PwC analysis of the major banks results for full year 2012

Modest growth, potential for more ...

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The most recent Australian bank results show the extent of headwinds facing the Australian banks. After two years of double-digit profit growth, underlying cash earnings rose by only 3.6% in 2012. All of that growth came early in the year; with profit showing no growth in the second six months compared to the first half-year.

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At the same time, the banks continued to strengthen their capital base with average shareholder funds rising by 8.5% in 2012 compared to 2011, so that return on equity (RoE) fell from 16.4% in 2011 to 15.6% in 2012, reinforcing our long-held view that bank RoEs are in transition to an era where 15% will set the upper bound, not the lower bound, for Australian bank average RoEs.

This cautious outlook is reinforced by global developments since our last report six months ago, and in particular that global growth expectations have been revised downwards, leading to further monetary policy easing across the globe, including in Australia. At the same time ECB President Draghi's commitment in July to do "whatever it takes" marked a much more constructive period for dealing with Eurozone concerns and supporting lower risk yields in many markets including wholesale funding markets for our banks over the past few months. The in-principle agreement to create a Eurozone banking union is a tangible sign of meaningful change.

Domestically, the main sea-change is vigorous debate about whether "the commodity boom is over?" reinforcing perceptions of the Australian economy's dependence on China. The fact that (as at the time of writing) the Australian official cash rate sits only 25bp above the all-time (GFC) low of 3.0% emphasises the sombre outlook for domestic demand, including credit. Credit demand shows little sign so far of responding and in fact seems to have slowed further from around July/August.

The pipeline of committed resources projects seems to be sufficient to keep the Australian economy growing, albeit slightly below trend. The main danger for China – and hence Australia – remains China's heavy dependence on fixed capital investment and the risk that too many investments turn out to be unprofitable. It would be foolhardy to dismiss that risk altogether. In short, the commodity investment boom has eased but is far from over.

In summary, the external environment for our banks has been by no means all negative, but it has reinforced community and industry perceptions of only modest growth in income and economic activity for the foreseeable future. Thoughts of a return to buoyant banking conditions are even further from everyone's minds than six months ago.

In aggregate, the banks have dealt with this difficult hand pretty well. Despite slower credit growth, total operating income grew fractionally quicker in 2012 (4.0%) than in either 2011 (3.7%) or 2010 (3.2%). However, net interest income growth slowed (3.5% in 2012 versus 5.0% in 2011). It was really only a big increase in trading income – up 31% and almost back to buoyant 2009 levels – which saved the day through non-interest income.

Digging further into net interest income, average net interest margins declined by 8 basis points over the year, reminiscent of the "norm" of 10 basis point declines per annum experienced for much of the two decades of strong lending growth leading up to the GFC. In those days it was price competition for lending which generated the secular decline in margins. This time around it is competition for deposits which is driving margin decline, together (for 2012 as a whole) with higher wholesale funding spreads in offshore markets. These substantial negative pressures on funding costs were partly offset in lending rates when official cash rates reduced. We believe that competition for deposits will continue to intensify. This is why we expect further modest falls in bank interest margins on say a two-year horizon, especially given the weak secular outlook for credit demand.

Another key feature was the upward movements in bad debt expense which increased by 16.1% between FY11 and FY12, the first annual increase since FY09. A disproportionate percentage of this increase came from offshore credit exposures, although we have also seen some adjustment in collective provision overlays to account for the domestic portfolios. Gross impaired assets remained steady at $20.6b, with commercial property continuing to

be overly represented. There is some anecdotal evidence that prices realised on sales of distressed commercial assets have fallen noticeably over the course of 2012.

Importantly, delinquency statistics for home loans, SME lending and credit cards have improved modestly, assisted by lower interest rates and lower unemployment. We're not sure that this trend has much further to run, given business conditions and the fact that the newest cohorts of home loans have a higher proportion of >90% LVR loans which are yet to season.

Other areas of revenue affecting the results include:

- Wealth management returns were assisted by a rebound in insurance premiums, with fewer disasters reducing the level of claims. By contrast, equity markets continued to be volatile and customers continued to favour lower risk/return investment options, all compounding in reduced management fees. In all wealth management income grew by 2.8%.
- Bank trading income was a real positive, with income up 31%, with a pick up in the first half of the year. Continued demand from customers for risk mitigation products has been a noticeable positive as has the growth in trading income from offshore expansion initiatives. In all, trading revenues approached the 2009 GFC highs.

