Major Australian Banks

A swift rebound

Half Year 2021 Results Analysis

May 2021

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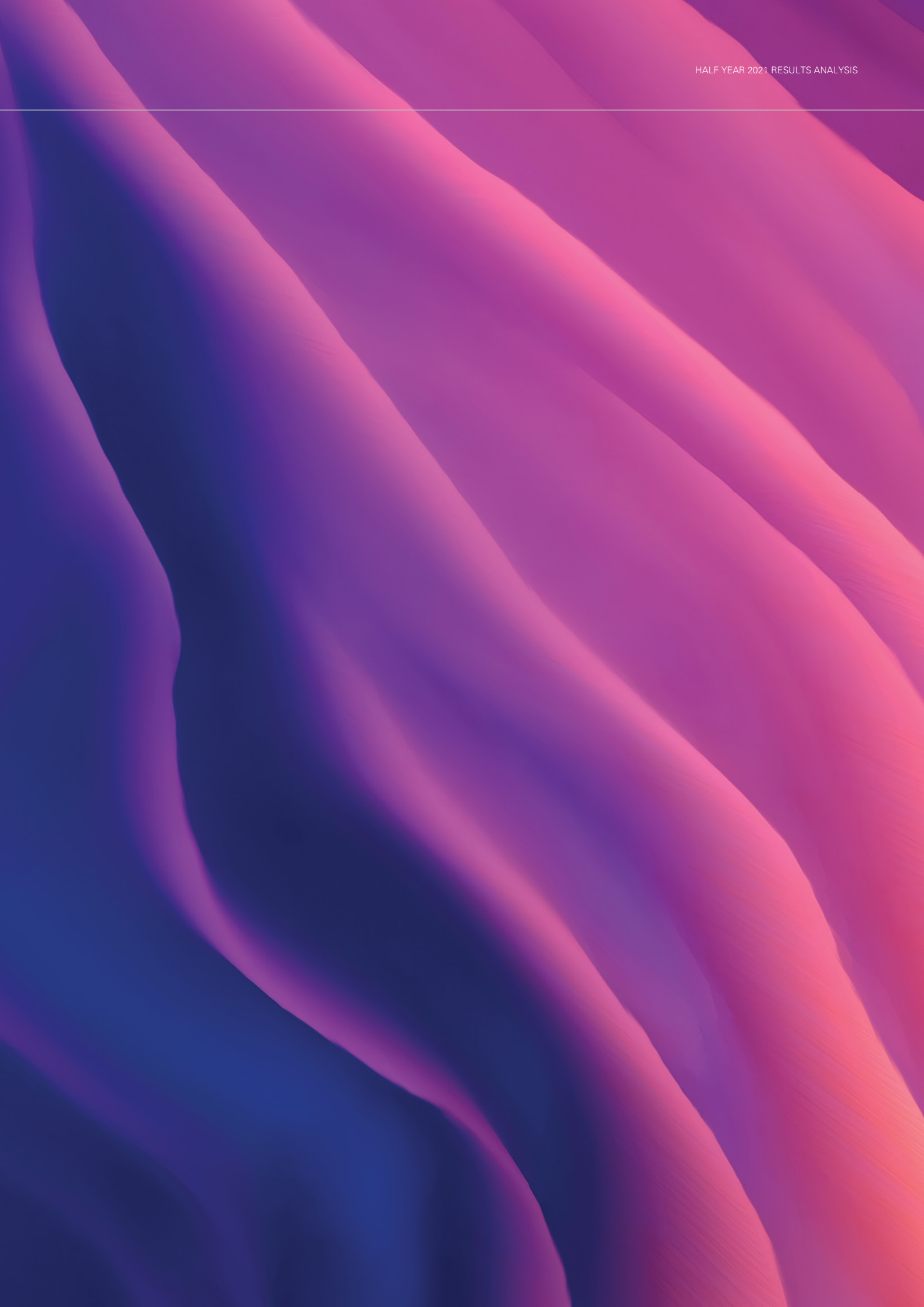
Contents



Major Australian Banks

Half Year 2021 Results Snapshot

REVENUE

Operating income decreased by **0.8%** to
$39.6 billion

Net interest income decreased by **1.5%** to
$31.7 billion

EARNINGS

Cash profit after tax **increased** by **62.3%** to
$13.8 billion

Average **net interest margin decreased** by **6 bps** to
187 bps

SHAREHOLDER RETURNS

Average **return on equity**[1] **increased** by **3.8% pts** to
10.4%

Average **dividend payout ratio increased** by **18.2% pts** to
63.2%

EXPENSES

Average **cost to income ratio**[1] **decreased** by **3.1% pts** to
50.2%

Share of **risk and compliance of total investment spend** increased by **0.3% pts** to
49.9%

ASSET QUALITY

Credit impairment charge (as % of GLA) decreased by **28 bps** to
-0.02%

Decrease in loan deferrals of
$206.9 billion

Write-back of credit provisions of
$109 million

BALANCE SHEET

Average CET1 **capital ratio increased by 105 bps** to
12.4%

Deposit to loan ratio increased 1.4% pts to
83.8%

Lending assets increased by 0.4% pts to
$2.7 trillion

*Comparisons are to the first half of 2020, adjusted for restatements as applicable.
[1] Includes notable items

