

# Media Release



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## ANZ Trading Update

In a shareholder update today after four months of trading, ANZ said its underlying business was continuing to perform well with Full Year 2009 cash earnings\* expected to be around 2008 levels despite the challenges posed by the deterioration in both the global and domestic economic environments.

### Key Points

- Year-to-date underlying business performance remains resilient, with strong revenue trends in a number of businesses.
  - Asia Pacific profit after tax up circa 125%
  - Institutional performing well, particularly in Global Markets
  - Australian income and margin trends positive with profit before provisions growth around 14%.
- Cash earnings for the first four months, excluding provisions and credit intermediation trades, were up 18% compared to the same period in 2008.
- Volatility in global credit markets continues to impact the credit intermediation trades with a further mark to market charge of \$370 million after tax taken year-to-date.
- Provisions for the full year are expected to be higher than 2008 but more evenly spread across the year, in line with current market consensus of between \$2.4 billion to \$2.5 billion.
- ANZ's proforma tier one capital ratio at the end of January 2009 was 8.4%.\*\* Organic capital generation will be further strengthened through the adoption of a more appropriate dividend policy for the current conditions with the dividend for 2009 expected to be reduced by around 25% and to be fully franked.
- ANZ continues to maintain a strong balance sheet including liquidity positioning, deposit growth and term funding.

ANZ Chief Executive Officer Mike Smith said: "Given the challenges ANZ faced from the global economic downturn and volatility in financial markets, our strategy and the actions taken last year to prepare ourselves for the new economic reality are paying off.

"While Australia is better positioned than most other countries and has been remarkably resilient so far, it has not given us immunity – nor will it this year. We are also facing difficult conditions in New Zealand.

\* Adjusted for non-core items (i.e. significant items and non-core income arising from use of derivatives in economic hedges and fair value through profit and loss).

\*\* 8.4% allows for the impact of reduced dividend payment.

“In this environment, our underlying business is travelling well. We are continuing to deal with legacy issues, managing the impact of the financial crisis and implementing our super regional strategy. The positive results, particularly from Asia Pacific and progress in turning around Institutional, demonstrate we are addressing current critical issues while not neglecting our longer term positioning.

“Importantly, we have strengthened our balance sheet through increased provisioning, significantly increased liquid assets, improved our tier one capital position; recognised the need to move to a more appropriate dividend payout ratio for the current conditions and strengthened our management bench in particular by increasing the number of senior executives with deep banking experience,” Mr Smith said.

### **Group Performance Overview**

There was a pronounced difference between trading conditions in the first half of 2008 compared to the second half, during which the rapid deterioration in financial markets gave rise to sharp increases in provisions for impaired loans and credit intermediation trade valuations. As a consequence, first half growth compared to the prior comparable period will be much weaker than for the full year.

Pro-forma statutory unaudited profit after tax for the period ended January 2009 was around \$1.2 billion, a decrease of 11% over the corresponding period in 2008. This includes around \$330 million after tax principally in mark to market gains on economic hedging which we regard as a non-core item (2008 year-to-date \$70 million) and the impact of the credit risk on derivatives charge related to credit intermediation trades of \$370 million after tax. Excluding these items, profit was down 4% on the same period in 2008.

Income growth (excluding the credit intermediation trades) has been strong, up 16% (FX adjusted) on the prior corresponding period, assisted by an improvement in the Group net interest margin (excluding Global Markets) and the weaker Australian Dollar. Global Markets has achieved record income based on the volatile conditions and customer flows with the strongest results coming from Asia, New Zealand and Europe/Americas.

Expense growth compared to the prior corresponding period was 14% (FX adjusted), largely driven by one off costs associated with the One ANZ restructuring program (5%), the continued expansion of the Asia Pacific division (4%) and remediation costs in Institutional. Expense growth for the New Zealand and Australia businesses has been in the low-to-mid single digits.

Profit before provisions (and excluding credit intermediation trades) is up 18% for the first four months with all divisions, except New Zealand, reporting double digit growth.

