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ASX Announcement

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NAB reports 9.4% fall in cash earnings

Key Points[1]

- Cash earnings fell by 9.4% to $2.0 billion reflecting tough market conditions, which further deteriorated during the half year to March 2009. The fall in cash earnings was largely due to increased charges for bad and doubtful debts and higher funding costs. Statutory profit decreased marginally to $2.7 billion.
- Group revenue increased by 11.5% to $8.5 billion, primarily because of the strong performance of Australia Banking and the Global Markets division of nabCapital. Australia Banking revenue benefited from increased market share in business banking and effective margin management. Revenue was weaker in the United Kingdom, due to significantly higher unrecovered funding costs, and in MLC due to weak investment markets. New Zealand Region revenue improved by 5.2%.
- Group cost growth was 2.7% on a like-for-like basis[2], excluding foreign exchange movements. (Unadjusted up 4.8% on the previous March half year.)
- Consistent with the challenging operating conditions, asset quality continued to decline with the six monthly charge for bad and doubtful debts increasing from $0.7 billion to $1.8 billion.
- Conservative funding and liquidity positions were retained. The group funding task for the full year is more than 86% complete and liquid asset holdings remain well above regulatory requirements.
- The Tier 1 capital ratio remains strong at 8.31%. The Group continues to target a strong capital position as one of its main priorities. In line with this objective, the half year dividend reinvestment plan will be partially underwritten to raise $500 million in additional capital and we remain open to opportunities to raise hybrid Tier 1 capital.
- Interim dividend has been reduced by 24.7% or 24 cents to 73 cents, fully franked.
- NAB continues to support the communities it serves. In Australia this included a leading microfinance program to support people excluded from mainstream banking, the Schools First program, nab's Indigenous Reconciliation Plan, and the response to the Victorian bushfires. In international operations, key charitable partners include Help the Hospice and the National Trust in the United Kingdom, the BNZ Save the Kiwi Trust and Preventing Violence in the Home in New Zealand, Earthwatch in nabCapital and in the US Great Western Bank supports local community affordable housing projects.

[1] March 2009 half year compared with March 2008 half year unless otherwise stated.

[2] Excludes expenses for Great Western Bank. Completion of the purchase of Great Western Bank took place in June 2008 and therefore Great Western Bank expenses were not part of the comparative March 2008 half year.

Overview

"The fall in cash earnings reflects the tough economic conditions that continued to deteriorate as the half year progressed. We continued to grow revenue while carefully managing costs, but this was offset by increased bad and doubtful debts and higher funding costs," NAB Group Chief Executive Officer Cameron Clyne said.

"Collective provision coverage has been increased and includes an additional $86 million that has been added to the economic cycle reserve to take this amount to $300 million. The original amount of $214 million was applied in March 2008 in response to the uncertain global economic environment.

"Actions were taken to address the deterioration in asset quality. These included ongoing detailed portfolio reviews, assigning additional resources to work with customers experiencing difficulties, an intensified focus on early identification of problem loans, as well as increased resources in the collections area.

"Growth in average lending of 10.3%, despite slower system lending growth in all the markets in which we operate, shows we have continued to support our customers.

"In managing our business for the economic downturn we recognised customers, employees, shareholders and the community all needed to be considered. This has been a challenging task as their interests are often divergent.

"Our approach has been to be upfront and open with the reasons for our decisions and focus on what we can control, namely the strategic objectives I outlined last month of keeping the bank stable and secure, controlling costs and investing in leadership, reputation and culture.

Capital and Funding

"To create the basis for improved total shareholder return, maximise opportunities for our employees and support our customers, we continued to look after the foundations of the business. The first priority was to maintain a strong capital and funding position, although this comes with a short term cost to earnings and to dividend. While conditions remain challenging, we will continue to focus on capital as a priority.

Cost Control

"Good cost control is now a consistent feature of our business with Group expenses up by 2.7% on a like-for-like basis, excluding foreign exchange movements.

