Bank Mortgage Pricing

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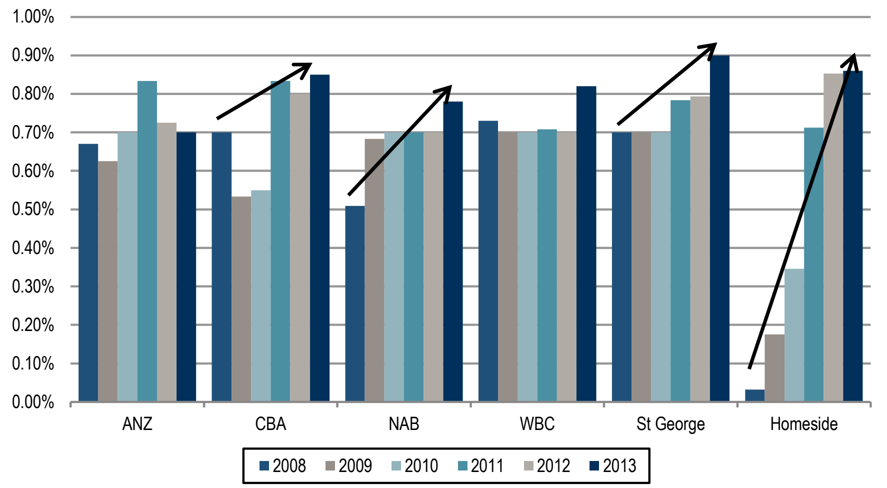
SECTOR REVIEW

Drilling down into mortgage discounting with proprietary data

Figure 1: **Mortgage package discounts have been generally rising over time**
Major bank average mortgage standard variable mortgage rate discounts 2008-13



Source: 1300HomeLoan

- **CBA mortgage margins potentially under pressure in 2013, WBC in 2014:** We see CBA stemming mortgage market share losses through discounting carded and effective rates, leading to possible 2013 margin pressures; WBC just recently discounted effective rates, but going forward could also discount carded rates, thereby leading to possible 2014 margin pressure. ANZ appears to have been the most effective in managing the margin/market share trade-off, with attractive carded rates assisting market share but modest package rate discounts preserving margin.
- **Peeling back headline mortgage rates:** Using proprietary data on Australian mortgage pricing (the Australian Lenders' Index from independent mortgage broker 1300HomeLoan), we have analysed the effective (rather than carded) standard variable mortgage rates offered by the major banks across a number of key brands, thereby capturing the mortgage discounts that are routinely embedded (but not transparent) in mortgage pricing.
- **Our major bank order of preference: ANZ** (NEUTRAL), **NAB** (NEUTRAL), **CBA** (UNDERPERFORM) and **WBC** (UNDERPERFORM).

Bank mortgage pricing

"Look, what I'd say with regard to AFS is firstly there's a portfolio and it's one of the benefits that we have within our AFS model is that we have a portfolio so even within that portfolio you've seen St George and Bank of Melbourne actually grow well above system on mortgages while Westpac RBB has actually been under system on mortgages. So that's…what I've really said is <u>I'd like to grow at or around system but happy to grow a little less with system being so modest. So if system growth is only 4, 4.5%, if you're growing at 0.8x or 0.9x of system I'm comfortable with that but as long as you're managing the margin</u>. Having said that, we would like to, we think we can, without compromising anything around discipline or without compromising anything around risk quality or pricing and margin management discipline, we think we can pick up our growth a little on the lending side. And so, you know, Brian has it in his sights to grow his overall mortgages for AFS as a whole at around system growth for the second half and now remember that's against a portfolio so it may not be identical across every brand but around system growth so that's a pick-up in mortgages."

WBC CEO Gail Kelly at the 1H13 profit announcement (emphasis added)

Our key insights

- <u>Headline or "carded" mortgage rates are quite misleading measures of price competitiveness</u>. For example, while currently both **ANZ** and **NAB** mortgage rates appear to be relatively inexpensive on a carded rate basis, **CBA** and **NAB's** Homeside brand are in fact the relatively inexpensive effective rates (with **CBA** relatively inexpensive since 2011). This suggests to us that: 1) <u>**CBA** is attempting to stem three years of modest (but consistent) mortgage market share losses by deploying price</u> (both through carded and effective rates) leading to likely 2013 net interest margin pressure, while 2) <u>**NAB's** ongoing mortgage market share gains in 2013 may be attributable at least in part to Homeside brand mortgage flows;</u>

- While currently **WBC's** carded rate is 13bp higher than the least expensive major bank brand <u>carded</u> rate (making **WBC** appear to be an "outlier" in terms of mortgage pricing), on an <u>effective</u> rate basis **WBC** is only 6bp higher than the least expensive mortgage. This follows on from a noticeable increase in both the **WBC** and **WBC** St George brand package discounts in 2013. Going forward, we see **WBC** supplementing these package discounts with carded rate discounts (capitulation on the reluctance to re-price the back-book), in turn leading to margin pressure in 2014;

- Over 2008-13 **NAB's** Homeside brand has been consistently the most competitively priced mortgage relative to the peer group (9bp average peer effective rate discount). More recently though, **NAB** appears to have eased its price competitiveness; since 2012 **NAB** has offered a relatively expensive nab brand effective mortgage rate (preserving margin) but concurrently also offered a relatively inexpensive Homeside brand effective rate (preserving market share momentum). This suggests to us that <u>**NAB** is currently perhaps deploying "multi-branding" and differential brand pricing better than **WBC** to balance the margin / market share trade-off</u>; and

- **WBC** and **ANZ** have been consistently the relatively most expensive peer mortgage rates over 2008-13 (**WBC** with an average peer group effective rate premium of 9bp). **ANZ** has progressively throughout 2012/2013 become now the relatively most expensive mortgage rate and has also been relatively slow over this period in passing through rate cuts to mortgage rates ("harvesting" margin). In turn, this suggests that <u>**ANZ** has effectively defended margin but without incurring market share attrition</u> (with attractive carded rates apparently assisting market share but modest package rate discounts preserving margin).

Why analyse mortgage rates at this juncture?

"In terms of the third party market it's still about 38% of our inflows in the mortgage book. Our view firmly as an organisation, we've had it consistently for the last five or six years, is there's a proposition that third parties offer customers which is it's a complicated product, we'll help you sort through the best offering and we'll do it without charging you and that proposition is not going away. So we will continue to work with brokers. Obviously, we would like to think that the level of service people can get through our proprietary offering is going to be so good that they won't want to go there, but the reality is a chunk of people are always going to want to and we need to be prepared to be good in that market."

CBA CEO Ian Narev at the 1H13 profit announcement

Our interest in the theme of mortgage pricing in Australia at this juncture is as follows:

- While the housing credit growth in the RBA system credit data series appears to have stabilised, overall system credit growth is very subdued (4.5% April 2013), making it incrementally more difficult for banks to generate positive lending growth momentum;
- Sustained market share trends appear to have emerged in the APRA Monthly Banking Statistics, with market share gains apparently entrenched for **NAB**, **ANZ** and **SUN**, and market share losses apparently entrenched for **WBC** and **CBA**. We see this as potentially an issue for **WBC**, whose mortgage rate is relatively high compared to the peers, yet whose balance sheet momentum in the last two half years has been relatively modest. Our assessment here is that **WBC's** apparent strategy of preserving "back-book" margin through a relatively high "Westpac" banded SVR mortgage price combined with pricing more sharply with fixed rate mortgages (a "front-book" product) and through subsidiary ("attacker") brands has not perfectly calibrated the margin / market share trade-off at this juncture.
- A period of out-of-cycle mortgage rate re-pricing late 2011/2012 appears to have come to an end in 2013, with: 1) all banks fully passing through the 7 May 2013 cash rate cut (we attribute this to the banks managing the potential political risk associated with undertaking out-of-cycle mortgage rate increases in a federal election year); and 2) **ANZ** in fact commencing out-of-cycle mortgage rate cuts on 10 May 2013 with a 27bp standard variable mortgage carded rate cut, matching **NAB** on its (previously leading) carded rates.