The banks' discipline on cost management in response to weak revenue growth is apparent, with total expenses rising only 2.4% yoy and not growing at all in the past six months. This is particularly impressive given the banks have continued to invest in regulatory initiatives and technology over the period. Staff expenses rose by 2.6% yoy, while technology expenses rose by 4.6%.

Shareholder value – global and Australian banks

	Pre-boom (2003)		Pre-crisis (2007)		Now		New equilibrium	
	Global	Aus	Global	Aus	Global	Aus	Global	Aus
Leverage	23x	15x	31x	17x	19x	15x	<20x	<17%
Cost of Equity (CoE)	9%	12%	10%	11%	10%-12%	11%	8-10%	12%
Return on Equity (RoE)	12%	15%	20%	20%	7%	15%	9-11%	13-15%
Economic Spread (RoE – CoE)	3%	3%	10%	9%	3%	4%	1-2%	1-3%

The fact that buoyant banking conditions seem as far away as ever will no doubt be focusing bankers' attention on how to limit cost growth to close to zero for the foreseeable future. This will be no easy task, given rising customer service expectations, operational risk and technology costs, and further regulatory imposts.

Recent PwC global research has focussed on how this new era of "lower growth, lower leverage" might impact on the creation of shareholder value by the banks. The table above reflects our findings for Global Banks and Australian Banks.

A sustainable outcome for global banks in this new era will see cost of equity running at 8-10% (a few percentage points lower than today) and return on equity running at 9-11% (a few percentage points higher) so that positive shareholder value (ie returns in excess of cost of capital) can be restored. While positive, the returns will nonetheless be marginal – say in the range of 1-2%.

We expect that Australian banks will see a modest increase in bank leverage as risk appetite from borrowers and lenders eventually normalises to new conditions. Cost of equity is expected to settle a couple of percentage points higher than their global counterparts, due to the perceived risks of a commodity based economy dependent on offshore funding.

We continue to stick to the view that average return on equity for the Australian banks will ease back to a 13% to 15% range. This reflects intense competition, subdued demand for credit, and ongoing cost pressures, not least from IT investments. Nonetheless these RoEs will be competitive relative to global peers.

As a consequence, the Australian banks will continue to generate positive shareholder value, with an economic spread in the order of 1%-3%, closer to the 1-2% of global peers. In other words, Australian banks will continue to be a more than competitive destination for global banking investors albeit, possibly to a lesser extent than today.

Looking to the more immediate future the PwC banking gauge – a consensus view across four leading banking analysts – predicts that the four major banks will deliver cash earnings growth of 5.4% in FY13, and 5.0% in FY14.

Note: PwC Banking gauge is a consensus view across four banks and four of Australia's leading analyst – James Ellis (Credit Suisse), Jonathan Mott (UBS), Matthew Davison (Merrill Lynch) and Scott Manning (JP Morgan).

Four majors' combined performance – A$ million – underlying cash earnings

	2012	2011	12 vs 11	2H12	1H12	2H vs 1H
Net interest income	51,128	49,404	3.5%	25,569	25,559	0.0%
Other operating income	24,441	23,284	5.0%	12,428	12,013	3.5%
Total income	**75,569**	**72,688**	**4.0%**	**37,997**	**37,572**	**1.1%**
Operating expense	34,114	33,310	(2.4%)	17,060	17,054	0.0%
Core earnings	**41,455**	**39,378**	**5.3%**	**20,937**	**20,518**	**2.0%**
Bad debt expense	6,162	5,306	(16.1%)	3,313	2,849	(16.3%)
Tax expense	9,966	9,616	(3.6%)	4,957	5,009	1.0%
Outside equity interests	92	94	2.1%	43	49	12.2%
Underlying cash earnings after tax before significant items	25,235	24,362	3.6%	12,624	12,611	0.1%
Statutory results	22,803	23,959	(4.8%)	11,241	11,562	(2.8%)

Net Interest Income

Credit growth

Despite swings and roundabouts, overall credit growth of 4.0% for year to September 2012 was marginally stronger than the 3.4% for the year to September 2011.

There has however been a noticeable improvement in business credit, having grown by 3.8% in the year to September 2012 compared to 0.3% for the previous year. Other personal lending (largely unsecured) was still in negative territory (-0.9% compared to -1.0% in the year to September 2011).

