Westpac GROUP

MEDIA RELEASE

16 February 2012

1Q12 update[1] – Sound underlying business performance impacted by lower markets income

Financial highlights[1]

- Cash earnings[2] of approximately $1.5 billion
- Statutory net profit of approximately $1.4 billion
- Operating income flat, absorbing a $200 million reduction in Markets/Treasury income
- Impairment charges of around $300 million, with stressed assets continuing to trend lower
- Strong balance sheet maintained, with Tier 1 ratio of 9.80%

Overview

The Westpac Group today said that cash earnings, on an unaudited basis for the three months to 31 December 2011, was approximately $1.5 billion. Statutory net profit after tax, on an unaudited basis, for the same period was approximately $1.4 billion.

Westpac's Chief Executive, Gail Kelly, said the Group's 1Q12 result reflected the more challenging operating environment which contributed to a $200 million decline in markets related income. This reduction in revenue was partially offset by profit on asset sales and the accelerated recognition of establishment fees in the Institutional Bank. In aggregate, these volatile items negatively impacted operating income by around $100 million. Excluding these items, cash earnings for 1Q12 would have been little changed over the average of cash earnings for 3Q11 and 4Q11.

At a divisional level, the underlying performance has been sound:

- Our retail and business banking divisions in Australia performed solidly with total revenues up around 1.3% over the quarter;
- The Institutional Bank continued to record strong transactional business and good customer flows although adverse movements in credit spreads negatively impacted the fair value of counterparty exposures;
- BT continued to be a market leader in Funds Under Administration (FUA) flows, and insurance sales and advice activity continued to be strong. However, softer markets contributed to lower revenues in the quarter; and
- Continuing its improving trend, New Zealand recorded stronger earnings with lower impairment charges.

Operating environment

Operating conditions deteriorated in the December 2011 quarter with slowing global growth and an escalation in the European sovereign debt crisis leading to high market volatility and increased business and consumer caution. In aggregate, the Australian economy performed solidly with continued growth and easing inflation. That said, activity in Australia continues to be uneven with some regions and industries showing little growth.

See footnotes on page 4.

More recently, events to shore up liquidity in Europe have assisted in improving market sentiment, although given the fundamental issues in that region we remain cautious about the outlook.

For the banking sector, ongoing business and consumer caution has led to weak demand for new credit, and a continuing preference for customers to divert more resources to paying down existing debt. Deposit growth on the other hand remains solid, supported by a further rise in deposit interest rates relative to wholesale market rates. This, combined with a significant increase in wholesale funding costs over the quarter, is contributing to a material increase in overall funding costs.

Earnings

At the top line, operating income was relatively stable in 1Q12 compared to the average of 3Q11 and 4Q11, despite the lower Treasury/Markets contribution. Around two thirds of the $200 million decline in Treasury and Markets income was due to movements in credit spreads which negatively impacted the fair value of the liquid asset portfolio, and the value of counterparty credit exposures. These items will continue to be volatile despite the strength of the underlying assets. The rest of the decline was due mostly to lower Treasury risk management income. Partially offsetting these items was a profit on asset sales and the accelerated recognition of establishment fees in the Institutional Bank.

Lending increased 1% between 30 September 2011 and 31 December 2011, with the mix reflecting our focus on relationship based facilities and a de-emphasis on price sensitive, single product offers that tend to provide a lower marginal return. This will be an ongoing trend consistent with our customer focused strategy and as we seek to increase the proportion of lending funded by deposits.

Loan growth was fully funded by around $5 billion in customer deposits raised over the quarter. Almost all the growth in customer deposits was in term deposits.

Net interest margin was 10bps lower for 1Q12 compared to the average of 3Q11 and 4Q11, principally from higher funding costs and lower Treasury earnings. The underlying margin, excluding Treasury and Markets income, was down around 2bps. Funding costs rose materially through the December 2011 quarter, mostly through higher deposit costs. This trend continued into the 2012 calendar year with both higher deposit costs and increases in wholesale funding costs further impacting margins.

Wealth income in the quarter declined as administration and management fees were impacted by lower average FUM and FUA balances from weaker asset markets. New platform flows continue to be strong relative to the market. Despite strong sales, insurance earnings were lower reflecting a rise in claims, which tend to be seasonal, and higher reinsurance costs.

Expenses were around 2% higher than the average of 3Q11 and 4Q11. The key contributors to the increase included: higher restructuring charges associated with our productivity initiatives; increased wealth expenses including from more advisors; and a higher proportion of project and technology costs being expensed rather than capitalized. Other costs were flat or down.

Impairment charges in 1Q12 were around $300 million, up modestly from the average of 3Q11 and 4Q11. The increase was principally due to lower institutional write-backs and a few provision top-ups to existing stressed assets consistent with some lower asset valuations and the continued subdued operating environment.

Strategic progress

At Full Year 2011, the Group outlined a number of metrics that will be used to assess performance against our strategic objectives. In 1Q12 we have made steady progress including:

- Underlying net customer return[3] improved around 4bps points in 1Q12, compared to the average of 3Q11 and 4Q11, to 4.1%;
- Insurance/wealth cross sell[4] was up 30bps to 17.3%;
- Customer numbers increased around 1.0% at WestpacRBB and 0.7% at St.George (including Bank of Melbourne up 2.5%) over the 3 months ended 31 December 2011;
- Deposits increased above system across brands, contributing to a 40bps rise over 1Q12 in the customer deposit to loan ratio to 63%; and
- Common equity ratio increased to 8.25% at 31 December 2011 (8.09% at 30 September 2011).

Productivity drive

The productivity program is a central element of the Group's strategic agenda to reposition us for the changed operating environment. In October 2010, initiatives to support our investment plans and reduce cost growth were commenced and have continued to deliver both improved service and process efficiencies. In November 2011, the Group announced the next phase of its strategy which included accelerating our productivity agenda.

