1H22 Result Preview

1H22 result briefing 10am, Friday 25 Feb 2022

Headline figures we are looking for include 1H22 revenue of A$46.7m, NPAT of A$13.1m, EPS of 30.0cps and a dividend of 21 cps.

More detailed banking metrics include an expected NIM of 1.97%, operating income growth of 3.8%, expense growth of 3.5%, leading to positive jaws of 0.3%. We are expecting its CET1 ratio to fall to 10.3% following the bank's strong mortgage growth.

Perhaps more importantly, the company may comment on the likely positive impact that APRA's recent changes to capital adequacy requirements will have, revealing just how much it could benefit from the capital relief under these changes which come into effect from 1 January 2023.

As per the company's invite released to the ASX, register for the briefing at Auswide Bank HY22 Results Call.

Continued strong lending growth in MADIS

APRA's Monthly Authorised Deposit Institution Statistics ("MADIS") for December reveal continued strong mortgage lending balance growth, increasing by 6.4% over the half for owner-occupied borrowers, and 5.0% over the half for total housing. This is stronger than ABA's resident deposit growth over the half of 3.9%, suggesting that the loan to deposit ratio has again ticked up slightly. While there may be some definitional and accounting differences between the APRA statistics and ABA's accounts, they provide a good insight as to what we should expect.

Rise in bond yields likely to pressure 2H NIMs

The rapid rise in bond yields since the end of November will likely put some pressure on ABA's NIM in 2H22 which could fall vs 1H22, potentially requiring the bank to reprice some of its mortgage products. However, with its loan book 90% funded by deposits, it is less exposed to this this risk than many of its larger peers.

Valuation

We value Auswide Bank at A$7.27. using a General Residual Income Model with a cost of equity of 8% referencing peer multiples to validate for reasonableness. Full details are within.

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
Price	A$6.87
Market cap	A$297m
Valuation	A$7.27

Company data	
Shares on issue	43.3m

Recent Events	
FY21 result	27 August 2021
AGM	23 November 2021

Next steps	
1H22 result	February 2022
Monthly APRA ADI statistics	Last business day of the following month

ABA Share Price (A$)

Glen Wellham, Senior Research Analyst

Financials

AUSWIDE BANK LTD ABA-AX

Year end 30 June, A$

MARKET DATA		
Price	A$	$6.70
Valuation	A$	$7.27
52 week low - high	A$	5.99 - 7.20
Market capitalisation	A$m	290
Shares on issue (basic)	m	43.3
Options / rights (currently antidilutive)	m	
Other equity	m	
Shares on issue (fuly diluted)	m	43.3

INVESTMENT FUNDAMENTALS		FY20A	FY21A	FY22E	FY23E	FY24E
EPS - diluted reported	cps	43.80	56.66	60.38	62.67	63.14
EPS - diluted cash	**cps**	**43.80**	**56.66**	**60.38**	**62.67**	**63.14**
EPS growth	%	7%	29%	7%	4%	1%
PE	x	15.3	11.8	11.1	10.7	10.6
DPS	A$	0.28	0.40	0.42	0.45	0.46
Franking	%	100%	100%	100%	100%	100%
Dividend yield	%	4.1%	6.0%	6.3%	6.7%	6.9%
Payout rato	%	63%	71%	70%	72%	74%
Operating cash flow per share	cps	351.0	260.7	237.4	250.9	260.4
Free cash flow to equity per share	cps	37.2	39.6	50.3	53.0	53.9
FCF yield	%	5.6%	5.9%	7.5%	7.9%	8.1%
Enterprise value	$m	3,807	4,166	4,628	5,075	5,490
EV/Total Revenue	x	49.7	47.4	49.6	50.4	52.0
NAV per share	A$	5.71	6.03	6.12	6.30	6.51
Price / NAV	x	1.17	1.11	1.09	1.06	1.03
NTA per share	A$	4.59	4.91	5.04	5.28	5.53
Price / NTA	x	1.46	1.37	1.33	1.27	1.21

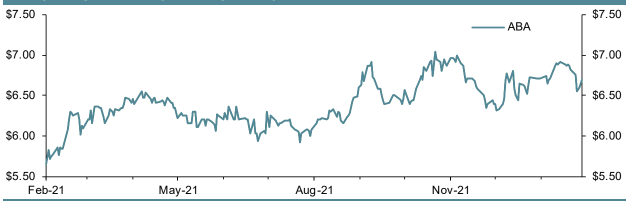
KEY RATIOS		FY20A	FY21A	FY22E	FY23E	FY24E
CET1 ratio	%	11.09%	10.84%	10.35%	10.45%	10.54%
Capital ratio	%	12.95%	13.31%	12.43%	12.34%	12.27%
Leverage ratio	%	6.58%	6.70%	6.23%	6.16%	6.10%
NII growth	%	11.6%	10.8%	6.0%	8.3%	4.9%
Expense growth	%	7.0%	6.2%	4.7%	7.1%	4.1%
Jaws	%	4.6%	4.7%	1.4%	1.2%	0.8%
ROE - reported	%	7.7%	9.7%	9.9%	10.1%	9.9%
ROE - cash	%	7.7%	9.7%	9.9%	10.1%	9.9%
Net debt	**A$m**	**3,517**	**3,876**	**4,338**	**4,785**	**5,200**
Leverage (net debt / invested capital)	x	5.1	5.5	6.0	6.5	6.8

