

Perspectives

Major banks analysis

November 2007

Some calm amid the global storm

It could have been a lot worse. As the US subprime mortgage market crash generated worldwide tremors, Australia's five major banks – ANZ, CBA, NAB, Westpac and St George – have so far emerged from the turmoil relatively unscathed. Their resilience is reflected in their FY07 results, which show combined underlying cash earnings growing by an impressive 14.7% over the year.

It was a completely different story outside Australia, where many large financial institutions suffered serious credit losses. Our five major banks were also able to avoid liquidity problems, thanks largely to their diversified funding sources. Domestic non-bank rivals, who are totally reliant on wholesale funding, fared rather worse as funding sources were frozen and/or the costs of funding rose significantly.

The robustness of Australia's banks in the face of the crisis helped them avoid some of the negative perceptions that have dented the reputations of other institutions both at home and abroad in what has transpired to be an important test of confidence.

The foreign banks in Australia remain a formidable threat to the majors, and the domestic competition continued to drive margin compression throughout the year. However, according to September 2007 data, the banks managed to largely maintain market share in their core markets, including housing and deposits.

The credit crunch, in fact, provided a good opportunity for the majors to grow market share at the expense of the smaller banks and non-bank rivals, since customers – both businesses and consumers – tend to look towards the larger banks during times of uncertainty. Moreover, while some competitors had little choice but to pass higher funding costs onto customers, the local majors could use their retail deposit base and strong balance sheets to their advantage to absorb costs, and, at least for the time being, price competitively.

Although the banks have so far managed to avoid the worst of the global credit crunch, it would be unwise to be complacent. We are undoubtedly in a new era of risk, with household debt at all time highs and a question mark over serviceability as interest rates continue to rise. The ripples from the US subprime collapse are also being felt by investors and, indirectly, businesses as a result of increased credit spreads. Oil prices, labour costs and the high

A\$ all point towards further pressure on certain businesses and an expectation that credit losses will continue to increase, albeit from a low base.

On the positive side, we're seeing the fruits of revenue diversification, especially banks' far-sighted foray into the wealth management sector. These investments are paying off handsomely as the government's tax reforms have given a welcome boost to superannuation inflows and equity markets are continuing to perform well in spite of the global upheaval.

Financial markets income was also up 30% this year. The volatility in the markets generated customer demand for foreign exchange and risk management products, in addition to which the banks generally traded successfully.

There are signs that managing expenses is likely to become increasingly challenging as labour costs and general inflation push up costs. As we have commented in the past, making the right investment decisions (i.e. projects whose cost will be exceeded by new revenue and/or expense savings) will be critical to keeping the expense-to-income ratios moving in the right direction.

Revenue growth will, however, remain their most significant challenge. Aside from the way in which the major banks respond to the changed debt market conditions, and the opportunities it might present, each bank has quite different overseas aspirations. The changing of CEO's at three out of the five majors will also bring a new dimension to how this plays out.

In aggregate the PwC Banking Gauge predicts that the major banks' cash earnings will grow 11.2% in FY08. A strong indication that our major banks might remain a calming influence in the financial markets.

Note: the PwC Banking Gauge is a consensus view across the five banks and across five of Australia's leading banking analysts – Ben Zucker (Macquarie), Brian Johnson (JPMorgan), Jeff Emmanuel (UBS), Matthew Davison (Merrill Lynch) and Nick Selvaratnam (Credit Suisse).



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A new dawn following the credit and liquidity crunch

The US subprime meltdown triggers a global crunch

When the US subprime market began gaining momentum some years ago, few anticipated the worldwide financial turmoil that the unchecked growth of high-risk loans would unleash down the line.

The first signs of trouble appeared around March 2007, when delinquencies in the US\$1.5 trillion sub prime market reached 15% and foreclosures rose to 2.5%, amongst other things causing payment defaults on a number of the securities funding these assets.

The onset of the crisis was linked to the nature of the subprime loans written as global investors chased high-yielding assets. Many of these were teaser loans with adjustable-rates starting as low as 1% and resetting to higher rates after two years, during which time as many as 17 interest-rate hikes occurred. The grace period for a large number of borrowers came to an end in early 2007. Over supply of housing and falling house prices in the US exacerbated the problem.

