![AUSWIDE BANK] henslow research

(ASX:ABA)

28 Oct 2021

Initiation

Long-established regional bank based in Bundaberg Queensland providing home loans, personal loans and credit cards.

Share Price	$6.95
Market Cap	$299.4m
Book Value	$257m
P/E Ratio	12.3x
P/B Ratio	1.2x
Dividend Yield	5.9%

Thesis

- Established in 1966, ABA is a regional bank based in Bundaberg providing home mortgage loans, personal loans and credit cards. Loans are mainly originated through the broker market and a select number of region-specific loan writers supported by a modest branch network and emerging digital channels.
- Under the current CEO, ABA's loan book has grown from $2.2bn in FY14 to $3.6bn in FY21 primarily by organic means rather than acquisitions.
- FY21 result was hard to fault with: loan book growth of 10% in FY21 (3.2 times system) despite the spectre of Covid19; a nominal increase in net interest margins despite interest rates at historical lows; a cost to income ratio of 60.1% (FY20: 62.5%); loans in arrears are currently at historical lows; and a strong overall capital ratio of 13.3% (FY20: 12.9%).
- ABA remains on the hunt for acquisitions with a focus on a merger with another ADI with a loan book of $500m+; a finance company providing SME/consumer lending; and/or a fintech in need of funding/compliance support.

Sensitivity

Sensitivity shows impacts on NPAT as interest earning assets and cost to income ratio change:

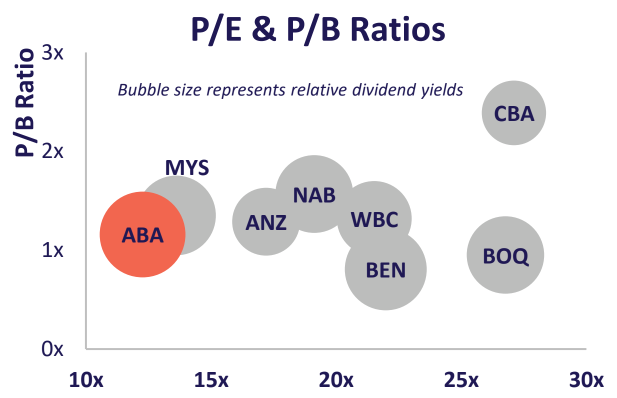
Growth in Interest Earning Assets

NPAT ($m)

Cost to Income Ratio	3%	6%	9%	12%
62%	23.7	24.4	25.1	25.8
61%	24.3	25.0	25.7	26.5
60%	25.0	25.7	26.4	27.1
59%	25.6	26.3	27.1	12.2
58%	26.2	27.0	27.8	28.5

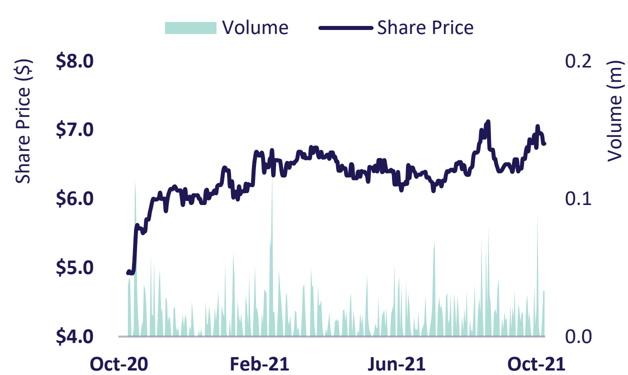
Comparative Valuation

- ABA is trading on a P/E ratio 12.3x, a P/B ratio of 1.2x and yielding a 5.9% dividend, which looks under valued.



Source: CapIQ

Share Price & Volume



Source: CapIQ

Investment View

ABA expects to maintain above-system loan growth in FY22.

Sensitivity Analysis & Valuation

1.1 Upside leverage to earnings comes from ongoing growth in its loan book subject to stable net interest margins and cost ratios.

1.2 ABA currently trades favourably compared to its peers.

Company Background

2.1 The origins of Auswide Bank (ABA) date back to the formation of Burnett Permanent Building Society (BPBS) in Bundaberg in 1966.

From 1976 to 2006 the group grew through a series of building society mergers in the central and south-east regions of Queensland to form Wide Bay Capricorn Building Society. In 2003 WBCB changed its name to Wide Bay Australia Ltd and listed on the ASX in 1994.

In 2013 current CEO Mr Martin Barrett joined the group in that role – Mr Barrett had previously been State Manager (Qld and WA) for St George Bank. ABA was awarded a banking licence by APRA in 2015 and changed its name to Auswide Bank.

ABA merged with the Brisbane based mutual Your Credit Union (YCU) in 2015 with ABA taking control by way of YCU members accepting cash and ABA scrip to extinguish their membership rights.

ABA's loan book remains skewed to Queensland – although this has reduced from 84% in FY15 to 71% at FY21 through the use of brokers and regional loan writers.

Financials

3.1 FY21 NPAT of $24m (+31% pcp) – a record result for ABA.

3.2 Strong overall capital ratio of 13.3% (FY20: 12.9%) well above Board target of 12.5%.

3.3 Loan Book has grown by 10%, funding is 75.7% from customer deposits and decreased arrears to 0.25% of total Loan Book.

Industry

4.1 The Australian residential mortgage market has c$2tn in loan outstandings of which just over 90% of the market is undertaken by licenced banks with balance being written by other authorised ADI's. The four major bank control almost 80% of the domestic mortgage market.

4.1 The Australian mortgage market has grown at a 20 year CAGR of c9% despite the period including the GFC and more recently Covid19.

4.2 We view the banking industry in three tiers being: Tier1 - the major banks; Tier 2 – the regionals - BEN, BOQ and SUN; and Tier 3 – smaller banks such as the ASX listed ABA and MYS with the segment also containing a number of mutual entities.