A one off cost of \$110 million, most of which has already been incurred, will be taken in the first half in relation to the One ANZ program.

A charge of \$130 million will be taken against revenue relating to ANZ's 49% share of the costs associated with a recent offer to investors in two of ING New Zealand's frozen funds.

The credit provision charge for the first four months was around \$800 million and is running higher than the average charge for the 2008 year.

The credit risk on derivatives charge associated with the credit intermediation trades was \$370 million after tax at the end of January 2009 compared to \$11 million for the same period in 2008. This compares to the charge of over \$280 million after tax disclosed on 23 October 2008. This mark-to-market charge will continue to be volatile.

## **Divisional Performance**

In Australia while volume growth has slowed, income and margin trends are more positive. Profit before provisions growth was around 14% despite significantly reduced earnings from ING Australia. Higher credit provisions in the period however have led to flat profit growth.

In Institutional (excluding credit intermediation trades), the year has commenced well with record Global Markets earnings, recovery in margins as repricing starts to flow through and mark to market gains on hedging of customer exposures. Expense growth in Institutional is largely being driven by the Asia Pacific expansion and costs associated with remediation activities. It is expected ANZ will take write downs against income this half of around \$100 million on assets contained in businesses being exited as part of the Institutional restructure including private equity and alternative assets.

In New Zealand, volume growth has been flat and margins under pressure due to higher wholesale funding costs, competition for deposits and break costs on mortgages as customers take advantage of lower interest rates. Costs are being well controlled but increased credit provisions will drive a reduction in earnings in New Zealand in 2009.

There has been recent publicity in New Zealand regarding certain frozen funds managed by our joint venture partner ING. Some of these funds were sold to ANZ customers. ING New Zealand yesterday made an offer to unit holders that allows them either a guaranteed value in five years time or the ability to exit the investment immediately for a cash settlement. ANZ's share of the current cost of this offer is around \$130 million which will be taken as a charge against revenue. The ultimate cost to ANZ will depend on the final value of the units and recoveries under ANZ insurance policies.

The Asia Pacific business continues to perform strongly with profit more than double the same four month period in 2008. Cost growth remains high reflecting the organic growth focus but is matched by revenue growth which is funding investment in the franchise.

## **Credit Environment**

ANZ's total credit impairment charge (collective provision and individual provision) is running at a higher level than the average run rate for 2008 and in line with the current market consensus average of between \$2.4 billion to \$2.5 billion. Understandably, the outlook is sensitive to the rate of slowdown in the Australian and New Zealand economies.

Institutional credit losses are tracking around 2008 levels. As expected at this stage of the cycle, downgrades in the portfolio are running ahead of upgrades and watch lists have been increased in order to systematically monitor emerging issues.

In Australia, as anticipated the slowing economic conditions are flowing through to considerably higher individual and collective provisions principally in consumer finance and Esanda. Mortgage arrears are tracking up slightly but within expectations. Home loan customers are benefiting from lower interest rates and the Australian government's stimulus packages. Since rate cuts began last year the proportion of customers making more than the minimum repayment on variable rate loans has doubled, from 35% to 74%. Credit card arrears, while up slightly, are being well controlled.

In the Australia commercial portfolio, arrears in business banking and the regional and rural portfolio are only marginally up on a year-on-year basis. Small and medium sized business delinquencies have increased more significantly albeit off a low base and the dollar impact is small. ANZ is working closely with its small business customers to manage through this period of the cycle.

The New Zealand economy has contracted sharply with delinquencies subsequently rising strongly off an historically low base but within expectations. It is anticipated that provisions could approach double those of last year (FY08 NZ\$286 million). Business lending arrears remain on par with the end of 2008. Unsecured lending delinquencies, including credit cards have increased, as expected in this part of the cycle, however tight control measures are in place.

