Auswide Bank Ltd

ABA.AX

MST Access

A research platform of MST Financial

3 March 2023

Taking up the challenge

Ambitious 3-year strategic plan launched

- New plan targeting $6bn lending book i.e. 50% growth
- NIM peaked in October, like industry
- Highly attractive vs peers on ROE and dividend yield

1H23 NIM of 202bps: The improvement in NIM to above Auswide's 200bps target is likely to be fleeting with growing pressures on both the lending and funding sides, consistent with experience across the industry.

Investing for growth: Non-interest expenses picked up in 1H23 with its cost to income ratio rising to 62.3% as Auswide instigates investments associated with its next 3 year strategic plan, which should see its cost to income ratio fall below 60% in the medium term.

Still hunting for acquisitions: rising borrowing costs in time should enable Auswide to acquire a modern digital non-bank lending business at depressed, if not distressed, prices. Its discipline not acquiring to date has been commendable.

Investment Thesis

Stronger growth part of its strategy: Auswide continues to have stronger growth prospects than the major banks, with an ability to grow home loans unimpeded at multiples of system when it is profitable to grow, and is undertaking targeted investments to increase its operational efficiency, further supporting growth.

Credit quality remains a competitive advantage: With one of the highest quality loan books in the industry, reflected in its low asset impairment charges, and conservative lending practices, Auswide stands well placed to capture market share when other lenders become distracted with growing mortgage stress.

NIM movement will also move ROE: While Auswide's ROE may fall modestly with its NIM as NIMs fall across the industry, its ability to protect and keep a relatively stable NIM should see Auswide's ROE continue to benchmark favourably against major and regional banks.

Valuation

Lifting earnings and valuation to reflect new 3 year strategic plan. We change our reported and cash EPS estimates: FY23E: 0%, FY24E: -2%, FY25E:+5%. Our valuation of ABA rises 30c to A$6.80, taking the average of a range of 8 different valuation techniques. At the current share price, we estimate ABA is trading on a FY23E PE of 9.7x, and a dividend yield of 7.5%, which compares very favourably to other banks in the sector.

Risks

Being a bank, Auswide has a range of risks applicable including macroeconomic conditions, liquidity and funding risks, credit risk, fraud, cybersecurity, asset-liability mismatch and compliance risks. Furthermore, it could suffer adverse changes from changes in the regulatory environment including in respect of bank capital and lending buffer requirements.

Equities Research Australia

Financials

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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.

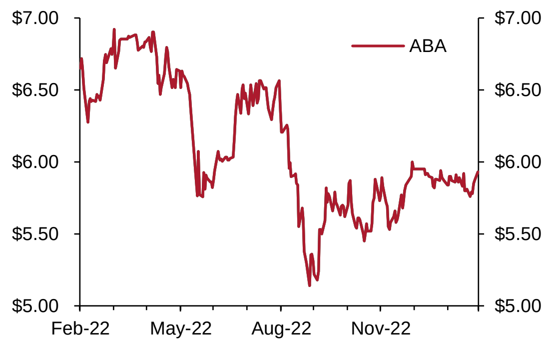
ABA has a strong presence in Queensland and is growing across the rest of Australia. The Company boasts a high-quality loan book with over $4.0b in assets, representing a market share of around 12 basis points (0.12%).

Valuation	**A$6.80** *(Previously A$6.50)*
Current price	**A$5.93**
Market cap	**A$270m**
Cash on hand	**NA**

Upcoming Catalysts / Next News

Period	
Monthly	APRA ADI statistics on the last business day of the following month
FY FY23	Result in late August

Share Price ($A)



Source: FactSet, MST Access

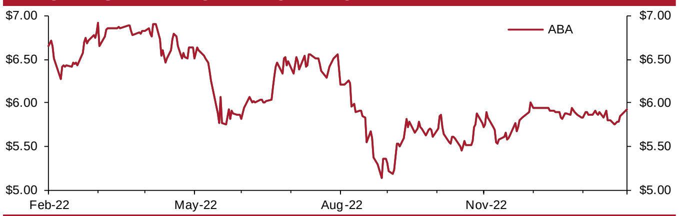
AUSWIDE BANK LTD — ABA-AX

Year end 30 June, A$

MARKET DATA

Price	A$	$5.93
Valuation	A$	$6.80
52 week low - high	A$	5.10 - 7.19
Market capitalisation	A$m	270
Shares on issue (basic)	m	45.5
Options / rights (currently antidilutive)	m	
Other equity	m	
Shares on issue (fuly diluted)	m	45.5

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS

INVESTMENT FUNDAMENTALS		FY21A	FY22A	FY23E	FY24E	FY25E
EPS - diluted reported	cps	56.66	60.48	60.91	64.62	73.22
EPS - diluted cash	**cps**	**56.66**	**60.48**	**60.91**	**64.62**	**73.22**
EPS growth	%	29%	7%	1%	6%	13%
PE	x	10.5	9.8	9.7	9.2	8.1
DPS	A$	0.40	0.42	0.44	0.44	0.45
Franking	%	100%	100%	100%	100%	100%
Dividend yield	%	6.7%	7.1%	7.4%	7.4%	7.6%
Payout ratio	%	71%	70%	74%	69%	62%
Operating cash flow per share	cps	260.7	99.7	-240.2	-350.9	271.9
Free cash flow to equity per share	cps	39.6	183.4	217.3	55.1	64.2
FCF yield	%	6.7%	30.9%	36.6%	9.3%	10.8%
Enterprise value	$m	4,145	4,451	5,384	6,210	6,828
EV/Total Revenue	x	47.1	46.8	51.1	53.0	51.0
NAV per share	A$	6.00	6.49	6.68	7.17	7.74
Price / NAV	x	0.99	0.91	0.89	0.83	0.77
NTA per share	A$	4.88	5.36	5.62	6.16	6.78
Price / NTA	x	1.22	1.11	1.06	0.96	0.87

