with the investor lending share rising to 33% and first-home buyer exposure growing to 12.6% through aggressive participation in the federal 5% deposit scheme at up to 95% LVR. Australian mortgage 90-day delinquencies stand at 0.57%, already above the pre-pandemic norm of 0.41% and on a rising trajectory, with the pandemic-era savings buffer that insulated households through the hiking cycle now substantially exhausted.

### Structural NIM Compression

Westpac faces structural net interest margin (NIM) compression that is both sector-wide and idiosyncratic to its own business mix. At the sector level, the competitive backdrop has intensified materially. Mortgage lending has become a price-driven race, with banks aggressively discounting rates to defend volume, squeezing the margin earned on new originations. Competition for deposits has

increased similarly as banks compete for cheaper, more stable sources of funding. This dynamic is compounded by the fact that following the Banking Royal Commission, the major banks largely exited high-yielding wealth management and insurance businesses, while simultaneously ceding ground in fee-generating verticals including payments, merchant acquiring, and foreign exchange. With these alternative revenue levers unavailable, NIM compression flows directly to the bottom line, reducing earnings and undermining Westpac's capacity to sustain the dividend yield that has historically defined its investment appeal.

Westpac's structural vulnerabilities compound this industry-wide pressure in distinct ways. Its reliance on mortgage brokers to originate new lending structurally erodes per-loan profitability, as a portion of margin is transferred to these third parties. As of 1Q26, proprietary channels accounted for just 44.4% of Westpac's mortgage originations, compared to 33% for CBA which indicates a more advanced hollowing-out of the direct-to-customer channel that underpins higher-margin lending. Westpac's retail deposit base also skews disproportionately toward higher-cost repricing savings accounts and term deposits, rather than the zero-cost transaction accounts that anchor competitors' funding bases. This structurally inflates interest expense, compressing the spread from both sides. Finally, Westpac's fragmented technology infrastructure which the UNITE program is attempting to remediate, impairs the bank's ability to reprice its loan book nimbly in response to RBA cash rate movements. This latency means Westpac is slower to capture margin uplift in rising rate environments and slower to defend against compression when rates fall, placing it at a systematic disadvantage relative to peers with more agile systems.

## Risks to the Sell Recommendation

### Sustained Investor Demand

A key risk to the recommendation is that capital continues to rotate into big four banks because of their entrenched position in Australian equity markets. The big 4 banks account for 26% of ASX 200 holdings, meaning passive inflows into Australian indices create ongoing buying support. Passive investors account for 45% of the Australian Share Market and ETP ownership have quadrupled since 2020. Because index-tracking funds allocate capital strictly in proportion to index weights, inflows into Australian equity products mechanically increase demand for the big four regardless of performance. This creates a structural source of buying that supports bank share prices independently of fundamentals.

Compulsory superannuation adds to this structural demand by directing a meaningful share of the approximately \$180 billion in mandated annual contributions toward Australian equities. This demand is reinforced as superannuation funds' performance is benchmarked against the ASX 200 and assessed on a short-term basis. As a result, fund managers have limited incentive to hold underweight positions in major index constituents, as doing so creates active risk against the benchmark. This means that even discretionary capital is often deployed broadly in line with index weights, sustaining demand for financials such as Westpac independently of fundamentals.

This demand is further supported by the structural role banks play as high yielding dividend stocks in Australia. Westpac's 4.14% fully franked dividend yield is particularly valuable to Australian investors because franking credits eliminate the double taxation of company profits. In periods of heightened market uncertainty, investors may also favour large, well-capitalised and systemically important banks over smaller or more concentrated exposures. This is particularly relevant in the current environment, where the RBA's rate hike to 4.35% could see investors rotate away from rate-sensitive growth stocks and toward large-cap, income-producing names such as the major banks.

### Successful UNITE Execution

A key risk to this sell recommendation is that WBC delivers UNITE better than, or in line with expectations. Successful delivery would materially strengthen the credibility of the targeted ~\$750 million in annual savings by 2030, supporting a meaningful reduction in Westpac's cost-to-income ratio and closing the gap against peers. This would in turn lift ROE from the 9.77% recorded in FY25 toward peer-level returns, directly addressing the structural underperformance that has weighed on the bank's earnings quality. As more initiatives are delivered and execution uncertainty fades, the share price would

likely benefit from progressive de-risking of the program, with each completed milestone reinforcing investor confidence and reducing the likelihood of further derating events like the FY25 timeline extension. Over time, this dynamic could support multiple expansion, particularly if delivery momentum is sustained through the most technically complex stages of the program. This introduces the risk of selling a stock that compounds returns through dividend income while simultaneously experiencing capital appreciation because of its transformation progress.

