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ASX Announcement

NAB 2015 Third Quarter Trading Update

Good result with further progress on strategic priorities

<u>Key points</u>

The quarterly average of the March 2015 Half Year results is used for comparison purposes unless otherwise stated.

- Unaudited cash earnings[1] were approximately $1.75 billion, which is approximately 9% up on the prior corresponding period and approximately 6% above the quarterly average of the March 2015 Half Year result.
- On a statutory basis, unaudited net profit attributable to the owners of the Company for the June quarter was approximately $1.85 billion. The main difference between statutory and cash earnings relates to elimination of treasury shares, and fair value and hedge ineffectiveness.
- On a cash earnings basis:
  - Revenue increased approximately 4%. Excluding a legal settlement gain in this quarter, and gains in the March 2015 Half Year from the UK Commercial Real Estate loan portfolio sale and SGA asset sales, revenue rose approximately 2%. Group net interest margin declined due to weaker Markets and Treasury[2] income and competition for business lending.
  - Expenses increased approximately 4%. Key drivers included investment in the Group's priority customer segments, impairment of a small legacy equity investment and the impact of changes in foreign exchange rates.
  - The charge for Bad and Doubtful Debts (B&DDs) for the quarter fell 15% to $193 million due primarily to lower charges in Australian Banking.
- The Group's Common Equity Tier 1 (CET1) ratio was 9.94% as at 30 June 2015, an increase of 107 basis points from March 2015 mainly reflecting the rights issue proceeds. The Group's CET1 target ratio from 1 January 2016 remains between 8.75% – 9.25%, based on current regulatory requirements.
- The Group's quarterly average liquidity coverage ratio as at 30 June 2015 was 118%.

[1] Refer to note on cash earnings on page 4 of this document.
[2] Markets and Treasury income represents Customer Risk Management and NAB Risk Management Income.

Executive Commentary

"This is a good quarterly result with continuing momentum in our Australian and New Zealand business, improvements in asset quality and further progress made towards addressing legacy issues," NAB Group CEO Andrew Thorburn said.

"Over this period we have maintained a clear focus on our core Australian and New Zealand business. We have continued to invest in a disciplined way in our priority customer segments of home lending, SME and Specialised Business, to deliver a better experience for customers and improve returns to shareholders. Business Banking loan growth has further accelerated in our priority segments which is encouraging, as are recent improvements in Australian business confidence and conditions highlighted in the June 2015 NAB Quarterly Business Survey. It's also pleasing to see results continue to improve in our Wealth business, including delivering strong investment fund performance for our customers.

"We continue to make good progress addressing our legacy and low returning assets to enable greater focus on building a stronger Australian and New Zealand business. Following the end of the third quarter, we successfully divested our remaining holding in Great Western Bank, which will release approximately $1.3 billion of CET1 capital (approximately 34 basis points). In addition, NAB Wealth's life reinsurance transaction took effect from 1 July 2015 which is expected to release a further $500 million of CET1 capital (13 basis points) to the NAB Group and reduces the Group's exposure to retail life insurance while maintaining distribution of life insurance products and services to the Group's customers. Substantial progress has also been made on our intention to pursue a demerger and IPO of Clydesdale Bank over the last three months and we will provide the market with a detailed update of the proposed transaction at our 2015 Full Year results.

"On the technology front, our Personal Banking Origination Platform pilot has recently commenced with a small volume of customer applications now processed in a live environment. This pilot marks important progress towards a step-change improvement in customer experience, driven by modernised product origination and fulfilment. We have also committed $50 million over three years to a new innovation fund, NAB Ventures, to accelerate the Bank's focus on customer-led innovation.

"Maintaining a strong balance sheet has been an essential component of our Group strategy, and the recently completed $5.5 billion rights issue was consistent with this objective. As a result, we are well placed to respond to APRA's announcement of an increase in mortgage risk weights from 1 July 2016," he said.

Business Unit Commentary

Australian Banking cash earnings increased reflecting further falls in B&DD charges, in part due to an agriculture and resources sector overlay taken in the March 2015 Half Year which was not repeated. Revenue rose slightly benefitting from higher volumes of housing and business lending, partly offset by lower Markets and Treasury[3] income and weaker margins in business lending.

NZ Banking local currency cash earnings rose over the quarter. Increased revenue, driven by higher margins and steady volume growth, was partly offset by higher expenses.

