# Showing how it is done

In our initiation on ABA, we argued that ABA's superior operational performance and high ROE put regional banks and some of the major banks to shame. ABA's 1H22 result was a demonstration of this execution excellence, lifting its ROE to 10.5%, reducing its cost to income ratio to sub 60% and improving on an already impressive credit quality.

## Better value too

A key factor in ABA's success is its attractive offering to customers – and we think its offering to (potential) shareholders is highly attractive too. At the current share price, we estimate ABA is trading on a FY23E PE of 10.8x, and a dividend yield of 6.4%. This makes it a cheaper way to gain exposure to the Australian banking sector than major and regional banks, given the low multiples the stock trades on; plus, it offers a higher dividend yield, fully franked, than the major and regional banks.

## Lifting earnings and valuation

Following ABA's 1H21 result we lift our reported and cash EPS estimates: FY22E: 3%, FY23E: 5%, FY24E:13%. We value Auswide Bank at A$9.50 per share (was $7.27), using a General Residual Income Model with a cost of equity of 8%, referencing peer multiples to validate reasonableness. Full details are within.

## NIM pressures manageable

A concern across the banking sector is the pressure that net interest margins (NIM) are under due to the intense competition for mortgages and rising funding costs. ABA has an above average ability to manage these pressures given the larger proportion of its book funded by deposits, plus is running down its (higher cost) securitised funding, while following the market repricing up mortgages. As such, it suggests that its NIM may only fall by a few basis points over the coming half, again likely outperforming much of the banking sector.

## Satisfaction leads to success

Auswide is not resting on its laurels. Recognising the importance of rapidly approving broker mortgage applications it continues to invest to improve the mortgage application process, enabling it to be competitive rather than market leading with its pricing in order to attract new business. This keeps everyone happy – borrowers, depositors, regulators, staff and shareholders. The growth it is achieving, its profitably and staff engagement are all confirmation of this.

**Glen Wellham**, Senior Research Analyst

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 in 2015 shortly after converting into a bank.

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%).

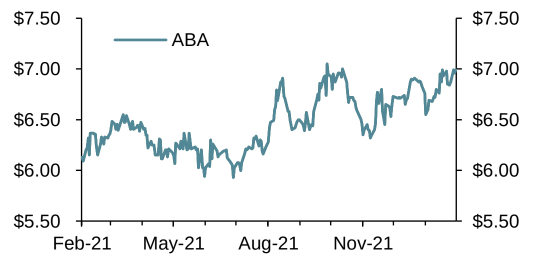
| | |
|---|---|
| **Stock** | ABA.ASX |
| **Market cap** | A$306m |
| **Price** | A$7.07 |
| **Valuation** | A$9.50 |

| **Company data** | |
|---|---|
| Shares on issue | 43.3m |

| **Recent Events** | |
|---|---|
| FY21 result | 27 August 2021 |
| AGM | 23 November 2021 |

| **Next steps** | |
|---|---|
| Monthly APRA ADI statistics | Last business day of the following month |
| FY22 result | August 2022 |

**ABA Share Price (A$)**



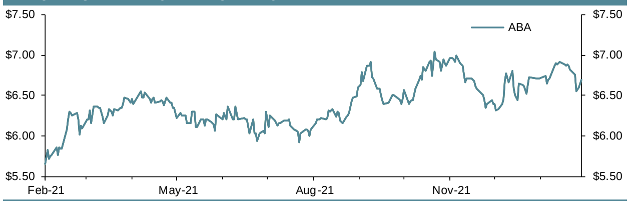
# Financials

## AUSWIDE BANK LTD — ABA-AX

**Year end 30 June, A$**

| MARKET DATA | | |
|---|---|---|
| Price | A$ | $7.07 |
| Valuation | A$ | $9.50 |
| 52 week low - high | A$ | 6.11 - 7.20 |
| Market capitalisation | A$m | 306 |
| Shares on issue (basic) | m | 43.3 |
| Options / rights (currently antidilutive) | m | |
| Other equity | m | |
| Shares on issue (fuly diluted) | m | 43.3 |

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 | 16.1 | 12.5 | 11.4 | 10.8 | 10.0 |
| DPS | A$ | 0.28 | 0.40 | 0.42 | 0.45 | 0.49 |
| Franking | % | 100% | 100% | 100% | 100% | 100% |
| Dividend yield | % | 3.9% | 5.7% | 5.9% | 6.4% | 6.9% |
| 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 | % | 5.3% | 5.6% | 24.6% | 7.8% | 8.5% |
| Enterprise value | $m | 3,823 | 4,182 | 4,727 | 5,707 | 7,153 |
| EV/Total Revenue | x | 49.9 | 47.6 | 49.2 | 55.4 | 64.2 |
| NAV per share | A$ | 5.71 | 6.00 | 6.33 | 6.56 | 6.80 |
| Price / NAV | x | 1.24 | 1.18 | 1.12 | 1.08 | 1.04 |
| NTA per share | A$ | 4.59 | 4.88 | 5.23 | 5.47 | 5.74 |
| Price / NTA | x | 1.54 | 1.45 | 1.35 | 1.29 | 1.23 |

