Auswide Bank (ASX:ABA)

30 August 2023

FY23 Result

Long-established regional bank based in Bundaberg Queensland providing home loans, personal loans and credit cards.

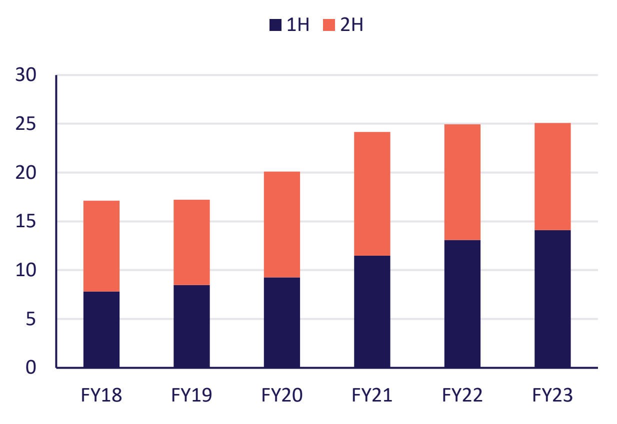
Share Price	$5.47
Market Cap	$248.1m
FY23 Price to Book	0.84x

(A$m)	FY23A	FY24F	FY25F
Net Revenue	100.5	105.5	114.8
NPAT	25.1	27.6	31.3
Net Loan Growth	*14.4%*	*8.1%*	*10.3%*
Net Interest Margin	*1.88%*	*1.92%*	*1.92%*
Diluted EPS (cps)	*55.6*	*60.2*	*68.2*
DPS (cps)	*43.0*	*45.0*	*51.0*
PE	*9.8x*	*9.1x*	*8.0x*

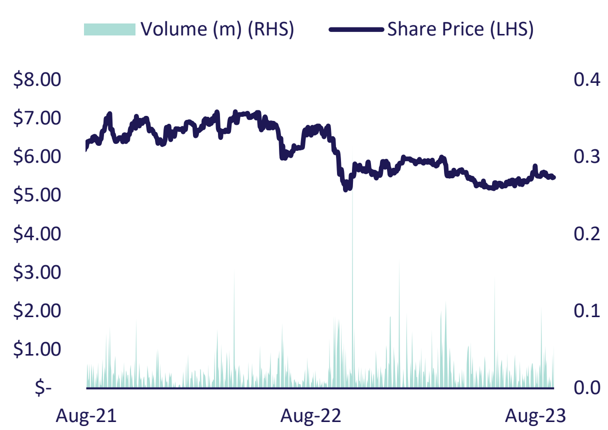
FY23 Result Highlights

- **Underlying NPAT:** $25.1m (+0.4% pcp), with 2H23 contributing $11.0m (-7.8% pcp).
- **Dividend:** 2H23 dividend of 21cps, total of 43cps for FY23 (FY22: 42cps). FY23 payout ratio based upon Stat NPAT of 77% (FY22: 73%).
- **Cost Ratio:** Cost-to-income ratio of 65% (FY22: 61.1%). FY23 featured heavy investment in IT/compliance.
- **Net Interest margin (NIM):** Reduced to 1.88% (FY22: 1.94%), NIM of 2.02% in 1H23, reduction due to higher wholesale funding costs
- **Loan book:** Gross loan book of $4.4bn (+14.2% pcp). FY23 loan book growth of 3X+ system.
- **Deposits:** $3.4bn (+11.6% pcp), customer deposit-to-loan ratio of 72% (1H23: 73%).
- **Outlook:** No profit guidance for FY24 but aims to: 1) continue loan book growth albeit at a more moderate rate than FY23; 2) reverse NIM pressure from a combination of growing deposits at the expense of wholesale funding, flow through of fixed to variable mortgage refinancing and the higher margin loans written in FY23; and 3) return to more normal OPEX levels.
- **Our view:** ABA's flat FY23 result shows it is not immune to NIM pressure. However, the recent strategy of pursuing above-system loan growth and riding the yield curve from here should underpin material earnings growth in FY24. The competition in the mortgage market for both loans and deposits appears to be easing. ABA's multi-year frustration in not undertaking acquisitions of third-tier banks/credit unions could end with smaller competitors facing higher regulatory/IT costs to stay in business.

