Question and Answer

Andrew Bowden
Head of Investor Relations

I might start with Richard. He had a hand up there first.

Richard E. Wiles
Morgan Stanley, Research Division

Rich Wiles, Morgan Stanley. You refer to intense competition several times during your presentation, Brian, but the trends in margins wouldn't really suggest that. Asset margins were flat in the half and deposit margins continued to improve. Could you perhaps explain why you're doing so well on asset margins, particularly in Westpac Retail & Business Bank, which I think were up about 8 or 9 basis points during the half?

Brian Charles Hartzer
MD, Group CEO & Director

Thanks, Richard. I think the first thing to say, when we talk about our margins, we look at the margin for the bank overall, and then within the divisions, we're trying to manage to an overall margin outcome. As I've said previously, that means that from time to time, you get widening on asset margins and shrinking on deposit margins, and other times it goes the other way. This time, the margin outcome that we got is, as Peter went through, is predominantly driven by a widening in margins on the deposit side, but the asset margins stayed pretty flat. Within that, though, there's quite a lot of movement. So we've seen -- as we -- as I talked about, a lot of pressure on the institutional margin side, global liquidity. We're starting to see that on the commercial side as well, there's been quite a lot of competition there. And then you have a bunch of different effects going on in mortgages. I think it's a little tricky to summarize it too easily in mortgages at the moment because we've had all this movement back and forth between investment property and owner-occupied and different things going on in different markets. So what I suppose we were trying to say is that we think that's going to continue to be a challenge, and perhaps, some of the opportunities on deposit margin aren't going to be as readily apparent as they've been in the last year.

Peter Francis King
Chief Financial Officer

Richard, the other thing I'd add is the asset spread was unchanged on the slide I presented. If you get underneath, there's a couple of basis points down in business lending and we ran off some of the low yield market inventory in WIB that offset it, so there was a little bit of asset compression in that business book.

Andrew Bowden
Head of Investor Relations

Jon?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. Just following on a little bit from that. If you look into the deposit growth, especially in St. George and Retail & Business Bank, about half of the growth came through from offset accounts. And if you sort of assume that's really just a growth [indiscernible] both sides of the balance sheet

[Audio Gap]

very low single digit deposit growth, and that obviously gave you the big tailwind in the 4 basis points you got. Do you need to step up that competition -- sorry, pricing, to start growing the deposit book a bit more because you can't really continue to grow deposits at low-single digit growth if you're going to have mid-single digit asset growth coming through? You can already see that funding gap is widening again.

Brian Charles Hartzer
MD, Group CEO & Director

So I'll give a high-level view, and you might add on this. I guess the way that we think about it is sticky deposits are really important and continue to be an important part of our priorities. And we did pretty well there in household deposits. Just with the implementation of LCR this year, we were a lot more nuanced about which deposits we had more value from and which ones we didn't. And so we were fairly tactical about letting, as I said in my remarks, letting some of the deposits run down. That was more a case in St. George than it was in RBB, for example. But looking to the future, growing deposits is going to be very important for us and we were pretty comfortable with how we went on overall household deposits.

Jonathan Mott
UBS Investment Bank, Research Division

So you've had to -- you don't expect the same tailwind, obviously, if you're running off some of these [indiscernible] less benefits?

Brian Charles Hartzer
MD, Group CEO & Director

Yes, we -- and I think Peter said that we don't have the same tailwind.

Peter Francis King
Chief Financial Officer

When we think about the funding base, we're looking at deposits alone and also the stable funding ratio, are the 2 primary reasons, and the LCR obviously now, because that's a regulatory requirement. When I look across the year, we've done well, ended up 121% on the LCR, so that box was ticked, if you like. The stable funding ratio is up slightly. But it was really a compositional mix within deposits, where we grew well in household, not as fast in the other portfolios. But net-net, when we put it together, we feel pretty good about the funding base. But moving forward, I think your observation's right. We will need to get a little bit more growth in the deposit book.

Jonathan Mott
UBS Investment Bank, Research Division

And your offset account is included in stable funding?

