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National Australia Bank (NAB)

AGM comments

Recommendation

Buy (unchanged)

Price

\$28.83

Target (12 months)

\$32.00 (previously \$31.00)

GICS Sector

Banks

Expected Return

Capital growth	11.0%
Dividend yield	4.4%
Total expected return	15.4%

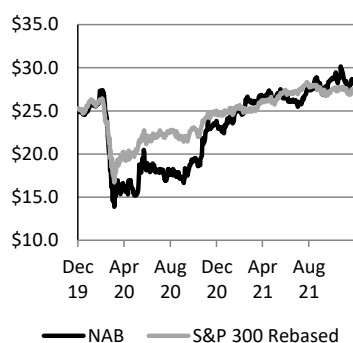
Company Data & Ratios

Enterprise value	n/m
Market cap	\$94,140m
Issued capital	3,265m
Free float	100%
Avg. daily val. (52wk)	\$174.1m
12 month price range	\$22.25 - \$30.30

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	29.40	28.18	23.55
Absolute (%)	-1.94	2.31	22.42
Rel market (%)	0.37	3.85	12.28

Absolute Price



SOURCE: IRESS

Better than ever

There is not much difference in the Chairman's address, being about COVID-19 and work continues in respect of performance and future of the business. While this appears to be well progressed, the years ahead continue to have their challenges. Nevertheless, there is a strong focus on customers/colleagues and to grow the business safely. NAB is now the second largest major bank by market capitalisation. The payout ratio is now close to its maximum, being 65-75% of cash earnings. ROE was 10.7% in FY21 and still climbing, while CET1 ratio was 13% and ahead of the 10.75-11.25% target range. The bank still intends to return surplus capital, being 40% complete. The acquisition of 86 400 plus the proposed acquisition of Citigroup's Australian consumer business will see the bank achieve scale in digital and consumer banking offerings. Likewise, change has been made as to how the bank has treated governance, accountability and culture. A number of regulatory matters have also been concluded and \$1.3bn has been returned to customers. As mentioned earlier, core earnings continued to improve and there were no large one-off items. The bread and butter role of its largest division Business & Private Banking had another good year in market share, likewise Personal Banking and Corporate & Institutional although Markets remains difficult for the time being.

Price target increased to \$32.00, Buy rating unchanged

Our FY22 and FY23 forecast earnings are slightly increased by 1%, all else being equal. We have also slightly increased NAB's valuation by around 3% and this is mainly due to better premiums ahead in Business & Private Banking (FY22 PE 15.5x), Personal Banking (FY22 PE 14.0x) and Corporate & Institutional Banking (FY22 PE 15.0x). Based also on a PB of now 1.6x overall, we have increased NAB's valuation and price target by 3% to \$32.00 (previously \$31.00). The Buy rating is unchanged.

Earnings Forecast

Year end 30 September	2021	2022e	2023e	2024e
Statutory earnings (A\$m)	6,364	6,227	6,420	6,620
Cash earnings (A\$m)	6,558	6,345	6,538	6,738
EPS (cash) (A¢)	199	192	195	200
EPS (cash) growth (%)	65%	-4%	1%	3%
PER (x)	14.5	15.0	14.8	14.4
P/Book (x)	1.5	1.4	1.4	1.3
P/NTA (x)	1.6	1.5	1.4	1.4
Dividend (A¢)	127	133	135	141
Yield (%)	4.4%	4.6%	4.7%	4.9%
ROE (%)	10.8%	10.0%	9.7%	9.7%
NIM (%)	1.72%	1.68%	1.67%	1.66%
Franking (%)	100%	100%	100%	100%

SOURCE: BELL POTTER SECURITIES ESTIMATES

AGM comments

Chairman's address

There is not much difference in terms of the Chairman's address. It is mainly about COVID-19 and that work continues at NAB in respect of performance to shareholders and the future of the business. While this appears to be well progressed, the years ahead still have their challenges and require resilience and ability to adapt. Nevertheless, there is a strong focus on customers and colleagues and to grow the business safely.

