Auswide Bank Ltd

ABA.AX

A research platform of MST Financial

7 September 2023

1H24 NIM to again be squeezed

Margin pressures to ease, but not immediately

- Market share gains come at a short term cost
- Strong capital position supports growth, dividend
- Highest dividend yield in the sector maintained

2H23 NIM just 175bps, further pressure expected on NIM in 1H24: The impact of the loans written during 2H23 contributing for an entire half (in 1H24) is set to be a further drag on ABA's NIM, before easing deposit pricing expected thereafter, accompanied with a more stable interest rate environment sees its NIM recover.

Near term loan growth expected to slow, but still committed to $6bn target: ABA is suggesting its loan growth will slow until conditions conducive for rapid growth return. It is still committed to achieving its $6bn loan book target by FY26.

Investing for growth and cybersecurity sees CTI increase: Strong origination volumes, accompanied by technology and cybersecurity spend has seen ABA's cost to income (CTI) ratio increase to 65% for FY23. It is looking at cost saving initiatives to offset some of these additional costs near term, while its CTI should drop in its 60% target as its NIM normalises on its larger loan book.

Investment Thesis

Unjustifiably trading below NAV: As pressures on its NIM and CTI ease, its ROE should again lift above its cost of capital, supporting >1x book value.

Capital and credit quality remain competitive advantages: With one of the highest quality loan books in the industry, reflected in its low asset impairment charges, and conservative lending practices, accompanied by a strong capital base with a CET1 ratio of 11.43%, Auswide stands well placed to capture market share when others become distracted with growing mortgage stress.

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 profitable, and is undertaking targeted investments to increase its operational efficiency, further supporting growth.

Valuation

Stronger growth lifts valuation while depressing earnings: We cut our reported EPS estimates: FY24E: -14%, FY25E: -4%, introducing our FY26 estimates for the first time. Our residual income model rises to $7.75, lifted by the higher loan growth trajectory, NIM normalisation and falling CTI in later years.

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 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 total assets over $5b, representing a mortgage market share of around 20 basis points (0.20%).

Valuation	**A$7.75** *(Prev A$6.81)*
Current price	**A$5.47**
Market cap	**A$251m**
Cash on hand	**Not meaningful**

Upcoming Catalysts / Next News

Period	
Monthly	APRA ADI statistics on the last business day of the following month
1H24	Result in late February 2024

Share Price ($A)

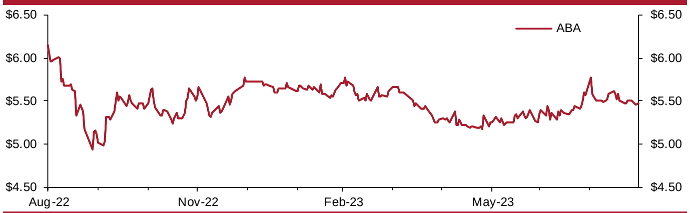
Source: FactSet, MST Access

AUSWIDE BANK LTD — ABA-AX

Year end 30 June, A$

MARKET DATA		
Price	A$	$5.47
Valuation	A$	$7.75
52 week low - high	A$	5.10 - 6.81
Market capitalisation	A$m	251
Shares on issue (basic)	m	45.9
Options / rights (currently antidilutive)	m	
Other equity	m	
Shares on issue (fuly diluted)	m	45.9

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS		FY22A	FY23A	FY24E	FY25E	FY26E
EPS - diluted reported	cps	60.48	55.64	54.69	69.69	77.41
EPS - diluted cash	**cps**	**60.48**	**55.64**	**54.69**	**69.69**	**77.41**
EPS growth	%	7%	-8%	-2%	27%	11%
PE	x	9.0	9.8	10.0	7.8	7.1
DPS	A$	0.42	0.43	0.42	0.48	0.53
Franking	%	100%	100%	100%	100%	100%
Dividend yield	%	7.7%	7.9%	7.7%	8.8%	9.7%
Payout rato	%	70%	78%	78%	70%	69%
Operating cash flow per share	cps	99.7	-296.1	-367.4	270.9	77.4
Free cash flow to equity per share	cps	183.4	71.0	44.6	60.1	68.3
FCF yield	%	33.5%	13.0%	8.1%	11.0%	12.5%
Enterprise value	$m	4,432	4,968	5,841	6,525	7,442
EV/Total Revenue	x	46.6	49.1	55.7	50.9	51.0
NAV per share	A$	6.49	6.42	6.80	7.29	7.87
Price / NAV	x	0.84	0.85	0.80	0.75	0.69
NTA per share	A$	5.36	5.34	5.78	6.33	6.96
Price / NTA	x	1.02	1.02	0.95	0.86	0.79

KEY RATIOS		FY22A	FY23A	FY24E	FY25E	FY26E
CET1 ratio	%	10.63%	11.43%	11.90%	11.89%	11.95%
Capital ratio	%	12.90%	13.70%	13.83%	13.55%	14.11%
Leverage ratio	%	6.57%	6.10%	6.14%	6.02%	6.27%
Operating income growth	%	6.7%	6.5%	4.6%	22.2%	13.7%
Expense growth	%	8.3%	13.3%	4.1%	15.6%	11.5%
Jaws	%	-1.6%	-6.9%	0.5%	6.6%	2.2%
ROE - reported	%	9.7%	8.7%	8.3%	9.9%	10.2%
ROE - cash	%	9.7%	8.7%	8.3%	9.9%	10.2%
Net debt	**A$m**	**4,181**	**4,717**	**5,590**	**6,274**	**7,191**
Leverage (net debt / invested capital)	x	5.7	6.4	7.2	7.7	8.2