Peter Francis King
Chief Financial Officer

Offset accounts will be.

Andrew Bowden
Head of Investor Relations

Jarrod?

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. Couple of questions. First of all, Peter, you highlighted the structural decline in Treasury income. The level that it's got to now, is that the expectation going forward of what that decline is? Or is there further structural decline to go? And then secondly, Basel IV, what are the pain points for the Australian banks, Westpac in particular, that you're looking and hearing from the committee?

Brian Charles Hartzer
MD, Group CEO & Director

Do you want to have a go at the first one? And then I'll...

Peter Francis King

Chief Financial Officer

Treasury, very hard to predict. So as you'd expect, I'm not going to put an exact number on it. But I think when I look at the business and I look at where they're at, we've dealt with a lot of the structural issues. So one of the things that we did over the last couple of years was move more of our liquid assets into the banking book, which reduced income, but reduced volatility in that business, which has been a -- something we've been pleased about, given all the volatility we've had in the last year, so that's been a good thing for us. And then, the team is well-positioned, I'll now look at what opportunities they get in any particular period. So I think it's set down, but we'll take advantage of the opportunities that we see. So it's hard for me to sit here and say it's going to be this number, because that's not the business it is.

Brian Charles Hartzer
MD, Group CEO & Director

On Basel IV, I suppose we're waiting to hear what the outcome's going to be around leverage ratio, TLAC in particular. Part of why we put up the numbers that we've done is to say that we feel like we're actually in pretty good shape. There's a chart in the pack that looks at, on a pro forma basis, where we end up on capital on a comparable basis to peers, and we're right up near the end of that chart, so we'll just have to see. And the other aspect is what APRA decides to do in terms of applying it. One of the points that is clearly going to be a matter for discussion is the fact that the nature of the assets that are on our balance sheet are quite different in some cases from the assets that are on the balance sheets of other banks. But -- so as you can see, from the leverage ratio that we've disclosed, we sit in a good place and the indications from APRA are that leverage ratio is only ever expected to be a backstop anyway, when they think that the other capital measures they put in are more likely to be relevant for us than the leverage ratio. So we'll just have to wait and see.

Peter Francis King
Chief Financial Officer

I'll probably just add, transition periods are really important here, too. So we'd encourage longer transition periods, where people can work into any impacts, if there are any. So transition periods are good for everyone, I think, in terms of changes as well if they eventuate [ph].

Andrew Bowden
Head of Investor Relations

I'm going to call from the phones. Matthew Wilson [ph]?

Unknown Analyst

This is a great outcome for shareholders, today. Obviously, very strong balance sheet, less gearing, more capital, strong profitability across some -- across the standard measures, and you'll preserve your ROE when you push up mortgage rates shortly. If you had to look at the Woolworths case study, is there anything to take out of that, that the sector should sort of monitor? And secondly, if you bumped into a mortgage customer this afternoon in one of your branches and they asked why do you need a 30% excess return on my mortgage? What would you say to justify that excess return and ensure they remain delighted customers of Westpac?

Brian Charles Hartzer
MD, Group CEO & Director

Well, Matthew [ph], I suppose -- thanks for the acknowledgment. We do think it's a pretty good outcome. What it shows is that we've tried to be quite disciplined in managing the impacts of regulatory change on all of our shareholders and our stakeholders and our customers, and we think we've got that balance about right. The reality is that the amount of capital we had to hold for mortgages went up by over 50%. As a result of that, we needed to raise about $6 billion in capital in the last year, and that is a very significant cost. And the increases that we put through on mortgage rates, on variable rate mortgages, do not, in themselves, return even the cost of capital. And it certainly is, as we've seen in the impact on shareholders, the overall return has declined this year. So we feel comfortable that while it was difficult, we got the balance about right.

Unknown Analyst

And the Woolworths case study?

