Auswide Bank Ltd

ABA.AX

A research platform of MST Financial

24 November 2023

NIM squeeze Material

Warning on NIM ahead of Friday's AGM

- Unable to avoid mortgage competition pressure
- Funding costs up from stampede back in term deposits
- Operational leverage falls, dividends set to fall too.

Mortgage wars and the rush back into term deposits hurt NIM: Consistent with recent major bank results, ABA has faced unprecedented pressure on its mortgage pricing due to competition which has led to it slightly shrinking its loan book, while depositors have stampeded back into term deposits following the rapid rise in interest rates. This has seen ABA's NIM fall to 1.52% as at 31 October 2023.

Watch out for falling operational leverage: While ABA has kept operating expenses tightly controlled, increasing less than 3% on pcp, the substantial drop in net interest income due to the decline in NIM is likely to see the bank's cost to income ratio spike to over 76% in 1H24, an incredible lift from the 62.8% in pcp.

Dividends per share are likely to also drop over the next two years: With the cuts to forward earnings estimates, we have also trimmed our dividend forecasts.

Investment Thesis

Competition should eventually become rational again: We expect to see pressures on ABA's NIM and CTI ease over the next couple of years, which should enable its ROE to 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 total capital at 31 October 2023 of 14.18%, 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

Lower NIM lowers earnings: We change our reported EPS estimates: FY24E: -34%, FY25E: -11%, FY26E: +1%, assuming that market conditions in the mortgage market will normalise over the next couple of years. Our residual income model falls to $7.13, also adversely impacted by lifting our cost of equity to 10.5% from 10.0%, given higher long bond yields.

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.

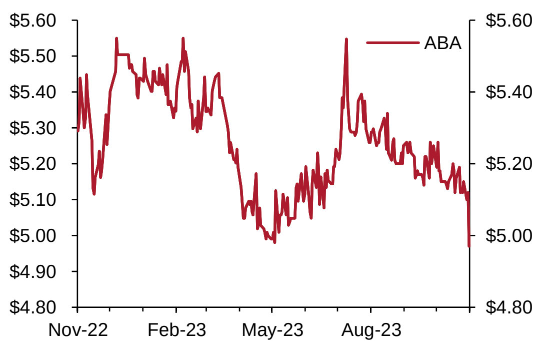
ABA has a strong presence in Queensland and is growing across the rest of Australia. The Company boasts a high-quality loan book with total assets over $5b, representing a mortgage market share of around 20 basis points (0.20%).

Valuation	**A$7.13** *(Prev A$7.75)*
Current price	**A$4.87**
Market cap	**A$229m**
Cash on hand	**Not meaningful**

Upcoming Catalysts / Next News

Period	
24 November 2023	AGM
Monthly	APRA ADI statistics on the last business day of the following month
1H24	Result in late February 2024

Share Price ($A)



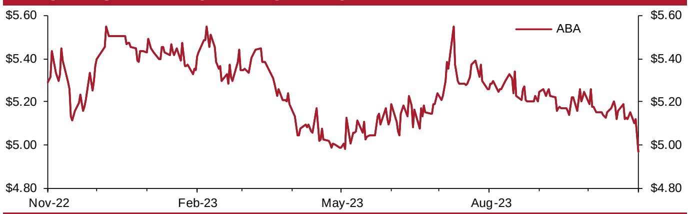
Source: FactSet, MST Access

AUSWIDE BANK LTD — ABA-AX

Year end 30 June, A$

MARKET DATA		
Price	A$	$4.94
Valuation	A$	$7.13
52 week low - high	A$	4.89 - 6.16
Market capitalisation	A$m	229
Shares on issue (basic)	m	46.4
Options / rights (currently antidilutive)	m	
Other equity	m	
Shares on issue (fuly diluted)	m	46.4

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS		FY22A	FY23A	FY24E	FY25E	FY26E
EPS - diluted reported	cps	60.48	55.64	36.04	61.56	77.24
EPS - diluted cash	**cps**	**60.48**	**55.64**	**36.04**	**61.56**	**77.24**
EPS growth	%	7%	-8%	-35%	71%	25%
PE	x	8.2	8.9	13.7	8.0	6.4
DPS	A$	0.42	0.43	0.26	0.42	0.53
Franking	%	100%	100%	100%	100%	100%
Dividend yield	%	8.5%	8.7%	5.3%	8.5%	10.7%
Payout rato	%	70%	78%	73%	69%	70%
Operating cash flow per share	cps	99.7	-296.1	-386.3	265.3	77.2
Free cash flow to equity per share	cps	183.4	71.0	25.9	51.8	68.0
FCF yield	%	37.1%	14.4%	5.2%	10.5%	13.8%
Enterprise value	$m	4,410	4,946	5,819	6,503	7,420
EV/Total Revenue	x	46.4	48.8	62.2	54.1	52.4
NAV per share	A$	6.49	6.42	6.68	7.07	7.61
Price / NAV	x	0.76	0.77	0.74	0.70	0.65
NTA per share	A$	5.36	5.34	5.66	6.09	6.68
Price / NTA	x	0.92	0.93	0.87	0.81	0.74