DUPONT ANALYSIS		FY20A	FY21A	FY22E	FY23E	FY24E
Net Profit Margin	%	24%	27%	28%	28%	29%
Asset Turnover	%	2.1%	2.2%	2.1%	2.1%	2.0%
Return on Assets	%	0.5%	0.6%	0.6%	0.6%	0.6%
Financial Leverage	x	15.38	15.93	16.65	17.24	17.40
Return on Equity	%	7.7%	9.7%	9.9%	10.1%	9.9%

HALF YEARLY DATA		2H20A	1H21A	2H21A	1H22E	2H22E
Net Interest Income	A$m	36.0	38.3	39.9	41.4	41.5
Total Revenue	A$m	37.9	42.8	45.1	46.7	46.7
Profit before income tax	A$m	13.2	16.5	18.2	18.8	18.9
Reported NPAT	A$m	9.2	11.5	12.7	13.1	13.2
Cash NPAT	A$m	9.2	11.5	12.7	13.1	13.2
EPS - diluted cash	**A$**	**0.22**	**0.27**	**0.30**	**0.30**	**0.30**
EPS - diluted reported	A$	0.22	0.27	0.30	0.30	0.30
DPS	A$	0.11	0.19	0.21	0.21	0.21

KEY PERFORMANCE INDICATORS		FY20A	FY21A	FY22E	FY23E	FY24E
Average loans and advances	$m	3,151	3,438	3,812	4,221	4,646
Total Revenue / Average loans and advances	%	2.43%	2.56%	2.45%	2.39%	2.27%
Cost to income ratio	%	62.3%	60.1%	59.5%	59.1%	58.7%
ECL allowance as a % of gross loans	%	0.21%	0.19%	0.19%	0.19%	0.20%
Growth in loans and advances	%	n.a.	10.9%	13.1%	10.1%	10.1%

12-MONTH SHARE PRICE PERFORMANCE



PROFIT AND LOSS		FY20A	FY21A	FY22E	FY23E	FY24E
Interest Revenues	A$m	126.3	111.0	117.8	134.7	157.3
Interest Expense	A$m	-55.7	-32.8	-34.9	-45.0	-63.1
Net Interest Income	**A$m**	**70.5**	**78.2**	**82.9**	**89.8**	**94.2**
Non-Interest Income	A$m	10.0	10.4	10.8	11.2	11.6
Total operating income	**A$m**	**80.5**	**88.5**	**93.6**	**101.0**	**105.8**
Provision For Loan Losses	A$m	-3.8	-0.6	-0.2	-0.3	-0.3
Total Revenue	**A$m**	**76.6**	**87.9**	**93.4**	**100.7**	**105.5**
Non-Interest Expense	A$m	-50.1	-53.2	-55.7	-59.7	-62.1
Profit before income tax	**A$m**	**26.5**	**34.7**	**37.7**	**41.0**	**43.4**
Income tax expense	A$m	-8.0	-10.5	-11.5	-12.5	-13.2
Reported NPAT	**A$m**	**18.5**	**24.2**	**26.2**	**28.6**	**30.2**
Cash NPAT	A$m	18.5	24.2	26.2	28.6	30.2
Weighted average diluted shares	m	42.2	42.6	43.4	45.6	47.9

BALANCE SHEET		FY20A	FY21A	FY22E	FY23E	FY24E
Cash and cash equivalents	A$m	106.5	112.6	115.7	172.1	156.8
Loans and advances	A$m	3,205.8	3,555.0	4,020.7	4,425.6	4,872.0
Other financial assets	A$m	378.3	398.8	406.8	415.0	423.3
Property, plant and equipment	A$m	21.4	21.3	21.3	21.3	21.3
Goodwill and other intangibles	A$m	47.6	47.8	47.8	47.8	47.8
Other assets	A$m	28.6	20.1	20.1	20.1	20.1
Total Assets	**A$m**	**3,788.1**	**4,155.8**	**4,632.5**	**5,102.1**	**5,541.4**
Deposits and short term borrowings	A$m	3,018.5	3,349.3	3,811.4	4,458.4	4,974.1
Loans under management	A$m	420.7	333.7	333.7	183.7	183.7
Other borrowings	A$m	49.8	150.8	150.8	101.0	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	23.4	23.4	23.4
Total Liabilities	**A$m**	**3,546.0**	**3,899.2**	**4,361.3**	**4,808.6**	**5,223.3**
Net assets	**A$m**	**242.0**	**256.5**	**271.2**	**293.5**	**318.1**
Net tangible assets	**A$m**	**194.5**	**208.7**	**223.3**	**245.7**	**270.3**
Invested capital	**A$m**	**690.3**	**704.8**	**719.4**	**741.7**	**766.4**
Tangible invested capital	**A$m**	**642.7**	**656.9**	**671.6**	**693.9**	**718.5**
Contributed equity	A$m	193.3	195.2	195.2	195.2	195.2
Treasury shares	A$m	0.0	0.0	0.0	0.0	0.0
Reserves	A$m	14.4	15.5	15.5	15.5	15.5
Retained earnings/accumulated losses	A$m	34.3	45.8	60.5	82.8	107.4
Non-controlling interests	A$m	0.0	0.0	0.0	0.0	0.0
Total equity	**A$m**	**242.0**	**256.5**	**271.2**	**293.5**	**318.1**
Basic shares on issue	m	42.4	42.5	44.3	46.6	48.9