DUPONT ANALYSIS		FY22A	FY23A	FY24E	FY25E	FY26E
Net Profit Margin	%	27%	25%	25%	27%	28%
Asset Turnover	%	2.2%	2.1%	1.9%	2.0%	2.0%
Return on Assets	%	0.6%	0.5%	0.5%	0.5%	0.6%
Financial Leverage	x	16.08	16.61	17.71	18.07	18.05
Return on Equity	%	9.7%	8.7%	8.3%	9.9%	10.2%

HALF YEARLY DATA		1H23A	2H23A	1H24E	2H24E	1H25E
Net Interest Income	A$m	46.5	42.7	42.2	51.3	56.7
Total Revenue	A$m	52.9	48.3	47.8	57.1	62.4
Profit before income tax	A$m	20.2	15.7	15.5	21.4	23.9
Reported NPAT	A$m	14.1	11.0	10.8	14.9	16.7
Cash NPAT	A$m	14.1	11.0	10.8	14.9	16.7
EPS - diluted cash	**A$**	**0.32**	**0.24**	**0.23**	**0.31**	**0.34**
EPS - diluted reported	A$	0.32	0.24	0.23	0.31	0.34
DPS	A$	0.22	0.21	0.21	0.21	0.23

KEY PERFORMANCE INDICATORS		FY22A	FY23A	FY24E	FY25E	FY26E
Average loans and advances	$m	3,739	4,188	4,569	5,272	6,152
Net Interest Margin	%	1.94%	1.88%	1.83%	2.00%	1.98%
Total Revenue / Average loans and advanc	%	2.54%	2.42%	2.30%	2.43%	2.37%
Cost to income ratio	%	61.1%	65.0%	64.7%	61.2%	60.0%
ECL allowance as a % of gross loans	%	0.13%	0.09%	0.13%	0.15%	0.15%
Growth in loans and advances	%	7.7%	14.4%	11.3%	16.7%	16.7%

PROFIT AND LOSS		FY22A	FY23A	FY24E	FY25E	FY26E
Interest Revenues	A$m	106.0	189.6	277.2	322.0	372.4
Interest Expense	A$m	-23.9	-100.4	-183.6	-205.5	-239.0
Net Interest Income	**A$m**	**82.0**	**89.2**	**93.5**	**116.5**	**133.4**
Non-Interest Income	A$m	12.4	11.3	11.6	11.9	12.7
Total operating income	**A$m**	**94.4**	**100.5**	**105.2**	**128.5**	**146.1**
Provision For Loan Losses	A$m	0.7	0.7	-0.2	-0.2	-0.3
Total Revenue	**A$m**	**95.1**	**101.3**	**105.0**	**128.2**	**145.8**
Non-Interest Expense	A$m	-57.7	-65.3	-68.0	-78.6	-87.6
Profit before income tax	**A$m**	**37.5**	**35.9**	**37.0**	**49.7**	**58.2**
Income tax expense	A$m	-11.4	-10.9	-11.2	-15.0	-17.6
Reported NPAT	**A$m**	**26.1**	**25.1**	**25.8**	**34.6**	**40.6**
Cash NPAT	A$m	26.1	25.1	25.8	34.6	40.6
Weighted average diluted shares	m	43.2	45.1	47.1	49.7	52.4

BALANCE SHEET		FY22A	FY23A	FY24E	FY25E	FY26E
Cash and cash equivalents	A$m	178.5	203.2	607.4	513.6	525.1
Loans and advances	A$m	3,827.6	4,377.8	4,873.9	5,686.2	6,635.6
Other financial assets	A$m	412.1	402.4	410.5	418.8	427.2
Property, plant and equipment	A$m	20.6	18.9	18.9	18.9	18.9
Goodwill and other intangibles	A$m	49.2	49.3	49.3	49.3	49.3
Other assets	A$m	16.6	7.8	7.8	7.8	7.8
Total Assets	**A$m**	**4,504.6**	**5,059.5**	**5,967.9**	**6,694.6**	**7,663.9**
Deposits and short term borrowings	A$m	3,617.3	4,042.9	4,717.3	5,501.1	6,418.5
Loans under management	A$m	370.8	530.8	830.8	730.8	730.8
Other borrowings	A$m	150.8	101.0	0.0	0.0	0.0
Subordinated capital notes	A$m	42.0	42.0	42.0	42.0	42.0
Other liabilities	A$m	41.6	49.0	49.0	49.0	49.0
Total Liabilities	**A$m**	**4,222.5**	**4,765.7**	**5,639.1**	**6,322.9**	**7,240.2**
Net assets	**A$m**	**282.1**	**293.9**	**328.9**	**371.7**	**423.7**
Net tangible assets	**A$m**	**232.9**	**244.5**	**279.5**	**322.4**	**374.4**
Invested capital	**A$m**	**730.3**	**742.1**	**777.1**	**819.9**	**871.9**
Tangible invested capital	**A$m**	**681.1**	**692.8**	**727.8**	**770.6**	**822.6**
Contributed equity	A$m	199.8	211.8	226.4	242.6	262.4
Treasury shares	A$m	0.0	0.0	0.0	0.0	0.0
Reserves	A$m	28.4	22.3	22.3	22.3	22.3
Retained earnings/accumulated losse	A$m	53.8	59.8	80.2	106.8	139.0
Non-controlling interests	A$m	0.0	0.0	0.0	0.0	0.0
Total equity	**A$m**	**282.1**	**293.9**	**328.9**	**371.7**	**423.7**
Basic shares on issue	m	43.4	45.8	48.4	51.0	53.8