Dimensioning the leverage to Australian mortgages

"In mortgages, while brokers continued as a source of new and highly valuable customers, better investment and training, more focused allocation of mortgage specialists and implementation of new systems and processes drove a 7% improvement in sales through branches. Proprietary channels represented the majority of sales in the half, reaching a high of 55% in March. … Mortgage volume has grown above system for 13 consecutive quarters."

ANZ CFO Shayne Elliott at the 1H13 profit announcement

Lending portfolio magnifies the revenue contribution: As illustrated in the chart below left, Australian mortgages are the single largest component of each of the listed Australian banks' lending portfolios, and among the major banks comprises 52% of the aggregate FY12 global lending portfolio and 63% of the FY12 domestic lending portfolio. However, as illustrated in the chart below right from **CBA**, mortgages are a leading but not dominant part of the major bank revenue base (mortgages being 64% of **CBA's** global lending portfolio but only 15% of their revenue base). The reconciliation here is that: 1) the lending portfolio is only a partial view as to a bank's revenue base (liabilities, payments, trading activities and non-banking businesses also generate revenues); and 2) mortgages are a relatively low spread (but also low risk) lending asset class, which diminishes the revenue contribution relative to the balance sheet contribution to that extent:

Figure 2: **Mortgages are dominant in the loan books…**
Australian listed banks' FY12 lending portfolio composition

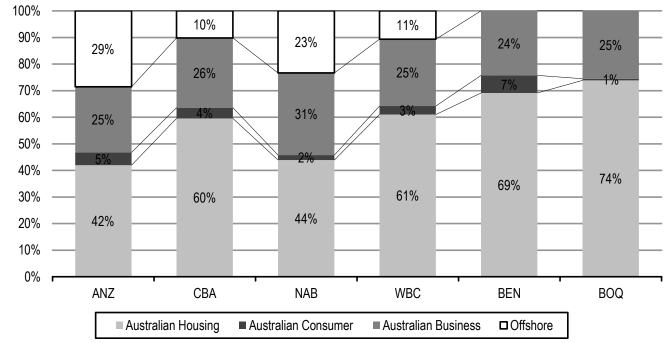
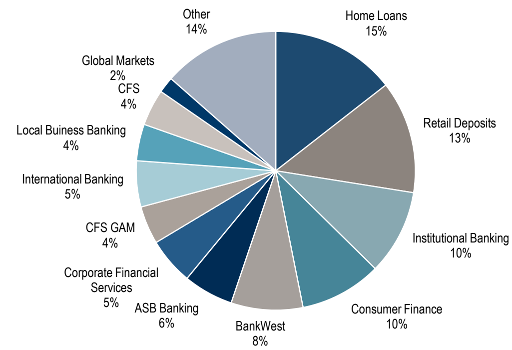


Figure 3: **…but less so in the revenue base (CBA 15%)**
CBA composition of FY12 revenues



Source for both charts: Company data, Credit Suisse estimates

This "silo" view of bank lending and revenues perhaps though understates the importance of mortgages, inasmuch as:

- A mortgage can act as a key product for new customer acquisition (notably among first home owners, upgraders and investors utilising their mortgage equity to gear into investments);
- Mortgages to new customers can often result in a multiple product relationship being created at that single point of origination (also for a single origination cost); and
- The transparency of mortgages (data relating to individual banks' mortgage prices and monthly portfolio balances is readily available) and the powerful re-pricing effects of out-of-cycle mortgage rate movements (when applied to both front and back books simultaneously) arguably elevates the prima facie importance of the mortgage product.

Introducing the "Australian Lenders Index" by 1300HomeLoan

"Well on the second point we've got to remain competitive in the market. We've done, I think, some good re-pricing and been able to maintain momentum which is critical. This is incremental to ROE. So, you know, <u>we obviously do have differential pricing in certain segments and we do differentially price through some of the channels based on asset quality but across the board you've got to have a competitive headline rate</u>. What's been quite clear is your headline rate, although not many people pay it, is a big determinant of your brand and how you attract customers. There's a study in the market at the moment as to how headline rates impact volume. As to whether we've seen the peak I think re-pricing is going to get hard because there's not a lot of growth there and as funding costs, depending on deposit competition, I think that the margin outlook in terms of re-pricing is going to be more difficult."

NAB CEO Cameron Clyne at the 1H13 profit announcement (emphasis added)

<u>We have analysed a proprietary data series for Australian mortgage pricing</u>, assessing the spread in major bank effective rate mortgage pricing through time, as well as the relationship between mortgage pricing and mortgage market share movements.

By way of background, independent mortgage broker 1300HomeLoan has collated and analysed industry mortgage pricing data (which is publicly available through the mortgage broker software company Finware) to produce a mortgage pricing index capturing monthly lender mortgage data from March 2008 to May 2013 corresponding to a $300,000 Standard Variable Professional Pack mortgage at a 70% loan to value ratio; the index has been constructed using mortgages distributed through broker channels. In our analysis below the reference below to "carded" rate refers to the Standard Variable rate (the undiscounted rate, which is usually higher).

The differentiation that we see in this mortgage pricing data is as follows:

- The Australian Lenders Index uses effective mortgages rates (the rate actually paid by a customer after relevant discounts) rather than the "carded" rate. This is important given that the contractual mortgage rate for the vast majority of mortgagees tends to be discounted from the "carded" rate, while discounts also tend to be an important component of overall mortgage price competition;
- The Australian Lenders Index incorporates a degree of multi-branding, inasmuch as it has separate pricing for **NAB's** Homeside brand and **WBC's** St George brand. Overall, the survey data covers six lender brands across the four major banks: ANZ, Commonwealth, nab, Homeside, Westpac, and St George; and
- The Australian Lenders Index is monthly data that continuously reaches back to March 2008, allowing for time series analysis to be undertaken.

1. Effective vs. carded mortgage rates

Assessing mortgage discount trends across key major bank brands: Our first view of the 1300HomeLoan data is to compare the "carded rate" of the relevant bank with the "effective rate" actually paid by the customer. This captures the point of sale interest rate discounts routinely granted to a majority of mortgagees; it does not, however, capture any fees associated with the mortgage (so is therefore not a true "comparison rate") and may not capture any non-standard mortgage discounts and concessions (e.g. more generous package discounts for "jumbo" mortgages). The following table details the May 2013 carded and effective rates; our key observations are as follows:

- Based on carded rates, **ANZ** and **NAB** would appear to be the equally lowest cost mortgages; based on effective rates though, **CBA** and **NAB's** Homeside brand would appear to be the cheapest;
- While on carded rates **WBC** appears to be relatively expensive (13bp higher than the cheapest mortgage), its effective rate is only 6bp higher than the cheapest corresponding effective rate mortgage (i.e. **WBC** is granting generous discounts). Conversely, **ANZ's** relatively attractive carded rate noted above correspond with the relatively highest effective rate (i.e. generous headline rates, but apparently limited "frontline" discounting); and
- Only a small degree of differential pricing is evident between the two subsidiary brands compared to the corresponding flagship brand; **NAB's** Homeside brand effective rate is 3bp lower than the nab brand effective rate, while **WBC's** St George brand rate is 2bp lower than the **WBC** brand effective rate. Overall though, the discounts on flagship and subsidiary brand mortgage rates were very similar.