NAB is now the second largest major bank by market capitalisation, previously fourth. Dividends have increased and the payout ratio is now close to its maximum (being 65-75% of sustainable cash earnings, subject to timing differences). ROE was 10.7% in FY21, higher than the previous year but still lower than in FY19. CET1 ratio was 13%, well ahead of the target range of 10.75-11.25% and the bank intends to still return surplus capital to shareholders. (40% complete).

The exit of MLC Wealth was a major milestone, and the acquisition of 86 400 plus the proposed acquisition of Citigroup's Australian consumer business will see the bank achieve scale in digital (for example, 94% of customer transactions are online and 40% of home lending appointments are through VCR) and consumer banking offerings. COVID-19 has generated shifts in the use of IT in other words.

Likewise, change has been made as to how the bank has treated governance, accountability and culture. A number of regulatory matters have also been concluded and roughly \$1.3bn has been returned to customers, with the remainder by the end of calendar year 2022. Pay has also been changed and this mainly reflects 100% fixed pay to most colleagues. Finally, NAB is still set to align its lending portfolio to achieve net-zero emissions by 2050 (still the only Australian major to have set an upper limit on oil and gas extraction and production exposures).

CEO's address

In terms of the CEO, it is now roughly two years since he started the role. It seems faster progress has been achieved to date in terms of being relationship-led, easy to do business with, safe banking and thinking long-term. As mentioned earlier, core earnings continued to improve and there were no large one-off items. Dividend is now 127cps (vs 60cps last year) and the bread and butter role of its largest division Business & Private Banking had another good year in market share. Likewise Personal Banking and Corporate & Institutional in market share increases, although Markets remains difficult for the time being.

There is however much to do, for example, better use data to make faster lending decisions and improve customer experiences. So it is all about having the right technology and investing to make the systems more modern, flexible and reliable.

Price target increased to \$32.00, Buy rating maintained

Our FY22 and FY23 forecast earnings are slightly increased by 1%, all else being equal. We have also slightly increased NAB's valuation by around 3% and this is mainly due to better premiums ahead in Business & Private Banking (FY22 PE 15.5x), Personal Banking (FY22 PE 14.0x) and Corporate & Institutional Banking (FY22 PE 15.0x). Based also on a PB of now 1.6x overall, we have increased NAB's valuation and price target by 3% to \$32.00 (previously \$31.00).

The Buy rating is unchanged.

Table 1 – Composite valuation					Table 2 – SOP valuation				
Composite Valuation	Value (\$m)	Per NAB share	Weighting	Composite value per NAB share	Sum-of-Parts (As Is)	FY22e NPAT	Pros. PE (times)	Value (\$m)	Per NAB share
DCF	84,461	\$25.87	25%	\$6.47	Business & Private Banking	2,574	15.5	39,893	\$12.22
Dividend yield (sustainable)	115,376	\$35.33	25%	\$8.83	Personal Banking	1,611	14.0	22,552	\$6.91
ROE (sustainable)	107,480	\$32.92	25%	\$8.23	Corporate & Institutional Banking	1,094	15.0	16,417	\$5.03
Sum-of-Parts	94,855	\$29.05	25%	\$7.26	Wealth Management	0	-	-	-
Surplus capital*	1,612	\$0.49		\$0.49	NZ Banking	1,066	15.0	15,993	\$4.90
Total				\$31.28	Other including distributions	0	0.0	0	\$0.00
					Total	6,345	14.9	94,855	\$29.05