By mid 2007 a large number of loan originators, followed by a smattering of global hedge funds and unit trusts, were forced to halt operations and some filed for bankruptcy protection. July 2007 saw belated action from the ratings agencies, as they downgraded a significant number of debt securities. Global debt markets began to experience a profound liquidity crisis with many players withdrawing as the extent of potential losses in the subprime sector became apparent. The depth of the crisis led to a widening of credit spreads and forced central banks in a number of countries to step in to provide liquidity to the short-term money markets.

As interest rates reset on as much as US\$900 billion worth of US subprime loans over the next 18 months, it remains to be seen whether losses can be contained to original worst-case scenarios of US\$100 billion. Some estimates now exceed US\$200 billion, and several global investment banks have recently recorded stunning third quarter losses. The effective dissemination of the debt throughout the global markets is making it a slow process for the losses (the result of asset devaluations) to be realised by those ultimately holding the debt – such as the global investment banks.

Weaknesses exposed in Australia, but strengths also

Australia has been partially insulated from the recent global credit market turmoil. This is partly because non-conforming loans (our equivalent of subprime loans) account for only about 1–2% of the country's \$900 billion total mortgage market and the 'teaser' loans of the US market don't exist to nearly the same degree here.

And while Australian lenders say they are recording a growing number of defaults and foreclosures a critical difference is that house prices are holding up. Moreover, although Australia's interest rates have been rising too, they have had less ground to make up than US rates, which started out from a considerably lower base.

On the other hand, some local investors have made losses either through investments in affected global hedge funds and unit trusts,

equity holdings in affected institutions or as a result of the general market volatility.

The crisis has also exposed weaknesses in the business models of a number of smaller Australian lenders who are heavily reliant on short-term funding and/or securitisation programs. Once acclaimed for forcing down margins and delivering competition to the major banks, some are now struggling to secure funding at affordable prices. A number have already been compelled to raise prices on their products and consequently lose market share. Others, such as RAMS (like the UK's Northern Rock), have had to be bailed out by stronger financial institutions.

Australia's top banks, however, have so far proven resilient, and some would say are in a sweet spot for the time being. That's mainly because their funding sources and revenue streams tend to be more diverse than those of their smaller competitors.

For highly rated banks borrowing wholesale funds, the credit spreads have not widened as much as they have for lesser rated banks and corporates. And as well as tapping the wholesale funding market, the majors get cheaper and more stable funding from retail and business deposits unlike many of their smaller counterparts.

In addition, the major banks diverse revenue streams means that even though rising funding costs might reduce profitability on straightforward lending operations, revenue in other areas, such as wealth management, is growing. This diversification helps to minimise profit volatility.

Another advantageous phenomena is that large banks tend to benefit at the expense of rivals during any significant market disruption. Under such circumstances, more money gets placed in perceived safer bank deposits, and borrowers prefer to deal with the more stable, trusted players.

The large banks' advantage in these new market conditions is plain enough. The question is what they will do with it. The conditions won't stay so favourable forever. For instance, confidence will return to the capital markets and the levels of corporate debt raisings and securitisation will return, albeit perhaps not at the prices seen immediately before the crunch.

The biggest question would seem to be over variable home loan rates. At the time of writing the majors have not raised rates and have instead absorbed the incremental funding costs. The intent has been that reduced margins would be more than offset by market share gains. But most of the majors have announced that rates will need to be increased eventually. It will be interesting to watch.

Some banks might also use the present market advantage to attack or grow a particular market segment. For example, some might consider a strategy that most have long supported in theory – a differentiated pricing approach that rewards the most profitable and loyal customers and turns them into advocates of the bank. Offering favourable rates and conditions to selected key customers might, in combination with service quality, persuade some to recommend the bank to others.



Net Interest Income

Lending volume growth drives NII increases

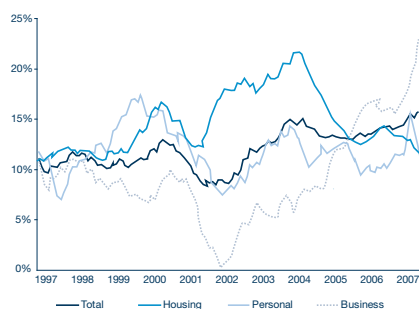
Net interest income across the five majors grew by a respectable 9.1% in the year to September 2007. This was largely due to volume increases flowing from continued strong lending growth at just below system, but offset by significant margin compression.

The outlook for the Australian economy in general looks healthy. Despite the global debt market problems and interest rate hikes, the Australian economy remains strong, driven by demand for resources among developing nations such as China. We don't see this robust growth slowing any time soon.

