Mortgage growth is slowing

APRA's monthly ADI statistics show Auswide's mortgage book growth slowing. It has now grown at below industry levels for the months of February, March and April, with ABA perhaps stepping back while some competitors are aggressively buying market share with sharp variable rate pricing and cash-back offers.

With the yield curve and swap rates rising, accompanied by some retail deposit pricing, this could be a prudent pull-back protecting margins until funding again becomes more attractive.

Auswide's strong underwriting and extremely high quality mortgage book should also reveal its benefits should industry bad debts start to rise alongside interest rates.

Read though from major banks positive

We note that none of the major banks sought to protect their margins by putting through a variable interest rate increase in excess of the 25bps increase by the RBA in April. Additionally, some major banks reported results, providing substantial visibility as to how the price setters of the industry are seeing things. While NIMs did come under pressure, the falls were all single digit bps. Credit quality remained solid. Capital requirements from interest rate risk in the banking book also modestly increased for the majors, and may also have a modest impact on Auswide Bank.

Rising interest rates stimulate deposits

Major banks debt funding costs have been rising in recent months, as the yield curve and swap rates have risen. Now that the RBA has finally commenced rising interest rates, this should also flow through to deposit rates. We believe this should stimulate deposit growth, the main source of ABA's funding, enabling faster loan growth for ABA while maintaining relatively stable NIMs.

Technology investment continues to lift

Auswide continues to invest in technology, including cloud and data, to improve its offerings for brokers and customers, as well as automation, which should support further operational efficiencies.

Still attractive on valuation and yield

At the current share price, we estimate ABA is trading on a FY23E PE of 10.4x, and a dividend yield of 6.6%. This makes it a cheaper way to gain exposure to the Australian banking sector than major and most regional banks, given the low multiples the stock trades on; plus it offers a higher dividend yield, fully franked, than the major and most regional banks.

AUSWIDE BANK

Auswide Bank Ltd (ABA) is Australia's 24th largest bank, and 54th largest bank operating in the Australian market. It was established in 1966 in regional Queensland, listed on the ASX in 1994, and rebranded when converting into a bank in 2015.

ABA has established an Australia-wide lending presence supported through branches, business bankers, accredited mortgage brokers and online.

ABA has a strong presence in QLD and is growing across the rest of Australia. The Company boasts a high-quality loan book with over $4.0b in assets, representing a market share of around 11 basis points (0.11%).

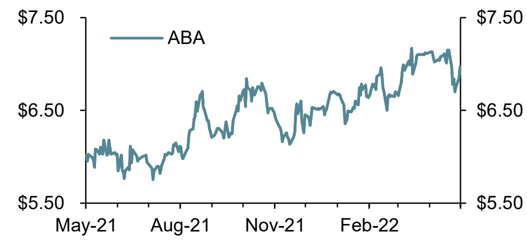
Stock	ABA.ASX
Market cap	A$307m
Price	A$6.81
Valuation	A$9.60 (was $9.50)

Company data	
Shares on issue	43.3m

Recent Events	
1H22 result	February 2022

Next steps	
Monthly APRA ADI statistics	Last business day of the following month
FY22 result	August 2022
AGM	November 2022

ABA Share Price (A$)



Glen Wellham, Senior Analyst

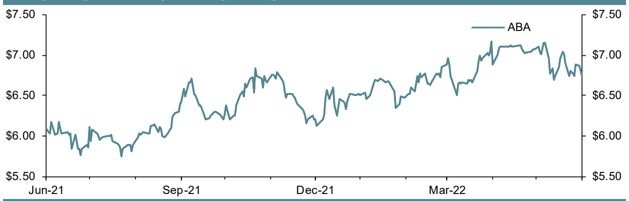
Financials

AUSWIDE BANK LTD — ABA-AX

Year end 30 June, A$

MARKET DATA		
Price	A$	$6.81
Valuation	A$	$9.60
52 week low - high	A$	6.11 - 7.20
Market capitalisation	A$m	297
Shares on issue (basic)	m	43.6
Options / rights (currently antidilutive)	m	
Other equity	m	
Shares on issue (fuly diluted)	m	43.6

