

RECOMMENDATIONS

Auswide Bank (ABA)

Rating **BUY ▲**
Risk Medium
Price Target **\$6.15**
Share Price \$5.22

MyState (MYS)

Rating **HOLD ■**
Risk Medium
Price Target **\$5.25**
Share Price \$5.01

BUSINESS DESCRIPTIONS

ABA is engaged in the provision of banking facilities and financial services, focusing on the raising of funds on deposits and the provision of finance for housing over mortgages secured by residential property.

MYS is a non-operating holding company and listed diversified financial products and services group. MYS provides a range of financial products and services through wholly owned subsidiaries MyState Financial and Tasmanian Perpetual Trustees.

12-MONTH PRICE & VOLUME



RESEARCH ANALYST

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Disclosure

The author owns no shares in ABA or MYS.

Auswide Bank (ABA) MyState (MYS)

COMPANY REPORT

No tears in the third tier

- Synopsis:** The ABA and MYS share prices continue to range trade in line with the broader banking sector. Whilst both companies are not immune from the temporary re-basing of industry growth (we expect 1H18 growth to be sluggish for both) due to restrictions on investor and interest only lending, there does appear to be good growth available at the smaller end of the banking market.
- Growth in the third tier:** In this note, we summarise FY17 net loan growth for what we refer to as the third-tier home loan providers, which includes mutual ADIs, building societies, ABA and MYS. At June 2017, this cohort comprised 22 entities accounting for net loans of \$67.6bn. In aggregate these entities grew their net loan books in FY17 by 11.9%, although after adjusting for acquisitions we calculate the underlying growth at a very healthy 11.0%. This compares to modest growth for the major banks and 5.9% system growth for the overall banking sector. Of note is that there appears to be a correlation between strong growth and net interest margin (NIM) contraction. For the cohort of 22 entities we calculated a decline in NIM of 14bp in FY17.
- M&A still happening:** During FY17 a number of mergers in the mutual ADI space took place including: 1) G&C Mutual Bank/Quay Bank; 2) Bank Australia/Intech Credit Union; and 3) Unity Bank/Bankstown City Credit Union. In theory, there remains a host of possibilities for ABA and MYS to consolidate third tier players, although most players appear keen to remain as mutuals.
- Change in mutual capital rules:** In 2017, the Federal Treasurer announced proposed legislation to allow building societies, credit unions and other mutual ADIs to raise external capital without risking their mutual status. APRA has since announced it will proceed with changes to enable mutuals to raise mutual equity interests (MEIs) up to a maximum of 25% of CET1 capital. Our view is that the issuance of MEIs will likely be undertaken by the larger mutual ADIs and that the smaller end of the industry may struggle to raise funds. This may be a catalyst for further consolidation.
- Credit union sector shrinkage:** At September 2017, there were 54 credit unions in Australia with aggregate net loans of A\$32bn. The number of credit unions in Australia has steadily reduced from a peak of 171 at the end of 2004 as the result of mergers or conversion to mutual ADI status.
- ABA investment view:** BUY retained with a valuation of A\$6.21 and price target of A\$6.15. Our view is that the bulk of the heavy lifting in relation to a new core banking platform, new lending systems and branch rationalisation has been completed, with benefits dropping to the bottom line from here. ABA has already flagged a 1H18 normalised NPAT of A\$8.4m (+15% pcp) despite commentary that 1H18 loan growth would be subdued due to constraints on investor lending. Stronger lending growth is expected in 2H18. Economic conditions in central Queensland also appear to be improving. We continue to view ABA as attractively priced at 1.0 times book with a steadily improving ROE and a healthy yield. M&A remains the wildcard in the ABA story, both as an acquirer or merge partner.
- MYS investment view:** HOLD call with a valuation of A\$5.24 and price target of A\$5.25. MYS has flagged subdued loan growth in 1H18, as it also responds to caps on investor lending. Like ABA, MYS looks to be on an upward trend as the business responds to recent year investments in systems and product platforms. It is also well positioned to respond to good economic conditions in Tasmania and improving conditions in Queensland. Wealth Management remains problematic and lacks scale and breadth. Our HOLD call is more valuation related rather than related to fundamentals and/or execution.

