

Australian Banks

2020s Vision – Then There Was None, No More Major Bank Buys

- **CBA back to a Neutral** – In our companion report released today, we suggest that the bull-run of outperformance in Australian bank stocks over the past 2 years is likely to be coming to an end. Consequently, we have downgraded CBA to Neutral with a revised target price of \$80.00 (from \$83.70) leaving MQG the only Buy rated stock in our universe. Our major bank pecking order is CBA, WBC, ANZ & NAB.
- **RoRWAs at a Turning Point?** – Since the GFC, the major banks have actively increased RoRWAs to offset the decline in bank leverage to maintain their ROEs. With competition re-emerging, a slowing in credit cost improvement and a re-establishment of pricing for risk, the major banks face significant challenges maintaining RoRWAs at the current 25 year high.
- **Industry ROE's to moderate by ~4 percentage points over a decade** – Given a combination of further reductions in leverage and significant declines in unlevered profitability (by 2025, major bank RoRWAs are expected to fall from 2.1% toward 1.6% - initially from declining returns in commercial banking) from what are currently close to 25 year peak levels. Major bank average ROE's are expected to decline from 16% to 12%, still well above their 10% cost of capital
- **Not all banks created equal** – Relative starting capital positions (bank leverage), different market positions in more competitive product markets (commercial banking) and different geographic mix means we expect to encounter a range of different ROE outcomes for the major banks over the longer term. Our new target prices for all the banks reflect our views on their long term sustainable ROEs

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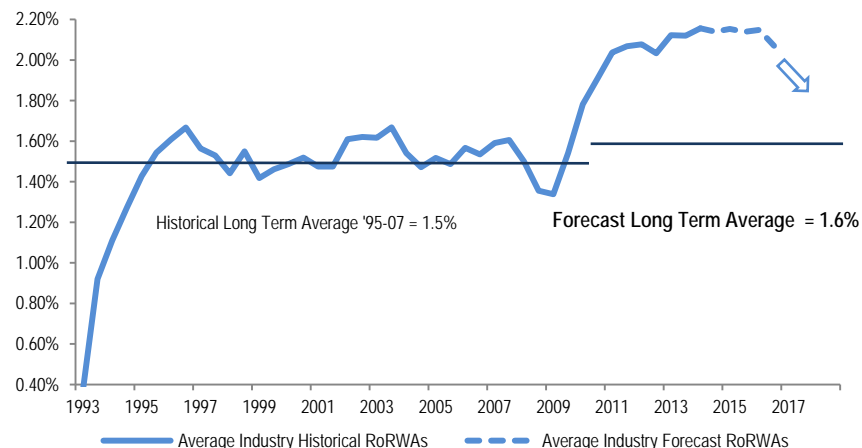
Company	Ticker	Rating		Target Price		Current Year Earnings Estimates	
		Old	New	Old	New	Old	New
ANZ Banking Grp	ANZ.AX	2	2	A\$31.00	A\$32.00	A\$2.53	A\$2.53
Commonwealth Bank	CBA.AX	1	2	A\$83.70	A\$80.00	A\$5.43	A\$5.43
NAB	NAB.AX	3	3	A\$34.00	A\$32.00	A\$2.36	A\$2.36
Westpac	WBC.AX	2	2	A\$35.75	A\$34.00	A\$2.40	A\$2.40

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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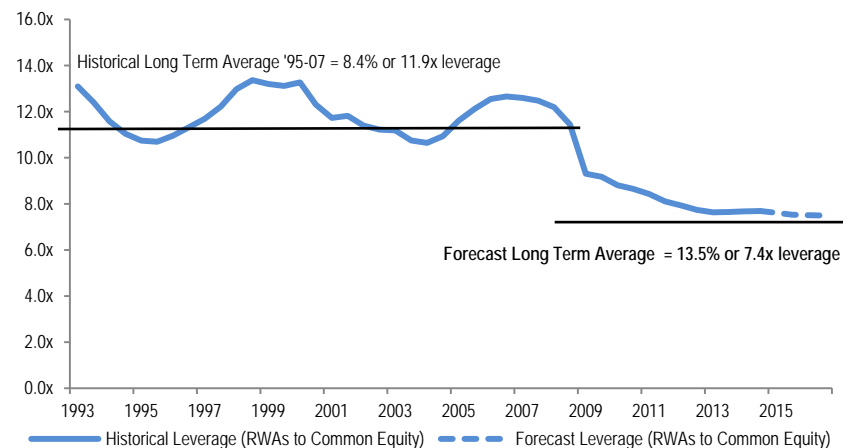
Long Term Major Bank ROEs in a De-Leveraged World