CASH FLOW		FY22A	FY23A	FY24E	FY25E	FY26E
Operating						
Net operating cashflow	**A$m**	**43.1**	**-133.4**	**-173.2**	**134.6**	**40.6**
Investment						
Capital expenditure	A$m	-2.7	-2.3	-3.0	-3.0	-3.0
Acquisitions and divestments	A$m	4.1	9.9	0.0	0.0	0.0
Net investment cashflow	**A$m**	**1.4**	**7.6**	**-3.0**	**-3.0**	**-3.0**
Financing						
Equity	A$m	-13.3	-7.3	-19.5	-21.6	-26.4
Debt	A$m	36.3	159.6	199.0	-100.0	0.0
Leases	A$m	-1.5	-1.8	-1.8	-1.8	-1.8
Net financing cashflow	**A$m**	**21.5**	**150.5**	**177.7**	**-123.4**	**-28.1**
Net cash flow	**A$m**	**65.9**	**24.7**	**1.5**	**8.3**	**9.5**
Free cash flow to equity	A$m	79.3	32.0	21.0	29.9	35.8

Source: ABA reports, MST Access estimates

Outlook

Auswide's outlook commentary around loan book growth and NIM are a key driver of the revisions to our earnings estimates.

Figure 1: FY24 Outlook Targets

> Quality and profitable lending
> Reversing downward pressure on the NIM
> Management of operational and administrative expenses
> Enhancing our customer satisfaction through service and technology
> Ensuring shareholders returns are maintained
> Seeking to add scale through M&A

Source: Company reports

Figure 2: FY24 Outlook

> Economic strengths include low unemployment and decreasing inflation
> Arrears remain at historic lows with increasing advance payments and offset balances
> Expected uplift in margin as fixed rates mature and competition in home lending and deposits normalise
> Cash back offers (offered by competitors) are being phased out to protect NIM and profitability
> AI technology employed to assist with retention activities

Source: Company reports

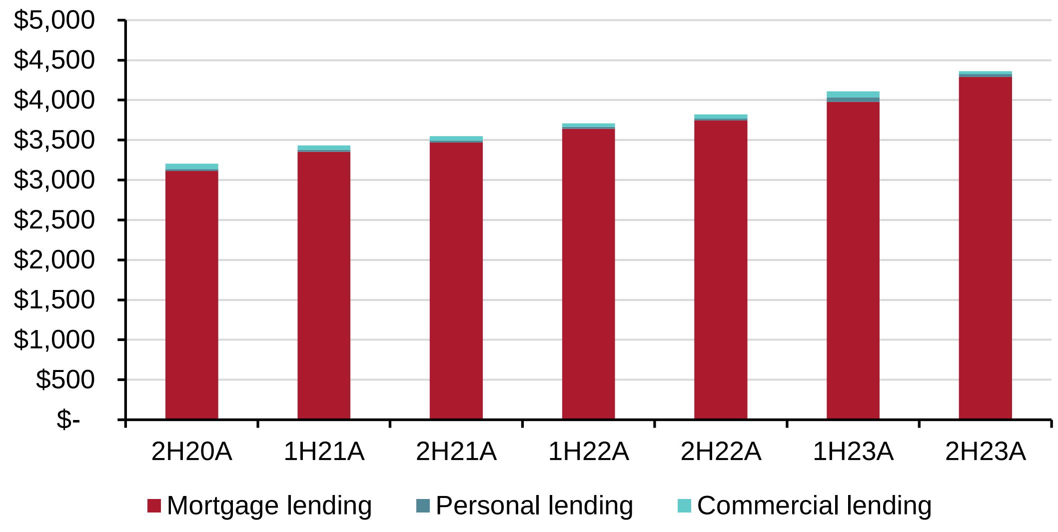
Figure 3: FY24 Headwinds

> Inflationary pressures on wages and costs
> Regulatory demands on resources and consultancy expenses
> Significant opex and capex for technology and cybersecurity
> Competition remains fierce, although starting to moderate, in retail deposits and loans with maturing fixed rates
> NIM pressure remains significant for both funding and lending activities
> Uncertainty surrounding further OCR movements

Source: Company reports

Loan book growth and outlook

Figure 4: Continuing to target a $6bn loan book by 2025. (Gross loans A$m)



