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NAB Capital Notes 2 (NABPD)

Fixed Income

Issue overview

Issuer	NAB
Issue ASX code	NABPD
Face value	$100
Estimated offer size	$750m
Bookbuild margin	4.95-5.10%
Franking	100%
Dividend payments	Quarterly
First distribution payment	7 Oct 2016
Minimum application	$5,000
Call Date	7 Jul 2022
Mandatory Conversion	8 Jul 2024

Timeline

Lodgement of prospectus	31 May 2016
Bookbuild margin	7 Jun 2016
Announcement of margin	8 Jun 2016
Offer opens	8 Jun 2016
Offer closes	
Securityholder offer	30 Jun 2016
Broker firm	6 Jul 2016
Issue date	7 Jul 2016
ASX listing (deferred settlement)	8 Jul 2016

Additional Disclosure: Bell Potter Securities Limited is acting as Co-manager to the NABPD issue and will receive fees for this service.

Supplying the chase for yield

NAB's new $750m Capital Notes 2 (NABPD) has been launched in an environment of strong investor demand for well priced Additional Tier 1 hybrid issuance. This is highlighted by the material scale back on new money bids on the recent Westpac Capital Notes 4 (WBCPG) offer launched on 17 May 2016, with the offer size upscaled from $750m to $1,450m at completion of the bookbuild.

The 4.95-5.10% bookbuild margin on NABPD provides a slight margin uplift on the 4.90% margin set on WBCPG, reflecting 7 months extra duration to the first call date (July 2022 vs Dec 2021). While NAB flagged the NABPD issue in its 1H16 result on 5 May as part of its "ongoing commitment to maintaining a strong and efficient capital position", It appears likely that NABPD will fund redemption of the $400m of the unlisted National Capital Instrument, which have a first call date on 30 Sep 2016.

NABPD has the potential to be another successful issue, when considering the following assessment criteria:

- **Historically high issue margin:** Second only to the 5.2% issue margin on CBAPE.
- **Sufficient uplift relative to secondary market:** Assuming NABPD is priced at a bookbuild margin of 4.95%, it provides a 0.32% margin uplift on CBAPE (Oct 2021 call) on a 4.63% trading margin at $103.88. It also offers a margin uplift of 0.55% relative to the avg trading margin of 4.40% on the index of 15 major bank prefs / capital notes, providing investors the potential to switch from lower margin issues.
- **Low deposit rates:** In a world of record low interest rates, high margin securities should become even more attractive to investors seeking income.
- **Strong demand for WBCPG issue**

Figure 1: Trading margins on debt and equity securities

	Ranking (prior to exchange)	Security	Trading Margin over BBSW	Maturity / Mand Conv*	First Call
Higher Ranking	Senior debt	NAB (OTC) senior	110bp	May 2021	
	Subordinated debt	NAB (OTC) subordinated	205bp	Mar 2025	Mar 2020
	Preferred equity	CBAPE (Additional Tier 1)	463bp	Oct 2023*	Oct 2021#
		WBCPG (Additional Tier 1)	490bp	Dec 2023*	Dec 2021#
		NABPD (Additional Tier 1)	**495-510bp**	**Jul 2024***	**Jul 2022#**
Lower Ranking	Equity	Ordinary NAB Shares	~600bp	Perpetual	

WHERE NOT CONVERTED OR WRITTEN-OFF ON ACCOUNT OF A CAPITAL TRIGGER EVENT OR A NON VIABILITY TRIGGER EVENT. FIRST CALL DATE IS DISCRETIONARY.

SOURCE: YIELDBROKER, BELL POTTER

* MANDATORY CONVERSION IS SUBJECT TO SATISFYING THE MANDATORY CONVERSION CONDITIONS NABPD IS PERPETUAL AND MAY NOT BE EXCHANGED.

Key features

- **Initial grossed up running yield of 6.95-7.10% (4.87-4.97% fully franked):** Floating rate based on 3 month bank bill of 2.00% + 4.95-5.15% bookbuild margin.
- **Option to exchange at year 6 with mandatory conversion at year 8:** NAB has the option to redeem or convert NABPD at the 7 July 2022 Call Date, subject to APRA approval and NAB being solvent, and a Capital Trigger or a Non-Viability Trigger Event not having occurred. NABPD may not be exchanged on the Mandatory Conversion Date, and you may continue to hold NABPD indefinitely.
- **Ordinary dividend restrictions:** Applies on the non payment of NABPD distributions. NABPD distributions are discretionary and subject to the distribution payment conditions being satisfied. Unpaid distributions are non-cumulative.