Investment in our people; focusing on Australian franchise

"We have continued to invest in all our businesses with a particular focus on the opportunities in our key Australian franchise, where investment spend was more than $143 million for the half year. The new business structure[3] and executive team is focused on bringing the Group through the current challenging trading conditions in a strong position to benefit once the operating environment improves," Mr Clyne said.

Business Commentary

Australia

Cash earnings before IoRE[4] were up 1.9% to $1.6 billion. The Australian region grew total revenue by 9.6% with both business and retail banking recording double digit revenue growth although this was partially offset by lower wealth management revenue due to weak investment markets.

Costs were carefully managed. The Efficiency, Quality & Service program is now in its fourth year and cumulative savings are now nearly $700 million. The charge for bad and doubtful debts increased from $301 million to $633 million.

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[3] The new business structure commenced on March 12, details are available on www.nabgroup.com. Financial reporting on the basis of the new business structure will commence for the 2010 financial year.

[4] Investment earnings on shareholders retained profits and capital in the life business.

Investment spend included $128 million dedicated to improved infrastructure, such as the new deposit platform for the direct banking channel UBank and efficiency and sustainable revenue improvement programs such as card swipe identity in branches and improved internet banking systems. The balance of investment spend was in compliance areas.

Banking

Australia Banking cash earnings increased by 7.5% to $1.5 billion compared with the March 2008 half year. Business & Private Banking and Retail Banking both contributed. Business & Private Banking was up 7.1% to $1.0 billion and Retail Banking was up 8.6% to $0.5 billion.

Revenue was 13.9% higher at $4.4 billion while expenses increased by 4.4% to $1.7 billion.

Continued cost control resulted in the cost to income ratio falling from 42.6% in March 2008 to 39.0% in March 2009. Average lending volumes increased by 9.5% to $270 billion and retail deposits rose by 17.3% to $123 billion.

In the Business Bank, investment spend included the recruitment of 80 additional business bankers, while in Retail Banking eight new branches were opened during the half, a new store format nabKiosk was launched and 18 branches were refurbished.

MLC

Substantially weaker investment markets were the main factor in the 28.2% decline in cash earnings to $158 million before IoRE. Net income fell by 16.6% to $539 million. MLC has maintained a strong focus on operating expenses, which were 2.1% lower at $330 million.

Cash earnings before IoRE for MLC Investments declined by 45.6% to $68 million. Net income of MLC Investments decreased by 21.4% to $335 million due to lower management fees as a result of the 22% fall in funds under management and lower revenue from advice due to weak market conditions.

MLC Insurance experienced strong sales, with annual inforce premiums up 10.8%, but cash earnings before IoRE declined by 5.3% principally due to the prior period mark-to-market gains on assets backing the Insurance portfolio which reversed in the current half. Net income was down 7.3% to $204 million.

Investment spend was focused on the MLC MasterKey product range which is now available online, with more than 45% of applications currently received electronically, improving the speed and consistency of customer service.

United Kingdom

Average lending volumes increased by 9.5% and retail deposits rose by 14.9%, demonstrating solid underlying business momentum and the strength of both the Clydesdale and Yorkshire brands. Investment spend was maintained during the half and included a new business customer internet bank channel for both Clydesdale and Yorkshire customers.

Revenue fell by 8.0% to £563 million. Costs were carefully managed and declined by 9.2% to £325 million, marking the seventh consecutive half year of flat or falling costs. The charge for bad and doubtful debts increased from £60 million to £168 million.

Cash earnings were down 64% to £50 million, reflecting lower income as a result of unrecovered higher funding costs and higher charges to provide for bad and doubtful debts, partially offset by good cost control. Underlying profit[5] was down 6.3% to £238 million, a creditable performance compared to peers in particularly difficult market conditions.

New Zealand

Cash earnings were down 4.6% to NZ$228 million reflecting higher charges to provide for bad and doubtful debts and higher funding costs.

Revenue rose by 5.2% to NZ$755 million, while costs fell by 1.5% to NZ$338 million. This was the eighth consecutive half year of flat or falling costs.