Source: Company reports, MST Access estimates

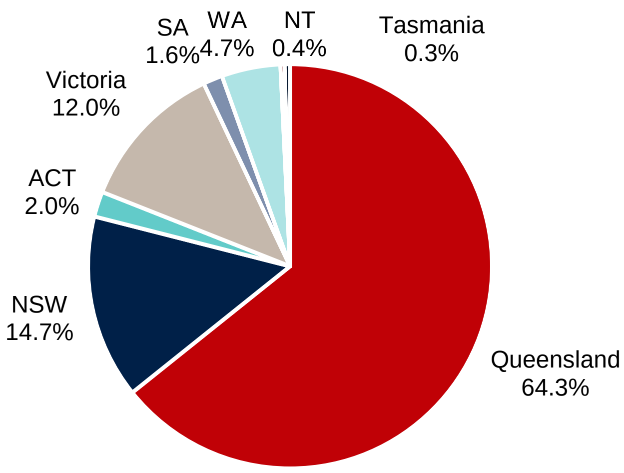
In FY23 Auswide delivered loan book growth of 14.2%, with its loan book closing at $4.403B in assets as of 30 June 2023, in excess of 3x the system growth of 4.5x during the period. As we have highlighted in our 3Q23 note, and in line with its result commentary, the banking sector experienced a period of intensifying deposit and home lending competition in 2H23, making the market share capture during the year particularly remarkable. Auswide have attributed the banks acceleration to its ongoing ability to generate loans via the broker channel.

In its results lease, Auswide reaffirmed its $6.0B loan book goal by 2025, congruent with our forecasts. However, Auswide notes that the immediate term lending environment is highly challenging with new originations slowing in response to interest rate uncertainty and profitable growth challenges. Currently, it is taking a cautious approach to growth given prevailing lending rates and funding costs.

It expects that its Private Bank and broker channel will continue to provide growth opportunities as the industry experiences declining system growth and the maturity of a material volume of fixed rate loans.

Assets originated in Queensland remain the largest portion of the loan book by State and Territory, however the loan book is steadily diversifying with assets originated in NSW growing by 16.7%, Victoria by 28.1%, Western Australia and the ACT by 53% and South Australia by 90% year on year.

Figure 5: Loan book geographic diversification as of 30 June 2023



Source: Company reports, MST Access estimates

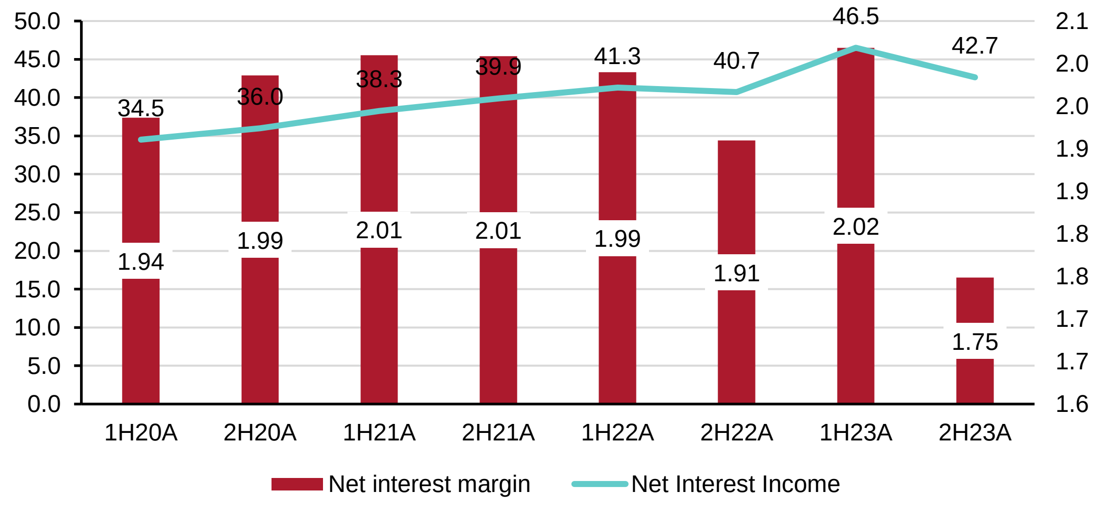
Net Interest Margin

The intensifying competition in mortgage and deposits in 2H23, and a substantial rise in wholesale funding costs throughout the current tightening cycle, placed significant pressure on Auswide's net interest margin as it endeavoured on its strategic growth initiatives throughout these headwinds. For FY23, Auswide recorded a 1.88% NIM, 6bps down on its recorded 1.94% in FY22, with a NIM of just 1.75% in 2H23, down on its reported 2.02% in 1H23.

While Auswide is confident of reversing the downward pressure on its NIM, it doesn't expect this recovery to occur until 2H24, with further pressure expected on its NIM through the first half of FY24 as the impacts of the loans written during 2H23 contribute for an entire reporting period (in 1H24).

As growth moderates, we also expect a rebound in the level of customer deposit as a percentage of total funds to support NIM expansion over the medium term as origination growth moderates. Deposits grew year on year, by 11.6% to 3.414B as of 30 June 2023, however due to the elevated growth level of the loan book, customer deposits as a percentage of total funds reduced from 73.16% to 72.37%, or around 80bps, as sales into securitisation warehouses were required to fund growth, increasing the interest expense.