Brian Charles Hartzer
MD, Group CEO & Director

Well, I think, we're certainly mindful that what we're trying to do is grow the long-term value of the company, and you can't do that if you focus too much on short-term returns. There are a number of case studies over recent decades that I think just emphasize that the real value that we create as a company is the value of our franchise, and that's about the size of our customer base, the depth of the relationships and how long those customers stay with us. And that is our primary focus, is how we grow that value of that franchise over the long term. And we know we have to deliver decent results along the way, and I'd like to think that this was another one of those for Westpac. But our primary focus is about delivering the service revolution and making this one of the great service businesses of the world. And it's fair to say that in that context, we aren't trying to be the cheapest. And the challenge for us is to be worth it and to generate high-quality relationships that endure.

Andrew Bowden
Head of Investor Relations

I'll take a question now on the phone from Craig Williams, please.

Craig Anthony Williams
Citigroup Inc, Research Division

As things sit today, you have a material gap in pricing between the Westpac and St. George brands in the mortgage market. Your slides indicate that your funding profile's inferior in St. George and your cross-sell levels are inferior, too. So is there, therefore, an optimal mix from a group perspective to have the St. George brand as your price leader, now that the other major banks have followed the Westpac lead on repricing. Does it make more sense to lift the St. George mortgage pricing, too? I have a subsequent question, too, please.

Brian Charles Hartzer
MD, Group CEO & Director

Well, Craig, you may have noticed that we did increase the St. George mortgage rates as well as part of this initiative. I think it goes back to the things we've said for a while, which is that having different brands gives us more flexibility. We can compete in slightly different markets, we can manage our margins more effectively overall. And part of the result that you see this time around is the benefit of that and what we've done there. So in terms of the various pricing gaps, we've shown -- it reminds me of a question that we got asked quite a lot in the last couple of years. We've demonstrated that we have lots of moving parts and lots of levers at our disposal to manage our overall margins. That's what we've done and that's what we'll continue to do.

Craig Anthony Williams
Citigroup Inc, Research Division

Okay. And just following up on the liability margin discussion, where there has been a significant shift in balances that have turned [ph] deposits into transaction accounts. Can you elaborate on the mechanics of how you've implemented that shift and how that's been executed?

Brian Charles Hartzer
MD, Group CEO & Director

Well, Craig, at a high level, what I'd say is that we focus on growing our transaction balances. I mentioned the phrase sticky deposits before. Transaction balances, saving balances, are a really important part of building a long-term relationship, and that's been a big focus in St. George, as it has been across all of our brands. So we've been trying to grow that as fast as we can through better service, better convenience, good strong marketing, focus of our sales force. That's worked pretty well and we saw that in the growth in customer numbers. And on the term deposit side, it's an ongoing tradeoff of margin and volume, and clearly, the implementation of LCR has meant that we've had to be a lot more focused on the term characteristics of those deposits and so that's factored into our thinking as well. Anything you'd add?

Peter Francis King
Chief Financial Officer

Craig, I'd just say over the cycle, we do get swings in and out of term deposits and online depending on the different shapes of the yield curve, so there's a bit of customer preference in what's going on at the moment as well.

Andrew Bowden
Head of Investor Relations

Okay, Brett?

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

Brett Le Mesurier from APP. Brian, a question on the margins in Saint George. It didn't change from 2014 to '15, but went up in the Retail & Business Bank. Why is it so hard to increase the margin in St. George rather than the success you're having in the Retail & Business Bank?

Brian Charles Hartzer
MD, Group CEO & Director

So there's a couple of different moving parts in there, and I think the main feature for us this year was around the deposit mix and the implementation of LCR and what that caused us to do on pricing of deposits in St. George. And I suppose the other generic factor is how we think about where we want to grow and how we use pricing in different markets to compete. And so you've just got a bunch of different moving parts. I wouldn't say it's fundamentally more difficult or easier in any of the brands. It's more a question of what we choose to do tactically, depending on the position of the brand, position of the balance sheet and what our objectives are, given the environment that we see.

Peter Francis King
Chief Financial Officer

The Saint George brand has more corporate deposits in it. And under the way that we transfer price with the introduction of LCR and the new CLF fee, they've borne a little bit more of that cost. So that's reflected in that business' margin.