At a Glance

	ANZ		CBA[1]		NAB		WBC	
	1H21	PCP[2]	1H21	PCP[2]	1H21	PCP[2]	1H21	PCP[2]
Ranking								
By profit before tax	4	2	1	1	3	3	2	4
By total assets	2	1	1	2	4	4	3	3
By total equity	3	3	1	1	4	4	2	2
By market capitalisation	4	4	1	1	3	3	2	2
By CET 1 capital ratio	2	3	1	1	2	2	4	4
Financial Performance – P/L (continuing operations)								
Operating Income - Cash	8,423	8,579	11,961	12,023	8,439	8,355	10,799	10,341
Profit before tax ($ million) – statutory basis	4,376	2,614	5,387	6,214	4,520	2,252	5,061	2,185
Profit after tax ($ million) – statutory basis	2,951	1,636	3,777	4,452	3,210	1,315	3,445	1,191
Cash profit after tax ($ million)	2,990	1,413	3,886	4,356	3,343	1,716	3,537	993
Performance Measures – P/L (continuing operations)								
Net interest margin – cash basis (basis points)	163	169	201	211	174	178	209	213
Cost to income ratio – cash basis (%)	53.2	53.7	46.5	43.3	45.8	56.8	55.4	59.6
Basic earnings per share – statutory basis (cents)	104	57.8	213.4	251.7	97.8	52.0	94.5	33.2
Basic earnings per share – cash basis (cents)	105.3	49.9	219.5	246.2	101.6	58.8	97.1	27.7
Return on average equity (%) – cash basis	9.7	4.7	10.5	12.3	11.1	6.3	10.2	2.9
Credit Quality Measures								
Impairment charge/(benefit) ($ million) (statutory basis) – P/L	(491)	1,674	882	649	(128)	1,161	(372)	2,238
Impaired loans to loans and advances to customers (%) – B/S	0.40	0.40	0.39	0.46	0.28	0.31	0.30	0.40
Collective provision to credit RWA (%) – B/S	1.25	1.39	1.58	1.44	1.50	1.56	1.42	1.54
Financial Position - B/S								
Total assets ($ million)	1,018,339	1,042,286	1,057,734	1,014,060	871,573	866,565	889,459	911,946
Total equity ($ million)	62,576	61,297	75,003	72,013	61,577	61,293	72,101	68,074
Capital Measures - B/S								
Capital Adequacy Ratios (%)								
- Total	18.3	16.4	18.9	17.5	17.9	16.6	18.4	16.4
- Tier 1	14.3	13.2	15.0	13.9	14.0	13.2	14.6	13.2
- Common Equity Tier 1	12.4	11.3	12.6	11.6	12.4	11.5	12.3	11.1
Market capitalisation ($ billion)[3]	80.2	48.8	145.7	122.9	85.8	58.4	89.6	60.8

[1] CBA reported as at 31 December 2020 and the prior comparable period (PCP) does not incorporate the impact of the coronavirus epidemic. All other Majors as at 31 March 2021.
[2] PCP data comprises of 1H20 for profit and loss (P/L) metrics and 2H20 for balance sheet (B/S) metrics, unless otherwise stated.
[3] Market capitalisation as at the reporting date of the Majors.

Executive Summary

The Australian Major Banks' (the Majors') half year results in 2021 stand in stark contrast to those of the last financial year, signalling a recovery in economic conditions and revitalised consumer confidence. However, the return to large profits does mask low underlying growth and stubborn costs.

Key highlights

The Majors reported a combined **cash profit after tax** from continuing operations of $13.8 billion, up 62.3% from the previous corresponding period. This is driven by the non-recurrence of significant provisions raised in FY20 in anticipation of the expected credit losses from COVID-19 which largely have not eventuated, as well as the absence of major notable expenses.

There is continued downward pressure on interest margins across the Majors, with **average net interest margin** (cash basis) decreasing 6 basis points from the first half of 2020. This has been driven by lower lending rates and higher holdings of low-yielding treasury assets, partially offset by the bottoming out of deposit rates and cheap funding through the Term Funding Facility (TFF).

Aggregate loan impairment expense has experienced write-backs in the period resulting in a $109 million benefit as three of the Majors released a portion of the provisioning raised during the height of the COVID-19 pandemic. The outlook remains positive with stronger than expected economic forecasts and more customers coming off loan payment deferrals. However, there remains some uncertainty over the trajectory of Australia's recovery and whether this would create a two-speed economy as some sectors continue to struggle post-COVID-19 pandemic.

The Majors have maintained their focus on 'fortress balance sheets' through the half, with capital ratios substantially above prudential minimum requirements. On average **Common Equity Tier 1 (CET1) ratio** increased by 105 basis points to 12.4% as the Majors retain a portion of profits and proceeds from divestments. It should be noted that the sector's capitalisation has not been this strong in recent decades and is a stark contrast to the single digit ratios observed during the Global Financial Crisis in 2007/08.

Cost-to-income ratios continue to remain stubbornly high, declining from 53.3 per cent in the prior comparative period to 50.2 per cent. This was largely driven by a continuation of customer remediation costs, as well as higher staffing levels to service increased operational volumes and increased investment in risk and compliance staff. Partially offsetting this was a significant item reported in the prior comparative period for one of the Majors relating to regulatory matters not repeated in the current period.

" While the banks have acted as shock absorbers for the economic downturn last year, so far they have been beneficiaries of more favourable market conditions in 2021."

Ian Pollari, National Sector Leader, Banking

Dividend pay-out ratios increased from 45.0 per cent in the prior comparative period to 63.2 per cent in the current year. This is largely due to relaxing of last year's guidance from the Australian Prudential Regulatory Authority (APRA) on capital and pay-outs. However, these remain well-below the levels seen prior to the COVID-19 pandemic.

