Question and Answer

Jon Earle Sutton
Former MD, CEO & Executive Director

So if you can -- it's a little hard to see here, so if you say your name so -- sorry.

James Ellis
Crédit Suisse AG, Research Division

James Ellis from Crédit Suisse. I just got 2 questions. Firstly, in relation to the mining-exposed states where, on the one hand, you had a slight increase in impairments in the equipment finance book, but you haven't seen any deterioration in the Housing books. Just wonder how you -- we can reconcile those 2 and whether they might be delayed response or whether Housing is going to remain insulated? And then secondly, in terms of the trading income, so in the second half, another good performance there. Six months ago, I think the statement was that the trading income performance shouldn't be regarded as consistently repeatable. I'm just wondering if you could give some color on what generated another good performance there as well.

Jon Earle Sutton
Former MD, CEO & Executive Director

Thanks, James. Look, I'll answer the first part of your question and then hand on to Anthony for the trading income. I just want to be really clear. We don't finance mines, okay, so we don't do holes in the ground. What we do, do is a lot of our business is to SME-type customers, so it's the people that might have mining-related service propositions. So for example, it might be a person that's a civil contractor at Toowoomba and won a -- might have won a mining contract and, therefore, they've lost that contract, and they have to hand back their D9 Dozer. So we're quite comfortable with the level of exposure that we have to that sector. We don't finance mines. And as Anthony demonstrated with the arrears numbers, we're starting to see those arrears numbers improve in BOQ Finance. In particular, your comment around Housing. We have different LVR settings in a lot of those regional locations as well. And a lot of the leading that we particularly did in WA has been to pretty much to owner occupiers as well as we rolled out to AFG. I don't expect to see a massive deterioration in our arrears rates in capital cities like Perth. But having lived in Perth for 4 years, I actually -- I was there at the height of mining boom, and I saw what people were paying for houses in Port Headland. Now we don't have that exposure in Port Hedland. And those people that have bought at the peak, those house prices are substantially down. But I'll hand on to Anthony to talk to the trading income.

Anthony Rose
Executive Officer

Yes, I think the point you make, Jon, about the tiered approach that we had to both size and LVR in those regional markets by post code have served us pretty well. As far as trading income, I did actually make the same comment again today in the presentation that we wouldn't say that, that number should be consistently repeatable year-on-year, but it's certainly within our range of expectations. But the team had a good result.

Jon Earle Sutton
Former MD, CEO & Executive Director

Here's Jon.

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. Just piecing together a few bits and pieces you gave out there. Costs next year, 45%, and I think that's one of the numbers you put out there. And also on the margin, I think you've been regularly commenting, saying that you like your margin to track or outperform what you're seeing with your peers, obviously, following the recent repricing that you've seen in the mortgage book, especially the investment. Probably the outlook for NIM across the sector is much better, probably up. So would that be fair to assume that your NIM, you'd expect to expand next year. You should see better volume growth. If those 2 come together, you would've thought with 45% cost growth, your cost-to-income ratio should be falling below that 45%, given that you've got positive jaws. So unless -- going back to James' question, the trading income is materially lower or there's other things we should be thinking about, you should be doing a lot better than that. So can you just piece all that together?

Jon Earle Sutton
Former MD, CEO & Executive Director

Look, I'll just reiterate by saying that our aspiration is to continue to drive that cost-to-income ratio down over the longer term. Your observations about where possible pricing may go and NIM expansion, I think Anthony gave a really succinct view on the outlook for NIM. But I'm not going to sit here and price signal what might not happen with investor loans or retail mortgages, but other than to say that I conquer with the thoughts that Anthony's put out there that the outlook for NIM is improved to what we would have saw 6 months ago. And finally, it's -- around operational efficiencies, it's a race that never ends, and we'll continue to look to do the things that we need to do to drive our cost-to-income ratio over a lower period. And the comment I want to make is I've talked about this quite a lot around our retail lending program. We are still a bank that use fundamentally pens, paper, paperclips, pins. We still have fax machines. We still get e-mails that say, such and such lending file has been lost. Can anyone send it back to us? We're really excited that we start to roll out a digital lending program in October that will help us lift our productivity over time.

Anthony Rose
Executive Officer

I think John's covered the margin part of that equation. You are right. As you know, revenue in a bank is largely driven by margin and the average balance sheet growth. And this year, we didn't have the normal tailwind that you get from the prior year's growth because we were -- we had no growth in 2014. 2015 has delivered some momentum. And as we look into 2016, obviously, there will be a stronger tailwind going forward. The -- there's a couple of items in the expense base that we've called out. And I suppose there's an element of cautiousness in the way we would provide sort of the outlook profile going forward.