| 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 |

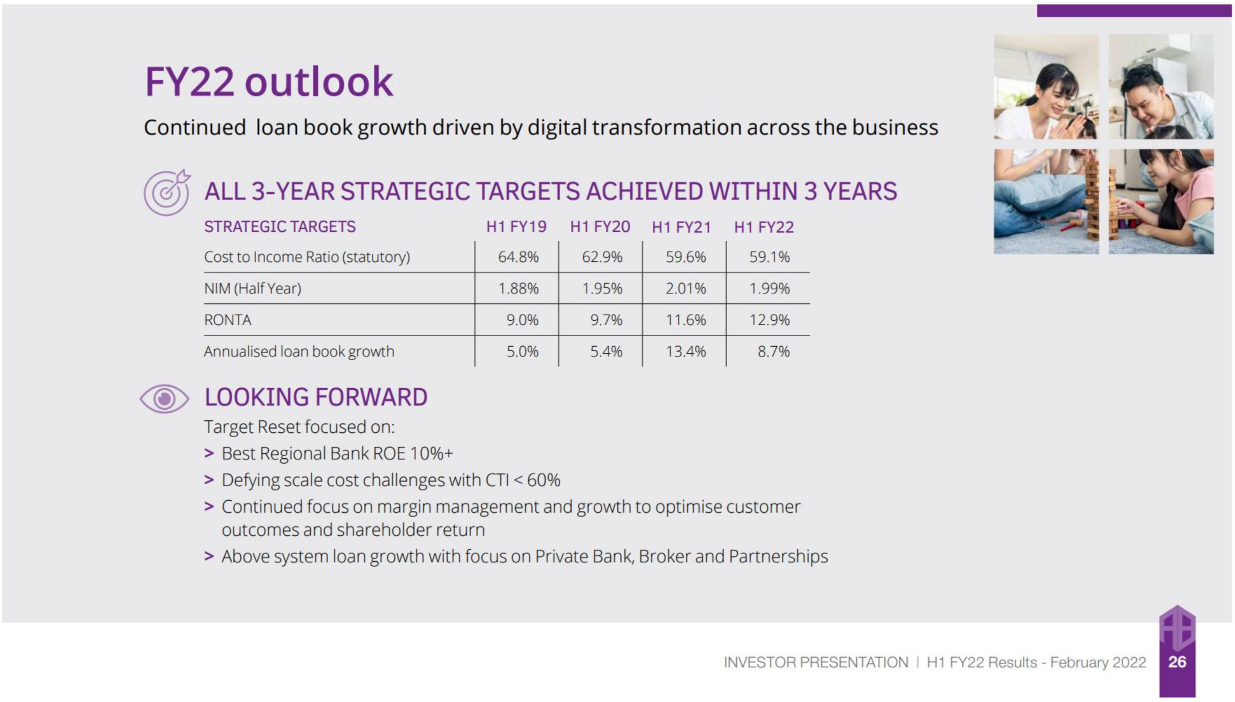
| CASH FLOW | | FY20A | FY21A | FY22E | FY23E | FY24E |
|---|---|---|---|---|---|---|
| **Operating** | | | | | | |
| **Net operating cashflow** | **A$m** | **148.3** | **111.2** | **101.9** | **75.0** | **82.3** |
| **Investment** | | | | | | |
| Capital expenditure | A$m | -2.8 | -1.9 | -2.9 | -3.0 | -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