4.2 The adoption of technology and the brand damage to the major banks from the Banking Royal Commission has generally resulted in smaller banks attaining a level of loan growth in recent years above system – as was evidenced by ABA in FY21.

Appendix

5.1 Board & Management

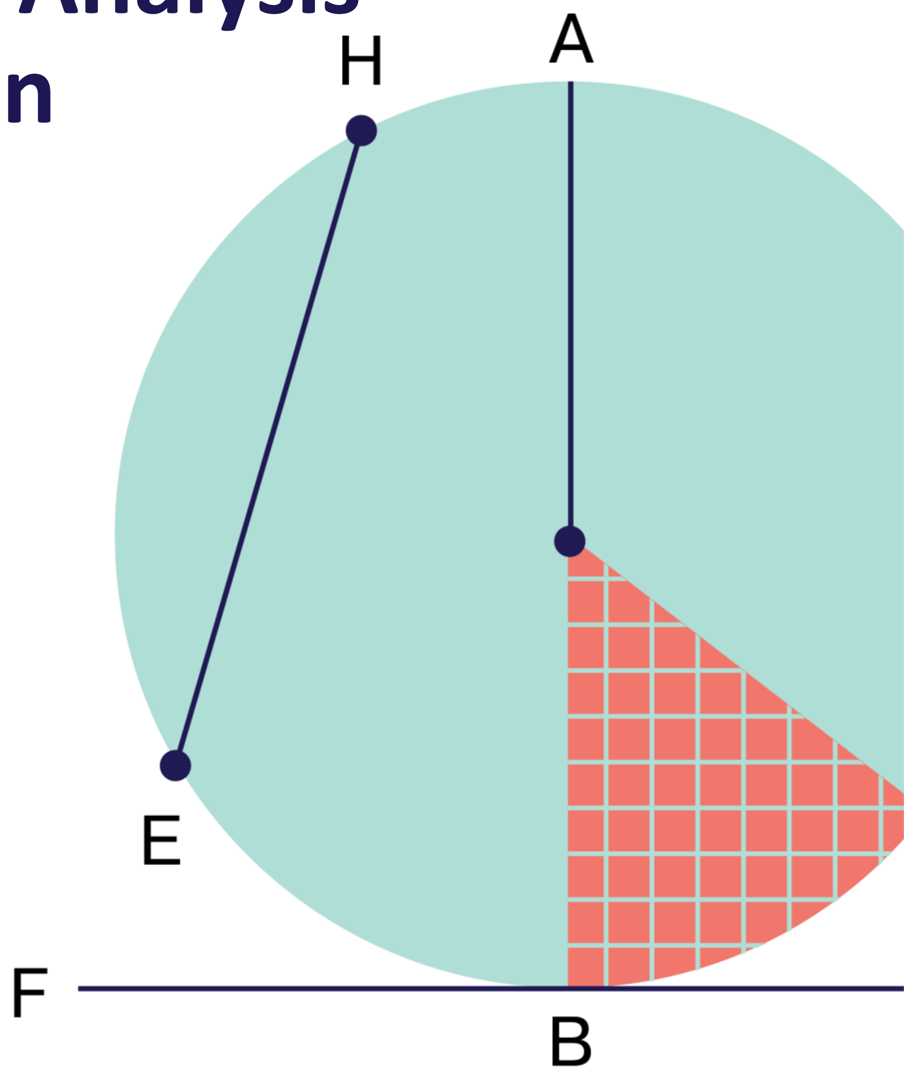
5.2 Register

5.3 Risks

5.4 M&A Activity

5.5 Disclaimer

Section 1: Sensitivity Analysis & Valuation



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Scenario & Sensitivity Analysis

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ABA's earnings are highly leveraged to growth in its loan book subject to maintenance of net interest margins and cost ratios.

Key Assumptions

- Sensitivity analysis (bottom) is based upon various rates of growth in ABA's average interest earning assets (loan book) vs. FY21 – ABA expects to achieve above system loan growth in FY22 which would likely place it closer to Scenario 3 than 2.
- Assumed that net interest margins remain stable at 2.00% attained in FY21 – this is ABA's current expectation.
- Cost to income ratio to remain at FY21 ratio of 60%.
- Bad debt expense to remain stable at 2% of average interest bearing assets.
- Tax rate of 30% assumed.

1 Scenario 1 shows FY21 results.

2 3 Scenarios 2 & 3 show incremental increases in net interest revenue, with net interest margins and cost to income ratio remaining stable versus FY21, and subsequent effects on NPAT.

	1	2		3	
Profit & Loss	**FY21**	**+3%**	**+6%**	**+9%**	**+12%**
Net Interest Revenue	78.2	80.5	82.9	85.2	87.5
Non Interest Income	10.4	10.7	11.0	11.3	11.6
Total Revenue	**88.5**	**91.2**	**93.8**	**96.5**	**99.1**
Operating Expenses	53.2	54.7	56.3	57.9	59.5
Bad & Doubtful Debts	0.6	0.6	0.6	0.6	0.7
Net Profit Before Tax	**34.7**	**35.9**	**36.9**	**38.0**	**39.0**
Income Tax Expense	10.5	10.9	11.2	11.5	11.9
NPAT	**24.2**	**25.0**	**25.7**	**26.4**	**27.1**

NPAT (A$m)

Cost To Income Ratio %	Growth In Interest Earning Assets %				
	FY'21 0%	3%	6%	9%	12%
62%		23.7	24.4	25.1	25.8
61%		24.3	25.0	25.7	26.5
60%	24.2	25.0	25.7	26.4	27.1
59%		25.6	26.3	27.1	12.2
58%		26.2	27.0	27.8	28.5