RBA September 2007 credit data shows overall lending continued to grow at an accelerating pace. The total lending market grew by 16% pa to September 2007 with business lending leading the way. At 23% pa to September 2007, business lending was at its' highest since 1989. With a strong and growing economy, businesses tend to be more confident and borrow more to invest in expansion to meet increased capacity requirements.

Despite the impressive market growth in institutional and business lending, the major banks did not capture their share, with market share actually declining 361bps in the 12 months to September 2007 to 47.7%. The major banks have been investing in both front line staff and technology to attack the SME markets, but the smaller banks have been similarly aggressive. At the top end, the global giants courted institutional clients, in particular thriving on the increased levels of private equity activity.

Domestic Credit Growth (Annual % growth)



Source: RBA data

Market share pressure alleviated by the flight to quality

The total value of mortgages, meanwhile, grew by a respectable (albeit declining) rate of 11.7% pa to September 2007. The major banks actually grew their mortgage books ahead of systems growth in the second half of FY07, helping to stem market share losses in the first half to the likes of HBOS and ING, losing only 27bps in the year to September 2007, to finish with a market share of 64.3% at September 2007. This indicates that the banks may be having some success with their strategy of improving the customer experience by deploying higher quality staff, better aligned service points (e.g. Saturday opening and mobile lenders) and opening more branches.

It also reflects the 'flight to quality' in the latter part of the year. Given the crunch probably influenced customers from mid-August onwards, and there is a time lag between approving new business and it being reflected on the balance sheet, the post-September statistics are expected to show further market share gains to the majors.

As noted in previous analyses, broker-generated sales appear to have stabilised at 40%pa, however they continue to represent a good proposition for customers who wish to get a competitively priced product, but don't wish to spend time shopping around. We wouldn't be surprised to see the percentage tick up further in the future.

Personal lending (both credit cards and personal loans) growth has been relatively stable at around 10%pa – 12%pa having peaked in June 2007 at 16.2%pa. However, the major banks' market share of personal loans fell by 14bps (101bps in 2H07) and credit card outstandings fell 251bps. The main market share winners in this segment were the non-bank players and foreign banks – especially Citibank and HSBC, which have been aggressively pushing a range of cheap card products onto the market.

The story with regard to deposits is positive for the majors. Their market share of household deposits grew 19bps to 78% at September 2007 – a 45bps positive turn around in 2H07 – at the expense of the foreign banks. ING was hit particularly hard as the big banks matched its aggressive on-line deposit rates.

Similarly, the major banks gained 14bps in market share of business deposits to end the year with 75.4% market share. They again benefited from the market volatility (i.e. uncertain equity prices) and the 'flight to quality'.

Although the market share picture remains mixed, it does seem that the major banks' customer service initiatives are beginning to have a positive effect. Nonetheless, the competition looks set to move up a gear following BankWest's announcement of plans to increase its east coast presence, and the merger of Bendigo and Adelaide banks.

Competition forces margin compression

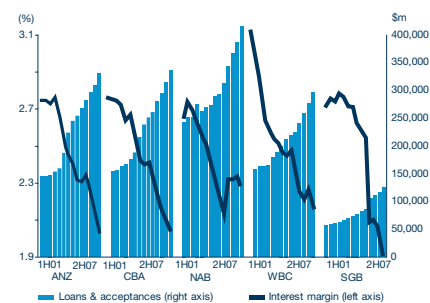
Across the major banks, interest margins declined 10 bps on average during the year. This compares to a decline of 7 bps during the prior year.

The decline was largely in line with expectations, and reflects many of the same underlying factors as have been experienced in recent years, such as the inevitable impact on margins from lending growing more quickly than deposits, as well as significant price competition.

However, in the second half the impact of higher funding costs in wholesale markets and a tendency by banks to hold additional liquidity as a buffer against market turmoil were also factors in the margin decline. Big picture, though, it was price competition which caused the majority of the reduction.

The severity of any margin compression next year is hard to predict, although we would expect the downward pressure to continue as the impact of increased funding costs continues to bite. We may see some respite in competition as smaller banks and non-bank players deal with the current liquidity squeeze and re-pricing of debt, and the flight to quality will assist the majors in growing their relatively low cost deposit base. But the overall trend for margins remains in one direction.

Interest margins and loans & acceptances



Notes: Historical data based on AGAAP. 2006 and 2007 based on AIFRS.

