Media statement
Thursday 4 May 2017

BNZ's ongoing investment and momentum delivers sound results

Strong underlying momentum has seen Bank of New Zealand (BNZ) report a statutory net profit for its banking group[1] of NZ$416 million and a significant increase in cash earnings[3] of 9% on the 2016 prior comparable period.

"This achievement reflects the progress the business is making in delivering its strategic agenda, in a challenging and competitive market. In our priority customer segments, we have seen a further lift in customer advocacy which is particularly pleasing. This is a result of our focus on the end-to-end customer experience, particularly in our digital offering, which allows us to deliver our customer promises and to help New Zealanders be good with money.

"The current strength of the New Zealand economy is delivering benefits and challenges, which is reflected in very sound credit quality and lower bad and doubtful debts, but with increasing margin compression as credit growth continues to exceed deposit growth in the system," said BNZ CEO Anthony Healy.

Key results: *(comparison with the 6 months ending 31 March 2016, unless otherwise stated)*

BNZ Banking Group[1]

- **Statutory net profit[1]** of NZ$416 million, NZ$35 million less than last year, due to mark to market movements on offshore debt instruments, partially offset by higher cash earnings.
- **Cash earnings[3]** of $484 million, increased by NZ$40 million or 9.0%
- **Common Equity Tier 1, Tier 1 and total capital ratios[1]** of 10.55%, 12.06% and 13.29%.

NAB NZ Banking Reporting Segment[2]

- **Underlying profit[2]** increased by NZ$23 million or 3.6% mainly due to higher net interest income.
- **Cash earnings[3]** increase of NZ$43 million or 10.4% to $455 million was driven by higher net interest income and lower charges for bad and doubtful debts.
- **Net interest income[2]** increased by NZ$25 million or 3.1%, driven by growth in lending and deposit volumes, partly offset by lower net interest margin.
- **Net interest margin[2]** decreased by 12 basis points to 2.15% driven higher funding costs and lower earnings on capital. This was partly offset by improved lending margin in both housing and business lending.
- **Other operating income[2]** increased by NZ$1 million or 0.4% mainly due to improved fees and commissions partially offset by lower markets sales income.
- **Operating expenses[2]** increased by NZ$3 million or 0.7% mainly due to the investment in Auckland and broker channels in 2016 resulting in higher depreciation and amortisation expense, offset by operating efficiencies.

---

1 "Banking Group" means Bank of New Zealand's financial reporting group, which consists of Bank of New Zealand, all of its wholly owned entities and other entities consolidated for financial reporting purposes.
2 "NAB NZ Banking Reporting Segment": excludes BNZ's Group Capital Management and BNZ Markets Trading Operations from the "Banking Group" and includes the Insurance operation in New Zealand for management reporting purposes.
3 Cash earnings is a non-IFRS key financial performance measure used by BNZ for its internal management reporting as it better reflects what BNZ considers to be underlying performance. Cash earnings is calculated by excluding fair value movements and hedging gains/(losses) as they introduce volatility and/or distortion within the statutory net profit which is income neutral over the full term of transactions. A reconciliation of cash earnings to net profit is included on the final page. Cash earnings is not a statutory financial measure, is not presented in accordance with NZ GAAP and is not audited or reviewed in accordance with International Standards on Auditing (New Zealand).

- **Charges for bad and doubtful debts**[2] decreased by NZ$44 million or 52.4% as a result of improved economic conditions, including the outlook for the dairy portfolio.
- **Customer deposits**[2] increased by NZ$4.2 billion or 8.6% as a result of the focus on deposit growth.
- **Gross loans and acceptances**[2] increased by NZ$5.1 billion or 7.2% driven by housing and business lending.

<u>Commentary – Anthony Healy</u>

Digital investment

"BNZ continues to invest in digital and online banking and payments technology to meet customer demand. Since FY14 we have seen a 25% increase in the number of people working in our digital teams. 89% of transactions are now either through internet banking or our app – that is up to 14m sessions each month. This is a 25% increase overall and mobile is up 34%.