Jon Earle Sutton
Former MD, CEO & Executive Director

Just up front, please.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Ed Henning from CLSA. A couple of questions. Firstly, just the rundown on liquid assets. Was that all due to the ADI license from BOQ Specialist? Or is it potentially more to go there? And just, if you look at -- you talked about your clogged arteries on your Mortgage business, and you're obviously addressing that, which is great. But you campaign at the moment that you'll beat any home loan rate from the major banks or you'll give their customer $1,000. Why kind of go and put this campaign out there if you're arteries are clogged? Wouldn't you wait to try and fix up your back office first?

Anthony Rose
Executive Officer

I might handle the first one. On the liquid assets, there's 2 moving parts. Part was we were running 2 separate ADIs, so therefore, you've -- 1 plus 1 was greater than 2, or adding the 2 together, you got to less than 2 is probably the better way to think about it. But also, in the introduction of the APS210, we've done a lot of work on the composition mix of our deposit base around the various buckets that those deposits sit in within the runoff factors. And you're seeing the benefit of that come through. I think the industry, as a whole, is in a much stronger perspective from a liquidity resilience assessment due to the things like 31-day notice accounts in term deposits and in some savings products, which do mean that there's a degree of liquidity risk that customers bear for that time period. We are largely done on that exercise, so we wouldn't be expecting anything more in the year ahead.

Jon Earle Sutton
Former MD, CEO & Executive Director

I just might add to your first part of your question, Ed, and I might use a medical analogy. We've applied a few stents to open up the arteries, and look, we've had a very deliberate strategy over the last couple of years to open up the channels of distribution. If you think about, say, mortgage brokers, for example, 15% of our applications come through mortgage brokers this year as settlements. We're up to 23%. If you look at any other financial institution, that probably ranges between say, 35% to 50%. Our branch network is very, very important to us still, and we're seeing productivity improvements come through there. So we've been quite deliberate in our strategy to allow us to be able to grow what we think is an acceptable level and not sort of blow up the proposition that we actually have with our branch network and with our brokers. We are still not in the major aggregated groups yet. There's still some other aggregated groups that we're not involved in yet. And as we progressively roll out our loan origination program, the digital part for applications, we'll continue to look to expand those channels. Sorry.

Nicole Mehalski
BofA Merrill Lynch, Research Division

Nicole Mehalski from Bank of America Merrill Lynch. I'm just following up on that one you talk about your flows being -- for brokers at 23% and the industry being at 35% to 50%. Where do you see yourselves getting to in terms of that level? And just a quick one on that. Where are you at on serviceability versus your peers now? Have they all moved to the same point as you? And I mean, just on the branch network outlook for next year, you talked about the fact that you did manage to grow settlements this year even though you've closed branches, but you're indicating you're going to close branches again next year, and the lending program benefits perhaps not kicking in until the second half. So can you give us a bit of a view on that too?

Jon Earle Sutton
Former MD, CEO & Executive Director

Yes. Look, just on the broker piece, that's a great question. We'd look to get to where our natural market share would be, so it's going to be somewhere between 35% and 50%. And obviously, in the market, it waxes and wanes. You have pre-GFC. It was probably a little lower for brokers, but over the recent years, our brokers have been more dominant in the sectors. So for us, just to be a more aligned distribution channel just did not make sense, and the times have changed. In terms of serviceability...

Anthony Rose
Executive Officer

Just to clarify, if I could, Jon, just to be clear, we were 15% for the half of the period, 23% was the -- what we achieved in August.

Jon Earle Sutton
Former MD, CEO & Executive Director

Yes. So just in terms of serviceability, look, all of you have written many column inches on serviceability, but the regulator was very direct in directing banks around serviceability. I'll just give you a really brief example of what we saw, and it's all contracted back. All of -- pretty much the industry is back to tolls on this. But assessing living expenses in Sydney: wife, husband, 2 children. Some of the things we were seeing at the time was that some institutions were assessing those living expenses in Sydney at $17,000, and we were expressing those living expenses more than doubled that. What that does then goes to the heart of the amount that you could borrow. If you're using a broker, if, say, for example, we're assessing we could lend that customer $1 million following the regulators' mortgage practice guide, and people that may not have been following that practice guide to the letter may have been offering $1.8 million. And so where do you think the broker may point that customer towards, in -- particularly, in a higher market?

We've seen a significant contraction back in those standards and a more level playing field. And I think the final question was...

Anthony Rose
Executive Officer

Branch.