Underlying NPAT (A$m)



Share Price



Source: CapIQ

Key Takeaways

ABA has laid a strong platform for profit growth in FY24.

Key Takeaways

- **Laying the base for FY24 and beyond:** ABA's aggressive loan book growth in the face of elevated funding costs has been uncharacteristic of the current management team. Our view of this scenario is that ABA has taken a one-off opportunity around the market shift from fixed to variable mortgages to materially increase the size of the book with new variable loans at higher NIM.
- **Cost increase looks temporary:** ABA's FY23 cost-to-income ratio of 65% surprised for a bank with a recent history of being closer to 60%. Whilst inflationary pressures are at play here, investments in technology (cybersecurity, AI, Open Banking, NPP) and increased business retention staff due to fixed rate expiries look transitory. ABA has also highlighted that these additional imposts and higher regulatory costs are not unique to ABA. As such, ABA CEO expects industry consolidation amongst 3rd tier bank mutuals to defray costs – ABA could participate in this process.
- **Funding mix needs some reorientation:** With FY23 loan book growth of 14.2% pcp exceeding deposit growth of 11.6% pcp, ABA needed to rely more heavily upon wholesale funding markets, which come at an elevated cost. As such, securitisation funding accounted for 11.2% of ABA's funding versus 8.8% in FY22 – ABA had previously reduced its weighting to more expensive securitisation funding in recent years. ABA also repaid $50 from the RBA Term Funding Facility (TFF), which was made available during COVID-19 at a heavily discounted rate – ABA will repay the balance owing of its TFF of $101m in FY24. In the interim, ABA has noted a 20-25bp easing in wholesale funding costs thus far in FY24.

Outlook

- No numerical guidance for FY24. In general terms:
  1) Grow the loan book profitably – group loan book target of $6bn by the end of 2025 remains an aspiration, although ABA will favour NIM/cost management over outright loan growth in FY24;
  2) Reverse downward pressure on NIM - reverse NIM pressure from a combination of growing deposits at the expense of wholesale funding, flow through of fixed to variable mortgage refinancing and the higher margin loans written in FY23;
  3) Management of OPEX – FY23 featured heavy investment in IT/compliance;
  4) Continue to invest in IT;
  5) Maintain shareholder returns;
  6) Continue to pursue M&A.
  7) RBA Term Funding facility at discounted interest rates reduced to 2.1% of total funding at FY23 (FY22: 3.6%) post $50m repayment, the remaining $101m to be repaid in FY24—retail deposits to be pursued at the expense of more expensive wholesale funding.
  8) Long-term CEO to retire in coming months.

Our View

- The flat FY23 result shows that ABA is not immune to NIM pressure as it has elected to pursue multiples of system growth and ride the yield curve from here. The good news is that ABA has been a late-cycle player in this strategy and has made a grab for growth from a strong starting NIM, as competition in the mortgage market is showing signs of easing. A dividend increase underlines the confidence in capital versus growth and reinforces ABA as a strong yield play. Frustration remains as the inability to consummate material acquisitions, which we largely attribute to the reluctance of third-tier mutual banks/credit unions to engage.

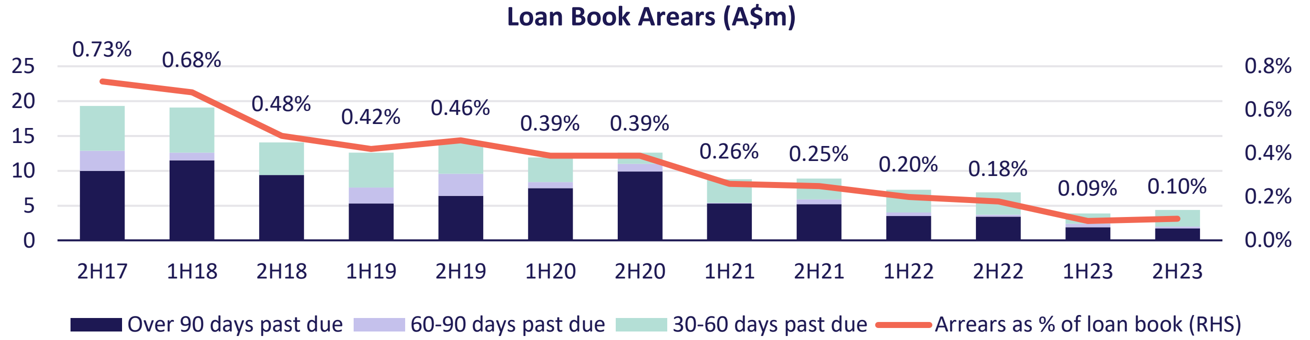
FY23 Results

The flat FY23 result is credible concerning NIM pressure and increased investment.