NAB Wealth cash earnings increased, benefitting from favourable investment markets, and higher premiums combined with lower retail claims.

[3] Markets and Treasury income represents Customer Risk Management and NAB Risk Management Income.

UK Banking local currency cash earnings declined over the quarter mainly due to the timing of the Financial Services Compensation Scheme (FSCS) levy and the non-recurrence of a one-off pension scheme gain reported in the March 2015 Half Year. Asset quality continued to improve.

<u>Group Asset Quality</u>

Group asset quality metrics continued to improve over the period. The ratio of Group 90+ days past due and gross impaired assets to gross loans and acceptances was 0.78% at 30 June 2015 compared to 0.85% at 31 March 2015.

The ratio of collective provision to credit risk weighted assets was 1.01% at 30 June 2015, unchanged from 31 March 2015. The ratio of specific provisions to impaired assets was 35.2% at 30 June 2015 compared to 35.5% at 31 March 2015.

<u>UK Customer Conduct Update</u>

At the March 2015 Half Year results announcement NAB provided an update on UK customer conduct matters including the requirement by the UK Prudential Regulation Authority (PRA) for NAB to provide £1.7 billion capital support to Clydesdale Bank in relation to potential future legacy conduct costs to achieve the proposed demerger and IPO of that business. The update also disclosed the ongoing significant risk and uncertainty in determining costs associated with conduct-related matters as a contingent liability of the Group. Since the release of the March 2015 Half Year results Clydesdale Bank has continued to operate its remediation program, including progress on the past business review and any consequent need to undertake further proactive customer contact.

Based on the work undertaken to date, which is ongoing and remains incomplete, it is currently expected that an additional provision in respect of payment protection insurance will need to be recognised in finalising the Group's 2015 Full Year accounts and that the provision may be in the range of £290 million to £420 million, primarily driven by increased costs to run the remediation program and impact of the past business review. In relation to interest rate hedging products, based on current redress calculations for completed reviews, and assuming redress calculations remain consistent, it is expected that an additional provision in the range of £60 million and £80 million may also be required at the 2015 Full Year result. Any provision taken will be reported in cash earnings as a specified item.

The amount of any provisions booked as part of the 30 September 2015 Full Year results form part of the previously announced £1.7 billion conduct mitigation package and will reduce the amount of the mitigation package provided in the event of demerger. As disclosed in the March 2015 Half Year results, there continue to be a wide range of uncertain factors relevant to determining the total costs associated with conduct related matters. A full assessment of the actual provisions to be recognised will be made in the normal course as part of the finalisation of the 30 September 2015 Full Year results.

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Note on Cash Earnings

Full detail on how cash earnings is defined, a discussion of non-cash earnings items and a full reconciliation of statutory net profit attributable to owners for the half year ended 31 March 2015 is set out on pages 2 to 7 of the 2015 Half Year Results Announcement under the heading "Profit Reconciliation".

The Group's results and Review of Divisional Operations and Results are presented on a cash earnings basis, unless otherwise stated. Cash earnings is a key financial performance measure used by NAB, the investment community and NAB's Australian peers with a similar business portfolio. NAB also uses cash earnings for its internal management reporting, as it better reflects what NAB considers to be the underlying performance of the Group. It is not a statutory financial measure and is not presented in accordance with Australian Accounting Standards nor audited or reviewed in accordance with Australian Auditing Standards. "Cash earnings" is calculated by excluding some items which are included within the statutory net profit attributable to owners of the Company. The Group's financial statements, prepared in accordance with the *Corporations Act 2001* (Cth) and Australian Accounting Standards, and reviewed by the auditors in accordance with Australian Auditing Standards, are included in Section 5 of the 2015 Half Year Results Announcement.

Treasury shares are shares in the NAB held by the Group's life insurance business and in trust by a controlled entity of the Group to meet the requirements of employee incentive schemes. The unrealised mark-to-market movements arising from changes in the share price, dividend income and realised profit and losses arising from the sale of shares held by the Group's life insurance business are eliminated for statutory reporting purposes.

Fair value and hedge ineffectiveness represents volatility attributable to the Group's application of the fair value option, ineffectiveness from designated accounting and economic hedge relationships and economic hedges of significant approved funding activities where hedge accounting has not been applied.

Disclaimer – Matters relating to potential demerger and IPO of Clydesdale Bank

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