### Macroeconomic Tailwinds

The current macroeconomic environment could act as a tailwind for WBC's earnings while reinforcing its defensive appeal at a time when the broader portfolio is exposed to volatility. The RBA's three cash rate hikes in 2026 to 4.35% have been passed on in full to variable mortgage borrowers while deposit repricing has lagged, widening the spread between lending and funding costs and supporting NIM expansion. Sustained higher rates also progressively lift returns on Westpac's low-cost transaction account deposits as the funding base is reinvested at higher yields, providing further structural uplift to NIM. In the current environment of elevated volatility and macroeconomic uncertainty, Westpac's defensive profile is reinforced by a CET1 ratio of 12.3%, well above APRA's 10.5% benchmark. Further, Westpac's systemically important status and fully franked dividend yield are particularly relevant for the SMF, whose tax-exempt status amplifies franking credits and makes franked income a key contributor to its annual distribution obligations. Selling into a backdrop that may support both Westpac's earnings and its defensive characteristics therefore risks compromising capital returns and a reliable source of franked income at a time when much of the SMF's wider portfolio is exposed to elevated cyclical and macroeconomic risk.

### Model Summary

Westpac reported modest net interest income growth in 1H26 supported by 4% lending growth and 3% deposit growth, with mortgages excluding RAMS growing at 1.2x system and continued momentum across institutional, business and consumer segments. Core NIM, excluding the timing impact of rate rises, held steady in 2Q26, though group NIM remains under pressure from sustained mortgage and deposit competition. CEO Anthony Miller flagged the impact of the Middle East conflict and energy market disruption as material headwinds for the operating environment, with elevated inflation and energy input costs expected to flow through to households and businesses across the remainder of FY26, prompting an increase in collective provisions through a portfolio overlay for energy-intensive sectors. Statutory net profit of \$3.4bn declined 5% on 2H25 (down 1% ex-notable items), partially reflecting \$75m in transaction costs associated with the pending RAMS divestment. CET1 remained robust at 12.4%, comfortably above the 11.25% target, supporting the 77 cent fully franked interim dividend.

### Net Revenue

Westpac's net revenue has been forecast as Net Interest Income (NII) plus Non-Interest Income, consistent with how the bank reports its top line. NII is the primary driver and is built bottom-up as Average Interest Earning Assets  $\times$  Net Interest Margin. Non-interest income is forecast by sub-line. Combining this together, net revenue growth tapers from ~3.9% in FY26 to ~3.6% in the medium term as above-system loan growth in housing and business lending is progressively offset by NIM compression in a competitive market, with the long-run path anchored to a 1.84% terminal NIM and ~4.4% asset growth.

### Average Interest Earning Assets

Average interest earning assets (AIEA) are modelled bottom-up across housing, business, personal and non-lending books, with the trajectory of each book aligned to management's strategy. This bottom-up approach produces average interest earning asset growth of 4.90% and 5.1% in FY26 and FY27 with strong near-term momentum across Westpac's lending divisions. Growth tapers from 5.0% in FY2028 to 4.4% across the remainder of the forecast period aligned to nominal GDP growth. Elevated near-term growth reflects Westpac's aggressive pursuit of volume in margin-dilutive segments and a shift toward business lending at a point in the cycle characterised by rising credit risk. A detailed explanation of growth rates for each AIEA type is provided in appendix D.

## Net Interest Margin

NIM is forecast against broker consensus, drawing on estimates from JPMorgan, Morgans, Goldman Sachs, Morningstar and Evans & Partners. The near-term NIM of 1.90% in FY26 reflects a partial offset from the higher cash rate environment, which provides a tailwind to higher margins. However, Westpac's aggressive volume-driven lending strategy, reliance on higher-cost repricing deposits, and intensifying mortgage market competition structurally compress margins over the forecast period and NIM tapers to a long-run floor of 1.84% in the terminal year. This is consistent with the ongoing structural decline in Australian bank NIMs.

