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Wednesday, 28 October 2015

ASX Announcement

NAB 2015 Full Year Results

Delivering on strategic agenda

Highlights

- Cash earnings[1] up 15.5%, or 2.4% excluding specified items[2]. Statutory net profit up 19.7% over the year
- All businesses contributing
- Final dividend 99 cents per share fully franked, as flagged in 1H15
- Sale of 80% of life insurance business and partnership with Nippon Life
- Intention to demerge and IPO CYBG[3] in February 2016
- Balance sheet remains strong, CET1 ratio of 10.2% and asset quality improved

Key points

Results for the 30 September 2015 full year are compared with 30 September 2014 full year unless otherwise stated.

- On a statutory basis, net profit attributable to the owners of the Company was $6.34 billion, an increase of $1.04 billion or 19.7%. Excluding discontinued operations[4], statutory net profit increased 22.7% to $6.36 billion.
- Cash earnings[1] were $5.84 billion, an increase of $0.78 billion or 15.5%. Excluding specified items[2], the increase was 2.4% over the year and 2.8% compared to the March 2015 half year. The main difference between statutory and cash earnings over the year relates to the effects of fair value and hedge ineffectiveness[1].
- On a cash earnings basis:
  - Revenue increased approximately 4%. Excluding gains from a legal settlement and the UK Commercial Real Estate loan portfolio sale and SGA asset sales, revenue rose approximately 3%, benefitting from higher lending balances, stronger Markets and Treasury income[5], increased NAB Wealth net income, and the impact of foreign exchange rates. Group net interest margin (NIM) declined 4 basis points, mainly due to competition for business lending.

[1] Refer to note on cash earnings, and fair value and hedge ineffectiveness on page 7 of this document.
[2] Specified items, which include UK conduct charges, have impacted expenses and cash earnings in FY14 and FY15, and are detailed on page 20 of the Full Year 2015 Results Announcement.
[3] Newly created holding company for Clydesdale Bank PLC and equivalent to the entity previously referred to as 'ListCo'.
[4] Included within discontinued operations are the post tax profit/loss of GWB and the post tax gain/loss recognised on the disposal of the assets relating to GWB.
[5] Markets and Treasury income represents Customer Risk Management and NAB Risk Management income.

  - Expenses fell approximately 1%, but excluding specified items[2] and foreign exchange rate impacts rose approximately 4%. Key drivers include investment in the Group's priority customer segments, increased technology costs, higher UK spend associated with preparing for separation, combined with wage increases.
  - Improved asset quality resulted in a total charge for Bad and Doubtful Debts (B&DDs) of $823 million, down approximately 5% due to lower charges in Australian Banking and UK Banking. The charge includes a collective provision overlay of $102 million for Australian agriculture and resource sectors, and an increase in New Zealand collective provision charges of NZ$78 million predominantly relating to the dairy sector.
- The Group's Common Equity Tier 1 (CET1) ratio was 10.2% as at 30 September 2015, an increase of 137 basis points from March 2015 mainly reflecting the rights issue proceeds. The Group's CET1 target ratio remains between 8.75% – 9.25%, based on current regulatory requirements. The CET1 ratio at 30 September 2015 is above the target range reflecting regulatory increases in mortgage risk weights from 2016 and the intended UK demerger.
- The final dividend is 99 cents per share (cps) fully franked, unchanged from the 2015 interim and 2014 final dividends.
- The Group maintains a well diversified funding profile and has raised approximately $26.5 billion of term wholesale funding in the 2015 financial year. The weighted average term to maturity of the funds raised by the Group over the 2015 financial year was 4.7 years. The stable funding index was 92.3% at 30 September 2015, 1.9 percentage points higher than at 30 September 2014.
- The Group's quarterly average liquidity coverage ratio as at 30 September 2015 was 115%.

Executive Commentary

"In 2015 we have been focused on delivering against our plan – driving improved performance in our Australian and New Zealand business, investing for growth, delivering significant technology milestones for our customers, building a stronger balance sheet and exiting our legacy and lower returning assets," NAB Group CEO Andrew Thorburn said.

"Improving the customer experience is a priority for us. In the first year of adopting the Net Promoter System (NPS)[6] our Australian and New Zealand businesses have oriented around it to drive a truly customer centric culture. NPS is now embedded in the 160 Performance Unit leader scorecards, ensuring the customer is central in our culture and helping us deliver continuous improvements to our customers.

"Our Wealth business has delivered significantly improved results since 2013 which has enabled us to secure the long term partnership we are announcing today with Nippon Life, one of the world's leading life insurers. Nippon Life will acquire 80% of NAB's life insurance business, while NAB will retain the remaining 20%. This partnership will enable us to continue to deliver insurance solutions to our customers while improving Wealth returns for shareholders.

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[6] Net Promoter® and NPS® are registered trademarks and Net Promoter Score and Net Promoter System are trademarks of Bain & Company, Satmetrix Systems and Fred Reichheld

“Wealth products remain important to our business which is why today we are also announcing additional investment of at least $300 million in NAB Wealth over the next four years in our superannuation, platforms, advice and asset management business. This will allow us to deliver a great customer experience while driving a closer relationship between our banking and wealth businesses.