* Less estimated NZ new capital requirement

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 3 – Estimate changes												
National Australia Bank Y/e September 30 (\$m)	FY22e			FY23e			FY24e			FY25e		
	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change
Profit & Loss												
Net interest income	13,984	14,003	0%	14,286	14,306	0%	14,596	14,616	0%	14,912	14,933	0%
Other income	3,061	3,061	0%	3,153	3,153	0%	3,248	3,248	0%	3,345	3,345	0%
Net operating income	17,045	17,064	0%	17,440	17,460	0%	17,844	17,864	0%	18,257	18,278	0%
Operating expenses	-7,480	-7,480	0%	-7,435	-7,435	0%	-7,383	-7,383	0%	-7,323	-7,323	0%
Credit impairment charge	-524	-633	21%	-688	-799	16%	-859	-881	3%	-943	-965	2%
Cash earnings b4 tax/distributions	9,042	8,952	1%	9,316	9,225	1%	9,601	9,600	0%	9,991	9,989	0%
Income tax expense	-2,696	-2,669	-1%	-2,778	-2,751	-1%	-2,863	-2,863	0%	-2,980	-2,979	0%
Distributions	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
Cash earnings	6,345	6,282	1%	6,538	6,474	1%	6,738	6,737	0%	7,011	7,010	0%
Statutory earnings	6,227	6,164	1%	6,420	6,356	1%	6,620	6,619	0%	6,893	6,892	0%
Cash earnings ex-notable items	6,302	6,239	1%	6,494	6,430	1%	6,695	6,693	0%	6,968	6,967	0%
DPS (c)	133	133	0%	135	135	0%	141	141	0%	145	145	0%
EPS (cash basis) (c)	192	190	1%	195	193	1%	200	200	0%	207	207	0%
- ex-notable items (c)	191	189	1%	193	191	1%	199	199	0%	206	206	0%
Cash payout ratio	69%	70%	-1%	69%	70%	-1%	70%	70%	0%	70%	70%	0%
- ex-notable items	69%	70%	-1%	70%	70%	-1%	71%	71%	0%	70%	70%	0%
ROE	10.0%	9.9%	0.1%	9.7%	9.7%	0.1%	9.7%	9.7%	0.0%	9.7%	9.8%	0.0%
NIM	1.68%	1.68%	0.00%	1.67%	1.67%	0.00%	1.66%	1.67%	0.00%	1.66%	1.66%	0.00%
CIR	44%	44%	0%	43%	43%	0%	41%	41%	0%	40%	40%	0%
- ex-notable items	44%	44%	0%	43%	43%	0%	42%	42%	0%	40%	40%	0%
Underlying cost base	7,542	7,542	0%	7,497	7,497	0%	7,445	7,445	0%	7,385	7,385	0%
Impairment expense as % of GLA	0.08%	0.10%	0.02%	0.11%	0.12%	0.02%	0.13%	0.13%	0.00%	0.14%	0.14%	0.00%
Effective tax rate	30%	30%	0%	30%	30%	0%	30%	30%	0%	30%	30%	0%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

National Australia Bank

Company description

NAB is a well-diversified financial services organisation providing a comprehensive range of retail and wholesale banking products and services. The bank largely operates in Australia (under the NAB umbrella brands) and in New Zealand (under the BNZ brand) and remains a leader in SME/business banking.

Investment strategy

NAB's turnaround and de-risking phase is complete following the demerger and IPO of CYB. The bank is now focused on the lower risk, capital efficient Australian and New Zealand retail, business and corporate banking market space. Our investment strategy is predicated upon NAB improving its NIM (through repricing and pricing discipline), maintaining tight cost management and lifting its overall ROE to levels that are closer to those of its major bank peers.

Valuation

Our price target is broadly based on a blend of DCF, sustainable dividend yield play, sustainable ROE and fully de-risked SOP valuation weighted equally and as its ROE outlook normalises towards at least 10-12% in the medium term.

