Question and Answer

Hany Messieh
Former Investor Relations

Now we'll commence the Q&A. [Operator Instructions]. So I'll start in the front with Ben Koo.

Ben Koo
Goldman Sachs JBWere Pty Ltd, Research Division

This is Ben Koo from Goldman Sachs JBWere. Just a question on the Business Bank, half of the cash earnings. When you're looking at the revenue trajectory going forward, can you give us a feel for the areas that you're seeing, the increase in the business lending pipeline? And also when you're looking at the fee income side of things, have you -- part of that also seems to be just the pricing for the fee repricing. Is that largely done, is that also pricing for undrawn facilities? And what do you see in the trends in that line and how do you expect to continue growing the fee component?

Cameron Anthony Clyne
Former Executive Director

I'm going to get Joseph to -- I mean I think what we -- as Mark said that we're seeing the pipeline very, very strong. I mean the issues, they're going to be around timing typically. Will it come back in second half '10? Will it be stronger in 2011? But Mark and Joseph can give a little bit more color on what you're seeing in those pipeline.

Joseph C. Healy
Australia and New Zealand Banking Group Limited

Well, we're seeing the pipeline quite strong right across the customer segments from the SME sector right through to large institutions. I mean the story of business lending over the last 12 to 18 months, there has been a huge delevering largely at the top end at that time. But many of those clients have left facilities clear but undrawn, and have indicated that they'll be using those facilities when the investment environment is supportive enough for them to move. So I think we're very confident about the pipeline across all segments. And as Mark mentioned in his comments, it's as strong as we've seen it at least in the last five years. So that's very encouraging. On the repricing, we've estimated that we've repriced around about 80% of our entire group. We've actually repriced everything at the top end, but there was a core of customers who are on fixed price, low ones come in to the GFC. And as those facilities come up for renewal, we'll obviously be repricing those at today's market. So there's still some repricing, which we're estimating across a bit to be equal to about 20% of our book. We do anticipate that as competition re-enters the business banking market which we've been seeing now for the last six months, there will be pressure on margins. So we don't see, I think as Mark and Cameron have said, we don't see margins going up much across the book except for some of that repricing and as higher funding costs still come in, there'll be more downward pressure. However, we're quite confident in our ability to manage the implications of that, so the strength of the relationship philosophy that we have very much is a debt-fining feature of this business. So that's certainly the feature.

Ben Koo
Goldman Sachs JBWere Pty Ltd, Research Division

Just when you're looking at the fee going forward, where's that going to come from?

Joseph C. Healy
Australia and New Zealand Banking Group Limited

I think fees will also be obviously influenced by level of activity because we've been in an environment where lending has been relatively flat. And as we see lending picking up, as we anticipate, we'll start seeing the second half going into FY '11 then we'll see fee-based income tied to additional lending and to the risk management that goes with that.

James Freeman
Deutsche Bank AG, Research Division

James Freeman from Deutsche Bank. I just want to ask on the margin side of things if I could. As you start to grow the balance sheet, which is obviously the objective over the next six to 12 months. Just the anticipation on what will happen to margins particularly given you obviously have that 20 basis point discount to the peers on the mortgage front and in particular just sort of what you expect to happen on the personal margins because I do note that you said the lack of repricing was one of the impacts there, but surely that must compound as you actually grow that balance sheet.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well yes, it does. I think that the aggregate feature is going to be pretty much akin with what Joseph said. I wouldn't be looking for margins to increase. I mean for start on the mortgage pricing, we have probably four months effective in this half and we'll get all of it as long as we keep it. And business will soften slightly. And you're right that, that new volume will require new funding, which is a mix of deposits which more expensive than they have been in wholesale. But you're right, so you're right. So it will probably soften slightly I would say going forward.

James Freeman
Deutsche Bank AG, Research Division

Is that slightly or at a faster rate than what you expect the...

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, there's so many moving pieces. It's hard to know. I mean the deposit competition was super intense and in the last couple of months, it relaxed. So it would be foolhardy to try and give a point estimate. But I wouldn't be looking to margins to ramp up significantly from this point.