Figure 1. A 25 Year View of RoRWAs



Source: Citi Research

Figure 2. A 25 Year View of Bank Leverage

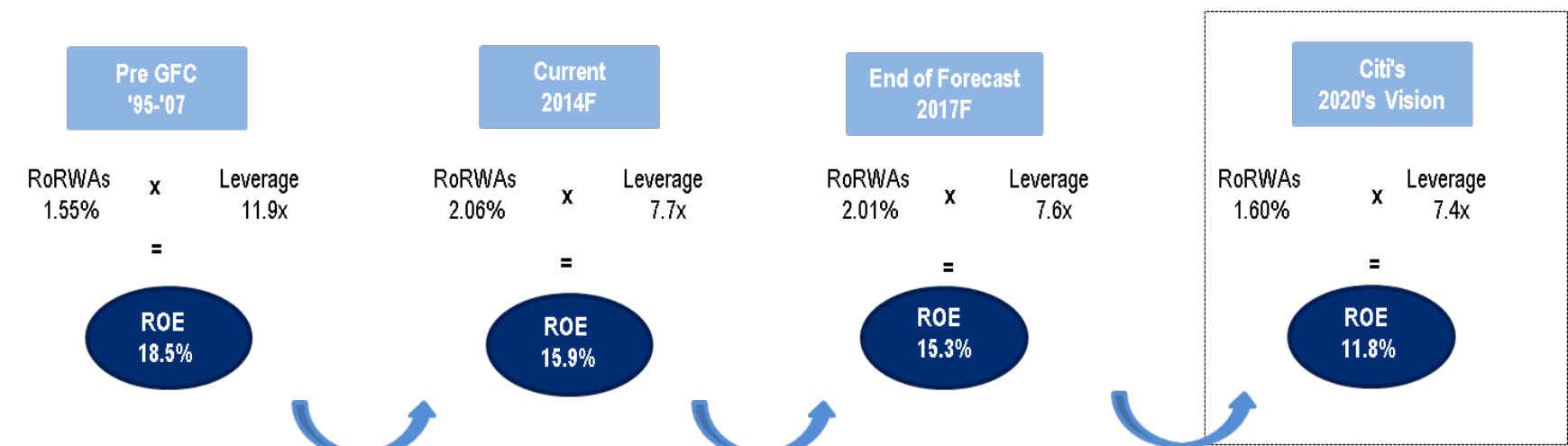


Source: Citi Research

- Since the GFC, the Australia major banks have successfully increased their RoRWAs to offset the permanent change to bank leverage imposed by the global regulators in order to minimize the impact on their ROEs
- Evidence is mounting that suggests this is not set to continue, with RORWAs forecast to taper off over our forecast period, and eventually declining over a longer time horizon. This is initially due to
 - Foreign competitors re-establishing their position in the market, especially in commercial banking
 - Large corporate clients continue to disintermediate as credit spreads in debt market accelerate their decline from GFC highs
- In the longer term, we see pricing for risk re-emerging as additional funding avenues continue to become available

Summary of Long Term ROE Assumptions

Figure 3. Impact of RoRWAs and Bank leverage on Major Bank ROEs Over Time



Source: Citi Research

Figure 4. Individual Bank ROEs

	Pre GFC '95-'07	Current 2014F	Forecast Period 2017F	Long Term 2025F
Cash ROE				
ANZ	18.9%	15.4%	14.1%	11.0%
CBA	17.3%	18.8%	18.5%	13.9%
NAB	18.5%	13.2%	13.0%	10.5%
WBC	19.4%	16.3%	15.4%	12.0%
Major Bank Average	18.5%	15.9%	15.3%	11.8%

