Banking Matters

Major Banks Analysis

May 2016

pwc

Major Banks Analysis – Wrap up

> *"Nobody said it would be easy.*

2.8% ↓

Cash earnings for the half declined 2.8% on the prior comparative period (pcp) to $14.9 billion (bn) and fell by 3.6% on the prior half (hoh). Lending growth and margin management in the half were more than offset by bad debt expense increases, and some significant one-offs.

245bps ↓

Return on equity (RoE) fell from 16.2% to 13.7% on pcp, a movement of –245 basis points (bps). This movement was driven by increased capital holdings and the fall in earnings.

1bp ↑

Net interest margin (NIM) increased slightly by 1bp on pcp and hoh. This masks substantial movement, with the negative impact of wholesale funding and regulatory costs offset by retail repricing of both loans and deposits.

49.3% ↑

Bad debt expense (BDE) rose by $834m (49.3%) on pcp and $520m (25.9%) hoh driven by a handful of single name exposures, particularly in the resources sector. Underlying asset quality metrics remain relatively stable but credit quality appears to be at a turning point.

180bps ↑

Expense-to-income ratio at 44.8% was 180bps higher on pcp and 140bps higher hoh. After adjusting for one-off items, expense-to-income increased 15bps on pcp.

116bps ↑

The combined Common Equity Tier 1 (CET1) ratio increased 116bps to 10.1% on pcp and 45bps hoh. The banks generated and issued $4.5bn of CET1 during the half and $19.8bn since pcp.

The half year results should serve to remind us just how complicated it is to be a Major Bank in Australia right now – another solid performance but where to from here?

The majors face a confluence of factors that will shape the future of banking: fundamental forces in the external environment, moderation in the traditional drivers of growth and an increasingly binding set of constraints – both external (regulation, capital, funding) and internal (legacy, culture).

At the same time, the social context is changing rapidly with culture and ethics in the spotlight, making for a very challenging outlook.

Fundamentally strong

Cash earnings for the half were $14.9bn, a decrease of 2.8% on pcp and decline of 3.6% on the prior half. Return on Equity of 13.7% was down 245bps on pcp and 163bps on the prior half. This represents the second straight half of earnings decline for the majors.

The majors' engine room of lending asset growth and steps to manage margin decline show the importance of the domestic retail and corporate market to their results.

On average, Net Interest Margin (NIM) rose only slightly to 2.04%, demonstrating the importance of asset repricing in late 2015 and deposit repricing given increased wholesale funding costs and institutional bank/ offshore margin pressure.

Asset quality remained strong in the core of portfolios but bad debt expense was significantly impacted by resource-related and 'single name' impairments. Bad debt expense increased $834 million (m) on pcp and $520m hoh to $2.5bn. $801m of the increase related to specifically identified loans, with portfolio expense rising only $33m in line with asset growth.

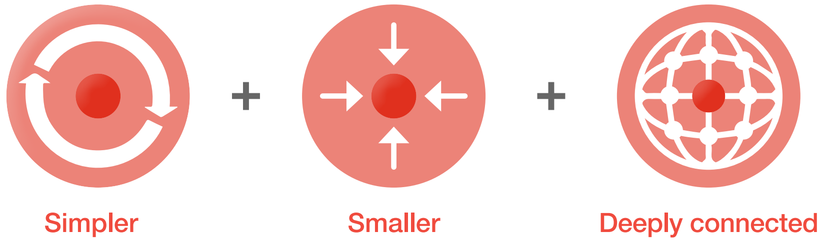
The increasing weight of constraints

The results also demonstrate the increasing weight of constraints facing the banks as they attempt to drive and navigate change and the complexity of decisions and strategic choices required as a result.

Perhaps the clearest example of this was ANZ's $717m of specified additional cost items during the half. The profile of these items (reassessment of software useful lives, impairment of overseas investments and restructuring costs) are instructive of the capital optimisation and investment decisions facing the majors.

Capital remained an obvious focus for all the majors with CET1 rising 45bps hoh to 10.1% and with approximately $19.8bn of CET1 gained through issuance, restructuring and organic generation on pcp. The outlook for further increases suggests that capital rationing will be a key factor in prioritising where and what is 'core' to the longer-term Australian banking franchise. We have already seen how this is translating in to dividend stances.

The cost and investment profile of the banks reflects the challenge of maintaining a large business in a heavily regulated industry while investing to meet rapidly-changing customer expectations. The average expense-to-income ratio increased to 44.8% and has been in the range of 43%-47% since 2008, including one-offs. The cost of maintaining infrastructure ($0.5bn) and regulatory/ compliance ($0.6bn) remain a significant proportion (51%) of the $2.2bn overall investment spend and will continue to factor into prioritisation decisions. Six months ago we noted that with the pace of technological change, payback periods for investments were shortening. The focus on expensing previously capitalised software and projects during the last few periods supports this unequivocally.



> *"...we suggest that the banks will need to be simpler, smaller and more deeply connected.*

Credit growth has been remarkably resilient and to date shows no signs of the fragility many are pointing to given political uncertainty (e.g. potential changes to negative gearing rules) and increasingly bearish commentary in certain areas of the residential property market such as over-supply in some capital cities. Housing credit grew at 7.2% per annum (p.a.) across the industry despite APRA succeeding in cooling investor lending (growing at 7.0% p.a. compared to 10.2% six months ago). Business credit remained at levels not seen since 2009 with a growth rate of 6.5% p.a.