Initiatives completed during the quarter included the implementation of a new operating model, to ensure we have the right structure to support our strategy. The establishment of Australian Financial Services and Group Services is assisting us to improve productivity through reducing divisional overlaps and management reporting layers in areas such as administration, support and operations.

We have also made good progress with our best sourcing arrangements, although there was little impact on expenses in 1Q12. As we progress these initiatives we will incur additional one-off expenses including:

- Costs associated with streamlining and better documenting our systems and processes;
- Technology costs to strengthen our infrastructure and enhance our interaction with suppliers; and
- Costs associated with restructuring our workforce.

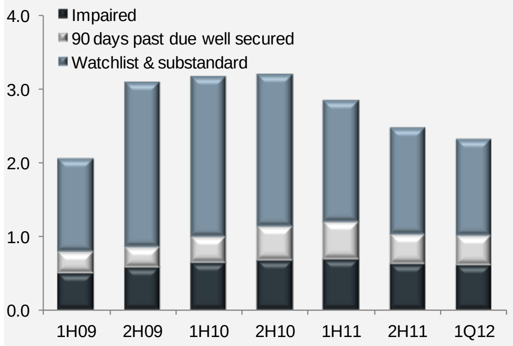
Given the significant one-off nature of this program, and that these expenses will not impact our dividend decisions, the Group expects to book these costs as a cash earnings adjustment. The size, timing and nature of these costs is still being finalised but are not expected to exceed $200 million.

Asset quality

There was further improvement in stressed assets to total committed exposures over 1Q12 (refer Chart 1). The ratio improved by 15bps to 2.33% at 31 December 2011, down from 2.48% at 30 September 2011.

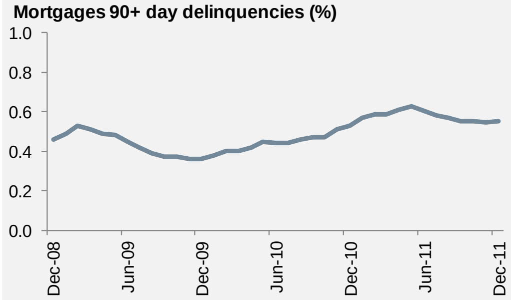
Total stressed assets declined $1.2 billion. Most of the decline was in the watchlist and substandard rating categories with further upgrades through the period and a reduction in both the number and value of new problems emerging. Total impaired assets were $164 million lower over the quarter with write-offs against individually assessed provisions in the quarter being $112 million.

Chart 1
Stressed assets as a % of total committed exposures (%)



Consumer asset quality remains strong and we continue to see consumers preferring to pay down debt.

Chart 2
Mortgages 90+ day delinquencies (%)



The Westpac Group mortgage 90+ day delinquencies were 55bps at 31 December 2011 unchanged from 30 September 2011 (refer Chart 2) and remain well below industry averages. Mortgage 30+ day delinquencies were up 16bps to 140bps largely due to seasonal factors. Other 90+ day consumer delinquencies were up a modest 4bps.

Total provisions increased modestly over the quarter (up $68 million). Provisioning coverage remains strong given the decline in stressed assets. No changes were made to economic overlays in the quarter.

Capital and funding position

The December quarter 2011 Pillar 3 report, released this morning, provides further detail on credit quality and capital ratios. Westpac Group's Tier 1 capital was strong at 9.80% at 31 December 2011. The increase over the last three months was due to good organic growth and included 10bps from the St.George tax consolidation (another 17bps in capital benefits will emerge from this over the next two years). These additions to capital were offset by a 1.6% rise in risk weighted assets, mostly due to increased risk weighted assets for operational risk following the implementation of a new operational risk capital model.

Westpac Group's Common equity (Core Tier 1) ratio at 31 December 2011 was 8.25%, up from 8.09% at 30 September 2011.

Westpac Group has raised $10 billion in term funding year to date at an average duration of 4.4 years, including our inaugural covered bond issues in the US, Europe and Australia. At 31 December 2011, the Group's stable funding ratio was 78% up 100bps from 30 September 2011.

The Group remains well positioned to transition to the new Basel III capital and liquidity requirements.

For Further Information

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Footnotes

1. Given the inherent volatility of quarterly numbers, for comparison purposes we have compared 1Q12 earnings to the average of the 3Q11 and 4Q11 earnings results unless otherwise stated.
2. In assessing financial performance Westpac Group uses a measure of performance referred to as cash earnings, which allows the Group to more effectively assess performance for the current period against prior periods and across peers. The adjustments made to statutory results relate to material items that do not reflect ongoing operations and items not considered when dividends are recommended, such as amortization of intangibles, impact of Treasury shares and economic hedging impacts. A detailed description of the adjustments to statutory results is set out in the Group's 2011 Full Year Results announcement. For 1Q12 the main adjustments included the amortization of St.George merger intangibles and the impact of economic hedges.
3. Net customer return is Operating income less Operating Expenses less Treasury and Markets Trading income, divided by average credit risk weighted assets. The underlying return adjusts for the sale of asset sales and the early recognition of establishment fees in the Institutional Bank.
4. Roy Morgan Research, Respondents aged 14+. Wealth penetration is defined as the number of Australians who have Managed Investments, Superannuation or Insurance with each group and who also have a Deposit or Transaction Account, Mortgage, Personal Lending or Major Card with that group as a proportion of the total number of Australians who have a Deposit or Transaction Account, Mortgage, Personal Lending or Major Card with that group. 12 months to December 2011 compared to 12 months to September 2011. Westpac Group includes BTFG and St.George. Other major banks include ANZ Group, CBA Group (incl. Bankwest) and NAB Group (incl. Aviva).