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ASX ANNOUNCEMENT

Thursday, 8 May 2014

NAB 2014 Half Year Results

Growth in earnings benefits from lower loan losses

Key Points

The March 2014 half year results are compared with March 2013 half year results unless otherwise stated.

- On a statutory basis, net profit attributable to owners of the Company was $2.86 billion, an increase of $390 million or 15.8%.
- Cash earnings[1] were $3.15 billion, an increase of $247 million or 8.5% on the March 2013 half year, reflecting improved performances from all of our banking businesses partly offset by higher UK conduct related charges. The main difference between statutory and cash earnings relates to the elimination of treasury shares coupled with the effects of fair value and hedge ineffectiveness.
- On a cash earnings basis:
    - Revenue increased by 2.6%, but decreased by 1.2% if foreign exchange movements are excluded. Group net interest margin (NIM) was 1.94%, down 9 basis points on the March 2013 half year, of which 3 basis points is attributed to increased holdings of liquid assets and marketable securities. Customer[2] NIM was flat reflecting lower deposit, funding and liquidity costs, offset by increased lending competition.
    - Expenses at a headline level rose 11.6%, largely driven by movements in foreign exchange rates and higher UK conduct related charges. Excluding these items operating expenses increased by 2.9% and compared to the September 2013 half year increased by 0.4%.
    - The charge for bad and doubtful debts (B&DDs) was $528 million, a 52% reduction from the prior corresponding period and 37% lower than the charge for the September 2013 half year. Lower loan losses in Australian Banking and the UK businesses were the main contributors to the reduction.
- For the financial year to date, the Group has raised approximately $16 billion of term wholesale funding (including approximately $3.6 billion of secured funding). The weighted average term to maturity of the funds raised by the Group for the financial year to date was 5.1 years. The stable funding index was 89.6% at 31 March 2014, a 0.4 percentage point increase on 30 September 2013.

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[1] Refer to note on cash earnings on page 4 of this document.

[2] Customer margin comprises the following components of net interest margin: lending margin, deposits, funding and liquidity costs and liability mix. It excludes lending mix and other components of net interest margin.

- The Group's Basel III Common Equity Tier 1 (CET1) ratio was 8.64% as at 31 March 2014, an increase of 21 basis points from 30 September 2013. In light of APRA's recently released framework in relation to Domestic Systemically Important Banks (D-SIBs), NAB intends to operate a CET1 ratio between 8.75% and 9.25% from 1 January 2016. APRA's recent announcement regarding inclusion of intermediate holding companies (principally National Wealth Management Holdings Limited) within the Level 2 Approved Deposit-taking Institution (ADI) group is expected to impact CET1 capital by $1.97 billion (currently equivalent to 53 basis points). NAB is well placed to organically meet this requirement over the transitional period to December 2017 and will also explore mitigating actions to reduce the impact.
- The interim dividend is 99 cents per share fully franked, an increase of 6 cents per share on the prior interim dividend. The dividend reinvestment plan (DRP) discount remains nil, with no participation limit. NAB will not be neutralising the new shares issued from this period's DRP.

<u>Executive Commentary</u>

"The Group achieved a good result for the six months ended 31 March 2014, with progress on a number of fronts," National Australia Bank Group CEO, Cameron Clyne said today.

"The economic environment continued to improve during the period. This is evident in the UK where confidence and economic growth have risen again and become more broad based. In Australia, the housing sector has strengthened further, and improved business confidence, along with corporate gearing at near 20 year lows, makes us optimistic about the business sector and potential for a recovery in business credit growth. However, against this backdrop competition remains elevated in our main markets and regulatory costs are rising.

"This result shows continued momentum in our Australian franchise with good growth over the year in home lending, up 5.8%, and retail customer satisfaction increasing 120 basis points[3]. Our business customer satisfaction has also improved over the 12 months to March 2014 in small and large segments[4]. NAB Wealth's results show early signs of the new team and strategy gaining traction, with retention initiatives delivering improved insurance lapse performance over the year, and closer integration between Australian Banking and NAB Wealth driving good growth in corporate super flows.

"Also pleasing was the further improvement in the performance of our UK businesses with UK Banking continuing to benefit from the restructure undertaken in 2012 and the recovery of the UK economy. We achieved further material run-off in the NAB UK Commercial Real Estate (NAB UK CRE) portfolio during the half year and continue to look at options to accelerate that progress.

"A major contributor to this result is the significant work undertaken over the past five years to reduce risk in our business. We have reduced exposure to higher risk segments including NAB UK CRE and parts of Australian business lending, and increased home lending exposure. While not without some cost in terms of business volumes and revenue, the benefits can be seen over the 12 months to 31 March 2014 in a material reduction in our B&DD charges, down 52%, and an $8.1 billion reduction in credit risk weighted assets attributable to improved credit quality and portfolio mix.