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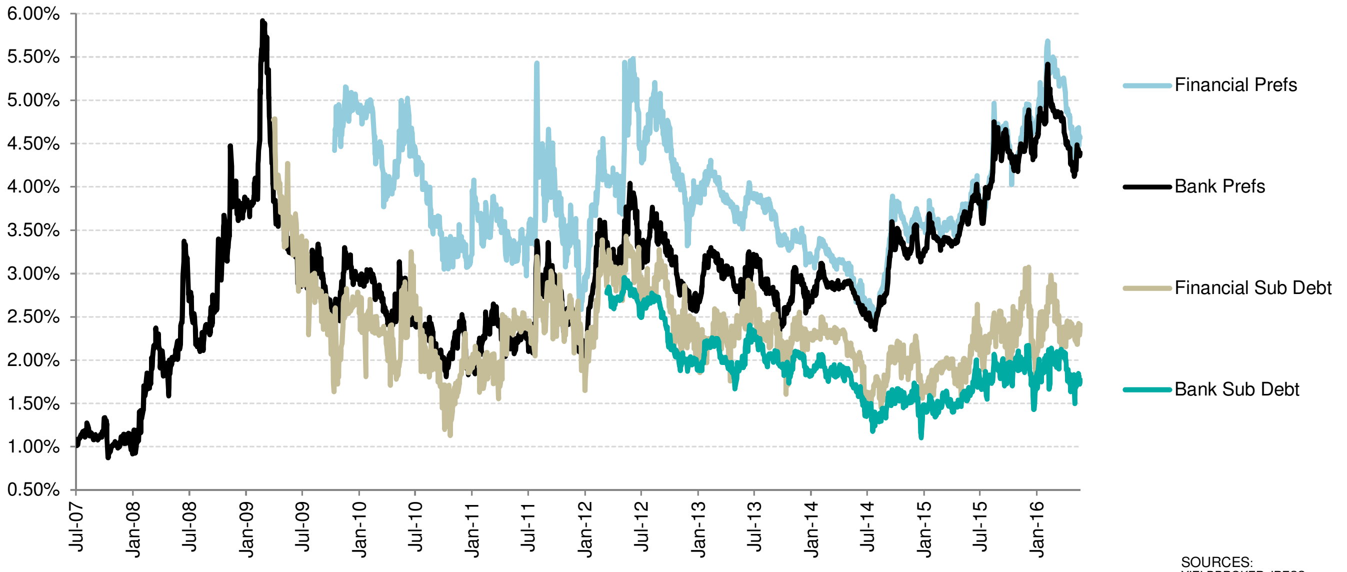
Trading margins on bank hybrids on the road to recovery

Figure 2 tracks the average trading margins split across 4 sectors:

* Financial Prefs (AMPPA, BENPD, BENPE, BENPF, BOQPD, CGFPA, IAGPC, IANG, MBLPA, MQGPA, MQGPB, SUNPC, SUNPE)
* Bank Prefs (ANZPA, ANZPC, ANZPD, ANZPE, ANZPF, CBAPC, CBAPD, CBAPE, NABPA, NABPB, NABPC, WBCPC, WBCPD, WBCPE, WBCPF)
* Financial Subordinated Debt (AMPHA, CNGHA, SUNPD)
* Bank Subordinated Debt (ANZHA, NABHB, WBCHA, WBCHB).

Figure 2: Trading margins on ASX listed debt and hybrid sectors

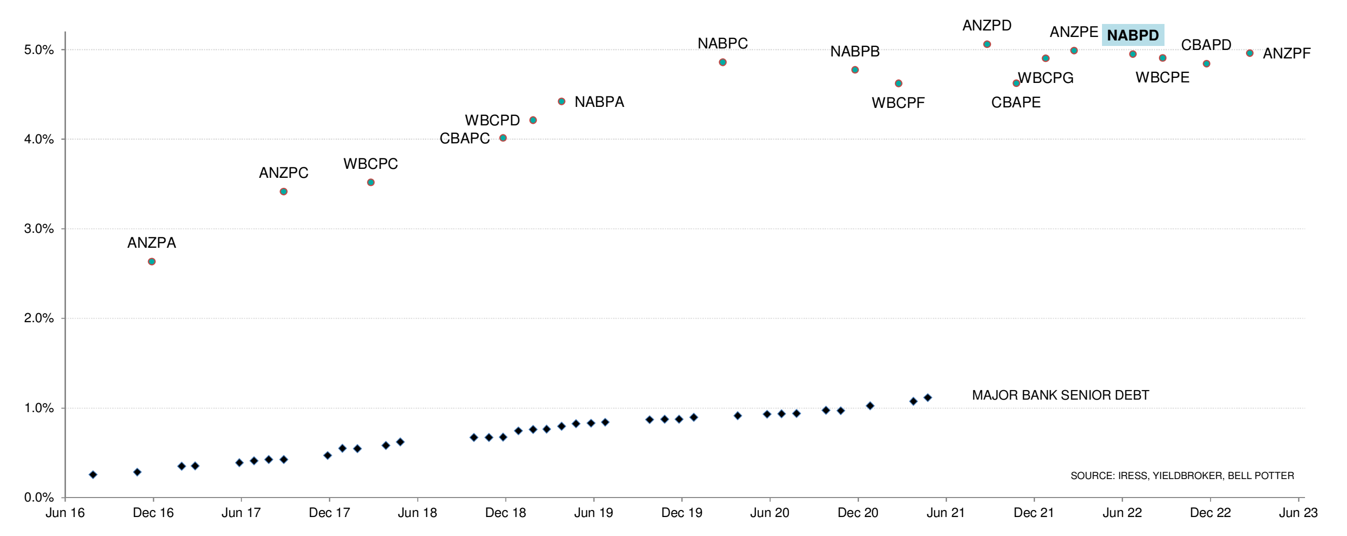


SOURCES: YIELDBROKER, IRESS, BELL POTTER

NABPD priced in line with securities of similar duration

The trading margin of all the ASX listed major bank prefs / capital notes currently does not exceed the NABPD bookbuild range of 4.95-5.10%. Ultimately, bidding into a new issue provides a number of advantages, including no brokerage charge on new subscriptions plus the ability to acquire their desired holding at face value, rather than chasing ASX listed stock where there may be limited liquidity.

Figure 3: Trading margin on ASX listed major bank prefs & capital notes versus wholesale senior debt (30 May 2016)



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Spread to average trading margin second only to WBCPG

One key metric to consider when investing in a new hybrid issue is the attractiveness of the pricing compared with prevailing market pricing reflected by the average trading margin of the 15 major bank prefs and capital notes - which currently stands at 4.40%. Assuming NABPD is priced at the bottom end of the bookbuild range at a margin of 4.95%, the spread to the average major bank trading margin of 0.55% ranks second only to the 0.70% spread offered on the recent WBCPG issue.