KEY RATIOS

KEY RATIOS		FY21A	FY22A	FY23E	FY24E	FY25E
CET1 ratio	%	10.84%	10.63%	10.67%	10.74%	10.74%
Capital ratio	%	13.31%	12.90%	12.55%	12.36%	12.13%
Leverage ratio	%	6.70%	6.57%	6.29%	6.17%	6.06%
Operating income growth	%	10.0%	6.7%	11.1%	12.5%	14.4%
Expense growth	%	6.2%	8.3%	14.3%	10.4%	11.4%
Jaws	%	3.8%	-1.6%	-3.1%	2.2%	3.0%
ROE - reported	%	9.7%	9.7%	9.3%	9.3%	9.8%
ROE - cash	%	9.7%	9.7%	9.3%	9.3%	9.8%
Net debt	A$m	3,876	4,181	5,114	5,940	6,558
Leverage (net debt / invested capital)	x	5.5	5.7	6.7	7.4	7.7

DUPONT ANALYSIS

DUPONT ANALYSIS		FY21A	FY22A	FY23E	FY24E	FY25E
Net Profit Margin	%	27%	27%	26%	26%	28%
Asset Turnover	%	2.2%	2.2%	2.1%	2.0%	2.0%
Return on Assets	%	0.6%	0.6%	0.6%	0.5%	0.6%
Financial Leverage	x	15.93	16.08	16.77	17.72	17.69
Return on Equity	%	9.7%	9.7%	9.3%	9.3%	9.8%

HALF YEARLY DATA

HALF YEARLY DATA		2H22A	1H23A	2H23E	1H24E	2H24E
Net Interest Income	A$m	40.7	46.5	47.3	52.1	55.0
Total Revenue	A$m	46.7	52.9	52.4	57.1	60.0
Profit before income tax	A$m	17.8	20.2	19.2	21.4	23.0
Reported NPAT	A$m	12.4	14.1	13.4	14.9	16.0
Cash NPAT	A$m	12.4	14.1	13.4	14.9	16.0
EPS - diluted cash	**A$**	**0.29**	**0.32**	**0.29**	**0.32**	**0.33**
EPS - diluted reported	A$	0.29	0.32	0.29	0.32	0.33
DPS	A$	0.21	0.22	0.22	0.22	0.22

KEY PERFORMANCE INDICATORS

KEY PERFORMANCE INDICATORS		FY21A	FY22A	FY23E	FY24E	FY25E
Average loans and advances	$m	3,438	3,739	4,156	4,815	5,621
Net Interest Margin	%	2.00%	1.94%	2.00%	2.00%	2.01%
Total Revenue / Average loans and advanc	%	2.56%	2.54%	2.53%	2.43%	2.38%
Cost to income ratio	%	60.1%	61.1%	62.8%	61.6%	60.0%
ECL allowance as a % of gross loans	%	0.17%	0.13%	0.10%	0.12%	0.14%
Growth in loans and advances	%	10.9%	7.7%	16.3%	16.7%	16.7%

PROFIT AND LOSS

PROFIT AND LOSS		FY21A	FY22A	FY23E	FY24E	FY25E
Interest Revenues	A$m	111.0	106.0	192.5	276.0	320.2
Interest Expense	A$m	-32.8	-23.9	-98.6	-168.9	-195.9
Net Interest Income	**A$m**	**78.2**	**82.0**	**93.8**	**107.1**	**124.2**
Non-Interest Income	A$m	10.4	12.4	11.1	11.0	10.8
Total operating income	**A$m**	**88.5**	**94.4**	**105.0**	**118.1**	**135.0**
Provision For Loan Losses	A$m	-0.6	0.7	0.4	-1.0	-1.2
Total Revenue	**A$m**	**87.9**	**95.1**	**105.3**	**117.1**	**133.9**
Non-Interest Expense	A$m	-53.2	-57.7	-65.9	-72.7	-81.0
Profit before income tax	**A$m**	**34.7**	**37.5**	**39.4**	**44.4**	**52.9**
Income tax expense	A$m	-10.5	-11.4	-11.9	-13.4	-16.0
Reported NPAT	**A$m**	**24.2**	**26.1**	**27.5**	**31.0**	**36.9**
Cash NPAT	A$m	24.2	26.1	27.5	31.0	36.9
Weighted average diluted shares	m	42.6	43.2	45.2	47.9	50.4