[3] Roy Morgan Research, Aust MFIs, population aged 14+, 6 months to March 2013 and 6 months to March 2014. Customer satisfaction is based on customers who answered very/fairly satisfied.

[4] DBM Consultants Business Financial Services Monitor 6 month rolling averages, Small ($1m - $5m), Medium ($5m - $50m), and Large ($50m+) Business Segments, March 2014. Differences not statistically significant.

"This is the first result reported under the new operating structure for our Australian businesses. The model, now fully implemented, aligns our organisation to the external environment and evolving customer behaviours, and is based around the key themes of simplification and digitisation.

"The transformation across our technology environment continues to make the experience easier for customers and employees. In March we installed the Direct Banking Release, a major milestone in progress towards the future deployment of NextGen into the core NAB franchise for origination and servicing of personal banking products. In April we launched a major upgrade and simplification of our on-line business banking portal, nabConnect, now hosted on NAB's private cloud, providing significant speed and usability benefits."

Business Commentary

Australian Banking cash earnings were $2,474 million, an increase of 1% on March 2013, with a lower charge for B&DDs the main driver. Revenue was down 1% with weaker margins partly offset by good growth in mortgage lending. NIM declined 4 basis points to 1.63%, driven by lower earnings on capital, higher holdings of liquid assets and marketable securities, and increased competition. Customer NIM was flat. The charge for B&DDs decreased by $218 million, down 37%, primarily attributable to lower specific charges and improved default rates across the business lending portfolio.

NAB Wealth cash earnings were $174 million, flat on March 2013. Income benefitted from strong growth in funds under management as a result of investment markets performance and positive net funds flow over the last three halves. However, this was offset by higher group insurance claims and higher costs to support regulatory change initiatives. Excluding costs supporting regulatory change, operating expenses remained flat. The continuation of insurance retention and claims management initiatives implemented over the last 12 months has led to improved results in these areas.

NZ Banking local currency cash earnings rose 3% over the March 2013 half year to NZ$400 million. Good growth in business lending, tight management of costs and lower loan losses were the main contributors. Asset quality indicators improved over the period.

UK Banking cash earnings improved to £73 million, up 121% on the March 2013 half year. Lower conduct related costs and a lower charge for B&DDs, down 40% to £55 million, were the main reasons for the improvement. However, total UK conduct related costs for the period totalled £128 million including £115 million reported in the Group Corporate Centre reflecting increased provisions relating to interest rate hedging products and certain tailored business loans. There remains a wide range of uncertain factors relevant to determining the total costs associated with conduct related matters and there is risk that additional provisions will be required.

Cash earnings in the NAB UK Commercial Real Estate (CRE) run-off portfolio improved in the half year to a loss of £7 million, compared to a £149 million loss in the March 2013 half year and a loss of £90 million in the September 2013 half year. The better performance was due to a much lower charge for B&DDs, with a slowdown in the emergence of new impaired loans, recoveries on existing impaired exposures and a £25 million reduction in the UK CRE overlay to £74 million. The portfolio continues to decline with the balance reducing by a further £0.7 billion over the half to £3.3 billion. Net of provisions, the outstanding balance is now £2.9 billion.

Great Western Bank cash earnings rose by US$8 million or 14% over the March 2013 half year to US$63 million. The increase was driven by lower operating expenses and a reduction in charges for B&DDs. Asset quality indicators improved over the half.

Group Asset Quality

Group asset quality metrics improved over the six months ended March 2014. The ratio of Group 90+ days past due and gross impaired assets to gross loans and acceptances was 1.52% at 31 March 2014 compared to 1.69% at 30 September 2013.

The ratio of collective provision to credit risk weighted assets was 0.91% at 31 March 2014, 3 basis points lower than at 30 September 2013. The reduction in the ratio is the result of several factors including a £25m release from the NAB UK CRE overlay, improved asset quality across the non-retail portfolio and housing lending growth which attracts a lower collective provision. The ratio of specific provision to gross impaired assets was 34.8% at 31 March 2014 as compared to 32.0% at 30 September 2013.

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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 for the half year ended 31 March 2014 is set out on pages 2 to 7 of the 2014 Half 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. The Group's financial statements, prepared in accordance with the *Corporations Act 2001* (Cth) and Australian Accounting Standards, and reviewed by the auditors in accordance with Australian Auditing Standards, are included in Section 5 of the 2014 Half Year Results Announcement.