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS		FY20A	FY21A	FY22E	FY23E	FY24E
EPS - diluted reported	cps	43.80	56.66	62.29	65.66	70.55
EPS - diluted cash	**cps**	**43.80**	**56.66**	**62.29**	**65.66**	**70.55**
EPS growth	%	7%	29%	10%	5%	7%
PE	x	15.5	12.0	10.9	10.4	9.7
DPS	A$	0.28	0.40	0.42	0.45	0.49
Franking	%	100%	100%	100%	100%	100%
Dividend yield	%	4.1%	5.9%	6.2%	6.6%	7.2%
Payout rato	%	63%	71%	68%	69%	70%
Operating cash flow per share	cps	351.0	260.7	235.2	170.2	183.5
Free cash flow to equity per share	cps	37.2	39.6	174.1	55.2	60.3
FCF yield	%	5.5%	5.8%	25.6%	8.1%	8.9%
Enterprise value	$m	3,814	4,173	4,718	5,698	7,144
EV/Total Revenue	x	49.8	47.5	49.1	55.3	64.1
NAV per share	A$	5.71	6.00	6.33	6.56	6.80
Price / NAV	x	1.19	1.14	1.08	1.04	1.00
NTA per share	A$	4.59	4.88	5.23	5.47	5.74
Price / NTA	x	1.48	1.40	1.30	1.24	1.19

KEY RATIOS		FY20A	FY21A	FY22E	FY23E	FY24E
CET1 ratio	%	11.09%	10.84%	10.71%	10.48%	10.24%
Capital ratio	%	12.95%	13.31%	12.85%	12.43%	12.03%
Leverage ratio	%	6.58%	6.70%	6.47%	6.23%	6.01%
Operating income growth	%	10.8%	10.0%	8.3%	7.8%	8.2%
Expense growth	%	7.0%	6.2%	7.8%	7.1%	7.5%
Jaws	%	3.8%	3.8%	0.5%	0.7%	0.7%
ROE - reported	%	7.7%	9.7%	10.1%	10.2%	10.6%
ROE - cash	%	7.7%	9.7%	10.1%	10.2%	10.6%
Net debt	**A$m**	**3,517**	**3,876**	**4,421**	**5,401**	**6,847**
Leverage (net debt / invested capital)	x	5.1	5.5	6.1	7.3	9.1

DUPONT ANALYSIS		FY20A	FY21A	FY22E	FY23E	FY24E
Net Profit Margin	%	24%	27%	28%	28%	28%
Asset Turnover	%	2.1%	2.2%	2.2%	2.0%	1.7%
Return on Assets	%	0.5%	0.6%	0.6%	0.6%	0.5%
Financial Leverage	x	15.38	15.93	16.66	18.40	21.57
Return on Equity	%	7.7%	9.7%	10.1%	10.2%	10.6%

HALF YEARLY DATA		2H21A	1H22A	2H22E	1H23E	2H23E
Net Interest Income	A$m	39.9	41.3	42.4	45.2	46.9
Total Revenue	A$m	45.1	48.5	47.6	50.7	52.4
Profit before income tax	A$m	18.2	19.7	19.1	20.4	21.2
Reported NPAT	A$m	12.7	13.7	13.3	14.2	14.7
Cash NPAT	A$m	12.7	13.7	13.3	14.2	14.7
EPS - diluted cash	**A$**	**0.30**	**0.32**	**0.31**	**0.32**	**0.33**
EPS - diluted reported	A$	0.30	0.32	0.31	0.32	0.33
DPS	A$	0.21	0.21	0.21	0.22	0.23

KEY PERFORMANCE INDICATORS		FY20A	FY21A	FY22E	FY23E	FY24E
Average loans and advances	$m	3,151	3,438	3,735	4,086	4,491
Net Interest Margin	%	1.97%	2.00%	1.97%	1.99%	1.97%
Total Revenue / Average loans and advances	%	2.43%	2.56%	2.57%	2.52%	2.48%
Cost to income ratio	%	62.3%	60.1%	59.9%	59.5%	59.1%
ECL allowance as a % of gross loans	%	0.21%	0.17%	0.14%	0.14%	0.14%
Growth in loans and advances	%	2.4%	10.9%	9.6%	9.8%	9.9%