KEY RATIOS		FY22A	FY23A	FY24E	FY25E	FY26E
CET1 ratio	%	10.63%	11.43%	12.05%	11.74%	11.82%
Capital ratio	%	12.90%	13.70%	14.08%	13.48%	14.08%
Leverage ratio	%	6.57%	6.10%	6.25%	5.99%	6.25%
Operating income growth	%	6.7%	6.5%	-6.7%	28.4%	17.8%
Expense growth	%	8.3%	13.3%	6.0%	11.1%	9.8%
Jaws	%	-1.6%	-6.9%	-12.7%	17.3%	8.1%
ROE - reported	%	9.7%	8.7%	5.5%	8.9%	10.5%
ROE - cash	%	9.7%	8.7%	5.5%	8.9%	10.5%
Net debt	**A$m**	**4,181**	**4,717**	**5,590**	**6,274**	**7,191**
Leverage (net debt / invested capital)	x	5.7	6.4	7.3	7.8	8.4

DUPONT ANALYSIS		FY22A	FY23A	FY24E	FY25E	FY26E
Net Profit Margin	%	27%	25%	18%	25%	28%
Asset Turnover	%	2.2%	2.1%	1.7%	1.9%	2.0%
Return on Assets	%	0.6%	0.5%	0.3%	0.5%	0.6%
Financial Leverage	x	16.08	16.61	17.93	18.71	18.87
Return on Equity	%	9.7%	8.7%	5.5%	8.9%	10.5%

HALF YEARLY DATA		1H23A	2H23A	1H24E	2H24E	1H25E
Net Interest Income	A$m	46.5	42.7	38.2	44.0	51.0
Total Revenue	A$m	52.9	48.3	43.8	49.8	56.8
Profit before income tax	A$m	20.2	15.7	10.2	14.1	19.0
Reported NPAT	A$m	14.1	11.0	7.1	9.9	13.2
Cash NPAT	A$m	14.1	11.0	7.1	9.9	13.2
EPS - diluted cash	**A$**	**0.32**	**0.24**	**0.15**	**0.21**	**0.27**
EPS - diluted reported	A$	0.32	0.24	0.15	0.21	0.27
DPS	A$	0.22	0.21	0.11	0.15	0.19

KEY PERFORMANCE INDICATORS		FY22A	FY23A	FY24E	FY25E	FY26E
Average loans and advances	$m	3,739	4,188	4,415	5,038	5,878
Net Interest Margin	%	1.94%	1.88%	1.65%	1.94%	2.00%
Total Revenue / Average loans and advanc	%	2.54%	2.42%	2.12%	2.39%	2.41%
Cost to income ratio	%	61.1%	65.0%	73.8%	63.9%	59.5%
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%	6.4%	16.7%	16.7%

PROFIT AND LOSS		FY22A	FY23A	FY24E	FY25E	FY26E
Interest Revenues	A$m	106.0	189.6	269.7	316.9	361.9
Interest Expense	A$m	-23.9	-100.4	-187.5	-208.3	-232.6
Net Interest Income	**A$m**	**82.0**	**89.2**	**82.2**	**108.5**	**129.3**
Non-Interest Income	A$m	12.4	11.3	11.6	11.9	12.7
Total operating income	**A$m**	**94.4**	**100.5**	**93.8**	**120.5**	**142.0**
Provision For Loan Losses	A$m	0.7	0.7	-0.2	-0.2	-0.3
Total Revenue	**A$m**	**95.1**	**101.3**	**93.6**	**120.2**	**141.7**
Non-Interest Expense	A$m	-57.7	-65.3	-69.3	-76.9	-84.5
Profit before income tax	**A$m**	**37.5**	**35.9**	**24.3**	**43.3**	**57.2**
Income tax expense	A$m	-11.4	-10.9	-7.4	-13.1	-17.3
Reported NPAT	**A$m**	**26.1**	**25.1**	**17.0**	**30.2**	**39.9**
Cash NPAT	A$m	26.1	25.1	17.0	30.2	39.9
Weighted average diluted shares	m	43.2	45.1	47.1	49.1	51.7