The median spread for the 28 major bank and financial issues launched since August 2011 is only 0.20%. NAB's previous issue of NABPC in February 2015 only offered a spread of 0.07% above the prevailing market.

Figure 4: New issue spreads versus prevailing hybrid margins

Security	Launched	Issue Margin	Trading Margin Bank Index	Issue Margin Spread vs Trading Margin
WBCPG	17 May 2016	4.90%	4.20%	0.70%
NABPD	31 May 2016	4.95%	4.40%	0.55%
NABPB	12 Nov 2013	3.25%	2.78%	0.47%
CBAPC	3 Sep 2012	3.80%	3.34%	0.46%
ANZPD	3 Jul 2013	3.40%	3.19%	0.21%
CBAPD	18 Aug 2014	2.80%	2.62%	0.18%
NABPC	17 Feb 2015	3.50%	3.43%	0.07%
NABPA	13 Feb 2013	3.20%	3.20%	0.00%

SOURCE: COMPANY DATA, IRESS, BELL POTTER

The 0.55% spread on NABPD appears to sufficiently compensate investors for a modest adverse market movement before listing. In recent years, it has been common to see some weakness in hybrid securities during the offer period as investors seek funding to participate in new issues.

Figure 5: Listing performance of Basel III Compliant Additional Tier 1 Hybrid Issues: 2011-2016

Security	Launched	Issue Margin	Trading Margin Index Bank / Financial	Issue Margin Spread vs Trading Margin	Listing Date	Opening Price	Trading Margin Index Bank / Financial	Trading Margin Index Change Since Launch
NABPD	31 May 2016	4.95%	4.40%	0.55%	8 Jul 2016			
WBCPG	17 May 2016	4.90%	4.20%	0.70%	1 Jul 2016			
CBAPE	16 Feb 2016	5.20%	5.42%	-0.22%	31 Mar 2016	$100.00	4.80%	-0.62%
MQGPB	23 Nov 2015	5.15%	4.57%	0.58%	21 Dec 2015	$100.51	4.77%	0.20%
AMPPA	26 Oct 2015	5.10%	4.27%	0.83%	1 Dec 2015	$100.10	4.70%	0.43%
WBCPF	27 Jul 2015	4.00%	3.94%	0.06%	9 Sep 2015	$99.00	4.51%	0.57%
BENPF	27 Apr 2015	4.00%	3.47%	0.53%	16 Jun 2015	$99.10	3.91%	0.44%
NABPC	17 Feb 2015	3.50%	3.43%	0.07%	23 Mar 2015	$100.00	3.40%	-0.03%
ANZPF	27 Jan 2015	3.60%	3.63%	-0.03%	6 Mar 2015	$99.99	3.33%	-0.30%
MBLPA	16 Sep 2014	3.30%	3.20%	0.10%	9 Oct 2014	$98.00	3.62%	0.42%
BENPE	3 Sep 2014	3.20%	2.92%	0.28%	13 Oct 2014	$98.00	3.76%	0.84%
CGFPA	27 Aug 2014	3.40%	2.82%	0.58%	10 Oct 2014	$99.00	3.69%	0.87%
CBAPD	18 Aug 2014	2.80%	2.62%	0.18%	2 Oct 2014	$97.00	3.45%	0.83%
WBCPE	7 May 2014	3.05%	2.90%	0.15%	24 Jun 2014	$101.48	2.61%	-0.29%
SUNPE	31 Mar 2014	3.40%	3.11%	0.29%	9 May 2014	$101.19	3.11%	0.00%
ANZPE	11 Feb 2014	3.25%	3.12%	0.13%	1 Apr 2014	$100.75	2.89%	-0.23%
NABPB	12 Nov 2013	3.25%	2.78%	0.47%	18 Dec 2013	$100.25	2.88%	0.10%
ANZPD	3 Jul 2013	3.40%	3.19%	0.21%	8 Aug 2013	$100.00	2.88%	-0.31%
MQGPA	14 May 2013	4.00%	3.65%	0.35%	20 Jun 2013	$100.70	3.91%	0.26%
NABPA	13 Feb 2013	3.20%	3.20%	0.00%	21 Mar 2013	$99.75	3.15%	-0.05%
WBCPD	30 Jan 2013	3.20%	3.12%	0.08%	12 Mar 2013	$99.94	3.15%	0.03%
BOQPD	7 Nov 2012	5.10%	4.17%	0.93%	27 Dec 2012	$101.00	4.07%	-0.10%
SUNPC	25 Sep 2012	4.65%	4.61%	0.04%	7 Nov 2012	$101.48	4.17%	-0.44%
BENPD	24 Sep 2012	5.00%	4.49%	0.51%	1 Nov 2012	$101.00	4.26%	-0.23%
CBAPC	3 Sep 2012	3.80%	3.34%	0.46%	18 Oct 2012	$101.61	3.10%	-0.24%
IAGPC	19 Mar 2012	4.00%	4.11%	-0.11%	2 May 2012	$99.60	4.01%	-0.10%
WBCPC	16 Feb 2012	3.25%	3.19%	0.06%	26 Mar 2012	$99.75	3.24%	0.05%
ANZPC	23 Aug 2011	3.10%	2.98%	0.12%	29 Sep 2011	$100.00	2.80%	-0.18%
			Median:	0.20%				

SOURCE: COMPANY DATA, IRESS, BELL POTTER

NAB Capital Notes 2

Strong demand for WBCPG set to flow into NABPD

The material scale-back on WBCPG new money bookbuild bids highlights the current strength of investor demand for well priced new Additional Tier 1 hybrid securities.