Table 4 – Composite valuation

Composite Valuation	Value (\$m)	Per NAB share	Weighting	Composite value per NAB share
DCF	84,461	\$25.87	25%	\$6.47
Dividend yield (sustainable)	115,376	\$35.33	25%	\$8.83
ROE (sustainable)	107,480	\$32.92	25%	\$8.23
Sum-of-Parts	94,855	\$29.05	25%	\$7.26
Surplus capital*	1,612	\$0.49		\$0.49
Total				\$31.28

* Less estimated NZ new capital requirement

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 5 – SOP valuation

Sum-of-Parts (As Is)	FY22e NPAT	Pros. PE (times)	Value (\$m)	Per NAB share
Business & Private Banking	2,574	15.5	39,893	\$12.22
Personal Banking	1,611	14.0	22,552	\$6.91
Corporate & Institutional Banking	1,094	15.0	16,417	\$5.03
Wealth Management	0	-	-	-
NZ Banking	1,066	15.0	15,993	\$4.90
Other including distributions	0	0.0	0	\$0.00
Total	6,345	14.9	94,855	\$29.05

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SWOT analysis

Strengths

1. Agribusiness and SME / commercial banking capabilities;
2. Highest proportion of investment grade exposures in the sector;
3. Lowest exposure to mining and energy;
4. High quality mortgage loan book;
5. Well diversified geographically;
6. Management execution; and
7. Cost and growth discipline, and ROE focus.

Weaknesses

1. NIM still soft in business lending; and

2. Market share loss in SME and business banking segments.

Opportunities

1. Further domestic banking and wealth management opportunities based on securing alternate distribution strategies;
2. Upside risk to planned cost savings following \$1.5bn investment spend; and
3. Driving the Personal and Business Banking cost ratio to below 35%.

Threats

1. Slippage in planned productivity increases;
2. Royal Commission and other political uncertainties;
3. Macroeconomic factors, e.g. unemployment and slowing credit growth;
4. Changes in regulatory environment, especially higher liquidity/capital/funding constraints under proposed global regulatory reforms, and the potential capping of funds management and advice fees that would crimp wealth management earnings growth; and
5. Increased competition specifically from the majors and disruptors on the domestic front in retail and wholesale banking and wealth management.

Sensitivities

Table 6 – Sensitivities

Y/e September 30	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Sensitivities									
Group NIM +10bp									
- NPAT upside (cash basis)	9.2%	9.2%	9.1%	9.0%	8.8%	8.6%	8.4%	8.2%	8.1%
- Price target upside	\$2.94	\$2.94	\$2.92	\$2.87	\$2.81	\$2.75	\$2.70	\$2.64	\$2.58
Group Loans +1%									
- NPAT upside (cash basis)	0.7%	0.7%	0.7%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%
- Price target upside	\$0.22	\$0.21	\$0.21	\$0.21	\$0.21	\$0.20	\$0.20	\$0.20	\$0.19
Australian loans +1%									
- NPAT upside (cash basis)	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
- Price target upside	\$0.13	\$0.13	\$0.13	\$0.13	\$0.13	\$0.13	\$0.13	\$0.12	\$0.12
NZ loans +1%									
- NPAT upside (cash basis)	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
- Price target upside	\$0.05	\$0.05	\$0.05	\$0.05	\$0.05	\$0.05	\$0.05	\$0.05	\$0.05
Other income +1%									
- NPAT upside (cash basis)	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
- Price target upside	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.10	\$0.10	\$0.10	\$0.10
BDD +1%									
- NPAT upside (cash basis)	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%
- Price target upside	-\$0.02	-\$0.02	-\$0.03	-\$0.03	-\$0.03	-\$0.03	-\$0.03	-\$0.03	-\$0.03
Costs +1%									
- NPAT upside (cash basis)	-0.8%	-0.8%	-0.8%	-0.7%	-0.7%	-0.7%	-0.6%	-0.6%	-0.6%
- Price target upside	-\$0.26	-\$0.25	-\$0.25	-\$0.23	-\$0.22	-\$0.21	-\$0.20	-\$0.19	-\$0.18

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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T S Lim, authoring analyst, holds a long position in NAB.

Disclosure: Bell Potter Securities acted as Co-Manager in NAB's NABPH (November 2020) offer and received fees for that service.

ANALYST CERTIFICATION

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