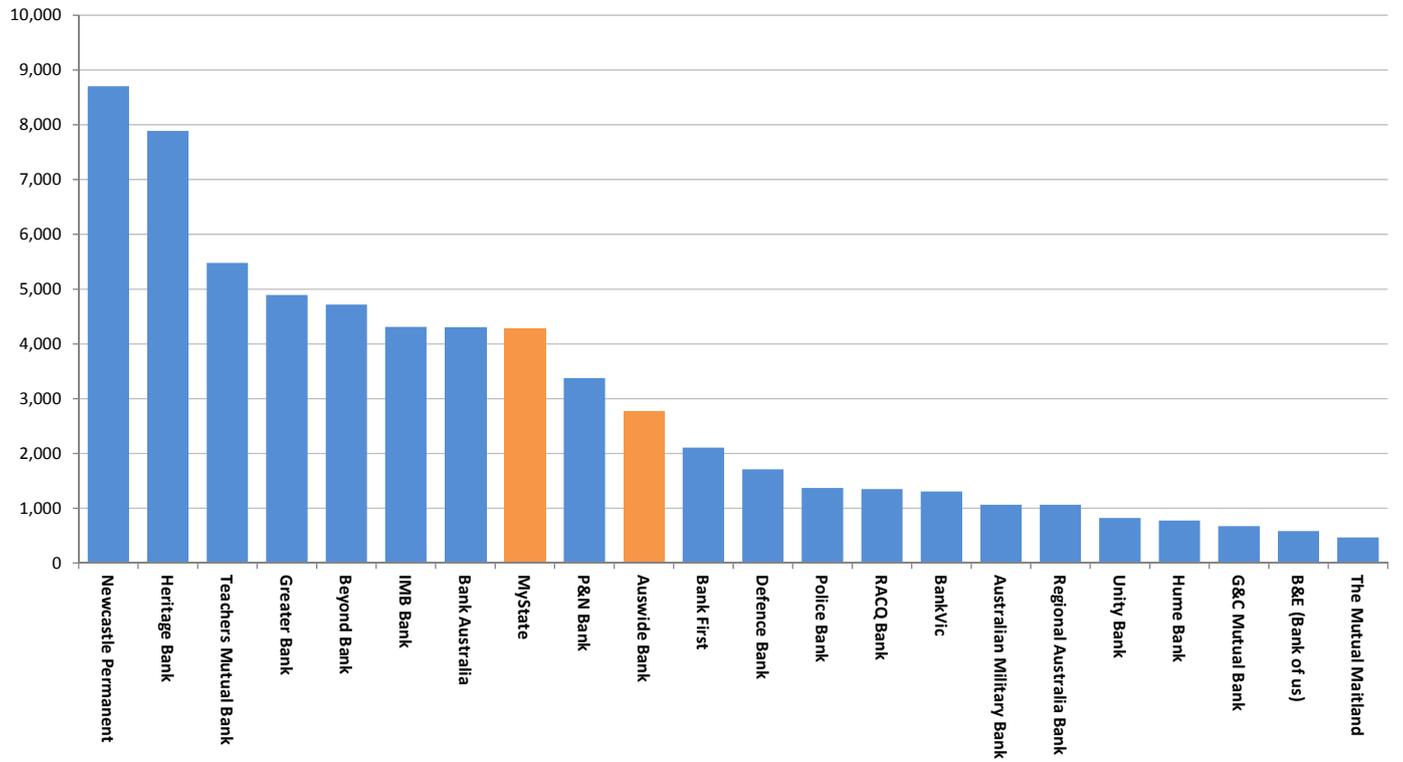
Financial summary – ABA

Auswide Bank Ltd											
Analyst:						Rating:	BUY				
Date:	02-February-2018					Price Target:	\$6.15				
Market Capitalisation A\$m:	\$220					Valuation:	\$6.15				
Share Price (\$A):	\$5.22					Upside/(Downside):	18%				
Year End:	30 June					Risk:	Medium				
PROFIT & LOSS (A\$m)	FY16A	FY17A	FY18E	FY19E	FY20E	EARNINGS	FY16A	FY17A	FY18E	FY19E	FY20E
Interest Income	124.3	125.9	139.1	154.3	168.8	EPS - Reported	31.2	37.0	43.7	51.9	60.3
Interest Expense	70.4	68.4	78.4	87.7	96.0	EPS - Normalised	37.5	38.5	42.6	51.9	60.3
Net Interest Margin	53.9	57.5	60.7	66.5	72.7	EPS Growth (%)	122%	3%	10%	22%	16%
Other Revenue	9.1	10.2	11.0	11.9	12.6	DPS	30.0	30.0	33.0	39.0	45.0
Bad & Doubtful Debts Expense	-0.6	1.0	0.9	1.0	1.1	Franking (%)	100.0	100.0	100.0	100.0	100.0
Other Expenses	46.4	45.0	45.5	47.3	49.2	Payout Ratio (%)	80%	78%	78%	75%	75%
Net Profit Before Tax	17.1	21.7	25.4	30.2	35.0	VALUATION	FY16A	FY17A	FY18E	FY19E	FY20E
Income Tax Expense/(Benefit)	5.8	6.7	7.6	9.0	10.5	P/E (x)	13.9	13.5	12.3	10.1	8.7
Minority Interests	0.3	0.0	0.0	0.0	0.0	Dividend Yield (%)	5.7%	5.7%	6.3%	7.5%	8.6%
NPAT - Reported	11.7	15.0	17.8	21.1	24.5	Price/Book (x)	1.0	0.9	0.9	0.9	0.8
Normalisation Adjustments	2.3	0.6	-0.5	0.0	0.0	Price/NTA (x)	1.3	1.3	1.2	1.2	1.1
NPAT - Normalised	14.0	15.6	17.3	21.1	24.5	Price/Cash/Flow per Share (x)	11.2	11.0	12.0	10.1	8.7
BALANCE SHEET (A\$m)	FY16A	FY17A	FY18E	FY19E	FY20E	GROWTH	FY16A	FY17A	FY18E	FY19E	FY20E
Assets						Net Loan Growth (% pcp)	14%	4%	11%	10%	10%
Cash	67.8	120.1	126.0	134.7	144.1	Net Int. Margin Growth (% pcp)	5%	7%	6%	10%	9%
Due From Other Fin.Institutions	22.0	11.8	11.8	11.8	11.8	Exp.Growth - ex BDD(% pcp)	12%	-3%	1%	4%	4%
Accrued Receivables	12.8	6.7	6.7	6.7	6.7	NPBT Growth (% pcp)	-10%	27%	17%	19%	16%
Financial Assets	225.0	291.9	291.9	291.9	291.9	MARGINS & RETURNS	FY16A	FY17A	FY18E	FY19E	FY20E
Loans & Advances	2,666.4	2,773.2	3,085.4	3,402.1	3,751.3	Net Interest Margin % (ex Int Free)	1.82%	1.76%	1.87%	1.85%	1.85%
Other Investments	0.5	1.1	1.1	1.1	1.1	Cost To Income %	74%	67%	63%	60%	58%
Property, Plant & Equipment	15.5	14.6	16.0	17.4	18.8	NPBT Margin %	27%	32%	35%	38%	41%
Deferred Tax Assets	5.9	5.3	5.3	5.3	5.3	Effective Tax Rate %	34%	31%	30%	30%	30%