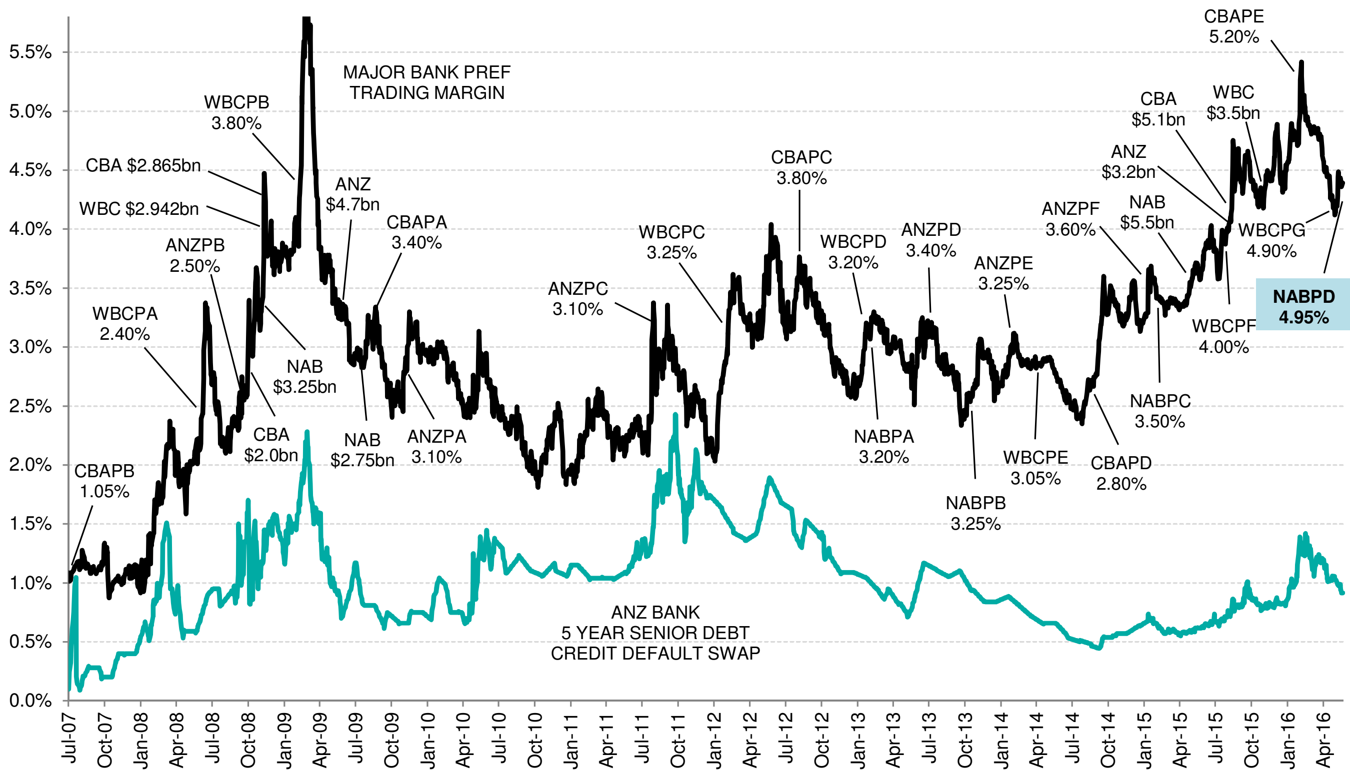
This represents a dramatic turnaround since when CBAPE was launched in mid Feb 2016, where in response to the poor market sentiment, a $650m cap was placed on new money bookbuild bids in order to create some scarcity value on listing. CBAPE was eventually upscaled from $910m at the completion of the bookbuild to $1,450m at the completion of the securityholder and reinvestment offers, with the press reporting one institutional investor taking a $250m stake. This is consistent with the top 20 securityholders list which indicates BNP Paribas Noms holds $285m of CBAPE.

NAB's last hybrid deal launched in Feb 2015 (NABPC) was in a much more subdued environment with patchy investor demand. NABPC managed to print a deal size of $1,342m. This compared favourably with ANZPF which launched three weeks earlier (Jan 2015), raising only $970m, representing the smallest major bank hybrid since WBCPB (Mar 2009).

With three of the four major banks launching new hybrids in 2016, major new supply for the remainder of the year appears limited to ANZ refinancing its $1.97bn ANZPA security by its Mandatory Conversion Date on 15 December 2016.

One risk we view as unlikely in the near term is the repeat of the major funding event of $17.3bn of bank equity raisings absorbed in 2015. The previous round of banks raising ordinary equity was undertaken in 2008-2009.

Figure 6: Average trading margin - major bank prefs and capital notes versus 5 year senior debt credit default swap



SOURCES: IRESS, BLOOMBERG, BELL POTTER

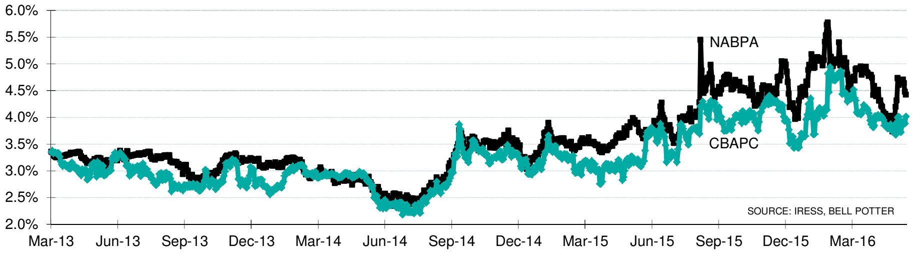
NAB Capital Notes 2

Investor preference for high margin / high income securities

The desire for higher income provides the potential for greater investor support of NABPD relative to other lower margin bank hybrids of a similar duration. Historically, CBAPC (PERLS VI) launched in September 2012 has been one of the better supported securities in the ASX listed hybrid market. Its 3.80% issue margin was first surpassed by the 4.00% issue margin on WBCPF launched in July 2015. The high income levels have been a key factor behind its strong investor support, highlighted by it trading on a monthly high above $100 every month since listing in November 2012.

