Market Release

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4/100 Havelock Street
West Perth WA 6005

PO Box 710
West Perth WA 6872

Balance Sheet strength and successful diversification delivers a resilient first half

Australian Finance Group Limited (**ASX:AFG**) today announced a strong start to the 2023 financial year (FY23), with the benefit of its diversification strategy evident. AFG's own lending book grew 22% on last year, while its strategic investments performed well, contributing $5.9 million or 19% of its FY23 first half profit before tax.

Amidst a well-publicised overall weaker market for residential mortgage settlements compared to the prior period, AFG has reported a solid result, with underlying net profit after tax and before amortisation of $25.6 million, broadly in line with last year. Credit growth remains positive, and in line with historical levels, with AFG well positioned to continue to grow.

Key Highlights

- Underlying NPATA of $25.6 million
- Reported NPAT of $21.9 million, down from $30.0 million last year
- Record first half gross profit & operating cashflow of $62.0 million and $26.9 million, respectively
- Fully franked interim dividend of 6.6c per share, an 8% annualised yield
- AFG Securities loan book $4.9 billion, up 22%, with a NIM of 145bps and no loan losses
- Return on Equity of 25%, with $200 million in liquid assets and high performing investments

AFG CEO, David Bailey, commented: "AFG had a strong first half, with a gross profit of $62.0 million. Our proven strategy to diversify income streams has allowed the business to weather the turbulent residential market conditions driven by policy intervention and the structural funding disadvantage for non-major lenders. Against that back drop we have grown our combined residential and commercial loan book by 9% to $199.8 billion.

"A highlight for the half is the position of AFG Home Loans as the sixth largest lender for home loan lodgements within the AFG network. It remains the only non-bank in the Top 10 for residential mortgages, reflecting the strength of our products and service, and the trust of our brokers.

"The annuity style earnings from both our trail book and AFG Securities has underpinned our result. The stability of these earnings provides the foundation for our cash flow performance, with a cash realisation ratio of above 100% for the half. Our track record of strong cash generation and the capital light business model gives us the confidence to pay a fully franked dividend of 6.6c per share."

Performance

Driven by interest rate rises, credit growth in the Australian residential mortgage market has slowed from a cyclical high however remains positive and in line with historical levels. For AFG, this has seen a moderation of settlement activity, with $28.6 billion of residential settlements for the half, compared to $30.8 billion in the first half of FY22 ($28.6 billion in H2 FY22). "Our core aggregation business has enjoyed strong broker recruitment, with our value proposition and support for our network clearly setting us apart in a competitive market."

"Although we have seen a 7.1% decrease in settlements, the level of market activity remains elevated, driven by the high levels of cash back and intensive competition for customers, with interest rate increases hitting Australian household budgets. The support provided by brokers to their customers has never been more important and with a Best Interests Duty enshrined in law for brokers, they are best placed to help borrowers navigate the changing market conditions."

The AFG Securities loan book was up 22% to $4.9 billion, supporting total revenue growth of 12%. "In the past six months, as the market has been flooded with cashback offers, the AFG Securities loan book has maintained a disciplined approach to margin management and credit quality. We have competed with variable products

For media enquiries, please contact

Alison Clarke
Head of Corporate Communications

P (08) 9420 7014 | P 0402 781 367
afgonline.com.au

ABN 11 066 385 822

at margins that are not sub economic. We made the decision to not chase volume against the funding advantage that has been enjoyed by the major banks."

"We have also had strong support for our securitisation program," said Mr Bailey. "AFG Securities issued $1 billion in paper in the first half of FY23, taking the total value of paper issued to the Residential Mortgage-Backed Securities (RMBS) market to $7.5 billion."

Operational expenditure increased in the half as the business continued to position itself for growth opportunities. "Over the past six months we have invested in both systems and people to support business growth. This has included a new lending platform for AFG Securities, further capacity for our RMBS program, a stepped-up investment in data security, and as COVID restrictions have eased, a return to face-to-face activity for our broker education and engagement program.

Strategic investments

"Our strategic investments have been a highlight," said Mr Bailey. "Fintelligence and BrokerEngine are exceeding their investment cases and delivering solid growth. The strength of the AFG broker distribution network has been proven and as a result, in just 12 months both businesses nearly doubled the number of brokers accessing their platforms."

ThinkTank has delivered a strong half. Its growing contribution to AFG's profit before tax was up 31% for the period. "Since we partnered with ThinkTank in 2018, we've seen that business go from strength to strength. Access to AFG's large distribution network, their reach into the broader broker market, and ThinkTank's innovation has seen their loan book grow from $0.8 billion at acquisition to nearly $5 billion. They are a highly successful business, providing much needed competitive lending products for SME and self-employed customers."

Outlook

"Our strategy to build scale and expand into higher margin lending services provides a platform for growth," said Mr Bailey. "Our diversification into the commercial lending market presents exciting opportunities for AFG and for our broker network to expand their businesses."

In the residential market, AFG expects headwinds to slow, particularly with the Term Funding Facility (TFF) advantage unwinding for bank lenders. "The TFF was a pandemic policy response, for which the market need no longer exists. We expect that when TFF funds are replaced with funding at market rates, and bank deposit margins return to a long-term average, the structural disadvantage for non-bank lenders' funding costs will abate. In these times of rising interest rates, the demand for brokers and alternate lending solutions will remain strong," said Mr Bailey.

An opportunity exists for AFG Home Loans to serve the remaining $30 billion of fixed rate loans originated by AFG brokers. "As these loans mature and borrowers seek competitive lending alternatives, there is potential to offer these customers a variable rate AFG Home Loans product."

"It is worth highlighting that activity in the residential lending market across the past 24 months was the result of expansionary monetary policy and the current softening in the market is a return to more normalised levels. Unemployment levels remain well below the historical average and net migration for Australia is forecast to increase above historical pre-pandemic averages. This will drive additional demand and is likely to feed into a continuing rate of credit growth and home loan mortgage settlements in the Australian market.

"AFG is well positioned. Broker recruitment is strong, and we now have over 3,700 brokers in our network. In addition, the broker channel has gained market share. Consumers are increasingly turning to brokers with the channel now facilitating more than 70% of all Australian home lending. The essential role mortgage brokers play in providing choice, convenience and competition leads to improved loan pricing and service across the entire market which benefits all Australian borrowers," said Mr Bailey.

"AFG's annuity style earnings provide strong cash generation, and our capital light business model positions the company for expansion. A strong balance sheet, the ability to harness opportunity in the commercial and asset finance market, and continued investment in technology all provide the foundation for future growth. We maintain a cautiously positive outlook that AFG will continue to perform well as we head in to the second half," he concluded.

-The release of this announcement was authorised by AFG's Board of Directors-

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Head of Corporate Communications

P (08) 9420 7014 | **P** 0402 781 367
afgonline.com.au