Other Assets	7.7	8.4	8.4	8.4	8.4	ROIC %	6%	6%	7%	8%	9%
Goodwill	49.1	56.9	56.9	56.9	56.9	ROE %	7%	7%	8%	9%	10%
Total Assets	3,072.8	3,290.0	3,609.5	3,936.3	4,296.3	OPERATIONAL DATA	FY16A	FY17A	FY18E	FY19E	FY20E
Liabilities						Risk Weighted Assets A\$m	1,263	1,276	1,390	1,533	1,690
Dep.& Short Term Borrowings	2,183.9	2,304.6	2,616.8	2,933.5	3,282.7	Total Capital Ratio %	14.3%	14.6%	14.6%	13.9%	13.3%
Due To Other Fin.Institutions	0.0	0.0	0.0	0.0	0.0	Loan Book A\$m	2,671	2,778	3,090	3,406	3,756
Payables & Other Liabilities	25.4	18.6	18.6	18.6	18.6	Deposits/Loans %	82%	83%	85%	86%	88%
Securitized Loans	613.8	708.0	708.0	708.0	708.0	Total Equity	216.7	223.7	231.1	241.1	251.9
Income Tax Payable	0.0	1.2	1.2	1.2	1.2	Contributed Capital	182.6	184.8	187.4	190.1	193.5
Deferred Tax Liability	2.2	2.9	2.9	2.9	2.9	Reserves	13.4	14.0	14.0	14.0	14.0
Provisions	2.9	2.8	2.8	2.8	2.8	Retained Earnings	20.7	23.7	28.4	35.7	43.1
Subordinated Loans	28.0	28.0	28.0	28.0	28.0	Minority Interests	0.0	1.3	1.3	1.3	1.3
Total Liabilities	2,856.2	3,066.3	3,378.5	3,695.2	4,044.3	Book Value Per Share (cps)	538.3	549.8	567.9	592.5	619.1
Contributed Capital	182.6	184.8	187.4	190.1	193.5	NTA Per Share (cps)	416.3	410.0	428.0	452.6	479.3
Reserves	13.4	14.0	14.0	14.0	14.0	CASH FLOW (A\$m)	FY16A	FY17A	FY18E	FY19E	FY20E
Retained Earnings	20.7	23.7	28.4	35.7	43.1	Cash at Start	51.5	67.8	120.1	126.0	134.6
Minority Interests	0.0	1.3	1.3	1.3	1.3	Cash Flow from Operations	17.4	19.2	17.8	21.1	24.5
Total Equity	216.7	223.7	231.1	241.1	251.9	Cash Flow From Investing	-358.9	-175.2	-313.6	-318.1	-350.6
Book Value Per Share (cps)	538.3	549.8	567.9	592.5	619.1	Cash Flow From Financing	357.7	208.2	301.8	305.6	335.5
NTA Per Share (cps)	416.3	410.0	428.0	452.6	479.3	Net Cash Flow	357.7	208.2	301.8	305.6	335.5
CASH FLOW (A\$m)	FY16A	FY17A	FY18E	FY19E	FY20E	Other Adj	16.3	52.3	5.9	8.6	9.5
Cash at Start	51.5	67.8	120.1	126.0	134.6	Cash At End	67.8	120.1	126.0	134.6	144.1
Cash Flow from Operations	17.4	19.2	17.8	21.1	24.5						
Cash Flow From Investing	-358.9	-175.2	-313.6	-318.1	-350.6						
Cash Flow From Financing	357.7	208.2	301.8	305.6	335.5						
Net Cash Flow	357.7	208.2	301.8	305.6	335.5						
Other Adj	16.3	52.3	5.9	8.6	9.5						
Cash At End	67.8	120.1	126.0	134.6	144.1						