"Highlights for this half include the New Zealand launch of BNZ Android Pay in December 2016 on our BNZ Flexi Debit Visa card. Within a week we had reached our 60-day target for customer sign ups. Transactions and sign ups show that our customers are open to new ways of paying. In April, we integrated Android Pay into the BNZ app which is an Asia-Pacific first. This means Android Pay can be set up and used with the BNZ app, (as opposed to having to download a separate Android app) making it easier for our customers to use.

"Our digital investment is helping our customers reach their financial goals. Our home loan repayment calculator allows them to increase their home loan payments from the comfort of their couch. So far, customers who have made increases to their payments stand to save $187m and take 43,000 years off their home loans. On average, customers using this tool to increase their payments have taken two years and three months off their home loan."

Re-shaping our channels

"Our customers' needs and preferences are changing rapidly - they expect simple, intuitive experiences, fast turnarounds, simple processes and technology that is "always on". We need to evolve with our customers to remain relevant, and it is this imperative that is driving our investment in digital platforms, our focus on end-to-end customer experiences, and our ongoing re-shaping of our physical and digital footprint.

With almost nine out of ten transactions with our customers now happening online, this means changes in our store network. Sometimes this means reducing hours, sometimes this means closing stores, and sometimes this means opening stores in new areas. This reshaping of our network will continue into the future, informed by our customers' needs and preferences.

And as we simplify and deliver better customer experiences that are faster and more efficient, we are automating and digitising things that are currently manual and don't need to be. Both these initiatives will mean fewer people in parts of our business as well as growth of investment in areas of our business that didn't exist 10 years ago or indeed, even today. Where possible we look to redeploy our people affected by these changes into other parts of our business where we are hiring."

Business Banking

"Our BNZ Partners offering continues to resonate strongly in the market with SMEs. We opened a new Partners Centre in the Christchurch CBD in December 2016, and in March opened a co-working space in our new Christchurch retail store, for small businesses, called community 101.

Our business banking model is a real differentiator for us in the market and our support of regional New Zealand can be seen through the reach of our 34 Partners Centres across the country."

Mortgage market
"We have had a real focus on sustainable growth and the broker market is key for us achieving that, with growth of $900 million in broker home loans this year. We have a strong portfolio of six broker partners, who in turn have more than 800 advisors. We've made improvements to our processes and we're realising the productivity benefits of this.

"Housing affordability continues to be an issue, though most recently we have seen the impact of the loan-to-value restrictions in the housing market and prices, particularly in Auckland, have seemed to plateau. We anticipate there will be increased pressure on lending margins in the coming months which will influence interest rates. Essentially, while funding costs have fallen they haven't fallen by as much as our lending rates, which means our margins have reduced. Today there are more people looking to borrow, so banks are paying more to win customers deposits so this will lead to higher lending costs being passed through to borrowers."

Contribution to a high-achieving New Zealand
"The expansion of the Community Finance Initiative is a real highlight. Government has committed an additional $4.2million in operating expenditure and we have worked with Good Shepherd and our community providers to expand this service in new areas including Whangarei, Hamilton, Tauranga, Hawkes Bay, Palmerston North, Rotorua, Wellington, Christchurch and Invercargill. Community Finance offers low and no interest loans to New Zealanders who typically don't meet bank criteria. We estimate that our $1,046,248 of lending has saved customers more than $560,000 compared with borrowing through alternative lenders. BNZ has committed a total of $60 million of lending to support growth of the community finance initiative and has a dedicated team to support the initiative."

Additionally, in March, BNZ's new responsible investment strategy took effect and we now exclude international equity investment in companies manufacturing cluster bombs, nuclear armaments, land mines and tobacco. We listened to the views expressed in the responsible investment debate last year and have aligned BNZ with our customers' opinions.

Capital and Funding Position
BNZ maintains a robust capital structure, with a strong balance sheet that is well funded through diversified and stable funding sources. BNZ's Core Funding Ratio (CFR) of 85.59% exceeds the Reserve Bank of New Zealand (RBNZ) minimum requirement of 75% as at 31 March 2017. BNZ's Common Equity Tier 1, Tier 1 and Total capital ratios of 10.55%, 12.06% and 13.29% respectively, as at 31 March 2017, were well above the RBNZ minimum capital ratio requirements of 7.00%, 8.50% and 10.50% respectively.

