

ASX Announcement

Wednesday, 28 October 2009

Solid NAB result reflects revenue growth and cost control

Key Points¹

- Group revenue increased by 9.7% to \$16.9 billion despite weakness across all the relevant economies. The driving factors were Australia Banking business revenues, high customer demand for risk management products, and strong trading performance in nabCapital Global Markets and Treasury. Tight cost management continued across all Regions.
- Cash earnings of \$3.8 billion were generated during 2009, a fall of 1.9% on the prior year largely due to an increased charge for bad and doubtful debts. Underlying profit² was up 14.6% to \$9.3 billion.
- The bad and doubtful debt charge was \$3.8 billion, an increase of \$2.3 billion excluding the charges for ABS CDOs booked in the previous year. This increase was due to higher specific provisions in the SME and corporate portfolios in all regions and higher collective provisions consistent with deteriorating economic conditions. The rate of increase in both the bad and doubtful debts expense and total provisions moderated during the second half of the year.
- Net profit was down 42.9% to \$2.6 billion, largely due to developments in several long standing and previously announced legal and tax proceedings, accounting volatility from market movements, and investment in the Efficiency, Quality & Service program which was not reported as an operating expense, consistent with the March 2009 half year results.
- Group cost growth was 4.2%. Excluding Great Western Bank expenses (under NAB Group ownership for only four months of the prior year) cost growth was 2.9%.
- A conservatively managed balance sheet remains a core strategic priority for the Group and at 30 September 2009, the Tier 1 capital ratio was 8.96%, reflecting a number of capital initiatives during the year.
- During 2009 the Group exceeded its funding target of \$19 billion to provide flexibility to support the growth agenda in 2010. It also increased the average maturity of term funding, recommenced non-Government guaranteed funding and delivered strong deposit growth. Conservative levels of liquidity were retained.
- The final dividend is 73 cents per share fully franked. Total dividend for 2009 was 146 cents per share fully franked, a reduction of 48 cents or 24.7% on 2008.
- During the year the Group remained committed to its community investments, and focus on inclusion and education, expanding the microfinance program with the AddsUp savings plan, awarding inaugural grants under the Schools First initiative and establishing an Indigenous Advisory Group to oversee NAB's work with Aboriginal and Torres Strait Islander people.

¹ September 2009 Full Year results compared with September 2008 Full Year results unless otherwise stated.

² Operating income less operating expenses excluding the charge for bad and doubtful debts

Overview

“This is a solid result based on revenue growth and continued good cost control. Under the challenging conditions over the past year, we further fortified our strong capital and funding position, invested in our customer relationships, accelerated our Efficiency, Quality and Service program, and took a leadership position on bank fees in Australia and New Zealand,” NAB Group Chief Executive Officer Cameron Clyne said.

“Deteriorating asset quality and high funding costs caused cash earnings to fall by 1.9% to \$3.8 billion. Underlying earnings were strong and reflected both good revenue growth and careful cost management.

“In a weak economic environment when confidence levels within financial markets were still fragile, we had to strike a careful balance between the various expectations of our shareholders, customers and the community. Our actions on fees and continuing to support our customers will stand us in good stead as markets recover.

“These actions demonstrate our commitment to improving the reputation of the bank, positioning us as a leader in the industry and creating stronger, sustainable customer relationships.

“The focus during the year was to responsibly position the Group to provide business momentum and sustainable returns in what may be a slower growth environment.

“The new executive team is fully settled into their roles and I am pleased with how the team is working.

“The Group’s priorities remain: to keep the bank safe with conservative management of capital and funding; to maintain tight control of costs; to invest in our people, our leadership, our culture and our reputation; and to pursue growth in our Australian franchise, while preserving value and the options for longer term growth internationally.

“Our sound position in capital and funding has allowed us to support customers and grow market share in key segments, such as business banking, despite the inevitable fall in asset quality stemming from the economic conditions.

“The Efficiency, Quality and Service agenda, which is focused on reshaping the business, was accelerated during 2009 at an incremental cost of \$254 million and is expected to deliver \$336 million of additional benefits in 2010.

“Recent customer initiatives include the abolition of overdrawn fees on all NAB and BNZ personal transaction and savings accounts, as well as the removal or significant reduction of some account service and over limit or late credit card fees in Australia.

“The Academy Melbourne was opened during the year to enhance employee development and support culture change through new and innovative work place learning.

