FIIG | Factsheet

MyState Limited

15 November 2022

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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.

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

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
AU3FN0070900	AUD 65m	Unsec. Sub. AT1	3M BBSW + 5.50%	Quarterly	30 Aug 2027	Perpetual
AU3FN0063889	AUD 25m	Unsec. Sub. T2	3M BBSW + 2.75%	Quarterly	3 Nov 2026	3 Nov 2031

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

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MyState Ltd

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.
Perpetual Tier 1 (AT1) Structure	
Interest Deferral/Cancellation	Interest is deferrable and non-cumulative. Interest payment is optional and, if unpaid, the issuer has no obligation to pay any deferred amounts later. A cancellation of interest does not constitute a default under the Notes for any purpose
Common Equity Tier 1 Trigger	If the issuer or prudential regulator determines that the then applicable Common Equity Tier 1 capital ratio falls below 5.125% on a consolidated basis, the issuer will, within one month, be required to write-off some or all the face value of the Notes. To the event of a subsequent recovery, the issuer will have the option (but won't be required) to write back part or all of the amounts of notes previously written off.
Non-Viability Trigger	If the prudential regulator determines that the issuer is at the point of non-viability (loosely defined as the point in which the issuer is failing or likely to fail), the issuer will be required to write-off some or all the face value of the Notes.
Mandatory Conversion	If not called prior, the issuer must convert the notes into equity on 28 February 2030 provided certain conditions (linked to the share price) are met.
Maturity	The Notes do not have a maturity date. This means that the issuer does not have an obligation to repay the principal.

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

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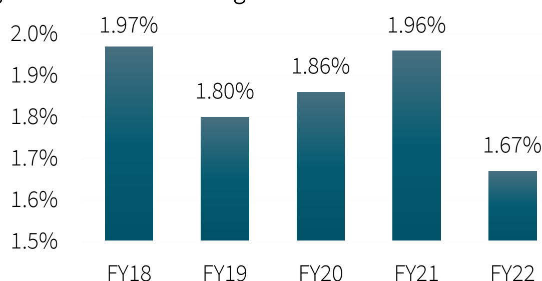
securitisation funding (reducing the mismatch between assets and liabilities and short-term funding risk). On-balance sheet liquidity provides complete cover for short-term unsecured wholesale funding.

- 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

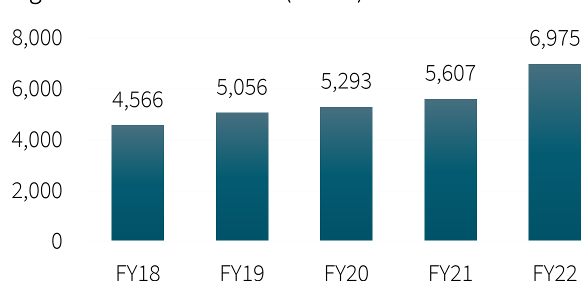
- Small market share: Although MyState commands a relatively sound market position in its home state of Tasmania (in terms of both home loans and deposits), its market share within the Australian home loan market has historically been insignificant at materially less than 1.0%. As a reflection of its 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.

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MyState Ltd

- 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

- Subordinated ranking: Tier 2 instruments are unsecured and subordinated instruments, ranking ahead only of ordinary shares and additional Tier 1 hybrids. Tier 2 instruments rank behind senior creditors, which includes depositors and senior unsecured creditors.
- Interest is deferrable (but cumulative): Interest is deferrable for Tier 2 capital instruments, but typically only in the highly unlikely circumstance that the payment would result in the bank becoming insolvent. Deferred interest does however accumulate.
- Basel III compliant structural features: Tier 2 subordinated instruments are classified as Basel III compliant Tier 2 capital instruments. As such, they contain the following features:
  - Conversion or write-down following a Non-Viability Trigger Event: If the prudential regulator determines that the issuer is at the point of non-viability (loosely defined as the point in which the issuer is failing or likely to fail), the issuer may be required to convert some or all of its Tier 2 hybrids into ordinary shares. Generally speaking, it is expected that any Tier 1 hybrids outstanding will be converted into equity before Tier 2 hybrids. Depending on the price of the ordinary shares at the relevant time, investors may suffer loss as the value of ordinary shares received by an investor may be less than the face value of the relevant hybrid.

    If, for any reason, the conversion does not take place, the face value of Tier 2 hybrids set aside for conversion will be written off and noteholders will not be compensated (including for any unpaid distributions or interest).
  - Optional call dependent on regulatory approval: Tier 2 hybrids include an early call feature where the face value of the instrument may be repaid early in cash. The optional redemption requires regulatory approval, which may not be provided.

    In general, regulators are unlikely to provide approval for a Tier 2 hybrid 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.

Risks relevant to Subordinated Unsecured AT1 instruments

- Deeply subordinated ranking: Additional Tier 1 (AT1) hybrids are unsecured and deeply subordinated, ranking ahead only of ordinary shares. AT1 hybrids rank behind senior creditors, which includes depositors, senior unsecured creditors, and non-deferrable subordinated debt (Tier 2) instruments.
- Basel III compliant structural features: Tier 1 hybrids are classified as Basel III compliant AT1 capital instruments. As such, they contain the following features:
  - Optional, non-cumulative interest payment: Payment of interest is optional whereby the issuer may elect not to pay interest and this will not constitute an event of default. In some circumstances, the issuer may be prevented from paying interest on its AT1 hybrids. If interest is not paid, it is non-cumulative and the issuer is under no obligation to make up the payment at a later date.
  - Conversion or write-down some or all of the face value of the notes: If the issuer's regulatory capital levels fall below a certain level, it may be required to convert some or all of the face value of its AT1 hybrids into equity (as outlined below). At the same time, any indication that the issuer's capitalisation is trending toward the 5.125% threshold for

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a Common Equity Trigger Event AT1 is likely to have a materially adverse effect on the capital price of the AT1 instruments. Depending on the price of the ordinary shares at the relevant time, investors may suffer loss as the value of ordinary shares received by an investor may be less than the face value of the relevant hybrid. If, for any reason, the conversion does not take place, the face value of AT1 hybrids set aside for conversion will be written off and noteholders will not be compensated (including for any unpaid distributions or interest).

  - Common Equity Trigger Event: If the issuer or prudential regulator determines that the then applicable Common Equity Tier 1 capital ratio falls below 5.125% on a consolidated basis, the issuer may be required to convert some or all of its AT1 hybrids into ordinary shares.
  - Non-Viability Trigger Event: If the prudential regulator determines that the issuer is at the point of non-viability, the issuer may be required to convert some or all of its AT1 hybrids into ordinary shares.

- No fixed maturity: AT1 hybrids do not have a fixed maturity date and are perpetual. This means that the issuer does not have an obligation to repay the notes on the relevant call date(s) and will only do so if it elects to provide a notice of redemption and obtains the relevant regulatory approval beforehand.
- Optional call dependent on regulatory approval: AT1 hybrids include an early call feature where the face value of the instrument may be repaid early in cash. The optional redemption requires regulatory approval, which may not be provided. In general, regulators are unlikely to provide approval for an AT1 hybrid 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.

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