## Operating Costs

While Westpac's 1H26 result provides no guidance on operating costs, FY25 operating expenses increased 9% to \$11.92 billion. The increase reflects a \$273 million pre-tax restructuring charge for the Fit for Growth productivity program, \$660 million of UNITE investment of which 76% was expensed, higher software amortisation, deliberate hiring in business banking to support lending growth, and elevated regulatory and compliance costs. Operating costs have been modelled as the sum of staff, technology, occupancy and other expenses, with growth forecasted individually for each component. Combined, FY26 operating expense of \$12.0 billion has been forecast at ~2% over most of the forecast period. A detailed explanation of line-item forecasts can be found in appendix D.

## Impairments

Impairments are forecast as a percentage charge of lending assets, with the ratio set at 11 basis points in FY26, stepping up to 15 basis points across FY29 and settling at 16 basis points from FY30 onwards. This sits above WBC's recent steady-state experience of 5 to 8 basis points (FY22 to 1H26) and at the pre-pandemic 5-year average, reflecting a mid-cycle normalisation as the current benign credit environment fades and energy-related stress in WBC's institutional book builds. Whilst we have not incorporated a full regime change, there is an assumption incorporated that underlying credit risk will return to normalised pre-covid levels.

## Scenario Analysis

We modelled multiple scenarios to capture the range of potential outcomes for Westpac. The bear case reflects downside risks from execution failure on the UNITE program and structural NIM compression in a competitive operating environment. The bull case captures upside from successful UNITE delivery and the realisation of targeted cost savings and sustained NIM expansion through repricing discipline and balance sheet mix improvements. Together, these scenarios highlight that while Westpac's upside depends on flawless execution against an already demanding valuation, downside risks remain material across all three core pillars of the investment case.

A full breakdown of the scenario assumptions, valuation deltas, and weighting methodology is provided in Appendix B.

## Valuation Summary and Recommendation

After evaluating the return and risk trade-off, our assessment is that the risk of holding WBC at its current valuation outweighs the potential upside. WBC is trading at \$36.61 against our base case valuation of \$34.04 including franking credits, implying a negative margin of safety of 7.03%. The Sell recommendation rests on the view that the original investment thesis has largely played out, and the current market valuation is being driven by entrenched banking sector sentiment, superannuation inflows and UNITE speculation rather than fundamental strength. Beneath these tailwinds, the underlying fundamentals are deteriorating. Credit risk is rising as pandemic-era conditions unwind and Westpac's loan book skews toward higher-risk segments, while NIM has compressed from 2.08% at purchase to 1.95% in FY25 under competitive pressure and structural weaknesses. At the same time, the market continues to price in successful execution of the UNITE program despite material execution risk. With upside dependent on the continuity of favourable sector sentiment and the successful execution of a

technically complex UNITE program, we recommend the SMF sell its entire active position in Westpac Banking Corporation (WBC) and invest the proceeds into the iShares Core S&P/ASX200 ETF (IOZ).

