National Australia Bank

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ASX Announcement

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NAB 2010 June Quarter Trading Update

Key points

- National Australia Bank unaudited cash earnings for the June quarter 2010 were approximately $1.1 billion, in line with the quarterly average of the first half of the 2010 financial year. Personal Banking cash earnings in the June quarter were ahead of the quarterly average during the first half of the year, representing progress in building the franchise. The cash earnings contribution from the rest of the Group was broadly stable, despite the generally challenging operating environment.
- In the June quarter, Personal Banking and Business Banking lending growth brought revenue momentum. However, Group revenue was marginally below the first half quarterly average primarily due to accounting volatility arising from increased credit spreads.
- Net interest margin during the June quarter was stable although competitive pricing pressures increased and funding costs remained an issue, as the average cost of wholesale funding in the quarter continued to rise.
- Moderate expense growth reflected a continued focus on driving efficiencies while investing in key strategic programs.
- Asset quality metrics, while subject to some volatility between quarters, were broadly stable compared to the first half of the 2010 financial year. The Group charge for bad and doubtful debts in the June quarter was $510 million, a decrease on the first half quarterly average.
- Approximately $24 billion of term wholesale funding has been raised to date, within the 2010 full year target range of $20 to $25 billion. Pre-funding opportunities for the 2011 financial year will be considered. The weighted average term to maturity of the funds raised year-to-date is 5.4 years. The Stable Funding Index was 83% at 30 June 2010, consistent with the 31 March 2010 position.
- The Group continues to maintain a strong and conservative liquidity position.
- The Group capital position is also strong, with the Tier 1 ratio at 8.79% (9.09% at 31 March 2010). The decrease in the Tier 1 ratio over the quarter is largely attributable to growth in risk weighted assets arising from regulatory requirements and the acquisition of TierOne Bank in the United States.

Executive Commentary

"In the June quarter NAB delivered solid, sustainable business results, improved customer satisfaction and remained financially strong during what was a period of continued uncertainty in global financial markets," National Australia Bank Group CEO Cameron Clyne said.

"Reaction to NAB's fee and interest rate initiatives from customers and other stakeholders has been very positive, both in perception of NAB and support for products and services.

"The June quarter results were consistent with the strategy announced last year, particularly the focus on developing our Australian businesses. Personal Banking began to reap the benefit of fee reductions and other initiatives with strong growth in mortgages and new transaction account openings.

"Having demonstrated strong support for customers during challenging times, and with additional bankers and specialists, Business Banking is well placed to benefit from a recovery in business credit growth.

"Furthermore, MLC & NAB Wealth is well positioned for expected regulatory change on fees and commissions. This has attracted advisory businesses to our brand. We are currently transitioning around 20 new advice businesses to MLC licensees. The integration of Aviva is progressing well with cost synergies ahead of expectations and cross-sell opportunities from the JBWere strategic alliance are being developed with NAB Private Wealth.

"As announced yesterday, the ACCC has commenced market consultation on undertakings that seek to address its concerns regarding NAB's proposal to acquire the Australian and New Zealand businesses of AXA Asia Pacific Holdings.

"Wholesale Banking is playing a key role in supporting the Business Banking and MLC & NAB Wealth businesses. The alignment of Wholesale Banking with our core franchises, combined with the growing demand for infrastructure financing, provides attractive opportunities for this business.

"NAB's offshore businesses generally performed well despite weak economic conditions.

"The combination of strong capital and sound funding positions gives us the flexibility and capacity to grow in line with our strategic agenda," he said.

Business Commentary

Business Banking

Business Banking revenue remained strong. Lending volumes improved on the 2010 March quarter, growing above system, even though system business credit remained subdued. Competition for loans and deposits remained intense.

Business Banking continues to be the number one business bank with market share of 22.3%, up 0.20% over the June 2010 quarter. During the same period overall business lending fell by 1.1%[1].

Business reputation and customer satisfaction indicators continue to improve with strong gains being made. Following investment in staff and processes and building on its client relationship model, NAB moved from 4th to 1st for Institutional Business Banking's target clients surveyed in the Relationship Strength Index[2].

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[1] APRA market share data June 2010 adjusted to include Business Market Loans, a lending product which provides flexibility for customers to borrow and protect themselves from adverse movements in interest rates. Business Market Loans are categorised in regulatory returns as "other assets" and not included in the loans market share data.

[2] Peter Lee Associates Large Corporate & Institutional Relationship Banking survey 2010 - Target clients are a subset of the survey.

The operating and economic environment continued to stabilise with asset quality in Business Banking remaining sound. The ratio of 90+ days past due and gross impaired assets to Gross Loans and Acceptances (GLA) increased marginally to 2.02% at 30 June 2010 from 1.97% at 31 March 2010.