Profit & Loss

(A$m)	FY19	FY20	FY21	FY22	FY23	pcp
Interest Income	136.4	126.3	111.0	106.0	189.6	*79%*
Interest Expense	(73.2)	(55.7)	(32.8)	(23.9)	(100.4)	*320%*
Net Interest Revenue	**63.2**	**70.5**	**78.2**	**82.0**	**89.2**	*9%*
Non Interest Income	9.5	10.0	10.4	12.4	11.3	*(8%)*
Total Net Revenue	**72.6**	**80.5**	**88.5**	**94.4**	**100.5**	*6%*
Loan Impairment	(1.1)	(3.8)	(0.6)	0.7	(0.7)	
OPEX	(46.9)	(50.1)	(53.2)	(57.7)	(63.9)	*11%*
NPBT	**24.6**	**26.5**	**34.7**	**37.5**	**35.9**	*(4%)*
Income Tax	(7.4)	(8.0)	(10.5)	(11.4)	(10.9)	*(4%)*
Reported NPAT	**17.2**	**18.5**	**24.2**	**26.1**	**25.1**	*(4%)*
Adjustments (Post Tax)	-	1.6	-	(1.2)	-	
Normalised NPAT	**17.2**	**20.1**	**24.2**	**25.0**	**25.1**	*0%*
Net Loan Growth	*6%*	*4%*	*11%*	*8%*	*14%*	
NIM	*1.87%*	*1.97%*	*2.00%*	*1.94%*	*1.88%*	
Cost To Income Ratio	*64.5%*	*62.3%*	*60.1%*	*61.1%*	*63.5%*	
Diluted EPS (cps)	*40.8*	*47.6*	*56.8*	*57.8*	*55.6*	*(4%)*
DPS (cps)	*34.5*	*27.8*	*40.0*	*42.0*	*43.0*	*2%*

- **Underlying NPAT:** $25.1m (+0.4% pcp), with 2H23 Underlying NPAT of $11.0m (-7.8% pcp). 2H23 dividend of 21cps making a total of 43cps for FY23 (FY22: 42cps). ABA's FY23 payout ratio is based upon a Statutory NPAT of 77% (FY22: 73%) versus the board's traditional target range of 70-80%.
- **Cost Ratio:** Cost to income ratio of 65.0% (FY22: 61.1%), with an increase driven by inflationary impacts on employee expenses and technology in addition to originating a much larger loan book. Apart from elevated regulatory costs, which will likely continue, ABA invested in cybersecurity, AI, Open Banking, NPP.
- **Net Interest margin (NIM):** Reduced to 1.88% (FY22: 1.94%) following NIM of 2.02% in 1H23. ABA attributes NIM contraction to the rising interest rate environment, market competition including deposits and a general switch from transaction accounts to term deposits.
- **Credit quality:** FY23 loan loss provision of $0.7m, which includes an $0.8m reversal in 1H23. Loan book arrears (30 days +) equated to 10bp of ABA's total loan book (1H23: 5bp) but remained near historical lows 1H23. Actual bad debts written off in FY23 were nominal. ABA stated that it has not seen an elevation in financial distress calls from customers at this stage



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Balance Sheet & Cash Flow

Capital ratio strengthened despite material uplift in loan growth.