Figure 4: **Westpac and St George providing the greatest discounts in May 2013**
Current carded rates, effective rates and discounts (May 2013)

	ANZ	CBA	NAB	WBC	St George	Homeside
Carded Rate (i.e. advertised)	6.13%	6.15%	6.13%	6.26%	6.24%	6.16%
Effective Rate (i.e. paid by the customer)	5.43%	5.30%	5.33%	5.36%	5.34%	5.30%
Discount (i.e. difference between carded and effective)	0.70%	0.85%	0.80%	0.90%	0.90%	0.86%

Source: Company data, 1300HomeLoan, Credit Suisse estimates

As illustrated in the chart below left, this disconnect between the most price competitive carded rate and the most price competitive effective rate appears to have been persistent through time (less so in 2010 perhaps). As illustrated in the chart below right, at the effective rate level, through time different brands have become relatively more or less expensive than the average peer effective mortgage rate. Among the different brands over the period shown, effective rates suggest that:

- **ANZ** and (particularly) **WBC** have been relatively expensive through time, while **NAB** has become relatively expensive since 2012 (countered though by **NAB's** Homeside brand being the least expensive mortgage over the same period); and
- **CBA** has been relatively inexpensive since 2011.

Figure 5: Discounts can affect relative price positioning
Average of carded and effective rates – by year

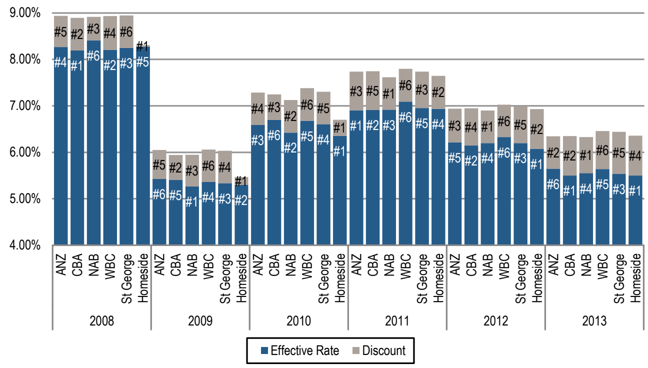
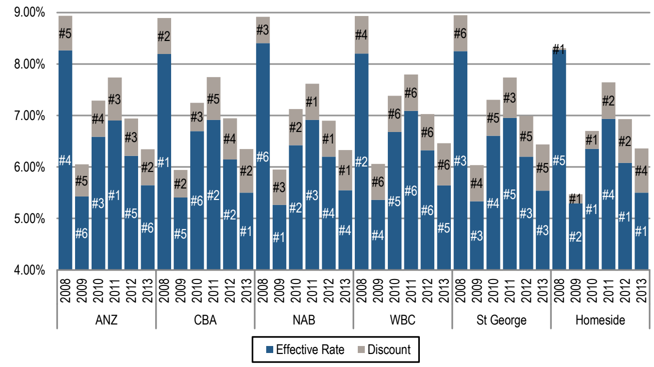


Figure 6: Price leadership can change through time
Average of carded and effective rates – by brand



Note: #1 denotes cheapest, #6 denotes most expensive
Source for both charts: Company data, 1300HomeLoan, Credit Suisse estimates

The following table illustrates the average discount paid across each brand by calendar year, highlighting:

- Across the board, discounts are greater in 2013 than they were in 2008; the greatest change in discounting has been seen from **NAB's** Homeside brand (from 3bp to 86bp);
- More recently, following the considerable out-of-cycle mortgage re-pricing undertaken in 2012 (which applies to carded rates), all brands with the exception of **ANZ** increased their mortgage discounts in 2013 compared to 2012, prima facie eroding the benefit of such re-pricing;
- **ANZ's** discounts were greatest in 2011, but since then their discounts have been progressively pared back; and
- In 2013 the discounts offered from both **WBC** and **WBC's** St George brand have notably increased (as we will discuss later, such pricing actions follow a period of mortgage market share losses for **WBC**).

Figure 7: Mortgage SVR discounting rising
Average of standard variable mortgage rate discounts by calendar year

Year	ANZ	CBA	NAB	WBC	St George	Homeside
2008	0.67%	0.70%	0.51%	0.73%	0.70%	0.03%
2009	0.63%	0.53%	0.68%	0.70%	0.70%	0.18%
2010	0.70%	0.55%	0.70%	0.70%	0.70%	0.35%
2011	0.83%	0.83%	0.70%	0.71%	0.78%	0.71%
2012	0.73%	0.80%	0.70%	0.70%	0.79%	0.85%
2013	0.70%	0.85%	0.78%	0.82%	0.90%	0.86%

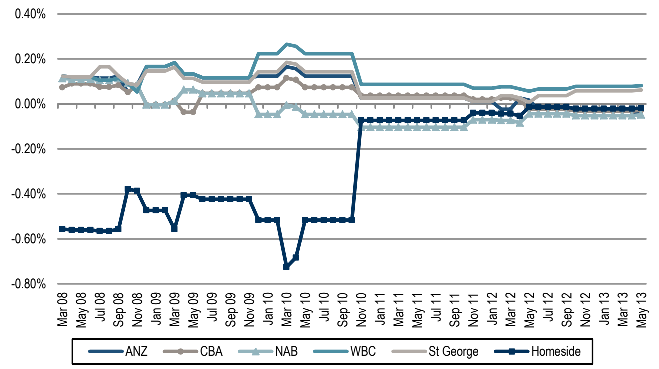
Source: Company data, 1300HomeLoan, Credit Suisse estimates

The following charts track through time the differences in mortgage rates compared to the average of the peers both on a carded rate (below left) and on an effective rate basis (below right). The charts tend to suggest that:

- Following a period of being relatively inexpensive compared to the peers in 2011, **ANZ's** effective mortgage rate has become progressively the most expensive compared to the peers throughout 2012 and 2013;
- Following a period of being relatively expensive compared to the peers in 2010, **CBA's** effective mortgage rate has joined **NAB's** Homeside brand in becoming the cheapest in 2013;
- While both the NAB and **NAB** Homeside brands offered relatively inexpensive effective mortgage rates in 2010, since mid-2011 NAB has priced broadly in line with the peer average, whilst since 2012 Homeside's relatively inexpensive pricing has migrated somewhat towards the peer group; and
- **WBC's** effective mortgage rates were relatively high than the peers throughout 2011 and 2012 than would be suggested by the carded rates, but in recent months have come back to the peer average.