BALANCE SHEET

BALANCE SHEET		FY21A	FY22A	FY23E	FY24E	FY25E
Cash and cash equivalents	A$m	112.6	178.5	492.4	605.6	354.8
Loans and advances	A$m	3,555.0	3,827.6	4,449.9	5,194.6	6,064.4
Other financial assets	A$m	398.8	412.1	434.2	442.9	488.3
Property, plant and equipment	A$m	21.3	20.6	19.2	19.2	19.2
Goodwill and other intangibles	A$m	47.8	49.2	49.5	49.5	49.5
Other assets	A$m	20.1	16.6	9.6	9.6	9.6
Total Assets	**A$m**	**4,155.8**	**4,504.6**	**5,454.8**	**6,321.5**	**6,985.9**
Deposits and short term borrowings	A$m	3,349.3	3,617.3	4,325.8	4,952.6	5,670.3
Loans under management	A$m	333.7	370.8	645.6	945.6	845.6
Other borrowings	A$m	150.8	150.8	101.0	0.0	0.0
Subordinated capital notes	A$m	42.0	42.0	42.0	42.0	42.0
Other liabilities	A$m	23.4	41.6	28.6	28.6	28.6
Total Liabilities	**A$m**	**3,899.2**	**4,222.5**	**5,143.0**	**5,968.8**	**6,586.4**
Net assets	**A$m**	**256.5**	**282.1**	**311.8**	**352.7**	**399.5**
Net tangible assets	**A$m**	**208.7**	**232.9**	**262.3**	**303.1**	**349.9**
Invested capital	**A$m**	**704.8**	**730.3**	**760.0**	**800.9**	**847.7**
Tangible invested capital	**A$m**	**656.9**	**681.1**	**710.5**	**751.3**	**798.2**
Contributed equity	A$m	195.2	199.8	216.6	232.2	248.7
Treasury shares	A$m	0.0	0.0	0.5	0.5	0.5
Reserves	A$m	15.5	28.4	25.3	25.3	25.3
Retained earnings/accumulated losse	A$m	45.8	53.8	69.4	94.7	125.0
Non-controlling interests	A$m	0.0	0.0	0.0	0.0	0.0
Total equity	**A$m**	**256.5**	**282.1**	**311.8**	**352.7**	**399.5**
Basic shares on issue	m	42.8	43.4	46.7	49.2	51.6

CASH FLOW

CASH FLOW		FY21A	FY22A	FY23E	FY24E	FY25E
Operating						
Net operating cashflow	**A$m**	**111.2**	**43.1**	**-108.5**	**-168.0**	**136.9**
Investment						
Capital expenditure	A$m	-1.9	-2.7	-2.5	-3.0	-3.0
Acquisitions and divestments	A$m	-17.2	4.1	-13.8	0.0	0.0
Net investment cashflow	**A$m**	**-19.1**	**1.4**	**-16.3**	**-3.0**	**-3.0**
Financing						
Equity	A$m	-10.7	-13.3	-10.0	-20.8	-21.9
Debt	A$m	-73.7	36.3	224.6	199.0	-100.0
Leases	A$m	-1.5	-1.5	-1.6	-1.6	-1.6
Net financing cashflow	**A$m**	**-85.9**	**21.5**	**213.0**	**176.6**	**-123.5**
Net cash flow	**A$m**	**6.1**	**65.9**	**88.2**	**5.6**	**10.4**
Free cash flow to equity	A$m	16.9	79.3	98.2	26.4	32.3

Source: ABA reports, MST Access estimates

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New three-year strategic targets

Figure 1: New three year strategic targets

LOOKING FORWARD

Target reset focused on:

> $6b loan book through organic growth by 2025

> Continued focus and delivery of digital transformation and loan processing capability with an aim of reducing the cost of each loan settled and increasing growth capacity

> Renewed focus on optimum funding sources to identify growth opportunities in the lower cost savings and transaction accounts portfolio

> Leveraging low arrears and well seasoned loans to facilitate a high quality Residential Mortgage Backed Security (RMBS) transaction providing long-term funding and capital benefits for investment strategies and loan book growth

> Continue with our sustainability practices to ensure Auswide Bank together with its customers is building better futures together

> Cost to Income ratio of less than 60% in the medium term with higher investment profile in short term to improve profitable growth ambition

> Identification of M&A targets to source asset growth and opportunities for scale over the next three years

Source: Company reports

ABA has launched new 3 year targets, as part of its new 3 year plan. These targets include:

- **Growing its loan book to $6bn, a ~50% increase from its current ~$4bn level.** We think that as interest rates rise, this may become more, rather than less affordable to achieve, as runoff in excess of contractual amortisation may decline. Furthermore we note that Judo exceeded the $6bn loan book mark six months ago, and to achieve this target still only requires Auswide to grow its loan book by high single digit growth rates each half (or high teen growth rates on an annual basis). We expect ABA 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.

- **Continued focus on digital efficiency**. This is good business hygiene and may become increasingly necessary to remain competitive as more competitors launch or acquire digital offerings.

- **A medium term cost to income ratio below 60%.** Auswide is set to run with a cost to income ratio above this level in FY23 and we forecast FY24 as it aggressively invests in its digital capabilities. In our view the growth in its loan book will help support it dropping its cost to income ratio back below the 60% level by the end of its 3 year plan, but it will also need to be accompanied by cost reductions delivered by the digital transformation.

- **Renewed focus on optimum funding sources.** Again to remain competitive, ABA needs to source efficient sources of funding. Several banks in recent years have sought to increase the mix of funding sourced from their transaction accounts, which pay little to no interest, as a way of boosting the profitability of their funding. In contrast, Macquarie Bank has recently sort to attract transaction accounts by offering relatively high interest rates on these funds. With deposit rates having been relatively slow to respond to the increase in the RBA's cash rate, there certainly seems to be space for Auswide to innovate in this space to strongly grow its deposits base in order to support its lending growth ambitions.

- **A new RMBS issuance.** Subject to market conditions, Auswide is planning to conduct an RMBS issue during 2H23. This should allow it to refinance mortgages which were written using the RBA's Term Funding Facility. While this is set to have an adverse impact of NIM, given the almost certainly higher cost of RMBS issuance than the TFF (at 10bps), we expect that Auswide will seek to manage this pressure through either repricing on its mortgage book or slower repricing of its deposit book.