## Appendix

### Appendix A: Key Financial Summary

| Financial year (AUD million)          | 2020(A)     | 2021(A)     | 2022(A)     | 2023(A)     | 2024(A)     | 2025(A)     | 2026(E)     | 2027(E)     |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>Volume</b>                         |             |             |             |             |             |             |             |             |
| Average interest-earning assets       | \$822,203   | \$842,244   | \$854,472   | \$894,268   | \$885,237   | \$1,026,879 | \$1,077,561 | \$1,132,275 |
| AIEA growth                           | -           | 2.4%        | 1.5%        | 4.7%        | (1.0%)      | 16.0%       | 4.9%        | 5.1%        |
| <b>Margin &amp; revenue</b>           |             |             |             |             |             |             |             |             |
| Net interest margin (NIM)             | 2.03%       | 2.06%       | 1.94%       | 1.95%       | 1.95%       | 1.94%       | 1.91%       | 1.90%       |
| Net revenue                           | \$20,183    | \$21,222    | \$19,606    | \$21,645    | \$21,588    | \$22,384    | \$23,505    | \$24,894    |
| Net revenue growth                    | -           | 5.1%        | (7.6%)      | 10.4%       | (0.3%)      | 3.7%        | 3.9%        | 3.7%        |
| <b>Costs</b>                          |             |             |             |             |             |             |             |             |
| Operating expenses                    | (\$12,739)  | (\$13,311)  | (\$10,802)  | (\$10,692)  | (\$10,944)  | (\$11,916)  | (\$12,092)  | (\$12,692)  |
| Cost-to-income ratio                  | 63.1%       | 62.7%       | 55.1%       | 49.4%       | 50.7%       | 53.2%       | 51.4%       | 51.0%       |
| <b>Credit quality</b>                 |             |             |             |             |             |             |             |             |
| Loan impairment expense               | (\$3,178)   | \$590       | (\$335)     | (\$648)     | (\$537)     | (\$424)     | (\$988)     | (\$1,170)   |
| Impairment/average loans              | 0.45%       | -0.08%      | 0.05%       | 0.08%       | 0.07%       | 0.05%       | 0.11%       | 0.12%       |
| <b>Profitability</b>                  |             |             |             |             |             |             |             |             |
| NPAT                                  | \$2,290     | \$5,458     | \$5,694     | \$7,201     | \$6,990     | \$6,916     | \$7,068     | \$7,334     |
| NPAT growth                           | -           | 138.3%      | 4.3%        | 26.5%       | (2.9%)      | (1.1%)      | 2.2%        | 3.8%        |
| <b>FCFE bridge</b>                    |             |             |             |             |             |             |             |             |
| Risk-weighted assets (RWA)            | \$437,905   | \$436,650   | \$477,620   | \$451,418   | \$437,430   | \$450,048   | \$474,127   | \$498,201   |
| CET1 ratio                            | 11.3%       | 12.4%       | 10.6%       | 11.5%       | 11.5%       | 11.7%       | 11.5%       | 11.5%       |
| Net CET1 capital                      | \$49,453    | \$54,314    | \$50,722    | \$52,273    | \$50,454    | \$52,582    | \$54,525    | \$57,293    |
| Δ CET1 (retention required)           | -           | \$3,564     | (\$5,136)   | \$2,250     | (\$1,774)   | \$1,623     | \$2,335     | \$3,171     |
| Free cash flow to equity (FCFE)       | \$2,290     | \$1,894     | \$10,830    | \$4,951     | \$8,764     | \$5,293     | \$4,733     | \$4,163     |
| <b>Financial year (AUD million)</b>   |             |             |             |             |             |             |             |             |
|                                       | FY28E       | FY29E       | FY30E       | FY31E       | FY32E       | FY33E       | FY34E       | FY35E       |
| <b>Volume</b>                         |             |             |             |             |             |             |             |             |
| Average interest earning assets (\$m) | \$1,188,978 | \$1,243,226 | \$1,300,613 | \$1,359,983 | \$1,421,424 | \$1,484,205 | \$1,549,190 | \$1,618,035 |
| AIEA growth                           | 5.0%        | 4.6%        | 4.6%        | 4.6%        | 4.5%        | 4.4%        | 4.4%        | 4.4%        |
| <b>Margin &amp; revenue</b>           |             |             |             |             |             |             |             |             |
| Net interest margin (NIM)             | 1.89%       | 1.88%       | 1.87%       | 1.86%       | 1.85%       | 1.84%       | 1.84%       | 1.84%       |
| Net revenue (\$m)                     | \$24,973    | \$25,840    | \$26,717    | \$27,571    | \$28,425    | \$29,273    | \$30,134    | \$31,019    |
| Net revenue growth (YoY)              | 3.6%        | 3.5%        | 3.4%        | 3.2%        | 3.1%        | 3.0%        | 2.9%        | 2.9%        |
| <b>Costs</b>                          |             |             |             |             |             |             |             |             |
| Operating expenses (\$m)              | (\$12,536)  | (\$12,809)  | (\$13,089)  | (\$13,381)  | (\$13,758)  | (\$14,150)  | (\$14,312)  | (\$14,711)  |
| Cost-to-income ratio (CTI)            | 50.2%       | 49.6%       | 49.0%       | 48.5%       | 48.4%       | 48.3%       | 47.5%       | 47.4%       |
| <b>Credit quality</b>                 |             |             |             |             |             |             |             |             |
| Impairments (\$m)                     | (\$1,426)   | (\$1,591)   | (\$1,747)   | (\$1,843)   | (\$1,919)   | (\$1,995)   | (\$2,072)   | (\$2,152)   |
| Impairment/average loans              | 0.14%       | 0.15%       | 0.16%       | 0.16%       | 0.16%       | 0.16%       | 0.16%       | 0.16%       |
| <b>Profitability</b>                  |             |             |             |             |             |             |             |             |