Figure 6: Net interest revenue (A$m) and margin (%)



Source: Company reports, MST Access estimates

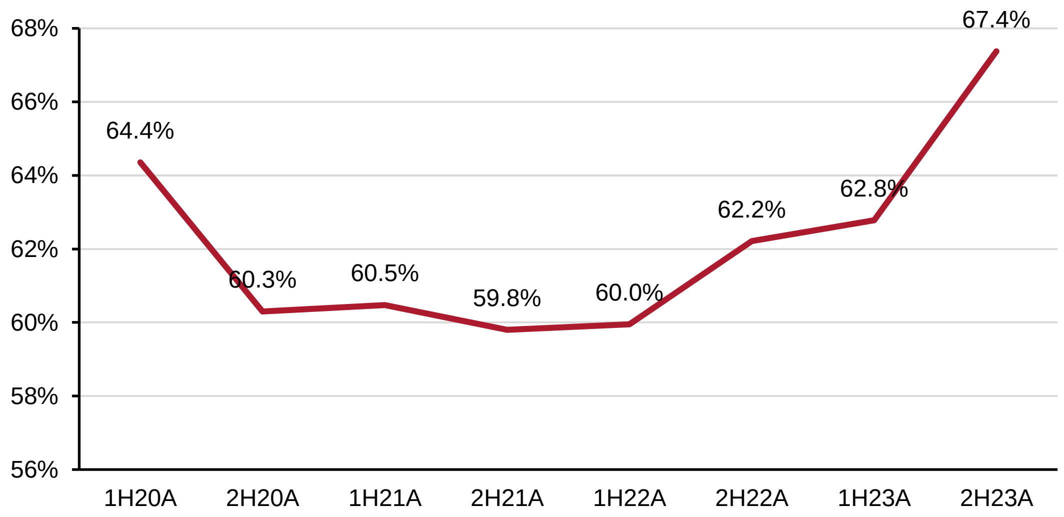
Expenses

In FY23, Auswide's total non-interest expenses increased 13.3% year on year to $65.3m, with the largest contributors to growth being, this figure is derived from:

- $27.2m in employee benefit expense, up 13.7% year on year. Auswide have attributed personal cost growth to additional resources to support third party loan volume and establish a lending centre to assist in home loan retention efforts, as well as general inflationary and superannuation guarantee increases.
- $16.7m in fees and commission, up 17.3% years on year, in line with elevated originations growth, particularly driven by the broker channel.
- $14.5m in general and administrative expense, up 11.6% year on year.

Auswide identified an increasing cost of compliance, fraud detection and technology and cyber expenses, with significant investments made in these areas in FY23 to proactively adapt. Major projects included a new website for customers, improved broker digital experience and the implementation of Elula, an AI tool to assist Auswide identify home loan customers at risk of refinancing and suggesting ways to retain them.

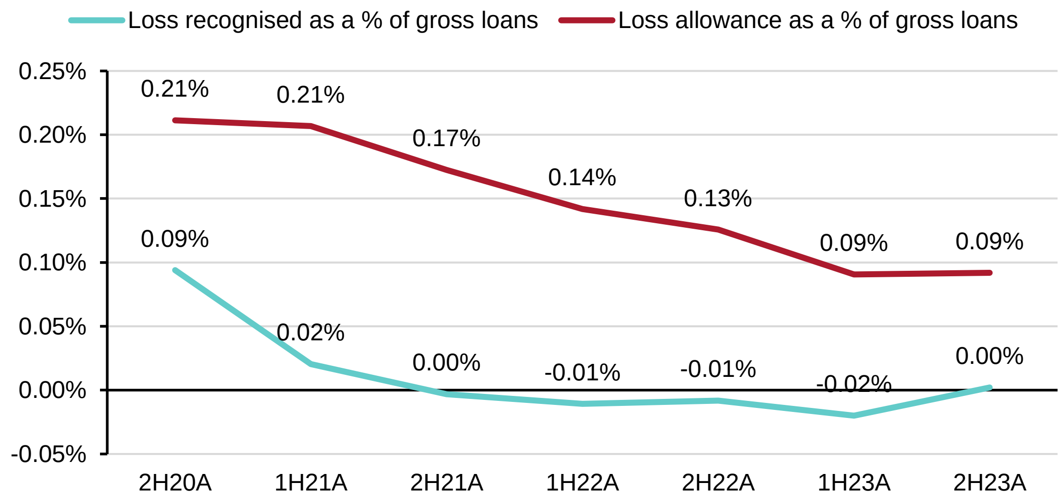
Figure 7: Cost to income ratio has increased, driven by origination growth and technology