Financial summary - MYS

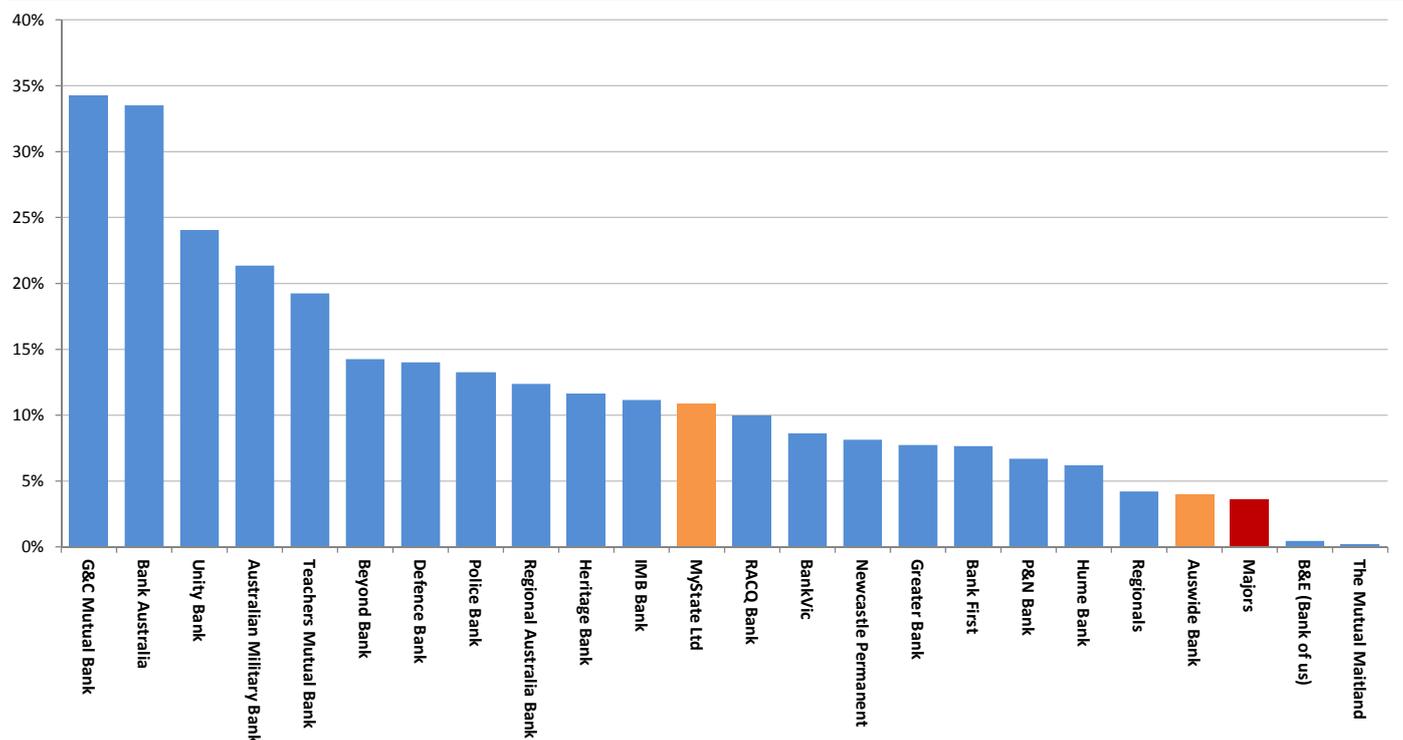
MYSTATE (MYS)											
Analyst:	Nick Caley					Rating:	HOLD				
Date:	02-February-2018					Price Target:	\$5.25				
Share Price (\$A):	\$5.01					Valuation:	\$5.24				
Year End:	30 June					Risk:	Medium				
PROFIT & LOSS (A\$m)	FY16A	FY17A	FY18E	FY19E	FY20E	Market Capitalisation A\$m:	\$451				
Interest Income	183.4	182.2	197.2	210.3	223.5	EARNINGS	FY16A	FY17A	FY18E	FY19E	FY20E
Interest Expense	94.4	94.1	104.1	111.2	118.3	EPS - Diluted	32.4	34.1	37.1	40.3	43.2
Net Interest Margin	88.9	88.1	93.1	99.1	105.1	EPS - Normalised	35.5	34.0	37.1	40.3	43.2
Other Revenue	34.5	36.5	37.5	39.6	41.8	EPS Growth (%)	4%	-4%	9%	9%	7%
Total Net Revenue	123.4	124.6	130.6	138.7	146.9	DPS	28.5	28.5	30.5	32.5	35.0
Expenses	81.1	82.2	81.8	85.7	90.2	Franking (%)	100	100	100	100	100
Net Prof. B. Tax/Doubt. Debts	42.3	42.5	48.7	53.0	56.8	Payout Ratio (%) - Normalised	80%	84%	82%	81%	81%
Bad & Doubtful Debts Expense	1.2	0.2	1.3	1.4	1.5	VALUATION	FY16A	FY17A	FY18E	FY19E	FY20E
Net Profit Before Tax	41.1	42.2	47.4	51.5	55.2	P/E (x)	14.1	14.7	13.5	12.4	11.6
Income Tax Expense/(Benefit)	12.8	12.2	14.2	15.5	16.6	Dividend Yield (%)	5.7%	5.7%	6.1%	6.5%	7.0%
NPAT - Reported	28.3	30.1	33.2	36.1	38.7	Price/Book (x)	1.5	1.4	1.4	1.4	1.3
Normalisation Adjustments	2.7	0.0	0.0	0.0	0.0	Price/NTA (x)	2.0	2.0	2.0	1.9	1.8
Normalised Net Profit After Tax	31.1	30.1	33.2	36.1	38.7						
BALANCE SHEET (A\$m)	FY16A	FY17A	FY18E	FY19E	FY20E	GROWTH	FY16A	FY17A	FY18E	FY19E	FY20E
Assets						Net Loan Growth (% pcp)	9%	11%	9%	7%	7%
Cash	80.1	64.2	70.2	77.7	85.6	Revenue Growth (% pcp)	-1%	1%	5%	6%	6%
Financial Assets	356.0	420.8	420.8	420.8	420.8	Expense Growth (% pcp)	3%	1%	0%	5%	5%
Receivables	17.9	35.2	35.2	35.2	35.2	NPBT Growth (% pcp)	-11%	3%	12%	9%	7%
Loans at Amortised Cost	3,863.1	4,282.5	4,656.5	4,974.5	5,314.5	NPAT Growth (% pcp) - Normalised	5%	-3%	10%	9%	7%
Other Investments	0.5	0.0	0.0	0.0	0.0	Margins & Returns	FY16A	FY17A	FY18E	FY19E	FY20E
Assets Held for Sale	0.0	0.0	0.0	0.0	0.0	Net Interest Margin %	2.00%	1.83%	1.88%	1.88%	1.88%
Property, Plant & Equipment	9.8	8.3	9.1	9.9	10.7	Cost To Income % - Reported	66%	66%	63%	62%	61%