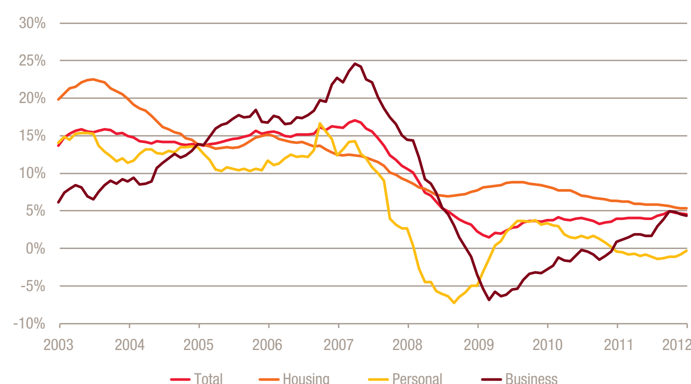
The real weak spot relative to historical experience continues to be housing, which grew by 4.7% over the year to September. This is another all-time low in a series which goes back to the mid-1970s and compares to 5.8% a year ago. Within this, investor housing has remained more or less static at 5.3% compared to 5.4% a year ago, supported by higher rents and lower property prices. Owner-occupied housing credit grew by 4.1% compared to 6.0% a year ago.

Much has been made of recent signs of recovery in both housing finance commitments and house price data, with commentators suggesting that the market has bottomed and to expect moderate growth in both house prices and turnover. The most recent Westpac-Melbourne Institute Index of Consumer Sentiment indicated that consumers, whilst cautious about many aspects of their finances, believe that now is a good time to buy a home. However we remain cautious, with household concerns about existing levels of debt likely to outweigh the positive from lower interest rates.

Indeed the most recent credit data paints a picture of some weakening. Momentum for credit growth had seemed to be gathering until the last month or so. For instance, in the six months to September total housing credit is only running at a 4.2% annualised clip, with owner-occupied housing down to 3.6%.

The major banks continued to dominate the Australian lending market. They have a 77.3% share of the housing market, despite losing 40bps to other Australian lenders. Similarly, they have a 76.6% share of the business market, having gained over 200bps in the last 12 months, from other Australian banks and foreign branches.

Domestic credit growth
(Annual % growth – 12 month rolling average)



Funding

Deposits from customers remain the most important source of bank funding. Our preferred measure of this market – core bank deposits – has risen by 10.2% in the year to September 2012, very similar to the 10.5% recorded in the previous year. Given low inflation, this still remains a healthy – but not exceptional – rate of deposit growth. To set it in context, core deposits have on average grown by 12.9% pa over the past five years since September 2007; they grew on average by 9.7% pa over the previous two decades.

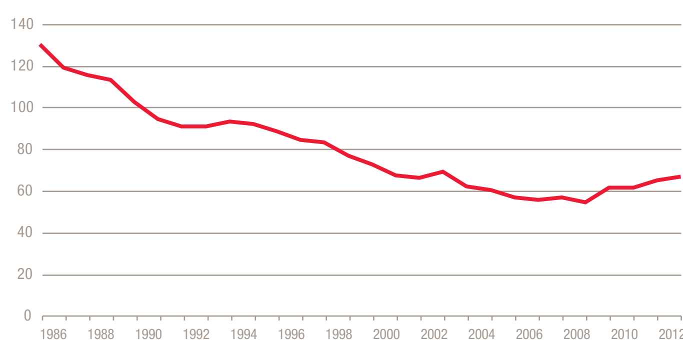
Market share for the major banks as a group has been relatively stable. Their market share of business deposits fell by 54bps to 79.8%, whereas they gained 92bps in household deposit market share to 82.4%.

The other main source of bank funding is wholesale funding. A major development has been the scope for the Australian banks to issue covered bonds, which effectively secure the bank's liability with a specific pool of lending assets. In total, approximately $35bn of covered bonds have been issued by the Australian majors, at margins which have steadily declined since the first issue in December 2011 as market conditions improved as sovereign debt concerns receded somewhat.

The banks have however been judicious in their use of the covered bond market in as much as they also raised unsecured debt as market conditions improved, indeed spreads contracted by around 80bps from the highs seen at the end of 2011. The use of unsecured debt has enabled the banks to leave room for raising more secured funding via covered bonds should market conditions once again deteriorate, as well as ensuring a balanced maturity profile over several years. With subdued credit growth, the banks have managed to fund new lending with deposits and only enter the wholesale markets to roll over maturing debt.

