Australian Banking Sector Update

APRA reignites the bank ROE debate

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Regulatory debate reignited as APRA searches for "Unquestionably strong"

Over the last week APRA made two significant speeches on its regulatory agenda. Most importantly while APRA see capital as core it intends taking other financial measures such as liquidity, funding, asset quality & earnings into account in its definition of "unquestionably strong". On capital, APRA views the banks as "*soundly capitalised*" following recent raisings. However the speeches suggest APRA believes further increases appear necessary given: (1) Global peers continue to build capital at around 40bp p.a.; (2) Australian banks rank relatively poorly on a Leverage Ratio basis; and (3) Basel 4 is approaching – "*The entire framework of risk weights is under review … some of the changes may well affect Australian ADIs to a proportionally greater extent*". APRA concludes "*One thing that is clear is the direction the world is moving. That is towards higher capital ratios, reflecting a view that not enough has yet been done*".

Net Stable Funding Ratio (NSFR) and more term deposits place pressure on NIM

The NSFR (requiring greater term funding) remains scheduled for 2018. APRA warned the Australian banks do not easily meet the NSFR and international comparisons are not favourable. Therefore "*some further lengthening of maturity profiles is likely to be needed.*" Further, APRA is concerned with the lack of improvement in term deposit funding & the banks ongoing reliance on short-term wholesale funding from offshore.

APRA asks what is the 'right' ROE?

"*The major banks have restored their returns to around pre-crisis levels (like their peers in Canada), while the remainder of the industry is earning an RoE closer to 10 per cent. While low relative to the major banks, this group of ADIs is still earning a return that is commensurate with large US banks, and above that of large UK and European banks. Therefore, one of the more interesting questions that I think remains open to debate is where the 'right' RoE for a more resilient banking system is likely to settle.*" APRA is always very deliberate in its comments. Investors should ask, why did APRA say this?

Pressure on bank returns continues to rise. No easy solution

While we believe the banks now offer more attractive valuations, we think the medium term outlook remains challenging. Capital ratios are continuing to drift higher (we believe 10% CET1 is the new minimum). Basel 4 and Leverage Ratios are on the agenda. Funding costs look likely to rise as banks increase term-deposits and term-wholesale mix to meet the NSFR. This may force the banks to continue to re-price their asset books to prevent further NIM erosion. (Where does this leave monetary policy?)

APRA speeches set the regulatory agenda

Over the last week Wayne Byres, Chairman of APRA, has made two significant speeches on the regulatory environment[1,2]. These speeches look at the topic of what is an 'unquestionably strong' bank, with a broader perspective than just capital.

> *"The FSI established the 'unquestionably strong' concept in terms of capital ratios. I think it important, however, to point out that to be truly 'unquestionably strong' requires an ADI to have more than just a strong capital ratio – and there may be trade-offs in how 'unquestionably strong' is achieved. To be sure, it's next-to-impossible to be regarded as 'unquestionably strong' if an ADI's capital base is weak. So capital must remain at the core of any definition. But other financial measures – such as liquidity, earnings, and asset quality – are important too. And even then, an ADI with strong financial metrics, but weaknesses in risk management, governance, and culture will surely see its financial strength eroded: it's only a matter of time. When we look to define an 'unquestionably strong' ADI, these other characteristics must therefore also be taken into account."*[2]

(Note: emphasis within the excerpt is by UBS)

APRA to take a much broader interpretation of "unquestionably strong"

Following a series of capital raisings by the banks over the last five months many in the market had believed that the Majors have sufficiently improved their capital positions to be considered 'unquestionably strong'. This was based on David Murray's Financial System Inquiry 'top quartile' definition. However, APRA has flagged that while it is yet to come up with its own definition of "unquestionably strong" it is likely to take a much broader view of this concept.

In this report we look at the major areas where additional strengthening may need to be undertaken, focusing on capital and funding. While we do not claim to know the answers, we believe it clearer that the pressure on ROE continues to rise.

Capital

APRA views the banks as "soundly capitalised". But more capital is required.

APRA continues to view capital strength as fundamental to a strong financial system. In that context it believes the Australian banking system is "soundly capitalised". However, the speeches suggest additional capital strengthening is required.

Global peers are continuing to accumulate capital at 20bp per half

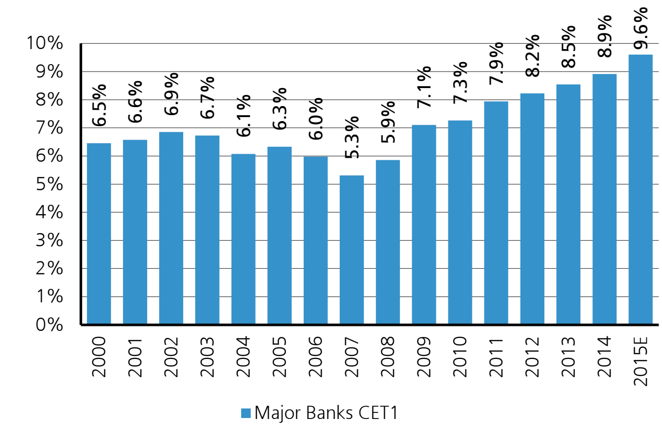
- Banks around the world are continuing to build CET1 at an average of 20bp every six months. This implies further capital accumulation will be required for the banks to attain and sustain top quartile positioning.

The banks do not compare well on a Leverage Ratio basis

- While the banks are now looking better on a CET1 basis relative to their global peers, they look less attractive on the Leverage Ratio. This is important as during times of crisis investors have tended to disregard risk weighted capital measures and revert to simple leverage ratios. Although the banks have materially strengthened their CET1 ratios since the crisis, the leverage ratio has remained broadly unchanged.

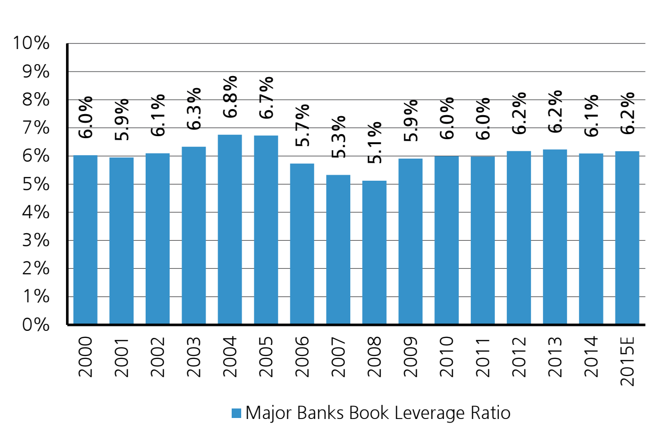
[1] "In search of ... Unquestionably Strong", Wayne Byres APRA Chairman, 15 Sept 2015
[2] "Regulation: Responding to Market Change or Driving it", Wayne Byres APRA Chairman, 15 Sept 2015. Excerpts taken from transcripts of the speeches.

Figure 1: Major Banks CET1 Ratio



Source: Company data, UBS estimates

Figure 2: Major Banks Book Leverage Ratio



Source: Company data, UBS estimates. Note: This Leverage Ratio is based on Book Leverage (equity to assets) rather than the Basel defined number which includes total exposures.

- Basel 4 remains on the agenda and will provide another headwind to the Australian banks' capital position. As Wayne Byres states

Basel 4 is in the pipeline and may impact Australian banks greater than other countries

> *"There are of course a range of initiatives coming down the pipeline from the Basel Committee that could materially change the capital framework. The entire framework of risk weights – standardised and model-based – is under review, as are the trading book and operational risk regimes. The Committee is also updating the operation of the so-called capital floor – something that APRA did away with some years ago on the basis that it was not binding. In a revised form, that may not be the case in future. Of course, these changes will affect all banks around the world in some way but, in the context of international relativities, some of the changes may well affect Australian ADIs to a proportionally greater extent than is the case in some other jurisdictions."*

It remains difficult to quantify the exact capital requirement the banks face. However, despite the recent capital raisings the requirement for the banks to continue to strengthen their capital position appears to be ongoing.

"So continuing to steadily accumulate capital looks to be a sensible strategy"

> *"While there is much that is uncertain, one thing that is clear is the direction the world is moving. That is towards higher capital ratios, reflecting a view that not enough has yet been done to deliver a resilient financial system taking into account the lessons of the financial crisis. So continuing to steadily accumulate capital looks to be a sensible strategy for a while yet."*

Our base case remains that CET1 ratios will eventually settle above 10% (APRA's definition) with additional risk weights likely to be felt as Basel 4 is implemented over the next couple of years.