Source: Citi Research

- In the longer term, the ROEs will be driven by risk based pricing, with the major banks on average earning a continuing 2% premium above the cost of capital given the oligopoly nature of Australia's banking markets
- The regional banks will still struggle to earn the cost of capital over the long term (as they did prior to the GFC). Any improvements to their relative competitive position will enable them to grow faster, as a viable alternative to the major banks

Company Focus

Australia and New Zealand Banking Group Ltd (ANZ.AX)

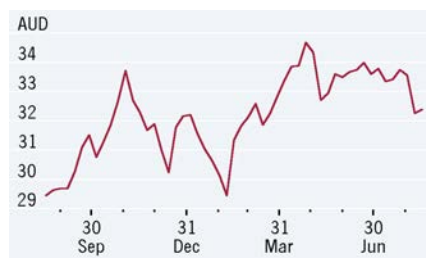
Change Target Price up to \$32 (from \$31)

■ Target Price Change

Neutral	2
Price (18 Aug 14)	A\$32.40
Target price	A\$32.00
from A\$31.00	
Expected share price return	-1.2%
Expected dividend yield	5.5%
Expected total return	4.3%
Market Cap	A\$89,314M
	US\$83,249M

Price Performance

(RIC: ANZ.AX, BB: ANZ AU)



■ **We retain our Neutral rating** - Our 12-month target price of A\$32.00 is based on our new DCF valuation of \$32.00. The implied P/BV multiple of our valuation is 1.7x, which is based on our new long term ROE assumption of 11% (achieved by 2025) and a cost of capital of 10%. In the forecast period, we forecast the current ROE of 15.2% is set to decline to 14.3% as core capital is retained to meet APRA's D-SiFi requirements and Asia continues to become a larger portion of the bank.

ANZ.AU revisions (Y/E Sep)	2012A	2013A	2014E	2015E	2016E
Reported Profit (A\$m)	5,650.0	6,266.0	6,844.5	7,280.7	7,487.7
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core Net Profit (A\$m)	5,819.0	6,492.0	7,079.0	7,414.7	7,621.7
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core EPS (A¢)	211.4	232.2	253.3	261.2	265.0
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
EPS Growth (%)	1.8	9.8	9.1	3.1	1.5
PE Ratio (x)	15.3	14.0	12.8	12.4	12.2
DPS (A¢)	145.0	164.0	176.0	179.0	184.0
Dividend Yield (%)	4.5	5.1	5.4	5.5	5.7
Franking Rate (%)	100.0	100.0	100.0	100.0	100.0

Source: Company Reports and dataCentral, Citi Research.

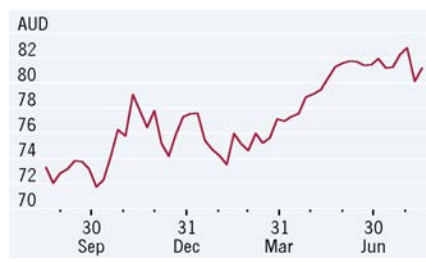
Company Focus

- Target Price Change
- Rating Change

Neutral	2
from Buy	
Price (18 Aug 14)	A\$81.28
Target price	A\$80.00
from A\$83.70	
Expected share price return	-1.6%
Expected dividend yield	5.2%
Expected total return	3.7%
Market Cap	A\$131,781M
	US\$122,833M

Price Performance

(RIC: CBA.AX, BB: CBA AU)



Commonwealth Bank of Australia (CBA.AX)

Change Target Price to \$80.00 (from \$83.70)

- **We downgrade from a Buy to a Neutral rating** - We lower our 12-month target price to \$80.00 which is derived from our new DCF valuation of \$78.98. The implied P/BV multiple of the valuation is 2.6x, which is based on our new long term ROE assumption of 13.9% (achieved by 2025) and a cost of capital of 10%. In the forecast period, we forecast the current ROE of 18.8% to decline to 18.5% as credit cost improvements slow and returns contract in commercial banking. With an ETR of 3.7% we downgrade to Neutral.