Tax Assets	3.7	4.7	4.7	4.7	4.7	Cost To Income % - Underlying	63%	65%	63%	62%	61%
Other Assets	5.8	6.6	6.6	6.6	6.6	NPBT Margin %	46%	48%	51%	52%	53%
Intangible Assets	79.0	88.2	88.2	88.2	88.2	Effective Tax Rate %	31%	29%	30%	30%	30%
Total Assets	4,415.9	4,910.5	5,291.2	5,617.5	5,966.3	ROIC %	13%	14%	15%	15%	16%
Liabilities						ROE %	10%	10%	11%	11%	12%
Deposits	4,068.2	4,549.0	4,848.1	5,102.5	5,374.6	ROA %	1%	1%	1%	1%	1%
Borrowings	30.7	34.3	109.1	172.7	240.7	Gearing	FY16A	FY17A	FY18E	FY19E	FY20E
Payables & Other Liabilities	0.0	0.0	0.0	0.0	0.0	Deposits/Loans %	105%	106%	104%	103%	101%
Tax Liabilities	4.4	4.1	4.1	4.1	4.1	Total Capital Ratio %	13.0%	13.3%	11.6%	10.9%	10.2%
Provisions	13.0	12.2	12.2	12.2	12.2	Segmental	FY16A	FY17A	FY18E	FY19E	FY20E
Total Liabilities	4,116.3	4,599.5	4,973.5	5,291.5	5,631.5	Banking	25.3	26.3	29.0	31.8	34.2
Equity						Wealth Management	3.8	3.8	4.1	4.3	4.5
Contributed Capital	134.8	141.3	141.3	141.3	141.3	Corporate	-0.7	0.0	0.0	0.0	0.0
Retained Earnings	159.3	164.4	171.1	179.5	188.2	Total Reported NPAT	28.3	30.1	33.2	36.1	38.7
Asset Revaluation Reserve	5.6	5.2	5.2	5.2	5.2	Divisional & Operating Data	FY16A	FY17A	FY18E	FY19E	FY20E
Emp. Equity Benefits Reserve	0.0	0.0	0.0	0.0	0.0	Banking					
Hedging Reserve	0.0	0.0	0.0	0.0	0.0	Net Loans A\$m	3,863	4,283	4,656	4,974	5,315
Other Reserves	0.0	0.0	0.0	0.0	0.0	Impaired Loans/Gross Loans %	0.03%	0.02%	0.02%	0.02%	0.02%
Total Equity	299.6	310.9	317.7	326.0	334.7	Wealth Management					
Book Value per Share (cps)	341.1	347.6	355.2	364.5	374.2	Funds Under Management A\$m	1,008	1,089	1,133	1,179	1,226
NTA per Share (cps)	251.2	249.0	256.6	265.9	275.6	Funds Under Advice A\$m	738	778	809	842	876
CASH FLOW (A\$m)	FY16A	FY17A	FY18E	FY19E	FY20E						
Cash at Start	66.3	80.1	64.2	70.2	77.7						
Cash Flow from Operations	42.2	40.6	33.2	36.1	38.7						
Cash Flow from Investing	-331.4	-523.0	-374.8	-318.8	-340.8						
Cash Flow from Financing	303.1	466.4	347.6	290.3	310.1						
Net Cash Flow	13.9	-15.9	6.0	7.5	7.9						
Other Adj.	-0.1	0.0	0.0	0.0	0.0						
Cash at End	80.1	64.2	70.2	77.7	85.6						