|                                 |           |           |           |           |           |           |           |           |
|---------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Net profit after tax (\$m)      | \$7,635   | \$7,956   | \$8,274   | \$8,598   | \$8,865   | \$9,142   | \$9,428   | \$9,589   |
| NPAT growth (YoY)               | 4.1%      | 4.2%      | 4.0%      | 3.9%      | 3.1%      | 3.1%      | 3.1%      | 3.0%      |
| FCFE bridge                     |           |           |           |           |           |           |           |           |
| Risk-weighted assets (RWA)      | \$523,150 | \$547,019 | \$572,270 | \$598,000 | \$625,358 | \$652,967 | \$681,542 | \$711,812 |
| CET1 ratio                      | 11.5%     | 11.5%     | 11.5%     | 11.5%     | 11.5%     | 11.5%     | 11.5%     | 11.5%     |
| Net CET1 capital                | \$60,162  | \$62,907  | \$65,811  | \$68,770  | \$71,916  | \$75,091  | \$78,377  | \$81,858  |
| Δ CET1 (retention required)     | \$3,282   | \$3,168   | \$3,337   | \$3,403   | \$3,601   | \$3,642   | \$3,765   | \$3,971   |
| Free cash flow to equity (FCFE) | \$4,353   | \$4,788   | \$4,937   | \$5,195   | \$5,263   | \$5,501   | \$5,663   | \$5,618   |

## Appendix B: Scenario Analysis

### Bear Scenario 1: UNITE Execution Failure — Cost-Out Targets Not Realised

This scenario models the risk that Westpac fails to execute the UNITE program substantially as planned, with the targeted ~\$750 million in annual savings by 2030 not materialising and the cost-to-income ratio remaining at or near current levels.

**Valuation: \$20.28 w/o FC (-44.6% Margin of Safety), \$29.13 w FC (-20.44% Margin of Safety)**

*Rationale:* UNITE is the central pillar underpinning the market's willingness to pay a premium for Westpac. A failure to deliver the targeted cost-out, whether through further timeline slippage, cost overruns, or operational incidents during migration, would leave Westpac structurally disadvantaged on cost-to-income relative to CBA and NAB and constrain ROE expansion over the medium/long run. Given that the program will absorb approximately 40% of total investment spend through FY27 and FY28 with the majority expensed rather than capitalised, execution failure means the SMF would absorb years of elevated cost without the corresponding earnings benefit, materially compressing intrinsic value.

*Model Changes:* Cost-to-income ratio remains elevated at historical levels of 54% throughout the forecast period, instead of declining toward the targeted ~48% by FY30. Modelled by heightened staff expenses (compressing from 3% in FY26 to only 2% in steady-state), occupancy expenses (stabilising at 3% in steady-state) and technology expenses (remaining elevated at 5% in steady-state). Subsequently, housing and business lending capacity reduces 2% in steady-state instead of the 3.8% and 4%, respectively, modelled in the base case.

*Bear Case Weighting: 40%*

### Bear Scenario 2: Sustained NIM Compression — Margin Defence Fails

This scenario models the risk that competitive pressures in mortgage and deposit markets, combined with Westpac's structural disadvantages, drive NIM materially below current levels through the forecast period.

**Valuation: \$17.06 w/o FC (-53.39% Margin of Safety), \$26.15 w FC (-28.58% Margin of Safety)**

*Rationale:* With NIM accounting for approximately 85% of major bank revenue, sustained margin compression flows almost directly to the bottom line. Westpac's structural reliance on broker-originated mortgages (only 44.4% of originations through proprietary channels versus 33% for CBA), its higher-cost deposit mix skewed toward repricing savings and term deposits, and its fragmented technology that limits repricing agility all amplify the sector-wide pressure on margins. With wealth, insurance and fee-generating verticals already exited or ceded, Westpac has limited offsets available to defend earnings if NIM compresses further from its current 1.95% level.