# Result Analysis

## Outlook commentary

Figure 1 – FY22 outlook

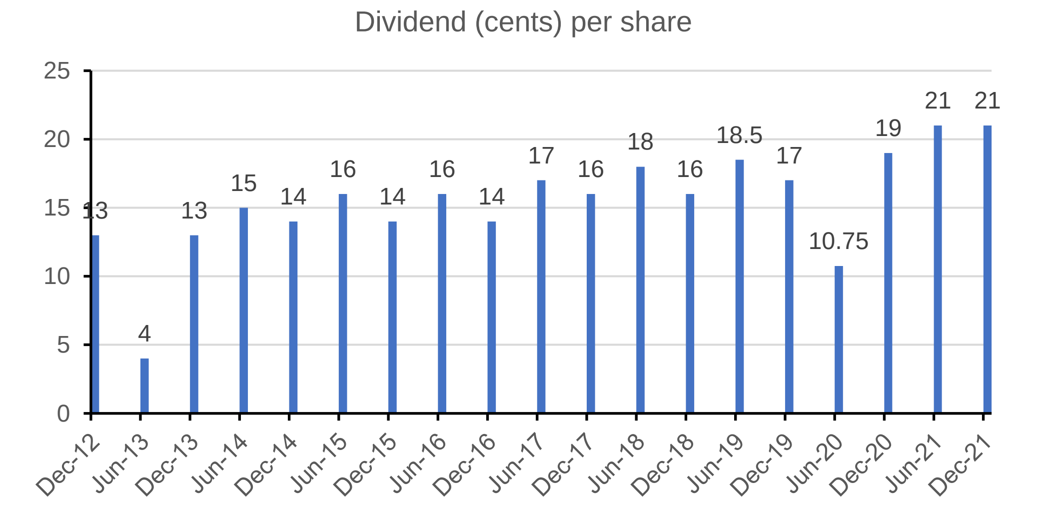



Source: Company reports

ABA reiterated its 3-year strategic targets, which it achieved within 18 months and continues to maintain. We expect it to achieve further incremental improvement in both its cost to income ratio and ROE as its organic growth slowly increases its scale, provided it is able to maintain its NIM around current levels.

This growth is benefiting shareholders, with the bank delivering its strongest trailing 12 months of dividends since FY13 and which we forecast to increase in coming years.

Figure 2 –Dividends per share of 21cps the highest since 1H13




Source: Company reports

## Actual result vs prior estimates

Figure 3 –Actual result vs prior estimates

| Half Yearly Data | | 1H21A | 2H21A | 1H22E | 1H22A | AvE $ | AvE % | Change % |
|---|---|---|---|---|---|---|---|---|
| Net Interest Income | A$m | 38.3 | 39.9 | 41.4 | 41.3 | -0.1 | -0.1% | 8.0% |
| Total Revenue | A$m | 42.8 | 45.1 | 46.7 | 48.1 | 1.4 | 3.1% | 12.4% |
| Profit before income tax | A$m | 16.5 | 18.2 | 18.8 | 19.7 | 0.9 | 4.7% | 19.3% |
| Reported NPAT | A$m | 11.5 | 12.7 | 13.1 | 13.7 | 0.6 | 4.8% | 19.4% |
| Cash NPAT | A$m | 11.5 | 12.7 | 13.1 | 13.7 | 0.6 | 4.8% | 19.4% |
| | | | | | | | | |
| **EPS - diluted cash** | **A$** | **0.270** | **0.297** | **0.304** | **0.319** | 0.014 | 4.7% | 18.1% |
| EPS - diluted reported | A$ | 0.270 | 0.297 | 0.304 | 0.319 | 0.014 | 4.7% | 18.1% |
| DPS | A$ | 0.190 | 0.210 | 0.210 | 0.210 | 0.000 | 0.0% | 10.5% |

Source: Company reports, MST Access estimates

- Net interest income was largely in line with our forecasts, coming in at $41.3m, just $0.1m less than expected.
- Total revenue was $48.1m, which was $1.4m better than expected.
- PBT came in $0.9m better than expected at $19.7m, and NPAT $0.6m better than expected at $13.7m.
- EPS was 31.85cps , also 4.7% better than expected.
- The dividend of 21cps was in line with our forecasts.
- ROE improved to an 10.5% - impressive relative to its banking peers.

# Earnings revisions

Following ABA's 1H22 result, we make the following changes to our earnings estimates for ABA:

Figure 4 –Earnings estimates for Auswide Bank

| | | FY22E | | | FY23E | | | FY24E | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Old | New | % chg | Old | New | % chg | Old | New | % chg |
| Net Interest Income | A$m | 82.9 | 83.7 | 1% | 89.8 | 92.1 | 3% | 94.2 | 100.2 | 6% |
| Non-Interest Income | A$m | 10.8 | 12.2 | 13% | 11.2 | 11.3 | 1% | 11.6 | 11.8 | 1% |
| Total operating income | A$m | 93.6 | 95.9 | 2% | 101.0 | 103.4 | 2% | 105.8 | 111.9 | 6% |
| Provision For Loan Losses | A$m | (0.2) | 0.2 | 187% | (0.3) | (0.4) | -61% | (0.3) | (0.5) | -61% |
| **Total Revenue** | **A$m** | **93.4** | **96.1** | **3%** | **100.7** | **103.0** | **2%** | **105.5** | **111.5** | **6%** |
| Non-Interest Expense | A$m | (55.7) | (57.4) | -3% | (59.7) | (61.5) | -3% | (62.1) | (66.1) | -6% |
| Profit before income tax | A$m | 37.7 | 38.7 | 3% | 41.0 | 41.5 | 1% | 43.4 | 45.4 | 5% |
| **Reported NPAT** | **A$m** | **26.2** | **27.0** | **3%** | **28.6** | **28.9** | **1%** | **30.2** | **31.6** | **5%** |
| Cash NPAT | A$m | 26.2 | 27.0 | 3% | 28.6 | 28.9 | 1% | 30.2 | 31.6 | 5% |
| EPS diluted reported | cps | 60.4 | 62.3 | 3% | 62.7 | 65.7 | 5% | 62.7 | 70.5 | 13% |
| **EPS diluted cash** | cps | 60.4 | 62.3 | 3% | 62.7 | 65.7 | 5% | 62.7 | 70.5 | 13% |
| DPS | cps | 42.0 | 42.0 | 0% | 45.0 | 45.0 | 0% | 45.0 | 45.0 | 0% |
| | | | | | | | | | | |
| PE ratio | x | 11.7 | 11.4 | (0.0) | 11.3 | 10.8 | (0.0) | 11.3 | 10.0 | (0.1) |
| Dividend yield | % | 5.9 | 5.9 | 0.0 | 6.4 | 6.4 | 0.0 | 6.4 | 6.4 | 0.0 |