[5] Underling profit is net operating income less operating expenses. This is before the charge for bad and doubtful debts and income tax expense.

The launch of the Group best practice iFS business model, BNZ Partners, delivered strong growth in business opportunities over the half. Average lending volumes increased by 14.3% and retail deposits rose by 6.3%. The charge for bad and doubtful debts increased from NZ$30 million to NZ$96 million.

The NZ Region continued to focus on three strategic themes of simplification, developing and maintaining a constructive culture, and new revenue initiatives.

nabCapital[6]

Cash earnings declined by 7.5% due to increased charges for bad and doubtful debts.

Revenue was 30.2% higher at $1.5 billion, due mainly to an outstanding performance by the Global Markets division and assisted by repricing of lending to reflect risk in a deteriorating environment. Costs increased by 10.0%. (Costs excluding foreign exchange movements, the consolidation of conduits, and some structured property funds rose by 4.6%.) The charge for bad and doubtful debts increased from $265 million to $628 million.

The performance of the Global Markets division reflected strong sales from higher client demand and transaction flow, improved margins and increased trading activity.

Great Western Bank[7]

Great Western Bank recorded cash earnings of US$27 million in the half year to March compared to US$18 million for the four months under NAB's ownership in the September 2008 half year.

Revenue increased from US$56 million to US$86 million while operating expenses rose from US$27 million to US$41 million. The charge for bad and doubtful debts increased from US$1 million to US$5 million.

Key developments during the half included the rollout of seven agri and SME centres with a team of 15 experienced bankers and the acquisition of the 20 branch distribution network in Colorado.

Balance Sheet Commentary

Capital

At 31 March 2009 the Group's Tier 1 capital ratio was 8.31%.

The increase in the Tier 1 ratio from 7.35% at 30 September 2008 is primarily due to the equity placement in November 2008.

The Group continues to target a strong capital position as one of its main priorities. The partial underwriting of the dividend reinvestment plan to raise an additional $500 million of Tier 1 capital supports this objective.

Supporting customers' need for finance and the worsening outlook for bad and doubtful debts both have potential to reduce our Tier 1 ratio over time. While conditions remain difficult to predict, continuing to seek opportunities to maintain and selectively build capital will remain a priority.

Later in the cycle when conditions become more predictable, it will be likely that the Group's Tier 1 can trend down to lower levels.

[6] As announced on 12 March 2009, nabCapital has been restructured and is known as Wholesale Banking, which incorporates product areas such as Global Markets, Treasury Services, Asset Servicing (formerly Custody) and Specialised Finance. Corporate Lending will be merged with the regional business banks. Non-customer franchise related assets (for example ABS CDOs) will be segregated and managed down in an orderly manner. These changes will be reflected in the financial reporting for the 2010 financial year.

[7] Please note that for comparative purposes Great Western Bank was acquired in June 2008 and therefore only owned by NAB for four months of the September 2008 half year.

Bad and Doubtful Debts Provisions

Collective provisions[8] increased by $1.2 billion to $3.6 billion compared with March 2008. The ratio of collective provisions to risk-weighted assets excluding housing increased from 0.89% to 1.38%.

The main influences were downgrades in customer credit ratings across all businesses and precautionary management overlays related to the economic cycle, and to conduit assets and derivatives transactions to reflect the uncertainty created by the rapidly deteriorating economic conditions and any consequent default.

Specific Provision balances have increased by $0.8 billion to $1.3 billion since March 2008. Total provisions balances as at 31 March 2009 increased to $4.9 billion.

Funding and liquidity

The Group raised $16.5 billion in term wholesale funding in the March half year, representing more than 86% of its 2009 full-year requirement of $19 billion. The majority of this has been raised utilising the Australian Government Guarantee. The weighted average term to maturity of the funds raised is 3.71 years.

The Group continues to maintain a conservative liquidity position with total liquid assets of $67.5 billion as at 31 March. Additional liquidity is also available through internal securitisation of loan portfolios across the Group, which can be used to access central bank funding as required.

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[8] Including credit risk adjustment on assets at fair value.