The increased relative funding contribution of deposits is evident in the further rise in the ratio of core bank deposits to bank lending for the banking sector overall. This ratio has risen from 66.8% in September 2011 to 69.2% in September 2012, well off the lows of 54.5% in April 2008. While we agree with recent commentary on the need for caution in interpreting this ratio it is useful short-hand in tracking the rebalancing in the Australian banking system. As the chart indicates, this ratio fell very steeply over the two decades up to the GFC, and the relatively modest improvement since then suggests – given the critical emphasis on stable funding – that the Australian banking sector still has a long way to go in rebalancing.

Core bank deposits to bank loans and advances (%)



Net Interest Margin

The decline in net interest margin (NIM) is perhaps the most notable aspect of the FY12. As the chart shows, the 13bp decline to 2.14% between 2H11 and 2H12 takes margins back to the level prevailing immediately after the Lehman's collapse, and reversing the significant re-pricing which then occurred in 2H09 in response to the full impact of the GFC. In year-average terms, NIM declined by 8bp from 2.24% in FY11 to 2.16% in FY12.

The reduction in average NIM can be broken down into four main factors:

***Customer deposit pricing* – (-9bps 2H12, -9bps FY12) –** Price competition for deposits remained intense throughout the year, as banks sought to rely more on customer deposits for funding, including in preparation for Basel 3. Depositors benefited from this in the order of 9bp over FY12.

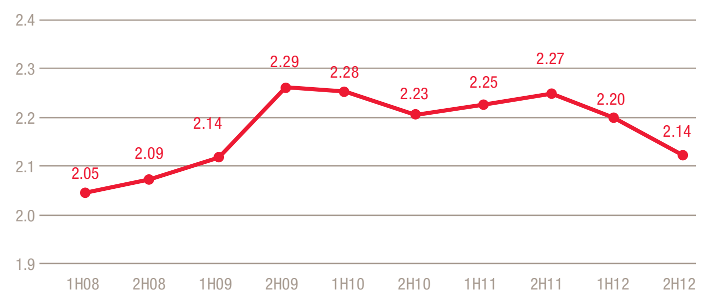
***Wholesale funding costs* – (-3bps 2H12, -7bpsFY12) –** Heightened risk aversion in offshore markets has seen the cost of wholesale funding for the Australian banks rise. While these markets were more settled in later months, the volatility early in the year impacted costs for the full year, as has the impact of the higher Australian dollar.

***Asset pricing* – (+10bps 2H12, +10bps FY12) –** As in recent years, the banks sought to recoup increases in deposit pricing and wholesale funding costs by passing some of those costs onto borrowers. This recouped 10bp of the 16bp reduction in NIM from those higher deposit and funding costs over the full year.

***Other* – (-4bps 2H12, -2bps FY12) –** Banks held additional liquid assets for risk management purposes which reduced the margin by 1bp for FY12,as did a higher proportion of lower margin assets.

On balance we expect NIMs to drift down further in coming periods. Much of course will depend on global developments in wholesale markets, and certainly those markets are looking much more settled at present. Time will tell whether this remains the case as the deadline for the "US fiscal cliff" comes closer. Separately, the Australian banks are relatively under-funded on deposits so we see price competition remaining intense. Low credit growth will also restrict the ability of the banks to pass on increases in lending margins. Finally, with official cash rates sitting at near-record lows, the NIM benefit from zero-interest deposit accounts is relatively less and this will also be a drag on NIMs.

Combined net interest margin



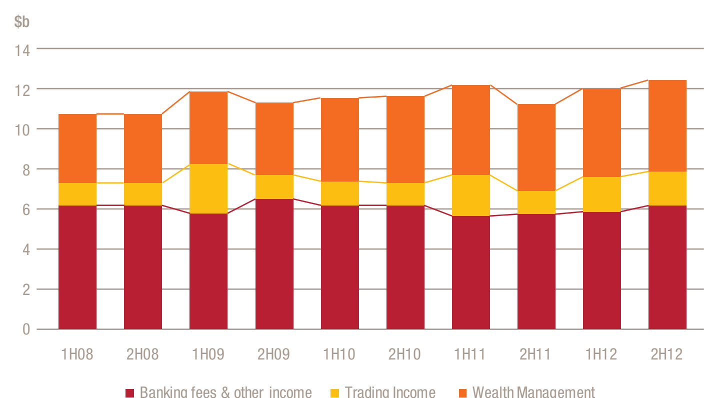
Other Operating Income

Other operating income grew by 5.0%, after two years of negligible growth.