We expect the cost and profile of funding of the majors to become increasingly critical as the implementation of the regulatory Net Stable Funding Ratio (NSFR) from 2018 nears. While there are complexities in the application of NSFR, we expect to see this impact business mix, a lengthening of the wholesale debt profile and/or a preference for 'stable' retail deposit funding. Given funding costs (inclusive of hedging impacts) contributed to a 4bps reduction in margin during the half this may become a further weight on results or put pressure on the banks to revisit asset pricing.

Redefining expectations

At the very same time as the majors are faced with the above challenges, the concept of a social contract between banks and the public is being scrutinised. Royal Commission or not, the resources diverted to an externally-driven change threatens the majors' ability to choose their priorities in a strategic, methodical way which would quite possibly achieve the same outcomes.

Banks operate in a unique and privileged intersect between shareholders, customers, regulators and government and in absolute terms (particularly when we look further afield) has served each of these well for some 100 years. Yet the context is now shifting dramatically as corporate and political expectations align with the broader social norms that we are now accustomed to – transparency, the renewed primacy of the individual, focus on customer experience, and fair-dealing.

These are not new concepts for banking and present significant opportunities if they are embraced in the right way. They are accelerating a change in focus that was already evident, enabled by a changing technology environment – a shift of the customer to the centre and a focus on trust.

The recent announcement by the Australian Bankers' Association of a fundamental review (including remuneration and incentives) is significant and unprecedented in recent history. The onus on the banks is to deliver on these expectations.

Such changes are not simple, take time and may, as we have said for some time, require a recalibration of returns for a period (possibly permanently), but should lead action and culture down the right path.

The recommendations from the ASIC Capability Review and subsequent funding announcements also serve to focus attention on which parts of the broader environment need to be strengthened to keep our industry "safe" and restore trust.

Outlook – simpler, smaller and more deeply connected

Our perspective "Banking 2020: the future of banking in Australia" takes a look at the external forces that are driving change, the challenges the majors face as they respond and presents a view on six priorities to be considered. In brief, we suggest that the banks will need to be simpler, smaller and more deeply connected, embracing their regulatory constraints for the safety and stewardship they provide.

Six months ago we expected to see the banks continue to focus on steady, disciplined reshaping and making the right investments for an uncertain future. While this has been borne out, the need for action is accelerating:

- Responding proactively to questions on conduct and culture, including strengthened regulator relationships to drive outcomes
- Maintaining sharp focus on credit performance, business sentiment and the broader economy
- Stronger emphasis on strategic cost management, investment prioritisation and make-buy decisions
- Preparing for transition to the Net Stable Funding Ratio and its consequential impact on business mix and asset/liability pricing
- Simplification of customer experiences and offerings, digitising and embracing fintech to provide customers multi-channel experiences
- Strategic capital choices aligned to potential returns while retaining options in a fluid world
- Being realistic about the sustainable equity returns achievable and warranted in a better protected, changing banking sector.

Overview

The major banks delivered combined cash earnings of $14.9bn, down 2.8% compared to the prior comparative period (pcp) and 3.6% on the prior half (hoh) – the second straight half of declining cash earnings (pre restatements).

After adjusting for the reported impact of non-recurring items, cash earnings increased 2.2% on pcp and 1.4% hoh. The growth on pcp was largely driven by balance sheet growth, in particular in Australian retail banking operations and by tight margin management.

Net interest margins increased 1bp versus pcp. The benefit of asset repricing at the end of 2015 was largely offset by competitive pressures in the institutional/offshore businesses, wholesale funding cost increases and the medium term impact of holding higher capital and liquid assets. Following the Reserve Bank's easing on 3rd May, it appears these will be pressured further.

Bad debt expense increased a significant $834m (49.3%) on pcp and $520m (25.9%) hoh. Almost all of this increase ($801m) related to specific exposures, particularly in resource-related industries, with portfolios continuing to perform well with only limited signs of stress. While consensus appears to be for a deterioration in broader credit quality, it does not appear that the impact of this will appear soon.

Banks' costs remain within the 43%-47% expense-to-income ratio range. After adjusting for larger 'one-off' expenses, the combined expense-to-income ratio was up 15bps on pcp to 43.1%.

With a flat to negative margin outlook, rising bad debt experience and the pending implementation of further regulatory tightening (Capital and Net Stable Funding), the banks are faced with a challenging outlook. We expect returns on equity (down 245bps against pcp and 163bps hoh) to continue their downward trajectory as a result.

2.8%

Cash earnings

Cash earnings declined 2.8% on the pcp and 3.6% hoh. This reflects a softening operating environment, with bad debt expense rising and margins remaining competitive despite repricing activity in the half.

163bps

ROE

Over the half, Return on Equity (RoE) declined 163bps from 15.4% at full year to 13.7%. The impact of capital increases over the last year, combined with slowing growth may signal a resetting of RoEs for some time.