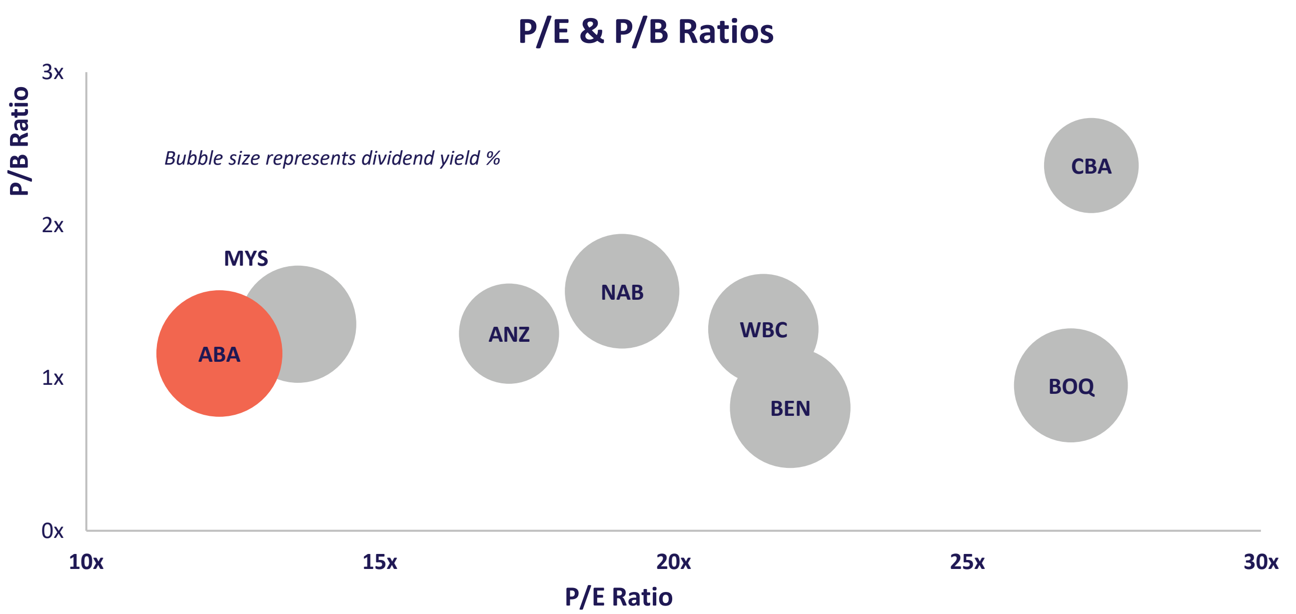
Comparable Valuation

ABA currently trades on favourable P/E & P/B ratios compared to its peers.

- ABA currently trading on P/E of 12.3 times FY21 earnings, price to book of 1.2 times and a dividend yield of 5.9%.
- This looks favourable against banking peers – our view is that with the stock continuing to trade at a nominal premium to book, the market has not taken account of its much improved RONTA in recent years.

Comparable Valuation	Share price ($)	P/E	P/B	Yield
ASX:ANZ	28.39	17.2x	1.3x	3.7%
ASX:BEN	9.38	22.0x	0.8x	5.4%
ASX:BOQ	9.21	26.8x	1.0x	4.8%
ASX:CBA	106.10	27.1x	2.4x	3.3%
ASX:NAB	29.30	19.1x	1.6x	4.8%
ASX:WBC	25.95	21.5x	1.3x	4.5%
ASX:MYS	5.33	13.6x	1.4x	5.1%
Average		**21.0x**	**1.4x**	**4.5%**
ASX:ABA	6.95	12.3x	1.2x	5.9%

- The graph below shows ABA vs. its peers on a P/E (x-axis) & P/B (y-axis) ratio basis.