“We are also pleased to confirm the demerger and Initial Public Offering (IPO) of CYBG PLC (CYBG) which is expected to be complete in early February 2016. This follows the completion of the Great Western Bank (GWB) sell-down, the finalisation of the life reinsurance transaction, and the sale of most of our UK Commercial Real Estate portfolio.

“In Australia, Personal Banking has had another strong year with pleasing revenue growth and has also entered into an exclusive 10-year scheme partnership with Visa enabling significant future investment in the cards portfolio. While Business Banking trends in our priority SME segments are promising, including improved market share, the environment remains very competitive and we remain focused on improving performance further in this business. Our New Zealand business continues to perform, delivering good underlying profit growth against a backdrop of weaker milk prices.

“We have achieved significant technology milestones this year which will deliver a better experience for our customers. The Personal Banking Origination Platform (PBOP) is currently in pilot with contact centres and select branches originating and fulfilling personal products on the new platform, delivering enhanced customer functionality and reducing turnaround times. We also successfully migrated over 1,000 business applications and 3,500 servers to our new state-of-the-art data centre in September.

“Over the year we have continued to strengthen our balance sheet. The $5.5 billion capital raising in May means we are now well placed to absorb higher regulatory capital requirements in the future. In addition, a focus on maintaining risk standards has contributed to further improvements in asset quality.

“In 2016, our business will be stronger and more focused on delivering for our customers and our shareholders. We know our people are also aligned to achieving these goals. We will have exited all our low returning offshore businesses, allowing us to fully focus on serving our priority customer segments and leveraging the investments we have made in Australia and New Zealand,” Mr Thorburn said.

<u>Sale of 80% of Life Insurance business and partnership with Nippon Life</u>

Consistent with our commitments to improve the returns from NAB Wealth and continue to provide wealth solutions for our customers, we are today announcing an agreement to sell 80% of NAB Wealth’s life insurance business to Nippon Life Insurance Company (Nippon Life) for $2.4 billion[7]. This transaction, which is separate and in addition to the life reinsurance transaction[8] finalised in July 2015, represents an attractive long term partnership with a high quality partner. Nippon Life is

[7] Sale price is as at expected completion date in the second half of calendar 2016 and is post capital release from the reinsurance transaction announced May 2015. This amount will be adjusted for certain capital inflows and outflows, including any dividends paid to NAB by the life insurance business between 28 October 2015 and completion.
[8] Life reinsurance transaction arrangement with a major global reinsurer covering ~21% of retail advised insurance book.

one of the world's leading life insurers with 126 years of history and a strong focus on the customer. As part of the partnership NAB will enter a 20 year distribution agreement to provide life insurance products through its owned and aligned distribution networks.

NAB will retain existing ownership of its investments business which includes superannuation, platforms, advice and asset management.

The transaction will occur through the sale of 80% of MLC Limited after the extraction of NAB's superannuation and investments business and certain other restructuring steps. NAB will retain the MLC brand, although it will be licensed for use by the life insurance business for 10 years, and will continue to be applied as is currently the case in our superannuation, investments and advice business. The transaction is expected to be completed by the second half of calendar 2016 subject to certain conditions including regulatory approvals, establishment of the life insurance business as a standalone entity, extraction of the superannuation business from MLC Limited and the finalisation of certain agreements. NAB will retain responsibility for managing the life insurance business until completion.

The sale price[7] represents a FY15 implied PE of 19x for the 80% stake based on pro forma earnings of approximately $160 million. The transaction is expected to result in an indicative loss on sale of approximately $1.1 billion[9] inclusive of transaction and separation costs, based on expected completion life insurance net assets of $3.6 billion including $1.6 billion of allocated goodwill[10]. In addition, NAB's pro forma FY15 CET1 ratio is expected to increase by approximately 50 basis points after allowing for transaction and separation costs, with this increased capital expected to be retained by NAB to meet potential increased regulatory capital requirements.

One off post-tax costs of approximately $440 million[11] are expected to be incurred by NAB relating to separation, and the extraction and simplification of the superannuation business.

<u>UK Update</u>

In line with our strategy to focus on the Australian and New Zealand franchise, the Group has announced its intention to divest CYBG PLC (CYBG)[3], through a demerger and Initial Public Offering (IPO), in early February 2016. Significant progress has been made on the proposed transaction, including advanced engagement with key regulators and listing authorities in both jurisdictions.

The Group's intention is to pursue a demerger of approximately 75% of CYBG to NAB shareholders and a sale of the balance by way of IPO (up to approximately 25%) to institutional investors. It is proposed that CYBG will have a primary listing on the London Stock Exchange (LSE) and a CHESS Depositary Interest (CDI) listing on the Australian Securities Exchange (ASX).

The proposed demerger and IPO remains subject to a range of matters, including various court and regulatory approvals and NAB shareholder approval. Shareholder approval will be sought at a meeting expected to be in late January 2016.