Liquidity and Funding headwinds

APRA believes the LCR and NSFR may have a greater impact on the Australian banks than changes to capital requirements

Funding and liquidity were critical issues for the banks during and immediately after the financial crisis. Over reliance on wholesale funding and too few deposits put pressure on the banks' balance sheets. Since this time the banks have attempted to improve their liquidity positions (now complying with the Liquidity Coverage Ratio), improve deposit funding and term out their wholesale exposures. In the eyes of many investors most of the heavily lifting appeared to have been done.

However, funding and liquidity remains an area of concern for APRA.

> "*The introduction of global liquidity and funding standards in Basel III - the 30-day Liquidity Coverage Ratio (LCR), and the longer-term Net Stable Funding Ratio (NSFR) – potentially have a greater impact on the Australian banking sector, given its excess of loans over deposits and reliance on foreign-sourced funding, than changes to capital requirements.*"

Further improvement in deposit funding

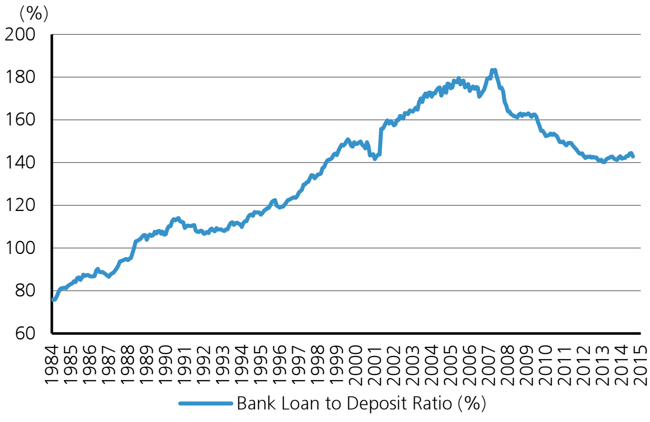
While the banks have improved their loan to deposit ratio since the crisis, the ratio remains elevated at 143%. Further, although the banks saw a rise in the percentage of term deposits post the crisis, this trend has deteriorated over the last three years as interest rates have fallen and the banks have become more comfortable with their funding mix.

APRA would like to see more term deposit funding

APRA appears unhappy with this situation:

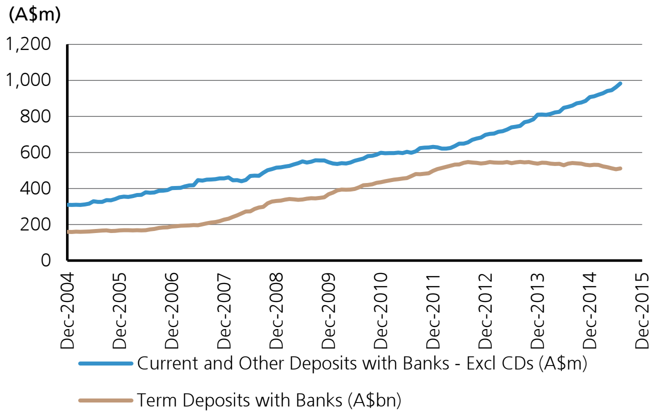
> "*While banks have actively pursued deposit growth, not all deposits have similar liquidity characteristics. In recent years, deposit growth has primarily come in the form of at-call, rather than term deposits. The apparent ceasefire in the 'war for deposits' means liquidity profiles have been strengthened less than it might first appear.*"

Figure 3: Banks Loan to Deposit Ratio (%)



Source: RBA, APRA, UBS estimates

Figure 4: Term Deposits vs Current/Other Deposits (A$m)



Source: RBA, APRA, UBS estimates

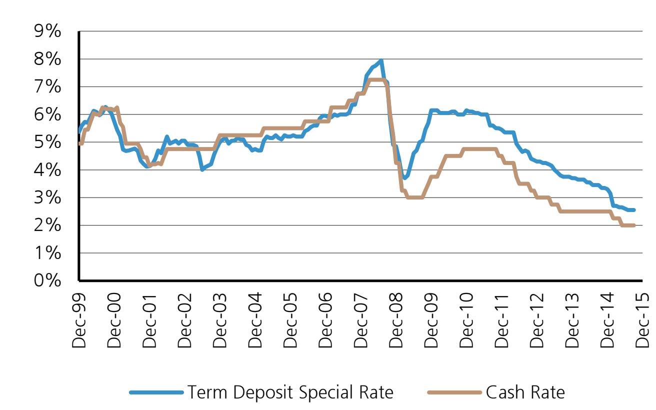
In our view the only way banks could achieve this is via higher Term Deposit interest rates

Importantly, we believe that if the banks are to improve their deposit funding mix and in particular increase term deposit funding, higher interest rates are the only viable option. Over the last three years the banks have been actively reducing their term deposit rates to help alleviate margin pressure. Combined with RBA rate cuts this has led to a reduction in Term Deposit 'Special' rates being offered to customers from around 5.0% to 2.5% at present.

With rates this low many depositors have been reluctant to lock in their money, preferring to leave their cash at-call. Further, many investors are unable to generate the income they need during retirement from deposits. As a result, they have 'chased yield' into higher risk assets such as equities (including bank shares and other 'yield' stocks) as well as residential and commercial property. This has been one of the key drivers of strong equity and property returns over the last few years.

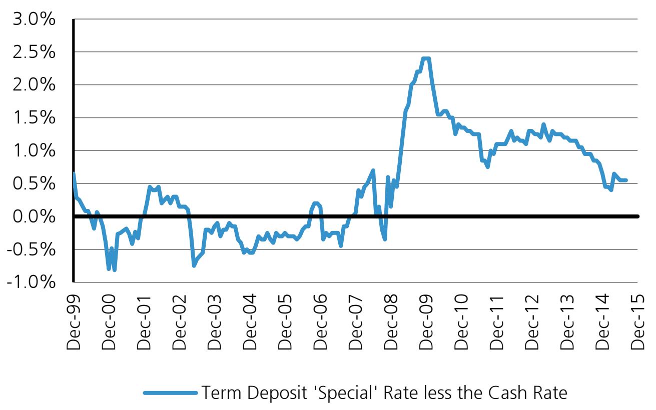
Higher deposit rates may have an implication for the attractiveness of other 'yield' asset classes

Figure 5: Term Deposit Rates vs Cash Rate (%)



Source: RBA, UBS Estimates

Figure 6: Spread between Term Deposit & Cash Rate (%)



Source: RBA, UBS Estimates

If regulatory change forces the banks to increase term deposit interest rates to attract more funding, this is likely to have an impact of retail and self-managed superannuation fund (SMSF) asset allocation. This would have an obvious read through for equity flows.

Net Stable Funding Ratio (NSFR) presents a challenge

The proposed introduction of the NSFR, which measures long term funding mismatch, has not been a focus of the market for some time. Initially many people considered the NSFR to be either unworkable or unattainable, while more recently it has not been a focus as the Discussion Paper is yet to be released.

The NSFR is still on the agenda. The Australian banks do not look good on this basis

However, Wayne Byres confirmed its scheduled implementation for 2018 and stated APRA will consult further on its implementation in coming months. Once again the speeches seem to suggest that the market may be underestimating the degree of regulatory change and the impact it may have on the banks.

> "*Given their funding structures, the largest Australian banks do not easily meet the new standard and, as things stand today, international comparisons are not favourable to them. Some further lengthening of Australian bank maturity profiles is therefore likely to be needed over time to truly strengthen their funding resilience. This is an important issue to address, because a key rationale for the FSI's 'unquestionably strong' recommendation was recognition this has been a key vulnerability in the past.*"

Too reliant on short-term wholesale funding from offshore

One of the biggest challenges for the banks during the financial crisis was an over-reliance on short-term wholesale funding from offshore. When the market froze in 2008 significant strain was placed on the financial system. However, while the

banks have addressed much of their funding mix, APRA believes that not enough has been done on one of the highest risk funding sources.