FIG.1: THIRD TIER ADIs EX-CREDIT UNIONS – NET LOANS A\$m



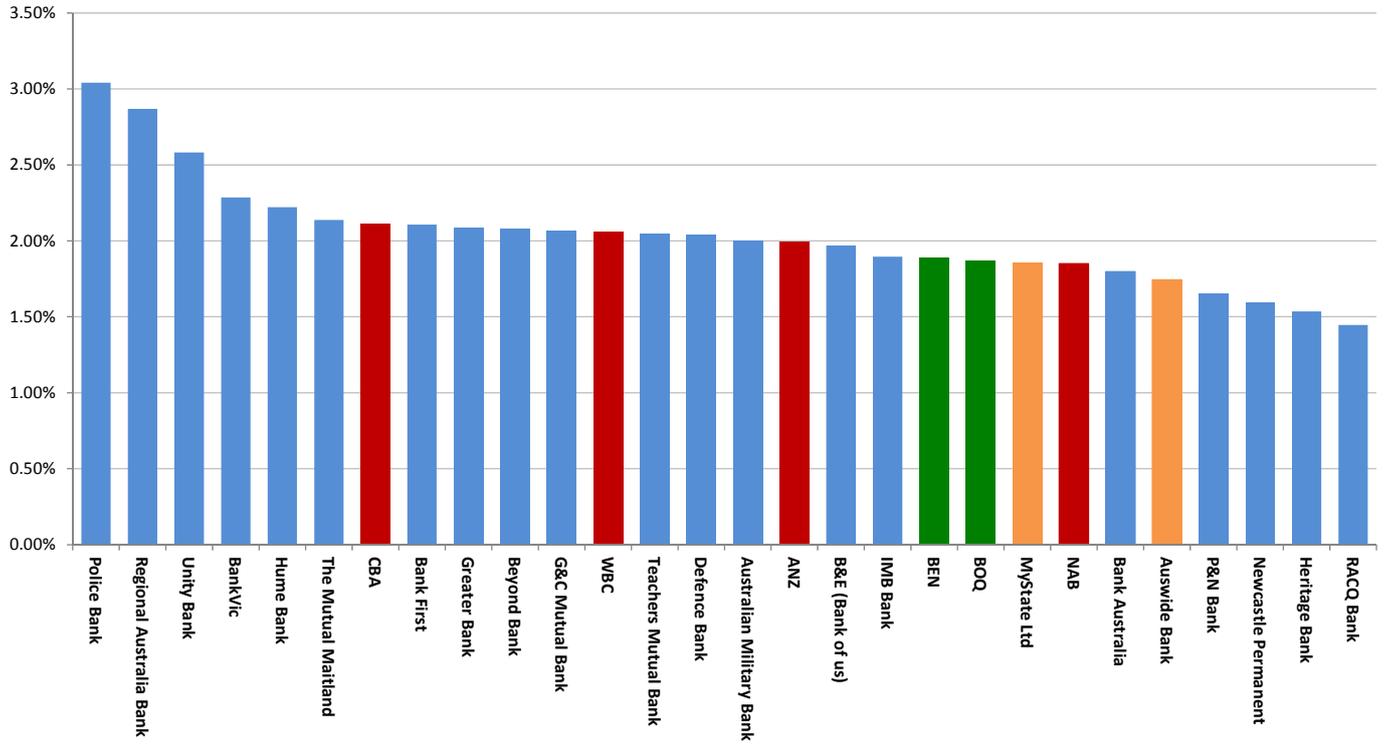
Source: Company annual reports

FIG.2: THIRD TIER ADIs EX-CREDIT UNIONS – NET LOAN GROWTH



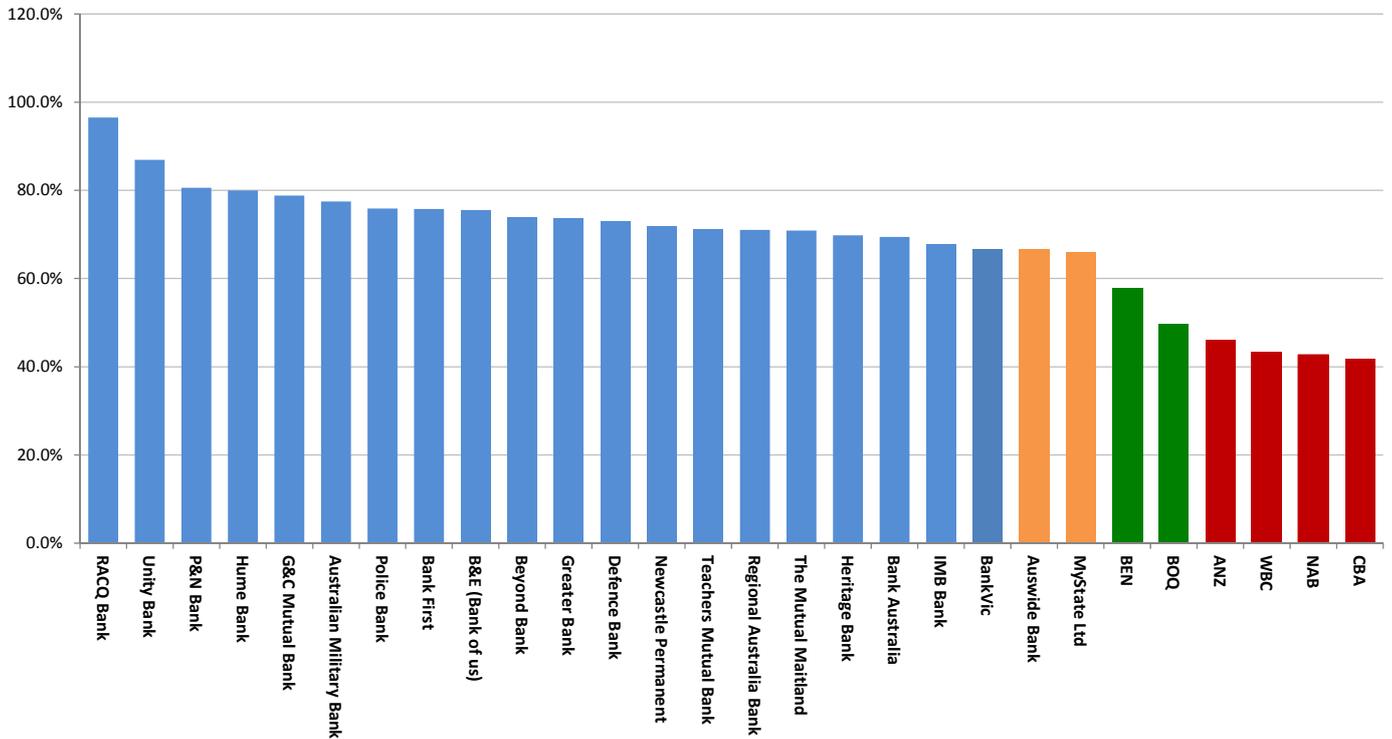
Source: Company annual reports

FIG.3: FY17 NET INTEREST MARGINS – BANKS, MUTUAL ADIs & BUILDING SOCIETIES