CBA.AU revisions (Y/E Jun)	2013A	2014A	2015E	2016E	2017E
Reported Profit (A\$m)	7,578.0	8,599.0	8,941.3	9,325.1	9,595.7
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core Net Profit (A\$m)	7,720.0	8,648.0	8,941.3	9,325.1	9,595.7
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core EPS (A¢)	468.5	522.8	542.6	567.0	585.4
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
EPS Growth (%)	8.1	11.6	3.8	4.5	3.3
PE Ratio (x)	17.3	15.5	15.0	14.3	13.9
DPS (A¢)	364.0	401.0	425.0	442.0	455.0
Dividend Yield (%)	4.5	4.9	5.2	5.4	5.6
Franking Rate (%)	100.0	100.0	100.0	100.0	100.0

Source: Company Reports and dataCentral, Citi Research.

Company Focus

National Australia Bank Ltd (NAB.AX)

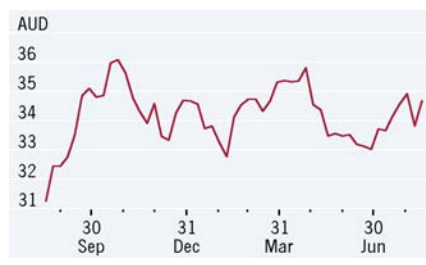
Change Target Price to \$32.00 (from \$34.00)

■ Target Price Change

Sell	3
Price (18 Aug 14)	A\$34.13
Target price	A\$32.00
from A\$34.00	
Expected share price return	-6.2%
Expected dividend yield	5.9%
Expected total return	-0.4%
Market Cap	A\$80,744M
	US\$75,261M

Price Performance

(RIC: NAB.AX, BB: NAB AU)



NAB.AU revisions (Y/E Sep)	2012A	2013A	2014E	2015E	2016E
Reported Profit (A\$m)	3,875.0	5,264.0	5,217.9	6,347.5	6,525.1
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core Net Profit (A\$m)	5,433.0	5,936.0	5,715.2	6,574.1	6,751.8
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core EPS (A¢)	238.8	250.6	235.9	265.7	267.0
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
EPS Growth (%)	-3.5	4.9	-5.9	12.6	0.5
PE Ratio (x)	14.3	13.6	14.5	12.8	12.8
DPS (A¢)	180.0	190.0	200.0	202.0	202.0
Dividend Yield (%)	5.3	5.6	5.9	5.9	5.9
Franking Rate (%)	100.0	100.0	100.0	100.0	100.0

Source: Company Reports and dataCentral, Citi Research.

Company Focus

Westpac Banking Corp (WBC.AX)

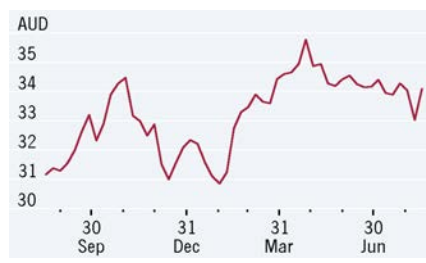
Change Target Price to \$34.00 (from \$35.75)

■ Target Price Change

Neutral	2
Price (18 Aug 14)	A\$33.91
Target price	A\$34.00
from A\$35.75	
Expected share price return	0.3%
Expected dividend yield	5.5%
Expected total return	5.8%
Market Cap	A\$105,428M
	US\$98,269M

Price Performance

(RIC: WBC.AX, BB: WBC AU)



WBC.AU revisions (Y/E Sep)	2012A	2013A	2014E	2015E	2016E
Reported Profit (A\$m)	5,970.0	6,816.0	7,362.6	7,592.8	7,754.8
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core Net Profit (A\$m)	6,598.0	7,097.0	7,639.3	7,846.2	8,008.2
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
Core EPS (A¢)	210.0	224.2	240.0	246.5	251.6
% revision	0.0%	0.0%	0.0%	0.0%	0.0%
EPS Growth (%)	4.0	6.7	7.1	2.7	2.1
PE Ratio (x)	16.1	15.1	14.1	13.8	13.5
DPS (A¢)	166.0	194.0	182.0	190.0	198.0
Dividend Yield (%)	4.9	5.7	5.4	5.6	5.8
Franking Rate (%)	100.0	100.0	100.0	100.0	100.0

Source: Company Reports and dataCentral, Citi Research.