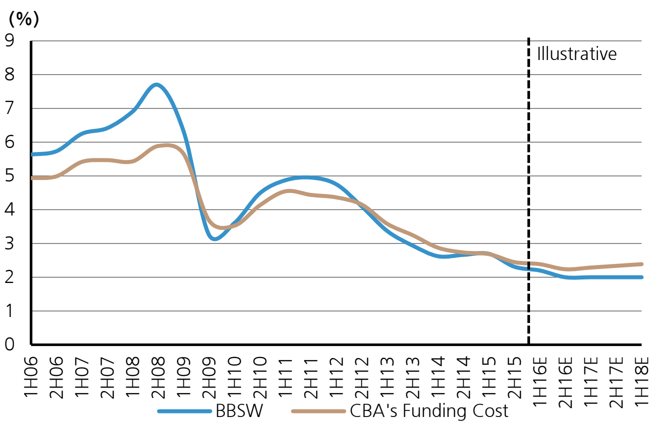
> "*While the industry has reduced its reliance on short-term funding, wholesale funding and offshore funding, it has not materially reduced its reliance on the form of funding that is most likely and able to run in a crisis: short-term wholesale funding from offshore. That might seem paradoxical, but as a percentage of total funding, short-term wholesale offshore funding is virtually unchanged from a decade ago.*"

We were surprised to see APRA's comments that the banks' reliance on short-term wholesale offshore funding is virtually unchanged from a decade ago

We believe that many of the major banks would dispute this finding, as they believe their reliance on short-term wholesale offshore funding has reduced. However, as has been seen in the capital debate when the regulator is not satisfied with a position further work usually needs to be done.

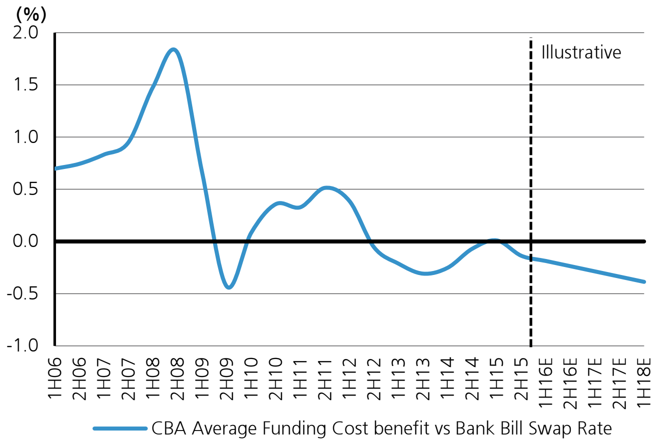
The banks may dispute this

Figure 7: CBA's Average Funding Cost vs 3 month Bank Bill Swap Rate (%)



Source: Company Data, Factset, UBS estimates

Figure 8: CBA's funding benefit over the Bank Bill Swap Rate (%)



Source: Company Data, Factset, UBS estimates

Impact – Funding costs to continue to rise

Given the number of moving parts, uncertain regulation (especially the NSFR) and competitive dynamics it is not possible to accurately estimate the potential additional funding costs the banks may face as they improve their funding and liquidity positions towards APRA's targets. However, from these speeches it seems clear to us that funding costs will rise, potentially significantly.

It is impossible to accurately calculate the impact of these additional funding requirements on the banks' funding costs.

We see this development as the most negative take-away from APRA's speeches, as we had presumed that most of the funding heavily lifting had already been achieved.

However, it seems clear funding costs will rise

Further, we had assumed that additional loan re-pricing would help the Major banks to expand Net Interest Margins and partially offset the dilutive impact of higher capital requirements. However, from APRA's speeches we believe that additional re-pricing may be necessary just to offset the additional funding costs the banks may face. This suggests the NIM outlook is now materially more negative than we had previously anticipated.

While we expect additional re-pricing this may be required to offset NIM pressure, not expand NIM

Potential implications for the economy and monetary policy

We believe that addition funding requirements has significant implications not just for the banks but potentially for the broader economy. If the banks need to

expand their asset yield to offset higher funding costs (as well as higher capital imposts) they will likely actively look to raise lending rates. While re-pricing is likely to initially focus on investment property and then owner occupied mortgages, we believe some widening of business and corporate spreads now appears likely.

This implies any future RBA rate cuts may be less effective

Additional funding costs to meet regulatory requirements as flagged by APRA may also imply that further potential RBA rate cuts may be less effective. The vast majority (or even all) of any future rate cuts are now unlikely to be passed onto borrowers, in our opinion. Perhaps borrowing costs have already reached their minimums for many products? A similar situation has been seen in other developed economies as interest rates approached zero.

Impact on medium term ROE

We were surprised to see APRA's comments on ROE

We were very surprised to see Wayne Bryres comments regarding earnings, ROE and cost of capital. While we agree with his comments that earnings and asset quality are key facets of an "unquestionably strong" banking system, APRA has in the past been silent as to what an appropriate level of returns should be. While APRA was not specific, the direction that it expects returns to move seemed clear:

> *"There was, however, an expectation that returns may well decline, certainly from the high teens and even 20+ per cent returns on equity achieved by many banks before the financial crisis. By making banks more resilient and, in particular, less leveraged, it was envisaged that returns to shareholders – both expected and required – would fall somewhat."*

APRA then continued, comparing the returns of the banks to global peers:

"One of the more interesting questions … is where the 'right' RoE for a more resilient banking system is likely to settle."

> *"The major banks have restored their returns to around pre-crisis levels (like their peers in Canada), while the remainder of the industry is earning an RoE closer to 10 per cent. While low relative to the major banks, this group of ADIs is still earning a return that is commensurate with large US banks, and above that of large UK and European banks. Therefore, one of the more interesting questions that I think remains open to debate is where the 'right' RoE for a more resilient banking system is likely to settle."*

It is the last sentence which is the most interesting, in our opinion. After stating that returns in other parts of the world are now lower, APRA asks what is the 'right' ROE for a "more resilient banking system"? We believe this comment has two elements:

Is APRA implying:
Cost of Capital should also fall;
Banks must accept lower returns?

(1) APRA believes that a better capitalised and more resilient banking system should have a lower cost of capital. Therefore it should still be priced on a similar multiple despite a lower return;

(2) Management should accept that returns will be lower as their Balance Sheets are strengthened. ROE targets such as 16% for ANZ and 15% for WBC may no longer be appropriate.

It is clear that many of the elements in Wayne Byres' speeches looking for "unquestionably strong" banks are negative for returns: more capital; better funding; and strong asset quality. In the past the banks have attempted to offset additional imposts by widening their lending spreads. This was seen recently when the banks re-priced their investment property mortgage rates. While we expect re-pricing to continue, and even broaden, we believe APRA is indicating that banks

must accept they will not be able to pass these costs on in full. Investors should be satisfied with lower returns given the riskiness of the sector has also reduced.

Du Pont breakdown of the major banks' returns

We believe that Du Pont analysis of bank returns provides a good methodology to analyse potential movements in returns and the pressures the banks are likely to face. This analysis breaks down bank ROE into Return on Assets (and its moving parts) and Leverage.

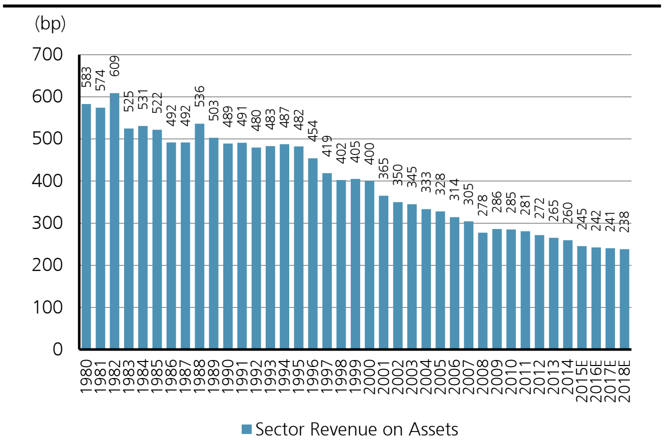
We had believed Revenue on Assets may expand as banks re-price to offset higher capital imposts.

Revenue on Assets – has been in steady decline over the last thirty-five years. This reflects movements in the composition of the book (more mortgages); increased competition and progressively lower interest rates. With the banks now facing additional pressures from funding costs as discussed above there is now an increased risk the banks' Revenue on Assets and NIM compression accelerates beyond current forecasts.