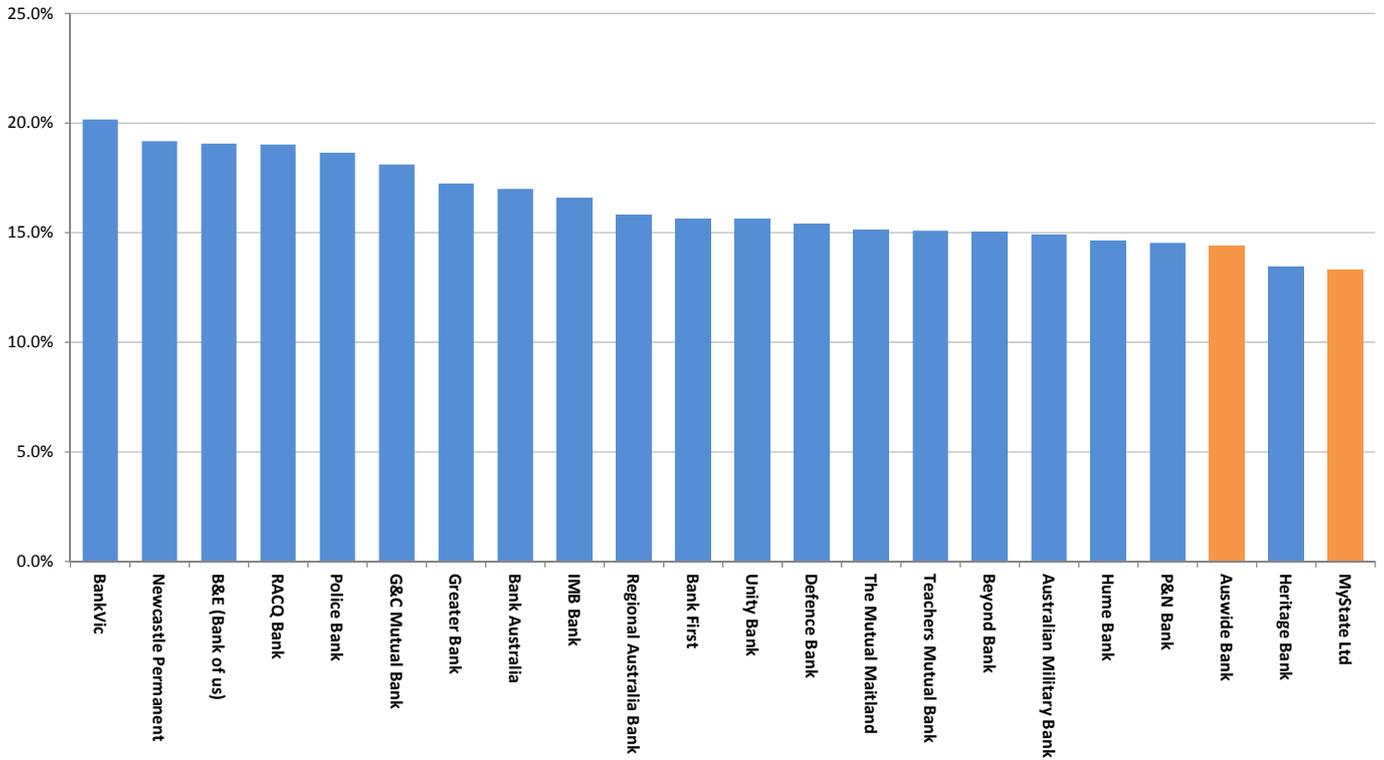
Source: Company annual reports, Baillieu Holst calculations

FIG.4: FY17 COST TO INCOME RATIOS - BANKS, MUTUAL ADIs & BUILDING SOCIETIES



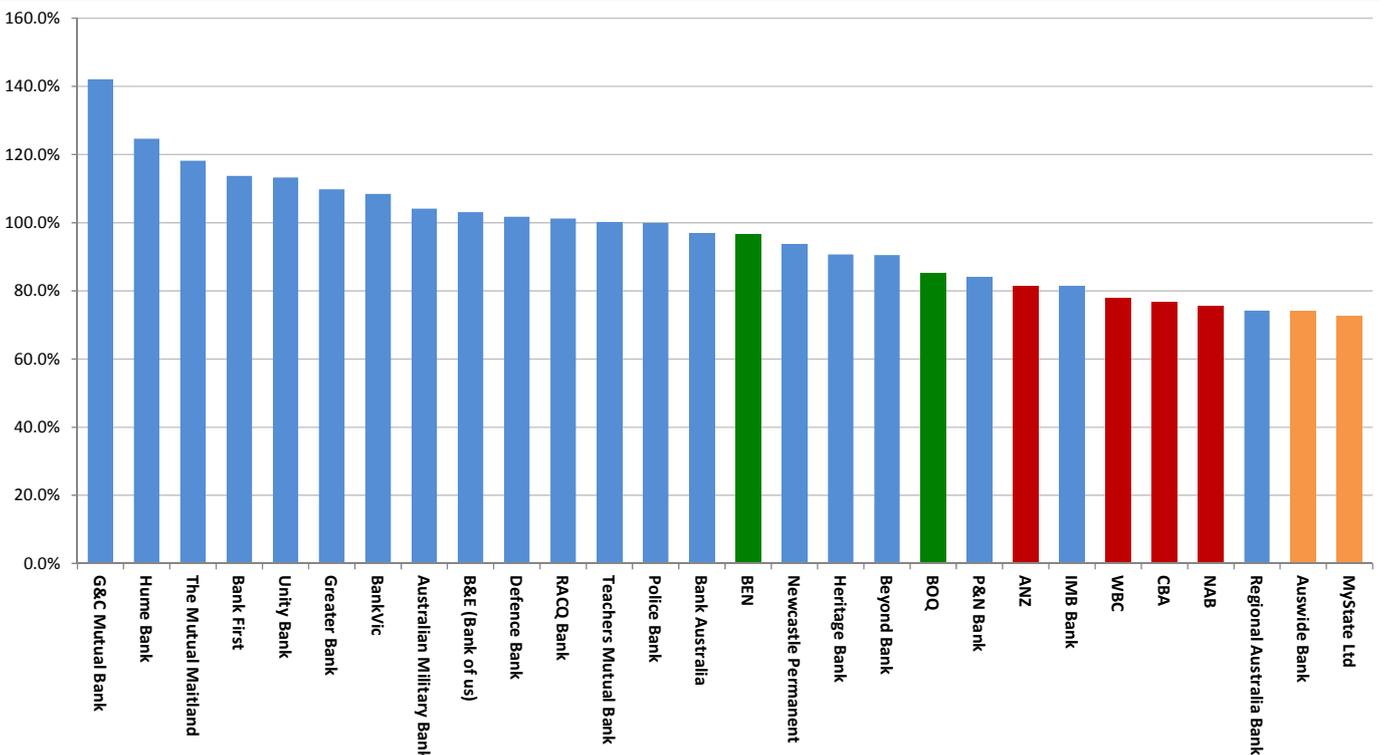
Source: Company annual reports, Baillieu Holst calculations