PROFIT AND LOSS		FY20A	FY21A	FY22E	FY23E	FY24E
Interest Revenues	A$m	126.3	111.0	113.2	134.2	161.9
Interest Expense	A$m	-55.7	-32.8	-29.5	-42.1	-61.8
Net Interest Income	**A$m**	**70.5**	**78.2**	**83.7**	**92.1**	**100.2**
Non-Interest Income	A$m	10.0	10.4	12.2	11.3	11.8
Total operating income	**A$m**	**80.5**	**88.5**	**95.9**	**103.4**	**111.9**
Provision For Loan Losses	A$m	-3.8	-0.6	0.2	-0.4	-0.5
Total Revenue	**A$m**	**76.6**	**87.9**	**96.1**	**103.0**	**111.5**
Non-Interest Expense	A$m	-50.1	-53.2	-57.4	-61.5	-66.1
Profit before income tax	**A$m**	**26.5**	**34.7**	**38.7**	**41.5**	**45.4**
Income tax expense	A$m	-8.0	-10.5	-11.7	-12.6	-13.7
Reported NPAT	**A$m**	**18.5**	**24.2**	**27.0**	**28.9**	**31.6**
Cash NPAT	A$m	18.5	24.2	27.0	28.9	31.6
Weighted average diluted shares	m	42.2	42.6	43.3	44.1	44.8

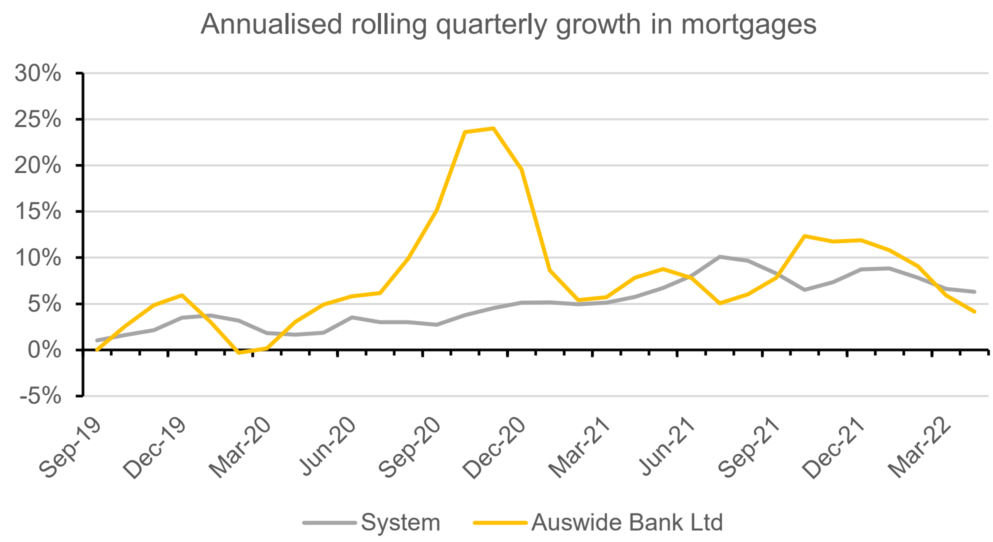
BALANCE SHEET		FY20A	FY21A	FY22E	FY23E	FY24E
Cash and cash equivalents	A$m	106.5	112.6	333.0	903.3	1,894.6
Loans and advances	A$m	3,205.8	3,555.0	3,897.8	4,281.6	4,707.3
Other financial assets	A$m	378.3	398.8	397.9	438.7	483.6
Property, plant and equipment	A$m	21.4	21.3	22.2	22.2	22.2
Goodwill and other intangibles	A$m	47.6	47.8	47.9	47.9	47.9
Other assets	A$m	28.6	20.1	19.5	19.4	19.4
Total Assets	**A$m**	**3,788.1**	**4,155.8**	**4,718.2**	**5,713.2**	**7,175.1**
Deposits and short term borrowings	A$m	3,018.5	3,349.3	3,921.5	5,101.5	6,648.8
Loans under management	A$m	420.7	333.7	306.3	156.3	156.3
Other borrowings	A$m	49.8	150.8	151.0	101.2	0.0
Subordinated capital notes	A$m	28.0	42.0	42.0	42.0	42.0
Other liabilities	A$m	29.0	23.4	21.4	21.4	21.4
Total Liabilities	**A$m**	**3,546.0**	**3,899.2**	**4,442.1**	**5,422.4**	**6,868.4**
Net assets	**A$m**	**242.0**	**256.5**	**276.1**	**290.8**	**306.7**
Net tangible assets	**A$m**	**194.5**	**208.7**	**228.2**	**242.9**	**258.8**
Invested capital	**A$m**	**690.3**	**704.8**	**724.3**	**739.0**	**754.9**
Tangible invested capital	**A$m**	**642.7**	**656.9**	**676.4**	**691.1**	**707.0**
Contributed equity	A$m	193.3	195.2	197.9	197.9	197.9
Treasury shares	A$m	0.0	0.0	0.0	0.0	0.0
Reserves	A$m	14.4	15.5	20.9	20.9	20.9
Retained earnings/accumulated losses	A$m	34.3	45.8	57.4	72.1	88.0
Non-controlling interests	A$m	0.0	0.0	0.0	0.0	0.0
Total equity	**A$m**	**242.0**	**256.5**	**276.1**	**290.8**	**306.7**
Basic shares on issue	m	42.4	42.8	43.6	44.4	45.1