In October 2016, BNZ issued NZ$900million of mandatorily convertible subordinated perpetual unsecured notes to its ultimate parent, National Australia Bank Limited.

Collectively, BNZ's funding and capital position is supportive of BNZ's long-term senior unsecured issuer credit ratings of AA-/Aa3/AA- (S&P/Moody's/Fitch).

ENDS
For further information, contact: Katherine Cornish, External relations manager M. 021 947 835
E. Katherine_cornish@bnz.co.nz

BNZ Banking Group

Income Statement Summary

	Mar 17 NZ$m	Sep 16 NZ$m	Mar 16 NZ$m	Mar 17 v Sep 16 %	Mar 17 v Mar16 %
Net interest income	**861**	875	882	(1.6%)	(2.4%)
Gains less losses on financial instruments	**22**	51	55	(57.6%)	(60.6%)
Other operating income	**195**	212	194	(8.0%)	0.6%
Total operating income	**1,078**	1,138	1,131	(5.3%)	(4.7%)
Operating expenses	**(458)**	(455)	(434)	(0.6%)	(5.4%)
Total operating profit before impairment losses on credit exposures and income tax expense	**620**	683	697	(9.2%)	(11.0%)
Impairment losses on credit exposures	**(43)**	(41)	(79)	(4.3%)	45.9%
Total operating profit before income tax expense	**577**	642	618	(10.1%)	(6.6%)
Income tax expense on operating profit	**(161)**	(180)	(167)	10.7%	3.8%
Net profit attributable to shareholders of Bank of New Zealand	**416**	462	451	(10.0%)	(7.8%)

Balance Sheet Summary

	Mar 17 NZ$m	Sep 16 NZ$m	Mar 16 NZ$m	Mar 17 v Sep 16 %	Mar 17 v Mar16 %
Assets					
Cash and liquid assets	**2,500**	1,799	1,531	39.0%	63.3%
Due from central banks and other institutions	**1,914**	2,299	1,529	(16.7%)	25.2%
Trading securities	**5,017**	4,703	5,110	6.7%	(1.8%)
Derivative financial instruments	**5,410**	7,319	7,388	(26.1%)	(26.8%)
Loans and advances to customers	**76,733**	74,378	71,359	3.2%	7.5%
Other assets	**2,449**	2,043	3,161	19.9%	(22.5%)
Total assets	**94,023**	92,541	90,078	1.6%	4.4%
Liabilities					
Due to central banks and other institutions	**1,463**	1,244	1,243	17.6%	17.7%
Derivative financial instruments	**5,745**	7,786	8,649	(26.2%)	(33.6%)
Deposits and other borrowings	**58,995**	57,511	54,062	2.6%	9.1%
Bonds and notes	**17,626**	16,723	16,078	5.4%	9.6%
Other liabilities	**3,361**	2,272	2,687	47.9%	25.1%
Total liabilities	**87,190**	85,536	82,719	1.9%	5.4%
Total shareholders' equity	**6,833**	7,005	7,359	(2.5%)	(7.1%)
Ordinary shareholder's equity	**6,833**	6,805	6,709	0.4%	1.8%
Contributed equity – perpetual preference shareholders	**-**	200	650	(100.0%)	(100.0%)
Total shareholders' equity	**6,833**	7,005	7,359	(2.5%)	(7.1%)

Performance Measures[1]

	Mar 17	Sep 16	Mar 16	Mar 17 v Sep 16	Mar 17 v Mar16
Net profit on average assets	**0.88%**	1.01%	1.02%	(13 bps)	(14 bps)
Net interest margin	**2.02%**	2.14%	2.23%	(12 bps)	(21 bps)
Cost to income ratio	**42.49%**	39.98%	38.37%	251 bps	412 bps

Capital Adequacy Ratios[2]

	Mar 17 Basel III	Sep 16 Basel III	Mar 16 Basel III	Mar 17 v Sep 16 %	Mar 17 v Mar16 %
Common Equity Tier One capital ratio	**10.55%**	10.21%	10.41%	34 bps	14 bps
Tier One capital ratio	**12.06%**	10.54%	11.03%	152 bps	103 bps
Total qualifying capital ratio	**13.29%**	12.04%	12.58%	125 bps	71 bps

1. Performance measures are based on the BNZ Banking Group which excludes the Insurance operation in New Zealand and includes BNZ's Group Capital Management and BNZ Markets Trading Operations. Performance measures are calculated on a net profit basis.
2. Based on the RBNZ's Capital Adequacy Framework.

