

Media Release

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BNZ delivers solid underlying performance in a highly competitive environment

Sound underlying profit growth and improved asset quality has led to Bank of New Zealand (BNZ) reporting a statutory net profit for its banking group¹ of NZ\$393 million for the six months to March 2014. The result demonstrates solid performance in the face of increased regulation, strong competition and costs from unforeseen events such as the Wellington earthquake.

Cash earnings² for BNZ's New Zealand banking operations³ increased by NZ\$13 million or 3.4% to NZ\$400 million, compared to the March 2013 half year, and are comparable to the \$401m achieved in the six months to September 2013. The result was driven by improved revenue and bad and doubtful debt charges, with expenses increasing in line with revenue.

Customer deposits continued to grow strongly, increasing by NZ\$4.6 billion or 12.4%³ compared with the half to March 2013. BNZ increased its market share in deposits by 20 basis points to 19.0%⁴ from the same period last year.

Outgoing CEO, Andrew Thorburn, says the result, in a highly regulated and competitive environment, reflects a focus on execution, innovation and strengthening the bank's balance sheet.

“Over the past three years, BNZ has been pursuing a strategy of growing customer deposits and reducing reliance on wholesale funding, particularly short-term wholesale borrowings. The success of this strategy has resulted in a funding mix that supports sustainable balance sheet growth.”

BNZ maintains a robust capital structure, with a strong balance sheet that is well funded through diversified stable funding sources. In February 2014, BNZ established a U.S. Rule 144A programme, enabling it to raise term funding in the U.S. market, further broadening the bank's wholesale funding base.

BNZ's core funding ratio (CFR) was above 85% at 31 March 2014, comfortably exceeding the RBNZ minimum requirement of 75%¹. Collectively, BNZ's funding and capital position is supportive of BNZ's long-term AA-/Aa3/(S&P/Moody's) credit rating and means BNZ is well-placed to meet new regulatory requirements in 2014 and beyond.

Average lending volumes increased by NZ\$3.1 billion or 5.2% to NZ\$62.5bn compared to the March 2013 half year³. The increase was driven by a strong business lending portfolio experiencing steady growth in institutional banking and agribusiness. Housing growth momentum was influenced by the RBNZ high loan to value ratio lending limits which came into effect on 1 October 2013, and intense market competition. However housing volume has grown by \$400m over the half in targeted segments.

Net interest margin decreased by six basis points to 2.34%³ compared with the same period last year, however increased by one basis point compared to the six months ended 30 September 2013. This was largely driven by customers' preference for lower margin fixed rate lending in a rising interest rate environment. The decrease in margin was partially offset by reduced funding costs.

Other operating income decreased by NZ\$1 million or 0.4%³ compared to the March 2013 half year. This was primarily driven by lower lending and commitment fees across BNZ Partners and Retail bank.

The improvement in asset quality was driven in part by the recent low interest rate environment and improved economic conditions, which drove a decrease in the provision charge for bad and doubtful debts of NZ\$15 million or 26.8%³.

1. "Banking Group" means Bank of New Zealand's financial reporting group, which consists of Bank of New Zealand, all of its wholly owned entities and other entities consolidated for financial reporting purposes.

2. Cash earnings is a common measure of financial performance which excludes items introducing volatility and one-off distortions that are unrelated to BNZ's ongoing financial performance. Cash earnings is based on statutory net profit which is adjusted to exclude fair value movements, hedging gains/(losses) and the disposal of subsidiaries. These items are excluded from cash earnings as they introduce volatility and/or distortions and are shown in the cash earnings to net profit reconciliation included on the final page. Cash earnings is calculated in accordance with Group (NAB) policy.

3. "BNZ's New Zealand banking operations": excludes BNZ's Group Capital Management and BNZ Markets operations (previously known as Wholesale Banking) from the "Banking Group" and includes the Insurance operation in New Zealand for management reporting purposes.

4. Source: RBNZ (February 14). Retail deposits exclude some deposits by business banking customers captured in money market deposits in the BNZ Disclosure Statement.