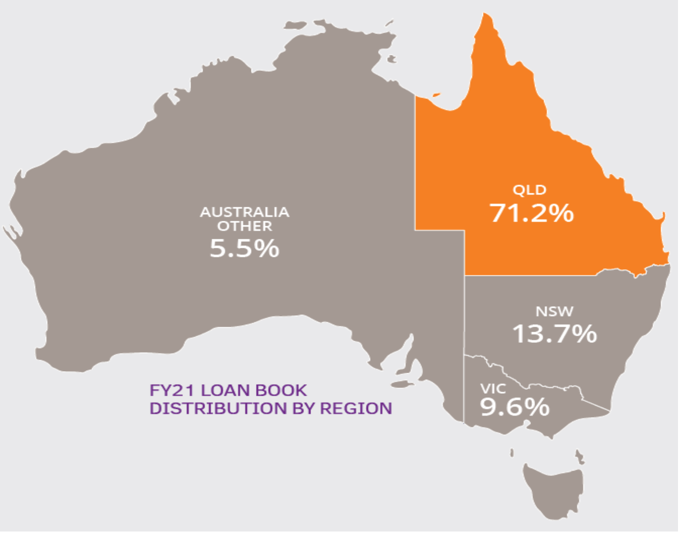
Source: Cap IQ & Henslow Analysis

Section 2: Company Background

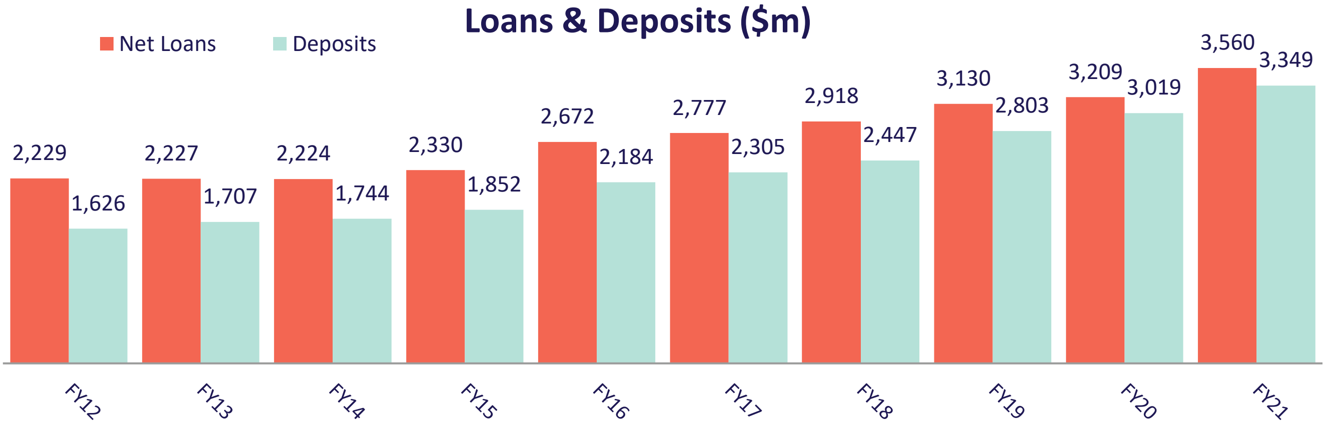
Company Background

ABA remains strongly correlated to the Queensland economy.

- The origins of Auswide Bank date back to the formation of Burnett Permanent Building Society (BPBS) in Bundaberg in 1966.
- The institution subsequently grew through a series of mergers in the central and south-east regions of Queensland. In 1979, BPBS merged with the local Maryborough Permanent Building Society to form Wide Bay Capricorn Building Society (WBCB). In 1981, WBCB merged with Gympie and North Coast Building Society. In 1983 WBCB merged with Port Curtis Building Society in Gladstone. In 2006, the group acquired the ASX listed Mackay Permanent Building Society.
- In 2003 WBCB changed its name to Wide Bay Australia Ltd and listed on the ASX in 1994.
- In 2013 current CEO Mr Martin Barrett joined the group in that role – Mr Barrett had previously been State Manager (Qld and WA) for St George Bank.
- ABA was awarded a banking licence by APRA in 2015 and changed its name to Auswide Bank.
- ABA merged with the Brisbane based mutual Your Credit Union (YCU) in 2015 with ABA taking control by way of YCU members accepting cash and ABA scrip to extinguish their membership rights.
- ABA's loan book remains skewed to Queensland – although this has reduced from 84% in FY15 to 71% at FY21 through the use of brokers and regional loan writers, and displayed in the graphic below.



Source: ABA Announcements.



Section 3: Financials

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Profit & Loss

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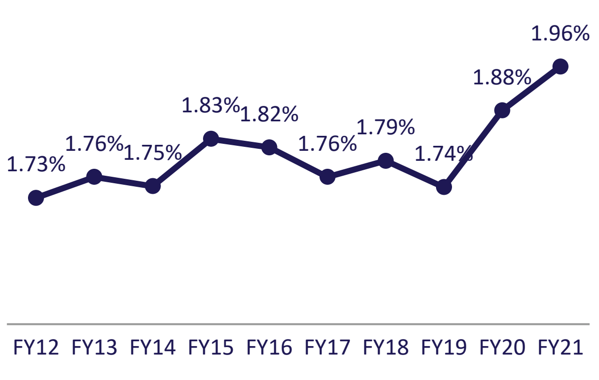
ABA achieved NPAT growth of 31% pcp in FY21 – a record result.

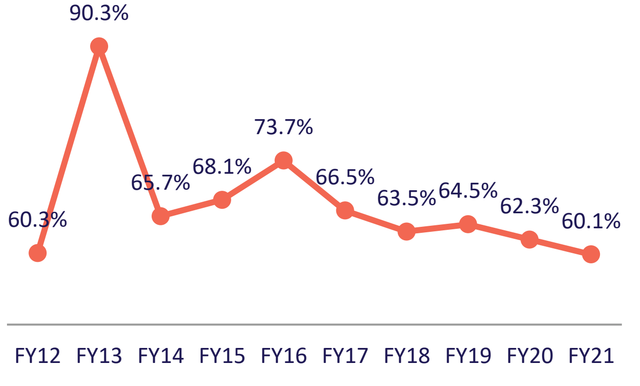
Auswide Bank			
Profit & Loss ($m)	**FY19**	**FY20**	**FY21**
Inrerest income	136.4	126.3	111.0
Interest Expense	73.2	55.7	32.8
Net Interest Revenue	**63.2**	**70.5**	**78.2**
Non Interest Income	9.5	10.0	10.4
Total Net Revenue	**72.6**	**80.5**	**88.5**
Operating Expenses	46.9	50.1	53.2
Loan Impairment Expense	1.1	3.8	0.6
Net Profit Before Tax	**24.6**	**26.5**	**34.7**
Income Tax Expense	7.4	8.0	10.5
Reported Net Profit After Tax	**17.2**	**18.5**	**24.2**
Normalisation Adjustments (Post Tax)	0.0	1.6	0.0
Normalised Net Profit After Tax	**17.2**	**20.1**	**24.2**
Ratios %			
Net Loan Growth % pcp	5.7%	3.9%	10.9%
Net Interest Margin % - ex free funds	1.74%	1.88%	1.96%
Net Revenue Growth %	3.2%	10.8%	10.0%
Opearting Expense Growth % - Ex Impairments	5.0%	7.0%	6.2%
Cost To Income Ratio %	64.5%	62.3%	60.1%
Effective Tax Rate %	30.2%	30.2%	30.4%

- Net Interest Margins: NIM of 2.00% (FY20: 1.97%) with ABA able to neutralise the impact of lower asset yields through strong deposit growth to $2.9bn (+12% pcp) and lower wholesale funding costs through lower reliance upon securitisation and by accessing the low-cost RBA Term Funding Facility.
- Other non-interest income: $10.4m (+4% pcp) which accounted for 11% of group operating revenue. Lag in fee growth to growth in loan book can be attributed to strong competition in the mortgage market.
- Operating expenses: Positive jaws with revenue growth of 10% pcp exceeding operating expense growth of 6% pcp delivering a cost to income ratio of 60.1% (FY20: 62.5%) – attainment of a ratio of 60% has been a long-term aspiration.
- Loan loss impairments: Net increase in provision of $589k (FY20:$3.8m) with the prior period loan loss charge inflated by caution around the impact of Covid19. At FY21 ABA's impaired loans were at historical lows.