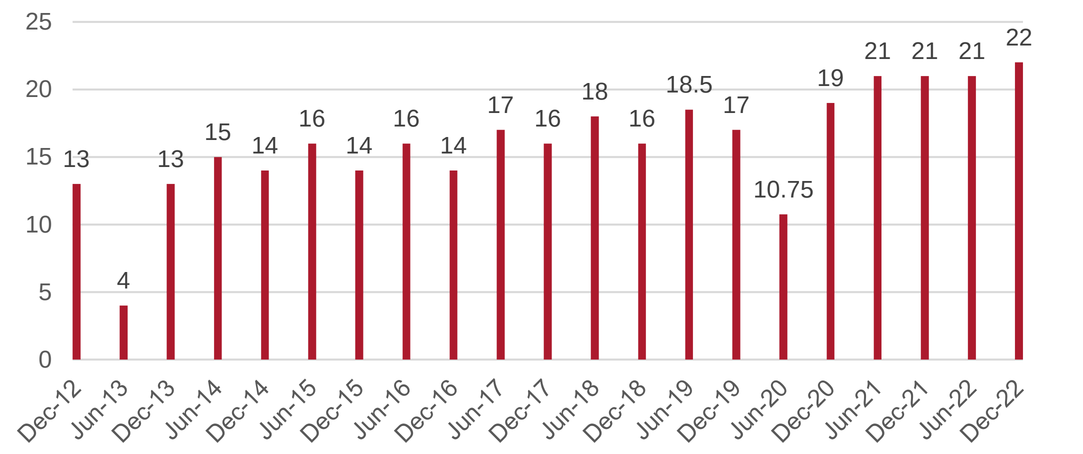
- **Identification of M&A targets.** This has been a longstanding component of Auswide's prior strategies, however the company has exercised exemplary discipline to wait until market conditions were more favourable. We suspect that conditions are moving in this direction, particularly with several non-bank lenders cutting back on new business volumes given more difficult funding markets, and some conducting strategic reviews – including, as publicised in the Australian, MONEYME through Morgan Stanley. Other non-bank personal lenders, when the value of their restricted cash is deducted off their market value, are trading at quite small market capitalisations and could be enticed with an appropriate premium.

These strategic targets should support Auswide's profit growth in the medium term, and we have adjusted our earnings forecasts to reflect the company likely achieving these targets.

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, despite paying out at the lower end of its target payout range.

Dividends per share of 22cps are the highest since 1H13

Figure 2: Historical dividends per share



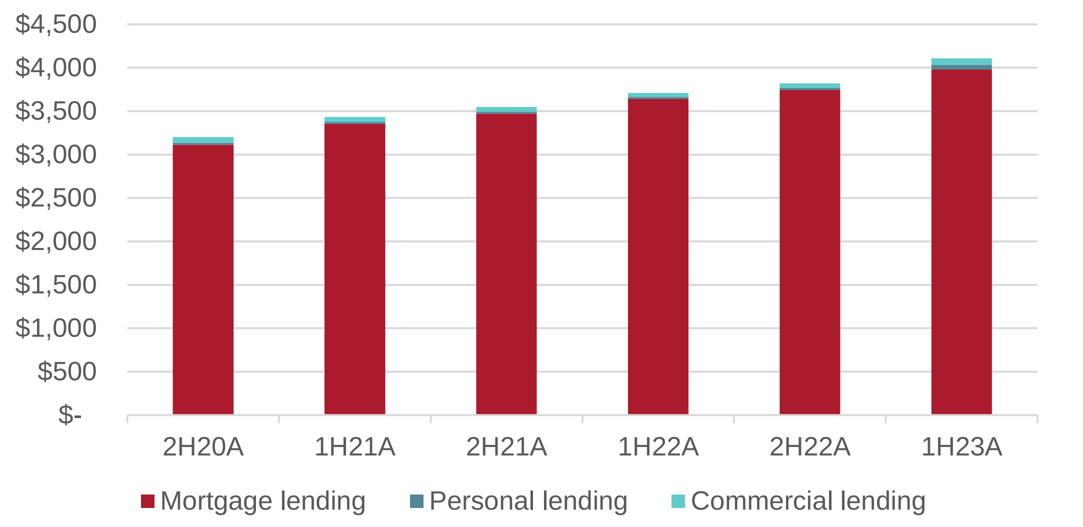
Source: Company reports

An ambitious loan book growth target

Over the past four years, Auswide has added ~$1bn to its loan book, increasing its size by a third.

It is now seeking to achieve a $6bn loan book by FY25, or a ~50% increase in the space of two years.

Figure 3: Now targeting a $6bn loan book by 2025



Source: Company reports, MST Access estimates

Such a rapid acceleration in growth will likely take a step change in growth rate:

- We think part of this ambition is attributable to M&A. This could be in the form of a non-bank personal lender which has fallen on hard times given the rapid increases in funding markets. There are both listed and unlisted non-bank personal lenders which it may be able to acquire, and Auswide may find it can achieve a better deal acquiring an unlisted non-bank personal lender, although it has the ability to use its scrip to acquire a listed non-bank personal lender which may allow it to acquire a larger business.