Personal Banking

The Personal Banking strategy is delivering strong, sustainable business with growth in home loans well above the industry average, in both the proprietary and broker channels, with improving asset quality. New transaction account growth was nine times the level achieved in the June quarter of 2009. These accounts represent attractive new business as average balances of new accounts are in line with existing account balances. This was combined with an improving customer satisfaction rating for the June quarter in the Roy Morgan survey, as work continued to improve service levels. Consequently, the Personal Banking revenue improved on the quarterly average in the first half.

The ratio of 90+ days past due and gross impaired assets to GLAs was 0.83%, an improvement from 0.90% at 31 March 2010.

MLC & NAB Wealth

MLC & NAB Wealth continues to deliver revenue momentum in both the investments and insurance businesses.

Average funds under management remained relatively stable despite adverse investment market conditions. Net inflows were strong, primarily from wholesale funds within Jana. NAB Private Wealth earnings increased through strong home loan volumes and stable net interest margins. Insurance net income rose in line with increased premiums in force. JBWere has increased both funds under advice and advisers during the quarter.

Operating costs continue to be well managed and synergies from the Aviva integration remain ahead of the initial business case.

Wholesale Banking

Despite challenging economic conditions, which included subdued business activity in the United Kingdom and United States and sovereign credit concerns in Europe, Wholesale Banking revenue in the June quarter remained consistent with the first half quarterly average revenue. Revenue was down on the prior year, when the business benefited from unprecedented levels of volatility and market disruption driving exceptional sales and trading income.

Wholesale Banking continued to encourage customers back into markets. NAB acted as the arranger and joint lead manager for the Members Equity Bank multi-currency Australian Residential Mortgage Backed Securities, the first multi-currency Australian issue since the onset of the financial crisis. NAB was also the sole manager of the first 10 year A$ corporate bond raising since 2006 on behalf of Telstra Corporation for $150 million.

The Peter Lee[2] survey results showed NAB was providing the best advice on foreign exchange and interest rate derivatives to institutional clients, reflecting the cross-franchise expertise and products and services being provided to Business Banking.

Asset quality remained sound, with bad and doubtful debts continuing at low levels. The portfolio is stable with over 90% the equivalent of investment grade.

New Zealand

The economic outlook for New Zealand remains weak, resulting in relatively low demand for both business and consumer credit. Nevertheless, New Zealand Banking revenue for the June quarter grew as the ongoing focus on repricing for risk continued to have a positive impact. Investment in the innovative Retail Store and Partners distribution networks continued, gathering momentum during the June quarter.

Despite the continuation of intense competition for customer deposits, New Zealand Banking maintained market share in the June quarter. Housing and business lending market share also remained stable, while credit cards and agribusiness lending share increased.

Asset quality is stabilising. The ratio of 90+ days past due and impaired assets to GLAs was 1.83% at June, consistent with the 31 March 2010 level.

United Kingdom

The United Kingdom economy showed signs of recovery during the quarter, but overall a cautious outlook remains appropriate. The economy is still absorbing the effects of the June emergency budget that set out the new government's programme for deficit reduction. Financial concerns about European banks are an additional reason for caution.

United Kingdom Banking continues to perform well despite the difficult market conditions. Credit demand remains subdued, although business confidence is showing some signs of improvement. Deposit growth remains strong.

The charge for bad and doubtful debts improved from 2009, although trading conditions remain challenging for businesses and this was reflected in asset quality measures. The ratio of 90+ days past due and gross impaired assets to GLAs increased to 3.36% from 2.98%. The coverage ratio of total provisions to GLAs has also increased to 1.51% in June 2010 from 1.40% in March 2010.

Specialised Group Assets

The United Kingdom and United States economies, although showing signs of recovery, remain fragile and are a strong influence on the Specialised Group Assets portfolio which comprises non-franchise assets.

Increased credit spreads, due to market conditions, created some adverse accounting volatility in the risk mitigation trades compared to the 31 March 2010 half year quarterly average. There was no material change to the underlying risk position of the Synthetic Collateralised Debt Obligations portfolio.

Bad and doubtful debts were lower during the June quarter than the first half quarterly average.

Group Asset Quality

The ratio of Group 90+ days past due and gross impaired assets to GLA was 1.91% at June 2010 compared to 1.86% at 31 March, primarily associated with Business Banking and United Kingdom Banking.

Collective Provision balances of $3,634 million were stable compared to 31 March 2010, while the collective provision coverage ratio was marginally lower at 30 June 2010. Specific Provision balances have increased to $1,744 million, up from $1,590 million at 31 March and the specific provision coverage ratio was stable.

Total provision balances (including the credit risk adjustment on assets at fair value) as at 30 June 2010 were $5,378 million compared to $5,200 million at 31 March 2010.

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