*Model Changes:* Group NIM is stepped down by 15 basis points each year in the forecast period from the FY26 level of 1.87% in the base case to 1.55–1.7% across the forecast period, reflecting persistent mortgage and deposit competition. Non-interest income growth is held flat to reflect limited offsets from fee-generating revenue.

*Bear Case Weighting: 20%*

### **Bull Scenario 1: UNITE Delivers Ahead of Plan — Full Cost-Out Realised**

**Valuation: \$27.81 w/o FC (-24.05% Margin of Safety), \$40.67 w FC (+11.08% Margin of Safety)**

*Rationale:* Successful execution of UNITE in line with, or ahead of, current expectations would validate management's ~\$750 million annual savings target and drive a meaningful reduction in Westpac's cost-to-income ratio toward peer levels. This would lift ROE from 9.77% in FY25 toward the 11–13% range achieved by CBA and NAB, supporting earnings growth, sustainable dividend coverage, and continued multiple expansion. As more initiatives are delivered and execution uncertainty fades, each completed milestone progressively de-risks the program in the eyes of investors, supporting further share price appreciation.

*Model Changes:* Cost-to-income ratio declines to approximately 48% by FY28 ahead of management guidance of by FY30 with further compression to ~39% by FY35. This is modelled by massive decreases in technology expenses (down to 0.5% FY31 onwards), occupancy expenses (continued compression in line with historicals, -0.5% in steady state) and staff expenses (compressing to 0.5% across the forecast period) due to UNITE efficiency gains and subsequent, rapid hikes in housing and business lending.

*Bull Case Weighting: 20%*

### **Bull Scenario 2: NIM Expansion Through Repricing Discipline**

**Valuation: \$30.62 w/o FC (-16.35% Margin of Safety), \$44.95 w FC (+22.77% Margin of Safety)**

*Rationale:* A reacceleration of inflation requiring the RBA to maintain higher cash rates for longer, combined with rational competitive behaviour across the major banks and successful repricing of Westpac's loan book, allows NIM to expand from current levels. Successful UNITE delivery also improves repricing agility, allowing Westpac to capture a greater share of margin uplift in higher-rate environments. Stronger institutional and business banking growth in higher-margin segments further supports group NIM, partially offsetting ongoing mortgage pressure.

*Model Changes:* Group NIM expands by 15 basis points from the FY25 level of 1.94% to 2.05–2.1% across the forecast period (FY26E–FY30E). Business lending remains elevated at 8% and housing lending at 4% in steady state.

*Bull Case Weighting: 20%*

## Weighted Scenario Analysis – UNITE Execution

|                      | Bear Case<br>(Disastrous Execution) | Base Case<br>(Partial, mediocre execution) | Bull Case<br>(exceptional execution) | Final                     |
|----------------------|-------------------------------------|--------------------------------------------|--------------------------------------|---------------------------|
| Weight               | 40%                                 | 40%                                        | 20%                                  | 100%                      |
| Valuation (excl. FC) | \$20.28<br>(MoS: -44.6%)            | \$23.18<br>(MoS: -36.69%)                  | \$27.81<br>(MoS: -24.05%)            | \$22.95<br>(MoS: -37.33%) |
| Valuation (incl. FC) | \$29.13<br>(MoS: -20.44%)           | \$34.04<br>(MoS: -7.03%)                   | \$40.67<br>(MoS: 11.08%)             | \$33.4<br>(MoS: -8.77%)   |

## Weighted Scenario Analysis – NIM Trajectory

|                      | Bear Case<br>(Massive NIM Compression) | Base Case<br>(Partial NIM Compression) | Bull Case<br>(Rapid NIM Expansion) | Final                     |
|----------------------|----------------------------------------|----------------------------------------|------------------------------------|---------------------------|
| Weight               | 20%                                    | 60%                                    | 20%                                | 100%                      |
| Valuation (excl. FC) | \$17.06<br>(MoS: -53.39%)              | \$23.18<br>(MoS: -36.69%)              | \$30.62<br>(MoS: -16.35%)          | \$23.44<br>(MoS: -35.96%) |
| Valuation (incl. FC) | \$26.15<br>(MoS: -28.58%)              | \$34.04<br>(MoS: -7.03%)               | \$44.95<br>(MoS: 22.77%)           | \$34.64<br>(MoS: -5.38%)  |