When comparing CBAPC with NABPA whose issue margin is 0.60% less at 3.20%, the average trading margin on CBAPC has been 0.30% lower since NABPA listed on 21 March 2013. There is only 95 days difference in duration between the call dates: 15 December 2018 on CBAPC versus 20 March 2019 for NABPA.

Figure 7: Average Trading Margin: NABPA versus CBAPD

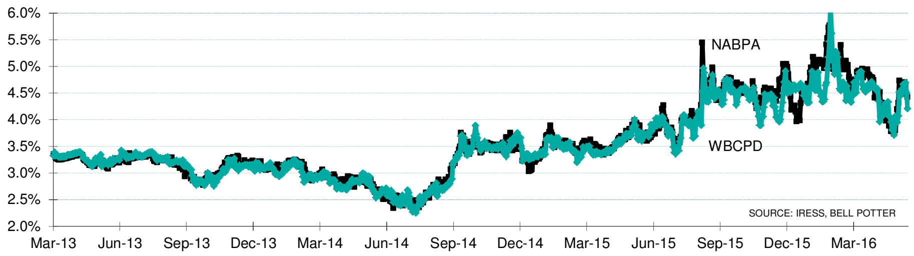


Negligible issuer difference between NAB and WBC

Tracking trading between NABPA and WBCPD highlights investor preference in the ASX listed market for two securities with the same issue margin (3.20%) and both with call dates in March 2019. Since NABPA listed on 21 March 2013, the average trading margin on NABPA has been 0.04% higher than WBCPD.

The key differences between the WBCPG and NABPD offers is 0.05% higher margin on NABPD and 7 months longer duration to the July 2022 call date.

Figure 8: Average Trading Margin: NABPA versus WBCPD



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Interest rates set to remain low into the medium term

Fixed income returns from Government bonds, term deposits and corporate bonds currently sit at historic lows. The 10 year Australian Government bond yield hit an all time low of 2.20% in May 2016, while ANZ Bank lowered its 1 year term deposit rate to 2.05% representing a spread of only 0.20% above 1 year swap. For banks to pass through interest rate reductions on mortgages, the inability to reprice interest free transaction accounts requires a greater reduction in term deposit rates. While terms deposit margins may compress, the margin income on NABPD is paid is locked in at 4.95% above 3 month bank bill for 6 years. *Distributions on NABPD are discretionary and subject to payment conditions.*

Figure 9: Bonds duration 5-6 years

Investment	Maturity	Yield To Maturity
Aust Govt Bond	Jul 2022	1.93%
Apple (OTC)	Aug 2022	2.95%
NAB Term Deposit	Jun 2021	3.00%
NAB (OTC)	Dec 2021	3.10%
Telstra (OTC)	Sep 2022	3.20%
Qantas (OTC)	May 2022	4.54%

SOURCE: YIELDBROKER, NAB, BELL POTTER

Figure 10: Australian 10 year Government bond yield 1875-2016

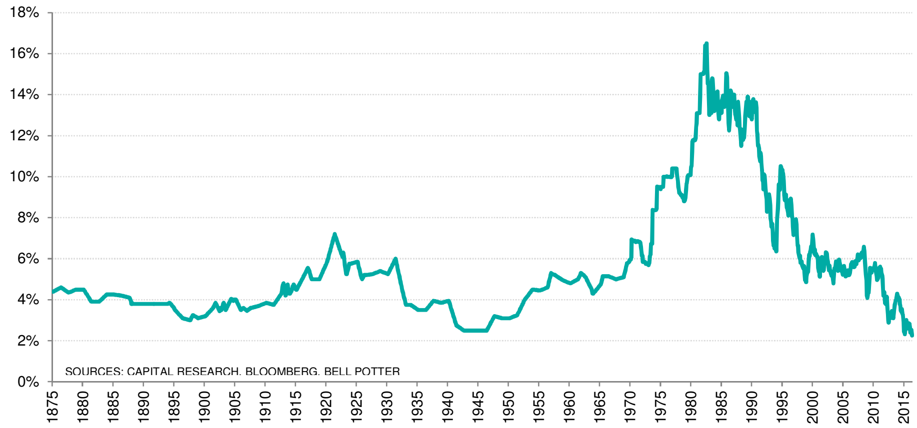
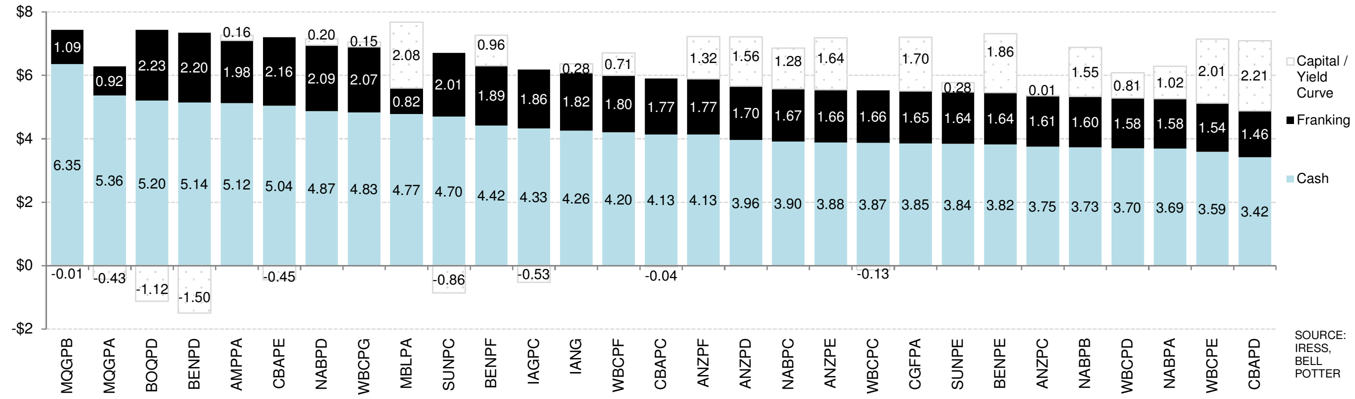