Net Interest Margin (%)



Cost to Income Ratio (%)



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Balance Sheet & Cash Flow

Balance Sheet

Balance Sheet ($m)	FY19	FY20	FY21
Cash	104	106	113
Due From Other Financial Institutions	21	16	13
Accrued Receivables	0	0	0
Financial Assets	317	378	399
Loans & Advances	3,086	3,206	3,555
Other Investments	1	1	1
Property, Plant & Equipment	14	21	21
Deferred Tax Assets	7	9	3
Other Assets	4	3	3
Goodwill	48	48	48
Total Assets	**3,603**	**3,789**	**4,156**
Deposits & Short Term Borrowings	2,803	3,019	3,349
Due To Other Financial Institutions	0	50	151
Payables & Other Liabilities	39	26	19
Securitised Loans	490	421	334
Income Tax Payable	0	0	0
Deferred Tax Liability	2	1	1
Provisions	3	3	4
Subordinated Loans	28	28	42
Total Liabilities	**3,365**	**3,547**	**3,899**
Net Assets	**238**	**242**	**257**
Contributed equity	192	193	195
Reserves	15	14	15
Accumulated losses	31	34	46
Equity	**238**	**242**	**257**

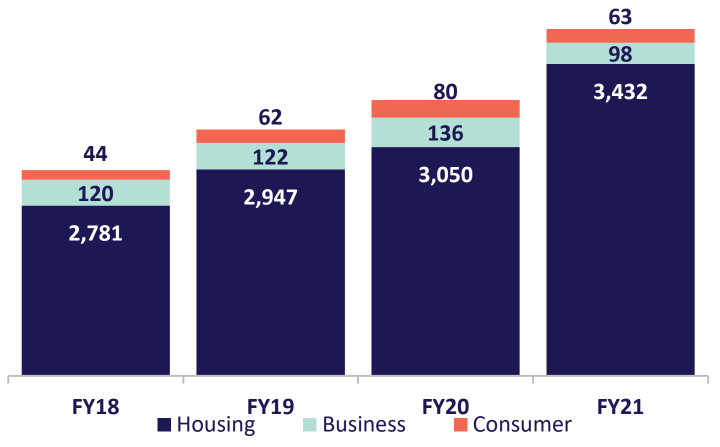
Cash Flow

Cash Flow ($m)	FY19	FY20	FY21
Interest Received	136.4	127.0	111.1
Dividends Received	0.0	0.0	0.0
Borrowing Costs	-70.8	-60.5	-36.6
Other Non Interest Income	14.6	10.7	10.2
Cash Paid to Suppliers & Employees	-34.4	-59.7	-50.6
Income Tax Paid	-10.2	-10.3	-4.9
Net Cash from Operating	**36**	**7**	**29**
Net Movement In Investment Securities	-61	-61	-21
Net Movement in Amounts Due/From Financial Institutions	-6	5	4
Net Movement In Loans	-169	-125	-350
Acquisitions	0	0	0
Net Movement In Other Investments	0	0	0
Payment for Property, Plant & Equipment	-1	-3	-2
Net cash from Investing	**-237**	**-184**	**-369**
Net Movement In Borrowings	352	264	430
Movement in Subordinated Loans	0	0	14
Net Movement in Amounts Due/From Financial Institutions	-118	-71	-88
Capital Raised	0	0	0
Dividends Paid	-14	-14	-11
Net cash from Financing	**220**	**179**	**346**
Net change in cash	18	2	6
Cash at beginning of year	86	104	106
Cash at end of year	**104**	**106**	**113**

- Loan book: $3.6bn (+10% pcp) which represents 3.2 times banking industry system growth in FY21. Growth was all organic and was driven by strong broker flows and extended loan writer presence in SE Qld, NSW and Victoria.
- Capital: Strong overall capital ratio of 13.3% (FY20: 12.9%) well above Board target of 12.5%.
- Dividends: Total dividends of 40cps (FY20: 27.75cps) with a payout ratio 73% (FY20:63%) with the prior period impacted by APRA's cautionary guidance on dividends due to Covid19.

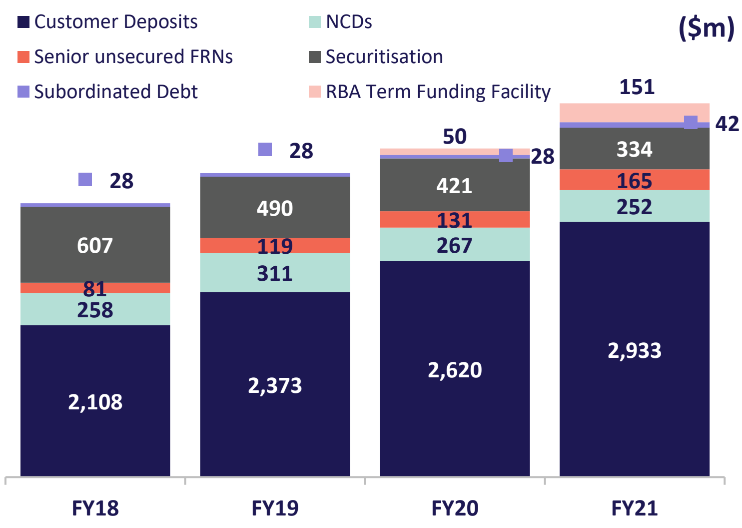
Loan Book

ABA has grown its Loan Book by 10%, is executing its focus on customer deposits funding (75.7% up 1.2% pcp), and arrears decreasing to 0.25% of total Loan Book.