Hany Messieh
Former Investor Relations

Going to pass it to Tom.

Analyst

Tom Comi [ph] from Macquarie. Cameron, can you give us an update on where you are in terms of progress and potentially the process with regards to AXA or in the ACCC's decision? And then also if you're able to update us on where you are in terms of the bidding process for the assets in the U.K. that RBS have to sale?

Cameron Anthony Clyne
Former Executive Director

I'll start on the U.K. I think as we said, we're at the IGM. We're considering a lot of options in the U.K. We've got a great franchise. We are very comfortable with the status quo. We don't feel any pressure to consolidate. We're setting the options. We feel that if we do look at any options to grow , then they need to be demonstrably and financially accretive. And we don't feel any pressure to ace it out [ph] because we are seeing the rebound on the status. So status quo process is okay and we're just going to keep an eye on opportunities as they progress. On AXA, we indicated our view that we didn't agree with the ACCC's decision. I've pointed to a number of issues. I think it's sensible having pursued the transaction that we actually explore what our options are, which is what we're doing. And we're keeping all our options open at this point in time as to how we might address some of the concerns that arise.

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS here. Just got a question on investment spend, you did highlight as picking up, and also just on the systems that you have in place at the moment. And we're hearing a lot of anecdotal evidence from third parties for example in the Personal Bank that you've tried to raise select the mortgage and mortgage business, but it has problems with processing, that it's taking a long time to get applications through, which is a huge headwind in recovering that. And also hearing from other people that in MLC and other types of business, legacy systems is still an issue. I'll add to that, that over the last few years, you really had a policy of keeping the cost, to lower inflation and lessen than your peers. Have you been underspending over a number of years now that has led to the existence issues? And do you actually need to materially increase your infrastructure spend to get those back up to speed?

Cameron Anthony Clyne
Former Executive Director

Well, we are continuing with the investment in next generation. I mean what you'll see on the chart that was put up there is that the spending has probably remain the same. But it was skewed in prior periods to more compliance type in issues, regulatory projects announced very much skewed towards the next generation project. I mean that's proceeding very well with the resources. We have 475 people working on that project. It is a high priority for us and would not overlay any of those resources or any other things we've done on to anything, but getting that replatforming done. I want you to at least sort of comment on the pricing issues because we are making a headway there. But I think the replatforming to us is a priority and I'll say it, I think when I took over that it was going to be one of the two or three most important things we didn't know of, taken sponsorship of it. So we're very pleased with the progress. The ultimate [indiscernible][ph] at least is, to comment on the pricing, I mean, the ultimate proof point is UBank. He's actually on the new platform. We have a functioning business, albeit limited its capability that was seeking to build that capability up with mortgages this year. That is actually a functioning example. The technology's actually got a proof point. So this is I think a demonstration we're delivering actually some new functionality into the market. Do you want to comment on the pricing, Lisa?

Unknown Speaker

I don't think it's any surprise that we have had some challenges around our mortgage processing. It's been a challenge for us over a period of time actually. And our focus historically had been to actually really streamline the component parts, which we had been able to do. Our focus now, though is looking at the whole end-to-end experience particularly in the wholesale approach to business where we've been able to -- has some challenge around [ph] side they are now, reducing while we focus on increasing the asset quality, bringing those loans in much more rapidly to the extent that we grow well above $60 million in February and March for that business. And banker rights and so forth have reduced as well. So we're now starting to see an uptick in that. In the very short term, it's about improving some of those prices and policies, which we are able to do and the longer term it's about investment in that next-gen platform.

Matthew Davison
BofA Merrill Lynch, Research Division

It's Matt Davison, Merrill Lynch. Just a question on the fair value agenda or in the Personal Bank. You've obviously seen a pretty heavy fall in profits over the period and now some signs of market share gains. I'm just interested going forward for the fair value agenda, do you need to keep giving up additional fee revenues? Do you need to keep giving up additional margin? Or have we seen exactly what we will to preserve where the brand is at? And just on the question, I guess, early you pointed to some political scrutiny and I sensed you thought that would happen in the retail bank. Just interested in why it would be the retail bank and not the business bank as well?