But funding costs now represent a greater headwind

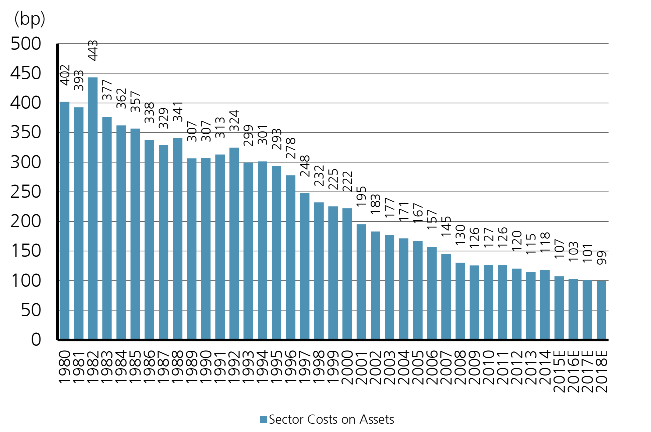
We have been bullish on the banks' ability to re-price their loan books to offset some of the pressure from dilution. However given these additional headwinds highlighted by APRA we are now less confident. Significant re-pricing may now be required, in our view. This also has an implication for the transmission mechanism for any future rate cuts by the RBA.

Figure 9: Sector Revenue on Assets (bp)



Source: Company Data, UBS estimates

Figure 10: Sector Costs on Assets (bp)



Source: Company Data, UBS estimates

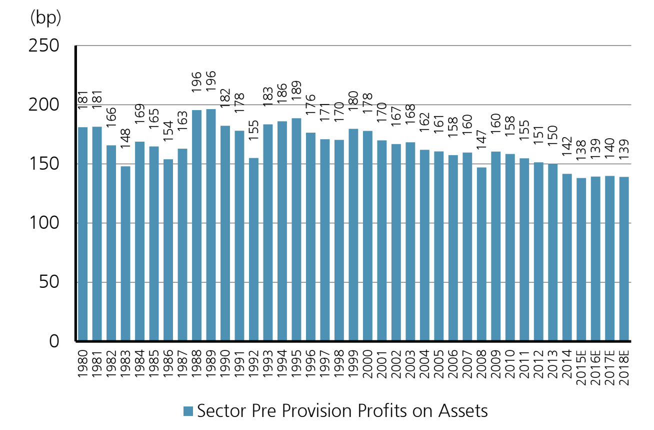
Costs on Assets – The banks have offset much of the revenue pressure they have been facing over the last few decades by improved efficiency and economies of scale. However, we believe the major banks remain very inefficient organisations.

The banks still have an opportunity to significant reduce costs

Across the major banks the cost base has now reached $37bn per annum. This appears to be a considerable amount of money to run a banking system across Australia and New Zealand. Given changing technologies and customer behaviours, we believe this number could be reduced materially. However, as has been seen globally, banks are risk averse and reluctant cost cutters, only undertaking structural cost decisions when forced to.

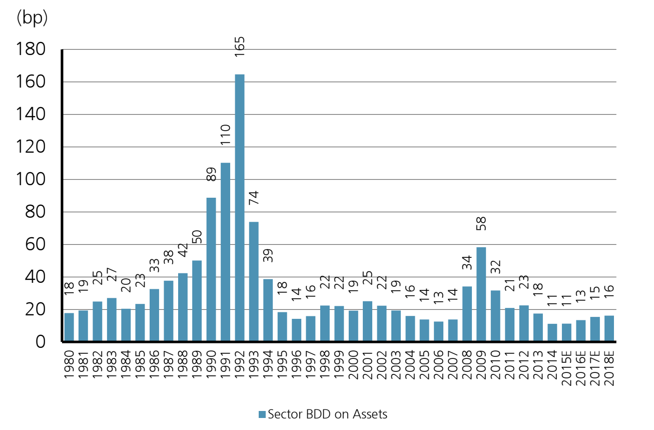
We see cost reductions as a medium term upside for the banks, but do not believe it will be sufficient to offset other ROE headwinds.

Figure 11: Sector Pre-Provision Profits on Assets



Source: Company Data, UBS estimates

Figure 12: Sector BDD charges on Assets



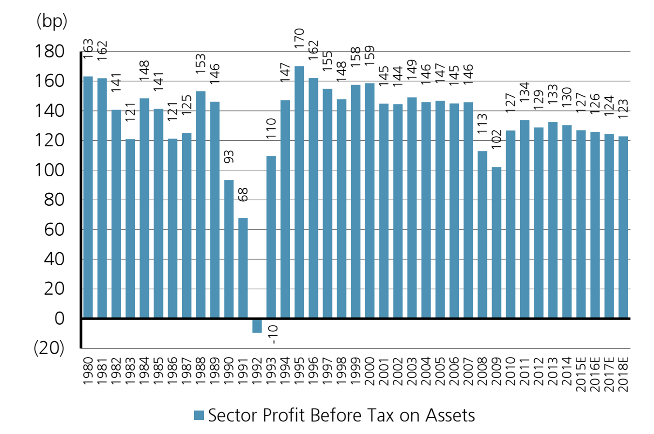
Source: Company Data, UBS estimates

Pre-Provision Profits on Assets – One of the most positive points on the Australian banks is the very steady Pre-Provision Profits on Assets they have been able to achieve over an extended period of time. This reflects both the flexibility of the banking sector to absorb change as well as the strong industry structure. However, for this to continue the banks will need to re-price their asset books materially or take further costs out to offset the additional funding cost pressures they are facing.

BDD should be the other key driver of bank returns

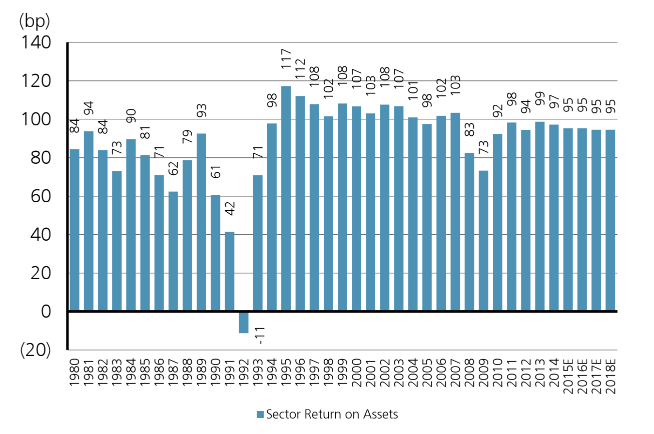
Bad and Doubtful Debts on Assets – Along with regulatory change risks to asset quality and BDD charges remains the biggest risk within the sector. Please refer to our recent report "*What would it take for banks to cut dividends?*" (3 Sept 2015) which looks at potential economic scenarios and the implications for bank returns and dividend policies.

Figure 13: Sector Profit before Tax on Assets



Source: Company Data, UBS estimates

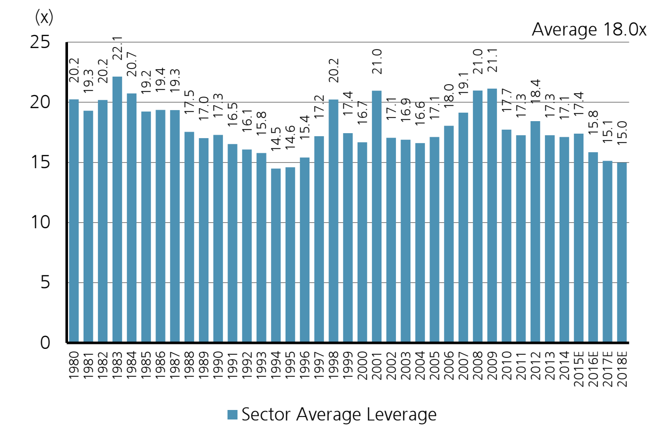
Figure 14: Sector Return on Assets



Source: Company Data, UBS estimates

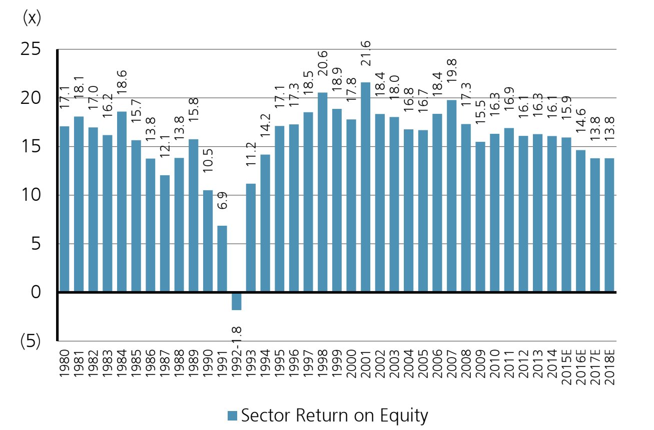
Return on Assets – While there are a lot of moving parts that drive the banks' ROA, we had believed there was potential upside if asset quality and BDD charges remained subdued. However, given APRA's comments and the likely ongoing pressure on funding costs, we believe this may no longer be the case. We believe re-pricing will now be required just to keep ROA flat. If the NSFR, greater term deposits and less reliance on short-term offshore wholesale funding are implemented risks to our forecasts are more likely to be on the downside. That said, asset quality and provision charges are still the key drivers of bank returns.