Figure 11 provides a ranking of securities on the highest cash distribution component. The white box represents the gap between income levels and Yield to First Call (maturity), where this component of return is associated with the impact of the capital price premium / discount allowing for bank bill movements priced in by the yield curve. In a low interest rate world, there appears to be continued investor support for high margin securities over lower margin securities.

Assuming pricing is set at a margin of 4.95% above the current 3 month bank bill rate of 2.00%, NABPD is expected to provide investors with annual cash income of $4.865 per security, plus franking of $2.085 ($6.95 grossed up). *Payment of distributions will be subject to payment conditions and may not be paid.*

Ultimately, investors seeking an uplift in income from a Government Guaranteed term deposit need to consider the risk / reward equation for the yield uplift.

Figure 11: Forecast cash and franking payments per bank and financial hybrid security (annualised) at 30 May 2016



NAB Capital Notes 2

Mandatory Conversion Conditions

In order for bank Convertible Preference Shares (CPS) and Capital Notes to qualify as Additional Tier 1 capital, APRA has imposed a maximum conversion number in order to limit the dilution of ordinary shares upon conversion.

This maximum exchange number represents the face value of the preference share divided by 50% of the volume weighted average price (VWAP) of the issuer on the 20 business days preceding the issue date (Issue Date VWAP). For example, if NAB's 20 day VWAP was $27.25 before the issue date, the maximum conversion number would be 7.34 NAB shares per NABPD security (i.e. $100 / (50% x $27.25)).

To protect NABPD holders from receiving less than face value at Mandatory Conversion, there are a number of Conversion Conditions to be aware of:

- First: VWAP of ordinary shares on the 25th business day before a possible Mandatory Conversion Date (31 May 2024) must be above 56.00% of the Issue Date VWAP. Using the NAB price on 30 May 2016 of $27.25 x 56.00% = $15.26.
- Second: VWAP of ordinary shares during the 20 business days immediately preceding a potential Mandatory Conversion Date (7 Jun 2024 - 8 Jul 2024) must be greater than 50.51% of the NABPD Issue Date VWAP (i.e. $13.76).
- Third: Continuous trading (i.e. No Delisting Event) prior to a possible Mandatory Conversion Date - to provide protection should investors wish to sell the ordinary shares they receive upon conversion. A Delisting Event occurs when NAB is delisted or suspended, or there is an Inability Event.

If the Mandatory Conditions are not satisfied, conversion on the Mandatory Conversion Date will not occur. Under this scenario, the security will remain on issue and continue to pay distributions at the same margin. *(Distributions are discretionary).* The Conversion Conditions will be tested on each subsequent future quarterly distribution date. The payment of NABPD distributions is subject to satisfaction of the Distribution Payment Conditions.

Figure 12: Mandatory Conversion Conditions

	NABPD	ANZPA	ANZPC	ANZPD	ANZPE	ANZPF	CBAPC	CBAPD	CBAPE	NABPA	NABPB	NABPC	WBCPC	WBCPD	WBCPE	WBCPF	WBCPG
Date of Hybrid Issue	7-Jun-16	18-Dec-09	29-Sep-11	7-Aug-13	31-Mar-14	5-Mar-15	17-Oct-12	1-Oct-14	30-Mar-16	20-Mar-13	17-Dec-13	23-Mar-15	23-Mar-12	8-Mar-13	15-Jun-14	8-Sep-15	30-Jun-16
Mandatory Conversion Date	8-Jul-24	15-Dec-16	1-Sep-17	1-Sep-23	24-Mar-22	24-Mar-15	15-Dec-20	15-Dec-24	15-Oct-21	22-Mar-21	19-Dec-22	23-Mar-22	30-Mar-20	8-Mar-21	23-Sep-24	22-Mar-23	20-Dec-23
Conversion Discount	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Issue Date VWAP	$27.25	$21.80	$19.53	$29.16	$32.30	$35.18	$56.08	$78.62	$75.50	$30.64	$33.86	$38.03	$20.83	$29.89	$34.37	$31.23	$30.88
50% Dilution Cap	$13.63	$10.90	$9.77	$14.58	$16.15	$17.59	$28.04	$39.31	$37.75	$15.32	$16.93	$19.02	$10.42	$14.95	$17.23	$15.62	$15.44
Max Conv No (Face Value/Dilution Cap)	7.34	9.17	10.24	6.86	6.19	5.69	3.57	2.54	2.65	6.53	5.91	5.26	9.60	6.69	5.81	6.40	6.48
Conv Test 1 - % Issue Date VWAP	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	56.00%	55.56%	56.12%	56.12%	56.12%	56.12%
Conv Test 1 Security Price	$15.26	$12.21	$10.94	$16.33	$18.09	$19.70	$31.41	$44.02	$42.28	$17.16	$18.96	$21.30	$11.57	$16.77	$19.29	$17.53	$17.33
Conv Test 2 - % Issue Date VWAP	50.51%	50.51%	51.28%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%	50.51%
Conv Test 2 Security Price	$13.76	$11.01	$10.01	$14.73	$16.31	$17.77	$28.33	$39.71	$38.14	$15.48	$17.10	$19.21	$10.52	$15.10	$17.36	$15.77	$15.60
Conv Test 3 - Continuous Trading	Yes	Yes	Yes	Yes	Yes	Yes	n/a	Yes	Yes	Yes	Yes	Yes	n/a	n/a	n/a	n/a	n/a
Parent Share Price - 30 May 2016	$27.25	$25.69	$25.69	$25.69	$25.69	$25.69	$78.18	$78.18	$78.18	$27.25	$27.25	$27.25	$30.88	$30.88	$30.88	$30.88	$30.88
Prem/Disc to Dilution Cap	100.0%	135.7%	163.1%	76.2%	59.1%	46.0%	178.8%	98.9%	107.1%	77.9%	61.0%	43.3%	196.5%	106.6%	79.3%	97.8%	100.0%
Prem/Disc to Conversion Test 1	78.6%	110.4%	134.9%	57.3%	42.0%	30.4%	148.9%	77.6%	84.9%	58.8%	43.7%	28.0%	166.8%	84.1%	60.1%	76.2%	78.2%