Figure 8: **Significant convergence in carded SVRs…**

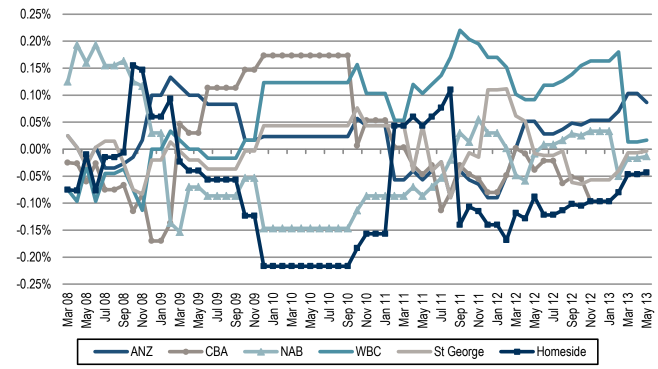
Carded mortgage SVR spreads to peer average carded SVR



Source: Company data, Credit Suisse estimates

Figure 9: **…and in recent months for effective SVRs**

Effective mortgage SVR spreads to peer average effective SVR



Source: Company data, 1300HomeLoan, Credit Suisse estimates

2. Effective mortgage rates vs. mortgage market shares

In this section we look at the impact of mortgage pricing on mortgage market share movements.

We acknowledge that price can be but one driver of market share movements: other non-price factors can include the intensity of advertising and promotion, effective sales channel management, and risk appetite/target market decisions. Further, price discounting strategies can be deployed differently: through subsidiary rather than through flagship brands, through package discounts rather than through carded rate (to preserve "back book" margins), and through fixed rates rather than through variable rates (again, to preserve back book margins). Further, there are inherent lags involved in deploying competitive pricing to shift market shares, since any increased share of mortgage flow only progressively emerges as an increased share of stock. Nevertheless, we see price as a key input into mortgage market share movements.

In terms of the duration of relatively low mortgage pricing / mortgage price leadership, over the period shown **NAB's** Homeside brand recorded by far the most months with the lowest mortgage rate (58% of the time) followed by the **CBA** and **NAB** brands (22% of the time). By way of contrast, **WBC** and **ANZ** recorded the most months as the highest interest rate brands (42% of the time):

Figure 10: Homeside most consistently lower priced…

Number of months the effective mortgage rate was below the market average 2008-13

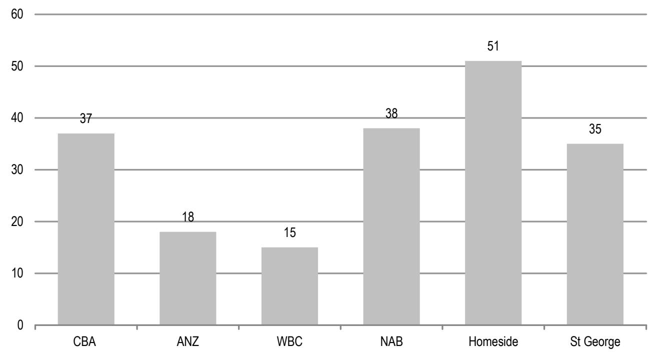
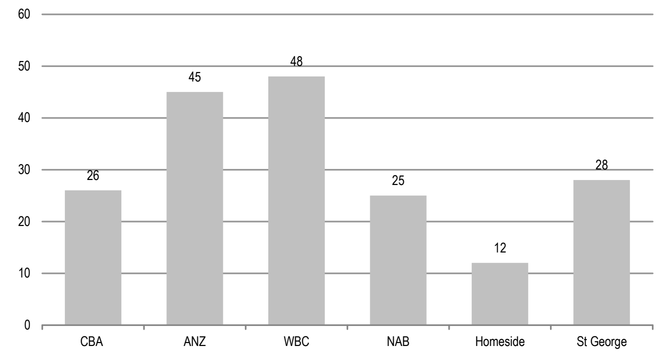


Figure 11: …with WBC and ANZ higher priced

Number of months the effective mortgage rate was above the market average 2008-13



Source for both charts: 1300HomeLoan

In terms of the magnitude of relatively low mortgage pricing / mortgage price leadership, the chart below left illustrates that over 2008-13 **NAB's** Homeside (-9bp) and **NAB** (-3bp) were below average over the period; conversely, on average **WBC** (+0.10%) was above industry average pricing. The chart below right shows the extent to which different mortgage brands over 2008-13 were prepared to price effective mortgage rates above or below the industry average, illustrating that **WBC** has reported the greatest extent of premium pricing and **NAB's** Homeside the greatest extent of discount pricing:

Figure 12: WBC relatively expensive through time

Mortgage effective rates 2008-13: average difference to industry

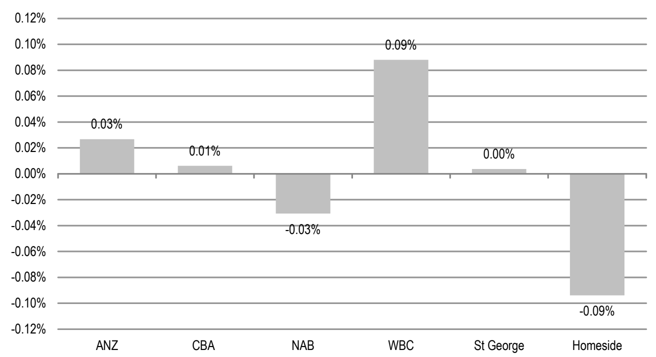
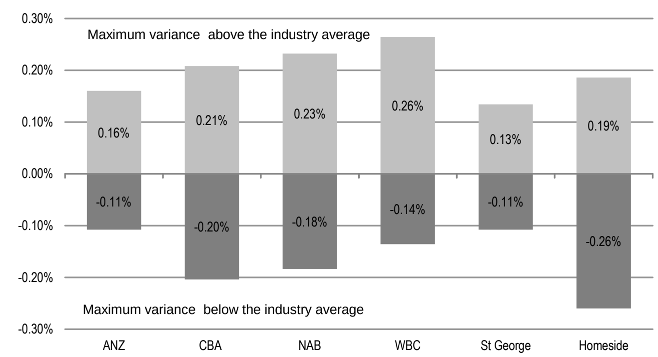


Figure 13: ANZ & St George pricing closer to the average

Mortgage effective rates 2008-13: variance from industry average



Source for both charts: 1300HomeLoan

The following charts overlay for each of the major banks mortgage market shares with variations in effective mortgage rates from the peer average from 2008 to 2013. Intuitively the charts tend to illustrate that periods of premium / discounted mortgage pricing were followed by corresponding periods of mortgage market share losses / gains (in turn reinforcing the price sensitive nature of consumer credit):

Figure 14: ANZ's rate appeared to influence share
ANZ housing share vs. effective mortgage SVR spread to peer avg.

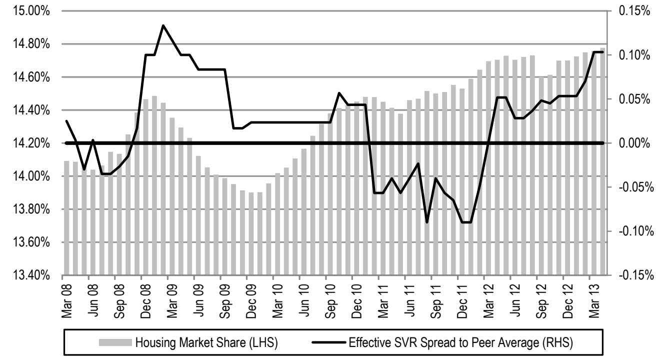


Figure 15: CBA's relatively high rate impacted share
CBA housing share vs. effective mortgage SVR spread to peer avg.