Jon Earle Sutton
Former MD, CEO & Executive Director

Branches. And I want to start at a big -- at a much higher level, which I've talked about before. Customers choose how and when they will deal with a financial services organization. They may start online. And in fact, our online mortgage growth, albeit off a very small base, has grown quite significantly. They may choose to use brokers. They may choose to go into a branch. Our owner manager network is second to none in providing service to customers. They will outperform any given corporate branch in the industry. What you need to understand is back in 2008 that BOQ had a very, very different strategy, where it was single-purpose focused on putting down owner manager branch footprint right across Australia. In the last half -- on the list [ph], you would have 18 reductions. We've had about 7 owner managers that actually have bought all the branches. We've had some corporate branches that are in on economic locations or poor locations. We've changed those. We're actively still seeking owner managers to come into the system, but we think another probably 18 to 20 next year, and that'll probably see us through.

Andrew Triggs
Deutsche Bank AG, Research Division

Andrew Triggs from Deutsche Bank. Just a follow-up on that OMB network. Could you just talk to those, I guess you said 18 to 20 that will come out next year? Today, looking at your stats, it looked like Queensland and Victoria saw most of those exited. Would that be a similar profile this year? And also, I think you mentioned 31 have adopted a balanced scorecard. What's the trajectory you think for the remainder of the branch network to adopt that? And why are people holding out, I guess, at this point, from going to that [indiscernible]?

Jon Earle Sutton
Former MD, CEO & Executive Director

Let me really be frank on that. They're not holding out. As the OMBs come up for renewal, that's when we move to the new scorecard. And in fact, some of the results we've actually seen from the earlier adopters has been phenomenal. For us, the cross-sell metrics have gone -- have increased materially. In fact, I was looking at one owner manager branch, and prescorecard -- balanced scorecard to where he is now has been quite remarkable. And it's sticky deposits. These are things that all banks need. It's credit cards. It's in a much more -- better relationship. I'll hand over to Anthony just to talk about where we think the...

Anthony Rose
Executive Officer

Yes, so look, something in the order of, yes, 15 a quarter but probably slower in the earlier period. It is a bit of a timing piece. It's -- it will be through 50% -- over 50% by sort of the end of next financial year. And then there will be a bit of a tail in the remainder. As Jon said, we have been quite buoyed by the lift in performance there. You can't go back to when we introduced the balanced scorecard and the point system, and they're all competitive. They all want to outperform the next person on the lead tables, and we've seen material improvement. And I think that health of the network around -- demonstrated by the deposit gathering in cities has been fantastic. Jon talked about the lift in Net Promoter Score. I mean, we often get asked the question, how do you turn Net Promoter Score into true value as an institution? When you think about our bank's customer base, we all spend a lot of time talking about the asset side of the balance sheet and mortgage lending. The reality is, we've got a multiple of the number of customers that deal with us that are deposit-only customers versus lending customers. And so, therefore, I think an NPS score is a better measure of your liability base than it actually is of your asset offering. And I think that is certainly clearly helping us in a positive.

Jon Earle Sutton
Former MD, CEO & Executive Director

Just in terms of our owner manager network, it'll be across the various states that we have.

Anthony Rose
Executive Officer

As far as the mix as to regions, I haven't got that level of detail. I will have to come back to you.

Andrew Triggs
Deutsche Bank AG, Research Division

Anthony, just following up on that -- coming around liability management. Is that an -- is that delivering you some optionality in terms of narrowing the gap in your TD pricing to the market because that's -- it has remained fairly -- so I think, 50 basis points or thereabouts above the major banks? Is that an area where you think you can narrow that gap longer term?

Anthony Rose
Executive Officer

We look at it really closely. And as Jon always says, we fight for every basis point in that spread. To be honest, to this point, our focus has been more on the negotiated space where spreads are actually much wider than that. And that's what we've been weaning ourselves off. And therefore, the carded rates that aren't at that top end have still been, on a net-net, more attractive for us. So that's not our area of focus at the moment. But if we continue to get that customer relationship momentum, there is, sort of longer term, further upside for that.

Jon Earle Sutton
Former MD, CEO & Executive Director

We might just go to the phones for a question. Is there anyone online, on phone? Online?

Operator

Your first question comes from the line of Craig Williams, Citi.

Craig Anthony Williams
Citigroup Inc, Research Division

I hate to head toward an exit margin question of sorts, but I think it's quite pertinent in this case. You've grown considerably in mortgages in the month of August, families spurred by your better rate of spring marketing campaign. For contrast, you've repriced roughly 40% of your mortgage book by investor in recent times, too. So what's been the impact on group margins being -- sit at the end of September? And how is your back office holding up to this surge in new business? And I suppose, I'll leave your earlier remarks about football code, given the nation's biggest football code and the premier timing from the world's most loveable city and risk to migration from that.