Source: Company reports, MST Access estimates

These changes reflect:

- Incorporating the 1H21 result into our model.
- Altering our NIM margin assumptions slightly, given likely out-of-cycle rate increases or additional rate increases alongside RBA cash rate rises to support margins.
- Non-interest income rises slightly given higher assumed growth in loan book.
- Allowing for slightly higher losses given expectations of rising interest rates and the potential impact they have on credit quality.
- Higher expenses reflecting the higher (mortgage book) asset base.
- EPS growth is higher in later years as we have scaled back the dilutionary impact of the DRP.

Full details of our revised earnings appear in the financial summary on page 2.

## 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 5 –MST Access General Residual Income Model (GRIM) valuation of Auswide Bank Limited

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Current date | | 23-Feb-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** | **0.07** | **0.09** | **0.09** | **0.10** | **0.11** | **0.13** | **0.11** |
| **Discounted cash flow** | A$ | **0.00** | **0.05** | **0.07** | **0.07** | **0.07** | **0.07** | **0.08** | **0.08** | **0.09** | **0.08** |

| | | | | |
|---|---|---|---|---|
| Sum of discount streams | A$ | 0.47 | **CAPM** | |
| Future value into perpetuity | A$ | 3.92 | Risk free rate | 2.00% |
| NPV of terminal value | A$ | 2.80 | Equity beta | 1.2 |
| add net assets | A$ | 6.23 | Equity risk premium | 5.00% |
| **Residual income value per share** | **A$** | **9.50** | Cost of equity | 8.0% |
| P/B multiple implied by GRIM valuation | x | 1.53 | Terminal growth | 2.0% |
| Upside/downside | % | 34% | | |

Source: Company reports, MST Access estimates

Many 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 2.0% and equity risk premium of 5.0%. We estimate ABA's equity beta to be 1.2. We estimate ABA's cost of equity to be 8.0% and terminal growth of 2.0%. This produces a valuation of A$9.50 per share, up strongly from the $7.27 per share prior to the 1H22 result. This rapid rise in valuation is attributable to the 23cps rise in net assets as well as the increase in earnings per share driven by its better thanexpected lending growth and relative margin stability, which we are expecting to continue.

Figure 6 –Peer comparative multiples for Auswide Bank

| Identifier (RIC) | Company Name | Price / EPS | Price / BVPS | Price / NTA | Dividend Yield % | ROE % |
|---|---|---|---|---|---|---|
| CBA.AX | Commonwealth Bank of Australia | 17.95 | 2.14 | 2.35 | 4.1% | 11.9% |
| NAB.AX | National Australia Bank Ltd | 14.29 | 1.48 | 1.59 | 4.9% | 10.8% |
| ANZ.AX | Australia and New Zealand Banking Group Ltd | 12.58 | 1.12 | 1.21 | 5.6% | 9.4% |
| WBC.AX | Westpac Banking Corp | 14.83 | 1.15 | 1.35 | 5.3% | 8.1% |
| BOQ.AX | Bank of Queensland Ltd | 11.26 | 0.84 | 1.05 | 5.9% | 8.1% |
| MYS.AX | MyState Ltd | 15.59 | n.a. | n.a. | n.a. | 7.6% |
| BEN.AX | Bendigo and Adelaide Bank Ltd | 11.92 | 0.79 | 1.07 | 5.4% | 7.4% |
| JDO.AX | Judo Capital Holdings Ltd | 314.30 | 1.57 | 1.56 | 0.0% | 0.5% |
| ABA.AX | Auswide Bank Ltd | 11.35 | 1.12 | 1.35 | 5.9% | 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

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 in 2015 shortly after converting into a bank.

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%).

Despite the impacts of COVID-19, ABA has maintained its four main medium-term financial targets, namely:

- A cost to income ratio of 60%
- A stable net interest margin targeted at 200bps,
- Return on net tangible assets of 10%, and
- Above system loan growth.

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