“Expansion of the branch network of Great Western Bank in the United States occurred in line with our strategy to maintain options for longer term growth in international markets. The acquisition of Aviva and the proposed acquisition of 80.1% of the Goldman Sachs JBWere private wealth management business will strengthen the scale, distribution and brand of our wealth management business.

“The addition of the Challenger mortgage management business, once complete, represents an important component of our Retail Banking growth strategy. Our business bank continues to be a key component of organic growth, with 145 additional frontline bankers appointed during the year with plans to add a further 200 during 2010,” he said.

Balance Sheet Commentary

Capital

At 30 September 2009, the Group Tier 1 capital ratio was 8.96% up 65bps on March 2009 reflecting capital raisings and other capital initiatives during the year. These raisings were to support capital absorbed through growth in customer lending and ongoing asset quality deterioration, acquisitions, provisioning on several long standing and previously announced legal matters, accounting volatility from market movements and an increased deficit in the Group UK pension schemes.

Although recent data suggests global economic conditions are improving, the Group has this strong capital position as a buffer against potential headwinds, including domestic and global regulatory changes. When conditions become more predictable the Group will consider allowing the Tier 1 Capital Ratio to trend down.

For capital efficiency, the Group targets an optimal mix of common equity and other capital instruments. Consistent with its strategy of remaining flexible in managing capital the Group continues to seek opportunities to issue hybrid capital as facilities redeem or convert.

Funding and liquidity

The Group raised more than \$15 billion in term funding in the second half of the financial year with more than half of this amount in unguaranteed format. For the full year the Group raised \$32.3 billion, well above the target of \$19 billion, which will create funding flexibility in 2010. The average maturity of the issuance increased from 3.9 years to 4.2 years. Strong deposit growth also contributed to the Group's sound funding position. Total liquid assets remained strong at \$71 billion. The level of liquidity will be reassessed during 2010 as the Group moves to implement the revised APRA liquidity standard.

Asset Quality

Asset quality softened across the Group in response to the deteriorating business conditions in all markets. The bad and doubtful debt charge was \$3.8 billion, an increase of \$2.3 billion excluding the charges for ABS CDOs booked in the previous year. Total provisions³ increased from \$3.3 billion to \$5.1 billion. The key ratio of the collective provision to credit risk weighted assets (excluding housing) increased from 1.07% to 1.46% at 30 September 2009.

In Australia, the subdued economic conditions led to a rise in watch loans and impaired assets, especially among corporate customers and small to medium sized businesses. Retail asset quality remained resilient, consistent with employment statistics and historically low interest rates.

In the UK, the ongoing recession and rising business lending defaults, particularly in the commercial property sector, were the main drivers of the increased bad and doubtful debt charge. The bad debt ratio remains below the average for UK competitors. In the mortgage portfolio the 90+ days past due loans were less than one third of the industry average.

In New Zealand, the recession caused a softening of asset quality focused in the property and agricultural sectors. Retail asset quality remained sound.

In nabCapital, watch loans and impaired assets continued to increase but the rate of high profile exposures experiencing financial difficulty has moderated, reflected in a lower bad and doubtful debt charge during the second half.

A provisioning charge of US\$14 million at Great Western Bank maintained appropriate coverage. The ratio of deposits to loans was 118%.

³ Including credit risk adjustment on assets at fair value.

Business Commentary

Australia Banking

Cash earnings fell by 5.3% to \$2.8 billion in 2009 while underlying profit was up 16.1% to \$5.5 billion. The underlying profit growth stemmed from both robust revenue growth and continued careful cost control. Business & Private Banking revenue increased by 11.3% due to the success of the iFS and Specialisation operating models, particularly in the SME, Agri and Health businesses. Revenue growth in Retail Banking was 10.3%. These factors were more than offset by the increase in the charge to provide for bad and doubtful debts, which rose from \$603 million to \$1.6 billion.

The cost to income ratio improved from 41.6% to 38.8%.

Net interest income increased by \$1.1 billion or 17.3% on the basis of good volume growth and active repricing for current risk settings.

Average interest earning assets grew by \$24.3 billion or 9.5% with growth in business lending the most significant contributor. Average retail deposits increased 18.6% to \$127.3 billion, growing market share by 1.7 times system growth.