Cameron Anthony Clyne
Former Executive Director

On the fee front. The fees that we took out last year were the fees that we thought were not part of sustainable business model. So we have a subsidy removed. These were the ones that were clearly the biggest buying points for customers, ones that we saw disappearing around the world. Yanling [ph] can add to the fact that there's been quite a substantial reduction fees in U.K. Banking off the back of regulatory chain. So we said, look this is not part of sustainable business model. In many respects, they generate a disproportionate level of compliance. We're better off taking an asset off at or around an issue. We don't see substantial other reductions because the ones -- we're seeing a lot of the fees that we charge are legitimate and relate to a service. The ones we took out were the ones, as I said, were not part of the business model. On the mortgage pricing, I think what we've tried to do is demonstrate -- I mean you can talk about supporting a customer. You can actually do it. So I think we demonstrated that we wanted to grow the business, but also demonstrate that we have an obligation as a commercial bank that is perceived to be anything rightly or wrongly from a whole series of systems to be doing the right thing. And we've done that. Now whether we sustain that over time, that will all depend on finding cost and a range of other things. But we took that decision also about the repositioning of the franchise. On the issue of retail, we see far more pressures. It could be government intervention. But if you think about where we're seeing is we talk to the market where the entrepreneurs are. They don't see any garage inventing products to attack 20% ROE markets. You're seeing in a garage [ph] 30% ROE markets. So where's the next attack is going to come through retail. It's going to new competitors, it's going to be researches at regional banks, in some ways it's the return of their capability, it's going to be where the most heat is on around. So I think we just a view much as we did in MLC. This is coming in some ways I [ph] perform. The pressure is there. And the best thing to do is get your business in line to do it. Whatever headwinds happen to emerge when in fact, this in fact should be beneficiary out there.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. Question for you, Mark. You made a comment that at the close of the half, you didn't think the risk of the SCDO portfolio had deteriorated. They are not on Slide 71 that there's a number of the deals that only require -- potentially another five credit events before you incur a loss and are not -- you incurred five credit events over the last half and considering some of the issues in Europe and the exposure of those portfolios, what makes you feel that the risk hasn't heightened over the half?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

You're right, there were five events. But these instruments point to different names. And you get one like [ph] back, which actually affects more of this than any other. So that's quite an extraordinary case. So you normally find if you get A credit events it maybe affects two instruments and doesn't touch the other four. So we had five in the period. If you go back to the September '09 equivalent slide and you go across that third to bottom line where you see the average number of events to reach the attachment point. So you can see 13.5, 11.9, 13, et cetera. You'll find typically they were about one different I think last time. So five events that's affected each of these instruments by about one. And what happened in this period with the five going -- and the five we really anticipate it. So we have a good feel for what's likely to come. The way we see the world at the moment anticipate that enough is going to come out of the pool to threaten these second attachment points.

Matthew Davison
BofA Merrill Lynch, Research Division

Nothing in Europe that's happened in the last month or so to impact that view?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Not to any material extent.

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles from Morgan Stanley. Cameron, you said you only participate in consolidation in the U.K., that creates shareholder value. I'm not so sure many people outside the organization know exactly what NAB means with that comment. So I'm wondering if you could perhaps expand on the importance of assessing your model pools across the book model pools. And also just from a NAB perspective, the relative importance of APS accretion and ROE accretion? And finally comment on how important your views on currency might be in assessing any opportunities in the U.K.?