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

Second question on the institutional business. It hasn't grown for a while, but the -- I noticed the return on tangible equity is going up. Is that the strategy? To hold back the growth until you get the return on tangible equity up to an acceptable level?

Brian Charles Hartzer
MD, Group CEO & Director

Well, we had pretty significant asset growth, but a lot of that was offset by margin compression. And I suppose we certainly don't see a big opportunity to increase the ROE in the institutional business. It's under a lot of pressure from margins and interest rates and commodity prices and the like. So the way we're thinking about that is that we've got this premier franchise, we want to continue to support long-term customers. We want to stay competitive in certain sectors that we think are attractive, but we are getting increasingly closer to the point where we have to make trade-offs about how much balance sheet we're willing to devote, given the returns that are there. So it's all part of this ongoing optimization challenge that Lyn has happily signed up for.

Peter Francis King
Chief Financial Officer

Brett, just year-on-year, the returns in the Institutional Bank are down. Half-on-half, the FVA is playing quite a bit of -- not having that FVA adjustment repeats is having quite a bit of an impact.

Andrew Bowden
Head of Investor Relations

Andrew?

Andrew Lyons
Goldman Sachs Group Inc., Research Division

It's Andrew Lyons from Goldman Sachs. You've highlighted a number of headwinds and tailwinds on the margin heading into 2016. Can I maybe just ask a question about fees and commissions? It's been a line item that you haven't seen much growth in, in recent halves. I'm just wondering, do you think the pendulum on fee rates has gone too far? Do you see much of an opportunity to actually -- to grow that line going forward?

Brian Charles Hartzer
MD, Group CEO & Director

So I'd say a couple of things, and then Peter might jump in here. So the first is that we've had a couple of offsetting items in the fee line this year, the card fees and so forth, which tend to make it a little harder to read through what's going on. The second thing I'd say is that we see some really important areas of growth in noninterest income generally through the continuing cross-sell of the WIB market's products set into our Retail & Business Banking businesses. That was up 6% this year. We see a lot more room to grow there in terms of FX and trade and the like. So that's not so much a change in the rate of fees, but it's just an increasing embedding of that. Noninterest income, obviously, is a huge part of the wealth story and why we're really excited about wealth over the next few years. So that's going to be a big help there. And then in terms of fees, generally, I can't comment on what we might or might not do on pricing, but certainly, it's the sort of thing that we look at.

Peter Francis King
Chief Financial Officer

And the only thing I'd add is the 2 big items this year were the large increase in insurance claims and dealings to that FVA adjustment in the first half. So those are pretty big drivers of what you saw in the fee line this year.

Andrew Bowden
Head of Investor Relations

Brian?

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. Just on the capitalized software...

Brian Charles Hartzer
MD, Group CEO & Director

Will someone write that down?

Brian D. Johnson
CLSA Limited, Research Division

After many years of being disappointed about the quality. Just on the capitalized software, today, shareholders are taking a hit of $482 million, and apparently, the cash earnings aren't. But when you think about the notional saving on that, if it was amortized over 4 years, that's pretty chunky. And yet today, we are flagging that the amortization cost goes up. We're also -- if you have a look in the staff line, you can see that there's been a lot of staff basically shed, which is over and above the sale of BT. It looks to me as though it should be really, really easy to do 2% to 3% cost growth in cash earnings. You get the subtle point that some of it isn't going through there. Why can't you do better than that?

Peter Francis King
Chief Financial Officer

Well, I think the first thing is we've spoken about a material increase in investment in the company that we went through at the Strategy Update. And I think one of the things about software amortization is as you just said, people thought that there would be a benefit next year in terms of software amortization. But actually, we've done another thing, which is accelerated the amortization of assets, which I think reflects the increasing nature or increasing speed of technology change. So that's really the issue that we faced into. We got a new technology strategy, where we're looking at the speed of change in technology and amortizing those assets faster. So when we put it all together, we've got increased spend, an uplift in productivity and then managing our normal BAU and investment pieces as well. And then as I called out in the presentation, we've got an unusual accounting outcome on some of the property costs next year as well. So that's why we think 2% to 3% is right.

