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NAB 2015 First Quarter Trading Update

Solid result with good progress on strategic priorities

Key Points

The quarterly average of the September 2014 Half Year results is used for comparison purposes unless otherwise stated. First quarter 2015 financials have been prepared incorporating the requirements of AASB 9¹, with transitional adjustments reflected in retained earnings. Prior comparative periods have not been restated.

- Unaudited cash earnings² were approximately \$1.65 billion, which is 6% up on the prior corresponding period.
- On a statutory basis, unaudited net profit attributable to the owners of the Company for the December quarter was approximately \$1.80 billion. The main difference between statutory and cash earnings relates to fair value and hedge ineffectiveness, elimination of treasury shares, and distributions.
- On a cash earnings basis:
 - Revenue rose approximately 4%, but excluding gains on the UK Commercial Real Estate (CRE) loan portfolio sale (as announced on 16 December 2014) and SGA asset sales, increased approximately 2%, benefitting from higher markets income and growth in lending balances over the quarter. Group net interest margin (NIM) was flat, but excluding Markets and Treasury was slightly lower.
 - Expenses fell 22%, but increased approximately 4% excluding specified items³ in the September 2014 Half Year. The main drivers include timing of enterprise bargain agreement-related salary increases, normalisation of performance based incentives and investment in the core franchise.
 - The charge for Bad and Doubtful Debts (B&DDs) for the quarter rose 30% to \$227 million, but was stable excluding releases from the Group Economic Cycle Adjustment (ECA) and UK CRE overlay in the September 2014 Half Year.
- The Group's Basel III Common Equity Tier 1 (CET1) ratio was 8.74% as at 31 December 2014, an increase of 11 basis points from 30 September 2014. As previously announced, the Group will target a CET1 ratio of 8.75% - 9.25% from 1 January 2016, based on current regulatory requirements.
- During the quarter NAB increased its share capital by approximately \$1.6 billion through a combination of Dividend Reinvestment Plan (DRP) participation (\$815m) and the partial underwriting of the DRP (\$800m), equivalent to a 44 basis point increase in NAB's CET1 ratio. This partly offset the impact of the final 2014 dividend declaration on CET1.

¹ Note 1 to the Group's financial statements published in the 2014 Annual Financial Report on 17 November 2014 includes further detail regarding AASB 9.

² Refer to note on cash earnings on page 3 of this document.

³ The September 2014 Half Year cash earnings contained a number of specified items totalling \$1.34 billion comprising earnings adjustments relating to UK conduct provisions, capitalised software impairment, deferred tax asset provisions and R&D tax policy change. Further detail can be found on page 20 of NAB's Full Year 2014 Result Announcement.

- For the financial year to date, the Group has raised approximately \$10.7 billion of term wholesale funding. The weighted average term to maturity of the funds raised by the Group for the financial year to date was 4.6 years.
- The Group's Liquidity Coverage Ratio as at 1 January 2015 was 114%.

Executive Commentary

"This is a solid first quarter result, which has seen the continued strengthening of our core Australian and New Zealand franchise and the further reduction of legacy issues," NAB Group CEO Andrew Thorburn said.

"We are making progress against the strategic priorities I announced on 30 October 2014, including our focus on the priority segments in Australia and New Zealand, comprising home loan, SME and Specialised Business customers. We know that we need to maintain this focus, including a balanced approach to investing and the achievement of productivity savings. This will deliver a better experience for our customers and better returns for our shareholders.

"Australian home lending continues to generate strong growth and has now delivered 20 consecutive quarters of above system growth. While the improvement in our core Business Banking franchise will take time, volume growth is now around system levels and we are well advanced on the hiring of additional business bankers. However, we continue to see intense competition for business lending.

"Further significant improvements in asset quality over the quarter are pleasing and reflect both the benign operating environment and the initiatives undertaken over recent years to improve our risk profile.

"Importantly, we also continue to make good progress in dealing to our low returning assets. Following on from the IPO of a 31.8% stake in Great Western Bank in October last year, we sold an additional £1.2 billion parcel of higher risk loans from our UK CRE portfolio in December, reducing the portfolio to approximately £800 million compared to the original balance of £5.6 billion in October 2012," he said.

Business Commentary

Australian Banking cash earnings increased over the period, benefitting from stronger markets income, continued good growth in mortgage lending and improved business lending volumes, partially offset by a lower NIM primarily relating to business lending competition. Over the quarter home lending grew at 1.4x system⁴ while growth in business lending represented 0.9x system⁵.

NAB Wealth cash earnings improved over the quarter benefitting from higher insurance premiums and stable claims and lapses, combined with the impact of higher funds under management.

NZ Banking local currency cash earnings rose over the quarter due to higher revenue from increased loan volumes, and lower B&DD charges.

UK Banking local currency cash earnings increased over the quarter reflecting lower charges for B&DDs. Revenue fell slightly, due to the non-recurrence of a gain arising from a property sale and leaseback transaction in the September 2014 Half Year.

⁴ Source: RBA Financial System / NAB - December 2014.

⁵ Source: APRA Banking System September - December 2014.

Group Asset Quality

Group asset quality metrics improved over the quarter. The ratio of Group 90+ days past due and gross impaired assets to gross loans and acceptances was 0.88% at 31 December 2014 compared to 1.19% at 30 September 2014.

The ratio of collective provision to credit risk weighted assets was 1.01% at 31 December 2014, compared to 0.83% at 30 September 2014, with the increase over the period reflecting transition to AASB 9¹. The ratio of specific provisions to impaired assets at 31 December 2014 remained stable over the quarter at 35.3%.

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Disclaimer

This announcement contains certain forward-looking statements. The words "anticipate", "believe", "expect", "project", "estimate", "likely", "intend", "should", "could", "may", "target", "plan" and other similar expressions are intended to identify forward-looking statements. Indications of, and guidance on, future earnings and financial position and performance are also forward-looking statements. Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of the Group, which may cause actual results to differ materially from those expressed or implied in such statements. There can be no assurance that actual outcomes will not differ materially from these statements. Further information on important factors that could cause actual results to differ materially from those projected in such statements is contained in the Group's Annual Financial Report.

Note on Cash Earnings

Full detail on how cash earnings is defined, a discussion of non-cash earnings items and a full reconciliation of statutory net profit attributable to owners is set out on pages 2 to 8 of the 2014 Full Year Results Announcement under the heading "Profit Reconciliation".

The Group's results and Review of Divisional Operations and Results are presented on a cash earnings basis, unless otherwise stated. Cash earnings is a key financial performance measure used by NAB, the investment community and NAB's Australian peers with a similar business portfolio. NAB also uses cash earnings for its internal management reporting, as it better reflects what NAB considers to be the underlying performance of the Group. It is not a statutory financial measure and is not presented in accordance with Australian Accounting Standards nor audited or reviewed in accordance with Australian Auditing Standards. "Cash earnings" is calculated by excluding some items which are included within the statutory net profit attributable to owners of the Company. Section 5 of the 2014 Full Year Results includes the Consolidated Income Statement of the Group, including statutory net profit attributable to owners of the Company. The Group's financial statements, prepared in accordance with the Corporations Act 2001 (Cth) and Australian Accounting Standards, and audited by the auditors in accordance with Australian Auditing Standards, were published in its 2014 Annual Financial Report on 17 November 2014.