One driver of this was growth in bank fees 1.1% after two years of significant falls, with the reductions in exception fees ending and business facility fees benefiting from some growth in business credit.

Trading income was the real star – up 31% - as customer demand for risk management increased and offshore expansion initiatives start to have an impact.

Analysis of other operating income



Lower insurance claims and solid sales saw insurance net revenues improve. Fund management flows remain subdued in line with equity markets and the shift to self-managed super.

Expenses

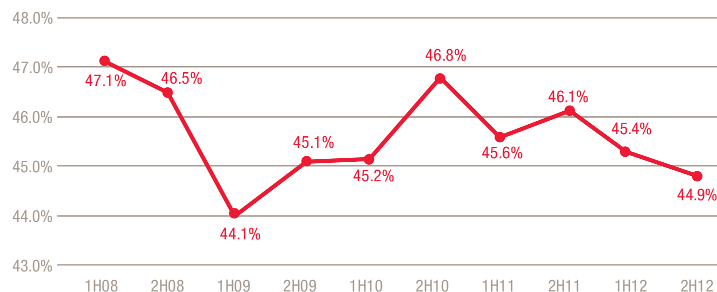
Expense control has been a major focus of the banks with the expense to income ratio improving 68bps to 45.1% for FY12 compared with 45.8% in FY11.

Full year costs rose 2.4%, but held steady half on half.

Occupancy was the fastest growing category, up 5.9% to $3.4b. Conversely, other expenses fell by 0.6% to $7.4b.

Technology costs rose 4.6% to $3.9b, including $1b of software amortisation costs. Capitalised software rose by $1b to $6.5b.

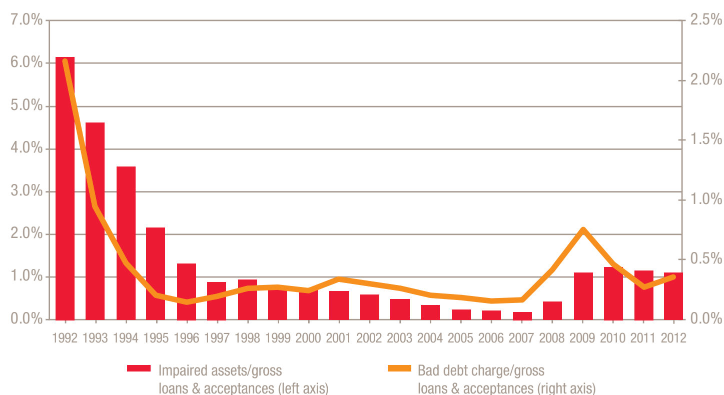
Combined expense-to-income ratio



Average FTE numbers fell by 1.9%, helping to limit the increase in total staff expenses to 2.6%. This category fell by 1.3% in the second half compared to the first.

Asset Quality

Impaired assets and bad debt expense



Notes: Pre 2006 AGAAP; post 2006 AIFRS

Gross impaired assets remain constant at $20.6b in 2H12 with relatively few "headline" problem assets emerging.

Bad debt expense rose 16.1% in FY12, the first annual increase since FY09. The banks have largely worked through the distressed assets which emerged at the height of the GFC (and generated write-backs in FY11 and FY10). Some banks have now needed to increase economic overlays in response to newly emerging economic stresses, including in offshore portfolios.

Delinquency rates in consumer portfolios have declined gently, assisted by low unemployment and falling interest rates. Any further improvement from here in consumer portfolio quality will be modest, while arrears in business portfolios may tick up as modest domestic demand and the high AUD take their toll.

Making payments pay

One of the most striking developments over the past year has been the renewed focus in banking markets on payments innovations. At least five factors are at play:

- Slowing income growth from intermediation and trading has encouraged banks to rediscover the importance of payments as a revenue driver.
- Payments at their core are the exchange of messages so are natural targets for innovation in the digital world.
- Payments are an enormous source of insight into customer spending patterns – in a world of big data, payments are the biggest prize.
- Payments are a natural entry point for technology-smart companies (from telcos to retailers to search engines to start-ups) to enter the banking value chain.
- Regulators around the world, including in Australia, are raising the stakes for real-time payments, and payments competition and innovation more generally.