CASH FLOW		FY20A	FY21A	FY22E	FY23E	FY24E
Operating						
Net operating cashflow	**A$m**	**148.3**	**111.2**	**103.1**	**114.3**	**124.6**
Investment						
Capital expenditure	A$m	-2.8	-1.9	-3.0	-3.0	-3.0
Acquisitions and divestments	A$m	-56.6	-17.2	0.0	0.0	0.0
Net investment cashflow	**A$m**	**-59.4**	**-19.1**	**-3.0**	**-3.0**	**-3.0**
Financing						
Equity	A$m	-13.6	-10.7	-18.0	-19.3	-22.2
Debt	A$m	-71.0	-73.7	-76.9	-85.8	-94.4
Leases	A$m	-2.2	-1.5	-1.4	-1.4	-1.4
Net financing cashflow	**A$m**	**-86.8**	**-85.9**	**-96.3**	**-106.5**	**-118.0**
Net cash flow	**A$m**	**2.1**	**6.1**	**3.8**	**4.9**	**3.7**
Free cash flow to equity	A$m	15.7	16.9	21.8	24.2	25.8

Source: ABA reports, MST Access estimates

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

Current date		1-Feb-22										
Last balance date		30-Jun-21										
		Jun-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$	6.03	6.03	6.12	6.21	6.30	6.40	6.51	6.62	6.73	6.84	6.97
Equity charge	A$		-0.24	-0.24	-0.24	-0.25	-0.25	-0.26	-0.26	-0.26	-0.27	-0.27
Cash EPS	A$	0.30	0.30	0.30	0.31	0.31	0.32	0.31	0.30	0.28	0.31	0.30
Residual income	A$	**0.30**	**0.06**	**0.06**	**0.07**	**0.06**	**0.07**	**0.05**	**0.04**	**0.02**	**0.04**	**0.03**
Discounted cash flow	A$	**0.00**	**0.06**	**0.06**	**0.06**	**0.06**	**0.06**	**0.04**	**0.03**	**0.01**	**0.03**	**0.02**

Sum of discount streams	A$	0.44	**CAPM**	
Future value into perpetuity	A$	1.13	Risk free rate	2.00%
NPV of terminal value	A$	0.81	Equity beta	1.2
add net assets	A$	6.03	Equity risk premium	5.00%
Residual income value per share	**A$**	**7.27**	Cost of equity	8.0%
P/B multiple implied by GRIM valuation	x	1.21	Terminal growth	2.0%
Upside/downside	%	9%		

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;

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$7.27 per share.

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

Figure 2 –Peer comparative multiples for Auswide Bank

Identifier (RIC)	Company Name	Price / Book	Price / NTA	Price / EPS	Dividend Yield %	ROE %
ABA.AX	Auswide Bank Ltd	1.09	5.04	11.10	6.3%	9.9%
AFG.AX	Australian Finance Group Ltd	2.67	2.54	9.74	7.2%	28.1%
ANZ.AX	Australia and New Zealand Banking Group Ltd	1.15	1.22	12.31	5.7%	9.7%
BEN.AX	Bendigo and Adelaide Bank Ltd	0.71	0.94	11.22	6.4%	7.1%
BOQ.AX	Bank of Queensland Ltd	0.79	0.98	10.61	6.2%	8.1%
CBA.AX	Commonwealth Bank of Australia	2.14	2.34	18.84	4.0%	11.6%
JDO.AX	Judo Capital Holdings Ltd	1.54	1.54	476.25	0.0%	0.4%
MYS.AX	MyState Ltd	n.a.	n.a.	13.30	n.a.	9.0%
NAB.AX	National Australia Bank Ltd	1.37	1.50	13.93	5.1%	10.3%
WBC.AX	Westpac Banking Corp	1.02	1.19	13.04	6.1%	8.1%

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

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 FY21 CET1 ratio of 10.84%), which is 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;
- 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 which Auswide Bank currently operates (such as New Zealand) or potential future markets.

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 is likely to lead to a competitive response by traditional unsecured personal 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 personal lending competitors strategic initiatives. There is a risk that the growing number of high value, long term BNPL providers (including retailers with white-labelled products) 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 economic stimulus appears to have had a positive impact on consumers' debt servicing capabilities, while merchants using Auswide Bank's services may also find their business viability challenged following the end of COVID-19 economic stimulus measures.
- **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.
- **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. This impact led to several finance firms 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 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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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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