Australia and New Zealand Banking Group Ltd

Company description

ANZ is a major Australian-based bank operating in retail and business banking in Australia, New Zealand and throughout the Asia Pacific. Australian operations make up the largest part of ANZ's business with commercial & retail banking & funds management.

Investment strategy

We rate ANZ Neutral. After strong share price appreciation, we expect more modest returns in the coming 12 months despite the banking industry structure remaining supportive for continued high, but declining returns on equity. While we believe that the push into APEA will be return - and valuation - dilutive over time, we believe that the bank's ~5% fully franked dividend yield is sustainable and will continue to be a key attraction for investors.

Valuation

Our 12-month target price of A\$32.00 is based on our new DCF valuation of \$32.00. The implied P/BV multiple of our valuation is 1.7x, which is based on our new long term ROE assumption of 11% (achieved by 2025) and a cost of capital of 10%. In the forecast period, we forecast the current ROE of 15.2% is set to decline to 14.3% as core capital is retained to meet APRA's D-SiFi requirements and Asia continue to become a larger portion of the bank

Risks

We believe banks' share prices and earnings performance are subject to common factors and risks - net interest margin pressure, interest rate risk, market risk, operational risk, funding risk and re-regulation. More specific to ANZ: i) in relation to its Asian expansion strategy, if the bank were to purchase a business at what is deemed too high a price, the share price may come under pressure; ii) there is a significant degree of execution risk in undertaking an offshore expansion strategy, both organically and via acquisition. From a positive perspective, success in developing its Asian franchise into a material component of the Group may offer scope for upside to earnings forecasts. Adverse or favourable movements in these risk factors may cause ANZ's share price to deviate from our target price.

Commonwealth Bank of Australia

Company description

Commonwealth Bank of Australia is Australia's largest retail bank. Its core business is the provision of retail, business and institutional banking services. It also is a major participant in Australia's wealth management sector with products covering superannuation and life insurance as well as retail and wholesale fund management activities.

Investment strategy

We rate CBA Buy. Relative to other banks, CBA is a more capital efficient business, with a dominant retail franchise. We believe that the bank's ~5% fully franked dividend yield is sustainable and will continue to be a key attraction for investors.

Valuation

Our 12-month target price of \$80.00 is based on our DCF valuation of \$78.98. The implied P/BV multiple of the valuation is 2.6x, which is based on our long term ROE assumption of 13.9% (achieved by 2025) and a cost of capital of 10%. In the forecast period, the current ROE of 18.8% is set to decline to 18.5% as credit cost improvement slows and returns contract in commercial banking

Risks

We believe banks' share prices and earnings performance are subject to common factors and risks - net interest margin pressure, interest rate risk, market risk, operational risk, funding risk and re-regulation. More specific to CBA: i) the bank is the most exposed of the major banks to movements in equity markets through funds management/wealth management; and ii) the bank is currently undertaking a significant core banking modernization program which carries execution risk. From a positive perspective, successful completion of the core banking refresh and realization of the expected revenue/productivity benefits offer upside to earnings forecasts. Adverse or favourable movements in these risk factors may cause CBA's share price to deviate from our target price.

National Australia Bank Ltd

Company description

National Australia Bank is a large financial services group providing a comprehensive and integrated range of financial products and services throughout Australia, NZ and parts of the UK. Australian banking operations dominate and represent 60% of group assets.

Investment strategy

We rate NAB Sell. We see poor expected FY14 revenue and underlying profit growth and continuing lackluster demand for business lending. With a number of sub-cost of capital returning businesses, we believe that NAB should trade at a discount to peers.