Balance Sheet

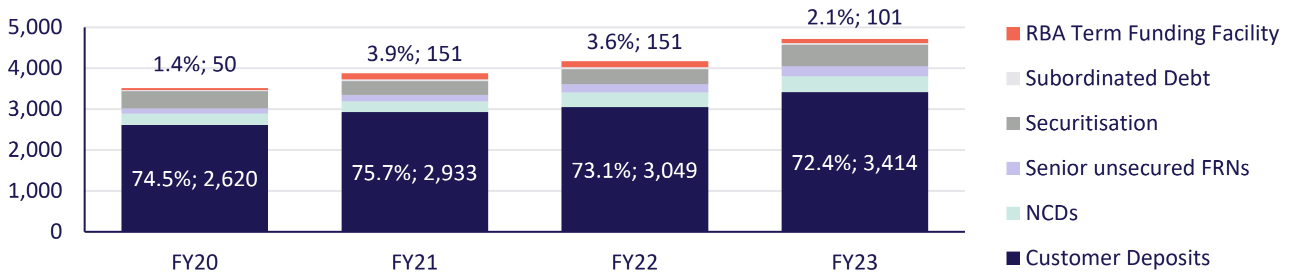
(A$m)	FY22	FY23
Cash	178.5	203.2
Due From Other Financial Institutions	11.8	3.0
Financial Assets	412.1	402.4
Loans & Advances	3,827.6	4,377.8
Other Investments	1.4	1.5
Property, Plant & Equipment	20.6	18.9
Other Assets	3.4	3.3
Goodwill	49.2	49.3
Total Assets	**4,504.6**	**5,059.5**
Deposits & Short-Term Borrowings	3,617.3	4,042.9
Due To Other Financial Institutions	150.8	101.0
Payables & Other Liabilities	33.1	43.3
Securitised Loans	370.8	530.8
Income Tax Payable	0.6	0.0
Deferred Tax Liability	3.9	1.6
Provisions	4.0	4.0
Subordinated Loans	42.0	42.0
Total Liabilities	**4,222.5**	**4,765.7**
Net Assets	**282.1**	**293.9**
Contributed equity	199.8	211.8
Reserves	28.4	22.3
Accumulated losses	53.8	59.8
Equity	**282.1**	**293.9**
Deposits/Net Loans	*95%*	*92%*
Capital Adequacy Ratio	*12.9%*	*13.7%*

Cash Flow

(A$m)	FY22	FY23
Interest Received	105.4	185.0
Dividends Received	-	0.0
Borrowing Costs	(24.8)	(77.5)
Other Non-Interest Income	14.0	16.5
Suppliers & Employees	(39.7)	(73.0)
Income Tax	(10.7)	(11.1)
Net Operating	**44.2**	**39.9**
Investment Securities	(13.2)	1.1
Amounts Due/From Financial Inst	1.0	8.8
Loans	(271.1)	(549.1)
Other Investments	(0.0)	(0.1)
Payment for PP&E	(2.7)	(2.3)
Net Investing	**(286.0)**	**(541.5)**
Borrowings	266.6	374.0
Amounts Due/From Financial Inst	54.5	159.6
Capital Raised	1.1	0.4
Dividends Paid	(14.4)	(7.7)
Net Financing	**307.7**	**526.3**
Cash at beginning	112.6	178.5
Net change	65.9	24.7
Cash at end	**178.5**	**203.2**

- **Gross Loan book:** $4.4bn (+14.2% pcp), compared to YTD annualised growth of 13.9% pcp to end 3Q23. FY23 loan book growth of 3X+ system, which is very aggressive under the current ABA management team.
- **Funding:** Deposits grew to $3.4bn (+11.6% pcp) vs $3.405bn at 3Q23, with a customer deposit-to-loan ratio of 72% (1H23: 73%). With loan growth out-pacing deposit growth, ABA relied upon securitisation funding, accounting for 11.2% of ABA's funding versus 8.8% in FY22.
- **RBA Term Funding Facility (TFF):** Discount TFF funding provided during Covid-19 reduced to 2.1% of total funding at FY23 (FY22: 3.6%) post $50m repayment, the remaining $101m to be repaid in FY24. Retail deposits are to be pursued at the expense of more expensive wholesale funding.
- **Capital:** The total capital ratio of 13.70% (1H23: 12.86%) remains unquestionably strong regarding APRA's requirements. Increase from 1H23 mainly due to retained earnings and DRP underwriting. ABA also sees ongoing relief from changes to APRA risk weightings and the impact on LVRs from property revaluations.

Funding Mix (A$m)



Forecasts & Sensitivities

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With loan growth from FY23, the keys will be NIM and costs from here.