Four major banks combined performance

Cash earnings – A$ million

	1H16	2H15	1H16 vs 2H15	1H16	1H15	1H16vs1H15
Net interest income	30,185	28,961	4.2%	30,185	28,157	7.2%
Other income	12,093	12,499	(3.2%)	12,093	12,421	(2.6%)
Total income	42,278	41,460	2.0%	42,278	40,578	4.2%
Operating expense	18,945	17,992	5.3%	18,945	17,447	8.6%
Core earnings	23,333	23,468	(0.6%)	23,333	23,131	0.9%
Bad debt expense	2,524	2,004	25.9%	2,524	1,690	49.3%
Tax expense	5,921	5,998	(1.3%)	5,921	6,096	(2.9%)
Outside equity interests	24	41	(41.5%)	24	52	(53.8%)
Cash earnings	14,864	15,425	(3.6%)	14,864	15,293	(2.8%)
Statutory results	14,364	16,671	(13.8%)	14,364	14,881	(3.5%)

Balance sheet dynamics

Credit

Australian domestic credit has continued to grow strongly relative to recent experience at 6.4% annualised (p.a.) to March 2016 (6.7% p.a. at the full year) driven by the sustained growth in housing credit (7.2% p.a.) and a resiliently high business lending growth rate of 6.5% p.a.

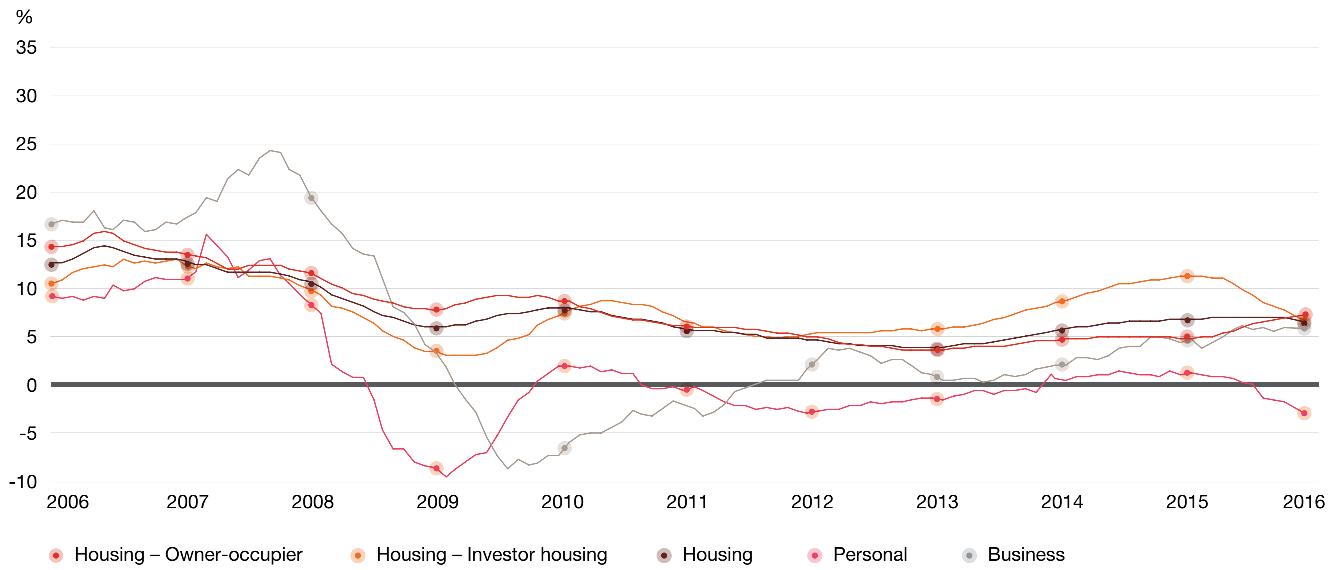
With the majors maintaining market share of total lending of 72.6% at March 2016 and September 2015, credit growth remains the significant driver of bank results.

Investor housing lending has cooled sharply in response to tightening credit settings and repricing and is now well within APRA's 10% growth benchmark at 7% p.a., down from 10.8% p.a. a year ago and 10.2% p.a. six months ago. This is a remarkable change in such a short period of time.

Owner-occupied lending picked up the slack however, growing at 7.2% p.a. annualised to March 2016, higher than 5.2% p.a. in March 2015 and 5.8% p.a. six months ago. These figures are reflective of significant reporting restatements by the major banks in particular.

Business credit growth has maintained its remarkable trend of growth above 6% p.a. at 6.5% p.a. Given the general economic commentary, this appears to indicate a more confident business sector than many believe. These remain growth levels not seen since 2009 and have now been at or above 6% p.a. for over a year.

Domestic Credit Growth (Annual % growth – 12 month rolling average)



Source: RBA

Balance sheet dynamics

Funding

Notwithstanding recent improvements in funding profile, the medium-term funding outlook for the Australian banks remains challenging.

The implementation of the Net Stable Funding Ratio (NSFR) from 2018 will require the majors to ensure a 100% stability match over each 12 month period between funding and assets. While it is dangerous to over-simplify the application of the rules, the banks are likely to need to lengthen their funding profile to match longer-term assets on the balance sheet.

In practice this may present challenges as the supply and pricing of longer-term wholesale funding reduces the attractiveness of this funding source relative to deposits. In addition, Australia has a relatively saturated retail deposit market (of which the majors hold 80.7% share) which has traditionally provided a lower share of funding relative to international peers.