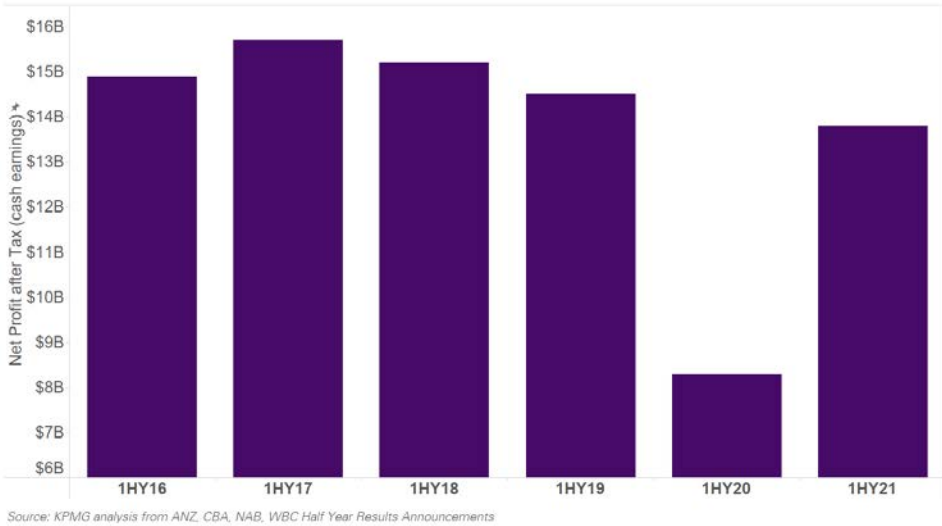
In the absence of large notable items in the current period, combined with stronger asset quality and growth in operating income, **Returns on equity (ROE)** for first-half of 2021 have rebounded. On average, ROE has increased by 381 basis points from the prior comparative period to 10.4 per cent.

Key observations

Strong rebounding under the economic basket

The increase in net profit and Return on Equity (ROE) of the Majors represents a significant rebound from FY20. Aggregate profits in 1H21 are still below those experienced in the years before the pandemic. Whilst the speed of recovery has been quicker compared to previous cycles, adjustments to key profit and return metrics for COVID-19 related provisions and subsequent writebacks (1H21) reveal the underlying picture is much more stable. Reported statutory pre-tax profit growth against 1H20 is 45.8%, however after these adjustments this is a more modest 1.3% is noted.

Diagram 1. Aggregate Cash Profit After Tax



The two faces of recovery

The Majors, alongside governments, regulators and central banks have underpinned the financial resilience of the Australian economy over the past year, having quickly mobilised operations to support households and businesses. With March 2021 marking the cessation of support measures, the fallout has been more subdued than initially anticipated as a reported 94% of borrowers that had been provided with deferral packages have returned to full payments. Three of the four Majors wrote-back $991 million of the $5.7 billion provisions raised in FY20 as a result of a more optimistic outlook. The exception was CBA, as their results, did not reflect more optimistic trends observed in recent months given their December 2020 release date and recorded an additional $882 million in impairment charges.

A level of uncertainty remains as small cohorts of borrowers continue to require assistance. This is most notable within business sectors such as tourism, aviation and office property markets which continue to feel the lingering effects of the pandemic. It is anticipated that non-performing loans will remain elevated until border restrictions ease and vaccinations take effect globally.

The cost agenda

In the current low margin environment, the pursuit for earnings growth has shifted towards a cost management agenda. Adjusting for recent notable items such as remediation, regulatory compliance and strategic write-downs, underlying cost-to-income ratios have remained stubborn. Whilst the banks are focussed on cost transformation and are making progress in areas, their overall cost efficiency has not improved significantly. The potential for cost reductions through operating model simplification, end-to-end process digitalisation and digital disruption remains high.

Outlook

The domestic economy is showing signs of recovery with the RBA revising forecasts for inflation and economic growth, and for unemployment to continue to fall in FY21. The RBA's commitment to holding interest rates low for an extended period has revitalised housing markets with strong asset price growth experienced in recent months. The sustainability of burgeoning house prices presents potential concerns as wage growth remains subdued, creating affordability risks for households despite low interest rates. Macro-prudential intervention has been garnering attention given previous mechanisms implemented in 2017 to limit investment and interest only lending, however APRA remains reluctant to impose such measures at this time.

Looking ahead, the earnings pressures facing the Majors will continue as low interest rates put pressure on net interest margins.

In this constrained environment where profitability has started to rebound, the challenge will be to balance investors' ROE and dividend payout expectations, the necessary growth, transformation efforts, and community and customer expectations. Whilst prior period concerns may be partially alleviated with a return to double-digit ROE in 1H21 and higher payout ratios, sustainability is now a key question of shareholders.

"In a lower margin environment, cost management becomes ever more important. The Majors need to focus on the root causes of inefficiency with their cost transformation efforts."

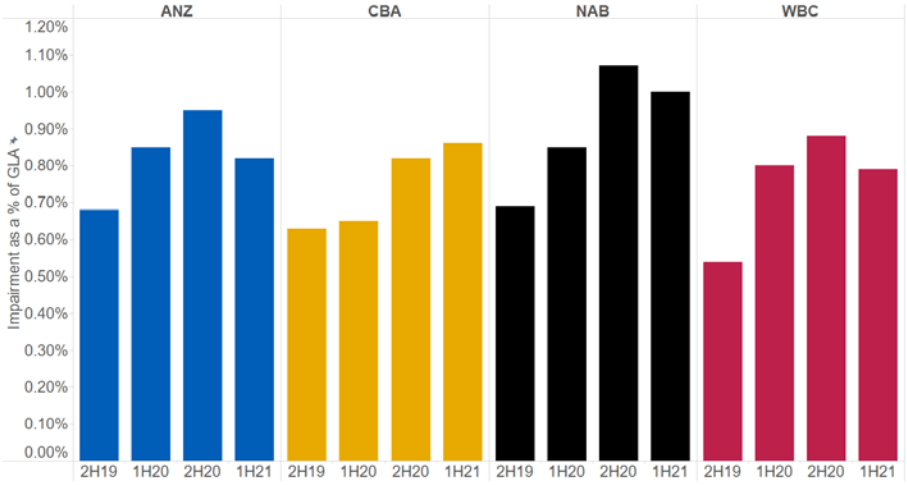
Hessel Verbeek, KPMG Banking Strategy Lead

Asset Quality

Improvements in macroeconomic forecasts have resulted in a significant decline in loan impairment expenses across the Majors when compared to 1H20.