SOURCE: COMPANY DATA, BELL POTTER

NAB Capital Notes 2

Early Conversion Events: Capital Trigger and Non-Viability

The fallout from the Global Financial Crisis has seen the Basel Committee on Banking Supervision establish new capital reforms to be phased in between 1 January 2013 and 1 January 2019. The key objective of these new reforms is to ensure banks are adequately capitalised in the event of future crises. On 28 September 2012, APRA published its final Basel III prudential standards which include a number of changes to the eligibility criteria for capital instruments, including stricter criteria for instruments to qualify as Additional Tier 1 Capital.

These requirements include a Capital Trigger Event and a Non-Viability Trigger Event, where securities such as NABPD must be converted into ordinary equity if the financial position of NAB requires an immediate injection of capital. These prudential standards also require Australian banks to hold a minimum Common Equity Tier 1 Capital Ratio of 4.5% on 1 Jan 2013. This increased to 8.0% on 1 Jan 2016 after inclusion of the 2.5% Capital Conservation Buffer and a further 1.0% D-SIB (Domestically Systemically Important Banks) Capital Buffer.

Capital Trigger Event

A Capital Trigger Event occurs when either NAB determines, or when APRA notifies NAB that it believes NAB's Common Equity Tier 1 Capital Ratio is equal to or less than 5.125%. Under this Trigger, NAB must immediately convert enough NABPA, NABPB, NABPC and NABPD securities on an approximate pro rata basis to boost the Common Equity Tier 1 (CET1) Capital Ratio above 5.125%. NAB's Basel III Common Equity Tier 1 Capital Ratio at 31 March 2016 stood at 9.69%, providing a buffer of $16.5bn. If we include NAB's cash net profit from continuing operations for the 12 months to March 2016 of $6.6bn, a breach of the Common Equity Trigger requirement appears very low, particularly as NAB has options such as cutting ordinary dividends and undertaking equity raisings.

Non-Viability Trigger Event

In addition, NABPD will be converted if APRA determines that NAB would be non-viable in the absence of an exchange or a public sector injection of capital. We note there are currently no precedents for a Non-Viability Trigger Event. Types of situations in which APRA may become concerned about non-viability include being insolvent, significant capital losses and financial stress, prolonged difficulties in raising funding in the public or private market, or maintaining sufficient liquidity.

Potential for Loss under Trigger Event if NAB below $5.45

Exchange resulting from a Capital Trigger Event or a Non-Viability Trigger Event will be done at the VWAP of NAB shares traded on the 5 Business Days immediately preceding the Conversion Date. While this is not subject to the Mandatory Conversion Conditions, it is still subject to the Maximum Conversion Number, which represents the face value of the preference share divided by 20% of the issue date VWAP. If NAB's 20 day VWAP was $27.25, the maximum conversion number would be 18.35 NAB shares per NABPD security (i.e. $100 / (20% x $27.25)). As such, NABPD investors may be exposed to receiving less than face value if NABPD is converted at less than $5.45. In practice this will only occur in the unlikely scenario that the issuer suffers severe impairment losses and does not raise equity to absorb those losses.

As it is likely that conversion under one of these Trigger Events would occur prior to a company Wind Up, NABPD holders will hold ordinary shares and rank equally with other holders of ordinary shares (i.e. lose priority ranking).

NAB Capital Notes 2

Inability Event

One additional risk is an Inability Event where NABPD will be written off if NAB is not able to issue ordinary shares from Conversion within five Business Days of the Trigger Event Conversion Date (i.e. Capital Trigger Event or Non-Viability Trigger Event). Scenarios under which this may occur include NAB being prevented from issuing ordinary shares by circumstances outside of its control, including an applicable law or order of any court, or action of any Government authority from issuing shares.

Under an Inability Event, NABPD holder's rights (including to distributions and face value) are immediately and irrevocably terminated, resulting in NABPD losing its value and investors will not receive any compensation.