New Zealand customers moving out of fixed rate home loans this year (fixed rate home loans account for around 80% of mortgage lending) will benefit from a circa 2% reduction in mortgage rates compared to 2006. The decline in the New Zealand Dollar has provided some buffer to the impact of falling commodity prices and lower export demand.

Growth in the Asia Pacific region, although slowing, remains above the rest of the developed world and over time will be significantly faster growing and larger than many western economies. Our Institutional strategy in this region is driven by customer relationships around cash management, markets and trade finance. The retail strategy is designed around a differentiated brand with a clear competitive advantage that in turn will drive a stronger deposit base. Expectations are that provisions for the Asia Pacific division (excluding Institutional) will be around 70% (FY08 approximately \$44 million) driven largely by growth in the business.

### **Credit Risk on Derivatives**

Charges for credit risk on derivatives (included in income) are expected to be substantial again in 2009. Further increases in credit spreads, downgrades and decline in the Australian Dollar have led to increased charges with the January year-to-date charge at \$370 million after tax. Around one-third of the increase is exchange rate related.

We expect the credit risk on derivative mark to market charge to remain volatile but to significantly reverse over future periods.

### **Capital and Dividend Policy**

ANZ flagged in 2008 that the global economic slow down was likely to be significant and protracted in many parts of the world and the Group's capital planning for both 2008 and 2009 has reflected this.

The Group's proforma tier one capital ratio at the end of January 2009 was 8.4%. This is substantially above both the regulatory minimum as well as ANZ's internal target range of between 7.5% and 8%, and compares well with both local and international peers.

Consideration has also been given to the impact on franking capacity of more subdued Australian earnings, the increased proportion of earnings generated outside Australia and the higher numbers of shares on issue.

In 2009, capital initiatives will include:

- a reduction of the dividend for 2009 to be determined when actual results are known but expected to be around 25% which will improve organic capital generation by approximately \$500 million per annum;
- continuing to pursue opportunities for hybrid equity issues.

While the amount of the Interim and Final dividends will be set based on the actual results for the year, a lower payout provides more flexibility and more certainty that full franking can be maintained given the percentage of ANZ's profit delivered from outside Australia. At current share prices, the dividend yield following the expected dividend reduction is around 8% fully franked.

Mr Smith said: "We see these steps as measured and sensible in light of the economic conditions facing the market. While I know reducing dividends impacts on all shareholders, particularly individuals, it is in the best long term interests of all our shareholders in this environment."

## Balance Sheet and Funding

Year-to-date, ANZ has issued \$15.8 billion of term debt, equivalent to 70% of the 2009 term funding requirement, with an average term of 3.9 years. The prime liquidity portfolio is currently around \$55 billion sufficient to cover over a year of offshore wholesale debt maturities.

Overall deposit growth has remained strong, with ANZ's total deposit portfolio increasing almost \$9 billion year-to-date, an annualised growth rate of 12% (FX adjusted). Competition for deposit volumes remains strong, which is reflected in deposit pricing.

Mr Smith commented: "We remain confident in our position and the future at a time when many banks around the world are facing very significant difficulty.

"The action being taken in Australia to address the deteriorating economic outlook through monetary and fiscal stimulus is considerable and welcome. Equally, we believe Australia's economic slow-down will not be as deep or as long as many other OECD economies and that Asia will continue to be an engine for growth for the global economy.

"Our underlying business is travelling well and we are continuing to take the necessary actions to create the right foundation for our business. We have the right strategy to come through this part of the cycle as a stronger, successful super regional bank," Mr Smith said.

A conference call for analysts and investors will be held at 9.30am today with Chief Executive Officer, Mike Smith and Chief Financial Officer, Peter Marriott. This call can be accessed live at <http://www.anz.com/aus/shares/presentations/default.asp>, an archived copy of the call will also be available on the website.

ANZ will report its Interim Results for the period ended 31 March 2009 in Melbourne on Wednesday, 29 April 2009. The date has been changed to bring the Half Year reporting in line with the timing of the Group's US (Rule 144A Program) reporting.

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