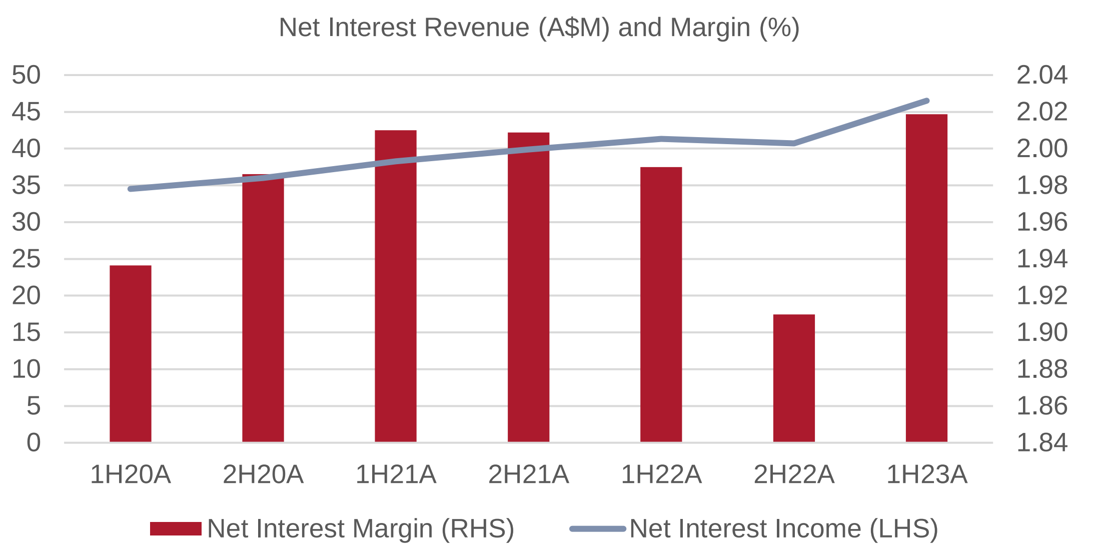
- Part of the ambition appears to come from increased commercial lending activity. The rapid growth of Judo since its launch as a neo-bank a few years ago (reaching a loan book of $7.5bn at 1H23) should provide inspiration to tier 3 banks like Auswide that they can grow by servicing unbanked or underbanked customer niches.
- Ongoing regional and rural branch closures by major banks appear set to create another set of unbanked or underbanked SMEs (as well as regional consumers), and Auswide might be able to marry up its Private Bank initiative (to keep staff productive) with some well targeted branch openings to further diversify its agri-banking footprint. Similarly, major banks withdrawing from traditional full service banking services such as foreign exchange, cheques and cash handling may also present niches for Auswide to fill in conjunction with its service partners.

We are backing the ingenuity and execution track record of Auswide against its strategic plans, and as a consequence have lifted our loan growth assumptions such that in our forecasts Auswide achieves this new loan book target by 2H25.

NIM pressure from both sides of balance sheet

Figure 4: Net interest revenue (A$m) and margin (%)

Net interest margins rebounded strongly, aided by the tailwind of the RBA's rapid cash rate repricing



Source: Company reports, MST Access estimates

Consistent with industry titan CBA's disclosures at its 1H23 result, Auswide suggests that its NIM peaked in October 2022, and has been falling since due to the headwinds to its net interest margin it is facing from both sides of its balance sheet:

- On the lending side, competition for refinancing expiring fixed rate mortgages is fever pitch, with some major banks offering thousands of dollars cashback in a bid to attract customers and retain market share, as well as new entrants into the market seeking to aggressively build market share to achieve scale. This is compressing NIMs across the sector; however customers still appreciate rapid approval times, and for lenders with quick approvals, this is working in their favour to resist this source of margin pressure. Auswide are working on keeping retention levels high, limiting the amount of new business it needs to win given new loans are being written at uneconomic rates.
- On the funding side, competition for deposits is intensifying as banks develop strategies to replace the funding provided by the RBA's Term Funding Facility ("TFF"). Auswide has already noticed the pickup in competition for term deposit rates, and noted the attraction of growing low-interest transaction accounts. Auswide also flagged the potential for an RBMS issue to meet this funding requirement, however this will also come at a significantly higher interest cost than the TFF funding it replaces.

Expenses increase with additional investment

While Auswide previously targeted a cost to income ratio below 60% under its former 3 year plan, and is again targeting a cost to income ratio below 60% in the medium term under its new year plan, its cost to income ratio has ticked up as it undertakes strategic systems investments. The benefits of these investments should help lower Auswide's cost to income ratio, while keeping the bank competitive with peers in respect of digital banking offerings and efficient service times.

Credit quality remains a competitive advantage

Auswide has a very clean lending book with very low arrears levels relative to the industry. This supports its low credit loss provisions, which have continued to trend lower in recent years.

