Media statement

Thursday 27 October 2016

Investment delivers strong volume growth for BNZ

Strong performance across small, medium and large business banking and growth in retail, offset by volatility in markets and debt instruments, has seen Bank of New Zealand (BNZ) report a statutory net profit for its banking group[1] of NZ$913 million for the year to 30 September, 2016.

The New Zealand Banking Operations[2] saw cash earnings[3] increase $13 million year on year with a particularly strong second half driven by solid revenue growth and a lower charge for bad and doubtful debts.

"Our strategy is delivering for the bank, despite a challenging year in a highly competitive banking environment and with higher funding costs affecting margins," said BNZ CEO Anthony Healy.

Key results: *(comparisons are to year-end 30 September 2015, for both banking group and New Zealand banking operations)*

BNZ banking group[1]

- **Statutory net profit**[1] of NZ$913 million, NZ$125m less than last year, due to lower trading income in BNZ markets, and losses on hedging derivatives from both the strengthening NZD and interest rate movements.
- **Cash earnings**[3] decreased by NZ$33 million or 3.4%.
- **Common Equity Tier 1, Tier 1 and total capital ratios**[1] of 10.21%, 10.54% and 12.04%, respectively.

New Zealand banking operations[2]

- **Underlying profit**[2] increased by NZ$11 million due to higher revenue, partly offset by higher expenses.
- **Cash earnings**[3] showed an increase of NZ$13 million or 1.6% to $836 million, assisted by a lower charge for bad and doubtful debts reflecting the strength of economic conditions outside the dairy sector.
- **Net interest income**[2] decreased by $7 million or 0.4% as lower product margins were partly offset by higher volume growth.
- **Net interest margin**[2] decreased by 19 basis points to 2.25% reflecting the competitive market environment, lower wholesale interest rates and rising funding costs.
- **Other operating income**[2] increased by NZ$26 million or 5.6%, due mainly to increased revenue from the retail wealth segment and improved revenue from the credit card portfolio.
- **Operating expenses**[2] increased by NZ$8 million reflecting investment in priority segments such as digital, SME, broker and Auckland.
- **Charges for bad and doubtful debts**[2] decreased by NZ$9 million or 6.7%. Lower specific provisions broadly reflected the strength of economic conditions. This was partly offset by higher general provisions, being mainly due to the dairy sector downturn in the first half.
- **Average customer deposits**[2] increased by NZ$3.7 billion or 8.2% with spot balances growing by NZ$4.7 billion.
- **Average lending volumes**[2] increased by NZ$5.0 billion or 7.6% with spot balances growing by NZ$6.1 billion. Average housing volumes increased by NZ$2.1 billion or 6.6% and business lending by NZ$3.0 billion or 9.2%.

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. "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.
3. 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 NAB Group policy.

Commentary – Anthony Healy

Digital investment

"Our digital investment is delivering a compelling customer experience, which was acknowledged when BNZ was ranked top of the banking sector in the SAP Digital Experience report. We're the only New Zealand bank offering the security and convenience of fingerprint login for our apps, which accounts for almost one in five mobile logins.

"Our biggest store is our digital store – the vast majority of our customers transact with us digitally and 89% of transactions are now either through internet banking or our app – that is 13.2m sessions each month. This is a 21% increase overall and mobile is up 36%.

"We migrated 500,000 customers to a new online banking platform, and in doing so rationalised thousands of accounts and products. We encourage our customers to increase their home loan payments through internet banking, and we have a compelling new feature that shows how a small repayment reduces the term and the interest paid. Since launching this feature, around 1,600 customers have already cut 7,000 years off their home loans."

Business banking

"We were awarded Canstar New Zealand's Best Small Business bank for the sixth year in a row and we continued our commitment to meeting the needs of these customers by opening a new small business hub in Hamilton and hiring new small business specialists in Auckland and Christchurch.

"Across SME we've seen extremely strong revenue growth of 9.1% year-on-year. Our business banking model is market leading and our support of regional New Zealand can be seen through our 34 Partners Centres. This support will continue with the opening of our new BNZ Centre in Christchurch in December."