Investment risks

Key Security Risks include:

- NABPD is not a bank deposit protected by the Government guarantee scheme
- NABPD is subordinated and unsecured, and ranks behind deposits, senior debt and subordinated debt in NABPD.
- NABPD distributions are non-cumulative and discretionary.
- NABPD distribution payments are subject to the following Payment Conditions:
  - ⇒ NAB, in its absolute discretion, making the Distribution;
  - ⇒ Payment not resulting in a breach of NAB's capital requirements as they are applied to the NAB Level 1 Group or the NAB Level 2 Group or both under APRA's prudential standards;
  - ⇒ Payment not resulting in NAB becoming insolvent; and
  - ⇒ APRA not otherwise objecting to the payment.
- Adverse movement in credit spreads as a result of a tightening in the availability and cost of credit.
- New issues may offer more attractive issue terms and margins, placing downward pressure on the security price.
- Adverse change in NAB's and financial performance which combined with a major bad debt event could lead to the Common Equity Tier 1 Capital Ratio falling below 5.125%, resulting in automatic conversion under the Capital Trigger Event. Automatic conversion may also be required under a Non-Viability Trigger Event.
- NABPD will lose its value and investors will not receive any compensation if NAB is not able to issue ordinary shares within 5 business days from Conversion under a Capital Trigger Event or Non-Viability Trigger. Scenarios under which this may occur include NAB being prevented from issuing ordinary shares by circumstances outside of its control, including an applicable law or order of any court, or action of any Government authority from issuing shares.
- Conversion of NABPD at the 8 July 2024 Mandatory Conversion Date requires NAB's share price at the time Mandatory Conversion to be above certain thresholds. If these thresholds are not met in July 2024 or at future quarterly distribution payment dates, NABPD may remain on issue indefinitely.
- NABPD holders may receive $101.01 of ordinary shares for each NABPD security held on the Scheduled Conversion Date, based on the 20 day VWAP. This VWAP may be higher than the market value of NAB shares converted.

NAB Capital Notes 2

Investment risks (continued)

Key Business Risks of NAB include:

- A material deterioration in global capital markets and the Australian economy.
- Adverse regulatory changes.
- Operational risks and trading errors.
- Increasing competition.
- Credit rating downgrades.
- Losses associated with counterparty exposures.
- Poor performance of acquired businesses.

Refer page 62 (Section 6) of the prospectus dated 31 May 2016 for further information on risks.

Additional investment risk:

ASIC "Be wary of the risks" warning: Money Smart website

The ASIC publication should be used as guidance which may be relevant to your consideration of NABPD – namely, information for retail investors who are considering investing in hybrid securities.

You can find this guidance by searching 'hybrid securities' at www.moneysmart.gov.au.

Basically, hybrid securities (including subordinated notes and convertible preference shares) may be from well-known companies but they are very different from 'normal' corporate bonds.

Some hybrid securities make investors take on 'equity-like' risks. Some also have terms and conditions that allow the issuer to exit the deal or suspend interest payments when they choose. Some are very long-term investments (for example, more than 20 years).

Hybrid securities may be unsuitable for you if you need steady returns or capital security typically from a bank term deposit style of investment.

Fixed Income

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Additional risks of hybrid securities

Hybrid securities are perpetual and do not constitute a deposit liability of the Issuer. They may be exchanged at the Issuer's discretion at the Optional Exchange Date (first call date) and then at the Mandatory Conversion Date if certain conditions have been satisfied. Hybrid securities pay discretionary dividends which are not cumulative if unpaid. Hybrid securities have complex terms of issue and each investment will differ in terms of conditions, time frame and interest rates. They often involve heightened risk and may not be suitable for all investors.

There are additional risks associated with this kind of investment as compared to a term deposit with the same issuer. These risks include:

- A 'trigger event' occurring leading to a deferral of interest payments or the Issuer repaying the hybrid early or much later than expected;
- Credit spreads widening making the return from the investment less attractive in comparison to other products;
- Additional new issuance at a higher margin;
- Market price volatility;
- Liquidity risk for hybrids is generally greater than shares in the Issuer company;
- Subordinated ranking;
- Distributions are at the discretion of the issuer;
- These products may be perpetual and can only be redeemed or exchanged for either cash or equity at the Issuer's option;
- Early repayment is at the Issuer's discretion

You should acquaint yourself with the specific returns, features, benefits and risks unique to any hybrid security before investing in them. If you do not understand, or have any concerns about a particular product you should talk to your Adviser. ASIC has published guidance, which may be relevant to your consideration of an investment of this kind, called "Hybrid securities and notes", under the heading 'Complex investments' at **www.moneysmart.gov.au/investing**

Disclosure of interest:

Bell Potter Limited, its employees, consultants and its associates within the meaning of Chapter 7 of the Corporations Law may receive commissions, underwriting and management fees from transactions involving securities referred to in this document (which its representatives may directly share) and may from time to time hold interests in the securities referred to in this document.

Additional disclosure:

Bell Potter Securities Limited has acted as Co-manager to the following issues: AMPHA, ANZPD, ANZPE, BENPD, BOQPD, CBAPC, CBAPD, CBAPE, CNGHA, CTXHA, CWNHA, IANG, MXUPA, MQGPB, NABHB, NABPA, NABPB, NFNG, ORGHA, PCAPA, SUNPC, SUNPD, TAHHB, TTSHA, WBCHA, WBCHB, WBCPF, WBCPG, WOWHC, and WBC's Oct 2015 retail entitlement offer. Bell Potter Securities Limited received fees for these services.

Bell Potter Securities Limited is acting as Co-manager to the NABPD issue and will receive fees for this service.

ANALYST CERTIFICATION

Each analyst is primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers and were prepared in an independent manner and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.