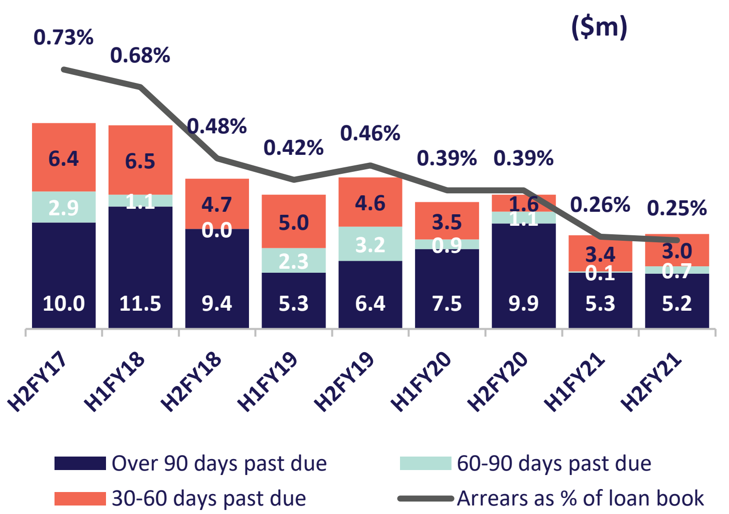
Loans & Advances Balances

- ABA remains very much a residential mortgage bank with housing loans accounting for 96% of its total loan book at FY21.
- FY21 loan growth driven by strong acceptance in broker channels and participation in the Federal First Home Loan Deposit Scheme.



Funding Mix

- ABA's dominant funding source remains retail deposits.
- ABA has fully utilised its share of the RBA Term Funding Facility at concessional rates put in place in response to Covid19. This has reduced the reliance upon more expensive securitisation funding.



Loan Book Arrears

- Fears of a Covid19 driven adverse credit cycle have not been realised with ABA's arrears book at an historical low at FY21.

Source: ABA Announcements.

Section 4: Industry

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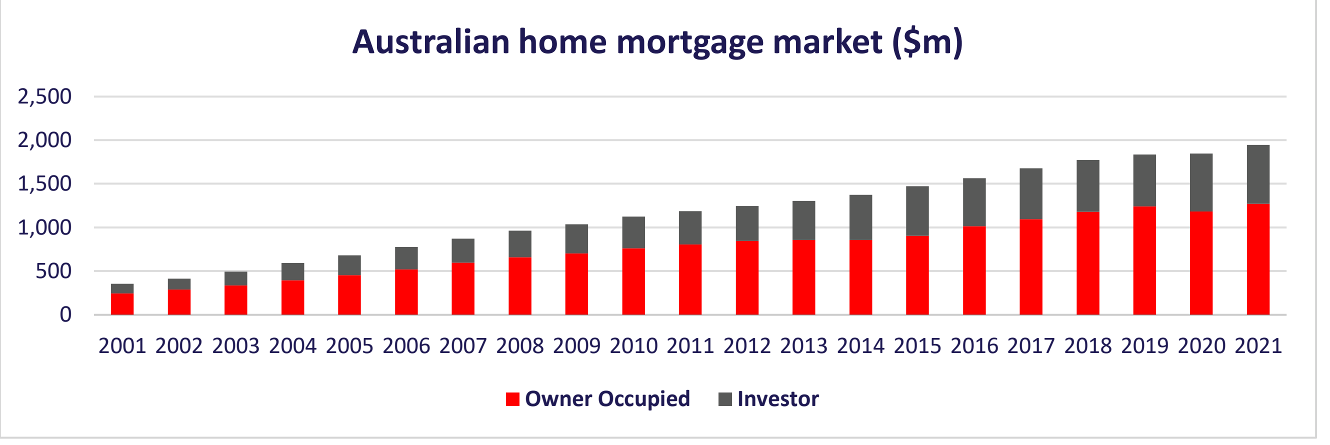
Industry

The Australian home mortgage lending industry has loan outstandings of c$1.9bn.



Market size

- The Australian residential mortgage market has approximately $2tn in loans outstanding of which just over 90% of the market is undertaken by licenced banks with balance being written by other authorised ADI's. The four major bank control almost 80% of the domestic mortgage market.
- The Australian mortgage market has grown at a 20 year CAGR of c9% despite the period including the GFC and more recently Covid19.
- We view the banking industry as being in three rough size tiers being: Tier1 - the major banks); Tier 2 – the regionals being BEN, BOQ and SUN; and Tier 3 – smaller banks such as the ASX listed ABA and MYS with the segment also containing a number of mutual entities including banks and credit unions.