While the impacts of COVID-19 continue to impact economies across the globe, the Australian economy has begun to recover as internal borders re-open and travel bubbles are formed. The decrease in unemployment rates and stronger forecast GDP growth has supported the recovery and have promoted optimism in the economic outlook. The partial return to 'normal' and the lifting of social distancing restrictions has allowed for many businesses to return to trading and individuals returning to the workplace. This has driven a decrease in the ratio of impaired loans to total GLA by an average of 28 basis points compared to 2H20.

Diagram 2. Provisions as a percentage of GLA



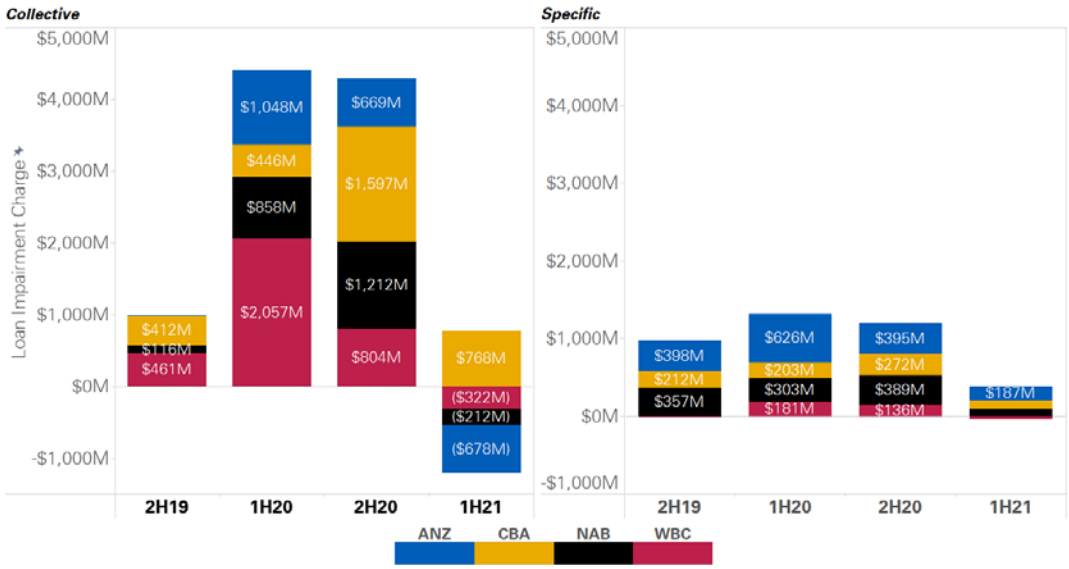
Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Loan impairment

The Majors have released $444 million in collective impairment charges for 1H21, which compares to the $4.4 billion charge raised in 1H20. This shift has been driven by stronger forward-looking macroeconomic indicators, improvements in underlying credit quality and increased recoveries over the last six months. As the Australian economy re-emerges from the immediate impacts of the COVID-19 pandemic, the base forward-looking economic scenarios adopted by the Majors have become more optimistic. Some economic uncertainty remains, as reflected by the Majors only partially releasing provisions that were built up in 2020.

The movement in specific impairment provisions has been consistent across each Major, with a decrease of $978m from 1H20. The result has been driven by improvements in asset quality, higher recoveries and single name exposures not repeated in the current period.

Diagram 3. Loan impairment expenses



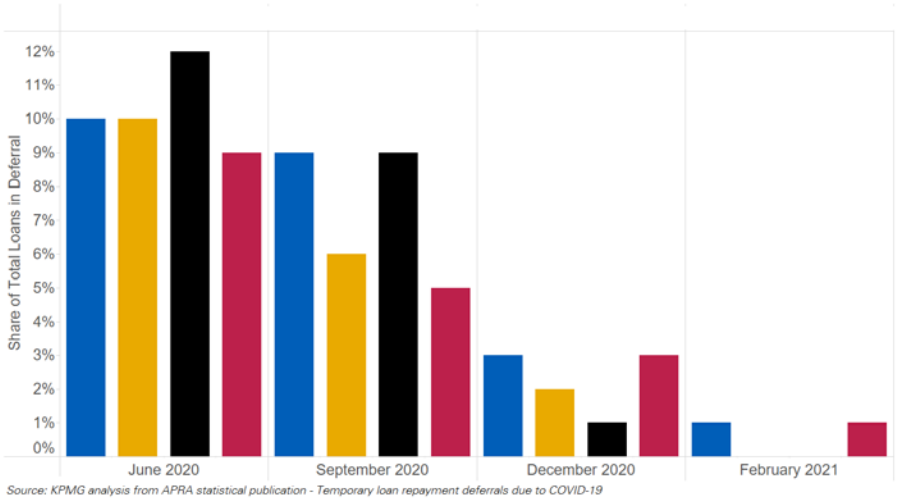
Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Loan deferrals

The loan deferral programs offered to customers impacted by COVID-19 by the Majors officially ended on 31 March 2021. Continuing from 2H20, the trajectory of loans moving off payment pause has accelerated, with the majority of these customers returning to a performing status.

Per the latest APRA deferral statistics, the total number of mortgage and small and medium business loan deferrals across the Majors declined from 714,002 loans ($219.1 billion) in June 2020 to 40,871 loans ($12.2 billion) as at February 2021. This represents an average of 94% of customers returning to a performing status at the end of their deferral periods, with the remaining portfolio comprising less than 1 percent of the total lending portfolio for the Majors.