Other Operating Income

Thriving wealth plays lift other operating income

A strong focus on income diversity has once again helped the major banks to increase their earnings from non-lending related activities. Total non-interest income rose by 12.9% in FY07 to represent 40.3% of total revenue, with wealth management contributing 35% to the overall figure, banking fees 49% and trading income 12%.

In the wealth management sector underlying cash earnings (income less operating expenses and tax) were up 22.4%. This was another excellent result that comes off the back of strong equity markets and exceptional net inflows, which have been boosted by the government's 'gift' of allowing workers to invest up to \$1m tax free in superannuation funds before 30 June 2007.

Clearly, the major banks are beginning to dominate the wealth management sector with combined market share of 55.7% of FUA (Plan for Life – Master Trusts) and 49.8% share of net annual inflows in to this sector. This is a tribute to their collective foresight in choosing, many years ago, to 'follow the money' into this now lucrative business area, particularly administration platforms.

Australia's managed funds market has benefited greatly from the combined effects of 9% employer super contributions, an increasing focus on voluntary super contributions and a very robust stock market, putting the banks in a good position. The latest AFG Funds Management Index puts Australia at the top of the global league table with overall managed funds per capita at A\$50,700 per person in 2006.

This is clearly a lucrative market and competition remains intense. Market respondents in the recent PwC Global Private Banking/Wealth Management Survey 2007 indicated that a growing focus was to increase their 'share of wallet' in private banking and wealth management. This is partly to avoid high customer acquisition costs and may explain why we're seeing providers such as NAB/MLC and St George Bank/Asgard beginning to offer fee discounts to people with balances above \$1m.

However we shouldn't overlook the problem that the majority of Australians still have worryingly low balances in their super plans. A problem further exacerbated by service provider and fund management fees eroding investment returns according to figures released by APRA – an issue that is receiving growing attention in the media. The current regime of full disclosure and choice of funds has not impacted as expected, as few individuals are in a position to make the detailed comparisons necessary to understand the information provided and fewer still change funds.

Improving the financial literacy of Australia's investing public continues to be a challenge. Given the market share of the related monies held by banks it appears a reasonable challenge to them to play more of a leadership role in bridging this literacy gap. By taking up this challenge, the bank owned wealth managers may help to shape any regulatory agenda formulating in this space, as well as positioning their organisations to leverage their strong brand appeal to ensure any such change creates an opportunity rather than a threat.

Wealth management has been through a very successful period. While opportunities remain, the banks face some considerable challenges ahead. The banks have each developed very different business models varying from fully integrated manufacturer/distributor to equity participation in third party manufacturer/distributor and everything in between.

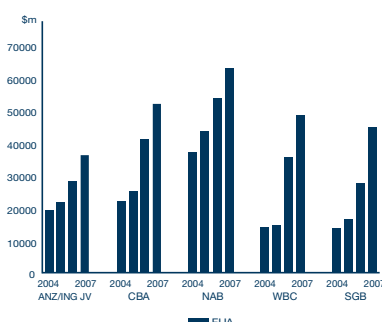
For those managing assets; increasing globalisation, low barriers to entry and margin compression represent significant challenges. At the retail distribution end the ongoing debate and call for regulation over fees and commissions is yet to be resolved. In all areas of the value chain, the "war for talent" remains as intense as ever.

While some look to influence margins for a particular part of the value chain, those exposed at each stage remain indifferent to how the margin is carved up as long as the end cost to the user remains stable. Having that broad exposure may ultimately prove to be the competitive advantage.

On a separate front, financial markets income was up 29.8% this year, reflecting overall favourable conditions generated by volatility in the markets – especially over the last quarter. The customer demand for foreign exchange and risk management products was complemented by generally successful trading results.

The Australian banks do not appear to have been caught holding much global debt linked to the US subprime market, and therefore have largely remained unaffected by the market disruption and ensuing losses. This is quite unlike their global counterparts, some of which have reported significant losses in their third quarter earnings.

Funds under administration



Source: Master Trusts, Plan for Life Market Share and Dynamics report June 2007.

Fears over fees

Income from banking fees, which comprise lending fees 28% and other fees and commissions 72%, rose by 8.9% in FY07. The increase was mainly the result of volume growth across the portfolios – including mortgages, credit cards, deposit and transaction accounts, and brokerage and merchant services

According to the Reserve Bank of Australia (RBA) Annual Survey of Banking Fees 2006, released in May 2007, growth in total domestic bank fees grew by 6%pa in 2006. Income from domestic business and corporate banking fees, which account for well over 50% of total domestic bank fees are only growing at 3%pa to December 2006, but household banking fees are growing at a faster rate – 10%pa to December 2006.