Auckland

"Our Auckland strategy has delivered growth within our existing risk appetite. We've targeted the housing and SME segments and both have seen strong volume increases. We continue to play an important role in helping support infrastructure growth and addressing housing supply issues."

Mortgage market

"We have retained our market share thanks to a focus on sustainable growth and our re-entry to the broker market has played a big part of that, with $1.8 billion in home loans written through broker this year. This year we have appointed four new broker partners: Mortgage Express, Global Financial Services, Kepa and Mortgage Link.

"Housing affordability continues to be an issue, and as long as migration and supply are key factors the recent loan-to-value restrictions will only have a short term effect. Like all banks, we anticipate that there will be increased pressure on lending margins in the coming months which will influence interest rates."

Agribusiness

"We have worked as a true partner to our dairy customers and I believe our management of the downturn has been market leading. We managed our risks well and took a prudent approach to our dairy lending, making provisioning decisions early. The outlook could be turning for the positive, but while there is still some uncertainty we will retain our prudent approach.

"In April, we announced an investment in cloud-based farm accounting software provider Figured Limited, making it easier for farmers to work with their accountants, farm consultants, and rural bankers.

"The challenges of dairy, which makes up about 57% of our agribusiness lending, have been noted. But it's important to acknowledge that many of our other customers in sheep and beef, forestry, kiwi and pip fruit and viticulture have had a very strong year."

Contribution to a high-achieving New Zealand

"The expansion of the Community Finance Initiative is a real highlight. We are working in partnership with the Government and Good Shepherd to offer this service in new areas including Wellington, Invercargill, Whangarei, Palmerston North and Christchurch. Community finance offers low and no income loans to New Zealanders who typically don't meet bank criteria, and have exhausted WINZ options. We estimate that our $700,000 of community finance lending has saved our clients more than $380,000 compared with borrowing through alternative lenders."

Capital and Funding Position

BNZ maintains a robust capital structure, with a strong balance sheet that is well funded through diversified and stable funding sources. BNZ's Core Funding Ratio (CFR) of 86.07% exceeds the Reserve Bank of New Zealand minimum requirement of 75% as at 30 September, 2016. BNZ's Common Equity Tier 1, Tier 1 and Total capital ratios of 10.21%, 10.54% and 12.04%, respectively, as at 30 September 2016 were well above the RBNZ minimum capital ratio requirements of 7.00%, 8.50% and 10.50%, respectively. Collectively, BNZ's funding and capital position is supportive of BNZ's long-term senior unsecured issuer credit ratings of AA-/Aa3/AA- (S&P/Moody's/Fitch).

BNZ's 2016 capital levels were impacted by the amortisation and redemption of Basel II transition eligible capital instruments totalling NZ$785m. In October 2016, BNZ strengthened its capital position by issuing NZ$900 million of mandatorily convertible subordinated perpetual unsecured notes ("Notes") to its ultimate parent, National Australia Bank Limited ("NAB"). This new capital instrument qualifies as Additional Tier One capital of BNZ for regulatory purposes. Subsequent to the Notes issuance, the capital ratios of BNZ for Tier 1 and Total capital would have been 1.48% higher than those reported as at 30 September 2016.

ENDS

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BNZ Banking Group

Income Statement Summary

	Sep 16 NZ$m	Sep-15 NZ$m	Sep 16 v Sep 15 %
Net interest income	**1,757**	1,735	1.3%
Gains less losses on financial instruments	**106**	322	(67.1%)
Other operating income	**406**	375	8.3%
Total operating income	**2,269**	2,432	(6.7%)
Operating expenses	**889**	865	(2.8%)
Total operating profit before impairment losses on credit exposures and income tax expense	**1,380**	1,567	(11.9%)
Impairment losses on credit exposures	**120**	128	6.3%
Total operating profit before income tax expense	**1,260**	1,439	(12.4%)
Income tax expense on operating profit	**347**	401	(13.5%)
Net profit attributable to shareholders of Bank of New Zealand	**913**	1,038	(12.0%)