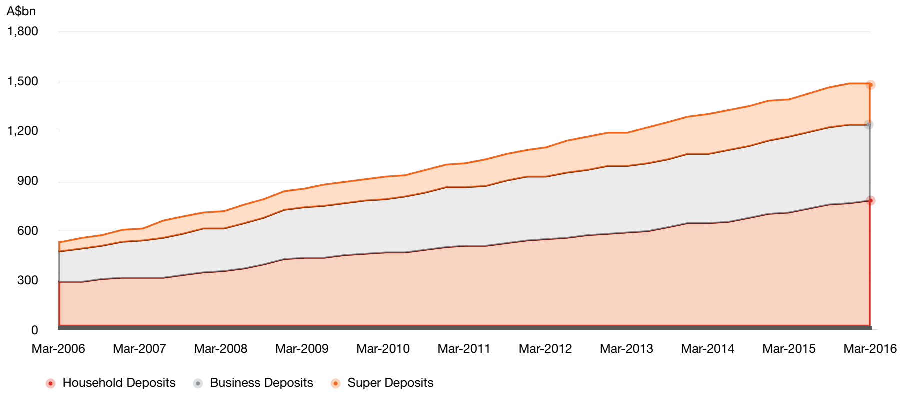
While the rules are yet to be finalised to allow for the unique Australian context, we regard the NSFR as being as significant as changes to the capital requirements for the banks. Either way, we consider it has the potential to impact margins (either through wholesale funding costs or deposit competition) and balance sheet structures (optimising asset/liability profiles).

Deposits continued to be the primary funding source for lending growth, with the loan to deposit ratio at 68.5% (69.7% 12 months ago). Wholesale funding costs have driven some margin compression in the last six months though to date deposit margins continue to improve for the banks. However, we have noticed some increased pricing competition for retail term deposits in recent months. The NSFR outlook may amplify this.

Bank deposits grew at 6.9% p.a. lower than the 7.2% p.a. in September 2015 and March 2015. Deposit mix continued to move away from term deposits (declining 1.6% against pcp at 31 March 2016) favouring call deposits which grew by 11.6% p.a., lower than in September 2015 at 15.4% p.a. or a year ago at 14.0% p.a.

Household deposits grew by 10.1% p.a., in line with a year ago but lower than the 11.0% p.a. seen in September 2015.

Composition of bank deposits (A$bn)



Source: RBA, ABS

Business deposits increased 1.9% p.a., as compared to 6.6% p.a. at September 2015 and 8.5% p.a. at March 2015. Superannuation deposits grew by 7.9% p.a., in contrast to 0.7% p.a. at September 2015 and a 3.8% p.a. contraction seen a year ago.

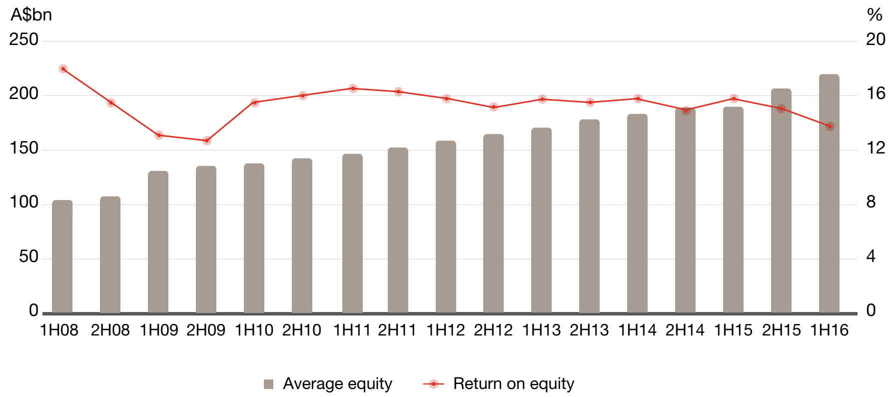
Capital

The major banks have raised or generated a remarkable $19.8bn of Common Equity Tier 1 (CET1) capital over the last year and $4.5bn over the half (net of full year dividends). The Combined CET1 capital ratio of the majors was 10.1%, an increase of 116bps on pcp and 45bps hoh.

RoE has fallen accordingly (in addition to the impact of softening results) down 245bps on pcp and 163bps hoh at 13.7%. In general, we see the regulatory bias towards higher capital for the Australian banks still has a way to run.

Having been in excess of 15% since 2010, our outlook is that RoE is likely to settle at lower levels as the majors adjust to a challenging market outlook, particularly bad debts and margin compression. That trend, together with less scope for profit growth, will see the market rethink the benchmark for Australian bank equity returns.

Average equity and return on equity



Revenues

Net interest income

Net interest income grew 7.2% on pcp and 4.2% hoh reflecting the resilience of domestic lending and deposit growth, and a modest increase in net interest margin.

The margin benefit of loan and deposit repricing in the half was offset by declining institutional banking margins, rising wholesale funding costs (which had been falling for some time), and the broader drag of lower return assets held for liquidity purposes.

The banks' combined net interest margin increased to 2.04%, a 1bp increase (after restatements) from 2.03% a year ago and hoh.

Following the recent Reserve Bank easing, the outlook for funding costs (including the impact of the NSFR) and the prospect of further capital activity, we expect margins to remain at or around these levels in the short-medium term.

There are a number of offsetting factors and the outlook is for further softening:

Lending
+1bp pcp, +3bps hoh

The positive impact of loan repricing in the half was partly offset by competitive asset pricing in the corporate and institutional businesses.

Deposits
+3bps pcp, +2bps hoh

All banks benefited from less intense competition in term deposits when compared to 12 months ago in particular.