Figure 15: Sector Book Leverage (x)



Source: Company Data, UBS estimates

Figure 16: Sector Return on Equity (%)



Source: Company Data, UBS estimates

Book Leverage – We expect the banks to continue to deleverage as their capital ratios are strengthened consistent with moves to an "unquestionably strong" capital position. We believe a CET1 ratio of above 10% is the new starting point, while RWA are likely to move higher as Basel 4 is implemented as flagged by APRA. These potential changes are yet to be fully reflected in our forecasts.

Risks to ROE are now even more skewed to the downside

Return on Equity – Our current forecasts assume ROE settles in the 13-14% range for the major banks. However, evidence above suggests ROE may fall below these levels. This appears consistent with comments from Wayne Byres and returns seen in other developed banking systems since the financial crisis.

Sector Valuations and Pricing

Figure 17: Sector PE (x)

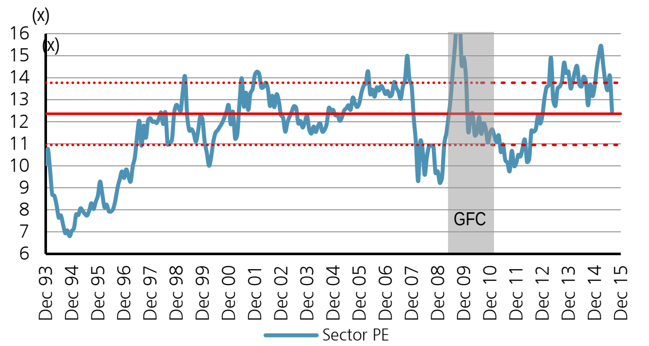


Figure 18: Sector PE Rel. the All Industrials (ex Financials)

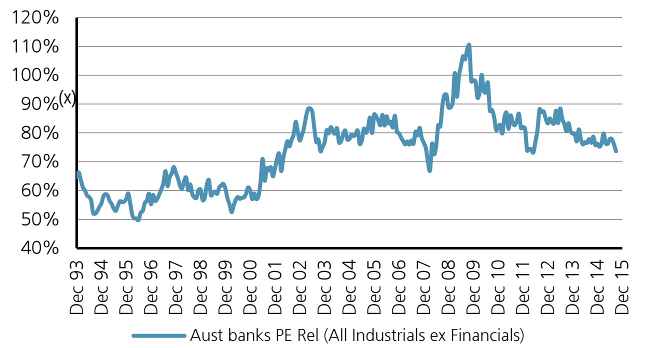


Figure 19: Sector Price to Pre-Provision Profits (x)

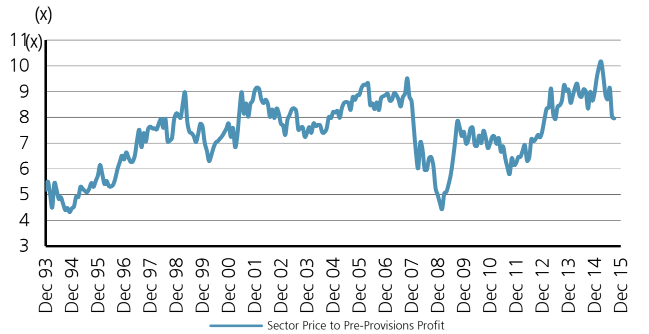


Figure 20: Sector Earnings Yield to Bond Yield (%)

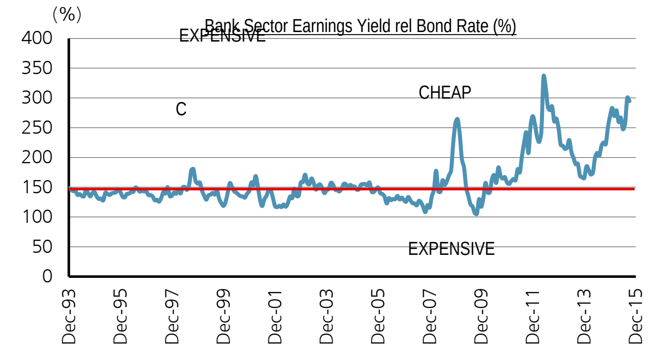


Figure 21: Sector Price to Book Ratio (x)

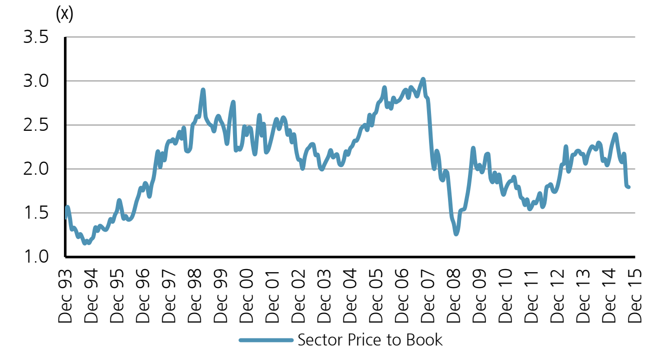


Figure 22: Sector Price to Book (x) vs Return on Equity (%)

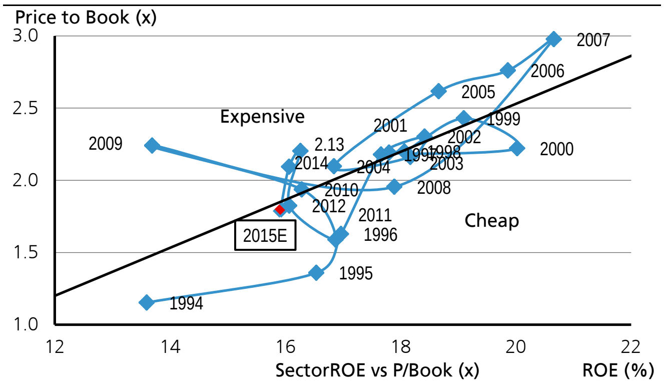


Figure 23: Sector Dividend Yield (%)

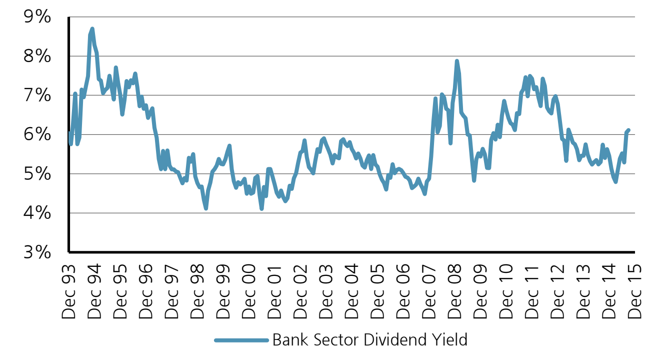
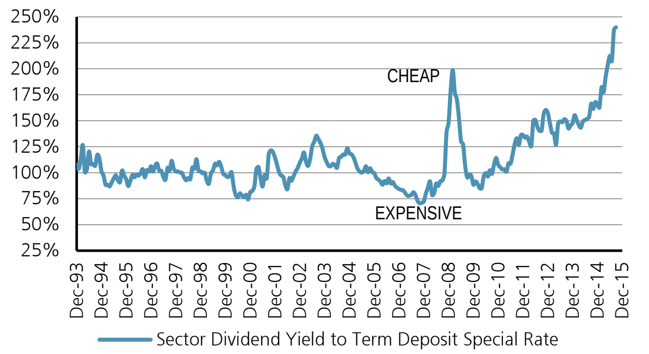


Figure 24: Sector Dividend Yield vs TD Special Rate (%)