Diagram 4. Share of total loans in repayment deferral



Delinquency

Delinquencies (90+ days past due) as a proportion of gross lending assets decreased from 75 basis points in 2H20 to 72 basis points in 1H21, driven by a combination of governments support initiatives and lower interest rates. This decline was seen across both the mortgage lending and consumer lending portfolios across the Majors.

Despite a consistent decrease in delinquency across all geographies, Western Australia and Queensland remain as areas with the highest proportion of loans in arrears within the retail portfolio. Within the commercial portfolio, exposures to the aviation, hospitality and commercial property sectors continue to experience stress.

Capital

Strong balance sheets have well positioned the Majors for growth as the economy recovers

Capital adequacy

The Majors continued to demonstrate their discipline over capital management throughout the pandemic. Despite a temporary relaxation of APRA's capital buffers during the pandemic, capital positions exceeded the 'unquestionably strong' threshold set by APRA, and continue to be amongst the strongest capitalised banks internationally.

Average CET1 ratio across the Majors increased by 105 bps to 12.4%. This has been driven by the flow-on effects from divestment of non-core businesses, improvements in asset quality as well as prudential constraints and a capital raising by NAB during 2020.

	ANZ		CBA		NAB		WBC	
	1H21	PCP	1H21	PCP	1H21	PCP	1H21	PCP
Common Equity Tier 1 (%)	**12.4**	**11.3**	**12.6**	**11.6**	**12.4**	**11.5**	**12.3**	**11.1**
Tier 1 Capital (%)	14.3	13.2	15.0	13.9	14.0	13.2	14.6	13.2
Tier 2 Capital (%)	4.0	3.3	3.9	3.6	3.9	3.4	3.9	3.2
Total Regulatory Capital ratio (%)	**18.3**	**16.4**	**18.9**	**17.5**	**17.9**	**16.6**	**18.4**	**16.4**

The average leverage ratio across the Majors increased by 19 basis points to 5.94%. This remains well above APRA's proposed minimum requirement of 3.5% for internal ratings based ADIs.

Liquidity

Across the Majors, liquidity ratios remain healthy, with the average liquidity coverage ratio (LCR) decreasing by 10 percentage points to 135.3%. As a result of increased issuances of Australian Government Bonds in 2020, there is now a greater pool of High Quality Liquid Assets (HQLA) available. Accordingly, this has led to a significant system wide reduction in the Committed Liquidity Facility (CLF) as of 1 January 2021 causing a decrease in LCR across the Majors.

Net Interest Income

Decreases in lending rates combined with the bottoming out of low deposit rates were partially offset by low cost funding through the Term Funding Facility, softening the impact on margins.

Cash Basis	1H21	PCP	Movement
Net Interest Income ($million)			
ANZ	6,986	7,222	(3.3)%
CBA	9,371	9,350	0.2%
NAB	6,839	6,908	(1.0)%
WBC	8,469	8,666	(2.3)%
Aggregate	**31,665**	**32,146**	**(1.5)%**
Net Interest Margin (basis points)			
ANZ	163	169	(6)
CBA	201	211	(10)
NAB	174	178	(4)
WBC	209	213	(4)
Average	**187**	**193**	**(6)**

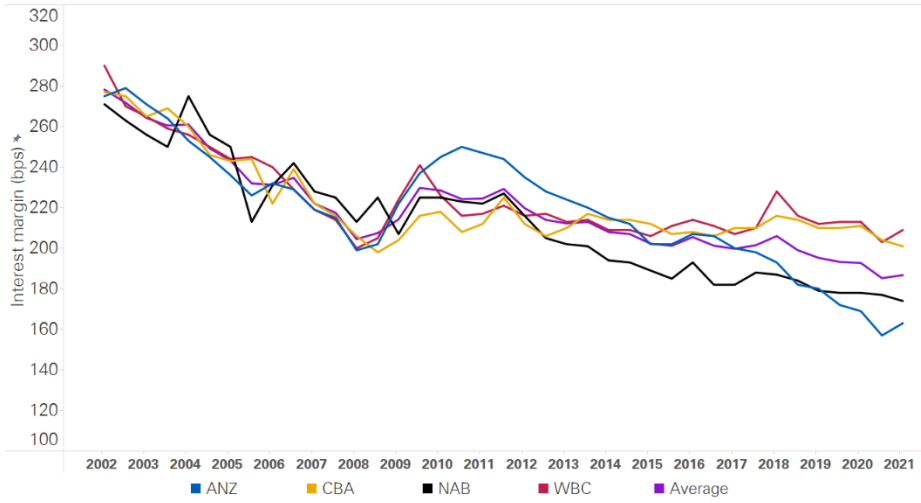
Net Interest Margin

Despite lower funding costs, net interest margin across the Majors continued to decline in 1H21, with an average decrease of 6 basis points. Across the Majors, key themes underpinning margin pressure included:

- Increased competition within mortgage markets driving lower rates for new lending have largely offset benefits from lower funding costs from customer deposit balances and the TFF;
- Higher refinancing activity as customers seek to take advantage of the low-interest environment and move from higher margin back-book loans to lower margin front book lending;
- Lower earnings on capital and treasury book assets due to the falling interest rate environment; and

- Reduced consumer demand for unsecured consumer lending resulting in a decline in higher margin assets.

Diagram 5. Net Interest Margins – cash basis



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Interest earning assets

Average interest earning assets decreased by 0.6% in aggregate from 2H20 to $3,381 billion with the exception of CBA which reported an increase.

Aggregate non-housing credit contracted by 2.6% from 1H20 to $933 billion, largely due to lower unsecured consumer lending with customers reducing debt, and lower business lending as institutions repaid facilities drawn in 1H20 in response to COVID-19.