The stakes here are big. Not just because of the potential to understand customer spending patterns, payments also drive customer activity with the payments providers. In a world where customer engagement is everything, the traditional role of payments in cementing customer relationships becomes ever more critical, especially for banks trying to fend off non-banks.

The stakes are also big for the regulators. Where does a payment end and a store of value (deposit) start? How do we minimise the risk of digital fraudsters in payments?

We believe the Australian regulators know their mind very clearly, intending that a new payments hub be developed for low value payments. This would not only allow for counterparties to segregate the systemic risk of counterparty failure in payments but also create the technical and regulatory frameworks for new payments entrants. It is not hard to see this becoming an "NBN" for payments, allowing entry for non-bank new entrants.

So how should banks respond to all these challenges?

The most fundamental point is the one already made – payments are at their core the exchange of messages between counterparties. Link this to the obvious point that in this era of convergence, messages are device agnostic, we see immediately that payments need to be at the heart of the customer engagement strategy for every bank. In the space of a few short years, payments have moved from the periphery of bank focus to the essence of customer engagement and hence strategy. Proprietary advantage and differentiation must come to the fore.

This challenge for Australian banks is exacerbated by the historical record – innovation in Australian payments has tended to come either from industry utility plays (such as BPAY), hardware (card swipe devices, which quickly became ubiquitous), or from non-banks (such as Cabcharge or the gift card providers).

Obviously there it is not a one-size-fits-all answer. Our *futuremoney* research though points to a six-element framework for banks to think through their choices.

Can you link your payment innovation efforts and the value that these create for your business? For some banks this is hard as their payments franchise is structured as a payments utility. This means though often the costs of

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payments investment can be defined and identified in the organisation, the immediate and long-term payoffs of those investments are less clear.

Some international banks solve this problem by defining a "payment P & L", with a business unit structure and leadership. ABSA in South Africa does this, leading many of its global peers in the percentage of income from payments. A first step is defining a payments portfolio – clearly linking investment with outcomes and identifying those initiatives that should be fostered, and those that are the costs of doing business as a bank.

Are you a first mover, investing in your own capabilities? Or are you a fast follower, focused on developing relationships with external providers? Both ends of this spectrum work. But it's important for banks to articulate their ambition for payments innovation.

How do you execute your payments strategy? Often these are around outsourcing vs insourcing. And often these choices are driven by culture, not capability. For example consider a payments product such as merchant acquiring. Many American banks outsource their payment brands to large schemes, sales to third party sales forces, processing to third party processors, risk scoring to third party bureau and delinquencies to risk taking debt collectors. Banks can be very successful with this strategy – and key is developing a culture that supports external partners.

Consider: Are you able to develop the strong partnering cultures needed to be successful in developing a payments portfolio, or do you need to do most things in house? Is this the most productive approach?

How do you attract both buyers and sellers? The answer to this question is often different for banks compared to non-banks. Banks often integrate their payments offer with other products say to encourage account retention, measured by net deposits. What often happens then is bank payment innovation is consumer centric, and the metrics for success are defined in terms of consumer take up and transaction volumes.

A striking feature of many successful non-bank payment innovators is their 'merchant centric' instrument deployment. In Australia this will mean the so-called "prosumers" – ie the 3 million or so people who both buy and sell online and use platforms ranging from Etsy to Elance to transact with their customers.

Consider: Do you cross-sell new instruments into many existing customers or do you focus on a small number of high need merchants, address their needs and drive instrument substitution through merchant acceptance?

Are you building a horizontal or vertical user proposition? Banks often build payment products to appeal to as many users as possible and price them to compete with (and substitute for) cash or low cost electronic or card products. This reflects the service ubiquity bias of payments utilities. It makes 'sense' to serve as many users as possible. Non-banks consciously or unconsciously do the opposite. By accident or design they identify some aspect of commercial activity that absolutely needs their new instrument, they get merchants to adopt the instrument and consumers are compelled to substitute their normal choices – but only for that specific transaction type.

PayPal is an example of this. Consumers use PayPal to pay merchants for goods and services bought online. But not many consumers use PayPal to pay their utility bills and not many utilities use PayPal to pay their tax bills. PayPal is an excellent vertical user proposition.