CASH FLOW		FY20A	FY21A	FY22E	FY23E	FY24E
Operating						
Net operating cashflow	**A$m**	**148.3**	**111.2**	**101.9**	**75.0**	**82.3**
Investment						
Capital expenditure	A$m	-2.8	-1.9	-2.9	-3.0	-3.0
Acquisitions and divestments	A$m	-56.6	-17.2	19.9	0.0	0.0
Net investment cashflow	**A$m**	**-59.4**	**-19.1**	**17.0**	**-3.0**	**-3.0**
Financing						
Equity	A$m	-13.6	-10.7	-15.4	-18.8	-20.9
Debt	A$m	-71.0	-73.7	-42.0	-46.1	-50.6
Leases	A$m	-2.2	-1.5	-1.6	-1.6	-1.6
Net financing cashflow	**A$m**	**-86.8**	**-85.9**	**-59.0**	**-66.5**	**-73.2**
Net cash flow	**A$m**	**2.1**	**6.1**	**60.0**	**5.5**	**6.1**
Free cash flow to equity	A$m	15.7	16.9	75.4	24.3	27.0

Source: ABA reports, MST Access estimates

APRA market share statistics show growth back at system

Figure 1 – Annualised rolling quarterly growth in mortgages



Source: APRA Monthly ADI Statistics, MST Access

Valuation

We consider a range of valuation approaches to estimate Auswide Bank's valuation, including:

- intrinsic valuation scenarios of its potential future growth profiles.
- peer multiples and growth rates.

Other equity market considerations such as short sales; any likely forthcoming changes in index inclusion; depth of stock research coverage; composition of and change in the mix of investors (such as founders, board and staff, domestic institutions, foreign institutions, and retail investors) are not incorporated in our valuation; however investors should consider such factors if they seek to develop a price target for the company.

Figure 2 –MST Access General Residual Income Model (GRIM) valuation of Auswide Bank Limited

Current date		1-Jun-22									
Last balance date		31-Dec-21									
		Dec-21	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26
Book value per share	A$	6.23	6.33	6.44	6.56	6.68	6.80	6.93	7.06	7.20	7.38
Equity charge	A$		-0.25	-0.25	-0.26	-0.26	-0.27	-0.27	-0.28	-0.28	-0.29
Cash EPS	A$	0.32	0.31	0.32	0.33	0.35	0.36	0.37	0.39	0.41	0.40
Residual income	A$	**0.32**	**0.06**	**0.07**	**0.08**	**0.09**	**0.09**	**0.10**	**0.11**	**0.13**	**0.11**
Discounted cash flow	A$	**0.00**	**0.06**	**0.07**	**0.07**	**0.08**	**0.08**	**0.08**	**0.09**	**0.10**	**0.08**

Sum of discount streams	A$	0.49	**CAPM**	
Future value into perpetuity	A$	3.94	Risk free rate	3.00%
NPV of terminal value	A$	2.88	Equity beta	1.0
add net assets	A$	6.23	Equity risk premium	5.00%
Residual income value per share	**A$**	**9.60**	Cost of equity	8.0%
P/B multiple implied by GRIM valuation	x	1.54	Terminal growth	2.0%
Upside/downside	%	41%		

Source: Company reports, MST Access estimates

Many financial sector analysts use some form of residual income or value-added valuation approach, due to the complexities and uncertainties involved in forecasting cashflow, in part due to regulatory capital requirements. Some of the advantages of this approach are that:

- the bulk of the valuation is generally recognized upfront, in the net asset value providing greater certainty around a large component of the valuation;
- uses profit, rather than cashflow, forecasts.

We use a two-stage model, using our explicit forecasts over the next five years, followed by a terminal value, to which we add current net assets per share. We assume a risk free rate of 3.0% (was 2.0%) and equity risk premium of 5.0%. We estimate ABA's equity beta to be 1.0 (was 1.2). This leads us to estimate ABA's cost of equity at 8.0% (unchanged) and terminal growth of 2.0%. This produces a valuation of A$9.60 per share, up from our $9.50 per share valuation following the 1H22 result due to the unwind of discount over the past three months.