Operating expenses increased marginally by NZ\$5 million or 1.3%³. The increase was primarily due to strategic investment projects such as BNZ's \$400 million NextGen business transformation process, increased depreciation costs from recently completed projects and costs resulting from the damage to BNZ's Harbour Quays building in last year's Wellington earthquake.

Mr Thorburn says that BNZ's investment in delivering relevant and customer-focused solutions is setting the bank apart.

"We're focused on quality over quantity with our mortgage book, on developing products and services that help customers develop a sustainable financial position while ensuring we continue to support New Zealand businesses to grow.

"Our relentless investment in delivering solutions relevant for our customers is starting to yield results. We are seeing a notable increase in mortgage pay downs due to products like TotalMoney and HomeAdvantage, designed to support our customers to reduce their debt and increase their wealth in manageable ways.

"The bank's mobile banking app won best app at the 2014 NetGuide awards and the breakthrough interactive banking platform, YouMoney, continues to be a key driver in attracting new customers, particularly in the under-25 market. HomeAdvantage, launched in November, saw BNZ as the first bank in the world to offer customers a credit card rate matched to the variable interest rate for the life of their mortgage.

"Our digital channels have been hugely successful in enabling our customers to interact with their banking more often. This means customers are in a position to really take control of their finances.

"We are investing heavily in our back-end systems to ensure that we continue to deliver a consistent, quality experience every single time our customers log on."

In the half year to March, there were 43.4 million interactions through BNZ's various digital channels.

In March, the BNZ KiwiSaver Scheme was named as a default provider, just one year following its launch.

Mr Thorburn says the BNZ KiwiSaver Scheme was developed to bring saving to the front of New Zealanders' minds so that it becomes as intuitive as paying the bills.

"We've done that by making savings balances very visible and by offering innovative incentives such as transferring FlyBuys points into retirement savings and that deliberately different approach has hit a chord with New Zealanders."

Mr Thorburn says the appointment as a default provider fits perfectly with the bank's aim to help people be good with money and will allow BNZ to make a larger contribution to ensuring New Zealanders are in the best financial position possible when they retire.

BNZ paid \$153 million in tax³ for the half year and employs over 5000 people in its network of stores, Partners' Centres and customer support functions.

The bank continues its national support of Plunket and Super Rugby, Kiwis for Kiwis, Ahuwhenua Farming Competition, KiwiNet and ICEHOUSE as well as a significant number of local sponsorships tailored to support the communities it works within.

In March BNZ added a physical presence to its unique Canterbury support hub. The *BNZ Canterbury Future Hub* brings together BNZ banking advisers, CERA residential advisory specialists, insurance experts, legal professionals, chartered accountants and a property firm. Mr Thorburn says the BNZ Canterbury Future Hub has helped more than 1,500 Cantabrians to embark on the next stage of their lives since it was established in August 2013.

Enabling a diverse workforce continues to be a core focus for the bank, building on its 2013 United Nations award for gender diversity. In February this year, 12 inaugural Te Pihinga Maori cadets began 6-month paid cadetships. In March, the bank also released a paper outlining the business case for diversity.

In delivering his final results before he takes on his new role as CEO of National Australia Bank, Mr Thorburn reflects on the growth BNZ has achieved during his tenure as chief executive of BNZ.

"I am proud of the way BNZ has stayed true to the ethos of helping New Zealanders be good with money, and supported New Zealand businesses to grow, all within a fast-changing, highly competitive environment," says Mr Thorburn.

"With more than 5000 highly capable staff and a passionate, experienced banker as the new CEO in Anthony Healy, I am certain that BNZ is in a strong position to continue to be an integral contributor to our customers and the larger New Zealand economy."