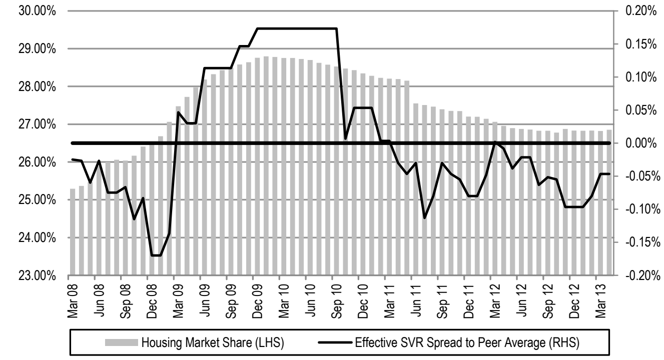


Figure 16: Market share gains for NAB since late 2009
NAB housing share vs. effective mortgage SVR spread to peer avg.

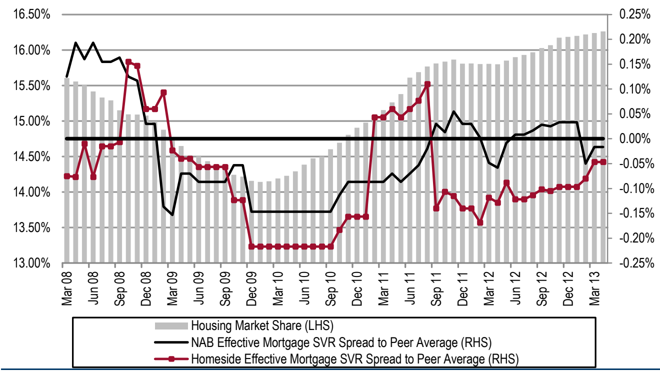
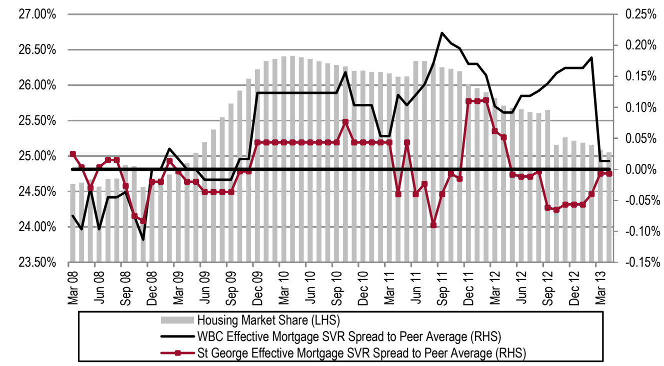


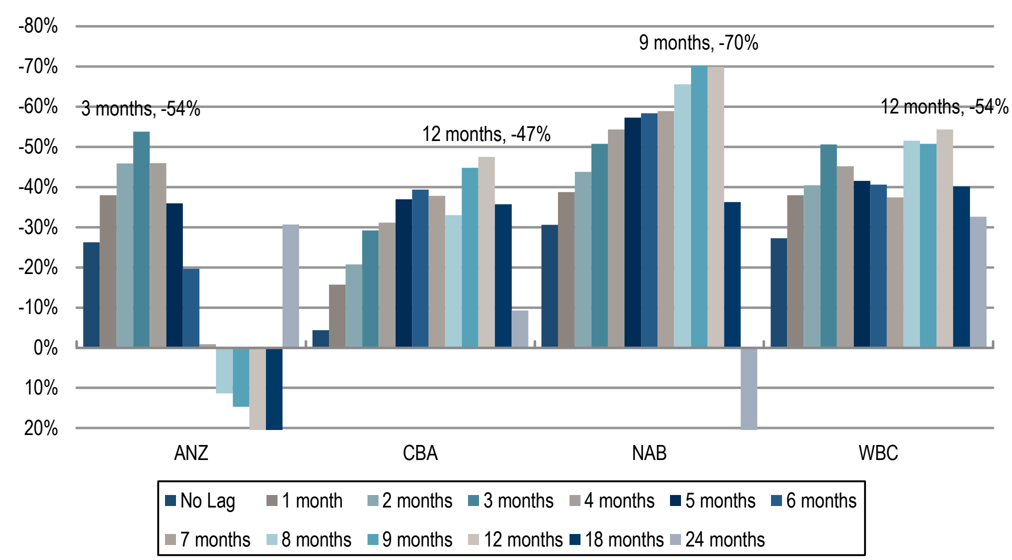
Figure 17: WBC's relatively high rate impacted share
WBC housing share vs. effective mortgage SVR spread to peer avg.



Source for all charts: APRA Monthly Banking Statistics, *1300HomeLoan, Credit Suisse estimates*

Finally, in recognition of the lagged nature of mortgage pricing actions to drive market share movements, the chart below seeks to assess when is there the greatest inverse correlation between effective mortgage rate movements relative to the average of the peers and market share changes, illustrating the lag tends to concentrated in the 9-12 months period of duration:

Figure 18: Market share changes appear to lag effective rate changes by 3-12 months
Correlation of change in housing market share and change in effective rate spread to peer average



Source: APRA Monthly Banking Statistics, *1300HomeLoan, Credit Suisse estimates*

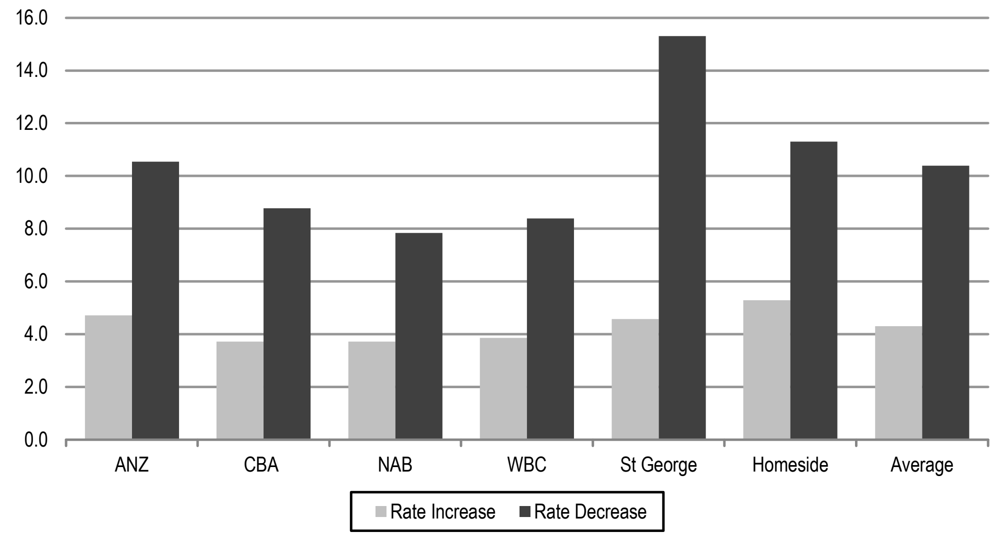
3. Gapping and re-pricing

Finally, we look at the responsiveness of lenders to changes in the RBA cash rate in terms of changes to their own headline carded rates. We acknowledge that, while cash rates are not a reliable indicative funding cost for bank mortgage portfolios, such "gapping and re-pricing" measures the extent to which base rate movements are delayed in their pass-through to mortgage rates (delaying a rate cut pass-through prima facie incrementally increases net interest income in the relevant operating period).