Figure 3 –Peer comparative multiples for Auswide Bank, sorted by ROE

Identifier (RIC)	Company Name	P/E	P/CF	P/B	P/NTA	Dividend yield %	ROE %
CBA.AX	Commonwealth Bank of Australia	20.0	13.5	2.4	2.6	3.5%	12.2%
NAB.AX	National Australia Bank Ltd	15.1	12.7	1.7	1.8	4.5%	11.2%
ANZ.AX	Australia and New Zealand Banking Group Ltd	12.1	1.6	1.1	1.2	5.6%	9.6%
BOQ.AX	Bank of Queensland Ltd	10.2	5.5	0.8	0.9	5.9%	8.2%
WBC.AX	Westpac Banking Corp	15.7	11.8	1.2	1.4	4.9%	8.0%
MYS.AX	MyState Ltd	15.0	n.a.	n.a.	n.a.	n.a.	7.6%
BEN.AX	Bendigo and Adelaide Bank Ltd	13.1	9.0	0.8	1.2	5.1%	7.4%
JDO.AX	Judo Capital Holdings Ltd	200.0	108.3	1.5	1.5	0.0%	0.8%
ABA.AX	**Auswide Bank Ltd**	**11.0**	**3.9**	**1.1**	**1.3**	**6.1%**	**10.1%**

Source: IBES FY1 (i.e. FY22) mean consensus, Refinitiv, MST Access estimates for ABA

Auswide Bank's listed Australian banking peers range from one of the largest listed companies on the ASX (CBA), to some of the smallest. The multiples it trades on likely reflect its relative profitability – and we think as the bank's ROE continues to improve, the multiples it trades on should continue to re-rate higher.

Investment Thesis

Auswide Bank offers a variety of attractions to investors:

- Stronger growth prospects than the major banks, with an ability to grow home loans unimpeded at multiples of system when it is profitable to do so, and increasing operational efficiency.
- One of the highest quality loan books in the industry, reflected in its low asset impairment charges.
- Return on equity metrics that put the regional banks and some major banks to shame.
- Cheaper exposure to the Australian banking sector than the major banks, given the lower multiples (both PE and P/B) the stock trades on.
- A higher, fully franked, dividend yield than the major and regional banks.
- A strong capital position (a 1H21 CET1 ratio of 10.84%), which may be set to be further enhanced with APRA's recently announced capital adequacy changes taking effect from 1 January 2023.

Auswide Bank have realised that scale and complexity in today's banking environment is not the advantage it once was. Simplicity and nimbleness backed by good value products that are distributed efficiently via multiple channels (proprietary and partner) has been identified by management as Auswide Bank's opportunity.

Risks and sensitivities

Auswide Bank's risks and sensitivities can be categorised under the categories of strategic, financial and operational risks and sensitivities:

Strategic

Auswide Bank is subject to a significant number of regulatory requirements, and could suffer from adverse changes to the requirements, including in Australia:

- Anti-money laundering and counter terrorist financing requirements administered by Austrac as well as the recently introduced autonomous (Magnitsky style) sanctions administered by the Department of Foreign Affairs and Trade;
- Privacy requirements administered by the Privacy Commissioner;
- Prudential regulations administer by the Australian Prudential Regulatory Authority;
- Financial Service licencing and Credit licencing administered by the Australian Securities and Investments Commission (ASIC);
- Australian Consumer Law and unfair contract terms contained in the Corporations Act administered by the Australian Competition and Consumer Commission (ACCC);
- Taxation legislation administered by the Australian Taxation Office (ATO);
- Accounting standards required under the Corporations Act administered by the Australian Accounting Standards Board (AASB) and ASIC;
- Design and distribution obligations, several of which will be governed by contract law

Similar requirements apply in other jurisdictions where Auswide Bank or its customers may have counterparties.

The personal lending sector is becoming increasingly crowded, with banks and specialist lenders all targeting a shrinking market. Auswide Bank operates in a competitive environment in which systems and practices are subject to continual development and improvement and new or rival offerings emerge periodically. At some stage consolidation is likely to occur, which could lead to changes the scale required to be profitable. This could present itself to investors in the form of both strategic M&A risks and general market risks.