Jon Earle Sutton
Former MD, CEO & Executive Director

Craig, it's Jon here. I look forward to your note on football codes, so that'll be good. But just on the back office, we've got some very high service standards. And I think that the thing that we want to understand is that we are very, very vigilant about making sure we've got the service standards right, but more importantly, that we are scrutinizing and maintaining our credit underwriting standards across our mortgage book and also in our Commercial portfolio. And be fair to say that we have put some more resources on to cope with the increase that we are seeing. But I'll hand to Anthony to chat about margin.

Anthony Rose
Executive Officer

Yes. There's a couple of things in there, Craig, that I will call out. We did have a reclassification of our APRA banking stats relating to the BOQ Specialist mortgages that's -- were -- there was a reclassification from Commercial into Housing. We did make an ASX announcement on that. That may well have -- some of the things you're picking up. A lot of the -- there is an increase in volume, of course, when you aggregate the BOQ Specialist channel as well. That business has been growing fulfillment staff to maintain the back end of that offering. And as far as the BOQ-branded back office, those levels, we're quite comfortable with the profile that's coming there, and we're not seeing any stresses. I would add that the owner managers do a great job of managing what is a -- with managing their customers through what is probably a reasonably clunky process. And they actually get fairly good conversion rates from application through to settlement. We don't necessarily get the same conversion rates in the other part -- in the other channels. And part of the digitization program we're putting in place is really to improve that conversion metric. So yes, there is more to do. As far as margin is concerned, look, there are so many moving parts to this that, as I said before, different pockets of the portfolio are moving in different directions. We're a bit hesitant to turn around and provide too much guidance into the next year because a lot of it is going to depend upon where the competitive environment actually sits. And we've seen obviously differences in investor and owner occupier margins for new business out there today. In the commercial space, we've seen quite aggressive repricing in some segments but some players more recently retracting to their existing customer base, taking some of the heat out of that market. So we're just a bit hesitant at this point to provide much more clarity than the statement that we've made, which is the outlook for margins from where we sit here today does look a lot more positive than where we sat here 6 months ago.

Jon Earle Sutton
Former MD, CEO & Executive Director

Do we have another question online or on the phone?

Operator

Your next question is from Richard Wiles, Morgan Stanley.

Richard E. Wiles
Morgan Stanley, Research Division

I have a couple of questions. Firstly, just following up on Jon Mott's question regarding the cost-to-income ratio. I'd agree that the guidance looks pretty conservative. You're talking about 4% to 5% cost growth. I think you were saying that was underlying, which means we should exclude the $16 million of one-offs in the first half. Would that imply that you're expecting reported cost growth of somewhere between 0.5% and 1.5%. Is that the right way to think about it? And secondly, in relation to the equipment finance loan losses, given the recent improvement in arrears, would you expect the loss rate to go down in the near term?

Jon Earle Sutton
Former MD, CEO & Executive Director

I'll -- thanks, Richard, for your questions. I'll take the equipment finance one. Look, we're being conservative around that, and we're very pleased to see those arrears rates fall on the equipment finance portfolio. It's under a lot of scrutiny, as you'd expect it to be. And look, the way I think about that is, if some of these regional areas -- just say if the iron ore price continued to plummet and fall or if coal prices continued to head south at a rapid rate, not all parts of the economy will probably suffer. But as we sit here at the moment, we're comfortable with our exposures, and we are heartened by the improvement we're seeing in arrears rates. But again, we are in a very volatile market at the moment, and some of those regional, as I said in my closing remarks, are doing it a little tougher. So -- but our exposure is at the SME level. It's not at the mine level, which is important to note. Anthony, if you talk in the [indiscernible].

Anthony Rose
Executive Officer

Sure. Richard, your question, the guidance that I did discuss before is referable to the $484 million cost base, which is excluding that $16 million. So I hope that provides the clarity you need.

Richard E. Wiles
Morgan Stanley, Research Division

So Anthony, you expect reported cost growth to be less than 2% next year. That's what your guidance implies if you adjust for the $16 million one-off?

Anthony Rose
Executive Officer

Yes.

Jon Earle Sutton
Former MD, CEO & Executive Director

Do we have any more questions here? Sorry.

Operator

And the final question is from David Spotswood, Shaw and Partners.