## Appendix D:

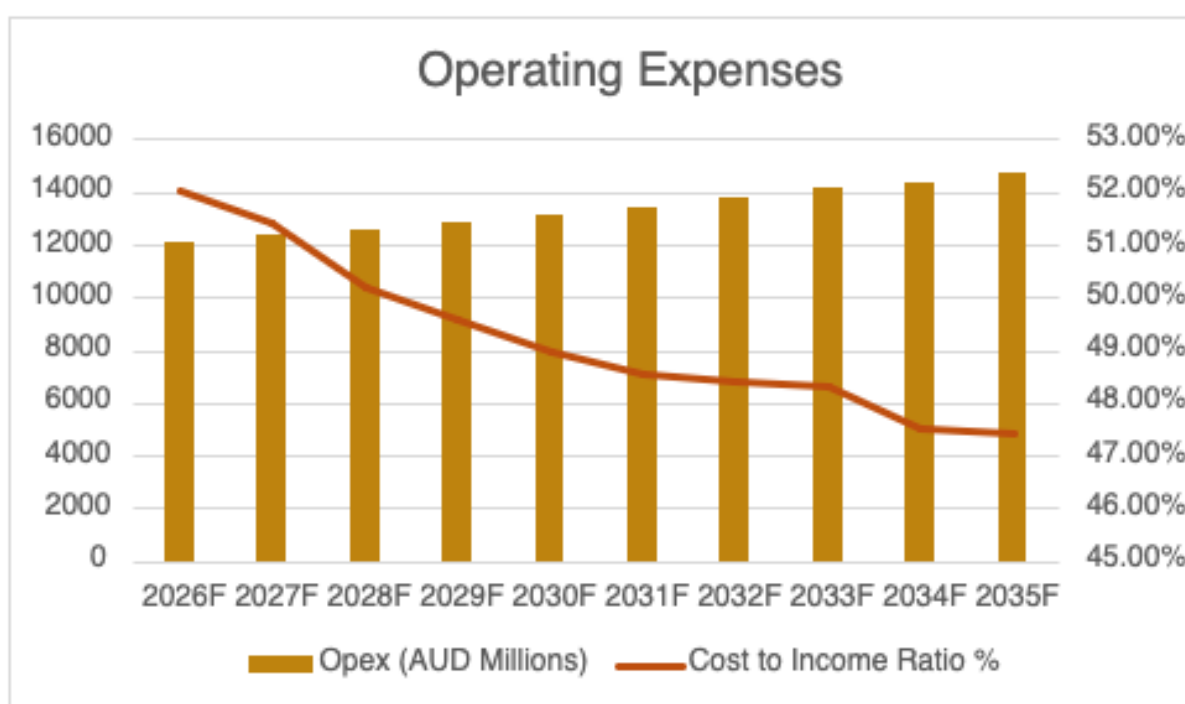
### Average Interest Earning Asset Growth

Housing loans are forecast with reference to Australian residential credit growth, incorporating mortgage affordability, household disposable income, residential property prices and Westpac's historical system capture rate. Near-term growth is set at 5.0% in FY26, in line with the 4% 1H26 reported figure and 1.2x system capture, with a deceleration as rising RBA rates tighten system growth. Over the medium term, growth moderates to ~4.3% by FY28 as system capture steps down toward 85% reflecting the unwind of WBC's volume-led strategy and normalisation toward system growth. Long run falls to ~4.0% by FY31, anchored to the 10-year average Australian residential credit growth rate of 5.4% per annum, with WBC's 75% historical average capture of system growth applied as an overlay in a mature, competitive market. Business lending growth is forecast with reference to Australian nominal GDP growth, with a qualitative overlay. Near-term growth remains elevated at 10% in FY2026, reflecting strong 1H26 momentum across Westpac's institutional and business banking divisions and its deliberate strategy to deploy capital into this segment. Longer term growth tapers to Australian nominal GDP growth and the forecast expects growth in business loans as a proportion of total loans. This reflects WBC's pursuit of volume in the business book and its shift toward higher risk weighted assets.

## OPEX Graph forecast

Staff expenses, historically the largest line, are forecast to grow at 1% in the near-term in line with RBA wage growth guidance of around 3% and accounting for the AI job displacements with an increase toward 2-3% from FY30 driven by wage growth in senior management positions as AI continues to displace lower-level jobs. Occupancy expenses contract in the short term, reflecting the Fit for Growth restructuring implemented in 2H FY25, the elimination of 200 teller roles, and a leaner physical footprint as digital banking reduces spatial needs. Growth stabilises modestly below long-run CPI from FY28 onward, consistent with ongoing branch consolidation.

