FIIG | Factsheet

MyState Limited

15 August 2022

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Sector: Financials
Sub-sector: Banks
Country: Australia
Ownership: Public

Issuer Outline

MyState Limited (MyState) is the listed (ASX: MYS) non-operating holding company for MyState Bank Limited. MyState Limited was formed in September 2009 following the merger of MyState Bank and Tasmanian Perpetual Trustees Limited (TPT).

MyState Limited, through its subsidiaries, provides banking, trustee, and managed fund products and services in Australia. The Company operates in two segments: Banking and Wealth Management. It offers personal and commercial lending, mortgage lending, savings and investment products, wealth management services, and insurance products under MyState Bank brand. The Company also provides a range of financial services, including managed fund investments, commercial lending, and trustee services that comprise estate planning, administration, and charitable trusts to individuals and corporate clients under the TPT Wealth brand.

Key Financials (AUDm)

LTM (30 Jun)	2022
Net interest income	110.2
Non-interest income	29.9
NPAT	32.0
Loans and advances	6,971.4
Total assets	8,079.9
Customer deposits	6,308.6
Other borrowings	1,289.6
Credit losses (new provisions) (%)	0.03
CET 1 ratio (%)	10.5

Source: FIIG Securities, Company Reports

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3FN0054904	AUD 25m	Unsec. Sub. T2	3M BBSW + 4.35%	Quarterly	10 Jul 2025	10 Jul 2030

[1]*Excludes potential terms that may allow the issuer to redeem prior to the first call date.*

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Tier 2 Structure	
Interest Deferral/Cancellation	Interest is deferrable and cumulative if, prior to the payment of interest, the issuer is not solvent or would not be solvent after payment.
Non-Viability Trigger	Yes, standard Basel III compliant non-viability trigger. If APRA determines the issuer is at risk of becoming non-viable, the terms of the notes indicate that the primary method of loss absorption will be via conversion of the subordinated notes into equity, in-part or in full.

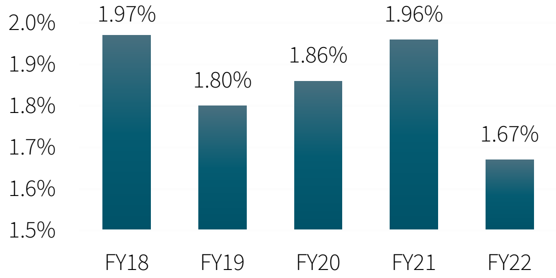
Strengths

- Focus on lower-risk retail lending underpins strong asset quality: MyState's banking operations are primarily focused on residential mortgage lending in Australia, which account for more than 98% of total loans, with consumer, small business lending, and commercial loans making up the residual. The Bank is focused on lending to high-quality borrowers, primarily owner occupied with a LVR less than 80%. As a result, asset quality metrics are relatively strong, with non-performing loans (90-day past due) at 0.2%, and provisions (as a percentage of credit risk-weighted assets) at 0.16%.
- Sound capitalisation, underpinned by good earnings quality: MyState is soundly-capitalised, with a regulatory Tier 1 Capital Ratio of 10.5% at 30 June 2022. MyState benefits from increased capital flexibility relative to the majority of its immediate peers as a listed-entity--although its dividend policy can be considered somewhat shareholder friendly (the dividend payout ratio is set between a target range of 60-80%), as a prudentially regulated entity, MyState is restricted in the amount of earnings it can distribute to shareholders. Consistent with larger peers, it is highly probable dividends would be reduced to support its capitalisation, if required. The quality of MyState's capital is strong and largely comprising of common equity (share capital and retained earnings), supported by a high proportion of earnings with recurring characteristics (net interest income accounts for ~78% of operating revenues), and with a further 10% derived from wealth management activities.
- Solid funding structure: MyState's banking operations are funded through a mix of customer deposits and securitisation (approximately 73% and 14% respectively), with wholesale deposits, subordinated and floating rate notes making up the residual. Although its reliance on wholesale in its entirety—which comprises securitisation and wholesale deposits—is higher than many of its immediate peers, the stability of its funding is enhanced given the long-dated nature of securitisation funding (reducing the mismatch between assets and liabilities and short-term funding risk). On-balance sheet liquidity provides complete cover for short-term unsecured wholesale funding.
- Sound macro environment and regulatory oversight: Australian financials benefit from operating in an economy characterised as having a very high degree of economic resilience with low susceptibility to event risk. While the Australian economy has recovered relatively strongly from the direct impacts of the pandemic, the current high inflation environment and associated interest rate increases by the Reserve Bank of Australia have the potential to put strain on the post-pandemic recovery, with increased pressure on consumers. The current low level of unemployment and significant savings accumulated over the past two years should provide a buffer. Nevertheless, MyState maintains adequate level of credit provisioning to account for this uncertain outlook. Australian banks including MyState are overseen by a highly regarded prudential regulator, APRA, who oversees banking, insurance and superannuation, with the aim of maintaining the integrity, safety and soundness of financial institutions.