Balance Sheet Summary

	Sep-16 NZ$m	Sep-15 NZ$m	Sep 16 v Sep 15 %
Assets			
Cash and liquid assets	**1,799**	1,634	10.1%
Due from central banks and other institutions	**2,299**	2,009	14.4%
Trading securities	**4,703**	4,918	(4.4%)
Derivative financial instruments	**7,319**	7,895	(7.3%)
Loans and advances to customers	**74,378**	68,216	9.0%
Other assets	**2,043**	2,115	(3.4%)
Total assets	**92,541**	86,787	6.6%
Liabilities			
Due to central banks and other institutions	**1,244**	1,439	(13.6%)
Short term debt securities	**6,030**	5,027	20.0%
Derivative financial instruments	**7,786**	8,310	(6.3%)
Deposits from customers	**51,481**	46,729	10.2%
Bonds and notes	**16,723**	16,156	3.5%
Other liabilities	**2,272**	2,084	9.0%
Total liabilities	**85,536**	79,745	7.3%
Total shareholders' equity	**7,005**	7,042	(0.5%)

Performance Measures[1]			
Net profit on average assets	**1.01%**	1.27%	(26 bps)
Net interest margin[3]	**2.19%**	2.33%	(14 bps)
Cost to income ratio	**39.2%**	35.6%	361 bps

Capital Adequacy Ratios[2]

	Sep 16 Basel III	Sep 15 Basel III	Sep 16 v Sep-15
Common Equity Tier One capital ratio	**10.21%**	10.70%	(49 bps)
Tier One capital ratio	**10.54%**	11.69%	(115 bps)
Total qualifying capital ratio	**12.04%**	12.67%	(63 bps)
Buffer ratio for Common Equity Tier One capital	**4.04%**	4.67%	(63 bps)

1. Performance measures are based on the BNZ Banking Group which excludes the Insurance operation in New Zealand and includes BNZ's Group Capital Management and BNZ Markets operations. Performance measures are calculated on a net profit basis.
2. Based on the RBNZ's Capital Adequacy Framework.
3. September 2015 restated due to change in methodology of Interest earning assets to exclude mortgage offset accounts.

New Zealand Banking operations

	Sep 16 NZ$m	Sep 15 NZ$m	Sep 16 v Sep 15 %
Net interest income	**1,617**	1,624	(0.4%)
Other operating income	**494**	468	5.6%
Net operating income	**2,111**	2,092	0.9%
Operating expenses	**(834)**	(826)	(1.0%)
Underlying profit	**1,277**	1,266	0.9%
Charge to provide for bad and doubtful debts	**(125)**	(134)	6.7%
Cash earnings before tax	**1,152**	1,132	1.8%
Income tax expense	**(316)**	(309)	(2.3%)
Cash earnings (NZ Banking)[1]	**836**	823	1.6%

Reconciling items to statutory net profit (BNZ Banking Group)

Structural differences between NZ Banking and BNZ Banking Group[2]	**97**	143	(31.9%)
Cash earnings (Legal Entity)	**933**	966	(3.4%)
Fair value movements and hedging gains/(losses)[3]	**(28)**	100	128.0%
Taxation on reconciling items	**8**	(28)	(128.6%)
Net profit attributable to shareholders of Bank of New Zealand[4]	**913**	1,038	(12.1%)

Average Volumes (NZ$bn)[5]			
Gross loans and acceptances	**70.8**	65.8	7.6%
Interest earning assets[6]	**71.9**	66.6	8.0%
Total assets	**73.9**	68.6	7.7%
Customer deposits	**48.6**	44.9	8.2%

Performance Measures[5]			
Cash earnings on average assets	**1.13%**	1.20%	(7 bps)
Net interest margin[6]	**2.25%**	2.44%	(19 bps)
Cost to income ratio	**39.5%**	39.5%	-

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 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.
6. September 2015 restated due to change in methodology of Interest earning assets to exclude mortgage offset accounts.