Industry trends

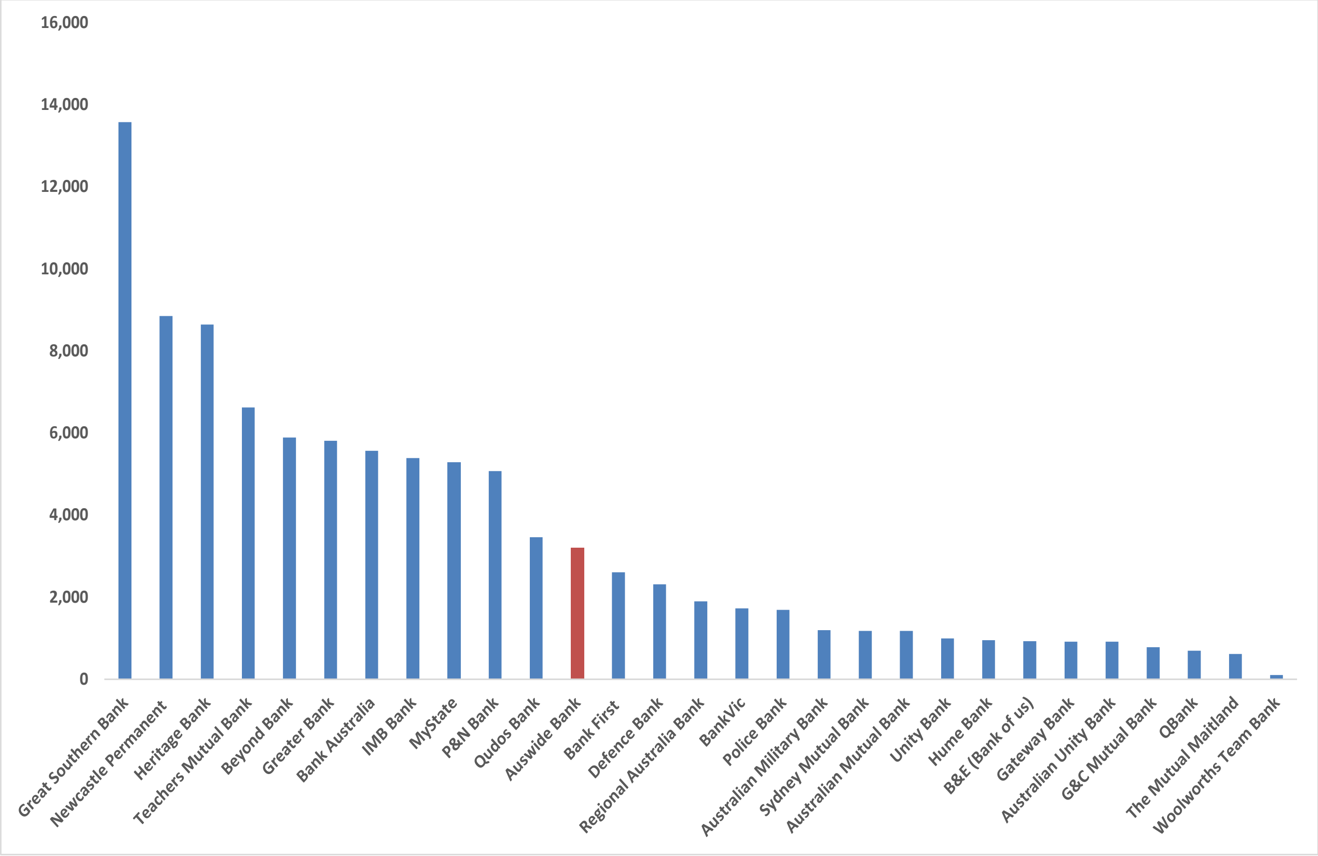
The industry landscape at the smaller end the domestic market (and credit unions) has been dynamic in terms of change in recent years. Observed trends have been:

- **Technology:** Smaller banks and credit unions have generally played a game of catch-up in terms of embracing technology in terms of digital banking, automated processing, banking apps and payment platforms – ABA recently added GooglePay access for its customers.
- **Growth:** The adoption of technology and the brand damage to the major banks from the Banking Royal Commission has generally resulted in smaller banks attaining a level of loan growth in recent years above system – as was evidenced by ABA in FY21.
- **Branding:** Many building societies and credit unions have changed to bank status and taken the opportunity to re-brand with a more modern look. Also, some institutions which were historically aligned to one industry or employer have re-branded and more actively pursued customers external to that industry or company – for example the Ford Credit Co-Operative is now known as Geelong Bank.

Industry Cont.

- **M&A:** Recent trend has been for consolidation of smaller banks (see slides 19-21) – particularly mutuals which have been seeking to add scale and defray increased technology and compliance costs. ABA has sought to participate in this consolidation but has generally been thwarted by mutuals agreeing to merge rather than consolidate with a listed company. Of interest, is that some recent M&A has involved more sizeable transactions such as the acquisitions of ME Bank by Bank of Queensland to create a combined loan book of $70bn+ and the pending merger of Heritage Bank and Pulse Credit Union to create a combined loan book of $15bn+.
- **Capital:** Whilst most smaller banks have very strong capital ratios (commonly 15%+), the regulator APRA in 2019 announced that mutual financial institutions could now issue what are known as Mutual Capital Instruments (MCI's) to external parties by creating a new class of investor with limited participatory rights. To date, there has been limited take-up of MCI's although the initiative co-incided with the advent of Covid19 at which time the RBA provided cheap term loan funding to the banking system which has been well used.

Australian Third Tier Banks – Net Loan Book at FY20



Section 5: Additional Information

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Board & Senior Management

	Shares	%
Ms Sandra Birkensleigh (Chairman)	-	-

- Appointed to the ABA Board in 2015 and subsequently appointed Chairman in January 2021.
- Previously a partner at PricewaterhouseCoopers for 16 years until 2013, with an industry focus on financial services.
- Currently a Non-Executive Director of MLC Insurance, the National Disability Insurance Agency, Horizon Oil and 7-11 Holdings.

	Shares	%
Mr Barry Dangerfield (Non-Executive Director)	43,291	0.1%

- Appointed to ABA Board in 2011 following at 39-year career with Westpac Banking Corporation holding positions across Queensland and the Northern Territory including Regional Manager Business Banking, Head of Commercial and Agribusiness and Regional General Manager Retail Banking.
- Currently a Director of the Bundaberg Friendly Society Medical Institute.