BALANCE SHEET		FY22A	FY23A	FY24E	FY25E	FY26E
Cash and cash equivalents	A$m	178.5	203.2	815.9	749.6	801.3
Loans and advances	A$m	3,827.6	4,377.8	4,657.3	5,433.2	6,340.1
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$m**	**4,504.6**	**5,059.5**	**5,959.7**	**6,677.7**	**7,644.6**
Deposits and short term borrowings	A$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**	**320.7**	**354.8**	**404.4**
Net tangible assets	**A$m**	**232.9**	**244.5**	**271.4**	**305.5**	**355.0**
Invested capital	**A$m**	**730.3**	**742.1**	**768.9**	**803.0**	**852.6**
Tangible invested capital	**A$m**	**681.1**	**692.8**	**719.6**	**753.7**	**803.3**
Contributed equity	A$m	199.8	211.8	222.9	235.3	254.0
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$m	53.8	59.8	75.5	97.2	128.1
Non-controlling interests	A$m	0.0	0.0	0.0	0.0	0.0
Total equity	**A$m**	**282.1**	**293.9**	**320.7**	**354.8**	**404.4**
Basic shares on issue	m	43.4	45.8	48.0	50.2	53.2

CASH FLOW		FY22A	FY23A	FY24E	FY25E	FY26E
Operating						
Net operating cashflow	**A$m**	**43.1**	**-133.4**	**-182.0**	**130.2**	**39.9**
Investment						
Capital expenditure	A$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$m	-13.3	-7.3	-14.8	-16.5	-25.0
Debt	A$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**	**182.4**	**-118.3**	**-26.7**
Net cash flow	**A$m**	**65.9**	**24.7**	**-2.6**	**8.9**	**10.2**
Free cash flow to equity	A$m	79.3	32.0	12.2	25.4	35.1

Source: ABA reports, MST Access estimates

Earnings estimate revisions

Following ABA's November 2023 trading update, we make the following changes to our earnings estimates for ABA:

Figure 1: Changes to earnings estimates for Auswide Bank

		FY24E			FY25E			FY26E		
		Old	New	% chg	Old	New	% chg	Old	New	% chg
Net Interest Income	A$m	93.5	82.2	-12.1%	116.5	108.5	-6.9%	133.4	129.3	-3.1%
Non-Interest Income	A$m	11.6	11.6	0.0%	11.9	11.9	0.0%	12.7	12.7	0.0%
Total operating income	A$m	105.2	93.8	-10.8%	128.5	120.5	-6.2%	146.1	142.0	-2.8%
Provision For Loan Losses	A$m	(0.2)	(0.2)	4.4%	(0.2)	(0.2)	4.4%	(0.3)	(0.3)	4.5%
Total Revenue	**A$m**	**105.0**	**93.6**	**-10.8%**	**128.2**	**120.2**	**-6.2%**	**145.8**	**141.7**	**-2.8%**
Non-Interest Expense	A$m	(68.0)	(69.3)	-1.9%	(78.6)	(76.9)	2.1%	(87.6)	(84.5)	3.6%
Profit before income tax	A$m	37.0	24.3	-34.1%	49.7	43.3	-12.8%	58.2	57.2	-1.6%
Reported NPAT	**A$m**	**25.8**	**17.0**	**-34.1%**	**34.6**	**30.2**	**-12.8%**	**40.6**	**39.9**	**-1.6%**
Cash NPAT	A$m	25.8	17.0	-34.1%	34.6	30.2	-12.8%	40.6	39.9	-1.6%
EPS diluted reported	cps	54.5	36.0	-33.9%	69.1	61.6	-10.9%	76.3	77.2	1.2%
EPS diluted cash	cps	54.5	36.0	-33.9%	69.1	61.6	-10.9%	76.3	77.2	1.2%
DPS	cps	42.0	26.0	-38.1%	48.0	42.0	-12.5%	53.0	53.0	0.0%
KEY PERFORMANCE INDICATORS										
Average loans and advances	$m	4,569	4,415	-3.4%	5,272	5,038	-4.4%	6,152	5,878	-4.5%
Net Interest Margin	%	1.83%	1.65%	-9.4%	2.00%	1.94%	-3.0%	1.98%	2.00%	1.0%
Total Revenue / Average loans and advances	%	2.30%	2.12%	-7.7%	2.43%	2.39%	-1.9%	2.37%	2.41%	1.7%
Cost to income ratio	%	64.7%	73.8%	14.2%	61.2%	63.9%	4.4%	60.0%	59.5%	-0.8%
ECL allowance as a % of gross loans	%	0.13%	0.13%	0.0%	0.15%	0.15%	0.0%	0.15%	0.15%	0.0%
Growth in loans and advances	%	11.3%	6.4%	-43.7%	16.7%	16.7%	0.0%	16.7%	16.7%	0.0%
KEY RATIOS										
CET1 ratio	%	11.89%	12.05%	1.3%	11.89%	11.74%	-1.2%	11.95%	11.82%	-1.1%
Capital ratio	%	13.83%	14.08%	1.8%	13.55%	13.48%	-0.5%	14.11%	14.08%	-0.2%
Leverage ratio	%	6.14%	6.25%	1.8%	6.02%	5.99%	-0.5%	6.27%	6.25%	-0.2%

Source: Company reports, MST Access estimates

These changes reflect:

- Lowering our mortgage book growth assumptions given the contraction experienced year to date in its loan book
- Lowering our NIM margin markedly in 1H24 given the fall to 1.52% through to 31 October 2023, before having it recover over the next two years to ABA's 200bps target.
- Altering our expense assumptions, noting that sub 3% growth in costs on pcp represents a substantial increase in its cost to income ratio due to the decline in its net interest income.
- Lowering our dividend forecasts given the fall in profitability.