Valuation

Our 12-month target price of A\$32.00 based on our DCF valuation of \$32.07. The implied P/BV of our valuation is 1.7x, which is based on our long term ROE assumption of 10.5% (achieved in 2025) and a cost of capital of 10.0%. In the forecast period, we forecast the current ROE of 13.2% to decline to 12.8% as core capital is retained to meet APRA's D-SiFi requirements and impacted by a decline in commercial & institutional banking.

Risks

We believe banks' share prices and earnings performance are subject to common factors and risks - net interest margin pressure, interest rate risk, market risk, operational risk, funding risk and re-regulation. More specific to NAB: i) the bank is currently undertaking a significant core banking system replacement ("NextGen") which carries significant execution risk; ii) the bank has a non-core presence in the UK which may be divested or scaled up and is therefore subject to price/execution risk. From a positive perspective, successful completion of the core banking overhaul and realization of the expected revenue/productivity benefits offer upside to earnings forecasts. Adverse or favourable movements in these risk factors may cause NAB's share price to deviate from our target price.

Westpac Banking Corp

Company description

Westpac is Australia's oldest bank and corporation. It operates a leading banking franchise in both Australia and NZ and has a strong presence in consumer, commercial, institutional banking and wealth. The acquisition of SGB confirmed the bank as a clear Top 2 bank by customer numbers and profit in addition to making the bank the largest in NSW.

Investment strategy

We rate WBC Neutral. In the near term, we believe that the bank's ~5% fully franked dividend yield is sustainable and will continue to be a key attraction for investors. However recent share price strength indicates the market has priced this in and expected total return is limited.

Valuation

Our target price is \$34.00 which is based on our new DCF valuation of \$34.07. The implied P/BV multiple of our valuation is 2.1x, which is based on our new long term ROE assumption of 12% (achieved by 2025) and a cost of capital of 10%. In the forecast period, we forecast the current ROE of 16.3% to decline to 15.4% as credit cost improvement slows and returns contract in commercial banking.

Risks

We believe banks' share prices and earnings performance are subject to common factors and risks - net interest margin pressure, interest rate risk, market risk, operational risk, funding risk and re-regulation. More specific to WBC, with a lower quality deposit-gathering franchise, WBC has a greater reliance on wholesale funding. From a positive perspective, progress on productivity initiatives may offer upside to earnings forecasts. Adverse or favourable movements in these risk factors may cause WBC's share price to deviate from our target price.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Westpac Banking Corp (WBC.AX)

Ratings and Target Price History Fundamental Research

Analyst: Craig Williams



	Date	Rating	Target Price	Closing Price
1	3-Oct-11	2M	*19.88	19.39
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*2	19.88	21.11
4	12-Jul-12	2	*21.37	21.74

* Indicates change

	Date	Rating	Target Price	Closing Price
5	8-Nov-12	*1	*28.33	25.78
6	25-Feb-13	1	*33.10	30.19
7	21-Jul-13	1	*33.10	29.18
8	24-Dec-13	1	*33.10	32.14

	Date	Rating	Target Price	Closing Price
9	15-Jan-14	*2	33.10	31.71
10	18-Feb-14	*1	*35.75	32.86
11	28-Apr-14	*2	35.75	35.86

Rating/target price changes above reflect Eastern Standard Time

Westpac Banking Corp (WBC.AX)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Craig Williams



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Commonwealth Bank of Australia (CBA.AX)

Ratings and Target Price History Fundamental Research

Analyst: Craig Williams



	Date	Rating	Target Price	Closing Price
1	3-Oct-11	2M	*45.00	43.88
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*2	45.00	46.25
4	14-Nov-11	*3	*46.00	49.86

* Indicates change

	Date	Rating	Target Price	Closing Price
5	15-Feb-12	*2	*50.00	50.23
6	12-Jul-12	*1	*58.50	53.51
7	8-Nov-12	1	*63.50	58.18
8	13-Feb-13	1	*73.70	67.11