A big driver of the growth in fee income from households was a rise in fee income from credit cards, which was up 13% pa to December 2006. Credit cards now account for about 25% of all fee income received from households. In turn, this reflects an increase in the volume of credit card accounts and usage, as well as a 21% increase in other credit card fees, such as penalty, over-limit and foreign-currency conversion charges.

Bank fees, particularly penalty fees are currently part of the focus for a Senate inquiry into ASIC's proposed "Fair Banking and Credit Card Fees" Amendment Bill 2007, aimed at curbing 'excessive' fees on bank accounts of all kinds. Countries such as New Zealand and the UK are also currently in the process of enacting similar legislation.

The Australian Bankers' Association (ABA) has been arguing that further legislation in this area is not needed as banks are already responding to competitive market forces which will naturally bring about a change from a "punitive" penalty fee model to a "fee for service model".

Another potential threat to the banks' fee income comes from proposed RBA changes to ATM interchange arrangements, aimed at allowing ATM machine owners to charge people directly for using their ATMs, rather than the current practice of ATM owners receiving interchange payments from the banks. The RBA believes this change in approach would promote greater competition and reduce ATM fees for consumers.

As noted in previous editions of Major Banks Perspectives, the smart pricing of fees is just one of the many levers that Australia's banks can pull to enhance value for their customers. Doing so could be vital to enabling the shift towards a customer advocacy model that they are seeking to cultivate.

Efficiency

Cost targets are not getting any easier

Containing expenses has always been a top priority for Australia's leading banks, with a focus on increasing the gap between revenue and expenses growth.

However, the banks' historically successful efforts to widen the 'jaws' of the gap, so to speak, appear to have slowed somewhat in the second half of FY07. Some of the banks experienced either a reduced pace of improvement in the expense-to-income ratio or indeed a deterioration in that ratio in 2H07.

In the 12 months to September, total expenses grew by 5.8% – and by 11.5% in 2H07 – suggesting that the banks, for the first time in a long while, can no longer take meeting their cost targets for granted.

The growth in expenses was itself not a complete surprise. It was broadly anticipated, for instance, that staff costs would escalate in FY07. Staff costs account for about 56% of total expenses and rose 11.8% over the year.

A factor that pushed up employee costs was the intensifying "war for talent" in the labour market, which has made it a lot harder (as in other industry sectors) to keep a lid on salary increases.

FTE numbers also went up as the banks implemented initiatives to improve customer service in a bid to beat off growing competition from brokers and foreign banks.

The banks' customer-centric efforts included expanding their physical footprints, and upgrading customer relationship management systems. However, expenses related to premises and computer software, which account for about 17.5% of total expenses, rose by only 1.8% in FY07.

One thing the banks can perhaps look forward to is a reduction in their significant spend over the past three-to-five years on compliance projects, including the implementation of AIFRS, Basel II and Sarbanes-Oxley. Indeed, some of the banks have now deregistered in the US, partly to reduce the associated compliance costs.

Clearly with pressure on revenue growth, the jaws will only continue to widen if the

'right' strategic decisions are made. That is, the investments must generate revenue and/or reduce ongoing costs ahead of the investment cost itself.

All of the majors continue with a variety of process-simplification and productivity-improvement projects. Prioritising the most important projects is one thing, but then ensuring they are successfully executed is no small challenge given the complexity of the banks' legacy systems and the increasing scarcity of skilled expertise in this field.

Reported banking expense-to-income ratios

	FY07	Fy06
ANZ	44.8%	45.6%
CBA	45.8%	47.7%
NAB	50.8%	54.5%
SGB	41.7%	43.1%
WBC	44.4%	46.5%



Asset Quality

The credit environment is turning

The major Australian banks experienced a significant rise in the charge for bad debts, which was up 27.1% for FY07 and had a direct impact on their cash earnings. Although this is a steep rise, it is up from a very low starting point and reflects a return towards longer-term averages. In aggregate, the charge now represents 18bps on average loans and advances, up from 17bps for FY06.

There are certainly now further signs that the benign credit environment has turned after a remarkably long period of little change. The banks' results also reflect the anxieties caused by the US subprime market chaos and subsequent liquidity squeeze.