Slightly counterintuitively, the fall in our dividend forecasts, combined with the high dividend reinvestment plan assumptions we have, lead to a reduction in future share issuance, which sees EPS rise slightly in FY26E.

Full details of our revised earnings appear in the financial summary on page 2.

Valuation

Figure 2: MST Access valuation appraoches of Auswide Bank Limited

Method	Metric A$	Multiple x	per share A$	Comments
FY24 earnings	0.360	12.0	4.33	
Midcycle ROE earnings	0.649	12.0	7.79	Estimated 10.0% midcycle ROE multiplied by current book value
FY24 dividend yield	0.260	5%	5.20	
Dividend Discount Model (including franking credits)			6.21	DDM with a cost of equity of 10.5% and terminal growth of 3.0%
Dividend Discount Model (excluding franking credits)			4.35	DDM with a cost of equity of 10.5% and terminal growth of 3.0%
General Residual Income Model			7.13	GRIM with a cost of equity of 10.5% and terminal growth of 3.0%
Theoretical book	6.42	0.93	5.99	assumes 10.0% ROE, 10.5% COE, 70% dividend payout
FY23 book	6.42	0.93	5.99	
FY23 tangible book	5.34	1.1	5.99	
Composite			**5.89**	**Range of A$4.33 - A$7.79**

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 4.5% (up from 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 10.5%, up from 10.0%.

This rise in the cost of equity reduces our theoretical book multiple drop from 1x to 0.93x, as we continue to assume a long term 10% ROE.

Figure 3: MST Access General Residual Income Model ("GRIM") valuation of Auswide Bank Limited

Current date		22-Nov-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	6.68	6.85	7.07	7.33	7.61	6.99	7.33	7.67	8.03
Equity charge	A$		-0.34	-0.34	-0.35	-0.36	-0.37	-0.38	-0.40	-0.37	-0.38	-0.40
Cash EPS	A$	0.24	0.15	0.21	0.27	0.34	0.38	0.39	0.41	0.42	0.44	0.46
Residual income	A$	**0.24**	**-0.18**	**-0.14**	**-0.08**	**-0.02**	**0.01**	**0.01**	**0.01**	**0.05**	**0.06**	**0.06**
Discounted cash flow	A$	**0.00**	**-0.18**	**-0.13**	**-0.07**	**-0.01**	**0.01**	**0.00**	**0.01**	**0.04**	**0.04**	**0.04**

Sum of discount streams	A$	-0.26	**CAPM**	
Future value into perpetuity	A$	1.55	Risk free rate	4.50%
NPV of terminal value	A$	0.98	Equity beta	1.2
add net assets	A$	6.42	Equity risk premium	5.00%
Residual income value per share	**A$**	**7.13**	Cost of equity	10.5%
P/B multiple implied by GRIM valuation	x	1.11	Terminal growth	3.0%
Upside/downside	%	44%		

Source: Company reports, MST Access estimates

Figure 4: 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	18.3		2.4	2.7	4.4%	13.3%
NAB.AX	National Australia Bank Ltd	12.9	499.1	1.4	1.6	5.9%	11.3%
ANZ.AX	ANZ Group Holdings Ltd	11.5	437.7	1.0	1.1	6.6%	9.3%
WBC.AX	Westpac Banking Corp	11.7	380.2	1.0	1.2	6.6%	8.9%
MYS.AX	MyState Ltd	8.5					8.6%
BEN.AX	Bendigo and Adelaide Bank Ltd	5.8	198.9	0.7	1.0	7.1%	7.5%
ABA.AX	Auswide Bank Ltd	13.7	19.1	0.7	0.9	5.3%	5.5%
BOQ.AX	Bank of Queensland Ltd	11.9	177.4	0.6	0.7	6.8%	5.5%
JDO.AX	Judo Capital Holdings Ltd	14.9		0.6	0.6	0.0%	4.5%
BBC.AX	BNK Banking Corporation Ltd	11.3	0.4	0.3	0.3	0.0%	1.5%

Source: IBES FY1 (i.e. FY24) mean consensus, Refinitiv, MST Access FY24 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.

Updated Investment Thesis

Auswide Bank offers a variety of attractions to investors:

- The potential of 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 improving profitability flow through.
- A strong capital position 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

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 flexibility
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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