Mortgage lending saw tempered growth across the Majors in 1H21, increasing by 2.0% on 1H20. The slowdown in growth was predominantly driven by payments in investor property lending exceeding originations, partially offsetting the growth experienced in Australian owner occupied lending and New Zealand housing lending

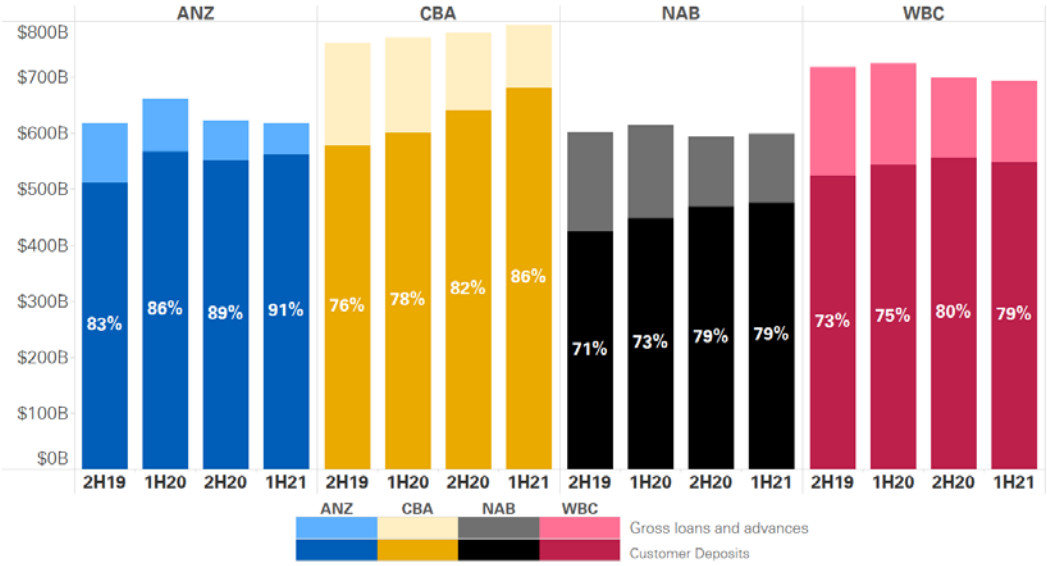
Funding Mix

Despite $67.4 billion drawn under the TFF in aggregate by the Majors, customer deposits remain the primary source of funding. The average proportion of customer deposits to total gross loans and advances across the Majors has increased by 143 basis points to 83.8%.

With near nil interest rate offered on transaction and deposit accounts, combined with the maturing of funding from the TFF across the industry, the Majors may have run out of room to further reduce funding costs in response to lower lending rates.

The rate of growth in customer deposits of 2.2% has significantly exceeded the ability of the Majors to grow their lending assets. In comparison, total gross loan and advances increased by 0.4%. Across the Majors, excess funding from customer deposits has been deployed into lower yielding treasury assets in order to generate a return (but resulting in lower margins nevertheless).

Diagram 6. Customer deposits proportionate to total gross loans



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Notable Items

Customer remediation programs, divestments and asset impairments continue to be key features across the Majors.

With the exception of NAB, notable items across the Majors have had a mixed impact on profits, which include:

- ANZ recorded a total $925m loss primarily due to impairment on divestments and losses on its Asian associates.
- CBA recorded $910m post-tax gain on its divestments and $241m (pre-tax) expense on remediation costs.
- Westpac recorded a total $302m loss due to customer remediation and write-down of intangibles, offset by gains on asset sales and revaluations.

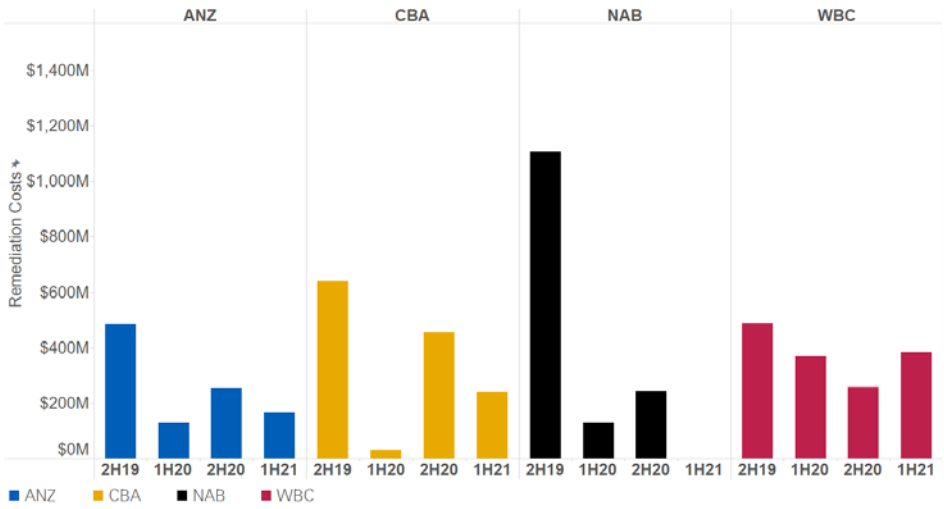
NAB reported no notable items for 1H21.

Customer remediation

Across the Majors, remediation charges remain a prominent theme in 1H21 and have continued to negatively impact cash profits. During the period, a further $683m in costs and reversals of revenue were incurred in relation to the continuation of remediation programs of work and customer refunds.

Since second half of 2019, the Majors have incurred a total of $5,268m in expenses and repayments to customers and it is expected that continued remediation expenditure is necessary.

Diagram 7. Customer remediation costs



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Divestment of non-core assets

Bank simplification and divestment of non-core assets continue to be a theme in the current period, with major divestments (and any associated impairments) announced or completed across the Majors.