Figure 5: Loan arrears are much lower than industry levels

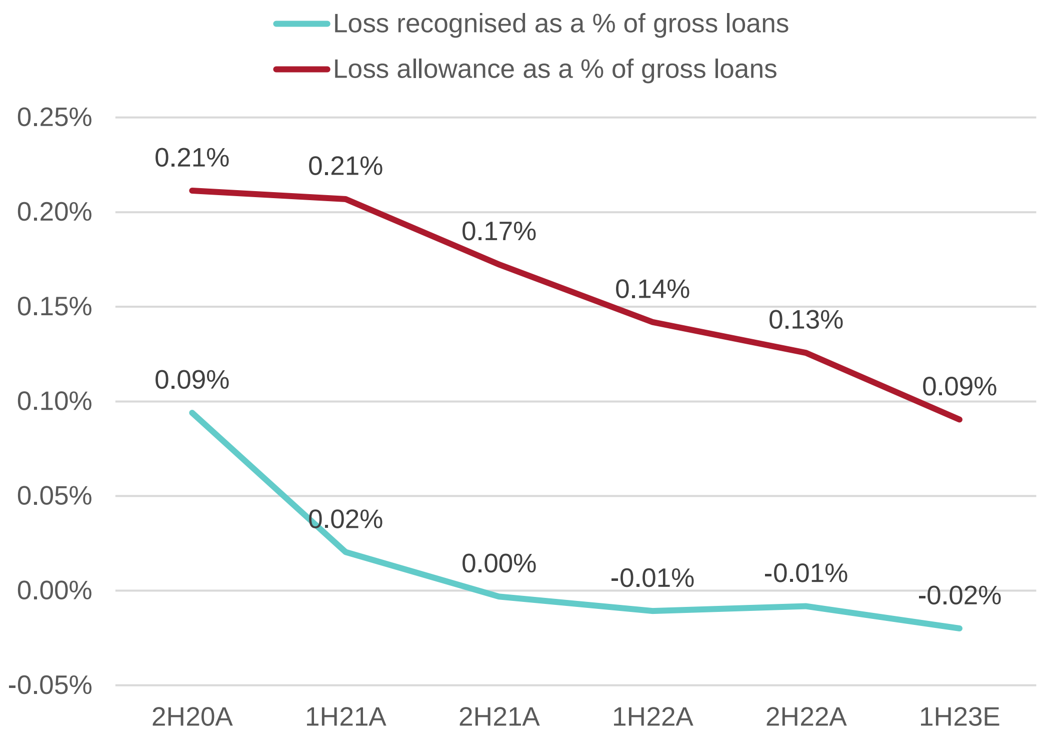
	30 days past due (includes >90 days past due)	90 days past due
AUSWIDE	0.09	0.05
SPIN (Other)	0.53	0.25
SPIN (Regional)	1.01	0.53

(Auswide figures: at 31 December 2022) SPINs: at 30 November 2022 (latest available at time of publication)

Source: Company reports, MST Access estimates

Auswide's past few results have benefited from credit loss reserve releases, as provisions for COVID overlays have gradually been released.

Figure 6: Credit loss allowances are very low



Source: Company reports, MST Access estimates

Despite the low levels of credit loss allowances, Auswide is still very conservatively provisioned, with a total provision coverage ratio of 16bps compared to its 9bps arrears level.

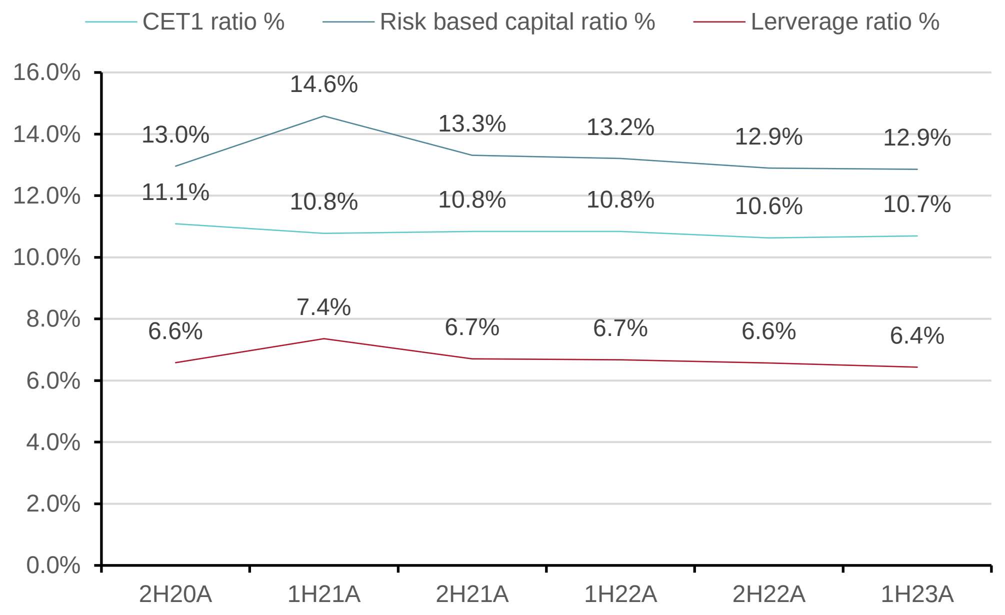
Auswide's credit experience benefits from its conservative lending practices, such as having lower proportion of loans at higher (>6x) debt to income ratios than the industry, as well as significant advance payments (>5% of its loan book) and >10% of its loan book held in offset accounts.

Capital unquestionably strong, aided by DRP

Auswide has been highly efficient in managing its capital while continuing to exceed prudential capital requirements to achieve a difficult combination:

- remain unquestionably strong
- maximise its ROE
- support its growth ambitions and
- pay attractive dividends to shareholders

Figure 7: Prudential Captial Ratios



Source: Company reports, MST Access estimates

As we discuss in our valuation section below, Auswide puts other regional and smaller banks to shame in terms of its superior ROE, and puts the major banks to shame in terms of its dividend yield.

Having underwritten its last dividend reinvestment plan with a 5% discount to strengthening its capital position, it will issue new shares under its dividend reinvestment plan at a reduced 3.5% discount.

Board renewal with impressive individuals

In the past month, Auswide Bank has appointed two new high calibre directors with significant relevant experience, whose experience should serve Auswide:

- Cameron Mitchell as an Independent Non-Executive Director, effective 1 February 2023. He will join the Auswide Bank Board Audit, Board Risk and Board Remuneration Committees.
- Lyn McGrath as an independent non-executive director, effective 1 March 2023. She will join Auswide Bank's Board Audit, Board Risk and Board Remuneration Committees.