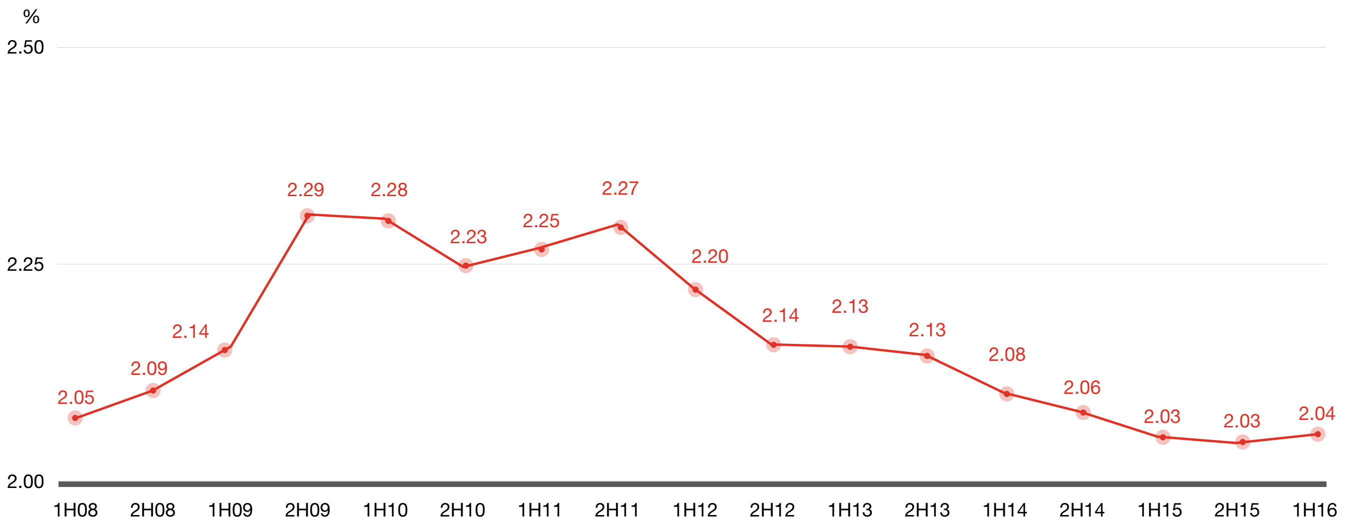
Wholesale funding
-1bp pcp, -3bps hoh

Wholesale funding costs turned during the half following a period of decreasing credit spreads.

Treasury and markets
-2bps pcp, -1bp hoh

Increased holdings of lower earning liquid assets and capital increases led to a drag on margins.

Combined net interest margin



Revenues

Other income

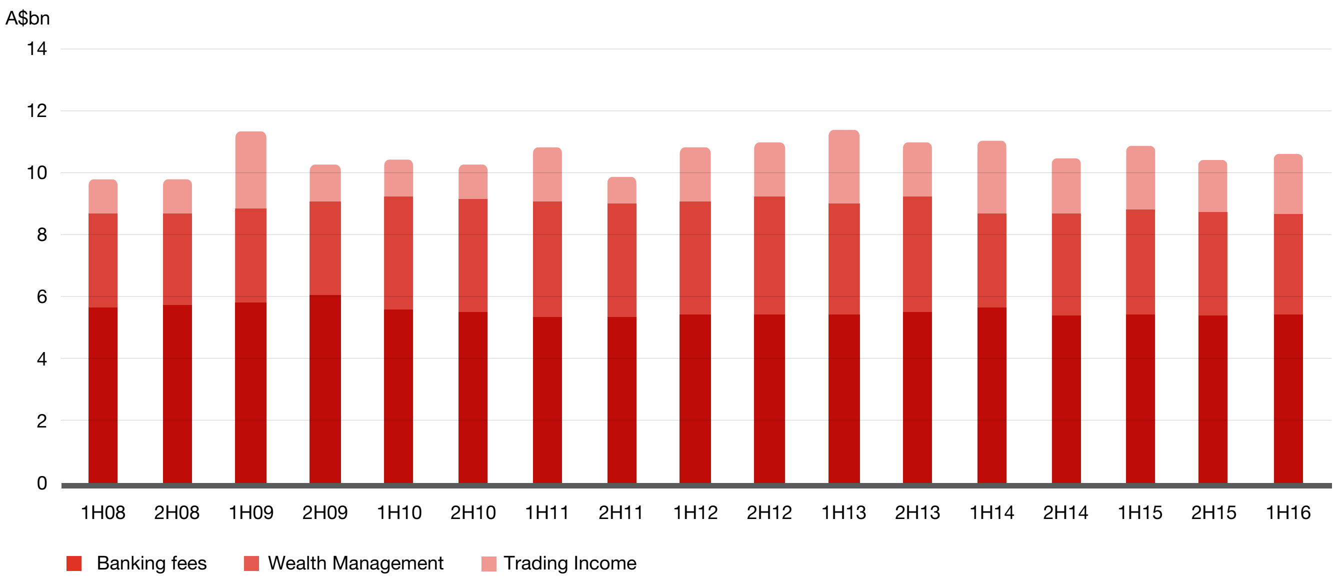
Other income continued to contribute 28.6% of the banks' total income, but declined 2.6% on pcp and 3.2% hoh, with banking fees contributing 45%, wealth management 27% and trading income 16%.

The decline in banking fees of 1.1% on pcp and hoh reflects in particular the competitive market in institutional banking and the impact of interchange fee changes during the half. The outlook for banking fees is likely to continue downward as the trends of digitisation, disruption and competition show no signs of abating.

Trading income trends differ across each bank. In aggregate, trading income declined slightly by $25m (1.2%) on pcp but increased $316m hoh (due to large hedge-related expenses not recurring) to $2.0bn. The banks generally experienced a favourable sales/trading performance in the period and accounting valuation adjustments (CVA etc.) continue to impact the trend.