Most notably:

- ANZ incurred a $251m write-down of goodwill attributable to its ANZ Share Investing business as it was reclassified as held for sale.
- CBA completed its sale of BoCommLife to MS&AD Insurance Holdings for a $369m post-tax gain.
- CBA announced the merger of Aussie Home Loans with Lendi, with CBA retaining a 45 percent interest in the combined business upon completion.
- Westpac incurred $231m in impairment losses from the proposed sale of its Pacific operations to Kina Securities Limited ($121m) and its Lenders Mortgage Insurance businesses to Arch LMI ($110m).
- Westpac also announced the sale of the General Insurance business to Allianz Australia for $725m, with a small post-tax gain on sale.

Other notable items

Other notable items during the period include:

- ANZ recorded $347m in losses on its equity accounted investment in AMMB Holdings Berhad (AmBank).
- ANZ recognised $48m post-tax in legal expenses in relation to a class action complaint in the United States and $76m post-tax in restructuring expenses.
- Westpac recognised a $546m revaluation gain on its investment in Coinbase Inc.

Costs

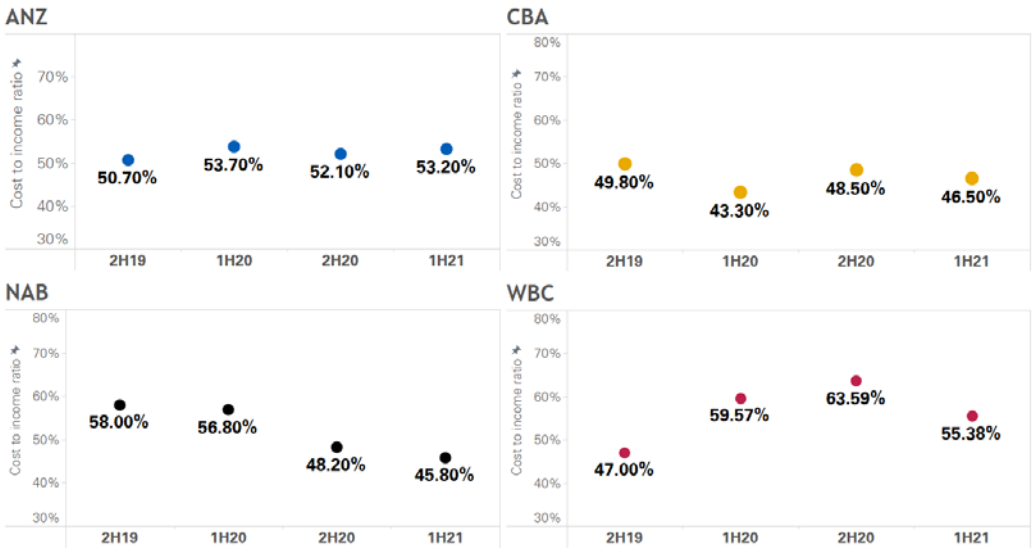
The Majors have been unable to substantially reduce costs, as they continue to face risk and compliance expenses as well as operational pressures from increased processing volumes.

Operating expenses

Operating expenses from continuing operations have decreased by 4.0% from 1H20 to $19.9 billion across the Majors. Average cost to income ratio decreased by 312 basis points from 1H20 to 50.2%, with three of the Majors reporting increases. Key drivers for this increase were higher personnel costs response to increased processing of higher volumes mortgages and customers impacted by COVID-19, and further investments in risk and compliance programs.

Excluding notable items included in the previous section, average cost to income ratio increased by 78 basis points from 1H20 to 47.2%, with increases reported for three of the Majors.

Diagram 8. Average Cost to Income Ratio – continuing operations



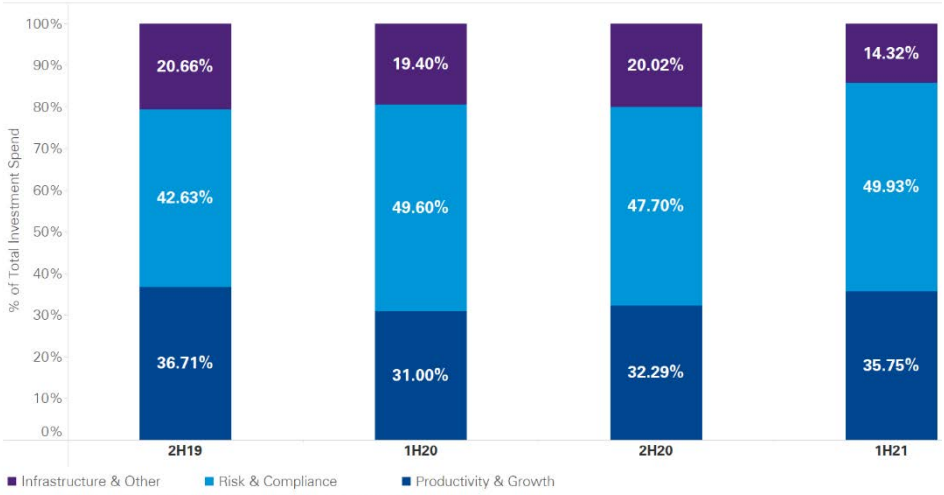
Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Technology and investment spend

Aggregate investment spend across the Majors increased by $154 million to $2,906 million in 1H21. Risk and compliance costs continue to be the focus of investment as the Majors strengthen their capabilities in financial crime. Risk and compliance costs comprised 49.9% of aggregate investment spending, representing an increase of 33 basis points from the prior comparative period.

Technology operating expenditures have decreased by $208 million to $3,794 million largely driven by non-recurring expenses experienced in 1H20. Spending towards cloud services continue to be a focus across the Majors in 1H21.