Brian D. Johnson
CLSA Limited, Research Division

So the spend will translate pretty well straight away into an amortization charge?

Peter Francis King
Chief Financial Officer

A lot of that additional spend will be expensed.

Brian Charles Hartzer
MD, Group CEO & Director

Remember, we've also got a very conservative approach on amortization as well. So that's an offset to the savings that we would we have otherwise gotten.

Brian D. Johnson
CLSA Limited, Research Division

Brian, a second question, if I may. I think you personally are to be congratulated for 1 major thing, and that is that all the other banks have decided to follow you on the pricing, except for a lot of the little guys. Can you just run us through strategically how the 15% ROE would basically settle, had the other banks not basically followed Westpac?

Brian Charles Hartzer
MD, Group CEO & Director

How it would settle?

Brian D. Johnson
CLSA Limited, Research Division

Would you able to deliver 15% ROE? Because going back to the question on Woolworths, if you have a look at Woolworths, Woolworths, many years ago, decided to go for ROE over growth, and now, we see the inconsequence on it. If you have a look at the major banks at the moment, everyone has basically followed, but a lot of the smaller players haven't. Can we just get a discussion about, strategically, what risk that actually raises?

Brian Charles Hartzer

MD, Group CEO & Director

Well, I suppose I don't want to go into the -- all the thinking that went behind our decision. We certainly thought about various scenarios and what might happen, but the bottom line was that the capital raising that we needed to make to meet the new requirements was very large, and we felt that the cost of that needed to be shared around. And we landed on a point where we felt was defensible and appropriate. And we made the point when we announced our price changes, that it was an industry issue, and that this wasn't a Westpac-specific thing. This was something that was happening to all the banks. We have -- to your other point, we have seen at least one of the smaller banks move their rates as well. And I think if you look at what the FSI was setting out to do, it was trying to increase returns of smaller banks. I mean, our interest rates were and remain, in some cases, lower than the smaller banks. So I guess, inevitably, if there had been a difference, we would've had to think about it. But we -- on the balance of what we felt was the reality of the costs that have been imposed on us and what we felt was an equitable sharing among our stakeholders, we felt it was the right thing to do.

Andrew Bowden
Head of Investor Relations

We'll take a question from Brendan Carrig, please.

Brendan Carrig
Macquarie Research

Brendan Carrig, Macquarie Securities. Just a quick one on the branch numbers. At the Strategy Update, there were sort of numbers quoted that the bank now in fresh start numbers of branches, would be 550 or 55% of the total network. Based on current numbers, there's sort of over 1,100 branch numbers, excluding in-store branches, could you just talk about how you're planning to manage the branch reductions to get through to those implied targets?

Brian Charles Hartzer
MD, Group CEO & Director

Sure. Well, I think as I said at the strategy briefing, we think branches are still important. We've got a service-led strategy and lots of our customers still like to go in person to see their bank manager or people in the branches to talk about their needs. We think that's an important part of the value that we offer to customers, is the ability to have in-person service. At the same time, though, if you think about what goes on in a branch, the transaction side of it, the cash processing, the check processing side of it is reducing dramatically. And historically, branch networks were scoped and located to deal with over-the-counter transactions. So as the demand for over-the-counter transactions reduces, it gives us the opportunity to look for relocations, to use smaller sites that are better located to where traffic patterns are, to be more flexible with hours, to use machinery better, and that's the transition that we're going through. So we don't set a particular target for how many branches, and this is not a sledgehammer approach like back in the '90s. This is about going market-by-market and saying, based on the behavior of customers in that area, how many locations do we need? What's our lease profile look like? And how can we migrate to that over time? We did make a significant decision around the in-store agency network, which we've already announced, and that will -- we're part of the way through that and that will continue to reduce those locations, albeit it's offset by a substantial increase in the number of places that customers can transact, thanks to the Aussie Post alliance.