During the year, business deposit market share increased by 1.6% to 24.0% and business lending market share increased by 1.4% to 20.1%. Business & Private Banking was ranked first among the major banks in customer satisfaction for businesses that turnover between \$5 million and \$500 million, and was also named 'Business Bank of the Year' by CFO magazine.

Retail Banking took a leadership position in announcing the removal of overdrawn account fees and monthly account service fees. It also joined the rediATM network during the year to provide NAB customers with access to more than 3100 ATMs, and launched the direct banking UBank brand. The proposed addition of the Challenger mortgage management business enhances NAB's Retail Banking growth strategy.

MLC

Cash earnings before IoRE⁴ fell by 23.8% to \$311 million. Volatile global investment markets affected average funds under management, which fell by 19% during the year and resulted in a 37.1% decline in Investments cash earnings. Despite these difficult market conditions, MLC continues to focus on profitable growth and has maintained investment margins.

Annual inforce premiums increased by 12.7% but insurance cash earnings fell by 9.2% as a result of deterioration in claims experience and lower earnings on assets backing reserves compared to recent years. Operating costs fell by 3% as further efficiencies were realised.

The Aviva acquisition, including its life insurance operations and discretionary investment platform Navigator will add scale, efficiency and new capabilities to MLC. The proposed strategic alliance with Goldman Sachs JBWere, together with the addition of NAB Private Wealth, will enhance the Group's wealth management offer to high and ultra high net worth customers.

United Kingdom

Operating conditions were consistent with the deepest UK recession in the post war period. Domestic property values declined, on average, by 20% from their peak and commercial property fell by 45%. Dislocation in funding markets increased funding costs. In this context, the UK Region demonstrated considerable resilience.

The region delivered cash earnings of £78 million. The reduction reflected an increase in the charge for bad and doubtful debts from £175 million to £421 million with underlying profit

⁴ Investment earnings on shareholders' retained profits and capital in the life business.

of £529 million up 2.1%. Net interest income was flat on the prior year as volume growth was offset by increased funding and liquidity costs. Deposit growth was 14.3%, almost four times the industry average and total assets increased by 18.3%.

New Zealand

New Zealand is experiencing a challenging period with the impact of a domestic recession and the global disruption to the credit markets, although pressures appear to have eased slightly in recent months.

Cash earnings fell 12.9% to \$420 million due to: the increase in the charge for bad and doubtful debts; margin reduction reflecting increased funding costs; the NZ Government's retail deposit and wholesale guarantee schemes costs and steps taken to strengthen the balance sheet and attract additional customer deposits. Margin reduction was partially offset by repricing. Business lending growth was supported by the launch of the BNZ Partners brand, which utilised the Group best practice iFS model.

Underlying profit was up 1.7% due to continuing flat costs, improved income flowing from customer demand for foreign exchange hedging demand and a 12.4% increase in lending volumes.

nabCapital

nabCapital cash earnings were \$634 million as a result of strong revenue growth across most product areas - particularly in Global Markets and Treasury - as well as ongoing repricing of lending. This was partially offset by costs associated with the risk mitigation trades and a management overlay provision of \$160 million in respect of conduit assets and derivatives.

Net operating income was up 31.4% flowing from increased customer demand for risk management products and increased trading activity while interest rate and currency markets were volatile. Costs rose by 11.5% largely due to additional personnel to support the revenue growth and a more normal level of incentive accrual following the increase in business profitability. Underlying profit was up 43.9%.

Excluding the ABS CDOs provision taken in 2008, the charge for bad and doubtful debts increased by \$626 million. Higher gross impaired assets reflected the continued deterioration in global economic conditions and a need for increased provisioning against a number of corporate and leveraged exposures largely in Australia and the UK.

Great Western Bank

2009 was the first full year of trading results for Great Western Bank. Cash earnings for the year were US\$53 million and underlying profit was US\$94 million. The charge for bad and doubtful debts was US\$14 million.

Operating performance during the year showed solid growth and maintenance of net interest margins together with operating efficiencies.

Average interest earning assets increased by 15.2%, reflecting the acquisition of 20 branches in Colorado from First Community Bank and organic growth that included increases from the agricultural strategy. The ratio of deposits to loans was 118% allowing asset growth to be fully funded from customer deposits.

Conclusion.

"Our solid performance in 2009 has the foundations of good revenue growth and cost control combined with actions that demonstrate our commitment to improving customer relationships and reputation. These are key to ensuring sustainable business momentum and shareholder returns," Mr Clyne said.

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