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[9] Actual loss will vary depending on level of earnings between signing and completion, the final allocation of goodwill at the time of deconsolidation, final transaction costs and a number of other items. The loss is expected to be reported in non cash earnings.
[10] The final allocation of goodwill is subject to change and will be determined at the time of deconsolidation.
[11] Included in indicative loss on sale of $1.1 billion; expected to be reported in non cash earnings.

As announced at the third quarter trading update on 10 August 2015, additional conduct provisions were expected to be required at the Full Year 2015 results in relation to both payment protection insurance (PPI) and interest rate hedging product (IRHP) costs. These additional provisions have now been determined and comprise the following:

- Provisions of £390 million (£323 million or A$704 million after tax) in relation to PPI reflecting the impact of the past business review and the consequent need to undertake further proactive customer contact, as well as costs to run the remediation program

- Provisions of £75 million (£63 million or A$135 million after tax) in relation to interest rate hedging products and fixed rate tailored business loans based on additional expected claims

As announced at the March 2015 Half Year results, in order to achieve the proposed CYBG demerger and IPO the UK PRA requires capital support for CYBG of £1.7 billion in relation to potential future legacy conduct costs. The provisions of £465 million recognised in the September 2015 half year will form part of the £1.7 billion support package and, combined with £120 million for CYBG's share of future conduct liabilities, will result in a capped indemnity from NAB of £1.115 billion upon separation[12]. Assuming no further pre-demerger provisions are raised, future legacy conduct costs will be shared 90.3%/9.7% between NAB and CYBG respectively.

On completion of the demerger, the capped indemnity amount of £1.115 billion[11] is expected to result in a deduction from NAB's CET1. To the extent that claims against NAB under the capped indemnity are ultimately less than £1.115 billion, this is expected to result in a commensurate CET1 benefit for NAB.

<u>Business Unit Commentary</u>

Australian Banking cash earnings were $5,111 million, an increase of 3% reflecting higher revenue and lower B&DD charges. Revenue rose 4% benefitting from stronger Markets and Treasury[5] performance combined with higher volumes of housing and business lending while NIM declined 3 basis points as a result of lending competition. Expenses rose 6% or 5% excluding the impact of changes in foreign exchange rates, with investment in front line banker roles in priority customer segments combined with higher project costs, partly offset by productivity savings. Asset quality metrics continued to improve and B&DD charges of $665 million fell 10% over the year and 18% over the March 2015 half year. This largely reflects lower new impaired loans, and is despite higher collective provision charges including a $102 million overlay for the agriculture and resource sectors.

NAB Wealth cash earnings increased 27% to $464 million benefitting from stronger insurance income and stable costs. Net income rose 10% reflecting higher premium pricing, improved insurance lapses and claims, and non-recurrence of insurance reserve strengthening in the prior year. While funds under management rose 8% with strong investment markets and the acquisition of Orchard Street Investment Management in the March 2015 half year, this was offset by lower IoRE[13] and lower investment margins mainly due to MySuper plan transitions and business mix changes.

[12] Unless other provisions are taken, and funded by NAB, prior to the demerger.
[13] Investment earnings on retained earnings.

NZ Banking local currency cash earnings of $823 million rose 2% over the year. Good underlying profit growth was partly offset by higher collective provision charges in the September 2015 half year predominantly relating to the dairy sector. Revenue rose 4% with improved lending volumes and higher margins. Cost growth was contained to 2%, while still investing in staff and technology to support the Auckland focused growth strategy.

UK Banking local currency cash earnings of £156 million were broadly flat. Mortgage volume growth and a halving of B&DD charges to £38 million reflecting asset quality improvements, were more than offset by higher costs particularly in the September 2015 half year, and lower margins. Costs rose 7% reflecting investment in the franchise and the impact of pre separation activities, which were partly offset by a one-off pension scheme gain.

Group Asset Quality

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 of 0.71% at 30 September 2015 was 14 basis points lower compared to 31 March 2015 and 48 basis points lower compared to 30 September 2014.

The ratio of collective provision to credit risk weighted assets was 1.01% unchanged from 31 March 2015. The ratio of specific provisions to impaired assets was 32.7% at 30 September 2015 compared to 36.0% at 31 March 2015.

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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 full year ended 30 September 2015 is set out on pages 2 to 8 of the 2015 Full 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 discontinued operations and other items which are included within the statutory net profit attributable to owners of the Company. Section 5 of the Full Year Results Announcement sets out the Consolidated Income Statement of the Group, including statutory net profit. The Group's financial statements, prepared in accordance with the *Corporations Act 2001* (Cth) and Australian Accounting Standards, will be released on 16 November 2015 in NAB's 2015 Annual Financial Report.

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 CYBG PLC

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The information contained in this announcement in relation to the potential demerger and IPO of CYBG PLC, the new proposed holding company for Clydesdale Bank, is for background purposes only and does not purport to be full or complete. No reliance may be placed for any purpose on the information contained in this announcement or its accuracy, fairness or completeness. This document is not intended to be relied upon as advice to investors or potential investors and does not take into account the investment objectives, financial situation or needs of any particular investor.

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