Mr Mitchell is an experienced business leader with an executive career that spans more than 25 years in Banking and Financial Services both domestically and internationally. Mr Mitchell offers experience in investment banking, managing multinational corporates and institutional clients in financial markets, debt capital markets, debt, relationship management, transactional banking, mergers and acquisitions, equity and investment markets, project finance and credit markets. In addition, Mr Mitchell has served on Asset and Liability Committees managing large balance sheets and setting credit, risk and pricing strategies.

Ms McGrath gained extensive executive experience in the financial services sector throughout her roles as Group Executive Retail Banking at BOQ and Executive General Manager, Retail at CBA. Ms McGrath's experience extends across retail banking, wealth management and retail distribution across multi brand, digital/data, marketing, product, and strategy development and execution in financial services, electricity and media research organisations.

1H23 result broadly in line with expectations

Figure 8: Actual result vs prior estimates

HALF YEARLY DATA		1H22A	2H22A	1H23E	1H23A	AvE $m	AvE %	Change %
Net Interest Income	A$m	41.3	40.7	46.3	46.5	0.2	0.5%	12.6%
Total Revenue	A$m	48.5	46.7	51.8	52.1	0.3	0.6%	7.4%
Profit before income tax	A$m	19.7	17.8	19.4	20.2	0.8	4.2%	2.8%
Reported NPAT	A$m	13.7	12.4	13.5	14.1	0.6	4.3%	3.0%
Cash NPAT	A$m	13.7	12.4	13.5	14.1	0.6	4.3%	3.0%
EPS - diluted cash	**A$**	**0.318**	**0.286**	**0.305**	**0.318**	0.012	4.1%	-0.1%
EPS - diluted reported	A$	0.318	0.286	0.305	0.318	0.012	4.1%	-0.1%
DPS	A$	0.210	0.210	0.220	0.220	0.000	0.0%	4.8%

Source: Company reports, MST Access estimates

Auswide Bank's 1H23 result was ~4% above our expectations, with better revenue growth and even stronger expense control.

- Net interest income was 0.5% above our forecast.
- Better expense control enabled PBT, NPAT and cash profit to be 4% ahead of our forecast.
- The dividend was in line with our forecasts.

Earnings estimate revisions

Following ABA's 1H23 result, we make the following changes to our earnings estimates for ABA:

Figure 9: Changes to earnings estimates for Auswide Bank

		FY23E			FY24E			FY25E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Net Interest Income	A$m	93.3	93.8	0.5%	103.3	107.1	3.7%	111.5	124.2	11.4%
Non-Interest Income	A$m	11.7	11.1	-5.2%	12.2	11.0	-10.1%	12.7	10.8	-14.8%
Total operating income	A$m	105.1	105.0	-0.1%	115.5	118.1	2.3%	124.2	135.0	8.7%
Provision For Loan Losses	A$m	(0.9)	0.4	142.9%	(0.9)	(1.0)	-7.5%	(1.0)	(1.2)	-14.2%
Total Revenue	**A$m**	**104.2**	**105.3**	**1.1%**	**114.5**	**117.1**	**2.2%**	**123.2**	**133.9**	**8.7%**
Non-Interest Expense	A$m	(65.1)	(65.9)	-1.3%	(71.0)	(72.7)	-2.4%	(75.9)	(81.0)	-6.7%
Profit before income tax	A$m	39.2	39.4	0.7%	43.5	44.4	2.0%	47.3	52.9	11.9%
Reported NPAT	**A$m**	**27.3**	**27.5**	**0.8%**	**30.3**	**31.0**	**2.1%**	**33.0**	**36.9**	**12.0%**
Cash NPAT	A$m	27.3	27.5	0.8%	30.3	31.0	2.1%	33.0	36.9	12.0%
EPS diluted reported	cps	60.9	60.9	0.1%	65.7	64.6	-1.7%	69.9	73.2	4.7%
EPS diluted cash	cps	60.9	60.9	0.1%	65.7	64.6	-1.7%	69.9	73.2	4.7%
DPS	cps	45.0	44.0	-2.2%	45.0	44.0	-2.2%	49.0	45.0	-8.2%

Source: Company reports, MST Access estimates

These changes reflect:

- Incorporating the 1H23 result into our model.
- Lifting our growth rates such that Auswide hits its $6bn loan book target by FY25.
- Altering our NIM margin assumptions slightly.
- Allowing for slightly higher losses given expectations of rising interest rates and the potential impact they have on credit quality, from the incredibly low level in 1H23.

- Higher expenses reflecting the higher (mortgage book) asset base as well as targeted investment under ABA's latest 3 year strategic plan.
- 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

Figure 10: MST Access valuation of Auswide Bank Limited

Method	Metric A$	Multiple x	per share A$	Comments
FY24 earnings	0.646	10.5	6.78	
Midcycle ROE earnings	0.648	10.5	6.80	Estimated 10.0% midcycle ROE multiplied by current book value
FY24 dividend yield	0.440	5%	8.80	
Dividend Discount Model			10.65	DDM with a cost of equity of 10.0% and terminal growth of 3.0%
General Residual Income Model			6.88	GRIM with a cost of equity of 10.0% and terminal growth of 3.0%
Theoretical book	6.48	1.0	6.48	assumes 10.0% ROE, 10.0% COE, 70% dividend payout
1H23 book	6.48	1.0	6.48	
1H23 tangible book	5.38	1.2	6.48	
Composite			**6.80**	**Range of A$6.48 - A$10.65**

Source: Company reports, MST Access estimates

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

- Multiple intrinsic valuation methods and 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.