Source: Company reports, MST Access estimates

Credit quality

Figure 8: Credit loss allowances are very low



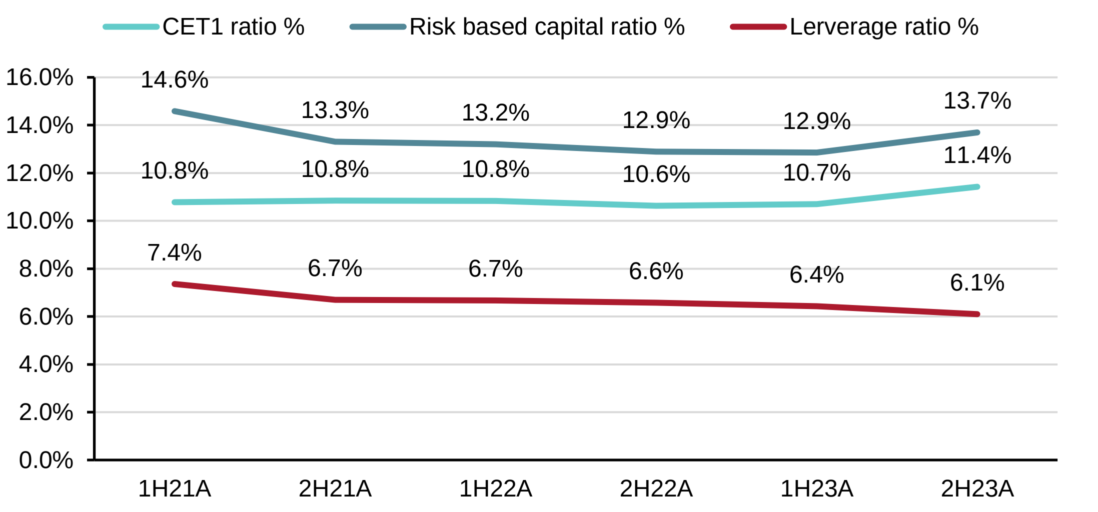
Source: Company reports, MST Access estimates

Loan arrears have remained at rates considerably lower than industry levels, with 30-90 day areas reaching a historical low of 0.10% of the loan book as of 30 June 2023 (including its modest pick-up in 30-60 day arears), compared to S&P's SPIN Index average of 0.8% (and 1.15% for regional banks). The 90+ days arrears reported at 30 June 2023 was 0.04%.

Auswide attribute the results to its lending focus is on low LVR, low risk home loans, and advance payments continuing to increase credit quality, with total advance payments in FY23 $244 (or 5.5% of loan book) and $443 in offset accounts as of 30 June 2023 (or 10.1% of loan book).

Capital unquestionably strong, aided by DRP

Figure 9: Prudential Captial Ratios



Source: Company reports, MST Access estimates

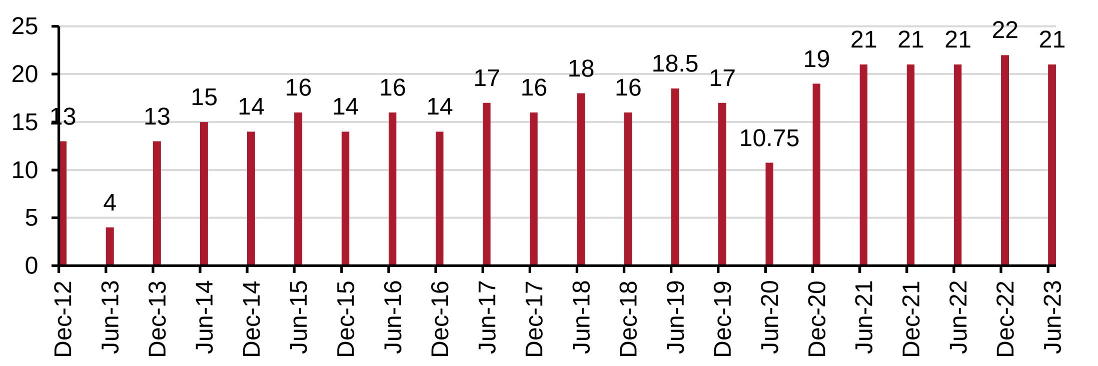
Auswide has been highly efficient in managing its capital while continuing to exceed prudential capital requirements to achieve a difficult combination:

- to remaining unquestionably strong. Which it did in FY23, delivering a CET1 ratio of 11.43%, up from 10.63% and well more than APRA's 10.50% hurdle. During Fy23 Auswide also strengthened its capital adequacy ratio to 13.70% as of 30 June 2023, up from 12.9% the year prior.
- to maximise its ROE, which was 8.7% in FY23, slightly down from 9.7% the year prior.
- to support its growth ambitions and
- to pay attractive dividends to shareholders.

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, offering the highest dividend yield in the sector.

Dividends per share of 21cps are down 1c on last half, but flat on pcp

Figure 10: Historical dividends (cents per share)