Source: Company data, UBS estimates

Source: Company data, UBS estimates

Stock Valuations and Pricing

Figure 25: ANZ PE Relative to the Major Banks (%)

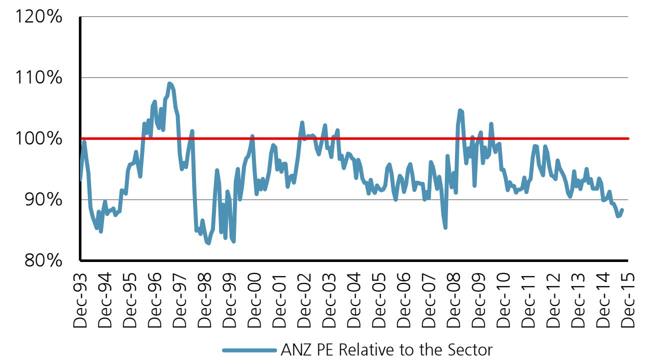


Figure 26: ANZ Price to Book (x) vs Return on Equity (%)

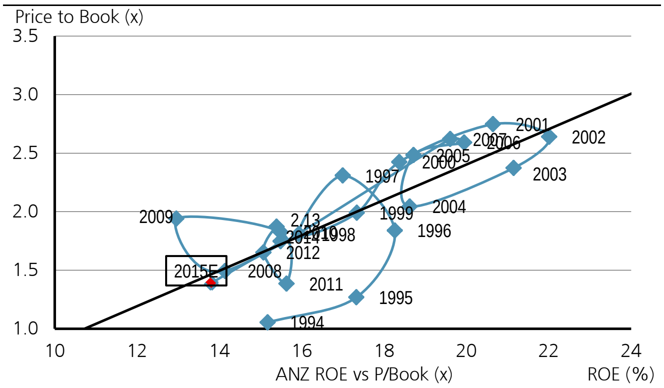


Figure 27: CBA PE Relative to the Major Banks (%)

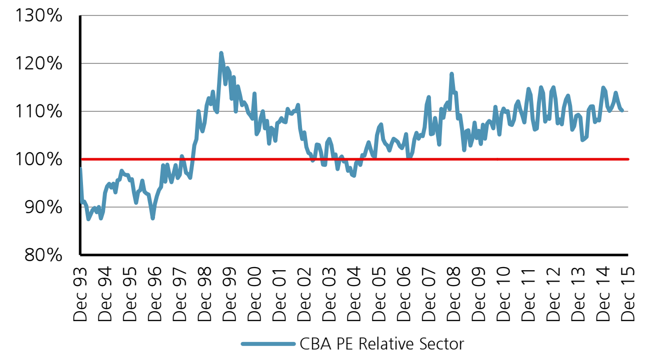


Figure 28: CBA Price to Book (x) vs Return on Equity (%)

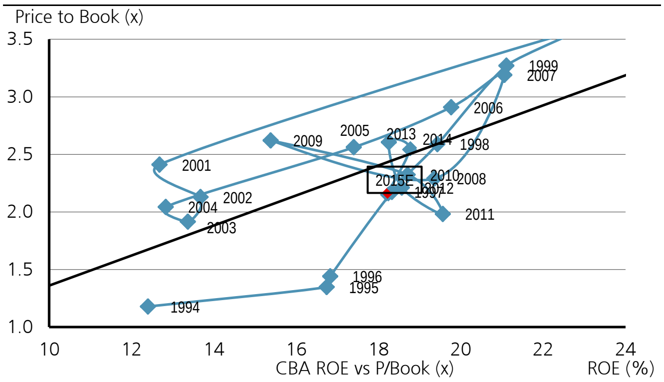


Figure 29: NAB PE Relative to the Major Banks (%)

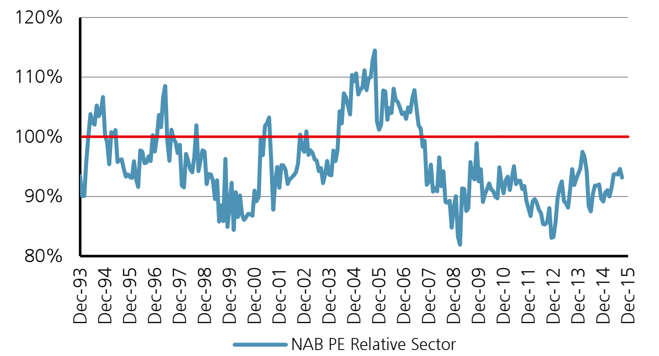


Figure 30: NAB Price to Book (x) vs Return on Equity (%)

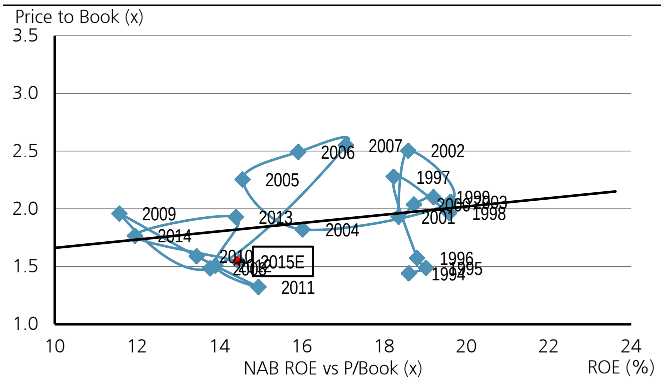
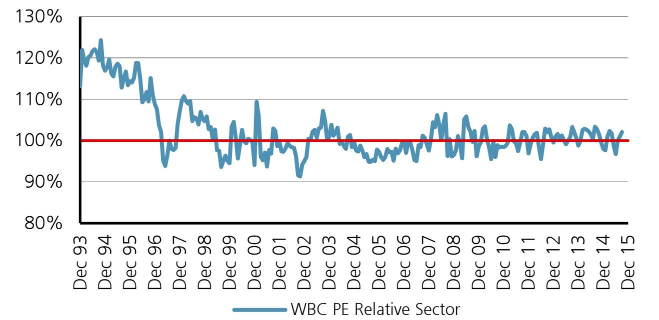
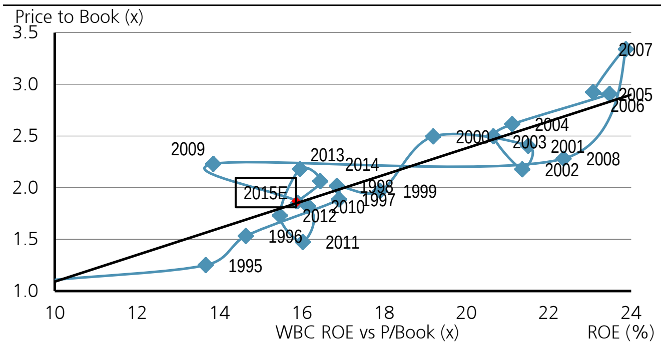


Figure 31: WBC PE Relative to the Major Banks (%)



Source: Company data, UBS estimates

Figure 32: WBC Price to Book (x) vs Return on Equity (%)