Brendan Carrig
Macquarie Research

So branches at -- sorry, just a follow up. So just branches at current numbers, you're not suggesting that they would necessarily decrease from where they are today?

Brian Charles Hartzer
MD, Group CEO & Director

We expect branch numbers, as a net effect of those things, will probably decrease from here, but we're not talking about a dramatic downsizing. And it will happen over time as customer behavior and demand shifts in local markets and as our lease profile permits.

Andrew Bowden
Head of Investor Relations

Scott?

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JP Morgan. I have 2 questions. Just following on, on those branches. So you can see in the slide pack, Westpac branches are down 70 year-on-year and Saint George down 20. So can you talk through the mix of how many of those was underlying in-store versus traditional kind of branches? What kind of cost benefit that's delivered? And also, any revenue drag associated with that?

Brian Charles Hartzer
MD, Group CEO & Director

So most of the reductions are the in-store agency network. They tend to be very, very small. And the transaction volume had fallen quite a lot in those. So a bit of cost savings out of that, but not very significant. And the rest of the branches have really been at the margin. And typically, when you've got a branch closure, it's because actually, the balance of activity in that area has dried up or there's not enough revenue to generate it. We certainly haven't seen any material impact from revenue. I mean, a lot of why we're doing this is because customers have already voted with their feet and have moved the transactions online and into the phone and so forth. So we're not viewing branch closures as a major cost saving in the way, perhaps back in the '90s, people thought about it. The branches that we're moving typically are the ones where the activity is -- has wound down and there's a better-located site in a local market that we can move to, where the lease cost is lower but the sales benefits are higher. So typically, we're seeing an increase in revenue and a reduction in cost when we move to a new site.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

And secondly, just on the capital allocations. You mentioned that the DRP partial underwrite from the first period hasn't been allocated yet. Can we just confirm that the capital, on a fully-loaded basis, will flow into retail in Saint George? Obviously, they get the benefit of the repricing, and so they're managing towards that economic profit in terms of their overall positioning of the business.

Brian Charles Hartzer
MD, Group CEO & Director

We certainly try to allocate the equity as much as we can on an economic basis to each of the businesses.

Peter Francis King
Chief Financial Officer

Scott, we tend to update those models from the 1st of October, so we'll build in both what we've done midyear and post-year into those model refreshers.

Andrew Bowden
Head of Investor Relations

Scott, can you just hand the phone across -- not the phone, the microphone across?

Andrew Triggs
Deutsche Bank AG, Research Division

It's Andrew Triggs from Deutsche Bank. Just a question, Peter, on your comments around increasing impairment expense trajectory. Just interested, I guess, on the drivers of what you're expect really there, in terms of is it sort of lower arrears rates -- oh, sorry, increasing arrears rates, lower writebacks or increase the new impaireds? And also perhaps a bit of focus on the watchlist & substandard, which seems to be, on Slide 68, still seems to have a pretty positive trajectory there in terms of reducing, and that does have a fair bit of cover against it?

Peter Francis King
Chief Financial Officer

Well, I think, in the last couple of years, the majority of lending growth has been in the mortgage book, which has got low losses, so low provisioning. What we're looking into, I think, we saw a pickup in business lending in the second half, AFS is about 4%. And with growth in that type of book, you'd normally see a pickup in your provisioning just because of growth. So that'll be -- that's a good thing. That's part of that. And then we're just alert to some of the sectors that are just doing a little bit tough. So we've highlighted mining, we've spoken about agriculture. You can't put a number on that because it's very -- depends on the customer and what's happened, but that's another source of potential increase. But I think as you highlighted the macro, the portfolio is in great shape. It's back down to the '08, '07 quality, so we feel good about the overall quality, but we'll just have to wait and see on the individual names.

Andrew Bowden
Head of Investor Relations

Okay. I think I'm going to call it quits today. We've all had opportunities to do some questions. So thank you very much and good morning.

Brian Charles Hartzer
MD, Group CEO & Director
Thank you.