Diagram 9. Investment Spend

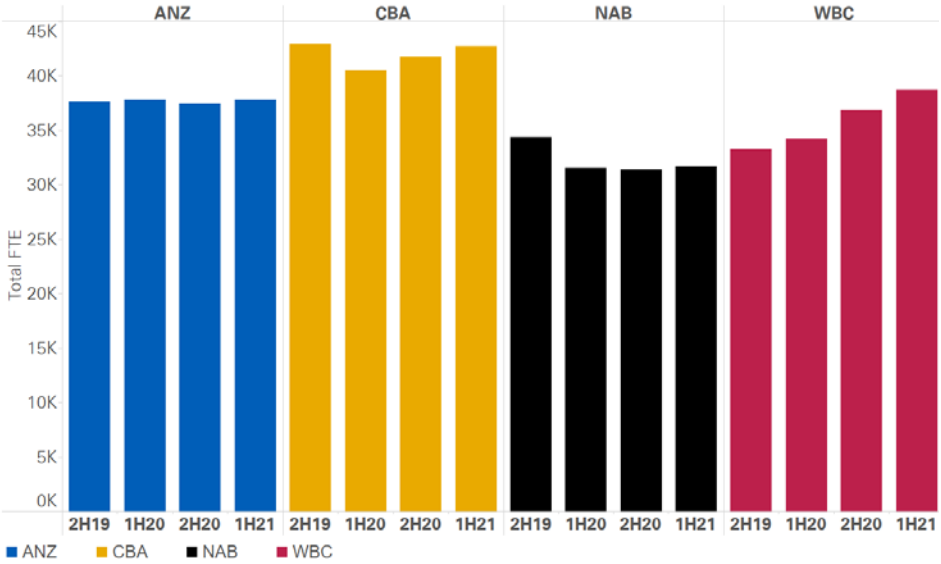


Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Personnel

The aggregate number of Full Time Equivalent (FTE) staff employed by the Majors has increased by 6,900 from 1H20. Most notably, Westpac and CBA increased their period-end FTE by 4,548 (13.3%) and 2,201 (5.4%) respectively. This was primarily driven by increased operational staffing in response to COVID-19 financial assistance, additional resources to support higher home loan and commercial loan volumes and increased resources in risk and financial crime teams.

Diagram 10. Total FTE – continuing operations



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

Shareholder Returns

Profits remain resilient with a return to modest dividends, leading to higher dividend payout ratios.

Return on Equity

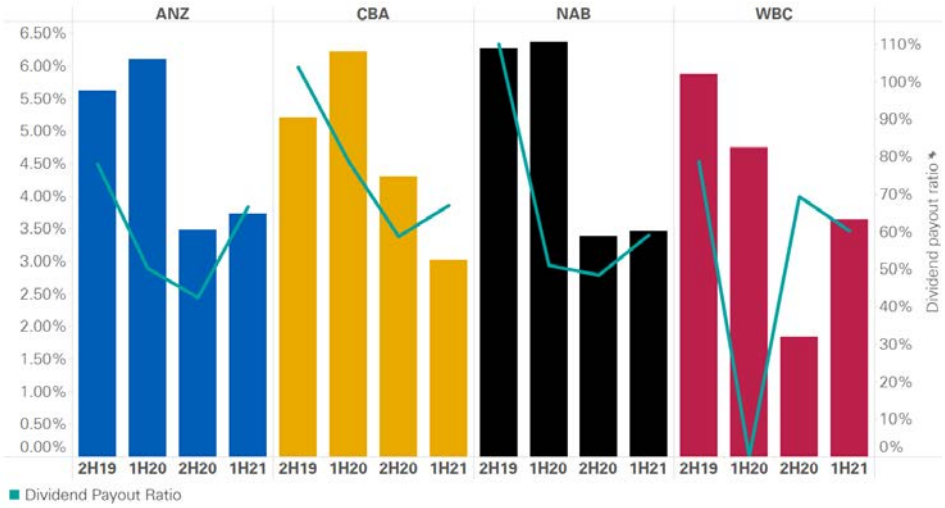
Return on equity has seen a rebound from the declining trend observed in 1H20 in aggregate across the Majors. Average ROE increased by 381 basis points to an average of 10.4% for 1H21, rising back towards pre-COVID-19 levels of double-digit ROE. This has been driven by the non-recurrence of one-off significant items in the prior period, impairment benefits and slight growth in operating income across the Majors.

Dividends

On 15 December 2020, APRA announced that from the start of 2021, it would no longer hold banks to a minimum level of earnings retention in light of stronger economic outlook and increased stability in the financial markets. Instead, APRA expects Authorised Deposit-taking Institutions (ADI) to moderate dividend payout ratios, utilise dividend reinvestment plans and implement other measures to mitigate the capital impact of dividends.

In response, the Majors have resumed prudent payments of dividends from their earnings, with average dividend payout ratios increasing from 45.0% in 1H20 to 63.2% in the current period. However, dividends, in both quantum and pay-out ratios, remain well below those experienced before the COVID-19 pandemic.

Diagram 11. Dividend Yield vs Payout Ratio



Source: KPMG analysis from ANZ, CBA, NAB, WBC Half Year Results Announcements

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Danny Pang

Matt Newell

Tia Kitchener

Kevin Kwan

Hugh McMicking

Sharmani Krishnan

Hailey Dy

Tony Kong

Contact us

Ian Pollari
National Sector Leader, Banking
+61 2 9335 8408
ipollari@kpmg.com.au

Hessel Verbeek
Partner, Banking, KPMG Strategy
+61 2 9458 1540
hverbeek@kpmg.com.au

Ben Flaherty
Partner, Audit, Assurance & Risk Consulting
+61 7 3233 3218
bflaherty@kpmg.com.au

KPMG.com.au

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