Profit & Loss

(A$m)	1H23A	2H23A	FY23A	*Previous* FY24F	*Revised* FY24F	*Debut* FY25F
Interest Income	82.3	107.3	189.6	189.9	228.7	250.2
Interest Expense	(35.7)	(64.6)	(100.4)	(92.3)	(134.8)	(147.7)
Net Interest Revenue	**46.5**	**42.7**	**89.2**	**97.5**	**93.8**	**102.5**
Non Interest Income	5.6	5.8	11.3	12.7	11.7	12.3
Total Net Revenue	**52.1**	**48.4**	**100.5**	**110.2**	**105.5**	**114.8**
Loan Impairment	0.8	(1.6)	(0.7)	(0.7)	(0.9)	(1.0)
Opex	(32.7)	(31.2)	(63.9)	(67.9)	(65.2)	(69.1)
NPBT	**20.2**	**15.7**	**35.9**	**41.6**	**39.5**	**44.7**
Income Tax	(6.1)	(4.8)	(10.9)	(12.5)	(11.8)	(13.4)
Reported NPAT	**14.1**	**11.0**	**25.1**	**29.1**	**27.6**	**31.3**
Adjustments (Post Tax)	-	-	-	-	-	-
Normalised NPAT	**14.1**	**11.0**	**25.1**	**29.1**	**27.6**	**31.3**
Net Loan Growth	*10%*	*7%*	*14%*	*12%*	*8%*	*10%*
NIM	*2.02%*	*1.82%*	*1.88%*	*1.95%*	*1.92%*	*1.92%*
Cost To Income Ratio	*62.8%*	*64.4%*	*63.5%*	*61.6%*	*61.7%*	*60.2%*
Diluted EPS (cps)	*31.7*	*23.9*	*55.6*	*64.2*	*60.2*	*68.2*
DPS (cps)	*22.0*	*21.0*	*43.0*	*46.0*	*45.0*	*51.0*

- **Changes to Forecasts:** Downgrade to FY24 NPAT forecast by 5% due to a combination of:
  1) A weaker starting NIM from 2H23;
  2) Higher cost base from FY23 flowing through; and
  3) More moderate loan growth assumptions in FY24.

NPAT (A$m)

Cost To Income	Ave Interest Earning Assets (A$m)				
	4,721	4,819	**4,917**	5,016	5,114
64%	25.1	25.6	26.1	26.7	27.2
63%	25.8	26.3	26.9	27.4	28.0
62%	26.5	27.1	**27.6**	28.2	28.7
61%	27.2	27.8	28.4	28.9	29.5
60%	27.9	28.5	29.1	29.7	30.3

- 2% increase in Average Interest Earning Assets:
  - NPAT ↑ c.$0.8m.
- 1% decrease in Cost to Income Ratio:
  - NPAT ↑ c.$0.7m.