For our intrinsic valuation models, including our dividend discount model and general residual income model, 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 4.0% and equity risk premium of 5.0%. We estimate ABA's equity beta to be 1.2, and retain our terminal growth assumption of 3%. This leads us to estimate ABA's cost of equity at 10%.

Figure 11: MST Access General Residual Inocme Model ("GRIM") valuation of Auswide Bank Limited

Current date		27-Feb-23									
Last balance date		31-Dec-22									
		Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26	Dec-26	Jun-27
Book value per share	A$	6.48	6.68	6.92	7.17	7.45	7.74	8.03	8.33	7.76	8.11
Equity charge	A$		-0.32	-0.33	-0.35	-0.36	-0.37	-0.39	-0.40	-0.42	-0.39
Cash EPS	A$	0.32	0.29	0.32	0.33	0.36	0.38	0.40	0.41	0.43	0.42
Residual income	**A$**	**0.32**	**-0.03**	**-0.02**	**-0.02**	**0.00**	**0.00**	**0.01**	**0.00**	**0.01**	**0.04**
Discounted cash flow	**A$**	**0.00**	**-0.03**	**-0.02**	**-0.01**	**0.00**	**0.00**	**0.01**	**0.00**	**0.01**	**0.02**

Sum of discount streams	A$	-0.02	**CAPM**	
Future value into perpetuity	A$	0.65	Risk free rate	4.00%
NPV of terminal value	A$	0.43	Equity beta	1.2
add net assets	A$	6.48	Equity risk premium	5.00%
Residual income value per share	**A$**	**6.88**	Cost of equity	10.0%
P/B multiple implied by GRIM valuation	x	1.06	Terminal growth	3.0%
Upside/downside	%	16%		

Source: Company reports, MST Access estimates

We present our dividend discount model below. Excluding franking credits, our DDM valuation would be A$7.46.

Figure 12: MST Access Dividend Discount Model ("DDM") valuation of Auswide Bank Limited

Current date		27-Feb-23								
Next balance date		30-Jun-23								
		Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26	Dec-26	Jun-27
Dividends	A$	0.22	0.22	0.22	0.22	0.23	0.26	0.28	0.30	0.30
Franking rate	%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Total dividend value	**A$**	**0.31**	**0.31**	**0.31**	**0.31**	**0.33**	**0.37**	**0.40**	**0.43**	**0.43**
Discounted cash flow	**A$**	**0.30**	**0.29**	**0.28**	**0.26**	**0.26**	**0.28**	**0.29**	**0.30**	**0.28**

Sum of discount streams	A$	2.55	**CAPM**	
Future value into perpetuity	A$	12.24	Risk free rate	4.00%
NPV of terminal value	A$	8.10	Equity beta	1.2
Equity value	**A$**	**10.65**	Equity risk premium	5.00%
			Cost of equity	10.0%
Upside/downside	%	80%	Terminal growth	3.0%

Source: Company reports, MST Access estimates

In the unique situation where the ROE is equivalent to the cost of capital, the theoretical book multiple is one.

Figure 13: 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	16.41	10.79	2.27	2.52	4.4%	13.5%
NAB.AX	National Australia Bank Ltd	11.75	15.43	1.50	1.64	5.8%	13.4%
ANZ.AX	ANZ Group Holdings Ltd	9.88	14.58	1.03	1.12	6.6%	11.1%
WBC.AX	Westpac Banking Corp	10.44	15.73	1.06	1.23	6.3%	10.7%
ABA.AX	**Auswide Bank Ltd**	**9.74**	**2.73**	**0.89**	**1.06**	**7.4%**	**9.3%**
MYS.AX	MyState Ltd	11.09	n.a.	n.a.	n.a.	6.1%	8.8%
BEN.AX	Bendigo and Adelaide Bank Ltd	10.08	12.93	0.79	1.07	6.3%	8.6%
BOQ.AX	Bank of Queensland Ltd	8.62	10.78	0.66	0.83	7.4%	8.3%
JDO.AX	Judo Capital Holdings Ltd	21.97	13.80	0.99	1.01	0.0%	4.6%

Source: IBES FY1 (i.e. FY23) mean consensus, Refinitiv, MST Access FY23 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. Investors are clearly rewarded for investing in ABA given it has the highest prospective dividend yield of the listed Australian banks, while trading on the second lowest P/E multiple.

Updated 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 grow, 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 above other regional banks and close to the level of major banks.
- 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 1H23 CET1 ratio of 10.70%), which will be further enhanced from its DRP.

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;
- Prudential regulations administer by the Australian Prudential Regulatory Authority;
- Financial Service licencing and Credit licencing administered by the Australian Securities and Investments Commission (ASIC);
- Privacy requirements administered by the Privacy Commissioner;
- 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

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 Queensland and is growing across the rest of Australia.

The bank boasts a high-quality loan book with over $4.0b in assets, representing a market share of around 12 basis points (0.12%).

Auswide has recently launched a new 3 year strategic plan with several ambitious targets including to:

1. Grow its lending book to $6bn
2. Embrace digital systems and loan processing capabilities to lower its borrower acquisition costs
3. Optimise its funding sources through low cost savings and transaction accounts
4. Issue RMBS to provide funding and capital flexiblity
5. Achieve a cost to income ratio below 60% over the medium term
6. Pursue M&A opportunities to help achieve scale

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