Source: Company data, UBS estimates

Figure 33: Major Bank Earnings & Valuation Summary

	ANZ	CBA	NAB	*NAB (ex-UK)*	WBC	Majors
Recommendation	Neutral	Buy	Neutral	-	Buy	Over Weight
Share price ($) 22 September 2015	27.83	73.80	30.51	*28.89*	31.11	
Price Target ($)	33.00	87.00	35.00	*33.38*	37.00	
Implied 2015E Price to Book (x)	1.6	2.8	1.8		2.2	2.2
Implied 2016E PE (%)	12.9	16.0	13.2		15.0	14.5
% Price Upside to Price Target	19%	18%	15%		19%	18%
Valuations						
PE (x)						
2014	11.0	14.2	14.3	-	12.9	13.2
2015E	10.9	13.7	11.4	-	12.7	12.4
2016E	10.9	13.6	11.5	*11.7*	12.6	12.3
2017E	10.6	13.4	11.9	*12.0*	12.5	12.3
PE Relative to All Industrials (%)						
2014	61	78	78	-	71	72
2015E	60	75	63	-	70	68
2016E	65	81	69	-	75	73
2017E	68	86	76	-	80	79
PE Relative to Major Banks (%)						
2014	84	107	108	-	98	n.a.
2015E	88	111	92	-	103	n.a.
2016E	88	110	94	*95*	102	n.a.
2017E	86	110	97	*98*	102	n.a.
Price to Pre-Provision Profit (x)						
2014	7.3	9.5	8.5	-	8.5	8.6
2015E	7.1	9.2	7.2	-	8.3	8.1
2016E	6.9	9.0	7.2	-	8.1	8.0
2017E	6.7	8.7	7.3	-	7.9	7.8
Diluted EPS growth (%)						
2014	8.8	11.8	-13.3	-	8.0	5.0
2015E	1.1	3.4	25.1	-	1.6	7.0
2016E	0.7	1.2	-1.1	-	1.2	0.6
2017E	2.8	0.9	-2.8	-	0.9	0.6
Growth in Book Value Per Share (%)						
2014	7.6	8.0	3.5	-	3.8	5.9
2015E	13.1	7.1	7.2	-	7.2	8.4
2016E	6.6	12.3	7.7	-	9.3	9.4
2017E	4.4	5.3	4.7	-	4.1	4.7
Div Yield (%)						
2014	6.4	5.4	6.5	-	5.9	6.0
2015E	6.5	5.7	6.5	-	6.0	6.1
2016E	6.6	5.8	6.5	*6.9*	6.1	6.2
2017E	6.8	5.9	6.5	*6.9*	6.3	6.3
Price to Book (x)						
2014	1.57	2.50	1.66	-	2.00	2.00
2015E	1.39	2.33	1.55	-	1.86	1.85
2016E	1.30	2.08	1.43	*1.52*	1.70	1.69
2017E	1.25	1.97	1.37	*1.45*	1.64	1.61
Price to NTA (x)						
2014	1.90	3.14	2.01	-	2.69	2.53
2015E	1.64	2.89	1.85	-	2.43	2.30
2016E	1.51	2.48	1.68	*1.82*	2.13	2.02
2017E	1.44	2.33	1.58	*1.69*	2.03	1.91

Financials	ANZ	CBA	NAB	*NAB (ex-UK)*	WBC	Majors
Cash NPAT (UBS post prefs) ($m)						
2014	7,111	8,635	5,172	-	7,628	28,546
2015E	7,233	9,085	6,817	-	7,776	30,911
2016E	7,773	9,714	7,230	*6,774*	8,185	32,903
2017E	8,202	9,952	7,388	*6,931*	8,571	34,113
Cash NPAT (Company format) ($m)						
2014	7,117	8,680	5,184	-	7,628	28,609
2015E	7,235	9,137	6,817	-	7,776	30,965
2016E	7,775	9,770	7,230	*6,774*	8,185	32,961
2017E	8,204	10,008	7,388	*6,931*	8,571	34,171
Cash EPS (fully diluted) (cps)						
2014	252	521	214	-	241	n.a.
2015E	255	538	268	-	245	n.a.
2016E	256	545	265	*248*	247	n.a.
2017E	264	550	257	*240*	250	n.a.
Basic EPS (Company format) (cps)						
2014	261	533	220	-	245	n.a.
2015E	262	558	274	-	248	n.a.
2016E	263	570	268	*252*	251	n.a.
2017E	271	575	261	*244*	253	n.a.
Book Value Per Share (cps)						
2014	1,770	2,953	1,841	-	1,559	n.a.
2015E	2,001	3,164	1,975	-	1,672	n.a.
2016E	2,134	3,553	2,127	*1,895*	1,828	n.a.
2017E	2,227	3,742	2,227	*1,995*	1,903	n.a.
Dividend (cps)						
2014	178	401	198	*198*	182	n.a.
2015E	182	420	198	*198*	187	n.a.
2016E	184	430	198	*198*	191	n.a.
2017E	188	436	198	*198*	195	n.a.
Return on Equity (%)						
2013	15.4	18.3	14.4	-	16.0	16.3
2014	15.5	18.8	12.0	-	16.5	16.1
2015E	13.8	18.2	14.5	-	15.9	15.9
2016E	12.7	16.8	13.0	*13.7*	14.6	14.6
2017E	12.4	15.7	11.9	*12.4*	13.9	13.8
Return on Assets (%)						
2013	0.96	1.08	0.80	-	1.04	0.99
2014	0.95	1.12	0.65	-	1.05	0.97
2015E	0.85	1.10	0.78	-	0.99	0.95
2016E	0.85	1.10	0.77	*0.79*	0.99	0.95
2017E	0.86	1.08	0.76	*0.77*	0.99	0.95
Core Tier 1 (APRA Basel III, %)						
2014	8.8	9.3	8.6		9.0	n.a.
2015E	9.8	9.1	10.0		9.5	n.a.
2016E	10.2	11.1	10.8	*10.0*	10.0	n.a.
2017E	10.3	10.0	11.2	*10.5*	10.4	n.a.

Key Earnings Drivers	ANZ	CBA	NAB	*NAB (ex-UK)*	WBC	Majors
Growth in Ave Interest Earning Assets (%)						
2013	10.1	3.8	5.0	-	3.8	5.5
2014	12.3	7.9	7.6	-	7.9	8.8
2015E	10.6	7.0	6.2	-	6.3	7.5
2016E	6.5	5.6	4.6	-	4.9	5.4
2017E	5.1	4.3	3.8	-	4.1	4.3
Margins (%)						
2013	2.22	2.13	2.03	-	2.15	2.13
2014	2.13	2.14	1.94	-	2.09	2.07
2015E	2.03	2.09	1.92	-	2.05	2.02
2016E	2.06	2.10	1.96	-	2.06	2.05
2017E	2.07	2.11	1.95	-	2.07	2.05
Non-Interest Income Growth (%)						
2013	-2.1	-1.7	3.5	-	7.4	1.5
2014	2.9	6.3	-0.3	-	6.8	4.2
2015E	3.4	6.4	3.6	-	1.3	3.8
2016E	2.8	4.0	1.0	-	4.8	3.3
2017E	2.9	3.2	3.7	-	3.8	3.4
Revenue Growth (%)						
2013	3.0	3.3	1.6	-	4.2	3.0
2014	6.5	7.6	1.9	-	5.2	5.4
2015E	4.8	5.3	5.0	-	3.4	4.6
2016E	6.4	5.6	5.1	-	5.3	5.6
2017E	4.9	3.9	3.5	-	4.5	4.2
Cost Growth (%)						
2013	-3.1	-2.0	4.8	-	5.1	0.9
2014	6.1	5.4	24.1	-	6.3	10.4
2015E	5.9	5.2	-11.0	-	4.1	0.6
2016E	3.2	2.0	2.7	-	2.8	2.6
2017E	3.0	2.7	3.0	-	2.3	2.7
Cost to Income Ratio (%)						
2013	44.9	43.3	44.2	-	41.2	43.3
2014	44.7	42.4	53.8	-	41.6	45.1
2015E	45.2	42.4	45.6	-	41.9	43.5
2016E	43.8	40.9	44.6	-	40.9	42.3
2017E	43.1	40.5	44.3	-	40.0	41.7
Core Earnings Growth						
2013	8.6	7.8	-0.9	-	3.5	4.7
2014	6.7	9.2	-15.7	-	4.5	1.5
2015E	4.0	5.3	23.6	-	2.9	8.0
2016E	9.0	8.2	7.2	-	7.2	7.9
2017E	6.3	4.7	3.9	-	6.0	5.2
BDD charge/loans (bp)						
2013	25	19	37	-	16	24
2014	19	16	16	-	11	15
2015E	22	15	16	-	12	16
2016E	25	18	19	-	16	19
2017E	26	23	22	-	18	22
Effective Tax Rate (%)						
2013	27.3	27.5	27.6	-	30.2	28.2
2014	27.5	27.2	32.4	-	29.6	28.9
2015E	27.5	27.3	28.6	-	29.7	28.2
2016E	27.5	27.3	28.3	-	29.7	28.2
2017E	27.5	27.3	28.3	-	29.7	28.2

Source: Factset, UBS estimates.

Statement of Risk

Australian banks are large, highly leveraged financial institutions operating across a number of markets, and as such are subject to the risk of changes in the general business and economic conditions within these markets. A change in these conditions could include changes in interest rates, inflation, unemployment, monetary supply, exogenous shock, changes in foreign exchange rates, and the health of the general economy. The banks also face the risk of regulatory changes and increased competition which could affect the profitability of the sector. A key risk that financial institutions face is associated with extending credit to other parties. Less favourable business conditions could cause potential losses from loans to increase putting pressure on the group's capital. The bank sector also faces operational risk from operating such large and complex businesses.