In terms of asset quality, there is evidence of a continuing distinction to be made between Australian banks' business and consumer portfolios. Impaired assets, which mainly reflect business and corporate lending, are showing signs of moderate increases (from a very low base), while consumer portfolios – including housing loans, credit cards and personal lending – are displaying a more marked (albeit still reasonably modest) deterioration.

There is evidence that personal borrowers are under mounting stress, with insolvency activity (bankruptcies, debt agreements, and personal insolvency agreements) up 17% in the year to June 2007, the vast majority in Victoria and NSW.

The latest S&P data on securitised loans shows that while default rates (i.e. accounts

90 days or more past due) on prime, fully documented loans, is at around 0.35% – arrears for low-doc loans are increasing, up from 0.92% to 1.01% over the past 12 months. Subprime defaults, meanwhile, are up to 7.20% from 5.53% compared with a year ago.

Household debt serviceability continues to be an issue, with recent census statistics indicating that more households are experiencing mortgage stress than ever before. However, according to the ABS Capital Cities House Price Index, house prices rose by 10.6% in the year to September 2007, with some convergence between the cities.

With unemployment rates at 33-year lows, a strong economy and with house-price appreciation firming up in the major cities, it is unlikely that major losses from consumer portfolios will materialise in the near future albeit the cost in managing such portfolios probably will. Nevertheless, with interest rates expected to rise further from what are already the highest levels since November 1996, there can be no absolute certainty on this.

Following another round of solid growth in business profits for the year to June 2007, business portfolio asset quality also looks sound, especially with economic growth forecast to continue. However, problems might emerge in the next year or two if the tight labour conditions lead to significant cost hikes for businesses, on top of the wider credit spreads that will be charged on loans as a direct consequence of the crunch.

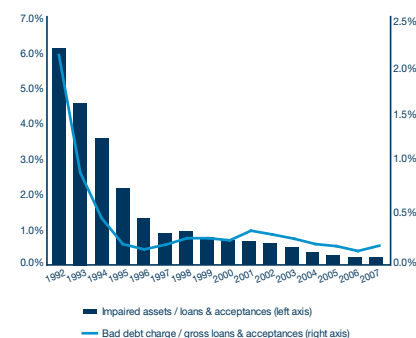
Another thing to emerge from the turmoil of the past few months is a return to more

prudent lending practices. For example, there has been a reduction in 'covenant-lite' loans at the top end of the corporate sector, plus a re-pricing of low-doc agreements in the retail market.

Nevertheless, the open question is how the current books (written over recent years with less stringent standards) will perform in the new environment, with an emerging combination of pressures such as: the recent interest rate rise, and more foreshadowed; increasing pressure on labour costs; high oil/fuel prices; high A\$ exchange rate; and bigger credit spreads and liquidity premiums.

Plus although the Australian economy has been significantly de-coupled from the US economy for some time now, the possibility of the US tipping into recession is not comforting. While the banks' portfolios are fundamentally strong, it is little wonder that further increases in bad debt levels are predicted.

Five majors: impaired assets and bad debt expense



Five majors' combined performance – \$A million – underlying cash earnings

	FY07	FY06	FY07/FY06
Net interest income	32,611	29,899	9.1%
Other operating income	22,020	19,499	12.9%
Operating income	54,631	49,398	10.6%
Operating expenses	25,558	24,147	5.8%
Core earnings	29,073	25,251	15.1%
Bad debt expense	2,451	1,929	27.1%
Tax expense	7,634	6,883	10.9%
Outside equity interests	1,097	837	31.1%
Underlying cash earnings after tax before significant items	17,891	15,602	14.7%

Key banking statistics – Full year 2007

	ANZ		CBA		NAB		SGB		WBC	
	12 mths Sept 07	12 mths Sept 06	12 mths June 07	12 mths June 06	12 mths Sept 07	12 mths Sept 06	12 mths Sept 07	12 mths Sept 06	12 mths Sept 07	12 mths Sept 06

Balance sheet

Total assets	392,613	334,640	425,139	369,103	564,634	484,785	125,800	107,002	375,908	299,578
Risk weighted assets	275,018	240,219	245,347	216,438	355,266	318,323	63,226	52,982	228,852	193,417
Total loans & acceptances (Gross)	307,384	273,166	321,653	280,282	394,651	346,689	106,552	93,723	273,914	235,684