On average, lenders were found to be more than twice as quick to pass on a rate increase than a rate decrease, taking 3-5 days on average to respond to a rate increase (**CBA** being the fastest at 3.7 days and **NAB's** Homeside being the slowest at 5.3 days) and taking 9-11 days to pass on a rate decrease (**WBC** and **NAB** being the fastest at 8.0 days and **WBC's** St George being the slowest at 15.5 days).

As illustrated in the following chart, **ANZ** and the subsidiary brands St George and Homeside were relatively slow to transmit on cash rates cuts into bank mortgage rates:

Figure 19: ANZ and subsidiary brands relatively slow to pass on rate decreases
Average number of days to respond to an RBA rate increase or decrease over 2008-13



Source: 1300HomeLoan

Chart gallery: Mortgage rates and discounts

Figure 20: ANZ SVR recently lower than peers
ANZ carded mortgage spread to peer average vs. discount

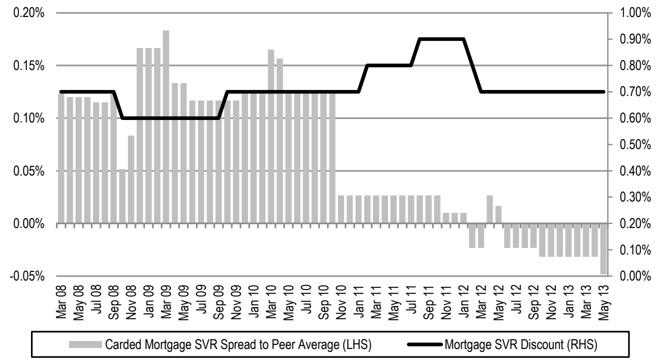


Figure 21: CBA SVR lower and with increasing discounts
CBA carded mortgage spread to peer average vs. discount

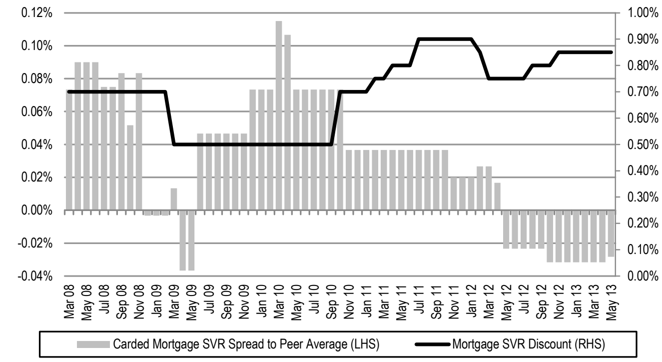


Figure 22: NAB has maintained cheaper rates longer term
NAB carded mortgage spread to peer average vs. discount

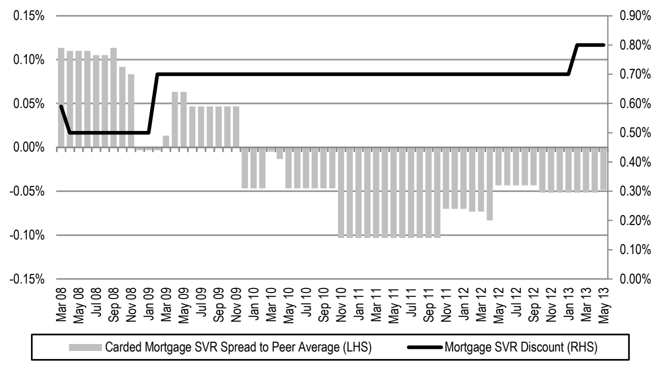


Figure 23: Homeside headline rates and discounts higher
Homeside carded mortgage spread to peer average vs. discount

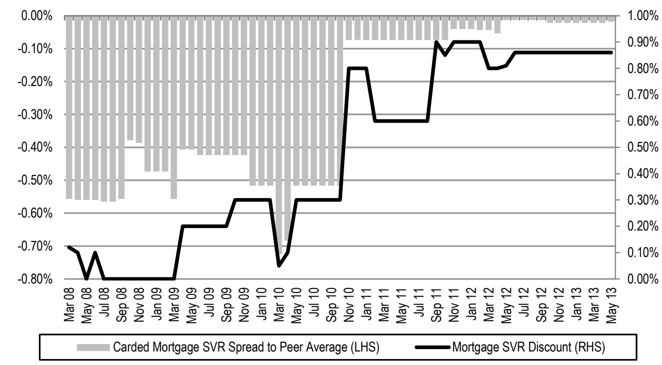


Figure 24: WBC's discounts stable but recently higher
WBC carded mortgage spread to peer average vs. discount

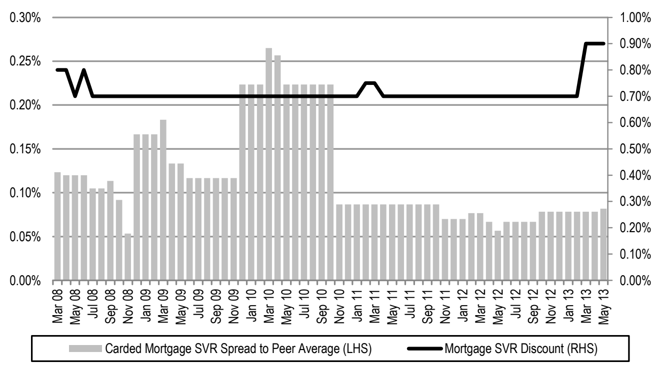
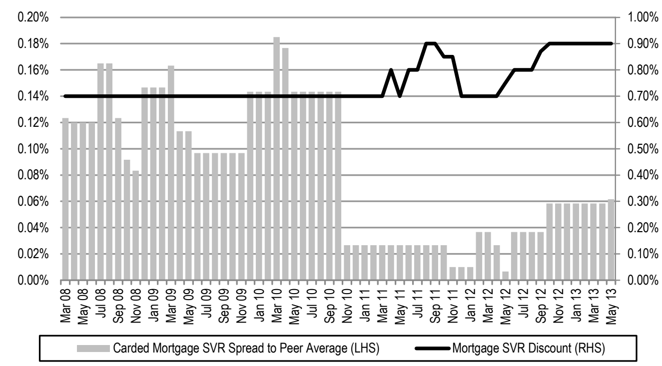


Figure 25: St George headline rates and discounts higher
St George carded mortgage spread to peer average vs. discount



Source for all charts: Company data, 1300HomeLoan, Credit Suisse estimates

Figure 26: ANZ's effective rate spread recently rising
ANZ effective mortgage spread to peer avg. vs. discount

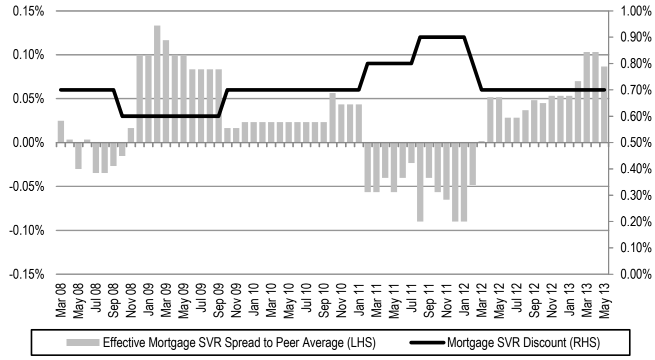


Figure 27: CBA pricing modestly aggressive
CBA effective mortgage spread to peer avg. vs. discount