FIG.5: FY17 COST TO INCOME RATIOS - THIRD TIER ADIs EX-CREDIT UNIONS



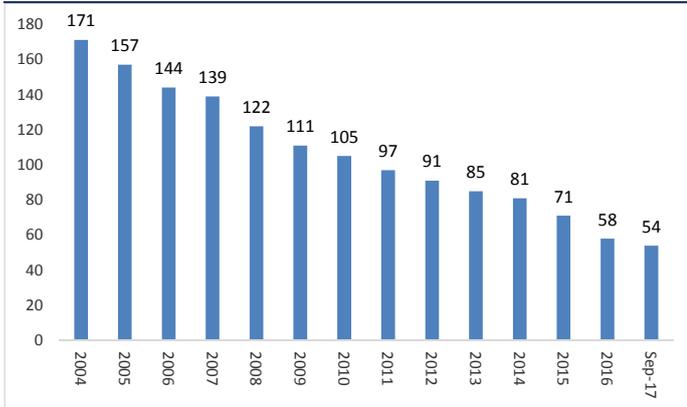
Source: Company annual reports, Baillieu Holst calculations

FIG.6: DEPOSITS/LOANS - BANKS, MUTUAL ADIs & BUILDING SOCIETIES



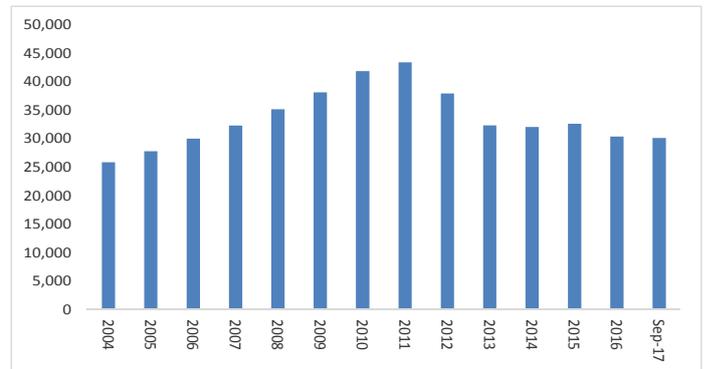
Source: Company annual reports, Baillieu Holst calculations

FIG.7: NUMBER OF AUSTRALIAN CREDIT UNIONS



Source: APRA

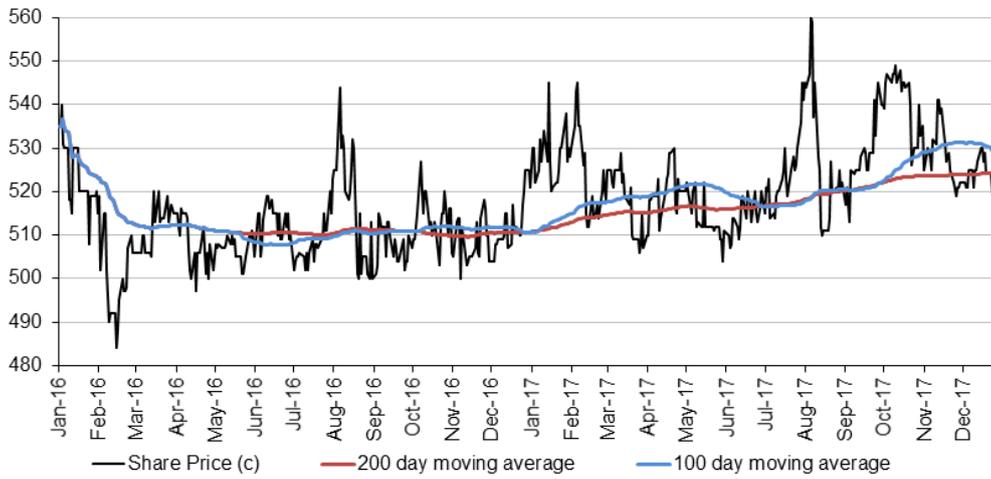
FIG.8: AUSTRALIAN CREDIT UNIONS – NET LOANS A\$m



Source: APRA

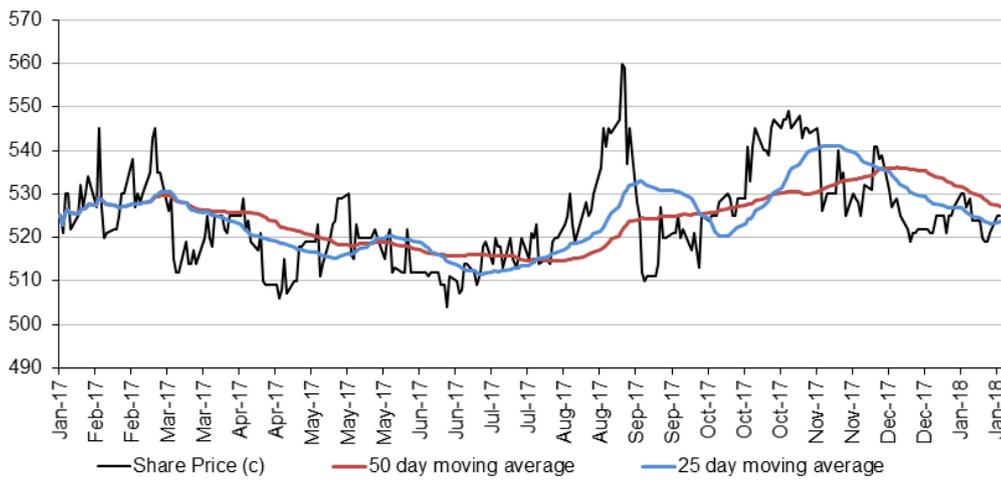
Appendix

FIG.9: LONG TERM MOMENTUM INDICATORS



Source: Iress

FIG.10: SHORT TERM MOMENTUM INDICATORS



Source: Iress

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Hold: The stock's total return is expected to trade within a range of \pm 10-15 percent from the current share price over the next 12 months.

Sell: The stock's total return is expected to decrease by at least 10-15 percent from the current share price over the next 12 months.

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Hold: 29%

Sell: 3%

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