Risks

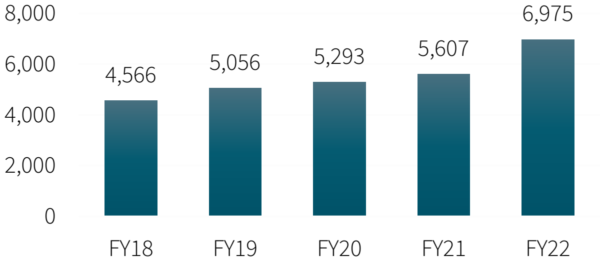
- Small market share: Although MyState commands a relatively sound market position in its home state of Tasmania (in terms of both home loans and deposits), its market share within the Australian home loan market has historically been insignificant at materially less than 1.0%. As a reflection of its size, the Bank also has a relatively high cost base, with its cost to income at 68.4%. These factors leave the Bank and its business volumes susceptible to competitive and margin (profitability) pressures (see Figure 2 below). The Bank to-date has managed this reasonably well without a significant shift in its risk profile, highlighting a relatively sound business base (see Figure 3). To manage these challenges, MyState has undertaken a digitisation growth strategy to improve its market share in deposits, lending, and funds under management which will help boost its geographic footprint, cost to income, and earnings. It has worked very well thus far, with its loan book and customer deposits increasing to AUD6.8bn and AUD5.6bn respectively (up 25.5% and 25.1% on the prior corresponding period). We note that one of the immediate impacts of MyState's growth strategy is a material increase of its cost base (ahead of the forecast business growth), and an inability to deliver on its plan would require a right sizing of its operations.

Figure 2: Net interest margin



Source: S&P Capital

Figure 3: Gross Loan Book (AUDm)



Source: S&P Capital

- Limited business line and geographic diversity: Although the quality and composition of MyState's earnings are very good, with net interest income accounting for ~78% of operating revenues, its stability is dependent on favourable residential property market dynamics (primarily house prices and employment), particularly in its home state of Tasmania, which accounts for ~36% of its lending activities. Although its concentration in Tasmania is relatively high, it is down materially from more than 41% in 2019. MyState is focused on increasing its national footprint through digital acquisition, and its success can be seen through the dispersion of its loan book with Queensland (20.5%), New South Wales (20.4%) and Victoria (19.6%) making up the majority of residual across other states and Territories.
- Liquidity risk within the bond: A bond's liquidity reflects the ability to sell a bond at a reasonable price (i.e. without causing a significant change in its price) in a reasonable amount of time. Given the size of the issuance (and the issuer), bond liquidity is unlikely to be high within the secondary market.
- Rating downgrades: Ratings on both issuers and issues can be influenced by factors that do not necessarily reflect the financial strength or credit quality of a specific issuer. For example, in early-2020 both S&P and Moody's placed the ratings on a number of Australian financial institutions on negative outlook due to concerns about the economic outlook for Australia, which was revised back to stable in June 2021 as a result of the strong economic recovery after the initial contraction caused by the COVID-19 pandemic.

Risks relevant to Subordinated Unsecured Tier 2 instrument

- Deeply subordinated ranking: Tier 2 instruments are unsecured and deeply subordinated instruments, ranking ahead only of ordinary shares and additional Tier 1 hybrids. Tier 2 instruments rank behind senior creditors, which includes depositors, senior unsecured and senior non-preferred creditors (mostly relevant for European banks, only).
- Optional call dependent on regulatory approval: Tier 2 notes include an early call feature where the face value of the notes may be repaid early in cash from a given date stated in the terms and conditions of the instrument. The optional redemption requires regulatory approval, which may not be provided.

  In general, regulators are unlikely to provide approval for a Tier 2 or AT1 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

- Conversion or write-down following a Non-Viability Trigger Event: A Non-Viability Trigger Event occurs when APRA determines conversion to ordinary shares (or write-off) of some or all of an issuer's contingent capital securities is necessary to prevent that financial institution becoming non-viable. Whether a non-viability trigger event will occur is solely at the discretion of APRA. APRA does not define what constitutes a non-viability event and there are currently no precedents under Basel III to determine non-viability. If such event occurs, the issuer may be required to convert some or all of its Tier 2 notes into ordinary shares. In a more severe scenario, the issuer may be required to write-off the value of these notes. We note that it is expected that the conversion / write-off would be expected to be applied first to AT1 hybrids (if any) and only then to the Tier 2 if the AT1 conversion / write-off was not sufficient to restore the issuer to a viable position.
- Capped equity conversion: Conversion of Tier 2 notes following a non-viability trigger event is subject to a maximum number of shares being issued. As such, if the notes are converted into ordinary shares, the value of ordinary shares an investor receives may be significantly less than the face value of their notes.

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