NAB NZ Banking Reporting Segment

	Mar 17 NZ$m	Sep 16[1] NZ$m	Mar 16[1] NZ$m	Mar 17 v Sep-16	Mar 17 v Mar-16
Net interest income	823	809	798	1.7%	3.1%
Other operating income	280	295	279	(5.1%)	0.4%
Net operating income	1,103	1,104	1,077	(0.1%)	2.4%
Operating expenses	(433)	(437)	(430)	0.9%	(0.7%)
Underlying profit	670	667	647	0.4%	3.6%
Charge to provide for bad and doubtful debts	(40)	(41)	(84)	2.4%	52.4%
Cash earnings before tax	630	626	563	0.6%	11.9%
Income tax expense	(175)	(174)	(151)	(0.6%)	(15.9%)
Cash earnings (NAB NZ Banking Reporting Segment)[2]	455	452	412	0.7%	10.4%
Reconciling items to statutory net profit (BNZ Banking Group)					
Structural differences between NAB NZ Banking Reporting Segment and BNZ Banking Group[3]	29	15	32	*large*	(9.3%)
Cash earnings (Legal Entity)	484	467	444	3.6%	9.0%
Fair value movements and hedging gains/(losses)[4]	(95)	(7)	10	*large*	large
Taxation on reconciling items	27	2	(3)	*large*	large
Net profit attributable to shareholders of Bank of New Zealand[5]	416	462	451	(10.0%)	(7.8%)
Volumes (NZ$bn)[6]					
Gross loans and acceptances	76.2	74.1	71.1	2.8%	7.2%
Average Interest earning assets	76.6	73.3	70.4	4.5%	8.8%
Total assets	79.8	77.5	74.0	3.0%	7.8%
Customer deposits	53.0	50.5	48.8	5.0%	8.6%
Performance Measures[6]					
Cash earnings on average assets	1.16%	1.20%	1.14%	(4 bps)	2 bps
Net interest margin	2.15%	2.21%	2.27%	(6 bps)	(12 bps)
Cost to income ratio	39.3%	39.6%	39.9%	30bps	60bps

1. Certain comparative balances have been restated to align with the presentation used in the current financial year. Statutory net profit remains consistent with prior periods. The previously reported NZ Banking segement has been changed to align with the restated NAB NZ Banking Reporting segment which includes Markets Sales Operations, this represents a movement between cash earnings and the structural differences reconciling item of (($25m) HTD Mar16, ($25m) HTD Sept16) and movements between cash earnings and Fair Value movements and Hedging gains/(losses) of ($7m HTD Mar16, $24m HTD Sept16).
2. NAB NZ Banking Reporting segment comprises the Retail, Business, Agribusiness, Corporate, Insurance and Market Sales Operations in New Zealand, operating under the 'BNZ brand'. It excludes BNZ's Group Capital Management and BNZ Market Trading operations reported at a Group (NAB) level.
3. BNZ Banking Group excludes the Insurance operation in New Zealand and includes BNZ's Group Capital Management and BNZ Markets Trading Operations.
4. Unrealised fair value gains or losses on economic hedges that do not qualify for hedge accounting and hedge ineffectiveness causes volatility in statutory profit, which is excluded from cash earnings as it is income neutral over the full term of transactions. This arises from fair value movements relating to trading derivatives for risk management purposes; fair value movements relating to assets; liabilities and derivatives designated in hedge relationships; and fair value movements relating to assets and liabilities designated at fair value.
5. Statutory net profit has been prepared in accordance with Generally Accepted Accounting Practice in New Zealand ("NZ GAAP"). It complies with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable Financial Reporting Standards.
6. Spot volumes and performance measures are based on NAB NZ Banking Reporting segement operations. Performance measures are calculated on a cash earnings basis.