Wealth management fees declined 1.3% on pcp and 1.4% hoh. The positive impact of growth in in-force premium, and improved lapse rates for insurance were offset by the impact of lower asset markets and the sale of wealth management business stakes.

Analysis of other operating income



↓ 1.1%

Revenue from banking fees ($0.5bn) declined 1.1% on pcp. Fees and commissions decreased 1.3% on pcp, driven by higher lending fees offset by the impact of the interchange reset in the half.

↓ 1.2%

Trading income was down 1.2% on pcp. The story differs from bank to bank, with accounting valuation adjustments impacting the period to period result.

↓ 1.3%

The wealth management businesses had negative income growth of 1.3% on pcp driven by growth in in-force premium and improved lapse rates for insurance offset by the impact of lower asset markets in the half and business sales.

Expenses

$2.2bn

The banks invested $2.2bn over the half, with 49.0% being spent on transformation and productivity projects. Risk and compliance spend ($0.6bn) increased 23.0% on pcp and remains 30.1% of total investment spend.

Total operating expenses increased by 8.6% on pcp and 5.3% hoh, compared to a 3.1% hoh increase at the full year.

The banks combined expense-to-income ratio for the half was 44.8%, higher than 43.0% at pcp and up 140bps hoh.

After adjusting for larger 'one-off' items (ANZ's specified items and NAB's conduct provisions) expense-to-income increased 15bps on pcp to 43.1%. Expense-to-income ratios have been in the 43%-47% range since 2008 and are unlikely to fall significantly given the investment profile needed for future customer engagement.

Total investment spend rose 2.6% on pcp at $2.2bn. A significant proportion of this spend (51.1% for the half) is committed to risk and compliance costs and 'maintenance' of existing systems and infrastructure. This is demonstrative of the challenge of being a large regulated institution in a fast moving sector.

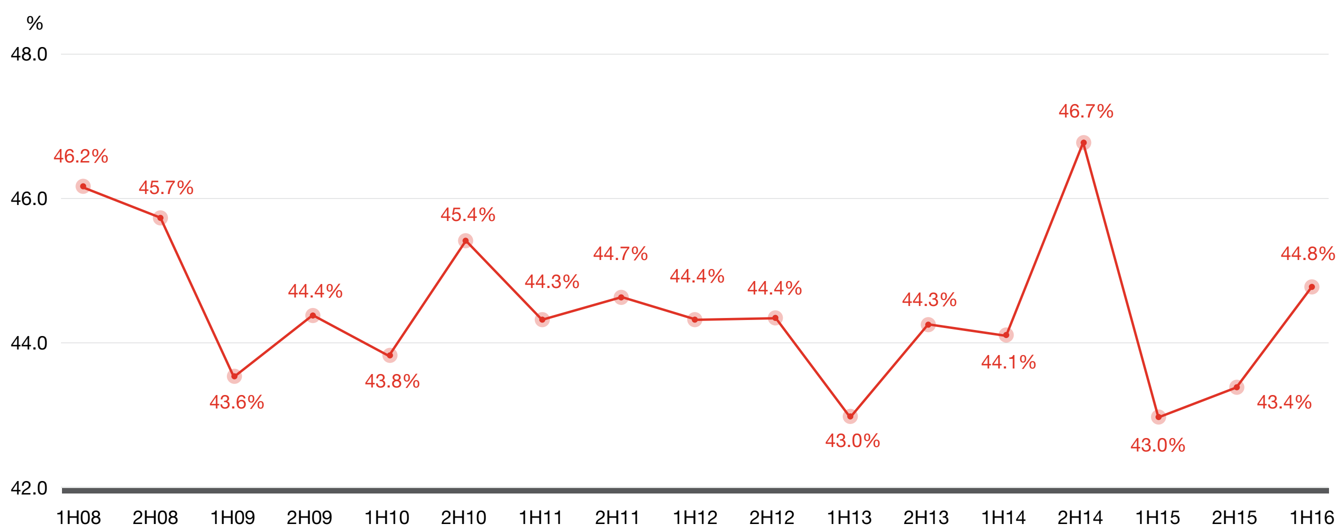
A further bank reassessed the useful lives of software and treatment of project costs during the period. The trend towards accelerating amortisation profiles of investments appears well founded given the pace of technological change and reiterates the criticality of investment prioritisation decisions in the current results outlook.

Software amortisation was $1.4bn for the half compared to $0.8bn in pcp as a result.

The number of full time equivalent staff fell 1.5% or 2,576 on pcp and 1.0% or 1,609 hoh, offsetting wage inflation. Given the trends towards automation, including robotics, we expect this to continue to fall. Personnel expenses were $10.6bn for the half, up only $460m on pcp as a result. Staff compensation is 56.0% of total operating expenses.

The investment prioritisation decisions of the majors are critical as they face an increasingly constrained and disrupted future within a heavily regulated market.

Combined expense-to-income ratio



Asset quality

21bps

Bad debt expense increased by $834m (49.3%) on pcp and $520m (25.9%) hoh due to the impairment of a number of single name exposures across the majors.

Of the $834m of bad debt expense increase, $801m related to individually identified exposures, with portfolio (or 'collective') bad debt expense increasingly only $33m.

This is reflective of continued benign loss experience in the retail loan portfolios, with only limited signs of stress at present.

Impaired assets accounted for 0.4% of total loans and advances at March 2016 down from 0.5% at the same time last year. Impaired facilities rose by 8.5% hoh, mainly within the resources or connected sectors. Non-performing loans or those 90 days past due have remained low at 0.4% of total loans and advances.