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12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	45%	36%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
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Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
ANZ Banking Group[2, 4, 5a]	ANZ.AX	Neutral	N/A	A$27.72	21 Sep 2015
Commonwealth Bank of Australia[2, 4, 5a, 5b]	CBA.AX	Buy	N/A	A$73.62	21 Sep 2015
National Australia Bank[2, 4]	NAB.AX	Neutral	N/A	A$30.47	21 Sep 2015
Westpac Banking Corporation[1, 2, 4, 5a, 5b, 16]	WBC.AX	Buy	N/A	A$30.85	21 Sep 2015

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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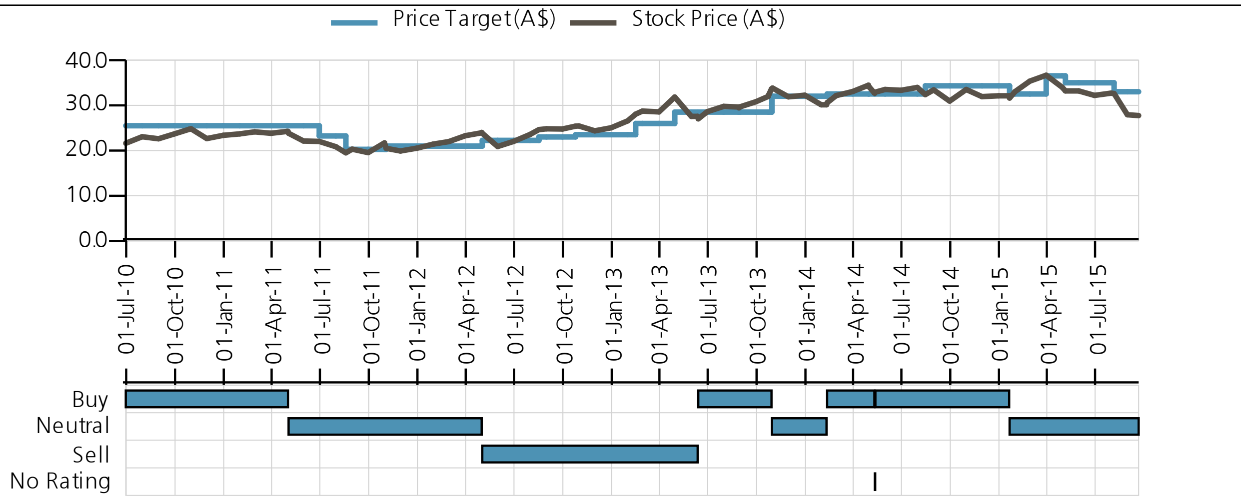
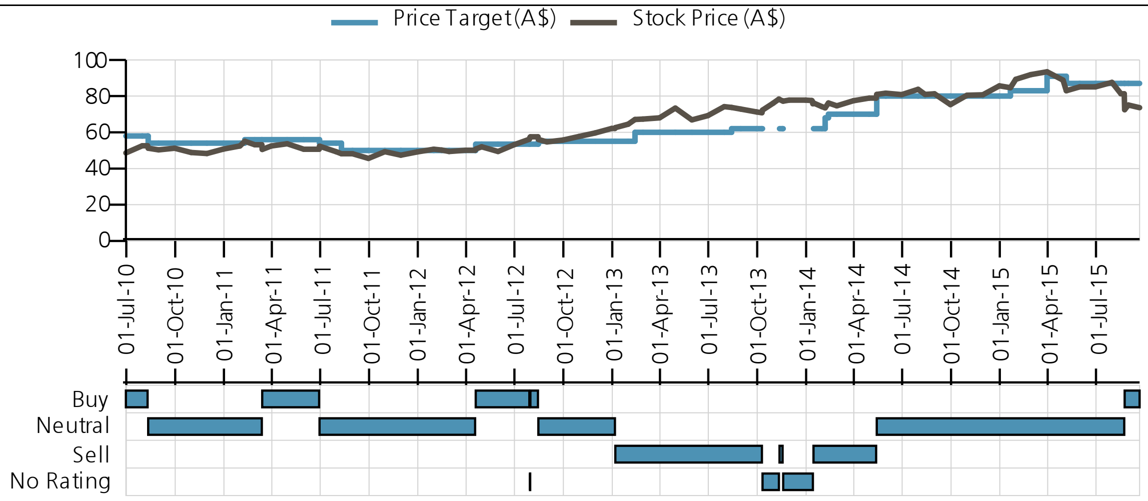
ANZ Banking Group (A$)



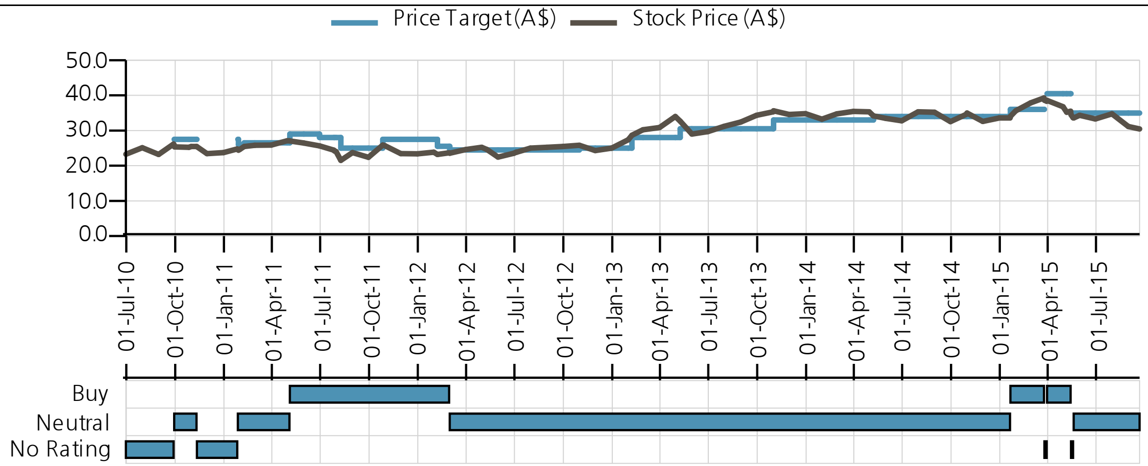
Source: UBS; as of 21 Sep 2015

Commonwealth Bank of Australia (A$)



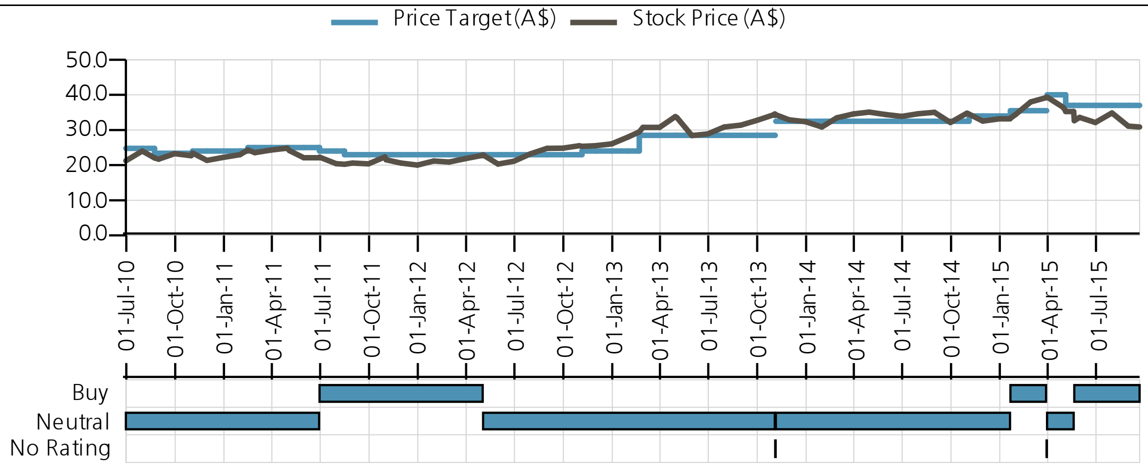
Source: UBS; as of 21 Sep 2015

National Australia Bank (A$)



Source: UBS; as of 21 Sep 2015

Westpac Banking Corporation (A$)



Source: UBS; as of 21 Sep 2015

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