	Date	Rating	Target Price	Closing Price
9	15-Jan-14	*2	73.70	76.19
10	11-Feb-14	*1	*83.70	75.92

Rating/target price changes above reflect Eastern Standard Time

Commonwealth Bank of Australia (CBA.AX)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Craig Williams



	Date	Rating	Target Price	Closing Price
1	3-Oct-11	*REM LP	-	43.88

* Indicates change

	Date	Rating	Target Price	Closing Price
2	6-Jun-13	*ADD MP	-	66.11

	Date	Rating	Target Price	Closing Price
3	12-Mar-14	*REM MP	-	75.75

Rating/target price changes above reflect Eastern Standard Time

Australia and New Zealand Banking Group Ltd (ANZ.AX)

Ratings and Target Price History Fundamental Research

Analyst: Craig Williams



	Date	Rating	Target Price	Closing Price
1	19-Aug-11	*2M	23.50	19.50
2	19-Aug-11	2M	*21.50	19.50
3	3-Oct-11	2M	*19.50	18.94
4	7-Oct-11	Stock rating system changed		

* Indicates change

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	*2	19.50	20.71
6	20-Jan-12	2	*21.50	20.89
7	2-May-12	2	*24.00	23.80
8	12-Jul-12	*1	*24.50	22.18

	Date	Rating	Target Price	Closing Price
9	8-Nov-12	1	*26.50	24.37
10	1-May-13	1	*35.00	31.69
11	21-Jun-13	1	*31.00	27.41
12	15-Jan-14	*2	31.00	30.97

Rating/target price changes above reflect Eastern Standard Time

Australia and New Zealand Banking Group Ltd (ANZ.AX)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Craig Williams



* Indicates change

National Australia Bank Ltd (NAB.AX)

Ratings and Target Price History

Fundamental Research

Analyst: Craig Williams



	Date	Rating	Target Price	Closing Price
1	3-Oct-11	*2M	*22.00	21.63
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*2	22.00	23.76
4	28-Oct-11	2	*27.00	25.99

* Indicates change

	Date	Rating	Target Price	Closing Price
5	20-Jan-12	2	*23.50	23.88
6	18-Jun-12	*1	*24.50	22.81
7	2-Aug-12	*2	24.50	25.15
8	8-Nov-12	2	*25.00	24.87

	Date	Rating	Target Price	Closing Price
9	1-Feb-13	*1	*29.75	28.00
10	13-Mar-13	*2	29.75	30.95
11	29-Nov-13	2	*34.00	34.58
12	28-Apr-14	*3	34.00	35.99

Rating/target price changes above reflect Eastern Standard Time

National Australia Bank Ltd (NAB.AX)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Craig Williams



	Date	Rating	Target Price	Closing Price
1	3-Oct-11	*REM MP	-	21.63

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Westpac Banking Corp

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Commonwealth Bank of Australia

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of Australia and New Zealand Banking Group Ltd

Citigroup Global Markets Inc. owns a position of 1 million USD or more in the debt securities of National Australia Bank Ltd

Craig Williams, Analyst, holds a long position in the securities of Australia and New Zealand Banking Group Ltd.

A member of the household of Brendan Sproules, Analyst, holds a long position in the securities of Australia and New Zealand Banking Group Ltd.

A member of the household of Brendan Sproules, Analyst, is an officer of Australia and New Zealand Banking Group Ltd.

Within the past 12 months, Citigroup Global Markets Inc. or its affiliates has acted as manager or co-manager of an offering of securities of Westpac Banking Corp, Commonwealth Bank of Australia, Australia and New Zealand Banking Group Ltd, National Australia Bank Ltd.

Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from Westpac Banking Corp, Commonwealth Bank of Australia, Australia and New Zealand Banking Group Ltd, National Australia Bank Ltd.

Citigroup Global Markets Inc. or its affiliates expects to receive or intends to seek, within the next three months, compensation for investment banking services from Westpac Banking Corp, Commonwealth Bank of Australia, National Australia Bank Ltd.

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