Cameron Anthony Clyne
Former Executive Director

Currency is currency. I mean you can do something pretty calculated on a currency end and get a worst outcome or better outcome. On consolidation, I think what we want to see substantial accretion in both EPS and ROE. I mean I think that's the -- we certainly don't subscribe to a view that says you need to get big in order for them to get out. Because I think if the first deal is not the financially attractive deal and you're waiting for the second deal to be the one that delivers that need, and you can't deliver the second deal then you're stuck with a larger franchise or worse economics. So [ph] was the only driver, is that it's going to be substantially attractive on both those measures. And if it is, then we'll consider it. If not, then we're very comfortable with the status quo. I'd also say we would -- rather than currency, we'd be looking at implementation risks because some of these issues is they are not, I mean, the carve-outs and things, which are quite different to whole bank acquisitions. So [ph]. And the regulatory environment. The regulatory environment is clearly more problematic in that market than it is in others. So we'd weigh all that up in looking at it.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. You're growing market share now in the Retail Bank on the mortgage side and in deposits. The pipeline commercial is the healthiest [ph]. We're seeing market's free [ph] base. Currency has probably seen its worst. Are you confident that we've seen the worst in terms of group revenue this half?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, let me get the crystal ball back out. I mean Business Bank is by far the most material franchise to us. So if we see a pickup in business activity in the second half as we believe will happen but barring a shock, and there are some shocks around it at the moment as we all know. Then that will definitely move the needle and we're going to be putting on assets and retail as well. And it looks like markets have settled out. But that's a highly unpredictable area and particularly one that is targeted by foreign banks because they don't need much infrastructure on the ground to compete for it. So there are still competing forces there, but if we get the balance sheet moving I think, we will be fine.

Analyst

It's [ph] from Southern Cross. Somebody once told me that you don't try to wrestle with more than one alligator at a single time. How confident are you at running more than one acquisition at a single time?

Cameron Anthony Clyne
Former Executive Director

Well, it seemed we'll always be, for a period at least anyway, until we shake it off [ph] perceptions what we've called out here is on the acquisitions we've done this year. We're exceeding expectations on our business case and our implementation run rate. They are relatively small, but we feel comfortable that we can handle those if we do get AXA. And we're very comfortable this will be the time to do the implementation in conjunction with the further work on Aviva. So even the frameworks to sit up and Aviva's exceeding our expectations. And at this stage we've made no call on what we're doing in the UK with running the business and benefiting from the upturn there. I mean we make that assessment along with everybody else if we decided to do something over there. But at the moment we're dealing with the existing portfolio I think pretty well.

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. Mark, one of the horrible things at NAB has been the unexpected just kind of happening. There was a quarterly disclosure that showed that you had $12 billion of Italian government bonds. Could you run us through what the figure is now? And I apologize if it's in here, but I haven't seen it. What is the figure now? Could you explain to us how they actually came into being? But more importantly, I'd like to understand what was the thinking between the counterparties which I believe one at Italian banks. So they chose those funds because it's just one of these things that I don't think anyone really understands if we can get a common sense explanation.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, so when we engage with other banks, for example around derivatives, if one side of a transaction is over the money, you typically get security posted. And so we had certain European banks putting up Italian government bonds of security. They're all repo-eligible quality instruments into the European Central Bank. So for us to lose money not only would the investment-grade back have to fail, but the underlying sovereign would have to fail. So it's a pretty unlikely case. Nevertheless, we took the point that it was an area of concentration. It's now down to I think about $5.5 billion and most of which matures over the next three to six months. So we're going through a process of deciding whether that's a reasonable level of concentration or not. With the probability of loss, there's so many steps removed that we don't see it as a significant issue.

Brian D. Johnson
CLSA Limited, Research Division

Must been up [indiscernible].

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

No. But we've just been imposing some limits on it as asset mature, but all turns over pretty quickly. So as it matures, we've just been managing it down as an area of concentration just because that's the prudent thing to do.

Operator

[Operator Instructions] Our first question comes from the line of Derek Francis from UBS.

Derek Francis

I just wish to just sort of elaborate a little bit on a question earlier, it's just on AXA and ACCC process et cetera, because I guess at the moment you're trying to see if this is a workable undertaking to be negotiated with the ACCC that makes commercial sense, but also to resolve the competition problem? I'm just wondering on a potential timeline for that and then just sort of probability there. And then secondly filing that, what's the probability of a legal challenge if that process doesn't prove particularly fruitful?