[Technical Difficulty]

Jon Earle Sutton
Former MD, CEO & Executive Director

Somehow, I don't think we're in realtime now. Is David -- are you online, David Spotswood? We might take a question down the front here, and then if we've got David, we'll finish and close with David.

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

Brett Le Mesurier, APP Securities. Presumably, your comments on margin are consistent with a renewed emphasis on investor lending rather than owner occupied lending, and just moving on to the capital positions. Since you're expecting to increase your Common Equity Tier 1 going forward and dividend is staying similar percentage of earnings, I presume you're going to continue to have a healthy use of the DRP?

Jon Earle Sutton
Former MD, CEO & Executive Director

I'll take the margin one on investor lending. We're not providing specific guidance on what the break-up is between investor and owner occupier and those sorts of things. This is a very, very fluid market out there. And I think Anthony eloquently put it that we do believe that the outlook for margin expansion is better than what it was 6 months ago. But it's a very fluid market out there at the moment. Anthony, if you could comment on the DRP.

Anthony Rose
Executive Officer

Yes, so we've had DRP in place at a 1.5% discount for quite an extended period now. We haven't got any plans to change that. I think I've said before that, after canvassing our sort of investor base widely, not unanimous, but the overwhelming majority do like to see a higher amount of franking credits out in their pockets able to be used relative to what would be the case if we did stop that DRP program. So...

Jon Earle Sutton
Former MD, CEO & Executive Director

We might just take one more question. David, are you online?

David Spotswood

Shaw and Partners Limited, Research Division

Maybe just a question to Anthony -- or 2 questions for Anthony. So I think you've got in here the 42% of the loan book is investor lending, and that's gone up like 29 basis points, and 80% of it is variable. So if you times those numbers together, that's 10% tailwind to the NIM for 2016, all those things being equal. So if you could just say whether that's correct or not. And the second question is, what do you think's a fair across the cycle bad debt charge for Bank of Queensland?

Jon Earle Sutton
Former MD, CEO & Executive Director

I might just talk about the bad debt charge, and we welcome your first question as well, but I think we'll probably leave what we've said before on where we're heading -- what might happen in the market on the expansion of NIM. Look, I said at the last results that we thought we're fast approaching the bottom in the bad debt cycle. What I will say is, I'm really pleased with the metrics that we've been able to show over the last 3 years in an improvement in what we do. And it's all about ensuring that we have a sustainable business that can withstand inevitable cycles that the Australian economy goes through. So those risk metrics, we're particularly pleased with. The Australian economy is no doubt patchy at the moment, and you can't just generalize the Australian economy. It is -- there's geographic differences, and we remain vigilant around where our credit risk settings are. And we're not in a benign environment. You have to think that we're certainly probably getting to the lower ends of what you'd expect, but who knows. Australia's got this economy that can bounce back. And I think at a bigger level, you should never underestimate the benefit of a lower Aussie dollar actually gives to business. And that's just not big businesses. It's small business. And when we're out and about talking to people -- in fact, the analogy I could draw best is, we have a customer in Cairns who recently just leased a new cruise vessel through us, and he's very excited about what he is seeing in the numbers of, say, Chinese tourists and other tourists coming back to Cairns and using his business. And BOQ Finance provided that, plus his mortgages and plus his other business loans. So it's a patchy economy out there, but we're pleased with where our settings are at the moment.

Anthony Rose
Executive Officer

I'd probably just add that, yes, as far as the Aussie dollar is concerned, we think Queensland is arguably the best leveraged state to that depreciation. The other really interesting factor, I think, that we're watching closely is that the gap between Sydney and Brisbane residential housing prices, median housing prices has widened to a peak, a cyclical peak, and that does tend to be a leading indicator of domestic migration to Southeast Queensland. And we would like to think that on the back of also the upcoming Commonwealth Games that we could see similar improved performance in activity as a consequence of those changes. The mortgage portfolio, whilst its [indiscernible] charge has continued to reduce, is still running. We are talking in small basis points in the single digits, obviously. But it's still running at a premium above other portfolios in the sector. We continue to have exposures in -- across the portfolio that -- Victoria remains a higher arrears portfolio for us than -- are considerably higher than other parts of our network. And there are still echoes of the past around risk appetite that continue to come through, not in alarming levels, but there is some more opportunity there. As far as the question on the margin and net interest income, David, probably, best to go through the maths on a one-on-one call, which I'm sure we'll be able to arrange later today.

Jon Earle Sutton
Former MD, CEO & Executive Director
Okay. Thanks very much, and really appreciate you all attending today on what is a busy day and invite you for a cup of tea. Thank you.