Asset quality & provisioning

Gross impaired assets	792	698	421	326	1,094	904	78	86	427	433
Net impaired assets	490	412	222	155	787	720	50	52	268	256
Gross impaired assets as a % of loans & acceptances	0.26%	0.26%	0.13%	0.12%	0.28%	0.26%	0.07%	0.09%	0.16%	0.18%
Individually assessed provisions	302	286	199	171	307	184	34	31	148	164
Individual provisions % of impaired assets	38.1%	41.0%	47.3%	52.5%	28.1%	20.4%	43.6%	36.1%	34.7%	37.9%
Collective provisions	1,992	1,940	1,034	1,046	1,800	1,838	291	268	1,410	1,194
Collective provisions % of non housing loans & acceptances	1.33%	1.46%	0.79%	0.92%	0.86%	1.05%	0.78%	0.86%	1.14%	1.16%
Total provisions	2,294	2,226	1,233	1,217	2,107	2,022	325	299	1,558	1,358
% of risk weighted assets	0.83%	0.93%	0.50%	0.56%	0.59%	0.64%	0.51%	0.56%	0.68%	0.70%
% of loans & acceptances	0.75%	0.81%	0.38%	0.43%	0.53%	0.58%	0.31%	0.32%	0.57%	0.58%

Profit & loss analysis (i)

Net interest income	7,302	6,943	7,036	6,514	9,767	8,785	2,193	2,015	6,313	5,642
Other operating income	3,765	3,146	6,272	5,423	7,131	6,535	1,079	939	3,773	3,456
Total operating expenses	4,953	4,605	6,427	5,994	8,245	7,954	1,390	1,299	4,543	4,295
Core earnings	6,114	5,484	6,881	5,943	8,653	7,366	1,882	1,655	5,543	4,803
Bad debt expense	567	407	434	398	790	605	178	144	482	375
Profit before tax	5,547	5,077	6,447	5,545	7,863	6,761	1,704	1,511	5,061	4,428
Income tax expense	1,616	1,486	1,816	1,606	2,200	2,030	515	466	1,487	1,295
Outside equity interests	7	4	27	31	994	749	2	1	67	54
Cash earnings after tax before significant items underlying profit (ii)	3,924	3,587	4,604	3,908	4,669	3,982	1,187	1,046	3,507	3,079
Operating profit after tax and outside equity interests (iii)	4,180	3,688	4,470	3,928	4,578	4,392	1,190	1,078	3,451	3,071

Key data

Other operating income (% of total income)	34.0%	31.2%	47.1%	45.4%	42.2%	42.6%	33.0%	31.8%	37.4%	38.0%
% Interest spread	1.72%	1.86%	1.83%	1.98%	1.80%	1.88%	1.81%	1.93%	1.85%	1.92%
% Interest margin	2.19%	2.31%	2.19%	2.34%	2.28%	2.31%	2.01%	2.11%	2.19%	2.29%
Banking expense/income ratio	44.8%	45.6%	45.8%	47.7%	50.8%	54.5%	41.7%	43.1%	44.4%	46.5%
Total number of full time equivalent staff	34,353	32,256	37,873	36,664	38,822	38,419	8,722	8,439	28,018	27,224
Operating costs per employee (dollars)	144,180	142,764	169,699	163,485	212,380	207,033	159,367	153,928	162,146	157,765
Cash return on average equity %	19.6%	20.1%	22.1%	21.3%	17.1%	15.9%	23.2%	22.9%	23.8%	23.0%

Capital ratios

Tier 1	6.70%	6.80%	7.14%	7.56%	6.67%	7.35%	6.70%	6.90%	6.50%	6.90%
Tier 2 (Net of deductions)	3.40%	3.80%	2.62%	2.10%	3.32%	3.46%	3.50%	3.90%	3.00%	2.70%
Total	10.10%	10.60%	9.76%	9.66%	9.99%	10.81%	10.20%	10.80%	9.50%	9.60%

All figures in AUD million unless otherwise indicated

i In arriving at 'underlying profit', income and expenses exclude significant items and certain noncash items. Significant items include the impact of accounting changes, gains on disposal of businesses and other items reported by the banks. Some components of income and expenses have been reclassified to improve comparability between banks.

ii NAB cash earnings after tax before significant items underlying profit are shown before distributions payments to holders of National Income Securities – September 07 \$283 million, September 06 \$254 million.

iii Statutory result as reported by the banks, unadjusted

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Disclaimer:

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