Source: Company reports

FY23 result broadly in line with expectations

Figure 11: Actual result vs prior estimates

PROFIT AND LOSS		FY22A	FY23E	FY23A	AvE $	AvE %
Interest Revenues	A$m	106.0	193.4	189.6	-3.8	-2%
Interest Expense	A$m	-23.9	-101.4	-100.4	1.0	1%
Net Interest Income	**A$m**	**82.0**	**92.0**	**89.2**	**-2.8**	**-3%**
Non-Interest Income	A$m	12.4	11.1	11.3	0.2	2%
Total operating income	**A$m**	**94.4**	**103.1**	**100.5**	**-2.6**	**-2%**
Provision For Loan Losses	A$m	0.7	0.4	0.7	0.4	101%
Total Revenue	**A$m**	**95.1**	**103.5**	**101.3**	**-2.2**	**-2%**
Non-Interest Expense	A$m	-57.7	-66.9	-65.3	1.5	2%
Profit before income tax	**A$m**	**37.5**	**36.6**	**35.9**	**-0.7**	**-2%**
Income tax expense	A$m	-11.4	-11.0	-10.9	0.2	2%
Reported NPAT	**A$m**	**26.1**	**25.5**	**25.1**	**-0.5**	**-2%**
Cash NPAT	A$m	26.1	25.5	25.1	-0.5	-2%
Basic shares on issue	m	43.4	46.8	45.9	-0.9	-2%
Weighted average diluted shares	m	43.2	45.2	45.1	-0.1	0%
EPS - diluted reported	cps	60.48	56.50	55.64	-0.86	-2%
EPS - diluted cash	**cps**	**60.48**	**56.50**	**55.64**	**-0.86**	**-2%**
DPS	A$	0.42	0.38	0.41	0.03	8%
Franking	%	100%	100%	100%	0%	0%
Payout rato	%	70%	68%	75%	7%	10%
NAV per share	A$	6.49	6.68	6.41	-0.27	-4%
KEY RATIOS		**FY22A**	**FY23E**	**FY23A**	**AvE $**	**AvE %**
CET1 ratio	%	10.63%	10.51%	11.43%	0.9%	9%
Capital ratio	%	12.90%	12.36%	13.70%	1.3%	11%
KEY PERFORMANCE INDICATORS		**FY22A**	**FY23E**	**FY23A**	**AvE $**	**AvE %**
Average loans and advances	$m	3,739	4,176	4,103	-73	-2%
Net Interest Margin	%	1.94%	1.95%	1.88%	-0.07%	-4%
Total Revenue / Average loans and advances	%	2.54%	2.48%	2.47%	-0.01%	0%
Cost to income ratio	%	61.1%	64.9%	65.0%	0.1%	0%
ECL allowance as a % of gross loans	%	0.13%	0.10%	0.09%	-0.01%	-14%
Growth in loans and advances	%	7.7%	18.3%	14.4%	-4.0%	-22%

Source: Company reports, MST Access estimates

Earnings estimate revisions

Following ABA's FY23 result, we make the following changes to our earnings estimates for ABA:

Figure 12: Changes to earnings estimates for Auswide Bank

		FY23E/A			FY24E			FY25E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Net Interest Income	A$m	92.0	89.2	-3.0%	106.9	93.5	-12.5%	124.0	116.5	-6.0%
Non-Interest Income	A$m	11.1	11.3	2.0%	11.0	11.6	6.1%	10.8	11.9	10.4%
Total operating income	A$m	103.1	100.5	-2.5%	117.9	105.2	-10.8%	134.8	128.5	-4.7%
Provision For Loan Losses	A$m	0.4	0.7	101.4%	(1.0)	(0.2)	80.5%	(1.2)	(0.2)	80.5%
Total Revenue	**A$m**	**103.5**	**101.3**	**-2.1%**	**116.9**	**105.0**	**-10.2%**	**133.6**	**128.2**	**-4.0%**
Non-Interest Expense	A$m	(66.9)	(65.3)	2.3%	(73.2)	(68.0)	7.1%	(81.6)	(78.6)	3.7%
Profit before income tax	A$m	36.6	35.9	-1.8%	43.7	37.0	-15.3%	52.1	49.7	-4.6%
Reported NPAT	**A$m**	**25.5**	**25.1**	**-1.9%**	**30.5**	**25.8**	**-15.4%**	**36.4**	**34.6**	**-4.7%**
Cash NPAT	A$m	25.5	25.1	-1.9%	30.5	25.8	-15.4%	36.4	34.6	-4.7%
EPS diluted reported	cps	56.5	55.6	-1.5%	63.7	54.7	-14.2%	72.2	69.7	-3.5%
EPS diluted cash	cps	56.5	55.6	-1.5%	63.7	54.7	-14.2%	72.2	69.7	-3.5%
DPS	cps	38.0	43.0	13.2%	38.0	43.0	13.2%	45.0	48.0	6.7%
KEY PERFORMANCE INDICATORS										
Average loans and advances	$m	4,176	4,188	0.3%	4,901	4,569	-6.8%	5,722	5,272	-7.9%
Net Interest Margin	%	1.95%	1.88%	-3.4%	1.97%	1.83%	-7.2%	1.97%	2.00%	1.2%
Total Revenue / Average loans and advances	%	2.48%	2.42%	-2.4%	2.38%	2.30%	-3.7%	2.34%	2.43%	4.1%
Cost to income ratio	%	64.9%	65.0%	0.2%	62.1%	64.7%	4.1%	60.5%	61.2%	1.1%
ECL allowance as a % of gross loans	%	0.10%	0.09%	-8.6%	0.12%	0.13%	9.4%	0.14%	0.15%	8.1%
Growth in loans and advances	%	18.3%	14.4%	-21.6%	16.7%	11.3%	-32.3%	16.7%	16.7%	-0.5%
KEY RATIOS										
CET1 ratio	%	10.51%	11.43%	8.7%	10.37%	11.90%	14.7%	10.37%	11.89%	14.6%
Capital ratio	%	12.36%	13.70%	10.8%	11.96%	13.83%	15.7%	11.73%	13.55%	15.5%
Leverage ratio	%	6.20%	6.10%	-1.6%	5.98%	6.14%	2.7%	5.87%	6.02%	2.5%

Source: Company reports, MST Access estimates

These changes reflect:

- Lowering our mortgage book growth assumptions, while altering our deposit growth assumptions to reflect ABA's strategy to "catch up" deposits with recent loan growth, to reduce higher cost wholesale funding.
- Lowering our NIM margin markedly in 1H24, before having it rebound thereafter towards ABA's 200bps target.
- Trimming our expense assumptions on cost control, noting that it still results in an increase in the cost to income ratio, given revenue compression due to the lower loan book and NIM.
- Altering our dividend forecasts given the changes to profitability.