Cameron Anthony Clyne
Former Executive Director

Sorry, it's going to be a short answer. We're just assessing all options. We've seen the decision. We've indicated we don't agree with it and we're thinking through our options.

Derek Francis

And so do you ever just possibly be looking at potential timeline for the actual, say, negotiation? Is there anything more you can add on that?

Cameron Anthony Clyne
Former Executive Director

No.

Hany Messieh

Former Investor Relations

Other one from the phones?

Operator

Joey Oldfield [ph] from [ph]

Analyst

Just on the specialized proved assets. Mark, you give us some flavor to the extent that borrowers are still looking to extend facilities because they can't get alternative funding sources elsewhere?

Cameron Anthony Clyne
Former Executive Director

I might ask Peter [ph] who's leading the portfolio.

Unknown Speaker

We are finding that there are a number of clients, about 50% so far in the first six months, we've had to extend for various periods of time, three to six months largely. So we do expect some continuation of that. In fact we've given a slide in the pack which shows our expectations based on experience to date.

Analyst

It's [ph] from Deutsche. Cameron, can I just confirm your response to Richard's earlier question in regards to acquisitions in U.K. where you're looking for substantial ROE and EPS benefit. Can we just confirm that when you're looking for those benefits, your cost of capital is incremental cost of capital rather than using some of the surplus that Mark alluded to earlier?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, I mean anything like that has to wash its face. We're not going to sort of marginal cost from a capital point of view or anything like that.

Analyst

Another question for Mark. Mark, fees go [ph] or few hours ago [ph] produced the result and the provision charge fell, the collective provision charge declined as a big something, increased in the general reserve for credit losses. If we look at this result, we see the specific provision charge falling. We see a very, very moderate rock back of the collective provision. We see the 50% expected loss decline a little bit, but then we see a big thumping increment into the general reserve for credit losses. Just on the GICL, could we get a feeling as to where that came through in the second quarter as opposed to the first quarter? And the second one is can you give us a feeling going forward the relationship between the P&L charge, the expected loss and the GICL as the business book continues to grow because that does actually put pressure on the cash distributable earnings going forward.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

It's really just relevant to capital, not relevant to earnings. So I would guess, all other things remaining equal, if we ran down collective provisions, the GICL would rise. And if we build collective provisions GICL would fall. It doesn't quite work like that because it points to slightly different things. So it removes any capital incentive for us in doing that. But it would still leave the P&L incentive, but there was a slight difference in your comment. We didn't actually release any collectives in this period. They're actually built up very slightly. You may be looking at something has some foreign exchange effects in it. So we haven't been releasing provisions. We still have our economic cycle adjustment. We worked hard to get to this level of provisioning. If anything, we still have our economic cycle adjustment. We worked hard to get to this level of provisioning. And if anything, the accounting rules may change to lock all that in any way. So we're not anticipating a significant release. And so the GICL is there and it will just, as I say, other things remaining equal they will just move opposite to each other.

Analyst

Does it kind of mean that as accounting earnings go up, cash earnings go up, obviously capital generation falls back a little?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

No, it should mean that capital generation is the same. If it goes up because you release collective provisions, then you would offset it with other things remaining equal. So in other words, if the release of collectives was unwarranted based on the underlying risk, then you wouldn't release any capital because the GIC would pick it up. If it was warranted, they would both move down together.

Hany Messieh
Former Investor Relations

We'll take one more question afer this.