	Shares	%
Mr Gregory Kenny (Non-Executive Director)	15,000	NM

- Appointed to ABA Board in 2013 after a lengthy career in the financial services/banking industry with Bank of New York, Bank of America, St George Bank and Westpac Banking Corporation.
- Previously, held position of General Manager NSW/ACT Corporate & Business Bank with St George Bank.

	Shares	%
Mr Grant Murdoch (Non-Executive Director)	14,000	NM

- Appointed to ABA Board in 2021 following a lengthy career as a partner with both Ernst & Young and Deloitte with a focus on corporate advisory, M&A, capital raisings/IPOs.
- Currently a director of OFX, Lynas Rare Earths and UQ Holdings.

	Shares	%
Ms Jacqueline Korhonen (Non-Executive Director)	-	-

- Appointed to ABA Board in 2021 after a 30+ year career with several multi-national technology companies including 25 years at IBM.
- Currently a director of MLC Life Insurance, au.Domain Administration and is Chair of Council for International House, Sydney University.

	Shares	%
Mr Martin Barrett (Executive Director & Managing Director)	246,045	0.6%

- Commenced as Chief Executive Officer at ABA in 2013 and appointed to the role of Managing Director shortly thereafter.
- Extensive experience in the banking industry previously holding the positions of Managing Dircetor NSW/ACT Corporate & Business Bank at St George Bank. Mr Barrett also previously held senior roles in the UK with National Australia Bank.

	Shares	%
Mr William Schafer (Chief Financial Officer)	57,012	0.1%

- Long-standing Chief Financial Officer of ABA having been appointed to the role of Company Secretary in 2001.

	Shares	%
Total Board & Mgmt. Holdings	**375,348**	**0.9%**

Share Register – Top 5

Below are the major shareholders as at September 30, 2021.

Rank	Investor	No. Shares (m)	Issued Capital %
1	Australian Ethical Investors	2.9m	6.7%
2	Ronald Hancock	2.3m	5.3%
3	Craig Kennedy	0.5m	1.2%
4	Graham Cockerill	0.4m	1.0%
5	K Sawyer	0.4m	1.0%
	Top 5 Shareholdings	**6.5m**	**15.1%**

Source: Cap IQ

Risks

There are several risks associated with an investment in ABA.

	Risk	Description
High Risk	**Credit risk**	• ABA relies upon its own credit risk framework of policies, procedures and systems to control credit risk. This includes the judgement applied by management in setting adequate provisions for borrowers not repaying loans taking into account a range of scenarios including the economic outlook.
High Risk	**Liquidity risk**	• ABA is exposed to any sudden shifts in the availability of both retail and wholesale funding to finance its balance sheet and associated cash flows.
Medium Risk	**Technology risks**	• The efficient and uninterrupted operation of ABA"s core IT infrastructure and systems is critical to maintaining reputation in the banking industry. This also includes the risks to the security of client funders due to cyber-risks.
Medium Risk	**Regulatory changes**	• ABA is exposed to any regulatory changes from Federal and/or state governments and associated industry regulators such as APRA. This includes changes relating to a range of factors such as lending constraints, capital requirements interest rates, use of broker distribution etc.
Low Risk	**Competition risks**	• ABA is continually exposed to competition risks from both traditional banks and more recently emerging ADI's including neo-banks.
Low Risk	**Economic downturn**	• A sustained economic downturn can impact a range of factors such as secured asset values, general demand for credit and debtor service capacity. ABA's risks are more concentrated in regional Queensland.

M&A Activity

Date	Entities	Consideration
2014	Bank Australia ($2.7bn) & Swan Hill Credit Union ($22m)	No consideration
2015	G&C Mutual Bank ($441m) & Quay Credit Union ($124m)	A $10 per QCU member credited to new G&C Mutual Bank account
	IMB Bank ($3.7bn) & Sutherland Credit Union ($168m)	No consideration - No account fees paid by SCU members for 2 years.
2016	Auswide Bank ($2.3bn) & Your Credit Union ($125m)	ABA paid YCU members $4k per member plus 696 Auswide shares.
	Encompass Credit Union ($201m) & Select Credit Union ($203m)	No consideration.
	Beyond Bank ($3.7bn) & Country First Credit Union ($29m)	No consideration.
	ECU Credit Union ($285m) & Queensland Country Credit Union ($1bn)	No consideration
	Beyond Bank ($3.7bn) & Country First Credit Union ($29m)	No consideration.
	Teachers Mutual Bank ($4.1bn) & Fire Brigade Employees Credit Union ($180m)	No consideration.
2019	P&N Bank ($3.7bn) & Bananacoast Credit Union ($1.4bn)	No consideration.
2020	IMB Bank ($6.1bn) & Hunter United Credit Union ($272m)	No consideration.
	Beyond Bank ($5.9bn) & Nexus Mutual ($301m)	No consideration.
2021	Teacher's Mutual Bank ($6.6bn) & Firefighter's Mutual Bank ($34m)	No consideration.
	Bank of Queensland ($47bn) & ME Bank ($27bn)	BOQ paid shareholders of ME Bank. $1.325bn, ~1.05x book value.
	Qld Country Credit Union ($1.9bn) & Maleny Credit Union ($28m)	No consideration.
	Teacher's Mutual Bank ($6.6bn) & Pulse Credit Union ($41m)	No consideration.
	Horizon Bank ($334m) & Lysaght Credit Union ($80m)	$200 payment per LCU member as a loyalty consideration.
	Heritage Bank ($8.6bn) & Pulse Credit Union ($7.9bn)	No consideration.
	Macquarie Credit Union ($89m) & Orange Credit Union ($146m)	No consideration.
	Greater Bank ($5.8bn) & Newcastle Permanent ($9.2bn) discussing merger	TBA

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