Consider: What are the returns of horizontal reach relative to the returns available from mastery of a vertical?

What service are you offering for what price? Banks often create payment instruments aimed at consumers with a horizontal transaction goals. This means multiple users across many payment types. The only way to ensure instrument substitution is to make sure merchants accept the new instrument, leading to a lowered cost per transaction.

For example some banks are developing mobile payment services aimed at substituting cash or cards at retail Point of Sales (POS) terminals. As the benefits to the merchant are mixed at the very least these transactions need to be priced at or below current merchant pricing. The result? Transaction pricing that will appeal to many merchants, typically a few basis points over interchange. In contrast, a non-bank new entrant such as *2Checkout* serves many tens of thousands of online merchants in 30 countries with multi-currency payments. It prices its payment service at approximately 200bp over interchange, many times more than its bank competitors would do.

Consider: Do banks have the capabilities to assist merchants sell and consumers buy beyond the transaction?

Finally do data and payments create a virtuous circle? Increased competition in the payments-as-commodity space inevitably drives down margins. The currency of payments here is data. Can banks use the huge exhaust of data that their payments instruments create? Applying big data analytics to these real time data sets will create many new opportunities to create and deepen relationships with both consumers and merchants and uncover new opportunities for commerce.

In the next few years banks and non-banks will compete for the payments market. The players have different assets, capabilities and strategies and ultimately the Australian consumer will benefit. We suggest that to effectively compete banks will need to think like challengers rather than incumbents.

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Key banking statistics – Full year 2012