Ends

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BNZ Banking Group

Income Statement Summary

	Mar 14 NZ\$m	Half Year to Sep 13 NZ\$m	Mar 13 NZ\$m
Net interest income	802	787	778
Gains less losses on financial instruments	(8)	4	(98)
Other operating income	213	225	209
Total operating income	1,007	1,016	889
Operating expenses	(422)	(434)	(409)
Total operating profit before impairment losses on credit exposures and income tax expense	585	582	480
Impairment losses on credit exposures	(38)	(40)	(73)
Total operating profit before income tax expense	547	542	407
Income tax expense on operating profit	(154)	(145)	(109)
Net profit attributable to shareholders of Bank of New Zealand	393	397	298

Balance Sheet Summary

Spot Balances (NZ\$m)	Mar 14	Sep 13	Mar 13
Total assets	76,922	75,310	72,798
Total liabilities	71,096	69,623	67,395
Total shareholders' equity	5,826	5,687	5,403
Ordinary shareholder's equity	4,916	4,777	4,493
Contributed equity – perpetual preference shareholders	910	910	910
Total shareholders' equity	5,826	5,687	5,403

Capital Adequacy Ratios¹

	Mar 14 Basel III	Sep 13 Basel III	Mar 13 Basel III
Common Equity Tier One capital ratio	9.13%	8.87%	8.73%
Tier One capital ratio	10.58%	10.68%	10.68%
Total qualifying capital ratio	12.13%	12.61%	12.76%

1. Based on the RBNZ's Capital Adequacy Framework.

New Zealand Banking operations

	Half Year to			Mar 14 v Sep 13 %	Mar 13 v Mar 13 %
	Mar 14	Sep 13	Mar 13		
	NZ\$m	NZ\$m	NZ\$m		
Net interest income	746	734	732	16%	19%
Other operating income	248	250	249	(0.8%)	(0.4%)
Net operating income	994	984	981	10%	13%
Operating expenses	(400)	(396)	(395)	(10%)	(13%)
Underlying profit	594	588	586	10%	14%
Charge to provide for bad and doubtful debts	(41)	(43)	(56)	4.7%	26.8%
Cash earnings before tax	553	545	530	15%	4.3%
Income tax expense	(153)	(144)	(143)	(6.3%)	(7.0%)
Cash earnings (NZ Banking) ¹	400	401	387	(0.2%)	3.4%

Reconciling items to statutory net profit (BNZ Banking Group)

Structural differences between NZ Banking and BNZ Banking Group ²	50	16	44	212.5%	13.6%
Fair value movements and hedging gains/(losses) ³	(79)	(33)	(18)	(139.4%)	58.0%
Taxation on reconciling items	22	13	55	69.2%	(60.0%)
Net profit attributable to shareholders of Bank of New Zealand ⁴	393	397	298	(10%)	319%

Average Volumes (NZ\$bn)⁵

Gross loans and acceptances	62.5	614	59.4	18%	5.2%
Interest earning assets	64.1	62.9	612	19%	4.7%
Total assets	63.9	62.7	613	19%	4.2%
Customer deposits	417	39.9	37.1	4.5%	12.4%

Performance Measures⁵

Cash earnings on average assets	1.26%	128%	127%	(2 bps)	(1bp)
Net interest margin	2.34%	2.33%	2.40%	1bp	(6 bps)
Cost to income ratio	40.2%	40.2%	40.3%	-	10 bps

1. BNZ's New Zealand Banking operations are reported as a separate division and include the Retail, Business, Agribusiness, Corporate and Insurance businesses. It excludes BNZ's Group Capital Management and BNZ Markets (previously known as Wholesale Banking) operations reported at a Group (NAB) level.
2. BNZ Banking Group excludes the Insurance operation in New Zealand and includes BNZ's Group Capital Management and BNZ Markets operations.
3. Includes unrealised fair value gains or losses on economic hedges that do not qualify for hedge accounting and ineffectiveness of designated hedge accounting relationships. Fair value movements are mainly driven by changes in interest rates, credit spreads and volatility on cross currency swaps.
4. Statutory net profit has been prepared in accordance with Generally Accepted Accounting Practice in New Zealand ("NZ GAAP"). It complies with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable Financial Reporting Standards.
5. Average volumes and performance measures are based on BNZ's New Zealand Banking operations. Performance measures are calculated on a cash earnings basis.