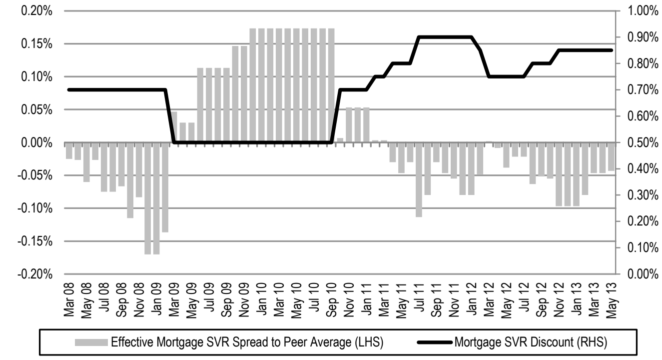


Figure 28: NAB effective rate in line with the peers
NAB effective mortgage spread to peer avg. vs. discount

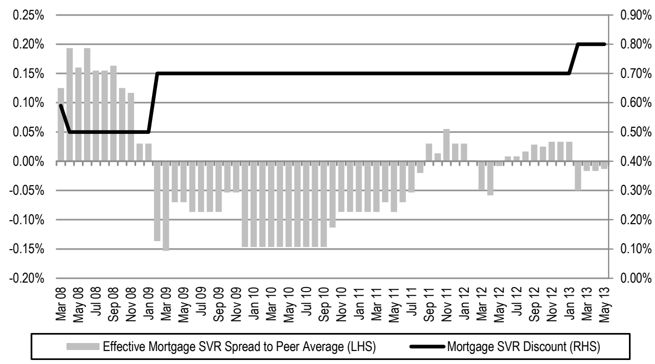


Figure 29: Homeside effective rate closing with the peers
Homeside effective mortgage spread to peer avg. vs. discount

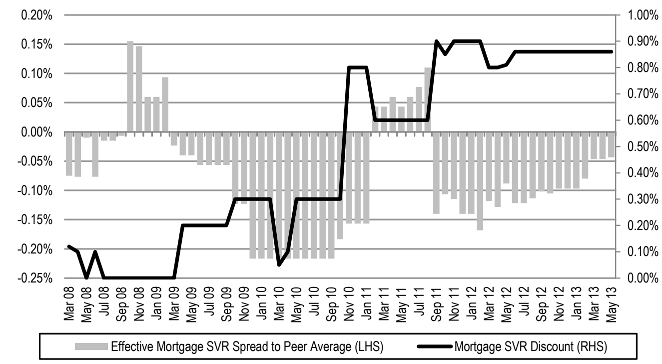


Figure 30: WBC relative effective rate recently much lower
WBC effective mortgage spread to peer avg. vs. discount

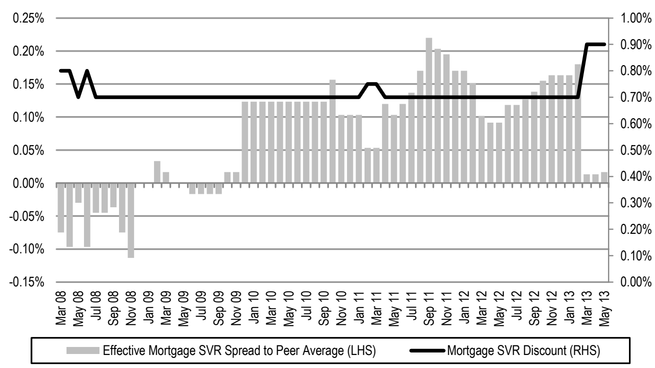
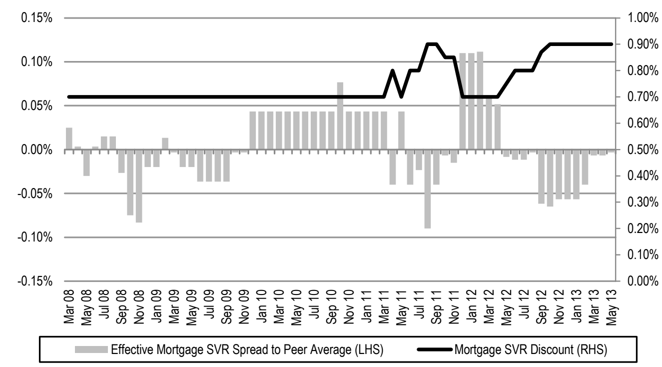


Figure 31: St George effective rate in line with peers
St George effective mortgage spread to peer avg. vs. discount



Source for all charts: Company data, 1300HomeLoan, Credit Suisse estimates

Companies Mentioned *(Price as of 14-Jun-2013)*

ANZ Banking Group (ANZ.AX, A$27.64, NEUTRAL, TP A$31.5)
Commonwealth Bank Australia (CBA.AX, A$66.6, UNDERPERFORM, TP A$71.0)
National Australia Bank (NAB.AX, A$29.19, NEUTRAL, TP A$34.0)
Westpac (WBC.AX, A$28.73, UNDERPERFORM, TP A$31.0)

Disclosure Appendix

Important Global Disclosures

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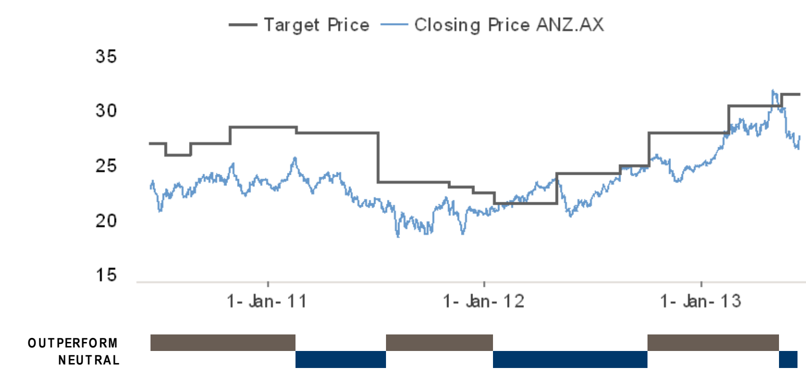
3-Year Price and Rating History for ANZ Banking Group (ANZ.AX)

ANZ.AX Date	Closing Price (A$)	Target Price (A$)	Rating
17-Jun-10	22.95	27.00	O
13-Jul-10	22.25	26.00	
23-Aug-10	22.95	27.00	
29-Oct-10	24.81	28.50	
18-Feb-11	24.89	28.00	N
06-Jul-11	21.85	23.50	
21-Jul-11	21.26	23.50	O
03-Nov-11	20.49	23.00	
12-Dec-11	20.95	22.50	
17-Jan-12	21.05	21.50	N
02-May-12	23.80	24.25	
17-Aug-12	24.61	25.00	
04-Oct-12	25.30	28.00	O
15-Feb-13	27.77	30.50	
15-May-13	29.98	31.50	N

** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for Commonwealth Bank Australia (CBA.AX)

CBA.AX Date	Closing Price (A$)	Target Price (A$)	Rating
13-Jul-10	49.93	57.00	O
12-Aug-10	50.70	55.50	N
11-Jan-11	50.30	56.00	
09-Feb-11	55.07	58.00	
06-Jul-11	51.47	53.00	
15-Nov-11	49.15	51.50	
12-Dec-11	49.83	50.00	
15-Feb-12	50.23	51.00	
03-Apr-12	50.04	51.50	
15-Aug-12	56.05	54.00	U
13-Feb-13	67.11	60.00	
15-May-13	72.65	71.00	