	ANZ			CBA (iii)			NAB (iv)			WBC		
	12 mths Sep-12	12 mths Sep-11	12 mths Sep-10	12 mths Jun-12	12 mths Jun-11	12 mths Jun-10	12 mths Sep-12	12 mths Sep-11	12 mths Sep-10	12 mths Sep-12	12 mths Sep-11	12 mths Sep-10
Balance sheet												
Total assets	642,127	604,213	531,703	718,229	667,899	646,330	763,090	753,757	685,952	674,965	670,228	618,277
Risk weighted assets	300,119	279,964	264,242	302,787	281,711	290,821	331,336	341,069	344,658	297,901	279,961	279,379
Gross Loans and acceptances	432,560	402,797	370,082	542,097	518,075	512,838	500,857	482,125	447,981	518,279	500,654	482,366
Asset quality & provisioning												
Gross impaired assets	5,196	5,581	6,561	4,499	5,297	5,216	6,543	6,386	6,048	4,386	4,616	4,585
Net impaired assets	3,423	3,884	4,686	2,491	3,172	3,224	4,560	4,840	4,524	2,745	2,953	2,721
Gross impaired assets as a % of gross loans and acceptances	1.20%	1.39%	1.77%	0.83%	1.02%	1.02%	1.31%	1.32%	1.35%	0.85%	0.92%	0.95%
Individually assessed provisions	1,773	1,697	1,875	2,008	2,125	1,992	1,983	1,546	1,524	1,470	1,461	1,622
Individually assessed provisions as a % of impaired assets	34.1%	30.4%	28.6%	44.6%	40.1%	38.2%	30.3%	24.2%	25.2%	33.5%	31.7%	35.4%
Collective provisions	2,765	3,176	3,153	2,837	3,043	3,461	2,920	3,064	3,223	2,771	2,953	3,439
Collective provisions as a % of non housing loans & acceptances	1.37%	1.69%	1.88%	1.48%	1.67%	1.83%	1.26%	1.34%	1.44%	1.61%	1.76%	2.05%
Total provisions	4,538	4,873	5,028	4,845	5,168	5,453	4,903	4,610	4,747	4,241	4,414	5,061
Total provision as a % of gross loans & acceptances	1.05%	1.21%	1.36%	0.89%	1.00%	1.06%	0.98%	0.96%	1.06%	0.82%	0.88%	1.05%
Profit & loss analysis (i)												
Net Interest Income	12,111	11,498	11,035	13,157	12,645	11,868	13,297	13,092	12,288	12,563	12,169	11,855
Other operating income	5,468	5,314	5,157	6,844	6,893	6,955	6,616	6,123	5,874	5,513	4,954	5,055
Total operating expenses	8,022	7,718	7,271	9,196	8,891	8,601	9,517	9,595	9,386	7,379	7,106	6,972
Core earnings	9,557	9,094	8,921	10,805	10,647	10,222	10,396	9,620	8,776	10,697	10,017	9,938
Bad debt expense	1,246	1,211	1,870	1,089	1,280	2,075	2,615	1,822	2,263	1,212	993	1,456
Profit before tax	8,311	7,883	7,051	9,716	9,367	8,147	7,781	7,798	6,513	9,485	9,024	8,482
Income tax expense	2,294	2,222	1,979	2,676	2,597	2,208	2,178	2,142	1,777	2,818	2,655	2,537
Minority Interest	6	9	6	16	16	16	1	1	1	69	68	66
Cash earnings after tax before significant items (underlying profit)	6,011	5,652	5,066	7,024	6,754	5,923	5,602	5,655	4,735	6,598	6,301	5,879
Statutory results (ii)	5,661	5,355	4,501	7,090	6,394	5,664	4,082	5,219	4,224	5,970	6,991	6,346
Key data												
Other operating income as a % of total income	31.1%	31.6%	31.8%	34.2%	35.3%	36.9%	33.2%	31.9%	32.3%	30.5%	28.9%	29.9%
Interest Spread	2.02%	2.12%	2.21%	1.82%	1.83%	1.91%	1.71%	1.80%	1.93%	1.88%	1.90%	1.94%
Interest margin	2.31%	2.42%	2.47%	2.09%	2.12%	2.13%	2.10%	2.24%	2.25%	2.17%	2.22%	2.22%
Expense/income ratio (as reported ratio)	45.6%	45.9%	44.2%	46.0%	45.5%	45.7%	41.3%	43.7%	45.9%	40.8%	41.5%	41.2%
Total number of full time equivalent staff	48,239	50,297	47,099	44,844	46,060	45,025	43,336	44,645	44,551	35,675	37,712	38,479
Operating costs per employee (dollars) – annualised	162,824	158,487	161,245	202,323	195,224	192,755	219,069	212,490	225,446	204,739	186,531	188,787
Return on average equity (as reported)	15.6%	16.2%	15.5%	18.6%	19.5%	18.7%	14.2%	15.2%	13.2%	15.5%	16.0%	16.1%
Return on average assets (underlying cash)	0.96%	0.99%	0.96%	0.99%	1.02%	0.92%	0.74%	0.80%	0.71%	1.00%	1.00%	0.97%
Capital ratios												
Common equity	8.8%	8.5%	8.0%	7.8%	7.7%	6.9%	8.3%	7.6%	6.8%	8.4%	8.1%	7.5%
Tier 1	10.8%	10.9%	10.1%	10.0%	10.0%	9.2%	10.3%	9.7%	8.9%	10.3%	9.7%	9.1%
Tier 2 (net of deductions)	1.4%	1.2%	1.8%	1.0%	1.7%	2.3%	1.4%	1.6%	2.5%	1.4%	1.3%	1.9%
Total	12.2%	12.1%	11.9%	11.0%	11.7%	11.5%	11.7%	11.3%	11.4%	11.7%	11.0%	11.0%
Funding Ratios												
Deposits (exclude CDs)/gross loans	75.6%	73.8%	69.6%	70.0%	66.9%	62.4%	67.7%	64.6%	63.2%	67.1%	61.9%	58.1%
Deposits (exclude CDs) / total liabilities	54.4%	52.5%	51.3%	56.1%	55.0%	52.4%	47.1%	43.8%	43.8%	55.3%	49.5%	48.5%

All figures in AUD million unless otherwise indicated

(i) In arriving at "underlying profit", income and expenses exclude significant items and certain non cash items. Non cash items include acquisition related adjustments, impact of hedge accounting and revaluation of treasury shares and other items reported by the banks. Significant items include the impairment of software and goodwill, restructuring and transformation costs and other items reported by the banks. Some components of income and expenses have been reclassified to improve comparability between banks.

(ii) Statutory result as reported by the banks, unadjusted.

(iii) In reporting CBA's underlying earnings we have excluded the impact of investment earnings on shareholder's retained profits and capital in life business from other operating income and the related tax impact: FY12 $89 million, FY11 $81 million and FY10 $178 million.

(iv) NAB's underlying cash earnings after tax before significant items are shown before distributions to holders to National Securities; and excluding investment earnings on shareholder's retained profits and capital in life business and related tax impact – FY12 ($207) million and $38 million, FY11 ($225) million and $30 million and FY10 ($215) million and $61 million.