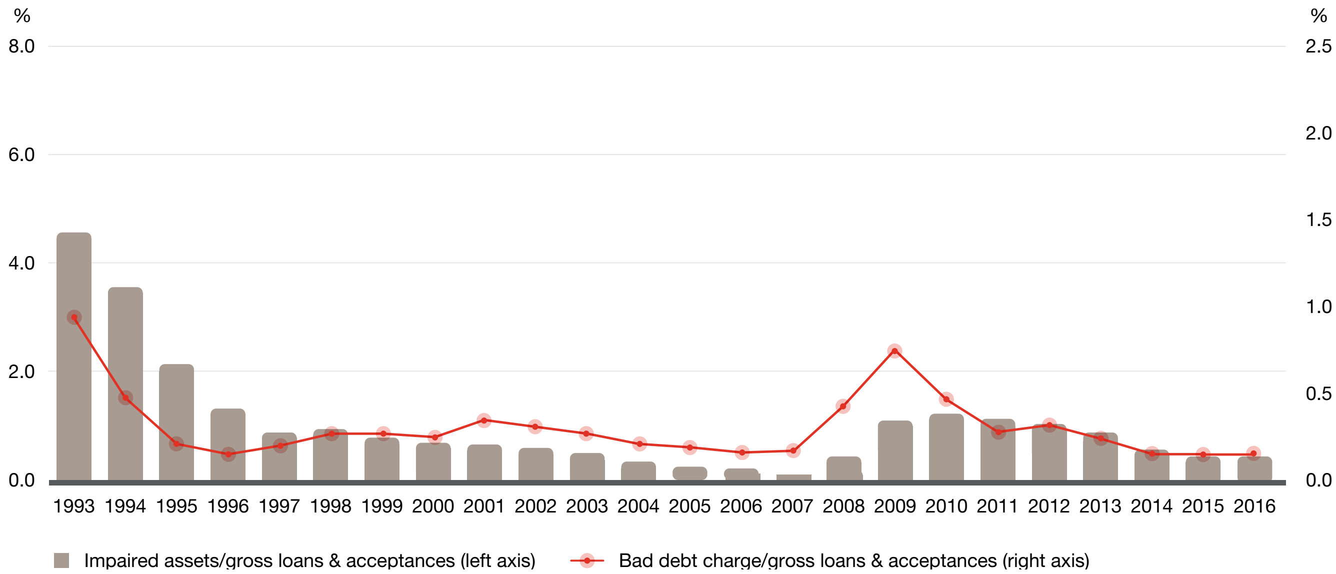
It is important to put all of these figures in the context of the credit cycle and longer term averages. Six months ago we commented that falls in bad debt expense had delivered combined growth in the banks' results of $10.2bn since 2009 and appeared to be bouncing on the bottom of the credit cycle.

Over the last 20 years on average bad debt expense has been 30bps of loans and acceptances, compared to only 22bps for the last three years. On that basis, it is reasonable to assume in time that bad debts will trend higher, but given domestic economic indicators, the interest rate environment and current portfolio performance, we do not see a significant risk of this happening soon.

At 21bps, bad debt expense as a percentage of loans and acceptances rose for the second consecutive half.

96.0% of this increase was attributable to individually identified loans, predominantly in the resource sector.