Full details of our revised earnings appear in the financial summary on page 2, where we present our FY26 forecasts for the first time.

Valuation

Figure 13: MST Access valuation appraoches of Auswide Bank Limited

Method	Metric A$	Multiple x	per share A$	Comments
FY24 earnings	0.547	10.5	5.74	
Midcycle ROE earnings	0.649	10.5	6.82	Estimated 10.0% midcycle ROE multiplied by current book value
FY24 dividend yield	0.420	5%	8.40	
Dividend Discount Model (including franking credits)			6.89	DDM with a cost of equity of 10.0% and terminal growth of 3.0%
Dividend Discount Model (excluding franking credits)			4.82	DDM with a cost of equity of 10.0% and terminal growth of 3.0%
General Residual Income Model			7.75	GRIM with a cost of equity of 10.0% and terminal growth of 3.0%
Theoretical book	6.42	1.0	6.42	assumes 10.0% ROE, 10.0% COE, 70% dividend payout
FY23 book	6.42	1.0	6.42	
FY23 tangible book	5.34	1.2	6.42	
Composite			**6.63**	**Range of A$4.82 - A$8.40**

Source: Company reports, MST Access estimates

We consider a range of valuation approaches to validate our Residual Income Model valuation of Auswide Bank, considering:

- 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%.

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

Figure 14: MST Access General Residual Income Model ("GRIM") valuation of Auswide Bank Limited

Current date		30-Aug-23										
Last balance date		30-Jun-23										
		Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26	Dec-26	Jun-27	Dec-27	Jun-28
Book value per share	A$	6.42	6.57	6.80	7.04	7.29	7.58	7.87	7.29	7.64	8.00	8.38
Equity charge	A$		-0.32	-0.33	-0.34	-0.35	-0.36	-0.38	-0.39	-0.36	-0.38	-0.40
Cash EPS	A$	0.24	0.23	0.31	0.34	0.36	0.38	0.39	0.42	0.43	0.46	0.46
Residual income	A$	**0.24**	**-0.09**	**-0.02**	**0.00**	**0.00**	**0.02**	**0.01**	**0.03**	**0.06**	**0.07**	**0.06**
Discounted cash flow	A$	**0.00**	**-0.08**	**-0.01**	**0.00**	**0.00**	**0.01**	**0.01**	**0.02**	**0.04**	**0.05**	**0.04**

Sum of discount streams	A$	0.08	**CAPM**	
Future value into perpetuity	A$	1.98	Risk free rate	4.00%
NPV of terminal value	A$	1.25	Equity beta	1.2
add net assets	A$	6.42	Equity risk premium	5.00%
Residual income value per share	**A$**	**7.75**	Cost of equity	10.0%
P/B multiple implied by GRIM valuation	x	1.21	Terminal growth	3.0%
Upside/downside	%	42%		

Source: Company reports, MST Access estimates

Figure 15: Peer comparative multiples for Auswide Bank, sorted by ROE

Identifier (RIC)	Company Name	P/E	P/CF	P/NTA	P/B	Dividend Yield %	ROE %
CBA.AX	Commonwealth Bank of Australia	17.9	11.2	2.6	2.3	4.4%	13.2%
NAB.AX	National Australia Bank Ltd	11.8	15.3	1.6	1.4	5.9%	13.0%
ANZ.AX	ANZ Group Holdings Ltd	10.2	20.8	1.1	1.1	6.5%	11.0%
WBC.AX	Westpac Banking Corp	10.4	19.8	1.2	1.0	6.5%	10.5%
MYS.AX	MyState Ltd	9.1	n.a.	n.a.	n.a.	n.a.	8.6%
ABA.AX	Auswide Bank Ltd	10.0	12.3	0.9	0.8	7.7%	8.3%
BEN.AX	Bendigo and Adelaide Bank Ltd	11.0	214.5	1.0	0.8	6.6%	7.6%
BOQ.AX	Bank of Queensland Ltd	9.6	242.0	0.8	0.6	7.1%	6.7%
JDO.AX	Judo Capital Holdings Ltd	14.7	n.a.	0.7	0.7	0.0%	4.6%
BBC.AX	BNK Banking Corporation Ltd	14.1	0.6	0.4	0.4	0.0%	1.4%

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.
- Improving return on equity metrics as the benefits of its increased scale and profitability flow through, which is already above most 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.
- The highest dividend yield in the listed Australian bank sector.
- A strong capital position (a FY23 CET1 ratio of 11.43%) supportive of further growth.

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 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 bank, 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 total assets over $5b, representing a mortgage market share of around 20 basis points (0.20%).

Auswide's 3 year strategic plan contains 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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