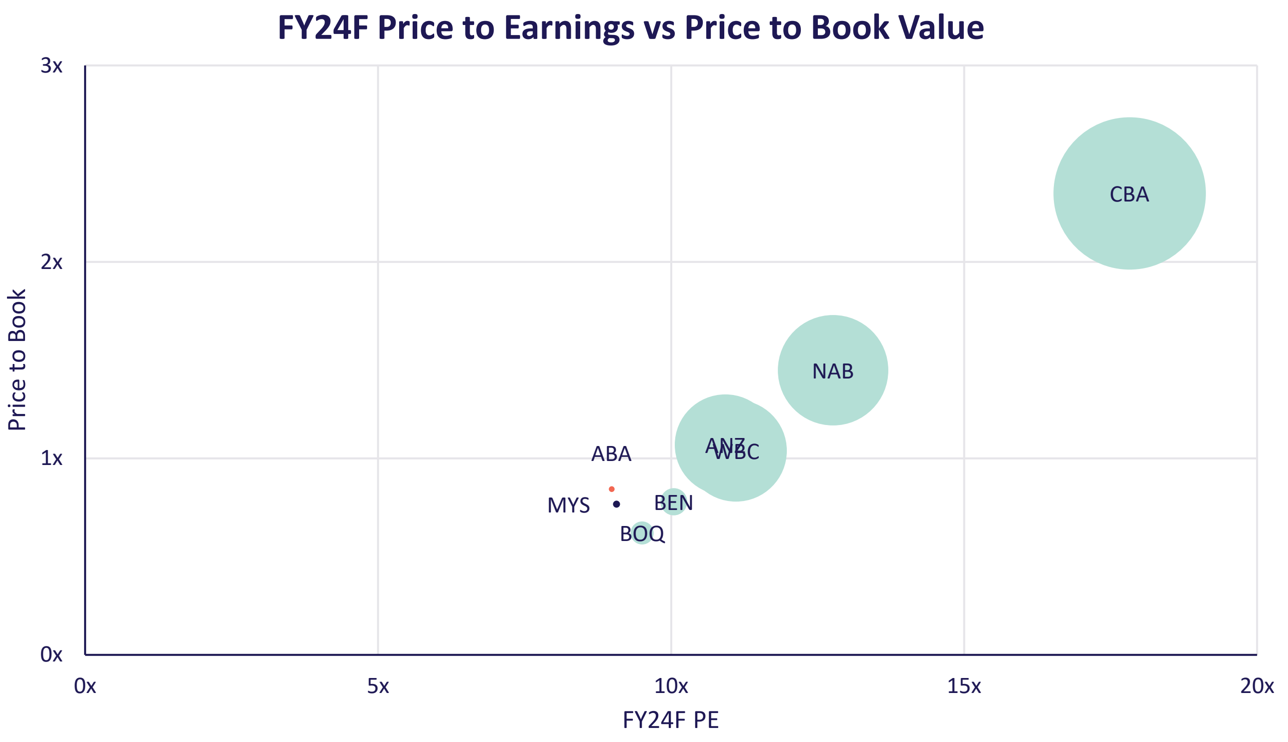
Dividend Yield

Yield	Ave Interest Earning Assets (A$m)				
	4,721	4,819	**4,917**	5,016	5,114
64%	7.48%	7.63%	7.79%	7.94%	8.10%
63%	7.69%	7.85%	8.01%	8.17%	8.33%
62%	7.90%	8.06%	**8.23%**	8.39%	8.56%
61%	8.11%	8.28%	8.45%	8.62%	8.78%
60%	8.32%	8.49%	8.67%	8.84%	9.01%

- 2% increase in Average Interest Earning Assets:
  - Dividend Yield ↑ c.16bps.
- 1% decrease in Cost to Income Ratio:
  - Dividend Yield ↑ c.22bps.

Comparable Valuation

Second/third-tier banks continue to trade at BV discounts to majors despite yield attraction.



Source: Cap IQ & Henslow Analysis

Code	Company name	SP	Mkt Cap	NPAT FY23A	NPAT FY24F	NPAT FY25F	PE FY23A	PE FY24F	PE FY25F	Price / Book BV	Price / Book TBV	Div Yield
ASX Banking Peers												
ANZ	ANZ Group	$25.10	74,429	7,501	6,814	6,954	9.9x	10.9x	10.7x	1.1x	1.1x	6.5%
BEN	Bendigo and Adelaide	$9.52	5,342	577	532	528	9.3x	10.0x	10.1x	0.8x	1.1x	6.8%
BOQ	Bank of Queensland	$5.87	3,877	485	408	425	8.0x	9.5x	9.1x	0.6x	0.8x	7.4%
CBA	Commonwealth Bank	$101.84	169,177	10,090	9,492	9,610	16.8x	17.8x	17.6x	2.3x	2.6x	4.8%
NAB	National Australia Bank	$28.87	88,956	7,822	6,971	7,173	11.4x	12.8x	12.4x	1.4x	1.6x	5.8%
WBC	Westpac Banking	$21.74	75,504	7,479	6,800	6,896	10.1x	11.1x	10.9x	1.0x	1.2x	6.5%
MYS	MyState	$3.28	351	39	39	42	9.1x	9.1x	8.4x	0.8x	0.9x	7.2%
						Mean	**12.6x**	**11.5x**	**10.7x**	**1.2x**	**1.3x**	**6.1%**
ABA	Auswide Bank	$5.47	248	25	28	31	9.9x	9.0x	7.9x	0.8x	1.0x	8.0%
						Premium/(Discount) to Mean	*(7%)*	*(23%)*	*(30%)*	*(27%)*	*(24%)*	*25%*

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