Impaired assets and bad debt expense



Key banking statistics – Half year 2016

	ANZ			CBA			NAB (iii)			WBC		
	6 mths Mar-16	6 mths Sep-15	6 mths Mar-15	6 mths Dec-15	6 mths Jun-15	6 mths Dec-14	6 mths Mar-16	6 mths Sep-15	6 mths Mar-15	6 mths Mar-16	6 mths Sep-15	6 mths Mar-15
Balance sheet												
Total assets	895,278	889,900	860,087	903,075	873,446	850,714	868,730	955,052	958,587	831,760	812,156	795,961
Risk weighted assets	388,335	401,937	386,863	392,662	368,721	353,048	361,433	399,758	393,238	363,248	358,580	346,823
Gross loans and acceptances	565,451	573,741	561,907	675,728	646,172	627,698	532,313	584,147	573,490	644,054	626,344	608,264
Asset quality & provisioning												
Gross impaired assets	2,883	2,719	2,708	2,788	2,855	3,360	2,174	2,050	2,558	2,487	1,895	2,148
Net impaired assets	1,645	1,658	1,594	1,756	1,829	2,116	1,572	1,379	1,651	1,302	1,018	1,121
Gross impaired assets as a % of gross loans and acceptances	0.51%	0.47%	0.48%	0.41%	0.44%	0.54%	0.41%	0.35%	0.45%	0.39%	0.30%	0.35%
Individually assessed provisions	1,238	1,061	1,114	900	879	1,116	596	637	872	952	669	806
Individually assessed provisions as a % of impaired assets	42.94%	39.0%	41.1%	32.28%	30.8%	33.2%	27.41%	31.1%	34.1%	38.28%	35.3%	37.5%
Collective provisions	2,862	2,956	2,914	2,763	2,739	2,744	2,453	2,883	2,871	2,717	2,663	2,699
Collective provisions as a % of non-housing loans & acceptances	1.14%	1.08%	1.07%	1.24%	1.24%	1.24%	1.07%	1.19%	1.18%	1.27%	1.26%	1.32%
Total provisions	4,100	4,017	4,028	3,663	3,618	3,860	3,049	3,520	3,743	3,669	3,332	3,505
Total provision as a % of gross loans & acceptances	0.73%	0.70%	0.72%	0.54%	0.56%	0.61%	0.57%	0.60%	0.65%	0.57%	0.53%	0.58%
Profit & loss analysis (i)												
Net interest income	7,568	7,478	7,138	8,364	7,890	7,875	6,600	6,288	6,210	7,653	7,305	6,934
Other income	2,748	2,864	3,057	4,056	3,961	3,852	2,323	2,459	2,426	2,966	3,215	3,086
Operating expenses	5,479	4,775	4,603	5,216	5,079	4,914	3,831	3,757	3,676	4,419	4,381	4,254
Core earnings	4,837	5,567	5,592	7,204	6,772	6,813	5,092	4,990	4,960	6,200	6,139	5,766
Bad debt expense	918	695	510	564	548	440	375	349	399	667	412	341
Profit before tax	3,919	4,872	5,082	6,640	6,224	6,373	4,717	4,641	4,561	5,533	5,727	5,425
Income tax expense	1,133	1,326	1,398	1,825	1,699	1,740	1,343	1,312	1,345	1,620	1,661	1,613
Minority interest	4	6	8	11	11	10	0	0	0	9	24	34
Cash earnings	2,782	3,540	3,676	4,804	4,514	4,623	3,374	3,329	3,216	3,904	4,042	3,778
Statutory results (ii)	2,738	3,987	3,506	4,618	4,528	4,535	3,307	3,753	3,231	3,701	4,403	3,609
Key data												
Other operating income as a % of total income	26.64%	27.69%	29.99%	32.66%	33.42%	32.85%	26.03%	28.11%	28.09%	27.93%	30.56%	30.80%
Interest spread	1.80%	1.82%	1.82%	1.94%	1.93%	1.95%	1.76%	1.71%	1.73%	1.95%	1.94%	1.87%
Interest margin	2.01%	2.04%	2.04%	2.06%	2.06%	2.11%	1.93%	1.88%	1.92%	2.14%	2.11%	2.05%
Expense/income ratio (as reported ratio)	53.10%	46.20%	45.10%	42.20%	43.30%	42.20%	41.60%	41.50%	41.00%	41.61%	41.64%	42.46%
Total number of full time equivalent staff	48,896	50,152	51,243	45,221	45,948	44,520	35,520	34,582	34,568	34,677	35,241	36,559
Operating costs per employee (dollars) – annualised	221,266	190,088	181,272	232,987	224,566	221,229	218,521	215,690	214,101	254,207	244,067	233,313
Return on average equity (as reported)	9.70%	13.30%	14.70%	17.20%	17.80%	18.60%	14.10%	14.30%	15.80%	14.15%	15.87%	15.81%
Return on average assets (underlying cash)	0.62%	0.81%	0.89%	1.06%	1.04%	1.13%	0.76%	0.75%	0.75%	0.94%	1.00%	0.96%
Capital ratios												
Common equity	9.80%	9.60%	8.70%	10.20%	9.10%	9.20%	9.69%	10.24%	8.87%	10.50%	9.50%	8.80%
Tier 1	11.60%	11.30%	10.60%	12.20%	11.20%	11.60%	11.77%	12.44%	11.13%	12.10%	11.40%	10.30%
Tier 2 (net of deductions)	2.10%	2.00%	2.00%	1.90%	1.50%	1.10%	1.49%	1.70%	1.68%	1.90%	1.90%	1.80%
Total	13.70%	13.30%	12.60%	14.10%	12.70%	12.70%	13.26%	14.15%	12.81%	14.00%	13.30%	12.10%
Lending and funding ratios												
Gross loans & acceptances/total assets	63.16%	64.47%	65.33%	74.83%	73.98%	73.78%	61.16%	61.16%	59.83%	77.43%	77.12%	76.42%
Housing loans gross loans & acceptances	55.41%	52.50%	51.47%	64.70%	65.44%	65.53%	58.54%	58.54%	57.60%	66.76%	66.13%	69.93%
Deposits (exclude CDs)/gross loans	86.52%	84.21%	85.79%	74.08%	73.84%	72.87%	70.76%	71.71%	72.68%	68.62%	68.20%	69.09%
Deposits (exclude CDs)/total liabilities	58.32%	57.90%	59.66%	59.37%	58.15%	57.20%	46.01%	46.57%	45.87%	57.12%	56.33%	56.36%

All figures in AUD million unless otherwise indicated

(i) In arriving at "cash earnings", income and expenses exclude certain non-cash items. Non-cash items include acquisition related adjustments, impact of hedge accounting and revaluation of treasury shares and other items reported by the banks. Some components of income and expenses have been reclassified to improve comparability between banks.

(ii) Statutory result as reported by the banks, unadjusted.

(iii) NAB's underlying cash earnings after tax are shown before distributions to holders of National Securities – 1H16 ($64m) 2H15 ($66m) and 1H15 ($109m), NAB only reports an expense-to-income ratio for its banking operations. NAB also restated 2015 results to reflect discontinued operations, the Clydesdale Bank IPO, and adjustments to how net interest margin is calculated.

Contacts

Julie Coates
Financial Services Leader
02 8266 2006
julie.coates@pwc.com

Hugh Harley
Financial Services – Global Emerging Markets Leader
02 8266 5746
hugh.harley@pwc.com

Sam Garland
Banking & Capital Markets
02 8266 3029
sam.garland@pwc.com

127038784