Any strategic initiative from Auswide Bank may lead to a competitive response by traditional credit providers such as banks, credit card providers and personal loan providers, while Auswide Bank may itself need to deliver a competitive response to its competitors strategic initiatives. There is a risk that the growing number of fintechs or existing competitors may deliver a superior proposition and customer experience offering to that currently offered by Auswide Bank.

Combined, these market dynamics create dynamic brand strategy risks (as well as the operational equivalent of this risk, marketing execution).

Financial

Being a finance company, Auswide Bank has a range of risks and sensitivities applicable to most companies in the financial sector. These include:

- **Macroeconomic conditions** – many of the following risks vary through the economic cycle. Loose monetary conditions, such as those currently being experienced, supress many of these risks which can them emerge suddenly as macroeconomic policy tightens, and conditions deteriorate. COVID-19 variants have caused rapid swings in macroeconomic conditions, restricting supply and demand at various times.
- **Liquidity and funding risks** – As a payment or finance provider, Auswide Bank is subject to a range of liquidity and funding risks. It can only extend funding to customers if it has the capacity to do so, which means having sufficient deposit funding and liquidity buffers.
- **Credit risk** – For organisations providing loans, advances or instalments, credit risk is usually thought of in terms of customer delinquencies or bad and doubtful debts which need to be impaired. However, there is also credit risk on the funding side, where the cost of debt funding could rapidly increase or become unavailable should lenders

become uncomfortable with Auswide Bank's counterparty risk – something that might happen should there be a large rise in customer delinquencies. For banks, this is typically expressed as a "depositor run on the bank". This impact led to several banks overseas failing during the global financial crisis.
- **Fraud** – Any payments or credit provider can also be defrauded by customers, staff or third parties.
- **Compliance risks** – There are many regulations that companies in the finance sector need to follow, outlined above in strategic risks, including anti-money laundering and counter terrorist financing know your customer requirements, where failure to comply with the regulatory requirements can lead to material financial penalties or litigation.

Operational

Most companies, including Auswide Bank, have a range of operational risks. These include:

- **Governance** – Increasingly an investment focus as part of ESG, governance risks include all matters of agency costs within the business, including delegated responsibilities and authorisations, internal controls and how conflicts of interest are addressed.
- **Key personnel** – Auswide Bank's ability to scale its business assumes availability of suitably qualified staff and a reliance on key personnel.
- **Information technology** - Should Auswide Bank's key technology infrastructure become corrupted such as from hardware failure or malware it would be highly disruptive to Auswide Bank's operations. Furthermore IT hardware and software becomes obsolete after a few years and requires capital investments to be updated, otherwise the company is at high risk of becoming inefficient relative to the market and being superseded by its competitors.
- **Cybersecurity and data protection** – Like any other business providing ongoing services to customers, Auswide Bank collects a substantial amount of customer data that is classified as personal information and thus obtains certain confidentiality protections under the Privacy Act. Human or system errors exposing this data could breach these confidentiality requirements, and could expose Auswide Bank to penalties. Similarly, Auswide Bank is a digital business reliant on its IT systems. A cyberattack could disable these systems, inconveniencing merchants or customers, or result in the loss of customer data – and creating substantial damage to the firm's reputation.
- **Force majeure events** – Events such as system failures, disruptions to utilities, natural perils (both environmental and human health) and warlike hostilities which prevent Auswide Bank from operating have a severe impact on its overall business, which grows exponentially the longer the system failure lasts for. For an example of how severe system failures can impact a finance business vaguely related to Auswide Bank, investors could study Tyro issues in early 2021, which led to a drop in transaction volumes and an attack on the company by a short seller. As Tyro has experienced, a prolonged outage can lead to damaged relationships leading to a loss of merchant contracts.
- **Litigation, claims and disputes** - Like any business, Auswide Bank could be subject to disputes and claims, which may end up being litigated, as well as litigation brought by regulators or class action funders. Such disputes tend to be expensive to resolve, can also result in substantial brand damage, and usually follow the realisation of another risk event. Catalysts can be contractual disputes, intellectual property infringement claims, employment disputes or indemnity claims. Auswide Bank is a member of the AFCA, which goes some way towards minimising some of the costs of some of these risks.

Company Description

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The bank boasts a high-quality loan book with over $4.0b in assets, representing a market share of around 11 basis points (0.11%).

Despite the impacts of COVID-19, ABA has maintained its four main medium-term financial targets, namely (1) a cost to income ratio of 60%; (2) a stable net interest margin targeted at 200bps; (3) return on net tangible assets of 10%, and (4) above system loan growth.

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