Chris Williams
UBS Investment Bank, Research Division

It's Chris Williams at UBS. So I just wanted to dig in to this personal banking result a bit more. If I have a look at your staff numbers, they're up well over 10% on a spot basis, your costs are up about 5%. So clearly we haven't had a full period effect of that. Your margins are down 30 basis points in the half notwithstanding the comments you made about funding attribution going into that business. And you haven't had a full period impact of the fee income flow through into that business. Clearly you point to this being a sustainable model that you're trying to implement into the business, so can you give us a feel for the sustainability of our current ROI 61 basis points or whether you think that will be sustainable and the current level of the margin and what you think a sustainable level might be? Just trying to get a feel for how long this sort of negative draws comes through the business and where we think you'll reach your buys [ph] in terms of growing that business from in the future.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I mean, I don't think we can give a very good forward-looking statement because we don't know exactly what settings we're going to maintain. There is an increasing cost in the business that has been bringing people in both for selling capacity and collections and problem resolution. So there has been some investment there. We see the volumes rising which means that's going to get spread across more business. And so we'll just have to see how that plays out. But you point to all the variables yourself. It's just a question of taking a view on those and have a sense of where it goes. But this is still a business with a high ROE and so it's a business we're very comfortable to grow.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. Just on the business credit growth. While we acknowledge that you do have a high proportion of your domestic earnings coming from the business side. Once you take into account your global positioning, the proportion of your total book that's in domestic business, it's actually pretty consistent with the other guys. So once you take that into account and I'm sure we're going to do a little bit of business credit growth of picking up in your forecast as well. There's probably limited opportunity there for "positive surprise" coming through. So what other areas of the business do you see that might actually provide the delta earnings with the global factors through the rebound in the U.K. or the conduit portfolio that you guys are fixing on?

Cameron Anthony Clyne
Former Executive Director

Well, there is a rebound in the U.K. I mean, I guess it's a question is to how that will progress and that's evident in this. I would make a comment though everyone's going to have a business credit rebound in their numbers, anyone's going to talk to a pipeline. The issue is can you actually capitalize on it. And the real issue here is you can't get back and redo the last 18 months. If you piss your customers off and handle those relationships poorly in the last 18 months, can't redo that. So I think the acquisition we're seeing and Mark alluded to the pickup of customers, the reputational surveys, those sort of things suggest that what you got in there actually can you deliver on. Now what we don't know is the timing, it may be a 2011 story. It's going to depend on that, but what we can feel very confident about is that we will capitalize on that pipeline given the reputation and how we handle the last 18 months, you can't redo that.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

So if we've got CVA in respect for any other housing market, you'll be above [ph] in Housing, then you're also indicating that the strength of differentials is you'd expect to be above system business growth as well?

Cameron Anthony Clyne
Former Executive Director

Correct and we traditionally have been, yes.

Joseph C. Healy
Australia and New Zealand Banking Group Limited

We have just slightly over 20% of business lending in Australia, which is a position that we've grown by just over 1% over the last 18 months but that disguises some fundamentally important insights into our book. And then we're quite light in terms of the top end, the so-called institutional market. But our market share is probably around sub-15%. But we're very, very strong in the SME market where we've got about 30% market share, a position that we've grown by close to, just over 200 basis points in the last 18 months. Now we believe that our reputation and strength at SME banking in particular will put us in very good stead to manage the growth that sort of we'll see coming through there, but also to manage their margin pressures because the margin pressures tend to start topping the tone, which [ph] quite quickly. We're underweight there. And the relationship, strength and their proposition mitigates some of those pressures where you get into mid-market. So your ability to manage margin pressure where you got strong relationship proposition in SME market is an important distinction when you look at the composition of a business banking franchise. And we see that as one of our core strengths and I'll point to the fact that 2% market share growth in SME banking over the last 18 months is equivalent in normal market conditions to close to 10 years of hard work. Growing your market share by 25 basis points in a competitive market is quite a challenging thing to do. But because we stood in the market and supported businesses when the market was uncertain and access to credit was a concern for many small businesses, we believe that we'll be able to build on that reputation going forward and some of the surveys that what Cameron and Mark talked to in our view is a proof point that we're well placed to continue to grow and manage the economics, so our margin and fees as the means to assess to build up particularly going into FY '11.

Hany Messieh
Former Investor Relations
That wraps it up. Thanks everyone for your participation. And feel free to call into the IR team through the afternoon if you have any further questions. Thank you.