

Research Update:

Judo Bank Pty Ltd. Assigned 'BBB-/A-3' Ratings; Outlook Positive

September 15, 2021

Overview

- Our ratings on Australia-based Judo Bank reflect its position as a newly formed and fast-growing business that has established a niche position in relationship-based SME lending.
- Judo Bank is well capitalized, allowing continued growth despite its limited profitability to date. The bank's SME lending focus facilitates competitive term-deposit pricing but has attracted a price-sensitive depositor base.
- We have assigned our 'BBB-' long-term and 'A-3' short-term issuer credit ratings to Judo Bank.
- The positive outlook reflects our view that Judo Bank is well placed to improve elements of its credit profile relative to peers as well as the Australian banking sector's improving systemwide funding characteristics.

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Rating Action

On Sept. 16, 2021, S&P Global Ratings assigned its 'BBB-' long-term and 'A-3' short-term issuer credit ratings to Australia-based Judo Bank Pty Ltd. (Judo Bank). The outlook on the long-term rating is positive.

Rationale

Judo Bank has had initial success in establishing a niche position in Australia's small and midsize enterprise (SME) lending market. The bank has leveraged broker relationships to generate new business volumes. Its business model is based on delivering a relationship-focused service to its customers. This is reflected in the bank's origination model, which prioritizes the character of borrowers and their cash flow ahead of the heavily collateral-focused lending approach of many of its competitors. Despite initial success in establishing its business, Judo Bank has yet to prove it will be able to sustain its business growth and retain its clients through a full economic cycle or periods of more aggressive competitive pressures while continuing to improve its profitability.

We expect Judo Bank will maintain a risk-adjusted capital (RAC) ratio sustainably above 15% in the next two years. The bank's current very strong capital position will support its rapid loan growth until it reaches a sustainable level of internal capital generation.

Judo Bank's funding profile is reliant on price-sensitive term deposits. To date, the bank has been successful in attracting term deposit funding in the current low interest rate environment where there is a segment of investors seeking higher returns from deposit products. In our view, this funding base is susceptible to volatile reinvestment rates and can be less stable than retail transaction deposits.

Given its focus on higher-risk SME lending, Judo Bank's asset quality experience has been strong compared to a residential lending focused bank. However, there remains ongoing uncertainty around Judo Bank's credit losses, both as its portfolio seasons and as the COVID-19 pandemic progresses given the greater sensitivity of SMEs to operating conditions. The bank has a strong assembly of experienced senior management who have successfully launched and developed the bank's business while managing its operational risks.

We have applied a one-notch negative adjustment to our issuer credit rating on Judo Bank to reflect risks from the bank's short track record in terms of both lending and profitability that make it less resilient than 'BBB' rated peers, in our view. Judo Bank has a limited record in establishing its market presence and is yet to demonstrate an ability to attract and retain customers if competition from peers intensifies. The adjustment also reflects Judo Bank's high reliance on term deposit funding, which makes the bank's deposit base susceptible to pricing and reputational risk, in our view. While the bank has had strong asset quality performance to date, it is yet to see out a full business cycle. Finally, Judo Bank's loan book and customer set are both concentrated due to its still small size and SME focus. While each of these elements individually is not material enough to shift any stand-alone credit profile (SACP) factor, we believe they collectively contribute to a weaker overall credit profile than 'BBB' rated peers.

Outlook

The positive outlook on our ratings on Judo Bank reflects our view that the bank is well placed to improve elements of its credit profile relative to peers. The bank is on track to continue its success of growing a sustainable business base, leveraging its customer-focused service strategy while improving its profitability and maintaining its asset quality through what are currently difficult operating conditions for SME customers. Judo Bank is also progressing efforts to diversify its funding to meet its growth ambitions and reduce its vulnerability to funding and liquidity pressures relating to its current reliance on price-sensitive term deposits.

The positive outlook also reflects our view that there is a one-in-three possibility Australian banks will face reduced industry risks in the next two years. We believe the Australian banking system's funding profile has been improving in the past 10 years on the back of growing customer deposits and falling offshore borrowing. We believe the stronger systemwide funding metrics could be sustained despite a modest weakening in the next three years as the COVID-19 driven rise in customer deposits through 2020 unwinds and the Reserve Bank of Australia's term funding facility matures.

Upside scenario

We could raise our issuer credit ratings on Judo Bank by one notch if:

- Judo Bank was to strengthen elements of its credit profile relative to higher rated peers; or
- We form a view that industry risks facing Australian banks have reduced sustainably and Judo Bank has made some progress in strengthening elements of its credit profile relative to higher rated peers. However, even if we form a view that industry risks facing Australian banks have reduced, that in itself would not necessarily result in us raising our issuer credit rating on Judo Bank.

Downside scenario

We expect to revise our outlook on Judo Bank to stable if the prospect of the bank improving elements of its credit profile were to diminish materially. If the bank's business development remains on track, we would not necessarily revise the outlook to stable if we form a view that industry risks faced by Australia's banking sector are unlikely to reduce in the next two years.

Ratings Score Snapshot

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Issuer Credit Rating	BBB-/Positive/A-3
SACP	bbb
Anchor	bbb+
BICRA economic risk score	3
BICRA industry risk score	3
Business position	Weak (-2)
Capital and earnings	Very Strong (+2)
Risk position	Adequate (0)
Funding and	Below Average (-1)
Liquidity	Adequate
Support	(0)
ALAC support	(0)
GRE support	(0)
Group support	(0)
Sovereign support	(0)
Additional factors	(-1)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

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- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Banking Industry Country Risk Assessment: Australia, April 27, 2021

Ratings List

New Rating; CreditWatch/Outlook Action

Judo Bank Pty Ltd.

Issuer Credit Rating	BBB-/Positive/A-3
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