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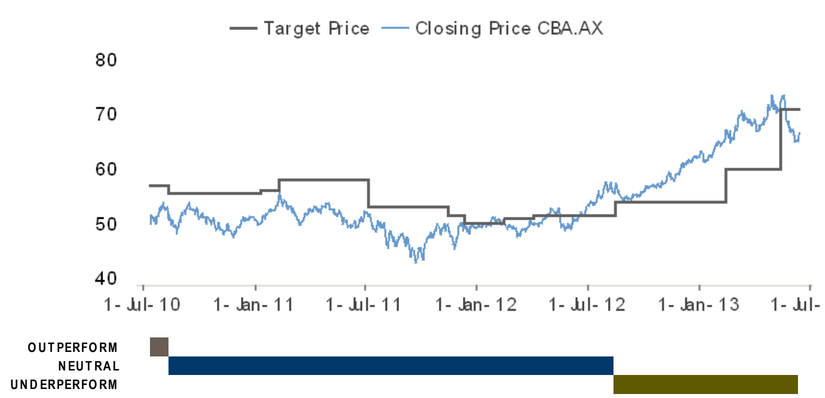

3-Year Price and Rating History for National Australia Bank (NAB.AX)

NAB.AX	Closing Price	Target Price	
Date	(A$)	(A$)	Rating
13-Jul-10	24.40	26.00	N
06-Oct-10	25.88	27.50	
11-Jan-11	23.89	28.00	O
05-Apr-11	26.06	29.50	
05-May-11	27.01	30.50	
06-Jul-11	24.96	28.50	
12-Dec-11	24.36	27.00	
17-Jan-12	23.80	25.00	N
03-Apr-12	24.61	26.00	
07-Feb-13	28.63	29.00	
15-May-13	33.07	34.00	

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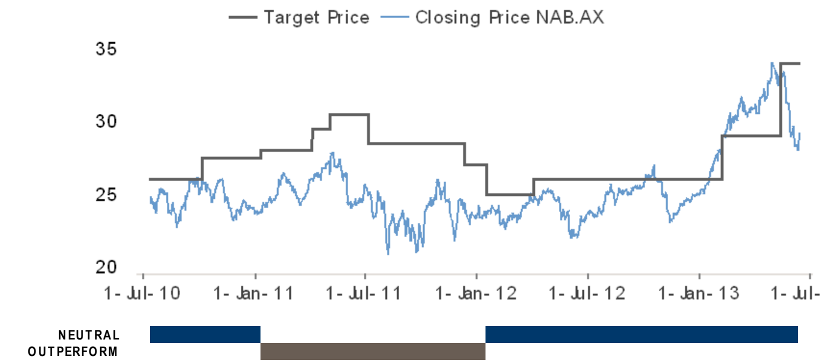

3-Year Price and Rating History for Westpac (WBC.AX)

WBC.AX	Closing Price	Target Price	
Date	(A$)	(A$)	Rating
13-Jul-10	22.13	24.85	N
15-Feb-11	24.16	25.84	
04-May-11	23.97	26.34	
06-Jul-11	21.76	23.36	
21-Jul-11	21.01	23.36	O
12-Dec-11	21.16	22.86	
03-Apr-12	21.69	23.86	
03-May-12	22.77	25.84	
27-Aug-12	24.53	26.59	
05-Nov-12	25.20	26.59	N
15-Feb-13	28.98	29.82	
15-May-13	31.67	31.00	U

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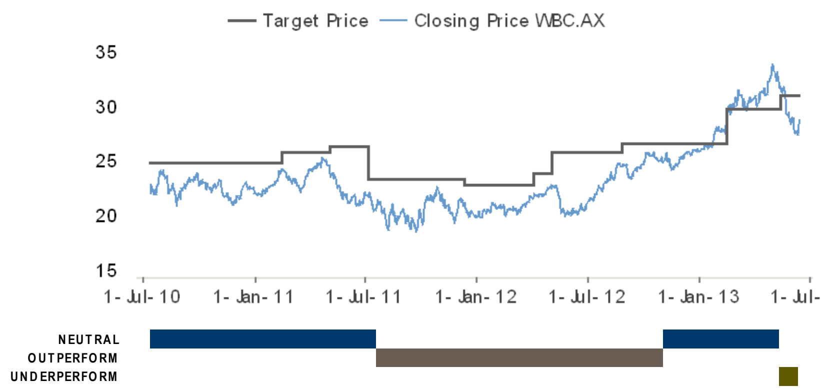

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Underperform/Sell*	15%	(39% banking clients)
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Price Target: (12 months) for ANZ Banking Group (ANZ.AX)

Method: Our target price of $31.50 is based on a valuation of ANZ using our $2.64 rolling 24mth forward cash earnings per share estimate and a combination of: 1) 51% historical bond yield / earnings yield relationship (50% weighting), 2) 87% historical price / earnings multiple relative to the S&P/ASX 200 ex-banks (25% weighting), and 3) 95% price / earnings multiple relative to the S&P/ASX 200 banks (25% weighting).

Risk: The risks to our $31.50 ANZ target price include acquisition risk, margin compression from higher wholesale fundng costs and competition in the deposit market combined with continued political pressure on banks limiting their ability to pass though the higher funding costs, the potential for further loan loss provisioning emerging in the SME and consumer lending books and the regulatory outlook (capital / liquidity / provisioning).

Price Target: (12 months) for Commonwealth Bank Australia (CBA.AX)

Method: Our target price of $71.00 is based on a valuation of CBA using our $5.07 rolling 24-month forward cash earnings per share estimate and a combination of: (1) 56% historical bond yield / earnings yield relationship (50% weighting), (2) 99% historical price / earnings multiple relative to the S&P/ASX 200 ex-banks (25% weighting), and (3) 107% relative to the banks index (25% weighting).

Risk: The risks to our $71.00 CBA target price include margin compression from higher wholesale funding costs and competition in the deposit market combined with continued political pressure on banks limiting their ability to pass though the higher funding costs, the potential for further loan loss provisioning emerging in the SME and consumer lending books and the regulatory outlook (capital / liquidity / provisioning).

Price Target: (12 months) for National Australia Bank (NAB.AX)

Method: Our target price of $34.00 is based on a valuation of NAB using our $2.87 rolling 24-month forward cash earnings per share estimate and a combination of: (1) 50% historical bond yield / earnings yield relationship (50% weighting), (2) 85% historical price / earnings multiple relative to the S&P/ASX 200 ex-banks (25% weighting), and (3) 92% relative to the banks index (25% weighting).

Risk: The risks to our $34.00 NAB target price include: acquisition risk (UK banking assets), execution risks from restructuring all parts of the business, a management team that is still relatively unproven, and the condtion of the UK economy.

Price Target: (12 months) for Westpac (WBC.AX)

Method: Our target price of $31.00 is based on a valuation of WBC using our $2.40 rolling 24-month forward cash earnings per share estimate and a combination of: (1) 53% historical bond yield / earnings yield relationship (50% weighting), (2) 92% historical price / earnings multiple relative to the S&P/ASX 200 ex-banks (25% weighting), and (3) 100% relative to the banks index (25% weighting).

Risk: The critical risks associated with our forecasts and valuation, and hence $31.00 target price for WBC, are the revival of business credit growth, the potential for further deceleration in housing credit growth, mortgage asset quality / house prices and the regulatory uncertainty regarding new capital and liquidity requirements.

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