Technology expenses, the second-largest line, is expected to front-load modestly in the near term as UNITE reaches peak deployment, before stabilising at 4–5% annual growth FY29 onwards as decommissioning of legacy systems yields efficiency savings — Morningstar notes that material cost savings are expected once banking systems are decommissioned late in FY2028, supporting the tapering growth profile thereafter as reinvestment normalises to a sustainable rate consistent with maintaining the technology base.



## Cost of Equity

The model applies a cost of equity of 8.39%, derived using CAPM. Risk-free rate is calculated using the Australian 10-year Government bond yield which has traded in the 4.3–4.7% range through the valuation period, approaching multi-decade highs amid elevated inflation and expectations of sustained higher interest rates. Applied against a market risk premium of approximately 6%, consistent with the long-run historical estimate used by Australian regulators like IPART, and a beta of 1.07, it reflects the defensive, oligopolistic characteristics of Australian major bank equities. This produces a cost of equity in the range of 8–9%. This is broadly consistent with third-party estimates: Alpha Spread calculates CBA's cost of equity at 7.79% using a beta of 0.75 and a risk-free rate of 4.7%, while Wallet Investor estimates WBC's cost of equity at 8.12% assuming a lower beta of 0.80. A cost of equity at the lower end of this band is reasonable for Westpac: as an institution subject to APRA oversight, WBC benefits from implicit government support backstop that compresses tail risk relative to non-financial corporates. Fully franked dividends reduce the effective required pre-tax return for Australian resident investors, and its market position provides earnings stability that justifies the near-market beta. However, the UNITE execution risk, structural NIM headwinds, and ROE remaining below peers introduces idiosyncratic risks that prevent a further reduction in the discount rate, supporting 8.39% as an appropriate estimate.

## Appendix C: Sensitivity Analysis

NIM

| NIM    | Valuation w/o FC | MoS w/o FC | Valuation w/ FC | MoS w/ FC |
|--------|------------------|------------|-----------------|-----------|
| -0.25% | \$12.99          | -64.53%    | \$20.88         | -42.95%   |
| -0.20% | \$15.02          | -58.96%    | \$23.52         | -35.77%   |
| -0.15% | \$17.06          | -53.39%    | \$26.15         | -28.58%   |
| -0.10% | \$19.10          | -47.82%    | \$28.78         | -21.40%   |
| -0.05% | \$21.14          | -42.25%    | \$31.41         | -14.21%   |
| 0.00%  | \$23.18          | -36.69%    | \$34.04         | -7.03%    |
| 0.05%  | \$25.22          | -31.12%    | \$36.67         | 0.15%     |
| 0.10%  | \$27.26          | -25.55%    | \$39.30         | 7.34%     |
| 0.15%  | \$29.30          | -19.98%    | \$41.93         | 14.52%    |
| 0.20%  | \$31.33          | -14.41%    | \$44.56         | 21.71%    |
| 0.25%  | \$33.37          | -8.84%     | \$47.19         | 28.89%    |

Cost of equity (Ke)

| Ke     | Valuation w/o FC | MoS w/o FC | Valuation w/ FC | MoS w/ FC |
|--------|------------------|------------|-----------------|-----------|
| -2.00% | \$36.59          | -0.04%     | \$53.93         | 47.30%    |
| -1.50% | \$31.95          | -12.72%    | \$47.04         | 28.48%    |
| -1.00% | \$28.36          | -22.52%    | \$41.72         | 13.95%    |
| -0.50% | \$25.51          | -30.33%    | \$37.48         | 2.39%     |
| 0.00%  | \$23.18          | -36.69%    | \$34.04         | -7.03%    |
| 0.50%  | \$21.24          | -41.97%    | \$31.17         | -14.85%   |
| 1.00%  | \$19.61          | -46.43%    | \$28.76         | -21.44%   |
| 1.50%  | \$18.21          | -50.25%    | \$26.70         | -27.08%   |
| 2.00%  | \$17.01          | -53.55%    | \$24.91         | -31.96%   |

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